FOCUS · Smaller and less productive firms in a fragmented European market

In the last 15 years the euro area has seen less growth than the US in spite of both economies having similar sizes and levels of development. The main factor behind the euro area's weakness is its lower growth in productivity which is still hindered, among other factors, by the fragmentation of national markets.

Although Europe's single market is theoretically a reality, in practice there are still a host of barriers that make it difficult for European firms to grow. For example, the cost of doing business in several countries remains high as, in most sectors, regulation is still very different in each country and companies have to adapt their products or services to local standards. However, in the US regulation is more standardised between the different states and this helps firms to grow.

Empirical evidence regarding the greater dispersion of European companies and how this relates to the fragmentation of Europe's market is convincing. For example, large firms (with more than 250 workers) are smaller in the euro area than in the US; in fact the average size of a large company in the US is 1,903 employees while in the euro area it is around 1,000 employees. Moreover, this difference is particularly marked in industries with a higher degree of regulation, such as energy and public services; US companies in non-regulated sectors are 1.9 times larger than their European peers but, in regulated industries, they are 2.5 times larger than European firms.

It is also important to note that it is precisely in regulated industries where economies of scale tend to be greater. Consequently, the potential benefits of enlarging market size (and the costs of not doing so) are particularly high for companies in such sectors. In the US, firms with more than 250 employees are larger in regulated industries than in non-regulated whereas in Europe there is no significant difference in company size between sectors (see the table).

Concern for the extensive fragmentation of Europe's business fabric is not to be ignored as company size and productivity always tend to go hand in hand. The second graph shows this clearly: labour productivity is much higher in companies with more than 250 employees than in smaller firms. It is also interesting to note that the productivity gap between companies of different sizes is greater in manufacturing than in services, probably due to manufacturing's greater need for investment in fixed assets. Lastly, to illustrate the importance of company structure on productivity, we should note that if the euro area had a similar distribution of company sizes as the US, its average labour productivity would be 14% higher than it is today.[1]

In short, the potential benefits of having a business fabric with larger firms is huge, whichever way you look at it and measures aimed at reducing regulatory and non-regulatory barriers that diminish the advantages of Europe's single market should therefore be the order of the day on the agenda of European reforms. Europe's economic and social situation makes this vital.

Average company size in the US and euro area

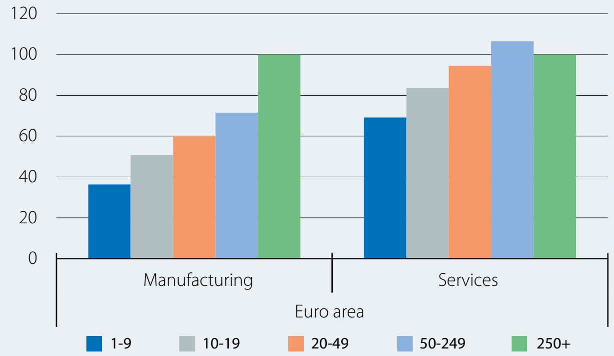
*Average number of employees in large firms **

	US	Euro area	Relative size (US/euro area) (%)
Regulated industries **	2,605	1,027	254
Non-regulated industries **	1,903	997	191
Relative size (regulated/ non-regulated industry) (%)	137	103	

Notes: ** Large firms are those with more than 250 employees.*
*** The regulated industries included are utility firms of gas, electricity, water, etc. (ISIC 4, sectors 35 to 39). Information on the banking and insurance sector is not available.*
Source: *CaixaBank Research, based on data from OECD Structural and Demographic Business Statistics.*

Labour productivity in the euro area by company size

*Value-added per employee, index (100 = large firms *)*



Note: ** Large firms are those with more than 250 employees.*
Source: *CaixaBank Research, based on data from OECD Structural and Demographic Business Statistics.*

1. Assuming that labour productivity by company size remains constant.