INVESTING IN CANADA

A NEWSLETTER ON CANADA'S INVESTMENT CLIMATE

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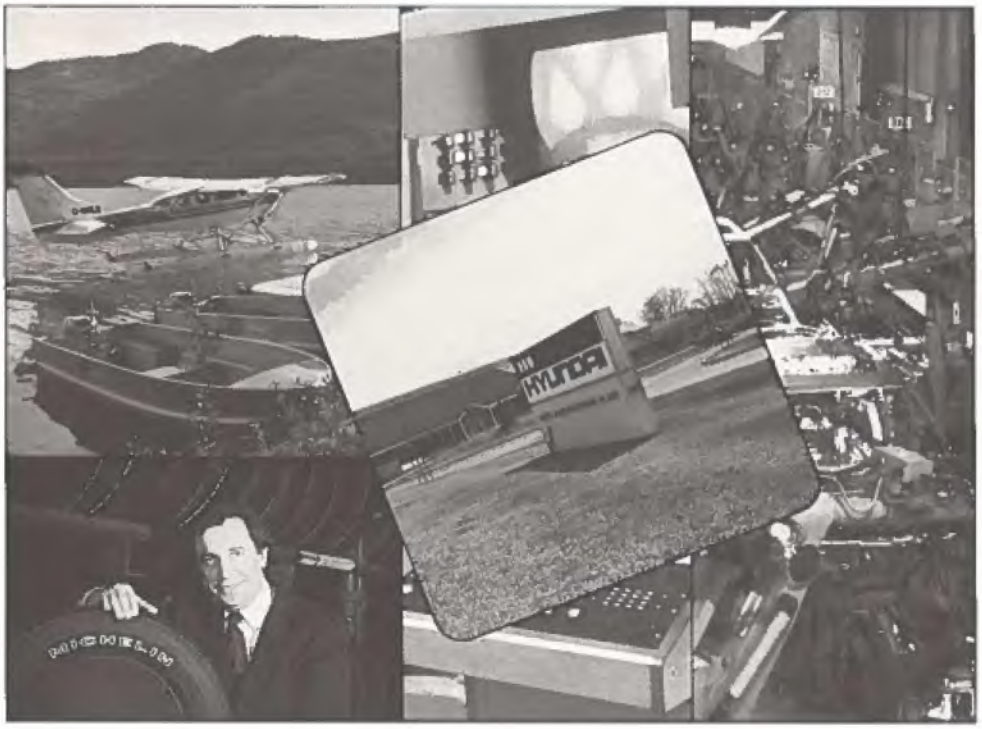
PROVINCIAL INVESTMENT DEVELOPMENT



This issue of Investing in Canada describes to potential investors and investment intermediaries the various economic sectors the provinces and territories are promoting, and actual investments that are being made; this is a continuation of the subject we began in our summer 1989 issue. As well, we have an article by Mr. Soo Gil Park, Ambassador of the Republic of Korea, delineating Korean investment in Canada. Korea has a relatively small share of Canada's foreign direct investment, but it is on the increase as Korea's rapidly-growing economy emerges on the world scene. And for business people who are seriously considering the merits of a joint venture, this month we are weighing the pros and cons of this type of business arrangement in a feature article entitled, Joint Ventures: How to Make Them Work.

BRITISH COLUMBIA

Canadian and Korean business people met in Vancouver November 22-24 for the 8th Joint Meeting of the Canada-Korea/Korea-Canada Business Councils. The councils aim to improve their members' knowledge of the respective economies, cultures, business systems and industrial capabilities to increase bilateral trade and promote increased joint investments and technology transfers between the two countries. *(p. 6)* ➤

CANADA • KOREA: INVESTMENT TRENDS

The following article was written for Investing in Canada *by the Ambassador of the Republic of Korea, His Excellency, Mr. Soo Gil Park.*

The steady growth of the Korean economy in the 1970s and 1980s, and the country's self-confidence in managing the external debt — which at one point reached US$46.8 billion in 1985, or 56% of GNP that year — led to a policy shift toward liberalizing Korean investment in foreign countries.

