

**Business Clusters Formation as a Means of Improving  
Competitiveness in the Tourism Sector**

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By  
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**Abstract**

*Business Clusters became foreground of economic thought in the 90s due to Michael Porter's research work, who argued that the most successful export companies belong to group of enterprises of the same industry that are geographically close to one another. This issue became even more acute because of the globalisation of the economy and the need to plan and implement policies aiming mainly at strengthening the competitiveness of small and medium sized enterprises. Tourism, as an economic activity, includes a wide range of small and medium enterprises engaging in various sectors of it. It is argued that business clusters within the field of tourism economics define de facto the competitiveness of a tourist destination. Business clusters of small and medium enterprises which operate in a tourism destination are a prerequisite contributing to its competitiveness. Especially in Greece, it is alleged that clusters can maximise the abilities offered by technology, new markets and other external factors and contribute to the strengthening of competitiveness in the tourism industry.*

**Keywords:** Business Clusters, tourism, competitiveness.

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## 1. Defining Business Clusters

Defining “Business Clusters” is a rather difficult task, since the term covers a wide range of different business structures on an international, national and regional level referring to productive and innovative systems with very broad goals. However, the most widely-known definition is the one by Michael Porter (1998), who defined that “*a cluster is a geographically proximate group of interconnected companies and associated institutions in a particular field, linked by commonalities and complementarities*”.

Porter noted that industrial production should be considered as a system with interconnected institutions and operations. He adopted the idea that concentrations are not a new phenomenon but he argued that the reasons behind this behaviour pattern have differentiated. Thus, what used to be an effort to facilitate the access to raw materials and provisions or at least to reduce the costs has now become an intentional choice of locating an enterprise next to other enterprises in a familiar environment? The result is that enterprises gain access to an environment bearing the following features: a) high level of innovation; b) increased specialisation; c) steady and continuous development of new products and services; d) attraction of specialised staff; and e) easy access to knowledge and information. Based on this point of view, business clusters can be considered a new approach differentiated from the previous ones.

In general, the borders of business clusters do not concur and are not aligned with the administrative borders of a region. Likewise, they are not aligned with the “natural” industrial borders either, since their links go far beyond that point. Business clusters are dynamic and their borders are in a state of permanent change due to the fact that new enterprises and new connections are created or cease to exist. According to Porter “the geographic scope of a business cluster ranges from a region, a state or even a single city nearby to a group of neighbouring countries” (Porter 2000).

Any attempt to confine business clusters within a particular activity and structure frame shall result in it losing its character, which is based on the main principle of achieving multiplied results through collaboration. However, a distinction between business clusters and business networks is essential, although not always easy. Practice has revealed that the concept of networks is definitely more confined than that of business clusters. In fact, business networks can arise through business clusters.

Within the above reference framework, this paper attempts to mark the particular features and processes followed by business clusters in order to create a competitive advantage. It also identifies good international practices related to tourism activity. It indicates the existing disadvantages and advantages that can be utilised by tourism industry bodies on an international level. The above follows a reference to the existing situation ever since the development of business clusters in Greece and abroad and respective conclusions are drawn as regards their future evolution.

## **2. Business Cluster Development Processes and Characteristics**

Based on the aforementioned definitions we will examine the main components that comprise business clusters. However, it is not a prerequisite that all these components appear in every case. It is generally accepted, though, that their existence leads to a successful business cluster establishment and development.

**Geographic Concentration:** It is a vital factor for business clusters, since the physical concentration of enterprises creates important advantages related both to the financial efficiency of enterprises and to the development of solidarity links among the various enterprises' Senior Managers. More particularly, geographic concentration provides companies the right framework for achieving domestic and foreign economies of scale, adopting innovations by facilitating access to new knowledge, increasing productivity and exchanging experiences (Baptista (2001). Furthermore, a crucial importance is attributed to the role of the "social capital", which is created by the ability of human resources to contact one another allowing therefore an unofficial exchange of knowledge and information.

**Specialisation:** Business cluster corporations are linked by a main activity which directs their markets.

**Complexity of institutions:** A major component of business clusters is the existence of many different institutions, which co-exist with the companies. Business clusters create deep bonds with a series of institutions, such as universities, research centres, public authorities, consumer organisations, etc.

**Competitiveness and Cooperation:** The concept of business clusters presupposes the co-existence of companies within an economic environment characterised by competition and cooperation. The combination of the above principles (competition and cooperation) ensures a balance state, where neither does competition go beyond the permissible limits undermining thus the quality of production nor do cooperation practices overshadow competition fully leading thus to negative effects for the financial efficiency and profitability of the flexible production system.

