Promoting Competitiveness in Practice

An Assessment of Cluster-Based Approaches

Prepared for
The U.S. Agency for International Development

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At the request of the U.S. Agency for International Development, The Mitchell Group has prepared four reports on promoting competitiveness. The complete series of reports includes:

Promoting Competitiveness in Practice
An Assessment of Cluster-Based Approaches

Promoting Competitiveness in Practice
The Manager's Guide to Cluster-Based Approaches

Promoting Competitiveness in Mongolia
Learning from a USAID Experience

Promoting Competitiveness in Campeche, Mexico
Learning from a Non-USAID Experience

PROMOTING COMPETITIVENESS IN PRACTICE
AN ASSESSMENT OF CLUSTER-BASED APPROACHES

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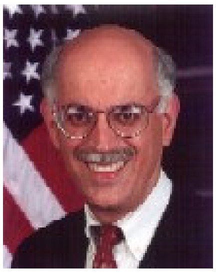

This report – *Promoting Competitiveness in Practice: An Assessment of Cluster-Based Approaches* – was prepared by The Mitchell Group at the request of the Office of Economic Growth in USAID's Bureau for Economic Growth, Agriculture, and Trade (EGAT). Harvard's Michael Porter and others have led the way in suggesting that development of dynamic and innovative business clusters is critical for countries to compete more effectively in world markets. Macroeconomic stability, strong institutions, and the rule of law are widely recognized as essential to economic growth. Porter's competitiveness approach emphasizes the need to pay attention to sector-specific reforms and other aspects of the microeconomic environment in which businesses thrive as well as the macro context.

USAID and other donors have taken up the challenge of applying this theory, launching a number of cluster-based competitiveness projects intended to facilitate the formation of sector-specific industry groups. The projects identify policy constraints, new technologies, and new ways of working together that, combined, are expected to increase productivity and allow the industry to compete effectively in global markets. Because cluster-based approaches are growing in USAID and among development practitioners generally, we felt that it was important to commission an independent assessment of these applications of cluster theory and the results they have achieved to date.

To our knowledge, this is the most comprehensive effort yet to evaluate the performance of cluster-based approaches to promoting competitiveness in developing countries. Many development professionals remain deeply skeptical of industry- or firm-level level work, preferring to emphasize efforts that develop the investment climate without running the risk of "picking winners" or promoting a particular sector. A careful reading of *Promoting Competitiveness in Practice* suggests, however, that work at the industry and firm level can quickly illuminate both macroeconomic and microeconomic constraints to growth and can engender a "participatory" process of reform that ensures private as well as public sector ownership. The report also offers concrete recommendations for increasing the effectiveness of cluster-based programs.

It is my sincere hope that this assessment will complement the impressive new information becoming available on investment and business climates across the developing world. We thank the authors and The Mitchell Group Inc. for an unusually thorough and thoughtful report.

Andrew S. Natsios

Andrew S. Natsios, *Administrator, USAID*

PROMOTING COMPETITIVENESS IN PRACTICE
EXECUTIVE SUMMARY

Over the past five years, USAID has become an increasingly important player in the field of promoting competitiveness. On the one hand, its competitiveness initiatives have often generated a new vision and enthusiasm for promoting economic change in developing countries. However, there is also considerable confusion and misunderstanding about what promoting competitiveness is all about and what missions can or should anticipate when they embark on a competitiveness initiative.

The purpose of this assessment is to take an objective look at the practice of promoting competitiveness; gain a better understanding of what has worked and what has not worked; and learn how to improve USAID's work in promoting competitiveness. This assessment does not look at the full range of activities that contribute to competitiveness. Rather, our focus is on cluster-based competitiveness initiatives – that is, the types of initiatives that are specifically designed to develop clusters as a vehicle for promoting competitiveness.

The assessment team carried out three distinct activities in order to better understand how cluster-based competitiveness initiatives play out. As a starting point, the team conducted a comprehensive desk review of USAID's competitiveness experience in 26 countries. This included in-depth interviews with USAID's contractors/practitioners, as well as its internal staff. The team then examined the experience of promoting competitiveness outside of USAID – first, by conducting an extensive review of the literature on competitiveness practice and then interviewing multilateral and regional donors and other organizations that have explored the use of cluster-based approaches. Lastly, the team carried out field assessments of two competitiveness initiatives – a USAID-funded initiative in Mongolia and *Transformando Campeche*, an initiative launched by the local business community to revitalize the state of Campeche in southeastern Mexico.

Key Results and Lessons Learned from Competitiveness Initiatives

In examining the experience of promoting competitiveness in Mongolia and Campeche, the team saw a number of positive developments. Most notably, firms are making changes that bring them closer to their customers and the market – and that bodes well for increased competitiveness over the long term.

The team's review of these two cases, as well as the USAID and non-USAID experience more broadly, reveals important lessons for future competitiveness initiatives:

- *The most important determinant of success is the "sweat-equity" investment of the cluster.*
- *Successful cluster-based initiatives are private sector driven – with links to the public sector. They are not public-sector driven – with links to the private sector.*
- *Cluster-based competitiveness initiatives are not a "quick fix" solution. They involve major shifts in thinking and practice and, hence, results take time.*

This assessment report represents the synthesis of what the team has learned through these three activities. As a preview, some key results and lessons learned are highlighted in the box above. Additional results and lessons learned are described and explained at the end of this executive summary and, in particular, in the main assessment report.

An Overview of Competitiveness Practice

Over the past decade, there has been tremendous growth in the practice of cluster-based competitiveness initiatives. As a result, today, there are literally hundreds of cluster initiatives in action around the world, all with their unique shape and twist depending on where and how they emerged and, often, who started the initiative. This has important implications for USAID. Most importantly, USAID is clearly not going down the path of exploring cluster-based approaches alone. Hence, while they may seem new and experimental to many leaders and officers within the Agency, there are many other organizations – both within the donor community and outside of the donor community – that are also implementing cluster initiatives. This is very much of a global phenomenon.

Much of the significant growth in the use of cluster-based approaches has emerged over the past five years. This is particularly true for USAID and other donors such as the World Bank and the Inter-American Development Bank. USAID launched its first major cluster-based competitiveness initiative in Lebanon in early 1998. However, as of January 2003, its portfolio of competitiveness initiatives had grown to nearly $60 million in 26 countries, including major initiatives in seven countries: Lebanon, Sri Lanka, Mongolia, the Dominican Republic, Uganda, Croatia, and Macedonia. Since January 2003, many USAID missions have expanded or added new competitiveness initiatives; the portfolio is definitely growing – in fact, quite rapidly.

What is a Competitiveness Initiative?

Each competitiveness initiative is unique. Despite their many differences, our review of the practice of competitiveness initiatives has revealed that they also have a lot in common. It is these shared or core elements that help us understand what a competitiveness initiative is in concrete terms. The core elements of competitiveness initiatives are best described in terms of: (i) their guiding principles; (ii) their key components; and (iii) the process or approach used to implement competitiveness initiatives.

The Guiding Principles

In looking at the collective experience of practitioners, we found that there is a core set of principles or concepts that serve as the foundation for their work. Many of these principles are closely aligned or derived from the theoretical foundations for competitiveness articulated by Michael Porter and other leading thinkers on competitiveness; however, many of the same principles have emerged through the practice of competitiveness initiatives. Today, theory and practice are closely intertwined in these guiding principles.

Individual firms cannot become competitive and stay competitive in the global market on their own; building competitiveness involves sustained change throughout the value chain. The close interplay between firms, their suppliers, and the business environment is why competitiveness theorists and practitioners focus on "clusters" as the locus of action, as opposed to individual firms or broad sectors. Clusters are "geographic concentrations of interconnected companies, specialized suppliers, service providers, and associated institutions in a particular field."[1] "Associated institutions" might include: educational and training institutions that build the workforce for an industry; research institutions that generate the scientific knowledge required for technological change; banking and financial institutions; government institutions whose policies and practices have an impact on the industry; and providers of infrastructure for the industry. These institutions are an essential part of the cluster as their "products and services" also feed into the value chain and their ability (or inability) to change and innovate has a direct impact on firms' ability to compete in global markets.

Geographic proximity is important …. especially in an increasingly global economy. A second principle underlying competitiveness initiatives is the importance of geographic proximity. To reiterate, clusters are defined as "*geographic concentrations* of interconnected companies, specialized suppliers, service providers, and associated institutions in a particular field." Hence, in many competitiveness initiatives around the world, we see a focus on "economic regions" as the engine of growth. Such regions have little to do with political or administrative boundaries and more to do with the clustering of firms and institutions that are interconnected ... or, in the case of many developing economies, should be interconnected.

Paradoxically, Porter argues that as the world becomes increasingly interconnected, building competitive advantage has more to do with things that are fundamentally local: relationships and interactions (which are easier to build when people are in close proximity and share a common language and culture) and information sharing (which is far more effective in face-to-face situations than through even the most sophisticated communication system).

Competitiveness initiatives are about building connections and relationships among firms and institutions that have traditionally acted in isolation. In most of the countries where USAID operates, there are very few connections or relationships among firms and institutions; moreover, firms and institutions are often weak in and of themselves. Competitiveness initiatives are about building connections and relationships among firms and institutions within a cluster so that they can more effectively tackle the barriers to increased productivity.

Building these connections requires major shifts in thinking and behavior … shifts that are not easily achieved. Competitiveness initiatives are about mobilizing people to re-think the way they do business: to focus on international market demand (as opposed to supply-driven approaches to production); to move toward offering more sophisticated and higher value-added products (as opposed to relying on basic commodities); to innovate (rather than imitate at lower cost); and to collaborate intensely with competitors and government and academia in the process (despite often long-standing antipathies and lack of trust).

While the focus is global, the momentum for change must be local. These kinds of changes are not changes that a donor – or any external agent -- can make happen. Promoting competitiveness requires fundamental change within firms; in the relationships among firms; and in the relationships between firms and their supporting institutions (including government and academia). These kinds of changes can only take place when firms see that it in their best interest to change and when they take ownership for making change happen. This does not mean that there is not a valid and important role for external agents like USAID; however, what is does

[1] The Institute for Strategy and Competitiveness website: www.isc.hbs.edu.

mean is that without local business leaders taking the lead in promoting and driving the process of change, the likelihood of substantial or sustainable change is minimal.

A participatory strategic planning process is the starting point. The participatory strategic planning process embedded in most cluster-based initiatives enables cluster members to: discuss and build their own consensus on the critical issues and the key impediments to engaging global markets; design a strategy and initiatives that will realistically enable them to engage global markets more effectively; and then – and most importantly – assume responsibility and ownership for specific initiatives and actions. It is a process that enables the cluster members themselves to determine the parameters of what they will do and will not do … as opposed to USAID or any other donor determining the parameters of what should be done from their perspective.

We believe that it is the participatory strategic planning process – and the resulting local ownership in and responsibility for implementation – that makes competitiveness initiatives distinctly different from USAID's other economic growth initiatives. Competitiveness initiatives are private sector led and driven in their implementation, and this implies a fundamentally different role for USAID and its contractors.

Key Components of a Competitiveness Initiative

Another way to understand what defines the core elements of a competitiveness initiative is to examine its typical components. Five typical components of competitiveness efforts are:

Cluster Development to Re-position Industry

The "heart" of competitiveness initiatives is cluster development to re-position the industry; The process of a cluster collaboratively designing a strategy and identifying and executing targeted actions results in "re-positioning industry" towards niche markets, greater value-added products. The key difference is that the strategies are devised and implemented by cluster members themselves, making local ownership and sustainability much more likely.

Strategic Reforms of Policies, Laws and Regulations

Such reforms typically emanate from the cluster development process described above. Again, the process of the cluster deciding which reforms are critical to its competitiveness – and which reforms the cluster realistically can affect and change – is what differentiates policy, legal and regulatory reform under a competitiveness initiative from other donor efforts in this arena. Rather than a donor or expatriate advisors identifying the key reforms that are necessary or desirable, local actors with personal and professional stakes in seeing through such reforms pinpoint a particular issue as a constraint, collectively decide to address it, and determine appropriate means to effect change.

Changing the Dialogue

To influence policy, legal and regulatory reforms, the private sector must interact with government, the enactor of such legislation and rules. How the private sector conducts such interaction is a central element of competitiveness initiatives. As outlined in the guiding principles, cluster members must begin to see that, although they are competitors, some issues present common obstacles and, consequently, it makes sense for the good of their business as well as the cluster to combat these challenges collectively. In this respect, the dialogue within the private sector itself changes, moving from confrontation to "cooperating to compete." Competitiveness initiatives aim to produce dialogue between public and private sectors that is less combative and more effective.

Partnerships
As dialogue both within the private sector and between the public and private sectors becomes more common, more effective and more trusted through a competitiveness process, joint activities and investments occur with greater frequency and involve greater complexity. Partnerships may include, for example, joint investments, agreements to separate functions and responsibilities into public or private hands, or collaboration on institution building. Because they involve sharing of financial and sometimes human resources as well as deep, strong consensus on goals, functions and anticipated outcomes, both public-private and private-private partnerships typically occur when competitiveness initiatives are at more mature stages.

Improving Understanding and Support for Competitiveness
Lastly, competitiveness initiatives typically include efforts to broaden knowledge of competitiveness, both within targeted groups and the general public. Many different mechanisms for information dissemination are used, including, for example, newspaper articles and editorials, training of journalists in competitiveness principles, workshops to deepen university professors' and students' knowledge, round-table discussions involving public and private sector leaders, and publicizing the deliberations and actions of national competitiveness councils, among other means. The central objective of media and public information efforts is to build knowledge of competitiveness principles so that the general public is supportive of different roles and dialogue between and within the public and private sectors; moreover, emerging clusters can observe, learn from and potentially emulate other clusters' experiences.

The Approach Used in Cluster-Based Competitiveness Initiatives

The desk assessment of USAID's worldwide competitiveness efforts reveals that the methodologies used by USAID contractors to implement competitiveness initiatives exhibit an overall consistency of approach. The general approach to competitiveness initiatives used by USAID contractors is delineated in detail below.[2]

Phase 1: Conducting Initial Competitiveness Diagnostics
A cornerstone of competitiveness initiatives is that local private sector leaders drive the process. The initial competitiveness diagnostics, in contrast, are led by the contractor – but nevertheless this stage is central to evaluating if local entities and individuals have the understanding, enthusiasm, and commitment to shoulder the responsibilities entailed in the competitiveness approach. The typical actions taken during this phase include:

[2] It should be noted that no practitioner follows the methodology exactly as delineated below. Instead, what is described below is a composite approach developed by the assessment team based on a number of contractors' implementation experiences. As such, the approach detailed below provides the assessment team's view of "best practices" learned from implementation of USAID's competitiveness initiatives.

- Assessing (in broad terms) the country's economic foundations;
- Benchmarking the country against comparative and/or competitive peers;
- Conducting an intensive series of workshops to improve understanding of competitiveness and its relevance in the local context; and
- Initiating outreach to local media, universities and other public communications channels.

Phase 2: Identifying Clusters

It is during this phase that the private sector-led nature of competitiveness initiatives emerges strongly. Prior to entering this phase, USAID and its contractors may identify sectors that meet criteria important to achieving the country's and USAID mission's economic growth objectives. However, regardless of which clusters are identified preliminarily, it is ultimately the interest and commitment demonstrated (or not) by various clusters that, at the end of this phase, determines if USAID moves forward on a competitiveness initiative and, if so, which clusters initially will be involved. By Phase 2, potential cluster participants should understand that competitiveness initiatives revolve mainly around their own efforts – with project-funded long-term advisors and strategic short-term assistance providing support rather than leadership.

Through the process above of testing cluster interest and commitment, USAID and its contractors avoid "picking winners" (a common criticism of competitiveness initiatives) and, rather, allow enthusiastic "self-selected" groups to gain valuable technical assistance with which they can improve their growth prospects. Regardless of a cluster's commitment at project inception, however, enthusiasm and action must be assessed on an on-going basis, and USAID must be willing to end support for clusters whose interest and activities wane.

Phase 3: Crafting Cluster Strategies

The objective of Phase 3 is to facilitate a strategic planning process that enables a cluster to define its common interests, strategic vision and action plan. The cluster develops a targeted set of achievable initiatives and assigns tasks: that is, it identifies individual and institutional champions that agree to carry out each initiative. Throughout the process, the contractor serves as a facilitator, lending expertise and objective data during points of substantive contention, defusing nonproductive disagreements, questioning overoptimistic or grandiose ideas, and continually focusing the dialogue on the major issues identified from the cluster analysis. The "task-volunteering" end of this step is a pivotal point in the cluster's development, as it represents the juncture at which cluster members must demonstrate concretely their willingness to do more than "talk."

Phase 4: Implementing the Cluster Strategies

This phase is the time when discussion and planning are turned into action. Each cluster will take different steps to achieve its goals; regardless of the specific actions, the overall objective is, simply put, to implement the strategy and action plan developed in Phase 3. Actions vary widely depending on the sector, the local context, and cluster members' interests. In all cases, the actions should be led by the responsible individual and institutional champions or civic entrepreneurs who committed in Phase 3 to take charge of the activity. The contractor lends a key supporting role to these activities. Types of support that contractors often provide during this phase are: targeted technical assistance; specialized training; international market research;

policy, legal and regulatory analysis; facilitation of dialogue and engagement with the public sector; and media outreach and assistance with public communications

Phase 5: Sustaining the Cluster Initiative
Most USAID-funded competitiveness initiatives are still on-going; that is, they have not yet reached the critical stage of transition from donor assistance to independent operations. From the experience of one of USAID's longest-running competitiveness activity, that in Sri Lanka, we see that each cluster's "graduation" strategy might be different. Three general paths are being considered by the clusters: (i) formation of a new (nonprofit, nongovernmental) apex organization to continue cluster activities; (ii) agreement to house and continue cluster activities within an existing organization; or (iii) commitment to continue activities and meetings in an informal manner, rather than through a specific entity.

Despite the linear and apparently straightforward methodology presented above, there is no "cookie cutter" approach to implementing competitiveness. Context and strategy determine the substance that clusters will address and the activities they will assume – and initiatives therefore play out differently depending on local circumstances. In many respects, the real test of a competitiveness initiative is its ability to "adjust" to the local terrain, as evidenced by its ability to change the way local actors understand and tackle the constraints to productivity. We see how this "test" plays out in the results.

The Results

Measuring results in development assistance projects is always difficult. Attributing results to project interventions leads to further complication. And choosing measures that are meaningful, reliable and reasonably available is yet more complex. Competitiveness initiatives share all of these often-seen difficulties of measuring results. At the same time, competitiveness initiatives also pose some unique challenges in measuring results. Our assessment encountered five central challenges, namely:

The lack of meaningful base-line data from which to measure change
We have not encountered a single instance in which baseline data about a cluster was collected. In other words, no in-depth "pictures" of cluster starting points have been taken, making it difficult to determine what has changed as a result of the competitiveness initiative. It should be noted that, as part of Phase 2, clusters are benchmarked at a "high" level – including data such as the industry's percentage of exports in the national and global economies, national or global market share, relative employment concentration, etc. However, "lower level" (and harder to obtain) data on skills, wages, productivity, investment, revenues, number of firms, linkages among firms, profitability, and other factors is lacking in the initiatives we examined.

The lack of cluster engagement in setting quantitative targets
Among the cluster initiatives that we examined, we also have not encountered an instance in which the clusters have been engaged in determining quantitative targets as part of the strategic planning process. As described in Chapter 4, clusters define a "big-picture" vision, strategic initiatives, and specific tasks to implement those initiatives. However, as part of this process,

there is no attempt to define quantitative targets that are meaningful and relevant for its members.

The time needed for quantitative results to emerge
It takes considerable time for quantitative results to emerge from a competitiveness initiative – particularly, if the metric is changes in productivity, value-added, or exports. A cluster-based competitiveness initiative involves promoting fundamental change in the way people do business, and this does not happen very quickly or easily.

The reliance on cluster facilitators to tell the results
The lack of quantifiable targets and monitoring systems in cluster initiatives, combined with the dearth of independent assessments and evaluations in this area, mean that cluster facilitators are generally the key sources of information on "results." We learn a tremendous amount from the experience of cluster facilitators. However, they also have a stake in promoting the success of their initiatives. Thus, reporting on results often gets entangled with marketing and promotion.

The difficulty of measuring the results of cluster development
One of the key tenets underlying cluster-based initiatives is that competitive advantage does not lie within an individual firm, but rather, in the *interaction* among firms in a value chain and associated institutions and organizations. As noted by Philip Raines, "these networks embed tacit knowledge, social capital and range of intangible assets which not only generate a territory's competitive advantages but sustain them over time."[3] It is precisely these intangible assets that are so important for cluster initiatives, but also so difficult to measure.

Developing a Strategy for Assessing Results

For all of the reasons outlined above, we do not have the evidence to make definitive or quantitative conclusions about the results of cluster-based initiatives. Recognizing the data limitations, the assessment team developed a strategy that would enable USAID to better understand some of the less-quantifiable – but equally important -- results of a cluster-based competitiveness initiative. Specifically, the team determined that its strategy for assessing results needed to:

Focus on the results from the two field assessments
The crux of our approach was to examine what has changed as a result of the cluster-based competitiveness initiative from the full range of stakeholders in the process, including firms, government, educational and research institutions, the facilitator and others – thus, enabling us to go significantly beyond the perceptions of cluster facilitators alone.

Recognize the validity and importance of qualitative changes
Because of the lack of base-line data, we recognized that we would not be able to measure quantitative changes in productivity or value-added. However, we also did not want the assessment to focus on the potential value-added associated with the clusters' strategic initiatives

[3] Raines, Philip, ***"The Challenge of Evaluating Cluster Behavior in Economic Development Policy,"*** European Policies Research Center, University of Strathclyde, May 2002, page 1.

in the future. Rather, our aim was to capture the actual changes that had occurred thus far – and this necessarily meant focusing on more qualitative types of changes.

Focus on changes that emerged as a result of the clustering process
We focused on those changes that could be attributed or linked to collective participation in a cluster effort, as the cluster process is what distinguishes competitiveness from other economic growth approaches. Specifically, we focused on change at two levels: change at the firm-level and change at the cluster-level.

Findings

Change at the Firm Level
As discussed in the guiding principles, competitiveness initiatives require firms to "re-think" they way they do business. No longer is competitiveness about offering the same product at a price lower than your competitor; and no longer is competitiveness about seeking increased subsidies or protection for your products. Rather, promoting competitiveness involves much more fundamental change within the firm and between firms and supporting institutions, beginning with what many competitiveness practitioners refer to as changes in the "mental models" – that is, the core assumptions that guide firm strategy and operations. We saw clear evidence of shifts in the mental models guiding firms in four distinct areas: (i) the understanding of competitiveness; (ii) a greater focus on the customer and market demand (as opposed to supply-driven approaches to production); (iii) a focus on offering more sophisticated and higher value-added products (as opposed to basic commodities); and (iv) emerging signs of innovation (rather than imitating at lower cost). For some clusters, these changes in mental models translated into behavior change – however, not always.

Change at the Cluster Level
Competitiveness initiatives are fundamentally about building connections and relationships among firms and institutions that have traditionally acted in isolation. Hence, in conducting our field work, we looked carefully at the question of whether the competitiveness initiatives had an impact on the interactions among cluster participants.

In Mongolia, we saw emerging signs of stronger linkages – particularly, among firms in the tourism industry. We also saw new and positive interaction between segments of the value chain in the cashmere industry, resulting in a much greater understanding of the need to focus on the customer. Our primary concern is whether these linkages can be sustained. In large part because Mongolia's competitiveness initiative was more contractor-driven than cluster-driven, it is not clear whether the strategic initiatives can or will be sustained in the absence of the contractor.

In Campeche, we saw relatively few signs of increased ties, trust and collaboration – even though this initiative started from a strong foundation, including a group of visionary business leaders, a strong and participatory strategic planning process, and the support of local government leaders. At the onset of the initiative, there was enthusiasm and strong support for the initiative from the business community, the local government, and the academic community. Each of the clusters developed a vision for the future, as well as a series of strategies and initiatives. However, in reality, only a few of these initiatives came to fruition.

Summary
Overall, we see some positive developments at the firm level and the cluster level. Most notably, in a number of cases, we see businesses making changes that bring them closer to their customers and the market – and we believe that bodes well for increased competitiveness over the long term. We also see emerging signs of cluster development. In some cases, firms are beginning to recognize the value of collective action and change the way they engage each another -- to their mutual advantage in the market.

Lessons Learned and Best Practices

The assessment of results focused specifically on the experience in Mongolia and Campeche. However, in order to understand the lessons learned from promoting competitiveness, the team drew upon not only these two cases, but also its comprehensive review of USAID experience in 26 countries and its review of the experience outside of USAID. Each lesson is described below, along with the operational implications that emanate from the lesson. As such, the lessons and best practices are intended not only to summarize the key findings of this assessment but also to provide practical guidance to shape on-going and prospective cluster-based initiatives.

The most important determinant of success is the "sweat-equity" investment of the cluster.
For a competitiveness initiative to develop successfully, cluster members must be committed and willing to devote time, resources and, most importantly, "sweat-equity" for the good of the industry as a whole. Cluster members first must take the time to thoroughly sort through the challenges facing their industry and then collectively define common ground and a common vision. With disparate parts of the cluster coming together for (in many instances) the first time, this issue identification and strategy development process takes time – time that cluster members must be willing to invest and time that USAID and its contractors must be willing to "give." Related best practices include:

- In the absence of significant dedication by cluster members to the principles above, USAID and its contractor must refrain from substituting themselves as the cluster leader.

- In such circumstances, USAID and its contractor must assess why the cluster is not demonstrating signs of commitment and consider one of these options: (i) address the underlying issues before proceeding with a cluster initiative; (ii) significantly modify the nature of the project away from the organizing theme of cluster-based competitiveness; or (iii) halt assistance to the cluster.

The private sector must own and drive the process of cluster development.
There is no doubt that the economic policy framework of a country is important for creating the conditions for competitiveness and growth. However, growth itself is generated by firms, not by public sector institutions that formulate economic policy. Therefore, successful cluster-based competitiveness initiatives are fundamentally private sector driven – with links to the public sector. They are <u>not</u> public sector driven with links to the private sector. This is not to say that engaging the public sector is not important for a cluster-driven competitiveness initiative. It is; but companies – through clusters – need to sit in the driver's seat because it is their decisions and investments that will directly propel sustainable growth. Related best practices include:

- USAID and its contractors must allow the initiative to proceed as fast – or as slowly – as the clusters are willing and able to go. Efforts by USAID or the contractor to jumpstart the process usually backfire, especially if such efforts override participatory mechanisms for defining strategies and developing consensus on actions.

- USAID and its contractors must act as facilitators – not leaders – of the cluster process. As such, the contractor's role is nonetheless critical and serves key functions such as: an honest and trusted broker among often-fractious parties; a neutral, objective outsider with needed global knowledge and perspective; and a provider of both strategic planning capabilities and in-depth industry expertise.

