Valuing Headquarters (HQs): Analysis of the Role, Value and Benefit of HQs in Global Value Chains

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Introduction

This report explores the growing importance of corporate headquarters in a world of global value chains. It examines the real and purported benefits of hosting corporate headquarters, and recent trends in location and operation of headquarters around the world and in Canada. It concludes with suggestions as to how governments may encourage headquarters to locate in Canada.

Governments around the world are keen to attract headquarters to their jurisdictions for a variety of reasons. Because of the nature of the headquarters function, headquarters typically employ highly-skilled and well-compensated professionals. Headquarters also purchase high-end professional services, notably auditing, management consulting and financial services, as they pursue their corporate mandate. Individuals in these high-end professional services roles are highly coveted by governments as high-end tax payers and consumers within the localities where they work. Their positive economic impact is compounded by the fact that a variety of services jobs are seen to grow up around them, thereby generating significant indirect economic benefits to the localities in which they work. As an added benefit, high-end professionals are also seen as being individuals who are likely to invest substantial time and resources in community development, philanthropy and good works.

Most importantly, for this study, headquarters are the preeminent decision-making centres within corporations, typically determining how corporate resources are allocated. Given the market significance of corporate resource allocation decisions, some analysts argue that a nation's economic welfare is directly tied to its ability to attract and retain corporate headquarters. This belief, which has been popular for at least 50 years, has been given further recent impetus with the emergence of global value chains.

Rise of Corporate Headquarters

The phenomenon of corporate headquarters precedes the rise of global value chains.

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* The Conference Board is grateful to the executives who shared their expertise and insights through interviews that were conducted as part of the research process for this project.

The report was prepared with financial support from the International Trade and Investment Centre and the CanCompete Program, The Conference Board of Canada; and the Department of Foreign Affairs and International Trade.

During the twentieth century, large diversified corporations emerged as the most powerful players in economic affairs. Today, such corporations account for up to 60 per cent of output in advanced developed countries[1] As corporations grew, they became more complex. To deal with complexity, corporations began to divide themselves into divisions that specialized in specific areas of the corporation's product and geographic portfolio. Over time, the managerial functions of the corporation were separated from the operating divisions, resulting in the creation of a headquarters as a specialized entity dedicated to the management of the corporate portfolio, physically separate from places of production.

Growth of Global Value Chains

The term "global value chain" refers to the geographic dispersal of the corporate value-added process. A good goes through a series of transformations before it reaches the final customer. Each transformation adds value to the good. For instance, raw logs are harvested, transported, sawed, transported again, then lathed, sanded and stained before being assembled as furniture. Each of the stages adds value to the raw logs as they become more refined and turned into something useful for consumers. That is the corporate value-added process. The "global" refers to the modern tendency for multiple countries to be part of these processes. Multi-country production processes have been greatly facilitated by the steady decline in trade barriers between countries and the declining costs of transportation and communication.

In the past, countries gradually moved through stages of increased integration, beginning with trade in final goods between countries based on absolute advantage; to trade in final goods based on comparative advantage; to trade in unfinished goods in mid-production processes based on comparative advantage (e.g. Canada-United States Auto Pact); to trade of unfinished goods on a global basis based on comparative advantage. In this evolution, global investment and trade have become increasingly intertwined and trade has become increasingly intra-firm as well as inter-firm. This evolution has substantially been engineered by managerial decisions made in corporate headquarters.

According to Statistics Canada, there are 2 million registered businesses in Canada. This includes all types of businesses. Yet Canada has only slightly more than 3,000 headquarters, as defined by Statistics Canada[2] As explained below, the great majority of these headquarters belong to large enterprises with at least $75 million in annual revenues (Canada has roughly three thousand of these enterprises).[3] Given that very large enterprises often maintain multiple headquarters (for instance, subordinate headquarters in addition to a corporate headquarters) it is very likely that most of the headquarters in Canada belong to very large organizations, most of which have over $500 million in annual revenues.[4] Significantly, these are the sort of enterprises with the geographic and operational scope to operate their own global value chains and to participate in other companies' global value chains. As such, there is a natural affinity between corporate headquarters and global value chains.

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[1] Collis, Young and Goold, "The Size, Structure and Performance", p.3.

[2] Custom run, Statistics Canada Business Registry. Statistic Canada actually refers to headquarters as "head offices". The "head office" terminology is British terminology. This report uses the term "headquarters", which is of American extraction. They are conceptually the same thing. See below, Box 1, p.4 for a discussion of the term "headquarters".

[3] Statistics Canada, *Corporations Returns Act*, p.12.

[4] Ibid. In 2006, the mean revenue for large Canadian controlled corporations was $531 million.

Method

This report is based on a number of sources. It draws heavily on special runs of Statistics Canada's Business Register to track trends in Canadian headquarters. These data are compared to data from other international headquarter sources. We have conducted a comprehensive review of the relevant literature. (Although the global value chains concept brings together the trade and foreign investment literatures, these are largely separate from the organizational design literature.) These literatures are linked together in our analysis of how corporate design relates to global value chains. Finally, these sources are supplemented by interviews with executives from a number of large Canadian companies with significant headquarters in Canada.

Concepts

What is a Headquarters?

A headquarters is a corporate unit that performs administrative and managerial functions at a location that is geographically separated from the corporation's production units. Although separateness from a "production unit" is what defines a headquarters, it does not specifically address the aspect of a headquarters which concerns us most: the power of the headquarters unit to make decisions (i.e. is it the corporate or subordinate headquarters), the nature of the enterprise, its breadth of geographical operations, and the types of decisions it takes (is it a local business or a global enterprise).

Headquarters are always functionally and very frequently geographically separated from other corporate facilities. One reason for this separateness is symbolic. Theoretically, a large corporation rationally and dispassionately manages a portfolio of assets to maximize corporate value to shareholders. For instance, in 2001, when The Boeing Company decided to move its thousand-person headquarters from Seattle to Chicago, its Chair and CEO, Phil Condit, suggested that the move was, in part, motivated by a desire to separate the headquarters from operations: "As we've grown, we have determined that our headquarters needs to be in a location central to all our operating units, customers and the financial community—but separate from our existing operations"[5]. This suggests that the headquarters is often seen as the common linking mechanism between a company's production capabilities, its customers and the financial community that provides it with capital.

Headquarters exist to add corporate value beyond that which is added by corporate divisions or business units. That value is related to several functions. The first is to exploit economies of scale in managerial functions and in raising capital. For public companies, the capital raising function often involves share issuance, which leads to a further headquarters function; corporate governance. Corporate governance entails fiduciary responsibilities to shareholders that involve legal obligations to report on corporate activities and to control corporate finances.

Beyond capital-raising, corporations also exploit economies of scale by pooling functional resources at their headquarters. A "shared service" model is employed whereby headquarters provide business units with corporate services. These services, in areas such as human resources, tax, marketing, finance and treasury, may be charged back to the

[5] CNN Money. "Boeing to Fly From Seattle".

business units. Finally, there are managerial efficiencies realized through senior executives working in a common location, which make it easier and quicker for them to communicate and discuss strategy and take collective decisions.

There are a great many permutations to headquarters design. Larger firms often have multiple centers of management and thus have multiple headquarters. In such cases there is usually a corporate headquarters where the CEO and direct reports of the 'C-Level' or 'C-Suite' are based, and one or more subordinate headquarters. For instance Stauss-Kahn and Vives found, in a sample of 21,000 US headquarters, that an average firm had 15 headquarters, so defined.[6] Depending on the type of product/service on offer, firm strategy and management philosophy, these headquarters vary in terms of function, location and size. Moreover, headquarter configurations also vary in terms of the relationship between the corporate headquarters and subordinate headquarters and, indeed, the relationship between subordinate headquarters.

Box 1. Defining Headquarters

At a base statistical level, a headquarters is simply a geographically separate unit whose sole purpose is to manage a corporation. There are significant qualitative differences between headquarters depending on their decision making role in the corporation.

