

Competitiveness: A New Economic Strategy for Peru

Professor Michael E. Porter
Harvard Business School

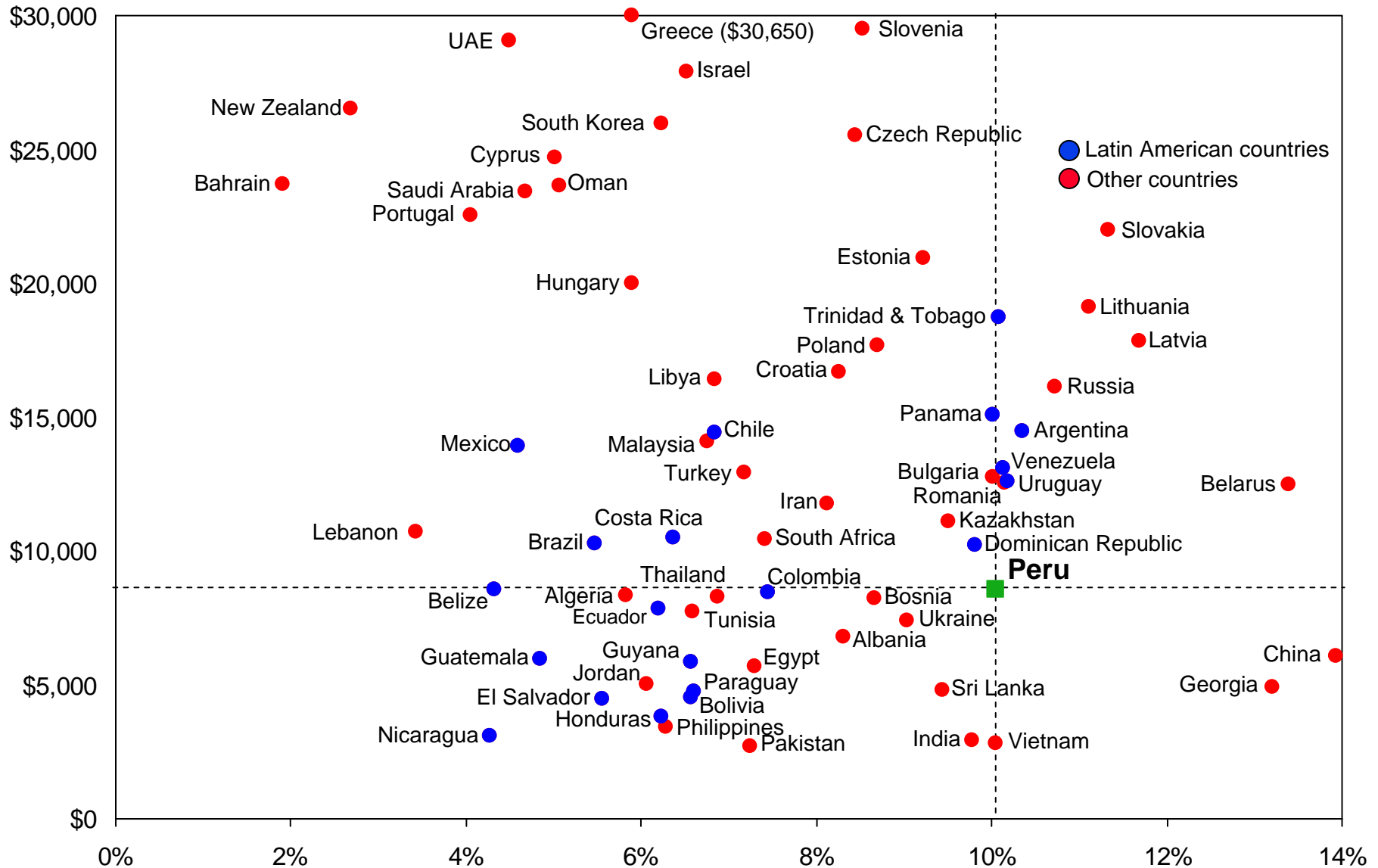
*Lima, Peru
November 30, 2009*

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. Version: November 27, 2009

Prosperity Performance

Selected Lower and Middle Income Countries

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

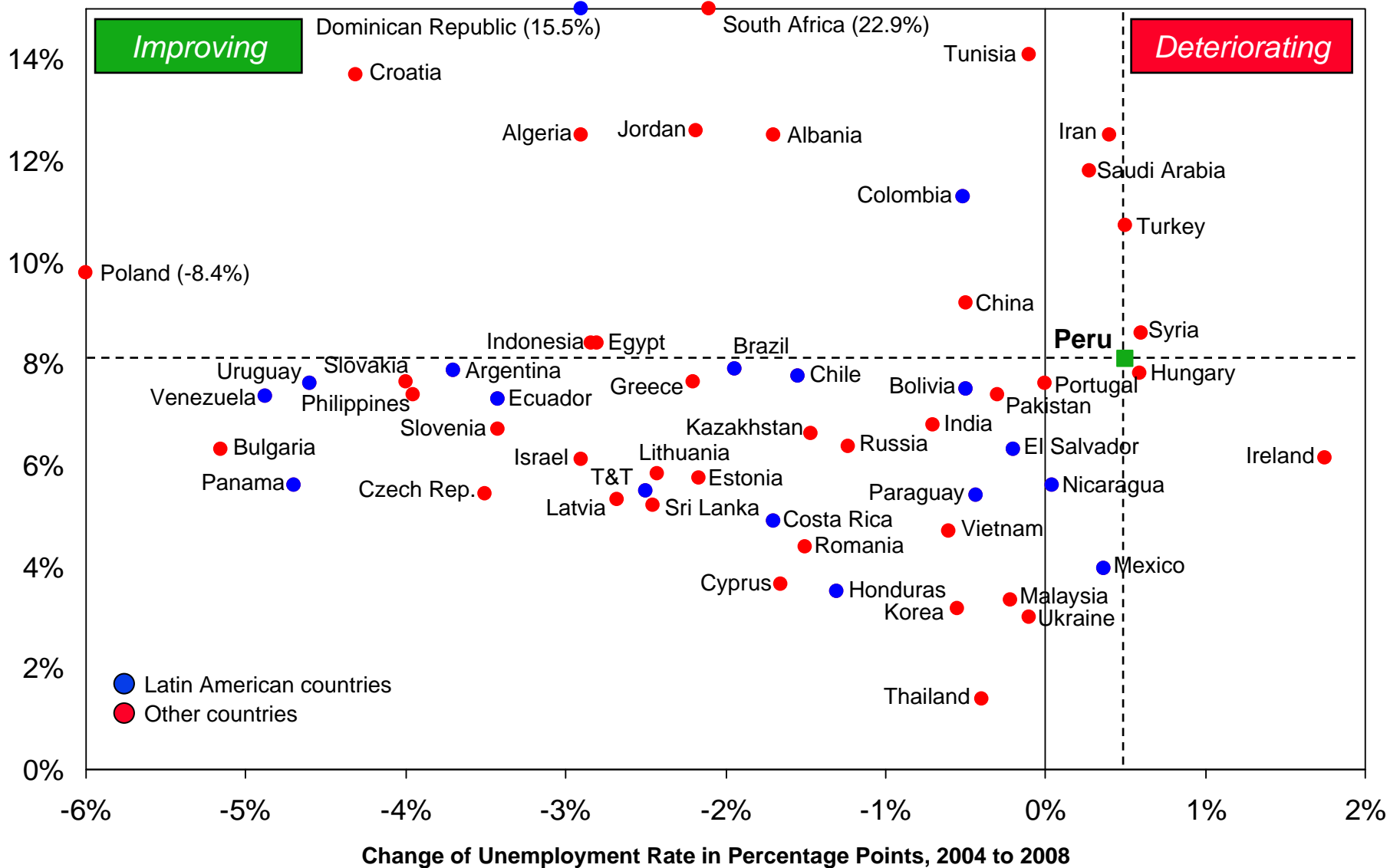


Growth of Real GDP per Capita (PPP-adjusted), CAGR, 2004 to 2008

Unemployment Performance

Selected Countries

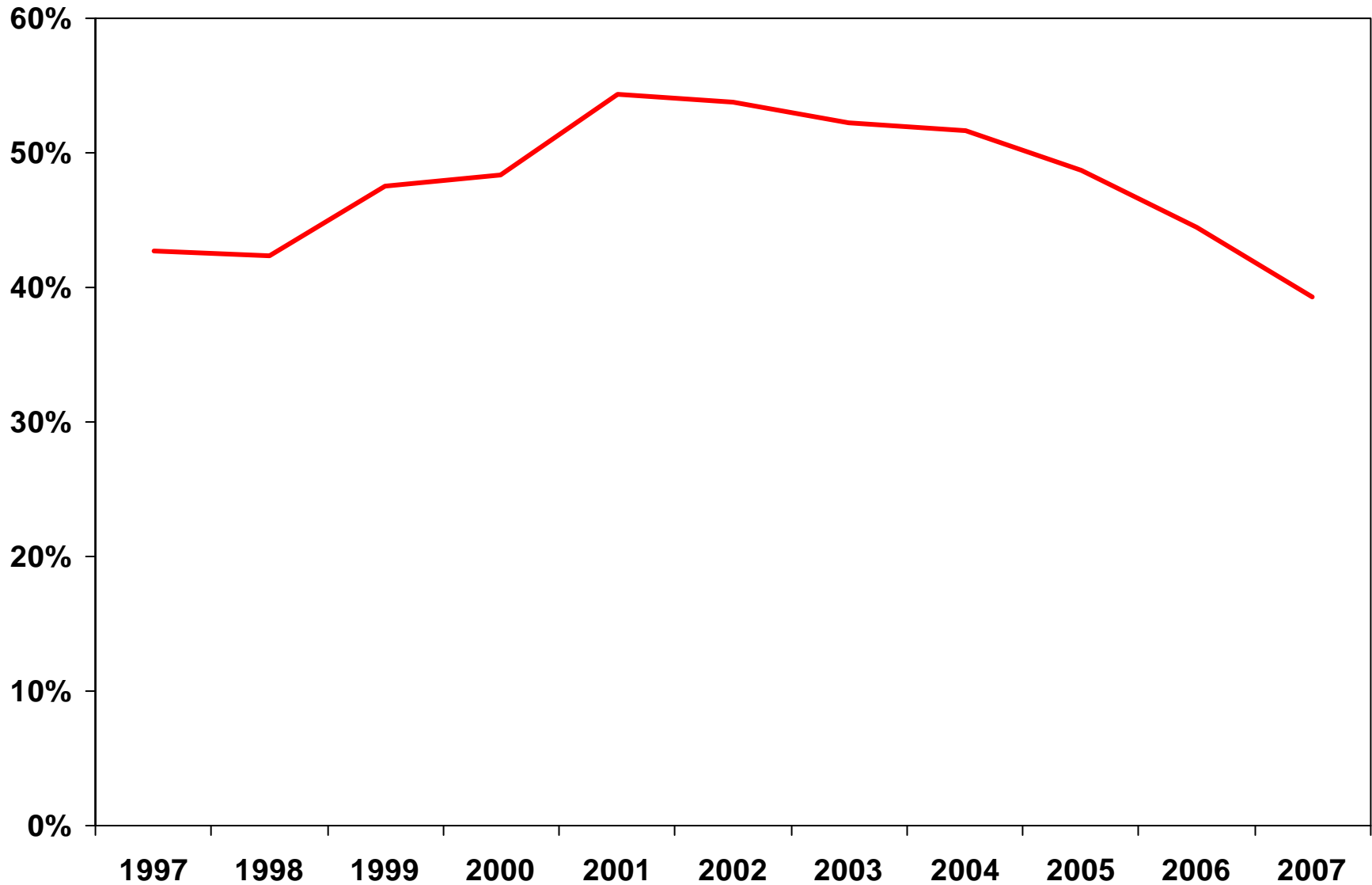
Unemployment
Rate, 2008



Poverty Rates

Peru, 2001 to 2007

% of Population Under
the Poverty Line



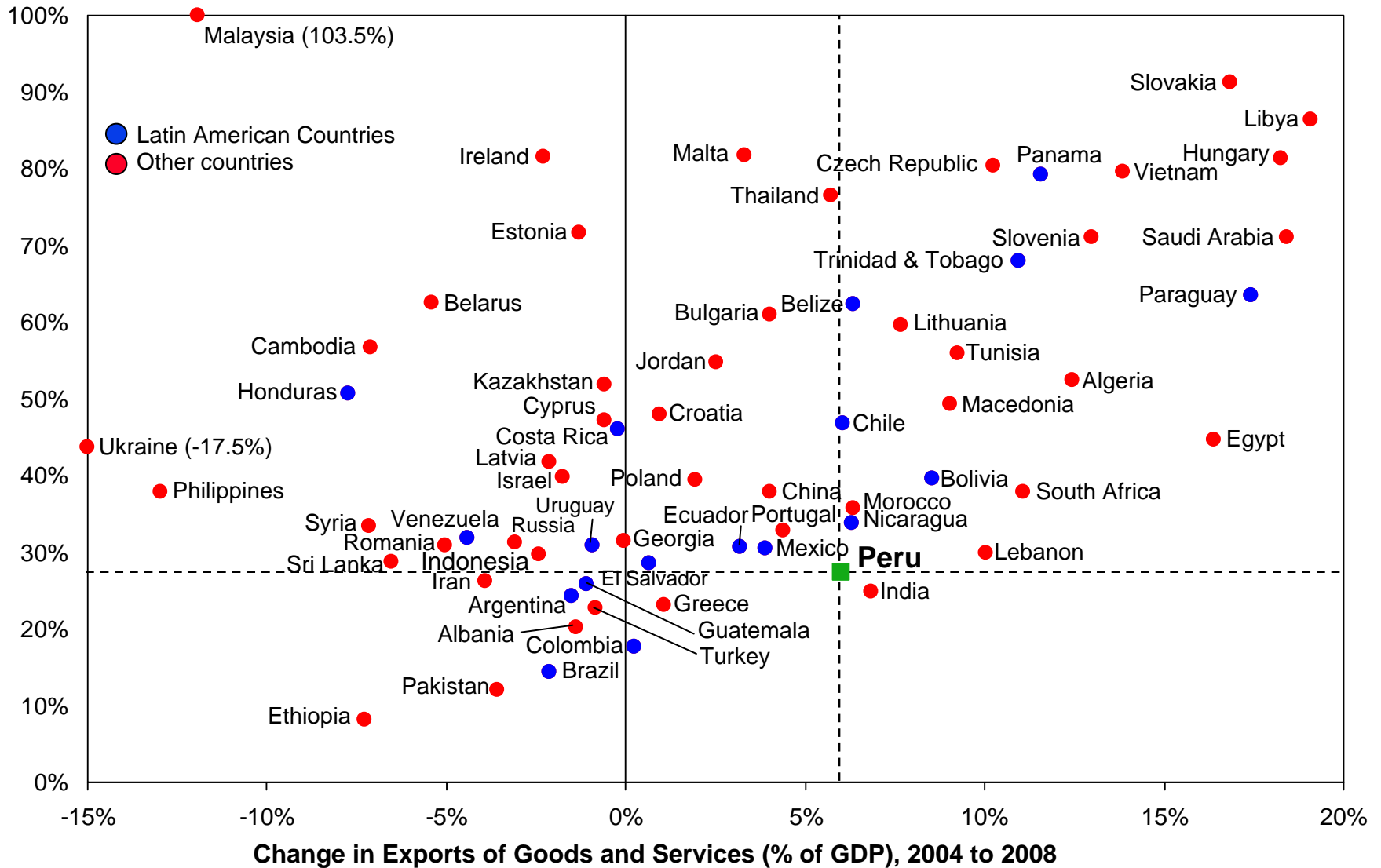
Source: Informacion Socio Demografica, from El Instituto Nacional de Estadistica e Informatica (INEI), 2009

