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oneLondon
business initiatives for an inclusive capital

A oneLondon lecture delivered by

**Professor
Michael E. Porter**

oneLondon Commentary

As part of their Public Policy programme, *oneLondon* invited **Professor Michael E. Porter of Harvard University** to deliver a lecture focusing on London's continuing influence in the world economy, reflecting on his highly publicised research on the competitive advantage of nations, regions and cities.

Professor Porter's work is a significant influence in devising the economic development policies of many of the world's major cities, and he is one of the leading authorities on city based strategies and regional competitiveness. His work in developing strategies to address inner city deprivation through highlighting the economic potential which resides in these areas, primarily through the Initiative for Competitive Inner Cities (ICIC), is now being used to underpin the 7 City Growth Strategy (CGS) pilot areas in the UK. 4 of these areas reside in the capital. *oneLondon* currently sits on the board of the Heathrow City pilot and the Corporation of London and the Greater London Enterprise group are currently providing significant input in remaining three CGS pilot areas.

His lecture, '**Regional Competitiveness: Towards an agenda for London**' covered three main areas, namely:

1. Foundations of Regional Competitiveness

He begins his lecture outline the focusing on the understanding that "...sources of prosperity are created and not inherited..." He summarises that competitiveness is based on the capacity to innovate, which leads to an increase in productivity, which leads to prosperity. Professor Porter also outlines the crucial need for the maintenance of "...institutions of collaboration" such as chambers of commerce, school networks, and industry associations.

2. Inner city revitalisation

Professor Porter's work states inner city distress as much an economic as a social problem. He highlights the need for an active business base with considerable employment opportunities to be created in or near inner cities, and that competitiveness must be the key driver behind the economic development of these areas.

3. New roles in regional prosperity

This element of his presentation recognises the need for a radical 'shift' in responsibility for the creation of economic development policy, away from a dependency on government led initiatives, to a more cross sectoral and collaborative process, with a specific focus on full engagement with the business sector.

Being a business led economic development agency, *oneLondon* has an inherent interest in the work of Professor Porter, and concur with his approach to providing solutions of social exclusion through establishing sound economic and social policies, and achieving this by working with all sectors. His approaches to engaging the business sector in

regeneration, by highlighting the competitive advantages of cities is a perfect synopsis of the principles which underpin our aims and activities.

We look forward to continuing a productive relationship with Professor Porter, and his team, as oneLondon continues to develop programs which engage the private sector in the economic development of the capital.

oneLondon Public Policy, July 2003

1. *oneLondon*, a subsidiary of Greater London Enterprise (GLE), is an enterprise and regeneration agency. As a membership organisation, it is a partnership of the private and public sectors; members are: BT, Cadbury Schweppes, Corporation of London, Greater London Enterprise, Hill and Knowlton, HSBC, Lloyds TSB, London South Bank University, St. George plc and United Biscuits.

2. **Greater London Enterprise** is London's economic development company. While owned by the London Boroughs, it is commercially and constitutionally independent and receives no public funding or subsidy. This unique positioning enables GLE to invest its profits to deliver quality support to enterprise for growth and regeneration across the capital on the Boroughs behalf. Focusing on SMEs, GLE has developed a track record of successful borrowing, lending, investing, managing funds and assets and developing property and innovative financial techniques to deliver for London.

Amanda Jordan OBE, Chair, *oneLondon*

Good morning everyone. My name's Amanda Jordan and it's my pleasure to extend a warm welcome to you to the *oneLondon* lecture delivered today by Professor Michael Porter. As I look around the room, I'm clearly aware that only a few cities could command such a distinguished audience and such an eminent speaker and obviously London is one of them. Only last week, Lord Mayor Gavin Arthur pointed out that London continues to be the leading multi-currency

global centre. 80% of every pound made in London is distributed throughout the country, so it's little wonder that London's economic wellbeing is of such great concern to so many, including *oneLondon*.

Our arena is a city that is second to none in its complexity, but London's challenges are the reasons we exist, and *oneLondon*'s role is to be a vehicle that integrates and capitalises on that diversity to create a sound economic base.

oneLondon is a business-led enterprise and regeneration agency with a special focus on innovation and inclusion. Our members, many of whom are here today, are leading institutions drawn from the corporate, academic and public sectors. Through this unique partnership, *oneLondon* is able to manage, deliver and implement initiatives which aim to support the capital's economic development, focusing particularly on enterprise and the crucial small business sector, whilst also delivering programmes which utilise corporate and public-sector expertise in supporting London's vast, diverse and particularly excluded communities. We are, by the way, now the largest non-bank lender to small businesses in England.

The lecture delivered by Professor Porter this morning is one of a series of policy meetings which form part of our public policy programme. These events are aimed at engaging all of our partners who wish to participate in the creation of better development strategies for London, but often lack an effective vehicle for engagement. But none of this could happen without the support of our parent company, Greater London Enterprise, better known to many of you as GLE. Together we have done and will do much more in the future to bring expertise and new sources of finance, particularly to distressed urban areas and excluded groups across London. But as a membership organisation, *oneLondon* is a unique partnership and this morning I would like to say a special thank-you to the two members who sponsored this event, the Corporation of London and Lloyds TSB Business, who we will hear from in a moment. And we are of course particularly delighted that this morning's lecture is being delivered by one as distinguished as Harvard University's Professor Porter. As many of you already know, Professor Porter's economic development strategies are used in virtually every major city in the world and are taught in most business schools. His strategies underpin Mayor Livingstone's own economic development plan, executed here by the LDA, and both *oneLondon* and GLE in particular have been involved here in the city growth strategies.

Professor Porter has been kind enough to take time out of his busy schedule to join us this morning to talk about how his strategies, rigorously tested in the US, are being applied in a London context. But before we hear Professor Porter's thoughts on current developments in London and his suggestions for the future, I would like to invite Michael Snyder, who many of you know is the Chair of the Resources and Policy Committee of the Corporation of London, followed by Mike Kirsopp on behalf of Lloyds TSB Business to say a few words. Michael.

Michael Snyder, Chair, Policy & Resources Committee, Corporation of London

Well thank you Amanda and good morning ladies and gentlemen. First and foremost, I would like to welcome Professor Michael Porter to the City of London and also to thank *oneLondon* for hosting and organising today's event. I must say it is with some considerable trepidation that I share even for a brief time the same platform with one of the world's foremost speakers, especially on business clustering and competitiveness. It is good to see in the audience such a wide range of key stakeholders in London. The Corporation of London, as the public authority for the Square Mile, is delighted to be a major sponsor of today's event. The Corporation's role is to enhance the effectiveness of the City of London and its surroundings as a world-class international financial and related business services centre, and as such the City creates considerable wealth for London and for the UK as a whole.

The Corporation believes that the City should be treated as the dynamic heart of London's central business district, an area which contains interconnected concentrations of financial and business service activity in surrounding boroughs. This cluster is an immense economic engine, employing nearly two million people. It helps to improve the economic, social and environmental wellbeing of London as a whole, and of London's capacity to develop further. The Corporation has been actively furthering its understanding of the dynamics of business clustering in the central business district. We jointly commissioned, with the Economic and Social Research Council, a study into the reasons for the clustering of financial services and related businesses in London. This research has identified a number of significant benefits from clustering for financial services firms, and some of them are London's credible address.

