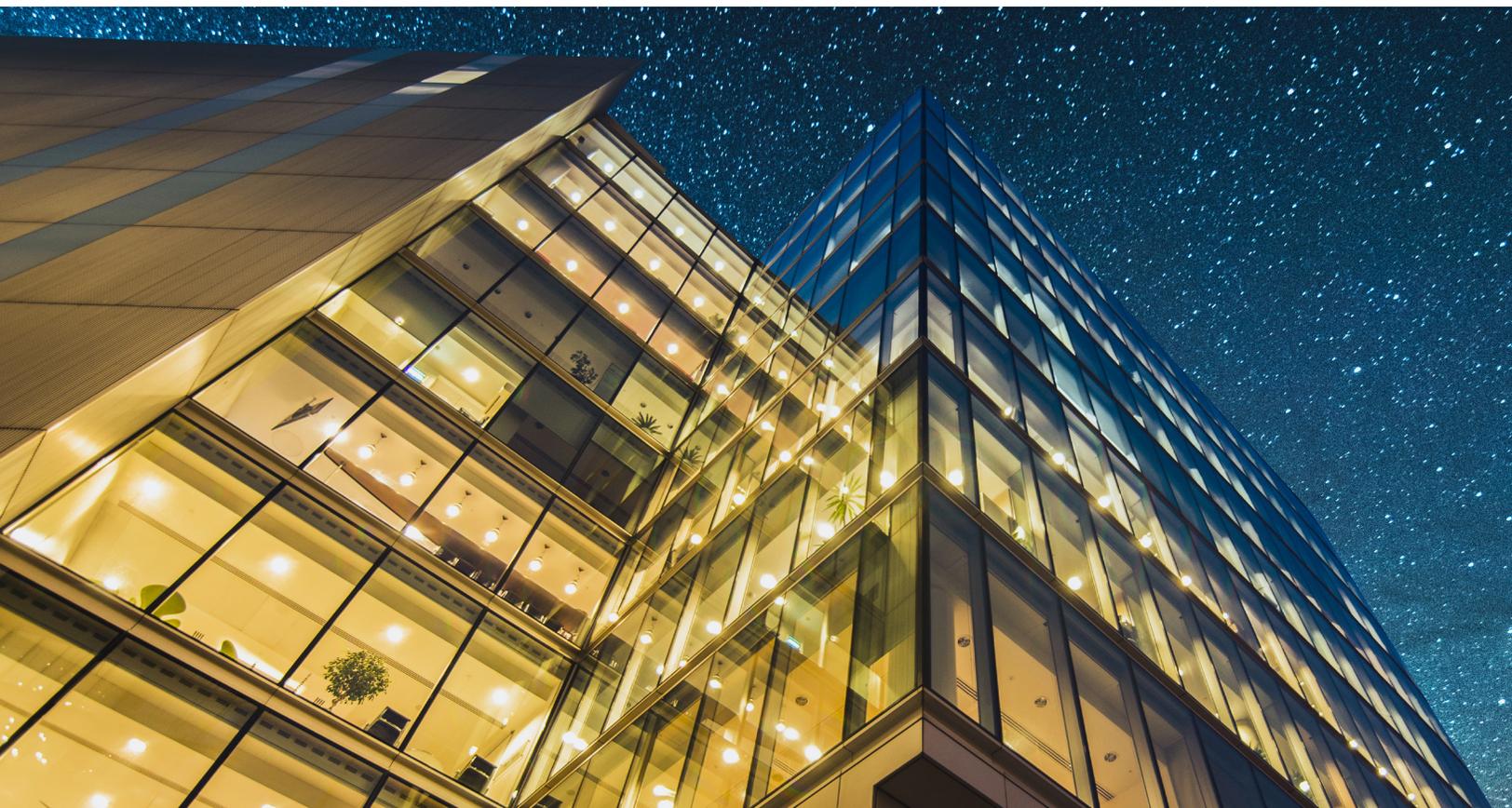


What every CEO needs to know about 'superstar' companies

The superstar effect is real, and in this new competitive environment, strategy matters more than ever.

by Sree Ramaswamy, Michael Birshan, James Manyika, Jacques Bughin, and Jonathan Woetzel



The rapid growth of very large global companies is fueling widespread debate about “superstar” effects and superstar companies. The McKinsey Global Institute (MGI) recently published its first findings in a series of research papers on this topic. One motivating factor for our ongoing research is that even as the debate grows, it is marred by confusing definitions, errors in measurement, and incomplete data—and as a result, the evidence remains inconclusive. We are also struck by the fact that the superstar phenomenon (the growing concentration of economic success) can be observed not just among companies but also in other aspects of the global economy, such as cities and sectors of economic activity. While we appreciate that important questions remain on the topic, in this article, we highlight key insights that our research has revealed to date—and their implications for business leaders around the world.

