

In each industry, the four largest companies based on total assets were grouped together to form one size class, while the remaining sample companies were grouped in a second size class. If there were fewer than eight sample companies in an industry, the sample was divided evenly between the two classes. The simple average of profit rates for the period 1963 through 1965 was computed for each size class of each industry. Table 3 summarizes the results of these tabulations.

TABLE 3.—SUMMARY OF RELATIVE PROFIT RATES OF LEADING COMPANIES AND OTHER COMPANIES, 54 INDUSTRIES

Type of industry ¹	Total number of industries ²	The number of industries in which the leading companies earned ³ —		
		Higher profits than other companies	The same as other companies	Lower profits than other companies
Consumer goods.....	19	15	0	4
Producer goods.....	35	16	3	16

¹ Industries classified according to Federal Reserve Board listing for the Index of Industrial Production.

² Arthur D. Little did not submit data for several industries which Conrad and Plotkin used in their analysis reported in "Risk and Return in American Industry." For this reason the total number of industries is slightly fewer.

³ Net income plus fixed charges over total capitalization. This is the profit ratio used by Conrad and Plotkin.

Source: Tables 3A and 3B.

For the period 1963 to 1965, the leading companies in fifteen of the nineteen consumer goods industries earned higher profit rates than the other companies in the industry as a group. In sixteen of the thirty-five producer goods and mining industries the group of leading companies had higher profit rates than the group of smaller companies; in another sixteen industries the group of smaller companies averaged higher profit rates than the group of leading companies; and in the remaining three industries both groups averaged exactly the same profit rates. Clearly, no great advantage accrued to producer goods or mining companies by reason of their being leading companies in their respective industries. The relationship between relative firm size and average profit rates was random.

The results of this test again support the proposition that the leading companies in consumer goods industries possess some unique advantages which do not accrue to the leading companies in producer goods and mining industries. It is our hypothesis that these advantages are the result of the largest companies' greater capacity to differentiate their products. As a result the companies which are most successful in achieving a highly differentiated product are able to charge higher prices and make higher profits than the less advantaged companies. In contrast, the products of producer goods and mining industries are more homogeneous. Consequently, relatively small firms ¹⁰ enjoy profit rates about equal to industry leaders.

DIFFERENCES IN PROFIT RATES AMONG CONSUMER GOODS INDUSTRIES

Economic theory posits that industries with a high degree of product differentiation will experience both higher average industry profits and greater differences in profits between the leading companies and the remaining companies in the industry than industries with a moderate to low degree of product differentiation.¹⁷ We are now able to test this theory by employing the underlying data used in the Arthur D. Little study.

In Table 4 the consumer goods industries listed in Appendix Table 3A have been grouped into three categories on the basis of the total advertising expenditures of the four leading advertisers in the industry in 1964. It shows that there is a strong positive relationship between the absolute amount of an industry's advertising and its average profit rates. In the top category, containing industries whose products were highly advertised, the average profit rates of both

¹⁰ The companies included in the Arthur D. Little sample generally included only large and medium size companies. Very small companies were excluded from the sample since it included only companies whose stocks were registered on principal stock exchanges.

¹⁷ Joe S. Bain, *Barriers to New Competition*, Harvard University Press, 1956.