

**COMPANION PAPER 5**

# **WHAT DO MULTINATIONAL FIRMS WANT FROM CITIES?**

**Insights from Investment Promotion  
Intermediaries and Location  
Advisory Consultants**

T. Juni Zhu, Yago Aranda Larrey, Valerie-Joy Santos  
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# BACKGROUND

**Interest in studying city competitiveness has skyrocketed in the last few years**, although the topic itself is far from new. Mayors and city leaders have long worried about the obstacles to job creation, competitiveness and economic growth that confront their cities.

**This paper is part of a broader research initiative (the “Competitive Cities Knowledge Base” project)** managed jointly by the Trade & Competitiveness Global Practice and the Social, Urban, Rural and Resilience Global Practice of the World Bank Group. Its objective is to create a knowledge base on competitive cities, to improve the understanding of job creation at the city level, and to serve as the foundation for a Community of Practice on this topic for World Bank staff, academia, donor partners and practitioners.

**Our goal in this initiative has been to focus our energies on bringing to our clients a robust body of knowledge** – to address their questions on benchmarking their performance, on understanding what has worked elsewhere and what has not, and on how to organize for delivery in different contexts.

**Our approach has focused on using different methodologies to tackle these questions – based on best practices, data availability, replicability and simplicity.**

In many cases, we leveraged new and existing data sources to shed new light on some unanswered questions; in other cases, we’ve conducted primary research since available data were inadequate. We looked at global and regional trends, comparing different typologies of cities – by income, sector and region. We have buttressed these findings with econo-

metric “deep dives” and case studies in selected countries and cities. We are able to inform the continuing debates on what really matters for economic outcomes in cities with analyses of over-arching trends and associations, supplemented with rigorous analyses to identify causal relationships. We also try to “stand on the shoulders of giants” where possible: We use and reference existing resources (research, analysis, toolkits and experts).

The summary findings of the overall research are presented in the framework paper “Competitive Cities for Jobs and Growth.”<sup>1</sup>

**The objective of this paper is to understand the factors driving the location decisions of multinational corporations. The paper uses literature-review and expert-interview techniques to understand what cities can do to be best positioned to attract international capital.**

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# 1. Introduction and Objectives

Foreign direct investment (FDI) is an important source of capital for economic development in developing countries, even though it represents only a small fraction of their overall national economies.<sup>2</sup> Not only does FDI generate jobs and economic growth, but it can also bring in highly desirable positive externalities, such as more advanced technologies and stronger management capabilities, which are often much-needed by developing countries. Well-directed foreign investment can also have multiplier effects for the economy, in the form of additional jobs created through forward and backward linkages with domestic enterprises,<sup>3</sup> including employment opportunities in supporting sectors (such as business services, retail and restaurants).<sup>4</sup>

FDI is closely linked to urban areas in most countries. The first point of entry for market-seeking and efficiency-seeking investors into new countries is almost always in or around major cities, which are seen as being more effective locations for new businesses and having lower entry costs and risks for investors. Urban areas provide many agglomeration benefits, such as access to infrastructure and skills, access to transportation hubs, the availability of support services, training and academia, and proximity to relevant government agencies.<sup>5</sup> Nevertheless, global competition for FDI is fierce<sup>6</sup> and only a small percentage of cities are consistently chosen as destinations by FDI: According to data from fDi Markets,<sup>7</sup> the top 100 FDI destination cities (out of 8,500 cities worldwide) accounted for 41.2% of all FDI projects from 2003 to 2012. This study sets out to understand what is so special about these urban areas that they can consistently and successfully attract FDI.

The literature on the determinants of FDI points to a wide range of influential factors relating to its destination, such as access to markets, macroeconomic stability, a predictable policy environment, efficient regulations and procedures, a low level of corruption, a well-educated labor force, high-quality infrastructure, and endowments such as a location's historic cultural ties.<sup>8</sup> City-level factors – such as infrastructure provision, labor recruitment and training, access to logistics and transportation services, and the ease of obtaining the permits needed to start operations – can have a significant influence on location decisions. In fact, some cities – such as Bogota (Colombia) and Chennai (India) in the 2000s – were able to focus their efforts on improving city-level conditions and thus were able to differentiate themselves from a weak national image.

The focus of this paper is straightforward: **What factors do multinational firms consider when they make decisions on where to invest, specifically in terms of locating their manufacturing facilities and professional-services staff in a new city? And: What have cities done to influence these location decisions?**

Since current literature has already covered extensively the major determinants of FDI, this paper strives to complement the existing work by focusing on “the last mile” of the

race: the key factors that eventually help *one* city stand out after the final three to four cities are shortlisted as potential locations for FDI. Rather than drawing data at random from a large number of firm samples, this paper has conducted interviews with pre-fixed open-ended questions, semi-structured and in-depth one-on-one interviews with seasoned professionals who witness and facilitate closing many FDI deals. The insights of these professionals – such as location advisory consultants and officials at city or regional investment promotion intermediaries (IPIs) – are probably most relevant.

This study aims to provide answers to the following, more nuanced, questions:

- Which determining factors are *the most important* for which type of firms: For example, manufacturing firms have different requirements from back-office services firms when they decide where to locate their new operations.
- Are there characteristics that *cities* should highlight when they market themselves to foreign investors?
- What are the recommended *dos and don'ts* for city governments based on observations on the ground by IPIs and location advisory consultants?

This study also serves as a reality check, reporting feedback from senior executives who provide location advisory services to multinational firms as well as professionals from city and/or regional IPIs. It distills the findings that seem to be most relevant to city policymakers and decision-makers. We hope that by documenting these experiences we can provide additional insights to answer why *certain cities* successfully attract inbound investment and why other cities fail. Indeed, this type of analysis could help frame the highest-priority actionable recommendations for city leaders who want to increase their odds of attracting, retaining and increasing foreign investment.

## 2. Multinational firms and the investment lifecycle

In this section, we examine how location advisors help multinational firms narrow down the list of their potential expansion locations. While different location advisory firms might employ slightly different methodologies, the general analytical process and rationale are remarkably similar. This section demonstrates that the location-selection process is a multi-dimensional and dynamic exercise, rather than a static or academic undertaking. The concept of investment lifecycle is then discussed, with a focus on the stages of investment-location selection and entry.

In designing investment promotion strategies, it is important for city officials to remember that, when considering location decisions, investors will think through the entire lifecycle of their prospective investments. In other words, they care not just about entry and start-up, but also the continuing operation of business, linkages with local suppliers and other organizations and, eventually, retention, expansion and diversification depending on the investor's overall strategic business model. While this study focuses on perspectives from city-level IPIs, it should be noted that their relationships with the national-level IPIs are important as well. In some sectors, cities compete with other cities that are within the same country. In others, cities have to compete internationally. While this study focuses on the first case as we try to formulate action points for city IPIs, the importance of national-level IPIs in helping cities to get on to international investors' radar screens should not be underestimated.

