

Ecuadorian Competitiveness: Ready for the Next Stage?

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Harvard Business School

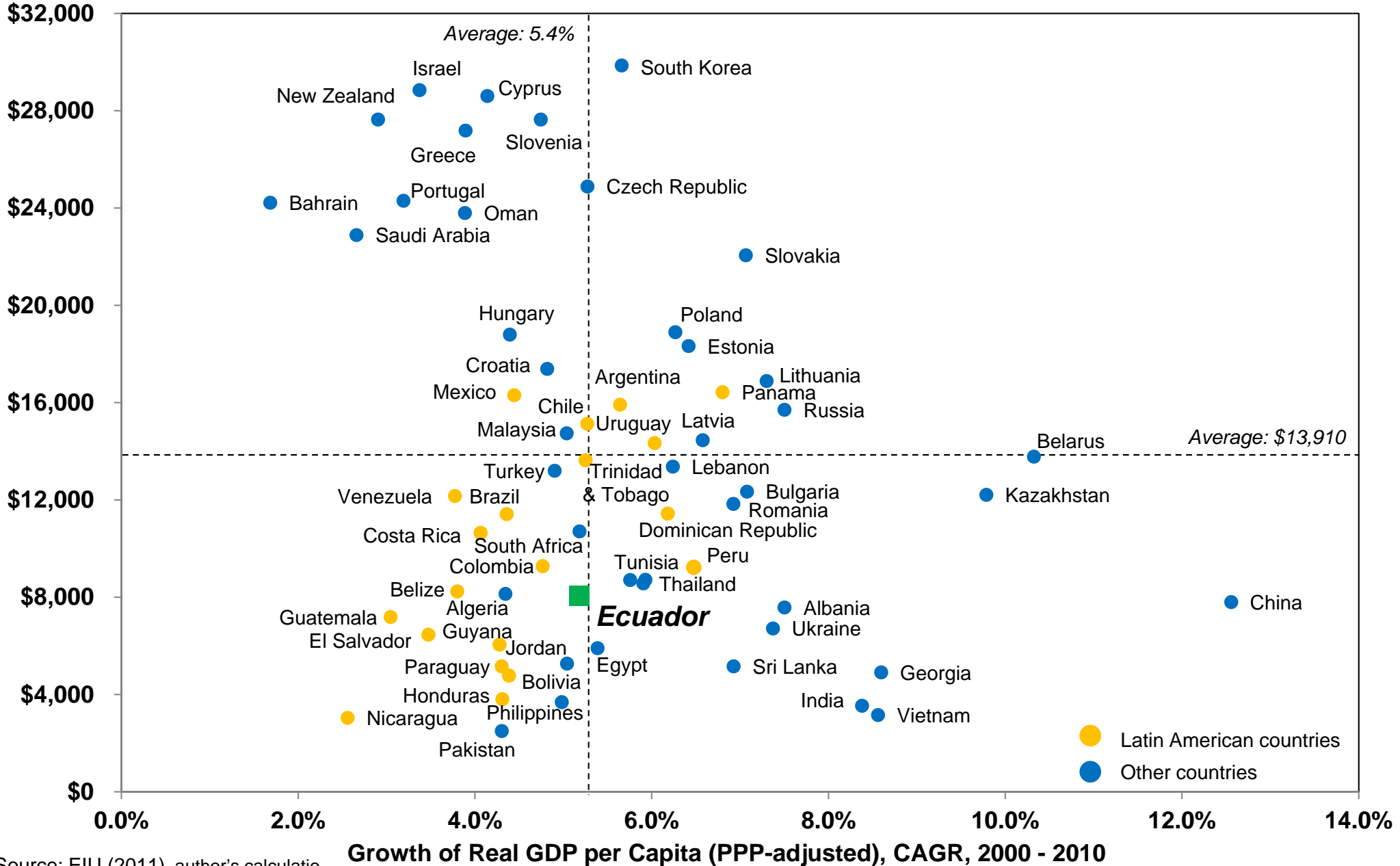
*Quito, Ecuador
October 24, 2011*

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)

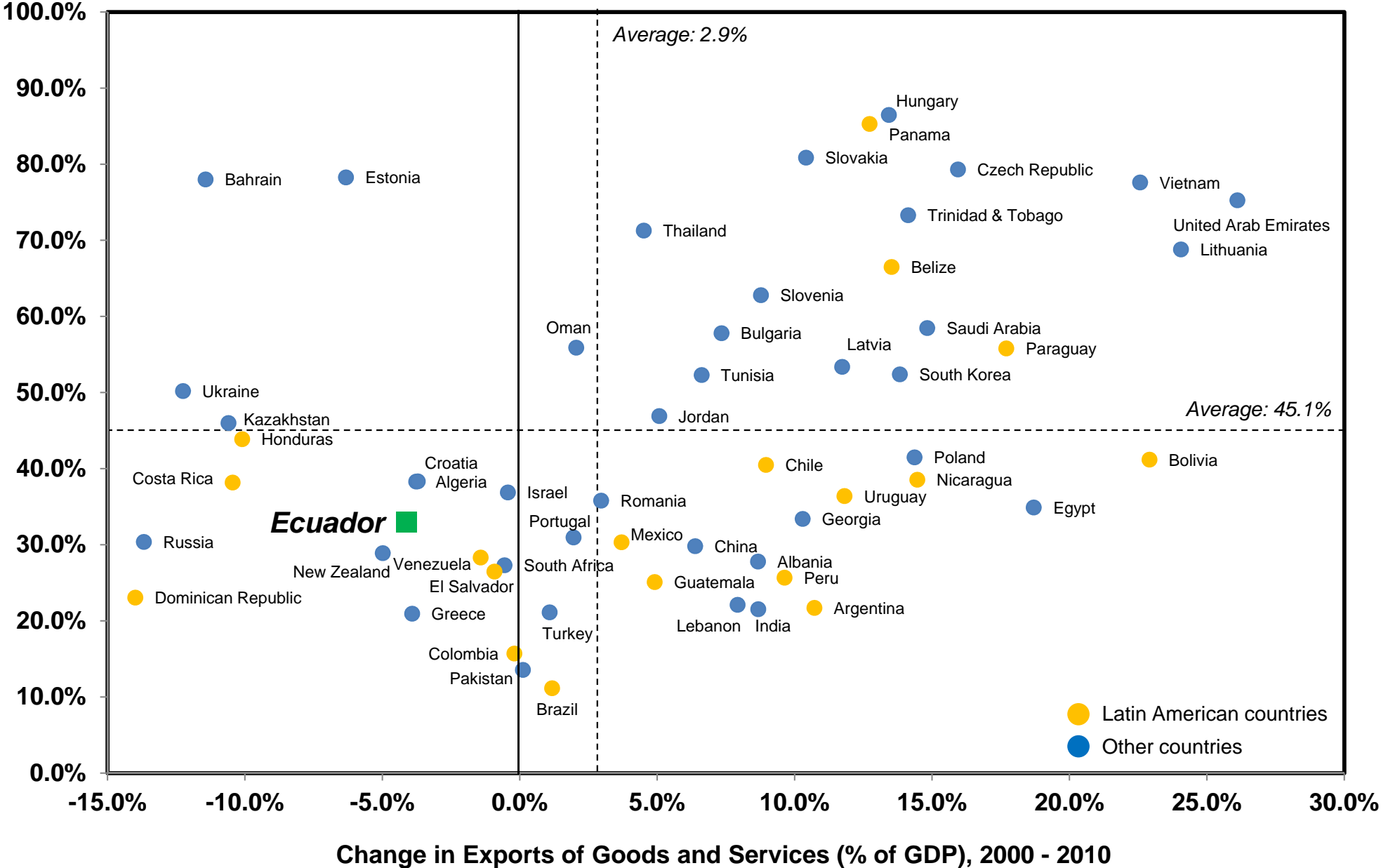


Source: EIU (2011), author's calculation

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Export Performance Selected Countries

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

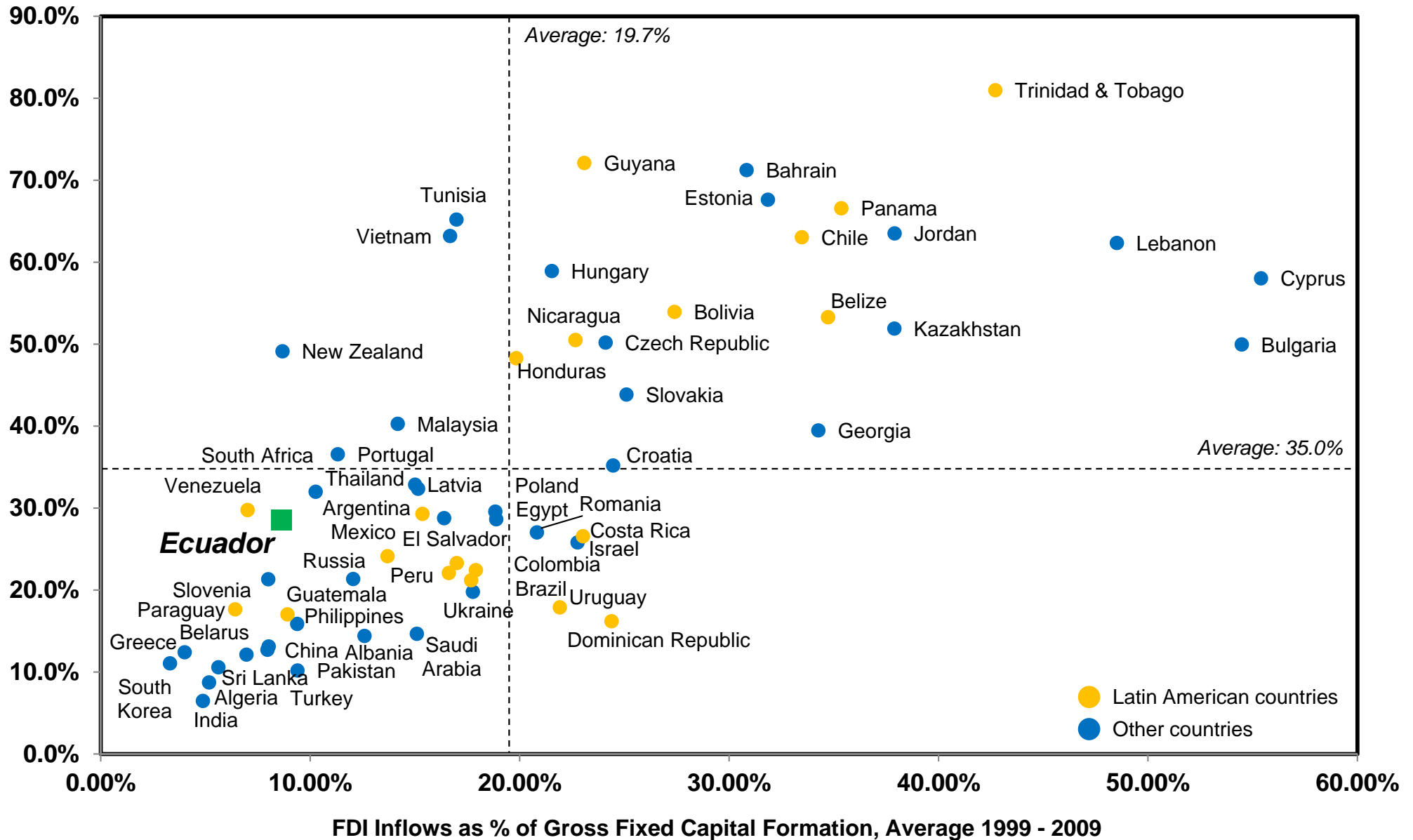


Source: EIU (2011), authors' analysis

Inbound Foreign Investment Performance

Stocks and Flows, Selected Countries

Inward FDI Stocks as % of GDP, 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

