Regional Competitiveness and the Role of Business

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Sintonía
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Agenda

I. Regional Competitiveness: The New Learning

II. The Role of Business in Economic and Social Development
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I. Regional Competitiveness: The New Learning

II. The Role of Business in Economic and Social Development
What is Competitiveness?

A nation or region is competitive to the extent that firms operating there are able to compete successfully in the global economy while supporting rising wages and living standards for the average citizen.

- Competitiveness depends on the long term productivity with which a nation or region uses its human, capital, and natural resources:
  - Productivity sets sustainable wages, job growth, and standard of living.
  - It is not what industries a nation or region competes in that matters for prosperity, but how productively it competes in those industries.
  - Productivity in a national or regional economy benefits from a combination of domestic and foreign firms.

- Nations and regions compete to offer a more productive environment for business.
- Competitiveness is not a zero sum game.
What Determines Competitiveness?

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- 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**
Improving the Quality of the Business Environment

Context for Firm Strategy and Rivalry

Factor (Input) Conditions
- Local rules and incentives that encourage investment and productivity
  - e.g., incentives for capital investments, IP protection, corporate governance standards
- Open and vigorous local competition
  - Openness to foreign competition
  - Strict competition laws
- Access to high quality business inputs
  - Human resources
  - Capital availability
  - Physical infrastructure
  - Administrative infrastructure (e.g., business registration, permitting, transparency)
  - Scientific and technological infrastructure

Demand Conditions
- Sophisticated and demanding local customers and needs
  - e.g., Strict quality, safety, and environmental standards
  - Consumer protection laws

Related and Supporting Industries
- Availability and depth of suppliers and supporting industries
  - Quality of collaboration organizations (e.g., trade associations)

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
Building and Upgrading Clusters
Tourism Cluster in Cairns, Australia

- Public Relations & Market Research Services
- Travel Agents
- Tour Operators
- Attractions and Activities e.g., theme parks, casinos, sports
- Hotels
- Restaurants
- 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
How Clusters Emerge and Develop
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 and 2000s
Surge in exports and international acquisitions

Clusters and Economic Diversification

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

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LQ, or Location Quotient, measures the state’s share in cluster employment relative to its overall share of Mexican employment. An LQ > 1 indicates an above average employment share in a cluster.
Geographic Influences on Competitiveness

- Nation
- Region
- State
Regions and Competitiveness

• Economic performance **varies significantly** across sub-national regions (e.g., provinces, states, metropolitan areas)
Mexico Real Growth Rate of GDP per Capita: 1.36%

Mexico GDP per Capita: $77,212

Source: INEGI. Sistema de Cuentas Nacionales de México.

Gross Domestic Product per Capita, 2010 (in constant 2003 Mexican Pesos)

Prosperity Performance in Mexican States

Real Growth Rate of GDP per capita, 2003-2010
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 and Competitiveness

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• Regions **specialize** in different sets of clusters
Specialization of Regional Economies
Leading Traded Clusters by U.S. Economic Area, 2008

Traded Cluster Composition of the Puebla Economy

Overall change in the Puebla Share of Mexican Traded Employment: +0.09%

Puebla Overall Share of Mexican Traded Employment: 4.20%

Change in Puebla’s share of National Employment, 2003 to 2008

-2.0% -1.0% 0.0% 1.0% 2.0% 3.0% 4.0% 6.0% 8.0% 10.0% 12.0% 14.0% 16.0%

Employment 2003-2008
- Added Jobs
- Lost Jobs

Puebla Wages in Traded Clusters vs. National Benchmarks

Regions and Competitiveness

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• Regions **specialize** in different sets of clusters

• **Cluster strength** strongly impacts regional performance
Strong Clusters Drive Regional Performance
Research Findings

- Presence of **strong clusters**
- **Breadth** of industries within each cluster
- Strength in **related clusters**
- Presence of a region’s clusters in **neighboring regions**

- **Job** growth
- Higher **wages**
- Higher **patenting** rates
- Greater **new business** formation, growth and survival

- Build on the region’s **existing** and **emerging** clusters rather than chase hot fields
- Economic diversification usually occurs **within clusters** and **across related clusters**


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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**
  - Business environment improvement
  - Cluster upgrading
Creating a Regional Economic Strategy

Regional Value Proposition

• What is the **distinctive competitive position** of a geographic area given its location, legacy, existing strengths, and potential strengths?
  – What unique strengths as a business location?
  – For what types of activities and clusters?
  – And what roles with the surrounding regions, nation, 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** can be built upon?

