

January 18, 2008

Mr. R. L. Wilson  
Chair  
Competition Policy Review Panel  
280 Albert Street  
Ottawa, ON K1A 0H5

Dear Mr. Wilson

We are pleased to provide our comments and observations about Canada's competition and foreign investment policies for your consideration as you develop your recommendations on how to enhance Canadian productivity and competitiveness.

In this letter, we address six important topics:

- ***The impact of globalization***—Canadians must broaden their international focus beyond the United States, since it is not always our toughest global competitor nor is it always the market that offers the best opportunities for us to pursue.
- ***The impact of foreign takeovers***—Loss of ownership shifts companies' decision making, supply relationships, intellectual property, oversight and accountability away from Canada. However, protectionism is not the solution.
- ***Canada as a destination for foreign investment***—Canada's aging workforce and the increasing competitiveness of many foreign capital markets are risks to Canada's ability to attract foreign investment.
- ***Improving our positioning in global supply chains***— Canadian companies must move from the lower end of the global value chains to higher positions, which requires capital, talent and leadership. The current strength of the Canadian dollar may provide a unique opportunity that should not be missed.
- ***Importance of leadership from boards of directors and CEOs***—Canada must develop more board and executive leaders with the vision, drive, courage and capability to build globally competitive Canadian organizations.
- ***The internationalization of financial reporting***—accounting is the international language of commerce and Canada's decision to adopt International Financial Reporting Standards (IFRS) is a significant step in helping Canadian companies become globally competitive.

The global economy and capital markets are evolving rapidly—while the opportunities are great, the risks to Canada for not enhancing our competitiveness are, perhaps, even greater. We applaud the urgency with which your panel is approaching its work. The time for public policy debates about competitiveness has passed. Others are already taking action, expanding their global market share and, as they do so, putting Canadian jobs at risk and encouraging investors to seek markets other than Canada.

Competitiveness is an extremely broad and complex issue. Our firm helps Canadian enterprises strengthen their competitive positions by advising them on strategy and operations, human capital, enterprise technology applications, enterprise risk management, security and privacy, climate change and social responsibilities, mergers and acquisitions and, of course, accounting, tax and auditing. The insights we've gained through this work provide the basis for the comments included in this paper, and we would be pleased to elaborate on and further discuss these and other issues related to Canadian competitiveness at any time.

As part of your research process, we have provided input to your panel on certain tax policy matters and their effect on Canadian competitiveness. Progressive and competitive personal and corporate tax policies must be a key component in any national strategy to enhance competitiveness. And in the area of tax policy, there is work to do. For example, while the current Canadian interest deductibility and foreign affiliate regime enables Canadian-based multinationals to effectively compete against foreign-based multinationals, it places at a distinct disadvantage those Canadian-based companies whose earnings are largely from domestic sources. The Department of Finance's proposed "Anti-Tax-Haven Initiative," contained in March 19, 2007 Federal Budget, which would limit the deductibility of interest used to finance "double-dip" transactions for Canadian-based multinationals would place foreign-based multinationals at a distinct competitive advantage compared to Canadian-based multinationals. The effect of both the current regime and the March 19 proposals would be to place both Canadian-based multinationals and Canadian-based companies with largely domestic earnings at a disadvantage created not by foreign competitors, but by our own Canadian tax policy.

## **Impact of globalization**

The globalization of the world's trading and capital markets creates an urgent need for Canada to enhance its competitiveness. This is a fundamental principle on which the remainder of this letter is based. We note that issues related to state-owned enterprises and implications for national security, while extremely important, have been excluded from the Panel's mandate and, therefore, we will not comment on these matters.

### ***Moving from a North American to a global perspective***

Traditionally, Canadian perspectives on globalization have been largely limited to North America. For many Canadian enterprises, "going global" refers almost solely to doing business in the United States. In fact, the Free Trade Agreement has encouraged Canadian business to focus on North America. We suggest that Canada must focus on being competitive in the global marketplace, not just the North American one.

The dominance of the United States in Canadian attitudes towards globalization is understandable. As the world's largest economy and one that is both the closest and most similar to Canada, the United States is the natural first destination for Canadian enterprises looking abroad, especially since the passage of, first, the Canada/U.S. Free Trade Agreement and later the North American Free Trade Agreement. Furthermore, inter-provincial trade barriers continue to fragment our domestic market, impairing the building of globally competitive organizations and further encourage north-south trading.

American enterprises have long proved to be tough competitors for Canadian companies. Continuing to allow ourselves to define globalization almost exclusively in the context of a bilateral competition with the United States, however, ignores the fact that U.S. enterprises are not always the leading global competitors and that those reshaping the U.S. marketplace are not just North American companies, but foreign competitors.

