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2. THE BUSINESS IMPLICATIONS
OF GLOBALIZATION =

LES CONSEQUENCES DE LA MONDIALISATION
POUR LES ENTREPRISES



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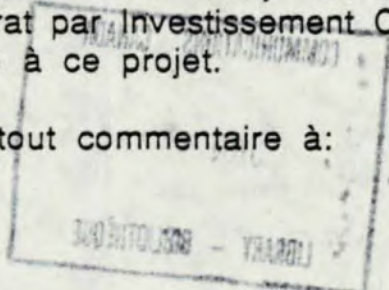
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THE BUSINESS IMPLICATIONS OF GLOBALIZATION

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RÉSUMÉ

Par mondialisation, on entend l'interdépendance croissante des économies nationales, qui font intervenir consommateurs, producteurs, fournisseurs et gouvernements. Les frontières entre les marchés intérieurs et internationaux s'estompent au fur et à mesure que les entreprises accroissent leur présence dans le monde entier. Le Canada, comme d'autres pays, se rend compte que la concurrence internationale s'est fortement intensifiée; le niveau de vie dépend de plus en plus de la capacité de vendre des biens et services d'une manière visant à satisfaire pleinement l'acheteur soucieux du prix et de la qualité, qu'il soit des États-Unis ou d'ailleurs. Même la plupart des biens et services vendus sur le marché intérieur doivent répondre aux normes internationales soit parce qu'ils seraient autrement importés, soit parce qu'ils servent de produits intermédiaires qui influent sur la compétitivité du secteur des exportations.

La mondialisation s'est effectuée graduellement sous l'effet des divers changements qui sont survenus. L'un des plus importants est le développement du libéralisme politique et économique pendant l'après-guerre, qui a entraîné un déclin du protectionnisme. Les autres changements qui ont contribué à la mondialisation vont du développement des télécommunications par satellite à la création du grand marché européen.

On peut déterminer huit grandes tendances économiques liées à la mondialisation.

- 1) La croissance du commerce international - De 1970 à 1986, la valeur des exportations mondiales s'est multipliée par sept, tandis que le volume de celles-ci a plus que triplé. En outre, la croissance du volume du commerce international dépasse celle de la production mondiale, surtout depuis 1986. Par conséquent, les exportations représentent une part accrue du PIB.
- 2) L'apparition de blocs commerciaux régionaux - Depuis 25 ans, un certain nombre de blocs commerciaux régionaux sont apparus, par exemple la Communauté européenne, la région Canada--États-Unis, la région Asie-Pacifique et l'Europe de l'Est. Les entreprises doivent servir des marchés géographiques plus divers si elles veulent rester concurrentielles.
- 3) L'accroissement des investissements étrangers directs - Les investissements étrangers directs se sont multipliés par 8 depuis 20 ans. Cette hausse s'est accompagnée de la diversification des sources et de la transformation des États-Unis, jadis un pays créateur, en un important pays débiteur.
- 4) La croissance des entreprises multinationales et l'uniformisation des marchés - Les multinationales se caractérisent généralement par des investissements étrangers

EXECUTIVE SUMMARY

Globalization refers to the growing interdependence of national economies - involving consumers, producers, suppliers and governments in different countries. Boundaries between domestic and international markets are becoming less relevant as businesses increase their profile abroad. Canada, as in the case of other countries, is finding that international competition has greatly intensified; living standards are increasingly conditional upon the ability to sell goods and services in a manner that fully satisfies the price and quality conscious buyer in the United States or overseas. Even most goods and services sold domestically must meet international standards, either because they would otherwise be imported or because they act as intermediary products that influence the competitiveness of the export sector.

Globalization has been a gradual process, stemming from a wide range of self-reinforcing changes. One of the most important of these is the growth in economic and political liberalism during the postwar period, which has led to a decrease in protectionist sentiments. Other changes which have contributed to globalization range from the development of satellite communications to the growth of the Eurobond market.

Eight major economic trends related to globalization can be identified.

- 1) The Growth of World Trade: between 1970 and 1986, the value of world exports increased sevenfold and the volume more than tripled; the growth in the volume of world trade is outpacing growth in world output, particularly since 1986, thus exports are accounting for an increased share of GDP.
- 2) The Development of Regional Trading Blocs: the last 25 years has seen the emergence of a number of regional trading blocs, eg. the European Community, Canada/U.S., Asia/Pacific and Eastern Europe; businesses must cater to a more diverse geographic spread of markets if they wish to remain competitive.
- 3) Increased Foreign Direct Investment: foreign direct investment has increased almost eightfold (in nominal terms) during the past two decades; the increase has been accompanied by diversification of the countries of origin and the transformation of the U.S. from a major creditor to a major debtor country.
- 4) The Growth of Global Corporations and the Standardization of Markets: global corporations are generally characterized as having a high level of foreign investment, a wide geographic distribution of company resources and a high level of integration and coordination among regional activities.

élevés, une vaste répartition géographique de leurs ressources et un haut niveau d'intégration et de coordination sur le plan des activités régionales.

- 5) La multiplication des alliances stratégiques - Les alliances stratégiques, dont celles contractées avec des partenaires étrangers, sont devenues plus fréquentes ces 10 dernières années. Beaucoup prédisent que la compétitivité d'une entreprise dépendra désormais non seulement des capacités internes de celle-ci, mais aussi des accords qui la lient à d'autres sociétés.
- 6) Le développement des marchés financiers mondiaux - La croissance rapide des prêts et des emprunts internationaux, l'ouverture grandissante des marchés financiers intérieurs aux établissements financiers internationaux et les innovations financières comme les échanges, les opérations à terme et la titrisation sont autant de facteurs qui contribuent à l'essor des marchés financiers mondiaux.
- 7) L'évolution technologique - Les progrès réalisés sur le plan des télécommunications et de l'informatique, ainsi que dans d'autres domaines ont facilité la mondialisation. La diminution de la durée de vie des produits et l'accroissement du coût de la mise au point de nouveaux produits contribuent eux aussi à la mondialisation, puisque les entreprises sont forcées de collaborer aux activités de recherche et de développement (R-D).
- 8) Les questions environnementales mondiales - En se rendant compte qu'un grand nombre des préoccupations touchant l'environnement concernent toute la planète, les différents pays ont pris conscience de leur interdépendance; la solution aux problèmes environnementaux mondiaux passe par la coopération internationale.

Il est difficile de prédire la voie que suivra la mondialisation. Une montée du protectionnisme pourrait limiter fortement le développement des marchés mondiaux. Les progrès technologiques pourraient provoquer dans les milieux d'affaires des modifications actuellement inimaginables. De plus, il existera toujours une opposition entre mondialisation et nationalisme. Néanmoins, un grand nombre des tendances décrites ci-haut se maintiendront probablement, dont celles traitant de la croissance du commerce international et des investissements étrangers directs, de l'influence des blocs commerciaux régionaux et de l'amélioration de la compréhension des questions environnementales mondiales.

La mondialisation oblige un grand nombre d'industries à « internationaliser » leur structure. Une industrie mondiale est une industrie où la compétitivité d'une entreprise dans un pays dépend en bonne partie de sa position dans d'autres pays. L'industrie ne se résume pas à un ensemble d'entreprises d'un pays donné; en fait, les entreprises suivent des stratégies internationales intégrées, exploitant sur un marché les avantages acquis sur un autre marché. Parmi les industries mondiales, mentionnons l'aviation commerciale, la télévision, les semi-conducteurs et l'automobile.

- 5) **The Growth of Strategic Alliances:** strategic alliances have become more frequent over the past decade, including alliances with foreign partners; many predict that competitive advantage will be based not only on a firm's internal capabilities, but also on its arrangements with other companies.
- 6) **The Development of Global Financial Markets:** the rapid growth in international lending and borrowing, the increasing openness of domestic financial markets to foreign financial institutions and financial innovations such as swaps, futures and securitization are all contributing to the development of global financial markets.
- 7) **Technological Change:** developments in telecommunications, computing and other fields have facilitated globalization; the decreased lifespan of products and increasing costs of new product development are also promoting globalization since firms are being forced to collaborate in research and development activities.
- 8) **Global Environmental Issues:** the realization that many environmental concerns are global has contributed to the perceived interdependence of countries; dealing with global environmental problems requires international cooperation.

It is hard to predict the future course of globalization. An increase in protectionism could greatly restrict further development of global markets. Technological developments could change the business environment in ways which are currently unimaginable. Moreover, there will be continuing tensions between globalism and nationalism. Nevertheless, many of the trends already outlined are likely to continue, such as the growth in world trade and foreign direct investment, the influence of regional trading blocs, and improved understanding of global environmental issues.

Globalization is causing many industries to become "global" in structure. A global industry is one where a firm's competitive position in one country is significantly influenced by its position in other countries. The industry is not merely a collection of domestic firms, rather firms follow integrated international strategies, exploiting benefits gained in one market for use in another. Global industries include commercial aircraft, television, semiconductor and automobile production.

Sweeping changes in the business environment are forcing many traditional multinational corporations to adopt corporate structures which better facilitate an integrated international strategy. The concept of comparative advantage is becoming more complex. In particular, it is no longer tied to the home-base of a firm, and the mobility and skills of human resources have become a crucial component of competitiveness. Further, the increased penetration of local markets by foreign firms and the growing need for domestic firms to pursue global strategies is raising the question of "who is us?". The increasing cost and importance of research and development is forcing alliances among what were staunch competitors. Even the

Des changements radicaux forcent un grand nombre de multinationales traditionnelles à adopter des structures qui facilitent l'exécution d'une stratégie internationale intégrée. Le concept de l'avantage comparatif devient de plus en plus complexé. Cet avantage n'est notamment plus lié à l'endroit où l'entreprise est établie, et la mobilité ainsi que les compétences des ressources humaines sont devenues un élément crucial de la compétitivité. En outre, la pénétration accrue des marchés locaux par les entreprises étrangères de même que le fait que les entreprises d'un pays donné doivent davantage adopter des stratégies internationales soulèvent un problème d'identité. Le coût et l'importance croissants de la R-D obligent des associations entre entreprises qui se livraient jusque-là une vive concurrence. Même la démarcation entre les industries de haute technologie et les industries traditionnelles s'estompe. Dans ces dernières, il est souvent essentiel d'utiliser efficacement les technologies avancées pour mettre au point de nouveaux produits et réduire les coûts de production.

La principale conséquence de la mondialisation pour les entreprises est peut-être le fait que, dans un grand nombre d'industries, il n'est plus rentable de se concentrer uniquement sur le marché intérieur. Comme nous l'avons déjà mentionné, même les entreprises qui n'exportent pas font face à la concurrence étrangère. Pour rester compétitives, les entreprises d'un pays doivent acquérir une meilleure connaissance des marchés et des concurrents étrangers. Elles doivent en outre axer leurs activités sur le marché mondial plutôt que sur le marché local.

Étant donné que les gens d'affaires prennent conscience qu'un grand nombre de pratiques ne sont pas opportunes, les sociétés restructurent leurs activités de diverses façons. Dans le cas des industries mondiales, les entreprises accordent une plus grande attention à la répartition de leurs activités entre les différents pays. Pour ce faire, il s'agit de déterminer où l'on procédera à la production, à la R-D, à la commercialisation et à la prestation du service après-vente, et de voir s'il faut concentrer certaines activités dans un endroit précis ou s'il vaut mieux les décentraliser. La décision de chaque entreprise concernant la répartition de ses activités dépend bien sûr en grande partie de la nature du produit qu'elle offre. Toutefois, il y a, en général, une tendance à la centralisation des activités « en aval », soit celles qui n'ont aucun rapport avec le consommateur telles que la recherche et la production. De plus, les entreprises mondiales décentralisent les activités « en amont », soit celles qui touchent directement le consommateur comme la commercialisation et le service après-vente. Ces changements témoignent du désir d'exploiter les économies d'échelle et de planifier dans une perspective mondiale tout en restant en contact avec les consommateurs locaux; bref, du désir de penser mondial, mais d'agir local.

Les sociétés déterminent où seront menées leurs activités dans une large mesure en fonction des nécessités de la rationalisation à l'échelle mondiale et du contact avec le consommateur. De même, elles s'emploient à se réorganiser de façon à accroître au maximum leur capacité de soutenir la concurrence et de saisir les occasions qui se présentent. Les sociétés délaissent les structures organisationnelles où la

dichotomy between high-technology and low-technology industries is disappearing. The effective application of high-technology is often crucial to the development of new products and less costly methods of production in traditional industries.

Perhaps the most significant implication for business is that a purely domestic focus is no longer a viable business strategy in many industries. As already noted, even businesses which do not export face international competition. In order to remain competitive, domestic firms will have to develop a greater understanding and knowledge of foreign markets and competitors; they must adopt a global rather than a local focus.

As the business community becomes aware of the inappropriateness of many practices, companies are restructuring in a wide diversity of ways. In the case of global industries, firms are giving increased attention to the worldwide configuration of their activities: where to undertake production, research and development, marketing and servicing; and whether specific activities should be concentrated in one location or decentralized to local markets. The outcome of each firm's decision on how to configure its activities is, of course, highly dependent on the nature of the firm's product. In general, however, there is a trend towards the centralization of "upstream" activities - that is, activities which are removed from the consumer such as research and production. Global firms are also decentralizing "downstream activities" - that is, consumer-tied activities such as marketing and servicing. These changes reflect the desire to both exploit economies of scale and plan on a global basis, as well as to remain in touch with local consumers: to think global but act local.

Just as the location of activities is being driven largely by the needs of global rationalization and consumer contact, corporations are striving to reorganize themselves in ways which will maximize their responsiveness to competitive pressures and opportunities. Organizational structures are moving away from accountability based on regional or product divisions, to more complex structures involving shared responsibility between these divisions. This often leads to a decrease in the autonomy of foreign subsidiaries, as they are more closely linked with head office strategy. These reorganizations may threaten minority ownership of subsidiaries, as reflected in a number of recent buy-outs by parents of Canadian subsidiaries.

Product changes are also occurring. The need for firms to specialize in a few areas is generally accepted, as is the emphasis on improving quality and developing market niches. It is not clear, however, whether there will be a continuing trend towards greater standardization of products, or whether greater differentiation between national markets will occur. Similarly, the importance of increased scale has not yet been established. In many cases, the resolution of these issues will differ depending on the particular industry concerned.

responsabilité est confiée aux divisions régionales ou aux divisions de produit pour adopter des structures plus complexes axées sur le partage de la responsabilité entre ces divisions. Cela entraîne souvent une diminution de l'autonomie des filiales étrangères, qui sont plus étroitement liées à la stratégie du siège social. Ces réorganisations peuvent menacer la participation minoritaire des filiales, comme en témoignent un certain nombre de récents rachats de filiales canadiennes par les sociétés mères.

Les produits subissent eux aussi des modifications. On reconnaît généralement que les entreprises doivent se spécialiser dans quelques domaines, et s'employer à améliorer la qualité de leurs produits et à exploiter des créneaux. On ne sait toutefois pas si la tendance à l'uniformisation des produits se maintiendra, pas plus que l'on ne sait si les marchés nationaux se différencieront davantage. De même, l'importance d'un accroissement des économies d'échelle n'a pas encore été établie. Dans de nombreux cas, la façon dont ces questions seront résolues variera d'une industrie à l'autre.

De façon générale, le Canada a fait preuve d'une compétitivité internationale de haut niveau et s'est montré apte à s'adapter aux changements qui s'opèrent sur le marché mondial. Toutefois, la faible croissance de notre productivité par rapport à celle de nos principaux partenaires commerciaux et la hausse des coûts unitaires de la main-d'oeuvre sont inquiétantes. Des études ont montré que la concurrence qui se livre au Canada est moins vive que chez nos principaux concurrents. Cela amène les entreprises nationales à ne pas exploiter à fond les économies d'échelle et les bienfaits de la spécialisation et à ne pas prendre une orientation fermement axée sur l'extérieur. On a également laissé entendre que les entreprises canadiennes sont plutôt lentes à mettre au point et à adopter de nouvelles technologies.

L'économie n'est pas confrontée à une crise sur le plan de la compétitivité. Qui plus est, considérer les défis de la mondialisation comme une crise sera probablement fort nuisible, car cette attitude serait à l'origine de politiques à court terme fragmentaires. Ce dont nous avons besoin, c'est une planification à long terme et des politiques qui créeront un milieu propice à la compétitivité des entreprises canadiennes au cours des prochaines décennies. De telles perspectives exigent la réévaluation d'un large éventail de politiques relatives à l'industrie, à savoir :

- . l'importance accrue de la recherche et du développement et la piètre performance des entreprises canadiennes à cet égard semblent indiquer la nécessité d'évaluer l'aide octroyée sur les plans quantitatif et qualitatif;
- . l'importance capitale d'une main-d'oeuvre mobile et compétente exige que soient réévaluées les politiques concernant l'enseignement et la formation;
- . si les économies d'échelle et la part de marché prennent une importance croissante comme éléments d'une stratégie de concurrence, les politiques en matière de concurrence doivent être revues pour s'assurer qu'elles ne nuisent pas

In general, Canada has displayed a high degree of international competitiveness and ability to adjust to changes in the global marketplace. Nevertheless, slow productivity growth relative to our main trading partners and increases in unit labour costs are worrying. Studies have indicated that competition within Canada is less intense than in our major competitors. This, in turn, has meant that domestic firms are not fully exploiting economies of scale and the gains from specialization, and do not have a strong outward-looking orientation. In addition, studies have suggested that Canadian firms are slow to develop and adopt new technology.

The economy is not facing a crisis in competitiveness. Moreover, treating the challenges of globalization as a crisis is likely to cause considerable harm, provoking piecemeal short-term policies. What is needed is planning for the long-term; policies which will create an environment which enhances the ability of Canadian business to compete over the following decades. This requires a reevaluation of a broad range of industry-related policies:

- the increased importance of research and development, and the poor performance of Canadian firms in this respect, suggests a need to assess not only the quantity but the quality of assistance;
- the crucial importance of a mobile and skilled labour force requires a reassessment of education and training policies;
- if scale and market share are becoming important components in a competitive strategy, competition policies may need to be reviewed to ensure they do not prevent needed rationalization while continuing to safeguard against anti-competitive practices;
- governments may also need to review the bias of support in favour of small business; (it should be noted that even if scale is important there could still be reasons to continue focusing on small firms; the latter may be more innovative or create more employment);
- there may be a role for government to provide information on such aspects as foreign management structures and business strategies so as to help entry into global markets; information may also be needed on how to develop overseas networks and strategic alliances;

à la rationalisation qui s'impose, tout en continuant de faire obstacle aux pratiques néfastes à la concurrence;

les gouvernements pourraient aussi être amenés à examiner le parti pris qu'ils ont en faveur des petites entreprises dans leur politique d'aide (il convient de noter que malgré l'importance des économies d'échelle, il pourrait toujours y avoir des raisons de continuer à mettre l'accent sur l'aide aux petites entreprises, celles-ci pouvant être plus novatrices ou créer davantage d'emplois);

le gouvernement pourrait jouer un rôle dans la prestation de renseignements sur des questions comme les structures de gestion et les stratégies commerciales des pays étrangers, afin de faciliter la pénétration des marchés mondiaux. Il pourrait aussi être nécessaire de diffuser de l'information sur la façon d'établir des réseaux outre-mer et des alliances stratégiques avec d'autres pays;

les politiques commerciales devront être réexaminées à la lumière du déplacement de l'intérêt, qui passe du système d'échanges commerciaux multilatéraux aux initiatives bilatérales et réciproques. De même, l'accent mis sur l'établissement de liens entre le commerce, l'investissement et les alliances stratégiques, et le fait que les entreprises de tête font de l'investissement direct un instrument clé d'accès aux marchés doivent être pris en considération dans toute politique commerciale. En outre, la nécessité d'être présent sur ces trois fronts de la triade pourrait exiger un rajustement de l'aide du Canada en matière de commerce;

l'importance accrue qu'on accorde au transfert de technologie, à l'accès aux marchés, à l'expertise en matière de gestion et au remboursement des coûts de R-D laissent supposer que l'investissement direct étranger est un élément capital de la concurrence. Il importe que le Canada maintienne sa politique favorable à l'investissement étranger, alors que l'investissement direct canadien à l'étranger doit être encouragé;

les trois niveaux de gouvernement doivent reconnaître que la mondialisation a pour effet de réduire leur indépendance pour ce qui est des questions de politique; par exemple, l'apparition de marchés financiers mondiaux rend de plus en plus difficile l'application d'une politique relative aux taux d'intérêt « faite au Canada »;

étant donné que l'économie nationale est davantage sensible aux tendances internationales, il conviendrait d'encourager une coordination plus étroite des politiques macroéconomique et microéconomique. De même, dans certains domaines, il pourrait falloir renforcer la convergence des politiques des divers pays et l'harmonisation des cadres réglementaires, notamment en ce qui a trait aux

- trade policies will need to be reassessed in light of the shift in emphasis from the multilateral trade system to bilateral and reciprocal initiatives; as well, the emphasis on linking trade, investment, and strategic alliances, and the fact that leading edge companies use direct investment as a key instrument for market access, must be factored into trade policy; also, the need to participate in all three components of the Triad may require some realignment of Canada's trade support;
- the increased importance of technology transfer, market access, management expertise and the defrayment of research and development costs suggests that foreign direct investment is a critical component of competitiveness; Canada must maintain its "open for business" policy towards foreign investment; also, Canadian direct investment abroad must be encouraged;
- all three levels of government must recognize that globalization is decreasing their independence in policy matters; for example, with the emergence of global capital markets it is increasingly difficult to pursue a "made-in-Canada" interest rate policy;
- given the increased vulnerability of the domestic economy to international trends, greater coordination of both macroeconomic and microeconomic policies should be encouraged; similarly in some areas a greater international convergence of domestic policies and harmonization of rules may be called for - most notably in the areas of competition policy, investment, innovation and technology policy, environmental regulation and the supervision of financial organizations.

Above all, governments must recognize that the policy environment has become harsher. With increased exposure to highly competitive international markets, governments must give greater consideration to their impact on competitiveness. Policies which reduce the competitiveness of Canadian industry will inevitably result in decreased growth and income.

Given the demands of globalization, more information and analysis is needed about how to manage the economy effectively. This report has probed one dimension of this analysis - the nature of globalization and the implications for the business community. We need to review, however, the proper role for government in light of these changes, and how this role compares with current federal and provincial policies and programs. This does not imply the sweeping away of national borders and separate cultural identities. It simply means that we must recognize that domestic policy choices will increasingly be conditioned by the international marketplace.

politiques en matière de concurrence et d'investissement, aux politiques relatives aux innovations et à la technologie, aux règlements concernant l'environnement et à la supervision des organismes financiers.

Les gouvernements doivent avant tout reconnaître que le cadre de politique s'est durci. En effet, les entreprises sont de plus en plus exposées à la concurrence acharnée qui se livre sur les marchés internationaux, et les gouvernements doivent en tenir compte. Les politiques qui restreignent la force concurrentielle de l'industrie canadienne auront inévitablement l'effet d'abaisser la croissance et le revenu.

Compte tenu des exigences de la mondialisation, nous avons besoin de plus d'information et d'études pour savoir comment gérer efficacement l'économie. Le rapport ci-joint s'attaque à un aspect de cette analyse : la nature de la mondialisation et les conséquences pour le secteur des entreprises. Nous devons toutefois déterminer le rôle pertinent du gouvernement à la lumière de ces changements, ainsi que son rôle en regard des politiques et programmes provinciaux et fédéraux en vigueur. Il n'est pas question ici de faire disparaître les frontières nationales ni d'anéantir les identités culturelles. Il suffit simplement que nous reconnaissions qu'à l'avenir les choix de politique nationale seront de plus en plus fonction du marché mondial.

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INTRODUCTION

The concept of globalization became increasingly popular during the 1980s. Business and labour groups, economists and politicians, all referred to the growing interdependence of markets and national economies. Yet many people using the term have very little idea of its full implications. In fact, we are already in danger of dismissing the concept as trite and over-used, when we have barely begun to comprehend the ramifications of the "global village".

