Regional skill relatedness: towards a new measure of regional related diversification

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ABSTRACT

This paper proposes a novel index of regional skill-relatedness and calculates this measure for all Norwegian labour-market regions. Studies of regional related diversification rely on measures of related variety, which build on the industry classification hierarchy. However, the growing literature identifying similarities in knowledge and competences across industries demonstrates that these classifications fail to identify a great deal of actual skill relatedness, and that measures based on empirical measures of industry relatedness are required. The skill relatedness measure builds on labour mobility flows across industries to develop a relatedness matrix for Norwegian industries. It further uses social network analysis to identify the number of other regional industries to which each industry in a particular region is related. Comparing this measure to the related variety index, the analysis shows that the two measures are highly correlated, but that the regional skill relatedness index is able to identify more of the relatedness across industries. In particular, the related variety index tends to underestimate the level of relatedness in many of Norway’s most technologically sophisticated manufacturing regions, whereas these rank highly in the regional skill relatedness index. Consequently, the regional skill relatedness index represents a promising new tool for identifying relatedness in regional systems.

ARTICLE HISTORY

Received 31 May 2016
Revised 31 August 2016
Accepted 29 September 2016

KEYWORDS

Related variety; skill relatedness; regions; knowledge spillovers; urban and rural regions; Norway

Introduction

Since Frenken, Van Oort, and Verburg (2007) introduced the concept of related variety in the regional studies literature, scholarly and policy interest in the approach has rapidly gained momentum. The core idea in this literature is that higher levels of regional related diversification, which means the extent to which industries in a particular region build on closely related skills and competences, leads to more local knowledge spillovers across industries. Ultimately, this will enhance regional growth and employment. In its wake, a range of studies have confirmed the positive effects of regional related diversification on employment growth (Boschma & Iammarino, 2009; Boschma, Minondo, & Navarro, 2012; Frenken et al., 2007), resilience (Diodato & Weterings, 2015) and
innovative performance (Antonietti & Cainelli, 2011; Castaldi, Frenken, & Los, 2015; Tavassoli & Carbonara, 2014), demonstrating the utility of this approach.

Most studies of regional related diversification have so far applied the measure of related variety by Frenken et al. (2007), which relies on the hierarchical structure of the NACE industry classification system. However, co-classification of two industries within the NACE system does not necessarily imply that these build on related knowledge, as the classification hierarchy is not based on considerations of the type of knowledge used in different industries. Furthermore, and more commonly, industries in completely different industry classes might be related even though they are not classified in the same industry class. Reflecting these problems, recent research has proposed better measures of relatedness across industries, focusing on co-occurrences, similarities, or flows between industries on input and output factors (e.g. traded goods, labour, machine, technologies and products) (Essletzbichler, 2015; Neffke & Henning, 2013). The underlying argument of these approaches is that relatedness across industries reveals itself in high levels of co-occurrence, similarity and/or resource flows between industries, which will only occur consistently over time if these industries are related. Compared to the hierarchical approach, these measures allow for the identification of relatedness between industries that are categorized in different higher level industry classes, as well as for the possibility that co-classified industries may not always build on related knowledge. The strength of this method has been demonstrated in studies of regional industrial dynamics, which have found a consistent relationship between entry and exit of industries and, for example, the skill relatedness of regional industries (Boschma, Minondo, & Navarro, 2013; Essletzbichler, 2015; Neffke, Henning, & Boschma, 2011). However, studies of skill relatedness have mainly focused on the industry level and have so far not been extended to a region-wide measure of relatedness across all regional industries. Consequently, studies at the regional level have been limited to the related variety measure based on co-classification as the only available approach. This paper addresses this shortcoming by proposing a novel regional skill relatedness measure based on mobility flows between industries, using social network analysis to develop an index of the overall level of relatedness across all industries in each region.

The empirical setting of the study is Norway, where we construct both the traditional measure of related variety and a new regional skill relatedness measure to analyse relatedness at the level of Norwegian regions. To identify the industrial composition of Norwegian regions, we rely on register data from Statistics Norway. This database also allows us to identify longitudinal employer-employee linkages, which can subsequently be used to identify industry affiliation and intra-industry mobility rates. The data on industry affiliation are used to calculate related variety, while labour mobility is used to measure skill relatedness across industries. The data on intra-industry mobility and industry affiliation are further combined in a novel measure of regional skill relatedness in Norwegian economic regions.

Comparing the related variety and regional skill relatedness measure, we find that the two measures are strongly correlated. However, the second approach identifies a lot more relatedness across industries in Norwegian regions than the traditional related variety measure would have us believe. A visual inspection of the two measures provides an indication that regional skill relatedness might better illustrate the industrial relatedness structure of a region compared to the traditional related variety measure. Furthermore, the
related variety measure tends systematically to underestimate relatedness in certain types of regions, in particular those specialized in manufacturing industries. Notably, the related variety index is negatively correlated with the share of employees in manufacturing industries, while the regional skill relatedness index is not correlated with the region’s share of manufacturing employment. This produces low scores on the related variety index for many of Norway’s most innovative manufacturing regions, while the regional skill relatedness index identifies a high level of relatedness in these regions.

The remainder of this paper is structured as follows. In the next section, we start with a literature review presenting an overview of studies that have used the concept of related variety to explain regional economic performance and the shortcomings of this measure. Thereafter, we present an alternative method of regional skill relatedness that can address some of these shortcomings. The empirical strategy will be presented in more detail in the method section after which we present the results, comparing the related variety index with the regional skill relatedness measure separately for large, medium-sized and small city regions, as well as for rural regions. The last section concludes.

