Canada-United States Law Journal

Volume 30 | Issue Article 14

January 2004

Cities: Competition for Inward Investment Proceedings of the Canada-United States Law Institute Conference on Multiple Actors in Canada-U.S. Relations: Cities: Competition for Inward Investment

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CITIES: COMPETITION FOR INWARD INVESTMENT

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U.S. Speaker

Thank you to the Canada-U.S. Law Institute and especially Henry King for this unique opportunity. As Jamie mentioned, I am not a lawyer. I do not get many opportunities to talk before groups like this. The presentations by Ambassador Giffin and Premier Rae on policy considerations are a great starting point for a discussion of location selection and the role incentives play in location decisions. I deal with these issues every day when I help companies make decisions based on conditions that result from the policy debate.

Following Ambassador Griffin and Premier Rae's analogy of looking across the border through both ends of a telescope, location consults do the same except our view is magnified both ways. We are looking from the U.S. to Canada trying to get the details of what is there and looking back the other way from Canada to the U.S. trying to get the same level of detail.

I am going to talk about that process of examination today, and talk about the role incentives play in location decisions. As Nate Green mentioned, it is really an end game. Incentives do not come in until the end.

As a way of introduction, let me digress a bit. As an introduction to my topic, I will describe my employer, The Austin Company, and how the work we do relates to location selection and incentives. The Austin Company, as Jamie mentioned, is a consulting, design, engineering, and construction com-

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pany based here in Cleveland.[1] We were founded in 1878[2] by Samuel Austin, an English carpenter. Austin was on his way to Chicago to help rebuild the city after the great fire when he stopped in Cleveland to visit family, met a woman, got married and the rest is history. Samuel Austin's millwork shop on Euclid Avenue, just down the road from this hall, was established in the 1880s.

It is fitting on at least two accounts that we are here at Case to talk about location selection and the role of incentives. Samuel Austin's son Wilbert attended Case University, graduated in 1901, and went into business with his father. Guided by his Case education, Wilbert helped realign the company to meet the needs of the expanding industrial base in the United States. Together father and son established in 1901 a method for integrating building design, engineering, and construction services under a single source of responsibility. The trademarked Austin logo, which recently marked its 100th anniversary,[3] is the overlaying of Alpha and Omega, beginning to end, and the letters A and M, the Austin Method. Evidence of Austin's early success can still be found locally. Hardly a stone's throw from this building is the Carnegie Medical Building built in 1927, still in use as part of the Cleveland Clinic complex. Austin has grown to a company of 700 professional staff, ten offices in the United States and the United Kingdom and serving a wide array of clients.[4] Now in our 126th year, 30,000 projects later, the Austin Company is still moving forward.

A second way in which Case distinguished itself, and perhaps of more significance to this group, was the role Case played in job creation and the generation of wealth. The benefits of educating Wilbert Austin rippled far beyond the Austin family and the boundaries of the Cleveland area. This is precisely the outcome we seek from our public institutions and the role we see for incentive programs, that they be effective tools for doing good things for the community at large.

Now, let me build on that company history and introduce Austin's location strategy consulting. Recognizing the importance of location in corporate success, Austin began offering location consulting services in the 1940s. These services are designed to help clients determine the number and location of manufacturing plants, distribution centers and office operations. Evi-

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1 *See* http://www.theaustin.com (last modified July 20, 2004).

2 *Id.*

3 The concept is called the Austin Method.® *See* http://www.theaustin.com/html/the_austin_method.html (last visited Sept. 14, 2004).

4 *See* http://www.theaustin.com/html/facts_and_data.html (last visited Sept. 16, 2004), *see also* http://www.theaustin.com/html/feedback.html (last visited Sept. 16, 2004).

dence of Austin's longevity in this field is the fact that we have been locating companies in Canada for over 40 years.[5]

Early in our company history Austin developed an effective methodology for location decision making that centers on modeling project characteristics and evaluating alternatives. I will review this modeling approach in more detail later in this presentation. It has become clear to Austin over the years that costs and functional relationships tend to drive location strategy and these factors precede things like development incentives, exchange rates, and other factors that prove to be peripheral considerations.

