

Clusters and Shared Value: Drivers of Competitiveness

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Harvard Business School

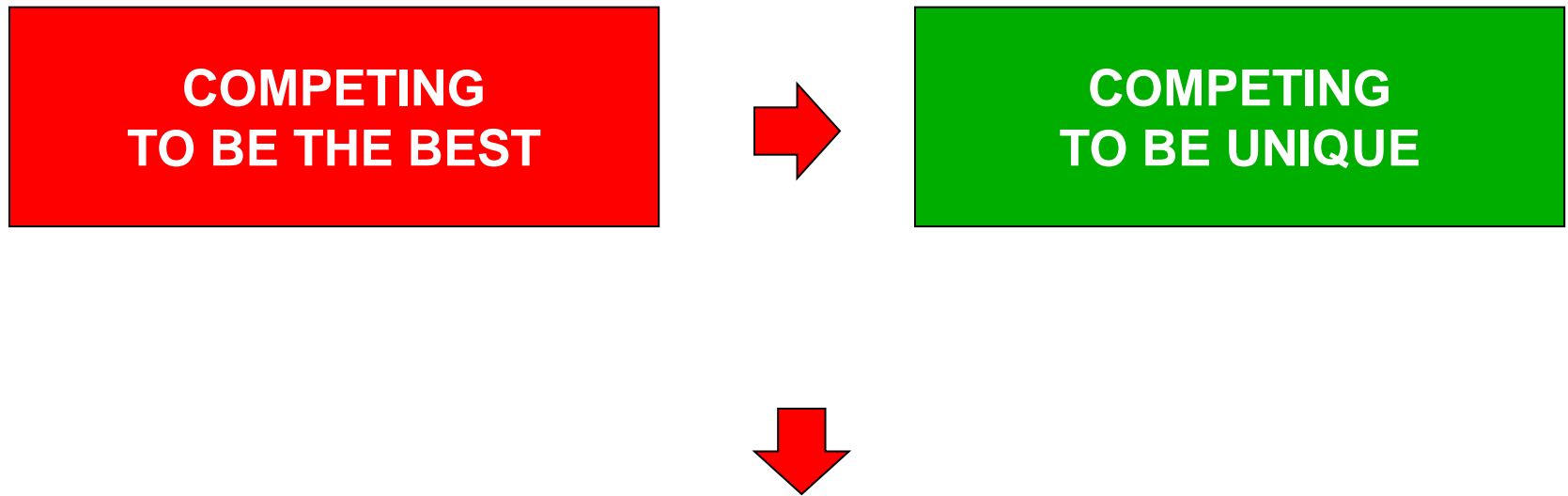
*Bogotá Chamber of Commerce
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This presentation draws on ideas from Professor Porter's articles and books, in particular, [The Competitive Advantage of Nations](#) (The Free Press, 1990), "Building the Microeconomic Foundations of Competitiveness," in [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), "[Creating Shared Value](#)" (Harvard Business Review, Jan 2011), the [Social Progress Index Report](#) (Social Progress Imperative) and ongoing related research. 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. For further materials, see the website of the Institute for Strategy and Competitiveness (www.isc.hbs.edu), FSG (www.fsg.org) and the Social Progress Imperative (www.socialprogressimperative.org).

Agenda

1. Company Strategy
2. Clusters and Competitiveness
3. Creating Shared Value

Thinking Strategically



The worst error in strategy is to compete with rivals on the **same dimensions**

Business Strategy

Drivers of Company Performance



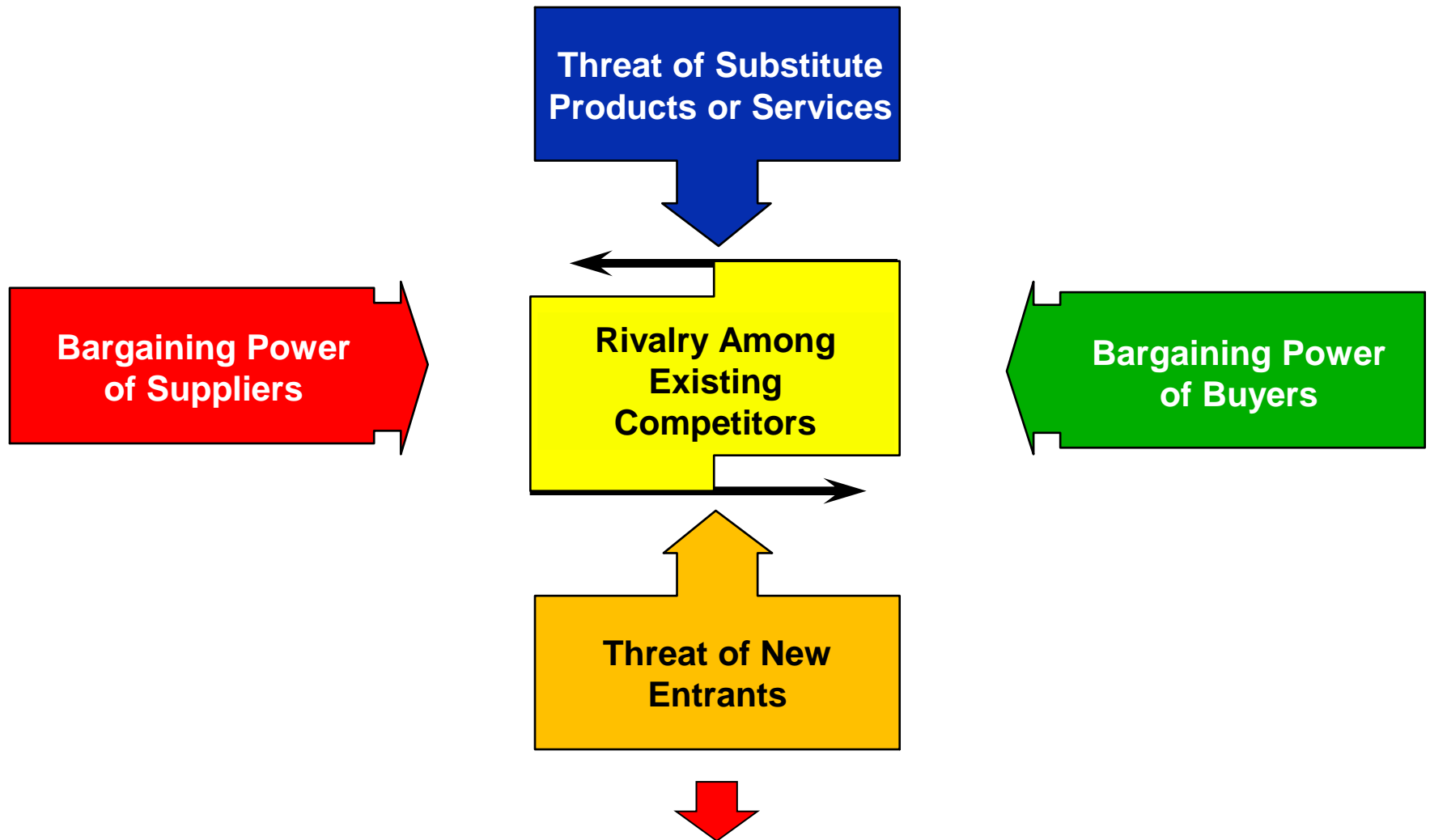
- *Industry Attractiveness*



- *Sustainable Competitive Advantage*

- Company economic performance results from **two** distinct causes
- Companies need to also focus on the **health of the industry**, which can be as important as a company's **own position**

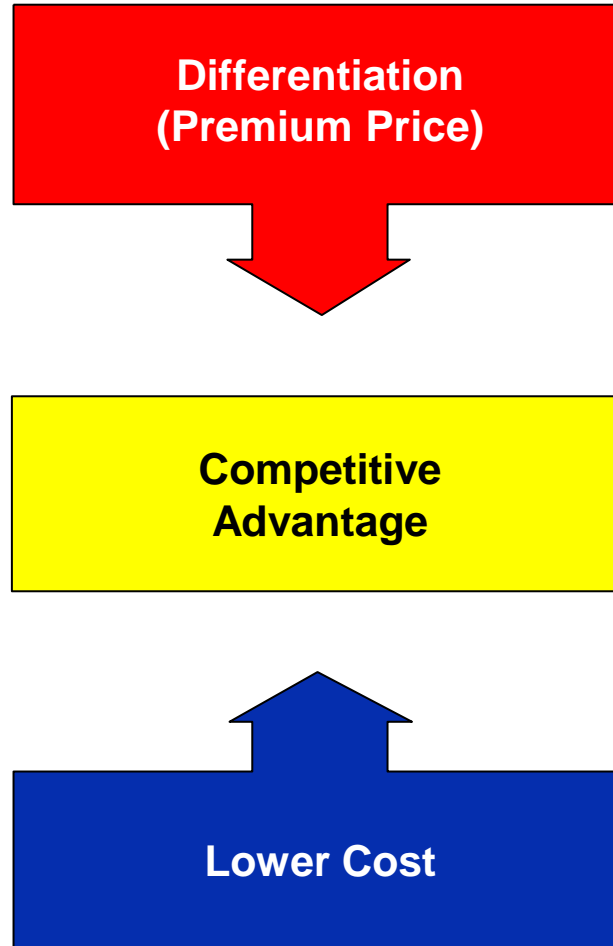
Understanding Industry Structure



- Part of strategy is to drive a **positive transformation** in industry structure

