INVESTING IN CANADA

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The Political Economy of Strategic Partnering

The following summarizes a research paper prepared for Investment Canada by Dr. Lynn Krieger Mytelka of Carleton University. It defines strategic partnerships, maps out the sectors and directions in which they concentrate, identifies factors that contribute to their success, and discusses their implications for Canadian investment and technology policy. The complete paper is available (see page 6 of this newsletter).

In the early twentieth century, companies began to require increasing knowledge to keep their products and processes competitive. By the 1960s and 1970s, low productivity growth, high inflation, and competition from low-wage countries accelerated the search for new technologies that might confer an advantage in the global market-place. Firms in dynamic, knowledge-oriented industries now formulate corporate strategy around technology capabilities as well as market characteristics.

The area of biotechnology is showing an increasing number of strategic partnerships between Canada and Japan. (See page 3) (Photo courtesy of the Embassy of Japan)

They realize that a strong foundation in several "generic" technologies can be applied to a wide variety of markets. As a result, companies are increasingly entering into agreements with firms possessing complementary technological capabilities.

Strategic partnerships — also known as strategic alliances or inter-firm cooperative agreements — are explicit, long-term, agreements intended to deal with the uncertainties of technological change. Unlike joint ventures, strategic partnerships need not involve equity participation or exchange, or payment for goods or services. They imply longer term considerations than those behind many joint ventures concerned with short-term profits, and often bring together firms that are actual or potential competitors.

Examples of such strategic partnerships are Original Equipment Manufacturer (OEM) agreements, or the consortia established among European firms, research institutes, and university laboratories through the European Strategic Program for Research in Information Technologies (ESPRIT). One important, central objective of strategic partnerships is the production and sharing of knowledge. By pooling resources, especially in technological expertise, they allow a reduction in the costs, risks, and uncertainties of research and development.

(cont. on page 6)

Free Trade and Investment: New Publications

As we go to press, the Canada-U.S. free trade agreement still awaits ratification. In future issues, Investing In Canada *will be covering this vital debate extensively; for now, the following list is our contribution to the discussion.*

ATLANTIC PROVINCES ECONOMIC COUNCIL, "Free Trade and Atlantic Canada: Background and Results of an Impact Study", *Atlantic Report* (87-2, Vol. XXII, No. 2, July 1987, pp. 2-7). Available from APEC, 5121 Sackville Street, Suite 500, Halifax, Nova Scotia, B3J 1K1, (902) 422-6516.
— summarizes principal findings from a project undertaken by APEC on behalf of the Governments of New Brunswick and Prince Edward Island, and the Economic Council of Newfoundland and Labrador.

Maurice Mandale (Editor): "This extensive econometric simulation of the potential impacts of bilateral free trade on the Atlantic economy indicates significant net economic benefits, especially for sectors such as fishing and fish ▶

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processing. There will be some industrial adjustment in industries which are more vulnerable, such as agriculture, food processing and textiles. In some cases there is no doubt whatsoever that the industry would die as we know it in the Atlantic Region. However, any industry which can specialize its product or even its image, as Moosehead beer has done, can survive and be successful. Moosehead is now exporting $40 or $50 million worth of beer to the States each year. You can always sell quality."

CANADIAN MANUFACTURERS' ASSOCIATION, *A Review of the Canadian-U.S. Free Trade Agreement* (CMA, Ottawa, December 1987). Available from CMA, 151 Sparks Street, Ottawa, Ontario, K1P 5E3, (613) 233-8423.

William Neil (Director for International Affairs): "The agreement represents an improvement on what we have, and a vast improvement on what we would have had without it. We see it as an essential component of improving Canada's international competitiveness, along with more R&D, better use of human resources, and tax reform.

"We wanted secure and enhanced access for our exports; under the agreement they are more secure, but we haven't yet got at the real problem which is U.S. trade laws. Also, government procurement is not a big part of the agreement; it's a huge market and we've only got access to a small piece of it so far. There is a timetable and a commitment to discuss these issues, and this is very important. Until we can negotiate new trade agreements and draw up new laws on both sides of the border, the CMA won't be fully satisfied."

CANADA WEST FOUNDATION,
1) *Sectoral Effects of Free Trade on the Western Economy* (CWF, Calgary, June 1987).
— sector by sector industry analysis.

2) *Geographic Effects of Freer Trade on the Western Economy* (CWF, Calgary, July 1987).
— graphically displays impact on metropolitan census areas.

3) *The Effects of U.S. Protectionism on the Western Canadian Economy* (CWF, Calgary, September 1987).
— U.S. trade actions against Canada 1980-87, and major U.S. trade barriers affecting Canadian goods.