Clear definition and regular tracking of meaningful performance indicators have been lacking – to the detriment of demonstrating results.
Far-reaching, concrete results from cluster-based competitiveness initiatives are scarce. One reason for the lack of measurable results is that such processes take time. However, the expected lengthy time frame for seeing demonstrable results does not explain the lack of systems in place today to monitor and track progress towards goals. A related best practice is that:

- Clusters themselves should set targets for their work and periodically evaluate progress toward (or lack thereof) the target. If the target is no longer relevant, then the cluster should define a new target if necessary. Setting such targets should be part of the strategic planning process and part of implementation of cluster activities.

One strong leader can make an enormous difference – and, conversely, the lack of a champion can mean an effort's stagnation or demise.
Nothing exemplifies the importance of the "human factor" in cluster development more than this lesson. In the same way that is true for most of human endeavor, an inspiring, respected and dedicated individual, more than any objective measures of cluster potential, can provide the impetus for change. Visionary business leaders and champions are key to making this process work. Related best practices include:

- The contractor must maintain a facilitative rather than directive role during the cluster identification and (especially) strategy development stages to permit "space" for new civic entrepreneurs to emerge.

- The contractor must cultivate and support champions or leaders who assume responsibility, inspire others and think beyond their parochial interests.

- Scarcity of emerging leaders is the first warning sign for USAID and its contractors that a given cluster may not coalesce or progress.

Cluster development is often hardest in traditional industries.
Participants in such sectors have "histories" with each other; memories of "glory days" tend to produce backward- rather than forward-thinking; and new ideas or participants can threaten older leaders, who may think only they know the sector. From cashmere in Mongolia to shrimp in

Campeche to coffee in El Salvador, traditional sectors demonstrated their reluctance to embrace the new ways of doing business embodied in cluster development. These findings reinforce the importance of the "self-selection" process discussed extensively in Chapter 4. Operationally, these findings tell us that:

- Cluster selection must rely on cluster members' interest and enthusiasm. To demonstrate the benefits of working together, cluster-based competitiveness funds must go where movement, however small, is happening ... not where the economy "used to be."

Funneling too much money through a competitiveness initiative may weaken local initiative.
Although it is not possible to prescribe a uniform budget for cluster-based competitiveness initiatives (as always, local context matters, as does the number of viable clusters), tens of millions of dollars are not likely to be necessary for this type of development assistance. Indeed, the more money available, the less the private sector may be willing to devote its own resources, thus undermining local ownership and initiative. As a result:

- Cluster-based competitiveness initiatives should include funding for both facilitation – including a long-term presence by trusted facilitators – and technical assistance on specific industry or functional topics.

- Funding for activities that primarily benefit one or a handful of companies should be avoided, and funding that replaces costs normally assumed by the private sector should not take place.

It may be more challenging to implement cluster-based competitiveness initiatives in transitional economies.
Transitional economies often are characterized by contextual obstacles that, though present in other countries where USAID operates, seem more pronounced or entrenched in nations that have experienced many years of central planning. These features include, for example: a weak civil society in which there is little or no trust between the public and private sector; a lack of tradition of taking joint action on a voluntary basis; a production rather than market or customer mindset; and weak understanding of international markets and basic business skills. From the experience in Mongolia, in particular, we learn that:

- Initial efforts to generate understanding of broad competitiveness principles (i.e., Step 1) may need to be hands-on, interactive and tangible, rather than academic and theoretical.

Cluster-based competitiveness initiatives are not a "quick fix."
Mindset change does not happen overnight. Neither does behavioral change. Trust develops over time, as does understanding of and ability to put into practice new concepts. As do new relationships among businesspeople. And so on. In other words, none of the key elements underlying the human dimension of cluster work occurs quickly, meaning that results from the overall process can be expected in the short-term. As a result,

- In the short term, USAID and its contractors must focus on qualitative outcomes to determine if an effort is on track.

- USAID and its contractors must realize that cluster-based competitiveness is fundamentally a human process ... and behavioral changes take time.

CHAPTER 1
INTRODUCTION

Over the past five years, USAID has become an increasingly important player in the field of promoting competitiveness. On the one hand, its competitiveness initiatives have often generated a new vision and enthusiasm for promoting economic change in developing countries. However, there is also considerable confusion and misunderstanding about what promoting competitiveness is all about and what missions can or should anticipate when they embark on a competitiveness initiative. USAID is not alone in this regard. Indeed, all of the donors we interviewed are wrestling with similar issues: what does promoting competitiveness mean, what kinds of results can be expected through competitiveness, and, ultimately, what is the role of the donor in promoting competitiveness.

These are not easy questions. As Michael Porter notes in his foreword to *The Cluster Initiative Greenbook*, "Hundreds of cluster initiatives have been launched involving virtually all regions of the world, and the number is growing. These initiatives, which take a wide variety of forms, are now an accepted part of economic development. However, we have surprisingly little systematic knowledge of these initiatives, their structure, and their outcomes. As more and more resources are devoted to efforts to foster cluster development, the need to understand best practices has become more urgent."[4]

It is precisely this need to understand best practices that drives this assessment. The purpose of the assessment is to take an objective look at the <u>practice</u> of promoting competitiveness, particularly in the context of developing and transitional economies; gain a better understanding of what has worked and what has not worked; and, on the basis of this understanding, learn how to improve USAID's work in promoting competitiveness. At the onset, the team established several defining parameters for the assessment. These parameters helped to focus the team on the issues of importance to USAID, as well as areas where relatively little analysis had been done previously. Key defining parameters include the following:

- ***A Focus on Cluster-Based Competitiveness Initiatives***

We fully acknowledge that much of what donors and governments do in the arena of economic growth and private sector development contributes to enhanced competitiveness and productivity. This assessment does not look at the full range of activities that foster competitiveness (such as, the important efforts to improve the overall business climate in developing countries). Rather, our focus is on cluster-based competitiveness initiatives – that is, the types of initiatives that are specifically designed to develop clusters as a vehicle for promoting competitiveness.

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[4] Örjan Sölvell, Göran Lindqvist, and Christian Ketels, ***The Cluster Initiative Greenbook***, Ivory Tower AB, August 2003, [Foreword by Professor Michael E. Porter, page 5].

➢ ***A Focus on the Practice of Competitiveness***

There is a rich body of literature on the theoretical underpinnings of cluster development and its links to productivity and innovation. We do not delve deeply into the theoretical underpinnings of cluster development, as this area is amply explored and debated in the literature.[5] Rather, our focus is on a relatively unexplored area: the practice of competitiveness. Hence, key issues for this assessment focus on: (i) what is a cluster-based competitiveness initiative … in practice? (ii) is there a methodology or approach that is typically used in cluster initiatives and, if so, what is it? (iii) what are the critical issues or challenges that emerge in cluster initiatives? (iv) what outcomes or results do we see from cluster initiatives? and (v) what do we learn from the experience to date that can improve future competitiveness initiatives? Many of our findings speak to issues that are rarely brought out in the literature on competitiveness; rather, they are based on the day-to-day issues and challenges faced by cluster practitioners.

THE APPROACH

The Mitchell Group (TMG) prepared this assessment at the request of USAID's Bureau for Economic Growth, Agriculture and Trade (EGAT). The primary authors of the assessment are Sydney Lewis (Team Leader and President of Lewis International, Inc.) and Lynne Manrique, consultant to TMG. Inputs to the assessment were provided by Montague Lord and Greta Boye, consultants to TMG. The team carried out three distinct activities in order to better understand how competitiveness initiatives play out in practice. This assessment represents the synthesis of what the team has learned through these three activities.

1. **Comprehensive Desk Review of the USAID Experience**
   The assessment process began with a comprehensive desk review of USAID's competitiveness experience. As a first step toward carrying out this assessment, EGAT requested that a number of its key contractors prepare a "self-assessment" of their experience in promoting competitiveness.[6] These self-assessments include: a description of competitiveness initiatives carried out by the contractor; their methodology and approach; results achieved to date; and identification of constraints and obstacles. Following a detailed review of the contractors' self-assessment reports, the team conducted a series of in-depth interviews with the contractor practitioners. In addition, the team interviewed a number of the USAID officers who have been most deeply involved with the Agency's competitiveness initiatives – including its proponents and its critics – to better understand the key issues and challenges for the Agency. The USAID desk review was completed in January 2003; hence, the results of this work reflect the status of the USAID portfolio at that time.

[5] See Michel E. Porter, "Clusters and Competition: New Agendas for Companies, Governments, and Institutions," in ***On Competition***, Boston: Harvard Business School Press (1998) for a summary of the theory.

[6] The following firms prepared self-reports for EGAT: (i) Nathan Associates (with J.E. Austin); (ii) Chemonics International; (iii) PricewaterhouseCoopers (with SRI International); and (iv) Carana Corporation.

2. **Desk Review of Non-USAID Competitiveness Initiatives**
   The team also carried out a review of some of the competitiveness initiatives conducted outside of USAID. Given the vast number of competitiveness initiatives in the non-USAID world, this review could not be as comprehensive or as deep as the USAID review; moreover, in most cases, the team was not able to meet one-on-one with the practitioners for these initiatives. Nonetheless, the team was able to garner the range of experience in developing countries and in industrialized countries, as well as better understand the experience of the multi-lateral and regional development agencies including the World Bank, the Inter-American Development Bank, UNIDO, and the OECD.

   This desk review has recently been supplemented by two other important synthesis reports:

   <u>The Cluster Initiative Greenbook</u>. This report was presented at The Competitiveness Institute's Sixth Global Conference in Gothenburg, Sweden in September 2003. Like the USAID assessment, its purpose is help fill some of the critical gaps in understanding cluster-based competitiveness initiatives and their outcomes. Specifically, its purpose is to describe how cluster initiatives operate and explore possible success – and failure -- factors. The report is based on an on-line survey of cluster initiatives, primarily in Europe, North America, New Zealand, Australia, and Japan. While the team received this report after the completion of much of its analytical work, we have attempted to incorporate the most relevant findings for USAID.

   <u>Report on Competitiveness Promotion in Colombia and El Salvador</u>, Inter-American Development Bank, July 2003 (unpublished manuscript). Like USAID, the IDB has been working toward understanding the process and the results of promoting competitiveness. Toward that end, it recently completed an in-depth review of competitiveness initiatives in Colombia and El Salvador. During its preparation, The Mitchell Group team coordinated with the IDB consultant team and shared approaches, findings and conclusions. We have incorporated some of the report's findings into this assessment.

3. **Field Assessments**
   In addition to these desk reviews, the team carried out in-depth field assessments of two competitiveness initiatives: the first one focused on The Competitiveness Initiative in Mongolia, a USAID initiative. The second field assessment focused on *Transformando Campeche*; this was not a USAID initiative, but rather, an initiative launched by the local business community to revitalize the state of Campeche in southeastern Mexico. The purpose of these field assessments was not to evaluate the performance of their respective contractor teams. Rather, they focused on learning about what worked in order to inform and improve future competitiveness efforts globally. The following types of questions were central to the field methodology:

   - What approaches have worked well – and what approaches have not worked?
   - What has changed as a result of the competitiveness initiative – at the firm level, at the cluster level, in the business environment, and in the policy arena? What types of

changes and results emerge during different time periods of implementing a competitiveness initiative?
- What are the lessons learned from these competitiveness initiatives?
- How can these "lessons learned" best be applied to future competitiveness initiatives?

Mongolia. Mongolia was selected as the first field assessment site for several reasons. First, Mongolia is one of the countries in which USAID has had a sizeable competitiveness initiative in operation for several years. Secondly, many USAID officers were particularly interested in understanding how a competitiveness initiative plays out in a transition economy such as that of Mongolia. Lastly, the mission was keenly interested in having an assessment of its experience. The fieldwork for the assessment was conducted in January/February 2003.

Campeche, Mexico. *Transformando Campeche* was selected because we thought it would tell a very different story from that of Mongolia and, hence, would amplify our understanding of competitiveness initiatives. Unlike Mongolia, *Transformando Campeche* was not donor funded; rather, it was funded by a local trust fund for economic development initiatives in the state of Campeche. Unlike Mongolia, *Transformando Campeche* went through a cluster-driven strategic planning process – a key component of most competitiveness initiatives. Nonetheless, Campeche also faced many of the characteristics faced by USAID countries: economic stagnation, significant unemployment, low levels of manufacturing, and the potential for social unrest. Finally, *Transformando Campeche* was launched in 1996; hence, we hoped to better understand some of the down-stream impacts of competitiveness initiatives through an experience that had been launched several years before any USAID initiative. The fieldwork for this assessment was conducted in July/August 2003.

* * *

This assessment is organized to address these questions. Specifically, Chapter 2 provides an overview of competitiveness practice, looking at how the practice emerged in the early 1980s and has evolved over the past twenty years. In addition, this chapter examines how cluster-based initiatives have been developed in the context of USAID, multilateral and regional organizations (such as the World Bank, the Inter-American Development Bank, and UNIDO), and in industrialized countries. Chapters 3 and 4 look at defining elements of cluster initiatives: their components, their guiding principles, and the methodology or process used to implement many cluster initiatives. In Chapter 5, we look at the results generated by cluster initiatives. Our work in this area draws heavily from our field case assessments in Mongolia and Mexico. Finally, in Chapter 6, we examine the lessons learned from the practice of cluster-based initiatives, and most importantly, the best practices that emerge from these lessons.

CHAPTER TWO
OVERVIEW OF COMPETITIVENESS PRACTICE

Over the past decade, there has been tremendous growth in the practice of cluster-based competitiveness initiatives. As a result, today, there are literally hundreds of cluster initiatives in action around the world, all with their unique shape and twist depending on where and how they emerged and, often, who started the initiative. *The Cluster Initiative Greenbook*, for example, identified more than 500 cluster initiatives around the world at the onset of its survey, of which 233 actually participated in the survey. The bottom line is that cluster-based initiatives have now become a widely-used approach to promote economic development – in both industrialized and developing countries.

This has important implications for USAID. Most importantly, USAID is clearly not going down the path of exploring cluster-based approaches alone. Hence, while they may seem new and experimental to many leaders and officers within the Agency, there are many other organizations – both within the donor community and outside of the donor community – that are also implementing cluster initiatives. This is very much of a global phenomenon; and one that is generating significant discussion and sharing of experience, as evidenced by The Competitiveness Institute's most recent annual conference in Gothenburg, Sweden, which brought together hundreds of cluster practitioners from around the world.

The purpose of this chapter is to provide an overview of the practice of competitiveness. We begin by looking at some of the roots of the practice and how it has evolved to become a significant force in the way many organizations now pursue economic development. We then provide an overview of the practice of competitiveness, looking specifically at how cluster-based initiatives have been developed in the context of USAID, multilateral and regional organizations (such as the World Bank, the Inter-American Development Bank, and UNIDO), and in industrialized countries.

THE ROOTS OF COMPETITIVENESS PRACTICE

To the best of our knowledge, there is no definitive or widely-accepted version of how competitiveness practice has evolved over time. Our review and interviews with a number of practitioners suggest that this has been far from a linear process. Rather, competitiveness practice represents the confluence of at least three distinct and separate developments that emerged through the 1980s: (i) the perceived loss of U.S. competitiveness … and the quest for solutions; (ii) the development of competitiveness theory; and (iii) the growing emphasis around the world on the role of the private sector as the engine of economic growth. As described below, each of these developments emerged independently of one another during the 1980s. However, over the past decade, they have become more closely inter-twined to shape the strategies and approaches often used to promote competitiveness.

- ***The Perceived Loss of U.S. Competitiveness … and States' Quest for Solutions***

The reality of global competition became palpable for many U.S. states in the early 1980s, particularly in the industrial mid-west. Commodity prices were falling sharply, threatening the viability of many key industries in the mid-west, and U.S. companies and industries sensed that they were losing out to their overseas competitors and, in many cases, they were. It was this sense of economic crisis that provoked policy-makers and business leaders alike to "rethink" their strategies for building competitiveness in an increasingly global economy.

For many U.S. states and cities, the solution involved creating new -- and often -- quite costly programs to attract investment in target industries. By offering an attractive package of tax and other incentives, states strived to lure companies to locate in their state and, hence, build new industries. At the same time, however, a group of economists at SRI International's Center for Economic Competitiveness began to look at the problems of regional economic development from a different perspective: that is, that building a strong economy is not about offering a better incentive package than your neighboring state, and competition is not a zero-sum game. Rather, the more sustainable solution involves building a strong "economic infrastructure."

At that time, the Center for Economic Competitiveness defined economic infrastructure in terms of five key building blocks: a skilled and adaptable workforce; access to technology; available financing; appropriate physical infrastructure; and a positive business climate.[7] This new model held appeal for policy-makers at the state and city level for several reasons: first, it offered an alternative to what some viewed as "giving up the house" through costly tax breaks. Perhaps, more importantly, it enabled policy-makers to define a pro-active strategy for promoting economic development. That is, by making critical and strategic investments in these various components of economic infrastructure, they could help their existing firms become more competitive and, at the same time, attract new firms.

The focus on developing a region's economic infrastructure was the starting-point for SRI International's cluster development work (and, indeed, today remains the "foundation" of the cluster pyramid, which is described in more detail in the next chapter). However, as the Center for Economic Competitiveness assisted more than 20 U.S. states and cities develop new strategies, its understanding of the dynamics underlying growth and development also evolved.[8] Specifically, in 1984, the Greater Austin Chamber of Commerce engaged SRI's Center for Economic Development to develop a strategy to build its fledgling high-technology industry. The strategy focused on helping Austin become a center of excellence for information technology – and entailed creating an environment in which there would be an unusually high concentration of technology-related firms supported by a specialized economic infrastructure. Hence, while not actually using the word "cluster," the team began to understand the synergies and dynamism that are created by agglomerations of competing and supporting firms, particularly when those firms are well-supported by economic infrastructure. Taking this

[7] Since then, the economic foundation concept has been modified in different ways by individuals/firms that were once part of or connected to SRI's Center for Economic Competitiveness. For example, the Economic Competitiveness Group led by Alec Hansen focuses on six basic building blocks: human resources, access to technology, access to finance, business climate, physical infrastructure, and quality of life.

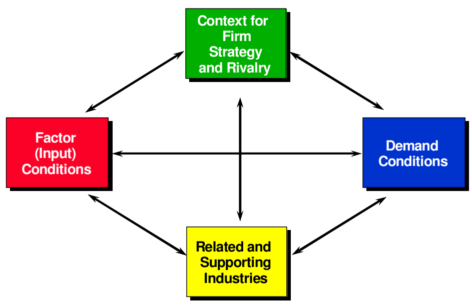
[8] Some of the key US states that the Center assisted included: Arizona, Connecticut, Florida, Iowa, Minnesota, Nebraska, New York, North Dakota, and Wyoming. Some of the key US cities included: Albuquerque, the metropolitan District of Colombia, Los Angeles, metropolitan New York, Portland (Oregon), Salt Lake City, Silicon Valley, and Wichita.

understanding to the next step, the team began to help its clients develop strategies to generate and build upon those synergies through "cluster" development.

This was the start of the practice of cluster-based competitiveness as we know it today. For SRI, the practice emerged in direct response to the need for US states and cities to re-think their approach to promoting economic development in the face of diminishing competitiveness. And, as they helped these states and cities develop new strategies for economic development, the concept of the cluster proved to be a powerful and practical tool for spurring collaboration and joint effort between inter-related firms and their supporting organizations.

➢ *The Development of Competitiveness Theory*

At the same time SRI was exploring the use of clusters as a mechanism for prompting change, Michael Porter was conducting extensive research around the world to examine the patterns and determinants of competitive success of industries in ten nations.[9] In doing so, he developed a new paradigm for thinking about competitiveness. His seminal book, *The Competitive Advantage of Nations*, published in 1990 argued that the competitiveness of locations is rooted primarily in the nature of the business environment they offer firms. He used his now famous diamond-metaphor to explain the attributes of an environment in which highly competitive industries and firms emerge. Specifically, as outlined in his September 18, 2002 presentation to USAID, competitive firms are more likely to emerge when:



- the local environment encourages efficiency, investment and upgrading, and where there is open and vigorous competition among locally based firms (firm strategy and rivalry).

- the local environment provides high-quality and specialized inputs to firms, including: human resources; physical infrastructure; capital resources; scientific and technological infrastructure; information infrastructure; and natural resources (factor conditions).

- there is a core of sophisticated and demanding local customers … that might anticipate demand that can be served globally (demand conditions).

- there are clusters, instead of isolated industries, including capable, locally-based suppliers and firms in related areas (related and supporting industries).

- there is vigorous interaction among these four elements, stimulating constant pressure for innovation and improvements in capabilities.

[9] These ten nations include: Denmark, Germany, Italy, Japan, Korea, Singapore, Sweden, Switzerland, the United Kingdom, and the United States.

Porter's theory of competitiveness and the role of clusters emerged from his observation of how successful industries emerged in industrialized countries. Nonetheless, his new paradigm had powerful implications for the way in which governments, organizations and firms would pursue competitiveness in the future in both developed and developing countries. Its message for government leaders was clear: macroeconomic reforms are critical, but not sufficient, to create greater productivity. "Microeconomic" reforms are also important -- that is, reforms that shape and strengthen the four points of the diamond and their interaction. His paradigm had an equally powerful message for business: that is, a firm's ability to gain competitive advantage is linked, in part, to factors and institutions outside of the firm itself and even the industry and, hence, firms – individually and collectively -- have a stake in strengthening the four points of the diamond and their interaction. Perhaps, most importantly, the implication of the new paradigm was that joint and collaborative action among a broad range of public and private actors in the economy was required to create an environment that fosters competitiveness. Increasingly, cluster-based competitiveness initiatives became the tool for mobilizing the necessary collaborative action.

Porter himself introduced the tools and principles of cluster-based competitiveness to a number of countries, including the United States, Portugal, Canada, and New Zealand, among others. However, a number of influential strategy consulting firms also began to introduce the diamond model and related principles through implementation of competitiveness initiatives. Most notably, the Monitor Company tested and adapted the model in the context of a number of developing countries, including El Salvador and Colombia. In 1997, two of the Monitor Company's senior consultants, Michael Fairbanks and Stace Lindsay, captured many of the lessons they learned from implementing competitiveness initiatives in Colombia and other Latin American countries in *Plowing the Sea: Nurturing the Hidden Sources of Growth in the Developing World.*

- ***Growing Emphasis on Market-Oriented Approaches to Development***

Yet another development emerging from the 1980s was the growing emphasis on market-oriented approaches to development. In both developed and developing countries, there was growing recognition that the public sector could ill-afford to produce and distribute needed goods and services and that this role was better served by the private sector. As this recognition solidified, many countries sought out strategies for sorting out and defining more effectively the appropriate role of government and the private sector in economic development. Similarly, countries began to actively seek to increase the size and vitality of their local private sector. It was, in large part, this growing receptivity to market-oriented and private sector development approaches that fueled the demand for competitiveness initiatives around the world. Hence, beginning in the early 1990s, the use of cluster-based approaches began to expand not only in U.S. states and cities, but also in other countries and regions around the world. For example:

- The state of Chihuahua in Mexico launched *Chihuahua Siglo XXI* in 1992 to develop and implement a strategy that would enable the state to take advantage of new opportunities emerging from NAFTA.

- Former East Germany, Slovenia, Slovakia and Hungary launched cluster-based initiatives in the early 1990s as part of their strategy for making the transition from a centrally-planned economy to a market-based economy.

- Malaysia took on an intensive cluster-based program to set the stage for its plan to become a developed nation by the year 2015.

While a number of initiatives were launched in the early 1990s, much of the significant growth in the use of cluster-based approaches has emerged over the past five years – and, as mentioned in the introduction to this chapter, we now see literally hundreds of cluster initiatives taking place around the world. Concomitant with this growth, donors have also started to explore the use of cluster-based initiatives in developing countries. One of the World Bank's earliest efforts was in Morocco in 1995. Carried out in close cooperation with the World Bank and with financing from the European Union, *Le Maroc Competitif* facilitated cluster development in four areas: textiles and apparel, sea products, tourism, and electronic and information technology. USAID launched its first major cluster-based competitiveness initiative in Lebanon in early 1998; as discussed in further detail below, USAID is now becoming an increasingly important player in promoting cluster-based approaches to economic growth. The Inter-American Development Bank featured competitiveness as the theme of its 2001 Economic and Social Progress Report and approved one of its first major projects for a cluster-based program in Panama in mid-2002.

* * *

In summary, competitiveness practice and theory emerged, initially, as two separate and distinct developments. During the mid-1980's, the practice of cluster development was becoming increasingly central to SRI's work. The SRI team was aware of Porter's evolving thinking and research on competitiveness theory and clusters; nonetheless, its focus on cluster development was driven largely by the needs of its clients. Similarly, Porter's theory of competitiveness was not linked to SRI's efforts to promote cluster development; the theory explained the success of clusters that had emerged organically as opposed to those that had been facilitated. Despite its different origins in practice and in theory, cluster development has now became an increasingly important dimension of promoting economic development, fueled, in part, by the recognition of the importance of market-driven approaches to economic development.

AN OVERVIEW OF COMPETITIVENESS INITIATIVES

In order to provide perspective on the breadth of competitiveness initiatives, this next section of the assessment provides an overview of practice of cluster-based initiatives. We begin by looking at the USAID's portfolio of cluster-based initiatives and, in particular, the seven major initiatives it has launched since 1998. We then explore how cluster-based initiatives have emerged in the context of multilateral and regional organizations, including the World Bank, the Inter-American Development Bank, and UNIDO. Lastly, we take a brief look at industrialized countries. We do not examine in depth the approach, the results, or the lessons learned from these initiatives in this chapter. Rather, our intent is to provide a context for understanding how USAID initiatives are similar and different from other cluster-based approaches to competitiveness and to provide a foundation for our synthesis of the approach, the results, and lessons learned presented in subsequent chapters.

USAID

Over the past five years, competitiveness initiatives have become an increasingly important part of USAID's economic growth portfolio. Indeed, many people in the donor and the cluster practitioner community now view USAID as taking a leading role in promoting competitiveness through cluster-based initiatives. This section of our assessment provides an overview and synopsis of USAID's portfolio of cluster-based competitiveness initiatives. The "Summary Table of USAID-Funded Competitiveness Activities" in Appendix 3 provides additional information. Delineating the portfolio necessarily raises definitional questions about what to include and what not to include. The team used the following parameters in developing its compilation of the portfolio:

- First, as noted in the introduction, the starting point for this assessment was the "self-reports" prepared by USAID's SEGIR/GBTI contractors.[10] Accordingly, this compilation of USAID's portfolio focuses largely on those firms that prepared self-reports of their experience in promoting competitiveness. These firms include: J.E. Austin Associates, Inc.; Carana Corporation; Chemonics International Inc.; IBM (including work conducted by predecessor firms PricewaterhouseCoopers and Coopers & Lybrand); Nathan Associates, Inc.; and SRI International.[11]

- Secondly, the SEGIR/GBTI contractors' self-reports did not reflect a uniform definition of what to include or what not to include as part of their competitiveness experience; indeed, most firms presented a fairly expansive view in order to demonstrate their corporate experience in this area. Again, as noted in the introduction to this report, the team took a decidedly more narrow definition of competitiveness initiatives and included only those initiatives that reflected a cluster-based approach to promoting competitiveness. In interviewing the contractors and discussing their experience in more depth, we also focused exclusively on cluster-based types of competitiveness initiatives (as opposed to broader policy or private sector development initiatives that may also address constraints to strengthening productivity in a developing economy).

