

# Competitiveness for the Third Millennium: Implications for Croatia

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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](http://www.isc.hbs.edu). Version: May 13, 2pm

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# The Croatian Economy in 2009

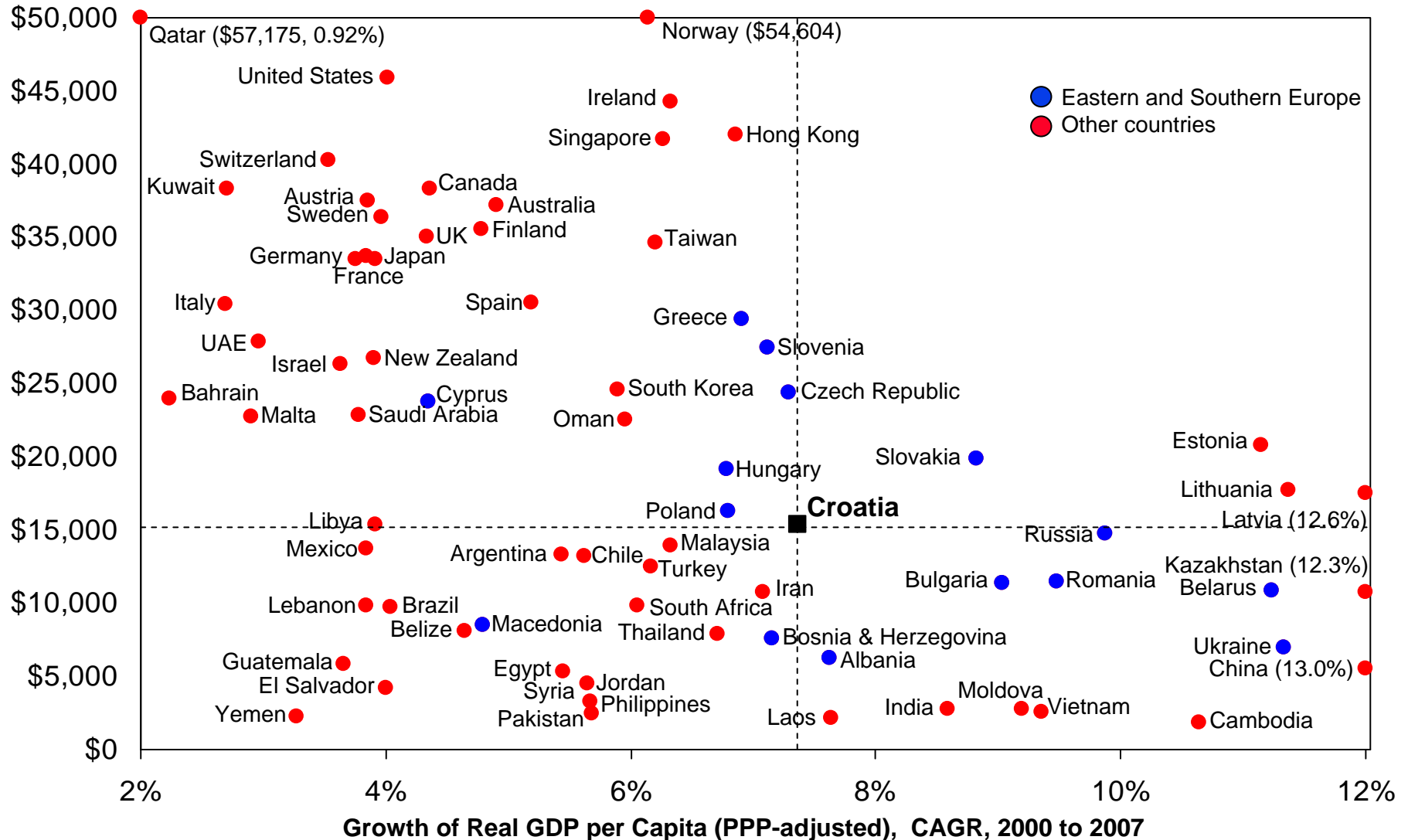
- Croatia has experienced **solid growth rates** over the last few years
- The **global economic** crisis is now starting to take its toll



- Despite the recent period of growth, Croatia is facing **serious competitiveness challenges**
- Croatia needs to **address these issues aggressively** instead of hoping for an automatic return to growth after the crisis
- Croatia **lacks a clear strategy** and the effective use of **public-private organizational structures** to improve competitiveness

# Prosperity Performance Selected Countries

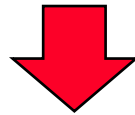
PPP-adjusted GDP per  
Capita, 2007 (\$USD)



Note: highlighted countries are part of the East African Community (EAC). Source: EIU (2009), authors calculations

# 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

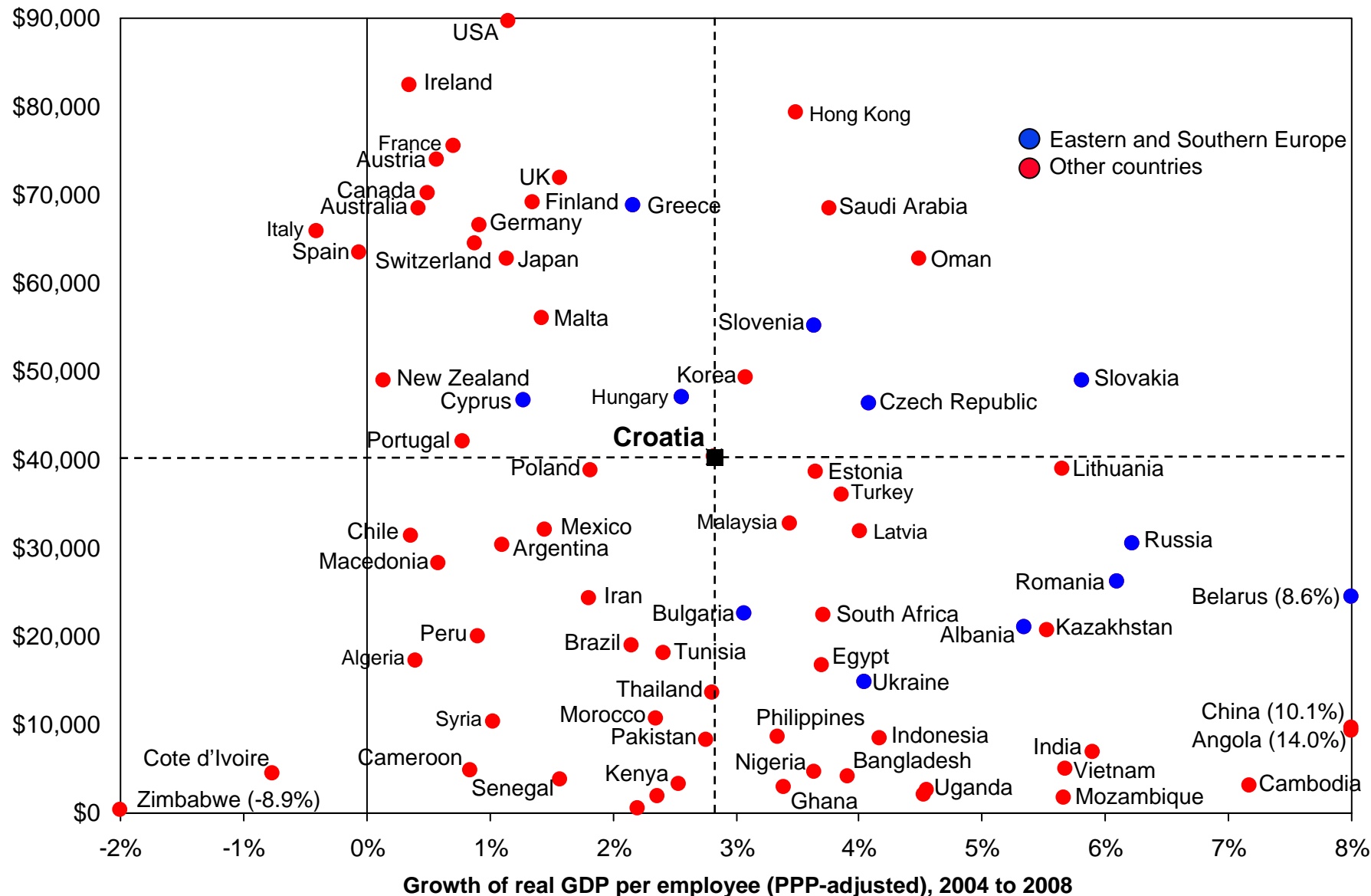


- Nations compete to offer the **most productive environment for business**
- The public and private sectors play **different but interrelated roles** in creating a productive economy

# Comparative Labor Productivity

## Selected Countries

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

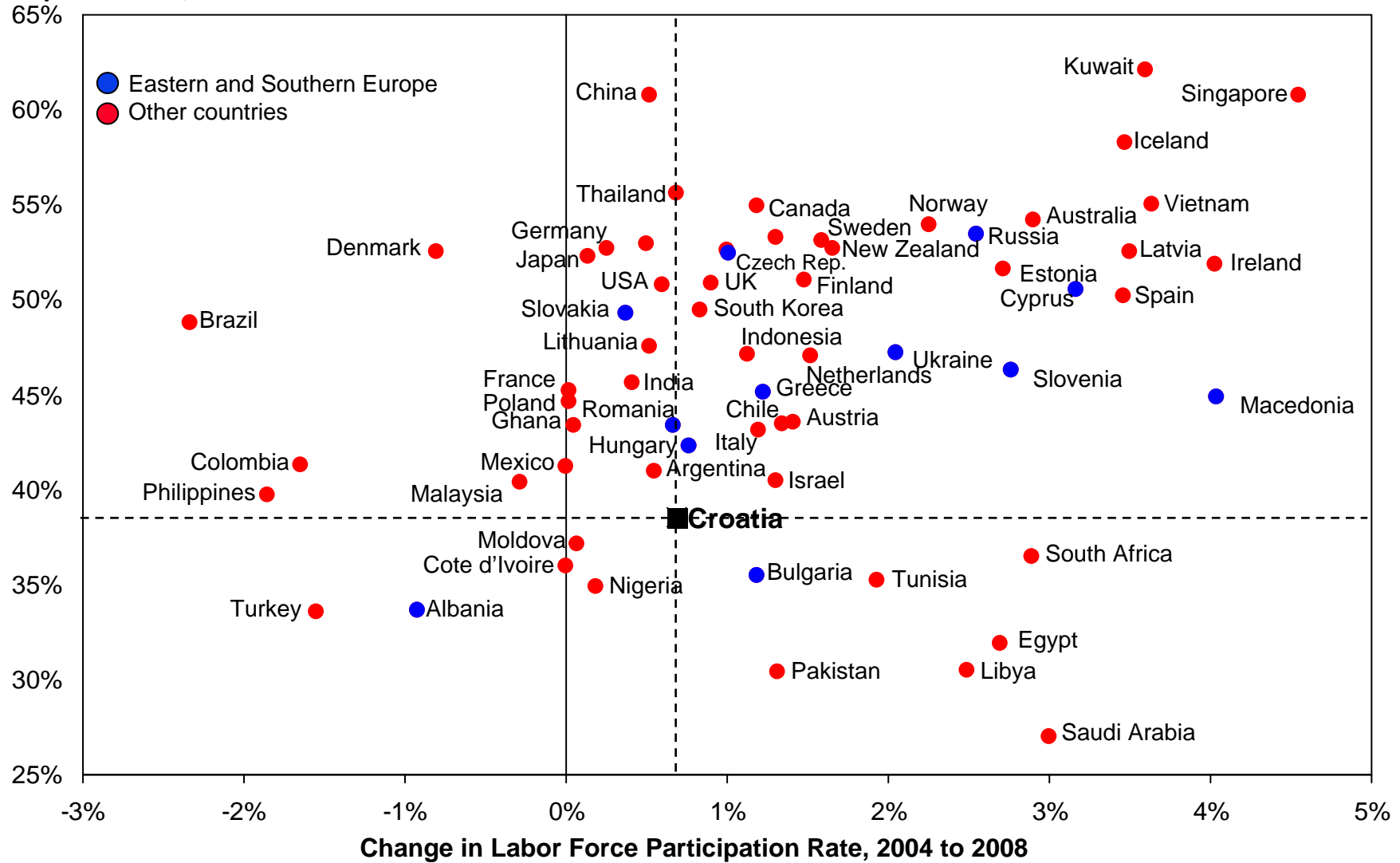


Source: authors calculation Groningen Growth and Development Centre (2009), EIU (2009)  
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# Labor Force Utilization

## Participation Rates, Selected Countries

Labor Force Participation Rate, 2008



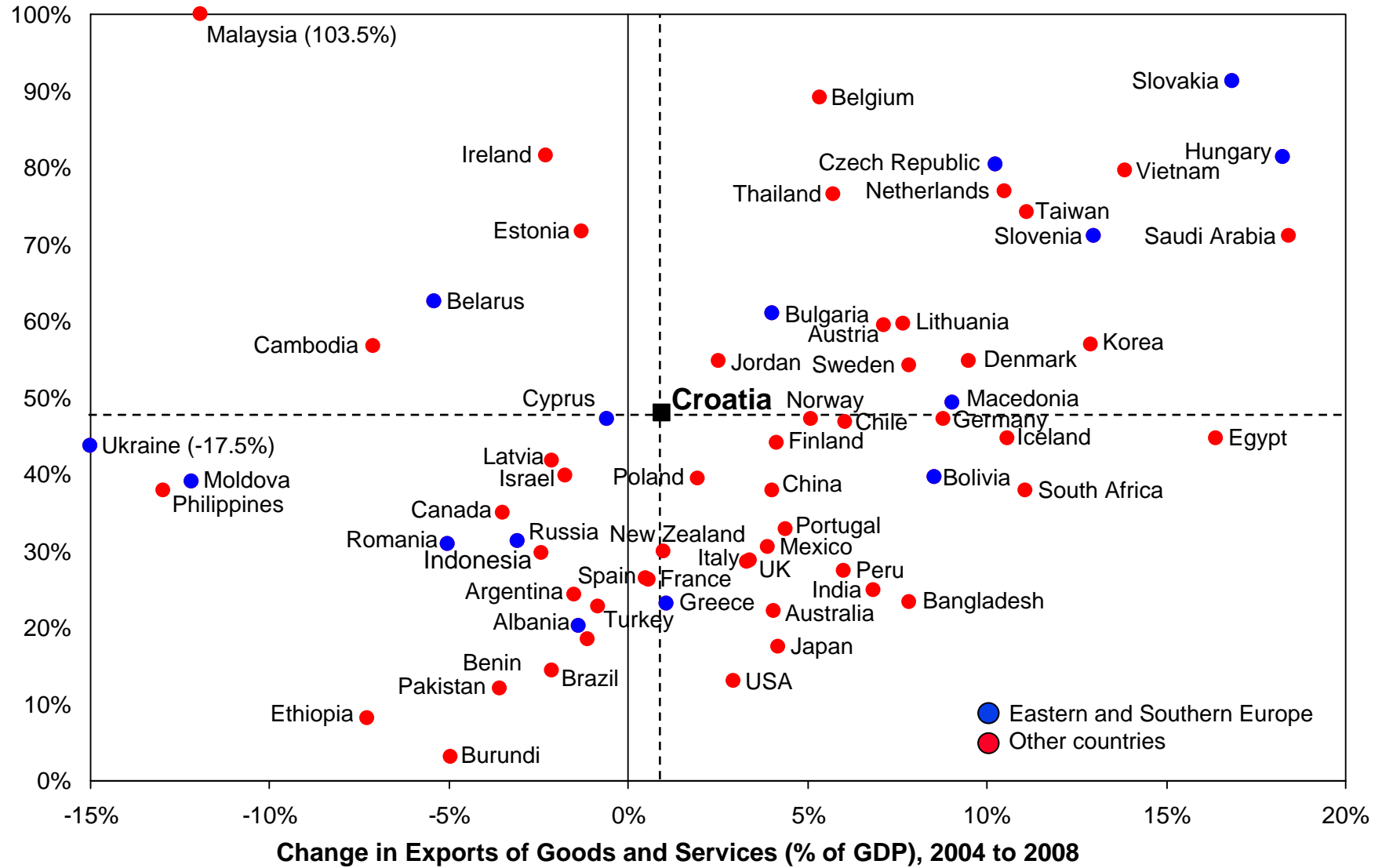
- With many of its less productive citizens outside of the active labor force, Croatian labor productivity is **overstated** versus peers

