



University of Navarra

Anselmo Rubiralta Center for Globalization and Strategy

Notes on Globalization and Strategy

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Welcome

You are reading the very first issue of the Notes on Globalization and Strategy Newsletter. It was created in order to offer readers information about the important phenomenon of globalization and its enormous repercussions on business.

Every four months, the Notes on Globalization and Strategy Newsletter will provide an in-depth analysis of the challenges and realities raised by the globalization process.

This first issue is devoted to competitiveness. The concern shown by individual countries about the competitiveness of their domestic economies is just one more symptom of the globalization process.

We are currently pursuing five separate lines of research at the Anselmo Rubiralta Center for Globalization and Strategy: strategic alliances, global strategy, innovation, sustainable development and competitiveness. It has always been one of our aims to communicate the work being done by IESE in this field. The other main aim of this newsletter is to provide an in-depth analysis of the challenges and realities raised by the globalization process from a strategic point of view, as well as identifying new ways of studying the process.

The Notes on Globalization and Strategy Newsletter will tackle issues such as competitiveness, the repatriation of business executives, financing instruments and transnational strategic alliances. This will be followed by an analysis of some of the associated research, and the newsletter will close with an opinion piece by one of IESE's professors, which will look at the developments observed and make recommendations.

This first issue is devoted to competitiveness, a controversial subject that is arousing great interest, both in political circles and in the media. But

what is competitiveness? Have governments really understood what it consists of? We asked Michael Porter, a professor at Harvard University and an authority on the subject, to share his concerns with us. Porter warns of the misunderstandings surrounding competitiveness and its importance in a microeconomic context. His article serves as a framework for the conclusions of the Global Competitiveness Report 2004-2005, from which we go on to assess the implications for Spain. IESE collaborates with the World Economic Forum in the preparation of this prestigious annual report through the Anselmo Rubiralta Center and the Nissan Chair on Corporate Strategy and International Competitiveness.

This issue closes with an interesting article by Eduard Ballarín, Professor of General Management at IESE, who offers his thoughts and suggestions on some measures that governments should take in order to improve their competitiveness.

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By Michael Porter

Michael Porter, Harvard University professor and director of the Center for Competitiveness

What Is Competitiveness?

Competitiveness has become a central preoccupation of both advanced and developing countries in an increasingly open and integrated world economy. Despite its acknowledged importance, the concept of competitiveness is often misunderstood.

Competitiveness is defined by the productivity with which a nation utilizes its human, capital and natural resources. To understand competitiveness, the starting point must be a nation's underlying sources of prosperity. A country's standard of living is determined by the productivity of its economy, which is measured by the value of goods and services produced per unit of its resources. Productivity depends both on the value of a nation's products and services – measured by the prices they can command in open markets – and by the efficiency with which they can be produced. Productivity is also dependent on the ability of an economy to mobilize its available human resources.

True competitiveness, then, is measured by productivity. Productivity allows a nation to support high wages, attractive returns to capital, a strong currency – and with them, a high standard of living. What matters most is not exports per se or whether firms are domestic or foreign-owned, but the nature and productivity of the business activities taking place in a particular country. Purely local industries also count for competitiveness, because their productivity not only sets their wages but also has a major influence on the cost of doing business and the cost of living in the country.

What Matters for Competitiveness

Almost everything matters for competitiveness. The schools matter, the roads matter, the financial markets matter and customer sophistication matters. These and other aspects of a nation's circumstances are deeply rooted in a nation's institutions, people and culture. This makes improving competitiveness a special challenge, because there is no single policy or grand step that can create competitiveness, only many improvements in individual areas that inevitably take time to accomplish. Improving competitiveness is a marathon, not a sprint. How to sustain momentum in improving competitiveness over time is among the greatest challenges facing countries.