Positioning

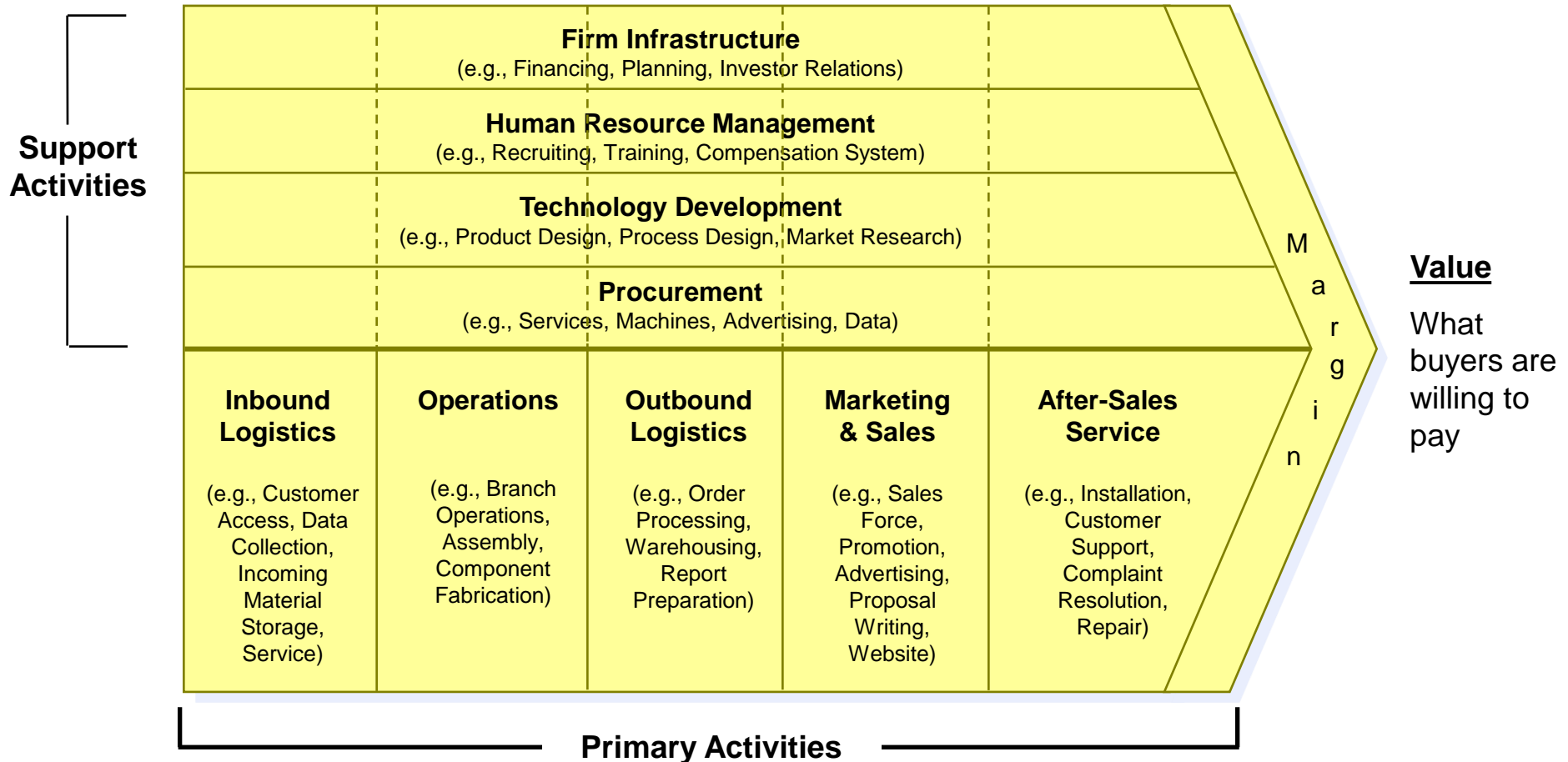
Types of Competitive Advantage



- Operating Cost
- Utilization of Capital

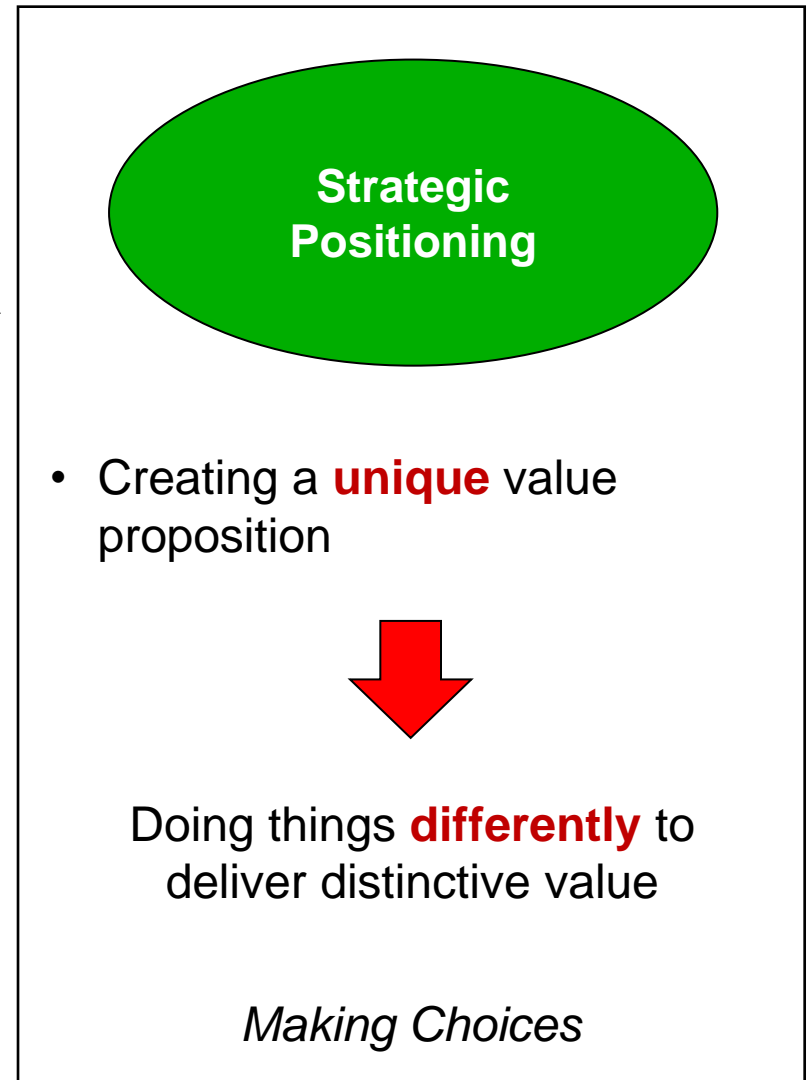
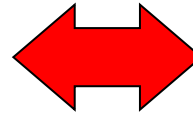
Sources of Competitive Advantage

The Value Chain



- The value chain is the **activities** involved in delivering value to customers
- Strategy is reflected in the **set of choices** about how activities are configured and linked together

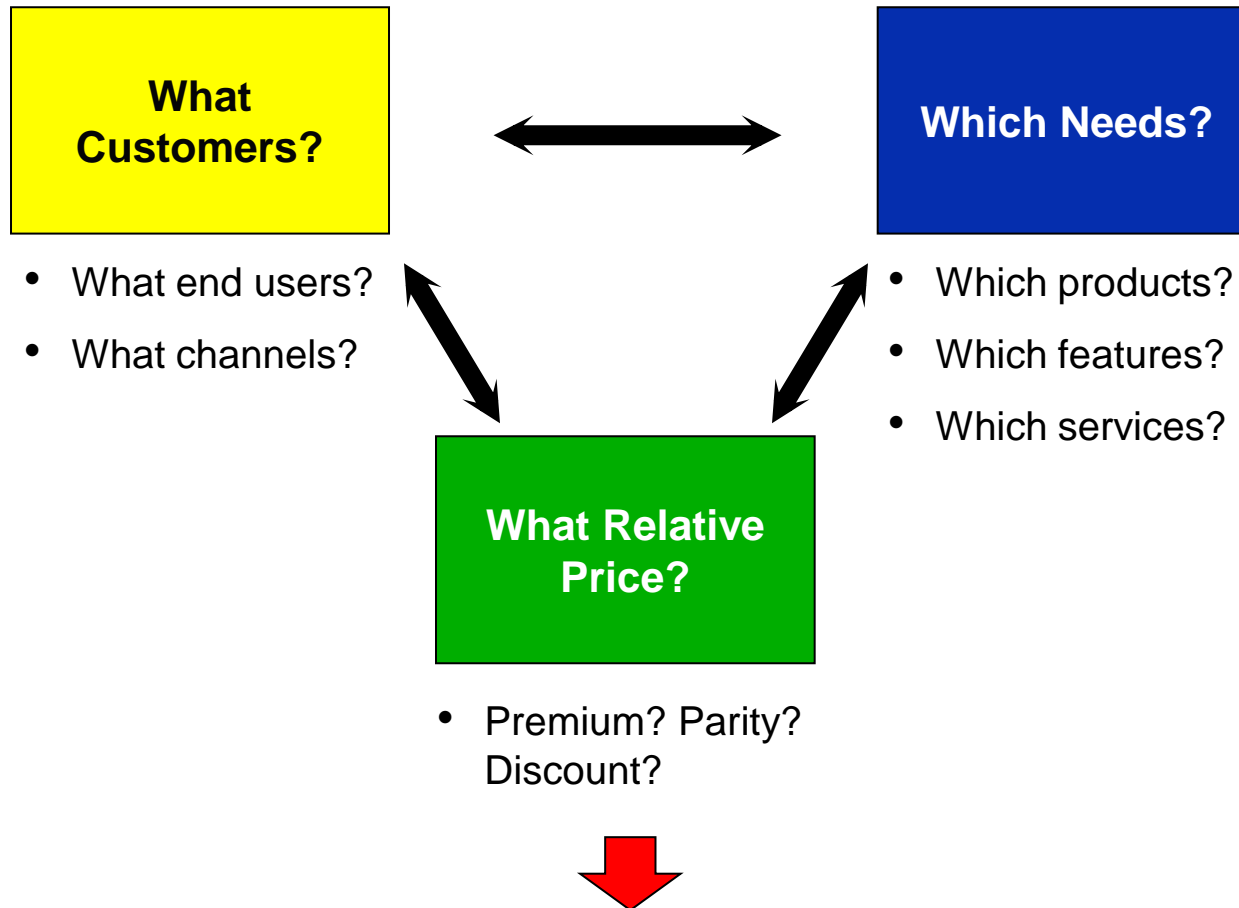
Operational Effectiveness Versus Strategy



