Competitiveness for the Third Millennium: Implications for Mexico

Professor Michael E. Porter
Harvard Business School

CEO Agenda Forum
Monterrey, Mexico
October 6, 2009
Prosperity Performance
Selected Lower and Middle Income Countries

PPP-adjusted GDP per Capita, 2008 ($USD)

Growth of Real GDP per Capita (PPP-adjusted), CAGR, 1999-2008

Source: EIU (2009), authors calculations
Mexico’s Exports By Type of Industry
Excluding Oil and Gas Cluster

Source: UNComTrade, WTO (2008)
Inbound Foreign Investment Performance
Flows, Selected Countries

Inward FDI Flows, % of GDP

Ranked by Inward FDI Flows (% of GDP), 2007

- Russia
- Mexico
- Brazil
- China
- India

Innovative Capacity
Innovation Output of Selected Countries

Average U.S. patents per 1 million population, 2004-2008

The Mexican Economy in 2009

• Despite significant reforms, Mexico has experienced slow prosperity growth over the last several years

• The global economic crisis is exposing underlying weaknesses

• Mexico must aggressively address its serious competitiveness challenges to realize its full growth potential
  – Waiting for a United States recovery is insufficient

• Mexico must reinvent itself
  – Adopt and implement an ambitious economic strategy which builds on the country’s unique competitive advantages
What is Competitiveness?

• Competitiveness depends on the productivity with which a nation uses its human, capital, and natural resources.
  – Productivity sets the sustainable standard of living (wages, returns on capital, returns on natural resources)
  – It is not what industries a nation competes in that matters for prosperity, but how productively it competes in those industries
  – Productivity in a national economy arises from a combination of domestic and foreign firms
  – The productivity of “local” or domestic industries is fundamental to competitiveness, not just that of export industries

• Only competitive businesses can create wealth and jobs
• Nations compete to offer the most productive environment for business
• The public and private sectors play different but interrelated roles in creating a productive economy
Macroeconomic competitiveness creates the potential for high productivity, but is not sufficient.

Productivity ultimately depends on improving the microeconomic capability of the economy and the sophistication of local competition.
Mexico’s Macroeconomic Competitiveness

• Some progress has been made in implementing **important reforms** during the past twenty years, such as political and economic liberalization, opening of the economy, and economic diversification

• Mexico’s **macroeconomic policy has been successful** in some areas, such as low inflation and low interest rates
  – However, fiscal resources are overly dependent on oil revenues and there is a narrow tax-base
  – Distortive system of taxes and subsidies is limiting competitiveness

• Mexico lags behind OECD countries on **human development indicators** in education and health

• Mexico’s **political and governmental institutions** have improved, but remain a significant weakness

• There is a serious lack of trust in **politicians** and the effectiveness in **legislative bodies**

• Fighting **organized crime** is major government challenge and priority

• While better than regional peers, **corruption** is limiting Mexico’s economic development
Governance Indicators
Selected Countries

Note: Sorted left to right by decreasing average value across all indicators. The ‘zero’ horizontal line corresponds to the median country’s average value across all indicators.
Corruption Perception Index, 2007

Note: Ranks only countries available in both years (91 countries total)
Source: Global Corruption Report, 2007
Mexico’s Macroeconomic Competitiveness

Action Priorities

• Build public support to continue the fight against organized crime
  – A safe environment for business is a necessary condition for competitiveness

• Intensify the fight against corruption

• Broaden the tax base and improve tax-collection capacity

• Tackle the system of state subsidies

• Upgrade the quality of basic education and health

• Reduce reliance on the U.S. through diversification of trading partners

• Reform political and governmental institutions to allow more effective policy
Many things matter for competitiveness

Successful economic development is a process of successive upgrading, in which the business environment improves to enable increasingly sophisticated ways of competing
### Competitive Advantages

<table>
<thead>
<tr>
<th>Relative to GDP per Capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>Soundness of banks</td>
</tr>
<tr>
<td>Quality of domestic transport network</td>
</tr>
<tr>
<td>Financial market sophistication</td>
</tr>
<tr>
<td>Overall quality of the education system</td>
</tr>
</tbody>
</table>