The current situation faced by the North American auto makers illustrates how global competitors are reshaping the North American automobile industry. To remain competitive, the "Big Three" have undertaken massive restructurings that include terminations and early retirements of thousands employees, plant closures, asset divestitures, product line eliminations, and other widespread rationalizations. The massive transformation of this industry has also had a negative impact on its suppliers; several of whom have been forced into Chapter 11 proceedings.

Paul Krugman addressed the impact of foreign trade on the U.S. markets in a recent column in the *New York Times*<sup>1</sup>, in which he wrote:

*.. imports of manufactured goods from the third world have grown dramatically -- from just 2.5 percent of GDP in 1990 to 6 percent in 2006. And the biggest growth in imports has come from countries with very low wages. The original "newly industrializing economies" exporting manufactured goods – South Korea, Taiwan, Hong Kong and Singapore – paid wages that were about 25 percent of U.S. levels in 1990. Since then, however, the sources of our imports have shifted to Mexico, where wages are only 11 percent of the U.S. level, and China, where they're only about 3 percent or 4 percent.*

**Our key message**      Canadians must broaden their international focus beyond the United States, since it is not always our toughest global competitor nor is it always the market that offers the best opportunities for us to pursue.

### ***Opportunities outside North America***

The impact foreign companies are having in the North American marketplace emphasizes how important it is for Canadians and Canadian businesses to be competitive on a global scale. In many cases, Canadians must look beyond North America to see their real competitors and their greatest opportunities. The following example illustrates this point:

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<sup>1</sup> "Trouble With Trade," Paul Krugman, *The New York Times*, 28 December 2007.

*For most of his 36 years in the metal roll forming business, Joe Repovs did what most Canadian businesses do and sold mostly to the close and familiar U.S. market.*

*Then one day he picked a book off an airport shelf that would transform his thinking. After racing through *The World is Flat*, the bestselling study of globalization by New York Times columnist Thomas Friedman, he decided that his Toronto-based Samco Machinery Ltd. had to broaden its horizons.*

*Two years ago, he jumped on a plane to India, where Mr. Friedman did much of the reporting for his book. Taking an Indian-born Samco executive along with him, the 62-year-old Mr. Repovs traversed the subcontinent, visiting Calcutta, Pune, New Delhi, Mumbai, Bangalore and several other places to meet potential customers and get the lay of the land.*

*One of those potential customers was Tata, the giant conglomerate with interests in everything from trucks and tea to hotels and call centres.*

*Last year, Samco got a call from the Tata people: Could the Canadian firm bid on a contract for the world's cheapest car?*

*Today, Samco is helping Tata build the chassis for the Tata Nano, the little car that captured worldwide attention when company chairman Ratan Tata unveiled it in New Delhi last week. The car is to go on sale in India later this year for 100,000 rupees, or about \$2,500, a price no other car maker in the world can match.<sup>2</sup>*

Canada is a small, open economy that sits adjacent to the huge U.S. market, but we must now look beyond North America to the global market place. Our future depends upon our ability to compete effectively both in North America and the broader global environment.

## **Impact of foreign takeovers**

Many Canadians are concerned about the effect of the takeover of Canadian public companies by foreign investors—the so-called “Hollowing Out” impact—and we share those concerns. The loss to Canada extends well beyond the companies being acquired. It also results in significant losses of business for their suppliers, a shift of important decision-making outside Canada, and the loss of effective oversight and accountability to the Canadian marketplace.

When examining the hollowing-out experience, consider the origin of the acquirers in the recent takeovers of large Canadian companies: Inco was acquired by Companhia Vale do Rio Doce (Brazil); Four Seasons Hotels was bought by a group representing U.S. and Saudi interests; Dofasco was purchased by Arcelor (Luxembourg); Stelco was purchased by U.S. Steel (United States), Algoma Steel Inc. was acquired by Essar Global (India); AltaSteel was acquired by SCAW (Sweden), Falconbridge was purchased by Xstrata (Switzerland), PrimeWest Energy

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<sup>2</sup> “Looking beyond America to the riches of India,” Marcus Gee, *The Globe and Mail*, 16 January 2008

Trust was obtained by Abu Dhabi National Energy Co. (Abu Dhabi); Alcan was bought by Rio Tinto (United Kingdom); and Cognos was acquired by IBM (United States).

The world has arrived, not just in our marketplace, but also in our board rooms.

Canadian competitive attitudes and priorities need to change. We often seem to be intent on limiting or prohibiting mergers of leading Canadian competitors, which leaves many of them too small to compete globally and, therefore, the targets of takeovers by foreign companies. Far from maintaining either a sizeable number of Canadian companies, or even just one or two large ones, that are capable of competing in world markets, Canadians have been left with no significant ownership stake in several key industries.

