

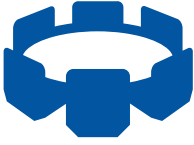
Attracting Global Mandates and Investment in Canada

SYNTHESIS REPORT



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The Public Policy Forum is an independent, not-for-profit organization dedicated to improving the quality of government in Canada through enhanced dialogue among the public, private and voluntary sectors. The Forum's members, drawn from business, federal and provincial governments, the voluntary sector and organized labour, share a belief that an efficient and effective public service is important in ensuring Canada's competitiveness abroad and quality of life at home.

Established in 1987, the Forum has earned a reputation as a trusted, nonpartisan facilitator, capable of bringing together a wide range of stakeholders in productive dialogue. Its research program provides a neutral base to inform collective decision making. By promoting informationsharing and greater links between governments and other sectors, the Forum helps ensure public policy in our country is dynamic, coordinated and responsive to future challenges and opportunities.

About the Authors

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About this report

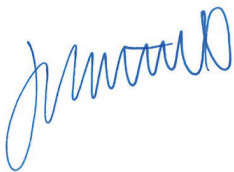
Innovation plays a key role in strengthening Canada's global comparative advantage. Places where innovation-oriented activities such as research, product design and manufacturing occur often have positive spin-off effects that benefit the broader economy. In a post-recession global marketplace, in order to maintain and strengthen Canada's comparative advantage, it is important to understand how multinational enterprises decide where to place high-value business functions that drive such innovation-oriented activities, as well as how governments at all levels can help support the efforts of Canadian operations to win global mandates.

Innovation is an important thematic area for the Public Policy Forum. Over the past two years, the Forum has convened several multi-sector leadership dialogues at the regional and national levels to help advance a culture and practice of innovation in Canada.

This study builds on these initiatives and illustrates, among many important points, that innovation involves a range of sectors and a range of champions. Strong private-public sector coordination and relationships across all sectors are critical to winning mandates that generate investment.

I would like to thank Industry Canada, our partner in this study, and all the interviewees for contributing their time and for sharing their ideas and insights. I would particularly like to acknowledge the work of AeroInsight, Cheminfo Services Inc, Desrosiers Automotive Consultants, Strathmere Associates, each of whom conducted sector level reports that contributed to this synthesis.

And, finally, I wish to thank Aaron Good, Vinod Rajasekaran and Paul Ledwell for their leadership in this important initiative.



David Mitchell
President and CEO
Public Policy Forum





Introduction

Attracting global investment is increasingly important in driving innovation, productivity and competitiveness. Recent Public Policy Forum (PPF) research¹ highlighted that Canadian operations of multinational enterprises (MNEs) not only compete with other MNEs and domestic firms, but, increasingly, they compete with company operations in other countries for investment. A significant amount of investment is tied to global and regional mandates to manufacture products or perform other key business functions. When Canadian operations win mandates for research and development (R&D), product design or manufacturing, they attract investment in innovation-oriented activities. In accessing this investment, they not only help their company's fortunes in Canada; they often drive innovation that benefits other enterprises and the broader Canadian economy.

As competition for global investment intensifies, it is essential to understand how MNEs decide where to locate high-value business functions that drive innovation. It is also important to understand the role governments, the research community and others play in helping Canadian operations compete for and win global and regional mandates.

This study examines how MNEs award global mandates that drive investment and innovation in Canada across a range of industries, including information and communications technologies (ICT), aerospace, chemicals and auto parts. It also explores how governments can facilitate and support the efforts of Canadian operations to win mandates and attract strategic investment.

This report draws on previous PPF work on innovation², and four sector-specific studies supported by Industry Canada, which were conducted by Cheminfo Services (chemical)³, Strathmere Associates (ICT)⁴, DesRosiers Automotive Consultants Inc. (auto parts)⁵ and AeroInsight (aerospace)⁶. Additionally, the PPF conducted its own interviews across a range of sectors. In total, this report represents insight from more than 40 companies operating in Canada.

The report is divided into three sections. The first provides an overview of the financial and strategic drivers of mandates. The second focuses on specific cost drivers

across industries, highlighting where they are more, or less, important; where Canada tends to be relatively competitive, or less competitive, and; how governments can help strengthen a local operation's comparative position. The concluding section outlines important strategies that federal and provincial governments can use to help Canadian operations be more competitive in their efforts to win mandates and investment.

