How Do MNC’s Regional Headquarters Influence on Local Economy*

Yongju Ren

Abstract: Multinational corporations’ (MNC) regional headquarters may influence the internal and external development of the local economy. The internality, rooted in the functions of MNC’s regional headquarters, may be explained by the cluster theory. The externality is embodied by the spatial value chain, including both the corporate spatial value chain which is rooted in the oligarch-monopoly market structure, and the industrial spatial value chain, rooted in the market structure of enterprises of small size and large numbers. The above theories may be demonstrated by the development of the regional economy centering in Hong Kong, which succeeds in absorbing thousands of MNC’s regional headquarters, and therefore forming Headquarters-economy. This success brings a series of reflections for us, on how to coordinate Chinese cities with each other, locate them, encourage competition between them, and develop high end oriented industries.

Key words: MNC’s regional headquarters; economy development; Hong Kong; Guangdong

1. Introduction

Issues related to MNC’s Regional Headquarters (thereinafter referred to as RHQs) are among those which greatly concern scholars at home and abroad. The most salient scholars and their points are as follows: Williams (1967), Parks (1969) and Dymsza (1972) are the earliest researchers who studied the reasons that MNCs in America failed setting up their RHQs in Europe. Bartlett and Ghoshal (1989) and Lasserre (1996) analysed the interaction between the international centers and RHQs through a historical lens, so did Wang (2005). Mori (2002) and Zheng (1998) defined RHQs according to their functions. Simon (2005) and Ren (2004; 2010) concerned themselves with RHQs location and the distribution of RHQs effects to host countries. Zhao (2004) did some researches on the gathering effect of RHQs of home and abroad which is called Headquarters-Economy.

From the above, we may know “the scholars overseas put emphasis on their subjective purpose and the strategic research, while scholars at home focus on the theories of anti-demand function on the basis of volitional motive and on how to absorb RHQs, how to build international finance center, and how to construct Headquarters- Economy (Wang, 2005: 35)”. One famous home scholar is Zhao, who ever unveiled the intrinsic mechanism about absorbing MNCs and developing Headquarters-Economy by the use of “Triple-win Model”. Zhao believes that an enterprise arranges its space layout in accordance with the Headquarters-Economy Mode. That is to say, the enterprise headquarter is situated in a metropolis, while its manufacture processing bases are in more underdeveloped areas. That arrangement will allow the enterprise to attain strategic resources from the metropolis and general resources from the underdeveloped areas at a lower cost.

The co-collocation of advantageous resources from two different areas in one enterprise not only decreases the enterprise’s total cost, releases the most effectiveness of qualified personnel, information, technology resources of the central cities where RHQs are located, but also gives full play to manufacturing resources concentrated in the underdeveloped areas where processing bases are situated. Therefore, Headquarters-Economy is an economic pattern to promote the tripartite benefits of enterprises, in areas where headquarters, production, and processing are located. From Zhao’s argument, three problems can be easily seen to be unconcerned: He discusses the spatial layout on the corporate level, but not on the industry level. He focuses more on the external aspect of RHQs than on the internal aspect. Finally, He ignores the relationship between RHQs and the high end oriented industries. Based on these, this paper will discuss RHQs acting on regional economy by applying the cluster theory and the space

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* Yongju Ren, The School of Economy, Tianjin University of Commerce, Tianjin, 300134 P.R. China. Tel: 138 2078 1484, Fax: 022-2666 9768, E-mail: yongjuren@eyou.com.
valuable chain theory, and by using the region centering on Hong Kong as a test case.

2. Theoretical bases

RHQs will promote regional economy from both the internal and external. The former, which is decided by RHQs’ special functions, can be explained by the cluster theory. The latter is embodied by the spatial value chain theory on both the corporate and industrial levels. The two kinds of effects are not self-existent, while they are also in close connection each other.

2.1 Internal effects of RHQs

From cluster theory, the most representative is that of the American scholar Markusen (1996). In his “Sticky Places in Slippery Space: A Typology of Industrial Districts” puts forward the three types of industrial clusters which are Marshallian industrial district, Hub-and-Spoke industrial district, and Satellite Platform industrial district. These types of industrial clusters which have different attraction on RHQs may reflect the internal aspect of RHQs to varying degrees.

