University Grant Program Research Report

FORIEGN TRADE AND INVESTMENT
DECISIONS OF CANADIAN COMPANIES

by

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Faculty of Commerce
and
Business Administration,
University of British Columbia.
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I. INTRODUCTION

During the spring of 1972 the Department of Industry, Trade and Commerce of the Federal Government of Canada commissioned the Faculty of Commerce and Business Administration at the University of British Columbia, Vancouver, B. C., to undertake a study of Foreign Trade and Investment Decisions of Canadian firms. This study will ultimately compare the international investment decision processes of Canadian firms with those of European, Japanese and U.S. firms, with the objective of making some useful predictions concerning future developments and Canadian successes relative to international competitors.

The study is being carried out by Dr. J.W.C. Tomlinson, Associate Professor (International Business), and Hans-Joachim Himmelsbach.

II. SELECTION OF A SAMPLE

Preliminary Research

For the purpose of obtaining a list of Canadian firms that have subsidiaries outside Canada, several sources of information were used. As a starting point firms were selected from the Canadian Trade Index (1972), published annually by the Canadian Manufacturers' Association. The Canadian Trade

Index, however, lists manufacturing firms only, so in order to obtain a broader representation of Canadian industry, the Financial Post Survey of Industrials (1972) and the Financial Post Survey of Mines were used as supplementary sources of information from which a list of firms in the service and mineral industries was obtained. Financial institutions were excluded from the sample, because their international investment decision processes are based upon criteria which are different from those of industrial corporations. Thus the inclusion of financial institutions would have tended to bias the findings untypically.

Criteria for Selection

The firms selected from the above sources of information had to meet the following criteria in order to be eligible:

a) The individual firm had to be Canadian-controlled in financial terms, in most cases this meant that more than fifty percent of the firm's outstanding common share equity had to be held by residents of Canada, and

b) The firm had to maintain physical assets (manufacturing facilities) or at least substantial minority interests outside Canada. Firms whose "foreign investments" consisted merely of sales offices abroad were not considered to be eligible for the purpose of this study.

Number of Firms Selected and Regional Breakdown

A total of 147 firms were approached located in the following regions of Canada:

Quebec	57
Ontario	83
Manitoba	3
Alberta	4
	147

Sixty-five firms participated, and interviews concerning their foreign investment experiences were completed. Information concerning eleven firms (eight from Quebec, 2 in Ontario and one Manitoba firm) was not included as they did not satisfy the criteria listed above.

The net sample of 54 firms eligible for the study was broken down into the following regions:

Quebec	14
Ontario	36
Alberta	4
	54

A number of firms were not approached, because they are small and unimportant for the purpose of this study; eight firms located in New Brunswick, Nova Scotia and Newfoundland were not interviewed because of geographical distances and time constraints faced by the researchers.

This preliminary report does not include information from firms that are still being interviewed in British Columbia. Adding the latter and taking into account some additional interviews that are to be done in Ontario, the overall sample of Canadian firms covered by this study will amount to approximately sixty-five.

An extensive questionnaire was prepared but was not mailed to individual firms, because, based on previous experience in similar studies, a poor participation rate and a poor quality of responses would have been expected. This expectation was also verified in this particular study, since corporate executives generally commented unfavourably on the method of mailing questionnaires. Instead top executives of the individual firms were interviewed personally, while the questionnaire was used as a guide and framework within which the interviews were conducted. Information was sought on six major sub-headings of the overall project. These major areas were:

I. General Classification and Description,

II. Exporting and Exports,

III. The Product Life Cycle Hypothesis,

IV. Research and Development, Licensing,

V. The Foreign Investment Decision, and

VI. Organization, Control and Evaluation.

III. GENERAL CHARACTERISTICS OF THE RESPONDENT FIRMS

a) Classification by Industry

The respondent firms were classified into the following NINE major industrial categories:

EXHIBIT 1

	Industry	No. of Firms	Percentage of Sample
1)	Food and Beverages	5	9.0%
2)	Lumber, Pulp, Newsprint and Paper	3	5.5%
3)	Primary Metals and Metal Fabrication	10	18.5%
4)	Machinery	9	17.0%
5)	Electrical and Electronics	4	7.0%
6)	Petroleum and Coal Products	3	5.5%
7)	Chemicals	2	4.0%
8)	Miscellaneous Manufacturing	9	17.0%
9)	Trade, Services and Utilities	9	17.0%

b) Ownership and Control of the Canadian Parent Firm

1) Form of Ownership

The sample included eighteen public corporations whose common equity was widely held (33 1/3% of the sample) and twenty-one (39%) where it was closely held. Fourteen firms (26%) were privately owned, while one was temporarily owned by the Government of Canada.

2) Degree of Canadian Ownership

Twenty firms were wholly-owned by Canadian residents (37%); in an additional thirty-one firms a majority of the common equity (>50%) was owned by residents of Canada. Fifty percent of one firm's common share capital was owned by Canadians (2%), while residents of Canada held minority stock positions in an additional two firms (4%). Although they did not exactly meet the criteria established for the purpose of this study, these latter firms were not eliminated from the sample as effective control appeared to be in Canadian hands.