For the purposes of this report, *corporate headquarters* refers to the chief decision-making centre of the corporation that houses the CEO and C-level executives who report directly to the CEO. These executives are typically provided a direct mandate from the board of directors, representing the shareholders, to set strategy for the organization and to run the corporation on a day-to-day basis. This level will typically have the most discretion in deciding on corporate supply chains. In this report, we call other headquarters *subordinate headquarters* in as much as they are subordinate to the corporate headquarters and do not have a direct mandate from the shareholders.

This is not to suggest that subordinate headquarters may not have very significant responsibilities, but these responsibilities are determined by the corporate headquarters and may change based on corporate headquarters decisions. Moreover, in complicated corporate structures the distinctions between the corporate and subordinate headquarters may blur because a corporation may choose to establish a subsidiary with its own C-level executives and board of directors. In the final analysis, the main issue is whether a headquarters is a significant part of the corporate decision-making apparatus and whether it is engaged in the value-adding processes of the corporation.

That decision-making authority and corporate engagement is not easy to discern from the mere the existence of a headquarters or even the title of its senior executives. For instance, a company may choose to appoint a "President" for Canada as a sort of figurehead for the Canadian market. Another company may only have Vice-Presidents or even Directors in Canada but these executives may be part of business units that cut across national boundaries. The result is that these "lower" level executives, in fact, have more actual decision-making power than a titular "President".

[6] Strauss-Kahn and Vives, "Why and Where Do Headquarters Move?" p.169.

Harzing has made a noteworthy attempt to organize the different types of headquarter configurations into a typology based on earlier work by Bartlett and Ghoshal.[7] The core Harzing typology attempts to classify different kinds of multinational corporations. In the table, below, we modify the Harzing typology to include a further category, that of the large domestic organization. In Canada, that includes large domestically-regulated companies with limited foreign competition, such as banks and telecommunication companies.

Harzing distinguishes between three types of multinationals: multi-domestic, global and transnational. The multi-domestic allows subordinates the most discretion to implement corporate mandates apart from the corporate headquarters. The global corporation is more centrally orientated and the corporate headquarters is much more directive that is the multi-domestic. A global corporation's subsidiaries tend to receive close direction from the corporate headquarters. Transnational corporations are a blend of multi-domestic and global. They will leave subsidiaries with more discretion, often because national regulatory structures require a beefed up corporate presence. For instance natural gas processing would appear to lend itself to a global structure similar to oil processing. But the distribution of natural gas is typically a highly regulated industry that involves a significant local corporate presence with expert understanding of the domestic legal and regulatory frameworks in effective in that country or location. That type of firm will favour a transnational structure that combines national presence with global scale. Meanwhile, the domestic corporation typically operates rather like the global corporation, where the "globe" is one country split into by market regions and/or production centres.

Table 1: Harzing's Typology, Modified to Include Large Domestic Companies

Parameter	**Domestic**	**Multi-domestic**	**Global**	**Transnational**
Organizational design				
Decentralized federation	Low	High	Low	Low
Network structure	Low	Low	Low	High
Inter-subordinate flows	Medium	Low	Low	High
HQ's pipeline	High	Low	High	Low/ medium
Centre of excellence	High	Low	Low	High
Local responsiveness				
Local production	Low	High	Low	Medium
Local R&D	Low	High	Low	Medium
Product modification	Low	High	Low	High
Adaptation of marketing	Low	High	Low/medium	High
Interdependence				
Total level of interdependence	Medium	Low	High	High
Level of HQ dependence	High	Low	High	Medium
Level of subordinate dependence	Low	Low	Low	High

Source: Anne-Wil Harzing, "An Empirical Analysis and Extension of the Bartlett and Ghoshal Typology of Multinational Companies"; The Conference Board of Canada.

[7] Anne-Wil Harzing "An Empirical Analysis and Extension of the Bartlett and Ghoshal Typology of Multinational Companies."

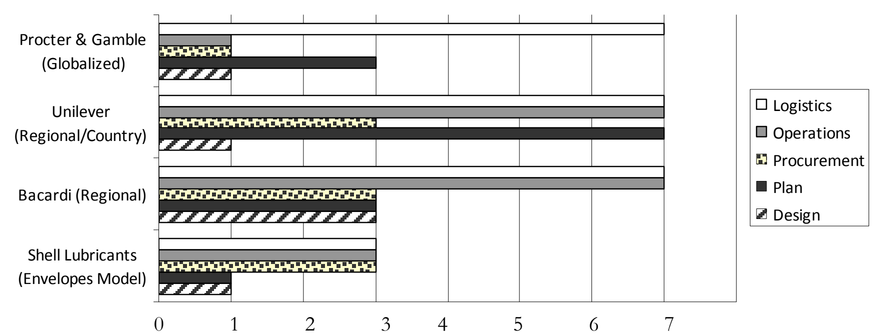
These different corporate headquarter configurations are related to the fundamental nature of the corporation's products or services, as well as corporate strategy. The extent of devolution to subsidiaries depends on the corporate evaluation of the relative benefits of headquarter control and economies of scale versus the desirability of maintaining a managerial presence near production or markets.

Thus, large global corporations that produce homogenous goods and incur huge capital costs, such as integrated oil and gas companies, place a premium on the capital-raising functions of the corporate headquarters. It makes sense for them to limit subordinate discretion because it is possible to use standardized approaches to extraction and processing regardless of where the company operates. The Dutch multinational Shell reflects this tight headquarters structure.

However, in situations where local preferences and regulatory conditions call for differentiated products, such as in food processing, it makes sense to devolve responsibilities to subsidiaries that are better able to vary a core product or function to local tastes and regulatory requirements. Transportation costs and local manufacturing costs and capabilities can also have an impact on the number of headquarters operated by a company. Those factors tend to favour devolved headquarter structures for consumer product companies like Bacardi and Unilever.

Another reason for devolution to subsidiaries is when these can serve as corporate "centres of excellence". In this approach, a division may take the lead in a certain area where it is seen to have special expertise. For instance, when Falconbridge was taken over by Xstrata in 2006, the Canadian headquarters was handed the global product mandate for nickel (the Canadian subsidiary is now called Xstrata Nickel) because of Falconbridge's capabilities in nickel extraction and processing. Similarly, Belgium-based Interbrew's acquisition of John Labatt Ltd. resulted in the Toronto office taking charge of technology for the Americas.[8]

Chart 1: Headquarters Involved in Decision Making by Supply Chain Model (Number of headquarters)*



*selected companies
Source: Adapted from: George Yip, "Global Supply Chains Paradigm".

Scale economies can also be achieved through the relationship between subordinate units. In some configurations, subsidiaries are tightly interlinked with one another in

[8] Bloom and Grant, *Hollowing Out, Vol. II.*

provider-customer type relationships. Companies will often engineer their own global value chains by taking stakes in subsidiaries and then linking these subsidiaries together in a network. That explains why intra-firm trade is an important part of global supply chains.

Headquarters are not created equal in their decision making power and staffing. Similarly, their impact on value chains and the national economy also varies considerably. Headquarters are differentiated in terms of corporate mandate and function; distinctions that can have very important implications for the size and benefits associated with hosting headquarters.

Although the size of headquarters generally grows with corporate revenues, revenue is not always the most important determinant or factor in a headquarter's impact, especially in cases of devolved headquarters structures. For instance, the leveraged buyout company, Kohlberg Kravis Roberts & Co., employs fewer than 80 people at headquarters yet reports over $40 billion in revenue. Meanwhile, before a restructuring in the 1990s, Coca-Cola Enterprises Inc. had nearly 5,000 employees at its corporate headquarters with less than $20 billion in revenue. [9]

Wide variations are found within some industries. For example, Hoescht, the German chemical and pharmaceutical company had 180 people in its corporate headquarters at the same time as its competitor Bayer had several thousand. This suggests that headquarter configurations are as much a matter of corporate strategy as they are the result of the underlying business of firms. Indeed, this explains why the configuration of headquarters often changes significantly with the arrival of a new Chief Executive Officer or after a merger or acquisition.[10] (These differences will be considered again, below, when Canadian headquarters are compared with those of other countries).