### ***Loss of decision-making, jobs, supplier services***

The importance of having a strong portfolio of Canadian companies headquartered in Canada cannot be overstated. It is our experience that, when control of Canadian companies is acquired by foreign investors, there immediately follows a shift away from Canada in the company's decision making, highest paying jobs, and demand for professional and other services.

While many foreign-owned subsidiaries establish a Canadian "head office" to comply with certain statutory requirements (e.g., tax) and for public relations purposes, these so-called headquarters are rarely of significant substance with any real economic clout or decision-making authority. The Canadian CEOs of a foreign-owned subsidiary are seldom responsible for marketing, sales, manufacturing, human resources, accounting etc., all of which are more likely to be decisions made at the global level. Often, these Canadian CEOs, whose role may be more that of a local marketing and public relations spokesperson rather than a true CEO, may even report to one of the company's global vice-presidents rather than its global CEO.

For example, as auditors to boards of directors, we have observed that Canadian companies acquired by foreign owners quickly organize their affairs to either avoid the requirement to have a statutory audit, or they integrate the audit of their Canadian operations into their global consolidated audit using global materiality levels, which significantly reduces the scope and work of the Canadian auditors. It also means that decisions about consolidated accounting, financial reporting and disclosure are made outside Canada.

While the scope of Canadian audit-related work diminishes when Canadian companies are acquired by foreign entities, the requirement for consulting and other advisory services, except tax compliance, becomes even more limited. For example, most international companies have implemented, or are in the process of implementing, global enterprise-wide information technologies and systems so they can seamlessly and efficiently conduct their business across multiple operating locations and countries. The information technology consultants, risk management and internal audit advisors retained to help implement these systems are individuals usually hired by corporate executives outside Canada in the jurisdiction of the company's foreign head office.

Capital expenditures and resource allocation decisions also become more complicated in corporate groups controlled by foreign owners. Whether or not these foreign owners provide their Canadian operations with R&D funding or capital expenditure allocations depends not just on the economics of the situation, but also on internal company “politics” and global strategies developed by the corporate executives in foreign headquarters.

### ***Loss of oversight and accountability***

Foreign ownership also has a serious impact on the board of directors and accountability. Boards of directors of wholly-owned subsidiaries often have a limited role, if any, in such key responsibilities as the selection of the CEO, compensation of the CEO and approval of strategic plans that take into account, among other things, the opportunities and risks of the business many of these responsibilities. Instead, these decisions are more often made by the company’s global corporate executives. The Canadian board of directors, therefore, often provides little “value add” to the organization and so is often staffed by management insiders who operate in a perfunctory manner, provide little effective oversight to the company’s operations and no accountability to Canadian stakeholders.

### ***Loss of investment***

But there is a more serious problem. The reason why shareholders have been persuaded to sell their shares in our landmark Canadian corporate icons is because the foreign acquirer promises to pay them more than the discounted stream of future cash flows that the shareholders might expect to receive by holding onto their shares. Shareholders who “cash out” and sell their shares in Canadian companies in takeovers also believe they will be able to invest the money to earn higher returns elsewhere.

The challenge for Canada is to ensure that the proceeds of “hollowing-out” are reinvested in the next generation of Canadian icons. While the loss of control of Canadian “crown jewel” companies that shift to foreign hands is worrisome, the consequences will be much more severe if it occurs when investors also view foreign markets as being more attractive than Canadian ones.

**Our key message**      Loss of ownership shifts companies’ decision making, supply relationships, intellectual property, oversight and accountability away from Canada. However, protectionism is not the solution.

### **Canada as a destination for foreign investment**

Recent experience suggests that Canada is a very attractive destination for foreign investment. Our country continues to have an abundance of natural resources and our public companies are much sought after targets with high-quality assets, solid management, market position and talent.

The Federal Government’s economic plan, Advantage Canada, announced in 2006, focuses on building a strong Canadian economy through five competitive economic advantages.

1. *Tax Advantage*—Reducing taxes for all Canadians and establishing the lowest tax rate on new business investment in the G7.
2. *Fiscal Advantage*—Eliminating Canada’s total government net debt in less than a generation.
3. *Entrepreneurial Advantage*—Reducing unnecessary regulation and red tape and increasing competition in the Canadian marketplace.
4. *Knowledge Advantage*—Creating the best-educated, most-skilled and most flexible workforce in the world.
5. *Infrastructure Advantage*—Building the modern infrastructure we need.

This framework of aspirational goals points us in the right direction. There are, however, three key factors that may limit our success in achieving these objectives. These are tax policy, which we have discussed with the panel and have summarized above; the aging of Canada’s workforce and the declining competitiveness of Canada’s capital markets are discussed below.

