1 The Economic Power of Global Cities

Companies—midsize and large multinational companies (MNCs)—need to figure out where to sell their goods and services. In their home market, they must decide geographically where to plant their headquarters, regional offices, production, distribution, and sales management. Companies have to choose the right cities, because city advantage is more decisive for business success than national advantage.

As companies move abroad, they decide which nation or nations to produce and sell in and choose specific locations where they intend to carry out their administration, production, distribution, and sales work. If a company chooses to sell in China, where does it locate its headquarters for China? Will it be Beijing, Shanghai, Hong Kong, or any of a dozen other cities? And in each Chinese city where it plans to operate, the company needs to develop specific presences and locations. Choosing a pattern of locations around the world is a gigantic task that can make a major difference in the company's success.

Every nation contains a set of cities that differ in their importance and national and global reach. Some of the world's cities are bigger than many nations. The 2007 Greater Tokyo metropolitan region of 13,500 km^2 had 35 million residents. It was roughly equal to the population of Canada and larger than that of Malaysia, the Netherlands, and Saudi Arabia.[1] Other megacity regions include Shanghai, Beijing, Mumbai, Delhi, New York City, Los Angeles, London, Mexico City, São Paulo, Buenos Aires, Rio de Janeiro, Dhaka, Lagos, Moscow, Cairo, and Istanbul, and they are likewise bigger than many country populations. These cities generate a huge level of gross national income for the nation. Each has extensive economic, political, and social relations with other cities and nations.

We assert that the growth of nations is intimately tied to the growth of their major cities. Top cities have grown faster in gross domestic product (GDP) than the rate of their country's GDP growth. Major cities are the source of a nation's wealth, not the other way around. In the markets of a nation's major cities, investment, trade, and consumption take place.

Yet development economists have spent the last nearly 70 years focusing on nation building and national economic growth, not city growth. Following World War II, the United Nations, World Bank, and International Monetary Fund, as well as the hegemonic powers of the United States and the Soviet Union, pursued policies of building national economies as the route to economic development and growth. Nation building deals with central government policy and structure, military modernization, social planning, large-scale infrastructure, global and bilateral trade agreements, global financial integration, and agricultural support.

When central planners in the Soviet Union, China, India, and other nations propounded central policy and held a tight rein on local initiative, many of their cities declined in economic growth, environmental quality, and social stability. The Soviet Union sank because its cities sank. The same warning could be applied to the United States. The federal government has paid little attention to the economic growth of key American cities. They let the cities economically decay in the face of suburban sprawl, financial liabilities, social engineering, and outmigration of businesses and talent to other parts of the country and offshore. Cities were seen as a place to improve the lot of the poor, not places to launch economic growth. To a lesser extent this was true of Europe, as well.

The net result has been the rise of financially draining central government bureaucracies, sluggish economic growth, political polarization, major corruption, and persistent social upheaval. National resources are politically spread across the regions of a country, with little ability to concentrate resources in top market cities for accelerated growth and greater contribution to national revenue. This attenuation of resources to politically favored regions of the country is one of the economic perils of both democracy and autocracy.

The United States and India are good examples of this. U.S. grants-in-aid programs to states and cities spread federal resources across the nation's cities according to "fairness" criteria that bear no relation to the productive potential of recipient cities. It is too little for too many and never enough for what can spur economic growth. The National Congress Party of India has departed from an earlier policy of targeted infrastructure investment designed to stimulate economic investment to embrace a policy of guaranteed income and discounted grain to the countryside (at 10 percent of the market price). The result is a reduction from 9.3 percent GDP growth (2010–2011) to 5 percent GDP growth (2012–2013).[2] Because central governments are generally not able to invest resources in key growth cities, local city governments and city regions have been forced to step up to the plate and initiate investment promotion programs.

A good example is the work that Mayor Michael R. Bloomberg undertook to improve the economic prosperity of New York City. Later we describe the many initiatives he undertook to strengthen New York City's role in the global economy. After his 11 years as mayor of the city, he created a high-powered consulting group to use his vast fortune to help reshape cities around the world. He views large cities as laboratories for large-scale experiments in economic development, public health and education, and environmental sustainability.[3]

This idea of stressing the key importance of major cities in the growth of a nation's GDP is also on U.S. President Barack Obama's mind. On December 13, 2013, Obama met with more than a dozen new mayors and mayors-elect and told them that the "nation's cities are central to the economic progress of the United States" and that he wanted "to work with mayors to provide an environment that makes them [the cities] key job creation hubs."[4]

There are strong reasons why global companies must focus investment on growing cities in the developing world. Major cities in the United States and Europe are declining in population, and their consumption, trade, and investment are weakening. They cannot be relied on by Western MNCs to provide sufficient markets for business growth and adequate return to shareholders. The fastest-growing cities are in developing countries, especially in Asia and Latin America, which are having rapid growth of their middle and affluent classes. This is where money can be made, and both developed- and developing-country MNCs and large domestic businesses are exploiting these opportunities. Western MNCs must move more aggressively before they are outpaced by new developing-country MNCs.[5]

We repeat: Midsize and large cities in developing countries generally have a growth rate exceeding that of their host countries.[6] The sum total of a nation's top cities comprises the greatest part of its GDP. In developed countries, cities provide as much as 80 percent of the national GDP. In the United States, cities contribute 79 percent of the national GDP. In developing countries, the range is 40 to 60 percent. Chinese cities contribute 60 percent of the national GDP and 85 percent of China's GDP growth rate. Thirty-five Chinese cities alone contributed just under 50 percent of China's GDP in 2013.[7]

Although many developing nations were in turmoil during the last decades of the twentieth century that precluded investment, they have since stabilized and attracted investment. The road to economic growth is still rocky in the Middle East and in parts of Latin America and Asia, but the major city regions of China, India, Brazil, South Africa, Chile, Colombia, Indonesia, South Korea, Mexico, Singapore, Vietnam, and elsewhere are open for business.