### Competitive Disadvantages

<table>
<thead>
<tr>
<th>Relative to GDP per Capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quality of math and science education</td>
</tr>
<tr>
<td>Ease of starting a new business</td>
</tr>
<tr>
<td>Quality of the educational system</td>
</tr>
<tr>
<td>Burden of government regulation</td>
</tr>
<tr>
<td>Domestic credit to private sector</td>
</tr>
<tr>
<td>Burden of customs procedures</td>
</tr>
<tr>
<td>Quality of electricity supply</td>
</tr>
<tr>
<td>Financing through local equity market</td>
</tr>
<tr>
<td>Availability of scientists and engineers</td>
</tr>
<tr>
<td>Quality of port infrastructure</td>
</tr>
<tr>
<td>Mobile subscribers per 100 population</td>
</tr>
<tr>
<td>Internet access in schools</td>
</tr>
<tr>
<td>Time required to start a business</td>
</tr>
<tr>
<td>Regulation of securities exchanges</td>
</tr>
<tr>
<td>Venture capital availability</td>
</tr>
<tr>
<td>Utility patents per million population</td>
</tr>
<tr>
<td>Procedures required to start a business</td>
</tr>
<tr>
<td>Tertiary enrollment</td>
</tr>
<tr>
<td>Ease of access to loans</td>
</tr>
<tr>
<td>Quality of railroad infrastructure</td>
</tr>
<tr>
<td>Protection of minority shareholders’ interests</td>
</tr>
</tbody>
</table>

---

**Note:** Rank versus 128 countries; overall, Mexico ranks 51st in 2008 PPP adjusted GDP per capita and 58th in Global Competitiveness. Source: Institute for Strategy and Competitiveness, Harvard University (2009)
## Context for Strategy and Rivalry

### Mexico’s Relative Position 2009

#### Competitive Advantages

<table>
<thead>
<tr>
<th>Relative to GDP per Capita</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Openness of foreign ownership</td>
<td>22</td>
</tr>
<tr>
<td>FDI and technology transfer</td>
<td>27</td>
</tr>
<tr>
<td>Strength of investor protection</td>
<td>31</td>
</tr>
<tr>
<td>Prevalence of trade barriers</td>
<td>49</td>
</tr>
</tbody>
</table>

#### Competitive Disadvantages

<table>
<thead>
<tr>
<th>Relative to GDP per Capita</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extent of market dominance by business groups</td>
<td>117</td>
</tr>
<tr>
<td>Quality of competition in the ISP sector</td>
<td>114</td>
</tr>
<tr>
<td>Efficacy of corporate boards</td>
<td>106</td>
</tr>
<tr>
<td>Rigidity of employment</td>
<td>102</td>
</tr>
<tr>
<td>Distortive effect of taxes and subsidies on competition</td>
<td>100</td>
</tr>
<tr>
<td>Intensity of local competition</td>
<td>97</td>
</tr>
<tr>
<td>Pay and productivity</td>
<td>96</td>
</tr>
<tr>
<td>Market disruption from state-owned enterprises</td>
<td>96</td>
</tr>
<tr>
<td>Impact of taxation on incentives to work and invest</td>
<td>91</td>
</tr>
<tr>
<td>Effectiveness of antitrust policy</td>
<td>87</td>
</tr>
<tr>
<td>Tariff rate</td>
<td>79</td>
</tr>
<tr>
<td>Intellectual property protection</td>
<td>77</td>
</tr>
<tr>
<td>Strength of auditing and reporting standards</td>
<td>70</td>
</tr>
<tr>
<td>Cooperation in labor-employer relations</td>
<td>63</td>
</tr>
<tr>
<td>Regulatory quality</td>
<td>57</td>
</tr>
<tr>
<td>Business impact of rules on FDI</td>
<td>51</td>
</tr>
</tbody>
</table>

*Note: Rank versus 128 countries; overall, Mexico ranks 51st in 2008 PPP adjusted GDP per capita and 58th in Global Competitiveness.*