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Export Performance

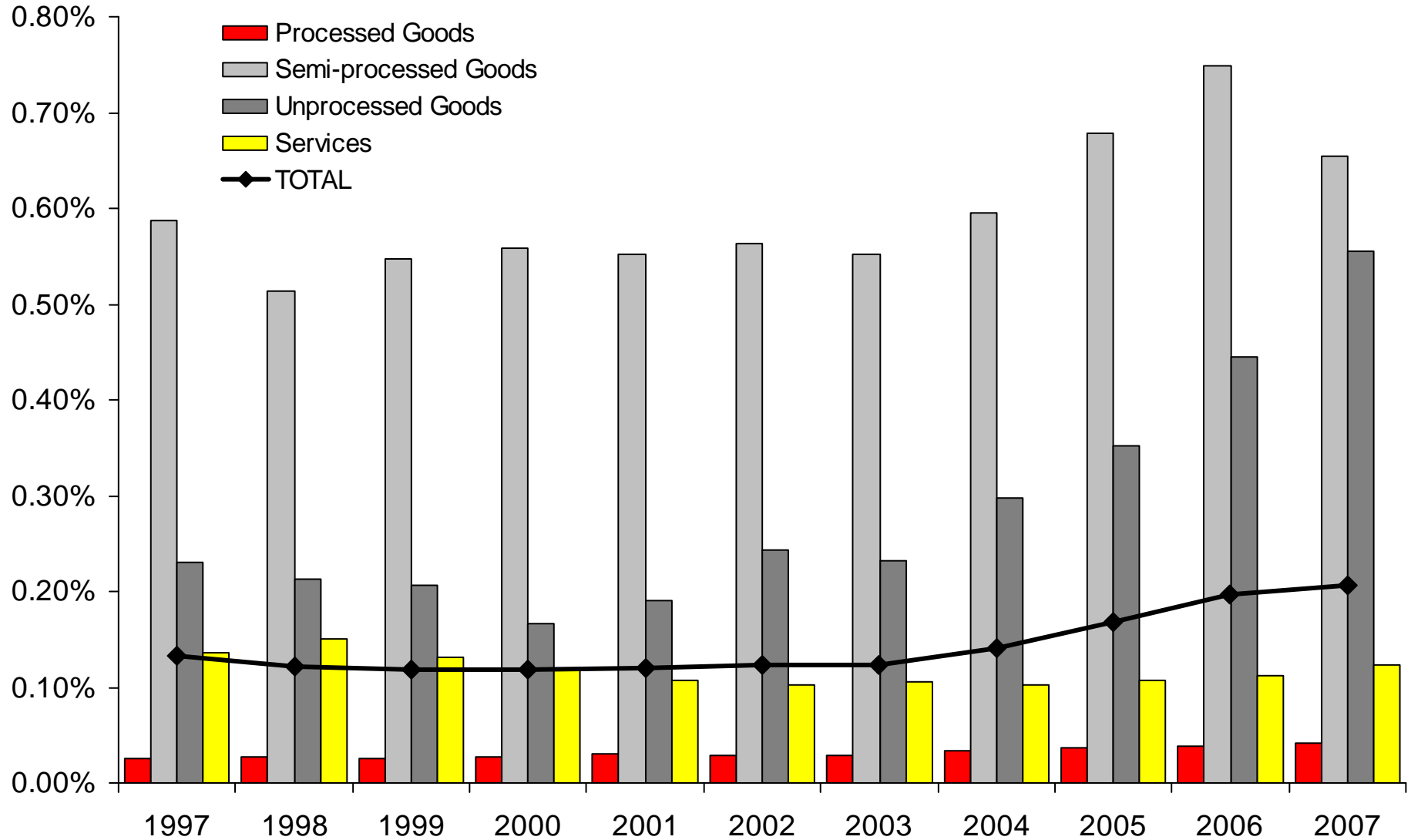
Selected Countries

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



Peru's Exports By Type of Industry

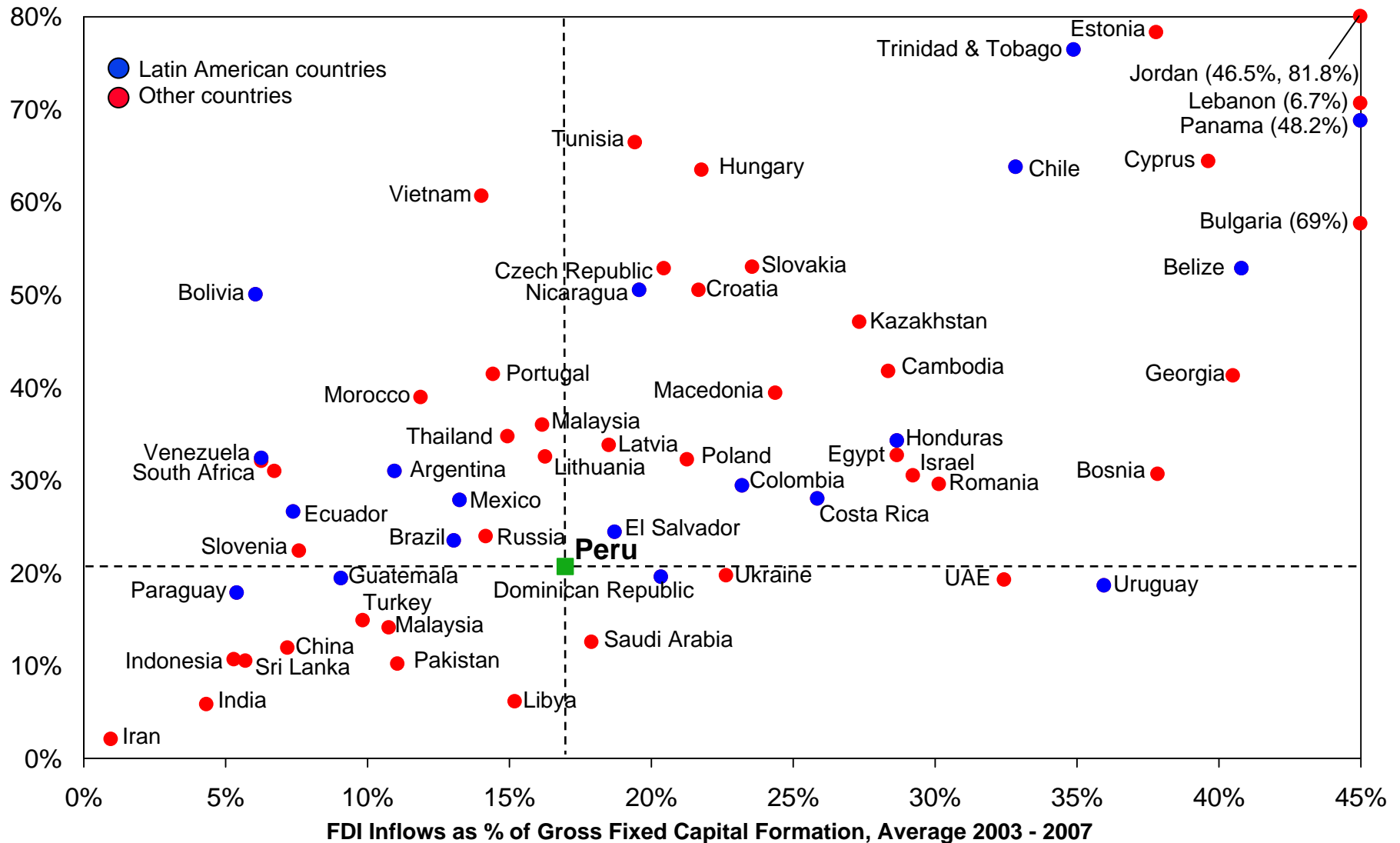
World Export Market
Share (current USD)



Inbound Foreign Investment Performance

Stocks and Flows, Selected Countries

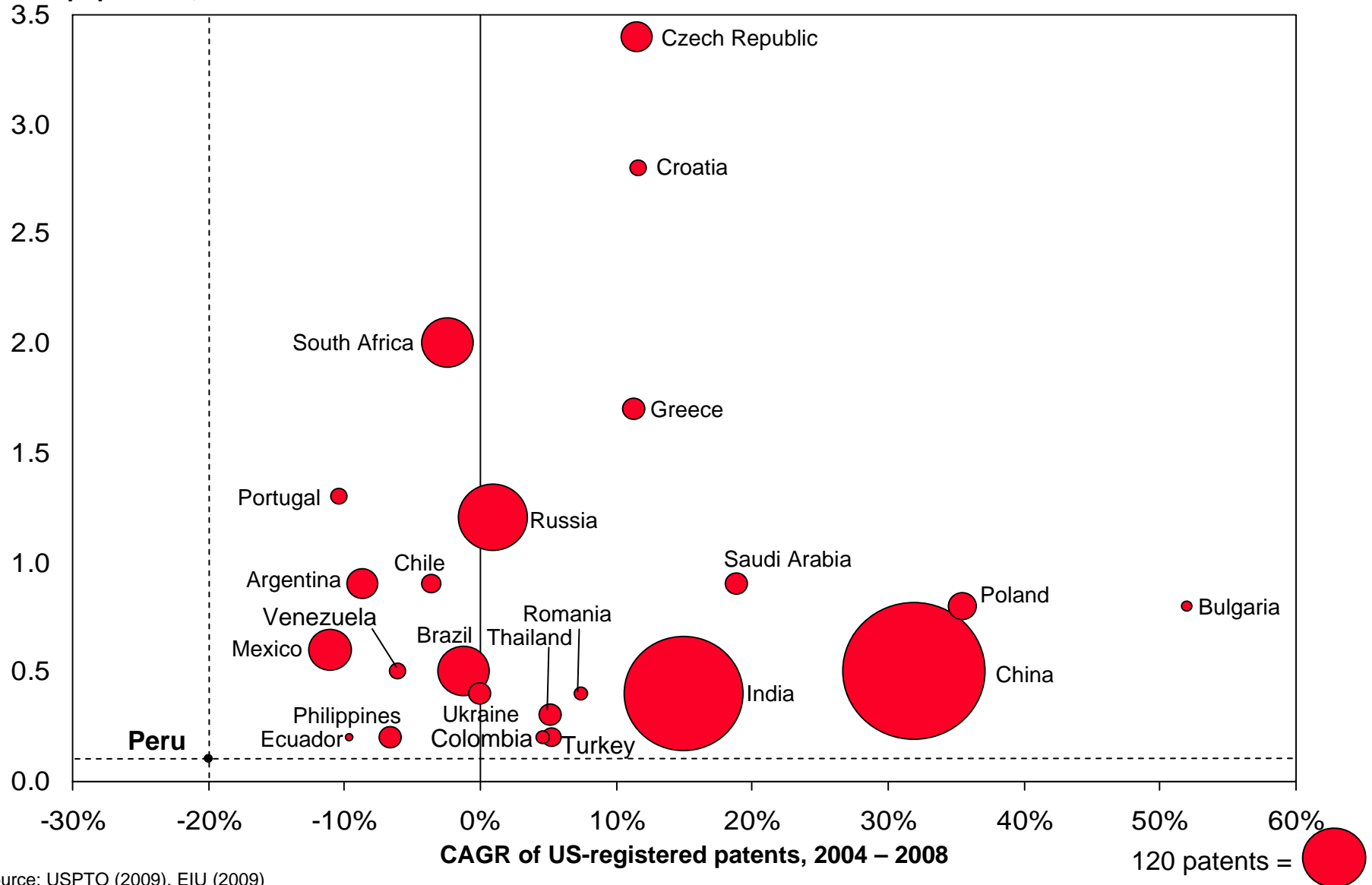
Inward FDI Stocks as % of GDP, Average 2003 - 2007



Innovative Capacity

Innovation Output of Selected Countries

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



Source: USPTO (2009), EIU (2009)

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The Peruvian Economy in 2009

- Peru has had a long history of **instability**
- Since 2001, Peru has experienced **high rates of economic growth**
 - Recent surge in FDI and exports has been driven by commodities
- Implementation of **sound macroeconomic policies** has allowed Peru to weather the current global crisis
 - Peru's economy has been one of the **most resilient** in Latin America

BUT

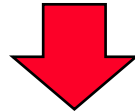
- Prosperity remains low and large segments of the population lack **access to basic needs**
- High **unemployment** and **inequality** persist
- Peru is overly dependent on **commodity** exports with limited potential to drive job growth and economic diversification



- Returning to 8 to 9% growth is possible only if Peru can substantially **improve competitiveness**
- Peru will need an **ambitious economic** and **social strategy**, building on the country's unique competitive advantages

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

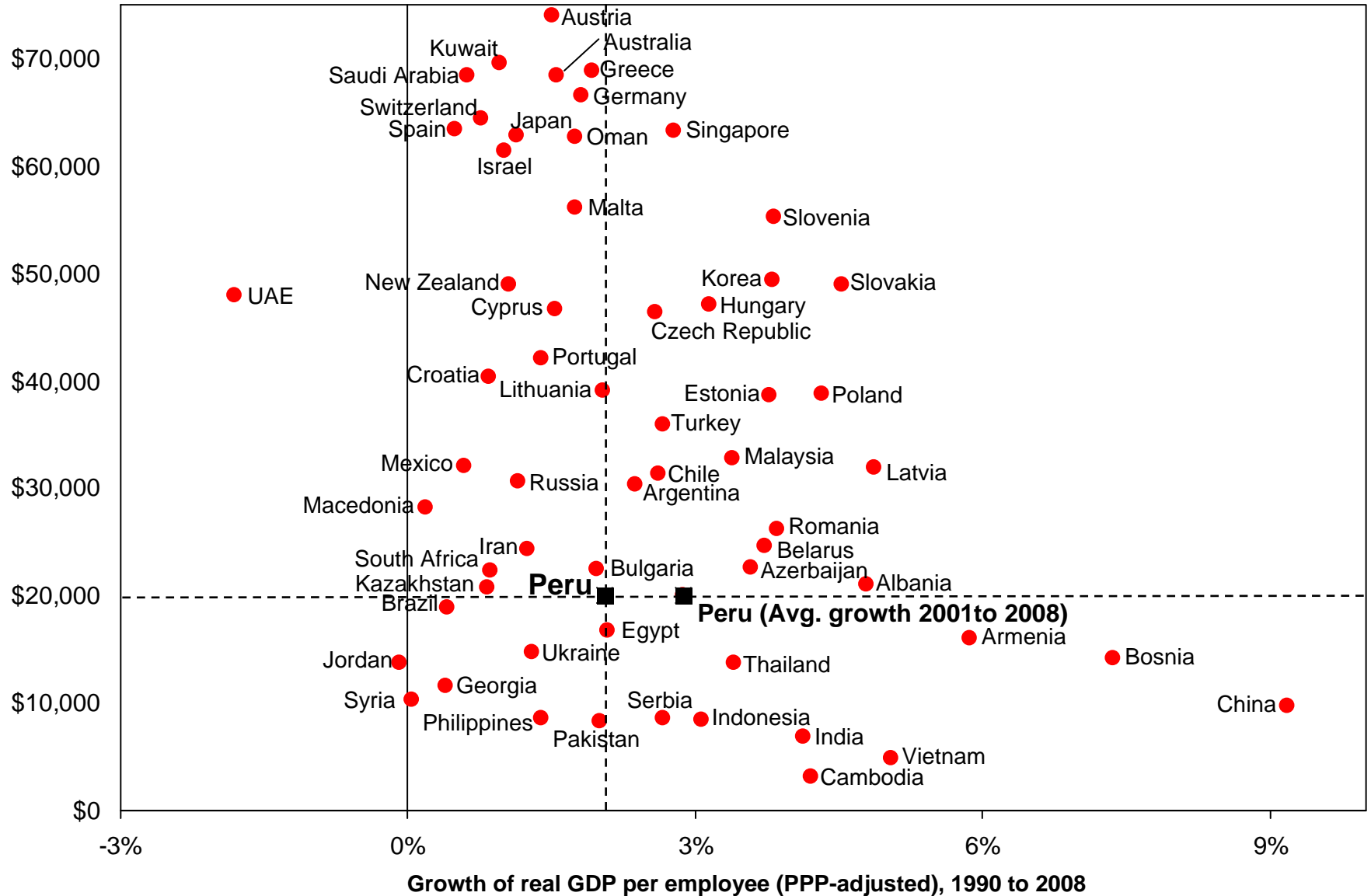


- Only **competitive** businesses can create wealth and jobs
- Nations compete to offer the **most productive environment for business**
- The public and private sectors play **different but interrelated roles** in creating a productive economy