2.1.1 Marshallian industrial district

The concept of the Marshallian industrial district is based on the discussions made by Marshall (1890) in “Principles of Economics”, and its main characteristics are the network of small-and-medium-sized enterprises which are rooted locally. But the Marshallian industrial district may embody some distinct features depending on the times. In early times, the Marshallian industrial district which formed a complete production-consumption system, had kept in very little touch with other foreign corporations. And nowadays, native corporations in Marshallian industrial district have more and more touch with foreign corporations. At this time, MNCs had not entered directly into the local production system, but became guest companies offering services for businesses in the industrial cluster. Therefore, it is unlikely for RHQs to enter, and it is even more unlikely for the clusters of RHQs to appear. And under the circumstances, it is very improbable for RHQs to have an effect on regional economy.

2.1.2 Hub-and-Spoke industrial districts

The simple mode of the Hub-and-Spoke industrial district lies in the single core of large business having local and external suppliers, and selling their products out of the business core. Around the production and living needs of these core businesses, there is a gathering of numerous auxiliary businesses. The features of Hub-and-Spoke industrial districts include two things: first, the district is dominated by one or more large businesses of vertical integration, which are the hub of the district and the core and regional economy; second, the core business and its external suppliers have close cooperative and trade relationships, based on long-term contracts. The cooperation in the district is normally between core businesses. Around core businesses, the district will form a kind of distinctive regional culture specialty. The core businesses will control the important resources including source of funds, technical expertise and business services, while local government will play a big role in managing and promoting core industrial development. The development of the regional economy lies on the strategic perspective of both core industries and hub businesses, and the joint effort between core businesses and government.

At this time, RHQs are very likely to appear. This is because of: ① cooperation both with the upstream or downstream firms and other businesses in the district; ② keeping track of the opponents’ strategies in the oligarch-monopoly market structure; ③ coordination with every local governments; ④ understanding the strategies of the corporate headquarters and implementing them; ⑤ coordination with other branches; and ⑥ the fact that if policy in the home country and the guest country permits, the large banks that have close business relationship with core enterprises would follow their clients to establish their own RHQs in the district; if policy does not allow, those banks’ RHQs will appear in a different form. Although there will be RHQs, with the oligarch-monopoly market structure, RHQs arise mainly from a few oligarch-monopoly businesses and it is less likely for the single-line RHQs to form clusters. As oligarch-monopoly businesses and their upstream or downstream firms cooperate more and more, those RHQs would gradually form clusters and increasingly improve the development of regional economy.

2.1.3 Satellite Platform industrial districts
Satellite Platform industrial districts are the aggregation of branches of large enterprises with headquarters located outside the region of the country; at this point, clusters of RHQs are very likely to appear. But these clusters should develop around core cities, including RHQs of various types. Their characteristics are as follows: First, RHQs, under the premise of not having conflict with their corporate headquarters, are responsible for production and investment within the district, harmonizing the relationship between upstream and downstream, and reinforcing cooperation with local suppliers as well as upstream with headquarters. Second, RHQs have the obligation to improve the communication and coordination with the other company’s RHQs outside the district, in order to avoid malignant competition between one another for a share of the market. Third, it is advocated to secure capital, technology, and business services internally and externally. The local government mainly provides infrastructure, taxation, and senior personnel management and preferential policies either before or after RHQs have entered. RHQs are actively blended into local public undertakings, and social welfare, etc. After RHQs gather together, a cluster is naturally formed, which is a kind of a high-end service-oriented cluster, and can therefore promote the industrial structure in the district and the development of its economy.

2.2 Externality of RHQs

The spatial value chain is composed of corporate spatial value chain and industrial spatial value chain, and to a certain extent embodying the externality of RHQs. Normally, the former is rooted in the oligarch-monopoly market structure, and the latter is rooted in the market structure of enterprises of small size and large numbers. The two kinds of spatial value chains would have different effects on regional economy in different forms.

