

Microeconomics of Competitiveness

THE **Andalucía** TOURISM CLUSTER



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Executive Summary

Spain is governed by a stable parliamentary monarchy, with decentralized power among its autonomous regions. Its economic performance in the early 2000s was strong, outperforming OECD average growth. However, the global financial crisis of 2008 hit Spain very hard, rising the unemployment level to 20% in 2010. More structurally, Spain suffers from lower productivity than its European peers, despite a converging trend.

In terms of macroeconomic competitiveness, the country scores relatively well in social and political indicators, but recent increases in public deficit and debt have been worrying international investors and inflated the cost of debt. At the same time, Spain's business environment ranks poorly relative to its GDP per capita . This reflects important weaknesses, in particular in context for firm strategy and rivalry (high taxes, unproductive SMEs, etc.), and in factor conditions (low quality of specialized education, bureaucratic administration, among others). Andalusian competitiveness profile has similar strengths to the overall country, but the main challenges are exacerbated.

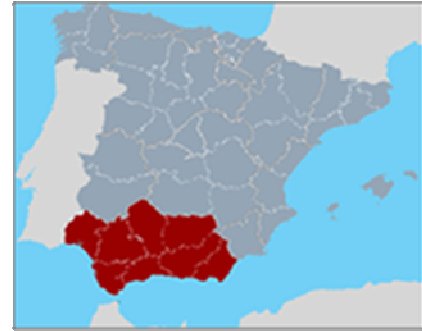
Spain, and Andalucía in particular, have remarkably strong tourism clusters. However, the majority of tourists attracted by the region come from inside Spain, focus in "sun and beach" and spend little. If the important shortcomings affecting the sector's business environment are tackled, the team believes Andalucía can attract higher-value tourists and expand tourism to new non-coastal areas, leveraging the strengths of the region (e.g., industries like wine, flamenco culture, exceptional endowments). As a priority, it will have to enhance public-private collaboration, increase employees skills and technology use and improve cluster infrastructure and regulation.

1. SPAIN AND ANDALUCÍA COMPETITIVENESS

1.1. Spain at a Glance

Spain is a country in the South of Europe, bordering Portugal and France. It occupies an area of 505,370 sq km, and benefits from a vast coastline of 4,964 km. It is home to 46.8 million people, predominantly Roman Catholic (94%).¹ Although Spanish is the official language, several regions have their own officially recognized regional language.

Figure 1 – Map of Spain and Andalucía



Source: ec.europa.eu/enterprise/ire/innovating-regions/

Spain was along with Portugal one of the first global empires, having lived its apogee in the 1600s. More recently, in the 20th Century, Spain went through a bloody civil war (1936-39) that marked the beginning of Francisco Franco's dictatorship. In 1975, Spain became a democratic nation again, joining the European Community in 1986 and the Euro area from its inception in 1999.

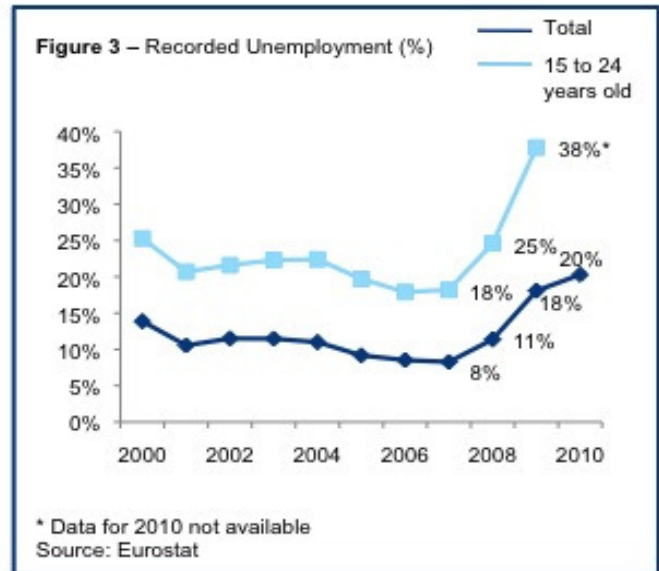
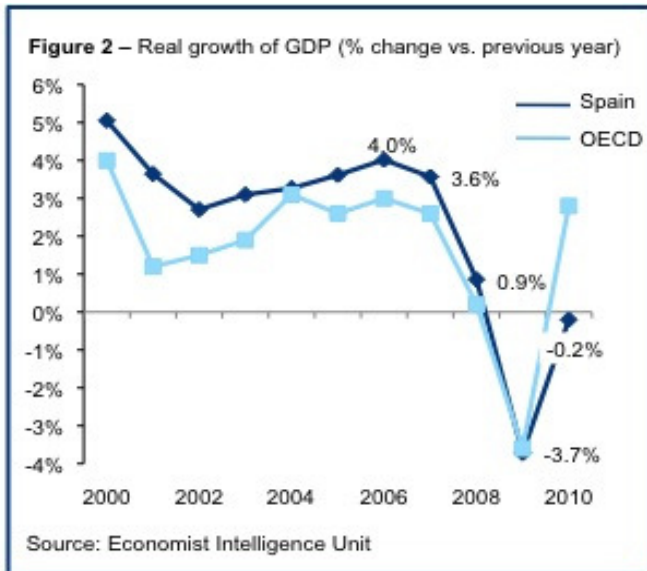
Today Spain is governed by a parliamentary monarchy, headed by King Juan Carlos I. Political and administrative power is heavily decentralized among its 17 autonomous communities and 2 autonomous cities.

1.2. Spanish Economic Performance

The 2000s were years of strong growth for Spain. It continually outperformed OECD countries, until the global recession strongly hit the country in 2008-2010. Its real GDP declined 3.7% in 2009 and a further 0.2% in 2010. This slowdown negatively affected the rate of unemployment, which reached 20% in 2010 (38% for young people

¹ CIA, "The World Factbook – Spain".

between 15 and 24 years old, in 2009). Nonetheless, unemployment in Spain is structurally high, which might be explained by the big underground economy and the extensive social safety net that reduces the incentives to find a new job. Moreover, there is a strong regional disparity, and Andalucía is one of the regions with highest unemployment rate (28% in 4Q 2010 [INE, 2011]).



The step increase in unemployment during the crisis is related to the collapse of the construction sector, which had been one of the major forces behind the 2000s growth (eventually contributing to a real estate bubble). Between 2007 and 2009, the construction sector saw employment decrease by 30% (against a national average of -7% [INE, 2011]). In fact, there seems to exist a positive correlation between overall national employment and activity in the construction sector, measured by number of building licenses awarded.²

² Team analysis based on data from Instituto Nacional de Estadística (Spain): unemployment rate (%), and building licenses awarded ('000s of m²).

As for the composition of GDP, accompanying the boom of the 2000s, services increased their share of the economy, growing from 63% in 2000, to 71% in 2010.³ Real Estate and Company Services represent a particularly high share of the services sector, with 24% of the value added in 2009 (INE, 2011).

In terms of social stability, Spain has traditionally been a fairly stable and equal country, offering its citizens a good quality of life by international standards. In 2010, Spain occupied the 15th position in UNDP's Human Development ranking, just below Sweden, and above Japan and Belgium (UNDP, 2010). As for income distribution, Spain ranks #34 out of 136 countries, using the Gini coefficient as inequality measure.⁴

However, the recent surge in the number of immigrants might be a threat to the social stability in the medium term (since 2000, almost 7 million foreigners entered Spain⁵). Moreover, given that most of those people went to work for the construction sector, the recent crisis has been particularly harsh on immigrants. Indeed, the pre-recession differential between migrant and non-migrant unemployment was 4 pp, but it increased to 13 pp in the end of 2009, a larger gap than in most comparable countries (OECD, 2010).

Besides these short-term issues, the Spanish economy suffers from a structural problem of lower productivity than its European peers, which translates into lower GDP per capita (\$30,600 for Spain in 2010, versus \$33,600 EU-15 average⁶). Although Spanish productivity levels have been converging towards EU-15 levels (from 89% of

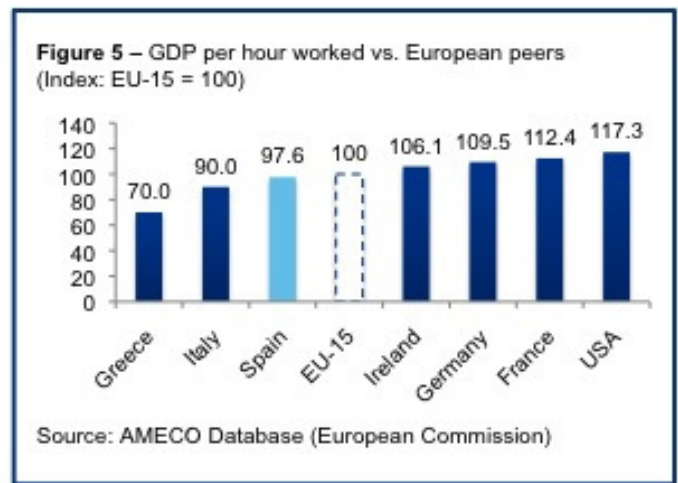
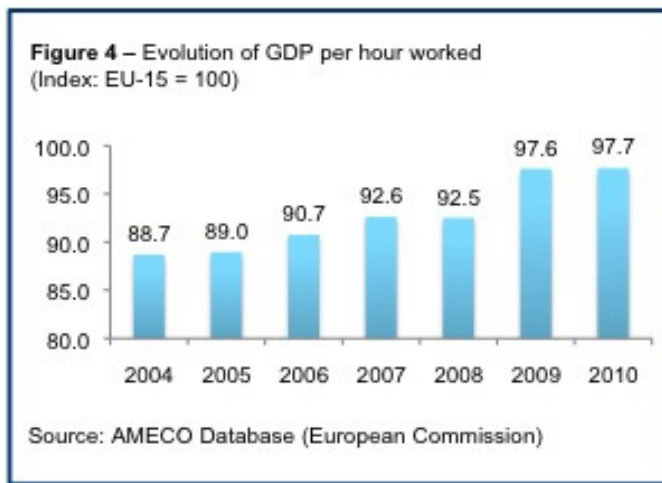
³ Economist Intelligence Unit.

