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1998

The Competitive Advantage of Nations

The Problem

- The long-dominant paradigm for why nations succeed internationally in particular industries is showing signs of strain.
 - There is an extensive history of theories to explain the patterns of nations' exports and imports, dating back to the work of Adam Smith and David Ricardo, but it has been generally recognized that these theories have grown inadequate.

The Problem (cont'd)

- Changes in the nature of international competition, among them the rise of the multinational corporation that not only exports but competes abroad via foreign subsidiaries, have weakened the traditional explanations for why and where a nation exports.
- Though new rationales have been proposed, none is sufficient to explain why firms based in particular nations are able to compete successfully in particular industries.

The Role of Productivity

- The only meaningful concept of competitiveness at the national level is national productivity.
- If there were no international competition, the level of productivity attainable in a nation's economy would be largely independent of what was taking place in other nations.
- A nation can thereby specialize in those industries and segments in which its firms are more productive and import those products and services where its firms are less productive than foreign rivals.

Toward a New Theory of National Competitive Advantage

- The central question to be answered is why do firms based in particular nations achieve international success in distinct segments and industries?
 - The search is for the decisive characteristics of a nation that allow its firms to create and sustain competitive advantage in particular fields.
- Competitive advantage is created and sustained through a highly localized process.
 - Differences in national economic structures, values, cultures, institutions, and histories contribute profoundly to competitive success.

Industry

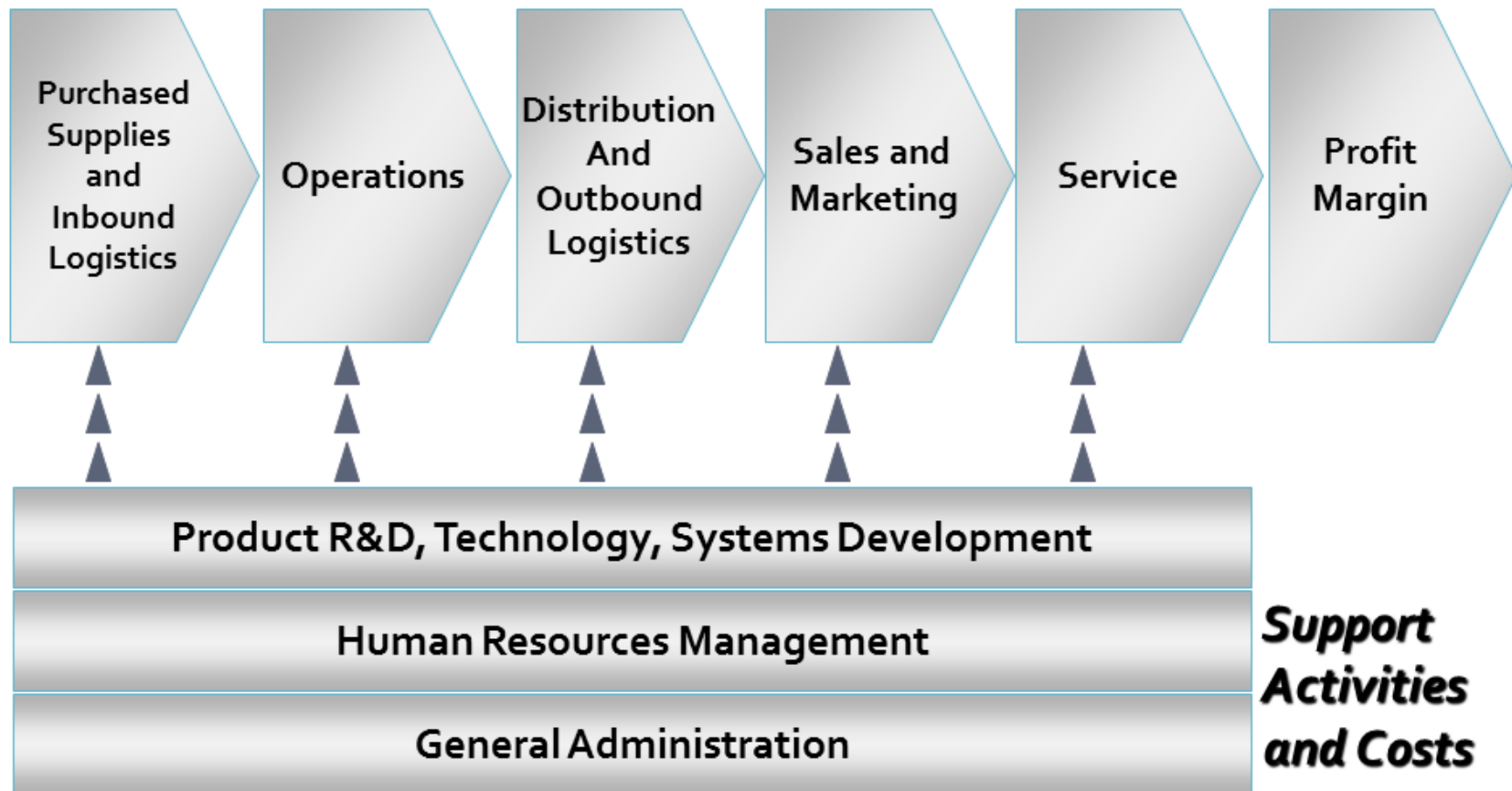
- The basic unit of analysis for understanding competition is the industry.
- Many discussions of competition and international trade employ overly broad industry definitions such as banking, chemicals, or machinery.
 - These are not strategically meaningful industries because both the nature of competition and the sources of competitive advantage vary a great deal within them.
- For our new theory, an industry is a group of competitors producing products or services that compete directly with each other.