Such a dismissal would be a grave error. Globalization involves a complete transformation of our economic, political and cultural environment. Above all, it involves a fundamental change in the nature and level of international competition. Not only are exporting firms facing greater competition, but international firms are increasingly penetrating foreign markets. Countries are becoming more and more open and susceptible to external forces. The distinction between tradeable and non-tradeable sectors is less clear and perhaps no longer relevant. If we are to succeed in this new environment, we must understand the changes that are occurring and adapt our policies, regulations and business practices accordingly. Burying our heads in the sand will not make the challenge go away. Rather, it will place in danger the competitiveness of Canadian business and our longterm standard of living.

This report is a synthesis of the literature on globalization, highlighting the implications for business and government. Defining globalization presents major problems, largely due to its complexity and the fact that it is being driven by a combination of social, governmental, business and technological pressures. On one level it can be seen as a phenomenon stemming from the gradual sweep of economic and political liberalism during the past century or more. Alternatively, it can be viewed as resulting from the actions of private sector corporations and consumers. The report does not provide a complete catalogue of all the dimensions of globalization. Rather, it concentrates on the economic aspects. It illustrates the changes which are occurring and provides a general overview of the business implications.

CHAPTER 1

WHAT IS GLOBALIZATION?

1. WHAT IS GLOBALIZATION?

The reality of globalization is not that new frontiers - new lines to be pushed back or pierced - have suddenly appeared. What is happening is precisely the reverse: the lines are disappearing. Globalization is not so much our going out into the world; it is the world coming in and enveloping us. We are not dealing with new frontiers; we are dealing with no frontiers.¹

1.1 The Evolution of Change

The term "globalization" was originally coined by Professor Theodore Levitt of the Harvard Business School, referring to the emergence of global markets for standardized consumer products and the growth of worldscale firms servicing those markets. As the term has become more popular it has taken on a broader meaning. It refers to the interconnectedness of national economies - the growing interdependence of consumers, producers, suppliers and governments in different countries. Activities in the domestic economy are more exposed to foreign trends and decisions taken in other parts of the world.

Boundaries between the domestic and international markets are becoming blurred as businesses increase their profile abroad and foreign businesses penetrate the domestic economy. Even firms which do not export are operating in a global marketplace. This means that business must face more intense and diverse foreign competition. It also means domestic firms are more able to draw on a wide range of inputs from around the world. Similarly, consumers are exposed to a wider range of international products. In addition, our general economic performance is becoming increasingly inter-related with economic trends in other parts of the world and dependent upon policies of governments other than our own.

Globalization has been a gradual process. It is not possible to pinpoint a particular year or even a particular decade, and say "this is when globalization occurred". We can, however, trace the evolution by identifying milestones which, together, have contributed to a fundamental change in the overall environment. Changes include: the rapid increase in world trade and the openness of economies; the development of instant communications around the world; the growth in international capital markets; the growth in foreign direct investment; the emergence of global corporations; and the growing attempts at government to coordinate economic policies. These are illustrated in the timeline in Table 1.

¹ Helen Sinclair, President of the Canadian Bankers Association.

Table 1

SOME MILESTONES IN GLOBALIZATION

- 1944 Bretton Woods meeting. The IMF is established as a mechanism to help member countries cope with short-term monetary difficulties. The U.S.S. is established as the world's major reserve currency.
- 1952 Royal Little proclaims Textron (a textiles firm) to be the first conglomerate.
- 1957 Treaty of Rome: formation of the EEC. Sputnik is launched, the first earth orbiting satellite.
- 1962 Transmission of first television pictures live across the Atlantic from the U.S. to Britain.
- 1964 The Council of Ministers of the EEC creates the Committee of Governors of Central Banks, the Budgetary Committee and the Medium-term Economic Policy Committee. This is a significant step in the direction of institutionalized economic co-ordination of monetary and fiscal policies.
- The second satellite to be successfully placed in a stationary orbit, Syncom III, transmits pictures from the Olympic Games in Japan to the west coast of the U.S.. Eleven nations form the International Telecommunications Satellite Consortium, an agreement which organizes satellite communications on an international basis, enabling all participating countries to assist in the design, share in the ownership and play a full part in management of the satellite system. By mid 1968 the number of signatories will have reached 61.
- 1970 Honda begins exports of the N-600 model to the U.S..
- 1971 The U.S. suspends dollar-gold convertibility, abolished exchange controls and floats the U.S. dollar.
- The National Association of Securities Dealers' automated quotation system provides a network of 20,000 miles of leased telephone lines, dealer-office video terminals and central computer to provide interactive quotation facilities.
- 1972 The United Nations Conference on the Human Environment is held in Stockholm. This is the first time that public and political leaders show an interest in environmental issues on a world scale.
- 1973 First oil shock. The development of the Eurobond market. Membership of IMF reaches 125 countries. Beginning of the Tokyo GATT Round.
- 1978 At the Bonn Summit participating countries agree to stimulate the world economy through a major increased in expenditure by West Germany and significant increases in output by other countries. End of Tokyo GATT Round.
- 1980 Eurobond market totals US\$133.4 billion.
- 1981 Introduction of the IBM PC.
- 1983 Creation of the World Commission on Environment and Development by the United Nations which culminated in the release of the Brundtland Report.
- 1984 The Chicago Mercantile Exchange and the Singapore International Monetary Exchange link up to offer round-the-clock trading in financial futures. Japan opens Tokyo Stock Exchange to membership by foreign financial institutions.
- 1986 At the Tokyo Summit the G7 countries agree that their finance ministers will work together more closely and more frequently in the periods between Summit meetings and review individual economic objectives and forecasts collectively at least once a year. U.K. opens London Stock Exchange to membership by foreign institutions.
- 1987 Single European Act sets target date for completion as December 31 1992. Stockmarket crash in October.
- 1989 Canada/U.S. Free Trade Agreement comes into operation. West Germany surpasses the U.S. as the country accounting for the largest share of world exports.
- 1990 Time magazine forecasts superpower status for India. Momentous changes in Eastern Europe continue.

Peter Drucker has likened such changes to the gradual divides which occur in political thought. To quote:

History, too, knows such divides. They also tend to be unspectacular and are rarely much noticed at the time. But once these divides have been crossed, the social and political landscape changes. The social and political climate is different and so is the social and political language. There are new realities.²

Drucker has traced the beginnings of globalization to the later 1800s and early 1900s, when the first wave of global competitors emerged. These included corporations such as Ford, Singer, Gillette and Otis, which developed world markets and operated integrated global strategies. Between 1920 and 1950, globalization retreated in the face of strong nationalist sentiments which fuelled trade barriers and inward looking strategies. Since 1950, however, globalization has again accelerated.

1.2 The Causes of Globalization

There is no one factor which can be said to have caused globalization. It has occurred due to a wide range of self-reinforcing changes. Broadly these can be categorized into three areas: attracting forces; enabling forces; and threatening forces. These are summarised in Table 2.

1.2.1 Attracting Forces

- Perhaps the single most important attracting force, at least initially, was the reduction in protectionist sentiments. Countries abandoned inward looking strategies during the postwar period, and accepted international trade and investment as important factors in economic growth. This was accompanied by a resurgence in belief in the importance of market forces and a growing disillusionment with government direction and control.

These changes encouraged the liberalization of trade through successive GATT rounds and regional agreements such as the European Free Trade Agreement. They also encouraged deregulation in areas such as the financial sector and investment, giving private companies greater freedom and flexibility to operate internationally.

² Peter Drucker, The New Realities (Library of Congress, U.S., 1989), p3.

Table 2

FORCES ENCOURAGING GLOBALIZATION

Attracting Forces

- decrease in protectionist sentiments encourages outward-looking policies
- resurgence of confidence in market forces encourages public policy to be developed in a market oriented framework
- growth in Asia/Pacific economies encourages shift in strategic focus
- geographical shift in world's technological resources encourages pursuit of a global market and exploitation of economies of scale
- rising costs of introducing new products
- convergence of consumer tastes

Enabling Forces

- decreased transportation costs allows global sourcing of products and components
- decreased communication costs allows global integration/coordination of information-intensive activities
- growing strength of mass merchandisers/national distributors allows high volume, low-cost entry to offshore markets
- emergence of global capital markets

Threatening Forces

- increased strength of offshore competition requires participation in domestic markets of offshore competitors
- rising protectionism requires investment in major export markets
- continuing exchange rate volatility requires a balanced geographic distribution of cash flow
- accelerating rate of technological change requires risk sharing, combining of complementary technologies and development of human resources
- increased number of companies pursuing global strategies requires other companies to make a parallel competitive response

Source: Adapted from Wachter, Thomas and Foxen, Richard, Going Global (Business Intelligence Program) Report no. 782, Fall, 1989, p4.

- The growth of the Asia/Pacific region has contributed to the growth and diversity of world trade. It has forced a shift in the strategic focus of business, away from reliance on the United States market.
- Similarly, there has been a shift in the geographic distribution of technological resources. Business faces new competition and must draw on resources and expertise from sources outside the domestic economy.
- The rising cost of introducing new products and the need for business to draw on a wider range of technological skills have been factors promoting globalization. Higher government standards have also contributed to increased costs. For example, testing requirements have been a major factor in the quadrupling of the costs of developing new drugs over the past two decades.
- To an increasing extent, firms must cater to large global markets in order to recoup the development costs of new products and to benefit from economies of scale. Rising costs have also encouraged the movement to global sourcing of raw materials and capital.

1.2.2 Enabling Forces

- Technological change has been a major enabling force. In fact, without the developments which have occurred in computerization and telecommunications, globalization could not have advanced to its current state. Such developments have permitted: the global coordination of geographically distant activities of firms; greater access to foreign resources, for example via electronic stock markets and global financial services; and more widespread dissemination of advertising through mediums such as television and computer marketing.
- Decreased transportation costs have also facilitated the growth of world trade, with the emergence of bulk carriers, container ships and large-scale aircraft.
- The emergence of global capital markets has enabled corporations to finance both foreign and domestic activities by drawing on international capital markets.

1.2.3 Threatening Forces

- Threatening forces include the strength of offshore competition. This is in part due to the growth of global corporations, which are able to benefit from specialization, economies of scale and global sourcing. The need to compete with such companies is forcing many firms to go global themselves.

- Exchange rate volatility, another threatening force fuelling globalization, is largely a product of the globalization of capital markets. It is encouraging firms to develop a balanced geographic distribution of cash flow and to adopt flexible planning practices within which the location of activities can be altered with changes in the exchange rate. It has also encouraged financial innovations such as foreign exchange futures and currency swaps, whereby firms can hedge their foreign exchange risk.
- Technological change was mentioned as an enabling factor, but it has also been a threatening force. Firms are having to draw on a wider range of technologies and the timespan between development of a new product and its obsolescence is decreasing. Firms must, therefore, seek outside alliances in order to draw on complementary technologies, as well as to share the risks of developing new products.
- Protectionism, or the threat of protectionism, has to some extent encouraged firms to develop a physical presence in export markets. For example, many Japanese firms are establishing a presence in Europe to ensure they have access to the E.C. market. In the long run, however, an increase in protection would impede rather than promote globalization.

1.3 Future Trends

Globalization is not just a fad or a new piece of rhetoric. It is recognition of the reality that our technological civilization has produced a single global community.³

It is hard to predict the future course of globalization. It is likely that we will see the continuation of many of the current trends: further increases in openness and the importance of foreign investment; an increasing proportion of businesses adopting global strategies and establishing a physical presence in foreign markets; and the emergence of new competitors and markets with the increasing importance of the Newly Industrialized and Third World countries.

³ Maurice Strong quoted in "Our Common Future: An Interview with Maurice Strong" in Canadian Business Review Vol. 17, no. 1, spring 1990, pp8-16.

Perhaps the most unpredictable element of all is technological change. Technological developments will most likely continue to stimulate globalization through increased communication and information capabilities. Computer-shopping and global electronic networks will become more popular. The development of smaller, lighter products will further facilitate transportation. Equally likely is the possibility that future technological innovations will provide completely new, and at present, unimaginable dimensions to globalization.

Another major uncertainty is the political context. The increasing interdependence of economies and the emergence of global problems, including Third World debt and environmental concerns, is forcing greater international coordination of government policies, such as the detailed discussions at the Tokyo Summit. Greater coordination is likely to result in the emergence of new international regulatory institutions, perhaps with significant powers over domestic policies. The decreased ability of national governments to control independently their domestic economic performances could promote closer economic unions between countries, such as monetary unions in the E.C. and in North America, and closer ties within Asia/Pacific.

The biggest threat to globalization is from protectionist sentiments. It is possible we will see freer trade within large regional trading blocs but increased barriers to trade between trading blocs. This problem could be seriously compounded if economic protectionism escalates to geopolitical considerations -as the U.S./Japan trade dispute threatens to do.

It must be acknowledged that there will be continuing tensions between globalization and nationalism. While there is likely to be greater cooperation between countries, nation-states will not disappear, let alone lose their distinct identities. They may even proliferate. Moreover, if globalization leads to greater disparities in economic activity, nationalist or regionalist sentiments may be fuelled by discontent and diverging regional priorities. One challenge facing countries will be to find the right balance between nationalism and globalism.

The pressures propelling the momentum of globalization should not, however, be underestimated. In particular, the growth in the number and power of global corporations encourages greater trade liberalization or other forms of deregulation. Moreover, many of the developments in communications are irreversible. Consumers will continue to gain information on products available in foreign countries, thus creating pressures for greater access to those or similar products. Similarly, global corporations will maintain good information networks on the opportunities available worldwide for both sales and sourcing. In addition, the development of Third World Countries, the continuing growth of Newly Industrialized Countries and the democratization of Eastern Europe, will all continue to diversify world markets and to reduce the dominance of the United States.

In summary, globalization will continue to progress and evolve. It is important, therefore, that Canada's business sector benefits from the increased opportunities globalization provides. If it does not make appropriate responses, the Canadian economy will become uncompetitive and living standards will fall. But before businesses can fully take advantage of the opportunities, changes may be needed both in business practices and in government policies. The economic environment is changing and we can not expect the old policies and practices to necessarily remain the most appropriate. Before we can begin to analyse the implications of globalization, a better understanding of its various aspects is needed. This is provided in Chapter 2.

CHAPTER 2
ASPECTS OF GLOBALIZATION

2. ASPECTS OF GLOBALIZATION

Eight major economic trends related to globalization can be identified: the growth of world trade; the development of regional trading blocs; increased foreign direct investment; the growth of global corporations; increases in cooperative ventures; the development of global financial markets; technological change; and the increased emphasis on sustainable development. Each of these is analysed below.

2.1 Growth of World Trade

The liberalization of trade regulations, growth in the industrial countries and, more recently, the emergence of global corporations, have all helped to fuel the growth in world trade. Between 1970 and 1986, the value of world exports increased sevenfold and the volume more than tripled.⁴ During the early 1980s world trade grew only slowly, reflecting the world recession and the collapse in commodity prices. But since 1985 growth in the volume of world trade has again outpaced growth in world output. Thus, more of what is being produced is crossing national borders. This can be seen in Figure 1.

Not only has the volume of trade increased, but exports are accounting for an increasing share of GDP. As can be seen in Figure 2, for the G7 countries as a whole exports of goods and services accounted for just under 15 per cent of GDP in 1987, compared to less than 10 per cent in 1960. This well illustrates the growing openness and interdependence of the industrialized economies.

Increased exposure to international trends is a phenomenon particularly applicable to Canada, which has always been one of the more open of the G7 countries. In 1960 exports accounted for around 17 per cent of GDP. In 1987 they accounted for more than 25 per cent.

⁴ Edward A. Carmichael, Katie Macmillan and Robert C. York, Ottawa's Next Agenda (C.D. Howe Institute, Toronto, 1989) p88.

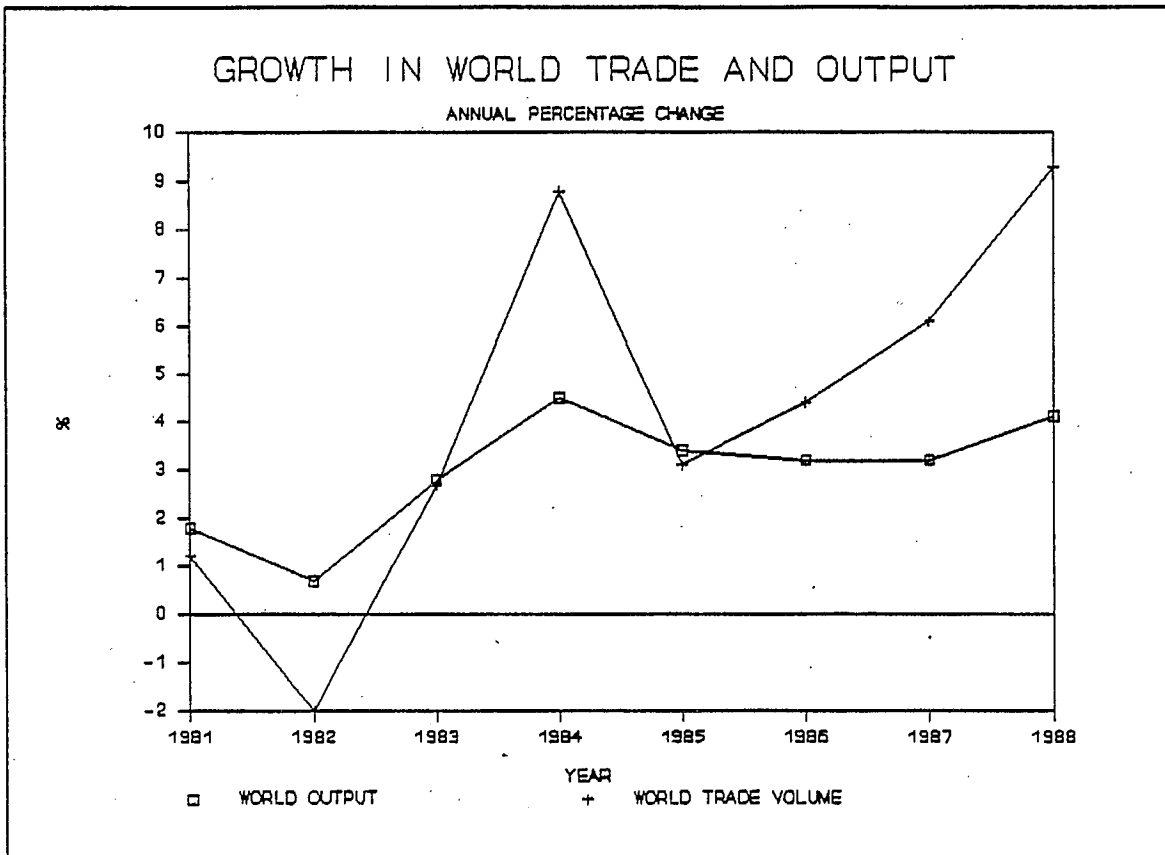


Figure 1

The increase in world trade has been accompanied by a change in the distribution of trading activity, in particular a decline in the dominance of the United States. In 1988 the United States lost its traditional position as the leading world exporter to West Germany.⁵ (West Germany accounted for 11.4 per cent of world exports whereas the United States accounted for 11.3 per cent.) Japan's exports have grown much more rapidly than world exports, and even developing countries increased their share of world trade.

⁵ Catharine G. Johnston, Globalization: Canadian Companies Compete (Conference Board of Canada, Ottawa, February 1990) p12.

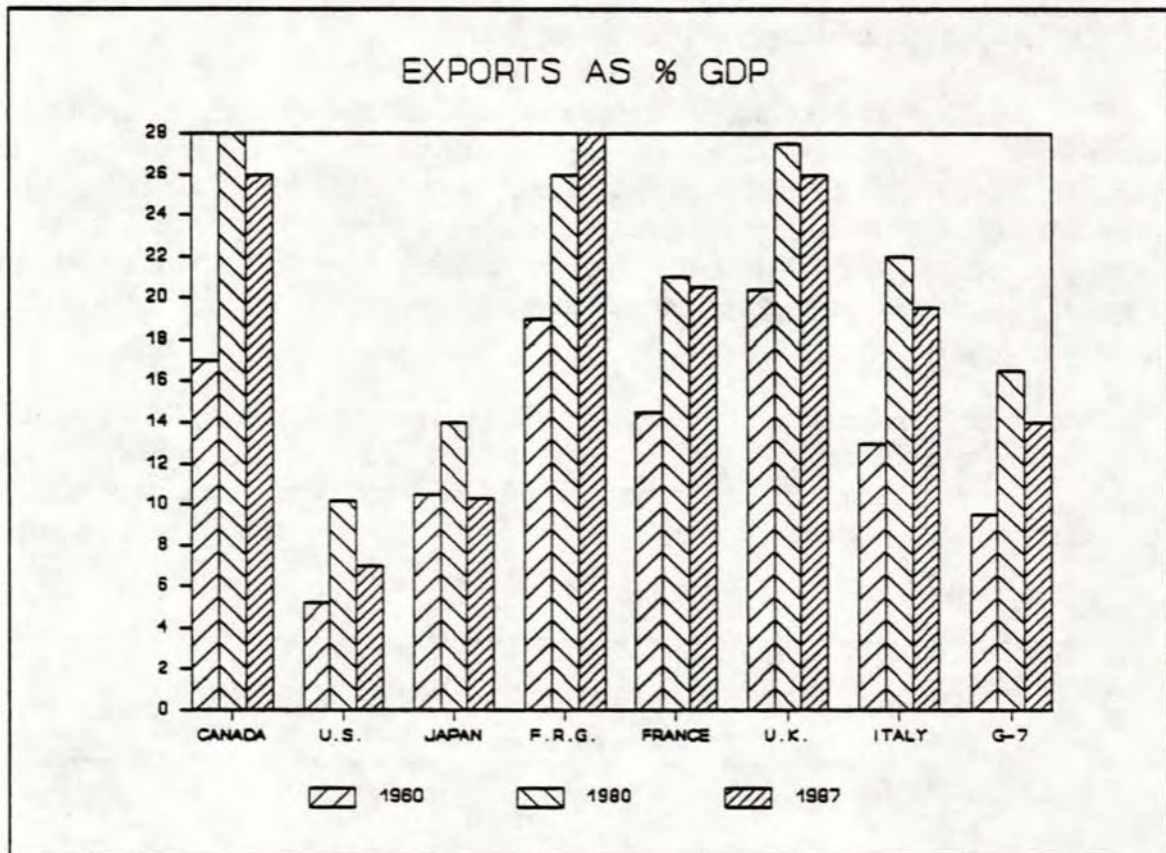


Figure 2

Intracorporate trade is accounting for a significant proportion of world trade. It has been estimated that at least one-third of world trade in manufactured goods may now be intracompany trade; for example, exports from the Mexican border plant of Sony to Sony's final assembly plant in San Diego.⁶ This proportion is likely to increase in the future as companies rationalize the geographic distribution of their activities. It should also be noted that services are increasingly being traded and they now account for approximately one-quarter of world trade.

⁶ Peter Drucker, "Drucker on Management" Wall Street Journal, May 26, 1987.

2.2 Development of Regional Trading Blocs

The last 25 years has seen the emergence of a number of regional trading blocs - areas where intra-regional trade flows are encouraged through the reduction of trade barriers. These blocs have altered the pattern of trade and investment. They have also provided a push to globalization since businesses must cater to a more diverse geographic spread of markets if they wish to remain competitive. At the same time, the risk of increased protection between regional blocs poses a significant risk to globalization.

Four main blocs can be identified: the European Community (EC); Canada/U.S.; Asia/Pacific; and the centrally planned economies of Europe. The growth of trade within the principal blocs is illustrated in Figure 3. Total within-bloc trade has increased from 45 per cent of world trade in 1970 to 48 per cent of world trade in 1986.

