

Regional Competitiveness and the Role of Business

Professor Michael E. Porter
Harvard Business School

*Encuentro de Comisiones Regionales de Competitividad
Bogotá, Colombia
April 26, 2012*

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

Agenda

- I. Regional Competitiveness: The Next Stage for Colombia
- II. The Role of Business in Economic and Social Development

What is Competitiveness?

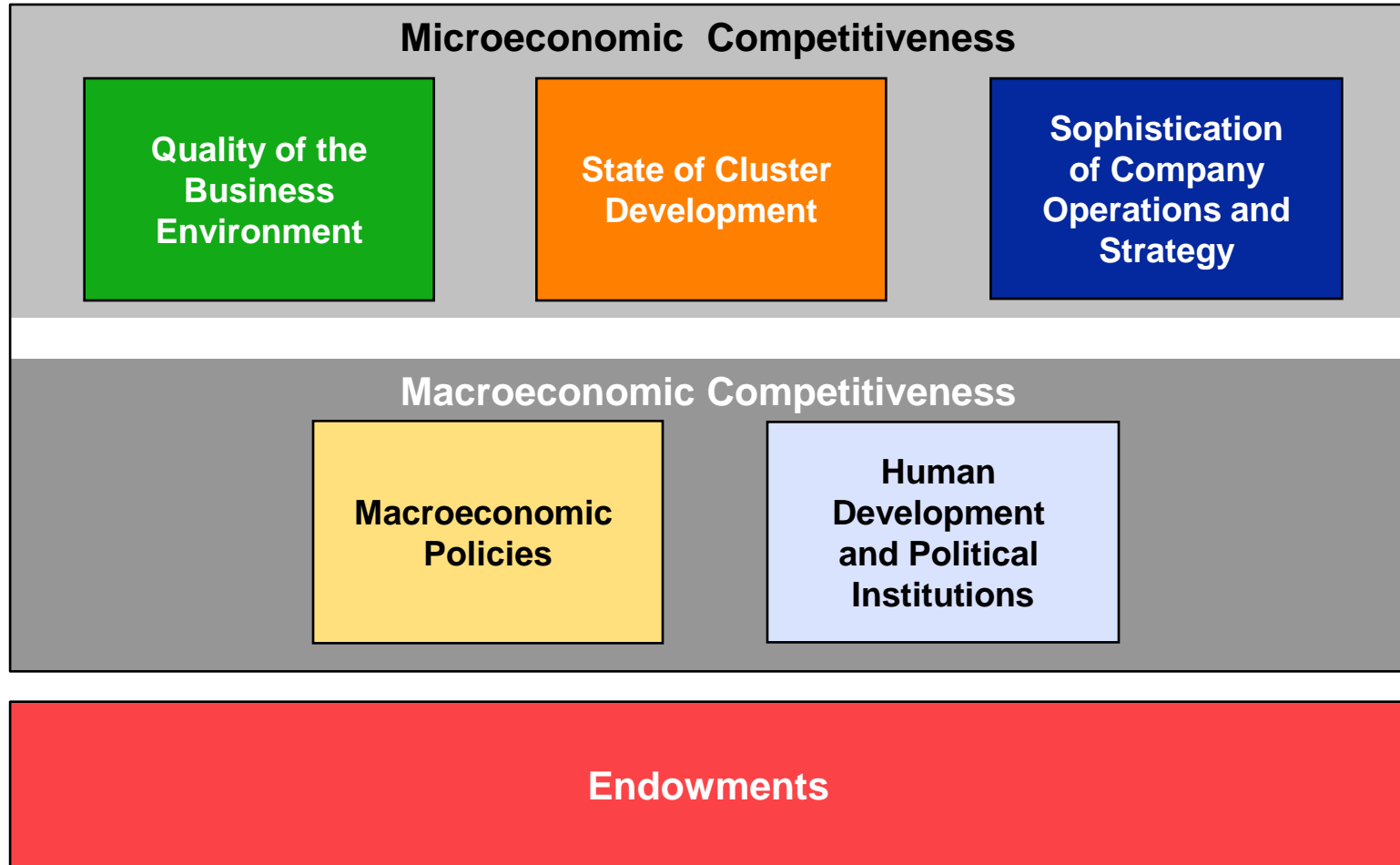
A nation or region is competitive to the extent that firms operating there are able to **compete successfully** in the global economy while supporting **rising wages and living standards** for the average citizen

- 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**



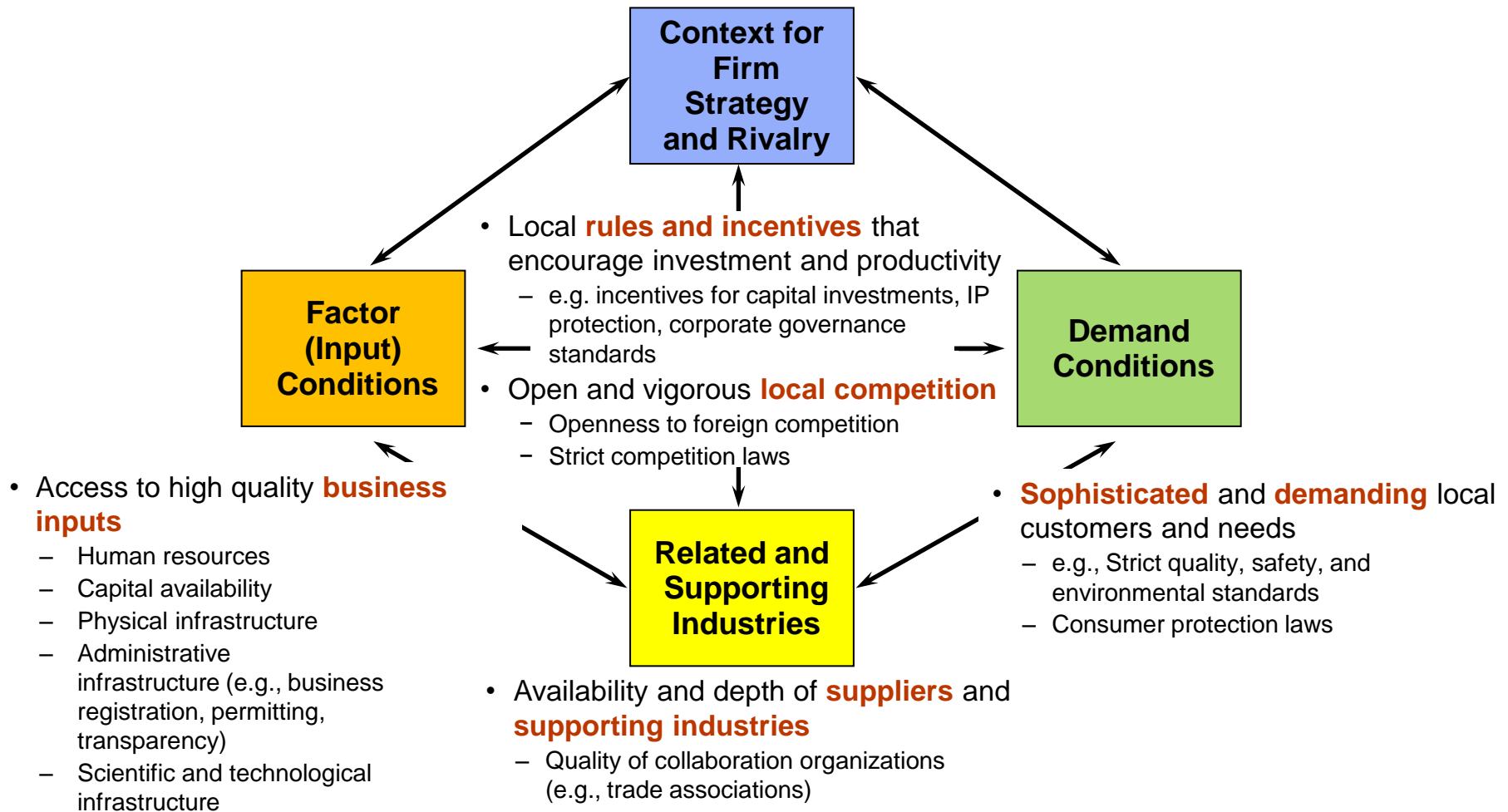
- Nations and regions compete to offer a **more productive environment for business**
- Competitiveness is **not a zero sum game**

