# Rising Further? Superstar Firms and Their Implications in the Time of COVID-19

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A small number of big firms are getting stronger and expanding their businesses a lot further in the time of COVID-19. The top ten firms' market value – including tech giants such as Apple, Alphabet, Amazon, and Facebook – exceeded 25% of total stock market capitalization in the United States as of August 2020, compared to less than 20% a year ago. Even though economists are researching the rise of so-called superstar firms mainly for the U.S. economy, it also seems to be a global phenomenon. We are now living in a world where competitions are less fierce in most countries and industries; thus, the economy's dynamism is declining over time.

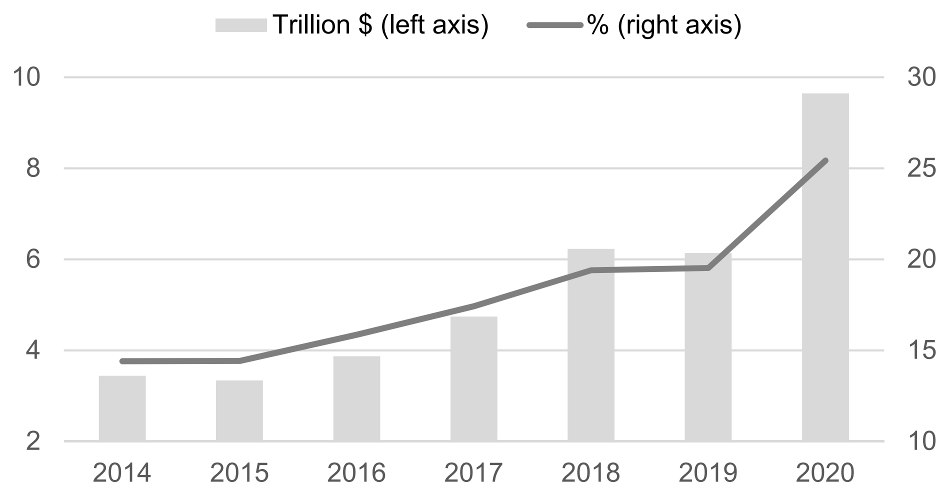
Then who are those new superstar firms, and what characteristics do they have? Ten years ago, the top U.S. firms were Exxon Mobil, Wal-Mart, IBM, Procter & Gamble, General Electric, AT&T, etc. Those big "old" firms' features include massive investment in physical capital and a high employment level, to name a few. On the other hand, several distinctive attributes are present for the "new" superstar firms. First, they accumulate a more considerable amount of intangible assets – such as research and development, management, and big data. Thanks to the nature of those assets, which can be easily transferable with no or little cost to other parts of the companies, they enjoy much higher profits than peer ones. Second, they make use of M&A activities aggressively to get rid of their potential future threats, absorb the business models of the acquired firms, and integrate them to make their own. Third, industries that one superstar firm resides in are not limited to any specific one, or perhaps it is obscure how to define and classify the superstar firms' industry boundary. For example, we cannot say that Amazon is just an online retail company. Fourth, but not the last, those firms create network effects using their platform, which intrigue more and more people to use their services and products, and make them interact with one another. Once consumers are locked in a platform, it is hard for competing firms to take them back.

Several macroeconomic implications are worth mentioning regarding the recent emergence of “new” superstar firms. First of all, the economy's overall productivity slowdown may be related to superstar firm effects. In an ideal economy, firms are born, grow, get old, and disappear from the market. This firm churning process is inevitable to economic growth because economic resources – such as labor and capital – should be reallocated to more productive units by firms' competing against each other. If firms are divided into only two categories – high growth dominant firms and stagnant small firms – the economy's overall productivity will be dragged down, because many resources will remain in small and unproductive firms who are the majority. Even further, it could be the case that new firms' entry to the market will be deterred in the first place. The second implication is about the increasing market power of superstar firms, measured by markups – the difference between the cost of producing one additional product and the firm's selling price. Diez et al. (2018) showed using firm-level data for 74 countries that if markup increases initially, the firm's investment and R&D expenditure also grow. However, once the markup reaches high enough, this relationship will be reversed. This result is consistent with our intuition that big firms with a considerable amount of market power tend to innovate less. Last but not least, it is essential to note that firm inequality and income inequality are inter-related. High-wage workers tend to work in high-paying superstar firms, and those workers usually work together. This means inter-firm wage inequality, rather than intra-firm wage inequality, explains household income disparity better. Besides, since superstar firms have monopsony power, the overall economy's labor income share will be affected negatively, which is in line with the data.

Although many economists are exploring the phenomenon of superstar firms, we still do not fully understand the mechanism of how these frontier firms interact with the rest of the economy.

Therefore, policy recommendations, whether on the taxation of firms, size-dependent policy, competition policy, or financing of new firms, should be given carefully. But the bottom line is that any policies must be geared to enhance the productivity, encourage the resource reallocation, lessen the income inequality, stimulate the entry of new firms, and promote competition and innovation of the overall economy, not for the small number of high-performing firms. KIEP

**Market Cap of Top Ten Firms in the US**




Note: Market cap for each year is calculated at Aug 31.
Source: Bloomberg and author's calculation