- Thirdly, the team has included only those initiatives that were clearly defined as cluster-based competitiveness initiatives from the onset. As such, we have not reviewed USAID's historical experience for activities that might be "like" competitiveness initiatives (even though they might, no doubt, provide valuable lessons). Rather, we have focused on

[10] The SEGIR/GBTI contracts are a vehicle that USAID missions use to procure technical assistance for economic growth and private sector development. Overall management and administration of the SEGIR/GBTI contracts is provided by USAID's Bureau for Economic Growth, Agriculture and Trade. SEGIR is Support for Economic Growth and Institutional Reform; GBTI is General Business, Trade and Investment.

[11] In late 2002 and early 2003, one additional contractor, Booz Allen Hamilton with ontheFRONTIER as a subcontractor, won competitiveness projects in Macedonia and Serbia. These projects are included in the summary table. However, because these projects began in parallel with this assessment, we have not examined their experience.

USAID's more recent experience in implementing activities that are explicit efforts to promote cluster development.

- Lastly, this compilation provides a snap-shot of USAID's portfolio as of January 2003. In the interim, many USAID missions have expanded or added new competitiveness initiatives; indeed, many of these activities were obligated in September 2003 at the end of USAID's fiscal year. The portfolio is definitely growing – and growing very rapidly. In light of this growth, USAID may wish to consider up-dating this compilation on a regular basis.

Key Findings

As of January 2003, USAID had carried out cluster-based competitiveness activities in 26 developing countries. The total value of these activities was nearly $60 million. These activities range from introduction of competitiveness principles and bench-marking a country's competitive position (relatively small-scale and low-budget activities) to full-scale cluster-based competitiveness initiatives. The chart below reflects the number of countries in which USAID has undertaken competitiveness activities and their value by USAID's Regional Bureaus.

USAID Regional Bureau	Number of Countries	Value
Africa Bureau	2	$2,746,182
Asia and Near East (ANE)	9	$25,211,888
Europe and Eurasia (E&E)	13	$29,352,089
Latin America & Caribbean (LAC)	2	$2,652,927
Total USAID Portfolio	26	$59,963,086

Clearly, most of USAID's cluster-based competitiveness work has taken place in the Europe and Eurasia region, as well as the Asia and Near East region. However, it is important to note that in both regions, the portfolio is dominated by a few major initiatives. Specifically:

- In the Europe and Eurasia region, three of the thirteen countries comprise 82% of the portfolio. The portfolio is dominated by these three country initiatives:
  - Macedonia: $11,674,375
  - Georgia: $ 9,000,000[12]
  - Croatia: $ 3,280,716

- Similarly, in the Asia and Near East region, three of the nine countries comprise 75% of the portfolio. The portfolio is dominated by these three country initiatives:
  - Sri Lanka: $11,343,067
  - Mongolia: $ 4,650,928
  - Lebanon: $ 2,826,925

[12] Estimated amount as of January 2003. At the time of the desk review, USAID had not begun to implement the initiative in Georgia; implementation was scheduled to begin in spring 2003. As a result, this initiative is not included among the seven major and/or most mature USAID initiatives described on the next page.

USAID's Major and/or Most Mature Competitiveness Initiatives
USAID has implemented seven major cluster-based competitiveness initiatives in the following countries: Lebanon, Sri Lanka, Mongolia, the Dominican Republic, Uganda, Croatia, and Macedonia. Each of these initiatives is described below in brief. The initiatives are presented in chronological order with USAID's longest-running initiative first.

<u>Lebanon Industry Growth Partnerships</u>**…………………………………..............$2,826,979**
USAID first began to explore opportunities for promoting competitiveness in Lebanon in early 1998. Still recovering from its prolonged civil war, Lebanon was disconnected from international best practices in business, much less strategies for promoting competitiveness and global integration. Its relative isolation and insulation from the global economy (including the world of donor assistance) made the country an environment that was ripe and open to a competitiveness initiative. Implemented by SRI International (under contract to and in collaboration with IBM), the program commenced with a detailed diagnostic of Lebanon's economic opportunities and constraints, followed by cluster development strategies and initiatives in agro-industry, tourism, and regional business services. Activities in regional business services were dropped during the course of implementation. SRI continues to provide technical assistance to develop clusters in Lebanon under the aegis of its cooperative agreement with USAID.

<u>Sri Lanka: The Competitiveness Initiative</u>**………………………………………..$11,343,067**
In many respects, Sri Lanka represents USAID's most mature competitiveness initiative to date; it is the only initiative in which the clusters are now moving toward developing strategies for how they will proceed without future support from USAID. J.E. Austin Associates launched the initiative in the summer of 1998 with a series of benchmarking exercises and extensive workshops for business and government leaders. Nathan Associates, Inc. in collaboration with J.E. Austin began full-scale implementation of the initiative in August 1999. Since then, the cornerstone of its work has been cluster development in eight areas: ceramics, coir, tourism, tea, information technology, jewelry and gems, rubber, and spices. Over time, the policy reform component of the project has grown more significant. Like most competitiveness initiatives, the competitiveness initiative works with clusters to help prioritize and communicate policy initiatives to the government. However, unlike many competitiveness initiatives, TCI has a major component devoted to providing direct assistance to the Government of Sri Lanka in policy analysis and reform. The project has also worked to establish a National Competitiveness Council and secure Sri Lanka's inclusion in the World Economic Forum's Global Competitiveness Report (discussed further in Chapters 4 and 5).

<u>Mongolia: The Competitiveness Initiative</u>**…………………………………………$4,650,928**
USAID Mongolia initiated The Competitiveness Initiative (TCI) in October 1999. Like many of its competitiveness initiatives, USAID began TCI in Mongolia with an initial "competitiveness exercise" designed to introduce Mongolia's public and private sector to competitiveness principles and gauge interest in cluster initiatives. Following this introductory phase, the mission began full-scale implementation of its competitiveness initiative in August 2000. In the words of the USAID Mongolia's mission director at that time, Ed Birgells, competitiveness provided the "glue" to pull together all of the mission's activities in economic growth. Since that time, Nathan Associates, Inc. in collaboration with J.E. Austin Associates has provided long-term and short-term technical assistance focused on the development of three industries: cashmere,

tourism, and meat. In addition, the initiative included a fourth component to strengthen public and private dialogue on competitiveness issues. The mission is currently in the process of launching a new phase of its competitiveness program that will combine its long-standing and deep involvement in economic policy reform with its activities to promote cluster-based competitiveness.

***The Dominican Republic*……………………………………………………………$2,551,978**
Building on the momentum of local private sector leaders' interest in competitiveness, USAID assistance has focused largely on strategy development -- at the national level, regional level and cluster level. Chemonics International has served as the lead contractor with additional assistance provided by J.E. Austin Associates and Monitor Company. In late 1999, the team launched an open and participatory strategic planning process designed to build consensus on a National Competitiveness Strategy. This was followed by the development of two pilot strategies, one for the province of Santiago and the other for the fruits and vegetable cluster. Over the past two years, the team has focused on facilitating participatory strategic planning sessions at the cluster level – specifically, for the tourism clusters in Romana-Bayhibe and Puerto Plata, and the eco-tourism and horticulture clusters in La Vega. The mission is now moving into a deeper phase of assistance under its new Competitiveness and Fiscal Reform Project, the funding for which is not included in the amount provided above.

***Uganda: The "COMPETE" Project* .....……………………………………………… $2,422,287**
USAID first began to explore competitiveness through a bench-marking exercise conducted in 1997 by J.E. Austin Associates and the Monitor Company. However, it was not until 2000 that the mission began implementation of its COMPETE Project through the Carana Corporation. Working in close collaboration with a Special Task Force on Competitiveness appointed by Uganda's President, the COMPETE Project selected three sectors for its focus: coffee, fisheries, and cotton. In addition, the project focused on the information and communications technology sector as a cross-cutting support sector. Compared to most of USAID's competitiveness initiatives, COMPETE's project duration was short: an eighteen-month period from November 2000 to March 2002.

***Croatia Competitiveness Initiative* …………………………………………………$3,280,716**
Launched in April 2001, the Croatia Competitiveness Initiative focused initially on developing mechanisms for private and public dialogue. Specifically, with long-term technical assistance provided by Nathan Associates and J.E. Austin, the project facilitated the formation of the Croatian Competitiveness Council, one of the first business round-tables in the country. Similarly, the project brought together leaders from business, government, labor and education to form a National Competitiveness Council. At the cluster level, the project is focusing on wood products, tourism and information technology.

***Macedonia Competitiveness Activity* ………………………………………………$11,674,376**
The Macedonia Competitiveness Activity is USAID's largest competitiveness initiative to date. Launched in September 2002, it is also USAID's most recent major initiative. The project is being implemented by Booz Allen Hamilton in collaboration with The OTF Group (ontheFrontier) over a four-year period. Unlike USAID's other initiatives, the Macedonia project has developed a formal competitive process for identifying and selecting clusters. Thus far, the

project has conducted two rounds of competition. The first round generated about 15 proposals, of which two were selected (the sheep industry and tourism). The second round generated about 10 proposals; two initiatives were selected representing clusters in information technology and wine. The project has also established a National Competitiveness Council and conducted numerous workshops and public education seminars to introduce competitiveness principles.

In addition to these major initiatives, it is important to recognize that a number of fairly significant activities were just beginning as we conducted the desk assessment of USAID's activities. Specifically:

- In July 2002, USAID launched the Industry Cluster Competitiveness Project in Bosnia, a $2 million initiative. IBM and SRI International are providing long-term technical assistance for this initiative. At the time of the desk assessment, the most promising clusters appeared to be furniture and tourism.

- In August 2002, USAID launched the South East Asia Competitiveness Initiative, a $3 million effort to promote competitiveness initiatives in Cambodia, Thailand, and Vietnam. The implementing contractor is Nathan Associates and J.E. Austin Associates in collaboration with the Kenan Institute Asia. In Vietnam, the program focuses on clusters in highly-focused localities: for example, ceramics in Bat Trang and computer software in Ho Chih Minh City. In Thailand, the team is working with a broad range of clusters, including gem and jewelry, high-value agriculture, tourism, handicrafts, seafood, and the silk cluster. In Cambodia, the project has recently launched a non-traditional fishing cluster at Tunle Sap Lake and is introducing competitiveness concepts in a north-west province of the country.

- In September 2002, USAID launched a $2 million competitiveness initiative in Serbia; the implementing contractor is Booz Allen Hamilton in collaboration with The OTF Group (ontheFrontier).

USAID has also funded a number of conferences, as well as benchmarking exercises, in order to promote a better understanding of competitiveness principles and generate interest in cluster initiatives. This is particularly true in the Europe and Eurasia area, where the regional bureau has been particularly active in facilitating dialogue and interest in competitiveness.

The World Bank

The World Bank has been exploring the use of cluster-based approaches for a few years longer than USAID and most other donors. However, at the onset, it is important to note that the concept of cluster-based competitiveness as a tool for economic development has not been widely embraced by the World Bank. Hence, it is best to describe its use of the tool as "exploratory" and, for many staff, the jury is still out. It is also important to recognize that cluster-based competitiveness often plays out differently under the aegis of the World Bank than under USAID. The two most significant differences are the following:

- First, cluster initiatives funded by the World Bank are generally a small part of a much larger project to promote policy reform or government reform. The overall size of the project may seem quite large in terms of funding and scope; however, the effort and funds devoted to cluster-based competitiveness are often quite small.

In contrast, cluster initiatives funded by USAID are generally the centerpiece of a mission's competitiveness initiative – and often a major component of its economic growth portfolio in a country. This does mean that there isn't an important policy dimension to USAID's efforts to promote competitiveness; there most definitely is. In countries where USAID has a competitiveness initiative, the policy reform effort is usually cluster-driven; that is, the clusters are determining the key policy, legal and regulatory constraints to their improved productivity and engaging the government in a collaborative process to address these constraints. However, in some cases, USAID also provides technical assistance to address broader policy reform issues at the same time – either under the aegis of its competitiveness initiative (as in Sri Lanka) or in close parallel to its competitiveness initiative (as in its Competitiveness and Fiscal Reform Project in the Dominican Republic).

- Secondly, the World Bank competitiveness initiatives have a very different structure and institutional locus than USAID initiatives. Because the World Bank's counterpart is the host-country government, the national government often assumes a much larger role in the actual organization and implementation of the initiative. As a result, the competitiveness initiative may often be housed within a government ministry (such as a ministry of economic affairs or the like); and the role of the national competitiveness council is generally quite significant. Indeed, when developing country governments request World Bank assistance on competitiveness, they often ask that assistance be provided to, first, form competitiveness councils, followed by cluster studies, and finally the development of a policy agenda.

  The USAID approach is notably different. None of its competitiveness initiatives are housed within a government ministry; rather, the projects often operate as independent project entities and work directly with the private sector. This does not mean that engaging and working with the government is not important in a USAID cluster initiative. To the contrary, promoting closer interaction and better dialogue between government and the private sector is a defining element of its cluster initiatives. However, for USAID, the starting point and the institutional locus for the initiative is not within the government. Moreover, as will be described in Chapter 4, the sequencing of a USAID initiative is different. Establishing a national competitiveness council is often not the first step; in fact, USAID's competitiveness initiatives may or may not include a competitiveness council at all.

The assessment team was not able to determine how much funding the World Bank is devoting to cluster-based competitiveness initiatives.[13] To the best of our knowledge, this kind of information is not being tracked systematically (again, signaling that this is not a core thrust for the institution). However, several of the Bank's significant initiatives include the following:

[13] A search of the World Bank's project documents under the key word of competitiveness highlights 250 projects; however, the vast majority of these projects do not use a cluster-based approach. Rather, the word competitiveness in used in a variety of ways. Today, some departments within the World Bank refrain from using the term "competitiveness" because it is has been so broadly and inconsistently applied in its projects.

***El Salvador Competitiveness Enhancement Technical Assistance Project*...........$16,000,000**
Launched in 1996 and completed in mid-2003, the El Salvador Competitiveness Enhancement Technical Assistance Project focused largely on increasing the efficiency of the public sector in support of competitiveness and in improving the legal environment for businesses. For example, the project supported government efforts to upgrade the country's customs procedures to meet WTO standards and permit electronic processing of customs documentation. The project also supported the government's efforts to undertake a wide range of legal and institutional reforms aimed at improving the country's competitiveness, such as new laws for telecommunications, electricity, and banks, as well as privatization of telecommunications. As described in detail in the recent IDB assessment, one relatively small component of the project focused on cluster development. Supported by the World Bank project, the government's Ministry of Economy served as the institutional locus for promoting cluster development with technical assistance provided initially by the Monitor Company and later by the *Instituto Technológico de Estudios Superiores de Monterrey* in Mexico.

***Guatemala National Competitiveness Program* $20,000,000**
The World Bank approved a US$20 million loan for the Guatemala National Competitiveness Program in 2001. The program aims to improve the country's competitiveness standing, accelerate economic growth and promote its peace accords by primarily helping small and micro businesses at two distinct levels. The first level seeks to improve the business environment through changes in four areas: domestic competition policy, training and information, quality improvement and investment. The second level is directed at broadening micro- and small business participation in national economic growth by (i) promoting increased investment in firm-level learning and innovation, (ii) piloting service and delivery innovation in information technology-based business development services, and (iii) expanding business development clusters and social responsibility. Success of the project will be measured on the incremental value-added and employment generated by small and micro enterprises.

Research on the theme of competitiveness is also an important World Bank activity. The recent publication titled *Globalization and Firm Competitiveness in the Middle East and North Africa Region* (Fawzy, 2002) is based on papers presented during a recent conference on firm competitiveness held in Cairo.[14] The publication is devoted to examining the environment in which firms operate, the opportunities globalization offers along with the risks it entails, and the partnerships required to build firm competitiveness in the MENA region. The clear message is that firms, governments, business associations, think tanks, media, and universities all have a role to play in building firm competitiveness.

[14] S. Fawzy, ***"Globalization and Firm Competitiveness in the Middle East and North Africa Region,"*** Report No. 24561, prepared in conjunction with the World Bank, Mediterranean Development Forum and Egyptian Center for Economic Studies, 2002. Available online at http://www-wds.worldbank.org/servlet/WDS_IBank_Servlet?pcont=details&eid=000094946_02080304010611.

The Inter-American Development Bank (IDB)

The Inter-American Development Bank has also been experimenting with and exploring the use of cluster-based approaches to competitiveness.[15] Until recently, most of its efforts involved providing grants in the range of $100,000 through its Multilateral Investment Fund to promote the development of specific clusters of small and medium-sized firms. However, over the past year, the IDB approach has rapidly changed. In June 2002, the IBD approved its first major competitiveness initiative involving a $10 million loan in Panama. Following a similar approach, the IDB approved a $5.4 million competitiveness initiative in Honduras in May 2003 and a $9.4 million competitiveness effort in the Dominican Republic in September 2003. While each of these three programs has its unique characteristics, they also share a number of similarities. We first look at these similarities and then provide a brief profile of two initiatives.

- This new wave of IDB competitiveness initiatives share a common objective: setting into motion a participatory consensus-building process to develop policies and strategies for strengthening competitiveness. As will be discussed in detail in subsequent chapters, USAID initiatives share this emphasis on participatory strategic planning processes.

- Like the World Bank, the IDB's counterpart is the host country government. As a result, the institutional locus for its competitiveness initiatives is within government ministries, and government will play a central role in project implementation and management. As noted previously, this is a key difference from the USAID approach.

- All three of these competitiveness initiatives involve the establishment of a competitiveness fund. The primary function of these funds is provide matching funds for the implementation of national-level, as well as cluster-level, competitiveness strategies and initiatives. They also provide the funding for technical assistance to implement these initiatives.

Panama: Program to Foster Competitiveness $10,000,000

This program aims to launch a consensus-building process that will generate strategies and projects focused on business competitiveness. The establishment of a "Competitiveness Team" is at the core of the program. Like a national competitiveness council, this team will spearhead a national strategic planning process on competitiveness issues. In addition, the project includes four other components: diagnostic assessments of competitiveness ($510,000); the development of competitiveness strategies and action plans at the national and cluster level ($322,000); establishment of a "Competitiveness Fund" ($6,860,000); and monitoring and impact

[15] It is important to note that the IDB also promotes competitiveness through large policy-based loan programs. These programs do not involve cluster initiatives *per se*, but may involve extensive public-private dialogue on competitiveness issues. For example, in Peru, nine public-private working groups (known as *mesas de trabajo*) were established, each one focusing on a key competitiveness issue highlighted by the World Economic Forum's Global Competitiveness Report (such as financial systems and capital markets, foreign trade and investment, infrastructure, human resources, education, and others). Facilitated by outside consultants, the participants collaborated to develop a policy matrix of key reforms needed to foster improved competitiveness. In early February 2003, the working groups presented their findings at a National Competitiveness Forum. Some of the short-term reforms identified through the consensus-building process will be implemented through the IDB's $300 million Competitiveness Reform Program, a policy-based lending program.

measurement ($294,000). At the onset, the project has identified four key sectors for intervention: agro-industry, logistics, technology services, and tourism.

Honduras: Program to Promote Competitiveness **…………………………...……....$5,400,000**
This competitiveness initiative focuses on four key interventions: (i) implementing the National Competitiveness Strategy; (ii) developing and implementing strategies and specific action plans for the forestry, agro-industry, and tourism sectors; (iii) helping SMEs join the competitiveness effort by helping them build linkages to clusters that have the potential to be internationally competitive; and (iv) establishing a $2 million Competitiveness Fund that will co-finance technical assistance to businesses to develop and improve products and processes.

Lastly, the IDB is now beginning to explore the development of a new approach in recognition of the critical role of the private sector in cluster-based initiatives. Specifically, in Colombia, the IDB is in the process of designing a $4-5 million project to be funded by the Multilateral Investment Fund. Grant funds will be channeled through a private non-governmental organization to be selected through a competitive bidding process (in lieu of the host country government, which must be the borrower under the IDB's lending programs). The project will facilitate cluster development in up to ten clusters, of which two will be selected jointly with Bank staff and the remaining eight will be selected by the NGO using transparent and objective criteria.

UNIDO

The United Nations Industrial Development Organization (UNIDO) has executed numerous projects on competitiveness and seems to have recently adopted a two-pronged approach in project design – one that addresses competitiveness issues in fairly broad terms and the other that focuses on clusters. In 2001, UNIDO launched the 'Development of Clusters and Networks of SMEs Program.' This program fosters inter-enterprise linkages as well as collaborative relations with local support institutions. It aims to promote collective efforts so that SMEs combine their strengths and jointly take advantage of market opportunities or solve common problems. The program covers horizontal networking (among SMEs), vertical networking (among SMEs and larger enterprises) and clustering. The clustering approach involves activities focused on the standard cluster methodology (viz., undertake diagnostic studies, identify priorities, and design a competitiveness plan), training courses for cluster 'brokers' or intermediaries, and cluster-to-cluster cooperation between countries by international study tours. UNIDO also undertakes research as part of its efforts to promote competitiveness. Its most recent Industrial Development Report (UNIDO, 2002) featured 'competing through innovation and learning' as its special research topic.

Industrialized Countries

As part of its review of competitiveness initiatives, the team also looked at how cluster-based competitiveness initiatives are playing out in the context of industrialized countries with a view to grasping how they are similar or different to the USAID experience in particular. *The Cluster Initiative Greenbook* also provides valuable perspectives on the implementation of cluster initiatives in industrialized countries.[16] Below, we provide a very brief overview of key cluster initiatives in industrialized countries below and highlight some of the key differences in which they differ from USAID initiative in terms of their set-up and focus. These similarities and differences will be further explored in subsequent chapters.

United States

Consistent with its origins, cluster initiatives in the United States have tended to focus on state or urban initiatives. Some of the states in which major initiatives have been implemented include: Arizona, California, Colorado, Connecticut, Florida, Illinois, Kansas, Massachusetts, Minnesota, New York, Oregon, Rhode Island, and Texas. For example:

- Arizona adopted the Governor's Strategic Partnership for Economic Development to strengthen the competitiveness of the state's economy thorugh export-driven industry clusters.
- Massachusetts undertook a state-wide analysis of its economic base and identified regional clusters. This analysis led to the development of *Choosing to Compete*, a statewide initiative that has focused on promoting export-oriented industries.
- Minnesota has used industry clusters as part of its regional planning strategy. In the southeastern part of the state, clusters have been widely used for promoting the competitiveness of plastic products, software, industrial machinery and processed foods; in the northeast, they have been used to promote the competitiveness of forest products, tourism, health services and information technology.

While the impetus for action has been largely at the state and municipal level, it is important to note that the US Congress also established a bi-partisan Council on Competitiveness in the early 1990s to address key constraints to US competitiveness and productivity growth. The Council was charged with analyzing information on the competitiveness of US industries and business and trade policy; creating an institutional forum from which to identify economic problems inhibiting the competitiveness of US agriculture, business, and industry; and developing long-term strategies to address constraints.[17]

Canada

There are a number of competitiveness initiatives in Canada at the national and the provincial level. Their common focus is that rapid economic growth is linked to major technological changes, fueled by a few leading-edge industries. At the national level, Industry Canada (a government agency) works at both the policy and enterprise levels to help Canadian industry and businesses to compete, grow and create jobs specifically in knowledge-based industries. At the provincial level, government has also made strategic investments to support cluster development

[16] *The Cluster Initiative Greenbook* does not explicitly focus on industrialized countries. However, almost 92% of the initiatives that participated in its survey are found in Europe, North America, New Zealand, Australia, and Japan. Moreover, only 5% of the initiatives that participated in its survey are found in countries in which USAID operates. Only four of the 233 initiatives were donor funded. Hence, the survey does provide valuable perspectives on cluster initiatives, principally in industrialized countries where initiatives are not funded by donor agencies.

[17] For details see, www.compete.org.

in areas such as bio-technology (Edmonton and Calgary), aquaculture (Halifax), and export-based clusters (Ottawa-Carleton).

Other Industrialized Countries

Cluster initiatives have become an increasingly important tool for promoting economic development in Europe, particularly in Finland, Sweden, Denmark, and Norway. Similarly, there is growing interest in clustering in Australia and New Zealand. For example, since 1997, the Wellington City Council has succeeded in generating a strong export-drive through its Wellington Business Clusters project. As a result, the Wellington region has developed a national and international image of excellence in e-business, mobile internet, software, film and television, education, and optics.

As can be readily seen from these examples, one of the key differences between cluster initiatives in the industrialized countries and USAID countries is the very nature of the clusters. Not surprisingly, cluster initiatives in industrialized countries focus on innovation and knowledge-based sectors; and, hence, investments in human resources and cutting-edge technologies are critical elements of their efforts to become competitive in the global market place. While information and communications technology is a common focus for USAID competitiveness initiatives, many of its cluster initiatives do not focus on high-technology industries.

Findings from
"The Cluster Initiative Greenbook"

The Global Cluster Initiative Survey conducted for the Greenbook found that:

- *Cluster initiatives tend to focus on technology-intensive industries such as information technology, medical devices, production technology, communications equipment, and biopharmaceuticals.*
- *Cluster initiatives are young … 72% of the cluster initiatives in its survey were initiated in 1999 or later.*
- *Taking the initiative to establish a cluster initiative is most often done jointly by industry and government (35% of survey respondents) or from government (32% of survey respondents).*
- *However, funding for the initiative comes primarily from government (54% of survey respondents) or jointly from government and industry (25% of survey respondents).*

Source: ***The Cluster Initiative Greenbook**, 2003.*

* * *

We now return to examine the USAID experience more deeply. The experience gained through implementing its cluster-based initiatives form the basis for the next two chapters. These chapters focus on the defining elements of USAID's – and many other -- cluster initiatives: their components, their guiding principles, and the methodology or process used to implement cluster initiatives.

CHAPTER 3
WHAT IS A COMPETITIVENESS INITIATIVE?

Each competitiveness initiative is unique. Our fieldwork in Mongolia and Mexico, in particular, made us appreciate how cluster initiatives even within a single competitiveness project play out in often completely different ways, produce very different – and often unanticipated – results, and raise unique sets of issues and challenges. Understanding what competitiveness initiatives are all about is compounded by the variety of ways in which the term "competitiveness" is used. As we have seen in the previous chapter, competitiveness within the donor community is used to label a broad range of efforts to promote policy reform, economic growth, or private sector development – with very little consistency in the use of the term either within or among donors.