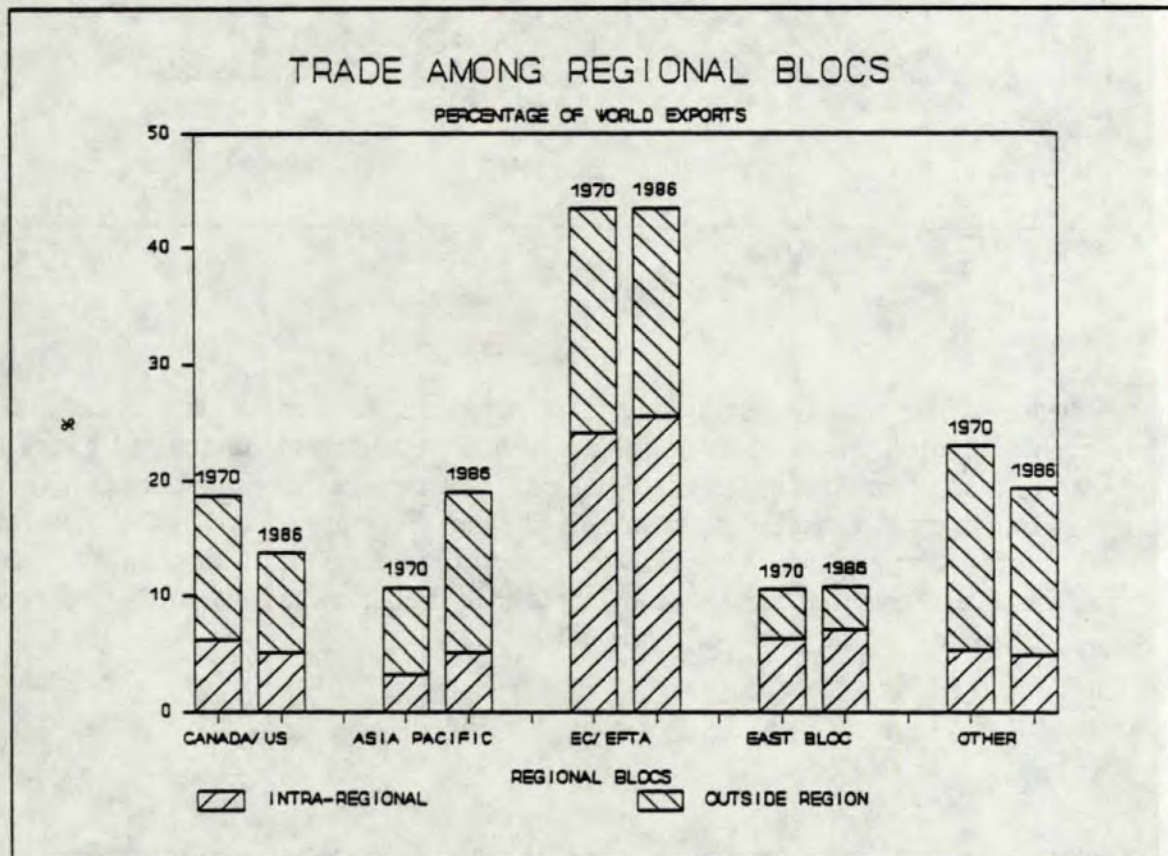


Figure 3

Source: Edward A. Carmichael, Katie Macmillan, and Robert C. York Ottawa's Next Agenda (C.D. Howe Institute, Toronto, 1989), p85.

The European Community is perhaps the most advanced of these blocs. In 1960, it included 6 members and a population of 165 million. With the Single European Act in 1992, 12 countries, including 320 million people, will be integrated into one market. But the EC will be far more than just a free trade area. The reforms include the liberalization of capital movements and the development of uniform regulations concerning mergers and acquisitions, trademarks and copyrights, bankruptcy and health. Value-added excise tax rates and many technical standards are also being harmonized. These reforms have been driven in large part by the belief that integration and rationalization are the only means to improve competitiveness.

The decline in the dominance of the United States market is reflected in the declining shares of world trade accounted for by the Canada/U.S. bloc. Since 1970, total exports of Canada and the United States have fallen from 18.7 per cent of world exports to 13.7 per cent. When analysing this performance it is important to remember that, as already noted, world trade has expanded rapidly. Thus, while North America accounted for a declining share of world trade, the absolute value and volume of exports from the region nevertheless increased considerably. It is likely that the North American bloc will expand in the future. The U.S. is already discussing a possible trade agreement with Mexico.

Of the blocs identified, the Asia-Pacific region has been the most dynamic. As a percentage of world exports, intra-regional exports have more than doubled. Exports to each of the other trading blocs have also increased. Exports from the Asia-Pacific region now account for 19 per cent of world trade, compared to 10.7 per cent in 1970.

Economic integration in Asia, largely driven by Japan, is occurring on a less formal basis than in Europe and North America. The Association of South East Asian Nations (ASEAN) has liberalized trade and investment flows between members. A number of other Pacific Rim countries have also entered into or are exploring bilateral trade deals. The Closer Economic Relations Agreement between Australia and New Zealand, for example, provides for free trade in goods and services.

The eastern bloc countries accounted for 10.8 per cent of world exports in 1986. Their participation in world trade is likely to greatly increase in the future with the adoption of more market-oriented policies. It is also possible that at least some of these countries may become associated with the E.C.. Hungary and Czechoslovakia have applied for special status. Such inclusions would add to the growing economic power of the European bloc.

Non-members of regional blocs have experienced a major decline in their share of world exports. They include countries in the Middle East, Africa and Latin America. Their share of world exports fell from 23 per cent in 1970 to 19.3 per cent. As economic development progresses in these countries, however, their participation in world trade is likely to increase.

The increasing importance of regional trading blocs presents both opportunities and challenges for Canada. The advantages are well known:

- with increased market access to the United States, Canadian firms can benefit from economies of scale and improved productivity;
- the reduction of input costs will help improve the competitiveness of many Canadian businesses;
- access to a large market will facilitate greater specialization and the development of "niche" products; and
- firms can also take advantage of freer investment regulations.

The challenges stem from the fact that members of other regional trading blocs will also reap similar advantages. Thus, while Canadian firms will have a larger initial market in which to develop, they will also face greater competition from firms outside North America. For example, the Single European Act will result in uniform technical standards which will reduce production costs. The establishment of a common transport policy will allow firms to decrease the large inventories currently kept to guard against late shipments. Above all, companies will have the opportunity to develop economic-scale production facilities to allocate resources in ways not open to them before.⁷ These strengths will enable European firms to compete with Canadian firms for U.S. markets, despite the advantages provided to Canada by the Free Trade Agreement.

As mentioned earlier, the emergence of regional blocs is challenging the dominance of the United States. In the past, the U.S. market was so large relative to other markets that major international firms had to enter it to be competitive. With the development of new markets of equivalent size this is no longer the case. For individual firms this means they must diversify their activities across a wider range of countries, including Europe and the Asia-Pacific region.

⁷ William F. Miller, The Single European Act of 1992: Implications for American and Asian Companies (SRI International, D88-1286, 1988).

Manufacturers in most industries today cannot have global strength unless they participate in the U.S. market. By the middle of the 1990s it may well be that a manufacturer will be globally successful only if he participates in the Single European market.⁸

Future trade and investment trends will depend on the attitude taken by the regional blocs to inter-regional trade. The dangers of increased protection in the United States or the development of a "Fortress Europe" mentality are very real:

The main significance of the regional economic blocs is that trade is being liberalized inside the blocs, while trade among the blocs is subject to increasing frictions, which in part reflect the increased importance of trade to all countries.⁹

With the continuing large current account deficits, calls for increased protection in the United States have intensified. Treasury Secretary Baker has boasted that the Reagan administration has defended American trade interests by imposing more protection than any other administration in the past 50 years.¹⁰ Similarly, Eilef Trondsen states that whereas only 8 per cent of U.S. imports were subject to some kind of protection in 1975, 25 per cent are currently protected in some way.¹¹ Sylvia Ostry points to the steady increase in "new protectionism" since the mid 1970s, involving border and domestic non-tariff measures.¹²

There is also a risk of increased protectionism in a united Europe. The EC's Common Agricultural Policy is an example of protectionist policies. Calls for further protection come from European automakers, citing their inability to sell in Japan. Others look at proposed US trade regulations and wonder if a Fortress Europe might not be the best response.

⁸ Ibid.

⁹ Ibid, p90.

¹⁰ Jeffrey J. Schott and Murray G. Smith (eds) The Canada-United States Free Trade Agreement: The Global Impact (Institute for International Economics, Washington, 1988), p11.

¹¹ Eilif Trondsen, The Future of International Services (SRI International, no. 725, 1985).

¹² Sylvia Ostry, Governments and Corporations in a Shrinking World (Council of Foreign Relations Press, March, 1990) p4.

2.3 Increased Foreign Direct Investment

Foreign direct investment has increased almost eight-fold (in nominal terms) during the past two decades, reflecting the growing interdependence of regions and the growth of global corporations. During the 1980s, foreign investment expanded at an annual average rate of between 8 and 9 per cent, which was considerably more rapid than the growth in world trade. This is illustrated in Figure 4. In 1986-87, the world stock of foreign direct investment increased by almost 24 per cent.

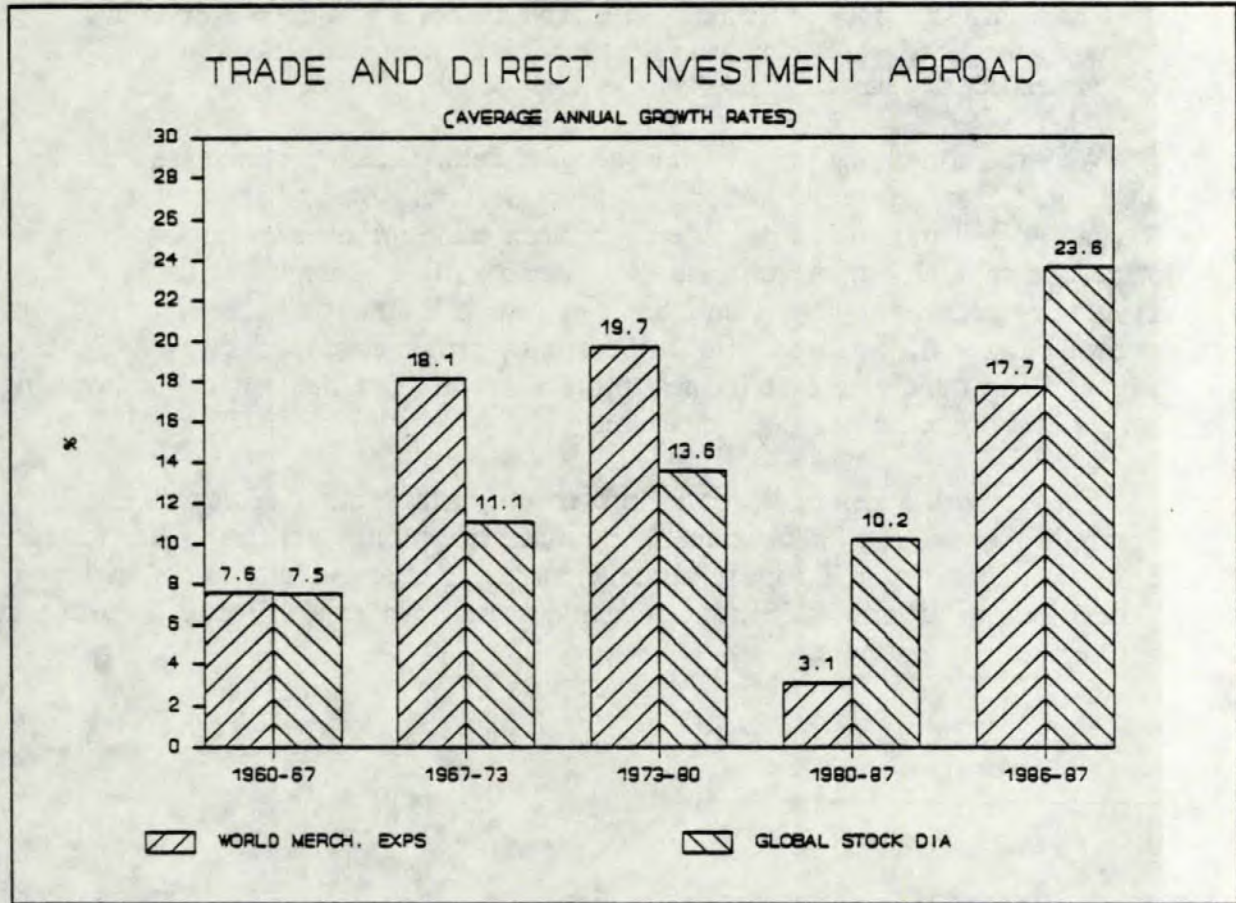


Figure 4

The increase in foreign direct investment has been accompanied by diversification of the countries of origin. In the past, the United States dominated foreign investment, accounting for 50.4 per cent of the world stock of direct investment abroad in 1967. In 1986, however, the United States accounted for only 33.3 per cent of the total stock. In contrast, Japan and West Germany increased their shares significantly, from 1.3 per cent and 2.7 per cent respectively in 1967, to 7 per cent and 9.3 per cent respectively in

1986. Figure 5 illustrates a much more balanced relationship among the Triad than was the case in the immediate post-war period.

From being a major creditor, the United States is now a major debtor country. The stock of foreign direct investment, as a percentage of the country's total capital stock, has increased from 2.8 per cent in 1985 to 3.6 per cent in 1987. Many in the United States feel that the country is being "sold overseas". A more restrictive treatment of foreign investment could apply in the future. The Exon-Florio amendments to Section 721 of the Omnibus Trade and Competitiveness Act allow the President to suspend or prohibit a takeover, or to make "other appropriate relief", if it is decided that U.S. national security is threatened and other laws are not adequate to deal with the threat. The provisions were invoked for the first time in early 1990, when President George Bush ordered a Chinese-owned corporation to sell its interest in a Seattle aircraft parts company.

Foreign direct investment flows into Canada have been consistent with world trends, more than doubling during the 1980s. The total stock of foreign direct investment in Canada in 1988 was \$110 billion, compared to \$48.3 billion in 1978. As a percentage of the total capital stock, foreign direct investment totalled 8 per cent in 1987, compared to 7.4 per cent in 1985. Compared to the other G7 countries, Canada appears to have one of the most open policies towards foreign investment.

Table 3

FOREIGN DIRECT INVESTMENT
(% of Capital Stock)

	1985	1987
West Germany	3.1	3.2
United Kingdom	4.5	5.4
United States	2.8	3.6
Canada	7.4	8.0
Japan	0.2	0.2

Source: Investment Canada

As is the case globally, Canada's sources of foreign investment have diversified in recent years. In 1978 the United States accounted for almost 80 per cent of Canada's total stock of foreign direct investment. In 1988 it accounted for less than 70 per cent. Over the same period the United Kingdom, Japan, West Germany and Hong Kong all increased their shares.

As well as increases in foreign direct investment, portfolio investment has been increasing sharply. In fact, since 1975 it has been increasing considerably faster than direct investment. The stock of foreign portfolio investment was \$182 billion in 1988, more than 50 per cent higher than the stock of direct investment.

INTERNATIONAL ORGANIZATIONS

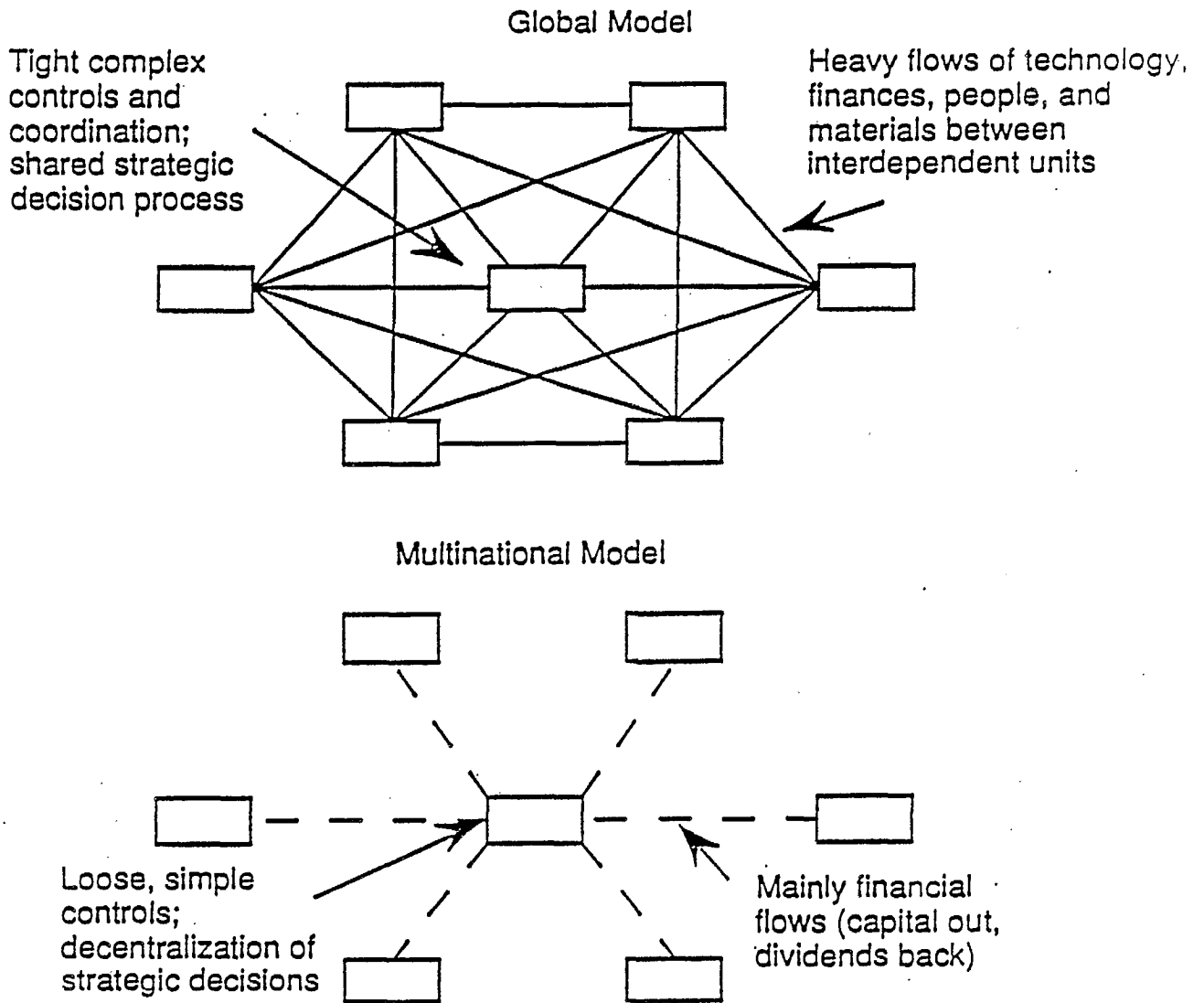


Figure 5

Canadian direct investment abroad has also been growing. Since 1984 flows have more than doubled, totalling \$12.4 billion in 1988. These figures understate the growth since they do not include financing in other countries. The total stock of Canadian direct investment abroad in 1988 was \$60.5 billion, compared to \$16.4 billion in 1978. More than 70 per cent of this is located in the United States.

The increase in foreign direct investment has been reflected in increased merger and acquisition activity. Of the major OECD countries, Canada, the United States and the United Kingdom have experienced the most substantial amount of merger and acquisition activity. In the 1970s the average number of mergers per year in Canada was 380, while in 1986 there were 938 and in 1987 1,087.¹³ Moreover, it appears that the number of large transactions has increased. Merger and acquisition activity is also increasing in the E.C., likely reflecting the anticipated benefits of 1992. In Japan the number of mergers and acquisitions is relatively low, in part due to barriers to outside participation in the economy.

2.4 The Growth of Global Corporations and the Standardization of Markets

There is widespread agreement that we are seeing the emergence of a growing number of "global corporations". There is much less agreement, however, on the meaning of "global corporation". Some authors use the terms global corporation and multinational enterprise interchangeably. Others stress the differences between them. Moreover, the same firms are often used to illustrate very different meanings. Japanese firms have been variously described as domestic corporations with foreign subsidiaries who are starting to go multinational and as examples of global corporations western business would do well to emulate.

In general, there seems to be a consensus that being "global" means more than just having foreign subsidiaries or exporting extensively. A global corporation can be characterised as having a high level of foreign investment, a balanced geographic distribution of company resources and a high level of integration and coördination among regional activities. For example, production or development activities may be specialized within regions and the results shared within the firm, across geographic boundaries.

This contrasts with the traditional view of a multinational corporation which also pursues a broad geographic distribution of resources, but has relatively low levels of integration or coordination among country and regional activities. Each subsidiary acts

¹³ R.S. Khemani, D.M. Shapiro and W.T. Stanbury, Mergers, Corporate Concentration and Power in Canada (Institute for Research on Public Policy, Halifax, 1988) p5.

independently of the others, and there is considerable duplication of activities between regions. These differences are illustrated diagrammatically in Figure 6.

Global corporations are also associated with a standardized product, crossing national, regional and cultural boundaries. Examples include Coca Cola, Gucci handbags and Levi jeans. Many see global corporations as bringing about a convergence of consumer tastes, described by Kenichi Ohmae as "the Californization of need." People are attracted to the products because they are relatively low priced and high quality. "Everyone, in a sense, wants to live - and shop - in California."¹⁴

Global corporations can be seen as bringing about far more than just a convergence of consumer tastes - they are also causing a convergence in business activity. Global corporations are highly competitive, constantly seeking to drive down prices through standardizing what they sell and how they operate. To compete effectively, other firms must do likewise:

It sells the same things in the same way everywhere...they exemplify a general drift toward the homogenization of the world and how companies distribute, finance, and price products. Nothing is exempt. The products and methods of the industrialized world play a single tune for all the world, and all the world eagerly dances to it.¹⁵

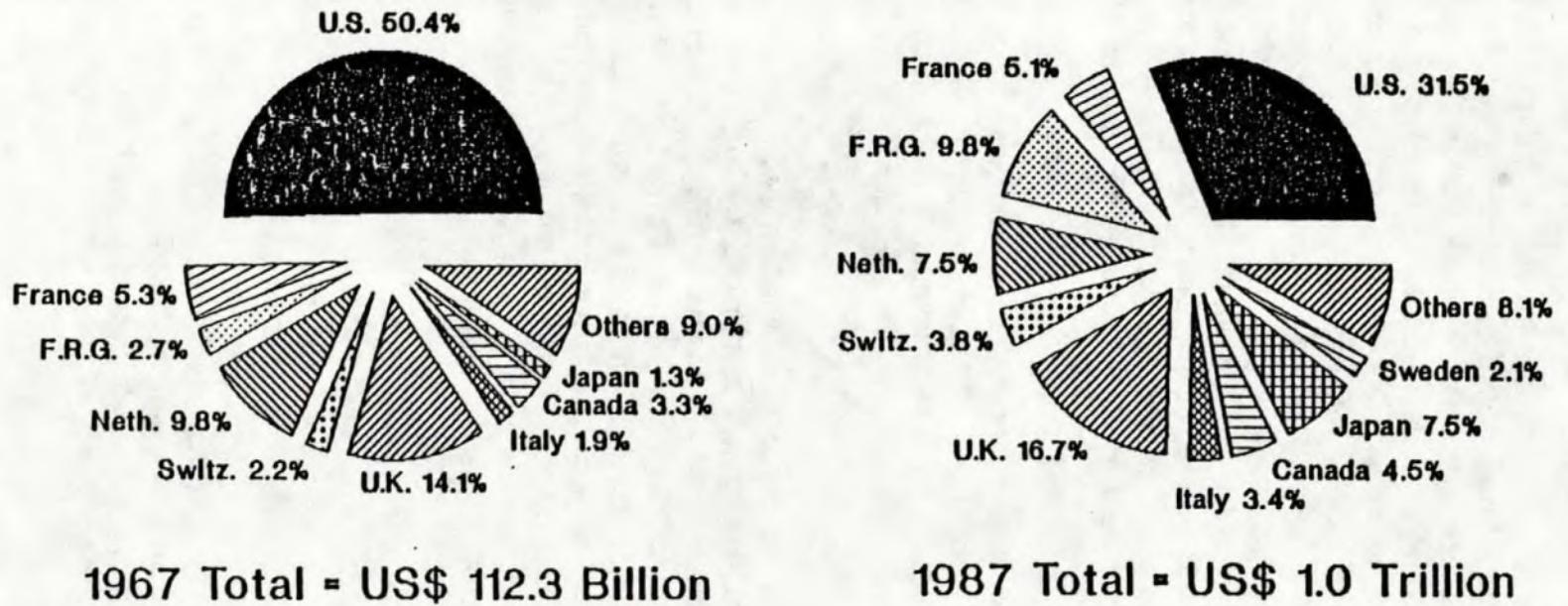
(It should be noted that while Professor Theodore Levitt originated the concept of global corporations producing highly standardized products, he now places far less emphasis on the importance and prevalence of product standardization.)