Sources of Competitive Advantage

- Competitive advantage grows out of the way firms organize and perform discrete activities.
 - The operations of any firm can be divided into a series of activities such as salespeople making sales calls, service technicians performing repairs, scientists in the laboratory designing products or processes, and treasurers raising capital.
- The activities performed by a firm can be grouped into categories in what is called a “Value Chain” (see next slide).
- Firms gain competitive advantage from conceiving of new ways to conduct activities.

The Value Chain

Primary Activities and Costs



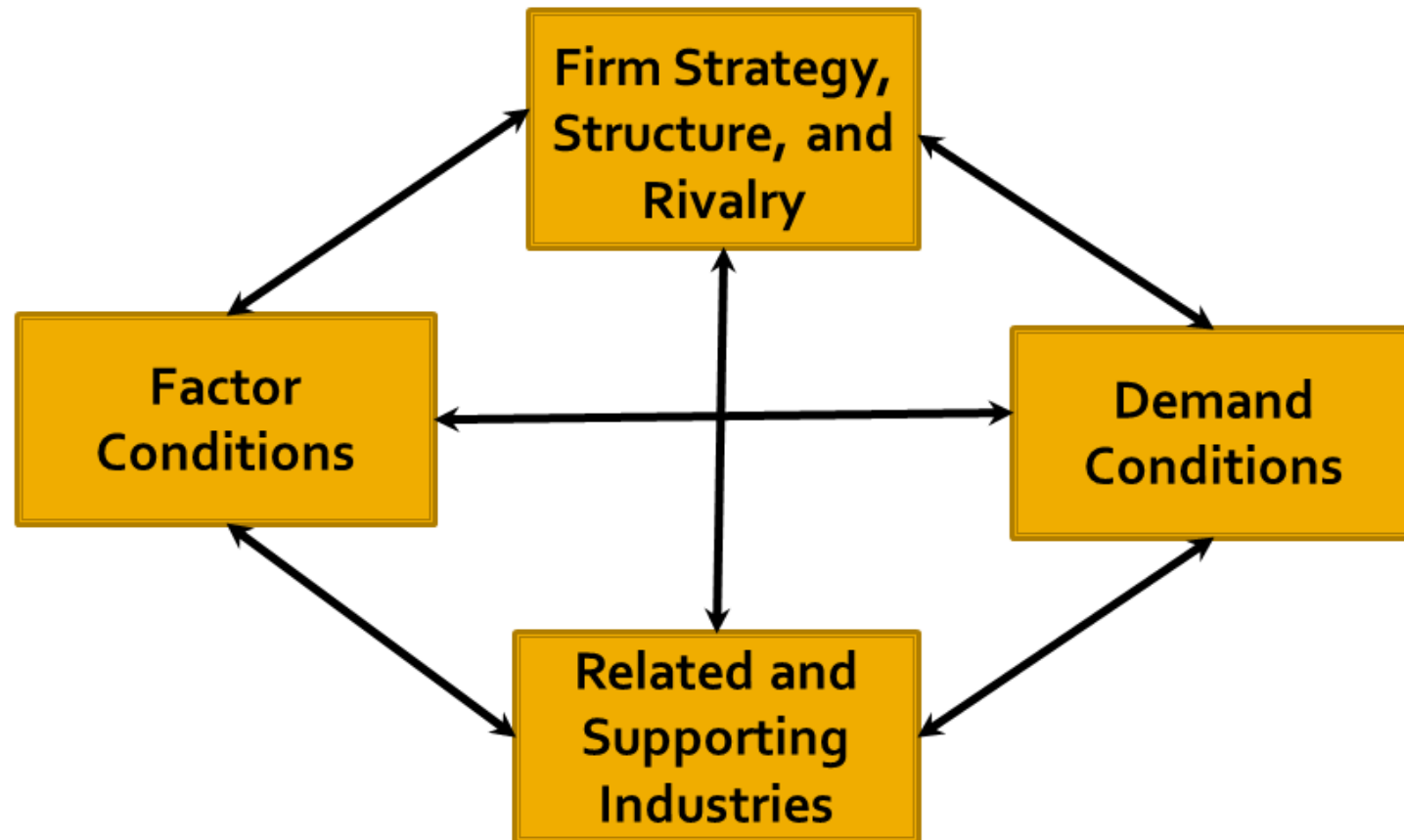
Determinants of National Competitive Advantage