Highlights

When Canadian operations of international companies win global and regional mandates, they attract investment in innovation-oriented activities that benefits the broader Canadian economy. This study draws on previous Public Policy Forum (PPF) work in innovation and economic development, interviews with executives, and four sector specific studies. It examines how mandates are awarded by multi-national enterprises and how federal and provincial governments can act together to help Canadian operations win mandates and bring more investment and innovation to Canada.

Mandates are generally awarded based on the relative quality of the business case presented. Costs of accessing quality primary materials, energy and services; appropriately skilled labour, and; appropriate transportation, storage and handling (including intermodal integration across borders) are major factors in a business case as are other costs of doing business including corporate tax rates, firms' regulatory compliance costs, legal and costs relating to intellectual property protection and navigating government systems and regulations. Governments have important roles to play in influencing the relative short-term and long-term cost positions of Canadian operations and their ability to attract mandates and investment.

To better facilitate and support the efforts of Canadian operations to win mandates, governments must focus on:

- Deeper engagement with business, academia and industry;
- Greater and more formalized coordination within and across jurisdictions to align regulations and approvals, and;
- Greater alignment of human capital development and mobility with business needs.





How Multinational Enterprises Award Mandates

Decisions on awarding mandates and related investment are almost always based on the strength of a Canadian operation's business case. Business cases are assessed individually and in relation to those developed by operations in other countries. While firm strategy can play a role, business cases are primarily assessed based on financial drivers, such as costs, access to capital and access to market. Financial and operational risks may also affect a business case.

Cost drivers are the most important factors identified by respondents. While the relative weighting of cost drivers varies by industry, product, mandate and business case, major drivers tend to include costs of:

- Obtaining quality primary materials, energy and knowledge-based inputs and services;
- Accessing appropriately skilled labour;
- Appropriate transportation, storage and handling, and;
- Doing business in the particular country, including corporate taxes, regulatory compliance costs, legal and intellectual property protection costs, and costs related to navigating government systems.

Cost factors are explored in detail in the next section.

Access to capital for research, startup and expansion is a key driver for capital intensive business plans. Overall, the Canadian financial sector tends to be relatively competitive in providing access to capital. Canada's banking sector is highly regarded around the world, and has been cited, particularly in light of the recent economic downturn, for its regulation and due diligence. Export Development Canada (EDC) and Business Development Bank of Canada (BDC) programs are used across sectors and are considered to be highly beneficial.

Access to market can be important to a business case, particularly when a company must set up production in a particular market to sell products or services there.

For regulated sectors that require local presence to sell into market (aerospace, for instance) and for sectors, like the chemical industry, that have high transport and logistics costs, large markets, including India, China, Mexico, Brazil, and other emerging economies, offer a clear market size advantage over Canada. Access to the U.S. automotive market has played an important role in the development of the Canadian auto parts sector⁷. Canada must ensure seamless access to U.S. markets if it is to leverage this geographic advantage in other sectors. Since Canada represents a relatively small economy (less than 2% of global GDP⁸), governments must ensure that interprovincial trade barriers do not further fragment the market and make investing in Canada less attractive.

“Investment has to be earned.”

- Senior MNE executive

Risk factors also contribute to the strength or weakness of business cases. Risk factors cited include:

- Stability of government, laws and regulations, on which Canada fares well;
- Exchange rate fluctuation, which can dramatically impact cost competitiveness. Generally, a stronger Canadian dollar relative to the U.S. can significantly lessen Canada's cost-related competitiveness in labour, material and distribution⁹;
- Time required to obtain necessary approvals. If government grants, tax credits and regulatory approvals take a long time to come through, firms may miss opportunities, including the window of opportunity to get to market on time. This is especially the case in knowledge-based sectors, where product cycles are typically short;
- Intellectual property (IP) protection. Canada has strong IP protection laws and this is cited as relatively low risk.





Key Cost Drivers

Accessing Quality Inputs and Services

Access to primary materials, energy and key services are critical to most business cases. These inputs include access to high-quality raw materials, including natural resources, and proximity and access to industrial facilities that provide key services such as data, tooling and pertinent parts and supplies.