*Source: Institute for Strategy and Competitiveness, Harvard University (2009)*

---

Mexico’s GDP per capita rank is 51 versus 128 countries

Change up/down of more than 10 ranks since 2008
Mexico’s Business Environment
Overall Strengths and Weaknesses

**STRENGTHS**
- Openness to FDI and technology transfer
- Solid basic skills and a large, young, available workforce
- Entrepreneurial population
- Good quality of roads and domestic transport network
- Sound banks
- High level of sophistication in leading Mexican companies

**WEAKNESSES**
- Impact of crime and violence on business
- High burden of government regulations
- Distortive tax and subsidy system
- Large informal market
- Weak primary and secondary education
- Poor higher education and training system
- Insufficient graduates in science and engineering
- Labor market inefficiencies
- Small pool of domestic credit
- Limited competition, including inefficient (public and private) monopolies and oligopolies
- Dominance of large business groups and state-owned enterprises
- Lack of innovation infrastructure
- Weak IP protection
Ease of Doing Business
Mexico, 2009

Mexico’s Productivity Burden

**Cost**

- **Security** related expenses
- Onerous bureaucratic government regulations
- Government monopolies distort markets
  - High cost and low quality of energy supply
  - High price of oil-related inputs
- Strong influence of labor unions
- Large informal economy avoids taxes and utility costs

**Price**

- Limited ability to differentiate
  - Low skilled labor force
  - Weak technology adoption
- Weak IP protection
Mexico’s Business Environment
Action Priorities

• Open up competition, particularly in areas with dominant firms
  – Also reduce distortive effects of subsidies
• Reform rules and regulations to ease the burden of doing business
• Reduce labor market rigidities
• Address other causes of informality
• Relax infrastructure bottlenecks
• Improve the quality of higher education and training
• Build technological and innovation infrastructure
• Enhance incentives for innovation and entrepreneurship
  – e.g., IP protection, venture capital
Microeconomic Competitiveness: Cluster Development
Tourism Cluster in Cairns, Australia

- Public Relations & Market Research Services
- Food Suppliers
- Property Services
- Maintenance Services
- Travel agents
- Tour operators
- Restaurants
- Attractions and Activities e.g., theme parks, casinos, sports
- Hotels
- Airlines, Cruise Ships
- Local retail, health care, and other services
- Local Transportation
- Souvenirs, Duty Free
- Banks, Foreign Exchange
- Government agencies e.g. Australian Tourism Commission, Great Barrier Reef Authority
- Educational Institutions e.g. James Cook University, Cairns College of TAFE
- Industry Groups e.g. Queensland Tourism Industry Council

Sources: HBS student team research (2003) - Peter Tynan, Chai McConnell, Alexandra West, Jean Hayden
The Houston Oil and Gas Cluster

Upstream

- Oil & Natural Gas Exploration & Development
  - Equipment Suppliers (e.g. Oil Field Chemicals, Drilling Rigs, Drill Tools)
  - Specialized Technology Services (e.g. Drilling Consultants, Reservoir Services, Laboratory Analysis)

Downstream

- Oil & Natural Gas Completion & Production
  - Subcontractors (e.g. Surveying, Mud Logging, Maintenance Services)
  - Business Services (e.g. MIS Services, Technology Licenses, Risk Management)

- Specialized Technology Services (e.g. Drilling Consultants, Reservoir Services, Laboratory Analysis)
- Subcontractors (e.g. Surveying, Mud Logging, Maintenance Services)
- Business Services (e.g. MIS Services, Technology Licenses, Risk Management)
- Equipment Suppliers (e.g. Oil Field Chemicals, Drilling Rigs, Drill Tools)
- Specialized Technology Services (e.g. Drilling Consultants, Reservoir Services, Laboratory Analysis)

Specialized Institutions
(e.g. Academic Institutions, Training Centers, Industry Associations)
The Australian Wine Cluster

History

1930
First oenology course at Roseworthy Agricultural College

1955
Australian Wine Research Institute founded

1965
Australian Wine Bureau established

1970
Winemaking school at Charles Sturt University founded

1980
Australian Wine and Brandy Corporation established

1990
Winemaker’s Federation of Australia established

1991 to 1998
New organizations created for education, research, market information, and export promotions

