Canadian Establishments in Western New York: Some Preliminary Findings

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In many regions of the United States, including the Northeast, foreign direct investment (FDI) has become a powerful source of new employment growth, technology transfer, and economic diversification (McConnell 1983; Little 1985, 1988). A prominent theme of the literature on this subject is that sustained inflows of FDI can substantially improve a region's export and income potential, especially over the long run, and that certain types of FDI can generate new input-output linkages between key sectors of a region's economy, adding fresh technological potential for local product innovation, exports, and industrial job retention.

The considerable body of empirical evidence amassed to date suggests a positive and expanding role for FDI in urban and regional development (Little 1988). Although dissenting views have been expressed periodically at the political level, especially among communities that have experienced net foreign disinvestment, many regions of the United States now regard FDI as a strategic priority for long-run economic planning. Indeed, as the 1990s unfold development agencies in a growing number of regions are reshaping their policy initiatives to attract new inward investment across a wide range of sectors, including services. This pro-FDI stance implies a need for

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detailed geographical work on the organizational and locational behaviour of foreign-owned companies, particularly with respect to corporate motives, entry modes, strategic expectations, and sector membership. Increased policy interest in FDI also suggests a need for systematic impact evaluation at the regional level, especially with respect to jobs, exports, new industrial linkages, and economic diversification effects.

Although recent foreign direct investment in the United States has come from a diverse range of sources, including Japan, Western Europe, and several of the newly industrializing countries (NICs), direct investment from Canada continues to play a significant and distinctive economic role, especially in regions that straddle the Canada-U.S. border (Investment Canada 1988). Since 1975, annual inflows of Canadian direct investment have consistently exceeded U.S. outflows to Canada, and many analysts expect this trend to continue (Rugman 1987; Investment Canada 1988). This expectation derives in part from the steady accumulation of investment capital inside Canada since the mid-1970s—capital that cannot be fully utilized at home. Moreover, as the governments of Canada and the United States begin to implement the Free Trade Agreement (FTA), Canadian direct investments in the United States are likely to continue in a wide range of sectors as investors seek to take advantage of lower production costs that may exist south of the border and to secure a physical presence within the U.S. marketplace (McConnell et al. 1989). In fact, recent empirical research suggests a trend toward increased international trade and investment in services (Harrington 1989), especially those that incorporate knowledge or information as the primary element in value-added activity (Hepworth 1988). Is this the case between Canada and the United States?

This article examines the economic development implications of recent Canadian direct investment in one region of the United States that stands to benefit significantly from the free trade accord—western New York. This region commands a strategic position with respect to Canada's industrial and commercial heartland—southern Ontario. Moreover, over the last few years western New York has absorbed substantial direct investment from Canada, and recent evidence suggests a continuation of this trend over the next few years. The focus of this article, therefore, is on the Canadian establishments that are operating within one geographic region. Such a perspective contrasts to most of the published research on FDI in the United States by regional scientists and geographers, in which the units of observation have typically been states, census regions, or metropolitan areas.

With these thoughts in mind, three major questions are addressed in the empirical section that follows. First, what are the principal factors attracting Canadian-owned establishments to the western New York border region? Second, what are some of the key industrial characteristics of these subsidiaries? And, third, what are the implications of these Canadian direct investments for the economic growth prospects of the region over the coming decade? Data for this analysis were gathered from a postal questionnaire distributed to Canadian-controlled establishments in western New York.

Although the geographical focus of this article is restricted to only one region (and one source of FDI), some of the empirical results suggest research directions that might be useful for a multiregional inquiry. The results also provide a starting point for comparative work on the scale, nature, and spatial distribution of inward-moving FDI from other countries. Before examining the survey data, however, we will consider the main locational and industrial characteristics that make western New York a potentially interesting test case.

