

Turkey's Competitiveness: National Economic Strategy and the Role of Business

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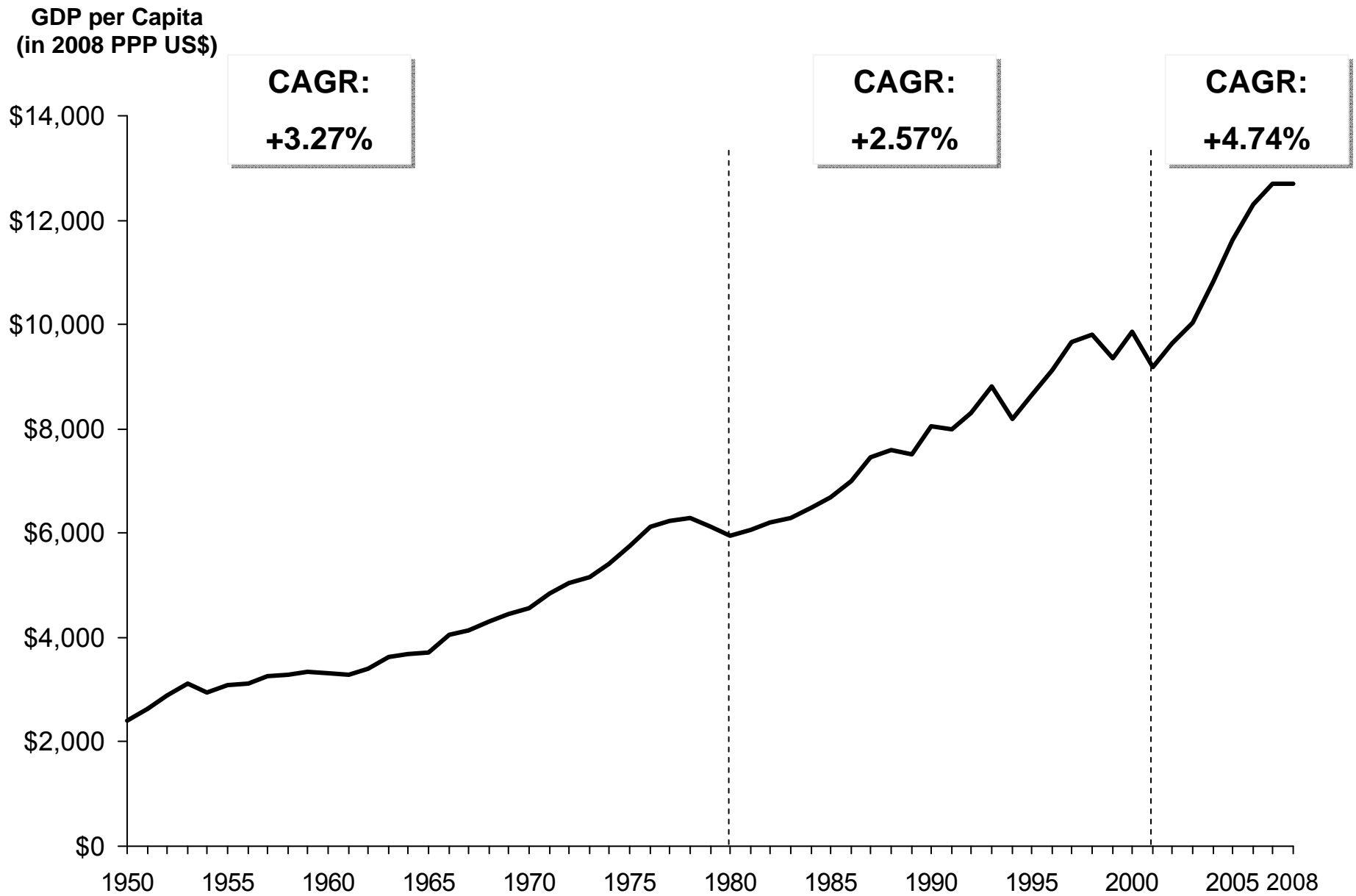
Istanbul, Turkey
16 October 2009

This presentation draws on ideas from Professor Porter's articles and books, including, *The Competitive Advantage of Nations* (The Free Press, 1990), "The Microeconomic Foundations of Economic Development," 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 at the Institute for Strategy 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,
Version: October 14, 2009 (6:30pm)

Agenda

- **Turkey's Economic Performance**
- Principles of Competitiveness
- Assessment of Turkey's Competitive Position
- Towards an Economic Strategy

Turkey's Prosperity Performance

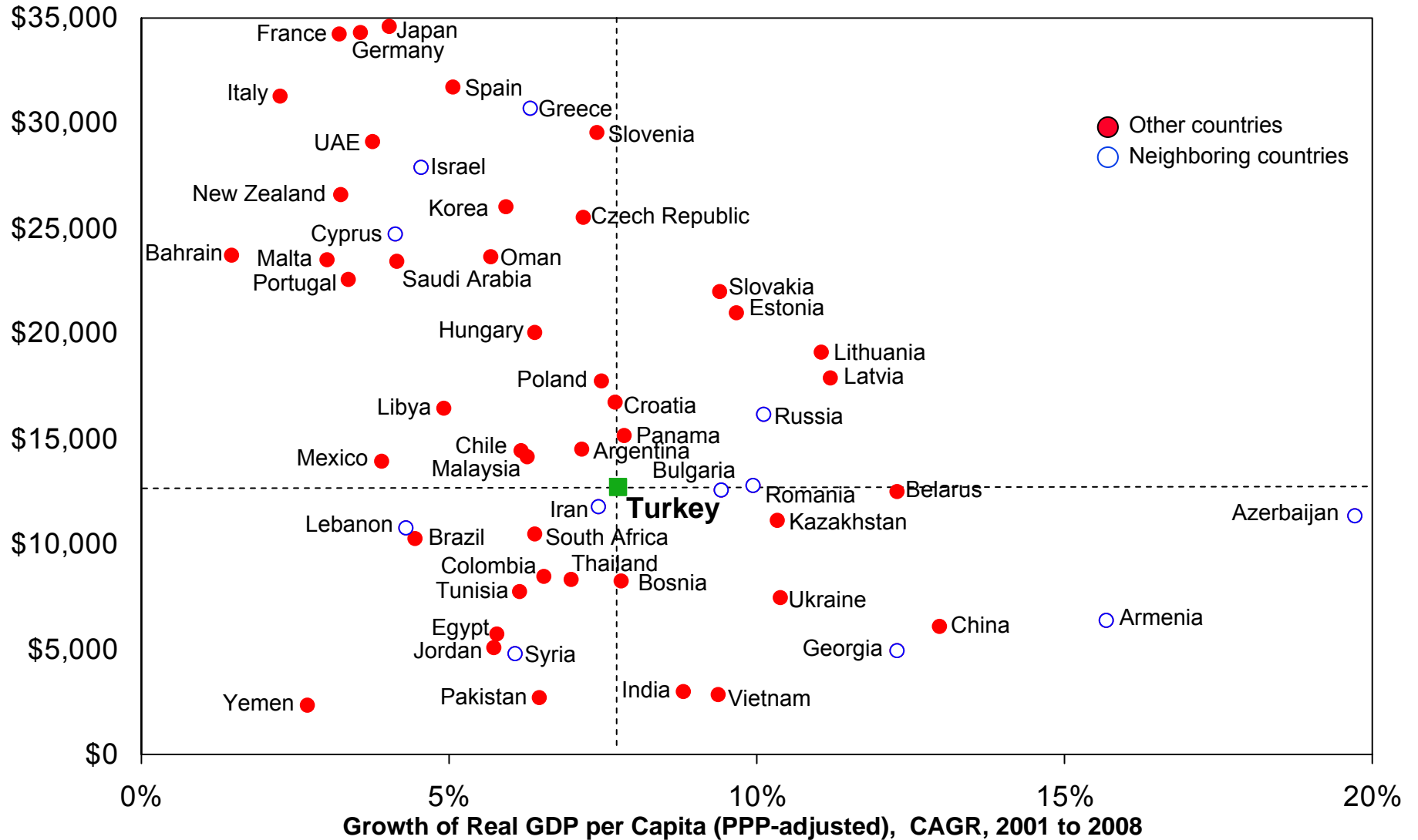


Note: PPP using EKS calculation methodology. Source: Groningen Growth and Development Centre, Total Economy Database (June 2009)

Prosperity Performance

Selected Middle and Upper Middle Income Countries

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



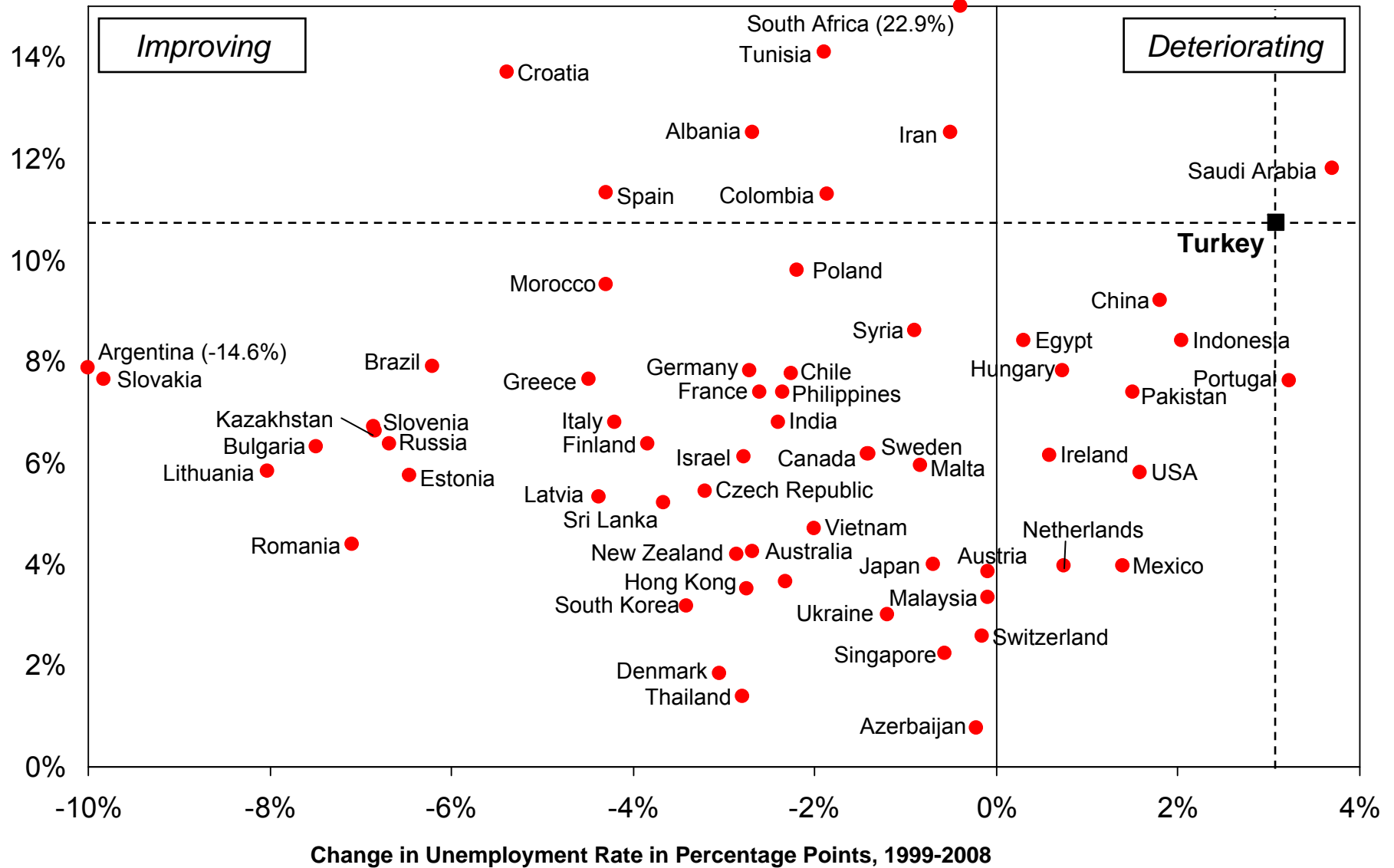
Source: EIU (2009), authors calculations

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Unemployment Performance

Unemployment Rate, 2008

Selected Middle and Upper Middle Income Countries



Note: In some cases, 1999 data was unavailable, so 2000 data used.

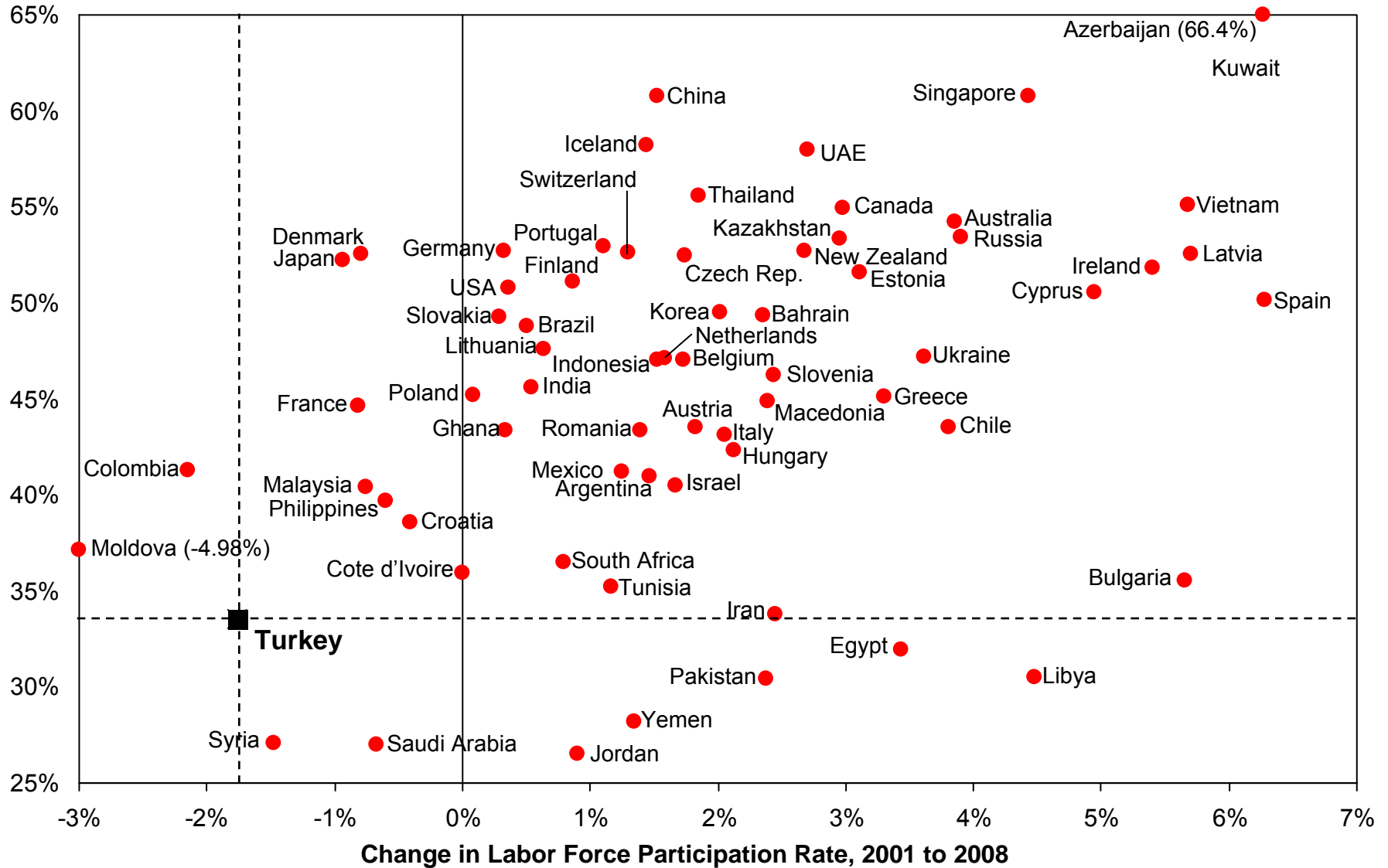
Source: EIU (2009)