### 2.1 How location advisors help multinational firms narrow down the list of locations

Location advisors need to **understand the motives or strategic drivers of their clients' investment needs** in order to render their advice relevant. The factors driving investment-location decisions vary considerably by the type of FDI and even by sector. There are four primary motives for expansion by multi-national corporations (MNCs), summarized by the widely quoted Dunning (1993):

- **Market-seeking:** in search of new consumers for the firm's goods or services. This type of investment can be an important source of job creation, particularly of the higher-skilled, better-paid jobs associated with the services sector. (For example: commercial banks, professional-services firms and retail stores of international brands.)
- **Efficiency-seeking:** in search of low labor costs or rationalizing their operation to decrease production and transport costs. This form of investment is almost entirely export-oriented, although business viability can often be built on a strong domestic consumer base. (For example: the automotive, textiles and electronics sectors, as well as back-office processing and call centers.)

- **Strategic asset-seeking:** in search of tangible or intangible assets through investments, acquisitions or alliances with competitors to strengthen a market-leading position, e.g. acquire advanced technology owned by competitors, access to broader specialized workforce, access to shared knowledge through networking and sharing within the industry. (For example: cultural or historic tourism ventures, or the biotech clusters near such cities as San Diego and Boston.)
- **Resource-seeking:** in search of cheaper natural resources and raw materials. (For example: international oil companies, mining companies or hydropower companies.)

**Efficiency-seeking investment has the most transformative potential of all types of foreign investment**, with its ability to transfer technology and skills and to diversify an economy rapidly by inserting it into global value chains for internationally traded goods and/or services. Resource-seeking and, to a great extent, strategic asset-seeking FDI is usually "pulled" into a location by the existence of the strategic or natural resources that investors are seeking. Market-seeking and efficiency-seeking FDI, by comparison, are typically mobile, with investors making location choices. It is this more mobile investment that cities typically compete for.

For these mobile investments, regardless of the sector, the basic location search and decision process follows the same pattern, according to the interviews conducted:

**First**, with the firm's motives for expansion in mind, location advisors apply a first-level filter to screen out the obvious "non-qualifiers" based on each country's **macroeconomic environment and political and social stability** – creating a long list of possible locations, often 10 or 20 locations. In the context of developing economies, macroeconomic systemic risks can be very high for investors, especially for first mover investors. For example, in 2008 and 2009, Cairo received substantial traction from investors as an upcoming destination for FDI, but the momentum was lost overnight as a result of the "Arab Spring."

**Second**, using project-specific criteria, the long list is refined into a short list of three to five locations for more detailed analysis. Advisors benchmark the long-listed cities among each other, using project-specific and determinant metrics (such as the quality of infrastructure, the cost of labor and the quality of life) to narrow down the list. In practice, this is done through a **site-selection scoring exercise**, with different weights assigned to factors to take into account the motives for expansion.

**After these first two stages**, detailed due diligence on the ground is conducted on the shortlisted locations, including site visits, to help executives reach a final decision. At this stage, firms start the **negotiation** process with governments, often with the local IPIs. The negotiations include

discussions on incentives, land and property availability.<sup>9</sup> They also aim to validate the information collected so far.

The views of primary corporate decision-makers are paramount in the decision-making process. This includes their personal experiences in interacting with local officials (Do they trust them? Can they work with them?); their cultural and national backgrounds and expectations; their vision for the firm; their preferences for risks;<sup>10</sup> their comfort levels with their local partners; and their individual needs in terms of quality of life for their families and staff. These can often be deciding factors in the final decision.

## 2.2 Understanding the investment lifecycle

In light of the significant benefits brought by FDI, competition among cities for foreign investment is high. City-level policymakers and officers working in investment promotion at the municipal level need to understand the investment lifecycle and the investors' needs in each of its stages, so that more targeted and cost-efficient efforts can be employed to attract investment. It is also important for the city to have the appropriate policy mix to attract, establish, retain and increase FDI and to create strong linkages between foreign investment and the domestic economy.

Figure 1 lays out the investment cycle to highlight key requirements by investors at the investment-attraction, entry and operations stages and to try to link those requirements to the roles that city administrations and their IPIs can play at each critical stage. The focus of this study is the phases that are more closely related to the location-choice decision-making process and to the early entry stages of the investment cycle – specifically, investors' needs at stages 1, 2 and 3 in the figure below. Please see Appendix 4 for a description of the full investment cycle that goes beyond investor attraction and operation. The full investment lifecycle also includes retaining investors and fostering linkages between FDI and the domestic economy.

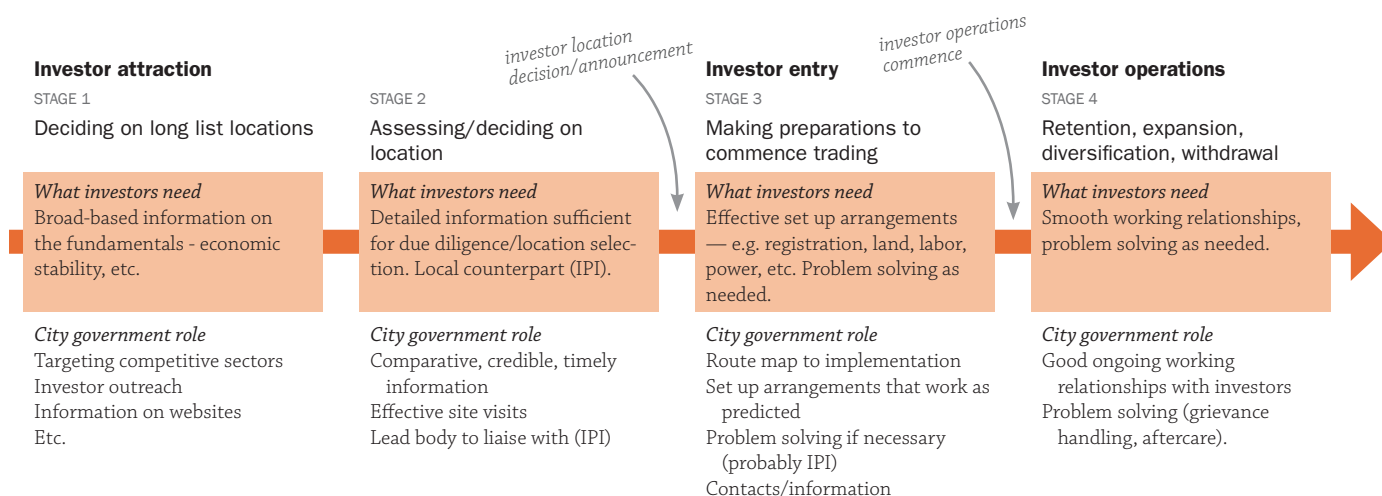
The main purpose in Stage 1 is for cities to get onto investors' long lists. This includes efforts by city-level governments to develop a clear city strategy and business proposition for investors, to build up the city's image, and to have sector-focused outreach activities. There is also considerable room for cooperation between national-level and city-level promotion intermediaries at this stage. National-level IPIs can help cities get onto the investors' long lists by promoting the overall country as an investment destination.