Recently, Korean business people have become more interested in overseas investment and see the multinationalization and diversification of their business operations as an effective means by which to adapt to the ever-changing global economic situation. To encourage overseas investment, the Korean government has strengthened a number of financial, insurance and tax incentives. *(p. 2)* ➤

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INVESTMENT CANADA INVESTISSEMENT CANADA

His Excellency, Mr. Soo Gil Park, Ambassador of the Republic of Korea

Korea's overseas direct investment last year amounted to US$213 million, representing a decline from the previous year's considerable increase. However, this year the trend is clearly on the rise again. Overseas direct investment in the first half of 1989 jumped 115% over the same period last year, to US$181 million.

This upswing can be attributed to such factors as the relative stabilization of the Korean currency after rapid appreciation through late 1987 and 1988 (the Korean won appreciated by 8.7% and 15.8% in 1987 and 1988 respectively, yet has slowed down to 2.6% as of the first half of 1989); the soaring domestic cost of labour; and growing trade protectionism abroad.

Korea's overseas investment in the late 1970s and early 1980s focused on the resource development sector with a view to securing a stable supply of natural resources. Development projects in coal and iron ore mining, pulp and lumber were notable areas in this regard. In recent years, however, there has been a surge toward the manufacturing sectors.

CANADA • KOREA: Investment Trends *(Cont'd from p. 1)*

Investment in Canada

Korean investment in Canada has followed a similar pattern: coal and uranium mine development as a primary stage in the early 1980s giving way to the manufacturing sector in later stages such as Hyundai's automobile plant in Bromont, Quebec, and the aluminum wheel plant in Newmarket, Ontario.

Other notable Korean activities include the purchase, by the Sammi Group of Korea, of four Rio Algom steel plants, and the Hanyang Chemical Corporation's PVC window frame plant being built in St. John's, Newfoundland. These investments are intended to serve the Canadian as well as the U.S. markets. Hence, it seems apparent that the Canada-U.S. Free Trade Agreement is a key factor in promoting Korean investment in Canada.

By June 30, 1989, Korea's total net cumulative overseas investment had amounted to US$1.2 billion, with Canada accounting for 8.2%, or some US$96 million.① The total project value of Korean investment in Canada to date amounts to approximately $800 million. After the U.S. and Indonesia, Canada is the third largest recipient of Korean overseas investment.

Due to the fact that last year's cumulative amount of US$1.1 billion represents only 0.7% of Korea's GNP in 1988, Korea's overseas investment will continue to grow, and Canada will continue to be a primary destination for Korean overseas investment as our two countries seem naturally destined for partnership. In this respect, I hope to see the investment flow from Canada increase further from the current modest figure as the economic conditions for foreign investment in Korea become more favourable.

Trade Relations

In terms of our trade relations, last year we recorded a mutual trade volume of $3.6 billion, making Korea and Canada each other's fifth largest trading partners. During the first half of 1989, Korean imports from Canada have risen a substantial 48.2%, while exports to Canada are up by 12.1%, thus narrowing Korea's trade surplus with Canada to $80 million from nearly $300 million during the same period last year. In a long-term perspective, I believe that our two-way trade volume might reach as much as $6 billion over the next four or five years.

Our two countries enjoyed a long history of friendship and co-operation well before any significant signs of economic exchanges emerged. Hence, I am confident that these bonds will be even further strengthened in tandem with ever-increasing economic relations.

Canada has been blessed with an abundance of rich natural resources and with people who have nurtured and refined their gifts with great care and prowess. This is no more evident than to the people of Korea who regard Canada as an excellent partner, not only because of the extremely successful society it represents, but also due to the complementary nature of our respective strengths.

