INVESTING IN CANADA

A NEWSLETTER ON CANADA'S INVESTMENT CLIMATE

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INVESTMENT: PILLAR FOR PROSPERITY

INVESTMENT CANADA LAUNCHES TWO BOOKS

Investment Canada and the University of Calgary Press jointly released two volumes in the Investment Canada Research Series in early December. One volume, ***Foreign Investment, Technology and Economic Growth***, addresses the key role played by foreign investment in facilitating technology transfers. The second volume, ***Corporate Globalization through Mergers and Acquisitions***, examines the phenomenon of mergers and acquisitions activity and the corporate motivations behind it.

The Investment Canada Research Series complements the Agency's Working Paper Series. The Research Series has three main objectives:

- to advance research on international investment in Canada and abroad based on the highest academic scholarship;
- to foster a better understanding among Canadians of globalization and the vital role played by international investment; and,
- to identify investment policy and research issues requiring the attention of the public and private sectors. *(p. 2)* ▼

International investment is critical to improving Canada's trade and productivity performance and ensuring our prosperity. Investment has been dubbed one of the "four pillars of prosperity" by the federal government's Prosperity Initiative.

In this issue of Investing in Canada *we focus on two books recently published by Investment Canada together with the University of Calgary Press. The books grew out of Investment Canada's Research Series.*

The Research Series indicates that international investment in Canada brings many benefits. These include technology transfers, international management expertise, production knowhow, and access to international markets. Joint ventures and other forms of strategic alliances with foreign partners are especially relevant for a country like Canada which must compete with much larger economies.

INSIDE THIS ISSUE

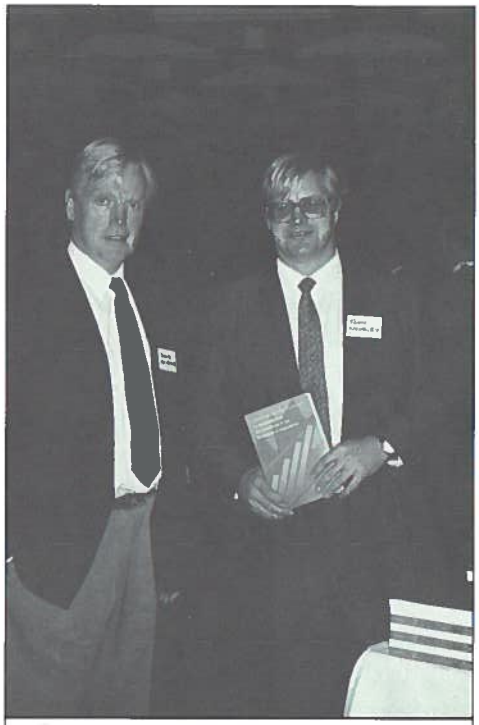
INVESTMENT CANADA INVESTISSEMENT CANADA

FOREIGN DIRECT INVESTMENT LEADS TO NEEDE

(Cont'd from page 1)

The research assembled in the two volumes is mainly the product of work undertaken by distinguished academics and professionals from Canada and abroad under contract with Investment Canada. The papers were presented at Authors' Conferences, and later revised in light of comments by Conference participants (see *Investing in Canada*, Winter 1990 and Spring 1991).

The two General Editors (Don McFetridge, Carleton University and Leonard Waverman, Centre for International Studies, University of Toronto) managed the projects, with the assistance of Investment Canada's staff. One of the research papers was also prepared by Agency staff.



Left: David Husband, Senior Policy Adviser of Policy and Research at Investment Canada, who conceptualized the research project; and John Knubley, Director of Investment Research, who managed the project and authored one of the papers.

Critics of foreign direct investment (FDI) often attribute Canada's relatively poor research and development (R&D) performance to the high level of foreign control in the economy. Yet the evidence tends to show the opposite.

Investment Canada's research volume, *Foreign Investment, Technology and Economic Growth*, examines the way foreign direct investment can lead to valuable transfers of technology and productivity gains for the Canadian economy.