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**

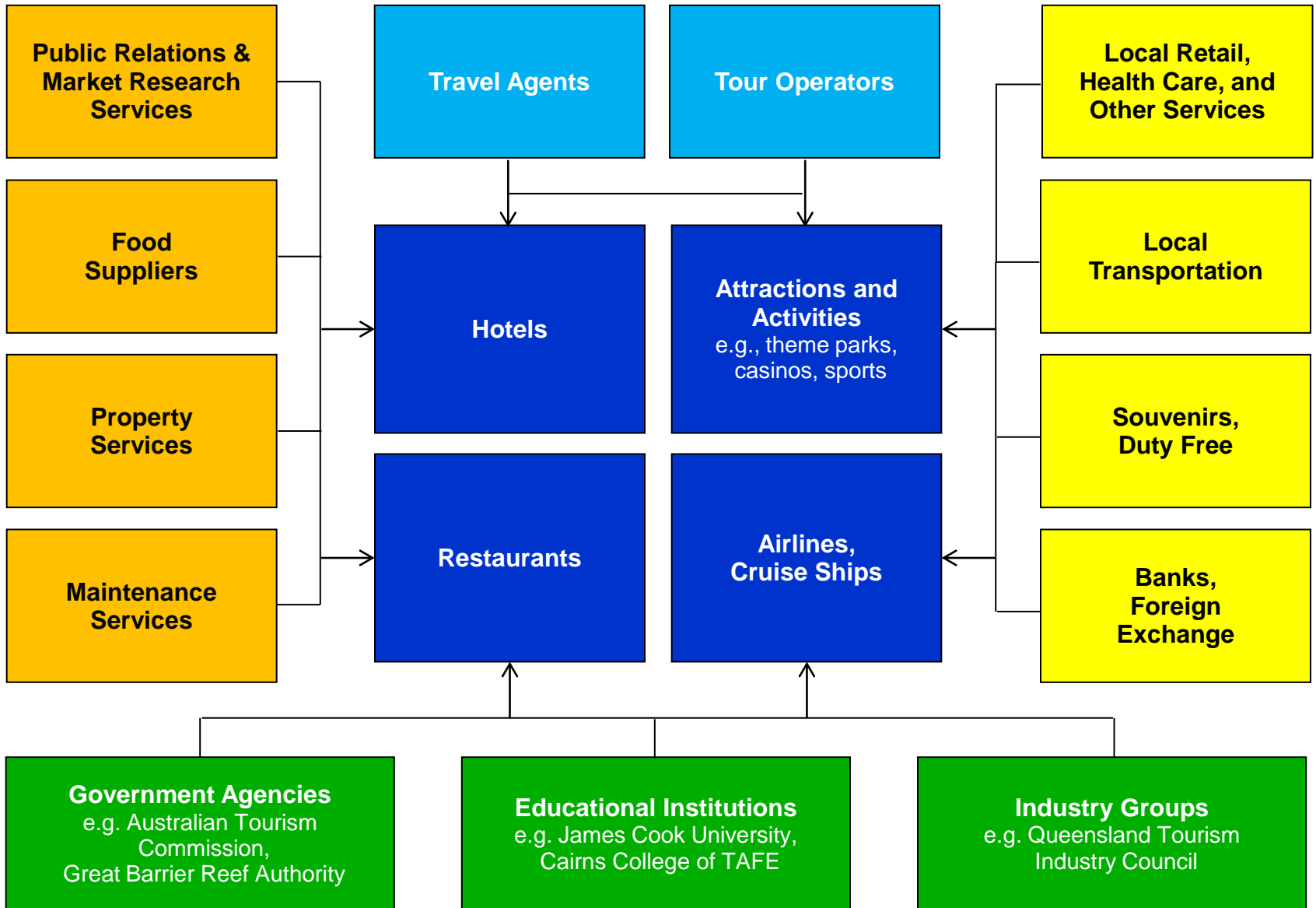
Improving the Quality of the Business Environment