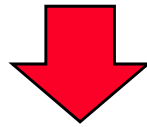
- In 2010, the Ecuadorian economic **growth was slower** than other Latin-American countries
- Prosperity remains **low**
- High **poverty levels** and **inequality** persist and large segments of the population lack **access to basic needs**
- Ecuador is overly dependent on **oil** exports



- 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**

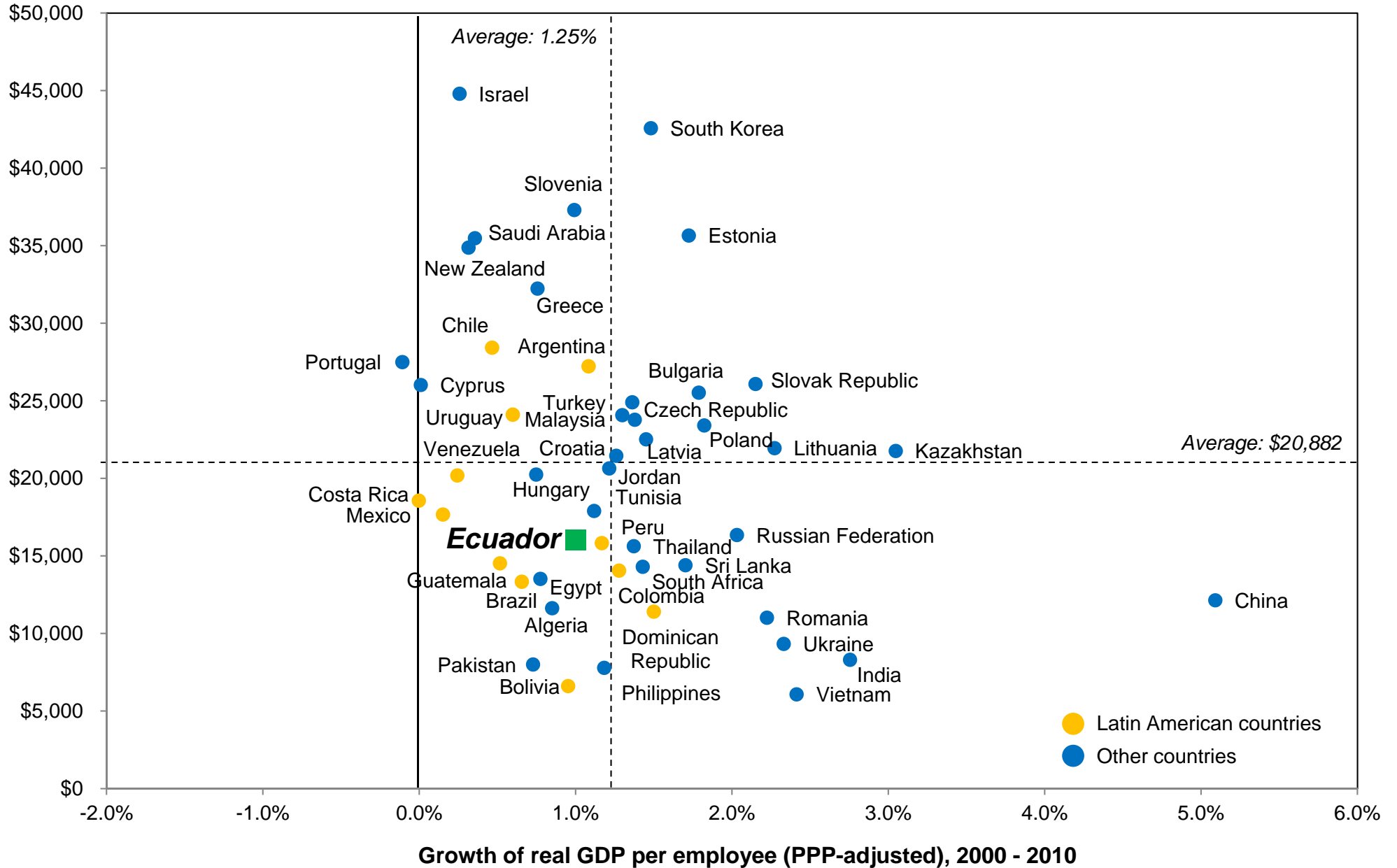


- Only competitive businesses can **create wealth and jobs**
- Nations compete to offer the **most productive environment for business**
- The public and private sectors play **different but interrelated roles** in creating a productive economy

Comparative Labor Productivity

Selected Countries

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



Source: Authors calculation Groningen Growth and Development Centre (2011), EIU (2011)

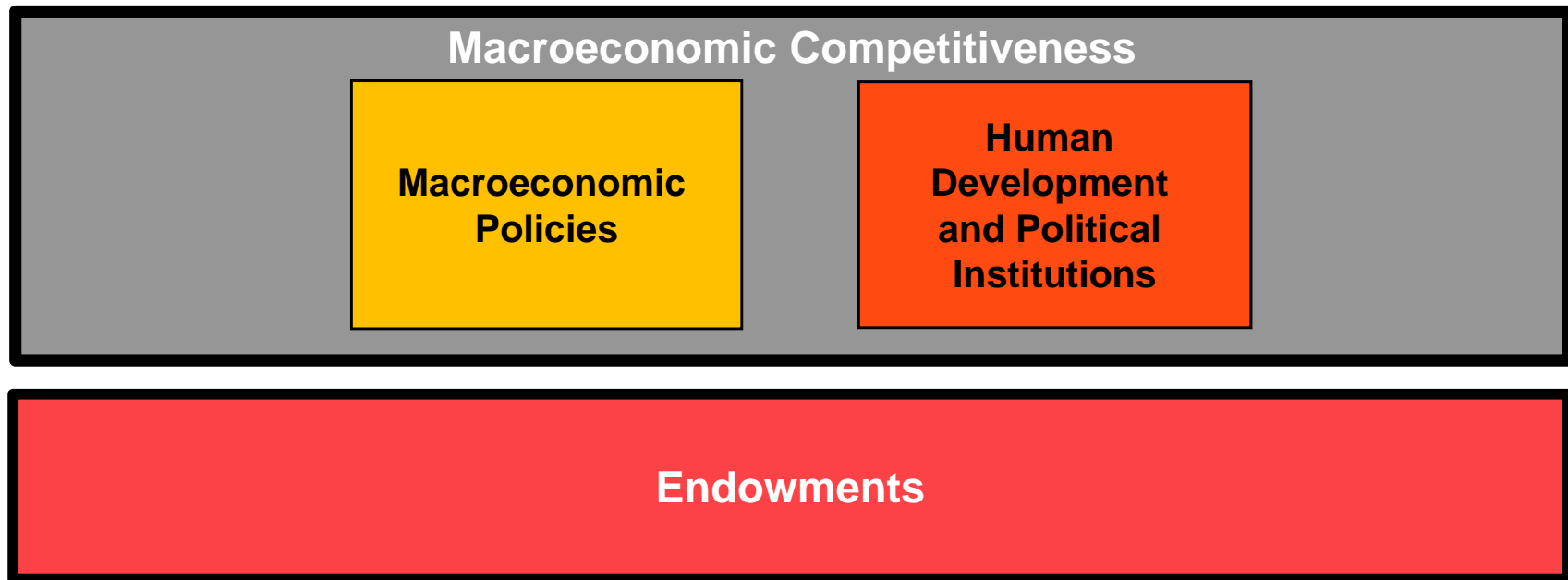
What Determines Competitiveness?



Endowments

- 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

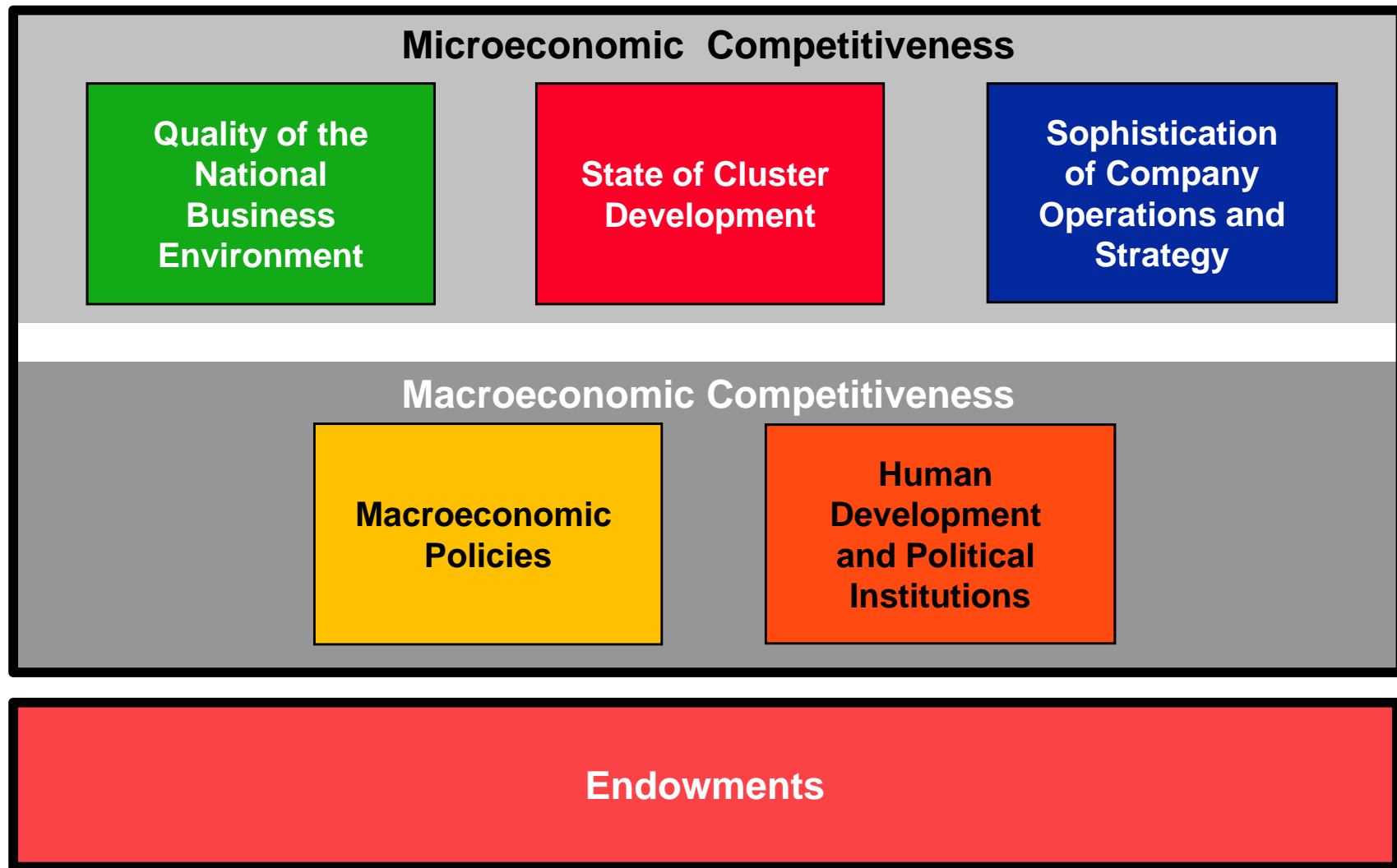
Macroeconomic Policies

- **Fiscal policy**
 - Government surplus/deficit
 - Government debt
- **Monetary policy**
 - Inflation
 - Business cycle management
 - Savings

