Limits to Firm Growth: All in the Family?

Francisco J. Buera* Siddhartha Sanghi† Yongseok Shin‡

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Abstract

We model a firm as a collection of managers who coordinate on joint production. The firm-level production technology features increasing returns to the number of managers and complementarity across managers of heterogeneous skills. Individuals are born into families that differ in size and managerial skill endowment. Each member of a family has the option to (i) work as a manager in the family firm; (ii) work as a manager in a non-family firm; or (iii) supply non-managerial labor for a wage. Non-family firms are constrained by a basic moral-hazard constraint: individual managers can steal a fraction of the joint output and forgo their managerial remunerations. The fraction that they may steal can be reduced by costly monitoring, which determines the optimal size of the firm. The limitation of family firms is, naturally, that the size and the managerial skill endowment of a family are exogenously given and immutable.

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*Washington University in St. Louis, CEPR and NBER
†Federal Reserve Bank of St. Louis
‡Washington University in St. Louis, FRB St. Louis and NBER

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