4) *Looking Ahead: Western Canada's Export Opportunities* (CWF, Calgary, September 1987).
— projected growth of U.S. market and its meaning for Western producers.

5) *Impact of the Proposed Agreement on the Western Canadian Economy* (CWF, Calgary, forthcoming).
— update of (1) applying actual provisions.

Each available in summary or in full from Canada West Foundation, Suite 1230, 101 6th Avenue SW, Calgary, Alberta, T2P 3P4, (403) 264-9535; (403) 264-3939.

David Elton (President, CWF): "We were not setting out to be provocative. Rather we intended to be informative, to apply what we knew, and address both the regional and micro-level (city) effects of free trade. The fifth report brings this up to date by applying the actual final agreement to our projections, so it won't be issued until after we see the t's crossed and the i's dotted."

DUBUC, Alain, *Simple comme l'économie* (Editions La Presse, Montréal, 1987).

Le libre-échange Canada-États-Unis (Centrale des bibliothèques du Québec, Montreal).
— collection of articles published September 26-October 7, 1987, in *La Presse*.

Alain Dubuc (economist, journalist): "According to what is known of the agreement, it is a good decision for Canada. For Québec, it is strongly favourable with respect to energy; secure access to the American market; and the structure of the manufacturing industry, which is very different from Ontario's.

"Some analysts have expressed concerns about the impact of free trade on culture. Because of its language, Quebec has a natural protection in this area that Anglo-Canadians don't have. In contrast to other regions of the country, in Quebec there has been a wide consensus in favour of the agreement, except in the case of the labour unions."

RAYNAULT, André, "Looking Outward Again", Wilkensen Lectures, McGill University, in: Riggs, A.R. and Vek, T., (eds), *Canadian—American Free Trade Papers*, (Institut de recherches politiques, Montreal, 1987, pp. 97-104). "Le libre-échange Canada-États-Unis", *l'Analyste*, (No. 12, Winter 1985-86, pp. 28-30).

"Trade Deal, or As We Are", *Policy Options — Options politiques*, (Institut de recherches politiques, Vol. 8, No. 3, April 1987, pp. 16-19).

Les enjeux et les perspectives de la libéralisation des échanges, opening lecture to the Québec Economists' Association, Hull, April 23, 1987 (forthcoming).

André Raynault (Université de Montréal): "Liberalisation of trade with the U.S. will be very favourable to the Canadian economy, because it will provide privileged and secure access to a market 10 times larger than Canada's, a greater specialisation of Canadian industry, economies of scale — considerable in some sectors, and stronger competition resulting in lower prices for products." ▶

Calgary Olympics — Alberta '88 Business House

Overlooking Olympic Plaza, where medal presentations will be made during the Winter Olympics in Calgary, Alberta '88 Business House will be the "United Nations" of business throughout the month of February for executives from around the world. Business House is part of an initiative undertaken by five Alberta departments to highlight areas of opportunity in the province and establish contact with international business people visiting the games who might be interested in ventures in Alberta.

Tren Cole, Chairman of the Olympic Business Program, says "We understand most of our visitors will be in Calgary to see the Olympics and to relax. When they visit Alberta '88 Business House, even for an hour, they'll enjoy a low-key environment and high-quality information they can take away and review when they return to their offices. Our emphasis will be on providing follow-up responses."

For information, call ahead to (403) 297-2750 or (403) 427-0669.

Japan & Canada—Investment Partners

KAO-DIDAK opened the world's largest 3-1/2" computer diskette manufacturing plant in Arnprior, Ontario, on November 10, 1987. (photo courtesy of Canada-Japan Trade Council)

RUGMAN, Alan M., *Trade Liberalization and International Investment* (Economic Council of Canada, Ottawa, forthcoming first quarter 1988). Inquiries: Dr. Sunder Magun, (613) 993-1253.

Alan M. Rugman (University of Toronto): "How will multinationals adjust to bilateral free trade? This paper includes a questionnaire filled out by 43 of the largest multinationals, which indicates that adjustment costs exist, but will in general be absorbed as running costs by the firm. The multinationals won't close up their firms here and go home as a result of a free trade deal. However, in the future, the rate of growth of Canadian direct investment going to the U.S. will slow down, and instead we will send exports of manufactured goods. If Canada had failed to reach a trade agreement with the U.S., this outflow would have speeded up, but now it will be slowing down."

