

INVESTING IN CANADA

A NEWSLETTER ON CANADA'S INVESTMENT CLIMATE

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CANADA'S INTERNATIONAL INVESTMENT POSITION

INTERVIEW WITH

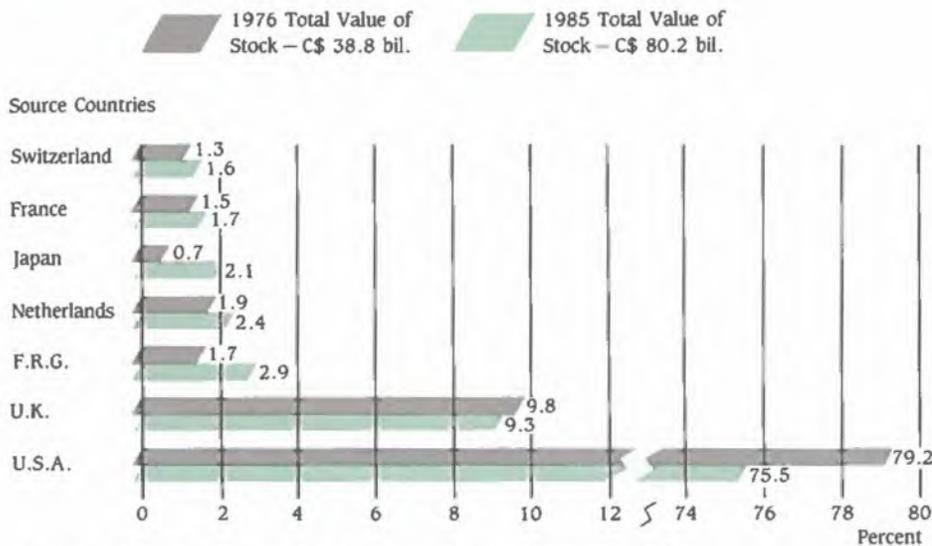
J.-P. MATHIEU

"We've come here at
the right time"

This article presents some of the more recent investment statistics available from Statistics Canada as adapted by Investment Canada's research division. They offer a picture of Canada's investment position in terms of the global economy.

J.-P. Mathieu is the Investment Counsellor for Investment Canada at the Canadian Embassy in Paris, France.

COMPARISON OF SOURCES OF STOCK OF FOREIGN DIRECT INVESTMENT IN CANADA – 1976 AND 1985 (% of Total FDI Stock)



Source: Statistics Canada, *Canada's International Investment Position*, 1976, 1985. Adapted by Investment Canada.

The world economic environment has changed dramatically over the past few years and the Canadian economy has performed strongly during that period, particularly in the area of investment.

Japan is now the world's largest net exporter of capital, but West Germany and Italy have also increased their shares. Other countries, not recognized in the past for their propensity to invest abroad, have made important contributions to total international investment levels. These include Sweden, Australia, South Korea and Hong Kong. At the same time, traditional sources of investment, such as the United States and the United Kingdom, have been contributing relatively smaller proportions to total global flows.

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Photo Réjean Lemieux

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FOREIGN INVESTMENT IN CANADA AND CANADIAN INVESTMENT ABROAD

— Six Decades of Flux —

This article is the second of two by C.F.J. Richards, Chief, International Investment Position Section of the International and Financial Economics Division of Statistics Canada. The first article, "International Investment Statistics: Can They Be Compared?", appeared in the Spring 1988 issue of Investing In Canada.

The history of foreign investment in Canada and Canadian investment abroad is by no means straightforward. As with international investment statistics, discussed in the previous article, confusion and misinformation can result if terms are not carefully defined and the definitions understood by users.

Of the foreign capital invested in Canada, Statistics Canada defines direct investment as the book value of long-term investment in Canada (both equity and debt) by a foreign resident or related group who is both able to exert influence on the affairs of a company and who owns about 10% of the equity of the company.

This may seem an unusually low percentage. In actual fact, a direct investor in most cases also ends up controlling the corporation. The amount of direct investment that does not form part of the controlling investment is minimal.

