

## **Portugal Country Chapter: “Reacting to the Double Squeeze”**

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### **Macroeconomic and Competitive Environment – The Double Squeeze**

Portugal’s economic performance has deteriorated markedly since 2000, with the slowdown turning out to be more severe and prolonged than in most other developed countries. Real GDP growth averaged less than 1% between 2000 and 2005 and the on-going recovery remains fragile, with annual growth expected to remain below 2% in 2006-07. Trend productivity growth in the business sector which, at 3% per year, was above average until the late 1990s has fallen to around 1% in 2004-05, constrained by a period of low productive investment.

Export performance has also deteriorated in a global environment where competition has become harsher. Major new players in world trade with lower labor costs are competing in Portugal’s traditional product markets, while new EU members are increasingly specializing in the medium- and higher-technology products where Portugal is also developing. Losses in export market shares have been aggravated by the appreciation of the real exchange rate (as measured by Portuguese unit labor costs relative to those in its trading partners), while a real depreciation through greater wage restraint could have been expected (and would have been desirable) in a period of large slack in demand. As a result of economic weakness and lax policies in the past, the fiscal deficit reached close to 6% of GDP in 2005.

Concerning the labor context, Portugal still has a considerable human capital lag within the EU. The labor market is characterized by traditionally high participation, but over the past years unemployment has risen to high levels, reaching 7.6% in 2005. Due to relatively restrictive employment legislation, firms have favored the use of fixed-term contracts. This legislation has been recently changed, increasing the flexibility in collective agreements at the firm level.

In essence, Portugal has been experiencing a big “competition squeeze” in the last 6 years and seems to be half-way on a journey from low-cost to value added production activities. The squeeze is felt from both ends: on one end, Portuguese firms are still exposed to price sensitive markets, experiencing fierce competition from low cost countries; on the other hand, Portuguese firms have still not made enough inroads into high value added markets and face fierce competition at this end from the new Eastern Europe countries that have joined the EU.

Source for economic data: OECD Policy Brief, Economic Survey of Portugal, April 2006.

### **Manufacturing’s Response – IMSS Findings**

The competition squeeze finds resonance in the Portuguese IMSS sample. Table 1 shows that Portuguese firms perceive their external environment to be extremely competitive, more so than the overall IMSS sample. Consistent with this, Table 2 shows that the key order winners for Portuguese firms are conformance quality and selling prices, whose importance is rated and ranked higher than in the overall sample. Product design and quality comes third for Portugal, while it comes first for the overall sample.

Table 3 shows that the top four improvement goals for the manufacturing function in Portuguese firms for the next 3 years are all related to cost and conformance (labor productivity, manufacturing conformance, delivery reliability and unit manufacturing cost). Portuguese firms also report an average planned effort within the next 3 years of 3.8 concerning the undertaking of programs to improve equipment productivity,

compared to an average rating of 3.5 for the overall sample (Section C of the questionnaire, question Q3). This seems to indicate a strong reaction to the competition squeeze at the low cost end. However, Portuguese firms do not seem to be planning to do enough to react to the squeeze from the high value added end. In fact, improving customer service, product customization and product innovativeness come last in the priorities of these firms (Table 3). Although the overall sample exhibits a not too dissimilar pattern, Portuguese companies need to recognize that they face a specific squeeze from the high value added end which is most probably not prevalent in the overall sample. Although the cost/productivity focus is certainly important in the short-term as a transition strategy, it is not a sustainable strategy in the long-term. Thus, Portuguese manufacturing firms need to place a greater emphasis on the high value added priorities, while still tackling their structural productivity deficit. Certainly, this double-edged focus will not be an easy challenge, but it is the only way out of the Double Squeeze.

**Table 1. Perception of the external environment (A4).**

Characheristic	Portugal	Overall Sample
Competition Intensity	4.5	4.2
Market Concentration (1: Few Competitors; 5: Many Competitors)	4.0	3.5
Market Entry (1: Closed to New Players; 5: Open to New Players)	3.7	3.2

**Table 2. Most important order winners (A5).**

Order winner	Portugal		Overall Sample	
	Rank	Avg.	Rank	Avg
Conformance quality	1	4.5	1	4.2
Selling prices	2	4.3	5	3.9
Product design and quality	3	4.2	1	4.2
Dependable Deliveries	3	4.2	1	4.2
Faster deliveries	5	4.1	4	4.0
Customer Service	5	4.1	5	3.9
Innovative Products	6	3.8	6	3.6

**Table 3. Most important improvement goals for the manufacturing function for the next 3 years (B4).**

Goal	Portugal		Overall Sample	
	Rank	Avg	Rank	Avg
Labor Productivity	1	5.0	2	4.3
Manufacturing conformance	2	4.5	6	3.9
Delivery reliability	2	4.5	3	4.1
Unit Manufacturing Cost	4	4.4	1	4.4
Product quality and reliability	5	4.3	3	4.1
Employee Satisfaction	5	4.3	6	3.9
Manufacturing lead time	7	4.2	5	4.0
Customer Service	8	4.1	6	3.9
Product Customization Ability	9	4.0	10	3.5
Product Innovativeness	10	3.9	9	3.6