Access to quality inputs and services is particularly important in the resource-based and manufacturing sectors. High-quality raw materials are vital for organic and inorganic chemical processes. Inputs are also important for manufacturing parts in the automotive sector. For many firms in the auto parts industry, particularly to tooling and assembly plants, proximity to suppliers and customers in their industry is a critical factor. Proximity is also important in this industry since parts are delivered in the order in which they are required¹⁰.

Canada is relatively competitive in providing access to large quantities of well-priced raw material inputs, many of which are needed for organic and inorganic chemical processes and manufacturing. Securing long-term access to these quality raw materials and other supplies at competitive prices are major considerations in the chemical and other resources-based sectors¹¹. Indeed, as a resource-rich nation, Canada's ability to provide long-term access to well-priced natural resources is a comparative advantage. Each year resource industries contribute nearly \$150 billion to the Canadian economy, roughly 12 per cent of the country's GDP¹². To stay competitive, Canadian operations must continue to develop and use robust and cutting-edge extraction technologies, which reduce inefficiencies, cost and environmental impact.

In addition, Canada has several fairly well developed regional industrial clusters consisting of raw material suppliers, services and manufacturing firms that are situated in close proximity to one another. For example, Alberta's Industrial Heartland Association, a group of five municipalities located in and around Edmonton, is a hub of world-class petrochemicals manufacturing. Similarly, Sarnia-Lambton's Refining and Petrochemical Complex is home to MNEs that produce plastics, synthetic rubber

and other chemicals. These industrial clusters are cited as a competitive strength. They reduce time and cost of accessing key services and materials and encourage higher specialization through competition. For example, in the resource-based sector, close proximity to existing chemical plants, refineries and other industrial facilities relates to effective delivery of products and availability of services¹³.

Canada is less competitive than other industrialized countries in providing access to intellectual support, including access to data, research and testing facilities. Strong intellectual support creates the conditions for cutting-edge experiments, knowledge-sharing, collaborating, development of prototypes and testing. While Canada has 67 universities and 146 colleges, many of which are research and development intensive, business leaders noted that Canada does not foster IP sharing between universities and the private sector as effectively as other countries¹⁴. Canada also has fewer interdisciplinary innovation clusters than other developed economies. Research parks and innovation clusters that bring together leading researchers, innovators, designers and scientists for open, interdisciplinary collaboration are important, particularly in ICT¹⁵ and chemical¹⁶ industries, where continuous innovation is critical to maintaining a competitive advantage. Canada also needs more opportunities for discovery and development initiatives between academic research and businesses.

Governments can help strengthen Canada's supply of accessible quality raw materials and other inputs and services by continuing to:

- Promote Canada's secure and long-term access to raw materials and price competitiveness;
- Showcase and invest in innovative extraction technologies, and;
- Support product and process innovation clusters to strengthen access to quality knowledge inputs and services in key industries.



Accessing Appropriately Skilled Labour

It is particularly important in industries and functions in which labour constitutes a high proportion of costs. Different sectors have different human capital needs. If an abundant supply of labour exists globally, lower-cost markets tend to be more competitive than Canada. In industries that need an abundance of low-skilled labour, Canada cannot always compete with other countries on a cost basis. However, when qualified labour is relatively scarce globally, as is the case with higher skilled R&D, product design professionals and IT programmers, Canada tends to have a cost advantage over other countries. To maintain this comparative advantage, Canada must look ahead to assess and develop the skills of the future.

While access to appropriately skilled labour affects the strength of the overall business case, it is a particularly key

“Knowledge-based employment is always going to be where the knowledge is.”

- Research Park representative

driver in knowledge-based sectors and other industries and functions in which human capital is the biggest component. Specifically, executives note that being able to hire entry and mid-career professionals is critical in digital media¹⁷, software, telecommunications and aerospace sectors¹⁸. Many firms in these sectors use Canada’s labour market information system to forecast skilled workforce demand and supply. Where possible, firms have established local partnerships with universities and colleges so that both sectors can be up to date on labour market trends and can support projected labour market growth. Showing the ability to secure a future supply of talent can be a key strength in a business case.

