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Prepare for a New Supercycle of Innovation

A financial crisis opens the economy to new forms of growth—which are about to start pouring down.

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Adverse events usually flow from a world financial crisis: unemployment, political turmoil and geopolitical reordering. We've seen these since the crash of 2008.

But there are benefits as well. Crashes are usually followed by massive economic reorganization, spectacular outbursts of innovation, the creation of new industries, increased productivity, and decades of high growth. We have not seen these benefits since the crash of 2008. Thankfully, this is about to change.

The 1930s, remembered mostly for the Great Depression, were also a time of great technological progress—jet engines, television, synthetic materials, even early computers. Other periods of economic stress, such as the 1970s, led to a similar explosion in innovation.

A decade past the worst crisis in recent memory, we've seen few of these benefits. The good news is that we are about to. The American economy is poised to embark on an innovation boom of historic proportions that will undermine incumbent players, transform everyday life, and make some alert investors very rich.

Why now? Let's start with how crashes usually spur new technologies and processes. Crashes play an important role in the economy by clearing out weak companies and outdated ideas. Think of a forest fire. By forcing a reallocation of financial and human capital, crashes compel firms to innovate to survive and wipe out those that fail to adapt. That transforms the economic landscape by opening room for new innovative companies to grow. Accepted wisdom and practices are challenged. Once-unassailable companies are vulnerable. The winners going into a crash are rarely the winners a decade later.

We haven't seen much economic transformation since the Great Recession because unprecedented government interference, policy, support and subsidy froze the economy and preserved the status quo.

First, central bankers slashed interest rates almost to zero. This recapitalized the financial system and sent stocks soaring. But it also propped up teetering inefficient giants in business and banking, removed pressure on governments to reform, and stifled upstarts.

Second, governments issued a flurry of regulations, further bolstering legacy players and shielding them from competition. Upstarts lack the scale to bear this regulatory burden. Incumbents flourish.

Along with lax antitrust enforcement, low rates made it attractive for large companies to buy competitors rather than invest productively, resulting in record levels of economic concentration and excess profits. In short, large enterprises and banks have felt no pain. As a result, they felt no pressure to change, and there was no room for innovative young companies to prosper.

Things are about to change. Consider information technology. Today's enterprise IT systems are built on platforms dating from the 1970s to the 1990s. These systems are now horrendously expensive to operate, prone to catastrophic crashes, and unable to ensure data security. The cloud only made this worse by increasing complexity.

Corporate CEOs complain that they are unable to get the data they need. These rickety systems cannot easily accommodate data mining and artificial intelligence. Evidence of their deficiencies is seen daily. The New York Stock Exchange stops trading for hours. Yahoo acknowledges the compromise of one billion user accounts. Airline reservation systems go down repeatedly. The pain level for users is becoming intolerable.

Each decade for the past 60 years, we have seen a thousand-fold increase in world-wide processing power, bandwidth and storage. At the same time, costs have fallen by a factor of 10,000. Advances in these platforms, in themselves, do not produce innovation. But they facilitate the development and deployment of entirely new applications that take advantage of these advances. Amazing new applications are almost never predictable. They come from human creativity. That is one reason they almost never come from incumbent companies. But once barriers to innovation are lowered, new applications follow.

The combination of advances in platforms and intolerable pain is about to result in an explosion in entirely new applications that are inexpensive to operate, are far less likely to fail, are far more secure, and easily accommodate unimagined advances in ease of use and effective output. This scenario will be seen in sector after sector.

While everyone is focused on Uber, Snapchat and consumer applications, a more colossal supercycle of innovation in enterprises is beginning to occur. Throughout the economy, companies desperately need to overhaul legacy systems and business models frozen in place for a decade. Incumbents, watch out. The coming innovation supercycle will upend the status quo whether you like it or not. Better late than never.

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