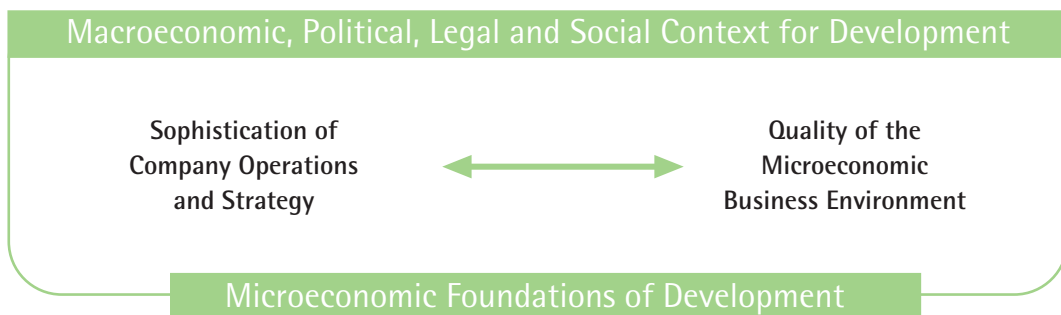
Creating Wealth at the Microeconomic Level

The cornerstones for economic development have long been considered stable institutions, sound macroeconomic policies, market opening and privatization. Most discussion of competitiveness and economic development is still focused on these areas. It is well understood that sound fiscal and monetary policies, a trusted and

Productivity allows a nation to support high wages, attractive returns to capital, a strong currency – and with them, a high standard of living.

Unless microeconomic capabilities improve, macroeconomic, political, legal, and social reforms will not bear full fruit.

Determinants of Productivity and Productivity Growth



Source: Michael Porter, Global Competitiveness Report 2004-2005.

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efficient legal system, a stable set of democratic institutions, and progress on social conditions contribute greatly to a healthy economy.

I have found that these factors are necessary for economic development, but far from sufficient. These broader conditions provide the opportunity to create wealth but do not themselves create wealth. Wealth is actually created in the microeconomic level of the economy. Wealth can only be created by firms. The capacity for wealth creation is rooted in the sophistication of the operating practices and strategies of companies, as well as in the quality of the microeconomic business environment in which a nation's companies compete. More than 80 percent of the variation of GDP per capita across countries is accounted for by microeconomic fundamentals. Unless microeconomic capabilities improve, macroeconomic, political, legal, and social reforms will not bear full fruit.

A Flawed View of Competitiveness

Worldwide, the most intuitive definition of competitiveness is a country's share of world markets for its products. This definition makes competitiveness a zero-sum game, because one country's gain comes at the expense of others. This view of competitiveness is used to justify intervention to skew market outcomes in a nation's favor (so-called industrial policy). It also underpins policies intended to provide subsidies, hold down local wages and devalue the nation's currency, all aimed at expanding exports. In fact, it is still often said that lower wages or devaluation "make a nation more competitive." Business leaders are drawn to the market-share view because these policies seem to address their immediate competitive concerns.

Unfortunately, this intuitive view of competitiveness is deeply flawed, and acting on it works against national economic progress. The need for low wages reveals a lack of competitiveness, and holds down prosperity. Subsidies drain national income and bias choices away from the most productive use of the nation's resources. Devaluation results in a collective national pay cut by discounting the products and services sold in world markets while raising the cost of the goods and services purchased from abroad.

Exports based on low wages or a cheap currency, then, do not support an attractive standard of living.

The world economy is not a zero-sum game. Many nations can improve their prosperity if they can improve their productivity. There are unlimited human needs to be met if productivity drives down the cost of products and productive work supports higher wages. Thus, the central challenge in economic development is how to create the conditions for rapid and sustained productivity growth. Microeconomic competitiveness should be the central item on the economic policy agenda of every nation.

The world economy is not a zero-sum game. Many nations can improve their prosperity if they can improve their productivity.

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The Race for Competitiveness

Once again, the Global Competitiveness Report has put the countries of the world in their place. Why are some more competitive than others? Here we examine the successes on the world stage.

Every year since 1979, the World Economic Forum (WEF) has published its prestigious Global Competitiveness Report, an exhaustive comparative analysis of the strengths and weaknesses of the world's economies. As well as measuring developments in competitiveness, the Report identifies key factors relating to economic development and the establishment of a favorable business environment.