Standardization is only one means of reducing costs. Global corporations are also characterized by their ability to establish activities wherever costs are lowest. Their planning is undertaken with reference to global conditions, not just those of one domestic market. Decisions on where to locate their activities will depend on the resources and markets available to them all over the world.

¹⁴ Kenichi Ohmae, "The Global Logic of Strategic Alliances" in Harvard Business Review, March-April 1989, p144.

¹⁵ Theodore Levitt, "The Globalization of Markets", Harvard Business Review, May-June 1983, p93.

World's Stock of Direct Investment Abroad Distribution by Major Source Countries



Source: U.S. Department of Commerce

Figure 6

Research and development activities are among those which are planned globally. Factors determining where research and development is carried out include the availability of skilled workers, proximity to major markets and government policies. Many governments encourage foreign firms to conduct research and development. For example, E.C. members are considering waiving import duties on products for those manufacturers which perform a certain level of research and development in Europe. Similarly, Australia has a Partnerships for Development program to encourage research and development by foreign firms. To qualify, a company must spend 5 per cent of its Australian turnover on research and development, exports must exceed imports by 50 per cent and exports must have an Australian added value of at least 70 per cent. Participating companies gain access to a large information technology market in Australia. Current participants include Apollo, Apple, Syncon, HP, Honeywell and IBM.

The development of global corporations is thought by many to make the concept of a national corporation outdated. Companies operating with global strategies are also contributing to interdependence. Policy changes in one country may alter the most profitable distribution of activities for a firm and thereby affect foreign investment and output in other countries.

It is hard to identify the number of Canadian global corporations, since being global rather than multinational is largely a matter of internal strategy and organization. It is possible, though, to identify firms which have significant foreign investments outside Canada and a significant proportion of whose sales are outside the domestic market, whether these be exports or the production of foreign subsidiaries. The 20 largest of these are shown in Table 4. Most are in the resource-based industries. The firms involved have engaged in considerable forward vertical integration, however, with fewer and fewer revenues being derived from sales of raw materials and more from manufactured and processed resource products.

2.5 The Growth of Strategic Alliances

Strategic alliances are not a new phenomenon. The Seaboard Lumber Sales consortium of British Columbia, to cite an example, has been in existence for over 50 years.¹⁶ There is general agreement, however, that strategic alliances have become more frequent over the past decade and increasingly involve foreign partners. Many predict that competitive advantage will be based increasingly not only on a firm's internal capabilities, but also on its arrangements with other companies. In some industries, such as the auto industry, strategic alliances are significantly changing industry structure.

¹⁶ Jean Sorensen, "Winning Together" in BC Business, August 1988, p55.

Table 4

20 LARGE CANADIAN INTERNATIONAL CORPORATIONS
(1983)

	Foreign To Total Sales (%)	Foreign To Total Assets (%)	No. of Foreign Nations In Which Active
Alcan	84	61	28
Seagram	92	93	20
Noranda	63	29	17
Hiram Walker	42	40	5
NOVA	29	14	4
Northern Telecom	79	55	11
Massey-Ferguson	91	79	33
MacMillan Bloedel	79	34	7
Moore	90	91	39
Inco	85	48	14
Genstar	60	52	1
Domtar	29	14	2
Abitibi-Price	63	12	1
AMCA	76	71	7
Molson	32	27	35
John Labatt	na	na	3
Consolidated-Bathurst	54	16	3
Cominco	73	15	12
Bombardier	67	22	4
National Sea	71	29	5

Source: Alan Rugman and John McIlveen, Megafirms (Methuen, Toronto, 1985), p22.

Strategic alliances can be described as formal, long-term alliances between firms that link aspects of their businesses but which fall short of a merger. They include joint ventures, which involve a partial and often temporary integration of the parents' functions in some new project, leaving the parents free to continue as separate operational units. They also include licensing agreements and marketing agreements. Examples of various kinds of strategic alliance are given in Table 5. It should be noted that partners in strategic alliances are not only businesses but also governments, universities, and health care institutions.

Table 5

STRATEGIC ALLIANCES

Joint Venture:

generally equity based and either performs some economic activity that neither partner could do as well alone or fulfill governmental requirements for doing business. One partner or a separate management operating at arm's length from the partners may manage such ventures.

R&D Consortia:

usually involve the establishment of a separate R&D activity, with partners sharing the costs and results and possibly contributing joint staff or other resources.

Resources Sharing:

a variety of mechanisms whereby partners share or trade skilled people, information systems, materials, manufacturing facilities, distribution systems, R&D.

Cross-licensing Agreement:

each partner has access to license technology developed by the other, on preferential terms. These agreements assume that each partner has or expects to have something to license.

Cross-distribution Arrangement:

each partner has rights to distribute products or services produced by the other, on preferential terms.

Tied Spin-off:

a new company formed by a group of employees from the parent company, yet maintaining a link with the parent company. Tied spin-offs enable companies to test new business ideas with minimal direct risk.

Symbiotics:

a condition in which two or more firms cannot exist without the other. Involved parties develop a cooperative supplier-customer relationship (from adversaries to allies) such as exists in the computer industry between hardware and software firms, or between auto assemblers and their parts suppliers.

IBM provides an example of a company that has made expert use of strategic alliances. The business software that made IBM computers so successful was developed by Lotus Development Corporation. Microsoft wrote the operating system on an Intel microprocessor. Many of the components of the IBM PC are out-sourced. "In fact the

heart of IBM's accomplishment with the PC lay precisely in its decision - and its ability - to approach the development effort as a process of managing multiple external vendors."¹⁷

Data on the incidence of joint ventures is scarce, but what information there is suggests they are becoming increasingly important. In Germany joint ventures accounted for 25 per cent of merger and acquisition activity between 1973 and 1982. In Japan the number of joint venture agreements involving at least one Japanese and one foreign enterprise doubled between 1970 and 1982.¹⁸

For U.S. based companies, arrangements involving overseas partners, licensees, or local shareholders, outnumbered fully-owned subsidiaries by a ratio of 4 to 1 in 1981. The strategic alliances, however, involved much smaller activities. Indexes such as assets or the number of employees indicate that the fully-owned foreign subsidiaries of U.S. based firms accounted for over two-thirds of the value of foreign investment.¹⁹

Traditionally, strategic alliances were not popular with business. Having to join forces with another firm was seen as a sign of weakness. Increasingly, though, this attitude appears to be changing. The high cost of technology development, combined with shorter lifespans for products, is forcing many firms to share the costs of research and development. This trend is reinforced by the complexity of technological change, forcing firms to draw on a variety of complementary technologies. Large firms are entering into alliances with smaller firms to exploit their entrepreneurial capabilities and market niches. In addition, the need for small and medium sized businesses to enter international markets in order to maintain competitiveness is fostering strategic alliances. Often small companies do not have the financial or managerial resources to build or buy subsidiaries abroad. Even for large companies, it may be easier to form an alliance with a firm which already has a knowledge of the local market rather than trying to build up that knowledge from scratch.

¹⁷ Kenichi Ohmae, "The Global Logic of Strategic Alliances" in Harvard Business Review March-April 1989, p145.

¹⁸ Organisation for Economic Cooperation and Development Competition Policy and Joint Ventures (OECD, Paris, 1986) pp12-13.

¹⁹ Farok J. Contractor, and Peter Lorange, "Why Should Firms Cooperate? The Strategy of Economics Basis for Cooperative Ventures" in Cooperative Strategies in International Business p4.

The aims of strategic alliances vary considerably. Table 6 provides a summary of these and Figure 7 shows the motivations for a sample of seventy cooperative agreements. Motivations include gaining access to skills, resources or markets, achieving economies of scale, reducing the risk of large and uncertain investments, and co-opting or blocking competition.

Table 6

CONTRIBUTION OF STRATEGIC ALLIANCES

- Risk Reduction

- Product portfolio diversification
- Dispersion and/or reduction of fixed cost
- Lower total capital investment
- Faster entry and payback

- Economies of Scale and/or Rationalization

- Lower average cost from larger volume
- Lower cost by using comparative advantage of each partner

- Complementary Technologies and Patents

- Technological synergy
- Exchange of patents and territories

- Co-opting or Blocking Competition

- Defensive joint ventures to reduce competition
- Offensive joint ventures to increase costs and/or lower market share for a third company

- Overcoming Government-Mandated Investment or Trade Barriers

- Receiving permit to operate as a "local" entity because of local partner
- Satisfying local content requirements

- Initial International Expansion

- Benefit from local partner's know-how

- Vertical Quasi Integration

- Access to materials, technology, labour, capital, distribution channels
- Establishing links with major buyers
- Drawing on existing fixed marketing establishment

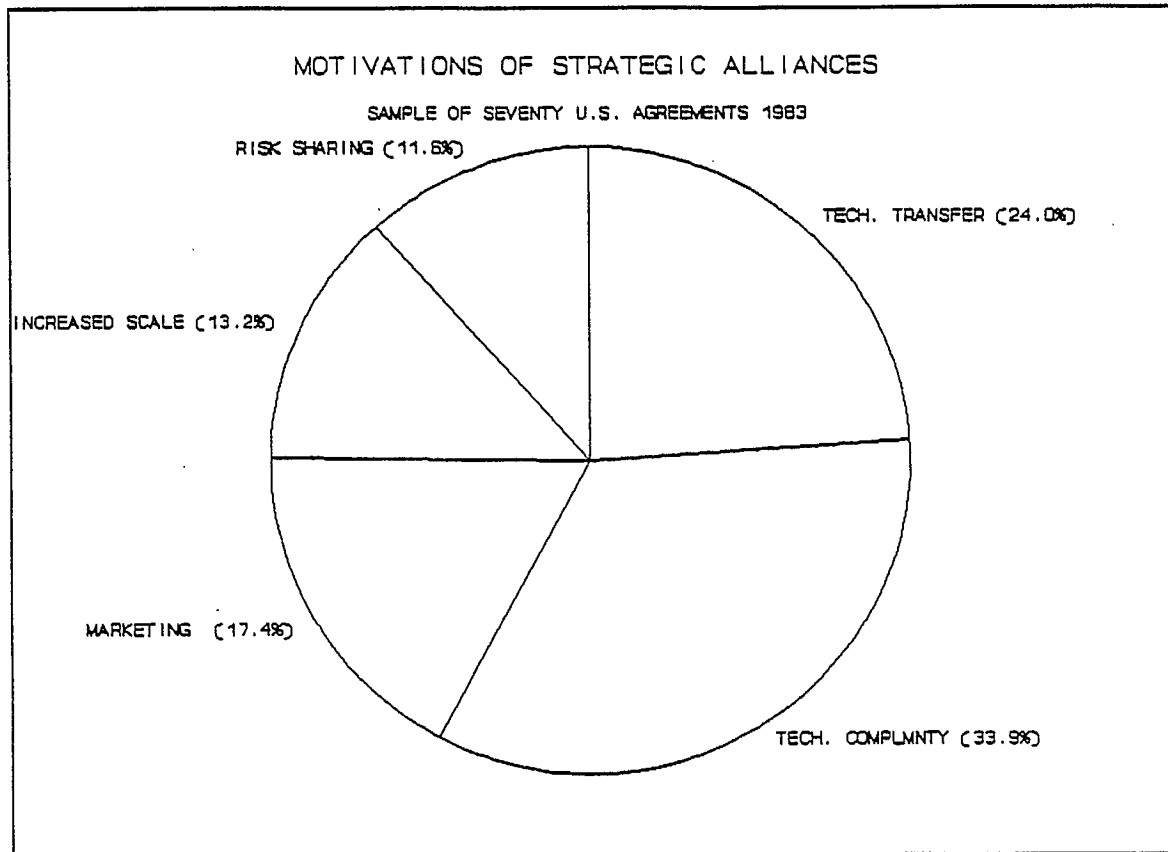


Figure 7

The character of joint ventures is changing. In the past such alliances were generally used to exploit peripheral technologies and markets.²⁰ Increasingly, however, they involve products, markets or technologies closely related to the parents' core activities and are critical to a company's strategic direction. For example, around 98 per cent of the joint ventures in existence in Canada involve two or more parent firms from the same industry. In the 1970s, foreign firms teamed up with local firms in foreign markets in order to produce or market their products. Now joint ventures include a wider variety of activities, including research and development.²¹

²⁰ Michael J. Geringer, Trends and Traits of Canadian Joint Ventures, prepared for Investment Canada, February 1990.

²¹ Karen J. Hladik, International Joint Ventures: An Economic Analysis of U.S.-Foreign Business Partnerships (Lexington Books, Massachusetts, 1984) p40.

The growth of strategic alliances in research and development is particularly interesting since it was an area jealously guarded by firms in the past. The importance of maintaining knowledge within the firm to gain market advantage is a prominent aspect of the traditional literature on multinational corporations. Now there are a number of programs promoting international collaboration between firms for research and development, the best known being the European Strategic Programme for Research and Development in Information Technologies (ESPRIT).

Where Canada fits into the overall trend in strategic alliance activity is uncertain. According to a 1989/90 survey of Canadian advanced technology firms by Ernst and Young, 41 per cent of respondents are involved in at least one strategic alliance.²² Table 7 shows the type of alliance by size of firm. In a study of Canadian joint ventures, undertaken for Investment Canada, it was found that, compared to the United States, Canada has a high number of joint ventures per capita and their survival rate is high.²³ The number of joint ventures decreased, however, during the 1980s. Given the changing nature of strategic alliances, it is not possible to tell from numbers alone whether or not alliance activity in Canada is consistent with international trends. (More information on Canadian strategic alliances is given in Section 3.3)

2.6 The Development of Global Financial Markets

No company, national government or individual can ignore or be insulated any longer from the financial revolution that is under way in Canada and throughout the world. Technological innovations have given rise to global computer systems and communications networks that mediate a growing volume of financial transactions and these are interlinking and integrating national markets.²⁴

Part of the trend toward greater interdependence and integration has been the emergence of global financial markets. The rapid international spread of the October 1987 stockmarket crash exemplifies for many the resulting increased vulnerability of domestic economies.

²² Ernst & Young, Directions '89/90: A Survey of Advanced Technology Companies in Canada, (December 1989).

²³ Michael J. Geringer, Trends and Traits of Canadian Joint Ventures, prepared for Investment Canada, February 1990.

²⁴ Maurice Estabrooks, "Global Innovations: The Impact on Canada's Financial Markets" a book review appearing in Globe and Mail, Tuesday July 25, 1989, pB6.

Table 7

ALLIANCES WITHIN CANADIAN HIGH-TECH INDUSTRY
(Results of a 1989 Survey of High-tech Firms)

	Total	Small	Medium	Large
R&D Consortia	223 (67%)	130 (66%)	74 (68%)	19 (67%)
Supplier Development Agreement	136 (41%)	73 (37%)	53 (49%)	9 (33%)
International Joint Venture	169 (51%)	99 (50%)	55 (51%)	15 (52%)
Co-Production/ Manufacturing Alliance	100 (30%)	49 (25%)	38 (35%)	12 (41%)
Technology Sharing Agreement	118 (35%)	68 (35%)	38 (35%)	12 (41%)
Other	5 (2%)	4 (2%)	1 (1%)	0 (0%)

Source: Ernst & Young, Directions '89/90: A Survey of Advanced Technology Companies in Canada (December 1989).

The globalization of finance has a number of important features:

- i) increased cross-border capital flows, largely the result of international lending and borrowing activity

International loans and credit facilities extended by banks in member countries of the OECD more than doubled between 1980 and 1985. In comparison, expansion of domestic bank loans was more limited. In Canada, loans to domestic businesses and governments by Canadian banks increased 32 per cent between 1980 and 1985; loans by Canadian banks in the United States to U.S. residents rose by 72 per cent.

Figure 8 shows the funds raised on international markets as a proportion of GDP in the G-7 countries. It can be seen that Canada has the highest proportion, at more than 4 per cent.

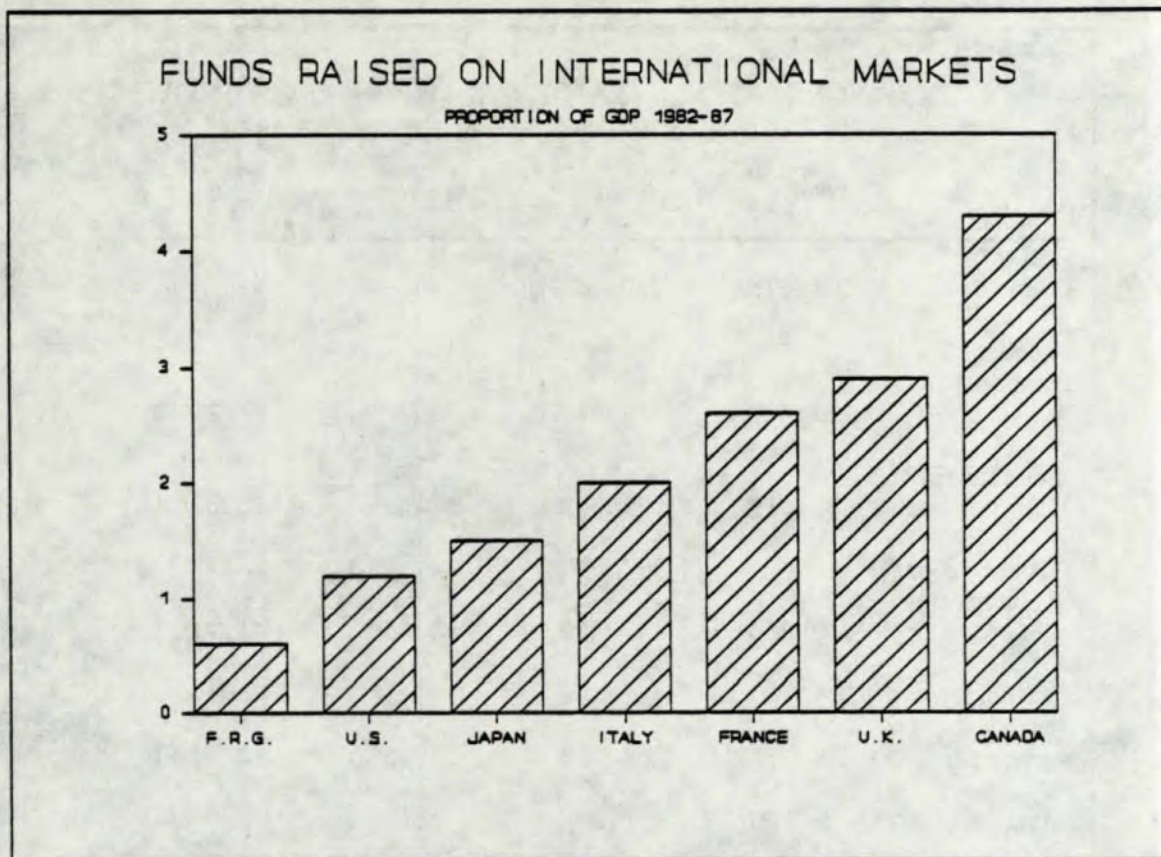


Figure 8

ii) portfolio diversification

Borrowers and investors are increasingly willing to deal in a greater variety of currencies. This can be seen in Figure 9, which shows the currency composition of international bond issues 1981-1988. In 1981, U.S. dollars accounted for 82.3 per cent of international bond issues. This fell to 41.3 per cent in 1987.

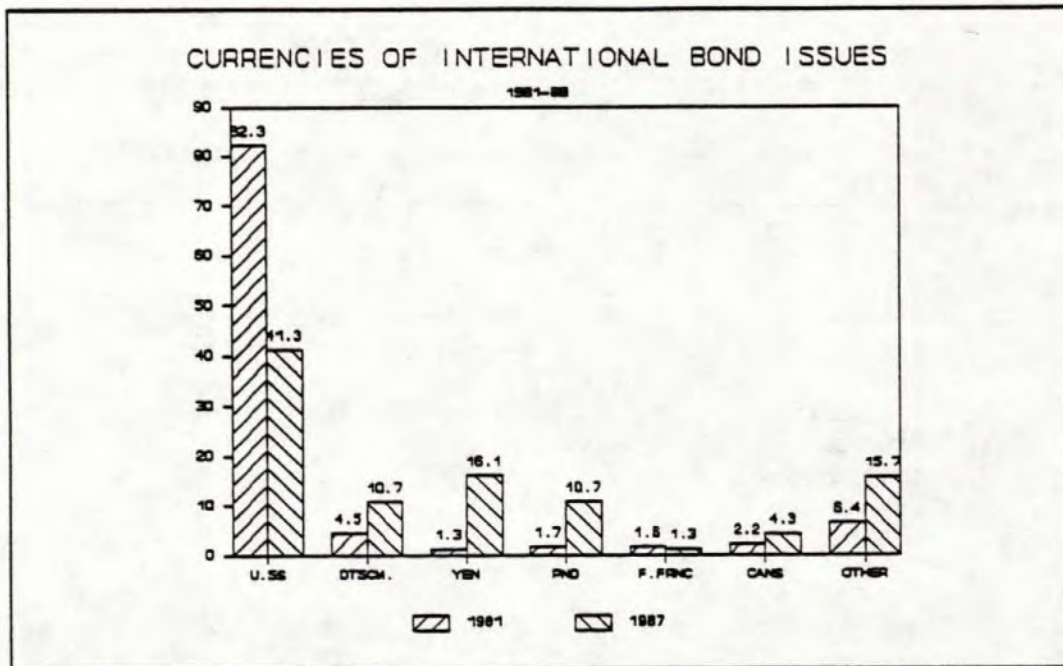


Figure 9

iii) the domestic financial markets of many countries are becoming increasingly open to financial institutions of other countries

In the past financial institutions tended to operate their international activities from their home base, often working through institutions already operating in the local markets. Increasingly, however, financial institutions have been establishing operations around the world. This can be seen in Table 8, which shows the number of foreign banks or banking offices in selected countries, including Canada.

iv) financial innovations

Innovation has also been an important aspect of the globalization of financial markets. It has both facilitated, and been fuelled by, the development of global markets. Innovation includes the development of new instruments, such as swaps, futures and securitization. These allow firms to hedge their risks and allow more flexible financing arrangements. Innovation has also occurred in financial services, such as the development of computerised trading and global electronic stock exchanges. For example, the National Association of Securities Dealers automated quotation system provides information on bids and prices via computer terminals, as well as allowing users to enter their own quotations.

Table 8**NO. OF FOREIGN BANKS IN SELECTED COUNTRIES**

	1960	1970	1980	1985	1987
(Number of Institutions)					
Belgium	14	26	51	57	-
Canada	-	-	-	57	58
Italy	1	4	26	36	-
Netherlands	-	23	39	40	-
Switzerland	8	97	99	199	-
United Kingdom	51	95	214	293	368
Australia	-	-	-	2	18
(Number of Banking Offices)					
France	33	58	122	147	156
Germany	24	77	213	287	-
Japan	34	38	85	112	-
Luxembourg	3	23	96	106	-
United States	-	-	579	783	691

Source: Economic Council of Canada, Globalization and Canada's Financial Markets (The Council, Ottawa, 1990) p5.

Other factors contributing to the globalization of financial markets include:

- the desire of large companies to raise money more cheaply, encouraging them to look to international markets;
- the desire of companies to diversify their portfolios; foreign assets reduce the risks resulting from domestic policy changes;
- the growth of multinational and global corporations requiring funds in local currencies;
- current account imbalances among the industrialized nations which have acted as a stimulus for financial institutions to look for new ways to recycle funds.

