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The Rise of the Urban Entrepreneur

A Harvard Business School professor explains that small urban businesses can thrive and how the government can help.

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The time for revitalizing the inner city is now. The solutions won't come from social programs but from the private sector -- from entrepreneurs who are prepared to tap the economic and entrepreneurial potential of our nation's inner cities

Jobs, investment, and businesses in our inner cities will materialize only as they have elsewhere -- as the result of private, for-profit initiatives and investment based on economic self-interest and true competitive advantage. If our aim is to create a healthy, sustainable economic base in the inner city with the employment, role models, and wealth that come with such a base, then our task is clear. It is to identify the unique existing and potential competitive advantages of inner cities that will sustain profitable companies, capable not only of serving the local community but also of "exporting" beyond it. Unless we start with the premise that inner-city businesses must be genuinely profitable and capable of competing on a regional, national, and even international scale, inner-city economies will forever be out of the economic mainstream.

Past attempts at inner-city revitalization have failed because they ignored those basic economic principles. They sought to meet highly visible social needs -- poverty, homelessness, and hunger -- with programs such as income assistance, housing subsidies, and food stamps, while they ignored the need to build viable inner-city businesses. The revitalization didn't take root because without economically viable companies the only growth social programs promote is their own.

Today is the right time for a dramatic reversal of inner-city decline. Inner cities harbor untapped economic and entrepreneurial potential. Inner-city residents and other citizens are tired of failed government programs and are ready to try a different tack. Government officials at all levels say they are ready to innovate. The private sector, if allowed to focus on enterprise building, is poised to help.

Toward a New Model

We need a new model to guide inner-city economic development. Its dimensions must be economic and social. It must draw its energy from the private sector, not from government or social-services agencies. It must address companies directly instead of trying to stimulate economic development through expensive investments in housing and community infrastructure. The model must incorporate the idea of creating profitable inner-city businesses instead of presuming the need for continuing public subsidies or incentives. It must attempt to integrate inner cities with regional and national economies and not view them as islands apart. The goal should be to create regional, national, and international companies, not just local small businesses.

The model I propose rests on the proposition that inner cities provide unique potential competitive advantages that companies can leverage in order to turn a profit. We need to focus on identifying those competitive advantages and on encouraging the formation and growth of companies that can exploit them. If companies are to put down roots in the inner city, they must be motivated by profits.

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The Advantages of Inner Cities

Location plays an important part in determining the ultimate success or failure of a business. Many people assume that the chief advantages of inner-city locations are low-cost real estate and available labor. But those two attributes are illusory. Real estate and labor costs are often higher in the inner city than they are in surrounding suburbs and certainly higher than in low-cost countries such as Mexico and Korea.

To understand the competitive advantages of inner-city locations, we need to see the inner city within the context of a broader regional economy. Every location -- whether it be a nation, state, or region -- has a set of unique local conditions that underpin the ability of companies based there to compete in a particular field. The competitive advantage of a location does not normally arise in isolated companies but in clusters of companies -- companies in the same industry or companies that are otherwise linked together through customer, supplier, or other relationships. Unusual or sophisticated local demand is one important reason why clusters form as companies gain insight into customers' needs. The clusters represent critical masses of skill, information, relationships, and infrastructure in a particular field.

I initially described the theory of location and regional clusters in my book *The Competitive Advantage of Nations*. I applied that theory to relatively large geographic areas of nations and states. But the theory is just as relevant to smaller areas such as the inner city.

The potential competitive advantages of inner cities lie in four areas: strategic location, local market demand, integration with regional clusters, and human resources. Those potential advantages have been recognized before, but no one in the private or public sectors has ever made a systematic effort to develop and harness them.

Strategic location. Inner cities occupy what *should* be economically valuable locations. They sit near congested high-rent business centers and astride transportation and communications nodes. Inner-city locations thus offer potential advantages for businesses that benefit from proximity to downtown business districts, logistical infrastructure, entertainment and tourist destinations, and concentrations of companies. Strategic location creates opportunities for relocating warehousing, data processing, food preparation, and other activities that benefit from downtown proximity away from more expensive downtown headquarters (or other company locations).

For example, Boston's fresh produce and food-processing cluster derives a critical competitive advantage from its inner-city location in Newmarket Square. Containing such businesses as flower wholesalers, seafood importers, meat processors, bakeries, and food distributors, the cluster is in close proximity to downtown; its location permits rapid deliveries and gives downtown buyers a convenient location for purchasing. The location has excellent access to highway, sea, and air transport, which gives businesses a particular advantage in the

importing and distribution of seafood. The location is also within walking distance of a supply of able employees from inner-city neighborhoods. That combination of factors has led to a dense concentration of processors, caterers, truckers, wholesalers, distributors, and other suppliers, which together form a vibrant cluster.