In Stage 2 – which is known as the short-listing and decision stage – cities are more directly involved and in many ways in the lead. At this stage, the investor's choice has come down to specific locations, with the investor seeking more detailed information to make its decision, including potential support from government, to identify and ensure the factors necessary for it to do business in the selected location. At this stage, cities try to become a finalist on the short list by offering timely, effective and efficient facilitation services to investors. Investors are usually eager to know more about infrastructure, local talent, mobility for employees, access to suppliers, connectivity with the outside world, and the availability and cost of industrial, office and commercial space. Being able to anticipate and meet investors' specific requirements for business entry, operations and growth helps cities stand out in this stage.<sup>11</sup>

In Stage 3, city governments or IPIs help investors prepare for and finally begin operations. This usually requires IPIs to coordinate with different government agencies and to provide the right contacts and information to help an investor establish its operation in the shortest possible time.

In Stage 4, cities build longer-term relationships with investors in order to help them operate efficiently and ultimately to retain, expand or diversify their business. Providing services to help investors resolve specific operational problems is an important element of the services offered at this stage.

**Figure 1. Investor needs and role of city governments**



Source: Internal documents from Investment Policy and Promotion team, The World Bank Group



### 3. What do multinational firms consider when making location decisions?

**Investors always invest locally**, usually close to urban centers where they can find the right mix of policy, infrastructure and labor. This factor highlights the importance of cities in firms’ location choice: It is local conditions that ultimately drive firms’ final decisions, and many of them can be directly influenced by local governments.

This section summarizes the key factors that multinational firms consider when making location decisions. The research is based on in-depth interviews with 16 professionals working in location advisory services firms as well as IPIs worldwide. These findings are based on discussions with practitioners, who are working “on the ground,” actively engaging in shaping the location-decision process. They both serve as a reality check and provide a list of simple dos and don’ts for policymakers. The findings are heavily focused on the investor-attraction and entry stages of the investment lifecycle.

#### 3.1 The Fundamentals: The main decision factors during investment attraction stage

**The fundamentals of a city – such as its institutions, infrastructure, human capital and its legal and regulatory environment – explain most of investors’ location-choice decisions.** These fundamentals of a city affect the day-to-day business operations of a firm. Several interviewees also pointed out that, as the competition for FDI has become fiercer in recent years, non-physical factors such as labor skills and costs have risen in importance.

**Table 1 Major factors that foreign investors consider when they make location-choice decisions**

Category	Factor
<b>Location endowment</b>	Proximity to major markets/distributors Natural resources
<b>Relationship with city</b>	Personal connections between firm and city “Soft power”: city image, proactive mayor, proactive and responsive IPIs
<b>General business environment</b>	Macroeconomic stability and growth potentials Institutional and regulatory environment Labor availability, skill, and cost Infrastructure and availability of land “Sweetener”: fiscal and nonfiscal incentives
<b>Level of sector development</b>	New opportunities due to a neighboring country or city moving up the value chain Presence of forward- and backward-linkages firms Presence of similar firms/competitors

**The location endowments of a city, as well as the personal preferences of top corporate decision-makers, often play a big role in firm location decisions.**<sup>12</sup> Location endowments could include proximity to major consumer markets, proximity to distribution routes, and access to natural resources or raw materials. These location factors can be complemented by more personal factors, such as the rapport or cultural fit between the firm and the city, and sometimes even by the CEO's personal preferences.<sup>13</sup> These, more “fuzzy” factors often affect the firm's final location decisions. Table 1 above lists the major factors that firms consider when making location-choice decisions, across four broad categories and their associated sub-factors: 1) location endowment factors; 2) the relationship between firms and cities; 3) the general business environment, and 4) the level of sector development of a location.<sup>14</sup>

From conversations with location advisors, firms in different sectors or with different motives for foreign expansion will have different priorities in evaluating these location factors. One critical policy implication for cities is that they don't necessarily control all the vital factors that go into such decisions: Some fall under their purview, others can be influenced, and still others can only be influenced by regional or national policy. Cities that seek to position themselves well, with regard to specific types of businesses and sectors that they seek to attract and nurture, should prioritize investments and reforms, especially those that fall within their remit.

**Table 2 Firms in different sectors with different expansion motives have different priorities to consider**

Category	Factor	Level of city influence	Efficiency seeking	FIRM TYPE		
				Market-access seeking	Strategic asset seeking	Resource seeking
Location endowments	Proximity to major markets/distributors	○	✘	✓		
	Natural resources	●	✘			✓
Relationship with city	Personal connections between firm and city	○	✓			
	“Soft power”: city image, proactive mayor, proactive and responsive IPIs	●	✓	✓		✓
General business environment	Macroeconomic stability and growth potentials	○	✓	✓	✓	✓
	Institutional and regulatory environment	●	✓	✓	✓	✓
	Labor availability, skill and cost	●	✓	✓		✓
	Infrastructure and availability of land	●	✓	✓		✓
	“Sweetener”: fiscal and nonfiscal incentives	●	✓			
Level of sector development	New opportunities due to a neighboring country or city moving up the value chain	○	✓	✓	✓	
	Presence of forward- and backward-linkages firms	●	✘	✘		✓
	Presence of similar firms/competitors	●	☀	☀	✓	

○ City has no influence

● City has influence but not full control

● City has major influence or full control

✓ Valued by all firm types (strategic asset-seeking and resource-seeking were not broken out by firm type)

☀ Valued by service firms only (efficiency-seeking refers to back office services; market-access refers to high-end services)

✘ Valued by manufacturing firms only

Note: IPI = Investment promotion intermediaries.

In particular, **if cities try to attract efficiency-seeking manufacturing**, then it will be critical to **fix problems that are related to the import and export of goods and services**, as investors look to use the location as their export base or to consolidate their operations. Such factors include customs permits, transportation and logistics, and the time and cost of goods movement. Such investors are often also more sensitive to factors affecting the movement of key staff – those in the managerial, technical, advisory and marketing ranks, for example. Therefore, entry permits, work

visas and the actual physical logistics of getting people in and out in a timely and safe way are essential. This explains why, on the surface, many cities seem to be able to provide the infrastructure and labor that are needed to attract investors, but, in reality – since many of the relevant regulations and procedures are decided by the national government and the national environment – might not truly be pro-business-oriented. See Table 3 for examples of regulation and procedures that are decided by different levels of government.

