Ecuadorian Competitiveness: Ready for the Next Stage?

Professor Michael E. Porter
Harvard Business School

Quito, Ecuador
October 24, 2011

This presentation draws on ideas from Professor Porter’s books and articles, in particular, Competitive Strategy (The Free Press, 1980); Competitive Advantage (The Free Press, 1985); “What is Strategy?” (Harvard Business Review, Nov/Dec 1996); “Strategy and the Internet” (Harvard Business Review, March 2001); and a forthcoming book. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means—electronic, mechanical, photocopying, recording, or otherwise—without the permission of Michael E. Porter. Additional information may be found at the website of the Institute for Strategy and Competitiveness, www.isc.hbs.edu.
Prosperity Performance
Selected Lower and Middle Income Countries

PPP-adjusted GDP per Capita, 2010 ($USD)

Average: $13,910

Source: EIU (2011), author’s calculations
Export Performance
Selected Countries

Exports of Goods and Services (% of GDP), 2010

Average: 2.9%

Ecuador

Change in Exports of Goods and Services (% of GDP), 2000 - 2010

Average: 45.1%

Source: EIU (2011), authors’ analysis
Inbound Foreign Investment Performance
Stocks and Flows, Selected Countries

Inward FDI Stocks as % of GDP, Average 1999 - 2009

FDI Inflows as % of Gross Fixed Capital Formation, Average 1999 - 2009

The Ecuadorian Economy in 2011

- Ecuador has had a long history of **economic and political instability**
- Since 2001, Ecuador has enjoyed **relative macroeconomic stability** as a result of dollarization
- High oil prices have allowed the country to **increase government spending**
- Ecuador **export growth** has been driven by **commodities prices**

**BUT**

- In 2010, the Ecuadorian economic **growth was slower** than other Latin-American countries
- Prosperity remains **low**
- High **poverty levels** and **inequality** persist and large segments of the population lack **access to basic needs**
- Ecuador is overly dependent on **oil** exports

- Higher economic growth rates and poverty reduction are possible only if Ecuador can substantially **improve competitiveness**
What is Competitiveness?

• Competitiveness is 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** it competes in those industries

  – Productivity in a national economy arises from a **combination of domestic and foreign firms**

• 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
Comparative Labor Productivity
Selected Countries

Real GDP per employee (PPP adjusted US$), 2010

Source: Authors calculation Groningen Growth and Development Centre (2011), EIU (2011)
What Determines Competitiveness?

- Endowments create a foundation for prosperity, but true prosperity is created by productivity in the use of endowments.
What Determines Competitiveness?

- Macroeconomic competitiveness sets the potential for high productivity, but is not sufficient.
- Endowments create a foundation for prosperity, but true prosperity is created by productivity in the use of endowments.
Components of Macroeconomic Competitiveness

Macroeconomic Policies

- Fiscal policy
  - Government surplus/deficit
  - Government debt

- Monetary policy
  - Inflation
  - Business cycle management
  - Savings

Social Infrastructure and Political Institutions

- Human development
  - Basic education
  - Health

- Political institutions
  - Political freedom
  - Voice and accountability
  - Political stability
  - Government effectiveness
  - Decentralization of economic policymaking

- Rule of law
  - Security
  - Civil rights
  - Judicial independence
  - Efficiency of legal framework
  - Freedom from corruption
Productivity ultimately depends on improving the microeconomic capability of the economy and the sophistication of local competition.

Macroeconomic competitiveness sets the potential for high productivity, but is not sufficient.

Endowments create a foundation for prosperity, but true prosperity is created by productivity in the use of endowments.
What Determines Competitiveness?

The **external business environment conditions** that enable company productivity and innovation.

### Microeconomic Competitiveness
- Quality of the National Business Environment
- State of Cluster Development
- Sophistication of Company Operations and Strategy

### Macroeconomic Competitiveness
- Macroeconomic Policies
- Social Infrastructure and Political Institutions

### Endowments
What Determines Competitiveness?

Microeconomic Competitiveness
- Quality of the National Business Environment
- State of Cluster Development
- Sophistication of Company Operations and Strategy

Macroeconomic Competitiveness
- Macroeconomic Policies
- Social Infrastructure and Political Institutions

Endowments

A critical mass of firms and institutions in each field to harness efficiencies and externalities across related entities.
Competitiveness and Poverty Reduction

- There is a strong connection between **economic** and **social** development
- Improving competitiveness and decreasing poverty requires improving the economic and social context **simultaneously**
What Determines Competitiveness?