1950s
Import of European winery technology

1960s
Recruiting of experienced foreign investors, e.g. Wolf Bass

1970s
Continued inflow of foreign capital and management

1980s
Creation of large number of new wineries

1990s
Surge in exports and international acquisitions

Clusters as a Tool For Economic Policy

- A forum for **collaboration** between government, the private sector, trade associations, educational institutions, and research institutions
- Brings together **firms of all sizes**, including SME’s
- Creates a mechanism for **constructive business-government dialogue**
- A tool to identify **problems** and concrete **action recommendations**
- A vehicle for identifying investments that strengthen **multiple firms/institutions** simultaneously
- Foster more sophisticated **competition** rather than distorting the market
Clusters

- Education and Workforce Training
- Management Training
- Business Attraction
- Export Promotion
- Market Information and Disclosure
- Physical Infrastructure
- Science and Technology Investments (e.g., centers, university departments, technology transfer)
- Standard setting and quality initiatives
- Environmental Stewardship
- Natural Resource Protection

Clusters provide a framework for implementing public policy and organizing public-private collaboration to enhance competitiveness.
National Export Portfolio
Mexico, 1997 to 2007

Change in Mexico’s world export market share, 1997 to 2007

Share of World Exports by Cluster
Mexico, 2007

Note: Clusters with overlapping borders have at least 20% overlap (by number of industries) in both directions.
Cluster Development in Mexico

• Mexico has some **well developed clusters**, including automotive, petrochemicals, entertainment equipment, and communications equipment
  – FDI has helped trigger cluster formation

• Cluster development has taken place **organically**

• Mexico has a **strong network of labor cost sensitive suppliers** due to NAFTA, but most clusters rely heavily on intermediate good imports

• Existing cluster development efforts suffer from **weak coordination** between the private and public sectors
Cluster Development in Mexico
Action Priorities

• Adopt **cluster development** as a central tool for organizing business development and policy implementation

• Utilize cluster initiatives as a tool to **engage the private sector** in more effective collaboration with government at the national and regional levels

• Use clusters to organize efforts to promote **higher value exports** and **FDI attraction**

• Cluster development is an effective approach to enable the transition to an **innovation-driven development model**
Successful Mexican Clusters
Baja California Sur Tourism

Enablers & IFC’s

Government Agencies (SECTUR)

Educational Institutions (24 tourism focus institutions nationwide)

Industry Groups (Tourism Promotion Council)

Core Services

Restaurants (419 restaurants)

Hotels & Lodges (290 hotels)

Natural Attractions & Activities

Airlines, Airports & Cruise ships (4 airports, 8 airlines; 5 charter)

Adjacent & Supporting Clusters

Convention Centers (344 centers)

Scuba diving & Snorkeling (38 rental & guides)

Whale Watching & Tour Guides (62 agencies)

Sports Fishing (29 agencies)

Golf Courses (8 courses; 3 Jack Nicklaus)

Clubs & Bars (59 nightlife spots)

Ecotourism Operators (56 operators)

Entertainment Services

Telecom, Internet

Financial Services

Energy

Food Supply

Construction & Developers

Maritime Services

Maintenance Services

Hospitals & Clinics

Retail & Transportation Services

Souvenirs & Handicrafts Stores

Travel Agencies (60 agencies)

Car Rental Agencies (36 branches)

Docs and Marinas (6 tourism marinas)

Maritime Transport (43 companies)

Taxi & Bus Services (39 companies)

Airport Support Services

Sources: Harvard Microeconomics of Competitiveness student team research (2008) - Daniel Acevedo, Nicho Garza Sada, Jose Luis Romo, and Bernardo Vogel
Successful Mexican Clusters
Jalisco’s Electronics

Sources: Harvard Microeconomics of Competitiveness student team research (2009) - Julian Arber Alison Chick, Gustavo De Loyola, Ina Mogollon, and Bernardo Novick
Geographic Influences on Competitiveness

