

Information Efficiency and Firm Size. Implications for Growth.

The picture of free markets and decentralized decision making is somewhat misleading. Companies are not democracies but highly organized and often hierarchical structures. Companies interact with one another and with their customers in a free market. Today's capitalist economies look more like collections or coalitions of centralized control communicating with one another in a free market environment.

If the central planner has perfect information, then their resource allocation and investment decisions are optimal. When information is imperfect, decentralization is better. The optimal firm can be thought of as a collection of resources within which information is perfect.

The maximum efficient size of a firm is therefore determined by how close to information perfection it is. In the past, information was highly imperfect imposing limits to efficient firm size. As the quantity of information and the ability to understand and manage this information has increased, the maximum efficient size of the firm has also increased.

One practical implication of this hypothesis is that as we generate, store and process information more effectively, as has been the case in recent history, firms are getting larger before they hit the limits of their growth. This is especially apparent in the tech industry where information is the main commodity. Other industries who recognize this can also grow beyond their historical limits.

Another implication is that a firm should focus on its information efficiency as it grows headcount. It should focus on how it obtains or generates information and processes it as

it expands.