Source: Economist Intelligence Unit (2009)

# Export Performance

## Selected Countries

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

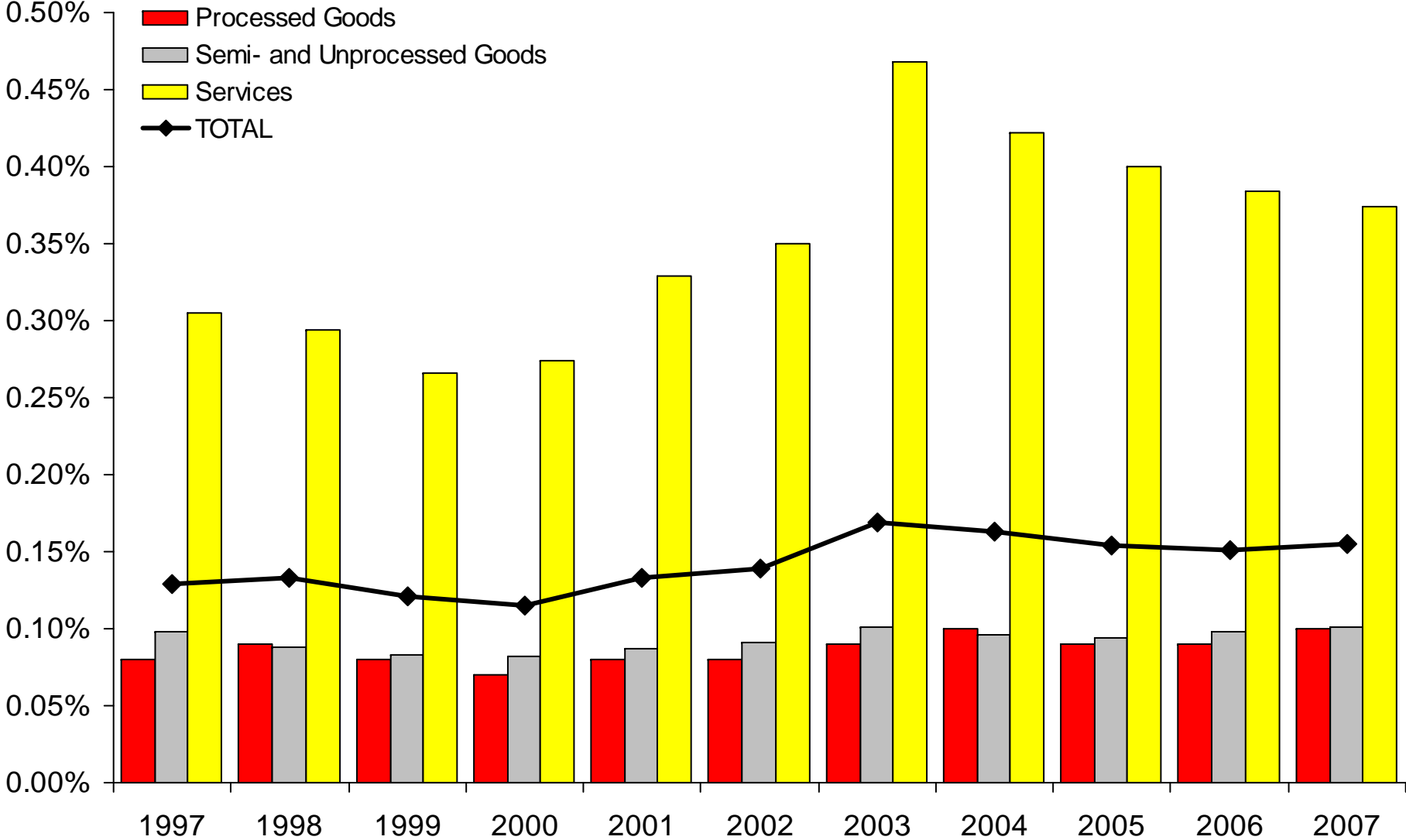


Source: EIU (2008), authors' analysis

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# Croatia's Exports By Type of Industry

World Export Market Share (current USD)

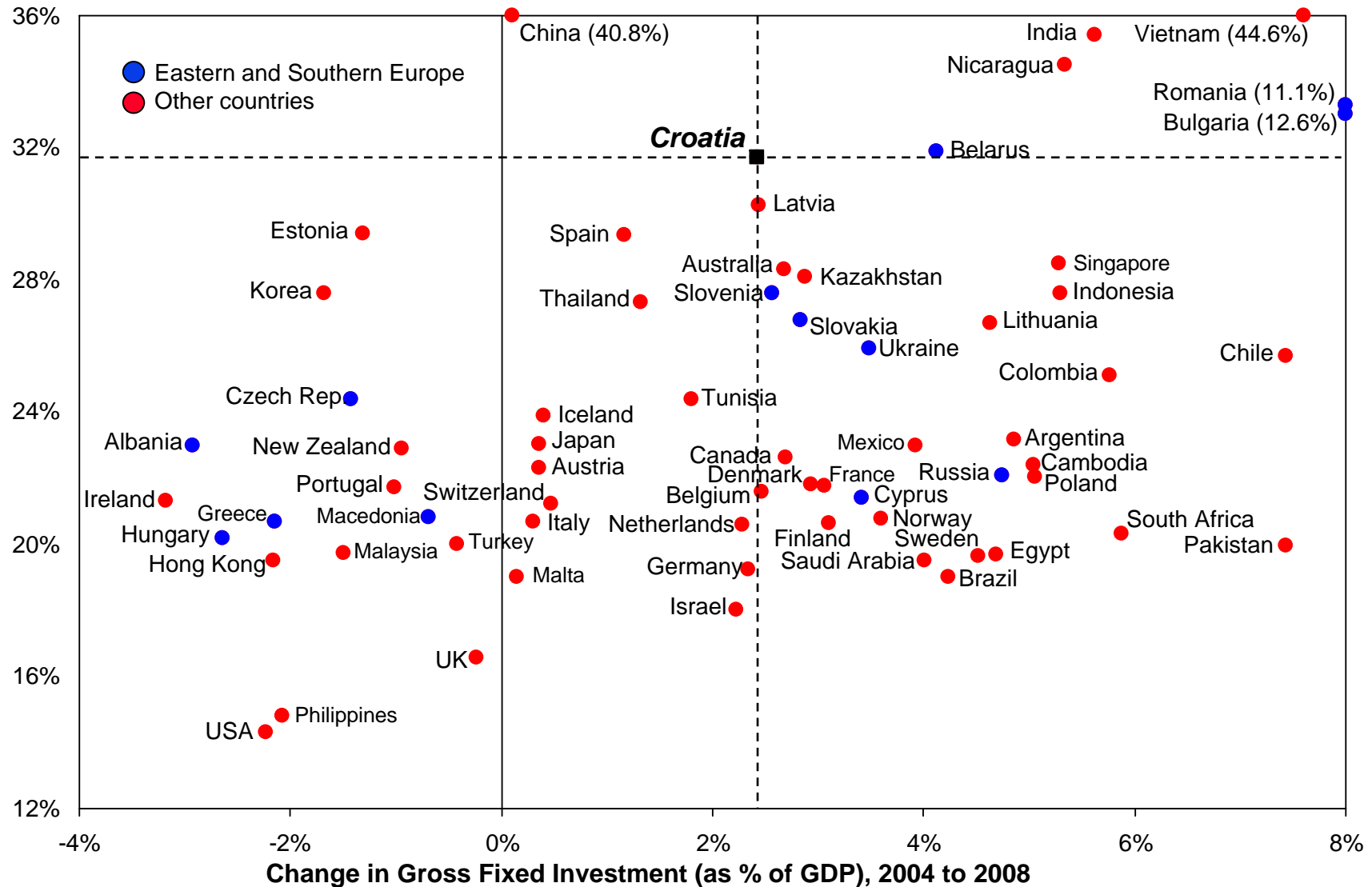


Source: UNComTrade, WTO (2008)  
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# Domestic Fixed Investment Rates

## Selected Countries

Gross Fixed Investment  
as % of GDP, 2008

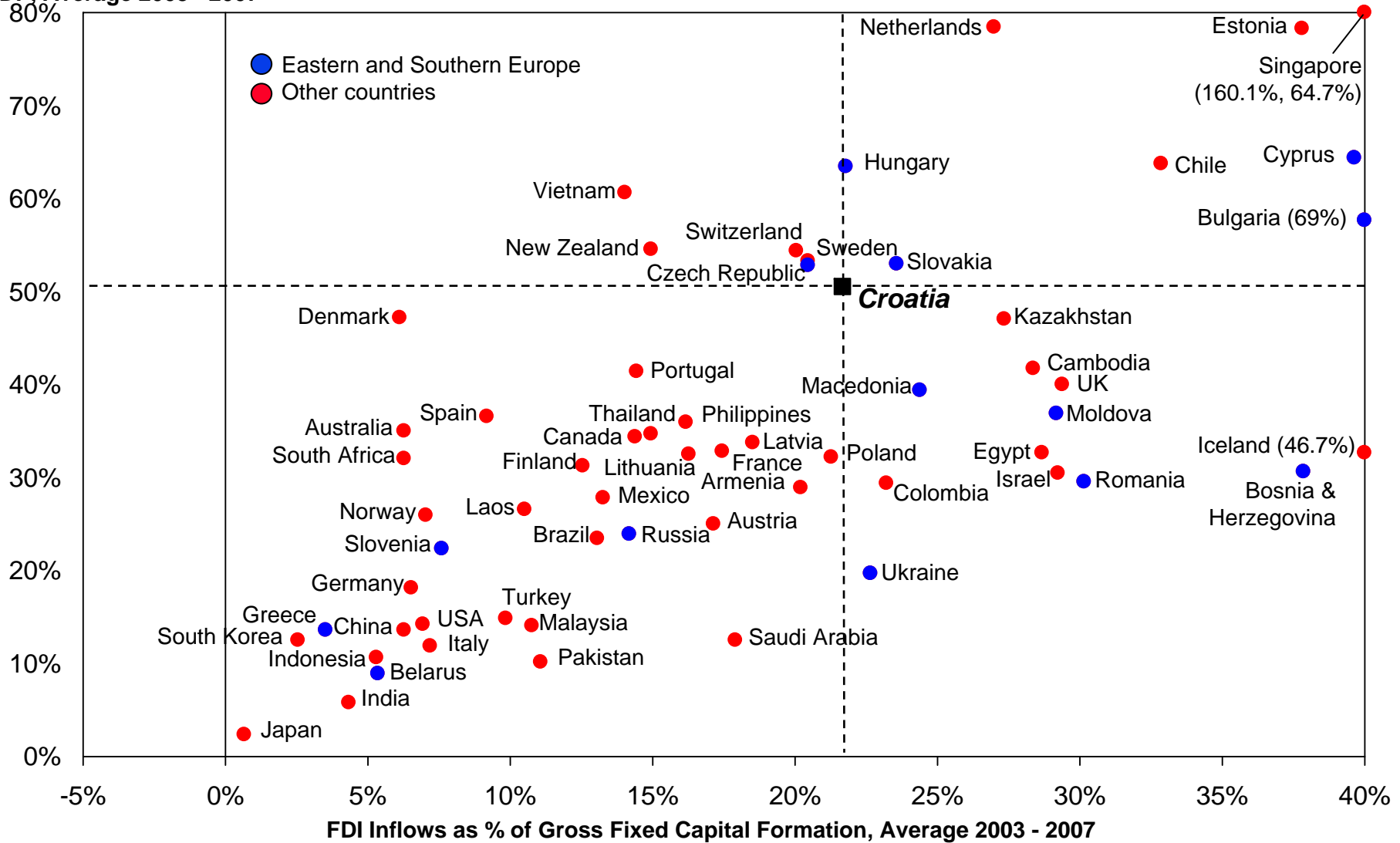


Note: Includes inbound FDI  
Source: EIU, 2009  
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# Inbound Foreign Investment Performance