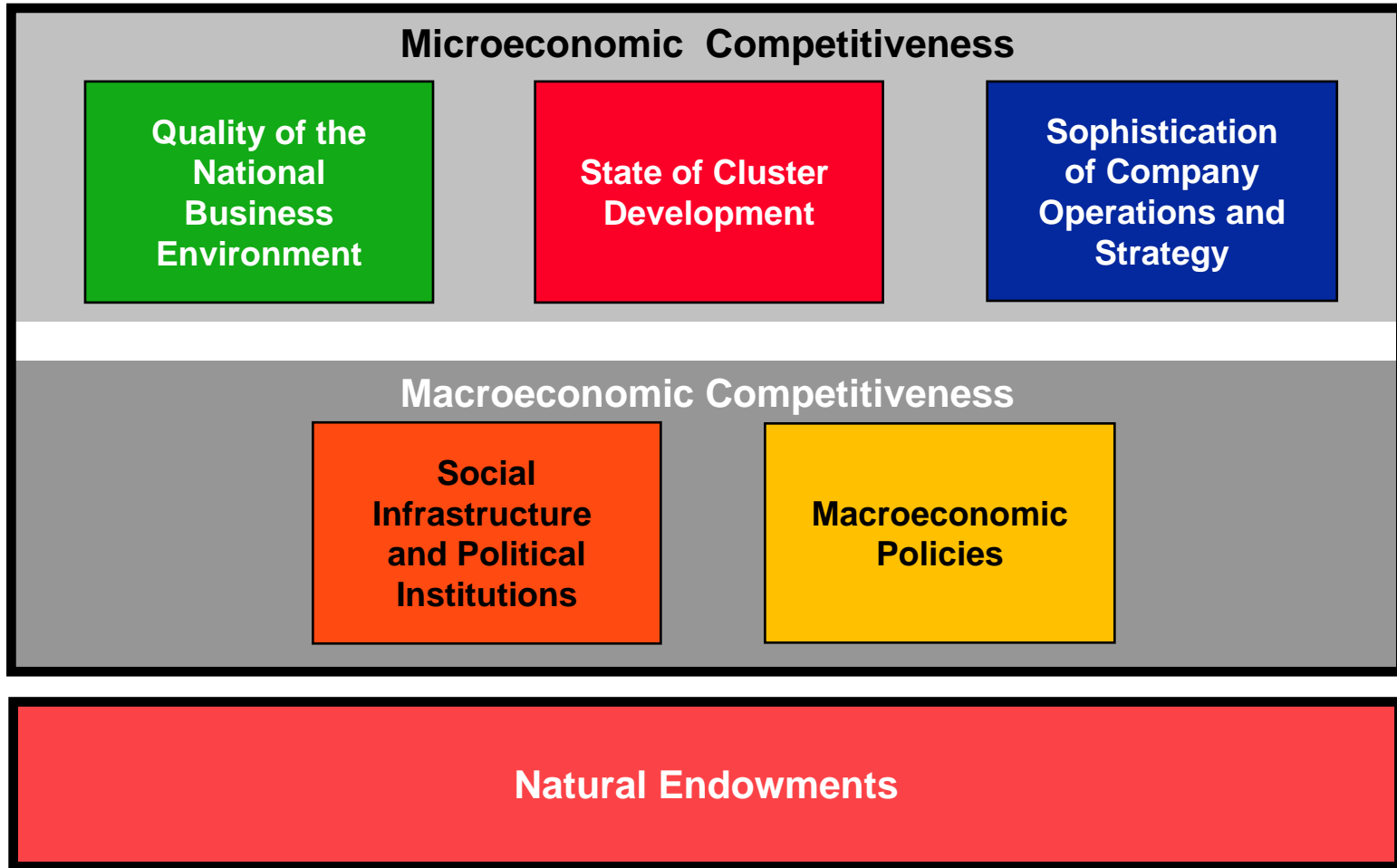
Comparative Labor Productivity

Selected Countries

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

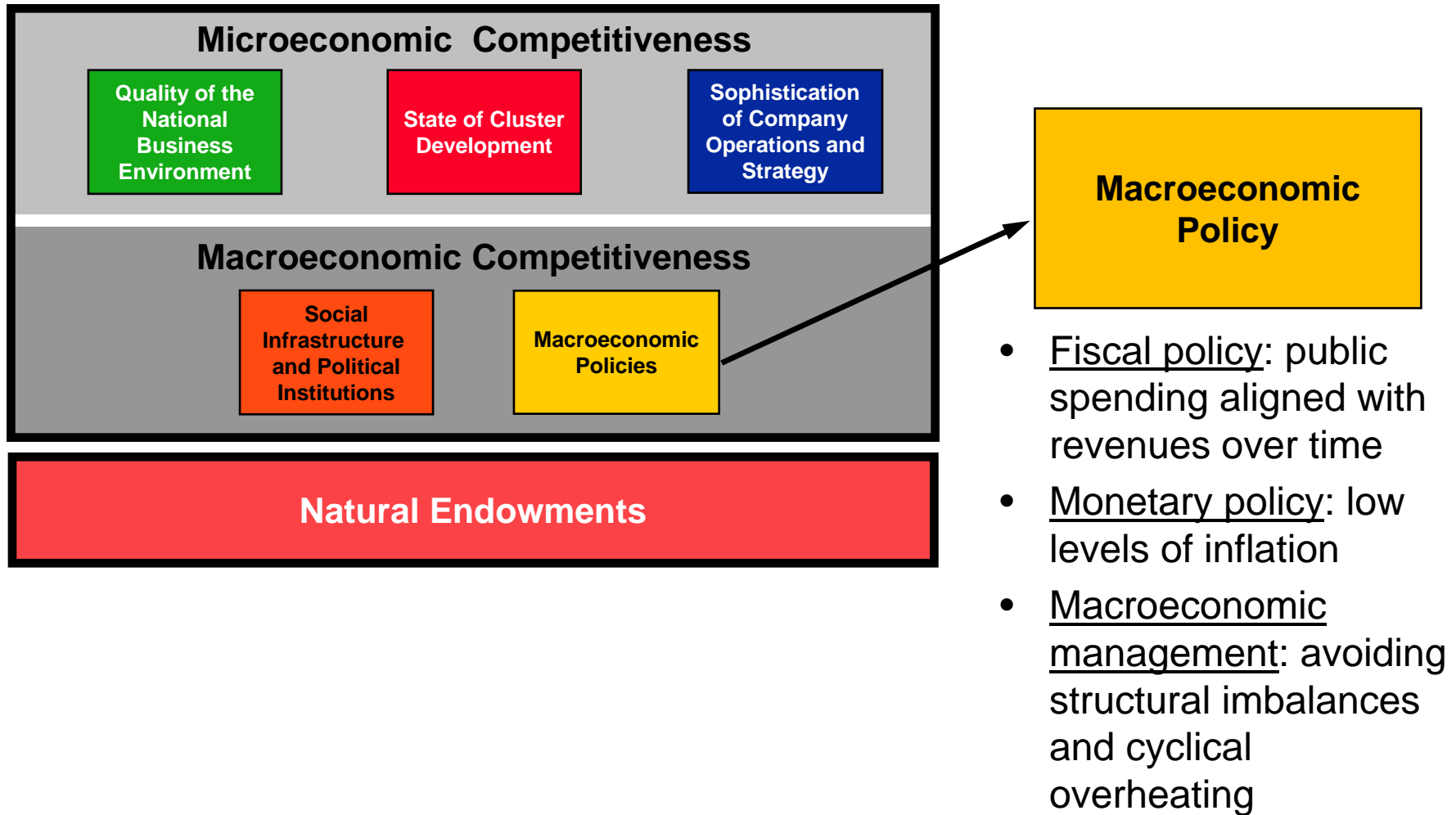


Determinants of Competitiveness

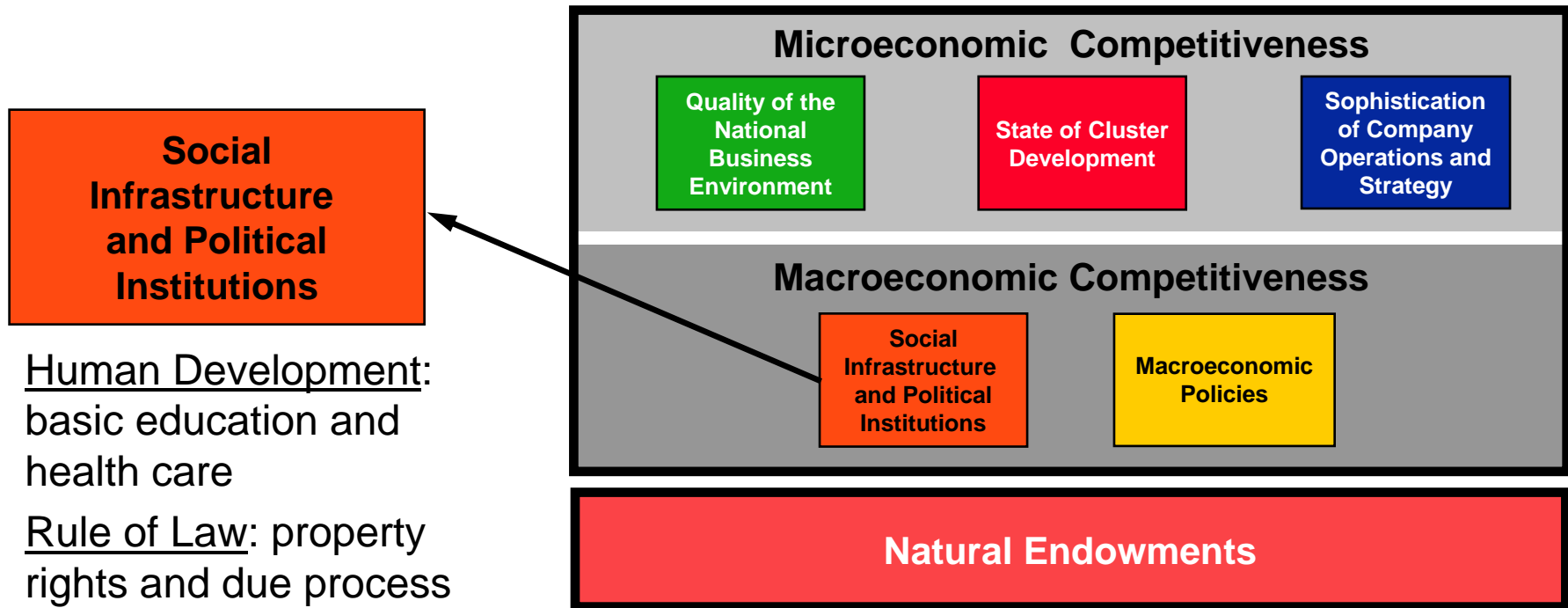


- Macroeconomic competitiveness creates the potential for high productivity, but is **not sufficient**
- Productivity ultimately depends on improving the **microeconomic capability** of the economy and the **sophistication of local competition**

Determinants of Competitiveness

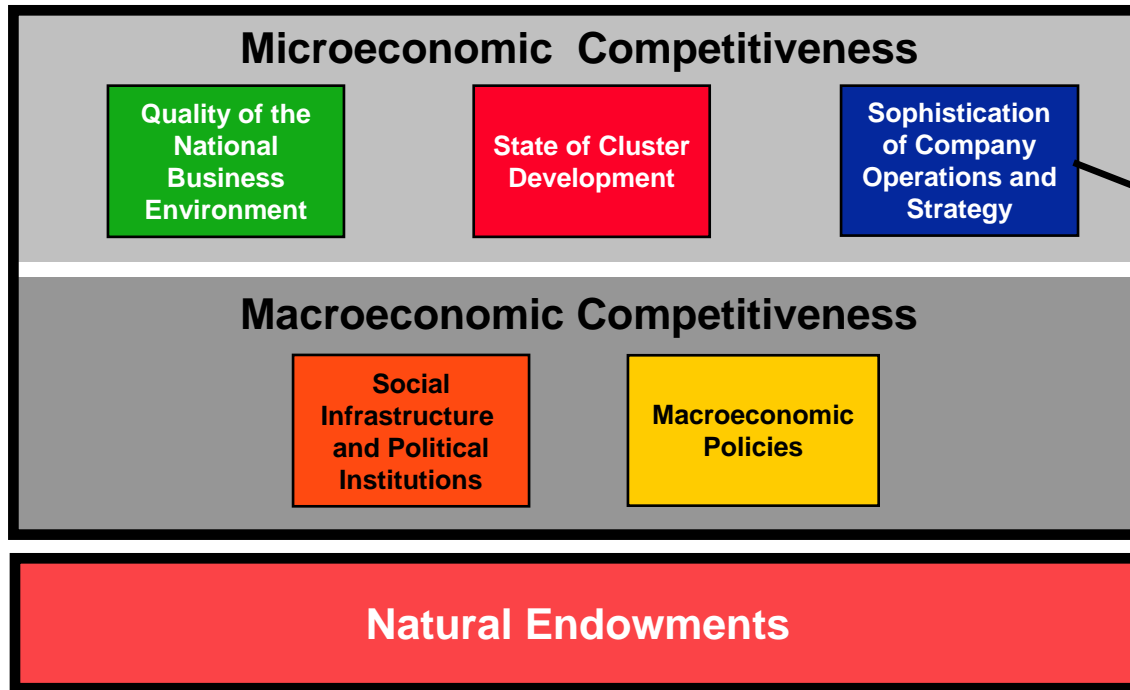


Determinants of Competitiveness



- 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

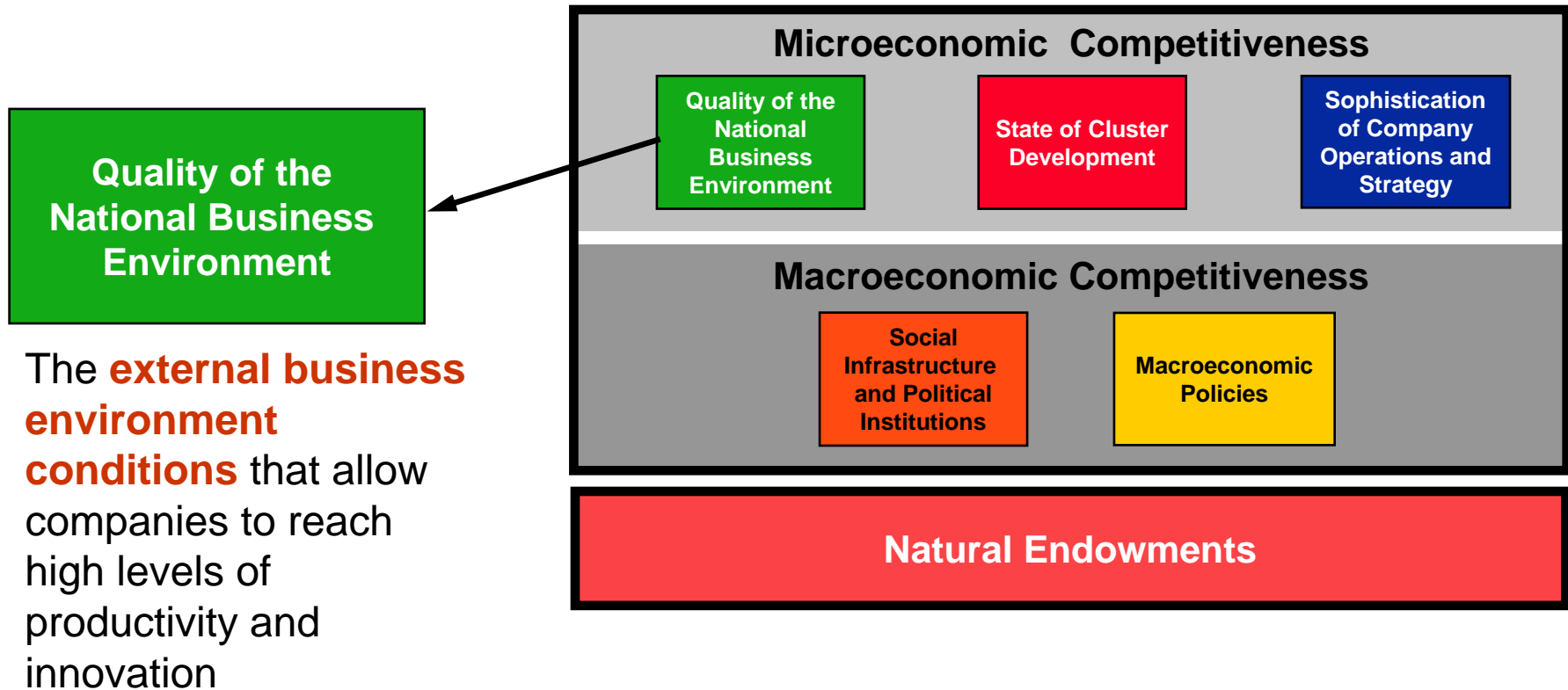
Determinants of Competitiveness



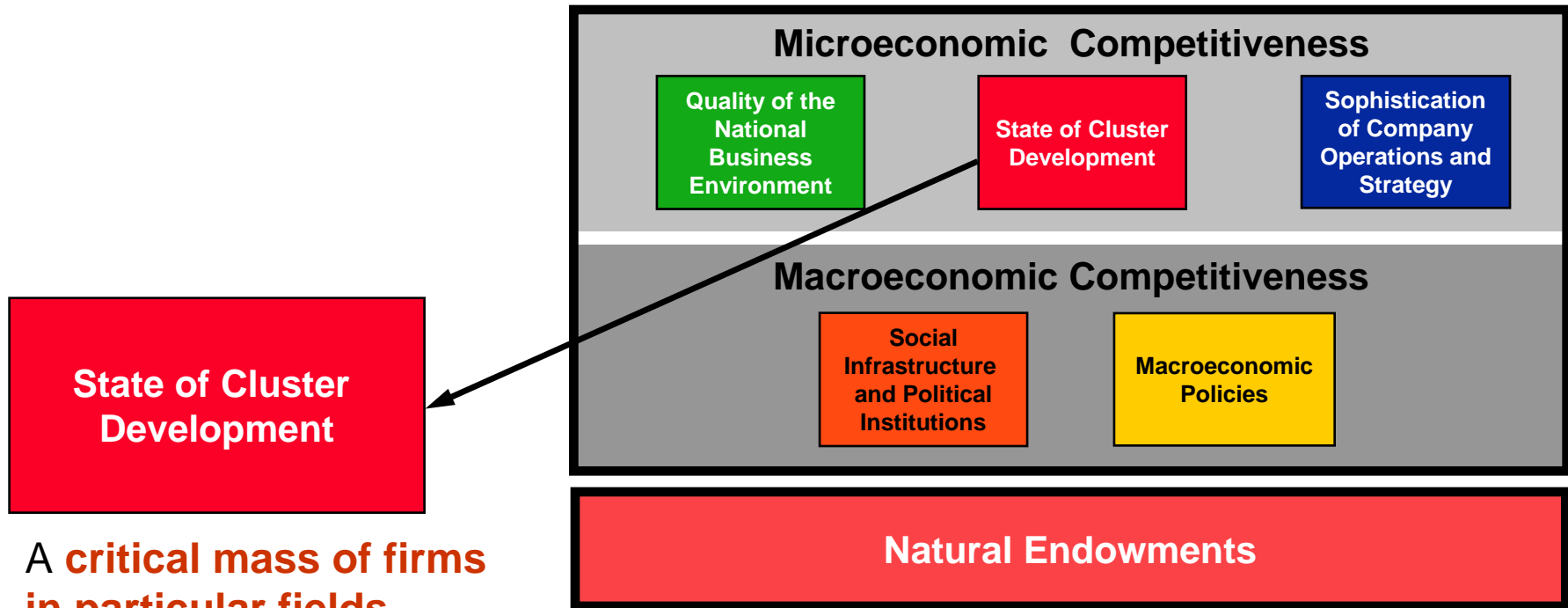
Sophistication of Company Operations and Strategy

