MOTIVES OF ECONOMIC ACTIVITY RELOCATION

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Introduction

Relocation is a multidirectional process and may be caused by various drivers, of which decreasing business costs is important as evidenced by the relocation from developed to developing countries. In recent years, the tide has turned and economic activity is shifting from developing countries to developing and developed ones. The objective of this paper is to analyze the directions and motives of economic activity relocation. The first part ascertains a brief conceptual demarcation of relocation and delocalization of economic activity. In the second part, the author shows the directions of relocation and drivers of forward and backward relocation. It is based on literature study and ERM database.

Defining relocation of economic activity

Relocation of economic activity occurs in domestic or international space. This process refers to partial or total enterprise activity shift, but also to transfer of functions to affiliated or non-affiliated firms. It has many directions. At the level of one company there are **forward** and **backward** shifts. The first movement is relocation from company in home country to company in host country (affiliated or non-affiliated), whereas the second is back relocation i.e. it has reverse direction. Taking a given state as a reference we may differentiate relocations from home country to host country (often referred to relocation) and also relocations to home country from host country (often referred to back relocation) (Lipsey (2004, p. 334-335); Hatzichronoglou (2005); Kinkel (2012, p. 696-698); Fernandes (2013), Gray et. al. (2013), cf. Panicz (2014b, s. 186).

Depending on the researcher's assumptions, the term of relocation is sometimes used separately or interchangeably with term of delocalization (Dorocki 2010, p. 125-136; Gierańczyk 2008, p. 89-92; Hunya, Saas 2005, p. 2; Odrobina 2009, p. 82; Pakulska 2011, p. 146; Radło 2013). In the literature there is no generally accepted definition of relocation, and a fortiori there is a lack of unambiguous conclusion of relation between relocation and delocalization (cf. European Parliament 2006, p. 3). Nonetheless, it seems that employment and production migration, which often results from relocation and is a necessary condition for delocalization, distinguishes these two terms[20]. As a result, relocation as a broad process, may involve economic activity shifts in the "invisible" and material form, e.g. capital and economic activity (material and service) flows. In this sense, relocation, in particular transitory relocation, may not cause negative effects on the demand of labour force. However, permanent spatial-economic changes, defined as changing localization of existing business or shifting economic activity to another place, may

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[20] Necessary delocalization conditions, in case of: 1) internal relocation (within company): a) Opening of affiliates abroad (or production units) which produce the same goods and services. These goods and services could also be produced by existing affiliates; b) In the compiling country, the enterprise which has relocated its production imports goods and services from its own affiliates abroad which had previously been consumed in that country, while exports decline due to the fact that they are partially or totally supplied from abroad and destined for the same markets as the exports from the compiling country; 2) external relocation (to external providers): a) the same activity which was partially or totally ceased is subcontracted on a regular basis to another non-affiliated firm or another institution abroad; b) the enterprise which gave the order and subcontracts goods and services abroad then imports these goods and services previously produced within the enterprise to satisfy domestic demand in the compiling country (country of the prime contractor) (Hatzichronoglou 2005, p. 14-15; Małuszyńska 2014, p. 29).

cause employment reduction as these changes involve closing the production process partially or entirely in one place in order to launch it in another localization.
Such a process of permanent changes in localization of economic activity is known as delocalization (cf. Gierańczyk 2008, p. 92). Finally, one might see a pattern according to which each delocalization is relocation, but every relocation is not delocalization. With regard to the above considerations author assumes that it is reasonable to use these two terms in a complementary way. Therefore, she proposes to define relocation as every partial or total economic activity displacement, both national and international and also within the company and between firms. Delocalization is to be considered a narrower term which means aforementioned displacement (relocation) with its results being employment reduction and/or production decreasing in home company (in home country). Taking into account the reverse directions of relocation, so-called back relocation (from host country to home country) the term delocalization should be defined as the aforementioned displacement (back relocation) with its result being employment reduction and/or production decreasing in host company (affiliated or non-affiliated with home company) in host country.