- **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

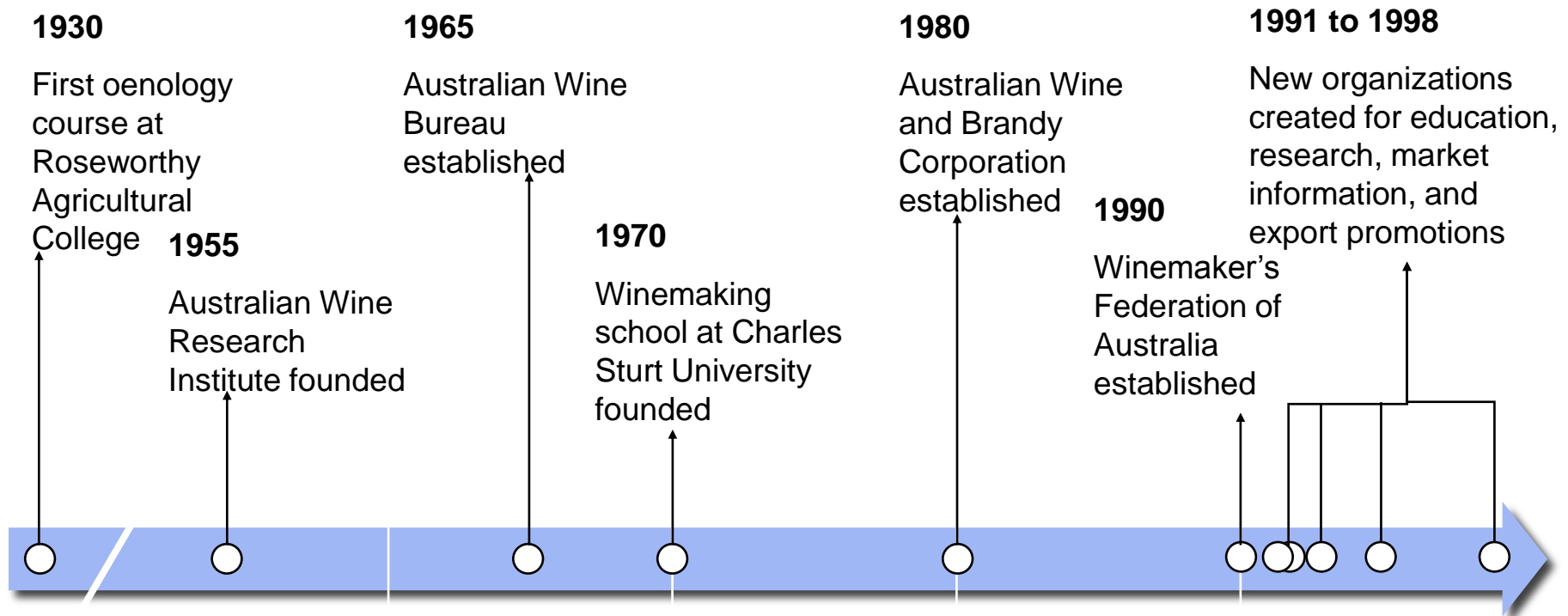
Building and Upgrading Clusters

Tourism Cluster in Cairns, Australia



How Clusters Emerge and Develop

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

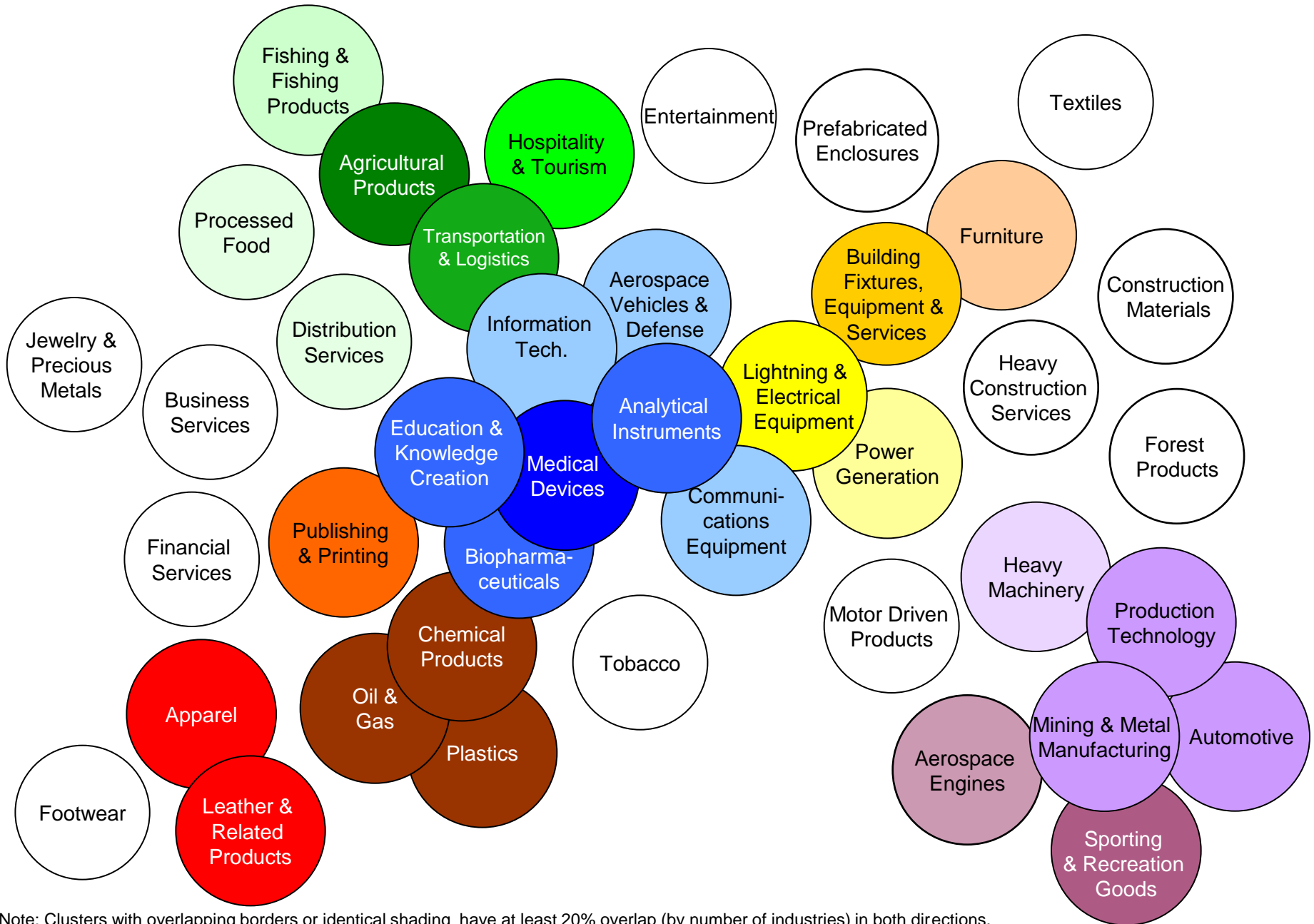
1980s

Creation of large number of new wineries