- The nature of competition and the sources of competitive advantage differ widely among industries and even industry segments.
 - We must isolate the specific influence of the nation on the firm's ability to compete.
- Global competitors often perform some activities in their value chains outside their home country.
- Firms gain and sustain competitive advantage in international competition through improvement, innovation, and upgrading.
- Firms that gain competitive advantage in an industry are often those that not only perceive a new market need or the potential of a new technology but those that move early and most aggressively to exploit it.

Determinants of National Competitive Advantage (cont'd)

- There are four broad attributes of a nation that shape the environment in which local firms compete that promote or impede the creation of competitive advantage (see the diagram on the next slide).
 - **Factor conditions** – The nation's position in factors of production, such as skilled labor or infrastructure, necessary to compete in a given industry.
 - **Demand conditions** – The nature of home demand for the industry's product or service.
 - **Related and supporting industries** – The presence or absence in the nation of supplier industries and related industries that are internationally competitive.
 - **Firm strategy, structure, and rivalry** – The conditions in the nation governing how companies are created, organized, and managed, and the nature of domestic rivalry.

Broad Attributes that Shape a Nation's Environment for Competitive Advantage



Broad Attributes: Factor Conditions

- Each nation possesses factors of production.
- Factors of production include:
 - Human resources
 - Physical resources
 - Knowledge resources
 - Capital resources
 - Infrastructure

Broad Attributes: Demand Conditions

- The most important influence of home demand on competitive advantage is through the mix and character of home buyer needs.
 - Nations also gain advantage in selected industries if home buyers pressure local firms to innovate faster and achieve more sophistication.
- The home market usually has a disproportionate impact on a firm's ability to perceive and interpret buyer needs for several reasons.
 - Attention – more sensitivity to nearby needs
 - Location – product development teams are usually based in home markets
 - Pride and ego – focus attention on home markets
 - Proximity and cultural similarity – makes for clearer communications.

Broad Attributes: Related and Supporting Industries

- A determinant of national advantage in an industry is the presence of supplier or related industries that are internationally competitive.
 - The home market is highly visible to domestic suppliers, and success there is a matter of pride.
 - Proximity of managerial and technical personnel, along with cultural similarity, tends to facilitate communication and information flow.
 - Related industries are advantageous because they permit sharing of activities in the value chain.

Broad Attributes: Strategy and Structure of Domestic Firms

- The way in which firms are managed and choose to compete is affected by national circumstances.
 - No managerial system is universally appropriate.
- Important national differences occur in such areas as training, background and orientation of leaders, group versus hierarchical style, the strength of individual initiative, the tools for decision making, the nature of the relationships with customers, the ability to coordinate across functions, the attitude toward international activities, and the relationship between labor and management.

Broad Attributes: Domestic Rivalry

- Among the strongest empirical findings is the association between vigorous domestic rivalry and the creation and persistence of competitive advantage in an industry.
- It is often argued that domestic competition is wasteful, because it leads to duplication of effort and prevents firms from gaining economies of scale.
- A look at the successful industries in the ten nations we studied cast grave doubts on this viewpoint.
- Nations with leading world positions often have a number of strong local rivals.

An Additional Broad Attribute: The Role of Chance

- In the histories of most of the successful industries we studied, however, chance events also played an important role.
- Chance events are occurrences that may have little to do with the circumstances of a nation and are often largely outside the power of firms and national governments to influence.
- Some examples of chance events are: inventions, discontinuities in input costs (oil discoveries), political decisions by foreign governments, and wars.

The Bigger Picture

- Having described the determinants of competitive advantage (including chance), a final variable is the role of government.
- Government is prominently discussed in treatments of international competitiveness.
- Many see it as a vital, if not the most important, influence on international competition, yet this is neither correct nor the most useful way to understand government's role.
- Government's role in national competitive advantage is in its influence of the four determinants previously discussed (see diagram on next slide).

Broad Attributes that Shape a Nation's Environment for Competitive Advantage