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Labor Force Utilization

Participation Rates, Selected Countries

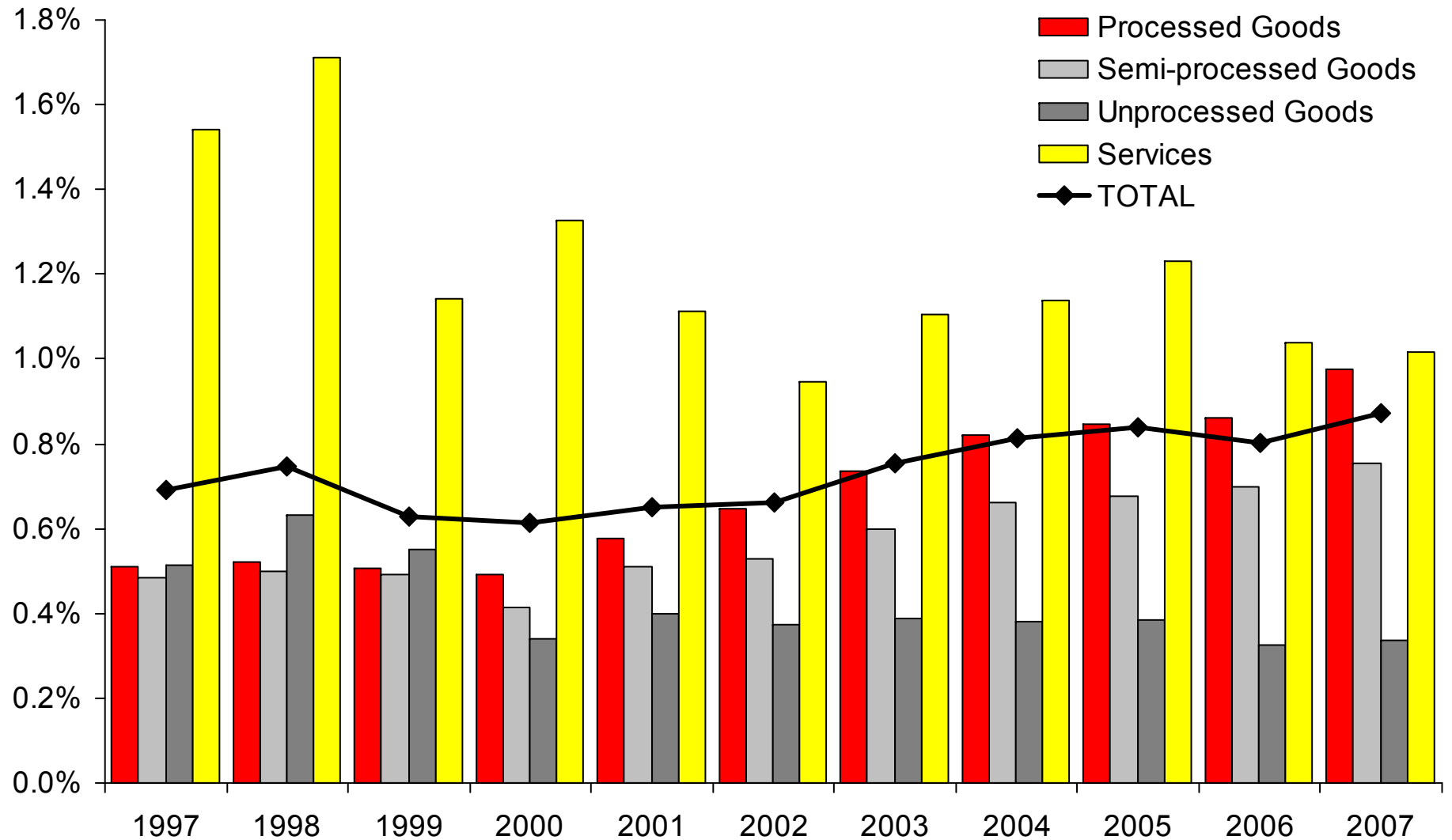
Labor Force Participation Rate, 2008



Source: Economist Intelligence Unit (2009)
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Turkey's Export Share Trends

World Export Market Share



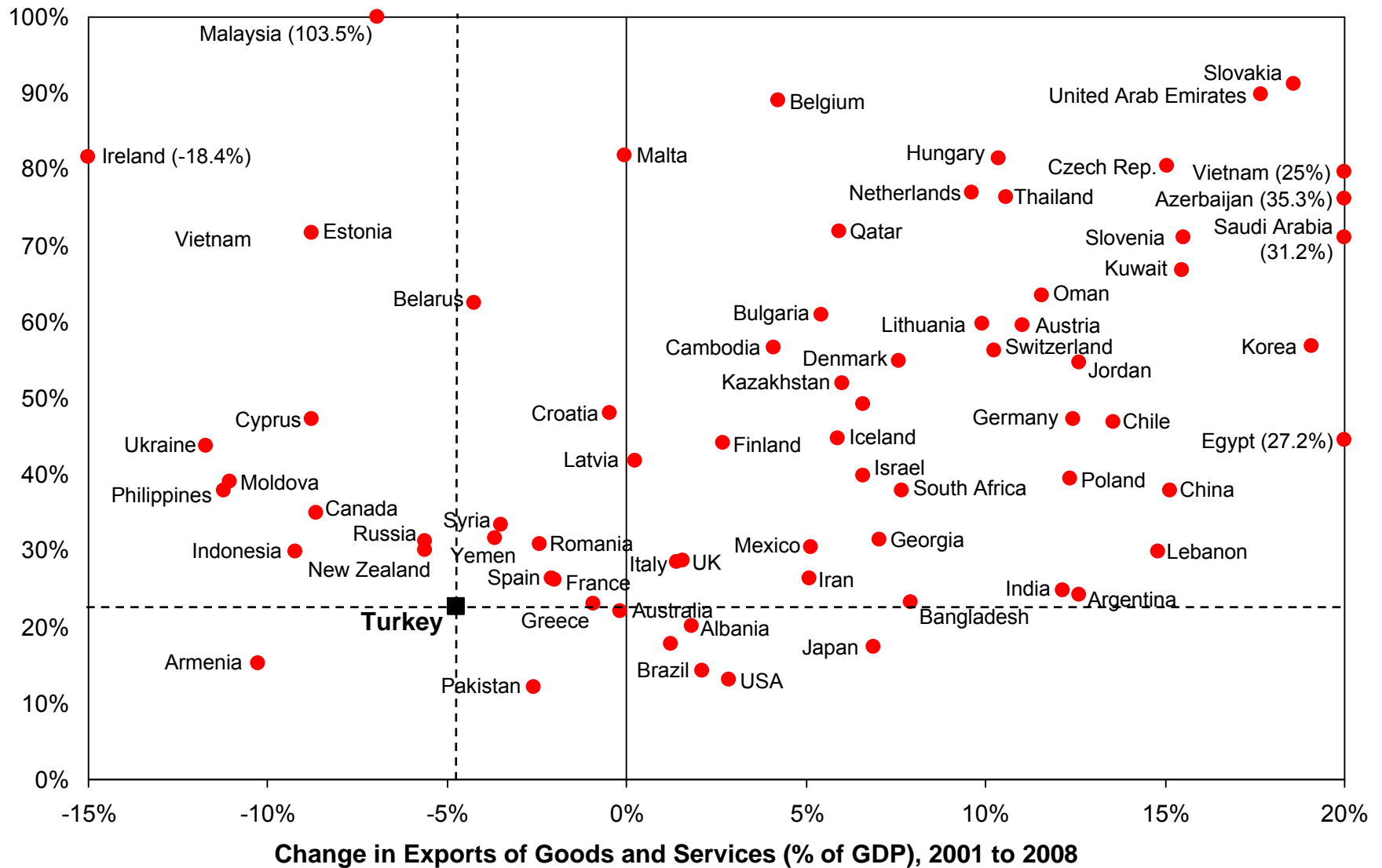
Source: WTO (2009)

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Export Performance

Selected Middle and Upper Middle Income Countries

Exports of Goods and Services (% of GDP), 2008

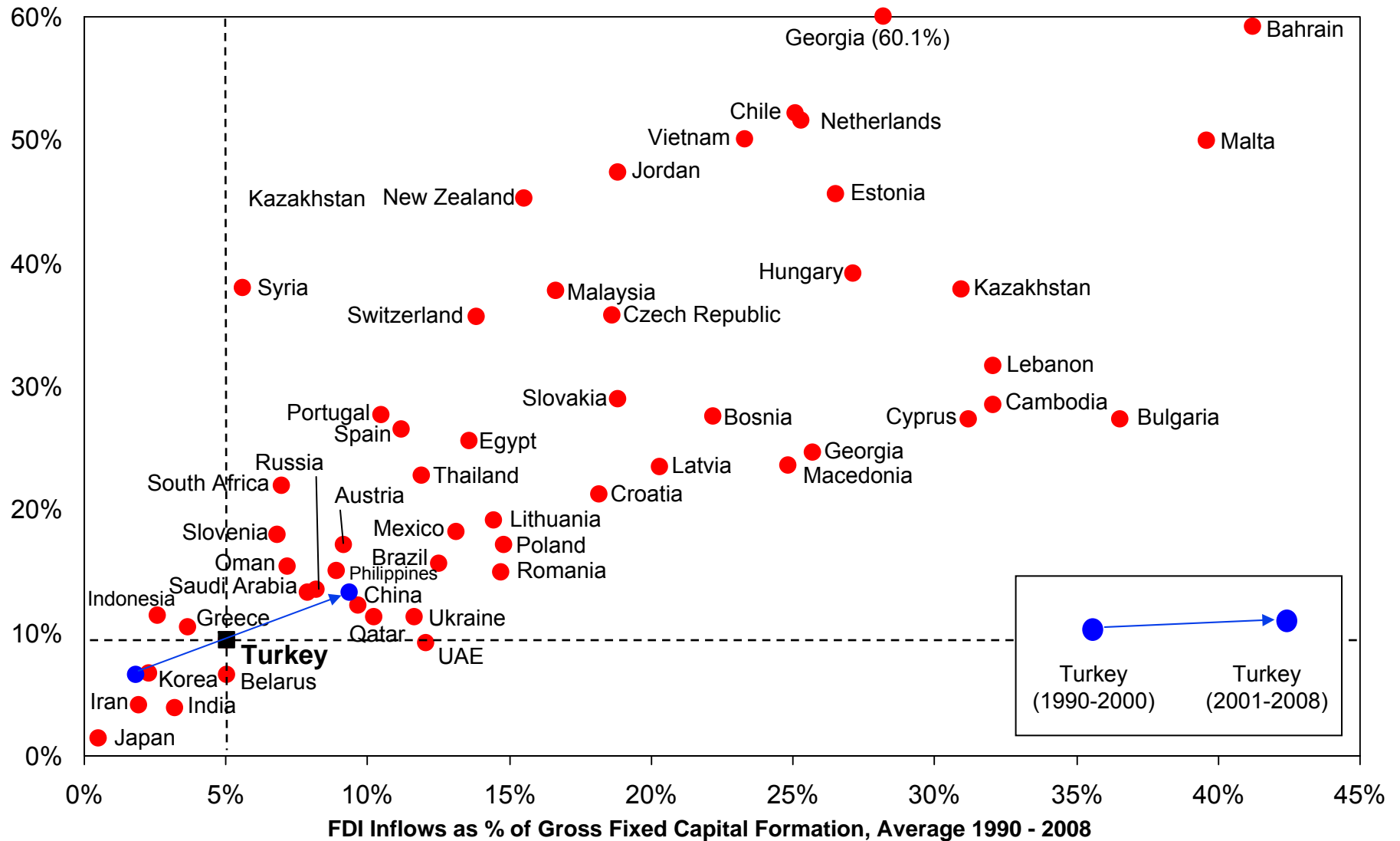


Source: EIU (2008), authors' analysis
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Inbound Foreign Investment Performance

Stocks and Flows, Selected Countries

Inward FDI Stocks as % of GDP, Average 1990-2008

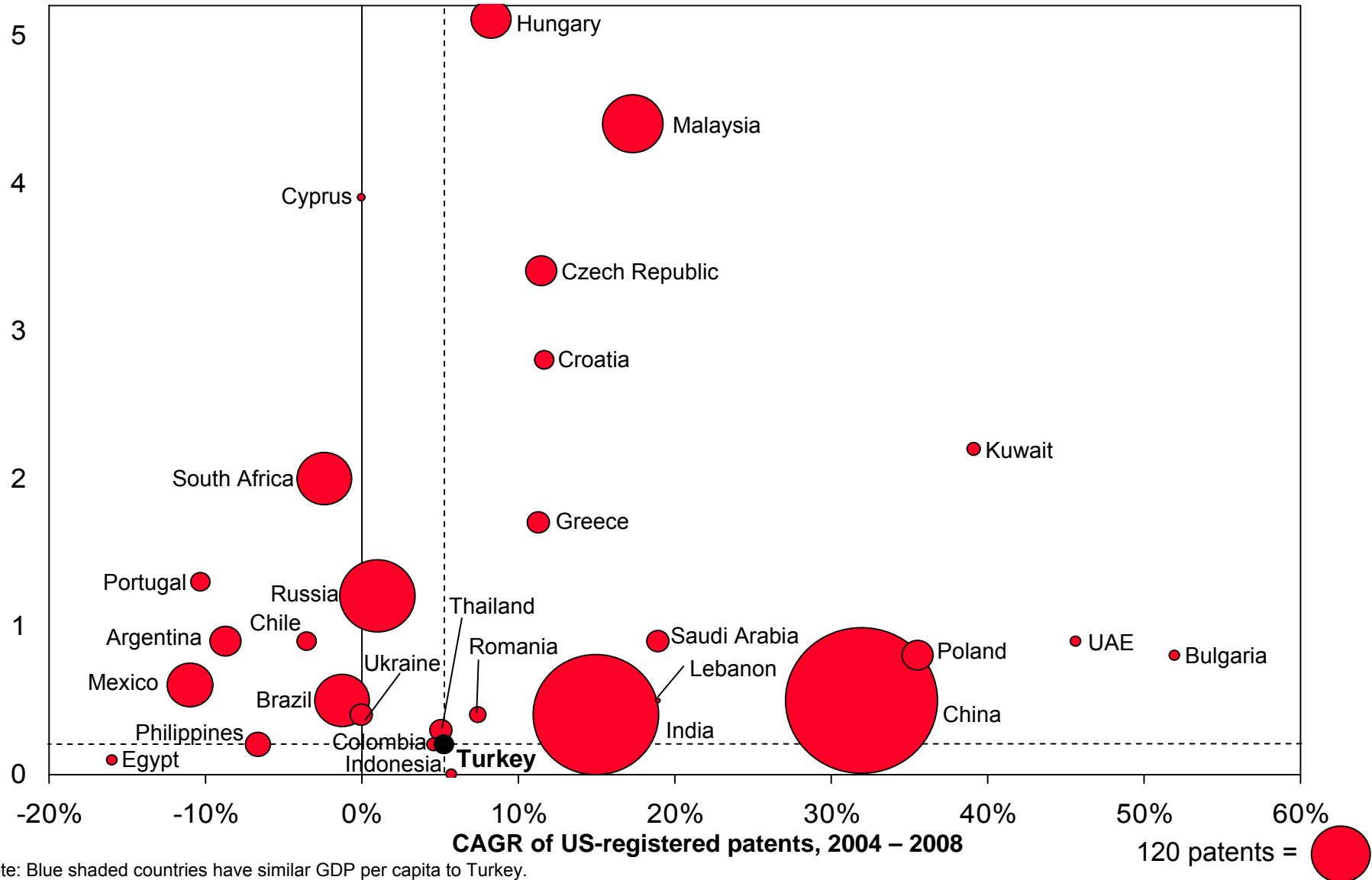


Source: UNCTAD, World Investment Report (2009)
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Innovative Capacity

Innovation Output of Selected Countries

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



Note: Blue shaded countries have similar GDP per capita to Turkey.