**Table 3 Investment attraction-related regulations decided by national vs. city governments**

The overall legal and regulatory framework for FDI is almost always determined at the national level. City entities have to function within those frameworks. Examples of regulations, policies and administrative procedures at both levels include the following:

<b>National</b>	<b>City</b>
Trade/Investment agreements	Local one-stop shops
Export/Import licenses	Construction permits
Customs	Technical certificates
Visas	Activity licenses
Company registration	Property registration
Foreign purchase/ lease of land permits	Land use certification
Sector incentives	Local incentives
FDI sector restrictions	
Income taxes	

- City entities can “lobby” their central government for changes/improvements in conditions for FDI investment decided at national level (e.g. customs, export/import licenses, visas, etc.)
- City IPIs, however, may have a strong role in fast-tracking investment procedures at the city level, e.g., company startup licenses, construction permits, etc.
- Even under the same overall regulatory framework, differences in the performance of local administrative and regulatory bodies can make an important difference.

Offering the optimal mix of quality and cost of operation makes cities stand out: In the eyes of multinational firms, a competitive location is one that provides the optimal mix of quality and cost. Higher-end activities, such as financial services, require a high-quality operating environment<sup>15</sup> and so are not purely cost-driven, while the opposite is true for some cost-sensitive operations. Therefore, knowing a city's position in the cost-quality tradeoff, and attempts to target firms that require a similar cost and quality profile, might be more effective than attempts to attract any specific firms. This also means that a competitive city does not have to be a London or a New York: Instead, standing out among peers that have similar cost-quality profiles can also yield a valuable reputation.

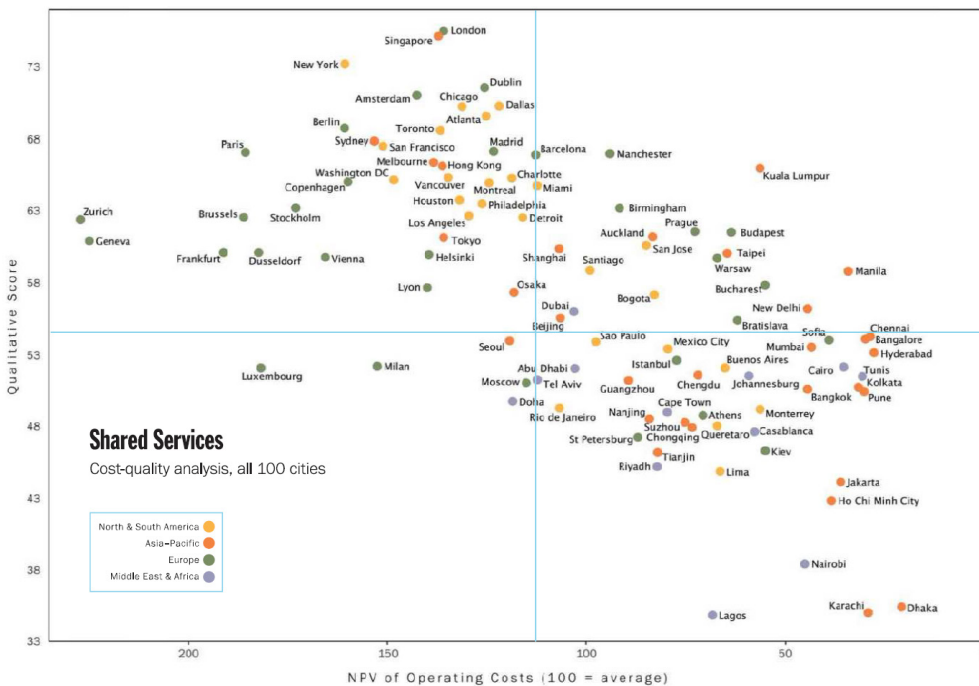
An example from the 2013 *The World's Most Competitive cities* report shows that, for a foreign investor seeking to set up a shared-services center (which provides various back-to-middle-office support functions to corporate operations, such as IT or customer support), cities like Kuala Lumpur and Budapest managed to position themselves as cost-attractive while scoring well with regard to factors related to business operations (such as talent, infrastructure and connectivity). While cities like London and Singapore probably provide a better environment for business operations, these are also

*“Average costs of labor of a country or a city often times mask the reality on the ground. A country might have a very low average labor cost as reported in their official statistics, but the labor cost for a specific skill-set or in a particular sector can be very high due to a shortage of those skills.”*

—Jacob Dencik, Senior Managing Consultant at IBM Global Business Services

accompanied by much higher costs. When companies make location decisions, they will opt for the mix of quality and cost that best suits their needs. For example, if an investor is mainly driven by low cost, the cities further to the right of Figure 2 may be more attractive, even if they offer a relatively lower quality. Conversely, if a company cares more about the quality of the location than about the costs of operations, then the cities in the top-left quadrant might stand out, despite their higher operating costs.

**Figure 2: An example of the quality and cost trade-off of a location**



Source: Site Selection Magazine & IBM Global Business Services (2013)

### 3.2 Individual perceptions can drive the location-choice decision

**Firms care deeply about the professional capacity of government staff**, including their ability to communicate the city's value proposition, their overall responsiveness to inquiries, and their knowledge of city offerings to match the firms' due diligence. An important element of location-choice decisions is the human-interaction dimension during the final stage of investor attraction and in the entry stage (i.e. Stages 2 and 3, as described in Section 2). The relationships that investors develop with local officials are an essential part of providing the necessary verification and assurance that the firm will be able to establish itself and work effectively in the city. If investors don't trust or can't work with officials at the site-selection stage, they will be skeptical of how they could manage to work with them once the facility is established and in operation. Such details matter very much during these interactions.

Some location advisors refer to this as “the 90–10 guideline” in the location decision-making process, in which 90 percent is about the fundamentals but a significant 10 percent is about these softer factors, or perhaps “the last mile.”<sup>16</sup> **In the last mile of the decision process, a city's IPI can make a huge difference.** While IPIs also play an important role in expediting the realization of some of the fundamentals (such as putting roads, water and electricity in place), it is IPIs' promotion, facilitation and marketing efforts that can often help seal the deal. IPIs not only help cities stand out on a firm's radar screen, but can also – once a few cities have been shortlisted by the firm – help guide the firm's interaction with local officials to influence the firm's final decision.

*“Some city governments who try to attract ‘star’ or ‘big’ companies tend to fail when they do not understand their city's core value for the firms. Understanding their own city's value proposition, being professional in information sharing and being honest about the operational risks that firms might face, tends to be more effective than over-selling.”*

—Jacob Dencik, Senior Managing Consultant at IBM Global Business Services

### 3.3 The benefits of retaining and expanding current investors is sometimes being overlooked

**Attracting new investors is critical to the growth of any city, but working with existing investors to expand and diversify their businesses is more efficient and is probably more productive.** Expansion by current firms accounts for a significant amount of the total FDI received in many countries and cities. Estimates by both location advisors and IPIs put FDI by **new companies** as representing about 20 percent to 30 percent of total FDI, whereas FDI by **existing firms** represent 60 to 75 percent of FDI. Encouraging current firms to expand their operations also appears to be more effective in providing employment and fostering growth.<sup>17</sup> The idea of attracting new firms tends to capture the imagination of political leaders and the news media, but retaining and encouraging the growth of existing firms is much more important, because they represent the majority of FDI inflows.