Headquarters and Global Value Chains

Headquarters are instrumental in the formation of global value chains. Global value chains are one manifestation of a corporation's search for efficiency as it competes for profits and market share. The corporate headquarters determines a strategy and then deploys it through its subordinate headquarters structure. Depending on the nature of that structure, this may result in a different pattern of trade. If that strategy involves the development of global supply chains, then it will be reflected not so much in the domestic headquarters but rather in the subordinate structure.

As an indication of how global supply chains are affecting headquarters structures, Sydor notes the growth of multinational corporations and their affiliates. In 1990, there were 37,000 multinational enterprises and around 170,000 foreign subordinates. By 2004, the number of multinational enterprises had roughly doubled while the number of foreign subordinates had grown by over four fold. Much of this growth, especially in foreign subordinates, can be found in developing countries. Developing countries now account for about a quarter of all multinational corporations and they host about half of the foreign subordinates.[11]

These statistics speak to the fact that global value chains are very much a phenomenon of the integration of the developing world into multinational supply

[9] These examples are provided in: Collis, Young and Goold, "The Size, Structure and Performance", p.13.

[10] We document this in Bloom and Grant, *"Hollowing Out": Myth and Reality.*

[11] Sydor, "The Rise of Global Value Chains", p. 50.

networks. Recently foreign direct investment flows to developing countries have come in two waves. The first, in the mid 1990s, was marked by China's initial opening up to global investors and Mexico's integration into the North American economic space. The second, in the 2000s, saw China expand further and the emergence of the other members of the BRIC countries, namely Brazil, Russia and India.

The integration of the developing world into global supply chains directly impacts the number of headquarters in several ways. First, it increases the number of sub-manufacturing headquarters, as now there is often a need for regional or country headquarters to co-ordinate production. Second, as countries grow, they become important markets for consumer products which, as indicated above, tend to require devolved headquarter structures. Finally, as countries become more technologically sophisticated they may become established as national centres of excellence, thereby attracting headquarters to take advantage of leading-edge capabilities for innovation and high-quality production.

The structure of affiliate headquarters has an impact on trade flows because more trade flows are now "in-house" between affiliates of the same corporation. For instance, Beugelsdijk et. al. analyzed trade flows of U.S. affiliates in 56 host countries between 1983 and 2003. Among US affiliates in developing countries the proportion of host-host, intra-firm trade increased significantly during this time. This was matched with a decline in the proportion of host-home and inter-firm trade. So multinationals have engineered greater vertical specialization by exploiting factor cost differentials across countries.[12]

Why Care About Headquarters?

When Canada experienced a wave of foreign mergers and acquisitions from 2005-07, there was much concern domestically about the loss of Canadian headquarters. This was often expressed as worries about the "hollowing out" of corporate Canada, as the takeover target's head office presence was perceived to be diminished through acquisition foreign-owned enterprises. At that time, there was a national debate about the value of headquarters.[13]

There are several reasons to care about headquarters. First, they employ highly skilled people as senior management, accountants, financiers, and information technology and human resource specialists. The corporate headquarters for a large company may comprise four of five C-level executives, 10-25 senior executives and scores of senior managers as well as highly paid specialists. These people invariably are well-educated and have considerable work experience, which is reflected in their salaries. In 2005, average salaries at head offices in Canada were $74,900, about double the average Canadian salary.[14]

In addition, headquarter's staff typically require ancillary services from other highly skilled management consultants, lawyers, financial services companies, auditors and technology companies. For these reasons headquarters are seen as engines for generating high paying jobs which in turn spillover beneficially to the local economy.

As will be explored later, there is a tendency for headquarters to cluster in urban centers. When this clustering occurs, it can affect the surrounding economy. Clustering

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[12] Beugelsdijk, Pedersen, and Petersen. "Is There a Trend Toward Global Value Chain Specialization?"

[13] See, for example: Martin and Nixon, "A Prescription for Canada: Rethink Our Tax Policy."

[14] Competition Policy Review Panel. *Compete to Win.* p.71.

often leads to technological spillover effects as headquarter centers provide economies of scale in industries that service headquarter functions.[15] That same infrastructure then creates the foundation for medium-sized companies to grow and prosper.

Further, headquarters are decision-making centres. They are both part of global value chains and they *create* global value chains. They determine organizational structure which, in turn, influences headquarters structure. This, in turn, affects a country's role in global innovation and productivity processes. Corporate headquarters, in particular, play a critical role in aggregating and distributing corporate resources. Engagement in global value chains is generally thought to reflect an engagement in international markets and the search for efficiency. The OECD has found that countries that are engaged with global forces tend to have higher productivity.[16] If headquarters are the mechanism for that engagement, then a strong argument can be made that headquarters are productivity-raising and therefore contribute to national prosperity and well-being.

The desirability of hosting a headquarters is part and parcel of the productivity enhancing processes of the underlying enterprise and the role of the headquarters in those processes. This is what drives the high wage jobs that we observe in headquarters, yet these process also exist outside of the headquarter function.

There is also the question: is there a home country 'bias' with headquarters? There is evidence that innovation and managerial decision centres profit disproportionately from global value chains.[17] Other research has shown a tendency for multinationals to repatriate their profits from subsidiaries.[18] Large research-intensive multinationals tend to conduct R&D in their head office city region. On the other hand, most have located, or are in the process of locating, their latest R&D facility elsewhere. Leading R&D performers increasingly choose locations that align with their research interests or their customers.[19] Headquarters also tend to favour local charities when making philanthropic decisions.

The Institute for Competitive and Productivity at the University of Toronto's Rotman School of Business found that these benefits of headquarters held for both Canadian and foreign-owned headquarters.

The existence of a headquarters, in itself, is not necessarily indicative of a high productivity enterprise or high productivity processes at headquarters. There has been a tendency to downsize corporate headquarters in instances where they become bureaucratic and detract from corporate value. Also, there is a significant difference between different types of headquarters in terms of their contribution to corporate value, depending on the nature of the enterprise and headquarter structure. A regional sales headquarters for a global enterprise has a very different function than a subordinate headquarters with a global manufacturing mandate.

The evidence suggests that the impact of headquarters varies significantly depending on:

a) Size of the headquarters
b) Productivity of the underlying enterprise and its global engagement;
c) Headquarters' role in the enterprises' productivity;

[15] Klier and Testa, "Location Trends".

[16] OECD, Moving Up the (Global) Value Chain.

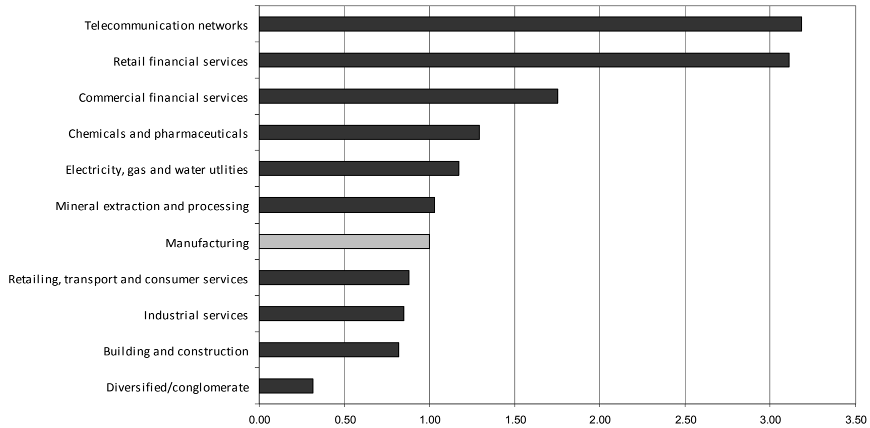
[17] Dedrick,Kraemer, and Linden, "Who Profits from Innovation in Global Value Chains?.