Directions of relocation

It seems the main aim of relocation is **to decrease business costs** as evidenced by the relocation from developed to developing countries, the so-called vertical relocations (see more: Małuszyńska 2006, p. 3). Reverse direction processes may result from **the lack of highly skilled labour in home country** and it may be connected with **higher costs of production factors**. These relocations involve in particular service companies (see more: Hahn 2010, p. 1-23). Horizontal relocations are a different issue since these include exclusively developed countries. These relocations involve the choice of relatively more expensive localization. Since wages in developing countries are growing and traditional cost advantages are decreasing, a cheaper localization for company from developed countries becomes another developed country, in particular if it exists in **the same geographical market** (cf. Panicz 2014).

The following table presents delocalization directions of enterprises' economic activity in the EU during 2003-2013. Measure of their intensity is the number of jobs lost. For the majority of Member States, New Member States (NMS12) was the main destination of delocalization. Thus, over 45% job losses were recorded as a result of relocation from Austria, Germany, Czech Republic, Portugal and Sweden. China was the main destination country for only two EU countries: Hungary and Slovakia, while India was the main destination for the Netherlands and the UK. Belgium and Poland were the only countries where the main destination for the vast majority of relocation job losses where EU15 countries (cf. Tab. 1) (ERM, p. 72).

Comparing Table 1 data with relocation directions, it is worth noting that there is not only one direction. Relocations occur **between countries with different level of development**, e.g. from France to NMS12 or from the UK to India but also from Poland to EU15; or **between countries with similar level of development**, e.g. from Belgium to EU15 or from Poland to NMS12.

Table 1. Directions and job losses in result of the relocation (%), years: 2003-2013.

		Destination									
n offshoring	home country	EU15	NMS12	Other Europe	Other Asia	China	India	Americas	Other	Not specified	Total
23	Austria	14	53	6	2	6	20	0	0	0	100
37	Belgium	67	21	3	0	2	1	5	0	2	100
23	Czech Republic	10	51	4	0	23	7	0	3	2	100
69	Germany	7	48	0	5	5	3	1	0	32	100
49	Denmark	32	40	6	1	15	2	2	0	3	100
29	Spain	21	39	1	12	8	1	7	8	3	100
37	Finland	8	25	8	17	20	10	5	0	5	100
85	France	10	36	2	13	7	1	3	17	12	100
15	Hungary	2	20	6	23	27	13	5	1	3	100
52	Ireland	5	37	7	10	9	12	11	3	6	100
43	Italy	17	39	15	3	10	2	7	0	8	100
32	Netherlands	12	23	3	4	12	32	12	0	3	100
9	Poland	43	14	0	0	5	20	0	18	0	100
25	Portugal	6	62	10	5	6	1	1	9	0	100
72	Sweden	17	45	1	12	10	1	4	1	8	100
9	Slovenia	7	20	33	0	9	0	0	31	0	100
9	Slovakia	11	29	14	0	31	0	7	0	7	100
142	United Kingdom	6	16	4	13	8	42	4	1	7	100
781	EU27	13	33	4	8	10	15	4	3	10	100

Source: ERM, p. 72.
Notes: It omits countries where offshoring cases <9. Main destination is highlighted in red for each country.

Decreasing costs of production factors is one of the main reasons of relocation. It is shown by the data outlined above which concern relocation between countries with different level of development. Among other causes of relocation there are e.g. increase in efficiency, improved access to foreign markets, acquisition and development of strategic resources (The EU Economy Review 2005, p. 119-121), which may be relevant to enterprises that move between countries with similar level of development.

Motives of relocation

Among the motives of international economic activity relocation one may distinguish the following aims: **economic, technical, market, strategic and organizational** (Małuszyńska 2013, p. 72). The first aim refers to the **reduction of production costs** either by closing and relocating part of production processes and/or service processes to branches in low-wage country in order to import components manufactured over there to the country of origin (*offshoring*) (Hunya, Saas 2005, p. 2; Hunya, Saas 2014, p. 5; cf. Cuatrecasas-Arbós, Fortuny-Santos 2006, p. 529; cf. Hira 2005) or by transferring non-core functions to external firms and focusing on main functions (*offshore outsourcing*).