Since 1926, residents of the United States have held the lion's share of foreign direct investment in Canada (FDIC). This has varied from a high of 87% in the early 1950s to a low of 73% in 1986. By comparison, Great Britain, the second most dominant direct investor here, has about 9% of the total, West Germany 3%, and the Netherlands, France and Japan 2% each.

"A direct investor in most cases also ends up controlling the corporation."

In Canada the high-water mark of direct investment was the period 1955-1970 when direct investment consisted of just a little over 50% of the total gross liabilities. By the end of 1985, its contribution had dropped to 27% — the same relative position as in 1926. The only period in which direct

investment exceeded portfolio investment was the 25 years from 1952-1977.

"The high-water mark of direct investment was the period 1955-1970."

It is no wonder that the period 1952 to 1977 coincided with the era of economic nationalism in Canada. The growth of foreign direct investment, both in absolute and in relative terms, seemed to imply that control of Canada's economic resources was passing into foreign hands. Various governmental commissions (from Gordon to Wahn to Gray) and agencies (such as the Foreign Investment Review Agency (FIRA)) were set up to address foreign ownership and control of Canadian industry.

In hindsight, it may turn out that the 1952-1977 period was an aberration in our economic history. In recent years, the rate of growth of foreign direct investment in Canada has been markedly subdued compared to that of Canadian direct investment abroad. In the six years ending in 1985, FDIC in Canada increased by 55%; Canadian direct investment abroad increased by 155%.

Most analysts miss an important reason for at least part of this difference: direct investment is recorded at book value. For FDI in Canada, it is based on the books of Canadian entities. For Canadian direct investment abroad (CDIA), however, it is valued according to the books of the subsidiaries and affiliates abroad of Canadian entities. In recent years, a substantial part of the CDIA increase is simply due to the depreciation of the Canadian dollar against foreign currencies.

The currency discrepancy should also be kept in mind when comparing foreign direct and portfolio investment in Canada. Any long-term investment not identified as direct investment is defined as portfolio investment.

Most foreign portfolio investment in Canada consists of bonds and other debt investments, many denominated in foreign currencies. The depreciation of the Canadian dollar against foreign currencies has an important effect on the value of foreign portfolio investment in Canada. Of the real growth in foreign direct investment in Canada, most has been through growth in retained earnings.

"The only period in which direct investment exceeded portfolio investment was the 25 years from 1952-1977."

Foreign portfolio investment was as high as 61% of Canada's gross liabilities in 1926. Its relative position then declined steadily to 28% at the end of 1971, when it began to increase again and reached 49% at the end of 1986. In the

last two years alone, an increase in Japanese investment has helped push foreign portfolio investment up another 6 points.

"It is no wonder that the period 1952-1977 coincided with the era of economic nationalism in Canada."

In absolute terms, the increase in portfolio investment was about 2.5 times as great at \$102.7 billion as that of direct investment at \$38.7 billion. One might therefore ask if the slack in foreign direct investment has been taken up by portfolio investment. The answer is an unequivocal "no." The relative decline of foreign direct investment pertained to equity capital in the private sector. The relative increase in portfolio investment arose largely from debt capital in the government sector and included provincially owned utilities.

Canadian direct investment abroad (CDIA) shows a variable pattern. There are three distinct periods of Canadian direct investment abroad: 1926-1976; 1977-1981; and 1982-1986. From 1926-1976, the rate of growth of CDIA was predictable. Then, beginning in 1977, CDIA grew at an unprecedented rate. It nearly tripled within just five years. The United States regained its preeminent position as a location for CDIA. Three industries were largely responsible for the growth: manufacturing, petroleum and natural gas, and real estate investment. Although manufacturing maintained its position, there were shifts among its subcategories; for instance, chemical and allied products became relatively more important than beverages or iron products. But in 1982 the rate of growth slowed markedly. We are now into a period of consolidation.

