Canadian Direct Investment in Western New York: A Tracking Study of Subsidiaries and Parent Companies

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Outflows of Canadian foreign direct investment (FDI) have grown apprecia-bly over the last few years, with much of this capital moving toward regional targets in the United States (Gandhi 1990; MacPherson and McConnell 1992; McConnell and MacPherson 1990; Meyer and Green 1996). For some Canadians, these outflows represent lost economic opportunities in terms of domestic production, employment, and exports (Drache and Gertler 1991; Merritt 1996). From this perspective, southbound investment is often associated with industrial plant closure and/or corporate downsizing in Canada, yielding a net loss to the Cana-dian economy. Other scholars view Canadian FDI as a pathway toward domestic corporate growth, new market development, and/or the creation of world-scale firms (Chow 1994; Rao et al 1994; Rugman 1990). Irrespective of which per-spective one happens to prefer, however, the fact that Canadian capital continues to seek new opportunities south of the border raises interesting questions regard-ing the precise mix of corporate motives that propel such outflows. While Dun-ning's (1977) eclectic paradigm provides an explanatory framework for assessing FDI behaviour at a macro-level, few models or theories give us a clear picture of the company-specific reasons that drive investments of different types. This is particularly true when it comes to small and medium-sized investors outside the corporate size-class.

This paper offers a region-specific perspective on the nature of Canadian FDI in the post-free trade era. Attention is focused upon the Western New York area of the Niagara Frontier. This region has absorbed considerable

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inflows of Canadian investment since the early 1970s (Harrington et al. 1986), not least because of its close proximity to Ontario (McConnell et al 1989). While there are limitations to the utility of regionally-focused FDI inquiries (see Meyer and Green 1996), such studies can supply detailed insights regarding the behaviour of specific groups of firms. On this note, the discussion which follows revisits an earlier inquiry that explored the origins, scale, nature and reasons for Cana-dian investment in Western New York (MacPherson and McConnell 1992). A temporal perspective on the business performance and operating characteristics of Canadian subsidiaries and their parent companies is offered. The paper also tracks recent patterns of market entry and exit, as well as relocations within the US. Three principal findings from the tracking-study deserve brief mention at the outset. First, post-1991 Canadian FDI in the study region has been overwhelmingly market-driven. Second, the close geographic proximity between Western New York and Toronto (the main location for parent companies) emerged as a central factor in the locational decisions of almost all investors (both p-re-and-post-FTA). Third, it would appear that the study region has been serving as an incubator for additional FDI beyond the Western New York area. Prior to a discussion of these findings, however, it is appropriate to outline a regional context for the study.

Regional Context

Western New York is an economically declining region with a long history of industrial plant closure, outmigration, and slow income growth (McConnell et al 1989). Local economic development agencies have for many years attempted to alleviate these problems by promoting the region as a low-cost production base for Canadian firms (Cole 1990; MacPherson 1996). The region's close proximity to Toronto, as well as its strategic location as a distribution point for Canadian exports, would appear to offer natural geographic advantages as far as Canadian investors are concerned. In recent years, however, Western New York has witnessed rather slow economic growth (outmigration continues to deplete the region's labour pool), and much of the job-creation that has taken place over the 1990s has been concentrated in low-order services (McClean 1997). At first blush, then, one might wonder why any Canadian company would wish to locate business facilities in the study region. The Canadian dollar has depreciated steadily since its 1991 high, rendering FDI more expensive than before. Ex-change rate movements have also reversed the cross border shopping trends of the early 1990s, in that Americans now spend more retail dollars in Southern Ontario than Canadians spend in Western New York (Canadian Consulate 1996). Adding these factors to a variety of other problems (for example, high corporate tax rates, shortages of skilled labour) suggests rather bleak prospects for the study region as far as new Canadian investment is

concerned (Bagchi-Sen and MacPherson 1998; McLean 1997).