A City location is a major advantage for firms. Access to a strong skilled labour supply, proximity to market leading customers and professional bodies, accessibility for customers outside London, access to and transfer of knowledge through formal and informal networks and social interactions. In addition to our work on the dynamics of the central business district, the

Corporation of London is also involved in two of the four London pilots of the City Growth Strategy Initiative. This Treasury-backed programme is based on Professor Porter's work and the American model developed by his organisation Initiative for Competitive Inner City. City Growth Strategies, as many of you know, aim to combat poverty by developing a strategy to revitalise the economies of distressed areas. Two of these pilots are in areas immediately surrounding the City. The City Fringe to the North and East and London South Central to the South. We await the results with interest and look forward to discussing further with Professor Porter how the United States model relates to the London experience.

Well, constantly seeking to reinforce the factors that made possible the development of the City and the central business district as a whole, the Corporation is acutely aware of growing drawbacks facing businesses in the Central London location, and thus we are aware of the challenges to maintaining this cluster's competitive advantage and I would just single out three of those. Firstly, the quality and reliability of public transport has failed to keep up with the growth in the number of those working and living in London. More does need to be done to deliver higher levels of investment in the provision of world-class public infrastructure.

Secondly, office costs are perceived to be high, even though in relative terms, they are lower than at the height of the property cycle in the late 1980s. A pipeline of top-quality office space has to be planned, designed and developed to cope with growing demand without, of course, overheating. And thirdly, we cannot, I believe, simply go on relying on the idea that the overall operating costs of conducting business in Central London will remain lower than in other financial centres. Government must recognise the need to actively maintain London as a business-friendly environment, so that tax and regulatory impacts do not become disproportionate and choke off innovation, enterprise and new jobs.

We are therefore working hard to remind central and regional government of the importance of ensuring that London's competitive position is not only maintained, but enhanced. I hope that I have shown why the Corporation is keen to support today's event. I'm sure it will be extremely valuable in helping to inform the debate on business clustering and competitiveness, deepening our own understanding of the key issues and on the interventions required to maintain London's position in the global economy. Thank you.

Mike Kirsopp, Network Director Business, Lloyds TSB Business

Good morning. A few words to say, and it will be very few, because I know that when you've got a speaker like Professor Porter to listen to, listening to somebody else go on for five minutes will just take the shine off the day for you. Lloyds TSB has been a board member of *oneLondon* for a long time, and as the latest in a long line of people associated with *oneLondon*, we've been delighted to be able to be associated and co-sponsor today's event.

We've keenly acted to incorporate economic development into our day-to-day operations by using our expertise to treat every corner of London as a business opportunity and not discard inner cities as public sector responsibilities. This philosophy has been cultivated in great part by Professor Porter's thinking on the need to identify and use all potential sources of economic growth. Approximately a quarter of all firms in the nation come to Lloyds TSB as a starting point for finance and advice and a significant portion of these firms are going to be located in inner cities.

We see our role as one of reducing perceived barriers to people who wish to consider starting up in business. We wish to help them sustain those businesses and achieve the success on the basis as they define it. However, we realise that there is a significant population of would-be entrepreneurs who have been excluded from mainstream finance for a number of reasons, but also who lack the confidence or administrative knowledge to approach a bank. Hence we are committed to integrating into our corporate philosophy the use of our knowledge and services to the fullest extent to address these issues, and through our involvement with *oneLondon*, we have actively engaged with policy-makers on how best to deliver financial services and encourage entrepreneurship among as many people as possible.

oneLondon helps us to find ways of reaching these people who might not feel confident in approaching us directly, and thus enables us to develop and refine a wider range of products and solutions, such as micro-credit and the business angel finance. Since incorporating Professor Porter's strategies and principles, we have developed and delivered practical tools for reviewing the competitive advantage for our business customers. We have good evidence that this has made a positive difference, not only to their satisfaction with us, which is very pleasing, but it also underpins their own success. And as the Chancellor has repeatedly said, the success of our small business sector is essential to guaranteeing prosperity in the economy as a whole.

Lloyds TSB will remain committed to bolstering this bedrock through the delivery of high-quality small business services, and in addition to our own involvement, we will also continue to work

with current partners and build new partnerships to provide even better business support. We will also urge other corporations to become involved in the new model of corporate engagement, both in providing services and addressing socio-economic issues in urban areas. As for our involvement in today's event, Lloyds TSB has closely followed the progress of the City Growth Strategies and other initiatives here in London. As a major contributor to the national wealth, London is a key market, and we are keen to contribute to the business strength of every area of the capital, including poor and excluded neighbourhoods. So, on behalf of Lloyds TSB Business, I'll stop the waffle. I'm keen to hear Professor Porter's thoughts on how we can better address deprivation with a sound economic approach to inner cities and national and regional competitiveness.

Professor Michael E. Porter

Well thank you all for the very kind introductions and for your opening comments which I thought were excellent. I don't think you should be shy about sharing a podium with me. In fact, I'll be lucky to do as well, so thank you. Very articulate, very clear and I think an excellent beginning to our session today.

It's a great honour for me to give the *one*London lecture. I have a very, very keen interest in what this organisation does, what this organisation stands for and I'd like to commend you on how innovative and dynamic you've been. There's a whole array of interesting programmes. I learned a lot as I read through the materials about *one*London and I think you're clearly making a difference and you're clearly on the right track. I think the major intellectual hurdle that most efforts like this have to address is whether to look at the problem of distressed areas and inclusion as a social issue or an economic issue. And I think what we've understood over the last five or ten years is that we have to treat the social problems that we find in our communities, in our distressed populations, but that that's only going to kind of keep us sane.

The only real solution is to understand that it's fundamentally an economic problem. It's fundamentally about building a healthy economy, not just in the city of London, but in all the boroughs of the city and all the neighbourhoods of the city, and I think this organisation is right on that point and I really commend that effort. It's still relatively rare around the world and I'm very, very delighted to see this kind of effort. I'm also delighted to see the diversity of people involved. As we'll see later, modern economic development is not something that should be led by government. In fact, it can't be led by government. The more we learn about competition, the

more we learn that it has to be a kind of a partnership between government, business, universities, schools, NGOs and other organisations if we're going to actually put in place the environment, the infrastructure required for a healthy economy.

Now, what I'd like you to do today is first of all recognise that we have a very limited amount of time, and I'd like to really try to focus on what we've learned about the competitiveness of cities in general, and then in particular what we've learned about the factors that lead to vitality in inner cities or what are often seen as economically distressed communities within cities.

There's been a lot of attention about competitiveness over the last, actually it's been more than twenty years now that competitiveness became a critical word in the lexicon all around the world, but only recently have we started to apply thinking about competitiveness, not just in nations, which has been the traditional focus, but increasingly there's a sense that we can apply thinking about competitiveness down at lower levels of geography; regions, cities, and most recently our efforts in the US were focused on applying some of the same thinking to actually inner city distressed areas within metropolitan regions.

So what I'd like you to do is start broadly, try to give you kind of a quick focused discussion on the kind of critical principles of regional competitiveness as we've come to understand them, then turn to the question of inner cities and what drives their prosperity, what we can do to revitalise these areas, and then finally I'd like to talk about roles and responsibilities, because I think one of the big issues here is how to get the right people working together in the right ways to address these issues. Had to move beyond the history work or focus in this area, which was almost exclusively government being left with the job. So with that introduction, let's begin.

I think, you know, we're standing in one of the most prosperous and competitive cities in the world. London has a very high GP per capita. London has achieved pretty good economic success over the last five years, but London's competitive situation is not without some issues. As we'll see in a minute, London's results are actually not the best of all the regions in London; London is not the most prosperous region within the UK. And London is facing some competitiveness challenges as a city, and has some very interesting issues of the coexistence of great prosperity and economic distress at the same time.

