INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

Seizing Global Opportunities

Building Strength Upon Strength

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To Calgary Chamber of Commerce

March 5, 2008

Sponsored by:

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Building Strengthen Upon Strengthen

Good morning. It’s great to be here in Calgary – the heart of the oil patch and one of Canada’s most vibrant centres of growth. As head of the Investment Industry Association of Canada, I am intensely interested in economic development as it takes shape in centres like Calgary, as it takes place nationally, and as it enables Canada to prosper as a dynamic G7 country on the global stage. IIAC is dedicated to building an investment climate that fosters such growth locally, nationally, and internationally.

Given my concern with Canada’s ability to create wealth, I was struck by what I learned on my recent trip to the Far East. I saw first-hand the unbelievable growth taking place in that part of the world. The head of the Hong Kong Exchange and Clearing Inc. summed it up when he told me: “We’re going to have a number of large stock exchanges in this part of the world. They will be growing faster than those in the developed world.” He pointed to the soaring wealth and power of mega-companies like China Mobile, PetroChina, and the Industrial and Commercial Bank of China (ICBC).

That trip made me realize more clearly than ever that the twenty-first century world in which Canadian firms must compete will be dramatically different from the one we knew only a few years ago.

Today, I would like to talk to you about Canada's place in this new global economy and my vision of a competitive strategy that will enable us to prosper. My message to you is that in the new world of global competition, Canada cannot rely solely on its larger firms: it must also develop its smaller niche players.

I'll look first at that new environment and then at how we in Canada can strengthen ourselves to face the challenges of competing globally.

New world of global competition

There is no question about it, the pace of international competition has intensified. That has come from the continuing spread of multinational firms, supply chains that stretch across oceans, and the adoption of new technologies and increased use of brainpower throughout the world. Let's examine these forces for change.

a. Tremendous scale

First, there is the sheer size of global companies – far larger in most cases than any of our home-grown businesses.

The oil patch amply illustrates this point. There are no finer Canadian firms than Petro-Canada, EnCana and Suncor. Their assets have grown enormously in recent years. But when it comes to size, they are simply not in the same league as companies like Exxon Mobil, Royal Dutch Shell, BP and Chevron, which have ten to 20 times the revenues of our own oil companies. It's no wonder these big oil companies and others are moving aggressively into the Canadian oil sands, tapping rich resources in our own back yard.

And these large companies are not just from the developed world. Looking beyond the oil patch, an example is India's Tata Group. It was established in the mid-19^{th} century to help build India's economy. Today, it is a conglomerate with 98 companies in seven business sectors that export to 80 countries. It also operates in a full 85 countries across six continents. Another firm that has a true global presence is Mittal Steel. With roots in the East, it is now the largest global steelmaker in the world with 320,000 employees in more than 60 countries and a leading presence in 26 European, Asian, African and American countries.

b. Broader markets

Second, successful companies are operating in what we might call "mega-markets" that transcend national and continental barriers.

The greatest thrust is coming from the developing world. According to Margaret Leung, General Manager and Global Co-Head Commerce Banking of HSBC, global economic power is shifting to the east. In a recent speech entitled “The Booming Asian Economy,” Leung said that a decade ago, non-G7 markets represented about 35 per cent of global GDP, today they represent 40 per cent and, based on current trends, *non-G7 countries will account for more than 50 per cent of the global economy within 10 years.*

The stock markets of the world reflect this redistribution of wealth in global markets. The Shanghai and Shenzen Stock Exchanges in 2007 led all other exchanges in growth of market capitalization. In 2007, the Shanghai Stock Exchange grew by a whopping 277 per cent, the Shenzen Stock Exchange was close behind with 222 per cent growth and India’s two stock exchanges came in third and fourth place in growth. The TSX Group, in comparison, limped along with a mere nine per cent growth in 2007. The New York Stock Exchange hardly grew at all – one per cent.

c. Innovation and brainpower

The third aspect of the global environment that’s created a new universe of both challenge and opportunity is the increased use of technological innovation. And with it, the demand for brainpower.