Achieving and Maintaining Parity with Peers

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

• **Priorities** and **sequencing** are necessity in economic development
The Evolution of Regional Economies
San Diego

Climate and Geography

Hospitality and Tourism

Transportation and Logistics

Power Generation

Communications Equipment

Analytical Instruments

Education and Knowledge Creation

Medical Devices

Bioscience Research Centers

Biotech / Pharmaceuticals

U.S. Military

Aerospace Vehicles and Defense

Sporting Goods

Information Technology

Transportation and Logistics

Power Generation

Analytical Instruments

Education and Knowledge Creation

Medical Devices

Biotech / Pharmaceuticals

Harnessing the New Process of Economic Development

Competitiveness is the result of both top-down and bottom-up processes in which many companies and institutions take responsibility.

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

**New Model**
- Economic development is a collaborative process involving government at multiple levels, companies, teaching and research institutions, and private sector organizations
Puebla’s Regional Competitiveness Initiative
Agenda

I. Regional Competitiveness: The New Learning

II. The Role of Business in Economic and Social Development
Company Sophistication and Economic Development

**Operational Effectiveness**
- Assimilating, attaining, and extending **best practices**
  
  Do the **same thing better**

**Strategic Positioning**
- Creating a **unique and sustainable** competitive position
  
  Do things **differently** to achieve a **different purpose**
Competing on Strategy
IKEA, Sweden

**Value Proposition**

- Young, first time, or price-sensitive buyers with design sophistication
- Stylish, space efficient and compatible furniture lines and accessories at very low price points.

**Distinctive Activities**

- Modular, ready-to-assemble, easy to ship furniture designs
- In-house design of all products
- Wide range of styles which are all displayed in huge warehouse stores with large on-site inventories
- Self-selection by the customer
- Extensive customer information in the form of catalogs, explanatory ticketing, do-it-yourself videos, and assembly instructions
- IKEA designer names attached to related products to inform coordinated purchases
- Suburban locations with large parking lots
- Long hours of operation
- On-site, low-cost, restaurants
- Child care provided in the store
- Self-delivery by most customers
Business and Society: Why the Disconnect?

- Companies (and investors) have adopted a **narrow model** of economic value creation
  - Meeting **conventional** needs of **conventional** customers
  - Profit improvement through **downsizing, outsourcing, relocating,** and **globalizing**
  - Optimization within **traditional company boundaries**
  - Emphasis on **capital structure** instead of real value creation
  - Driving revenue through **acquisitions** instead of new business creation
  - Societal issues treated as **outside** the scope of business

- **Huge societal needs** go unmet
- **Growth** and **innovation** suffer
The Role of a Company in Its Communities

Philanthropy

- Donations to worthy social causes
The Role of a Company in Its Communities

- Philanthropy
  - Donations to worthy social causes

- Corporate Social Responsibility (CSR)
  - Good corporate citizenship and compliance with community standards
  - “Sustainability”
Societal Needs and Economic Value Creation

- **Social** deficits create **economic** cost
- **External** conditions shape **internal** company productivity
- Social needs represent the **largest market opportunities**
- There is a growing **congruence** between economic value creation and societal objectives
The Role of a Company in Its Communities

- **Philanthropy**
  - Donations to worthy social causes

- **Corporate Social Responsibility (CSR)**
  - Good corporate citizenship and compliance with community standards
  - “Sustainability”

- **Creating Shared Value (CSV)**
  - Integrating societal improvement into economic value creation itself
The Concept of Shared Value

**Shared Value**: Corporate policies and practices that enhance the competitiveness of the company while simultaneously advancing social and economic conditions in the communities in which it sells and operates.

- Create *economic value* by creating *societal value*
  - What is good for the community is good for business
- Use *capitalism* to address social problems
- All profit is *not equal*. Profit involving shared value enables society to advance and companies to grow faster

- Incorporating societal issues into strategy and operations is the **next major transformation** in management thinking.
Moving to Shared Value

CSR

- **Values**: “doing good,” good citizenship, philanthropy, and sustainability
- **Discretionary**
- **Separate** from profit maximization
- Agenda **externally determined**
- Impact is **limited** by the corporate footprint and CSR budget

CSV

- **Value**: economic and societal benefits relative to cost
- Integral to **competing**
- **Essential** to profit maximization
- Agenda is **business specific**
- Mobilizes the **entire company** budget

Example: Fair trade purchasing
Example: Transforming procurement to increase quality and yield

In both cases, **compliance** with laws and ethical standards and reducing harm for corporate activities are **assumed**
Levels of Shared Value

• Reconceiving **customer needs, products, and markets**

• **Redefining productivity** in the value chain
  – How the organization conducts its business

• Enabling **local cluster development**
Creating Shared Value in Products and Markets

