

## **EUROPEAN HEADQUARTERS:**

### **LOCATION DECISIONS AND ESTABLISHING SEQUENTIAL COMPANY ACTIVITIES**

*Final report*

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## Executive summary

### *European Headquarters (EHQ) trends*

After the global economic downturn in the first years of the new century, we are currently witnessing an increase in the mobility of Headquarters (HQ) activities. This trend takes place against the background of the current wave of *offshoring and outsourcing* of service related activities. While, Ernst & Young's *European Investment Monitor (EIM)*, since its start in 1997, showed an increase in the number of EHQs, it has recorded a steep fall in the number of EHQ investment projects for the seven researched countries in 2001 (from 123 in 2000 to 73). After 2001 it remained relatively stable in 2002 and 2003 (around 65-75 projects a year).

Over the period 1997-2003 most of the EHQ projects (app. 79%) in the seven countries are conducted by North American (largely US) Multinational Companies (MNCs). The software industry accounted for 40% of the investments followed by business services and electronics, with both 7,5%. 44% of the investments related to EHQs with less than 20 employees. The Netherlands has, similar to the other six researched countries, also experienced a fall in EHQ projects after 2000. However, the longitudinal analysis shows that the Netherlands does not experience a more severe decrease in EHQ projects than its major competitors. Most countries saw the investment numbers rise until 2000 and a decrease thereafter. Only the investment numbers in Germany (very volatile) and Belgium (very stable) deviate from the general trend. The stable number of new European Headquarters in Belgium is in contrast with the statement of Michel Tilmant (CEO ING Group) that MNCs in Belgium have relocated to other countries in the past decade.

Although, the preliminary data for 2004 should be treated with caution, the signs are promising. Based on the preliminary 2004 EIM data, the first nine months of 2004 recorded 126 EHQ projects in the seven countries. This is more than in 2000, the year with the highest number of EHQs.

### *Survey*

This study surveyed 98 EHQs. Approximately one quarter of the 98 surveyed EHQs were the result of a relocation in the past to its current location. While, eight EHQs have been relocated within the same country, fifteen EHQs have been international relocations (16%). Based on the findings on EHQ relocations within our surveyed sample, the Netherlands is not *subject to* outward relocations, but moreover attracting EHQs from other competing countries. It is thus pulling EHQs away from competing locations. Although 16% of the surveyed EHQs have been relocated across national borders in the past, we can conclude that international relocations of corporate EHQs are not a very widespread phenomenon (yet). New developments in the EU policy may enhance this trend however.

The results show that EHQs are an important source of job creation (often high value added jobs). At start-up an average EHQ employed 30 employees; at the time of the survey this has increased to an average of 89 employees per EHQ. For each country researched, the average number of employees in EHQs has increased. Germany and the Netherlands have experienced the largest increases: from 36 to 180 and from 28 to 179 employees respectively.

The surveyed EHQs were asked for the location criteria that they included in the location decision making for their EHQ and for the location criteria that they would include if they had to choose an EHQ location now. “Proximity to clients” proved to be the most important location factor at the time of choosing the current EHQ location. Large countries thus tend to benefit from economies of scale, making the relative position of the Netherlands even better. However, together with another top 10 location factor (“Centrality”) this location criterion is shaped by a country’s geographical position rather than by governmental policy-making.

Observing the similarities and differences between the location decisions in the past and when choosing a new location now, the Top 10 of key EHQ location criteria has remained relatively stable. However, the relative importance companies attach to the key location criteria has changed. “Proximity to clients” has become less important, while “Quality & availability of labour”, “Tax” and “Transport and accessibility” have increased in importance (the relative weight in location decisions has increased). These latter three factors are valued high as location criteria and increasingly play a larger role in EHQ location decisions. This development can be explained by the fact that regional integration in Europe has surfaced out the differences between ‘basic’ location criteria that are comparable in all European Union (EU) countries, but that territorial competition increasingly centres and concentrates on a few key location factors. For instance, the “general business environment” and attitude is similar and comparable in all EU countries.

Companies with their EHQ located in the Netherlands value “Transport & accessibility” and “Proximity to major airports” higher than others. The survey showed that companies with their EHQ located in the Netherlands give their location a 7,8 when rating on a scale of 1-10, which is nearly equal to the average score of 7,9. 86% of the respondents from the Netherlands would choose the same location again.

In addition, the survey results show no strong relationship between the establishment of EHQs and the subsequent establishment of other company activities. Most other activities are established before or simultaneously with the EHQ. In only three cases the EHQ investment had triggered and pulled other investments. The presence of a marketing & sales office seems to be of importance for the establishment of EHQs. “Other activities” thus rather attract EHQs than vice versa. This can be explained by the fact that internationalization is often a process that shows an increasing involvement and commitment in a foreign location. The experience a company has with its current location can thus be an important determinant for attracting a future EHQ.

On average about 1 of every 4 respondents say they have other activities in the country of their EHQ. In the Netherlands this ratio is higher, about 40% of the EHQs have other activities as well. This indicates that the experience companies have in the Netherlands has been above average and has led to the establishment of an EHQ.

The counterintuitive relationship between establishing other activities prior to the EHQ rather than vice versa (i.e. “other activities” attract EHQs) can largely be explained by the fact that internationalization is an evolutionary process, companies tend to open sales departments in different countries as a first step for further involvement and commitment to a specific location, often production or higher value added activities follow (i.e. EHQs). In addition, if one takes a more historical view towards internationalization it shows that EHQs, and the internationalization of higher value added activities is a relative new phenomenon. Although, we must add that the EHQs in this survey have been established quite recently (e.g. the majority in the last decade), in the longer term the pull effect of EHQs might prove to be stronger. Conducting a similar survey in five years time may reveal a stronger pull effect of EHQs. For instance it may well be that, although EHQs followed “other activities”, they may in the long run even attract more sequential investments in the current location. Increasingly, these sequential investment and location decisions will be determined by the *experience* the EHQ has in its current location.

### ***Investment climate***

Switzerland has the best overall investment climate for EHQs, both from a cost as well as a benefit point of view. The Netherlands, however, is a strong competitor with a strong second position. The United Kingdom and Luxembourg have a relatively bad investment climate for EHQs, although the differences between the countries are not that big. Nevertheless, the United Kingdom attracts a large number of EHQ projects. This can possibly be explained by the fact that most of these EHQ projects originate in the United States. US MNCs might tend to favour the cultural historical proximity of the United Kingdom to the United States in terms of “psychic distance”. A location factor that is hard to compete in attracting EHQ projects. However, MNCs do value “proximity to clients”, “other company activities” and “centrality” as important location criteria for the establishment of EHQs. With the accession of eight Central and Eastern European countries to the European Union in 2004 resulting in a centre of gravity moving eastwards, geographic centrality may also change. Consequently, the geographic position of the United Kingdom (as most important EHQ location) is becoming less favourable.

To improve the Dutch investment climate, taking care of transport & accessibility, the tax investment climate, the availability of a major airport and the general business environment will have the strongest impact on the relative position of the Netherlands. Nevertheless, the balance between the cost and quality of labour is increasingly mentioned as an important criteria as well. Although, wages tend to be higher in the Netherlands, MNCs are willing to pay higher wages if the quality is guaranteed.

## Management Samenvatting

### Locatietrends Europese Hoofdkantoren (EHK's)

Na de recessie in de eerste jaren van deze eeuw, is er weer sprake van een toename van de mobiliteit van hoofdkantooractiviteiten. Deze ontwikkeling valt samen met de huidige trend van offshoring en outsourcing van dienstengerelateerde activiteiten. Ernst & Young's European Investment Monitor (EIM) liet in de periode 1997-2000 een stijging zien van het aantal EHK projecten. In 2001 was er echter sprake van een sterke daling (van 123 in 2000 tot 73 EHK's in de zeven landen in 2001). In 2002 en 2003 bleef het aantal EHK projecten ongeveer gelijk (ca. 65-75 EHK projecten per jaar).

In de periode 1997-2003 waren Noord-Amerikaanse bedrijven (m.n. uit de Verenigde Staten) verantwoordelijk voor 79% van de EHK projecten in de zeven in dit onderzoek betrokken landen. Software was de belangrijkste sector met een aandeel van 40% in de EHK projecten, gevolgd door zakelijke dienstverlening en elektronica, met ieder een aandeel van 7,5%. Een groot deel (44%) van de nieuwe EHK's had minder dan 20 werknemers op het moment van oprichting.

Nederland heeft, net als de zes andere onderzochte landen, een daling van het aantal nieuwe EHK's ervaren in de periode na 2000. De longitudinale analyse laat zien dat er voor Nederland geen sprake is van een sterkere daling van het aantal EHK projecten dan voor de concurrerende landen. De meeste landen zagen het aantal projecten stijgen tot 2001, waarna de daling inzette. Alleen Duitsland (erg wisselvallig) en België (erg stabiel) wijken van dit algemene patroon af. Het stabiele aantal EHK projecten in België botst met de uitspraken van Michel Tilmant (CEO ING Group) die zegt dat vrijwel alle multinationals België in het afgelopen decennium verlaten hebben ten gunste van andere landen.

Hoewel de voorlopige data in EIM voor 2004 (data voor de periode januari-september) met enige terughoudendheid gebruikt moeten worden, zijn de eerste tekenen veelbelovend als het gaat om het aantal EHK's. In de eerste negen maanden van 2004 zijn er 126 EHK's gemonitord in de zeven onderzochte landen, wat al meer is dan in heel 2000, het topjaar tot op heden.

### Survey

Voor het onderhavige onderzoek zijn 98 EHK's geïnterviewd. Ongeveer een kwart van de 98 ondervraagde EHK's was in het verleden op een andere Europese locatie gevestigd. Acht van deze EHK's zijn destijds verplaatst binnen het zelfde land, de overige 15 (16% van de geïnterviewde EHK's) zijn over landsgrenzen heen gereloceed. Op basis van onze bevindingen is de voorlopige conclusie dat er geen EHK's uit Nederland vertrokken zijn, en dat er bovendien wel EHK's aangetrokken zijn die voordien in concurrerende landen gevestigd waren. In algemene zin kunnen we stellen dat, hoewel 16% van de EHK's in het verleden is verplaatst van het ene land naar het andere, er (nog) geen sprake is van internationale EHK relocaties als een wijdverbreid fenomeen. Nieuwe ontwikkelingen in het beleid van de Europese Unie (EU) zouden deze trend echter wel kunnen versterken.

De resultaten laten zien dat EHK's een belangrijke bron zijn voor de creatie van banen. Op het moment van vestiging van het EHK is het gemiddelde aantal werknemers 30. Ten tijde van het onderzoek is dit aantal gestegen naar een gemiddelde van 89 werknemers per EHK. Voor alle zeven onderzochte landen geldt dat de gemiddelde werknemersaantallen zijn gegroeid. EHK's in Duitsland en Nederland hebben de grootste personeelsgroei doorgemaakt: respectievelijk van 36 naar 180 en van 28 naar 179 werknemers.

De ondervraagde EHK's zijn gevraagd naar de locatiefactoren die een rol hebben gespeeld bij de toenmalige locatiebeslissing en welke factoren een rol spelen indien het bedrijf nu een locatie zou moeten kiezen. "Nabijheid tot klanten" bleek de belangrijkste locatiefactor te zijn geweest voor de keuze van de huidige locatie. Grote landen profiteren hierbij dus van schaalvoordelen, wat de relatieve positie van Nederland bij het aantrekken van EHK's alleen nog maar beter maakt. Echter, net als een andere locatiefactor, "Centrale ligging", wordt deze factor bepaald door de geografische ligging van een land en niet door overheidsbeleid.

Er zijn een aantal duidelijke overeenkomsten en verschillen tussen de factoren die een rol speelden bij de keuze van de huidige locatie en de factoren die een rol spelen indien het bedrijf nu een locatie zou moeten kiezen. De top 10 van locatiefactoren is voor beide scenario's ongeveer gelijk. Echter, het relatieve belang ("het gewicht" in de overall locatiebeslissing) dat aan de verschillende locatiefactoren wordt gehecht verschilt voor de toenmalige keuze en een nieuwe locatiekeuze nu. Het gewicht van "Nabijheid tot klanten" is nu kleiner dan destijds (alhoewel nog steeds de belangrijkste locatiefactor), terwijl "Kwaliteit en beschikbaarheid van personeel", "Belastingklimaat" en "Transport en bereikbaarheid" belangrijker zijn geworden ten opzichte van de toenmalige locatiekeuze. De drie laatstgenoemde factoren worden belangrijker geacht dan destijds en worden steeds belangrijker bij locatiekeuzes voor EHK's. Deze ontwikkeling kan worden verklaard doordat de regionale integratie in Europa de verschillen tussen landen op een aantal locatiefactoren heeft weggenomen, waardoor de concurrentie tussen landen zich meer en meer toespitst op een aantal essentiële locatiefactoren.

Bedrijven die hun EHK in Nederland hebben gevestigd vinden "Transport en bereikbaarheid" en "Nabijheid tot een groot vliegveld" relatief belangrijker dan EHK's in andere landen. De geïnterviewde EHK's waarden het Nederlandse vestigingsklimaat gemiddeld met een 7,8 op een schaal van 1-10, wat vrijwel gelijk is aan het gemiddelde voor alle EHK's in deze survey (waardering vestigingsklimaat 7,9). 86% van de EHK's in Nederland zou de zelfde locatie opnieuw kiezen indien men nu opnieuw een EHK locatie zou moeten kiezen.

De surveyresultaten laten geen sterke relatie zien tussen de vestiging van een EHK en de vestiging van andere bedrijfsactiviteiten daarna; er is dus geen sprake van een sterke aanzuigende werking op andere bedrijfsactiviteiten door EHK's. Uit het onderzoek bleek dat wanneer er ook andere activiteiten zijn gevestigd in het land van het EHK, deze activiteiten vaak al gevestigd zijn voor of gelijktijdig met het EHK. In slechts 3 gevallen heeft het EHK andere activiteiten aangetrokken.

De vestiging van een EHK wordt vaak voorafgegaan door de vestiging van een Marketing & Saleskantoor. EHK's volgen eerder andere activiteiten dan dat andere activiteiten EHK's volgen. Dit zou kunnen worden verklaard doordat internationalisering vaak een proces is dat steeds sterkere betrokkenheid en commitment bij een buitenlandse locatie laat zien. De ervaring die een onderneming nu opdoet in een land kan van belang zijn voor de toekomstige vestiging van een EHK. Ongeveer een kwart van de ondervraagde bedrijven heeft andere activiteiten in het land waar het EHK gevestigd is. Van de ondervraagde EHK's in Nederland heeft zelfs 40% van de ondernemingen ook andere activiteiten in Nederland. Dit geeft aan dat deze bedrijven Nederland bovengemiddeld waarderen als vestigingslocatie, wat (ondermeer) heeft geleid tot de vestiging van een EHK.

Hoewel het wellicht onaannemelijk lijkt dat het vestigen van andere activiteiten vooraf gaat aan de plaatsing van een EHK, kan dit grotendeels worden verklaard vanuit het oogpunt van internationalisering als een evolutionair proces. De eerste stap die ondernemingen in het buitenland vaak zetten is het openen van verkoopkantoren in verschillende landen, gevolgd door productie of activiteiten met hogere toegevoegde waarde (bijv. EHK's). Wanneer men vanuit historisch oogpunt kijkt naar internationalisering, dan blijkt internationalisering van EHK's en andere activiteiten met hogere toegevoegde waarde een relatief nieuw fenomeen te zijn. Daarbij dient opgemerkt te worden dat de EHK's in dit onderzoek zich redelijk recent hebben gevestigd (voornamelijk in het laatste decennium) en dat op termijn de aanzuigende werking van EHK's groter kan blijken. Een onderzoek over vijf jaar zou een sterker effect van aanzuigende werking kunnen vaststellen. Hoewel de huidige EHK's veelal andere activiteiten volgden, kunnen zij op hun beurt weer nieuwe activiteiten aantrekken. Deze potentiële investeringen en locatiebeslissingen hangen voor een belangrijk deel af van de *ervaring* die het EHK heeft op de huidige locatie.

### **Investeringsklimaat**

Zwitserland heeft het beste investeringsklimaat voor EHK's, zowel vanuit *kosten-* als *voordelen-* ("Benefits") perspectief. Nederland is een sterke concurrent op de tweede positie. Het Verenigd Koninkrijk (VK) en Luxemburg hebben een relatief slecht investeringsklimaat voor EHK's, hoewel de verschillen tussen de landen niet zo groot zijn. Ondanks het relatief slechte investeringsklimaat trekt het VK veel EHK's aan. Dit kan wellicht worden verklaard vanwege het feit dat veel projecten hun oorsprong vinden in de Verenigde Staten (VS). Ondernemingen uit de VS kunnen een voorkeur hebben voor het VK vanwege de cultureel-historische band. Dit soort 'gevoelsfactoren' zijn moeilijk te verslaan. Aan de andere kant hechten multinationals voor de locatie van hun EHK veel waarde aan "Nabijheid tot klanten", "Aanwezigheid van andere bedrijfsactiviteiten" en "Centrale ligging". Met de toetreding van de acht Oost-Europese landen tot de Europese Unie (EU) is het zwaartepunt van Europa naar het oosten verschoven en daarmee is ook het geografische centrum van de EU verschoven. Als gevolg daarvan is de geografische positie van het VK (als voorname EHK locatie) minder interessant geworden.

Om het Nederlandse investeringsklimaat te verbeteren zijn een aantal zaken van belang: voornamelijk transport & toegankelijkheid, het belastingklimaat, de aanwezigheid van een groot vliegveld en de algemene zakelijke omgeving zijn daarbij doorslaggevend voor de relatieve positie van Nederland. Daarnaast wordt de balans tussen kosten en kwaliteit van arbeid steeds vaker genoemd als belangrijk criterium. Hoewel lonen in Nederland hoger zijn, is men bereid deze te betalen als de kwaliteit gegarandeerd blijft.

## 1 Introduction

Are corporate (regional) headquarter (RHQ) activities the next candidates for international relocation? Internationalization of sales (through exports) and production is by no means a new phenomenon (Van den Berghe, 2006 *forthcoming*). However, the recent wave of internationalization has also taken place for those activities typically associated with corporate (regional) headquarters. In the latter case, this concerns corporate activities of higher added value (services), such as, research and development and corporate services. The lowering, or even elimination, of trade and investment barriers in combination with the increasing sophistication of ICT and transportation technologies enables corporations to slice up their corporate headquarter value chain of activities and optimize each individual value adding activity's geographic location.

In a press release UNCTAD (2003) counted 829 establishments or relocations of HQ operations worldwide between January 2002 and March 2003. UNCTAD speaks of a new trend, as in the past transnational corporations only relocated or established individual subsidiaries, today they relocate entire HQs, a process qualified as "the next stage of globalization". Examples of HQ divisional and regional HQ relocations are: Philips' components division to Silicon Valley (Het Financieele Dagblad, 2000), Akzo Nobel's Organon to the pharmaceutical cluster in New Jersey (Het Financieele Dagblad, 2002) and Ahold's US office move to its business 'arena' in the Boston area (Ahold Press Release, 2004). An example of an entire HQ relocation is VNU's relocation from Haarlem to New York in 2001.