— Mr. Soo Gil Park, Ambassador of the Republic of Korea

① *Korean direct investment is based on international balance of payment calculations. The total value of the projects cited in this article exceeds this amount because it includes money financed in international and local markets, which includes government grants.*

OVERVIEW OF KOREAN INVESTMENTS IN CANADA

In the last 35 years, the Republic of Korea transformed itself from a war ravaged country into the tenth largest trading nation in the world in 1988, and ranks among the 15 largest economies. By the year 2000, it is expected that Korea, and most other Pacific Rim countries, will outperform the economies of the OECD nations.

Growing trade surpluses, mounting trade friction with the U.S., a strengthening won, and rising domestic labour costs have generated considerable pressures on the Korean government to liberalize domestic markets and encourage offshore investment. Canada is benefiting from Korean investment in areas such as pulp mills, coal and uranium mines, specialty steel manufacturing, automobiles and parts, banking and trading.

Korean investment in Canada is currently estimated at 0.1% of total foreign investment in Canada. Canada is the third largest recipient of Korean investment abroad, after the U.S.A. and Indonesia. Statistics Canada estimates that, at the end of June 1989, the total value of Korean investment in Canada stood at approximately $118 million.①

Korean investments abroad in the 1970s and early 1980s focused on the resource sector. The Shinho Group of Korea is investing up to $120 million in a new pulp mill in the Thunder Bay area, to be completed by 1990. It will supply 120,000 tonnes per year of pulp, 50% of which will be exported to the Korean market. The initial investment of $30 million should create 100 jobs. The first stage of the plan is now complete with the purchase of Kakabeka Timber Company for $3.3 million, and a waferboard plant and land owned by MacMillan Bloedel. And in June 1989, Sammi Steel purchased Atlas Steel from Rio Algom for $250 million and plans to spend another $200 million for expansion of one of the plants in either Quebec or Ontario.

However, the latter part of the 80s has seen increased interest in the manufacturing sector. Notable investments in this area include Hyundai's 1987 construction of an $18 million head office and distribution centre in Markham, Ontario, a $20 million automobile aluminum wheel manufacturing plant in Newmarket, Ontario, which has been operational since February 1989, and a $350 million automobile plant in Bromont, Quebec.

During the official opening of the Bromont plant, on July 4, 1989, Mr. Chung Ju-Yung, President of the Hyundai Group, announced that a $121 million plant would be built in Bromont, adjacent to the current plant, to manufacture chassis parts. Construction started this summer, with a target of October 1990 to begin operations. The Quebec government will provide $5 million in subsidies, $1 million of which will be for job training. At full capacity, 120 people will be employed.

The Bromont plant, operating since January 1989, is the first overseas Hyundai plant. When the plant is operating at full capacity by 1991, employment will exceed 1,200 and production will reach 100,000 units. Easy access to the American market is an extra bonus to Hyundai Canada, given the recently signed deal with Chrysler Corporation. The deal allows Sonata sedans to be sold through Chrysler's Jeep-Eagle network in the United States, and the first cars to be delivered will be 1991 models.

In another manufacturing venture, Hanyang Chemical Corporation, a member company of Korea Explosives Group, signed a joint venture agreement in 1988 with the Canadian company BAE Group to invest in a greenfield project to build a $16.5 million PVC window frame plant in St. John's, Newfoundland. The investors anticipate sales in 1989 of $18 million with a doubling of plant capacity in the near future.

In addition to the Korean investments mentioned above, there are approximately 35 Korean companies with a presence in Canada. According to Rick Mann, Minister-Counsellor in the Canadian Embassy in the Republic of Korea, "The fact is that Korea is a full-blown, middle sized economy which has exploded on the world scene and represents both a market and economic partner largely untapped by Canada."

Hyundai's state-of-the-art assembly line, Bromont plant, Québec
(Courtesy of Hyundai)

JOINT VENTURES: HOW TO MAKE THEM WORK

Joint ventures — investments entailing shared ownership and decision making — are increasing in frequency and in strategic importance for firms operating in international markets. With the rise of the global economy, international joint ventures have become critical tools for attaining corporate goals. A constraining factor on their use, however, has been their relatively high rate of failure, estimated to be 70%. The comments included here, we hope, will help increase the chances for success.

