UPWARD AND OUTWARD: CANADA'S COMPETITIVENESS IMPERATIVE

Thomas d'Aquino

In an era of intensifying global competition and free investment flows, what must Canada do to build and retain large, internationally successful businesses? In its final report, the Competition Policy Review Panel concluded that the best defence against the so-called "hollowing out" of corporate Canada is a strong competitive offence. Thomas d'Aquino agrees, and adds that this strategy must focus on one central goal: encouraging more Canadians to unleash their creative potential at home and on the world stage. We must encourage large enterprises to continue expanding domestically and internationally — and we must encourage more of our dynamic smaller enterprises to grow into the next generation of global champions. Combining leading-edge entrepreneurial vision and sound public policies, Canada can fulfill the Canadian Council of Chief Executives' vision of making our country "the best place in the world in which to live, to work, to invest, and to grow."

En cette ère d'intensification de la concurrence mondiale et du mouvement des investissements, que doit faire le Canada pour créer et pérenniser des entreprises performantes à l'échelle mondiale ? Selon le rapport final du Groupe d'étude sur les politiques en matière de concurrence, la meilleure défense contre l'achat de grandes entreprises canadiennes par des intérêts étrangers réside dans une stratégie concurrentielle offensive. Thomas d'Aquino confirme, ajoutant que cette stratégie doit viser à inciter les Canadiens à faire valoir leur potentiel créatif. Nous devons encourager nos entreprises à poursuive leur expansion nationale et internationale, précise-t-il, tout en favorisant l'essor des petites entreprises dynamiques qui formeront la prochaine génération de champions mondiaux. En combinant vision entrepreneuriale de pointe et politiques publiques éclairées, le Canada pourra devenir « le meilleur endroit au monde où vivre, travailler, investir et prospérer », conformément à la vision du Conseil canadien des chefs d'entreprise.

As an organization made up of chief executives and leading entrepreneurs, the Canadian Council of Chief Executives (CCCE) has an obvious and direct interest in the question of what Canada must do to build and retain globally successful businesses with a robust head-office presence in our communities. It is an issue that we have grappled with for many years, and also was the focus of the Competition Policy Review Panel, which issued its final report in June 2008.

The panel, headed by Lynton (Red) Wilson, was appointed in 2007 with what seemed to be a fairly narrow mandate, to consider changes to competition and foreign investment policies in the wake of a string of high-profile foreign takeovers of Canadian companies. But the panel came to much the same conclusion as we did: that the best defence against any "hollowing out" of corporate Canada is a broad and bold competitive offence.

The presence of large, internationally engaged corporations with substantial head-office operations matters a great deal to the well-being of all Canadians. As centres for corporate decision-making, head offices create clusters of well-paid jobs both directly and in related service industries.

They are drivers of innovation both within their companies and through business relationships and research partnerships. They provide a focus for business investment in communities, providing private-sector leadership for charitable causes, education, health care and cultural activities. They also play a crucial role in the growth of other companies, whether by spinning off operations, providing capital to new ventures or simply offering opportunities for local enterprises to move onto a larger stage at home and abroad.

Large businesses are vital to the well-being of Canadians in another way too: they are huge generators of tax revenue

for governments. While Canada, like other countries, has been cutting its corporate income tax rates in recent years, revenue from this source has continued to grow. And this is just one part of the tax story. A study published in May 2008 by PricewaterhouseCoopers (PwC) looked at the total tax contribution of 39 large Canadian enterprises, with average annual revenues of $4.8 billion and including publicly traded companies representing 61 percent of the market capitalization of the S&P/TSX 60 Index. The study found that in 2006, these companies paid a total of $10.5 billion in 34 different forms of tax — and also collected and passed on to governments another $19.8 billion in other taxes generated by their activities. For every dollar in corporate income tax, they paid a further 82 cents in other taxes and 67 cents in non-tax levies such as resource royalties, and generated an additional $3.41 worth of tax revenue from their activities.

The presence of large, internationally engaged corporations with substantial head-office operations matters a great deal to the well-being of all Canadians. As centres for corporate decision-making, head offices create clusters of well-paid jobs both directly and in related service industries.

Why do large companies generate so much tax revenue? In part, it is because in a relatively small market like Canada's, large companies inevitably are engaged beyond our country's borders — tapping into global supply chains, exporting goods and services, investing in international operations, hiring global talent and seeking investment abroad. Microeconomic research long ago established that multinational companies, both Canadian and foreign-owned, tend to be more innovative and have higher productivity, investing more in research, in employee training and in developing products for export. It is no surprise, therefore, that the companies in the PwC study paid an average salary of $60,428, some 60 percent higher than the national average.

Another striking finding of the PwC study was that even within this group of large enterprises, the ones at the top of the heap made a disproportionately bigger contribution to government coffers. The top 10 companies alone (a quarter of the sample) accounted for about two-thirds of all the taxes paid and collected. This in turn reinforces the importance to Canada of building large, globally engaged enterprises in our communities.