### ***Aging of the Canadian workforce***

Your publication, *Sharpening Canada’s Competitive Edge*, includes an important statement that deserves emphasis and discussion:

*“Given demographic changes in Canada, with projections of an aging population and slower growth of the labour force, Canada’s productivity performance will grow in importance as a determinant of the future well-being of Canadians.”*

The aging of Canada’s population and its workforce is not a new phenomenon; both Statistics Canada and the Conference Board of Canada have tracked and reported the demographic changes occurring in Canada. In an article published in the *National Post* on November 5, 2007<sup>3</sup>, Glen Hodgson, the Chief Economist of the Conference Board outlined three options for addressing this issue:

*As labour market conditions tighten further, Canadians will have to choose between accepting slower potential economic growth and its consequences, or adapting. If we choose not to adapt, real incomes will stay high (since labour shortages will translate into upward pressure on real wages), but slower growth will inevitably translate into slower revenue growth for governments, making it harder to deliver quality public services -- like health care. Yet the demands of an ageing population will mean higher real costs for those same public services, placing pressure on the fiscal framework of our governments. The Conference Board's fiscal projections suggest that provincial fiscal deficits could re-emerge as early as 2013, which would mean an eventual choice between deficits, higher taxes or a decline in public service such as further de-listing of specific health care services.*

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<sup>3</sup> “Three options for the coming labour crunch,” Glen Hodgson, *National Post*, 5 November 2007

*If Canadians do not want to meekly accept slower economic growth and its consequences, we need to become more active in changing government policies and improving organizational practices at all levels, based on three basic options:*

*The first option is to rethink the workforce and boost the rate of labour force growth. A more aggressive and integrated immigration policy, enhanced efforts to retain older workers, expanded use of aboriginal workers and higher participation rates for women would all be part of an effort to boost labour force growth.*

*A second option is to boost productivity growth – through increased investment, elimination of barriers between the provinces, increased competition in specific sectors and investment in infrastructure. We need to invest more in new plant, in machinery and equipment (M&E), but also in the workers that will use the more advanced technology. M&E investment spending grew at a good pace up to 2007, but has faltered this year despite the competitive pressure of a dollar beyond par. Education spending for all governments has fallen as a share of GDP over the past decade, and private firms have sustained, but not increased, their expenditure on training. These trends are not compatible with stronger productivity growth.*

*And the third basic option is to restructure our economy, and individual firms, through greater reliance on off-shore outsourcing and through more investment abroad. American business has moved significant amounts of standardized, labour-intensive manufacturing production offshore over the past decade, but Canadian firms have not followed suit to the same degree. Will we see a more aggressive off-shoring response from Canadian firms in the years ahead?*

*These options are not mutually exclusive. If we choose, all three options can be implemented simultaneously. But let there be no doubt about the demographic fundamentals: We are already at the transition point from labour surplus to labour shortage. The Canadian labour market crunch has arrived.*

Mr. Hodgson provides an excellent analysis of the consequences facing Canada as its population ages, and the options for addressing that situation. Our firm's experience in working with Canadian companies suggests that few Canadian organizations have yet to seriously consider this issue, let alone begin to address it in a meaningful way. Our belief is further supported by a 2007 survey of 1,300 companies conducted by Manpower Canada, which found that two-thirds of employers in Canada have no strategy for recruiting or retaining workers aged 50 or over. Only 17 per cent have a plan to recruit such workers and only 24 per cent have a strategy to retain them.

These demographic changes will not only have a significant impact on Canada's long term competitiveness, but if they are not addressed effectively they also have the potential to counter advances we might make in other areas. While all of the options put forward by Mr. Hodgson are worth pursuing, we believe the greatest benefits will be achieved through boosting productivity growth and restructuring our economy to take advantage of offshore outsourcing

and investments abroad (see our discussion below on improving our position on global value chains).

### ***Competitiveness of our capital markets***

Enhancing Canada's competitiveness will require capital. Canadian equity markets are not only attractive hunting grounds for foreign buyers seeking takeover opportunities, they are also a critical source of capital that is central to financing our competitiveness and our future.

The attractiveness of Canadian capital markets is influenced by things such as corporate law, tax incentives for domestic investors, tax incentives for foreign investors, and the regulatory and litigation environment in which these capital markets operate.

