Multinational Companies on the Move: How Switzerland Will Win the Battle!

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Note to the Reader

The first study in our three years series on Multinational Companies (MNCs) in Switzerland, focused on the Forgotten Sector: Foreign Companies in Switzerland. This year we look at all MNCs with operations in Switzerland, including Swiss MNCs.

The reason for this expansion is twofold:

- With 34% of GDP, MNCs represent an important part of Switzerland's economy.
- MNCs – Swiss and Foreign – have similar needs and flexibility regarding location. In this respect they are very different from Swiss domestic companies: Competitive pressure forces them to continuously optimize their location mix, and new technology, market and political developments increasingly enable them to do so.

While our first report showed that the Forgotten Sector has been growing faster than the rest of the economy, we where surprised to see that Swiss MNCs' contribution to GDP has been shrinking. Overall the contribution of MNCs to the Swiss GDP has been constant.

A look at the drivers of this trends shows, that all MNCs are following a similar logic. When Foreign MNCs optimize locations, they select Switzerland for specific functions, especially in Financial Services, in Life Tech and increasingly for international management centers. This created many attractive jobs in Switzerland. Swiss MNCs go abroad for low labor cost, large markets and access to large "brain pools". The impacts of these trends compensate each other.

Other nations are aggressively attracting MNCs with attractive tax schemes and relevant infrastructure. This development is challenging Switzerland's leading position. A look at studies, which compare the attractiveness of countries, shows that the gap between top tier players has become smaller, and Switzerland, while still leading, has some clear and evident weaknesses.

We propose a five-step plan for Switzerland to ensure attractiveness for MNCs. The plan builds on the favorable tax rates, improved mobility for qualified employees, better infrastructure for MNCs, better cooperation between stakeholders in Switzerland and a coordinated communication as the "Best Place to do Business" instead of the traditional "Heidi Land"-image and competition between cantons. The opportunity and the risk for Switzerland are large!

More than ever, MNCs are on the move for best locations. For Switzerland's international economy it is crucial to win over other locations. We hope you enjoy reading our 2007 study. Your comments and feedback are highly appreciated. Please do not hesitate to contact us.

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1. Executive Summary

One Third of Swiss GDP Comes from Multinationals

For the purpose of this study, we have defined multinational companies (MNCs) as those companies that can, do, and must optimize the location of their operations around the globe according to specific location factors. This definition includes all foreign companies in Switzerland, as well as Swiss companies with large exports (more than 25 percent of total revenues) and significant foreign direct investments (measured as more than 25 percent of employees abroad). Thus, MNCs can be large companies or small and midsize companies, and they include companies from all sectors of the Swiss economy. MNCs, accounting for 34 percent of the total GDP in 2004, are very important to the Swiss economy. Foreign and Swiss MNCs account for 10 percent and 24 percent of the GDP, respectively. With increasing globalization, MNCs are becoming more flexible and sophisticated in optimizing their global locations on a function-by-function level:

- Experience in managing internationally distributed operations
- Increased ability to move more and more functions worldwide
- Competitive pressure to continuously optimize global geographic-location mix

For Switzerland, this presents the opportunity to attract additional companies or functions of companies already present in Switzerland. On the other hand, the risk of losing companies or functions to other countries is increasing and thus the retention efforts regarding Swiss and foreign companies become even more important. In total, 34 percent of the Swiss GDP is at risk, but also there is a significant potential for more.

Competition Between Countries Is Highly Dynamic

During the last decade, competition between countries vying for MNCs has intensified. The shrinking spread of the top ten countries in the World Economic Forum (WEF) Global Competitiveness Index (GCI) survey reflects this development. Switzerland has improved its absolute and relative ranking, reaching the number one position in 2006. While this is an excellent achievement, a closer look at the subcategories shows that Switzerland is performing poorly in some categories important to MNCs, for example, ease of hiring foreign labor, trade barriers, and ease of doing business. While WEF puts Switzerland at the top, other studies with similar rankings see Switzerland around the tenth place behind Ireland and the Netherlands.

Even in light of its excellent position, Switzerland must not become complacent. International competition is more aggressive, and alternative locations can become more attractive and more active in approaching MNCs.

Switzerland Profits from Multinationals, but These Multinationals also Contribute Negative GDP Growth

MNCs decide on location on the basis of a few common criteria: labor cost, access to large markets, political stability, taxes, the quality of the infrastructure, and a knowledge environment that encourages education and protects innovation.

On one hand, foreign MNCs come to Switzerland for very specific reasons: a skilled work force, tax benefits, quality of life, a robust infrastructure, and a stable political environment. As a consequence, the contribution of foreign MNCs grew significantly between 2000 and 2004: employment rose 3 percent and GDP rose 5 percent per year.

On the other hand, Swiss MNCs go abroad mainly for three reasons: access to large markets, availability of low-cost labor, and access to highly skilled personnel. Consequently, they have been moving low-cost functions, such as shared services and lower-value manufacturing, to India, China, and selected Eastern European countries. In the recent past, Swiss MNCs have also started moving such functions as R&D to countries such as the United States, Germany, and China. These countries provide better circumstances, especially easier access to skilled-labor resources and infrastructure. In light of Switzerland's growing shortage of skilled labor, such as engineers and scientists, this trend is rapidly evolving toward higher-value-added positions. This shift of functions abroad has already resulted in a negative development of Swiss MNCs' contribution to the Swiss GDP: between 2000 and 2004 employment fell 2.4 percent, and GDP dropped 2.4 percent per year.