Some observers argue that advances in transportation and communication have eliminated the competitive importance of location. However, the growth of concepts such as just-in-time delivery, superior customer service, and product-development relationships between customer and supplier continue to make location a critical business factor. Take, for example, Atlanta's Matrix Exhibits. With 30 employees and \$2.2 million in sales, the company assembles, supplies, and delivers trade-show exhibits. Because Matrix is based in the inner city, only a six-minute drive from the Georgia World Congress Center, it can respond faster than its suburban competitors to exhibitors' frequent last-minute requests.

In Boston, proximity-sensitive businesses -- food processing and distribution, printing and publishing, commercial laundry, and other support services -- have remained in the inner city, notwithstanding attendant difficulties. (See table, page 9.) Likewise, in Los Angeles many of those and other businesses -- toy and electronics importing and distribution, for instance -- are location sensitive. Such businesses have emerged and remained in the inner city despite government policies that erode the area's locational value. That persistence suggests that the potential to expand the base of location-sensitive businesses in inner cities is significant.

Local market demand. The second potential competitive advantage of the inner city lies in the unmet demands of its own population. Even though average incomes are relatively low in inner cities, high population density creates substantial purchasing power and a large market. Total family income in Boston's inner city, for instance, is an estimated \$3.4 billion, not an insignificant market. Although average household incomes are 21% lower than in the rest of Boston, spending power per acre is comparable. In some cases it is higher than in the surrounding suburbs.

Inner-city markets are not only large but young and rapidly growing, in part because of immigration and relatively high birthrates. Their largely minority consumers, as some established companies have already realized, represent a major growth market. Chicago's historic retailer, Goldblatt's Department Stores, for example, found new life after bankruptcy, with a strategy built on inner-city stores. In 1981 the company closed all but six of its stores. Focusing on cash-and-carry items, Goldblatt's has re-emerged as a competitive retailer, now with 14, mostly inner-city, stores.

The principal inner-city business opportunity springs, however, not from the size of the market but from its character. People in largely lower-income ethnic and minority communities have distinctive needs and tastes, which demand tailored products and services. But most companies design products and services for white middle-class consumers and businesses. Hence, their product configurations, retail concepts, entertainment, and personal and business services don't fit inner-city customers' needs. Microsegmentation lags in the inner city, but it represents a substantial opportunity.

Companies and entrepreneurs based in the inner city are uniquely positioned to understand and address the needs of consumers and businesses in their own and other similar markets. Many of the largest and most enduringly successful minority-owned (although not necessarily inner-city-based) companies have drawn their advantages from targeting those buyers in fields such as food products (Parks Sausage, Brooks Sausages); beauty care (Soft Sheen, Pro-Line, Dudley, Luster Products, Johnson Products); and media (Essence Communications, Earl G. Graves Inc., Johnson Publishing, Black Entertainment Television). Other examples include Cacique, a Latino-owned cheese manufacturer that has become a leader in the Mexican cheese market in the United States. Miami-based, Latino-owned CareFlorida Inc. has rapidly grown its health-maintenance organization by tailoring its marketing to Latino customers. Universal Casket, in Cassopolis, Mich., has grown to \$3 million in annual sales by marketing to African American-owned funeral homes.

A focus on satisfying ethnic needs does not necessarily limit the growth and potential of minority businesses.

Instead, a focused strategy can provide a competitive advantage over large established manufacturing-company players like Procter & Gamble, Safeway, and Levi Strauss, and a base from which to expand into other market segments. Inner-city-based firms can sell not only in their own communities but to similar communities nationally and even internationally, creating the opportunity for large multiunit companies. The rapid progress of Americas' Food Basket, a Cuban-owned supermarket based in Boston's inner city, suggests the potential for growth in retailing concepts that cater to local ethnic demand. In just its second year of operation, the company is profitable on annual sales of \$8 million. Americas' Food Basket has developed a product mix that satisfies local demand better than mainstream supermarkets do. And unlike nearby mom-and-pop stores, Americas' Food Basket has developed a partnership with a leading national wholesaler, which helps it make its selection, prices, and services better than those of its smaller competitors. In San Antonio, Handy Andy Supermarkets focuses on the Latino market. The company has 23 stores in Texas and projected sales of more than \$400 million for 1994.