Top of the Class

In the WEF's 2004-2005 Report, which provides information on 104 developed and emerging economies, **Finland** heads the Growth Index for the third year running. Why is **Finland** still the most competitive economy in the world? Effective macroeconomic management and the outstanding quality of its public institutions are two important reasons. This Scandinavian country shows extremely low levels of corruption and scores highly in areas such as respect for contractual agreements and the law. In addition, its microeconomic environment is so developed that **Finland's** position in the Business Competitiveness Index (second only to the **U.S.**) is higher than it ought to be for its per capita GDP. This can be put down to the country's private sector, which has shown itself to be highly willing to adopt to new technologies, assuming a leading role in the creation of a culture of innovation.

The **U.S.** holds second place, unchanged from last year. The country is at the forefront of the technological revolution, thanks to the penetration of the Internet, the rich creativity of its scientific community and the heavy investment by **U.S.** companies in R&D. However, its technological supremacy is partially offset by a weaker performance in the quality of its public institutions and the stability of its macroeconomic environment. Nevertheless, the **U.S.** heads the Business Competitiveness Index, helped by the ready availability of venture capital, the intense competitiveness of its local businesses and the number and quality of available suppliers.

Along with **Finland**, the other Scandinavian countries all numbered among the top 10 most competitive economies in 2004, with **Sweden** in third place, **Denmark** in fifth, **Norway** in sixth and **Iceland** at number 10. Of these, **Norway** has shown the greatest improvement, moving up three places from ninth to sixth as the result of improvements in its public institutions, particularly in the area of respect for contractual agreements and the law.

Japan has broken into the top 10, rising from 21st position in 2001 to ninth this year 2004. Its position reflects a combination of factors, including a strong ongoing economic recovery process that has rekindled business confidence, and notable improvements in indicators measuring the transparency of public institutions. The increased sophistication of its financial markets and improvements in the quality of the country's administrative services have also had an effect.

Achievements and Setbacks

The big players in the European economy, **France**, **Germany**, the **United Kingdom** and **Italy**, returned widely varying results. While the **United Kingdom** has seen a significant improvement in its relative position (moving up four places to number eleven), **France** and **Germany** show a strong imbalance between their respective growth (**Germany** in 13th place, **France** in 27th) and business competitiveness indices (**Germany** 3rd, **France** 12th). On a business level, **Germany** scores top marks in operational and strategic sophistication, and its technology mark is high, meaning that the worsening of the country's macroeconomic stability (public deficit, level of savings, expectations of recession, access to credit, effective rate of exchange) has had an effect. **France** is in a similar position, though its results are worsened by its insufficient advances in the area of technology.

Finland continues to be the most competitive economy, thanks to its macroeconomic management, the quality of its public institutions and the development of its business environment.

In the U.S., businesses benefit from intense competition, the latest technology and greater access to venture capital.

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For its part, **Italy** seems incapable of slowing its steady decline (falling from 26th place in 2001 to 47th this year). The country holds the lowest position of the EU-15 nations and scored even lower than some of the countries that recently joined the organization. Its worsening situation is evident in all areas, particularly in the quality of its public institutions (e.g. the independence of the courts, favoritism in public sector decision-making and the economic cost of crime). By contrast, **Estonia** achieved an outstanding position (20), and has shown itself to be by far the most competitive of the 10 countries that joined the EU in May 2004.

In spite of its current leading role in the world economy, **China** (46) has not registered any great

change from the previous year (44), continuing to show mixed results. A stable macro-economic environment, which reflects the strength of its economic activity and an absence of imbalances, is countered by institutional weaknesses in areas such as the strength of the banking sector, administrative controls and bureaucracy, along with poor accounting and auditing standards.

In the rest of Asia, **Taiwan** (4) and **Singapore** (7) continue to lead the region with their complementary strengths. **Taiwan** gained an unusually high ranking in the area of technology (in 2nd place behind the **U.S.**), while **Singapore** holds the top place in terms of the quality of its macro-economic environment, a position it has held for several years.

In general, Europe scored well, particularly the countries of Scandinavia. Within the EU, France and Germany suffered as a result of macroeconomic shortfalls.

Two Indexes, One Diagnosis

The report sets out two complementary indexes in order to analyze the level of competitiveness in each country: the Growth Competitiveness Index (GCI) and the Business Competitiveness Index (BCI).

