Reinventing the company

Entrepreneurs are redesigning the basic building block of capitalism

NOW that Uber is muscling in on their trade, London's cabbies have become even surlier than usual. Meanwhile, the world's hoteliers are grappling with Airbnb, and hardware-makers with cloud computing. Across industries, disrupters are reinventing how the business works. Less obvious, and just as important, they are also reinventing what it is to be a company.

To many managers, corporate life continues to involve dealing with largely anonymous owners, most of them represented by fund managers who buy and sell shares listed on a stock exchange. In insurgent companies, by contrast, the coupling between ownership and responsibility is tight (see pages 23-26). Founders, staff and backers exert control directly. It is still early days but, if this innovation spreads, it could transform the way companies work.

Listing badly

The appeal of the insurgents' model is partly a result of the growing dissatisfaction with the public company. True, the best public companies are remarkable organisations. They strike a balance between quarterly results (which keep them sharp) and long-term investments (which keep them growing). They produce a stream of talented managers and innovative products. They can mobilise talent and capital.

But, after a century of utter dominance, the public company is showing signs of wear. One reason is that managers tend to put their own interests first. The shareholder-value revolution of the 1980s was supposed to solve this by incentivising managers to think like owners, but it backfired. Loaded up with stock options, managers acted like hired guns instead, massaging the share price so as to boost their incomes.

The rise of big financial institutions (that hold about 70% of the value of America's stockmarkets) has further weakened the link between the people who nominally own companies and the companies themselves. Fund managers have to deal with an ever-growing group of intermediaries, from regulators to their own employees, and each layer has its own interests to serve and rents to extract. No wonder fund managers usually fail to monitor individual companies.

Lastly, a public listing has become onerous. Regulations have multiplied since the Enron scandal of 2001-02 and the financial crisis of 2007-08. Although markets sometimes look to the long term, many managers feel that their jobs depend upon producing good short-term results, quarter after quarter.

Conflicting interests, short-termism and regulation all impose costs. That is a problem at a time when public companies are struggling to squeeze profits out of their operations. In the past 30 years profits in the S&P 500 index of big American companies have grown by 8% a year. Now, for the second quarter in a row, they are expected to fall, by about 5% (see page 63). The number of companies listed on America's stock exchanges has fallen by half since 1996, partly because of consolidation, but also because talented managers would sooner stay private.

It is no accident that other corporate organisations are on the rise. Family companies have a new lease of life. Business people are experimenting with "hybrids" that tap into public markets while remaining closely held. Astute investors like Jorge Paulo Lemann, of 3G Capital, specialise in buying public companies and running them like private ones, with lean staffing and a focus on the long term.

The new menagerie

But the most interesting alternative to public companies is a new breed of high-potential startups that go by exotic names such as unicorns and gazelles. In the same cities where Ford, Kraft and Heinz built empires a century ago, thousands of young people are creating new firms in temporary office spaces, fuelled by coffee and dreams. Their companies are pioneering a new organisational form.

The central difference lies in ownership: whereas nobody is sure who owns public companies, startups go to great lengths to define who owns what. Early in a company's life, the founders and first recruits own a majority stake—and they incentivise people with ownership stakes or performance-related rewards. That has always been true for startups, but today the rights and responsibilities are meticulously defined in contracts drawn up by lawyers. This aligns interests and creates a culture of hard work and camaraderie. Because they are private rather than public, they measure how they are doing using performance indicators (such as how many products they have produced) rather than elaborate accounting standards.

New companies also exploit new technology, which enables them to go global without being big themselves. Startups used to face difficult choices about when to invest in large and lumpy assets such as property and computer systems. Today they can expand very fast by buying in services as and when they need them. They can incorporate online for a few hundred dollars, raise money from crowdsourcing sites such as Kickstarter, hire programmers from Upwork, rent computer-processing power from Amazon, find manufacturers on Alibaba, arrange payments systems at Square, and immediately set about conquering the world. Vizio was the bestselling brand of television in America in 2010 with just 200 employees. WhatsApp persuaded Facebook to buy it for $19 billion despite having fewer than 60 employees and revenues of $20m.

Three objections hang over the idea that this is a revolution in the making. The first is that it is confined to a corner of Silicon Valley. Yet the insurgent economy is going mainstream. Startups are in every business from spectacles (Warby Parker) to finance (Symphony). Airbnb put up nearly 17m guests over the summer and Uber drives millions of people every day. WeWork, an American outfit that provides accommodation for startups, has 8,000 companies with 30,000 workers in 56 locations in 17 cities.

The second is that the public company will have the last laugh, because most startups want eventually to list or sell themselves to a public company. In fact, a growing number choose to stay private—and are finding it ever easier to raise funds without resorting to public markets. Those technology ▸▸

▸ companies that list in America now do so after 11 years compared with four in 1999. Even when they do go public, tech entrepreneurs keep control through "A" class shares.

The third objection is that ownership in these new companies is cut off from the rest of the economy. Public companies give ordinary people a stake in capitalism. The startup scene is dominated by a clique of venture capitalists with privileged access. That is true, yet ordinary people can invest in startups directly through platforms such as SeedInvest or indirectly through mainstream mutual funds such as T. Rowe Price, which buys into them during their infancy.

Today's startups will not have it all their own way. Public companies have their place, especially for capital-intensive industries like oil and gas. Many startups will inevitably fail, including some of the most famous. But their approach to building a business will survive them and serve as a striking addition to the capitalist toolbox. Airbnb and Uber and the rest are better suited to virtual networks and fast-changing technologies. They are pioneering a new sort of company that can do a better job of turning dreams into businesses. ■