Source: USPTO (2008), EIU (2008)

Strategic Issues Facing Turkey in 2009

- There have been significant **policy improvements** since 2001, such as opening the economy to trade and competition, streamlining regulations, and improving infrastructure
- However, the **slowdown of reforms** during 2008 exposed Turkey to the brunt of the global crisis
 - Investors and consumers are still wary given Turkey's historical track record
- Improving Turkey's future economic performance will require addressing **numerous challenges**
 - Turkey has only reached the first stage in becoming a truly competitive economy
- Second stage reforms are considerably **more challenging**
- Turkey needs a coherent **economic strategy** in order to continue its progress
- The **private** and the **public sector** must collaborate in order to take the economy to the next level

Agenda

- Turkey's Economic Performance

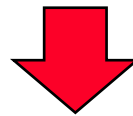
- **Principles of Competitiveness**

- Assessment of Turkey's Competitive Position

- Towards an Economic Strategy

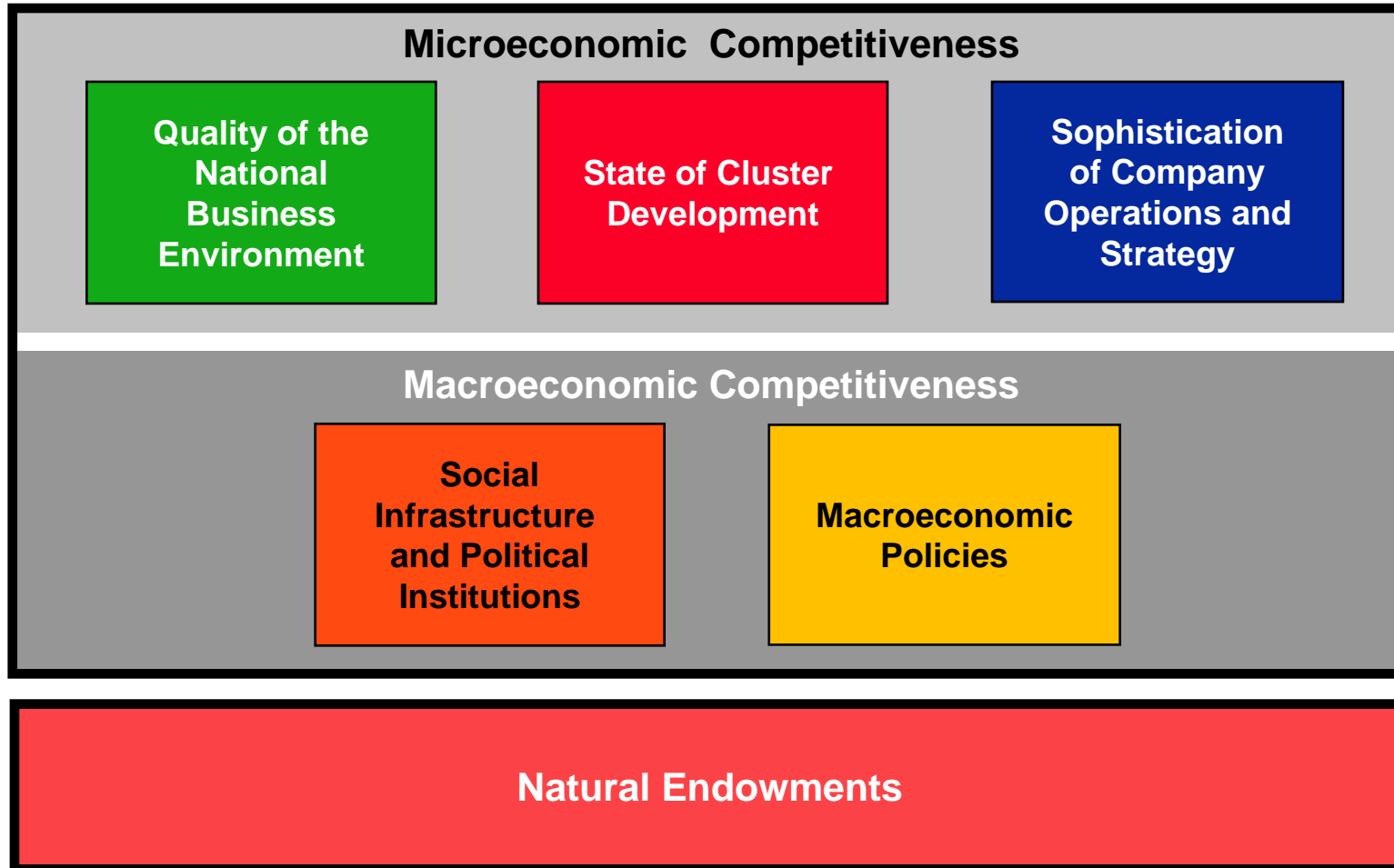
What is Competitiveness?

- 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
 - Relentless **innovation** in technology, products, and organizational methods is necessary to **drive productivity growth** and a rising standard of living



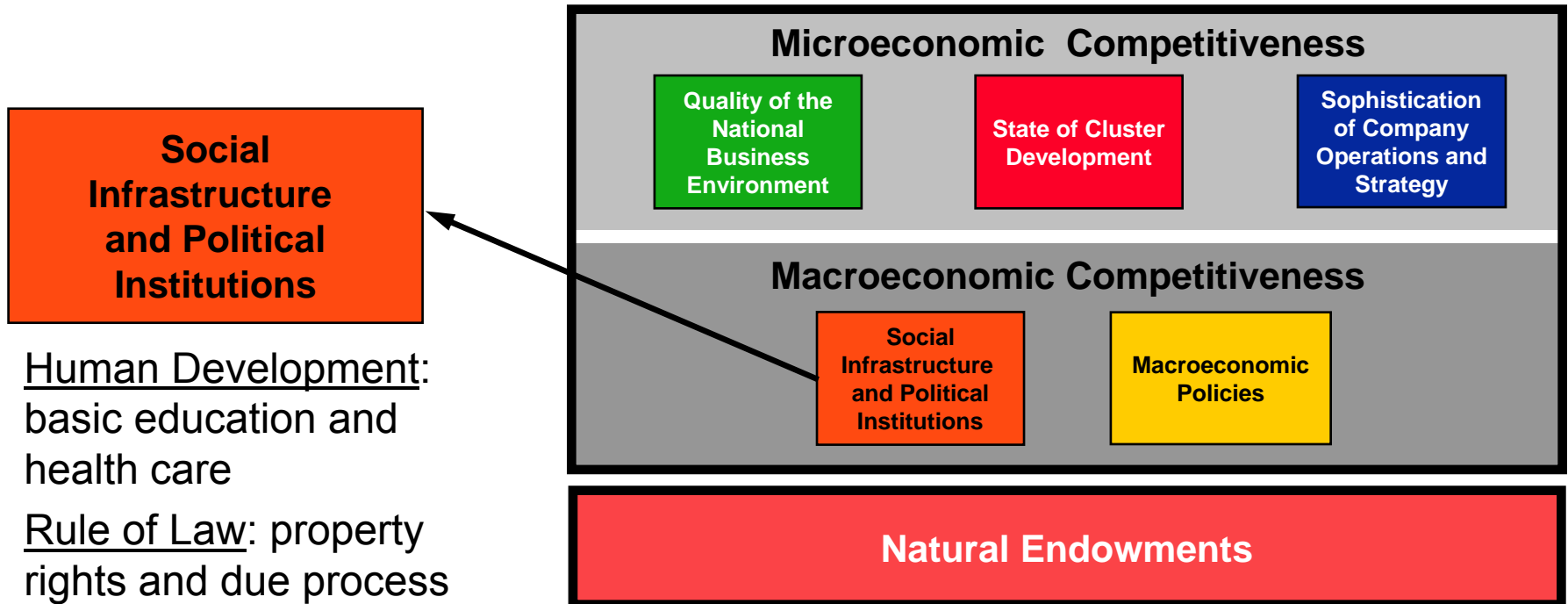
- Nations compete to offer the **most productive environment for business**
- The public and private sectors play **different but interrelated roles** in creating a productive economy

Determinants of Competitiveness



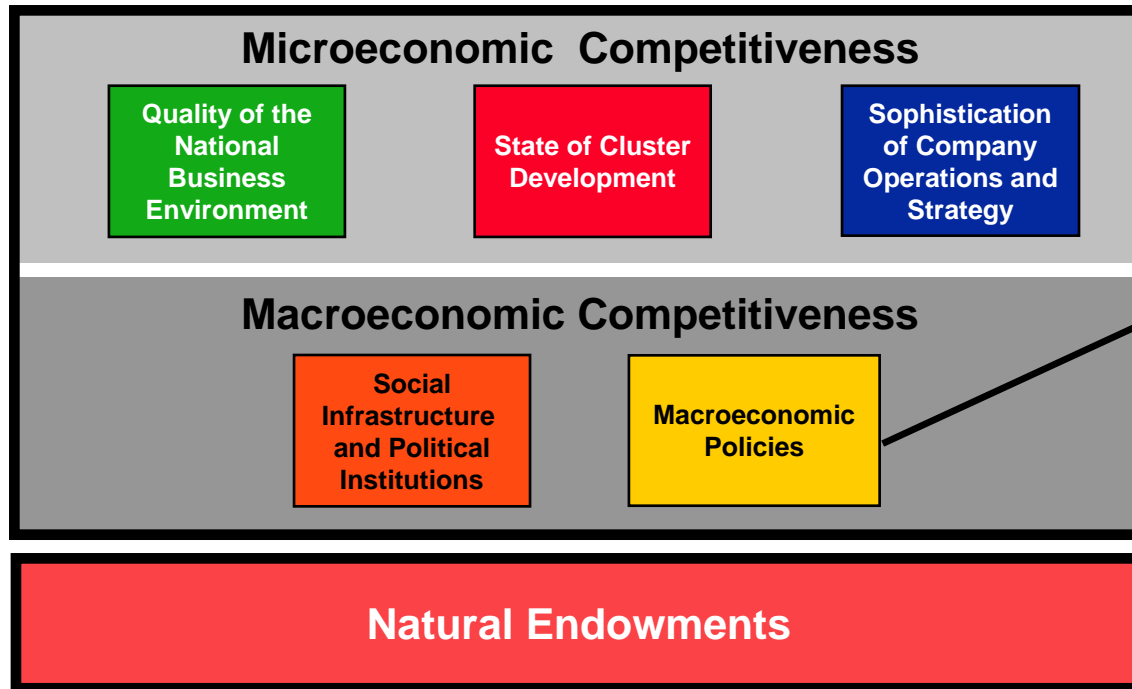
- Macroeconomic competitiveness creates the potential for high productivity, but is **not sufficient**
- Productivity ultimately depends on improving the **microeconomic capability** of the economy and the **sophistication of local competition**

Determinants of Competitiveness



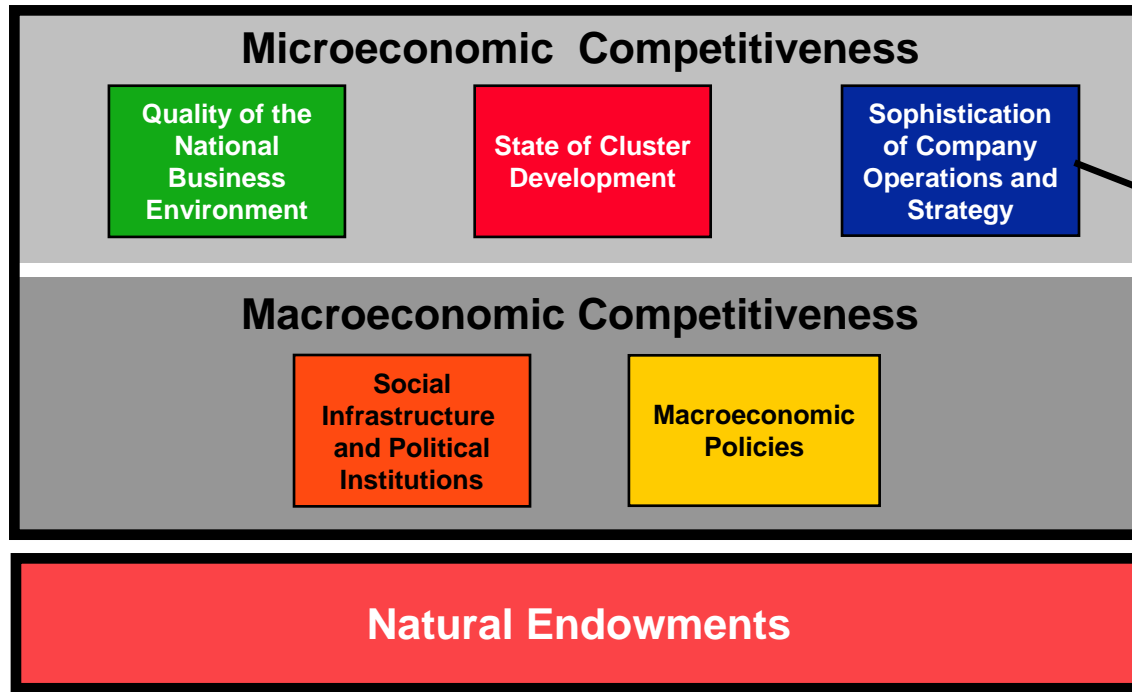
- Human Development: basic education and health care
- Rule of Law: property rights and due process
- Political Institutions: stable and effective political and governmental processes and organizations

Determinants of Competitiveness



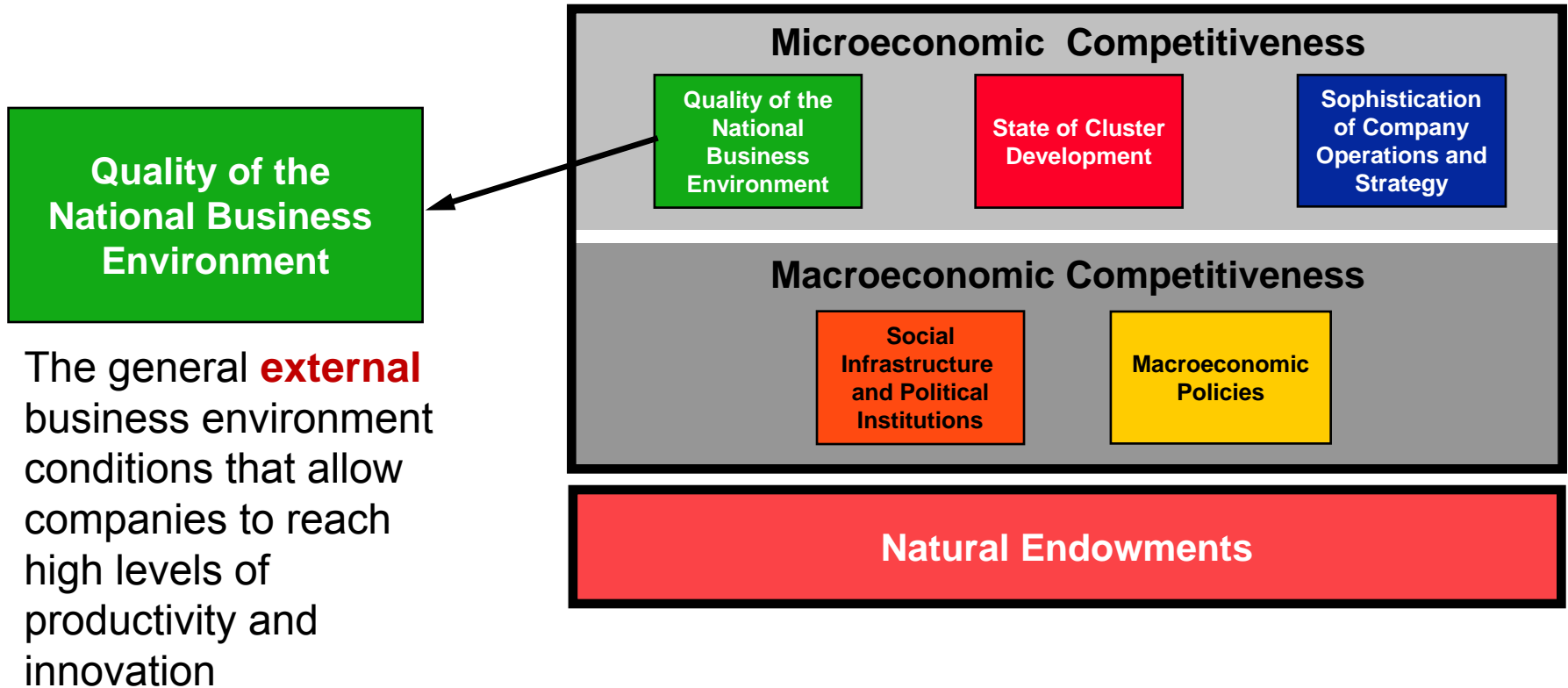
- Fiscal policy: public spending aligned with revenues over time
- Monetary policy: low levels of inflation
- Macroeconomic management: avoiding structural imbalances and cyclical overheating