Tests of a Successful Strategy

- A **unique value proposition** compared to competitors

Defining the Value Proposition



- A novel value proposition can **expand the market**
- Finding a unique value proposition often involves a new way of **segmenting** the market

Tests of a Successful Strategy

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- A **distinctive value chain** involving clear choices about how the company will **operate differently** to deliver its value proposition

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Tests of a Successful Strategy

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- Making clear tradeoffs, and choosing what **not to do**
- Integrating activity choices across the value chain to **fit together** and **reinforce each other**
- **Continuity** of strategic direction with continuous improvement in realizing the unique value proposition

Finding a Unique Strategic Position

- Understanding **industry structure**
- Finding a **novel value proposition**
 - Creative segmentation
- **Reinventing** the value chain
- Capitalizing on **changes** in technology, customers, needs, regulation, and other areas



- Successful strategies involve a core strategic insight that is **improved and expanded** over time

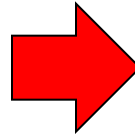
Shifting the Nature of Industry Competition

Zero Sum Competition

- Compete **head to head** on price
- One company's **gain** requires another company's **loss**



- Competition **dissipates** industry structure and profitability



Positive Sum Competition

- Compete on **distinctive strategic positioning**
- **More than one** company can be successful



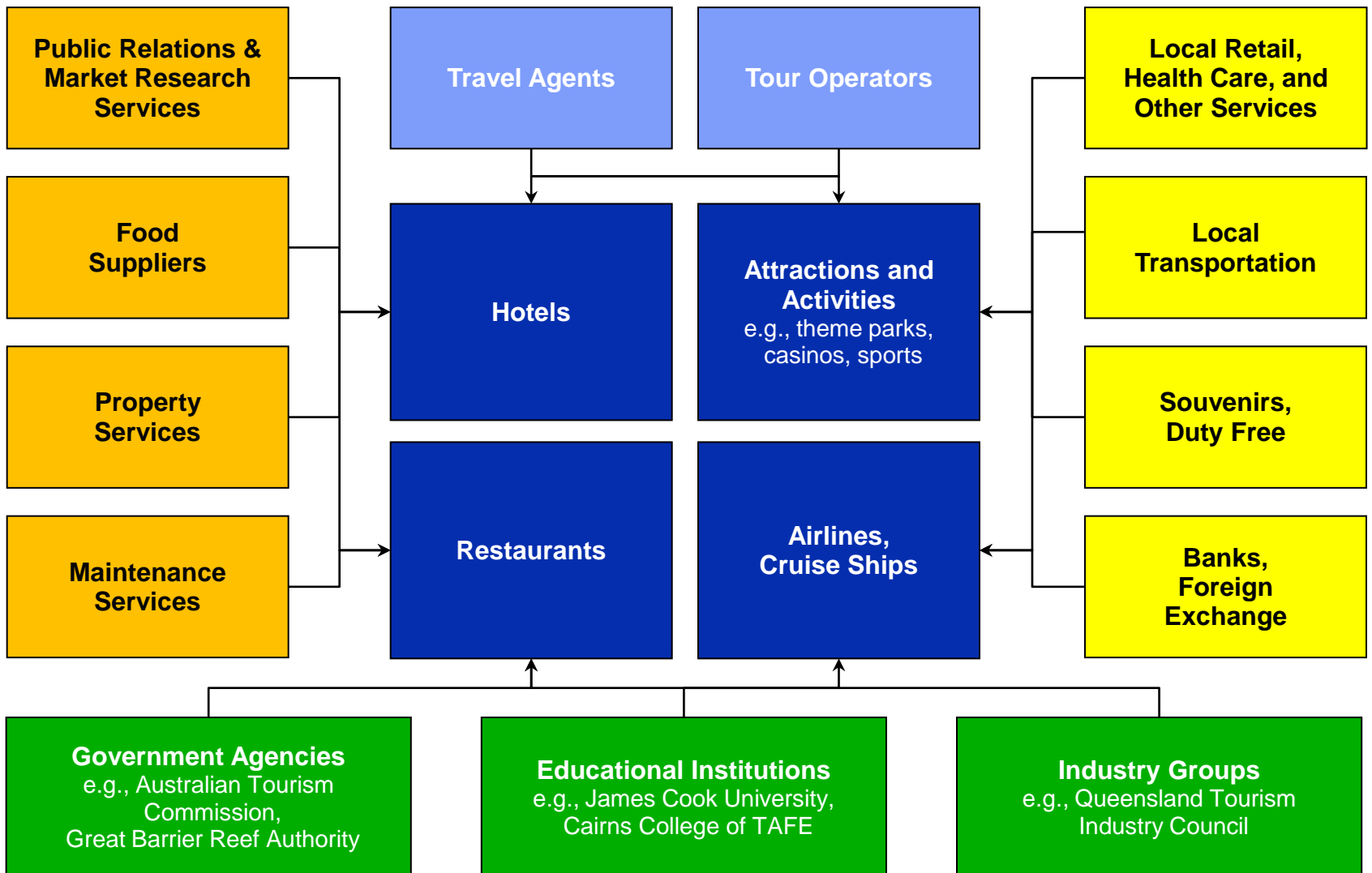
- Competition **expands** the customers served, the needs that are met, and the overall value pool

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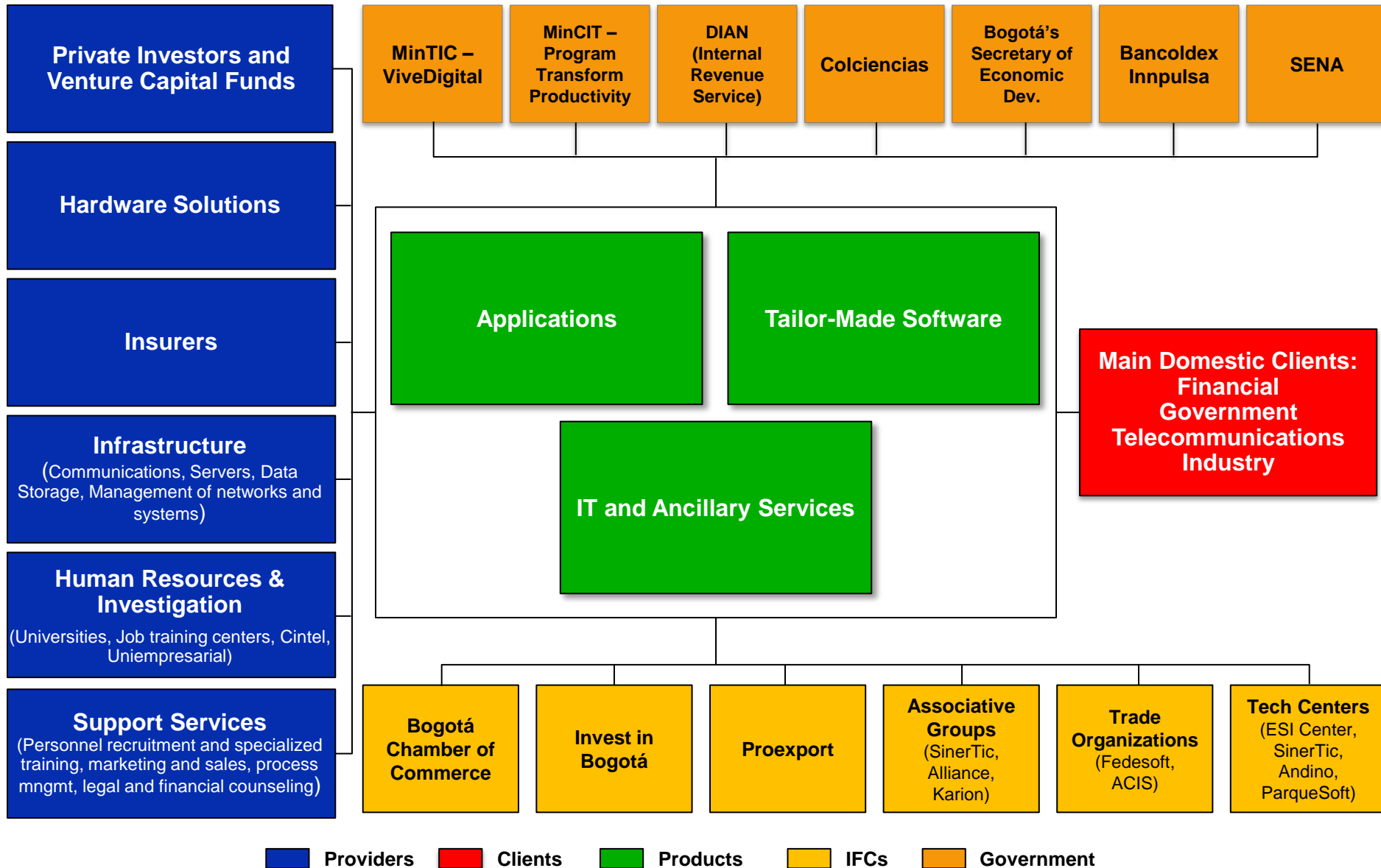
What is a Cluster?