Canada tends to be relatively cost competitive in attracting and supplying high-value human capital. In knowledge-based sectors, where work can be undertaken in a virtual environment, cost of living is an important consideration and thus, influences the business case. This gives Canadian cities a cost of living advantage over Palo Alto or New York City, for example. Similarly, in the resource-based sector, Canada’s labour cost advantages relative to the US have historically been lower by about 15 per cent for skilled labour, 20 per cent for technical/professional labour and 23% for senior management¹⁹. The availability of high-value Canadian human capital for a lower cost relative to the U.S. is seen

as attractive for MNEs. However, as the Canadian dollar has risen against the U.S. dollar, this cost advantage has been reduced or eliminated.

Canada tends to be less competitive in facilitating interprovincial and international labour mobility. Labour mobility across provinces and countries is essential for many companies. In gaming and digital media industries²⁰, for example, the ability to quickly bring top-tier talent to Canada is a major influence on investment location. ICT sector executives told us that Canadian governments must better coordinate and enable international labour mobility and immigration²¹. Canada has robust strategies and practices that assist new immigrants and their families to integrate into the workforce. However, Canada’s foreign worker program is cited as cumbersome for companies and slow relative to product life cycles in the knowledge sectors.

Executives also noted that Canadian governments, universities and colleges must better engage the private sector to determine and meet future skilled labour needs. Collaborative studies using Canada’s labour market information system can help assess current and future labour market demand and compare it to projected supply. Executives in the ICT sector highlighted the importance of labour market analysis and forecasting. They note that Canadian post-secondary institutions, governments, and the private sector do not collaborate on skills analyses as well as their foreign counterparts²². This makes Canadian operations less likely than those in other countries to accurately cite human capital availability when putting together their business cases.

Governments could strengthen Canada’s competitiveness by:

- Working more proactively and across jurisdictions to identify potential areas of labour market growth, and investing in appropriate training and education;
- Facilitating university and private-sector partnerships to spearhead industrial innovation through research, product development and educational programs, and;
- Better enabling national and international labour mobility, particularly for top executives, key mid-career professionals, and spouses, whose movement is likely to help drive investment in Canada.



Appropriate transportation, storage, and handling

Access to well priced, appropriately skilled labour is important in virtually all industries. Canada is the second-largest country in the world by land mass, making its transportation system vital to trade and attracting investment. Pipelines, rail, roadways and waterways are essential components of this system. Transportation and logistics needs vary by industry and depend on the season (particularly for products that need to be heated or cooled).

Transportation and logistics costs are particularly important for firms with long supply chains or high transport costs, including manufacturing and resource-based sectors. Indeed, if these costs are enough of a factor, firms will choose to cluster together. For example, in the auto parts sector, firms primarily locate close to existing industry clusters that house assembly plants, tooling facilities and the R&D facilities of original equipment manufacturers (OEM). Such close proximity allows for collaboration on process-driven innovation between the OEM and the supplier. While clustering reduces the challenge of transporting unfinished products between suppliers and producers, access to transportation networks are important for connecting consumers with finished products²³. In the inorganic chemicals sector, for instance, access to ports is an important consideration because long distances between the coasts and the market present cost challenges for shipping²⁴. Aerospace executives also highlight the importance of proximity to their customers. In this industry, long product cycles makes relationships between suppliers and customers particularly important²⁵.

Executives highlighted Canada's high-quality pipeline and storage infrastructure. The country has an extensive energy pipeline system that facilitates the movement of large quantities of crude oil, natural gas and refined petroleum products across provinces and markets—a must for the resources sector. Similarly, executives in the chemical sector say their important cost drivers include the availability and cost of large and high-quality storage infrastructure, including underground salt caverns typically used for petrochemical and raw materials²⁶.

Several Canadian provinces have attractive electricity prices relative to the U.S.²⁷. Low electricity prices are an important factor in the inorganic chemicals sector where energy intensive electrochemical processes are applied, and chemical products are stored for long periods of time. This has led many inorganic chemical manufacturing and storage facilities to locate in Manitoba, Quebec and British Columbia to take advantage of low electricity prices.