Determinants of Competitiveness

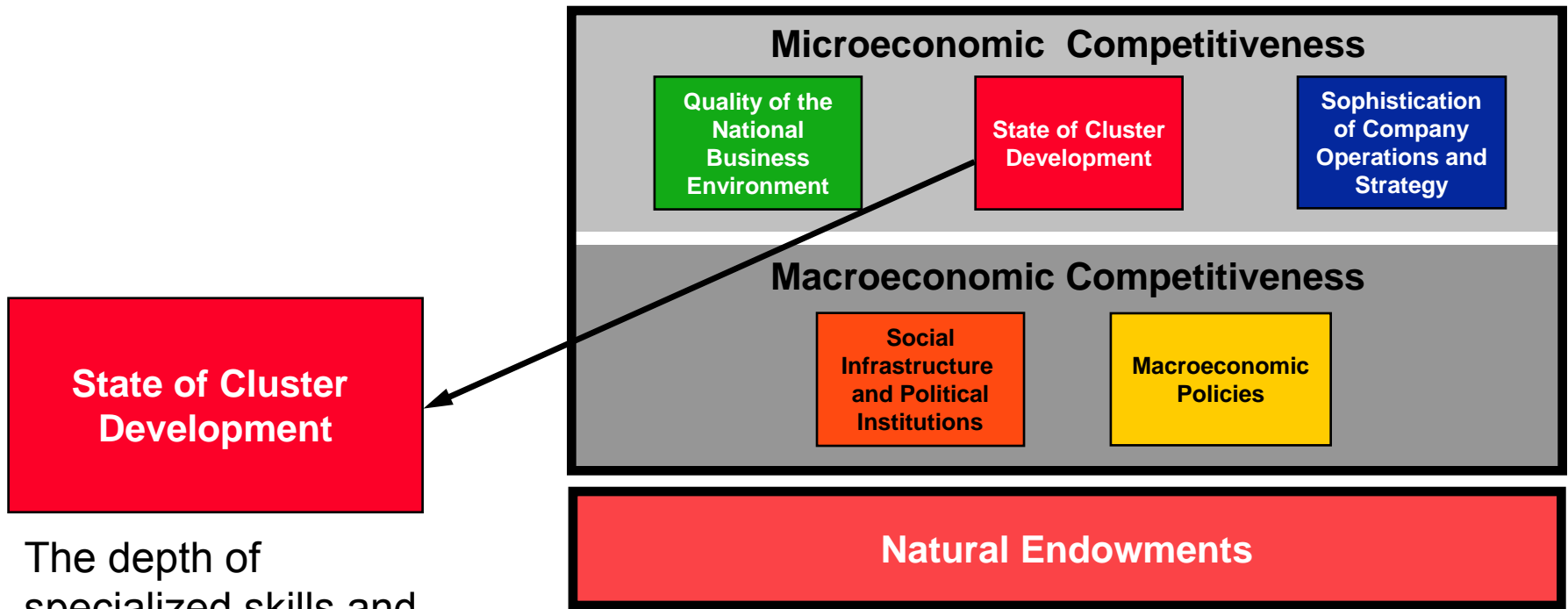


- The **internal** skills, capabilities, and management practices needed to attain the highest level of company productivity and innovation possible

Determinants of Competitiveness

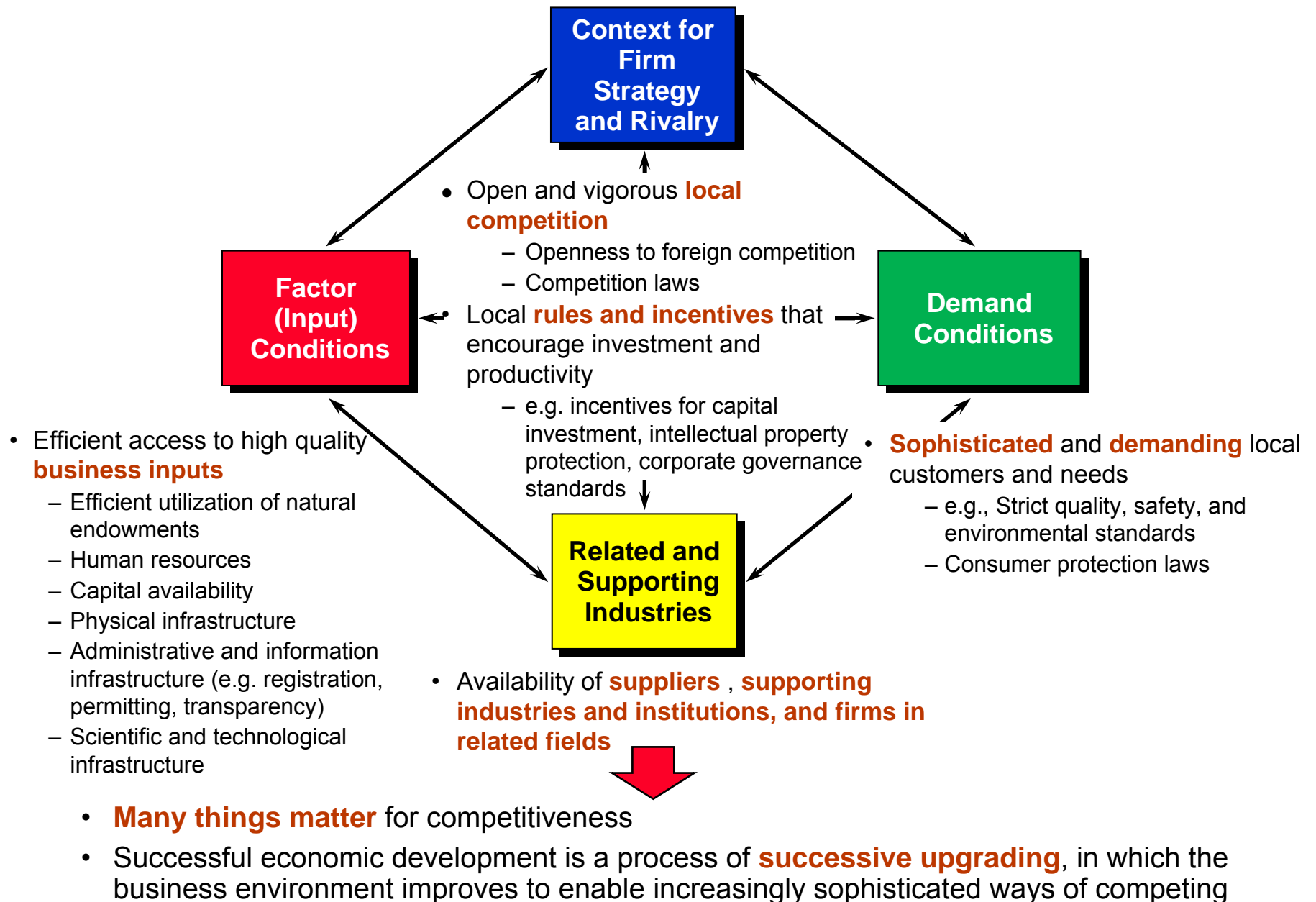


Determinants of Competitiveness



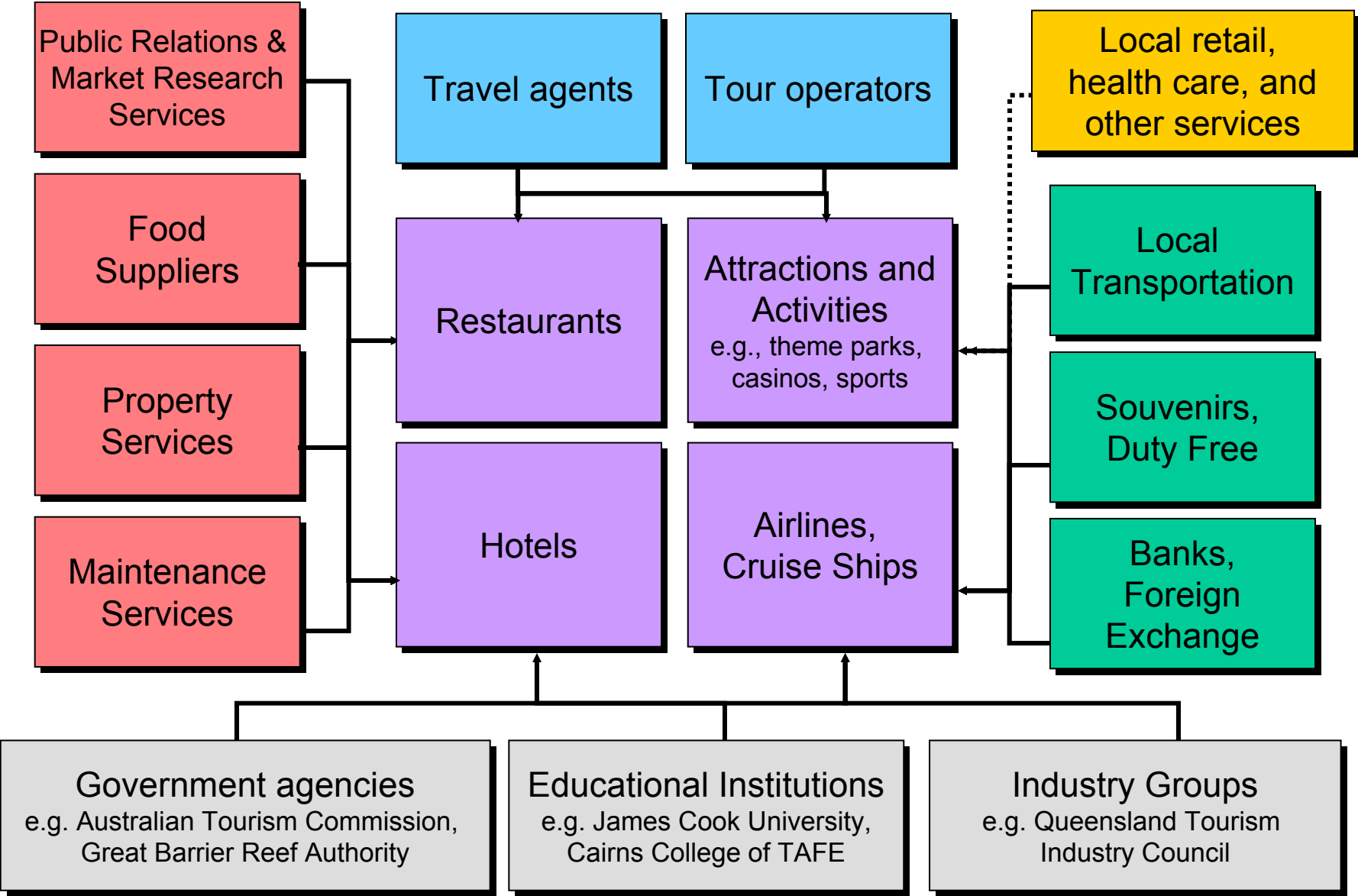
- The depth of specialized skills and assets and the ability to capture **synergies** across related firms and industries

Quality of the Business Environment



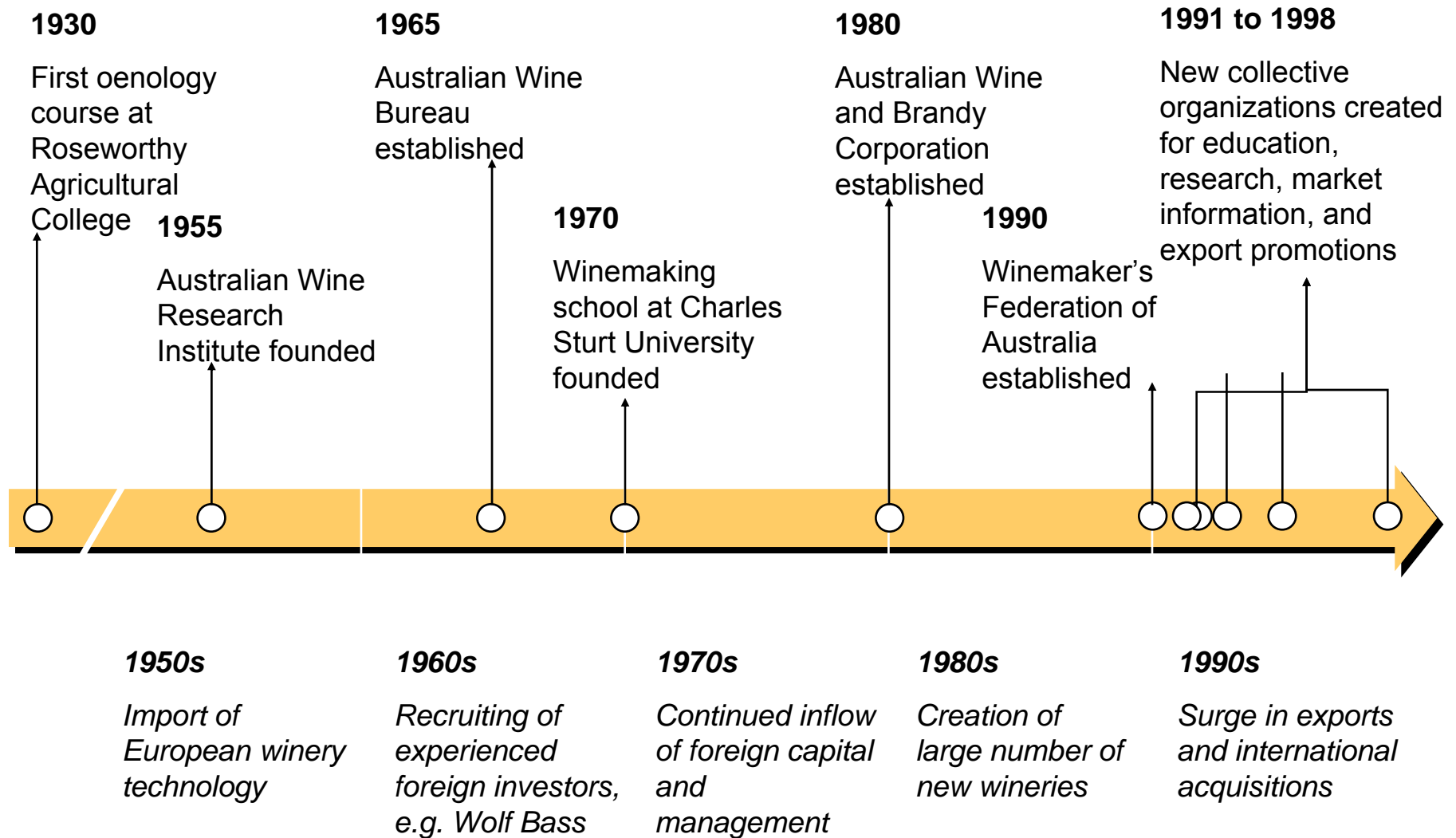
State of Cluster Development

Tourism Cluster in Cairns, Australia



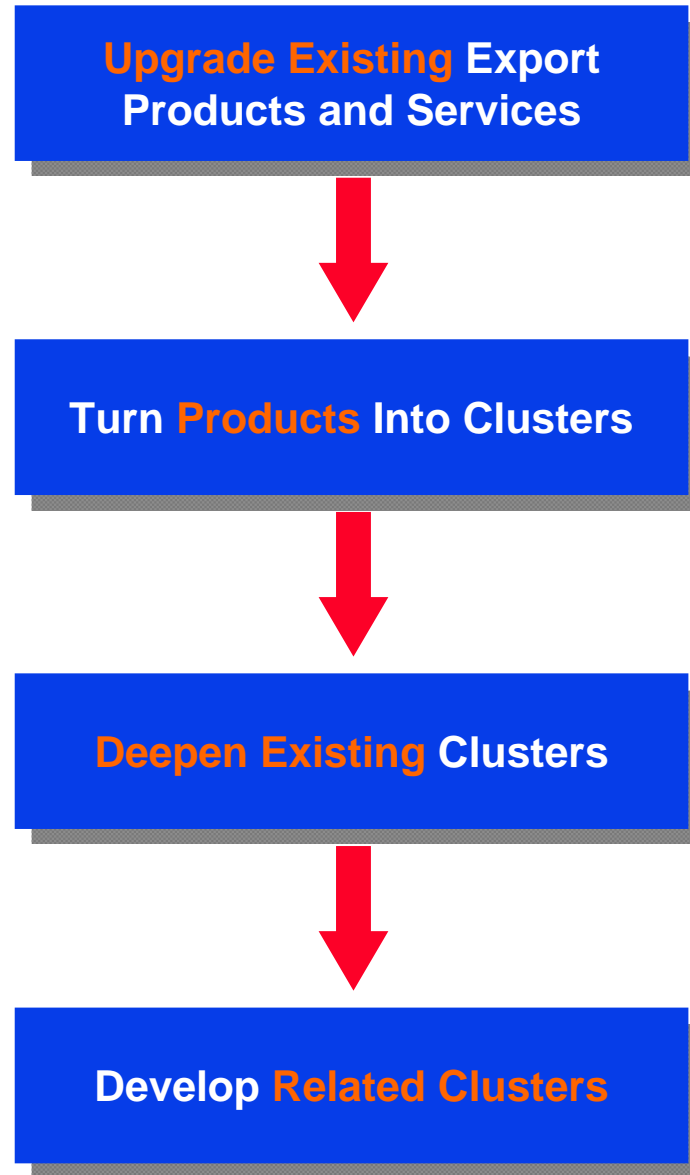
Sources: HBS student team research (2003) - Peter Tynan, Chai McConnell, Alexandra West, Jean Hayden

