Swiss companies abraod : the Sixth Switzerland

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The Sixth Switzerland

One in five Swiss companies conducts business abroad. Swiss companies are responsible for creating no fewer than 1.8 million jobs outside our country. Switzerland ranks in the top league when it comes to direct investments abroad. But is this good or bad for the country itself? By Rolf Ribi

The Fifth Switzerland is, of course, the 635,000-strong community of Swiss Abroad in all corners of the globe. But what is the Sixth Switzerland? Silvio Borner, professor of economics at Basle University, coined this phrase some time ago to describe the contributions to the Swiss economy earned abroad. One in five Swiss companies is active elsewhere in the world through subsidiaries, collaborations or joint ventures (according to the Swiss trade promotion organisation Osec).

Switzerland cannot escape the current trend towards globalisation. Liberalised trade with Europe and the world is a necessity for our small country and its national economy. Even now Switzerland is "one of the most globalised countries in the world," according to Philipp M. Hildebrand, member of the governing board of the Swiss National Bank. As an example of close-knit economic ties with other countries, he cites the high percentage of gross domestic product accounted for by exports, the worldwide presence of many Swiss companies, the attractiveness of Switzerland as the European headquarters of foreign companies – and Switzerland's leading position in terms of direct investments abroad.

Global Player Credit Suisse: Head office at Paradeplatz, Zurich

In the premier league

International capital movements are a typical characteristic of economic globalisation. Every day, funds in the order of USD 3.5 billion flow around the world in the form of direct investments and equity investments. Since 1990 these international capital flows have grown at twice the rate of global trade and four times faster than the global production of goods and services. Switzerland is heavily involved in global capital exports and plays in the premier league when it comes to direct investments by companies as well as investments in securities by private investors (see box on Portolio).

The Swiss National Bank records statistics on direct investments by the Swiss business community in foreign ventures (capital exports) and foreign direct investments in our country (capital imports). According to its definition, direct investments "exercise a lasting and direct effect on a company's business activities abroad." In addition to equity capital, the bank collects statistics on loans granted by Swiss companies and income earned and re-invested by foreign subsidiaries.

According to the latest report, direct Swiss investment abroad amounted to CHF 33 billion in 2004, of which acquisitions and intragroup lending accounted for more than two thirds. Between 2000 and 2005, direct investment abroad developed as follows: CHF 75 billion in 2000, CHF 31 billion in 2001, CHF 13 billion in 2002, almost CHF 21 billion in 2003, CHF 33 billion in 2004 and an estimated CHF 53 billion in 2005.

Of the more than CHF 33 billion invested in 2004, almost CHF 22 billion flowed into the industrial sector. At CHF 12 billion, the heaviest investor was the chemical industry, mostly accounted for by acquisitions abroad. The food and construction industries as well as metal and engineering industries also undertook sizeable investment abroad. Direct investment in the service sector amounted to CHF 12 billion or CHF 2 billion less than the previous-year figure. The heaviest Swiss investors abroad, i.e. Nestlé, Novartis, Roche, UBS and Holcim, are also among the world's 100 largest investors.

Capital flow to Europe

Which countries are the main focus of these billions in Swiss direct investment? As in the previous three years, Swiss companies invested most heavily in the European economic area. At CHF 16 billion, more than half of all direct investments were made in the 25 EU member states. The most favoured countries were the UK (CHF 5 billion), the Netherlands (CHF 4 billion) and France (CHF 3 billion). A total of CHF 6 billion was invested in the USA and CHF 3 billion in Canada. The chemical industry was by far the largest Swiss investor in both countries. The main focus of Swiss direct investment in Asia was Singapore (CHF 4 billion) and Japan (CHF 1 billion). At CHF 34 billion in direct investments, North America was the most favoured region in the world in 2000.