Although, most headquarter activities are still in the country of origin of MNCs (Baaij *et. al.*, 2004), policy makers in Europe are thus increasingly concerned by these developments and raise concern about the attractiveness of the headquarter investment climate. Questions that hence arise are: Have (R)HQ become more mobile and footloose and are these activities increasingly being relocated? What are the location criteria in (R)HQ investment decisions and how have they changed over time?

Belgium has experienced a rapid relocation of most of the Multinational companies (MNCs) between 1992 and 1998 and has lost its locational attractiveness for EHQs, according to Michel Tilmant (CEO of ING Group in NRC Handelsblad November 11, 2004: "*Bedrijven niet meer Nederlands*"). In his view, large MNCs are not Dutch, German or British. Large MNCs are global companies that have to deal with for example foreign investors, banks and are able to relocate rapidly.

Against this background the Netherlands Foreign Investment Agency (NFIA), part of the Ministry of Economic Affairs, has asked Ernst & Young's *International Location Advisory Services* to conduct a study into the location determinants of European Headquarters (EHQs), the relative locational attractiveness of the Netherlands for EHQs and the sequence of establishing different company activities in one and the same country. In this study, we have focused on EHQs established in the Netherlands and in six competing alternative countries:

- Belgium;
- France;
- Germany;
- Luxembourg;
- Switzerland;
- United Kingdom.

This report is structured as follows. Chapter two discusses the literature on regional headquarters and associated location factors. The subsequent chapter three, shows recent European headquarter projects established in the period 1997-2003, based on Ernst & Young's *European Investment Monitor*. Chapter four focuses on the survey that was conducted to analyze (changing) patterns in location factors in EHQ projects and analyze the sequential nature of these projects. Following the outcome of the survey, chapter five, analyzes the EHQ-investment climate of the seven countries in order to gain insight in the relative position of each country on the different location factors. Finally chapter 6 provides conclusions and policy recommendations.

## 2 Literature on Regional Headquarters location decisions

### 2.1 Definition of Regional Headquarters

Over the years different researchers have recognized that regionalization is the solution to break the “balancing act” of MNCs between the pressures for global integration and the pressures for local responsiveness and also have provided evidence that regionalization is on the move (Rugman, 2002). Morrison, Ricks and Roth (1991) suggest that “instead of developing global strategies, managers should reassess their strategies with the objective of strengthening regional competitiveness” and their research failed to uncover widespread support for “the advice calling for pursuit of global strategies”.

European headquarters (EHQs) can be considered as regional headquarters. Most large established MNCs have regional headquarters in major regional markets (i.e. Asia, Europe and North America), while some –depending upon the size of their activities in these markets – have regional headquarters that are coordinating centres for several markets. Regional Headquarter (RHQ) can be defined as “organizational units concerned with and involved in the integration and co-ordination of activities of the MNC within a given geographical region, and are the link between the region and the headquarters” (Schütte, 1996). Sullivan (1992) adds that the *mission* of the RHQ is to manage the “tension between headquarters’ call for global efficiency and local subsidiaries’ push for national effectiveness”. An RHQ may consist of an independent legal unit in a location separate from headquarters and/or national units. At the other extreme, it may comprise individual headquarters (or subsidiary) managers as the smallest organisational unit charged with regional responsibilities.

### 2.2 Location decisions and location factors

In recent literature, attention has been paid to the strategic motives and location variables for (re)locating (regional) headquarters. A number of empirical studies into the location of a RHQ have been carried out over the past years. These studies show that the importance of different location factors vary depending on for instance country of origin, investment region and type or part of the headquarter.

Holt *et. al.* (2000) were the first who systematically examined the complex of location issues surrounding RHQ investments. According to Holt *et. al.* (2000) two strategic purposes of RHQ establishment can be distinguished; establishing an RHQ for “regional market responsiveness” purpose or establishing an RHQ for “global coordination & facilitation” purpose. Holt *et. al.* (2000) matched these two RHQ establishment purposes with a number of location variables and found out that the importance of these location variables is different for the two strategic purposes. For instance, low living cost as a location variable appeared to be more important for RHQs that are established for the purpose of global coordination & facilitation than for RHQs

that are established for the purpose of market responsiveness. Another objective of their research was matching the location variables with the different countries of origin of MNCs. To do so, the researchers matched the same location variables with three regions of origin; North America, Asia and Europe (The so-called “Triad”). The importance of the different location variables varies a lot for the three different regions. For instance, favourable financial environment as a location variable for the establishment of RHQs is very important to European MNCs, quite important to North American MNCs and not very important to Asian MNCs.

To analyze the strategic motives for (re)locating headquarters, Baaij and van den Berghe *et. al.* (2005, *forthcoming*) did look beyond the headquarter as a whole and disaggregated the headquarter. The reason for this, is that different parts of the headquarter are subject to different location criteria. The activities of the corporate headquarter can be divided into three parts:

1. the ‘minimum headquarter’ (the statutory seat of the corporation and includes activities like taking care of legal compliance, tax and financial reporting, financial control and internal audit, and investor relations);
2. the ‘value-adding function’ (defined as providing strategic guidance for the businesses, building and leveraging corporate-wide competences, and facilitating synergies between the businesses);
3. the ‘shared services’ (comprises the non-core activities of the businesses which lie in the corporate headquarter because of economies of scale, scope or specialization).

The first part, *the minimum headquarter*, is virtually always part of the global corporate headquarters. The minimum headquarter fulfils primarily a legal and financial role and, therefore, there is less need to be located near the value adding activities.

The *value adding function* needs to be located near the businesses of the corporation. Originally the value adding headquarter was conveniently located at the site of the value adding activities of the corporation. However, with the relocation of the value adding activities, the original location of the headquarter becomes ‘out of sync’ with the rest of the value chain. The value-adding headquarter should, therefore, follow the centre of gravity of the corporation.

The *shared services part* does not need to be close to the business. It is the most mobile part of the headquarter. These services can be off-shored or even outsourced as they are non-core and discretionary. Corporations relocate their shared services primarily for efficiency reasons. Clear evidence of this is for example the relocation of IT-activities to India and administrative services to Eastern Europe.

Tax burdens and incentives are often mentioned as an important factor in HQ location decisions. A Swedish study by Braunerhjelm (2003) into the location of (especially Swedish<sup>1</sup>) Headquarters concluded that a variety of factors affect the location of HQs. Regarding incentives, this study found that they may have an impact, where, if incentives are used, they will most likely take the form of different tax packages. Still, even though they may become important, incentives influencing taxes is not sufficient to attract HQs. Other factors, such as the location of other HQs, customers and suppliers and similar linkages, as well as the firms view on how favourable long-

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<sup>1</sup> Companies from Sweden, not headquarters from foreign companies in Sweden.

term government policies are, “quality of life” factors, etc., will of course also influence the future location of HQs.

With regard to the location of (R)HQs, four factors seem to dominate the location of (R)HQs in the literature:

- proximity to customers;
- attractive regulatory regimes;
- taxes;
- availability of and proximity to efficient communications (ICT, air, train etc.).

Other, partly empirical, studies have also researched the location factors in location decisions. The table below provides an overview of the results from these studies:

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Table 1: Location factors found in (partly empirical) studies

**Cost of Labour**

Employment costs  
Expatriate costs

**Tax**

Overall “tax misery”  
Profit tax  
Expatriate tax  
Tax incentives

**Office property**

Rental costs  
Availability of space  
Quality of office property

**Grants and incentives**

Investment grants  
Infrastructure grants  
Employment grants  
Assistance with recruitment & training

**Transport and accessibility**

Accessibility from corporate headquarters  
Airport facilities  
Local public transport  
Intercity rail services  
International road links  
Proximity to major markets/Centrality of location  
Proximity to other companies (like suppliers)

**Labour regulations**

Regulations (working time, hiring/firing costs)  
Ease of employing expats  
Union activity

**Labour - Quality and Availability**

Quality and availability of employees  
Multilingual skills  
Other Skills  
Local universities and business schools

**Business Support services**

Ease of doing business  
Economic and political stability  
Business climate  
Availability of business support services  
Technological factors

**Telecom**

ICT infrastructure  
Costs

**Quality of life**

Quality of life  
Cost of living  
Image of location  
Medical facilities  
International and multicultural orientation

Some factors that have gained much more attention since 9-11, like safety issues and crime prevention, were all missing in these studies (published before 2001).

### **2.3 Spin off effects of Headquarter activities**

Relatively limited studies have focused on the spin off effects of (R)HQ activities to the regional and local economy where they operate. An exception is the Swedish study by Braunerhjelm and Lindqvist (1999). Based on a sample of 35 Swedish companies, selected from the list of the 50 largest Swedish firms (based on turnover), Braunerhjelm and Lindqvist (1999) demonstrated the extensive links of HQs to other service sectors in the economy.

Obviously, HQs are particularly important customers to providers of legal, financial and IT-services, but also in relation to less advanced services (hotels, conferences, etc.). For instance, the 35 corporate HQs considered account for about 4.6 percent of total sales in the marketing sector, and between 1.5 and 2 percent for IT- and other providers of consulting services. Dependent on the individual firms' strategies, the level and organization of procurement of services varies between HQs. Some firms decentralize a considerable part of the procurement of services, in particular marketing, education, and other production related services, while others pursue more centralized procurement strategies in order to keep prices low and identical across different units within the group. Therefore we can quite safely claim that we are only capturing a part of the HQs' interaction with other sectors.

Thus, data confirms that HQs do have extensive links with other – often knowledge-intensive – sectors and companies in the economy. The interaction between demanding customers and competent supplier is likely to generate spillovers and to produce new knowledge.

However, the literature remains scarce on the relationship between establishing HQ activities and sequential MNC activities. The question whether HQ activities trigger the establishment of additional activities *by the same company* or vice versa has received no academic attention to date.

### 3 Analysis of EHQ investment projects and location trends

#### 3.1 Trends in EHQ location decisions in seven countries

The recent remarkable new phenomenon in international business has been the growth in offshoring and outsourcing of services. This trend of increased relocation of service related company activities (i.e. back office work such as ticketing, accounting, human resource payments and customer interaction services) has emerged since the global economic downturn in 2000/2001. Thinking further along these lines regional HQ activities may have also become more mobile. To explore whether this is the case, this chapter will present the key figures with regard to EHQ Foreign Direct Investment (FDI) projects in the period 1997-2003. This period covers a number of years prior and after the economic downturn and the rise in offshoring and outsourcing strategies. These figures have been drawn from *Ernst & Young's European Investment Monitor (EIM)*<sup>2</sup>.

We have selected the projects in accordance with the selection criteria for the survey:

- EHQs established in Belgium, France, Germany, Luxembourg, The Netherlands, Switzerland or the UK;
- a new investment project (greenfield) or a new co-location<sup>3</sup>;
- the parent company originates from outside Western Europe.

In the period 1997-2003, Ernst & Young identified 579 EHQ<sup>4</sup> investment projects that meet these requirements. The years 1999 and 2000 showed the highest number of EHQ projects (95 and 123 respectively). After a steep fall in 2001, in line with the global economic downturn, the number of EHQ projects has been quite stable in 2002 and 2003 (72 and 66 EHQs respectively). However, the preliminary data on 2004 show a sharp increase in the number of EHQs (126 in the period January-September).

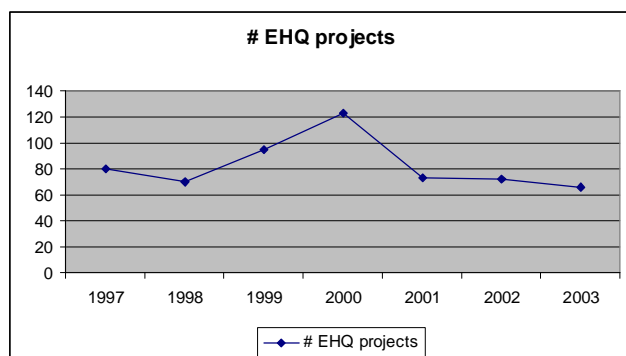
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<sup>2</sup> The *European Investment Monitor*<sup>2</sup> (EIM) is a comprehensive database containing information gathered from over 2,500 sources, which tracks announcements of new greenfield projects, expansions and co-location investments in Europe since 1997. At the time of writing, data were available up to September 2004. For reasons of consistency, we have excluded the preliminary 2004 data in this overall trend analysis.

<sup>3</sup> A co-location is the establishment of a new function, co-located at or near an existing activity.

<sup>4</sup> EIM defines European Headquarters (EHQs) as establishments of foreign companies, which have as their main task the co-ordination of operational subsidiaries of the parent company and/or independent representatives (agents/vendors) in several European countries.

Figure 1: Number of EHQs per year in the seven countries (1997-2003)



The table below (Table 2) shows the location of all 579 EHQ projects between 1997 and 2003<sup>5</sup>.

Table 2: Country of establishment of EHQs (1997-2003)

Country	1997	1998	1999	2000	2001	2002	2003	Total
Belgium	4	3	5	4	5	4	4	<b>29</b>
France	6	8	13	10	10	6	4	<b>57</b>
Germany	5	10	9	11	3	10	3	<b>51</b>
Luxembourg	0	0	0	0	0	0	0	<b>0</b>
Netherlands	5	4	8	10	9	5	6	<b>47</b>
Switzerland	6	3	6	12	5	5	5	<b>42</b>
UK	54	42	54	76	41	42	44	<b>353</b>
<b>Total</b>	<b>80</b>	<b>70</b>	<b>95</b>	<b>123</b>	<b>73</b>	<b>72</b>	<b>66</b>	<b>579</b>
<b>Market share NL</b>	<b>6.3%</b>	<b>5.7%</b>	<b>8.4%</b>	<b>8.1%</b>	<b>12.3%</b>	<b>6.9%</b>	<b>9.1%</b>	<b>8.1%</b>

Of the seven countries the United Kingdom has been the most popular location for EHQ projects between 1997 and 2003 with a market share of over 60 percent. The other countries follow at distance; with France, Germany and the Netherlands and Switzerland attracting around 50 EHQ projects. The Netherlands and Switzerland perform relatively well compared to the size of their economy. The position of Luxembourg is remarkably without any EHQ projects. Recently, it has, however, listed one EHQ project in the European Investment Monitor 2005 (*forthcoming*). The position of Luxembourg may possibly be explained by the fact that most EHQ projects may not be registered as such but rather as holding structures.

<sup>5</sup> At this stage (April 2005) finalized EHQ data for 2004 from Ernst & Young's *European Investment Monitor* are not yet available.

The longitudinal analysis shows that the Netherlands does not experience a more severe decrease in EHQ projects than its major competitors. Most countries saw the investment numbers rise until 2000 and a decrease thereafter. Only the investment numbers in Germany (very volatile) and Belgium (very stable) deviate from this general trend.

### Country and region of origin of EHQ projects

Almost 80 percent of the EHQ projects in the seven selected countries originate from the North American Free Trade Agreement (NAFTA) region (459 projects). US companies account for 436 of these projects, Canadian companies established 23 EHQs in this period. The number of EHQ projects from the USA reached its top level in 2000 (106 EHQs), but since then declined year-by-year to 41 in 2003. Again, this downward trend can be explained by the worldwide economic downturn. Japan follows at a distance with 45 EHQ projects over the 1997-2003 period. Compared to 2000 and 2001 Japan shows an increase in the number of EHQ projects in 2002 and 2003. Similarly, the Tiger Economies<sup>6</sup> also showed a more stable trend in EHQ projects over the entire 1997-2003 period compared to the United States.

Table 3: Country of origin of EHQs (1997-2003)

Origin	1997	1998	1999	2000	2001	2002	2003	Total
Africa	1	-	-	1	-	1	1	4
Asia <sup>7</sup>	-	-	-	1	-	-	2	3
Central and South America	-	-	-	-	-	-	1	1
India	-	-	2	3	-	8	4	17
Japan	10	10	9	1	3	6	6	45
Middle East	2	-	-	3	2	1	1	9
NAFTA (largely USA)	62	54	80	107	63*	49	44	459
Oceania	-	2	-	2	3	2	2	11
Turkey	1	-	-	-	-	-	-	1
Tiger Economies	4	4	4	5	2	5	5	29
<b>Total</b>	<b>80</b>	<b>70</b>	<b>95</b>	<b>123</b>	<b>73</b>	<b>72</b>	<b>66</b>	<b>579</b>

Note: \* this includes one joint venture between a US and Japanese MNC

<sup>6</sup> Tiger Economies include: Hong Kong (China), Singapore, Taiwan, South Korea, Malaysia.

<sup>7</sup> Asia excluding Japan, Tiger Economies and Indian Sub-Continent (India, Pakistan, Bangladesh, Sri Lanka, Burma).

### Sector trends in EHQ projects

The table below lists the ten most represented industries in EHQ projects.

Table 4: Top 10 industries in EHQ projects (1997-2003)

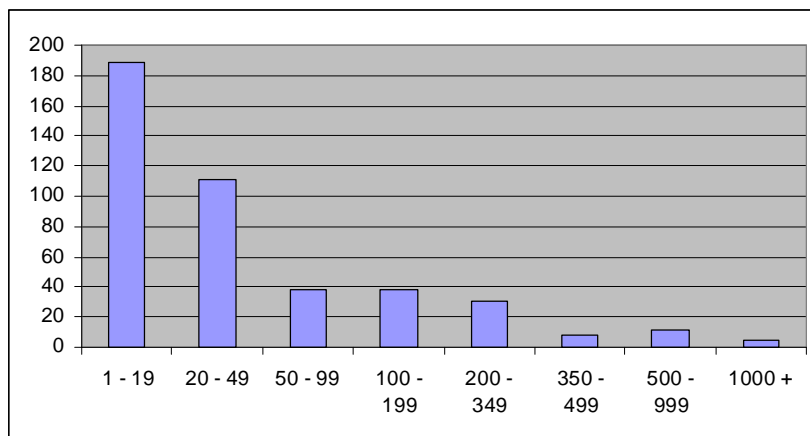
	Sector	1997	1998	1999	2000	2001	2002	2003	Total
1.	Software	22	17	36	65	33	39	21	<b>233</b>
2.	Business Services	3	1	3	19	6	4	7	<b>43</b>
2.	Electronics	9	4	8	8	5	6	3	<b>43</b>
4.	Computers	2	9	3	6	4	-	4	<b>28</b>
5.	Scientific Instruments	5	-	5	2	2	3	8	<b>25</b>
6.	Telecommunications & Post	1	3	4	5	6	1	3	<b>23</b>
7.	Pharmaceuticals	2	3	4	3	2	2	2	<b>18</b>
8.	Chemicals	5	2	3	1	1	1	1	<b>14</b>
8.	Financial Intermediation	4	3	3	2	-	2	-	<b>14</b>
10.	Food	3	2	1	-	1	2	3	<b>12</b>

The most important sector for EHQ projects was the software sector (39 percent, 223 projects). The business services and the electronics sector were holding the second rank, with 43 EHQ projects each.

