Regional Competitiveness and the Role of Business

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This presentation draws on ideas from Professor Porter’s articles and books, in particular, The Competitive Advantage of Nations (The Free Press, 1990), “Building the Microeconomic Foundations of Competitiveness,” in The Global Competitiveness Report (World Economic Forum), “Clusters and the New Competitive Agenda for Companies and Governments” in On Competition (Harvard Business School Press, 2008), and ongoing research on clusters and competitiveness. 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. Further information on Professor Porter's work and the Institute for Strategy and Competitiveness is available at www.isc.hbs.edu
Agenda

I. Regional Competitiveness: The New Learning

II. The Role of Business
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I. Regional Competitiveness: The New Learning

II. The Role of Business
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.
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**
Quality of the Business Environment

Context for Firm Strategy and Rivalry

- 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

Factor (Input) Conditions

- 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
Cluster Strength
Tourism Cluster in Cairns, Australia

Public Relations & Market Research Services
Food Suppliers
Property Services
Maintenance Services
Travel Agents
Tour Operators
Hotels
Attractions and Activities
e.g., theme parks, casinos, sports
Restaurants
Airlines, Cruise Ships

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

Local Retail, Health Care, and Other Services
Local Transportation
Souvenirs, Duty Free
Banks, Foreign Exchange

Sources: HBS student team research (2003) - Peter Tynan, Chai McConnell, Alexandra West, Jean Hayden

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Note: Clusters with overlapping borders or identical shading have at least 20% overlap (by number of industries) in both directions.
Colombia’s Share of World Exports by Cluster, 2010

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Geographic Influences on Competitiveness in the Caribbean Region of Colombia
Regions and Competitiveness

• Economic performance **varies significantly** across sub-national regions (e.g., provinces, states, metropolitan areas)
Prosperity Performance
Colombia Caribbean Departments, 2009

Colombia GDP per Capita: $9,061,535

Colombia Real Growth Rate of GDP per Capita: 3.11%

data source: Banco de la República. Note: GDP in constant 2005 Colombian Pesos ($); bubble size proportional to department population.
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**
Competitiveness Index Performance
Colombia Caribbean Departments, 2009

Colombia GDP per Capita:
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Regions and Competitiveness

• Economic performance \textbf{varies significantly} across sub-national regions (e.g., provinces, states, metropolitan areas)

• Many essential levers of competitiveness reside at the \textbf{regional level}

• Regions \textbf{specialize} in different sets of clusters
Composition of Regional Economies

- Serve **national** and **global** markets
- Exposed to competition from other **regions and nations**

Local Clusters
- Serve almost exclusively the **local** market
- Limited exposure to cross-regional competition for employment

Traded Clusters
- Serve **national** and **global** markets
- Exposed to competition from other **regions and nations**

Resource-based Clusters
- Location determined by **resource location**

Note: Cluster data includes all private, non-agricultural employment.

Specialization of Regional Economies
Leading Traded Clusters by U.S. Economic Area, 2008

Regions and Competitiveness

• Economic performance **varies significantly** across sub-national regions (e.g., provinces, states, metropolitan areas)

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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**

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
### Atlántico's Business Environment: Assessment

#### Context for Firm Strategy and Rivalry
- Open to foreign investment
- Level of competition
- Challenging firm formation
- Registering property
- Paying taxes
- Enforcing contracts
- High level of corruption

#### Demand Conditions
- Low sophisticated demand from the regional and local governments
- Consumer demand not sophisticated or trend-setting

#### Factor (Input) Conditions
- Geographical location
- Water Resources
- Good logistics infrastructure
- High quality technical education
- Internet use density
- Air transportation
- Weak higher educational system
- Low skill levels in the labor force, mismatch with demand
- Relatively few advance degree holders: notably scientists and engineers
- Scarce bilingual population
- Low penetration of financial system
- Limited access to venture capital
- Variety of traded clusters
- Healthy collaboration between the private sector and universities
- Recent set of cluster initiatives
- Low quality of suppliers

Based on "Competitiveness of Department of Atlántico " by Jorge Ramirez-Vallejo, 2008
How Clusters Emerge and Develop
The Australian Wine Cluster

1930
First oenology course at Roseworthy Agricultural College

1955
1950s
Import of European winery technology

1955
Australian Wine Research Institute founded

1965
1960s
Recruiting of experienced foreign investors, e.g. Wolf Bass

1970
Winemaking school at Charles Sturt University founded

1980
1970s
Continued inflow of foreign capital and management

1980
Australian Wine and Brandy Corporation established

1990
1980s
Creation of large number of new wineries

1990
Winemaker’s Federation of Australia established

1991 to 1998
1990s and 2000s
Surge in exports and international acquisitions

The Evolution of Regional Economies
San Diego

Climate and Geography

Hospitality and Tourism

U.S. Military

Transportation and Logistics

Aerospace Vehicles and Defense

Power Generation

Analytical Instruments

Education and Knowledge Creation

Bioscience Research Centers

Communications Equipment

Information Technology

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.
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 advantage 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
Improving the Business Environment of Atlántico

