# The Rise and Fall of the Big, Bureaucratic Corporation

By Joel Kotkin

In an old industrial building in lower Manhattan, Jon Kamen and his workers are creating a future urban economy that relies on the entrepreneurial ethos of the past. The walls and doors in this spartan 1930s factory are black steel and tin, and large windows open on a sweeping view of mid-century Manhattan skyscrapers. But the workers of @Radical Media are not stitching garments, or typing on carbon paper. They are creating the products increasingly valued in our Information Age. The advertising firm is crammed with television monitors, computers, and the latest film-editing and graphics equipment.

More important than the space or equipment, says Kamen, is the spirit of individualism animating his company. Each member of the workforce of highly skilled artists—75 of them on staff with another 100 on contract or free-lancing—has considerable autonomy.

Kamen founded his firm in 1994 and won the coveted Palme d'Or for best advertising in 1998. Today he is able to attract talent that once would have gone to the elite big firms. The problem with large, centralized businesses, Kamen suggests, is that "the talent walks in and the firm is walled off like a bunch of fiefdoms. There's no community there." Much of the higher-order work in advertising, and in many other industries, is now conducted by small, flexible organizations like Kamen's.

The growth of firms like @Radical Media at the end of the millennium refutes notions that dominated economic thinking at mid-century. At that time all the virtues that make a company like Kamen's work—artisanship, individualism, collaboration with free-lancers—would have seemed positively archaic. The world was supposed to be dominated by large, centralized corporations. Virtually all the mainstream thinkers of that epoch—David Lilienthal, A.A. Berle, Daniel Bell, Joseph Schumpeter—as well as the entire Marxist academic contingent believed that as the economy grew more sophisticated, Ameri-

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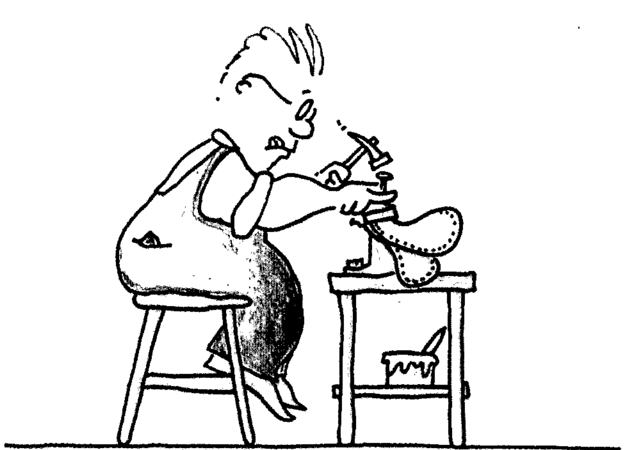

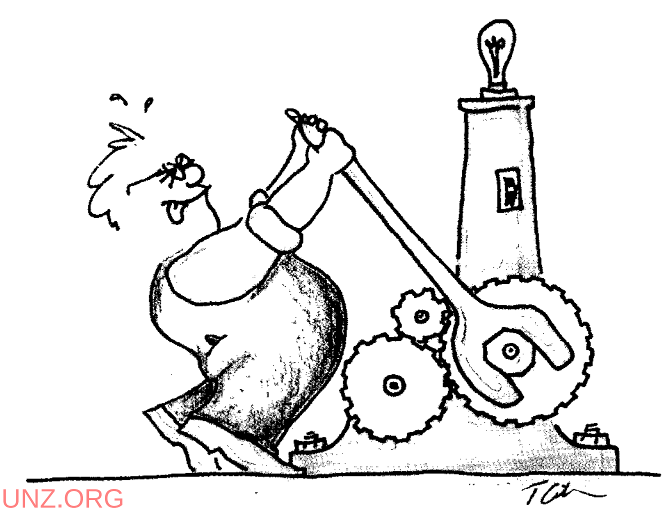

Illustrations by Tom Gibson

> THE *FORTUNE* 500, WHICH ACCOUNTED FOR ONE OUT OF FIVE WORKERS IN 1970, NOW EMPLOYS FEWER THAN ONE IN TEN.

can businesses would amass into increasingly huge, unified firms.