### Employment figures EHQs

Table 5 shows the number of jobs created by the establishment of EHQs. EIM contains employment figures for 429 EHQs. A large number of EHQs (189) created each between 1 and 19 jobs. The four largest EHQs created more than 1000 jobs each. Based on the median score for each employment band, these 429 EHQs account for the creation of 37,515 jobs.

Table 5: Employment figures EHQs



### **Preliminary results 2004**

The EIM has not been completed yet for the year 2004, hence the following data should be treated with caution. However, based on the results for the months up to September, we can provide a preview of the results for 2004. In the first nine months of 2004, we have identified 126 EHQ projects in the seven countries. This is more than in the year 2000, the year with the highest number of EHQ investments. The United Kingdom and Luxembourg have won market share, while Germany and the Netherlands have lost market share.

The United States is still the dominant source of EHQ projects (60% in 2004), although it has never reached its level of 2001 and before. The most outstanding feature of the 2004 results is the gaining importance of Chinese EHQ projects (11 EHQs, almost 10%). China takes the second place, ahead of Japan (10 projects). In 2004, the most important sectors do not differ a lot from the period 1997-2003. The Computers and the Food industries lost in importance (2 and 1 EHQs respectively).

### **3.2 Conclusions**

The main conclusions with regard to the trends in EHQ locations (1997-2003) are:

- After a steep fall in 2001 the number of EHQ investment projects remained stable in 2002 and 2003 (around 65-75 projects a year);
- About 79% of the investments are conducted by North American companies (largely US MNCs). The decline in EHQ projects can thus largely be attributed to the decline in US EHQ projects;
- The software industry accounts for 40% of the investments followed by business services and electronics, with both 7,5%;
- 44% of the investments concerns EHQs with less than 20 employees;

Preliminary conclusions for 2004 are:

- The (preliminary) data for 2004 show a sharp increase in the number of EHQ investments. In the period January-September already 126 EHQ projects have been monitored. This is more than in 2000, the year with the highest number of EHQs;
- In addition, the preliminary 2004 EIM data show that the number of newly established EHQs in the seven countries of this study has increased;
- Chinese EHQ projects are gaining importance in 2004: China has taken over the second place with 11 EHQ investment project (almost 10%).

## 4 Survey

### 4.1 Introduction

This chapter describes the survey methodology and the survey results and consists of the following sections:

- Sampling methodology (4.2);
- Survey methodology (4.3);
- Characteristics EHQs of participating companies (4.4);
- Survey results: location factors for establishing an EHQ (4.5);
- Survey results: sequence of establishing different company activities (4.6);
- Conclusions (4.7).

### 4.2 Sampling Methodology

Our sample is based on data in the European Investment Monitor (EIM). We have composed this sample by selecting all European Headquarters FDI projects over the period January 1997 – September 2004<sup>8</sup> that fit the following criteria:

- EHQs that have been located in Belgium, France, Germany, Luxembourg, the Netherlands, Switzerland or the UK;
- a new investment project (greenfield) or a new co-location;
- The parent company of the EHQ project should originate outside (Western) Europe.

By adding the EHQs established in 2004 (126 between January and September 2004, see section 3.1), the number of EHQ investment projects that fit these criteria increases from 579 (number of EHQ projects between 1997 and 2003, see section 3.1) to 705. In addition, we have added 12 recent EHQ projects in the Netherlands (provided by the Netherlands Foreign Investment Agency). Finally, in order to enhance the number of responses from Luxembourg, we have added 13 EHQs in Luxembourg. The total base sample thus consists of 737 *EHQs*.

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<sup>8</sup> Other than in the trend analysis (Chapter 3), we have included the preliminary EIM data for the first three quarters of 2004 to enlarge the base sample.

Table 6 shows the country distribution of these 737 EHQ projects.

Table 6: The number of EHQs in the base sample, by country

Country	# EHQ projects
Belgium	35
France	70
Germany	55
Luxembourg	14
Netherlands	71
Switzerland	50
United Kingdom	442
<b>Total</b>	<b>737</b>

### 4.3 Survey methodology

Ernst & Young International Location Advisory Services has conducted a survey by telephone. Although a survey by telephone is more time consuming than a written survey (postal mail, email, fax), we have given preference to a survey by telephone because, based on our previous experiences, this approach often leads to higher response rates and, in addition, provides the possibility to get in close contact with the (investment) managers that have been involved in the EHQ project in the past. This open approach in communication often triggers an interesting discussion about the nature of the EHQ investment project in the past.

The first step consisted of checking the contact details of these 737 EHQs (address, telephone number). We have searched these details for each company through KPN International, Yellow Pages, Amadeus, Dun & Bradstreet, Internet and other sources. We were not able to gather this information for each company due to a variety of reasons (due to for instance bankruptcy, mergers & acquisitions (M&As)). The remaining companies have been contacted. Hence our initial sample was reduced to approximately 630 firms.

If there was no contact person within the firm, the next step for each interview was to identify a company employee who ideally was involved in the investment decision process or alternatively, was well informed about the drivers of the past EHQ investment decision. The majority of the respondents hold senior positions like General Manager Europe, Director Business Development, Financial Manager or HR Director.

The main aim of the survey was twofold:

1. identify the key location factors for an EHQ investment;
2. identification whether an EHQ investment is of a sequential nature, *i.e.* does the presence of other company activities influence the EHQ location decision and/or vice versa does the presence of an EHQ influence the establishment of other company activities.

In addition, some general questions have been added for statistical analysis, like:

- year of establishment of EHQ;
- size of EHQ at start up and now;
- business industry.

The complete questionnaire has been included in Appendix 1.

#### 4.4 Characteristics participating companies and their EHQs

This section is intended to give an overview of the main characteristics from the companies/EHQs that have participated in our survey. The total number of responses per survey question does vary due to the fact that not each respondent was able to answer all questions.

Our starting point was to include an equal number of EHQs per country of establishment. The second point of attention was to include companies that originate from a variety of countries and continents. During the execution of this survey, we had to drop a large number of EHQ projects from our survey due to various reasons (companies that refuse to participate, bankrupt companies, companies that have been acquired, companies that do not have an EHQ anymore et cetera). Of the approximate 630 companies that were defined in our initial sample 98 responded positively to our survey request, putting the response rate at approximately 15 percent. The 98 EHQs are distributed over the seven countries as follows:

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Table 7: Country of destination for establishing EHQs

Country	Responses
Belgium	9
France	7
Germany	6
Luxembourg	0
Netherlands	15
Switzerland	8
UK	53
<b>Total response</b>	<b>98</b>

The response rates largely correlate with the representation of the country in the base sample and the number of EHQ projects that the country attracts (see chapter 3). For instance, the United Kingdom accounts for more than 50 percent of all responses. This reflects the large market share of the United Kingdom in the base sample (section 4.2).

The table below (Table 8) shows the countries of origin of the companies that have taken part in this survey. The US accounts for more than 50 percent of the responses, which again reflects its market share in all EHQ investments in Europe. The other companies originate from Asia, the Middle East, Oceania and Canada. The EHQs from Denmark and the United Kingdom were part of the list provided by NFIA.

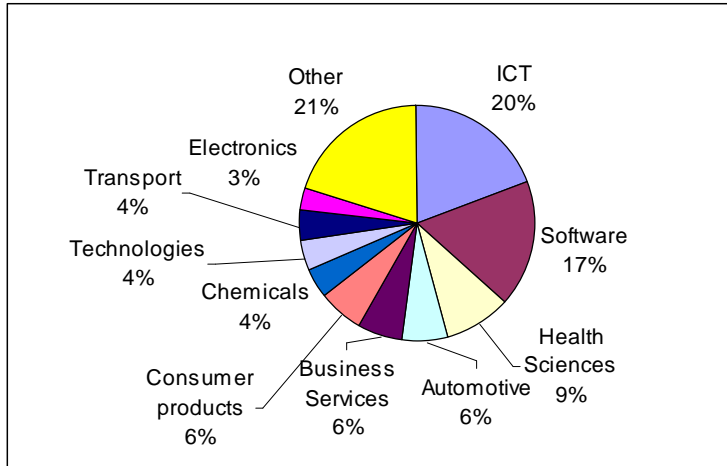
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Table 8: Countries of origin of participating companies

<b>Country</b>	<b>Origin</b>
Australia	3
Canada	8
China	3
Denmark	1
Hong Kong	1
India	4
Japan	15
Korea	3
Philippines	1
Saudi Arabia	1
South Korea	1
Taiwan	2
UK	1
USA	54
<b>Total</b>	<b>98</b>

If we look at the business sectors of the companies (see figure below), we see that a large number of business sectors are represented in our survey. The group “Other” consists of a range of sectors, like Mining, Oil & Gas, Trade, Office supplies, Plastics, Defence industry and more.

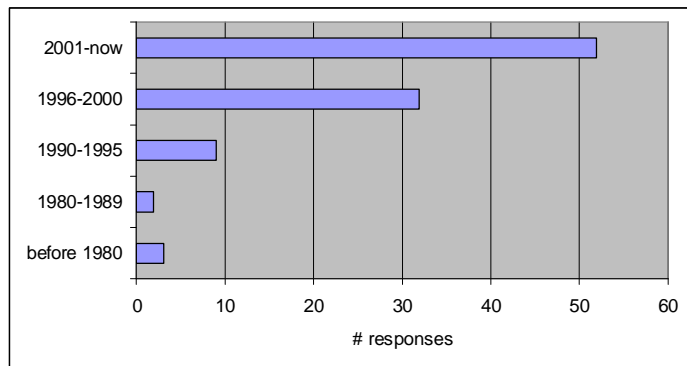
Figure 2: Responses per sector (% of all responses)



The majority of the EHQs that have participated in this survey have been established at its current location in the period 2001-now. 14 EHQs have been established at its current location before 1990 (see Figure 3). Although the EIM, the main source for our sample, contains data for the period 1997-now, we did receive responses from companies that did establish its EHQ before 1997. Reasons for this could be that:

- EIM registers an investment in 1997, while the company did make the location decision already before the public announcement in 1997;
- A company assigned another company location as the EHQ;
- The EIM registers an establishment as an EHQ, while it is for instance the Benelux Headquarters. In these cases we got re-directed to the pan-European Headquarters;
- Time lag between the availability of public company information (i.e. EHQ establishments) and processing of this information in the EIM database.

Figure 3: Number of responses by year of establishment EHQ



The majority of the EHQs are responsible for the company's activities in the whole of Europe or the EMEA region. Less than 10% is responsible for only part of Europe, 15% of the EHQs has an area that is larger than the EMEA region.

Table 9: Area of responsibility of EHQs

Area of responsibility	EHQs
Western Europe	5
Part of Europe	3
Europe	44
EMEA	31
EMEA + other	7
Global, except the USA	3
Global	5
<b>Total</b>	<b>98</b>

### Employment creation by EHQ projects<sup>9</sup>

In the survey we have asked for the number of employees in the EHQ *at start-up* (year of establishment of EHQ) and the number of employees *at this moment* (= February 2005 when the survey was conducted). At start-up, 2,666 people were employed in 88 EHQs (10 companies were not able to inform us about the number of employees at the time of establishment of the EHQ), which is an average of 30 employees per EHQ. At this moment, 97 EHQs employ 8,628 people in total, which is an average of 89 employees per EHQ. EHQs clearly create employment (often high value added) over time.

Table 10 shows the average number of employees per EHQ per country, based on the EHQs that have participated in this survey. At start-up, EHQs in Switzerland employ on average 47 people. In contrast, EHQs in France employ only 7 people on average at start-up. The Netherlands holds an average position, with EHQs that employ 28 people on average at start-up.

The table also shows the EHQ employment at this moment. For each country, the average employment has increased. Germany and the Netherlands have experienced the largest increases: from 36 to 180 and from 28 to 179 employees respectively.

<sup>9</sup> It is important to note here that due to the limited number of responses for the majority of these countries we should treat these numbers with caution.

Table 10: Average number of employees per EHQ per country (at start-up and currently)

Country	At start-up		Currently	
	Responses	Avg # employees	Responses	Avg # employees
Belgium	7	40	9	65
France	5	7	6	24
Germany	5	36	6	180
Netherlands	15	28	15	179
Switzerland	8	47	8	56
UK	48	29	53	70
<b>Total</b>	<b>88</b>	<b>30</b>	<b>97</b>	<b>89</b>

Figure 11 shows that longer established EHQs are not necessarily larger (in employment) than EHQs that have established more recently. A possible explanation for this is that most MNCs have increased their European activities over the past ten to fifteen years increasing the need for larger regional coordination centres (i.e. EHQs).

### Relocations of EHQs

23 of the 98 companies have relocated its EHQ to its current location. Eight of them have relocated its EHQ within the same country (5 in the UK, 2 in the Netherlands, 1 in Belgium). Fifteen EHQs have been relocated to another country. Four EHQs have been relocated to the UK and the Netherlands each. The UK attracted EHQs that were previously established in Norway, Italy and Germany. The Netherlands attracted three EHQs that were established in the UK and one from Germany.

Five companies that have participated did relocate their EHQ from the UK to another country (three to the Netherlands, two to Germany). 4 companies did relocate their EHQ to France (2 EHQs), the UK and the Netherlands. In our sample we did not find a company that did relocate its EHQ from the Netherlands to one of the other countries.

Based on these findings we can conclude that the Netherlands is thus not subject to relocations, but moreover attracting EHQs from other competing countries.

### *Additional facts & figures of the participating companies:*

- 7 companies (7%) have more than one EHQ;
- 46% of the surveyed companies also have Regional Headquarters for other regions, primarily in North America and Asia. These companies are not necessarily the largest MNCs (i.e. Fortune/Forbes Global 500).

## **4.5 Survey results: location factors**

### **4.5.1 Introduction**

What are the key location criteria when MNCs establish an EHQ? And how positive are the respondents about their current EHQ location? This chapter presents the results in the field of location factors.

### **4.5.2 Methodology**

During the company interviews, the respondents were asked to point out ‘which factors would be considered in a present location decision for the EHQ’. The next question was to point out ‘which location factors were considered in the past when setting up the EHQ’.

Respondents were free to choose factors, basically no steering was done through standard pre-defined EHQ location criteria. Through this approach we have been able to stay close to the ‘CEO/CFO perception’ of a location. In case respondents had difficulty interpreting the question, some (general) suggestions were made in relation to EHQ location factors. All different factors were interpreted, and in some cases aggregated, to fit the final list.

In the questions about location factors, respondents had to assign a total of 100 point to past and 100 points to present factors to be able to compare the importance of these factors. Of the 98 participating EHQs 95 respondents gave sufficient information to determine. Therefore, past as well as present factors were given a total of 9500 point each (95 times 100).

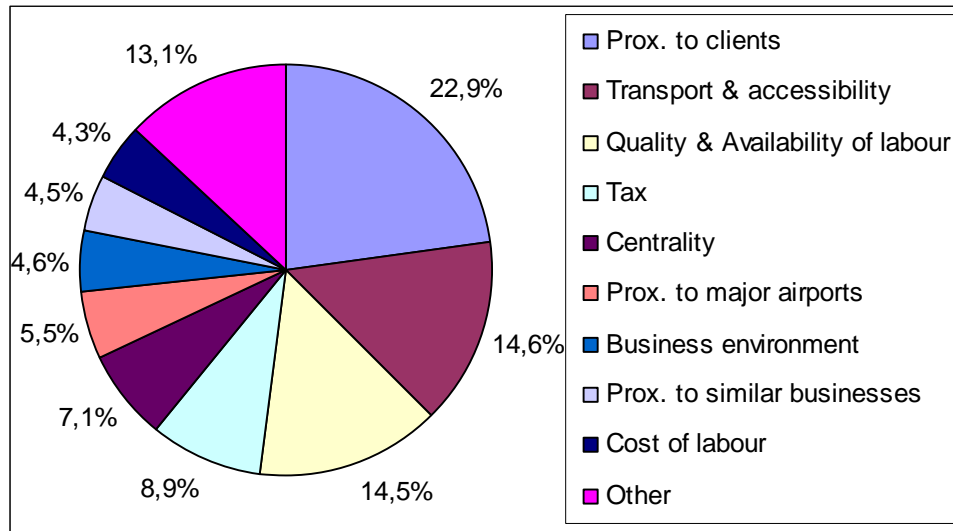
In this report, “PRESENT scenario” refers to the responses, weightings and rankings with regard to the location decision if a company would have to choose a new location now. The expression “PAST scenario” refers to the responses, weightings and rankings with regard to the location decision in the past.

In addition respondents were asked to evaluate the current location.

### **4.5.3 Location factors**

The main goal of the questions related to location was to determine which factors are considered for the location of an EHQ.

Figure 4: Perception of EHQ location factors (present) in percentage of total weight



The figure above shows the segmentation of present location factors. The figure is based on the percentage of the accumulated weight (9500) assigned by the respondents to the different location factors when choosing a location now.

The top three location factors are: Proximity to customers (22,9%), Transport & accessibility (14,6%) and the Quality & Availability of Labour (14,5%). On average these three location factors together account for more than half of the weight when companies establish an EHQ. According to the respondents the importance of tax regime, business environment and the centrality of the location have a weight of respectively 8,9%, 7,1% and 5,5%. Factors which did not account for more than 4% were taken aggregated in the category ‘Other’. These factors can be found in Appendix 3 in Table 21 under “present”.

The table below in fact shows the top 9 of location factors that would be taken into account when a company would consider to (re)locate its present EHQ. It displays all factors which score higher than 4%. Table 21 in Appendix 3 displays all total weights concerning the location factors and the number of respondents that have mentioned these factors for both past and present location decisions. Both weight and responses are specified as percentage of the total. With ‘prox’, proximity is meant, similar to distance. For instance: The distance to clients is in both cases (past and present) the most important location decision. When locating now, 2171 points (which is 22,9% of 9500) were assigned to this factor by 38 respondents. The percentage in responses is based on the total of number of times respondents mentioned a factor. In this case, 38 out of 285 responses concerning present location factors mentioned this factor, which is 13,3%. Therefore the total of responses is 244 (average of 2,6 factors per respondent) for factors in the past and 285 (average of 3 factors per respondent) for present factors.

The average weight is the total number of points assigned by the respondents (column “Total Score”) divided by the number of responses. In the present scenario, the average weight for proximity to clients is 2171 (“Total Score”) divided by 38 responses is 57. This implicates that, if a company takes the proximity to clients into account in its EHQ location decision, this factor will have an average weight of 57% in the overall EHQ location decision.