Despite their many differences, our review of the practice of competitiveness initiatives has revealed that they also have a lot in common. It is these shared elements that help us understand what a competitiveness initiative is in concrete terms. We began the process of identifying and synthesizing the "core elements" of competitiveness initiatives in our review of the USAID experience. However, our fieldwork in Campeche, Mexico (a non-USAID experience) and our interviews with practitioners working outside of USAID revealed that these elements were by no means exclusive to USAID. The core elements of competitiveness initiatives are best described in terms of: (i) their guiding principles; (ii) their key components; and (iii) the process or approach used to implement competitiveness initiatives.

THE GUIDING PRINCIPLES OF COMPETITIVENESS INITIATIVES

In looking at the collective experience of practitioners, we found that there are a core set of principles or concepts that serve as the foundation for their work. Many of these principles are closely aligned or derived from the theoretical foundations for competitiveness articulated by Michael Porter and other leading thinkers on competitiveness; however, as outlined in the previous chapter, many of the same principles have emerged through the practice of competitiveness initiatives. Today, theory and practice are closely intertwined in the following five guiding principles of competitiveness initiatives.

- ***Individual firms cannot become competitive and stay competitive in the global market on their own; competitiveness involves sustained change throughout the value chain.***

A central premise underlying competitiveness theory and practice is that individual firms cannot become competitive and stay competitive in global markets on their own. Firms must constantly innovate and create new products, new processes, and new ways of managing their operations to stay competitive; should they not innovate, they stand to lose their customer to the next competitor who can offer the same product at a lower cost. However, innovation within any given firm is a necessary – but not sufficient – condition to complete globally. A firm's suppliers and supporting institutions must also continually improve their capabilities in order to provide the firm with necessary inputs and services. Hence, building competitiveness requires sustained change all along the value chain. Two examples from developing countries illustrate the point.

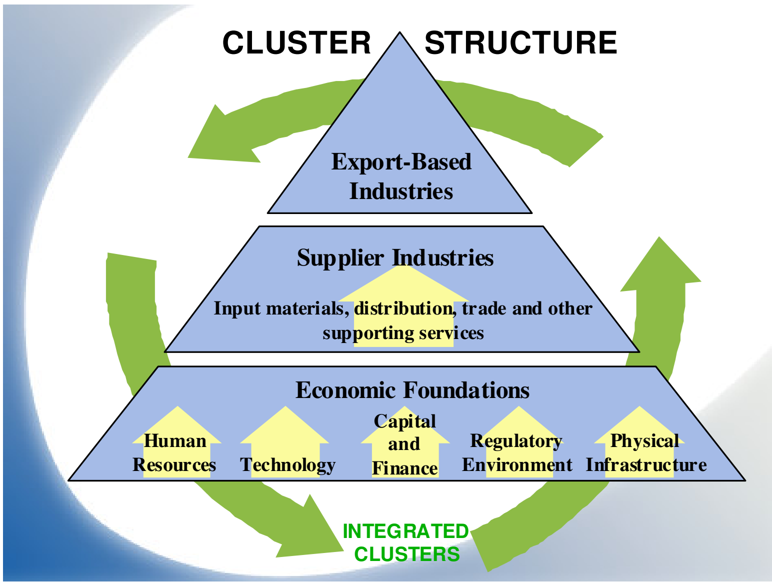
- In Mongolia, meat processors are trying to develop new markets in an effort to move beyond their traditional mode of shipping low-value frozen carcasses to Russia. However, in order to do so, there must also be significant improvements in herding practices, prevention of infectious disease among animals, improved sanitation and quality control in slaughter-houses, and establishment of inspection practices that give confidence to international buyers in the safety and quality of Mongolia's meat. Meat processors may make significant improvements in their operations; however, these investments will have little impact on their ability to compete unless there are changes in other parts of the value chain. These kinds of changes required concerted and coordinated effort from the private sector, government, and the educational and training community.

- The state of Campeche has some of Mexico's most significant Mayan ruins and yet it is consistently overlooked as thousands of tourists flock annually to Chichen-Itza, Palenque and other sites. The state is virtually unknown – both in Mexico and abroad – as a tourist destination. No one firm can make a significant dent in changing this situation. In order to foster tourism, tourists need to be sold on what Campeche has to offer. And once they arrive, there need to be hotels, transportation, restaurants, and something to do. Again, these kinds of changes require concerted and coordinated effort from the private sector, government, and the educational and training community.

The close interplay between firms, their suppliers, and the business environment is why competitiveness theorists and practitioners focus on "clusters" as the locus of action, as opposed to individual firms or broad sectors. Clusters are "geographic concentrations of interconnected companies, specialized suppliers, service providers, and associated institutions in a particular field."[18] "Associated institutions" might include: educational and training institutions that build the workforce for an industry; research institutions that generate the scientific knowledge required for technological change; banking and financial institutions; government institutions whose policies and practices have an impact on the industry; and providers of infrastructure for the industry. These institutions are an essential part of the cluster as their "products and services" feed into the value chain. Hence, their ability (or inability) to change and innovate also has a direct impact on firms' ability to compete in global markets.

The SRI International model of cluster development illustrates the cluster as a pyramid. The top tier of the pyramid represents the "*core cluster firms*" that export goods or services to other states, regions, or countries. The second tier of the pyramid represents "*supplier firms*" or those firms that provide inputs to the core cluster firms and are an essential part of the value chain. The bottom tier of the pyramid represents the "*foundation factors*" that provide the building blocks of the cluster. However, perhaps the most important dimension of the model is the arrow that surrounds the pyramid -- in other words, the synergies and dynamism that result when all three layers of the pyramid are engaged and working toward a common goal. The SRI International cluster pyramid is illustrated below.

[18] The Institute for Strategy and Competitiveness website: www.isc.hbs.edu.



According to Porter, the key determinants of a region's competitiveness are: (i) the sophistication and productivity of its firms; (ii) the quality of the business environment in which they operate; and (iii) the vitality of its clusters. The first two determinants are well-known to USAID. For years, its private sector development programs have included efforts to strengthen businesses through firm-level assistance and training. Similarly, USAID has significant strides in improving the quality of the business environment in developing countries by helping countries to: establish sound and business-friendly policies; privatize state-owned companies; establish intellectual property rights; strengthen financial policies and institutions; reduce red-tape and administrative barriers to firm creation and investment; and carry out many other initiatives that target the "micro-economic" environment. In contrast, the last determinant – strengthening the vitality of clusters – is a relatively new endeavor for USAID and has emerged most prominently in its new wave of competitiveness initiatives. What is meant by "strengthening the vitality of clusters" is explained in further detail through the guiding principles.

- ***Geographic proximity is important …. especially in an increasingly global economy.***

A second principle underlying competitiveness initiatives is the importance of geographic proximity. To reiterate, clusters are defined as "*geographic concentrations* of interconnected companies, specialized suppliers, service providers, and associated institutions in a particular field." Hence, in many competitiveness initiatives around the world, we see a focus on "economic regions" as the engine of growth. Such regions have little to do with political or administrative boundaries and more to do with the clustering of firms and institutions that are interconnected ... or, in the case of many developing economies, should be interconnected.

One might assume that globalization would minimize the importance of geographic proximity; however, Porter argues to the contrary. With increasing globalization, the inputs to production flow more freely around the world; hence, they also become more readily available to any producer and less of a differentiating factor. Paradoxically, as the world becomes increasingly interconnected, building competitive advantage has more to do with things that are fundamentally local: relationships and interactions (which are easier to build when people are in close proximity and share a common language and culture) and information sharing (which is far more effective in face-to-face situations than through even the most sophisticated communication system).

> **The Importance of Economic Regions**
> **Lessons from Mongolian Cashmere**
>
> *In Mongolia, the distances between segments of the value chain are enormous. The producers of raw cashmere are nomadic herders, spread across vast areas of sparsely populated terrain with limited access to communication and transportation. The processors of cashmere are located in Mongolia's capital city, Ulaanbaatar; and the purchasers of Mongolia's semi-processed cashmere and finished goods are located primarily in Europe and North America. Before the introduction of USAID's Competitiveness Initiative, the sheer distances and the lack of communication and direct interaction made it impossible for cashmere producers to understand the requirements of processors; hence, producers continued to gin out large quantities of poor-quality cashmere. Once the initiative was launched, the geographical distances between producers and processors also made it challenging to bring the cluster together – even from a purely logistical perspective. However, more importantly, the geographical distances had translated into deep hostilities and lack of trust, precluding this cluster from even sitting together at the same table.*

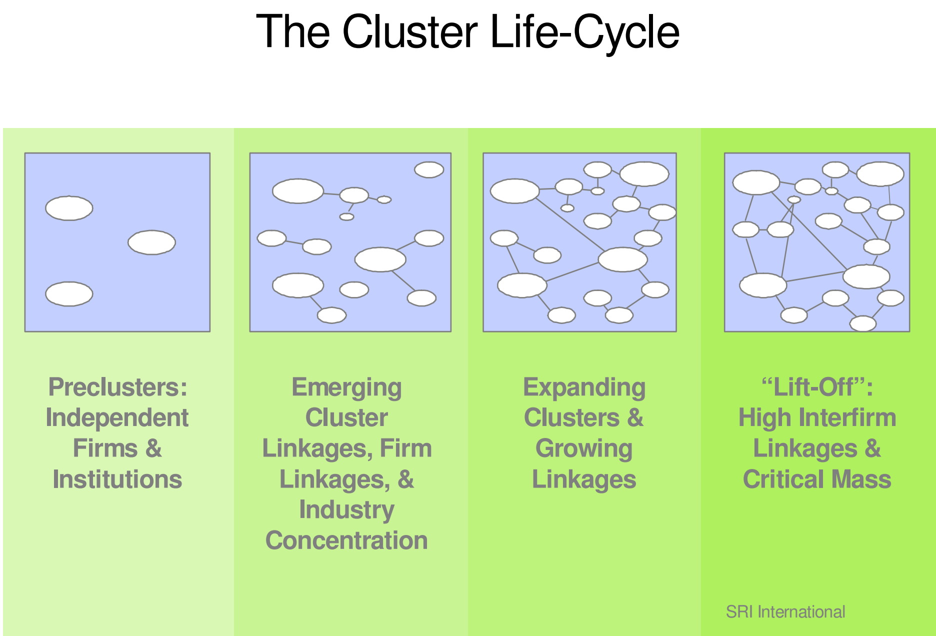
- ***Competitiveness initiatives are fundamentally about building connections and relationships among firms and institutions that have traditionally acted in isolation.***

While the "paradox of location" may sound theoretical, particularly from a developing country perspective, its implications are a cornerstone of competitiveness practice. That is, competitiveness initiatives are about building connections and relationships among firms and institutions within a cluster. This principle is central to implementation, no matter whether the location is Hollywood or Rwanda. The principle is best illustrated in terms of the life cycle of the cluster (pictured on the following page).[19]

The starting point for every cluster-based competitiveness initiative is different. Taking two extremes where cluster initiative have been undertaken, Hollywood and Rwanda start in very different segments of the cluster life-cycle and they will no doubt remain in different segments for a long time. Nonetheless, the fundamental focus for these two cluster initiatives is the same: strengthening the relationships and connections between firms and institutions so that they can more effectively tackle the barriers to increased productivity.

Most of the countries in which USAID operates are characterized by "pre-clusters," where there are very few connections or relationships among firms and institutions; moreover, firms and institutions are often weak in and of themselves. The connections between firms are most often

[19] SRI International, ***"Cluster Competitiveness Initiative: USAID Progress Report,"*** PowerPoint presentation prepared for USAID Bosnia, October 2002, p. 6.



present in the context of a trade or business association, whose primary function is to lobby government on behalf of industry. However, these kinds of "connections" are not what we mean by promoting competitiveness – particularly when the real motivation is to seek subsidies or special favors from government; indeed, they are the antithesis of competitiveness as they detract firms from focusing on the real changes they need to make to increase productivity.

On the other end of the spectrum, dynamic clusters are characterized by intense cooperation between firms, their suppliers, and supporting institutions. Continuous and strong interaction within the cluster creates the opportunity for better flow of information, enabling buyers to communicate their needs to suppliers and institutions more easily and rapidly. This, in turn, gives suppliers and institutions the information they need to develop increasingly specialized products and services for their customers. Hence, through intense interaction in which firms both compete and cooperate, dynamic clusters generate a cycle of improved efficiency, quality, service, and innovation through the value chain -- and it is this cycle that drives increased productivity and competitiveness.

➢ ***Building these connections requires major shifts in thinking and behavior … shifts that are not easily achieved.***

To reiterate, competitiveness initiatives focus on strengthening the relationships and connections between firms and institutions so that they can more effectively tackle the barriers to increased productivity. This is by no means a simple task; and, indeed, in commenting on their experience in promoting competitiveness, many USAID missions note that competitiveness is more difficult to put into practice than it would appear in theory. This assessment will reveal and illustrate some of the very real challenges practitioners face. However, it is important to recognize that, *a priori*, competitiveness initiatives are challenging in practice for several reasons:

Competitiveness initiatives require a shift in mindset …
Practitioners agree that competitiveness initiatives involve major shifts in "mindset" and that this shift in mindset is all the more pronounced in the developing country environment. A large part of the mindset change goes back to the first guiding principle: an individual firm cannot alone become competitive and stay competitive in world markets. Recognizing and understanding this principle has enormous implications for changing the terms in which firms think about competitiveness and their role vis-à-vis other firms and government. Suddenly, competitiveness is no longer a matter of thinking in terms of "I win, you lose" – a perspective that is embedded in most of our minds when we think about competitiveness. Rather, the thinking shifts to "what do we need to do to make our cluster more productive and competitive in global markets?"

In theory, this mental shift may sound easy; in practice, this shift is often very difficult. It begins with a focus on the market, and this in and of itself requires a paradigm shift that many businesses in developing countries have yet to make. We anticipated that we would confront mind-set hurdles in Mongolia, as it continues its transition to a market economy. However, the "mind-set" challenges proved no less daunting in Mexico.

Competitiveness initiatives require joint and collaborative action …
Mirroring the shift in mind-set, competitiveness initiatives focus on mobilizing firms and institutions within a cluster to "collaborate to compete" (a key phrase for some competitiveness practitioners). This too is challenging because it changes the terms of engagement, both within the private sector and between the private sector and government. Firms that are fierce rivals in the marketplace begin to realize that they also face common hurdles and that their resolution requires joint and collaborative action; but collaboration is not easy when they have been long-term competitors, and there is little basis for trust or willingness to work together.

Similarly, competitiveness initiatives call for joint and collaborative action between the private sector and the government; but this too is not easy when they have been long-term adversaries. It is often far more comfortable for the private sector to sit back and "blame" the government for its ills; however, a competitiveness initiative forces businesses to think much more critically – and strategically -- about what actions are in its sphere of action and what actions can realistically be carried out by the government. Similarly, no longer can the private sector expect the government to "solve" its problems through protective legislation and subsidies; these are off the table in a competitiveness initiative.

Competitiveness initiatives require changing the way business is done …
Competitiveness initiatives are about mobilizing people to re-think the way they do business: to focus on international market demand (as opposed to supply-driven approaches to production); to move toward offering more sophisticated and higher value-added products (as opposed to relying on basic commodities); to innovate (rather than imitate at lower cost); and to collaborate intensely with competitors and government and academia in the process (despite long-standing

antipathies and lack of trust). It is no wonder USAID missions and others find this a challenging endeavor.

To add one more hurdle and layer of complexity, in some countries, there may be individuals or institutions that have a vested interest in not changing the way business is done in a country. Those who have a strong financial interest in maintaining the status quo will, no doubt, wield their power to block a competitiveness initiative from moving forward. Hence, we see that in environments where corruption is a concern, competitiveness initiatives often pose a direct threat to the sources of corruption – without ever using the "c-word" – as illustrated in the box below.

Tackling Corruption through Competitiveness
Lessons from Mongolian Cashmere

Mongolian cashmere processors consistently underutilize their processing capacity because they are unable to source sufficient raw cashmere of high enough quality. The main problem, from their perspective, is aggressive competition from Chinese traders who also source raw cashmere in Mongolia. During the mid-1990s, the Government of Mongolia enacted a ban on exports of raw cashmere in order to prevent Chinese processors from accessing Mongolian cashmere. The ban was ineffective, as Mongolia could ill-afford to police its 2,900 mile border.

The Mongolian government then instituted a tax on exports of raw cashmere. While its intent was to keep raw cashmere within Mongolia and, hence, protect the interests of cashmere processors, the export tax also created an incentive for extensive smuggling and corruption at the border. Some analyses suggest that up to half of the country's raw cashmere production was being exported illegally in some years.

USAID's Competitiveness Initiative in Mongolia offered a different solution to address processors' need to access high-quality cashmere – a solution that would not depend on protective and essentially anti-competitive measures, such as the export ban or tax, but rather, a market-based solution that would give herders the financial incentive to sell to Mongolian processors. The Competitiveness Initiative, in collaboration with the USAID's Gobi Initiative, established a series of cashmere market days that gave herders and processors the opportunity to engage in face-to-face transactions for the very first time. Herders saw, first-hand, the premium that Mongolian processors would pay for high-quality and pure cashmere; hence, for once, they had an incentive to sell to Mongolian producers versus across the border. Herders were able to obtain a higher price for their cashmere, and processors were able to source the high-quality cashmere they needed. The cashmere market days offered a win-win solution for herders and processors; however, in changing the incentives, they also undermined a key source of smuggling and corruption.

While the focus is global, the momentum for change must be local …

The kinds of changes that we have discussed above are not changes that a donor – or any external agent -- can make happen. Promoting competitiveness requires fundamental change within firms; in the relationships among firms; and in the relationships between firms and their supporting institutions (including government and academia). These kinds of changes can only take place when firms see that it in their best interest to change and when they take ownership for making change happen. This does not mean that there is not a valid and important role for external agents like USAID; however, what it does mean is that without local business leaders taking the lead in promoting and driving the process of change, the likelihood of substantial or sustainable change is minimal.

- ***A <u>participatory</u> strategic planning process is the starting point for building the momentum for change. It is this process – and the resulting local ownership in and responsibility for implementation – that makes competitiveness initiatives distinctly different from USAID's other economic growth initiatives.***[20]

During implementation, competitiveness initiatives may look a lot like USAID's more traditional economic growth activities, all brought together under the rubric of "competitiveness." Indeed, as part of competitiveness initiatives, we do see many activities that look very familiar: promotion of policy, legal and regulatory reform; study tours to better understand industry best practices; training and technical assistance to address industry-wide issues; strengthening of local business associations, to name a few of the types of activities. So, many economic growth officers ask, what is new or different about competitiveness?

Competitiveness initiatives have as their starting point ***a participatory strategic planning process***. It is a process that enables ***cluster members*** to: discuss and build their own consensus on the critical issues and the key impediments to engaging global markets; design a strategy and initiatives that will realistically enable them to engage global markets more effectively; and then – and most importantly – assume responsibility and ownership for specific initiatives and actions. It is a process that enables the cluster members

The Participatory Strategic Planning Process
Lessons from the Dominican Republic

Of all of the USAID competitiveness initiatives we reviewed, the "participatory" strategic planning process seemed uniquely strong in the Dominican Republic. In this case, cluster members have been deeply involved in the strategic planning process, wrestling first-hand with the research, writing, and the wording of their strategies. As a result, these are not strategies that were developed by the USAID contractor – and then shared with the cluster members for their buy-in. Rather, the cluster members themselves went through the process of figuring out the critical impediments to competitiveness and then deciding what they wanted to do to address those impediments; the USAID contractor facilitated the process, but the decisions were in the hands of the Dominicans.

Interestingly, according to the implementing contractor, the strategies developed by the clusters were not that different from what it would have recommended. The process definitely took longer than if the contractor had prepared the strategies itself. However, the key difference was that these were now strategies that the Dominicans had grappled with, vetted, internalized, and "owned." This sense of ownership was exemplified at the end of the first phase of the project, when key members of the strategy groups presented the results of their work to date to USAID – as opposed to the contractor taking the lead. In other words, these were the clusters' strategies and not the contractor's.

[20] It is important to note that USAID does work in close collaboration with local stakeholders – private and public – in designing and implementing economic growth initiatives; indeed, with its strong field orientation, this has always been one of USAID's strengths. Competitiveness initiatives are distinct in that the locus of action is the cluster itself. As a result, the participatory dimension of a competitiveness initiative goes significantly beyond close collaboration and interaction with local stakeholders to actually mobilizing local stakeholders to take action themselves.

themselves to determine the parameters of what they will do and will not do … as opposed to USAID or any other donor determining the parameters of what should be done from their perspective.

We believe that it is the participatory strategic planning process – and the resulting local ownership in and responsibility for implementation – that makes competitiveness initiatives distinctly different from USAID's other economic growth initiatives. Competitiveness initiatives are private sector led and driven in their implementation, and this implies a fundamentally different role for USAID and its contractors, as illustrated on the previous page.

It is also the participatory strategic planning process that distinguishes competitiveness from industrial policy – a concern that is frequently raised by USAID and other donor economists. There are instances in which industrial policy is pursued in the guise of competitiveness initiatives; however, as practiced in the USAID context, competitiveness initiatives are not consistent with industrial policy. USAID's competitiveness initiatives involve a bottom-up approach, where it is largely the private sector that determines the critical issues it faces in increasing productivity and the strategies it will employ to address these issues. USAID plays a valuable role in facilitating the strategic planning process and supporting clusters' efforts to become more competitive. However, as a general rule, it works with clusters that show a real commitment to the process in terms of time and resources. Hence, promoting competitiveness in the USAID context is not about picking, targeting and subsidizing "winners" *per se*; rather, it is about building on the momentum for change in the private sector, wherever it may be.[21]

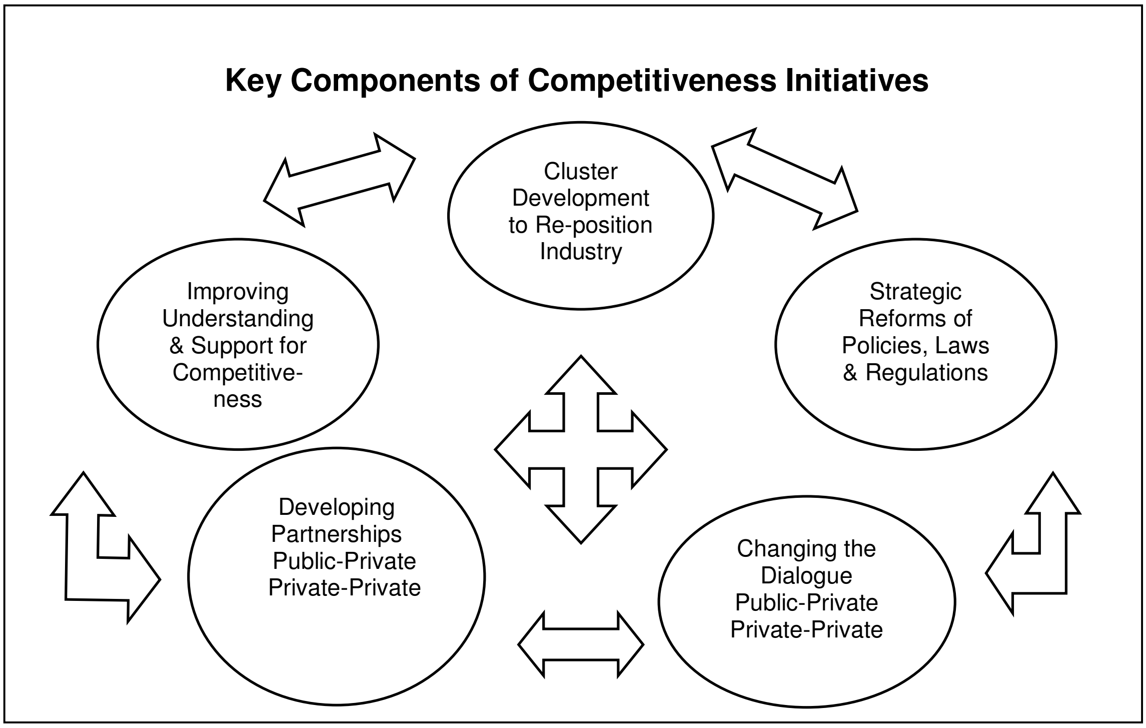
* * *

These guiding principles give us one perspective on what competitiveness initiatives are all about. A second way of looking at these initiatives is in terms of their key components, as outlined below.

[21] USAID leadership in the field is far more pragmatic regarding the concern of "picking winners." Three of the mission directors who have led major competitiveness initiatives noted it is not a matter of "picking winners;" basically, you go with what little there is in the country. There are usually not a lot of choices to be made in the countries in which USAID works.

KEY COMPONENTS OF A COMPETITIVENESS INITIATIVE

The team developed the diagram below to illustrate the five typical components of competitiveness efforts, namely: (i) cluster development to re-position industry; (ii) strategic reforms of policies, laws and regulations; (iii) changing the dialogue, both between the private and public sectors and within the private sector; (iv) developing partnerships, again both private-public and private-private; and (v) improving understanding and support for global competitiveness.



Cluster Development

The "heart" of competitiveness initiatives is cluster development to re-position the industry; "Cluster development" encompasses the process of different parts of a sector's value chain coming together to: (i) discuss issues confronting the sector; (ii) define areas of common interest; (iii) cooperatively design a strategy for advancing cluster competitiveness; (iv) jointly identify specific actions to be taken; and (v) assign responsibility for completing actions. The process of a cluster collaboratively designing a strategy and identifying and executing targeted actions results in "re-positioning industry" towards niche markets, greater value-added products. The key difference is that the strategies are devised and implemented by cluster members themselves, making local ownership much more likely than if an outside advisor recommends potential paths.

Strategic Reforms of Policies, Laws and Regulations

Such reforms typically emanate from the cluster development process described above. Again, the process of the cluster deciding which reforms are critical to its competitiveness – and which reforms the cluster realistically can affect and change – is what differentiates policy, legal and regulatory reform under a competitiveness initiative from other donor efforts in this arena. Rather than a donor or expatriate advisors identifying the key reforms that are necessary or desirable, local actors with personal and professional stakes in seeing through such reforms pinpoint a particular issue as a constraint, collectively decide to address it, and determine appropriate means to effect change.

