

Competitiveness as an Engine for Economic Growth: Implications for Saudi Arabia

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This presentation draws on ideas from Professor Porter's articles and books, in particular, The Competitive Advantage of Nations (The Free Press, 1990), "Building the Microeconomic Foundations of Competitiveness," in The Global Competitiveness Report 2006 (World Economic Forum, 2006), "Clusters and the New Competitive Agenda for Companies and Governments" in On Competition (Harvard Business School Press, 1998), and ongoing research on clusters and competitiveness. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means - electronic, mechanical, photocopying, recording, or otherwise - without the permission of Michael E. Porter. Further information on Professor Porter's work and the Institute for Strategy and Competitiveness is available at www.isc.hbs.edu Version: January 18, 2008, 4pm

Saudi Arabia's Competitive Position in 2008

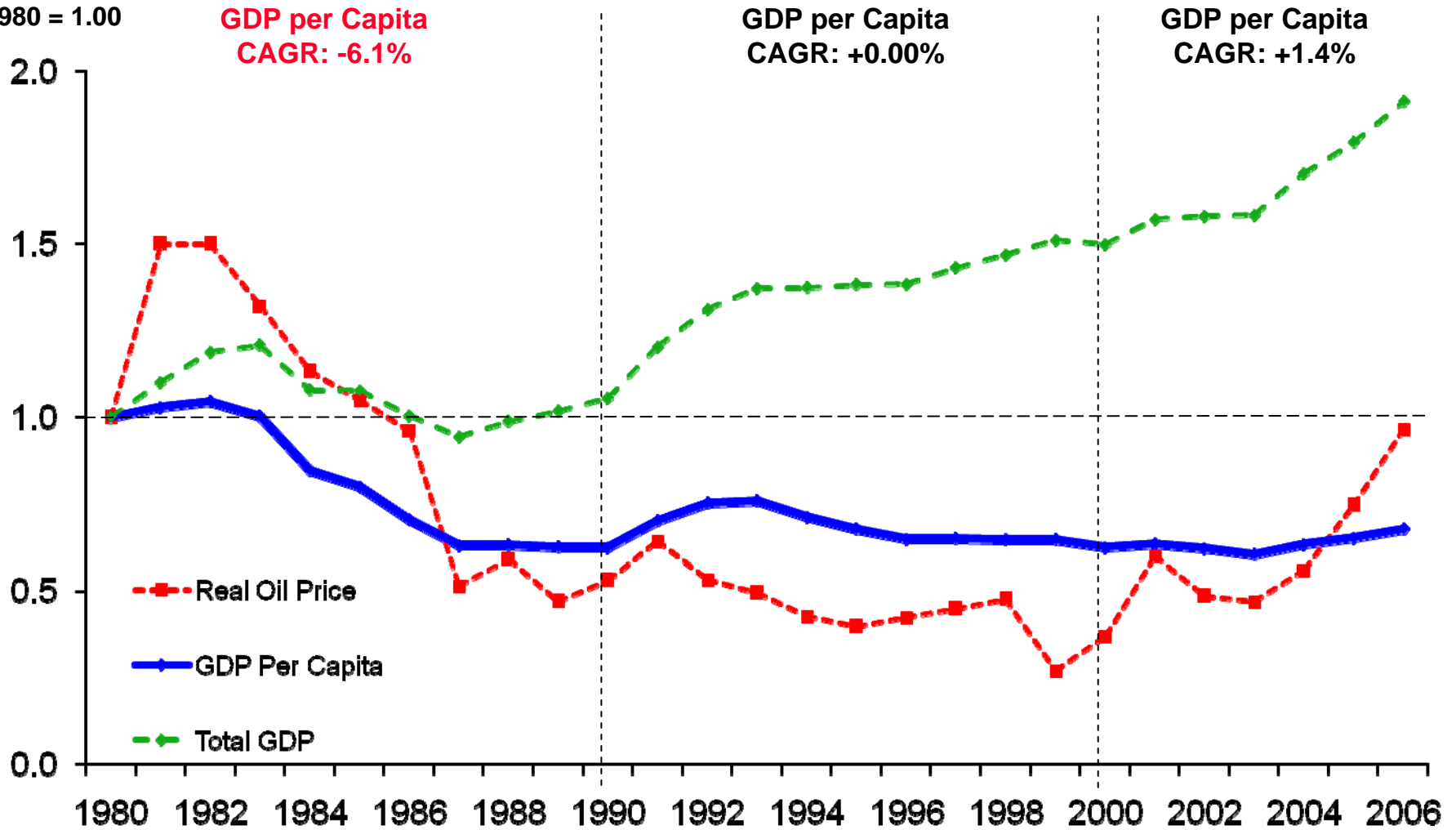
- The dramatic increase in oil prices has created **significant** resources and **rapid** growth for the Saudi economy
- There is a **new level of determination** to leverage this opportunity to build a truly competitive economy and diversify beyond natural resources
- Saudi Arabia can **succeed on this path**, but only if it is willing to take a strategic approach, make multiple improvements in its business environment, truly open up competition and entrepreneurship in the private sector, and embark on a sustained effort to equip Saudi citizens with new skills, attitudes and mindsets



- It will be easy to become **impatient and distracted** by near term economic growth and the ability to support uncompetitive practices and policies

Saudi Arabia's Long-Term Prosperity

Index Values,
1980 = 1.00

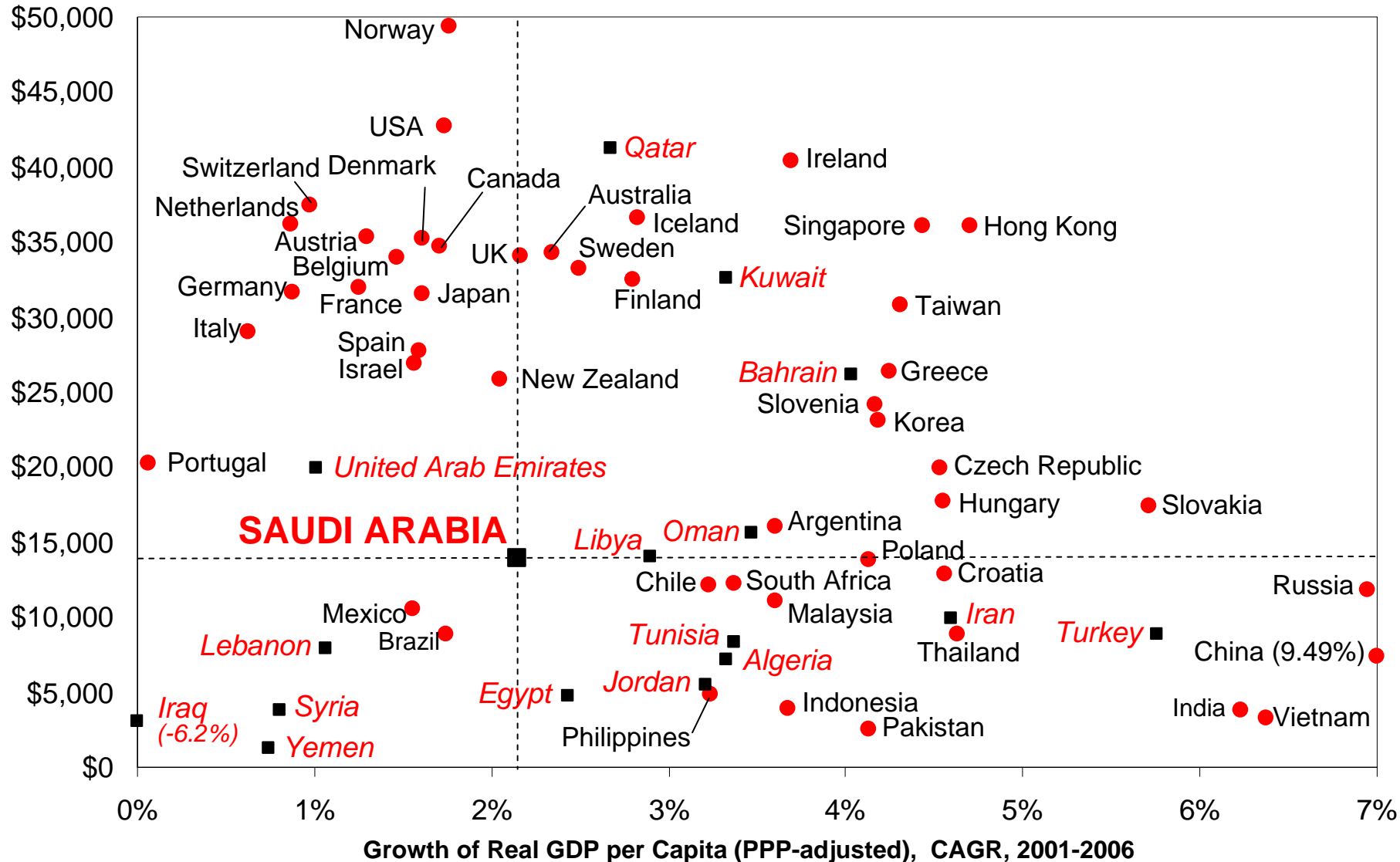


Source: Groningen Growth and Development Centre and The Conference Board (2007), Swivel (2007)

Prosperity Performance

Selected Countries

PPP-adjusted GDP
per Capita, 2006



Source: EIU (2007), authors calculations

Competitiveness Master = 2007-11-14.ppt

What is Competitiveness?