Wipro Technologies is a good example of such an innovative firm. Based in India, this company which began as a cooking oil firm in 1966, now focuses on software design, IT services and business consulting. It is valued at over $15 billion and has over 80,000 employees, including 500 at several Canadian locations. And the number of Canadians it employs is growing. Wipro hires top Canadian graduates and then sends them to Bangalore, India, for further training.

As a country that has invested heavily in human capital, Canada deserves its share of this evolving global market for brainpower. According to a 2006 OECD survey, Canada invests 2.4 per cent of GDP on higher education, with the U.S. only slightly higher at 2.5 per cent. All other countries – except Korea which tied with Canada – fell short of that mark.

We must create an environment where Canadian firms can use that brainpower to make inroads into the global economy. For example, Hong Kong is experiencing a huge surge in the demand for services. These are services such as accounting, audit, design, legal, investment advisory, IT and logistics. All areas that call for human capital. We should be there.

What can we do to ensure that the economic sun, which for the moment seems to be rising in the East and setting in the West, in fact shines brightly over our own country?

Seizing the Global Opportunity

We must seize new global opportunities with everything we've got. Canada needs its larger firms to compete abroad, but it also must develop its smaller niche players for these expanding markets. It must build strength upon strength.

a. Our larger companies are doing a good job

Many of our biggest companies are doing an excellent job. They may not be world beaters in size, but they remain dynamic businesses.

If you've checked your RIM Blackberry recently, you have a good example of what I mean. Bombardier sells its transportation equipment around the world. The Thomson Group has evolved from newspapers to electronic media. Magna is an important automotive supplier not only in Canada, but also in a long list of countries.

Our major banks and financial institutions have all expanded beyond our borders. Next to Royal Bank, Manulife Financial is the largest Canadian company. It is also one of the five largest insurance companies in the world, and now serves millions of customers in 19 countries and territories worldwide.

I'm pleased that Minister Flaherty in last October's Economic Statement gave Canadian businesses some important tax breaks. Ottawa reduced the corporate income tax by one per cent in 2008, and it is committed to bringing the corporate tax rate down to 15 per cent by 2012 from more than 22 per cent today.

b. We must also strengthen our smaller companies

But we can't simply rely on big firms. We must also encourage our small firms, those with fewer than 100 employees, and our medium-sized companies, those with between 100 and 500 employees. These firms nicknamed *small and medium-sized enterprises* or *SMEs*, for short are niche players. And if we nurture them, they can become much more than that.

We see SMEs from Scandinavia, Israel, and Australia flourishing on the global stage. For example, a group of firms in the Australian wine industry succeeded in the face of tough international competition. They did so by entering non-traditional growth markets, including China, India, Thailand and Japan, matching brand styles and prices to specific regions, and developing consistent supply and quality. Canada has a great wine industry. We could be there too!

SMEs, are collectively of great importance in the Canadian economy. Canada has 2.3 million of these businesses. They are a powerful engine for job growth. In fact, they've done a much better job of creating employment than have the largest firms. According to statistics provided by Industry Canada, between 1993 and 2006, small firms created 780,000 new jobs, and new positions at mid-sized firms totaled 263,000. That's a lot better than large companies, which shed 44,000 jobs.

Collectively, the impact of these smaller firms is striking. In 2006, according to Statistics Canada, just under half, or 49 per cent, of private sector employment in Canada was supplied by small and medium-sized enterprises. And according to the Canadian Federation of Independent Business, the SME sector accounted for fully 45 per cent of the nation's gross domestic product. Any plans for growth must include these dynamic companies.

What are these companies like? Let me illustrate with some concrete examples drawn from the world of small and medium-sized enterprises. There are literally hundreds of good case studies to choose among. I'll limit myself to three that show the diversity of small and medium-sized businesses driving Canadian growth. Each of the three has grown rapidly, and each of the three gains most of its revenue from export sales.

Coastalcontacts.com, a Vancouver-based company, sells contact lenses online. Between 2001 and 2006, its number of employees grew from 8 to 164, and its revenues climbed from less than $3 million to more than $80 million. Coastalcontacts grew by deciding to become a global brand, and by making strategic acquisitions in Sweden, Japan, Singapore and the Netherlands. Over 90 per cent of its revenue now comes from outside Canada.