Tourism in Cairns, Australia



What is a Cluster?

Bogota's Software Cluster



Source: Cluster Bogota and authors.

Institutions of Collaboration (IFCs)

The Australian Wine Cluster

Winemakers' Federation of Australia

- Established 1990
- Focus: Public policy representation of companies in the wine cluster
- Funding: Member companies

Cooperative Centre for Viticulture

- Established 1991
- Focus: Coordination of research and education policy in viticulture
- Funding: Cluster organizations

Australian Wine Export Council

- Established 1992
- Focus: Wine export promotion through international offices in London and San Francisco
- Funding: Government; cluster organizations

Grape and Wine R&D Corporation

- Established 1991 as statutory body
- Focus: Funding of research and development activities
- Funding: Government; statutory levy

Wine Industry Information Service

- Established 1998
- Focus: Information collection, organization, and dissemination
- Funding: Cluster organizations

Wine Industry National Education and Training Council

- Established 1995
- Focus: Coordination, integration, and standard maintenance for vocational training and education
- Funding: Government; cluster organizations

Why Clusters Matter?

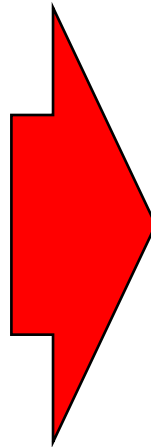
- Clusters **increase productivity** and **operational efficiency**
- Clusters stimulate and enable **innovations**
- Clusters facilitate **commercialization** and **new business formation**



- Clusters reflect the fundamental importance to productivity and innovation of **linkages and spill-overs** across firms and associated institutions

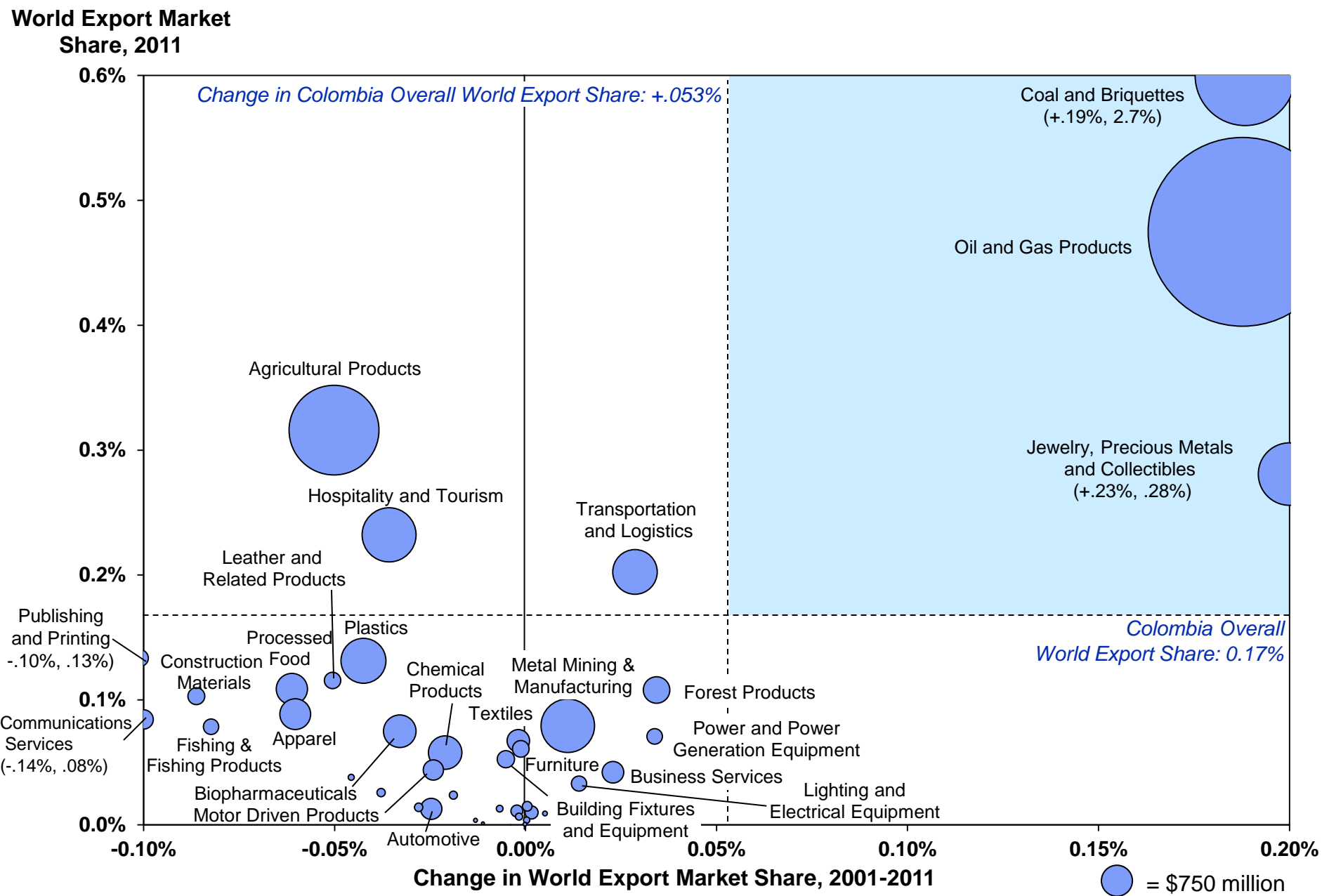
Evidence on the Impact of Clusters

- Specialization in **strong clusters**
- **Breadth** of industries within the cluster
- Strength in **related clusters**
- Presence of a region's clusters in **neighboring regions**

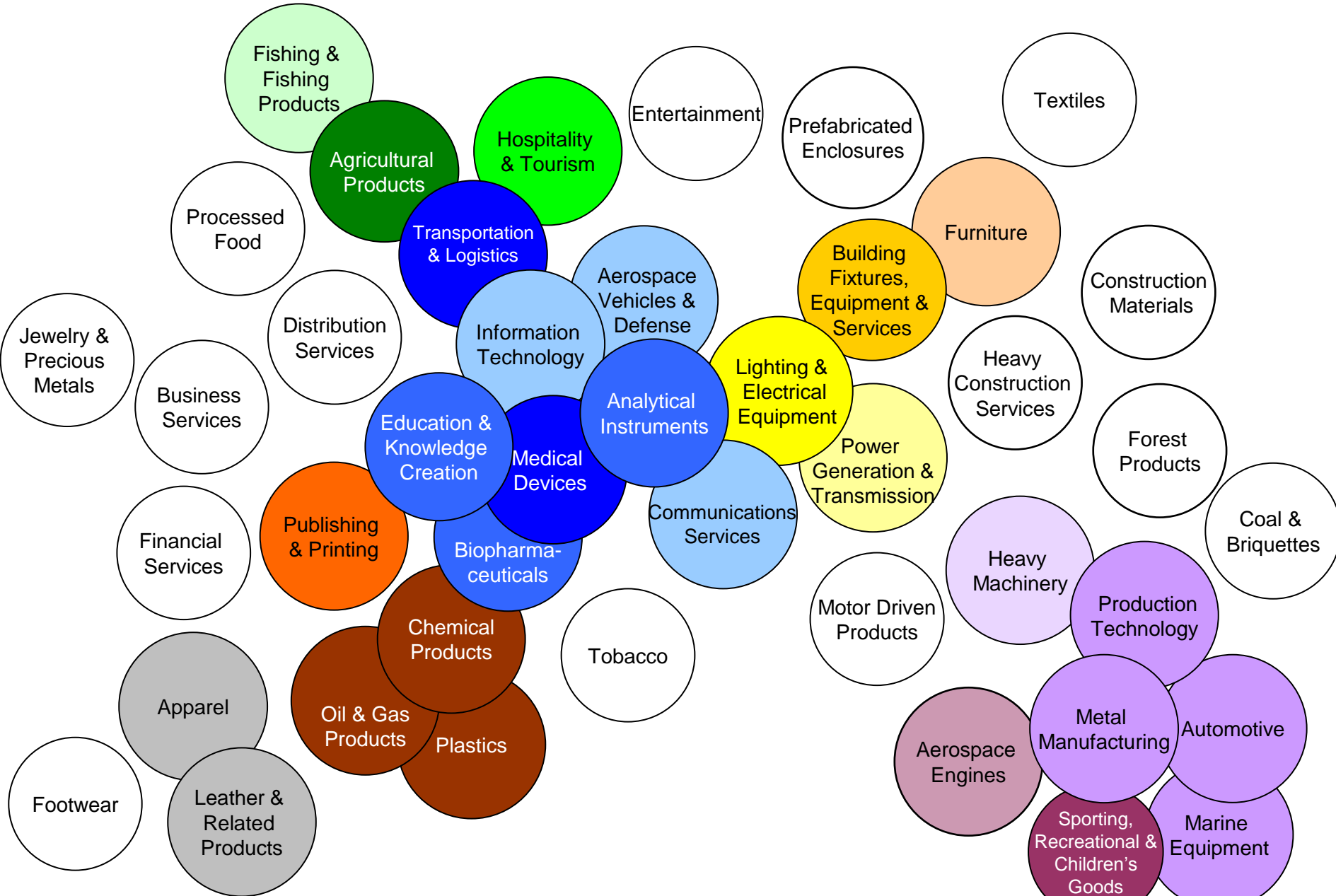


- **Job** growth
- Higher **wages**
- Higher **patenting** rates
- Greater **new business** formation, growth and survival

