

Roger Martin

Say goodbye to the National Franchise Co.

ROGER MARTIN

From Wednesday February 23 Globe and Mail

The proposed merger of the Toronto and London stock exchanges has caused great angst and anguish, despite the fact that it's symptomatic of what's happening broadly in our economy. Across the world, a particular kind of company – one like TMX – is disappearing. And while that disappearance is disconcerting because it involves change (which is always scary), it shouldn't be viewed as a bad thing. It's just part of the evolution of our world.

Traditionally, there have been three kinds of large companies in every country of the developed world: national franchises (such as TMX, Zellers, La Senza, Molson and Labatt) that compete primarily in the domestic market; home-based global players (such as RIM, Magna, Thomson Reuters and Barrick) that have a major position in a market globally; and domestic subsidiaries of foreign-owned multinationals (such as GE Canada, Honda Canada and Bayer Canada).

The first kind of company is disappearing. We call it “hollowing out,” and it doesn't just apply to Canada. It's part of a global rearrangement of the ownership of assets. Is it an unalloyed good? No. It can't be argued there's no downside. But the upside is that the acquired business becomes part of an international business with the capacity to compete rather than a national franchise player that will wither away and die a death of competitive incapacity.

Sometimes, even global players get acquired by those further along in their global strategies, as was the case with the acquisitions of Dofasco, Cognos and Zenon. Other times, big dumb global players acquire wonderful global Canadian companies by paying ridiculous premiums, only to write them off almost immediately, as was the case with Alcan and ATI. Those last ones are a really sad part of modern life.

The job for Canadian policy-makers is not to protect indefensible Canadian national franchises against the evolution of global markets. The two imperatives are to grow as many home-based global players as possible, and to make Canada a great place for foreign-owned multinationals to undertake important, high-value-added activities. With respect to the latter, most of the myths about the Canadian headquarters of foreign-owned multinationals are just plain wrong – and dangerously so. They give as much to charity; they employ as many professional advisers; they pay higher salaries; they do more R&D: they are great for Canada. And guess what? RIM, Magna, Thomson Reuters and Barrick operations elsewhere are great for those jurisdictions, too.

On the first imperative, the policy framework Canada uses for foreign acquisitions is critically important. Sadly, our federal government applied a tragically flawed policy framework – “net

benefits” – to stop BHP Billiton’s acquisition of Potash Corp. of Saskatchewan. Virtually every acquisition that has ever been proposed here or abroad can be shown by any government that wants a negative outcome to fail a “net benefits” test.

No one would have trade agreements if “net benefits” was the test procedure used. We have helpful trade deals only because the world has adopted the conceptual framework of reciprocity for merchandise and service trade – you let in my goods tariff-free, and I’ll let in yours, too. There are many industries that suffer net detriment in any trade agreement, but there are so many overall benefits that agreements continue to work.

Reciprocity should have stopped BHP-Potash because the Australian government has provisions that would never let Potash buy BHP. And Vale-Inco should have been stopped because the Brazilian government has similar provisions that make Vale takeover-proof. But reciprocity should allow the LSE to merge with TMX. Britain has been clear in not blocking the Canadian acquisition of British gems, including the recent acquisitions of Reuters by Thomson, and Tomkins by Onex and the CPP Investment Board. Maintaining reciprocity in the arena of foreign direct investment is critical to Canada’s long-term development. Potash was a mistake – not the outcome, but the rationale.

In the case of TMX, the facts are pretty clear. In the world of exchanges, there’s a massive global consolidation going on. While we may wish that the world of stock exchanges stood still and left our local players alone, it isn’t co-operating – as even the mighty New York Stock Exchange has found out. So, in this situation, our policy-makers should focus on the second imperative: doing what they can to ensure there are great jobs in Canada for the foreign-owned multinational. From what I can tell from afar, it appears that TMX has negotiated a number of provisions that do just that without government intervention.

In the end, however, it’s important to remember that the resulting organization is going to have to compete cleverly in a tough, consolidating global market. What’s best for Canada is an LSE-TMX that adds more value to its customers than do its big global competitors. Only a competitively strong LSE-TMX will result in great exchange services in Canada and abroad for Canadian corporations and great jobs in the merged company’s Canadian operations. While this merger represents a lot of change, it shouldn’t be seen as bad change but, rather, as part of a natural evolution.

Roger Martin is dean of the Rotman School of Management at the University of Toronto.