1. The Growth Competitiveness Index (GCI) analyzes the potential shown by world economies to achieve sustainable growth in the medium and long term. The index is based on three fundamental components: the macro-economic environment, the quality of public institutions and technology.

2. The Business Competitiveness Index (BCI) attempts to identify the factors that will facilitate high productivity. It reflects the microeconomic bases, with one sub-index focusing on business sophistication and another on the quality of the business environment.

Growth Competitiveness Index

1. Finland _____
2. USA _____
3. Sweden _____
4. Taiwan _____
5. Denmark _____
6. Norway _____
7. Singapore _____
8. Switzerland _____
9. Japan _____
10. Iceland _____
11. United Kingdom _____
12. Netherlands _____
13. Germany _____
14. Australia _____
15. Canada _____
16. United Arab Emirates _____
17. Austria _____
18. New Zealand _____
19. Israel _____
20. Estonia _____
21. Hong Kong _____
22. Chile _____
23. Spain _____
24. Portugal _____
25. Belgium _____
26. Luxembourg _____
27. France _____
28. Bahrain _____
29. South Korea _____
30. Ireland _____

Business Competitiveness Index

1. USA _____
2. Finland _____
3. Germany _____
4. Sweden _____
5. Switzerland _____
6. United Kingdom _____
7. Denmark _____
8. Japan _____
9. Netherlands _____
10. Singapore _____
11. Hong Kong _____
12. France _____
13. Australia _____
14. Belgium _____
15. Canada _____
16. Austria _____
17. Taiwan _____
18. New Zealand _____
19. Iceland _____
20. Norway _____
21. Israel _____
22. Ireland _____
23. Malaysia _____
24. South Korea _____
25. South Africa _____
26. Spain _____
27. Estonia _____
28. United Arab Emirates _____
29. Chile _____
30. India _____



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The Case of Spain

In the Growth Index, **Spain** displays a number of competitive disadvantages in the areas of both technology and public institutions.

Strong macroeconomic results and technological improvements offset the falling quality of public institutions.

In respect of technology, **Spain** scores well. However, it now needs to move from using foreign technology to actually creating its own.

Although **Spain** held its position at number 23 in the Growth Index, it is still behind some of its main European rivals and also scores worse than supposedly less developed countries such as **Singapore** and **Chile**. The absence of any significant change in comparison with last year is due to some strong macro-economic results and an improvement in its technology index, which together have countered the decline in the quality of its public institutions.

Given that **Spain** has remained in 23rd position, and bearing in mind that this is also the place it holds in the world rankings for GDP per capita, the result can be seen as positive. However, though it is true that Spain retains certain important competitive advantages in respect to the macroeconomic environment and a highly positive position in this regard (16), the quality of the country's public institutions (34) leaves much to be desired, having fallen three places from last year. Issues such as the independence of the judiciary, irregular payments and the protection of property rights have placed Spain among the lowest-placed European countries and behind countries like **Ghana**, **Botswana** and **Morocco**.