The creation of retailing concepts tailored to inner-city consumers in such areas as food, clothing, toys, books, and restaurants in turn breeds opportunities to manufacture products for that market. For example, specialized supermarkets boost the demand for established ethnic-food producers and distributors like Goya Foods, a supplier of Latino foods, with annual sales greater than \$450 million. Inner-city companies can also specialize as distributors for products targeted at inner-city consumers or provide professional services such as advertising and market research to outside companies seeking to serve inner-city markets.

An even more exciting opportunity presents itself when we realize that the needs and tastes of inner-city buyers represent trends that often cross ethnic and socioeconomic strata. For example, products, such as Parks Sausage, originally tailored to the tastes of African American consumers have entered the mainstream.

To capitalize on that large market opportunity, the new breed of inner-city businesses cannot be small high-cost companies. They must quickly build themselves into efficient, high-quality businesses that use the latest in technology, marketing, and professional management techniques.

Integration with regional clusters. A third potential competitive advantage of the inner city is a company's ability to leverage access to nearby regional business clusters. Boston's inner city, for example, is next-door to clusters of world-class financial-services and health-care providers. While inner-city companies are currently isolated from the regional economy, those unique regional clusters represent promising opportunities for economic growth. They create opportunities for new or growing companies to provide services and production inputs as well as the opportunity to sell downstream products and services. Proximity to Detroit's large cluster of automotive companies, for example, enabled \$103-million Mexican Industries, a 1,000-person inner-city manufacturer of armrests, headrests, and air bags, to become a respected supplier by forging close relationships to General Motors, Ford, and Chrysler.

The inner city's proximity to regional clusters also offers employment opportunities to appropriately trained residents. Those jobs are usually far more practical and accessible than jobs in distant suburbs. With training and other work-force development programs tailored to cluster needs, both the regional firms and the inner city benefit.

Human resources. The fourth potential competitive advantage of the inner city lies in its human resources. Inner-city workers are often more motivated and loyal in businesses that suffer high turnover. For instance, a bakery in the heart of Boston's inner city supplies decorated cakes to supermarkets. It attracts and retains residents from the area at \$7 to \$8 an hour (plus contributions to pensions and health insurance), and its labor pool is one factor that has allowed the company to thrive. Those entry-level, hourly jobs represent a starting point in building a sustainable inner-city economy.

Furthermore, research reveals a substantial capacity for entrepreneurship in inner cities. However, most legitimate inner-city entrepreneurship is now invested in the provision of social services, for which there is strong local demand. Boston's inner city, for example, hosts a remarkable number of social-services providers as well as social, fraternal, and religious organizations. Behind the creation of those organizations is a cadre of

minority entrepreneurs who have responded to the local demand for social services and to funding opportunities provided by government, foundations, and private-sector sponsors. The challenge is to redirect some of that entrepreneurial talent toward the building of for-profit businesses and wealth creation.

Another potential human-resource advantage of the inner city is the growing pool of highly trained and experienced minority managers available today. About 4,000 African American and almost 2,000 Hispanic students graduated from M.B.A. programs last year, compared with just a handful two decades ago. More and more minority M.B.A.s are gaining work experience in highly regarded companies. To date, few of those talented people have started or acquired businesses at all, much less businesses in the inner city. But many of them have developed the skills, network, capital base, and confidence that will allow them to join or found entrepreneurial companies. In addition, many young people still attending or just leaving business school are attracted to entrepreneurship and to community involvement. They are eager to apply their talent and training to economic development. A new pool of founders and managers of inner-city businesses, then, is poised for action.

The businesses that are present and that remain in inner cities invariably draw on one or more of the four competitive advantages described above. That suggests that substantial numbers of new inner-city jobs could be created if public policies were to shift from providing subsidies to businesses and welfare to residents to developing and reinforcing the economic advantages of the inner city.

Overcoming Inner-City Disadvantages

The economic potential of the inner city will be realized when companies leverage the competitive advantages and when the disadvantages are confronted directly. Most of the disadvantages of locating businesses in the inner city can be eliminated, moderated, or overcome.

Land. A large percentage of companies moving out of the inner city would stay but can't for lack of space. Inner cities lack adequate parcels of land for construction and expansion. For instance, Rebuild L.A. estimates that only 9 of 200 vacant or underutilized lots in South Central Los Angeles are larger than one acre. Wal-Mart requires four to six acres to build a new store. Even when land is available in the inner city, it's often broken into small, unusable lots. The development of Jeffery Plaza, a shopping center on Chicago's South Side, required eight years and substantial government involvement to assemble 21 contiguous parcels. Even after they're assembled, inner-city sites often require expensive demolition and environmental cleanup. Private developers and banks tend to avoid sites with even a hint of environmental problems, because of punitive liability laws.