Aside from exchange rate movements, however, problems of the sort outlined above were arguably more severe in the late 1980s and early 1990s than they are today. And, as MacPherson and McConnell (1992) have shown, these types of problems were not sufficient to deter a significant number of new Cana-dian investors immediately after the FTA was ratified (see also McConnell and MacPherson 1990). These authors set out to explain the reasons for post-FTA Canadian investment in the study region, as well as to examine various aspects of parent-subsidiary linkages, local economic impact, and the long-run strategic goals of Canadian investors.

A number of key findings emerged from MacPherson and McConnell's (1992) study, some of which deserve brief mention. First, the actual level of Canadian investment was found to be substantially lower than popular media reports on both sides of the border had initially suggested. For example, a total of 133 Canadian firms were positively identified as having a direct business presence in the study region in 1991, compared to estimates of well over 400 reported by local development agencies and/or newspapers (the main difference in these estimates turned out to be PO Boxes). Second, MacPherson and McConnell (1992) estimated that only 30% of the 133 subsidiaries started business in the Western New York area after the 1989 FTA had been approved, compared to estimates in the range of 40-50% reported by several other authorities. In short, an element of exaggeration was uncovered -- and corrected.

A second finding from the MacPherson and McConnell (1992) study was that cost factors were found to be relatively insignificant to the locational decisions of most of the Canadian investors that were surveyed (both pre-and-post FTA arrivals). Instead, most investors indicated that their primary motive was to establish a direct physical presence inside the US, while at the same time enjoy-ing close physical proximity to parent units in Canada. In contrast to local media reports on both sides of the border, the FTA was generally not seen as a particu-larly important factor in the FDI decisions described by any of the Canadian firms that were surveyed. For many firms, in fact, Western New York was perceived as a logical starting point for a first-time corporate expansion via FDI.

A third finding was that recent investment in Western New York had not been accompanied by any significant disinvestment in Canada. Instead, most post-FTA arrivals were found to be experimental offshoots from small and medium sized companies that were already growing quite quickly inside Canada. In short, Western New York was generally seen as a first step toward non-export -dependent expansion at the international level.

Taken together, these three findings suggest that recent Canadian FDI in Western New York can best be viewed in terms of the 'market-seeking' explana-tion for investment described under Dunning's (1993) revised eclectic model. Of the four general explanations for FDI identified by this

model (that is, resource- driven, efficiency-seeking, market-seeking, and strategic asset -acquisition), the market-based explanation appears to fit best. Under this explanation, investors typically seek reduced transaction costs by establishing a direct physical presence inside a target market (internalisation advantages), as well as enhanced market access and/or lower production costs (locational advantages). More broadly, the eclectic model suggests that FDI will generally take place whenever the transfer costs associated with direct investment are lower than the export -marketing costs associated with international shipments. Given the relatively short physical distance between Western New York and most of the Canadian parent compa-nies, the transfer costs associated with FDI are presumably quite low in relative terms.

On this note, the remainder of this paper describes the results of a tracking study (1991-1997) that was conducted to assess the stability of Canadian FDI in Western New York. The Canada-United States Trade Centre at the University at Buffalo supervised the study, which was organised around two principal questions. First, how durable has recent Canadian FDI in Western New York actually been? Second, what are the main characteristics of recent exits and entries? Partial answers to these questions come from a postal survey of Canadian subsidiaries and parents that were analysed earlier by MacPherson and McConnell (1992), as well as from personal and/or telephone interviews with 'new arrivals' and 'recent exits' (including parents).

Tracking Study Methodology

The task of identifying the population of Canadian-owned subsidiaries in any US region is far from a simple one. No public agency on either side of the border maintains an accurate record of inward or outward investment at the establish-ment level. Consequently, population estimates can only be assembled via an examination of multiple sources. In the case of Western New York, these sources include local Dun and Bradstreet credit files, the New York State Department of Economic Development, the Buffalo Office of the Canadian Consulate, the Greater Buffalo Partnership (a local economic development agency), published directories (for example, the Upstate New York Directory of Manufacturers), and establishment-level records from the files of the Canada-United States Trade Centre. In 1991, these sources pointed to the existence of some 133 Canadian establishments with a direct physical presence in the Western New York area (excluding over 200 listings that were either PO Boxes or single-person sales offices). By 1997, a total of 169 establishments were identified, suggesting a net gain of 36 business units. Of the 133 subsidiaries that were surveyed in 1991, 58 provided detailed information on their operating characteristics (as well as insights into the motivations underlying their investment decisions, strategic objectives, and long-range expectations). These 58 establishments were re-contacted in 1997 for tracking purposes (using a postal questionnaire). The remaining 111 establishments in the sampling frame were contacted by telephone.