In general, as with other investment transactions, the United States has always been the most important location for CDIA. The U.S. share grew from about two-thirds of all CDIA in the late 1920s to nearly four-fifths by the late 1940s and early 1950s. After that, a steady relative decline set in, reaching

50% by the end of 1973. Then the United States share of CDIA grew again, reaching about 71% by the end of 1986.

However, by comparison, the United States share of foreign direct investment in Canada, which also peaked in the 1950s at about 87%, declined to about 73% for 1986. It would seem then that, by different routes, the United States portion of both CDIA and FDIC have reached approximately the same point.

In recent years, there has been a relative decline in CDIA in developing countries. Since the late 1970s, CDIA has been growing at about one-third the rate of that of the developed countries. Among the developing regions, CDIA grew fastest in Asia. Indonesia is the most prominent host country. For the first time since 1972, Canadian direct investment in developing countries declined in absolute terms in 1985.

The role of intermediate holding companies in CDIA has increased to such an extent in recent years that the task of statistical collection and proper geographical and industrial allocation of CDIA is much more complex than it was. Some of the direct investments held temporarily in certain Caribbean countries through holding companies, for example, will eventually find their way to other countries.

"In hindsight, it may turn out that the 1952-1977 period was an aberration in our economic history."

As well, a fair-sized portion of CDIA is in the control of families, not institutions, management, or other groups. This raises the possibility that the heads of these companies could take their corporate assets and their residence outside of Canada at any time. (To date, those migrations that may have taken place from Canada for tax considerations or other reasons have not affected the amount of CDIA to any substantial degree.)

Direct investment abroad is also classified according to the country of beneficial ownership of capital invested and

the country of control of the investor company. Under this classification, part of Canadian direct investment abroad is attributed to non-resident interests to the extent of their ownership in the Canadian enterprises. At the end of 1983, Canadian residents held direct investment equity of \$28 billion, or 74% of total direct investment, but controlled a larger share of \$31.7 billion or 84% of the total. Conversely, non-residents, through their investments in Canadian enterprises, held \$9.8 billion or 26% of direct investment equity abroad, but controlled less (16%).

"By different routes, the United States portion of both CDIA and FDIC have reached approximately the same point."

At the end of 1983, there were 1,460 Canadian enterprises with direct investments in 3,723 foreign concerns. Some 5% of these Canadian enterprises accounted for 78% of the value of investment abroad, reflecting concentration of investment by a few Canadian enterprises. Canadian-controlled enterprises invested, on average, in more foreign concerns than those enterprises controlled by non-residents.

Another classification shows Canadian controlled investment abroad in terms of both the direct investment portion of capital employed as well as that portion owned by third-party investors. By year-end 1983, Canadian-controlled investment abroad reached \$73.1 billion, of which 52% was owned by Canadian direct investors and the remaining 48% was owned by third parties.

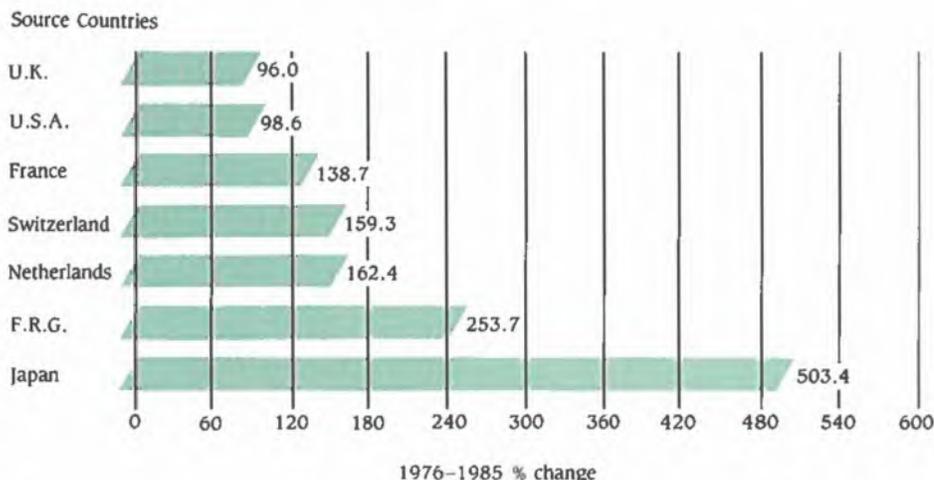
Canadian portfolio investments abroad (CPIA), on the other hand, have remained at a fairly steady one-fifth of all long-term Canadian investments abroad in recent years. The five-year bull market - 1982-1987 - and the popularity of globally invested mutual funds have to be credited for this performance. It remains to be seen what the effect of the market crash of October 1987 will be on CPIA. ♣

