WE'D CALL IT THE OPPOSITE OF A PERFECT STORM: a set of external circumstances that together create an exceptionally favorable economic environment. The largest North American and European multinational corporations have been sailing through one for the past 30 years. In that time they have enjoyed their longest and strongest run of

rising profitability in the postwar era, thanks to an environment that has supported robust revenue growth and cost efficiencies.

From 1980 to 2013 global corporate after-tax operating profits grew 30% faster than global GDP; today they stand at about 9.8% of global GDP, up from 7.6% in 1980. Corporate net income grew more than 50% faster than global GDP, from 4.4% of global GDP in 1980 to 7.6% in 2013. North American and Western European companies now capture more than half of global profits. North American firms increased their post-tax margins by 65% over the past three decades; today their after-tax profits, measured as a share of national income, are at their highest level since 1929. (See the exhibit "The Profit Boom" for a summary of key figures.)

It has been a remarkable era, but it's coming to a close. Although corporate revenues and profits will continue to rise, the overall economic environment is becoming less favorable, and new rivals are putting the Western incumbents on notice. Many of the new players are from emerging markets, but some are surprise intruders from next door, either tech companies or smaller technology-enabled enterprises. Those competitors often play by different rules and bring an agility and an aggressiveness that many larger Western companies struggle to match. In this new world, corporate performance will no longer outpace the global economy. We forecast that in the decade ahead, although operating profits will continue to grow in absolute terms, they will fall to 7.9% of global GDP—around what they were when the boom began. In other words, the stratospheric gains of the past 30 years could all but vanish in just 10.

In the following pages we'll explain what is changing in the global economic and competitive environment and consider how today's leaders can be tomorrow's as well. To set the context for that, let's look at the main drivers of success so far.

WHY PROFITS ROSE

The start of the profit boom coincided with the spread of deregulation and privatization around the world. That trend first took hold in Western countries and moved on from there; in the early 1990s India, China, and Brazil all undertook varying degrees of privatization. The movement introduced private-sector competition to vast swaths of global business, from automobiles, basic materials, and electronics to infrastructure industries such as telecom, transportation, and utilities—all of which had a strong legacy of state ownership. In 1980 those infrastructure industries, most of which were tightly regulated, generated more than $1 trillion in revenue. By 2013 they were generating more than $10 trillion, two-thirds of which was open to private-sector competition. (All revenue and profit figures for 1980, 2013, and 2025 are in 2013 U.S. dollars.)

During the same period a huge wave of urbanization and industrialization in emerging markets contributed to the growth of the global consumer class (which includes people with disposable income exceeding $10 per day). That segment has grown from around one billion in 1980 to around 3 billion today, creating new markets for the offerings of Western multinationals and spurring global investment in infrastructure, factories, and housing. In China alone, capital investment grew from 29% of GDP in 1980 to 47%, or $4.3 trillion, in 2013, and countries across Asia have undertaken ambitious capital projects, from oil refineries and power plants to steel mills and cement plants. Globally, fixed capital formation has nearly tripled in real terms since 1990, with the private sector accounting for a vast majority of the increase. For Western multinationals, those investments have more than made up for declining capital investment at home: Publicly traded companies from advanced economies have poured almost $4.5 trillion into the build-out, much of it across the emerging world, just since 2000.

The multinational companies that have been best placed to exploit those factors have come mostly from North America and Europe. Although Japanese and Korean companies accounted for nearly 10% of global profits in 2013, their margins haven't risen as much as those of their Western rivals, which dominate the more profitable sectors: idea-intensive industries such as pharmaceuticals, media, finance, and information technology, which account for about 22% of revenues but 41% of profits.

The strong position of multinationals from developed countries rests on three advantages:

Scale. In some industries—even idea-intensive ones—the bigger a company, the higher its profit. Just 10% of public companies accounted for 80% of the profits generated by all such firms in 2013. In North America, public companies with annual sales of $10 billion or more captured 70% of the profits in 2013, up from 55% in 1990 (after adjusting for inflation). Here, developed countries had a head start because they were home to the world's biggest businesses. They still are. Some of these companies are as large as nations: Walmart's profits are comparable to Botswana's GDP, and its workforce is bigger than the population of Latvia or Slovenia. Exxon Mobil's profits are the same as Bolivia's GDP. At nearly $750 billion in early 2015, Apple's market capitalization was almost as large as the whole of Russia's stock market.

A global presence. Successful Western companies have used their size to expand aggressively abroad, thus capturing the increase in global revenue driven by economic development in China,

Idea in Brief

THE CHALLENGE
In the decade ahead global profits will fall back from just under 10% of global GDP to about 7.9%—about the level they were in 1980. Hardest hit will be North American and Western European companies, which currently account for more than half of global profits.

THE REASON
The economic environment is becoming less favorable, and new rivals from emerging economies and the tech sector are putting Western incumbents on notice. The newcomers play by different rules and bring an agility and an aggressiveness that many Western companies struggle to match.

THE RESPONSE
To maintain their lead in the coming years, big North American and European companies must:

- Be paranoid
- Seek out patient capital
- Overcome inertia
- Build new intellectual assets
- Go to war for talent

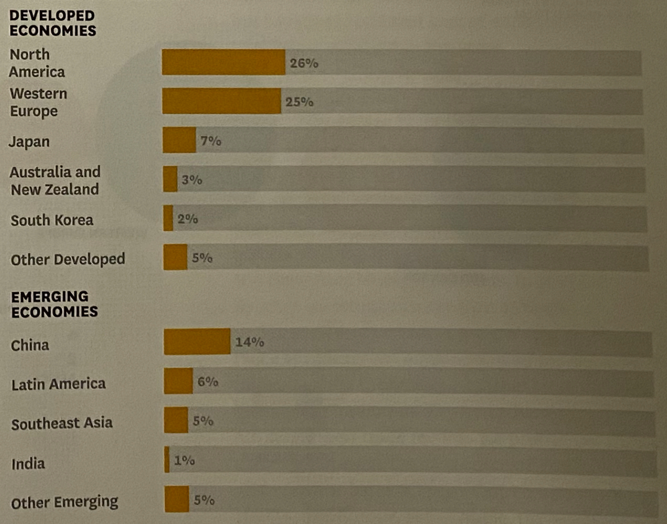
THE PROFIT BOOM

Since 1980 corporate profits have grown at an unprecedented rate, increasing their share of global GDP by 30%.

GLOBAL CORPORATE AFTER-TAX OPERATING PROFITS (2013 US$ TRILLIONS)

Multinationals from North America and Western Europe have been the biggest beneficiaries.

% OF GLOBAL PROFITS, 2013



SOURCE MCKINSEY GLOBAL INSTITUTE; DATA IS FROM 16,850 PUBLICLY LISTED FIRMS AND 11,400 PRIVATELY HELD FIRMS, EACH WITH MORE THAN $200 MILLION IN ANNUAL REVENUE.