**Related variety, skill relatedness and regional economic growth**

**Overview of the literature**

There has been a long-standing interest in understanding the link between the industry structure of a region and regional economic performance. Two ideal types of industry structures have dominated this line of research (Van der Panne, 2004). On the one hand, agglomeration externalities that emphasize the importance of regional specialization, often referred to as Marshall–Arrow–Romer (MAR) externalities (Glaeser, Kallal, Scheinkman, & Shleifer, 1992). Such regional specialization leads to thick and specialized labour markets, access to specialized suppliers and large markets, and promotes regional knowledge spillovers, as firms rely on similar knowledge, skills and competences. Conversely, a different school of thought emphasizes agglomeration externalities as the result of diversified regional structures, that is, Jacobs externalities (Jacobs, 1969). In such a regional structure, diversity is the trigger of new ideas, which would lead to new economic activities and subsequent regional economic growth. Diversity could be expected to lead to more radical innovation (Castaldi et al., 2015), while specialization predominantly produces incremental innovation. Empirical research has demonstrated positive and negative effects of both types of externalities on innovation performance and activities (Feldman & Audretsch, 1999; Paci & Usai, 1999; Shefer & Frenkel, 1998).

Frenken et al. (2007), by introducing the concept of related variety, provided a more nuanced perspective on how specialization and diversity affect regional economic performance. They positioned themselves in between the two schools, arguing that knowledge spillovers that are useful for innovation mainly take place across industries which are different, but also not completely unrelated. Knowledge spillovers are not expected between all sectors, as some level of complementarity in competences is required or at least beneficial for knowledge spillovers. However, too much proximity potentially hampers interactive learning and innovation as well (Boschma, 2005; Fitjar, Huber, & Rodriguez-Pose, 2016; Nooteboom, 2000). Consequently, neither regional diversity nor
regional specialization is beneficial for innovation and regional development per se. Interactive learning, innovation and regional development will most likely occur when knowledge flows between sectors that are technologically related, but not identical. Thus, related variety leads to more knowledge spillovers, which will enhance regional growth and employment. On the other hand, unrelated variety, which means that there are no apparent or only limited complementarities between sectors, may have a portfolio effect that protects regions against the impacts of economic shocks, mitigating unemployment growth. However, more recently, studies have argued that such portfolio effects might also be achieved in a setting of related variety if the related sectors are subject to different business cycles (Boschma, 2015; Diodato & Weterings, 2015).

The concepts of related and unrelated variety have lent themselves well to empirical testing. Over the last couple of years, many studies of the effects of related and unrelated variety in industry structure have emerged. These studies have investigated how related and unrelated variety affect a range of regional economic performance indicators, including employment and unemployment growth, productivity, value-added growth and regional innovation capabilities (Bishop & Gripaios, 2010; Boschma & Iammarino, 2009; Boschma et al., 2012; Falcioğlu, 2011; Frenken et al., 2007; Hartog, Boschma, & Sotarauta, 2012; Tavassoli & Carbonara, 2014; Van Oort, de Geus, & Dogaru, 2015). Others have used these concepts to explain national growth rates (Saviotti & Frenken, 2008) and more recently, firm-level performance, using indicators such as innovation and productivity growth (Aarstad, Kvitastein, & Jakobsen, 2016; Antonietti & Cainelli, 2011).

Frenken et al. (2007), upon introducing these concepts, investigated the impact of related and unrelated variety on regional economic development in the Netherlands. The paper examined whether there was a potential spillover effect of related variety, which would create jobs, and a portfolio effect for unrelated variety, which was better able to sustain economic shocks and therefore dampen unemployment. This study concluded that related variety positively affects employment growth, which was corroborated in studies in Italy (Boschma & Iammarino, 2009) and Spain (Boschma et al., 2012). Despite the general character of the theory, there is considerable heterogeneity between sectors in the size of this effect (Bishop & Gripaios, 2010). In particular, the effect is typically stronger for high-tech industries (Hartog et al., 2012). Furthermore, there was an additional positive effect when the region had high levels of related trade variation, that is, when it interacted with regions whose industry structures can be characterized as related, rather than similar or unrelated (Boschma & Iammarino, 2009). Meanwhile, unrelated variety had a negative or non-significant effect on regional employment growth (Boschma et al., 2012; Frenken et al., 2007). However, unrelated variety tends to dampen unemployment growth (Frenken et al., 2007), although these results are not robust for a wider set of European regions (Van Oort et al., 2015).

**Measuring related variety**

In order to measure related variety, research tends to rely on the hierarchical structure of the industrial classification system (Essletzbichler, 2015; Neffke & Henning, 2013). Industrial classification systems like NACE and SIC have various levels of aggregation. These are often utilized to measure related variety. The underlying assumption is that all lower level categories within a higher level category are related. To illustrate, the low-level industry
class ‘manufacturing of batteries and accumulators’ is considered related to the low-level industry class ‘manufacturing of electricity distribution and control apparatus’ since these classes are both part of the higher level industry category ‘manufacturing of electrical equipment’. However, these industries are not related to the manufacturing of fluid power equipment, which belongs to a different higher level industry category (‘manufacturing of machinery and equipment not elsewhere classified’). This approach has several properties that make it an interesting approach for research. First, these classification systems are internationally harmonized, allowing for international comparison and thus for comparative studies of the impact of related variety (Van Oort et al., 2015). Second, similar approaches can be, and have been, applied to other hierarchical classification systems like patents (Castaldi et al., 2015), education, occupations and product classes. Third, the aggregated nature of the data needed to investigate this form of relatedness is often readily available from statistical offices.

However, the downsides of this approach are also obvious as, for example, Neffke and Henning (2013) and Essletzbichler (2015) stress. The classification of industries is not based on considerations of relatedness across them, meaning industries that have little in common are sometimes grouped together. For example, ‘manufacturing of medical and dental instruments and supplies’ is part of the same two-digit category as ‘manufacturing of games and toys’, and ‘transportation via pipelines’ is part of the same category as ‘taxi operation’. In addition, and perhaps more commonly, it also fails to capture apparent relatedness across the higher level categories. For example, one might argue that industries within the same supply and value chain (e.g. ‘manufacturing of computer, electronic and optical products’ and ‘computer programming, consultancy and related activities’) are related, as they both rely on the same skills, competences and technologies. But given that these are in different two-digit industry classes, this type of relatedness is not identified using the traditional co-classification measure.