2.7 Technological Change

..it took five months for Queen Isabella to learn of Columbus' voyage; two weeks for Europe to learn of President Lincoln's assassination; and 1.3 seconds for the world to witness Neil Armstrong's first step on the moon.²⁵

There has been no similar experience [to the revolution in communications technology through satellites and computers] since 1867, when an even greater unification of world security markets occurred as a result of the completion of the transatlantic cable between London and the United States. Instead of waiting two weeks to find out what the price of the dollar was in London, you could get it in two minutes. That was a much greater improvement than satellites have brought.²⁶

It is common to read that technological change has radically transformed the way in which business is carried out. But while some believe we are going through a technological revolution, with faster and more radical changes than ever before, others claim the pace of change is no faster than in the past. In reality, it is very hard to measure the degree of change occurring; for example whether the completion of the transatlantic cable was more or less of an advance than satellite communications is difficult to judge. Current advances often seem more sweeping, just because they are the most immediate.

Technological change is normally thought to be a two-stage process. The first stage is the initial development of a product or process. The second stage is one of consolidation and convergence. Both these stages may involve considerable business restructuring, and even the demise of whole industries. An example of restructuring in the vacuum tubes industry is given in Table 9. In the mid 1950s vacuum tubes were a \$700 million market, whereas the market for transistors totalled around \$7 million. By 1982 there had been a complete turnover in industry leadership. Only two of the companies which were successful producers of vacuum tubes also became successful producer of transistors and integrated circuits: RCA and North American Philips.

²⁵ Paraphrase of statement made by Isaac Asimov in Jerome M. (ed.) The Global Marketplace (Library of Congress, U.S., 1988) p95.

²⁶ Milton Friedman, "Internationalized Economy is Nonsense" Globe and Mail, Saturday May 6, 1989, pB2.

Table 9

FROM VACUUM TUBES TO SEMICONDUCTORS

	1955 (Vacuum tubes)	1955 (Transistor)	1960 (Semi- conductor)	1965 (Semi- conductor)	1970 (Semi- conductor)	1975 (IC)	1980 (LSI)	1982 (VLSI)
1	RCA	Hughes	TI	TI	TI	TI	TI	Motorola
2	Sylvania	Transitron	Transitron	Fairchild	Motorola	Fairchild	Motorola	TI
3	GE	Philco	Philco	Motorola	Fairchild	National	National	NEC
4	Raytheon	Sylvania	GE	GI	RCA	Intel	Intel	Hitachi
5	Westing- house	TI	RCA	GE	GE	Motorola	NEC	National
6	AmpereX	GE	Motorola	RCA	National	Rockwell	Fairchild	Toshiba
7	National Video	RCA	Clevite	Sprague	GI	GI	Hitachi	Intel
8	Rawland	Westing- house	Fairchild	Philco/Ford	Corning	RCA	Signetics	Philips
9	Eimac	Motorola	Hughes	Transitron	Westinghouse	Philips	Mostek	Fujitsu
10	Lansdale Tube	Clevite	Sylvania	Raytheon	American Micro	American Micro	Toshiba	Fairchild

Source: Richard N. Foster, Innovation: The Attacker's Advantage (Summit Books, New York, 1986) p133.

To a very large extent technological change enabled globalization to occur. We are often described as having moved from an economy based on the technologies of power, mechanics and commodities, to one based on knowledge. Computers enable the easy collection and analysis of large quantities of information; improvements in telecommunications allow almost instantaneous dissemination of information; new materials, products and processes have been developed which have altered production and consumption.

As well as assisting large companies to become truly global, technological change has facilitated competition in world markets by small firms. This is because information, computer, electronic and automation technologies are decentralising in nature. They allow small firms to undertake a greater range of activities. Designing a new product used to involve a team of engineers, long lead times and many resources; now it may require no more than a PC, some computer-aided design software and one designer. Similarly, marketing used to require many resources. Nowadays small companies can go right to the consumer through telemarketing. Teletel, operated by the French government, had more than 4 million subscribers and 7,600 listing merchants in 1988 and generated more than \$1 billion in user fees.

Movement to a knowledge-based economy is also causing changes in the inputs to the production process. Most notable has been the decline in the use of basic commodities such as energy, steel and cement. Smaller quantities of traditional materials are used in part because they have been replaced by new materials, such as the replacement of copper by fibre optics, steel by polymers and ceramics. In part it is also due to more efficient use of materials, for example the manufacture of smaller, lighter automobiles. Commodity prices have - consequently - been relatively weak, to the disadvantage of Canada's terms of trade.

Instead of access to cheap resources, the skills of the workforce and the quality of research and development are becoming the keys to success. Movement towards a "knowledge-based" economy has important implications, not only for the future of individual industries, but also for the location decision of firms. Global corporations may be less attracted by good access to raw materials, and more concerned about the availability of engineers, scientists and other specialists.

Technological changes have also acted as "threatening forces". In the past, most research was done in-house. Given the speed of change and the decreased period between the development of a product and its obsolescence, however, companies are increasingly recognising they cannot rely entirely on their own research. Developments in the computer industry provide a good illustration of early obsolescence. In 1973 a prototype integrated circuit was developed with 1K (1,024 bit) memory. Two years later I.C. memories could handle 4K, in another two years 16K and another two 264K. Thus the performance of integrated circuits quadrupled every four years.

2.8 Global Environmental Issues

The time has come for a recommitment to multilateralism, to the search for global solutions...The founding fathers of the UN saw the need for a strong institutions to deal with threats to international peace and security. We now need stronger mechanisms to deal with the new threats to our security, such as the challenges from the environment. I believe that certain elements of supranationality should be considered on a global level. In regional cooperation, nations are gradually learning to accept majority decisions that on occasion may be viewed as contrary to narrowly defined national interests. A more long-term view of our common future must become the underpinning also in our global cooperation. Collective management of global interdependence is no empty slogan. It is, very simply, the only acceptable formula in the world of the 1990s.²⁷

Another important feature of globalization is the growing concern over environmental problems and, in particular, the realization that actions in one part of the world can have a significant impact in very distant countries. For many years environmental problems were viewed as largely local issues: smog in Los Angeles; an oil spill in Alaska; pollution in the Great Lakes. But increasing concern over problems such as acid rain and global warming are promoting the realization that action is required on a global scale. The nuclear accident at Chernobyl in 1987 drove home this requirement. Radioactive waste was distributed over a broad geographic area, contaminating reindeer in Lapland, vegetables in Sweden and milk in Scotland.

Environmental concerns are not limited to the industrialized world. Developing countries also face grave environmental risks. The destruction of vegetation, which results from clearing farmland and the dependence on wood as a source of fuel, has already caused severe changes in local climates. The destruction of the Amazonian Rain Forests threatens the world climate. Developing countries are also producing increasing amounts of industrial pollutants, often exacerbated by low standards or primitive processes. China, for example, is turning to coal-fired thermal generators that will seriously add to the carbon dioxide build-up in the atmosphere. In addition, the almost total absence of environmental standards in some countries risks their becoming a dumping ground for the toxic wastes of the industrialized world.

²⁷ Gro Brundtland, Keynote Address at Globe '90 Conference, Vancouver, 19 March, 1990.

Combining environmental concerns with the development needs of the Third World will be a major challenge over the next decade - a challenge for both developing and industrialized countries. In a recent address to the Globe '90 Conference in Vancouver, Gro Brundtland stressed the need to assist the poorest countries so that they can avoid repeating the mistakes of the industrialized nations. This will require financial assistance as well as the transfer of technology.

There are also severe environmental problems in the eastern bloc countries. In East Germany, for example, few if any precautions are taken to prevent seepage of waste-products from city dumps into groundwater. In the U.S.S.R. a scheme to irrigate farmland precipitated the drying-up of the Aral Sea. The rehabilitation of the natural environment will be, therefore, one of the challenges in the construction of a new political order.

Dealing with global environmental problems requires international cooperation. Countries cannot solve problems originating outside their territories. Canada cannot solve the problem of acid rain unilaterally, since many of the pollutants are created in the U.S.. Similarly, developing countries cannot be expected to volunteer to avoid heavy reliance on coal as an energy source, or to discourage the wide use of refrigerators. Solutions will require collective effort, and a flow of resources and technology to Third World and eastern bloc countries.

One of the earliest international environmental initiatives was the United Nations Conference on the Human Environment, held in Stockholm in 1972. It was followed by the establishment of the United Nations Environmental Program and the negotiation of a number of agreements between countries to deal with joint environmental concerns such as pollution in common seas. In 1983 the General Assembly of the United Nations established the World Commission on Environment and Development, which culminated in the Brundtland Report. Regional conferences on the Environment and Development are now held regularly, sponsored by the U.N..

Many people are calling for the creation of new international institutions to deal with environmental issues. The Norwegian Government, for example, has proposed the establishment of a World Climate Fund and has pledged to contribute 0.1 per cent of GDP to the fund if the majority of industrialized countries will do likewise.

2.9 Conclusion

Globalization is a reality that all countries must deal with. It is driven by the contest among firms for markets and the lowest possible costs of production and distribution. It forces each country to examine its business climate in comparison with other countries competing for new investment. This climate is defined by such factors as access to world markets, taxation, availability of a skilled and educated work force, and, above all, political and economic stability. Countries that choose to swim against this powerful tide risk losing investment and seeing their relative living standards flounder.²⁸

Globalization involves the increasing interaction of countries: economically; socially; and culturally. It is not a short term trend likely to alter in the future. Rather, it involves a radical transformation of the business and policy environment. Above all, it involves an increase in competition as the lines between domestic and international markets blur. Even firms which do not export will face foreign competitors within the domestic market.

Expected global trends in the future include:

- the continued growth of world trade and foreign direct investment at a more rapid pace than world output;
- the continued diversification of trade and investment; the dominance of the U.S. will continue to wane while the importance of West Germany and Japan will grow;
- the distinction between tradeable and non-tradeable sectors will blur;
- the private sector will continue to drive industry restructuring; intracorporate trade will account for a larger share of world trade;
- the decreased lifespan of new products will force firms to cooperate further in research and development; technological change will also intensify the need for countries to be competitive in knowledge-based industries and to ensure a mobile and highly trained labour force;
- investment and trade decisions will be greatly influenced by regional trading blocs, the liberalization of Eastern Europe, and the potential growth of Newly and Less Developed Countries;
- tensions between the pressures of globalization and nationalism will continue;

²⁸ Edward A. Carmichael et al, Ottawa's Next Agenda (C.D. Howe Institute, 1989).

- understanding of global environmental problems will increase, bringing with it greater international coordination to solve the problems.

There are, of course, disadvantages to globalization: loss of autonomy; greater vulnerability and exposure to international trends; declines in some domestic industries which are not able to compete; and the pervasive fear that Canada will be "sold off" overseas, compromising our economic and cultural future. But the alternative to globalization - building walls around Canada and protecting it from international competition - is not feasible. Protectionist policies will lead to loss of competitiveness and an inevitable decline in our standard of living. Globalization forces governments to define national and strategic interests in a much harsher light - it forces them to take greater account of the impacts of policies on the competitiveness of the business sector.

Chapter 3 examines how the business sector is adapting to globalization.

CHAPTER 3

ASPECTS OF INDUSTRIAL AND FIRM RESTRUCTURING

3 ASPECTS OF INDUSTRIAL AND FIRM RESTRUCTURING

Globalization is causing major changes to the business environment: competition facing domestic business has intensified dramatically; the nature of the competition has altered; and markets open to business have greatly expanded. Such changes are increasing the pressures on business to pay more attention to factors long held to be important determinants of competitiveness, such as investment in research and development, quality control and employee training. Further, these changes have given rise to new factors that must be incorporated into business strategies - including new forms of organizational structure.

This chapter reviews the main business implications of global restructuring by first considering the emergence of global industries. It then traces the implications for firms by considering "traditional" aspects of business organization which are becoming increasingly inappropriate in global markets. The structural changes firms must make to remain competitive are then described. Finally, some brief comments are made on the ability of Canadian firms to adjust.

It should be stressed at the outset that firms are responding to the pressures of globalization in a diversity of ways. Exceptions can be found for almost any generalization about corporate restructuring. The difficulty of identifying general trends is further compounded by the fact that most analyses are based on case studies of a few large multinational corporations. These are rarely complemented by more broad-based empirical work. How representative the case studies are of the general corporate experience, particularly the experience of smaller firms, is impossible to judge. Yet, this has not deterred many authors from making strong recommendations about needed changes in corporate behaviour. While this chapter attempts to identify general trends in the literature, the conflicting studies and poor nature of the data preclude reaching firm conclusions on the restructuring industries and firms must undergo to compete successfully in global markets.

3.1 The Emergence of Global Industries

Any study of changing firm behaviour should start by considering industry structure, since the industry is the environment within which firms must operate. In order to consider the implication of globalization it is useful to differentiate between two extremes of industry structure: multidomestic industries; and global industries.²⁹

²⁹ Michael Porter, "Changing Patterns of International Competition", California Management Review, Vol. XXVI, no 2, winter 1986.

In the case of multidomestic industries, competition in each country is essentially independent of competition in other countries. Multidomestic firms may transfer knowledge from their home-base to foreign countries. Local subsidiaries then modify the product to local conditions. The international industry is, therefore, a collection of essentially domestic firms. Examples of multidomestic industries include consumer packaged goods, retailing, distribution, insurance and consumer finance. These are products and services which are normally associated with a high degree of differentiation between countries.

A global industry is one where a firm's competitive position in one country is significantly influenced by its position in other countries. The international industry is not merely a collection of domestic firms, but firms which follow integrated international strategies, exploiting benefits gained in one market for use in another. Global industries include commercial aircraft, television sets, semiconductors, automobiles and watches.

The emergence of global industries began as early as the 1880s. Firms such as Ford, Singer, Gillette, National Cash Register, Otis and Western Electric had developed extensive world markets by the early 1900s and operated with integrated worldwide strategies. This early globalization of industries was driven by similar pressures to those driving it today: rising production scale economies stemming from technological improvements; homogenization in product needs between countries; improvements in transport including the development of the railroad and steamships; and easier communications as a result of the telegraph then the telephone.

Between 1920 and 1950 some industries moved towards a multidomestic pattern, as high tariff barriers, economic crisis and rising nationalism impeded integrated international strategies. Many American and European firms established foreign subsidiaries but they tended to adopt country-centred strategies.

Since 1950 the trend towards globalization has again appeared. The liberalization of trade barriers, along with developments in technology, transport and communications, have increased the competitive advantage of competing worldwide from concentrated activities. In turn, the costs of concentration have fallen. Demand has to some extent homogenized between countries, but at the same time there is greater market specialization within countries. This is leading to the emergence of global firms which focus on a narrow segment of the worldwide market, for example Daimler-Benz and Rolex. Industries are segmented by buyer differences which transcend country boundaries, rather than differences between countries.

3.2 Traditional Business Concepts Requiring Change

Not surprisingly given the sweeping changes occurring in the business environment, many traditional business practices are becoming outdated. Behaviour appropriate to a sheltered domestic market is often not the same as that needed to compete in the global marketplace. Yet there is a tendency to cling to old ideas, or to fail to realize in time how inappropriate past practices have become. Before considering how firms need to restructure, therefore, it is useful to list business methods that fail to recognize the implications of globalization.

3.2.1 Purely Domestic Focus

Globalization is rendering the concept of a sheltered domestic market increasingly irrelevant. Instead, the domestic market is becoming integrated into a world market. Trends contributing to this were described in Chapter 2. They include: the increasing penetration of imports; the rising levels of foreign direct investment; and mass communications which allow dissemination of information to consumers over a wide geographic area. These changes mean that even firms which do not export will face increasing international competition.

As the lines between the domestic and international economies become increasingly blurred, firms which attempt to isolate what they do domestically from what is done in the rest of the world will be at a disadvantage. They will not be able to anticipate future competition and may as a consequence be taken by surprise by less expensive or better quality products reaching the market. Moreover, a firm which is only catering for the domestic market and sourcing its inputs domestically will in many cases be at a competitive disadvantage compared to a firm which is producing for the world market and sourcing its inputs from a variety of countries.

In order to remain competitive, therefore, most firms must develop an understanding of world markets: potential competitors; consumers; and suppliers.

Whether a company elects to operate within its own borders or go abroad, the leaders of that organization must have a global rather than a local orientation in order to anticipate and react to new situations as they arise.³⁰

³⁰ Catharine G. Johnston, Globalization: Canadian Companies Compete (Conference Board of Canada, Ottawa, February 1990) p31.

3.2.2 Blurring of Distinction Between Tradeables and Non-tradeables

The need for firms to adopt a global vision is of equal concern to sectors traditionally thought of as being "non-tradeables" as it is to the conventional "tradeable" sectors. In fact, globalization is blurring the distinction between tradeables and non-tradeables. This is well illustrated by the competitive pressures being experienced by the service sector, due both to its impact on costs for manufacturers and to the emergence of global markets for services.

As important business inputs, many domestic services have a direct impact on the cost and quality of manufactured goods. Even services which are not direct inputs, such as health services, have an indirect impact on firm costs. In the face of intensified international competition, manufacturers must ensure that inputs from the service sector are efficiently supplied.

Additional competitive pressures are occurring with the development of international markets in services. Many firms are shopping globally for services, just as they are for other inputs. Thus, if domestic services are not competitive, both local and foreign firms will try to source their services elsewhere. This may involve moving their operations outside Canada. Alternatively, they may import services. Imports and exports of services have grown rapidly in recent years. The export of health services, for example, includes hospital management and maintenance contracts, health insurance, fitness advice, counselling and training.

3.2.3 The Traditional Multinational Corporation

In some industries which are adopting global structures, the traditional multinational corporation is becoming increasingly inappropriate. As described in Section 3.1, multinational firms adopt multidomestic strategies: their decentralized structure gives considerable autonomy to each geographic subsidiary and regional managers have primary control of the corporation's activities within the subsidiary's area. In other words, their international strategy is a series of separate country strategies.

The traditional multinational structure emerged in part as a reaction to trade barriers, with companies able to gain market access only by opening up production facilities in foreign countries. The structure allows close association with the local market and adaptation to local tastes. An autonomous subsidiary is also able to integrate with the local economy, adapting its practices to local customs and conditions. Such autonomy, along with the presence of production and sometimes research facilities, is greatly favoured by country governments.

The multinational structure, however, has a major disadvantage. It does not allow corporations to plan strategically at the global level. There is no mechanism whereby the allocation of resources and activities can be rationalized worldwide. Instead, resources are duplicated in each country. Increasingly, multinational corporations are facing competitors who are planning globally and who are, moreover, gaining a competitive advantage from doing so. As described in Section 2.4, global corporations integrate their worldwide activities according to an overall strategy. They streamline costs by centralizing activities in locations offering particular advantages, such as better access to skilled labour or low cost raw materials. Centralization also allows them to benefit from greater economies of scale.

In other words, the geographic spread of a firm's activities has become an important strategic issue in many industries, but the traditional structure of a multinational corporation is ill-equipped to address such planning. Concluding that the traditional multinational corporation is dead is somewhat extreme since there are still many multidomestic industries. It is true, however, that industries are becoming increasingly globalized with corporations adopting more centralized structures in order to rationalize their worldwide activities.

3.2.4 Growing Complexity of Comparative Advantage

The growing importance of global strategies is increasing the complexity of comparative advantage. The traditional concept of comparative advantage states that there are factor-cost and factor-quality differences among countries and these determine what products are produced in what countries. Those countries which have a comparative advantage in producing a particular product tend to export this product to other countries. In an industry where firms are rationalizing their activities on a worldwide basis, the location of activities is still crucial to the ability of a firm to compete. Comparative advantage, however, is no longer tied to the firm's home-base or country of ownership.

Whereas the traditional concept of comparative advantage relates to production, location has become equally important for other activities such as research and development, marketing and servicing. Technological change is also altering the importance of individual elements of advantage. Raw materials are becoming less important, while the mobility and skills of human resources have become a crucial component of competitiveness.

In addition, the traditional determinants of competitive advantage relate to country-specific factors. Yet country-specific factors are becoming increasingly unstable. Advantages stemming from low cost inputs, such as labour, can be abruptly undercut by the emergence of new competitors. Similarly, volatile exchange rates can radically alter relative costs. Moreover, exchange rate movements may be driven more by international capital movements than by the underlying cost structure of the economy.

This growing instability is placing greater importance on how a corporation plans and undertakes its activities, in contrast to where it locates activities at any one time. To be competitive over the longterm a company must be flexible: it must be able to alter its processes, suppliers and locations, as conditions alter.

The key to having a competitive advantage is the existence of a strong organization capable of anticipating and reacting to changes in the environment, or looking down the road to see opportunities before the competition does.³¹

3.2.5 The National Firm

With the increased penetration of local markets by foreign firms and the growing need for domestic firms to pursue global strategies, the concept of what constitutes a domestic firm (or "Canadian" firm in Canada's case) is becoming increasingly unclear. In particular, the country of ownership of a firm is becoming less important than the actual activities carried out domestically by the firm.

This can be illustrated by considering two alternative examples:

Firm A is owned domestically, but carries out little production in Canada and employs largely non-Canadians in its foreign operations. It undertakes little research and development in Canada.

Firm B is owned overseas but undertakes significant production in Canada. The resulting goods are sold in the local market and exported overseas. The company also has a major research laboratory in Canada. Both the production and research facilities are staffed primarily by Canadians. (e.g. Dupont, Esso.)

Company A would normally be classified as the "Canadian" firm, because it is Canadian owned. Yet is it company B which is making a more important contribution to the local economy and thus is more important to our economic future. The remarks of Robert Reich referring to the U.S. are equally true for Canada:

³¹ Catharine G. Johnston Globalization: Canadian Companies Compete (Conference Board of Canada, Ottawa, February 1990) p56.

But today, the competitiveness of American-owned corporations is no longer the same as American competitiveness. Indeed, American ownership of the corporation is profoundly less relevant to America's economic future than the skills, training, and knowledge commanded by American workers - workers who are increasingly employed within the United States by foreign-owned corporations.³²

Some still place importance on ownership, feeling that a firm which is controlled within Canada is more likely to operate in Canada's national interest than one controlled outside Canada. But as firms pursue global strategies, the interests of corporations are becoming increasingly distinct from domestic national interests. For example, the national interest may suggest that production be carried out in the local market, whereas corporate competitiveness requires off-shore production which can then be imported into the domestic market. In such situations it is unlikely that companies will place the national interest above corporate goals. This is born out by numerous examples of companies which undertake a large share of their production and research outside the home market. Indeed, the growing prevalence and importance of off-shore activity underscores the fact that the conventional interpretation of national interest is itself out-dated.

3.2.6 Solo and Sporadic Research and Development

Section 2.7 described the radical advances being made in telecommunications, computers, and manufacturing. The ongoing development and application of high-technology is becoming an increasingly crucial determinant of a firm's ability to compete. Yet, at the same time, the increased cost of research and development is pushing it beyond the capabilities of single firms.

An important factor contributing to both the need for and cost of research and development is the rapid rate of obsolescence. The time period between the development of a product and its replacement by a more advanced version has decreased greatly in recent years. Spurred on by the shrinking product development times of their Japanese competitors, Xerox reduced the development times of copiers from five years to only two and a half. Rolls-Royce cut the development-to-certification time for new turbine blades from five to two years, and IBM halved the product development time of the personal computer to 18 months.³³

³² Robert B. Reich "Who Is Us?" in Harvard Business Review, January-February 1990, p54.

³³ Business International The 1993 Company: Corporate Strategies for Europe's Single Market (Business International, London, 1989) p49.

The rapid rate of obsolescence means firms must constantly renew technology if they are to remain competitive. This requires on-going investments in research and development. At the same time, however, the expected sales period of products, and thus the period over which the research and development costs can be recaptured, is decreasing. Firms are cooperating, therefore, sharing the costs and risks of research.

A second factor contributing to escalating research costs is the growing complexity of technology. Firms need to draw on a wider range of complementary skills for their research, skills which are often beyond the scope of the firm's existing activities. Developing such capabilities is often not feasible, thus firms must gain them through mergers and acquisitions, or through cooperative ventures.

3.2.7 Dichotomy Between High-Technology and Low-Technology Industries

The importance of adopting new technology and investing in research and development is not only relevant to the so-called "high-technology industries". Even in more traditional industries, the effective application of high-technology is often crucial to the development of new products and less costly methods of production. The dichotomy between high-technology and other industries is decreasing.

