Corporate Canada and foreign ownership

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RESTRUCTURING CORPORATE AMERICA

Critical structural changes have occurred in the nature of the global economy, affecting in turn the structure of national economies and patterns of foreign investment and ownership. Even more powerful changes are under way.

In 1975, when I came to Canada to do research for a five-nation study of host country-MNC relations, U.S. subsidiaries were facing intense regulatory and political pressures to increase Canadian content and control. Many Canadian managers were pushing for greater autonomy and, at that time, most U.S. firms were willing to be better "corporate citizens."

By the 1980s, however, powerful changes in the global economy had forced U.S. firms to rethink their corporate strategies and structures in North America. Among the many pressures precipitating this corporate rethink were changes in policy trends—for example, the long-term impact of GATT liberalization, and the more immediate policy shifts after the 1982 oil price crash. As well, the impact of new technology in reducing the effect of distance in complex production processes and in altering the nature of control systems had greatly heightened competition in global markets.

Reducing overcapacity was central to meeting these competitive pressures. Although many Canadian branch plants had generated substantial profits for their corporate parents, such plants had become painful liabilities in an increasingly competitive environment. As distinctly national markets began to blur, firms worked out more rational, less expensive sourcing, production, marketing, and distribution networks in North America, resulting in a more integrated continental system. Subsidiaries increasingly became operations located in Canada or Mexico rather than operations producing for Canadian and Mexican markets.

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A NORTH AMERICAN MARKET

Companies adopted a variety of arrangements. Some sought to capture efficiencies and synergies globally through centralized control of key activities. Subsidiary managers were, with good reason, apprehensive of this approach, as control over their own operations was centralized to strategic business units or operating companies. Lacking an overall view from headquarters of a Canadian role, these units often reduced the scale of Canadian operations and autonomy—as subsidiary morale, output, and productivity all deteriorated.

An alternative model envisaged a different dynamic at the core of global organizational change. Instead of being constrained by centralization, this model viewed subsidiaries as driven by the competition between different operations. Under this approach, even though Canadian operations report directly to U.S.-based business units, Canadian managers are able to collaborate to maintain a high level of Canadian identity in their identification of possible production, research, or sales mandates.

Despite these different approaches, though, the overall result was much greater specialization for Canadian businesses. Canadian operations that had produced a wide range products for their parent companies now focused on single products or even components. Thus, an increasing share of cross-border trade in North America takes place within corporations.

PATTERNS OF CHANGE

Patterns of change have not been homogeneous across all sectors. The emergence of a North American economic system has been most visible in manufacturing. While in financial services and telecommunications, for example, change has been slower.

The trend toward deeper integration intensified in the 1990s. Cross-border trade (much of it intra-company) rose to more than a billion dollars a day, and flows of investment increased dramatically. Canada's inward stock of foreign direct investment (FDI) rose from

Can.$90 billion in the mid-1980s to upward of Can.$190 billion in the mid-1990s. Acquisitions soared. Americans bought stock in Canadian firms and also bought Canadian firms outright.

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The internationalization of markets for corporate shares makes the whole question of foreign ownership even more complex. On any given day, even a Canadian icon, like Canadian National, might be heavily foreign owned. As well, companies have much greater choice in raising capital. In 1988, just seven Canadian companies issued new equity in the United States, raising only U.S.$94 million. In 1998, 30 companies raised nearly U.S.$2 billion on U.S. markets.

WHY WERE AMERICANS BUYING CANADIAN?

The cheap exchange rate was one reason. Canada is viewed as a very good buy, both for quality and for bargain basement prices.

Canadians are active foreign investors, too. Canada's outward stock of FDI increased by the same magnitude as inward FDI, from Can.$90 in the mid-1980s to Can.$190 in the mid-1990s. Canada is the fourth-largest investor in the United States. As well, during the 1990s, Canadian direct investment abroad grew twice as fast as foreign investment in Canada. Despite tax credits for owning local stocks and a government-mandated cap on Canadian pension funds' foreign investments, Canadians own upward of $60 billion of foreign stocks.

A SINGLE NORTH AMERICAN ECONOMY?

What this reveals is that goods and capital markets are no longer national: Canada, the United States, and Mexico increasingly share a single economy. Investment decisions are influenced by a wide array of factors, including federal, provincial/state, and local regulations and benefits, currency values, labour costs, and so on. Each of these decisions are also made within the context of competition for continental and global markets, rather than being seen as strategies to gain access to national markets.

Is it useful to consider these issues on a national basis at all? Probably not. Sectors and regions are the critical variables. As Courchene observes in *From Heartland to North American Region State* (University of Toronto, 1988), "It is time to view Canada as a series of north–south, cross-border economies with quite different industrial structures." Patterns of foreign investment, incoming and outgoing, will differ in each of these economies.

Sectors may be even more important. The auto industry, for example, accounts for more than 11 percent of Canada's manufacturing GDP, more than 4 percent of total GDP, one-third of all retail sales and manufacturing exports, and nearly 5 percent of total employment. As Pradeep Kumar and John Holmes say, in a new study of the Canadian auto industry,

> The most significant and distinctive factor that has shaped the Canadian automobile industry over the past three decades is the high level of integration with its counterpart in the United States. . . . The rationalization of production and trade triggered by the Auto Pact has led to the full integration of production of both parts and assembled vehicles into one industry that supplies the combined U.S. and Canadian market.

As more sectors operate like the auto industry, national borders, while still relevant, will simply be one of an array of factors that create the context in which corporate strategy emerges.

QUESTIONS FOR CANADA IN THE GLOBAL MARKET

First, how powerful is foreign investment in explaining Canada's well being? How important is it that firms be headquartered in Canada? One might ask if Canada has been ill served by the continental integration of the auto industry. There are no Canadian auto companies, but there are a lot of jobs, production, and exports. Has Canada been better served by a more protected financial or telecom sector?

Second, foreign ownership might soon become a very old issue as technology-driven change in business structure may render this debate irrelevant. If one trend in the global economy is toward amalgamation, another is toward outsourcing and unbundling value chains in many industries. While there are fewer auto companies worldwide, these giant companies are outsourcing significant pieces of their business. Smaller, locally owned firms may discover high-value niches in this system.

In this emerging era of alliances, out-sourced, networked, and virtual companies, foreign investment may grow less prominent in international business, as alliances and networks link companies rather than ownership and investment. Levels of foreign ownership are much less important where economies are no longer protected or national. Canada's future will be more influenced by decisions regarding its macroeconomic policy, social policy, infrastructure, and relations between Ottawa and the provinces than by levels of foreign investment or foreign ownership.