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INTERNATIONAL TRADE IN SERVICES
AND THE INTERNATIONAL DEVELOPMENT
STRATEGIES OF CANADIAN SERVICE FIRMS

by

G. Garnier
University of Sherbrooke

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* I would like hereby to thank my colleague Etienne Bastin for his invaluable help with the processing and analysis of the results of the survey.

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Executive Summary

This report is divided into two parts: the first deals with the broad question of services both in the world environment and in the Canadian context. Essentially, it uses a macroeconomic approach. The second part relates to the international operations, strategies and investment policies of Canadian service firm. It uses a microeconomic approach.

Part I: Services in National Economies and in International Trade

Services are playing an increasingly important part in the economies of many countries: most of these countries are rich, industrialized countries but the same phenomenon is appearing in a few industrializing nations. In most industrialized countries, services account for between 50% and 60% of Gross National Product; in addition they provide employment for over 50% of the labor force.

It is expected that the tendency toward a service-based society will develop in the next century, however few service jobs will be in high technology, high pay sectors. The high technology service sectors will be related to information processing telecommunications and transportation.

In Canada, in 1984, services accounted for 65% of the GNP and for 64% of total employment. Some sectors are developing quite fast: information, communications, transportation. However, there are threats on some of these sectors.

Increasingly, services enter international trade: in 1980, world trade in services reached US $350 billion and is expected to grow. Some underdeveloped countries, like Singapore, are fuelling their development by exporting services. It is expected that in some sectors competition will be on a global scale and will be fierce.

At present, Canada's international trade in services is rather limited, well below its potential: it represents only 10.3% of merchandise exports. In addition, Canada imports more services than she exports, hence a deficit of several billion dollars. Exports are significant only for three categories of services: consulting and professional services, which represent more than one third of total receipts; "Insurance transactions" and "Management and administrative services" are far less important.

Part II: <u>The International Development Strategies of Canadian service firms.</u>

This part develops the results obtained through a questionnaire survey; the analysis was supplemented by a number of interviews with high ranking executives of international firms in diverse sectors. The sample which included 132 firms was broken down into four sectors: Commerce, Insurance, Finance and Other services.

1) Significant differences were found to exist between firms with international operations (the international firms) and those without such activities (domestic firms) both in the whole sample and in each of the four sectors.

Essentially:
- -international firms anticipated a lower future rate of growth of the Canadian economy than domestic firms.
- -international firms thought the regulation of their activities was more harmful to their profitability.
- -they had more customers with international operations.
- -their services were more technically advanced and complex.
- -they were more diversified.
- -they rated international activities as less risky than did domestic firms.
- -they were bigger than domestic firms.
- -there were fewer international firms which were majority owned by foreign interests.

The size of international activities varied from one sector to another: for the whole sample, foreign revenues averaged $223 millions, representing about 29% of total revenues. Finance firms had the largest percentage (37.5% of total revenues), commerce enterprises the lowest (17.9%).

International operations are conducted mainly through "exports" but sales abroad through majority-owned affiliates are almost as important a source of revenues. The United States overwhelmingly account for the largest part of foreign revenues for most firms.

International investment is rather limited in general: 90% of the responding firms have invested in the U.S. but the average number of countries in which Canadian service firms have invested is 4 (median: 2).

Canadian service firms are relatively new to the field of international investment: their foreign subsidairies, mainly US subsidiaries, operate as largely autonomous firms and are hardly integrated in the Canadian strategies.

The limits to foreign expansion come from three sources: restrictions by the foreign host countries, restrictions by Canada, and weaknesses in the firms itself. The latter should not be underrated: these limits are due essentially to a lack of resources (human and financial) but also to a lack of experience abroad.

INTERNATIONAL TRADE IN SERVICES AND THE INTERNATIONAL DEVELOPMENT STRATEGIES OF CANADIAN SERVICE FIRMS

Gérard Garnier

Definitions, Methodology and objectives of the study

1- Definitions

Service activities are extremely difficult to define precisely because they include such widely different activities as transportation, communications, wholesaling and retailing, construction, financial counseling, health services, restaurants, education, etc... Actually most official statistical bureaus define them by exclusion as being all activities other than manufacturing (secondary sector), agriculture, fisheries, and extraction (primary sector). They constitute the tertiary sector. One characteristic most of these activities have in common is that their output is of an intangible nature (hence the term of invisibles attached to trade in services in most balances of payments). Vague as it is, this will be the definition used in this report. Firms will be considered as service firms if their main activity is a service activity even if they do have other (sometimes important) activities, which often is the case in large service firms.

Service firms are not the only ones to provide services, firms in all kinds of activities produce and sometimes sell services ancillary to their other activities: this is particularly true for manufacturing firms. Government also provide services: in Canada the different governments are among the largest suppliers of services.

The measurement of the value of service activities is made particularly difficult by the fact that services are often provided between different units of the same firm rather than sold to outside firms; their value is then often not accounted for and even when it is, it is not valued on a really arm's length basis.

Most firms providing services sell them in the national market; however an increasing number of firms (service firms or others) provide their services to clients located in other countries thus giving rise to an international trade in services, similar to exports or imports of goods. However some services cannot be provided from a distance: they have to be delivered where the customer is (e.g. hotels, restaurants, etc...). When the customer is located in another country, the firms have to build permanent establishments abroad, thus giving rise to a flow of direct investment abroad. Thus most governments differentiate between trade and investment (or establishment) activities.

Statistics Canada includes the trade component of international service transactions (or parts of it) in the Current Account section of the Canadian Balance of International Payments (see Table II) and the investment component in the Direct investment flows, which are a part of the Balance of Capital. It should be noted that most international banking transactions are treated as short-term capital movements and then included in the Balance of Capital.

Diagram I

Classification of service activities according to type of organization providing them and according to market

Market in which services are provided

		Domestic	International
	Non service business firms (manufacturing, extractive, etc.)	I	II a) trade b) Investment
Organization providing service activity	Service business firms	III	IV a) trade b) Investment
	Governments (and International institutions)	V	VI

Table II also shows that the Service Transactions part of the Current Account includes more than bona fide international trade transactions: in particular, it includes "Interest and dividends" which can hardly by considered as service transactions. Rather they represent the monetary counterpart of direct investment activities (both by service and non service firms).

All the above factors are included in Diagram I which represents the total universe of service activities. This universe can be broken down by market, into a Canadian domestic market and an international market; it can also be segmented according to the type of organization providing the service: non-service business firms, service business firms and governments (or international organizations).

2- Objectives and outline of the study

One of the objectives of the present study will be to give a broad view of the whole universe of service activities, mainly of the services provided by business firms. This will be done in Part I of the study, which will describe the importance and evolution of service activities in the world, and the development of international service transactions throughout the world. Then it will concentrate on the Canadian situation: the importance of domestic service activities in the Canadian economy (quadrants I and III) will be sketched rapidly, then the international expansion of services provided abroad by Canadian business firms, either non-service firms (quadrant II (a) and (b)) or service firms (quadrant IV) will be studied in more detail. The service activities consist either of "tradeable" services or "non tradeable or investment" activities. Part I will then take a macroeconomic approach to the problem of service activities.

By opposition, Part II will be a microeconomic study centered on the international development strategies of Canadian service firms (quadrant IV, a and b). This part will include four elements:

1- An analysis of the characteristics of Canadian service firms having international transactions (either trade or investment). A sample of these "international" firms will be compared to purely "domestic" firms and an evaluation will be made of the differentiating factors.

2- An analysis of the characteristics of the international transactions of the "international" service firms, together with an analysis of the motives for international expansion and of the strategies followed by these international firms.

3- An analysis of the main obstacles which prevent Canadian service firms from increasing their international operations.

4- Suggestions will be offered to remedy the situation.

3- Methodology

Two types of methods were used to deal with the two parts of the study:

1- For Part I: an analysis of the existing litterature wasa conducted together with an analysis of the available statistics. Unfortunately the level of aggregation of the data published by Statistics Canada is too high to allow a really fine analysis of these macroeconomic data.

2- For the second part, data were collected through a questionnaire. The questionnaire was sent to a sample of 500 Canadian service firms (firms declaring to have a service activity as their main activity). The actual mailing list of firms was drawn up from two sources:

a) The 1984 Survey of Industrials, published by the Financial Post. All public service firms reported in the Survey of Industrials were included in the list.

b) The Guide to Canadian Manufacturers - 1984, published by DUN and BRADSTREET Canada, which includes smaller private firms. A certain number of private firms not included in the Financial Post Survey were drawn at random to make up the balance of 500. It should be noted that very few firms (either international or domestic) on the list have sales or revenues of less than $1 million. In this sense the sample cannot be considered as a random sample nor claim to be representative of the general population of Canadian service firms which consists overwhelmingly of very small firms. The selected sample was made up to achieve a balance of "international" and "domestic" firms of about the same size thus allowing comparisons between the two groups.

PART I: Services in National Economies and in International trade: an aggregate study

I. Phenomenal development of services activities throught the world

We are now on the threshold of a societal revolution of a fantastic magnitude which will be similar in kind to the Industrial Revolution, the one that changed the social and economic life of Europe in the middle of the 19th century and then spread to the whole world. However, there will be some differences: above all the effects of the coming Revolution will be felt much faster and they will immediately affect the vast majority of the present nations of the world. In the 1850's the Industrial Revolution involved a change from predominantly agricultural economies to highly industrialized nations in which industry was a powerful engine of growth. During that period the income level of the countries undergoing the change went considerably up together with the level of employment of their populations. The coming revolution, which some authors have labelled the Post-Industrial Revolution, will involve the transformation of highly industrialized nations into economies based primarily on services and it is anticipated that this change will bring with it an unprecedented increase in the welfare of the world.

What is causing this revolution? There are quite a number of reasons but most of them are of a technological nature: the growing importance of technology and of related services in the manufacturing process of goods, the development of communications, the increasing dependence on information.

a) Since the end of World War II, most large countries, the so called industrialized countries, have been relying on the manufacturing of goods as their main source of income, growth and employment. However, over the last twenty to twenty five years a new phenomenon has increasingly affected manufacturing, and this phenomenon is technology. Manufacturing has become quite dependent on applied scientific discoveries, what is generally known as Research and Development, to develop new products and new processes. But R & D is essentially a service activity. In addition, these new products and processes are becoming always more complex, that is more complex to produce, but also to use and to maintain. One has only to compare a present day commercial jet airliner with its 1940 counterpart to measure the technical progress which has taken place in that field in less than 50 years but also the phenomenal increase in technical complexity. It takes far more time to plan, draw and test a 1985 jet airliner than a 1940 engine powered aircraft. It also takes more time to train the crew and to maintain the aircraft. In other words, it takes more services per unit of production now than 30 or 40 years ago. A large part of what is considered as the manufacturing working force is actually providing services and this part is growing: <u>The US National Study on Trade in Services</u>(1) indicates than in 1950, production workers comprised 82% of the manufacturing workforce in the United States but that by 1980, the percentage had dropped below 70%.

In only 30 years, the percentage of the manufacturing workforce which in fact provides services has increased by 12%.

b) Actually, the importance of services to the manufacturing activities has been more important still due to the trend within manufacturing companies to contract out their service inputs to outside specialized service firms. This trend has reached such an amplitude that many firms which once had manufacturing as their main activity but which had developed a strong service sector like maintenance, repairing, information data base, etc...have found it worth their while to abandon completely their manufacturing activities in order to concentrate on supplying services to their once competitors.

