

## HOW PEOPLE GET RICH NOW

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**April 2021**

Every year since 1982, *Forbes* magazine has published a list of the richest Americans. If we compare the 100 richest people in 1982 to the 100 richest in 2020, we notice some big differences.

In 1982 the most common source of wealth was inheritance. Of the 100 richest people, 60 inherited from an ancestor. There were 10 du Pont heirs alone. By 2020 the number of heirs had been cut in half, accounting for only 27 of the biggest 100 fortunes.

Why would the percentage of heirs decrease? Not because inheritance taxes increased. In fact, they decreased significantly during this period. The reason the percentage of heirs has decreased is not that fewer people are inheriting great fortunes, but that more people are making them.

How are people making these new fortunes? Roughly 3/4 by starting companies and 1/4 by investing. Of the 73 new fortunes in 2020, 56 derive from founders' or early employees' equity (52 founders, 2 early employees, and 2 wives of founders), and 17 from managing investment funds.

There were no fund managers among the 100 richest Americans in 1982. Hedge funds and private equity firms existed in 1982, but none of their founders were rich enough yet to make it into the top 100. Two things changed: fund managers discovered new ways to generate high returns, and more investors were willing to trust them with their money. [1]

But the main source of new fortunes now is starting companies, and when you look at the data, you see big changes there too. People get richer from starting companies now than they did in 1982, because the companies do different things.

In 1982, there were two dominant sources of new wealth: oil and real estate. Of the 40 new fortunes in 1982, at least 24 were due primarily to oil or real estate. Now only a small number are: of the 73 new fortunes in 2020, 4 were due to real estate and only 2 to oil.

By 2020 the biggest source of new wealth was what are sometimes called "tech" companies. Of the 73 new fortunes, about 30 derive from such companies. These are particularly common among the richest of the rich: 8 of the top 10 fortunes in 2020 were new fortunes of this type.

Arguably it's slightly misleading to treat tech as a category. Isn't Amazon really a retailer, and Tesla a car maker? Yes and no. Maybe in 50 years, when what we call tech is taken for granted, it won't seem right to put these two businesses in the same category. But at the moment at

least, there is definitely something they share in common that distinguishes them. What retailer starts AWS? What car maker is run by someone who also has a rocket company?

The tech companies behind the top 100 fortunes also form a well-differentiated group in the sense that they're all companies that venture capitalists would readily invest in, and the others mostly not. And there's a reason why: these are mostly companies that win by having better technology, rather than just a CEO who's really driven and good at making deals.

To that extent, the rise of the tech companies represents a qualitative change. The oil and real estate magnates of the 1982 Forbes 400 didn't win by making better technology. They won by being really driven and good at making deals. [2] And indeed, that way of getting rich is so old that it predates the Industrial Revolution. The courtiers who got rich in the (nominal) service of European royal houses in the 16th and 17th centuries were also, as a rule, really driven and good at making deals.

People who don't look any deeper than the Gini coefficient look back on the world of 1982 as the good old days, because those who got rich then didn't get as rich. But if you dig into *how* they got rich, the old days don't look so good. In 1982, 84% of the richest 100 people got rich by inheritance, extracting natural resources, or doing real estate deals. Is that really better than a world in which the richest people get rich by starting tech companies?

Why are people starting so many more new companies than they used to, and why are they getting so rich from it? The answer to the first question, curiously enough, is that it's misphrased. We shouldn't be asking why people are starting companies, but why they're starting companies again. [3]

In 1892, the *New York Herald Tribune* compiled a list of all the millionaires in America. They found 4047 of them. How many had inherited their wealth then? Only about 20% — less than the proportion of heirs today. And when you investigate the sources of the new fortunes, 1892 looks even more like today. Hugh Rockoff found that "many of the richest ... gained their initial edge from the new technology of mass production." [4]

So it's not 2020 that's the anomaly here, but 1982. The real question is why so few people had gotten rich from starting companies in 1982. And the answer is that even as the *Herald Tribune's* list was being compiled, a wave of [consolidation](#) was sweeping through the American economy. In the late 19th and early 20th centuries, financiers like J. P. Morgan combined thousands of smaller companies into a few hundred giant ones with commanding economies of scale. By the end of World War II, as Michael Lind writes, "the major sectors of the economy were either organized as government-backed cartels or dominated by a few oligopolistic corporations." [5]

In 1960, most of the people who start startups today would have gone to work for one of them. You could get rich from starting your own company in 1890 and in 2020, but in 1960 it was not really a viable option. You couldn't break through the oligopolies to get at the markets. So the

prestigious route in 1960 was not to start your own company, but to work your way up the corporate ladder at an existing one. [6]

Making everyone a corporate employee decreased economic inequality (and every other kind of variation), but if your model of normal is the mid 20th century, you have a very misleading model in that respect. J. P. Morgan's economy turned out to be just a phase, and starting in the 1970s, it began to break up.

Why did it break up? Partly senescence. The big companies that seemed models of scale and efficiency in 1930 had by 1970 become slack and bloated. By 1970 the rigid structure of the economy was full of cosy nests that various groups had built to insulate themselves from market forces. During the Carter administration the federal government realized something was amiss and began, in a process they called "deregulation," to roll back the policies that propped up the oligopolies.

But it wasn't just decay from within that broke up J. P. Morgan's economy. There was also pressure from without, in the form of new technology, and particularly microelectronics. The best way to envision what happened is to imagine a pond with a crust of ice on top. Initially the only way from the bottom to the surface is around the edges. But as the ice crust weakens, you start to be able to punch right through the middle.