[18] Matthias Dischinger and Nadine Riedel, "There's No Place Like Home:"

[19] Institute for Compettiveness and Prosperty. "Flourishing", p.15.

d) Whether there is a host country bias in headquarters decision making;
e) Whether headquarters cluster together.

Chart 2: Relative Headquarters Size by Sector, Manufacturing=1 (N=467)



Note: Sample drawn from France, Germany, the Netherlands, the UK, the USA, Japan and Chile. The index is controlled for company size.
Source: Collis et. al. "The Size, Structure and Performance", Table 8.

What Determines Headquarters Size?

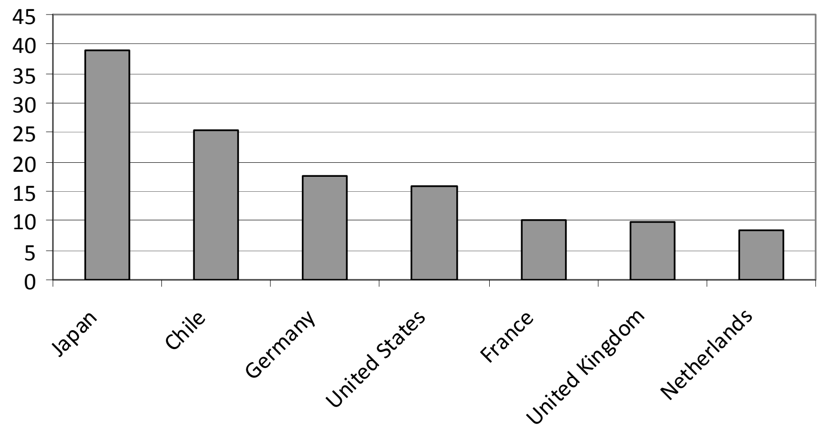
Headquarters are designed to concentrate managerial functions in areas where there are returns to that concentration. As headquarters' economies of scale diminish, headquarters add fewer people per unit of output. So while the size of headquarters is positively related to the number of employees in the corporation, larger corporations have proportionately fewer headquarters employees.

In an international survey of headquarters, Collis et. al. found that a doubling of company size corresponds to about a 25 percent drop in the proportion of employees working in headquarters. They also found significant differences in headquarters staffing across industry sectors.[20] This reflects the aforementioned differences between industries regarding the need for concentrated versus diffuse headquarters structures.

These data confirms two countervailing forces. On the one hand, companies with operations in one country, such as telecommunication companies and utilities tend to have large headquarters. Yet large headquarters are also a feature of companies with wide geographic scope of operations. Even though these globalized companies may devolve decision making outward to subsidiaries, their greater geographic spread requires a larger corporate headquarters to co-ordinate the full range of their global activities. Given these forces, a large headquarters may indicate either less engagement in global value chains or more engagement, depending on the nature of the business.

[20] Collis, Young and Goold, "The Size, Structure and Performance", p.30.

Chart 3: Mean Headquarter Staff per Thousand Employees, Selected Countries



Source: Collis et. al. "International Differences", Table 2.

There are significant cross-country differences in headquarter staffing. Apart from Germany, which tends to have headquarters of similar size to the United States, most European countries sampled had significantly smaller headquarter than in the United States. Japan tends to have very large headquarters, as does Chile.

To put this in concrete terms, a European corporation with 20 thousand employees will typically employ 124 people at headquarters compared to 255 for a similar-sized US corporation and 467 for a similar Japanese firm. The US was also found to have significantly larger legal, tax, and treasury functions than the common European model, perhaps reflecting its litigious corporate culture. The authors cite cultural and home country differences to account for country variations in headquarter size.[21]

What Attracts Headquarters?

Headquarters are attracted by factors that maximize their productivity. They look to locate in centres that facilitate the efficient gathering and use of information and that offer easy access to sources of finance and skilled people. Subordinate headquarters locations are more likely to be influenced by proximity to customers and/or efficient production facilities. Subordinate headquarters, too, want to efficiently gather and use information and so they will tend to be located near major regional centers.

Taxes, whether in the form of tariffs or corporate income tax, can also have a powerful influence on headquarters location. California, for instance, hosts fewer major headquarters than Texas largely because of its more punitive tax system (e.g. the unitary tax). As tariff barriers have fallen, the relative importance of other corporate taxes has increased. Major changes to corporate taxation can have a significant effect on headquarters' decisions.

Access to information processing and finance leads to most headquarters gravitating towards cities. There are two agglomeration forces that help explain the geographic

[21] Collis et. al. "International Differences".

concentration of headquarters. First, large metropolitan areas offer a wide diversity of large-scale business and financial services that make headquarters operations more efficient. Second, these centers allow the clustered headquarters to exchange information and develop a sense of market conditions. Cities are also well served by networking infrastructure in the form of advanced telecommunication networks and airports. [22]

Lovely et al. empirically tested the proposition that a need to obtain information contributes to headquarters agglomeration. They found that the spatial concentration of headquarters is higher among exporters to difficult markets than for other exporters or domestically oriented firms. That is, agglomeration increases as the need to obtain information about relatively unknown markets increases.[23]

The agglomeration of headquarters may lead to higher headquarters costs as headquarters tend to bid up prices. For this reason, corporations will often limit their corporate headquarters to major centres and disperse subordinate headquarters functions to medium-sized regional centres that are still large enough to support good networking infrastructure and attract talented people. Any factors that increase the cost of headquarters in relationship to the corporate value of the headquarters will have a tendency to thwart the creation of headquarters. This includes unpredictable or burdensome public policy regimes or sudden increases in corporate taxes. In some cases this may lead to headquarters reconfiguring the responsibilities between the corporate headquarters and subordinate headquarters to reduce overall headquarter costs. In extreme circumstances, it may involve headquarters moving locations.

Why Do Headquarters Move?

Headquarters move because either their business changes or the business environment around the headquarters changes. The most common case of the former is when a merger or acquisition results in a rationalization of the headquarters function. That usually involves rationalization towards one center, resulting in either the diminishment or elimination of (usually) the targets' headquarters (i.e. the firm that has been acquired).

One of the most comprehensive studies of headquarters movement was conducted by Strauss-Kahn and Vives for the United States. Using a database of 30,000 headquarters in the continental US, they found that, between 1996 and 2001, 1,500 of these moved, a rate of 5 per cent over the period, or 1 per cent annually. The authors found that headquarters tend to relocate to metropolitan areas with good airport facilities, low corporate taxes, low average wages, high levels of business services, same industry specialization, and agglomeration of headquarters in the same sector of activity. That is, the factors that attract headquarters are also the factors that cause them to move to other centres.

Strauss-Khan and Vives also found that headquarters that are larger (in terms of sales) and younger (in terms of time in a given location) tend to relocate more often, as do firms that are larger (in terms of the number of headquarters), are foreign, or are the outcome of a merger. Headquarters that are already in locations with good airport facilities, low corporate taxes, and with significant agglomeration of headquarters in the same sector of activity tend to stay put. So, if a centre has attracted a sufficient number of headquarters, it is likely to keep them unless, of course, any of the key environmental factors changes.

[22] Bel and Fageda, "Getting There Fast", p.471.

[23] Lovely et. al, "Information, Agglomeration".

Recent Trends in Headquarters

As with business in general, the headquarters function is constantly evolving as corporations strive to improve performance.

One trend is that the global distribution of headquarters is shifting towards developing countries. This is a natural outcome of the integration of developing countries into global value chains. As noted above, the number of foreign affiliates of multinationals in developing countries has grown rapidly in recent years. With this growth comes the establishment of regional headquarters of multinationals to oversee production from new centres and distribution to rising markets.