The concept of skill relatedness

Some of these shortcomings of using the hierarchical method of related variety can be dealt with by measuring relatedness based on flows of resources between different types of industries. Common approaches are to look at input–output tables to identify the presence of strong trade linkages between industries, or, in an approach developed more recently, and which this paper applies, at labour mobility flows (Boschma et al., 2013; Neffke et al., 2011; Neffke & Henning, 2013; Timmermans & Boschma, 2014; Timmermans & Fitjar, 2015). Labour mobility flows provide an indicator of relatedness because workers are more inclined to move to employers who value their skills and competences and reward them according to their human capital. Thus, workers tend change to employers either in the same industry or in industries that rely on similar skills and competences. We thus expect mobility between industry pairs to be more frequent when skills and competences are transferable to another industry. Consequently, higher levels of mobility between industry pairs is a sign that these industries are more related. This measure has been used to predict the entry and exit of new industries, that is, regional branching, in Sweden (Neffke, Henning, & Boschma, 2012), Spain (Boschma et al., 2013) and the US (Essletzbichler, 2015). Furthermore, this indicator of relatedness has also proven useful to explain resilience of Swedish and German shipbuilding industries.
(Eriksson, Henning, & Otto, 2016) and labour productivity growth of Danish plants (Timmermans & Boschma, 2014).

Overall, this measure provides useful information on how individual industries, or firms within a particular industry, are related to other firms and industries in a particular geographic context. Skill relatedness measures have mainly been used to explain industry dynamics and labour market dynamics of particular industries in conjunction with their related industries and individual firm or plant performance. However, as far as we could identify, this industry skill relatedness measure has not yet been aggregated to a regional level and as such has not been compared to the measure of related variety.

**Method**

**Data**

This study investigates the link between regional skill relatedness and related variety as introduced by Frenken et al. (2007) in the context of Norway. We calculate relatedness across regional industries for Norwegian regions using two measures: Frenken et al.’s (2007) measure of related variety, and the novel regional skill relatedness measure which we develop in this paper. Both measures are created based on data from the Norwegian registers. The data contain detailed universal and longitudinal information on the workplace, industry and work location of individuals for the period 2008–2011. From this register, we first build a data set of the number of workers per industry in each economic region of Norway. Industries are identified at the five-digit NACE level. Second, we build a separate data set of inter-industry mobility across industry pairs in Norway, which we subsequently use to construct our skill relatedness measure. Finally, the two data sets are combined to create the regional skill relatedness measure, to which we will return shortly.

We calculate the measures of related variety and skill relatedness for labour-market regions, which in Norway correspond mostly to the statistical category economic regions. Economic regions are officially defined by Statistics Norway (2000) and represent NUTS 4 regions¹ at the level between the counties and municipalities, which are the official political and administrative units.² However, we merge integrated labour markets on the basis of Gundersen and Juvkam’s (2013) analysis of labour market flows.³ This gives a total of 78 regions, which we further classify as large cities, medium-sized cities, small cities, and rural regions, again following Gundersen and Juvkam’s (2013) classification based on population size and availability of services.

**Related variety**

To measure related variety, we follow the same approach as Frenken et al. (2007) of analysing the industrial structure in each region, making a distinction between the higher (two-digit) and lower level (five-digit) NACE industry classification. All five-digit industry classifications $i$ fall under a two-digit industry classification $S_g$, where $g = 1, \ldots, G$. The share of employees in each two-digit industry class ($P_g$) can be calculated by summing the five-digit sub-disciplines ($p_i$). Summing all employment shares in the various industries within a region will add up to 1. The level of unrelated variety in the region is
calculated as an entropy of the distribution of industry classes. This measure is calculated as follows:

\[ \text{URV} = \sum_{g=1}^{G} P_g \log_e \left( \frac{1}{P_g} \right). \]

Related variety is calculated as the weighted entropy index for lower level five-digit NACE industry classes in each of the two-digit industry classes, indicating the diversity within the lower levels.

\[ \text{RV} = \sum_{g=1}^{G} P_g H_g, \]

where

\[ H_g = \sum_{i \in S_g} \frac{P_i}{P_g} \log_e \left( \frac{1}{P_i/P_g} \right). \]

**Regional skill relatedness**

In order to examine the regional skill relatedness in each region, we further develop the measure of skill relatedness between industry pairs based on labour mobility patterns, as developed by Neffke and Henning (2013). To measure this relatedness, we rely on the unique person and workplace identifiers from the register data. These allow us to identify mobility patterns between employers and industries. We use information on nationwide individual workers’ mobility between industries to measure skill relatedness across Norwegian four-digit industries.\(^4\) When observing more mobility than expected between industries, these industries are considered related, as they can be expected to build on similar human capital. We measure the skill relatedness between two industries \(i\) and \(j\) as follows:

\[ \text{SR}_{ij} = \frac{F_{ij}/F}{(F_i/F)(F_j/F)} = \frac{F_{ij} F}{F_i F_j}. \]

In this equation, \(F_{ij}\) is the total number of employees moving from industry \(i\) to industry \(j\); \(F\) is the total number of employees who change employers in any given year; \(F_i\) is the number of individuals who leave a firm in industry \(i\); and \(F_j\) is the number of employees who enter a firm in industry \(j\). We furthermore standardize the measure to a range between \(-1\) and \(+1\) using the formula

\[ \hat{\text{SR}}_{ij} = \frac{\text{SR}_{ij} - 1}{\text{SR}_{ij} + 1}. \]

In order to create a general measure of skill relatedness across industries, we combine data for all regions over a four-year period. This is done to reduce the impact of random noise on the measure, so that only industry pairs which consistently across time and space display higher inter-industry mobility rates than what would be expected due to chance are considered skill-related. Consequently, we apply a four-year measure of skill relatedness in the whole of Norway to identify regional skill relatedness in one particular region\(^5\).
at a particular point in time. Two industries are considered related if $\hat{SR}_{ij}$ is higher than 0.25 for the period 2008–2011 as a whole, and higher than 0 in at least two of the four years. In total, 6614 industry pairs are related, representing 3% of all possible industry pairs and 14.5% of all empirically observed industry pairs. A more detailed description of the method, along with the full relatedness matrix for Norwegian industries, is presented in Timmermans and Fitjar (2015).

