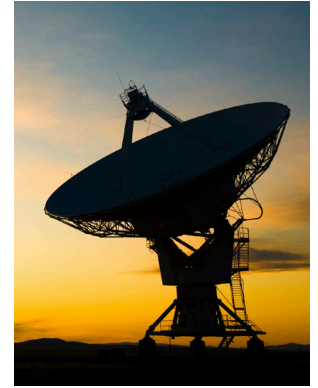
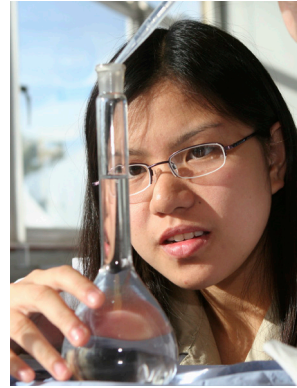


McKinsey Global Institute



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Growth and competitiveness in the United States: The role of its multinational companies



US multinational companies as a percentage of all US companies

<1%

the share of the total number of US companies accounted for by US multinationals

11%

the share of private sector employment growth generated by US multinationals since 1990

19%

the share of the private sector work force employed by US multinationals in 2007

25%

the share of private sector wages paid by US multinationals in 2007

25%

the share of total US private sector gross profits earned by US multinationals in 2007

31%

the share of growth in real private sector GDP accounted for by US multinationals since 1990



37% multinationals' share of total US goods imports in 2007

41% the gains in labor productivity accounted for by US multinationals since 1990

48% multinationals' share of total US goods exports in 2007

53% the gains in labor productivity accounted for by US multinationals during periods of economic expansion since 1990

74% the share of the nation's private sector R&D spending made by US multinationals

90% the share of US multinationals' intermediate inputs purchased from other US-based firms

Executive summary

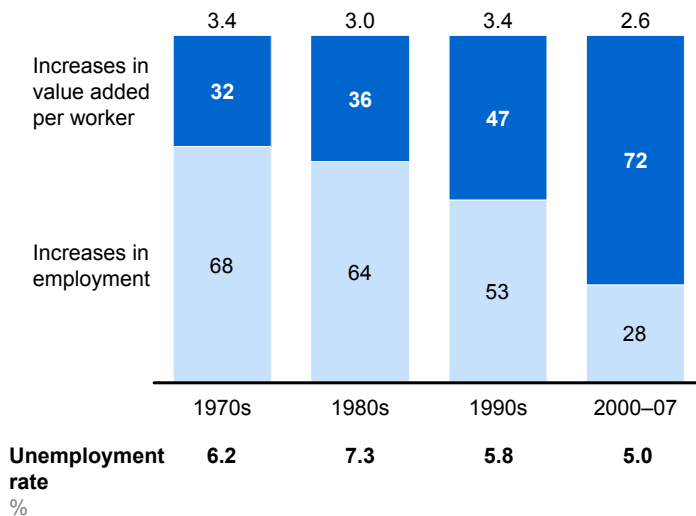
With the US economic recovery under way, government and business leaders are seeking to identify and nurture future sources of economic growth. These will include the contributions of large and small companies. Both types of companies are necessary, and both contribute differently to the performance of the economy. In this report, we focus on the contributions of US multinational corporations and examine the shifting global landscape in which these companies compete and make choices about where to participate and invest.

In summary, we find that, relative to their size, US multinational companies contribute disproportionately to private sector real GDP growth (or value added) and labor productivity. These metrics matter because productivity increases have delivered nearly three-quarters of US real GDP growth from 2000 through 2007, with the rest coming from employment gains—the reverse of the situation 30 years ago (Exhibit 1). Multinational companies’ record on employment growth is mixed across sectors and business cycles. They are more concentrated than other companies in globally competitive sectors (such as manufacturing) that were hard hit in the 2001 recession, yet they have played a critical role in fueling the expansions that followed past recessions. Therefore, these companies could potentially play a similar role, contributing to growth in the current recovery and beyond through their continued strong participation in the US economy.