CANADA'S INTERNATIONAL INVESTMENT POSITION (cont. from page 1)

Despite this change, Canada's share has remained stable at about 4%, but recent investments in the United States and the United Kingdom are expected to alter that proportion upward.

The changing global environment regarding investment flows is illustrated in the changes and growth that have occurred in the stock of foreign direct investment (FDI) in Canada in recent years.

PERCENTAGE CHANGE IN STOCK OF FDI IN CANADA BY SOURCE COUNTRY



Source: Statistics Canada, *Canada's International Investment Position*, 1976, 1985. Adapted by Investment Canada.

U.S. investors continue to hold approximately three-quarters of the stock of FDI in Canada. Nonetheless, the American position of preeminence has been subjected to slow but steady erosion because of the relatively rapid increase in investment in Canada from West Germany, the Netherlands, and Japan, as well as France and Switzerland. The absolute value of British investment has been rising in Canada, and, although the British share of the FDI stock in Canada is lower than it was 25 years ago, in recent years it has begun to rise consistently.

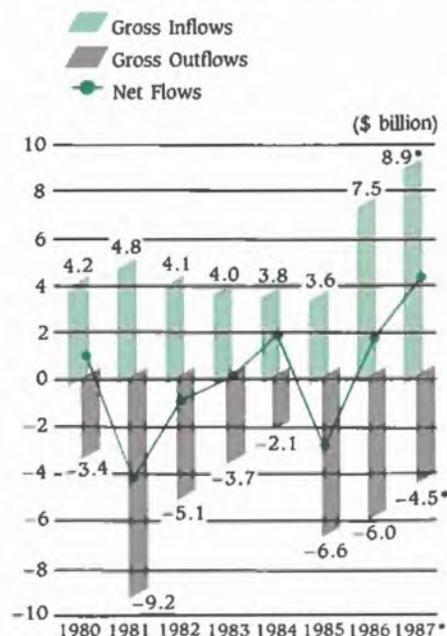
Foreign investors all over the world are finding Canada an increasingly attractive place in which to invest and do business. Preliminary figures show that the gross direct investment flows coming in have more than doubled in the last two years – reaching an all-time high of almost \$9 billion last year.

Canadian investors, too, are responding to the changing world of foreign investment. Canadian direct investment abroad has grown rapidly, almost doubling in the last five years. Last year, for the second year in a row, a record high of over \$8 billion was reached.

These figures show the growth of Canadian enterprises abroad. As world leaders in certain areas of technology and innovation, they can best capitalize on their expertise by bringing it to other countries and by moving into new markets.

For example, Northern Telecom, which spearheaded the digital revolution in communications, is now revamping the entire telephone system for the U.S. government in Washington. Olympia & York, which has been reshaping the South Manhattan skyline for over a decade, has just taken on the same task in London, England – the Canary Wharf Project, the largest real estate development in the world.

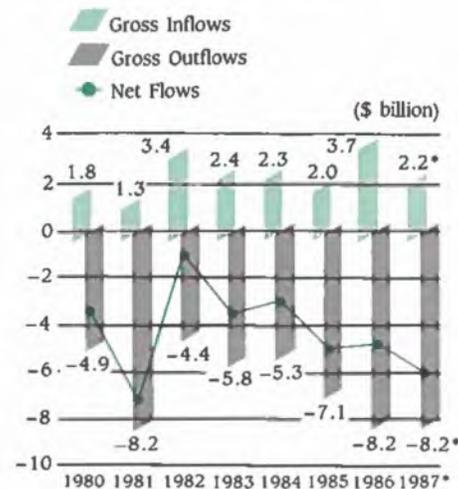
GROSS AND NET FLOWS OF FOREIGN DIRECT INVESTMENT IN CANADA



*Preliminary data.