The Nature of Japanese Investment in Canada

by Richard Lovatt, Investment Canada

Japanese global foreign direct investment has grown exponentially since 1975, doubling every four years — to US$106 billion (cumulative since 1951) by 1987. Last year, Japanese businesses invested a record-shattering US$22.3 billion abroad, US$10 billion of it in the United States alone.

At the same time, Japan's global current-account surplus has been climbing rapidly since 1982 — to $86 billion in 1986, larger than even those of the OPEC countries in the 1970s. Japan is taking in much more money than it can possibly spend at home.

Canada — "one of the world's best-kept secrets", according to Andrew H. Malcolm (*The Canadians*, Fitzhenry & Whiteside 1985) — received only US$276 million in Japanese investment last year, and less than US$2 billion cumulatively to March 1987. American markets — the richest, biggest and most dynamic in the world — are very attractive to Japanese investors. Canada, with a smaller economy and lower international profile, has been largely overlooked. As well, the Japanese perception of Canada as somewhat hostile to foreign investment has lingered in spite of the proclamation of the very liberal Investment Canada Act in June 1985.

Nevertheless, recent appreciation of the yen and growing protectionist sentiments in the U.S. and Europe are producing a new uncertainty within Japan about continuing to manufacture domestically and export to western markets. Setting up overseas appears cheaper and often more attractive from a cost and trade-barrier perspective.

In this context, Canada's favourable exchange rate offers reasonable offshore production costs for Japanese investors who establish plants here. We have a small but real market with its own excellent opportunities. Moreover, our US$167 billion two-way trade with the United States makes Canada an attractive place for investments designed to gain access to the U.S. market — an attraction increased by the new free trade agreement between the two countries.

Since the mid-1970s, when Japanese international investment began expanding rapidly, the trend has been for Japanese investors to secure raw materials and build manufacturing plants in low-cost locations. Direct investment in Canada, established at that time, is still primarily concentrated in coal, metals, forestry, and uranium exploration, with only a small amount in marketing and manufacturing — mainly of electronic consumer products.

Now the emphasis is shifting worldwide, both geographically and in terms of the kinds of investment. Recently there have been very few investments in resource projects in developed countries. Moreover, in 1978, Asian countries received about 42 percent of Japanese direct overseas investment in manufacturing, but this dwindled to 21 percent by 1986. The share for North America changed from a mere 16 percent ▶

to 58 percent. In an amazing about-face, goods manufactured in developed countries are starting to be exported back to Japan for sale in their domestic market. Honda, for example, is shipping cars made in the United States back to Japan.

Some of this investment is coming our way. The combination of a new business climate in Canada and recent aggressive marketing to the Japanese by government and business is having an effect. Recently, Japanese firms like Honda, Suzuki and Toyota have been investing in automotive assembly plants here — opening the way for related investments in parts manufacturing and high technology products.

In 1985, there were 30 Japanese companies in Mississauga; by May 1987, when a civic reception was held to honour the Japanese business community for its "outstanding contribution to the cultural and economic life of Mississauga", there were 53 — a 77 percent growth in two years.

Elsewhere, Didak Manufacturing in Arnprior, Ontario, formed a joint venture last year with Kao Corporation to manufacture floppy disks in Canada and is already expanding production from 2 million to 5 million units per month (see photo, previous page).

Servo Robot of Montreal recently joined Deihan Corporation of Osaka to manufacture Deihan robots with Servo's vision system — a vision system developed at the National Research Council.

In May, Taiho Pharmaceutical and the University of Alberta established a joint venture for R&D into antibiotics. Initially, Taiho will provide $2 million for research but by 1989 will be manufacturing in Canada.

In August, Allelix established a joint venture with Mitsui Petrochemical to develop anti-cancer drugs from the African periwinkle plant.

In Japanese eyes, Canada may be becoming what Andrew Malcolm went on to describe as "an exciting place of new beginnings". ♣

— Richard Lovatt is Senior Investment Program Manager — Pacific Rim in the Investment Promotion Division of Investment Canada.

Kanao Report Says Canada Rich Site for Investment

Minoru Kanao, Chairman of Nippon Kokan K. K., and Chairman of the Japan-Canada Economic Committee of the Keidanren, led a major Japanese investment mission to Canada last year, and wrote a report entitled Discovery of a "New Canada". *As well as the points mentioned below, the report placed key importance on prospects of enhanced access to the United States market in making Canada attractive as a manufacturing location for North America. Following are extracts from Mr. Kanao's introductory message.*

"To briefly summarize (the mission's findings) I found most impressive:

1. A friendly and reliable relationship, invaluable in today's international society, has been firmly established between our countries in both the government and business sectors.

2. Policies of both the federal and provincial governments, designed to promote foreign investment in Canada and to secure international competitiveness, are being effectively implemented.