A good example of the importance of high technology in traditional industries is provided by the textile industry. Methods of production and design have been transformed by increased automation and computerization.

3.2.8 Environmental Insensitivity

Companies which do not take adequate account of environmental issues will face poor growth prospects. Managers are being forced by their markets to become more environmentally aware:

- consumers are becoming more conscious about the environmental hazards of particular production processes and the problems associated with particular consumption patterns; for example, the recent emergence of "green" products in many supermarket chains in Canada is a response to consumer demand for more environmentally friendly products;
- "green" unit financial trusts, that invest only in environmentally sound companies, are growing in popularity, especially in Europe; for example, the first explicitly environmental fund in the United Kingdom was the Merlin Ecology Fund, launched in 1988; it lends to companies which are either directly engaged in pollution control or that demonstrate a positive commitment to the long-term protection of the environment;

- insurance industries are becoming more involved in environmental policies, in light of the potential for civil litigation in cases of environmental damage.

In addition to these market factors, government regulations concerning environmental standards are likely to stiffen. These changes mean that companies will have to consider the environment as a crucial factor of production, affecting both production processes and their final products.

3.3 Aspects of Structural Change

As the business community becomes aware of the growing inappropriateness of many traditional strategies and systems, companies are restructuring in a wide diversity of ways. These involve changes in locational configuration, organizational structure, scale and the nature of final products. As stated at the outset of the chapter, this diversity of experience, combined with a paucity of broadly representative data, precludes the drawing of unequivocal conclusions. Rather, this section reviews some of the major conundrums and highlights where possible, emerging trends.

3.3.1 Rationalization of Location

Michael Porter comments that many aspects of the strategy followed by international firms are the same as those important to purely domestic firms:

Many of the strategy issues for a company competing internationally are very much the same as for one competing domestically. A firm must still analyze its industry structure and competitors, understand its buyer and the sources of buyer value, diagnose its relative cost position, and seek to establish a sustainable competitive advantage within some competitive scope, whether it be across-the-board or in an industry segment.³⁴

He states that the major difference between international and domestic strategies is that international firms must give on-going attention to the global configuration of their activities: where to undertake production, research and development, marketing and servicing; and whether specific activities should be concentrated in one location or decentralized to local markets. This aspect of global strategy has already been described earlier in this chapter as well as in Section 2.4.

The outcome of each firm's decision on how to configure its activities cannot be stated beforehand. It will be highly dependent on the nature of the firm's product. Factors such as the degree to which economies of scale can be exploited, the particular

³⁴ Michael E. Porter, "Changing Patterns of International Competition" in California Management Review, Vol. XXVIII, no. 2, Winter 1986, p11.

features of specific locations such as low cost resources or access to skilled personnel, and the nature of competitors will all impact on the decision. Transport costs are another factor. When the transport costs associated with moving final goods is high, production facilities may need to be situated nearer to local markets than supplies of inputs.

The importance placed on consumer contact and the degree to which production and research are linked to local markets is also a crucial locational determinant. All firms face conflicting pressures between the need to centralize activities so as to increase efficiency, and the need to remain in touch with local consumers - in other words, between the need to think global but act local.

The telecommunications industry provides an illustration of these conflicts. Pressures towards centralization come from the high costs of research and production and the existence of significant economies of scale. Yet the world market for telecommunications equipment is still highly fragmented, in part due to considerable government intervention in domestic markets. Thus, there is a need for customization of equipment and active participation in local economies.

The diversity of potential responses to the question of global configuration, notwithstanding, two general trends can be discerned from the literature: the centralization of upstream activities; and the decentralization of downstream activities. These are both considered below.

Centralize Upstream Activities

The need for greater efficiency is encouraging greater centralization of upstream activities (i.e. those activities which are less closely linked to the consumer). Upstream activities generally include production, research and development, and financial planning. It should be noted that centralization does not mean that all research and production activities are undertaken in one large complex. Rather, it means that similar activities are centralized in one location, rather than being duplicated across regions. All research related to one objective, for example, would be carried out in the same place, but there may be many research strands, and hence, research locations. Similarly, all basic research would be centralized, but not necessarily in the same location as production is undertaken.

IBM's manufacturing operations provide an example of centralization. Each facility is highly specialized and supplies the global needs of the company:

...for a given system as ordered by a European customer, the water-cooled CPU might come from France (but with ceramic multi-layer substrates and memory modules from Germany, and power supplies from Spain), the disk drives might come from Germany

and the tape drives from Spain, the printers from Sweden, and the display units (VDUs) from the UK but with network mini-computers as controllers coming from Italy!...the development laboratory may be on the other side of the world.³⁵

As mentioned earlier, the locational features attracting a firm will depend on the nature of the specific activity. They also include supply advantages such as access to natural resources and skilled labour. They include advantages on the demand side, such as access to a large consumer market. In addition, government policies will impact on a firm's decision, including incentives for particular activities such as research and development. Barriers to trade also continue to impact on location. Many companies feel that to compete in Europe they will be required to make significant investments there in terms of production and research facilities. In general, however, protectionist policies are more likely to hinder than help the centralization of activities.

Decentralize Downstream Activities to Local Markets

With increased international competition and more easy dissemination of information about products, there is a widespread view that consumers are becoming more discerning in their tastes. Many see the needed response as closer contact with the consumer. Thus, while the need for greater efficiency is creating pressures to centralize upstream activities, the need for greater consumer contact is encouraging the decentralization of consumer-linked activities such as sales, marketing, and servicing.

The European division of NEC Electronics combines highly centralized manufacturing with decentralized marketing. The company has manufacturing plants in Scotland and Ireland, which form part of a global sourcing system along with a Japanese plant. But to maintain consumer contact it has established design centres in local markets enabling response to local customer requirements. The European headquarters in West Germany acts as bridge between the sales offices and the factories, collecting consumer orders and consolidating them in a coherent production plan.

Decentralizing downstream activities obviously allows companies to better tailor products to national tastes, respond to local changes in demand and mount more aggressive marketing strategies. Depending on the extent of decentralization, firms can also gain better access to new technologies, new ideas and information about new sources of inputs. Moreover, the larger the operation, and the more extensive the activities performed in the local market, the greater the goodwill generated with the government.

³⁵ David Mercer IBM: How the World's Most Successful Corporation Is Managed (Kogan Page Ltd., London, 1987) p148.

Successful local operations may require, however, more than just establishing a physical presence in the local market. Firms may also need to closely integrate their operations with the local economy, including the adoption of local management practices and customs, and the employment of local workers. Jerome Rosow's exhortation "When in Rome do as the Romans do!" is emerging as an effective corporate policy.³⁶

3.3.2 Rationalization of Organizational Structure

Alternative Structures of Corporate Organization

Good organization design is not neat and clean. Basic formats, such as the International Division structure, rarely operate in a manner that is close to a "pure" textbook description. Nor is organization design a highly rational and scientific process but a minefield of internal complexities. Finally, since people and conditions are in a constant state of change, an organization is at least partially out of date - even at the very moment a new format is announced.³⁷

Just as the location of activities is being driven largely by the needs of global planning and consumer contact, corporations are striving to organize themselves in ways which will enable them to think global but act local. Again this is causing a considerable degree of experimentation. It is useful, therefore, to consider the possible alternative structures before ascertaining those which are gaining popularity.

The multidomestic structure of the traditional multinational corporation has already been described earlier in the chapter. This is illustrated in Figure 10, with each region having full control of business activities within its own geographic area. As stated earlier, a major disadvantage of this structure is that it detracts from global strategic planning.

³⁶ Jerome M. Rosow (ed.) The Global Marketplace (Library of Congress, U.S., 1988) p8.

³⁷ Business International Organizing for International Competitiveness: How Successful Corporations Structure Their Worldwide Operations (Business International, London, 1989) p4.

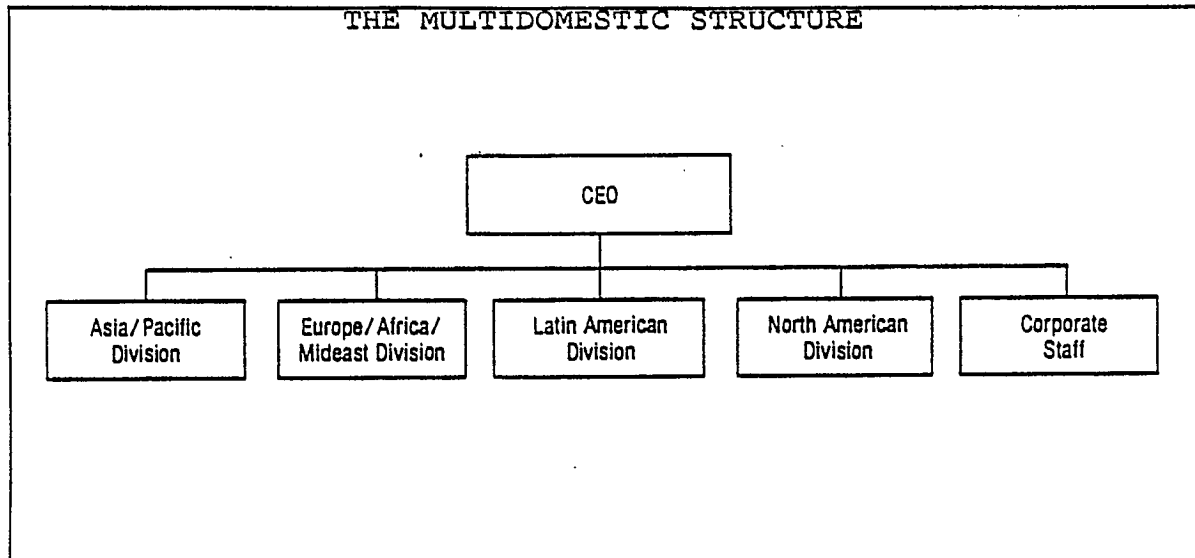


Figure 10

Cap Gemini Sogeti, Europe's largest software and systems consulting group, is a good example of a highly decentralized company with a multidomestic organization. Cap Gemini Sogeti is the holding company for four operating groups: Cap Sogeti France, SESA, Cap Gemini Europe and Cap Gemini America. Each group is run independently and is structured into branches responsible for different products and functions.

Two other structures provide equally extreme cases: the worldwide product structure; and the worldwide functional structure. These are illustrated in Figures 11 and 12.

The worldwide product structure is organized into product divisions, with each division responsible for its own worldwide product line. This structure was commonly adopted by U.S. multinationals and allows good global coordination of activities but poor links with local markets. General Electric Co. provides an example of this kind of structure. G.E. is organized into 18 businesses, all of which are responsible for their own worldwide operations and report directly to the Corporate Executive Office.

The worldwide functional structure is rarely used at the corporate level, more often occurring within businesses, divisions, regions and countries. Divisions are based on the company's major business functions, such as marketing, manufacturing and engineering, with the chief executive officers of each division having worldwide responsibility for their function.

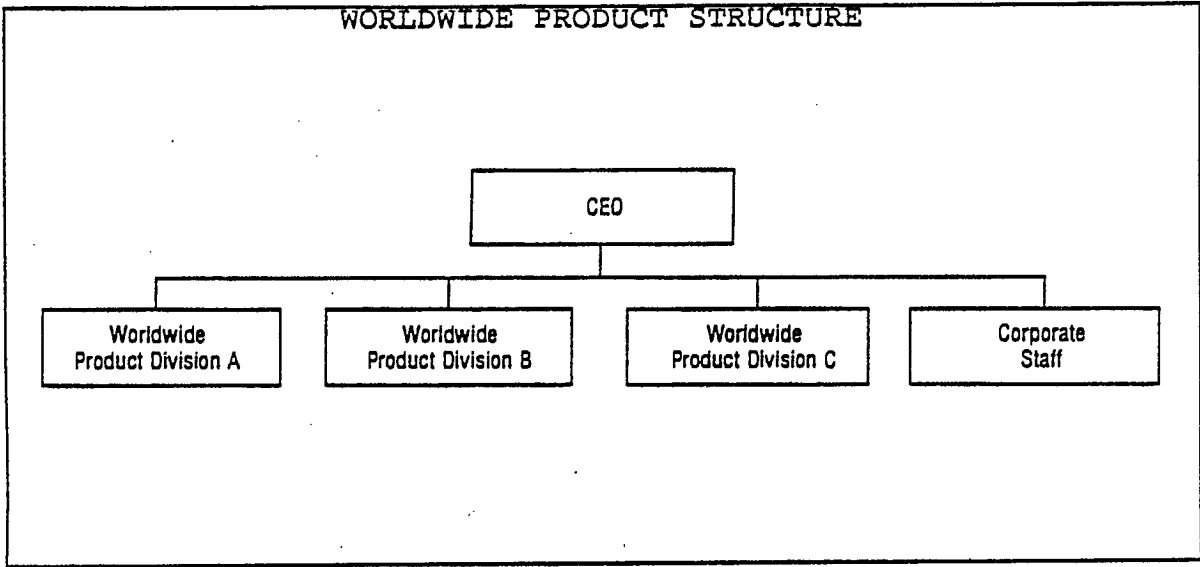


Figure 11

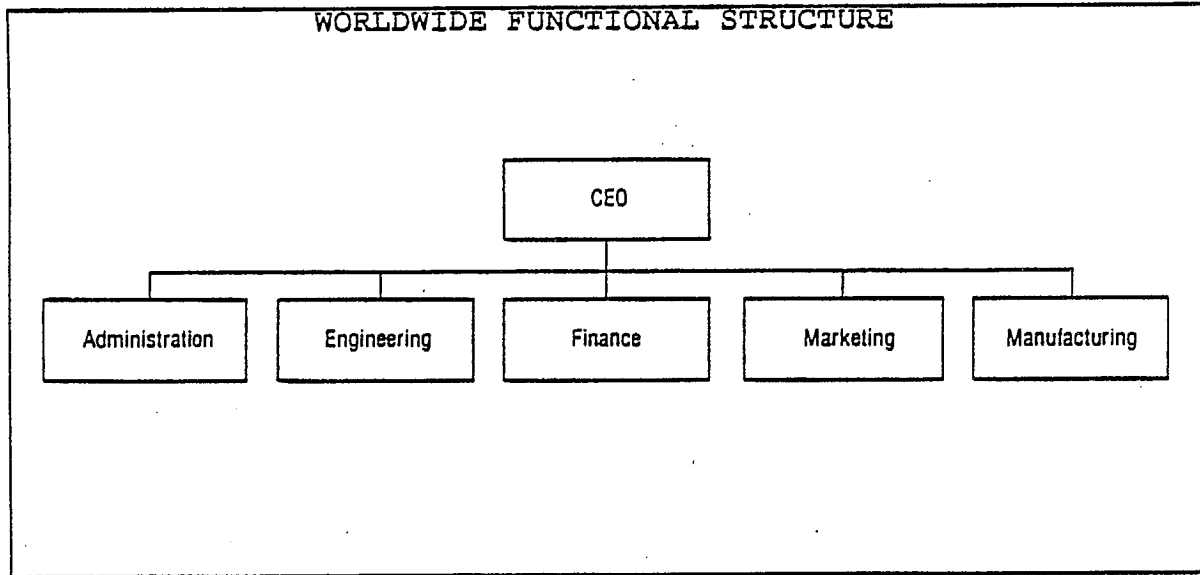


Figure 12

Although the rejection of the multinational structure has been most extensively commented on, there is also a movement away from organizing on purely product or function lines. In general, corporations are increasingly opting for structures which integrate different divisions.

A compromise alternative widely promoted during the 1970s is the matrix structure. Matrix organizations allocate strategic responsibility between product divisions and geographic divisions. While there is no single standard, matrix structures normally involve a dual rather than a single chain of command. Global and local concerns are incorporated into strategic planning through joint decision-making by the managers of the two sets of divisions.

For many companies, the matrix structure proved difficult to implement. Problems included excessive management, an unclear division of responsibilities and decreased accountability. But despite a rejection of the pure form of the matrix by some, many companies are adopting less rigid matrix-like structures. Business International describes these as "matrix overlays". These occur when companies originally organized along product, geographical or functional divisions, build-in greater structural accountability for the other two organizational elements.

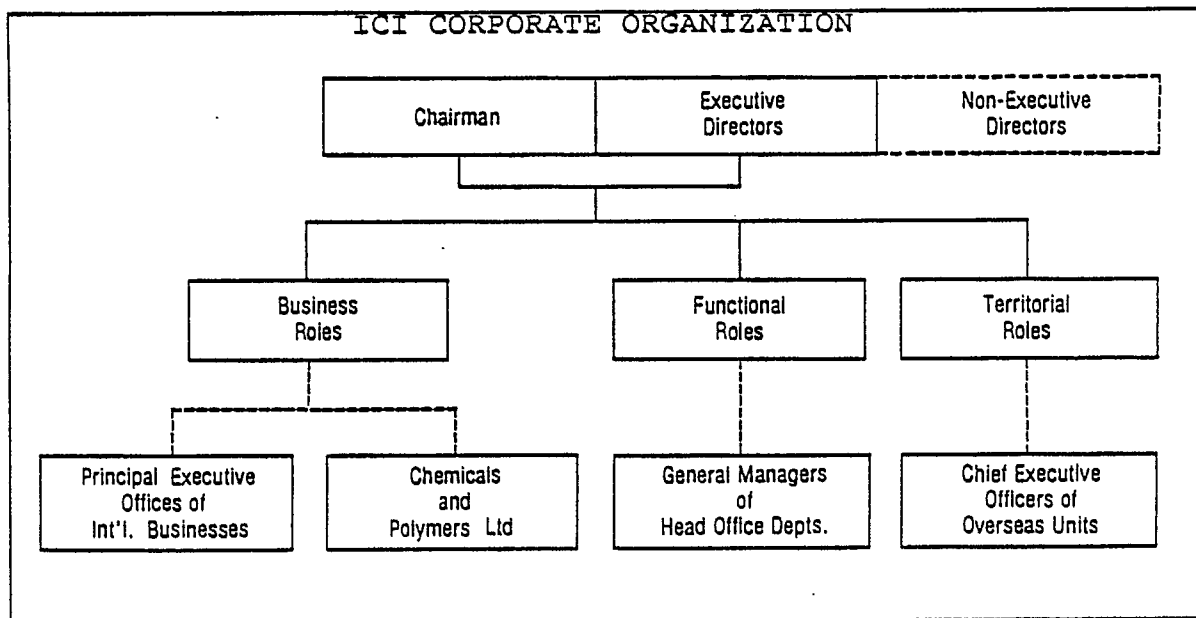


Figure 13

ICI is a company which has adopted a matrix-overlay structure. Product responsibilities play the lead role, but geographic divisions are nevertheless important. As illustrated in Figure 13, nearly half of ICI's activities are organized around "International Businesses" headed by a Principal Executive Officer. The balance of the business is consolidated in one limited company, ICI Chemicals and Polymers Ltd.. The principal executive officer is responsible for the worldwide development of the assigned business, including control over product development, research, production strategy and marketing. Country companies are headed by chief executive officers who are

responsible for maximizing total ICI sales and the efficiency of ICI operations within their territory, including any production or research operations. General corporate strategies to maximize ICI's global role and its local presence in each market are devised through a process of dialogue between the product and geographic divisions.

Another trend identified by Business International is the increase in "mixed" structures, where two or more of the "pure" structures are combined within the same corporation. For example, Gillette Co. has two principal operating units: Gillette North Atlantic and Gillette International/Diversified Operations. The first of these two units includes several of the company's businesses in North America and Europe, while the second includes both international operations outside Europe and three self-contained worldwide businesses. This is shown in Figure 14. Mixed structures have the flexibility to meet the needs of different product lines which may have unique patterns of worldwide competition, demand and supply.

Implications for Foreign Subsidiaries

Quite evidently, the locational configuration of activities and the organizational structure adopted have important implications for the role and activities of foreign subsidiaries. Subsidiaries under the multinational structure have substantial autonomy, since country managers have complete responsibility for activities in the given area. To the extent that traditional multinational structures are becoming outdated, however, there will be a general movement to reduce the autonomy of subsidiaries.

The other extreme to the multinational subsidiary is sometimes termed the rationalized subsidiary, where local subsidiaries produce one or two products in large volume for world markets. The subsidiary is seen primarily as a source of supply which responds but does not contribute to the general corporate strategy. The rationalized subsidiary is the counterpart of the global corporation which has centralized activities across locations.

The need to meet the dual goals of global planning and consumer contact normally requires an allocation of responsibilities somewhere between the two extremes of the multinational and rationalized structures. In particular, subsidiaries normally have responsibilities for activities such as national marketing, tactical pricing, distributor supervision, national communications and local personnel selection and motivation. They are likely to have some input into corporate planning but to a large extent will be guided by company policy on issues such as sourcing policy, finance, research and manufacturing.

The Gillette Co Present Organization

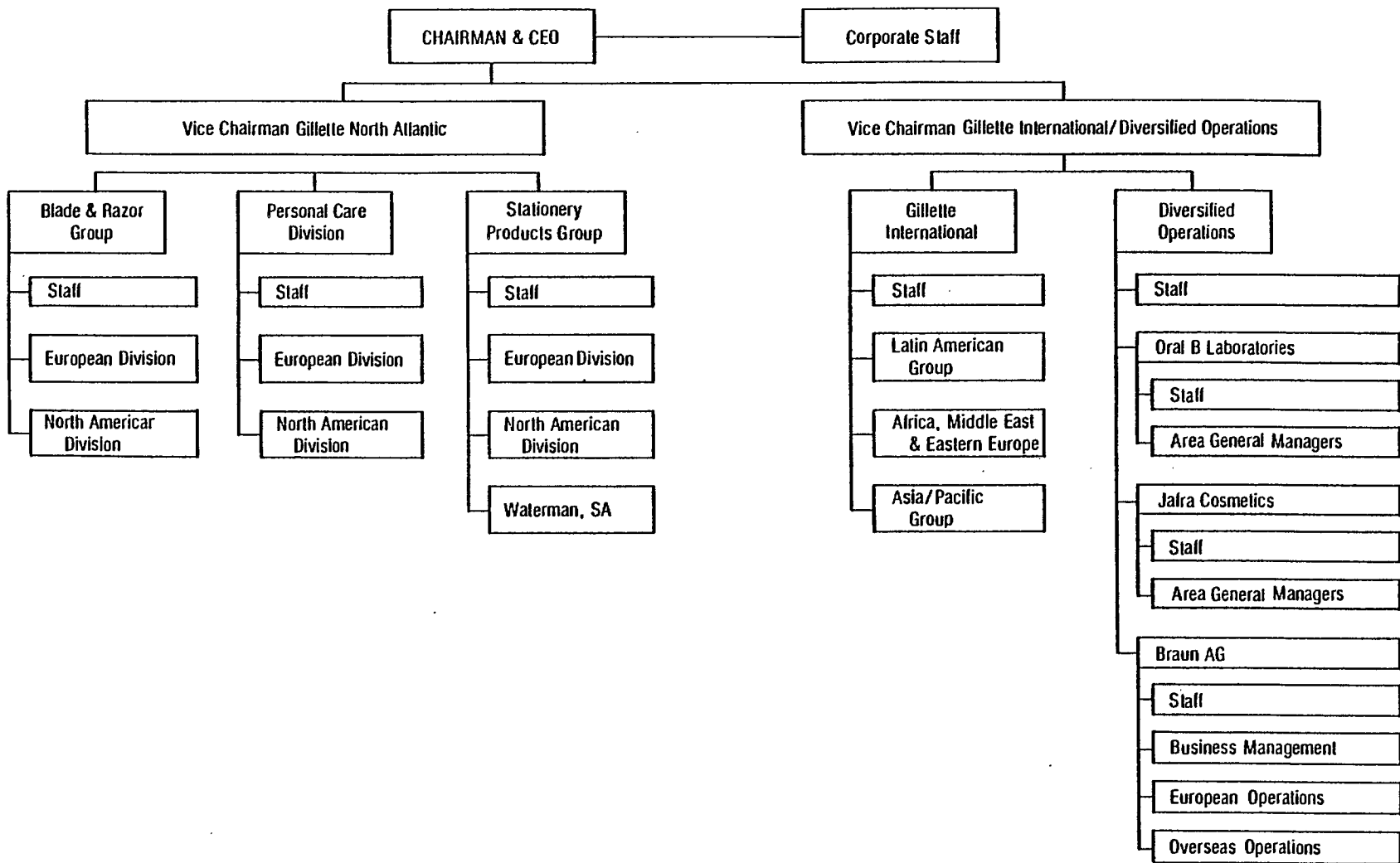


Figure 14

A high degree of autonomy may still be extended to a subsidiary if it can develop a "world product mandate" - that is, responsibility for the global operations of a particular product. Honeywell's Canadian subsidiary developed a world mandate by redesigning one of the parent company's products to reduce its cost and widen its application. It became responsible for the product's international marketing strategy. As this example indicates, the role allocated to the subsidiary depends, at least to some extent, on the initiative shown by local staff in developing their own roles.