In September 2006, the final report of The Task Force to Modernize Securities Legislation in Canada observed:

*Businesses which cannot access capital at an efficient price, through an efficient market will be slow to prosper, if at all. Wages they pay will be low and employment rationed. They will have no choice.*

*If Canada wants domestic capital flows to shop at home for properly risked returns and to attract internationally capital flows, it must provide a capital market which excels in every aspect.*

*There is no other choice but to excel and it is a choice which affects us all.*

How well have Canadian capital markets performed? First, some good news:<sup>4</sup>

- The TSX increased 19.9% in value and 17.1% in volume in 2007
- Over the last four years, only the NYSE and the London Stock Exchange have consistently been the sources of more financing than Toronto Stock Exchange.
- The TSX is a "window" into the U.S. capital markets and has more U.S.-based listings than any exchange group in the world outside the United States. At the end of December, 2006, the TSX had 205 U.S.-based listing compared to the LSE and AIM, which had just 79 U.S.-based listings.
- Last year, approximately 40% of trading on TSX came from the United States.
- The TSX is the world leader in mining; almost 60% of the world's mining companies are listed on the TSX. The TSX is also the number one exchange in terms of oil and gas listings; almost 50% of the world's public energy companies are listed on the TSX.

There are clouds on the horizon, however, and they are being driven by the winds of globalization and Canada's ability to deal with them. Many foreign capital markets have reorganized and repositioned themselves in a way that has significantly improved their

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<sup>4</sup> From the TSX website.

attractiveness to both investors and companies seeking to raise capital. Canadian capital markets, on the other hand, are losing the leadership roles they once played.

For instance, Ian Delaney, the executive chairman of Sherritt, one of Canada's largest miners, suggests that Canada is no longer the world leader in financing mining companies and he blames poor policy decisions for costing Canada its crown as the best place in the world for mining companies to raise capital.<sup>5</sup> "It's a shame," Mr. Delaney told the *Globe and Mail*. "We had it and lost it because of a complete policy vacuum and a leadership vacuum." It is Delaney's opinion that London has become the world's top mining hub, usurping the place of Toronto and Vancouver. "That's because the British government has implemented policies to attract and retain industry investment."

SEC Chairman Christopher Cox has reported that the number of global IPOs more than doubled in recent years, increasing from 839 in 2002 to 1729 in 2006. It came as a great surprise to the Americans, however, that 90 percent of the companies around the world are choosing to go public by listing on their domestic exchanges, an indication of the greater depth and liquidity to today's global markets.

In 2006, European exchanges raised the most capital – 39% (US\$95 billion) of the total IPO capital raised in that year. Asia-Pacific exchanges were second, with 35% (US\$85.5 billion), and North American exchanges had 19% (US\$46.3 billion). These numbers suggest that U.S. and Canadian capital markets face significant challenges in competing effectively with their global counterparts.

The world's stock exchanges are globalizing and consolidating. In the past year, the New York Stock Exchange combined with Euronext, and will now acquire the American Stock Exchange; Nasdaq has bid to acquire the OMX exchange in Stockholm; Borse Dubai has invested in Nasdaq and in the London Stock Exchange; Eurex Frankfurt has acquired the U.S.-based International Securities Exchange; the Chicago Board of Trade has combined with the Chicago Mercantile Exchange; and the London Stock Exchange has merged with Borsa Italiana.

Richard Nesbitt, the outgoing CEO of the TSX, discussed the reasons for this round of consolidation in a speech delivered to the Canadian Club in Montreal on November 26, 2007<sup>6</sup>. He stated:

*And the increasing tendency to consolidate cash and derivative markets made clear that the emerging global market model was not a specialized market in one asset class or another but a multi-asset model with an integrated cash-derivative model at the core.*

Nesbitt then used this concept to explain the NYSE actions:

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<sup>5</sup> "‘We're done. It's over'; Delaney says poor leadership is fuelling the loss of head offices and investment," Andy Hoffman, *The Globe and Mail*, 25 May 2007

<sup>6</sup> Montreal Canadian Club, Remarks for Richard Nesbitt, November 26, 2007.

*NYSE, having concluded its deal with Euronext – itself a product of European market consolidation – is now made up of not one equity exchange but six, and not one options exchange but six. It is also in the hunt for another North American derivatives exchange to strengthen its place in this market.*

In Canada, the TSX announced in March 2007 that it had formed an alliance with International Securities Exchange – ISE – to create a new Canadian Derivative Exchange, to be known as DEX. In December, the TSX announced an offer to acquire the Montreal Exchange Inc. to create the new TMX Group Inc. This transaction will be voted on at a special general meeting of MX shareholders to be held in Montréal on February 13, 2008.