1990s and 2000s

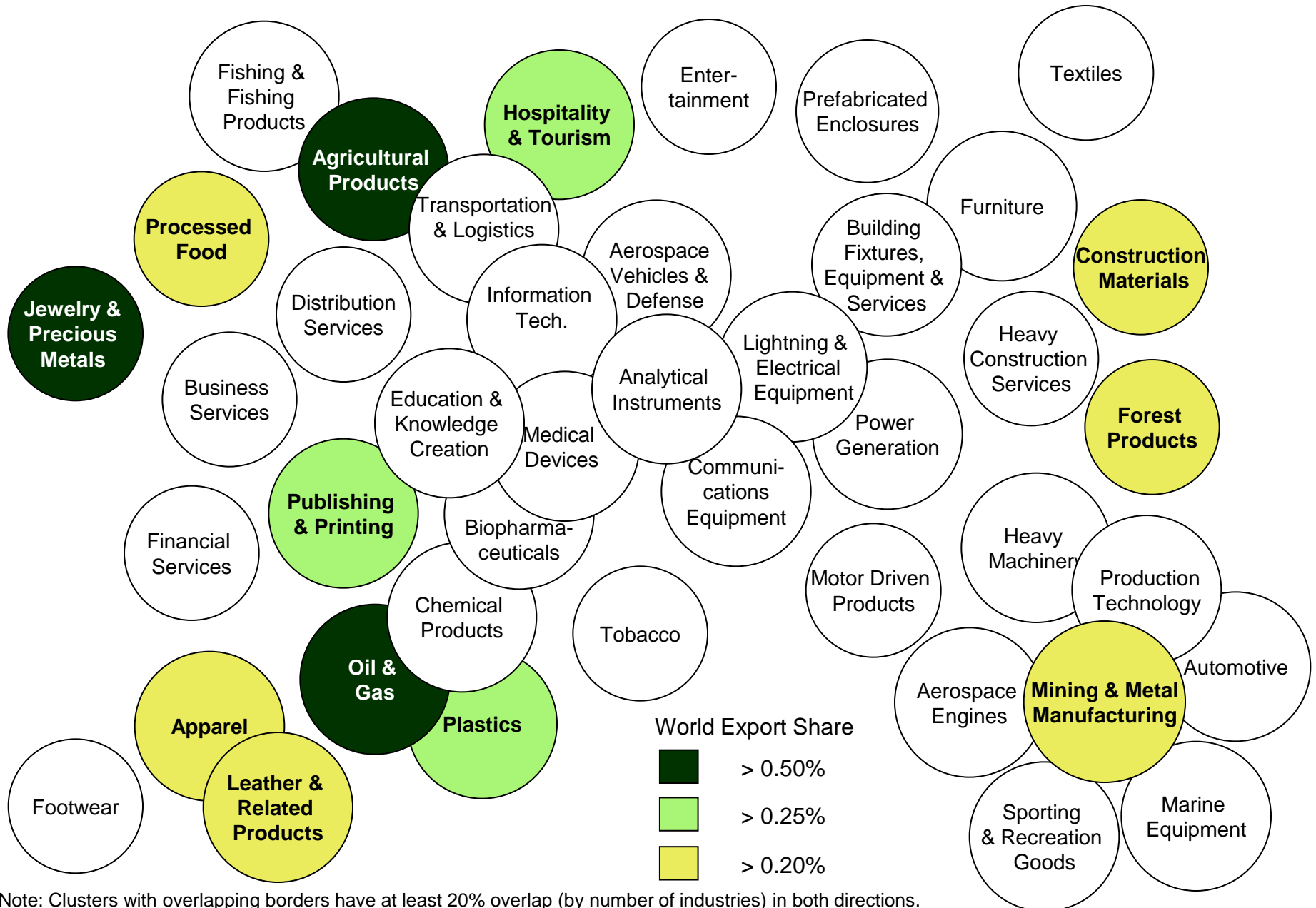
Surge in exports and international acquisitions

Clusters and Economic Diversification



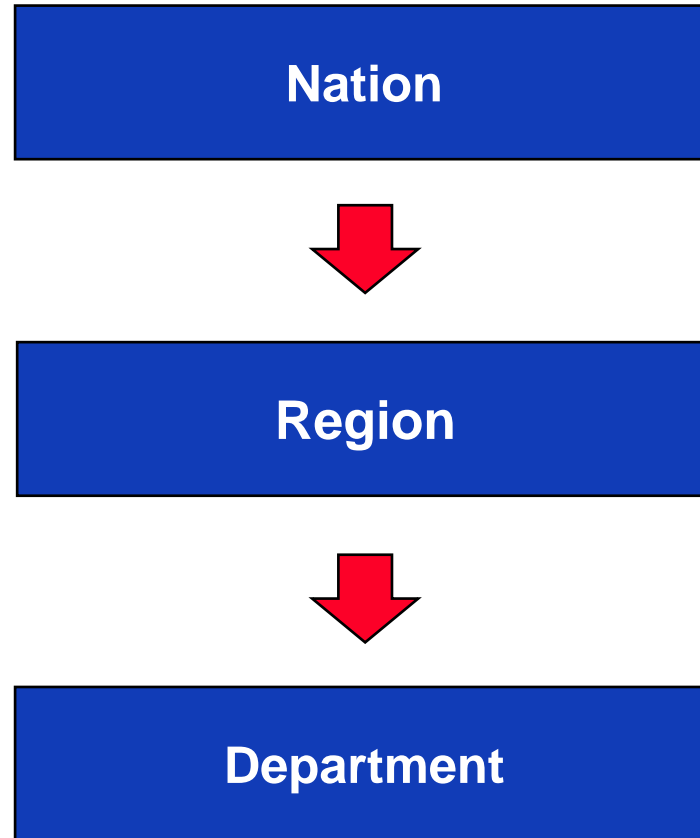
Note: Clusters with overlapping borders or identical shading have at least 20% overlap (by number of industries) in both directions.