The Joint Venture's Life Cycle:

Start-Up

Despite careful planning, this phase will still involve the greatest challenge. The integration of different cultures and activities, as well as the pressure of deadlines, will challenge even the best of working relationships. It is also important to keep in mind that venture start-up typically demands large amounts of cash and other inputs. The limited resources of a new venture can be strained.

Operational

Once the joint venture has begun, the parents must be able and willing to make compromises and adapt to changing circumstances. They must be prepared to tighten — or loosen — the degree of control or ownership structure as circumstances warrant.

Termination

Termination is a natural part of the cycle for many joint ventures. Termination, however, need not be equivalent to failure. A joint venture may not be successful on a commercial basis, yet it may have achieved its parents' strategic objectives, such as promoting technology development.

1. Clearly define your strategic objectives, e.g:

- ❒ gaining access to new skills or resources for existing markets;
- ❒ gaining access to new markets;
- ❒ achieving economies of scale;
- ❒ reducing risk of large or uncertain investments;
- ❒ co-opting or blocking competition;
- ❒ permitting orderly withdrawal from a business or market.

2. Understand the drawbacks of forming a joint venture.

Despite their potential benefits and the dramatic increase in their frequency and strategic importance, joint ventures can entail significant drawbacks:

- ❒ the complexity of managing a joint venture increases with the number of partners;
- ❒ the formation and management can be expensive, both in terms of human and financial resources;
- ❒ the failure of the venture can project a negative image to customers, suppliers, etc.;
- ❒ the compromising of a parent company's technology.

3. Choose the right partner.

Perhaps the most critical decision in attempting a joint venture is finding the right partner. Your choice of a partner will influence how successfully the partners will be able to work together and, ultimately, how effectively you will be able to implement your joint venture strategy. It is essential that:

- ❒ your partner is complementary to your firm;
- ❒ your partner can supply the skills and capabilities your firm does not possess, but which are necessary for the venture to be economically viable, and to achieve each partner's strategic objectives;
- ❒ your partner can work effectively and efficiently with your company;
- ❒ your partner has the financial resources to maintain the joint venture;
- ❒ your partner and your firm understand what each desires from the joint venture.

4. Determine ownership and control of the venture.

There are typically two ownership alternatives, majority/minority (one partner has over 50% of the venture's equity) or equal ownership.

a) advantages of majority/minority ownership:

- ❒ a majority owner can exercise dominant control over the venture, allowing rapid decision making and avoiding costly compromises or deadlocks;
- ❒ a majority owner can limit diffusion of technology or other knowhow to partners;
- ❒ a majority ownership can enable the dominant parent to integrate the venture's business into its global strategies and local operations.

b) advantages of equal ownership:

- ❒ equal partners are more likely to feel each shares equal commitment to the joint venture;
- ❒ it helps in guaranteeing that both partners' interests are protected; fosters consensus decision making; and forces the partners to negotiate as equals;
- ❒ it helps in structuring the venture so each partner has control over functions they view as strategically important.

The crucial objective for each parent company is to exercise control over a joint venture in a manner that will permit the firm to successfully implement its strategy without incurring a level of administrative or organizational inefficiency which outweighs the gains from the venture. A parent firm may also be able to achieve its strategic objectives by exercising dominant control over only a few activities of the venture rather than attempting to control all of the joint venture's operations.