2.2.1 Value chain system between RHQs and production bases

The corporate spatial value chain is formed by the corporate value chain, which includes RHQs and production bases. Namely, RHQs are MNC’s internal financing center, settlement center, R&D center, operating center, public relations center etc., while production bases mainly undertake the production. With the ever-accelerated development, the corporate element will bear the growing pressure, so the key of corporate development is how the corporate element integrates its internal resources and the various resources between different size cities. The best solution is to separate RHQs and production bases. Normally, RHQs will locate in the metropolis while production bases will choose under-developed areas around the metropolis in order to realize a reasonable spatial layout of their different departments. Eventually the value chain system is formed, with a core of RHQs and with a bond of the corporate spatial value chain, radiating the production bases in surrounding and related areas. That is, the value chain system between RHQs and production bases is formed. But the corporate spatial value chain is formed with RHQs concentrating and coordinating capital, production, trade, human resources and information of various branches in the surrounding areas.

The RHQs promote the development of the regional economy by the way of realizing the best distribution of resources among different regions. At this time, the characteristics that affect regional economic development are as follows: ① the corporation’s functions appear separate, and normally RHQs and production departments are separate and choose their location in metropolis and under-development areas apart. ② RHQs coordinate all kinds of resources in order to achieve them optimum allocation. ③ RHQs of the same business would gather. ④ the production department of the same business would gather. ⑤ The contacts between corporate and corporate or government would increase.

2.2.2 Value chain system between core areas and industrial bases

The industrial spatial value chain is formed by the industrial value chain. Namely, the aggregation of RHQs leads to the spatial separation between the related industries’ high-end decision making, comprehensive management, the links of production, and supply of raw materials and logistics. The industrial spatial value chain is formed, with a bond of the industrial value chain, with core areas of RHQs and the collaboration of the industrial bases. That is, the value chain system between core areas where RHQs are located and industrial bases is formed. Based on the dominant industry, the core enterprises and the related others form the industrial value chain through the collaboration of forward, backward, sideward relations; and the integration of the headquarters in different industries, their production companies, and other related enterprises. In this way, distinctive industrial value chains are formed, such as the automotive industrial chain (Zhang, 2006: 180), which is the final form for RHQs to promote regional
economic development and the realization of regional linkages.

At this time, the characteristics of affecting regional economy development are as follows: ①RHQs gather in metropolis which is the core of high-end industries, while their production bases gather in under-development areas around metropolis, and in the end the metropolis and production bases would share out the work and cooperate with on another under relationship CP. ②The industrial chain would be formed surrounding the core area of RHQs location. ③The regional plan with uniform and harmonious would appear. ④RHQs have multi-levels. ⑤The contacts between government and government, corporate and corporate, government and corporate would be growing.

3. Empirical research: Hong Kong

Hong Kong (thereinafter referred to as HK) has some advantages: Asia’s business capital, international business environment, low and simple tax, strategic location, gateway to mainland China, world-class infrastructure, efficient and skilled workforce, research and development, cosmopolitan lifestyle (Investment Promotion Bureau, HK, 2010). Because of these advantages, HK has already grown as a top location to Asia’s business and as an attractive destination for a large number of RHQs. By June 1st, 2009, RHQs in HK had reached the number of 1,298, which had been the statistically new high since 1991. That number was 2.16 times as large as the one in 1991. Meanwhile, the number of countries of origin of RHQs locating in HK has been 15 across North America, Europe, Asia etc. (Fig. 1). These RHQs gathering to HK have been affecting regional economic development including HK and Guangdong and even Pan-Pearl river delta.

3.1 Internality of RHQs

The core function of RHQs is to promote the integration and inter-availability of operation resources, including tangible assets and technology-human resources, material resources and capital resources and intangible assets management experience and know-hows; and to improve decision-making efficiency. The functions cover: holding company function, management staff function, integrated adjustment function, and promoting the new undertakings in the district. As far as the properties of these functions are concerned, they “belong to the business functions, including operation strategy, planning, management, personnel, labour service, financial affairs, accounting, law, publicity, advertising, investigation, etc., and are carried out mainly within the business quarters”( Zheng, 2002: 10). They highlight service more than pure FDI, and their contribution to GDP belongs to the tertiary industry. Therefore, RHQs can promote upgrading of the industrial structure and improve economy structure adjustment. The more RHQs a city attracts, the more beneficial it is the upgrading of the local industrial structure.