To understand company dynamics better, we analyzed 5,750 of the world’s largest public and private companies, each with annual revenues greater than \$1 billion. Together, they made up 65 percent of global corporate pretax earnings (earnings before interest, taxes, depreciation, and amortization) from 1994 to 2016. Our metric for superstar companies is economic profit, a measure of a company’s invested capital times its return above its weighted cost of capital. We focus on economic profit because it reflects the economic value created by a company’s operating activities and investments.

Among the world’s largest companies, as prior McKinsey research has shown, economic profit is distributed unequally along a power curve, with the top 10 percent of companies capturing 80 percent of positive economic profit. The middle 60 percent of companies record near-zero economic profit on average, showing how hard it can be to defy market forces. The bottom 10 percent destroy as much value as superstars create. We label companies in the top 10 percent as superstar companies. These companies come from all regions and sectors and include global banks and manufacturing companies,

long-standing Western consumer brands, and fast-growing US and Chinese tech companies. The top 1 percent of these superstar companies, those creating the highest economic value, account for 36 percent of all positive economic profit among large companies.

1. The superstar effect is real: The distribution of corporate returns is getting more skewed over time

The distribution of economic profit along the power curve has gotten more skewed over the past 20 years. After adjusting for inflation, today’s superstar companies have 1.6 times more economic profit, on average, than the superstar companies of 20 years ago. It is not just economic profit that qualifies these companies as superstars: they are among the world’s most sought-after employers, most valuable brands, and most valuable equity listings.

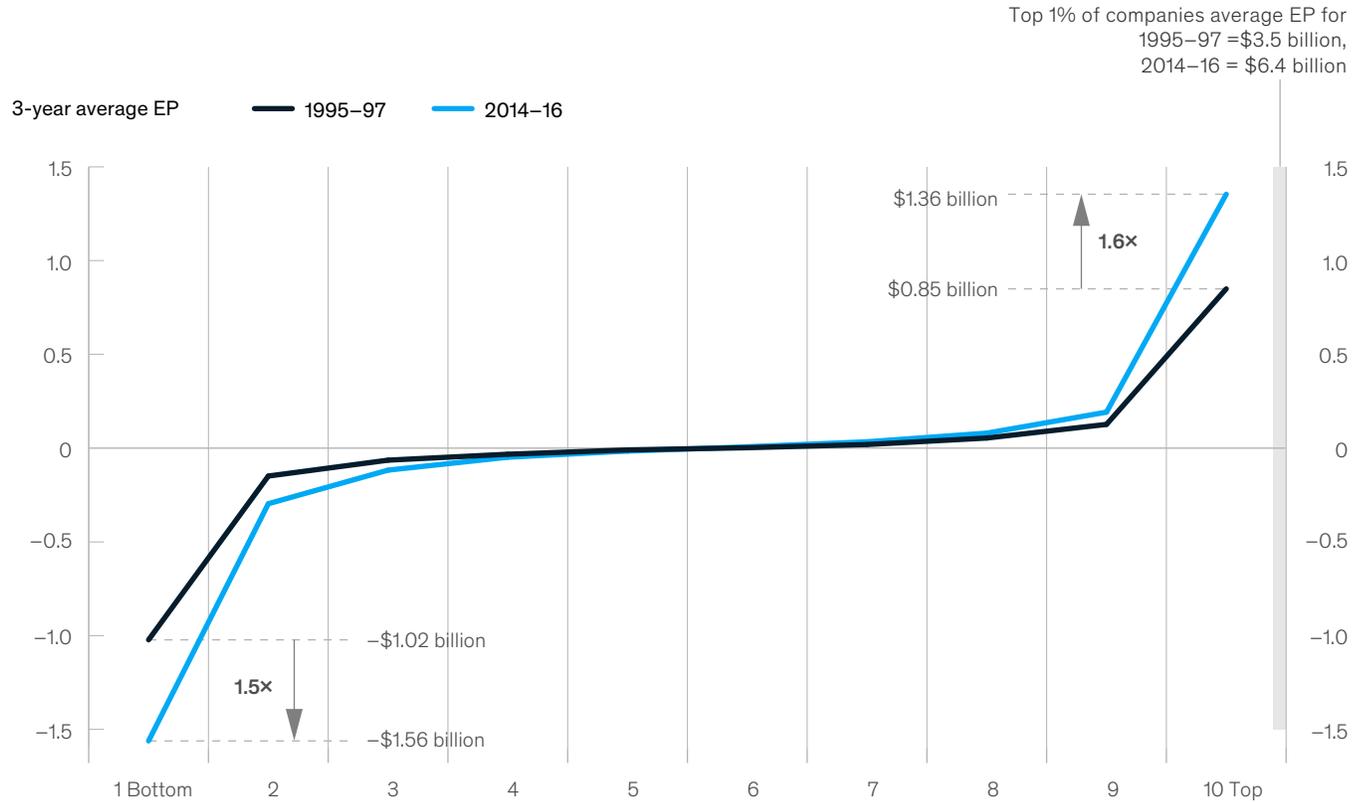
As economic profits grow larger, so do economic losses at the other end of the distribution. The bottom 10 percent of companies destroy as much value as the top 10 percent create, and today’s bottom-decile companies have 1.5 times more economic loss, on average, than their counterparts of 20 years ago (Exhibit 1). That means for every company that creates economic value, there is another company that destroys economic value. Yet these value-destroying companies continue to survive, holding on to their resources for increasingly longer durations and continuing to attract capital. A growing number are turning into “zombie” companies, unable to generate enough cash flow even to sustain interest payments on their debts. The impact of these economic losses goes beyond these companies’ investors, managers, and workers: it drives down the returns for healthy companies that compete for the same resources or profits.