The reason I'm so pleased to be involved with this organisation is because I think London is a very interesting case study and I think what the set of issues that are affecting cities of all types and of all sizes throughout the economy, and I think that I'm hopeful that the efforts that all of you are involved in here in London can actually not only benefit London, but they can also serve as a model for other cities. We have four of the pilot projects of the seven pilot projects in the City Growth Strategies are actually parts of London, and I think that if some success can be achieved in these areas, I think that's going to have a tremendous impact in rolling out this whole way of thinking throughout the UK.

Chancellor Brown is, I think, very, very keenly interested and focused on how to regenerate business activity in cities in the UK and I think that stakes are high that we get it right here in the London experiment.

Now, what do we know about competitiveness? Well, let's just kind of remind ourselves of some of the fundamentals of what makes a city or a metropolitan area competitive. But indeed these same principles can be applied to what makes any geographic area competitive. And the basic starting point for thinking about competitiveness is that prosperity of any area is fundamentally driven by productivity. If you can be very productive, if you can produce a lot of output with a day of work or a pound of capital invested, you can be prosperous. If you can produce a lot of output you can pay yourself a high wage. On the other hand, if you're not productive, if you can't produce very much valuable output in that day of work or that pound of capital invested, you're going to be resigned to having a low wage. Productivity is what determines prosperity.

There's an almost 100% correlation between the productivity of cities, the output per employee and per unit of capital and the standard of living. This is a very strong relationship and it holds throughout economies all over the world. Basically when we think about the competitiveness of London then, we've got to think about what makes London a productive place in which business can be done. If London can be a productive place, it can allow businesses to operate efficiently, if it can allow businesses to create very valuable and unique products and services, London will continue to be prosperous.

On the other hand, if London loses its ability to be a productive platform for business, then London is going to slowly ebb away in terms of its current pre-eminence. Now in building a competitive economy, what we've learned is that it doesn't matter so much what particular

products or services a city or region produces. You can be productive in almost anything. You can be productive in agriculture, you can be productive in financial services, you can be productive in virtually any part of the economy. There are no unproductive sectors of the economy. There are only unproductive companies. There are only unproductive locations, but no sector is inherently unproductive.

There are no low-technology industries or sectors anymore. Every sector can employ very advanced technology today to enhance its productivity. This notion that some industries are high tech and other industries are low tech is a really very dangerous way of thinking, because it masks the tremendous opportunities for transforming businesses throughout the economy with information technology and many other kinds of new technology that exists today.

Therefore, what this says is that when we try to understand why a region is competitive, we don't really focus so much on what exactly that region does. What we really need to focus on is how the region does it. If you can be very productive in a field because you've got the right business environment in that field, because the right skills exist, because the right infrastructure exists, you can be prosperous in virtually any field. When we compare cities in metropolitan areas in the U.S. statistically and we try to explain why some cities are more prosperous than others, we find a result that you might find a little counterintuitive. We find that the prosperity differences across cities are not very much affected by the mix of clusters or industries that those cities are in. What dominates the differences in prosperity is how competitive the cities are in the clusters that they're in.

So the challenge is to understand what you can build in terms of the unique competitive portfolio in your region. If you can build the productivity of that you will be prosperous. But of course productivity is a constantly moving target. You always have to get more and more productive and to get more and more productive you have to develop innovative capacity. You have to develop the capacity in the firms and other institutions in a particular region to generate new ideas, new ways of producing, new ways of delivering service, new products, new features, and so when we look for the long term vitality of a metropolitan area or city we're looking at indicators of innovation. Is there a good capacity for innovation in the region?

Now, I thought you might be interested in a little bit of data about London and how London compares to the rest of the UK [reference to power point slide]. There is not good consistent data

which would allow me to compare London to other major cities in the world, but I thought you might be interested to learn that although London is quite prosperous in terms of GP per capita in the UK, in fact it's on the top of the list in terms of GP per capita. GP per capita is probably the best single measure of prosperity that is consistent and used by economists all over the world. We see on the horizontal axis growth and employment and indeed London has grown employment over the last five years and slightly higher than the UK average, but it's interesting to see that London is not the fastest-growing part of the UK in terms of employment. It's currently the highest wage, the highest per capita income, but not the most rapidly growing in terms of employment.

There's probably a lesson here that causes us to kind of ask ourselves what's going on. If we look at not only the GP per capita level, but the growth in GP per capita, again we see that here London is on the top in terms of the per capita income, but London is not growing GP per capita as fast as some other parts of England. You know these regions much better than I do, but it's interesting to see the kind of dynamism and the growth in productivity seems to be greater in other parts of the country. Again, I think this is not necessarily a danger sign. There's certainly – we're certainly not in a situation like we see in the Northeast or Northwest or East Midlands, but London is not overwhelmingly dynamic compared to some of these other areas. London is a major export base in the UK, but from a per capita point of view it's not the highest exporter of goods and services. Other parts of England are the same ones that are growing GP per capita very rapidly. Actually have a higher export per capita and finally we see that London is a substantial centre for R & D and innovation, the development of new technology, but it's not again overwhelmingly the centre of innovative activity in the UK.

If we look at R & D activity as a measure of innovative investment, we see on a per employee basis much higher average levels of R & D per employee in other parts of the country. I think what we see when we look at London and look at our key metric of prosperity and some of the indicators that signal future prosperity, we see a kind of a mixed situation. London is strong, London is prosperous, but there is some indications that London may not be the most dynamic location. I thought you might be interested in the kind of patenting activity in the UK. We look at university patenting as an interesting indicator of the kind of vitality of the innovative infrastructure in a particular region. This is the data for the UK [reference to power point slide]. This looks at all British universities in terms of their US patenting.

The reason we use U.S. patenting as a metric is because any really commercially important technology is always going to be patented in the U.S., and so that sets a nice high bar for whether a technology is important or not and when we compare locations in terms of US patenting rates we get some very interesting indications and indeed in the UK we see that the top two patent generators in terms of universities are actually located in London. You see the data. But just for a moment fix your mind on these numbers, the absolute numbers, and now I'm going to show you my city, Boston, and you see that at the universities in Boston are generating intellectual output at a very, very rapid rate and if we had similar – if we looked at data on new start-up firms that spin out of universities, technology licences, all kinds of metrics of technology transfer, we would find that in Massachusetts and in California and in some of our US regions, that the link are the generation of businesses out of universities is much, much, much more vital than it is in the UK.

I think one of the challenges that London has is to turn its technological capability into business generation, and this is a more generic problem facing the UK which was a finding from the overall review of UK competitiveness that I recently completed for DTI and the ESRC. These are just some kind of quick snapshots of how London is doing as a metropolitan area compared to other parts of England and along some of the key metrics that we look at. Now, the more interesting question of course is why. Why is a region prosperous? What allows a region to be productive? What allows a region to create a stream of innovation? And here we have developed and refined over the last decade or so a framework for thinking about the competitiveness of locations, locations of any geographic size.

We can use this framework to look at the nation; we can also narrow down our focus and look at a region, a metropolitan area, and indeed as we'll see later, we can actually look within metropolitan areas at particular sub-units of metropolitan areas. Basically the concept is very simple. If you're going to be productive, there are four major influences on productivity. Number one is the quality of the inputs available, the quality of the roads and the physical infrastructure, the quality of the people and their skills, the depth and accessibility of the scientific base and so on. Businesses can only be productive if they have access to high-quality efficient inputs. If a business – if it takes three hours for a business to make a delivery because the road system is clogged up, that saps the productivity of the business. That's just one example of how one particular input affects the productivity of firms in a given location. That's one set of factors.