Seeking to lower costs of employment, companies exploit wage differences existing between countries among identical competences in the sectors (cf. Janko, Koch 2005, p. 10). Therefore tenfold wage difference between the U.S. and India in the sector of computer software production may be a sufficient reason to consider relocating production between these countries (McKinsey 2003, p. 1). One example of relocating economic activity from country with higher labour costs to lower ones was relocation of an Italian company – Indesit, announced in 2012. The reason was that the labour costs in Poland were four times lower than in Italy and also by the fact of a marked decline in sales (Newsweek 2012). Similarly, a French producer – Seita announced plans of business relocation to Poland in the middle of 2014. Savings caused by a marked decline in tobacco products' sales, were the main objective (Niedbał 2014). Electrolux, in turn, offered its Italian workers wage equalization with their Polish and Hungarian counterparts (see more examples: Niedbał 2014).

Lower corporate tax rates are also a stimulus for discussing relocations. In EU, the countries with the lowest corporate tax rate in 2014 were as following Bulgaria (10%), Cyprus and

Ireland (12,5%) and Lithuania with Latvia (15%). The highest rate was 35% in Malta, 33,99% in Belgium and 33,33% in France (Rzeczpospolita 2014; KPMG).

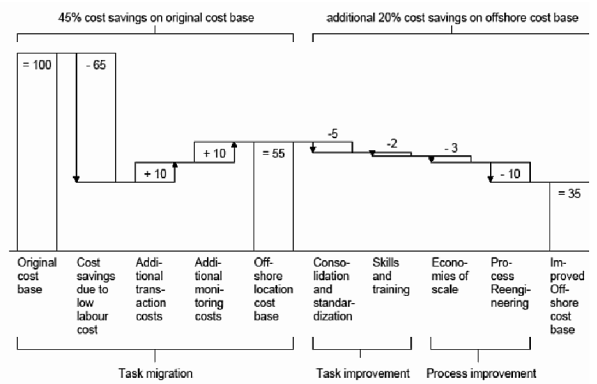
Other motive of relocation may be enterprise concentration on core competences, which is also connected with savings on running business costs. Since an enterprise transfers its non-core tasks to external providers while focusing on main competences, in other words, tasks which it can do best and most effectively, it improves functionality of existing production and develops new products and it becomes innovative (cf. Janko, Koch 2005, p. 13-14). Company development is thus a result of structure change of invested capital – by reducing capital invested in support functions the accumulated capital may be allocated to the core tasks.

The additional reason for partial or total business displacement is the diverse nature of employment connected with the segmentation of the labour market. This segmentation is caused by the division of the market into a primary market characterized by stable employment or higher wages and skills, and a secondary market with worse working conditions and salaries. As a result some jobs will have adequate supply in quantitative and qualitative terms, whereas others may remain vacant or occupied by less qualified workers, young people or immigrants. The secondary market is characterized by greater fluctuations of the labour force and uncertainty (cf. Gębski 2009, p. 330). For these reasons, motivation of workers on this unattractive market is lower and may translate into lower productivity. The economic activity relocation to country with better jobs may be a solution of this problem. One example may be relocations from developed countries to developing ones (McKinsey 2003, p. 1). As a consequence, it is observed that in comparison to workers with the same tasks in developed countries, workers in low-wage countries make fewer mistakes and serve more clients while having more transactions (McKinsey 2003, p. 1).

Significant cost savings may be generated by locating closer to client market, also the one changing location. Thus, additional reason to relocate economic activity may be economic relocation of a company being main client. Geographical proximity of both of these companies enables one of them to respond quickly on demand for new products and services. What is more, delivery time is shortened and building up stock is prevented which allows to save on storage costs (cf. Małuszyńska 2013, p. 72).

It seems that the Total Cost Offshoring model (TCO model) developed by McKinsey (2003) presents the best way to reduce the operating costs of an enterprise by *offshore outsourcing* process. This model shows the volume and the structure of savings resulting from the relocation discussed (cf. fig. 1). The starting position for company is 100, which defines costs of company's economic activity in a country of origin before relocation. Reduction of labour costs by 65 units is a result of tasks being transferred to an external firm to a host country. At the same time additional costs arise which are connected with monitoring and managing (plus 25 units). Ultimately, running a business after a relocation is 45 units cheaper than before. The next stage involves improving company functions by concentrating on main competences and using external providers to perform non-core tasks. This process allows saving 20 units. When the decision about relocation turns out to be right the improvement of enterprise activity ensues, which in turn involves the reduction of total business costs – it is 35 instead of 100 at the beginning (cf. Janko, Koch 2005, p. 11-12).

