

Bigger is better, or is it?

Are larger companies worth more than their smaller peers?



Size matters, but why? Are larger companies worth more than their smaller peers?

Can the same € 1 million in profits be valued differently depending on the size of the company earning it? A commonly held view among executives, M&A advisors, and finance professionals is yes: larger companies tend to be valued at higher multiples than smaller ones. This perceived uplift - often referred to as the size premium - suggests that being bigger somehow demands a valuation premium.

But is this premium really about size alone? Are larger companies valued at a premium to their smaller peers, simply because they are larger in size?

This article explores what drives the size premium, why larger companies often appear more valuable, and the conditions under which this logic breaks down.

What drives the size premium?

Ultimately, a company's ability to generate shareholder value depends on its ability to consistently perform well on both two fundamental value drivers:

- Organic growth
- Economic spread

Economic spread: (the ability to generate a ROIC (Return on Invested Capital)¹⁾ which is higher than the cost of capital²⁾)

Considering these, it becomes clear that size alone does not guarantee value.

However, you may think of characteristics commonly associated with larger companies that can contribute meaningfully to higher

growth, higher ROIC and potentially lower costs of capital. Such characteristics could justify a higher valuation multiple - or a premium vis a vis smaller peers.

“size alone does not guarantee value”

As we look beyond size itself, a number of scale-related characteristics emerge that often explain why larger companies can grow faster, generate higher returns, and ultimately command a valuation premium.

1 Economies of scale

In essence, larger companies can spread fixed costs - such as R&D, marketing, infrastructure, management overhead, IT - over a broader revenue base. This reduces per-unit costs, improves profit margins and hereby ROIC.

1) ROIC or Return on Invested Capital is a measure of how efficiently a company generates after-tax operating profit from the capital invested in its operations. It is calculated as EBIT after-tax / Invested Capital.

2) Cost of capital is a measure of the minimum return a company must generate to compensate its debt and equity investors for the risk of investing in the business. It is usually estimated by the formula for the WACC, i.e., the Weighted Average Cost of Capital.



Software example

Scale enables software providers to spread development costs over a larger ARR base, which allows the company to accelerate product innovation without proportionally increasing costs.

IT-services example

Economies of scale could include hosting or managing data for a larger client base using the same underlying infrastructure (data centers, private cloud, monitoring software), driving higher revenue without proportionally higher costs.

Other key operational efficiencies from scale includes the ability to bulk-purchase from suppliers, resulting in lower unit pricing, for example more favourable deals on IT equipment, cheaper 3rd party software licences, etc.

All in all, economies of scale will improve margins, and how much you get in return on a capital investment (increase the ROIC).

2 Greater financial stability & lower bankruptcy risk

Larger companies usually have more diversified revenue streams, larger customer bases, and stronger balance sheets. These characteristics make larger companies more resilient during market downturns. For example, losing 5 customers may mean turning unprofitable for a small company while the effect for a larger company would be negligible.

Software example

Size usually implies a broader customer cohort across multiple verticals, geographies, and product modules. This reduces dependency on a handful of accounts and strengthens resilience and predictability of cash flow (ARR).

IT-services example

Larger companies usually benefit from longer, multi-year, managed-services contracts, and a diversified operational footprint (suppliers of various software and hardware vendors, cloud, security, ERP, support). Long contracts make revenue predictable, and a broad operational footprint can reduce risk should there be market movements against a certain solution or supplier.

“long contracts make revenue predictable”

Taken together, these factors mean that larger companies enjoy greater financial stability and face a lower risk of financial distress. This dynamic leads to two direct valuation effects:

- Lower cost of capital, as investors or banks demand a lower risk premium;
- Greater access to capital, which enables larger firms to outspend smaller peers in areas such as marketing, R&D, and strategic acquisitions.



3 Professionalization & organisational structure

As companies grow, they typically develop clear organisation structures, professional boards, and well-defined roles. A professional board of directors should support executives in strategic decision making. It should also help them identify the most effective ways to allocate scarce capital to generate the highest return on invested capital (ROIC).

Software example

Size would usually result in structured product management and development processes, ensuring improved product quality. A professional board can help technical founders find the best places to invest to ensure - not only great - but also commercially strong products.

IT-services example

Scale often means clearly defined delivery processes, specialised service teams (for example specialists within cloud, cybersecurity, ERP), and structured/standardized SLA frameworks. This improves service quality, customer satisfaction, and operational scalability.

Also, this professionalization and more well-defined roles usually promote distribution of responsibilities. This can help decreasing the firms' dependency on a few "key individuals" and allow the company to sustain a high ROIC or growth even if a key person leaves.

4 Brand recognition and talent advantages

Larger companies usually enjoy stronger brand equity, greater market trust and customer loyalty. Most B2B customers tend to choose and stick with trusted and well-established platforms who they perceive as stable and long-lasting. This is because onboarding software or business systems from a supplier that may not survive or even exist a year from now is risky. It allows large companies to win more customers (grow), but also to fend off competition from smaller new incumbents while they maintain pricing power (ROIC).

Software example

Reputation from size matters not only with customers but also with developers. Scaled companies with strong product engineering cultures attract better products and technical talent, which accelerates innovation and strengthens the competitiveness of the respective software platform.

IT-services example

Scale usually means offering a broader range of skills in-house and multi-vendor support. Both the brand strength and multi-vendor capability enable larger firms to service larger clients, public and private, for whom IT-downtime or vendor dependency can be mission critical.

Next to this, larger organizations can offer interesting career growth opportunities and are seen as having higher job certainty by current and future employees, making attracting talent easier. In other words, larger companies can be holding greater employee branding.



What argues against a size premium?

While size offers many advantages, it is not universally positive. It may also come with challenges that can potentially work against a size premium. Such factors could be bureaucracy leading to slower decisions, diseconomies of scale including managerial complexity and overhead, innovation inertia where agility declines, or cultural dilution which makes execution harder. These issues can erode growth and ROIC, meaning that in specific situations smaller firms may deserve a higher multiple. The conclusion is, size itself doesn't cause a premium, the structural advantages from scale do.

“size itself doesn't cause a premium, the structural advantages from scale do“

In sum, while it may be difficult to assume a direct premium arising from a company's size alone, there are certain traits related to size which can describe why larger companies are usually worth more. Ultimately, it is better to consider size as a visible byproduct of structural advantages such as economies of scale, financial resilience, structure, professionalization, and brand recognition – all of these make companies more efficient in their use of invested capital, increase growth, and reduce financial risk.

These underlying traits explain why larger companies tend to be valued more than smaller peers, even when generating similar profits. The “size premium” is therefore probably not about size in isolation but about

the efficiencies, capabilities, stability, and strategic options that often come with size.

Pride Capital Partners' perspective

At Pride Capital Partners, one of our investment strategies is to assist ambitious software & IT-services entrepreneurs accelerate these scale benefits through structured buy-and-build execution. Pride Capital Partners actively support management teams of our portfolio companies in acquiring complementary companies to (1) realize synergies, but also to (2) realize the various size benefits. If you are interested in learning more about our approach to investing and how to unlock additional value creation via buy-and-build please don't hesitate to reach out to nikolaj@pridecapital.dk for an introduction.



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