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 Next Stage for Colombia

II. The Role of Business in Economic and Social Development
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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
• 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

• 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
Building and Upgrading Clusters
Tourism Cluster in Cairns, Australia

Sources: HBS student team research (2003) - Peter Tynan, Chai McConnell, Alexandra West, Jean Hayden
# How Clusters Emerge and Develop

## The Australian Wine Cluster

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
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<tbody>
<tr>
<td>1930</td>
<td>First oenology course at Roseworthy Agricultural College</td>
</tr>
<tr>
<td>1955</td>
<td>Australian Wine Research Institute founded</td>
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<tr>
<td>1965</td>
<td>Australian Wine Bureau established</td>
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<tr>
<td>1970</td>
<td>Winemaking school at Charles Sturt University founded</td>
</tr>
<tr>
<td>1980</td>
<td>Australian Wine and Brandy Corporation established</td>
</tr>
<tr>
<td>1990</td>
<td>Winemaker’s Federation of Australia established</td>
</tr>
<tr>
<td>1991-1998</td>
<td>New organizations created for education, research, market information, and export promotions</td>
</tr>
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</table>

### 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.
Colombia’s Cluster Portfolio, 2010

Note: Clusters with overlapping borders have at least 20% overlap (by number of industries) in both directions.
Geographic Influences on Competitiveness

Nation

Region

Department
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
Composition of Regional Economies

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.

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** 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
The Evolution of Regional Economies
San Diego

- Climate and Geography
- U.S. Military

1910
1930
1950
1970
1990
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
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
Agenda

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Company Sophistication and Economic Development

Operational Effectiveness Is Not Strategy

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
<table>
<thead>
<tr>
<th>Value Proposition</th>
<th>Distinctive Activities</th>
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- Young, first time, or price-sensitive buyers with design sophistication
- Stylish, space efficient and compatible furniture lines and accessories at very low price points.

- 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

- 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

**Example**: Fair trade purchasing

**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**: 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
Enhancing Cluster and Community Development

**Nespresso**

- 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

### Shared Value

<table>
<thead>
<tr>
<th>Farmers</th>
<th>Community</th>
<th>Nespresso</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Better yields</td>
<td>• Economic development</td>
<td>• Stable supply</td>
</tr>
<tr>
<td>• Better prices</td>
<td>• Environmental sustainability</td>
<td>• Better quality</td>
</tr>
<tr>
<td>• Better processing</td>
<td></td>
<td>• Reinforces strategic positioning</td>
</tr>
</tbody>
</table>

- 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

<table>
<thead>
<tr>
<th>NGO</th>
<th>Description</th>
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<tbody>
<tr>
<td>TechnoServe</td>
<td>Promotes the development of agricultural clusters in more than 30 countries</td>
</tr>
<tr>
<td>RootCapital</td>
<td>Provides financing to more than 400,000 farmers and businesses</td>
</tr>
<tr>
<td>Bill &amp; Melinda</td>
<td>Forms partnerships with global corporations to foster agricultural clusters</td>
</tr>
<tr>
<td>Gates Foundation</td>
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</tbody>
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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**