Figure. 1. Total costs of *offshore outsourcing* model.



Source: McKinsey (2013, p. 1); Janko, Koch (2005, p. 11).

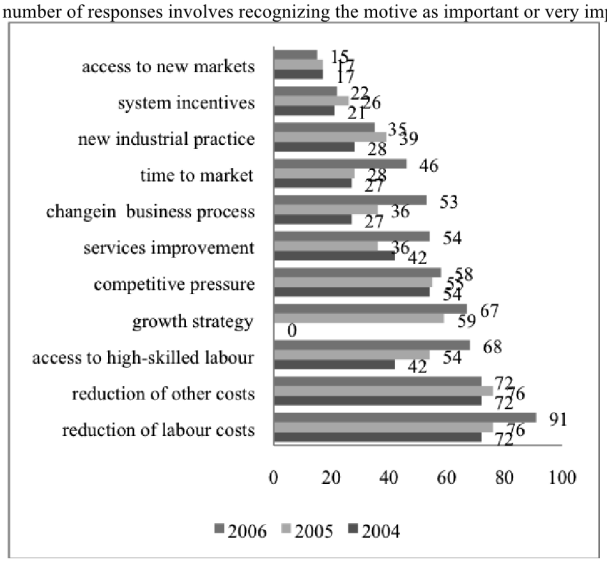
Certainly, the McKinsey model is of limited applicability. First of all, it assumes that positive results of *offshore outsourcing* will be achieved immediately after its implementation. It does not take into account time and costs of change. Secondly, model does not provide for the probability of taking wrong decisions and the resulting costs, i.e. *insourcing costs*, connected with the return of previously outsourced functions.

Even if *offshore outsourcing* eventually succeeds according to Overby (2003) there are hidden costs of this relocation i.e. assimilation of cultural differences, training of employees, know-how transfer or transaction costs. According to Computerwoche (2004) the transitional period may take up to three years (see more: Overby 2003; Computerwoche 2004, for: Janko, Koch 2005, p. 11-12). Thus, the aforementioned model is applicable to results of *offshore outsourcing* after few years since implementation provided that the decisions were correct.

It follows from the above considerations that the reduction of economic activity costs, in particular, labour costs, is the main motive behind discussed relocations. It is confirmed by research focused on changing the significance of international business relocations' motives in the U.S. and the EU countries (cf. graph 1, graph 2). Therefore, since the research concerns different periods and groups of countries it is not easily comparable. However, by analyzing it separately it is possible to notice that in the U.S. the cost factor's importance almost is not decreasing. A marked increase is observed in the labour costs factor where importance of this factor increased in 2006 by 19% in comparison with 2004, and by 15% in comparison with 2005. In the EU countries the importance of this factor decreased by 4% in 2009 in comparison with 2006 but it still seems to have little significance when compared with other less important motives.

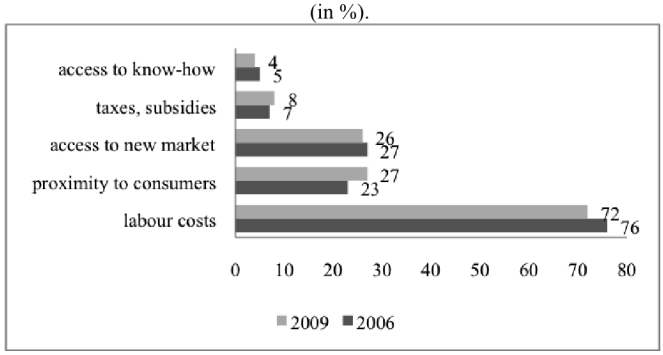
Graph 1. The change in *offshoring* motives in the U.S. during 2004-2006.

The number of responses involves recognizing the motive as important or very important (in %).



Source: Małuszyńska 2013, p. 75.