The premise of Western nation building has been that economic development springs from democratic institutions. Although democratic nations such as South Korea, Taiwan, India, Brazil, and Mexico are doing well, autocratic nations such as China, Singapore, Saudi Arabia, and the United Arab Emirates are doing just as well without democratic political institutions. Even Russia, a dubious democracy, is rising from her ashes.

If economic prosperity does not necessarily come from democratic institutions, where does it come from? Beneath the shell of nation building, developing economies have thrived through the rapid growth of cities and their dynamic interplay of rapid urbanization, industrialization, trade, consumption, and education. Cities have grown through external and internal investment, transplanted global industries, indigenous industries, innovative implementation of central government investment and enterprise policies, improved operations and marketing skills, and indigenous entrepreneurial talent and spirit.

National institutions occasionally play a facilitating role in attracting external investment, trade, and consumption, but more often they play an inhibitive role. The leadership and enterprises of the megacities and large cities in the developing world are the engines of local economic growth, which produces added revenue for central governments. The nation does not produce wealth; at best, it facilitates urban growth. Cities grow the wealth of nations. Nations are the beneficiaries of city economies, not the progenitors.

According to 2011 McKinsey Global Institute data, the top 600 cities in the world included 20 percent of the world's population and generated US$34 trillion, or roughly half of the gross world product (GWP). By 2025, the top 600 cities are expected to double their GDP to US$65 trillion and contribute 67 percent to the GWP.[8]

The GDP purchasing power parity (PPP) of developing cities is racing toward the purchasing power of the West. The standard of living today in Shenzhen, China, is equivalent to that in Chicago and has more middle-class households.[9] Living in Shanghai and Beijing is more expensive than living in New York City. From 2007 to 2010, the GDP of large Chinese cities rose from 20 percent to 37 percent of the GDP of large U.S. cities.[10]

By 2025, the distribution of developed- and developing-country GWP contributions will likely be inverted. By 2025, it is estimated by the Paris School of Economics that China will be second to the United States in nominal GDP, with a GDP that is two-thirds the GDP of the European Union (EU) and half that of the United States.[11] The Chinese economy of 2010 was equal to the U.S. economy of 2000. Also by 2025, India is expected to be the sixth-largest economy, equal in GDP to France.[12] The epicenter of global economy is turning from the cities of developed countries to the cities of developing countries.

How can this be? Why is the economic development of Asia and other developing areas eclipsing Western economic dominance? The West expected continuing political and economic domination after the Cold War with the Soviet Union ended, not that economic giants in the developing world would challenge American preeminence.

The answer is simple. Since the rise of nation states in the nineteenth century, comparative politics and economics have been based on national data. Nations were compared by absolute nominal GDP, not GDP PPP or rate of GDP growth. The same still holds for comparative GDP data. Nominal GDP is calculated in U.S. dollars, not in PPP—namely, what it comparatively costs people to live in different countries at the same lifestyle. Nominal GDP in the developed world is a historic legacy. The growth rate of GDP PPP is a contemporary dynamo.

Country data does not reflect differences in city GDP within the country or city contribution to country GDP. For example, in 2011, the top 15 cities in India contributed 56 percent of India's GDP yet only held 7.5 percent of its population.[13] In other words, national GDP data lag behind in-country city data. Cities are growing faster than their countries. Cities are more attractive markets than their countries as a whole. Cities are the economic powerhouses of countries.

PricewaterhouseCoopers[14] estimates that Brazil's annual growth rate in the period 2010–2025 will be less than 3 percent, while the estimate for São Paulo in the same period is an annual growth rate of 4.3 percent, and in Rio de Janeiro the estimated annual growth is 4.2 percent. India's estimated annual country growth rate is 5 percent, while Mumbai and New Delhi are estimated to grow at 6.3 and 6.4 percent, respectively. In the case of China, which is estimated to grow at a 5.5 percent annual rate over this period, its top city growth rate in Shanghai, Beijing, and Guangzhou is expected to exceed this by as much as 10 percent. In 2012, Tianjin's GDP grew at 16.4 percent, while China's GDP grew at 10 percent. In the United States, the 2011 growth rate for San Jose, California, over the previous year was 7.7 percent; Houston grew 3.8 percent; and Midland, Texas, had a 9.5 percent increase in GDP.[15] These well exceed the 2011 U.S. GDP growth rate of 1.7 percent. Which figures should businesses turn to for investment in market expansion—national data or city data?

Economic growth springs not from nation building but from national policies that invite global private investment in industries, trade, and consumption to top-growing cities in both the developed world and the developing world. This investment catalyzes industrialization and commercial development in invested cities. It adds value to urbanization by inviting new skills, improving education, improving infrastructure and technology capacity, advancing household income growth and middle-class expansion, stimulating small-business supplier enterprises, and increasing capital formation, trade, investment, and consumption.

City building, not nation building, has been the key to the rise of emerging markets. The megacities and large cities of the world have an 80 percent higher per capita GDP than that of their host economies.[16] By 2025, only 12 of the top 25 cities with an annual average household income above $20,000 in PPP are expected to be in developed regions, namely, Tokyo, New York, London, Paris, Rhein-Ruhr, Osaka, Los Angeles, Seoul, Chicago, Milan, the Randstad, and Madrid.[17] The other 13 are expected to be in developing regions, namely, Shanghai, Beijing, Moscow, Mexico City, São Paulo, Mumbai, Cairo, Hong Kong, Taipei, Shenzhen, Istanbul, Delhi, and Buenos Aires.