Social Infrastructure and Political Institutions

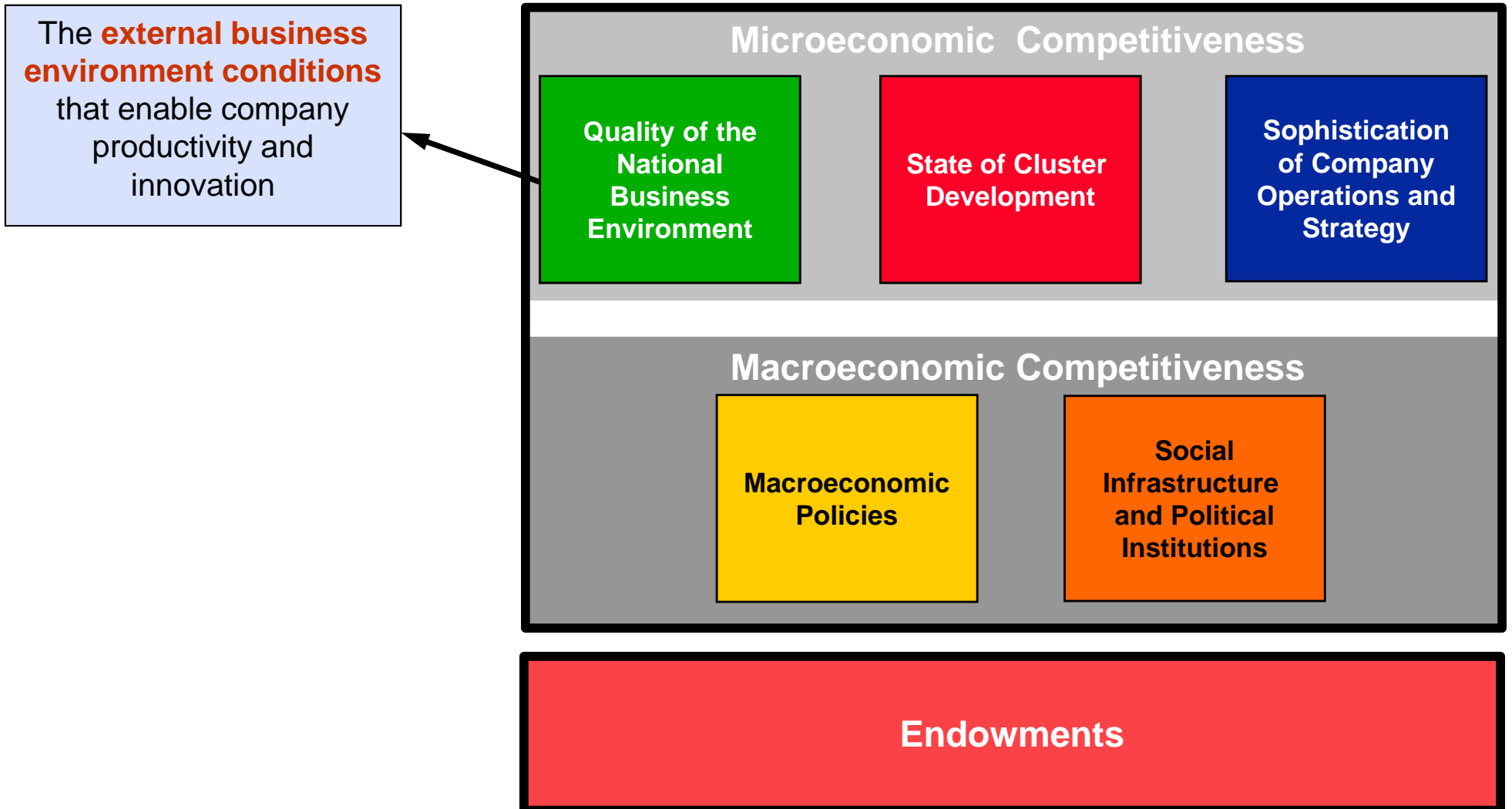
- **Human development**
 - Basic education
 - Health
- **Political institutions**
 - Political freedom
 - Voice and accountability
 - Political stability
 - Government effectiveness
 - Decentralization of economic policymaking
- **Rule of law**
 - Security
 - Civil rights
 - Judicial independence
 - Efficiency of legal framework
 - Freedom from corruption

What Determines Competitiveness?

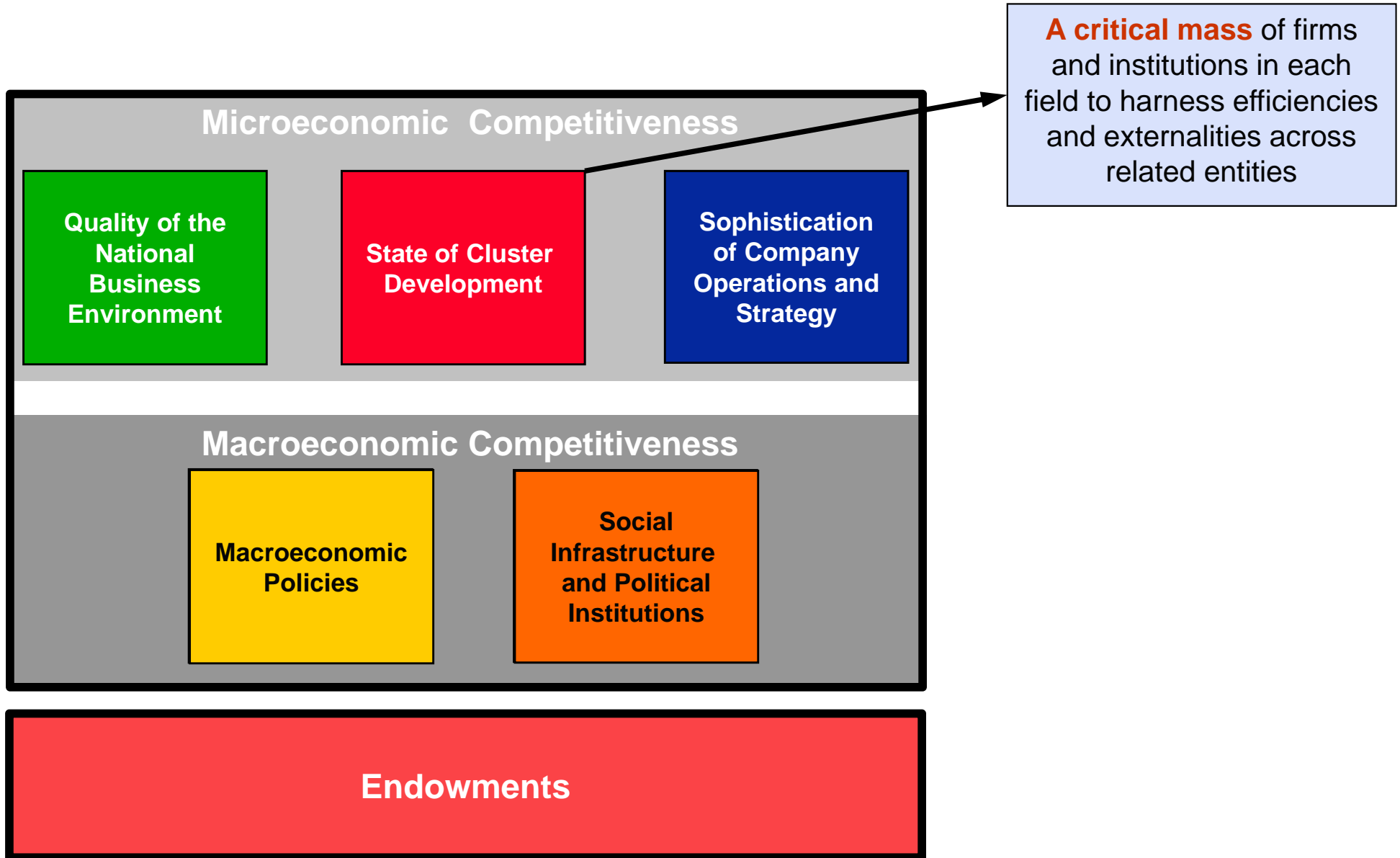


- Productivity ultimately depends on improving the **microeconomic capability** of the economy and the **sophistication of local competition**
- Macroeconomic competitiveness sets the **potential** for high productivity, but is **not sufficient**
- Endowments create a **foundation** for prosperity, but true prosperity is created by **productivity in the use of endowments**

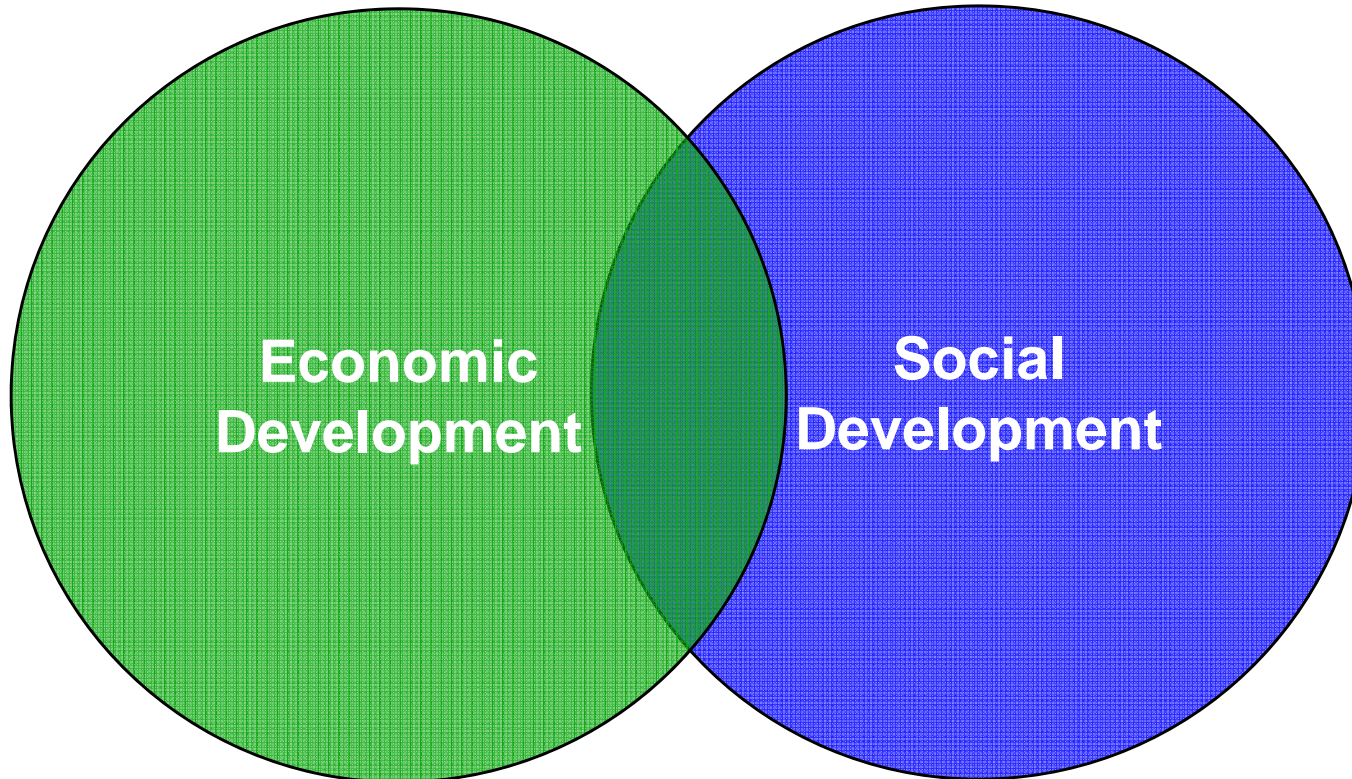
What Determines Competitiveness?



What Determines Competitiveness?