**Critical mass:** The integration of a sufficient number of companies in a business cluster is a crucial factor for its efficiency. In order for a business cluster to achieve an internal potential, the integration of a sufficient number of institutions is required, since this will form the critical mass. Therefore, a prerequisite for the effective operation of a business cluster is having a minimum number of employees, managers, businessmen, financiers, etc.

**The structural characteristics:** Business clusters as a means for organising production are differentiated from temporary company groupings aiming at implementing a particular project. Business clusters are long-lived phenomena characterised by long-term perspectives and goals.

**Innovation:** It is commonly accepted that the concept of business clusters can only be interesting when it focuses on innovation. Innovation is perceived as a broad concept including products, services, technologies or organisation practices. Innovation is a key-word for business clusters since the companies forming them

participate actively in processes of technical, commercial or organisational changes (Nordin, 2003).

The links of the companies produce knowledge, social capital and other advantages which constitute the competitive advantage core within a sector or area. Due to their nature and complexity these can only hardly be copied by competitors and thus they offer a longer life (Raines 2002). Proximity affects both innovation and the international comparative competitive advantage. Due to the fact that “knowledge is generated and transmitted more efficiently via local proximity”, the economic activity based on it can better develop when there are company links, which should be encouraged by public policies (Audretsch 1998).

According to Audretsch, a sector’s performance –and in our case tourism– is affected significantly by the existence and operation of interconnected companies. National economy is the sum of all industries and regions. The strengthening of productivity, innovation and flexibility on a local level is the base of competitiveness and development in a new era that relies on information, is driven by knowledge and aims at services.

Scott and Storper (2003) argue that the great concentration of financial activity in some regions through the establishment of clusters is an important pillar of the development procedure of a region nowadays, irrespective of the country’s development level. The location where the enterprises maintain their seat affects significantly the creation of a competitive advantage by means of operational effectiveness and business strategy (positioning in the industry) but also the attractiveness of the industry.

### **3. Distinguishing Business Clusters**

Business clusters can be distinguished into various classes according to two criteria: The first criterion is the degree of verticalisation, which distinguishes business clusters into the following categories:

Horizontal business clusters constitute the most common and easily recognisable cluster type. They consist of enterprises producing the same or similar products, which are competing with one another. These clusters are usually formed aiming at a common promotion, research and development of new products, common material provision leading to better prices, etc.

Vertical clusters are clusters in which each member develops a particular degree of specialisation in a specific field of the chain of production, thus serving the effective production and distribution of a particular class of products to the end market. These clusters are based on buyer-seller relationships. An example of such a cluster is the wine producer cluster in Napa Valley in California.

Supplementary or diagonal business clusters, which are formed by enterprises that are not competing with one another, instead they are supplementary and they are not interconnected in a chain of production. These clusters are mostly created to promote common interests of different industries, to form integrated packages of products and services, to create information centres,

to establish particular quality assurance specifications, to protect the environment, to promote innovation and to transfer know-how in common sectors. This phenomenon is observed in many tourist destinations, where different companies -each of them with a different productive process- offer activities, transportations, accommodation, etc. (Michael, 2007)

The second criterion is the maturity stage of business clusters, according to which they are distinguished into:

a. Emerging Business Clusters: This concerns geographically concentrated groups of enterprises, which gradually develop a series of co-operations around a main activity, discovering this way common benefits and opportunities that they can utilise through this relation. At this stage, enterprises have not yet developed any interdependence and communication among them.

b. Developing Business Clusters: This concerns those clusters that have already created interdependence and communication relations among their members and are in a state of examining the increasing specialisation developing within the chain of production.

At this stage arises the need to effectively manage the cluster and in most cases arises also the need to establish more specific structures. The existence of an administrator proves to be a key factor for success.

Mature Business Clusters: these are the ones that have reached the critical mass of participating institutions and create interconnections with other business clusters or institutions dealing with different subjects and activity sectors. They have gained an internal potential of creating enterprises that utilise new ideas and have rather limited possibilities for further development whereas they are able to govern themselves without the interference of any third parties.

The benefits arising for an enterprise through its participation in a business cluster are the following (Porter 1990):

- Establishing a well-known brand name;
- The networking and interconnecting with various local development institutions aiming at creating the necessary supporting infrastructure for matters related to administration, promotion, technology, integration of innovation in the process of production, new product design, etc;
- Improving the competitiveness of the enterprises by means of adopting and applying new innovative and productive technologies;
- Common planning and implementing of actions, which could hardly be effectively implemented when acting individually (e.g. advertisement, participation in exhibitions);
- Unification of business operations (e.g. supplies, distribution) and utilisation of the arising economies of scale;
- Orientation towards exporting in international markets and especially in the European ones.
- The operation of clusters as a reference point for all enterprises which is characterised by professional administration and technocratic organisation.

