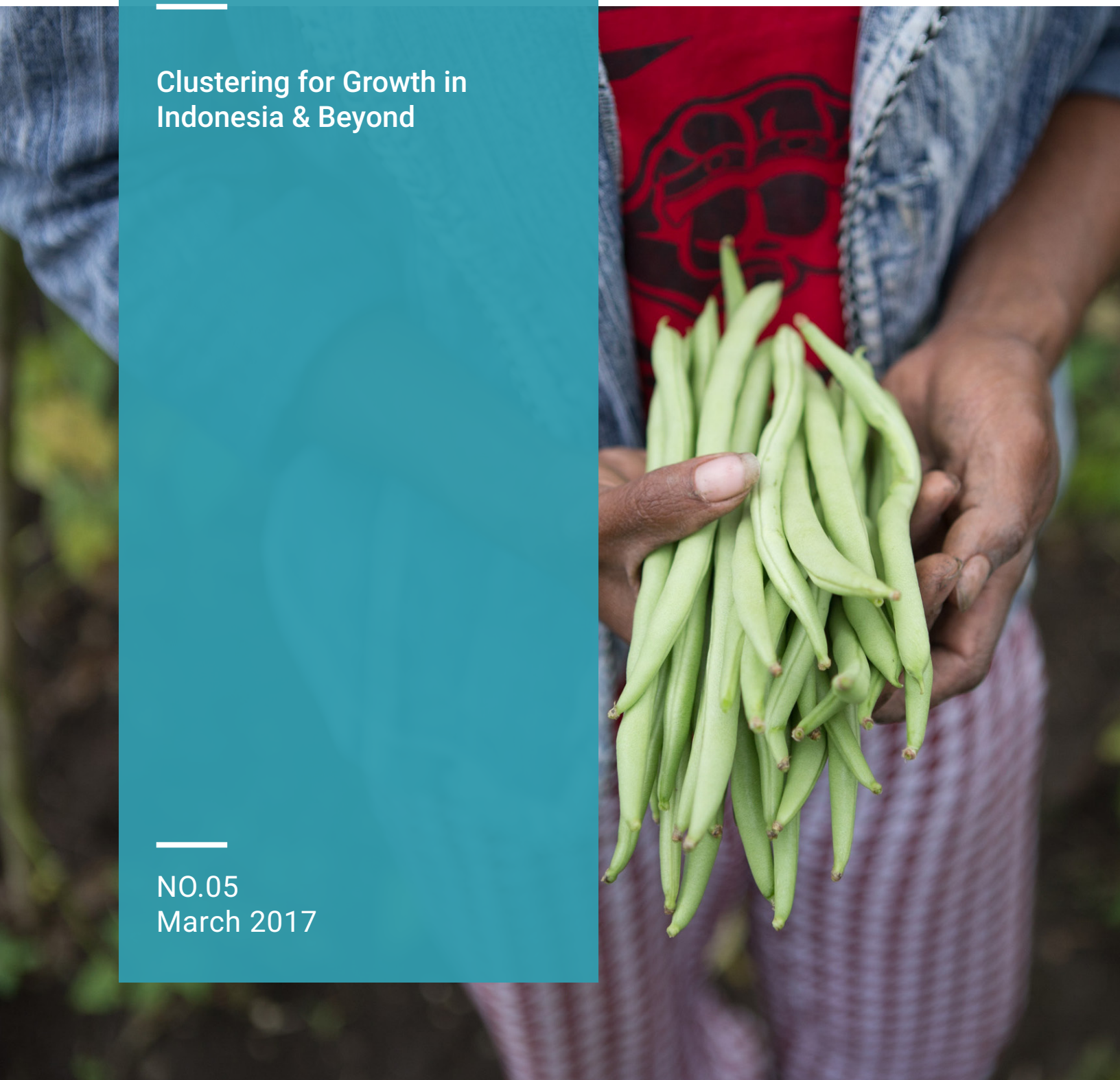
cowater INTERNATIONAL INC.

CANADA'S BEST MANAGED COMPANIES

CATALYZING ECONOMIC DEVELOPMENT

Clustering for Growth in Indonesia & Beyond



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UNLOCKING BARRIERS

Economic clusters – geographic concentrations of inter-connected companies and institutions in a particular field[1] – have driven the development of regional industries and economies throughout modern history, from the trading houses of Venice and the shipbuilding industry in England to modern salmon farming in Chile, coffee and flower production in Kenya, and the Good Agricultural Practices clusters of Thailand.

Successful economic clusters exhibit a number of common characteristics: strong brand identities; robust export strategies[2]; extensive opportunities for inter-firm interactions and partnerships; and the presence of a diverse range of institutions from the public, private and academic sectors. As a result, clusters are also attractive 'one stop shops' for visiting investors and trade missions, important conduits for tapping into new international markets.

Through their economies of scale, single clusters can also anchor other economic sectors. For instance, the wine cluster in the Napa Valley backstopped the development of related industries such as bottling, corking, and testing as well as tourism. In Indonesia's case, innovations in the fisheries and seaweed sectors have similar potential to serve as catalysts for the birth or expansion of local eco-tourism industries.