Table 2: Net Changes in Headquarters: Four Country Comparison (% reporting increase less % reporting decrease)

PAST FIVE YEARS	Germany	UK	U.S.	Japan
Number of staff	-14	-19	19	-39
Outsourcing	47	32	37	-3
HQ influence	2	15	27	n.a.
Services provided	25	13	36	7
FUTURE FIVE YEARS				
Number of staff	-33	-22	-13	-70
Outsourcing	35	36	40	10
HQ influence	2	19	20	n.a.
Services provided	14	3	30	8

Source: Collis et. al. "International Differences", Table 7.

Within the developed world, a second trend has emerged: increasing convergence towards a common headquarter model based on that of the United States. Collis et. al. found that the countries with the largest headquarters, such as Japan and Germany, were most dissatisfied with their performance and therefore more inclined to call for reductions in staff and influence. Although US corporations had relatively large headquarters, they tended to be more satisfied with their performance and therefore a relatively small number of these corporations suggested that there would be declines in headquarters staff and a larger share of respondents thought headquarters influence would grow over time.

A final trend, noted through US research, is the movement of headquarters away from high cost centres toward regional centers that possess many of the characteristics (low taxes, good networking infrastructure) that headquarters find desirable while offering lower costs. Although major centers like New York and Houston continue to be favoured by Fortune 500 companies, these centres are increasingly challenged by medium-sized cities such as Greensboro and Pittsburgh that offer attractive features such as tax breaks and modern infrastructure.

Table 3: United States Metropolitan Centres Net Gain and Loss of Headquarters 1996-2001

Metropolitan Area	Net Change in number of headquarters
Gaining	
Greensboro-Winston-Salem-High Point	10
Pittsburgh	10
San Diego	7
Detroit-Ann Arbor-Flint	7
Phoenix-Mesa	6
Indianapolis	5
San Antonio	5
Dallas-Fort Worth	5
Raleigh-Durham-Chapel Hill	4
Nashville	4
Jacksonville	4
Losing	
New York-New Jersey-Long Island	-32
Cleveland-Akron	-10
San Francisco-Oakland-San Jose	-8
Youngstown-Warren	-8
Minneapolis-St. Paul	-8
Philadelphia-Wilmington-Atlantic City	-7
Los Angeles-Riverside-Orange County	-7
Denver-Boulder-Greeley	-3
Tulsa	-3
Rochester	-3
Atlanta	-3
Allentown-Bethlehem-Easton	-3

Source: Strauss-Kahn and Vives "Why and Where Do Headquarters Move?" p. 181.

Table 4: Top Ten US Cities Ranked by Fortune 500 Headquarters, 2009 (number of HQs)

New York	43
Houston	27
Dallas	14
Atlanta	9
Chicago	9
Minneapolis	9
San Francisco	7
St. Louis	7
Charlotte	6
Los Angeles	6

Source: Fortune

This evidence suggests that headquarters are becoming more dispersed and, in some cases, smaller, in response to shareholder demands for greater value.

Where Does Canada Fit In?

During the 2005-07 mergers and acquisition wave, and in response to the Competition Policy Review Panel's investigation into Canadian competitiveness, Statistics Canada produced several studies looking at headquarters.[24] Some of this work was based on the Statistics Canada Business Register, a database that which allows researchers to look headquarters as separate managerial units. The original work dated to 2007; we had Statistics Canada update the data to 2009 for this report.

Recent Trends

The first fact that stands out from the updated data is that the number of Canadian headquarters has fallen since 2005 and now stands at the lowest level in over 10 years. The number of headquarters has fallen by 17 per cent since 2005. One reason for this is the wave of foreign acquisitions in the 2005-2007 period which led to some consolidation of headquarters. A second reason is the worldwide recession since 2007, which has seen a reduction of headquarters globally. As shown elsewhere, the changing fortunes of companies are a much more powerful influence on the number and nature of headquarters than are mergers and acquisitions.[25]

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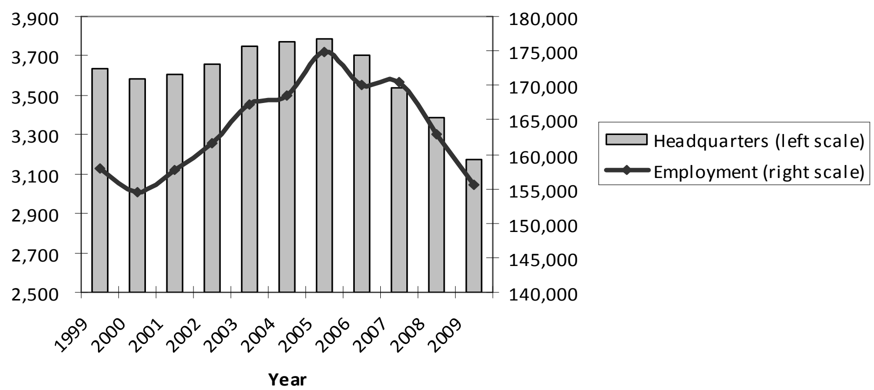
[24] Beckstead, and Brown, Head Office Employment in Canada 1999-2005. Baldwin, Beckstead and Gellatly. Global Links: Multinationals in Canada.

[25] Bloom and Grant, *Hollowing Out,* Vol. 1.

Chart 4: Number of Headquarters and Headquarter Employment, Canada, 1999-2009



Source: Custom Run of Statistics Canada Business Register Database

Table 5: Average Canadian Headquarters Size, by Sector, 2009

Agriculture, Forestry, Fishing and Hunting	7
Mining and Oil and Gas Extraction	50
Utilities	351
Construction	17
Manufacturing	68
Wholesale Trade	39
Retail Trade	28
Transportation and Warehousing	84
Information and Cultural Industries	58
Finance and Insurance	106
Real Estate and Rental and Leasing	22
Professional, Scientific and Technical Services	34
Management of Companies and Enterprises	187
Administrative and Support, Waste Management and Remediation Services	28
Arts, Entertainment and Recreation	20
Accommodation and Food Services	14
Other Services (except Public Administration)	15

Source: Custom Run of Statistics Canada Business Register Database

Half the decline in headquarters is accounted for in two sectors: retail trade, which accounted for 28 per cent of the decline, and manufacturing, which accounted for a further 22 per cent. But since manufacturing headquarters are typically three times as large as retailer headquarters, manufacturing accounted for almost 60 per cent of the decline in headquarters employment. That supports the view that the decline in headquarters and headquarters employment is closely related to recessionary forces that have hit these two sectors hard.

The pattern of Canadian headquarters by sector largely conforms to international experience: utilities and financial services have especially large headquarters. The main exception is in the "management of companies" sector, in other words, conglomerates. According to the Statistics Canada data, this sector historically has had a small number of relatively small headquarters. However, in 2008-09 there was a significant increase in both the number of headquarters, employment in headquarters and the size of headquarters in this sector.

On average, Canadian headquarters employ 49 people, a number that has actually increased slightly since 1999. The Business Register data is not strictly comparable to Collis' international data which is based on the ratio of headquarters employees to total employees. However, research carried out for the Canadian manufacturing sector found that headquarters employment was about 12 people for every thousand employees, which would put Canadian head office employment in line with that of the United States. This is not surprising given the similarities between the Canadian and United States business cultures and approaches to management.[26]

Canadian companies typically account for about 3 times as many headquarters as foreign companies. This is because there are more Canadian-owned companies in Canada than foreign-owned companies and because Canadian companies will often have multiple Canadian headquarters. Yet foreign headquarters tend to have somewhat larger headquarters than Canadian companies, at about 60 employees per headquarters. Even though foreign firms, on average, employ more people, they have an ambiguous impact on head office employment. On the one hand, the arrival of a foreign firm through acquisition may result in a downsized Canadian headquarters. This is what happened following the 2005-06 wave of foreign acquisitions of Canadian companies. But on the other hand, foreign firms accounted for most of the growth in head office employment in the 1999-2005 period because they were expanding their presence in the Canadian market through new headquarters.[27]

Turnover

These top line changes disguise considerable flux in the number of headquarters. For instance, Beckstead and Brown found that 37 per cent of the headquarters that existed in 1999 had exited by 2005.[28] Yet these were replaced by the 38 per cent of the headquarters that did not exist in 1999. That suggests that over a 6 year period about 40 per cent of headquarters may turnover. As we discuss below, there is a much higher rate of headquarters turnover that results from changing business conditions than that which is due to headquarters moving location, which is typically about 1 per cent annually.