Colombia National Cluster Export Portfolio, 2011

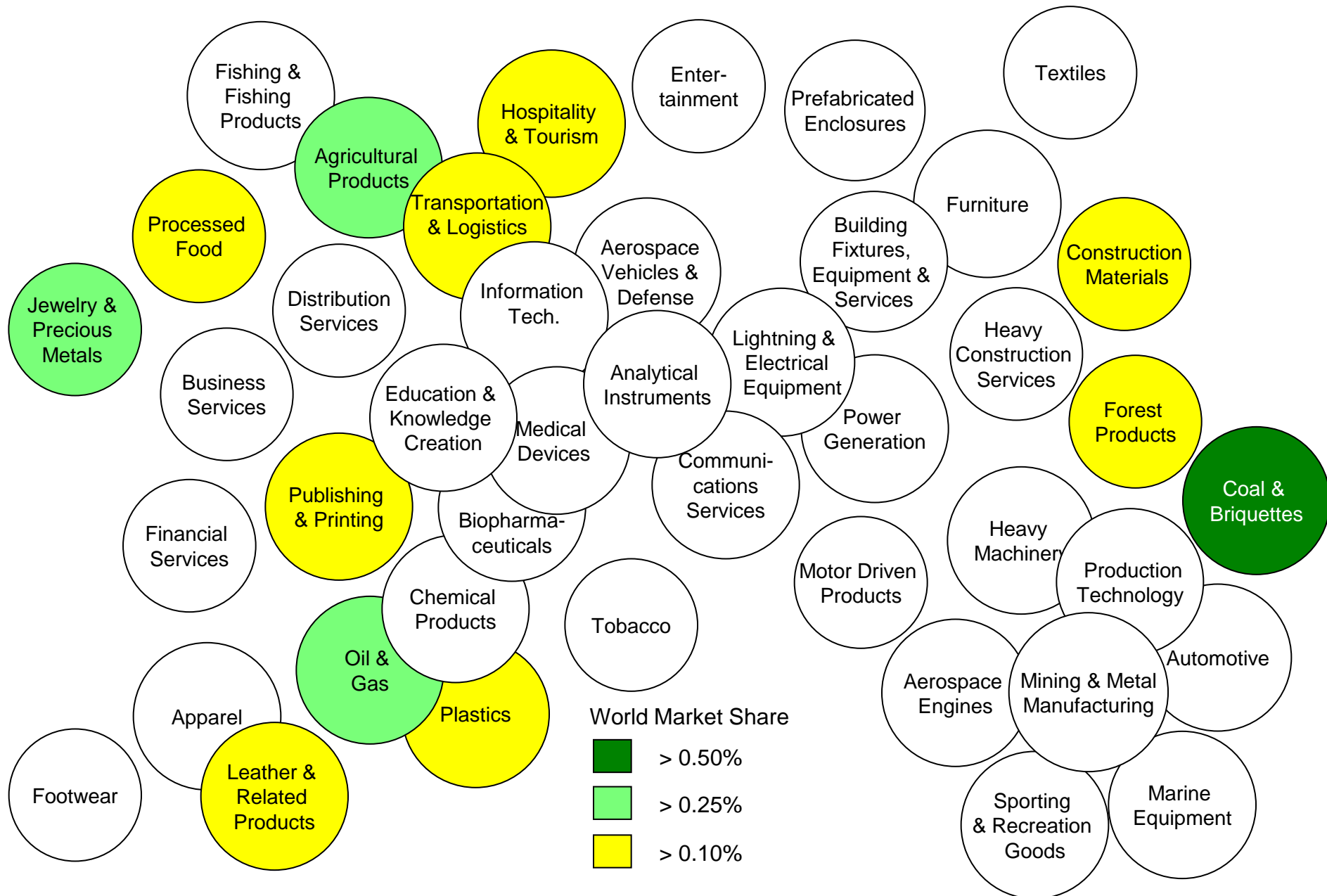


Related Clusters and Economic Diversification



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

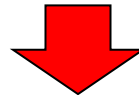
Colombia's Share of World Exports by Cluster, 2011



Note: Clusters with overlapping borders 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
- Enhances the efficiency and effectiveness of **traditional economic policy** areas, such as training, R&D, export promotion, FDI attraction, etc.



- Sound cluster policy addresses **all clusters**, and does not pick winners

Clusters in Developing Economies

Principles

- Improving the general business environment is essential, but **cluster development** is necessary to attain middle-income levels
- Developing economies should **upgrade traditional clusters** (including agriculture), never abandon them
- **Existing MNCs** in the country should be treated as **nodes** for cluster development
 - The best way to **retain** companies is for them to be part of a cluster
- Attracting **foreign direct investment** should focus on existing and emerging clusters, not generalized appeals to locate in the country
- **Free Trade or Export Processing Zones** should be organized around clusters, with governing regulations designed to **encourage linkages** with the local economy
- A formal **process for cluster development** is an important component of economic development
 - Private sector led
 - Government roles in convening, supporting, and participating
 - Seed funding for cluster assessment and the formation of cluster-based IFCs

Cluster Initiatives

The Role of Government

Government should

- Support *all* existing and emerging clusters
- Participate
- Enable data collection and dissemination at the cluster level
- Be ready to implement recommendations

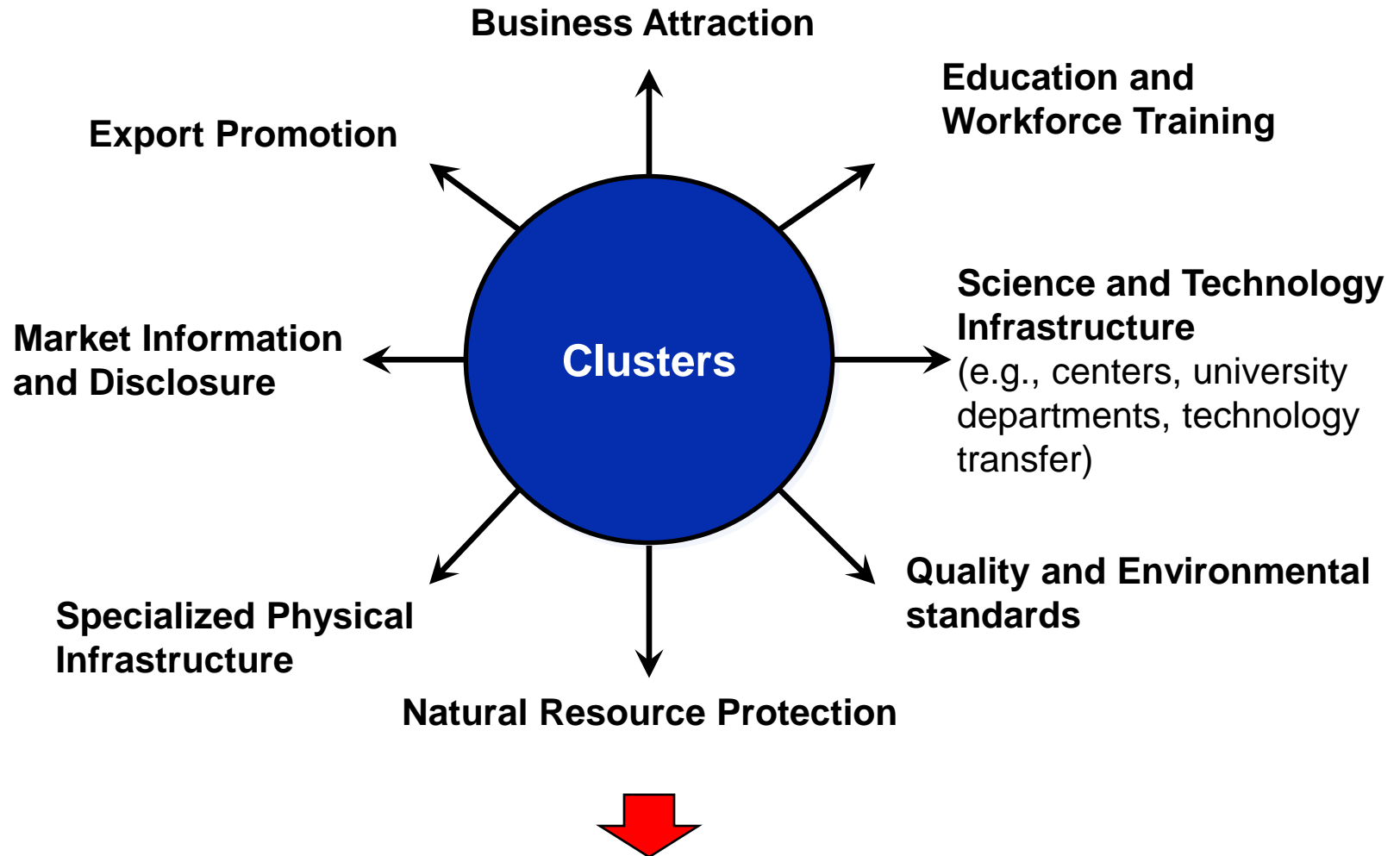
Government may

- Initiate/ Convene
- Co-Finance

Government should not

- Pick favored clusters
- Pick favored companies
- Subsidize or distort competition
- Define cluster action priorities