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

Determinants of Competitiveness

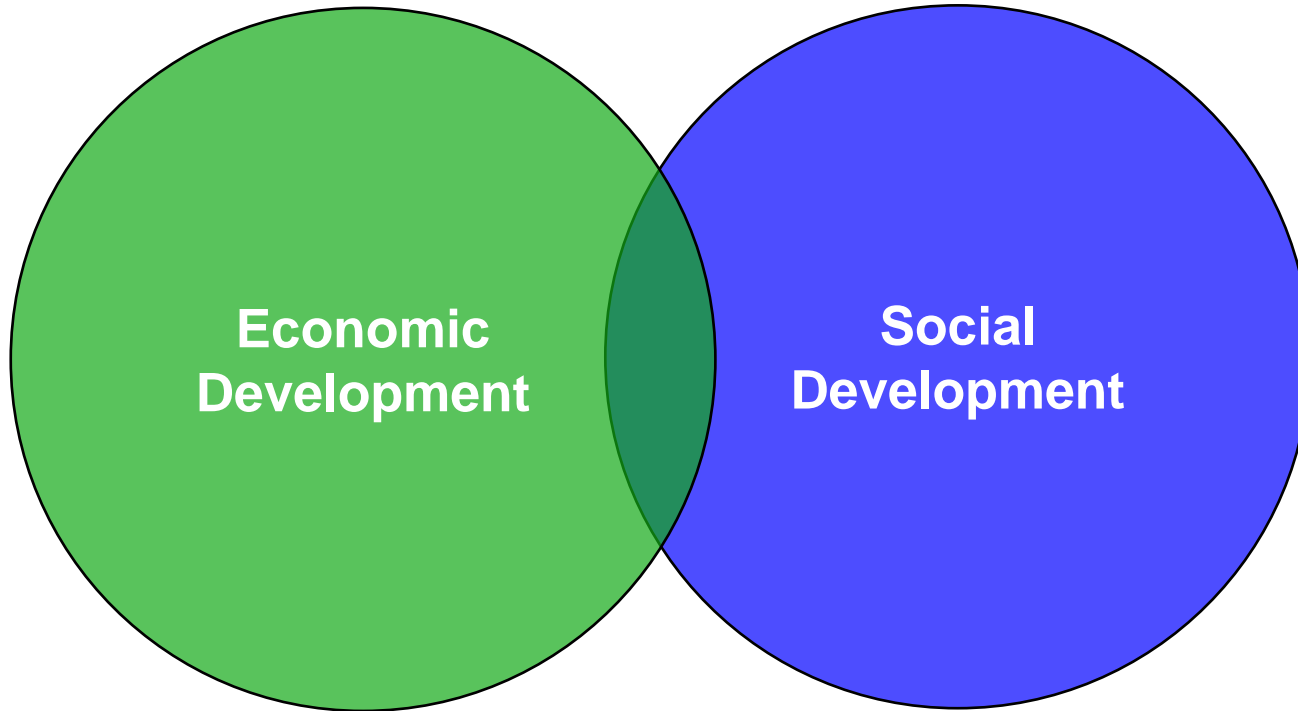


Determinants of Competitiveness



- A **critical mass of firms in particular fields**, together with specialized skills, infrastructure, and supporting institutions, to support high productivity through efficiencies and synergies

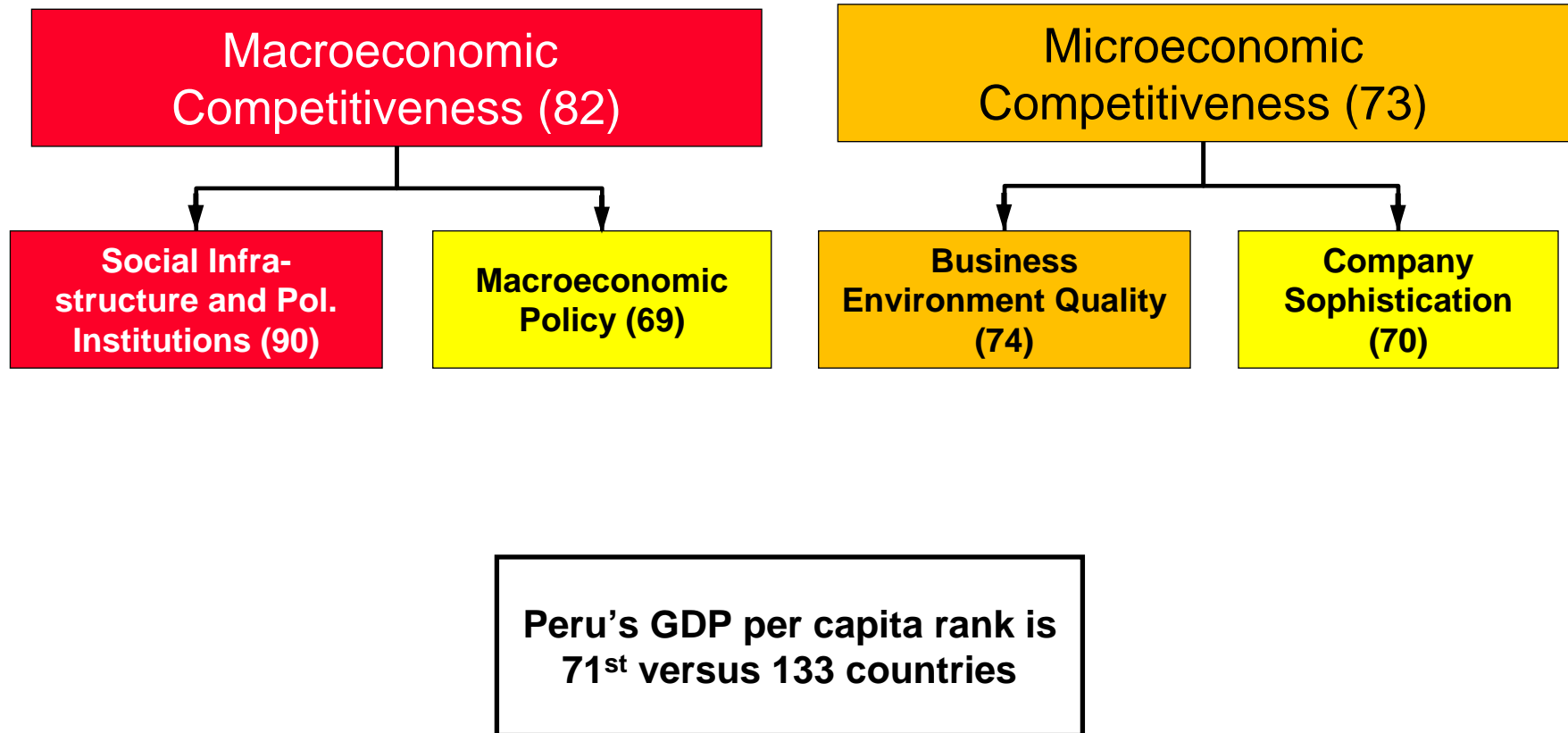
Competitiveness and Poverty Reduction



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

Peru's Competitiveness Profile, 2009

ISC Country Competitiveness Model



Note: Rank versus 133 countries; overall, Peru ranks 71st in 2008 PPP adjusted GDP per capita and 75th in 2009 Global Competitiveness
Source: Country Competitiveness Model (CCM), Institute for Strategy and Competitiveness, Harvard University (2009)

Peru's Macroeconomic Competitiveness

Macroeconomic Policy

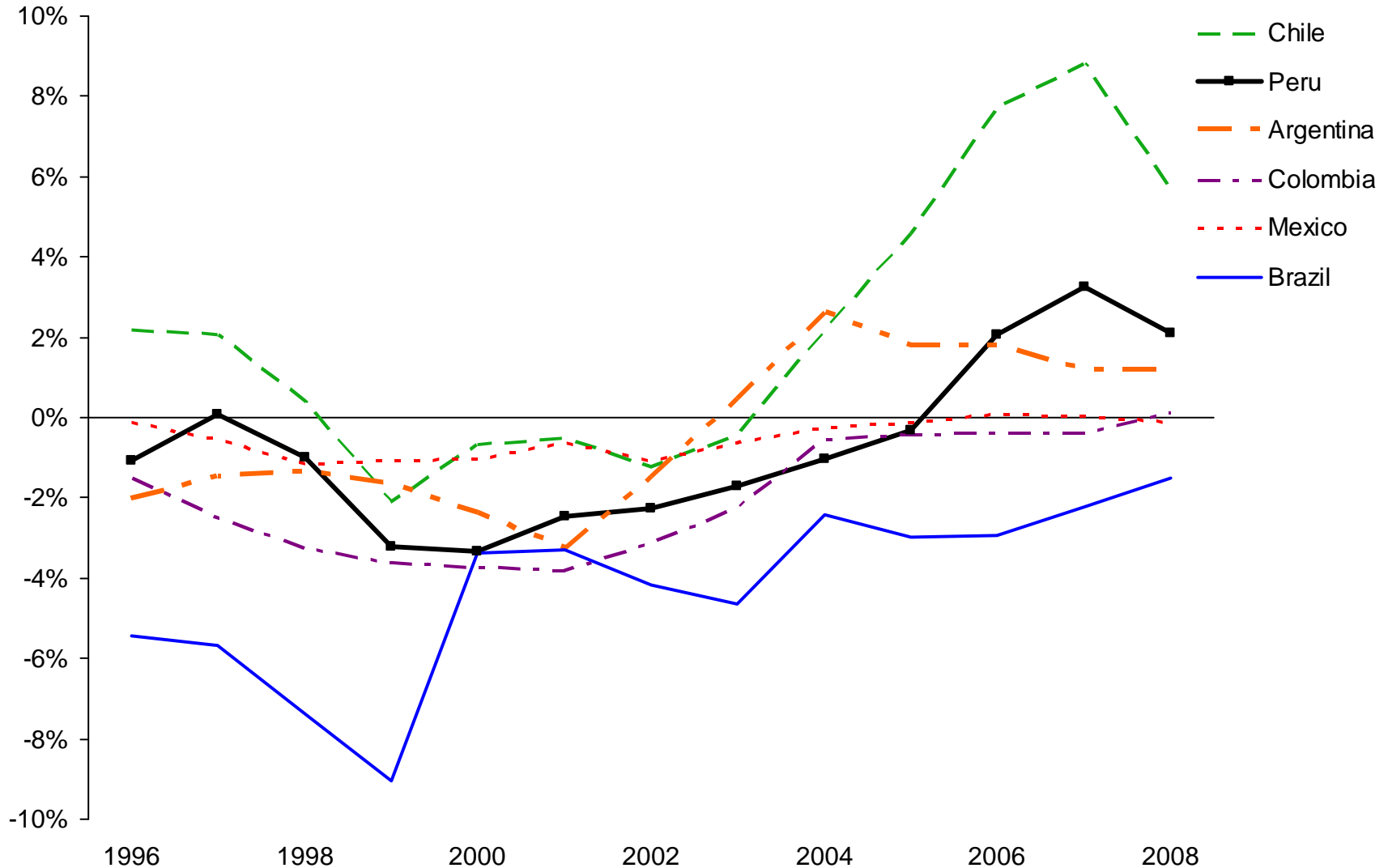
- **Conservative** fiscal policy

Government Budget Balances

Selected Countries

Budget Balance
(% of GDP)

Ranked by
Surplus, 2008



Peru's Macroeconomic Competitiveness

Macroeconomic Policy

- **Conservative** fiscal policy
- Sound **macroeconomic management**
- **Stabilization fund**

However

- Peru's macroeconomic position remains **overly dependent** on commodities and commodity prices

Peru's Macroeconomic Competitiveness

Macroeconomic Policy

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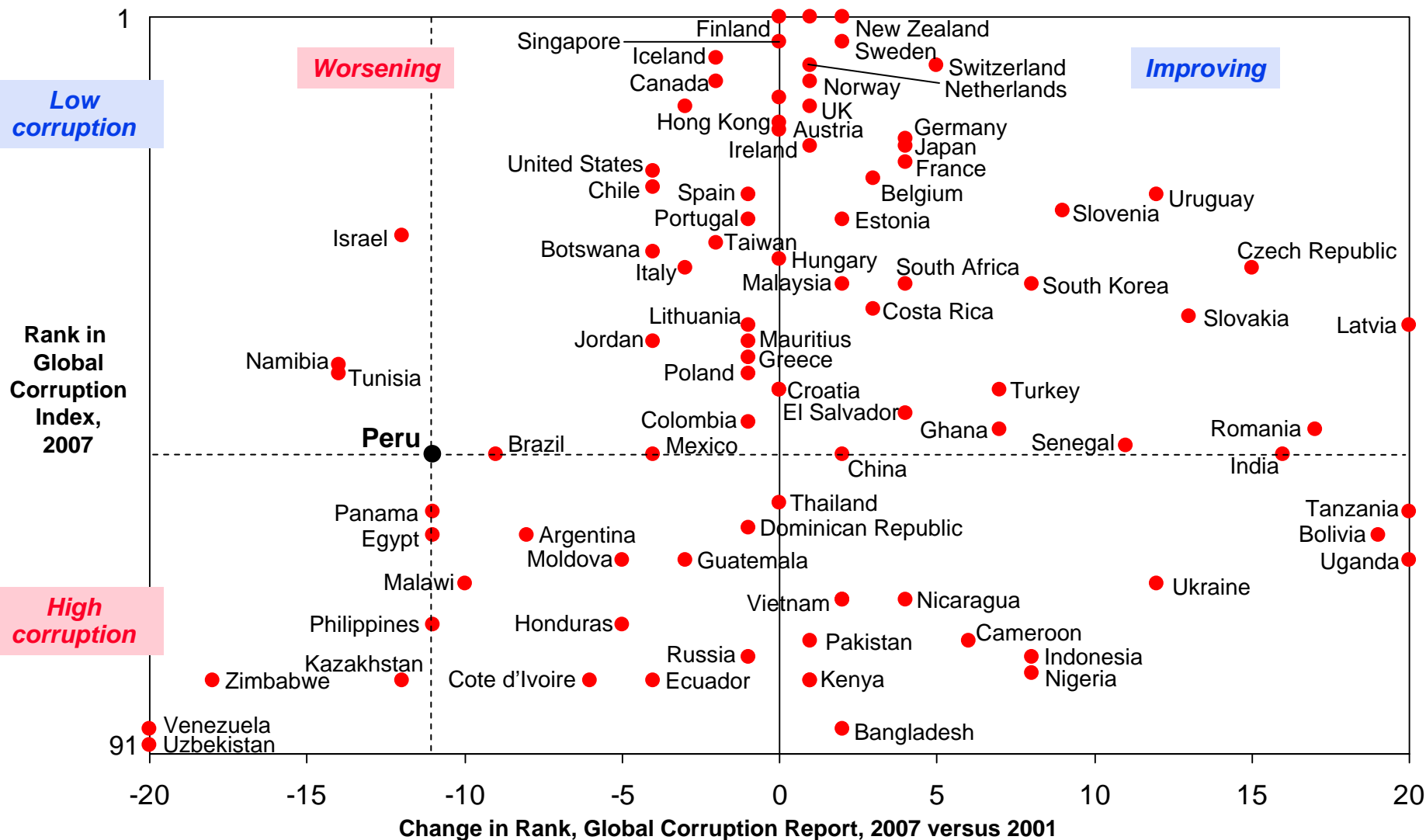
Social Infrastructure and Political Institutions

- **Continued** problems with corruption

However

- Peru's macroeconomic position remains **overly dependent** on commodities and commodity prices

Corruption Perception Index, 2007



Peru's Macroeconomic Competitiveness

Macroeconomic Policy

- **Conservative** fiscal policy
- Sound **macroeconomic management**
- **Stabilization fund**

However

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Social Infrastructure and Political Institutions

- **Continued** problems with corruption
- Sharp **inequality** between indigenous groups and other citizens
- Weak **education system**
- Inadequate **health care system**, despite some improvements
- Weak legal system and effectiveness of **property rights**
- Unstable **political processes** and **institutions**
- **Government institutions** are inefficient and held in low esteem by the public

Peru's Macroeconomic Competitiveness

Action Priorities

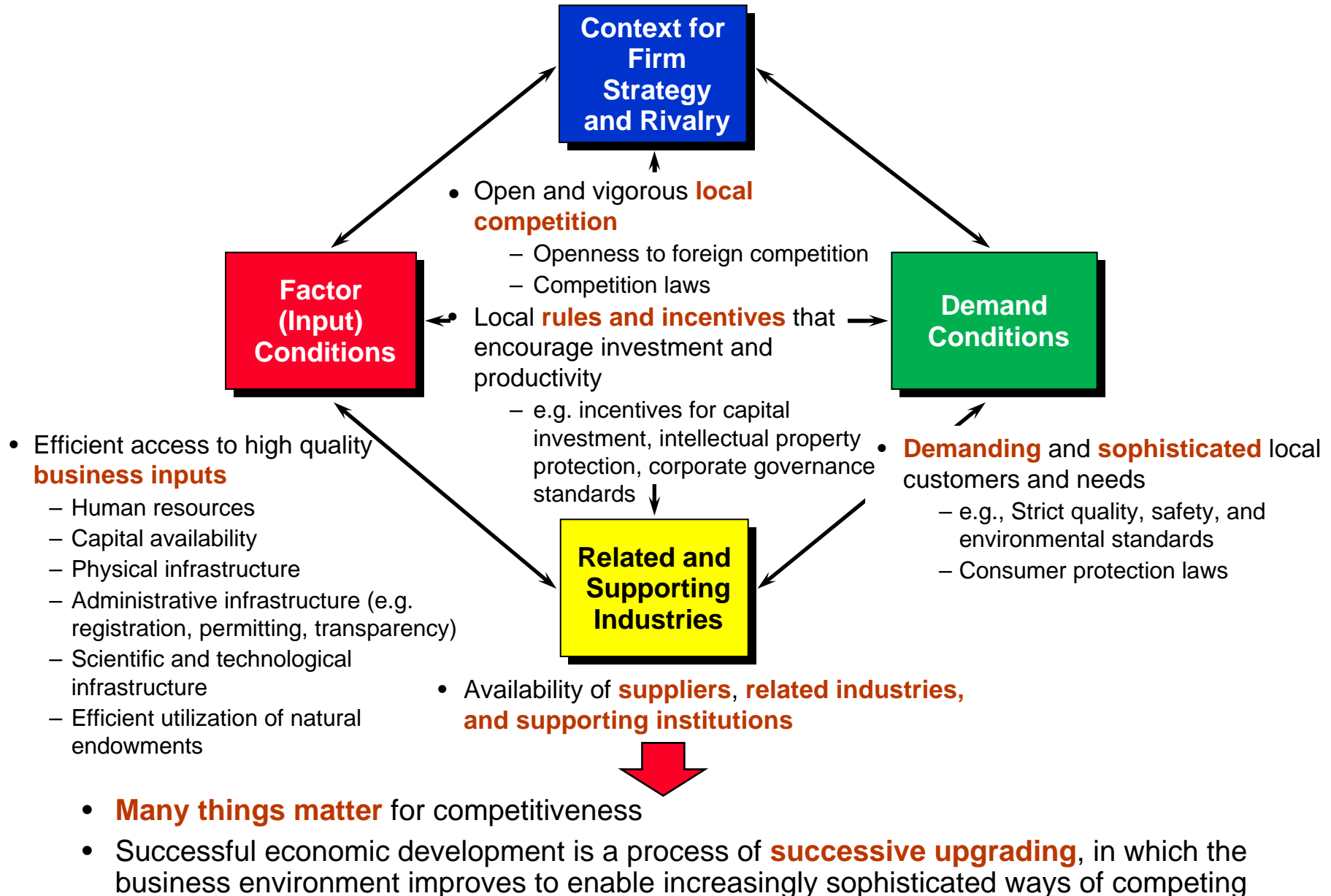
Macroeconomic Policy

- Maintain **macroeconomic stability**
- Broaden the **tax base** and improve **collections**