The volume addresses a number of questions:

- Have foreign takeovers of domestic high-tech firms in Canada been numerous?
- Does a change in the nationality of a firm imply a change in its activities, especially in terms of technology?
- Does a change in the technological capacity of a firm following a foreign takeover affect the innovation of other firms and individuals in the Canadian economy?
- What is the appropriate role of Investment Canada with respect to regulating foreign investment in high-tech firms?

The paper by Baldwin and Gorecki, and the one by Globerman address the first question, and conclude that although there have been a number of highly publicized foreign takeovers of Canadian high-tech firms, they have been relatively minor, especially in terms of the value added involved.

The second and third questions are addressed in one way or another by virtually all the papers in the volume. The consensus is that foreign takeovers do affect the way firms behave. There are two main benefits:

- FDI is one of the main sources for technology transfer. Multinational firms experience a continual flow of technological transfer through such mechanisms as education and training, exchanges of technical personnel, development and transfer of specialized equipment, documentation, and trouble-shooting.
- The papers by Harris, Blomström, Globerman and Bernstein underline that, in addition to the direct benefits of technology transfer, indirect benefits accrue from the spillover process. In this way, domestic firms not subject to foreign takeover gain from technology transfers.

Imported technology acts as a catalyst, spurring product development and innovation. Multinationals encourage domestic firms to adopt more efficient production, management and labour practices, thereby enhancing productivity.

The traditional view that R&D tends to be concentrated only in the home country of the foreign multinational is also challenged. Possible reasons for R&D activities outside of the "headquarters" include recognition of the innovative capability of the acquired firm, which is often embedded in local organizations and local networks.

As the Cantwell paper shows, international specialization has increased the scope for foreign multinationals and their affiliates to carry out R&D in different geographic locations.

The appropriate role for Investment Canada in regulating foreign takeovers of high-tech firms was a question much debated at the Authors' Conference. ▶

RANSFERS OF TECHNOLOGY AND PRODUCTIVITY GAINS

Most economists agree with Investment Canada's premise that foreign investment is good for the country and should be encouraged.

However, the issue is whether commitments to local R&D and other undertakings, negotiated by Investment Canada, really make a difference. There was some evidence that firms would have undertaken these activities in any case, although Lipsey argued in his "Rapporteur's Comments" (see box) that it would be folly to take this for granted.

Lipsey stressed that economic performance is the result of a number of independent decisions, all of which feed on and reinforce earlier decisions. In this path-dependent environment, Investment Canada's participation in the structuring of takeovers for the net benefit of Canada can have significant implications for the future of a firm and for an entire industry.

—John Knubley, Investment Canada

John Knubley is Director of Investment Research for Investment Canada (613) 995-7077

Future books in the Investment Canada Research Series are currently being designed. The next volume in this Series is to examine the nature and impact of outward Canadian investment (see article on the CDIA Round Table, p. 6). The Investment Canada Research Series is published in both official languages.

Richard Lipsey
"Rapporteur's Comments"
Foreign Investment, Technology and Economic Growth

"Economists...are seeking to understand the link between science and technology. To do so requires an understanding of the overall process within which a scientific discovery is: first made outside the firm; goes through the precompetitive stages of development; finds its way into the firm's research agenda; and then into process and product innovations...policy advisors and policy makers do not adequately understand the linkages of science-driven technological change from the lab to the shop floor and the feedback effects of such changes in the other direction."

"Governments throughout the world are engaged in a high-stakes strategic game. If we refuse to play, it is at our own risk. A small push by Investment Canada now can, as positive feedback theory shows, have enormous effects five to ten years down the line."

Investment Canada's official book launch held at the National Arts Centre. Standing: Leonard Waverman, Centre for International Studies at the University of Toronto; seated: Don McFetridge, Department of Economics at Carleton University; and Jean C. McCloskey, President of Investment Canada.

GLOBALIZATION AND MERGERS AND ACQUISITION

Globalization has fundamentally changed the way companies, and countries, do business. During the 1980s, mergers and acquisitions (M&As) were a principal means of industrial restructuring in Canada (see chart). Investment Canada's Research volume, *Corporate Globalization through Mergers and Acquisitions*, examines these developments in Canada and abroad and their implications.