Given the current global environment, this consolidation of Canadian equity and derivatives exchanges makes good competitive sense, as did the consolidation of Canada's six equity exchanges a few years ago. What remains to be seen, however, is whether the new TMX Group will be competitive enough to succeed the rapidly consolidating and evolving global market place. Similarly yet to be seen is what this consolidation will mean for Canadian companies seeking to raise the capital they need to be competitive. Will Canada be shut out of these new global exchange networks that are being created? Or will the TMX Group be yet another chapter in the Canadian "hollowing-out" saga?

Investors are also globalizing. Between 1980 and 2005, gross trading activity (purchases and sales) in foreign securities by investors in the United States grew from \$53 billion to \$7.5 trillion. Foreign trading activity in U.S. securities also exploded during this period, growing from \$198 billion in 1980 to \$33 trillion in 2005.

#### Free trade in securities

The question now being debated in financial centres around the world is "free trade" in securities. Commissioner Annette L. Nazareth of the U.S. Securities and Exchange Commission posed the question as follows<sup>7</sup>:

*So, the question is whether we should grant a foreign exchange some sort of exemption from U.S. exchange registration, subject to certain conditions, if the foreign exchange is subject to "comparable" regulatory oversight. In return, we could expect the foreign jurisdiction to afford comparable treatment to U.S. markets, that is, allow U.S. markets to operate in the foreign jurisdiction on comparable terms. This "mutual recognition" would represent a very positive step forward and would present significant opportunities for U.S. investors and firms.*

This is where Canada has a problem. In a world of "multi-asset" global exchange networks with "free trade" in securities, the quality of securities regulation becomes critical. In a world of "mutual recognition," however, a Canadian securities regulatory regime that is administered by 13 provincial and territorial securities regulators is unlikely to measure up to global standards and raises questions as to whether Canada will be left out of the free trade in securities

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<sup>7</sup> "Remarks before the securities industry and financial markets association annual meeting," Annette L. Nazareth, November 9, 2007

agreements, thereby not only disadvantaging investors but also hampering the ability of Canadian companies to raise capital.

Concerns about Canada's lack of a national securities regulator are not new. Thirteen separate regulators creates a duplication of effort, unnecessary extra costs, the need to negotiate between provincial regulators, conflicting policy positions, and—most importantly—ineffective enforcement. Our current regulatory system is symptomatic of the Canadian policy of maintaining competitive or duplicate domestic regimes at the expense of our overall global competitiveness.

In an environment in which globalization is transforming capital markets and their regulators, maintaining our current regulatory framework is a burden. Barbara Stymiest, the current COO of RBC and former CEO of the TSX Group, has described our securities regulatory system as “archaic” and says it “makes our capital markets less attractive and somewhat of an international embarrassment.”<sup>8</sup> If so, then how will Canada convince the U.S. and other countries to allow us to participate in “free trade in securities” based on the principle of mutual recognition?

But there is a deeper problem that impacts the competitiveness of Canadian companies. The Task Force to Modernize Securities Legislation has stated:

*“recent research has indicated that the cost of equity capital in Canada is 25 basis points higher than that in the United States. Researchers compared valuation multiples of firms in listed in Canada and in the U.S. holding all relevant factors constant and observed that multiples were higher in the U.S. market by about 10 percent.”*

The existence of a “Canadian discount” impacts all Canadian public companies and places yet another burden on them as they strive to be globally competitive.

We, therefore, urge the panel to consider the question of who is responsible for ensuring our Canadian capital markets are globally competitive.

Never has the issue of the competitiveness of our capital markets been more important than now. The policy vacuum described by Mr. Delaney and the archaic regulatory system portrayed by Ms. Stymiest will almost certainly ensure that it will not be addressed. As a result, the Canadian discount will continue to exist and Canadian companies will continue to face additional constraints in getting the capital they need to be globally competitive.

Two objectives drive securities legislation in Canada: to protect investors and to foster fair, efficient capital markets as well as confidence in these markets. We strongly support the recommendations made in the reports of both The Task Force To Modernize Securities Legislation in Canada and the Five Year Review Committee established to review securities

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<sup>8</sup> “Canada's regulations a global ‘embarrassment’; Single market ‘a better solution,’ conference told,” Bertrand Marotte, *The Globe and Mail*, 11 September 2007

legislation in Ontario, both of which urged that securities legislation be broadened to include maintaining the competitiveness position of Canada's capital markets.

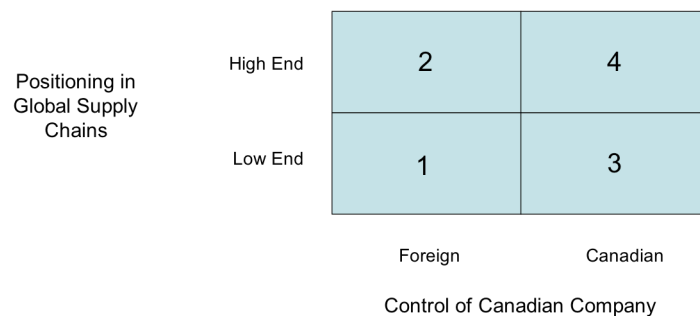
**Our key message** Canada's aging workforce and the increasing competitiveness of many foreign capital markets are risks to Canada's ability to attract foreign investment. Securities legislation be broadened to include maintaining the competitiveness position of Canada's capital markets.