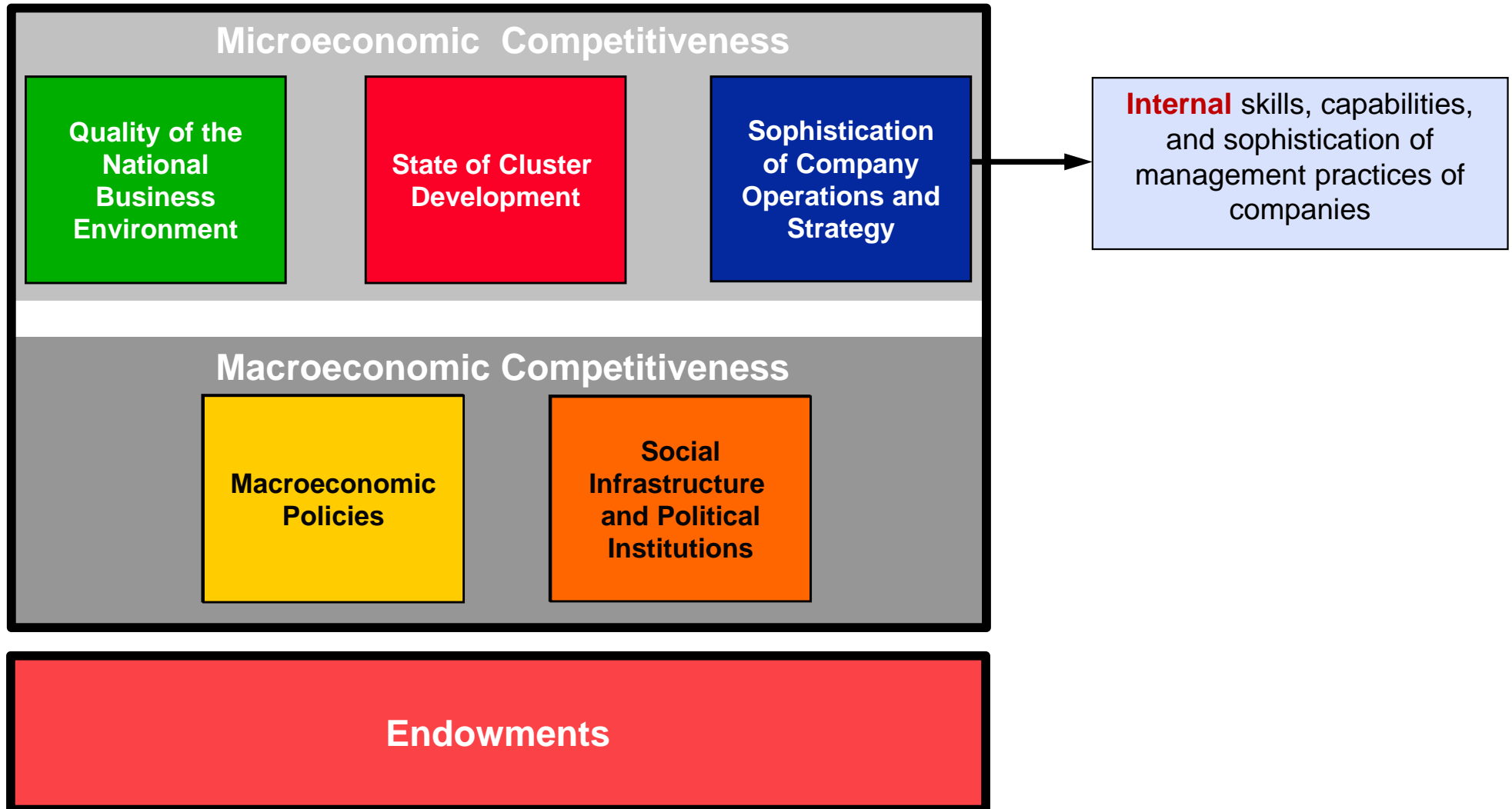


Competitiveness and Poverty Reduction

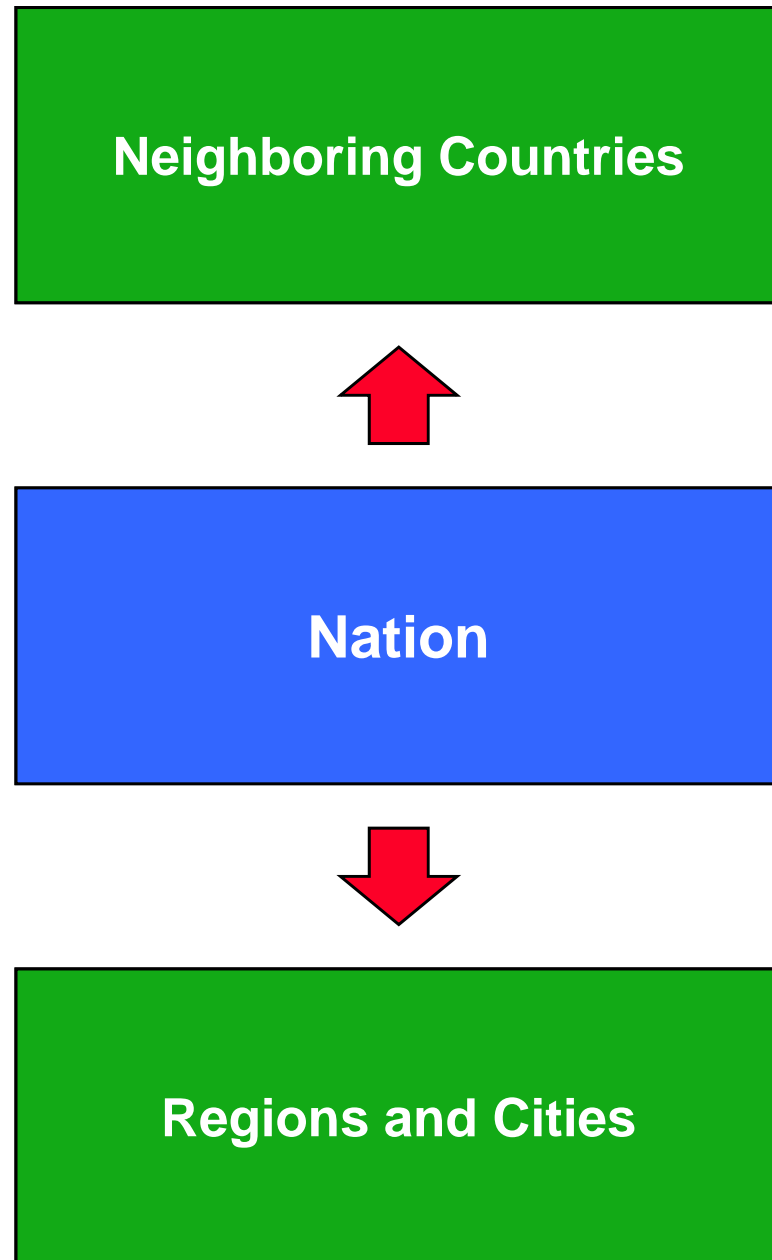


- There is a strong connection between **economic** and **social** development
- Improving competitiveness and decreasing poverty requires improving the economic and social context **simultaneously**

What Determines Competitiveness?