Even more impressive than the annual direct investments is the amount of capital stock built up abroad over a century. At the end of 2004, the stock of direct Swiss investment abroad amounted to more than CHF 448 billion, of which CHF 159 billion was in the industrial sec-

Photo: Credit Suisse

tor and CHF 289 billion in the service sector. More than half of Swiss capital stock (CHF 230 billion) was located in European countries (CHF 47 billion in the UK alone), followed by North America, Central and South America at CHF 85 billion each, and Asia at CHF 34 billion.

Three yardsticks

The true dimensions of the Swiss economy's global capital involvement are reflected in the ratio of direct investments abroad to gross domestic product, the importance of capital earnings, and the number of jobs created:

■ The global stock of CHF 448 billion in direct Swiss investments abroad is virtually on a par with Switzerland's gross domestic product of CHF 446 billion. Capital invested by Switzerland abroad therefore corresponds to the total annual domestic economic performance. Measured on the basis of its economic strength, Switzerland ranks second to Luxembourg and ahead of other comparable national economies such as Sweden, Netherlands and Ireland. In absolute figures, Switzerland ranks sixth in terms of direct investments abroad. "Switzerland is one of the most important direct investors in the world," says Monika Engler of the Economic Research Unit of Credit Suisse.

■ Income from direct Swiss investments abroad amounted to CHF 51 billion in 2004, thanks to good business performance by foreign subsidiaries. This corresponds to 11 percent income measured on the basis of capital stock. Of this income, CHF 29 billion flowed back to Switzerland and CHF 22 billion was re-invested locally. Income earned on capital from direct investments abroad makes up four-fifths of Switzerland's positive balance of payments of CHF 63 billion, and a remarkable 0.5 percent of economic growth. By way of comparison, the balance of goods (export surplus) accounted for just under CHF 7 billion of the balance of payments, while services contributed CHF 27 billion (thanks to tourism and bank commission income). "Direct investments were and are of major importance for Switzerland," comments Niklaus Blattner, Vice Chairman of the Governing Board of the Swiss National Bank.

■ A surprising and less well-known yardstick is provided by the labour market. At the end of 2004, the 5,000 or so Swiss companies with capital holdings abroad employed more than 1.8 million persons: 1 million in the industrial sector and 0.8 million in the service sector (according to the Federal Office of Statistics): half the number of persons employed in Switzerland (3.6 million). The 39 Swiss companies in the Association for Industrial Holding Companies, whose members include most multinational groups, employed some 100,000 persons in Switzerland and almost one million abroad.

This raises two fundamental questions: Why are Swiss companies transferring some of their operations abroad? And: Do such outsourcing moves reduce the number of jobs available in Switzerland, thereby reducing prosperity at home?

Reasons for investments abroad

In the past, some Swiss companies outsourced parts of their company abroad for cost reasons. More than half of the 1.8 million persons employed by foreign branches of Swiss companies work in the industrial sector. This is indicative of the trend towards transferring labour-intensive production abroad. The target markets are countries in Eastern Europe, with their attractive production conditions, cheap labour costs and market potential. China and India are in the process of building up enormous industrial capacities and offer cost-effective manufacturing as well as rapidly growing home markets. According to Simone Hofer of UBS, the textile industry leads the way in outsourcing production to countries with cheap labour costs. But the same trend can be seen in the fields of electronic equipment, pharmaceuticals, software and hardware.