## Stocks and Flows, Selected Countries

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

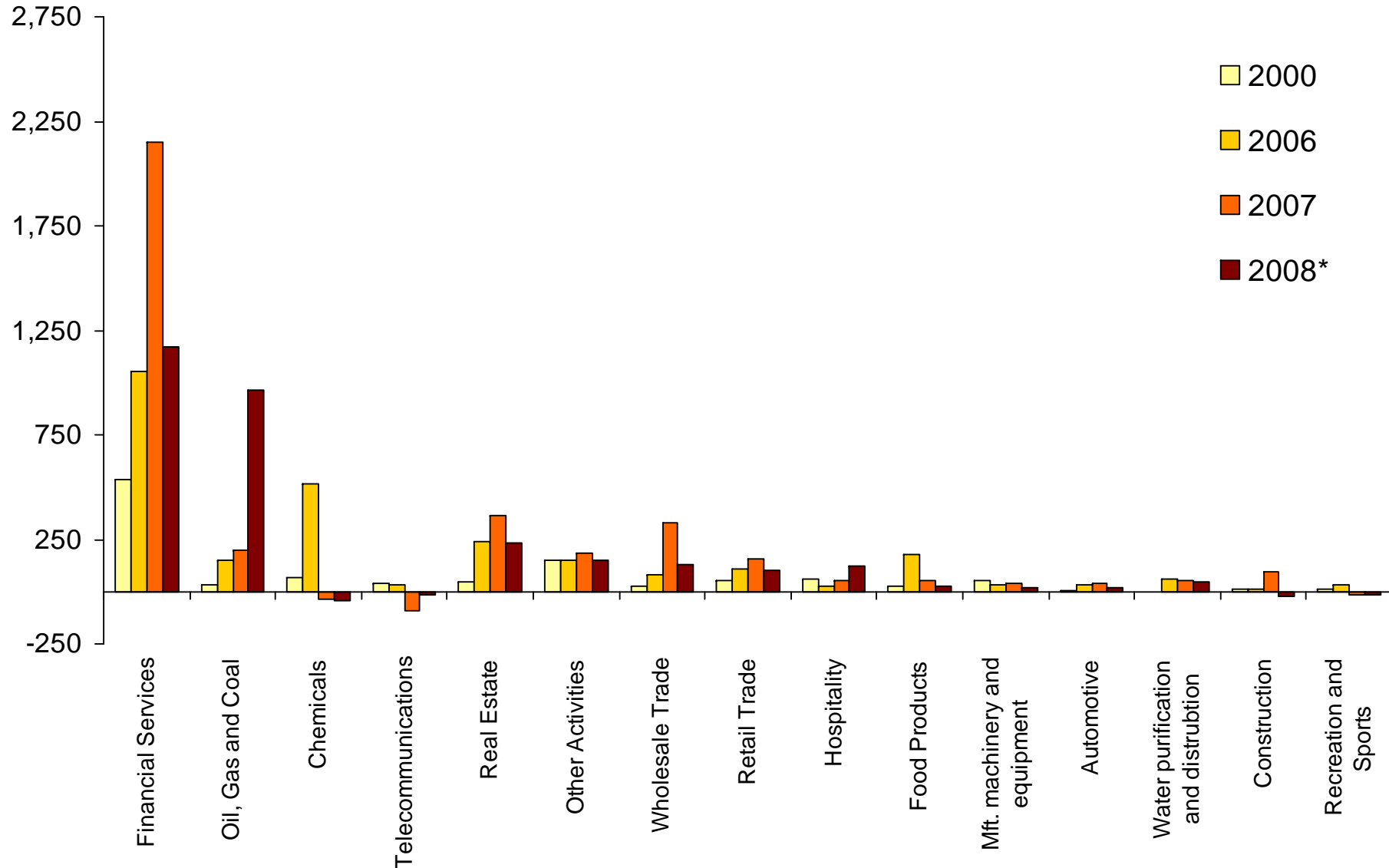


- Foreign direct investment inflows have been a **key driver** of economic growth

# Foreign Investment in Croatia

## Selected Activities

Average FDI by activity, millions of €



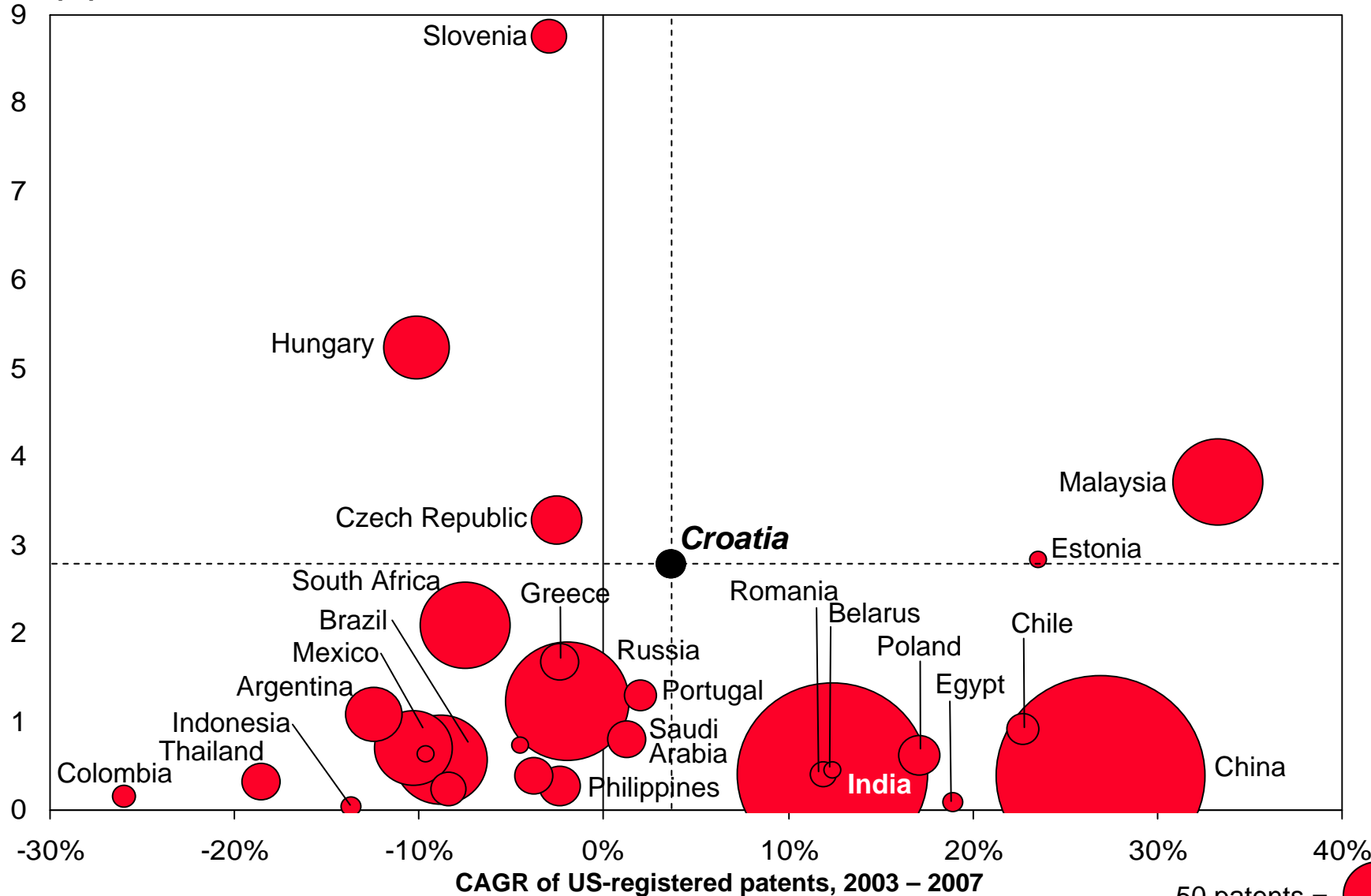
\*2008 is estimated figure.

Source: Foreign Direct Investment in Croatia (by activity), Croatian National Bank, 2009  
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# Innovative Capacity

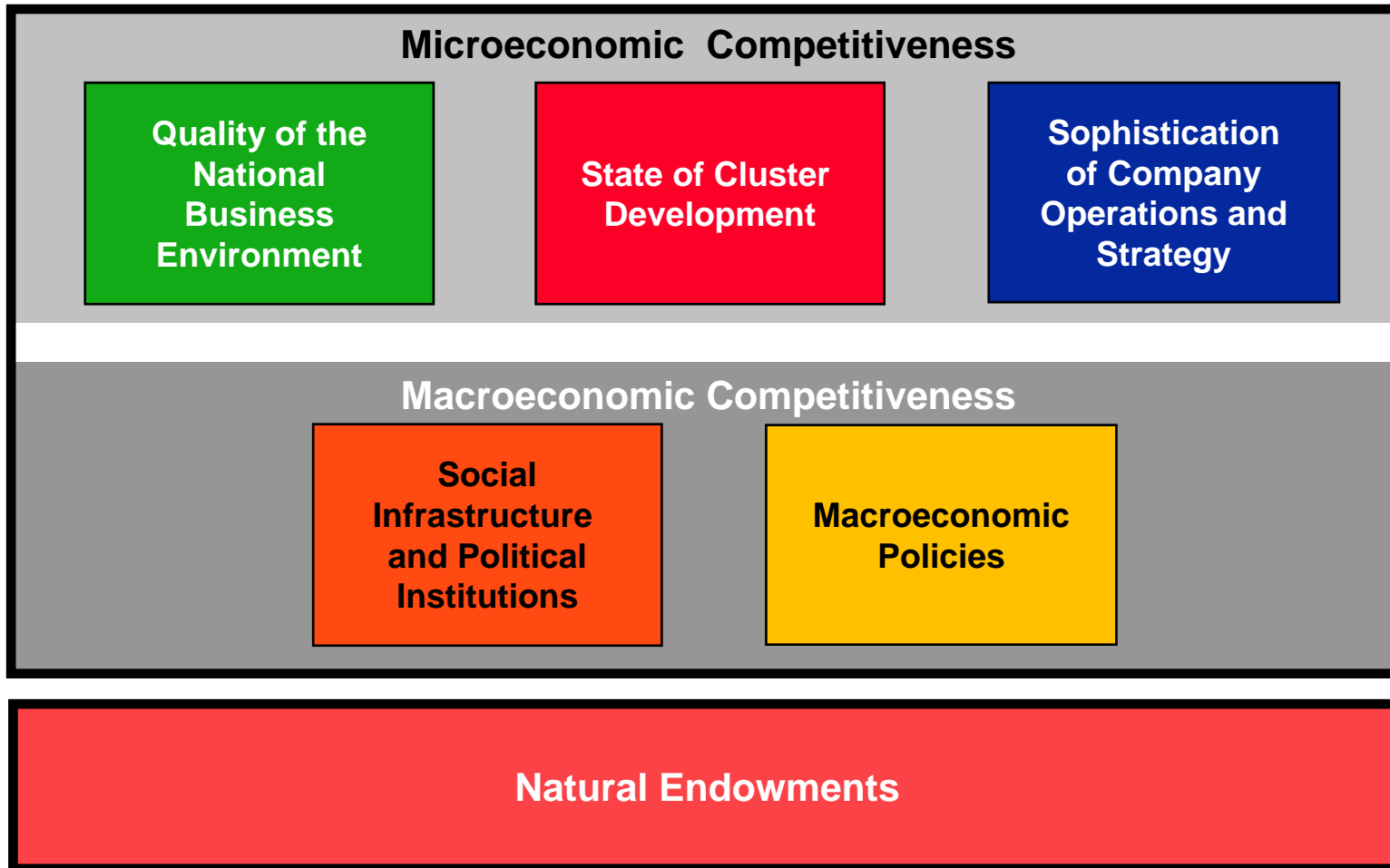
## Innovation Output of Selected Countries

Average U.S. patents per 1 million population, 2003-2007



Source: USPTO (2008), EIU (2008)  
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# Causes of Competitiveness



- Productivity ultimately depends on improving the **microeconomic capability** of the economy and the **sophistication of local competition**

# Macroeconomic Competitiveness

## Social Infrastructure and Political Institutions

- **Basic human capacity**
  - Education
  - Health
- **Safety and security**
- **Political institutions**
- **Rule of law**

## Macroeconomic Policies

- **Fiscal policy**
- **Monetary policy**
- **Economic openness**

# Croatia's Competitiveness

## Progress on the Competitiveness Index

|   | 2007 | 2008 |
|---|------|------|
| <b>Estimated</b> Ranking:<br>New Global Competitiveness Index | 63   | 63   |
| Macroeconomic Competitiveness                                 | 67   | 68   |
| Social Infrastructure and Political Institutions              | 58   | 59   |
| Macroeconomic Policy  | 91   | 84   |
| Microeconomic Competitiveness                                 | 60   | 69   |
| GDP Per Capita Rank (ppp-adjusted)                            | 48   | 48   |

Note: Rank versus 130 countries; overall, Croatia ranks 48<sup>th</sup> in 2008 PPP adjusted GDP per capita and 63<sup>rd</sup> in Global Competitiveness

Source: Institute for Strategy and Competitiveness, Harvard University (2009)