Table 11: Perception of present EHQ location factors with weight higher than 4% (total scores, responses and average weight)

Factor	Present				
	Total Score	%	Responses	%	Avg weight
Prox. to clients	2171	22,9%	38	13,3%	57
Transport & accessibility	1384	14,6%	46	16,1%	30
Quality & Availability of labour	1374	14,5%	45	15,8%	31
Tax	845	8,9%	23	8,1%	37
Centrality	679	7,1%	22	7,7%	31
Prox. to major airports	525	5,5%	18	6,3%	29
Business environment	439	4,6%	13	4,6%	34
Prox. to similar businesses	430	4,5%	15	5,3%	29
Cost of labour	405	4,3%	12	4,2%	34

The table above shows that the average weight of “Proximity to clients” (57%) is significant higher than the average weight of the other factors in the top 9 (the other factors each have an average weight of approximately 30 points). For example: transport & accessibility is mentioned more often (46 times) than proximity to clients (38), but because of the high weight given to the last, the total score of transport & accessibility is lower. So, if the distance to clients is a location factor it often is a very important one. Transport & accessibility and the quality & availability of labour are factor which are taken into account by almost half of the respondents (respectively 46 and 45 of 95 respondents) and therefore plays a large role in the decision making process more often but has less overall importance than the proximity to clients.

Table 12: Top 10 of most important location factors (past & present)

Factor	Past	Factor	Present
1 Prox. to clients	2303	1 Prox. to clients	2171
2 Quality & Availability of labour	1174	2 Transport & accessibility	1384
3 Transport & accessibility	1116	3 Quality & Availability of labour	1374
4 Tax	705	4 Tax	845
5 CEO nationality	690	5 Centrality	679
6 Presence of other company activities	565	6 Prox. to major airports	525
7 Centrality	549	7 Business environment	439
8 Prox. to major airports	435	8 Prox. to similar businesses	430
9 Business environment	327	9 Cost of labour	405
10 Takeover	240	10 English language	224

Comparing the top 10 of location factors in the past with the present, the top 10 exists of slightly different factors. First of all, the top 10 location factors have remained relatively stable. “Takeover” (e.g. is the EHQ location decision determined by a takeover process) and the “nationality of the CEO” have disappeared from the top 10, while new location factors in the top 10 are “cost of labour” and “English language”. Secondly, “Quality & Availability of labour ” and “Transport & accessibility” have changed positions, while accessibility factors like “Centrality” and “proximity to major airports” have jumped from seventh to fifth position and from eight to sixth position respectively. Thirdly, the location factor “general business environment” jumped from ninth to seventh position.

In comparing EHQ location criteria in the past and present it is important to analyse the changing ‘value’ or importance companies attach to the different EHQ location factors. This can be done by comparing the weights that companies have attached to key EHQ location criteria in past and present. Although, the Top 10 key EHQ location criteria have remained relatively stable, the relative importance companies attach to the key location criteria have changed. “Proximity to clients has become less important, while “quality & availability of labour” and “transport and accessibility” have increased in importance. In sum we can conclude that EHQ location decisions increasingly concentrate among a few key location criteria that have also increased in importance.

#### **4.5.3.1**     *Location factors per country of destination*

In Table 23 (Appendix 4) the average (present) weights per country of destination are shown. Factors are arranged by countries: Belgium (9 respondents), France (7), Germany (5), the Netherlands (15), Switzerland (7) and the United Kingdom (52). The average scores on the different types of location factors are displayed.

The respondents in Germany value business environment highly with a score of 26,6. Besides that respondent with EHQ in Germany say the image of the location is important. Not a single respondent in Germany said the quality & availability of labour was a factor. This might not be a problem in Germany and therefore not be considered in future decisions. Companies with EHQ in the Netherlands or Germany say the distance to an airport is more important. An other notable outcome is the higher weight companies in Switzerland give to the tax regime (38,57). The importance of labour costs seems to be lower than average for companies in Switzerland and higher than average for companies in Belgium. Multilingualism is considered as most important by EHQs located in Belgium. Besides that the UK scores high (35,54) on the distance to clients. Other notable outcome for the UK is the very low appreciation of centrality as a location factor. English language as a factor has only been mentioned by companies situated in the UK. Another contrast is the importance of proximity of similar business in France, with a score of 19,29 which is almost 15 points higher than the other countries. Transport & accessibility is considered to be a significant factor for EHQs in France and in the Netherlands.

Table 13: Most eye-catching differences in weight of location factors by country of destination (Present)

Factor	Country of Destination					
	Belgium	France	Germany	Netherlands	Switzerland	UK
Business environment	3,33	0,00	26,60	9,00	13,57	0,88
Centrality	8,89	11,43	14,00	12,33	11,43	3,54
Cost of Labour	10,00	2,86	6,00	6,67	0,71	3,08
English language	0,00	0,00	0,00	0,00	0,00	4,31
Image of location	0,00	0,00	10,00	0,00	0,00	0,00
Multilinguality	8,33	2,86	0,00	2,00	0,71	0,77
Prox. to similar business	3,33	19,29	0,00	1,00	1,43	4,62
Prox. to major airport	1,11	7,86	16,00	10,00	3,57	3,94
Prox. to clients	5,56	15,71	6,60	4,67	8,57	35,54
Quality & Availability of Labour	18,89	11,43	0,00	15,33	7,14	16,23
Tax	13,33	3,57	10,00	11,67	38,57	3,94
Transport & accessibility	13,89	19,29	8,80	20,33	7,14	13,93

#### 4.5.3.2 Other survey results

##### Factor weightings by country of origin

- Table 22 (Appendix 4) shows the differences and similarities of the weighting of location factors by countries of origin. In this table USA (52 respondents), Japan (14) and Canada (8) are displayed. The group Asia consists of companies from India (4), China (3), Korea (3), Taiwan (2), South Korea (1), Philippines (1) and Hong Kong (1).
- Asian and American EHQs assign on average ten points more to ‘Proximity to clients’ than Canadian and Japanese do.
- Asian EHQs assign much less weight to ‘Quality & availability of labour’ than companies from the other three countries.
- Canadian companies consider the availability of a major airport as more important than companies from other countries.
- Business environment is appreciated highest by Asian companies. Japanese companies value the availability of “English language” higher than the US and Canada. Tax is found most important by Japanese respondents.

### **Factor weightings by duration of establishment**

- Table 24 displays the location factors based on the year of establishment. Two categories have been distinguished: EHQs established until 1996 (14 respondents) and EHQs established in 1996 or later (81).
- The longer established EHQs assign almost double weight to Tax compared to more recently established EHQs.
- On the other hand do respondents from more recent established EHQs value Transport & accessibility higher than longer established EHQs.

### **Factor weightings per industry**

- Table 25, in Appendix 4, displays the factor weightings for the three most important industries in our responses: ICT (19 respondents), Software (16) and Health Sciences (8).
- The most striking difference is the distance to clients which is found very important in ICT and Software, but less important in Health Sciences.
- Quality & availability of labour is considered an important factor in Health Sciences and ICT.

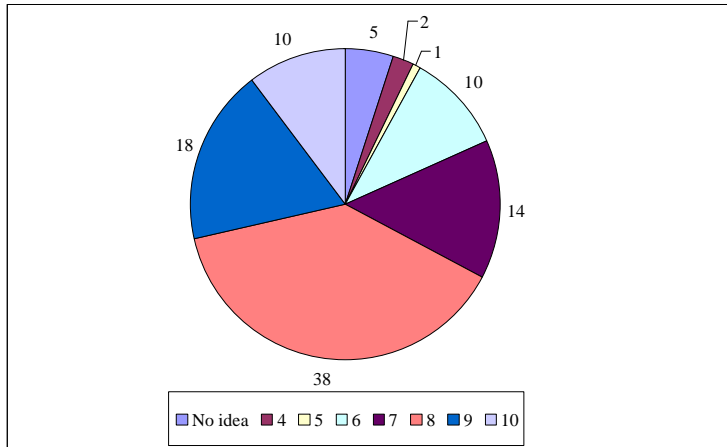
### **Factor weightings by number of fulltime employees**

- In Table 26 (Appendix 4), factors are divided in three categories, less than 20 FTEs (51 respondents), 20 to 100 FTEs (27) and more than 100 FTEs (16).
- Both proximity to clients and quality & availability of labour are considered more important if the size of the EHQ increases.
- Transport & accessibility is considered as less important by respondents of large EHQs (over 100 employees).
- Small EHQs (<20 FTE) say tax is a more important location criterion (weight 12,2%) compared to larger EHQs.

## **4.6 Satisfaction with current EHQ location**

Respondents were asked to rate their current EHQ location on a scale of 1-10. Most of them were satisfied since 70 respondents gave an 8, 9 or even 10.

Figure 5: Overall rating of locations of EHQs (1-10, 10 is high)



The table below shows rates which were given by companies in the different countries. Another question also point out the high satisfaction of companies with their EHQ location. In total 84 respondents indicate that they would choose their current location again. The table also shows the percentages of the respondents who would choose their location again. Besides that, 5 companies said they consider closing the EHQ and opening it somewhere else. In the Dutch case, the company was already building another EHQ within the same region in the Netherlands. In this process also other European cities were taken into account like Zurich and Gent (Belgium). The other companies which considered relocation expect to stay in the country as well, except for a company located in the UK. This organisation said London had too many regulations and did not live up to the expectations.

Table 14: Satisfaction with location

	Avg. Rating	Choose location again?			Consider relocation?	
		Yes	No	% Yes	Yes	No
<b>Belgium</b>	7,94	8	1	89%	0	8
<b>France</b>	6,83	4	3	57%	0	7
<b>Germany</b>	9,40	6	0	100%	0	6
<b>Netherlands</b>	7,80	12	2	86%	1	14
<b>Switzerland</b>	8,50	7	1	88%	1	6
<b>UK</b>	7,85	47	6	89%	3	52

## 4.7 Survey results: Sequence of establishing different company activities in a country

### 4.7.1 Introduction

This section presents the part of the survey which was dedicated to the sequence of establishing different company activities in a specific country. Is an EHQ a pull factor for the establishment of other activities of the same company, or vice versa? The outcomes of this part of the survey provide insight into the sequential nature of EHQ investment decisions.

If the company has other activities (for instance sales and logistics) in the country of its EHQ, respondents were asked:

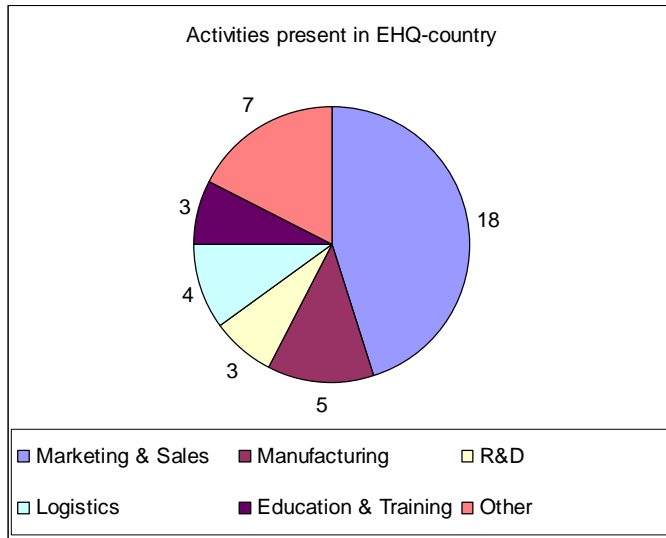
1. 'when this activity was established' (i.e. prior to, simultaneously with or after the establishment of the EHQ) and;
2. 'how many people are employed' for these other activities.

If these other activities were established prior to the establishment of the EHQ, respondents were asked to determine the importance of the presence of other activities for locating the EHQ in this country. If on the other hand these activities were established after or simultaneously with the EHQ, respondents were asked to determine the importance of the presence of the EHQ for locating other activities in this country.

### 4.7.2 Sequential investments

Approximately 25 percent (24 out of 98) of the surveyed companies have other additional activities established in their current EHQ country. Companies often have more than one other activity. Figure 6 shows the segmentation of different types of business activity.

Figure 6: Other activities in EHQ country



“Marketing & Sales” is by far the most common activity located in the EHQ’s country. The category other exists of “Shared Service Centres”, “Branche Offices” and “Maintenance Centres”. The number of employees working for these additional activities varies from 5 to 4,500. The majority of these activities employ less than 100 people in the country of their EHQ.

In order to determine the “pull factor” of other activities in a country prior to the presence of an EHQ or vice versa, respondents were asked to indicate the importance of the presence of other company activities (or vice versa: the presence of the EHQ) for the establishment of the other company activities/EHQ. The respondents could choose between ‘Not important’, ‘Some importance’ or ‘Decisive’. The table below shows the results. ‘Prior’ indicates that other activities were established before the establishment of the EHQ. If the answer is ‘after’, other activities were established after the EHQ had been established in the country. If the answer is simultaneous the EHQ was established at the same time as the other complementary activities.

Table 15: Number of activities established in EHQ country and pull effects

Activity	Prior #	Importance			Simultaneous #	Importance			After #	Importance		
		-	-/+	+		-	-/+	+		-	-/+	+
Marketing & Sales	5		67%	33%	11	43%		57%	2	50%		50%
Manufacturing	2	n.a.	n.a.	n.a.	3	n.a.	n.a.	n.a.	0			
R&D	1	n.a.	n.a.	n.a.	2			100%	0			
Logistics	2	50%		50%	2	n.a.	n.a.	n.a.	0			
Education & Training	2			100%	0				1	n.a.	n.a.	n.a.
Shared Service Center	0				2			100%	0			
Branche office	3	50%	50%		0				0			
Maintenance	2	100%			0				0			
<b>Total</b>	<b>17</b>				<b>20</b>				<b>3</b>			

- # = number of activities in this category
- = Not important
- /+ = Some importance
- + = Decisive
- n.a. = no answer on this question

The results show that in general EHQ investments follow other activities (17 times) or are established simultaneously with (20 times) other activities. In only three cases the EHQ investment had triggered and pulled other investments. The presence of marketing & sales office seems to be of importance for the establishment of EHQs. This can be explained by the fact that internationalization is an evolutionary process, companies tend to open sales departments in different countries as a first step for further involvement and commitment to a specific location, often production or higher value added activities follow (i.e. EHQs). Taking a more historical view towards internationalization shows that EHQs, and the internationalization of higher value added activities is a relative new phenomenon (cf. van den Berghe, 2006, *forthcoming*).

From these results we may conclude that, “other activities” rather attract EHQs than vice versa. Although, we must add that the EHQs in this survey have been established quite recently (e.g. the majority in the last decade), in the longer term the pull effect of EHQs might prove to be stronger. Conducting a similar survey in five years time may reveal a stronger pull effect of EHQs. For instance it may well be that, although EHQs followed “other activities”, they may in the long run even attract more sequential investments in the current location. Increasingly, these sequential investment and location decisions will be determined by the *experience* the EHQ has in its current location.

### **Number of sequential investments by country**

Some differences exist if we analyze the country of destination of the companies that have other activities established in the country of their EHQ. Table 16 illustrates these differences per country.

- More than 50% of the EHQs in Belgium and Germany say they also have other activities in their EHQ country.
- Only 8% of the EHQs in the UK has other activities established in the EHQ country.
- In Belgium most of these other activities were established simultaneously with the EHQ. The EHQs in Switzerland were also often established simultaneously with other activities.
- EHQs in the Netherlands and the UK show a different pattern. Seven out of nine “other activities” in the Netherlands and four out of six “other activities” in the UK were established before the EHQ.

Table 16: Number of companies with activities per country of destination

	Total respondents (Table 8)	Respondents with other activities	% other activities	Prior	Sim.	After
<b>Belgium</b>	9	5	56%	1	10	1
<b>France</b>	7	2	29%	1	1	
<b>Germany</b>	6	4	67%	3	2	1
<b>Netherlands</b>	15	6	40%	7	2	
<b>Switzerland</b>	8	3	38%	1	4	
<b>UK</b>	53	4	8%	4	1	1
<b>Total</b>	98	24	24%	17	20	3

- We found no significant differences in the number of sequential investments between the different countries of origin.
- Seven respondents with other company activities established in their EHQ country (out of 24) established their EHQ before 1996. The other 17 EHQs were established at the current location in or after 1996.
- Comparing these results to the total response shows that in the first category 50% of all respondents have other activities, because the total response of companies which established their EHQ before 1996 is 14. In the second category only 17% of the participating EHQs have other activities in their EHQ country. The total response in this category is 84.

## 4.8 Conclusions

### *Survey sample*

- At start-up, 2,666 people were employed in 88 EHQs (10 companies were not able to inform us about the number of employees at the time of establishment of the EHQ), which is an average of 30 employees per EHQ. At this moment, 97 EHQs employ 8,628 people in total, which is an average of 89 employees per EHQ. EHQs clearly create employment (often high value added) over time.
- The surveyed EHQs in Germany and the Netherlands have experienced the largest increase in the size of their workforce.
- 23 of the 98 companies have relocated their EHQ to its current location. Eight of them have relocated its EHQ within the same country (5 in the UK, 2 in the Netherlands, 1 in Belgium). Fifteen EHQs have been relocated to another country. Based on the findings on EHQ relocations within our surveyed sample, the Netherlands is not subject to relocations, but moreover attracting EHQs from other competing countries.

### ***Location factors and weightings***

- Proximity to clients is the most important location factor respondents mention. However, together with another top 5 location factor (“Centrality”), this criteria is shaped by a country’s geographical position rather than by governmental policy-making;
- The top 5 factors is completed with 3 factors that can be influenced by governmental policy: Transport & accessibility, Quality & availability of labour and Tax. These three factors are valued high as location criteria;
- The importance of certain factors changes if we compare location decisions in the past with current (fictitious) location decisions. Especially the importance of labour costs and the proximity to similar business is increasing;
- Companies with EHQ located in the Netherlands value transport & accessibility and proximity to major airports higher than others;
- Quality & availability of labour is considered an important factor within the health science sector;
- Companies with EHQ located in the Netherlands give their location a 7,8 when rating on a scale of 1-10, which is just below the average score of 7,9. 86% of the respondents from the Netherlands would choose the same location again.

### ***Sequential investments***

- The survey results show no strong relationship between the establishment of EHQs and the subsequent establishment of other company activities. On average about 1 of every 4 respondents say they have other activities in the country of their EHQ. In the Netherlands this ratio is higher, about 40% of the EHQs have other activities as well. In most cases these activities are marketing and sales related;
- Most other activities are established before or simultaneously with the EHQ. Only a few other activities have been pulled by the EHQ;
- The results show that in general EHQ investments follow other activities (17 times) or are established simultaneously with (20 times) other activities. In only three cases the EHQ investment had triggered and pulled other investments. The presence of marketing & sales office seems to be of importance for the establishment of EHQs.
- As EHQs are a relative new phenomenon in the evolution of corporate internationalization, conducting a similar survey in five years time may reveal a stronger pull effect of EHQs.