## 4. What are the key promotion efforts adopted by cities in response to investors' needs?

City IPIs and national IPIs conduct similar activities and share the general objectives of FDI attraction to boost economic growth and development. However, city IPIs, due to their focus only on the city level, have a deeper understanding of the city's strengths and weaknesses and can provide very specific assistance to domestic and international investors. **Attention to detail and to the specific characteristics of cities can be key factors in promoting urban location choices, especially during investors' final decision-making process and during their entry stages.**

### 4.1 Identify and communicate the city's value proposition

**Developing a clear value proposition for the city is a key first step for IPIs during the investor-attraction stage.** To start promoting a city, IPIs need to follow a strategy, which will usually be aligned with regional- and national-level economic objectives. The starting point for a city to promote itself is to understand well its strengths and weakness relative to competitor locations. Based on this initial assessment, IPIs can develop a clear and effective value proposition to market a city's comparative advantage to potential investors.

*“Welcoming Glasgow’s business leaders into the shaping of the city’s value proposition brought some reality to the task. CEO’s who trade and invest abroad will usually see their own city through much more dispassionate eyes.”*

— Stuart Patrick, CEO of Glasgow Chamber of Commerce

Different cities have different characteristics, and therefore they need to build up specific business propositions to attract companies from a variety of economic sectors. However, no city can compete in every sector. For example, in the case of Bogotá, after analyzing different options, the city decided to focus its efforts on trying to attract investors from the shared-services sector. The city seemed to have a competitive advantage in the call-centers business: Bogotá was able to provide an adequate level of well-educated and skilled labor, and was able to provide the office space needed at comparatively lower costs compared to other domestic locations. Bogotá was thus able to take this sector to a higher-value-added segment (i.e., IT services) when faced with competition from other Colombian cities entering the call-center market. It was also able to build up a strong offer to international firms, allowing Bogotá to grow and progress up the value chain.

### 4.2 Building a city's image to make it on to investors' radar screens

Cities that successfully attract and retain FDI typically have a good international image. Issues of security risks, corruption, poor infrastructure and unstable political systems contribute to a ruinous image. These fundamentals must be addressed if a city is to get onto investors' radar screens.

There are also cities that have enjoyed significant improvements but where a **reality-perception gap** remains – for

*“We spent quite some time doing pro-active city image promotion. Bogotá had changed, but people did not know it. City branding does not have to do with flashy videos but with a more important set of things: culture, talent, events and architecture.”*

— Virgilio Barco, Former staff at Invest in Bogotá

example, cities where potential investors' perceptions are still poor, despite the cities' improvements in infrastructure, education levels, security and other critical areas. In these situations, having an effective marketing and promotional mechanism, such as a well-functioning IPI, will be important to communicate the good news. In order to project an attractive image internationally, IPIs need to project a clear vision backed up with sound data to illustrate the improvements. For example, the Washington D.C, Economic Partnership figured out an appealing way to package and present data about the growth in its residents' spending power to prospective investors. This helped address the negative perception gap about Washington that existed among potential investors, and it successfully attracted a significant number of retailers to open stores in downtown Washington.

### 4.3 Effective cross-unit coordination and nurturing local networks

In practice, city IPIs (or other local institutions playing this role) undertake pro-active investment promotion, but investors often come looking for information. Investors (or their location advisory consultants) who approach cities usually already have some knowledge of the location: They are not seeking general information (related to such factors as macroeconomic trends or political stability) but are seeking data about local skills and labor quality, access to local clusters, the quality of services, the quality of the local infrastructure, the quality of life and specific costs of utilities. **Comparable, credible and timely information is key in helping investors who are making the final location decisions.**

*“In the case of Glasgow, the ‘Team Glasgow’ approach was one of the most important pieces of our successful story. The public-private sector cooperation enabled and facilitated the change that the city needed.”*

— Gordon Kennedy, Former Deputy Chief Executive at Scottish Enterprise

Coordination among the different institutions and government agencies involved in the city’s economic and business agenda is very important in attracting and facilitating investment. The problems that investors face at the city level often involve factors that are a mix of national and sub-national responsibilities, especially regarding entry arrangements. In order to provide the best solutions to investors, close collaboration is needed among the various levels of government. Being able to establish the right linkages improves the city’s business environment (e.g. smoothing the procedures for obtaining licenses or increasing the efficiency of public services). Investment projects are often lost at the facilitation stage, and this stage is where local coordination is most critical.

Investors appreciate and value local collaboration and partnership. Local partners and networks – such as local government authorities, private-sector associations and education institutions – are more than just data providers; they are ambassadors, facilitators, “connectors” and even initiators of new promotion activities. A good city IPI should always try to build up effective relationships and networks that eventually will benefit international and domestic investors. *Every* city IPI that was interviewed highlighted the importance of partnerships at the city level. **It is this local “know-how” that provides local-level IPIs with their specificity, and that is what ultimately differentiates one local-level IPI from another.**

*“Over the years, we’ve recognized that, while sites and incentives might drive deals, relationships close deals. We pride ourselves on being connectors and offering foreign firms easy access to our community.”*

— Olga Stella, Chief Operating Officer of Detroit Economic Growth Corporation

**To what extent does city leadership affect the investor-attraction and entry efforts?** City leadership must set the tone during the attraction and entry stages. The evidence suggests that this can be a critical factor in galvanizing the city’s team approach (referred to above) and in assuring investors that the city is serious about its efforts to assist investment. The cases of Bogotá in the early to mid-2000s, and Glasgow and Barcelona in the 1980s and 1990s, all illustrate this point. Having strong city leaders was critical in all three cases: First, the fact that the most senior official in the local government was eager to attract investment drew news-media attention and publicity. Second, and more important, all the relevant local government agencies involved worked together to ensure smooth entry for investors. IPIs often have difficulty in getting other agencies to assign a strong priority to FDI attraction. City leaders can make this happen. When the local leadership is less strong or less inclined to give full support to the FDI efforts, investment can be lost if there is a perception of insufficient support for their investment plans.