## Improving our positioning in global supply chains

The panel has specifically asked for views on ways that Canada can improve its positioning in global supply chains.

"Sharpening Canada's Competitive Edge" indicated that Canada's goal should be to make itself the location of choice for the higher-value elements of the global value chains – whether led by Canadian firms or as part of others' supply chains – as higher-value productive activity translates into higher wages and salaries, more occupational choice and a better quality of life for Canadians. We agree fully with this statement.

The following diagram illustrates the positioning of Canadian companies in global supply chains.



Quadrant one contains Canadian companies that are foreign-owned and operate at the low end of global supply chains. The foreign owners of Canadian companies in this quadrant typically focus on improving the productivity and efficiency of these Canadian subsidiaries, but they usually have little incentive to move their Canadian operations to a higher position on the supply chain (Quadrant two). In fact, these companies are among the most likely to be moved out of Canada to lower cost jurisdictions. However, almost all of their design and R&D activities are often undertaken outside the country, a situation faced not just by Canada but by others that operate on the lower end of global value chains. For example, ThinkPad notebook computers are made by the Chinese company, Lenovo, however much of the research and development for these computers is undertaken in the United States.

Quadrant three contains Canadian controlled companies that operate at the low end of the global supply chain. While the opportunity exists for these companies to move up the global supply chain (Quadrant four), doing so requires capital, innovation and leadership. We believe that, to

move to quadrant four, Canadian companies would also need to be much more aggressive in making foreign acquisitions so that they extend their ownership across the entire global supply chain.

**Our key message** Canadian companies must move from the lower end of the global value chains to higher positions, which requires capital, talent and leadership. The current strength of the Canadian dollar may provide a unique opportunity that should not be missed.

### **Importance of leadership by boards of directors and CEOs**

Much has been written about Canada's poor record of productivity. In *Sharpening Canada's Competitive Edge*, you state:

*From 2001 to 2005, Canada's average annual productivity growth ranked twenty-first, well below the Organisation for Economic Cooperation and Development (OECD) average, and second lowest in the G7.*

This is a persistent and disturbing fact, which is compounded by the findings of a Statistics Canada study reported in *The Globe and Mail*:

*Productivity growth has been relatively high in foreign-controlled plants compared with domestic plants, and there are productivity spillovers from foreign-controlled plants to domestic producers... Also, mergers involving foreign producers more frequently lead to gains in productivity, wages, profitability or market share than do domestic mergers.<sup>9</sup>*

The need to for Canadian companies to expand their horizons beyond Canada has been made by many researchers and business leaders. Ian Mallory, president of Calgary-based Pickworth Investments LP<sup>10</sup>, recently addressed a Liberal Party of Canada conference, warning that too many Canadian companies aren't aggressive enough in exploring foreign markets.

*"Regrettably, Canada's businesses are not doing their job internationally to bring home the bacon," he said. "Most Canadian businesses are content to stay at home."*

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<sup>9</sup> "Foreign buyouts help economy, StatsCan says; Now owners tend to invest in innovation," Eric Beauchesne, *The Ottawa Citizen*, 14 November 2007

<sup>10</sup> "Canada's regulations a global 'embarrassment'; Single market 'a better solution,' conference told," Bertrand Marotte, *The Globe and Mail*, 11 September 2007

***Elements of competitiveness—how and where we compete***

These two elements of competitiveness – how we compete (productivity) and where we compete (domestic vs. global) – are illustrated below:

How we compete	World Class	2	4
	Not World Class	1	3
		Canada/ North America	Global
		Where we compete	

Most economic analyses indicate that Canadian companies do not operate at world class levels of productivity and performance. As a result, we believe that many Canadian business, if not most of them, operate in quadrant one.

Over the past two decades, most Canadian companies that operated in quadrants one and three were able to do so only because the low value of the Canadian dollar more than offset poor productivity levels and other practices that were below world class. As the dollar appreciated, the less able Canadian companies could compete globally with operations that were below world class levels. These companies now urgently need to take advantage of the dollar's appreciation to invest in new technologies and reengineer their business practices to attain world-class capabilities.

Canada does have companies that operate at world class levels and compete on the global stage (quadrant four). These companies also own or have significant influence over the global supply chains in which they operate. The problem for Canada is that we simply do not have enough of these companies.