Although the 1991-92 recession, together with a more guarded approach to the financing of leveraged buyouts and other forms of corporate reorganization, have led to a marked slowdown in the number of mergers and acquisitions, another wave in the not too distant future is predictable. Corporate restructuring to meet the requirements of global competition is never complete. Indeed, the many dimensions of globalization appear to encourage joint ventures and other forms of strategic alliances, often causing the merger of once serious rivals in a common fight for market share.

These forces are generally not well understood or researched, and this volume is but a beginning. Little data exist on the extent of cross-border M&A activity, and how such activity impacts on the economic performance of a country. There are many questions addressed in this volume, including:

- Is M&A activity high in Canada relative to other countries?
- Are there particular explanations for this activity, such as tax advantages, or are there general explanations such as "corporate strategy"?
- Do M&As lead to productivity improvements and other benefits?
- Do cross-border M&As differ significantly from domestic M&As?
- What public policy concerns arise as a result of cross-border M&As?

Concerning the first question, the paper by Khemani describes the merger wave in Canada and abroad during the 1980s. The volume of M&As was highest in the United States. However, when adjustments are made for the relative size of countries, M&As were highest in Sweden, followed by Canada and the United Kingdom. Trends in M&A activity in Canada tend to parallel those in the United States and the United Kingdom.

The Knubley et al paper indicates that, over the past two decades, Canadian direct investment abroad has increased steadily relative to inward investment. Canada, like other small countries, tends to show a marked tendency to invest abroad. A small number of large firms with several affiliates account for most of the value of outward Canadian investment. However, two-thirds of the Canadian firms investing abroad are small or medium-sized, most with only one affiliate in the United States.

The paper by Mintz and Halpern addresses the question of what motivates M&As. They conclude that tax considerations are not the primary motivation in the case of cross-border acquisitions. Once the decision to acquire a foreign firm has been made however, tax considerations are important for determining the ultimate structure and operations of the acquired firm.

The paper by Patry and Poitevin concludes that strategic considerations (enhancing competitiveness and gearing up to take advantage of global markets) are the dominant factor explaining takeovers. Further, they conclude that sellers, not buyers, typically gain the most in terms of shareholder value.

The paper by Baldwin and Caves examines the impact of M&As. The authors demonstrate that industries with high levels of foreign ownership are restructured more through changes of ownership control and less through the births and deaths of firms (i.e. new businesses and closures) compared to industries with lower levels of foreign ownership. In addition, the authors conclude that changes in the country of control typically produce positive results for productivity and efficiency.

Foreign takeovers, therefore, are usually of net benefit to the Canadian economy. In fact, the favourable effects of changes in control increase in direct relationship to the degree of foreign ownership of an industry. ▶

A.E. Safarian
"Rapporteur's Comments"
Corporate Globalization through Mergers and Acquisitions

"Increased globalization has raised awkward questions in a world where governments often appear to be doing two contradictory things: developing their own multinationals through various subsidies, protected local markets, public ownership and the like, while insisting they must also have access to other countries' markets through the acquisition of firms as well as through trade...it is...not difficult to envisage the damage to foreign trade and investment such policies can bring...."

HANGE THE WAY COMPANIES DO BUSINESS

They attribute this result to intangible assets such as technology and management expertise transferred to Canada.

The paper by Rugman and Waverman examines the nature of cross-border acquisitions, particularly in the context of Michael Porter's model for analysing the Canadian economy and foreign investment. They find acquisition patterns in Canadian industry—the resource, manufacturing and service sectors—to be broadly similar among acquirors from Japan, the United States and the European Community.

The authors conclude that the foreign parent decides to acquire Canadian firms based on judgements relating to economic opportunities in Canada. This result is contrary to Porter's analysis which suggests the foreign parent is driven by considerations developed in its home country.