My second example, Digital Oilfields, now called DO2 Technologies, is another remarkable small business success story. This company, with its head office here in Calgary, provides business process solutions to oil and gas companies. Between 2001 and 2006, it grew from 19 to 77 employees, while revenues soared from less than $200,000 to $12 million. DO2 does a thriving business here in Canada, but gains most of its income from export sales.

The third example, Kaboose Inc., based in Toronto, is a shining example of a great Canadian small business that's grown into a medium-sized company. Kaboose is like Yahoo on a smaller scale. It provides a web portal for parents who want to plan constructive activities for their children. Between 2001 and 2006, its revenues soared from $650,000 to over $20 million, and its employees rose from 8 to 155. Almost all its revenues are generated from sales outside Canada.

These companies deserve our admiration. They are job-creation machines and export earners. From their ranks will come the next RIM, or CAE, or Bombardier. In fact, every year, over 40 companies graduate from the TSX Venture Exchange to the TSX Exchange. And another group of Venture companies, perhaps 12 or 15 a year, are acquired by TSX listed firms.

The Steps We Must Take to Grow the SMEs

We need to grow these smaller companies, and we have to do better than we've done up to now. It's true that some smaller companies jump from the Venture Exchange to the big board of the TSX – but many more should. Those 40 companies that move up each year represent only a small fraction of the 2,000 plus firms on the Venture Exchange. There are many at entry levels, but as they get to the $50 million range, we find fewer and fewer of these companies. Why? Some can't find the needed risk capital. And some of the most promising ones are picked off by foreign firms For example, Lion Ore was recently bought by a Russian firm, and several years ago, Canadian Hunter by an American firm.

How can we best help these job and prosperity incubators succeed while still letting market forces prevail? Here are five steps that governments – both provincial and federal – should take.

First, the government should reduce the capital gains tax for small and mid-sized companies. This is something that my Association has been pushing for. We were disappointed that last week's federal budget did not provide capital gains tax cuts. Why are these tax cuts important? I've given you a few success stories. But there are many entrepreneurs who try and don't succeed. In some cases, they mortgage their houses, borrow from family and friends – and lose it all. Business is about risk-taking, and that's the way it should be. But we have to encourage that risk taking, not discourage it.

Reducing the tax rate on capital gains earned on the common shares of private companies and mid-sized companies listed on the TSX and TSX Venture Exchange improves the after tax return of the shares of these businesses to compensate for the higher investment risk.

A Statistics Canada survey of the SME sector provides strong support for this suggestion. According to the "Survey on Financing of Small and Medium Enterprises," levels of taxation stand as the greatest external obstacle to business growth and development among small and mid-size firms. More than half of those polled pointed to this problem.

Tax policy, in fact, punishes growth. Small companies earning up to $400,000 in profits are taxed at about 17 per cent, but earnings above that are taxed at 33 per cent. As well, when companies go public or grow beyond $15 million in assets, their tax rate increases. Furthermore, small private companies are eligible for $500,000 capital gains tax exemption on their shares. The exemption disappears when they grow in size or become public. Tax policy should encourage, not discourage, growth.

Second, we should provide enhanced tax credits for R&D expenditures. Small companies are innovators, they have to be. People may buy IBM solutions because of the company's name. But when Digital Oilfields began, or other similar companies started up, no one had heard of them. They landed their sales because they could convince tough-minded buyers that a new company offered a better product. And that meant the application of technology. It's no secret that R&D expenditures are lower in Canada than in most G7 nations.

Let's give a tax break to companies that engage in R&D to produce better and more competitive products. And let's continue to support them with R&D tax credits as they grow. Today, Canadian-controlled private corporations can claim a 35 per cent federal R&D tax credit, but as they grow, that claim is reduced to 20 per cent. When they become public, they get nothing. Why penalize small businesses for success?

While the Association is pleased that last week's federal budget expanded and enhanced the flexibility of Scientific Research & Experimental Development (SR&ED) credits, the measure will still benefit just small private companies. We are disappointed that the Budget failed to recognize the needs of the provinces and provide sufficient incentives for small and mid-sized public and private companies to raise risk capital and improve their competitiveness.