The Study Region

Western New York is centrally located within a 500-mile radius of more than half of the 270 million people that live in Canada and the United States, 52 percent of the total personal income of the two countries, 55 percent of U.S. manufacturing activity, 77 percent of Canadian manufacturing activity, and over 50 percent of the skilled professional and technical workers of the two nations (McConnell et al. 1989). The region serves as a natural land link between the dominant metropolitan centres of both trading partners (Toronto and New York City), giving the two main counties of western New York—Erie and Niagara—a potentially strategic location from a North American marketing perspective. In addition to locational strengths, western New York offers significant cost advantages for both domestic and foreign-owned companies seeking alternative business locations to serve the expanding North American marketplace. For example, raw industrial land in western New York sells for between $20,000 and $30,000 an acre, compared with between $200,000 and $400,000 an acre in the Toronto metropolitan area (Erie County United States/Canada Commerce Task Force 1989). Relative to southern Ontario, moreover, western New York contains an abundant supply of cheap labour, low-cost energy, inexpensive housing, and low-priced office space (McConnell et al. 1989). In fact, the average cost gradient between the Toronto metropolitan region and western New York slopes unequivocally downward, leaving the Canadian segment of the Golden

Horseshoe at a significant price disadvantage relative to competing urban centres on the southern shore of Lake Ontario.

Clearly, then, competitive factor prices (together with a liberal tax environment) make western New York a potentially attractive location for Canadian investors looking for greater access to the U.S. domestic market (Canada-United States Trade Center 1989). For some Canadian firms, moreover, western New York may also serve as an attractive export platform. Several prominent Canadian companies are already well established in the region, including Acres International (engineering consulting), Abitibi-Price (computer services), George Weston Limited (food and bakery products), Harlequin Enterprises (publishing), Moore Corporation (business forms), Armstrong S.A. Limited (pumping equipment), and Cybermedix (medical laboratories). Many of these firms serve export markets outside North America. To date, however, scant empirical work has been carried out on the scale, nature, or geographic distribution of Canadian direct investment in this region. And, although the same can be said for other parts of the United States, policy agencies in western New York are in the curious predicament of not knowing the total population of Canadian companies. Recent estimates range from a high of over 500 establishments to a low of about 150. In practical terms, however, it is difficult to corroborate reliably any of the available estimates, resulting in survey research fraught with measurement problems. While more will be said about this later, it is emphasized that the results presented in this article are suggestive rather than conclusive—if only because a reliable sampling frame is unavailable.

Survey Methodology

A questionnaire was designed and pretested as a comprehensive instrument for collecting proprietary information across four interconnected dimensions: corporate strategy, business performance, organizational structure, and regional economic impact. Before the survey was mailed in October 1989, the manager of each establishment received a packet containing two "advance" letters: one from the two investigators describing the purpose of the research and another from the president of the Can-Am Business Council of the Niagara Frontier endorsing the study. Several days later, the survey instruments were mailed to the managers of 182 Canadian-owned establishments in the five-county region of western New York. At the time of the mailing, these companies were believed to represent the entire population of Canadian-controlled establishments in the area, calculated using

listings from the area chamber of commerce, the Canadian government, the New York State Department of Economic Development, and the Canada-United States Trade Center at the State University of New York at Buffalo.

Of the 182 companies to whom questionnaires were distributed, 41 were subsequently eliminated from the population because they were either no longer in business or were improperly identified as Canadian-owned. From the remaining 141 companies, 40 responses were received and used as the sample for this analysis. The response rate of 28.4 percent is considerably higher than that typical of other recent government- and private sector-sponsored surveys. Although the establishments in the sample represent a wide mix of manufacturing and service sectors, size categories, and lengths of stay in the area, the full extent of non-response bias remains unknown.

Factors Attracting Canadian Direct Investors

Contrary to much local popular belief, most of the Canadian-owned subsidiaries in western New York did not move across the border to escape U.S. tariffs, government taxes, or other regulations of commerce. Over 75 percent of the managers in the sample indicated that such concerns were not significant in the company's initial decision to locate operations within the study area.[3] This is a significant finding because much of the anti-free trade rhetoric during the pre-election debates in 1988 was based on the argument that, once the Canada-U.S. Free Trade Agreement (FTA) was initiated and tariffs began to decline, many Americans conducting business in Canada and Canadian business people in the United States would lose their motives for locating direct investment activities across the border and return to their respective home countries. To the extent to which the establishments in this sample are representative of cross-border investors, such restructuring does not seem likely at this time.

