Idea Rents and Firm Growth

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Abstract

Which firms drive aggregate productivity growth? Price-earnings ratios differ markedly and persistently across publicly-listed firms. Large differences remain after netting out proxies for firm-specific discount factors. The implication is that listed firms deviate from Gibrat's Law, under which expected growth rates are the same across firms. We find further that high P/E firms tend to see increases in their earnings relative to sales, which we interpret as rents from ideas. We construct an endogenous growth model with persistent shocks to firm innovation step-sizes and calibrate it to match patterns in the data. The model can be used to infer expected growth contributions of individual firms (such as members of the Magnificent Seven) and sectors (such as AI firms). We find that the share of growth coming from the smallest listed firms exceeds their 10% sales share, whereas the largest listed firms account contribute notably less than their 10% sales share.

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