The Economist

Schumpeter

Death and transfiguration

The golden age of the Western corporation may be coming to an end

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EDWARD GIBBON, the great English historian, begins his "Decline and Fall" with a glowing portrait of the Roman Empire in the age of Augustus. The Empire "comprehended the fairest part of the earth". Rome's enemies were kept at bay by "ancient renown and disciplined valour". Citizens "enjoyed and abused the advantages of wealth and luxury". Alas, this happy state of affairs was not to last: the Empire already contained the seeds of its own destruction. Gibbon soon changed gear from celebrating triumphs to chronicling disasters.

Perhaps the history of the Western corporation will one day be written in much the same vein. Today's corporate empires comprehend every corner of the earth. They battle their rivals with legions of highly trained managers. They keep local politicians in line with a promise of an investment here or a job as a consultant there. The biggest companies enjoy resources that have seldom been equalled; Apple, for instance, is sitting on a cash pile of more than $200 billion. And they provide their senior managers and leading investors with "wealth and luxury" that would have impressed even the most jaundiced Roman.

A new report by the McKinsey Global Institute provides some invaluable statistics for any future Gibbon, which MGI calculated by crunching data from nearly 30,000 firms across the world. Corporate profits more than tripled in 1980-2013, rising from 7.6% of global GDP to 10%, of which Western companies captured more than two-thirds. The after-tax profits of American firms are at their highest level as a share of national income since 1929.

Yet the men and women from McKinsey change gear as quickly as Gibbon. The golden age of the Western corporation, they argue, was the product of two benign developments: the globalisation of markets and, as a result, the reduction of costs. The global labour force has expanded by some 1.2 billion since 1980, with the new workers largely coming from emerging economies. Corporate-tax rates across the OECD, a club of mostly rich countries, have fallen by as much as half in that period. And the price of most commodities is down in real terms.

Now a more difficult era is beginning. More than twice as many multinationals are operating today as in 1990, making for more competition. Margins are being squeezed and the volatility of profits is growing. The average variance in returns to capital for North American firms is more than 60% higher today than it was in 1965-1980. MGI predicts that corporate profits may fall from 10% of global GDP to about 8% in a decade's time.

Two things in particular are shaking up the comfortable world of the old imperial multinationals. The first is the rise of emerging-market competitors. The share of *Fortune* 500 companies based in emerging markets has increased from 5% in 1980-2000 to 26% today. These firms are expanding globally in much the same way as their predecessors from Japan and South Korea did before them. In the past decade the 50 largest emerging-world firms have doubled the proportion of their revenues coming from abroad, to 40%. Although the outlook for many emerging markets is more mixed than it was just a couple of years ago, troubles at home may push rising multinationals to globalise more rapidly.

The second factor is the rise of high-tech companies in both the West and the East. These firms have acquired large numbers of customers in the blink of an eye. Facebook boasts as many users each month as China has people: 1.4 billion. Tech giants can use their networks of big data centres rapidly to colonise incumbents' territories; China's e-commerce giants Alibaba, Tencent and JD.com are doing this in financial services. Such firms can also provide smaller companies with a low-cost launching pad that allows them to compete in the global market.

MGI does not dwell on it, but the political environment is also becoming more hostile. Populists on both the left and the right rage against corporate greed. In America, presidential hopefuls Bernie Sanders and Donald Trump both criticise companies for exploiting tax loopholes. Even middle-of-the-road politicians are sounding a more anti-corporate note. Angela Merkel introduced Germany's first minimum wage in 2014; and in Britain David Cameron is phasing in a "living wage". Companies may find themselves under pressure to "give back" to wider society.

How can Western companies navigate these threats to their rule? MGI advises them to focus on the one realm where they continue to have a comparative advantage—the realm of ideas. Many companies in labour- and capital-intensive industries have been slaughtered by foreign competitors, whereas idea-intensive firms—not just companies in obvious markets such as the media, finance and pharmaceuticals, but in areas such as logistics and luxury cars—continue to flourish. The "idea sector", as MGI defines it, accounts for 31% of profits generated by Western companies, compared with 17% in 1999.

Capitalist redemption

The relative decline of the Western corporation could also lead to a rethinking of some of the long-standing assumptions about what makes for a successful business. Public companies may lose ground to other types of firm: in America the number of firms listed on stock exchanges has fallen from 8,025 in 1996 to about half that number now. The cult of quarterly earnings may lose more of its following. A striking number of the new corporate champions have dominant owners in the form of powerful founders. They are willing to eschew short-term results in order to build a durable business, such as Mark Zuckerberg at Facebook, the Mahindras and other assiduous families in India, and private-equity firms. Gibbon's great work was a tale of decline and fall, as classical civilisation gave way to barbarism and self-indulgence. With luck, the tale of the relative decline of the Western corporation will also be a tale of the reinvention of capitalism as new forms of companies arise to seize opportunities from the old.

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