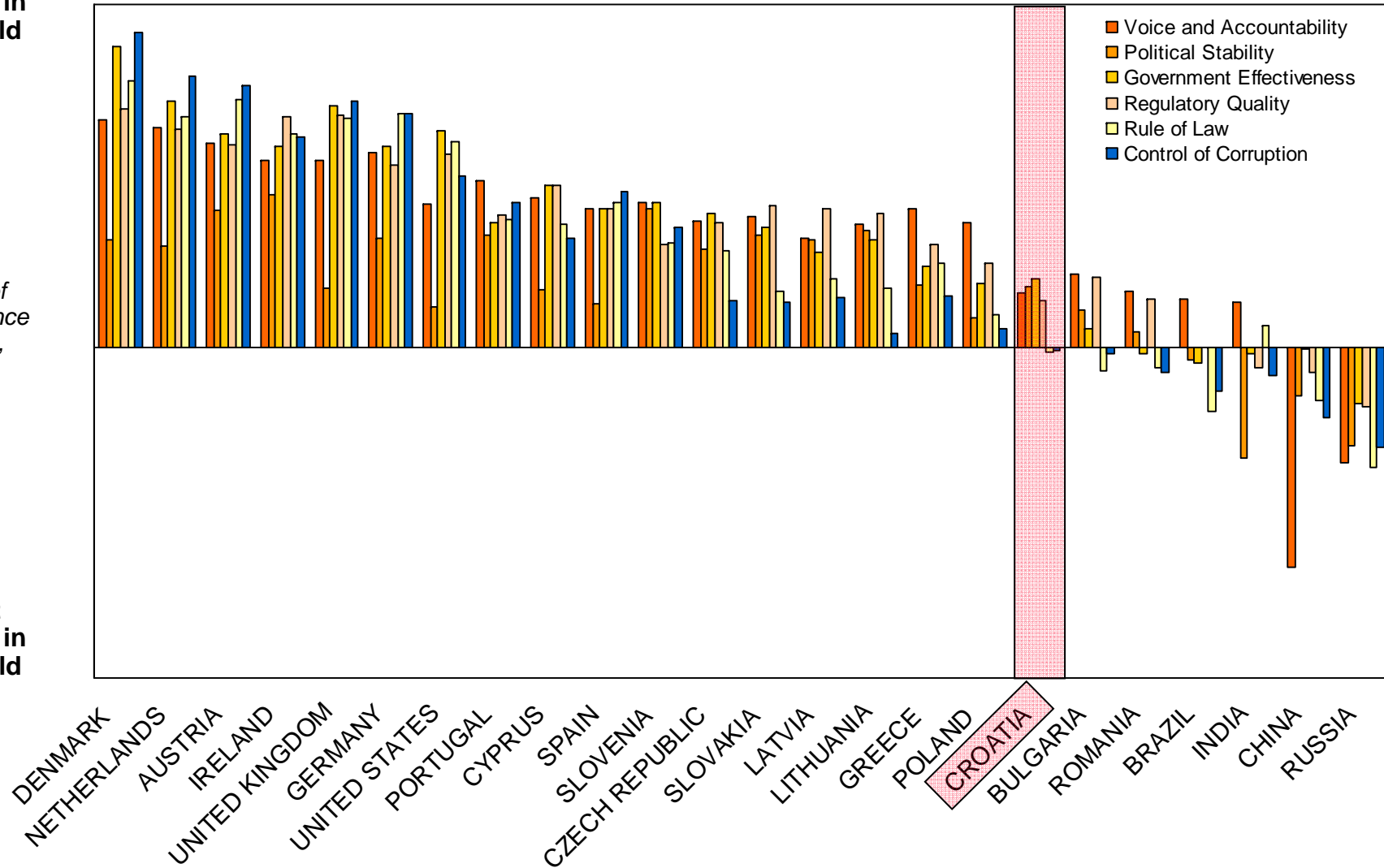
# Governance Indicators

## Selected Countries

Best country in the world

Index of Governance Quality, 2006

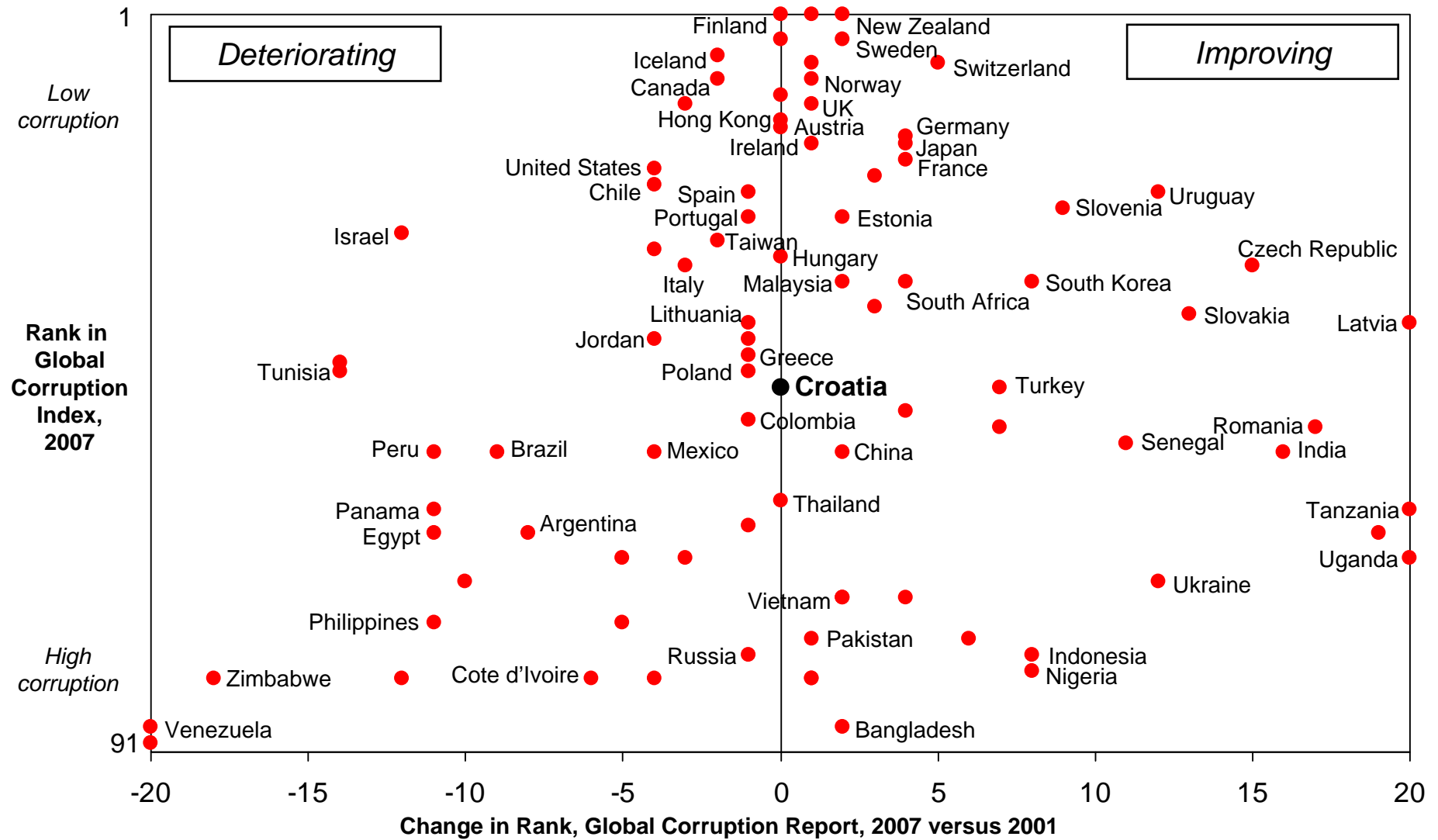
Worst country in the world



Note: Sorted left to right by decreasing average value across all indicators. The 'zero' horizontal line corresponds to the median country's average value across all indicators.

Source: World Bank (2008)  
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# Corruption Perception Index, 2007



Note: Ranks only countries available in both years (91 countries total)

Source: Global Corruption Report, 2007

# Macroeconomic Competitiveness

- Croatia has a **solid position** in terms of basic human development indicators, in line with many other former Communist countries
- Croatia has made some **progress on macroeconomic policy indicators**, but the current global crisis will test the sustainability of these improvements
  - Croatia has been running high current account deficits for the last decade
- Croatia remains a **regional laggard** in terms of political and legal institutional quality and there are few signs of fundamental improvements



- Croatia has **much work to do** to improve its macroeconomic competitiveness, especially its institutions

# Croatia's Position

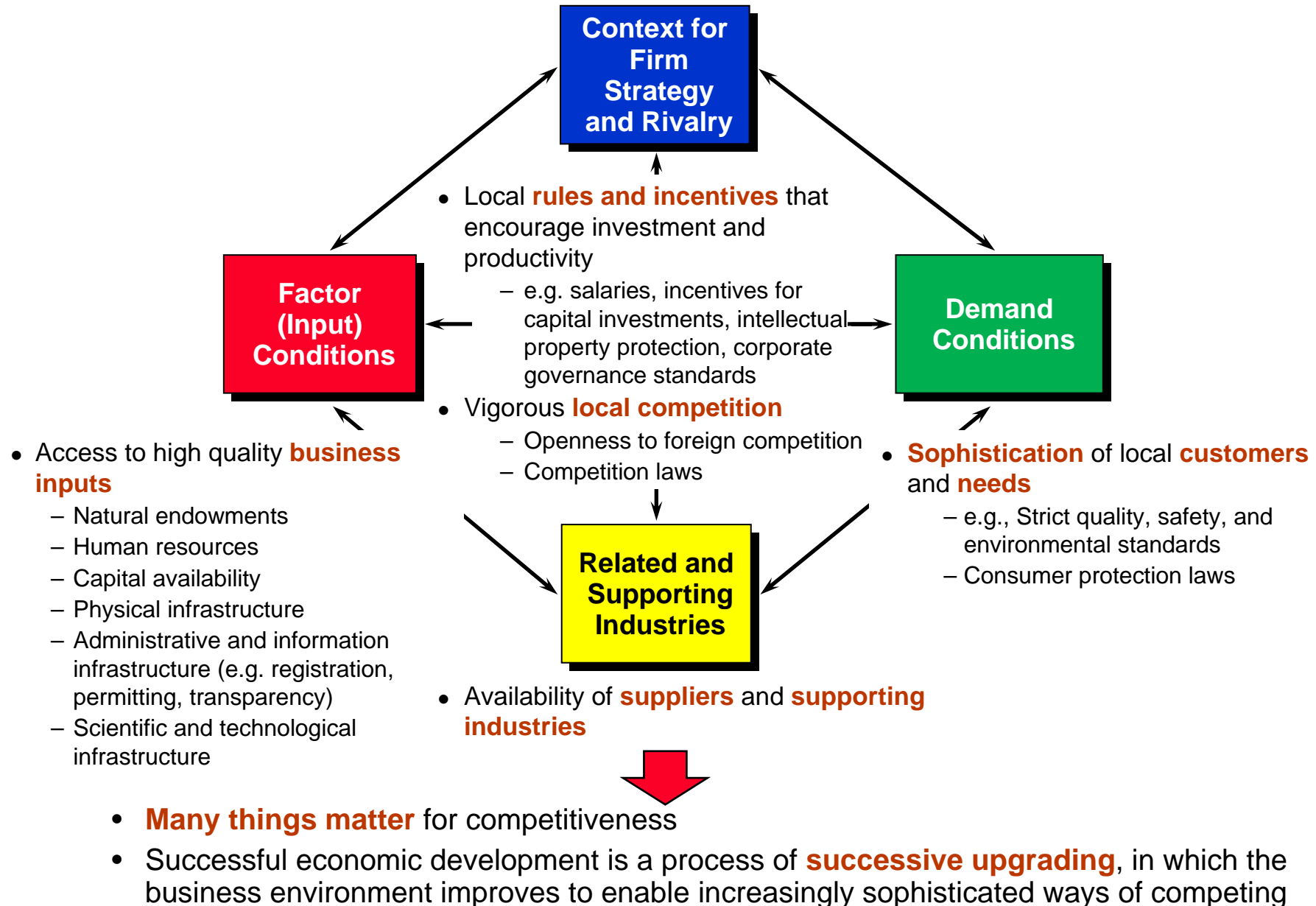
## Microeconomic Competitiveness

|  | <u>2007</u> | <u>2008</u> |
|--|-------------|-------------|
| <b>Estimated</b> Microeconomic Competitiveness Index | 60          | 69          |
| National Business Environment                        | 63          | 69          |
| Company Operations and Strategy                      | 58          | 64          |

Note: Rank versus 130 countries; overall, Croatia ranks 48<sup>th</sup> in 2008 PPP adjusted GDP per capita and 63<sup>rd</sup> in Global Competitiveness

Source: Institute for Strategy and Competitiveness, Harvard University (2009)

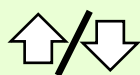
# Microeconomic Competitiveness: Quality of the Business Environment



## Factor (Input) Conditions Croatia's Relative Position 2008

### Competitive Advantages Relative to GDP per Capita

|   |    |   |
|---|----|---|
| Mobile telephone subscribers per 100 population   | 26 | ↑ |
| Telephone lines per 100 population                | 30 |   |
| Quality of roads                                  | 30 | ↑ |
| Quality of math and science education             | 35 | ↓ |
| Internet users per 100 population                 | 35 |   |
| Utility patents per million population            | 36 |   |
| Ease of starting a new business                   | 42 | ↓ |
| Personal computers per 100 population             | 43 |   |
| Quality of telephone infrastructure               | 44 | ↓ |
| Quality of electricity supply                     | 44 |   |
| Quality of railroad infrastructure                | 44 | ↑ |
| Number of procedures required to start a business | 44 | ↑ |
| Quality of scientific research institutions       | 47 | ↑ |



Change up/down of more than 5 ranks since 2007

### Competitive Disadvantages Relative to GDP per Capita

|  |     |   |
|--|-----|---|
| Protection of minority shareholders' interests | 101 | ↓ |
| Burden of government regulation                | 97  | ↑ |
| Time required to start a business              | 91  |   |
| Venture capital availability                   | 87  | ↓ |
| Quality of port infrastructure                 | 84  | ↑ |
| Quality of air transport infrastructure        | 83  | ↓ |
| Ease of access to loans                        | 81  | ↓ |
| Brain drain                                    | 80  | ↓ |
| Quality of management schools                  | 76  |   |
| Regulation of securities exchanges             | 74  |   |
| Financial market sophistication                | 71  | ↓ |
| Burden of customs procedures                   | 63  | ↓ |
| Quality of the educational system              | 62  |   |
| Demand conditions                              | 61  |   |
| Soundness of banks                             | 60  | ↓ |
| University-industry research collaboration     | 51  | ↓ |
| Tertiary enrollment                            | 49  |   |


Note: Rank versus 130 countries; overall, Croatia ranks 48<sup>th</sup> in 2008 PPP adjusted GDP per capita and 63<sup>rd</sup> in Global Competitiveness

Source: Institute for Strategy and Competitiveness, Harvard University (2009)

# Context for Strategy and Rivalry

## Croatia's Relative Position 2008

| Competitive Advantages<br>Relative to GDP per Capita |    | Competitive Disadvantages<br>Relative to GDP per Capita |       |
|--|----|---|-------|
| Low Tariff rates                                     | 34 | Business impact of rules on FDI                         | 114 ↓ |
|  |    | Cooperation in labor-employer relations                 | 110   |
|  |    | Low market disruption from state-owned enterprises      | 110   |
|  |    | Impact of taxation on incentives to work and invest     | 103 ↓ |
|  |    | Rigidity of employment                                  | 102   |
|  |    | Effectiveness of antitrust policy                       | 98 ↓  |
|  |    | Extent of market dominance by business groups           | 98 ↓  |
|  |    | Efficacy of corporate boards                            | 98    |
|  |    | Strength of investor protection                         | 95    |
|  |    | Pay and productivity                                    | 88 ↓  |
|  |    | Distortive effect of taxes and subsidies on competition | 80 ↑  |
|  |    | Restrictions on capital flows                           | 76    |
|  |    | Strength of auditing and reporting standards            | 76 ↓  |
|  |    | Prevalence of trade barriers                            | 73 ↓  |
|  |    | Intensity of local competition                          | 71    |
|  |    | Intellectual property protection                        | 68 ↓  |
|  |    | Regulatory quality                                      | 54    |