3. Canada is now concentrating great effort on the development of high technologies and has succeeded in developing some which are unique.

"Canada is experiencing big changes and all members of this mission were impressed by what they perceive as "a new Canada".

"It is difficult to forecast long-term patterns. . . . However, I would venture the following observations:

1. Our natural resource trade is to be conducted on a long-term basis and will play an important role in our trade relations. At the same time, we expect to see a rise in the import of Canadian manufactured goods to Japan.

2. Today, both countries' high technologies show great potential for further development. We expect cooperation through exchanges of technologies or joint development in this field.

3. Direct capital investment in Canada by Japan, especially in the manufacturing sector, is expected to increase. This, too, promises new developments in our relations.

4. Great potential exists for cooperative activities of Canada and Japan in the third world countries, especially in the Pacific Rim and in Central and South America. I can envision a wide range of cooperative efforts such as joint venture programs and industrial plant export, to name but two....

"Regarding Japanese investment in Canada, we have been encouraged by the improvements the federal and provincial governments have realized in the investment environment through promotion programs and the betterment of the labour situation, and we hope to see such programs maintained and even strengthened.

"We would also like to see the private sector demonstrate greater eagerness in dealing with these issues at both the industrial and the company levels."

Minoru Kanao, Chairman of the Board of Nippon Kokan K.K., and David Culver, Chairman and CEO of Alcan Aluminum, at the Canada-Japan Businessmen's Conference held in Vancouver May 10-13, 1987. Kanao and Culver were the Chairmen of the Japanese and Canadian delegations respectively. (photo courtesy of Canada-Japan Trade Council)

Interview With Michael Howard

Michael Howard is the Senior Advisor (Investment) at the Canadian Embassy in Tokyo, Japan. Before taking up his posting, he served as National Director, Japanese Practice, in an international accounting firm, travelling to Japan 17 times over 12 years. Following are extracts from a recent conversation with Investing In Canada.

What do you actually do?

My role is to coordinate the Embassy's efforts to attract direct investment from Japanese corporations into Canada through intermediaries like banks and trading companies and through promotional programs, seminars, trade fairs, direct mailings — generally activities which will bring prospective investors to the fore for subsequent "one-on-one" efforts.

The job is enormously complex because I'm marketing an abstraction — an attractive alternative to investing in the U.S. — to an audience that's enamoured of the U.S.

The work with intermediaries is key. There are two or three hundred thousand companies in Japan in our targeted sectors — an unimaginably high number for a direct contact program without some preliminary screening. We need leverage. Institutions like banks and trading companies have tremendous databases of customers and others known to them. If we can persuade them it's in their own interest to act as intermediaries to find prospective investors from Japan for Canada, everybody's interests will be served.

Is it hard to promote investment in Canada to the Japanese?

It's very complex. Apart from the large companies who have been in Canada for some time, potential investors have an image of Canada as only a tourist site; their memories are of visiting Niagara Falls, the Rocky Mountains. Often, before discussing investment, we need to fill out this picture. We emphasize the high technology environment, skilled labour, sophisticated workforce, modern distribution systems, and so on.

Michael Howard

And the job is enormously complex because I'm marketing an abstraction — an attractive alternative to investing in the U.S. — to an audience that's enamoured of the U.S. The largest market in the world for Japanese companies is the U.S.A., and the amount of Japanese investment there is increasing at an extraordinary rate.

What do we have to offer in comparison?

We offer a potential for Japanese companies to manufacture products in Canada as a relatively low cost base from which to export into the U.S. market. We have some strong economic arguments to persuade Japanese companies to think seriously of Canada for North America penetration: the favourable exchange rate between U.S. and Canadian dollars; low cost electrical energy; comparable productivity performance with the U.S.; comparable labour performance in terms of work stoppages and labour settlements. And we think there is some intrinsic advantage in quality of life in Canada which has proven attractive to Japanese companies in the past: our countryside, the space and quiet of our cities, our welcoming approach to newcomers. . .

On top of all that, in recent years we've seen a 40% appreciation of the yen against the dollar, which has had a tremendous impact. For large Japanese companies who have been manufacturing in Japan and selling into the North American market, profit margins have been eroded to the point where, for the first time in decades, they are recording losses entirely attributable to the shift in foreign exchange. One obvious strategy is to move their manufacturing offshore — either to countries with relatively low labour costs; or to the markets, particularly North America. The proposed Canada-U.S. free trade agreement is also strengthening our argument that Japanese companies can find profitable opportunities by installing plants in Canada.