A number of policy questions are addressed in the paper by Daniels. He looks at how M&As affect the interests of stakeholders, especially employees, suppliers, customers and creditors. Daniels argues that some stakeholders can be harmed at times, but that these ill effects are not the principal or central feature of most M&As. He rejects specific policies designed to shield stakeholders from certain negative effects of M&A activity, favouring instead general economic and labour adjustment policies.

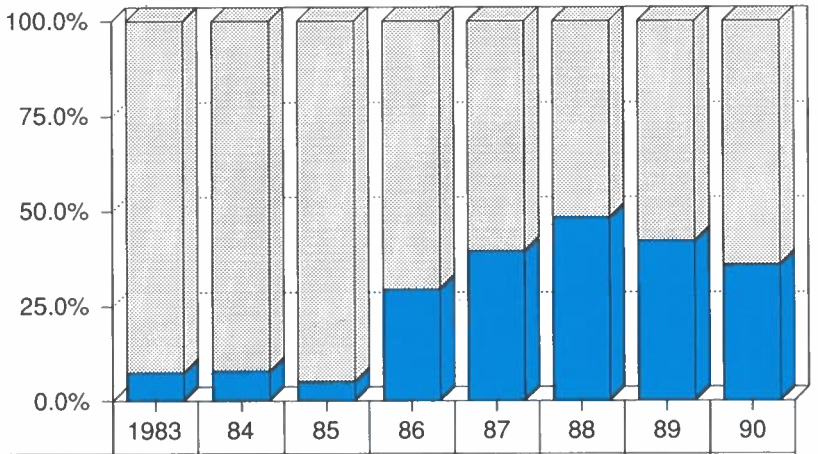
A.E. Safarian's "Rapporteur's Comments" (see box, p. 4) raise a number of policy issues. He notes that Canada is relatively open to hostile takeovers. Such takeovers are much more difficult in Japan and most European countries (the United Kingdom is an exception). Informal barriers to investment in these countries, such as close relationships between the financial and commercial sectors, make hostile bids virtually impossible.

Safarian concludes that national differences in the treatment of M&As will grow in importance and will be the subject of much policy debate, particularly with the event of Europe 1992. Informal barriers to investment are of growing importance and concern.

—John Knubley, Investment Canada

John Knubley is Director of Investment Research for Investment Canada (613) 995-7077

Relative Importance of Foreign Acquisitions Versus New Businesses and Expansions



	1983	84	85	86	87	88	89	90
New Bus. & Expan.	3.7	3.5	3.7	5.7	6.4	4.7	8.2	5.7
Acquisitions	0.3	0.3	0.2	2.4	4.2	4.4	6.0	3.2
Gross FDI Inflows	4.0	3.8	3.9	8.1	10.6	9.1	14.2	8.9

($ Bn.)

Source: Investment Canada compilations from Statistics Canada.

CDIA ROUND TABLE

In October, Investment Canada held a round table on Canadian direct investment abroad (CDIA) in Vancouver with senior academic, business and provincial representatives. Foreign direct investment in Canada has been the traditional focus of past research and policy debates. The round table looked at the patterns, motivations and impact of Canadian outward investment.

In our global economy, international investment is increasingly a two-way street. The more even relationship developing in Canada between inward and outward investment is typical of other major industrialized economies, except Japan. In 1950, CDIA was relatively small and unimportant. By 1990, the stock of CDIA had reached almost $85 billion, or equivalent to more than two-thirds of foreign direct investment in Canada (see table below).

The round table identified a possible research agenda on CDIA, building on the economic expertise of the academics present. The proposed agenda addressed such issues as labour market effects, adjustment, R&D and technology diffusion, trade and capital flows, and the mode of direct investment (viz. wholly owned versus strategic alliances).

The round table also permitted business participants to cite their own practical experience with CDIA. The discussion pointed to the importance of linking research work on CDIA with the broader issues of Canadian competitiveness and prosperity.

The research agenda on CDIA will be developed based on discussions at the round table, and ultimately academics will be contracted to complete papers on topics related to CDIA. This work is to be followed by a public conference for peer review of the academics' papers and then publication of a book. This will serve as the third volume in the Investment Canada Research Series.