Colombia's Cluster Portfolio, 2010



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

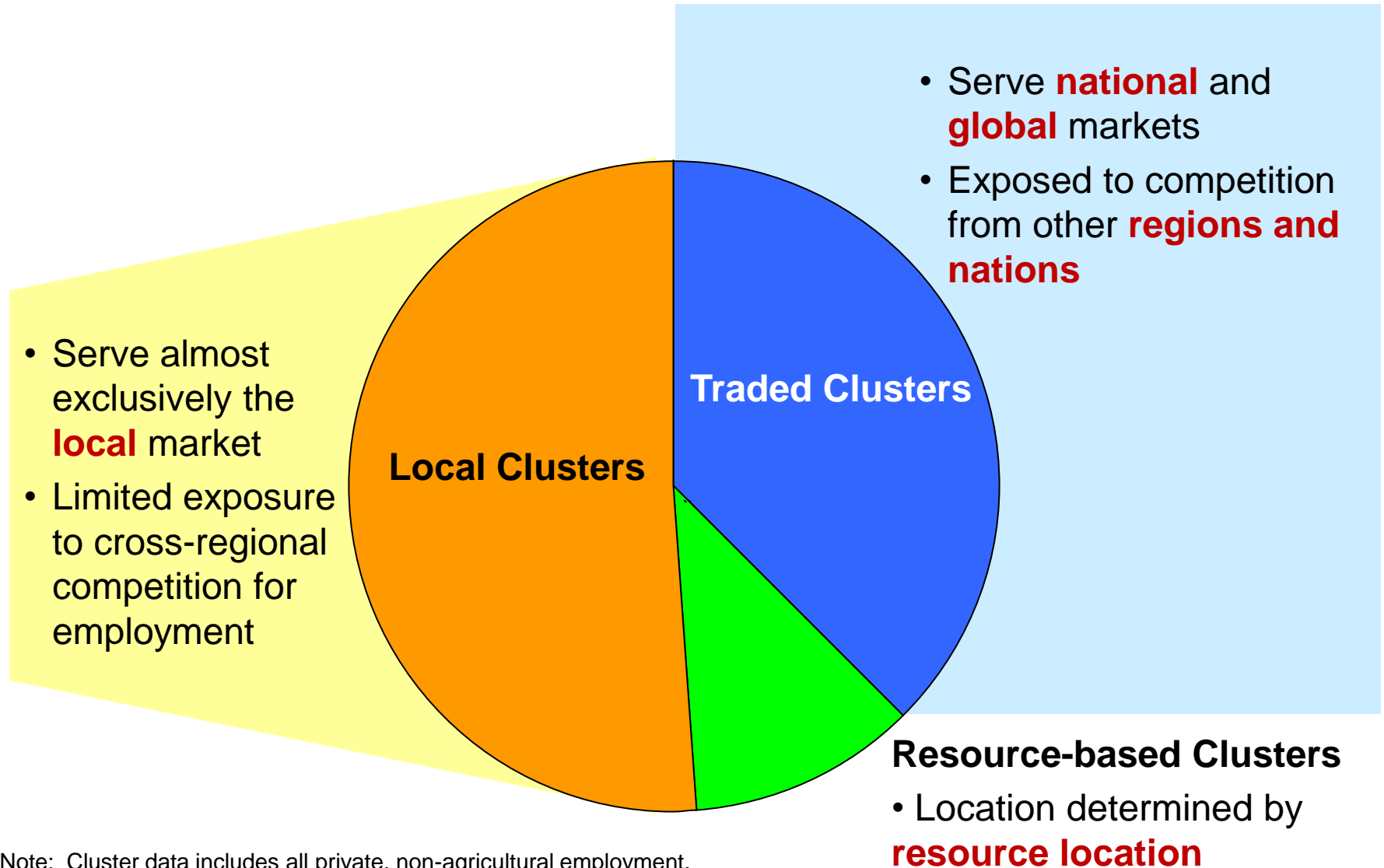
Geographic Influences on Competitiveness



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

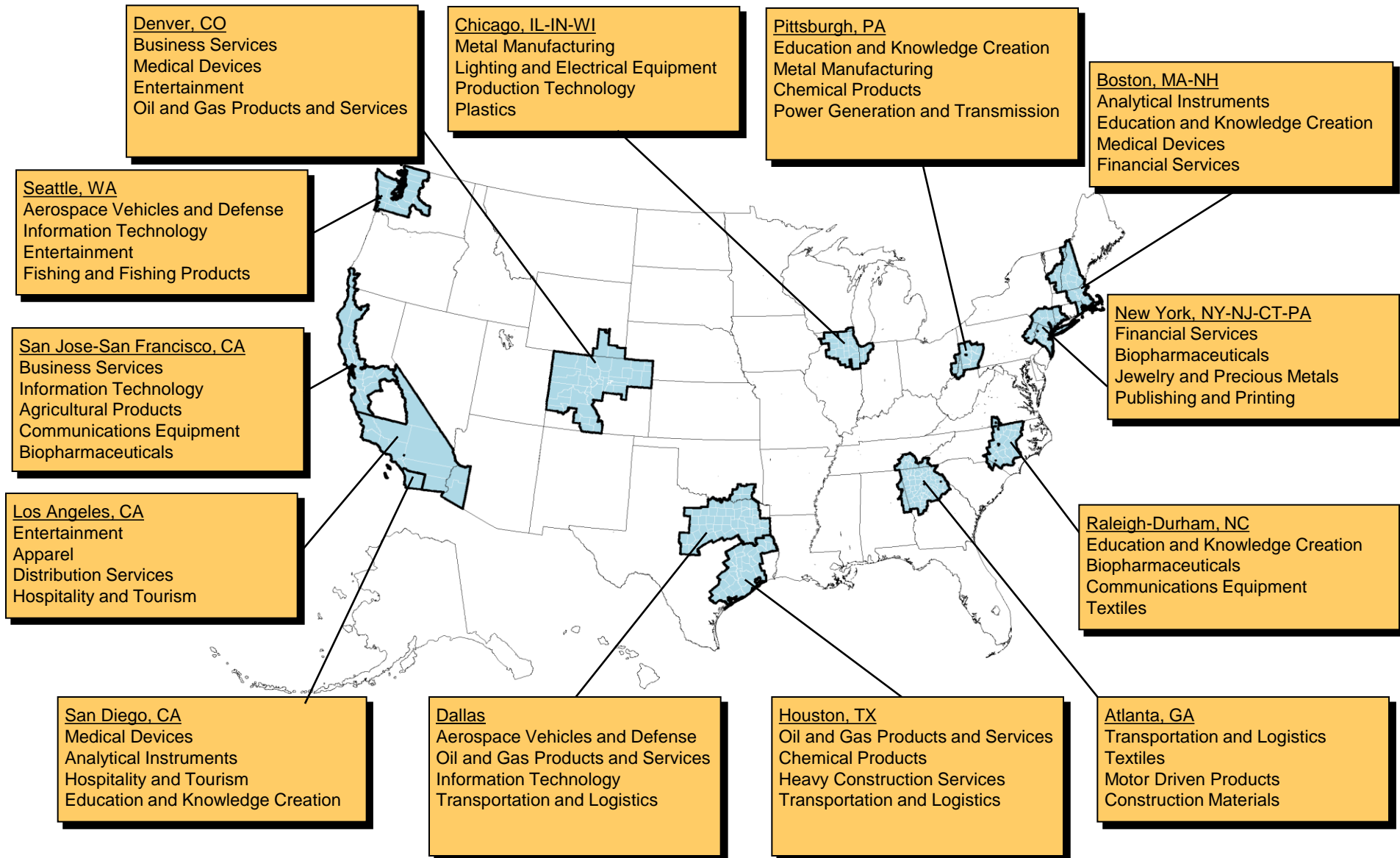


Note: Cluster data includes all private, non-agricultural employment.