Do you say different things to different investors?

If I'm talking to a company interested in high technology, I alert it to the variety of companies in the high technology sector in Canada, and the strong interest in developing joint venture initiatives.

Start with the assumption that Japanese business operates according to completely different precepts.

If I'm talking to a company that has been selling into the Canadian market in the past, I encourage it to investigate manufacturing the product in Canada as a way of alleviating the pressures of a high yen.

If the investor is looking at North America for the first time, I encourage it to include Canada as an equal contender with the United States, given the economic advantages we can offer. If, for example, it's an automotive parts company looking to set up a plant somewhere between the Japanese car assembly plants in the U.S. and Canada, I encourage it to include a Canadian site in its feasibility studies. Given the recent decisions by assemblers to locate plants in Canada, there's significant interest from parts companies, and we expect not only 100% investment by Japanese companies, but also joint venture investment, which we think is key to capitalizing on the recent investment by assemblers. ▶

What advice would you give a Canadian company trying to interest a Japanese investor?

Start with the assumption that Japanese business operates according to completely different precepts from Western business. Don't make prior assumptions about how to succeed. Nothing is simple in Japan, nothing is as it seems in Japan. Be prepared to completely redefine the concept of patience and the investment of time you have to put in. Everything takes longer in Japan — days not hours, months not weeks. Ask for advice, read a lot, become informed, because there's a good possibility that the person you will be dealing with is most thoroughly prepared and has taken the trouble to become completely briefed about your industry and indeed your business. The Japanese success story of the last 40 years can be traced to tenacity, hard work, perseverance, long-term planning, single-mindedness and dedication, and their business people respond positively to these characteristics in a prospective partner from another country. The happiest partnerships come from bringing together Canadians and Japanese with an equal amount of such dedication.

— Susan McMaster with files from Catherine Anka

Davos — January 28–February 3, 1988

The Davos Symposium, held annually in Davos, Switzerland, is sponsored by the World Economic Forum and is recognized as a world-class event bringing together almost a thousand senior-level industrialists and economic leaders. This is the third year Investment Canada will be participating and working very closely with federal ministers, the provinces, and the private sector to ensure a strong investment profile for Canada.

New Publications from Investment Canada

Annual Report 1986-87 — describes the investment climate in Canada with detailed graphs and statistics, outlines the Agency's mandate, activities and achievements during its second year of operations, and lists investments approved during the year under review.

Canada: Federal Tax and Financial Incentives, Update — material reviewed as of 1 September 1987. Reviews Canadian tax system and provides information on financial incentives for industry. Covers federal and provincial income and sales taxes and compares Canadian and U.S. income tax systems. Outlines major reforms of tax system proposed by the Government of Canada in June 1987.

The Political Economy of Strategic Partnering, by L.K. Mytelka — defines, describes, and discusses factors in success and failure and policy implications of such alliances (see page 1 of this newsletter).

Copies of these or other Investment Canada publications can be obtained by contacting the Publications Manager, Investment Canada, P.O. Box 2800, Station D, Ottawa, Ontario K1P 6A7.

. . .Strategic Partnering

(cont. from page 1)

An examination of four data bases (from the Center for Science and Technology Policy, Troy, N.Y.; Venture Economics, Wellesley, Mass.; FOR, Rome; and CEREM, Paris) yields the information that: the number of agreements is increasing over time; U.S. firms are clearly predominant as principal partners; technology production and sharing have become important components of agreements; larger firms are more likely to enter into multiple agreements with a variety of partners to achieve their technological objectives; and inter-industry and intra-industry agreements have both increased in importance.

For Canada, adoption of knowledge-intensive flexible production techniques holds out the promise of overcoming the disadvantages of a relatively small market. Investment policy should provide funding and assistance to identify sectors and partners for strategic partnerships; to restructure activities within knowledge-intensive enterprises; to negotiate agreements with foreign firms; and to stimulate R&D in frontier technology sectors in which Canadian firms can be internationally competitive. Technology policy should encourage basic research into generic technologies, initiatives in higher education, and consortial R&D involving private firms, universities and research institutions.

Kiyomizu Temple in Kyoto is an outstanding example of Japan's traditional wood-frame style.

Investing In Canada is published quarterly by Investment Canada, the investment development agency of the federal government. Opinions expressed in this issue are not necessarily those of the Agency. Letters of opinion, response or analysis are welcome, and may be published in future issues subject to the writer's consent. Comments and inquiries should be directed to The Editor, *Investing In Canada*, 235 Queen, 5th Floor West, Ottawa, Ontario K1P 6A5, tel. (613) 995-9630.