The US <u>National Study on Trade in Services</u> indicates that in 1972, manufacturing firms in the United States purchased $86 billion in services in the course of producing goods valued at $587 billion and that service inputs then accounted for 15% of the value of manufacturing products in that year; this percentage is thought to have increased since then. The same study adds that according to estimates, 25% of US GNP was accounted for services used as inputs by goods producing industries.

Although we have no comparable data for Canada, it can by safely conjectured that the trend has been the same in our country even if the actual importance of services has been a little lower.

c) Another trend which explains the development of service activities is the increasing mechanization and recently the robotization of manufacturing processes. While this trend brings with it an increase in productivity per employee, it also means that the same volume of production can be realized by fewer human employees.

Unless the demand for manufactured goods increases considerably, there-by increasing the volume of production and consequently the level of employment in production, this phenomenon will mean that many workers presently employed in manufacturing will lose their jobs over the next 20 to 30 years and will constitute a pool of people looking for work. Service activities will then be the only solution to absorb the increasing number of displaced workers.

d) Probably the two most important phenomena of the last 20 years have been the fantastic development of communications on one side, of computers and information processing on the other. The joint effect of these two phenomena has given a tremendous boost to traditional service activities like banking, accounting, insurance and more generally to financial services, all activities which process mainly information. In the same time the combination of information processing capabilities and of high speed communications has created brand new service activities like satellite communications, cable television, radiotelephones, software design, bureautics, data banks, etc... In addition, the possibility to transmit information almost instantaneously anywhere in the world has favoured the international spread of service firms. This is particularly important in the banking area: it is now possible to borrow or to lend money anywhere in the world and to transfer large amounts from our country to another in a few seconds. This possibility has given a new life to the Euro-money market which now exceeds $2 trillion and which has become a truly international money market.

e) In addition to these technological developments, some recent economic and social factors are also responsible for the present and soon to come boom in service activities. In the economic sphere, the world-wide increase in income and welfare which has taken place since the end of World War II has been a strong stimulus to the demand for services. It has long been observed that a continous increase in the income level of a country results first in an increased demand for goods, particularly for manufactured goods but in the same time for services. When income reaches a certain level, the demand for goods tends to level off and the demand for services such as educational services, insurance, financial and banking services, increases rapidly. This trend is observable not only in the most developed countries but also in many poorer countries, like the Newly Industrialized countries.

f) In the social field, the spread of the international communications network, particularly of television shows, has tended to spread the western way of living everywhere in the world and its emphasis on services, thus raising the demand for similar services in many countries. This factor also contributes to the international spread of service firms which are capable of providing high quality services in countries which lack the infrastructure for getting them from local firms.

g) Another important social factor is the change in the age composition of the populations in most developed countries. These populations are now getting older and this trend will continue for the foreseable future. Older people consume less goods but require more services than younger people (one has only to think of the considerable increase in the demand for health services in most advanced countries over the last 20 years) therefore contributing to the growing demand for services.

h) Finally the growing affluence of many segments of the world population, combined with the large-scale development of transportation systems which has dramatically cut down the cost of transportation, have created an important demand for travel services and for accomodation of all kinds, mainly in poorer countries. Travel, tourism and related services thus represent a major source of earnings for many developing countries.

According to the US National Study on Trade in Services: "For the eight largest developing country exporters of services, travel and tourism was the largest category accounting for 36% of export receipts or $13.2 billion in 1980."(2)

All these factors then contribute to the growing demand for services all over the world. This trend is particularly visible in the advanced industrialized countries in which services account for over half the value of national GNP. Thus, in 1978, the share of services in the nominal GNP reached 65% in the case of Canada, 63% for the United States, 62% for Great Britain, 58% for France, 55% for Japan, 51% for Italy and 49% for the Federal Republic of Germany.(3) For all these countries, the proportion of services in the national GNP had increased from 1960 to 1978. The exceptional importance of services in the Canadian economy should be stressed.

The importance of service activities in the total value of goods and services produced by the industrialized countries is paralleled by their role as sources of employment: in several countries these activities provide well over 50% of all employment. In 1978, their share of total employment reached 65% in the U.S., 64% in Canada, 55% in the U.K., 51% in France, 48% in Japan and 48% in Germany. Of the 20 million net new jobs created in the U.S. in the 1970s, 90 percent were in services. Similarly, of the 2.7 million new jobs created in Canada during the same decade, some 2.2 million (over 80%) originated in the service sector. This phenomenon is not limited to rich industrialized countries but is spreading practically all over the world. To quote once more the US Study on Trade in Services: "For most countries in 1979 - industrialized and developing - more workers were employed in service than in either agriculture or industry. Except for some low-income countries and countries with centrally-planned economies, service sector growth outpaced other sectors in virtually all countries. More than half the workforce in 12 developing countries was employed in services. In 26 additional L.D.C., at least one third of the work force was employed in services".(4) In Singapore, still considered as an underdeveloped country, services account for 68% of G.D.P. and 69% of employment (1980).

The growing dependence of national economies on service activities then seems to be a universal phenomenon. It brings with it both promises of increased opportunities for development and threats for the future. The bright side is related to the possibility for the poorer countries to catch up with the richer countries: the service revolution may reshuffle completely the present international distribution of economic power and wealth. If the service boom develops as expected and if the presently underdeveloped countries get a good start in the coming race, they may completely bypass the industrialized stage and end up in the future group of most developed countries. The threat comes from the possibility of a delayed entrance in the service era or of a misguided positioning in the race for the top of the ladder. Both threats and opportunities apply to Canada as well as to all other countries: many countries are getting prepared for the day when there are fewer barriers to the international trade of services and therefore increased competition between firms of all nations. There will then be a fierce competition for shares of the international market but thereafter competitive positions will probably be quite difficult to change. Therefore it is of the utmost importance that Canada also gets prepared by deciding in which area she wants to have a competitive advantage: for a small country like Canada, it will probably not be possible to be in the top group in all areas. Therefore it will be important to specialize and to devote a maximum of resources to the selected areas.

This idea of specialization brings with it another notion - that of the unequal development of diverse sectors of the service industries. Although the service activities, as a group, have progressed considerably within the last 30 to 35 years, some sectors have developed much faster than the average while others have stagnated or even regressed. In addition, the future prospects for some sectors are much brighter than for others.

In this respect, one word of caution should be offered: the change from the industrial stage to the service stage will not necessarily bring with it an improvement in the standard of living of the populations nor an increase in the rate of growth of the economies. It is a possibility, nothing more. Actually, if one can rely on projections prepared for the United States by the Bureau of Labor Statistics (B.L.S.), the situation might be rather grim in about 10 years; to quote an article published in Fortune: "according to BLS projections, the greatest number of new jobs between now and 1995 will be for janitors, cashiers, waiters and waitresses, and others at the low-tech, low-pay end of the spectrum", (5) most of them in the service sector. Actually out of a projected increase of 25,600,000 jobs between 1982 and 1995, 778,000 jobs will be for janitors and 155,000 for typists.

According to BLS projections, although the "high tech, high-paying service jobs, such as computer service technician, system analyst, electrical engineer, and office machine repairer" will be the fastest growing occupations, in absolute numbers they will represent only a modest part of total employment, accounting for approximately one job out of twenty". Experts believe the situation will be similar in most advanced countries.

All that means that there will be two distinct sectors within the service area: first, a rather limited high-tech, high growth sector, probably centered around the computer, telecommunications, information processing and tranportation nexus. Then there will be a large traditional services sector probably plagued by low growth, low technology, low productivity problems. The first sector, the glamour world of telecommunications and information and, to a lesser degree, of transportation will be characterized by a quick rate of technological change and by intense competition, both domestic and international. In this area, competition will be worldwide, pitting nations or groups of nations against other nations or groups.

A limited number of firms and of countries will probably come to dominate the world market. The importance of this sector comes not only from its own rate of growth but mainly from its impact on all other sectors, manufacturing as well as service. Several authors have characterized the coming era as the "era of information", meaning that the gathering, analysis and transmission of information will be at the heart of economic activity. In addition, the growing multinationalization of business all over the world will require the capacity of shuttling people and information quickly from one place to another, thus stressing the importance of transportation and communication.

By opposition, the traditional sector will probably know a slower growth; however there will be important sectoral differences according to the capacity of each sector to integrate the new technologies and thus to improve its productivity. Traditionally, the service sector has been considered as a low productivity growth sector. Although part of the problem is of a statistical nature in that there are problems connected with the measurement of output in services, The Background Report of the Task Force on Trade in Services offers four reasons for this situation:

1- a slower rate of increase in the amounts of capital used per employee.

2- a slower rate of increase in the quality of labor employed.

3- a slower rate of technological innovation.

4- a general inability to capture economies of scale due to the preponderance of small-sized firms.(6)

The situation for the first two factors is changing quite rapidly. According to Fortune: "Despite the myth that they are all labor-intensive businesses, service industries have been far and away the biggest buyers of the new information technology. The service sector purchased more than 80% of the $25 billion of computers, office equipment and communications equipment shipped in 1982".(7) And of course, they had to train and upgrade their personnel to use this sophisticated equipment.

Activities in the financial service sector, like commercial banking, insurance, stockbroking, investment banking, will use extensively the recent developments in information processing and transmission and will also take advantage of the growing internationalization trend in these services to fuel a rapid rate of growth. Two examples will illustrate this conclusion: the gross size of the Euromarket which can be considered as the international money market jumped from less than US $100 billion in 1970 to over US $2 trillion in 1983 and is still expected to grow. Also, the world (excluding the Eastern Bloc) insurance premium volume grew from US $20 billion in 1950 to over US $450 billion in 1981.

However, an increased utilisation of technological developments is quite different from an increased rate of technological innovation. Traditionally, the service sector has been noted for its low rate of innovation due to its very nature. Services are of an intangible nature and it is therefore very difficult to protect new ideas from being copied by competitors. Whereas in manufacturing, innovations are embodied into new products which can be given a temporary monopoly through the process of patenting, in the service area, new ideas cannot be easily protected. Service firms develop mainly expertise but expertise is embodied in some employees who can leave the firm at any time.

The consequence is that service firms have devoted little money and few resources to develop their own research capacity but have relied on R & D conducted by manufacturing firms, such as suppliers of computers or of telecommunication equipment. As long as they do use sophisticated and efficient equipment, there is no real necessity for them to conduct their own research.

The last problem, i.e. the scale of operations and consequently the size of the service firms and of the markets they serve, can be very serious in some smaller-sized countries. Several service sectors like retail and wholesale distribution, banking and insurance are characterized by important economies of scale: larger firms can spread their overhead (particularly important with the acquisiton of sophisticated equipment) over a much larger volume than smaller firms and therefore reach much lower costs. This problem is particularly important for Canada and will be discussed in the following paragraph.

