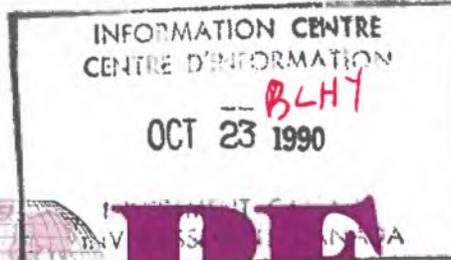


INVESTING IN CANADA

A NEWSLETTER ON CANADA'S INVESTMENT CLIMATE

Vol. 4, No. 2 – Fall 1990



EUROPE 1992



At the stroke of midnight, December 31, 1992, the Single European Act (SEA) will come into force. The SEA aims to sweep away the remaining obstacles to the free movement of goods, workers, services and capital within the Economic Community, creating a unified common market of 325 million consumers.

European competition may become even tougher, but Canadian firms with solid business linkages in the Community will benefit in the same ways as European firms from the uniform set of business standards and procedures.

In this issue we examine the European strategies of two Canadian companies, Resource Integration Systems and Lavalin, the problems encountered and the advice they have for other Canadian firms contemplating expansion into Europe. And from the other side of the Atlantic, Dowty Group explains the benefits of investing British pounds in Canada.

EUROPEAN COMMUNITY LAWS: IMPACT ON FOREIGN DIRECT INVESTMENT*

European Community (EC) regulations have been developed to establish consistency across the Community, and to ensure that benefits of the single European market accrue in the first instance to member states.

While no EC laws have been formulated with the specific intent to either positively or negatively affect foreign direct investment (FDI), certain regulations can influence FDI as a result of their very nature and the areas of activity treated. The areas concerned are rules of origin, competition policy, company law and state aids. (p. 2) ▼

*Information for this article was drawn from various sources, including:

Business International, "Implications of a Unified European Market: Part I, Effects on Europe", a study commissioned by External Affairs and International Trade Canada, (Feb. 1989);

Brunsdale, A. and Cass, R., *The Effects of Greater Economic Integration Within the European Community on the United States*, U.S. International Trade Commission, (July 1989);

Gunter, P., *Toward a United Europe: 1992 and Beyond*, SRI International, Business International Program, Report No. 787, (1990).

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INVESTMENT
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EUROPEAN COMMUNITY LAWS ▲ (cont'd from p. 1)



Rules of origin establish the economic nationality of a product. Within the EC, a product's origin is important in determining its right to move freely without customs duties or other import restrictions which are applied to goods originating outside the Community. Various methods are used to determine origin. Two important methods variously define origin on the basis of local content or on what is called the "last substantial process" method.

Since 1968, the Commission has adhered to the notion of "last substantial process" in determining origin. This method, adopted at the international level by the Kyoto Convention of 1973, establishes that where two or more countries are involved in the manufacture of a product, origin is attributed to the country where the last substantial operation was carried out.

In February 1989, however, in a case involving the semiconductor industry, the EC Commission appeared to shift its basis of determining origin to the "most substantial process". There is fear that should this ruling be more widely applied in the future, it could have substantial implications for production and, as a result, for investment of foreign firms located in the EC.

The Commission has rejected the notion that it had deviated from the last substantial process rule. It explains that in the three-stage manufacture of integrated circuits, only one stage (not the last) is important enough to qualify as

"substantial" and therefore be designated the last substantial process.

As a result of this debate, the Non-Tariff Measures Negotiating Group of the GATT is considering a proposal that standards be adopted governing the regulation and application of rules of origin by members. Currently, countries are free to select their own rules of origin and consequently a variety of rules apply internationally; in some cases, countries apply different rules of origin in different circumstances.

Rules of origin and the related issue of minimum local content requirements are areas of great sensitivity where EC member states and various industrial sectors (particularly the automotive and consumer electronics sectors) periodically exert substantial protectionist pressure. Their concerns have tended to focus particularly on competition from Japanese goods and Japanese direct investment.

These concerns prompted the French government in 1989 to deny the "European" label, and thus duty-free entry, to Nissan Bluebird cars of U.K. manufacture, and to include them instead in France's quota for Japanese cars. This action was taken on the grounds that the cars did not contain sufficient local content. France agreed to allow the Nissans entry under the European label but only after Nissan undertook to increase local content levels.