Perhaps the most influential writer on this subject was John Kenneth Galbraith. A Harvard professor, Kennedy confidant, and author of *The Affluent Society* and *The Anatomy of Power*, Galbraith is perhaps this century's most popular liberal economist. From the beginning he argued that the growing importance of science, engineering, and other highly specialized skills gave large firms an unbeatable advantage over smaller competitors. "Providence has made the industry of a few large firms an almost perfect instrument for inducing technical change," he preached. The independent entrepreneur was destined to become "a diminishing figure in the new industrial system."

Galbraith's worldview was accepted by generations of influential professors, journalists, and lawmakers—including current liberal mandarins like Robert Reich, James Fallows, and Ira Magaziner. Yet even as Galbraith was finishing his book *The New Industrial State* in the mid-1960s, new forces were coalescing to bring back the entrepreneur. While large corporations were combining and re-combining like cancer cells (mergers and acquisitions accounted for roughly one-third of all expenditures by industrial companies between 1960 and 1968), the number of new incorporations began to soar. By 1970 the rate of new business start-ups had more than tripled the rate of just two decades earlier. Decentralization was well underway.

Much of this shift took place in the sunbelt region, from the Carolinas to California, far from the Northeastern centers of media and corporate giantism. Out in these provinces new empires were quietly built on real estate, oil, entertainment, and even steel. The new faces included firms like Litton Industries and Teledyne in Southern California, the Nucor Corporation of Charlotte, North Carolina (makers of the first U.S. minimill for steel production), and Federal Express in Memphis, Tennessee. Many of the greatest American companies were soon shaken, relegated to second-rank status, or even absorbed or liquidated. The new stars were not the powerhouses of the '70s like ITT, Sears, and General Motors. They were firms that had been barely recognized or nonexistent three decades earlier: Microsoft, Wal-Mart, and WorldCom.

The new breed of companies was smaller. In the early 1990s the number of workers in firms with fewer than 20 employees grew 9 percent, while the figure for workers in firms with more than 2,000 employees *dropped* by 2 percent. This pattern held across virtually all sectors except finance. The *Fortune* 500, which accounted for one out of every five U.S. workers in 1970, now employs fewer than one in ten.

As a new century begins, America's economic cutting edge is again entrepreneurial, forged in new companies like Dell Computers, Dreamworks, or Amazon.com. But these are not the final heroes of the story. They are already being challenged by new waves of small firms. This extraordinarily fluid, competitive, and utterly decentralized pattern will shape our economic reality in the century to come.

What forces created the late-century entrepreneurial revolution? There are four major reasons for the shift away from big, centralized businesses: Shifting tastes among consumers, new attitudes toward work, globalization and immigration, and, perhaps most important, the technology revolution.

CHANGING CONSUMER TASTES—As mass wealth began to accumulate in the post-war years, an affluent, educated middle class grew much faster than the national population as a whole, creating a more knowledgeable and discerning public. This wealth made possible the experimental counter-culture of the 1960s and '70s, which was fundamentally individualistic and non-conformist. The change in culture helped push consumer demand away from basic manufactures and toward more distinct products and services.

In this new economy companies had to find ways to appeal to ever more sophisticated and fragmented consumer tastes. Product positioning, quality, and image became much more important. Americans now look for products that are somehow stimulating. Specialized products of artisans, from furniture to apparel to food, have gained sharply, even among everyday consumers, which explains why the number of small, specialized manufacturers grew by 28 percent from 1967-95.

Julian Tomchin, senior vice president for special merchandising at Macy's-West, says he now spends much of his time with small specialty companies in Los Angeles, New York,

and San Francisco, rather than concentrating on large producers. "There's a new breed of company out there that is combining craft-based industry in a factory setting," he says. "It used to be part of hippiedom; now it's an industry."

The shift to artisanal "craftory" production has begun decentralizing the food industry, once a bastion of standardization and mass production. American consumers in the last few decades have increasingly demanded diversity and sophistication in their diets, creating opportunities for specialized processors. Even the bread industry has seen significant change. Since the 1970s, the market for mass-produced white pan bread has been dropping, while the market for specialty varieties has soared. "People here will now pay for a better bread, just like they'll pay for a finer bottle of wine," says Noel Comess, president of the 140-person Tom Cat Bakery, standing in front of an oven at his sprawling Long Island City facility.

