A Prescription for Canadian Competitiveness

Relentless innovation and upgrading are the keys to international competitiveness in the modern economy. Canada has some firms that are meeting this standard, but we need more of them to keep our economy moving forward.

By Professor Roger Martin

Canada is currently enjoying macroeconomic conditions it could have only dreamed of a decade ago. In a remarkable turnaround, our budget deficit and inflation have disappeared and interest rates have plummeted. Our macroeconomic environment now ranks with the best in the world. In addition, we have been ranked third in the world for our microeconomic conditions for competitiveness. However, the performance of the Canadian economy in other important respects has declined precipitously. The Canadian dollar is at a record low and our world standing in GNP per capita has fallen three places. Despite a healthy macroeconomic climate, we face a decline in prosperity unless our firms choose a distinctly different path from the one they have been following.

COUNTRY-LEVEL COMPETITIVENESS

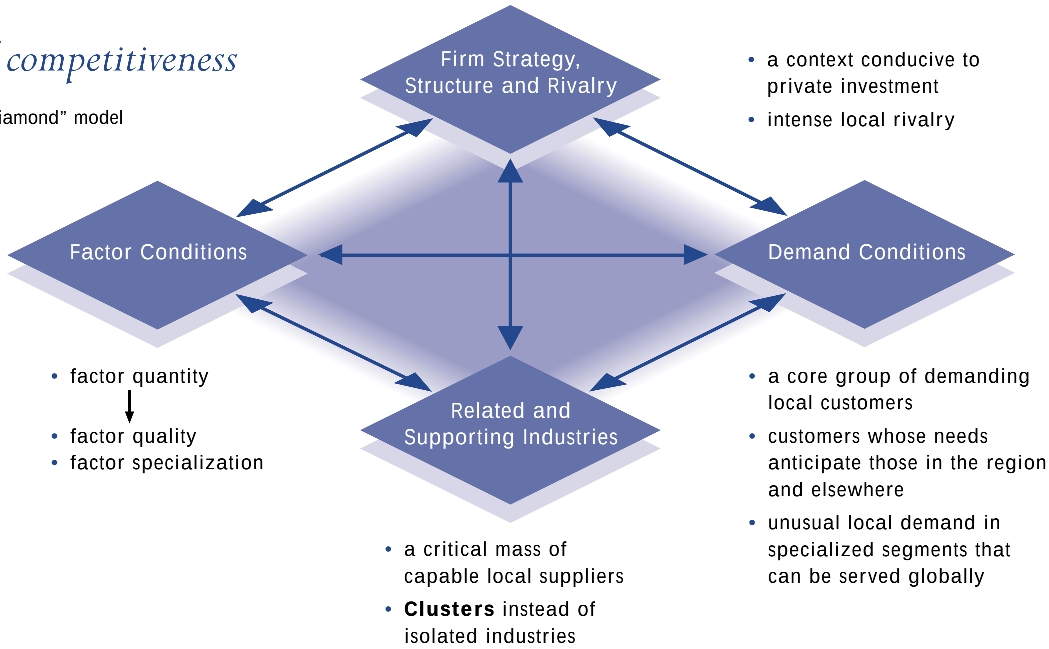
Michael Porter, the well-known Harvard business professor, believes that a firm's international competitiveness is a function of how effectively its industry "diamond" operates in the firm's home country. Porter described this "diamond" model of how industries compete in his 1990 landmark work, *The Competitive Advantage of Nations*.

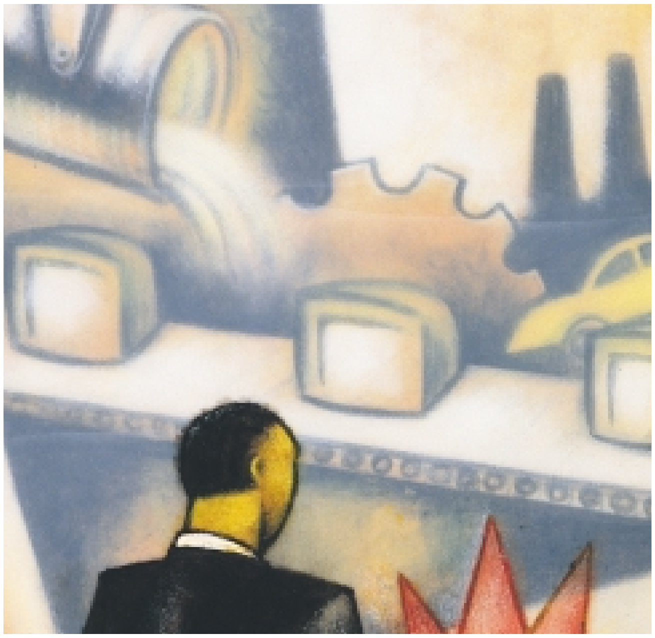
Porter found that firms facing intense home-country pressures who respond by investing continuously in order to upgrade their competitive advantage will prosper internationally. Having sophisticated local buyers causes a firm to make investments to make its product better than anywhere else. For example, Japanese car buyers have been so demanding of perfection that Japanese car manufacturers have had to produce superior products to satisfy their local buyers. As a result, Japanese car manufacturers made huge inroads into the American market beginning in the 1970s, because the cars they produced were superior in important areas such as reliability, fit and finish.