For the vast majority of the world’s largest companies, those making up the middle 60 percent of the power curve, economic profit is hard to retain. They record near-zero economic profit, on average. For these companies, market forces are powerful

Exhibit 1

The distribution of economic profit and loss has become more skewed over the past 20 years.

Average economic profit (EP) per company by EP-distribution decile,¹ \$ billion



¹In 2016 dollars. Considers corporations with average sales of ≥\$1 billion (adjusted for inflation) to calculate economic profit in each time period. Sample sizes are 2,450 companies in 1995-97 and 5,750 companies in 2014-16.

Source: Chris Bradley, Martin Hirt, and Sven Smit, *Strategy Beyond the Hockey Stick: People, Probabilities, and Big Moves to Beat the Odds*, John Wiley & Sons, 2018; ‘Superstars’: *The dynamics of firms, sectors, and cities leading the global economy*, McKinsey Global Institute, October 2018, McKinsey.com; Corporate Performance Analytics by McKinsey; McKinsey analysis

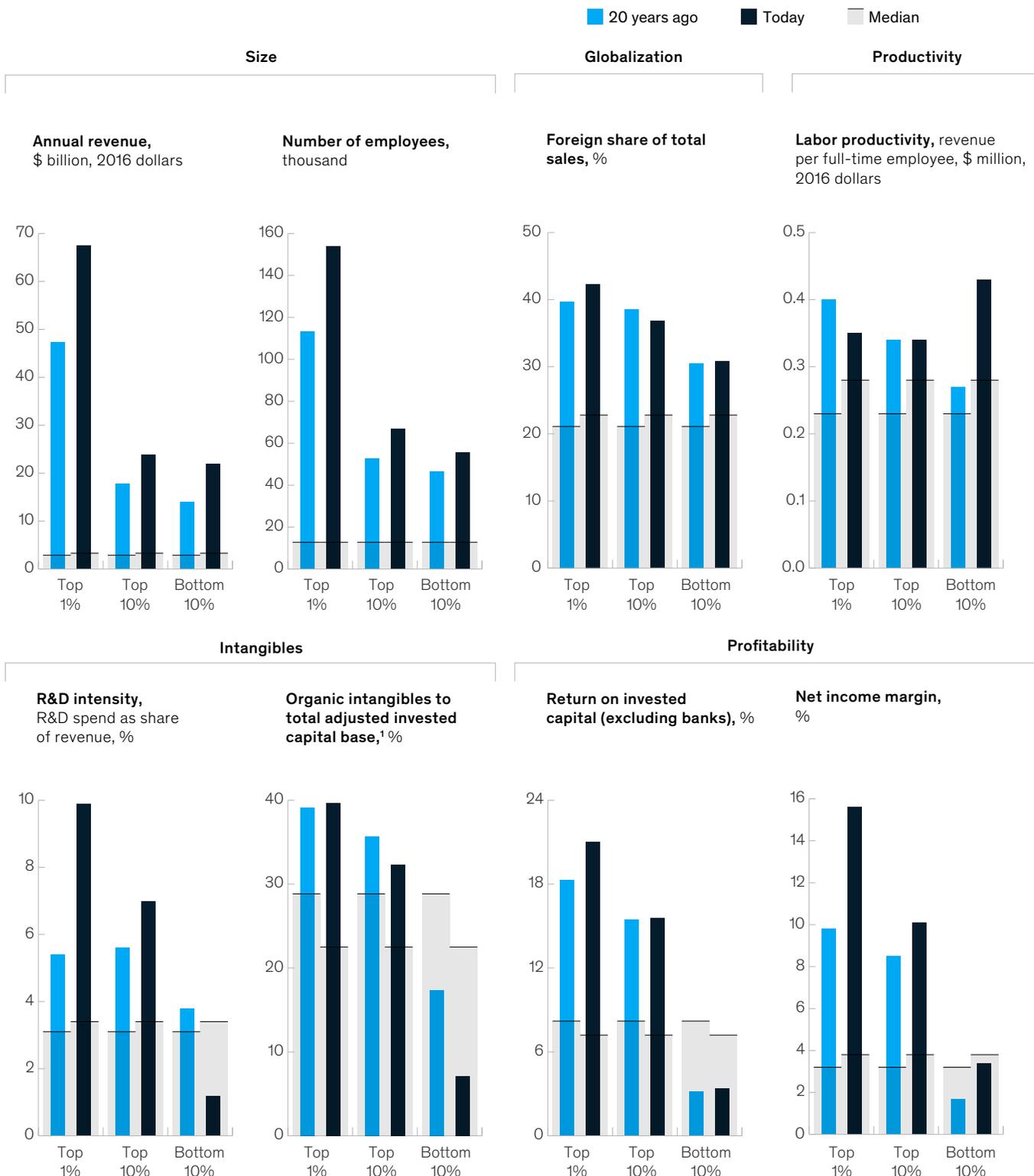
constraints on creating and retaining value, forcing them to compete away whatever advantages they may have in the marketplace. For the average company, the skew of economic profit means that it becomes relatively more painful to be in the middle of the pack, and strategy becomes even more relevant.