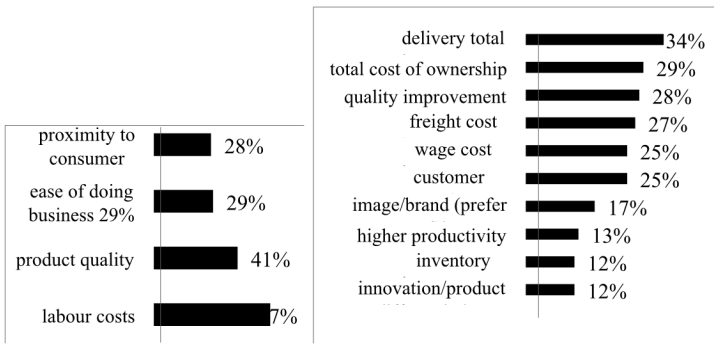
Graph 2. The change in delocalization motives validity in the EU countries during 2006-2009 (in %).



Source: Małuszyńska 2013, p. 75.

With reference to the reverse relocation, it is noticed that the increasing number of *reshoring*[21] cases results from **lower than expected cost effectiveness** arising from *offshoring* (Graebel Companies 2012). In 2012-2014, as compared to 2009-2011 more than twofold increase of the number of enterprises (from 9% to 19%) was expected to come back to home country (The Hackett Group 2012). In the Boston Consulting Group research from 2012, it was noticed that 37% of U.S. enterprises, with annual sales value exceeding 1 trillion dollars, considered relocation from China back to the U.S. Among main reasons was labour cost but also product quality, ease of doing business and proximity to consumers were cited (Needham 2014, p. 3). Results of A.T. Kearney research were similar. Among ten top motives the following were pointed out total operating costs, costs of transport, image/brand (American brand was preferred), higher capacity, innovation/improvement of product differentiation, improvement of stock (Van Den Bossche et al. 2014) (cf. graph 3).

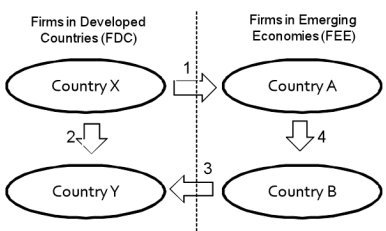
Graph 3. The reason of reshoring according to the Boston Consulting Group research (at the left) **and A.T. Kearney** (at the right).



Source: Needham 2014, p. 3; Van Den Bossche et al. 2014.

It seems that the definition of *offshoring* or *offshore outsourcing* is reduced to economic activity relocation from developed to developing countries (internal or external) as a result of recognizing cost factor as a main relocation motive (cf. Blinder 2005, p. 1; Robinson, Kalakota 2004, p. 4). However, according to Sleuwaegen et al. (2000, p. 2) and Radło (2006, p. 33-34) relocation does not always refer to the shift of economic activity from developed to developing countries because the transfer may also occur from developing to developed countries, e.g. relocation within the EU (cf. Hildebrandt 2006, p. 19; Monczka et. al 2005, for: Radło 2013, p. 20). According to Gião and Júnior (2012, p. 42-51) relocation can take place (1) from developed to emerging countries, (2) among developed countries, (3) from emerging economies to developed countries and (4) among emerging economies (cf. Fig. 3).

Figure 3. Relocation in/between developed and emerging economies



Source: Gião, Júnior (2012).

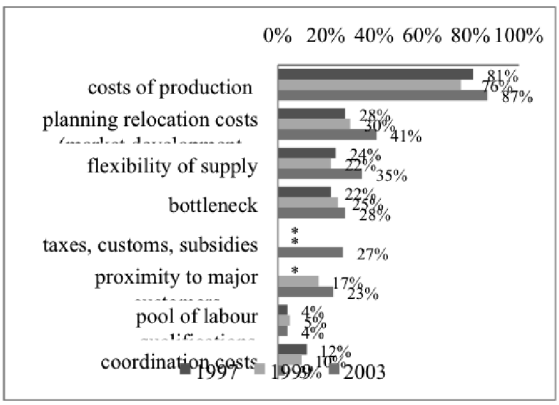
[21] *Reshoring* is a reverse of *offshoring*. See more: Needham 2014, p. 1, Fernandes 2013, Panicz 2014b.

Furthermore, the research by van Welsum (2004, p. 14-19) in respect to India as a host country, demonstrated that its attractiveness is not only determined by low labour costs but that it also stems from the following: low-skilled workers, finance structure, business environment, availability[1]. Similarly, Sleuwaegen et al. (2000, p. 2) emphasize the importance of other relocation factors, e.g. access to local market, tax benefits or know-how (Sleuwaegen et al. 2000, p. 2).