Under a new regulation, effective September 1990, the EC Commission

will now have prior authority over any proposed concentration of companies which would create an undertaking of "European dimension". This regulation would involve any takeover, merger or joint venture where: (a) combined worldwide revenues of the companies amount to ECU¹ 5 billion (C\$7.4 billion) or more; (b) combined EC revenues of two of the companies involved amount to ECU 250 million (C\$370 million) or more; or (c) two-thirds of the companies' EC revenues come from more than one of the member states. When threshold levels are met, the Commission will have exclusive jurisdiction over the proposed concentration and its decision will be binding on member states.

As a number of member states presently have laws governing business concentrations, the new EC regulation permits them to call upon the Commission to apply the regulation on their behalf below the stated "European dimension" thresholds. It is expected that several member states may exercise this right where concentrations involving worldwide revenues of between ECU 2 to 5 billion are in prospect, even if there is no downward adjustment of the worldwide combined revenues test.

Legal experts believe the regulation may impact upon companies outside the EC wishing to do business in the Community. For instance, a large merger within the U.S., or a takeover by a Canadian company of a Swedish company, may be reviewed by the Commission if the regulatory definitions are met. Accordingly, non-EC firms increasingly will have to consider Community competition regulations in making other business decisions. (p. 3) ▼

¹See page 8 for a description of the ECU.

EUROPEAN COMMUNITY LAWS ▲ (cont'd from p. 2)

There have already been instances where Community law has been applied against firms non-resident in the EC. In 1988, an EC Court of Justice ruling in the Wood Pulp Case upheld the right of the EC Commission to impose heavy penalties for price fixing on firms from Canada, the U.S., Sweden and Finland even though all these companies were based outside the Community with no registered business presence within the Community. The Court held to be pertinent the fact that these companies were competing for business in the Community and that their price fixing had a detrimental effect on business competition within the Community.



The EC's aim in this area is to create specifically European legal structures which would free EC firms from the constraints of 12 distinct legal systems. Community action has proceeded on two fronts: the creation of a contractual instrument called a European Economic Interest Grouping, and the framing of a European Company Statute. These two initiatives promise to provide EC companies with more efficient methods of expanding their operations throughout the Community.

1 European Economic Interest Grouping (EEIG)

This regulation creates an original instrument within which companies in different member states can jointly pursue certain specific activities – such as research, purchasing, promotion, distribution, etc. – while continuing to retain their national legal incorporation and economic independence.

An EEIG is established by contract rather than by incorporation, and may be formed by companies incorporated under the laws of a member state and having registered headquarters in the EC. Therefore, EC-incorporated subsidiaries of third-country companies may participate in an EEIG, but a non-resident parent firm may not. Once registered in one member state, an EEIG may operate throughout the Community without additional registration procedures. Profits or losses are transferred to its founding companies for taxation purposes.

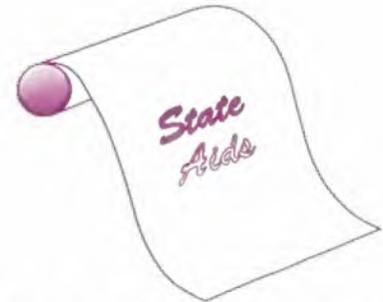
2 The "European Company" Statute

This statute proposes to constitute a new form of company. When adopted, it will allow EC companies to opt for incorporation under EC statute rather than under member state law. Currently, expansion-minded companies must incorporate full subsidiaries in each of the 12 member states and must comply with 12 different sets of taxation, reporting and labour rules.

A "European Company" would operate from a single headquarters in any member state and could establish simple service or production units in any other member state. Furthermore, while the European Company would be subject to the tax legislation of the member state in which it had its headquarters, losses incurred by a subsidiary unit in another member state could be offset against profits prior to calculating the European Company's tax base.

A European Company could be established through a merger, through the creation of a holding company, or through the establishment of a joint subsidiary. A company already incorporated under member state law may not shed its national incorporation and become a European Company. It may, however, set up a European Company

by merging at least two subsidiaries in different member states.



State aids refer to investment inducements which member states use to attract new investment. (This category excludes aid to the agricultural sector which is administered under the Common Agricultural Policy.) During 1981-1986, the average member state expenditure for such purposes was equivalent to 3% of GDP. Denmark, the Netherlands and the U.K. spent less than 2% of GDP for state aid. Greece, Germany and France spent the equivalent of between 2.5% to 2.7%. Italy and Luxemburg were the highest spenders, at 5.6% and 6.0% of GDP.