⁴ CIA, "The World Factbook – Country Comparison – Distribution of Family Income – Gini Index".

⁵ Eurostat.

⁶ Economist Intelligence Unit.

EU-15 average in 2004 to 98% in 2010), they are still below comparable countries like France and Germany (112% and 110% of EU-15 average, respectively).



The lower productivity of the Spanish economy has been referred to as the “mystery of Spanish productivity”. Potential causes are (i) the failure to develop and adopt new technologies and (ii) the high proportion of small companies, which are on average less productive, as they have less incentives and capacity to invest in productivity-enhancing improvements (Comin, 2010).

1.3. Spanish Competitiveness Analysis

In this section, we will use the MOC framework, which divides sources of competitiveness into endowments, macroeconomic, and microeconomic factors.

1.3.1. Endowments

On the positive side, Spain enjoys a good location among “rich” Western European countries, which allowed it to become a full member of the European Union. Besides the significant help Spain received when it joined the Union in 1986 (not only in terms of funds but also the upgrade of Spanish economic structure and institutions), the

EU membership gives Spain stable access to the big European market. Furthermore, Spain is seen as the gateway of EU to Latin America and Africa, with whom Spain has developed important relationships, including bi-lateral agreements. Finally, it benefits from a favorable climate for tourism, agriculture and most renewable energies and boasts endowments, including beautiful beaches and natural landscapes, and cities and monuments of cultural and historical significance.

Nonetheless, Spanish endowments in mineral resources are limited, which makes the country highly dependent on imports of energy supplies (dependency rate above 80% in 2008⁷). Indeed, Spain does not have petroleum, the once-plentiful coal reserves are no longer sufficient, and its natural gas has very limited commercial potential. Responding to this challenge, the country is investing significantly in renewable energy, which represented 20.6% of electricity consumption in 2008.⁸

1.3.2. Macroeconomic competitiveness

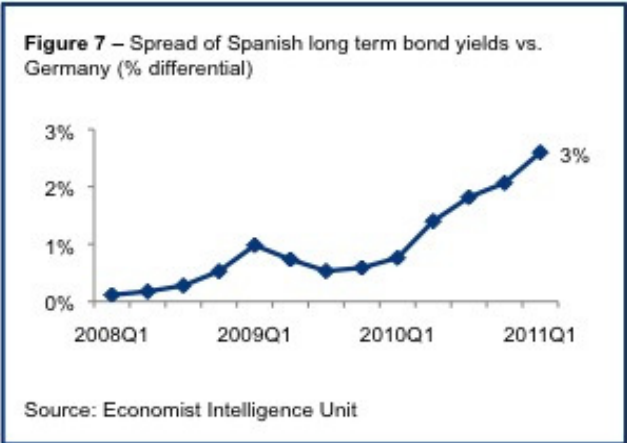
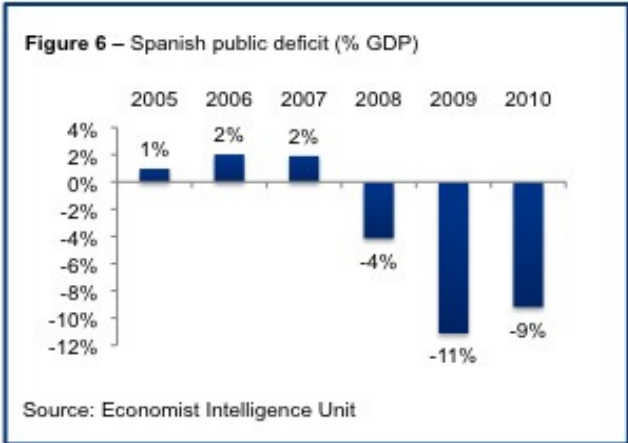
As for **Social Infrastructure and Political Institutions**, Spain scores overall well but has specific weaknesses. Its human development indicators are strong, with a human development index of 0.863 in 2010, slightly above OECD average (at 0.853). Life expectancy at birth is high, 81.3 years in 2010, and both literacy and school enrolment rates are high (97.9% and 96.5%, respectively). Healthcare is accessible, provided by public organisms (public expenditure on health amounted to 6.1% of GDP in 2010) (all data: UNDP, 2010). On the negative side, however, PISA scores demonstrate a low quality of Spanish basic education, scoring below OECD average in the three areas under analysis – reading, math, and science (OECD, 2010).

⁷ Eurostat, “Energy dependency”.

⁸ Eurostat, “Electricity generated from renewable sources”.

Political institutions are well developed and stable, with policymaking decentralized in the various autonomous regions. However, government has lately been accused of wasteful spending and lack of transparency in policymaking, leading to an increasing distrust of politicians. These trends are probably related to the recent macroeconomic dynamics (analyzed in the next section). Rule of law is fairly strong in Spain, offering a relatively safe environment, with low prevalence of corruption. However, the efficiency of the legal system is in a negative trend (ISC, 2010).

In terms of **Macroeconomic Policies**, as a member of the European Monetary Union, Spain benefits from a stable monetary environment, with low inflation. However, it cannot use monetary instruments as an economic policy tools, given that all decisions rely with the European Central Bank. Public debt was 60% of GDP in 2010, still not high by European standards (Eurozone average of 86%).⁹ However, it reveals an upward trend, fueled by a high and growing public deficit (in part explained by the lack of control over autonomous regions spending). As a result, in the context of the recent financial collapses of Greece, Ireland, and recently Portugal), investors are increasingly nervous about Spain, which is reflected in the rising cost of Spanish sovereign debt.

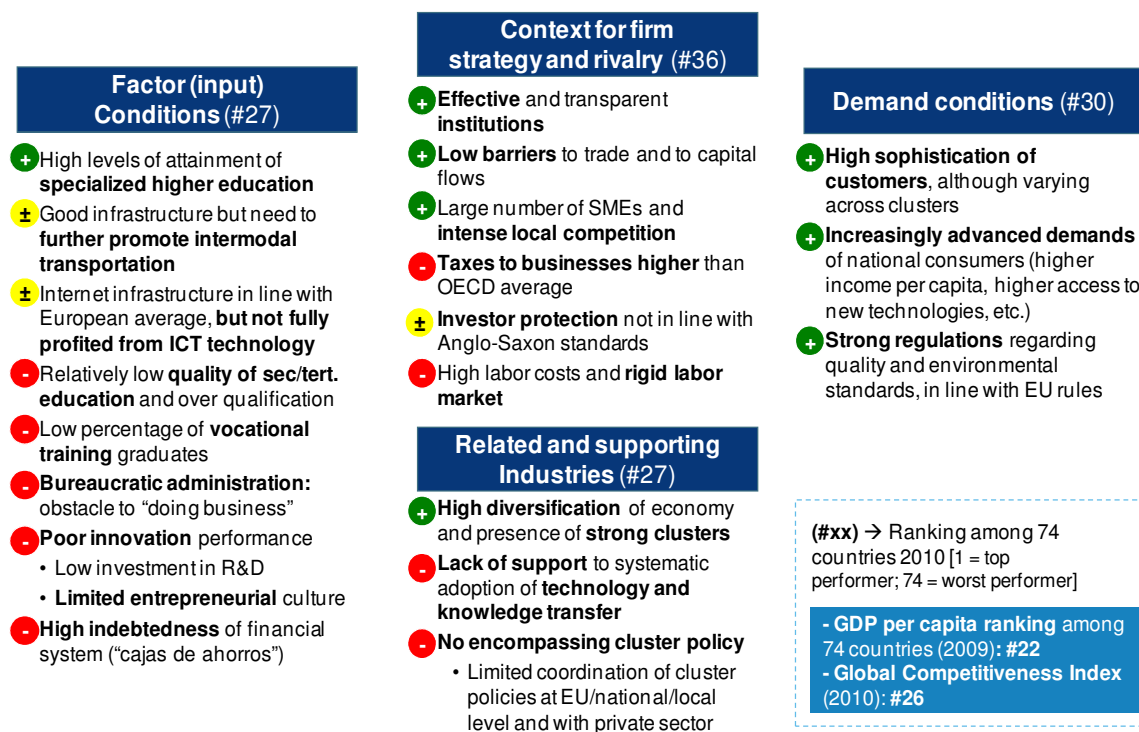


⁹ Economist Intelligence Unit.