City Agglomeration

Research shows that headquarters tend to agglomerate in cities. It is worthwhile to consider how Canadian cities have fared in attracting and retaining headquarters. We

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[26] Calculated based on data in Baldwin and Brown. *Foreign Multinationals and Head Office Employment*. p.12.

[27] Beckstead and Brown, W. Mark, *Head Office Employment in Canada 1999-2005*.

[28] Ibid, p.12.

looked at seven major urban centers: Montréal, Ottawa-Gatineau, Toronto, Winnipeg, Edmonton, Calgary and Vancouver.

Table 6: Headquarters and Headquarters Employment, Selected Cities, 1999 and 2009

	Headquarters		Employment	
	1999	**2009**	**1999**	**2009**
Toronto	826	793	49,649	54,435
Montréal	596	443	36,763	32,840
Vancouver	355	279	16,894	10,094
Calgary	279	253	11,815	15,697
Edmonton	139	132	2,972	3,790
Winnipeg	114	105	7,410	5,881
Ottawa-Gatineau	100	83	3,634	4,369
Total for Seven Centres	**2,409**	**2,088**	**129,137**	**127,106**
Seven Centre Share of Canada	**66%**	**57%**	**81%**	**82%**

Source: Statistics Canada Business Register Custom Run. The Conference Board of Canada.

In aggregate, the seven major centres lost headquarters over the period, both absolutely and in relationship to other Canadian centres, as indicated by their falling number of headquarters and falling share of total headquarters in Canada. Yet they maintained their share of headquarters employment. This suggests that major Canadian cities retain larger headquarters and tend to lose smaller headquarters. The average size of headquarters in these major cities actually increased from around 53 to 60 in the 1999-2009 period. Given that 2009 was at the tail end of a recession, this suggests that smaller headquarters may be more sensitive to the high overhead costs of operating in major centres over the course of the business cycle.

Over the past decade, both Montréal and Vancouver have seen significant declines in both the number of headquarters and headquarters employment. In Montréal's case, the issue may be related to corporate concerns about its relatively unsettled political situation. In Vancouver, the challenge is the relatively high cost of living. The literature shows that both factors tend to affect the number of headquarters and the employment levels in headquarters.

International Comparisons

It is difficult to compare headquarters among countries because countries have different ways of defining headquarters. At any rate, it is not clear that the number of headquarters matters as much as the nature of headquarters. As we have already argued, the benefits associated with headquarters are very much related to their size, their global engagement and whether a country tends to host clusters of these headquarters. These types of large, globally-engaged, clustered headquarters tend to be a small fraction of the total.

To illustrate, the Institute for Competitiveness and Prosperity has attempted to gauge "global leader" Canadian-owned and headquartered companies.

Table 7: Canadian-Headquartered Global Leaders, April 2008

Abitibi Bowater	Cott	Major Drilling	Shawcorp
Agrium	Couche-Tard	Manulife Financial	Sierra Wireless
Ahton-Potter (MDC)	Dalsa	McCain	SMART Technologies
Atco	Exfo Electro-Optical Engineering	MDS	SNC-Lavalin
ATS	Finning International	Methanex	Spectra Premium Industries
Barrick Gold	Fording (Elk Valley Coal)	Mitel	SunGro Horticulture
Bombardier	Garda World	Norbord	TD Waterhouse
CAE	Gildan	North American Fur Auctions	Teck-Cominco
Cameco	Goldcorp	Nortel	Tembec
Canam Steel	Harlequin (Torstar)	Nova Chemicals	Thompson Creek Metals (Blue Pearl)
Canfor	Husky Injection Molding	Open Text	Thomson Corporation
CCL Industries	Imax	Patheon	Timminco
Celestica	Jim Pattison Group	Peerless Clothing	TLC Vision
CGI	Maax Holdings	Pollard Holdings LP	Transat A.T.
CHC Helicopter	MacDonald Dettwiler	Potash Corp.	Trimac
Chemtrade Logistics	Magna	Premier Tech	Velan
Cinram	Magnequench (Neo Material Technologies)	Quebecor World	Westcast Industries
Cirque du Soleil		Research In Motion	Weston Foods
CN Rail		Ritchie Bros. Auctioneers	Zarlink
Connors Bros.		Scotia Mocatta	

Source : Institute for Competitiveness & Prosperity. *Flourishing in the Global Competitiveness Game.*

The Institute defines a Canadian global leader by size (revenues exceeding $100 million) and market share (top five in its market segment globally). In April 2008, Canada had 77 global leaders. This was double the 1985 figure, yet down from the peak of 83 in 2003. Either way, the number of "global leaders" is only a small fraction of the 2,000 Canadian-owned and Canadian-headquartered companies. And few of these global leaders were on the list in 1985, suggesting that the emergence of new companies such as Cirque du Soleil, Research in Motion, Open Text and Finning International is a very important factor in the number and size of major headquarters.

Another relevant measure is Canada's share of large global headquarters, as captured by the Fortune Global 500 list of the world's largest companies. In 2009, 14 Canadian companies made this list. However, most are relatively small in global terms and/or focused primarily on the Canadian market. Only 4 of the 14 companies are both large and "global leaders" as defined by the Institute for Competitiveness & Prosperity. So although Canadian companies appear to be represented in line with Canada's share of global output (2.5 per cent), this share seems to reflect the size of Canada's local market and its natural resource endowment more than the global ambitions and activities of its companies.

Table 8: Canadian-Headquartered Global 500 Companies, 2009

Country Rank	Company	Global 500 Rank	Revenues ($ million s)	City	Global Leader?
1	Royal Bank of Canada	211	36,616	Toronto	
2	Power Corp. of Canada	226	35,125	Montreal	
3	George Weston	254	32,361	Toronto	x
4	Manulife Financial	276	30,948	Toronto	x
5	EnCana	284	30,064	Calgary	
6	Suncor Energy	325	27,680	Calgary	
7	Petro-Canada	340	26,054	Calgary	
8	Bank of Nova Scotia	343	25,944	Toronto	
9	Onex	353	25,207	Toronto	
10	Toronto-Dominion Bank	354	25,070	Toronto	
11	Magna International	384	23,704	Aurora	x
12	Husky Energy	396	23,162	Calgary	
13	Bombardier	468	19,721	Montreal	x

Source: Fortune. Conference Board of Canada

By way of comparison, the Netherlands is a good example of a relatively small economy that is home to large globally-orientated headquarters. It has a gross domestic product about half the size of Canada. Yet it hosts (with Britain) Royal Dutch Shell, the world's largest company by revenue in 2009. Moreover, it is home to the financial service leader ING Group, the aerospace company EADS and electronics giant Royal Phillips.

These Dutch companies are larger and more globally orientated than *any* Canadian-headquartered company. Even though the Netherlands has two fewer companies on the Fortune Global 500 list, the combined global revenues of those companies are over $US 650 billion greater than the fourteen Canadian companies on the list.[29]

This is significant because corporate size is important: global value chains are disproportionately constructed by the largest multinational companies. The 100 largest non-financial multinationals accounted for between 10 to 15 per cent of the foreign assets, sales and employment of all the multinationals in the world.[30] They have been steadily increasing the foreign assets over the last 20 years. Thus, while the Netherlands may have fewer headquarters than Canada, the size of its largest companies means that their headquarters are more likely to make significant decisions about global value chains. And the spillover benefits from these companies is also likely greater.