During the same period, Swiss domestic companies, which account for the remaining 66 percent of GDP, have increased their contribution. A closer look at the drivers shows that the public sector accounts for close to half that growth. The rest is driven primarily by domestic financial-services companies and insurance companies in particular, which are also highly dependent on international financial markets.

Availability of Skilled Labor Is Key

Switzerland must ensure that the current shortage of skilled labor – including engineers, scientists, and international management expertise – does not accelerate the trend of exporting higher-value-added positions out of Switzerland. While Switzerland's evolution into a top-tier European location for foreign MNCs is obvious, its attractiveness for Swiss MNCs has become less clear. Switzerland must accept certain natural phenomena – low-value functions moving to low-cost countries, for example – but must also find ways to help Swiss MNCs retain their high-value-added functions in Switzerland.

Five Key Measures Are Crucial

We have identified five areas that Switzerland must address to remain competitive in order to become the best place worldwide for international business, further attract foreign MNCs, and retain key functions of Swiss MNCs:

1. **Remaining competitive on the tax front:** For most MNCs, tax is a knockout criterion at the start of every location screening, while later in the evaluation process, other factors become more important.

2. **Supplementing local skilled and specialized labor:** Make it easier for skilled foreign labor to work in Switzerland. This will become increasingly important as the battle for local talent intensifies – especially if Switzerland continues to attract foreign MNCs. Clearly, any policy in this domain requires a holistic approach toward immigration, but finding a differentiated approach that addresses economic and humanitarian immigration will be key. Major efforts in education will be needed to improve the domestic knowhow pool.

3. **Developing collaboration and coordination between cantons and providing a consistent Swiss interface to the world:** Ensure that MNCs are not confronted with a myriad of inconsistent messages, while continuing to leverage the decentralized and highly personalized service the cantons offer.

4. **Addressing critical amenities and infrastructure capabilities:** These include international airline connections and international schools. Globalization will increasingly drive the need for MNCs to have seamless connections among their key global locations. Providing the infrastructure for this with better airline connections out of the three Swiss international airports, better public IT infrastructure (Switzerland is ranked ninth), low administrative hurdles, and greater access to international schools for both foreign nationals and internationally mobile locals will support this ambition.

5. **Refocusing communication activities about the business location Switzerland:** Clearly define what Switzerland stands for (the best place for international business) and make large efforts to communicate this reality in a coherent fashion. The successful national marketing campaign for Switzerland as a tourist-focused "Heidi Land" is a good example of how the government can create a coherent message in its marketing of the business location Switzerland. This cannot be delegated to individual cantons with competing messages.

Switzerland Needs to Define Its Strength and Communicate with Self-Assurance

Traditional Swiss strengths – for example, expertise in precision machining, a long history of excellence in chemicals and pharmaceuticals, and a highly developed banking system – attract a disproportionate number of foreign MNCs in such fields as medical technology, biotechnology, and wealth management, and many MNCs also establish their headquarters in Switzerland. Therefore, Switzerland has become one the leading clusters for international management – for corporations and international organizations such as the United Nations (UNO), the United Nations Children's Fund (UNICEF), the United Nations Human Rights Council (UNHRC), the World Health Organization (WHO), the World Food Programme (WFP) etc, as well as non-governmental organizations (NGOs) such as the International Committee of the Red Cross (ICRC), the International Federation of Association Football (FIFA), and the Union of European Football Associations (UEFA).

Removing hurdles for MNCs that have a natural affinity for Switzerland will help consolidate the country's position in the global marketplace. Discussions with executives of MNCs indicate that while Switzerland has easily attracted MNCs in specific sectors, it should consider taking a more active role in building its appeal in the coming years. Competing countries – for example, Ireland, the Netherlands, Singapore, Hong Kong, and Dubai – have developed clearly articulated strategies focused on specific clusters such as biotechnology, medical technology, and wealth management. Given that building clusters is a zero-sum game, a victory by a competing nation is a loss to Switzerland.

Switzerland Has to Be Open-Minded, Thinking with New Perspectives

Switzerland has a heritage of international involvement. It has always been a catalyst in the development of how nations interact with each other. Translating this heritage in the current context could help Switzerland define a new role in the globalization race. For example, Switzerland could think about an economic alliance that is defined not by the partners' geographic proximity but by their economic similarity. More specifically, Switzerland could team up with other small, highly developed countries such as Singapore, selected Eastern European countries, specific economic regions in the United States (for example, the Boston area), and India to establish a global network that could provide MNCs with a totally new basis for their global operations.

In short, Switzerland has a great starting position, enormous potential to win the game for the optimal business location, and the goodwill of CEOs and other decision makers. But it is unclear whether it has the will to grab this opportunity. In the negative case, the risk is large: 34 percent of GDP is “at risk”, and significant portions could be moved to other locations in the next 10 to 15 years.