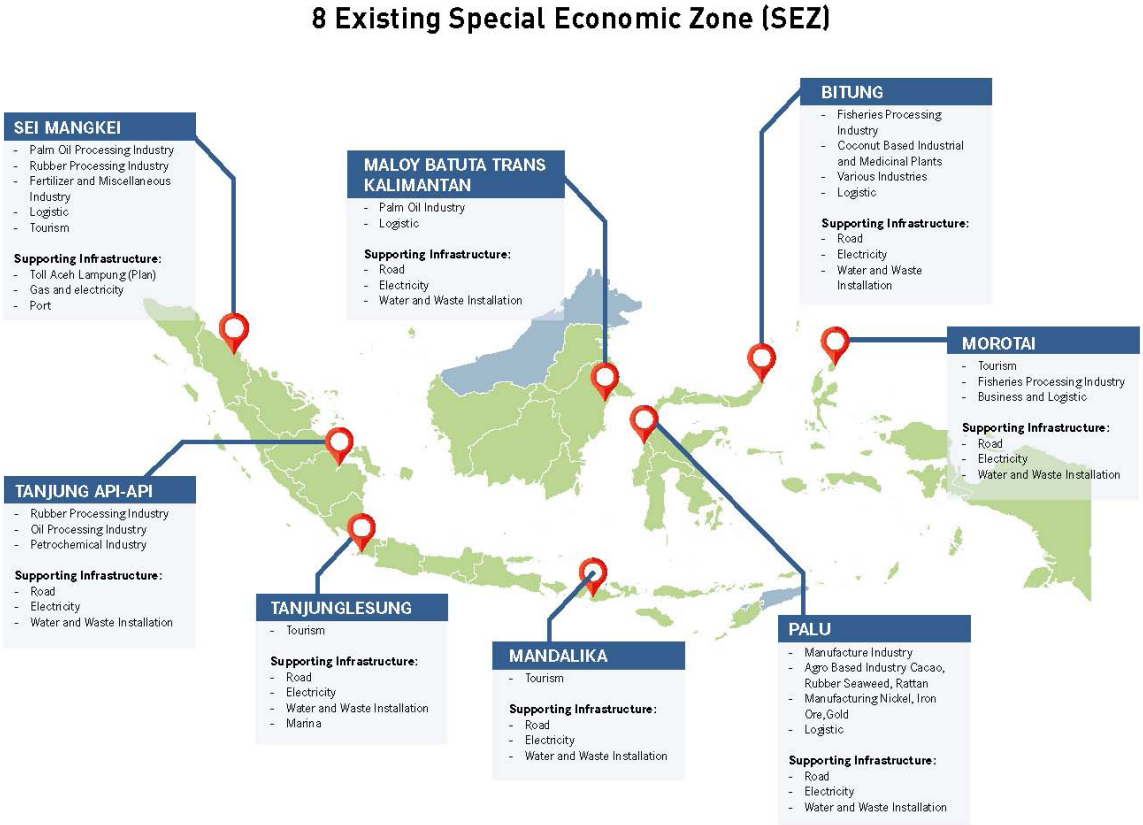
Taken together, such factors drive inwards investment and attract skilled workers that can keep such clusters in an ongoing cycle of growth and innovation.

1. *Porter, M., "Clusters and the New Economics of Competition", Harvard Business Review, Nov.-Dec.1998.*
2. *Gálvez-Novalez, E., "Agro-based clusters in developing countries: staying competitive in a globalized economy", FAO, 2010.*

> **In support of this effort, the governments of Canada and Indonesia developed the National Support for Local Investment Climates Project (NSLIC).**

With these intentions and historical precedents in mind, Indonesia adopted its Master Plan for Acceleration and Expansion of Indonesia Economic Development (2011-2025). A key element of this plan was the identification of industrial clusters and special economic zones that would extend beyond defined administrative boundaries at the provincial and district levels. This was included as an explicit effort to promote regional economic development, increase the economic competitiveness of rural areas, and encourage rural-urban and inter-regional linkages. Businesses and institutions engaged in the same sectors would be encouraged to connect to join forces in addressing common challenges and opportunities, with a particular focus on products unique to each region. Together, such businesses, typically small to medium-sized enterprises (SMEs), would then be better able to exploit the comparative advantages of each region while also reducing barriers to trade between them.

Figure 1: Indonesia's Special Economic Zones



The challenge, however, has been how a national government could then move to the next step of putting these theories and good intentions into practice in a highly decentralized economy. In support of this effort, the governments of Canada and Indonesia developed the National Support for Local Investment Climates Project (NSLIC). Focused primarily on the two provinces of Southeast Sulawesi and Gorontalo, NSLIC will promote over its seven-year lifespan inclusive growth through the expansion of 'economic growth centres', or clusters, in the agriculture, forestry and tourism sectors.