The RHQs of service industry are of absolute share in HK, which would promote regional economic development centering on HK in the three following aspects: ①The RHQs of service industry belong to the tertiary industry. They are beneficial to updating the composition of industrial structure, with the four industries, like wholesale, retail and import/export trading, business services, transportation and related services, financial and banking services, outnumbering 91.0% of the market share for all RHQs in both 2005 and 2006 (Table 1). ②Most of the service RHQs locating to HK belong to producer services belonging in the high-end section of the tertiary industry, sector which makes a direct contribution to high-end industry and economic development in HK. ③The composition of the three industries has been changing at recent year because of the RHQs locating to HK, for example, 0.07: 10.39:
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86.07 in 2003 and 0.06: 7.38: 88.63 in 2007.

<table>
<thead>
<tr>
<th>Classified by main business scopes of RHQs (Number/Percentage)</th>
<th>Classified by main business scopes of parent companies outside HK (Number/Percentage)</th>
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<tbody>
<tr>
<td>Wholesale, retail and import/export trading 615/52.7 (643/52.4)</td>
<td>380/32.6 (405/33.0)</td>
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<tr>
<td>Business Services 271/23.2 (270/22.0)</td>
<td>217/16.6 (194/15.8)</td>
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<tr>
<td>Transportation and Related Services 103/8.8 (115/9.4)</td>
<td>101/8.7 (118/9.6)</td>
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<tr>
<td>Financial and Banking Services 74/6.3 (93/7.6)</td>
<td>83/7.1 (107/8.7)</td>
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<tr>
<td>Manufacturing 73/6.3 471/40.4</td>
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<td>Construction, building and civil engineering 35/3.0 38/3.3</td>
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<td>Telecommunications 17/1.5 21/1.8</td>
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<td>insurance 16/1.4 17/1.5</td>
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<td>Real Estate 12/1.0 13/1.1</td>
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<td>Restaurants and Hotels 11/0.9 16/1.4</td>
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3.2 Externality of RHQs

The externality of RHQs in HK is embodied by the industrial spatial value chain, and is reflected by Headquarters-Economy with the relationship CP between HK and Guangdong. That is, the industrial structure of HK and Guangdong both change, which leads to their cooperation, forms regional linkages, and promotes regional economic development centering on HK. All of this is embodied by the changing industrial structure of HK and Guangdong.

3.2.1 The macroeconomic structure of HK

In 1990s, with the increasing number of RHQs entering HK, HK's macroeconomic structure began to transform itself to a service economy; this is shown by the composition of three kinds of industries in GDP and their employment rates. The composition of the secondary industry in GDP and its employment rate has been declining, respectively from 24.3% and 36.0% in 1990 to 7.7% and 13.7% in 2007. So does manufacturing industry, respectively from 16.9% and 27.7% in 1990 to 2.5% and 5.8% in 2007 (Fig. 2).

The composition of the tertiary industry in terms of GDP and its employment rate has been rising, respectively from 71.5% and 62.4% in 1990 to 92.3% and 85.7% in 2007 (Fig. 3). Among which the composition of various services have been rising to different degrees, for example, that of the four major services of finance service, tourism, trading and transportation, professional services and other

86.07 in 2003 and 0.06: 7.38: 88.63 in 2007.
supporting services of industry and commerce increased from 53.8% and 45.2% in 2004 to 56.7% and 47.2% in 2008 (The Government of the HK Special Administrative Region, 2010).

From the above, with the composition in GDP and employment rate declining within secondary industry and manufacturing, services have been increasing. All these data indicate that HK is being transformed to the service industry.