5. Negotiate effectively.

a) prenegotiation activities include:

- ❒ preparing a business plan for the proposed venture;
- ❒ selecting a negotiating team with the necessary mix of company knowledge and negotiating skills;
- ❒ identifying and using joint venture champions from your company;
- ❒ ensuring that top management will participate in negotiations;
- ❒ conducting a thorough analysis of the proposed joint venture's technology, products or services, as well as those of your firm and your prospective partner(s).

b) negotiation of the agreement:

The first step is the preparation of a Memorandum of Understanding, specifying the venture objectives and the means for achieving them. Once the actual negotiations begin, important considerations include:

- ❒ determining ownership and control over individual activities of the joint venture;
- ❒ undertaking a qualitative and quantitative evaluation of the partner's asset contributions to the venture (not only financial but also contributions of intellectual property, including copyrights, trademarks, patented and unpatented technology);
- ❒ determining what, if any, service contracts the joint venture will enter into with the parent companies;
- ❒ determining transfer prices for inputs to the venture or outputs from the venture;
- ❒ ensuring that the legal personnel preparing the agreement are knowledgeable and competent concerning the specific issues relevant to joint ventures (e.g. the leakage of technology, knowhow or proprietary resources);
- ❒ ensuring there are termination clauses in addition to a pre-set, usually renewable time limit on the agreement.

6. Staff and manage the joint venture.

a) key issues:

- ❒ the venture should not become a dumping ground for mediocre personnel;
- ❒ the personnel recruited should be capable of understanding and functioning effectively within the different corporate and national cultures that often constitute a venture's operating environment;
- ❒ the venture's general manager should recognize and understand the objectives of each parent; possess the diplomatic skills to manage conflicts which may arise due to differing objectives of the parents; and feature the strength of personality to maintain an unbiased and objective management style.

b) parent-joint venture relationship:

The joint venture has the best chance of performing well when it is permitted sufficient autonomy, particularly on day-to-day issues, to develop an independent spirit and achieve its operational objectives. But good communication links between the joint venture and parents are critical to avoid surprises.

— Geoff Nimmo, Investment Canada

Key Points:

Joint ventures marrying corporate partners can be a valuable option for many firms, far preferable to going it alone. Caution, however, is essential. Success or failure of a joint venture depends not only on a venture's underlying strategic rationale, but also on how well the partner companies can work together. The preparatory work done before deciding upon a joint venture and the ongoing assessment of the joint venture are essential to prevent the joint venture from becoming a costly and negative endeavour.

1. Clearly define your strategic objectives.
2. Understand the drawbacks of forming a joint venture.
3. Choose the right partner.
4. Determine ownership and control of the venture.
5. Negotiate effectively.
6. Staff and manage the joint venture.

This article is based on a study Investment Canada commissioned J. Michael Geringer to undertake. Geringer is Assistant Professor of Policy at the School of Business Administration, the University of Western Ontario, where he teaches courses in business policy and international business. The purpose of the study was to provide a broad and useful set of guidelines for forming and managing joint ventures. Material for the study was gained through personal interviews with over 80 senior executives from both joint ventures and their parent companies in Canada.

PROVINCIAL INVESTMENT DEVELOPMENT *(Cont'd from p. 1)*

The Government of B.C. has long recognized the potential benefits that increased economic relations with Asia and the Pacific Rim would bring. In 1987, the B.C. and federal governments jointly committed $6 million to the Asia Pacific Initiative to enhance B.C. as Canada's Pacific Centre for trade, commerce and travel. The province has also established a network of offices in Hong Kong, Korea, Singapore and Japan, and indirectly works with the B.C. Trade Office in Taiwan. These initiatives, as well as a close working relationship with the federal government, have paid off for British Columbia.

Kirin Brewery Co. Ltd. of Japan, the world's third-largest brewing company, signed an agreement with Molson Breweries of Canada to manufacture beer in Vancouver and Montreal. Most of Kirin's $15 million initial capital investment went towards a major expansion of Molson's Vancouver brewery. Production will increase 10% in the first year and as much as 25% in three years, enhancing employment security for Molson workers.

(Courtesy: Government of British Columbia)

Since 1988, YHS Fruit Concentrates Ltd. of Singapore has run the former East Chilliwack Co-operative facility and now plans to invest over $9 million in plant expansions, enabling them to manufacture and pack the drinks in the same factory. The company also plans to introduce a soybean milk drink for the Canadian and U.S. markets.