3) Degree of Control

Of the sample of fifty-four firms, fifty-three stated that the control over their decision making processes rested in Canada. The Canadian management of two of these firms appeared to have control over decisions despite the fact that Canadian shareholders held minority positions; this was possible, because the common shares were widely held among several thousands of shareholders. In the case of one firm control seemed to rest in a foreign country. A large minority share was owned by several members of a foreign family, which appeared to give them effective control over management decisions, since the majority of this firm's common equity was widely held by residents of Canada. Despite this fact it was decided not to eliminate this firm from the sample, at least during the early stages of analysis, since it met the financial definition of ownership and control adopted for the purpose of this study.

c) Size Classification

1) Assets, Revenues, Earnings

Where detailed information was obtained, the breakdown of the firms according to domestic and foreign assets, revenues and earnings before taxes was as follows:

EXHIBIT 2

	DOMESTIC OPERATIONS	(NUMBER OF	FIRMS)	FOREIGN OPERATIC	
Size	Total Assets	Revenues	EBT	Total Assets	Revenues
< $1m	3	3	14*	12	13
$1m<x<$5m	8	10	10	9	17
$5m<x≤$25m	7	10	14	7	10
$25m<x≤$100m	12	13	3	5	3
$100m<x≤$250m	5	6	2	2	3
$250m<x	10	8	0	5	4
	45	50		40	+50

* includes firms operating at losses; three domestically and four abroad.

Generally, with some individual exceptions, Canadian firms have employed a relatively minor portion of their overall assets abroad, and revenues derived from foreign affiliates have been similarly restricted when compared with total revenues. Preliminary estimates show that on average the firms interviewed maintained approximately 27% of their total assets outside Canada; foreign revenues accounted for 26% of total revenues, while foreign pre-tax earnings represented approximately 25% of total earnings before taxes. Variances around these averages were very large within the sample, however.

2) Number of Employees

When firms in the sample were grouped according to number of total employees, the following results were obtained:

EXHIBIT 3

No.of Employees	Domestic Operations	Foreign Operations	Total Operatior
	NO. OF FIRMS		
NIL	0	1	0
0-100	6	19	3
100-500	16	15	14
500-1,000	7	5	10
1,000-2,500	8	4	7
2,500-5,000	7	2	4
5,000-10,000	3	2	3
10,000-25,000	4	1	7
over 25,000	2	2	5
N/A	1	3	1
	55		

As expected, in a majority of cases, the respondent firms employed a much larger organization in Canada than abroad. There were, however, some situations in which firms maintained larger operations outside Canada. Additional analysis of these preliminary findings, particularly cross-tabulation of the aggregate results presented above, will clarify this feature further.

3) Number of Product Lines

There were some problems in determining relative numbers of product lines, a major one being the difficulty of defining explicitly what constituted a product line in individual situations. Where such difficulties arose, particularly in the case of relatively diversified companies, a firm's main activity was classified as a product line.

A generalization which can be inferred from the results obtained so far is that the number of product lines maintained for domestic and export business was larger than the number of product lines offered by the firms' foreign subsidiaries. This was expected to be the situation but in several cases foreign activities were different from domestic and export business, and definitive comparisons will have to take into account such differences. Such adjustments will be made through further analysis by cross-tabulation of the preliminary data obtained.

d) Competitors and Suppliers of the Respondent Firms

1) Competition

The main competitors of Canadian firms in 31 percent of the cases were other Canadian firms, many of which were subsidiaries of foreign corporations. Many Canadian companies (29%) also faced vigorous competition from U.S. firms. Approximately twelve percent of the responding firms' products were competing with goods made within the European Economic Community, while six percent of the companies in question had world-wide competitors. The remaining respondents were competing with firms located in various countries.

2) Suppliers

i) Domestic Production:

For the majority (52%) of product lines the suppliers for the domestic production of the respondent firms were other Canadian companies, or the individual firms' own raw materials resources (e.g. mineral and forest product firms). In twenty-three percent of the cases, the main suppliers were located in the United States, nine percent in Germany, and the remainder of the firms were supplied from various countries.

ii) Foreign Production:

Twenty-seven percent of the supplies used for foreign production originated in Canada, while twenty-eight percent of the firms were supplied from the U.S. The majority of these U.S. cases were actually classified as "local" suppliers to the U.S. subsidiaries. The remaining foreign subsidiaries were supplied locally within the host countries.

e) Geographical Distribution of Foreign Investments of Canadian Firms

The fifty-four Canadian firms covered so far had 312 foreign affiliates, the majority of which were located in developed countries. The distribution by geographical areas was as follows:

