

The Cluster-Based Initiative Approach to Competitiveness and Economic Growth

Background

This technical brief draws on and summarizes the findings of the recently completed USAID funded report by the Mitchell Group, *Promoting Competitiveness in Practice: An Assessment of Cluster-Based Approaches* (Washington, D.C., 2003).

A cluster is a value chain¹ of enterprises, plus related and supporting organizations and supporting organizations including trade associations, universities and vocational schools, financial institutions, and local and national-level government agencies. The close interplay between firms, their suppliers and the business environment in clusters has led competitiveness theorists and practitioners to focus on “clusters” as the locus of action, as opposed to individual firms or broad sectors

Individual clusters are defined by the linkages among the firms, industries, and economic infrastructure typically of a particular region.² It is argued by competitiveness initiative proponents that working in a frame of reference of geographically-concentrated “clusters” of firms and other development actors is an integral part of a competitiveness-enhancing program and is a promising way of increasing economic growth – thus, that competitiveness initiatives should typically be at least in part cluster-based so as to capitalize on cluster-driven economic growth

For economic growth to take place and take hold, firms needed to become continually more productive. Business people have to rethink their ways of doing business. But typically they cannot do this rethinking in the economically most productive way on their own, but only as part of a growing, self-coordinating whole. The “cluster” approach to analysis of economic competitiveness is motivated by the observation that firms have a variety of relationships with other firms: competing, complementary, interdependent, or a combination of those basic types.

Although the proposition is not universally accepted, Michael Porter of Harvard and other leading economists and development practitioners have put forth the idea that dynamic and innovative business clusters are the key feature of competitive, rapidly growing, resilient economies. Since 1998, from a small initial base of known clusters of inter-related businesses and their partners, hundreds of potentially economic growth-producing clusters have been fostered by USAID and others. It is claimed that strategies for economic growth and development are strengthened when a cluster-based approach is utilized. Saying this is easy. Putting it into practice is more difficult, and this is what the Mitchell report is about.

Clusters Facilitate Building Competitiveness in Global Markets

Firms in a particular region, even when in different industries, are typically related to each other to a greater or lesser degree through buyer-supplier relationships and a shared set of fundamental economic factors. The fundamental factors are the range of locally-available economic resources: workers, financial capital, technology, infrastructure (such as port facilities), natural resources, institutions, legal environments, and policy regimes. Each of these factors is usually complex. For example, workers can be skilled, adaptable, or entrepreneurial, while financial markets may vary in terms of depth and breadth. The array of fundamental factors and their current state of interconnectedness define, in a first order sense, the competitiveness of a particular region or country in the global marketplace (and in its own

marketplace for that matter).

The inventory of these fundamental factors and their current configurations does not tell the whole story of competitiveness. The degree of dynamism in horizontal and vertical networks within industry clusters will determine the competitive position of a country or region. Competitiveness requires innovation and dynamism to be adopted all along the value chain of an industry. In what is commonly called the new paradigm of competitiveness, the competitiveness of a country or region depends on the development of its various clusters of inter-connected companies, specialized suppliers, service providers, and associated institutions in a particular field as well as the quality of its microeconomic business environment. To promote effective cluster-based competitiveness-building efforts, donors provide technical assistance to local business people and partners in government and academia to develop a cluster's economic growth potential.

Cluster-Based Competitiveness Initiatives and How to Do Them to Make a Difference

USAID and other donors have been applying competitiveness-oriented cluster theory to undertake competitiveness initiatives in particular countries and regions in the developing world. The assessment typically results in the identification of institutional and policy constraints to business development, new technologies or new ways of using existing technologies, and new ways for firms to develop complementary or interdependent relationships. The Mitchell Group report looks at and appraises the experience of USAID and others in doing this, and offers a sizable set of lessons learned and cautionary admonishments.

USAID launched its first large-scale cluster-based competitiveness initiative in Lebanon in 1998. USAID's portfolio of these types of competitiveness initiatives has been growing rapidly since then, and USAID now has accumulated experience of this type in more than two dozen countries.

The process of engaging firms and policymakers in the competitiveness assessment is the beginning of a process with broader implications. Industries can be re-positioned, so that the firms enter niche markets for products, or profit from higher value added products. Policy, legal, and regulatory reforms can be conducted within an effective strategic framework. Public dialogue on economic policies can be changed, with improved support for competitiveness. Partnerships, both private-private and private-public, can be newly forged and sustained.

Lessons Learned From The Mitchell Report

The recently released USAID-funded report by the Mitchell Group, *Promoting Competitiveness in Practice: An Assessment of Cluster-Based Approaches* assesses the experience of USAID's cluster-based competitiveness initiatives. The key conclusions were:

- The most important determinant of success is the “sweat-equity” investment of the cluster participants.
- The private sector must own and drive the process of cluster development.
- To gauge success in assisting cluster development and economic growth impact, donors need clearly defined, meaningful performance indicators and regular tracking of implementation - but these have been lacking – to the detriment of demonstrating results.
- Leadership matters. One strong leader can make an enormous difference – and conversely, the lack of a champion can mean an effort's stagnation or demise.
- Leadership must come from the local community – donor-funded consultants play a facilitative role and cannot be expected to substitute for local leadership. Absence of emerging leadership in a cluster is a warning sign that the cluster may fail to coalesce or progress in spite of outside assistance.
- TA should not be provided for clusters with little prospect for private sector ownership of the cluster strategy and activities.
- Cluster development is often hardest in traditional industries.

- Don't over-water the garden. Funneling too much money through a competitiveness initiative may weaken local initiative.
- Funding activities that primarily benefit only one or a handful of companies should be avoided and funding to cover costs that would normally be assumed by the private sector should not be provided.
- It may be more challenging to implement cluster-based competitiveness initiatives in transitional economies than in others.
- Cluster-based competitiveness initiatives are not a "quick-fix" – they take time to work, so expectations of results should be tempered accordingly.

FOR FURTHER READING See the comprehensive report, *Promoting Competitiveness in Practice: An Assessment of Cluster-Based Approaches* (November 2003). Copies are available from the Office of Economic Growth of EGAT. The report is one of four key reports on cluster approaches commissioned by USAID and completed by The Mitchell Group. Contact Amy Cogan, Senior Competitiveness Advisor, acogan@usaid.gov, of EGAT's Enterprise Development Team for your copy today.

¹ An economist would probably want to say a "value-added chain" but the term "value chain" seems to be the one in use with competitiveness experts.

² The Mitchell Report cites a definition of clusters from the Institute for Strategy and Competitiveness website: www.isc.hbs.edu clusters are "geographic concentrations of interconnected companies, specialized suppliers, and associated institutions in a particular field."