Development of the Australian Wine Cluster



Source: Michael E. Porter and Örjan Sölvell, The Australian Wine Cluster – Supplement, Harvard Business School Case Study, 2002

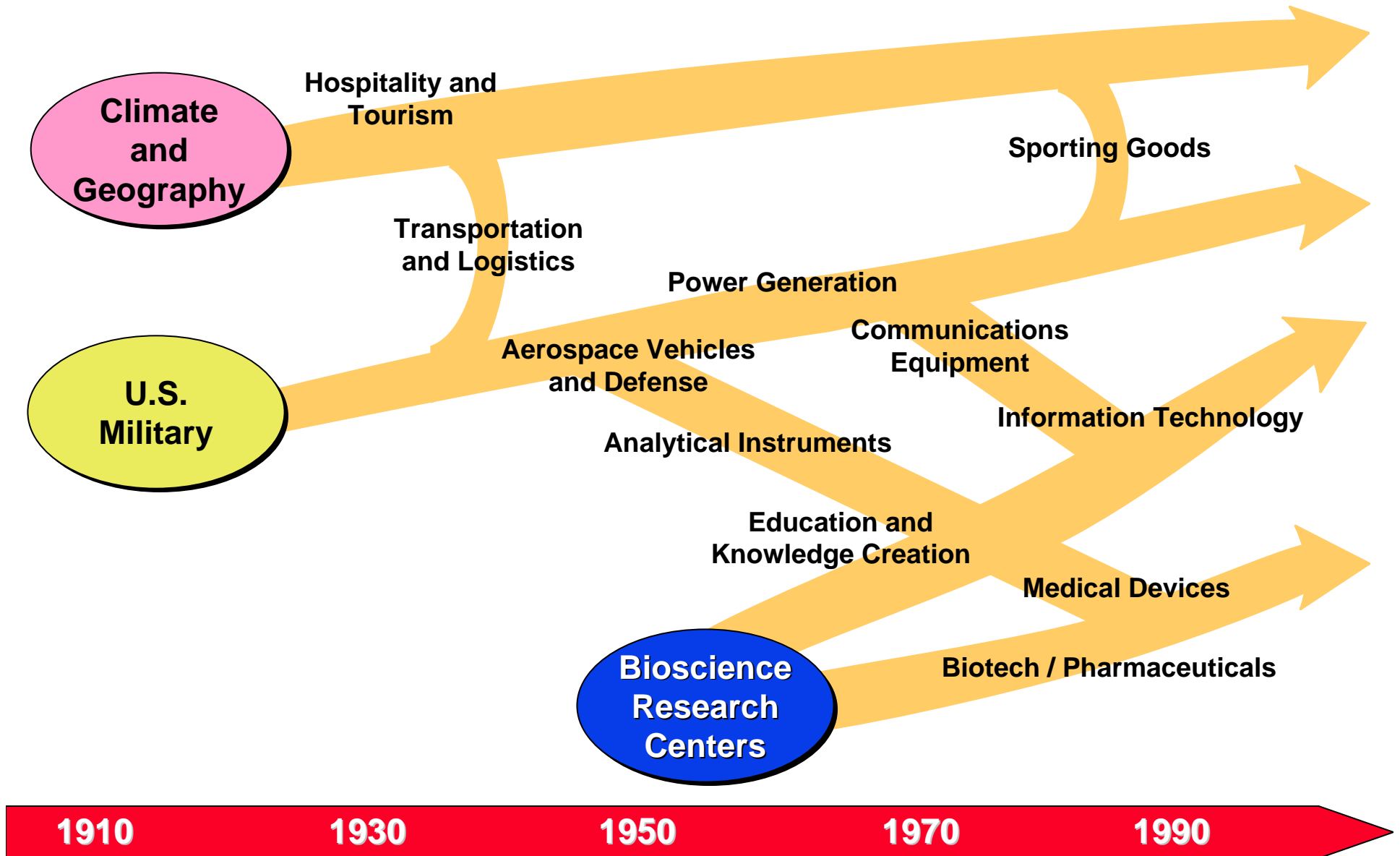
Clusters and Economic Diversification



- Local firms
- MNCs

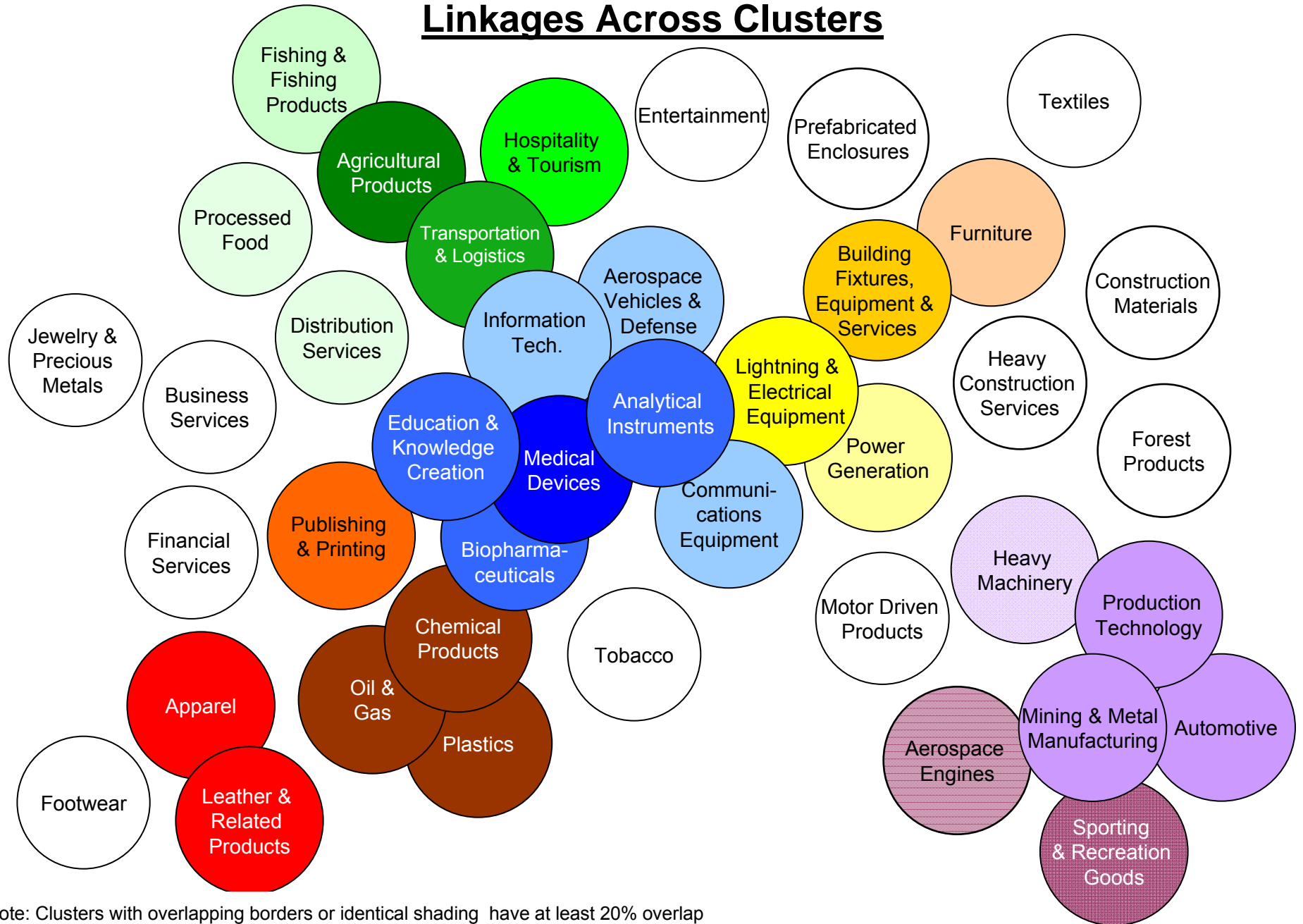
The Evolution of Regional Economies

San Diego



Clusters and Economic Diversification

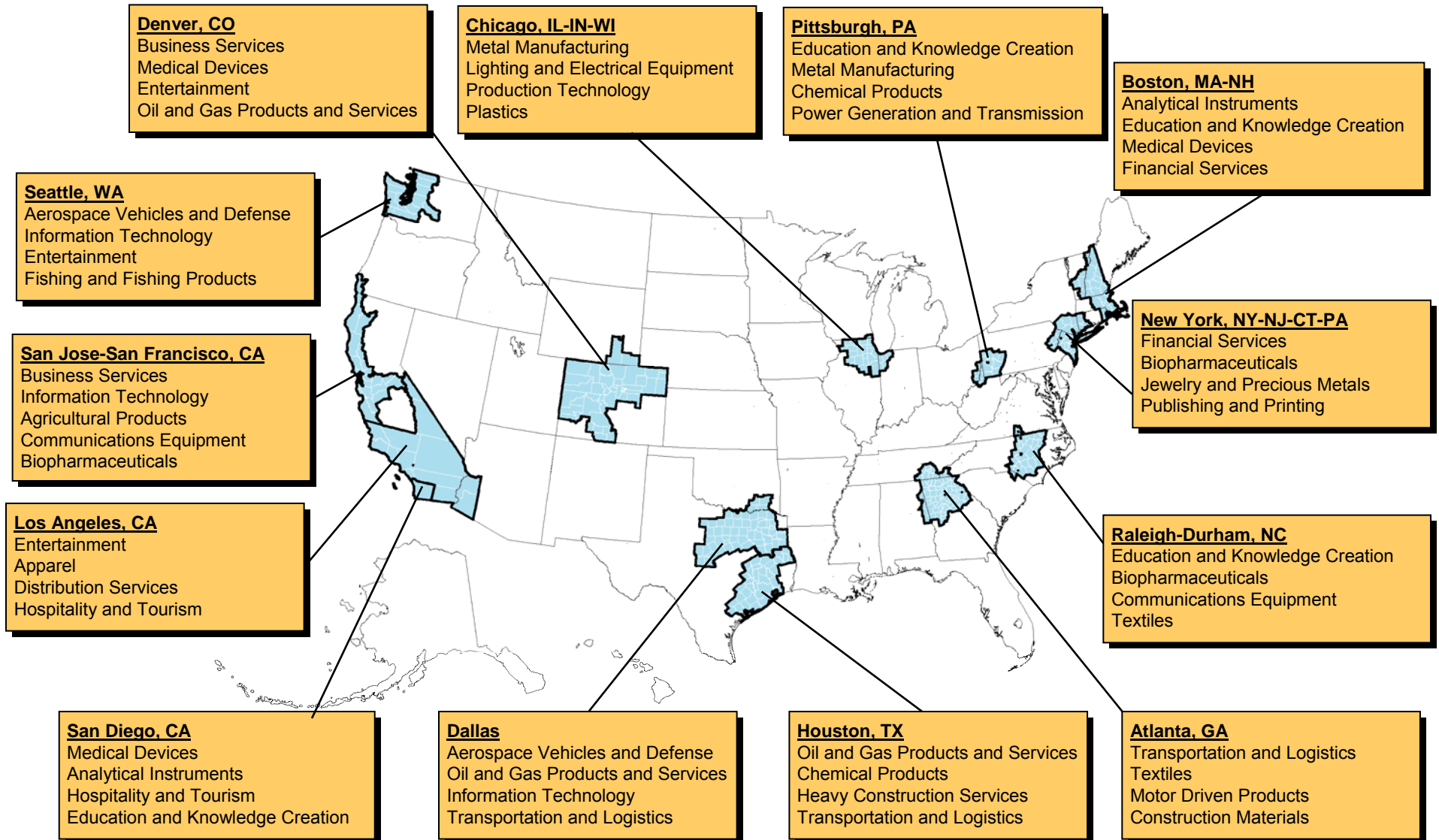
Linkages Across Clusters



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

Specialization of Regional Economies

Leading Clusters by U.S. Economic Area, 2007



Source: Prof. Michael E. Porter, Cluster Mapping Project, Institute for Strategy and Competitiveness, Harvard Business School; Richard Bryden, Project Director.

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**
- Region's **specialize** in different sets of clusters
- **Cluster strength** directly impacts regional performance
- Each region needs its own distinctive **competitiveness agenda**
- Competitiveness requires **effective policy collaboration** between regions and the national government



- **Decentralization** of economic policy is especially important in large countries to foster regional specialization, internal competition, and accountability

Economic Integration Among Neighboring Countries

Turkey's Neighborhood



- Turkey sits at the crossroad between Europe and the Middle East
- Economic coordination among neighboring countries can significantly enhance competitiveness
- Integration offers greater opportunities than participation in broader economic forums (e.g., EU)

Competitiveness and the Neighborhood

- Opening **trade and investment** among neighbors
 - 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 a more attractive location for **investment**
- Economic coordination to drive **improvements in the business environment**
 - Capturing **synergies** in policy and infrastructure
 - Gaining 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 infrastructure**
- Creating an efficient **energy** network
- Enhancing regional **communications** and **connectivity**
- Linking **financial markets**
- Opening the movement of students for **higher education**
- Harmonizing **administrative requirements** for businesses

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

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

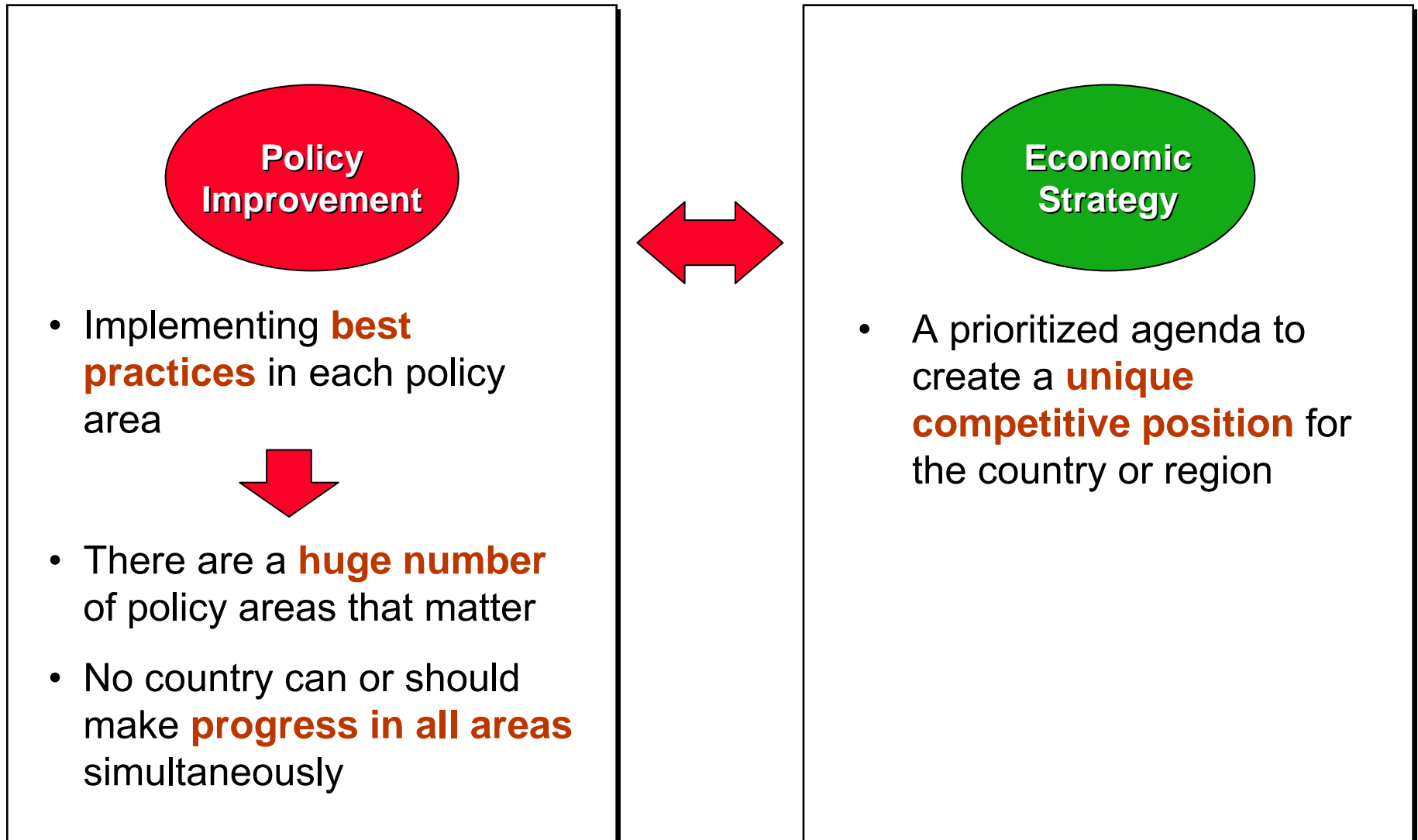
Related and Supporting Industries

- Facilitating **cross-border cluster development**
 - e.g., Supplier networks
 - Transport & Logistics
 - Quality standards

Macroeconomic Competitiveness

- Coordinating **macro-economic** policies
- Coordinating programs to improve **public safety**

The Need for an Economic Strategy



The Need for an Economic Strategy

National Value Proposition

- What are the **distinctive competitive assets** of the nation's economy given its location, legacy, rate of progress, existing strengths, and potential strengths?
 - What unique value as a business location?
 - In what types of fields / clusters?
 - What roles with neighbors, the broad region, and the wider world?