EXHIBIT 4

Geographical Distribution of Foreign Subsidiaries

Area	No. of Subsidiaries	Percent of Total
U.S.	89	28%
E.E.C.	55	18%
U.K.	50	16%
Other Europe	13	4%
Africa	17	5%
Australasia	21	7%
Asia	16	5%
Latin America	33	11%
Other America	18	6%

Further refinement of the above distribution showed that ten firms (19%) had foreign investments in the U.S. only, a further twenty-five (46%) had invested exclusively in developed countries including the United States, while only nineteen companies (35%) had affiliates in developing countries, (even these companies were not exclusively in less developed countries). Most of the firms surveyed maintained subsidiaries in one or two different foreign countries as shown below:

EXHIBIT 5

No. of Different Countries Where Investments are Located

No.	No. of Parent Firms	% of Total
1	13	24%
2	15	28%
3	8	15%
4	7	13%
5	2	4%
6	3	6%
7	3	6%
11	1	2%
16	1	2%
31	1	2%

Detailed breakdowns of financial figures were readily made available for approximately twenty-five percent of the total value of foreign investments of the sample firms ($\frac{\$670m}{\$2744m}$). The largest portion of these assets, as expected, was employed in the U.S. ($611m), with England, the European Economic Community and Latin America following in order of importance. Companies that did not supply detailed geographical breakdowns of the values of their various foreign investments revealed only total figures which aggregated $1,357 million. Thus the sample covered by this survey represented approximately sixty percent of total foreign investment by Canadian industrial firms (estimated at $4,660 million). The above figure excluded some large firms, and some smaller, mostly private companies which refused to breakdown domestic and foreign assets. There were also some companies with sizeable foreign investments which this survey did not cover; while some additional firms are yet to be visited and their data will be incorporated at a later stage. On the basis of our information it appears that Canadian-owned firms are responsible for approximately ninety percent of total foreign investments by Canadian-based corporations. There is also some indication that Canadian investment within the European Economic Community is at least equalling, if not surpassing, the traditionally large Canadian investment in England, in numbers as well as in importance. Canadian firms are increasingly looking at investment opportunities in the various member countries of the European Economic Community. As the United Kingdom is now a member of the E.E.C., the growth of Canadian investment in that country seems likely to accelerate further, since, like earlier U.S. investors abroad, many Canadian firms view England as an ideal bridgehead for access to the large European market. This is due in particular to the absence of language problems and significant cultural differences between Canada and Great Britain.

IV. STAGES OF FOREIGN INVESTMENT

Preliminary findings in this section of the survey are based mainly on two questions of the questionnaire; these questions were designed to determine the historical stages of business activity which preceded the individual decisions to commence assembly or full manufacturing operations abroad.

The largest single group of respondents (33 1/3%) had skipped an exporting stage entirely and invested in the host countries in question without having had prior exporting experience. This high percentage was largely due to the fact that a fair number of firms within the sample were either producing non-exportable products (because of prohibitive tariffs, transportation costs and other restrictions) or services, or were companies which had expanded abroad through acquisitions. There were also some natural-resource based firms, particularly in the extractive industries, whose capital investments in certain countries were not functions of prior exports to those countries.

A further large group of firms (32%) merely exported their products to certain countries, using local independent distributors, prior to making the decision to invest in manufacturing, processing or assembly facilities.

In twenty individual cases (14%) the firms invested in sources of raw materials abroad; most of the production of those subsidiaries was then exported to third countries.

Only eight percent of the individual investments covered progressed through a combination of stages whereby the firm first exported to a host country using local independent distributors, then established a local sales office and finally set up assembly and full-scale manufacturing operations in the country. The remaining investments examined were scattered among a variety of other combinations of stages.

A preliminary evaluation was also carried out concerning expected trends in export sales, royalties, fees and other income derived from abroad, if the investments in question had <u>not</u> been made. Generally the responses were that "other foreign income", (usually meaning profits) was eventually higher because of the investments made (41% of the individual situations). In 25% of cases foreign source income from exports was virtually unchanged and in some cases (14%) would probably have been lower. It appeared therefore that foreign investments had only stimulated exports from Canada in fourteen percent of the cases.

Exports to the host countries declined subsequently in approximately five percent of the situations in question. Three percent of the time "other foreign income" would have been higher if the investments had not been undertaken; these were situations in which the foreign ventures were, or still are, losing propositions.

In six percent of the answers received it was stated that royalties would have been lower, while five percent of the situations revealed that royalties were unchanged, i.e. non-existent. In none of the cases would royalties have been higher.

V. THE FOREIGN INVESTMENT DECISION

a) Importance of Foreign Operations and Profitability

When asked about the degree of importance attached to their firms' international operations vis à vis competitors, the overwhelming majority of the responding executives (81%) felt that their international operations were important, and only nineteen percent saw no real importance of the foreign subsidiaries relative to the overall performance of the firms.

