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The Corporate Aging Phenomenon

Prof. Claudio Loderer, University of Bern (Principal Investigator)

As firms have more assets in place, more of management's limited attention is focused on assets in place rather than developing new growth options. In such firms, managers put in place policies and processes designed to maximize the performance of assets in place, but these policies and procedures create rigidities that make it harder for them to innovate and change. Consequently, as firms grow older, they have fewer growth options. This simple theory predicts that Tobin's q falls with age on average and that a firm is highly unlikely to ever again have the Tobin's q of its youth. Further, competition in the product market and in the market for corporate control is expected to accelerate the decrease in Tobin's q with age because there is less room for error in managing assets in place, so that management has to be more focused on these assets. In contrast, greater competition in the labor market reduces the decrease in Tobin's q with age because old firms are in better position to hire employees that can help with innovation.

In a pilot study for listed U.S. firms, we find strong support for these predictions. Alternative explanations for the decrease in Tobin's q with age, such as greater managerial entrenchment in older firms or reduced ability to invest due to credit constraints do not appear to explain our results.

A second subproject studies the implications of this managerial attention hypothesis for firm survival. Because older listed firms focus on managing their assets in place and are able to limit their agency problems, they offer little value added to potential acquirers. Consistent with that, we find that takeover hazard drops significantly with age. At the same time, since older firms become more efficient, their failure hazard should decline as well. The evidence supports this prediction, too. We explore a number of alternative explanations, including unobserved heterogeneity, but none is fully consistent with our findings. Whereas hazards decline with age, they do not go to zero. This explains why, eventually, all listed firms disappear.

In later stages of the project, we plan to take the issue to the international level and study the relation between firm age and growth opportunities in a large sample of listed firms from around the world. An international sample provides much more variation than a U.S.-based sample to study the implications of competition in the markets for goods and services, as well as in the markets for labor and corporate control on corporate aging. Finally, to shed more light on the potential sources of the aging effect, we also plan to conduct a large-scale survey of firms.

Research Team

Senior Researchers:
Prof. Claudio Loderer, University of Bern (Principal Investigator)
Prof. Urs Wälchli, University of Bern

Associated Participants:
Prof. René M. Stulz, Ohio State University

Fields of Research

Corporate Finance
Other topics in Financial Economics