Serving the needs of demanding local buyers were nine car companies in Japan. This large number of companies produced intense local rivalry in a small market — far more than existed among the "big three" car manufacturers in the larger U.S. market. The combination of demanding consumers and intense local rivalry created a constant force to upgrade. These pressures

Sources of competitiveness

Michael Porter's "diamond" model





forced Japanese car manufacturers to constantly strive to differentiate themselves from the other eight local competitors.

The presence of several rivals in a market also leads to a local build-up of specialized human resources and infrastructure, for example, local, but world class, automotive steel and robotics suppliers in the Japanese automotive industry.

The Japanese auto industry is one example of how firms facing intense home-country pressures that respond by investing continuously to upgrade their products or processes will prosper internationally. This phenomenon has been seen in many industries worldwide including the U.S. movie business, Dutch cut flowers, Italian footwear, German printing presses, Japanese video cameras, and Canadian telecommunications equipment.

In 1991 Michael Porter, John Armstrong, and I looked at Canada's competitiveness in a study called *Canada at the Crossroads* and found many problems including:

- Most of Canada's competitive clusters were both narrow in competitive products produced and shallow in the competitiveness of related and supporting industries.
- Canadian firms tended to compete using out-of-date methods and technologies.
- Provincial and federal policies were resulting in weaknesses in the economy.
- Canada's workforce was not trained well enough.
- Spending on innovation and R&D was low.

The old economic order in Canada had led to an array of policies, strategies, and attitudes on the part of governments, business, labour, and individuals that left our economy ill-equipped to respond to the changes sweeping across the world economy.

RECENT CHANGES BY CANADIAN FIRMS

Eight years later, Canadian firms have made considerable progress in improving their operations and strategies. We are using more sophisticated processes to compete, including CAD/CAE/CAM technology in manufacturing. Exports as a share of GDP have increased from 25.2% in 1989 to 41.5% in 1998 — the largest increase among G-7 nations. And we're not just exporting raw materials. Exports of unprocessed and semi-processed raw materials have dropped from 30% in 1991 to 26% in 1996.

TROUBLING TRENDS

There are, however, highly troubling trends evident in Canadian competitiveness. "Structural" or long-term unemployment continues to increase, with each trough in unemployment deeper than the last one. And while exports are increasing as a percent of GDP, the proportion of exports to the U.S. has continued to rise from 75% in 1990 to 81% in 1997, calling into question the breadth of Canada's export customer base.

The major troubling trend has been the world's view of the value of our economy which, measured in Canadian dollars, has fallen against the U.S. dollar by 25% over the last eight years. Canadians are simply not keeping pace in the international economy.

In 1997 Michael Porter updated his work with a study of 52 countries in which he looked at the influence of managerial practices of firms on competitiveness. In this study, Canada ranked a disappointing 15th. His key finding was that Canada was 21st in the world in terms of the type of competitive advantage we pursue. Rather than pursue competitive advantage

COMMODITIES — A SPECIAL CHALLENGE

Commodities have not fared well in the global economy over the long term. Commodities, by definition, are not unique products; however, there can be unique processes used to extract commodities. Competitors around the world have found lower-cost sources of raw materials and lower cost labour to extract and process the raw materials. By 1998 prices of commodities had fallen to 50% of their 1971 levels in real terms. It's very hard to have real productivity gains in a business where the value of what you're producing is falling steadily. It's no wonder that with 44% of Canada's export sector engaged in producing products that are steadily falling in value, our currency has been under steady downward pressure.

In contrast, the U.S. economy is increasingly weighted towards firms producing unique products using unique processes. This investment has far outperformed investment in commodities.