Microeconomic Competitiveness

- Quality of the National Business Environment
- State of Cluster Development
- Sophistication of Company Operations and Strategy

Macroeconomic Competitiveness

- Macroeconomic Policies
- Social Infrastructure and Political Institutions

Endowments

Internal skills, capabilities, and sophistication of management practices of companies
Geographic Influences on Competitiveness

- Neighboring Countries
- Nation
- Regions and Cities
Prosperity Performance
U.S. States, 1999 to 2009

Gross Domestic Product per Capita Real Growth Rate, 1999 to 2009

Gross Domestic Product per Capita, 2009

High but declining versus U.S.

Low and declining versus U.S.

Low but rising versus U.S.

Notes: Real GDP figures in 2005 chained US dollars from the Bureau of Economic Analysis. Growth rate is calculated as compound annual growth rate. D.C. excluded.
Regions and Competitiveness

- Economic performance **varies significantly** across sub-national regions (e.g., provinces, states, metropolitan areas)
- Many essential levers of competitiveness reside at the **regional level**
- Regions **specialize** in different sets of clusters
- **Cluster strength** directly impacts regional performance
- Each region needs its own distinctive **competitiveness strategy and action agenda**
- Improving competitiveness requires **effective policy collaboration** between regions and the national government

- **Decentralization** is important to foster regional specialization, internal competition, and greater government accountability
- Effective decentralization requires clarity on roles and responsibilities, and sufficient administrative **capacity at local and regional level**
Economic Coordination with Neighboring Countries
Competitiveness and the Neighborhood

• Opening trade and investment among neighbors
  – Expands the available market
  – A nation’s neighbors are its most natural trading and investment partners
  – The natural path of internationalization for local firms is the neighborhood
  – Open trade and investment make each country a more attractive location for investment

• Economic coordination to drive improvements in the business environment
  – Capture synergies in policy and infrastructure
  – Gain greater clout in international negotiations

• External agreements to help overcome domestic political and economic barriers to reform
Economic Integration Among Neighbors
Capturing Synergies

Factor Conditions
- Improving the efficiency of the regional transportation network
- Creating an efficient energy network
- Enhancing regional communications and connectivity
- Harmonizing administrative requirements for businesses
- Linking financial markets
- Facilitating the movement of students for higher education

Context for Strategy and Rivalry
- Eliminating trade and investment barriers within the region
- Simplifying and harmonizing cross-border regulations and paperwork
- Coordinating anti-monopoly and fair competition policies

Demand Conditions
- Opening government procurement within the region
- Harmonizing environmental standards
- Harmonizing product safety standards
- Establishing reciprocal consumer protection laws

Related and Supporting Industries
- Facilitating cross-border cluster development
  - e.g., Supplier networks
  - Transport & Logistics
  - Quality standards

Macroeconomic Competitiveness
- Coordinating macroeconomic policies
- Coordinating programs to improve security and public safety
Ecuador’s Competitiveness Profile, 2010
Harvard Country Competitiveness Model

Overall Ranking (113)

Macroeconomic Competitiveness (107)
- Social Infrastructure and Pol. Institutions (117)
- Macroeconomic Policy (55)

Microeconomic Competitiveness (125)
- Business Environment Quality (127)
- Company Sophistication (114)

Ecuador GDP per Capita
Rank 77

Note: Rank versus 139 countries

Source: Country Competitiveness Model (CCM), Institute for Strategy and Competitiveness, Harvard University (2010)
Ecuador’s Macroeconomic Competitiveness

**Macroeconomic Policy**

- Dollarization **stabilized** the economy
  - Inflation relatively low since dollarization in 2001
- **Expansionary** fiscal policy funded by borrowing and oil resources
  
  *However*

- **Budget deficit** threatens the dollarization model
- **Central Bank** is no longer an autonomous institution
- No **stabilization fund**

**Social Infrastructure and Political Institutions**

- Lack of high-quality **public education system**
- Weak **social security system**, despite some improvements
- **Persistent** problems with corruption
- Weak **legal system** and effectiveness of **property rights**
- Need for modernization of **political and government institutions**
Corruption Perception Index, 2010

Change in Rank, Global Corruption Report, 2010 versus 2006

Note: Ranks only countries available in both years (160 countries total)
Source: Global Corruption Report, 2010
Quality of the National Business Environment

• Local **rules and incentives** that encourage investment and productivity
  – e.g., salaries, incentives for capital investments, intellectual property protection, corporate governance standards

• **Sophisticated and demanding** local customers and needs
  – e.g., Strict quality, safety, and environmental standards
  – Consumer protection laws

• Open and vigorous **local competition**
  – Openness to foreign competition
  – Competition laws

• Access to high quality **business inputs**
  – Human resources
  – Capital availability
  – Physical infrastructure
  – Administrative and information infrastructure (e.g., registration, permitting, transparency)
  – Scientific and technological infrastructure
  – Efficient access to natural endowments

• **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

---

[Diagram showing the relationships between factors, conditions, and industries]
Ecuador’s Business Environment