Building costs. The price of building in the inner city is significantly higher than the price of building in the suburbs because of complex logistics, restrictive zoning and architectural codes, permits, inspections, community group negotiation, and government-required union contracts and minority set-asides. Equally if not more damaging to inner-city development is the uncertainty that regulations create for potential investors. Developers in Boston, Los Angeles, and Chicago all expressed frustration at the three-to-five-year regulatory process required to obtain the necessary approvals to expand, build, or improve their facilities. Cities need to dismantle regulatory and bureaucratic mazes if they hope to compete with suburban locations.

Other nonwage costs. Many inner cities have high costs for utilities, workers' compensation, health care, property insurance, unemployment and liability insurance, real estate and other taxes, Occupational Safety and Health Act compliance, neighborhood hiring requirements, and "linkage" payments. One manufacturing company in Boston's inner city operates a comparable plant in upstate New York. The Boston plant's expenses are 50% higher for family medical insurance, 55% higher for workers' compensation, 67% higher for electricity, 166% higher for unemployment insurance, and 340% higher for water.

Because they have a greater proportion of residents dependent on welfare, Medicaid, and other social programs than the suburbs do, many inner cities must spend more and thus charge higher taxes. But the costs cities incur are often exacerbated by the same factors that drive up building costs: entrenched unions and inefficient

bureaucracies.

Security. Crime is a real deterrent to doing business in the inner city, but the perception of crime is greater than the reality. Crime against property raises costs. For example, the Shops at Church Square, an inner-city strip shopping center in Cleveland, spends \$2 per square foot more than a comparable suburban center because it has a full-time security guard, more lighting, and continuous cleaning. Its overall costs are thus raised by more than 20%. Crime against employees and customers discourages people from working in and visiting inner-city establishments and restricts their hours of operation.

Infrastructure. The competitive-advantage model rests on the locational value of the inner city. Thus, good transportation infrastructure is critical to the development of "exporting" businesses as well as the integration of inner-city business with regional clusters. Although the need is obvious, the infrastructure of the inner city has fallen into dismal disrepair. The capacity of highways and the location of on and off ramps, the inner city's access to rail and airport facilities, and the road and communication links to downtown from the inner city are often inadequate.

Employee skills. Many inner-city residents are not work-force ready and lack the skills to work in all but the most unskilled occupations. With large pools of lower-wage labor available across the globe, many inner-city residents need more than just basic skills. They need skills appropriate to the particular occupations and industries located in or near their communities.

Management skills. Many managers of inner-city companies, like managers of small businesses everywhere, lack formal managerial training, especially in the areas of strategy development, market segmentation, information technology, process design, and cost control. Unfortunately, the quality of the government-sponsored programs that teach those skills is uneven, and entrepreneurs are hard-pressed to find time to attend them.

Access to capital. Poor access to debt and equity capital is a formidable barrier to entrepreneurship and company growth in inner-city areas. Banks and other sources of debt financing are perceived as unfairly withholding capital because of bias, redlining, or poor understanding of inner-city companies. While those problems must be addressed, they are exacerbated by two other conditions. First, relatively few inner-city businesses meet investors' and lenders' underwriting standards. Capital will flow to inner-city companies once viable, competitive businesses are in place. Second, banks find small-business lending only marginally profitable because transaction costs are high relative to amounts lent.

The federal government has made several efforts to address the dearth of debt capital available to inner-city companies. The Community Reinvestment Act (CRA), intended to overcome bias in lending, has forced banks to pay more attention to inner-city areas. Additionally, the Specialized Small Business Investment Company (SSBIC) program of the U.S. Small Business Administration targets smaller enterprises for equity investments. While those efforts help, some of their underlying assumptions are questionable. Far more debt capital is earmarked for business lending in the inner city than has actually been lent. Quasi-government institutions are more risk averse than commercial banks out of fear of losing public money and being accused of mismanagement. The proliferation of special financing sources also leads to fragmentation, duplicates overhead, confuses borrowers, and discourages the development of high-quality, private-sector expertise in minority and inner-city business financing.

Equity capital is all but absent in inner cities. Entrepreneurs usually lack personal or family savings and networks of individuals to draw on for capital. Institutional equity investors have virtually ignored inner-city business opportunities.

Attitudes. Attitude issues exist on at least three levels. First, the private sector has a checkered track record in inner cities, resulting from its disinvestment, redlining, worker exploitation, and environmental pollution. That history has contributed to a general antibusiness attitude within inner-city communities, especially toward

companies that are not owned by minorities or local residents. While understandable, that attitude constitutes a significant barrier to current and future economic development. Locally owned or minority-owned businesses are more likely to hire locally, but the hard truth is that inner cities do not have the human or financial capital to revitalize themselves without outside participation. In neighborhoods where the attitude is "development will be on our terms or not at all," the result has been little or no development. Inner cities must welcome outside investors -- as long as the businesses they support provide decent jobs for local residents, do not pollute, and are good citizens.