2. How you play matters: Superstar companies stand out for the scale of their intangible investments and the returns they generate from them

Superstar companies stand out for their size. Compared with median companies with annual revenues greater than \$1 billion, superstar companies are seven times larger by revenue and capital investment (Exhibit 2). They are also more productive, with 20 percent higher capital and labor productivity on average compared with median companies. But while size and productivity matter, they are not exclusive features of superstar companies. Bottom-decile companies are as large as superstars in terms of revenue and have even higher levels of capital investment and labor productivity.

Superstars are larger, more globalized, and more productive than median companies and benefit more from intangible investments than do bottom-decile companies.

Company performance by economic-profit-distribution decile



¹Adjustment for organic intangibles done by capitalizing companies' R&D expenditures and a portion of their selling, general, and administrative expenditures. For more, see Ryan H. Peters and Lucian A. Taylor, "Intangible capital and the investment-q relation," *Journal of Financial Economics*, February 2017, Volume 123, Issue 2, pp. 251-72, sciencedirect.com.

Source: S&P Capital IQ; Corporate Performance Analytics by McKinsey; McKinsey Global Institute analysis

A key distinguishing feature of superstar companies is their investment in intangible assets, such as software, data, brands, customer contracts, supply-chain partnerships, and even training. On an annual basis, superstar companies spend two to three times more on R&D than peers do, accounting for 70 percent of total spending on R&D by the 5,750 largest companies in our analysis—and their share has increased over the past 20 years. This is even more noticeable at the very top. Superstar companies in the top 1 percent by economic profit are almost three times more R&D intensive than median companies are and nearly ten times more R&D intensive than companies in the bottom decile are. The capitalized spending on intangibles accounts for one-third of superstars' invested capital, four times the share of bottom-decile companies.

Acquired assets from inorganic growth are also a factor that drives superstardom. Superstar companies today rely more on M&A than peers do. As a share of total assets, superstar companies have 1.5 times more goodwill and 1.5 to 2.0 times more acquired intangible assets, such as intellectual property, software, and brand value, compared with median companies.

The best-performing companies can thus attract and invest capital at a faster rate than their peers can. They can use their capital to outperform their peers on intangible investments, participate to a greater extent in M&A activity, and expand into global markets more aggressively. For some superstar companies, the larger capital investments in intangible assets translate to increasing returns to scale (evidenced by higher return on invested capital) over time. Intangible investments may generate higher returns because of their intrinsic nature, such as their ability to scale easily and complement other intangible assets.

These differences among companies may become more magnified in an increasingly digitized business environment. Digital capabilities tend to complement other intangible investments and yield higher returns to companies that do it well, even as digital disruption reduces overall returns in

the market. Advances in artificial intelligence and automation can further increase the gap between those on the digital frontier and everyone else—and by doing so, increase the gap between intangible-driven superstar companies and others.

However, companies do not become superstars simply by attracting and investing more capital. Bottom-decile companies have kept pace with the growing scale of superstar companies, and many also share characteristics such as greater M&A activity, increased scale, and higher labor productivity, but they seem unable to translate these features into commensurate returns. They may have unwise strategy, poor execution, or both and may need to be better at selecting and integrating assets to generate higher returns—for example, by having more systematic and programmatic M&A.

3. Where you play matters: Superstar companies benefit from participating in a select number of superstar activities

While we tend to think of a company operating in one particular industry, in practice, a company can have establishments (such as affiliates, business units, and distinct activities) that straddle many different industries, such as with automobile companies and their customer-finance activities and with industrial companies and their after-sales service activities. Taking an establishment lens, rather than a company lens, can provide insights to understand the economic gains accruing to these different activities.

