

The empirical distribution of firm profit rates

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Abstract

The classical notion of competition rests on the idea that entrepreneurs will allocate their capital into the most profitable sector or business activity, utilizing the average rate of profit as a benchmark in their investment decision. We propose a statistical equilibrium model in the spirit of Foley (1994) that interprets the tendency for competition to equalize profit rates as a dispersion measure around an average profit rate. The model predicts an exponential power (a.k.a. Subbotin) distribution of firms' profit rates. We investigate the profit rate distribution among more than a dozen diverse US business sectors, and find that profit rates have a clearly non-Gaussian distribution, mostly speaking in favor of the so-called Laplace distribution. The Laplace distribution is a particular case of the more general Subbotin distribution, having previously been observed in firm growth rates as well.

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