Let's illustrate the power of cities by the example of China. In 1980, Deng Xiaoping, Communist Party leader of China, instituted special economic zones (SEZs) in five Chinese east coast cities to test market economics after decades of state planning. The experimental cities included Shenzhen, Zhuhai, and Shantou in Guangdong Province; Xiamen in Fujian Province; and the entire province of Hainan. These cities became free trade zones, export processing zones, industrial parks, free ports, free economic zones, and urban enterprise zones.

China's first foreign capital inflows to these city zones came not from Western countries but from private offshore Chinese capital in Hong Kong, Singapore, and other overseas Chinese investors. Western corporate and financial investment capital followed. However, not all of these Chinese investors were in capitalist countries. Some were in countries that were Socialist at the time, such as Indonesia.

When the Shenzhen SEZ was organized, the zone consisted of a small fishing town and a trading town of 30,000 people, settled on no more than 3 square kilometers of dilapidated buildings and lacking even a traffic light. A new urban landscape of economic development was to be built on this barren settlement. Shenzhen was the most special of the four SEZs, with the greatest freedom to explore economic policy innovations. By 1982, additional portions of the Shenzhen municipality were added to the SEZ, bringing its population up to 351,871.[18]

By 2000, only eight years after its SEZ designation, Shenzhen reached a population of 7,008,428. By 2010, its population had soared 47.8 percent to 10,357,938,[19] and most of the Shenzhen municipality was subsumed in the SEZ. Its GDP reached US$3,581 per capita by 2012, with a PPP of $23,897.[20] At a 10 percent annual growth rate, Shenzhen's PPP is nearly equal to the 2010 per capita GDP of $29,535 of Chicago. It has already exceeded Cleveland's per capita GDP and at the time of this writing was expected to soon match Philadelphia's per capita GDP.

In short order, the experimental SEZs spread to all cities in China, and great industrial and commercial cities proliferated in Beijing, Shanghai, Chongqing, Chengdu, Tianjin, Wuhan, Xi'an, Guangzhou, and other city regions. Western companies entered these cities' markets independently or as joint ventures in selected industries with state-owned companies, which provided market entry in exchange for investment, technology transfer, and management skills. External investment, along with new internal private and public capital formation, also fueled private and state-owned sector growth. There was vast public and private investment in infrastructure, and within three decades, Chinese cities grew to become some of the largest global economic urban centers and made China the world's second largest economy.

By 2010, China's private sector had generated 65 percent of its GDP and held 40 percent of its capital. The Communist Party built a prosperous market economy with Chinese characteristics. Similar patterns of Western and internal investment followed in other countries to turn the developing cities of Jakarta, Bangkok, Kuala Lumpur, Dubai, Mexico City, São Paulo, and Mumbai into great global cities.

China is now following the pattern of Western investment into China by investing in African cities. Chinese investment in Africa exceeds the investment of the World Bank on that continent. China has developed and used its own capital resources for foreign investments and acquisitions of industrial, property, and commercial companies; technology; and logistical assets in Africa, as well as in other developing regions and developed countries. China pursues direct foreign investment and can financially leverage its capital for foreign investment.

Urbanization

The key to the shift of national wealth from developed to developing countries lies in the rapid urbanization of vast populations of low-wage workers into large cities, which creates compelling production cost advantages to global companies and investors, as well as access to new huge markets. With advances in education and technology, this shift has progressed to value-added supply chains and brands for export and new middle-class domestic consumption.

Jane Jacobs[21] and other urban analysts have pointed out the wealth-creating effect of cities. Although early writers such as Jacobs focused on the urbanization of developed countries, there is today a far larger scale of wealth creation in cities in the developing world. According to McKinsey, "China's economic transformation resulting from urbanization is happening at 100 times the scale of the first country in the world to urbanize—the United Kingdom—and at 10 times the speed."[22] The question that every American has to ponder is whether the United States, with a population of 315 million in 2013,[23] can effectively compete with a 2010 urban developing world of 2.6 billion people.[24]

For the first time in human history, we live in an urban world. More than 50 percent of the world's population lives in cities and generate 80 percent of the GWP. As of 2007, 380 cities of McKinsey's index of

600 top global cities, accounted for 50 percent of the GWP. By 2025, the 600 largest cities are expected to generate 60 percent of the GWP.[25] The 2025 players will change. In the developing world, 136 new cities (100 cities in China alone) will likely enter the 600 city index. One out of every three developed cities in the 2007 index will likely drop from the list. The key element of new wealth creation will derive from consumption, which is expected to rise from 485 million households with an average per capita income $20,000 in 2007 to 735 million households with an average per capita income of $32,000 in 2025.[26]

The Economy of Cities

Cities are intensively productive environments for infrastructure and commercial investment, industrialization, employment, higher-wage migration from rural areas, logistics and trade, educational advancement, property development, consumer marketing and distribution, cultural attraction, and capital formation. Cities and city clusters provide the supply chains for both manufacturing and services industries.

The upside of large cities and megacities is their opportunity for industrial, technology, and commercial investment. They are great company markets for household consumption income and personal career advancement through education and enterprise. They also have downsides of environmental degradation and pressure on natural resources. Large cities pose great challenges of political and administrative management and social harmony.

