Land of the corporate giants

*The Economist*

Nov 3, 2012
Getting bigger

- Something only gets bigger, e.g., skyscrapers and shopping malls.
- In some cases, like boats, greater size promises greater efficiency, as fixed costs are spread over higher output.
• Container ships provide a good example of economies of scale in action

• In 1950s, the first ships could carry 480 TEU (20-foot equivalent) container, a new range of 18,000 TEU ships is due to launch in 2013
Between 1931 and 2007, world’s tallest building rose from 381 to 828 metres.

As the building get taller, the fixed cost of land per square metre of office space falls.

But the wind force on a building rises exponentially with height, design and construction becomes more costly.

Study suggests that most very tall building are at an inefficient scale.
Bigger corporations

- Long-run trend seems to be towards bigger companies (Lucas, 1978)
- The world’s biggest firms keep on getting bigger
- How? Gradually, or suddenly as firms merge
- So are businesses like boats or buildings: are they seeking out economies of scale, or are they too big to be efficient?
- Economies of scale: average costs fall as a firm grows bigger
Container ships and building

- 船運服務之成本: 船租金 + 船員薪水
- 辦公空間之成本: 辦公室租金 + 維護人員薪水
- 租金主要決定於興建成本
- 假設薪水遠低於租金, 而載運費 2 倍商船之興建成本少於 2 倍, 則 ATC 下降
Bigger corporations

- Firms are getting bigger and producing more output
To answer this question

- How to answer this question? Estimate cost function
- But cost function can be tricky to establish
- Studies show that some very large firms have reached the limits of scale
Why expanding?

• If so, why do big firms keep expanding?
• One possibility: seeking to boost profits not by driving down costs but by *raising prices*
• Buying up rivals softens competition and enables firms to charge more.
• There are evidences from health-care mergers.
• Some firms may be growing not to lower cost but to receive the comfort of implicit state support, eg., big banks (too big to fail)
• So antitrust authorities should be much more sceptical about mergers that claim to be justified because of economies of scale