We also recognize that Canada and the United States often compete for new investment, more now than in the past. To better understand how these countries compete, let me frame the competition by giving you a historical perspective on the changing nature of location decision making. From the 1950s to 1980s, Austin helped more than 500 companies move from the northeast region of the United States, the so-called "rust belt", to the southern region to take advantage of lower labor costs and better labor management relations.[6]

This mass exodus ended by the early 1980s as drivers of location had changed. Wage rates have equalized from region to region.[7] There was a fading influence of organized labor.[8] The deregulation of natural gas, the deregulation of transportation, and now the deregulation of electric power[9] had a significant impact on where companies moved.[10] Networking of information and the global economy have continued to change the way companies operate. The net effect of these changes has been a leveling of the playing field from region to region with respect to many economic activities. Consequently, investments are not drawn as forcefully to one location or another as they once were.

From a strategy standpoint, investment tends to fall into one of three categories. We now see fewer traditional "cost based" location decisions such as companies that produce low value, bulky products.[11] Secondly, within our

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[5] *See* http://www.theaustin.com/html/facility_location_services.html (last visited Sept. 16, 2004).

[6] *Is the Sunbelt getting a little chilly?*, INDUSTRY WEEK, Sept. 7, 1981 at 139.

[7] *See* U.S. Bureau of Labor Statistics, Average Annual Wages for 2001 and 2002 for All Covered Workers By State, (2004) *available at:* http://www.bls.gov/cew/state2002.pdf (last visited Sept. 25, 2004).

[8] Barbara L. Jones, *Labor and Management Lawyers Divided in Their Views on Workplace Legal Issues*, THE MINNEAPOLIS LAWYER (Sept. 6, 2004).

[9] *See* Rachael Hedgcoth, *Juice Up Your Bottom Line With Low Electric Rates*, EXPANSION MANAGEMENT, Feb. 1, 2002, *available at*: http://www.expansionmanagement.com/smo/articleviewer/default.asp?cmd=articledetail&articleid=15532&st=2 (last visited Sept. 25, 2004).

[10] *Id.*

[11] *See* Thomas W. Gerdel, *Going Global; Electronic Conferencing, Communications Let-*

maturing economy, more and more location decisions are "relationship based." Companies either cluster around customers to fulfill just-in-time delivery,[12] or they locate around knowledge centers[13] as in the example of pharmaceutical or plant genetics research. Third are companies that are "footloose"; they can essentially locate wherever they want. Software developers, back office claims processing, and fulfillment centers are examples of footloose facilities.

U.S.-Canadian competition over new investment can occur for projects in any of these categories.

I mentioned earlier about Austin's analytical approach to location selection that models location alternatives. I will quickly run through the idea of modeling strategic alternatives here.

Every project is different. As I just indicated, some projects are cost sensitive while others have very little focus on cost. From a methodology standpoint we approach all projects essentially the same. We begin by establishing project requirements. This starts by defining the mission of the facility, the technology that is going to be employed in the facility, labor requirements that support the technology and the kind of activities that will take place. For example, will the client have people flying back and forth between facilities? Does management visit the remote operation every week or once a year? Is air service important? Does the client need to be connected to suppliers or institutions of learning? These factors, along with labor requirements, transportation characteristics, utilities, site and building size, project schedule, and, of course, the size of the investment in terms of dollars, will drive the location decision.

Once we have guided the client in defining the project we then take these needs and translate them into measurable variables. Once the measurement variables are defined we select trial location cities and gather information about each location. The objective of using the trial location methodology is to identify the regions and communities that best meet basic project requirements.

In a recent project for a food manufacturer, Austin looked at London, Ontario and Montreal, as well as eight U.S. trial cities. The primary reason for considering Canadian trial cities among the U.S. trial cities was the differential in the cost of sugar between Canada and the U.S. Sugar price differentials between the countries illustrate the importance of industrial policy.

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ting Companies Operate Internationally, THE PLAIN DEALER, (Clev.) Sept. 3, 1995, at 1H.