1. Neighboring Countries
2. Nation
3. Regions and Cities
Specialization by Traded Cluster
U.S. States, 2006

**Oregon**
- Agricultural Products
- Prefabricated Enclosures
- Forest Products
- Analytical Instruments

**South Dakota**
- Heavy Machinery
- Sporting, Recreational and Children's Goods
- Financial Services
- Processed Food

**Illinois**
- Biopharmaceuticals
- Lighting and Electrical Equipment
- Heavy Machinery
- Metal Manufacturing

**Maine**
- Forest Products
- Aerospace Engines
- Communications Equipment
- Hospitality and Tourism

**Kentucky**
- Automotive
- Plastics
- Construction Materials
- Transportation and Logistics

**South Carolina**
- Textiles
- Forest Products
- Automotive
- Production Technology

**South Dakota**
- Heavy Machinery
- Sporting, Recreational and Children's Goods
- Financial Services
- Processed Food

**Alaska**
- Fishing and Fishing Products
- Power Generation and Transmission
- Heavy Construction Services
- Hospitality and Tourism

**Idaho**
- Agricultural Products
- Information Technology
- Prefabricated Enclosures
- Furniture
- Forest Products

**Nevada**
- Leather and Related Products
- Heavy Construction Services
- Hospitality and Tourism
- Transportation and Logistics

**North Carolina**
- Textiles
- Forest Products
- Automotive
- Production Technology

**Colorado**
- Oil and Gas Products and Services
- Medical Devices
- Aerospace Vehicles and Defense Entertainment

**Mississippi**
- Furniture
- Fishing and Fishing Products
- Power Generation and Transmission
- Motor Driven Products

Competitiveness of Mexican States

- **Strong disparities** exist across Mexican states in business environment, innovative capacity, and economic performance
  - Greater specialization since NAFTA, especially in Northern border states
  - Growth potential in Southern states depressed by poverty and failure to capitalize on NAFTA
- **Decentralization of economic policy** is essential to success in large countries such as Mexico

Source: Map from Mexico.org
Prosperity Performance
Mexican States

GDP per Capita, 2007
(MXN Pesos)

Source: Mexican Statistical Office
Mexican States
Action Priorities

• Close the **productivity gap** between Northern and Southern states

• Utilize better **infrastructure** to integrate other states into the national and global economy

• Encourage internal trade and investment to facilitate **economic specialization** and increase **domestic competition**

• Develop state government capacity to improve **policy formulation** and **implementation**

• Support states in creating **distinctive state economic strategies**

• Step up efforts to reduce **corruption** at the state level
Geographic Influences on Competitiveness
Economic Coordination with Neighboring Countries

- Economic coordination among neighboring countries can significantly enhance competitiveness
Mexico and NAFTA

• The Mexican economy has benefited greatly from NAFTA, which has driven growth, brought in FDI, and transformed Mexico into a more open economy.

HOWEVER

• The existing NAFTA model is insufficient to drive future growth
  – Maquiladora model has exhausted its capacity to generate important benefits
  – Since 1994, bilateral trade in goods and services has outstripped GDP growth
• Mexico needs to diversify its export and integration focus beyond the U.S.

• A shift toward a higher productivity/innovation-based economic model will be necessary to take NAFTA to the next level.
Developing an Mexican Economic Strategy

National Value Proposition

• What is the unique competitive position of Mexico given its location, legacy, endowments, and potential strengths?
• What is Mexico’s value proposition for business?
• In what clusters can Mexico excel?
• What role can Mexico play in its region?

Developing Unique Strengths

• What are the key strengths that Mexico must build upon?

Addressing Crucial Constraints

• What weaknesses must be addressed to achieve parity with peer countries?