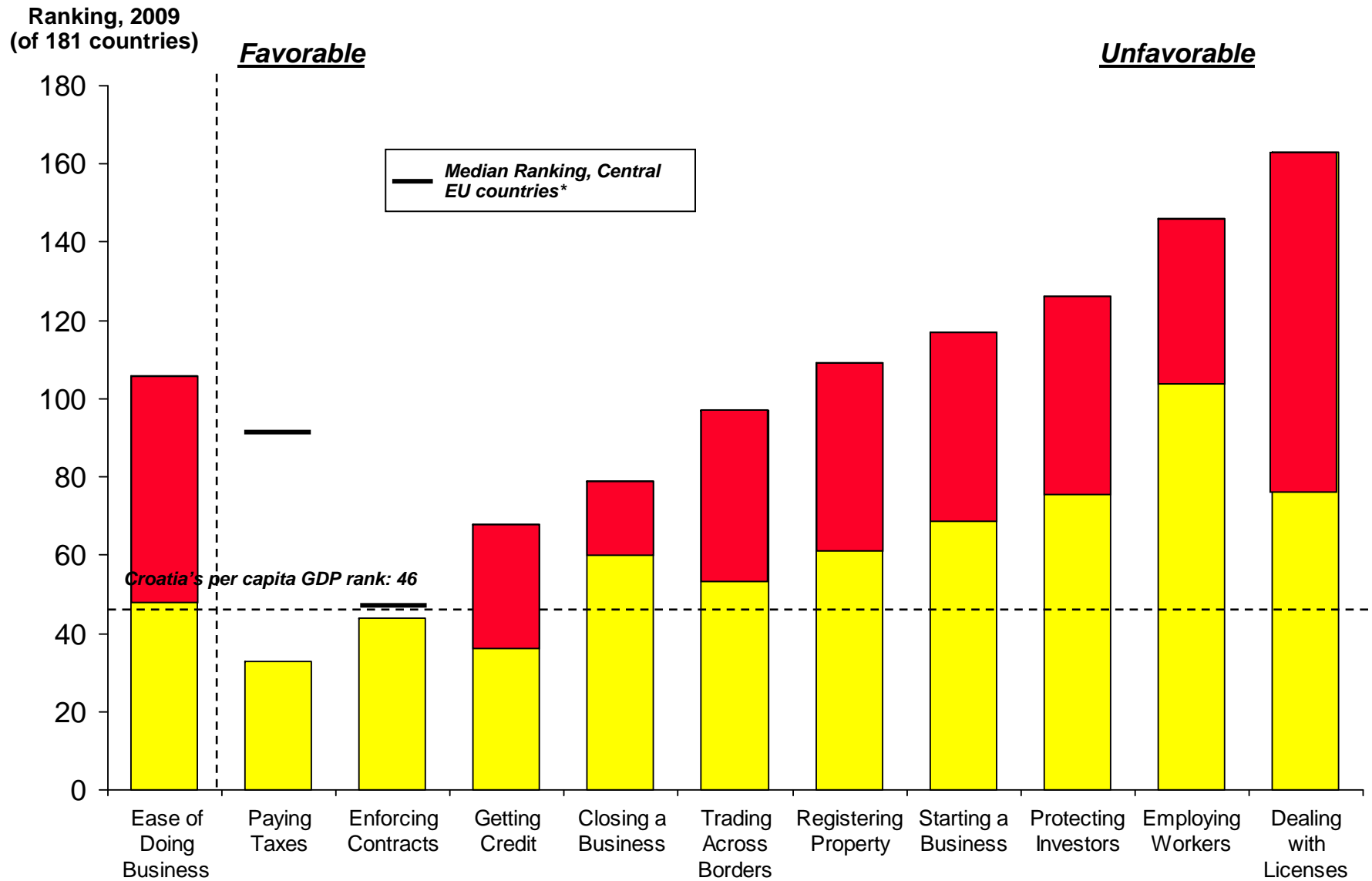


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Source: Institute for Strategy and Competitiveness, Harvard University (2009)

# Doing Business Indicators



\* Central European EU countries include: Austria, Bulgaria, the Czech Republic, Estonia, Greece, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia  
Source: World Bank Report, Doing Business (2009)



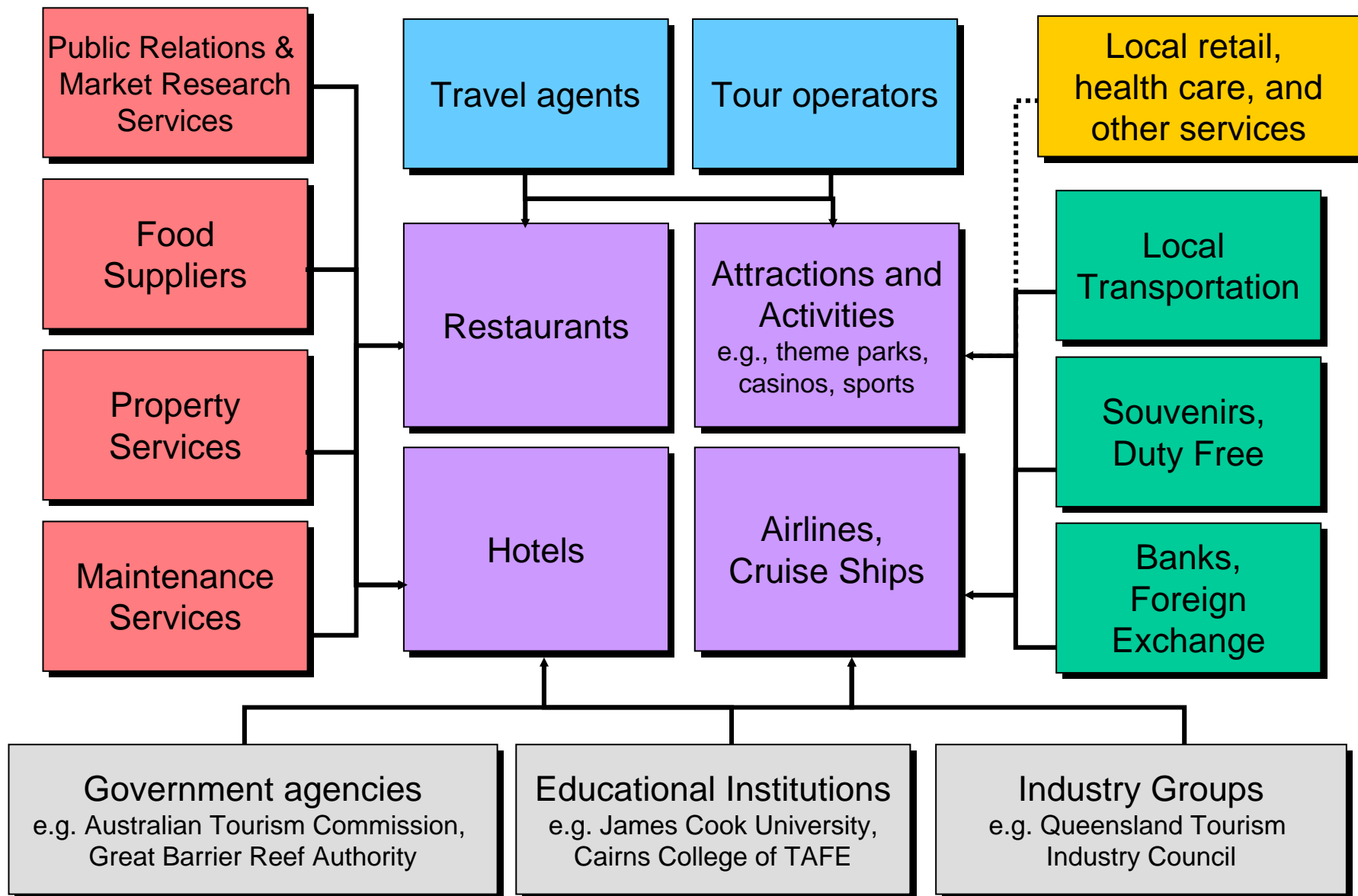
# Croatia's Business Environment Quality

## Overview

- Basic factor conditions are relatively strong but weaknesses exist in more advanced dimensions
  - Relative strength in road transportation and communications infrastructure as well as fundamental innovative capacity
  - Relative strength in primary and secondary education
  - Relative weakness in financial market sophistication
  - Relative weakness in port and airport infrastructure
- Business rules and regulations remain cumbersome and distortive
  - Problematic labor relations
  - Local market still dominated by entrenched domestic business groups
  - Rules and regulations for foreign direct investors are cumbersome

# Competitiveness and Cluster Development

## Tourism Cluster in Cairns, Australia

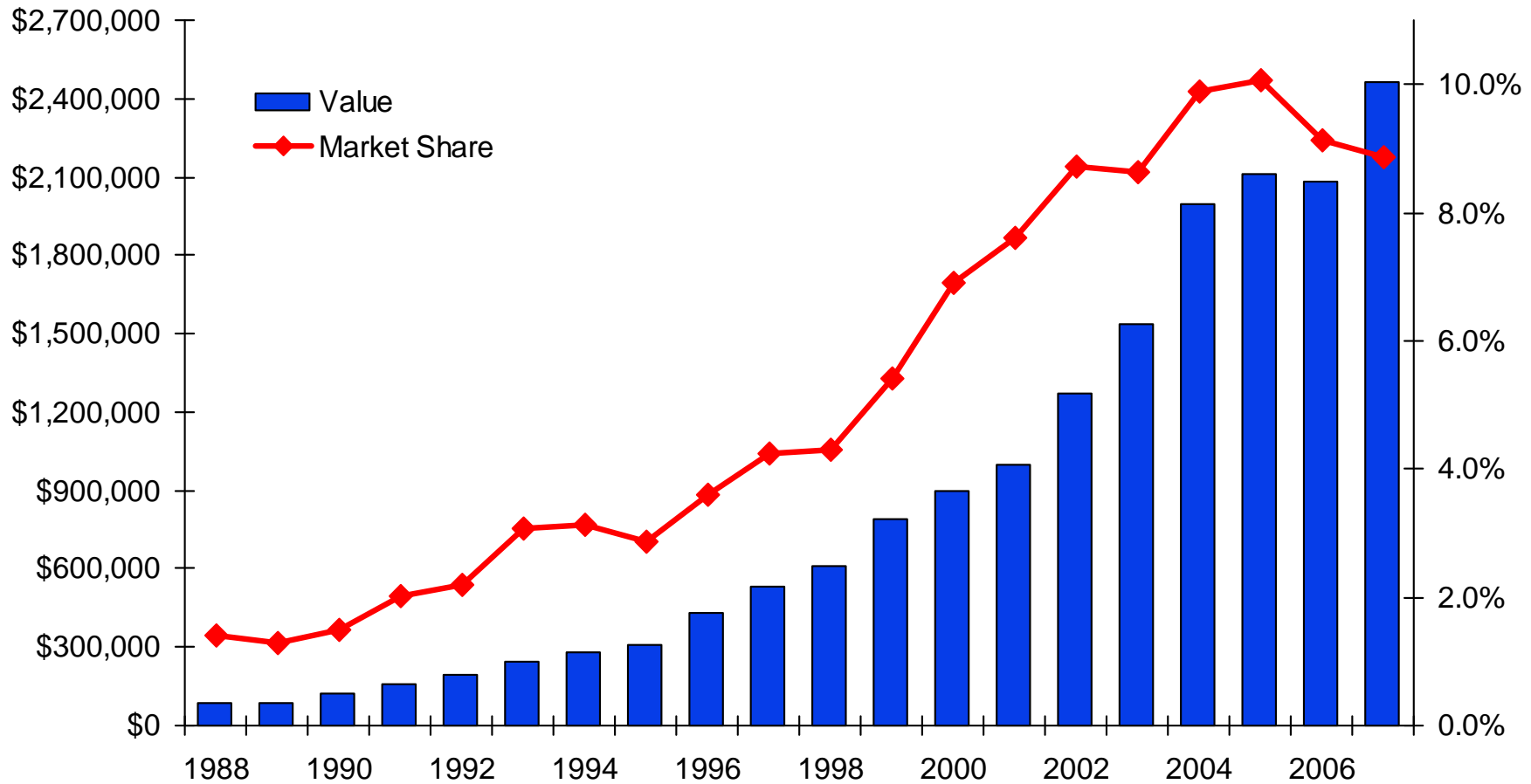


# The Australian Wine Cluster

## Trade Performance

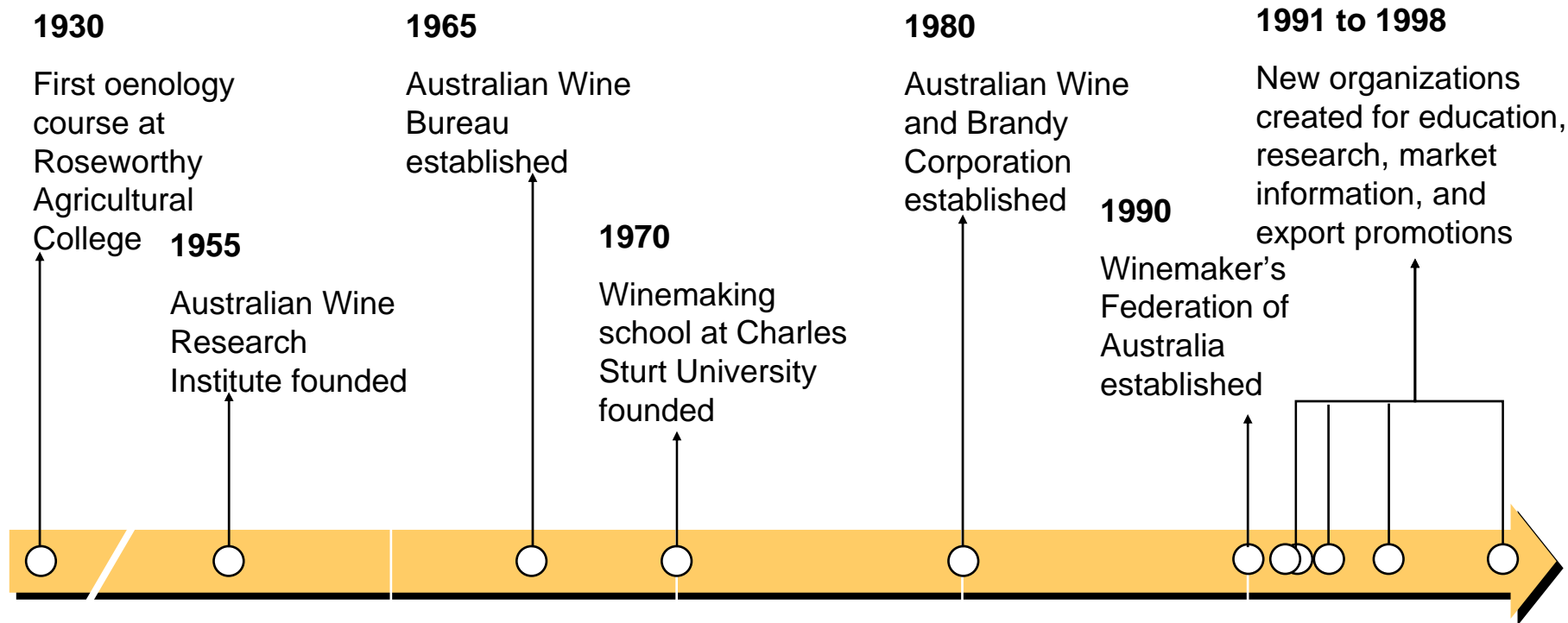
Australian Wine Exports in thousand US \$