1.3.3. Microeconomic competitiveness

In ISC's **Business Environment** ranking in 2010, Spain ranked #26 among 74 countries, while ranking #22 in GDP per capita. In fact, a deeper analysis of the Spanish Business Environment reveals important weaknesses that underlie that performance:

Figure 8 – Analysis of Spanish Business Environment and Competitiveness



Source:

Team analysis; Global Competitiveness Index (Institute for Strategy and Competitiveness)

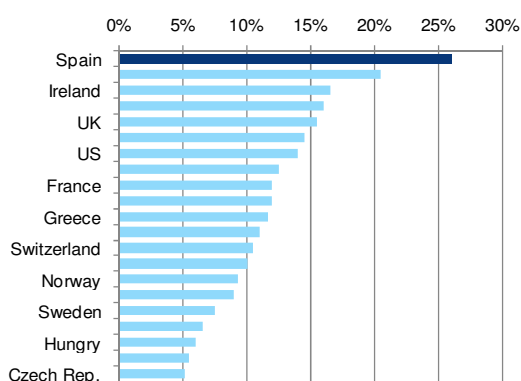
Factor Conditions Spain ranked #27 in Factor Conditions in 2010, positively impacted by a good infrastructure and high levels of attainment in secondary and tertiary education. However, Spain suffers from low innovation and entrepreneurship, a “bipolar” educational system (over qualification of graduates for their jobs and low levels of vocational training [OECD 2010]), bureaucratic administration and high indebtedness of the financial system and private companies.

Logistical and communications infrastructure: Although some improvements can be achieved on intermodal transportation and broader adoption of ICT technologies, Spain displays quite good quality of logistical (e.g., it is a leader in high speed rail) and communications infrastructures (McKinsey, 2010).

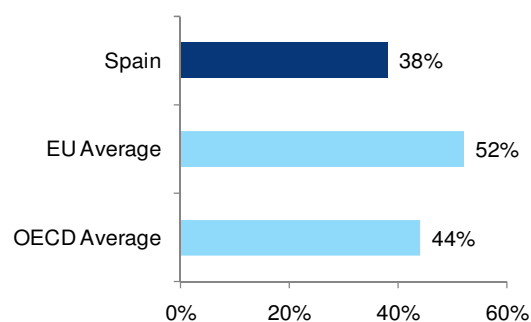
Secondary and Tertiary Education, vocational training: Secondary and tertiary education enrollment rates in Spain are high, in line with other European countries. Nonetheless, quality of education is below OECD countries' average, as revealed by the most recent PISA reports from 2006 and 2009 and by the fact that only one Spanish university is listed in the World's Top 200 Universities.¹⁰ Besides, Spain suffers from very high over qualification, while scoring poorly in vocational training attainment. Over qualification means there is a mismatch between the available graduates skills and the private sector needs, mostly attributable to a low degree of private-public coordination, between companies and universities. Vocational training has been socially neglected until very recently and still prompts a negative social stigma among many people.

Figure 9 – Education: Over qualification and vocational training.

Rate of over qualification – 2008 (% population with a higher qualification than required for their job)



Vocational training graduates - 2009 (% for selected countries)



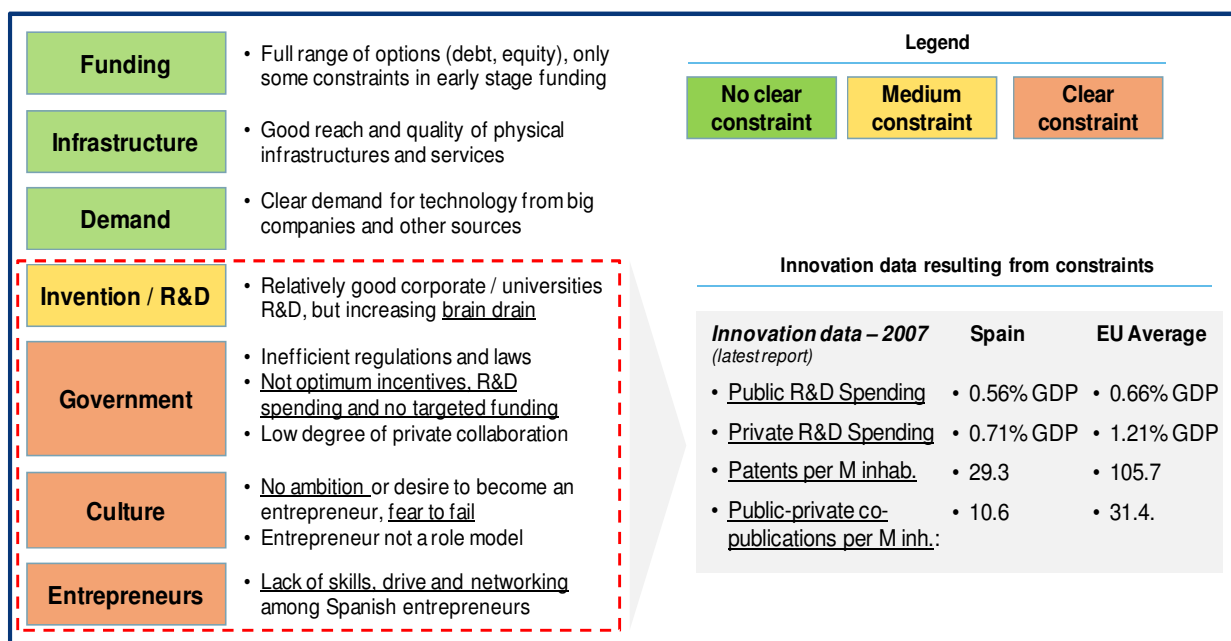
Sources: OECD, 2010. Observatorio, 2008.

¹⁰ Only Universidad Autónoma de Madrid listed in the Top 200 in 2006. OECD and Shanghai Jiao Tong University Index

Innovation infrastructure and Entrepreneurship: Recently, MIT eLab applied its innovation and entrepreneurship framework¹¹ to Spain and Andalucía (see figure 10), concluding that the main constraints for innovation are:

- *Government*: below-average spending in R&D and no clear and coordinated plan with private sector to foster innovation & entrepreneurship;
- *Culture and Entrepreneurs*: Only 20% Spanish students want to be entrepreneurs while more than 50% would like to become civil servants.¹²
- *“Brain drain”*: More than 1.3 million Spanish live abroad and 120,000 left in the last 2 years looking for better careers. However, the Spanish Diaspora could be embraced as an opportunity and used as an engine for innovation.

Figure 10 – MIT eLab analysis on Spanish innovation. Innovation data for Spain and EU Average.



Source: MIT ECAT 2010; Andalucía Económica, 2010; CERA, 2010

¹¹ MIT eLab defines seven dimensions to analyze innovation and entrepreneurship capacity: funding, infrastructure, demand, invention/R&D, Government, culture and entrepreneurs (skills, drive, etc).

¹² Survey to Spanish students in 2009. To the question “What do you want to be?”, the response was: 21% entrepreneurs, 56% civil servants, 22% employees. “Entrepreneurs” definition is Spain is usually referring to entrepreneurs who create small enterprises at a level of “subsistence” (e.g. restaurant, store)

Administrative Infrastructure – Ease of Doing Business: Spain ranked #49 in the “Ease of Doing Business” World Bank ranking, negatively impacted by a complex four-level administration (national, regional and local, as well as EU), bureaucracy at the local level, perception of low transparency and relatively high taxes.¹³

Capital Markets Infrastructure – Financial market sophistication, bank soundness: Capital market infrastructure has deteriorated due to the recent financial crisis (Spain ranked #24 in 2008, #37 in 2009, and #32 in 2010). The “cajas” or savings banks,¹⁴ which account for approximately half of Spain’s financial system, were severely hit by the real estate collapse. They had provided €500bn of loans to fund property acquisition, sprawling beyond their traditional regions, and sometimes tripling the size of their loan books in only a few months, eventually generating a housing bubble.¹⁵ The socialist government of José Luis Zapatero has accelerated the restructuring of the Spanish savings bank system this year as part of a drive to improve Spain’s credibility in the international sovereign bond markets. Caja groups have already been reduced from 45 to 17 through mergers and the seizure of two faltering cajas by the authorities.¹⁶ On the other hand, the big Spanish banks (Santander and BBVA) are among the most profitable in the world and have emerged even stronger after the financial crisis⁷.

Context for Firm Strategy and Rivalry The Spanish labor market is one of the most rigid in Europe and in the World (ranked #157 in “Employing workers” in the World

¹³ 47 days to start a business on average (vs. 14 for OECD countries). Perception of low level of disclosure. Difficult for shareholders to sue managers. High labor taxes (35% vs. 23% for OECD average). Profit taxes also above OECD average (21% vs. 17%).