What does appear from the responses of the 40 managers is that the western New York border region possesses several attributes ideally suited to the business operations of these Canadian investors. For example, at least 50 percent of managers in the sample indicated that each of the following factors was either "important" or "very important" to their decision to locate operations in western New York:

1. In this first phase of the research, the managers of the subsidiaries were not asked why their parent corporations decided to make a direct investment in the United States. This question is part of the authors' follow-up research, which is focused on the decision-making strategies of the establishments' headquarter operations in Canada.

(1) the physical proximity of the region to the Toronto area; (2) the desire of the parent corporation to grow and expand business operations outside Canada; (3) the importance to the parent corporation of having a physical presence within the United States; (4) proximity to existing transportation facilities and services in the United States; (5) the need to be centrally located with respect to the establishment's principal market area; and (6) the availability in the area of an important labour supply. A smaller percentage of managers ranked highly the availability of low-cost industrial land and the ease of establishing business operations in the western New York area.

In short, many of the Canadian investors in the sample viewed the border region as a platform for beginning operations in the U.S. marketplace. Such a location in the United States enables them to exercise considerable control over their business operations and, at the same time, to take advantage of the region's wide range of business support services, its very favourable costs of doing business, and its proximity to the economic heartland of North America. The importance of having a physical presence within the United States and yet of not being located too far from the corporate headquarters in Canada correlates precisely with the results of Gandhi's (1989) study of 29 Canadian investments in the northern region of New York State. Gandhi surveyed 81 Canadian-owned establishments in the Plattsburgh, New York, area and received a response rate of 36 percent. According to Gandhi, these establishments need to be close to their parents because most are small, family-owned operations for which commuting time to and management control over the subsidiary are critical considerations in the investment decision (Gandhi 1989: 22).

Profile of the Canadian Subsidiaries

Several general characteristics of the 40 Canadian-controlled subsidiaries in the sample are noteworthy. First, all but one have their headquarters in the province of Ontario; the other province represented is Quebec. Second, the average age of the establishments in the sample is a little over 12 years (they range in age from a few months to 79 years). Third, the average employment level of the establishments at the time of their establishment was 21; by the time of the survey the average employment level had increased to about 75. For comparison purposes, the profile of Canadian establishments in Gandhi's study of the Plattsburgh area revealed that most investments originated in Quebec; the average age of the establishments was 8.5 years; the initial average level of full-time employment was five; and the average employment at the time of the survey was 20 (Gandhi 1989: 19).

The Canadian-owned establishments in the western New York sample represent a relatively wide range of industry-level categories. For example, nine out of the 20 possible two-digit Standard Industrial Classification (SIC) categories in manufacturing and 11 different two-digit SIC service sector categories are located in the region. Furthermore, all but five subsidiaries were created as new businesses in the area (as opposed to acquisitions of existing operations), and the average annual sales over the most recent operating year were slightly over $9.6 million. In contrast, the average annual sales of these establishments during their first years of operation were just over $1 million. Although Gandhi did not report similar categories of information, his results reveal that the typical Canadian investment in the Plattsburgh area is small, with total assets valued at "a little over $830,000" (Gandhi 1989: 19).

Employment Growth by Industry Sector

This investigation sought to determine the relationships between the industry affiliations of the 40 subsidiaries and their relative success in generating new employment growth. Fourteen (or 35 percent) of the establishments in the sample were manufacturers, representing the following two-digit SIC manufacturing categories: food, apparel, furniture, printing and publishing, rubber and plastics, leather, primary metals, industrial machinery and equipment, and electrical equipment. The number of respondents per two-digit industry sector is fairly evenly dispersed across the nine categories, with the largest concentration—three establishments—in the electrical equipment subsector.

Although the 26 service sector establishments (representing 65 percent of the sample) are also dispersed over a relatively wide range of activities, they tend to be somewhat more concentrated than the manufacturing firms. For example, approximately 27 percent of the service sector cases are in transportation-related activities, and 46 percent are in wholesale trade (both durable and non-durable). Two firms offer engineering services, and the remaining five provide hotel, business, and health services. The performance of these establishments in terms of employment growth is depicted in Figures 1, 2, and 3. Figure 1 reveals that Canadian investments in the service sector have generated a larger percentage of total employment over the lifetime of these operations in western New York than investments in the manufacturing sector. Between the start-up of the Canadian-owned firms