Source: Michael E. Porter, Economic Performance of Regions, Regional Studies (2003); Updated via Cluster Mapping Project, Institute for Strategy and Competitiveness, Harvard Business School (2008)

Specialization of Regional Economies

Leading Traded Clusters by U.S. Economic Area, 2008



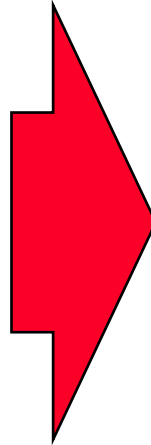
Regions and Competitiveness

- Economic performance **varies significantly** across sub-national regions (e.g., provinces, states, metropolitan areas)
- Many essential levers of competitiveness reside at the **regional level**
- Regions **specialize** in different sets of clusters
- **Cluster strength** strongly impacts regional performance

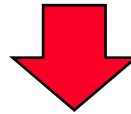
Strong Clusters Drive Regional Performance

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



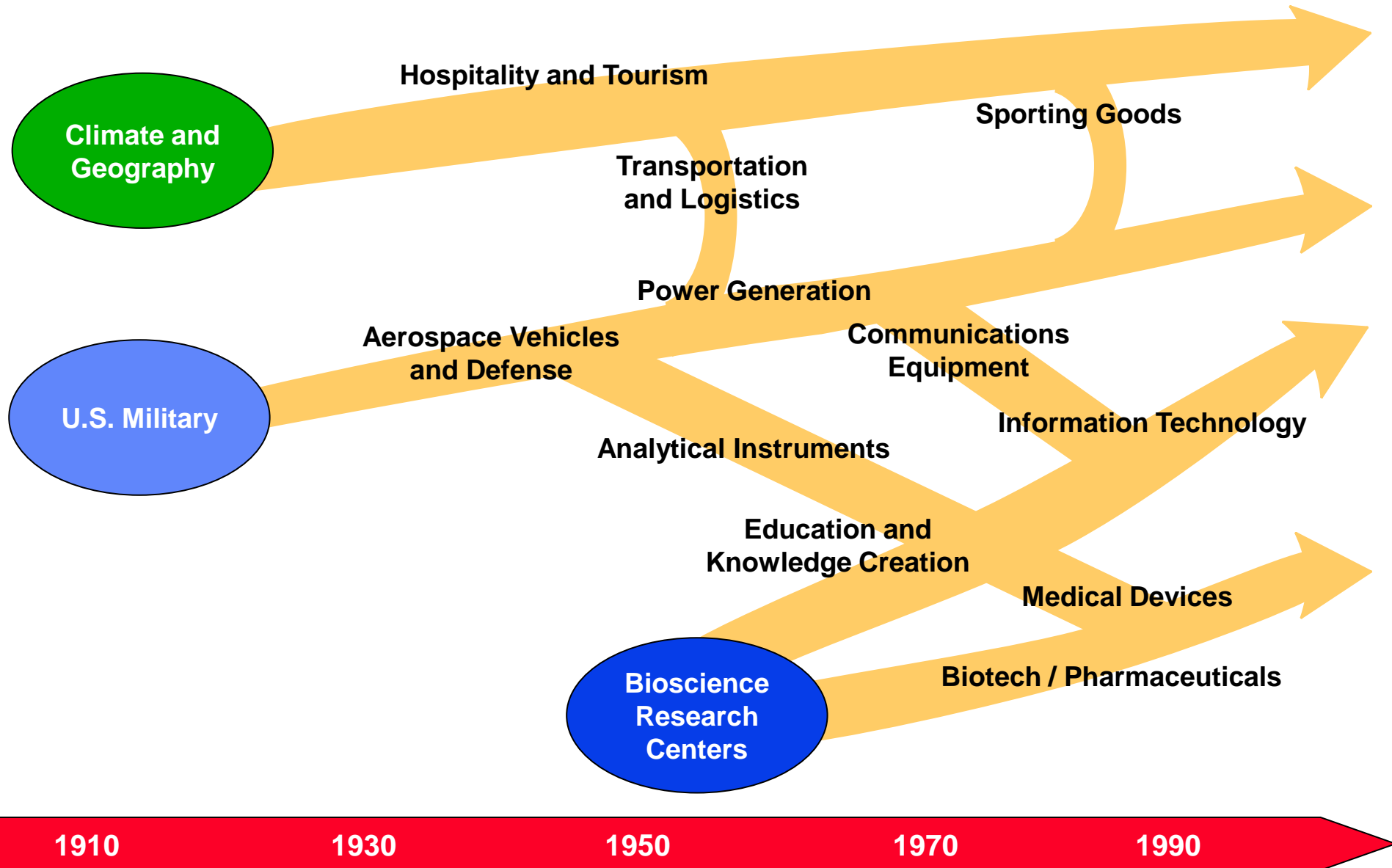
- Build on the region's **existing** and **emerging** clusters rather than chase hot fields
- Economic diversification usually occurs **within clusters** and **across related clusters**

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



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

- I. Regional Competitiveness: The Next Stage for Colombia
- II. The Role of Business in Economic and Social Development

Company Sophistication and Economic Development

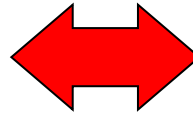
Operational Effectiveness Is Not Strategy

Operational Effectiveness

- Assimilating, attaining, and extending **best practices**

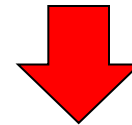


Do the **same thing better**



Strategic Positioning

- Creating a **unique** and **sustainable** competitive position



Do things **differently** to achieve a **different purpose**

Strategic Positioning

IKEA, Sweden

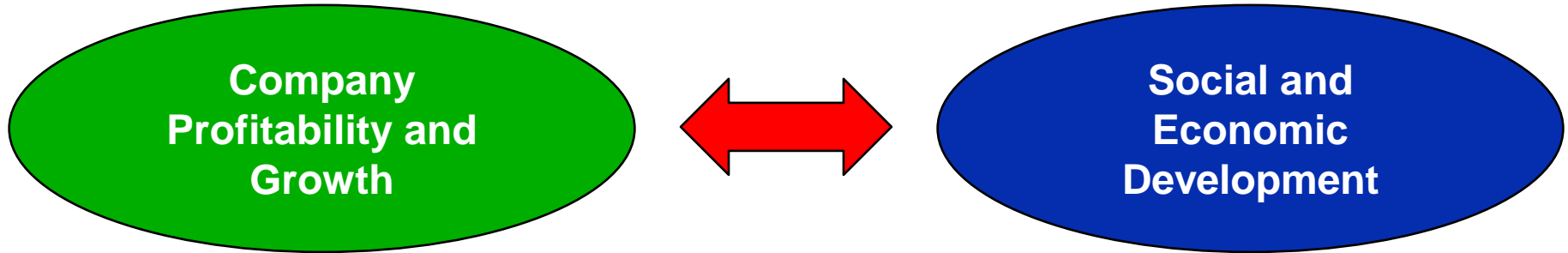
Value Proposition

- Young, first time, or price-sensitive buyers with design sophistication
- Stylish, space efficient and compatible furniture lines and accessories at very low price points.