Another set of factors has to do with the context, if you will, in which competition takes place in that region, which has to do with the rules and regulations and incentives that have been created. We know that productivity demands investment and so one of the things you always look for in a region is what's the incentive for investment. How is the tax system and how are the incentive structures either encouraging investment in that location or discouraging it because the incentives are behind other locations? We also see the tremendous power of competition to influence productivity. We see over and over again if we can have a lot of rivalry, head-to-head rivalry, local rivalry in a given region, that tends to spur improvement and gains in productivity, whereas if we have a dominant company in a particular location, only one, or only two in a particular field, that tends to lead to less vitality and less innovation and less productivity. I think this is one of the keys to what is going on in the city of London.

We have a lot of competitors in close proximity watching each other every day, constantly fighting for every deal, they get better. They get more innovative, they find ways to differentiate themselves, they find ways to create new products; whereas if you had one monopoly financial services firm, it would just sit back and coin money and have tea and go to long lunches. And so we want healthy competition. We find that there's a very strong link between local competition and international and national success.

Third thing you want to have if you want to have a competitive region is you want to have sophisticated buyers. If your local customer is demanding, if your local customer has cutting-edge needs, if your local customer is very anxious to have the best product or the most innovative product, that really helps, because you can understand your local customer base better than anybody else, because you're there. You have the relationships, you have the access, you have the understanding of those local customers that's superior to other firms, so we find, for example, that US software companies are internationally competitive because US users of software are more advanced than in many other locations. And working with the advanced user gives you competitive advantage versus other locations. So that's kind of a third aspect of the business environment that allows you to be productive.

And the final aspect of course is clusters. Clusters is a phrase that's now becoming somewhat better-known in the thinking about economic development and competitiveness and it's really a striking feature of every single economy in the world. It's one of those things that we've known about for a long time. It was featured in the books of Alfred Marshall at the turn of the century.

But in terms of the recognition of the importance of clusters for economic prosperity and innovation, the kind of data and research on this is comparatively recent. This is an example of a cluster. It's the life sciences cluster in Boston, again my hometown.

And we're actually involved, you might be interested to know, now in a major effort to kind of bring together this cluster and try to build it to the next level. A cluster consists of obviously a bunch of firms. The core firms in this cluster make biological and pharmaceutical products, but what we see is a cluster is much more than just end-product producers. It's much more than just financial services firms in the city of London. A cluster is also a place where key supplier businesses exist. It's a place where specialised service providers are present. In Boston, there's any number of accounting firms that are expert in doing all the legal work in starting biotech companies, in doing FDA approvals in the kind of specialised areas of law that relate to pharmaceutical and life sciences and FDA. That's an example of how a specialised supplier located in close proximity to firms in that field create sort of a symbiosis that is the essence of clustering.

We see also the tendency for related products and related industries to be co-located. In the case of Boston, we not only have biopharmaceuticals and biological products that make them up, but health and beauty products often drawing off of life sciences technology; skincare products and other products. We see a surgical instruments, medical equipment; all of these things are co-located. And of course we also have some great teaching hospitals that are providing healthcare services so we have the demanding customers located in Boston as well. The specialised capital providers and then there's all the other institutions that are part of clusters. Clusters are not just commercial firms. They're not just for-profit firms. Clusters also include – often the best, deepest and most vibrant clusters include educational institutions, specialised research programmes, think-tanks, specialised training of courses, all of which are tailored or specialised to the particular field in question. All of these things –

Question from the audience: “What's the geographical radius of that cluster?”

Professor Porter continued

This cluster now extends out to Route 495, so that would be about a thirty-mile, thirty to forty-mile radius. I'm going to answer this question, but only this one, because we'll never get done if I take any before. We find that actually if you're within a day's drive, you're close enough to be

part of a cluster in many cases, because a day's drive gives you the opportunity for regular, easy, efficient, personal human interaction and that interaction and that easy to and fro between companies and their suppliers and their educational institutions is what really creates the dynamism of clusters.

Why are clusters important? They are important because they create a more productive environment in which to do business. Yes, a Massachusetts biotechnology firm could go to a New York law firm and get their legal services. But that's less efficient than if there is a very high-quality Boston law firm that's a real expert in their business. Yes, a Boston-based pharmaceutical company could buy its medical equipment or its laboratory equipment from a supplier in Germany. But other things being equal, it's more efficient to have that supplier right there. Not only because you get better service and more responsiveness in terms of dealing with that supplier, but you can actually work jointly with that supplier, that local supplier to develop the next generation of laboratory equipment, whereas if you're dealing with a faraway supplier who has their research and headquarters somewhere else, you don't have the same opportunity to create the kind of synergistic interactions that really are crucial to competitiveness.

The concept of clusters is puzzling to many because it seems to fly in the face of all the trends in competition. You know, we are assaulted with the idea that we're in a global economy and we are. We have this revolutionary new communications and information technology which allows you to move information and goods and services very easily across borders. What – how could clusters exist? Why don't we see everything spread out? And the answer is a bit of a paradox. But it's quite simple once you actually grasp it.

The answer is that anything that a firm can access from a distance is no longer a competitive advantage. If you can access a machine from Germany, so could anybody else. If you can access components from Portugal, so can anybody else. If you can get information, the relevant information over the internet, so can anybody else. So what's happened ironically is as things have globalised and it's easier to move people, goods and services around the world and information around the world, location has gotten more important, not less, because the only competitive advantages that remain come from unique relationships and unique access to information and people and unstructured knowledge and interaction and partnerships and relationships that are almost inherently locally-based.

See, and as we look at the data on how economies are developing, we see an increasing tendency for clustering to be more pronounced in this new global era than it was in the previous less global era. Europe is actually a great case in point. In Europe, where there were lots of barriers to trade and investment and information flow, every country had all the industries. The clustering was not nearly as pronounced. But now as things have opened up, we see an increasing tendency for specialisation. Only the most productive locations actually win and persist and they grow and get even bigger. So economies get more and more specialised around areas in which that region can develop unique expertise, where that region can develop the clusters that are deep and have the infrastructure and the skill base and the technology base that allows them to be unusually productive.

Again, I don't need to talk to you about the city of London. This is a schematic of some of the pieces of this cluster [reference to power point slide] that we're in right, physically right now as we speak, and it's a classic example of a cluster, but what I want to just emphasise here is this city of London is not unusual. It's a very vivid example of a cluster. It illustrates very powerfully the advantages of proximity and co-location as was already described, but this is not a unique phenomena. This occurs throughout the economy; all kinds of industries work this way, not just the city and not just biotechnology, but virtually all kinds of industries in the economy.

Now, there's another interesting phenomena that I want to briefly talk about that is underlying this process of productive competition in metropolitan areas and regions, and that's what we call institutions for collaboration. We find that there's a proliferation now, particularly in the most advanced economies of which the UK is certainly one, of institutions that are neither firms nor government agencies nor universities. There's kind of a whole class of firms that fall somewhere – entities that fall somewhere in between. I've just given you some examples. They're chambers, professional associations, alumni networks, industry associations, etc. And what we find is that in this modern knowledge-based competition, which is based on a lot of skill and a lot of R and D and technology and information flow and networking and so forth, these institutions become critical glue that facilitates the relationships and the exchanges that underlie the whole phenomena of clustering.

So if you would look at a region like Boston in life sciences, you would find dozens, literally dozens of organisations, the medical – Mass Medical Devices Association, the Mass Pharmaceutical Association, the Hospital Association. All those organisations are part of the

cluster and they play important roles in facilitating joint activity among their members and connective relationships among the various pieces of the cluster. I find that these organisations are relatively less dense in the UK. That's been my experience, relative to the US and a few other regions in the world. I think that's a reflection of the fact that in the UK there's tended to be more of a top-down focus of economic policy. It's been very centrally directed out of the national government in London.