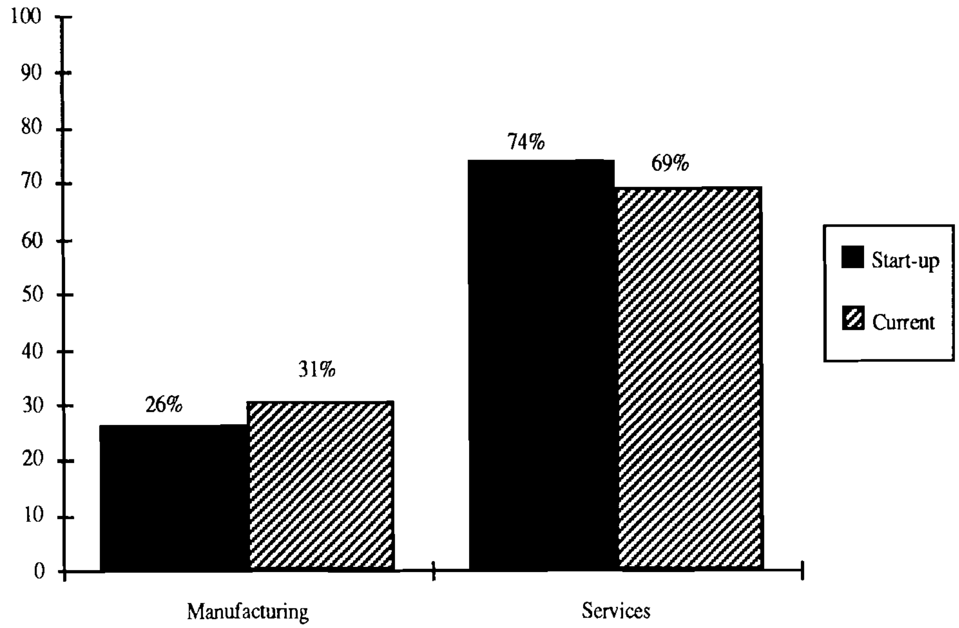

FIGURE 1 **Sectoral shares of total employment in Canadian-owned establishments, disaggregated by start-up and current employment**

and the 1989 survey, however, manufacturing operations gained a larger share of their total employment than service activities.

Further analysis of the relationship between current and start-up employment in the two industry sectors (Figures 2 and 3) reveals that Canadian-owned establishments in the manufacturing sector are proportionately more likely to expand significantly their employment base than companies in the service sector. For example, 43 percent of the manufacturing establishments currently employ 50 workers or more compared with only 7 percent at start-up time. For the service sector, the proportions are 23 and 8 percent, respectively (compare Figures 2 and 3).

Finally, since the early 1980s, Canadian investors have been giving preference to investments in manufacturing over service activities (Figure 4). Sixty-five percent of Canadian-owned manufacturing operations arrived in the 1980s, compared with 48 percent of service sector activities. Moreover, a good deal of the recent Canadian-related employment growth in both sectors has occurred since 1985—indeed, fully 38 percent of the region's Canadian-owned subsidiaries arrived in the region within the past five years. Arrivals in this group account for well over 40 percent of the jobs created by the establishments in the survey.