British Columbia also has offices in the United Kingdom, West Germany and the United States. "We're mixing B.C. apples and California oranges," was the slogan for the opening of the trade office, in March 1989, in Irvine, California. The state is B.C.'s second largest foreign trading partner after Japan, with two-way trade between them reaching close to $2 billion each year.

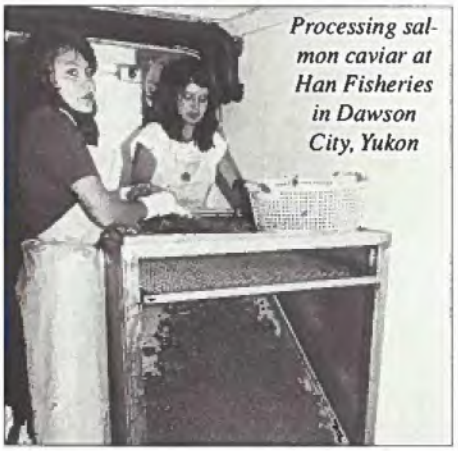
YUKON

The Government of the Yukon Territory is committed to the creation of an attractive investment climate and is currently developing a comprehensive trade and investment policy. Yukon residents are eager to expand their economy and increase their self-sufficiency in the Canadian and world context while respecting the value of their natural environment.

Traditional industries of mining and trapping are expanding into services, tourism, forestry, retail trade, manufacturing and processing. One example of this trend is a new Yukon company called Wild Berries which has plans for an innovative berry processing plant and is seeking investment or possibly a joint venture. All regions of the Yukon are connected through an extensive road and air network making it easily accessible to the rest of Canada, the United States, the Pacific Rim countries and the European community.

A number of foreign investors are taking notice of Yukon development projects from fisheries to high-quality forest products and mines. Japanese business expertise is at work in Yukon fish processing plants, providing state-of-the-art advice on processing salmon caviar for Canadian and international markets.

While the Klondike gold rush made the territory famous for its gold, the Yukon is also known for its high-quality, fine grained wood and varied mineral deposits. The Chinese have helped develop the Wellgreen deposit near Burwash Landing which contains high concentrations of rare platinum and platinum group metals. Curragh Resources' lead-zinc mine in Faro is one of the world's largest and has attracted substantial Australian investment. For the action-oriented tourists attracted to this magnificent wilderness, German and Swiss entrepreneurs are investing in lodges and wilderness adventure companies.



Processing salmon caviar at Han Fisheries in Dawson City, Yukon

(Courtesy: Government of Yukon)

The territorial government has sent fact-finding missions to Japan and West Germany, and most recently completed a successful mission to Sweden and Finland. The Yukon takes a proactive approach to investment which is a far cry from the stereotypical isolated, remote territory with few opportunities for business ventures.

SASKATCHEWAN

Saskatchewan will enjoy the greatest growth of all the provinces in the 1990s, claims the Toronto Dominion Bank in its 1989 forecast for annual growth rates. Last year, non-residential investment was $3.8 billion and is expected to grow to $5.1 billion by 1992.

Saskatchwan's positive approach towards development and industrial diversification has resulted in a healthy economic climate. Ease of access to the vast North American market is an extra incentive to foreign investors, now that the Canada-U.S. Free Trade Agreement is in place, and several foreign companies have recently increased their profile in Saskatchewan industry.

Australian company Ralph McKay Ltd. has undertaken a major expansion of its existing Regina farm implement manufacturing plant, diversifying into specialized rail clips for the American and Canadian railroad markets.

Rendamax B.V. of the Netherlands, a division of the Stokvis Group owned by Gulf International, has opened a factory in White City, just east of Regina. This joint venture with a Saskatchewan firm will manufacture energy-efficient commercial and industrial boilers for markets throughout North America.