II- The development of service activities in Canada

Canada boldly entered the service era some 20 to 30 years ago: services now account for a large percentage of her total production (of goods and services): in 1978, 65% of Canada's GNP was accounted for by services while 64% of total employment was in service activities. The same forces which are changing the composition of the world economy are also reshaping the Canadian economy: increasing dependence of manufacturing on R & D and on services, increased robotization and mechanization of production processes releasing a large number of workers, phenomenal development in the demand for information, communication and transportation activities, changes in the age pyramid of the population, increasing standard of living, etc...

However, once again, it should be stressed that the change to an economy oriented mainly towards services should not necessarily be construed as an improvement in the situation: this change might be a harbinger of brighter times to come, of growth and full employment - it might also be portentous of danger.

Canada should definitely steer her economy towards the high technology, high growth sectors without neglecting some of the more traditional areas like banking, insurance, education, engineering in which she has some comparative advantage. The latter areas are starting to feel the impact of the new communication and information processing technological developments and are bound to see their productivity increase.

However, in spite of interesting advantages, particularly of an innovative spirit, Canada is facing two important obstacles which will be described in more detail in the following chapters: the small size of her domestic market in several sectors on the one hand the proliferation of small sized firms catering exclusively to local markets and the resultant lack of larger sized firms capable of tackling the world market, on the other. The small size of the Canadian market means that in many sectors the most dynamic firms will have to go and compete in international markets if they are to grow. In the service sector as in the goods sector, Canada will have to fight for a share of the world market. On the other hand, the atomization of several service sectors, that is the lack of large sized firms with the resources to tackle foreign markets raises questions about Canadian firms' capacity to adopt an international strategy.

III- International trade in services

A third characteristic of services throughout the world, in addition to their growing importance in the economies of most countries, and to their sectoral growth differences, is their increasingly international character. For a long time, service firms have catered exclusively to national markets when not to a restricted local market. The cultural differences between customers of different countries, the numerous regulations imposed on service firms in most countries and the fantastic differences in these regulations from one country to another, seemed to be insuparable barriers to the international trade of services. However, in recent years, technological developments in communication and transportation, increasing standardization in the ways of living and the necessity of find new "products" to sell abroad have completely changed the situation.

According to the US National Study on Trade in Services: "the value of the world's trade in the output of service industries, excluding foreign investment earnings, is estimated to have exceeded $350 billion for in 1980".(8) This amount is still small compared to the value of $1 650 billion for merchandise trade, (hardly 21%), however it is just the beginning. From 1970 to 1980 "world services exports increased at an average compound rate of nearly 19 percent (nominal values)... This rate was not as rapid as for merchandise exports (20 percent) but substantially exceeded growth in world production (14 percent)".(9) Table I is a list of the 25 countries with the largest volume of service exports in 1980 - the 5 largest alone account for 45% of the total. It is obvious that the largest service exporting countries are also the largest merchandise exporters and that they are the major industrial countries: United States, United Kingdom, France, Germany, Italy, Japan, etc... However, it should be noted that among the 25 top service exporters eight are less industrialized countries: Mexico, Singapore, Korea, Yugoslavia, Greece, Saudi Arabia, Israel and Egypt. As a general rule these less industrialized countries have a high ratio of service exports to merchandise exports: 60% for Egypt, 56% for Israel, 50% for Yugoslavia and 46% for Mexico. Not being very industrialized, they have a limited merchandise export base and they try to make up for that deficiency with an all-out effort to export services (tourism, freight and shipping, etc...): Singapore is a particularly interesting example of one of these countries which has established itself as a worldclass trade and financial center. As more countries, presently in the underdeveloped group, get industrialized, the demand for international trade in services should grow considerably. For nationalistic as well as economic reasons, many of these countries are reluctant to allow foreign multinational firms to establish majority-owned affiliates on their territory although they need their technological and organizational knowledge. One solution is to sign technology transfer agreements between local and foreign firms: this seems to be the solution preferred by the Chinese government when dealing with foreign firms. Firms in developed countries which are ready to accept this solution might be able to obtain interesting service contracts.

In addition, the increasing affluence of several less industrialized countries tends to increase their demand for services of all kinds (education, business services, health services) which local firms often are not in a position to satisfy: the country then has to import these services. On the other hand, the affluence of the richer countries tends to develop a growing demand for tourism which then constitutes an important "export" for many less developed countries.

For all these reasons, it can be safely predicted that trade in services should grow in the coming years unless national restrictions and regulations choke its development. In practically all countries, most services are regulated by the local authorities for reasons of public order, for instance to ensure a proper level of competition or to protect the consumer, or because these sectors belong to the public or parapublic domain. However, many regulations have protectionist incidences: their intended or accidental consequence is to keep the local market to local firms. It is therefore understandable that the main service exporters, particularly the United States, have become interested in the issue of service trade liberalization and are putting some pressure on the international community, through international organizations, to have this question discussed openly. Two international bodies are presently conducting studies on the question of service trade liberalization: they are the Organization for Economic Cooperation and Development (OECD) and the GATT. The latter organization is committed to examine the question in its next round of discussion for further trade barriers reduction. It should be noted that most government and international organization make a difference between trade in services and investment and that all efforts are presently concentrated on trade liberalization to the quasi exclusion of investment. However, both issues are intimately connected and it is difficult to negotiate one issue while ignoring the other.

IV- Canada's international trade in services: an aggregate view

Canada is one of the world's most important merchandise exporters: according to IMF statistics, (Table I) Canada ranked in 8th place in 1980, with exports reaching the amount of US $67.6 billion (according to Statistics Canada, merchandise exports accounted to CAN $112.5 billion in 1984). On the other hand her performance in service export is quite disappointing: they amounted to only US $7.0 billion in 1980, placing Canada in 15th position, far behind the main service exporters like the US, the U.K., France, Germany and Japan, but also behind smaller industrialized countries like the Netherlands, Belgium, Austria and even behind Mexico.

Several disturbing factors can be noted:

1) Canada's ratio of services exports to merchanidse exports (10.3%) is one of the lowest among the 25 largest service exporters: only Saudi Arabia has a lower ratio, for very special reasons. Canada's ratio of service to merchandise exports is far below the world average of 21%.

2) Likewise her ratio of service exports to G.D.P. (2.7% in 1980) is extremely low, one of the lowest of the group of 25: only countries with large domestic markets like the US and Japan have lower ratios.

3) Canada is one of the few countries in the group of 25 to have a negative balance in her service account. In itself this factor is not particularly disturbing as some large exporters of services like Germany and Japan are in the same position, and have even larger deficits. However, combined with the other factors, it shows that Canada's service exports are quite low in relation to her level of income and to the importance of international trade in her economy.

In connection with this problem the Task Force on Trade in Services wrote in its <u>Background Report</u>: "It has been put to the Task Force that the Canadian deficit in "tradeable" services is not necessarily undesirabale nor symptomatic of an underlying weakness".(10) This comment seems to be overly optimistic. It is true that this deficit is not catastrophic; it is also true that some very large countries like Germany and Japan have even larger deficits in their services balances (cf. Talbe I). However it should be recognized that the situation of these two countries is slightly different from the Canadian position: they have a much stronger position in their merchandise trade and can therefore afford a deficit in services and still retain a strongly positive current account.

In addition, the <u>Background Report</u> points out that an econometric simulation was conducted by the firm INFORMETRICA for the Task Force to simulate what would happen to the Canadian economy if the deficit on the tradeable service account ($3.1 billion in 1977) was eliminated. Three scenarios were envisaged: in the first the deficit was eliminated totally in 1990, in the second it was in 1985 and in the third, the deficit was cut by half in 1990. Whatever, the scenario, the simulation indicated that real GNP would increase causing an increase in employment.(11)

Table II indicates in 1984 that the surplus in merchandise trade ($20.8 billion) was enough to cover our large deficit in services ($19.7 billion) which includes the deficit on investment income - and even allow a small surplus in the current account. Although there are changes from year to year, the situation in 1984 can be considered as typical. However, there are two disturbing factors which should be noted:

1) The large merchandise trade surplus is due exclusively to exports of raw materials and semi-finished products (agricultural products, crude materials and "fabricated materials"). On the other hand, trade in finished products (called end products) is generally characterized by a large deficit: $15.5 billion in 1984. This deficit is particularly serious in the case of sophisticated, high technology products: in 1984, trade in telecommunication equipment and electronic computers between Canada and the rest of the world showed a deficit of $8.5 billion. It was shown above that these high tech products are the key to the post-industrial society and therefore a large deficit in these products is a very disturbing factor.

To put it briefly, at present, Canada has to export large amounts of raw materials - many of which are not renewable - just to cover her deficit in practically all other areas of trade: industrial machinery, high technology products, but also services. What will happen in 40 or 50 years hence when our natural resources will approach deplition? It does not seem probable that the exports of manufactured products will grow sufficiently to make up for the deficit in the rest of the current account. One solution which should be seriously investigated is to take steps to promote increased exports of services.

2) The second point relates to the composition of the large deficit in service transactions. Most of it ($11.3 billion out of $19.7 billion) is made up of a huge discrepancy between incoming and outgoing payments of investment income. Considering the large amount of foreign direct investment in Canada and the still limited stock of Canadian investments abroad, it can be expected that this deficit in investment income is natural and will continue for some time to come. What is not natural, is the deficit in the other service items: travel and tourism and "other services".

With respect to travel and tourism, Canada's performance is far from satisfactory. It is difficult to accept that with her remarkable natural resources, Canada should not be able to attract more visitors. There is no doubt that some actions should be taken to remedy this situation.

Freight and shipping is the only service category to present a small but consistent surplus of about $0.5 billion, year after year. In spite of this encouraging situation, it is probable that this activity could be improved: a recent report suggested that Canada try to attract foreign ship-owners by granting them fiscal incentives if they would adopt a Canadian port as their home port. This is an interesting solution. Too large a percentage of our exports is shipped under foreign flags.

The most interesting account in the balance of services is the "other service transactions" which includes all kinds of transactions such as government transactions, miscellaneous income transactions but mainly business services. Once in every four years Statistics Canada conducts a survey of such business services by sending a questionnaire to all firms having conducted international transactions in these services: Table III compares the results of the 1977 and 1981 surveys, the latter being the latest for which results are available (however, previous surveys will also be mentioned in the present text).

It should be stressed that the results indicated by the 1981 survey (Receipts of $2 billion in 1981 against payments of $3.6 billion, thus resulting in a deficit of $1.6 billion) do not cover all service transactions (see Table III): however they cover most business service transactions between Canada and non-residents and as such give very important information.

Another point to be raised is that these international business service transactions are not limited to transactions carried out by service firms: in fact, in 1981, $854 million out of the total receipts of $2,011 million (42%) originated in the manufacturing sector. These $854 million represent essentially the value of payments made by foreign affiliated firms to their Canadian manufacturing parents for services rendered by the parent. Similarly, out of the $3.6 billion in payments sent from Canada to foreign firms, about $2.0 billion originated in the manufacturing sector.

The most encouraging factor to be derived from the study of statistics is that in the 12 year period from 1969 to 1981, receipts for business services increased nine-fold, twice as fast as the growth in payments: receipts increased from $218 million in 1969 to about $2 billion in 1981, while payments increased from $721 million in 1961 to $3.6 billion in 1981. However, in spite of this interesting performance the deficit on business services was multiplied by three during the same lapse of time ($503 million in 1969 - $1.6 billion in 1981).

