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Size matters

The dominance of 'superstar' companies exacerbates social inequality. Europe must take action

Read this article in German.

Like many industrialised economies, Germany and Europe at large are experiencing a slowdown in the most important generator of wealth: productivity. Data from the European Central Bank, for example, shows that over the past 20 years, growth in labour productivity has been reduced by nearly half. For some economists, these alarming numbers are signs of 'secular stagnation' – a state of chronically weak economic growth.

But a closer look at economies around the world suggests a surprising phenomenon: certain companies have been largely spared from these productivity woes. They constitute a global elite that manages to achieve high productivity growth while that of their competitors stagnates. In fact, the OECD notes that the gap between these elite companies and the others is widening. In the services sector, the top 5 per cent of leading companies increased their productivity by more than 40 per cent, while the remainder achieved only about 10 per cent.

These leading businesses with huge productivity gains are the 'superstar' companies that have taken their industries by storm. They are highly innovative and productive: technology giants like Apple and Google or, in the offline world, Walmart and Starbucks. They all have one thing in common: dominance in their respective industries.

Winner takes all

A US research team led by economist David Autor shows that in nearly all US sectors, 'company concentration' has increased sharply – meaning the collective market share of the four largest companies of each industry has grown sharply at the expense of their other competitors. For example, in the retail trade the concentration rate has doubled since the 1980s.

Recent OECD figures show a similar trend for Europe. As a result, more and more markets are following the 'winner takes all' principle: network effects and economies of scale mean leading companies are gaining an ever greater market share, making it virtually impossible to catch up. The rest of the industry can no longer keep pace, and ultimately no longer holds a competitive position.

We may think this increasing concentration harms competition in a social market economy. When a few dominant companies can dictate prices thanks to greater market power, small suppliers barely enter the market anymore, and this can slow down innovative capability. However, new findings are even more worrying: the growing concentration of companies also apparently increases inequality.

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That's because the rise of the superstar companies could well account for the decline in the wage share in many European economies. For example, the latest OECD study shows that in industries where concentration is increasing, the wage share – that is, the share of wages in the value added of the companies – is decreasing.

This is mainly due to the superstar companies' business model: wages and the labour factor make up only a relatively small portion of their operations. This applies, for example, to digital companies that are less dependent on the labour factor and instead tend to be more capital-intensive. But even in more traditional sectors, the wage share is declining, particularly in the face of increasing digitalisation.

Falling wage share

As the superstars are gaining in importance in the entire economy and employees' share of the economic pie is decreasing across the board, the wage share is also declining overall – and thus the share of wages in the total national income. In fact, in recent decades the wage share has fallen: in Germany and France by about 6.5 per cent, in Italy and Spain by as much as 14 per cent. Its counterpart, the profit share, indicates the income of employers and investors; that is, the capital factor. It rose in the same period. This has consequences for income inequality, as investment income tends to be concentrated at the top of income distribution.

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increases are not keeping pace with the huge growth in productivity. In other words, the superstars don't pass their high productivity gains along to the workforce. Consequently the wage share is falling, and investment income is growing faster than wages. In this way, inequality can increase overall.

What can and should be done? Germany is currently discussing the 'National Industrial Strategy 2030', presented by Minister for Economic Affairs and Energy Peter Altmaier. Part of the strategy could be, for example, an innovation policy that allows the superstars' springboard innovations to reach other companies more effectively. This could address the weakness of productivity in many parts of the economy and improve competition in many sectors; such an innovation policy on a deliberately wide scale could also benefit regional development.

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In Germany, and within the EU, regional differences between thriving regions and the structurally weak periphery are increasing, something that not only burdens social cohesion but is also a breeding ground for populism in the long run, as has happened in Italy.

One remedy could be better networking between universities, companies and other regional players, who bring research and knowledge to market maturity along a value-added chain. In particular, in structurally weak regions, measures of this kind could increase the ability to innovate and thus enable better prospects overall. The successor to the EU's Horizon2020 programme for research and innovation could prove instrumental in supporting a European regional innovation promotion strategy.

Driven by digitisation

Prosperity for all also requires competition for all. In this era of (digital) winner-takes-all markets, competition law needs to be updated. After all, the superstars initially acquired their advantage by developing better products. But in the long run, they can become so dominant that small, innovative companies are discouraged from entering the market – which in turn inhibits new innovations and bolsters the superstars' dominance. The market itself cannot help on its own, according to competition economist Luigi Zingales. His suggestions include better portability of data between digital platforms and the automatic sharing of data above a certain level of market share.

In addition, Europe needs to move forward with digital taxation. There are new approaches to the efficient taxation of data that need to be discussed. Digitisation is a key driver of corporate concentration: it helps the superstars make better use of network effects and economies of scale, so that, as a result, productivity gains and wages no longer go hand in hand. The efficient taxation of digital value creation could restore the link between productivity and wage growth.

Finally, stronger trade union participation, especially in digital platform companies, provides leverage for better passing along productivity gains to employees. For example, the growth in productivity and wages could be reconciled and the wage share at least stabilised. If the latter does not succeed, the superstar economy will produce one thing above all: many losers.



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