- Ability to standardise production and creation of a common quality assurance system.
- Reinforcement of the interconnections among other companies and networks aiming at establishing and utilising new business ideas.
- Faster and more effective exchange of information and best practices as regards operational issues (suppliers, possible sources of financing).
- Allocation of new investment and new market entrance risk.
- Exchange of experiences and know-how among the enterprises as regards both the organisation and the administration level.
- Completion of product variety through the supplementarity of the various institutions.
- Facilitation of financing such investments that each individual enterprise would be unable to support on its own.

Besides all the above advantages the participation in a cluster includes also a series of **risks** for the enterprises, which could gradually reduce their competitiveness (Porter 1990).

- The specialisation of businesses in a particular field can render them more vulnerable to some external factors and sudden changes of their operational environment.
- Reduction of competitive pressures among the participants and lessening of the need for innovations.
- Stopping being alert and obtaining a feeling of self-sufficiency and security, which in some cases can be quite misleading.
- An inclination to excessive support to the members of the cluster can lead to abandoning any attempt to create connections with other institutions outside of the cluster.
- Flexibility in decision-making and direction-changing, which characterises small enterprises, can be lost when the cluster gets bigger.

The stages followed during the development process of business clustering are the following:

- *Development of a “social capital” and establishment of a relation of trust:*
- Establishing mutual trust among the co-operating institutions is the most essential factor that has a direct impact on the effective operation of a cluster. Thus, it is very important to take all necessary actions in order to *prepare the grounds in the best possible way and to create the right atmosphere* to render the initiative for developing such a cluster successful.
- *Developing strategic connections:*

- A major issue for a cluster's viability is defining and developing strategic connections among the partners. Most of the times, it is useful to have a standardised way of interaction among the institutions to facilitate the defining of a mutual strategic goal. It is also important to ascertain any complementarities but it is even more important to discover any possible shortages that will have to be made up for. Such shortages can be made up for by integrating new partners or by means of research projects of academic partners or last but not least by training the existing members.
- *Defining a strategy and a vision:*
- Establishing a common vision and strategy can be achieved in several ways, by means of evaluating the existing situation and "foreseeing" any future evolutions.
- *Proceeding to clustering actions:*
- This stage concerns implementing common actions leading to achieving cluster goals regarding its financial efficiency.

#### **4. Experience of Business Cluster Development in Tourism Activity**

A good example of business cluster development which arises from the international experience is the one of Napa Valley located in the northern side of San Francisco, which is worldwide known for its high quality wines and is a famed tourist destination that attracts approximately five million visitors annually (Aoki and Takizawa 2002). The increasing interest observed for wine tourism brought a great number of visitors to the Valley and caused an increase of wine consumption due to the special wine routes and the various wine tasting events organised in the area. As a result, a wine business cluster develops the necessary interconnections and links outside its environment with other supporting sectors, which contribute to a business cluster success. According to Porter "a business cluster develops interconnections with other clusters, such as the rural, the tourism and the hotel and restaurant cluster".

Wine tourism has become one of most important industries in Napa Valley. The tourism sector in the area took a long time until it was finally developed and this happened mostly thanks to the opening of vitivinicultures to tourists and the organisation of special wine tasting events in the beginning of the '80s, which happened at the same period the first tourist accommodation was built. There was no infrastructure for the hosting of visitors prior to 1976. The economy of Napa Valley was based for a very long time mainly on the rural sector, which formed the major wealth and employment source in the area. Aiming at changing the vitiviniculture state of dominance in the area the Napa Valley, the Economic Development Corporation was established about two decades ago, which intended to differentiate the economic base of the region. In 1995 a strategic plan was drawn for the promotion of business clusters, which in the future would be able to create both good-paid jobs and the prerequisites for a financial regeneration. In terms of this change developed the hosting sector and in general the tourism industry of the area.

In brief, what the majority of the researchers highlight is that wine tourism is the last chance for interconnection with the consumers and the establishment of long-term relations with them. While visitors are given the chance to see the vitivincultures, the bottling line and the wine aging barrels they are linked to the wine producing company and the region itself. By means of facilitating the access to the area and improving the advertising campaigns the number of visitors travelling to the Napa Valley has increased greatly during the past time.

The case study analysed above shows the close interconnection between wine business clusters and rural accommodation business clusters and provides important information on the ways that they can help each other and on the synergies that can develop.