Australian Wine World Export Market Share



Source: Prof. Michael E. Porter, International Cluster Competitiveness Project, Institute for Strategy and Competitiveness, Harvard Business School; Richard Bryden, Project Director. Underlying data drawn from the UN Commodity Trade Statistics Database.  
 20090515 - CAON Croatia.ppt

# The Australian Wine Cluster History



**1950s**

*Import of European winery technology*

**1960s**

*Recruiting of experienced foreign investors, e.g. Wolf Bass*

**1970s**

*Continued inflow of foreign capital and management*

**1980s**

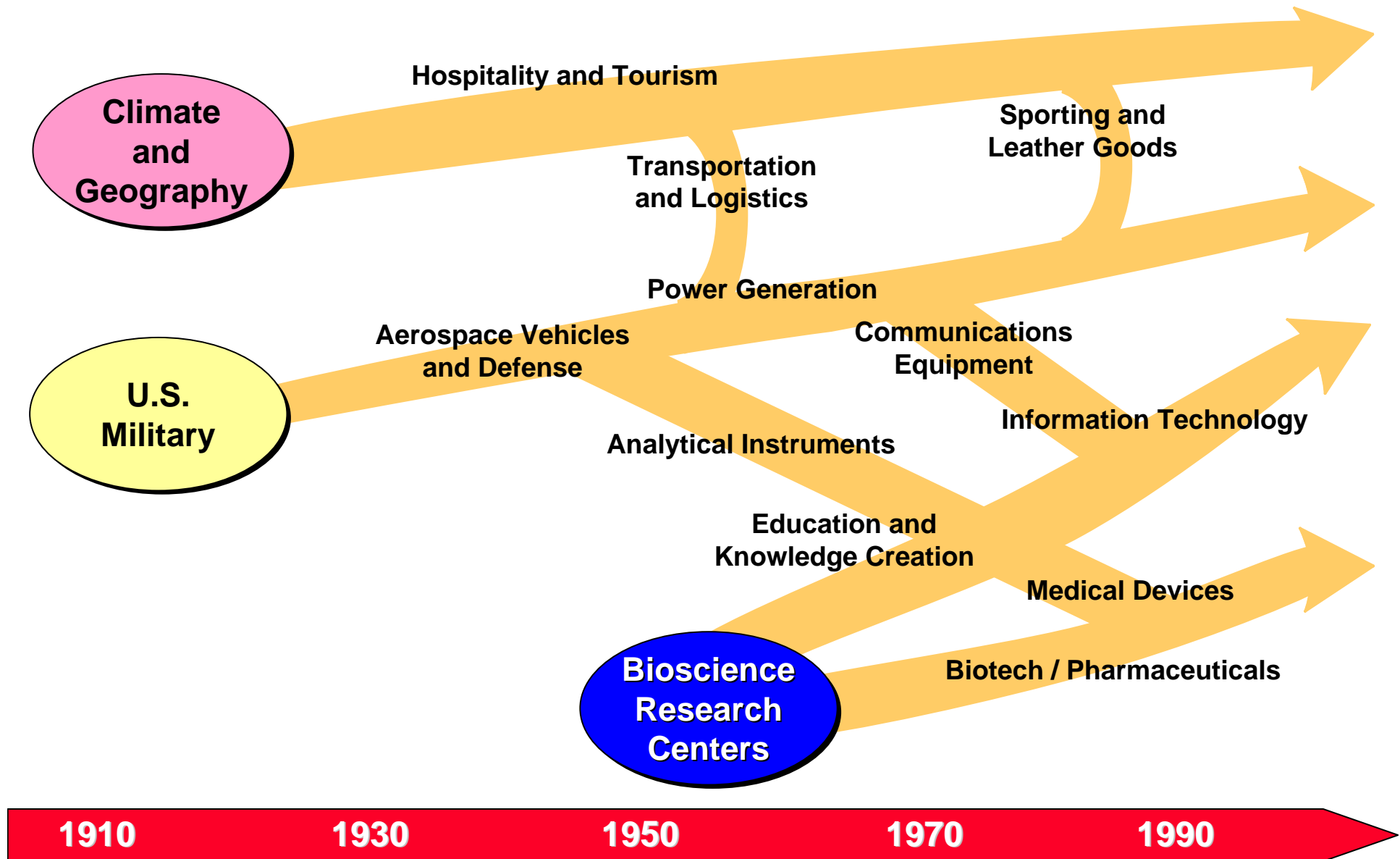
*Creation of large number of new wineries*

**1990s**

*Surge in exports and international acquisitions*

# The Evolution of Regional Economies

## San Diego



# Related and Supporting Industries

## Croatia's Relative Position 2008

### Competitive Advantages Relative to GDP per Capita

### Competitive Disadvantages Relative to GDP per Capita

|  |     |   |
|--|-----|---|
| State of cluster development                   | 105 | ↑ |
| Extent of collaboration in clusters            | 98  |   |
| Local supplier quantity                        | 88  |   |
| Supporting and related industries and clusters | 77  | ↓ |
| Local supplier quality                         | 72  | ↑ |
| Local availability of process machinery        | 61  |   |



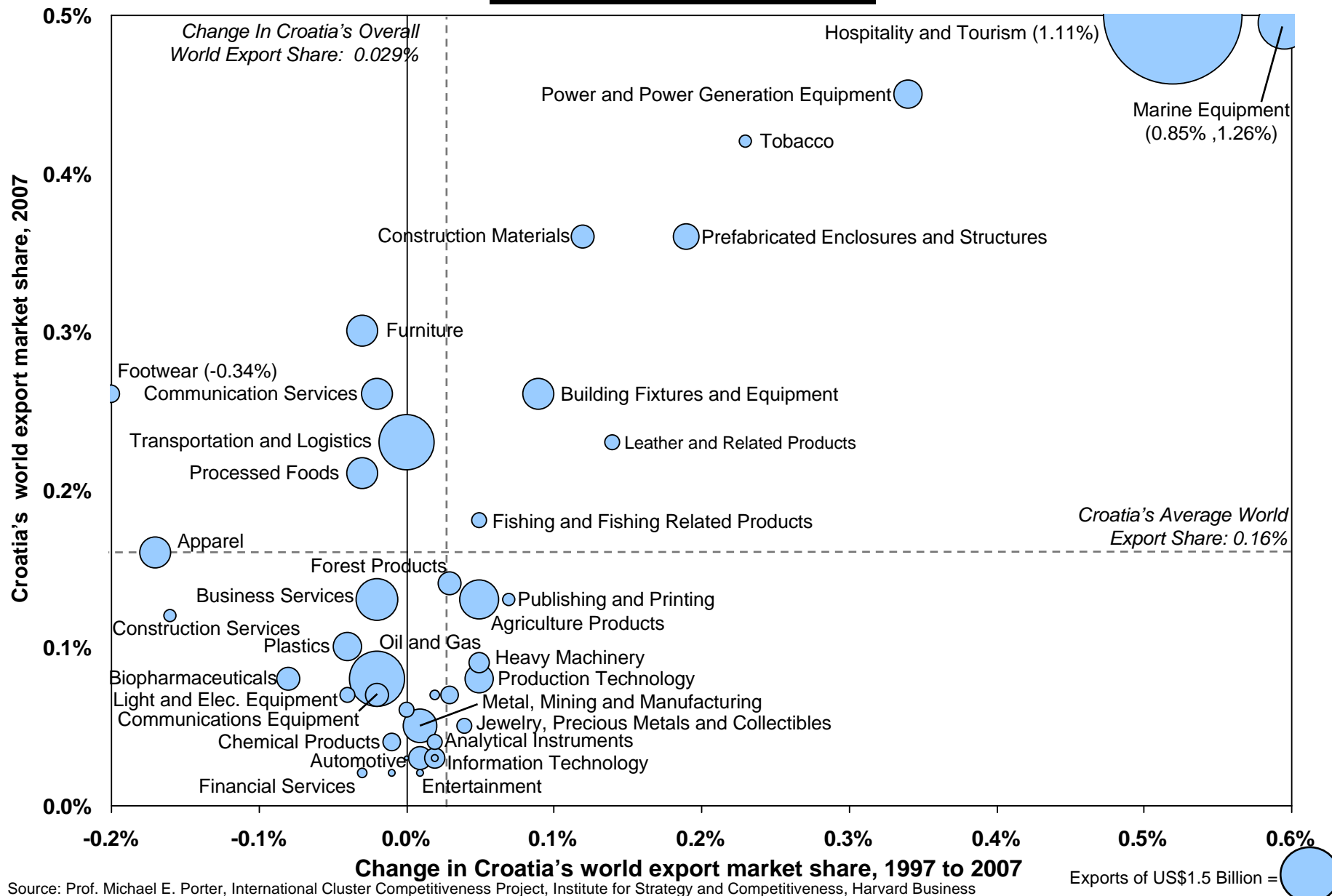
Change up/down of more than 5 ranks since 2007

Note: Rank versus 130 countries; overall, Croatia ranks 48<sup>th</sup> in 2008 PPP adjusted GDP per capita and 63<sup>rd</sup> in Global Competitiveness

Source: Institute for Strategy and Competitiveness, Harvard University (2009)

# National Cluster Export Portfolio

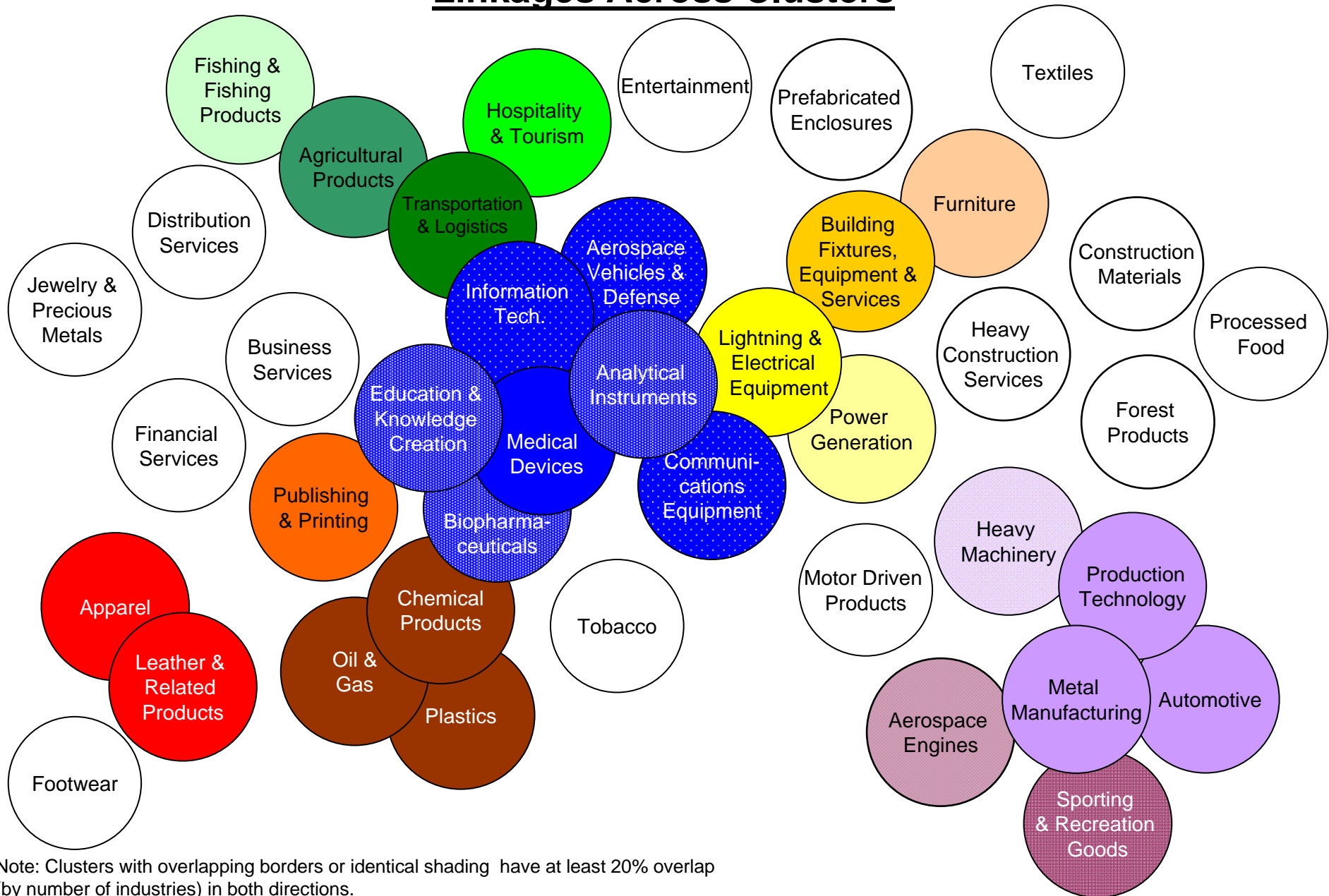
## Croatia, 1997 to 2007



Source: Prof. Michael E. Porter, International Cluster Competitiveness Project, Institute for Strategy and Competitiveness, Harvard Business School; Richard Bryden, Project Director. Underlying data drawn from the UN Commodity Trade Statistics Database and the IMF BOP statistics. 20090515 - CAON Croatia.ppt