## 5 Benchmarking with competitors: comparing EHQ investment climates

### 5.1 Introduction methodology

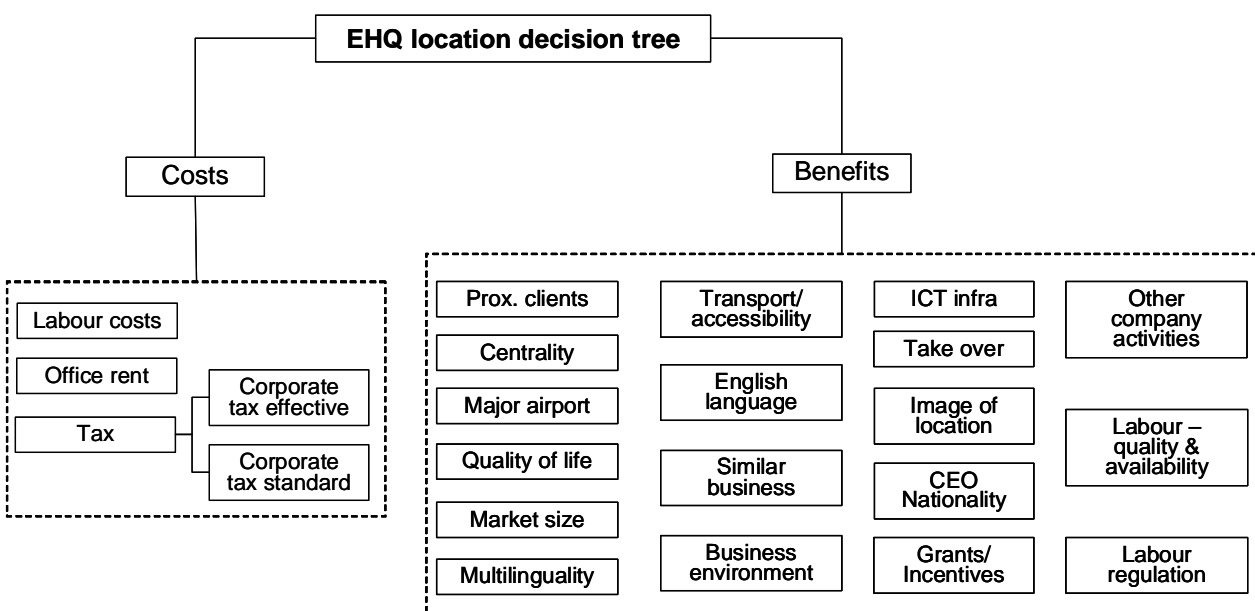
In this chapter, we will show how the countries rank on the individual location factors and how this results in an overall, weighted ranking of the countries. This overall ranking will be shown for both the Past and Present scenarios. Hence it is possible to show a change in the relative HQ attractiveness of the seven countries.

Based on objective sources, Ernst & Young has assigned scores to each country on each of the individual location factors. These scores have been entered into HiView, a decision analysis tool. HiView enables us to visualize the competitive position of the Netherlands vis- a-vis the six other countries.

### 5.2 Decision tree

Based on the outcomes of the survey, the figure below (Figure 7) shows the decision tree for EHQ location decisions. The location factors at the bottom of the model have been drawn from the survey results (see Table 21 in the Appendices). The weights assigned to these factors differ for the past and present scenarios. The applicable weights are displayed in the same table.

Figure 7: Decision tree HiView for Past and Present scenarios



In the following section (5.3) we will show the country rankings on the individual location factors. Sections 5.4 and 5.5 describe the results of the overall ranking of the countries for two scenarios (past and present), based on the data presented in section 5.3 and the weightings as presented in Chapter 4 (outcomes of the survey).

### 5.3 Country rankings on individual location factors (present scenario)

As explained in section 5.1, these data have been drawn from various objective sources (E&Y sources, World Bank, IMD, Watson Wyatt, UBS Warburg, World Markets Research Centre, ITU, EIU and others). For some indicators that are not measurable (like Proximity to clients, Proximity to similar businesses, Proximity to other company activities) we have assigned the maximum score (100 points) to each country.

The first table (Table 17) shows the three cost factors (labour costs, office rents, tax<sup>10</sup>). The second table (Table 18) shows the ratings of the seven countries on the benefits factors. The weights in the tables represent the weights as in the Present scenario.

Table 17: Cost factors and ratings

Cost factors Node										
Reset		Add		Costs Data Breakdown						
BRANCH	Wt	FR		Lux		Swi		UK	CumWt	
		BE	GE	NL	UK					
* Labour costs	4	93	87	76	82	97	63	100	4.3	
Tax	9	51	48	45	51	55	100	57	8.9	
* Office rent	1	85	50	72	75	100	71	28	1.3	
TOTAL	15	67	60	56	63	72	86	67	14.5	

<sup>10</sup> Appendix 5 gives an overview of Tax aspects of European Headquarters and Details of national tax regimes for each of the countries under review.

Table 18: Benefits factors and ratings

Benefits factors Node										
Reset		Add		Benefits Data Breakdown						
BRANCH	Wt	FR		Lux		Swi		UK	CumWt	
		BE	GE		NL					
* Prox Clients	23	100	100	100	100	100	100	100	22.9	
* Transport	15	99	94	99	87	100	95	87	14.6	
* Airport	6	50	100	100	10	90	70	100	5.5	
* Labour QA	15	100	97	94	89	89	97	78	14.5	
* Labour regula	1	39	34	25	49	52	100	62	0.8	
* English lang	2	75	50	75	75	75	75	100	2.4	
* Multilinguality	2	90	60	75	75	75	100	60	1.8	
* Centrality	7	80	80	90	90	80	100	60	7.1	
* Bus. environm	5	86	85	82	100	97	99	89	4.6	
* Similar busine	5	100	100	100	100	100	100	100	4.5	
* Other activitie	2	100	100	100	100	100	100	100	2.3	
* ICT infra	2	95	89	99	88	92	100	85	1.6	
* Grants & Inc	1	79	81	61	100	87	92	81	1.2	
* Quality of life	1	89	85	93	94	89	100	79	0.7	
* Market size	0	13	73	100	1	21	13	74	0.2	
* Prestige	1	68	61	81	100	95	100	91	0.5	
* Take over	0	100	100	100	100	100	100	100	0.4	
* CEO nationalit	0	100	100	100	100	100	100	100	0.0	
<b>TOTAL</b>	<b>86</b>	<b>92</b>	<b>92</b>	<b>94</b>	<b>87</b>	<b>93</b>	<b>96</b>	<b>88</b>	<b>85.5</b>	

#### 5.4 Country ranking based on PAST location decision

Table 19 shows the scores of the countries on overall costs (first row), overall benefits (second row) and the overall score (TOTAL, under the line) for the past scenario. A higher score indicates a better investment climate for EHQs, according to the results of our survey and the scores on the individual location factors. This table shows that Switzerland is the best overall location, followed by the Netherlands and Germany. The differences between the countries are small: the Netherlands holds the second spot with a score of 92, while the country with the lowest ranking (Luxembourg) has only 6 points less.

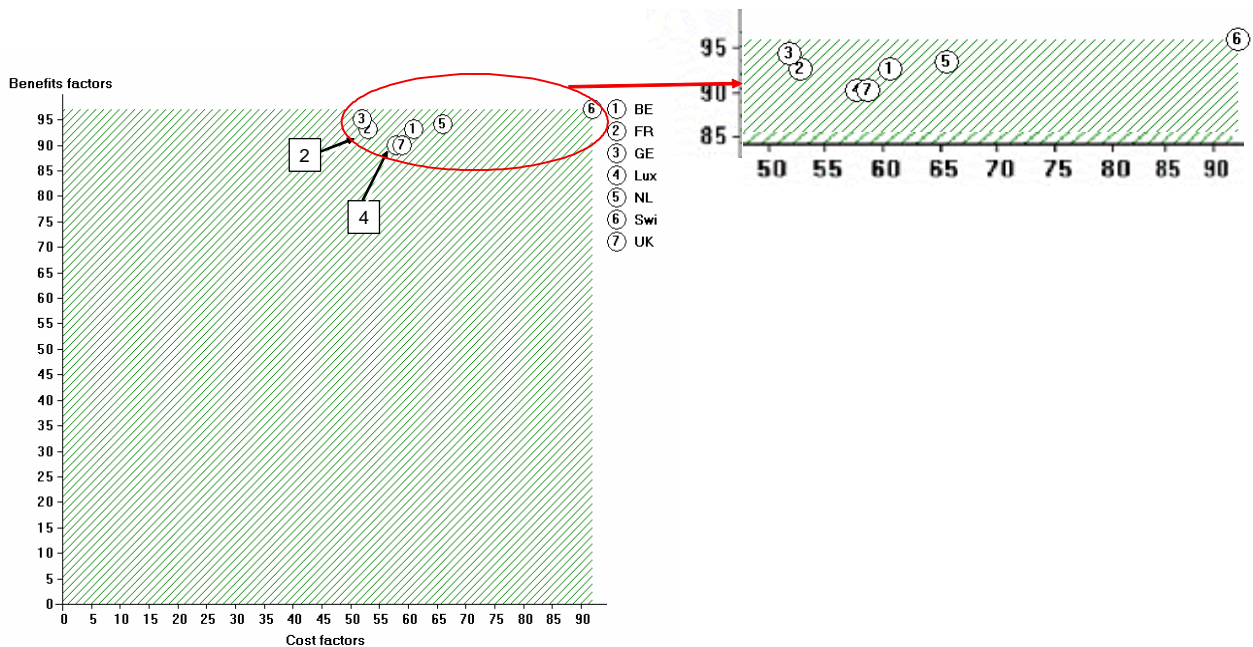
Table 19: Overall country ratings Past scenario

EHQ1 Data Breakdown									
BRANCH	Wt	BE	FR	GE	Lux	NL	Swi	UK	CumWt
Costs	10	61	53	52	58	66	92	59	9.9
Benefits	90	93	93	95	90	94	97	90	90.1
<b>TOTAL</b>	<b>100</b>	<b>90</b>	<b>89</b>	<b>91</b>	<b>86</b>	<b>92</b>	<b>96</b>	<b>87</b>	<b>100.0</b>

Figure 8 is a visualization of the above table. The right top corner indicates the best location for an EHQ. Due to the large weight assigned to Benefits (90,1%), a high score on Benefits (top side of the figure) has more impact on the overall score of a country than a high score on Costs (far right side of the figure).

Switzerland (6) is the best location (highest score on both Costs and Benefits). The Netherlands (5) and Germany (3) hold the second and third place respectively. Luxembourg (4) holds the last place, although the figure seems to indicate a better position than options 2 and 3 (France and Germany). However, the latter have a better score, due to their higher score on Benefits.

Figure 8: Ranking of EHQ investment climate (past scenario)



## 5.5 Country ranking based on new (PRESENT) location decision

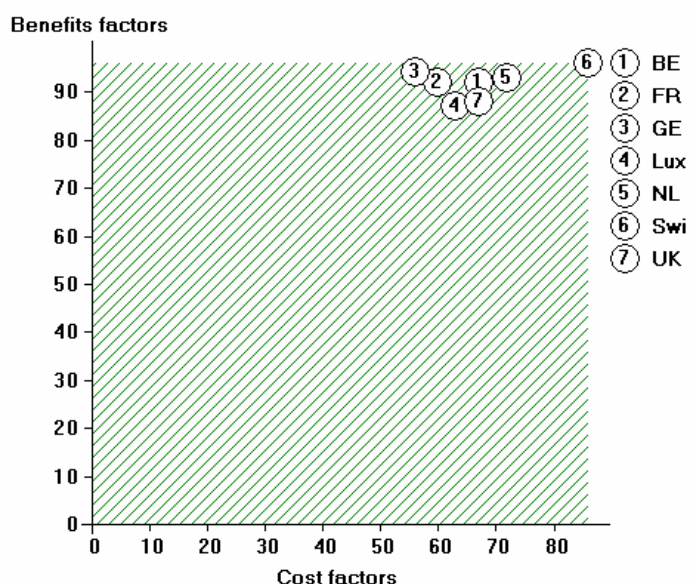
Table 20 shows the scores of the countries on overall costs (first row), overall benefits (second row) and the overall ranking (under the line) for the present scenario. A higher score indicates a better investment climate for EHQs, according to the results of our survey and the scores on the individual location factors. This table shows that Switzerland is the best location (94 points), followed by the Netherlands (90 points) and Germany (89 points). Also the ranking of the other countries did not change compared to the PAST scenario.

Table 20: Overall country ratings Present scenario

EHQ present Node									
EHQ2 Data Breakdown									
Reset Add									
BRANCH	Wt	FR		Lux		Swi		UK	CumWt
		BE	GE		NL				
Costs	15	67	60	56	63	72	86	67	14.5
Benefits	86	92	92	94	87	93	96	88	85.5
<b>TOTAL</b>	<b>100</b>	<b>88</b>	<b>88</b>	<b>89</b>	<b>84</b>	<b>90</b>	<b>94</b>	<b>85</b>	<b>100.0</b>

Figure 9 is a visualization of the above table. The right top corner indicates a better location. Switzerland (6) is the best location again (highest score on both Costs and Benefits). The Netherlands (5) holds the second place and Germany (3) is the third best country again. The different positions of the countries in this figure compared to their positions in Figure 8 (PAST scenario) are being caused by the different distribution of the weights (14,5% costs, 85,5% benefits).

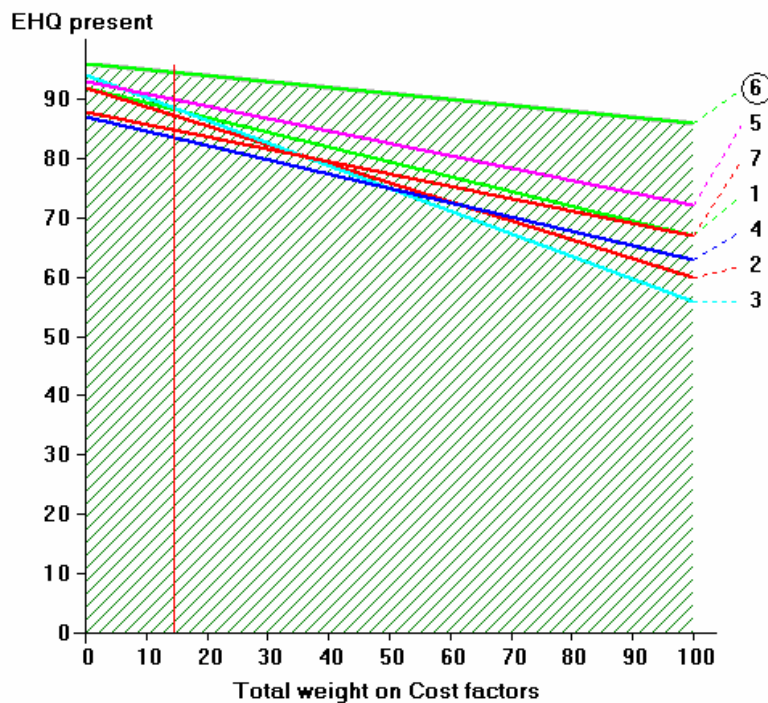
Figure 9: Ranking of EHQ investment climate (present scenario)



A sensitivity analysis (Figure 10) shows what happens to the relative positions of the seven countries if we assign more or less weight to the cost factors. A higher position in the figure implicates a better investment climate for EHQs. The cross point of the red vertical line with the coloured country lines shows the score of each country (Y axis) in the current situation (14,5% assigned to “Costs” and 85,5% assigned to “Benefits”). In this case the ranking is: 1) Switzerland and 2) the Netherlands and 3) Germany.

If the weight of “Costs” is close to zero (very left part of the graph), Switzerland still is the best option, with the Netherlands, Germany, Belgium and France following at close distance. Whatever the weight distribution is, Switzerland remains number one. The Netherlands holds its second position, unless the total weight assigned to Costs is less than approximately 5% (very left part of the figure). The far right part of the figure shows the ranking of the countries if the weight assigned to Costs is 100%. In this case, the United Kingdom (sixth rank in the PRESENT scenario) rises to the third place, just ahead of Belgium.

Figure 10: Sensitivity analysis Present scenario



## 5.6 Conclusions

- Although there are some significant difference in the weighting of location factors, the PAST and the PRESENT scenarios do not show much difference in the overall ranking of the countries.
- In both scenarios, Switzerland has the best investment climate for EHQs, based on the weights, as assigned by the EHQs in our survey, and the ratings of the countries on the location indicators.
- The Netherlands holds the second position, followed by Germany in third place. Belgium, France, the UK and Luxembourg complete the ranking in this order.
- Switzerland is also the best option from a Costs point of view, in particular Tax, followed again by the Netherlands. The third place is taken by Belgium (past scenario) and Belgium and the UK (present scenario). Germany drops from the 3rd place to the last place (7th), France falls to the 6th place.
- From a Benefits point of view, Switzerland has the best investment climate, too. Germany takes over the 2<sup>nd</sup> place from the Netherlands, which is ranked third on Benefits. The United Kingdom and Luxembourg have low scores on the Benefits part of the investment climate.
- The United Kingdom is by far the most popular destination for foreign EHQs, although its EHQ investment climate has a below average score compared to the competitors taken into account in this study.
- Changing the weights assigned to Costs and Benefits does not influence the outcomes very much. Switzerland has the best investment climate for EHQs, from a cost perspective as well as from a benefits perspective. The Netherlands scores well on both, Germany is especially good from a benefits perspective, while the UK and Belgium score good from a costs point of view.

## 6 Conclusions and policy recommendations

After the global economic downturn in the first years of the new century, we are currently witnessing an increase in the mobility of HQ activities. This trend takes place against the background of the current wave of *offshoring and outsourcing* of service related activities. Although the preliminary data for 2004 should be treated with caution, the first signals are promising. Based on the preliminary 2004 EIM data, the first nine months of 2004 recorded 126 EHQ projects in the seven countries. This is more than in 2000, the year with the highest number of EHQs.