#### 4.4 Other promotion tools and the role of existing investors: incentives and aftercare services

**The overall role of investment incentives in attracting FDI is not clear-cut in the early attraction stages, but they seem to matter when the race is down to the final two or three cities.** Generally speaking, research into the effectiveness of such incentives demonstrates that generic and widely available fiscal incentives tend to be ineffective in attracting investment. More targeted (SMART<sup>18</sup>) incentives, however, are more effective. Several location advisors reflected during interviews that incentives only start to matter when everything else seems to be equal among competing cities. In other words, the fundamentals matter most, and investors tend to make decisions based on how those factors stack up. Nevertheless, there are some occasions where cities seem equally attractive, and incentives can then play a role: Once the selection is down to the final two or three cities, location advisors and local governments start putting together tailor-made incentive packages for the potential investor.<sup>19</sup> In sectors that seek lower production costs, incentives probably play an even bigger role.<sup>20</sup>

*“Incentives are like the cherries on a tart: You can’t turn a bad location into a good location by providing incentives.”*

— Lee Elliott, Head of Research for Europe, Middle East, and North Africa region, Jones Lang LaSalle

Finally, it is also worthwhile to mention that “aftercare” services and efforts to retain investment by IPIs are extremely important to help existing firms expand operations, although these efforts are not the main focus of this study. Re-investments from established firms send positive signals to new investors. Word-of-mouth is powerful in shaping investors’ location-choice decisions. Prospective investors will talk to current firms in the city in parallel with their talks with – or even before their talks with – local officials. **IPIs should foster positive relationships with existing investors as a promotion tool.** If executed well, the IPI can help the city “*make an impression when a company is considering further overseas expansion*” fDiIntelligence (2015).



## 5. Conclusions

**Interviews with location advisory firms suggest that cities compete for foreign investments primarily on such fundamentals as the quality of their institutions, the strength of their infrastructure, their availability of suitable human capital and their overall investment climate.**

Some fundamentals can be fixed directly by cities (e.g. infrastructure and labor skills), while some are under the purview of the national government (e.g. investment-climate reforms, business regulations and tax codes). The fundamentals explain the majority of location-choice when multinational firms seek to expand into new markets. However, other factors can and do play a role. These “softer” factors – such as the professionalism and responsiveness of cities to investor needs, and the overall image and quality of life that cities present to corporate leaders – often tip the balance of a decision between one city and its two or three closest competitors in securing an investment. Investment promotion intermediaries are essential in expediting the provision of some of these fundamentals, but the role they play is also critical in “the last mile” of the decision-making process, when softer factors help close deals.

**Our interviews also suggest that FDI determinants vary by the type of investor, and that cities need to develop a value proposition that is nuanced according to the city’s comparative advantages.** A city first needs to understand its existing value proposition and what needs to be done to improve it (such as through investments in infrastructure or pushing for business regulatory reform). The city should then try to identify which types of investors are most likely to be interested in the city’s value proposition. Investor outreach and promotion efforts can then center on communicating the city’s identified comparative advantages to its targeted investors. As explored in Chapter 3, some of these investments or reforms can be directly enacted by cities, while others require leveraging other tiers of government and private-sector partnerships. If cities face limitations in

influencing some factors that are important to certain types of investors, then targeting investors in those sectors will be more difficult. Targeting sectors that cities can affect, either through their direct administrative remit or by leveraging other tiers of government, might be a better and more efficient way of demonstrating to investors that the cities not only are able to **identify** their core competitiveness, but also are able to **deliver** what they say they are good at. Some interviewees also urge city leaders to pay attention to new globalization trends. For example, the current expectations of a city’s value could change in the future under different scenarios of globalization: The reshoring of manufacturing activities that are currently offshored for cost reasons, for instance, could have a huge impact on many cities.



**Cities’ IPIs also need to go the extra mile to promote the city, to provide compelling information, and to coordinate different government departments’ action to meet potential investors’ specific needs.**

Investment Promotion Intermediaries at the city level can make a difference if they develop the right set of activities to provide to investors. This is especially true in the final stage of the decision-making process, where cities can influence the final decisions. The overall impression and confidence that firms develop while interacting with IPIs and other city authorities will be determined by the level and quality of coordination within local institutions and agencies, by the efficiency demonstrated by the city institutions when they respond to specific and difficult questions, and by the overall effectiveness of the services provided. “Aftercare” services to retain current investors should not be ignored, either. Word-of-mouth from existing investors is the most effective marketing tool to attract new investors. Finally, visionary leadership, combined with reform-minded and business-friendly government, is crucial in helping cities stand out in investment attraction and entry, which ultimately will lead to continuing economic development and stronger job creation.

## 6. Recommendations

We provide policy recommendations in this section, based on the evidence discussed earlier in this paper, to help cities attract multinational firms to locate in their cities. There is no dispute that cities compete primarily on the basis of the city's fundamentals: their investment climate, their infrastructure, their labor skill sets, and the quality of their institutions. However, competition for FDI is fierce, and there is still a need for cities to go beyond the fundamentals.

This section is especially relevant for secondary cities in developing countries that have invested in improving their fundamentals but that still face limited success in attracting FDI. The table below highlights extra efforts that successful FDI-attracting cities make. It also underscores some common mistakes that location advisors and practitioners say cities should avoid.

<b>Do</b> 	<b>Who best to initiate/ coordinate this?</b>	<b>Key actions...</b>
<b>Establish a key role for the city's leadership</b>	Mayor/ City governor	<ul style="list-style-type: none"> <li>Set the tone and clarify the city's comparative advantage</li> <li>Pro-actively communicate the city's business proposition to investors</li> <li>Find mechanisms (e.g. local partnerships, committees, sector focus groups, etc.) that enable the city to align various incentives and interests from different parties</li> <li>Empower and provide resources to the city's investment promotion intermediary, so that it has properly qualified and trained staff, sufficient budget, and access to the necessary statistics and information that can help them deliver a professional level of service to investors</li> </ul>
<b>Promote effective partnerships &amp; coordination</b>	City investment promotion intermediary/ relevant city body	<ul style="list-style-type: none"> <li>Form partnerships not only across government agencies at the city level and but also with other levels of government (e.g. at the regional or national levels) to help smooth the investor's entry process</li> <li>Foster partnerships with private-sector players in key sectors, since they can also play a significant role in the city's promotional efforts – illustrating that the city is attractive to investors</li> </ul>
<b>Implement effective marketing</b>	City investment promotion intermediary/ relevant city body	<ul style="list-style-type: none"> <li>Maintain an investor-relevant website with access to high-quality city information and statistics<sup>21</sup></li> <li>Build the capacity of staff to professionally handle investor inquiries and to pursue needed follow-up</li> </ul>
<b>Build effective monitoring systems</b>	City investment promotion intermediary/ relevant city body	<ul style="list-style-type: none"> <li>Establish an effective investor tracking system to manage long-term relationships with investors, from first contact to aftercare</li> </ul>
<b>Don't</b> 		
<b>Don't oversell &amp; overpromise</b>		<ul style="list-style-type: none"> <li>Any over-stretched marketing claims or exaggerations, or any errors in data, will almost certainly be spotted and will detract from the city's offer.<sup>22</sup> Multinational firms conduct careful due diligence before they start negotiating directly with city governments, and they verify all the facts before making the final location decision.</li> <li>Don't promise things that are beyond the city's control.<sup>23</sup> This is especially problematic in the context of the need to coordinate different interest groups among county/city/region officials.</li> </ul>
<b>Avoid unaffordable incentive packages</b>		<ul style="list-style-type: none"> <li>An incentive that has a positive economic impact can have a negative fiscal impact on cities. Being able to differentiate and calculate the economic and fiscal impact of incentive packages given to investors is critical to keep the city's finances balanced.<sup>24</sup></li> <li>Incentives matter when the final race comes down to two or three similar cities, but, if certain incentives are found to be unaffordable or not effective, they should be dropped.</li> </ul>

