Opinion **Mergers & Acquisitions**

New life in the idea of the big company

Companies still want to expand - for good reason

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The life and career of Ronald Coase, who died last week aged 102, spanned the century in which modern management developed. That is appropriate, because Coase contributed immeasurably to our understanding of the potential and limits of the basic management unit that is the modern company.

Even so, a few thinkers are taking a chisel to the solid foundations he laid. Author John Hagel has blogged that it is time to reassess Coase's view of the corporate world and come up with "a new rationale . . . to drive institutional success".

In "The Nature of the Firm", the 1937 paper that helped earn Coase his Nobel Memorial Prize in Economics, he sought to penetrate the corporate "black box" and define why companies are needed. In brief, it is because by co-ordinating activity internally, they avoid the high transaction costs that would apply if everybody did business directly with one another in the "perfect" market beloved of "blackboard economists".

Since then, though, the technology-fuelled ability of individuals and small companies to collect and analyse big data and collaborate across eroding national and sectoral frontiers has cut the transaction costs Coase identified. At the same time, the increasing complexity of relationships within multinationals, and between companies and third parties, has, according to Mr Hagel and others, made it harder to manage the largest groups. Coase himself wrote: "As a firm gets larger, there may be decreasing returns to the entrepreneur [manager] function, that is, the costs of organising additional transactions within the firm may rise." Some utopians believe the biggest companies must now implode under the weight of management bureaucracy. A frictionless market will then be open for exploitation by smaller, more agile, more open groups.

But recent evidence – including Verizon Communications' purchase last week of Vodafone's stake in Verizon Wireless and Microsoft's acquisition of Nokia's mobile phone business – suggests companies are still bent on increasing their size.

For good reason. While managers may complain about the pace of change and their increasingly complex roles, they also take for granted the extraordinary online and mobile tools now available to help them achieve their tasks. Take the kind of analysis Coase himself carried out. When he went to the US in the 1930s to explore the complexities of its industrial companies, his data sources included the Chicago phone directory, whose variety of specialist providers of goods and services was a revelation. As recently as 1991, in his Nobel Prize acceptance lecture, he urged academics to dig into corporate contracts, laboriously drawn together in university databases. These days, both analytical exercises can be carried out on a much larger scale. With similar tools, managers should be capable of overseeing and running larger and more complex enterprises.

Most companies have flattened their hierarchies, eliminating middle managers and improving efficiency. Many are exploring new ways to collaborate with the crowd beyond their formal corporate boundaries. But as Ray Fisman and Tim Sullivan point out in their recent book *The Org*, a Coasean hymn to the necessity and durability of organisations, technology has also prompted some companies to bring more services in-house. They point out how Lowe's, the US home improvement chain, hired fewer freelance truckers (who drove more carefully than company-employed drivers) once onboard computers allowed managers to monitor and
co-ordinate the fleet more easily.

Sometimes, too, it makes more sense to dismantle borders between companies to create a seamless larger entity. A Nokia engineer I talked to in Helsinki last week said the rationale for full integration with Microsoft became obvious when he realised it would allow joint phone development teams to "focus on building the product, and not on the processes around the product".

Trends in technology and globalisation will not necessarily tear down big, vertically integrated companies. They may well prompt managers to adjust more frequently the balance between what is best done within a company's walls and what is done outside. But this, too, Coase foresaw 76 years ago. "Businessmen will be constantly experimenting," he wrote, "controlling more or less, and in this way, equilibrium will be maintained." Long live that insight.

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