In formulating a targeting strategy to attract both relocating EHQs and new EHQs, a number of developments have been highlighted in this survey that need to be implemented into a structured targeting program:

- 1 In attracting relocating or existing EHQs, this study showed that the Netherlands is not *subject to* outward relocations of EHQs, but moreover attracting EHQs from other competing countries. It is thus pulling EHQs away from competing locations. *Attracting EHQs from the United Kingdom, Germany and Belgium offers opportunities for the NFIA. Given the limited psychic distance between the United States, the United Kingdom attracts a large share of EHQs from the United States. As the Dutch economy has a strong Anglo Saxon orientation, attracting mobile EHQs from the United Kingdom offers many opportunities;*
- 2 In order to attract new EHQs, the United States remains an important source of EHQ projects and therefore *requires a focused targeting strategy;*
- 3 In addition, to attract new EHQs the survey results show no strong relationship between the establishment of EHQs and the subsequent establishment of other company activities. Most other activities are established before or simultaneously with the EHQ. "Other activities" (like for example Marketing & Sales, manufacturing or R&D) thus rather attract EHQs than vice versa. *The NFIA needs to develop a structured targeting program that focuses on EHQ investments by companies that have some activity/-ies in the Netherlands and Belgium, but do not yet have an EHQ. Their EHQ might follow other activities. Most of these companies can be found in World Trade Centres from where they coordinate their European sales activities.*

In order to develop a structured targeting program this study highlights a number of trends that can be implemented and highlighted in such a program:

- 1 This study surveyed 98 EHQs in seven countries. The results show that EHQs are an important source of job creation (often high value added jobs). The Netherlands, together with Germany, has experienced above average growth rates for employment in EHQs. *A signal that the Dutch labour market offers qualified personnel for EHQs. This can be highlighted in the targeting strategies of EHQs by NFIA.*

- 2 Approximately one quarter of the 98 surveyed EHQs has been relocated in the past within Europe to its current location. 15 of these EHQs were in fact international relocations. None of these international relocations took place from the Netherlands. *Hence we can conclude that relocation of corporate EHQs is thus not a very widespread phenomenon (yet), although 16% of the surveyed EHQs have been relocated across national borders in the past. EHQs in the Netherlands have so far not been relocated.*
- 3 The relationship described above can be explained by the fact that internationalization is often a process that shows an increasing involvement and commitment in a foreign location. The experience a company has with its current location can thus be an important determinant for attracting a future EHQ. On average about 1 of every 4 respondents say they have other activities in de country of their EHQ. In the Netherlands this ratio is higher, about 40% of the EHQs have other activities as well. This indicates that the experience companies have in the Netherlands has been above average and has led to the establishment of an EHQ. *The NFIA must therefore approach some of these companies to serve as testimonials in its EHQ acquisition strategy.*

86% of the respondents from the Netherlands would choose the same location again for their EHQ. This indicates that they are satisfied with their current location. However, it still remains an important task for the Dutch government to improve the Dutch investment climate for EHQs. In particular the following location factors remain crucial:

- 1 A factor that has been mentioned frequently in this survey was “proximity to clients”. This factor is hard to influence as it is shaped by a country’s size and its geographical position rather than by governmental policy-making. *Nevertheless, proximity to clients is also a relative location factor that can be influenced by taking care of accessibility and infrastructure.*
- 2 While “Proximity to clients” has become less important, “Quality & availability of labour”, “Tax” and “Transport and accessibility” have increased in importance (the relative weight in location decisions has increased). These latter three factors are valued high as location criteria and increasingly play a larger role in EHQ location decisions. Companies with their EHQ located in the Netherlands value “Transport & accessibility” and “Proximity to major airports” higher than others.
- 3 Taking care of transport & accessibility, the tax investment climate, the availability of a major airport and the general business environment will have the strongest impact on the relative position of the Netherlands.
- 4 With the accession of eight Central and Eastern European countries to the European Union in 2004 resulting in a centre of gravity moving eastwards, geographic centrality may also change. With some of the new EU member states becoming attractive as locations for EHQs in the future, labour costs may become a critical determinant in the location selection of EHQs. *Hence the Netherlands should maintain the balance between the cost and quality of labour (increasingly mentioned as an important criterion).*

Finally, we must add that the EHQs in this survey have been established quite recently (e.g. the majority in the last decade), in the longer term the pull effect of EHQs might prove to be stronger. *Conducting a similar survey in five years time may reveal a stronger pull effect of EHQs. For instance it may well be that, although EHQs followed “other activities”, they may in the long run even attract more sequential investments in the current location. Increasingly, these sequential investment and location decisions will be determined by the experiences the EHQ has at its current location.*

**Introduction**

This study aims to reveal the critical location factors for companies when selecting the location for its European Headquarters (EHQ). In addition, we would like to gain insight into the sequence of establishing different company activities (like headquarters, sales offices, logistics) in a country/continent. For instance do HQ activities follow other activities that have already been established in the specific location or vice versa?

We highly appreciate your time and consideration in supplying us with information.  
Thank you in advance.

**A General Questions**

1. Can your office be regarded as an EHQ? YES / NO

---

If YES, please continue with the question 2.  
From this point, if we use the term EHQ, we refer to your office.

If NO, could you please provide us with the contact details of the person we should approach regarding this issue?

Name of contact:	
Country and City of EHQ:	
Telephone Number:	

2. In which city is the EHQ located?

---

3. In which year did your company establish its EHQ here?

---

4. Is this the first EHQ location for your company? YES / NO

---

If NO, when and where (country/city) did your company first establish an EHQ?

---

5. Is this your company's only EHQ? YES / NO

---

If NO, please specify the other EHQs.

---

6. Does your company have more regional HQs? YES / NO

---

If YES, please specify where?

---

7. How many people are working (FTE) at this EHQ?

At start-up	
Currently	
Number of expatriates	

8. In which business sector(s) is your company/division active?

---

9. Which functions have been allocated to this EHQ? (open question)

---

10. For which region is this European Headquarter responsible for?  
Global / EMEA / Europe / Western Europe / Other, please specify:

---

11. What role does this EHQ play in the decision-making process within your firm?

---

12. What is the level of autonomy assigned to this EHQ (level of decentralisation)?

---

**B Motives for establishing a regional HQ**

13. What have been the main reasons to set up a regional HQ in Europe?

---



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Examples of Location Factors	
<u>Cost of Labour</u> Employment costs Expat costs  <u>Office property</u> Rental costs Availability of space	<u>Labour - Quality and Availability</u> Quality and availability of employees Multilinguality Skills Local universities and business schools
<u>Transport and accessibility</u> Accessibility from corporate headquarters Airport facilities Local public transport Intercity rail services International road links Proximity to major markets/Centrality of location Proximity to other companies (like suppliers)	<u>Quality of life</u> Quality of life Cost of living Image of location Medical facilities International and multicultural orientation  <u>Tax and Incentives</u> Overall tax burden Profit tax Expatriate tax
<u>Labour regulations</u> Regulations (working time, hiring/firing costs) Ease of employing expats Union activity	<u>Business Support services</u> Ease of doing business Economic and political stability Business climate Availability of business support services

16. If you could choose now, would you choose the same location again?

---

## D Sequence of establishing company activities

17. Has your company located other company activities (like sales, logistics, R&D) in this country<sup>11</sup>? YES / NO

---

If NO, please continue to question 22.

If YES, please specify the year of establishment and number of people currently employed (FTE).

---

<sup>11</sup> Also if these activities have been relocated to another location/country.

Activity	Established in country of EHQ?	When <sup>12</sup> established?	# people employed (currently)
Logistics			
Marketing and sales			
R&D			
Manufacturing			
Education & Training			
Contact Centre			
Shared Service Centre			
Other 1:			
Other 2:			

18. If your company established other activities in this country prior to establishing its EHQ, how important was the presence of other activities for locating the EHQ in this country?

Importance	If appropriate, please specify which activity
Not important	
Of some importance	
Decisive	

19. If your company did establish other activities at this location simultaneously or after establishing this EHQ, how important was the presence of the EHQ for establishing the other activities?

Importance	If appropriate, please specify which activity
Not important	
Of some importance	
Decisive	

<sup>12</sup> Please indicate year of establishment. If you do not know the exact year, please indicate if it was prior to, simultaneous with or after the establishment of your company's EHQ in this country.

**E Future**

20. How do you rate your current EHQ location on a range from 1-10?

---

21. Does your company consider relocating its EHQ to another location? YES / NO

---

If NO, please continue with question 19.

If YES, please answer the following sub-questions.

a. What are the main drivers for the possible relocation?

---

b. Which location is considered? [city / country/ region / continent]

---

c. If your company is going to relocate its EHQ, will other activities relocate as well? If YES, please specify which activities will or might follow?

---

**F Contact**

22. Thank you very much for your time and efforts. Could you please provide us with your contact details?

**Organization:** \_\_\_\_\_

**Name:** \_\_\_\_\_

**Position:** \_\_\_\_\_

**Address:** \_\_\_\_\_

**City/Postal Code:** \_\_\_\_\_

**Country:** \_\_\_\_\_

**Telephone:** \_\_\_\_\_

**Fax:** \_\_\_\_\_

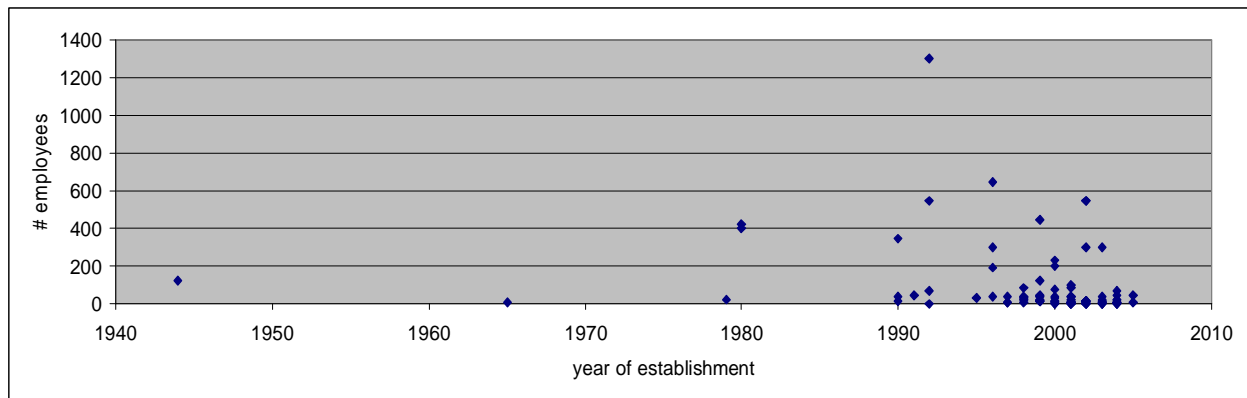
**E-mail:** \_\_\_\_\_

23. Would you like to receive an executive summary of our findings after completion?

---

Figure 11 displays for each EHQ the year of establishment and the number of employees, to test the hypothesis that longer established EHQs employ on average more people than EHQs that have been established more recently. The figure shows that there is no strong causal relation between these two characteristics.

Figure 11: Year of establishment in relation to employment



## Appendix 3

Table 21: Total weights and responses per factor in past en present (nominal and relative)

Factor	Past					Present				
	Total Score	%	Responses	%	Avg weight	Total Score	%	Responses	%	Avg weight
Prox. to clients	2303	24,2%	37	15,2%	62	2171	22,9%	38	13,3%	57
Transport & accessibility	1115,5	11,7%	35	14,3%	32	1383,5	14,6%	46	16,1%	30
Quality & Availability of labour	1174	12,4%	36	14,8%	33	1374	14,5%	45	15,8%	31
Tax	705	7,4%	17	7,0%	41	845	8,9%	23	8,1%	37
Centrality	549	5,8%	18	7,4%	31	679	7,1%	22	7,7%	31
Prox. to major airports	435	4,6%	14	5,7%	31	525	5,5%	18	6,3%	29
Business environment	327	3,4%	11	4,5%	30	439	4,6%	13	4,6%	34
Prox. to similar businesses	220	2,3%	11	4,5%	20	430	4,5%	15	5,3%	29
Cost of labour	120	1,3%	5	2,0%	24	405	4,3%	12	4,2%	34
English language	199	2,1%	7	2,9%	28	224	2,4%	7	2,5%	32
Presence of other company activities	565	5,9%	8	3,3%	71	215	2,3%	5	1,8%	43
Multilinguality	167	1,8%	6	2,5%	28	170	1,8%	8	2,8%	21
ICT Infrastructure	162	1,7%	6	2,5%	27	152	1,6%	7	2,5%	22
Office rents	115	1,2%	4	1,6%	29	120	1,3%	8	2,8%	15
Grants & Incentives	112,5	1,2%	5	2,0%	23	112,5	1,2%	5	1,8%	23
Labour regulation	65	0,7%	2	0,8%	33	75	0,8%	3	1,1%	25
Quality of life	136	1,4%	8	3,3%	17	70	0,7%	7	2,5%	10
Image of location	80	0,8%	2	0,8%	40	50	0,5%	1	0,4%	50
Takeover	240	2,5%	3	1,2%	80	40	0,4%	1	0,4%	40
Market size	20	0,2%	1	0,4%	20	20	0,2%	1	0,4%	20
CEO nationality	690	7,3%	8	3,3%	86	0	0,0%	0	0,0%	0
<b>Total</b>	<b>9500</b>	<b>100%</b>	<b>244</b>	<b>100%</b>		<b>9500</b>	<b>100%</b>	<b>285</b>	<b>100%</b>	

Table 22: Average weight of factors per country/region of origin (present)

Factor	Top 4 Country/Region of Origin			
	Canada	Japan	Asia	USA
Business environment	0,00	1,00	10,00	5,29
Centrality	6,25	2,50	5,60	7,79
CEO nationality	0,00	0,00	0,00	0,00
Cost of Labour	5,63	5,00	8,67	1,92
English language	0,00	4,57	0,00	3,08
Grants & Incentives	0,00	3,75	0,00	1,15
ICT Infrastructure	3,75	3,86	4,53	0,00
Image of location	0,00	0,00	0,00	0,96
Labour regulation	0,00	0,00	0,00	1,44
Market size	0,00	0,00	0,00	0,38
Multilinguality	0,00	6,43	0,00	1,54
Office rents	3,13	0,00	0,00	1,83
Presence of other company activities	3,13	0,00	0,00	2,69
Prox. to similar business	0,00	1,79	6,00	5,96
Prox. to major airport	16,25	7,14	9,00	2,12
Prox. to clients	16,25	16,07	24,20	26,98
Quality & Availability of Labour	20,00	17,11	8,33	14,32
Quality of life	0,00	0,71	1,33	0,77
Takeover	0,00	2,86	0,00	0,00
Tax	3,75	11,57	6,67	9,58
Transport & accessibility	21,88	15,64	15,67	12,20
<b>Total</b>	<b>100,00</b>	<b>100,00</b>	<b>100,00</b>	<b>100,00</b>

Table 23: Average weight of factors per country of destination (present)

Factor	Country of Destination					
	Belgium	France	Germany	Netherlands	Switzerland	UK
Business environment	3,33	0,00	26,60	9,00	13,57	0,88
Centrality	8,89	11,43	14,00	12,33	11,43	3,54
CEO nationality	0,00	0,00	0,00	0,00	0,00	0,00
Cost of Labour	10,00	2,86	6,00	6,67	0,71	3,08
English language	0,00	0,00	0,00	0,00	0,00	4,31
Grants & Incentives	5,56	0,00	0,00	0,00	0,00	1,20
ICT Infrastructure	1,11	4,29	2,00	3,67	0,00	0,90
Image of location	0,00	0,00	10,00	0,00	0,00	0,00
Labour regulation	1,11	0,00	0,00	0,00	2,14	0,96
Market size	0,00	0,00	0,00	0,00	0,00	0,38
Multilinguality	8,33	2,86	0,00	2,00	0,71	0,77
Office rents	0,00	0,71	0,00	0,00	0,00	2,21
Presence of other company activities	0,00	0,00	0,00	3,33	1,43	2,98
Prox. to similar business	3,33	19,29	0,00	1,00	1,43	4,62
Prox. to major airport	1,11	7,86	16,00	10,00	3,57	3,94
Prox. to clients	5,56	15,71	6,60	4,67	8,57	35,54
Quality & Availability of Labour	18,89	11,43	0,00	15,33	7,14	16,23
Quality of life	1,11	0,71	0,00	0,00	3,57	0,58
Takeover	4,44	0,00	0,00	0,00	0,00	0,00
Tax	13,33	3,57	10,00	11,67	38,57	3,94
Transport & accessibility	13,89	19,29	8,80	20,33	7,14	13,93
<b>Total</b>	<b>100,00</b>	<b>100,00</b>	<b>100,00</b>	<b>100,00</b>	<b>100,00</b>	<b>100,00</b>

Table 24: Average weight of factor per year of establishment (present)

Factor	Year of Establishment	
	< 1996	1996-now
Business environment	6,07	4,37
Centrality	4,64	7,58
CEO nationality	0,00	0,00
Cost of Labour	8,57	3,52
English language	0,00	2,77
Grants & Incentives	0,00	1,39
ICT Infrastructure	3,57	1,26
Image of location	0,00	0,62
Labour regulation	0,71	0,80
Market size	0,00	0,25
Multilinguality	5,00	1,23
Office rents	0,36	1,42
Presence of other company activities	0,00	2,65
Prox. to similar business	5,71	4,32
Prox. to major airport	5,71	5,49
Prox. to clients	18,21	23,65
Quality & Availability of Labour	13,07	14,70
Quality of life	1,79	0,56
Takeover	2,86	0,00
Tax	14,79	7,88
Transport & accessibility	8,93	15,54
<b>Total</b>	<b>100</b>	<b>100</b>

Table 25: Average weight of factors per sector (present)

Factor	Top 3 Sectors		
	Health Sciences	ICT	Software
Business environment	4,4	1,1	8,3
Centrality	10,0	3,9	5,0
CEO nationality	0,0	0,0	0,0
Cost of Labour	6,9	1,3	5,6
English language	0,0	2,6	6,9
Grants & Incentives	0,0	0,0	0,6
ICT Infrastructure	0,0	1,6	0,0
Image of location	0,0	0,0	0,0
Labour regulation	1,9	2,6	0,0
Market size	0,0	1,1	0,0
Multilinguality	5,0	0,0	0,0
Office rents	2,5	2,6	1,3
Presence of other company activities	1,3	0,0	8,1
Prox. to similar business	4,4	6,3	6,9
Prox. to major airport	3,1	6,8	3,8
Prox. to clients	11,3	30,3	23,0
Quality & Availability of Labour	25,9	18,4	9,5
Quality of life	3,1	0,5	0,0
Takeover	0,0	0,0	0,0
Tax	7,3	6,8	3,8
Transport & accessibility	13,1	13,9	17,3
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>

Table 26: Average weight of factors per number of fulltime employees (present)

Factor	Number of FTE at EHQ		
	< 20	20-100	>100
Business environment	4,1	7,2	2,2
Centrality	7,3	6,8	7,8
CEO nationality	0,0	0,0	0,0
Cost of Labour	4,2	3,0	6,9
English language	4,1	0,5	0,0
Grants & Incentives	0,2	1,9	3,3
ICT Infrastructure	1,7	2,5	0,0
Image of location	0,0	0,0	3,1
Labour regulation	1,0	0,6	0,6
Market size	0,4	0,0	0,0
Multilinguality	2,1	1,9	0,9
Office rents	1,2	1,5	1,3
Presence of other company activities	3,0	0,4	3,1
Prox. to similar business	5,7	3,0	2,8
Prox. to major airport	6,3	5,2	3,1
Prox. to clients	19,8	23,4	33,1
Quality & Availability of Labour	12,2	15,3	16,6
Quality of life	0,2	1,3	1,6
Takeover	0,0	1,5	0,0
Tax	12,2	5,9	3,9
Transport & accessibility	14,4	18,4	9,7
<b>Total</b>	<b>100,0</b>	<b>100,0</b>	<b>100,0</b>

## I. Tax aspects of European Headquarters

In light of the underlying study, we have researched the taxation aspects surrounding headquarters in the countries under review. In the second part of this chapter, we provide details for each of the countries on the following elements:

- 1) The system of taxation;
- 2) The statutory tax rate;
- 3) The effective tax rate applying to a headquarter.