- Competitiveness is determined by the **productivity** with which a nation uses its human, capital, and natural resources.
 - Productivity **sets the standard of living** (wages, returns on capital, returns on natural resources) that a country can sustain
 - It is not **what** industries a nation competes in that matters for prosperity, but **how** it competes in those industries
 - Productivity in a national economy arises from a **combination of domestic and foreign firms**
 - The productivity of **“local” or domestic industries** is fundamental to competitiveness, not just that of export industries



- Nations compete in offering the **most productive environment for business**
- The public and private sectors play **different but interrelated roles** in creating a productive economy

Sources of Prosperity

Inherited Prosperity

- Prosperity is derived from selling or exploiting **inherited natural resources**
- Prosperity is **constrained**



- **Government** is the central actor in the economy as the owner and distributor of resource wealth
 - Resource revenues allow **unproductive policies and practices to persist**
- **Government's role** gravitates towards the **distribution of wealth** as interest groups seek a bigger share of the pie

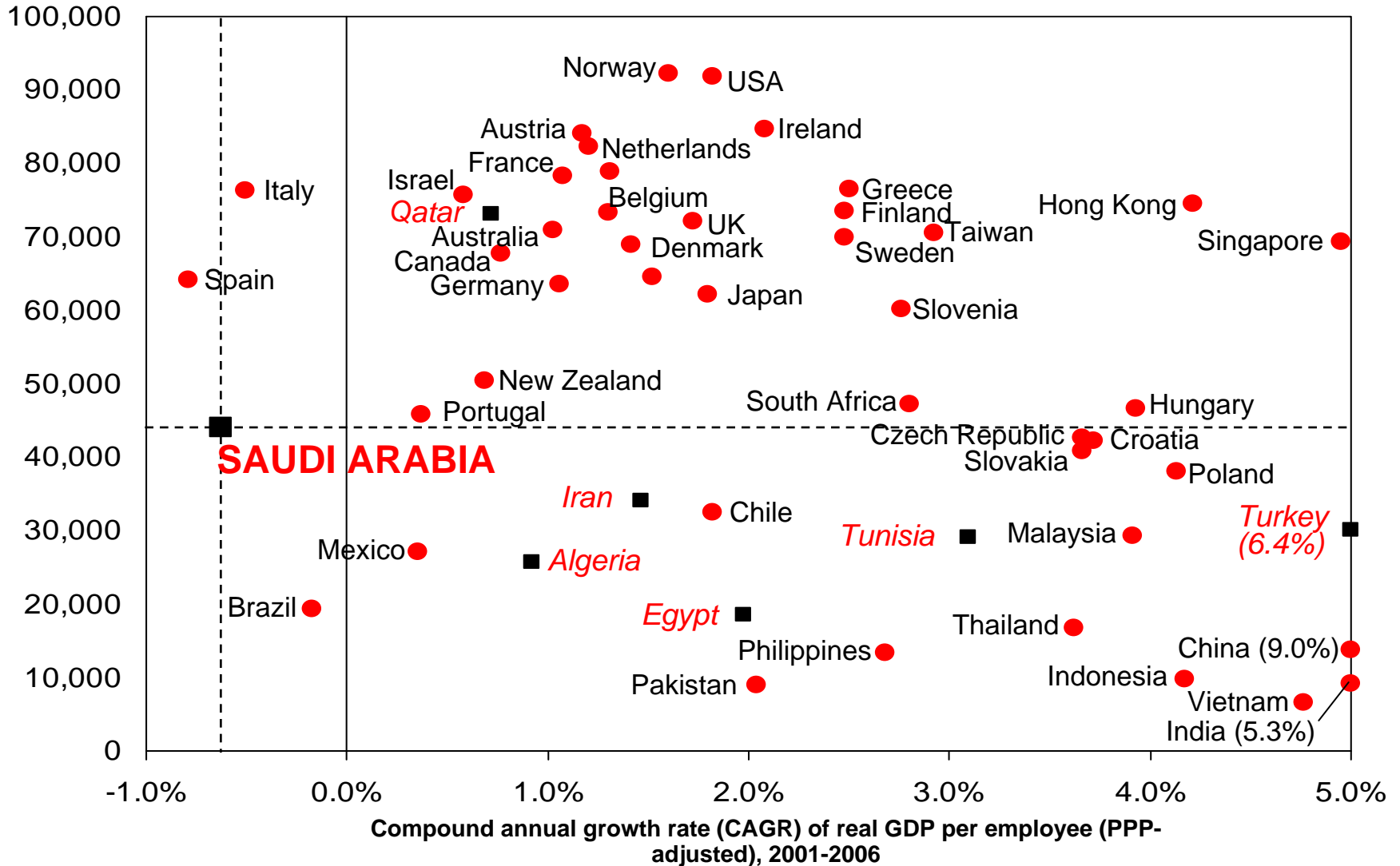
Created Prosperity

- Prosperity is derived from **creating valuable products and services**
 - Prosperity is **unlimited**
- 
- **Companies** are the central actors in the economy
 - Prosperity can only be created by **firms**
 - **Government's role** is to create the **enabling conditions for productivity** and foster private sector development