Prior to a discussion of the survey results, however, it should be noted that several public and private organisations in the Western New York area believe that the population of Canadian subsidiaries is much higher than 169. For in-stance, one local bank serves at least 200 Canadian business units in the study region (this bank cannot release its client list for confidentiality reasons). In a similar vein, a local export-management consultancy estimates the Canadian population to exceed 250 (again, a client list could not be obtained as a result of confidentiality problems). In some respects, then, it is likely that the results presented below are somewhat conservative.

TABLE 1 Survival Rates Among Canadian Subsidiaries

Sector	1991	1997	Change	Survival %
Manufacturing	24	21	-3	85.7
Services	34	22	-12	64.7
Total	58	43	-15	74.1

This said, the tracking study uncovered a number of interesting changes over the study period. Of the 58 subsidiaries that were surveyed in 1991, for example, 15 were no longer operating in the study region by 1997 (Table 1). A total of 12 losses were found within the service sector (an exit rate of 35%), compared to 3 losses on the manufacturing side (an exit rate of 12%). Significantly, telephone interviews with parent units in Canada revealed that 9 of the 12 exits from the service sector were due to relocations within the US. Parent units for the remain-ing 3 service companies could not be tracked down, suggesting either business failure or a change in corporate identity. Of the 9 subsidiaries that moved away from the study region, 8 were traced to new locations outside New York State (mainly Pennsylvania). A similar pattern emerged on the manufacturing side, in that all 3 losses were traced to relatively short-distance relocations. While the various reasons for these relocations are discussed later in the paper, it should be noted that subsidiaries in the manufacturing sector appear more locally anchored than their service-oriented counterparts. In short, Canadian industrial establishments are less likely to leave the study region than service units.

The growth characteristics of the 43 'surviving' subsidiaries are summarised in Table 2. In terms of employment counts, approximately half of the survey establishments expanded over the 1991-1997 period, while 35% indicated that jobs had been cut. In sectoral terms, the data suggest a

significantly higher incidence of growth among industrial establishments. For example, 66% of the manufacturing units increased their employment base over the study period, compared to only 36% among service companies. Put another way, only 24% of the manufacturing units indicated job losses, compared to over 45% among service establishments. Follow-up telephone interviews with the 43 surviving subsidiaries uncovered a mix of reasons for growth or decline (discussed later). For the moment, however, it should be mentioned that growth among manufac-turing units was traced mainly to the development of new markets outside Upstate New York.

Keeping this finding in mind, Table 3 compares the spatial extent of markets for both sectors over the study period. In 1991, for example, 45% of the manufacturing units obtained more than half of their sales from customers located

TABLE 2 Post-1991 Growth Characteristics of Survivors[1]

Sector	Manufacturing	Services	Total
Expanded	14 (66.6)	8 (36.3)	22 (51.2)
No Change	2 (9.50)	4 (18.2)	6 (13.9)
Declined	5 (23.9)	10 (45.5)	15 (34.9)
Total	21 (100.0)	22 (100.0)	43 (100.0)

Note: 1. This 3x2 pattern is significant at p = < 0.05 (Fishers Exact Test).
2. Bracketed terms are the percentage of the column total.

