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Mohit Kishore

Firms and their role in society

B-School Corner

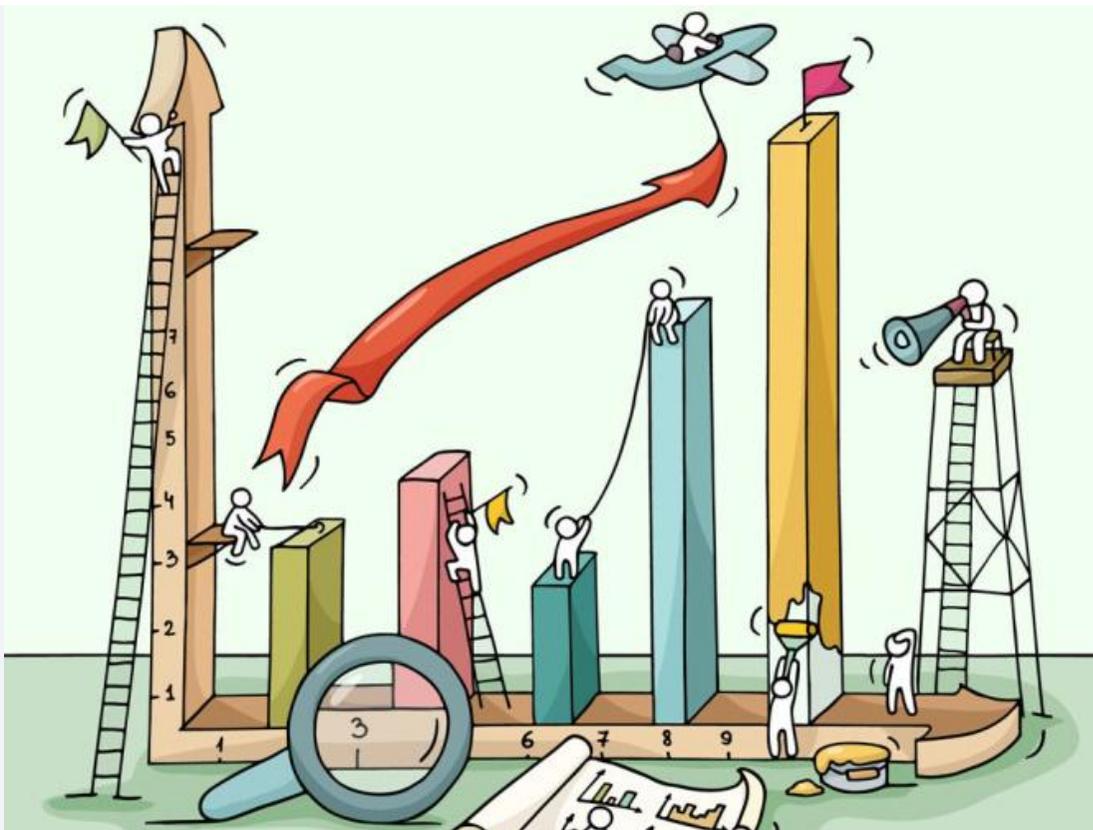


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A healthy economy depends on a fair distribution of power and resources across firms of all sizes

Why do firms exist? The most enduring answer to this question is the one proposed by economist Ronald Coase: conducting activities within the structure of a firm helps reduce transaction costs that would otherwise be incurred in going to the external marketplace and negotiating with each supplier as it



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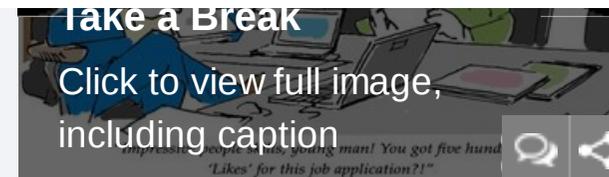


were. Thus, an entrepreneur takes over a small sphere of economic activity and coordinates the tasks therein through employees by setting up open-ended, long-term contracts with them.

However, the complexity of relying on the marketplace for everything may not be as significant a factor for, say, an artisan (a one-man enterprise) and therefore, he may choose to remain independent while running a simple operation. However, any commercial activity at scale automatically reverts to the structure of a firm as the number of moving parts or coordinating entities increases.

