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Firm Size, Employees and Profitability in U.S. Manufacturing Industries

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Abstract

We examine the relation between profitability and size for sixty-four manufacturing industries between 1990 and 2001. We use three measures of profitability: Earnings before interest, taxes, depreciation and amortization as a percent of sales (EBITDA margin); earnings before interest and taxes as a percent of sales (EBIT margin) and EBIT as a percent of total assets (EBIT/TA). Our measure of firm size is the natural log of the number of employees.

We find the following:

- (1) In about half of the sixty-four industries firm profitability increases at a decreasing rate and eventually declines as firms become larger.
- (2) For the remaining half of our manufacturing industries, no relationship exists between size and profitability.
- (3) For a given level of total assets, firms with fewer employees exhibit greater profitability.
- (4) For a given level of sales, firms with fewer employees exhibit greater profitability.


Our results are consistent with theories of firm size that specify trade-offs between economies of scale and organizational costs and with theories that ascribe certain competencies to firms that allow them to offset the advantages often ascribed to large firms such as economies of scale.

Keywords: Profitability, Size, Financial Statement Analysis

JEL Classification: G30

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