Organize Public Policy around Clusters



- Clusters provide a framework for **organizing the implementation** of many public policies and public investments directed at economic development

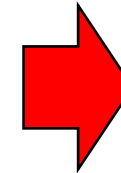
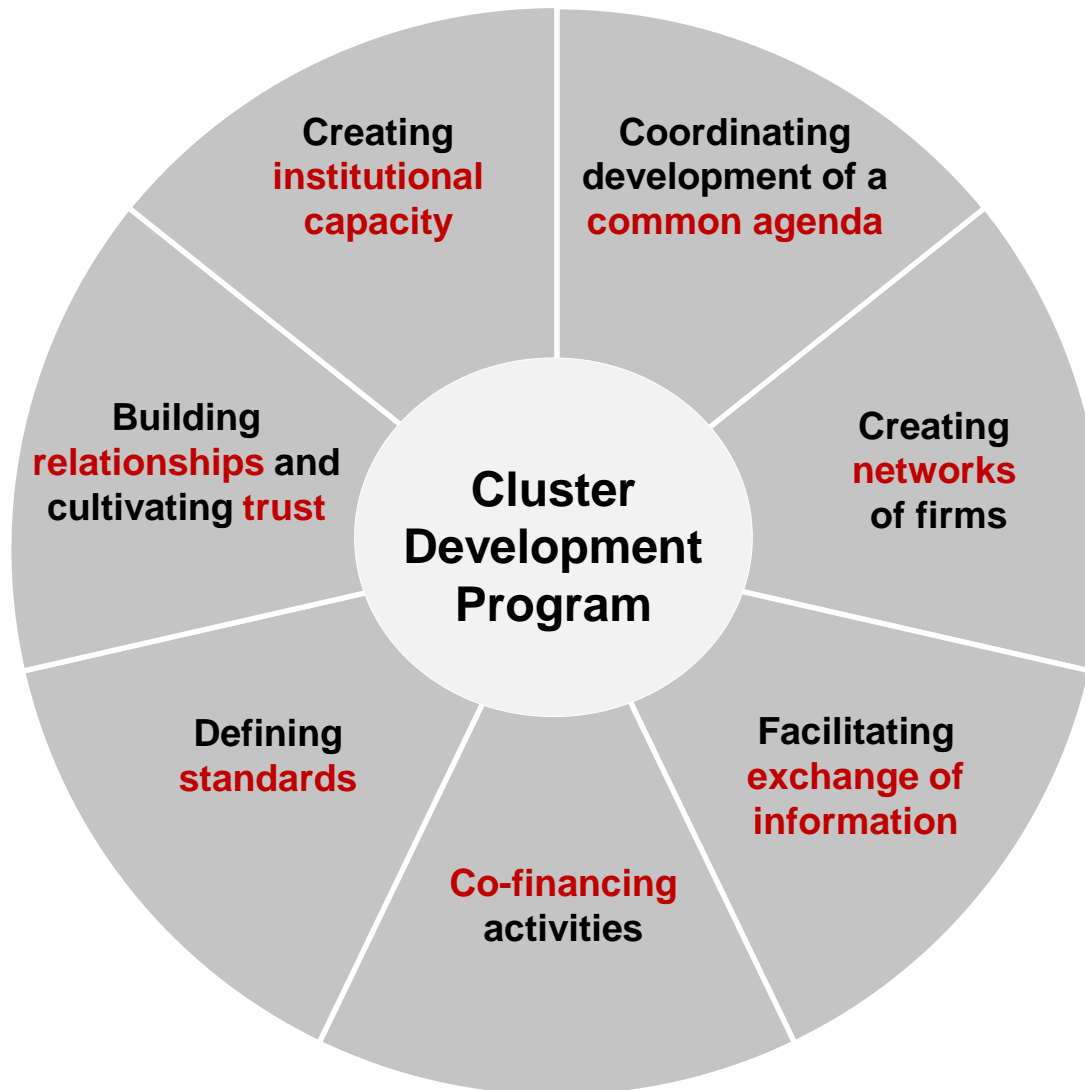
Chamber of Commerce of Bogotá

Cluster Growth Strategy

- Created a **private sector-led** cluster upgrading program with matching support from all actors (government, institutions of collaboration, academia)
- Built on **existing and emerging** regional cluster strengths rather than chasing hot fields
- Focused on clusters where the Bogota region has **potential competitive advantages**
- Created **institutional capacity** to coordinate activities
- **Aligned other economic development policies** with clusters, including targeted workforce development, export promotion and specialized infrastructure and research initiatives
- Linked cluster programs with **shared value promotion**

The Role of an Institution for Collaboration

Bogotá Chamber of Commerce (CCB)



Initial Clusters:

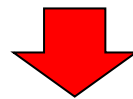
- Tourism
- Creative Industries
- Software and IT
- Apparel
- Leather and Footwear
- Cosmetics
- Graphic design
- Jewelry

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3. **Creating Shared Value**

The Role of Business in Society

- Only business can **create economic prosperity**, through meeting needs at a profit
- Societies everywhere are facing significant **social, environmental and economic development** challenges
- Government and NGO's **lack sufficient resources and capabilities** to fully meet these challenges alone
- Corporate social responsibility efforts are greater than ever, but the **legitimacy of business has fallen**



We need a **new approach**

The Role of Business in Society

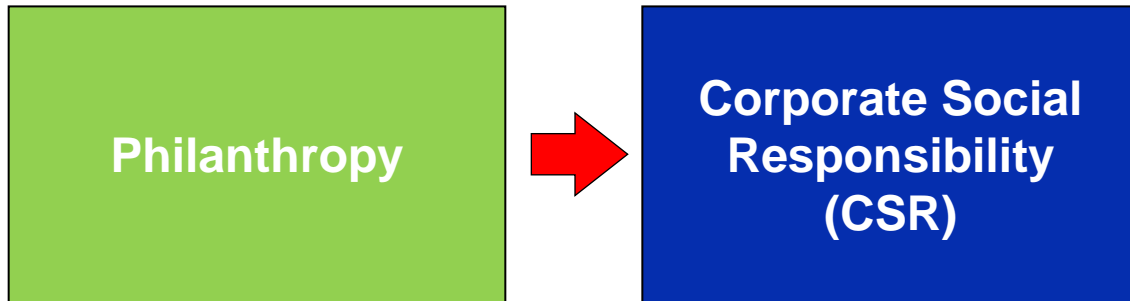
Evolving Approaches

Philanthropy

- Donations to worthy social causes
- Volunteering

The Role of Business in Society

Evolving Approaches



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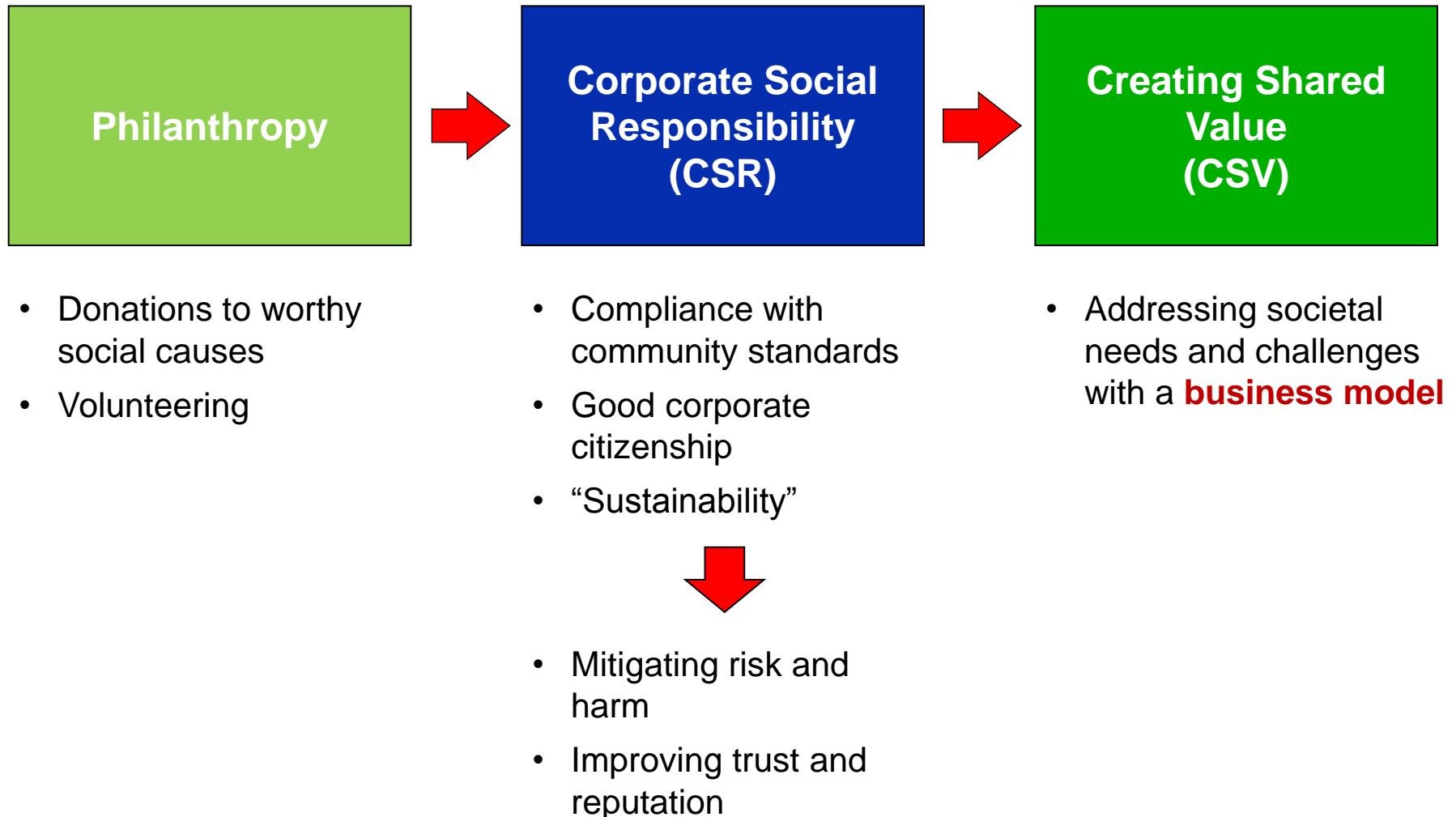
- Compliance with community standards
- Good corporate citizenship
- “Sustainability”