# Competitiveness and the Composition of the Economy

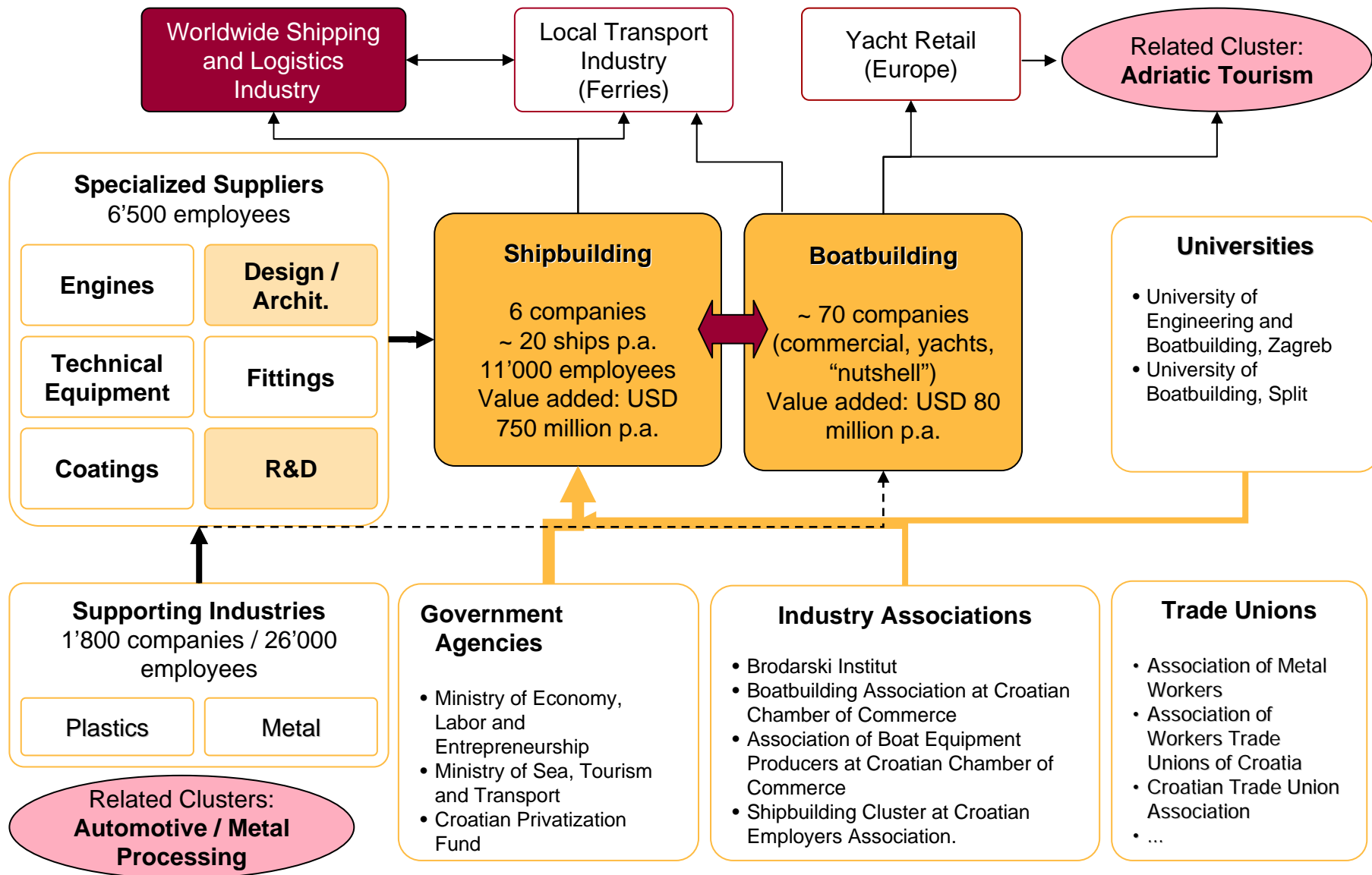
## Linkages Across Clusters



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

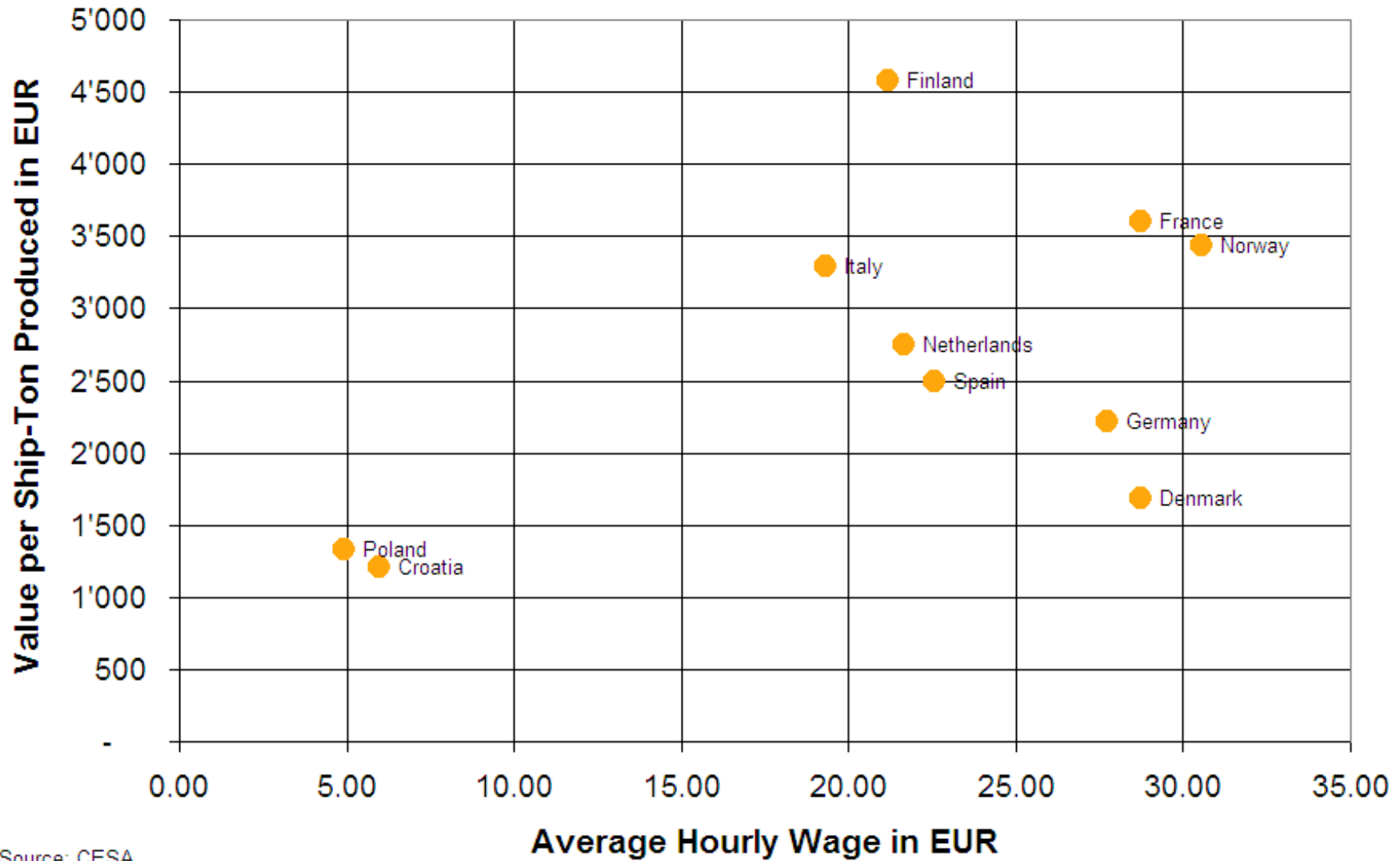


# Croatian Maritime Cluster



# Shipbuilding Cluster Productivity

## Select European Countries

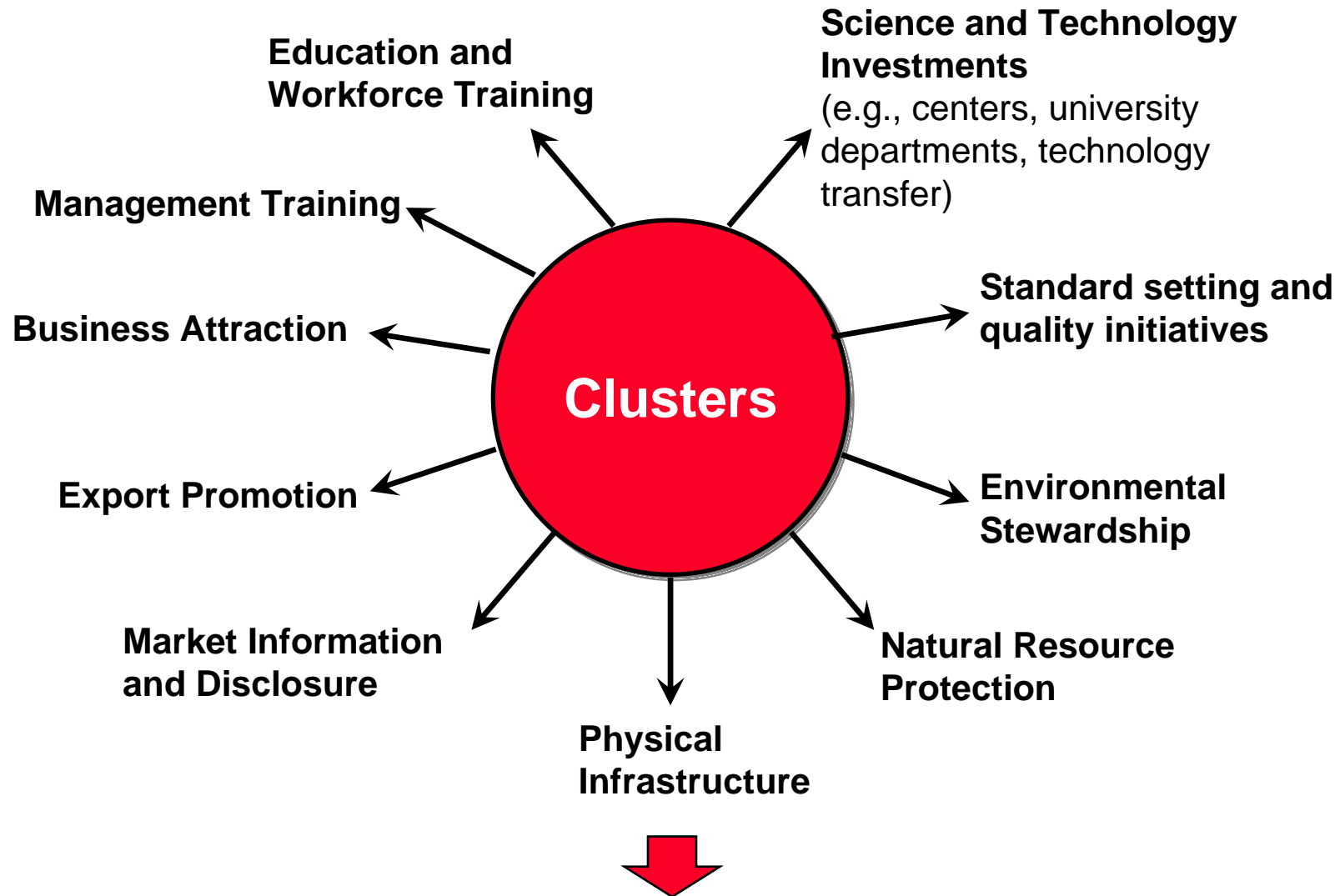


Source: CESA

# Croatian Clusters

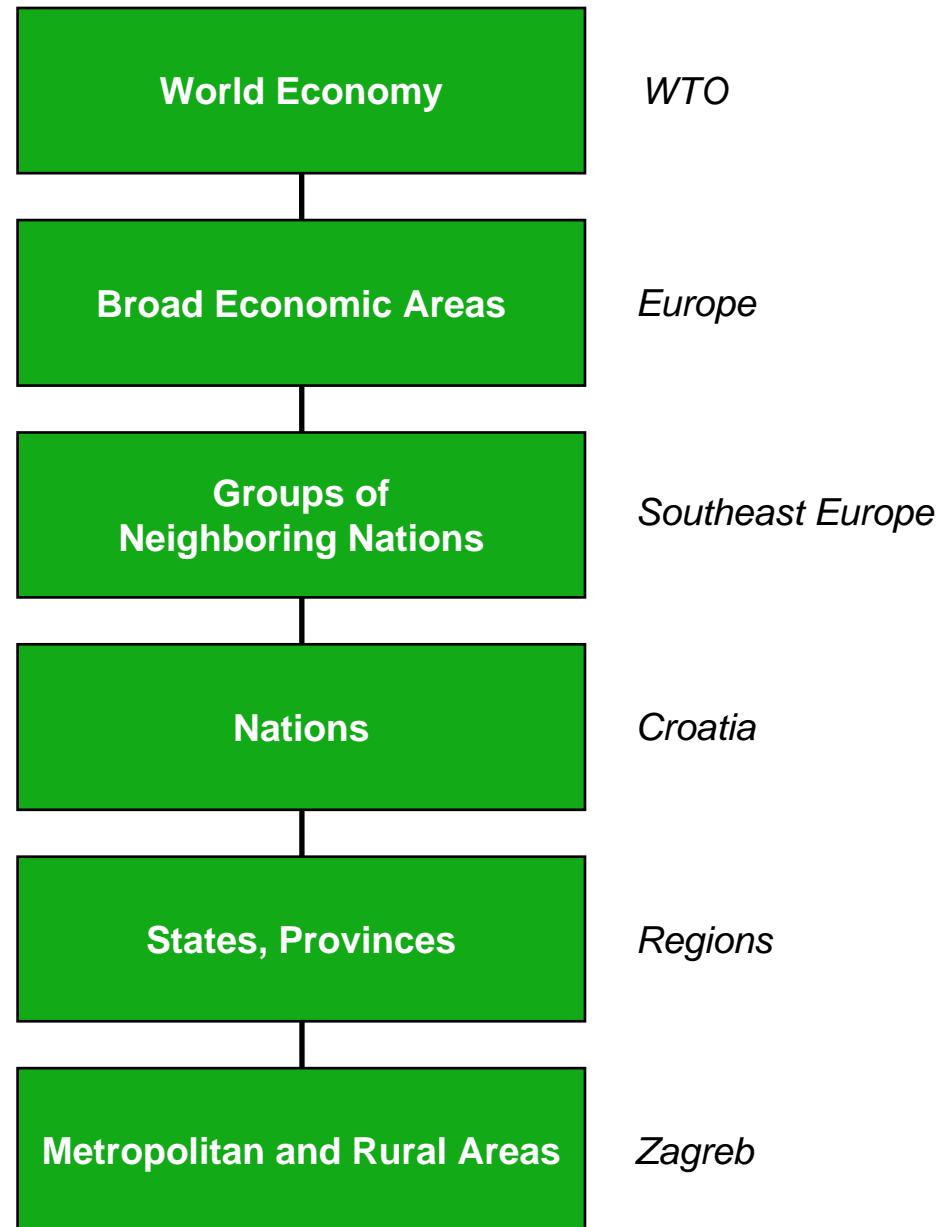
- Croatia's clusters have **developed naturally** and reflect the strengths of legacy and location but also the challenges of the current business environment conditions
  - Clusters provide an **important perspective** to understand the issues facing the Croatian economy
  - Cluster-level competitiveness efforts are **less politicized** and enable action on more tractable issues related to productivity
  - Cluster efforts are an opportunity to engage in a **new model of public-private dialogue** and cooperation
- 
- Clusters are so far an **unexploited dimension of economic policy** that Croatia can ill-afford to neglect