The changing role of the subsidiary has important implications for local economies. Multinational subsidiaries are generally liked for their autonomy, but disliked for the fact that they tend not to carry out extensive research and development in foreign markets, nor to export extensively. Global strategies offer greater potential for research and exports, but less autonomy.

The declining degree of autonomy threatens minority ownership of subsidiaries. This is an important issue for Canada since quite a number of Canadian subsidiaries have a degree of local ownership. For example, out of the 1988 Financial Post top 500, 203 were subsidiaries, 136 of which were wholly-owned and 67 of which had minority Canadian shareholders.

Minority ownership was encouraged in the past since it increased accountability of the subsidiary to the local population. Boards of directors with strong local representation may be an impediment, however, if subsidiary strategy needs to be integrated with the general corporation strategy. This development has been reflected in a number of recent buy-outs by parents of minority shareholders in Canadian subsidiaries. Nabisco bought out its minority shareholders, ICI bought out the minority shareholders in CIL and General Electric has purchased the 8 per cent public shareholdings in GE Canada.

International Concentration and Cooperation

Corporate structure is being influenced by both mergers and acquisitions, and cooperative ventures. The growing incidence of mergers and acquisitions and the increasing importance and changing nature of cooperative ventures have already been described in Chapter 2. Both phenomena are to some extent alternative means of realizing goals such as increased market share, gaining access to technologies, and entering new markets. Firms can choose between acquiring needed facilities or skills, or co-operating with another to share them. Cooperative ventures also give firms the opportunity to share costs and risks. As shown in Table 10, General Motors has made strategic use of acquisitions, mergers, and joint ventures to gain access to new skills and ideas.

Table 10

AN EXAMPLE OF INTERNATIONAL COOPERATION

"We knew we had to reach out beyond our own resources for the best technology and best thinking available - forming joint ventures and buying into other companies where necessary to make this happen."

- Roger B. Smith, Chairman and Chief Executive Officer, General Motors Corporation.

Two key acquisitions by General Motors were:

Electronic Data Systems, a computer services company, acquired in 1984. EDS is a world leader in industrial communication networks and is developing a telecommunications network to link GM offices and factories worldwide, as well as dealers and suppliers.

Hughes Aircraft, acquired in 1985. Hughes Aircraft was acquired to accelerate the application of electronics in cars. Use of Hughes' technology will also improve driveability, fuel economy and safety.

GM has entered into nearly 40 joint ventures since 1971, including a joint venture agreement with Toyota. A new independent company was formed: New United Motor Manufacturing Incorporated, to build the Chevrolet Nova in California. The car was based on a design by Toyota. GM learned both new manufacturing and management skills from their Japanese partners.

While mergers, acquisitions and cooperative ventures are becoming important aspects of a firm's behaviour, empirical work suggests that corporate concentration is not necessarily the best response to globalization. Many analyses of mergers and acquisitions have found that profitability is not generally improved and may even decline. While analysis of the success of cooperative ventures has tended to be less rigorous, it also suggests poor rates of success. If mergers and ventures become more crucial to business viability, firms will have to place greater priority on ensuring successful outcomes.

3.3.3 Rationalization of the Product

Standardization

Standardization of output is often portrayed as integral to the growth of global corporations. Global products allow companies to centralize production and to reap economies of scale. These advantages are reinforced by the convergence of consumer tastes as consumers everywhere are subject to mass advertising of worldwide products.

Theodore Levitt gives a very graphic illustration of the growing homogeneity of markets:

Who can forget the televised scenes during the 1979 Iranian uprisings of young men in fashionable French-cut trousers and silky body shirts thirsting with raised modern weapons for blood in the name of Islamic fundamentalism? In Brazil, thousands swarm daily from pre-industrial Bahian darkness into exploding coastal cities, there quickly to install television sets in crowded corrugated huts and, next to battered Volkswagons, make sacrificial offerings of fruit and fresh-killed chickens to Macumban spirits by candlelight...The world's needs and desires have been irrevocably homogenized.³⁸

Yet the movement towards even greater standardization is not as inevitable as sometimes stated. Many companies are gaining greater market share by adapting their products to local markets. While McDonalds may be selling identical hamburgers all over the world, Cadbury Schweppes adapts its soft drink recipes for different markets. To cater for markets in France, Italy and Spain, the company developed less sweet versions of its Tonic Water and Canada Dry.

To a large extent the degree of standardization possible depends on the nature of the products. Local variations in taste for electronics equipment are not significant, whereas they may be more significant for packaged foods and consumer appliances.

More generally, there are significant pressures encouraging greater differentiation of products. These include greater consumer wealth and the resultant demand for customized items, and the enduring cultural differences between countries. An executive of the European retail chain Carrefour commented on the integration of E.C. countries: "True, markets will become slightly more similar. But the real trend is increasing market segmentation."³⁹

³⁸ Theodore Levitt, "The Globalization of Markets", Harvard Business Review, May-June 1983, p93.

³⁹ Quoted in Business International The 1993 Company: Corporate Strategies for Europe's Single Market (Business International, London, 1989) p59.

Specialization and the Development of Niche Products

As a response to increased competition, firms are increasingly specializing in a smaller range of product areas - those areas where they are most competitive. Peripheral processes are being abandoned, sold, or spun off into joint ventures. For example, Phillips has been divesting products which have insufficient strategic compatibility with its core activities.

Attaining significant market share is another factor in the decision to specialize. This is fuelled by the need to recapture investments in research and development, during an increasingly short product life-span. To illustrate, it is estimated that the market for public (telephone) switching can only support six or seven firms due to the high sales volumes and market shares needed to recoup research expenditures.

The need to attain high market share is also fuelling the development of niche products, which are aimed at a particular group or fulfil a specialized purpose. The \$30 billion dollar world paint industry is - as a result of globalization - now based on market niches. ICI is number one in decorative paint and in can and industrial coatings; BASF and PPG dominate in the auto paint market; and Courtauld's International Paints has a 40 per cent share of the marine coatings market.

The era of the general purpose supplier is over. It is being replaced by a global market served by specialist manufacturers dominating a market segment.⁴⁰

Quality of Production

Product quality is the secret ingredient that makes it possible to produce and sell world-class products while controlling costs and sustaining competitive prices.⁴¹

It is often stated that globalization is changing the nature of consumer tastes. Exposed as they are to information on products from all over the world; consumers are putting less emphasis on where products are produced and much greater emphasis on quality.

Decentralizing consumer-linked operations to local markets is one response to this change, increasing consumer contact and service. Firms are also emphasising ways to increase the reliability and dependability of products. These include new assembly and

⁴⁰ Ibid, p51.

⁴¹ Rosow, Jerome M. (ed.) The Global Marketplace (Library of Congress, U.S., 1988) p9.

plant designs. They also include new systems of management and employee participation, such as Total Quality Control, where workers are organized into quality control circles. Greater work effort and reliability is encouraged through greater responsibility.

3.3.5 Rationalization of Scale

Many authors in business management journals assume that the increasing need for firms to go global implies a need for firms to increase in size; that there is a certain minimum size required to pursue a global strategy. On the other hand, as mentioned in Chapter 2, technological change has facilitated competition on international markets by small firms. Developments in computing and telecommunications have greatly reduced the infrastructure required to undertake global marketing and distribution in some industries. Moreover, a study of Canadian firms by the Conference Board of Canada found that many felt they had placed too great an emphasis on larger size to achieve economies of scale. As a result they became burdened by bureaucratic and inflexible organizations.⁴²

As in the case of the locational configuration of activities, it is not possible to draw any conclusions as to the ideal size of a firm. Peter Drucker stated:

Finally, corporate size will by the end of the coming decade have become a strategic decision. Neither "big is better" nor "small is beautiful" makes much sense.⁴³

3.3.6 Conclusion Re Structural Change

Globalization is altering the structure of many industries, with the growth of global industries in which firms are forced to adopt integrated international strategies. In these industries many traditional business practices are becoming increasingly inappropriate. These include focussing solely on the domestic market, the traditional multinational structure, solo and sporadic research and development, and environmental insensitivity. As stated at the outset, however, the diversity of responses to globalization complicates the identification of viable alternatives. In terms of rationalization of location, it appears that there is a general trend towards the centralization of upstream activities, along with the decentralization of downstream activities. Organizational structures are moving away from the classic structures based on regional, functional or product divisions, to more complex structures involving shared accountability and

⁴² Catharine G. Johnston Globalization: Canadian Companies Compete (Conference Board of Canada, Ottawa, February 1990).

⁴³ Peter Drucker, "Peter Drucker's 1990s" in The Economist, October 21, 1989.

responsibility. In the case of products, the need to specialize in a few areas is generally accepted, as is the emphasis on improving quality and developing market niches. It is not clear, however, whether there will be a continuing trend towards greater standardization of products, or whether greater differentiation between national markets will occur. Similarly, the importance of increased scale to competing in global markets has not yet been established. In many cases, the resolution of these issues will differ depending on the particular industry concerned.

3.4 How Well Are Canadian Businesses Adjusting?

Canadian business magazines are full of examples of highly successful Canadian companies who are taking advantage of the opportunities provided by the global marketplace. Yet there is a general public perception that such companies are the exceptions. Apart from the few high-fliers, Canadian businesses in general are viewed as not adjusting to the new environment. The lack of broad-based data on business restructuring makes any investigation of these issues extremely difficult. Evidence is limited to general indicators of competitiveness, overviews of industrial structure and some case-studies of individual firms.

3.4.1 Indicators of Competitiveness

In recent years concerns have been growing about Canada's ability to compete on world markets. A number of groups, including the Economic Council, have been very critical of our recent performance. Nevertheless, the picture is very mixed. While there are evident problems, there is no indication that Canada is experiencing a crisis in competitiveness.

To the extent that relative economic performance is an indication of how well Canadian business can compete internationally, Canada's record is strong. Between 1984 and 1988 our economic growth has been well above that of the United States and the OECD average. This is shown in Figure 15. In recent years, however, a growing proportion of output growth has been due to increased domestic demand, rather than increased exports. Further, it must be acknowledged that Canada's rapid growth in output has been spurred along by continued strong growth in the labour force.

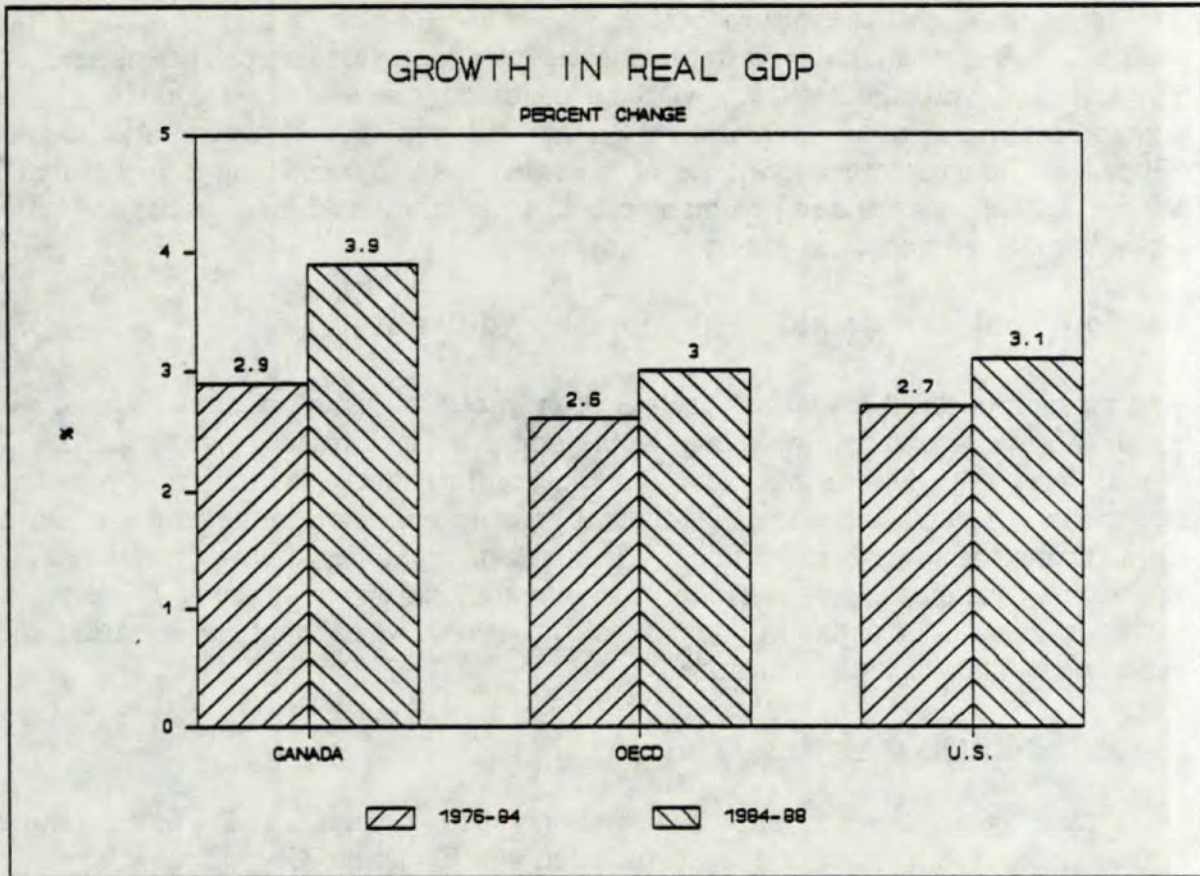


Figure 15

Reflecting the strong output and labour force growth, employment has increased more rapidly than the OECD average. Real business investment, another general indicator of economic performance and growth potential, has also shown a strong performance relative to other OECD countries. Between 1984 and 1988 business investment grew by 9 per cent, compared to 5.6 per cent in the United States and 3.5 per cent for the OECD as a whole. The debt-to-equity ratio of large industrial corporations fell substantially after the 1981-82 recession. Much of the strong investment spending from 1985 to 1987 was financed by internal funds and equities. The debt-to-equity ratio is increasing again, however, particularly since the stock market plunge of October 1987 which made equity financing less attractive.

Historically, Canada's level of productivity has been relatively high. For some years, though, productivity growth has been below that occurring in many industrialized countries. This is shown in Figure 16. Between 1976 and 1984, productivity in Canada increased at a compound annual average rate of only 1 per cent compared to 1.7 per cent overall for the OECD. Between 1984 and 1988 productivity grew at an annual rate of 0.9 per cent in Canada, compared to 1.6 per cent for the OECD countries

collectively. According to the Economic Council, a number of European countries, such as West Germany, France and Italy, now have higher manufacturing productivity levels than Canada.

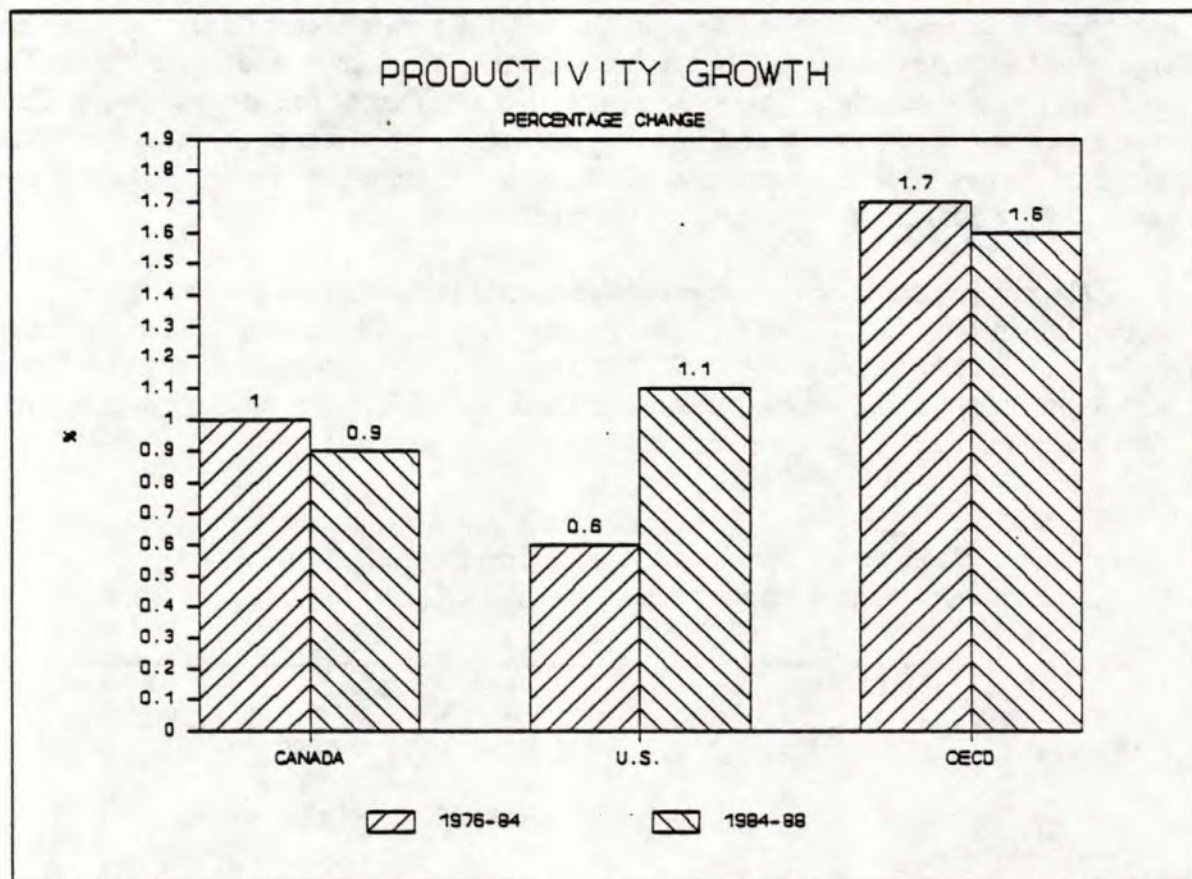


Figure 16

This trend would be less worrying if our unit labour costs had also been increasing more slowly than the average, but this has not been the case. In recent years unit labour costs in Canada have increased faster than in the U.S. and the OECD average, largely as a result of more rapid wage increases. A number of recent policy changes will, however, help improve Canada's productivity record. The Free Trade Agreement, corporate income tax reform and the proposed sales tax reforms are expected to raise total factor productivity growth by 0.5 percentage points per year.⁴⁴

⁴⁴ The Budget, Federal Government of Canada, February 20, 1990, p53.

The recent trends in productivity and unit labour costs are worrying. Still, there is no evidence that the Canadian economy is facing a competitive crisis. Despite an approximate 20 per cent appreciation of the Canadian dollar against the U.S. dollar since 1987, Canadian exports have remained strong. Canada's current account position has deteriorated badly, but this reflects the serious public sector deficit position and a high level of imports to satisfy heavy investment in machinery and equipment. The latter serves to strengthen Canada's competitive ability. As mentioned above, Canadian businesses have been saving and investing at impressive levels ever since the 1981-82 recession. They appear determined to avoid the vulnerability they displayed in the early 1980s when the global economy contracted sharply.

This preparedness, and the business restructuring it reflects, has been well recognised in the 1989 World Competitiveness Report, which ranked Canada fourth among the OECD nations in overall international competitiveness. Only the United States, Switzerland and Japan out-ranked Canada. This was a marked improvement on 1986 when we were ranked seventh among OECD nations.

The ranking in the World Competitiveness Report is based on 292 "factors of competitiveness", covering a wide range of economic and social considerations. Table 11 summarizes the factors into ten main areas and shows our ranking for each.

Table 11

FACTORS OF COMPETITIVENESS

	1986 Rank	1989 Rank
Dynamism of the Economy	7	3
Industrial Efficiency	8	4
Dynamics of the Market	7	4
Financial Dynamism	7	11
Human Resources	4	2
State Interference	8	3
Natural Endowments	3	2
Outward Orientation	12	14
Forward Orientation	9	15
Socio-Political Stability	7	6

Source: Alan M. Rugman and Joseph R. D'Cruz New Visions for Canadian Business (Kodak Canada Inc., Toronto) p13.

It is important to note the three areas where Canada did not perform well relative to other countries. Canada was ranked eleventh in financial dynamism, largely due to high federal and provincial government deficits. Canada was ranked fourteenth on outward orientation, despite the fact that the Canadian economy is relatively open. The poor ranking was due to the fact that exports are not diversified, relying heavily on the U.S. market and on raw and semi-processed materials. Finally, Canada ranked fifteenth with respect to forward orientation. This was due to the low level of expenditures on research and development, and the failure of Canadian business to commercialize available technology.

3.4.2 Use of Technology

One of the explanations frequently put forward for Canada's relatively poor productivity performance is the failure of business to adapt to technological change. The Economic Council has stated in a number of publications that Canadian businesses are slow to adopt new technology. Other general indicators, such as the number of people graduating with degrees in science and engineering and the number of patents secured by Canadians, show poor performance compared to our major competitors.⁴⁵

Canada is also criticised for the low level of expenditure on research and development. In Canada, gross expenditure on research and development in 1987 was 1.4 per cent of GDP, compared to 2.79 per cent in the United States, 2.9 per cent in Japan and 2.8 per cent in Germany.⁴⁶ According to the Economic Council of Canada, the Canadian business sector accounted for only about 48 per cent of total Canadian research and development expenditures, compared to 72 per cent in the United States and 65 percent in Japan.⁴⁷ These findings suggest there is a need for concern about Canada's low research and development activity. It should be noted, though, that comparisons centred solely on Japan, Germany and the United States exaggerate the deficiency. A comparison with all OECD countries shows Canada to be only slightly below the average (around 1.3 per cent of GDP compared to 1.6 per cent, for 1986).⁴⁸

⁴⁵ For a discussion of such indicators see the Report of the Premier's Council, Competing in the Global Economy, Vol III (Premier's Council, Toronto, 1988) Appendix D.

⁴⁶ Report of the Premier's Council, Competing in the Global Economy, Vol III (Premier's Council, Toronto, 1988) Appendix D.

⁴⁷ Sunder Magun and Someshwar Rao The Competitive Position of Canada in High-Technology Trade (Economic Council of Canada, Ottawa, June 1989).

⁴⁸ Alan M. Rugman and Joseph R. D'Cruz New Visions for Canadian Business... (Kodak Canada Inc., Toronto, 1990), p30.

