

Corporate Headquarters — Will They Be Outsourced?

It is becoming increasingly common for major corporations to outsource certain job functions overseas, particularly to locations in Asia.

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During the last 30 years, the United States experienced several significant changes in the geography of manufacturing and corporate headquarters. In the early 1970s, the nation observed a dramatic shift in the location of manufacturing from the Rust Belt of the Northeast and Midwest to the Sunbelt of the South and Southwest. This shift was largely motivated by the availability of low-cost, nonunion workers. Manufacturers also needed to vacate their old, inefficient, multistory factories traditionally located in the older, congested areas of northern cities.

At the same time that this migration to the South and Southwest was occurring, another dynamic shift was taking place, first by manufacturing and distribution facilities and followed by offices. During the mid-1970s through the 1980s, the United States experienced the suburbanization of commercial and industrial real estate activity. Along with the development of suburban regional malls, there was a tremendous development of suburban industrial parks and suburban multitenant office buildings and corporate headquarters.

Commercial and industrial activity followed population growth to the suburbs. For example, in 1965 there were only eight 25,000-square-foot or larger multitenant suburban office buildings in the Chicago metropolitan area. By 2003, there were more than 1,487 suburban buildings representing more than 134 million square feet. The same dynamic growth was occurring with industrial and distribution facilities. Today, most manufacturing and practically all distribution has fled our cities for the suburbs and rural areas.

As multitenant office and industrial growth progressed in the southern and southwestern states and in the suburbs, it was logical that corporate headquarters would follow. In 1970, virtually all of the nation's largest corporations had their headquarters in the central business districts of major cities, primarily in the North and Midwest. By the end of the twentieth century, only 20 percent of all Fortune 500 companies had their headquarters in cities with populations of one million or more, and if New York is eliminated, that percentage drops to 11 percent.

Historically, corporate headquarters for manufacturers have been located at the same location as production. As companies' production becomes increasingly national and global, the locational tie to a specific production facility often begins to diminish. This trend is especially true as the company adds production facilities. Often these corporate headquarters, especially for large national and multinational companies, will gravitate toward major metropolitan areas like New York, Chicago, Los Angeles, Houston, or Atlanta. As mentioned, during the latter part of the twentieth century, many headquarters dispersed from central business locations to suburban locations of major business centers. This ability to move away from production facilities has been aided by improved communications and motivated by a need to be closer to major business centers with other corporate customers and services, including finance, advertising, legal, and accounting.

As manufacturing headquarters tend to gravitate away from production as a company grows, they also tend to change in character and function. Engineering may be dispersed to plant locations, research and development may develop its own location apart from the headquarters, and back-office type functions may gravitate to low-cost suburban or more rural locations. While Fortune 500 companies may follow this pattern, the vast majority of headquarters for small and mid-sized manufacturing firms still prefer to be located near production operations. They also tend to have engineering, R&D, legal, accounting, and other office functions centrally located at the headquarters.

U.S. Companies Chase Labor

The nation is now in the process of entering a period of dramatic change in where we do business, including our corporate headquarters. These changes will make the shifts that occurred over the past 30 years pale in comparison. Economists refer to such dramatic shifts as structural change rather than cyclical change. In the last two years, there has been no shortage of press about the shift in manufacturing to offshore locations, primarily to Mexico and China. As was the case in the late 1960s and 1970s, U.S. manufacturers are chasing low-cost labor in rapidly growing foreign consumer markets.

Including benefits, a manufacturing worker in the Midwest can earn \$20 to \$30 per hour, as opposed to a worker in Mexico that earns \$2.50 per hour; a worker in Shanghai that earns \$1.42 per hour; and as low as \$.60 per hour for workers in interior China. During 2002, foreign investment in China exceeded \$53 billion. The U.S. trade deficit with China totaled \$44 billion for the first five months of 2003, a 27 percent increase from the previous year. Wal-Mart alone has doubled its imports from China in the last year to \$12 billion, and now accounts for 10 percent of all imports to the United States from China. Within 10 years, China, if it can maintain its political, social, and economic stability, will be the world leader in manufacturing. It is currently ranked number four.

The June 23, 2002 issue of Automotive News reported that Ford, GM, and Chrysler are all pressuring their North American suppliers to join the migration to China. The U.S. Department of Commerce statistics show that imports of auto parts from China totaled \$2.2 billion in 2002, triple the amount from 1997. According to Automotive News, GM has told suppliers that they soon expect to be purchasing \$10 billion in parts from China per year. The paper also reports that Ford has begun asking smaller Tier One suppliers to build factories in China, and is using "China prices" to demand lower prices from American suppliers.

As reported in the Pollina Corporate Top 10 Pro-Business States study, when it comes to retention of jobs for the American worker, the federal government and most states are failing. The report identifies a limited number of states making a serious effort to preserve jobs and the lack of federal support. Since mid-2000, the United States has lost nearly three million manufacturing jobs. During the same period, roughly 8,000 manufacturing facilities were closed or were being underutilized as a direct result of this loss of jobs.

As more manufacturing operations move offshore, there will be a significant impact on where the headquarters for these companies are located. For many of these companies, headquarters may evolve into nothing more than a few key executives, and the legal and marketing staffs with other functions will move offshore. If the majority of manufacturing occurs offshore, the headquarters for these companies that may have traditionally been tied to plant sites will likely gravitate toward major metropolitan area business centers in the United States. Over a longer period of time, headquarters for many manufacturers area also likely to move offshore. This will occur as the huge, virtually untapped markets of China and India begin to dwarf the North American market and as management, marketing, and research and development leaders emerge from the offshore operations.