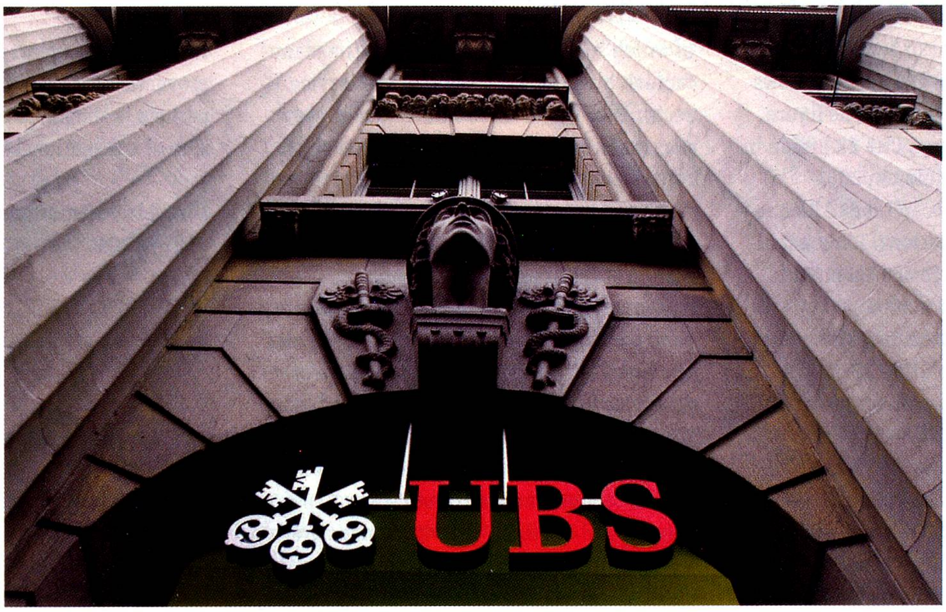
In addition to this defensive response on account of cost considerations, outsourcing is also prompted by offensive reasons i.e. the opportunity to penetrate new sales markets. Gaining new market shares abroad is now the dominant motive behind direct investment, says Serge Gaillard, Head Economist for the Swiss Federation of Trade Unions. While this poses a threat to jobs in Switzerland, demand for Swiss goods and services would quickly grow in these new production countries. Local presence is becoming increasingly important in order to hold on to market share, emphasises Simone Hofer of UBS. "Even in new markets, customers are choosy when it comes to service and customer care."

Two practical examples illustrate this point: The large and attractive US market cannot be penetrated on the strength of exports alone. Success on the American market calls for local presence, coupled with a proximity to innovative industries and leading research institutes. These were the reasons behind Swiss pharma giant Roche's decision to build a strong presence in San Francisco's Bay Area, a bastion of biotechnology. And Swiss pharma Group Novartis spent CHF 1 billion building another biotech centre in Massachusetts, on the east cost of the USA.

Yet another example is textile equipment manufacturer Rieter of Winterthur: "The markets have undergone a dramatic shift away from northern Europe and North America and towards Asia. To be closer to the customer and for cost reasons, we are expanding our production and development capacities in China and India. This has repercussions for our locations in western Europe and in Winterthur," explains CEO Hartmut Reuter.

Good or bad?

Direct investments abroad can result in a loss



Global Player UBS: Head office in Bahnhofstrasse, Zurich

Photo: Keystone

of jobs and income at home. Factory and workshop closures, redundancies and an increase in social cases in municipalities are the other side of the globalisation coin. But there are compelling arguments in favour of direct investment in industrialised countries and developing countries:

- Three quarters of Swiss direct investments abroad flow to Europe and North America. The main aim is to penetrate new markets and establish service and sales networks – not to outsource production.

- More than half of Swiss direct investments are undertaken by banks and insurance companies, as well as the chemical industry. "These are branches of industry in which Switzerland is among the world's strongest players," says Monika Engler of Credit Suisse.

- The majority of key export branches are also important direct investors. This points to the fact that direct investments abroad and export activities are often complementary.
- Outsourcing production abroad for cost reasons can boost an industrial sector. "Relatively unproductive manufacturing operations are outsourced, while areas with higher added value remain," comments economics professor Franz Jaeger in a reference to the textile industry.

- According to economics professor Silvio Borner, "The past twenty years have shown that companies which engage in a high level of direct investment also create a relatively high level of jobs in Switzerland."

- "To refrain from transferring jobs abroad out of local considerations and accept that such a decision may weaken the company may in the long run turn out to be an 'unpatriotic' move", comments Gerhard Schwarz, Business Editor of the "Neue Zürcher Zeitung".

Constraints and risks

Naturally there are constraints and risks involved with direct investment abroad. Switching to a different, foreign culture often means having to deal with different business customs and with problems of communication. The cost of entering foreign markets is usually high, and such investments frequently have to bear fruit within only a few years. The attractiveness of a production location can diminish if labour costs rise, if customers favour local providers, or ecological problems crop up. According to Serge Gaillard, unsuccessful outsourcing projects account for roughly one third of direct investments abroad.

