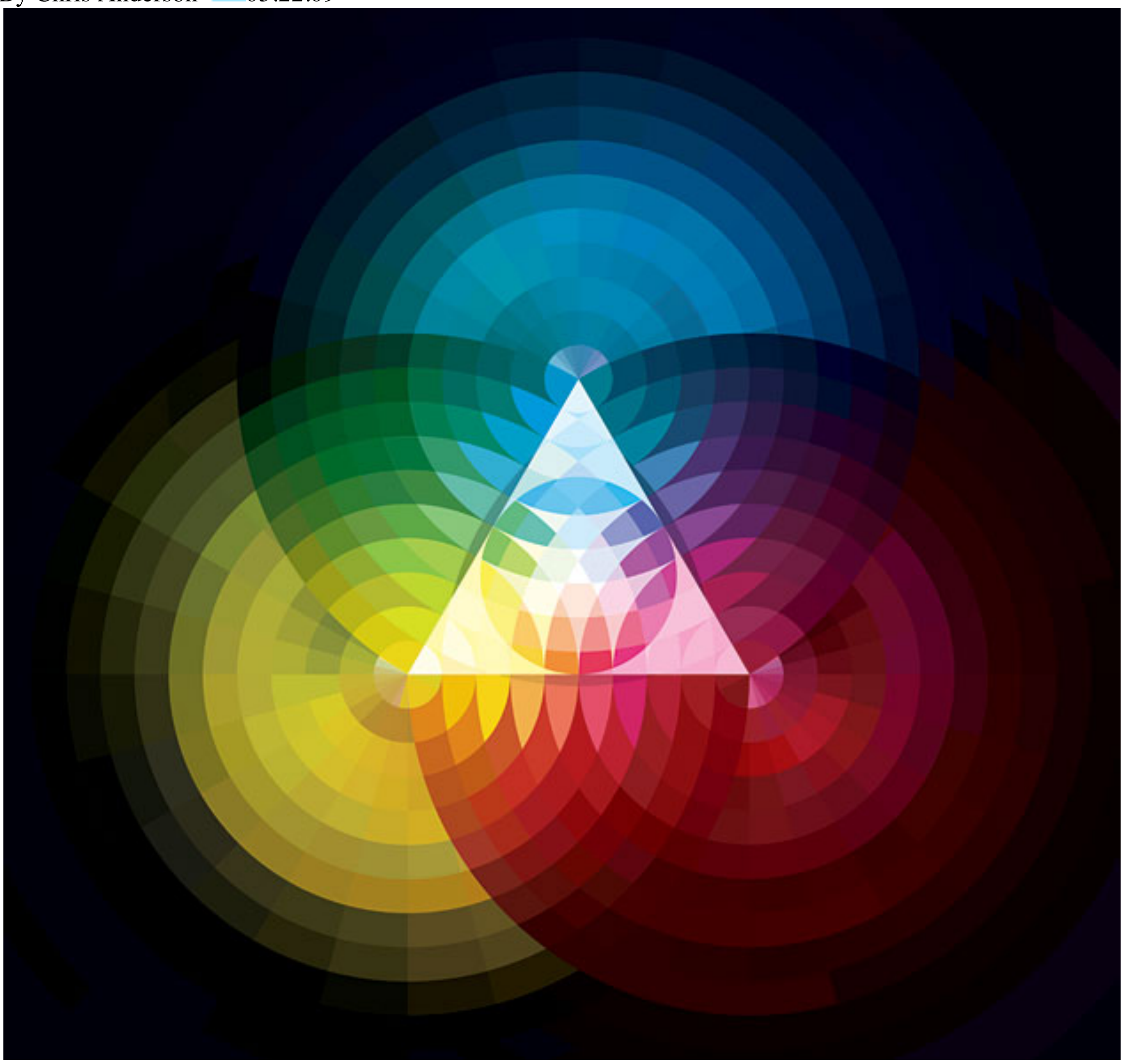
The New New Economy: More Startups, Fewer Giants, Infinite Opportunity

By Chris Anderson 05.22.09



The era of the huge conglomerate is over.
Illustration: Andy Gilmore

As the Internet was taking shape in the late 1980s, an MIT professor named Tom Malone started thinking about how it could change the structure of industries. In a series of papers, he predicted that the big top-down companies of the 20th century would soon "decentralize and externalize" into industry ecosystems. "Imagine an AT&T that breaks up into not two or three different companies but two or three hundred thousand different companies," Malone told *Wired* in a July 1998 interview. "This sort of voluntary, radical disaggregation is an attractive alternative for some large organizations."