Comparative Labor Productivity

Selected Countries

GDP per employee
(PPP adjusted US\$),
2006

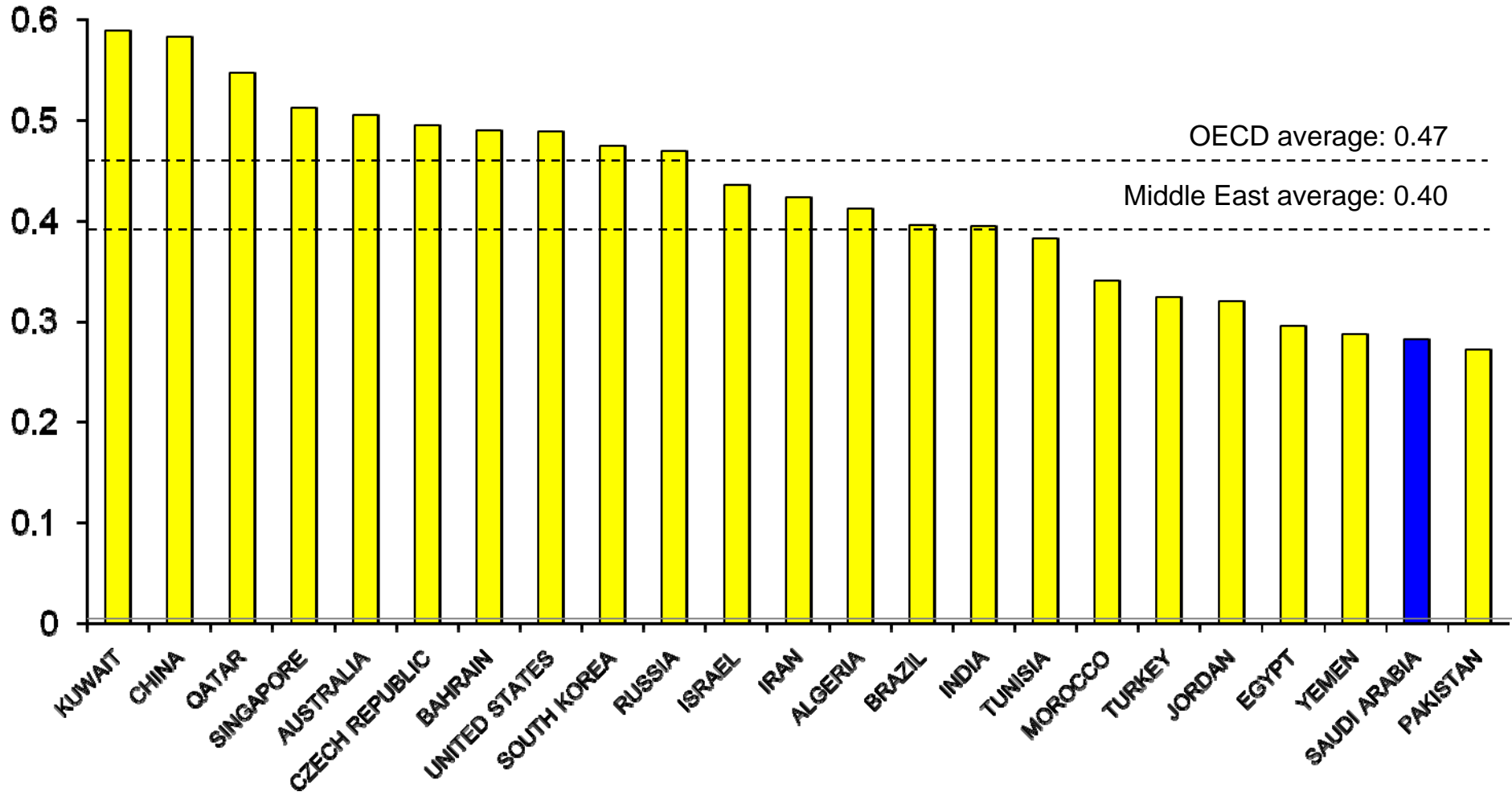


Source: EIU (2007), Saudi Arabia employee data (number persons employed) from ILO LABORSTA (2007)

Labor Force Mobilization

Selected Countries

Employees as % of
Population, (2006)



Note: Use most recent year available, either 2005 or 2006

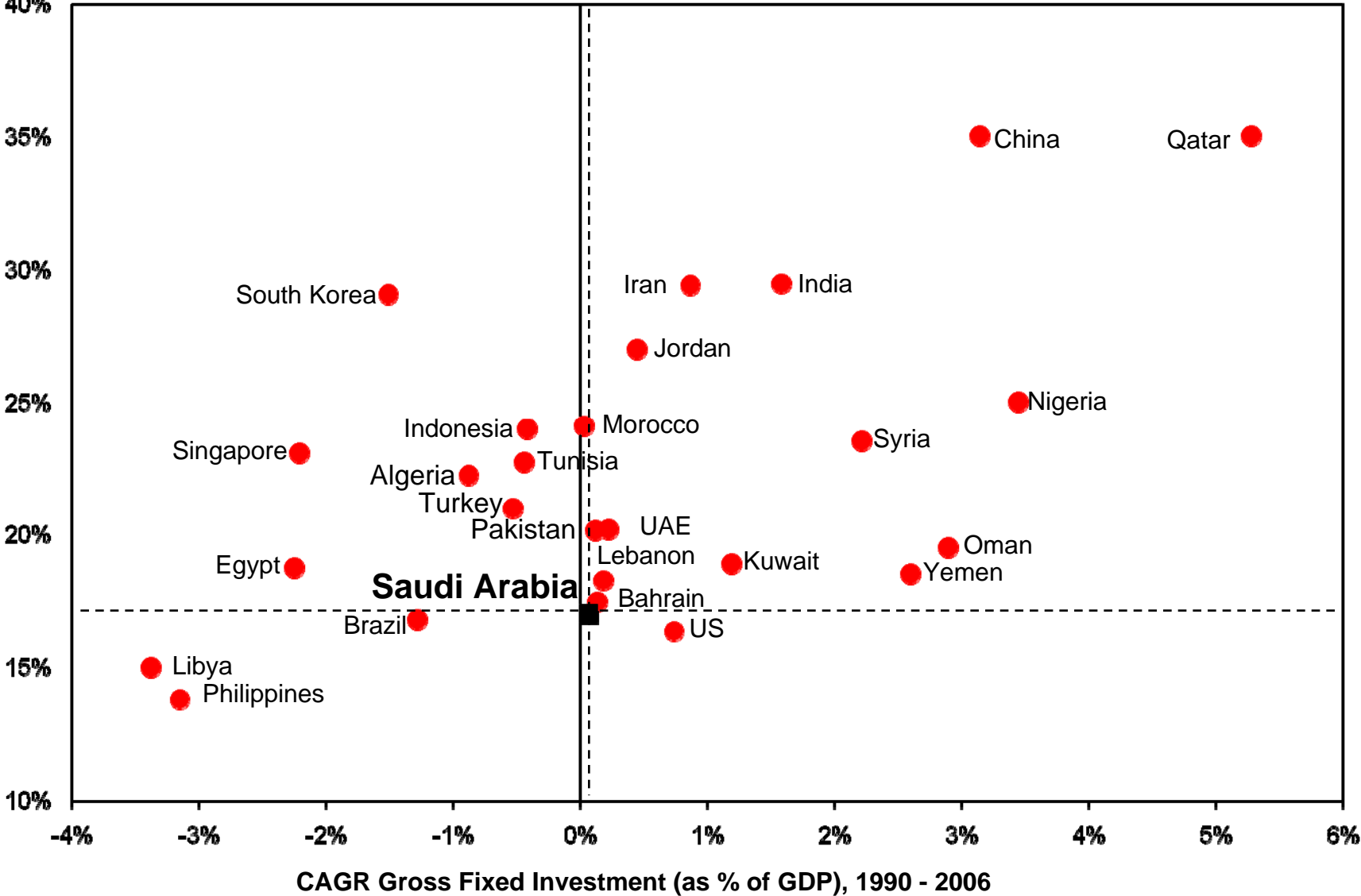
Source: The Conference Board and Groningen Growth and Development Centre, Total Economy Database, November 2007

Competitiveness Master = 2007-11-14.ppt

Fixed Investment Rates

Selected Countries

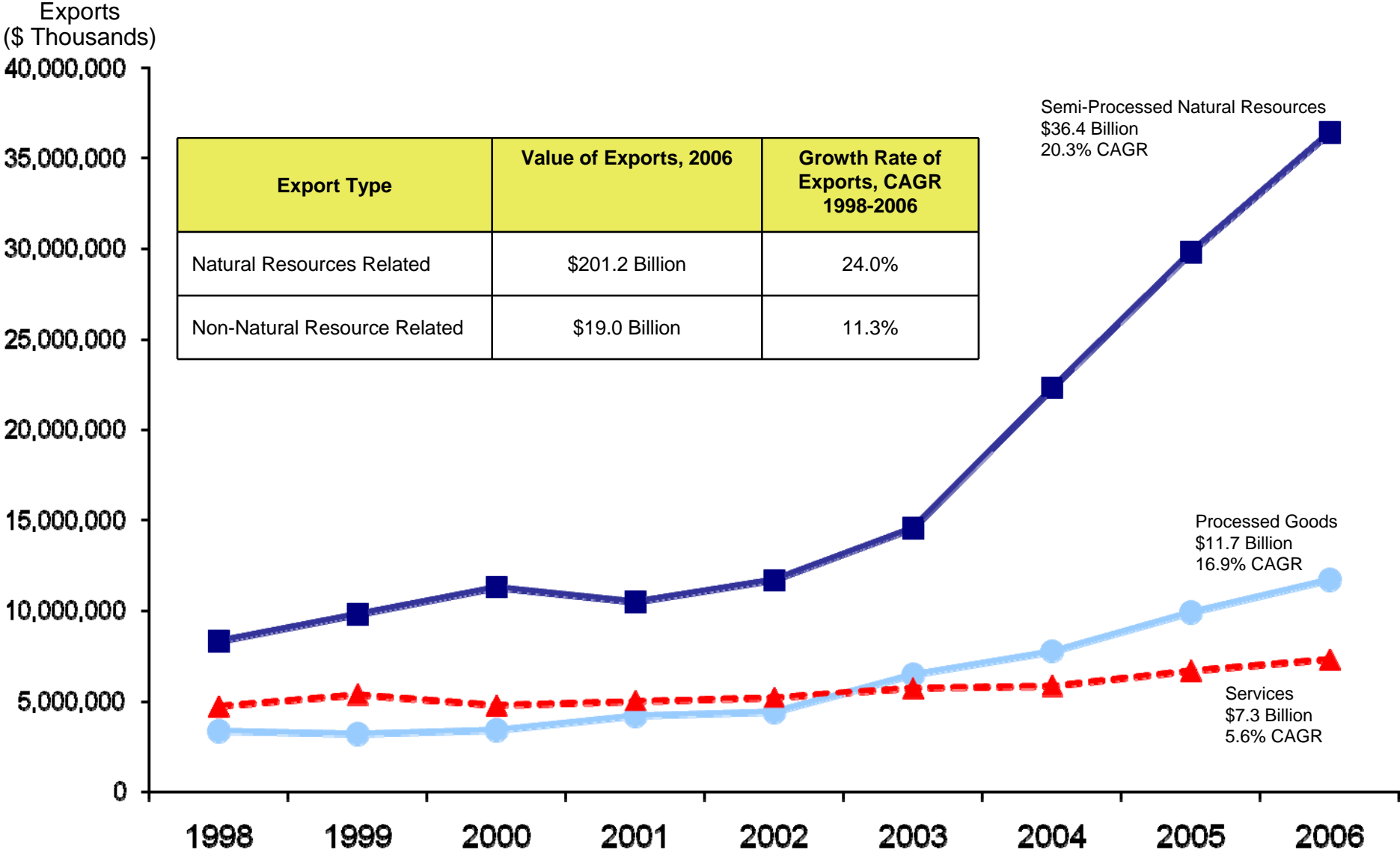
Gross Fixed Investment
as % of GDP (2006)



Source: EIU, 2007.