- Mitigating risk and harm
- Improving trust and reputation

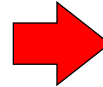
The Role of Business in Society

Evolving Approaches



CSR versus Shared Value

Fair Trade



Fair Trade

- Paying a **higher price** to farmers for the same products
- **Certification** as a fair trade company

Transforming Procurement

- Collaborate with farmers to **improve quality and yield**
- Supporting investments in **technology** and **inputs**
- Higher prices for **better quality**
- Higher yield increases **quantity** produced
- **Environmental** impact also improved

The Opportunity for Shared Value



- **Social deficits** and **environmental impact** create **economic costs** for companies
- **Community weaknesses** affect company productivity
- Social needs represent the **largest unserved market opportunities**

Levels of Shared Value

I. Reconceiving **needs**, **products**, and **customers**

- Meeting **societal needs** through products and services
- Serving **unserved** or **underserved** customers

Shared Value in Products

Dow Chemical

- Dow recognized that global social issues represent its **largest market opportunities**
- Created the “**Breakthroughs to World Challenges**” Program
 - Each business unit was challenged to apply Dow’s tradition of “solutionism” through innovation to a **range of global problems** inspired by the Millennium Development Goals



- One of Dow’s business units developed **Omega-9 canola and sunflower seeds** that produce cooking oil with no trans fats and low saturated fats
- The technology yields **twice the oil per hectare** for farmers than soybeans, raising farmer and farmland productivity
- The oils have longer **shelf life** and **usage life** for food processors



- Has become one of Dow’s largest selling product lines, with 2012 total revenues of approximately **\$700 million**

Shared Value in Products and Markets

Banco de Crédito e Inversiones (BCI), Chile

- BCI launched in 2007 the “**Nace**” fund to provide credit to scale entrepreneurs who did not qualify for conventional financing
- **Unique lending criteria** targeted entrepreneurs with a high level of commitment and perseverance, as well as high quality business plans
- In addition to capital, Nace provides tools and advice to clients for **business planning** and **networking**



- Since its inception, the program has extended **\$160 million** in credit to **7,500 entrepreneurs** with a comparable default rate to BCI’s conventional SME clients
- An estimated **15,000 new jobs** have been created
- Nace profits have grown by a **factor of 25** and the program is considered to be an important opportunity for continued growth at the bank

Levels of Shared Value

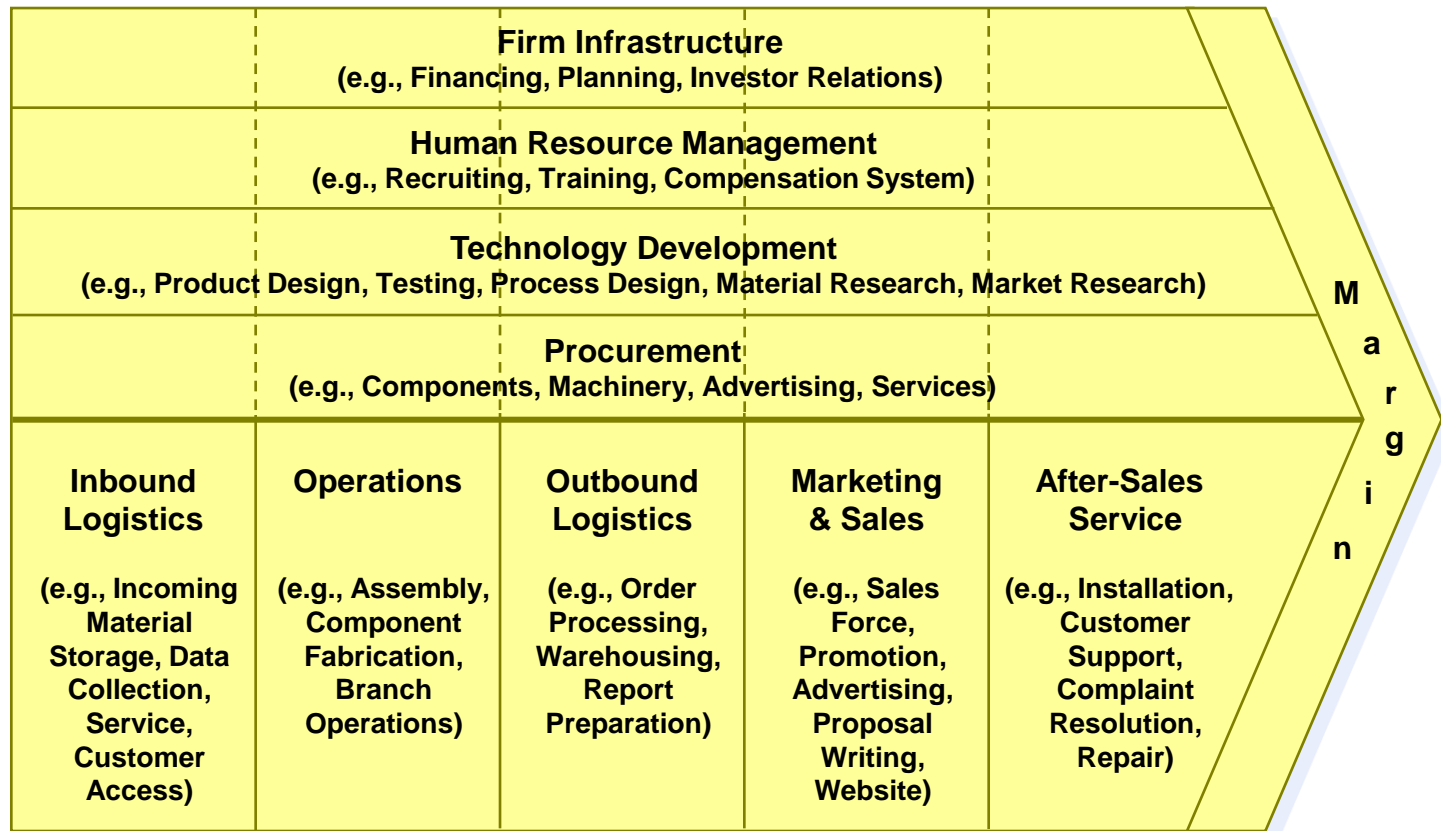
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II. Redefining **productivity in the value chain**

- Utilizing resources, energy, suppliers, logistics, and employees **differently and better**

Shared Value in the Value Chain

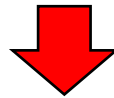


- Procurement that **enhances supplier capabilities and efficiency**
- Improving **energy, water** and **resource** efficiency across the value chain
- Minimizing **logistical intensity**
- Improving employee **health** and **safety**
- Enhancing the productivity (and through this wages) of **lower income** employees
- Recruiting to reflect the **diversity of customers** and the **communities** where a company operates
- Others...