### 3.2.2 The macroeconomic structure of Guangdong

In contrast with HK, Guangdong has been transforming to a manufacturing basis. From the overall development trend, the proportion of manufacturing in GDP and the employment rate have been going up, respectively from 41.6% and 19.9% in 1997 to 48.3% and 34.1% in 2008 (Fig. 4). Meanwhile tertiary industry performs very differently, with the three major industries appearing divergence. The employment rates of the wholesale, retail trading and the catering industry have been going up, from 9.8% in 1997 to 15.8% in 2008, from which the composition in terms of GDP deviates, a rise at first and then declines afterwards, from 11.8% in 1997 to 9.3% in 2008. The composition of transportation, storage, post and telecommunications in terms of GDP and employment rates has been declining synchronously. The composition of finance and insurance in GDP is very unstable and has increased very fast to 5.8% in 2007 and 5.9% in 2008, but their employment rates have not increased synchronously (Fig. 5). The above facts show that the service industry in Guangdong has been weakened compared with HK, but manufacturing still holds a very important position and has the potential to further develop. These facts indicate that Guangdong has been changing to a manufacturing base.

### 3.2.3 The results of macroeconomic changes HK-Guangdong

RHQs are gathering in HK, gradually leading the changes of the industrial structure of HK-Guangdong centered on "Pearl River Delta". The regional division of labor between HK and "Pearl River Delta" basically takes the shape of HK acting as a service-oriented core city that executes major service function, and "Pearl River Delta" mainly engaged in processing and manufacturing (Tuan etc., 2003: 753). And then the urban economic division between HK-Guangdong has appeared and gradually forming a single--dimensional Headquarters-Economy, with the relationship CP with HK as the core and Guangdong as the periphery. Along with Guangdong economic development, its one city, such as Guangzhou or Shenzhen, may develop into a sub-core city. In this way the sub-Headquarters-Economy are able to come into being, and eventually the single-dimensional Headquarters-Economy can be transformed into the multi-dimensional Headquarters-Economy (Ren, 2007: 69).

### 4. Conclusion

RHQs constitute the major power of the local industrial structure, and how to exert the power? The key is to
coordinate both between the cities and all aspects in one city. RHQs’s unique characters and their value chains constitute two major powers that promote the local industrial structure. However, how to give full play to these powers is not easy, and they need the coordination between the inside and outside of cities. For example, "three carriages" of Chinese economic development in combination with two new areas are attracting RHQs in order to develop Headquarters-Economy. Finally, the key is how to coordinate between them and intercity in the district, and how to establish and implement development strategies.

The unique functions of RHQs promote every city to absorb them, and the key is the orientation of domestic cities. The unique functions of RHQs are manifested through their accumulative effects, which have become the direct incentive for domestic cities to formulate their corresponding preferential policies in order to attract RHQs, and to develop Headquarters-Economy. However, with a limited number of large MNCs, the fixed size “cake” has to be shared by more and more cities. How much can each city share? Since the establishment of RHQs is a complex systems engineering and each city poses alternative, MNCs would have the last choice to locate RHQs to a city. So, domestic cities are required to reconsider their orientation, and how to apply the accumulative effect of RHQs more practically.

The gathering of RHQs would form the Multi-dimensional Headquarters-Economy with the relationship CP, and the key is how domestic cities compete with one another. The gathering RHQs is shown by the Headquarters-Economy with the relationship CP. This Headquarters-Economy has its own characteristics and decides to the type and level of competition between cities, the implementation of optimal resource allocation and how to cause regional linkage. Finally, how do cities compete with one another? One of the direct manifestations of this type of competition is how each city formulates corresponding preferential policies. However, the question is whether the policies approach the bottom line. If the answer is negative, it is perfect; otherwise, MNCs will be glad, which would be worthless to Chinese urban development and its upgrading of industrial structure.

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**About the Author**

Yongju Ren works in the School of Economy, Tianjin University of Commerce, Tianjin, P. R. China as a vice-professor, who earned her PHD of Nankai University in 2004 and finished her postdoctoral research in Fudan University in 2009 and granted Grade 1 and Special Foundation of the financial support from China Postdoctoral Science Foundation. She has focused her mind on the problems about RHQs and FDI for several years. Until now, she has published two monographs and more than 20 articles and finished two planned projects.

**Contact Information**

Yongju Ren, School of Economy, Tianjin University of Commerce; Add: DongKou of Road JinBa, BeiChen District, TianJin, P.R. China (300134); E-mail: yongjuren@eyou.com.