The Innovation Factor

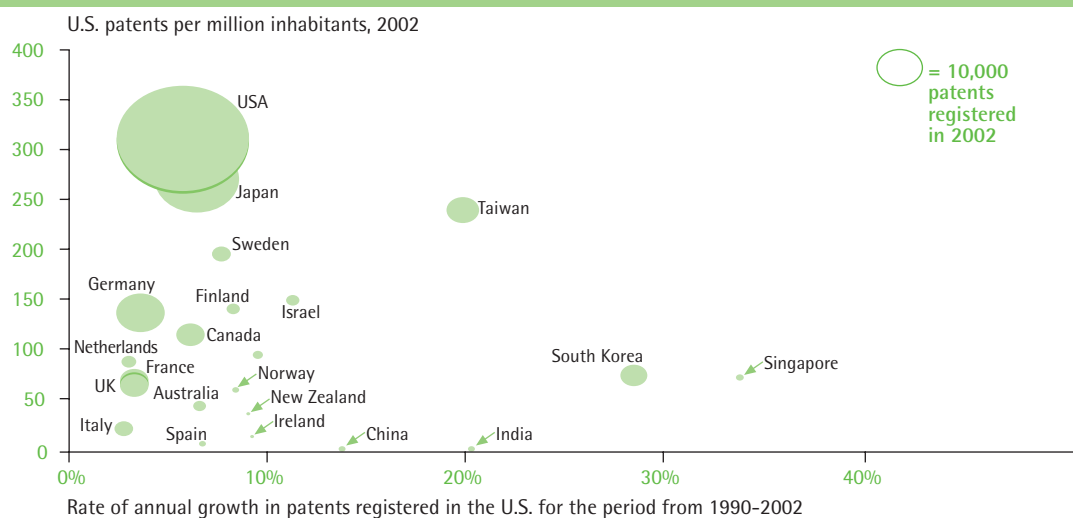
As far as technology is concerned, **Spain** scored well (20), though this observation should be qualified. Firstly, the WEF report uses different formulae for measuring the technological competitiveness of the various economies, depending on whether or not they belong to the group of innovative countries. This group includes the 25 economies with the highest number of **U.S.** registered patents, and distinguishes between countries whose growth depends on their capacity for innovation and those that depend on the adoption of foreign technology, as is the case in **Spain**. In this second group, the formula applied gives much less weight to innovation and the use of Information and Communications Technologies (ICT), while including technology transfers, which basically consists of using investment and foreign licenses as a basis for acquiring new technology. It is clear that, when assessed in this way, **Spain** obtains a high ranking, though the country must then be capable of moving up to the next level and becoming a technology creator.

Secondly, the areas in which **Spain** shows significant competitive disadvantages, which are basi-

Internationals Patents

Patents

The number of registered U.S. patents is a good indicator of a country's capacity for innovation. Spain is at the bottom of the pile of developed countries in this field, and developments over recent years indicate that it will find it difficult to move into the top division.



Source: U.S. Patent and Trademark Office (www.uspto.gov). Michael Porter analysis, 2004.

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Both Sides of the Coin					
Competitive Advantages		Competitive Disadvantages			
	Spain*		Spain*	Spain*	
Macroeconomic Environment (1) -----	16	Macroeconomic Environment (1) -----	16	Public Institutions (1) -----	34
Interest Rate Differential-----	2	Real Interest Rate-----	88	Judicial Independence-----	50
Credit Rating-----	16	Access to Financing-----	50	Irregular Payments-----	39
Government Deficit/Surplus-----	17	Inflation-----	50	Property Rights-----	38
Technology (1) -----	20	Expectations of Recession-----	49	Organized Crime-----	38
Mobile Telephones-----	8	Savings-----	39	Favoritism in Government Decisions-----	36
Higher Education-----	14	Technology (1) -----	20	Sophistication of Operations and Strategy (2) -----	25
Sophistication of Operations and Strategy (2) -----	25	Government Support for ICTs-----	69	Regional Sales-----	43
Variable Salary Payments-----	18	Incorporation of Technology in Business-----	52	Delegation of Authority-----	40
International Distribution-----	18	Competitive Quality in the ISP Sector-----	46	Investment in R&D-----	39
Presence of the Value Chain-----	21	Business Investment in R&D-----	41	Quality of the Microeconomic Business Environment (2) -----	25
Quality of the Microeconomic Business Environment (2) -----	27	Laws Relating to ICTs-----	39	Reliability of Policing Services-----	77
Centralization of Economic Policy-----	4	Access to Internet in Schools-----	38	Bureaucracy for Start-ups-----	61
Mobile Telephones-----	7	Internet Users-----	36	Company-employee Cooperation-----	52
Quality of Business Schools-----	8				

*Spain's position in the world ranking

(1): GCI: Growth index

(2): Business Competitiveness index

Source: Global Competitiveness Report 2004-2005.

cally those that relate to ICT, have a direct influence on the way the business community functions. As a result, the creation of new technologies and higher levels of investment in research and development are key to obtaining higher levels of productivity.

Weak Business Environment

Spain's position in the Business Competitiveness Index is lower than the level achieved in respect of GDP per capita. This places the country among the group of "over-achievers," those nations whose economic results are better than they should be according to the competitiveness index. The special case of another over-achiever, **Norway**, offers a better understanding of this contradiction. This is a country with very high levels of per capita income but a rather lower competitiveness score. Why should this be? **Norway** has abundant oil reserves, but its companies lack the dynamism and ability shown by those of **Finland** and **Japan**, where an absence of natural resources has forced them to "get their act together" and look to continuous innovation as a way of attaining an increasingly improved standard of living.