Saudi Arabia's Exports

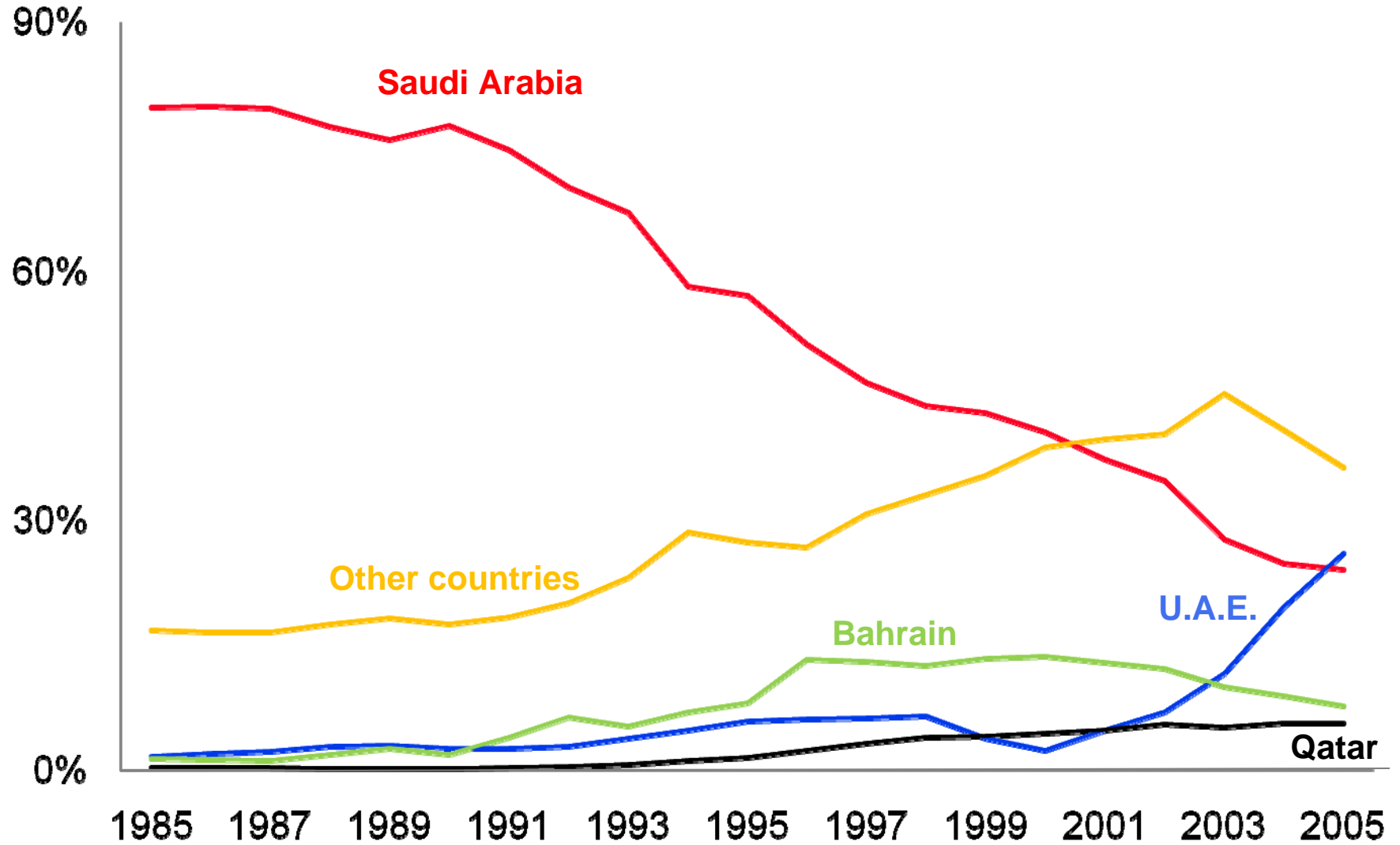
Types of Goods and Services



Source: Institute for Strategy and Competitiveness – International Cluster Competitiveness Project; UN Comtrade; IMF BOP statistics.

