Ditch zombie companies and embrace entrepreneurs

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We've been warned that corporate zombies are stalking Europe. One remedy offered is to recapitalise them with taxpayer support and regulatory forbearance. No doubt this would save some jobs in the short run, but the history of public sector rescues and government equity stakes is not encouraging.

Often it simply postpones the inevitable, while consuming government resources and skewing the market against more resilient and newer competitors. Better to encourage private capital and labour to move to new and growing sectors through the unfortunately named process of "creative destruction" described by the political economist Joseph Schumpeter.

The UK experience with British Leyland is a stark example of an expensive taxpayer rescue that led to the drawn-out death of a former champion of national innovation. Successive governments spent more than £200bn in today's money in equity and loans to British Leyland and its successor companies from 1975 to its final bankruptcy in 2005.

Despite its collapse, the residual skill base in the Midlands and Wales was able to attract investment by foreign companies with different business models, new production technologies and managerial expertise. Soon Nissan, Ford, BMW and Tata Motors were all producing cars in the UK. Local supply chains developed as old Leyland employees found new ways to apply their knowledge. The story of the UK auto industry is one of creative destruction that Schumpeter would recognise.

The economic policy debate over responses to the depression of the 1930s between Schumpeter and John Maynard Keynes has similarities to today's choices about government support post-Covid-19. Keynes believed economic shocks should be countered by government spending to recover full employment and general equilibrium; Schumpeter argued against the latter notion and believed market economies were constantly adapting to new technologies and organisational models, supply discontinuities and other disruptions. Such adaptation and innovation were the primary engines of growth.

The Covid-19 shock has been a spur to innovation. Many companies have found new ways to co-ordinate working online and to reach customers with strategies for home delivery of goods and online delivery of entertainment, educational and other services. The dramatic effect of the lockdown supercharged the use of digital technologies.

> We must acknowledge that coronavirus has permanently changed our economy

As a result, the prospects for a V-shaped recovery have brightened. The National Institute for Economic and Social Research forecasts a 15 per cent rise in gross domestic product in the third quarter after the fall of 20 per cent in the second. Monthly data from the Office for National Statistics showed that half of the peak-to-trough fall in gross domestic product in March and April had been recovered by July.

The rapid adjustment of business models, working practices and consumer choices is spreading across many sectors. Plans for pruning costs and low-return activities that sat on the shelf are now being dusted off. In the worst-affected sectors such as air travel, severe cost-cutting and at least partial capacity destruction is under way. Travel-minded consumers have pivoted to domestic holidays instead.

There is also anecdotal evidence that the disruption to business travel has brought both productivity and lifestyle gains to the client-facing professional services sector. Deloitte says it transferred 20,000 of its UK employees to remote working in less than a week, saving that many commutes.

Early action by the Bank of England to lower interest rates and keep financial markets liquid has facilitated private-sector adjustments to the Covid-19 shock. Companies including Ryanair and Wetherspoons have been shoring up their balance sheets with equity issues and longer-dated bonds. Private investors, not taxpayers, will bear the cost if those efforts fail.

There will always be calls for government support by companies in trouble, especially the zombies. But many abhor the strings attached to partial state ownership. A Schumpeterian policy would avoid the distortions of politically chosen winners that tilt the playing field against small competitors and disruptive technologies. Instead, it would prioritise taxpayer support for skill development and retraining, as well as plugging the gaps in funding for start-ups.

It's time to update and rebrand Schumpeter's strapline: out with creative destruction, in with accelerated adaptation.

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