The consumption taking place in cities is divided among the poor, the low-income consumers, the middle class, and the wealthy upper class, as well as all of their subdivisions. In the emerging 440 developing-market cities, households above $20,000 PPP are expected to rise from 35 percent of households in 2010 to 55 percent of households in 2025. Developing cities will also have a large high-income and wealth class, defined as household income in excess of $70,000 at per annum PPP. This number of high-income households is expected to triple in the developing world's top cities from 20 million in 2010 to 60 million in 2025, representing 60 percent of global growth in urban high-income households and exceeding the number of wealthy households of the developed cities. China alone will likely account for 19 percent of new high-income developing-city households.[27]

Of the 26 anticipated large cities in 2025, with a population of 5 million to 10 million and with a median household income of more than $20,000 (middle-income and high-income classes), 11 cities will likely be in the developing world—Brazil, Russia, India, and China (BRIC countries) and others—whereas the remaining 15 cities will likely be in the developed world.[28] Only 3 of the top 26 large cities are anticipated to be in the United States—New York, Los Angeles, and Chicago. If we turn to the 23 anticipated megacities with a population of more than 10 million and the highest number of middle-income households, McKinsey estimates that only 7 will be in the West—New York and Los Angeles in the United States; London, Paris, and Rhein-Ruhr in Europe; and Tokyo and Osaka in Japan. The remaining 16 megacities will likely be in developing regions—Shanghai, Beijing, and Chongqing in China; Mumbai, Delhi, and Kolkata in India; and Mexico City, São Paulo, Buenos Aires, and Rio de Janeiro in Latin America, plus Karachi, Dhaka, Manila, Moscow, Cairo, and Istanbul. The epicenter of the marketing of all business-to-business (B2B) and business-to-consumer (B2C) companies will likely have shifted from developed to developing regions.[29]

Variances in factors other than income alone, like the age of the population, the number and size of households, and the population's education level, will distinguish the problems and opportunities of doing business in these top cities and the broader McKinsey index of the top 600 cities. Multinational and indigenous companies will need to adjust their strategies and operations to different cityscape profiles.

Business Strategy in City Economies

In her 1984 book *Cities and the Wealth of Nations,* Jacobs brilliantly dismantled national theories of wealth creation by demonstrating in realistic terms that cities and their regions are the true generators of national wealth.[30] She argued that cities grow through different stages: (1) markets for imports, (2) import replacement (jobs), (3) industrial and commercial transplants, (4) technology, and (5) capital formation and investment. She demonstrated how great Western city regions joined with other importing and exporting city regions within a nation to create the wealth of nations. The city region is the core of the national economy. As core cities flourish in import replacement, they begin to export their surplus production and innovations to nearby core cities and then to foreign countries. Imports are continually converted into replacements and exports, and the wealth of city regions grows. When the central city declines in energy and inventiveness, the city region degrades.

Jacobs wrote an earlier book in 1961, *The Death and Life of Great American Cities,* in which she traces the competitive race between cities and city regions within the United States and the various reasons some cities won and others lost.[31] Every city competes for markets, jobs, transplants, technology, and capital. Cities may be permanent, but there is no permanence to their wealth and economic power.

Jacobs witnessed the rise of Tokyo and other major Japanese cities and the rising wealth of Japan. But she did not live to see the economic rise of megacities and large cities in China, India, and the other regions of Asia; São Paulo, Rio de Janeiro, and Mexico City in Latin America; Istanbul and Dubai in the Middle East; or Lagos in Africa. Nor did she live to see the declining economic growth of Tokyo and other major Japanese cities during decades of stagnation in the 1990s and forward or the collapse of Detroit and the economic decline of many prominent American and European cities. But Jacobs has been right all along. The changing economic fortunes of city regions rest on the shifting sands of domestic and global markets, jobs, transplants, technology, and capital.

By the time of Jacobs's 1961 book, the Soviet Union had not collapsed. The new world order of free trade, financial integration, and new global financial instruments were not yet in place. There was no World Trade Organization to facilitate the transformation of protectionist trade to more open trade. China had just begun its rapid market growth in the heart of Communist China. Socialist India had not yet begun market reforms. Multinational corporations had not yet become the global behemoths that they are today. By the time Jacobs died in 2006, the outline of the new world had already appeared. Our book is a tribute to her pioneering work on the wealth of cities and how business and political, social, and personal life must adjust to this new urban world.

Let us look at how Jacobs's five stages shape today's and tomorrow's global economy.

Markets

We have already documented the new landscape of city markets (defining a city as a metropolitan region, just as Jacobs called it a city region). In 2008, there were 80 million middle-class and wealthy-class households in the developing cities of the world's top 600 cities and 172 million such households in the developed world.[32]

Regarding the fastest rate of city GDP growth in 2025, China alone is expected to have 15 of the top 25 greatest city GDP growth rates in the world. Only one U.S. city, Los Angeles, will probably rank in the top 25 GDP growth rates. In terms of the number of households above $20,000 GDP PPP per annum, only New York, Los Angeles, and Chicago in the United States will likely rank in the top 25 cities, matched by Shanghai, Beijing, and Shenzhen in China. More broadly, 12 of the top 25 cities with a household income above $20,000 GDP PPP per annum will likely be in the developing world.[33]

The profile of markets as a factor of wealth has changed from developed to developing countries. This means that the epicenter of consumption is shifting because of a combination of city GDP growth, population size, household number and size, and per capita income.

The key to the growing market consumption of top developing cities is the global reach of multinational corporations in manufacturing, brand power, and retail chains. This is enhanced by the rise of indigenous companies and their production power, styling, advertising, and distribution though their retail chains and malls.

Western multinational B2C and B2B companies initially exported their goods and services to developing cities. In short order, these MNC imports were copied and sold by developing-country companies to businesses and consumers at a lower price. To meet this market threat and to meet export competition, MNCs transplanted their production to host developing cities to protect their brands for host-country markets and to take advantage of low-cost labor that they could export to their home countries and other markets.

MNCs tried to trump indigenous import replacement with patent and copyright protection. This has historically been a hopeless task. Nonetheless, MNC brands took root in host economies, and Western industrial and commercial investments added economic power to developing cities while imperiling the manufacturing economy of their home countries.