Global economic data indicate that over the past 20 years, 70 percent of growth in GDP and gross surplus (an economic measure of profit) occurred in just five worldwide superstar activities: financial services, such as banking, credit, insurance, and asset management; internet-, media-, and software-product development; pharmaceutical and medical-product development; professional services, such as R&D, management, and other high-skilled services; and real estate, rental, and leasing. Just two sectors of activity, financial services and real

estate, account for about 45 percent of all the gains in gross surplus (Exhibit 3). In contrast, GDP and surplus growth have slowed or reversed in more traditional capital- and labor-intensive activities. These include infrastructure activities, such as utilities, transportation, and natural-resource extraction and development; capital-goods and component manufacturing; consumer services, such as hospitality and retail; and consumer-goods manufacturing activities.

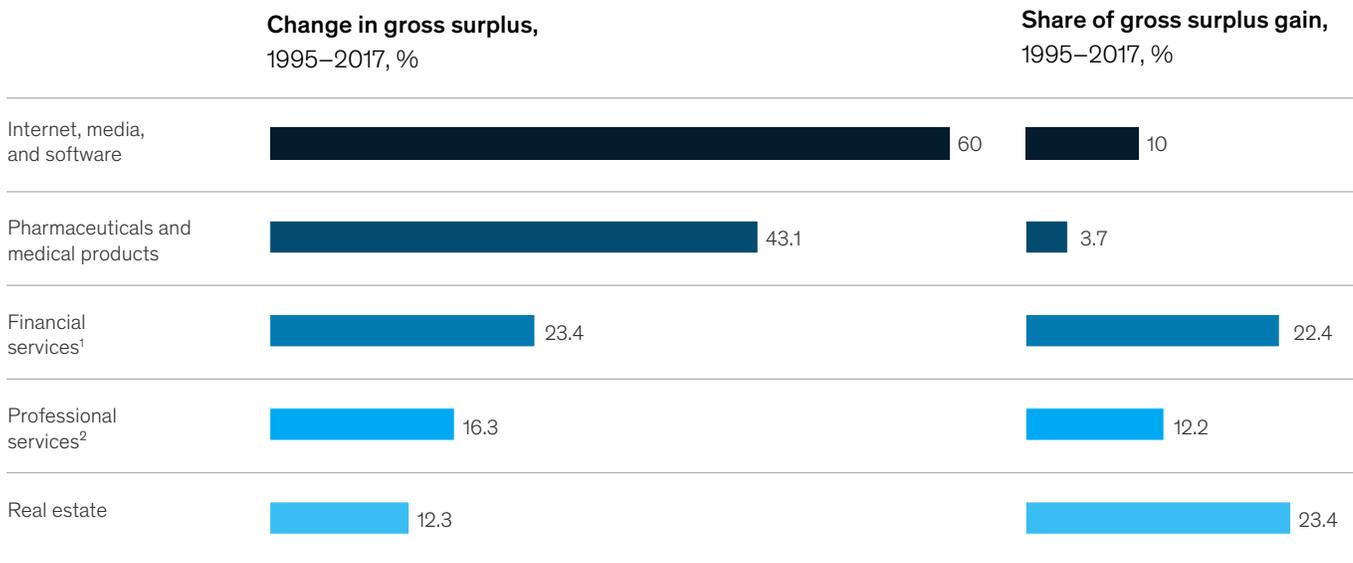
We find that superstar companies, regardless of their conventional industry classification, tend to have one or more of these superstar activities prominently in their portfolio. Some examples include industrial or retail companies that have large financing arms, telecom or utility companies with landholdings or asset-leasing arms, consumer-goods companies with huge outlays in R&D, and

advanced manufacturing companies that offer equipment leasing or after-market maintenance services. It thus matters where companies play, not just in their core industries or geographies but in what activities they control and execute in the commercial value chains and ecosystems in which they operate.

Prior McKinsey research has found that where a company plays matters for success: sector or geography constitutes half or more of the economic success of a company. Having an economic tailwind can also help maintain superstar status. It may also be easier to attract capital to superstar activities. Participation in these activities often requires large up-front investment in intangible assets, such as intellectual property, talent acquisition, databases, and content development. Some of these assets depreciate very quickly, which means companies

Exhibit 3

Across most G-20 countries, a few sectors account for most of the growth in gross surplus and gross value added over the past 20 years.



Note: Sector analysis is based on establishment-level data as reported in national accounts. Sectors are agglomerations of similar economic activities at establishments such as factories, retail stores, offices, and laboratories.

¹Such as banking, insurance, and asset management.

