



# Valuing Headquarters for Managing a Global Value Chain

## ITIC Meeting

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# How Important are HQs?

- How important are corporate HQs in a world of global value chains (GVCs)?
- What are the real and perceived benefits of hosting a corporate HQ?
- What are the trends in location and operation of HQs globally and in Canada?



# Growth of Global Value Chains

- “Global value chain” refers to geographic dispersal of the corporate value-added process. A good goes through a series of transformations before reaching final customer: each adds value.
- “Global” refers to tendency for multiple countries to be involved—facilitated by decline in trade barriers and declining costs of transportation and communication.



# HQ Defined

- 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.
- the headquarters unit's power to make decisions (defines whether it is the corporate or subordinate headquarters).



# Purpose of HQ

- Headquarters exist to add corporate value beyond that which is added by corporate divisions or business units:
- Exploit economies of scale in managerial functions and in raising capital, including share issuance.
- Corporate governance includes fiduciary responsibilities to shareholders, legal obligations to report on corporate activities and to control corporate finances.



# Purpose of HQ

- Economies of scale by pooling functional resources at their headquarters.
- A “shared service” model: HQ provides business units with corporate services:
  - HR, tax, marketing, finance and treasury
- Managerial efficiencies realized through senior executives working in a common location: easier to communicate and take collective decisions.



# Value of HQs

- HQs employ highly skilled people: senior management, accountants, financiers, IT and HR specialists.
- Corporate HQ for a large company may comprise 4-5 C-level executives, 10-25 senior executives, scores of senior managers as well as highly paid specialists.
- In 2005, average salaries at head offices in Canada were \$74,900, about double the average Canadian salary.



# Value of HQs

- In addition, HQ staff typically require ancillary services from other highly skilled management consultants, lawyers, financial services companies, auditors and technology companies.
- Thus HQs are seen as engines for generating high paying jobs which in turn spillover beneficially to the local economy.



# Value of HQs

- Tendency for headquarters to cluster in urban centers—can shape the surrounding economy.
- That tendency leads to technological spillover effects as urban HQ centers provide economies of scale in industries that service HQ functions.
- That same infrastructure then creates the foundation for medium-sized companies to grow and prosper.



# Value of HQs

- HQs are part of GVCs and they *create* them.
- Corporate HQs play a critical role in aggregating, distributing corporate resources.
- Engagement in GVCs is generally thought to reflect an engagement in international markets and the search for efficiency.
- OECD: countries engaged with global forces tend to have higher productivity. If HQs are the mechanism for that engagement, then HQs are productivity-raising, contributing to national prosperity and well-being.



# Importance of HQs

- Governments are keen to attract HQs:
  1. Full of high-skilled, highly paid professionals
  2. Purchase high-end professional services (auditing, financial services, management consulting)



# Importance of HQs

- Governments are keen to attract HQs:
  3. They are high end consumers and tax payers
  4. Multiplier effect: generate services jobs – indirect benefits
  5. Invest substantial time and resources in community development, philanthropy



# National Importance of HQs

- HQs are the decision-making centers within corporations, typically determining how corporate resources are allocated.
- Given this, some analysts argue that a *nation's economic welfare* is directly tied to its ability to attract and retain corporate headquarters.



# HQs and Global Value Chains (GVCs)

- Belief in importance of HQs—popular for 50 years—has been given recent impetus:
- The emergence of global value chains has created a heightened sense of importance of HQs.



# *Rise of Corporate Headquarters*

- As corporations grew, they became more complex: began to divide into divisions that specialized in specific areas—product or geographic portfolio.
- Over time, came the creation of HQs dedicated to managing the corporate portfolio, physically separate from places of production.



# Global HQs and Value-Add

- Global investment and trade involving multi-stage value-add have become increasingly intertwined and trade has become increasingly intra-firm as well as inter-firm.
- This has substantially been engineered by managerial decisions made in corporate headquarters.