TABLE 3 Spatial Extent of Markets (Surviving Establishments)

Sector	% mainly serving Upstate New York[1]		
( ) = n-size	1991	1997	Change
Manufacturing	45 (9)	20 (4)	-5
Services	9 (16)	78 (18)	+2

Note: 1. Subsidiaries that obtained more than 50% of their sales from customers located within Upstate New York.

within Upstate New York, compared to only 20% by 1997. This suggests that non-local sales have been growing appreciably among industrial establishments. Fully 17 (81%) of the 23 surviving manufacturing units increased their non-local sales over the study period. An estimated 75% of this non-local growth was traced to the acquisition of new customers in Pennsylvania and/or Downstate New York, suggesting a geographically conservative approach toward market expansion. Among service units, however, the data suggest that local customers within Western New York

continue to act as the main revenue base. In 1991, for example, 69% of the service units obtained more than half of their sales from customers located within the study region. By 1997, this proportion had climbed to 78%. Clearly, then, it would appear that industrial establishments are more likely to expand via non-local sales than their service-oriented counterparts.

On a broader note, 33 of the 133 subsidiaries that were identified in 1991 had disappeared from the region by 1997 (Table 4). With an estimated 1997 population of 169 establishments, however, it would appear that some 69 Cana-dian subsidiaries moved into the study region after 1991 (giving a net population increase of 36 establishments). This translates into an average net gain of 6 Canadian establishments per annum between 1991 and 1997. Of the 33 exits, 21 (63%) were traced to short-distance relocations (the remaining 12 could not be tracked). On the arrivals side, 53 were small service companies (with employ-

TABLE 4 Establishment Counts for 1991 and 1997 by Sector

Sector	1991	1997	Exit[1]	Entry[2]	Net Change
Manufacturing	44	54	3	13	+10
Services	89	115	30	56	+26
Total	133	169	33	69	+36

Note: 1. Post 1991 closures in Western New York.
2. Post 1991 arrivals in Western New York.

ment counts ranging from 2 to 5 employees), 13 were small industrial establishments (5-10 employees), while 3 represented small-scale Canadian acquisitions of US-owned service companies. Significantly, 42 (61%) of the 69 post-1991 arrivals had established US commercial addresses via PO Boxes prior to business entry.

Interestingly, all of the 69 newcomers indicated that the investment decision was motivated primarily by a need to establish a direct physical presence inside the US market. The need for this presence is fairly obvious in the case of service companies that produce non-exportable outputs (for example, hotel and accom-modation services), but less obvious for service firms that produce transportable wares (for example, management advice). Subsidiaries belonging to the latter category almost universally identified 'geographic proximity to customers' as being the single most critical factor in the investment decision (including the 3 small industrial units). Consistent with the earlier study by MacPherson and McConnell (1992), almost all of the post-1991 arrivals identified the study region's close proximity to the Toronto metropolitan area as being a major advantage. Perhaps not surprisingly, the Toronto area was found to be the dominant Canadian location for parent companies (n = 60, or 87%).

At first blush, then, it would appear that Western New York continues to attract Canadian direct investment. This said, it is difficult (if not impossible) to estimate the net employment change associated with arrivals versus exits. On the arrivals side, for example, Canadian parent companies and their subsidiaries were more than willing to specify employment figures for new or recent invest-ments. In contrast, such figures were not readily supplied by parent companies that had either transferred operations to other locations or closed down in the US altogether. In short, the net employment impact over the study period could be positive, negative, or neutral -- despite a net gain in terms of establishment counts. Even with regard to the 43 'surviving' subsidiaries that were part of the more detailed tracking study, the question of net employment change is equally difficult to assess. For example, few of the subsidiaries that reported employment losses over the study period were willing to specify how many jobs were cut, and the same holds true for at least three parent companies that are known to have eliminated jobs in Canada as part of a broader response to NAFTA (these compa-nies cannot be identified in this paper). Clearly, then, an important limitation of this study is that incomplete data prohibits an accurate assessment of employment impact.

Discussion

While the results summarised above reinforce some of the conclusions drawn several years ago by MacPherson and McConnell (1992), a number of newer trends can be identified that warrant discussion. To begin with, most of the Canadian subsidiaries that were present in 1991 but absent by 1997 did not simply go out of business. Instead, these establishments moved to other parts of the US (notably Pennsylvania). To an extent, then, Western New York may represent a testing ground for small-scale Canadian direct investment (rather than a final destination). Nevertheless, it would appear that entry rates are higher than exit rates, giving some cause for optimism among local development agencies. A second finding is that many of the region's recent arrivals had established PO Boxes in Western New York prior to business entry. It would appear that the presence of Canadian PO Boxes may say something about future investment potential. A third feature of the data is that industrial investment (manufacturing) appears to be more locationally rooted than service investment. Specifically, subsidiaries in the manufacturing sector appear less likely to relocate than their service-oriented counterparts. From a local policy perspective, then, the greater durability of Canadian industrial investment ought to be noted. Each of these three points is discussed in more detail below.