[12] Thomas F. McInerney, *Implications of High Performance Production and Work Practices for Theory of the Firm and Corporate Governance*, 2004 COLUM. BUS. L. REV. 135 (2004).

[13] Richard W. Painter, *Responding to a False Alarm: Federal Preemption of State Securities Fraud Causes of Action*, 84 CORNELL L. REV. 1, 74 (1998).

Sugar in Canada is traded at the world price.[14] In the U.S. the cost of sugar is subsidized to support domestic producers.[15] Companies located in the U.S. using sugar are at a competitive disadvantage. There are numerous examples of companies that have left the US to take advantage of lower cost sugar in Canada and other free trade countries such as Mexico.

Let me stray a moment from our discussion of modeling alternatives and give you a sense of the U.S. versus Canada playing field within the context of location decisions. This builds on Ambassador Griffin and Premier Rae's earlier discussion about how we view each other and how are we different, the cost of sugar as example. Maybe a good starting point is to look at the European Union (EU). The EU has followed a historic European tradition of strong industrial policy.[16] Policy has had a way of dramatically shaping what happens in regions within the EU.[17] Conversely, the United States is at the other extreme. We are very laissez-faire and we generally sidestep policies that actively guide investment in specific regions of the country. The examples of aggressive federal development incentives are few. An exception is the Renaissance Zone program that targets chronically depressed neighborhoods and districts.[18] We also have trade zone policy[19] but these are often weakly applied when compared to EU involvement in local development.[20]

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[14] "Canada's sugar producers are unique in the world in that they do not depend on government subsidies. Basing their prices on world raw sugar markets, Canadian producers sell sugar at prices that are among the lowest in the world." Canadian Sugar Institute, *Sugar Facts, International Sugar Trade, available at:* http://www.sugar.ca/fact_intNatl.htm (last modified June 7, 2004).

[15] Taxpayers for Common Sense, *Federal Sugar Subsidies: A Sweet Deal for Sugar Processors, available at:* http://www.taxpayer.net/agriculture/learnmore/factsheets/TCSSugarCommodityFactSheet_2003.pdf (last visited June 30, 2004).

[16] *See generally* Industrial Policy in an Enlarged Europe Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions, COM(02) 714 final, *available at*: http://europa.eu.int/comm/enterprise/enterprise_policy/industry/doc/com714_2002_en.pdf (last visited Sept. 25, 2004).

[17] *Id.* at 12-14.

[18] Also called "enterprise zones" or "empowerment zones," they provide targeted tax relief to businesses that locate in certain, usually distressed regions. *See* Michael LaFaive and Martin Wing, *Make Michigan One Big Renaissance Zone*, MICH. PRIVITIZATION REP., Summer 2002, at 5, *available at:* http://www.mackinac.org/archives/2002/mpr2002-03.pdf (last visited Sept. 25, 2004).

[19] "Foreign-trade zones are designated sites licensed by the Foreign-Trade Zones (FTZ) Board (the Secretary of Commerce is Chairman) at which special customs procedures may be used. FTZ procedures allow duty-free export and deferral of customs duty payment on items used in domestic commerce, helping to offset customs cost advantages available to plants abroad." *Available at:* http://ia.ita.doc.gov/ftzpage (last visited Aug. 30, 2004).

[20] *See generally* Nicholas von Hoffman, *A Mighty Fortress Was Once Our Economy*, NEWSDAY (Mar. 22, 1992) at 32.

In the U.S., location decisions are more likely to be made based on the business factors discussed earlier and not on government dictates.

I see Canada as a hybrid of these approaches. There is a lot of active involvement at Federal and provincial levels, which you do not see in the U.S.[21] In Canada the federal government is more active in promoting investment and often uses incentive programs to target industries and regions for development.[22] We also see a high level of involvement in the provinces.[23] It may also be important to consider the municipal government movement in Canada as another difference between the U.S. and Canada. I am not certain where this is going and what it may mean to location decisions, but the agglomeration of a number of communities into a single political entity is very significant in terms of what government can deliver to industry.