More Disadvantages than Advantages

The Business Competitiveness Index reveals the weak points that prevent productivity levels in

Spain from reaching a par with those of its main European partners. As the attached tables show, **Spain's** main competitive advantages can be found in its businesses, though this is also where its main disadvantages lie. The country enjoys significant competitive advantages in areas such as interest rate differentials, mobile telephone penetration, the strength of the banking system and the quality of its business schools.

That being said, when it comes to doing business in **Spain**, regulation and employment practices, access to financing, the state promotion of Information and Communications Technologies (ICT) and bureaucracy represent real obstacles for business. It is imperative that governments create a business environment that operates in optimum conditions of competition and efficiency. This allows companies to take advantage of their full production potential. For their part, the companies themselves display worrying weaknesses, such as insufficient sophistication in the areas of operations and strategy, particularly in respect of R&D. To counteract this, businesses must place greater emphasis on investment.

Spain's economic results are better than they should be according to its level of microeconomic competitiveness. This must be reversed in order to ensure a platform that will allow higher levels of GDP per capita and sustainable growth.

The greatest obstacles to business are regulation and employment practices, access to financing and bureaucracy.


 By **Eduard Ballarín**,

*Professor of General Management,
IESE Business School*

Competing in Order to Grow

Countries are discussing ways of improving the competitiveness of their economies. How should their efforts be directed? The solution lies in designing effective policies for sustainable development.

Properly managed, an increase in competitiveness guarantees the sustained growth of an economy. A country will sell more, increase its dynamism and thus create more wealth in the long term. As a consequence, any economic measures that governments decide to adopt in order to improve their competitiveness should be directed towards this goal of sustainability. In short, they should concentrate on three key factors: the macroeconomic indicators, the industrial environment and innovation.

We can find an example of effective macroeconomic policy within the euro zone, where the Stability Pact and price controls have had a clearly positive effect. Nevertheless, the fiscal deficits of **France** and **Germany** and inflation in countries such as **Spain** are worrying, since they make the zone less attractive for foreign investment and lead to a loss of competitiveness with other countries. If they want to correct these shortcomings, European governments must convince themselves of the need to maintain tight fiscal policies, moderating wage costs and stimulating competition through more a decisive drive towards liberalization. Combating unemployment is also important for economic growth, but doing so to the detriment of

productivity would be a mistake, since the creation of employment is a formula that ceases to have any meaning once its objectives have been attained. In the long term, by contrast, improving productivity is more beneficial as a result of its sustainability. Consider the case of the **U.S.** It has the second most competitive economy in the world and the country is approaching full employment. By comparison, the majority of EU countries show worse results for both indicators.

Companies are Also Important

We should not forget that companies form the basis of the economy and are direct creators of wealth. An improvement in the macroeconomic environment will be merely "cosmetic," or superficial, if it is not accompanied by the proper industrial policy. In this sense, the move to introduce new sectors at any cost, while ambitious, is also risky. Why not start with industries that are already consolidated? It's a question of identifying related sectors and encouraging corporate groupings or regional clusters. These combine the efforts of both government and industry and create a more favorable competitive environment, as demonstrated by the Oulu technological park in **Finland**, the

biotechnology sector in Strängnäs, **Sweden** and the chemical industry cluster in the Ruhr Basin in **Germany**.

Innovation is another factor that leads to greater competitiveness, given that it can offer cost reductions and improvements in output. This factor is closely linked with education and the continuous training of the work force, without which any company investment would be rendered meaningless. Governments have a two-fold responsibility in this area: offering incentives for R&D projects and making more effort to direct the education system towards new technologies. This is what **Ireland** did during the 1990s. The country immersed itself in the information technologies sector and the training of its work force, a strategy that was underpinned by a fiscal regime that favored investment. The result? A number of foreign technology companies moved there, even taking their decision-making departments with them.

In short, governments can do much for both competitiveness and economic growth. Their most effective tools are policies based on budgetary equilibrium, support for the most competitive industrial sectors and encouragement for innovation.

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