The edges of the pond were pure tech: companies that actually described themselves as being in the electronics or software business. When you used the word "startup" in 1990, that was what you meant. But now startups are punching right through the middle of the ice crust and displacing incumbents like retailers and TV networks and car companies. [7]

But though the breakup of J. P. Morgan's economy created a new world in the technological sense, it was a reversion to the norm in the social sense. If you only look back as far as the mid 20th century, it seems like people getting rich by starting their own companies is a recent phenomenon. But if you look back further, you realize it's actually the default. So what we should expect in the future is more of the same. Indeed, we should expect both the number and wealth of founders to grow, because every decade it gets easier to start a startup.

Part of the reason it's getting easier to start a startup is social. Society is (re)assimilating the concept. If you start one now, your parents won't freak out the way they would have a generation ago, and knowledge about how to do it is much more widespread. But the main reason it's easier to start a startup now is that it's cheaper. Technology has driven down the cost of both building products and acquiring customers.

The decreasing cost of starting a startup has in turn changed the balance of power between founders and investors. Back when starting a startup meant building a factory, you needed investors' permission to do it at all. But now investors need founders more than founders need investors, and that, combined with the increasing amount of venture capital available, has driven up valuations. [8]

So the decreasing cost of starting a startup increases the number of rich people in two ways: it means that more people start them, and that those who do can raise money on better terms.

But there's also a third factor at work: the companies themselves are more valuable, because newly founded companies grow faster than they used to. Technology hasn't just made it cheaper to build and distribute things, but faster too.

This trend has been running for a long time. IBM, founded in 1896, took 45 years to reach a billion 2020 dollars in revenue. Hewlett-Packard, founded in 1939, took 25 years. Microsoft, founded in 1975, took 13 years. Now the norm for fast-growing companies is 7 or 8 years. [9]

Fast growth has a double effect on the value of founders' stock. The value of a company is a function of its revenue and its growth rate. So if a company grows faster, you not only get to a billion dollars in revenue sooner, but the company is more valuable when it reaches that point than it would be if it were growing slower.

That's why founders sometimes get so rich so young now. The low initial cost of starting a startup means founders can start young, and the fast growth of companies today means that if they succeed they could be surprisingly rich just a few years later.

It's easier now to start and grow a company than it has ever been. That means more people start them, that those who do get better terms from investors, and that the resulting companies become more valuable. Once you understand how these mechanisms work, and that startups were suppressed for most of the 20th century, you don't have to resort to some vague right turn the country took under Reagan to explain why America's Gini coefficient is increasing. Of course the Gini coefficient is increasing. With more people starting more valuable companies, how could it not be?

## Notes

[1] Investment firms grew rapidly after a regulatory change by the Labor Department in 1978 allowed pension funds to invest in them, but the effects of this growth were not yet visible in the top 100 fortunes in 1982.

[2] George Mitchell deserves mention as an exception. Though really driven and good at making deals, he was also the first to figure out how to use fracking to get natural gas out of shale.

[3] When I say people are starting more companies, I mean the type of company meant to [grow](#) very big. There has actually been a decrease in the last couple decades in the overall number of new companies. But the vast majority of companies are small retail and service businesses. So what the statistics about the decreasing number of new businesses mean is that people are starting fewer shoe stores and barber shops.

People sometimes get [confused](#) when they see a graph labelled "startups" that's going down, because there are two senses of the word "startup": (1) the founding of a company, and (2) a particular type of company designed to grow big fast. The statistics mean startup in sense (1), not sense (2).

[4] Rockoff, Hugh. "Great Fortunes of the Gilded Age." NBER Working Paper 14555, 2008.

[5] Lind, Michael. *Land of Promise*. HarperCollins, 2012.

It's also likely that the high tax rates in the mid 20th century deterred people from starting their own companies. Starting one's own company is risky, and when risk isn't rewarded, people opt for [safety](#) instead.

But it wasn't simply cause and effect. The oligopolies and high tax rates of the mid 20th century were all of a piece. Lower taxes are not simply a cause of entrepreneurship, but an effect as well: the people getting rich in the mid 20th century from real estate and oil exploration lobbied for and got huge tax loopholes that made their effective tax rate much lower, and presumably if it had been more common to grow big companies by building new technology, the people doing that would have lobbied for their own loopholes as well.

[6] That's why the people who did get rich in the mid 20th century so often got rich from oil exploration or real estate. Those were the two big areas of the economy that weren't susceptible to consolidation.

[7] The pure tech companies used to be called "high technology" startups. But now that startups can punch through the middle of the ice crust, we don't need a separate name for the edges, and the term "high-tech" has a decidedly [retro](#) sound.

[8] Higher valuations mean you either sell less stock to get a given amount of money, or get more money for a given amount of stock. The typical startup does some of each. Obviously you end up richer if you keep more stock, but you should also end up richer if you raise more money, because (a) it should make the company more successful, and (b) you should be able to last longer before the next round, or not even need one. Notice all those shoulds though. In practice a lot of money slips through them.

It might seem that the huge rounds raised by startups nowadays contradict the claim that it has become cheaper to start one. But there's no contradiction here; the startups that raise the most are the ones doing it by choice, in order to grow faster, not the ones doing it because they need the money to survive. There's nothing like not needing money to make people offer it to you.

You would think, after having been on the side of labor in its fight with capital for almost two centuries, that the far left would be happy that labor has finally prevailed. But none of them seem to be. You can almost hear them saying "No, no, not *that way*."

[9] IBM was created in 1911 by merging three companies, the most important of which was Herman Hollerith's Tabulating Machine Company, founded in 1896. In 1941 its revenues were \$60 million.

Hewlett-Packard's revenues in 1964 were \$125 million.

Microsoft's revenues in 1988 were \$590 million.

**Thanks** to Trevor Blackwell, Jessica Livingston, Robert Morris, Russ Roberts, and Alex Tabarrok for reading drafts of this.

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