The objective at the end of our modeling of trial location alternatives, after comparing labor, utilities, taxes, and other location factors is to select the locations, trial cities or regions, which best satisfy project requirements. And despite the policy differences of the United States and Canada we can still make a direct comparison between the countries on any particular project. We can work through the differences and still make an "apples-to-apples" comparison.

We do this by taking the measurable variables and creating spreadsheets that compare trial locations. These spreadsheets can be simple or highly complex. For example, a comparison of trial city transportation characteristics may involve a simple tabulation of trucking rates or a complex computer model that optimizes alternative approaches to operations. In the case of labor characteristics, we go through a similar analysis and look at labor costs in its various forms, both simple and complex.

Once all the information has been gathered and tabulated, we are then able to compare locations in Canada with those in the United States and determine, on a high level, which are better for the proposed operation.

In our food company example, the lowest cost city is the "Base" and all other locations are a percentage over that. In this example, Columbus, Ohio is the lowest cost location among the places evaluated, and London, Ontario is about two percent higher in annual operating cost. In the location consulting game, a five percent difference, plus or minus, is considered the same.

We tend to make the initial location selection based on factors that provide firm numbers, numbers we can be confident in like transportation and labor costs. More subjective factors, like taxes and quality of life, are gener-

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[21] *See generally* Jean Raby, *The Investment Provisions of The Canada-United States Free Trade Agreement: A Canadian Perspective*, 84 AM J. INT'L. 394 (1990).

[22] *Id.*

[23] *Id.*

ally looked at later. So, in the example of the food industry project, the recommendation was to narrow the search and focus further investigation on two favorable locations; Columbus, Ohio and London, Ontario.

The next step in the process is to refine the analysis and drill down into the details of local communities. To do so, we start to look at those decisions factors that are more negotiable and ill defined; we work with our client to analyze these factors and work towards a consensus on issues such as taxation and development incentives.

At this stage of the project we begin to work more closely with development officials. In the case of the U.S., we talk with state and local organizations and even private organizations like utility companies as we work through the details. In Canada, we are more likely to deal with the Federal government, as well as Provincial and municipal organizations and local communities.

Financial modeling in the decision process is typically addressed at this later stage of the project. In the case of a Canada versus U.S., the financial model must consider exchange rates.[24] Exchange rates can make or break a deal. It can push the project from Canada back into the U.S. or back into Canada.

We also get involved in performing sensitivity analysis.[25] Corporate executives, for example, will look at forecasts and ask what will happen if we are more optimistic about growth? What will happen if we are more optimistic about the success of a new product? What will new assumptions do to the results of the decision model?

The adoption of new technology can also have a big impact on the requirements of the project and consequently the results of the decision model. Corporate managers must look to the future and adjust their thinking about new technologies that may be looming on the horizon. Opportunities outside the scope of the original mission can also alter the outcome. For example, managers may wish to understand the impact on the location decision of acquiring another company.

In summary, companies test location strategy by modeling alternatives. The model focuses on operating costs and functional relationships first[26], then considers development incentives, and then finally looks at the "what if" scenarios that could alter the outcome.[27]

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[24] *Is the US Current Account Deficit a Black Hole?,* BANQUE PARIBAS CONJONCTURE, (Nov. 30, 2003) at 2.

[25] *See* Craig N. Oren, *Prevention of Significant Deterioration: Control-Compelling Versus Site-Shifting*, 74 IOWA L. REV. 1, n.202 (1988).

[26] *See* http://www.theaustin.com/html/facility_location_services.html (last visited Sept. 16, 2004).

[27] *Id.*

Canada and the United States often compete for new investment. Let me say in closing that attracting investment depends on how well communities understand the decision process and subsequently do what is required to both meet the needs and anticipate the needs of business, positioning themselves accordingly to influence decision makers. Whether or not a new investment comes their way may well depend on how well they do this. Success may mean greater funding for education and infrastructure, or setting up trade missions around the world. There are many ways that communities can influence location decisions and they must work to do this if they hope to compete globally.