Canada is cited as less competitive in intermodal (road, rail, air, sea) integration at the coasts and at the U.S. border. This is an issue for resource-based and manufacturing sectors. Efficient intermodal integration at the Pacific and Atlantic coasts, as well as year-around access to the St. Lawrence Seaway would allow chemical and refined petroleum products to move quickly throughout the year. Similarly, rail integration at the Canada-U.S. border impacts the cost of shipping for many manufacturing firms²⁸. Inefficient intermodal integration at the U.S. border creates bottlenecks and delays in accessing the market and suppliers. For example, most of Canada's auto parts sector is located along Ontario's Highway 401, a congested highway system that increases transit times and reduces the sector's ability to be competitive with U.S. locations.

Governments could help strengthen Canada's comparative position in transportation and logistics by:

- Continuing to strategically invest, along with companies, in transportation and storage infrastructure that companies need to access, use and store raw materials and product, and;
- Working more proactively across jurisdictions and federal departments, particularly in transportation, port authorities and border services, to decrease transit times and increase intermodal integration.



Other Business Costs

There are several other cost factors that influence a firm's business case. Governments influence many of these factors through their corporate tax rates and investment incentives, and through direct and compliance costs associated with regulation, permits and programs.

Canada has internationally competitive corporate tax rates and levels of investment incentives. Executives cite government investment strategies and stimulus as key contributors to business cases. Recent stimulus packages, including *Canada's Economic Action Plan* and Ontario's new *Green Energy & Green Economy Act, 2009 (GEA)* and *Green Jobs Skills Strategy*, have attracted investment. Access to research grants and startup incentives is an important factor in location decisions. The Industrial Research Assistance Program (IRAP), Ontario Auto Investment Strategy (OAI), Scientific Research & Experimental Development (SR&ED), and advisory programs offered by EDC and BDC benefit all sectors. While there was consensus that existing government grants and tax credits are relatively competitive, the programs should be reviewed to ensure that they continue to stay ahead of other international jurisdictions²⁹.

Canada is less competitive in the way programs, regulations and approvals are structured, harmonized and delivered. Specifically, programs are less predictable and harder to navigate than they might be. Regulation and permit approvals need to be better harmonized to reduce compliance costs and administrative burden.

While executives believe that Canada has strong investment incentives, they said programs, including the SR&ED and OAI, are "not predictable and have uncertain outcomes"³⁰. This is partly due to the long wait—up to 18 months—to receive funds. During this waiting period, firms have to find interim financing. Executives also noted that SR&ED is a cumbersome process and they have to devote significant resources to making the required submissions. Streamlined approval processes and quick lead and response times within all levels of government are critical for investment. If approvals are slow, firms may miss the window of opportunity to get to market on time. For instance, in knowledge-based sectors, where product cycles are typically short, slow government approvals and response times may stop a project from going forward³¹.

Executives hope that the Government of Canada will act on recommendations from the recent Expert Panel on Federal Support to Research and Development to address some of these issues.

Incentive programs could also be improved through better coordination among governments and between governments and business. Some interviewees noted that governments lack deep knowledge of industry realities and needs³². For example, executives in the auto parts sector note that R&D focuses primarily on process innovation rather than product innovation. Existing R&D incentive programs do not, however, support process innovation. Consequently, they are not as effective as they could be in advancing innovation in this industry.

"We need a creative team in a creative environment. We would never go [some places] no matter how much money they threw at us."

- Game/animation firm representative

Canadian governments should also improve the alignment of regulations and credential recognition frameworks, and reduce internal trade barriers. Executives noted that several professionals, including engineers, must navigate a cumbersome process for each province before they can register to work there³³. Similarly, to transport materials across multiple provinces, manufacturing firms must check and comply with freight transport regulations in each jurisdiction.

Respondents said they would like to see better coordination across federal departments on transport, environment, immigration and skills training needs³⁴. Currently, approval processes are cumbersome, the wait times are long and the outcomes are unpredictable due to poor inter-governmental coordination. One executive cited the former *Investment Partnerships Program*, a joint government program between Industry Canada and Foreign Affairs and International Trade Canada, as a successful program that attracted and retained global mandates. In this program, officials were assigned to help companies navigate government approvals, serving as a single-window interface for MNEs looking to invest in specific projects.