Social Infrastructure and Political Institutions

- Modernize **political** and **governmental** institutions to improve policy formulation and execution
- Tackle **corruption** at every level of government
- Improve the effectiveness of the **legal system**
- Improve **property rights**
- Improve **human development**
 - Rapid improvements in **education**, **health**, and **nutrition** are needed
- Create **equal opportunity** for all groups

Microeconomic Competitiveness: Quality of the Business Environment



Peru's Business Environment

Overall Strengths and Weaknesses

STRENGTHS

Trade and Investment Liberalization

- Openness to foreign investment
- Low restrictions on capital flows
- Simplification of custom procedures
- Low trade barriers
- Improvements in investor protections

Improving Financial Markets

- Soundness of banks
- Improving financial market

IT Infrastructure

- Good quality of telecom infrastructure
- Sound IT policies

Other

- Good management training
- Improving sophistication of local buyers
- Efforts to strengthen competition policy

WEAKNESSES

Physical Infrastructure

- Low quality of air, transport and port infrastructure
- Inadequate electricity supply

Workforce Development and Training

- Poor quality of the higher education system
- Low skill level of the labor force
- Limited availability of scientists and engineers

Competitive Context

- Low intensity of local competition
- Difficulty in business formation
- Burdensome government regulations
- Rigidity of employment
- Weak intellectual property protection
- High informality in the economy

Innovation Infrastructure

- Limited technological capacity
- Weak university-industry research collaboration
- Low patenting rates

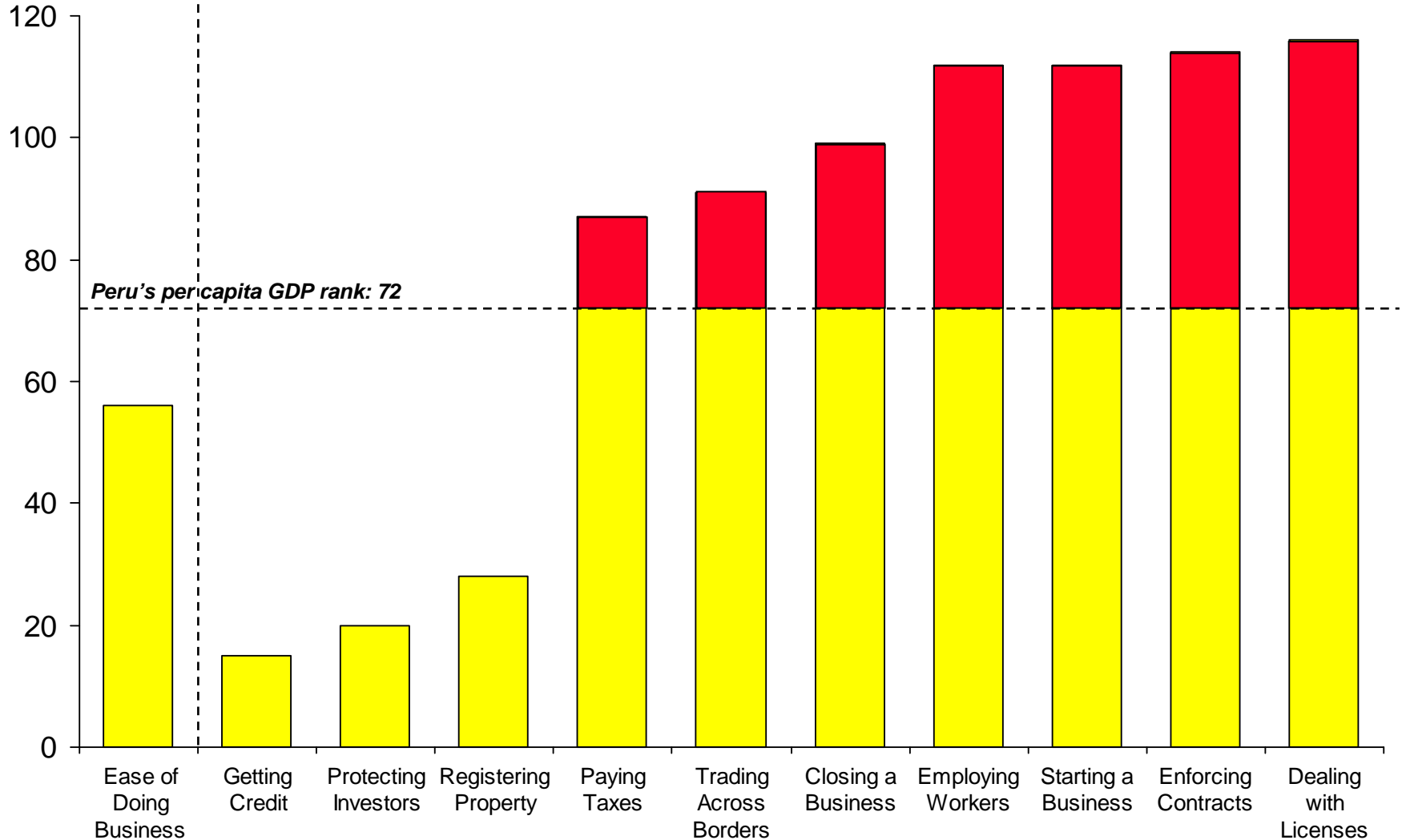
Ease of Doing Business

Peru, 2009

Ranking, 2009
(of 183 countries)

Favorable

Unfavorable



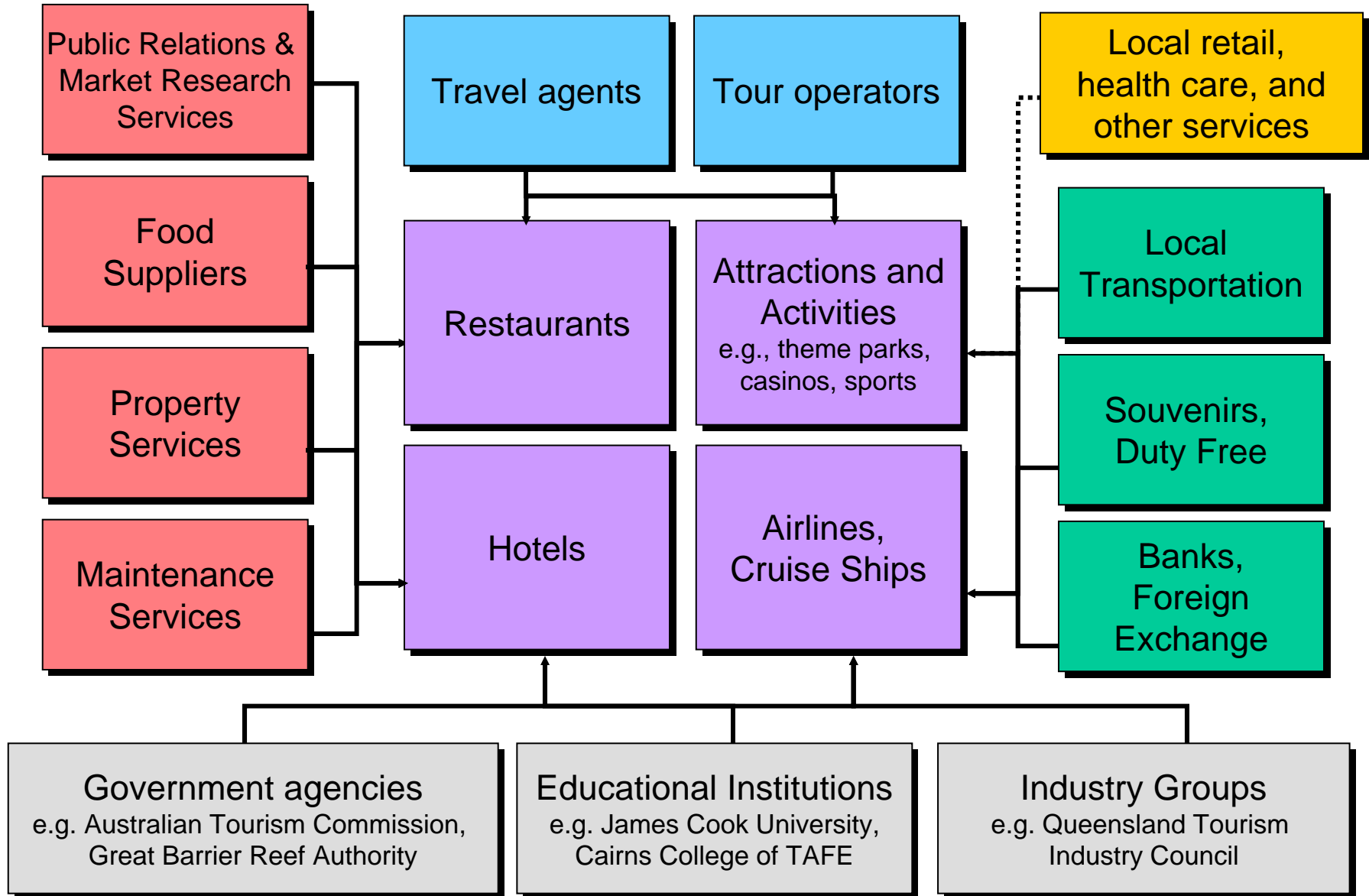
Peru's Business Environment

Action Priorities

- Improve **physical infrastructure**
- Create an effective system for **workforce training**
- Upgrade **higher education**
- Encourage **entrepreneurship** and **SME** business formation
 - Simplify **business formation**
 - Reduce **tax burden** and **labor market** rigidities
 - Address other causes of **informality**
 - Strengthen **financing** for SMEs
- Improve **environmental standards**
- Develop **innovation infrastructure**
 - Upgrade **technology standards** in key clusters of the economy

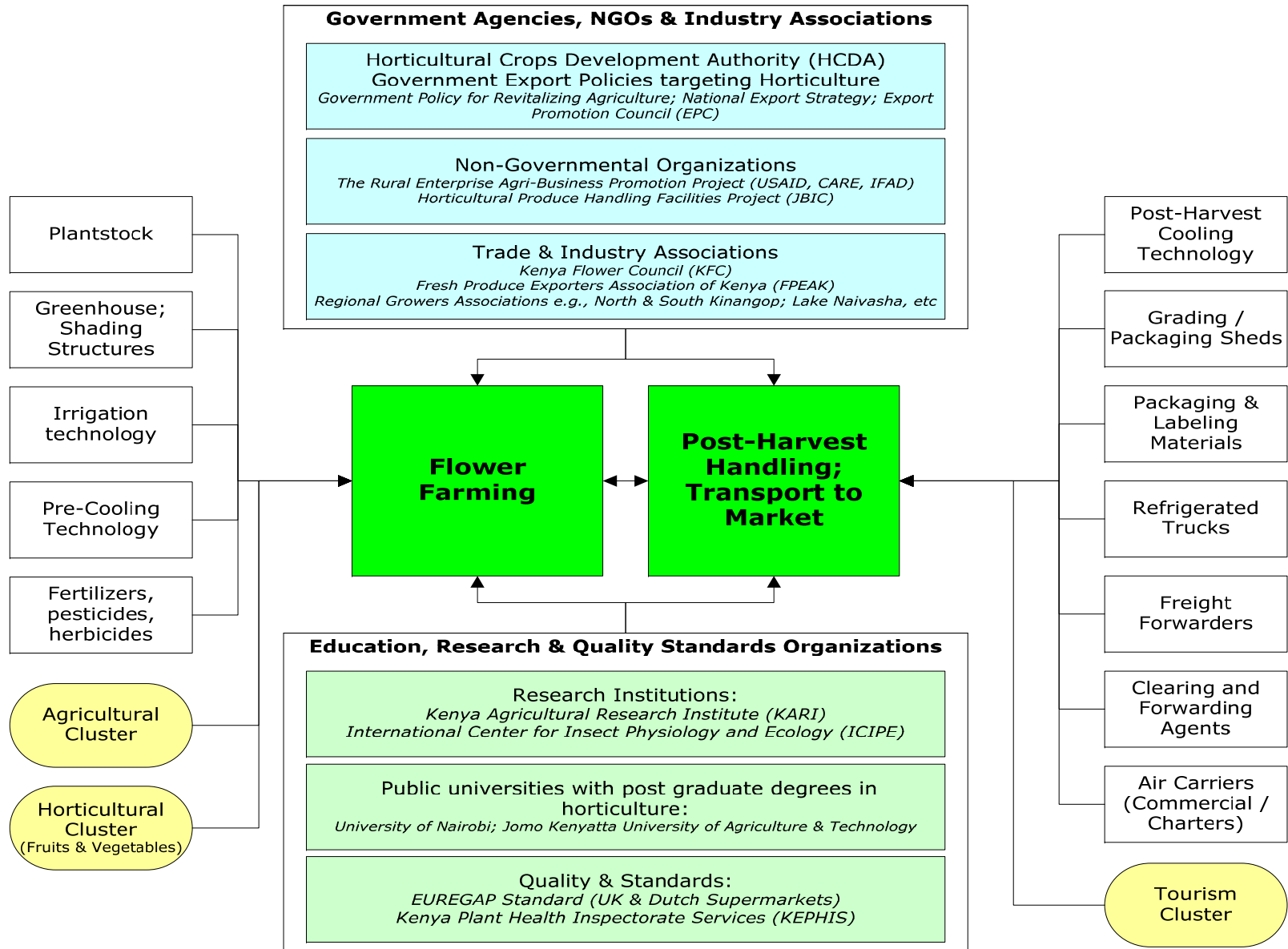
Microeconomic Competitiveness: Cluster Development