Changing the Dialogue

To influence policy, legal and regulatory reforms, the private sector must interact with government, the enactor of such legislation

Repositioning Industries in Sri Lanka

USAID's Competitiveness Initiative in Sri Lanka focuses on repositioning eight industries vis-à-vis global markets. For example:

***In tourism**, the strategy is to reposition the industry beyond low cost "sun and sand" markets to higher end niches such as ecotourism and adventure tourism. To that end, the cluster is:*

- *creating a National Cycling Trail as an adventure tourism and mountain biking destination;*
- *establishing a model eco-lodge to highlight Sri Lanka as an ecotourism destination; and*
- *creating an industry-driven tourism training facility.*

***In the gem and jewelry industry**, the cluster aims to move beyond exports of gems and capture higher value-added by designing and exporting unique and "branded" jewelry. The cluster is:*

- *creating the "Ceylon Sapphire" branding program that engages the industry in developing a new line of jewelry with a world-renowned designer;*
- *establishing a free-standing Gem & Jewelry Institute to provide advanced training and services for the industry; and*
- *establishing an internationally-accredited gem laboratory in Sri Lanka that will certify the quality of gemstones and, thus, increase their value.*

***In information and communications technology (ICT),** the cluster strategy focuses on improving the overall business climate. To that end, the cluster has:*

- *developed specific policy recommendations needed for ICT growth; and*
- *launched three centers of excellence, focused on e-learning, project management and, e-government.*

and rules. How the private sector conducts such interaction is a central element of competitiveness initiatives. As outlined in the guiding principles, cluster members must begin to see that, although they are competitors, some issues present common obstacles and, consequently, it makes sense for the good of their business as well as the cluster to combat these challenges collectively. In this respect, the dialogue within the private sector itself changes, moving from confrontation to "cooperating to compete."

Changing the dialogue between the private and public sectors on such issues as policy, legal and regulatory reform is also a central component of competitiveness initiatives. For example, rather than attacking government with "laundry lists" of problems that government must solve, the private sector is encouraged to prioritize its needs and suggest realistic solutions that take into account the public sector's responsibilities and interests. Likewise, rather than an individual company going to a personal contact in government to get a problem "solved" for the individual company, competitiveness initiatives demonstrate the power of companies interacting as a group with the public sector, as a way to improve the overall business environment. In other words, competitiveness initiatives aim to produce dialogue between public and private sectors that is less combative and more effective.

Promoting Public-Private Dialogue
Lessons from Colombia

Initially, the Government of Columbia established a national competitiveness council as part of its major effort to promote competitiveness. The council was comprised of a mix of public-private leaders, including ministers and representatives from the business community, labor unions and academia. However, as the council was chaired by the president and its members were selected by the president, its mandate also become closely associated with the president's administration. Once the government changed, the council dissolved.

Over the past four years, the Colombians have taken a seemingly far more successful approach to promoting dialogue through the establishment of semi-annual Encuentros Nationales de Productividad y Competitividad. *Unlike its national competitiveness council, the* Encuentros *bring together as many as 1,000 people from the public and private sector to discuss competitiveness issues, and, hence, they represent a significant broadening of the dialogue. Both government and private sector leaders regard the* Encuentros *as a valuable mechanism for promoting action on competitiveness. As a result, the forum has continued for four years – despite changes in administration. And, when the government recently proposed holding the forum only once a year due to the considerable preparation time they entail, the private sector resisted. It appears that the government is reconsidering its proposal.*

Partnerships

As dialogue both within the private sector and between the public and private sectors becomes more common, more effective and more trusted through a competitiveness process, joint activities and investments occur with greater frequency and involve greater complexity. Partnerships may include, for example, joint investments, agreements to separate functions and responsibilities into public or private hands, or collaboration on institution building. Because they involve sharing of financial and sometimes human resources as well as deep, strong consensus on goals, functions and anticipated outcomes, both public-private and private-private partnerships typically occur when competitiveness initiatives are at more mature stages.

Improving Understanding and Support for Competitiveness

Lastly, competitiveness initiatives typically include efforts to broaden knowledge of competitiveness, both within targeted groups and the general public. Many different mechanisms for information dissemination are used, including, for example, newspaper articles and editorials, training of journalists in competitiveness principles, workshops to deepen university professors' and students' knowledge, round-table discussions involving public and private sector leaders, and publicizing the deliberations and actions of national competitiveness councils, among other means. The central objective of media and public information efforts is to build knowledge of competitiveness principles so that the general public is supportive of different roles and dialogue between and within the public and private sectors; moreover, emerging clusters can observe, learn from and potentially emulate other clusters' experiences.

* * *

This chapter outlines our synthesis of the "core elements" of competitiveness initiatives from two perspectives: the guiding principles that serve as the foundation for competitiveness practice and the key components that comprise most competitiveness initiatives. As mentioned in our final guiding principle, ***the <u>participatory</u> strategic planning process is the starting point for building the momentum for change***. This process is central to the methodology and approach used by many cluster practitioners. We devote the next chapter to describing how the process starts and how it often unfolds over the course of a competitiveness initiative, particularly within the context of USAID.

CHAPTER 4
CLUSTER-BASED COMPETITIVENESS METHODOLOGIES

INTRODUCTION

The desk assessment of USAID's worldwide competitiveness efforts reveals that the methodologies used by USAID contractors to implement competitiveness initiatives exhibit an overall consistency of approach, a consistency that is somewhat remarkable given the relatively short period in which USAID has engaged in competitiveness efforts. While there are more similarities than differences in the general approach, contractors nevertheless do emphasize different elements or nuances in addressing a country's, region's or sector's competitiveness. The general approach to competitiveness initiatives used by USAID contractors is delineated in detail below, followed by outlines of and perspectives about key nuances emphasized by different contractors. It is important to emphasize that, although the forthcoming description of cluster-based methodologies is based primarily on USAID experience, it also reflects practitioner experience in some non-USAID cluster development efforts. For example, the process used in Campeche parallels nearly identically the first three phases described below; this same process has been or is being implemented by the Campeche contractor elsewhere in Mexico and a number of other countries.

It should be noted that no practitioner follows the methodology exactly as delineated below. Instead, what is described below is a composite approach developed by the assessment team based on a number of contractors' implementation experiences. As such, the approach detailed below provides the assessment team's view of "best practices" learned from implementation of USAID's competitiveness initiatives.

APPROACH USED IN CLUSTER-BASED COMPETITIVENESS INITIATIVES

As discussed in Chapter 2, from 1998 (when the agency first began to explore this approach to economic growth) to early 2003 (when the analysis for this assessment was conducted), USAID has engaged a range of contractors to implement competitiveness initiatives. Review of practitioner documentation, detailed interviews with key contractor personnel and fieldwork in Campeche and Mongolia defined five major phases that typically characterize competitiveness initiatives. These phases are:

- Phase 1: Conducting Initial Competitiveness Diagnostics
- Phase 2: Identifying Clusters
- Phase 3: Crafting Cluster Strategies
- Phase 4: Implementing Cluster Strategies
- Phase 5: Developing Exit and Sustainability Strategies

It should be noted that, although their aims are distinct, Phases 1 and 2 usually are conducted simultaneously. The purposes and key actions involved in each phase are detailed in the following sections.

Phase 1: Conducting Initial Competitiveness Diagnostics

Objective

A cornerstone of USAID competitiveness initiatives is that local private sector leaders drive the process. However, Phase 1 is led by the contractor – but nevertheless is central to evaluating if local entities and individuals have the enthusiasm and commitment to shoulder the responsibilities entailed in the competitiveness approach. The objectives of this phase, highlighted below, reflect its evaluative nature:

- Generate understanding of competitiveness principles;
- Gauge overall receptivity to competitiveness ideas; and
- Ascertain issues that a competitiveness initiative potentially could address.

Key Actions

Although practitioners use different terminology and to some extent different techniques to progress towards these objectives, the usual actions taken during this phase include:

- Assessing (in broad terms) the country's economic foundations (including human resources, financial resources, physical infrastructure, technological infrastructure and regulatory environment);

- Benchmarking the country against comparative and/or competitive peers;

- Conducting an intensive series of workshops to improve understanding of competitiveness and its relevance in the local context; and

- Initiating outreach to local media, universities and other public communications channels.

Phase 2: Identifying Clusters

Objective

It is during Phase 2 – the cluster identification stage – that the private sector-led nature of cluster-based competitiveness initiatives emerges strongly. Prior to entering this phase, practitioners (and, often, donors themselves) identify clusters or sectors that meet criteria important to achieving the country's and donor's economic growth objectives. The box to the right summarizes criteria used by SRI International to identify potential clusters.[22]

Useful Criteria for Identifying High-Potential Clusters

Source: SRI International

The potential cluster should:

- *Offer clear promise for growth as well as expanded and new opportunities for investment*
- *Have an existing critical mass of skills and resources*
- *Be capable of generating substantial employment opportunities*
- *Exhibit strong potential for generating export and foreign exchange earnings*
- *Demonstrate strong interest in collaborating on common issues*

[22] PricewaterhouseCoopers and SRI International, ***"USAID Competitiveness Interventions Review,"*** prepared for USAID, November 2001, p. 45.

Regardless of which clusters are identified preliminarily in this process, it is – at least theoretically – the interest and commitment demonstrated (or not) by various clusters that determines if USAID moves forward on a competitiveness initiative at the end of this phase and, if so, which clusters will be involved. It is therefore important that any initial identification or analysis of clusters not raise expectations – for the private sector, government, or even USAID itself -- that may be difficult to fulfill without real cluster interest and commitment. As noted in Chapter 2, however, both donor officials and practitioners often believe that the economies of many developing countries often offer little room for stringent exclusions of potential clusters. Nevertheless, the experience of El Salvador (see the box below) demonstrates the perils of overriding the cluster self-selection process and instead targeting economically "important" clusters. In sum, the objective of this phase is to determine the clusters' interest in and commitment to engaging in this type of initiative.

Cluster Selection and Development in El Salvador

Under the aegis of a World Bank project, the Government of El Salvador in 1997 established four clusters, with technical assistance from its Ministry of Economy and the ministry's contractor. Drawing on the contractor's analyses, the government chose leading sectors in which to support cluster development, namely coffee, apparel, handicrafts and the emigrant community. Furthermore, the Ministry of Economy selected the cluster members, with the intention of including a broad representation of the industry. By 2000, it was clear that action in the clusters was not taking place, leading to the ministry's and contractor's recognition, in hindsight, that using this process was an error that failed to stimulate private sector leadership and that by selecting cluster members inadvertently produced or reinforced a status-quo orientation.

With assistance from a different contractor, the Ministry revised its approach – inviting proposals from self-selected groups of entrepreneurs who were willing to commit to share funding for the cluster development activities. The development of the four self-selected clusters – beekeeping, ornamental plants, machine tools and tourism – was much more successful than the handpicked clusters.

For example, the beekeeping (or apiculture) group has operated continuously since November 1998. The group includes the broad spectrum typically associated with a "cluster": three major producers of honey-based products, a Ministry of Agriculture official, an academic researcher, and a cooperative that represents 630 rural beekeepers. As a result of the group's work, two national quality standards have been developed for honey (whereas none existed before); the cluster members have agreed to standardize and improve containers used for transport; and there has been some joint exporting to achieve cost reductions. Similar advances have been seen in the ornamental plants group, which, for instance, agreed upon a uniform box size (allowing for savings via group purchasing) and cooperatively paid for technical assistance from an American expert in tropical plant inspections. The group also negotiated with the Ministry of Agriculture for permission to import for its own use (i.e., not for sale) any product approved by the U.S. Environmental Protection Agency, even if use of those products are not otherwise permitted in the country.

The contrast in effectiveness of these two different approaches to cluster identification and selection reinforces strongly the paramountcy of cluster commitment over any other factor that might also be incorporated into the selection process – and demonstrates the potential difficulty of working in traditional sectors, which often have entrenched interests, compared to newer, more enthusiastic groups.

Key Actions
Within the USAID context, in Phase 2, the contractor, the clusters and the donor all have significant responsibilities to undertake, as follows:

- ***The contractor:*** Benchmarks various clusters versus international competition.

- ***The contractor:*** Convenes a second round of intensive workshops involving a broad cross-section of mainly private sector leaders and players.

- ***The clusters:*** Demonstrate, individually and collectively, their understanding that local leadership, action and collaboration form the core of competitiveness initiatives and, through their interaction, indicate their willingness to engage actively and constructively in fulfilling these responsibilities.

- ***USAID (or other donor):*** Decides whether to proceed with a competitiveness initiative, based on observation and feedback solicited from contractors and clusters.

The practitioner's roles in Phase 2 – bringing knowledge of the international marketplace to the clusters (through benchmarking) and serving as convener of a local group of activists – foreshadow the functions that it typically does (and should) assume if a full-fledged initiative is undertaken. Knowledge transfer is critical because many clusters in developing countries lack access to information about the markets they hope or intend to serve. Through their corporate resources and experience in other countries, contractors provide not only scarce, hard-to-find data necessary to plan competitiveness strategies but also objective "facts and figures" that form a basis for strategic planning. It should be noted that in Phase 2, contractors generally do not develop detailed cluster analyses. Rather (as outlined in the next paragraph) at this stage, when many potential clusters may be emerging, the purpose of the workshops (and the information provided within them) is to gauge how well, or poorly, potential cluster participants engage in strategic collaborative dialogue with the help of outside facilitators. ***In sum, in this phase the contractor demonstrates its ability to serve as a neutral, high-quality resource and advisor*** to the clusters regarding the global marketplace – and tests the reactions of potential cluster members to working on the basis of objective data.

As mentioned above, in Phase 2 the contractor must demonstrate that it can serve effectively as a convener of sometimes antagonistic individuals and groups. In many cases, the workshops held under Phase 2 may be among the first opportunities for different parts of a cluster's value chain to interact directly with each other. Accordingly, it is critical that the contractor guide and facilitate – but not dominate – the discussion and interaction among these various elements so that, through direct conversations, reactions and even disagreements, the propensity towards greater trust, confidence in the group's ability to problem-solve and collaboration can be instilled. ***In other words, in this phase the contractor establishes its "credentials" and practices its service as an honest broker and facilitator among often fractious parties***. It should be noted that acting as a facilitator – rather than an "expert advisor" – is a different role for most USAID contractors, which typically are expected, and encouraged, to independently analyze issues, identify solutions, recommend courses of action, implement initiatives and produce results. Under cluster-based competitiveness initiatives, contractors bring data and resources to the table and "mediate" clusters' strategic planning sessions – but cluster members themselves should assume analysis, solution-identification and action plan development functions.

The mechanisms for demonstrating and assessing cluster interest and commitment are primarily subjective. In the workshops in Phase 1, not only general competitiveness principles but also the participatory process used in implementing competitiveness initiatives will have been detailed. As a result, by Phase 2, potential cluster participants should understand that competitiveness initiatives revolve mainly around their own efforts – with project-funded long-term advisors and strategic short-term assistance providing support rather than leadership. By Phase 2, it should also be clear that direct funding for individual firm efforts will be minimal or nonexistent. Rather, it should be understood that the majority of technical assistance will be directed toward supporting joint efforts – if the cluster can bring itself together. With knowledge of these realities, the interest of potential clusters members can be inferred in part from their willingness to engage actively in Phase 2's second round of intensive workshops: time is money, and willingness to "spend" time without the prospect of immediate direct benefit is a significant indicator of interest.

The concept of "cooperative personalities," used by SRI International, also can illuminate whether a given cluster is not only interested and committed but also whether work with that cluster might be fruitful. Potential cluster members demonstrate "cooperative personalities" by actions such as:

- Through self-regulation, allowing all parties to speak during workshop discussions, rather than permitting a few individuals to dominate;
- Encouraging a variety of viewpoints to be expressed without significantly raising group tension or personal animosities; and
- Ability to see beyond one's individual interests to the greater good.

To evaluate cluster interest and commitment, USAID and its contractors use mainly observation. In addition to the topics covered above, key questions to ask are:

- Do the potential cluster members who have participated in the activities above represent the full cluster – or are they instead more like a "club"? Who is not at the table? Why?
- Have cluster members stayed engaged – attending multiple workshops and meetings with active participation?
- Have champions in government (both politicians and bureaucrats) emerged? If so, are there champions among several political parties?

Despite the private sector impetus of competitiveness initiatives, the last question is important. In every cluster-based competitiveness initiative that the assessment team reviewed, the cluster inevitably engaged with government to remedy strategic policy, legal or regulatory concerns. Thus there needs to be some understanding, awareness and support for a cluster-based competitiveness initiative across the public sector and political parties in order for cluster-initiated efforts to endure over the longer term.

Through the process above of testing cluster interest and commitment, "picking winners" (a common criticism of competitiveness initiatives) is generally avoided and, instead, enthusiastic "self-selected" groups emerge and gain the privilege of accessing valuable technical assistance with which they can improve their growth prospects. Regardless of a cluster's commitment at project inception, however, enthusiasm and action must be assessed on an on-going basis, and USAID must be willing to end support for clusters whose interest and activities wane. An example from Lebanon illustrates this point (see the box below).

Phase 3: Crafting Cluster Strategies

Objective

Phase 3 deepens the relationship among cluster participants, solidifies the practitioner's "honest broker" role, and establishes a roadmap for cluster actions. From an implementation perspective, the objective of Phase 3 is to facilitate a strategic planning process that enables a cluster to define its common interests, strategic vision and action plan. Three multi-faceted steps – cluster formation, cluster analysis and cluster strategy and action plans – compose Phase 3.

Key Actions

Step 1 – Cluster Formation: This first step concentrates on the "process" that will guide the competitiveness initiative – and deliver its results. Through the contractor's introduction of typical techniques and mechanisms used in cluster development, the cluster members define the group's "rules of engagement," roles and responsibilities as well as develop a clear understanding of the respective responsibilities of the cluster versus the contractor.

The Business Services Cluster in Lebanon

Prior to the prolonged violence that Lebanon experienced from the 1970s to 1990s, the country was a prominent supplier of financial and business services to the Middle Eastern region. Recapturing this role was defined in the early stages of USAID's competitiveness effort as a potential significant contributor to the country's economic growth. The cluster was expected to encompass businesspeople in financial services (including investment banking, insurance, private banking, on-line services, among others) as well as (to a lesser extent) advertising, publishing, software, telecommunications, conference center services, trade and transshipment and medical services.

Within the context of USAID's support for the business services group, a number of steps were taken, including: implementation of a web-based business matchmaking service to connect overseas Lebanese to opportunities in the country; and development of the concept for a regional education initiative. But, the business services group never truly "gelled" – participants had a wide array of interests that were not always complementary or compatible. As forward movement petered out, USAID decided to end its support to the cluster – a difficult but necessary decision – and one that other USAID missions will face and (have faced) during the course of their cluster-based competitiveness initiatives.

Step 2 – Cluster Analysis: In this step, the contractor leads the cluster through an analysis of the cluster's current status. Diagnostic tools, such as SWOT analysis[23], elaboration of the Porter diamond, and supply chain mapping, frame the dialogue, which culminates in agreement on the "diagnosis" of major challenges and opportunities confronting the cluster.

Step 3 – Cluster Strategy and Action Plans: During Step 3, the cluster uses Step 2's analysis to develop a consensus ***vision***, in as specific terms as possible. The cluster also develops a targeted

[23] SWOT analysis examines the strengths, weaknesses, opportunities and threats facing an industry or cluster.

set of ***achievable*** ***initiatives*** linked to the vision. Lastly, the cluster assigns ***tasks***: that is, it identifies individual and institutional champions that agree to carry out each initiative. Throughout the process, the contractor serves as a facilitator, lending expertise during points of substantive contention, defusing nonproductive disagreements, questioning overoptimistic or grandiose ideas, and continually focusing the dialogue on the major issues identified from the cluster analysis. The "task-assigning" end of this step is a pivotal point in the cluster's development, as it represents the juncture at which cluster members must demonstrate concretely their willingness to do more than "talk."

Although the steps of this phase may seem straightforward, the process of progressing through them is not; indeed, the box on the next page provides examples of two different process "breakdowns." Simply put, it takes time for cluster members to learn how to engage each other effectively; to agree upon common challenges; to sift through challenges to discern core issues; and to devise concrete strategies and actions that gain the consensus of the group. It is at this stage that USAID contractors feel most pressed or inclined to revert to an "actor" rather than "facilitator" role. Likewise, it is at this stage that USAID itself may wonder "what's happening" and if movement forward will ever be achieved. If Phase 3 is successful – meaning that clusters are able collectively to develop a strategy – the time invested leads to ownership by the cluster and a greater likelihood for cluster members assuming responsibility for translating strategies and plans into action. By contrast, if a cluster cannot coalesce, analyze and strategize, then at some point USAID and its contractor must be willing to limit or cease further support.

Phase 4: Implementing the Cluster Strategy

Objective

This phase is the time when discussion and planning are turned into action. Each cluster will take different steps to achieve its goals; regardless of the specific actions, the overall objective is, simply put, to implement the strategy and action plan developed in Phase 3.

Key Actions

Actions vary widely depending on the sector, the local context and cluster members' interests. In all cases, the actions should be led by the responsible individual and institutional champions who committed in Phase 3 to take charge of the activity. The contractor lends a key supporting role to these activities. Types of support that contractors often provide during this phase are:

- Targeted technical assistance
- Specialized training
- International market research
- Policy, legal and regulatory analysis
- Facilitation of dialogue and engagement with the public sector
- Media outreach and assistance with public communications

Strategy Development: Issues from Campeche and Mongolia

As described above, Step 3 involves two key actions: winnowing of strategies to focus on achievable activities and assigning responsibility for actions. In Campeche and Mongolia, lack of attention to these actions produced important repercussions from which future cluster initiatives can learn.

Campeche: *During the strategy development stage in Campeche, clusters were encouraged to "brainstorm" activities that members thought warranted attention. Based on our review of the cluster strategy documents and interviews it appears that few (if any) potential activities were questioned as too grandiose. Indeed, many "huge" potential projects were incorporated into the cluster strategies, including a new airport, new port, new airline, $300 million bio-ethanol project (which would directly compete with the state's major revenue generator, petroleum), etc., etc. The prevailing philosophy during the Campeche strategy development phase seems to have been: all ideas are good, but for a good idea to move forward, a champion or group would have to mobilize to get the work done. In many cases, champions did not emerge, and work did not start ... or did not proceed very far. This turn of events led to a widespread sense that Transformando Campeche was "all talk" and no action. Ultimately, the enthusiasm that characterized the initiative's launch quickly dissipated. Cluster participants needed to see some concrete changes emerge fairly quickly in order to sustain momentum.*

Mongolia: *Lack of champions was a significant impediment in Mongolia's competitiveness initiative in the cashmere sector. One of the main components in the cashmere sector was development of support and legal/operational mechanisms for a certification trademark for Mongolian cashmere. In the absence of private sector willingness to spearhead this effort, the contractor assumed responsibility for moving the trademark forward – meeting individually with cashmere processors to explain the concept and gain their interest in using the mark, working with relevant government officials on necessary legislative changes, and testing reaction to a Mongolian trademark with fiber dealers, fabric weavers and clothing manufacturers outside the country. Practically, these activities put an enormous burden on the contractor team; operationally, assumption of these responsibilities placed the contractor squarely in the "actor" rather than "facilitator" role; and conceptually, lack of active, local champions willing to invest significant time and resources toward the cashmere mark signaled a clear departure from the local ownership that should characterize a cluster-based competitiveness initiative.*

As illustrated in the box on the next page, support for implementation for the above types of activities was almost uniformly absent in Campeche. Based on the Campeche experience, we believe that donor funding for such assistance is key. Absent from the list of types of support, it should be emphasized, is provision of investment capital or financing from USAID (or other donors) to the cluster. Strong consensus emerged from the assessment team's interviews that any projects initiated by the cluster must be bankable – that is, capable of winning finance and investment from private sources on market terms, not from USAID or other donors.

The critical issue in this phase is sustaining momentum. The previous phases typically generate excitement about what the broad ideas of competitiveness might mean to the cluster. By contrast, this phase is about working on concrete tasks, not ideas in the abstract. In vernacular terms, Phase 4 is where the rubber meets the road.

Implementation Issues in Campeche

Our interviews in Campeche had a common refrain: there was much excitement and enthusiasm during the awareness building, strategy development and action planning stages – and much frustration and disappointment once the time came for implementation. According to cluster members, the first two phases had illuminated "what" to do, but not know "how" to do it. "How" is the essence of Phase 4 – that is, putting into action the shared plans of the previous phases.

Only one element of the strategies developed in Campeche – investment promotion – received any technical assistance beyond periodic meeting facilitation. Training, study tours, and other substantive advice on building the investment promotion program were provided by the contractor to the newly created organization that housed this activity. And, as was widely recognized, the investment promotion program achieved significant results (outlined in the next chapter). In contrast, interviewees from other clusters noted that there had been no assistance available to translate the "what" to the "how" – and that their results were therefore far less striking.

The complaints in Campeche about lack of assistance undoubtedly stem in part from a tradition and mindset of expecting others (usually government) to assume the initiative for action. Nevertheless, in the absence of any assistance, forward movement is unlikely given lack of knowledge of the new areas into which clusters typically intend to enter. Hence we believe that helping cluster members understand "how" is a key function of the contractor; however, actually "doing" the work for the cluster is not the function of the contractor.

Phase 5: Developing Exit and Sustainability Strategies

Most USAID-funded competitiveness initiatives are still on-going; that is, they have not yet reached the critical stage of transition from donor assistance to independent operations. One exception is USAID's competitiveness initiative in Sri Lanka, which ended in August 2003. Because no follow-on effort is anticipated, since late 2002 the USAID contractor has been working with each of the project's eight clusters to define cluster-driven ideas and strategies for autonomously sustaining competitiveness activities. According to the contractor, all of the clusters plan to continue their work. We attempted to obtain detailed information about each cluster's "graduation" strategy, but such information was not available. However, we were told that each cluster's strategy was anticipated to be slightly different, and three general paths were most often being considered:

- Formation of a new (nonprofit, nongovernmental) apex organization to continue cluster activities;

- Agreement to house and continue cluster activities within an existing organization; or

- Commitment to continue activities and meetings in an informal manner, rather than through a specific entity.

DIFFERENCES AMONG COMPETITIVENESS METHODOLOGIES

While the overall process for cluster development within competitiveness initiatives is, for the most part, consistent among practitioners, different emphases emerge with regard to complementary or supporting activities. These differences in some cases are based on philosophical concerns, in others on host country circumstances, and in still others on USAID mission priorities. Regardless of the reasons, in designing and implementing competitiveness initiatives, USAID missions and contractors should carefully consider the possible usage of such efforts. The section below is intended to highlight pro's and con's of each potential component.

National Competitiveness Councils

Following the lead of many developed countries (including the United States), several developing countries have established "competitiveness councils" or other similarly-named national forums that are intended to serve as high-level public-private advocates for furthering a country's competitiveness and as an institutionalized means for public-private dialogue. Among the USAID practitioners whose activities were reviewed, initiation of competitiveness councils is espoused particularly by J.E. Austin Associates. There are several potential functions and issues (outlined below) that a USAID mission or contractor should consider before deciding whether to include a national competitiveness forum in its competitiveness effort. The box on the next page encapsulates some of the different circumstances that frame decisions about forming a national council.