Refining Unique Strengths

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

Addressing Crucial Constraints

- What are the crucial **weaknesses** and **constraints** that must be addressed to achieve parity with peer countries and allow the country to move to the next level?

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

The Process of Economic Development

Shifting Roles and Responsibilities

Old Model

- The **central government** drives economic development through policy decisions, spending and incentives



New Model

- Economic development is a **collaborative process** involving government at multiple levels, companies, educational and research institutions, and private sector organizations

- Competitiveness must be a **bottom-up process** in which many individuals, companies, and institutions take responsibility and act

Role of the Private Sector in Economic Development

- The competitive advantage of companies depends partly on the **quality of the business environment** at the national and regional level
- A company gains advantages from being part of a strong **cluster**

Corporate role in competitiveness

- Inform government on **business needs** and **constraints** bearing on company and cluster development
- Nurture local **suppliers** and attract foreign suppliers
- Work closely with local **educational** and **research institutions** to improve their **quality** and **create specialized programs addressing the cluster's needs**
- Collaborate with other companies to enhance competitiveness through **trade associations** and other mechanisms
- **Participate actively** in national and regional competitiveness initiatives
- Focus **corporate social responsibility initiatives** on enhancing the business environment

Private Sector Role in Economic Development

Turkcell in Anatolia

- Turkcell was facing wage pressure and high turnover in its **Istanbul** call center operations, where employees faced long commutes and had many alternative job opportunities
- Turkcell opened new call centers in **Erzerum** and **Diyarbakir**, which had become much more accessible by improved air travel and infrastructure



- **Turkcell** was able to attract a highly loyal staff from local universities at significantly lower wage costs
- **Erzerum** and **Diyarbakir** each gained jobs and momentum in improving competitiveness

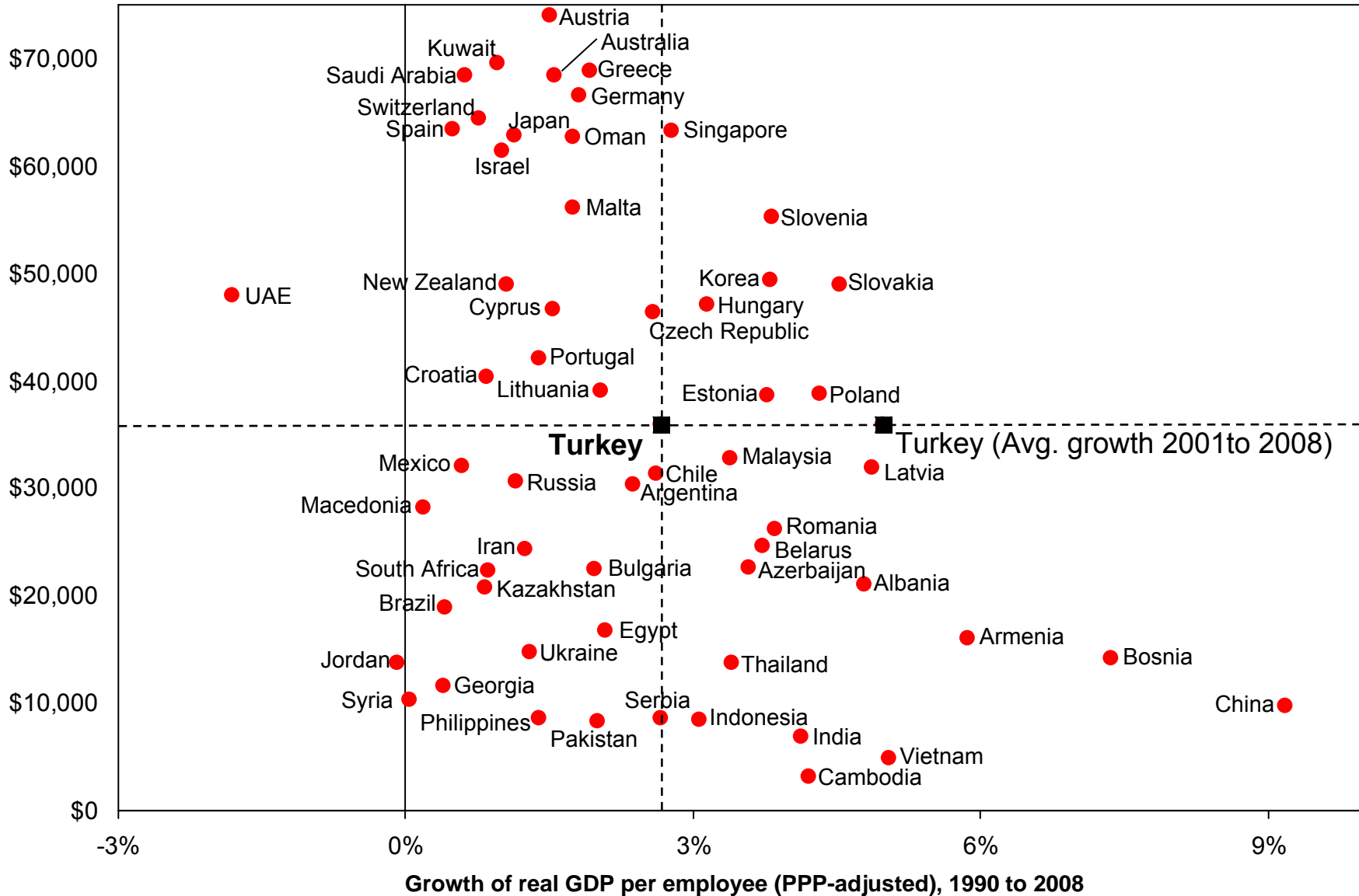
Agenda

- Turkey's Economic Performance
- Principles of Competitiveness
- **Assessment of Turkey's Competitive Position**
- Towards an Economic Strategy

Comparative Labor Productivity

Selected Countries

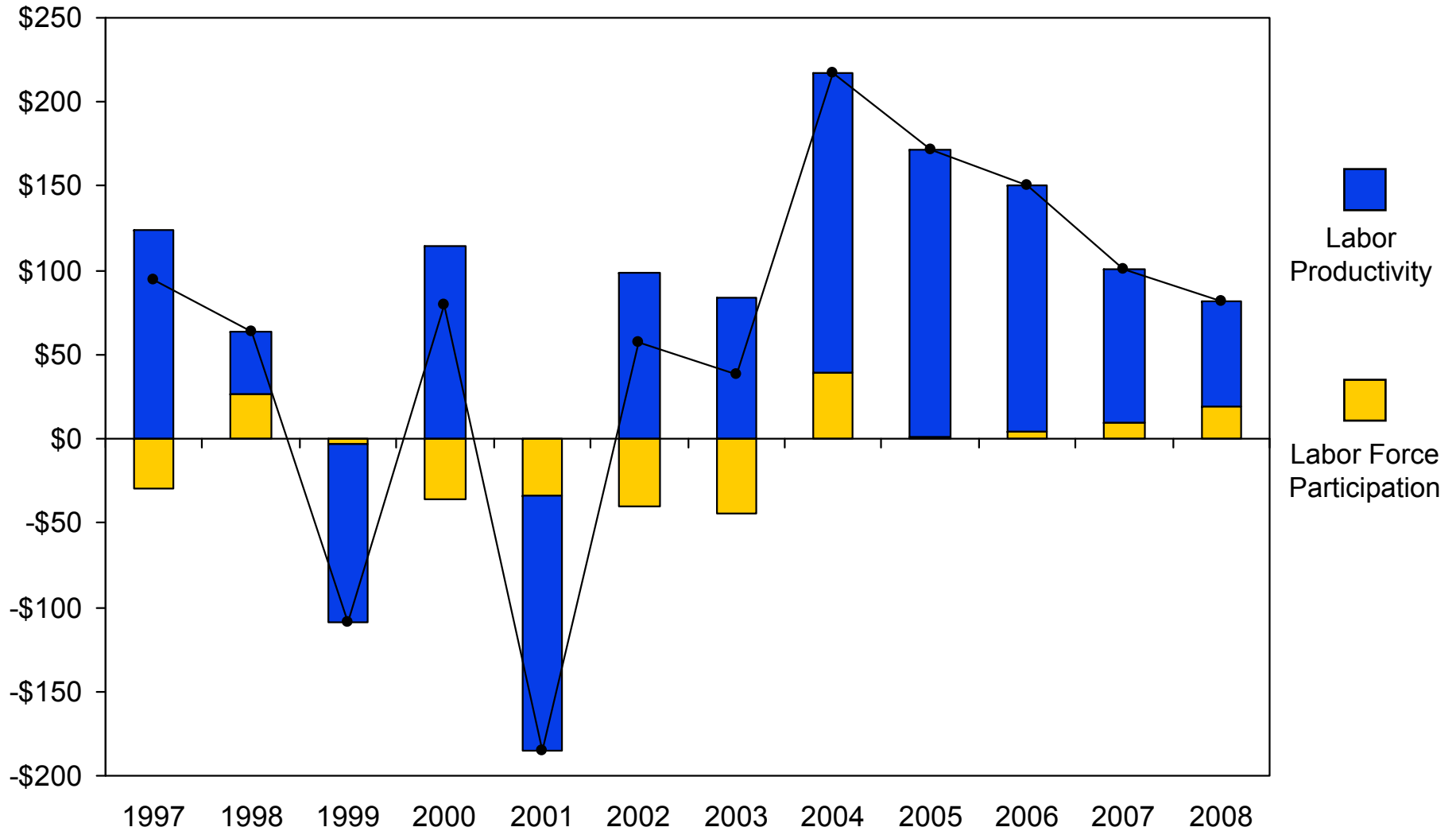
Real GDP per employee
(PPP adjusted US\$), 2008



Source: authors calculation Groningen Growth and Development Centre (2009), EIU (2009)
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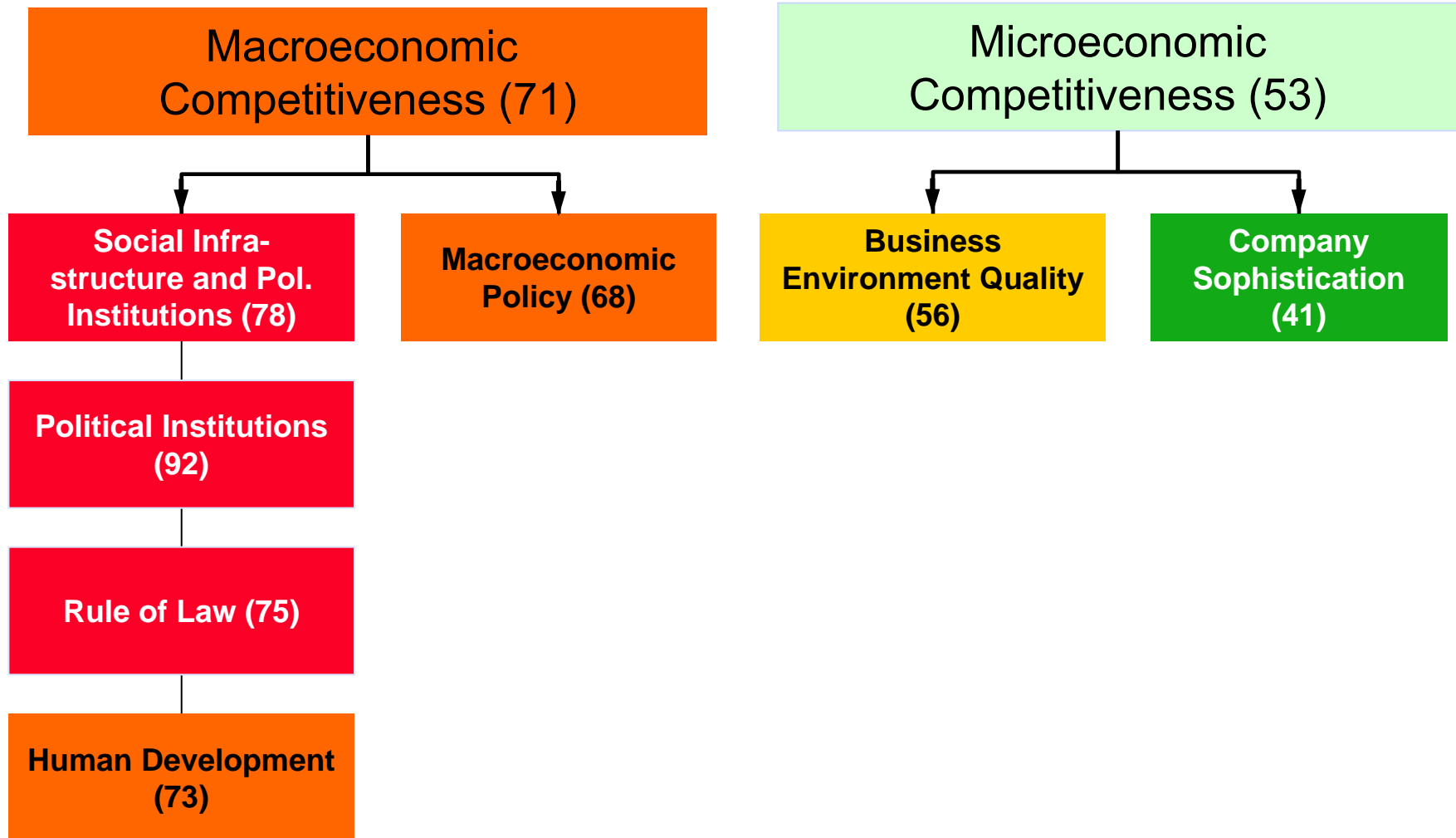
Decomposing Turkey's GDP per Capita Growth

Contribution to change in real GDP per Capita (PPP adjusted)



Source: EIU (2008), GGDC total economy database (2008)