Governments bear many of the costs related to regulation and compliance. As such, strong public-private sector relationships are critical to better understand the bottlenecks, so regulations and processes can be aligned and improved in order to win mandates. For example, executives in the aerospace sector consider engagement relationship building with governments vital to their future market positioning, as the civil aviation market in Canada is limited and product cycles can last for years. Executives understand that when governments establish relationships with industry and are “partners in the economy”, it gives them confidence and makes execution easier³⁵.

Governments can help Canadian operations compete by:

- Systematically working with companies to streamline processes and approvals for support programs and permits, and to make approvals more predictable;
- Better coordinating regulations and compliance procedures across jurisdictions, and;
- Offering a single-window interface to coordinate across departments.





Conclusion: How Governments Can Help

Innovation and investment are critical to Canada's prosperity and success. When Canadian-based operations win global and regional mandates, they attract investment and often drive innovation that benefits the entire country. Federal and provincial governments have important roles to play in helping companies win mandates. Canadian governments tend to have relatively strong framework policies. Increasingly, it is the design of specific policies, programs, practices and regulations, and the interaction between them, that affects whether companies win mandates, and whether global investment and innovation occur in Canada or abroad.

"There is no silver bullet" to improving locational competitiveness in Canada.

- Common theme from OE parts sector

In sum, to help companies bring mandates to Canada, governments must:

1. Develop **greater knowledge of companies seeking mandates**. Specifically, governments at all levels must have a deeper understanding of the dynamics in industries and the challenges that companies experience. They must understand factors that influence location-based investment for the company and the conditions required to attract mandates. These dynamics will vary from company to company and from business to business. To gain this level of understanding, governments and business must have more profound and sustained partnerships, and there must be continuous knowledge-sharing and dialogue among public-sector and private-sector leaders. Because government resources (such as human and monetary resources) are limited, governments should establish criteria to **prioritize high-potential industries** where Canada can sustain or develop a comparative advantage. If governments do not strategically prioritize industries, they risk limiting the impact of their own efforts.
2. Increase their **alignment and coordination, and develop a single-window interface for companies**. Business cases are influenced by departments and ministries across governments. A coordinated strategy to help companies win mandates should be

led by a single federal unit. This coordinating unit should also provide a single-window interface for companies seeking approvals and supports. It should mobilize others to address a range of issues, including international and interprovincial labour mobility, human capital development, access to natural resources, border services, transport integration, and trade and regulation³⁶. Specifically, the coordinating unit should work horizontally to improve:

- Alignment of regulations and requirements across Canadian jurisdictions;
 - Predictability and speed of responses in program and regulatory approval processes;
 - Labour mobility between provinces, as well as immigration processes, particularly for key mid-career professionals and top executives and spouses, whose movement is likely to help drive investment in Canada;
 - The quality and amount of open collaboration between academia and industry to support research, product development and educational programs, including the number of innovation clusters and;
 - Co-ordination among federal and provincial bodies in charge of transport, ports and border services to decrease transit times and increase intermodal integration.
3. Continue to **champion investment** by promoting Canada domestically and abroad as a business-friendly economy. Specifically, trade and investment missions should highlight national efforts to create better business and investment conditions.

No one sector is responsible for innovation. New and better practices evolve through the interactions of leaders across federal and provincial governments, the private sector, academia and other parts of society. For Canada to fulfill its economic potential and to maintain its global comparative advantage, all sectors must work collaboratively. Private- and public-sector leaders must engage each other more deeply to build Canadian advantage, and governments must co-ordinate more fully to help companies bring mandates to Canada.



Endnotes

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³⁵ *Firm-Level Study of Location Decisions: Aerospace*, AeroInsight, 2011

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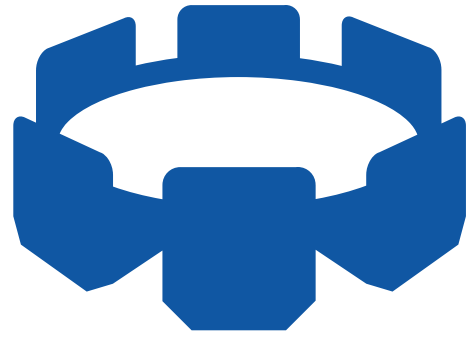
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