# Large Companies Have HQs

- 2 million registered businesses in Canada but only 3,000 HQs, most with \$75+ million revenues.
- Very large enterprises often maintain multiple HQs (subordinate HQs plus corporate HQ) so most HQs belong to organizations with \$500+ million revs.
- These have the geographic and operational scope to operate their own global value chains and to participate in other companies'.
- Thus, there is a natural affinity between corporate headquarters and global value chains.



# HQ & Typology of Companies

- Three types of MNCs (Harzing): multi-domestic, global and transnational.
- Differences in sector, regulatory environments, need for access to large capital sums etc. lead companies into these diff. categories—which, in turn, affects how centralized they are and how significant are HQs.



# Impact on Value Chains Varies

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



# Size Varies

- Although the size of HQ generally grows with revenues, revenue is not always the most important determinant or factor in a headquarter's impact, especially in cases of devolved headquarters structures.
- E.g. LBO company, Kohlberg Kravis Roberts & Co., \$40 billion in revenue and only 80 people at HQ vs Coca-Cola with 5,000 employee corporate HQ in 1990 with less than \$20 billion in revenue.



# HQs and Value Chain ‘Formation’

- HQs 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.
- Corporate HQ determines a strategy—such as developing global supply chains—and deploys it through its subordinate HQ structure and operating units.



# Proliferating MNCs and HQs

- Sydor (“The Rise of Global Value Chains”) notes the growth of multinational corporations and their affiliates:
- In 1990, there were 37,000 MNCs and 170,000 foreign subordinates.
- 2004, MNCs had doubled while foreign subordinates increased four fold—much of growth in developing countries which now account for one quarter of MNCs and host half of foreign subordinates.



# GVCs and Developing World

- GVCs are a substantially phenomenon of the integration of the developing world into multinational supply networks.
- Recent FDI flows to developing countries in two waves. First, mid-1990s, China opened up to global investors and Mexico integrated into NA economic space. Second, in 2000s, China expanded further, BRIC countries emerged.



# How Integration Impacts

- Integration of developing world into global supply chains directly impacts the number of HQs:
  1. Increases the number of sub-manufacturing HQs: now there is often a need for regional or country HQs to co-ordinate production.
  2. As countries grow, become major consumer products markets—often need devolved HQ structures.



# How Integration Impacts

3. As countries become tech sophisticated they may become national centres of excellence—and attract HQs wanting to take advantage of leading-edge capabilities for innovation and quality production.



# What Attracts HQs?

- HQs attracted by factors that maximize their productivity.
- Locate in centres that facilitate efficient gathering and use of information and offer easy access to finance and skilled people.
- Subordinate HQ locations are influenced by proximity to customers and/or efficient production facilities, and where can efficiently gather and use information: thus often locate near major regional centers.



# Agglomeration Forces

- Access to info. processing and finance leads HQs towards large cities:
  1. Large CMAs offer a wide diversity of large-scale business and financial services that make HQ operations more efficient.
  2. These centers allow the clustered HQs to exchange information and develop a sense of market conditions.
  3. Cities are also well served by networking infrastructure in the form of advanced telecom networks and airports.



# Information Matters

- Lovely et al. tested the proposition that a need to obtain information contributes to headquarters agglomeration.
- Found: spatial concentration of HQs is higher among *exporters to difficult markets* than for other exporters or domestically oriented firms.
- Agglomeration increases as the need to obtain information about relatively unknown markets increases.



# Taxes

- Taxes, as tariffs or corporate income tax, is powerful influence on HQ location.
  - E.g. California hosts fewer major HQs 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—increases in corporate taxation can significantly effect on HQ decisions.



# Why Do HQs Move?

- HQs move because either their business changes or the business environment around the HQ changes.
- Most common case of former is when M&A results in a rationalization of the HQ function usually toward one center, resulting in diminishment or elimination of (usually) the targets' headquarters.