Action Items

1. Reduce unnecessary costs of doing business

2. Establish training programs that are aligned with the needs of business

3. Prioritize infrastructure investments on the most leveraged areas for productivity and economic growth

4. Protect and enhance the department's higher education and research institutions

5. Relentlessly improve the public education system, the essential foundation for productivity in the long run

6. Design all policies to support new company formation in the department

7. Improve access to credit and venture capital
Clusters as a Tool for Competitiveness 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

• Enhances the efficiency and effectiveness of traditional economic policy areas, such as training, R&D, export promotion, FDI attraction, etc.
Agenda

I. Regional Competitiveness: The New Learning

II. The Role of Business
### What Determines Competitiveness?

<table>
<thead>
<tr>
<th>Microeconomic Competitiveness</th>
<th>Macroeconomic Competitiveness</th>
<th>Endowments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quality of the Business Environment</td>
<td>Macroeconomic Policies</td>
<td></td>
</tr>
<tr>
<td>State of Cluster Development</td>
<td>Human Development and Political Institutions</td>
<td></td>
</tr>
<tr>
<td>Sophistication of Company Operations and Strategy</td>
<td></td>
<td></td>
</tr>
</tbody>
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- Productivity ultimately depends on improving the **microeconomic capability** of the economy and the **sophistication of local competition**
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Thinking Strategically

The worst error in strategy is to compete with rivals on the same dimensions
## What Creates a Successful Strategy?

- A **unique value proposition** compared to other organizations
- A **distinctive value chain** tailored to the value proposition
- Making clear tradeoffs, and choosing **not to do**
- Choices across the value chain that **fit together and reinforce each other**
- **Strategic continuity**, with continual improvement in realizing the strategy
Strategic Positioning
Nespresso

Value Proposition

- Uniquely high quality, easy to prepare single-serve espresso coffee at a premium price
- Demanding, convenience-sensitive, affluent consumers, and offices

Distinctive Activities

- Extra-high quality ground coffee in 16+ varieties
- Individually proportioned capsules for freshness and ease of use
- Tailored espresso machines manufactured by high-end machine vendors
- Capsules sold only online or through about 200 coffee boutique shops in major cities, not in mass market food channels
- Nespresso Club to achieve high levels of communication with customers
- Focused image-oriented media advertising
Defining the Value Proposition

What Customers?
• What end users?
• What channels?

What Relative Price?
• Premium? Parity? Discount?

Which Needs?
• Which products?
• Which features?
• Which services?

• A novel value proposition often expands the market
The Role of a Company in Its Communities

Philanthropy

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

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

- Good corporate citizenship and compliance with community standards
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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
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

- Firm Infrastructure (e.g., Financing, Planning, Investor Relations)
- Human Resource Management (e.g., Recruiting, Training, Compensation System)
- Technology Development (e.g., Product Design, Testing, Process Design, Material Research, Market Research)
- Procurement (e.g., Components, Machinery, Advertising, Services)
- Inbound Logistics (e.g., Incoming Material Storage, Data Collection, Service, Customer Access)
- Operations (e.g., Assembly, Component Fabrication, Branch Operations)
- Outbound Logistics (e.g., Order Processing, Warehousing, Report Preparation)
- Marketing & Sales (e.g., Sales Force, Promotion, Advertising, Proposal Writing, Website)
- After-Sales Service (e.g., Installation, Customer Support, Complaint Resolution, Repair)
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
The Role of Business in Competitiveness

Action Agenda

Improving Skills

• Create or expand an apprentice program to train workers to be employable by company and others
• Create or expand a training program to upgrade the skills and productivity of current or prospective employees
• Partner with a community college, technical school, or university to align its curriculum with the needs of business, and commit to hire a number of its graduates

Upgrading Supporting Industries

• Identify and increase sourcing from capable local suppliers
• Mentor local suppliers to upgrade their capabilities and make them more attractive partners
• Join consortia that help small companies access procurement contracts
The Role of Business in Competitiveness

Action Agenda

Supporting Innovation and Entrepreneurship

• Participate in research collaboratives in company’s field that build businesses of the future

• Invest in or incubate promising startups related to company’s business

Shifting the Business-Government Relationship

• Advocate business-wide improvements rather than lobby for special interests

Increasing Overall Cluster Strength

• Participate in a cluster competitiveness initiative in your field
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

• The goal of economic strategy is to enhance department’s productivity. This is the only way to create jobs, high income, and wealth in the long run

• Improving productivity does not just involve new public resources, but using existing resources better

• Economic strategy is non-partisan and about getting results

• Improving productivity demands that the private sector engage government and vice versa

• Improvements in competitiveness take time to produce results
Summary and Next Steps - Continued

- **Competitiveness** improvement is essential to take advantage of the FTA with the United States
- Adopt a **cluster-centric** economic development framework
- Utilize the **royalties** from mining and oil to invest in upgrading long term competitiveness
- Create a **clear strategy** for each department in collaboration with government and other stakeholders
- Strengthen the **organizational capacity** of each departmental competitiveness commission
- Engage the **private sector** more effectively in cluster development and improving the departmental business environment
- Embrace the **creating shared value** model as a way to engage business to addressing the social and environmental problems of the region
- Take advantage of opportunities for collaboration with **neighboring departments** to improve productivity in logistics, energy networks, higher education and other areas