Globalisation can also falter if policy makers accede to appeals for protectionist measures in key countries. Against this backdrop, comments Philipp M. Hildebrand of the Swiss National Bank, "a reverse trend away from globalisation is not out of the question."

DOCUMENTATION
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FOREIGN DIRECT INVESTMENT IN SWITZERLAND

Foreign direct investment in Switzerland was less dynamic than capital exports but shows significant fluctuations: In 2000 the figure amounted to CHF 32 billion, CHF 22 billion in 2003 and a mere CHF 1 billion in 2004 (mainly accounted for by capital and loan repayments abroad). The National Bank anticipates some CHF 7 billion in capital imports from foreign companies for 2005.

The stock of foreign direct investment in Switzerland amounted to CHF 222 billion (i.e. half the stock of Swiss direct investments abroad), of which CHF 109 billion was held in finance and holding companies, followed by far less significant amounts invested by trade, banks and the industrial sector. More than half of foreign capital stock in Switzerland (CHF 125 billion) was attributable to EU countries. The biggest investor in our country was the Netherlands, followed by Germany and France. Investors from the USA held CHF 89 billion or 40 percent of foreign capital stock.

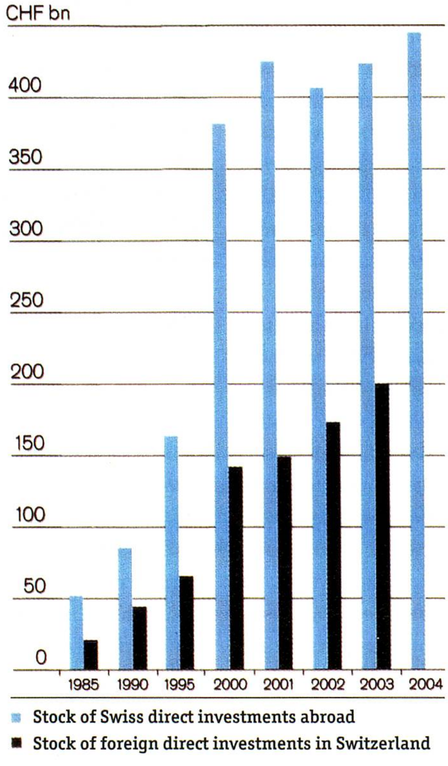
Investment income of CHF 19 billion yielded returns of 9 percent in relation to the foreign capital stock. CHF 8 billion of this amount was reinvested in Swiss subsidiaries, and CHF 11 billion was transferred to parent companies abroad. One interesting statistic recorded by the National Bank is the 167,000 personnel employed by foreign subsidiaries, of which 75,000 were employed in the manufacturing sector and 92,000 in the service sector. More than three-quarters of these persons in Switzerland were employed by European companies, and 34,000 by North American investors.

Strong foreign presence

More than 6,500 foreign companies operate their own branch offices in Switzerland, and the trend is growing. A study by the Swiss-American Chamber of Commerce examined the economic significance of these foreign companies. The key findings: foreign companies in Switzerland contribute some 10 percent or CHF 40 billion to Switzerland's gross domestic product (roughly as much as the canton of St. Gallen or the entire engineering industry), employ 210,000 persons (including 35,000 in international headquarters in Switzerland), and have accounted for virtually one quarter of economic growth over the past eight years.

More than one hundred leading foreign companies in Switzerland were questioned about Switzerland as a business location. The survey found that 90 percent would still decide on Switzerland as a location. In addition to tax considerations, Switzerland's political stability, skilled workforce, liberal job market and "economic neutrality" are highly valued factors. Respondents wanted to see an improvement in the procedure for issuing work permits, a simplification of VAT, and an expansion of international flight connections. RR

Direct Investments 1985–2004



Quelle: SNB, CS Economic Research