# U.S. Data-base Evidence

- Strauss-Kahn and Vives study of US HQ movement, using 30,000 HQ database: in 1996-200, 1,500 moved—1 per cent annually.
- HQs tended to relocate to CMAs with good airports, low corporate taxes, low average wages, high levels of business services, same industry specialization, agglomeration of HQs in same sector.
- That is, the factors that attract HQs are same that cause them to move to other centres.



# U.S. Data-base Evidence

- HQs that are larger (in sales) and younger (in time in a given location) tend to relocate more often, as do firms having multiple HQs, are foreign, or are the outcome of a merger.
- HQs 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.
- If a city has attracted enough HQs, it is likely to keep them—unless key environmental factors change.



# US Trends

- Top 'Winners':
  - Greensboro-Winston-Salem-High Point (+10)
  - Pittsburgh (+10)
  - San Diego (+7)
  - Detroit-Ann Arbor-Flint (+7)
  - Phoenix-Mesa (+6)



# US Trends

- Top 'Losers':
  - New York-New Jersey-Long Island (-32)
  - Cleveland-Akron (-10)
  - San Francisco-Oakland-San Jose (-8)
  - Youngstown-Warren (-8)
  - Minneapolis-St. Paul (-8)

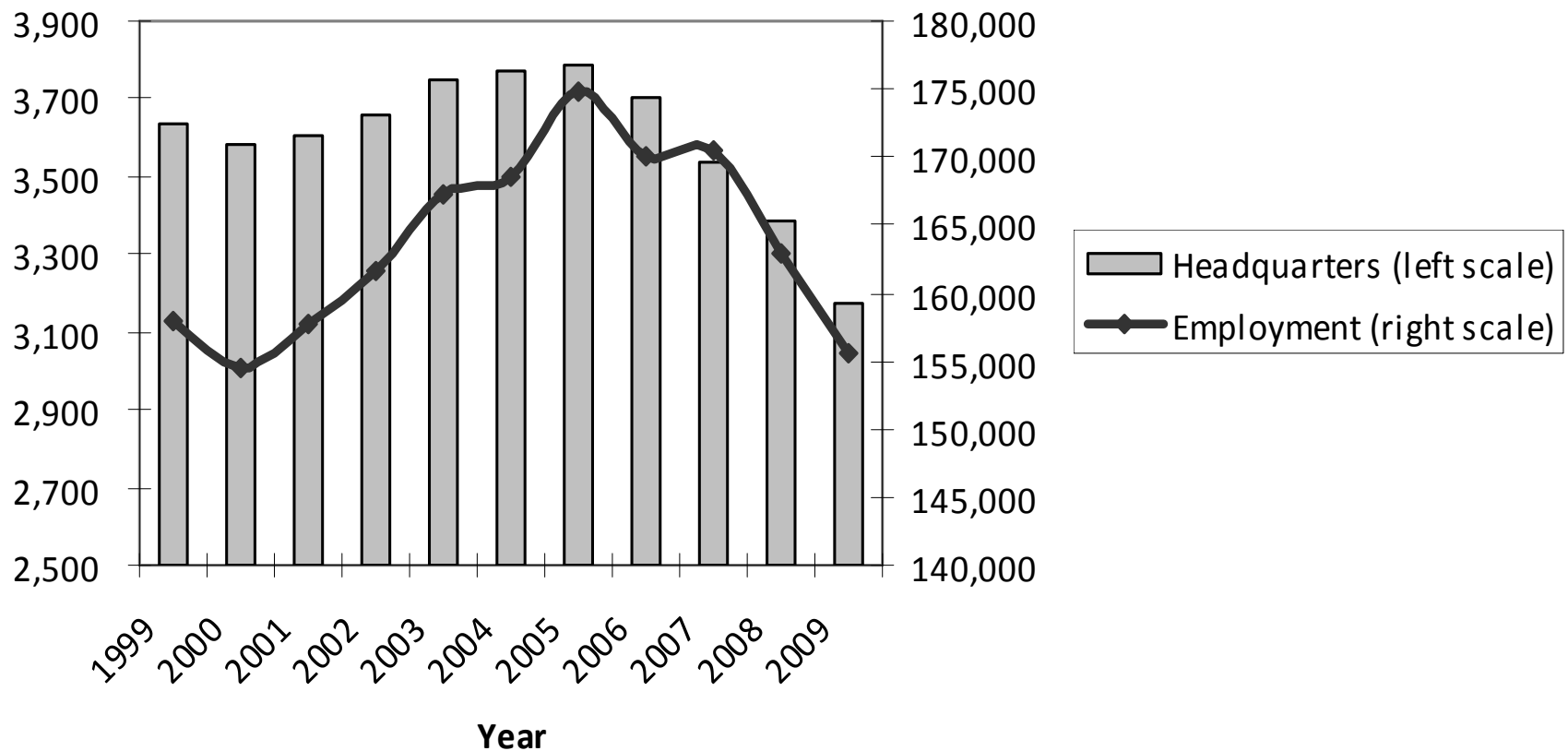


# Canada: Recent Trends

- Number of Cdn HQs has fallen by 17 per cent since 2005 and now stands at the lowest level in over 10 years. Why?:
- Wave of foreign acquisitions in 2005-2007 led to some consolidation of headquarters.
- Recession 2007-9, saw reduction of HQs globally—as changing corporate fortunes are a much more powerful influence on the number and nature of HQs than are M&As.



# HQs and HQ Employment, Canada, 1999-2009



# Sectoral Decline

- Half the decline in HQs comes from two sectors: retail trade (28 per cent) and manufacturing, (22 per cent).
- Since manufacturing HQs are 3 X as large as retailer HQs, manufacturing accounted for 60 per cent of decline in HQ employment.
- Indicates that decline in HQs/employment are closely related to recessionary forces that hit these two sectors hard.