"There's something nostalgic about homemade bread—a sense of warmth and wholesomeness," explains Manfred Frankl, founder of La Brea Bakery, the nation's largest craft bread bakery, at his 67,000-square-foot facility in L.A.'s San Fernando Valley, "that's valued amidst a current lifestyle full of faxes and answering machines."

New Attitudes Toward Work—Just as a search for improved quality of life now drives consumer culture, many employees are demanding a higher quality of work. Dakota Jackson, a prominent New York furniture maker, started out in the 1970s restoring old pianos, then began restoring furniture. By the 1990s Jackson was running a small furniture factory in Long Island City. For him and his workforce, about half of whom are immigrants, non-economic factors are an important part of their job satisfaction. "I am not a businessman by motivation. For me, it's all about coming up with designs and making things that interest me."

This trend is particularly pronounced in fields that depend heavily on the creative skills of talented individuals. These workers carve out careers that allow them to be in places they like. The desire to control one's environment and fate—a deeply entrenched American tradition—is now a central part

## WHY SMALL COMPANIES OFTEN WORK BEST

*More successful Internet businesses have been spawned by Caltech graduate Bill Gross than by any other person on the planet. Through idealab!, his Southern California-based incubator, he has launched dozens of enterprises that are now worth many hundreds of millions of dollars, including e-commerce pioneers like CitySearch and eToys. In this essay, extracted from the November/December 1998 issue of the* Harvard Business Review, *he explains why radically decentralized ownership and decision-making makes companies more potent.*

My greatest revelation as a businessman was crystallized in two words: Let go.

It was 1994, and a team of developers at Knowledge Adventure (KA), the educational-software company I founded, had developed a powerful technology for three-dimensional visualization and navigation—so powerful I started selling the technology to other software firms as a stand-alone product. But KA's infrastructure wasn't well-suited to the task; so KA's board suggested we "spin out" the product and its ten-person development team. The venture would break from the main company but, unlike a "spin-off," never entirely leave its orbit.

I was loath to release my clutch on such a hot property. I was even more put off by the board's insistence we keep only 19.9 percent of the new company's equity.

The board, however, would not relent. What ensued astonished everyone. Within a year, Worlds Inc., the new company, grew almost as large as KA itself. Its employees rose to new heights of creativity and passion in closing deals, improving the product, and recruiting star workers. My earlier reluctance suddenly seemed laughable: Instead of owning 80 percent of a $5 million business, KA now owned 19.9 percent of a $77 million business.

The act of spinning out Worlds sharpened its strategic focus, enabling it to communicate a consistent message to its customers. Spinning out Worlds also enabled it to attract outside investors, giving it greater access to cheap capital. But by far the greatest factor was the magnification of human potential. That's because we decentralized ownership, giving employees a near-total stake in Worlds, which unleashed a new level of performance and built economic value.

At any given time, four or five embryonic companies will be in development under idealab!'s roof. Those that seem flightworthy are then hatched into stand-alone enterprises. About 20 companies have left the nest so far. Among them: eToys, an on-line toy retailer; WeddingChannel, which lets people use the Internet to plan their weddings; and ideaMarket, an on-line market for intellectual property that survived only a few months before folding.

We give each spin-out no more than $250,000 in seed funding and take no more than a 49 percent equity. Everyone on the payroll gets some equity. I also insist on a salary cap for the CEO, usually in the neighborhood of $75,000.

As economies of scale grow less important in the new information-based economy, small tribes of employee-owners are more viable economic entities than they used to be. When a company has between 10 and 100 people, it feels like a tribe—that primordial unit of human organization. Belonging to a small team exerts an emotional pull on employees.

Thermo Electron, a Waltham, Massachusetts industrial giant, has achieved stellar success with this model, spinning out more than 20 companies around its core intellectual competency of electrical and chemical engineering.

Corporate CEOs are always pining for ways to "get that small-company soul and small-company speed inside our big-company body." You can't create a small-company feel unless you create a small company.

*—Bill Gross*