¹⁴ Caja de ahorro (saving bank) is a financial institution which specializes in accepting savings and granting loans. Their original aim was to create the habit of thrift amongst the poor but they now compete with commercial banks

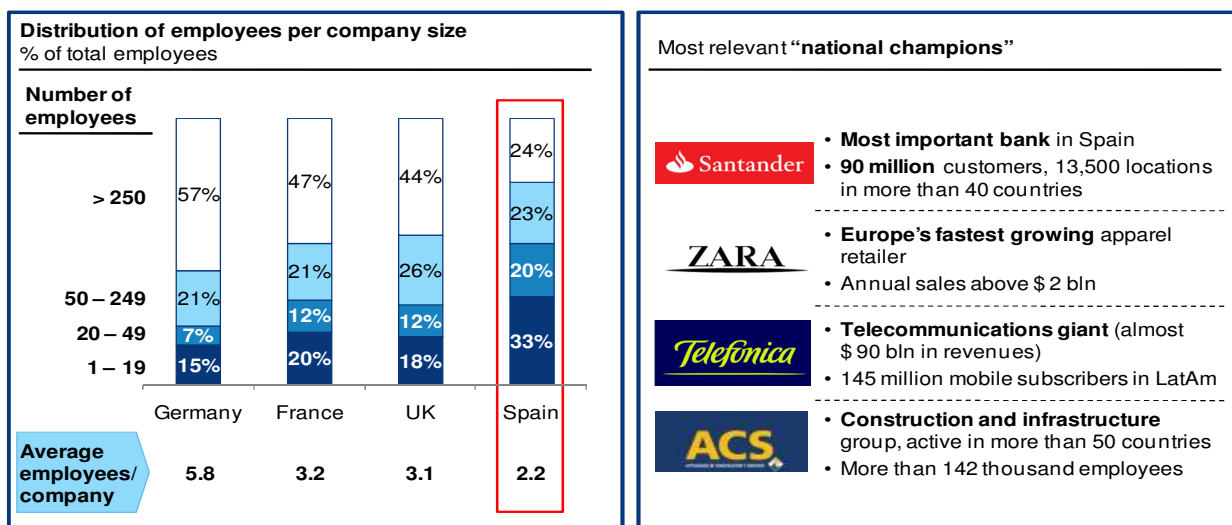
¹⁵ Financial Times – “Caja deals dance starts in Spain”. Feb 22nd 2011

¹⁶ Financial Times – “Spain brings in new bank capital rules”. Feb 18th 2011

Bank Doing Business Index - 2010¹⁷). The main reasons for this rigidity are the high firing costs, high wages and unemployment benefits and the centralized sector-wide wage bargaining dominated by very powerful unions (Comin, 2010). Those barriers to employment significantly impact unemployment, as explored in section 1.2. A labor market reform was approved in September 2010, but some observers reported it fell “well short of what was needed but may nevertheless do some good”¹⁸. Additionally, high taxes (57% of profits in 2009, among the highest in Europe) hamper the capacity to compete and stimulate the growth of informality (valued at 20% of official GDP).

The competitive environment is dominated by a large number SMEs, which fosters competition. However, their weight in Spanish economy is too high and their productivity too low (McKinsey, 2010). Lately, the emergence of big, internationally competitive “conquerors” with a significant presence and weight in the overall economy and internationally, is impacting positively the competitive environment.

Figure 11 – Competitive environment: SMEs and “national champions” presence



Source: McKinsey, 2010. Comin, 2010. Hoover’s

¹⁷ Data not available for 2011. “Employing workers” methodology is being revised by World Bank, therefore it was not included in 2011 “Doing Business Ranking”

¹⁸ The Economist, “Spain offers a test case for labour-market reform in Europe”, Oct 7th 2010.

Related and Supporting Industries Cluster policies and Institutions for Collaboration (IFCs) are in general not well developed in Spain, despite its early adoption in the Basque country. Cluster policies are relatively recent (*European Cluster Alliance, Cluster Observatory* and *cluster initiatives* developed from 2006; Spanish Government started defining a strategic framework to coordinate cluster efforts in 2000), less sophisticated and lead by public sector with significantly more Government intervention than in US (Ministerio de Industria de España, 2010; European Cluster Initiative, 2007; Cluster Greenbook, 2003).

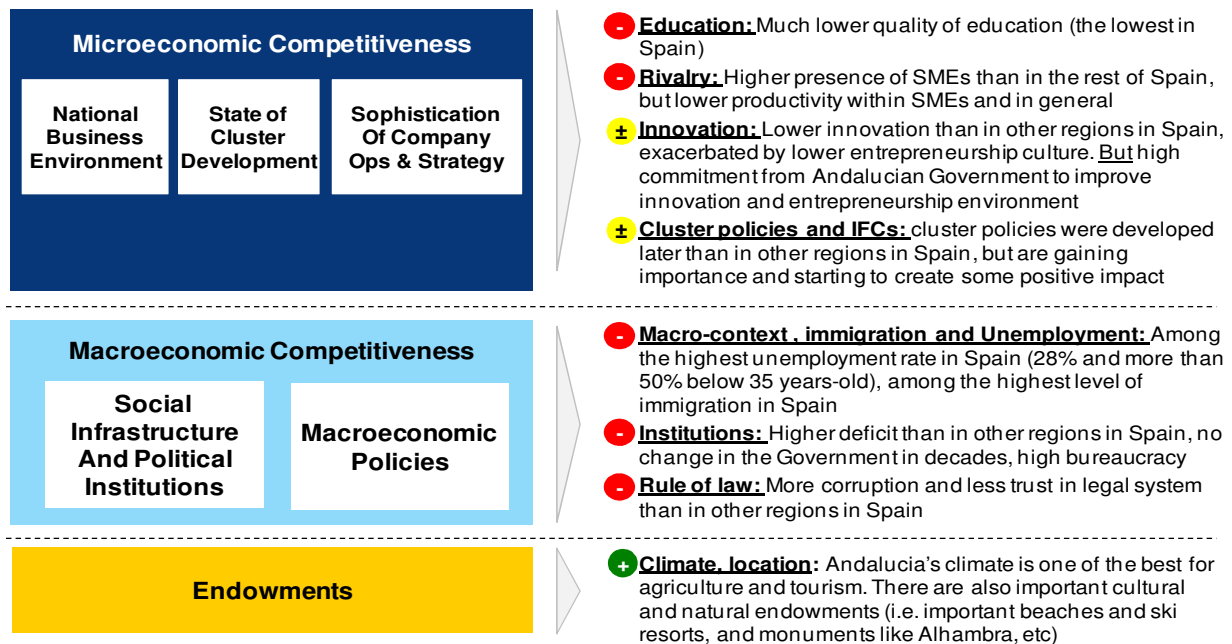
Demand Conditions EU membership has provided a great access to a more sophisticated pool of consumers and has raised the Spanish consumer's sophistication, who increasingly demand higher product standards, in line with the improved acquisition power and access to new education and technologies.¹⁹

1.4. Andalucía Business Environment

Andalucian competitiveness profile has similar strengths to Spanish's, albeit with exacerbation of the main negative issues: lower quality of education, higher weight of SMEs in the economy, higher immigration and unemployment (28% unemployment rate), higher deficit and inefficiency of the public sector. On the other hand, the climate and location of Andalucía are more favorable for agriculture and tourism and there is a strong commitment from the present government to develop comprehensive cluster policies and foster innovation and entrepreneurship (see figure 12 below for a detailed analysis of competitiveness profile).

¹⁹ Interviews and report ("Apparel Cluster in Galicia" – Microeconomics of Competitiveness, 2009)

Figure 12 – Andalusia Competitiveness Analysis



Source: Team analysis, interviews, MIT analysis

1.5. Recommendations for Spain and Andalucía

In figure 13²⁰, we present our proposal of an action plan for Spain and Andalucía to tackle the issues previously identified. We present our recommendations for each of the areas in the competitiveness framework. We added the existing policy in each area, the “level of accountability” (European, Spain or regional), “responsible” entity for its implementation (public, private, both) and “sequencing” (prioritization of the recommendation according to impact and feasibility - #1 are the highest priority). The highest priority measures involve the full implementation of austerity measures, the improvement of skills and vocational education, a relentless transformation of Spain into an innovation-based economy and a renewed approach to the development of clusters.

²⁰ Overall and cluster (chapter 2) recommendations were constructed through the application of the MOC framework on the basis of secondary sources, interviews with experts and government authorities and the team’s analysis.

Figure 13 – Challenges and Recommendations for the Spanish and Andalusian overall competitiveness