In this context, it was not surprising to see media coverage of the Wilson report focus on its recommendations for greater openness to foreign investment. News coverage and commentary suggested that higher thresholds for government review of foreign takeovers and expanded limits for foreign investment in currently protected sectors could lead to another rash of high-profile takeovers. It reinforced worries that the story of the steel and beer industries, where no major Canadian-owned players remain, could be repeated in other key sectors of our economy.

What the Wilson panel recognized, however, is that ownership is not the most critical issue when it comes to building and maintaining head-office jobs. Many wholly owned subsidiaries of multinational enterprises have extensive head-office operations in Canada, often with continental and even global responsibilities and product mandates. By the same token, as Canadian companies grow globally, they set up operations abroad and recruit talent internationally. Over time, the result can be a significant shift of leadership functions out of Canada even in the absence of a takeover bid.

Canadian and foreign companies alike evaluate on a continuing basis where to carry out their activities, including high-value head-office functions. The takeover of a Canadian company may lead to an initial shift of key decision-making responsibilities out of Canada, but the bigger challenge for Canadian communities is to compete for the high-end jobs of internationally active businesses no matter who owns the shares and where those shareholders live. This is why so much of the Wilson report focused on encouraging greater openness rather than building stronger defensive walls.

The Wilson report does not ignore the need for a level playing field in the merger and acquisition stakes. Indeed, one of its most profound and under-reported recommendations was to give Canadian boards of directors the same defensive flexibility as that enjoyed by companies registered in the state of Delaware, the benchmark jurisdiction in the United States. In particular, the report called on securities regulators to eliminate the current restriction on the use of tactics such as "poison pills" and to get completely out of the business of judging board decisions when dealing with takeover offers, leaving that job instead to the courts. When combined with a more relaxed approach to competition policy, one that would give Canadian companies more flexibility to compete on a level playing field with foreign bidders for Canadian assets, the report's recommendations could have a huge impact in enabling Canadian enterprises to develop and stick to long-term strategic growth plans and reject opportunistic takeover bids.

Indeed, the meat of the Wilson report deals with the need to reinforce the ability of Canadian companies to grow and, in particular, to grow internationally. Ultimately, business growth and not investment restrictions will determine the standard of living of all Canadians.

International growth is critical to increasing private-sector innovation and productivity and therefore to the future health of Canada's economy. One of the most important recommendations made by the Wilson panel effectively calls for a fundamental shift in the way government deals with small and medium-sized enterprises (SMEs). In the past, the policy focus has been on job creation and therefore on maintaining the small businesses that account for the

vast majority of private-sector jobs. But as demographics push Canada further and further into a labour-short economy, the quality of the work Canadians are doing is becoming more important than the quantity of jobs. The panel therefore recommended that instead of blanket support for small business, the policies of federal and provincial governments "should focus on those firms that demonstrate the desire and capacity to grow to become large enterprises."

For now, too few SMEs seem able to grow rapidly or are interested in rapid and continuing growth, with owners often content to settle for moderate prosperity. Even fewer are driven to grow through export sales and international investment. The Wilson panel recommendation would represent a fundamental shift in attitude as well as practice, one that is long overdue. Canada's future prosperity depends on building more large enterprises in our communities. This requires encouraging smaller businesses with ambition and ability to grow outward as well as upward.

Encouraging Canadian businesses to grow globally involves far more than targeted efforts such as expanded access to venture capital. It means taking every opportunity to reduce policy barriers to growth within our regulatory and tax systems. For instance, as federal and provincial governments continue to cut the statutory corporate income tax rate, they should seek to eliminate the differential between the regular and small business rates, which encourages entrepreneurs to keep their companies small. More broadly, governments must be relentless and pervasive in their efforts to make Canada a superb place in which and from which to do business globally.

This is a goal that the Canadian Council of Chief Executives has been pursuing through a wide range of initiatives for more than three decades. In the 1980s, our focus was on opening up the Canadian economy through free trade. In the early 1990s, we concentrated on battling high inflation and government deficits while sponsoring the ambitious review of Canada's competitiveness by Harvard University's Michael Porter.

The top 10 companies alone (a quarter of the sample) accounted for about two-thirds of all the taxes paid and collected. This in turn reinforces the importance to Canada of building large, globally engaged enterprises in our communities.

Through the repeated crises of national unity, we focused on ways to make Canada's federation stronger and its economic union work more efficiently. As deficits gave way to surpluses, we fleshed out strategies for driving productivity and growth through lower taxes in the course of our Canada Global Leadership Initiative. In the wake of the terrorist attacks of September 11, 2001, we returned to the Canada-United States agenda through our North American Security and Prosperity Initiative. After the string of corporate scandals in the United States that triggered the *Sarbanes-Oxley Act*, we blazed the trail toward better corporate governance in Canada. Throughout the long debate over the Kyoto Protocol and global climate change, we have focused on the need for a coherent national approach that will deliver real reductions in greenhouse gases while encouraging innovation and enhancing Canada's economic competitiveness. In 2007, as foreign buyers took control of several high-profile Canadian businesses, we brought thoughtful perspective to the issues of foreign investment and head-office growth. Through it all, we have championed numerous other issues related to competitiveness, from smart regulation to innovation and intellectual property, education and training, immigration, corporate citizenship and both bilateral and multilateral efforts to liberalize trade and investment.