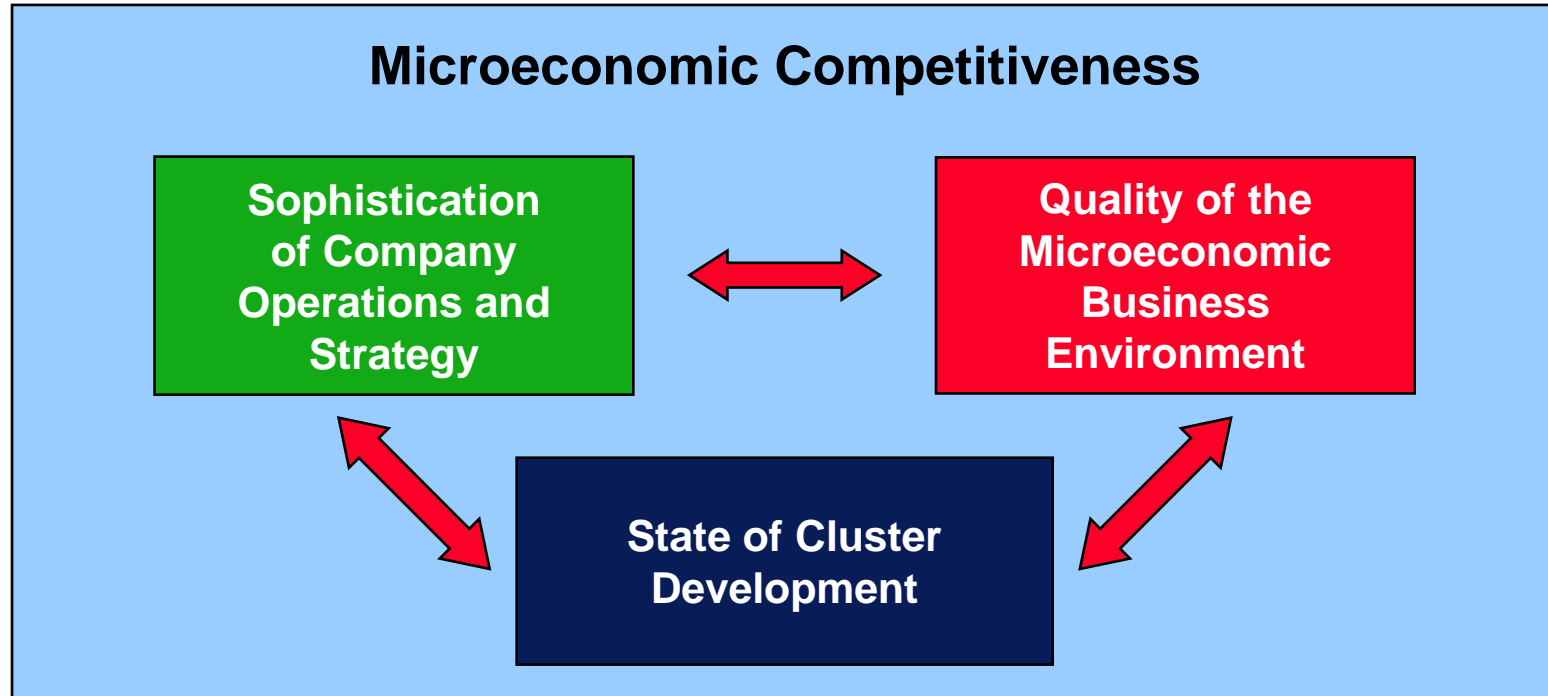
Inward Foreign Direct Investment Stock

Share of Middle East
Inward FDI stock



Determinants of Competitiveness

Macroeconomic, Political, Legal, and Social Context

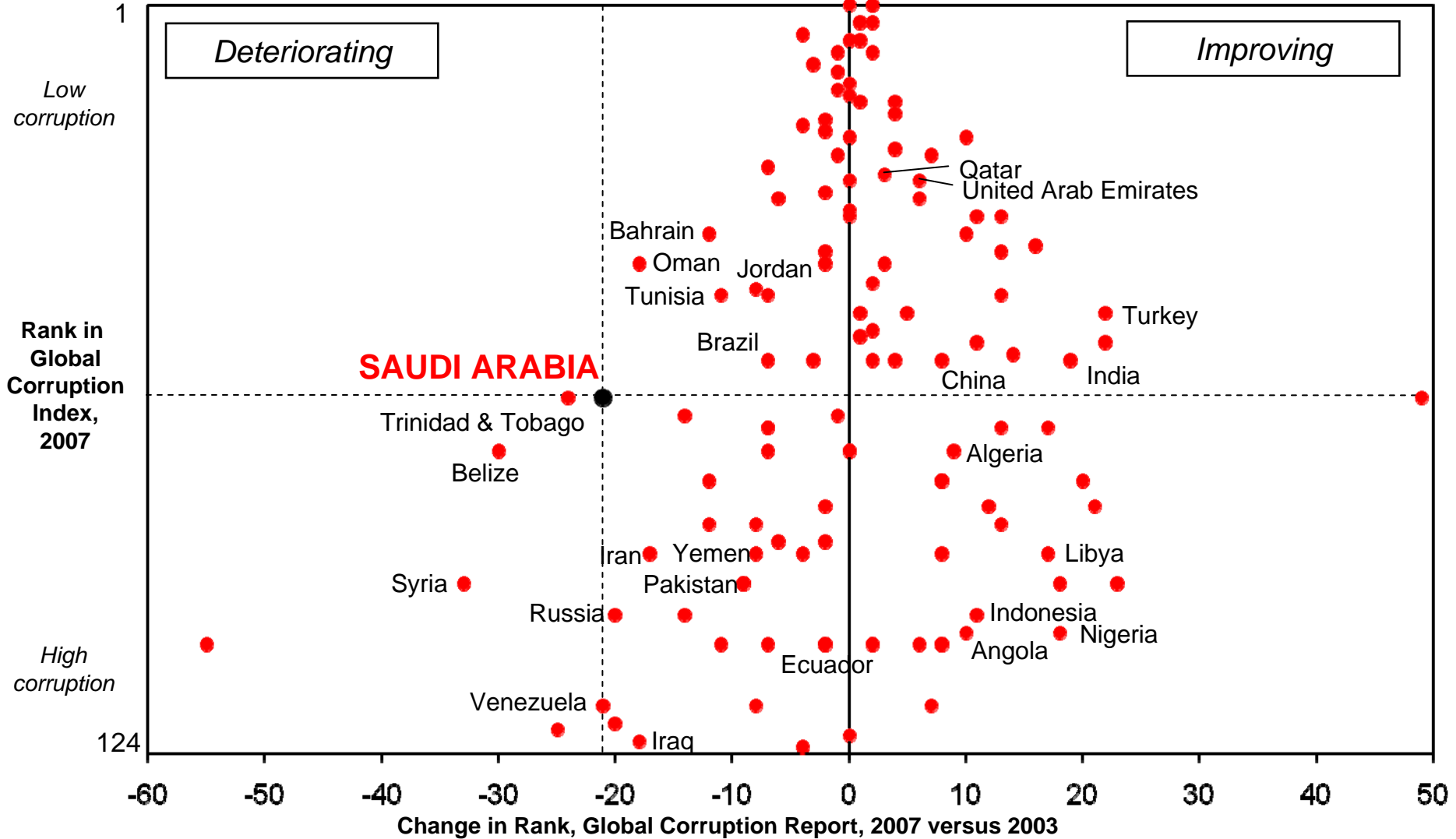


- A sound macroeconomic, political, legal, and social context create the potential for competitiveness, but is **not sufficient**
- Competitiveness ultimately depends on improving the **microeconomic capability** of the economy and the **sophistication of local competition**

Macroeconomic, Political, Legal, and Social Context

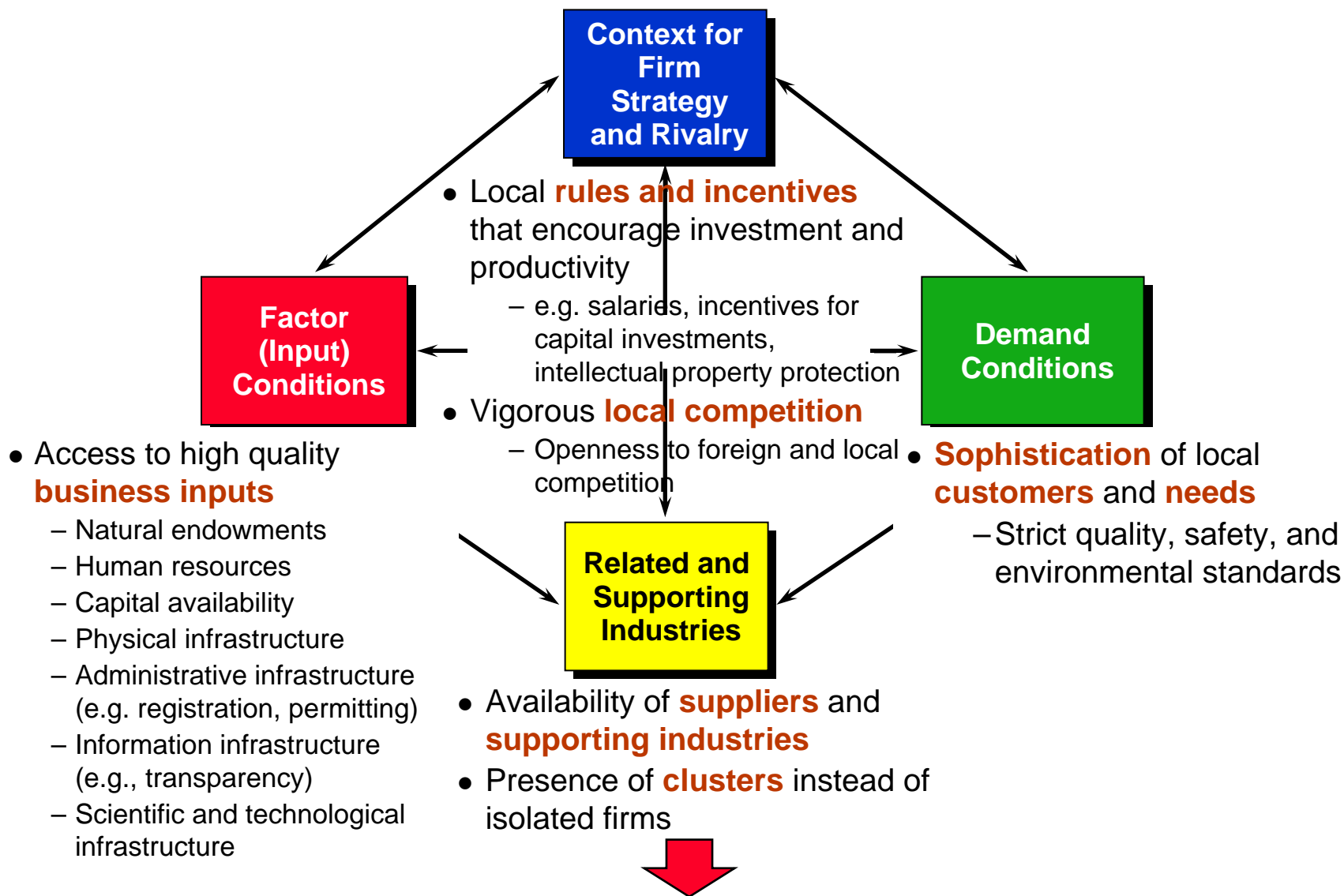
- Saudi Arabia has registered sound macroeconomic policies, but **transparency remains limited** and **inflationary pressures** are rising
- There are ongoing debates about direction and speed of **political reforms**, which limits predictability and policy stability. Government processes remain complex and have limited transparency
- The Saudi legal system is in the process of modernization, but concerns remain about **uncertainty** in judicial decision making
- Social policies have addressed poverty and basic **social needs**, but challenges arise in education, gender relations, and the large expatriate community