SETTING A STRONG FOUNDATION

Cowater's program managers, technical experts, and particularly our locally-based staff can spend up to a year socializing key project concepts and goals with local stakeholders and establishing the program governance structures required to align the interests of national, regional and district level counterparts. This is always time well spent, as the roles and relationships of the various parties are best defined before funds begin to flow towards project activities or grantees. Such allowances for broad stakeholder participation, consultation and transparency also go a long way to ensuring the active engagement in and support for the project. These efforts at the outset of the program are then complemented by a heavy investment at the provincial and district levels throughout the program's implementation to deliver technical assistance and create the feedback loops required for effective and agile program management.

Similarly, establishing a requirement for co-investment in selected project initiatives by grant recipients or other direct beneficiaries is a second and related priority in setting up a successful foundation for the program's success. More specifically, if there is no ability for the recipient to contribute to the funding of programs or initiatives defined under the program's financial support mechanisms, one should question whether these programs and initiatives will survive beyond the end of the project.

Simply put, grants which are not leveraged in some manner will likely not generate sustainable results. For this reason, in Cowater's recently completed project, Supporting Indonesia's Islands of Integrity Program for Sulawesi, also financed by the Government of Canada, project investments to modernize and streamline district level service delivery facilities all required co-investments from local government beneficiaries equal to at least 50% of the project's share. In reality, most of our 10 district and provincial government partners far exceeded this threshold.

THE ROLE OF THE PUBLIC SECTOR

> **"Ensuring transparency in procurement and the delivery of public sector services can also have a dramatic effect on the economic health and attractiveness of a province or district."**

Over and above the co-investments described above, there are a number of other obvious areas where public sector can focus their attention to support the development of economic growth centres, or clusters, as envisioned under NSLIC and Indonesia's Master Plan. For instance, one can look to the creation of sector-specific regional business councils that involve both public and private sector members; streamlining licensing and regulation requirements; or reducing overlapping duties and taxes for goods transiting through or to districts within a given supply chain. Moreover, ensuring transparency in procurement and the delivery of public sector services can also have a dramatic effect on the economic health and attractiveness of a province or district wishing to host an economic cluster. Finally, as we have recently seen in Mozambique, efforts to modernize land management systems and formalize land tenure can serve as critical springboards to encouraging related businesses to congregate in a given area and to boosting investor confidence in a given district or province.

Whichever priority public sector interventions are selected, which will vary between regions and level of government, it is critical that they be determined based on broad private sector and community input while appealing directly to the comparative advantages of each region.

THE ROLE OF THE PRIVATE SECTOR

Building on the above, effective consultation with local businesses to identify such comparative advantages within the "4Ps" of product, price, place, and promotion tends to be another critical step towards the development of successful economic clusters. A central priority within this consultation exercise is to identify the place of local businesses within the broader value chain – the "full range of activities that firms and workers carry out to bring a product/good or service from its conception to its end use and beyond" – in which they are situated.[3] In a developing country context one can find numerous examples of gaps along this chain that impede the efficient development, marketing and delivery of new products and services.

For instance, poor road conditions in Uganda cause breakage and spoilage of local beer during transport. Elsewhere, a limited supply of financial products and services to address the working capital needs of SMEs prevent the expansion of companies across the ASEAN region and inflates the costs of final and interim goods and services. And in regions with low post-secondary enrollment rates or weak technical and vocational institutions, companies can offer only limited value-add to products, services and other SME partners along this pathway. All of these challenges are only amplified for companies wishing to access international markets, a step that requires competing against firms and clusters already well established in their given areas of expertise.

If governments are to address these challenges in an efficient and impactful way, close integration with the private sector to ensure policy and investment efforts effectively target needs is a critical prerequisite to successful cluster development and local economic growth.

3. https://globalvaluechains.org/concept-tools

THE ROLE OF ACADEMIA

> **"Canada's 'Silicon Valley of the North' – Ontario's Kitchener-Waterloo region – is a perfect example of such synergies."**

Finally, in addition to the important roles played by both the public and private sectors in the growth of successful economic clusters, academic and research institutions also play a critical part through their role as knowledge hubs generating new ideas that can be shared and tested widely by surrounding enterprises. Such sharing can be through direct partnerships between firms, but also through the fertilization of new product or design ideas by former students. Canada's 'Silicon Valley of the North' – Ontario's Kitchener-Waterloo region – is a perfect example of such synergies in action. There, the University of Waterloo has over the last two decades developed deep, foundational connections to the local software industry that have spawned numerous successful start-ups created by Waterloo alumni. Moreover, such alumni represent exactly the right talent these businesses will need in order to grow.

As visible in this 'cluster', rather than obliging each business to invest in research and development from scratch on their own, the investments already being made by pre-existing academic and research bodies can be leveraged multiple-times over at far less cost to each individual firm. These institutions can also be called up on 'as required' to bring in new ideas can generate the innovations to address key development challenges. These innovations can appear in the form of new technology, but also in the form of new processes and approaches to managing the value chain resulting from the cross-pollination of ideas between otherwise unrelated businesses.

LOOKING AHEAD

In closing, the multiplicity of variables at play and stakeholders involved in making a Master Plan such as Indonesia's a success can appear daunting at first. However, if the team behind a program such as NSLIC can break it down into a strategy anchored by the four pillars above, adaptable to the unique needs of each region, then the potential for its realization all of sudden becomes much more real for all concerned.

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