In 1981, receipts by Canadian firms for business services offered outside Canada amounted to slightly above $2 billion. Three categories of transactions accounted for about half this amount: consulting and professional services which received $687 million dollars (34% of the total), insurance transactions with $133 million (7%) and management and administrative services ($126 million - 6%). Another large category, "other services" ($806 million) represents retroactive price adjustments in respect of tooling charges and will therefore be ignored here. Consulting and other professional services is the most dynamic component of trade in business services in addition to being the largest category: receipts for these services jumped from $29 million in 1969 to $627 million in 1981, most of the growth occuring lately, between 1977 and 1981. This is about the only category of business services in which Canada enjoys a surplus in transactions with foreign countries. Canadian consulting firms, paticularly consulting engineers and communications consultants, seem to have reached an international stature and to enjoy a good reputation in many parts of the world. They have been able to apply abroad the experience and expertise accumulated in Canada in the large energy projects completed in the 1970's as well as in the particularly stressing conditions of the northern part of the country.

Canadian consultants should be encouraged to increase their efforts to win contracts abroad: it should not be forgotten that in addition to bringing in fees, these contracts result in often substantial exports of Canadian manufactured products, thus contributing to employment in vital sectors of the economy.

Although they are not as substantial as consulting fees, insurance transactions have contributed earnings of $133 million in 1981. In the 1977-1981 period, receipts have progressed faster than payments, thus contributing to a promising decline in the deficit of the category. However not all insurance transactions are covered by the survey.

Management and administrative services have seen their deficit increase in spite of a 58% increase in receipts between 1977 and 1981. Most of these transactions (receipts as well as payments) are conducted between affiliated firms and represent payments for administrative services rendered by parent firms, to their affiliates; it is therefore difficult to determine their real value as they can hardly be considered as arm's lenght transactions. Finally it should be stressed that of the \$126 million paid by foreign firms to Canadian enterprises for management and administrative services, \$73 million (58%) were paid to manufacturing firms, and therefore only \$53 million to service firms.

Finally, "Scientific research and product development" as well as "Royalites, patents and trademarks" are characterized by much larger payments abroad than receipts, contributing together for about \$1 billion to the deficit of the business services transactions. This is a distressing situation which indicates the dependence of the Canadian economy on research and intellectual rights provided by foreign firms.

Several kinds of service transactions are missing in Table III, the most prominent being the transactions conducted by banking institutions which undoubtedly represent the largest service receipts category in the Canadian Balance of Payments. These transactions are included in part in the capital movements section of the Balance.

All in all it is almost impossible to get from official statistics enough data to have a comprehensive view of international service transactions between Canadian and foreign firms. It is still more difficult to get a picture of the international activities of Canadian service firms, partly because these activities are not limited to international trade but include also investment activities

Table IV shows the evolution between 1975 and 1980 of the total stock of Canadian direct investment abroad as well as the growth of its components, particularly in the service sector. The latter element represents direct investment carried on by service firms. Over this 5 year-period, total Canadian direct investment abroad increased by 145% whereas investments in service facilities increased by only 126% (from about $3 billion to $6.8 billion); therefore the share of service investments declined slightly. However, the remarkable fact is the considerable decline in the share of manufacturing investments abroad accompanied by a parallel increase in extractive investments.

In the service sector, Table IV reveals that financial firms have multiplied by four the size of their investments abroad in only 5 years: these investments now represent about 54% of total service direct investments and 33.5% of the grand total. On the other hand, the share of utilities in the total stock has declined considerably (from 49.7% to 21.4%). Finally, merchandising firms have multiplied their investments by 2.5 thus raising slightly their share in total service direct investments (from 13.9% to 16.1%).

Table 5 indicates the number of Canadian service firms having direct investments abroad, according to data provided by Statistics Canada, and computes the average investment in each service sector. In

1982, there were 336 Canadian service firms (an infinitesimal percentage of the total number of service firms in Canada) having are average of $23 million investment abroad; this represents a very small amount in comparison with the average direct investment in the manufacturing sector. Financial firms had the largest average ($32.3 million), with utilities and merchandising firms having average investments of respectively $16.0 million and $19 million.

PART 2: The International Development Strategies of Canadian service firms

I- General characteristics of the firms in the sample

As indicated in the introduction, 500 questionnaires were sent to relatively large Canadian firms known to provide services as their main activity. 132 questionnaires were returned and used for the analysis, giving a rate of return of over 26% which is quite satisfactory in this kind of survey. It can therefore be assumed that this subsample of 132 firms is representative of the population of large Canadian service firms.

The sample is about equally divided between "international" firms (60) which had international activities (whatever their form) in 1984, when the survey was conducted, and "domestic" firms (58) which never had any international activity. A third group was created to include firms which had international operations in the past but had terminated them at the time of the survey: this group included 14 firms (see Table VII).

Practically all service activities are represented in the sample: transportation, communications, utilities, wholesale and retail trade, banks, trust companies, insurance, real estate, stock brokers, consulting engineers, computer services, hotels, restaurants, etc... Table VI lists all these activities according to their SIC number. To facilitate analysis and allow comparisons with data published by Statistics-Canada, all firms were grouped in four activity categories:

1) Commerce which includes wholesalers and all kinds of retailers; services to persons, hotels and restaurants were also included in that group which numbers 23 firms.

2) Insurance, the most homogeneous group, with 33 firms (general property and liability insurance as well as life insurance).

3) Finance, which includes banks, trust companies, stock brokers, investment firms, real estate operators. The group includes 35 firms.

4) Other services which gather all other firms, mainly consulting firms and computer service enterprises but also health services, transportation, communication and public utilities. It represents 41 firms but is highly heterogeneous.

Table VII indicates their distribution between the international, domestic and past international categories.

One last characteristic of the sample is its extreme diversity. The service industries do not represent a homogeneous group, far from it. There are tremendous differences between sectors and, within each sector, between firms. One element will suffice to illustrate this diversity, the size element. Size can be measured in many ways: amount of income, value of assets, number of employees. Table IX shows the distribution of the firms in the sample between five categories of Canadian income (1983) and four sectors of activity. It should be stressed that the selection of the population limited it to 500 firms with a minimum annual amount of revenues of about $1 million, thus eliminating a lot of service firms, most of them domestic firms.

For the 117 firms which gave data on their Canadian income, revenues ranged from les than $1 million in 1983 (6 firms) to about $5 billion for some giant firms, the average being $394 million. However this average is highly influenced by a few giant firms and the median income (the most frequent) is only $80 million. It is interesting to compare the differences between sectors: the commerce sector is dominated by very large firms which gives it an average income of $977 million, the highest of the four groups. At the other extreme, the "other services", with an average income of $277 million (but median of $19 million) includes a large number of relatively small firms. Insurance and Finance stand in the middle: the latter includes some very large multinational banks but also small stockbrokers.

II- Differences between "international" and "domestic" firms

Internationalization is an element of the general strategy of a firm. The question immediately arises as to why do some firms decide to select this kind of strategy whereas others select a purely domestic strategy? The question can be expressed in different ways: what are the factors which contribute to the decision to internationalize, or else, are there some factors which allow to differentiate between international and domestic firms?

To try to answer these questions, a quantitative model based on regression analysis was set up. The dependent variable was of the binary type, taking on a value of 1 when the firm had international activities, 0 otherwise. To simplify matters, all firms which once had international activities but no longer had them (14 firms), were eliminated. Were also removed from the sample 21 firms which were more than 50% owned by foreign interests because most of them (17 out of 21) had no international operations and would thus have biased the sample. Finally only 97 firms could be integrated in the model, 51 with international activities and 46 without. The model used was a model of discriminant analysis but, due to the fact that there were only two groups, it was equivalent to a regression model on a binary variable and the usual tests on the meaning of the variables could be carried on. Two series of tests were conducted, first simple regressions between each of the explanatory variables and the dependent variable, then multiple regressions.

Twenty one explanatory factors were used; without getting into details, it can be said that they were grouped into four distinct categories:

1- growth variables, which included factors measuring the elements which could influence the growth of a dynamic firm: degree of saturation of the Canadian market, growth rate of Canadian market, degree of competition in Canada, degree of regulation of the sector of the firm, degree of concentration and of internationalization of clientele, etc...

2- profitability variables, measuring three elements: the possibility of economies of scale, the perception by the firm of relative profitability in Canada and abroad, and finally the presence or absence of monopolistic advantages related to the degree of complexity and technicality of the services provided by the firm.

3- risk variables such as degree of cyclical variation of domestic demand, degree of domestic diversification, perception of relative risks in Canada and abroad.

4- general characteristics of the firm: age, size, degree of foreign ownership.

Results obtained with bivariate and multivariate tests were very similar. Eight variables discriminated significantly international firms from domestic firms. Put in simple terms:

1- International firms anticipated a significantly lower future rate of growth of the Canadian market and were more dissatisfied with the Canadian economic performance than domestic firms.

2- International firms thought that the regulation of their activity by the government or other bodies was more harmful to their profitability than did domestic firm.

3- International firms had more customers with international operations.

4- International firms rated their services as more technically advanced and complex.

5- International firms were more diversified (by "products" or activities) at home.

6- International firms rated international activities as less risky than did domestic firms.

7- International firms were bigger in terms of Canadian revenues in 1983.

8- Surprisingly international firms were owned to a larger extent by foreign interests than domestic firms.

This latter result requires some explanation: it was mentioned earlier that all firms (21) which were more than 50% owned by foreign interests had been removed from the sample. To the extent that 17 out of these 21 (81%) had no foreign operations, it is true that a high degree of foreign ownership generally results in an absence of international transactions. However, for firms which are majority-owned by Canadian interests, the larger the percentage of the capital held by foreign interests the higher the probability of foreign operations.

The stepwise multiple regression, using all 21 independent variables, allowed to explain about 35% of the variance of the dependent variable. In terms of predictive power, the variables allowed to categorise correctly 85 of the 97 firms in the sample, that is 87.6%. A random classification would have given a corresponding percentage of 51.2%. Therefore the model has an unquestionable usefulness.

The preceding tests were conducted on the global sample (97 firms) and their results apply to all the service firms in general, whatever their particular sector.

However, it soon became obvious that there were important differences between the sectors (Commerce, Insurance, Finance, other services).

Of the eight significant variables listed above, six play an important role in the decision to internationalize, role which sometimes differs from one sector to another; it is then worthwhile exploring them in more detail.

a) The size factor:

The influence of size as a determining factor is the decision to internationalize is a hotly debated issue. Many exporters of goods are small-sized firms, however, the evidence seems to indicate that the proportion of exporters is greater among larger firms than among smaller firms. In the case of the present sample, size, measured by the amount of Canadian income in 1983 was statistically significant as an explanatory variable. That means that the international firms of the sample are larger than the purely domestic ones: in 1983, the former averaged annual sales of $624 million compared to an average of $225 million for the latter. The difference is statistically significant.

In addition in the sample, there is a larger percentage of domestic firms among the smaller-sized firms (that is with revenues of up to $10 million): 30% of domestic firms are in that category against 17% for international firms. For medium-sized firms (with revenues between $11 and $200 million), the percentage is the same in both categories. Finally, for very large firms (over $1 billion), the proportion of international firms is higher: 17% against 6%.