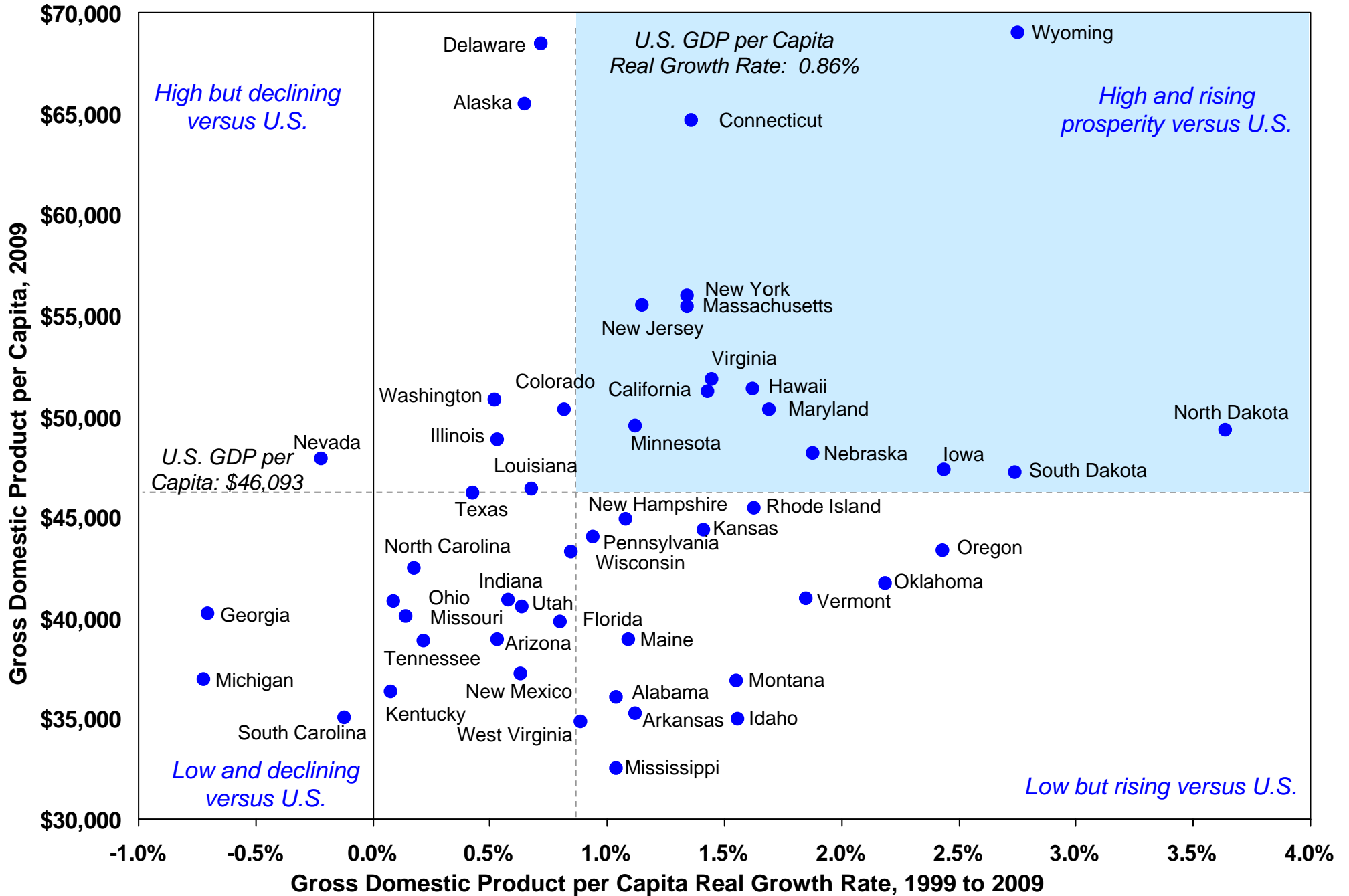


Geographic Influences on Competitiveness



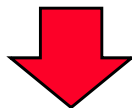
Prosperity Performance

U.S. States, 1999 to 2009



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

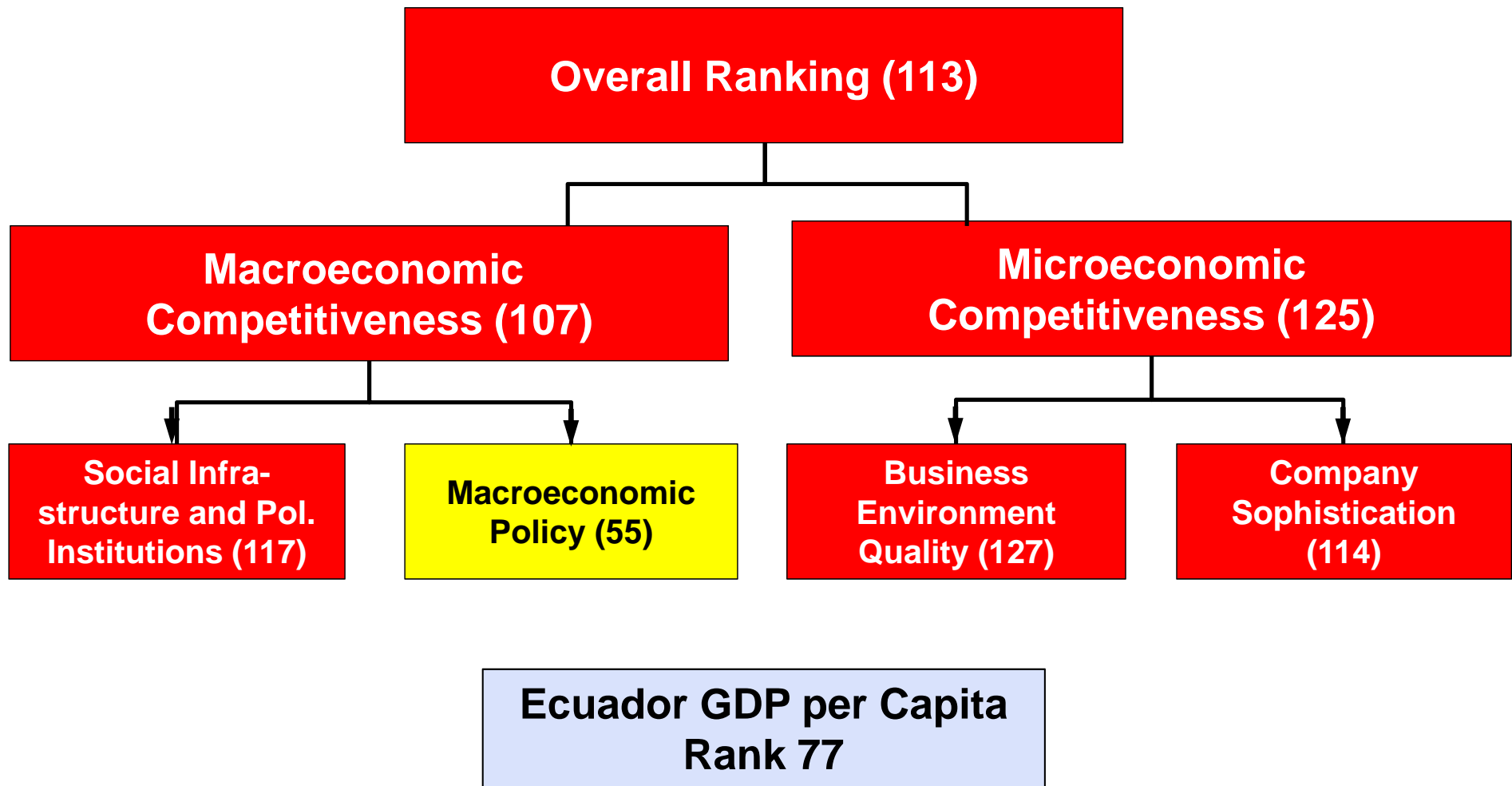
- Facilitating **cross-border cluster development**
 - e.g., Supplier networks
 - Transport & Logistics
 - Quality standards

Macroeconomic Competitiveness

- Coordinating **macroeconomic** policies
- Coordinating programs to improve **security** and **public safety**

Ecuador's Competitiveness Profile, 2010

Harvard Country Competitiveness Model



Note: Rank versus 139 countries

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

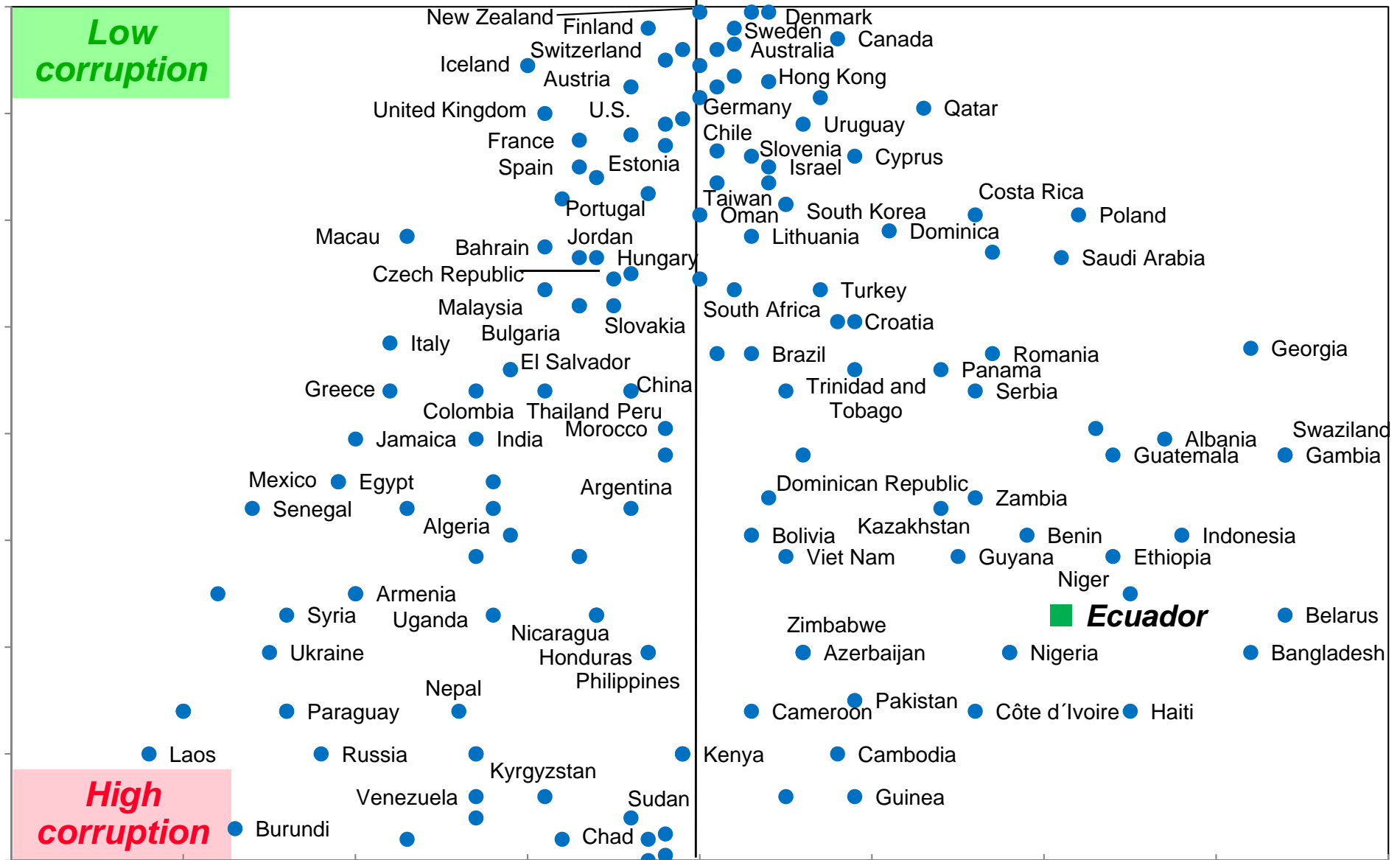
- **Budget deficit** threatens the dollarization model
- **Central Bank** is no longer an autonomous institution
- No **stabilization fund**

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**

Rank in Global
Corruption Index,
2010

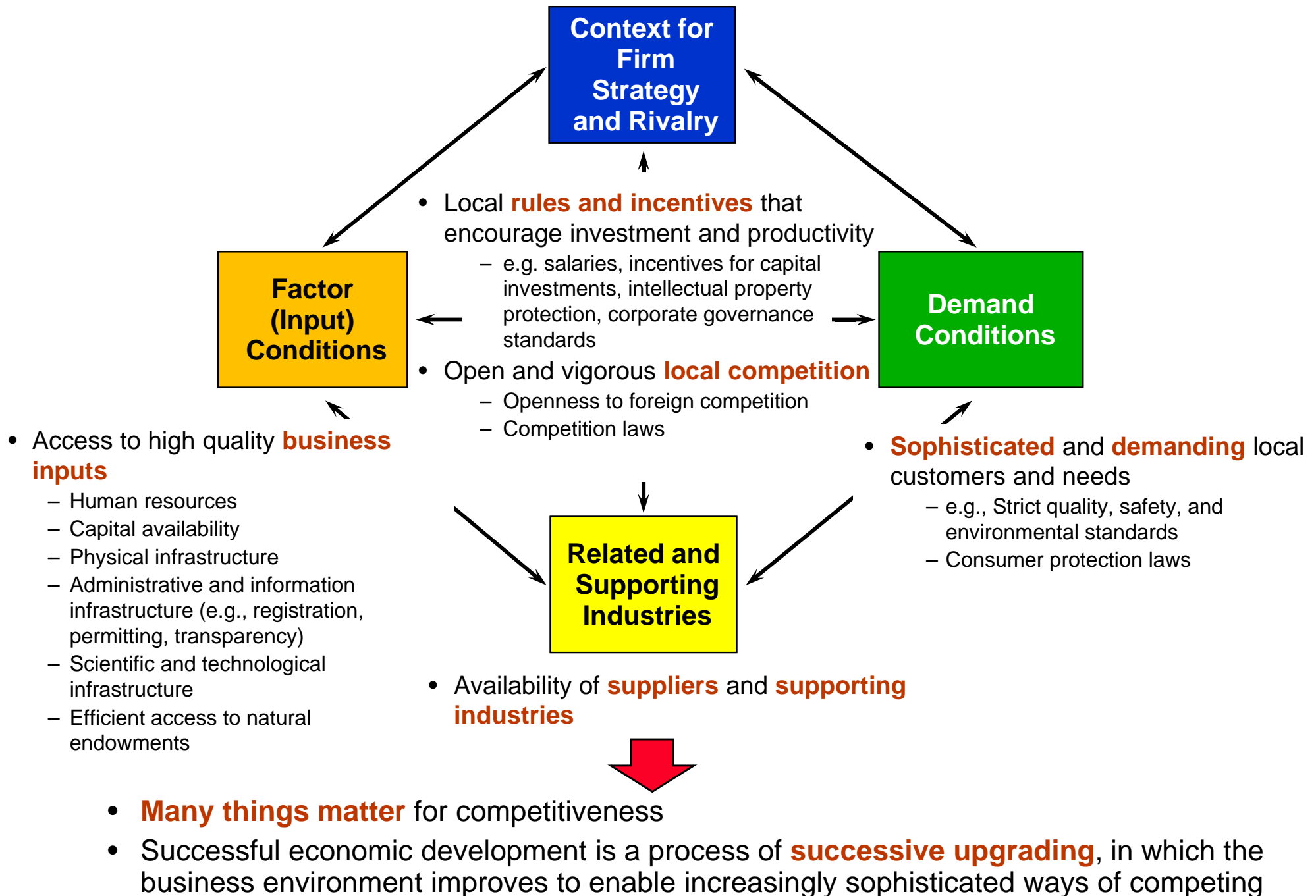
Corruption Perception Index, 2010



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



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

Financial Markets

- **Weak** financial markets

Workforce Development and Training

- Low **skill level** of the labor force
- **Poor quality higher education** system

Competitive Context

- **Import substitution strategy** reducing competitiveness
- High level of **government subsidies** distort competition
- **Low** intensity of local **competition**
- Limited **internationalization** of firms
- Burdensome **government regulations**
 - Labor regulations give rigidity to the market
 - Customs and Trade regulations
 - Difficult new business formation
- Weak **investor protection** and protection of **intellectual property**
- High **informality** in the economy

Trade and Investment Liberalization

- **FDI** limited to **oil** and **mining sectors**
- New **restrictions** on capital flows
- High **trade barriers**
- Complex **custom procedures**
- Few **trade agreements** with other countries