Actual and Potential Functions. National competitiveness councils can serve as a galvanizer of public awareness about competitiveness issues. Populated by prominent public and private sector leaders, such councils' meetings and proclamations often are covered by local media, leading to opportunities to advance the general public's knowledge of competitiveness. In theory, competitiveness councils also could serve as advocates for the policy, legal and regulatory reforms strategically targeted by the various clusters; however, in its review of USAID's competitiveness experiences, the assessment team has not encountered instances in which this has occurred. Competitiveness councils by definition are broadly-representative of the country's economy; thus, members' abilities (or interests) to act at the sub-sectoral (i.e., cluster) level that is the heart of competitiveness initiatives may be limited. Nonetheless, as a national-level "attention-focusing" body, competitiveness councils may be able to play a role in sharing lessons learned across clusters. Again, this lesson-sharing role is not one that the assessment team has encountered; rather, it is a possible function for such bodies.

Potential Issues. The issue that led USAID Mongolia and its contractor to decide not to establish a national competitiveness council – namely, that the relatively small number of individuals on the council could exert extraordinary control because of the small size of the country's political and economic "space" – is one that may be relevant in many small developing countries. Unlike members of competitiveness councils in most developed countries, participants in similar bodies in developing countries may be less likely to know – or heed – nuances of the market system such as recusing oneself from decisions or projects that represent a conflict of interest. Thus, national councils may have the tendency – or may feel pressure – to selectively target certain sectors of the economy for support based on potential benefit to themselves or their allies. It should be noted that Macedonia is the only country we are aware of where a national council is involved in selecting clusters. This approach is new and thus results are yet to be seen; however, we believe this example needs to be watched carefully as significant conflicts of interest or patronage (or at a minimum, perceptions thereof) could easily arise.

National Competitiveness Councils and USAID Competitiveness Initiatives

Country	Is there a Competitive-ness Council?	Did USAID Initiate or Support It?	Why or Why not? or Type of interaction
Croatia	*Yes*	*Yes*	*Lack of vehicles for public-private and private-private dialogue was identified as a constraint in the early analysis; hence a council was formed to address this need.*
Dominican Republic	*Yes*	*No*	*The council pre-dated USAID's competitiveness initiative. Now, there is some information sharing between clusters and the council at national meetings.*
Macedonia	*Yes*	*Yes*	*Some functions differ from other councils; specifically, the council serves as: a forum for discussing policy issues; a coordinating mechanism for donor activities; and the reviewing and selecting body for cluster initiatives.*
Mongolia	*No*	*No*	*Decided that power would be too concentrated in too few hands.*
Sri Lanka	*Yes*	*Yes*	*Initially, USAID decided against a council but later in the project changed its perspective and supported council development. The Sri Lankan government passed legislation authorizing the council's formation.*
Thailand	*Yes*	*No*	*USAID coordinates with this pre-existing national council but will operate cluster-based activities separately.*
Uganda	*Yes*	*No*	*USAID's initiative coordinated closely on policy issues with the pre-existing national council.*

A second potential concern relates to maintaining the cluster-propelled nature that is typical of the competitiveness initiatives discussed in this report. Given the powerful, influential membership that generally comprises national councils, there is a danger that competitiveness initiatives that incorporate national councils could become council-driven rather than cluster-driven. Such an outcome would detract from the highly participatory process that underlies cluster development.

A third concern that can arise is tension between the development of the national council and the clusters. In some countries, the priorities for policy reform and public sector investment identified by the clusters have not fed into the priorities and actions of the national council, resulting in significant frustration and tension. The need for close coordination and linkages between the cluster working groups and the national council may seem all too obvious; however, the experience in some countries demonstrates that these linkages are often difficult to achieve in practice – particularly, when cluster groups and the national council "compete" for donor resources.

A fourth issue relates to the time requirements and resources associated with supporting national councils. Because of the high level and extensive responsibilities of most council members, it is unlikely that the council members themselves will conduct any significant portion of the council's day-to-day work; instead, this work likely will fall on the contractor's shoulders if it is a USAID-initiated effort.[24] Accordingly, in a context of limited resources, USAID and the contractor must evaluate whether dedicating substantial resources toward establishing a competitiveness council is in the project's overall best interests, or – if a council was established independently of the competitiveness initiative – to what extent and in what ways the contractor should support its efforts.

Role of the Global Competitiveness Report

In Sri Lanka, J.E. Austin Associates and Nathan Associates worked with the World Economic Forum to include the country in its Global Competitiveness Report. Based on this experience, Austin Associates (with Nathan Associates) encourages USAID's competitiveness initiatives to consider using existing competitiveness rankings in their project or funding the necessary surveys to gain inclusion in global rankings. The rationale for seeking a country's inclusion in competitiveness reports is based on the following factors:

- Global competitiveness rankings tend to attract and involve the country's leadership and thereby prompts dialogue, engagement and awareness;
- The rankings provide the private sector with objective, neutral data on which they can base future discussions with government;
- The rankings tend to confirm and focus the private sector's priorities about what most impedes competitiveness; and
- Media coverage of rankings can build the general public's knowledge about competitiveness.

Because the countries where USAID works can be expected to fall relatively low in such competitiveness rankings, use of the rankings must be carefully planned in order to be effective. In other words, without a clear strategy for rolling out the results of such reports, the rankings can easily be interpreted as "bad news" from misinformed or unsympathetic "outsiders."

Workforce Development

As indicated in the discussion of competitiveness methodologies, skilled human resources are commonly considered one of the foundations of a nation's (or industry's) competitiveness. More than most contractors, IBM and SRI International are noted for focusing attention on workforce development issues as a major component of competitiveness initiatives (or even as stand-alone efforts). In contrast to cluster-led competitiveness efforts, a major or sole focus on workforce

[24] If the council was founded prior to USAID's competitiveness initiative, as in the Dominican Republic, Thailand and Uganda, autonomous mechanisms for completing the council's work presumably already will have been established.

issues (even at a sub-sectoral or cluster level) typically is USAID- or host country-initiated; it is not, from the assessment team's review, an issue that cluster members typically raise as a "top" priority in developing countries (although often it is identified as such within the contexts of cluster strategies in developed countries, including the United States). Thus, while ultimately contributing to a country's overall competitiveness, workforce development efforts as they have been practiced to date typically do not reflect the participatory strategic planning process described in this chapter's first section.

Role of the Contractor

The phrases "honest broker" or "objective facilitator" reflect the most common view held by USAID and USAID contractors about the contractor's role in a competitiveness initiative. An exception to this generalization was expressed by Carana Corporation, which, based on its experience implementing USAID Uganda's competitiveness initiative, views the contractor's role as focused on getting quickly to the stage where a new idea can be implemented, usually as a demonstration project. Often, from Carana's experience, new ideas also are brought in by what it calls a "catalytic investor." This emphasis on the contractor's or an investor's ideas and actions contrasts sharply with the cluster-led and -initiated efforts described above.

Demonstrations of Cluster Commitment

As indicated in the previous section, evaluating cluster commitment is mostly subjective. In one of the earliest competitiveness initiatives (namely, in Sri Lanka), J.E. Austin Associates used more tangible demonstrations of commitment. First, Austin Associates required potential clusters to sign memoranda of understanding (MOUs) to signal the commitment of the signatories to participating in the initiative. MOUs do not appear to have been used in other USAID-funded initiatives nor in non-USAID experiences.[25] The theory behind a formal declaration of commitment is sound; in practice, however, it is unclear to what actions the signatories are committing. Moreover, because competitiveness initiatives require periodic re-assessment of cluster commitment, it is conceivable that a signed MOU could serve as a deterrent to USAID's ability to drop a cluster if interest and action were to wane.

In Sri Lanka, J.E. Austin Associates and Nathan Associates initially required that clusters raise resources for and hire a coordinator to serve as primary liaison with the contractor and as the focal point of cluster activities. A change in leadership at USAID Sri Lanka resulted in an end to this practice, and financial and supervisory responsibility for cluster coordinators was transferred to the contractor. Requiring clusters to fund a coordinator does represent a significant commitment by the cluster, but it also requires a significant "leap of faith" by cluster members – to invest their scarce funds as well as precious time before the first activity has started. As such, it is unclear if such commitment could be generated on a widespread basis. It should be noted that, other than the initial framework in Sri Lanka, no USAID-funded cluster-based competitiveness initiative has required cluster funding for this purpose.

[25] SRI International reports that it occasionally uses MOUs in the United States, usually when the MOU signatory is the client paying for the competitiveness effort.

Findings from "The Cluster Initiative Greenbook"

The Global Cluster Initiative Survey provides perspective on the approach and process used in many cluster initiatives in industrialized countries. Specifically, the survey found that:

- Cluster selection: *Most cluster initiatives are not formed on an ad hoc basis, but as part of a concerted government effort to improve competitiveness. In many cases, government made their choice to support a cluster based on research identifying attractive industrial sectors (54%). Often, this was combined with a process where clusters had to compete with each other in a bidding process to receive financing (44%).*

- Cluster participation: *Cluster initiatives have broad membership; they rarely exclude foreign owned companies, competitors, or small companies. Collective action requires new attitudes of all parties.*

- Cluster strategy: *Cluster initiatives tend to have a vision (84%), but less (68%) also have quantified targets for their activities. Building consensus in the early phase of a cluster initiative takes significant effort; this is also true later in the process when a cluster initiative needs to change its focus.*

- Cluster financing: *Financing changes over time. Initially, government often plays a leading role. In later stages, government money decreases as a general rule and membership fees becoming more important. Hence, surviving cluster initiatives often move from a project-based organization to a more membership-based organization.*

Source: ***The Cluster Initiative Greenbook****, 2003*

In summary, there is no single strategy can be replicated identically for cluster-based competitiveness initiatives. Even if they have similar macroeconomic policy environments, no two countries share identical human, financial, or natural resources, all of which contribute in a complex mix to a country's overall (and cluster) competitiveness. All of these factors – along with the most critical input, cluster commitment, which is inherently "local" and unique – combine to shape debate and decisions about what needs to be done – and what, realistically, the cluster can do. Chapter 3 describes five "typical" components of competitiveness initiatives, but precisely what is undertaken and in what sequence will vary over the course of the initiative.

In short, despite the linear and apparently straightforward methodology presented above, there is no "cookie cutter" approach to implementing competitiveness. Context and strategy determine the substance that clusters will address and the activities they will assume – and initiatives therefore play out differently depending on local circumstances. In many respects, the real test of a competitiveness initiative is its ability to "adjust" to the local terrain, as evidenced by its ability to change the way local actors understand and tackle the constraints to productivity. We see how this "test" plays out in the next chapter on results.

CHAPTER 5
RESULTS

INTRODUCTION

Measuring results in development assistance projects is always difficult. Attributing results to project interventions leads to further complication. And choosing measures that are meaningful, reliable and reasonably available is yet more complex. Competitiveness initiatives share all of these often-seen difficulties of measuring results. At the same time, as outlined below, competitiveness initiatives also pose some unique challenges in measuring results. The assessment team began its exploration of these issues by looking at the literature on competitiveness, as well as current practices in measuring results and impacts of competitiveness initiatives. The key findings from this review are the following:

- ***Competitiveness theorists and practitioners are just beginning to explore strategies for measuring results and impacts from cluster-based initiatives.***

The use of cluster-based approaches to promoting economic development has increased dramatically over the past five years, as explained in Chapter 2. Donor organizations are relative newcomers to the field. However, as they become more significant players, donors have sparked greater interest in the development of methodologies for measuring the results and impacts of cluster-based initiatives. "Sparked" is the key word … as measuring results is new territory for both competitiveness theorists and practitioners, and there are no state-of-the-art tools, methodologies, or widely-accepted best practices at this time.

As we began this assessment, we found that most of USAID's practitioners were just starting to think about monitoring and evaluation issues (even though some have been working in the field for more than four years); over the past year, these issues have become an area of increasingly keen interest and exploration for some contractors, most notably, J.E. Austin Associates. For practitioners that have traditionally worked outside of USAID, we found that measuring results and impact is unexplored territory – in large part because their clients have paid for their involvement at the front-end of the cluster development process and rarely in later stages.

Even in the vast literature on competitiveness and cluster development, there is relatively little discussion of how to measure results or impact from cluster-based initiatives. The one area of the literature that might be considered an exception is the rich debate on the Global Competitiveness Report (GCR).[26] As noted in Chapter 4, the GCR measures a country's comparative strengths and weaknesses on a broad range of issues related to economic competitiveness and growth. As such, the GCR is used as an indicator of a country's competitiveness, and countries often seek to move up the GCR competitiveness rankings through cluster-based competitiveness initiatives. Some analysts suggest that selected GCR variables

[26] For a summary of the methodology and some of the issues surrounding the Global Competitiveness Report, see the Inter-American Development Bank's ***Report on Competitiveness Promotion in Colombia and El Salvador,*** July 2003, (unpublished manuscript), Chapter 4.

might be used for measuring the effectiveness of competitiveness programs. However, in most cases, establishing a link – much less, a causal relationship -- between cluster initiatives and changes in the GCR would be speculative at best, as a multitude of factors are likely to influence the macro-level variables measured in the GCR.

- ***Very few independent assessments or evaluations of cluster-based competitiveness initiatives have been conducted to date.***

The assessment team searched for assessments of cluster-based competitiveness initiatives – in part, to inform our methodology for conducting the field assessments in Mongolia and Mexico, but also to feed into our understanding of the results that emerge from a cluster-based approach. Consistent with our first finding, we were able to identify only a handful of independent assessments or evaluations of cluster-based competitiveness initiatives. For example, USAID conducted a mid-term assessment of its competitiveness initiative in Sri Lanka; however, this assessment focused largely on USAID and contractor management issues as opposed to results and impact (as the program was at a fairly early stage in its implementation). The *Corporación Andino de Fomento* (CAF) has also funded independent assessments and evaluations of competitiveness initiatives, including a mid-term assessment of the Andean Competitiveness Program and, more specifically, a major evaluation of the *convenios* established in Colombia.[27] All in all, the number of independent assessments and evaluations adds up to a mere handful.

- ***Very few competitiveness programs have been set up to track results or impact … or even what has changed as a result of the cluster initiative.***

Reflecting the overall lack of focus on measuring results and impact of competitiveness efforts, the assessment team found that most competitiveness programs lack systems for monitoring progress or change resulting from cluster initiatives. Looking at the USAID portfolio reveals some important points:

***<u>Sri Lanka</u>*:** The Competitiveness Initiative was launched in 1998, and USAID funding was due to terminate in August 2003. Recognizing the importance of capturing the results of its efforts, the project developed a monitoring and evaluation framework in the spring of 2003. The monitoring and evaluation framework focuses on the project's impact on productivity and the standard of living in Sri Lanka.[28] The monitoring system could not examine changes in productivity over time, as the project had not established base-line data on productivity measures at the onset of the project. As a result, the proposed monitoring system focuses on capturing the value-added associated with each of the cluster's strategic initiatives. The key problem is that, according to the monitoring and evaluation framework report, many of the initiatives have begun recently and will outlast the project. Hence, after five years of effort, we do not have any quantitative information about the actual changes in value-added or productivity resulting from

[27] The *convenios* are agreements between the Colombian government and the private sector specific industries on actions to be taken to address competitiveness issues.

[28] A focus on productivity is consistent with the thinking of many competitiveness theorists, including Michael Porter. In a presentation to USAID, Porter noted "The appropriate definition of competitiveness is productivity" (*Microeconomics of Development*, PowerPoint Presentation, September 18, 2002, page 4).

the project; rather, we have a tool and approach for estimating the *potential* value-added that might accrue once the initiatives have been more fully implemented.

Mongolia: The Competitiveness Initiative in Mongolia prides itself on being one of the few competitiveness initiatives that has been tracking quantitative information on results. On an annual basis, the contractor provides information on selected indicators related to the mission's strategic objectives and the sectors targeted by the competitiveness initiative. For example, for the cashmere sector, the contractor reports changes in foreign exchange earnings from processed and manufactured cashmere exports (adjusted for raw material price fluctuations); for the tourism sector, the contractor reports changes in the number of annual tourist arrivals (other than from Russia and China).

We agree that these are measures that a competitiveness initiative should influence; however, making any kind of definitive link between the two is speculative. In fact, it seems that tourism arrivals to Mongolia have been affected by some major exogenous factor almost every year of the project's implementation, be it the September 11 attacks in 2001 or the onset of SARS in 2003 to name a few. Hence, the question is whether tourism arrivals *per se* are a good indicator of the effectiveness or the impact of the competitiveness initiative in Mongolia.

We highlight the experiences of Sri Lanka and Mongolia because they help to illustrate some of the broader challenges of determining results and impact of competitiveness initiatives. Specifically, we believe there are five key issues:

1. The lack of meaningful base-line data from which to measure change …

We have not encountered a single instance in which baseline data about a cluster was collected. In other words, no in-depth "pictures" of cluster starting points have been taken, making it difficult to determine what has changed as a result of the competitiveness initiative. It should be noted that, as part of Phase 2, clusters are benchmarked at a "high" level – including data such as the industry's percentage of exports in the national and global economies, national or global market share, relative employment concentration, etc. However, "lower level" (and harder to obtain) data on skills, wages, productivity, investment, revenues, number of firms, linkages among firms, profitability, and similar factors is lacking in the competitiveness initiatives we examined.

2. The lack of cluster engagement in setting quantitative targets …

Among the cluster initiatives that we examined, we also have not encountered an instance in which the clusters have been engaged in determining quantitative targets as part of the strategic planning process. As described in Chapter 4, clusters define a "big-picture" vision, strategic initiatives, and specific tasks to implement the initiatives. However, as part of this process, there is no attempt to define quantitative targets that are meaningful and relevant for its members. As a result, when there is an attempt to instill cluster "accountability" (and often there is not), it is focused largely on whether progress has been made on implementing the specific tasks in the action plan as opposed to achieving targets that the cluster has established for itself. As noted previously, we see a similar issue (albeit not as stark) among cluster initiatives in industrialized countries. *The Cluster Initiative Greenbook* notes that 84% of the cluster initiatives it surveyed have defined a vision, but only 68% of the initiatives have quantified targets for their activities.

3. The time needed for quantitative results to emerge …
Sri Lanka illustrates that it takes considerable time for quantitative results to emerge from a competitiveness initiative – particularly, if the metric is changes in productivity or value-added. Moreover, it is important to recognize that the experience in Sri Lanka is not different from what we see in other competitiveness initiatives. The IDB assessment of the experience in Colombia and El Salvador also concludes that it takes considerable time for quantitative results to emerge (using exports as a metric). And, along similar lines, *The Cluster Initiative Greenbook* notes that it takes considerable time to build up the momentum for a cluster initiative, "typically more than three years." As we have emphasized in each chapter of this report, a cluster-based competitiveness initiative involves promoting fundamental change in the way people do business, and this does not happen very quickly or easily.

4. The reliance on cluster facilitators to tell the results …
The lack of quantifiable targets and monitoring systems in cluster initiatives, combined with the dearth of independent assessments and evaluations in this area, mean that cluster facilitators are generally the key sources of information on "results."[29] We learn a tremendous amount from the experience of cluster facilitators. However, they also have a clear stake in promoting the success of the initiatives they work on. Reporting on results often gets quickly entangled with marketing and promotion, be it from a contractor (who has a clear financial interest in reporting success) or from a government agency (which has a bureaucratic interest in reporting success).

Some of the complications of relying on cluster facilitators to tell the results are illustrated in *The Cluster Initiative Greenbook*. Given the large number of cluster initiatives it included in its survey, the authors chose to focus on three basic aspects of success: cluster competitiveness, cluster growth, and cluster initiative goal fulfillment. These dimensions of performance are measured by using a series of agree/disagree questions. As the authors fully acknowledge, "the drawback of this method is that we rely on the perception of the respondent, who is often the facilitator and thus has a vested interest in the project [page 45]." However, another important drawback is that the facilitators' perception and internal definitions of "cluster competitiveness" and "cluster growth" may be quite different. As a result, *The Cluster Initiative Greenbook* reports these curious findings [page 43]:

- About 85% of the survey respondents agree that the cluster initiative has helped improve the general competitiveness of the cluster. However, only 66% of the respondents agree that the cluster initiative has helped firms become more competitive on an international level and only 58% agree that new technologies have emerged through the cluster initiative.

- About 90% of the survey respondents agree that the cluster initiative has helped the cluster to grow. However, only 60% agree that this growth meant higher employment. Similarly, 59% agree that new firms were attracted to the area or new firms were formed as a result of the cluster initiative. However, 17% of those who say the cluster initiative helped the cluster to grow do not agree that employment has increased, new companies have been attracted to the area, or new companies have been formed.

[29] We use the term cluster facilitators broadly to include contractors that facilitate the cluster process or government and non-governmental entities that facilitate cluster development.

These findings beg the question of what the facilitators understood by improving the general competitiveness of the cluster, improving cluster growth, or whether cluster competitiveness or growth really happened.

5. The difficulty of measuring the results of cluster development …
As discussed in detail in Chapter 3 (guiding principles), one of the key tenets underlying cluster-based initiatives is that competitive advantage does not lie within an individual firm, but rather, in the *interaction* among firms and associated institutions and organizations. As a result, the cluster is more than the sum of its individual members. As noted by Philip Raines, "these networks embed tacit knowledge, social capital and range of intangible assets which not only generate a territory's competitive advantages but sustain them over time."[30] It is precisely these intangible assets that are so important for cluster initiatives, but also so difficult to measure. Raines highlights two other key issues for monitoring and evaluation cluster-based initiatives:

- First, the focus of evaluation efforts should be the cluster as a whole and not just the individual members of the cluster. Most evaluation methodologies examine how individual firms have changed – but this approach misses the crucial aspect of cluster development, which is that competitive advantage is generated through building connections and relationships among firms and institutions that have traditionally acted in isolation. Hence, "evaluation should consider not just changes in business performance but whether collective participation in a cluster is the source of any business improvements."[31]

- Secondly, many evaluation methodologies look at economic growth indicators for a region and assume that there is a connection between economic change and the cluster-based initiative. However, this too misses another crucial aspect of cluster development. That is, as noted in Chapter 3, the cluster-based approach is premised on the notion that intense interaction among firms and institutions generates a cycle of improved efficiency, quality, innovation, and, hence, increased productivity and competitiveness. As a result, it is not sufficient for an evaluation to assume the link between cluster strategies and economic growth; rather, it is important to know whether the cluster process itself is the source of changes in economic growth.

These five challenges had important implications for the development of the team's approach to examining results emerging from cluster-based competitiveness initiatives, as described below.

DEVELOPING A STRATEGY FOR ASSESSING RESULTS

As stated so succinctly in Michael Porter's foreword to *The Cluster Initiative Greenbook*, "data limitations preclude definitive findings regarding the performance of cluster initiatives."[32] While Porter was referring specifically to the survey conducted for the *Greenbook* in this statement, we

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[30] Raines, Philip, ***"The Challenge of Evaluating Cluster Behavior in Economic Development Policy,"*** European Policies Research Center, University of Strathclyde, May 2002, page 1.

[31] *Ibid*, page 10.

[32] Örjan Sölvell, Göran Lindqvist, and Christian Ketels, *op. cit.,* 2003, [Foreword by Professor Michael E. Porter page 5].

believe that the statement has broader applicability to the practice of cluster-based initiatives. For all of the reasons outlined above, we do not have the evidence to make definitive or quantitative conclusions about the results of cluster-based initiatives.

With these data limitations in mind, the assessment team developed a strategy that would enable USAID to better understand some of the less-quantifiable – but equally important -- results of a cluster-based competitiveness initiative. Specifically, the team determined that its strategy for assessing results needed to:

1. Focus on the results from the two field assessments …

As noted previously, the team began the assessment process by synthesizing the findings and conclusions of the "self-reports" prepared by USAID's contractors. While the self-reports revealed important information about the methodology and approach used by USAID's contractors, they told us precious little about results – in part, because most of the initiatives were at a fairly early stage of implementation; and, in part, because contractors had no systems in place for measuring results. As a consequence, results often proved to be either a description of the strategic initiatives (that is, the activities as opposed to the results) or indicators of process, such as the number of meetings or workshops conducted, the number of participants convened, the number of citations of competitiveness in media accounts – all of which told us fairly little about the results of cluster-based initiatives. In retrospect, the contractors also revealed very little about some of the difficulties of achieving results, focusing largely on the administrative constraints imposed by USAID (i.e., insufficient funding or time lags) and ignoring the very real challenges inherent in developing an understanding of competitiveness principles or bringing a cluster together to work on joint initiatives.

Given the limited evidence of results from the contractors' self-reports (as well as the literature on competitiveness more broadly), our discussion of results focuses on the evidence that we could garner through our two field assessments in Mongolia and Campeche, Mexico. On the one hand, this approach had the benefit of going significantly beyond the perceptions of cluster facilitators or contractors. The crux of our approach was to examine what has changed as a result of the cluster-based competitiveness initiative from the full range of stakeholders in the process, including firms, government, educational and research institutions, the facilitator and others. On the other hand, we fully acknowledge the limitations of assessing results by looking at two cases. We do not presume to make the case that the results of Mongolia and Campeche reflect the results of cluster-based competitiveness initiatives more broadly. However, their experience does give us a much better understanding of the kinds of results that might emerge, as well as some of the possible constraints to achieving results.

2. Recognize the validity and importance of qualitative changes …

Because of the lack of base-line data, we recognized that we would not be able to measure quantitative changes in productivity or value-added since the onset of the two initiatives. However, we also did not want the assessment process to focus on the <u>potential</u> value-added associated with the clusters' strategic initiatives in the future. Rather, our aim was to capture what changes had actually occurred thus far – and this necessarily meant focusing on more qualitative types of changes.

3. Focus on changes that emerged as a result of the clustering process …
Lastly, in recognition of the issues raised by Raines and mentioned earlier in this chapter, we focused on those changes that could be attributed or linked to collective participation in a cluster effort, as the cluster process is what distinguishes competitiveness from other economic growth approaches. This is an important distinction. In some competitiveness initiatives, there may be important initiatives and results that have little to do with the cluster development process itself (such as direct technical assistance to the government to promote or implement policy reform or firm-level assistance to up-grade the efficiency of a business). Such activities are familiar territory to USAID and other donors, and they know what they can and cannot achieve through these kinds of efforts. In contrast, our aim was to capture the changes that have occurred as a result of bringing the cluster together. Specifically, we focused on change at two levels:

Change at the Firm or Organizational Level: Through a series of in-depth interviews with the full range of cluster participants – firms, government, business associations, educational and training institutions, research organizations and others -- we focused on determining whether participating firms and organizations have made significant changes in their thinking about competitiveness, or in their strategies or operations as result of the cluster development process. For example, as a result of bringing the cluster together:

→ Have firms and organizations changed their thinking about what it means to be competitive?
→ Have they introduced new products or processes?
→ Have they developed and/or changed their marketing strategies?
→ Have they changed their strategies for investing in their people?
→ If so, what changes have they made and to what effect?