Corruption Perception Index, 2007



Note: Ranks only countries available in both years (124 countries total)
 Source: Global Corruption Report, 2007

Improving the Business Environment: The Diamond

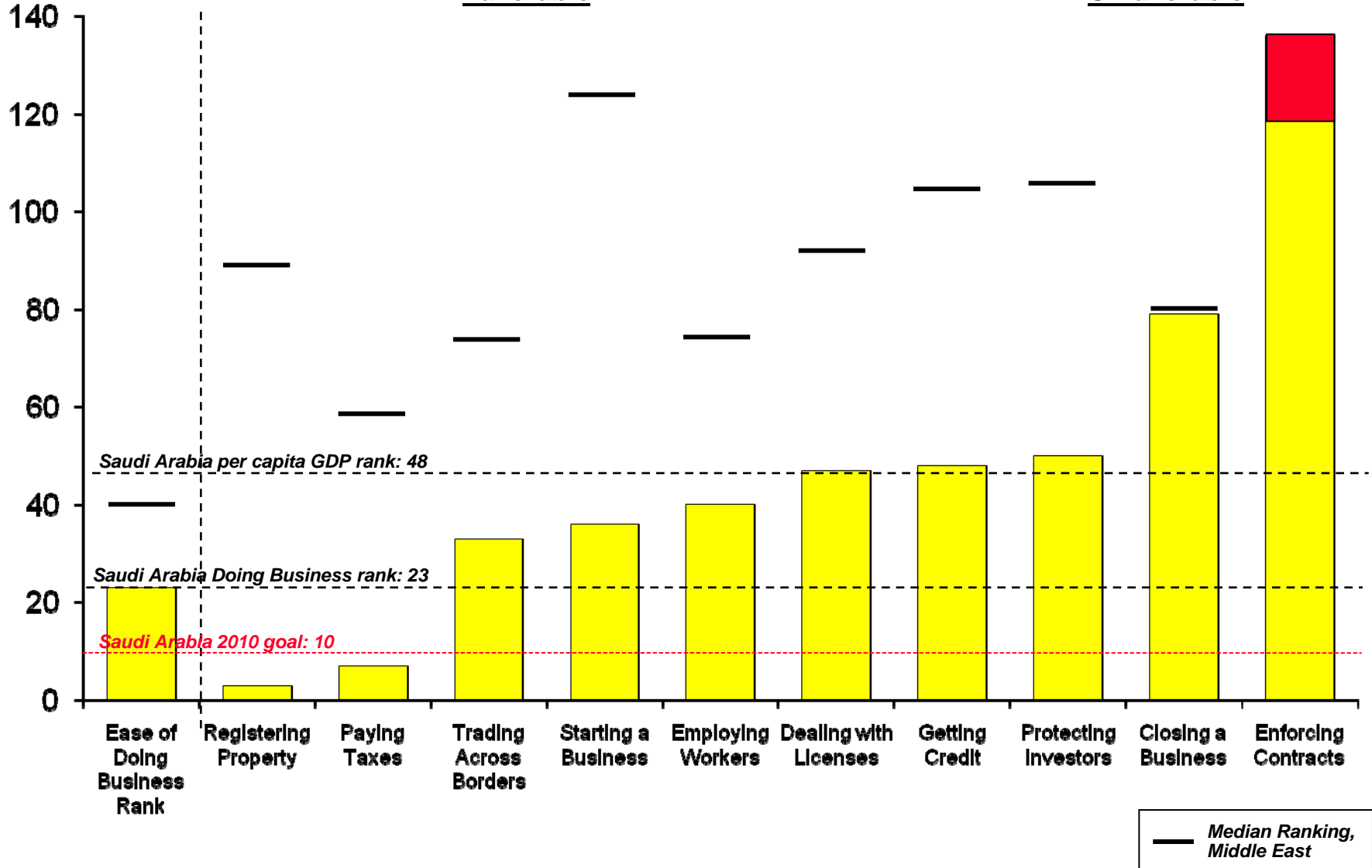


- Successful economic development is a process of **successive upgrading**, in which the business environment improves to enable increasingly sophisticated ways of competing

Ease of Doing Business

Saudi Arabia

Ranking, 2007 (of 178 countries)



Saudi Arabian Business Environment

Selected Advantages and Disadvantages, 2007

Competitive Advantages Relative to GDP per Capita

Quality of electricity supply	40
Quality of port infrastructure	42
Air transport infrastructure quality	43
Reliability of police services	45

Competitive Disadvantages Relative to GDP per Capita

Stringency of environmental regulations	101
Business costs of corruption	89
Buyer sophistication	81
Quality of management schools	73
Quality of private property rights	72
Absence of trade barriers	69
Decentralization of economic policymaking	69
Local equity market access	65
Quality of math and science education	65
Local availability of specialized research and training services	65
Quality of primary education	64
Financial market sophistication	63
Availability of scientists and engineers	57
Effectiveness of antitrust policy	57
Intensity of local competition	53
Quality of scientific research institutions	51

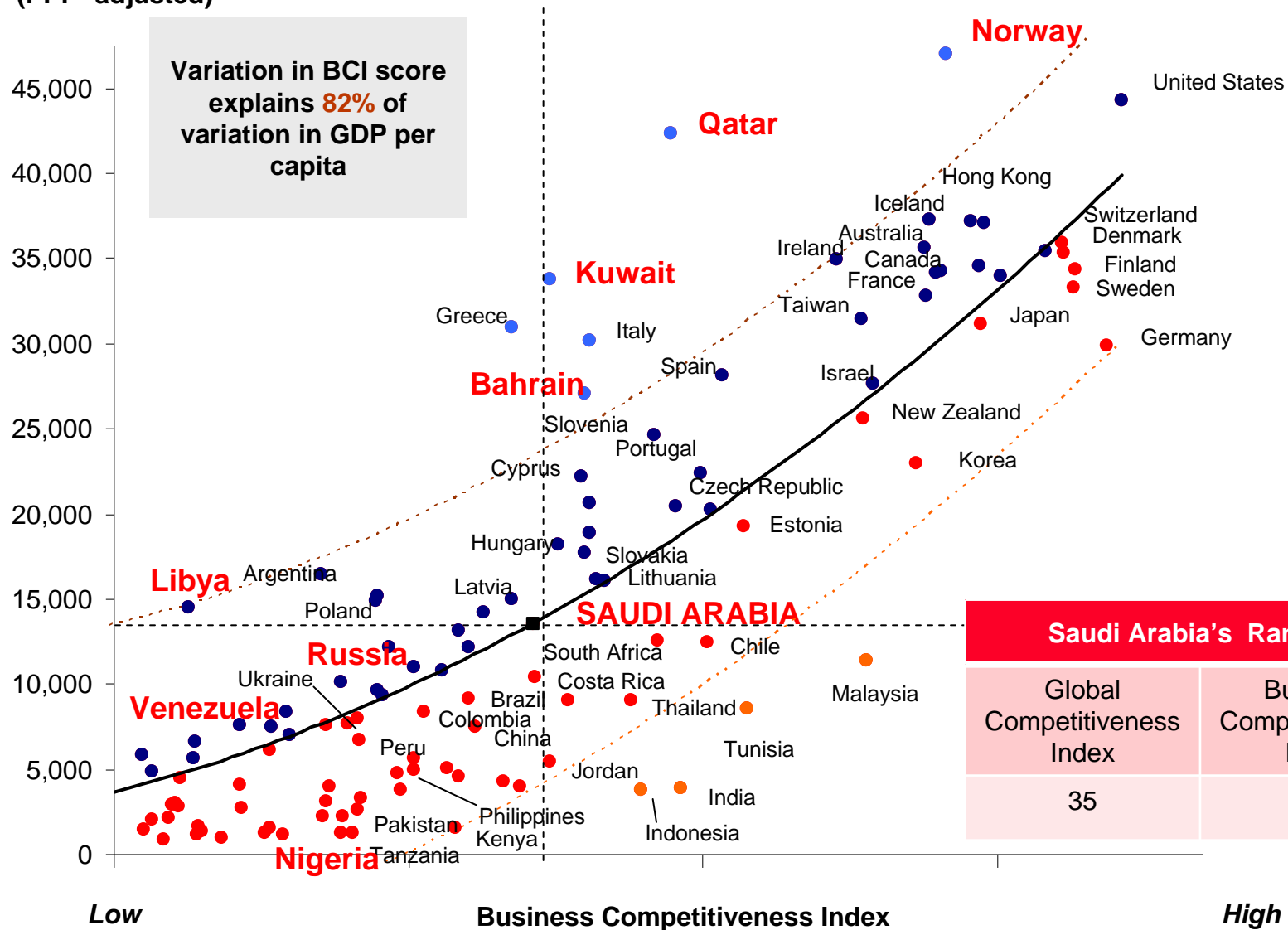
Note: Rank versus 127 countries; overall, Saudi Arabia ranks 48th in 2006 PPP adjusted GDP per capita and 51^h in Business Competitiveness. Only 2007 data available.