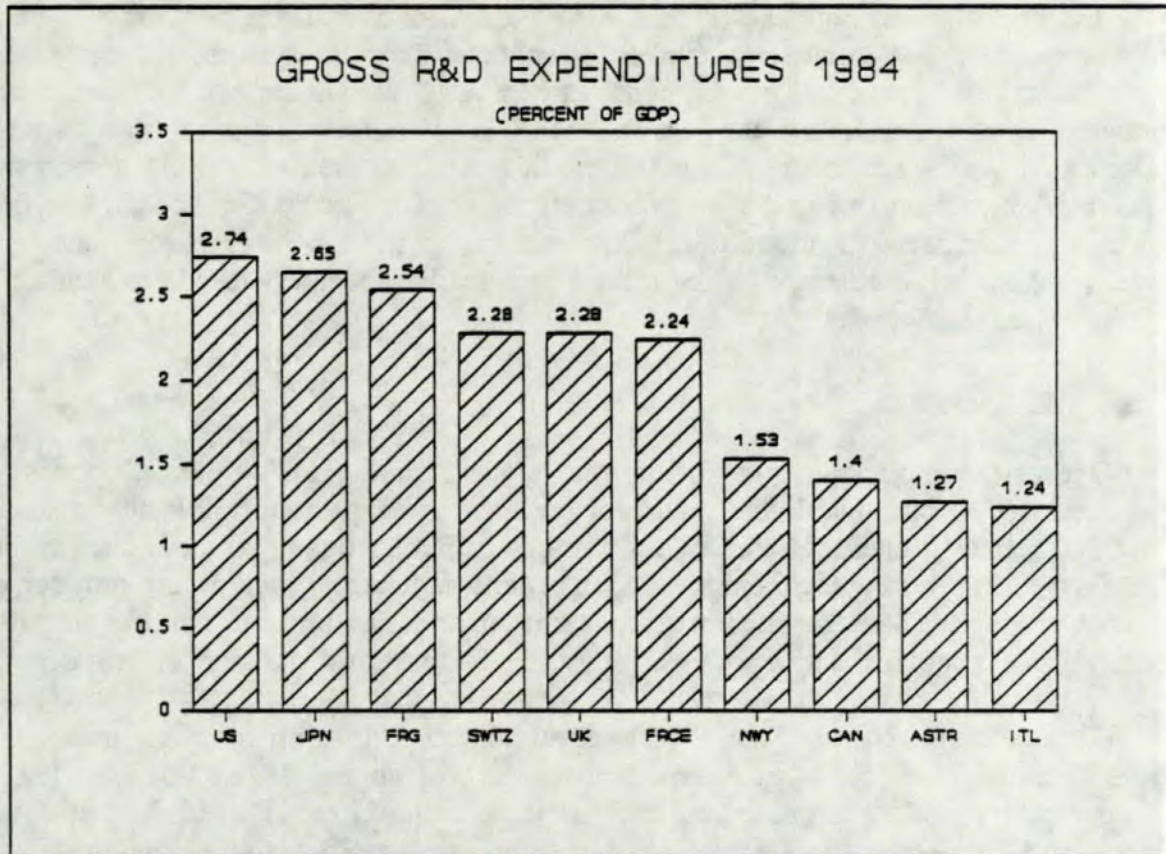


Figure 17

3.4.3 Services Sector

Given the importance of a competitive service sector, it is useful to consider indicators of its recent performance. The World Competitiveness Report compared productivity in the service sectors of a variety of countries by calculating the ratio of employment in the sector to its value-added in GDP. Canada's service sector was found to be more productive than the average of the OECD countries. Canada's service sector was more productive than those of Japan and the United States, but behind those of Taiwan, Korea and Germany.

The Economic Council focused on one particular sector - financial services - analysing Canada's participation in international financial markets. They found evidence of both strengths and weaknesses. International markets have been a strong source of growth for many Canadian financial institutions. The international business of the six largest Schedule A banks grew at an annual rate of almost 7 per cent between 1982 and 1987, which is more than twice the rate of increase in domestic assets.⁴⁹ Despite this, Canadian institutions experienced declining market shares internationally. The average annual growth of assets of Canadian banks over the 1980-87 period was the lowest among all the countries considered by the Council. Ranking banks internationally on the basis of asset size, the largest Canadian bank fell from sixteenth place to fifty-seventh.

A number of factors may have contributed to the declining performance of Canadian financial institutions. The Council cited as possible explanations their small size, less aggressive pricing policies, less developed networks and expertise, and regulatory restrictions. It also stated that the slow growth may reflect the overcommitted position to poor performing Third World loans and, therefore, caution about competing in the highly competitive Euromarket. Nevertheless, even if this is the case, it may have undesirable long-term implications in terms of lost networks and expertise.

3.4.4 Industry Structure

In addition to considering measures of Canada's ability to compete internationally, it is useful to compare the domestic industrial structure to that of other countries. As the discussion in Section 3.1 has made clear, it is not possible to point to one particular structure as the ideal. However, some general factors can be identified.

The first important consideration is the level of competition within the domestic market. In a study for the Royal Commission on the Economic Union and Development Prospects for Canada, R.S. Khemani found that competition in Canada tends to be lower than in other industrialized countries, including the United States.⁵⁰ Competition increased during the 1970s and 1980s, both in Canada and internationally.

⁴⁹ Economic Council of Canada, Globalization and Canada's Financial Markets (The Council, Ottawa, 1990) p72.

⁵⁰ R.S. Khemani, "The Extent and Evolution of Competition in the Canadian Economy" in Canadian Industry in Transition research coordinator Donald G. McFetridge (University of Toronto Press, Toronto, 1986) pp135-176.

Consistent with this is the finding that Canadian firms are not exploiting economies of scale to the same extent as their competitors. A study by Donald Daly has found that production costs in Canada are generally above those in the United States and Japan, but could be decreased substantially with longer production runs.⁵¹ Daly also found that Canadian firms tend to be less specialized than their U.S. counterparts. Interviews indicate that, on average, manufacturing plants in Canada produce a wider range of products than U.S. plants of similar size.

Related to the question of competition is the issue of concentration. Khemani found that Canadian industries were, on average, more concentrated than those of our main trading partners. During the 1970s and 1980s there has been a gradual increase in concentration. As stated above, the level of competition has also increased.

A notable exception to the finding of high concentration is the financial sector. Table 12 shows the size of the largest bank relative to GDP in 14 OECD countries for 1987. The largest Canadian bank, the Royal Bank, was equivalent to less than 0.2 per cent of GDP, one of the lowest shown. This compares to Switzerland, where the Union Bank of Switzerland is equivalent to over 0.7 of GDP. Moreover, over the period 1979-1987 the level of concentration in Canada's financial markets decreased.

While the concentration of Canadian markets may be relatively high, by international terms Canadian firms are generally relatively small-scale. A comparison between the Financial Post 500 of Canadian companies and the Fortune 500 of U.S. companies shows a large disparity in size, both in terms of sales and assets. This can be seen in Table 13 which shows the top ten rankings of each. It should be noted that 34 out of the top 100 Canadian rankings are more than 50 per cent foreign owned and seven firms are owned by federal or provincial governments. In the entire top 500, 40 per cent are controlled abroad.

The conclusions which can be drawn from such a comparison are limited. Nevertheless, it does illustrate that Canada lacks the large corporations found in the United States. Where economies of scale are important, Canadian businesses may be at a disadvantage.

⁵¹ Donald J. Daly, "Rationalization and Specialization in Canadian Manufacturing" in Canadian Industry in Transition research coordinator Donald G. McFetridge (University of Toronto Press, Toronto, 1986) pp177-209.

Table 12

SIZE OF LARGEST BANK RELATIVE TO GDP 1987

	Bank	Ratio of Assets to GDP
Australia	Westpac Banking	0.236
Austria	Creditanstalt Bankverein	0.355
Belgium	Banque Generale	0.469
Canada	Royal Bank of Canada	0.176
Denmark	Den Danske Bank	0.225
France	Credit Agricole	0.244
West Germany	Deutsche Bank	0.151
Italy	Banca Nazionale del Lavoro	0.127
Japan	Dai-Ichi Kangyo	0.114
Netherlands	Algemene Bank Nederland	0.398
Sweden	S-E-Banken	0.252
Switzerland	Union Bank of Switzerland	0.734
United Kingdom	Barklays	0.245
United States	Citicorp	0.044

Source: Economic Council of Canada, Globalization and Canada's Financial Markets (The Council, Ottawa, 1990) p78.

Table 13

TOP RANKING COMPANIES

	Sales (\$CM) ¹	Assets (\$CM)
Canadian Financial Post Top Ten ²		
BCE Inc.	15,253	28,069
Canadian Pacific Ltd.	12,016	17,651
George Weston Ltd.	10,831	3,476
Alcan Aluminium Ltd.	10,497	10,273
Campeau Corp	10,395	17,805
Noranda Inc.	8,858	11,285
Provigo Inc.	7,379	1,603
Brascan Ltd.	7,051	4,854
Ontario Hydro	5,813	34,358
Hydro-Québec	5,223	31,762
Fortune Top Ten		
General Motors	140,640	190,559
Ford Motor	107,374	166,520
Exxon	92,405	86,291
Int'l Business Machines	69,319	84,832
General Electric	57,394	128,768
Mobil	55,981	45,089
Chrysler	41,200	56,409
Texaco	38,961	30,590
Du Pont	37,765	35,680
Philip Morris	30,036	42,929

1 U.S.S converted at rate of exchange 1.1615

2 excludes companies more than 50% foreign owned.

...there is doubt in many quarters about the competitiveness of Canadian business, especially as trade barriers fall. The fear is that beyond the Seagrams, the Lavelins and the Incos, the Canadian commercial presence in the world is small. Moreover, it will be harder to compete as the big get bigger in the Era of Acquisition.⁵²

An additional issue of interest in this context is the extent to which industrial restructuring is responsive to changes in demand and competitiveness. There is a pervasive belief that Canada is very slow to adapt. Common criticisms include the continued high emphasis on natural resources and the low proportion of GDP and exports accounted for by high-technology, high-growth industries. The Ontario Premier's Council Report shows that the share of value-added in high-wage industries in Canada accounted for by high growth industries was only 11 percent in 1985, compared to 25 per cent in the United States.⁵³ This can be seen in Figure 17.

Other research, however, suggests that the Canadian economy adjusts relatively well. A study on structural change undertaken for the Royal Commission of the Economic Union and Development Prospects for Canada found that our post-war experience compares favourably to other countries.⁵⁴ The study concluded as follows:

- the rate of structural change appears to be reasonably constant, indicating that realignment proceeds relatively smoothly; none of the cumulative change series exhibit long periods of structural stagnation followed by rapid change which might indicate that structural imbalances are only dealt with once they become severe;
- international comparisons showed that the rate and pattern of structural realignment in Canada at both the sector and industry level have been similar to that occurring in other western industrialized countries.

⁵² Andrew Cohen, "Canada Battles the Trade Winds" in The Financial Post, Summer 1989, p30.

⁵³ Report of the Premier's Council, Competing in the Global Economy, Vol I (Premier's Council, Toronto, 1988) p64.

⁵⁴ Michael F. Charetter, Robert P. Henry and Barry Kaufman, "The Evolution of the Canadian Industrial Structure: An International Perspective" in Canadian Industry in Transition, research coordinator Donald G. McFetridge (University of Toronto Press, Toronto, 1986) pp61-124.

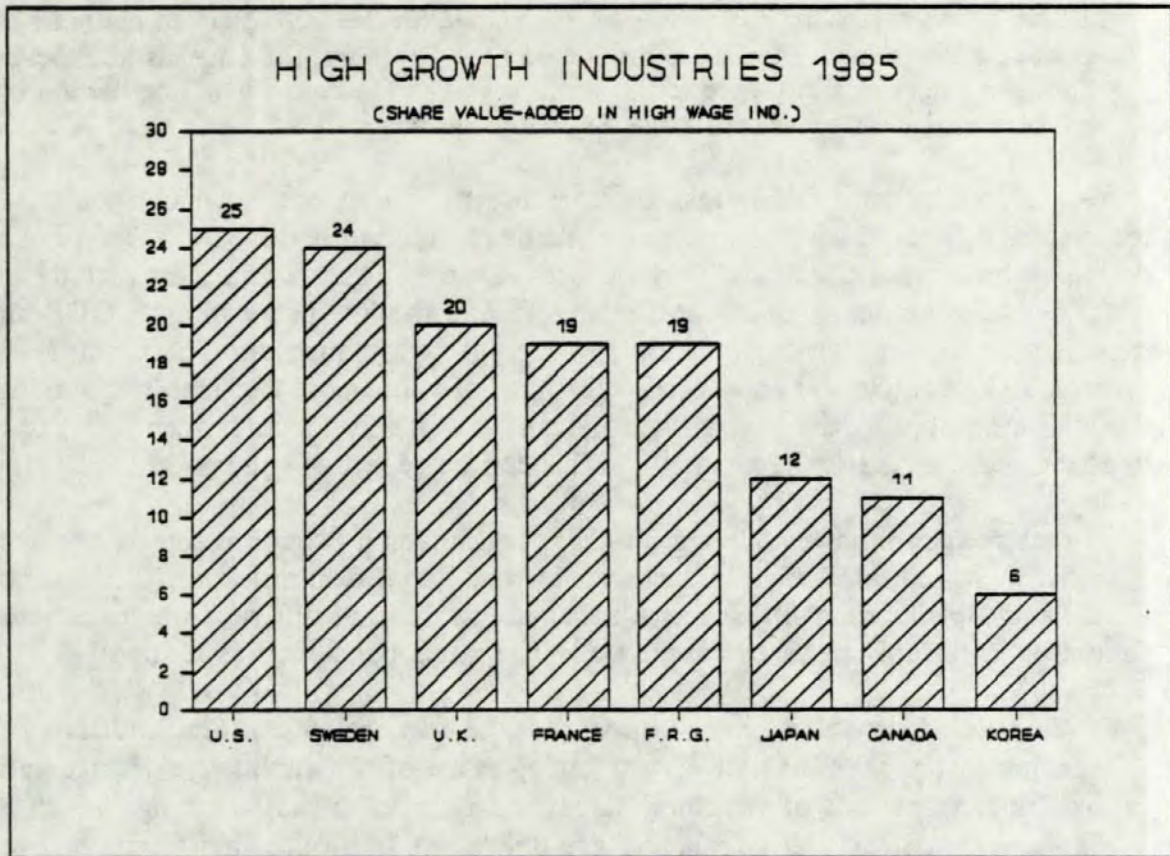


Figure 18

3.4.5 Diversity of Export Markets

The World Competitiveness Report ranked Canada fifteenth on outward orientation, due to the high degree of specialization in both products exported and our export markets. This is illustrated in Table 14, which shows exports by country of destination and product category. Over three-quarters of Canada's exports go to the United States. Similarly, almost 40 per cent of exports involve machinery and transport equipment, 91 per cent of which are destined for the United States market.

Table 14

DIVERSIFICATION OF EXPORTS 1987
(% of total exports)

Destination	Food	Raw Materials	Energy	Machinery & Transp. Eqpmt	Semi- Manuf.	Other	Total	
U.S.		3.9	8.0	8.7	35.3	14.2	6.6	76.7
OECD-Europe		0.9	3.4	0.2	1.6	1.1	1.1	8.3
Japan		0.9	2.6	1.0	0.1	0.2	0.3	5.1
Other OECD		0.1	0.2	0.0	0.2	0.1	0.1	0.7
Non-OECD		2.8	2.1	0.3	1.5	1.4	1.1	9.2
Total		8.6	16.3	10.2	38.7	17.0	9.2	100.0

Source: OECD Economic Surveys: Canada (OECD, Paris, 1989) p32.

Given Canada's close proximity to the large United States market it is not surprising that it is our dominant trading partner. It will be important, however, not to neglect the growing markets in other areas of the world, including the E.C. and the Asia/Pacific region. The export figures suggest that Canada's export base is narrow, possibly denoting a lack of outward orientation on the part of many industries.

3.4.6 Use of Cooperative Ventures

In Chapter 2 it was noted that on a per capita basis Canada has a high number of cooperative ventures. Compared to the United States, Canadian joint ventures also have a high survival rate.⁵⁵ The number of joint ventures has, however, been declining during the 1980s.

Joint venture activity is concentrated in the provinces of Ontario, Quebec, British Columbia and Alberta. A high proportion of joint ventures are in the finance sector. Many of these appear to be substitutes for imperfect or underdeveloped financial markets, peculiarities of the tax code or a result of regulatory requirements. Compared to the United States, Canada also has a high proportion of joint ventures in natural resource industries such as agriculture, forestry, fishing, mining, oil and gas. Joint ventures in the manufacturing and service industries are a small and declining share of the total, whereas in the United States they are the largest and growing share.

⁵⁵ Michael J. Geringer, "Trends and Traits of Canadian Joint Ventures", prepared for Investment Canada, February 1990.

3.4.7 Conclusions re Business Adjustment

In general, Canada has displayed a high degree of international competitiveness and ability to adjust to changes in demand. Nevertheless, recent trends in productivity and unit costs are worrying. Our brief analysis highlighted a number of specific problems. Studies have tended to show that the level of competition within Canada is lower than that in our major competitors. This in turn has meant that domestic firms are not fully exploiting economies of scale and the gains from specialization and do not have a strong outward-looking orientation. Canadian firms appear to be smaller in scale than international firms, which may place them at a competitive disadvantage. In addition, studies have suggested that Canadian firms are slow to develop and adopt new technology.

It should be repeated that these problems do not constitute a crisis. Moreover, treating them as a crisis is likely to cause considerable harm, provoking piecemeal short-term policies. What is needed is planning for the longterm; policies which will create an environment which enhances the ability of Canadian business to compete over the following decades.

Clearly, Canada and the United States face an increasingly competitive world economy. The pressures for adjustment come from technological competition among high-income economies, from the emergence of the newly industrialising countries in heavy industries, and from export-oriented developing countries in light manufacturing. But these are longterm challenges, which need to be analyzed carefully before policy changes are proposed and implemented.⁵⁶

⁵⁶ Richard G. Lipsey, and Murray G. Smith, Global Imbalances and U.S. Policy Responses: A Canadian Perspective (C.D. Howe Institute and National Planning Association, Toronto, 1987). p41.

CHAPTER 4
CONCLUDING COMMENTS

4. CONCLUDING COMMENTS

Globalization refers to the growing interconnectedness of national economies; the blurring between domestic and international markets as local businesses increase their profile abroad and foreign businesses penetrate the domestic economy. Businesses are facing greater and more diverse competition. Consumers are exposed to a wider range of international products. Domestic economic performance is also becoming increasingly inter-related with economic trends in other parts of the world and with the policies of governments other than our own.

The forces which have contributed to globalization are a combination of economic, political, and social factors. These include:

Attracting Forces: the reduction in protectionist sentiments over the post-war period; the disillusionment with government control and a resurgence in confidence in market forces; the growth in the European and Asia/Pacific economies, which has contributed to the growth in world trade and forced a shift in the strategic focus of business, away from reliance on the United States; a shift in the geographic distribution of technological resources, forcing business to draw on expertise outside the domestic economy; and the rising costs of introducing new products.

Enabling Forces: decreased costs of transportation and communication; and the emergence of global capital markets.

Threatening Forces: the growing strength of offshore competition; exchange rate volatility; the need to draw on a wider range of technologies and the increased importance of research and development to remain on the leading edge of technological change.

As stated at the outset, this report has focused on the economic aspects of globalization. In this respect eight main trends were identified:

- the growth of world trade;
- the development of regional trading blocs;
- increased foreign direct investment;
- the growth of global corporations;
- the growth of strategic alliances;
- the development of global financial markets;
- technological change; and
- the growing importance of global environmental issues.

Globalization is not a single event which occurred in the past but an accumulation of changes which are still occurring. It is hard to predict the future course of globalization. An increase in protectionism could greatly restrict further development of global markets. Technological developments could change the business environment in ways which are currently unimaginable. Nevertheless, a number of trends are likely to continue, including:

- the continued growth of world trade and foreign direct investment at a more rapid pace than world output;
- the continued diversification of trade and investment, including the growing importance of NICs and LDCs;
- continued increase in the costs of research and development, forcing more and more firms to cooperate and share resources;
- further international coordination of policies through institutions such as the OECD and G7 Summit meetings and perhaps the emergence of new international institutions;
- the continued growth in regional blocs, and their extension beyond purely trade agreements;
- increased understanding of global environmental problems, bringing with it a greater commitment to reach collective solutions.

There will be a continuing tension, however, between globalization and nationalism. Globalization will not sweep away differences between nation-states. If some countries and regions experience different rates of economic growth, feelings of discontent in slower growth areas may even increase nationalist sentiments. A major challenge facing countries will be to find a balance between nationalism and globalism.

One area of uncertainty is future trends in the restructuring of industries and firms. The diversity of experimentation and the lack of broadly representative data make it very difficult to draw conclusions. Nevertheless, a number of trends appear to be emerging. In particular, a growing number of industries are adopting global structures; that is, firms in these industries are adopting integrated international strategies, rather than a series of domestic strategies. Further, many traditional business practices are becoming increasingly inappropriate. These include: the traditional multinational structure; solo and sporadic research and development; the distinction between high-technology and low-technology activities; and environmental insensitivity.

There is a general trend within global industries towards the centralization of activities such as production and research, while consumer-linked activities are being decentralized to local markets. Organizational structures are becoming more complex, involving shared responsibility for planning between regional and product divisions. Firms also appear to be specializing and exploiting particular market niches in order to gain market share. Whether or not products are becoming more standardized is unclear. The importance of scale in competing in global markets has also not yet been established.

Perhaps the single biggest implication for business is the fact that a purely domestic focus is no longer a viable business strategy in many industries. Even businesses which do not export will face competition from international firms. In order to remain competitive domestic firms will, therefore, have to develop a greater understanding and knowledge of foreign markets and competitors: they must adopt a global rather than a domestic focus.

These changes also have important implications for government policies. The evolving business response to globalization necessitates a reevaluation of a broad range of industry-related policies. Examples include:

- the increased importance of research and development, and the poor perception of the performance of Canadian firms in this respect, suggests a need to assess not only the quantity but the quality of assistance;
- the crucial importance of a mobile and skilled labour force requires a reassessment of education and training policies;
- if scale and market share are becoming important components in a competitive strategy, competition policies may need to be reviewed to ensure they do not prevent needed rationalization while continuing to safeguard against anti-competitive practices;
- governments may also need to review the bias of support in favour of small business; (it should be noted that even if scale is important there could still be reasons to continue focusing on small firms; the latter may be more innovative or create more employment);
- there may be a role for government to provide information on such aspects as foreign management structures and business strategies so as to help entry into global markets; information may also be needed on how to develop overseas networks and strategic alliances;

- trade policies will need to be reassessed in light of the shift in emphasis from the multilateral trade system to bilateral and reciprocal initiatives; as well, the emphasis on linking trade, investment, and strategic alliances, and the fact that leading edge companies use direct investment as a key instrument for market access, must be factored into trade policy; also, the need to participate in all three components of the Triad may require some realignment of Canada's trade support;
- the increased importance of technology transfer, market access, management expertise and the defrayment of research and development costs suggests that foreign direct investment is a critical component of competitiveness; Canada must maintain its "open for business" policy towards foreign investment; also, Canadian direct investment abroad must be encouraged.

Above all, governments must recognize that the policy environment has become harsher. With increased exposure to highly competitive international markets, governments must give greater consideration to their impact on competitiveness. Policies which reduce the competitiveness of Canadian industry will inevitably result in decreased growth and income.

A wide variety of structural policies impact on productivity and the allocation of resources. These include tax policy, regional policies, a range of social policies, efficiency within the government and the macroeconomic policy setting. These should be reevaluated in light of the changing costs and benefits of pursuing particular goals. It may be possible to minimize the equity/efficiency tradeoffs through such initiatives as removing the poverty trap caused by the very high effective tax rates facing those on welfare who wish and are able to find employment. A determined effort would appear needed to reduce Canada's 7.5-8 per cent level of structural unemployment, which represents an enormous cost both individually and to the competitive position of Canadian businesses.

Governments must also recognize that globalization is decreasing their independence in policy matters. For example, with the emergence of global capital markets it is increasingly difficult for Canada to pursue a "made-in-Canada" interest rate policy. Domestic and international policies are becoming more and more interdependent, as illustrated by the current Structural Impediments Initiative between Japan and the United States.

Given the increased vulnerability of the domestic economy to international trends, greater coordination of both macroeconomic and microeconomic policies should be encouraged. Examples of international coordination of macroeconomic policies include the GATT talks and cooperation between the G7 countries. It may be necessary to extend trade talks to a greater range of commodities and services, perhaps with the creation of a World Trade Organization. But there are other areas, as well, where it would appear that a greater convergence of domestic policies and harmonization of rules may be called for - most notably in the areas of competition policy, investment, innovation, environmental regulation and the supervision of international financial organizations. Similarly, new or rejuvenated mechanisms to provide greater cooperation with developing countries may be needed.

Given the demands of globalization, more information and analysis is needed about how to manage the economy effectively. This report has probed one dimension of this analysis - the nature of globalization and the implications for the business community. We need to review, however, the proper role for government in light of these changes, and how this role compares with current federal and provincial policies and programs.

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