Change at the Cluster Level: A fundamental premise of competitiveness theory and practice is that firms and institutions within a cluster need to collaborate in order to be competitive in the global market. Actions at the firm level are critical – however, firms acting in isolation can rarely sustain competitiveness in the global market. It is therefore important to look beyond the firm level to examine changes in relationships and interaction among cluster members. Through our interviews with cluster stakeholders, we focused on determining whether participating firms and organizations have made significant changes in the way they interact with each other; if so, how the relationships had changed and to what effect? For example, as a result of the cluster development process:

→ Have firms changed the way they interact with their customers, suppliers, and competitors?
→ Have firms changed the way they interact with government, and vice versa?
→ Have firms changed the way they interact with educational institutions, and vice versa?
→ Have the tenor and substance of public-private dialogue changed? Have new structures or mechanisms emerged to promote dialogue? Are they making a difference?

ASSESSING RESULTS IN MONGOLIA AND CAMPECHE, MEXICO

As stated in our introduction to Chapter 3, each competitiveness initiative is unique. Our fieldwork in Mongolia and Campeche, in particular, made us appreciate how cluster initiatives even within a single competitiveness project play out in often completely different ways, produce very different – and often unanticipated – results, and raise unique sets of issues and challenges. In order to better understand the kinds of results that did and did not emerge in these two cases, we begin by looking at some of the key differences in the way cluster-based competitiveness initiatives played out in these two settings. This is, by no means, an attempt to "compare" the effectiveness of the two approaches, but rather, serves to illustrate the importance of local context in determining strategies and approaches. A few of the most salient differences in how these two initiatives started and played out include the following:

1. ***The impetus for the competitiveness initiative***

***Mongolia*:** The impetus for the competitiveness initiative in Mongolia was USAID itself. According to USAID's mission director at the time the initiative was launched, competitiveness offered a framework and an organizing principle for pulling together a number of the mission's economic growth initiatives. In addition, it offered a mechanism for furthering and deepening the relationships the mission had already established with Mongolia's key industries – specifically, the cashmere industry (in which the mission was already involved through its Gobi Initiative) and the meat industry (to which the mission had provided technical assistance through its Farmer-to-Farmer Program). As such, USAID was introducing competitiveness principles and strategy to Mongolia, as opposed to responding to an articulated need or request from either the government or the private sector.

***Campeche, Mexico*:** The impetus for *Transformando Campeche* was different. In 1995, during the midst of Mexico's economic crisis, a small group of business people in the city of Campeche decided that the state needed a different approach to promoting economic development. Over the past fifteen years, the local economy had steadily weakened; per capita income had declined and unemployment was becoming a growing concern. The state was losing many of its commercial and services activities to neighboring states; moreover, Campeche was consistently overlooked as a site for industrial development among investors. While recognizing the need for change, Campeche's business leaders were also beginning to hear about the experience of Chihuahua in promoting cluster-based competitiveness … and based on this experience, Campeche's business leaders began to pursue cluster-based competitiveness.

2. ***The role of the strategic planning process***

As outlined in Chapters 3 and 4, a participatory strategic planning process is a distinguishing characteristic of most competitiveness initiatives. It is during this process that ***cluster members*** discuss and build their own consensus on the critical issues and the key impediments to engaging global markets; design a strategy and initiatives that will realistically enable them to engage global markets more effectively; and then – and most importantly – assume responsibility and ownership for specific initiatives and actions.

***Mongolia*:** A participatory strategic planning process was a difficult starting point for many of Mongolia's industries. In the cashmere sector, for example, relationships among cashmere processors were so poor and some individuals within the processing community so domineering and uncooperative that productive group discussions, analysis and strategic planning seemed impossible at the onset of the initiative; moreover, animosities multiplied when other parts of the cashmere value chain were included. As a result, the competitiveness strategies and initiatives were not developed by the cluster; rather, they were generated largely by the contractor. While the strategies reflected a deep understanding of the issues facing the sector, they were not strategies that the clusters members themselves had vetted, internalized, and "owned." Not surprisingly, the contractor played a much more significant role in implementing the initiatives than one would anticipate in a competitiveness initiative. In fact, the clusters never did meet on a regular basis during the course of initiative's implementation. Rather, the contractor had to create opportunities that would enable cluster members to see and feel the value of coming together as a cluster; understanding the value of group effort was just not a "given" at the beginning of the initiative as it may be in many other environments.

Campeche, Mexico**:** In this case, the participatory strategic planning process was central to the initiative. The role of the contractor was to facilitate the strategic planning process. Seven years later during our interviews, the role of the contractor versus the role of the cluster participants remained vivid in people's minds. From the onset of the initiative, the contractor made it clear that the strategic planning process was about mobilizing the cluster members to take action on initiatives that were of importance to them; and there was no doubt in their minds about the role of the consultant team as facilitator.

3. *The role of technical assistance in implementation*

Mongolia**:** Technical assistance played a very significant role in the implementation of Mongolia's competitiveness initiative. Indeed, with a budget of more than $4 million and few resources devoted to the strategic planning process, the Mongolia exercise offered considerably more opportunities for delivering technical expertise than the case of Campeche.

Campeche, Mexico**:** In contrast to Mongolia, the role of technical assistance was quite small in the Campeche competitiveness initiative. The total budget for contractor assistance was less than $1.5 million, much of which was devoted to facilitating the strategic planning process over an 18 month period. However, the contractor provided technical assistance in the implementation of one major strategic initiative, the creation of an investment attraction program.

4. *The timing of the field assessment*

Mongolia**:** While not a component of the initiative itself, we believe that it is important to acknowledge that the timing of a field assessment also plays a role in people's perceptions of the results. In the case of Mongolia, the field assessment was conducted approximately six months before the close of the project. The activities were on-going and fresh in people's minds. Moreover, there appeared to be an expectation among some individuals that we interviewed that the assessment would feed into the mission's decisions about future funding for the initiative.

Campeche, Mexico**:** The timing of the field assessment was quite different in Campeche. In fact, part of the reason that we selected Campeche as a site for fieldwork was that its initiative had been launched several years before any of USAID's initiatives; we hoped that this might enable us to see more of the downstream economic impacts of a competitiveness initiative. However, an important twist to the timing – which we could not appreciate until we were well into the fieldwork -- was that our visit coincided with the aftermath of a close and contentious electoral race for the state's new governor. In many people's minds, *Transformando Campeche* was more than an economic initiative; it was also closely associated with the economic platform of the governor of the past six years. It was all too clear that cluster participants' views on *Transformando Campeche* as an economic initiative were shaped – positively or negatively -- by their perspectives on the outcome of the recent elections.

5. *The politics of a competitiveness initiative*

We mention the role of Campeche's elections, in part, to illustrate that promoting competitiveness is often not an apolitical process. Perhaps this is not surprising in light of the importance of mobilizing leaders from the private sector and public sector as part of the process. Politics played a role in both Campeche and Mongolia's competitiveness initiatives -- albeit in different ways and with different results.

***Campeche, Mexico*:** As noted previously, the impetus for *Transformando Campeche* began with a small nexus of business leaders in 1995; however, following Campeche's gubernatorial elections in 1996, many of the leaders that had played a key role in launching and mobilizing the initiative assumed leading roles in the governor's new cabinet. This shift had critical implications for the perceived – and real – impetus for *Transformando Campeche*. While the initiative had been launched from the business community, the champions and visionaries for the initiative became leaders in state government; and many of the ideas that had emerged from the *Transformando Campeche* strategy process became the centerpiece of their new administration. *Transformando Campeche* as an institution remained grounded in Campeche's Business Council (the CCE). However, the real leadership and action was with its champions in state government -- with serious consequences for the cluster process that had been its strength at the onset.

Mongolia: In 1999, when USAID initiated its competitiveness exercise, Mongolia's Democratic Party was the country's ruling party. Generally considered pro-market, Democratic Party leaders embraced the concepts introduced through USAID's initial competitiveness exercise and signaled enthusiasm and support for the full-fledged competitiveness initiative. However, a year later, Mongolia held national elections and the Democratic Party was trounced by the Mongolian People's Revolutionary Party (MPRP). The MPRP, the legacy party of the socialist system, is ideologically distant from competitiveness principles; moreover, having won with a resounding majority, its political "instinct" was to strongly differentiate itself from the Democratic Party. Hence, with a few notable exceptions, the competitiveness initiative made little progress in engaging the public sector in the process of change. The public-private dialogue component of the project never progressed very far; nor did the efforts to address the many policy-related and infrastructure-related issues affecting cluster productivity and competitiveness.

As we can see from these dimensions of Mongolia and Campeche, two initiatives that started from the same base of competitiveness principles quickly evolved into very different competitiveness initiatives in practice. The Mongolia competitiveness initiative is best described as a "pre-cluster" initiative in light of the perceived barriers to bringing the full cluster together and letting it lead the process, as one would anticipate in a competitiveness initiative. In contrast, Campeche had many characteristics that often considered ideal as a starting point for a cluster-based initiative: an economic crisis that motivated leaders to "re-think" strategies; a group of visionary business leaders; a strong and participatory strategic planning process; and the support of local government leaders. The next section of this chapter looks more fully at how these two initiatives played out with a focus on the results they produced.

RESULTS IN MONGOLIA AND CAMPECHE, MEXICO

Consistent with our field methodology, we examine below the results of the competitiveness initiatives in Mongolia and Campeche at two levels: the firm level and the cluster level.

Change at the Firm Level

As discussed in the guiding principles, competitiveness initiatives require firms to "re-think" they way they do business. No longer is competitiveness about offering the same product at a price lower than your competitor; and no longer is competitiveness about seeking increased subsidies or protection for your products. Rather, promoting competitiveness involves much more fundamental change within the firm and between firms and supporting institutions, beginning with what many competitiveness practitioners refer to as changes in the "mental models" – that is, the core assumptions that guide firm strategy and operations. We saw clear evidence of shifts in the mental models guiding firms in four distinct areas: (i) the understanding of competitiveness; (ii) a greater focus on the customer and market demand (as opposed to supply-driven approaches to production); (iii) a focus on offering more sophisticated and higher value-added products (as opposed to basic commodities); and (iv) emerging signs of innovation (rather than imitating at lower cost). As illustrated below, sometimes these changes in mental models translated into behavior change – however, not always.

1. ***Changing the understanding of competitiveness***

Mongolia Tourism: Dominated in communist times by the single state-owned tour company, Mongolia's tourism industry was fledgling at the start of USAID's competitiveness initiative. Tour operators engaged in cut-throat competition with one another, consistently "stealing" customers from each other through relentless downward price competition. In fact, promoting competitiveness in the tourism industry meant offering a lower price to attract the limited and (in the industry's view) fixed number of tourists coming to the country.

The Competitiveness Initiative in Mongolia helped tour operators understand that growing the entire industry was in the self-interest of each firm, as well as the industry as a whole. In other words, building competitive advantage was not about increasing a firm's share of the country's tourist arrivals -- at the expense of a rival firm. Rather, building competitive advantage was about increasing the overall number of tourists coming to Mongolia and, specifically, drawing the kinds of tourists that would spend significant sums of money when they came to the country. As revealed in further examples, this changed understanding of competitiveness implied significant change in tour operators' strategies and operations. In essence, they began to realize that they all had a stake in promoting Mongolia as a tourist destination and that getting Mongolia on the tourist map required collective action; no one firm would be able to tackle this issue alone.

2. Shifting toward a customer-oriented focus

In Mongolia, the most significant firm-level change inspired by The Competitiveness Initiative was a greater focus on customer and market demand. For many firms, this entailed a huge shift from their traditional supply-driven approaches. In all three sectors in which the initiative was engaged (cashmere, tourism, and meat), we saw concrete signs of firms changing their core operations in order to focus more effectively on market demand. It is important to recognize that this process of change did not occur through the cluster development process as we have outlined in Chapter 4. Rather, the contractor sought to build an element of trust and collaboration among a smaller group of firms within the value-chain; and then "connect" those firms with other parts of the value-chain – often in a market situation. The end-result was a stronger focus on the customer. In many cases, firms made significant changes in their operations to target customer demand more effectively.

Mongolia Cashmere: In light of the palpable animosities among cashmere producers (nomadic herders), traders, and cashmere processors (located in Ulaanbaatar), USAID Mongolia's competitiveness initiative did not bring the cluster together as a whole. Rather, the initiative focused largely on cashmere processors; moreover, another USAID project, the Gobi Initiative, was already providing extensive technical assistance to herders. As outlined in Chapter 3, a key concern of the processors was gaining increased access to high-quality cashmere so that they could utilize their processing capacity more effectively. In order to address this need, the competitiveness initiative, in collaboration with the Gobi Initiative, established a series of cashmere market days. While the idea of bringing together buyers and sellers in a market setting may not seem revolutionary, such opportunities are still rare in Mongolia's cashmere sector.

The market days enabled the cashmere processors to address their immediate need for increased access to raw cashmere. However, the unintended – and yet far more significant – consequence of the market days resulted from the face-to-face interaction between herders and processors. During the market days, herders saw, first-hand, the premium that Mongolian processors would pay for high-quality and pure cashmere; this, in turn, gave herders a market-based incentive to make far-reaching changes in their practices.

To illustrate the point, one herder we interviewed spoke candidly about her disappointment that her cashmere fetched a lower price during the market day than a friend's cashmere, which had earned a higher quality rating and therefore was more valued by the processors. For this herder, the difference in the price she received versus the one her friend received prompted a far-reaching review of her herding practices, including culling of older goats and plans to buy better breeding goats to raise overall herd quality. Selling cashmere at a market, surrounded by "competitors" (i.e., other herders) and multiple potential buyers, drove home the relationship between quality and price in much more striking manner than, for example, participation in a workshop or other educational event. In sum, transmitting customer requirements to herders in a tangible, impact-oriented manner was an important result of the cashmere trade fairs.

***Mongolia Tourism*:** Seventy years of communism did little to instill a culture of customer service in Mongolia. The competitiveness initiative went a long way toward helping businesses in the tourism sector make a fundamental shift in thinking, in strategy and in operations – with the customer as the focal point. The initiative organized a series of hands-on training workshops for tour operators, honing in on the very real and practical issues they face in serving customers. Unlike other training offered in Mongolia, the initiative's training was not academic; its method was dynamic and interactive, placing the tour operators in the same situation they would face regularly in serving tourists and then helping them develop more effective strategies for meeting the specific needs of different types of tourists. This approach was new; it was different; it was practical; and, as one tour operator noted, it caught on like "a house on fire." The most significant result is that firms are changing. They are more focused on delivering good service; they are thinking in terms of new products; and they are going after new markets.

Mongolia Meat**:** The competitiveness initiative introduced the critical importance of hygiene, sanitation, and quality control issues to the meat industry. The first step was to help the industry realize that promoting good hygiene and sanitation was not just a "good thing to do" -- but also a pre-requisite to engaging the international market. No firm would be able to export (at least beyond Russia) unless it had systems and procedures to ensure the quality and safety of its product. Moreover, the industry needed to recognize that no firm in Mongolia had the necessary systems and procedures to meet international standards and requirements. And, in fact, few firms really knew or fully understood international market requirements for food safety. The initiative developed a series of industry workshops, followed by plant audits, to address these critical industry-wide issues. Most importantly, through these workshops, the initiative introduced the concept of HACCP (Hazard Analysis and Critical Control Points), a total management system for assuring the safety of food and ingredients.

HACCP was a brand new concept for Mongolia's meat industry, and for the first time, the industry began to develop an understanding of the demands and standards of the international market. Mongolian firms understand what HACCP is; they know they need to move forward on HACCP principles; but the "how-to" is still missing. The bottom-line is that firms made some significant progress on addressing hygiene, sanitation and quality control during the course of the initiative; but, once assistance to the meat industry ended, most firms proved unable to sustain the process of change.

3. Shifting toward value-added products and services

As emphasized throughout this assessment, a key premise of competitiveness initiatives is the importance of moving up the value-chain -- that is, moving away from production of commodities and toward production of higher value-added products and services. Creating an awareness of the importance of this shift was particularly critical in the case of Campeche.

Campeche: The very name of the competitiveness initiative, *Transformando Campeche*, held a revelation for local businesspeople. For centuries, Campeche has relied upon exploitation of geographical advantage or natural resources, from its origins as a port and trading post in Spanish colonial times to export of tropical dyewood in the 1800s to shrimp fishing and oil extraction in the 1900s. Fortunes waxed and waned with varying demand for Campeche's different raw materials – and Campeche's citizens accepted these ups and downs as a simple fact of life. Perhaps one of the most significant contributions of *Transformando Campeche* was that the local business community began to understand that perpetual vulnerability to commodity cycles was not inevitable – if businesses could build on abundant availability of natural resources by adding value to them. In short, transforming Campeche's economic future depended in large part on firms' ability to "transform" and add value to the region's natural resources.

Moving up the value-chain was a powerful concept for many businesses in Campeche; however, proceeding from the concept to the actual implementation proved far more difficult. We saw relatively few firms make progress in moving toward higher value-added products. Seven years after the onset of the initiative, firms continued to recognize the validity, merit, and relevance of the concept for Campeche; however, they seemed to lack the resources – including know-how and financial resources – to make this fundamental shift. Moreover, *Transformando Campeche* as a project had little budget for technical assistance to help clusters move up the value-chain – thus, highlighting the critical role of the fourth phase in the methodology outlined in Chapter 4.

4. *Signs of innovation versus imitation*

As discussed in the guiding principles, innovation is key to building competitive advantage. Leading firms compete by differentiating their products and services and creating new demand, rather than imitating the pack and offering the same product or service at a slightly lower cost. By no means did we see in either Mongolia or Campeche the cycle of "improved efficiency, quality, service, and innovation" that is said to be created by dynamic clusters; however, we also did not see particularly well-developed or dynamic clusters in either case. Nonetheless, as described below, we did see glimmers of innovation and new business ideas emerge from the cluster process in Campeche. We also saw signs of innovation emerge in Mongolia – often facilitated by the technical assistance provided by USAID Mongolia's competitiveness initiative, but having little to do with the cluster process *per se*.

***Campeche Agriculture and Food*:** In Campeche, the cluster meetings brought about the occasional instance of innovation. For example, a businessman who participated sporadically in *Transformando Campeche's* initial cluster development process took an idea generated in the meetings and "ran with it." Specifically, the businessman recalls that in the cluster meetings small agricultural producers expressed a desire to make juice with fruit that would otherwise be wasted because is was too small or of insufficient quality for export[33] – or simply because transportation to market while the fruit was fresh was not available.[34] The small producers' primary constraint to making and selling fruit juice was obtaining appropriate bottles at a reasonable price. Campeche had no bottle-making factory at the time, so the potential juice producers were forced to buy quantities larger than they needed (or could afford at one time) and paid high prices due to the cost of transporting glass bottles long distances. According to this entrepreneur, the food cluster meetings opened his eyes to this opportunity. He began bottle production with one machine and has since expanded to four machines; customers in Campeche, neighboring Mexican states, and Belize now purchase the bottles, which are available in a wide variety of sizes, shapes, and quantities.

[33] For mangos, for example, it is estimated that 30% of production in Campeche is exported. The remaining 70% could be used for juice or other processed foods.

[34] The state's weak infrastructure limits the amount of fruit that small producers can transport to market.

***Mongolia Tourism*:** The competitiveness initiative provided technical assistance to help develop the Three Camel Lodge in the Gobi Desert. Unique in its quality and design, this lodge provides an innovative twist to the typical lodging offered to tourists in the countryside. Guests stay in a Mongolian tent (*ger*) similar in structure to that of the nomads, but are also treated to some of the same comforts and service they would experience at a small inn in the US or Europe. Local artisans built a main lodge for guests to congregate in the evenings – an innovation in and of itself. This lodge, pictured to the left, was built in accordance with the canons of Mongolian Buddhist architecture (without using a single nail); the artisans also used local stone in order to complement the natural surroundings. The lodge uses solar and wind power as its primary source of energy. Lastly, the managers of the lodge have adopted a series of waste management practices to deal with refuse while protecting the fragile desert environment. All of these features are new and innovative in Mongolia's tourism industry.

Change at the Cluster Level

In the chapter on guiding principles, we stated that "competitiveness initiatives are fundamentally about building connections and relationships among firms and institutions that have traditionally acted in isolation." Hence, in conducting our field work, we looked carefully at the question of whether the competitiveness initiatives had an impact on the interactions among firms, between firms and government, and between firms and the educational community. In other words, did firms and supporting institutions understand the concept of "collaborating to compete" and, if so, to what effect?

1. ***Recognizing the Value of Collective Action among Firms***

***Mongolia Tourism*:** Before the competitiveness initiative, Mongolia's tourism companies participated in a rudimentary form of collective action: they would pay for and share a common booth at international tourism trade fairs. That represented the full extent of their collaboration: in the booth itself, if there were ten companies, there would be ten company banners (placement of which would have involved intense fights as companies sought prominence), ten different images of Mongolia, ten different reasons to consider visiting Mongolia, etc, etc. In other words, "working together" in the booth was an extension of the cut-throat competition alluded to earlier in this chapter.

With introduction of the competitiveness initiative, Mongolian tourism companies learned about the concept of destination marketing materials, which advocates a uniform, consistent message to entice travelers to a country. The tourism companies began to understand that Mongolia needed first to be on the "tourist map" – and that once greater recognition of Mongolia as a potential tourist destination was developed, each company could market itself as the best vehicle for exploring this destination. In a fundamental shift, Mongolian tourism companies began participating in international tourist trade fairs under a single banner with a single theme, "Mongolia: Art, Spirit, & Adventure." They also began using related destination marketing materials as the first "calling card" to introduce potential visitors to the country – and, once interest was elicited, then brought out individual company marketing materials to describe particular tours or offerings. In other words, companies began to recognize that they had a collective "stake" in broadening and deepening knowledge about Mongolia as a tourist destination, and they changed their behavior accordingly.

***Mongolia Cashmere*:** Yet another important result of the cashmere market days was that cashmere processors were required to interact and coordinate in preparing for the market days, a process that has increased trust among this small but highly-fractured group. An example (that may appear minor to the reader unfamiliar with the Mongolian cashmere industry, but that was cited by processors as a major change in behavior and attitudes) illustrates this new level of trust. Prior to the 2001 market day, the competitiveness initiative worked with processors to identify their requirements, so that these needs could be relayed through the Gobi Initiative to herders. One such requirement was that raw cashmere should be baled and transported to the markets in polypropylene-free bags. Because such bags are not readily available in the Mongolian countryside, eight processors, with TCI encouragement, decided to purchase appropriate bags on the herders' behalf; jointly identified a source to supply bags that were inexpensive enough to donate to the herders (but strong enough to be re-used); pooled resources to pay for the bags; and entrusted one processor to acquire the bags, which were then given to the Gobi Initiative to distribute to herders. In Mongolia's cashmere sector, such collaboration toward a goal that served common needs, especially with donation of financial resources, is fundamentally new.

2. *Changing the Interaction between Business and Government*

As described in Chapter 3, the process of the cluster deciding which reforms are critical to its industry's competitiveness is what differentiates policy, legal and regulatory reform in a competitiveness initiative. Moreover, the cluster's goals for its interaction with policymakers are different – that is, such interaction is intended to benefit the entire industry rather than produce a "favor" for one company.

***Mongolia Tourism*:** Again, Mongolia's tourism industry provides an illustration, albeit incomplete and emerging. Strengthening the Mongolian Tourism Association (MTA) was a central element of Mongolia's competitiveness initiative. Although (as detailed in the Mongolia country report) we believe that the contractor's work with MTA was too hands-on, there is no doubt that the MTA is a different institution than it was three years ago. It has gained the confidence and support of many tour operators in Mongolia. Businesses believe that MTA is now able to provide meaningful services to the industry. And as the MTA's credibility among private sector operators builds, so does its ability to dialogue with government.

One concrete illustration of changing public-private dialogue involved an October 2002 roundtable convened by MTA to discuss problems that arose during the previous summer's peak season and identify new possibilities for tourism development. For the first time, the government seemed really interested in knowing what the private sector was saying. To build on that interest, the MTA sent a letter to the Ministry of Infrastructure (which is responsible for tourism issues), outlining the concerns voiced during the meeting. Shortly thereafter, the Prime Minister issued a draft resolution to ministries on what needed to be done to prepare for the 2003 tourism year and used MTA's letter as the basis for the resolution (almost word for word). Both events – sending a collective letter (rather than individual complaints) and rapid, public (i.e., not secretive) government response – represent the beginning of a change in the interaction between business and government.

3. *Changing the Interaction between Business and Education*

Workforce issues are critical in Mongolia and Campeche. In both places, there is relatively little interaction or linkage between the business and education communities, resulting in huge gaps between the workforce requirements of local industry and the programs and services offered by local universities and training organizations.

In Mongolia, the competitiveness initiative developed its own set of training initiatives to address the need for more practical and industry-driven training in the country. As discussed previously, these training programs met an important need for the tourism industry and seem to have had a significant impact on their strategies for engaging customers in the global market. Nonetheless, the larger and more systemic problem remains: there has been no change in the interaction between business and education and, hence, local educational and training organizations will continue to churn out graduates that are ill-prepared to meet the needs of industry.

In Campeche, the competitiveness initiative also made little headway in addressing the business-education gap. As part of the strategy development process, the business community specifically highlighted these issues:

- The lack of mechanisms to transmit the private sectors' needs to those educating or training future workers;
- The lack of qualified workers at all levels, whether general labor, technicians or professionals;
- The disconnect between the majors offered in Campeche's universities and the demands of the private sector, with university students predominantly focused on attaining increasingly scarce government jobs; and
- The lack of what was termed a "labor culture," i.e., lack of understanding of employers' needs (such as punctuality and consistency), derived from a long history of self-employment through shrimp fishing, farming, etc.

In spite of cogently analyzing the workforce problems facing the state, the business community ultimately did very little to change the situation: they understood the problem, but could not identify how to collectively address it in a meaningful, widespread manner.

Other Changes

Campeche provides an illustration of a change that was neither at the firm or cluster level *per se*. We include this example because it was uniformly cited as the most significant achievement of *Transformando Campeche*. However, as discussed in the box on the next page, the success and results of this strategic initiative – even though numerically impressive – are mixed.

Investment Promotion in Campeche: A Success Story?

Of all the initiatives spawned by Transformando Campeche, the investment attraction program is nearly always cited as the most successful effort. This success is closely associated with its champion, Arturo May Mass. At the onset, May was the owner of a small bakery in the town of Campeche; however, his vision extended far beyond the bakery walls. One of the few individuals that recognized that Campeche was at a critical crossroads in the mid-1990s and, more importantly, that the business community needed to play the leading role in changing the course of growth, May was appointed Secretary of the newly-created Secretariat for Industrial and Commercial Development a year after Transformando Campeche began – and immediately began work on investment attraction. From a 1997 base of four manufacturing firms, the investment attraction program by 2003 brought in:

- *Forty-seven new investment projects now in operation, with another 8 projects in the process of being established, for a total of 55.*
- *10,400 new jobs to date, with an estimated additional 3,600 jobs when the 55 projects are operational.*
- *US$217 million in new private sector investment in Campeche, and public sector investment in these projects worth an estimated $58 million.*

Leadership and commitment were key ingredients in the success of the investment attraction initiative. Without a leader like Arturo May Mass, this ambitious initiative could have easily withered on the vine, as did many other initiatives spawned by Transformando Campeche. The investment attraction initiative illustrates the importance of a local champion, particularly one who has the ability to mobilize money behind the effort.