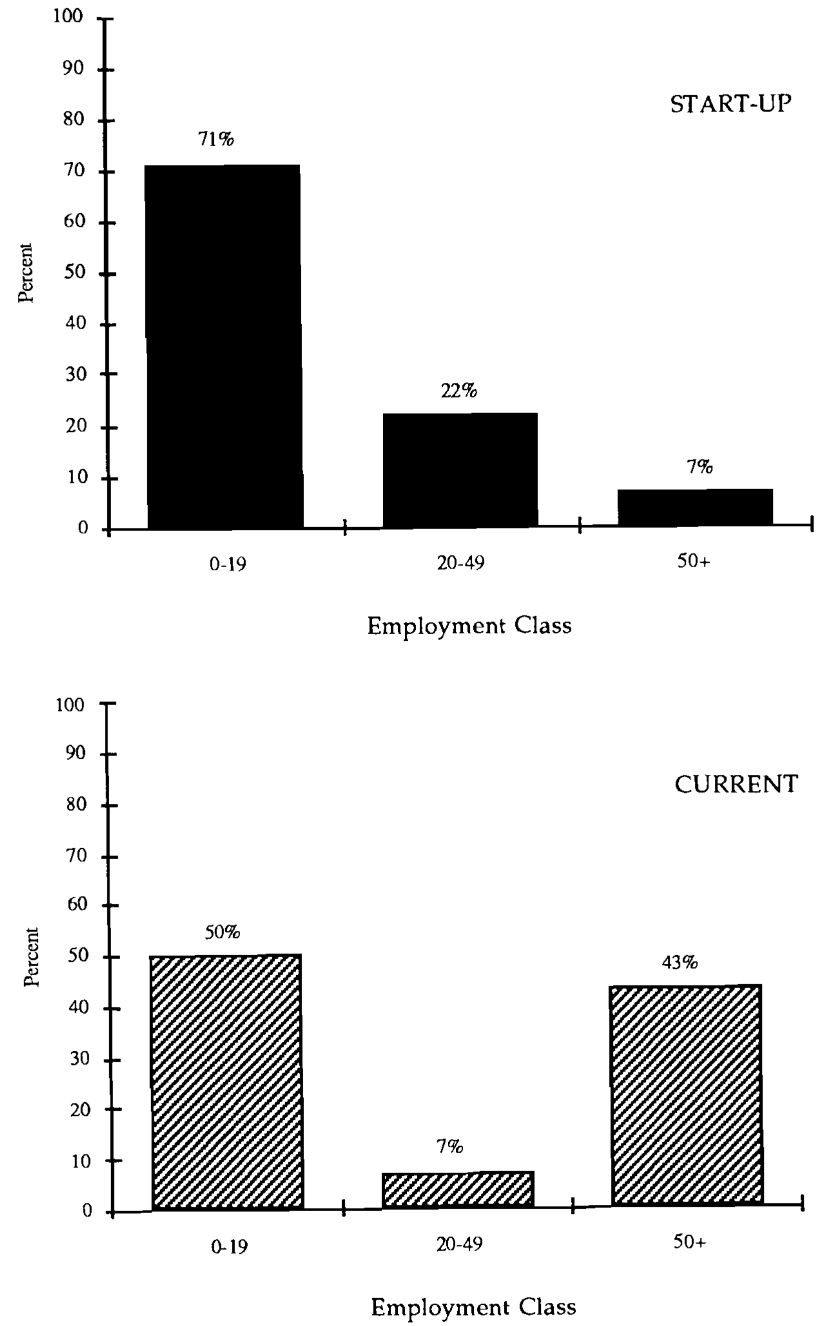

FIGURE 2 **Percentage distribution by employment class of Canadian-owned establishments in the manufacturing sector, disaggregated by start-up and current employment**