The influence of size comes from the fact that it is a proxy for the amount of resources available to the firm: the larger the firm, the more resources of all kinds, financial, technical but also human, it can gather. This is an important factor in the decision to extend activities in other countries, that is beyond the firm's traditional markets. The firm will have to tackle an unfamiliar environment with different laws and regulations, different customers. To have a chance of success it will have to devote a lot of time and resources to conquer these new markets. As will be indicated later, many firms which had to give up international activities blamed their failure on the lack of available resources.

However, before concluding definitely to a general link between size and internationalization, it should be noted that there is a strong industry influence in the size factor. When the sample is disaggregated into the four sectoral subsamples, only the Commerce and the Finance sectors (banks) show a significant relationship between size and internationalization: the relationship is not significant for insurance and other service firms.

b) Foreign ownership:

It is well known that in Canada most firms in the service sectors are Canadian-owned: this is also true of the firms in the present sample: out of 127 respondents, 77 (61%) were entirely Canadian. Surprisingly there is a slightly larger percentage of firms with some degree of foreign ownership among international firms than among domestic firms: 41% against 39%. However, in the case of international firms the degree of foreign ownership is very limited whereas in domestic firms it is rather high. In 81% of the international firms with some foreign capital, foreign ownership is limited to 50% or less of the common stock: in fact the average percentage of foreign ownership is 27% (Canadian ownership: 73%). On the other hand, Canadian capital is predominant (50% or more) in only 23% of domestic firms; the degree of foreign ownership reaches 77% on average in these firms.

The difference between international and domestic firms is particularly visible in the firms which are wholly owned or almost wholly owned (that is with at least 90% of foreign capital) by foreign interests: 64% of all domestic firms in which there is some foreign capital are in that category against only 14% in the case of international firms.

However, when the total sample is divided into sectoral subsectors, it becomes apparent that only one sector, the insurance sector, is really affected by this element. In all the other sectors, the foreign ownership question is not a crucial decisive factor between domestic and international firms as it is in the insurance sector. In the latter activity, foreign ownership is widespread, particularly in the general insurance field (property and liability insurance) in which most large firms are branches or wholly owned subsidiaries of American and British multinational groups, whereas Canadian owned firms are predominantly smaller firms. The result is that general insurance is conspicuously lacking international activities as Canadian branches are not allowed to compete against other branches of the multinational parent in foreign countries. The situation is much better in the life branch which is dominated by large Canadian firms with sometimes extensive foreigh operations.

c) Technology and complexity of services: influence of perceived technological superiority on the decision to internationalize

It is generally taken for granted that services are low technology sectors because the level of R & D conducted by member firms is quite limited. However, as was discussed in Part I, this is not always the case: it is true that service firms do not have large R & D expenditures but they rely on research conducted in other industries, like the computer industry... In that sense, all service sectors connected with computers, telecommunication equipment, benefit from the huge R & D expenditures made in these sectors. In addition, several traditional service sectors like banking, insurance and financial services are using sophisticated information processing and telecommunication equipment and can therefore be considered as capital intensive as well as technology intensive sectors. In addition several activities offer highly technical and complex services which require very competent and experienced personnel.

If the technical degree and the complexity of the services provided can be taken as a measure of the level of technological sophistication, a majority of the 131 firms of the sample can be considered as reasonably advanced: on a 7 point scale going from 1 (routine and simple work) to 7 (highly technical and complex services), the firms rated themselves mainly in the upper categories, the average for the whole sample being 5.1. However there are considerable differences between sectors: the sector with the most advanced technological level is the other services sector with an average of 5.8, followed by the Insurance sector (5.2) and the Finance (5.1), the commerce sector being the least technologically advanced (3.6). Now the real question is the following: does the level of technological sophistication allow to discriminate between international and domestic firms? For the whole sample, the answer is unambiguously positive; international firms are clearly more sophisticated that domestic ones. Put it another way, perceived technical superiority seems generally to be one of the main arguments for internationalizing. However, once again, there are differences among the sectors. Surprisingly the differences in technological intensity between international and domestic firms are significant only for the two extreme sectors: the other service sector which is the most advanced, as it includes computer software firms, engineering consultants, etc... and the least advanced, the Commerce sector. For the Insurance and Finance sectors, the differences are not significant: all firms have about the same level of sophistication.

d) Perception of the (present and future) rate of growth of the Canadian market

Most authors now agree that the decision to get into international activities, particularly the decision to invest abroad, is not generally an offensive, dynamic decision but rather a defensive one: the case of the Canadian service firms illustrate this point. Interviews with executives of a number of sample firms confirmed the conclusions reached from the analysis of the questionnaires: most service firms are very pessimistic concerning the present and mainly the future rate of growth of the Canadian demand for their services and therefore are looking outside the borders to find more dynamic markets. This fact, combined with the perspective of a buoyant demand in the USA are the primary motives for their decision to internationalize their operations. The survey data show clearly a negative relationship between the anticipations of future growth in Canada and the binary dependent variable (1: international firms, 0: domestic firms): firms which have only domestic operations have more optimistic anticipations than the international firms and the differences in anticipations is significant for the sample as a whole. However, on a sectoral basis, only the Merchandising sector shows a significant relationship. It seems that the recent acquisitions by several Canadian food wholesalers and retailers of facilities in the United States are due to their anticipation of a quasi nul growth in the Canadian population and therefore in the demand for food.

e) Internationalization, diversification and strategy:

Internationalization is an element of the strategy of diversification which is itself one of the main elements of the general strategy of a firm. It is now generally accepted that one of the basic drives of a business firm is the desire to grow; this can be achieved in two ways: either by expansion of the current activities which will be conducted simply on a larger scale or by diversification which brings the firm into new activities or new markets. Therefore there are two kinds of diversification: diversification by products or activities - which we shall denominate simply diversification - and geographical diversification into new markets, particularly into foreign markets which henceforth will be called internationalization. The basic questions are the following: first, why have some firms chosen one kind of strategy whereas others have selected the other; second, what factors contributed to the decision to internationalize and third: are the two kinds of diversification mutually exclusive or are they compatible? Only the last question will be addressed here. Answers to the other two will be given later.

Diversification is a concept which is very difficult to define and still more difficult to measure, particularly when dealing with different industries: a firm can be considered as very diversified according to the standards of one industry and rather concentrated according to the norms of another. There are several ways of measuring diversification: the easiest is to measure the number of products or services offered by the firm. However, implicit in the term is the idea of an extension of the firm into activities rather different from its core business. Two approaches were used in the present study: one consisted in determining the different sectors of activities in which the firm was operating; the second was to request the respondents to the questionnaire to gaugue the degree of diversification of their firms on a 7-point scale.

a) Without getting into details, the general impression is that service firms, particulary those covered by the analysis, are not very diversified. Of course, there are some firms which consider themselves as holding companies and which are operating in very different sectors of activities, but they are few: only 2 out of the 132 firms in the sample are considering themselves as primarily holding companies. Generally speaking, most firms have diversified into areas which are closely related to their core business: this is particularly true in the financial sectors as a consequence of the deregulation movement. For instance banks have diversified into financial services at large, into investment counseling (merchant banking), into real estate; some have ventured into petroleum activities; others have become holdings.

Insurance companies have widely diversified into pension funds, into mortgage lending and into real estate; some offer investment advisory services or even management services. Trust companies have activities very close to the banking sector, they offer loans, accept deposits, particularly savings deposits, sell some kinds of securities and of insurance policies, offer financial management services, leasing services and finally have ventured into real estate, etc... In brief, due to the deregulation movement in the financial field, different sectors which traditionally were quite segmented are now overlapping to a continuously increasing degree: this is true in the international as well as in the purely domestic areas. The most diversified service industries, with the exception of holding companies, which by definition are quite diversified, are: the transportation industry, the hotel and restaurant business, the banking and financial sectors. The most attractive sectors for diversification, that is the sectors which attract companies with other activities are, the real estate sector, the transportation, the commerce, the hotel and restaurant businesses and finally the area of services to people.

b) As to the quantitative approach, it confirms that service firms do not consider themselves as very diversified: on a 7 point scale, going from 1 = very concentrated, to 7 = very diversified, the average rating is 2.75, quite below the average.

At first sight, there seems to be differences in the subjective ratings between international and domestic firms: the former would be more diversified (average: 2.98) than purely domestic firms (average 2.53), however the difference is not statistically significant. The difference in diversification between domestic and international firms is not significant in most sectors with the exception of the other services sector which includes industries such as transportation, services to people, consulting engineers. So, with the exception of that sector, international firms are not significantly more diversified than purely domestic firms.

c) The interesting fact is that the correlation coefficient between the diversification rating and the international - domestic dichotomy is positive in general and in almost all sectors, indicating that geographic diversification is not an alternative to product or activity diversification. This confirms the fact that in the service sectors as in the manufacturing sector, the typical multinational firms is a large, diversified (in many activities), firm. However, in the present study, the correlations between product and geographic diversifications were not significant: they may be due to chance. In fact, there are many instances of firms, now international, which have grown and prospered by discovering and exploiting a special niche first in Canada then abroad: they have managed to become international in spite of limited product diversification, however this is not the general case.

f) Differences in perception of risk abroad

Another significant difference between international and domestic firms is related to their respective perception of risks abroad: purely domestic firms seem to have an inflated vision of the risks entailed by foreign operations. The difference in risk perception is particularly marked in the Finance group and, to a lesser degree, in the Insurance group: this indicated the importance of risk diversification in the financial enterprises.

In conclusion, it is now well established on the basis of the data provided by the sample that there are significant differences between international and purely domestic firms; it is also well established that these differences often differ from one sector to another. These sectoral differences were investigated by using correlation analysis; the conclusions can be summarized as follows:

1) In the Commerce (merchandising) sector, international firms anticipate a slower rate of growth of the Canadian demand for their services, they have a more international clientele and think that competition in the Canadian market is harder than to domestic firms.

2) In the Insurance sector, international firms are older, anticipate a slower rate of growth of Canadian market than domestic firms.

3) In Finance, international firms think that risk abroad is relatively lower and have a more international clientele.

4) Finally, in the other services, international firms are more diversified.

III- The international operations and strategies of Canadian service firms

Many aspects of these operations and strategies have already been discussed. The present chapter will present a few additional factors related exclusively to the operations and strategies of international firms. Four points will be developed here: international operations are relatively important for Canadian service firms - they take the form, either of exports or of foreign sales by majority - owned local affiliates - most affiliates are concentrated in the United States - finally, the international strategy of most firms is rather primitive.