Tourism Cluster in Cairns, Australia



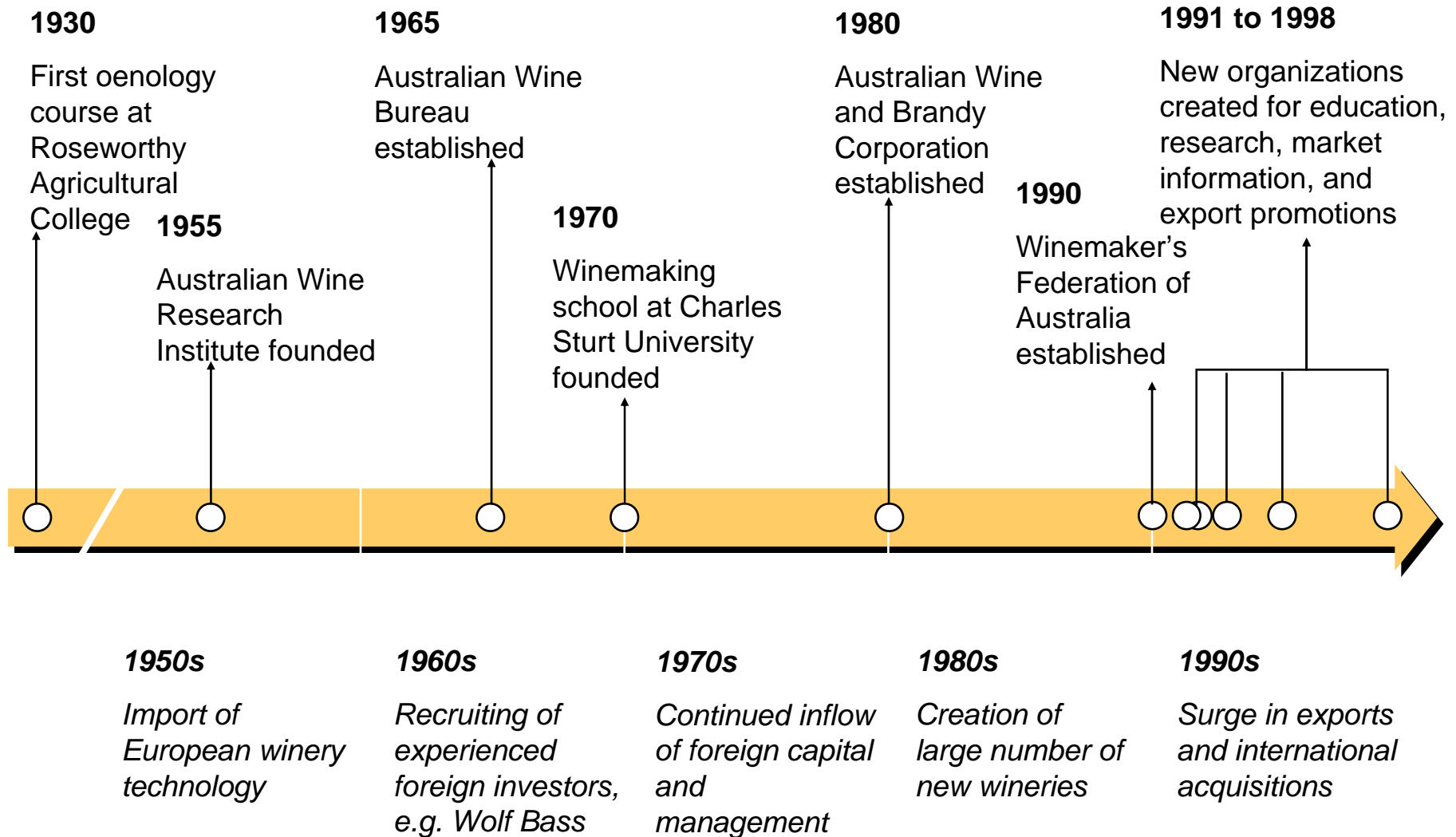
Cluster in Developing Countries

Kenya's Cut Flower Cluster



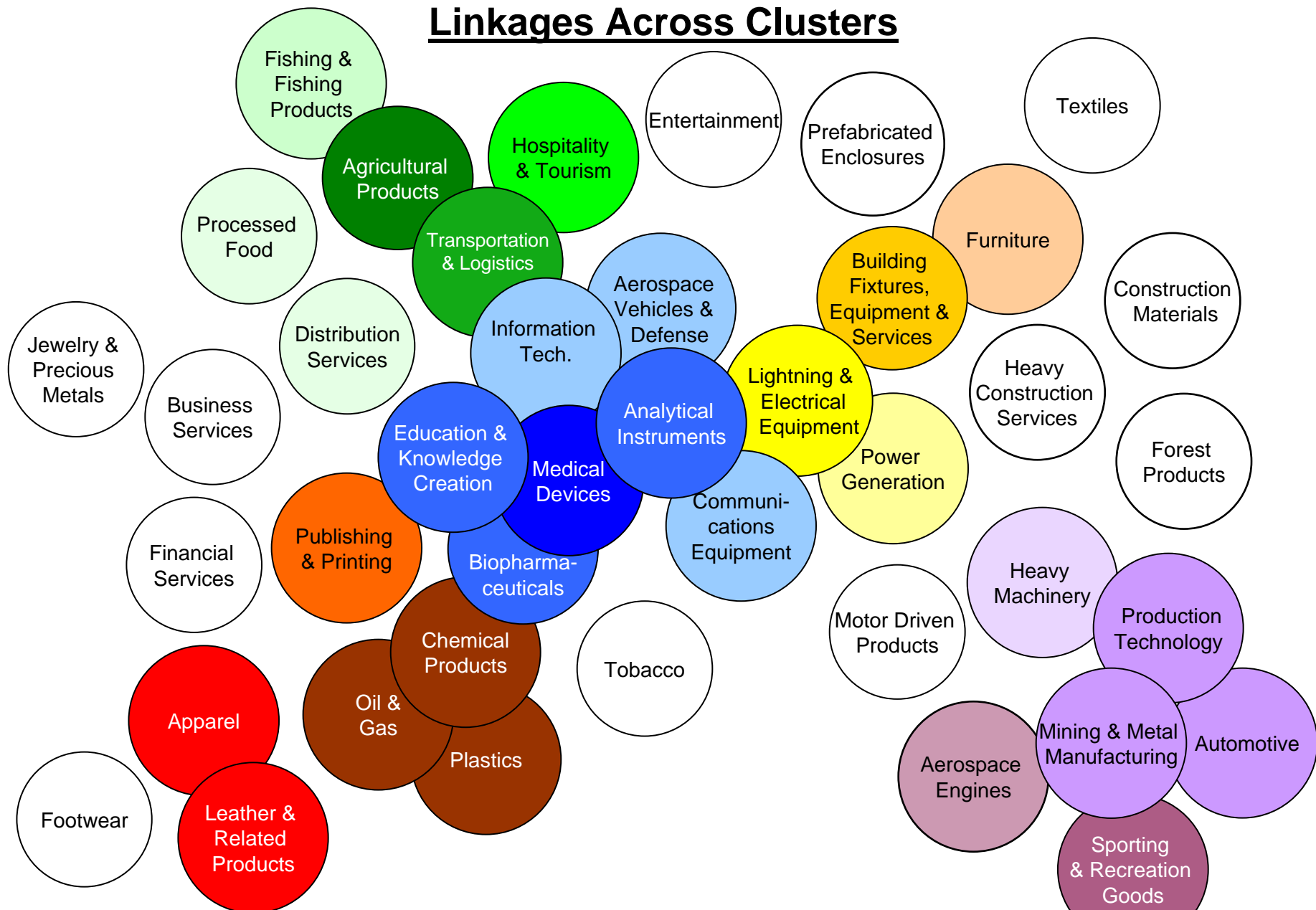
Sources: Student team research by Kusi Hornberger, Nick Ndiritu, Lalo Ponce-Brito, Melesse Tashu, and Tijan Watt, Microeconomics of Competitiveness Course, 2007

The Australian Wine Cluster History



Clusters and Economic Diversification

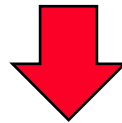
Linkages Across Clusters



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

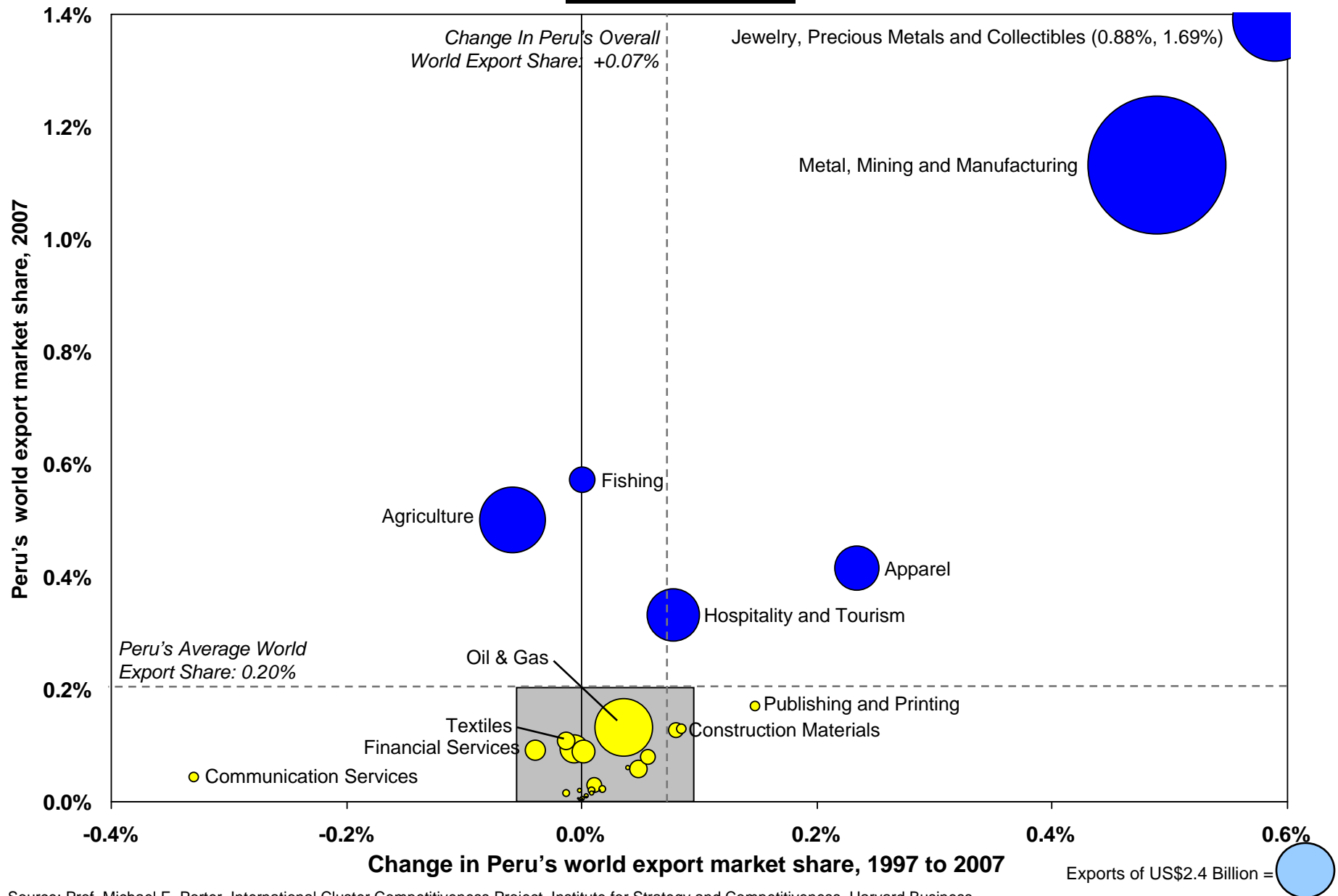
- A forum for **collaboration** between government, the private sector, trade associations, educational institutions, and research institutions
- Brings together **firms of all sizes**, including SME's
- Creates a mechanism for **constructive business-government dialogue**
- A tool to identify **problems** and concrete **action recommendations**
- A vehicle for identifying investments that strengthen **multiple firms/institutions** simultaneously
- A framework for **implementing government policies** towards business