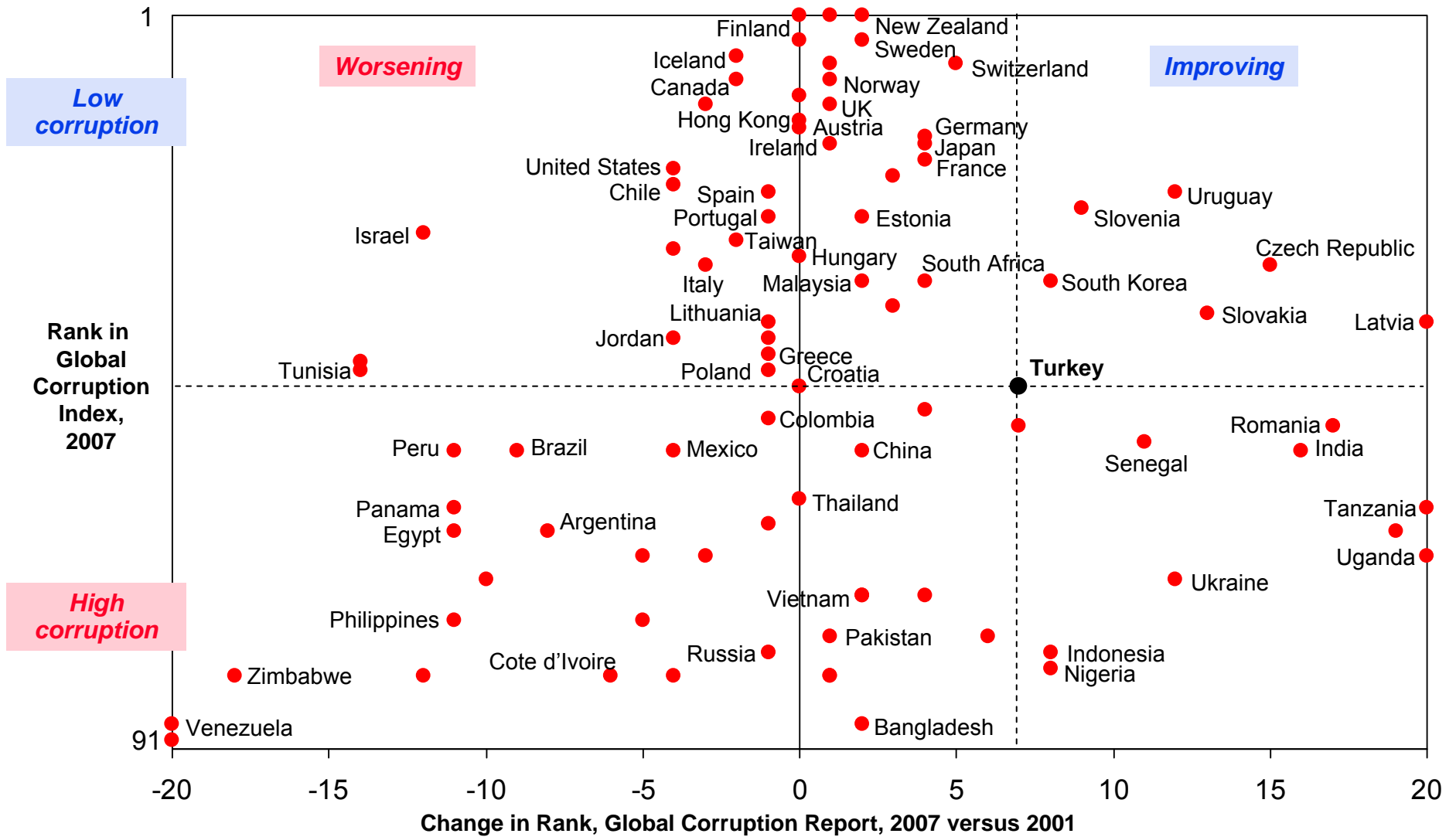
Turkey's Competitiveness Profile, 2009



Note: Rank versus 128 countries; overall, Turkey ranks 57th in 2008 PPP adjusted GDP per capita and 64th in Global Competitiveness

Source: World Economic Forum and Institute for Strategy and Competitiveness, Harvard University (2009)

Corruption Perception Index, 2007



Note: Ranks only countries available in both years (91 countries total)
 Source: Global Corruption Report, 2008

Human Development Turkey vs. Peer Countries

Country	GDP per capita (PPP US\$), 2007	Rank, 2007				
		GDP per capita	Human Development Index (HDI)	Life Expectancy Index	Education index	Gender Development Index (GDI)
Slovakia	\$ 20,076	45	42	59	46	40
Hungary	\$ 18,755	46	43	73	28	37
Lithuania	\$ 17,575	49	46	94	20	42
Latvia	\$ 16,377	51	48	86	26	44
Croatia	\$ 16,027	52	45	48	51	43
Poland	\$ 15,987	53	41	51	33	39
Gabon	\$ 15,167	54	103	154	103	85
Russia	\$ 14,690	55	71	133	43	59
Libya	\$ 14,364	57	55	67	61	54
Mexico	\$ 14,104	58	53	48	78	48
Chile	\$ 13,880	59	44	35	49	41
Botswana	\$ 13,604	60	125	170	122	105
Malaysia	\$ 13,518	61	66	61	99	58
Argentina	\$ 13,238	62	49	56	37	46
Turkey	\$ 12,955	63	79	95	111	70
Romania	\$ 12,369	64	63	83	53	52
Venezuela	\$ 12,156	65	58	69	47	55
Montenegro	\$ 11,699	66	65	64	66	..
Panama	\$ 11,391	67	60	51	72	51
Mauritius	\$ 11,296	68	81	91	106	67
Bulgaria	\$ 11,222	69	61	75	44	50
Uruguay	\$ 11,216	70	50	46	31	45
Iran	\$ 10,955	71	88	104	119	76
Kazakhstan	\$ 10,863	72	82	140	22	66
Costa Rica	\$ 10,842	73	54	33	84	47
Belarus	\$ 10,841	74	68	116	26	57
Serbia	\$ 10,248	75	67	65	66	..

Source: World Bank, Human Development Index 2009

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Turkey's Macroeconomic Competitiveness - Continued Action Priorities

- Strengthen the **independence** of institutions like the Central Bank
- Stronger fiscal discipline
 - Create greater stability in government spending through **fiscal rules**
- Agree on a process of resolving the **domestic political tensions** among key institutions and interest groups
- Improve the **quality of governmental organizations**, including at the provincial level
- Continue efforts to improve the accessibility and quality of **education** and **health care** services across the country

Turkish Company Sophistication

Assessment

- Significant **improvements**, especially among large companies
- Solid **operational efficiency** in manufacturing but weaker performance in **services**
- A **huge gap** between the large business groups, that compare favorably to international peers, and the huge number of SMEs that are far behind
- The World Bank reports significant entry and exit of new companies, but **little sustained growth** of small companies in the Turkish economy

Action Agenda

- **Consolidate** efforts to improve the performance of SMEs
- Strengthen the **linkages** between large business groups and SMEs
- Use **cluster policy** as a tool to boost SME development

Turkey's Business Environment

Overall Strengths and Weaknesses

STRENGTHS

- Domestic transportation and communication infrastructure
- Rules and regulations for starting new companies
- Openness to foreign investment
- Moderate level of tariff barriers
- Domestic rivalry improving
- Availability of local suppliers
- IT policies
- Improving sophistication of the financial system

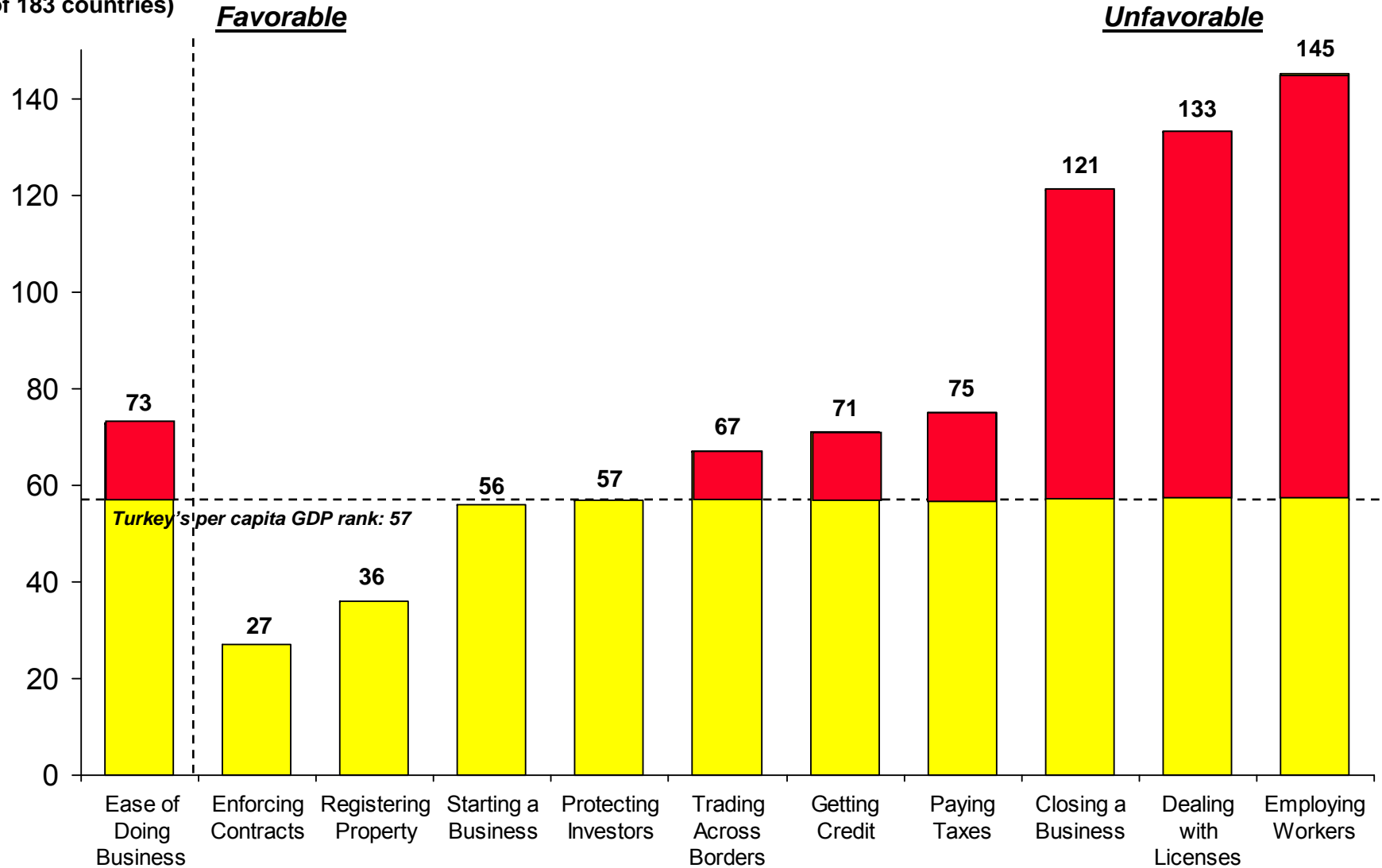
WEAKNESSES

- Tax system
- Access to credit, especially for SMEs
- Limited workforce skills
- Low sophistication of local buyers
- Weak governance and auditing
- Distortive effects of government-owned companies on competition
- Unreliable electricity supply
- Innovation infrastructure
- Burdensome customs procedures
- Intellectual property protection
- Low patenting rates
- Limited management schools
- Labor rigidity
- Regulatory quality

Note: Rank versus 128 countries; overall, Turkey ranks 57th in 2008 PPP adjusted GDP per capita and 64th in Global Competitiveness
Source: Institute for Strategy and Competitiveness, Harvard University (2009)

Ease of Doing Business Turkey, 2009

Ranking, 2009
(of 183 countries)



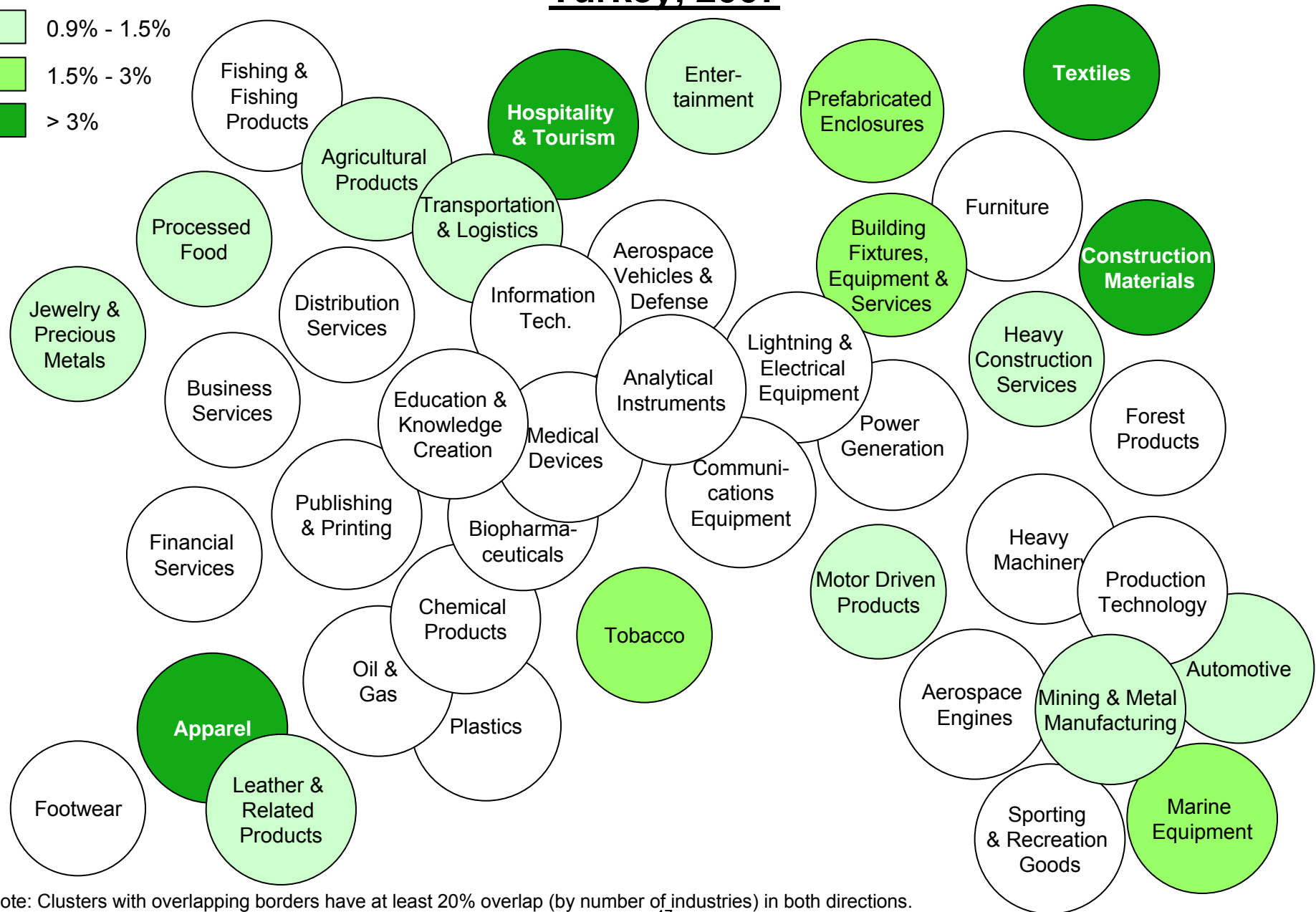
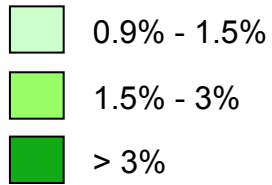
Source: World Bank Report, Doing Business (2009/10)

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Share of World Exports by Cluster