It's only recently that we have the RDAs, that we have an attempt to decentralise and disperse economic policy thinking and initiative at the local level. I also find that the business community in the UK still has not yet stepped quite as far as it might in terms of getting engaged in economic development relative to what we see in some other countries. Again, I think that's a reflection of the history, the fact that the government was so much the dominant force and I think – but we're now seeing some increasing animal spirits on the part of companies that they can play a role, they should play a role. And I think this area of dealing with economically distressed communities is a very important test case in which we build kind of new roles for business in the whole process of economic development.

Traditionally, economic development has been thought of the role of government. Businesses have viewed themselves as consumers of economic development, not as producers of economic development, but I think the whole concept of clusters suggests that every firm has a stake in the quality of its cluster and in the quality of the business environment in which it operates, and that those local advantages or disadvantages are going to be really important to its competitive success. It's not just going to be successful or fail based on what it only controls. It depends inevitably on the environment in which it operates.

Now I really have already made this point, but another very important new line of thinking in economic development, believe it or not, thinking and research is aggregate units like nations, when we think about economic development and drive our thinking down into sub-national units, like cities and even inner cities. Why is that? Because if you look at that diamond, if you look at those elements that create productivity, the quality of the inputs, the quality of the customer and so forth, those key areas are not necessarily national. In fact, they vary dramatically from location to location, even within a country of the size of the UK, not to mention something like the US, where we have tremendous differences across locations in terms of the quality of the infrastructure, the quality of the skill base, the nature of the customer and so forth.

So as we understand competitiveness more, we understand that certain things need to be set at the national level, certain rules, certain policies, but most of the action actually is not at the national level. It's at finer levels of geography, and that's another reason why we need cities and regions to take more ownership of the process of economic development, because unless they do, we're going to be left with a national government setting broad cost-cutting policies that often are not going to address the real needs of a particular region. Moreover, the decisions that are made by the national government about where to put capital, where to build roads, where to build the infrastructure, will not be well-informed by a deep understanding of the real characteristics and conditions of the local economy.

You know, there was a time when we thought economic development was mostly driven by macroeconomic policy and building roads and transportation infrastructure. In that world, perhaps the central government could do it. But increasingly in a world of knowledge-based competition, where you need to create these dense clusters, where you need very specialised skills, where you need very specialised research capability, the central government can't sit back here in London and figure out what to do. They desperately need to give up more authority and responsibility, drive it down to lower levels, and that process is underway in the UK, but again I think it's actually one of the disadvantages of the UK competitively.

Germany, the US, other parts of the world I think have put more focus historically at the regional and local level in economic development. The state governments, the local governments have had more power, more clout, more authority, and I think that is one of the key reasons why some of these areas have been more competitive. You also see the really exciting progress in some parts of India and China and again it's not India and China as a whole. It's where you got a very locally focused effort in Shanghai or in Uttarpradesh. That's where the vitality is being generated, not by setting national policies that affect the entire region.

All this suggests that we need *one* London badly. We need – London needs an economic strategy for itself. That economic strategy needs to be built based on productivity. Some parts of that economic strategy are going to be based on how – on general business environment conditions and let me join the chorus of votes about transport and physical infrastructure. It is a huge competitive disadvantage, not just for London, but for the whole country. There's been decades of under-investment in physical infrastructure, as well as scientific and technical infrastructure by

the way. However, London needs – and so some of those things are going to apply to London as well.

But increasingly what we're understanding is that to look at London and develop an economic plan for London, we need to understand the clusters in London, the areas where London has built a critical mass of competitive depth and capability and clusters, and we need to understand what are the constraints in each of those clusters. What will allow them to move to the next level of productivity; what's holding them back; is it skills; is it science; is it regulation; just what is it? That's the process.

Now, a couple of other quick points and I'm going to run out of time if I'm not careful. When we look at a metropolitan area or a regional economy, there's also another critical distinction we have to make in our thinking and that's the distinction between what we call traded clusters and local clusters. If you look at say the London metropolitan area, what you're going to find is that some of the businesses in the London metropolitan area are basically local businesses. They serve almost exclusively the local market. Their demand is local, and if we go to any other region in London, we will find those same clusters. An example would be restaurants. Restaurants is a local business. The needs – the restaurant serves people that, most of the time, you know, people that live there. What we find is that if we use statistical techniques to sort out industries in the economy based on the evenness of their distribution across regions, it actually turns out that about two-thirds of all the jobs based on US data are local. They are basically evenly – those particular industries are evenly distributed across the economy.

The other industries as we see in a given area are the traded industries. These are the industries where the demand is not just local, but where they're competing to serve markets nationally and international. So for example financial services is a traded cluster. It's not just serving the needs in the local area; it's serving needs of firms all over England and all over Europe and all over the world. And it turns out that the traded clusters account for at least, based on US data, about a third of the jobs.

So when you think about a metropolitan area economy, you've got to think about these two pieces. The traded clusters, as you see on this chart, actually have much higher average wages. They have higher wage growth; they have higher productivity; they have much higher levels of innovative activity than the local clusters. But they're both important. And the local clusters

account for a big chunk of the jobs. But the local clusters can't be vital and healthy unless the traded clusters are vital and healthy. The traded clusters are kind of the engines of the regional economy or the city economy. The local clusters benefit from the success of the traded clusters, but if the local clusters are inefficient, they then feed back and make those traded clusters less efficient. So there's a symbiosis between the two, but what this analysis suggests is that when we look at a region, we have to be particularly careful to look at those traded clusters.

What are those products and services that we produce here that we're actually exchanging with other parts of the country in other parts of the world? And we see a tremendous specialisation across geography in terms of which particular set of clusters a particular region is in. Again, there are mounds of data on this. I don't have time to get onto this. It's the same in the UK.

If you look at different regions in the UK, you see tremendous differences and mix of the economy, the trading part of the economy, and those differences are both striking and important to understand how regional economic development takes place. That's the general picture. That's sort of the – some of the basic learning about the competitiveness of regions as a whole.

Now what we need to do is we need to ask the question of OK if that's how we think about competitiveness in general throughout the metropolitan area, how do we think about the inner city part, the parts of these metropolitan areas that are economically distressed?

Often located in the urban core, in more traditional neighbourhoods that have lost their vitality over time. I initially got interested in this question of inner cities and inner city competitiveness and distressed communities because in the US of course a huge part of our poverty, proportion of our poverty is rooted in urban areas and in certain neighbourhoods in those urban areas. And as you look in cities across the US and look census track by census track, there tends to be groups of contiguous census tracks where the poverty really concentrated. And there's been a tremendous concern in the US and in many countries where this phenomena exists about what to do about that, because here we have a very prosperous place like the UK or London, or a very prosperous place like Boston, but yet within this very prosperous place we have a very poor place, and there's been a lot of concern about that for a variety of reasons, not the first of which is just simple equity. Not wanting to have any citizens left behind.

And so there's been a whole history of efforts to deal with distressed communities and this is the topic that we became very interested in because as the work on overall competitiveness started to be more and more explored and applied, there were these areas that were being left behind. So how do we think about those areas? Well, the first major thing that I've already mentioned is that we've got to think about those distressed areas as economic issues, not just social issues.

Fundamentally we found over and over again that it's the lack of accessible jobs and business activity and business vitality that is really at the root of most economically distressed communities. And what we also concluded was that you can't just expect that you can create jobs in some areas of the metropolitan areas and then the people that live in the distressed areas will find their way to those jobs. That was often the traditional view in the US, that the jobs were going to be created in the suburban areas or in the central business district and the people – and the challenge was to get the people in the distressed areas to get to the jobs that were going to be in the other areas.