All of the above factors such as access to: know-how, external expertise, specific competences and to new technologies constitute the technical objectives of the discussed relocation. These factors are intended to increase the possibility of designing, testing and developing new products and services (Małuszyńska 2013, p. 72). According to the above mentioned research a discussed factor is quite important in the U.S. while in the EU countries it is less important (cf. graph 1 and 2). The technical motives are important for the global expansion of Chinese enterprises. The aim is to gain access to raw materials and modern technologies or new markets (Gradziuk, Szczudlik-Tatar 2012, p. 13). Energy security is also of strategic importance to Chinese enterprises because internal resources are insufficient for the needs of a growing industry.

The research carried out by the ISI Institute from Karlsruhe among German enterprises of metal and electric industry in 1997, 1999 and 2003 demonstrated that in addition to the production costs, the motives for relocation are as follows: planning relocation costs, flexibility of supply and bottleneck effects. The bottleneck effects refer to insufficient satisfaction of demand at existing productivity in a specific enterprise in Germany. The additional motives are taxes, customs and subsidies or proximity to major consumers. Less or not relevant at all to the surveyed companies are the costs of coordination, access to the pool of labour qualifications, the existence of competition and the opportunity to develop, through placement in centres where technological knowledge is available (cf. graph 4) (Kinkel, Lay 2004, p. 7-8).

Graph 4. Drivers of relocation – results of research ISI Institute from Karlsruhe.



Source: Kinkel, Lay 2004, p. 8.

Among market motives there is, in particular, a willingness to gain new markets, which could enhance the competitive position and the company image, by association with a particular supplier. Entry into new foreign markets, through economies of scale, contributes to high economic activity. Functioning on several geographic markets concurrently, i.e. territorial diversification of activities, not only enables to reduce the risk of the loss, in case of economic

[1] Such conclusions were drawn by van Welsum after analysing *offshore* location attractiveness index developed by A.T. Kearney in 2004 (for more information on methodology refer to: A.T. Kearney 2004, p. 5-9).

crises, but also increases the probability of higher gains (see more: Tomidajewicz, Panicz 2014, p. 61-77, cf. Małuszyńska 2013, p. 72).

The remaining two objectives i.e. organizational and strategic are related to the motives mentioned earlier. The organizational objectives comprise primarily the change of organizational structure towards lean management to improve management and production process controlling (Małuszyńska 2013, p. 72). The strategic objective is access to high-skilled labour and to focus on problems and core activity, allowing for the optimal use of time and resources. In addition, the enterprises seek to increase the freedom of establishment, and to select business partner as well as operating conditions. Such freedom allows the enterprises to become more flexible within the areas of their activity and to adapt to changing conditions (Małuszyńska 2013, p. 72).

Conclusion

As demonstrated by the research, relocation of economic activity is result of the labour costs and production costs or planning relocation costs (market development costs). The cost factors are vital to back relocation. However, the U.S. companies also point out the importance of technical drivers, e.g. improvement of supply time.

Another study found that the most attractive locations for a new activity should be countries with lower labour costs. In relation to relocation directions in the EU, it can be seen that relocation occurs in multiple directions, even to countries with labour costs that are higher than in the home country. This trend may be due to a business strategy, e.g. expansion into new markets, or a wish to gain highly skilled labour. The additional factor may be decreasing labour costs difference between developed and developing countries.

Finally, the concept of the lower production costs becomes more relative because taking into account all relocation factors, including, e.g. operating on the foreign market or increased transportation costs, production costs are higher in comparison to home regions. In such a case, back relocation can be observed among enterprises that did not succeed in their migration.

The aim of further research should be to analyze forward and back relocation factors but also its impact on employment at the level of one company. It seems back relocation will be more significant in low-wages host countries than another. It should be study in various branches.

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Abstract

The paper presents directions and drivers of economic activity relocation focusing, to a large extent, on cost motives. There are other motives used as points of reference in defining the importance of cost factors in comparison to other drivers. The author points out the cost factor is still important and can be translated into the fact that it is largely the NMS of the EU, characterized by lower production costs, that are host countries of relocation. Simultaneously the other motives of economic activity relocation cannot be ignored as relocation to the old Member States of the EU and to the non-EU countries is still taking place.
Key words: relocation, delocalization, relocation drivers, low-wage countries.