	Challenge	Existing policy	High level recommendation	Seq.
Endowments	<ul style="list-style-type: none"> Less dependence on external Energy 	<ul style="list-style-type: none"> Move to renewable energy (target of 20% in 2020); reg. plan of energy efficiency 	<ul style="list-style-type: none"> EU Comprehensive Energy Plan, including not only energy generation, but also reduction/efficiency in consumption SP 	P/G 3
Macro	<ul style="list-style-type: none"> National and regional deficit 	<ul style="list-style-type: none"> Jan and May 2010 Gov't announced austerity measures; not full implemented yet 	<ul style="list-style-type: none"> AN Continue/push for austerity measures at regional level, with the right incentive system; foster efficiency, meritocracy and cut in red tape at reg. level; consider cutting unemployment benefits 	G 1
SIPI	<ul style="list-style-type: none"> Low quality of basic education 	<ul style="list-style-type: none"> No clear and/or coordinated action 	<ul style="list-style-type: none"> AN Develop a comprehensive plan to improve education quality (public and private), including incentives system for professors/teachers and other actors AN Raise the standards throughout education system, including Higher Education, using benchmarks from best practices like Finland 	P/G 2
	<ul style="list-style-type: none"> Politicians and institutions quality decreasing 	<ul style="list-style-type: none"> No clear and/or coordinated action 	<ul style="list-style-type: none"> SP Reform parties system and public administration to foster meritocracy 	G 4
Factor conditions	<ul style="list-style-type: none"> Low quality of sec/tertiary education 	<ul style="list-style-type: none"> Reg. actions on knowledge transfer and internships 	<ul style="list-style-type: none"> AN Comprehensive plan to improve sec/tertiary education, increase links with private sector 	P/G 2
	<ul style="list-style-type: none"> Bipolar education: over qualification and low vocational training 	<ul style="list-style-type: none"> No clear and/or coordinated action. Some actions at reg. level in the past to promote vocational training 	<ul style="list-style-type: none"> AN Communication campaign to improve social image of vocational training; higher coordination with private sector to create "vocational" jobs/ trainings and diminish mismatch in degrees SP 	P/G 1 IFC
	<ul style="list-style-type: none"> Limited innovation & entrepreneurship 	<ul style="list-style-type: none"> Some initiatives at European level; INGENIO and CENIT program at national level; several initiatives at regional level 	<ul style="list-style-type: none"> All Develop coordinated program for innovation involving all agents at all levels (EU/Sp/regional) All Support transition towards a more entrepreneurial culture through education at all levels All Attract, develop and retain Human Capital (entrepreneurs) All Foster adoption of technologies and knowledge transfer through public-private collaboration: <ul style="list-style-type: none"> Providing high-quality applied research, stimulating the introduction of new products and processes, supporting SMEs 	P/G 1 IFC
	<ul style="list-style-type: none"> Low "Doing business" rank 	<ul style="list-style-type: none"> Some actions regionally 	<ul style="list-style-type: none"> AN Cut red tape and create "one-stop-shop" AN Develop a support institution for potential investors which proactively presents opportunities to investors, anticipates needs and provides quick and effective responses 	P/G 3
	<ul style="list-style-type: none"> Low productivity of SMEs 	<ul style="list-style-type: none"> Some initiatives (mostly best practice sharing) national/reg. 	<ul style="list-style-type: none"> All Create adequate SME support through: <ul style="list-style-type: none"> End-to-end help to all exporting companies, stimulation of cost-sharing in services across SMEs, financial support for the consolidation and partnership of micro-enterprises, Institutions for knowledge transfer and technology, similar to Fraunhoffen Institut in Germany 	P/G 2 IFC
Context for firm strategy and rivalry	<ul style="list-style-type: none"> Inflexible labor market 	<ul style="list-style-type: none"> Labor reform in Sept 2010 	<ul style="list-style-type: none"> SP Push for a "social pact" with all constituencies and parties to implement labor reforms <ul style="list-style-type: none"> Currently, no consensus on labor reform All actors (parties, unions, companies, etc) should do a "social pact" to implement further labor reforms, since the reform in Sept 2010 was not addressing all the inflexibilities of the labor market 	P/G 3 IFC Unions
	<ul style="list-style-type: none"> High taxes 	<ul style="list-style-type: none"> Unify EU corp. taxes (proposal) 	<ul style="list-style-type: none"> SP Study potential cuts in corporate taxes 	G 4
Related and supporting industries	<ul style="list-style-type: none"> Not coordinated cluster policy and low presence of IFCs 	<ul style="list-style-type: none"> Plans developed at EU, state and regional level, but not highly coordinated or involving all constituencies 	<ul style="list-style-type: none"> All Develop a coordinated cluster strategy, leveraging regional level and including all actors (private sector, academia, workers, etc) AN Catalyze IFCs creation (i.e. Basque country) 	P/G 1 IFC
Demand conditions	<ul style="list-style-type: none"> Relatively low promotion and adoption of new technologies 	<ul style="list-style-type: none"> No clear and/or coordinated action 	<ul style="list-style-type: none"> SP More involvement of government is needed to foster quicker adoption of technologies → Plan to be defined AN 	G 5

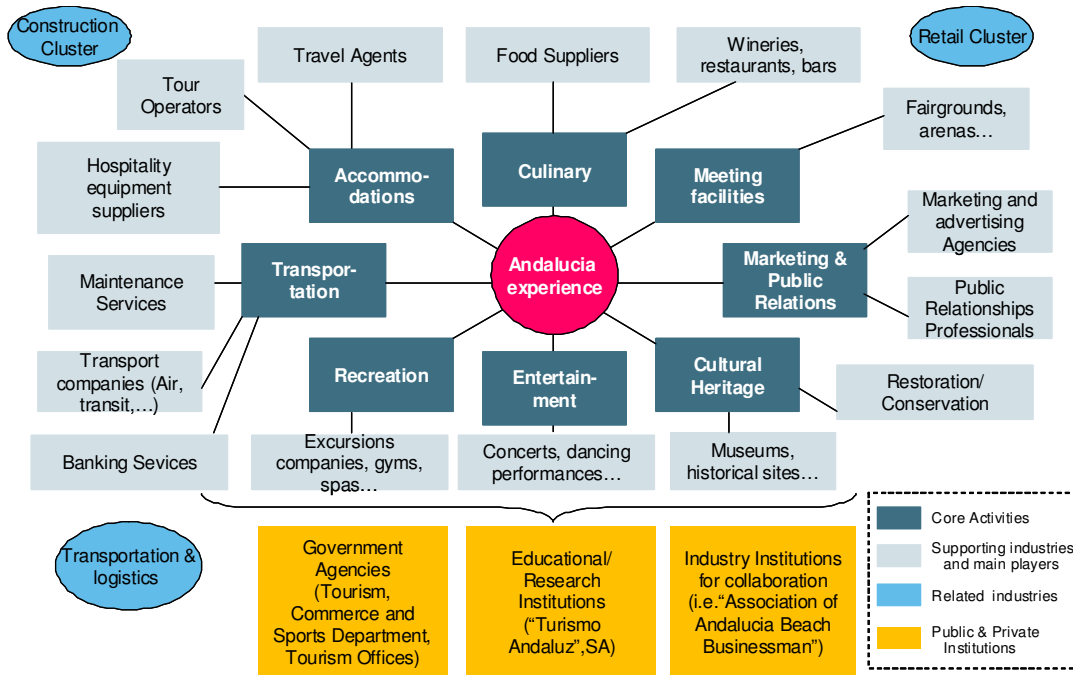
Level of action (accountability) **SP** National Level (Spain) **EU** European Level **AN** Regional Level (Andalusia) **All** All levels
 Responsible **P** Private sector **G** Public sector / Government **IFC** IFCs

2. ANDALUCÍA TOURISM CLUSTER

2.1. Tourism cluster map

Andalucía has developed a strong tourism cluster, as observable in figure 14.

Figure 14 – Tourism Cluster Map



Source: Team Analysis

We can identify a number of distinct components that contribute to the experience of a tourist visiting Andalucía. These elements range from the principal tourism attractions to the suppliers of direct and indirect services and products, to the infrastructure that enables the whole system to function.

In terms of major attractions, Andalucía offers a wide variety of activities and unique places to visit. The region is famous for its deep cultural heritage including the well-known "flamenco" dance, typical food and impressive centenarian traditions such as the celebration of the Easter week and folklore fairs. In addition, the region boasts a wide variety of historical sites and monuments, such as the Córdoba's Mezquita or

Granada's Alhambra Palace, and abundant natural endowments like beaches, mountains, rivers, thus having the right setting both for urban and nature tourism experiences.

There are a number of players that contribute to the tourists' experience by supplying services to them, directly or indirectly. Among these, there are naturally the companies running accommodation businesses, restaurants, tour operators and attraction providers, as well as famous trade fairs. Additionally, there are a number of suppliers and distributors that interact with these players and should be considered as part of the cluster. Finally, some key Governmental Agencies and Institutions for Collaboration play the important role of ensuring that the overall cluster works smoothly.

It is also remarkable that the Andalusian tourism cluster has stimulated the growth of other clusters of high importance in the region, including the construction, retail and transportation clusters.

2.2. History of tourism in Andalusia

As the 20th century progressed, tourism was increasingly regarded as a priority for Spain and all governments worked towards developing and improving the sector.

1940's – 1970's Strategy: Maximize growth and focus on Sun & Beach offer

During this period, Franco's government started regulating the tourism industry, emphasizing the importance of maintaining low prices and increasing the quality of accommodation. First, in 1939, the government regulated the hotel industry to ensure good quality of services. Second, in 1942, the government, through the State Credit

Bank, started offering low-interest rate credit for investment in hotels to increase capacity and incentivize private investment. Then, from 1941 and after WWII, the government established fixed prices in accommodation in order to attract the middle-income population that was growing in the rest of Europe. Finally, in 1952, the government established the “Dirección General de Turismo” (General Tourism Agency).

Since then and increasingly in the 1960’s, Spain really started opening to foreign tourism. In 1958 and 1961, Spain entered into international agreements to streamline the customs procedures. In addition, in 1964-1967, the first “Tourism development Plan” was drafted with the main objective of maximizing the attraction of foreign tourists to the country.

1970’s – 2000’s: Development of a more sustainable offer diversified from “sun & beach segment” In 1978, after Franco’s death, the new government realized that the previous strategy, focused on volume maximization, had indeed increased the size of the sector, but it had compromised the region attractiveness and the industry sustainability, due to the negative pressures on infrastructure and natural beauty.

In 1972-1975, a new “Tourism development plan” was created with a two-fold goal: to attract foreign tourists with higher income and to keep increasing local demand. To achieve these objectives, new regulations and marketing efforts were implemented in the following years.