²Such as corporate-management, scientific-research, design, engineering, and technical-advisory activities.

Source: S&P Capital IQ; Corporate Performance Analytics by McKinsey; McKinsey Global Institute analysis

need to refresh these investments constantly as well. One example is the increasing use of data analytics and machine-learning algorithms, which benefit from continually refreshed data sets.

However, while sector or geography matters, it can be overcome. Many superstar companies maintain their status even in the face of economic headwinds that contribute to a slowdown or reversal of growth in their primary industry. In some of these cases, capital-expenditure-heavy superstar companies have diversified into aftermarket services or focused on economies of scale. In other cases, manufacturing companies in slower-growing industries have used their intangible assets (such as brand) to carve out resilient niches within the industry or find new growth markets, while others have focused on productivity improvements. In a few cases, companies have retained superstar status by passing on headwind-related pressures to their suppliers, thus ensuring near-term profitability but potentially creating longer-term fragility in their supply chains.

4. The crown is contestable: Superstar companies are becoming more diverse, and the odds of becoming one—or remaining one—are unchanged

Superstars come from all sectors and regions of the global economy and are getting more diverse over time. The largest increases in representation has been among Asian companies and among sectors such as consumer and business services, computers and electronics, and internet and media (Exhibit 4). Yet strong economic growth in Asia alone cannot explain the rise of superstars from this region. To become a superstar, a company must still beat the market. The increasing diversity shows that any company, from any part of the global economy, can become a global superstar company.

However, even though success brings greater reward than in the past, it is no more likely to persist. Superstar status remains highly contestable, and despite the increasing concentration of economic profit, it is easy to fall from the top. In our analysis, we found nearly half of superstars lost their status in

every business cycle. This churn rate has remained broadly unchanged over the past three business cycles, going back more than 30 years. There is also some variation by geography, with superstar companies from emerging markets indicating higher churn rates of around 60 percent compared with 40 percent for superstar companies from developed markets.

The cost of failure may also be greater than in the past: when superstars fall, they tend to fall far. Over the past 20 years, 40 percent of companies that lost their top positions fell to the bottom decile of economic profit. In the most recent business cycle, more than 50 percent of superstars that lost their top positions fell to the bottom decile. This is due to the greater scale among today's companies compared with 20 years ago and its role in amplifying both success and failure.

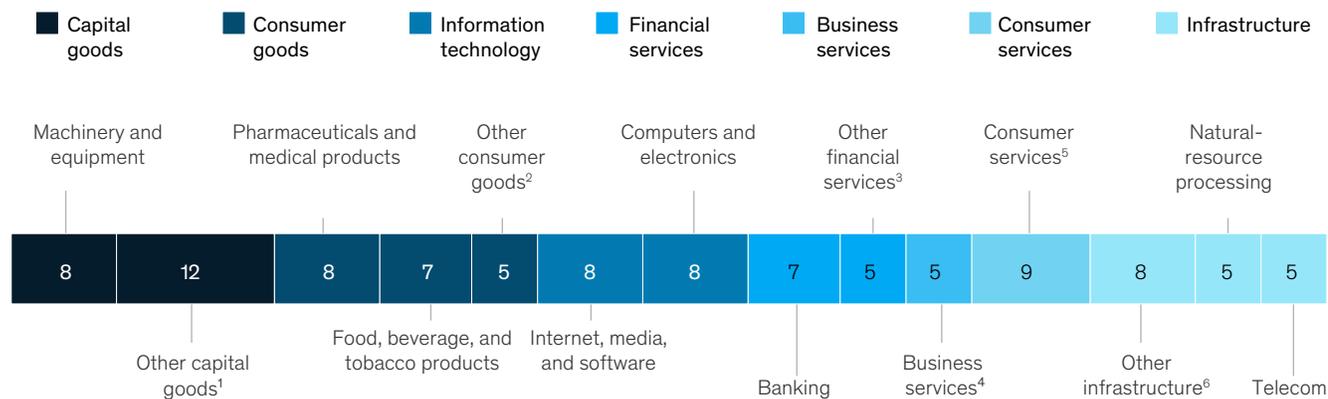
For challengers, this is good news, because it indicates that the prospects for success have not changed, even as the rewards for success have increased. Tomorrow's superstars could come from anywhere along the power curve, even the very bottom decile, and challengers today have the same prospects as in the past of displacing superstar companies. Indeed, some companies have risen from the bottom 10 percent to higher deciles, a few all the way to the top 10 percent, within a single business cycle. At the very top, we found that two-thirds of companies in the top 1 percent of economic profit today were not in the uppermost echelons of economic-profit creation until the most recent business cycle. The mobility and dynamism we find among large companies highlight the potential for all companies to learn from superstars.