Innovation Infrastructure

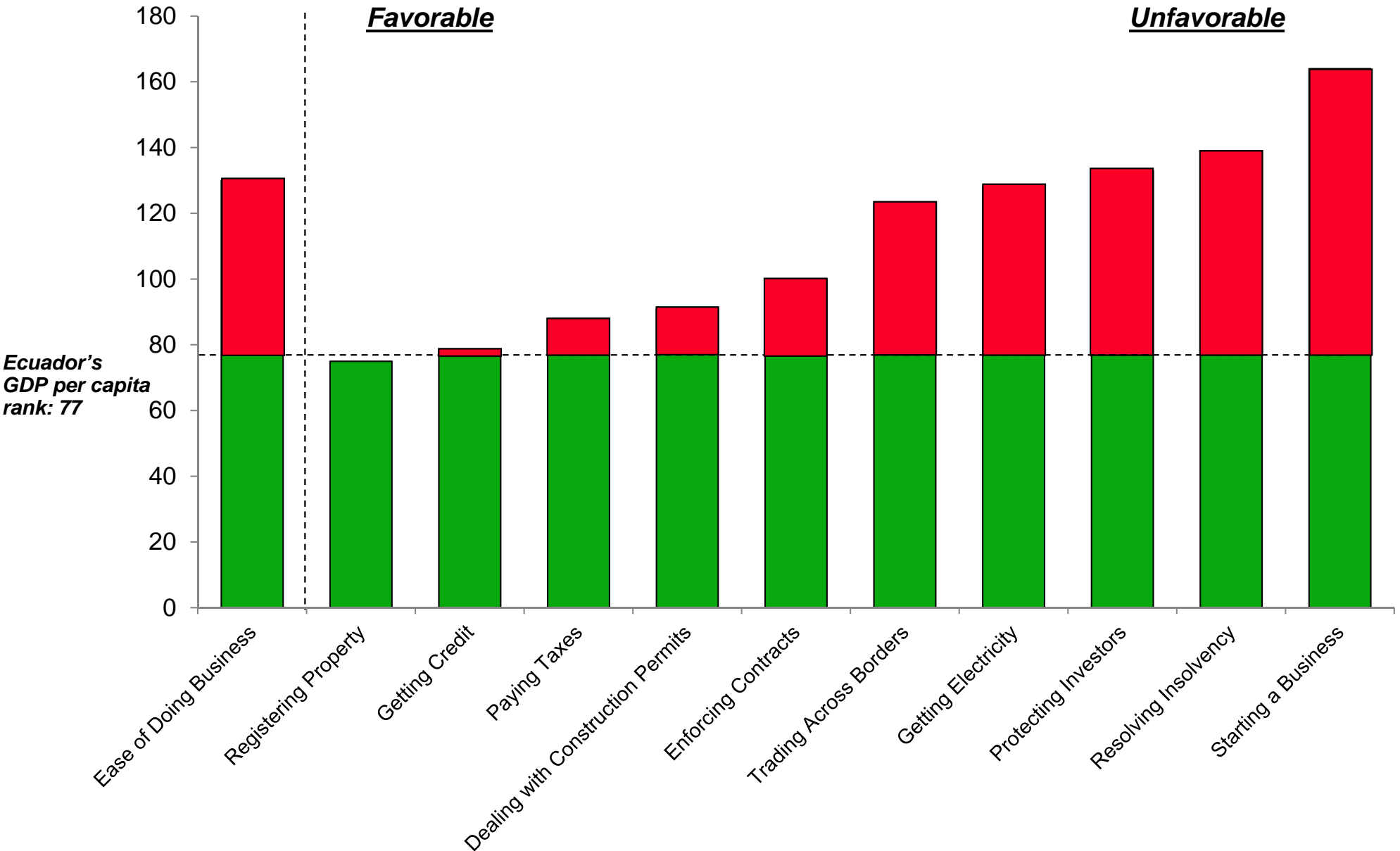
- Weak university-industry **research** collaboration
- Low **patenting rates**

Other

- Low level of **quality certification**

Ease of Doing Business Ecuador, 2010

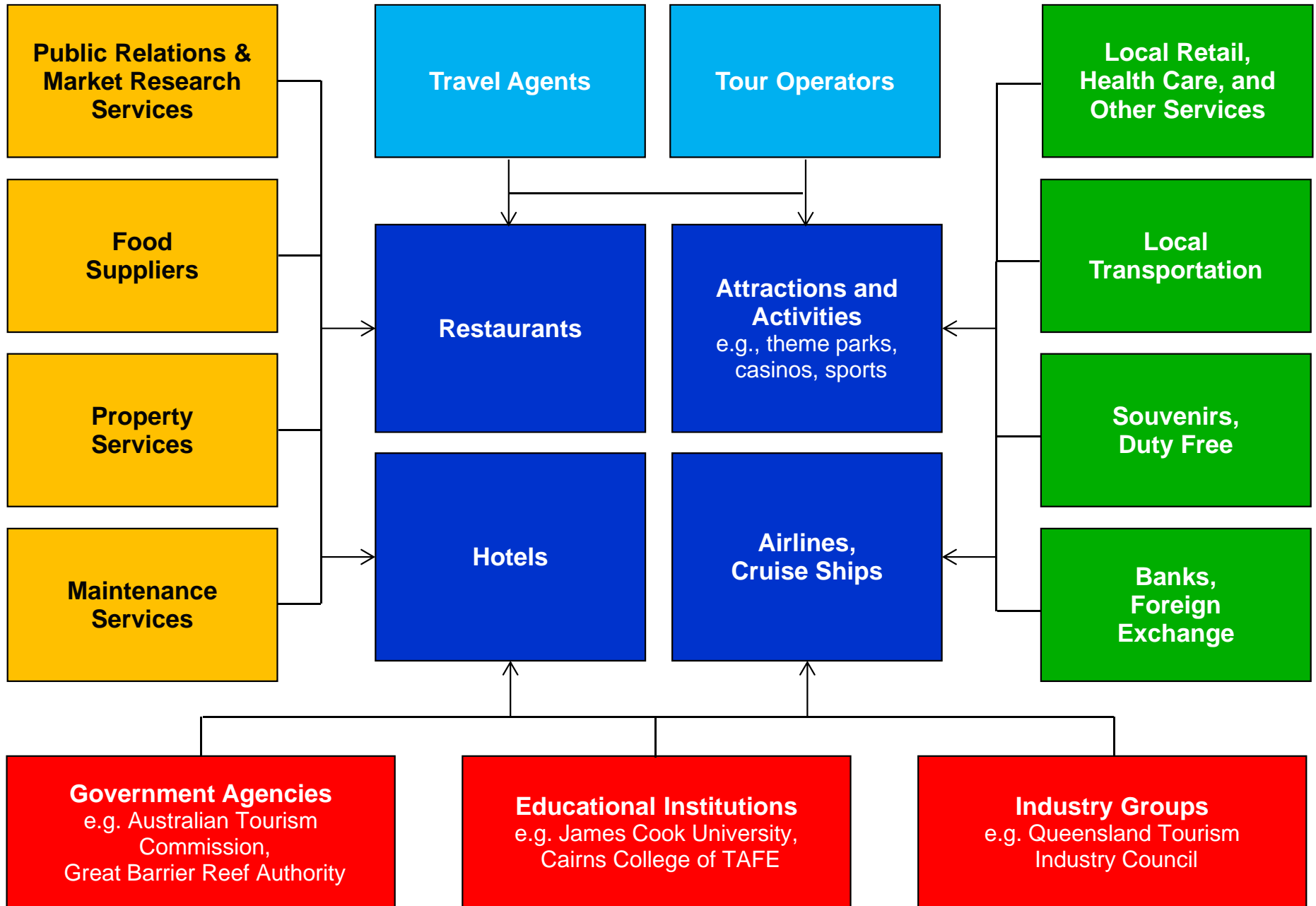
Ranking, 2010
(of 183 countries)



Source: World Bank Report, Doing Business (2010); GPD per capita ranking based on 2009 GCI data.