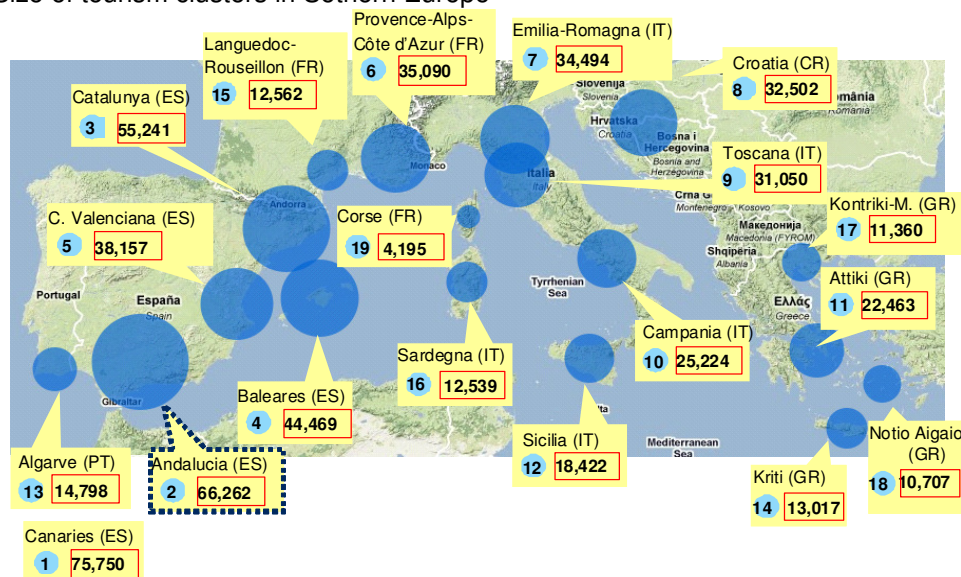
First, a new law issued in 1970 established the minimum level of infrastructure quality required for any facility for tourists. Second, in 1984 the new “Spanish Tourism Council” was established to foster interaction between the public and private sectors

and thus a more sustainable tourism offer. Third, marketing-wise, the regional government launched an aggressive local advertising campaign. Finally, it tried to strengthen the variety of Andalusian tourism offer. The global recognition as “World Heritage” of the “Alhambra and Generalife”, “Mezquita” (1984), “Cathedral, Alcázar Palace and West Indies Archives” (1987), Úbeda and Baeza (2003) and the promotion of Andalusian cultural heritage with special events (e.g. Easter week) strived to expand the concept of Andalucía beyond “sun and beach”, with limited success.

2.3. Cluster highlights and performance analysis

As we can see in figure 15, the importance of Andalucía in the tourism sector is remarkable, ranking second in number of employees in Southern Europe, only after the Canary Islands (#1) and Catalonia (#3), both in Spain.

Figure 15 – Size of tourism clusters in Southern Europe

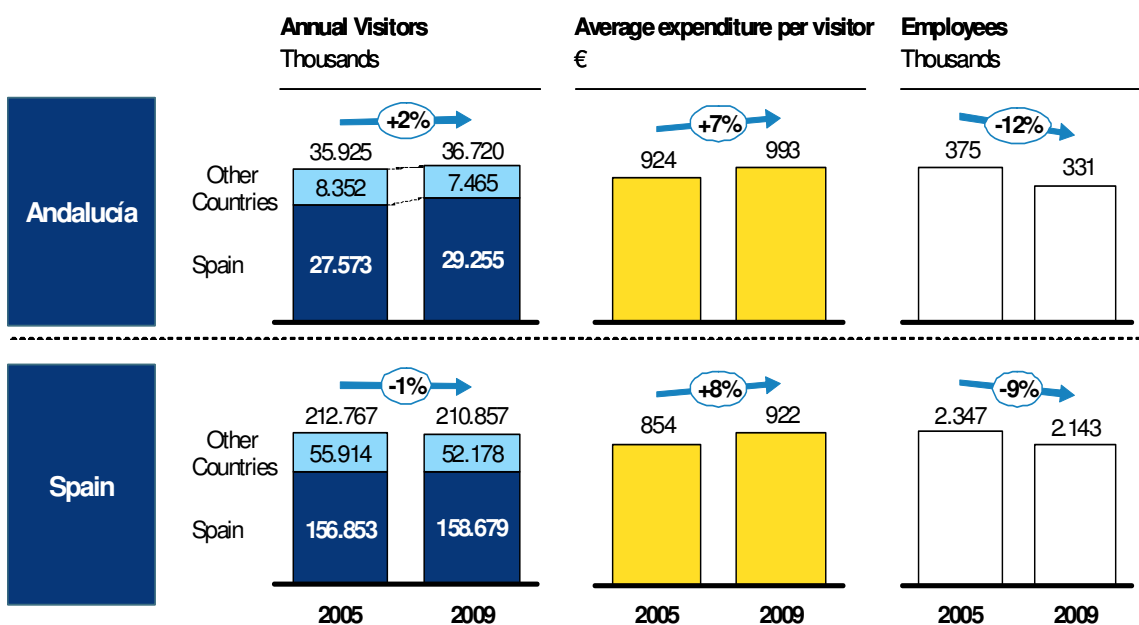


Source: EU Cluster Observatory

The typical visitor that comes to the region is semi-qualified, middle-income, young and attracted by the “sun and beach” offer, not taking advantage of the cultural experience.

Figure 16 shows that Andalucía has experienced a decrease in the number of foreigners visiting the region between 2005 and 2009, while the number of local tourists has increased. Overall, the total number of tourists increased 2%, outperforming the national average (-1%). As for the average expense per tourist, it increased by 7%, above inflation but below the increase in the national average. The growth was driven by the improvement in the economies of the main countries of origin, U.K. and Germany. Finally, the number of employees in the sector decreased 12%.

Figure 16 – Performance of tourism cluster 2005-2009



Source: IET España.

The vast majority of tourists in the region are Spanish nationals coming from other regions (approximately 80% of total tourists in 2009), as observed in Figure 17.

Among foreign tourists, U.K., Germany and France are the main countries of origin. Other areas like Americas and Asia, as well as parts of Europe, are barely represented.

In terms of daily expenses per traveler, the tourists that spend the most are those who come from outside Europe (Figure 18). Local tourists spend the least per day.

The fact that most tourists are nationals is detrimental for Spain since less capital flows into the country, but positive for the region. Local tourists are the most loyal (90% of visitors have come to Andalucía more than once). Moreover, there are limited differences in the relatively high satisfaction levels between foreigners and nationals²¹, indicating similarly sophisticated demand levels.

Individual visitors to Andalucía and their total spend per visit
2010

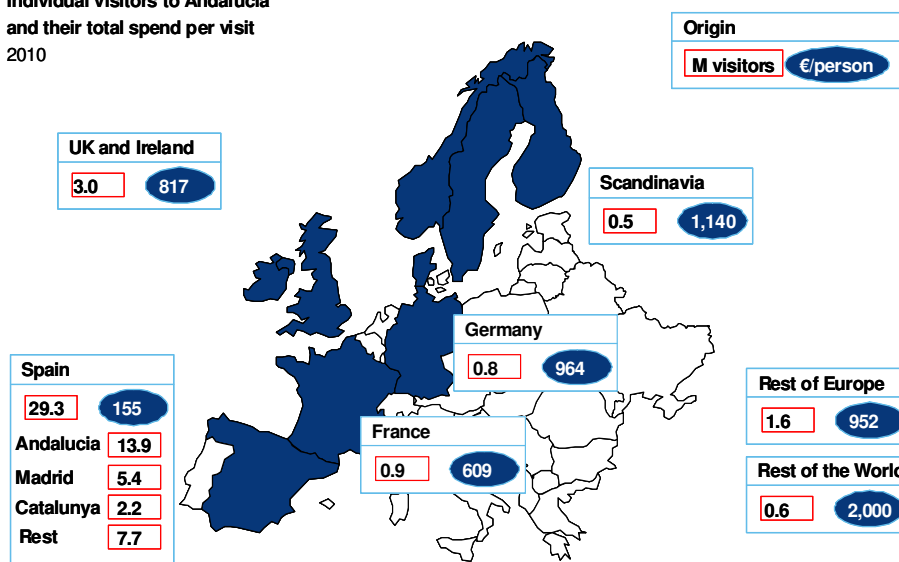


Figure 17 – Visitors to Andalucía and expense per visit by country of Origin

Source: IET España

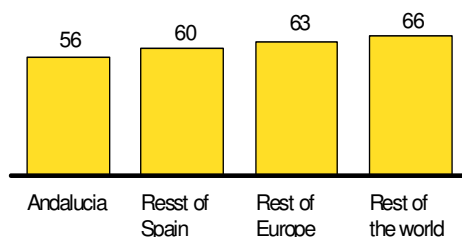


Figure 18 – Expenses per tourist/day

Source: IET España

²¹ 8.7 for local tourists vs. 8.4 for foreigners (Junta de Andalucía 2007).

