The Nature of Firm Growth

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Benjamin W. Pugsley¹, Petr Sedláček¹,² and Vincent Sterk¹,²

¹Centre For Macroeconomics, ²University College London, ³University of Notre Dame, ⁴University of Oxford

High-growth firms are widely seen as pivotal contributors to economic prosperity, if only for the large number of jobs that they create. But what is it that distinguishes such firms from others that stay small throughout their lives? One view is that, following entry, firms are exposed to productivity or demand shocks; some startups are lucky and grow large. An alternative view is that there are ex-ante differences in the growth potential of startups with some businesses poised for growth, while others are destined to stay small.

In this paper we use micro data on employment in the population of U.S. businesses and estimate that the lion’s share of differences across firms is driven by ex-ante heterogeneity, rather than ex-post shocks. We embed such heterogeneity into a firm dynamics model to study how ex-ante differences shape the distribution of firms, “up-or-out” dynamics and the associated aggregate output gains. “Gazelles” – a small subset of startups with particularly high growth potential – emerge as key drivers of these outcomes. Analyzing the changes in the distribution of ex-ante firm heterogeneity over time reveals that gazelles are driven towards extinction, creating substantial aggregate losses.