1- Importance and extent of international operations

This importance can be measured in several ways, either in terms of revenues derived from foreign operations or of assets acquired abroad. The importance can also be stated in absolute or relative terms.

a) Revenues derived from foreign operations in 1983:

Foreign revenues for the firms in the sample range from about $1 million dollars to about $2 billion, with an average of $223 million. However this average is strongly influenced by a few very large firms with extensive foreign operations. The average foreign revenues differ considerably from one sector to another: surprisingly, the commercial sector has the largest foreign revenues, with an average of $458 million (due to the presence of a few very large firms); it is followed by the

Finance sector (banks) with an average of $271 million then by the Insurance field (average: $253 million). Other service firms, have more modest revenues: $63 million as an average.

b) When the amount of foreign revenues is computed as a percentage of total revenues, the results are somewhat different: for the sample as a whole, the foreign revenues account for 28.7% of total revenues but vary from a few percentage points to over 90%. The Finance firms have the highest average foreign ratio with foreign revenues accounting for 37.5% of total revenues; then come the Insurance firms (29.7%), other services (26.9%) and finally the Commerce sector (17.9%).

c) Foreign assets:

When international implication is measured in terms of foreign assets, the picture is not very different: the average foreign assets amount to $555 million for the 52 firms which have direct investments abroad, but again there are wide differences: from about $6 million to $10 billion (in 1983). Finance firms (particularly banks) have the largest average foreign assets: $1.6 billion, followed by insurance companies (average: $1.2 billion). Merchandising firms have limited foreign assets: $189 million as an average, and other services still smaller assets: $27 million. As will be seen below, these last two categories are mainly exporters of services but have few permanent establishments abroad. It should be stressed that of the 60 firms which declared having international operations, 52 have invested abroad. This shows that is is difficult to simply export services without having permanent establishments abroad.

2- Form of operations abroad

Service firms can have four kinds of international operations. First, they can deal in foreign assets from their regular Canadian offices: for example, many stockbrokers do not have foreign establishments but simply buy foreign bonds or stocks for their Canadian clients; also insurance firms can invest a certain percentage of their domestic reserves in foreign securities. This form of operations represents the minimal implication in "foreign" activities: it can be assimilated to a form of "import" of foreign assets.

The second form is represented by traditional exports: services are provided abroad from Canadian-based offices. Finally, the last two forms involve direct investment, either in affiliates majority-owned by the Canadian parent or in minority-owned affiliates.

As an average, operations on foreign assets provide only 15% of foreign-revenues: they are important only in the case of firms in the insurance (22.5%) and finance sectors.

Traditional exports represent, as an average, 33.4% of foreign revenues for the whole sample: they reach a high of 43% in the case of other services firms, a low of 15.4% in the case of Merchandising firms. Majority-owned affiliates provides 34.5% of foreign revenues as an average: they are used mainly by Commerce firms (57.6% of foreign revenues), and in a limited way in insurance firms (21%). Finally, minority-owned affiliates or ties with foreign associates account for about 15% of foreign revenues for the whole sample: this percentage varies from a low of 11% in the case of other services to a high of 21% for insurance firms.

In summary, merchandising firms use mainly majority-owned affiliates; insurance firms prefer to provide services directly from Canadian offices. Finance enterprises use about equally export and sales from majority-owned affiliates. Finally, other service firms use mainly exports.

3- Geographic distribution of international operations

a) The revenues derived from foreign operations (exports or foreign sales by local establishments) are extremely concentrated geographically. For the whole sample of 57 repondents with international operations, 41 (72%) declared that their main market was the United States, while for 6 others (10.5%) it was Great Britain. The dependence on the American market, though always important, was the highest for the firms in Finance and Insurance and the lowest for those in other services (in which only 57% considered the U.S. to be their main market). The low dependence of the latter category on the American market can be explained by the presence of consulting firms which deal mainly with underdeveloped countries.

b) In terms of investment the situation is very similar: 45 out of 50 respondents (90%) had investments in the US in which they had.

established 223 establishments out of a total of 395 establishments abroad (56%). Europe was the second most popular continent in which Canadian service firms had investments: 74 affiliates (19% of the total) were located there; 62 affiliates (16%) were established in Latin America, 23 (6%) in Asia, etc... Finally, it should be noted that Canadian service firms have invested in relatively few countries, though some banks and insurance companies have establishments in more than 20 countries. For the whole sample, the average is 4 countries, but the median is two. Firms in the other services category are the more geographically diversified with an average of 5.7 countries but with a median of 1.5 countries: a few firms are largely diversified. The least diversified category is the Commerce: average: 2.36 countries, median 1 country (most merchandising firms invest only in the U.S.).

4- Some comments on the international strategies of Canadian service firms

In addition to the survey questionnaire, many data where collected through about 20 interveiws with high ranking executives of service firms in all categories. Although it is difficult to generalize from this limited sample and although strategies differ considerably from one industry to another, the following points emerged from all these interviews:

- many executives expressed concern about the small size of the Canadian market and their anticipation of its low rate of growth. They were concerned about their firm's capacity to grow in such a context.

- on the other hand they were fascinated by the size and dynamism of the American market. Many of them were not interested by the possibility of investing in others foreign countries.

- in spite of these concerns, they stressed the importance they attached to serving Canadian customers.

- in many cases the decision to buy a foreign (American) establishment come suddenly, a little by chance, although, in several cases, the actual decision to invest abroad had been taken some years ago.

- in many cases the acquisition was recent (less than 5 years) and the foreign firm continued with its former management. In addition the new acquisition (particularly in the case of American acquisitions), seemed to operate independently with a minimum of control from the Canadian parent firm: in many cases there was no integration with the Canadian operations, no synergy. The American firm developed its own strategy, independently of the Canadian strategy.

5- Motives for investing abroad (Table X)

In the questionnaire sent to the firms, 14 motives were proposed to respondents and they had to indicate their importance for their firm on a 7 point scale running from 1 = totally unimportant to

7 = extremely important. Table X indicates the mean scores for each scale, first for the total sample, then for each of the four sectors. Although there are important differences in the ranking of the 14 motives, the broad picture is basically the same for all sectors, and confirms the data obtained during the interviews.

The size and growth potential of the foreign market is the primary factor in the decision to invest abroad. This motive is particularly important in the commercial sector, relatively less in the two financial sectors (Insurance and Finance).

As a general rule, the commercial sector stresses mainly market oriented motives: the size and growth potential of the foreign market and by opposition the limited size and growth potential of the Canadian market. This sector also seems very concerned by the level of competition in Canada and by the domestic regulations. Its primary method of investment seems to be the acquisition of existing foreign firms. Finally it is attracted abroad by the low costs of operating in some foreign countries, although this is not a primary motive for diversifying geographically.

Insurance firms and other services stress mainly their technological and managerial superiority as a decisive weapon against foreign competition. Together with the Finance sector, they stress the importance of the geographic diversification of risk. Insurance firms seem to be quite bothered by the strong competition in Canada.

Financial firms, particularly banks, seem to be the only ones to give some importance to the necessity of following Canadian customers abroad. They also put a premium on the possibility of offering in some countries services which are not available locally.

The same motive is also important to firms in the other services sector but to a lesser extent. They seem to be more motivated by their perceived technological superiority. Of the four sectors, it is the one which gives the more weight to the vertical integration of activities. This sector also gives some importance to the low level of costs in some foreign countries.

6-. Competitive advantages of Canadian firms on the international scene (Table XI)

Many reasons were offered to explain the success of Canadian service firms abroad, each kind with many subcategories. Two kinds of reasons dominate: above all the technical advantages, which take mainly the form of specialized knowledge but also of the possession of sophisticated equipment (computers) or of exclusive "products". The other main category consists of market related advantages, particularly in the form of superior service. It is interesting to note that price is rarely mentioned.

IV- Lack of foreign activities and obstacles to international expansion

This chapter will deal with three related problems which can be stated as three questions:

1- Why do some firms decide not to have international activities and limit their operations to the Canadian market?

2- Why do some firms which once had international operations decide to abandon them?

3- What are the main obstacles to the growth of international operations for firms which have already started them?

1- Reasons for a lack of foreign activities

The majority of Canadian service firms never had activities outside Canada and in all probability never will. But why is it so? The question was put to the 58 or so firms in the sample; which are only domestic; however before interpreting the following results it should be remembered that these firms are in majority large or very large firms and may not be representative of the myriad of small service firms. The many different answers were regrouped in a few categories; two of these dominate:

a) The main reason is a strategic decision to concentrate on the Canadian market because the Canadian market seemed large enough to justify such a concentration or because it presented interesting growth possibilities. This reason confirms the conclusion reached previously that a basic differentiating factor between international and domestic firm relates to their anticipations regarding the future of the Canadian economy, its future rate of growth. In turn, the difference in anticipations is related to size and perhaps to some specialization (product or geographic) of the firm.

b) A second important group of firms indicated that, being subsidiaries or agencies of foreign multinational corporations they were barred by the parent firm from having activities outside Canada.

c) A more restricted group indicated that Canadian legal restrictions prevented them for having operations abroad, for example because their licence was limited to Canada or to a province: it is the case with telephone companies, for instance,or with schedule-B banks (Canadian subsidiaries of foreign banks).

The lack of interest, or the lack of time was also cited by a small group. A few firms thought that their business was not suited for foreign operations because their services were specifically accepted to the Canadian context and could not be sold abroad. Another small group blamed their decision on a lack of resources. Very few indicated the foreign environment as a reason.

2- Reasons for dropping international activities

14 firms which had started international business decided at one time or another to drop it. The main reason invoked for their action is related to profitability: many firms mentioned an economic decline in

the foreign countries in which they were operating, a drop in the market demand for their services, causing financial loses. The second most frequent reason is related to conditions in the foreign environment: restrictive local laws, pressures by local government to gain control over their operations, negative political decisions. In third position is the lack of adequate resources human as well as financial to continue foreign operations.

3- Impediments to further expansion of foreign activities (Table XII)

There are three categories of such impediments:

a) Restrictions by the foreign host countries.

b) Restrictions by the home country.

c) Weaknesses in the business firms which contemplate expanding foreign operations.

Traditionally, all enquiries on impediments to trade in services and foreign investment have centered on the first category. All countries in the world have some kinds of restrictions. Usually these restrictions have been edicted in order to protect the public (safety rules, antimonopoly laws, etc...), however several of them have protectionist side effects: they tend to limit access to the local market to domestic firms and bar foreign firms from operating in it. In some countries, regulations have been imposed mainly for protectionist reasons.

These restrictions are now well documented: for instance the U.S. National Study on Trade in Services offers an exhaustive list of all kinds of barriers to trade in the different categories of services. This effort will not be duplicated here.

Restrictions by the home country are also well documented: the US study, the Canadian Background Report of the Task Force on Trade in Services as well as reports by other members of the GATT have discussed frankly and openly their respective legislative structures with respect to services and to the possible restrictive impact they can have on trade and investment.

The third category, that is weaknesses in the business firms themselves, is generally ignored, however important it is in practice. These weaknesses will be emphasized here. The present discussion will be centered on the data gathered by the questionnaire: Table XII indicates the main answers offered by the 60 firms which had international activities in 1983, grouped in six main categories. The three kinds of impediments to international business indicated above are present: barriers imposed by the foreign country or resulting from foreign conditions: groups 2 and 3; barriers resulting from Canadian laws, group 5; and finally weaknesses in the Canadian firm: groups 1, 4 and 6.

Quite understandably many firms insist on the barriers imposed by foreign countries, from local laws restricting the hiring of expatriates or limiting firing of local personnel, to the ultimate risk of nationalization, which quite a few firms seemed to fear. As important were limits to the growth of local operations due to local business conditions: lack of demand for the Canadian firm's services, strong competition from local and foreign firms, cultural differences resulting in a lack of interest by the local population for the services offered, exchange risk, etc... Actually many of these limits should have been investigated and discovered by the Canadian firms before entering the local market: they reflect a lack of preparation by the firms.