5. A superstar ecosystem is emerging: Superstar companies and activities tend to be geographically concentrated, fueling the rise of superstar cities

Superstar activities tend to be concentrated in fewer larger cities compared with traditional activities that have a wider geographic footprint. As a result, profit and wage gains from superstar activities are also concentrated, fueling the rise of superstar cities.

Superstar companies come from all sectors of the global economy and are geographically diverse, with the United States making up the largest share.

Representation of top-decile companies by sector, 2014–16, %



Representation of top-decile companies by country or region, 2014–16, %



¹Such as automobiles and parts, industrial chemicals, and fabricated components. ²Such as apparel, luxury goods, and consumer packaged goods. ³Such as insurance and real estate. ⁴Such as construction, distribution, logistics, and professional services. ⁵Such as healthcare, hospitality, and retail. ⁶Such as transportation and utilities. ⁷Primarily includes companies from Africa, Caribbean, Eastern Europe, and Middle East.

Source: S&P Capital IQ; Corporate Performance Analytics by McKinsey; McKinsey Global Institute analysis

We identify 50 such global superstar cities that are centers of global finance, trade, governance, and technology. They house only 8 percent of the world's population, but they are home to the headquarters of nearly 50 percent of the 5,750 large companies in our analysis. Another 75 smaller, fast-growing "regional superstar" cities show similar features.

We find that an emerging superstar ecosystem of superstar companies, activities, and cities is pulling away from the rest of the global economy. Within this ecosystem, economic profit is concentrated among superstar companies, these companies participate in activities that tend to be geographically localized, and this localization occurs in a few large urban areas that attract talent and capital and where wage and wealth growth become concentrated. There is

also a risk that digitization could be reinforcing this concentration. The emergence of such a superstar ecosystem has implications for those inside and outside the ecosystem and raises questions about how best to foster inclusive growth.

For superstar companies, the rise of the superstar ecosystem is a harbinger of an intensifying competition for talent and resources. As the economic-profit distribution becomes more skewed, superstar companies need access to ever-larger pools of capital, talent, and intellectual property. As demand for these assets increases, there can often be geographic constraints on the supply—for example, the ability of talent to move to these cities—resulting in a bidding war for scarce resources in local markets. Highly skilled workers wanting to

relocate to these cities may often be “priced out” of superstar cities or have to settle for a lower standard of living if they do move. This also has implications for other inhabitants. While superstar cities are hotbeds of opportunity, they are also marked by income inequality, high cost of living, and congestion.

Beyond the search for talent, the growing disparity across companies and regions poses long-term risks to all companies. For those outside the ecosystem—not just companies but also workers and establishments such as production plants—finding growth opportunities becomes more difficult as the superstar ecosystem pulls away by measures of income and value-added growth. The increasing

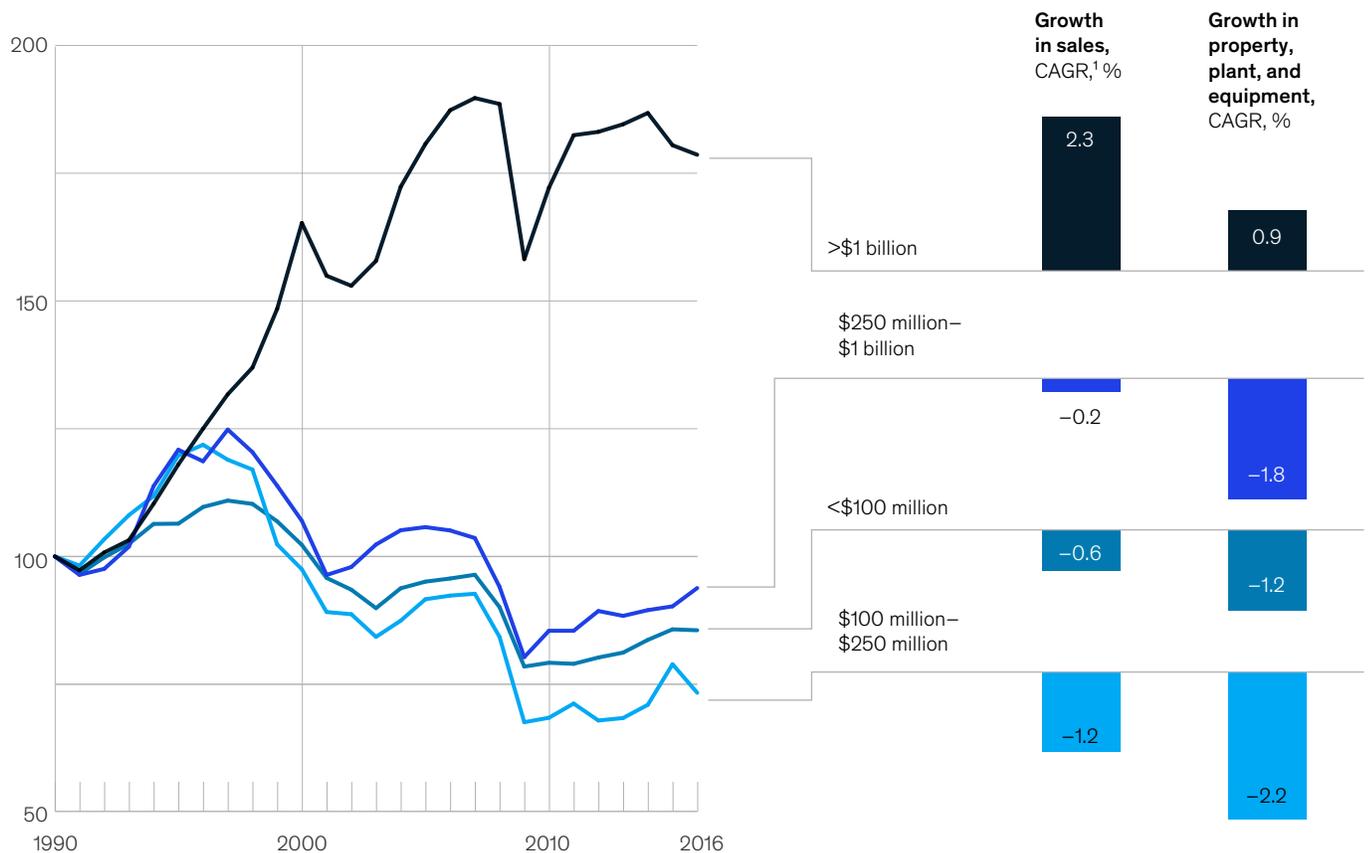
disparity in growth rates could translate to growing investment and productivity gaps among companies. One instance of this is in the US manufacturing sector: for the past 20 years, the largest companies have captured growth, even as the domestic supply chain, spread across manufacturing communities, has seen negative growth, divestment, and flat or declining wage growth (Exhibit 5). Additionally, companies may need to rethink their own corporate ecosystems, including supply chains, distribution networks, and R&D investments, given the growing disparity across companies and regions.