These skill relatedness measures only provide an indication of whether particular industry pairs are related and do not provide an overall regional measure of skill relatedness as such. For this purpose, we apply social network analysis in which we combine data on regional employment and skill relatedness to construct network measures for each region. The network analysis is used to measure the number of regional industries related to each industry $i$ by calculating the number of ties between $i$ and all other industries $j$ present in the region. As the relatedness of larger industries is of greater importance for the possibility for local knowledge spillovers, we weight the industry’s number of ties by the square root of its share of regional employment. As an overall measure of regional skill relatedness, we measure the average number of weighted ties for all industries in the region. The introduction of the weight makes the measure sensitive to the overall distribution of regional employment. Hence, we further standardize the measure by dividing the score with the regional average of this weight term. This ensures that the regional skill relatedness index is determined exclusively by the number of ties and not by the distribution of regional employment (and hence by the level of specialization in the region). The regional skill relatedness (RSR) is calculated as follows:

$$\text{RSR}_r = \frac{\left(\sum_{i=1}^{n} \frac{d_i}{2} \sqrt{P_{ir}}\right)/N_{ir}}{\left(\sum_{i=1}^{n} \sqrt{P_{ir}}\right)/N_{ir}},$$

where $P_{ir}$ is industry $i$'s share of total regional employment in region $r$, $N_{ir}$ is the number of industries present in region $r$, and $d_i$ is the sum of incoming and outgoing ties for industry $i$ to other industries in region $r$. The weighted numbers of ties are summed over all $n$ industries present in each region $r$.

Regional skill relatedness and related variety

In order to compare the regional skill relatedness measure to the related variety measure, we compare the scores and rankings of Norwegian regions on the two measures. Overall, the two indices are highly correlated with a Pearson’s $R$ of 0.79. The concurrent validity of the measure is therefore high. However, there are also some notable discrepancies between the two indices. For instance, the related variety index is significantly negatively correlated with the share of manufacturing employment in the region ($R = -0.40$), whereas the regional skill relatedness index is not significantly correlated with manufacturing employment ($R = -0.03$). This suggests that the regional skill relatedness index might be less sensitive than the related variety index to certain types of regional industrial structures, for example, manufacturing regions.

We further examine the face validity of the regional skill relatedness measure through visual inspection of a series of network graphs, focusing on regions in each category where there are discrepancies between the indices. These graphs show the size and relatedness...
ties across industries in one region which ranks higher on the regional skill relatedness measure than on the related variety index, and one region where the opposite is true. Examining the underlying data on which the measure is calculated will give an indication of which types of regional industry structures would produce higher or lower scores on the regional skill relatedness measure.

The possibilities for skill relatedness are highly correlated with region size, that is, the more economic activities there are in a region, the more regional diversity there will be, including related variety and regional skill relatedness. Hence, the bivariate correlation between employment size and regional skill relatedness is 0.59, while the correlation between employment size and related variety is 0.46. To account for this, we conduct the comparisons both across the two indices and across regions which differ in their rankings on the two measures separately for regions of different sizes, looking in turn at large cities, medium-sized cities, small cities and rural regions.

**Large cities**

It is not surprising that the largest city regions are among the regions with highest level of regional skill relatedness and related variety, and that Oslo tops the regional ranking for both measures (see Table 1). The three remaining large city regions are more comparable to each other. However, the ranking of the three is reversed in the regional skill relatedness index compared to the related variety index. In the former, Stavanger is second with Bergen close behind, while Trondheim clearly has a lower score. In the related variety index, Trondheim ranks second, followed closely by Bergen, while Stavanger is trailing by a margin. Furthermore, none of the three regions has particularly impressive scores on the related variety index. Indeed, 5 of the medium-sized city regions discussed below have higher scores than Trondheim on this index, and 12 out of 16 medium-sized city regions have higher scores than Stavanger. This raises the question: Are Norway’s large cities outside the capital region characterized by related variety, as the regional skill relatedness measure would suggest, or are they not, as suggested by the related variety index?

**Figure 1** demonstrates the differences between Trondheim and Stavanger in greater detail. The network graphs show all relatedness ties between industries. The size of the nodes indicates the share of regional employment in this industry. Both regions have dense networks, reflecting that Stavanger and Trondheim are among the regions with the most regional skill relatedness in Norway. Both regions are, however, also specialized in some industries that are not related to any other industries in the region, shown as isolated nodes to the right.

The Stavanger region, which is heavily reliant on the oil and gas industry, has an industry structure that could be characterized as more specialized. However, the oil and gas

|                  | RSR | Rank | RV  | Rank |
|------------------|-----|------|-----|------|
| Oslo             | 16.69 | 1    | 1.47 | 1    |
| Stavanger        | 14.82 | 2    | 1.02 | 4    |
| Bergen           | 14.74 | 3    | 1.17 | 3    |
| Trondheim        | 14.19 | 4    | 1.24 | 2    |
industry is composed of various sub-industries specializing in different aspects of the production of oil and gas (e.g. extraction of oil and gas, oil and gas services and various manufacturing and service industries), and the complete value chain within the upstream part of the industry is represented in the Stavanger region (Fitjar & Rodríguez-Pose, 2011). Hence, the region also has a fairly diversified industry structure within oil and gas. Arguably, this is precisely what the concept of related variety is meant to capture – a series of

Figure 1. Large cities’ regional skill relatedness networks.
different industries that are connected through a common knowledge core, in this case, engineering knowledge, particularly in fields such as chemistry, geology and construction. However, as the oil and gas industry is spread over several two-digit industry codes, covering mining, manufacturing and services, a lot of the relatedness across different sub-sectors of the oil and gas industry is not picked up by the traditional related variety index. The related variety score is therefore lower than in the other city regions.