Who Will Occupy Our Corporate Headquarters?

White-collar jobs are also fleeing the country at an alarming rate. Today, U.S. universities graduate 101,000 engineers per year, versus 291,000 per year in India. Many of the engineers and computer scientists in India are trained at universities that are considered to be superior to those in the United States. Since 1997, the number of U.S. citizens receiving Ph.D.s in engineering and science decreased 16 percent, including a 25 percent drop in math and computer science.

The number of engineering colleges in India is expected to increase 50 percent to nearly 1,600 within four years. Increasing numbers of highly skilled and highly paid jobs are also moving abroad. These are exactly the type of jobs that U.S. workers thought would always remain theirs. A typical software programmer might be paid \$66,000 per year in the United States, but only \$10,000 in India. A U.S.-based mechanical engineer would typically receive \$55,000 per year, versus \$6,000 per year for a comparably trained Indian engineer.

It is not just technical jobs that are being threatened. An M.B.A. in India with comparable experience and training to a U.S.-based M.B.A. can earn as little as \$12,000 per year, versus \$90,000 in the United States. The management consulting firm A.T. Kearney expects that more than 500,000 jobs in the financial-services industry will be relocated overseas in the next five years, with India being the major recipient. Forrester Research estimates that among white-collar jobs in engineering, programming, and accounting, 4,000 jobs will leave the United States per week.

The October 2003 issue of CFO Magazine reported that increasing technology, R&D, and IT jobs are migrating overseas, soon to be followed by downstream drug research efforts of U.S. and European pharmaceutical companies. It is not just the cost advantage, but also the vast pool of highly talented individuals in countries like India and China, that is attracting senior U.S. executives. The magazine also reports that Electronics Engineers U.S.A., a professional society, claims that the global decentralization of R&D is responsible for the rise in unemployment in their profession to unprecedented levels.

Impact of Job Loss on Office Space

If we look at the loss in jobs estimated by A.T. Kearney and Forrester Research, they equate to approximately 54,000,000 square feet of corporate office space that will either be vacated or unneeded per year. This is roughly the equivalent of shutting down one-third of Chicago's downtown office space each year, and the loss of \$1.2 billion in rent per year. Two key factors are at play here: First and foremost is the outsourcing of jobs overseas, and secondly, the increasing productivity of American workers.

As increasing numbers of financial services, IT, engineering, and accounting jobs exit the United States, corporate headquarters will be significantly impacted. Corporate headquarters locations are strongly influenced by where the "C" level officers live, and, in the case of manufacturing companies, by where their manufacturing facilities are located. With high-tech industries and R&D facilities, location is strongly influenced by where the best scientists and engineers can be attracted. Today, 60 percent of U.S. science graduates are not U.S. citizens. These graduates have been essential to U.S. success and dominance in scientific and high-tech R&D.

In the Silicon Valley alone, Business Week (Dec. 8, 2003) reported that there are more than 30,000 Indian IT professionals, many of whom have excelled as managers, entrepreneurs, and venture capitalists. As of the year 2000, Indians were either founders or top executives of 972 Silicon Valley companies. A growing number of these professionals are returning to India to start new businesses or to expand R&D labs for Silicon Valley companies such as Cisco Systems, Intel, and Oracle. The magazine also reported that in November, hundreds of engineers lined up at a job fair in Santa Clara to apply for jobs in India.

If corporations increasingly rely on scientists, engineers, and other high-skilled professional jobs in India and elsewhere, will the United States cede its lead in innovation? As job opportunities and educational opportunities grow overseas, will these foreign students who have fed our universities' science and engineering departments and in turn our high-tech industries and laboratories stay in the United States? Today, those that do graduate from U.S. universities frequently return to their native countries. Will the next generation of CEOs, CFOs, COOs, and CIOs come from overseas? This scenario is very likely if the current trends continue. Certainly, many of the current generation of top officers in the U.S.-based companies come from the very departments that are being outsourced overseas.

Looking Ahead

There are a number of trends at play in the United States that do not bode well for the future of corporate headquarters locations here over the next 30 years. First, we have begun to outsource many of the functions that have traditionally taken place at corporate headquarters. It is specifically these types of jobs that are outsourced that have been the seeds from which many new American companies have grown and "C" level executives have been developed. Along with this trend in leadership, the world's largest emerging markets are in Asia, and these will draw manufacturing facilities, research and development, and corporate headquarters. In addition, the world's largest corporations, many of which are located in the United States, are increasingly becoming multinational in ownership and leadership and are less affected by a sense of nationalism or inertia relative to a specific country or location.

Couple the out-migration of jobs, both white- and blue-collar, with the desire for manufacturing companies to keep their headquarters close to production and R&D, and we can expect to see two trends in corporate headquarters in coming years. As more jobs are outsourced, U.S. corporate headquarters as well as R&D facilities will decrease in size. This trend has already begun. Following this trend, there will be an out-migration of corporate headquarters overseas for companies that are high-tech and heavily R&D-oriented, as the next generation of "C" level executives are likely to come from countries like India and China.