2.4. The tourism cluster in Andalucía

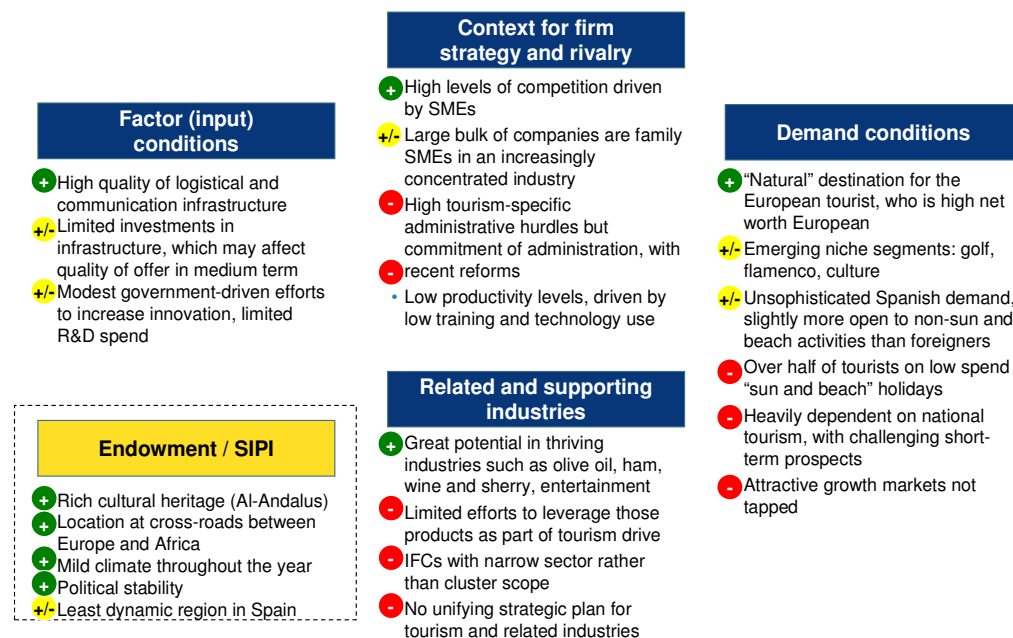
The tourism cluster in Andalucía displays remarkable strengths, thanks to the attention it has benefited from since the 1950s. Nevertheless, although the tourism endowments, basic factor conditions and level of competition are very strong, the cluster is failing both to keep up with recent price-based competition from across Europe and to upgrade and differentiate itself to attract higher-end tourists.

2.4.1. Endowments and cluster-specific macroeconomic competitiveness

The tourism cluster in Andalucía has access to unparalleled endowments. It has a mild climate all year round (around 20° C). Situated in Europe, but very close to Africa (and being the historic gateway to America), it has 910 km of coastline, with both Atlantic and Mediterranean beaches. Further, it has unique historical sites dating back to the Al-Andalus period, and it has enjoyed a stable political context since it first opened up to foreigners in 1950s (in contrast to some of the North Africa competitors).

2.4.2. The Andalusian tourism cluster business environment

Figure 19 – Andalucía’s tourism Business Environment



Factor (input) conditions Top-of-class transport infrastructure is available: high-speed rail connects Andalucía to the rest of Spain; six publicly-owned airports are present, one of them the third largest in Spain by volume (Málaga); and uninterrupted highway communication with the rest of Spain and France.

Other tourism infrastructure (hotel buildings, promenades) have recently deteriorated due to under-investment in comparison to other countries (World Economic Forum, 2011). The current reduced capacity to finance by Spanish banks will probably worsen the situation. Those investments, in addition to upgrading in infrastructure, should tackle one of the challenges the tourism industry as a whole that has not yet resolved: the difficulty of leveraging innovation to increase productivity in a technology-light industry. In other regions, such as Switzerland, innovation in the sector has resulted from government-led competitions for the rethinking of services and the improvement of processes. Other options are the continuous upgrade of quality certification requirements to impose continuous improvements (16% of Andalusian hotels and restaurants are already certified), as well as very selective applied research in the improvement of offerings and processes through firms-universities partnerships.

Context for Strategy and Rivalry One of the biggest challenges for the Tourism Cluster in Andalucía is productivity. While being increasingly outcompeted in price (ranked 106 in WEF [2011] in price-competitiveness), it is the least productive cluster within Spain (Exceltur 2009). This is due to three main issues. First, the cluster suffers from a severe lack of skills (a factor condition) despite the wealth of public universities (nine) in the region. Less than a quarter of employees have tertiary training compared to

a third in Spain, due to the low quality and prestige of hospitality and tourism training (and lack of specialized training such as sommeliers, sports trainers...). Second, tourism-related companies exhibit low penetration of technology, 45% of them only using the most basic PC applications and the Internet (Junta de Andalucía, 2009). Finally, Andalusians score poorly in foreign languages skills, with only a third speaking a different language (Eurobarometer, 2002).

The context of the Andalusian tourism is also hindered by a over-bureaucratic and often misguided regulation. The Andalusian government is the slowest of Spanish administrations in dealing with tourism-related activities, which often have peaks in activity and require quick turnarounds (such as event planning or construction permits [Exceltur, 2010]). Also, the four levels of administration generate delays in dealing with decisions such as giving a permit to open a restaurant: national, regional and local, as well as EU-wide regulation is involved. Moreover, administrative decisions have too often not taken the best interest of the cluster in mind: rezoning made it possible that 75% of the coast is completely built up in some areas, which drives a lot of the physical deterioration (Greenpeace, 2010). This is closely related to the considerable corruption: there have been 179 court cases relating to coastal construction in Andalucía between 2006-2009 (Greenpeace, 2010).

The tourism companies' structure provides a context for strategy that affects poorly their ability to perform. The fact that most firms are micro-enterprises (with 4 employees on average, and only one fifth of the hotels affiliated to chains [Río Gómez and Cuadrado, 2004]) is good for competition but out of line with the industry evolution towards more horizontally and vertically integrated tourism companies. Take the

example of Thomas Cook, formerly a UK wholesale travel agent that, as a result of integration of over 35 companies, now owns retail agencies, airlines, hotels, etc. (Thomas Cook, 2010). It is therefore able to provide a high quality integrated offer to most markets and to leverage internal synergies. Andalusian companies are missing this trend and may suffer as these conglomerates steer the markets in a different direction, diminishing Andalucía's presence in integrated packages and offerings.

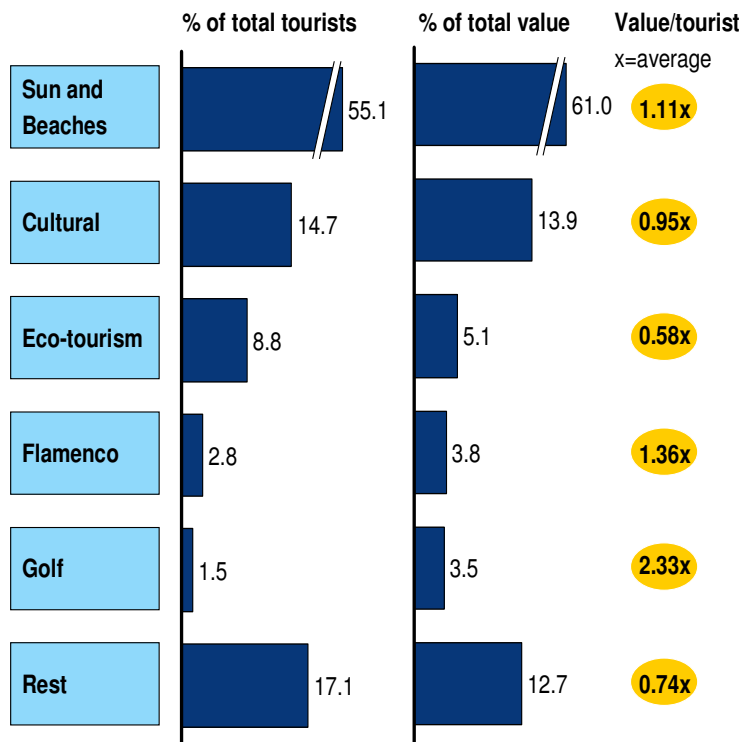
Demand conditions The local Spanish demand, which constitutes 30% of total demand, is extremely reliable, as the recent spike during the global recession has shown. However, the median Spanish tourist in Andalucía is relatively unsophisticated (most high-end domestic destinations are elsewhere in the islands). As mentioned in section 2.3, he spends on average 20% of a UK tourist and typically looks for a family holiday in an apartment (34%), using his own car (75%). 61% are “sun and beach” tourists and only about a third do other activities (Junta de Andalucía, 2007). However, local demand often pioneers the discovery of other activities and has been driving the majority of the eco and cultural tourism offers outside the largest destinations. International demand typically follows these trends.

Andalucía has also become a “default” sun destination for the rest of Europe's holidays, helped by the no-borders agreement within Europe and the rise in flight connectivity, making the whole of Europe a *de facto* second-order local demand for Andalucía. In this set, we find some of the most demanding customers in the world.

Andalucía was able to position itself as a leader in the “sun and beaches” segment. However, it did so historically through highly concentrated real estate

development and a low cost offer, hardly leveraging other opportunities. Other high-value sub-segments such as golf and the (uniquely Andalucian) flamenco are up to twice as lucrative (while lower value is extracted from cultural and eco-tourism tourists).

Figure 20 – Segmentation of tourism demand in Andalucía



Source: Junta de Andalucía. Consejería de Turismo, Comercio y Deporte. Data for 2003-04.

In particular, the golf sub-segment is part of a higher-end segment, which is heavily concentrated in places like Marbella and Puerto Banús, (which display one of the highest concentrations of luxury hotels in Europe). However, this luxury segment is very small, with stays at 5-star hotels constituting 5% of total stays (Junta de Andalucía, 2007). In Andalucía,

rather than expanding, luxury demand has been increasingly decreasing as a result of the already referred high-intensity of construction and the failure to develop a differentiated offer against competitors (Monaco, Côte d’Azur, parts of Sardinia, Dubai).

Similarly, Andalucía has been unable to attract the high-growth demand from the BRICs. While European consumers constitutes 92% of the demand in Andalucía, Europe is expected to grow at only 3% over the next 10 years, while markets such as China, Russia and India will grow at more than 15% (Euromonitor, 2009). Andalucía

does not attract these high-growth customers largely because its offer is not distinctive and sometimes unsuitable for remote visitors.