Exhibit 1

Labor productivity has become the dominant driver of US GDP growth

Growth in real GDP, nonfarm business sector
Average annual change (%)



SOURCE: Bureau of Economic Analysis

However, the global context in which these companies compete and invest is shifting. The United States retains many strengths that make it one of the most attractive markets for multinational companies' participation and investments. But numerous fast-growing emerging markets and some advanced economies are making huge strides in increasing their attractiveness, and are thereby influencing how multinationals decide where to participate and invest. Thus, the United States has entered a new era of global competition for multinational activity. Given the importance of multinationals to the US economy, it is critical that they compete—both at home and abroad—on at least an even basis against companies domiciled in other countries.

US policy makers can influence this race. They can recognize how the economic landscape is shifting and play to US strengths—free markets, a highly educated and skilled labor force, openness to foreign workers, and support for innovation. With the right policies, the United States can keep and attract multinationals, enable new ones to emerge, and create an environment that allows them to grow and thrive around the world. At stake is far more than the value of specific investments and related jobs. For with these investments and jobs comes the dynamism generated in an economy by the presence of these productive and globally competitive businesses.

Multinationals are the US companies most exposed to global competition. However, many other US companies—particularly those that rely on global customers, supply chains, and business networks—confront the same pressures and choices. Therefore, US multinationals may serve as a “canary in the coal mine” of the US economy, providing some indications of how other companies, and indeed the economy as a whole, may respond to increasingly intense global competition.

Because so much is at stake, US multinationals' increasing activities abroad often raise questions about their economic impacts at home and their reasons for expanding elsewhere. To address such questions, we analyzed the data, reviewed the academic literature, and drew on our prior research on sector competitiveness. To gain additional insights, we interviewed senior executives from 26 of the largest and best-known US multinationals and examined how they make investment decisions.¹ These companies have a combined market capitalization of nearly \$2 trillion and annual sales of \$1.5 trillion, and they employ 2 million US workers.²

1 The executives participated in the interviews on condition that they and their companies not be identified by name. Throughout this report, any references to specific companies are drawn from public information.

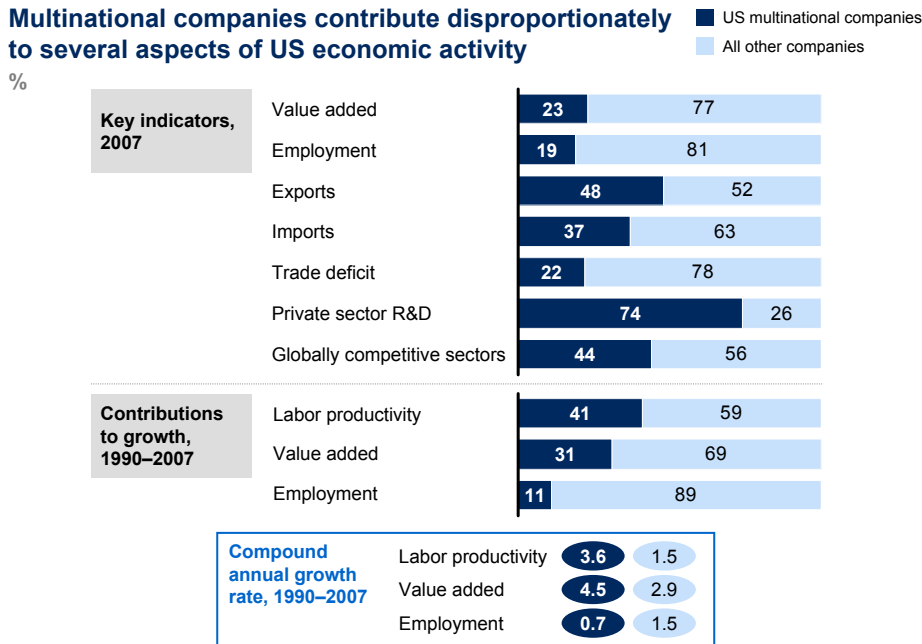
2 Based on the most recent annual reports as of February 2010 and market capitalization on February 9, 2010.