Third, we should encourage close working relationships between the business community and our universities and colleges. We're already doing this in several Canadian centres. We have to do more of it, and make those links still more productive and more open to small and medium-sized businesses, to improve innovation and competitiveness.

The business and academic linkage has demonstrated success in several parts of Canada. The cluster of businesses that have grown up around University of Waterloo is one example. RIM is the brightest star in that galaxy. There were some years when RIM hired all the Waterloo grads with a specialization in computers and telecommunications.

I'm also impressed by the links that have developed in Saskatoon between business and the university. Saskatoon is now recognized as one of the world's leading centres of excellence in agricultural biotech research and boasts about 30 per cent of Canada's biotech activities.

And here in Calgary you have a partnership between the City of Calgary and University of Calgary. Called the Urban Alliance, it is a research program that will help develop the city's transportation system and the broader urban environment.

We have to allow smaller companies, with less of a research budget, to take advantage of these collaborative opportunities. Let's use this resource to help smaller companies stand out in world markets.

Fourth, we must improve the efficiency of our capital markets, so that small companies can make the leap to becoming mid-sized ones, and mid-sized firms can continue to grow.

A recent poll indicated that over a third of those surveyed in small and mid-sized businesses cited securities regulation as a serious obstacle to growth. The 2007 paper by the Canadian Bankers Association (CBA) demonstrated that our current decentralized regulatory system limits SMEs' ability to tap into all of Canadian capital market and imposes high costs on smaller firms. The CBA estimates that if a firm wants to raise capital in all 13 jurisdictions, the regulation-related costs would double, to 16 per cent for a firm seeking to raise $1 million, compared to four per cent of capital for a firm seeking to raise $10 million.

We need regulation to protect the interest of investors, issuers and the marketplace. It must be streamlined and harmonized across Canada and it should be principles-based.

Fifth, provincial governments should harmonize the tax system with recent federal initiatives. The federal government did a commendable job of improving the business climate in Canada through lowering corporate, dividend and capital tax rates. Now we need the provinces to follow suit and make corresponding adjustments to provincial rates.

Conclusion

It’s clear Canada faces challenges in the years ahead. The world is reshaping itself before our eyes. The upcoming Beijing Olympics is only confirmation of the rise of a new economic superpower in the Far East. Our large companies will continue to be important for Canadian growth. But they can hardly do it alone.

With that in mind, let me underscore my message: to compete internationally, we must not only rely on our largest companies, we must also build on the strengths of our smaller firms.

Canada has always been a country that has been dedicated to growth, enterprise and success. Being a G7 country is no small feat. Now is the time to continue to build on opportunities that await both our large and smaller companies.

It will take courage. I am reminded of Sir Winston Churchill’s statement about Britain in 1941: “We have not journeyed all this way across the centuries, across the oceans, across the mountains, across the prairies, because we are made of sugar candy.”

Canada has journeyed this far because we are made of entrepreneurial spirit and strong national pride. Let’s pull together – large businesses, small businesses, intermediaries and governments – to make this next chapter in Canada’s economic history a stunning success.

IAN C.W. RUSSELL, FCSI

President and Chief Executive Officer

Investment Industry Association of Canada

Ian C.W. Russell is President and CEO of the Investment Industry Association of Canada, a position he has held since the Association's inauguration in April 2006. Under Ian's leadership, the Association has successfully advocated for the industry on a broad range of regulatory and tax issues.

Previously, Ian headed the Industry Relations and Representation group of the Investment Dealers Association (IDA). His 20-year tenure at the IDA included resolving conflicts of interest around raising capital for small companies (The Hagg Committee), and setting standards for research analysts in the securities industry (The Crawford Committee). Before joining the IDA, Ian was a financial analyst for *The Bank Credit Analyst*, a respected international publication based in Montreal. He also spent six years at the Bank of Canada.

Ian has an honours degree in economics and business from the University of Western Ontario, and a post-graduate degree from the London School of Economics. He has completed the Partners, Directors and Officers Qualification Examination and is a Fellow of the Canadian Securities Institute.