Relative profitability of foreign vs. domestic operations was not clear-cut. Forty percent of the firms had foreign subsidiaries which were more profitable than their domestic business, while 36% of the foreign operations were less profitable or even incurred losses. Four percent of the respondents stated that there was no difference in profitability between Canadian and foreign operations. In some cases, 16% of the sample, the performance of foreign subsidiaries could not be directly compared with domestic operations, because the firms were engaged in different business activities outside Canada.

b) Criteria Applied When Making the Foreign Investment Decision

This section attempted to assess the relative importance of various criteria which are commonly considered by companies considering investment abroad. In this preliminary report we simply describe briefly the general nature of the firms' responses when questioned on the validity of each specific factor.

1) Attractive new market potential abroad or relative saturation of the Canadian market by the firms' products were viewed as being highly important criteria for the firms' decisions to locate abroad in 84% of the situations covered. Various degrees of importance were attached to this criterion, "critical" being the dominant adjective. Only in ten percent of the decisions was it unimportant, while in six percent of the cases market potential had not made any difference.

2) Surplus Capital or Physical Assets Available to the Canadian Firm

This question was interpreted in most cases as having funds available for investment in Canada or elsewhere. The majority of the respondents (83%) viewed this as an important criterion for their investment decisions; the stress was on the adjective "important" rather than "critical" or "very important". In ten percent of the situations surplus capital was not important, and in seven percent the availability of surplus capital did not influence the decision to invest abroad.

5) Developing an Existing Export Market

For a majority of the respondent firms (56%), the further development of a market area currently serviced by exports from Canada was a very important reason for making the decision to manufacture abroad. Almost one half of these executives attached critical importance to this criterion. However, ten percent of the respondents felt that, although considered, export displacement had no influence on their decision to invest abroad while in 34% of the cases this criterion was either unimportant or not even considered.

Thus while export displacement appeared to be an important determinant for many Canadian firms, so too was the fact that they may have been producing a non-exportable product in Canada. The latter applies particularly to the service and extractive industries and to some manufacturing firms whose products could not be exported because of prohibitive transportation costs, import restrictions or other reasons.

6) Using Patents and/or Know-How

Whether the answer concerned actual patents, involving protection of secrecy of the product, or the firm's manufacturing processes and technology, two thirds of the firms questioned saw prime importance in using their technology themselves rather than sharing their know-how. Thus Canadian firms preferred direct investment abroad over licensing or the sale of technology by a wide margin, the reasons being mainly financial and legal. Most firms were not satisfied with the lower returns associated with licensing or the sale of technology, they were also aware of the difficulties and costs associated with enforcing the agreements and defending patents successfully.

7) Managerial Facilities Available

The availability of management personnel within the firm was usually an important factor in the foreign investment decision process in that sixty-eight percent of the Canadian sample described it as such. Yet it was apparently not a critical factor since more than half said it was important but not critical or very important. Only in eleven percent of the cases was the issue described as unimportant. The remainder stated that the availability of management personnel, although considered, did not influence the decision to invest.

8) Higher Return on Investment

Higher expected return on capital invested abroad relative to returns on Canadian operations was viewed as one of the most important factors influencing a firm's decision to locate abroad, with seventy percent of the answers stressing various degrees of importance. In 23% of the cases higher prospective returns did not affect the decision either way, and a mere seven percent attached no importance to higher profitability. Some of these latter were natural resource firms which felt that going abroad was a matter of survival rather than higher profitability. Others were firms whose foreign investments were parts of package deals whereby the Canadian parent firm was acquired together with its domestic and foreign subsidiaries.

9) Ready-made Opportunity

Almost two thirds of the respondents viewed this criterion -- with all its various interpretations -- as being highly important, while eighteen percent attached no importance to it. The remainder felt that it did not influence their foreign investment decision. The respondent firms discussed ready-made opportunities such as an offer made by a prospective partner, the discovery of a commercially feasible mineral deposit or oil field, or the award of an important contract. In some cases such an opportunity consisted of an incentive by the prospective host government or a disincentive created by the Federal Government in Ottawa. Thus these answers overlap somewhat with the answers to other questions.

10) Preference or Experience of (a) Senior Executive(s)

Sixty-one percent of the respondents stressed that this was an important factor in deciding upon investment abroad, while eighteen percent felt that this issue was unimportant in their cases. The remaining twenty-one percent stated that the consideration of this factor did not influence their decision making process either way. The most common preferences or experiences of the senior executives who replied to this question included specific knowledge of certain foreign markets, education and international travels. In some cases proficiency in the host country's language or ethnic origins accentuated these preferences and influenced the decision making to some extent. In other cases, especially in the mining and oil industries, such experiences consisted merely of the knowledge of certain geological formations. (Thus the nickel industry had been aware of the existence of laterite deposits located almost exclusively in developing countries like the Dominion Republic, Guatemala, and Indonesia.)