Indigenous companies in developing cities not only substituted imports and grew their own brands and position in the marketplace but also began to invest in research and development (R&D) and innovation. By 2011, China became the second-largest export country, after the EU and ahead of the United States.[34] In 2012, Chinese telecommunications giant Huawei invested 13.7 percent of its annual revenue in R&D.[35] By 2013, China had shifted its export profile to value-added products and was competing successfully with MNC products in its domestic markets.

Jobs

There are more jobs in the top developing cities than in the top developed cities. You can fit the 2025 projected population of the five top per capita income developed cities in the world (Oslo, Doha, Bergen, Trondheim, and San Jose) into one job district of Shanghai.[36] Most top-performing per capita cities have small populations and job markets but are rich in natural, human, and financial resources.

Where did these abundant jobs of developing cities come from? Shenzhen grew from a population of 30,000 inhabitants in 1980 to more than 10 million in 2010. Tianjin grew from 7.7 million in 1980 to 11 million in 2012. Mumbai's metropolitan area grew from 8.2 million in 1981 to 13 million in 2012. São Paulo's metropolitan area population grew from 8.5 million in 1980 to 13 million in 2012.[37]

In general, 70 percent of the total population is a working-age cohort. Of this group, 50 percent represent an aging population. Taking the Organisation for Economic Co-operation and Development (OECD) definition of a working-age population as a range from age 15 to age 64, the top-performing GDP cities in the developing world, with their large populations, have high employment growth.[38]

The developing world added 886 million nonfarm jobs from 1980 to 2010, or an increase of 61 percent, versus 164 million new nonfarm jobs in the developed world, or an increase of 9 percent.[39] Annual employment growth in top developing cities is running at a 1 to 2 percent increase annually. By contrast, the top developed cities recorded 2012 unemployment in the following order: Paris at 11.4 percent, Los Angeles at 9.7 percent, London at 9.6 percent, Chicago at 9.5 percent, and New York at 7.7 percent. Since 1980, 50 U.S. metropolitan areas have had a net decline of employment ranging from −1 to −4.9 percent. Although net unemployment over a 30-year period of boom and bust is far less severe than the post–financial crisis job decline, it is evident that recoveries and new booms cannot offset long-term decline. The long-term decline is far worse in Europe.

The job growth rate of top developing cities comes principally from countryside migration to cities for higher wages. The principal factor of city job growth is urbanization. China and India have a long way to go until they meet the 80 percent urbanization level of the developed world.[40]

An additional factor of city job growth is the workforce penetration of the population. Workforce penetration is a ratio of current employment to working-age cohort. Latin America has reached an 80 percent level of workforce penetration.[41] Its stronger rate of GDP growth compared with the United States partly results from higher workforce participation to working-age population. Brazil also has a higher ratio than the United States. U.S. labor force participation has declined from its height of 67 percent in 2000 to 63.2 percent in 2013 and is projected to decline to 60 percent by 2040.[42] Many unemployed working-age Americans have stopped looking for work. One reason is declining economic growth, but another is the vast expansion of jobless benefits over the past two decades. The situation in high-welfare countries of Europe is even worse. In 2012, Italy and Spain had workforce penetration of only 44 percent to their working-age cohorts. France had 51 percent workforce penetration.[43]

Transplants

A large portion of urban population and employment growth in developing-country cities derives from indigenous public and private infrastructure and industrial and services investment. But a major source of this growth since 1980 has been the transplantation of manufacturing from developed city regions to developing city regions.

Many factors, including low wages, improved education and skills training, infrastructure, logistics, local supply, large metropolitan consumer markets, favorable bilateral and global trade policy, and investment incentives of host countries, have joined forces to move the industrial core of the developed world to the developing world.

The epicenter of middle-class consumption and per capita wealth is moving in concert with this industrial and commercial investment shift.

Developing cities are marketing their investment advantage in concert with central and local government policy and monetary, fiscal, and trade support. They compete among one another for foreign direct investment (FDI). Cities primarily market transplants, not central governments. Trade delegations led by mayors from every large city in China send marketing delegations to U.S. cities and European cities to present their investment opportunities. These delegations go to cities in the United States, like San Francisco, Dallas, Atlanta, Chicago, and New York, not to the federal government in Washington, DC.

Investment for industrial transplants and branches is a city-to-city exchange, not a country-to-country exchange. American presidents may trumpet investment and trade accomplishments. But these deals are made on from global city to global city. Country presidents bring delegations of city mayors and business leaders to global cities for business attraction to their own cities.

We can expect a continued hollowing out of manufacturing in the developed world and its passage to developing cities for decades to come.[44] This trend is reflected in the earlier stated reference to comparative city GDP growth in the developed and developing worlds. Higher absolute GDP and per capita income in the West are legacy attributes that will likely wane in coming decades.

Whereas U.S. cities once developed indigenous industries for import replacement from cities of Europe, today the cities of developing regions are attracting transplants and developing indigenous manufacturing for import replacement from the West. The vast scale and rapid pace of this replacement account for the fast growth of developing cities and their consuming classes.

The only hope of economic growth for low-population developed cities is innovation for export. However, this too is expected to be continuously replaced by importing cities of the developing world. China aims to reduce its technology imports from 50 percent to 30 percent by 2020. While China's share of global R&D rose to 12 percent in 2011, U.S. share is global R&D declined from 36 percent to 34 percent.[45] Innovation and productivity are keys to the future balance of economic power between cities of the developed and those of the developing world.

