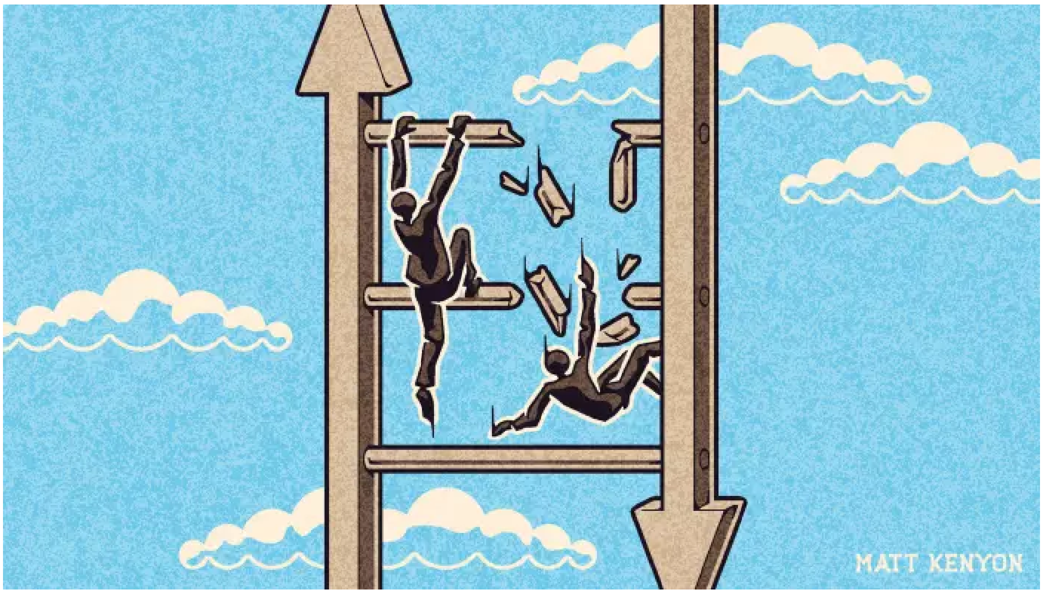
Opinion **Technology sector**

Superstar companies also feel the threat of disruption

Turnover at the top means market competition may work better than we thought

RANA FOROOHAR



Rana Foroohar OCTOBER 21, 2018

A couple of years ago, I interviewed an executive at a major US technology platform, who told me something that made me scoff.

I was pressing him on the fact that, in the "superstar" economy of today, in which a small number of companies, sectors and cities take more and more of the overall economic pie than they did 20 years ago, businesses like his were winnowing out competition, and thus decreasing innovation. He replied that, in fact, his company — large and powerful though it was — felt it was always in danger of being disrupted. At the time, I wrote the remark off as self-serving cognitive bias.

But an interesting piece of new research on the superstar economy has made me question that first reaction. According to a McKinsey Global Institute report, which will be released on Thursday, there is much more mobility in the winner-take-all world than we might have thought.

The report analyses nearly 6,000 of the world's largest public and private companies, each with annual revenues greater than $1bn and which together make up 65 per cent of global corporate pre-tax earnings.

Among this group, the top 10 per cent (the "superstar" companies) take 80 per cent of economic profit — defined as a company's invested capital multiplied by its returns above the cost of that capital. The top 1 per cent alone takes 36 per cent of the pie.

We know who some of the top 10 per cent are — they include the high-margin Faang companies (Facebook, Apple, Amazon, Netflix and Google) as well as others who have been able to exploit the value of intangible assets such as software, data, patents, and brands. We also know that the network effect allows such companies to ringfence markets quickly and at scale, giving them big competitive advantages.

But what the MGI report shows is that there is much more churn among that top 10 per cent than we might have expected. In fact, the report shows that about half of the top 10 per cent of companies fell out of that top tier every business cycle — and that 40 per cent of those dropouts fell all the way down to the bottom 10 per cent.

Meanwhile, a scrappy few were able to climb all the way from the bottom decile to the top during the same period. “Firms at the very top of the scale are capturing a lot of profit,” says MGI director James Manyika, who led the research. “But there’s also a fair bit of competition at the top.”

The diversity of both the top 10 per cent and 1 per cent is far greater today than it was 20 years ago. These companies include not just the usual suspects from Silicon Valley but also those from many other sectors (a number of global banks and manufacturing companies are in the top tier) and geographies (there are plenty of western multinationals on the list, but also many fast-growing Chinese businesses).

Why is it that companies can rise so fast, and fall so much further, faster, than they did a couple of decades ago?

Part of the answer clearly has to do with globalisation — when an idea hits, the potential market for it is much greater than in the past, and the access to global capital to scale up that idea is greater, too.

It is worth thinking about this point at a time when the value of globalisation is being challenged. If profitability is predicated on being able to quickly and easily access global markets, reversing those forces will surely change the picture dramatically.

But the churn in the superstar economy also reflects the fact that certain individual companies, no matter their sector, are able to leverage the tools of the new economy — networks, data, and ideas — and others are not. One of the more worrisome details revealed in the report is that the bottom 10 per cent of businesses is destroying as much value as the top 10 per cent is creating.

While there are still many questions to be asked and answered about why this might be, one point seems clear. The losers tend to own more things — tangible assets like factories and equipment — whereas the winners are concerned with leveraging intangible assets.

To understand this idea better, take a look at *The Seventh Sense: Power, Fortune, and Survival in the Age of Networks*, by Joshua Cooper Ramo, the co-director of consultancy Kissinger Associates. The book is a particularly readable parsing of the economic, political and social effects of this shift.

The idea that there is turnover in the superstar economy is important. It means that forces of economic competition may be working better than we have assumed. And yet, the churn at a company and sector level is not being spread equally within countries. In fact, we are seeing more geographic bifurcation than ever before. In the US, for example, just 10 per cent of all counties take 90 per cent of the GDP.

The result is a handful of cities that are like "luxury products", in the words of former mayor of New York City Michael Bloomberg. It also produces a growing crop of left-behind cities that could become like Detroit or Minneapolis — places where forgotten populations and polarised politics are the norm.

If we cannot find a way to bridge that divide, more competition within the top corporations will not matter.

rana.foroohar@ft.com

Letter in response to this column:

Growing risks to investors as technology accelerates / From Richard Cragg, Kingston upon Thames, Surrey, UK

Latest on Technology sector

Follow the topics in this article

Rana Foroohar

Technology sector

Disrupters

McKinsey

Silicon Valley PLC

How easy or hard was it to use FT.com today?