Source: Statistics Canada. Prepared by Investment Canada, March 30, 1988.

GROSS AND NET FLOWS OF CANADIAN DIRECT INVESTMENT ABROAD

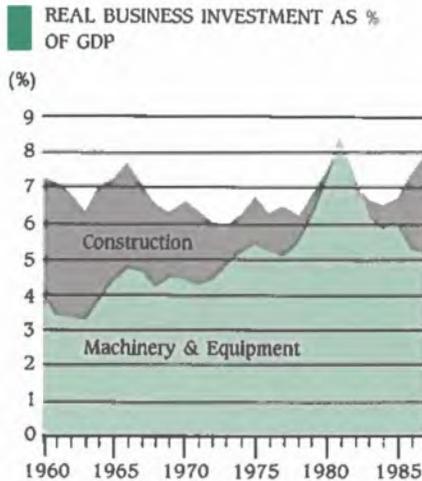


*Preliminary data.

Source: Statistics Canada. Prepared by Investment Canada, March 30, 1988.

One can measure business investment within Canada in a variety of ways. Total business investment in Canada (both foreign and domestic but not including residential construction or government spending) was \$62.3 billion in 1987. From 1982 to 1987, real business investment (adjusted for inflation) grew by 20%, or at an average annual compound rate of 4.7%. This was faster than the real rate of growth for the economy over the same period, which averaged 4.4%, the highest among the G-7 countries.

Investment is comprised of two parts: construction, and machinery and equipment. It is the latter category which contributes primarily to productivity and competitiveness. Over the last 27 years, the proportion spent on machinery and equipment has been increasing, from 33% of the total in 1961 to 60% in 1987. In addition, the proportion of investment spent on machinery and equipment as a percent of GDP has risen, particularly since the beginning of the decade. It presently stands at 8%, more than double the 3.5% of 1961 and well above the 27-year average of 5.3%. It appears that the more productive portion of investment has been rising as a percentage of GDP even though the entire amount has recently been declining in relative terms.



Source: Statistics Canada, National Accounts.

Real business investment grew from \$14.8 billion in 1960 to \$55.8 billion in 1987 at an average rate of 5% per year. Over the 27 years, investment intensity (business investment as a percent of domestic product) measured in constant dollars averaged 11.9%.

These indicators have shown Canada to be an attractive place to invest with minimal risk. No doubt they will be watched carefully by investors as the Canada-U.S. Free Trade Agreement comes into effect. Most forecasts predict increases in both domestic business investment and foreign investment as more investors seek to serve the Canada-U.S. market from a Canadian base. 🍁

INTERVIEW WITH J.-P. MATHIEU

“We’ve come here at the right time” *(cont. from page 1)*

Mr. Mathieu has extensive experience in international marketing and trade. Since 1975, he has been with CEGIR, most recently as Vice President, Asia and Pacific. After two and a half years in Paris, he will be leaving his assignment with the Embassy in the fall of 1988. The following interview took place in May 1988.

Perhaps we could start with a brief summary of what you do in Paris.

The Investment Development Program in Paris started two years ago. From the beginning, we took a very direct and aggressive approach in trying to meet with potential investors interested in investing in Canada.

The first year we started from scratch; we decided it would be most effective to contact the companies which might be potential investors directly. In order to identify prospects, we undertook sectoral studies in three sectors: advanced materials, biotechnology and microelectronics.