With regard to business relocations, telephone interviews with senior man-agement personnel uncovered a set of consistent motives for expanding

elsewhere in the US (these interviews were conducted with representatives from the parent companies as well as the subsidiary units). Without exception, the top ranked motive was to "serve customers better". By probing this type of response in more detail, it became evident that all relocations were demand driven. For instance, several of the subsidiaries that had relocated to Erie (PA) indicated that fast access to Pittsburgh was a major factor, as well as fast access to Erie itself (a small but growing city). Meanwhile, Western New York markets were still deemed desirable and accessible (Erie being less than a 90 minute drive from Buffalo). On balance, however, the Western New York area was not seen as a critical market. Whether by design or by chance, Western New York served as a convenient incubator for a much deeper penetration of US markets. Interest-ingly, most respondents indicated that their new facilities were operating at higher output levels than before. In this regard, the departure from New York State as a whole, and Erie County in particular, was seen by many interviewees as a partial response to high personal and corporate tax rates. While this should come as no surprise to any New York State resident, incoming investors must surely have been alerted to these conditions prior to establishing facilities in Western New York. In short, the tax problem may have been an incentive to move, but it was not the prime factor. In general, respondents from parent companies echoed this interpretation.

Regarding the question of PO Box conversion, personal interviews with executives from subsidiaries that were established after 1991 indicated that the creation of a US business address had been part of an experimental strategy to test US market interest. In most cases, PO Boxes that eventually converted to live business facilities underwent an intermediate stage involving a local service company that sells the impression that a Canadian firm is actually established on US territory. This innovative (and perfectly legal) practice provides a remote sales office where all communications and ordering (including freight forwarding and customs documentation) is arranged via a Buffalo telephone number. Having successfully used this service for at least a year, several former PO Box owners eventually decided to take the extra step (FDI). In virtually every case, one of the main reason for selecting FDI over exports was logistics-based. For instance, many executives noted that the task of finding new US customers is hampered by the perception (real or erroneous) that export shipments from Canada are subject to unacceptable delays as a result of transportation factors (shipment distances, customs inspections, documentation requirements), communications difficulties (for example, postal strikes in Canada), and other irritants (for example, import duties, import licensing requirements). Despite the increasing permeability of the Canada-US border as far as trade is concerned, many Canadian firms that wish to serve the US market believe that a physical presence inside the US makes good sense. As noted earlier, fast access to customers often requires close geographic proximity between buyers and sellers. In this regard, the gradual shift toward just-in-time inventory management by several US customers was identified as an important factor by many of the industrial subsidiaries that were surveyed.

This said, it would appear that some types of Canadian investors are more likely to stay inside the study region than others. Specifically, the survey evi-dence suggests that subsidiaries in the manufacturing sector are more securely anchored than service-oriented units. The evidence also suggests that industrial subsidiaries are more likely to grow than non-industrial establishments. One possible explanation for this pattern is that FDI by relatively small industrial firms involves a locational commitment that cannot be easily changed once sunk costs have been incurred. Personal interviews unequivocally confirmed this interpretation in some 15 cases. In other cases, however, capital mobility was not regarded as a serious problem. Interviewees in the latter category indicated a commitment to the Western New York area for a wide variety of reasons, rang-ing from personal factors (for example, "the company owner was born in Buf-falo") to geographic factors (for example, "we are almost equidistant between Chicago and New York City, our main markets"). Anecdotes aside, however, the common factor among industrial subsidiaries is that virtually all of them targeted Western New York as a long-term location for business activity from the outset. Interviewees from the various service establishments, in contrast, conveyed a more experimental attitude toward business development. To the extent that it is easier to move an office or service facility than a factory, this more experimental attitude among service-based subsidiaries is understandable.