Well we found that that didn't work, that if you're expecting people in a distressed community to get physically to jobs located in some other community and to compete with workers based in those other communities, that doesn't work. So we concluded fairly quickly that we had to tackle the problem head-on. That is, rather than think about creating bussing companies to bus people from inner cities to jobs somewhere else, we had to actually deal head-on with the issue of how can we create a healthy business base actually in the inner city itself, where people don't have to drive, take a bus for three hours to get to work or where they don't – where they might even be able to walk to work. And in order to build a healthy economy actually in inner cities, we found that we had to approach that with the same basic competitiveness perspective that I've just been talking about. We had to find a way of understanding how businesses could be genuinely sustainably profitable in inner city areas.

Now, that was, you know, I think initially viewed as kind of a hopeless task. How could you have competitive advantage in an economically distressed urban neighbourhood? You know, that I think, when this work was initially discussed, was viewed as crazy. But actually the more you think about it, and if you take off your blinders and your perceptions of these areas that have grown up over time because of crime, because of other signs of social distress that are often very evident in those communities, we actually discover that if we apply competitive advantage thinking, we can find a role for these areas in the overall economy.

As we looked at US cities and I think what we found in the UK as we've applied this is the same basic principles apply; when we look at urban areas, distressed urban areas within cities, we see four potential competitive advantages to build on. One is strategic location. We find that many inner city areas, many distressed areas, have close physical proximity to markets, to other areas that are major markets for the product; they also often have close physical proximity to infrastructure, to railroad networks, to other transportation networks, airports and so forth, and by taking advantage of that strategic location we can build a viable and healthy business base in fields that depend on that competitive advantage. We found that inner city areas often had pools of underemployed workers, workers that could – were available and accessible, who could be employed in a more gainful way in overall tight labour markets.

You know, we face in many of our advanced economies in the world a kind of ageing labour force; the number of new entrants to the labour force is relatively low; labour markets are getting tight; population is ageing, and increasingly we find that businesses have to seek out new pools of employees. And in many countries the new pools of employees are minorities or immigrants who are often concentrated in these economically distressed communities, but yet have lack the access and the pass of getting into the higher level employment base. So that was another competitive advantage. If we could find businesses that depended on that kind of workforce, that could utilise that kind of workforce, we saw businesses that could be successful. We see the opportunity in inner cities to integrate with a city or regional business cluster, so for example these areas that were previously mentioned, that are abutting the city of London, how could we get those areas to build strategies around producing the kind of goods and services that were consumed nearby in the city of London.

How could we integrate these areas with often very nearby concentrations of employment and economic success? Typically cities have major financial centres, cities have major healthcare delivery centres, hospital complexes, cities have universities. All of these are major economic engines; cities have major tourism attractions. How can these distressed urban areas be integrated or connected to the economic engines that are often very close by, often next door. We discovered that as an opportunity. And finally we found a kind of a puzzling, initially puzzling result, and that is that often in inner cities there were markets that were not being served. There was a lot of people that had some purchasing power, often some very dense purchasing power,

but they were being ignored, because the average incomes were low and therefore people thought that there wasn't a good market.

And we were able to document in the US and I think the same was true here, that often these dense urban neighbourhoods, even if they have low average incomes, can be very, very attractive markets, often under-served by retailers and other service providers who have kind of overlooked the opportunity. So the basic principle here is that if we're going to address economically distressed communities, we have to view it as an economic issue. How do we create a viable competitive business space?

To create that business space we've got to apply the same basic competitiveness thinking that needs to be applied when we look at the city of London or the UK as a whole, and if we're going to apply that thinking we've got to think in terms of what are the potential competitive advantages in the business environment and these are some of those potential competitive advantages that could be built upon, and then what are the clusters that depend or benefit from these competitive advantages that could be developed. That's the kind of chain of thinking. That sounds pretty obvious, but if you actually look at the history of economic development efforts around the world in these kind of communities, you'll find that that's very, very different from the trajectory that was taken.

The trajectory instead assumed that these areas could never be competitive, viewed it as fundamentally a social issue and the approach to developing business activity was subsidy, and real estate projects to try to tempt businesses to come to areas where they didn't really want to be, rather than turn the question around and ask the question of OK what are the inherent advantages that might make a business want to be in this particular area. And then how can we deal with the problems in the business environment that may be holding back those market investments that would otherwise be made. So when we work in the ICIC or inner city initiative on a city, apply this kind of thinking, the first step is kind of understand the potential advantages, the clusters, but then of course we have to address the weaknesses in education and training and infrastructure in other areas that often hold this potential back.

Now, we went through – we have a process in the inner city initiative of identifying rapidly growing inner city-based companies. These are companies actually based in economically distressed urban communities. We do this because we found that one of the biggest barriers to

further progress in inner city economic development was perceptions. If everybody thought that these areas were hopelessly uncompetitive, why would any company ever want to invest? Why would any company ever go look for a supplier in these areas? Why would any company go look for a market in these areas? So one of the major barriers historically to economic revitalisation in these areas has been perceptions. To address those perceptions we created this idea of the Inner City 100.

Let's go and look in these areas and find high-growth companies and see if they exist, and if so let's create a list, let's create a ranking, let's publish it, get it out there and start to shift the perceptions. And we started in the US with this project and now it's been spread to the UK. And we actually now have gone through two UK Inner City 100s, and I thought you might be interested just to see some of the overall metrics. The top 100 inner city companies in the UK in terms of growth had an average five-year growth rate of 503%. That's pretty good. These are shooting stars. These are very rapidly growing business. Their average revenue is 6 million pounds as of the 2002 list. They have about 64 employees. They've created a lot of jobs.

So I think for any of you that are sceptical about the ability to build successful high-growth companies in economically distressed urban areas, hopefully this statistic, these data, these companies actually dispel that perception. And as we developed this program further in the US, and I'm sure the same thing will happen in the UK, we find there's actually more and more companies. We start out with 225 nominations for our list; five years later we have 5,000 nominations for the list. The average growth rates are going up and up and up as more companies hear about it and nominate themselves, and as we learn more and more about these inner city companies, we find that the mayors and the other organisations that never really thought in business development terms and entrepreneurial development terms all of a sudden see that there's a reality here that they can hook onto.

It's interesting that when I started my work on inner cities I thought that we were at best going to create a situation where inner cities could maybe catch up with the rest of the economy. That was sort of the dream; if we could overcome the disadvantages and build on the strengths, maybe inner cities could somehow have a future. The more we have gotten into inner city economic development the more we've seen that inner cities actually may be not just in a catch-up situation but they actually may be really a mirror into where the economy is going, not where it's been. Why? Because so much of the urban inner city revitalisation effort taps into the notion of kind of just in time in physical proximity, which is one of the major trends in the way businesses are

organised. You know, businesses don't want a delivery once a day. They want deliveries four times a day. Businesses don't want service tomorrow, they want service now.

And so we find that in a funny way, the value of the urban location is going up, rather than down. We find that in growing tight labour markets, where conventional workforce pools are getting tapped out, we find that the inner city represents the place where kind of the new segments of workers exist, and so it's not just about dealing with a social problem, it's businesses and learning about the kind of employees of the future; how to find those employees, how to train those employees, how to assimilate those employees into their workforce. We see some of the most vibrant clusters in the economy that are growing the fastest, being actually quite deeply rooted in cities.

Education, entertainment, healthcare, financial services, these are areas that are going to be growing for years and years to come, and yet they're inherently tied in many cases to cities and urban concentrations. So I think the message here is that cities actually represent very viable economic competitive locations for the future.