By 2013, major developing countries and their indigenous private and state-owned MNCs and large businesses were financially able to support indigenous innovation. For the Chinese GDP, 60 percent comes from the private sector in China, and 40 percent of China's wealth is in private hands.[46] China's private sector is growing at a faster rate than state-owned companies, and Chinese wealth, public and private, is investing and acquiring businesses in developed cities of Europe, Japan, and the United States for advanced technology, market access, and brand power.

Enterprise transplants are beginning to move in an opposing direction. Huawei is the second-largest telecommunications equipment company in the world. It is privately held and has facilities and operations throughout the world—in Europe, Latin America, South and Southeast Asia, Africa, the Middle East, and even the United States, where its activity is largely blocked by the federal government. Lenovo is the biggest PC maker in the world, and it is publicly listed in Hong Kong. China has vast private, as well as public capital for the global expansion of its city businesses. Chinese enterprises have made many company acquisitions in both Europe and the United States. In the first nine months of 2013, Chinese firms spent a record $12.2 billion on 55 greenfield projects and acquisitions in the United States, well on the way to a new record of Chinese FDI in the United States.[47]

Developing cities have been exporting more goods to developed cities than they have been importing. As a result, there has been a major growth of foreign currency reserves in China and elsewhere in the developing world for global business investment and expansion, which adds to the wealth of the developing cities and nations. The economic hope of developed regions to offset the loss of transplanted industries and jobs is innovative technologies. This brings us to the next element of city economic growth: technology.

Technology

China and many other developing countries require joint venture structures for foreign investment in selected industrial sectors. This is partly for the purpose of adding capital assets and revenue to state-owned companies but also for indigenous partners to learn the technology of high-value production and copy this knowledge for their own branded products and components. Indigenous joint venture partners are also learning how to efficiently manage large-scale business operations and management processes.

MNCs accept this condition of joint venture and technology transfer for the short-term benefit of market access and sales revenue to meet their corporate bottom line. MNCs are constant victims of intellectual property theft, whether by joint partners or third parties. For all of the comment and complaint on this issue, and all of the legal expenses of MNCs to secure intellectual property, little can be done. First, there is nothing new about this; it is the ancient process of import replacement. Furthermore, in a world of Internet information, corporate espionage is not only pecuniary but also malicious fun. Cyber security is a horserace between inventors and pirates, and pirates are often the winners.

Copying is the core of city economic growth. All cities grow by import replacements, which is a fancy phrase for *copying*. No legal system or procedure can stop the heart of city economies from copying and growing. They must reproduce what they import to grow their economies and then export at a low price what they previously imported.

Many Indian companies have copied the art of software from the West, and now Infosys is a world leader in software. Haier has copied General Electric (GE), Electrolux, and Bosh appliances and is now the largest white goods appliance maker in the world.[48] Galanz copied American microwave ovens and by 2007 became the largest microwave oven producer in the world.[49] Not only do developing city regions replace imports for their home market and for export, they also end up producing and even designing the original branded imports they replaced. Western consumer MNCs have become largely marketing organizations, outsourcing design as well as production. Branded retail chains in the West import replacement goods directly as private-label brands.

As Chinese companies absorb more Western technology in their manufacturing base, they also invest in new technologies. From 2009 to 2013, ZTE, formerly Zhongxing Telecommunication Equipment, a Chinese telecommunications equipment and smartphone maker, spent 10 percent of its sales revenue on R&D, far higher than American companies generally.[50] Apple spends only 3 percent of sales on R&D. In addition, the Chinese government invests heavily in R&D. Under the twelfth five-year plan, which runs until 2015, China will likely increase public R&D expenditure to 2.2 percent, and then it will likely increase it to 2.5 percent by 2020. This would put it on par with developed countries. The OECD average in 2011 was 2.3 percent. Increased funding for science in China is planned to reach $36 billion by 2012, up more than 12 percent year on year from 2011. Of this, about 14 percent is being allocated to basic research.

China now leads the world in solar and wind power. It is ahead of the United States in electric car manufacturing and sales. China's overseas direct investment (ODI) is purchasing European machinery manufacturing and technology at a speedy rate. China's Sany acquired

Putzmeister in Germany and is now on par with U.S. and Japanese cement mixers for construction. If there's a race to lead the Internet of things (IoT), China aims to set the pace. Beijing has focused on developing technology by which devices can communicate via infrared sensor, radio-frequency identification, and other machine-to-machine technology. The Chinese Ministry of Information and Technology estimates China's IoT market will hit $80.3 billion by 2015 and then double to $166 billion by 2020. China is also leading in light-emitting diodes and mobile payment technology, as well as advancing to leadership in semiconductor technology, optoelectronics, and grapheme technology. According to the Battelle Institute, the largest manager of scientific laboratories in the U.S., "The growth of China's R&D will far outpace those of the U.S., which has resumed modest growth that is expected to be relatively stable through 2020. . . . At the current rates of growth and investment, China's total funding of R&D is expected to surpass that of the U.S. by about 2020."[51]

What all this means is that Chinese cities like Shenzhen, home to ZTE and Huawei; India cities like Bangalore, home to Infosys; and Mumbai, home to Reliance, are catching up to Western cities in technology and talent, as well as investment, trade, and consumption.

Capital

New York, London, Paris, Frankfurt, Tokyo, and Singapore are still the major global financial centers of capital, but Hong Kong (legally part of China), Shanghai, Beijing, Mumbai, Delhi, São Paulo, and Dubai are not far behind.

The essential matter is that more global investment capital is flowing to the 480 developing cities of the McKinsey 600 index than to its 120 developed cities.[52] Just as the West places its manufacturing offshore, it is placing its investment capital offshore. Western MNCs are keeping billons in profit offshore to invest in developing city regions, instead of bringing these earnings back to their home countries for taxation and limited domestic investment opportunity.