• An economic strategy requires rigorous prioritization and sequencing
## Toward a Mexican Economic Strategy

### Unique Strengths
- Located between two oceans
- Privileged access to the United States’ market, which includes large Mexican diaspora (30 million)
- Proximity to Central and South American markets
- Largest Spanish speaking market
- Young hard working population
- High level of entrepreneurship
- Large geographic area

### Implications
- Fight Organized Crime and Corruption
- Open Competition
- Next Stage Regulatory Reforms (labor, unions, energy, formalization, education, public administration)
- Excellent Infrastructure Linking the Country Together and Enabling Southern Trade
- Better Quality Higher Education and Training
- Building Innovation Infrastructure
- Foster Cluster Development
- Unleash Entrepreneurship and SME Development
The Process of Economic Development
Shifting Roles and Responsibilities

**Old Model**

- **Government** drives economic development through policy decisions and incentives

**New Model**

- Economic development is a **collaborative process** involving the private sector, government at multiple levels, universities, labor, and civil society

- Competitiveness must become a **bottoms-up process** in which many individuals, companies, and institutions take responsibilities
- **Every** community and cluster can take steps to enhance competitiveness
- The **private sector** must become more engaged in competitiveness to improve rapidly
Organizing for Competitiveness

- Sustained improvements in competitiveness require **coordination among many parts of government**
  - Across different ministries to align policies
  - Across geographic levels of government
- Improving competitiveness requires **collaboration with the private sector**
  - Public-private dialogue to identify competitiveness priorities and implement solutions
- Mexico has created some organizations for competitiveness, but **policy coordination** between government and the private sector remains a challenge
  - Mexican Competitiveness Institute (IMCO) advances new competitiveness proposals but is positioned primarily as a think tank
  - Legislative competitiveness committees are present, but coordinate principally with the executive branch
  - Many states do not have an effective strategic plan nor engage in effective public-private dialogue
Mexico: Moving from Diagnosis to Action
Organizing for Competitiveness Priorities

• Strong **private sector leadership** is needed to address the well documented competitiveness challenges facing Mexico

• Create a private-sector led **National Council on Competitiveness** to build consensus on an overall economic strategy and track implementation
  – Public sector and academia participation is critical in order to develop effective national policy and coordinate implementation

• Encourage creation of **State Competitiveness Councils** to drive consensus on state plans and monitor implementation
  – Involve representatives from the public, private and academic sectors as well as federal government participation
The Role of the Private Sector in Economic Development

• A company’s competitive advantage depends heavily on the quality of the business environment
• A company gains advantages from being part of a cluster
• Companies have a strong role to play in upgrading their business environment
  
• Take an active role in upgrading the local infrastructure
• Nurture local suppliers and attract foreign suppliers
• Work closely with local educational and research institutions, to upgrade their quality and create specialized programs addressing the cluster’s needs
• Inform government on regulatory issues and constraints bearing on cluster development
• Focus corporate philanthropy on enhancing the local business environment

• An important role for trade associations
  – Greater influence if many companies are united
  – Cost sharing between members
• There is an **inevitable link** between a business and society

• The **health of a society** depends on having competitive companies that can create wealth and support high wages

• The **competitiveness of companies** depends on the health of the surrounding community
  - E.g., educated and skilled employees
  - Safe working conditions
  - A transparent, corruption-free business environment
  - A sense of equal opportunity
  - Low levels of environmental degradation (productive use of physical resources)

• Companies can positively affect many **social** issues

• There is a long-term **synergy** between economic and social objectives
Creating a Social Dimension of Strategy

- Company strategy in Mexico should have a **social dimension**
  - Customers value **social performance**, not just economic performance
- Companies should address those social issues where they can create **shared value**

**Shared value**: benefit society while enhancing the long-term competitiveness of the company

- Companies can have the greatest social impact in areas **tightly connected to their business**
- Companies should incorporate a **social dimension to their value proposition**
- This social dimension can be **more sustainable** than conventional cost and quality advantages
Strategic CSR

Pressure Politics → Giving / Charity / Corporate Image → Shared Value

- Points of conflict
- Branding / PR
- Obligation / charity
- Proliferation of causes and projects

- Create mutual interest
- Achieve social impact / results
- Integrate strategy and society
- Focus on strategic impact
Inside-Out Links with Society
Value Chain Social Impacts

- Relationships with universities
  - Ethical research practices (e.g. animal testing, GMOs)
  - Product safety

- Financial reporting practices
  - Governance practices
  - Transparency
  - Use of lobbying