With these impressive "numbers" and leader, can the investment promotion effort be termed an unqualified "success"? There is no doubt that the industry attracted through the program met an urgent need: job creation. However, from the perspective of cluster-based competitiveness principles – and from the perspective of local businesspeople – the results of the investment promotion initiative are more complex ... and mixed. Issues related to the investment effort include the following:

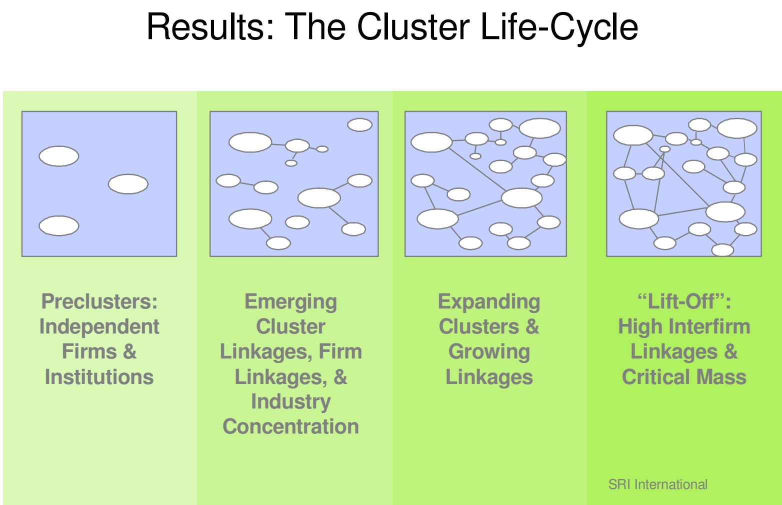
- ***Continued reliance on a "commodity."*** *A precept of competitiveness initiatives is that enterprises need to add value to their products in order to command a premium from the marketplace. As with most maquiladora operations, however, plants in Campeche merely bring materials to the state for assembly. The input Campeche provides is cheap labor – essentially a commodity, albeit a new commodity in the state's long history of natural resource exploitation. To be sure, the implementers of the investment promotion program see these initial investments as a first step toward greater industrialization. For now, though, the investment attraction program has brought many jobs – but these jobs are in Campeche due in large part to lack of competition for labor, which keeps wages low.*
- ***Cluster absence in implementation.*** *By definition, leaders have "followers" – that is, fellow believers who work to achieve the common goal. In this case, the "followers" were mainly within the Secretariat itself; that is, the program was not a cluster effort in implementation even though it had been in conception.*
- ***Lack of linkages.*** *As with many maquiladora-type activities, those in Campeche have established few if any linkages with local enterprises. For example, we heard much discussion of a failed attempt by a group of local truck owners to negotiate a deal to provide the plants with transportation services between Campeche city and the nearest port.*
- ***Local resentment.*** *Most Campeche businesspeople could not qualify for the incentives offered in the investment promotion program because the incentives required a level of investment (and jobs to be created) that they could not dedicate (lack of finance is a critical constraint in Campeche). The perception that the program only benefited foreigners quickly became ingrained and led to significant acrimony.*

In sum, instead of value added, cluster development and local ownership, the investment promotion program – successful as it was in fulfilling its main purpose, creating jobs – veered significantly from central principles of cluster initiatives. As such, its "success" and "results"— even though numerically impressive – are mixed.

CONCLUSIONS

In our chapter on guiding principles, we presented a chart of the cluster life-cycle[35]. We now return to this chart to consider whether the competitiveness initiative in either Mongolia or Campeche had a significant impact on cluster development.

As indicated, over time, firms and associated institutions in a cluster are anticipated to gradually increase and strengthen their ties, trust and collaboration. The evidence provided above suggests emerging signs of cluster linkages and firm linkages in Mongolia – largely, in the tourism industry. We also see new and positive interaction between segments of the value chain in the cashmere industry through the market days, resulting in a much greater understanding of the need to focus on the customer. Our primary concern is whether these linkages can be sustained in the absence of a donor-funded competitiveness initiative. In part, because this initiative was driven more by the contractor than the cluster, it is not clear whether the strategic initiatives can or will be sustained. This speaks to the importance of the participatory strategic planning process that is at the heart of most competitiveness initiatives, as it is a process that builds on local ownership and local responsibility for implementation … hence, implementation proceeds in sync with the will and capacity of local actors.



Surprisingly, we saw relatively few signs of increased ties, trust and collaboration in Campeche. We say surprisingly because, as noted previously, this initiative started from a strong base: an economic crisis that pushed leaders to re-think strategies; a group of visionary business leaders; a strong and participatory strategic planning process; and the support of local government leaders. And, indeed, at the onset of the initiative, there seemed to be a great deal of enthusiasm and support for the initiative from the business community, the local government, and the academic community. Each of the clusters developed a vision for the future, as well as a series of strategies and initiatives. However, in reality, few of these initiatives came to fruition (with the one major exception being the Investment Attraction program described in the previous box). Over time, cluster participants became increasingly frustrated and dismayed over the perceived lack of movement, and all the more so because their expectations had been so high at the onset.

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[35] SRI International, ***"Cluster Competitiveness Initiative: USAID Progress Report,"*** PowerPoint presentation prepared for USAID Bosnia, October 2002, p. 6.

There is no simple explanation for the lack of cluster movement. However, we believe that two factors played a critical role. First and foremost, many of the leaders who had played a key role in launching and mobilizing the initiative assumed leading roles in state government less than a year later. This had important implications for the locus of action for *Transformando Campeche*. *Transformando Campeche* as an institution remained housed with Campeche's Business Council (the CCE); however, many of the ideas that had emerged from the initiative's strategy process became the centerpiece of the governor's new administration. As a result, the perceived locus of action also shifted from the private sector to government, permitting the private sector to readily point the finger at government for lack of progress or results. This perception was reflected in a statement that we heard repeatedly throughout our interviews in Campeche: "The government never stepped forward." In sum, rather than making fundamental changes in the way they interact, the government and the private sector fell back into their well-entrenched patterns of paternalism and dependency – to the detriment of the cluster process and the initiative as a whole.

We believe that the experience in Campeche also reveals the importance of the "phase four" of a competitiveness initiative – the phase in which a contractor provides technical support for cluster-led initiatives. This does not mean that the contractor should take lead responsibility for the initiatives. It does mean that the contractor may need to provide technical assistance to help cluster members translate strategies into actions and sustain the momentum.

Overall, we do see some positive developments at the firm level and the cluster level resulting from these two competitiveness initiatives. In a number of cases, we see businesses making changes that bring them closer to their customers and the market – and we believe that bodes well for increased competitiveness over the long term. We also see emerging signs of cluster development. In some cases, firms are beginning to recognize the value of collective action and change the way they engage each another -- to their mutual advantage in the market.

The experience in Mongolia and Campeche illustrate the types of results that can emerge from competitiveness initiatives, as well as some of the issues that might arise during the process. However, it is important to reiterate that these are two cases only – and they do not necessarily reflect the full range of results or issues one might see in cluster-based competitiveness initiatives more broadly. For this reason, in looking at the lessons learned from competitiveness experience to date, we draw from not only these two initiatives, but also the many other initiatives reviewed as part of this assessment. These lessons and related best practices are revealed in the next chapter.

CHAPTER 6
LESSONS LEARNED AND BEST PRACTICES

While the assessment of results presented in the previous chapter focused on the experience in Mongolia and Campeche, the team looked significantly beyond these two cases in order to understand the lessons learned and best practices from competitiveness experience. The team's comprehensive review of USAID experience in 26 countries and its review of the experience outside of USAID also yielded important lessons for future cluster-based competitiveness work. Each lesson is described below, along with the operational implications that emanate from the lesson. As such, the lessons and best practices are intended not only to summarize the key findings of this assessment but also to provide practical guidance to shape on-going and prospective cluster-based initiatives.

1. **The most important determinant of success is the "sweat-equity" investment of the cluster.**

   For a competitiveness initiative to develop successfully, cluster members must be committed and willing to devote time, resources and, most importantly, "sweat-equity" for the good of the industry as a whole. Cluster members first must take the time to thoroughly sort through the challenges facing their industry and then collectively define common ground and a common vision. With disparate parts of the cluster coming together for (in many instances) the first time, this issue identification and strategy development process takes time – time that cluster members must be willing to invest and time that USAID and its contractors must be willing to "give."

   Not only time is important, however; attitude is equally so. Cluster development requires "cooperative personalities" – individuals who listen to and respect others' views, even when they are seemingly opposing, and search for common threads that can bind the group together and focus its strategy and initiatives. Only through such commitment of time and cooperation will sustainable progress be made toward greater competitiveness. And only through real sweat-equity will the cluster be truly "self-selected."

   Related Best Practices:

   - In the absence of significant dedication by cluster members to the principles above, USAID and its contractor must refrain from substituting themselves as the cluster leader.

   - In such circumstances, USAID and its contractor must assess why the cluster is not demonstrating signs of commitment and consider one of these options: (i) address the underlying issues before proceeding with a cluster initiative; (ii) significantly modify the nature of the project away from the organizing theme of cluster-based competitiveness; or (iii) halt assistance to the cluster.

2. **The private sector must own and drive the process of cluster development.**

   There is no doubt that the economic policy framework of a country is critical for creating the conditions for competitiveness and growth. However, growth itself is generated by firms, not by public sector institutions that formulate economic policy. Therefore, successful cluster-based competitiveness initiatives are fundamentally private sector driven – with links to the public sector. They are not public sector driven with links to the private sector.

   This is not to say that engaging the public sector is not important for a cluster-driven competitiveness initiative. It is, especially in countries where the governments' understanding of its role in a market economy is still evolving. But companies – through clusters – need to sit in the driver's seat because it is their decisions and investments that will directly propel sustainable growth. Likewise, the private sector must identify the policy, legal and regulatory issues that, from its perspective, most directly stymie sustainable growth – and then engage the public sector to remedy these constraints.

   Related Best Practices:

   - USAID and its contractors must allow the initiative to proceed as fast – or as slowly – as the clusters are willing and able to go. Efforts by USAID or the contractor to jumpstart the process usually backfire, especially if such efforts override participatory mechanisms for defining strategies and developing consensus on actions. External agents can foster – but not force – cluster development; as a result, donor and consultant timeframes and work-plans cannot dictate action "on the ground" if such action is to be truly cluster-driven.

   - USAID and its contractors must act as facilitators – not leaders – of the cluster process. As such, the contractor's role is nonetheless critical and serves key functions such as: an honest and trusted broker among often-fractious parties; a neutral, objective outsider with needed global knowledge and perspective; and a provider of both strategic planning capabilities and in-depth industry expertise.

3. **Clear definition and regular tracking of meaningful performance indicators have been lacking – to the detriment of demonstrating results**

   As evidenced by Chapter 5, far-reaching, concrete results from cluster-based competitiveness initiatives are scarce. As discussed in that chapter, a significant reason for lack of measurable results is that such processes take time. However, the expected lengthy time frame for seeing demonstrable results does not explain the lack of systems in place today to monitor and track progress towards goals.

   We recognize that there is a clear tension between establishing definitive targets and permitting the cluster time to work at its own pace in a collaborative manner. Indeed, if a target is set – and the cluster seems unable to meet it in "on time," the unintended outcome may be the contractor stepping forward and doing for the cluster what the cluster should do itself. In other words, the very focus on results can create a tendency to subvert the participatory, locally owned process that is the core of cluster development.

Related Best Practice:

- Clusters themselves should set targets for their work and periodically (e.g., quarterly) evaluate progress toward (or lack thereof) the target. If the target is no longer relevant, then the cluster should define a new target if necessary. Setting such targets should be part of the strategic planning process and part of implementation of cluster activities.

4. In cases where a policy, legal and regulatory issue is overriding, public sector receptivity to change on that issue must be strong for a cluster-based approach to progress.

Implementers of cluster-based competitiveness initiatives must recognize that there will be instances in which the environment surrounding a pressing issue is so overwhelmingly negative that private sector action will be insufficient to effect real change without consistent, pervasive and enduring commitment by the government to cooperate in altering these conditions. This is a difficult lesson to define in the abstract; hence, the box to the right provides a tangible illustration of the degree of policy "domination" to which we refer.

Mongolia's Meat Sector

As part of USAID's competitiveness initiative, Mongolia's meat industry was introduced to the concept of Hazard Analysis and Critical Control Points (HACCP), which is essentially a total management system for assuring the safety of food and ingredients. HACCP was a brand new concept for Mongolia's meat industry, and during the assistance period, firms made some significant progress on addressing hygiene, sanitation and quality control.

However, in this case, private meat companies could not effectively use HACCP because of the overall context, which included diseased animals, insufficient veterinary services and, most importantly, a regulatory framework for meat safety and hygiene that fell far below international standards. Having instituted the safety and hygiene regulations only two years before the competitiveness initiative began, the Government of Mongolia had no interest whatsoever in revisiting the regulations ... a factor that no amount of HACCP implementation among potential meat exporters could overcome.

Related Best Practice:

- Where major policy issues affect an industry, the contractor must guide the cluster as it identifies what actions it can feasibly take to "fix" the policy environment. The contractor should persistently probe how the cluster intends to overcome the obstacle by asking, for example, for the cluster to define specific steps to overcome the roadblocks or key contacts in government whom the cluster can approach and realistically convince.

5. **The initial objectives and sponsorship of a cluster project often determine and/or delimit its scope, orientation, participation, and ultimate success.** [36]

The key factors [in the startup process] include: Who are the initial promoters of the project? What are the funding sources? What is the institutional setting for the project?[37] Practitioners that have worked in a variety of settings agree that the most effective starting point for a cluster initiative is when a group of private sector leaders come together and join forces to solve critical issues through a cluster initiative. They have the vision for what they want in their region and are motivated to make it happen … but need the "how-to." However, rarely is this starting point faced by donors. Hence, a critical step in the process is creating opportunities for these types of "civic entrepreneurs" to emerge … so that they can lead the process and generate the momentum for local action and change.[38]

Related Best Practice:

- For USAID and the contractor, a critical part of the cluster identification and strategy development processes is creating opportunities for new civic entrepreneurs to emerge – that is, people who have vision and the leadership to motivate others in the business, government and academic communities to change the way they interact and change the way they pursue common goals and address common constraints. Without such leadership, the strategic planning process is likely to be contractor-driven and, ultimately, far less sustainable.

6. **One strong leader can make an enormous difference – and, conversely, the lack of a champion can mean an effort's stagnation or demise.**

Nothing exemplifies the importance of the "human factor" in cluster development more than this lesson. In the same way that is true for most of human endeavor, an inspiring, respected and dedicated individual, more than any objective measures of cluster potential, can provide the impetus for change. Amorphous as this lesson is, it was repeatedly expressed by competitiveness practitioners and was vividly illustrated in the investment promotion example from Campeche, as cited in the previous chapter.

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[36] Dr. Eric Hansen, Economic Transformations Group, Inc., ***Clustering, Innovation, and Regional Development: What Works!, Lessons from Successful Clustering Project Implementation,*** Background Paper, UNIDO Workshop on Cluster-Based Economic Development, June 2003, page 11.

[37] *Ibid.*

[38] "Civic entrepreneur" as a term originated with Douglas Henton, John Melville and Kimberly Walesh, the founders of Collaborative Economics, a regional economic strategy firm based in California (also a spin-off from SRI International's former Center for Economic Competitiveness). The concept is discussed in detail in their book, ***Grassroots Leaders for a New Economy: How Civic Entrepreneurs Are Building Prosperous Communities*** (1997). They note that civic entrepreneurs can emerge from private, public, social, or civic organizations. However, these individuals look significantly beyond the issues faced by their own organizations and assume a leadership role in defining and tackling the issues faced by their communities or regions.

Related Best Practices:

- When the contractor maintains a facilitative rather than directive role during the cluster identification and (especially) strategy development stages, there is “space” for volunteering of responsibility and emergence of champions and leaders.

- The contractor must cultivate and support champions or leaders who assume responsibility, inspire others and think beyond their parochial interests.

- Scarcity of emerging leaders is the first warning sign for USAID and its contractors that a given cluster may not coalesce or progress.

7. Cluster development is often hardest in traditional industries.

Reviewing a dictionary definition of “traditional”[39] hints at why cluster-based processes in long-standing sectors can become problematic. Participants in such sectors have “histories” with each other; memories of “glory days” tend to produce backward- rather than forward-thinking; and new ideas or participants can threaten older leaders, who may think only they know the sector. From cashmere in Mongolia to shrimp in Campeche to coffee in El Salvador, traditional sectors demonstrated their reluctance to embrace the new ways of doing business embodied in cluster development.

Related Best Practice:

- For cluster development to work, cluster selection must rely on cluster members’ interest and enthusiasm. To demonstrate the benefits of working together, cluster-based competitiveness funds must go where movement, however small, is happening ... not where the economy “used to be.”

8. Funneling too much money through a competitiveness initiative may weaken local initiative.

Although it is not possible to prescribe a uniform budget for cluster-based competitiveness initiatives (as always, local context matters, as does the number of viable clusters), tens of millions of dollars are not likely to be necessary for this type of development assistance. Indeed, the more money available, the less energy and time the local private sector will need to dedicate, thus undermining local ownership and initiative.

Related Best Practices:

- Cluster-based competitiveness initiatives should include funding for both facilitation – including a long-term presence by trusted facilitators – and technical assistance on specific industry or functional topics.

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[39] For example, the Merriam-Webster online dictionary (www.m-w.com) defines “tradition” as “an inherited, established, or customary pattern of thought, action, or behavior.”

- Funding for activities that primarily benefit one or a handful of companies should be avoided, and funding that replaces costs normally assumed by the private sector should not take place.

9. It may be more challenging to implement cluster-based competitiveness initiatives in transitional economies.

Transitional economies often are characterized by contextual obstacles that, though present in other countries where USAID operates, seem more pronounced or entrenched in nations that have experienced many years of central planning. These features include, for example: a weak civil society in which there is little or no trust between the public and private sector; a lack of tradition of taking joint action on a voluntary basis; a production rather than market or customer mindset; and weak understanding of international markets and basic business skills.

- **Related Best Practice:** Particularly in transitional economies, initial efforts to generate understanding of broad competitiveness principles (i.e., Step 1) need to be hands-on, interactive and tangible, rather than academic and theoretical.

Findings from "The Cluster Initiative Greenbook"

The Cluster Initiative Greenbook *comes to a number of similar conclusions and lessons learned as the USAID assessment of cluster initiatives. Specifically, based on its survey of cluster initiatives in largely industrialized countries, the report concludes:*

- *It takes time to build up the momentum for a cluster initiative, typically more than three years.*
- *The future success of cluster initiatives often depends on one key individual (40%).*
- *Cluster initiatives often face three critical challenges:*

1. *Monitoring performance: "Monitoring the impact of CIs [cluster initiatives] is increasingly critical to sustain the commitment of cluster participants. This is a complex task, because many effects of the CI on cluster competitiveness will take a long time to materialise and will depend on other external factors as well. CIs need to develop an indicator system that documents their activities on different levels and becomes an integral part of tracking the cluster's performance over time."*

2. *Organizing the CI process over time: "CIs never start at zero; there is always a history of the cluster and often of previous attempts to organise it. … The analysis – action divide, moving from setting objectives to implementing solutions, requires a massive shift in the participation of cluster members."*

3. *Integrating the CI in a broader microeconomic policy agenda: CIs will be "much more effective, if they occur in the context of other CIs and the upgrading of the business environment areas affecting many clusters."*

Source: ***The Cluster Initiative Greenbook****, 2003, page 14.*

10. Cluster-based competitiveness initiatives are not a "quick fix."

Mindset change does not happen overnight. Neither does behavioral change. Trust develops over time, as does understanding of and ability to put into practice new concepts. As do new relationships among businesspeople. And so on. In other words, none of the key elements underlying the human dimension of cluster work occurs quickly, meaning that results from the overall process can be expected in the short-term.

Related Best Practices:

- In the short term, USAID and its contractors must focus on qualitative outcomes to determine if an effort is on track.
- USAID and its contractors must realize that cluster-based competitiveness is fundamentally a human process ... and behavioral changes take time.

APPENDIX 1
LIST OF INDIVIDUALS INTERVIEWED[40]

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[40] This list does not include individuals who were interviewed specifically for the field assessments in Mongolia and Campeche, Mexico. Each field assessment report also includes a separate list of individuals interviewed.

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APPENDIX 2
LIST OF RESOURCES[41]

Part 1: General References

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Appendix 3
Summary Table of USAID-Funded Competitiveness Activities
January 2003

Country	**Project Name**	**Clusters Targeted**	**Start Date**	**End Date**	**Value**	**Contractor** (Prime/Sub)
Azerbaijan	Rural Enterprise Competitiveness Project	TBD	April 2003 (Approxi-mately – RFP to be issued in Jan. 2003)	2008	TBD	TBD
Bosnia	Industry Cluster Competitiveness Project	• Furniture • Tourism	July 2002	December 2003	$ 2,000,000	IBM*/SRI
Bulgaria	National Competitiveness Exercise	• Apparel • Canned produce • ICT • Maritime transport • Tourism • Wine	May 2002	April 2003	$ 256,858	Nathan Associates and MSI/JAA
Cambodia, Indonesia, Philippines, Thailand and Vietnam	Competitiveness Benchmarking and Regional Conference	N/A	September 2000	April 2001	$ 765,943	Nathan Associates/JAA
Cambodia, Thailand and Vietnam	South East Asia Competitiveness Initiative	<u>Vietnam</u>: ceramics and computer software <u>Thailand</u>: jewelry, tourism; agriculture; handicrafts; seafood and silk. <u>Cambodia</u>: non-traditional fishing	Sept. 2002	Sept. 2004	$ 3,022,683	Nathan Associates/JAA and Kenan Institute Asia

* Includes activities undertaken by predecessor firms, i.e., Coopers & Lybrand and PricewaterhouseCoopers

Country	Project Name	Clusters Targeted	Start Date	End Date	Value	Contractor (Prime/Sub)
Croatia	Competitiveness Initiative	• Information & communications technology • Tourism • Wood	April 2001	May 2004	$ 3,280,716	Nathan Associates/JAA
Dominican Republic	Critical Assistance to the Government of the Dominican Republic Policy Reform Efforts	N/A	July 1998	December 2000	$ 1,180,066	Chemonics/JAA
Dominican Republic	Policies to Improve Competitiveness in the Dominican Republic	• Eco-tourism • Horticulture • Tourism	June 2001	March 2003	$ 1,371,912	Chemonics/ JAA
Dominican Republic	Competitiveness and Fiscal Policy Reform	TBD	March 2003	Sept. 2007	TBD	TBD
Egypt	Workforce Development Strategies	• Information technology • Tourism	July 2000	April 2001	$ 492,776	IBM*/SRI
Egypt	Tourism Workforce Development	• Tourism	February 2002	February 2004	$ 2,000,000	IBM*
Europe & Eurasia	Agro-industry Competitiveness in E&E	• Agro-industry • Environment	Sept. 2001	May 2002	$ 50,000	Chemonics/JAA
Europe & Eurasia (Azerbaijan, Serbia, Romania, and two other countries, TBD)	Regional Agro-industry Competitiveness Initiative	TBD	Sept. 2002	March 2004	$ 500,000	Chemonics/JAA
Georgia	Georgia Enterprise Growth Initiative – Component 3 (Georgia Competitiveness Initiative)	TBD	Spring 2003 (Expected start date)	Spring 2005 with 3 one-year extension options	$ 9,000,000 (Estimated)	TBD
Haiti	Assistance to Centre pour La Libre Enterprise et La Démocratie (CLED)	N/A	October 1999	December 2000	$ 100,949	Nathan Associates/JAA
Hungary	NIS Regional Competitiveness Conference	N/A	March 2002	March 2002	$ 90,966	CIPE/JAA
Kazakhstan, Russia and Ukraine	Competitiveness Building Exercises	N/A	July 2001	February 2003	$ 299,521	Nathan Associates/JAA

* Includes activities undertaken by predecessor firms, i.e., Coopers & Lybrand and PricewaterhouseCoopers

Country	Project Name	Clusters Targeted	Start Date	End Date	Value	Contractor (Prime/Sub)
Lebanon	Lebanon Economic Policy Assessment	N/A	Feb. 1998	May 1998	$ 59,482	IBM*/SRI
Lebanon	Lebanon Economic Growth Initiatives	N/A	August 1998	January 1999	$ 658,564	IBM*/SRI
Lebanon	Lebanon Industry Growth Partnerships I, II and III	• Agro-industry • IT • Regional Business Services • Tourism	July 1999	Sept. 2002	$ 2,108,933	IBM*/SRI
Macedonia	Macedonia Competitiveness Activity	• Sheep • Tourism • IT • Wine	Sept. 2002	Sept. 2006	$11,674,376	Booz Allen Hamilton/ on the frontier
Mongolia	Competitiveness Exercise	N/A	October 1999	May 2000	$ 292,219	Nathan Associates/JAA
Mongolia	Competitiveness Initiative	• Cashmere • Meat • Tourism	October 1999	August 2004	$ 4,358,709	Nathan Associates/JAA
Serbia	Serbia Competitiveness Policies	TBD	Sept. 2002	Sept. 2003	$ 2,000,000 (approx.)	Booz Allen Hamilton/ ontheFRONTIER
South Africa	Workforce Development Strategies & Action Planning Tool	• Tourism	Sept. 1998	July 1999	$ 275,719	IBM*/JAA
South Africa	Capacity Strengthening	N/A	August 1999	October 1999	$ 48,176	IBM*/JAA
Southeast Europe (Albania, Croatia, Macedonia and Romania)	National Competitiveness Building	N/A	Sept. 2000	March 2001	$ 199,652	Nathan Associates/JAA
Sri Lanka	Competitiveness Benchmarking Study	N/A	June 1998	December 1998	$ 202,378	IBM*/SRI/JAA
Sri Lanka	Workforce Development Strategies	• Garments • Information technology • Jewelry	April 2000	December 2000	$ 109,512	IBM*

* Includes activities undertaken by predecessor firms, i.e., Coopers & Lybrand and PricewaterhouseCoopers

Country	Project Name	Clusters Targeted	Start Date	End Date	Value	Contractor (Prime/Sub)
		• Rubber • Tea • Tourism				
Sri Lanka	The Competitiveness Initiative	• Ceramics • Coir • Information Technology • Jewelry/Gems • Rubber • Spices • Tea • Tourism	August 1999	August 2003	$11,140,689	Nathan Associates/JAA
Uganda	Competitive Private Enterprise and Trade Expansion (COMPETE)	• Coffee • Cotton • Fish	Nov. 2000	March 2002	$ 2,422,287	Carana

Number of Countries: 26

Value of Projects: $ 59,963,086

* Includes activities undertaken by predecessor firms, i.e., Coopers & Lybrand and PricewaterhouseCoopers