## **APPENDICES**

## Appendix 1: Deciding factors by MNC expansion motive

<b>1) Market-seeking MNCs:</b>	<ul style="list-style-type: none"><li>• Market size and per capita income</li><li>• Market growth</li><li>• Access to regional and global markets</li><li>• Country specific consumer preferences</li><li>• Structure of markets</li></ul>
<b>2) Natural resource-seeking MNCs</b>	<ul style="list-style-type: none"><li>• Access to raw materials</li><li>• Access to natural resources</li><li>• Access to low-skilled labor</li></ul>
<b>3) Strategic asset-seeking MNCs</b>	<ul style="list-style-type: none"><li>• Access to skilled labor</li><li>• Access to new competitive advantages, e.g. coming from firm-specific technological and other created assets (e.g. brand names)</li><li>• Availability of and access to strategic infrastructure (e.g. ports, roads, power, telecommunication, oil pipelines)</li></ul>
<b>4) Efficiency-seeking MNCs</b>	<ul style="list-style-type: none"><li>• Cost of resources and assets listed under resource- or asset-seeking</li><li>• Other input costs, especially transportation and communication costs</li><li>• Costs of other intermediate products</li><li>• Membership of a regional integration agreement conducive to the establishment of regional corporate networks</li><li>• Low-cost unskilled or skilled labor</li><li>• Different comparative advantages of countries</li><li>• Better deployment of global resources</li></ul>

Source: UNCTAD (2010)

## Appendix 2: Deciding factors by MNC Sector

Using the secondary sector (manufacturing) for example, locations in **developing countries** that have seen strong FDI inflows also tend to have lower real exchange rate (i.e. cheap local currency), high FDI stock in the past, better labor-market flexibility, better financial depth, and higher-quality infrastructure. For locations in **advanced economies**, strong FDI inflows in the secondary sector are also correlated positively with high FDI stock, labor-market flexibility and infrastructure quality, but are negatively correlated with judicial independence, financial depth and secondary-school enrollment.

Summary of Qualitative Variables' Impact on FDI Inflows			
	Primary FDI	Secondary FDI	Tertiary FDI
<b>Macroeconomic</b>			
Openness	...	...	+
Real Exchange Rate	...	--	+
GDP Growth	...	...	+
FDI Stock	...	+	+
Average Inflation	...	...	...
GDP per capita	...	...	--
<b>Qualitative/Institutional</b>			
Labor Market Flexibility	...	+(dev); +(adv)	-(adv)
Judiciary Independence	...	-(adv)	+(adv)
Legal System Efficiency	...	...	...
Financial Depth	...	+(dev);-(adv)	+(adv)
Infrastructure Quality	...	+(dev); +(adv)	+(dev)
Primary Enrollment	...	...	...
Secondary Enrollment	...	-(adv)	...
Tertiary Enrollment	...	...	...

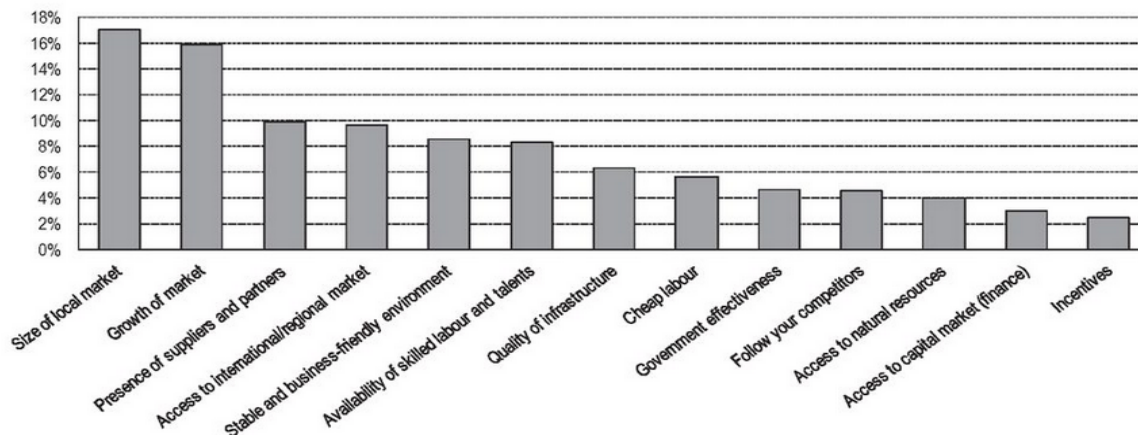
+ represents significantly positive, - represents significantly negative, 'dev' represents developing countries, and 'adv' represents advanced economies.

Source: Walsh and Yu (2010)

## Appendix 3: Example of Survey Results of Determinants of FDI Location

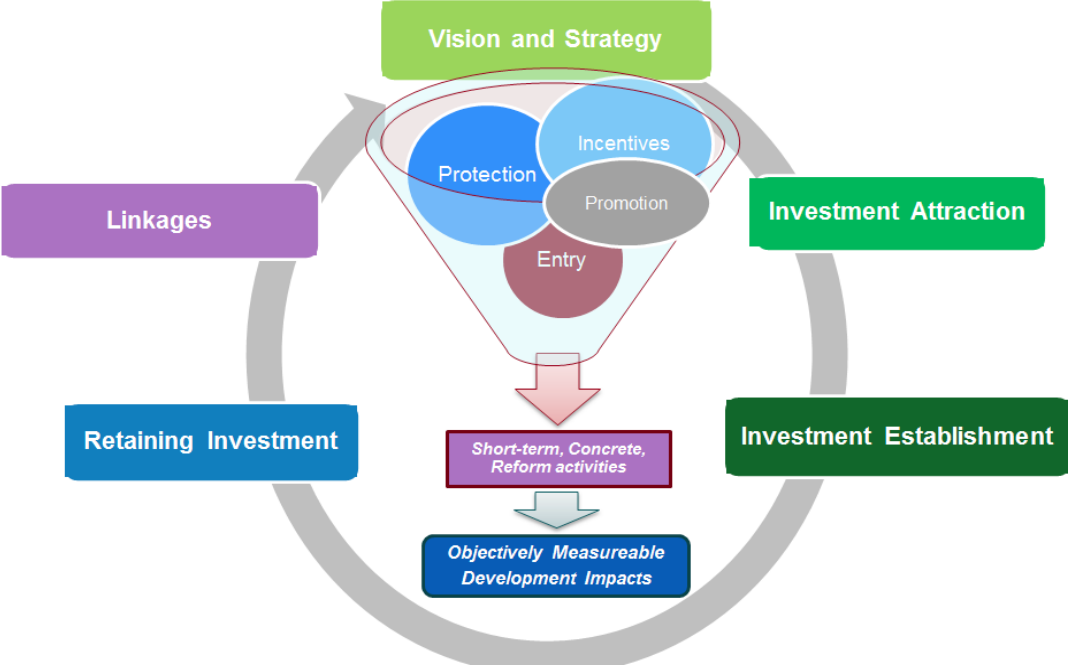
Figure 2.1. Location factors by order of importance, 2009-2011

