



BUSINESS CLUSTERS: PROMOTING ENTERPRISE IN CENTRAL AND EASTERN EUROPE

EXECUTIVE SUMMARY

“Clusters” – local concentrations of horizontally or vertically linked firms that specialise in related lines of business together with supporting organisations.

Since the publication in 1990 of Michael Porter’s book, *“The Competitive Advantage of Nations”* (Macmillan, London), clusters have grasped the imagination of both policy makers and entrepreneurs. In a globalising world where small and medium-sized firms increasingly have to compete internationally, clusters play an important role in supporting firm competitiveness by increasing productivity, innovation and firm formation.

Due to the benefits associated with a range of agglomeration economies, clusters have attracted the interest of policy makers wanting to boost innovation in industrial growth sectors such as biotechnology and telecommunications, as well as to support local economic development in disadvantaged localities and regions. Governments in central, eastern and south east Europe have realised that in order to achieve sustainable economic growth and to foster regionally balanced economic development, it is crucial to encourage entrepreneurial spirit at the local level. Clusters, demanding interaction among entrepreneurs and local institutions, co-operation of both local and federal levels of government, as well as co-ordination among various policy areas have the potential to dynamise their local economies. As a result, cluster policies and initiatives have proliferated in recent years. Do clusters only occur spontaneously or can they be formally encouraged? What role do the public authorities play? Which policies work best? These are just some of the questions hotly debated.

Today, countries that have successfully made the transition from socialist economic systems to market economies more than a decade ago seemingly face the same challenges as other OECD countries, namely to increase the international competitiveness of their economies. Strong regional disparities due to an over-reliance on traditional industry and agriculture that lacks international competitiveness; regional disparities due to an uneven distribution of foreign direct investment; power asymmetries in relationships between small firms and international investors; the necessity to embed foreign direct investment and related issues of skills formation. These issues are all too familiar to advanced capitalist economies. In the case of countries having recently undergone political and economic transformation, they are compounded by their intensity and simultaneity. Aggravating the situation is a lack of social capital which seems to be characteristic of many post-communist economies. On the policy side, pressures deriving from the sheer speed of change and the interdependence of reforms carried out simultaneously make themselves felt. An important related issue here is the lack of qualified development practitioners trained in interdisciplinary thinking both inside and outside ministries.

The focus

This publication gives an overview of enterprise agglomeration in **Slovenia, Slovakia, Poland, Hungary** and the **Czech Republic**, assessing its local, national and international dimensions in terms of boundaries, impacts and linkages. In the first part, theoretical background is provided, framing the cluster concept and addressing methodology questions in the first chapter. In the second chapter, special attention is paid to the concept of social capital, a crucial element in cluster formation and upkeep, especially in post-communist settings.

The second part of the publication is dedicated to individual country case studies of Slovenia, Slovakia, Poland, Hungary and the Czech Republic, presenting cluster evidence at local and regional level including evidence on links with the international economy, as well as the underpinning country policy framework. The five case studies present a snapshot of the cluster phenomenon in central Europe and provide insights on trends in economic development with the aim of informing economic and industrial policy making. In addition, the publication aims at spreading innovative cluster practices developed and implemented in central, eastern and south east Europe.

Slovenia

(i) Existing clusters

Slovenia's approach of "dynamic concentric circles" encouraging clustering of SMEs around a lead company, mostly large in size, had fostered eleven institutionalised clusters encompassing 700 companies working on more than 150 joint projects in areas such as marketing, production, R&D and internationalisation in 2003.

(ii) Cluster policy

Slovenia became interested in clusters towards the end of the 1990s while trying to grapple with the significant lag in productivity of Slovenian industry compared with the EU average. In contrast to the other four countries researched, Slovenia decided to integrate the concept of clusters systematically in a comprehensive approach to serve long-term economic policy goals. It anchored clusters at the heart of a pro-active industrial policy aiming at SME support and the upgrading of productivity levels and innovation potential of Slovenian industry dedicating significant resources both in money and in attention paid to the process.

(iii) Areas for improvement

While knowledge about the benefits of the cluster concept has been carried into the economic arena, making clusters work by overcoming lack of trust among big and small firms remains an issue.

(iv) Lessons for other countries

The Slovenian cluster chapter provides key insights into how Slovenian economic policy is shaped, particularly with regard to clusters spanning the period of 1999 to 2006. It gives a step-by-step description of the Slovenian cluster mapping exercise which served as a basis for devising Slovenian cluster policy. It then delves into the intricacies of promoting clusters, describing the incremental process of cluster building.

Slovakia

(i) Existing clusters

The aim of the Slovak cluster study was to investigate the locational and clustering behaviour of foreign and domestic firms by both quantitative and

qualitative means identifying 46 “spatial concentrations” identified by location quotients.