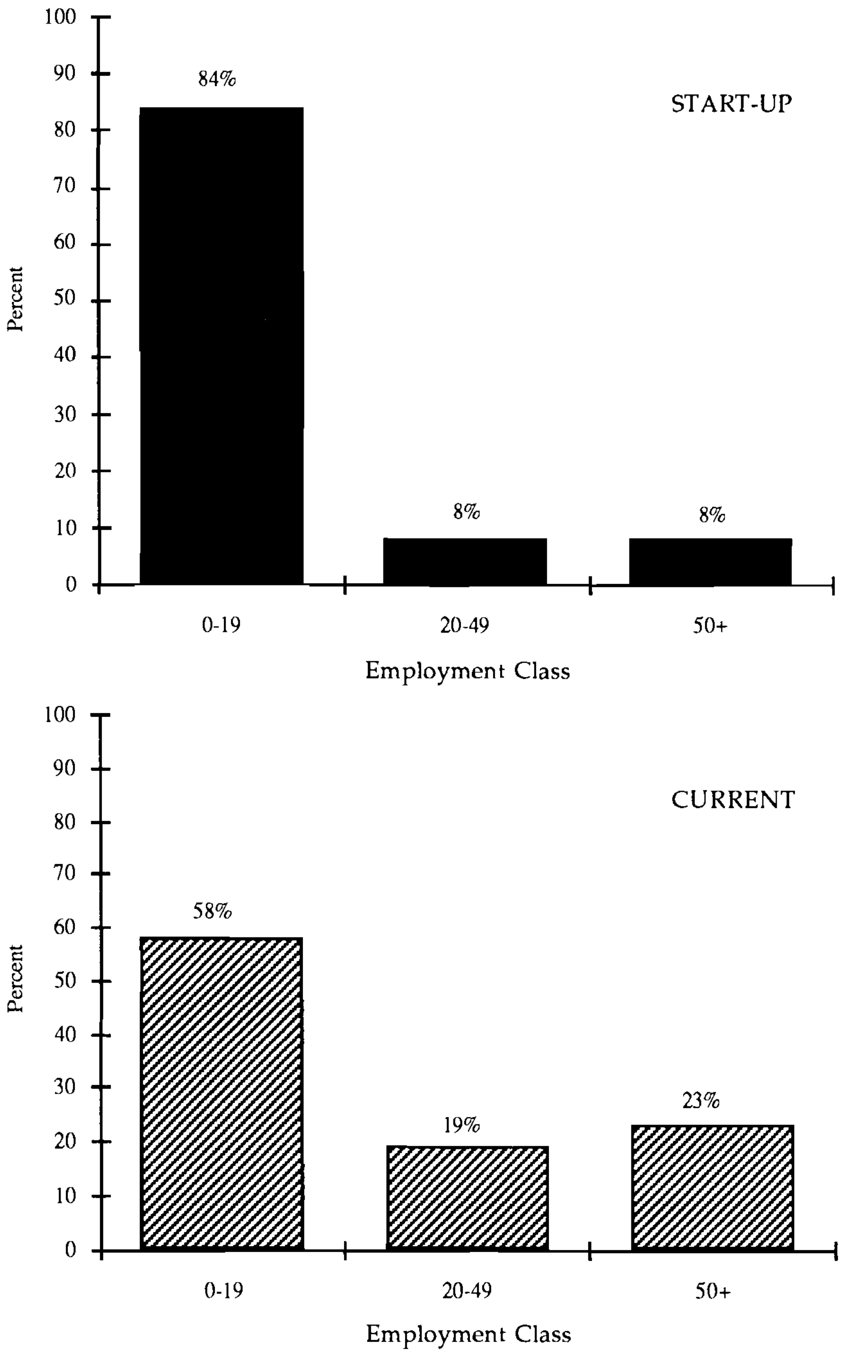

FIGURE 3 Percentage distribution by employment class of Canadian-owned establishments in the services sector, disaggregated by start-up and current employment

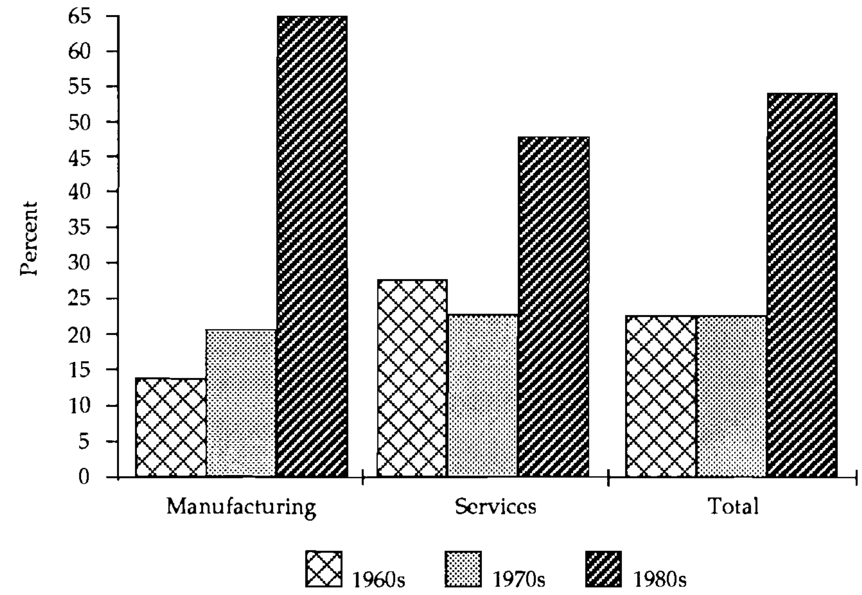

FIGURE 4 Percentage distribution by date of arrival in western New York of establishments in each sector

An important implication of these findings is that efforts to attract inward investments should not overlook the manufacturing sector as a source of new employment. The manufacturing establishments in this sample have significantly outperformed the service sector in terms of average growth rates between start-up time and the present—that is, almost 400 percent for manufacturing establishments and some 270 percent for service operations. This impressive performance of the Canadian-owned manufacturing subsidiaries warrants policy consideration by those at the local and regional planning levels responsible for promoting the business opportunities of the region.