[29] Calculated from Fortune, *Global 500, 2009*.

[30] United Nations Conference on Trade and Development (UNCTAD) *World Investment Report,* p. 18.

Interview Findings

About the Interviews

In order to probe deeper into the relationship between headquarters and global value chains, 10 corporate executives from large companies were interviewed. The companies were selected with an eye towards diversity; we wanted to include both large global companies with operations in Canada as well as domestic companies whose supply chains are increasingly global. The purpose of the interviews was to deepen our qualitative understanding of the way corporations make decisions about their headquarters and involvement in global value chains. Given the small sample size, we did not seek to generalize from what we learned of the experiences of these companies. Rather, the purpose of the interviews was to get a sense of the managerial decisions behind the number and location of headquarters and their relationship to global value chains.

Box 2, below, describes the sample of 10 companies. All the interviewees represented companies with significant sales; the smallest had annual revenues of just over $3 billion. Companies of this size tend to have more complicated supply chains than do smaller companies. The interviews were with senior executives with responsibility for supply chains. As senior executives, these interviewees had strong insights into the drivers of headquarter location. As they had direct responsibility for supply chains, they were also in a good position to comment on the evolution of their companies' value chains and particularly the relationship between headquarters configuration and value chains.

Box 2: About the Interviewees (n=10)

Size of Companies	*Low*	*High*	*Mean*	*Standard Deviation*
Sales ($Millions)	$ 3,100	$ 110,500	$ 29,428	40,413
Market Cap ($millions)	$ 4,300	$ 167,650	$ 35,957	51,303
Employees (thousand)	3	405	115	155
Sectors				
Airline Computer hardware and services				
Engineering (2)				
Equipment (2)				
Medical supplies				
Mining				
Retail				
Telecom				

Orientation				
Domestic	2			
Multi-domestic	2			
Transnational	4			
Global	2			
	Low	*High*	*Mean*	*Standard Deviation*
Number of countries that company….				
Operates in	1	175	57	59
Sources inputs	3	85	28	28
Sells	1	110	48	48
Main headquarters is …				
Canadian	4			
Foreign	6			

A condition for their participation was that the companies not be named, for reasons of commercial confidentiality. Since the analysis focuses on overarching themes rather than details of specific cases, the companies are refered to using general descriptors.

Key Themes Emerging from the Interviews

The advantage of an interview methodology is that it reveals nuances that may get lost in pure statistical analyses. The fact is that corporate strategies and transformations can be very difficult to categorize and attempts to do inevitably end up simplifying. Yet complex corporate strategies are the main determinant of the number of headquarters and the configuration of global value chains.

Two overarching themes emerge from the interviews. First, there are clear pressures for companies to transform their global value chains to remain competitive. Second, the number of headquarters is less important than what headquarters do. The mere existence of a large company headquarters is not necessarily an indication of engagement in a global value chain. Moreover, a focus on the movement of headquarters locations is less important than the transformation of the role of headquarters. In fact, those roles are changing much faster than are headquarters locations.

There is a clear trend towards all the interviewed companies becoming increasingly globalized, largely as a consequence of the economic emergence of the developing world. Developing countries are very attractive sources of inputs and, over time, are becoming more attractive as end markets. The integration of developing countries, especially in Asia, into global value chains has affected all the companies in our sample. But the question is how this integration plays out in corporate transformations and specifically the relationships between corporate and affiliate headquarters.

Engagement in Global Value Chains

The interviewed companies differed significantly in the extent to which they are engaged in global value chains. At one extreme were large Canadian-controlled domestic companies that have very little engagement in global value chains. At the other end of the continuumare large foreign-owned companies that are very engaged in global value chains and whose Canadian operations are part and parcel of that engagement.

Highly regulated Canadian companies with a domestic market orientation, such as telecoms, utilities and retail financial services are, not surprisingly, mostly disengaged from global value chains. On the other hand, domestic retailers have been pushed to source their inputs globally for cost competitive reasons. For some, this has involved the extension of their supply chains to East Asia and, to a lesser extent, India. Initially they did so through standard buying arrangements. But as the breadth and sophistication of imported products evolves, these retailers became increasingly involved in establishing separate regional supply headquarters in those countries from which they source goods.

For example, a large Canadian retailer told us that it had been through this process over the last 10 years. The company established a regional manufacturing headquarters in Shanghai and a logistics headquarters in Hong Kong. The Shanghai headquarters' role was to manage relationships with regional vendors to control quality and production schedules. The Hong Kong headquarters' role was to ensure that goods arrived in a timely fashion in the Canadian marketplace.

About a quarter of Canadian headquarters (and a third of headquarters employment) is associated with foreign affiliates. There was an uptick in the number of affiliates following the wave of foreign acquisitions of Canadian companies, 2005-07. Many affiliates were set up essentially as sales and marketing operations with a limited geographic mandate for Canada, for example, in office equipment. Some foreign-owned companies went a step further and established local manufacturing capabilities, such as in computer services, automobiles and pharmaceuticals.

Given the trend toward globalization by large companies, the question then becomes: how can a Canadian affiliate plug into that process? It is very difficult for pure sales and marketing affiliates to transform their role to become more essential to the global value chain of a global company. One executive observed the opposite: there is a tendency to degrade the responsibilities of these Canadian sales affiliates. The reason is that it is now possible to outsource a variety of corporate functions (e.g. accounting) to lower cost jurisdictions, whereas these were previously organized on a market-by-market basis in the local affiliates.

Affiliates with operational responsibilities beyond marketing and selling seem to be in a somewhat better position to transform themselves along with the global enterprise and to consequently carve out a valuable niche. For instance, we spoke with a pharmaceutical company that now integrated its Canadian research and development capacity into the parent's global research and development efforts. This means the Canadian researchers are part of much larger global research and development projects.

Similarly, an engineering company has been successful at positioning its Canadian operations to be part of international projects that service clients around the world. The company increasingly takes a portfolio approach to managing its global projects. So, for example, if the Canadian affiliate is seen as being an expert on health information system (a Canadian specialty) then that expertise will be brought to bear on all such projects undertaken overseas by the parent company. In these situations, there is a much greater fluidity in the way corporate resources are organized to satisfy client needs.

Many Ways to Add Value

There may be a tendency to think that organizational structures pre-determine the relationship and division of roles between parent and affiliate headquarters. The pursuit of global product mandates, for instance, is seen as being a "good thing" for a country. That may very well be true, but a focus on global mandates misses other ways that a corporate headquarters adds value. In the examples above, there is no "global product mandate" per se but rather shifting mandates that change constantly with client needs. When the Canadian affiliate is instrumental in satisfying those needs, due to its expertise and capacity, then it is, by definition, an important part of the global value chain.

One aspect of adding value that is often ignored is in the area of process improvement. An engineering company told us how the Canadian company was seen as an expert in critical processes (e.g. Six Sigma process improvement methods). This methodological expertise was being applied around the globe, greatly adding value to the company. Once again, that is part of "global value chain" but not necessarily directly related to the supply chain.

Home Country Bias?

Many of those who favour attracting more corporate headquarters to Canada or to a particular city in Canada tend to believe that there is a home country bias in headquarters' managerial decisions relating to procurement and the construction of global value chains. Our interviewees were evenly split as to whether they thought that there was a home country bias in procurement or whether they felt that these decisions are purely commercial. The key determinant appears to be the extent of the difference in cost between the Canadian option and a foreign supply option. If there is an existing Canadian supplier to a Canadian company, then that relationship is unlikely to be severed through modest differences in price. In other words, where economic considerations are approximately balanced, there is some home country bias, perhaps due more to the safety and convenience of existing supplier relationships located nearby than to national sentiment. But major differences in price are likely to have a very significant impact on those relationships for the simple reason that the firm in question will not be able to compete if it maintains high-cost vendor relationships.