# HQ Employment

- Ave. Cdn HQ employs 49 people—up slightly since 1999.
- In Cdn. manufacturing sector, HQ employment is 12 people per 1,000 employees: in line with U.S.
- Canadian companies account for 3 X as many HQs as foreign companies.
- Foreign HQs average 60 employees per HQ.
- Foreign firms have an ambiguous impact on head office employment: sometimes causing downsizing through takeover, other times expanding presence through new HQs.



# Turnover

- Beckstead and Brown: 37 per cent of HQs in 1999 had exited by 2005; replaced by 38 per cent of the headquarters that did not exist in 1999.
- In 6 years 40 per cent of HQs may turnover due to business conditions: a much higher turnover rate than the 1 per cent annual HQ transfer of location.



# City Agglomeration

- Looked at seven major urban centers: Montréal, Ottawa-Gatineau, Toronto, Winnipeg, Edmonton, Calgary, Vancouver.
- All seven lost HQs, absolutely and in relation to other centres, as indicated by their falling number of HQs and falling share of total HQs in Canada.
- Maintained their share of HQ employment—retained larger HQs and lost some smaller ones: ave. size up from 53 to 60 in 1999-2009 period.
- Smaller headquarters may be more sensitive to the high overhead costs of operating in major centres over the course of the business cycle.



# Cities: HQs and Employment, 1999, 2009

• Toronto	826	793	49,649	54,435
• Montréal	596	443	36,763	32,840
• Vanc.	355	279	16,894	10,094
• Calgary	279	253	11,815	15,697
• Edmon.	139	132	2,972	3,790
• Winnipeg	114	105	7,410	5,881
• Ottawa	100	83	3,634	4,369



# Canadian Share of Global Leaders

- Global leader: annual revenues over \$100 million and in top five in its market segment globally.
- In April 2008, Canada had 77 global leaders—40 more than in 1985, yet down from the 83 that it registered in 2003.
- A small fraction of the 2,000 Canadian-owned and Canadian-HQ'ed companies.
- Few of these global leaders were on the list in 1985, suggesting that the emergence of 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 HQs.