Canadian Subsidiaries and Their Parent Corporations

This investigation also sought to determine the nature of the organizational and technological linkages between the Canadian-owned establishments located in western New York and their parent corporations in Canada. For example, to what extent are the decisions made by the subsidiary controlled by the parent, and what are the specific cross-border linkages between the two organizations?

Several measures of such linkages were examined in this study such as intracorporate trade linkages. It is generally held in international business that between one-third and one-half of world commerce is intracorporate trade. This survey revealed that 17 (42 percent) of the 40 Canadian subsidiaries are exporting some of their output to Canadian customers. Of these, eight establishments send 100 percent of their Canada-bound exports to their parents, and two others send 15 and 50 percent, respectively, of their products to parents. The remaining seven companies export to Canada, but no products or services are exchanged with their parent corporations. In short, almost 60 percent of the 17 subsidiaries with Canadian export markets have direct intracorporate trade linkages with their Canadian parents.

Another measure of intracorporate relationships is the cross-border flow of technology, information, and management expertise. In the survey, companies were asked if they were transferring technology acquired or developed in the western New York area back to their parent corporation; if so, what kinds of technology they were transferring to their parent firms; and to what extent they were dependent on their parent firms for various corporate planning and development responsibilities. The responses indicated that 10 of the 40 subsidiaries are regularly sending technology and information back to their parent corporations in Canada. Furthermore, the most frequently exchanged were strategies for marketing in the United States, new product design and development, and process development ideas. A smaller number of subsidiaries also transfer export marketing strategy, product modifications, and advertising techniques back to their Canadian parents. It is also clear from the survey that many of the subsidiaries rely heavily on their Canadian parent corporations for various support services. For example, the parent corporations of over one-half of the subsidiaries assume over 50 percent of the responsibility for research and development technology, product design, accounting, marketing strategy, quality control, and product testing. A slightly smaller number of establishments also depends heavily on parent enterprises for their engineering drawings, equipment specifications, and export planning.

In short, most of the Canadian-owned subsidiaries located in the border region are maintaining relatively close ties with their corporate parents through cross-border linkages that are economic, organizational, and technological in nature. It also appears that these flows are truly two-way in nature, so that both the Canadian parent corporation and the western New York region are beneficiaries of the intracorporate transactions. A more precise measurement of the net flow of technology is planned for the near future by the investigators.

Economic Impact of Canadian Direct Investments on the Region

What are the potential impacts of these Canadian direct investments on the western New York economy over the next decade or so? As has been suggested, the border region is benefiting from the export propensity of a significant proportion of the subsidiaries; foreign-owned manufacturing enterprises find the area attractive and suitable for growth and job creation; the managers of about one-half of the establishments have adopted an "aggressive" marketing strategy, which is positively associated with firms that are keeping pace with technological change, outperforming competitors, and adopting an enterprising pricing policy; and the subsidiaries are maintaining strong cross-border ties with their parents, which is contributing to an inflow of strategic planning know-how. Also noteworthy, over 87 percent of these Canadian investments are new starts as opposed to acquisitions. (New-start operations are frequently viewed more favourably than acquisitions from the perspective of job creation and expansion of the tax base in a region.) All these attributes seem to be positive benefits for the local economy.

Three other factors are important in assessing the long-term impacts of these direct investments on the western New York region. First, all 40 Canadian establishments are purchasing some of their services within the western New York area, over one-half purchase all their services from the local area, and some 78 percent purchase 50 percent or more of their services locally. Of those companies that purchase all or part of their services from the local region, the major categories of services include (in order of importance): advertising, accounting, printing, banking, office and secretarial support, customs brokerage, legal advice and counsel, transportation and shipping services, supplies, and marketing know-how. Thus, the consumption of services by these foreign-owned operations is another positive impact for the region. Interestingly, one Canadian bank has already opened a branch operation in Buffalo, and several other Canadian banks are expected to announce a similar move in the near future. Thus, the local suppliers of some services may experience increased competition for the business of the Canadian-owned establishments.