It simply stood to reason: Huge vertically integrated conglomerates were created to minimize what economist Ronald Coase called transaction costs between teams and up and down the supply chain. Now distributed-information networks would do the same outside the walls of a single company. The Web would be globalization taken to the extreme. Projects would be open to the best of breed anywhere, creating virtual flash firms of suppliers and workers that would come together for one product and then re-form for another. "Small pieces, loosely joined" was the mantra.

But out in the reality of the world's great industries, the opposite seemed to happen. Corporations just kept getting bigger. On Wall Street, Goldman Sachs was pulling in almost $90 billion a year, tripling annual revenue in less than a decade. The pharmaceutical industry consolidated through hundreds of mergers and acquisitions. The Fortune 10, which today includes Wal-Mart and General Electric, more than tripled in size since 1990. And AT&T, far from breaking up into 300,000 different companies, became even bigger than before and, once again—at least for iPhone users—a monopoly.

And then last September it all came toppling down. Those big financial firms turned out to have been inflated by debt at levels never before seen (and hopefully never repeated). The big car companies crashed head-on into skyrocketing oil prices and plummeting consumer demand. Big Pharma ran out of blockbusters. Wal-Mart kept closing stores, while GE tried to sell off divisions. (OK, AT&T is still an iPhone monopoly, but give it time!)

So now, in the graveyard of giants, it's worth asking: Was Malone right? Was his age of nimble mammals simply delayed by the final march of corporate dinosaurs into the tar pits?

This crisis is not just the trough of a cycle but the end of an era. We will come out not just wiser but different.

What we have discovered over the past nine months are growing diseconomies of scale. Bigger firms are harder to run on cash flow alone, so they need more debt (oops!). Bigger companies have to place bigger bets but have less and less control over distribution and competition in an increasingly diverse marketplace. Those bets get riskier and the payoffs lower. And as Wall Street firms are learning, bigger companies are going to get more regulated, limiting their flexibility. The stars of finance are fleeing for smaller firms; it's the only place they can imagine getting anything interesting done.

As venture capitalist Paul Graham put it, "It turns out the rule 'large and disciplined organizations win' needs to have a qualification appended: 'at games that change slowly.' No one knew till change reached a sufficient speed."

The result is that the next new economy, the one rising from the ashes of this latest meltdown, will favor the small.

Take Detroit. The only way for the Big Three to survive, Charles C. Mann writes in "Beyond Detroit", is to harness the innovation of the myriad startups working on automotive technology.

Or take Google. As Steven Levy explores in "The Secrets of Googlenomics", the company deploys a bottom-up model for ad sales, dictated not by firm handshakes but by hard math.

Or even society at large. A century ago, mass collective action could be organized only by the state. Now we have the Web. Kevin Kelly resurrects socialism—without the state—in "The New Socialism".

To all the usual reasons why small companies have an advantage, from nimbleness to risk-taking, add these new ones: The rise of cloud computing means that young firms no longer have to buy their own IT equipment, which helps them avoid having to raise money or take on debt. Likewise, the webification of the supply chain in many industries, from electronics to apparel, means that even the tiniest companies can now order globally, just like the giants. In the same way a musician with just a laptop and some gumption can accomplish most of what a record label does, an ambitious engineer can invent and produce a gadget with little more than that same laptop.

"Involuntary entrepreneurship" is now creating tens of thousands of small businesses and a huge market of contract and freelance labor. Many will take full-time jobs again once they become available, but many others will choose not to. The crisis may have turned our economy into small pieces, loosely joined, but it will be the collective action of millions of workers hungry for change that keeps it that way.

Chris Anderson (canderson@wired.com) *is* Wired*'s editor in chief.*