# Winner-takes-all phenomenon creates new divides

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The past 10 years have seen the unstoppable growth of the "winner-takes-all" phenomenon in economies, markets and politics.

A glaring example is in businesses built on network effects. A network gets its value from its size. Grow the network, it becomes more valuable; attract new members, it becomes yet more valuable, and so on. Facebook's Mark Zuckerberg and Amazon's Jeff Bezos knew this.

The dominance of Microsoft software on computing operating systems came from the same place. Reaching critical mass is everything. Future winners must invest heavily at the start hoping that big profits will come later. The growth of internet-based technology conveniently coincided with a period of easy access to very cheap financing. This meant visionaries could invest their way for years into a now dominant position.

The strategic importance of this is far-reaching. In the retailing space the vision of a shopper pushing a cart through a supermarket will soon vanish, thanks to the rise of e-commerce. Myriad traditional retailers will become zombie companies at the feet of a handful of e-commerce giants. As the majority of consumer products have turned global, and so has access to digital e-commerce platforms, winners will capture the lion's share of consumer spending around the world. If food producers traditionally found negotiating with large retailers tough, they will soon find it impossible with oligopolistic e-commerce counterparties. The latter may soon literally "own" all consumer-related flows, from orders to payments, thereby short-circuiting all traditional intermediaries, including advertising companies and banks.

The advantage of market or customer dominance is cumulative. Research and development in artificial intelligence is expensive, but holds huge potential for the future. Their vast revenues mean that today's internet giants are in pole position to be future winners in this space.

The paradox is that 20 years ago internet-based businesses were expected to usher in an era of limitless opportunities and low barriers to entry for a multitude of burgeoning start-ups. The reality is that free markets in today's winner-takes-all mode have delivered us oligopolies.

Conglomerates argue that consumers/users are the first beneficiaries of their model, and that their platforms are open to all suppliers, including small ones, for them to compete on an even field. But governments and regulators are now starting to grasp the dynamics at play. Social media is even being seen by some as a threat to democracy. The cheap money ingredient to the winner-takes-all model is here to stay. While central banks' cheap money stance will gradually normalise, structural deflationary forces are still powerful. The financial crisis has left many very reluctant to ramp up debt again. So with the help of growing populations, a savings glut has built up, pushing down the cost of money.

Investors are encouraged to flock to higher-risk assets in their desperate quest for yield. Then in another winner-takes-all dynamic, the prices of stocks and corporate bonds rise as more demand inflates prices, which attracts more investors to join the party. Passive and "momentum" investors have benefited and, in turn, fuelled the bull market of the century. But most active investors have remained true to their disciplined analysis of companies and industries, and have grossly missed out and under-performed blind money. Active fund management has lost, while passive investors, who buy rising assets, have enjoyed a golden decade.

The contrast between strong asset (bonds and shares) price inflation and anaemic economic growth has widened the gulf between winners and losers in the real world. Inequality of wealth creation between holders of financial assets and wage earners has kept rising, fuelling discontent and frustrations in the population of left-outs. These are the roots of populist creeds in Western economies.

Further East, political leaders watch Western democratic governments grappling with these pressures. Leaders in China and Russia meanwhile carefully tighten the grip on their already very large and concentrated powers. The winner-takes-all phenomenon has tended to be economic in the West and more political in the East, in the form of strong men supported by autocratic systems. However, business giants such as Alibaba or Tencent have now emerged in the East.

In contrast to their Western counterparts, they are not exposed to the risk of colliding with the efforts of governments to regain control: their interests have from the outset been strictly aligned with those of their governments. This commonality of interest between politics and economics could give them the ultimate competitive advantage.

Investors need to realise that the so-called "emerging markets" have leapfrogged European countries when it comes to investing in technologies of the future. The size of Tencent, a Chinese internet player still unknown to the European consumer, matches that of Facebook. In a world where economic growth will labour for years under a hangover of debt from the financial crisis, profit growth will keep concentrating in the hands of a few winning companies. Sad to say, we must recognise these will mostly be American and Chinese.

*'In the retail space, the vision of a shopper pushing a cart will soon vanish thanks to the rise of e-commerce'*

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