A second factor likely to affect the long-term economic prospects of the region is the extent to which new, foreign-owned direct investments will diversify and strengthen the industry mix of the border region. Over 60 percent of the local employment base of western New York is now in the service sector. In comparison, some 65 percent of the Canadian-owned subsidiaries in the sample fall in this sector as well. This suggests similar trends in the two distributions. When viewed over time, however, the picture changes: only 39 percent of the Canadian-owned subsidiaries that located in the region before the 1980s are in manufacturing, whereas 43 percent of the new arrivals from Canada over the past 10 years have been in manufacturing.

When one combines this relative increase in the ratio of Canadian manufacturing establishments to service activities over the most recent decade with the reasons given by the managers of these companies for locating in the border region, it seems clear that the local business environment for manufacturing activity continues to be perceived favourably by Canadian corporations, and this bodes well for those anxious to strengthen the manufacturing base of the area. Moreover, the Canadian manufacturing establishments being located in the region represent a fairly broad range of two-digit SIC manufacturing categories. This too bodes well because one of the primary objectives in the development of the economy of western New York is the creation of a more diversified industrial mix so that the negative impacts of major recessions and structural changes in the national economy on an overly specialized regional industrial economy are minimized.

A third factor likely to be important for the long-term economic growth of the region is the recently adopted Canada-U.S. Free Trade Agreement. The survey was conducted about nine months after implementation of this agreement, and the managers were asked to indicate how they believed the new trade accord would affect their own businesses and the general economic health of western New York. In assessing the potential impact of the FTA on their exporting operations and U.S. market share, approximately one-third were uncertain what impact the agreement would have, and over 40 percent said that the accord would likely have no impact. Less than 10 percent believed that the FTA would increase their exports and U.S. market share. In contrast, Gandhi's findings in northern New York State revealed that 70 percent of the Canadian companies expect to benefit from free trade (Gandhi 1989: 28).

The survey results for the western New York region underscore the continued uncertainty within the business community about the potential benefits of the FTA. Many have yet to sort out what the agreement means for their operations, and others, while having some understanding of the new accord, are apparently reluctant to move forward with any specific plan of action. Rugman and Verbeke (1989) argue that, because of the significantly larger American marketplace, Canadian managers of small and medium-sized establishments are more likely than are their American counterparts to perceive new marketing opportunities across the border stemming from the FTA.

Such a proposition seems to be supported by the recent cross-border movement of real and potential direct investors (and land speculators) in southern Ontario and western New York—movement that is biased in a southerly direction.

When asked how the FTA would affect the regional economy of western New York, 98 percent of the managers said the new trade accord would have a "modestly positive" or "strongly positive" impact. In short, most managers believe that the agreement will have a significant and positive impact on the local regional economy, which should be well received south of the border if not in some of the competing regions to the north.

Conclusions

While Canadian direct investment in western New York is hardly a new phenomenon, a moderate acceleration in investment appears probable over the next few years. Data presented earlier suggest that future inflows from Canada are likely to tilt toward manufacturing rather than services, even though non-industrial activities are now the sources of new jobs in most North American cities. An implication here—and one that deserves detailed policy consideration at the local level—is that secondary manufacturing may not be as unrewarding for modern urban economies as many would have us believe. On a more cautious note, the survey results presented here are exploratory rather than conclusive. Of considerable concern, of course, is the extent to which non-response bias affects our conclusions.[2] For the moment, however, at least three general conclusions can be drawn, each offering a distinct research direction in itself. First, Canadian companies have not been moving to the study region in response to the Canada-U.S. Free Trade Agreement. The typical location decision reflects a more prosaic set of geographical concerns. Second, recent entries from Canada span a wide range of start-up size classes, sectors, and industries. And, third, the cross-border technological and informational linkages between the western New York subsidiaries and their Canadian parents are far from insignificant. In sum, the investment relationship between Canada and western New York is significantly more intricate than the authors had initially anticipated.

2. In this regard, funding has been secured from the Canadian government to continue our investigation of these subsidiaries.

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