11) The Availability of Local Physical Assets

This factor in part overlapped with the question on Ready-made Opportunity which meant the mere possibility of setting up manufacturing facilities. This question did, however, go a step further, because it covered situations where local manufacturing facilities, plants and equipment, land, established ore bodies and oil reserves were already available for lease or purchase, or where an existing local enterprise was available for purchase or participation. The answers to this question were relatively inconclusive. Slightly over fifty percent of the respondents attached some importance to this factor, while forty percent felt that this issue was unimportant. The remainder, although having considered it, felt that this criterion did not influence their decision.

12) Availability of Local Management

Despite the fact that the largest single group of respondents (29%) stated that this factor did not influence their decision, fifty-four percent of the respondents overall felt that the availability of local management personnel was important, though by no means critical. The remaining seventeen percent attached no importance to this issue. It is likely therefore that initially the availability of local managers may not be of prime importance. Most Canadian firms however are quite concerned about obtaining some form of local identity and being recognized as good corporate citizens of the host countries. The general pattern emerges that after Canadians have established the local operation, local personnel are trained and are eventually given managerial responsibilities with considerable degrees of autonomy. Thus at later stages the availability of local management personnel becomes more important than at the initial decision-making stages.

13) Matching Competitors

Despite the fact that the largest single group of respondents (28%) felt this factor did not influence the decision to invest abroad, and that it was unimportant to a further twenty percent, fifty-two percent of the overall responses attached various degrees of importance to the issue. In some cases the foreign investment decision was even made in order to prevent potential foreign competitors from establishing themselves and eventually entering the Canadian firms' markets. In some other situations the Canadian firm bought existing foreign companies that competed with the firm in Canada and in foreign markets.

14) Future Protection of an Existing Market

Answers to this question were inconclusive; forty-three percent of the respondents stated that this factor, though considered, did not influence their decision. Thirty-four percent felt that this issue was important, while the remaining 23% stressed that future market protection was not an important consideration.

15) Availability of Local or International Capital

Forty-one percent of the overall responses attached various degrees of importance to this factor, while thirty-eight percent felt that this issue was not important to their foreign investment decision. The balance (21%) considered this problem, but it did not influence their decision-making process either way. As will be explained in more detail below, many Canadian firms, particularly the large corporations, had no difficulties in gaining access to international money and capital markets. Several of the medium-size and smaller companies were restrained by a lack of competent management personnel rather than by lack of capital. Access to local or international capital resources nevertheless appeared to be somewhat important to the majority of the respondent firms.

16) Lower Cost Conditions

Somewhat surprisingly, the responses to this question were also rather inconclusive. Approximately forty-seven percent of the respondents stated that possible lower cost conditions did not influence their decisions, while twenty-eight percent felt that this issue was unimportant. In only twenty-four percent of the cases were lower manufacturing cost an important factor. Many executives stressed that lower production costs were not a prime consideration. The more important issue was to gain access to certain markets - for instance the European Economic Community or the U.S. - ensuring growth in sales. Many firms hoped that their increased international exposure through growth in sales would be accompanied by growth in profits. In the case of the natural resource industries the mere existence of commercially feasible mineral deposits or oil fields was a more important incentive than possibly lower production costs.

17) Overcoming Tariff or Quota Barriers

This factor was rated as being relatively unimportant in approximately fifty-three percent of the situations, while thirty-six percent of the respondents felt that the issue was important. The remaining eleven percent considered tariff or quota barriers, but their decision to invest in the individual countries was not affected by these considerations. Rather than tariffs or quotas, other official and inofficial barriers to imports from Canada were cited as having been more important. Among these were: "Buy American" policies encouraging Canadian firms to adopt a local identity through the establishment of local manufacturing or assembly operations, EXIMBANK restrictions requiring a certain amount of U.S. content; red tape in the form of required specifications or modifications, customs classification policies (particularly in the U.S. and the E.E.C.) Foreign exchange controls imposed by the local governments were also more important than tariffs and quotas. In addition, as mentioned above, prohibitive transportation costs applicable to the products in question also played a greater role in the decision making process in the cases of several firms than did tariffs and quotas.

18) Obtaining Raw Materials Or Components

This criterion was viewed as being unimportant by the majority of the firms (69%), while some twenty-one percent felt that this was an important issue. The balance of the firms (10%) stressed that this factor did not sway their decisions either way. These results were chiefly due to the fact that Canada is endowed with ample raw material resources. The firms that considered this issue to be critical were chiefly members of the natural resource industries (mining and petroleum), in particular the nickel industry which was aware of the passing of Canada's monopoly in this mineral and was paying increased attention to the large laterite deposits located in developing countries.

19) Host Government Incentives

In only fifteen percent of the cases in question did local government incentives play an important role in influencing the investment decision, while 75% of the sample felt that such incentives had no direct bearing on the investment decision itself. Other factors, such as market potential, profitability, risk,had a greater degree of influence on the decision making process. Local government incentives, although welcomed in most cases, were merely incidental. This was particularly true in developing countries, where such incentives could disappear overnight; thus "firms should not base their decisions too strongly on such incentives", as one executive explained.