- Procurement practices (e.g. bribery, child labor, conflict diamonds, pricing to farmers)
- Use of particular inputs (e.g. animal fur)
- Conservation of raw materials
- Recycling

- Transportation impacts (e.g. emissions, congestion, logging roads)
- Emissions and waste
  - Biodiversity and ecological impacts
  - Energy and water use
  - Worker safety and labor relations
  - Hazardous materials

- Marketing and advertising (e.g. truthful advertising, advertising to children)
- Pricing practices (e.g. price discrimination among customers, anticompetitive pricing practices, pricing policy to the poor)
- Consumer information

- Employee education and job training
- Safe working conditions
- Diversity and discrimination
- Health care and other benefits
- Compensation policies
- Layoff policies

- Disposal of obsolete products
- Handling of consumables (e.g. motor oil, printing ink)
- Customer privacy

Every activity in the value chain touches on communities in the locations where a company operates. These impacts can be **positive** or **negative**.
Identifying Shared Value
Outside-In Social Impact on the Company

• Competitive context is often influenced by or inextricably linked with social conditions

Factor (Input) Conditions
- Availability of qualified human resources (Marriott's job training)
- Access to specialized training programs
- Efficient physical infrastructure
- Efficient permitting and regulatory practices
- Availability of scientific and technological institutions (Microsoft's Working Connections; Nestlé's knowledge transfer to farmers)
- Sustainable access to natural resources (GrupoNueva's water conservation)
- Efficient access to capital

Context for Firm Strategy and Rivalry
- Fair and open local competition (e.g., the absence of trade barriers, fair regulations)
- Intellectual property protection
- Transparency (e.g., financial reporting, corruption: Extractive Industries Transparency Initiative)
- Rule of law (e.g., security, protection of property, legal system)
- Meritocratic incentive systems (e.g., antidiscrimination)

Demand Conditions
- Nature of local demand (e.g. appeal of social value propositions: Whole Foods' customers)
- Fair and demanding regulatory standards (California auto emissions & mileage standards)
- Local needs that can be served nationally and globally (Urbi's housing financing, Unilever's "bottom of the pyramid" strategy)

Related and Supporting Industries
- Availability of local suppliers and support services (Sysco's locally grown produce; Nestlé's milk collection dairies)
- Access to partner firms in related fields
- Access to a cluster instead of isolated firms and industries

20091008 – Monterey Mexico.ppt
Mitigating Negative Value Chain Impacts

• Measure social impacts whenever possible

• Identify best practices in limiting harm across the value chain

• Make performance in social impacts of activities a responsibility of operating units
Creating Shared Value
Nestlé

Nutrition

Water

Rural Development
Corporate Role in Economic Development

Nestlé in India

- Nestlé’s history in the Moga region of India begins in 1962, when the region was in severe poverty
- Local milk supply was hampered by small parcels of land, poor soil, periodic droughts, animal disease, and lack of a commercial market
- Nestlé established local milk purchasing organizations in each town
- Nestlé invested in improving competitive context
  - Collection infrastructure such as refrigerated dairies was accompanied by veterinarians, nutritionists, agronomists, and quality assurance experts to assist small farmers
  - Medicines and nutritional supplements were provided to improve animal health
  - Monthly training sessions were held for local farmers
  - Wells to secure water supply for animals were dug with financing and technical assistance from Nestlé
- Nestlé has built a productive milk cluster in Moga, and buys milk from more than 75,000 farmers in the region through 650 dairies in local villages

- Moga has advanced its economic development versus other nearby regions
- Nestlé has developed a long-term competitive advantage in the milk cluster in numerous developing countries
Strategy in Economic Downturns

• Create a **positive** agenda

• Refocus on **strategy**

• Return to **economic fundamentals**

• Downsize **to a strategy**, not across the board

• **Do not overreact** to distressed industry conditions

• Use the downturn to **get things done** that would be more difficult in normal times

• Position for **long term economic performance**, not near term stock price

• Seize opportunities for **discontinuities** which are more likely to emerge

• Strategy is **more important** in downturns, not less