From the details one can determine that all countries tax headquarters at the normal statutory tax rate. Should this be the sole (or even prime) indicator, the country with the lowest tax rate would arguably be the most favourable country from a tax perspective:

1) Switzerland	14 – 30.00%
2) United Kingdom	30.00%
3) Luxembourg	30.38%
4) The Netherlands	31.50%
5) Belgium	33.99%
6) France	34.93%
7) Germany	38 – 42.00%

Please note that the statutory tax rate does in our view not constitute the most important aspect from a tax perspective. Much depends on the scope of services performed by the headquarters.

Should the services performed by the headquarter be “limited” to support type of services (legal, administration, tax, HR etc.), the amount of profits reported at the level of the headquarters will for statutory purposes be limited, if not resulting in a loss (in case no or a limited fees are charged to the group companies involved). Most countries under review do however provide for the possibility of determining the taxable profit on a cost-plus basis (the headquarter will for tax purposes (be regarded) to on-charge the expenses with a mark-up on the costs involved).<sup>13</sup> If the headquarter carries out headquarter (support type of) activities “only” and if each country would apply the same cost plus percentage and would include the same type of costs in the basis on which the cost plus is applied, the normal statutory rate of the countries under review would determine their ranking.

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<sup>13</sup> The cost plus acceptance provides further substantiation that the headquarter activity does not result in significant profits.

However, as explained in the second part of this chapter, in some of the countries a lower cost plus percentage may be negotiated than in others and also the cost base may vary per country. As this is highly dependent of the facts and circumstances, the particularities of the single case are usually laid open in discussions with the tax authorities of the country involved.

In addition, many companies setting-up their headquarters in a centralised location will focus on other activities as well. In such instances, the role tax plays will become more important. Activities that come to mind are (i) intra group financing, (ii) exploitation of Intellectual Property, (iii) supply chain management (iv) holding activities, etc. Most of the countries mentioned below in such cases provide for the possibility of obtaining upfront tax rulings, which either combined with appropriate tax planning or not, provide for a beneficial effective tax rate.

If we focus on such set-ups, the countries that provide for the best possibilities (in alphabetical order) are:

- 1) Belgium
- 2) Luxembourg
- 3) The Netherlands
- 4) Switzerland

### *Belgium*

To increase Belgium's attractiveness, the Belgian Government decided on December 23, 2004 to introduce a system of notional interest deduction, providing for a tax deduction for the cost of capital for both Belgian and foreign companies. The draft bill introducing the notional interest deduction is expected to be voted on in Parliament before the end of June 2005, and is intended to apply as from January 1, 2006 (naturally, the proposed bill might be subject to amendments during the legislative enactment procedure). Through the grant of a notional interest deduction, the attractiveness of Belgium for capital intensive companies as well as, e.g., for equity funded headquarters and treasury centres of multinationals will further improve.

### *Luxembourg*

In the last decade, Luxembourg has become a big player in international tax planning structures. The country not only provides for a participation exemption system, it also has a very elaborate ruling practice. Before the change in ruling policy in the Netherlands, and even more so since the introduction of the new Dutch rules, Luxembourg has focused on the fields previously provided for in the Netherlands. The country is nowadays widely used for the intra-group activities described above.

The use of Luxembourg was especially interesting for US multinationals due to the 0% dividend withholding tax rate of the Luxembourg – US tax treaty and the relaxed limitation of benefits clause. Due to the lack of actual infra-structure Luxembourg may be less interesting for companies wanting to set-up factories.

### *The Netherlands*

The Netherlands have traditionally provided for an ideal tax climate. Starting off as one of the few countries with an ideal participation exemption regime<sup>14</sup>, the Netherlands also provided for a very elaborate tax treaty network which resulted in a reduction of double taxation and withholding taxes<sup>15</sup> and an elaborate ruling practice. The latter provided for beneficial treatment of (i) intra group finance activities<sup>16</sup>, (ii) intra group royalty flows, (iii) participation exemption rulings and (iv) cost-plus rulings (for support activities, amongst which head office activities). In 2001, Dutch ruling policy changed due to EU scrutiny. As a result, the ruling policy became stricter and demanded for more substance in the Netherlands in order to benefit from the beneficial tax treatment (most notably the use of the treaty network). The Netherlands subsequently perceived a decline in the role in the international tax planning environment.

Next to the Advance Tax Ruling practice, an Advance Pricing Agreement (“APA”) practice was introduced. The APA practice allows for obtaining upfront agreement on the transfer prices to be used by a Dutch tax payer. This new practice proves to provide very interesting opportunities and has made the Netherlands a more interesting location to invest in or through.

Given the above and despite the enhanced scrutiny of the Dutch tax authorities, the Netherlands still provide for an ideal location for European Headquarters. Especially in situations in which a new investment is made providing for new employment or other forms of sustainable substance, the APA and ATR practice provide interesting opportunities. With the introduction of a 0% dividend withholding tax rate under the Netherlands – US tax treaty, the role of the Netherlands may become more important again.

### *Switzerland*

Switzerland has a long standing reputation as having a very favourable tax regime. Depending on the Canton used, the effective tax rate can be very low. Next to the use of Switzerland in intra-group finance and royalty structures, the country nowadays is often used in more enhanced supply chain structures. In such scenarios, the risks incurred in production and sales processes (and the corresponding profits) are shifted to a so-called Principal located in Switzerland. The countries that previously bore such risk will remain to perform the activities such as production and sales, but no longer on behalf of their own but on behalf of the Principal. In order to substantiate this shift, relevant personnel (decision makers) are transferred to Switzerland as well. More and more often, other Headquarter functions are transferred as well.

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<sup>14</sup> Based on which income stemming from qualifying participations (both dividends and capital gains) are tax exempt

<sup>15</sup> Levied often by countries from which interest, dividends and/or royalties are paid.

<sup>16</sup> Initially through a Swiss finance branch ensuring a very low effective tax rate and later aimed at reducing withholding taxes and preventing discussions on the at arm’s length criterion (famous 1/8% spread).

All in all, from a tax point of view, Switzerland appears to provide the best answer for the location of a headquarters.

Based on the details mentioned above and in the second part of this chapter, the countries Switzerland, Luxembourg, the Netherlands and Belgium can be rated rather accurately but the other countries are in a grey area. Based on our experiences with the various countries, we would rank the seven countries involved as follows (from most favourable effective tax rate downwards):

- 1) Switzerland (cost plus 5% possible as a save haven rule, effective tax rate of 3-10% could be achieved)
- 2) Luxembourg (very flexible ruling practice, cost plus 6-10% possible for support services)
- 3) The Netherlands (cost plus 5-10% possible for support services, APA/ATR possible, lower tax rate as of 2007)
- 4) Belgium (cost plus 5-10% possible for support services, proposed notional interest deduction, ruling possible)
- 5) France (cost plus 6-10% possible for certain types of (non-operational) services provided to group companies)
- 6) Germany (cost plus 5-10% possible for support services)
- 7) United Kingdom (cost plus 5-10% possible for support services)

To achieve a workable rating for the purpose of this study and to be able to make a tax comparison between the countries involved, it is assumed that the services performed by the headquarters are “limited” to support type of services and that the cost base is equal in all countries (EUR 1,000). Based on the cost plus remuneration acceptable in the various countries and the applicable statutory tax rates, the headquarters would pay the following amounts of corporate income tax:

COUNTRY	cost plus	tax rate	tax payable (in EUR)	average tax
1) Switzerland	5 %	14 – 30.00 %	07.00 – 15.00	11.00
2) United Kingdom	5 – 10 %	30.00 %	15.00 – 30.00	22.50
3) The Netherlands	5 – 10 %	31.50 %	15.75 – 31.50	23.63
4) Belgium	5 – 10 %	33.99 %	16.99 – 33.99	25.49
5) Luxembourg	6 – 10 %	30.38 %	18.23 – 33.80	26.02
6) France	6 – 10 %	34.93 %	20.96 – 34.93	27.95
7) Germany	5 – 10 %	38 – 42.00 %	19.00 – 42.00	30.50

## II. Details of national tax regimes for each of the countries under review

### Belgium

#### Belgian system of taxation for Belgian resident companies in general

Belgium levies corporate income tax on the income of companies as specified in the Belgian Income Tax Code (“ITC”). For Belgian tax purposes, a company is resident in Belgium if its statutory seat, its principal establishment or its seat of management or administration is located in Belgium. Belgian corporate income tax is levied on the worldwide taxable income of Belgian resident companies.

The taxable income is based on the annual financial statements and includes the increase of retained earnings, non deductible expenses and dividends distributed to shareholders. Provided some conditions are met, reductions of the taxable profit are possible for foreign source profit, dividend income, previous year’s losses etc.

In principle, tax losses may be carried forward indefinitely in time (no carry back allowed). The deduction of losses may be restricted in case of certain tax free reorganisations. Moreover, losses will not be carried forward in case of a change of control, unless the change of control may be justified by legitimate financial or economic needs.

Dividend income may, under certain conditions, benefit from the participation exemption (i.e. 95% of the dividend received income is deducted from the taxable income, if the shareholder holds a minimum participation of 10% in the share capital of the subsidiary, or a participation equal to an acquisition value of €1,200,000.00, if he holds or engage itself to hold these shares for at least one year uninterruptedly and accounts it in its books for as fixed financial assets). In addition to this, the subsidiary must meet the ‘subject to tax’ test.

Capital gains on shares may be exempt from tax if potential dividends on those shares would qualify for the participation exemption (cfr supra however neither a minimum holding period, nor a minimum share ownership is required). Correspondingly, capital losses on shares are in general not deductible.

Beside some provisions in the ITC that relate to specific aspects of transfer pricing, one should know that the internationally agreed arm’s length principle has recently been introduced in the ITC. The introduction of the arm’s length provision in a cross border situation is accompanied by a change in the ruling commission and its decision making process. In this respect it is possible to obtain an advance ruling on the arm’s length allocation of profits among related enterprises.

Belgian resident tax payers may claim relief for the avoidance of double taxation in respect of foreign source profits under the applicable double tax treaties concluded by Belgium with approximately 85 other countries.

A notional interest deduction regime (calculated on risk capital) based on (accounting) equity amount might be available in the future (very likely to be approved in order to be applicable as from January 1<sup>st</sup>, 2006)

### **Statutory tax rates in Belgium**

The standard Belgian corporate income tax rate is currently 33% (increased by a 3% crisis surcharge up to 33.99%). In certain cases, provided some conditions are being met, taxable income below €322,500 is taxed at progressive rates ranging from 24.25% to 34.5% (+ 3% crisis surcharge).

Very generally, Belgium levies domestic withholding tax of 15% on interest or royalty payments. Dividend withholding tax is levied at the domestic rate of 25% or 15%. Several withholding tax exemptions are possible under the domestic tax law provisions. Moreover, domestic withholding tax rate may be reduced, even up to 0% according to applicable double tax treaty provisions, the Parent Subsidiary Directive or the Interest Royalty Directive depending upon fact and circumstances at hand.

A registration duty of 0.5 % is levied on the contribution to share capital of a Belgian company (exemption possibilities may be available).

### **Effective Belgian tax rate for European headquarters**

A corporate European headquarter located in Belgium is subject to the normal Belgian corporate income tax regime as described above. An advance ruling may possibly be obtained from the Belgian tax authorities in order to determine upfront the arm's length remuneration for any headquarter activities depending upon the type of activities of the headquarter (dependable cost allocation system based upon the arm's length principle). Adequate remuneration for these services should be agreed among parties and requires preliminary functional analysis and benchmark.

## France

### French system of taxation for French resident companies in general

France levies corporate income tax on the income of companies specified in the French “CGI”. The French corporate income tax system is based on the principle of territoriality. As a result, French companies carrying on a trade or business outside France are generally not taxed in France on the related profits. However, under CFC legislation income earned by a French enterprise through a foreign enterprise may be taxed if the levy paid abroad is less than 50 % of the one the company of which would have been indebted in France. Companies are French when they are registered in France. In principle, losses may be offset against the taxable profits of the three preceding financial years (carry-back) and may be carried forward indefinitely.

Capital gains are taxed like normal trading income. However, a reduced rate applies to capital gains derived by parent companies from disposals of qualifying shares of subsidiaries. The capital gain tax amounts to 15% in 2005 and 8 % in 2006.

Resident tax payers may claim relief for the avoidance of double taxation in respect of foreign source profits under the applicable French tax treaties.

### Statutory tax rates in France

The standard corporate income tax rate is 33 1/3 %. A surtax of 0.5% is imposed 2005 and will be abolished as from 2006. A social security surtax of 1.1% is imposed on the portion of corporate tax due exceeding €763,000 (and if at least 75% of the company is owned directly or indirectly by individuals). Consequently, the effective tax rate would be 34.93% for FY 2005 and 34.43% for FY 2006.

In most cases there is no capital duty in the formation of capital.

As a general rule, a 25% withholding tax is imposed on dividends paid to non-residents. In addition, under the EU Parent-Subsidiary Directive, dividends distributed by a French subsidiary to an EU parent company are exempt from withholding tax, if, among other conditions, the recipient holds 25% or more of the shares of the subsidiary and commits to keep such shares during two years.

In practice and according to several conditions, there is no withholding tax on interests. Under the French law a 33 1/3% withholding tax is imposed on royalties paid to non-residents. However, withholding tax on royalties paid between direct associated companies of different EU states is abolished since January 1, 2004. For royalties that do not benefit from the above EU Directive provisions, domestic withholding tax may be reduced or eliminated by tax treaties.

### **Effective French tax rate for European headquarters**

The French tax authorities issue rulings that grant special tax treatment to headquarters companies. These rulings are only granted when certain types of services such as administration, strategy, marketing, audit and coordination are provided to the group companies only. They can not have an operational activity such as treasury management or purchase activities for the group. They should provide services to group companies based in several countries.

These companies are subject to corporate income tax at the normal rate on a tax base corresponding to 6% to 10% of their total annual operating expenses, depending on the headquarter' size. The rulings are granted for a period of 3 to 5 years and can be revised if the actual business does not correspond to the activities described in the ruling application.

In addition, certain employee allowances are exempt from income tax (tax equalization, scope fees).

## **Germany**

### **German system of taxation for German resident companies in general**

Corporations that have their statutory seat or effective place of management in Germany are subject to German corporate income tax on their worldwide income. No distinction is made between capital gains and trading income. Furthermore, Germany has a Trade Tax which is imposed by the municipalities. Basis for trade tax is the income calculated for corporate tax purposes with certain adjustments. Especially interest on long-term debt is only deductible at one half for trade tax purposes. Trade tax is a deductible business expense. In principle, losses may be offset against the taxable profits of the preceding financial year (carry-back) up to the amount of € 511,500. Though losses may be carried forward indefinitely in time, the amount of carry forwards that can be offset against taxable profits is limited up to €1 Million per fiscal year. Income exceeding €1 Million can only be offset by 60 % against the remaining loss carry forward. Resident tax payers may also claim relief for the avoidance of double taxation in respect of foreign source income according to the German tax treaties as well as in respect of national law.

The German corporate tax system also includes various case-specific particularities, e.g.

- Participation exemption. Dividends and profits derived by selling shares in corporations are generally tax exempt at 95 %. Correspondingly, losses derived by the sale of shares and depreciations in shares of corporations are not tax deductible. Expenses and costs

(especially financing costs and interest) associated with the participation are fully deductible.

- Fiscal unity (“Organschaft”). By owning the majority of the voting rights of another corporation since the beginning of a fiscal year and by concluding a profit and loss pooling agreement for at least five years, profits and losses of each company can be offset against each other. In fact, the profit of the corporations in fiscal unity is only taxed at the level of the dominant company. If fiscal unity is established for corporate tax purposes, it is also compulsorily established for trade tax purposes.
- Thin capitalization rules. These rules apply when a German corporation is financed with related party debt. The expression “related party” needs to be interpreted very broadly. If the interest is calculated as a percentage of the loan capital of the corporation, the rules allow basically a debt/equity ratio of 1.5 to 1. Furthermore, the rules only apply when the related party interest exceeds the amount of €250,000.
- Binding ruling. For tax issues not covered by a binding statement by fiscal authorities published in the Federal Tax Gazette, there is the possibility of obtaining a binding ruling.
- Transfer Pricing issues. All intra-group-transactions must be carried out at arm’s length, and all contracts need to be concluded in advance. Since 2003, there is the statutory obligation to prepare and provide transfer pricing documentation.
- Withholding tax. According to German national law, Germany levies withholding tax on dividends (20 % in general). On royalties (20 %), a withholding tax is only imposed in case the recipient of the payments is a non-resident. No withholding tax is generally imposed on interest, assuming the creditor is not a bank. If the recipient and the debtor are located in the EU, withholding tax may not be levied. Apart from this, the German tax treaties normally assign the taxation right for interest and royalties to the country of the recipient. Due to the participation exemption regimes stated in the tax treaties, dividends are normally taxed at a rate of 0 % to 5 %.
- Capital tax. Germany does not levy any capital tax.
- Law on external relations. If a German controlled foreign company located in a country where the effective tax rate is below 25 % acts as a finance company (in general: passive income), the foreign company will be disregarded for German tax purposes and, instead, the German shareholder will be taxed directly.

### **Statutory tax rates in Germany**

The standard corporate income tax rate is 25%. A surtax of 5.5% (“solidarity surcharge”) is imposed on the corporate income tax. Therefore the effective tax rate is 26.375%. The effective trade tax rate varies from 13% to 20.5%.

### **Effective German tax rate for European headquarters**

Corporate European headquarters located in Germany will be effectively subject to German national corporate income tax (25%), solidarity surcharge (5.5%) and trade tax (13% up to 20%).

As a result, the effective tax rate in Germany is in general about 38% to 42%. Since the German national participation exemption regime applies, in some cases the effective tax rate can be significantly lower.

However, the basis on which the tax rate should be applied can be influenced by the facts and circumstances (functions or services performed, assets employed) and by the transfer pricing method used to calculate the profit of the headquarters.

As already mentioned above, all intra-group transactions must be concluded in accordance with the at arm's-length principle. Transfer pricing methods accepted by the fiscal authorities are the comparable uncontrolled price method, the cost-plus-method and the resale price method. The decision as to which method is appropriately applicable depends on the individual transaction. Service fees can be allocated directly or by using the indirect charge method.