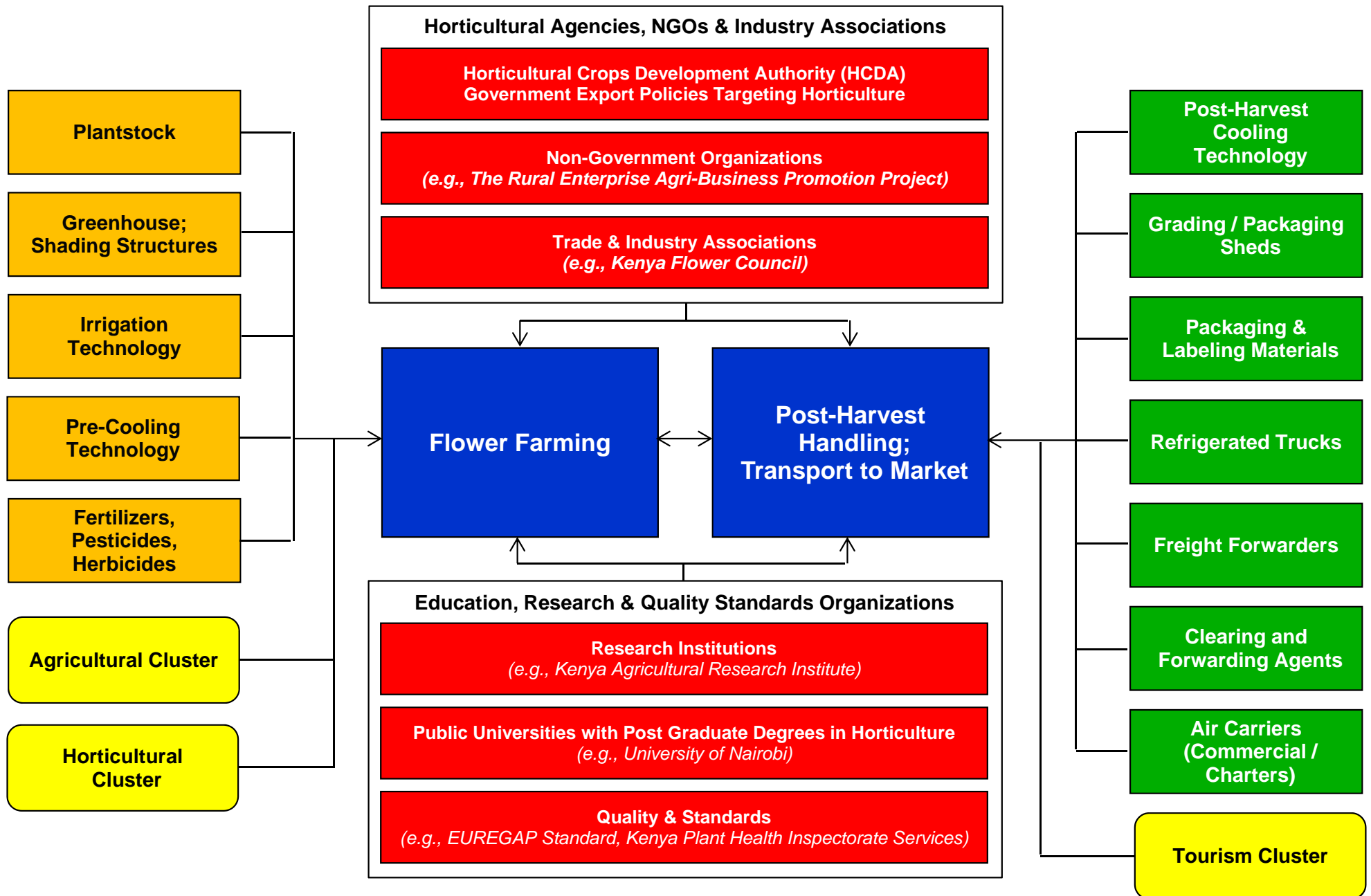
State of Cluster Development

Tourism Cluster in Cairns, Australia



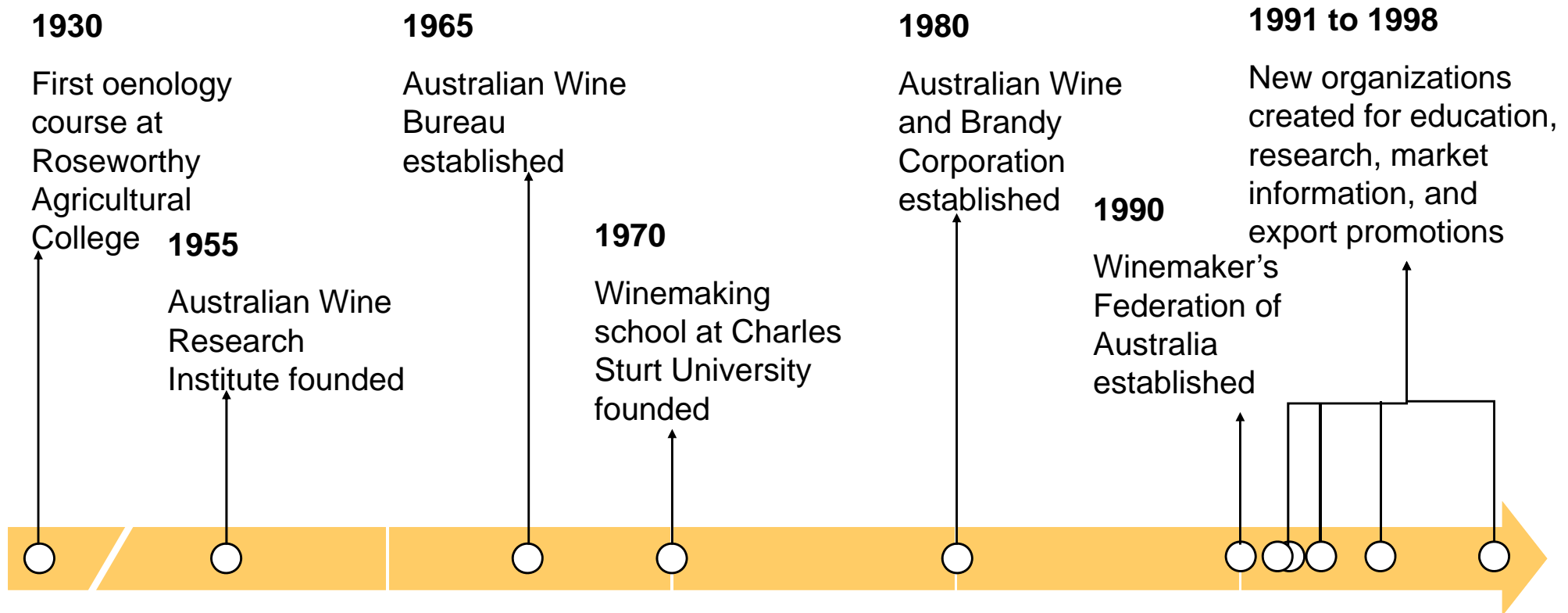
State of Cluster Development

Kenya's Cut Flower Cluster



Clusters Development Over Time

The Australian Wine Cluster



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

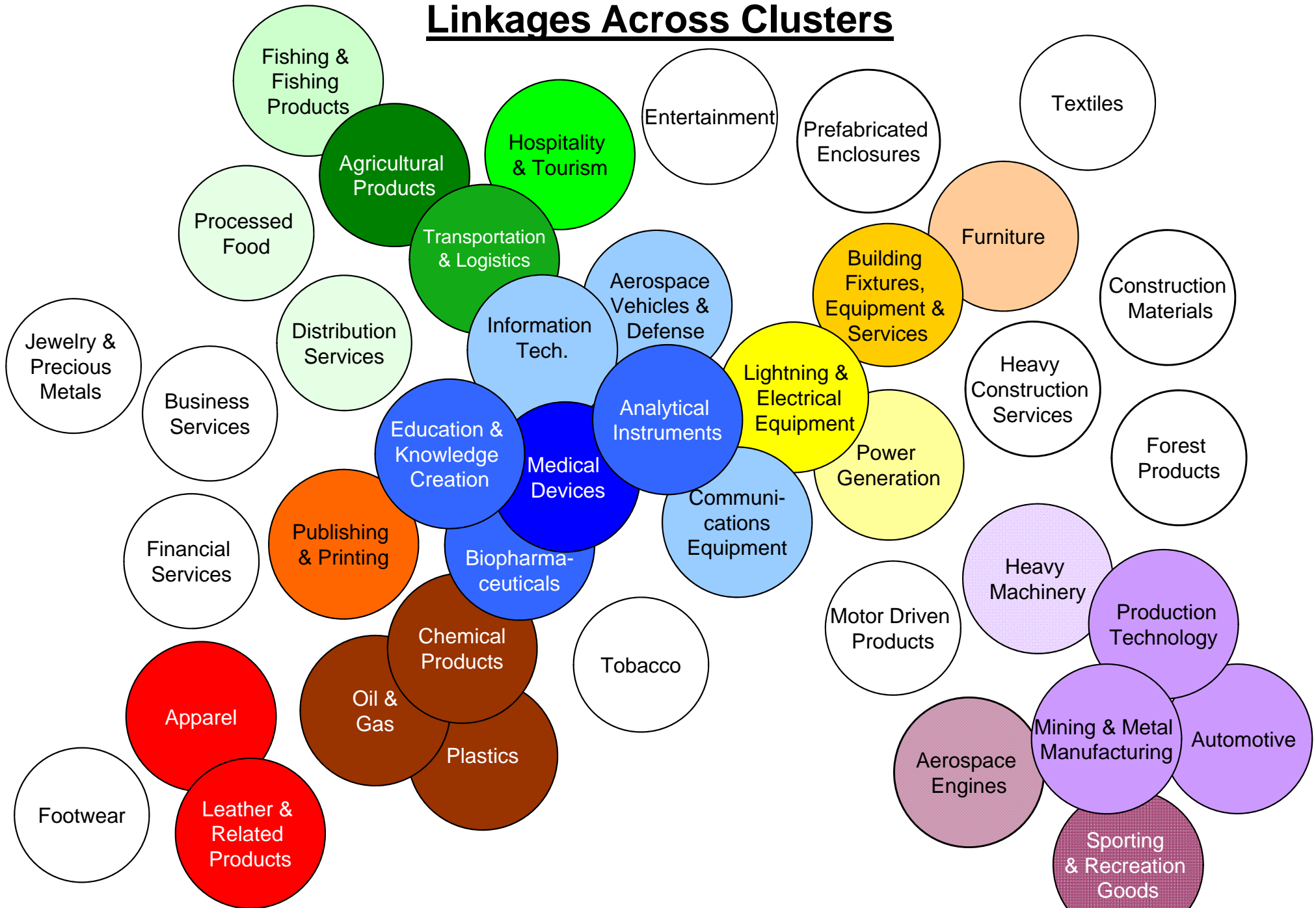
Creation of large number of new wineries

1990s

Surge in exports and international acquisitions

Clusters and Economic Diversification

Linkages Across Clusters

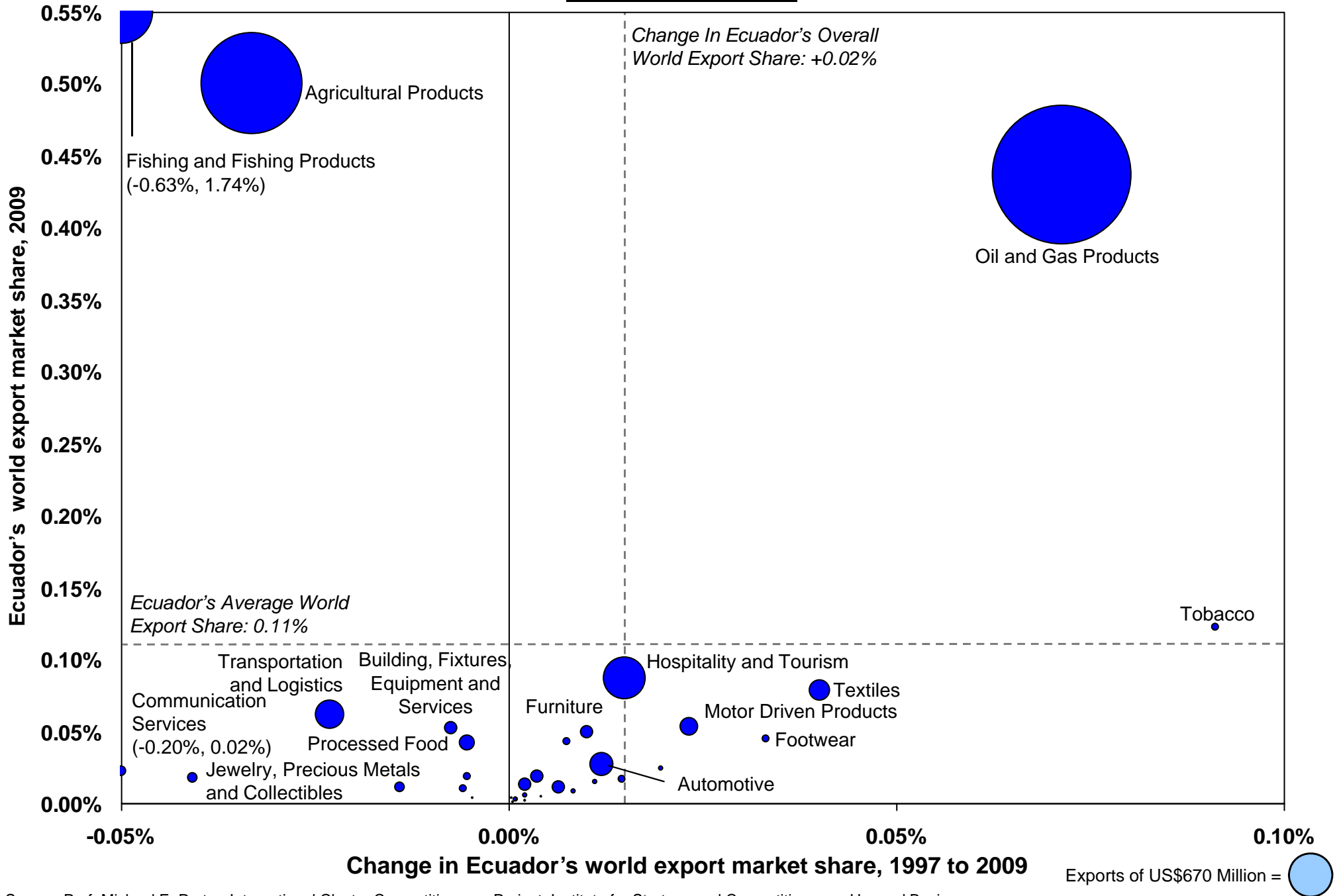


Note: Clusters with overlapping borders or identical shading have at least 20% overlap (by number of industries) in both directions.