A second attitude problem is the tendency of community leaders to view business as a means of directly meeting social needs. For example, businesses interested in locating in Boston's inner city have been driven away by demands that they give community-based organizations control over their hiring and training, build playgrounds, and fund scholarships. Businesses exist primarily to earn profits for their owners. They are not, nor should they be, social-services providers. Such demands on business only serve to drive jobs and investment to more welcoming locations.

Instead of intimidating potential inner-city investors with their demands, community-based organizations and their leaders can work to improve the business climate in the inner city. They might, for instance, create referral networks to help companies screen potential employees, help educate the community to the needs of business, and facilitate commercial site development.

Lastly, inner-city companies themselves often harbor unhealthy attitudes to the extent that they have come to rely on subsidies and the absence of real competition to remain viable. Minority preference programs can breed complacency and undercut efforts to improve quality, reduce costs, and sell beyond the captive market. Changing those attitudes will require the replacement of subsidies that only preserve uneconomic businesses with mutually profitable business-to-business relationships. If minority purchasing preferences are useful in getting some inner-city businesses started, the terms of the preference must require those businesses to win a meaningful amount of nonmandate business within a reasonable period of time. Larger established companies should be mentoring smaller companies during this period to increase the probability of success. If the new companies can't succeed, they should be allowed to fail.

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Changing Responsibilities and Roles: The Private Sector

Building on the competitive advantages of the inner city while overcoming its competitive disadvantages will require the commitment and involvement of government, business, and the nonprofit sector. All three will have to abandon old ideas and practices to address the inner-city challenge from an economic perspective -- and the private sector must take the lead, motivated not by charity but by economic self-interest.

Entrepreneurs, managers, and investors, because they alone have profit-oriented motives and incentives, will seek out the best opportunities for creating wealth. The business community, however, must rethink its strategy and adopt new attitudes to succeed in the inner city. Most private-sector initiatives today -- contributions to inner-city social-service agencies or participation in preferential contracting programs -- are fueled by charitable motives. However well intended, they do not contribute much to building a sustainable inner-city economic base. The private sector will contribute more when it focuses on what it does best: creating wealth and building competitive businesses.

Six goals should guide private-sector initiatives:

- 1. Create and expand business activity in the inner city.** The most important contribution a company can make in the inner city is simply to do business there. Inner cities hold untapped potential for building profitable businesses if companies seek out and seize the opportunities that build on the area's true advantages. Retailers, franchisers, and financial-services companies have immediate opportunities. Franchisers represent an especially attractive model for inner-city entrepreneurship because they provide a tested business concept, training, and

support.

Controversy has surrounded the efforts of mainstream retailers -- ranging from supermarket chains to Wal-Mart to Walgreens -- to locate in inner cities. Many argue that outside firms do not benefit the inner city because they damage local merchants and siphon profits away from the community. Such arguments reflect the old failed model. Some small percentage of sales do leave the community, but the wages paid to inner-city residents and the lower cost of living that efficient businesses bring to inner-city residents more than compensate for the loss. And while some local merchants may suffer, the large retailers will generate additional foot traffic for new and existing locally owned businesses.

2. Tailor operating practices to meet inner-city needs. Successful inner-city businesses have learned to tailor their products, services, and operating practices to the local market. Goldblatt's, for example, understands that its customers buy to meet immediate needs, and it has matched its merchandising to customers' buying habits. Unlike suburban retailers, which stock a large selection of winter coats in the fall, Goldblatt's shows its winter coats in the winter. One way companies improve their understanding of the inner-city market is to build relationships in the community and hire locally. Neighborhood employees build loyalty from neighborhood customers and help stores customize their product offerings.

3. Deal with disadvantages creatively. Government is not the only group responsible for minimizing the disadvantages of doing business in the inner city. Some companies have pioneered creative tactics for dealing with, for instance, security issues. MetroTech, a back-office-operations complex in Brooklyn, serves financial firms in the nearby Wall Street area. While MetroTech is located in a high-poverty and -crime area, its developers created an 18-acre campus that could support 4 million to 8 million square feet of office space. Thus, they spread security costs among a large number of businesses, and tenants collectively pay only 33 cents a square foot for 24-hour security service. Furthermore, in such a large business complex, the perception of security, just as important as the reality, is also enhanced.

Transportation improvements added to the perception of security at MetroTech, especially for customers and employees who travel to and from the site. MetroTech enlisted the city government

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