US MULTINATIONAL COMPANIES MAKE DISPROPORTIONATE CONTRIBUTIONS TO THE US ECONOMY

US multinational companies include some of the most famous brand names in the world, and they operate in a wide range of industries. Although they have foreign affiliates, these 2,270 companies operate primarily in the United States. In 2007, they generated 60 percent of their collective sales, employed two-thirds of their workforce, paid three-quarters of their total wages, and held 60 percent of their assets in the United States.³ They account for less than 1 percent of all US companies, yet they contribute disproportionately to the US economy’s growth and health in many ways (Exhibit 2).

Exhibit 2

Multinational companies contribute disproportionately to several aspects of US economic activity



SOURCE: McKinsey Global Institute analysis

Specifically:

- While US multinationals accounted for 23 percent of US private sector GDP in 2007, they contributed 31 percent of the growth in real GDP since 1990 and an average of 38 percent of the growth during the two economic expansions in this period.⁴ The concentration of their activities in the most dynamic and globally competitive sectors helped fuel this growth.
- US multinationals accounted for 41 percent of US gains in labor productivity, or real value added per worker, since 1990 and an average of 53 percent of increases during periods of economic expansion. This partly reflects their commitment to the research and development that fuels innovation; US multinationals finance three-quarters of the nation’s private sector R&D spending.

3 The latest complete US Bureau of Economic Analysis survey of US multinational activity was for 2007. Therefore, this report does not cover the effects of the recession that began in December 2007. The bureau has released advanced summary estimates data for 2008. For details, see *Appendix: Technical notes*.

4 Throughout this report, private sector GDP refers to the total value added by the private sector, excluding banks and educational services. See *Appendix: Technical notes* for details.

- US multinationals accounted for almost half of the nation's exports and more than a third of its imports in 2007, resulting in a more favorable trade balance than in the case of other US companies.
- US multinationals accounted for 19 percent of the private sector workforce in 2007 and contributed 11 percent of employment growth since 1990. They fueled a surge in job creation as they led the high-tech boom in the 1990s, but cut jobs during the dot-com bust in 2000. Since 2001, they have created jobs at a pace similar to that of other companies in their mix of sectors.
- US multinationals' employment record since 2000 partly reflects their significant presence in manufacturing, which has been shedding jobs for three decades. Three-quarters of US multinationals' job losses from 2000 through 2007 occurred in manufacturing. Other US manufacturers reduced their employment as well, and by a similar proportion, during this period.
- In addition to their direct impacts on the US economy, US multinationals have a significant indirect, or "multiplier," effect because they purchase approximately 90 percent of their intermediate inputs from other US-based firms. We estimate that adding the indirect effects raises their total contribution to US private sector GDP to 34 percent in 2007. Similarly, they were responsible—directly and indirectly—for 28 percent of US employment.
- US workers earn relatively high wages and benefits when employed by a US multinational. For managerial, professional, and technical employees (nearly one-third of their 22 million workers), US multinationals paid an average of \$102,000 in 2007—37 percent higher than the national average; for all other employees, total compensation was an average of \$45,000, or 13 percent higher.⁵
- US households also share in the wealth created by US multinationals. In 2007, US residents held 86 percent (\$17.5 trillion) of the total market value of all US companies' equities either directly as individual investors or indirectly through pension funds, and retirement and insurance accounts.⁶ In 2007, nearly 58 percent of US households had the rights to a defined benefit or other similar pension plan.

The impact of US multinationals on the US economy depends not only on their ability to win customers at home, but also on their success in serving markets abroad through their foreign affiliates and from a US base. US multinationals' investment in their foreign affiliates, and the resulting job creation and sales overseas, are associated with increases in these same activities in the parent company at home.⁷

5 The data do not allow us to examine how the median compensation per worker of multinationals compares with that of other companies.