It is apparent from Table XII that he main impediments to foreign expansion come from limits in the Canadian firms themselves: the lack of resources, whether human or financial, is the most frequent brake to expansion of foreign operations; the lack of experience in foreign operations is another frequent weakness. Some others weaknesses are also mentioned: for example Canadian costs or interest rates are declared to be too high.

Finally, some barriers to foreign expansion are created by the Canadian environment itself, for instance tax laws discourage some kinds of foreign operations.

This analysis suggests two kinds of conclusions:

1) It would be naive to believe that the successful negotiation at a GATT meeting of total or partial elimination of all kinds of barriers to trade and investment would bring ipso facto an important increase in the volume of Canadian exports and investment in services. It is not assured that Canadian service firms are ready to tackle foreign markets. Actually several fields are characterized by a situation of

atomistic competition that is by the existence of a large number of small firms which probably do not have the resources, the knowledge nor the interest required to start foreign operations. Several countries which wanted to increase their exports of services in some specific sectors started by encouraging the merger or fusion of the predominantly small firms in a few larger groups which then were in a better position to start selling their services abroad. It is the contention of the present report that large firms with a reasonable share of the Canadian market have in general more chances to have successful and widespread international operations than smaller firms.

2) The elimination of all barriers would mean, in reverse, that foreign firms would be allowed to sell freely their services in the Canadian markets. It would be interesting to determine in more detail what impact such a move could have on the local firms and on employment. It is still too early to decide whether more open trade conditions in services would be beneficial or detrimental to Canada: many more studies are required before such a conclusion can be reached.

It would certainly be worthwhile, in the meantime, to determine in which specific sectors Canada seems to have an advantage. From the data gathered in the present study, it would seem that sectors like engineering consulting (in the field of energy and of construction in extreme conditions), banking, life insurance, computer software would enjoy a good position on world markets. Other sectors might be developed. One point worth stressing is that countries do not have a natural specific comparative advantage in some sector of the service field: they create it. The examples of Great Britain, Switzerland, France, Norway, Greece and Singapore abundantly prove that point.

V- A few recommendations

It is difficult to make recommendations for such different sectors as those which make up the service industry: actually the best recommendation would be to make surveys of each sector seperately, to determine the main problems in connection with international trade, then make specific recommendations. For the moment, it will be enough to make some rather general suggestions along the following lines:

1) The information system on all aspects of services, in particular information on their international trade and investment movements, should be improved. With the present statistical data, it is impossible to have a clear view of the international balance situation of most sectors.

2) The conditions under which the service sectors operate in Canada should also be improved and the government should strive to make these sectors more productive. This suggestion can take on several aspects:

   a) Encouragement of the high technology sectors which will be tomorrow's engines of growth: sectors like computing services and telecommunication are promising sectors but their future is not clear yet. To quote from the Background Report of the Task Force on Trade in Services: "Software could see a major trade deficit if measures were not taken to promote software development in Canada."

b) Several more traditional sectors, like banking, insurance, and financial services at large are increasingly using high tech equipment like computers and telecommunication equipment. This move will undoubtedly increase the productivity of these sectors and should be encouraged by all means.

c) Several sectors, particularly the new highly technological sectors, are characterized by an excessive number of small firms. The Background Report notes that in computer services, for instance, "a shake-out might occur later in the decade within Canada in the number of companies selling these services". In that sector, as well as in some others it would be good to encourage some concentration by favoring mergers or acquisitions in order to have some larger companies with enough resources to tackle international markets.

d) It was shown that in some sectors excessive foreign ownership can be a brake to the development of Canadian subsidiaries, mainly by preventing the latter from entering international business. Although the present tendency is toward granting foreign investors more freedom to acquire Canadian firms, it is recommended that some limits to foreign ownership be put in a few sectors considered as strategic for the development of the Canadian economy.

e) It is proposed that the government in as much as is possible, limit the number of regulations affecting Canadian service firms. The present trend is in that direction with the deregulation movement which started in the US and is now sweeping the financial and transportation systems in Canada. The deregulation movement should increase competition and improve productivity.

3) The Departments and Agencies responsible for Canadian external trade should unambiguously indicate their will to support all initiatives tending to increase our exports in services and improve our balance of services. This may mean several things:

a) That the Export Development Corporation grant more credits to and make insurance easier for service firms which manage to sell outside Canada, and that the special conditions in which these firms operate be taken specifically in consideration when engineering credit lines for export.

b) That special financial assistance be given to firms wishing to explore the possibility of selling their services in some specific foreign markets. Also that marketing assistance be given these firms in the form of market research, intelligence data, etc....

c) That the E.D.C. when arranging credit lines for exporters of goods insist that services ancillary to these exports (insurance, transportation, financing) be contracted out to Canadian service firms. Several countries offer their exporters special financial packages under the condition that these services be provided by local firms.

d) The authorities should also encourage the creation of export consortia gathering groups of firms offering complementary services or groups of merchandise exporting firms together with firms providing complementary services: e.g. a consortium grouping computer equipment manufacturers, software development firms and telecommunication consultants.

4) Canadian agencies should try to promote a certain geographical diversification in the international activities of Canadian service firms. A present most firms have concentrated their activities in one or two markets with the United States getting the lion's share. It is natural, due to physical and cultural proximity, that the United States be the most important market. However it is always dangerous to have all one's eggs in one basket. Some other foreign markets are growing fast and should not be ignored: the Japanese market is about to open up to foreign firms, the whole Pacific basin area is growing very fast, Singapore is becoming a prominent international financial center. Finally the long heralded European Common market in banking, insurance and high technology will probably come to life within a short time. Canadian firms have everything to gain by watching these developments and trying to take advantage of them.

5) Canadian agencies should try to single out the sectors in which Canada has some kind of advantage over other countries and give these sectors all possible assistance which would allow them to make a breakthrough in overseas markets. Several sectors have already be singled out in previous chapters; for instance:

a) Canada seems to be a leader in consulting services, particularly with consulting engineers. It should be possible to capitalize on that advantage and to increase our lead. This consulting sector is particularly important as it is responsible for large exports of manufactured goods and of sophisticated equipment.

b) Software equipment firms also seem to do well in foreign markets. However the government should promote software development in Canada if we want to keep the leading position we have at present.

c) Financial firms, by and large, are doing rather well. They should be encouraged to expand abroad but in the same time they should be under closer surveillance. The question of Latin America debt, these last years, has cast some doubts on the traditional prudence of Canadian bankers.

d) Tourism and all services connceted to it such as hotel and restaurant businesses, should be developed. Canada has all the natural sites required for a highly developed tourist industry but it seems that promotion abroad is insufficient to reach the many potential tourists. In addition, most hotel companies are small firms and are lacking the financial resources to develop an international network similar to the well known chains: Holiday Inns, Hilton, etc... Some countries like the United Stated, France, Great Britain have prosperous international hotel chains which contribute positively to the balance of payments of these countries.

These are some sectors which at present have rather substantial interests abroad or which are likely to develop international activities in the near future. However it should not be forgotten that there is no deterministic comparative advantage in some kinds of services. The sectors which will have important foreign activities tomorrow are those in which Canadian business firms are deciding today to explore foreign opportunities.

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Table I

The 25 largest service exporters in 1980 (1980 billions of dollars)

Country	Value of service exports	Value of foreign investment income	Value of merchandise exports (rank)	Services Balance	Services Exports to G D P ratio (%)	Services exports to merchandise Exports Ratio (%)
- United States	34.9	70.2	223.4 (1)	6.0	1.4	15.6
- United Kingdom	34.2	17.1	110.9 (4)	9.8	6.5	30.9
- France	33.0	18.4	107.6 (5)	5.5	5.1	30.7
- Germany	31.9	8.5	185.5 (2)	- 17.9	3.9	17.2
- Italy	22.4	5.3	76.8 (7)	6.2	5.7	29.2
- Japan	18.9	7.2	126.8 (3)	- 13.4	1.8	14.9
- Netherlands	17.7	10.0	67.5 (9)	0.2	10.5	26.2
- Belgium	14.5	17.6	55.2 (10)	0.5	12.1	26.3
- Spain	11.7	0.2	20.5	6.3	5.6	56.9
- Austria	10.8	2.5	17.2	5.1	14.0	62.6
- Switzerland	8.4	N.A.	29.3	1.9	8.3	28.9
- Sweden	7.5	0.8	30.7	0.5	6.0	24.3
- Mexico	7.4	1.0	16.2	0.2	4.0	45.8
- Norway	7.3	0.5	18.7	0.3	12.7	39.2
- Canada	7.0	2.9	67.6 (8)	- 2.5	2.7	10.3
- Singapore	5.9	N.A.	18.2	3.1	54.1	32.7
- Korea	4.5	0.3	17.2	0.6	7.7	26.1
- Yugoslavia	4.5	0.2	9.0	- 0.7	7.1	49.9
- Greece	4.0	*	4.1	2.6	9.9	97.2
- Saudia Arabia	3.7	N.A.	100.7 (6)	- 8.0	3.2	3.7
- Australia	3.5	0.7	21.7	- 2.5	2.5	16.2
- Israel	3.2	0.7	5.8	0.4	15.9	55.8
- South Africa	3.0	0.4	25.5	- 1.7	3.8	11.8
- Finland	2.8	0.2	14.1	*	5.6	19.6
- Egypt	2.3	0.3	3.9	0.1	9.8	60.2

* less than $ 50 million

Sources IMF: Balance of Payments Statistics - International Financial Statistics Various issues.

TABLE II

The current account in the Canadian balance of payments - 1984

(millions of dollars)

	Receipts	Payments	Balance
I- Merchandise Trade:			
- Live animals, feed, beverages and tobacco			+ 4,876
- Crude materials, non edible (petroleum, gas and minerals)			+ 9,551
- Fabricated materials, inedible			+ 18,933
- End products, inedible: of which:			- 15,490
. Telecommunication and related equipment:			(- 4,374)
. Electronic computers			(- 4,105)
- Special transactions, trade			- 1,105
- Other			+ 4,066
Merchandise Trade	112,511	91,679	+ 20,831
II- Service Transactions:			
- Travel	4,338	6,557	- 2,219
- Interest and dividends	1,805	13,072	- 11,267
- Freight and shipping	4,578	4,047	+ 531
- Other service transactions:	8,636	14,252	- 5,616
- Withholding tax		1,100	- 1,100
Total service transactions: (1)	19,357	39,028	- 19,671
III- Transfers	3,113	2,317	+ 795
IV- TOTAL CURRENT ACCOUNT	134,980	133,025	+ 1,955

(1) Balance of services: - 19,671

of which:

Non Tradeable services: - 12,367

Tradeable services: - 7,304

Source: Statistics Canada. Quarterly estimates of the Canadian Balance of International Payments. 4th quarter 1984.