Canada also has companies that operate in quadrant two. They have developed world class practices and performance and are, therefore, capable of competing successfully in the global arena. For various reasons, however, they have decided to stay at home. We urge these companies to also take advantage of the dollar's appreciation and give serious consideration to making foreign acquisitions to expand their markets and move up the global supply chain.

In our view, the challenge is not just to improve our productivity performance. It is also to change both the way that Canadian companies compete and where they compete – in other words, we must develop significantly more Canadian companies that operate in quadrant four. The capital requirements necessary to move into quadrant four are significant (e.g., financing global acquisitions), however, which is why Canada must have globally competitive capital markets that can attract foreign investment and support our Canadian companies.

We believe that tax and other incentives must be provided to encourage more investment in technology, training for workers, higher education, and to encourage innovation and R&D, etc. While all of these investments are important, however, our experience is that they will not solve all of our problems. We can't blame our poor productivity performance and "stay at home" attitude entirely on the lack of policies or incentives.

### ***The urgent need for leaders***

What Canada needs is leadership from its CEOs and Boards of Directors. We need more CEOs who have the vision, drive, courage and capabilities to take their organizations into quadrant four. This is, in our view, a critical need for Canada.

Boards of Directors must also play a greater leadership role. In the past five years, many boards have been focused on capital market reform and compliance with new U.S. and Canadian securities regulations arising from the Sarbanes Oxley Act of 2002. It is interesting to note, while boards have been struggling with compliance, the dollar has appreciated by over 50% and significantly changed their organizations' competitive capabilities.

Boards of Directors must make their organizations' global competitiveness a top governance priority. After all, it is the board that hires, evaluates and agrees the compensation for the CEO, and approves the organization's strategy, which outlines how and where it competes.

In our view, Canada does not have enough directors with the experience, vision and courage to challenge a "stay at home" CEO or to advise and counsel a CEO on the ways to move the organization into quadrant four. We need directors with business experience and international experience. That includes a need to find ways to enable Canadian directors, and directors in board leadership roles, to join boards of foreign companies so they can develop international board experience.

In this regard, the chairman of the board has an important role to play. Most Canadian public companies have separated the role of CEO and chairman of the board. The board's effectiveness in addressing governance issues is highly correlated with the capabilities of its chairman. We would be pleased to provide the panel with further thoughts on ways to make global competitiveness a governance priority for boards of directors, and ways to enhance the capabilities of Canadian directors and those directors in leadership roles.

**Our key message**      Canada must develop more board and executive leaders with the vision, drive, courage and capability to build globally competitive Canadian organizations.

### **International financial reporting**

Accounting and financial reporting is the language of commerce. For the past 30 years, the Canadian Institute of Chartered Accountants has been pressed to harmonize the standards for Generally Accepted Accounting Principles (GAAP) and Generally Accepted Auditing Standards (GAAS) with those of the United States. As a result, many of the differences between U.S. and Canadian GAAP have been reduced.

Recently, the CICA decided to end its efforts to align Canadian GAAP with US GAAP and to instead adopt International Financial Reporting Standards (IFRS), which are set by the International Accounting Standards Board. In moving to IFRS, Canada joins more than 74 countries, including China, the UK, South Africa, Australia and the European Union, that have either adopted IFRS or plan to do so in the near future.

Choosing to align our financial reporting standards with global standards rather than U.S. standards is consistent our belief that Canada must be able to compete globally, and not just compete in North America. IFRS is the global yardstick. When IFRS is implemented, Canadian accountants will be operating at world class accounting and auditing standards and be capable of auditing, advising, and working in finance functions of global companies. More importantly, the language of commerce for all Canadian companies, both private and public, will be the global language, which will facilitate them in their move into quadrant four and in making international acquisitions, building international analyst followings, and communicating with international investors and lenders etc.

**Our key message** accounting is the international language of commerce and Canada's decision to adopt International Financial Reporting Standards (IFRS) is a significant step in helping Canadian companies become globally competitive.

## **Conclusion**

Sharpening Canada's competitiveness is a complex and challenging task. We have highlighted areas we believe have both immediate and longer term impact on Canada's competitiveness.

In summary, improving our competitiveness is dependent on improving the way we compete (e.g., productivity) and where we compete (e.g., globally), which we have described as quadrant four—becoming world class with the ability to compete globally. Getting to quadrant four requires many things, competitive capital markets, appropriate tax policies, relevant investment and competition policies and much more. Most of all, it requires leadership—from CEOs and Boards of Directors.

Having world class companies competing globally is the key to Canada's future. If we want this future, we must have the courage and be prepared to fight for it.

Yours truly,



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