# Cluster-Based Policy Implementation



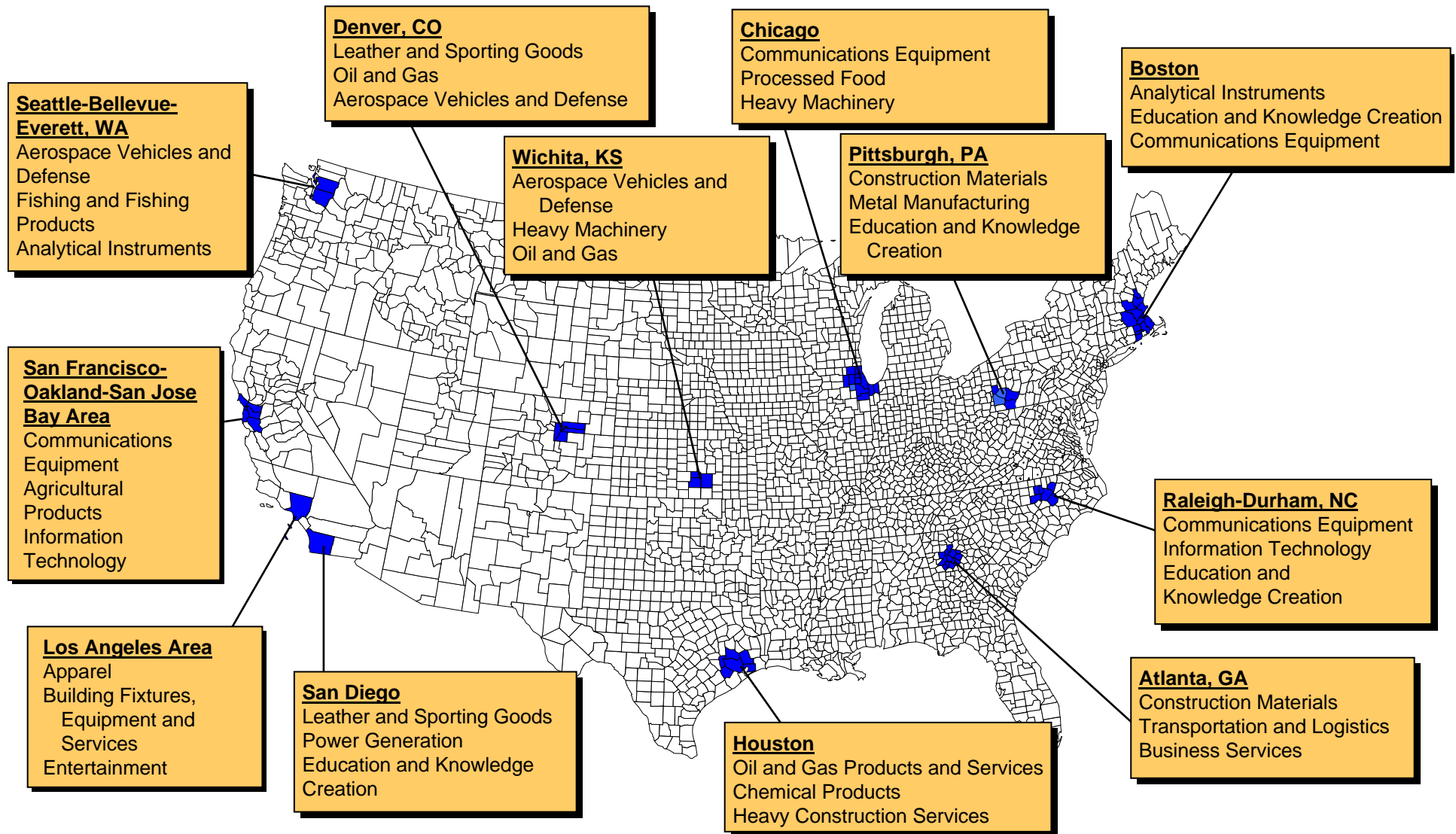
- Clusters provide a framework for **implementing public policy** and **organizing public-private collaboration** to enhance competitiveness

# Geographic Levels and Competitiveness



# Specialization of Regional Economies

## Selected U.S. Geographic Areas



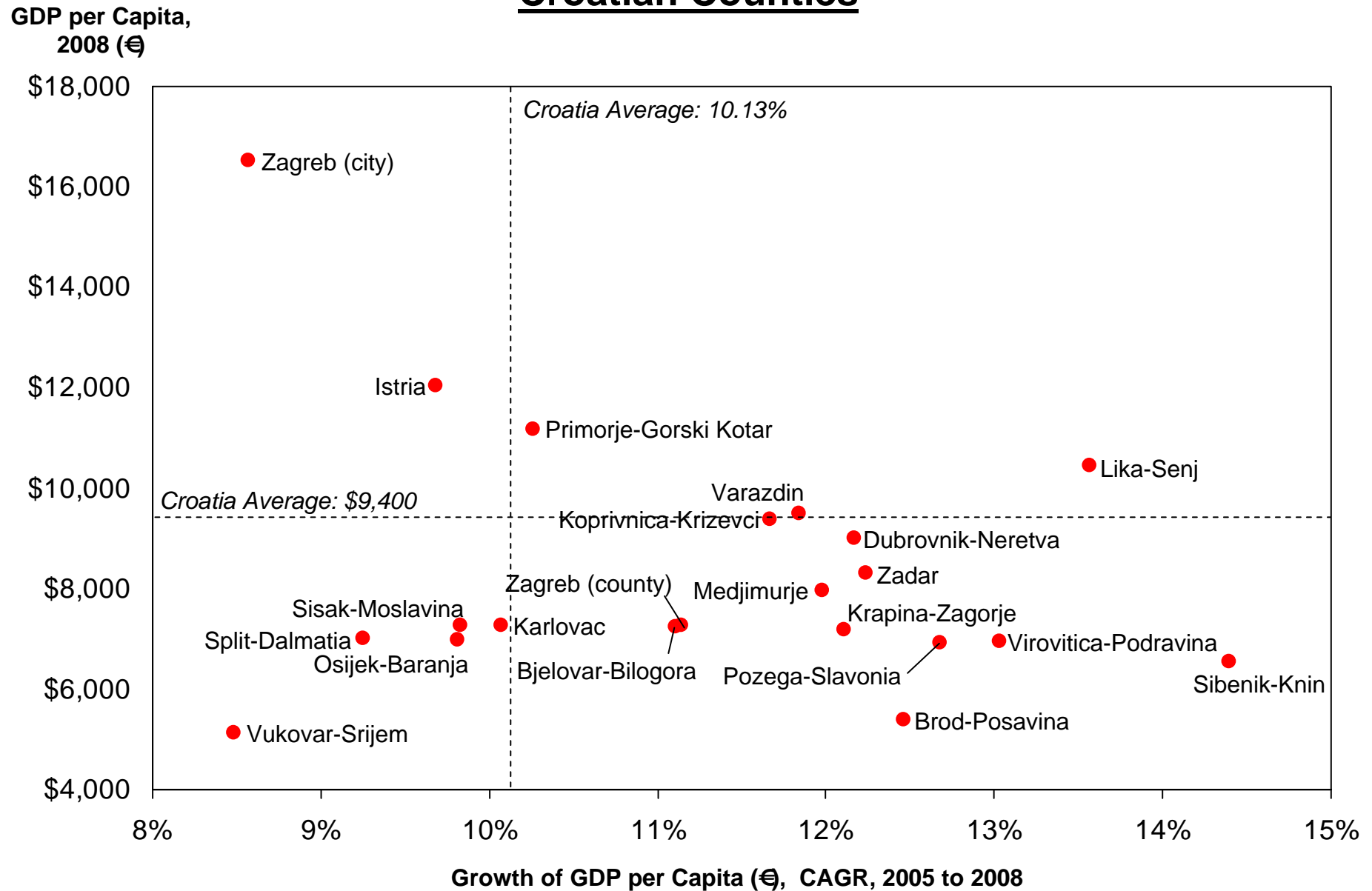
Note: Clusters listed are the three highest ranking clusters in terms of share of national employment.

Source: Cluster Mapping Project, Institute for Strategy and Competitiveness, Harvard Business School, 11/2006.



# Prosperity Performance

## Croatian Counties



# The Neighborhood

## Southeastern Europe



- Economic coordination among neighboring countries can significantly enhance competitiveness

# Croatia's Competitiveness Challenge

- Croatia's recent economic growth has been driven by **natural catch-up** following integration into the European and global economy
- Process can only be sustained if Croatia is able to continuously upgrade its **competitiveness**
- EU accession is an **important opportunity**, but the benefits will depend on reforms by Croatia to address its own competitiveness challenges

## Key Challenges

- There are **numerous weaknesses** in the Croatian business environment
- The **vitality of competition** remains weak as a consequence of policy choices and a relatively isolated domestic market
- **Clusters** are present in the Croatian economy (e.g. tourism), but they have not been used as an effective policy tool
- The **institutional weaknesses** of the country have been a key barrier to achieve sustain improvements
- **Croatian regions** have not been challenged and enabled to contribute to competitiveness improvements

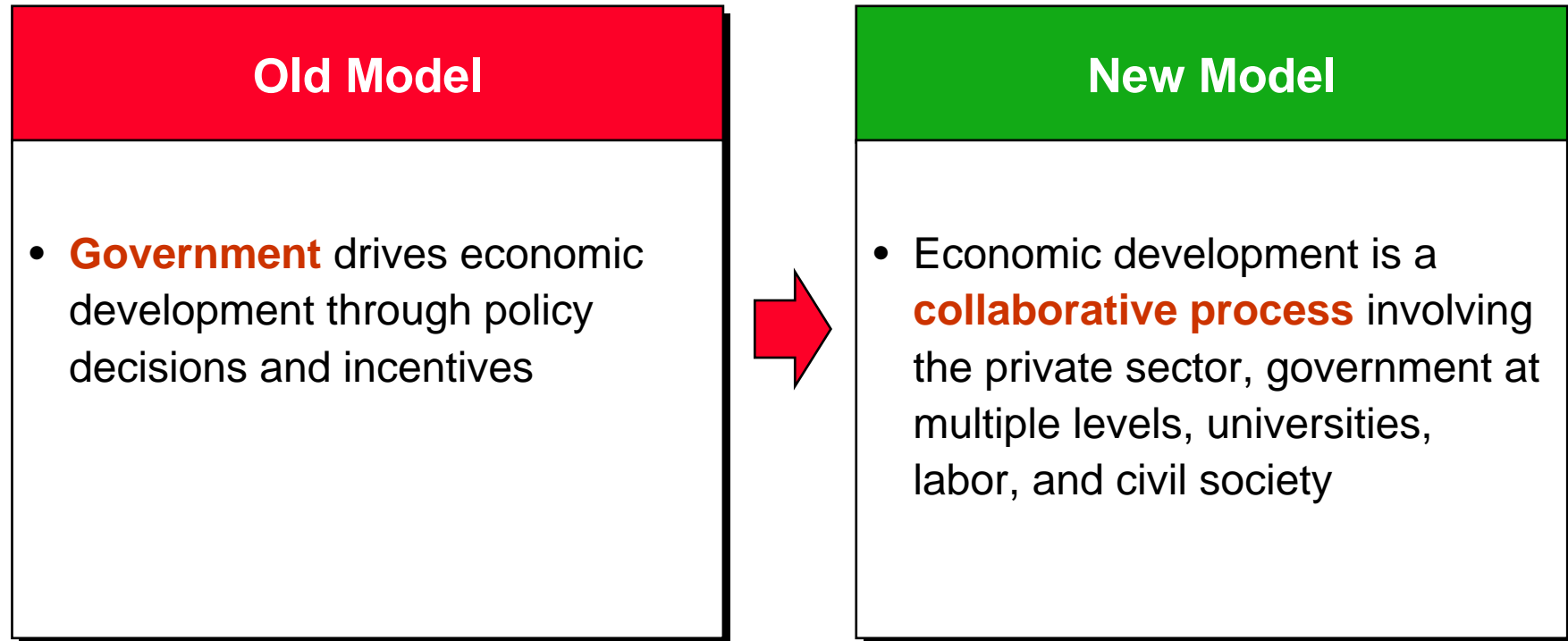
# Croatia's Competitiveness Agenda

## Action Priorities

- Address **corruption** and **weaknesses in political and legal institutions**
- Ensure the sustainability of **public finances**
- Reform the **rules and regulations for business**
- Open up **local markets** to **competition**
- Create **attractive conditions** for foreign investors
- Strengthen the **higher education system**, **financial markets**, and **airport/port infrastructure**
- Use **clusters as an organizing principle** for upgrading workforce skills, infrastructure, and FDI attraction
- Support **Croatian regions** in their competitiveness efforts
- Strengthen economic cooperation in **South-East Europe**

# The Process of Economic Development

## Shifting Roles and Responsibilities



- Competitiveness must become a **bottoms-up process** in which many individuals, companies, and institutions take responsibilities
- **Every** community and cluster can take steps to enhance competitiveness
- The **private sector** must become more engaged in competitiveness to improve rapidly

# Defining a Croatian Economic Strategy

## National Economic Strategy

- What can be the **unique competitive position** of Croatia given its location, legacy, endowments, and potential strengths?
  - What is its unique value as a business location?
  - What role can it play with neighbors?
  - In what range of clusters does the nation excel?

## Developing Unique Strengths

- What are the **key potential strengths** that Croatia must preserve or build?

## Achieving and Maintaining Parity with Peers

- What **weaknesses** must be neutralized to achieve parity with peer countries?

- The **private sector** must lead the process of competitiveness improvement and provide continuity and accountability

# The Croatian Competitiveness Paradox

- Croatia has institutions like the **National Competitiveness Council** designed to guide competitiveness upgrading
- Croatia has **plans** that identify the weaknesses the country needs to address

**BUT**

- Croatia has made **limited if any progress** on upgrading its competitiveness in recent years

# The Moment For Action

- The struggle for independence, the war with Serbia, and the path to political normality after the war have shifted **political focus** away from competitiveness
- **Economic growth** due to a natural catch-up has been sufficiently good so that there has not been pressure for real reform
- **EU membership** has been seen as the automatic path to competitiveness, requiring no further action within the country
- **Entrenched interest groups** in the political and economic sphere have paid lip service to competitiveness but have been unwilling to engage in real reforms that threaten the status quo



- Leaders in business and government must **launch a new chapter** in Croatia's economy if the country is to hold its gains, much less see further standard of living improvements