% of company responses



Source: World Investment Prospects Survey 2009-2011, UNCTAD (2012)

# Appendix 4: A typical investment lifecycle



Source: Internal Documents, Investment Policy and Promotion team, The World Bank Group

## Notes

<sup>1</sup> World Bank Group (2015) *Competitive Cities for Jobs and Growth: What, Who and How?*

<sup>2</sup> The UNCTAD 2012 World Investment Report calculated that FDI contributed to 12.2 % of total value added, and 7.9% of total employment in developing economies.

<sup>3</sup> For example: in the automobile industry in India, for every 100 jobs generated in automobile manufacturing, 300 more jobs are generated in auto-component and body-building manufacturing. Additional jobs are generated through auto services (such as dealerships, auto finance and auto insurance). See Bhasker (2013).

<sup>4</sup> The literature shows that the impacts of FDI can depend on which sector the FDI belong to, and the absorptive capacity of host countries. See Alfaro (2003) and Durham (2004) as examples.

<sup>5</sup> See this article using Boston as an example why certain cities attract so much FDI: <http://www.betaboston.com/news/2014/05/27/why-boston-attracts-so-much-foreign-direct-investment-a-global-perspective-on-our-city/>

<sup>6</sup> There are estimates of 1,000 or more investment promotion intermediaries (IPIs) worldwide.

<sup>7</sup> FdiMarkets, FDI Intelligence, Financial Times

<sup>8</sup> Current literature that explores location determinants of FDI by multinational corporations (MNCs) when they expand to new markets can be summarized in the following four categories: 1) papers that study location determinants as driven by the primary motives of FDI (see appendix 1); 2) papers that study determinants by type of sector (see appendix 2); 3) papers that survey the determinants by ranking (see appendix 3); and 4) many more academic papers that use econometric methods to test the significance of specific determinants (see Sánchez-Martín et al. (2014), Cheng and Kwan (2000), and Nunnenkamp and Mukim (2012) as examples).

<sup>9</sup> Most Fortune 100 firms also use one of the top global real-estate firms to broker these types of transactions.

<sup>10</sup> Risks here can be a combination of systematic country/political risks and idiosyncratic project risks.

<sup>11</sup> Although some countries are able to establish themselves as attractive FDI destinations, unique challenges still exist for cities located in less-developed areas of those countries, especially those without a track record of attracting FDI. In this situation, the lesser-known city's challenge is often to persuade investors already located in, say, the country's better-known or larger cities to expand into their area. The lesser-known cities might, for example, reach out and establish representative offices in the country's major cities with a view to targeting investors that are operating in those big cities.

<sup>12</sup> In fact, from a fixed-effect model econometric exercise utilizing the fDi market database, time invariant fixed factors, such as a city's endowments explain 70 percent to 90 percent of the reason why FDI flows into a certain location.

<sup>13</sup> An extreme example of this is Tony Hsieh, Zappo's CEO, who decided to buy 60 acres of land and 100 buildings in downtown Las Vegas to build his own "startup paradise": <http://www.bloomberg.com/bw/articles/2014-12-30/zappos-ceo-tony-hsiehs-las-vegas-startup-paradise>.

<sup>14</sup> This list is compiled based on conversations with location advisors. It is not meant to be exhaustive, but it strives to capture the major factors.

<sup>15</sup> A high-quality-operating environment, in this realm, mainly includes a good combination of business environment, talent pool, infrastructure and connectivity.

<sup>16</sup> The 90-10 guideline is illustrative only. It is likely that this balance between the hard fundamentals and the softer factors will vary substantially by sector, business type and even by individual corporate decision maker.

<sup>17</sup> Hortaçsu and Syverson (2009) document that existing firms in a location, regardless of whether they are vertically or horizontally integrated, are often more productive. They argue that firm size helps explain productivity variation among firms.

<sup>18</sup> SMART incentives are designed to target specific goals (e.g. sector- or technology-specific goals, or indeed social and labor market goals). The acronym stands for "Specific Measurable Achievable Relevant Timely."

<sup>19</sup> See these examples on how New Jersey and Chicago are able to use incentives to attract investors – although the generous incentive packages they give out also receive criticism, and skeptics raise doubts about whether they are necessary: [http://www.nytimes.com/2014/06/12/nyregion/with-tax-incentives-new-york-and-new-jersey-fight-for-jobs.html?\\_r=0](http://www.nytimes.com/2014/06/12/nyregion/with-tax-incentives-new-york-and-new-jersey-fight-for-jobs.html?_r=0); [http://chicagoist.com/2012/11/12/united\\_airlines\\_to\\_return\\_56\\_millio.php](http://chicagoist.com/2012/11/12/united_airlines_to_return_56_millio.php).

<sup>20</sup> This observation is also largely consistent with findings from several studies examining the role and the extent to which incentives matter, e.g. James (2009).

<sup>21</sup> See these good examples: Invest in Bogota: <http://en.investinbogota.org/>; Invest Hong Kong: <http://www.investhk.gov.hk/index.html>

<sup>22</sup> Similarly, many cities tend to communicate well their general value proposition, but not specific details or advantages which are more interesting to investors.

<sup>23</sup> For example, underestimating the number of days required for imported goods or equipment to clear customs, offering land that has not been secured.

<sup>24</sup> Economic impact measures changes in local employment, business activity, earnings, and income as a result of the incentive package while fiscal impact is more focused on measuring changes in the revenues and costs for local governments. For example, to attract advanced manufacturing firms that are capital-intensive, a city can offer an incentive package of free land, infrastructure built specifically for the firm, and income tax abatement. The city can see direct positive economic impacts on job creation by the company. However, if these additional costs to the governments cannot be covered by other income streams, this incentive package will create a negative fiscal impact on the city: Eventually, this cost either must be covered by city debts or must be borne by someone else. Use cost-benefit calculations to ensure that the positive impacts on incentives offered outweigh their costs. See this article for example: Texas had to cut public education spending by \$5.4 billion to balance its statewide budget, after it offered \$19 billion worth of incentives to corporations: [http://www.nytimes.com/2012/12/03/us/winners-and-losers-in-texas.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2012/12/03/us/winners-and-losers-in-texas.html?pagewanted=all&_r=0).



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