For both service and industrial establishments, however, it is worth noting that post-1991 investment in the US (including locations outside Western New York) was not accompanied by any major disinvestment in Canada. More typi-cally, FDI was associated with corporate growth as a whole, in line with the earlier findings reported by MacPherson and McConnell (1992). Of the 69 post-1991 arrivals, for instance, 47 (68%) indicated that the FDI decision was made during a period of sustained expansion within Canada itself (notably the Toronto area), 17 (24%) stated that their parent companies enjoyed employment stability, while 5 (8%) noted that small numbers of jobs (ranging from a low of 1 to a high of 9) had been transferred to the Buffalo area as a result of the invest-ment. These impressions were confirmed via telephone interviews with parent companies. On balance, the picture is not one of closure or disinvestment in Canada as a result of FDI in the study region. Given that at least a portion of the operating profits generated by Canadian subsidiaries in Western New York flow northward toward corporate parents, the overall economic benefits to Canada are probably quite positive (for a more complete discussion of this point, see MacPherson and McConnell 1992).

Summary and Conclusions

The results of the tracking study suggest that Canadian investment in Western New York has remained fairly steady since 1991. Much of this investment remains market-driven, locationally-linked to Toronto, and experimental -- just as it was in 1991. Although recent levels of new business entry exceed exit rates by a comfortable margin, it is difficult to assess whether the net employment impact of this trend is positive, negative, or neutral. Nevertheless, the fact that new business development continues at a steady pace is surely good news for Western New York. On the other hand, recent relocations from the study region to other parts of the US suggest that Western New York is not always a perma-nent destination for Canadian capital. This is especially true for service-oriented activity, which is much more mobile than industrial activity. Canadian subsidiar-ies in the service sector depend upon local markets to a much greater extent than their industrial counterparts. The former appear to have difficulty penetrating broader markets via regional exports. This may explain the higher propensity of service establishments to relocate. Industrial subsidiaries, in contrast, exhibit a significantly higher propensity to serve customers outside the study region.

To put these findings in perspective, however, it should be emphasised that Canadian FDI in Western New York has long been dominated by small investors rather than corporate giants. Few large or even medium-sized Canadian firms are currently present in the study region (notable exceptions on the 'medium' scale include Moore Business Forms, Acres International, and Bartell). Nevertheless, there is widespread agreement within local policy circles that these small Canadian investors contribute significantly to the Western New York economy, as well as to the overall business performance of their parent companies in Canada (that is, intra-corporate trade and technical linkages). More broadly, Canadian investment in Western New York can be viewed as part of a wider process of regional economic integration within the Niagara Frontier (Cole 1990). This crossborder region is already well integrated in terms of intraindustry trade, business travel, transportation planning, retail spending, and tourism (Canadian Consulate 1996). Although the current weakness of the Canadian dollar may portend a deceleration of Canadian investment in the study region over the immediate future, there is no reason to anticipate a curtailment of Canadian FDI over the next few years.

Finally, it would be inappropriate to conclude the paper without acknowledg-ing some of the inherent weaknesses that afflict research efforts of this type. For example, many firms agreed to participate in the survey on the understanding that their precise sector membership and/or employment data be kept totally confident-ial. Consequently, it was not possible to offer anything other than broad (often categorical) snapshots from the data (for

example, growth versus decline, man-ufacturing versus services). Data limitations of this ilk make it hard to analyse recent patterns of change with any real precision. A second problem is that the population of Canadian subsidiaries operating in the study region is known to be higher than 169. Unfortunately, no single sampling frame is currently available that captures the entire population. To some degree, then, the results presented earlier may be conservative. A third problem is that changes in corporate identity often render the task of tracking firms over time highly problematic. Thus, for example, several of the subsidiaries that were present in 1991 (but absent by 1997) may have relocated within the US, failed completely, returned to Canada, altered their identity, or changed their Western New York business address. In short, tracking studies of the sort described in this paper are almost always plagued by incomplete data. On this note, the findings described earlier should be treated as suggestive only.

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