The Commission has indicated that state aids must be strictly contained so that they do not produce competitive distortions which would offset the very benefits sought in creating the unified internal market. Here, however, the Commission faces resistance from member states, who value the aids as important means of realizing industrial and regional policy.

Nevertheless, the Commission has underscored its determination to enforce order in this matter. In 1990, the European Commission, in two separate actions, ordered British Aerospace PLC and Renault to pay back C\$90.5 million and C\$1.26 billion, respectively, for unjustified state aid subsidies advanced by the British and French governments.

– Rosemary MacDonald,
Investment Canada

INVESTMENT BAROMETER

The world's largest trading region, the European Community, will combine the economies of its twelve member states into one market on December 31, 1992. The EC has already eliminated all internal tariffs and adopted one common system of external tariffs. Efforts are well under way to eliminate non-tariff barriers, streamline decision-making procedures, and harmonize regulatory standards.

In the voluminous amount of literature that has been written about the implications of 1992, certain themes stand out.

- 1** The emerging single market will not automatically dissolve all of Europe's national differences into a single homogenized market. There will continue to be variations of taste in the twelve countries, with buying patterns not conforming to any set pattern.
- 2** The new Europe will force drastic changes in corporate operations and, in many cases, cause the wholesale restructuring of companies and

industries through consolidations, mergers, acquisitions and joint ventures. This process is already well under way, but will likely become more intense as 1992 approaches.

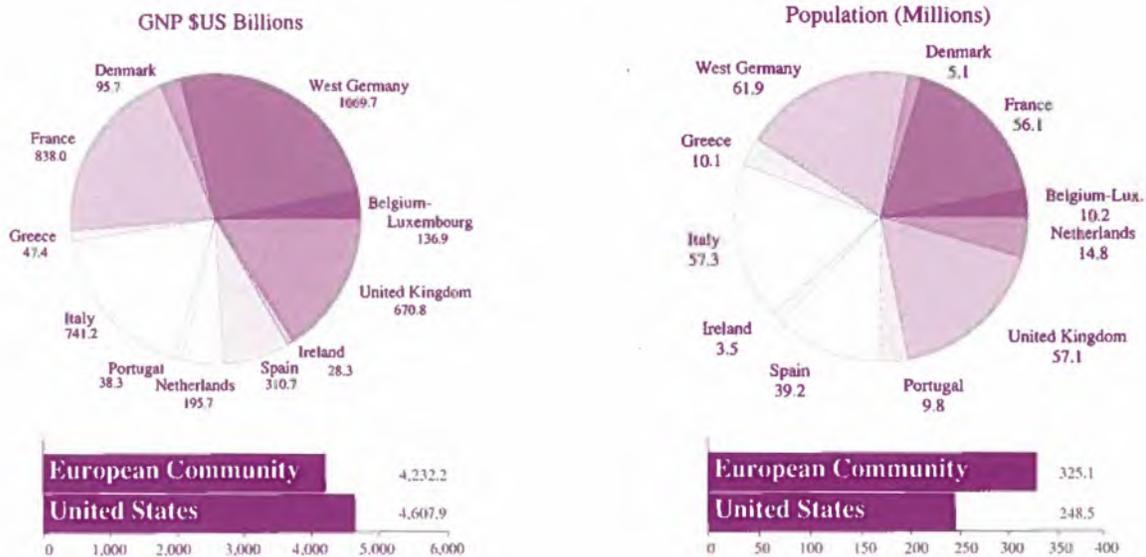
- 3** The European market will be extremely competitive after 1992. This is not only because European companies will be more competitive, but also because of the decrease in regulations in the market.
- 4** Companies from non-EC countries that are solidly established within the European Community will be well positioned to compete in Europe. They could possibly do even better than European companies that have, in some cases, led fairly sheltered lives because of heavily protected national markets.
- 5** Two-fifths of the 279 legislative measures needed to eliminate European non-tariff barriers have been implemented. The measures adopted suggest that companies from non-EC

countries will be given fair and full opportunity to compete in Europe.

- 6** The challenge of 1992 will be global as well as continental. By creating an integrated market, the EC is constructing a framework within which European companies can take advantage of industrial efficiencies, economies of scale, and expanded research and development opportunities in order to compete in any market of the world.
- 7** There will be bumps on the road to 1992. The increased competitiveness and employment gains that are promised after 1992 will not come about without the rationalization of European industry. This rationalization will entail the closing of inefficient operations and the relocation of sectors of the European work force.