Thus, on the one hand, we have a one-man enterprise, followed by small firms and start-ups; and, on the other, we have large-scale (even global) organisations.

A healthy economy (and society) depends on a fair distribution of power across this wide range of firms, as each one brings a unique value to economic growth. One-man enterprises and small firms, in general, are havens of autonomy and craftsmanship. Small firms (of the start-up type) play the crucial role of experimenting with new ideas and bringing them to market. Large firms run with proven concepts and help in the large-scale, cost-effective delivery of products and services to customers.



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Large firms

Following from the transaction cost argument, it is natural to expect that, with the dramatic growth in technology and communication in the last century, large firms would diminish in importance, since coordination costs with the market have come down. Yet, that has not happened. This is possibly because technology, while reducing external transaction costs, has also helped reduce internal transaction costs. This means it is now possible to leverage technology, as well as management approaches, to help a company have thousands of people across the globe coordinate their efforts to achieve the goals of an organisation.

Then there is the fact that a large-scale enforcement of contracts outside the firm remains complicated enough to justify hiring employees versus contractors. So, while it still makes sense to parcel out certain types of well-defined tasks to an outsourcing partner, it doesn't make as much sense to outsource everything. In other words, it is quite unlikely that large firms will become obsolete any time soon, though it increasingly appears that larger and larger revenues are now possible with a smaller workforce.

Small firms

Large firms bring with them a number of limitations. First, there is the concentration of power that comes with size. This brings with it the risk of exploitation of customers through predatory pricing, poor service, and the like. It also comes with the risk of exploiting the workforce.

Second, and this is related to concentration of power, is the concentration of capital and wealth with large firms, which can impede the development of the free market, thus creating a society where the same small set of players control multiple sectors owing to deep pockets.

Third, there's the larger moral issue of alienation caused by the loss of community and meaning in large firms, where people are reduced to 'roles'. Fourth, and perhaps the most important from the perspective of society as a whole, game-changing innovation has always come from small start-ups looking for disproportionate payoffs, and not as much from large firms. Leaving the task of innovation to large, unwieldy firms is a risk to progress. Thus, small firms generally offer a haven of relative meaning and autonomy, while start-ups (small firms of a specific type) drive the innovation agenda for society.

Helping start-ups flourish

In order to strengthen the environment for small firms and to allow start-ups to flourish, policy interventions are critical. Transaction costs with the external market must be lowered for small firms and start-ups by simplifying regulations, applications for patents, access to talent, and the like.

Access to capital, particularly domestic capital, must be made easier too. In addition to special vehicles for equity and debt financing run by the government and private sector financial firms, the ways to include the broader public should also be evaluated. Finally, in terms of culture, society needs to value the role of an entrepreneur as an important catalyst who drives things forward. Only if a large number of people put their stake in the ground regardless of a probability of failure, will a significant enough number of them create disproportionate payoffs for themselves and the world.

In conclusion, it is important to recognise that firms of all sizes play unique roles in the economy. Policy-making should focus on creating the right conditions for all types to prosper while ensuring that the power balance is maintained.

Keywords: [Entrepreneurship](#), [Start-ups](#), [Businesses](#), [Management](#)

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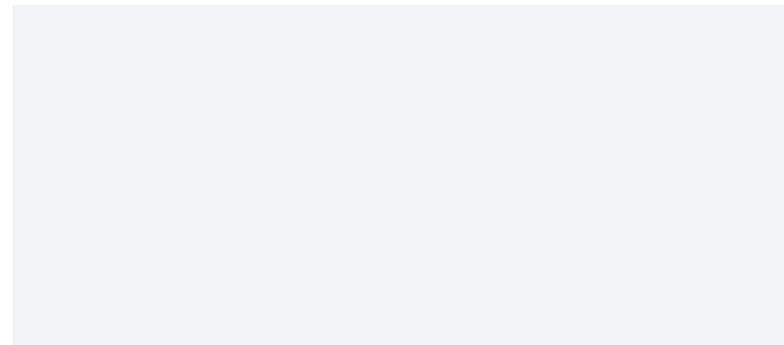




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