6 US Federal Reserve Flow of Funds, third quarter of 2009, Table L.213. This table does not provide separate figures for multinational companies alone. Ownership of US equity by US residents has been over 90 percent for decades, although foreign holdings have been rising slowly over the years. After averaging 7 percent during the 1990s, the share of foreign holdings started rising from 9 percent in 2000 to 14 percent in 2007 and 2008.

7 See, for example, Mihir Desai, C. F. Foley, and J. R. Hines Jr., "Domestic Effects of the Foreign Activities of U.S. Multinationals," *American Economic Journal: Economic Policy* 1:1 (February 2009), 181-203; A. Ebenstein et al., "Estimating the Impact of Trade and Offshoring on American Workers Using the Current Population Surveys," National Bureau of Economic Research (NBER) Working Paper 15107, June 2009; N. Gregory Mankiw and Phillip Swagel, "The Politics and Economics of Offshore Outsourcing," NBER Working Paper 12398, July 2006.

MULTINATIONALS' PERFORMANCE REFLECTS THEIR CONCENTRATION IN GLOBALLY COMPETITIVE SECTORS

US multinationals' record on productivity, growth, and employment partly stems from their concentration in eight sectors—manufacturing, information, professional services, retailing, mining and resource products, finance, wholesale trade, and utilities. From 2000 through 2007—the period on which our sector analysis focuses—these eight sectors accounted for all the productivity growth and nearly 70 percent of the increases in value added in the US private sector.⁸

US multinationals' contributions to productivity reflect the fact that 44 percent of their economic activity is within globally competitive sectors. By comparison, just 24 percent of the activity of all companies is in such sectors.

Numerous MGI studies show that a competitive environment in an industry increases pressure on management to adopt best practices in its business processes.⁹ Higher levels of competitive intensity produce stronger gains in productivity as businesses innovate to maintain and gain market share. At the same time, these pressures force businesses to maintain cost competitiveness relative to their peers. Recent academic work also demonstrates this link between competition and innovation growth.¹⁰

PARTS OF THE WORLD ARE CATCHING UP IN THE COMPETITION TO ATTRACT US MULTINATIONAL ACTIVITY

The United States possesses many of the economic and institutional attributes that attract and foster multinational activity. These include a large, growing economy; a highly educated and skilled workforce; political stability; a business-friendly legal and regulatory climate; and good physical and telecommunications infrastructure. But parts of the world are catching up.

The United States faces intensifying competition as other countries' economic prospects improve and they develop as better places to do business. Much of the increased attractiveness of markets outside the United States arises from organic factors, such as population growth, GDP growth, and rising affluence. While US real GDP rose at a 2.9 percent compound annual growth rate from 1995 through 2008, China's economy expanded at a 9.6 percent rate, India's at 6.9 percent, and Russia's at 4.7 percent. Real consumer spending is also growing much faster in emerging markets; from 1995 through 2008, real household consumption rose at a 3.3 percent annual rate in the United States, but at a 7.2 percent rate in China, a 6.7 percent rate in Russia, and a 5.1 percent rate in India.

Some countries are actively and successfully competing for new corporate investment through programs to improve their business climate, workers' skills, and infrastructure. They are providing companies with more consistent, and more

8 Consistent North American Industry Classification System (NAICS)-based industry information is available starting in the 1999 benchmark survey. Furthermore, real value added can be computed only at the industry level from 2000 to 2007 because of data requirements for the appropriate chain-weighted calculation. Thus our sector analysis focuses on this period. See *Appendix: Technical notes* for details.

9 See, for example, *US productivity growth 1995–2000: Understanding the contribution of information technology relative to other factors*, McKinsey Global Institute, October 2001, available online at www.mckinsey.com/mgi. Or see numerous country studies at www.mckinsey.com/mgi/rp/CSPProductivity.