(ii) Cluster policy

Since the early 1990s, small and medium-sized enterprise (SME) support has been established as a priority at all levels of governance. However, despite recommendations by international agencies including the United Nations Industrial Development Office, the Organisation for Economic Co-operation and Development and the European Commission, no cluster approach is used in Slovakia either at the policy analysis or at the policy development level. Certain parallels to the cluster approach can be found in the policies pertaining to the Slovak automotive industry and to industrial parks, although these developments seem to be driven mainly by the influx of foreign direct investment (FDI) and employment policy concerns.

(iii) Areas for improvement

A cluster orientation highlights the fact that different policy areas directly influence national competitiveness, a fact often neglected, especially among government circles. It is recommended that Slovakia takes advantage of this policy tool to inform its regional development policy planning.

(iv) Lessons for other countries

Clusters provide a way of organising thinking about inter-related policy areas helping to co-ordinate and guide policies in science and technology, education and training and export and foreign investment promotion, among others.

Poland

(i) Existing clusters

Polish clusters in traditional and high-tech branches have a strong regional element, with spontaneous bottom-up networking in evidence since economic transformation. Emerging regional innovation systems show a strong similarity to clusters, especially in high-technology sectors.

(ii) Cluster policy

The concept of clusters as a policy tool is a brand new in Poland, with growing interest in networking observable specifically in terms of innovation policy. At the beginning of the 1990s, self-governed communes started to

operate at the local level, with regional development managed by self-governed regions following a decentralisation reform in 1999. Throughout Poland, regional innovation strategies are being carried out as an important ingredient of regional development strategies.

(iii) Areas for improvement

Cluster mapping and the regional studies presented show that there is strong potential for the development of competitive cluster structures in Poland. However, an overview of policy and institutions supporting small and medium-sized enterprises reveals that so far, no specific measures to foster clusters have been undertaken.

(iv) Lessons for other countries

A model for policies conducive to cluster development would be the offer of the Polish Agency for Enterprise Development to provide financial assistance to consortia of SMEs in public procurement as well as grants for the consolidation or joint-ventures, setting up groups of producers or supply/trading networks for the creation of joint marketing.

Hungary:

(i) Existing clusters

Hungary has successfully mastered economic transition benefiting from its geographic location and attracting the lion's share of foreign direct investment in central and eastern Europe. Over the last years, Hungary has seen the emergence of clusters in several of its industries, ranging from the automotive sector, logistics, construction and tourism. The investment-based, export-orientated machinery and automotive industry (for example the Pannon Automotive Cluster, PANAC, representing 10% of GDP) has been the frontrunner in this development.

(ii) Cluster policy

Under the Ministry of Economy's Szechenyi plan in 2000, 21 consortia of firms have been officially recognised as clusters receiving state support. A first analysis reveals however that only a third of all recognised clusters can be backed up by statistical evidence.

(iii) Areas for improvement

Large multinational firms play a very significant role in the Hungarian economy, accounting for the overwhelming proportion of the nation's GDP, exports and research and development activity. However, growth has been concentrated in the western parts of the country and there is a widening east-west economic divide. Cluster-building has been largely foreign investment-driven, with home-grown clusters slowly emerging.

(iv) Lessons for other countries

The recent economic slowdown has exposed Hungary's over-dependence on FDI, further emphasising the need for alternative strategies of economic and regional development, such as the Pannon Economic Initiative. The Pannon Economic Initiative (PGK) founded in 2001 strives to establish a co-operative partnership between regional and economic development organisations to increasingly involve both private funds and assistance from international financial institutions in regional development. It provides a joint regional platform for the automotive, wood, electronics, thermal and fruit clusters creating the framework for network-based economic development in Western Transdanubia, thus extending the scope of enterprises contributing to the economic dynamism of the region.

Czech Republic

(i) Existing clusters

The phenomenon of clustering in the Czech Republic encompasses both firm concentrations localised in old industrial areas (such as in metallurgy and engineering, like in Moravia), as well as country-wide supplier networks for large international firms such as Volkswagen/ Skoda. At the same time, SMEs are starting to cluster together following a bottom-up approach in an effort to withstand the asymmetric power relations in supplier-networks, be it faced with transnational supermarket chains or the automotive industry.

(ii) Cluster policy

While the cluster concept is still relatively new in the Czech Republic, a lot of governmental programmes are targetting entrepreneurial co-operation and SME development in general. The Society of Technology Parks, the counselling agency Czech Venture Partners and the Czech Innovation Centre among others provide general support for enterprises. The Czech Agency for Foreign Investments (Czechinvest) stands out as an important actor in FDI-driven

cluster development co-ordinating the foundation of industrial zones and searching for strategic investors.