In 2006, the CCCE published a strategy paper, *From Bronze to Gold: A Blueprint for Canadian Leadership in a Transforming World*. This paper argued that Canada must move decisively to shape its future as a creative economy, one in which each Canadian in each region and in each industry brings more value to his or her labour:

> To forge a prosperous future as a creative economy, Canada must compete much more effectively on three fronts: people, ideas and money. It must do better at unleashing the creative potential of all Canadians and at attracting more talented people to our country. It must do better at encouraging Canadians to generate innovative ideas and to put these ideas to effective use. Finally, Canada must make itself a much more attractive place for individuals and companies to invest in innovative technologies and new ventures.

Now consider what the Wilson panel described as the essential elements of a competitiveness agenda: lower taxes; attracting and developing talent; head offices and cities; business growth; corporate governance; Canada's economic union; Canada-United States relations; international trade and investment; smart regulation; innovation and intellectual property.

The CCCE and the Wilson panel share a recognition that the solution to the competitiveness challenge is not a single silver bullet, but a shotgun shell full of many policies aimed in the same direction. Our competitiveness strategy also must be dynamic, anticipating and responding to an ever-changing global environment.

This is especially important when it comes to tax policy. The Wilson panel set out a bold vision and direction, but left the door open to others to flesh out key elements. In particular, it highlighted the work now being done by another external panel, the Advisory Panel on Canada's System of International Taxation, headed by Peter Godsoe, former CEO of the Bank of Nova Scotia.

The CCCE submission to the Godsoe panel made six strategic recommendations:

- Make Canada's tax rates attractive

internationally, to draw business investment and talented people, and to reduce the need for complex and costly rules to protect the tax base;
- Maintain a level playing field for Canadian and foreign investors in Canada, to ensure that Canadian-based enterprises are treated fairly when bidding for acquisitions in this country;
- Avoid discouraging Canadian-based enterprises from investing abroad, in particular by reversing the 2007 tax change limiting the deductibility of interest on money borrowed for investment in foreign affiliates;
- Simplify Canada's international tax system, notably by moving to a full exemption system for foreign business income;
- Make Canada a magnet for talent and creativity by ensuring that the country's personal tax rates are attractive to highly skilled and internationally mobile people; and
- Ensure transparency and consistency in making tax changes, so that the consequences of proposed changes are fully understood and that investors are not subject to effective retroactive penalties on decisions made in good faith under existing rules.

An international tax policy that supports foreign investment by Canadian-based enterprises is particularly important for a relatively small economy like Canada's, because investment abroad drives both trade and the growth of Canadian businesses. The Organisation for Economic Co-operation and Development (OECD) has estimated that each dollar of outward direct investment generates two dollars of additional exports for the originating country. In this context, the 2007 federal budget pushed the tax system in precisely the wrong direction. As the Wilson panel pointed out, the 2007 budget measures affecting interest deductibility "will not enhance Canadian tax revenues but will disadvantage Canadian companies seeking to become global players."

Tax policy matters a lot both to business investment decisions and to the choices made by talented individuals about where to live and work, but it is not the only answer to Canada's competitiveness challenge. In 2007, for instance, the CCCE established a joint research project with Industry Canada to look deeper into the issue of private-sector research and development. We surveyed CEOs to ask what factors were enabling and limiting investment in innovation by Canadian companies. We also asked about the factors that affect decisions by multinational enterprises on whether to invest in innovation in Canada or somewhere else. The most striking finding was that despite Canada's strengths in terms of skilled people, the two most important drivers of location decisions are the regulatory regime and the treatment of intellectual property — and these factors also were ranked as Canada's two greatest weaknesses.

This reinforces the point that in the intensifying global competition for people, money and ideas, Canada must pursue a multifaceted strategy. But this strategy must focus on one central goal: encouraging more Canadians to unleash their creative potential on the global stage. To continue funding our generous social safety net and high quality public infrastructure, our economy needs more of the high-quality jobs that flow from international expansion by large and growing Canadian enterprises. We must encourage existing large enterprises to continue expanding globally from homes in Canadian communities. And we must encourage more of our dynamic smaller enterprises to grow into the next generation of Canada's global champions.

If many of the prescriptions put forward by the Wilson panel seem familiar, it is because we have known for years much of what needs to be done. Our challenge as a country now is to seize the opportunity and get on with the job.

Thomas d'Aquino is chair of the Canadian Council of Chief Executives' Competitiveness Initiative and the Canadian Advisory Group to the North American Competitiveness Council. He is the co-author along with David Stewart-Patterson of Northern Edge: How Canadians Can Triumph in the Global Economy.