— Geoff Nimmo, *Investment Canada*

ECONOMIC OVERVIEW OF THE EUROPEAN COMMUNITY (1989)



Source: *Business America*, January 15, 1990.

TESTIMONIAL: "WE INVESTED IN CANADA"

DOWTY GROUP PLC

The Venture

June 28, 1990 was the official project launch of Dowty's \$90 million landing gear facility near Montreal, Quebec, scheduled to open in spring 1991.

Products

Landing systems for large aircraft, including Airbus Industrie A330 and A340 airliners.

Size

The new plant will occupy 180,000 square feet, and is expected to employ 350 people.

Markets

Dowty Canada is a supplier to British Aerospace, Boeing, Canadair, McDonnell Douglas, Lockheed, Kaman, Bell, Gulfstream, Indal, Oerlikon, Supply and Services Canada, and the U.S. Air Force.

Future

Dowty Aerospace aims to grow into a leading supplier in the manufacture and support of landing gear, propellers, actuation systems and hydraulics.



Artist's impression of Dowty Aerospace's new facility near Montreal, Quebec. Inset: Tony Thatcher, Chief Executive, Dowty Group PLC (Courtesy of Dowty)

Dowty has come a long way from the small firm founded in a loft by a young Cheltenham engineer in 1931. With annual sales of approximately US\$1.2 billion – of which 65% is civil based and 35% defence – Dowty employs almost 15,000 people around the world. Dowty Group now has over 50 operating units, in four divisions, based in 13 countries. Fifty-eight per cent of Dowty revenue comes from sales overseas.

Dowty's group of advanced technology companies creates innovative systems and products in electronics, mechanical and polymer engineering. Customers are in the aerospace, maritime, defence, professional electronics, information technology and automotive industries.

"The competition in aerospace equipment is relentless," says Jim Lightfoot, Managing Director of Dowty Aerospace. "It is essential that we refocus our businesses to ensure we develop winning strategies," he adds.

The new Montreal plant provides Dowty with the opportunity to increase its commitment to British Aerospace on the European Airbus programs, and to develop the company's global aerospace facilities. The new plant will allow Dowty for the first time to offer a complete range of landing gear from small

through to the very largest sizes in North America.

Canada was chosen for the site because of its good infrastructure for the aerospace industry, the logistics of source and supply to the European and U.S. markets, and the need to protect dollar income by manufacture in a closely related currency.

Dowty provides solutions for customers' problems which range from huge landing gear, to minute but safety-critical seals in automotive fuel injection systems; and from global computer networks for the world's leading banks to microchips which compress vast computer power into a few square centimetres.

In order to respond to changes in markets, Dowty has recently launched a new corporate identity. The company has invested in target areas such as North America, Europe and the Far East, concentrating, as a global player, on four key sectors: aerospace, electronic systems, information technology and polymer engineering. Under the reorganization, the common elements of the various international companies will be combined into new business units.



Colin Knight carries out final fittings on the largest main landing gear ever produced for civil aircraft. It stands 15 feet 6 inches (4.72m).

RESOURCE INTEGRATION SYSTEMS

Founded in 1977, Resource Integration Systems (RIS) is North America's largest and most experienced consulting firm specializing in solid waste reduction and recycling. RIS ranks 22 on the list of Canada's 50 fastest growing companies (Small Business, May/June 1990).

RIS designs and implements waste reduction, recycling and composting programs that are cost effective and environmentally sound. The programs have helped industry and government resolve waste management issues and adapt to rapidly changing environmental standards.

RIS first established a solid base in Canada with its highly successful 'blue box' curbside recycling program. In its pioneering efforts RIS went not to government but directly to industry to promote the blue box program.

"In Ontario the consortium that came together was made up primarily of the soft drink industry and their suppliers," says Damian Bassett, RIS Chief Operating Officer. "From there we gravitated to the soft drink industries and their suppliers throughout the U.S., and the next logical step was over to Europe."

RIS was recently hired by a European consortium of multinational firms which includes Coca-Cola, Pepsi-Cola, Procter & Gamble, Pechiney (one of the world's largest aluminum companies) Eastman Chemicals and Heineken. "The playing field in Europe is



Mr. Damian Bassett

broader," says Bassett, "because the awareness level is broader than just the soft drink industry."