(iii) Areas for improvement

There seems to be strong potential for cross-border co-operation that would benefit from support: The authors expect the emergence of a supranational automotive multicluster in central Europe with its core in the northeastern part of the Czech Republic within reach of Poland, Slovakia and Hungary.

(iv) Lessons for other countries

Since 2000, the Czech Ministry of Industry and Trade has been disbursing funds aimed at fostering inter-firm co-operation in conjunction with the Czech-Moravian Bank of Guaranty and Development. In April 2003, 58 applications of firms had been positively reviewed and a total amount of contribution 213 million CZK (approximately 6.5 million EUR) paid.

Policy recommendations

Over the last twenty years, a great body of academic research, as well as practical experience regarding clusters has been constituted. Below, overall policy recommendations deriving both from past and present cluster study and experience, as well as from the five countries regarding cluster strategy, cluster programme design and cluster management will be presented.

The five case studies reviewing cluster experiences from Slovenia, Slovakia, Poland, Hungary and Czech Republic review various policy tools and initiatives to foster cluster development directly or indirectly. Some good practices, such as Slovenia's top-down/ bottom-up approach forming both inter-ministerial and inter-firm networks, Hungary's Pannon Growth initiative offering an integrated concept of regional development, the Czech co-operative cluster model and the Polish regional-based innovation approach stand out. Analysis of case studies countries confirms the relevance of already identified general policy recommendations regarding cluster formation and upkeep.

While most policy recommendations are valid for all countries, this publication aims to encourage further study regarding the merit of measures specifically targeting clusters in countries having recently undergone political and economic transformation and therefore has a particular focus on recommendations for countries in central, east and south east Europe.

Cluster Strategy

- **Utilise cluster mapping to identify local and regional competitive advantage:** Clusters are a useful tool to benchmark industries and identify trends to inform industrial policy making.
- **Encourage clusters to help upgrade firm competitiveness and innovation:** Cluster participants are better prepared to cope with the pressures associated with international competition thanks to pooling of key resources and processes of collective learning and rivalry that support more rapid process and product innovation.
- **Integrate the cluster approach into regional and local development policy design and implementation:** Regional development policy needs to strengthen the regional institutional system for the efficient use of European Union funds and the implementation of independent regional programmes tailored to local needs. The cluster concept is a useful one in encouraging local and regional capacity building.
- **Use clusters to encourage local development and to strengthen SMEs:** Fostering clusters can be used to achieve a wide range of local development goals, such as SME support, job creation and skills upgrading that are important locally and translate into welfare gains at the regional and national levels.
- **Integrate the cluster concept into national strategies for attracting and embedding foreign direct investment:** Countries such as Sweden and Finland have been successful in attracting investment based on a strategy of promoting and developing cluster competencies in specific industrial sectors. By identifying and building on local competitive advantage, central and eastern European countries can successfully embed FDI.

Cluster Programme Design

- **Grasp the importance of sustainability:** Cluster policies need to be designed with a long time horizon in mind.
- **Favour a hands-off approach strictly limiting state intervention:** Support should be based on clear criteria conditional upon bottom-up entrepreneur-led initiatives with a proven potential for self-sustainability.

- **Build public-private partnerships to develop a constructive dialogue to identify local development needs:** Networking of local stakeholders is crucial to moving forward localities economically and socially. Exchanges between entrepreneurs, civil society and public authorities can help to dynamise local economies.
- **Integrate the concept of social capital:** Special attention needs to be paid to building social capital among cluster participants, earmarking resources for this task in the programme design.
- **Foster inter-ministerial co-operation to form “policy clusters”:** Policies to advance regional development, to strengthen SMEs and to increase innovation need to be carefully co-ordinated to achieve synergies. Forming inter-ministerial groups taking into account the multiple facets of clusters will help to achieve these goals.
- **Encourage evaluation:** Policies and programmes in place need to be continuously monitored and evaluated. Cluster mapping needs to be undertaken on a regular basis as an instrument to benchmark industries/ sectors and to identify industry trends.

Cluster Management

- **Build up a critical mass of information, knowledge, skills and technology** to allow groups of companies to seize new organisational models and technologies as viable business opportunities.
- **Invest in network management and social capital building** through the training of network mediators and the selection of cluster managers, among other things.
- **Increase productivity** through joint communication and information links, specific education and training programmes and local supply chains.
- **Increase innovation** through joint research and development and outsourcing of research and development.
- **Enhance openness** by enabling new members to bring in new knowledge, resources, technology and experience and by encouraging linkages with international network structures.