The sovereign wealth funds of developing countries are growing at a faster rate than are surpluses in developed countries, which are largely deficit countries with enormous national and local bond liabilities. The future solvency of the peripheral EU is still open to question, as is the EU currency zone. There is no end to U.S. sovereign debt, which is supported by the U.S. dollar being the preeminent global reserve currency, still settling 80 percent of global trade transactions.

The Chinese renminbi (RMB) is making rapid progress in international trade settlement. The Wall Street Journal Market Watch reported that, according to figures from the Society for Worldwide Interbank Financial Telecommunication, the Chinese yuan surpassed the euro in October 2013 to become the world's second-most-used currency in international trade and finance.[53] Deutsche Bank predicted that yuan trade settlement would increase by 50 percent in 2014.[54]

Within a decade, the Chinese RMB will likely become fully convertible and shake up the financial resources of the developed world. China's trade settlement with Europe is likely to surpass the Asia trade settlement by the end of 2014.[55] Russia and Brazil are settling some of their China trades in RMB, and further bilateral swap agreements with other countries are on their way. These swaps, like the recent Australian dollar–to–China RMB swap, bypass the dollar and reduce the cost of trade. When China's policy makers are ready for the big step of convertibility is anyone's guess, but convertibility is coming.

The most interesting element of capital flows is China's Overseas Direct Investment (ODI). Chinese ODI grew from $3 billion in 2004 to a current level of $87.8 billion in 2012.[56] China is becoming an important investment competitor to the West.

U.S. direct investment abroad exceeded domestic investment in the United States in 1990 and did so by a wider margin than in

1985—$184 billion versus $152 billion. By 2011, the U.S. Direct Investment Position Abroad on a Historical-Cost Basis reached $273 billion and was distributed in the following proportions: 55.6 percent went to Europe, 13 percent went to Canada, 17 percent went to Asia, 13 percent went to Latin America, and 8 percent went to Africa and the Middle East. In summary, 30.8 percent, or $84 billion, went to developing city regions.[57]

As reported by the U.S. Bureau of Labor Statistics, in 2013, U.S. domestic investment during the decade of 1992 to 2002 grew 6.2 percent annually. During the following decade of 2002 to 2012, investment precipitously declined to 0.6 percent annually. Outward decade projection of 4.7 percent annual growth from 2012 to 2022 is hypothetical. The real fact is the actual decline, not the speculative increase.[58]

What this means is that the United States has substantially decreased its capital investment in its city industries and is, in effect, financing industries in developing cities to beat the economic growth of its own cities. Furthermore, investment into rich, developed countries fell by 9.5 percent in the first half of 2012, compared with the same period in 2011.[59] The United States has also given up on European growth.

The top cities of developing countries now receive more than half of global FDI inflows.[60] In the first half of 2012, however, China surpassed the United States and became the world's largest recipient of FDI. This category refers to international investment in which the investor obtains a lasting interest in an enterprise in another country. Most concretely, it may take the form of buying or constructing a factory in a foreign country or adding improvements to such a facility in the form of property, plants, or equipment.[61] In short, global capital is making its bet on the economic growth of developing city regions, rather than that of developed city regions.

Business Strategies for Developing-City Markets

McKinsey reported that in 2012, "Only 19 percent of surveyed business executives were reporting that their company's senior executives were making business location decisions at the city, rather than the country level and that they expect that share to remain constant over the next five years."[62] Furthermore, 36 percent make strategic business expansion decisions based on regional investment and leave the task of allocating investment to cities to working groups. Astonishingly, 61 percent of senior executives don't plan at the city level "because they are perceived as an irrelevant unit of strategic planning."[63] Among senior executives, 52 percent don't use city information in their daily work. If these senior executives are looking for customers, they are overlooking the most salient fact of where customers are. They are not in global countries and global regions but in the cities and city regions of countries.

When MNCs seek locations for improved market access and local talent, only 30 percent report that these decisions are made at a city level.[64] Professionals live in cities, not just in countries. Country-level statistics of professional and management talent, not to mention local market size, cannot identify Silicon Valley, Bangalore, Shenzhen, Tianjin, Wuhan, Jakarta, or Chennai. Maybe old habits can identify Minneapolis, Chicago, Manchester, Munich, Frankfurt, Lyon, or Stockholm, but none of these cities were among the top 23 city regions of high- middle-income households of 2007, and none were anticipated to be in this group in 2025.[65]

Corporate Culture

Senior executives of Western MNCs have been in management positions for decades. It is tough to unlearn a mind-set of 30 to 40 years, especially when that mindset has long been successful. Most U.S. consumer and services MNCs still do much of their business in the United States, but this picture is changing quickly. As of 2011, Walmart still did 76 percent of its business in the United States. Nike does 50 percent of its business in North America. Marriott is still American enough to do 84 percent of its business in the United States, and McKesson, the largest U.S. drug distributor, does 91 percent of its business in the United States.[66]

Still, there is slippage. McDonald's earns 66 percent of its revenue overseas. Apple receives 65 percent of its sales revenue from overseas sales. Even Amazon is seeing 45 percent of its sales overseas. Turning to the industrial sector, we see Intel with 88 percent of its revenue overseas, Dow Chemical at 67 percent overseas, IBM at 67 percent overseas, GE at 54 percent overseas, and Ford at 51 percent overseas.[67]

If we take 50 percent overseas sales as the tipping point for a truly global U.S. MNC, it is likely that we will see most U.S. Fortune 500 and Fortune 1,000 companies selling more than 50 percent abroad by the end of the decade. With the exceptions of Intel, Ford, and IBM selling a small share of foreign sales directly to central and state governments, most of these sales are to municipalities and companies. These procuring companies and consumers are in cities. The largest city destinations of U.S. foreign sales are Western developed countries in Europe, Japan, Korea, and Australia. Although we do not have the figures on the percentage of sales to developing cities, it is a fair bet, with European and Japanese economic stagnation and rapid developing-city growth, that a majority percentage of U.S. multinational foreign sales will shift from developed cities to developing cities before 2025.