TABLE III

Canada's International Trade in Services:

Results of the special surveys conducted by Statistics Canada in 1977 and 1981

(millions of dollars)

	1981 survey			1977 survey			Changes between the two surveys in % of 1977 results	
	Receipts	Payments	Balance	Receipts	Payments	Balance	Receipts	Payments
- Consulting and other professional services	687	603	84	186	130	56	269%	364%
- Management and administrative services	126	603	- 477	80	376	- 296	58%	60%
- Commissions	64	168	- 104	60	99	- 39	7%	70%
- Insurance transactions	133	203	- 70	59	158	- 99	125%	28%
- Scientific research and product development	79	280	- 201	31	190	- 159	155%	47%
- Computer services	22	63	- 41					
- Royalties, patents. trademarks and film rentals	41	769	- 728	31	460	- 429	32%	67%
- Advertising & sales promotion	40	42	- 2	28	37	- 9	43%	14%
- Equipment rentals	8	52	- 44	17	25	- 8	- 53%	108%
- Franchises and similar rights	5	12	- 7	--	11	- 11		9%
- Other services	806	189	617	342	484	- 142	136%	- 61%
- Special tooling & other automotive charges		638	- 638					
a) Total of business services and other transactions	2,011	3,622	- 1,611	834	1,970	- 1,136	141%	84%
b) Other items not covered by survey - including miscellaneous income transactions	3,822	8,019	- 4,197	1,079	976	103		
c) Government transactions	433	903	- 470	371	594	- 223		
TOTAL "Other Services" as per the Canadian balance of international payments	6,266	12,544	- 6,278	2,284	3,540	- 1,256		

TABLE IV

Stock of Canadian direct investment abroad in manufacturing and service activities: selected years (end of year)

(millions of dollars)

	Amounts			Percentages		
	1975	1978	1980	1975	1978	1980
1) - Manufacturing activities	5,315	7,619	10,794	50.5%	46.4%	41.8%
2) - Extrative (mining and petroleum)	2,220	3,986	8,245	21.1%	24.3%	32.0%
3) - Service activities:	2,991	4,817	6,761	28.4%	29.3%	26.2%
				100.0%	100.0%	100.0%
- Merchandising	417	623	1,087	13.9%	12.9%	16.1%
- Utilities:	1,488	2,058	1,449	49.7%	42.7%	21.4%
- Railways	413	522	617			
- Other utilities	1,075	1,536	832			
- Financial	831	1,788	3,626	27.8%	37.1%	53.6%
- Other enterprises	255	348	599	8.6%	7.3%	8.9%
TOTAL	10,526	16,422	25,800	100.0%	100.0%	100.0%

TABLE V

Total and sectorial stock of Canadian direct investments abroad in the service sectors: 1980 & 1982

(millions of dollars)

	Stock of direct investments in 1980 [1]	Net flows of direct investments in 1981 & 1982 [2]	Computed stock of direct investments in 1982 [3]	Number of firms in 1982 [4]	Average direct investment in 1982 [5]
- Merchandising	1,087	212	1,299	68	$ 19.1
- Financial	3,626	599	4,225	131	32.3
- Utilities	1,449	141	2,189	27	16.0
- Other entreprises	599			110	
TOTAL services	6,761	952	7,713	336	23.0

[1] - Table IV.

[2] - Quarterly estimates of the Canadian Balance of payments - 4th quarter 1984.

[4] - Data provided by Statistics Canada.

[5] - [3] ÷ [4].

TABLE VI

Detail of the activities of the sample firms - according to their SIC number

Group symbol (1)	SIC-2 digit	Description of main activity	Number of firms: Total	International firms	Domestic firms	Past international
		I- Utilities	12	6	5	1
z	50	- Transportation	5	4	-	1
z	54	- Communications	5	1	4	-
z	57	- Public utilities	2	1	1	-
		II- Trade	16	7	7	2
x	61	- Wholesalers	5	2	1	2
x	63	- Retailers: food	3	2	1	-
x	64	- Department stores	1	-	1	-
x	65	- Retailers: auto dealers	2	1	1	0
x	66	- Retailers: clothes	1	1	-	-
x	67	- " : domestic equipment	1	-	1	-
x	69	- " : jewellers and sundry	3	1	2	-
		III- Finance	68	26	36	6
o	70	- Banks and other financial intermediaries	29	10	17	2
◊	72	- Insurance	33	12	19	2
o	73	- Real estate	6	4	-	2
		IV- Miscellaneous services	36	21	10	5
z	82	- Health services	1	1	0	0
z	85	- Computer services	10	4	4	2
z	86	- Consulting engineers	18	12	4	2
x	87	- Services to persons	2	-	2	-
x	88	- Hotels and restaurants	5	4	-	1
		GRAND TOTAL	132	60	58	14

(1) Symbols of groups:

x - Commerce: N = 23, SIC groups: 61, 63, 64, 65, 66, 67, 69, 87, 88

◊ - Insurance: N = 33, SIC group: 72

o - Finance: N = 35, SIC groups: 70, 73

z - Other services: N = 41, SIC groups: 50, 54, 57, 82, 85, 86

TABLE VII

Number of international and domestic firms, by sectors in the sample

	Number of firms				Percentages			
	Total number	Have internat. operations	Used to have internat. operations	Never had	Present internat.	Past internat.	Domestic	Total
- Commerce	23	11	3	9	48%	13%	39%	100%
- Insurance	33	12	2	19	36%	6%	58%	100%
- Finance	35	14	4	17	40%	11%	49%	100%
- Other services	41	23	5	13	56%	12%	32%	100%
TOTAL	132	60	14	58	45%	11%	44%	100%

TABLE VIII

Canadian revenues in 1983 (millions of CAN $)

Canadian income (sales) 1983	Number of firms			
	Total	International firms A	Domestic B	Past international C
Less than $ 1 million	6	3	2	1
1 - 10 millions	26	5	14	7
11 - 20 "	6	3	3	-
21 - 30 "	4	3	1	-
31 - 40	5	1	3	1
41 - 50	4	2	2	-
51 - 75	6	3	3	-
76 - 100	4	1	3	-
101 - 150	13	6	6	1
151 - 200	8	3	5	-
201 - 250	6	2	3	1
251 - 300	4	1	3	-
301 - 400	9	5	3	1
401 - 500	2	2	-	-
501 - 750	2	1	1	-
751 - 1,000	-	-	-	-
1,000 - 2,000	2	1	1	-
2,001 - 3,000	4	2	1	1
3,001 - 4,000	4	3	1	-
4,001 - 5,000	2	2	-	-
Total answers	111	46	53	12
Total N/A	15	11	3	1
Average income	$ 394 millions	$ 624 millions	$ 225 millions	$ 245 millions
Median Income	80 "	130 "	64 "	9 "

- Generally firms with internat. operations are larger: there is a large proportion of firms under $ 10 millions among non-internat. firms (26% against 11%).
- However between $ 10 and $ 200 millions (middle-sized) there is the same proportion: (over $ 1 billion): 8 (17%) against 3 (6%) for non internat. This is due largely to the presence of banks.
- Without the banking sector the difference would be negligible.

TABLE IX

Canadian Income (1983) by groups of activity

Canadian income in 1983 (millions of dollars)	Number of firms				
	Total	Commerce	Insurance	Finance	Other sources
Up to 10	32	4	2	9	17
11 - 100	29	4	8	7	10
101 - 250	27	5	12	5	5
251 - 1 billion	17	1	9	5	2
over 1 billion	12	6	1	3	2
Total	117	20	32	29	36
N/A	15	3	1	6	5
Average income (million of dollars)	394.3	977.3	224.1	326.0	276.9
Median income (million of dollars)	80.0	130.5	141.0	64.0	19.0

TABLE X

Main reasons for investing abroad for the whole sample and by sectors

Scale going from 1 = Totally unimportant to 7 = extremely important

	TOTAL		COMMERCE		INSURANCE		FINANCE		OTHER SERVICES	
	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score
Size and growth potential of foreign markets	1	5.78	1	6.20	1	5.46	1	5.50	1	5.95
Advantage of technical and managerial know-how	2	4.22	5	3.90	2	4.27	4	3.43	2	4.90
Geographic diversification	3	4.09	4	4.55	4	3.27	2	4.93	4	3.70
Limited Canadian Màrket	4	3.98	3	5.00	5	3.00	3	4.00	3	4.00
Limited L.T. growth potential in Canada	5	3.87	2	5.30	3	3.82	6	3.36	5	3.55
No comparable services in some foreign countries	6	3.02	9	2.30	7	2.82	4	3.43	6	3.21
Excessive competition in Canada	7	2.82	6	3.80	5	3.00	12	2.14	8	2.68
Vertical integration of activities	8	2.72	12	2.00	9	2.55	9	2.69	6	3.21
Excessive regulations in Canada	9	2.69	6	3.80	8	2.73	11	2.36	9	2.32
Opportunity to buy foreign firm	10	2.51	8	3.67	10	2.46	8	2.71	11	1.84
Follow Canadian Customers abroad	11	2.25	11	2.10	11	2.09	7	3.00	12	1.83
Set up local joint venture abroad	12	2.08	12	2.00	14	1.54	10	2.64	10	2.00
Low foreign costs	13	1.73	9	2.30	13	1.64	14	1.23	12	1.83
Retaliation against foreign competitors	14	1.60	14	1.30	12	2.00	13	1.39	14	1.67

TABLE XI

Competitive advantages enjoyed by canadian service firms

Advantages	Total	Commerce	Insurance	Finance	Other services
I- Technical advantages:					
- Technical expertise Specialized knowledge	16	1	2	1	12
- Sophisticated equipment	4				4
- Exclusive 'products' (services)	3	2	1		
- Efficiency	2			1	1
II- Marketing-related advantages:					
- Superior service	7	4	1	2	
- Marketing methods	3	1	1		1
- Price	2	1			1
III- Financing capacity	5	2		1	2
IV- General management:					
- Quality of management	3			2	1
- Superior business methods	2	2			
- Management in French	1				1
- Centralized control	2	1	1		
- Cost effectiveness	1		1		
- Low overhead	1			1	
V- Miscellaneous reasons:					
- Business connections	3	1		2	
- Reputation of Canadian firms	3		2		1
- Relationship with suppliers	1				1
- Stability	1		1		

TABLE XII

Obstacles to expansion of present foreign operations

	Total	Commerce	Insurance	Finance	Other Services
I- Lack of resources:	18	3	4	6	5
- Human resources	10	2	2	3	3
- Financial: lack of capital	8	1	2	3	2
II- Foreign business conditions:	14	5	2	4	3
- Lack of opportunities, of market capacity	4	2	-	1	1
- Competition from local firms	8	2	2	2	2
- Competition from countries offering better financing	1			1	
- Lack of good candidate for acquisition	4	1	1	-	2
- Cultural differences	1	1			
III- Foreign conditions: political and exchange risk:	14	1	5	2	5
- Nationalization & country risk	9		4	2	3
- Local laws on personnel management	1				1
- Complexity of foreign laws	1		1		
- Foreign taxes	1				1
- Import quotas	1	1			
- Foreign exchange risk	1			1	
IV- Lack of experience with foreign environment:	4	1		3	
- General lack of experience	1			1	
- Lack of local contacts	1	1			
- Time to develop foreign market longer than expected	2			2	
V- Canadian government limitations:	4	2	2		
- Canadian tax laws	3	1	2		
- Lack of support by Canadian government	1	1			
VI- Weaknesses in Canadian parent:	4	2	1		
- Canadian costs too high	1		1		
- High canadian interest rates	2	1			1
- Strategic decision to concentrate on Canadian market	1	1			

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