—John Knubley, Investment Canada

STOCK OF FDI AND CDIA IN SELECTED YEARS

YEAR	FDI ($B)	CDIA ($B)	CDIA/FDI (%)
1950	4.0	1.0	25.0
1960	12.9	2.5	19.4
1970	26.4	6.2	23.5
1980	61.7	27.0	43.8
1985	87.2	54.1	62.0
1990	126.6	84.8	67.0

Source: Statistics Canada, 67-202

GLOBE '92

One of the ways the Government of Canada has responded to the global challenge of achieving sustainable development is the establishment of GLOBE (GLobal Opportunities for Business and the Environment), a biennial series of international conferences and trade fairs.

The GLOBE mission is to advance global sustainable development by encouraging practical solutions to environmental challenges and promoting the related business opportunities and responsibilities.

Richard LePage, Manager of Environmental Technologies, will represent Investment Canada at this year's events. "GLOBE '92 is one of the single most important environmental events in the world, bringing together industry, government and consumer groups. I am certain this integrated approach is the best method of dealing with today's pressing environmental problems."

Investment Canada is involved in an ongoing project, together with Industry, Science and Technology Canada, and External Affairs and International Trade Canada, to enhance the international competitiveness of Canadian industrial wastewater firms. Efforts will focus on arranging one-on-one meetings between Canadian and foreign firms interested in possible business collaboration. To this end, Investment Canada will be involved with three GLOBE '92 programs: the Exchange Program, the Tour Program, and the International Business Centre.

GLOBE '92 will bring together business, industry, government, non-government organizations, labour, and environmental groups to discuss global environmental problems and to propose market-led solutions. More than 3,000 conference delegates, 750 trade fair exhibitors, 360 expert speakers, 400 international media representatives and 15,000 visitors will attend.

The GLOBE '92 Honorary Patron is Grö Harlem Brundtland, Prime Minister of Norway. The Chairman is the Honourable John A. Fraser, Speaker of the House of Commons.

For information or registration forms, please contact:

GLOBE '92
601 - 535 Thurlow Street
Vancouver, B.C. V6E 3L6
Tel: (604) 666-8020
Fax: (604) 666-8123

NEW PRESIDENT OF INVESTMENT CANADA

Jean C. McCloskey (Photo by Michael Bedford Photography)

Jean C. McCloskey was recently appointed as the new President of Investment Canada.

Mrs. McCloskey, a career civil servant, joined the industry department in 1968 before moving in 1982 to External Affairs and International Trade, where she was most recently the Assistant Deputy Minister in charge of the Asia and Pacific Branch.

In this position, Mrs. McCloskey was responsible for promoting Canada's political and economic interests in the Asia Pacific region in the areas of foreign policy, economic and trade policy, export development, immigration, and public affairs, including cultural affairs and academic relations.

Her key duties involved early identification of significant long-term trends, initiating major strategic policy thrusts, and providing leadership in efforts by all levels of government and the private sector to better secure economic, trade, investment and foreign policy goals.

Mrs. McCloskey has been active in focusing Canadian interest in the Pacific Rim and in fostering international co-operation in the region. She is a member of the Board of Directors of the Asia Pacific Foundation and the Canadian Committee for Pacific Economic Co-operation. In addition, she played a significant role in establishing the Asia Pacific Economic Co-operation ministerial forum, an organization of Foreign and Trade Ministers from leading Pacific nations, who meet to review current economic, social and political issues.

Mrs. McCloskey replaces Paul Labbé, who was recently appointed President of the Export Development Corporation.

MINISTER WILSON IN MUNICH

A two-day meeting focusing on issues relating to investment, technology and strategic alliances was held in Munich, Germany in September 1991.

Hon. Michael H. Wilson, the Minister of Industry, Science and Technology Canada, attended the The European Investment, Strategic Alliances and Technology Meeting, along with commercial counsellors from the European posts, and representatives from External Affairs and International Trade Canada (EAITC), Industry, Science and Technology Canada (ISTC), and Investment Canada.