There was a time when we thought that cities were obsolete, that you know, cities were a dinosaur, that they wouldn't work, that globalisation was rendering them irrelevant, that it was really about suburban spread and inner rings and outer rings and all that sort of stuff. Now I think we've seen that the city actually is getting more and more valuable in the modern global economy as the economy becomes more service-oriented and knowledge-oriented, skill-oriented, technology-oriented, and so the challenge is to hook the inner city distressed neighbourhoods into this opportunity, and that opportunity is growing.

You know, I've had many people ask me, 'you know, I understand the equity arguments for inner cities, but why do we really care if distressed inner city areas do well? You know, why as a business should I care?' And I think what we found is that yes there's a major equity issue and that would be enough to focus efforts on inner city revitalisation. But there's also some economic efficiency reasons for focusing on this agenda, having to do not only with better utilisation of our infrastructure and asset base, avoiding urban sprawl, better utilising land and transportation infrastructure, but also creating a higher level of efficiency for industrial activity. You know, it just isn't efficient to have a service provider located way, way out, thirty-five miles from London, fighting their way into traffic every day to serve their London customers. That isn't efficient.

It's much more efficient in a service and delivery-related business to have that business located right in the urban core. And by sort of ignoring these areas and not thinking of them as important to the economy, I think we've given up efficiencies that are very important for cities like London and others.

So I just want to emphasise how important it is for all of you here in the private sector to kind of address this issue. It's not just an issue of social equity. It's an issue of actually of economic efficiency and utilising the workforces of the future and organising industry in a more efficient way.

There's kind of a meta-point here which is that I think we have tended to see economic policy and social policy historically in two different categories, and I think what hopefully I have been saying so far this morning suggests to you that there's an increasing interconnectivity between social and economic issues and we need to start seeing them as integrated and in a holistic way, rather than treat them separately.

Now the City Growth Project, City Growth Strategies Project is kind of an exciting opportunity to test some of this thinking in a variety of UK areas, geographic areas. It's a partnership between the organisation that I founded in the US, the ICIC; Initiative for Competitive Inner City, quite a mouthful, and the Small Business Service, nice crisp name. It's a pilot project; it was launched in January of last year and as you've already heard there are four areas of London that are participating and three other cities that you see on the slide. And what we've been trying to do in that project is actually bring together the players. Those types of players that I've been describing are necessary, private sector players, NGO type players, city government type players and others to kind of consider how to develop an analytical understanding of these communities and then how to build strategies that harness the advantages, create the linkages and connections that I was talking about. And then bill consensus on all sides to implement.

This effort is well underway and I think it's been – it's producing some very interesting results. This is not the form in which we will present the results of that project, but I do want you to keep very closely attuned to how that's progressing. I think we have here an opportunity to test out this perspective, this model and then very hopeful that we can make it a success and then it needs to be spread much more widely. I want to conclude by just stressing again how economic development has shifted in terms of what all the kind of people in this room need to be doing.

Again, traditionally, economic development was the job of government and perhaps some community-based organisations that were closely related to government, whose job it was to worry about the community as a whole. Now, as I've stressed, economic development is inevitably a collaborative process involving multiple constituencies and it's a process in which the private sector has fundamental roles and a fundamental stake.

All we've learned about clusters tells us that a firm's competitive success is not just contained within that firm. The firm is not successful solely because of the decisions it makes within its own borders, within its own boundaries. Firms have a stake in the health of their cluster, they have a stake in how good their local supplier base is. They have a stake in how good their local skill base is, because if they have a good cluster, they can operate more productively. So we found that firms have a critical role to play in economic development.

Now, it's been harder for firms to see that they have a critical role not only in generalised economic development for their region, but also in the inner city. But I think a growing number of firms are starting to realise that they have again a big stake in the success of the inner city as well and an opportunity to gain advantages and benefits from a corporate point of view in pursuing this agenda. We find that many companies in the US are increasingly seeing the inner city as a business opportunity, like the Lloyds TSB case, where if there is successful business growth in inner cities, Lloyds TSB has more clients.

If there's a success in stimulating better income and homeownership in inner cities, then mortgage societies and home insurance firms have a better business. Firms I think are increasingly seeing that healthy inner city economies are one of the last ways of opening up under-served populations, under-served markets. And those markets are right at home. You don't have to diversify and internationalise to tackle those markets; they're right here. So shouldn't we be focusing more attention on opening up those opportunities?

We're seeing more and more companies recognising that inner cities can be good supplier bases, that instead of outsourcing or seeking suppliers in distant locations which are hard to manage, which involves substantial logistics, looking for nearby local suppliers, working with those local suppliers creates a win-win opportunity. So I want to just suggest that all of you in the business community here not only step up your overall role in economic development, but you see increasingly that the inner city matters to your company.

This leads to kind of one final comment I want to make and that is, you know, the role of corporate philanthropy. I think that many companies today are pondering the question of corporate philanthropy and corporate social responsibility and what role should they be playing in their community, and I think we're undergoing another major transformation in that realm as well. I think historically when companies have thought about what they should be doing in their community they've seen it as primarily a social issue.

You know, what are the important social problems in our community, and then how can we give some money or volunteer some people to help and benefit our community? And I don't want to demean this activity at all, but we have trained, you know, PhD engineers building houses or cleaning up trash or teaching young people to read, all of which are good things to do, but those don't harness the power, the leverage and the skills of the corporation to really address the areas of the community's needs that corporations are best positioned to address.

Companies are best positioned of all the institutions in our society to help revitalise the economies of their communities, and I believe very strongly that much of corporate philanthropy should be directed at this issue of economic development, and inner city economic development in particular, because this is an area where all of you that are here in corporations can really add value, because you understand business, you understand how to start business, you're a major purchaser of goods and services, you can help companies get going, you're a supplier, you could work with emerging customers in inner cities and help them get going.

So I think we have to start kind of redefining the way we think about this whole set of issues and in particular I think many companies need to think about their roles in a different way. Well, I've taken all of my time, but I really would like to stay a few more minutes if all of you are patient enough and address a few questions. I know there'll be some questions, but I do hope that first of all that all of you continue your commitment to this work. This is extremely important.

The greatest problem we have in our country is inequality. The greatest problem we have is that everybody is not sharing in the prosperity, and that is a corrosive problem that will ultimately undermine all of our standards of living, and it just isn't fair. So we have to find pragmatic and sustainable approaches to address that problem and I think the discussion we've been having today is right on point. So thank you very much and let's take a few questions.

Amanda Jordan OBE, introduces question & answer period

Thank you so much, Professor Porter. That was really fascinating and you've been incredibly generous with your time and we will take you up on your offer and I know we've had one or two questions in advance, so I'm going to go straight to Stephen Pegge from Lloyds TSB Business.

Stephen Pegge, Head of External Affairs, Lloyds TSB Business

First of all, thank you very much. That was absolutely fascinating. One of the things I've been particularly interested in is what you consider to be the role of small scale enterprise in regeneration and respective roles of business support against regulation, deregulation, enabling that in a city?

Professor Porter response

Well, that's a big question. I think what we've learned actually is that the role of smaller scale businesses is growing, not shrinking. I think the data is quite clear; the big guys are shedding jobs in large numbers. They're outsourcing. What we're finding is that the efficient organisation of industry is not the large vertically integrated firm. That may have been true in a previous era with previous levels of technology and previous ways of doing business, but today we find that increasingly you want to have a network of relatively small firms who are specialised, who are dynamic, who are responsive, who you can recombine in different ways to provide goods and services to partner with and so forth.

So I think small scale business has a growing role in the clusters that I was describing. Many of the players in the cluster are small- and medium-sized enterprises, and the more specialised and focused those firms are the better for the cluster, because of course the cluster then gets more specialised services and more specialised skills. As for the relative role of deregulation versus business support, you know, I think that, you know, if you just reflect on the UK and on economic development in general, I think we found ourselves, you know, a decade or so ago in many countries with an overbearing role of government. You know, government had just gotten too involved in the economy, was trying to manage the economy, was heavily involved in the economy and the UK was Exhibit A.