# Size Matters!

- Canada's share of Fortune Global 500 list of the world's largest companies is small. In 2009, 14 Canadian companies that made this list—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”.



# Size Matters!

- So although Canadian companies appear to be represented in line with Canada's share of global output (about 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.



# Netherlands

- By comparison, the Netherlands is small country that is home to large globally-orientated HQs.
- Has has a GDP about half the size of Canada, yet hosts (with Britain) the world's largest company by revenue, in 2009, Royal Dutch Shell. Also home to ING Group, the aerospace company EADS and electronics giant Royal Phillips.



# Netherlands

- Two fewer companies on the Fortune Global 500 list, the global revenues of those companies are over \$US 650 billion more than the fourteen Canadian companies on the list.
- Netherlands may have fewer headquarters than Canada, but much more likely to host HQs that make significant decisions about GVCs.
- Spillover benefits from these companies is also likely greater.



# Interview Findings

- Companies face competitive pressures that cause them to transform their GVCs.
- The number of HQs in a country or city is less important than what they do.
- Large companies are becoming more globalized in most sectors largely due to the economic development of the ‘developing world’ as a source of inputs and, increasingly, end markets.



# Interview Findings

- Large, Cdn-controlled domestic companies, especially in highly regulated sectors like telecom, utilities and retail financial, are largely disengaged from GVCs.
- Domestic retailers have been pushed to expand their GVCs for cost competitive reasons into Asia.



# Interview Findings

- This has led to more Asian subordinate HQs to handle relationships with vendors, logistics and quality control.
- Subordinate HQs are becoming increasingly important as determinants of corporate spending and strategic decisions.



# Interview Findings

- One-quarter of Cdn HQs and one-third of Cdn HQ employment is associated with foreign owned subsidiaries in Canada.
- Hard for foreign-owned subsidiaries to play into GVCs if they are pure sales and marketing affiliates.
- Easier for them to connect into GVCs if they run R&D, engineering and manufacturing operations.



# Interview Findings

- Cdn. firms can do well by becoming involved with large, innovative MNCs, especially MNCs with devolved management structures, to add value to their GVCs:
  - provide R&D, process improvement (e.g. six sigma') and project management expertise.



# Interview Findings

- Some ‘home country’ bias in procurement versus commercial-only decisions.
- The key determinant is the *extent* of the difference in costs between Cdn and foreign procurement options.
- When *small difference* there is a ‘home country’ bias—perhaps due to preferring the safety and security of nearby suppliers rather than to national sentiment.



# Interview Findings

- Major price differences trump safety and security and national sentiment because large differentials undermine competitiveness—which is why China is having a big impact on procurement, supply.



# Interview Findings

- Canada will become more engaged in GVCs through large MNCs —*either* by developing them in Canada through domestic growth and M&A *or* by connecting with existing GVCs of foreign MNCs.
- Ownership less important economically than whether a company is a leading innovator.
- Being acquired can lead to a larger global mandate.



# Interview Findings

- Policies that are good for business are also good for attracting HQs:
  - Low taxes
  - Skilled labour
  - Liquid capital markets
  - Transportation and communications infrastructure
  - Modernized patent and copyright system, including improvements to counterfeit and piracy laws



# Interview Findings

- Fiscal incentives to attract HQs are unlikely to work as well.
- Cities could provide more of their own infrastructure in order to build an environment that would attract HQs—but this requires provincial/federal help to build cities' capacity to tax or raise funds.



# Interview Findings

- DFAIT could help Canadian cities attract HQs by doing more to spread the word internationally about our Canadian advantages of expertise, resources, safe operating environments, skilled people, top professional services, and trade orientation.