Distinctive Activities

- 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

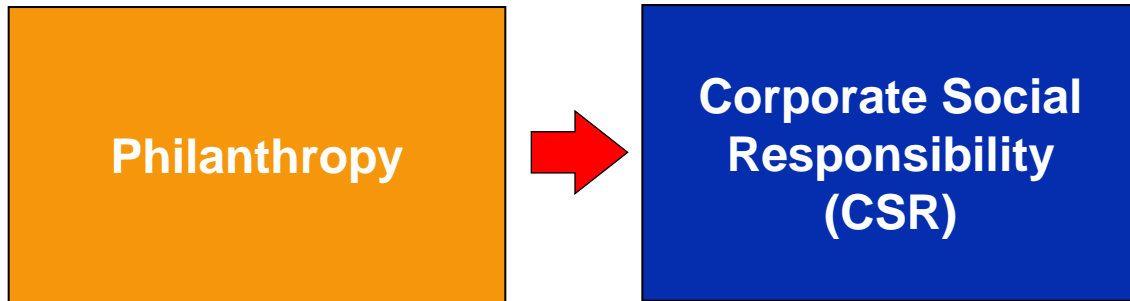
The Role of a Company in Its Communities



Philanthropy

- Donations to worthy social causes

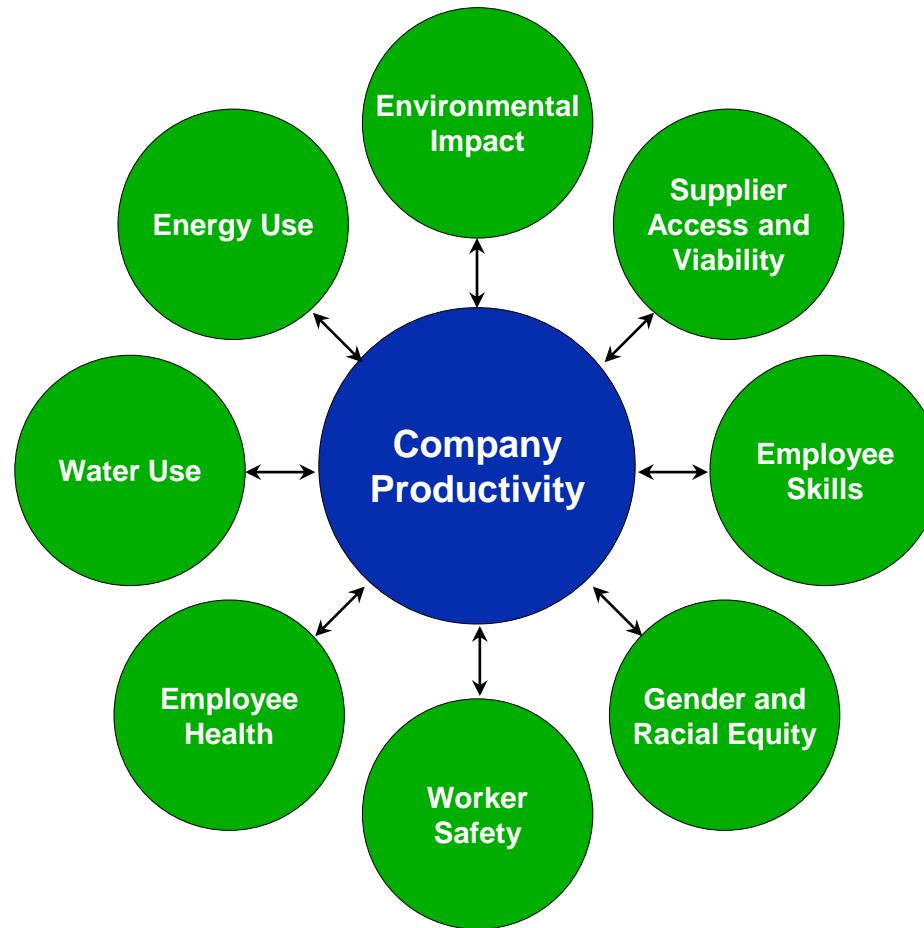
The Role of a Company in Its Communities



- Donations to worthy social causes

- 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



- Donations to worthy social causes

- Good corporate citizenship and compliance with community standards
- “Sustainability”

- Integrating societal improvement into **economic value creation** itself

The Concept of Shared Value

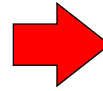
Shared Value: Corporate policies and practices that **enhance the competitiveness** of the company while simultaneously **advancing social and economic conditions** in the communities in which it sells and operates

- 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



- **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

- **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: Fair trade purchasing

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

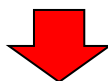
- The program has **trained 55,000 physicians** to date, each treating approximately 230 patients