20) Canadian Government Incentives

Only two percent of the sample indicated that incentives or encouragements given by the Federal Government in Ottawa had much influence on the firms' decisions to locate abroad. Ninety-eight percent saw no influence whatsoever in Canadian government incentives. Some firms even saw an inverse relationship whereby a lack of, or elimination of, incentives at home stifled future growth and forced them to establish foreign operations. Canadian oil firms channelled virtually all their foreign exploration programmes through U.S. subsidiaries because of advantages enjoyed in depletion allowances and other tax incentives in the U.S. Some mining companies also saw better returns abroad because of the recent Canadian income tax reforms which abolished some of the tax advantages enjoyed earlier by those firms. Generally corporate executives felt that the Federal Government should created a more favourable environment for the formation of multi-national firms in Canada.

Under its guidelines issued in 1968 pertaining to foreign investments by individuals, industrial corporations and financial institutions, the Federal Government has discouraged rather than encouraged overseas investments by Canadians, the U.S. being explicitly excluded from these guidelines. The extent to which these guidelines were enforced by the Department of Industry, Trade and Commerce or by the Department of Finance was not clear from the responses in this survey. There were considerable subjective comments and complaints but little specific detailed evidence either way.

21) <u>Integrating Control of Global Operations</u>

This criterion was also unimportant within the overall decision making process. Eighty-two percent of these respondents attached no importance to integration. One firm viewed this factor as being somewhat important, and the balance perceived no real influence either way.

22) <u>Other Criteria</u>

In addition to the criteria explicitly introduced many executives named some other factors which they stated were of importance for their firms' decisions to invest outside Canada. Twenty percent of the firms that supplied such supplementary comments felt the main incentive was the existence of mineral deposits abroad, mainly ore bodies and oil wells. A further sixteen percent anticipated better growth abroad or considered that the large market potential of the European Economic Community could not be ignored. Five percent of the respondents stressed that establishing a local identity eased entrance into the particular market; this was particularly true for firms which established subsidiaries in the United States. A further five percent were approached by local governments requesting their participation, and in five percent of the cases foreign military contracts necessitated local manufacture. The remaining comments touched on a variety of other factors.

c) Search and Survey of Foreign Investment Opportunities

1) Informal Contacts Abroad

The most important sources of information concerning various local situations were the parent firms' own executives who were familiar with the local scene (30%) and local contacts (28%). When measured according to relative importance, the executives' familiarity with the local environments was generally viewed as very important or important, whereas local contacts were generally considered to be critical or very important.

One third of the executives replying to the question on local contacts supplied further information on the kind of local contacts used. Twenty-seven percent of these latter firms obtained preliminary information from local agents and distributors of their products, a further twenty-seven percent were approached by prospective partners, and twenty percent were informed by local export customers. The remainder of the local contacts was distributed among local banks, local governments, associated firms and even family relatives of the chief executive.

Additional important sources of information were monitoring the operations of the firms' competitors (eleven percent) and host country government contacts (14%). Canadian government contacts, although utilized in nine percent of the cases, were generally viewed as not important; the Export Development Corporation was used occasionally and so was the Department of Industry, Trade and Commerce. Other contacts in Canada were useful in approximately six percent of the cases, but the information obtained from these sources generally had no bearing on the investment decision itself. (Canadian customers, suppliers and associated firms were the specific contacts within this category.) Finally, information from competitors was rarely obtained - in only three percent of the cases - and such information was not even considered in making the foreign investment decision.

2) Surveys

Canadian firms generally tended to be self-reliant when surveying particular investment opportunities. Fifty-six percent of the respondents had undertaken prior surveys of the particular countries through their own staff, and in eighteen percent of the cases wider international surveys were undertaken by company personnel. Unsolicited information was quite important in 24% of the situations; of these latter the majority of sources were private (80%), and the remainder constituted information received via the Canadian or host country governments.

Generally, the surveys undertaken were of short duration, usually less than one year. In some cases, however, surveys undertaken by the mining industry, consisting of exploration, engineering and feasibility studies and the development of pilot plants, had extended over many years, before a positive decision was made.

In the majority of the individual situations, once the surveys had been completed, the decision whether or not to invest usually followed almost immediately. In exceptional cases, again involving natural resource industries, the decision sometimes took longer because of lengthy negotiations concerning financing, marketing, local equity participation and other items.

d) Risk

Preliminary results in this subject area are based chiefly upon answers received to a number of more subjective questions asked during the personal interviews. The replies to those questions overlapped somewhat and most firms essentially gave one answer covering several questions. Of the total answers received the following percentages of respondents had considered these various aspects of risk:

Political situation:	30%
Commercial risk:	24%
Currency convertibility:	11%
Market penetration:	8%
Economic stability:	6%

The remaining answers were scattered over a wide range of more specific aspects of risk.

Generally, Canadian firms did not employ sophisticated models to resolve political aspects of risk. "Gut feel", "Seat-of-the-Pants" and other expressions of largely subjective evaluations of political risk were the main "techniques". Only one firm was currently in contact with a group of professors and graduate students at the Harvard Business School who were working on the development of a model dealing with political risks and their evaluation.