The concept that RIS is pioneering in Europe is the multi-material curbside program. The underlying principle of the blue box program is that by putting all the recycled material in the box, you allow the valuable materials to be the engine that drives the system.

"Aluminum is the single most valuable material and the one that potentially can produce the most revenue," explains Bassett. "If you set up depots for independent redemption of materials, every city in the world would have one for aluminum, but nobody would want plastic or glass."

RIS recently opened an office in Brussels staffed with one employee, and is expecting to hire one or two more in the next 12 months. In addition to dealing with the time zone differences which present

a major "hassle," RIS has also been trying to establish banking relationships to ensure efficient transfer of funds.

"We've got tax people working to help us find the most efficient way to position ourselves in Europe," says Bassett. "There are some differences whether we go over as a branch or as a subsidiary. Also, in dealing with multinationals, we're not necessarily sure that we should be paid in the currency of the country in which we operate."

"I think firms can nurture relationships with the Canadian subsidiaries of multinationals here in Canada and they ought to leverage that to get opportunities in Europe or Asia," advises Bassett.

"The other aspect is the critical need for talented local people and I cannot overstate the importance of recruiting," says Bassett. "The individual heading up our Brussels office happens to be a Canadian who was educated in Europe and working for an environmental consulting firm in the U.K."

"We're also actively involved in what we call 'organizational greening,' explains Bassett, "which is helping corporations become more environmentally aware. It's a healthy trend, and I think it's going to be the vehicle for significant growth here and internationally."

PROMOTING
LBOE
IN EUROPE

Investment Canada, with the German Ministry of Science and Technology, launched a project under the Canada-Germany Science and Technology Agreement to explore the potential for co-operation in the area of laser based opto-electronics. The LBOE project has three phases. The first phase involved circulating a survey to companies

actively involved in LBOE. The second involved creating a kit to advertise co-operative opportunities that exist with Canadian companies. The third and on-going phase involves efforts to introduce foreign organizations to these opportunities. The LBOE kit outlines the LBOE business opportunities in Canada and offers

THE LAVALIN GROUP

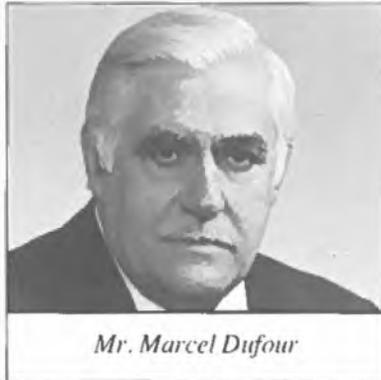
Lavalin was recently ranked first of the top 200 international design firms in the world, according to a major American magazine, *Engineering News Record*. The Lavalin Group now has a work force of 7,200 employees and its revenues are over a billion dollars. For the Group as a whole, exports accounted for a total of \$600 million. Lavalin operates in 70 countries, and Europe accounts for 10 per cent of its business.

The company first entered the international market in 1968 by going to French-speaking Africa where it is today the number one design firm. In 1983, Lavalin bought majority interest in Lafarge Études, a cement engineering firm owned by Lafarge Coppée. Lavalin created Lafarge Coppée Lavalin in Paris, Coppée Engineering in London, along with Coppée Lavalin and Coppée Courtoy in Brussels.

The Paris office, which is a strategic centre for Lavalin's African activities, also gives Lavalin a foothold in Europe for financing large international projects, as well as opening up the Eastern European market.

"Things will be easier because the common market will provide a broader market for the same company," says Marcel Dufour, President of Lavalin International Inc.

Does Lavalin have any particular problems doing business in Europe? "It took a bit of time before we could make some money," says Dufour, "but now



Mr. Marcel Dufour

everything is going quite well. English and French are common languages in Europe so we don't have any problems in that way."

As Belgium's prime chemical engineering consultant, S.A. Coppée-Courtoy N.V., a Lavalin subsidiary, is seeking to strengthen its position in the Belgian market. During 1989, the firm commissioned a number of major industrial installations, including a chocolate manufacturing unit in Brussels; a vinyl chloride recovery plant; and a power plant and aniline production facilities in Antwerp.

The firm also carried out several studies, including projects for the proposed Brussels and Antwerp metro, NATO headquarters, a munitions dismantling unit and the administration building of the European Common Market.