Porter (1998:24) stresses that the formation of business clusters can often become very intense at the point where different business clusters meet. As a result, the combination of wine and tourism and the creation of new products can lead to an increase of competitiveness of all participating institutions. Another key factor for success is related to changing the base destination of tourists to attract more visitors throughout the year and achieving a general increase of visitation to the area. The promotion of an integrated "package" has formed another important key for success increasing thus the days of stay and maximising consequently the consumption in the area. The exploitation of new technologies and more particularly of the ones offered by the internet has proven a very important and cost-effective tool. Another key for success have been the continuous efforts to employ specialised personnel and to improve personnel training. Furthermore, the co-operation efforts among wine producers (for example by means of exchanging ideas as regards the viticulture methods but also their participation in common promotion campaigns, which started in the '60s) have contributed to making Napa Valley well-known and constitute a good example of how competitiveness can increase.

## **5. The European Experience from the Formation of Business Clusters**

In Europe, business cluster development policies have been directed mostly towards urban centres industry and no specialised policies for tourism activity have been applied. The policies that appear to have brought the best results are designed on a central government level but they are particularised and implemented by regional and local authorities that know the particularities of their areas better. With the exception of Italy and Great Britain, these policies are based mostly on promoting state funding projects for the formation of co-operation networks. In Spain, policies are drawn and implemented entirely by regional authorities.

The co-operation of enterprises is based on a particular business mentality and depends on the social structures offered in every region. Italy, despite the fact that it has not developed any particular policy as regards clusters, represents an international cluster exemplar. This is mostly due to its "social capital" and the

particular business mentality that characterises the Italian Small and Medium Enterprises.

Business cluster formation in tourism industry is part of the general framework of each country's policies (Roelandt – Hertog, 1999). However, despite the poor results we have experienced until today on an international level, it cannot be doubted that their growth course has been rather satisfying. The increasing tourism competition forces many countries to adopt policies for the strengthening of business clusters in order to create a value adding web and to ensure having a competitive advantage. Such examples are found in countries with intense tourism activity (e.g. Italy, Spain, Portugal), which is based on SMEs.

## **6. The Greek Experience from Business Cluster Formation**

According to the data provided by the General Secretariat for Research and Technology (GSRT) and the Eurostat, the Greek economy has no organised business clusters. However, there is an unofficial interconnection and a limited number of conventional business clusters (Piperopoulos 2005). In general, in the case of tourism development in Greece it is estimated that business clusters should be formed on two different levels and aiming at different goals.

On a national level, hotel units –which have high quality infrastructures– could co-operate both with other similar hotel units and with other institutions, such as specialised travel agents, professional unions, national institutions, etc., in order to promote Greece as a tourist destination in the global tourism market.

On a local / regional level business clusters could be formed based on geographical characteristics and could rely on the co-operation of *smaller participants*. For example, they could form a cluster in the mountainous Greece which shall consist of rural tourism enterprises, enterprises producing and trading local products, local government institutions, various environment protection and viable development unions, various cultural institutions, etc.

A typical example on a local level is the Wine Producers Network of the Prefecture of Heraklion, which has all key factors mentioned in the literature that are considered necessary in order to characterise a business co-operation as business cluster.

The Wine Producers Network of the Prefecture of Heraklion, with the characteristics named above, constitutes a new form of business organisation in rural regions and is based on establishing close relations with the area. Businessmen have realised that their personal prosperity can only be achieved through the prosperity of the whole region so that the results can act multiplyingly maximising the benefit for everyone. To achieve this, wine producers “completed” their product (wine) with some supplementary services (tourist visits to wineries through Wine Routes).

Finally, best practices or examples to learn from are the following: achievement of common goals (e.g. tourism training), development of a business co-operation mentality and understanding in tourism industry and rendering a complete rural-tourism product (accommodation, cuisine, traditional products and tourism routes).

## 7. Conclusions - Policy Making Suggestions for the Formation of Clusters

Despite the fact that the term business cluster already existed during the 19<sup>th</sup> century and although there is a good documentation of the procedures that need to be followed and their results have already been empirically confirmed, it is obvious that there is still a global unwillingness as regards their formation. Leaving out the few existing successful examples that we need to learn from, there is no systematically organised procedure and policy on a European level that could strengthen their formation in the tourism industry. More particularly, the Greek tourism industry is characterised by an unofficial co-operation of many small and medium enterprises, which is the first sign of business cluster formation. Of course, this requires organised actions to promote innovative and creative tourism business co-operation networks.

And to achieve this it is necessary to facilitate the communication among tourism enterprises – state – universities encouraging thus the co-operation for innovation development and making the participants interested in the benefits offered by business clusters. However, it has been observed that in Greece the interconnection of universities, research and technology institutions with tourism enterprises is a prerequisite for the formation of clusters in order to strengthen the know-how exchange and promote innovation through business clusters.

Therefore, tourism strategy in Greece should aim at business networking as a foundation for business cluster formation but also at creating the necessary institutional environment that would render the Greek tourism product more competitive.

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