An underlying objective of the meeting was to discuss the proposed government's programs to assist Canadian companies become more competitive internationally, particularly with respect to strategic alliance initiatives.

A discussion was undertaken to assess the capabilities of Canadian companies to identify their international business needs, and to evaluate the capacity of the Canadian network and infrastructure in meeting these needs and in introducing Canadian companies to possible European partners.

Workshops focused on the exchange of operational information between the posts and Ottawa, with a view to improving program implementation, administrative support and promotional techniques. An interdepartmental committee has been set up to review the recommendations made in Munich.

"It's very important that we educate Canadian companies with respect to the need to form strategic alliances with foreign partners to attract foreign investments, or to invest abroad," said Minister Wilson, "and the importance of partnering and technology acquisition to improve the competitive advantage for Canadian companies."

From Left: John A. MacDougall, M.P. for Timiskaming; Paul Labbé, former President of Investment Canada; and the Hon. Michael H. Wilson, Minister of ISTC, and Minister responsible for Investment Canada.

SEARCHING FOR JAPANESE PARTNERS

Richard Lovatt, Investment Canada's Manager for Japan, offering investment information to Japanese visitors to G-BOC.

For the second year in a row, Investment Canada took part in the Global Business Opportunities Convention (G-BOC) in Osaka, Japan in October 1991. G-BOC is organized by the Osaka Chamber of Commerce and Industry and other economic development organizations in the Kansai area (region surrounding Osaka) which account for 20 per cent of Japan's GNP.

About 800 government and business people from 42 countries took part, mingling with some 20,000 Japanese business visitors who represented over 2,000 companies. The keynote speaker was well-known author Alvin Toffler. Seminars and workshops were held on such subjects as "How to Gain Access to the Japanese Market," and Richard Lovatt of Investment Canada addressed audiences about the Canadian investment climate.

A critical feature of G-BOC was a matchmaking exercise in which individual business meetings were arranged between Canadian and foreign firms in the fields of optoelectronics, artificial intelligence, advanced ceramics, industrial wastewater management and biotechnology.

As a result of participation in G-BOC, the Canadian team gained a good deal of exposure among business people in the Kansai area. Investment Canada received a number of trade and investment-related inquiries, many of which are expected to lead to business linkages between Japanese and Canadian firms.

— Richard Lovatt, Investment Canada

GROWING TOGETHER

Growing Together, a new handbook from the Investment Development Program, provides practical advice to Canadian business people considering joint ventures as a means of expansion.

The handbook covers the whole life of a joint venture, from conception to winding up. Special attention is given to selection of a partner, the negotiation process, and the management of the joint venture. Critical success factors identified include: getting a clear understanding of your own and your partner's objectives; building trust; realistic recruitment; and senior management commitment.

Experienced joint venturers who reviewed the handbook commented that it was "a thorough and comprehensive study of what makes a joint venture tick" and "an excellent summary of the aspects to be considered before entering a joint venture".

— Ken Hart, Investment Canada

ANNUAL REPORT '90-91

Significant benefits normally accrue from foreign direct investment, and because of this, Investment Canada's leadership role is increasingly important in the globally competitive marketplace.

In the Agency's 1990-91 Annual Report, the Minister responsible, Hon. Michael H. Wilson, points out that the Agency's role is to advise the government of Canada's investment performance to get across the message to all Canadians that investment is crucial to our economic future, and to co-ordinate a national effort to attract and facilitate value-added investment from abroad.

The report suggests that the rapid adoption of technological capabilities that can come through foreign investment is particularly important for Canada, and that Canada's competitiveness has become a matter of real concern.

Recent studies by the Agency into the country's competitiveness indicate that "there is no easy panacea for raising Canada's productivity and economic growth. A wide variety of measures are called for, of which greater investment and savings will clearly be a part".

Investing in Canada is published quarterly by Investment Canada, the investment development agency of the federal government. The mandate of Investment Canada is to promote investment in Canada, by both Canadians and non-Canadians; to carry out research and provide policy advice on investment matters; and to review major foreign investments to ensure they are of net benefit to Canada.

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