Strengths

Infrastructure
• Significant improvements in transportation infrastructure
• High mobile phone penetration

Competitive Context
• High levels of entrepreneurship

Other
• A new national agenda for innovation and entrepreneurship
• Improving sophistication of local buyers
### Ecuador’s Business Environment

#### Weaknesses

<table>
<thead>
<tr>
<th>Financial Markets</th>
<th>Workforce Development and Training</th>
<th>Competitive Context</th>
<th>Trade and Investment Liberalization</th>
<th>Innovation Infrastructure</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>• <strong>Weak</strong> financial markets</td>
<td>• Low <strong>skill level</strong> of the labor force</td>
<td>• <strong>Import substitution strategy</strong> reducing competitiveness</td>
<td>• <strong>FDI</strong> limited to <strong>oil</strong> and <strong>mining sectors</strong></td>
<td>• Weak university-industry <strong>research</strong> collaboration</td>
<td>• Low level of <strong>quality certification</strong></td>
</tr>
<tr>
<td></td>
<td>• <strong>Poor quality higher education</strong> system</td>
<td>• High level of <strong>government subsidies</strong> distort competition</td>
<td>• New <strong>restrictions</strong> on capital flows</td>
<td>• <strong>Low</strong> <strong>patenting rates</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• <strong>Low</strong> intensity of local <strong>competition</strong></td>
<td>• High <strong>trade barriers</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Limited <strong>internationalization</strong> of firms</td>
<td>• Complex <strong>custom procedures</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Burdensome <strong>government regulations</strong></td>
<td>• Few <strong>trade agreements</strong> with other countries</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>– Labor regulations give rigidity to the market</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>– Customs and Trade regulations</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>– Difficult new business formation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Weak <strong>investor protection</strong> and protection of <strong>intellectual property</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• <strong>High</strong> <strong>informality</strong> in the economy</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Ease of Doing Business
Ecuador, 2010

Ranking, 2010
(of 183 countries)

Favorable
Unfavorable

Ecuador's GDP per capita rank: 77

State of Cluster Development
Tourism Cluster in Cairns, Australia

- Public Relations & Market Research Services
- Food Suppliers
- Property Services
- Maintenance Services
- Travel Agents
- Tour Operators
- Attractions and Activities e.g., theme parks, casinos, sports
- Restaurants
- 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
State of Cluster Development
Kenya’s Cut Flower Cluster

Horticultural Agencies, NGOs & Industry Associations
- Horticultural Crops Development Authority (HCDA) Government Export Policies Targeting Horticulture
- Non-Government Organizations (e.g., The Rural Enterprise Agri-Business Promotion Project)
- Trade & Industry Associations (e.g., Kenya Flower Council)

Agricultural Cluster
- Plantstock
- Greenhouse; Shading Structures
- Irrigation Technology
- Pre-Cooling Technology
- Fertilizers, Pesticides, Herbicides

 Horticultural Cluster

Flower Farming

Post-Harvest Handling; Transport to Market

Education, Research & Quality Standards Organizations
- Research Institutions (e.g., Kenya Agricultural Research Institute)
- Public Universities with Post Graduate Degrees in Horticulture (e.g., University of Nairobi)
- Quality & Standards (e.g., EUREGAP Standard, Kenya Plant Health Inspectorate Services)

Tourism Cluster
- Post-Harvest Cooling Technology
- Grading / Packaging Sheds
- Packaging & Labeling Materials
- Refrigerated Trucks
- Freight Forwarders
- Clearing and Forwarding Agents
- Air Carriers (Commercial / Charters)

Sources: MOC student team research by Kusi Hornberger, Nick Ndiritu, Lalo Ponce-Brito, Melesse Tashu, Tijan Watt, Harvard Business School, 2007
Clusters Development Over Time
The Australian Wine Cluster

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 and Economic Diversification
Linkages Across Clusters

Note: Clusters with overlapping borders or identical shading have at least 20% overlap (by number of industries) in both directions.
Clusters as a Tool For Economic Policy

• A forum for collaboration between the private sector, trade associations, government, educational, and research institutions

• Brings together firms of all sizes, including SME’s

• Creates a mechanism for constructive business-government dialog

• A tool to identify problems and action recommendations

• A vehicle for investments that strengthen multiple firms/institutions simultaneously

• Fosters greater competition rather than distorting the market
Ecuador’s Cluster Export Portfolio
1997 to 2009

Ecuador’s Average World Export Share: 0.11%

Change in Ecuador’s Overall World Export Share: +0.02%

Exports of US$670 Million =


Copyright 2011 © Professor Michael E. Porter
Ecuador’s Share of World Exports by Cluster, 2009