A much greater degree of sophistication, however, was displayed by the various firms when evaluating the much more easily quantifiable commercial and currency risk aspects. Only thirty-nine responses were received to the question on specific criteria considered when dealing with risk. The more important factors were as follows:

Return on investment:	23%
Payback:	15%
Small capital investment:	10%
Competent local partners	8%

Growth	8%
Metal grades of the mineral deposits	8%

The remaining responses were widely distributed, covering various other criteria.

When asked whether the firms had established definite threshold levels for the above criteria, fifty percent of the respondents stated that the levels applied to foreign operations were not different from those applied to domestic activities. Eleven percent of the executives stressed the need to be flexible by judging each situation on its own merits. A further eleven percent required a higher return on investment from a foreign operation in order to compensate them for the higher risk incurred. This last group of executives did not specify the profit margins required, but it appeared that the firms demanded merely "higher" margins without having established quantitative criteria. Seven percent preferred partnerships with local residents, because such a policy was believed to minimize political risk; specific policies on equity percentages were not disclosed, however. Only thirteen percent of the respondent firms had established definite, clear-cut policies concerning acceptable levels of risk. Some firms demanded a definite level of profitability which might be expressed either in profit margin or return on invested capital. A few firms had established policies concerning the percentage of their overall assets they were prepared to employ abroad or the portion of revenues they wanted to derive from outside Canada. Some firms had established guidelines on how much of the equity in the foreign subsidiaries they would be willing to turn over to local partners. A few natural resource firms tried to apply predetermined discount rates when making Discounted Cash Flow calculations.

Generally, Canadian firms were quite conscious of the political risks attached to foreign investment opportunities. Most firms would not invest in South America generally, Chile, Peru and other South American countries specifically. Three firms were not overly concerned about political risks abroad; this lack of concern was expressed through the following remarks: "We go anywhere in the world where an opportunity arises", or: "We can't do anything about political risk anyway, so we neglect this aspect entirely", and: "the only country where we were ever expropriated is Canada, so why should we worry about risks in foreign countries". The latter (firms) were mining or other natural resource companies. For various reasons several firms would not invest in some European countries or in the United States. Four firms were not willing to invest anywhere else. Two firms would not consider "the majority" of foreign countries for investment purposes, and four firms excluded most or all of the developing countries.

e) Opportunity Costs

Most firms did look at relative opportunity costs of foreign and domestic investment prospects in one way or another (66%), but they did not appear to apply any clearly-defined models for such analyses. Thirty-four percent of the firms did not compare opportunity costs, or only considered them occasionally.

The majority of the respondents (79%) viewed relative opportunity costs as important factors, even when they themselves did not attempt the specific calculations. The remaining twenty-one percent attached no importance to such comparisons.

f) Negotiation and Financing

1) Availability and Cost of Capital

A large majority of the respondents (66%) stated that lack of investment capital did not prevent their firms from investing in foreign countries. Some of these firms, as mentioned above, stressed that lack of management personnel or lack of opportunities might have been a more important impediment in some situation than lack of funds. The remainder of the firms questioned felt that lack of capital either was (or still is) a major factor (22%), or that insufficient funds had been a restraining influence upon their investment decisions in specific cases (12%).

A majority of the respondents (58%) attached no real importance to relative costs of obtaining funds in Canada or abroad for capital investments in foreign countries. The remainder (42%) stated that such costs were important within the framework of their foreign investment decision making process. Of these latter, thirty-five percent attached minor importance to this factor, eighteen percent felt that it was a very important issue, while twenty-one percent perceived it to be critical.

Most firms stressed, however, that, although the cost of capital was important, the really important issue was the availability rather than the cost of investment funds.

2) Sources of Financing

Canadian firms generally tended to finance their foreign ventures out of Canadian capital resources which were either internal funds (49%) or other Canadian funds (18%). Local or international financing was also quite important, representing approximately thirty percent of the investments. Of these latter the majority of funds was obtained from private sources (90%), and the remaining ten percent were partly financed by local governments. Local or international financing was generally obtained for large projects. The firms using these sources were usually either large corporations which enjoyed a relatively easy access to international capital and money markets, or smaller firms that entered into joint ventures or obtained debt financing through local government agencies. The medium-size firms generally financed their foreign subsidiaries - which on average were fairly small - through the use of retained earnings or by higher utilization of the parent company's debt capacity (i.e. increase in leverage). In a few cases, Canadian firms entered into consortium ventures consisting of partners of various nationalities. In other instances customers located in third countries (mainly Japan), as well as the host governments, supplied some of the investment funds and in return obtained equity or debt instruments of the operation.

VI. PARENT CONTROL OVER FOREIGN SUBSIDIARIES

Analyzing the Canadian parent firms' equity ownership in their foreign subsidiaries, we found that the majority of the respondent firms (55%) maintained wholly-owned subsidiaries abroad. Most of the executives, however, would not explicitly state that 100% ownership was a definite policy of their company, in fact they expressed their willingness to enter into joint ventures - preferably maintaining majority ownership - with local partners.