The Japanese firm Hitachi Ltd. is also interested in developing the North American market and, with its joint venture partner, Marubeni Corporation, recently invested $14 million in Saskatoon to build the company's first offshore turbine manufacturing plant.

In 1986, the U.S.-based forestry giant Weyerhaeuser invested $250 million in Prince Albert to acquire and expand a pulp mill, and to construct one of Canada's largest fine paper mills. The company is gearing up for free trade by investing a further $21 million in additional paper processing and $25 million for doubling the capacity of a recently-acquired chemical plant in Saskatoon.

ONTARIO

Over the past six years the Ontario economy has grown by over 40%, outperforming virtually all the major industrialized countries as well as most of the U.S. states.

Foreign interest in the province is at an all-time high. Ontario attracts over 60% of the foreign direct investment that comes into Canada, close to $10 billion annually. The free trade agreement has sparked even greater American investment interest in Canada and Ontario, and has also brought increased investment inquiries from Europe.

Spinning plastic fibres, Polymer Int'l Inc., Truro, Nova Scotia. (Courtesy: Gov't of N.S.)

"Many European companies see Ontario as a springboard into the important northeastern U.S. market," says Richard Howard, Manager, Europe, Middle East and South Asia Branch, for the Ontario Ministry of Industry, Trade and Technology. "And they feel comfortable in Ontario because it has a very strong European flavour."

Ontario's booming automotive industry spearheads much of the foreign investment in the province. In recent years General Motors has put billions of dollars into Autoplex in Oshawa, the world's largest and most advanced car manufacturing facility. GM is also a partner with Suzuki in a $650 million joint venture to assemble cars in Ingersoll. And new automotive assembly plants in the province were recently opened by Honda and Toyota.

Parts suppliers have found it critical to be near the assembly plants, resulting in many new investments by foreign autoparts suppliers. Lemmerz-Magna is a joint venture between Magna International, Canada's biggest autoparts maker, and Lemmerz-Werke of West Germany. The $50 million Collingwood plant, with 250 employees, combines Magna's tooling and operations strength with Lemmerz's world-class cast-aluminum wheel design, development and manufacturing technology.

RONAL Canada is a wholly-owned West Germany subsidiary, best known as a supplier of wheels for sports cars, including Alfa Romeo, Audi and Opel. It also supplies wheels to Rolls Royce. RONAL's $15 million plant near Niagara Falls has 200 employees and produces cast-aluminum wheels for North American passenger cars.

NOVA SCOTIA

It is expected that the Canada-U.S. Free Trade Agreement will renew many historic trade and investment channels between Nova Scotia and New England and, as a result, the province's Department of Industry, Trade and Technology has identified New England as a primary market for new trade and investment sources. Over the next year, Nova Scotia's famous seagoing ambassador, Bluenose II, will carry trade and investment envoys to ports of call throughout the New England States.

The provincial government has underlined the importance of fostering closer relationships among government and business and labour, and as an example, points to Pratt & Whitney's manufacturing facility adjacent to the Halifax International Airport. In response to the company's need for highly trained personnel, Nova Scotia developed an automated manufacturing technology training centre that is now turning out workers equipped to tackle the challenges of today's highly computerized and automated work environment.

Michelin, already with three plants and 4,000 employees in the province, has undertaken a $500 million expansion of its Nova Scotia tire production facilities. The most recent expansion will increase the work force by 750 people. Michelin credits the quality and commitment of their Nova Scotian employees as one of the critical reasons for their continued investment confidence in the province.

Western Europe has also been targeted for investment missions. In a joint venture agreement between a Swiss company and a Nova Scotia company, Cellpak Aerospace of Lunenburg was created. Over the next five years it is expected that this advanced composite manufacturing facility will generate annual sales of $20 million and about 100 new jobs.

PRINCE EDWARD ISLAND

Prince Edward Island is proving to be a place where offshore technology and investment can find a friendly and profitable home. The province has an abundance of raw produce from the land and sea which is processed locally using technology and investment capital from other parts of the world.