Clusters as a Tool For Economic Policy

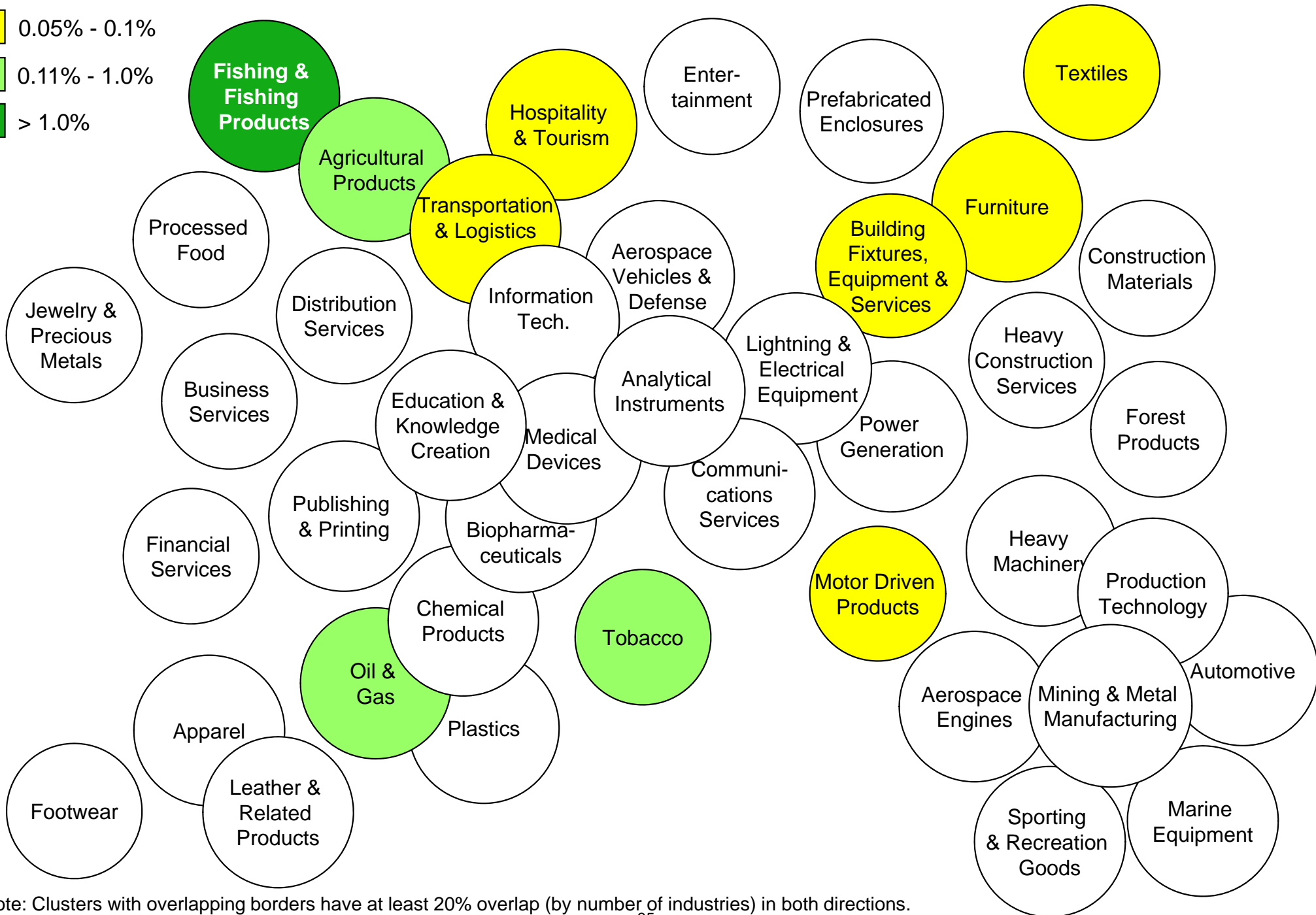
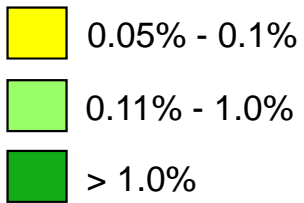
- A forum for **collaboration** between the private sector, trade associations, government, educational, and research institutions
- Brings together **firms of all sizes**, including SME's
- Creates a **mechanism** for **constructive** business-government dialog
- A tool to identify **problems** and **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 Share of World Exports by Cluster, 2009

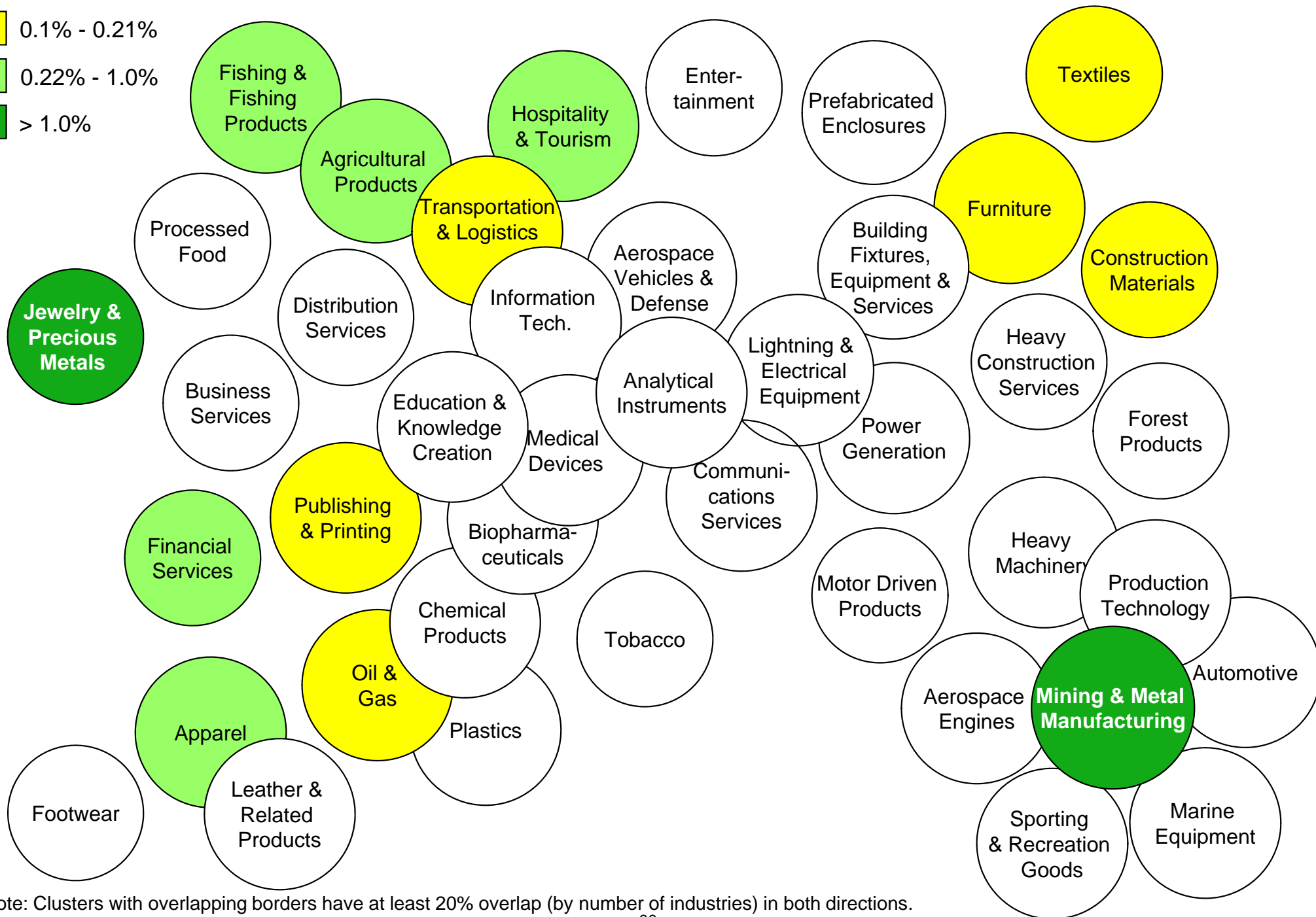
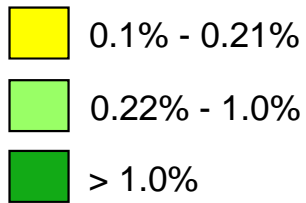
World Market Share



Note: 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

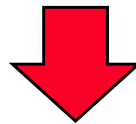
World Market Share



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

State of Cluster Development in Ecuador

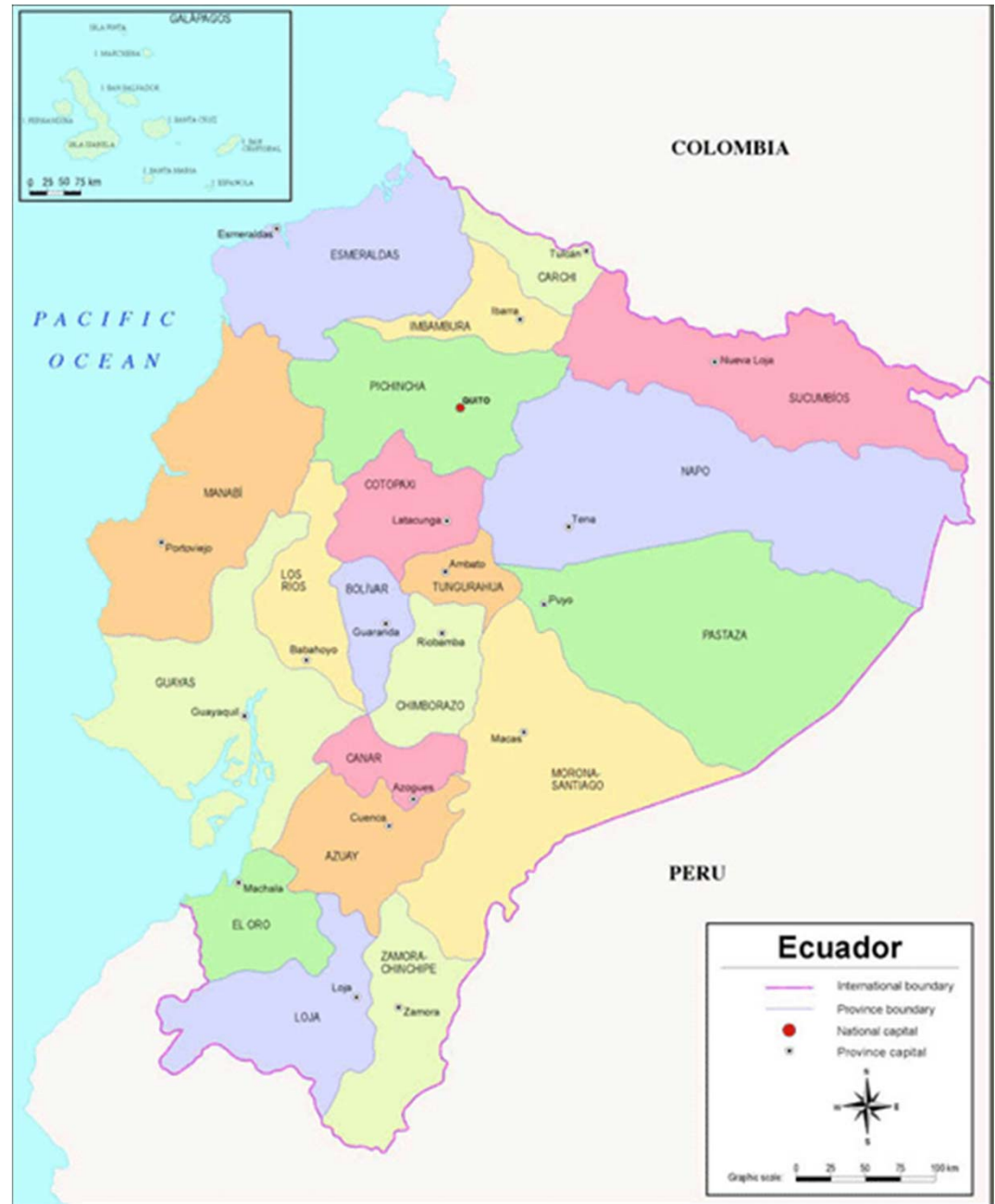
- Ecuador has **strengths in resource-related clusters**, including cut-flowers, bananas, coffee, cacao, fishing, and tourism
- Clusters that serve mainly the **domestic market** include textiles, apparel, automotive, and metalworking
- Most of the clusters are **shallow**, with a **weak** supplier base
- 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 policies
- 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

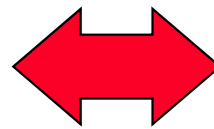
The Need for an Economic Strategy



- 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



- 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