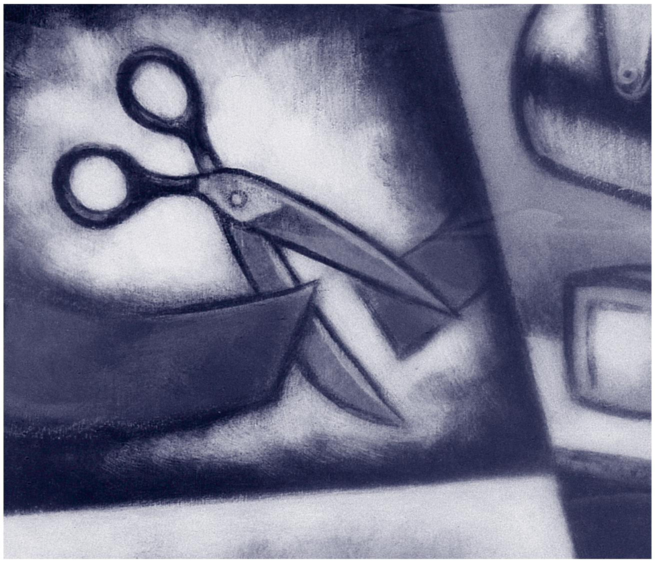
through unique products and processes, Canadian firms, to too great an extent, pursue advantage through cheap raw materials or low-cost labour. Despite advances in company operations and strategy among Canadian firms, Canada remains far behind key international competitors.

Canadian firms must wake up to the fact that they aren't just competing with individual firms worldwide; they're competing with entire clusters of firms, and it's hard to hang on. Canada is not as competitive as it needs to be because we have not established enough of these kinds of clusters. Spreading firms out across the country — such as steel mills in Cape Breton, Sault Ste. Marie, and Hamilton — works against creating related and supporting industries nearby that can help these firms do better. Creating clusters of steel mills, for example, would in turn spawn related and supporting industries and a specialized labour force. This would more likely be a better strategy in our competitive global marketplace.

DISTINCTIVENESS IS THE KEY TO COMPETITIVENESS

In order to achieve competitiveness in the global arena, Canadian firms will have to change their strategies. The operations and strategies of our firms, for the most part, remain far behind those of key international competitors. Canada, on the whole, has pursued replication, not distinctiveness — particularly in commodities industries. But competitiveness does not result from benchmarking and matching. It results from creating unique products with a distinctive system of activities. Companies that try to copy a competitor's product or service often fail because they can't replicate the entire activity system. Low-cost labour and raw materials can be trumped by a competitor producing the same product using even cheaper labour and raw materials.

Canada can be certain that its progress will be constrained if its firms do not even try to seek advantage on the basis of unique products and processes.



GOVERNMENT INVESTMENT IN OUR FUTURE

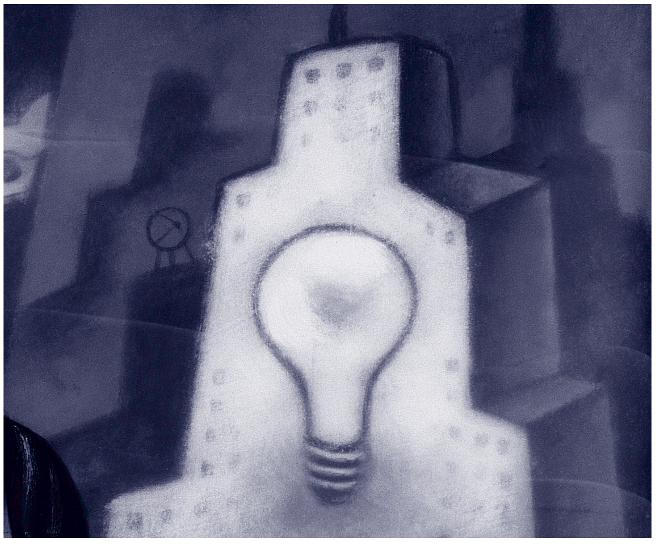
To improve our international competitiveness, government must keep the macroeconomic climate favourable by maintaining low and stable inflation and low taxation of work and investment. With regard to microeconomic policies, we need an aggressive competition policy, strong consumer and environmental protections, and heavy investment in specialized education. Education, training, and specialized skills upgrading are among the highest pay-off investments governments can make. Canada must make an unprecedented level of investment in specialized education to support its industries.

Canadian governments can become distinctly innovative in regulation. In a world in which regulation is often heavy-handed and counterproductive to competition and upgrading, Canada can pursue regulation that has the lightest touch and is maximally market-oriented, for example in telecommunications and education.

THE WAY FORWARD

The way forward for Canada toward greater productivity growth, greater competitiveness and greater prosperity is through uniqueness not replication, through bold strategy choice not operational effectiveness. This applies to the macroeconomic environment, the microeconomic environment, and most of all, company operations and strategy. Greater investment in building related and supporting industries as well as in creating specialized factors of production will be required in a number of industries.

While embracing uniqueness, not replication, businesses must see their job as competing internationally, not simply in Canada.



In that context, they must work cooperatively with governments to build the "diamonds" in their industries, as if their lives depend on it… which they do. Building these "diamonds" involves increasing investment in specialized training and development; nurturing Canadian-based supplier industries; and satisfying the most demanding local buyers.

When both business and government step up to new ways of thinking and competing, Canada will truly prosper in the new millennium.

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Canada's structural unemployment continues to increase