I mean, the UK government was just deeply involved in everything in the economy. I think for the first level challenge then was to fix that, to just get the heavy hand of regulation and detailed, you know, minutia off the table, and I think that happened in many countries; many countries

found that they needed to lighten the hand of regulation, focus regulation more on areas that were truly areas of social concern like the environment and so forth, get out of setting prices, get out of affecting lots of business decisions. That was a logical step.

But what I think that that doesn't mean that government has no role in competitive success. Government has a fundamental role in first of all creating the right environment of incentives which are aligned with productivity; the right tax policies, the right incentive structures. Government also must make certain investments that businesses can't make; investments in basic assets that all firms or many firms draw on; investments in skills; investments in technology bases; investments in physical infrastructure; investments like that. And I think it's the area of these business investments that is where is now the current frontier in the UK.

I think the UK did a good job of deregulating, making things relatively efficient, simplifying, opening, all that, that was done very well. The challenge in the UK now is these investment deficits and the crappy roads are just kind of step one, you know. But there's a deficit in science and technology; there's a deficit in skills; there's a deficit in a lot of the investment areas and I think the government recognises this and you do see the numbers starting to move in the right direction and I think we all need to kind of keep encouraging that activity.

Linda Houston, Pool of London Partnership

I have a particular question I'd like to ask you, Michael, in terms of clusters. Most of the research that we hear about has been very much based on regional and national economies, like clothing and [] and so on. But what we're interested in is how you can see the revitalisation of inner cities relating to that theory, in particular the development of clusters in small sub-regional or local economy areas, which is what we're looking at. So [] think the reaction [] and if so are there any examples in the UK that you might like to share with us?

Professor Porter responds

Well, yes I do think one can apply the same concepts, and again, you know, you all see it every day. I mean, there's one district of the city where all the furniture stores are. That's a cluster. You find these things, they permeate economies.

When you're talking about regions like London, or countries like the UK, we're talking about clusters that are trading and competing with other similar regions, so a cluster in London might be

serving other parts of the UK. When we're thinking about the inner city, we have some of those. There'll be some clusters in inner cities that are serving the entire UK.

But more often than not, we find that inner city clusters are actually serving the regional market and there are certain things that are efficient to do in the inner city to serve the rest of the region and other things that are efficient to locate in other areas. So I think you can apply the same basic thinking at smaller and smaller geographic units, but when you get down to very small areas, like inner city areas, often your clusters are really not trading with other metropolitan areas. They're really providing services to a given metropolitan area. So that would suggest for example that if you're going to have a logistic and wholesaling cluster in your – in the city of Boston or in the metropolitan area of Boston, that would probably be very efficiently located right in the heart of the city, near all the transportation hubs, than way out in some suburban location, you know, forty miles from the downtown.

That transportation logistics cluster is primarily serving the Boston metropolitan area, but it's located in the most efficient place within that area. And what we found is that the neglect and various kinds of policy mistakes have tended to create an inefficient spatial location of industry within metropolitan areas and that is what we're talking about redressing with this way of thinking.

Dame Judith Mayhew Jonas, Deputy Chair of the London Development Agency

Would you outline for us some of the more imaginative tax regulations which have supported city growth strategies in the States?

Professor Porter responds

Well let me start with the ones that don't support it and then we can move to the more imaginative positive ones. You know, I think the first round of thinking about getting business development in urban areas and distressed areas was, my God, these areas are a cesspool, you know, nobody here can hold a job, so the only way we're going to get business in these areas is we're going to have to provide massive subsidies. Come here, we'll give you a cheque. Come here, you'll pay no taxes. We have found that that almost never works.

If the only reason that somebody is locating in an area is because they're getting a subsidy, then as soon as something goes wrong or as soon as the subsidy ends, they're gone. So we have lots of abandoned buildings in US inner cities that were created based on that model. That doesn't work.

A more positive approach is to – rather than have tax rate reductions on kind of annual tax payments, a more promising approach that is starting to work is to actually have capital gains relief. That is, if you make a business investment in a firm or a location in an inner city, and that is actually valuable enough to appreciate in value and you want to sell it someday, you don't pay any taxes. So basically the reason that capital gains relief is better than operating tax subsidies is that the capital gains relief isn't useful unless the business is valuable.

See, what you want to do is you want to align the tax structure with true competitive advantage and true profitability, and I've been an advocate for some time and we now have been making substantial progress in creating these kind of zones in which you get capital gains tax relief.

One other, I think, innovative thing that I've seen quite successfully pursued in a variety of areas is something that goes under a variety of different names, but one of the names that's most common is business improvement districts. I don't know if you've heard that phrase. The idea is you actually provide a legal taxing authority of a given commercial zone or business zone which requires that each of the businesses located in that area pays a little bit of a tax. The reason you need legal authority is for the free-rider problem. You don't want people to be able to opt out. You want everybody to have to pay. And then that money is pooled and used to provide superior improved local services in terms of security, cleanliness, infrastructure upgrading and so forth. And so essentially it says that businesses in an area band together through this mechanism to start upgrading themselves, and in some cases you find that governments are willing to chip in and kind of co-fund those efforts as well.

So those would be some of the directions I think that are the most promising. But, you know, we're finding in the US that if people could just think about the issue differently, you often don't need big tax incentives. You know, we've discovered, we did a study with Boston [] Group – we meaning the Inner City Initiative – about, you know, six years ago, or seven years ago, and we actually found that the size of the inner city retail market in America was much bigger than almost every country in the world. And we had retailers who were saturated in the suburbs and they completely ignored the inner city market because they didn't think there was a market there.

Oh well there's a bunch of poor people living there, there's no market. But they didn't realise that there's a lot of people with relatively low incomes concentrated in a very small geographic area, and so the income density, or the purchasing power density, was very high, and they'd completely missed that.

So once you start to provide the facts and once you start to show the reality of these opportunities, the kind of advantages I talked about, often you find that the market forces produce investment without the need for any subsidies. In fact, I think pretty much every major retailer in America now that has a product or a service that's relevant at all to urban neighbourhoods now has an inner city retail location strategy, and so we're having hundreds and thousands of new retail investments back in inner cities, and they're not being particularly subsidised.

But yeah, we have a long way to go and it's a matter of, I think, through the City Growth Strategies Project engaging various groups of leaders in cities to think about the inner city in a new way, look at themselves in a new way, it's the UK Inner City 100s, that the word starts to get out that, my God there's all these growing companies in cities, wow isn't that interesting. [There is a need for] society to start to change that mindset, because, again, there's an absolutely inextricable connection between, you know, social progress and economic progress. It's not a trade-off. That's obsolete thinking; that's dinosaur level thinking. And so we all have to understand that the private sector in the market forces are a tremendous force that we can harness behind addressing some of these issues and then if companies can also see that they have an increasing role not just within their own boundary but also in their communities out of self-interest, not charity, then we'll really have something going. So I think we're now out of time.

Closing Comments by Amanda Jordan OBE

I'm sure we are. You've been very, very generous. Thank you so much. It just leaves me to thank you all for coming, to thank the One London team, particularly Reshma and Jeffrey. You've worked incredibly hard on this. To thank our sponsors again; to thank the London Stock Exchange for the rather splendid hospitality; but once again to thank you, Michael.

You've been fascinating, and our only disappointment, if we would have sat here for however long you wanted to go on, because there's been so much in that and I know you've got a very important commitment to get to, so we'll let you do that, but please join with me in thanking Michael again.