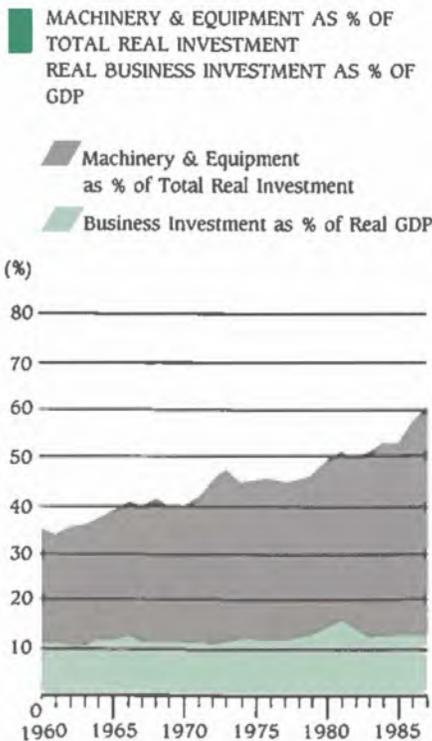
Over a six-month period, we designed a fully computerized system, now in place, that enables us to identify companies that are good prospects on a sectoral and regional basis — a lead-tracking and follow-up system. The system, which is

called PARINVEST, is a basic day-to-day management tool, designed to enable us to identify prospects, to organize a promotional activity directed towards a specific prospect, and to follow up on the prospect. ▶

Jean-Pierre Mathieu



Photo Réjean Lemieux



Source: Statistics Canada, CANSIM.

Using this system, we identified close to 300 potential investors and started meeting with these companies last spring (1987). At each company, we made sure we met with the president and the top management, because they are the ones who are aware of the company's strategy in terms of foreign market expansion and penetration, and they are the decision-makers.

Why have you studied these companies by sector?

We feel it is more important to take a focussed approach than a macro or shotgun approach – and the results of our efforts are coming to fruition this year. All the companies we were following last year through the sectoral studies are leading investors. This year we will look at two or three more sectors, ones we did not really cover last year, such as defence and the aerospace industries, which are very strong in France.

The plan is simple and down-to-earth, and it works. You gain knowledge in specific sectors and you're more convincing when you talk to people in a given area in France or in Canada.

■ "What has helped tremendously . . . is the confirmation that there will be a Free Trade Agreement between Canada and the U.S."

What attracts French investors to Canada?

They know it is easier to do business in Canada than in the States; they feel more secure about establishing their businesses in Canada than about going directly to the U.S. market. They know it's cheaper to do business here in many ways. As well, we tell them often that they can easily find a partner in Canada – a company that is seeking new technology and that has been doing business with the Americans for a number of years and therefore already has its own distribution network. A joint venture with a Canadian company will accelerate the process of market penetration and thus save a lot of time and money.

Do you see results from your efforts?

In 1987, French companies have invested very close to \$1 billion in Canada. This is in the form of acquisitions, direct investment and joint ventures. The Investment Development team in Paris participated in or was instrumental in bringing in a third of this investment.

That's roughly \$350 million that we've generated through our contacts, our promotional activities and our identification activities.

I would like to stress that we take a team approach to investment development, not only in Paris – with Marie Vanasse, Michel Bélanger, Céline Bilodeau and myself – but in Ottawa, with DRIE, Investment Canada and External Affairs. None of this would have been achieved without real cooperation.

What direction is French industry taking?

France is a country that is changing a lot. French companies are tremendous in developing new technologies and are quite active in R&D, but in marketing they have been living in the past. France's worldwide market share has steadily gone down, losing 5% or 6% over the last five or six-year period. This is now changing. The French government has really convinced companies to reduce their export activities and to increase their investment activities in foreign countries. Since 1986, the government has had an international strategy of making sure that French companies were positioned in the markets instead of just exporting.

We arrived at the same time, and with the same message – we were also trying to attract these companies to a foreign country.

And, in return, are you finding Canadian investors who are interested in France or Europe?

Our mandate is to attract French investment to Canada, but this often has a double effect. If we attract a French company to Canada and establish a joint venture with a Canadian company, it becomes a great opportunity for the Canadian partner, in turn, to go back to Europe and deal with the French partner and thus penetrate the European market.