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

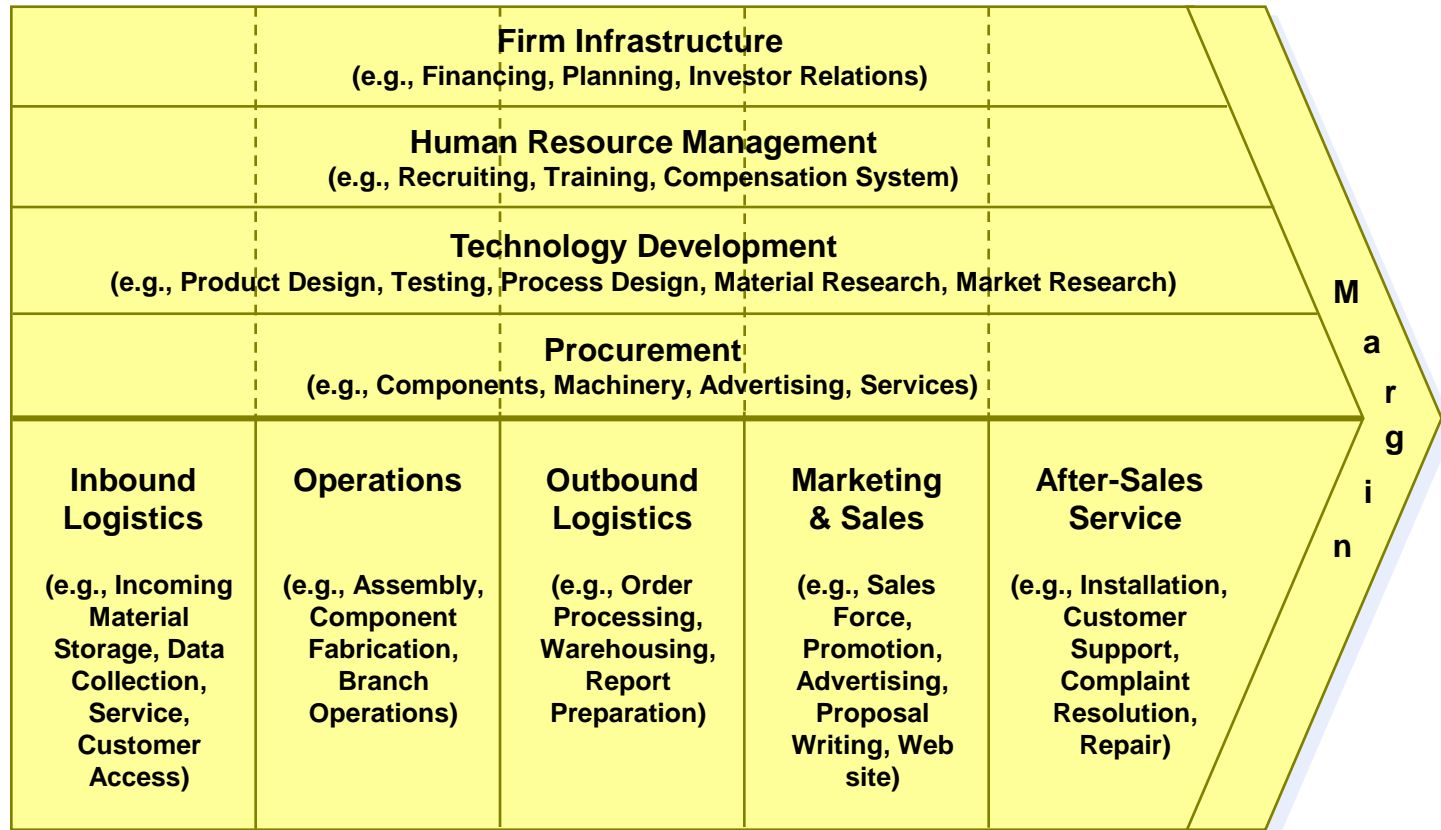
Product design that reflects Chinese patient demographic and culture

- 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**

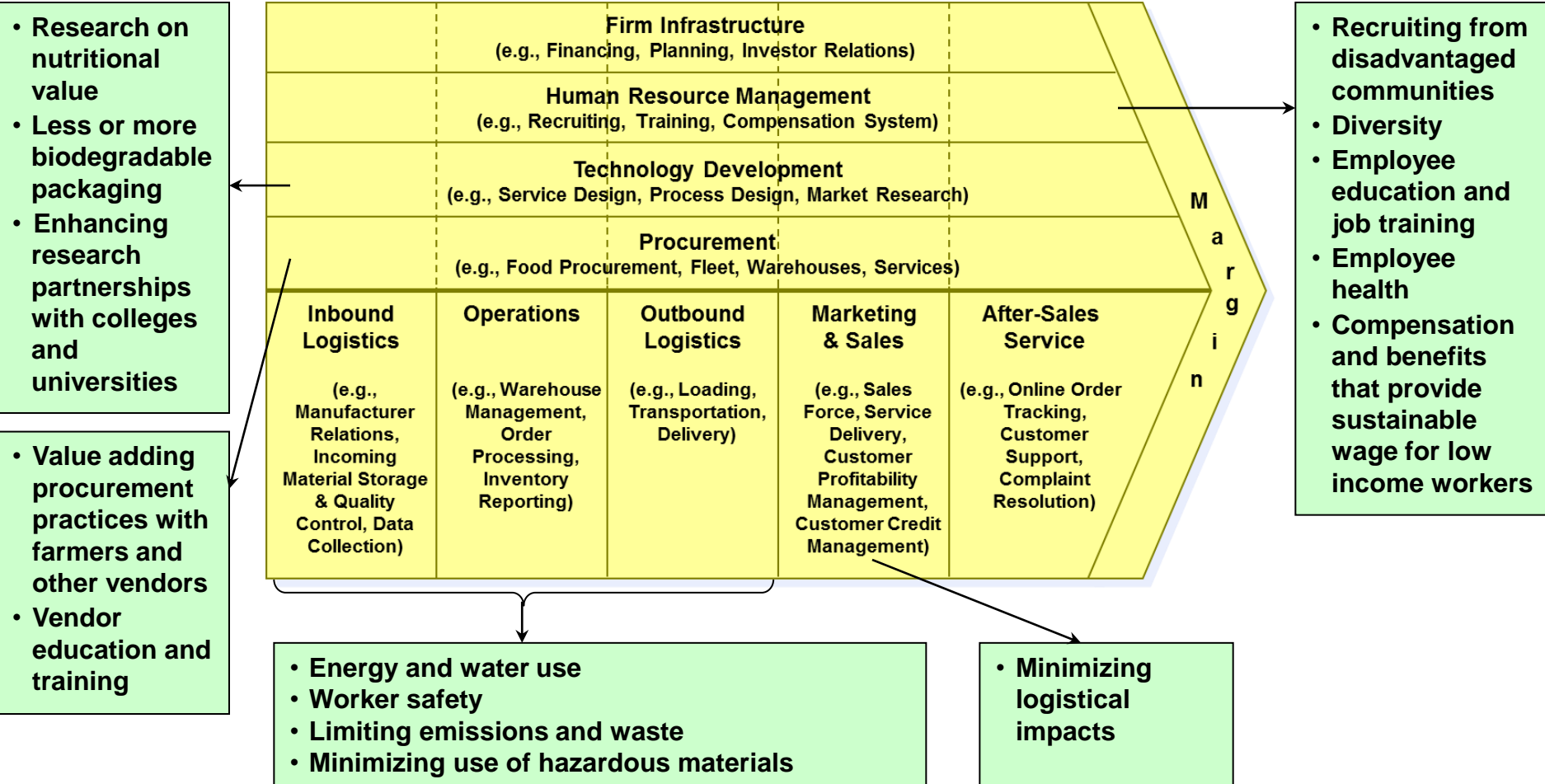
Redefining Productivity in the Value Chain



- 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



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

<u>Farmers</u>	<u>Community</u>	<u>Nespresso</u>
<ul style="list-style-type: none">• Better yields• Better prices• Better processing	<ul style="list-style-type: none">• Economic development• Environmental sustainability	<ul style="list-style-type: none">• Stable supply• Better quality• Reinforces strategic positioning



- 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

- **TechnoServe** Promotes the development of agricultural clusters in more than 30 countries
- **RootCapital** Provides financing to more than 400,000 farmers and businesses
- **Bill & Melinda Gates Foundation** Forms partnerships with global corporations to foster agricultural clusters

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**