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**Competition Policy Review Panel**  
**Research Paper Summary**

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**Title: Assessing the Economic Impact of Head Offices in City Regions**

**Subjects Addressed:**

- Impact of head offices on R&D location decisions
- Impact of head offices on community involvement and charitable giving
- Impact of head offices on the quantity and quality of high value business services and occupations in the city
- Differences between Canadian-owned and foreign-owned head offices

*Head Offices –General Considerations:*

Head offices are important to the economic health of large city regions, but the evidence does not support the conclusion that head offices of Canadian-owned firms are more important than those of foreign-owned firms.

Head offices pay much higher salaries than other establishments. In both Canada and the United States, the average annual salary of those employed at a headquarters establishment is about double the average national salary. However, headquarters account only for a small share of total employment.

Head offices are drawn to large cities, high concentrations of financial services and specialized business services, critical infrastructure such as major airports, highways and telecommunications, and concentrations of highly-skilled professionals. A 10% increase in the number of local specialized business or financial service providers in a US county increases the birth rate of headquarters in the county by 3.6%.

Nearly three quarters of head office employment in Canada is located in four cities. At the same time, high value occupations and business services are concentrated in larger cities. Since both head offices and high value business services are found in large cities, it is very difficult to determine whether head offices drive these high value industries or vice versa. More than likely, they support each other in a mutually reinforcing framework.

*Research and Development (R&D):*

In the area of research and development, we find that the location of a global head office is becoming less important in the establishment of new corporate R&D facilities. Legacy effects mean that most large R&D performers globally have facilities near their head office. The 25 largest R&D performers in the world all conduct R&D in the same city as their head office, but none conduct all their R&D there. Current and future expansions are being located close to customers

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or researchers, either in emerging markets in Asia or established locations in the US and Europe.

Multi-national corporations (MNCs) view the assignment of R&D responsibilities to a subsidiary as an investment in the subsidiary's capacity not only to *create* new technical knowledge through internal efforts but also to *absorb* spillovers of external knowledge from competitors' R&D activities.

According to a Thursby and Thursby survey, only 34 of 105 US firms surveyed were locating their latest R&D facility in the US and only 51 of 119 Western European-based R&D leaders are locating their next facility in their home country. However, home countries attract a large share of current R&D funding; half of the respondents performed 75% or more of their R&D in their home country.

Canadian-owned firms performing R&D are significantly smaller than Canadian operations of foreign-owned firms in Canada. The average Canadian firm conducting any R&D has revenues of \$27 million; the average foreign-owned firm in Canada has revenue of \$547 million in Canada and hence more funds to invest in R&D.

*Contributions to local Charities and Community Involvement:*

Head offices are significant contributors to local charities in corporate and employee financial contributions and through the involvement of senior managers and employees on boards and in donation drives. Among 292 private sector board members on charities, 55% came from companies with head offices in the same city, 20% from companies with head offices in another Canadian city, and 25% from companies with head offices in another country.

Among the largest corporate donors to United Ways/Centraides in Canada's largest headquarters cities, Canadian firms tend to donate more than foreign firms – although the strength of Canadian firms' contribution is borne heavily by our five large banks in Toronto. In part, this may be due to the fact that the foreign firms on United Ways/Centraides corporate honour rolls are smaller; proportional to revenue, foreign-owned firms' contributions are actually slightly higher than those of Canadian-owned firms.

In the future, head office locations will become less important to local charities as corporate giving becomes more strategic and related to business needs. Strategies are set to reflect business priorities, employee and/or customer preferences, relationships with communities surrounding company operations, and brand image. The importance of a head office then depends on the number of employees, though the location of senior decision-makers and the networks of which they are part also matter.

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Regression analysis across Canada's 27 city regions shows that the presence of head offices in a city region does not drive total donations to United Ways/Centraides higher.

*Spillover Benefits to High-Value Business Services:*

Head offices are associated with high value business services, particularly information technology, advertising services, financial services and business services. To varying degrees, head offices correlate with more employment and/or higher wages in these clusters. These results are a correlation, they do not show causation.

In Canada, the strongest linkage is between head office employment and the size of and salaries paid in the information technology clusters, although we see no such relationship in US city regions. The next most important linkage in Canada is with advertising services, where employment in head offices is significantly correlated with the size of and salaries paid in the cluster; this is also an important linkage in the US. The third most important linkage in Canada is with financial services; this is the most important linkage in the United States. Head office employment in Canada is also correlated modestly with employment in professional services (esp. engineering) and wages in local business services, such as accounting and legal services.

In Canada, a 10% increase in head office employment is associated with a 4.6% increase in employment in information technology and a 1.1% average wage increase in the information technology cluster; a 10% increase in the number of head office units is associated with a 9.9% increase in information technology employment. A 10% increase in head office employment is correlated with a 2.1% increase in advertising services employment and a 1% increase in wages; a 10% increase in the number of head office units is correlated with 5.2% increase in advertising services employment.

Where the regression analysis indicates a statistical relationship, there is a tendency for the presence of Canadian head offices to have a stronger association than foreign head offices with high value cluster employment and wages; but there is a slightly greater tendency for there to be no difference.

*Differences between Foreign-owned and Canadian-owned Companies:*

A recent Statistics Canada survey shows that employees at foreign-owned firms in Canada receive higher salaries, wages and benefits than their counterparts at Canadian-owned firms. The gap in average salaries and wages was 7.6% and the gap in average salaries, wages and benefits was 11.9%. Canadian-owned head offices spend more on outside business services (legal, accounting, etc.). Foreign firms spend significantly more on advertising and promotion services. They also spend more on employment agencies, and slightly more on outside R&D (though the overall level is low).

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The evidence does not indicate that Canadian-owned head offices have greater local economic impact than foreign-owned firms. Foreign-owned firms in Canada are more productive than Canadian-owned firms, with higher wages being one of the outcomes. Foreign-owned firms also confer positive impacts for their domestic-owned neighbours through greater competitive intensity and technology diffusion. It is important to note that the research points to the multi-national aspect of these firms, not that they are foreign. Canadian-owned and foreign-owned MNCs have developed capabilities and advantages that allow them to expand internationally and so they are to be expected to have a better performance than their competitors who are domestically focused.

Nevertheless, it is important that Canada develop its own firms who are global leaders for three reasons. First, the profitable expansion of a Canadian company to become a global leader often creates huge equity gains for its owners here in Canada, with ensuing local spillovers. Second, the presence of successful Canadian global leaders helps ensure Canada's relevance on the global stage in the creation of important international economic agreements. Third, the success of Canadian-owned firms is a strong indicator that our economic environment is conducive to innovation and creativity.

*Conclusions:*

From a public policy perspective, it is important that our economic environment support the success of both Canadian-owned and foreign-owned businesses. Economic policy should both drive innovation and creativity by Canadian firms to propel their global expansion and make Canada a compelling destination for investment. Foreign-owned head offices provide similar economic benefits to their city regions in Canada and policies aimed at blocking their investment in Canada will be counter productive to our national prosperity and the creation of a competitive environment that stimulates Canadian firms.

Canada's economic policies need to support the vibrant growth of our city regions and the continued development of skilled human capital. In a virtuous circle, this supports the success of head offices, which in turn enhances our human capital, thereby increasing the vibrancy of Canadian cities and the country as a whole.