Source: Institute for Strategy and Competitiveness, Harvard University (2007)

Ranking Microeconomic Competitiveness

Business Competitiveness Index, 2007

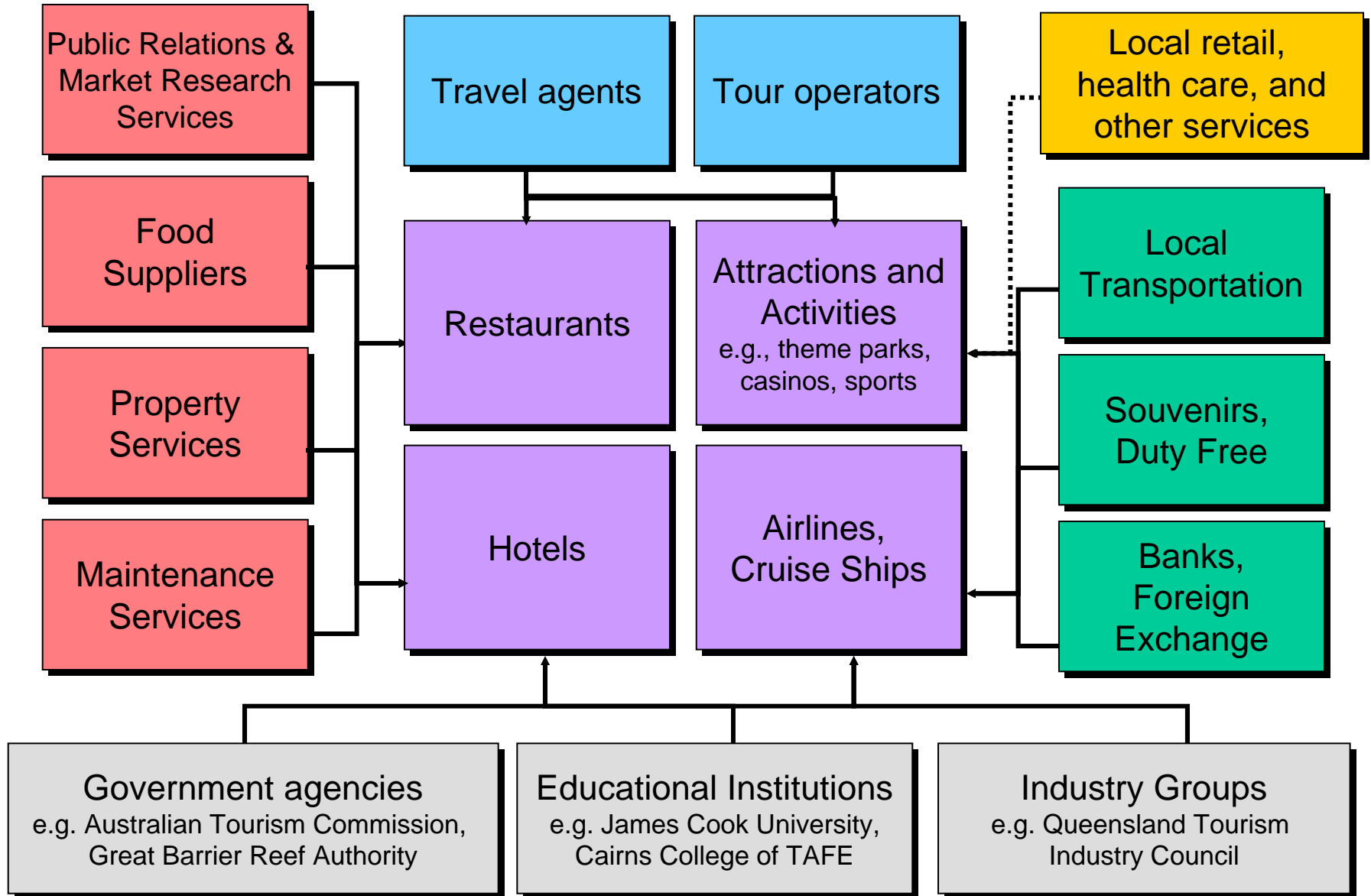
2006 GDP per Capita
(PPP- adjusted)