The oil and gas industry in Stavanger is clearly presented with the two largest nodes in the map (shown in purple). These are related not only to each other but also to many smaller sectors in the region. Notably, several of the major manufacturing sectors (red nodes) in Stavanger are related to oil and gas and tend to cluster close to the oil and gas industries on the map. The effect of this is that larger nodes are placed in close proximity on the map, which indicates that there are relatively strong relatedness ties among larger industries in Stavanger. Conversely, the industries (including manufacturing) located further away from this cluster tend to be smaller. Compared to Stavanger, Trondheim has fewer major nodes, reflecting that the region is less specialized than Stavanger. Furthermore, the largest nodes are in some cases located on opposite edges of the network and are unrelated to each other. Scientific and technical consultancy services (brown nodes) are located in the upper right-hand corner of the map, surrounded by many smaller manufacturing and service (pink nodes) industries. In the opposite corner of the map is a set of construction (yellow nodes) and transportation (blue nodes) industries that have a large share of regional employment, but benefit little from the region’s strength in scientific and technical services (an exception is the electrical installation industry, shown as a large yellow node close in the upper right section, close to scientific and technical consultancy). The same could be said for the financial sector (orange nodes) in the upper left part of the map. Trondheim’s score on the regional skill relatedness measure is therefore lower than Stavanger’s.

**Medium-sized cities**

Table 2 shows the ranking of medium-sized cities. In most cases, the rankings tend to be quite similar. The top three regions in the regional skill relatedness index are also the top three in the related variety index. There are also low-ranking regions on both measures, such as Molde, Bodø, Gjøvik and Lillehammer. However, there are also some discrepancies, which tend to follow along a clear geographical pattern: While the medium-sized coastal cities in Eastern Norway (Drammen, Tønsberg, Fredrikstad, Sandefjord and

| Table 2. Medium cities, regional skill relatedness and related variety scores. |
|--------------------------------|---------------|----------------|---------------|----------------|---------------|
|                               | RSR Score     | Rank | RV Score | Rank | RSR Score | Rank | RV Score | Rank |
| Drammen                        | 14.00         | 1    | 1.42     | 1    | 12.00      | 9    | 1.22      | 6    |
| Tønsberg/Horten                | 13.38         | 2    | 1.33     | 3    | 11.94      | 10   | 1.13      | 9    |
| Fredrikstad/Sarpsborg          | 12.93         | 3    | 1.39     | 2    | 11.64      | 11   | 1.01      | 14   |
| Kristiansand                   | 12.86         | 4    | 1.12     | 10   | 11.60      | 12   | 1.26      | 5    |
| Sandefjord/Larvik              | 12.72         | 5    | 1.26     | 4    | 11.34      | 13   | 1.07      | 11   |
| Skien/Porsgrunn                | 12.51         | 6    | 1.17     | 7    | 10.89      | 14   | 1.15      | 8    |
| Haugesund                      | 12.18         | 7    | 0.90     | 16   | 10.85      | 15   | 1.01      | 13   |
| Arendal                        | 12.08         | 8    | 0.98     | 15   | 8.83       | 16   | 1.07      | 12   |

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Skien) tend to do well on both measures, the southwestern cities Haugesund, Kristiansand and Arendal all score much higher on the regional skill relatedness than on the related variety index. Kristiansand is fourth on the regional skill relatedness index, but only tenth on the related variety index. Similarly, Haugesund and Arendal are both above the median in this category for regional skill relatedness, but occupy the two lowest places in the related variety index ranking. Conversely, another group of cities in Eastern Norway – Moss, Hamar, Gjøvik and Lillehammer – all rank higher on the related variety than on the regional skill relatedness index, as do the Northern Norwegian cities Tromsø and Bodø.

How can this be accounted for? To examine this, Figure 2 shows the skill relatedness maps for Haugesund and Tromsø, which moved in opposite directions on the two indices. The two regions are similar in size, with a population in 2008 of 99,000 and 78,000, respectively, although Haugesund has a higher share of private sector employment, translating into a private sector workforce that was 55% higher than Tromsø’s in the industries considered. The industrial structures of the two regions are also quite different. As the maps show, Haugesund relies much more on manufacturing (red nodes) than Tromsø. The two largest industries in Haugesund are both in manufacturing (shipbuilding and aluminium production). Both of these are also located quite centrally in the map and are surrounded by several smaller manufacturing industries. This includes various metal products and machine production industries, which – as they are in different two-digit categories – are not picked up by the related variety index as being related to either of the two largest industries. This is also true for other large industries in Haugesund, such as the sea freight industry (blue node at the top) and the oil and gas industries (purple nodes). The related variety index therefore fails to detect a lot of the relatedness across industries in Haugesund, while the regional skill relatedness measure picks up much more of these linkages.

The manufacturing industries in Tromsø are much smaller and also more dispersed throughout the map. Tromsø’s major specializations include the construction (yellow nodes) and transport (blue nodes) industries, which form two separate clusters in the upper right and left parts of the map, respectively. The industries within these sectors tend to be skill-related, but this kind of relatedness is to a greater extent also picked up by the related variety index, as construction and transport both cover a limited number of two-digit industries (3 and 5, respectively, compared to 24 in manufacturing). Being host to a research university, Tromsø also has a set of scientific and technical service industries (brown nodes) which cluster at the bottom of the map. However, as in Trondheim, these industries are somewhat disconnected from other large industries in Tromsø, although they are related to a series of smaller information and communication services (pink nodes) and financial services (orange nodes) industries in Tromsø. Overall, however, the division between two or three relatively unrelated specializations in construction, transport and scientific/technical services translate into a fairly low level of regional skill relatedness in Tromsø.