World Market Share
- 0.05% - 0.1%
- 0.11% - 1.0%
- > 1.0%

Clusters with overlapping borders have at least 20% overlap (by number of industries) in both directions.
Peru’s Share of World Exports by Cluster, 2009

World Market Share
- 0.1% - 0.21%
- 0.22% - 1.0%
- > 1.0%

Clusters:
- Fishing & Fishing Products
- Agricultural Products
- Transportation & Logistics
- Hospitality & Tourism
- Biopharmaceuticals
- Analytical Instruments
- Lightning & Electrical Equipment
- Power Generation
- Motor Driven Products
- Heavy Machinery
- Production Technology
- Marine Equipment
- Mining & Metal Manufacturing
- Aerospace Engines
- Sporting & Recreation Goods
- Automotive
- Heavy Construction Services
- Forest Products
- Textiles
- Construction Materials
- Furniture
- Prefabricated Enclosures
- Building Fixtures, Equipment & Services
- Aerospace Vehicles & Defense
- Information Tech.
- Education & Knowledge Creation
- Distribution Services
- Financial Services
- Publishing & Printing
- Business Services
- Jewelry & Precious Metals
- Processed Food
- Travel & Tourism
- Entertainment
- Prefabricated Enclosures
- Distribution Services
- Financial Services
- Publishing & Printing
- Business Services
- Jewelry & Precious Metals
- Processed Food
- Travel & Tourism
- Entertainment

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

- Ecuador has **strengths in resource-related clusters**, including cut-flowers, bananas, coffee, cacao, fishing, and tourism
- Clusters that serve mainly the **domestic market** include textiles, apparel, automotive, and metalworking
- Most of the clusters are **shallow**, with a **weak** supplier base
- There are weak **supporting institutions** with poor coordination between the private and public sectors
- Ecuador’s clusters have been subject to **traditional industrial policy** characterized by subsidies and protectionism

- Clusters could become an important **tool for economic development**
Competitiveness of Ecuador’s Regions

- 75% of business activity is concentrated in **two provinces**, Guayas and Pichincha

- Ecuadorian regions **vary greatly** in the quality of business environment

- **Decentralization** of economic policy remains incomplete, with **weak capacity** at local level

- **Free Trade Zones** have been created in some rural areas
Action Agenda for Ecuador

Macroeconomic Policy

• Maintain macroeconomic stability
• Reduce the budget deficit
• Create a stabilization fund
• Broaden the tax base and improve collection

Social Infrastructure and Political Institutions

• Modernize the social security system
• Fight corruption at every level of government and private sector
• Improve the effectiveness of the legal system
• Improve system of "checks and balances“ in government
• Improve human development
  – Rapid improvements in education, health, and nutrition are needed
• Create equal opportunity for all groups
Action Agenda for Ecuador

Improving the Business Environment

• Open up greater internal competition
• Further open the economy to trade and investment
  – Reduce tariffs
  – Simplify trade procedures
  – Negotiate trade agreements with strategic countries rather than limit them
  – Welcome foreign investment
• Upgrade workforce training and higher education
• Reduce informality by limiting the cost and complexity of registering companies
  – Simplify new business formation
  – Reduce the tax burden and labor market rigidities facing smaller firms
Action Agenda for Ecuador

Cluster Development

• Adopt cluster development as a central tool to engage the private sector and implement economic policies
• All clusters are important to enhancing prosperity
• Apply a cluster-based approach to economic diversification
• Leverage clusters to attract FDI

Regional Development

• Continue decentralization of responsibilities and resources to sub-national governments
• Improve the capacity of local governments to plan, design, and implement development polices
• Improve national-regional collaboration to implement regional programs
• Address the underlying causes of inequality between the coastal, Andean and Amazon regions
Action Agenda for Ecuador

Neighborhood Development

• Improve land connectivity with neighbors
• Upgrade political and trade relations with Colombia and Peru
• Restructure the Andean Community of Nations to make it an effective instrument for integration
The Need for an Economic Strategy

Policy Improvement

- Implementing best practices in each policy area
- There are a huge number of policy areas that matter
- No country can or should try to make progress in all areas simultaneously

Economic Strategy

- A prioritized agenda to create a unique competitive position for a country or region
Creating a National Economic Strategy

National Value Proposition

- What is the **distinctive competitive position** of Ecuador given its location, legacy, existing strengths, and potential strengths?
  - What unique advantage as a business location?
  - For what types of activities and clusters?
  - And what roles with neighbors, the region, and the broader world?

Developing Unique Strengths

- What **elements of the business environment** can be unique strengths relative to peers/neighbors?
- What **existing and emerging clusters** represent local strengths?

Achieving and Maintaining Parity with Peers

- What **weaknesses** must be addressed to remove key constraints and achieve parity with peer countries?

- **Priorities** and **sequencing** are necessity in economic development