10 For example, P. Aghion, N. Bloom, R. Blundell, R. Griffith, and P. Howitt, "Competition and Innovation: An Inverted-U Relationship," *Quarterly Journal of Economics* 120:2 (May 2005), 701–728.

business-friendly, environments in which to operate. By some measures, the United States is losing ground. It slipped from 15th to 34th in overall institutional effectiveness since 1997, and it now ranks 20th in business and communications infrastructure, according to the World Economic Forum (WEF). And although the United States maintains a substantial advantage in human capital, pools of highly skilled labor are emerging in many countries.¹¹

In 2000, 36 percent of Fortune Global 500 companies had their headquarters in the United States, and 16 percent were domiciled outside the G-7 countries.¹² By 2009, 28 percent had their headquarters in the United States, and 33 percent were based outside the G-7.

US MULTINATIONALS MAY BE THE “CANARY IN THE COAL MINE” OF THE US ECONOMY

US multinationals must pursue new growth opportunities and continually improve operations to remain globally competitive. They go where the markets are expanding, where the talent lives, and where they can earn superior returns. Increasingly, this means going after opportunities in emerging markets. To serve new markets, US multinationals often develop networks of foreign affiliates. Designed primarily to serve overseas markets (in 2007, only 10 percent of foreign affiliate production was “exported” to the United States), these affiliates have proven beneficial to the United States. The most recent academic research suggests that US multinationals’ investments, job creation, and sales abroad are associated with increases in these same activities at home.

Many other US companies that operate only in the United States also face intensifying pressures from domestic and foreign rivals, particularly as the relative position of other countries improves. These companies may not respond by investing directly overseas, but they can move some of their operations offshore by contracting with foreign suppliers. This activity is hard to observe directly. But through the Bureau of Economic Analysis surveys, we have good data on US multinational corporations’ investment in their foreign subsidiaries. Thus, the actions of US multinationals provide us with an indication of how other companies can use access to markets abroad to cope with similar competitive pressures. US multinationals may serve as a “canary in the coal mine” of the US economy, providing warnings of possible future risks. In this case, the risk is that the United States could lose future corporate investment—by both multinationals and other companies—if it loses its competitive advantage in certain areas. The risk is that foreign-domiciled companies will win the battle to create new industries or will leverage their advantaged position at home to capture US markets.

POLICY MAKERS MUST WORK TO MAINTAIN THE UNITED STATES’ ECONOMIC COMPETITIVENESS

Many of the executives we spoke with emphasized the need to ensure they are competing on a level playing field. They believe that current US policies—particularly in the areas of corporate taxes, limits on the immigration of skilled workers, and bureaucratic hurdles and inconsistencies—handicap US companies when competing abroad and in some cases discourage investment at home. And several

¹¹ See *The emerging global labor market*, McKinsey Global Institute, June 2005. Available at www.mckinsey.com/mgi.

¹² Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

executives expressed concern or doubts about the ability of the United States to compete for corporate investment and jobs in the future.

However, our research does not suggest that corporate decisions turn solely on particular policies. And there are challenges to investing in other countries. MGI research has found that developing countries' attempts to lure multinational investment solely through tax and monetary subsidies were largely ineffective. Instead, US leaders should recognize all the factors that weigh into business decision making and determine the right policy responses.

The United States cannot rest on past success and assume it will win the intensifying global competition for corporate investment. It cannot take its multinationals—and the contributions they make to real GDP growth, productivity, and jobs—for granted. In this changing environment, US policy makers, working with businesses, must redouble their efforts to examine the array of choices they face and actively decide how to compete and maintain the United States' preeminence in an evolving global economy. US policy makers should seek to sustain an environment in which globally competitive businesses can emerge and continue to make significant contributions to the US economy's growth and performance.

□ □ □

Leaving the status quo in place is one option. However, if current trends continue, the United States' competitive edge could erode, making the country less attractive as a destination for investment and as a base for expanding global operations. This would reduce the contributions that multinational companies make to the growth and performance of the US economy. But this needn't happen. The right policies can enhance the competitiveness of the economy and multinationals, fueling the economy's continued growth and vibrancy for years to come.