There is so much potential in Europe. We don't understand why so few Canadian companies are coming to Europe to find technology they can bring back to Canada.

What trends are you seeing in Europe in general?

What's happening today is pretty new in terms of international trade or investment activities. There are free trade agreements that are being created in the two most important markets, North America and Europe. Europe is targeted to be a single market in 1992, and the free trade agreement between Canada and the U.S. will be brought in over the next 10 years.

All the companies we're meeting with are taking these two deadlines very, very seriously. For the first, they have established the priority of positioning themselves in Europe before 1992.



Photo Réjean Lemieux

For Canada, what has helped us tremendously over the last six or seven months in attracting investment prospects is the confirmation that there will be a free trade agreement between Canada and the U.S. It was really an eye-opener for a lot of European companies, and they are now considering a number of options in order to be positioned in North America as soon as possible.

Overall, we've come here at the right time. The timing of our investment prospecting program couldn't be more perfect, because all the companies across the world are repositioning their international activities over the next two or three years, in Europe, in North America, in Japan. Canada's investment development program is really filling the gap that is being created by this market globalization. ♣

—interview by Susan McMaster, Investment Canada

Investment Opportunity

Data Bases

The 1988 Fall issue of *Investing in Canada* will feature an article on investment opportunity data bases in Canada.

Investment opportunity data bases are basically computerized information systems made available to investors looking for investment opportunities and entrepreneurs who wish to find business people interested in investing capital in new, expanding or well-established businesses. Thanks to these data bases, investors and entrepreneurs looking for investment partners often end up making a match that benefits both parties.

Investment Canada is presently conducting a survey on such computerized data bases. In order to carry out a com-

plete study, the Agency is interested in obtaining further information about existing investment data bases. We would like to receive information on these investment data bases from the operators and users of these systems.

Your input would be greatly appreciated. Please send information to:

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Current Publications

Investment in Canada — A Selected Bibliography. Ottawa: Investment Canada, 1988.

Investment Canada has compiled a selected reading list from its own publications as well as those of other departments and agencies of the Government of Canada, and from the private sector, to help investors and consultants both within and outside Canada find the information they need about investing in Canada. Information for ordering is included; most publications are available without charge for single copies.

Ordering information for *Investment in Canada — A Selected Bibliography* and other Investment Canada publications can be obtained by contacting the Publications Manager, Investment Canada, P.O. Box 2800, Station D, Ottawa, Canada K1P 6A5.

The Canadian Edge. Ottawa: Investment Canada, 1988.

The 1988 edition of this compendium of almost 1,000 pages of text, maps, charts, tables and graphs summarizes investment in Canada in relation to the geographic, social, political and business climates. The hardcopy version is available in Canada for \$150 (\$180 in other countries), with text updates for \$75 (\$90). An electronic version, consisting of software that is IBM P.C. compatible and an instruction manual, is available for \$75 (\$90). Bonus — for those who purchase the hardcopy version of The Canadian Edge, the software version is available free of charge, on request. (Handling charges: \$4.50 for hardcopy version, \$2.25 for all others.)

To order, send cheque/money order (payable to the Receiver General of Canada) to: Canadian Government Publishing Centre, Ottawa, Canada, K1A 0S9, telephone (819) 997-2560.

Trade Liberalization and International Investment, Discussion Paper No. 347, by Alan Rugman, University of Toronto. Ottawa: Economic Council of Canada, March 1988.

Multinational enterprises operating in Canada will be able to absorb most of the adjustment costs of a bilateral free trade agreement. This is the key finding of this research study, based on theoretical and empirical analysis, supplemented by a questionnaire to the 43 largest industrial multinationals with sales of over one billion dollars.

Discussion papers are working documents made available in limited number and in the language of preparation to interested individuals for the benefit of their professional comments. Contact the Director of Information, Economic Council of Canada, P.O. Box 527, Ottawa, Ontario K1P 5V6. ♣

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