Small cities

Moving to smaller city regions (see Table 3), a similar pattern emerges. The top of the two rankings is once more identical, with the same two regions occupying the first two
positions in both rankings. However, also in this category, there is a group of manufacturing-oriented regions with very high scores in the regional skill relatedness index, which are in the bottom places on the related variety index. This includes the third-ranking region Sunnhordland and fifth-ranking Kongsberg, as well as Egersund, Sogndal/Årdal, Halden and Mo i Rana. All of these regions are mainly specialized in one or more manufacturing industries, which tends to result in lower related variety scores due to the limited number

Figure 2. Medium cities’ regional skill relatedness networks.
of four-digit industries normally present within each two-digit manufacturing sector in most regions. Conversely, several regions in Northern Norway score much higher in the related variety than in the regional skill relatedness index also in this category. This includes regions such as Alta and Kirkenes, both in Finnmark, which are third and sixth, respectively, in the related variety index, while they are nineteenth and rock bottom, respectively, in the regional skill relatedness index. Other northern regions, such as Hammerfest and Finnsnes, also move in the same direction. Much like Tromsø, these regions tend to be much more dominated by the construction and transportation services sectors.

To illustrate this, Figure 3 shows the network graphs for Kongsberg in Eastern Norway and Kirkenes in Finnmark. Kongsberg is fifth in the regional skill relatedness measure, but third from bottom in the related variety index. The opposite is the case for Kirkenes, which is sixth in the related variety index, but last in the regional skill relatedness index. The dominance of manufacturing industries in Kongsberg is clear from the large red nodes in the upper left part of the network. Kongsberg has emerged in recent years as one of the major high-technology manufacturing regions in Norway, home to the Subsea Valley oil and gas technology cluster, as well as leading weapons manufacturers (Isaksen, 2009; Onsager, Isaksen, Fraas, & Johnstad, 2007). The three largest nodes in Kongsberg are shipbuilding, weapons manufacturing and instrument manufacturing, which all belong to different two-digit NACE industries, but are clearly skill-related as shown by the links between them as well as their proximity in the map. Most other manufacturing industries in Kongsberg are also located close to the largest industries, while the service industries tend to be fairly detached from this cluster. Overall, however, the relatedness ties among all three dominant industries, as well as the many ties between these and other industries in Kongsberg, lead to a high regional skill relatedness score for Kongsberg.

Kirkenes is also specialized in a manufacturing industry, in this case, ship repairs. This industry also has a central position in the regional network, although with few other manufacturing industries nearby. However, the construction and transportation industries are much more important in Kirkenes than in Kongsberg, as shown by the larger yellow and blue nodes. In particular, many of the construction industries are in the two-digit category specialized construction, while many of the transportation industries are in storage or land

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**Table 3. Small cities, regional skill relatedness and related variety scores.**

|                | RSR  | RV   | RSR  | RV   | RSR  | RV   |
|----------------|------|------|------|------|------|------|
|                | Score| Rank | Score| Rank | Score| Rank |
| Askim/Mysen    | 10.56| 1    | 1.21 | 1    | 8.21 | 16   |
| Kongsvinger    | 10.17| 2    | 1.08 | 2    | 8.19 | 17   |
| Sunnhordland   | 10.02| 3    | 0.66 | 28   | 8.12 | 18   |
| Hønefoss       | 9.75 | 4    | 0.92 | 13   | 8.11 | 19   |
| Kongsberg      | 9.69 | 5    | 0.68 | 27   | 7.96 | 20   |
| Kristiansund   | 9.52 | 6    | 0.97 | 5    | 7.91 | 21   |
| Steinaker      | 9.19 | 7    | 0.95 | 9    | 7.23 | 22   |
| Levanger/Verdalsøra | 9.02 | 8 | 0.83 | 18 | 7.22 | 23 |
| Halden         | 8.90 | 9    | 0.70 | 25   | 7.13 | 24   |
| Harstad        | 8.85 | 10   | 0.93 | 10   | 7.09 | 25   |
| Notodden/Bø    | 8.71 | 11   | 0.95 | 8    | 6.98 | 26   |
| Mo i Rana      | 8.45 | 12   | 0.82 | 19   | 6.82 | 27   |
| Elverum        | 8.39 | 13   | 0.99 | 4    | 6.53 | 28   |
| Egersund       | 8.38 | 14   | 0.65 | 30   | 5.90 | 29   |
| Førde          | 8.35 | 15   | 0.95 | 7    | 5.61 | 30   |
transport, leading to a high score on the related variety index. However, particularly in the case of construction, these industries are not skill-related, as the network map shows. For instance, the large node in electrical installations is only related to one other industry in Kirkenes and is therefore on the periphery of the network, even though there are

**Figure 3.** Small cities’ regional skill relatedness networks.
several other specialized construction industries in the region. In this case, therefore, the related variety index might have, in some cases, overestimated relatedness across industries in Kirkenes. Meanwhile, the largest nodes are spread out in different parts of the regional network, with large nodes in the top, bottom, right and centre of the network. Few large industries are located in the vicinity of other large industries in Kirkenes. This results in a low regional skill relatedness score.

**Rural regions**

Finally, the classification for rural areas tends to show the largest discrepancies. While there are certainly many regions that are at the top or, especially, at the bottom of both indices, this is the only category where the top of the two lists looks quite different. In particular, the top-ranking region for regional skill relatedness, Ulsteinvik, is nearly at the bottom of the related variety index. Conversely, a region in Finnmark once more stands out with a much higher score in the related variety index than in the regional skill relatedness measure: Vadsø is second for related variety, compared to its twelfth place in the regional skill relatedness index. Nonetheless, there are also similarities. In particular, several inland regions in Eastern Norway, such as Hadeland, Hallingdal and Valdres, do well on both measures, while the smallest regions are at the bottom in both indices, as would also be expected (Table 4).