- Foster more sophisticated **competition** rather than distorting the market

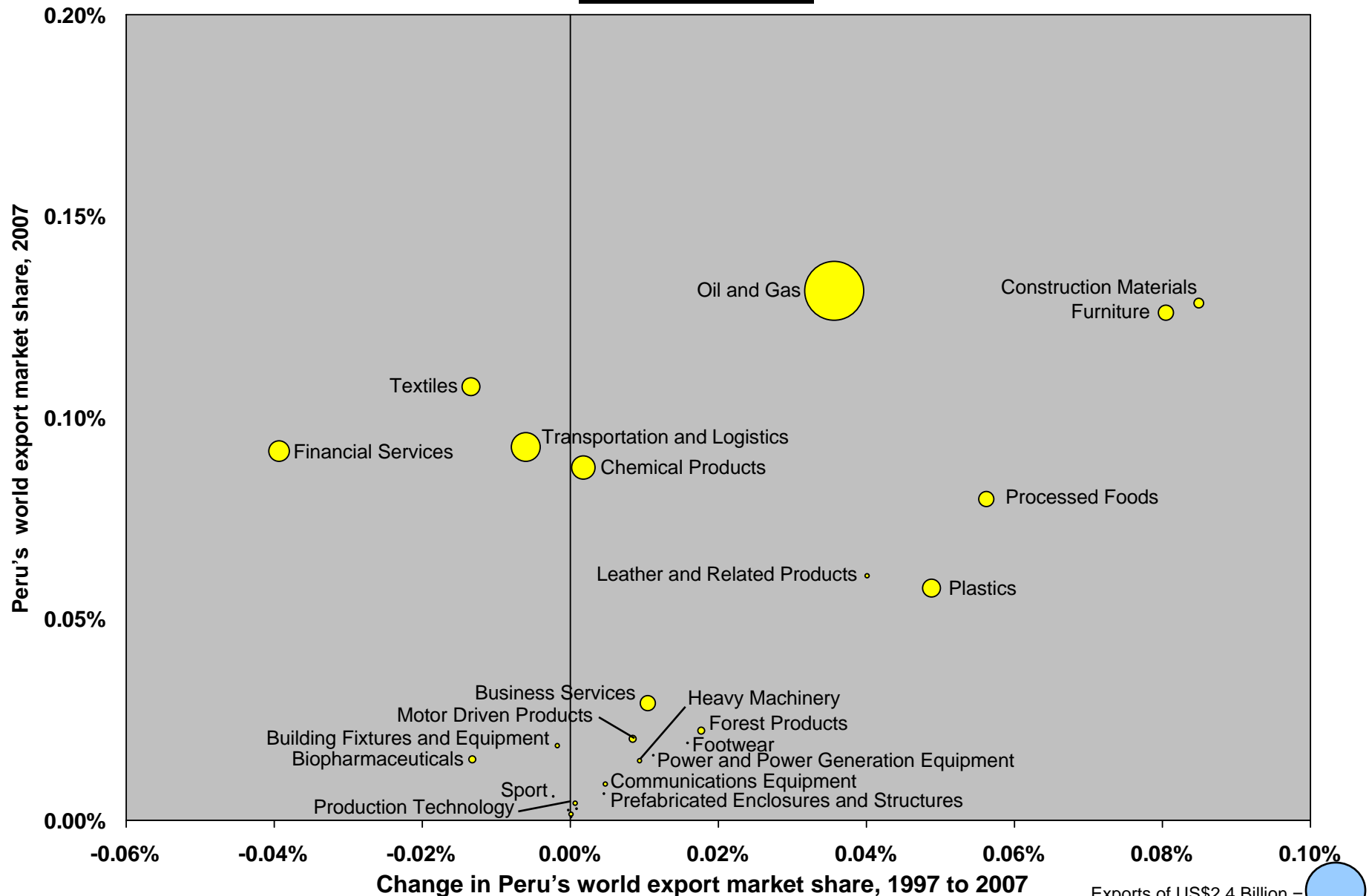
Peru's Export Portfolio

1997 to 2007



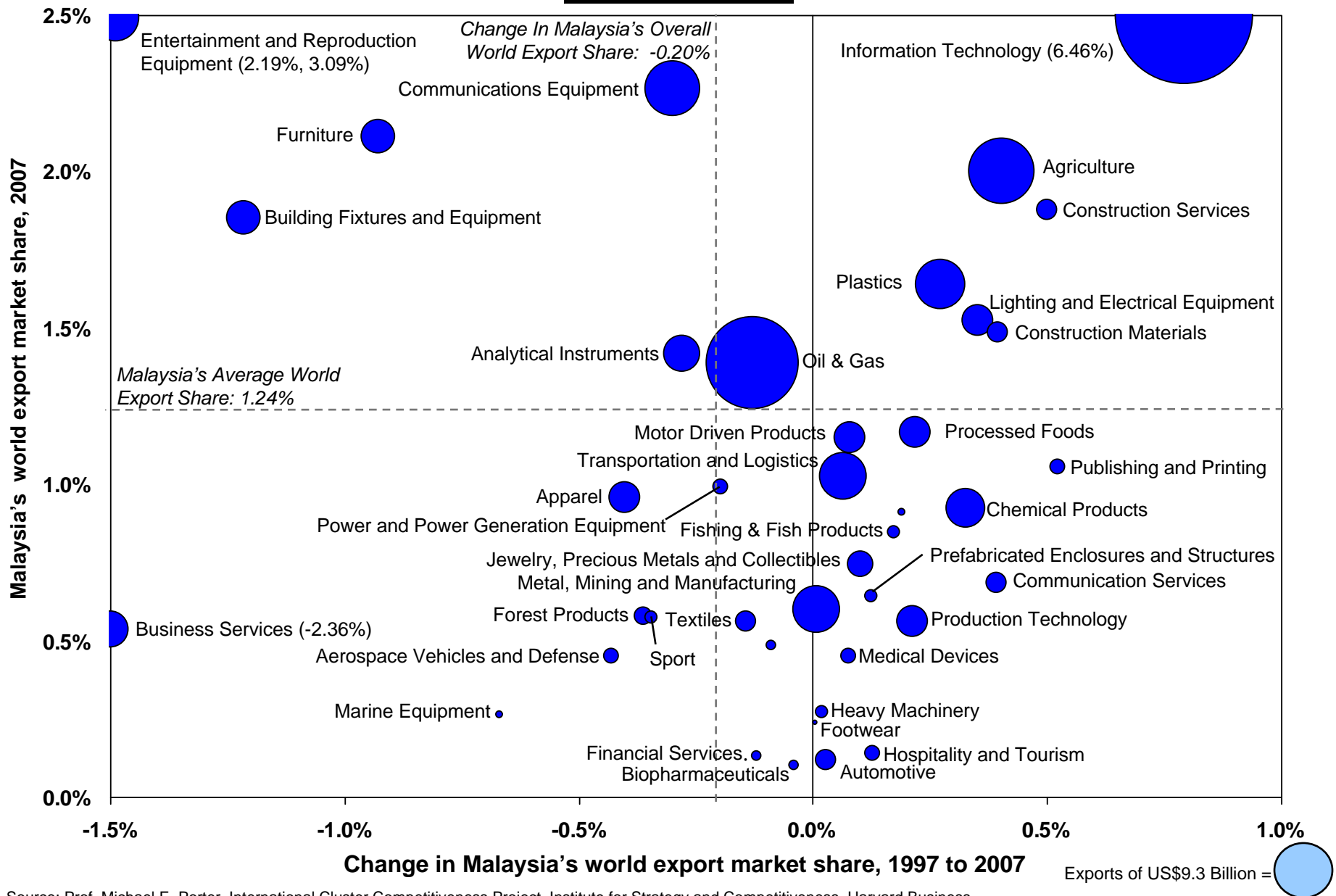
Peru's Export Portfolio

1997 to 2007



Malaysia's Export Portfolio

1997 to 2007



Share of World Exports by Cluster

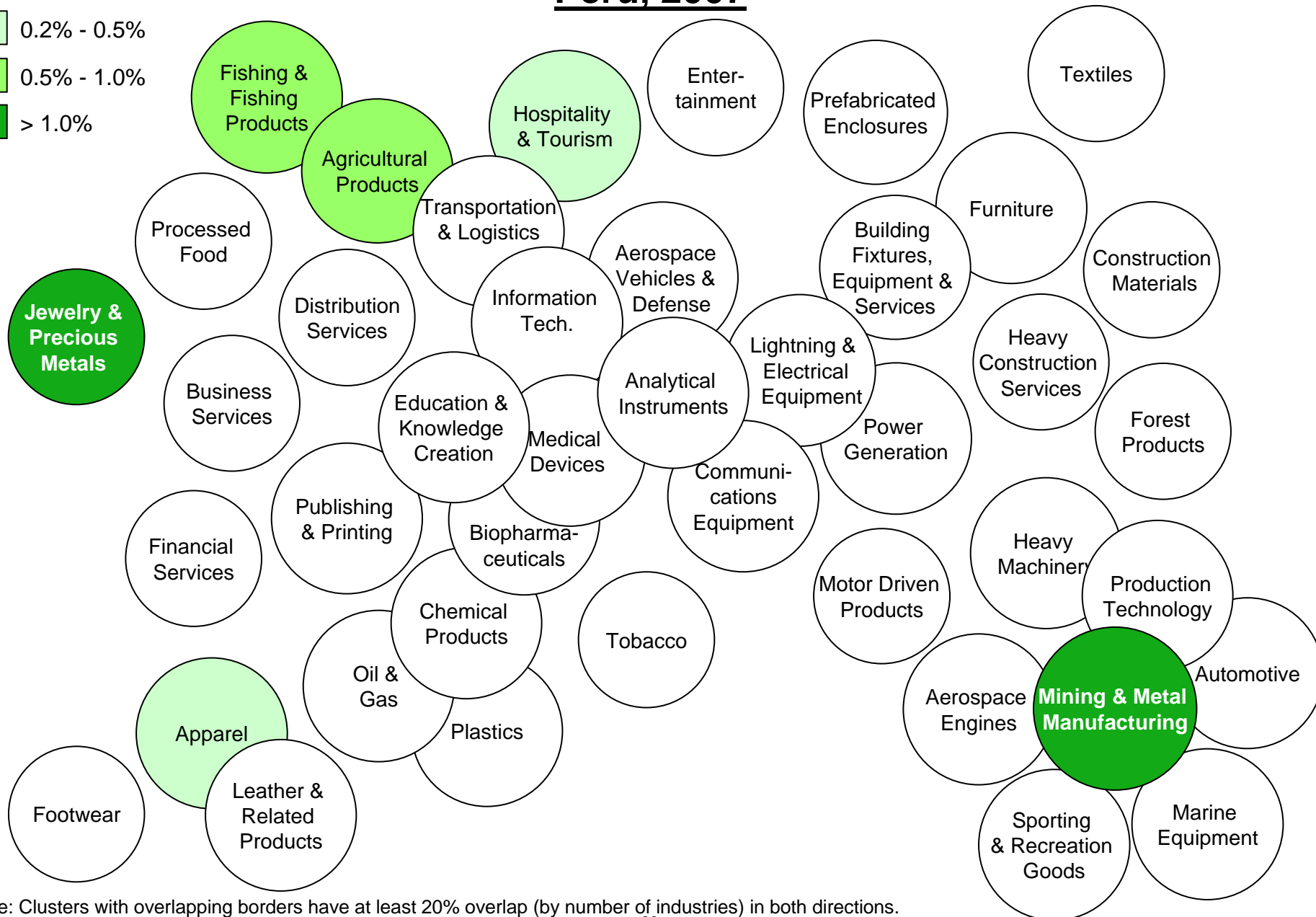
Peru, 2007

World Market Share

0.2% - 0.5%

0.5% - 1.0%

> 1.0%

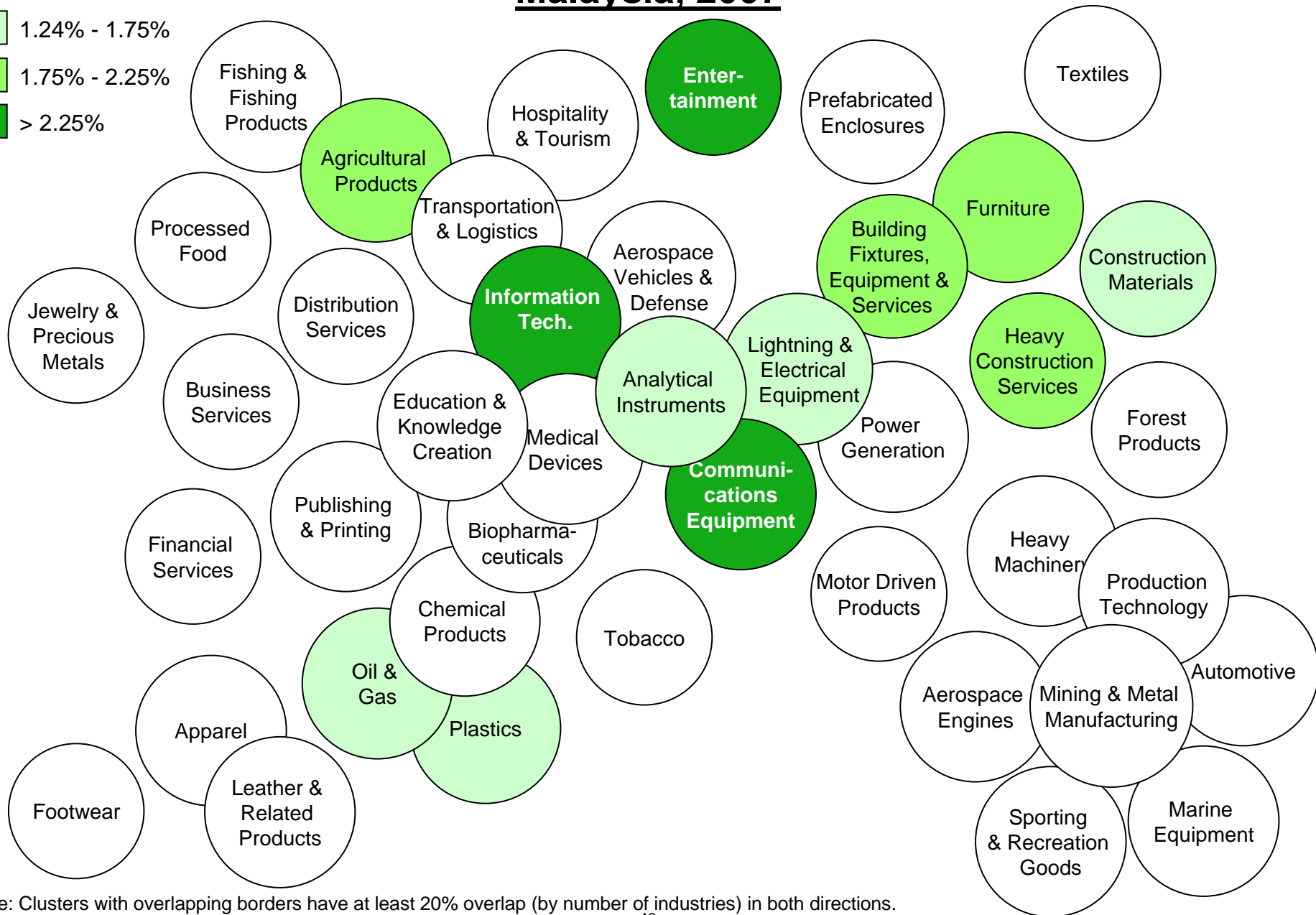
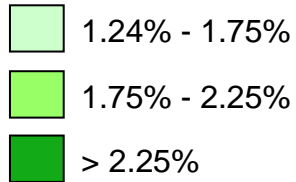


Note: Clusters with overlapping borders have at least 20% overlap (by number of industries) in both directions.

Share of World Exports by Cluster

Malaysia, 2007

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 Peru

- Peru has **strengths** in several clusters, including mining, fishing, agribusiness, tourism, jewelry and apparel
- Peru's clusters are based heavily on **natural endowments**, with limited further upgrading
- Peru's clusters are **shallow**, with weak supplier bases and supporting institutions
- The limited cluster development efforts underway in Peru suffer from **poor coordination** between the private and public sectors



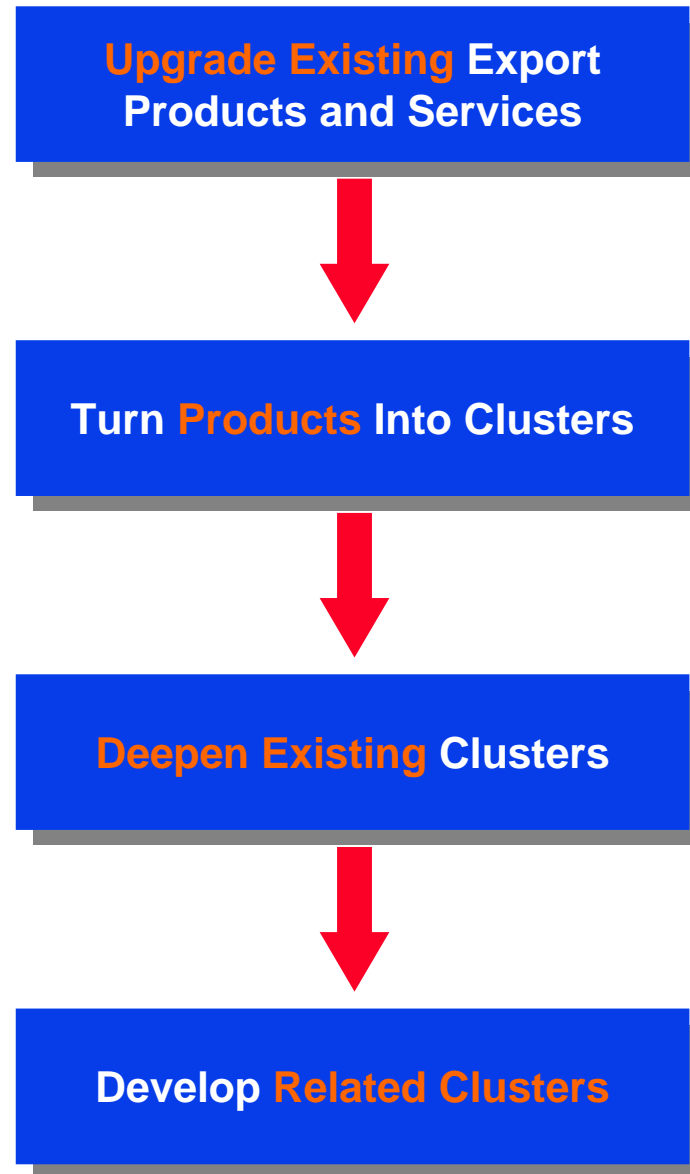
- Clusters are so far an **unexploited dimension** of economic policy at the national and regional levels

Cluster Development in Peru

Action Priorities

- Adopt **cluster development** as a central tool for organizing business development and implementation of economic policies supporting businesses
- Use cluster development to encourage **value-add upgrading** within existing clusters
 - Promote spillovers and synergies to upgrade local economies
- Apply a cluster based approach to **economic diversification**

Clusters and Economic Diversification



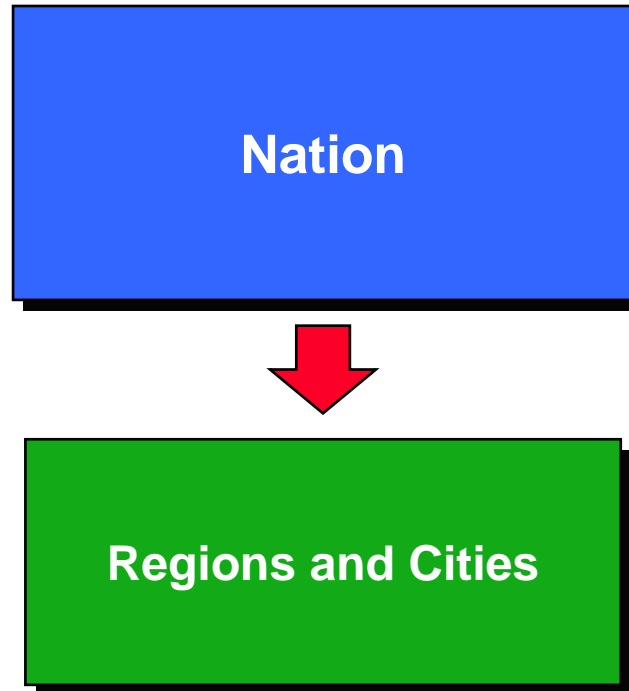
- Local firms
- MNCs

Cluster Development in Peru

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- Use cluster development to encourage **value-add upgrading** within existing clusters
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- Apply a cluster based approach to **economic diversification**
- Leverage clusters to **attract FDI** and **facilitate integration** with the global economy
- Use cluster initiatives to **engage the private sector** in more effective collaboration with government at the national and regional levels
 - Cluster development is an effective approach to promote **private sector-led growth**
 - Create **Institutions for Collaboration** (e.g., trade associations) to organize cluster participants

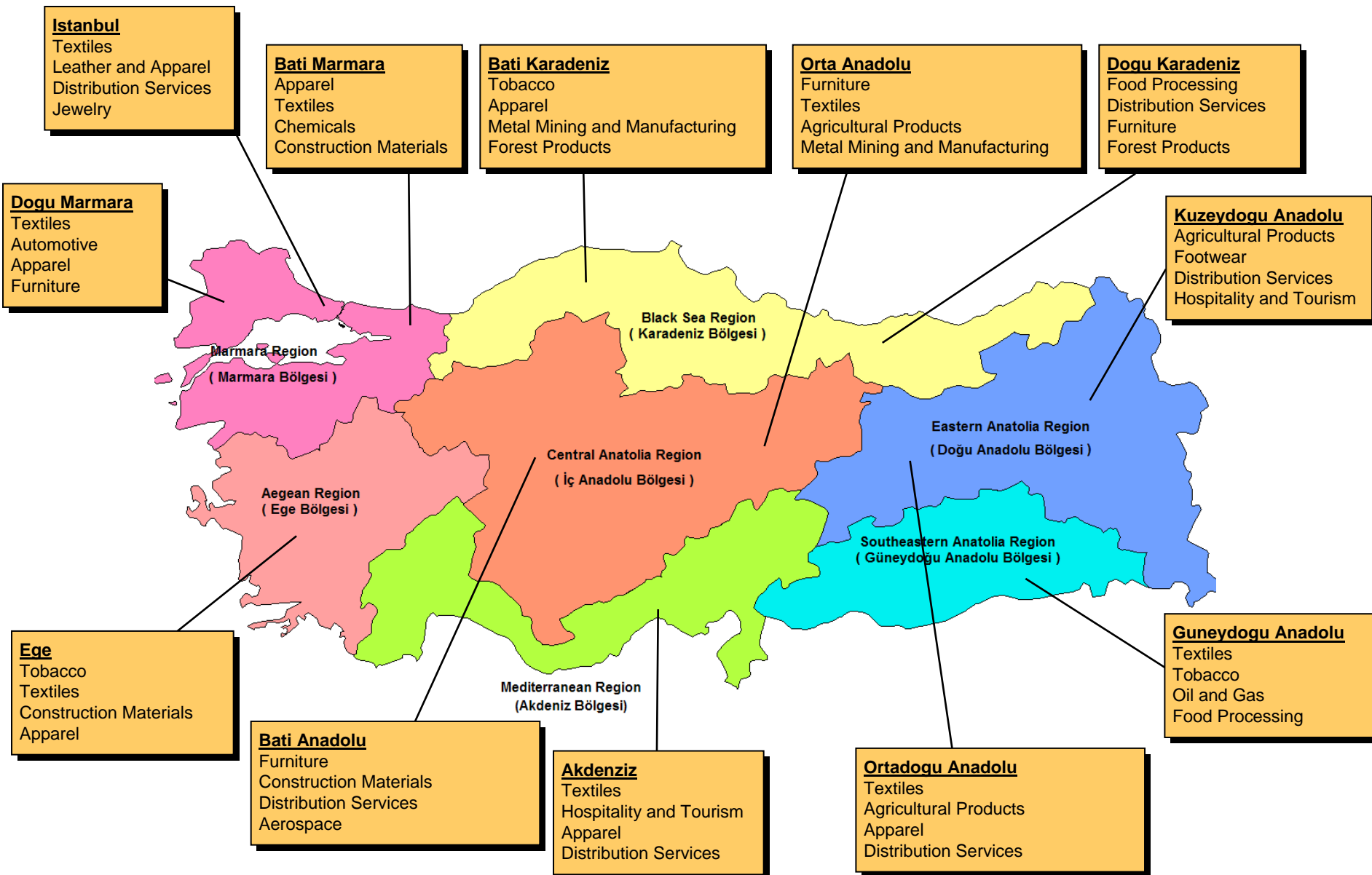
Geographic Influences on Competitiveness



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**
- Region's **specialize** in different sets of clusters

Specialization by Cluster, Turkish Regions 2007



Note: Source: European Cluster Observatory, 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**
- Region's **specialize** in different sets of clusters
- **Cluster strength** directly impacts regional performance
- Each region requires its own distinctive **competitiveness agenda**
- Improving competitiveness requires **effective policy collaboration** between regions and the national government