It is the strategic challenge of every company to figure out the location change of sales revenue and rates of this shift. Companies have enough research capability to see the city path of their business shift over the coming decade if they accept the premise of city market economies. They need competitive intelligence to see where their

Western MNC competitors are going, when, and how. They have to track the rise and competitive strategies of new emerging-market MNCs and the global city spaces in which they plan to operate.

They have to change the culture of their headquarters and stakeholders to understand two basic changes. First, don't put too many resources in developed city markets. They are declining in consumer and business growth, whereas developing-city markets are growing. Second, forget global regions and countries and focus management talent on city markets, both in the developing and in the developed regions. Western failure to accomplish this business cultural shift will only advance the rise of new MNCs in developing cities and eventually their encroachment in developed cities.

Segmentation

City markets in developing countries are growing at different rates in population, household number and size, household and per capita income, educational level and talent, age distribution, and the mix of supply resources to meet demand. Developing cities with increasing households need residential and commercial property and all the fittings for middle-class living. Cities with high fertility rates need baby products. Those with a rising aging population need advanced health care.

Every midsize and large MNC has to map its product line to the demographics of developing-country city regions. Large companies have to be good geographers and know the top city regions in developing countries that represent the best opportunities for their product line.

Developing cities with high savings cultures are reluctant to spend. Those with spending cultures are ready to buy. Cities with many institutions of higher education and research have a large stock of talent for R&D and innovation. Newer developing cities that have not yet replaced their imports have fewer indigenous competitors than older cities. Cities with agile entrepreneurial political leadership are more inviting to Western MNC entry and growth than bureaucratic cities, which are protectionist toward their own indigenous companies. Some cities have highly suitable and outward looking partners for joint venture and strategic alliances; others are too restrictive, distrustful, and reluctant to deal with Western partners. Every company needs to segment its opportunities and formulate its criteria for ranking the attractiveness of cities.

Targeting

The McKinsey 600 cities index, with its 430 developing cities, is too vast a landscape for strategic investment. Which cities should your business invest in and according to what criteria? What time order and investment scale do you set for your company among these opportunity developing cities?

Below the city level, what demographic segments should you target? Every MNC has diversified product lines for different income, age, gender, education, occupation, and lifestyle group. Which brands are most salient to the changing demographic groups in these fast-growing developing city regions? Which products will have the greatest appeal and least competitive pressures in these growing cities? Which products in your portfolio fit the local culture, and how effectively can these products be localized for maximum consumer appeal? How do you deploy your product line of price points, design, and features for distribution to households and personal shoppers in these different cities?

What mix of distribution channels do you devise? Chinese cities have the highest number of Internet users and fast-growing e-commerce sales. India's cities have a slower rate of e-commerce growth. The United Arab Emirates cities are high wealth centers for luxury goods and travel. They want elegant retail channels. African emerging cities need more standard household goods and services and favor big-box chains. Top Chinese cities have millions of luxury and middle-class consumers, as well as many more in countryside towns and rural districts. The channels have to be highly diversified.

How do you advertise in developing cities with different cultures? Cultural variation and taste differ enormously among cities, even in the same country. The people of the Middle East are highly sensitive and alien to Western outlook. How does a Western product achieve credibility in the massive city region of Cairo?

Sales programs also have to be different. Developing-city consumers are used to bargaining. Everyday low prices do not work in a marketplace of haggling. That did not work for JCPenney when it tried unsuccessfully to abandon its heritage of frequent sales promotions to emphasize celebrity branding, higher prices, and no sales promotions.

How do you price for profit in vast developing cities that have a heritage of flexible pricing and fragmented distribution? What systems do you need to control price flexibility in the distribution chain, as well as the supply chain? The distribution pie has many more slices.

If we have to move from a global regional and country company organization, how do we organize for city regions? If the wealth of companies comes from developing-country city regions, companies have to have senior executives at the city region level. They cannot succeed with tactical work groups. The most promising approach is to target the fastest-growing city region clusters and seat senior management at the city region cluster level.

We are facing a new generation of marketing, different from the past and with an uncertain future. What we do know for certain, as borne out in the data, is that global city regions in the developing world will likely dominate market economies and be a fundamental source of company growth and prosperity. Developed city regions will still play a large role because of their high per capita GDP and their still great store of capital and intellectual and management assets. The new global organization of business will have to meld these diverging worlds. This book addresses these issues in detail and with strategic insight.

Conclusions

Here are some points to remember from this chapter:

- City metropolitan regions are the real generators of national wealth, not the nation.
- Multinational corporations (MNCs) are the major investors in city region growth.
- Urbanization in the developing world is growing rapidly and changing the global business landscape.
- City regions in the developing world are growing faster in GDP, population, and middle-class consumption than are cities in developed countries.
- Developing countries are generating their own MNCs to compete domestically and globally with Western MNCs.
- Western MNCs have to recognize the growing competitive technology of developing countries and their high-talent cities.
- Western MNC culture and leadership has to reflect the increasing percentage of revenues from the developing world.
- MNCs have to target top-growth city metro regions for investment in order to create revenue growth.
- Businesses have to reconfigure their administration, production, and marketing on the basis of the power of city markets, not national markets.

Questions for Discussion

1. Which city metropolitan regions are offering you the most promise for future revenue and growth? In which regions should you make plans for further expansion?
2. Which city metropolitan regions are declining? Where should you consider reducing your investment?
3. Which of your competitors are likely to present the strongest competition in the future? Why?