Figure 4 shows the network maps for Ulsteinvik and Rørvik, which have similar related variety scores (0.63 and 0.60, respectively), even though Ulsteinvik’s regional skill relatedness score is more than double that of Rørvik. Ulsteinvik is a heavily manufacturing-oriented region which hosts world-leading and highly technologically sophisticated shipbuilding firms (Karlsen, 2005). Its largest sectors are shipbuilding (red node) and ship transportation (blue node). Shipbuilding in particular is related to a large number of other manufacturing industries in Ulsteinvik, mostly in the machine or metal products manufacturing sectors. Consequently, most manufacturing industries in Ulsteinvik are located in close proximity on the map, linked by a large number of relatedness ties. This results in a high score on the regional skill relatedness index. However, many of these linkages are not picked up by the related variety index, as shipbuilding belongs to

**Table 4.** Rural regions, regional skill relatedness and related variety scores.

| Region               | RSR Score | Rank | RV Score | Rank | RSR Score | Rank | RV Score | Rank |
|----------------------|-----------|------|----------|------|-----------|------|----------|------|
| Ulsteinvik           | 8.90      | 1    | 0.63     | 24   | 6.10      | 15   | 0.67     | 22   |
| Nordfjord            | 8.55      | 2    | 0.95     | 3    | 6.03      | 16   | 0.80     | 11   |
| Vesterålen           | 8.18      | 3    | 0.91     | 6    | 5.97      | 17   | 0.76     | 15   |
| Hadeland             | 7.97      | 5    | 1.05     | 1    | 5.90      | 18   | 0.74     | 17   |
| Valdres              | 7.66      | 4    | 0.93     | 5    | 5.70      | 19   | 0.77     | 12   |
| Hallingdal           | 7.46      | 6    | 0.94     | 4    | 5.66      | 20   | 0.42     | 27   |
| Nord-Gudbrandsdalen  | 7.19      | 7    | 0.86     | 10   | 5.46      | 21   | 0.39     | 28   |
| Lyngdal/Farsund      | 7.17      | 8    | 0.76     | 14   | 5.34      | 22   | 0.68     | 21   |
| Flekkefjord          | 6.85      | 9    | 0.72     | 18   | 5.14      | 23   | 0.71     | 19   |
| Midt-Gudbrandsdalen  | 6.83      | 10   | 0.90     | 7    | 4.94      | 24   | 0.74     | 16   |
| Risør                | 6.62      | 11   | 0.86     | 9    | 4.70      | 25   | 0.76     | 13   |
| Vadsø                | 6.34      | 12   | 0.95     | 2    | 4.53      | 26   | 0.64     | 23   |
| Brekstad             | 6.34      | 13   | 0.71     | 20   | 4.18      | 27   | 0.60     | 25   |
| Vest-Telemark        | 6.20      | 14   | 0.87     | 8    | 4.10      | 28   | 0.42     | 26   |
a different two-digit category (manufacture of transport equipment) than machine or metal products manufacturing. Ulsteinvik’s score on the related variety index is therefore much lower.

Figure 4. Rural regions’ regional skill relatedness networks.
Ostensibly, the industry structure in Rørvik is similar to that of Ulsteinvik, although the region is much smaller. Its largest industries are also ship transportation – as in Ulsteinvik – and a manufacturing industry. However, in this case, the manufacturing specialization is fish processing, which has less to do with ship transportation than Ulsteinvik’s shipbuilding industry. Fish processing also has fewer ties to other industries in Rørvik in general, with only a few other small food production industries related to it. The other manufacturing industries in Rørvik are located in a different part of the map, and are mostly quite small. Furthermore, ship transportation is only related to three other industries in Rørvik, whereas the same industry has seven related industries in Ulsteinvik. Despite being one of the least densely populated regions in Norway, Rørvik also has a small concentration of IT industries (pink nodes), the largest being wireless telecommunications. However, this is located in a different part of the network from the other large industries in the region. Overall, there are also considerably fewer ties across industries in Rørvik than in Ulsteinvik, as the density of linkages on the two maps illustrates. This results in a low score for Rørvik on the regional skill relatedness index.

**Conclusion**

Understanding how the different industrial structures of regions create or deter opportunities for knowledge flows between industries has long been a topic of interest for academics and policy-makers. During the last 10 years, the concept of related variety, which takes into account the extent to which industries in a given region build on related knowledge, has gained momentum as an approach to explaining regional economic performance. Existing empirical research tends, with some exceptions, to support this idea. However, the empirical support for the benefits of related variety has relied mainly on studies using indices which build on the co-classification of industries in the NACE hierarchical industry classification system. In the meantime, new measures of industry relatedness have been introduced which are in many cases clearly better at identifying relatedness between industries. In particular, such measures are able to capture links between industries that build on related knowledge, but which are classified in different parts of the NACE system. However, these measures tend to focus on individual industries rather than regional systems. A macro-level measure of relatedness at the regional level has hitherto not existed.

In this paper, we have created such a measure. The paper proposes a measure of regional skill relatedness based on empirical measurement of relatedness ties across regional industries as identified by labour mobility flows. We create and calculate this measure for all Norwegian regions using social network analysis, building on the comprehensive linked employer–employee data available from Statistics Norway. We further compare the measure to the related variety measure as introduced by Frenken et al. (2007). When comparing these measures, we see some notable discrepancies between them. Relatedness between industries appears to be underestimated for most regions in the related variety index. This underestimation is mainly driven by the failure of the related variety index to identify a large number of linkages between industries belonging to different two-digit NACE codes. Relying exclusively on related variety as identified by the classification hierarchy would particularly be problematic for smaller regions, where many industries are not co-located with other industries in the same two-digit NACE
The measure of regional skill relatedness identifies these industries more clearly, thus highlighting a larger number of industries that can (potentially) benefit from being co-located in the same area. Furthermore, while the sheer number of relatedness linkages is underestimated in all regions, this is particularly a problem in manufacturing-oriented regions. The correlation analysis demonstrates a negative correlation between the share of employees active in manufacturing industries and related variety, and this is also apparent in several of the individual regions shown in the analysis. A consequence of this is that regions specializing in manufacturing tend to score lower on the related variety index than on the regional skill relatedness index in all size categories. Consequently, the level of related variety in many of Norway’s most technologically sophisticated and export-oriented manufacturing regions is severely underestimated by the related variety index, including large cities such as Stavanger, medium-sized cities such as Kristiansand and Haugesund, small cities such as Sunnhordland, Kongsberg and Halden, and rural regions such as Ulsteinvik. Conversely, the proposed regional skill relatedness index picks up more of the relatedness across industries in these regions, placing many of them close to the top of the rankings in the respective categories.