Related and supporting industries Tourism has been a priority for the government of Andalucía for many years and as such government-led IFCs have thrived, including the powerful Regional Tourism Ministry (Dirección General de Planificación y Ordenación Turística), the Tourism Innovation Center (Centro Innovación Turística de Andalucía) and the government-owned company charged with promoting Andalusian Tourism in new markets (Turismo Andaluz SA). In contrast, the team's interviews confirmed there was very little collaboration involving the private sector. Any such collaboration was led by the very big national tourism players who group together in Exceltur, but with a narrow focus on producing some high quality research on tourism and on lobbying. Broadly speaking, firms in the cluster, typically very small, have not taken upon themselves the task of upgrading the cluster nor tried to communicate with the government in a unified voice. There has not been any coordinated planning effort for the cluster except as part of Junta de Andalucía's economic plans, which is telling of the limited levels of collaboration.

In terms of industries related to the cluster, they are currently largely disconnected from it. This is despite the fact that some of Andalusian industries of high tourism potential are world-class, such as wineries (of wine and sherry), olive groves, and Iberian ham producers. Other obvious attractions, such as the booming Spanish gastronomy, do not have a presence in Andalucía (only 1 restaurant out of the 19 in Spain that have 2/3 Michelin stars, and no presence of world-renowned Spanish chefs).

Tellingly, 93% of “sun and beach” tourists never leave their resort (Junta de Andalucía, 2007) to visit any of the 6 world heritage sites or a flamenco performance. These adjacent industries are often not prepared for these visitors: for instance, very few sherry wineries have suitable facilities, skilled custom-facing personnel or organize tours at all. Contrast this with the vast tourism industry around wineries in Napa and Sonoma valleys in California.

2.5. Strategic vision, challenges and recommendations for the cluster

Our analysis of the business environment of the Andalucía tourism cluster shows there is a huge potential for enhancing its competitiveness. Our vision for the cluster is that it should simultaneously upgrade the quality of the offer in “sun and beach” to attract higher value visitors while increasing the volume in other premium segments beyond sun and beaches, capitalizing Andalusian endowments and attractive industries. We present our recommendations along the MOC framework, in order of priority.

Factor conditions There has not been enough investment in the maintenance and upgrade of infrastructure, which experienced a boom in the 1970s. The Ministry of Public Works should stimulate higher investment in quality tourism infrastructure.

In addition, there is a lack of innovation in the tourism industry, due to the nature of the sector, but exacerbated by the very limited innovative capacity by small and medium enterprises (SMEs) and traditional R&D channels such as universities. The different actors in the private, public and academic arena “should be innovative in promoting innovation” in product and processes through: collaborative university-firm

R&D; company ingenuity (prizes); external pressure for innovation (e.g. quality standards) and strategic use of tax credits for technology adoption.

To partially tackle the low productivity, the Andalusian government should invest in high quality training programs in specialized skills (e.g. kitesurf instructor, sommelier, etc.) and language skills, developed in collaboration with cluster players.

Demand conditions Spain, including Andalucía, has limited access to high growth markets such as China and Russia, partially due to poor positioning in premium market segments (golf, flamenco). The national and regional governments, along with the private sector and institutions for collaboration (IFCs) should conduct more aggressive marketing strategies by dedicating a cluster-wide marketing team that develops a high quality offer around the concept of “Andalusian experience” beyond sun and beaches. In addition to broad messages through fair trades and media, specific bundles to targeted public should be developed (e.g., package offers of golf, olive oil tours, La Alhambra visits and beach programs to Russian tourists).

Context for firm strategy and rivalry Junta de Andalucía should “educate not only the industry but also the supporting financial institutions on the relevance of vertical and horizontal integration to enhance competitiveness and consider selective incentives for those. In parallel, the IFCs should promote increased collaboration within the industry to create shared services for SMEs such as common booking or e-commerce platforms. IFCs and Junta should foster the wider use of technology by the industry.

Finally, the different levels of government should streamline tourism regulation, making it more transparent and cutting red tape through the creation of a cross-administration body that speeds all processes.

Related and supporting industries Andalucía tourism actors should leverage the related industries and natural and cultural resources. For instance, connect agriculture and gastronomy in the form of sherry or olive oil tours. Inclusive, private sector-led IFCs should be created to develop an integrated tourism plan across industries, serve as focal point for interactions with government, as well as channel the collaboration with emerging Andalusian hi-tech industries to enhance tourism.

Figure 21 – Challenges and Recommendations for Andalusian tourism cluster

	Challenge	Current situation	High level recommendation	Seq.
Factor conditions	<ul style="list-style-type: none"> Ageing infrastructure, much of it dating from 60s-70s Innovation not obvious in tourism: technology-light industry 	<ul style="list-style-type: none"> Insufficient Continuous investment in the upgrade of infrastructure Limited innovative capacity by (small)firms and usual R&D channels (universities) 	<ul style="list-style-type: none"> SP Stimulate investment in quality tourism infrastructure, matching a new vision for Andalusian tourism All Continuous cluster upgrade and innovation through: university R&D; company ingenuity (prizes); external pressure for innovation, (e.g. increasingly demanding quality standards); strategic use of tax credits for technology adoption 	<ul style="list-style-type: none"> G P/G
	<ul style="list-style-type: none"> Highly qualified human capital needed to attract premium tourism 	<ul style="list-style-type: none"> Limited productivity driven by low qualifications and language skills 	<ul style="list-style-type: none"> AN High quality training programs in specialized skills (sommelier, kitesurf instructor, etc.) 	<ul style="list-style-type: none"> G
	Demand conditions	<ul style="list-style-type: none"> European and Spanish markets expecting limited and even negative growth Increasing access to other “sun and beach” destinations for all markets (high-growth remote and European) 	<ul style="list-style-type: none"> Limited access to high growth markets (Russia, China) Poor positioning in premium markets (golf, premium cultural), limiting access to high growth markets 	<ul style="list-style-type: none"> All Access to high-growth markets and segments: <ul style="list-style-type: none"> – Distinct high quality offer – Dedicated cluster-wide marketing team – Development of “Andalusian experience” beyond sun and beaches
Context for firm strategy and rivalry		<ul style="list-style-type: none"> Industry structures evolving towards greater vertical integration 	<ul style="list-style-type: none"> Limited participation by Andalusia Could drive markets to “equivalent” locations in Europe with greater presence of integrated companies 	<ul style="list-style-type: none"> AN Support for M&A activity CO Increased collaboration through more effective IFCs, to include creation of shared services for SMEs (e.g., common booking/e-commerce platform)
	<ul style="list-style-type: none"> Highly qualified human capital needed to attract premium tourism 	<ul style="list-style-type: none"> Limited productivity driven by low technology use 	<ul style="list-style-type: none"> CO IFCs driving the use of technology, possibly with government incentives 	<ul style="list-style-type: none"> IFC
	<ul style="list-style-type: none"> Regulation affects tourism heavily 	<ul style="list-style-type: none"> Highly bureaucratic and often misguided administration 	<ul style="list-style-type: none"> AN Streamline tourism regulation through cross-administration body (Tourism Development Board) 	<ul style="list-style-type: none"> G
Related and supporting industries	<ul style="list-style-type: none"> Andalusia perceived as a pure “sun and beach” destination Heavily seasonal destination –large summer peaks in demand 	<ul style="list-style-type: none"> Andalusian industries and resources disconnected from tourism Limited capacity to exploit industries for tourism purposes (e.g., sherry or olive tours, etc.) 	<ul style="list-style-type: none"> All Leverage great Andalusian industries (gastronomy, agriculture) and natural and cultural resources: <ul style="list-style-type: none"> – Drive communication and planning across industries (cluster IFCs) – Leverage emerging high-tech industries for cluster upgrade 	<ul style="list-style-type: none"> P/G IFC

Level of action (accountability) **SP** National Level (Spain) **EU** European Level **AN** Regional Level (Andalusia) **All** All levels
Responsible **P** Private sector **G** Public sector / Government **IFC** IFCs

Disclosures and Appreciations

Four members of the team are Spanish nationals.

In the preparation of this project, the team has conducted interviews with several experts from the government, academia, and private sector. We would like to express our sincere appreciation to all of them for having the time to help us with the project:

Government representatives

- Juan M. Barea – Director of Innovation of Andalucía Government
- Javier Gutiérrez – Tech. analysis, Dir. Innovation of Andalucía Government
- Alvaro Leiva – Project Director, Dir. Innovation of Andalucía Government
- Geronimo Sanchez – Former Director of cluster policies in Andalucía
- M. Rivera, N. Shea – Managers of Start-up Chile, Chile Gov

Experts and scholars

- Professor Ricardo Hausmann – Director of Harvard Center of International Development
- Professor Diego Comin – Leader of IXP Peru 2010, HBS and expert in Spanish economics
- Professor A. Martínez-Jerez – HBS professor, expert in Spanish economic situation
- Professor W. Aulet – MIT Professor, eLab director
- M. Burson – Spanish lawyer, expert in taxes

Business representatives

- J. A. Puerta – Famous Spanish chef, owner of several US restaurants
- Miguel Oñate – Founder of Grupo Marina, Real Estate Developer

- Francisco Casas – Country Manager of Schott Solar
- Javier Angulo – Founder and CEO, Syderis
- José Moya – Proprietor and CEO, Persán
- Alvaro Basa – Regional manager of Konecta BPO
- Enrique Tapia – Genera Mobile, CEO
- Enrique Vázquez – Neocodex, CEO
- José Ramil – Celgene Institute, CEO
- Manuel Boza – Legsgo Bioprotesica, CEO

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