The Prince Edward Island Food Technology Centre was established in Charlottetown to investigate the potential markets for P.E.I. food products and to help food processors generate new wealth for the island. The centre has assembled an international team of food scientists to seek out new technologies and adapt them to their needs.

A recent example of a transfer of foreign technology is found in the joint venture which created C&L Seafoods (Canada) Ltd. The mussel industry in P.E.I. wanted to introduce their 'Island Blue' mussel to the frozen seafood market, and the Food Technology Centre searched out Carlsson & Lundvall AB of Sweden, which had developed mussel freezing technology. They successfully tested the Swedish technique on the 'Island Blue' and the result was the establishment of the joint venture between Sweden and Prince Edward Island. C&L Seafoods (Canada) Ltd. is currently putting together a group of domestic and foreign investors to take advantage of this exciting market opportunity.

The government of P.E.I. is ready to assist with identifying appropriate technologies as well as investors, and to facilitate in the establishment of new industries to add value to the island's natural resources. Interested in new ideas and innovative technologies, the province offers a generous package of incentives through the P.E.I. Development Agency, which includes financial assistance for job creation; an immediate 20% to 30% cash dividend to investors starting up businesses in the province; and assistance with immigration. The federal Atlantic Canada Opportunities Agency (ACOA) also offers generous incentives designed to complement those put in place by the Government of P.E.I.

For more information on provincial investment opportunities contact:

BRITISH COLUMBIA
Province of British Columbia,
International Business and Immigration,
750 Pacific Boulevard South,
Vancouver, B.C. V6B 5E7
Fax: (604) 660-4048
Tel: (604) 660-3900

NOVA SCOTIA
Mr. Robert Baillie, Director,
Industrial Promotion Branch,
Dept. of Industry, Trade and Technology,
P.O. Box 519,
Halifax, Nova Scotia, B3J 2R7
Fax: (902) 424-5739
Tel: (902) 424-5320

ONTARIO (U.S. INVESTMENT)
Mr. George Hanus, Manager Investment,
United States & Latin America Branch,
Government of Ontario,
Ministry of Industry, Trade and Technology,
5th Floor, 900 Bay Street, Hearst Block,
Toronto, Ontario, M7A 2E1
Fax: (416) 965-7791
Tel: (416) 965-5702

ONTARIO (EUROPEAN INVESTMENT)
Mr. Richard Howard, Manager,
Europe, Middle East and South Asia Branch,
Fax: (416) 965-8852
Tel: (416) 965-9710

PRINCE EDWARD ISLAND
Mr. Don Baker, Executive Director,
Business Development Division,
P.E.I. Development Agency,
West Royalty Industrial Park,
Charlottetown, P.E.I. C1E 1B0
Fax: (902) 566-4030
Tel: (902) 368-5800

SASKATCHEWAN
Assistant Deputy Minister,
Saskatchewan Trade and Investment,
1919 Saskatchewan Drive,
Regina, Saskatchewan, S4P 3V7
Fax: (306) 787-2198
Tel: (306) 787-9071

YUKON
Yukon Government,
Department of Economic Development, Mines and Small Business,
Box 2703,
Whitehorse, Yukon, Y1A 2C6
Fax: (403) 668-6205
Tel: (403) 667-5466

FEDERAL
Investment Canada,
Investor Services Group,
P.O. Box 2800, Station D,
Ottawa, Ontario, K1P 6A5
Fax: (613) 996-2515
Tel: (613) 996-7868

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Editor-in-Chief — Richard Bégin
English Editor — Lillian Rukas
French Editor — Réjean Lemieux
Production — Bernard Cossais
Publishing Assistant — Claude Mailhot

Investing in Canada,
P.O. Box 2800, Station D,
Ottawa, Ontario, K1P 6A5
Tel: (613) 995-9525
Fax: (613) 996-2515