Similarly, the disparity can affect companies in the superstar ecosystem by widening the performance

Exhibit 5

Large US manufacturing companies have seen growth and investment, but the domestic supply chain has been left behind over the past 20 years.

Normalized manufacturing cumulative sales by asset size, 1990–2016, index (100 = FY 1990)



¹Compound annual growth rate.

Source: US Bureau of Economic Analysis; US Census Bureau; McKinsey Global Institute analysis

gaps between their activities within and outside the ecosystem. MGI research has found productivity gaps of up to 40 percent between high-performing and low-performing plants at the same company. Superstar companies' long-term resilience may be at risk if their supply chains and other partners are outside the ecosystem and unable to keep pace with the income, investment, and technology growth inside the superstar ecosystem. There is a growing realization among some OEMs, as they look to increase their US sourcing in response to changes in US trade and tax policy, that domestic suppliers need significant investment and capability upgrades. Over the long term, the growing disparity may have a negative impact on overall economic growth—those left out of superstar ecosystems do not benefit from growing incomes, a situation that might dampen aggregate demand and create a cycle of economic stagnation. In that case, finding new ways to promote inclusive growth would become even more important.

The superstar effect is real, and in this new competitive environment, strategy matters more than ever. Executing well is also crucial in a global economy where zombie companies compete without necessarily having to earn the same returns as everyone else. Intangible investments have become critical to a company's strategy and growth

trajectory, and inorganic growth also plays a role. Additionally, productivity matters—but not by itself. And while sector and geography also count, they can be overcome. Finally, in the face of growing economic distance between companies, workers, and cities within the superstar ecosystem and those outside it, companies must now give careful thought to the resilience of their physical footprints and supply chains. This raises wider questions for CEOs about their role in fostering inclusive growth in the communities in which their companies operate.

There is still a lot more about superstar companies to uncover to help companies navigate changing global markets. For instance, understanding the different types of superstar companies that exist today could reveal critical insights: Why are a minority of them able to get higher returns? Why are some able to retain their superstar status, but most cannot? And why do some companies stick around for decades, while others seemingly come out of nowhere? All this requires understanding the effect of superstar companies on markets and the overall economy. Are markets really getting more concentrated? Is productivity strong within the superstar ecosystem? How should companies ensure they and their partners—workers, investors, goods suppliers, and service providers—remain resilient, even as the distance between the top and bottom grows? MGI will continue to investigate these and other issues in the months ahead.

Sree Ramaswamy is a partner of the McKinsey Global Institute, where **James Manyika** is chairman and director and **Jacques Bughin** and **Jonathan Woetzel** are directors. **Michael Birshan** is a senior partner in McKinsey's London office.

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