## Luxembourg

### Luxembourg system of taxation for Luxembourg resident companies in general

Luxembourg levies corporate income tax on the income of companies specified in the Luxembourg corporate income tax law. Corporate income tax is imposed on the worldwide profits of Luxembourg tax resident entities. A company is resident in Luxembourg if its principal place of management or registered office is there. In principle, losses may not be offset against the taxable profits of the preceding financial years (carry-back), but may be carried forward indefinitely in time.

A Luxembourg resident company is also subject to municipal business tax (“impôt commercial communal”) on its local source income (i.e. income earned in the relevant municipality).

Luxembourg resident companies are also subject to net worth tax (“impôt sur la fortune”) on their unitary value, i.e. broadly speaking, their net asset value, as per 1 January.

Resident taxpayers may claim relief for the avoidance of double taxation in respect of foreign source profits under the applicable Luxembourg tax treaties and the unilateral double tax relief rules.

The Luxembourg system of taxation for Luxembourg resident companies includes various case-specific features and requirements, including but not limited to:

- Participation exemption. This exemption seeks to prevent double taxation of business profits at different corporate levels. Under application of the participation exemption, all capital gains and income derived from a qualifying participation are exempt from corporate

income tax and municipal business tax. Correspondingly, capital losses are not deductible. Costs, including foreign exchange results, associated with the participation are deductible.

- Fiscal unity. Upon request, and subject to certain conditions, Luxembourg tax resident companies can form a fiscal unity with (nearly) wholly owned resident subsidiaries. As a consequence, the companies involved can file a consolidated return for income tax purposes. The main advantages of a fiscal unity are that losses of one company can be offset with profits of another and that assets can be transferred from one company to another without any recognised income at that time.
- Advance Tax clearances are common.
- Arm's length principle. Based on the arm's length principle, transactions between related parties should be at arm's length.
- Thin capitalization legislation. The thin capitalization rules apply when Luxembourg entities are funded with related party debt. The ratio accepted by the tax authorities depends on the sector and the activities.
- Availability of grants and (tax) incentives, such as investment tax credits.
- Tax infra-structure. Luxembourg offers an extensive and high quality tax treaty network, a professional and well educated (tax) advisory sector and a well established network of trust companies.

### Statutory tax rates in Luxembourg

The Luxembourg corporate income tax rate is:

- 20% when the taxable income does not exceed €10,000;
- €2,000 plus 26% of the income exceeding €10,000 when the taxable income ranges from €10,001 to €15,000;
- 22% flat when the taxable income exceeds €15,000.

Additionally, a surtax of 4% of the amount of corporate income tax is payable to the unemployment fund. Furthermore a local municipal business tax is levied by the different municipalities. The rate varies between the municipalities. The average rate (which is applicable e.g. in Luxembourg-City) is 7.5%. As a consequence, the combined income tax rate is about 30.38%.

The annual net worth tax rate amounts to 0.5%.

Luxembourg does not levy withholding tax on interest payments, except where:

- the loan is structured under the form of bonds or other similar securities; and
- aside from the fixed interest, a supplementary interest varying according to the amount of profit distributed by the borrower is paid.

Dividend withholding tax is levied at the national rate of 20%. This withholding tax concerns both dividend payments to residents and to non-residents. Furthermore, Luxembourg does not levy any withholding tax on royalties.

The rate for capital tax in Luxembourg is 1%.

### **Effective Luxembourg tax rate for European headquarters**

A corporate European headquarter located in Luxembourg will be effectively subject to the Luxembourg national combined income tax rate of 30.38% (for companies in Luxembourg-City). However, the basis on which the tax rate should be applied can be influenced by the facts and circumstances (functions or services performed in Luxembourg, risks borne and assets used) and by the transfer pricing method used to calculate the profit of the headquarter.

If intra-group services are provided by the European headquarter, an appropriate cost allocation system should be put in place (based on the arm's length principle). Service fees can be allocated on the basis of the direct charge method or the indirect charge method, charging an appropriate profit mark-up (except in a few exceptional circumstances). For the direct method, costs relating to the services to one or more specific group companies can be charged directly to these group companies. The transfer pricing method used could be the Comparable Uncontrolled Price method or the cost plus method. The indirect charges are allocated on the basis of an appropriate allocation key. Under the cost plus method, lowering the cost basis in Luxembourg could push down the effective tax rate.

## **The Netherlands**

### **Dutch system of taxation for Dutch resident companies in general**

The Netherlands levy corporate income tax on the income of companies specified in the Dutch Corporate Income Tax Act ("CITA"). Corporate income tax is imposed on the worldwide profits of Dutch tax resident entities. No distinction is made between capital gains and trading income. The taxable amount equals the taxable profit<sup>17</sup> minus any losses carried forward or back from other years. In principle, losses may be offset against the taxable profits of the three preceding

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<sup>17</sup> The total income derived from a business, in whatever form and under whatever name, allocated to the appropriate financial year by reference to the sound business practice ("goed koopmansgebruik"). In principle, business expenses can be deducted unless a specific provision in the tax legislation disallows the deduction. Some important exceptions to the deductibility of expenses are foreign tax levied on profits and Dutch corporate income tax (not deductible), distributions of profits (not deductible) and in certain cases interest expenses and/or finance costs (can be deferred or disallowed in a number of scenarios, listed in the CITA).

financial years (carry-back) and may be carried forward indefinitely in time. Resident tax payers may claim relief for the avoidance of double taxation in respect of foreign source profits under the applicable Dutch tax treaties and the unilateral double tax relief rules.

The Dutch system of taxation for Dutch resident companies includes various case-specific features and requirements, including but not limited to:

- Participation exemption. This exemption seeks to prevent double taxation of business profits at different corporate levels. Under application of the participation exemption, all capital gains and income derived from a qualifying participation are exempt from corporate income tax. Correspondingly, capital losses are not deductible. Costs, including foreign exchange results, associated with the participation are deductible.<sup>18</sup>
- Fiscal unity. Upon request, and subject to certain conditions, Dutch tax resident companies can form a fiscal unity with (nearly) wholly owned resident subsidiaries. As a consequence, the companies involved can file a consolidated return for corporate income tax purposes. The main advantages of a fiscal unity are that losses of one company can be offset with profits of another and that assets can be transferred from one company to another without any recognised income at that time.
- Advance Pricing Agreements ("APA")<sup>19</sup> and Advance Tax Rulings ("ATR")<sup>20</sup> practice. <sup>21</sup> We refer to paragraph 1.3 below.
- At arm's length principle and documentation requirements. Based on the at arm's length principle (article 8b CITA), transactions between related parties should be at arm's length.
- Thin capitalization legislation. The thin capitalization rules apply when Dutch entities are funded with related party debt and in general allow a debt/equity ratio of 3:1 (if the ratio of the group as a whole is higher, a higher ratio can be allowed).
- Availability of grants and (tax) incentives, such as education or investment deductions.
- Tax infra-structure. The Netherlands offer an extensive and high quality tax treaty network, a professional and well educated (tax) advisory sector and a well established network of trust companies.

The Netherlands levy dividend withholding tax on profit distributions, including various transactions specified in the Dutch Dividend Withholding Tax Act, on shares and other profit sharing instruments (certificates, bonds). Under certain listed conditions, no dividend withholding tax needs to be withheld (e.g. in case of a distribution to a qualifying EU shareholder).

The Netherlands levy capital tax on contributions to the share capital of resident entities.

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<sup>18</sup> Following EU case law (the "Bosal" ruling), the limitation on the deduction of these costs was removed from the CITA as of January 1, 2004.

<sup>19</sup> APA: an arrangement that approves, in advance of cross-border transactions between related entities and between divisions of one single entity, the (method of) determination of the appropriate transfer pricing for such transactions

<sup>20</sup> ATR: can stipulate certainty in advance regarding the tax treatment of certain (indicated) transactions.

<sup>21</sup> The APA/ATR regime was introduced as of April 1, 2001.

### **Statutory tax rates in the Netherlands**

The Dutch corporate income tax rate is currently 27% on the first EUR 22,689 and 31.5% on the rest (tax rates for 2005). Legislation has been adopted to lower the corporate income tax rate gradually over the years, to 25% (on the first EUR 22,689) and 30% (on the rest) as per the year 2007.

The Netherlands do not levy withholding tax on interest or royalty payments. Dividend withholding tax is levied at the national rate of 25% (potentially lowered under the applicable tax treaty). The Dutch capital tax rate is currently 0.55%.

### **Effective Dutch tax rate for European headquarters**

A corporate European headquarter located in the Netherlands will be effectively subject to the Dutch national corporate income tax rate of 27% (for the first EUR 22,689) and 31.5% (for the rest). However, the basis on which the tax rate should be applied can be influenced by the facts and circumstances (functions or services performed in the Netherlands, risks borne and assets used) and by the transfer pricing method used to calculate the profit of the headquarter.

Depending on the actual activities of the European headquarter, various scenarios are possible.

If intra-group services are provided by the European headquarter, an appropriate cost allocation system should be put in place (based on the arm's length principle). Service fees can be allocated on the basis of the direct charge method or the indirect charge method, charging an appropriate profit mark-up (except in a few exceptional circumstances). For the direct method, costs relating to the services to one or more specific group companies can be charged directly to these group companies. The transfer pricing method used could be the Comparable Uncontrolled Price method or the cost plus method. The indirect charges are allocated on the basis of an appropriate allocation key. Under the cost plus method, lowering the cost basis in the Netherlands could push down the effective tax rate.

To obtain certainty in advance regarding the taxable basis or tax treatment in the Netherlands, a binding agreement can be closed with the Dutch tax authorities in the form of an Advance Pricing Agreement/Advance Tax Ruling ("APA/ATR"). For example, if the European headquarter carries out finance activities, based on a functional and economic analysis and benchmark an at arm's length finance spread can be determined and confirmed in an APA. Also, if the European headquarter carries out preparatory or auxiliary activities, an appropriate cost plus could be determined and confirmed in an APA. The particularities of the single case are usually laid open in discussions with the tax authorities.

## Switzerland

### Swiss system of taxation for Swiss resident companies in general

Switzerland is a federation of 26 cantons. Taxes are levied at three levels: federal, cantonal and communal level. Under the Swiss income tax system, earnings are taxed at the corporate level and, to the extent profits are distributed and the participation exemption is not applicable (see below), again at the shareholder's level.

In principle, a corporation is tax resident in Switzerland when its registered office is in Switzerland. A corporation is also considered a resident when it is effectively managed in Switzerland. Companies resident in Switzerland are taxed for their world income. However, according to the Swiss Federal Direct Tax Act ("FDTA") income from foreign real estate and foreign permanent establishments is exempt from Swiss taxation. No distinction is made between capital gains and trading income. The taxable amount equals to the taxable profit<sup>22</sup> minus any loss carry forward. Losses can be carried forward for tax purposes for seven years.

The Swiss system on taxation of Swiss resident companies provides various case-specific features and requirements, including but not limited to:

- At arms length principle. Based on the at arm's length principle of article 58 FDTA, transaction between related parties must meet at arm's length standards.
- Thin capitalization legislation. The thin capitalization rules are applicable for Swiss entities funded with debts from related parties. The tax administration published safe haven rules depending on the kind of assets of the Swiss entity.
- Participation exemption. According to this rule the amount of corporate income tax is reduced in proportion of the net participation income to the total taxable profit. The net participation income includes dividend income and capital gain from qualifying participation. Losses on participation are deductible.
- Cantonal and communal law provides for very favourable tax treatment on cantonal and communal level for Holding, Domiciliary and Mixed companies.
- Tax incentives. Tax holidays are available for up to ten years for companies setting up new or expanding existing business in Switzerland.
- Tax treaty network. Switzerland offers an extensive and high quality treaty network.

Switzerland levies withholding tax of 35% on any profit distribution on shares in corporate entities as well as on specific interest payments. No withholding tax is generally levied on interest payments on inter company loans and royalty payments.

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<sup>22</sup> Income shown in commercial financial statements generally serves as the basis for taxation. However, the tax authorities may require adjustments to correct for items such as excessive depreciation and provisions.

Contributions to the share capital or the capital surplus of Swiss resident entities are subject to 1% share issuance tax, however, numerous exemptions are applicable. Switzerland levies securities transfer tax on the transfer and the brokerage of securities to third party against consideration as far as a Swiss securities dealer is involved in the transaction. The securities transfer tax rate is 1.5‰ for Swiss and 3‰ for foreign securities and is levied on the amount of the consideration.

Swiss VAT of 7.6% (ordinary rate) applies to the following transactions:

- The supply of goods and services made in Switzerland by taxable persons;
- Services acquired from abroad for more than CHF 10'000 a year; and
- The import of goods from abroad, irrespective of the status of the importer.

The general VAT registration threshold in Switzerland is annual turnover of CHF 75,000. A taxable person may recover input VAT to the extent that purchases of goods and services are related to taxable supplies, including zero-rated supplies and supplies rendered abroad, which would be taxable if rendered in Switzerland.

### **Statutory tax rates in Switzerland**

The federal corporate income tax rate is 8.5%. However, tax payments are tax-deductible and therefore the effective tax rate is 7.8%. There is a great difference between the various cantonal and communal tax rates. The combined effective tax rate of federal, cantonal and communal taxes ranges from approximately 14% to 30%.

### **Effective Swiss tax rate for European headquarters**

For a corporate European headquarter located in Switzerland generally more favourable tax treatment can be achieved. The services of Swiss resident companies providing coordination or management services to a multinational group need to be charged at market price. As a safe haven rule a cost + 5% rate can be applied

European headquarters in Switzerland primarily engaged in activities abroad may qualify for the Domiciliary or Mixed company status. The profits of these companies are taxed at substantially reduced rates at cantonal/communal level resulting in an overall tax burden of as low as 10% depending on the circumstances. Furthermore in case the Swiss company's main activity is the holding of participation the holding status might be available if it does not have any business activities in Switzerland. In this case corporate income tax is only levied on federal level resulting in a tax burden of 7.8%.

Should the European headquarter in Switzerland assume risks and responsibilities for certain activities such as purchasing, planning of R&D, manufacturing and distribution, logistics, treasury, administration etc. it may apply the specific rules for principal companies. The federal guidelines can result in a combined effective tax rate of as low as 5 to 10% depending on the particular set-up and the location.

Finally, a (partial) tax holiday for up to 10 years on cantonal/communal and in certain locations also on federal level is available for Domiciliary, Mixed, and principal companies, bringing the effective tax rate down to as low as 3%. A tax holiday is granted on the set up of new and on the expansion of existing business.

Switzerland has a long standing advance ruling practice. The particularities of the single case are usually laid open in discussions with the relevant tax authorities and the fiscal treatment is determined in writing.

## **United Kingdom**

### **U.K. system of taxation for U.K. resident companies in general**

The U.K. levies corporate income tax ('corporation tax') on the taxable profits of companies that are resident (managed and controlled) in the UK, in accordance with the provisions of the UK tax code, as set out in the Income and Corporation Taxes Act ('ICTA') 1988, together with various annual Finance Acts and other relevant statute and tax case law. Corporation tax is imposed on the worldwide profits of U.K. tax resident entities. Capital gains are also subject to corporation tax at the same rate as trading profits. Tax losses arising from the company's trade can be offset against other non-trading profits (e.g. loan interest income) of the company in the same year or carried back for offset against the taxable profits of the preceding financial year, or carried forward indefinitely in time for offset against profits arising from the same trade as that which generated the losses. If the company is a member of a group for corporation tax purposes then it may also surrender its tax losses for offset against the profits of another UK tax resident company in the same group ('group relief').

### **Statutory tax rates in U.K.**

The U.K. corporation tax rate is currently 30% (and has been since the year 2000). If a company's taxable profits for an accounting period are below £300,000, a 19% 'small companies' tax rate may be claimed. Marginal relief is also available to companies with a taxable profit between £ 300,000 and £ 1,500,000 (these limits are subject to adjustment based on the number of companies in the group). For companies with a taxable income below £ 10,000, the tax rate is 0%.

Companies must file a tax return within 12 months following the end of the accounting period (e.g. for the year ended 31 December 2004 the corporation tax return must be filed on or before 31 December 2005). In addition, large companies must make instalment payments of their estimated tax liability during the year, in addition to filing the final annual return.

The U.K. also levies a withholding tax on interest and royalty payments. The withholding tax on interest and royalty payments is levied at a rate of 20% (the basic rate of UK income tax) (potentially lowered under the applicable tax treaty). The U.K. does not levy withholding tax on dividends.

UK companies are also subject to UK value added tax ('VAT') at 17.5% and stamp duty on certain transfers.

### **Effective U.K. tax rate for European headquarters**

A European headquarters located in the UK in the form of a UK resident company will be subject to UK corporation tax as described above. Double taxation relief will be available on dividends received from its overseas (e.g. European) subsidiaries. This relief takes the form of credit for the underlying tax suffered on the dividends, rather than an exemption from UK tax of the dividends received. In addition future gains on disposals of the European subsidiaries by the UK corporate headquarter company could be exempt from corporation tax if the UK 'substantial shareholdings' exemption is met (i.e. a form of 'participation exemption').

If a U.K. headquarter is carried out in the form of a branch or a permanent establishment it will be subject to UK corporation tax in the same way as any other UK branch of a non-resident company. However, it may be possible to negotiate a cost-plus basis with the U.K. tax authorities for assessing the branch profit. This would depend, among other things, on demonstrating that the headquarters perform only an administrative or service function.

## Interpretation of HiView tables (Table 17 and Table 18)

Table 17 and Table 18 in Chapter 5 show the ratings and the weightings of the seven countries on the location factors. This Appendix explains how to interpret these tables, using Table 17. This table shows the results for the Cost factors in the PRESENT<sup>23</sup> scenario.

Table 27: Cost factors and ratings

BRANCH	Wt	Costs Data Breakdown							CumWt
		FR		Lux		Swi		UK	
		BE	GE		NL				
* Labour costs	4	93	87	76	82	97	63	100	4.3
Tax	9	51	48	45	51	55	100	57	8.9
* Office rent	1	85	50	72	75	100	71	28	1.3
<b>TOTAL</b>	<b>15</b>	<b>67</b>	<b>60</b>	<b>56</b>	<b>63</b>	<b>72</b>	<b>86</b>	<b>67</b>	<b>14.5</b>

**Branch** refers to the branches in the decision tree. The branches on the Costs side are “Labour costs”, “Tax” and “Office rent”.

**Wt** is the overall weight (**CumWt**) of each criterion, rounded off to zero decimal places.

**BE, FR, GE, Lux, NL, Swi and UK** refer to the seven countries. The rating (score) of each country on the three cost factors is displayed below the country abbreviations. For each factor, the range of the ratings is 0-100. We have assigned 100 points to the country that has the best score on a certain factor.

**CumWt** is the overall weight of a location factor in the location decision.

The row **TOTAL** is the total result of each column and shows the sum of the columns **Wt** and **CumWt** and the weighted average of the scores on the location factors for the seven countries.

<sup>23</sup> If we had used this table for the PAST scenario, only the weightings would have been different.

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