This has implications for regional policy building on the concept of relatedness, also beyond the Norwegian context. If the related variety index tends to underestimate relatedness, in particular in manufacturing regions, entrepreneurial discovery processes (Foray, 2015) may simply fail to identify many promising combinations of existing regional skills and competences. Policy-makers thus need to include a broad variety of indicators in their analyses and build on empirical measures of industry relatedness rather than co-classification. The analyses of Norwegian regions also show that there are highly different relatedness patterns, even across regions of similar size. While there is clearly more relatedness in large urban regions than in smaller and more peripheral ones, there are also large differences across regions within each category. An effective regional policy for Ulsteinvik would likely look very different from an effective policy for Rørvik, and Kongsberg has very different needs from Kirkenes. Hence, we should be cautious of policy approaches that treat all rural or peripheral regions as the same, or indeed which dish out the same policy solutions for all large urban regions. One size does not fit all, even if they are all peripheral, to paraphrase Tödtling and Trippl (2005). The development of appropriate regional policies has to depart from specific analyses of the regional context in each individual region.

Our analysis comes with some limitations. First, our proposed measure needs to be fine-tuned further, as it is strongly correlated with the size of the region. A consequence of this is that it is challenging to investigate how well this measure can explain regional economic performance beyond general centralization trends. Second, the Norwegian context is one of the factors that should be considered. Our findings thus provide a call for future research to investigate the robustness of our proposed regional skill relatedness measure, not only compared to the Norwegian setting, but also to existing measures of regional industrial diversity. The oil and gas industry plays an important role in the Norwegian economy as it provides jobs for a diverse labour force, paying high wages. As such, labour mobility patterns and subsequent related variety might be to some extent affected by the strong dominance of this industry. Furthermore, Norway’s main industries are in many cases distributed across different NACE categories. This is the case for oil and gas, but also for maritime industries as the examples discussed in the paper have shown. This
might lead the related variety index into greater problems in Norway than in industrial settings that conform more to the logic of the classification hierarchy. Third, relatedness based on labour mobility patterns is only one way to empirically measure industry relatedness. Other measures could also be aggregated into regional indices (see Neffke and Henning (2013) and Essletzbichler (2015) for a more detailed discussion on the type of relatedness measures that can be constructed). However, this paper has provided a first step towards developing an overall regional measure of relatedness which relies on empirical industry relatedness rather than on the classification hierarchy.

Notes

1. Norway, with its population of 5.2 million inhabitants, is among the most sparsely populated countries in Europe. Consequently, economic regions are highly dispersed in both geographic size and population size, and the NUTS 3 regional classification is relatively large. Smaller Norwegian NUTS 3 regions are often the same size as NUTS 2 regions in other European countries, while regions located in the north are similar in geographical extent to the countries of Denmark, the Netherlands or Belgium. Hence, NUTS 4 regions is the best equivalent of functional economic regions. As we question the validity of these knowledge spillover dynamics in regions which cover very large areas, we rely on NUTS 4 regions in our analyses.

2. However, many economic regions are also represented by organizations such as regional councils or regional development agencies, which are normally joint ventures by several neighbouring municipalities with responsibilities especially for development policy.

3. The following economic regions are identified as part of the same labour market by Gundersten and Juvkam (2013) and are therefore classified as one region: Oslo, Follo, Bærum/Asker, Lillestrøm and Ullensaker/Eidsvoll; Drammen and Sande/Svelvik; Tønsberg/Horten and Holmestrand; Skien/Porsgrunn and Kragerø; Kristiansand and Lillesand; Stavanger/Sandnes and Kragerø; Kristiansand and Lillesand; Stavanger/Sandnes and Jæren; Kristiansand and Lillesand; Stavanger/Sandnes and Jæren; Haugesund and Søndre Sunnhordland; Trondheim and Stjørdalshalsen; and Namsos and Grong.

4. When calculating the regional skill relatedness index, industries are measured at the four-digit level in order to retain a reasonable number of employees in each industry. While the related variety index is measured at the five-digit level for consistency with Frenken et al.’s (2007) approach, we have also tried calculating this at the four-digit level with no meaningful differences in the results.

5. Of course, labour mobility could be higher (or lower) between an industry pair in a particular region, leading these industries to be related in this region even if they are not related at the national level (or vice versa). However, the intention here is to identify industries which are related in a more general sense of building on the same skills, and we therefore calculate a national measure where industries are only considered related if the mobility levels between them are high across the whole country. It is thus not possible to determine from the relatedness maps whether there are actually high levels of mobility between any two industries in an individual region, only that these industries are related in the sense of building on the same skills as evidenced by higher than expected mobility at the national level.

6. The analysis focuses on employment in the private sector only. Following Frenken et al. (2007), we further exclude the primary sector industries agriculture and fisheries from the analysis. We also exclude retail, hotels and restaurants, as well as temp agencies. The three former industries are excluded, as they include lots of temporary workers, while the latter is excluded, as it mainly acts as a channel to place workers in other industries; consequently, the knowledge and skills that are being transferred are not specific to the temp agency industry, but related to the industries in which temp agencies place workers.

7. The sum of all industries’ employment shares is by definition 1 in all regions. However, the root transformation implies that the sum of the weights will be higher for regions with more diversified industrial structures than for more specialized regions.
Acknowledgements

Earlier drafts of the paper have been presented at workshops in Stavanger and Oslo. The authors are grateful to all participants at these events for their helpful comments and suggestions.

Disclosure statement

No potential conflict of interest was reported by the authors.

Funding

This work was supported by the Research Council of Norway (Norges Forskningsråd) under the programmes Demosreg, grant no. 209761, and VRI, grant no. 233737. The relatedness matrix and regional industrial statistics were analysed in the former project based on data from Statistics Norway, and the relatedness matrix developed in this project is available in Timmermans and Fitjar (2015). The regional skill relatedness method was further developed in the latter project.

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