Shared Value in the Value Chain

Fibria, Brazil

- Fibria, the world's leading manufacturer of chemical pulp, utilizes planted eucalyptus trees and integration of native habitat to **dramatically reduce the land required** and sustainability in wood fiber cultivation
- The company also encourages **small-scale producers** near its mills to plant eucalyptus in conjunction with other crops, assisting them with technical training and inputs



- Fibria achieves far greater **land and water efficiency** than traditional plantation methods
- Small scale producers currently contribute **27% of the raw material volume** utilized in Fibria mills, improving efficiency
- Over **4000 households** have significantly increased employment and incomes

Shared Value in the Value Chain

Manuelita Palm Oil Company, Colombia

- Manuelita's palm oil extraction company in the Eastern Plains of Colombia involved **high energy cost**, and methane emissions from the production process were a major environmental problem
- The company began capturing the **methane gas** emitted during production and invested \$8.5 million in a **bioreactor** for gas processing



- Manuelita energy costs **fell by 80%**
- Methane gas emissions **fell by 85%**

Levels of Shared Value

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II. Redefining **productivity in the value chain**

- Utilizing resources, energy, suppliers, logistics, and employees **differently and better**

III. Improving the **local and regional business environment**

- Improving **skills**, the **supplier base**, the **regulatory environment**, and the **supporting institutions** that affect the business
- Strengthening the **cluster** on which the company depends



- Strengthens the link between **company** success and **community** success

Shared Value in the Local Business Environment

Arca Continental

- Arca Continental is the **second largest bottling company** in Latin America, and **one of the largest Coca-Cola bottlers** in the world
- Arca Continental established a program to train and invest in the **micro-entrepreneur retailers** who sell more than 60% of the Company's products, including **management, sales and marketing** and **merchandising**
- Invests in **low energy use coolers** and **fixture improvements**



- Participating retailers register **sales increases of 25%** or more, with improved customer satisfaction, leading to similar **increases in the sales of Arca's products**
- Arca Continental **recovers its investment** in 6 months or less
- Beginning in **Mexico**, the program is being extended to **Argentina** and **Ecuador**

Shared Value in the Local Business Environment

BHP Billiton, Chile

- BHP Billiton invested USD \$50 million over 4 years in a **supplier development program** that engages local suppliers to develop **innovative solutions to critical aspects of mining**
- Goal of creating **250 world-class mining suppliers** with export potential by 2020
- Originated within the company's business and the social investment teams jointly, and was launched in collaboration with Government of Chile, NGOs, and non-mining companies

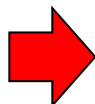


- Engaged 36 suppliers in the initiative, with over \$400 million in combined sales and **5,000 employees** between them
- Operated **43 innovation** projects so far, which have **resulted in capacity improvements and innovations**
- Estimated **savings of \$121 million to BHP Billiton**

Partnering for Shared Value

NGOs

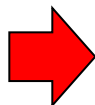
- Hold business accountable
- Seek donations



- Partner with business to **implement** and **scale** shared value solutions

Government

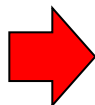
- Regulate how businesses operate
- Tax businesses to pay for social services
- Operate social programs



- Regulate to **encourage** market solutions
- **Jumpstart market solutions** through purchase commitments or incentives
- **Partner** on shared value solutions to delivering social services
- Invest in **infrastructure** to enable shared value approaches (e.g. roads, skills)

Foundations

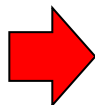
- Donate to charitable causes



- Invest **with** companies, NGOs and government to enable shared value solutions

Competitors

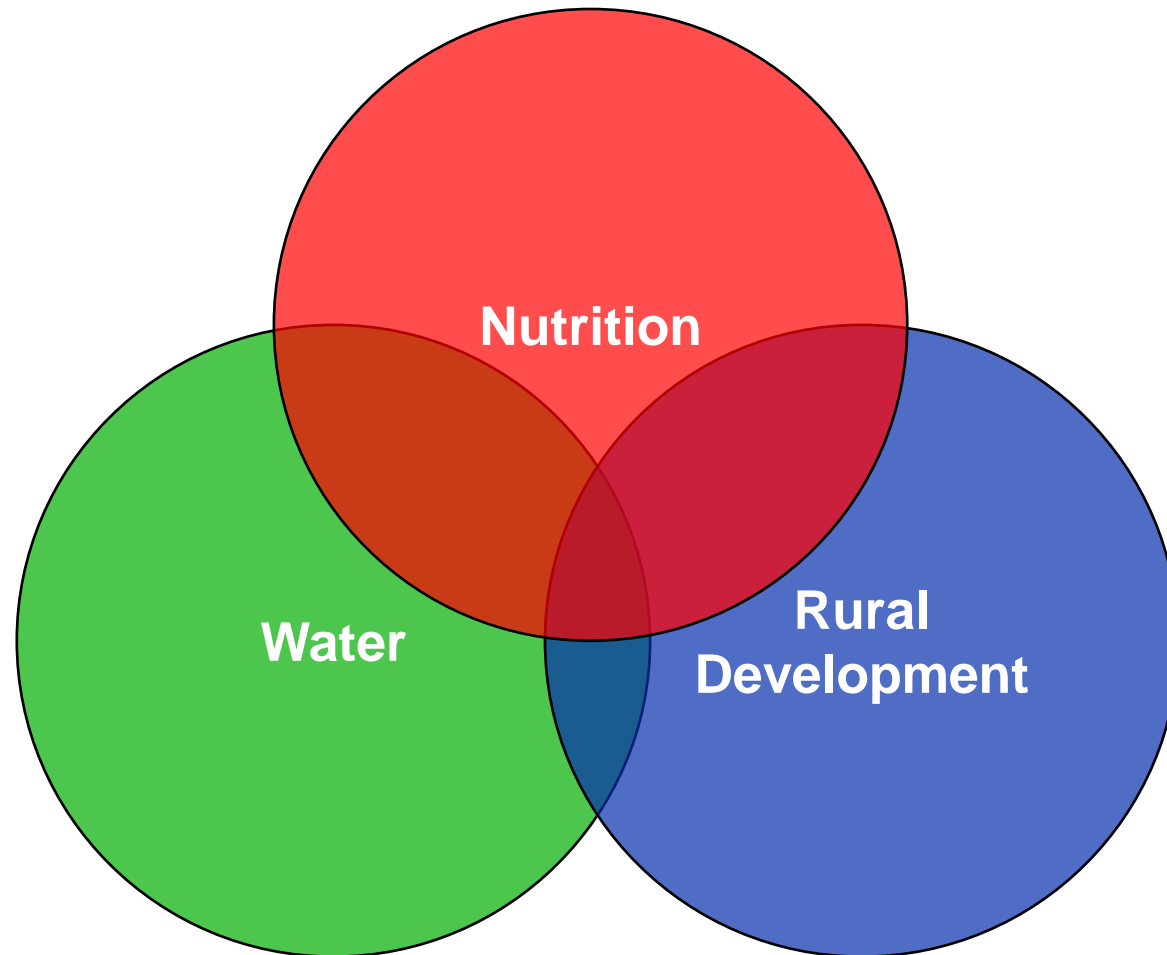
- “Brand” solo CSR initiatives



- **Partner** on business environment improvements

Creating Shared Value: Where is the Opportunity?

Nestlé



- Opportunities to create shared value are **inevitably tied closely** to a company's particular businesses

Shared Value and Company Strategy

Whole Foods Markets

Value Proposition

- Natural, fresh, organic, and freshly prepared foods and health items with excellent service at premium prices
- Cater to specialized nutritional requirements (gluten allergies, vegan, etc.)
- Serve educated customers who are passionate about food and a healthy lifestyle

Distinctive Activities

- Well-lit, inviting supermarket store formats with appealing displays and extensive prepared foods sections
- Produce section as “theater”
- Café-style seating areas with wireless internet for meals and meetings
- Each store carries local produce and has the authority to contract with the local farmers. Company provides low-interest loans if needed
- Nutrition information and education provided to shoppers along with products
- High touch in-store customer service via knowledgeable, flexible, and highly motivated personnel
- Flat compensation structure
- Own seafood procurement and processing facilities to control quality, sustainability and price from the boat to the counter
- Heavy emphasis on environmental sustainability in all activities
- Emphasis on supporting community development

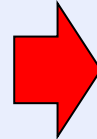


- Whole Foods is the most **economically successful** food retailer in North America
- Successful strategies in the future will embody a significant **shared value dimension**

Purpose Based Strategic Positioning

Traditional Positioning

- Nestlé** • Food and Beverage Company
- Pearson** • Book Publishing
- Discovery Health Insurance** • Health Insurance



New Positioning

- Nutrition, Health and Wellness Company
- Improving Educational Outcomes
- “Making People Healthier and Enhancing Their Lives”

- Defining the **clear social purpose** underlying a company’s products and activities opens **new opportunities** for growth and profitability, while **motivating and attracting** consumers, business partners, employees, shareholders, and the public

Redefining Corporate Purpose

Danone

- In the late 1990's, Danone realized that it had drifted away from its origins as a manufacturer of **healthy foods**



- **Sold off** its beer, meat and cheese units
- Refocused the company on **dairy** and **water**
- Acquired **medical nutrition** and **baby foods** businesses
- Created **Innovation Committees in business units** to provide “healthy food for as many people as possible”

Vision

The ‘dual economic and social’ project, creating economic value by creating social value

Mission

Bringing health through food to as many people as possible by refocusing on four complementary business lines and expanding into fast-growing new regions

Driving Shared Value

Bogotá Chamber of Commerce (CCB)

- In 2012, CCB redefined its institutional value proposition to promote **rising prosperity** of Bogota by increasing the value generated by companies in the region
- Focused on **facilitating the creation of shared value** by companies in Bogotá and promoting a **new business culture**



- Realigned its **corporate social responsibility** program towards **shared value**
- Explained the shared value concept to the **business community**
- Promoted the shared value framework within **local government**
- Designed a training program for **consultants** on shared value creation methodologies
- Modified its **innovation program** to help companies in the process of identifying new customer needs, products, and markets that create shared value
- Adopted a **cluster development** vision for economic development with companies at the core
- Built a supplier development program with **partner companies**
- Promoted shared value events, a **shared value prize**, and marketing campaigns

The Purpose of Business

- The purpose in business is to create economic value while creating **shared value for society**
- Businesses **acting as businesses**, not as charitable givers, are arguably the most powerful force for addressing many of the pressing issues facing our society
- Shared value will give rise to **far broader opportunities** for strategy and economic value creation and will drive the next wave of **innovation, productivity, and economic growth**
- A transformation of business practice around shared value will give **purpose** to the corporation