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

Competitiveness of Peru's Regions

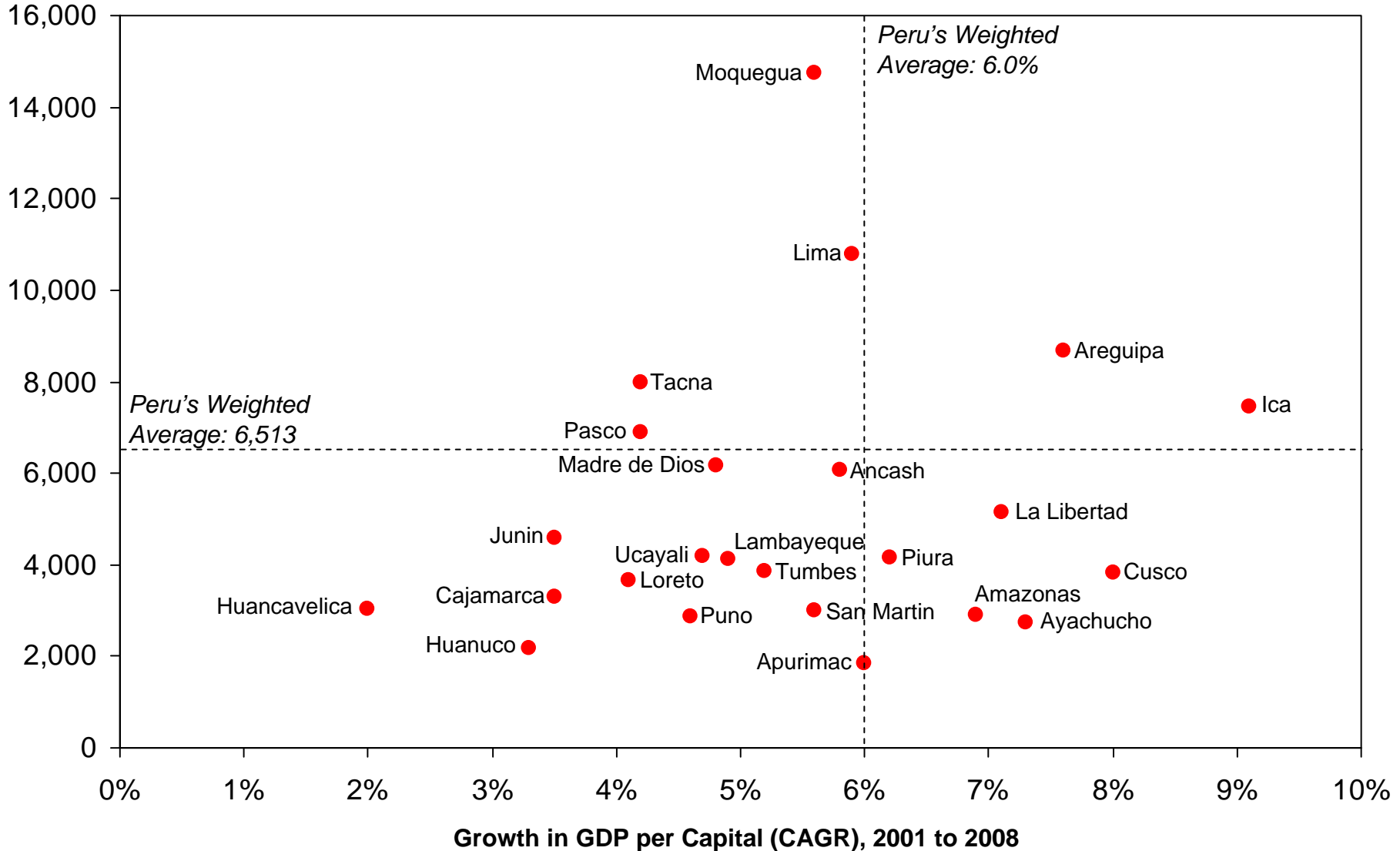
- **Strong disparities** exist across Peruvian regions in business environment, innovative capacity, and economic performance



Prosperity Performance

Peru's Regions

GDP per Capita, 2008 (1994
New Peruvian Soles)



Source: Fuente: Instituto Nacional de Estadística e Informática - Dirección Nacional de Cuentas Nacionales

Competitiveness of Peru's Regions

- **Strong disparities** exist across Peruvian regions in business environment, innovative capacity, and economic performance
- **Decentralization** remains incomplete and has produced some social tension and unrest
- There is weak **planning, design, and implementation capacity** at the local level
- Sub-national governments are **highly dependent on transfers** from the central government

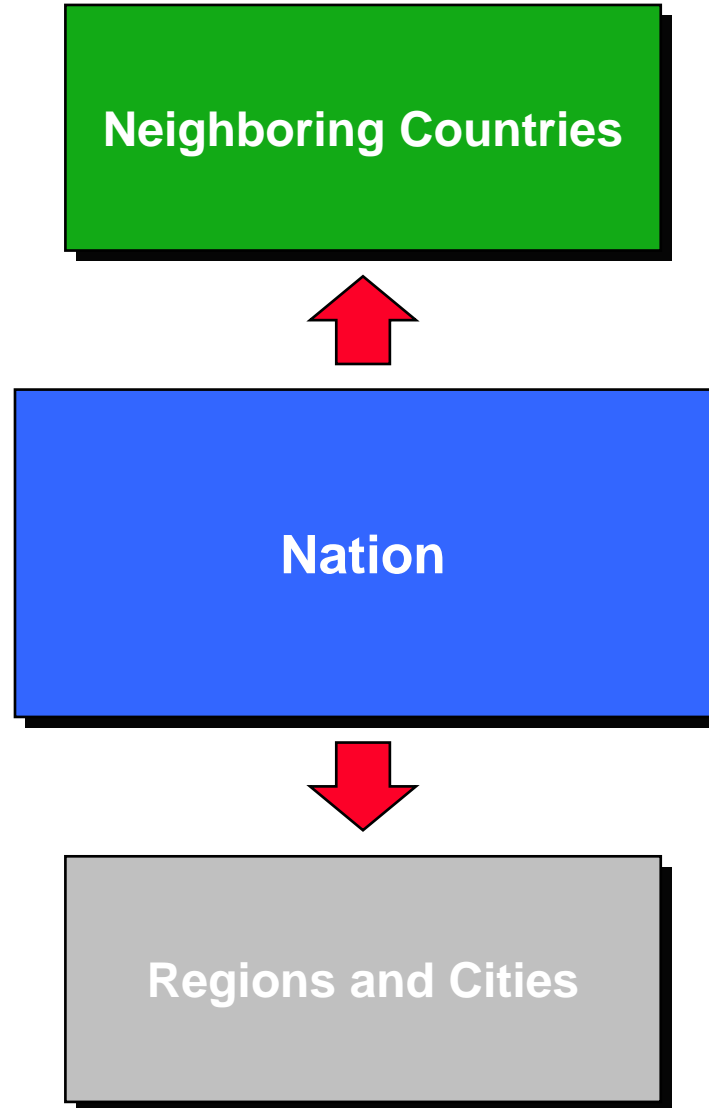


Peru's Regions

Action Priorities

- 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
- Adopt specific steps to reduce **corruption** at the regional level
- Improve **physical connections** among regions to support economic and social integration
- Promote greater **linkages** between resource clusters and regional economies
- Address the underlying causes of **inequality** between the highland, coastal and Amazon regions
 - Strengthen human development in the poorer highland regions

Geographic Influences on Competitiveness



Economic Coordination with Neighboring Countries



Competitiveness and the Neighborhood

- Opening **trade and investment** among neighbors fuels growth and specialization
 - A country's **neighbors** are its most natural trading and investment partners
 - The most natural path for **internationalization** by local firms is the neighborhood
 - Open trade and investment make each country a more attractive location for **foreign investment**
- Economic coordination with neighbors drives **improvements in the business environment**
 - Capturing **synergies** in policy and infrastructure
 - Gaining greater clout in **international negotiations**
- External agreements help **overcome domestic political 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**

Peru and the Neighborhood

Assessment

- Peru remains a relatively **isolated** country for geographic reasons
- Peru has **weak relations** with some of its neighbors
- Peru has taken some **positive steps** to improve relations with some neighbors
- Peru's recent trade liberalization program, including with the U.S. and China, has created significant opportunities for new **economic linkages** with neighbors

Action Agenda

- Economic coordination with neighboring countries is an **important tool** in economic development
- Peru can take a proactive **leadership role** in promoting trade liberalization efforts with particular neighbors and the region
- Peru can be a **platform** for South American firms seeking to access the U.S. and Asian markets
- Leverage inbound and outbound FDI with neighbors **to upgrade local competitiveness**

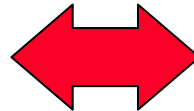
The Need for an Economic Strategy

Policy Improvement

- 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



Economic Strategy

- A prioritized agenda to create a **unique competitive position** for a country or region

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 broader 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

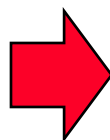
- What are the crucial **weaknesses** and **constraints** that must be addressed to achieve parity with peer countries and allow the country to move to the next level?

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

Toward a Peruvian Economic Strategy

Unique Strengths

- Abundant natural endowments
- Vast biodiversity and ecosystems
- Central location in South America
- Young, hard working population
- Rich culture and history
- Legacy of domestic collaboration to overcome obstacles
- Open to FDI and capital flows
- Privileged access to major foreign markets (United States, China, etc.)



Implications

Upgrade Ground, Air and Port Transportation Infrastructure to Connect Peruvian Regions with Neighbors and the World

Foster Cluster Development Around Resource Strengths

Reduce and Eliminate Corruption

Create New, More Stable Effective Political Institutions

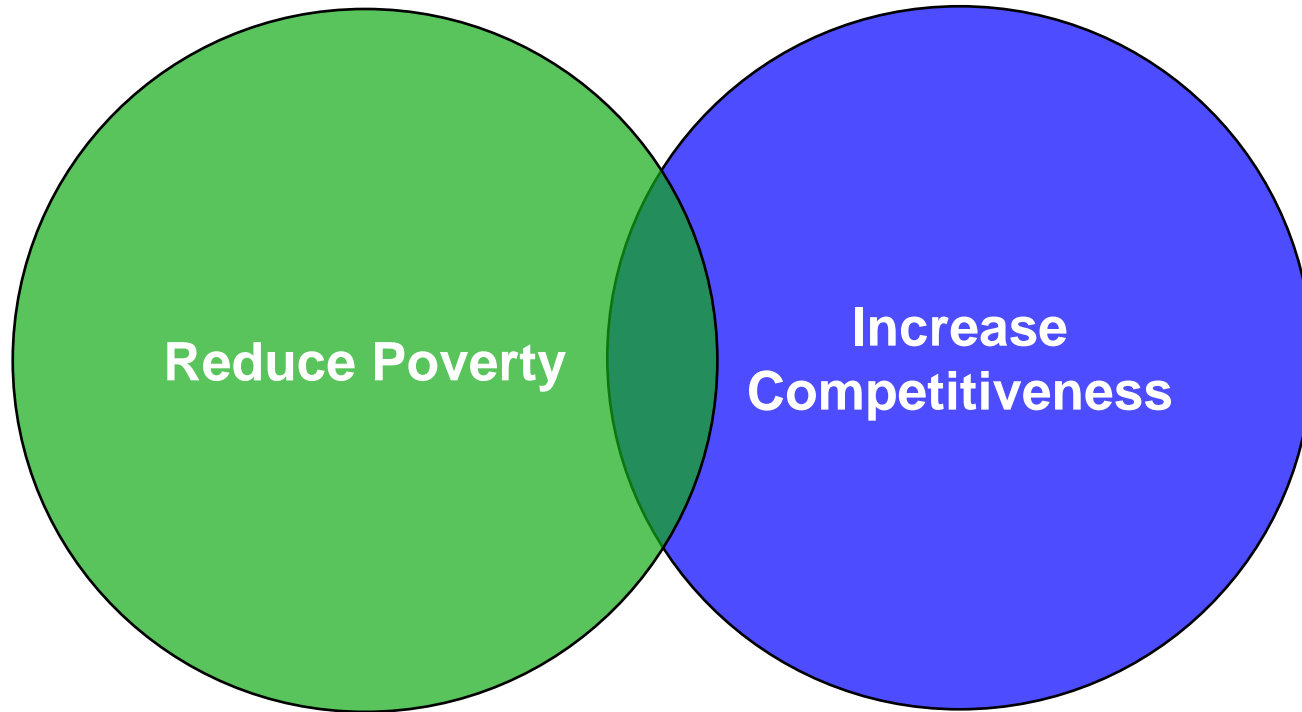
Implement Next Stage Regulatory Reforms to Improve the Business Environment

Improve the Quality of Education and Workforce Training



- Upgrade Peru's competitive assets to achieve high rates of **sustainable economic growth** while improving **welfare** of the poor

Accelerating Poverty Reduction in Peru



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

Organizing for Competitiveness in Peru

Assessment

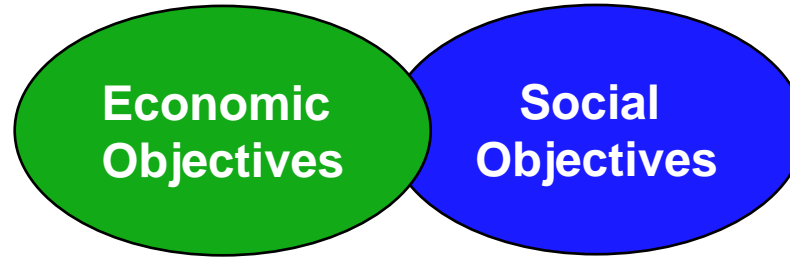
- Peru has **weak coordination** among government ministries and agencies responsible for improving competitiveness
 - Across different ministries to align policies
 - Across geographic levels of government
- The **National Council on Competitiveness** was created in 2002, a positive step, but it has had limited impact
- There are few competitiveness **initiatives** at the regional level to mobilize strategic thinking and drive action
- The **private sector** has limited engagement in competitiveness development

Revitalizing Peru's Organization to Drive Competitiveness

Action Agenda

- Create an **effective coordination** structure within government across ministries and agencies
- Restart the National Council on Competitiveness to build consensus on an overall **economic strategy** and **track implementation**
 - The council will require strong private sector leadership
- Create **Regional Competitiveness Councils** to drive consensus on state plans and monitor implementation
 - Involve representatives from the private, public and academic sectors as well as federal government participation
- The private sector must assume a **catalytic role** in economic strategy formulation and implementation

Integrating Business and the Society

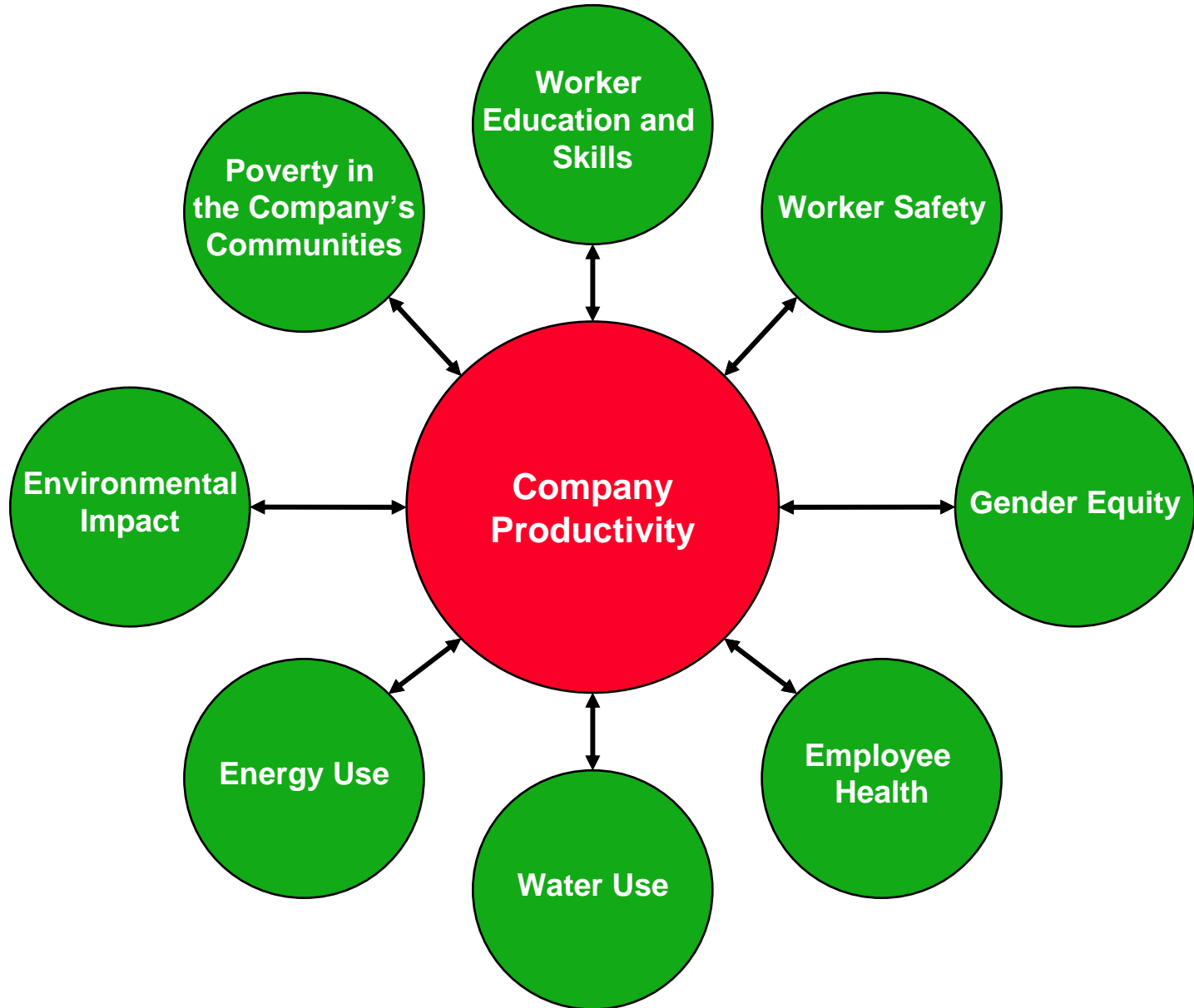


- There is an **inevitable link** between business and society
- A **healthy business** depends on a **healthy community** to create demand for its products and provide a supportive business environment
- A **healthy society** depends on **competitive companies** that can create jobs, support high wages, build wealth, buy local goods, and pay taxes



- There is a long-term **synergy** between economic and social objectives

Competitiveness and Social Issues



Corporate Role in Competitiveness

The Concept of Shared Value

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



- Find the **points of convergence** between economic and social objectives, not assumed tradeoffs or the need for redistribution
 - These points of convergence are **growing**
- Achieving shared value requires **new thinking, new technologies, and new approaches to management**
- Shared value opportunities are **even greater** in developing countries
- Shared value thinking applies equally to **NGOs** and **governments**

Corporate Role in Competitiveness

Action Agenda

- **Organize** the private sector to have a collective voice in competitiveness
- **Participate actively** in national and regional competitiveness initiatives
- 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
- Focus **corporate social responsibility initiatives** on enhancing the business environment