A further sixteen percent of the foreign subsidiaries were controlled by their Canadian parents who owned more than fifty percent of the shares. In twenty percent of the cases the Canadian parent firms were minority shareholders in the foreign ventures, and nine percent of the respondents maintained 50/50 joint ventures.

In most cases the remaining shares of the foreign subsidiaries were held by local individuals, corporations and governments. As mentioned above, in some cases a portion of the share capital was held by third-country nationals, notably residents of the U.S. and Japan. Consortia with partners of various nationalities, including host country interests, were quite common in the larger ventures undertaken by the mining and petroleum industries. Much less frequent were cases in which two or more Canadian firms pooled their interests in foreign ventures.

VII. PRODUCT LIFE CYCLE

Responses to this section were rather sketchy and they generally lacked quantitative figures. The majority of executives stressed that their products were rather unsophisticated and were not originally invented or developed in Canada. What the individual firms engaged in was further refinement and sophistication of either the products or the manufacturing processes. A few firms did invent or develop certain products (e.g. Arborite, combine harvesters)other developed process technology; (i.e. Canadian nickel mining and refining firms are world leaders in nickel technology).

To arrive at some results, however sketchy, the time lag between initial manufacture of the product in Canada and first export sales was calculated. This time lag ranged from "zero" to twenty years for the twenty-nine responses, resulting in an overall average of approximately four and one-half years. Taking the time lag between initial export sales and the commencement of manufacturing operations abroad, the results showed an average lag of approximately four and one-half to five years for the twenty-two cases. Two firms with unusually large time lags of forty-five and one hundred years respectively were excluded from this analysis in order to avoid an unnecessary bias.

Where applicable, (for nineteen respondents) the time lag between the start of local production and exports from that country to third countries was analyzed, and the results showed that, on average, export business with third countries started almost immediately, with the average time lag having been less than one year. It must, however, be stressed that the above results have to be interpreted with a great deal of care, because the evidence indicated that generally Canadian industry does not invent a great deal of new and revolutionary products, and that a large amount of new technology used by Canadian firms originates outside Canada.

The above statement can be confirmed to some extent by analyzing the individual firms' research and development expenditures as will be done in the next section of this preliminary report.

VIII. RESEARCH AND DEVELOPMENT AND LICENSING

a) Research and Development Spending by Canadian Firms

On average the respondent firms spent approximately two percent of their revenues on Research and Development in Canada. This amount, however, includes Federal Government research grants obtained by some of the firms. Allowing for these public contributions the above figure would be between 1.6%-1.8% of sales. Generally, exploration outlays of natural resource firms were treated as Research and Development expenditures, because executives of these firms felt that exploration was a form of R & D. However, two of these cases whose exploration expenditures were exceptionally high (twenty-two percent and fifty percent of revenues respectively) were excluded. The largest single group of respondents reported spending less than one percent of total sales on R & D in Canada.

Outside Canada the respondent firms spent approximately 2/3% of their total revenues on research and development; (exploration expenditures of the mining and oil industries included). In a few cases, the respondents conducted their entire R & D outside Canada, particularly in the U.S. The majority of the respondents (67%) did not conduct research and development outside Canada.

b) Licensing

In order to obtain some information on the determinants of licensing, as compared with investment in foreign manufacturing, firms were asked specifically whether a steadily rising level of export sales alone was likely to encourage them to consider:

i) licensing a foreign manufacturer

or ii) direct investment in manufacturing.

The answers were summarized as follows:

i) licensing a foreign manufacturer:

yes	:	26%
no	:	50%
N/A	:	24%

ii) direct investment in manufacturing:

yes	:	56%
no		20%
N/A		24%

Thus Canadian firms generally appeared not to favour licensing foreign or domestic firms. Although some of the information in this section has not yet been evaluated, the main reasons for this generally negative attitude were:

1) fear of possible legal problems, such as difficulties in defending patents against infringements or enforcing the license agreements.
2) unsatisfactory returns.
3) the firms' products or activities were not sufficiently sophisticated making licensing impossible.

IX. CONCLUDING COMMENT

This interim report has merely presented some of the information obtained during the first stage of the study in simple summary form. While the report has been prepared, another four firms in Ontario and four in B.C. have been interviewed. This data is being added to the results shown here and the whole is being put on file for computer analysis.

The most interesting results will come from further analysis using cross tabulations and correlations of the refined and detailed information which is broadly summarized here. After this analysis it will be possible to interpret our Canadian results more explicitly in terms of both theory and the current situation in Canada.

In the second stage of the study, we shall be conducting interviews with European and Japanese firms to form a basis for comparison and evaluation of the nature and determinants of foreign trade and investment decisions in different countries. The ultimate objective is to provide useful models for Canadian companies to build upon and to improve their performance in international operations.

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