This is why China, in particular, is having such a powerful effect on global value chains. Chinese vendors can often produce at a small fraction of the cost of Canadian-based vendors. According to one retailer we interviewed, that difference is pushing Canadian vendors into three niches where Canadian suppliers have a domestic advantage: high quality niche products, products with thin inventories that trade on immediacy of supply, and products that have a high weight/volume in relationship to their value (e.g. laundry detergent) which makes transportation costs onerous for internationally-based suppliers. A pharmaceutical manufacturer argued that there was still a lot of concern about quality control in China and that it therefore China would not push North American manufacturers out of pharmaceutical products.

How Can Canada Become More Engaged?

The interviewees made it clear that large global corporations are the primary platforms for engagement in global value chains. Canada can either develop these globally engaged companies on its own or work through existing global corporations to add value by engaging in their global value chains. It matters less whether the company in question is

Canadian-owned or foreign-owned. Rather, what matters more is whether the globalized company is a leading innovator and whether the Canadian company is a significant component of the global value chain.

The interviewee from one large mining affiliate which had recently been transformed from a Canadian-owned company to a foreign-owned affiliate, shed light on this. Although the mining affiliate had, on the face of it, a reduced mandate (relating to a particular metal) in many ways it was more engaged in global value chains than before its acquisition. For instance, the acquirer came with a managerial philosophy of devolving procurement decisions compared to the Canadian company's central sourcing. This meant that local Canadian sites had more discretion in their supply chain decisions. Moreover, the new company had a much larger global footprint than the acquired company. This meant that Canadian managers and mining engineers were much more likely to work on extremely large global mining projects: even more than before the acquisition.

In general, Canadian firms do well by becoming an integral part of large innovative companies with devolved management systems. When Canadians add value to such companies by providing higher value corporate services, which encompass everything from research and development, to process improvement, to functional expertise and project management expertise, then Canada does well. But clearly not all large companies that operate in Canada are part of these global innovation and delivery mechanisms. Many large companies in Canada are exclusively focused on the Canadian, or in some cases, North American market. The headquarters of these types of companies will produce headquarter jobs but they are much less likely to be engaged in the sort of innovation processes that are critical for Canada to carve its niche in global value chains.

What Can Governments Do?

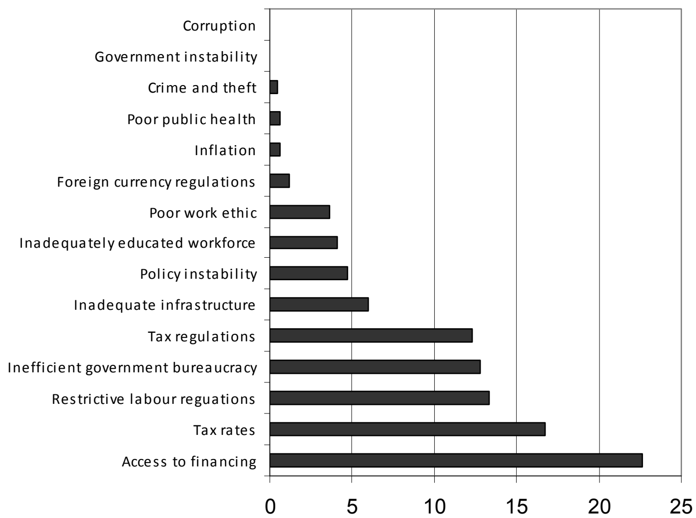
Our interviews confirmed that headquarter location and global value chain decisions are primarily driven by historical and commercial factors. A headquarters is only as viable as the underlying enterprise. Most enterprises start small as small entrepreneurial companies with little need for a separate location headquarters. That explains why the number of headquarters is a small fraction of the number of businesses. However, as businesses grow, they develop a need for a separate management function and a headquarters is born. As such, policies that are good for growing businesses — low taxes, skilled labour, liquid capital markets, good public infrastructure— are good for headquarters.

There is significant turnover in the ranks of headquarters. As we discussed, up to 40 per cent of headquarters may be gone within 6 years and replaced by new entrants. Foreign firms, in particular, are attracted to Canada when the economy is performing well. Foreign companies accounted for the lion's share of head office employment growth in the 1999-2005 period. But those entries and exits should not be construed as headquarter relocations, as research shows that only about 5 per cent of headquarters relocate over a 5 year period. Rather, foreign companies set up affiliates in Canada to either contest the domestic or North American market or take advantage of Canada's natural resources or human capital. Once establish they have, to date, moved infrequently.

So headquarters policy is largely a matter of good business policy. If Canada enhances the competitive environment for business investment, it will stimulate the creation of more headquarters by investing companies which will establish these headquarters to manage their investment. Our interviewees indicated that business people are largely averse to the government playing an activist role to attracting headquarters, through, for instance, fiscal incentives. They are skeptical about the government's ability to pick the "right" type of headquarters to attract and are concerned that government efforts to incent headquarters to come to Canada might adversely affect the situation of existing headquarters.

As such, the interviewees favour more general policies that make Canada a desirable place to invest. That involves getting four policies right: tax, business competitiveness, infrastructure and inward investment promotion.

Chart 5: Most Problematic Factors for Doing Business in Canada, 2009, Weighted Responses (%)



Source: World Economic Forum

According to the World Economic Forum, Canada suffers from a relatively high corporate tax rate and poor tax regulatory system. Another study found, Canada had the third highest tax rate on business investment: 36.6 per cent versus the average of 20.6 per cent (for 30 countries).[31] But the United States is also a relatively high tax country, as is Germany. The difference between Canada and those countries, however, is that Canada currently is host to fewer corporate headquarters of large multinational corporations and lacks global 100 companies with very large international operations. This reality has been recognized by the federal government, which has set the goal of Canada having the lowest statutory corporate tax rate in the G7.

As the Competition Policy Review Panel has noted, Canada would benefit from reforms in its business competitiveness policy environment.[32] That includes the modernization the Canadian patent and copyright system, including improvements to Canada's counterfeit and piracy laws. The Panel also has called for the review of Canada's policy of sector specific investment restrictions. Canada maintains special foreign

[31] Martin Nixon. "A Prescription for Canada: Rethink Our Tax Policy."

[32] Competition Policy Review Panel. *Compete to Win*

restrictions in five industries: transportation, cultural industries, broadcasting, and uranium; financial services have separate ownership restrictions requiring that they be widely held. A relaxation of these regimes would expose Canadian firms to more competition and could lead to more foreign headquarters being established in Canada.

Research shows that headquarters agglomerate in urban centers. The infrastructure that makes these centres liveable and that allows them to be linked to other urban centres (through good airports, roads and telecommunication infrastructure) is a critical factor in attracting headquarters. One approach would be to allow cities to obtain other sources of secure funding beyond property taxes and user fees. Granting cities an improved ability to provide for their own infrastructure, as do many American cities, would go some way to making them attractive as centres for headquarters, which could stimulate the creation of new headquarters, and, in some instances, the movement of existing headquarters to our major cities.

Finally, The Department of Foreign Affairs and International Trade (DFAIT) is actively involved in 'selling' Canada to foreign firms through its Invest in Canada bureau. The bureau is beginning to make good use of market intelligence to target foreign companies who may be interested in establishing headquarters in Canada. There is room for the bureau to more systemically develop leads from this market intelligence and to actively pursue these. Often times Canada may be beneath the radar of foreign firms and a well organized promotional effort can pay dividends. Canadians are often averse to trumpeting their expertise. But that trumpeting will be required more and more in order for it to distinguish itself in a world of constantly evolving global value chains. Promoting our expertise, can help increase Canada's share of corporate headquarters and its role in global value chains.

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