Novo Nordisk in China

- **Diabetes training programs for physicians** in partnership with government, NGOs, and opinion leaders to promote the latest thinking on diabetes prevention, screening, treatment, and patient communication
  - The program has **trained 55,000 physicians** to date, each treating approximately 230 patients

- **Diabetes education programs for patients** focusing on prevention, lifestyle changes, and effective use of insulin products
  - **Television, radio, and print media campaigns** about diabetes prevention, detection, and treatment
  - **Changing Diabetes Bus** program to raise patient awareness and provide on-site advice
  - **NovoCare telephone hotline** and **NovoCare Club** providing ongoing support to members

- **Product design** that reflects Chinese patient demographic and culture
  - Formulation with **appropriate insulin dosage** to reflect lighter body weight
  - **Product name** Nuo He Ling means “commitment, harmony, and effectiveness” in Chinese

- Since 1994, Novo Nordisk **market share increased from 0% to 63%** and China became the Company’s **third largest market**, with **revenues of $935 million** in 2011
- Company efforts saved China **140,000 life years** by 2010 and **$2,317 of total lifetime costs per patient**
Redefining Productivity in the Value Chain

- Purchasing
- Energy use
- Resource use
- Logistical efficiency
- Employee productivity
- Location of facilities / supply chain
Identifying Opportunities for Shared Value in Food Services

The Value Chain

- Research on nutritional value
- Less or more biodegradable packaging
- Enhancing research partnerships with colleges and universities
- Value adding procurement practices with farmers and other vendors
- Vendor education and training

- Energy and water use
- Worker safety
- Limiting emissions and waste
- Minimizing use of hazardous materials

- Recruiting from disadvantaged communities
- Diversity
- Employee education and job training
- Employee health
- Compensation and benefits that provide sustainable wage for low income workers

- Minimizing logistical impacts

Firm Infrastructure
(e.g., Financing, Planning, Investor Relations)

Human Resource Management
(e.g., Recruiting, Training, Compensation System)

Technology Development
(e.g., Service Design, Process Design, Market Research)

Procurement
(e.g., Food Procurement, Fleet, Warehouses, Services)
Cluster Development in the Company’s Major Locations

• A strong local cluster improves company growth and productivity
  – Local suppliers
  – Supporting institutions and infrastructure
  – Related businesses

• Companies, working collaboratively, can catalyze major improvements in the cluster and the local business environment

• Local cluster development strengthens the link between a company’s success and community success
Implementing shared value in **sourcing** premium coffees from farmers in Costa Rica, Guatemala, Colombia, and Ghana

Upgrading the cluster
- Supporting local **cluster development** in coffee growing regions, including establishment of cluster institutions
- **Partnering** with stakeholders

**Enhancing Cluster and Community Development**

**Nespresso**

- Better yields
- Better prices
- Better processing

**FARMS**

**COMMUNITY**

- Economic development
- Environmental sustainability

**NESPRESSO**

- Stable supply
- Better quality
- Reinforces strategic positioning

- The three levels of shared value are often **mutually reinforcing**
Creating Shared Value
Implications for Government and Civil Society

• Government and NGOs often assume that trade-offs between economic and social benefits are inevitable
• Government and NGOs will be most effective if they enable shared value by business

Implications for NGOs
• NGOs bring unique expertise, implementation capacity, and relationships of trust with communities

A New Type of NGO

- TechnoServe: Promotes the development of agricultural clusters in more than 30 countries
- RootCapital: Provides financing to more than 400,000 farmers and businesses
- Bill & Melinda Gates Foundation: Forms partnerships with global corporations to foster agricultural clusters

Implications for Governments
• Governments should make platform investments in public assets and infrastructure to enable shared value by business
• Government should regulate in a way that reinforces and rewards shared value in business, rather than working against it
The Purpose of Business

- There is an opportunity to transform thinking and practice about the role of the corporation in society.

- Shared value gives rise to far broader approaches to economic value creation.

- Shared value thinking will drive the next wave of innovation, productivity growth, and economic growth.

- Businesses acting as businesses, not as charitable givers, are arguably the most powerful force for addressing many of the pressing issues facing our society.

- A transformation of business practice around shared value will give purpose to the corporation and represents our best chance to legitimize business again.
Summary and Next Steps

• Create a **shared** understanding of competitiveness
  - Productivity driven
  - Cluster-centric

• Develop a **second-generation strategy** for Puebla which identifies the unique competitive position of the state as a platform for competitiveness
  - Sequence and prioritize action items

• Establish **Sintonía** as the coordinating organization to develop an overall strategy, action priorities, and ensure effective implementation

• Engage the **private sector** more effectively in cluster development and improving the state business environment

• Embrace the **creating shared value** model as a way to engage business to addressing the social and environmental problems of the state

• Develop **metrics** for assessing and reporting progress