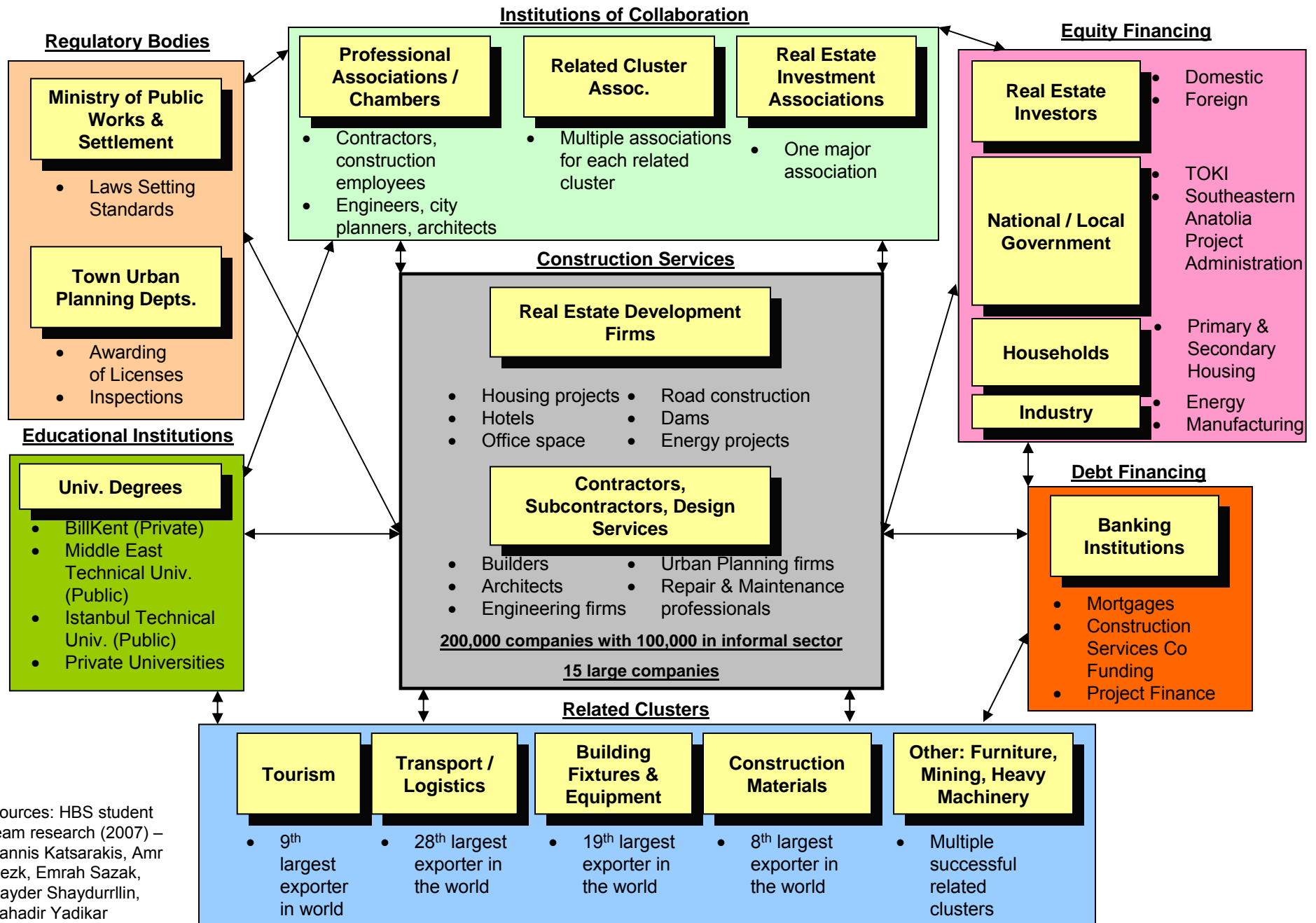
Turkey, 2007

World Market Share



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

The Turkish Construction Cluster



Sources: HBS student team research (2007) – Yannis Katsarakis, Amr Rezk, Emrah Sazak, Hayder Shaydurrllin, Bahadir Yadikar

State of Turkish Cluster Development

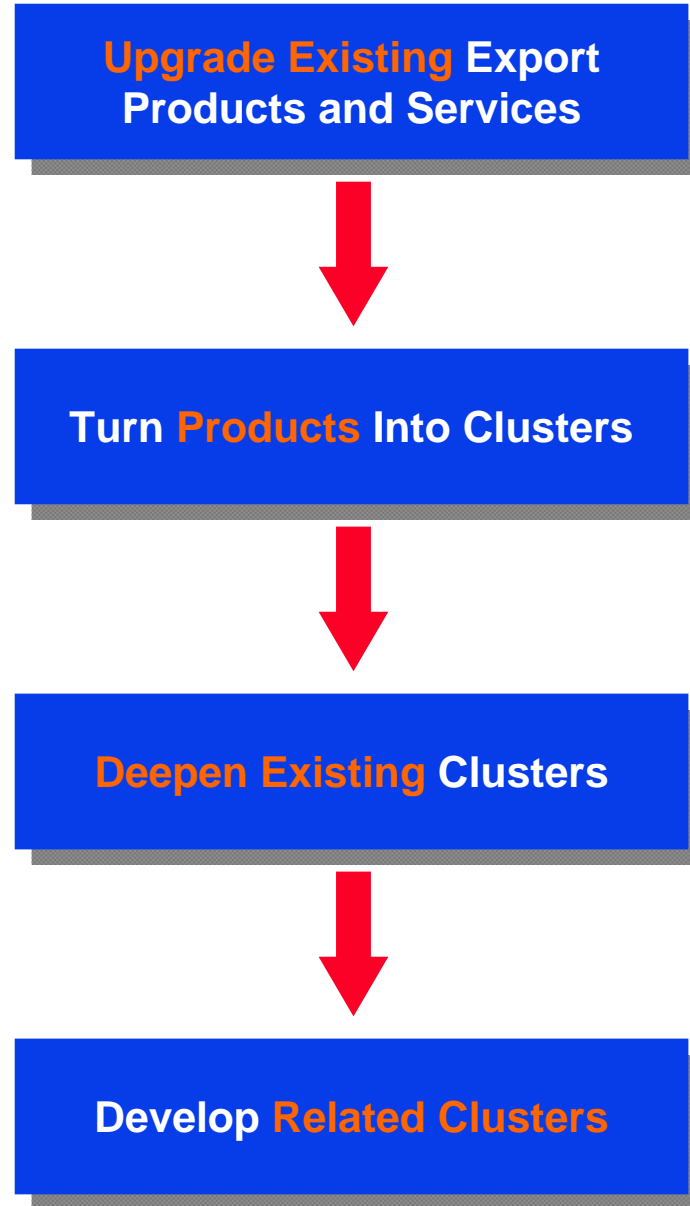
Assessment

- Turkey's economy has **naturally developed** around clusters
- **Organized collaboration** within these clusters remains **low**
- Economic policy has **not leveraged cluster development** as a tool to create synergies and deliver government policies more effectively
 - Recent EU-financed cluster programs have **not yet** had a significant impact in Turkey

Action agenda

- Pursue an aggressive **national cluster development** agenda to support existing clusters and enable the emergence of new clusters in related fields
- Utilize clusters as a central tool for upgrading company sophistication, stimulating growth in SMEs, and driving regional competitiveness

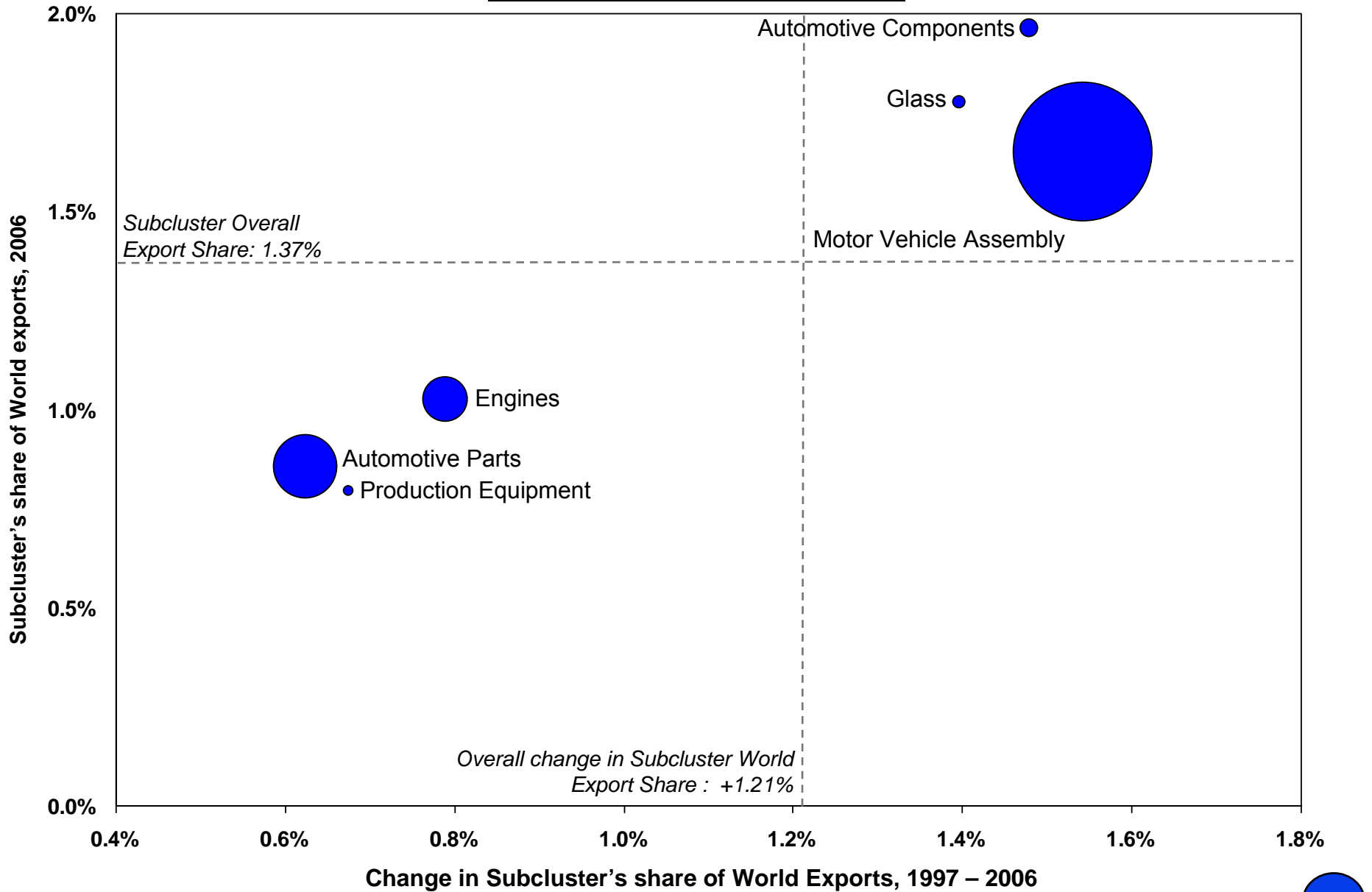
Clusters and Economic Diversification



- Local firms
- MNCs

Turkey's Automotive Cluster, 1997 – 2007

Exports by Subcluster

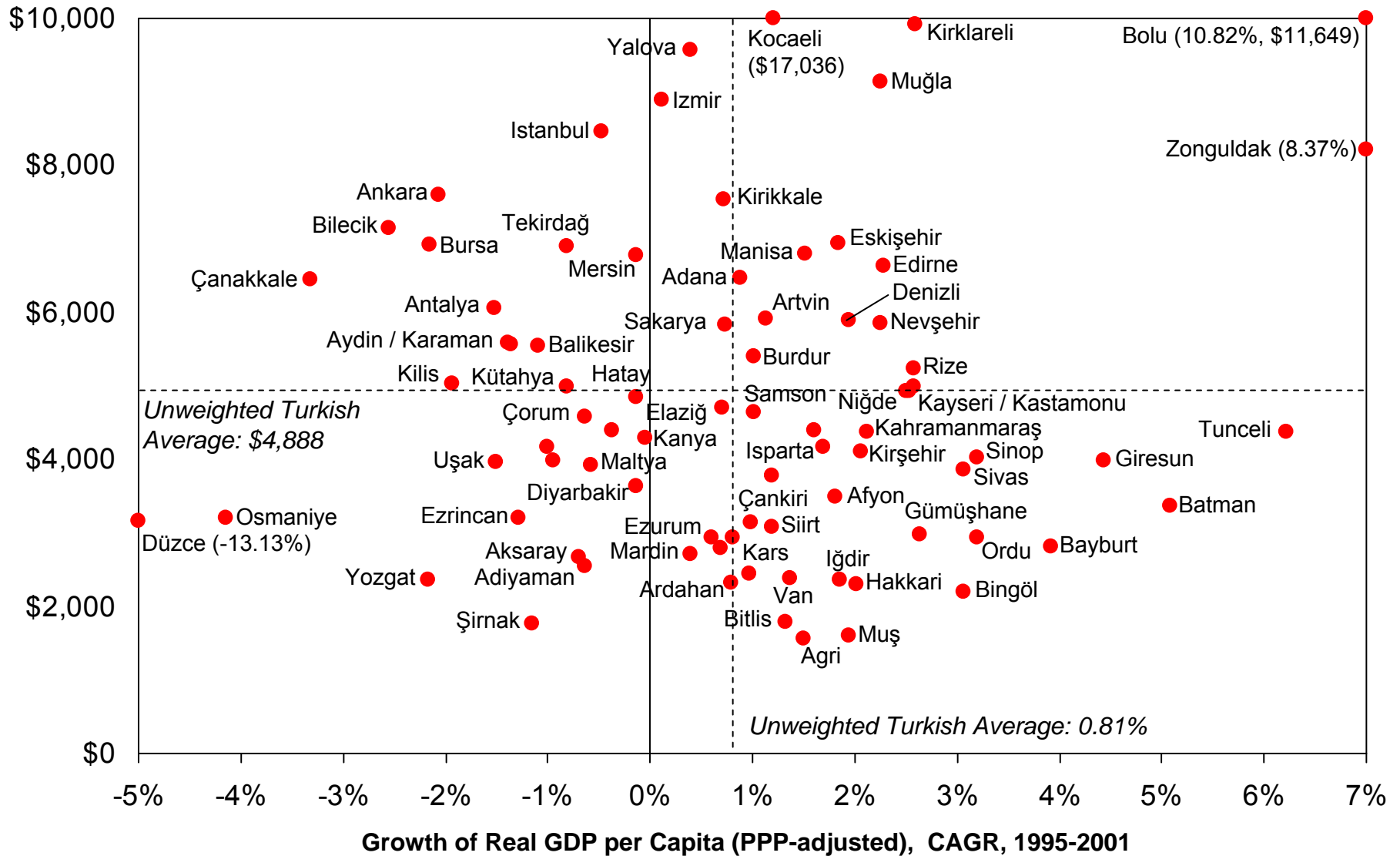


Source: Prof. Michael E. Porter, Cluster Mapping Project, Institute for Strategy and Competitiveness, Harvard Business School; Richard Bryden, Project Director.

Regional Economic Performance

Turkish Provinces

GDP per Capita, 2001
(USD, PPP-adjusted)

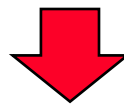


Note: 2001 is latest available data for Turkish provinces. Source: OECD Regions at a Glance: 2009

Regional Economic Development in Turkey

Action Agenda

- Decentralize economic policy making to enhance **regional leadership** while creating **incentives / accountability for performance**
- Create a sound **development platform** in each region, including sound physical infrastructure and the provision of basic public services
- Create **regional governmental capability** to assume responsibility for regional economic development



- Decentralization of economic policy should be seen as a **long term process**, with devolution taking place in stages as regional government capabilities develop

Economic Integration Among Neighboring Countries

Turkey's Neighborhood



- Turkey sits at the crossroad between Europe and the Middle East
- Economic coordination among neighboring countries can significantly enhance competitiveness
- Integration offers greater opportunities than participation in broader economic forums (e.g., EU)

Economic Coordination with Neighboring Countries

Assessment

- Turkey's geographic position between a number of important global regions provides **huge opportunities**
- While government policy has focused on **politically stable relations with neighbors**, companies have started to extend their operations into these neighboring countries

Action Agenda

- Turkey should pursue economic coordination with neighboring countries as a **critical tool of economic policy** to reap the full benefits of its geographic location
- Turkey has a great opportunity to **create a new Eastern neighborhood**

Agenda

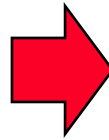
- Turkey's Economic Performance
- Principles of Competitiveness
- Assessment of Turkey's Competitive Position

- **Towards an Economic Strategy**

Toward a Turkish Economic Strategy

Unique Strengths

- Large workforce with a strong work ethic at competitive wage levels
- Strong entrepreneurial “trading” legacy
- Significant and growing domestic market
- Large, spread out geographic area with heterogeneous regions
- Geographic position at the crossroads of major world regions
- Companies with experience to operate in challenging policy environments
- Stronger market institutions than other emerging economies



Implications

Maintain a sound macroeconomic policy platform

Continue to strengthen workforce skills

Achieve political stability

Strengthen physical infrastructure connecting provinces and neighbors

Simplify trade of goods and services

Mobilize cluster development

Consolidate efforts for SME development

Decentralize economic policy and strengthen regional institutions

Intensify economic collaboration with neighbors

Turkey: Moving to Action

- Strong **private sector leadership** is needed to address the well documented competitiveness challenges facing Turkey
- Encourage **Provincial Competitiveness Councils** working with the new economic development agencies to drive consensus on provincial plans which monitor implementation
 - Involve representatives from the public, private and academic sectors as well as federal government participation
- Work towards the creation of 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

Moving the Next Level of Turkish Competitiveness: The Role of the Private Sector

- The recent improvements in Turkish economic policy have created new **opportunities** for Turkish companies to grow and upgrade
- The next stage of economic development will require companies to become a more **active partner** in the design and implementation of economic policy
 - Participate in national and regional competitiveness efforts
 - Collaborate with other companies in upgrading the business environment
- A **coherent economic strategy** for Turkey will be crucial to allow the country to be able to fundamentally enhance competitiveness
- Such a strategy will only be effective only if it is based on a new **model of collaboration** between business and government