Dufour admits that one of the reasons Lavalin bought in Europe was to gain experience in new fields. "These companies were doing engineering projects for fertilizer plants, pharmaceutical plants, and chemical plants in Belgium, and for the petroleum industry in the North Sea which we didn't have the expertise to do over here in Canada."

On the other hand, Lavalin's Canadian expertise has opened up other market opportunities. Dufour says Lavalin was invited into the Soviet Union because one of its Alberta-based companies was experienced in drilling for gas in permafrost. Lavalin has just completed a half billion dollar project in the Soviet Union, connected to the petroleum industry.

Lavalin sees the integration of the European market in 1992 creating huge growth in communications and transportation, and is preparing to go into urban transport in a big way. The company also sees tremendous growth prospects in cross-border projects, such as the Channel tunnel.

Mr. Dufour has this to say to Canadian companies who are contemplating expanding into Europe: "It's time to go! There will be a tremendous market over there, and quite a few projects in the next while."

reasons why we are a good base for North American ventures. It also provides profiles of Canadian firms and research institutes seeking co-operative arrangements with foreign counterparts. The kit contains 52 company and 22 institute profiles, outlining the companies' products and areas of expertise, their accomplishments,

future products and research aspirations. They also indicate the forms of business co-operation that are being offered to or sought of the European firms. Investment Canada's industry consultant, Dr. Gregg Van Volkenburgh, has met with 27 European firms concerning a range of agreements, which include selling each other's products,

joint product development and co-operative research. This fall, Dr. Van Volkenburgh will return to Europe to continue promoting the LBOE industry in Britain and Germany, Italy, Austria and the Netherlands. For more information call James Holloway at (613) 995-9617.

INVESTMENT CANADA: AT YOUR SERVICE

QUESTION:

My company is considering the possibility of entering into a strategic alliance with a European partner where we would manufacture his product for the North American market and he would manufacture ours for the European market. How would our business arrangement be affected by fluctuating European currency rates?

ANSWER:

The establishment of the European Monetary System (EMS) in 1979 was designed to create a zone of monetary stability to minimize the wild currency fluctuations that had impeded trade and discouraged European firms from undertaking major investment projects across national borders.

The EMS is based on a system of fixed but adjustable exchange rates, resting on a variety of intervention and

credit mechanisms. Central banks must intervene if the currencies threaten to move beyond margins that are set around these rates. The core of the EMS is the European Currency Unit (ECU).

The ECU is a "basket" of specified amounts of each EC currency. The ECU basket is not an abstract idea, since it is composed of actual amounts of member states' currencies. Contained in this basket are the German mark, British pound sterling, French franc, Italian lira, Dutch guilder, Belgian franc, Luxembourg franc, Danish krone, Irish pound and Greek drachma. The Portuguese escudo and the Spanish peseta are not yet included.

The ECU's value is determined by using the current market rate of each member currency. In addition to its functions within the EMS, the ECU is the Community's accounting unit.

It is also becoming increasingly popular as a private instrument. There are ECU-dominated travellers' cheques, bank deposits and loans, and the ECU is beginning to be used in business as a currency for invoicing and payment.

If you have a question in mind regarding an investment opportunity or a business proposal, contact:

*Investor Services,
Investment Canada,
P.O. Box 2800, Station D,
Ottawa, Ontario. K1P 6A5
Tel: (613) 996-7874
Fax: (613) 996-2515*

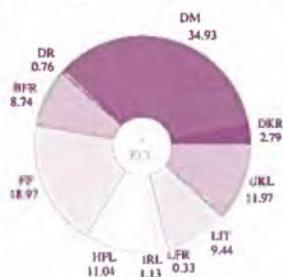


VALUE OF THE ECU

The ECU is the sum of the following currencies

German Mark (DM)	0.719
Pound Sterling (UKL)	0.0878
French Franc (FF)	1.31
Italian Lira (LIT)	140
Dutch Guilder (HFL)	0.256
Belgian Franc (BFR)	3.71
Luxembourg Franc (LFR)	0.14
Danish Krone (DKR)	0.219
Irish Pound (IRL)	0.00871
Greek Drachma (DR)	1.15

One ECU comprises the following percentages of national currencies



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Editor-in-Chief – Richard Bégin
English Writer/Editor – Lillian Rukas
French Writer/Editor – Vincent Beaulieu
Production – Bernard Cossais
Publishing Officer – Suzanne Le Blanc
Cover Design – Daphné Robert

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