Source: Global Competitiveness Report 2007

Enhancing Cluster Development

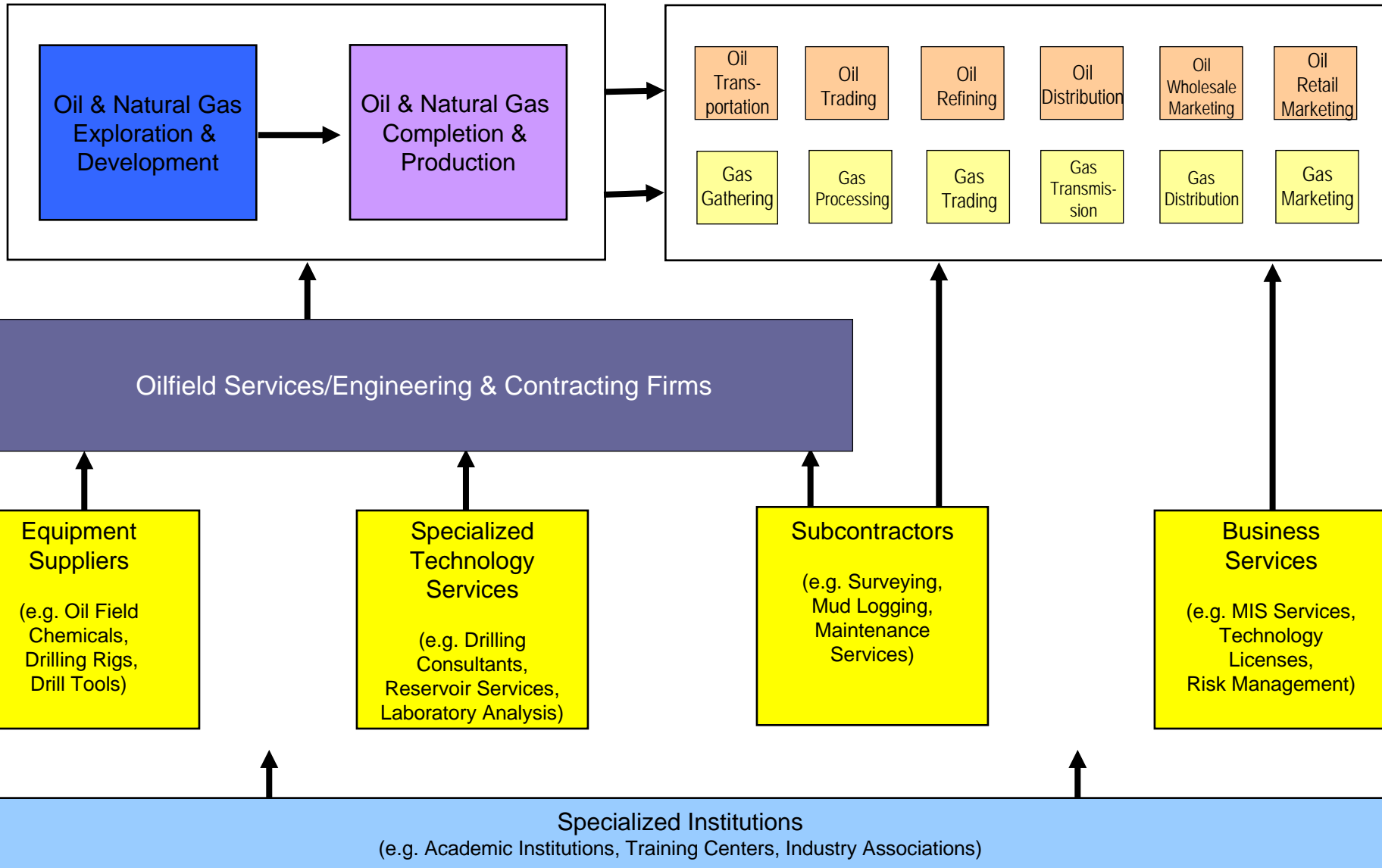
Tourism Cluster in Cairns, Australia



The Houston Oil and Gas Cluster

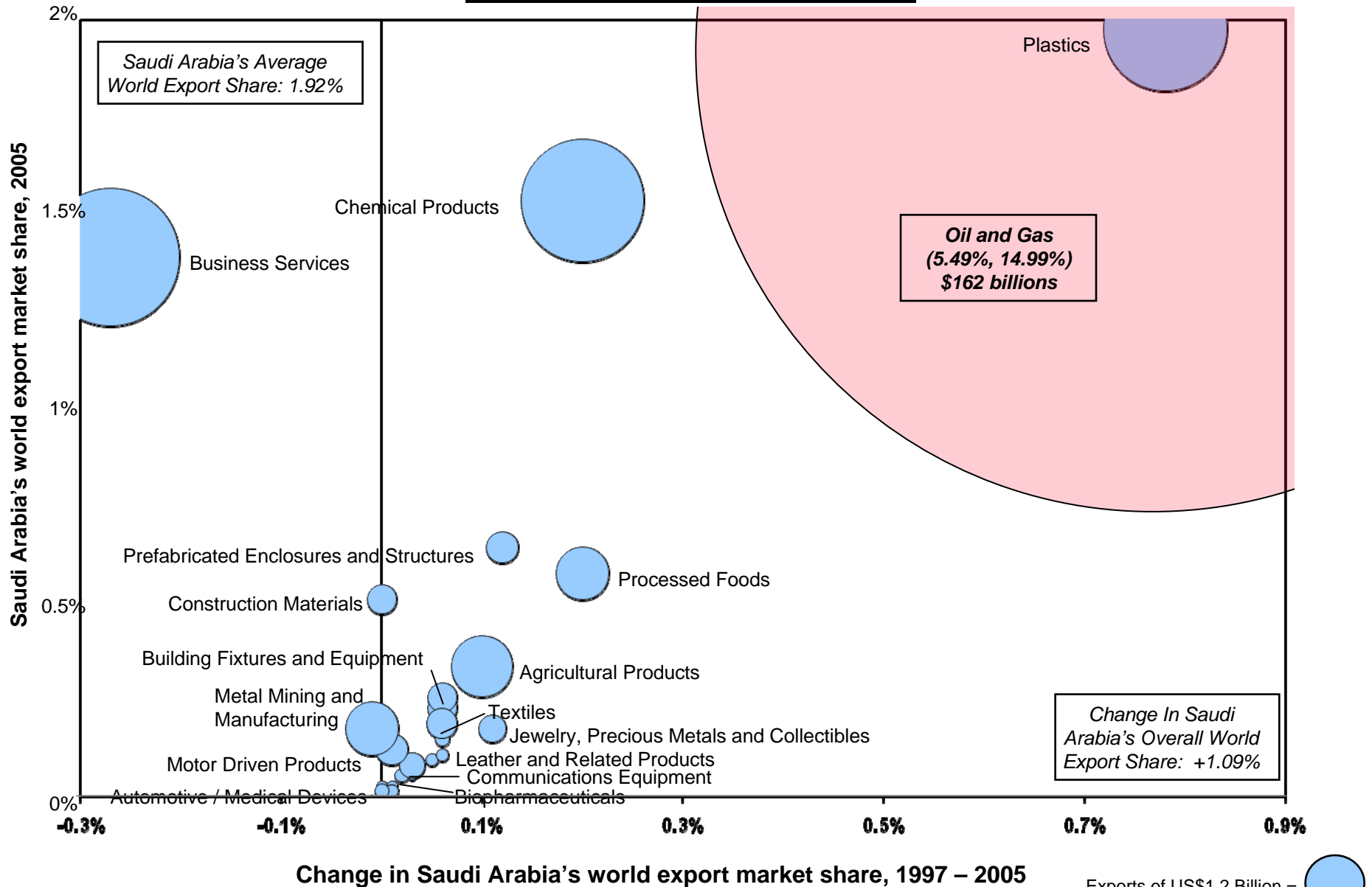
Upstream

Downstream



National Cluster Export Portfolio

Saudi Arabia, 1997-2005



Source: Prof. Michael E. Porter, International Cluster Competitiveness Project, Institute for Strategy and Competitiveness, Harvard Business School; Richard Bryden, Project Director. Underlying data drawn from the UN Commodity Trade Statistics Database and the IMF BOP statistics.

Improving Company Sophistication

Relative Position of Saudi Arabian Companies, 2007

Competitive Advantages Relative to GDP per Capita

Control of international distribution	19
Production process sophistication	32
Value chain breadth	34

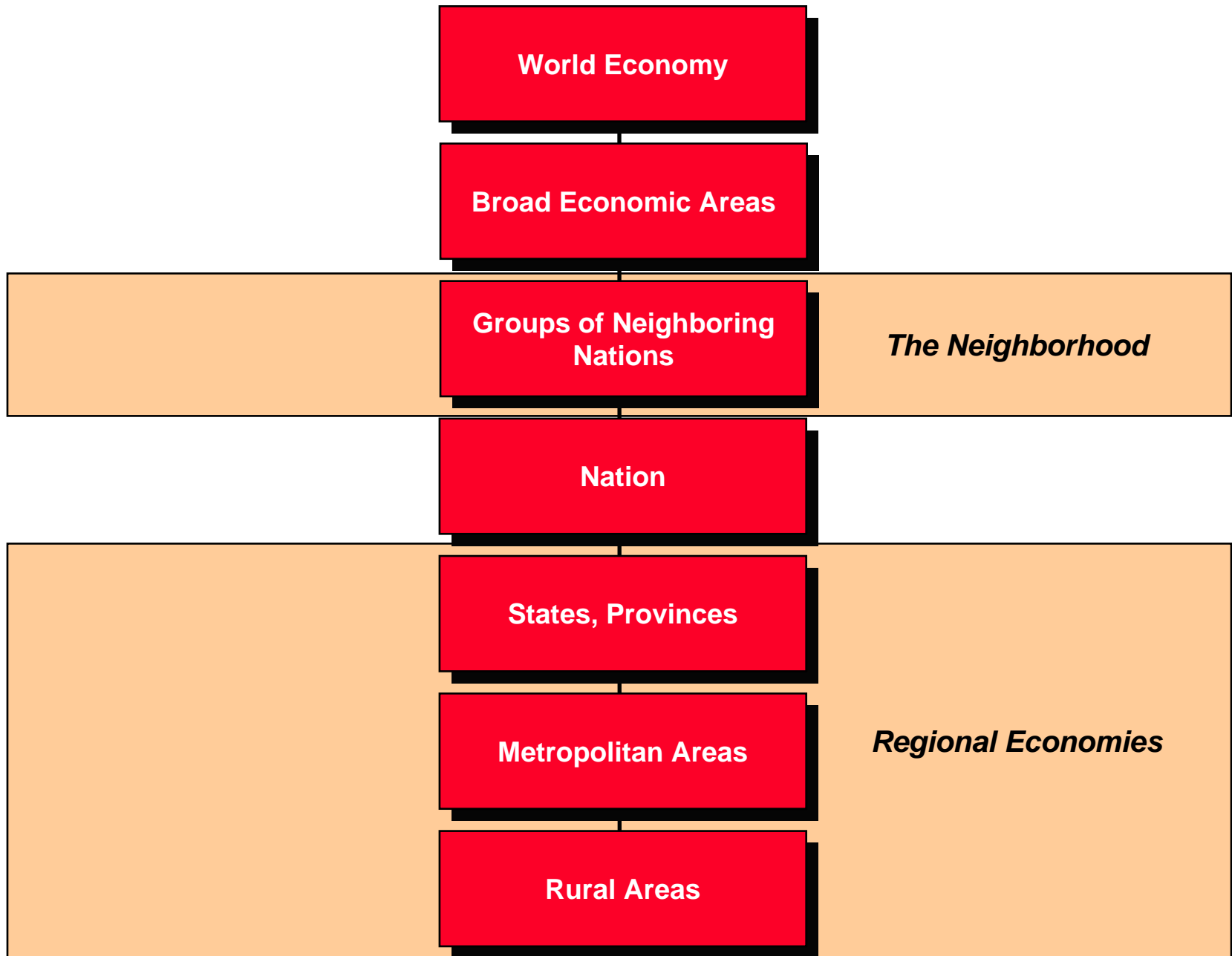
Competitive Disadvantages Relative to GDP per Capita

Extent of staff training	77
Reliance on professional management	71
Degree of customer orientation	69
Extent of marketing	68
Prevalence of foreign technology licensing	62
Extent of regional sales	61
Extent of incentive compensation	56
Breadth of international markets	52
Capacity for innovation	49
Nature of competitive advantage	49
Willingness to delegate authority	47

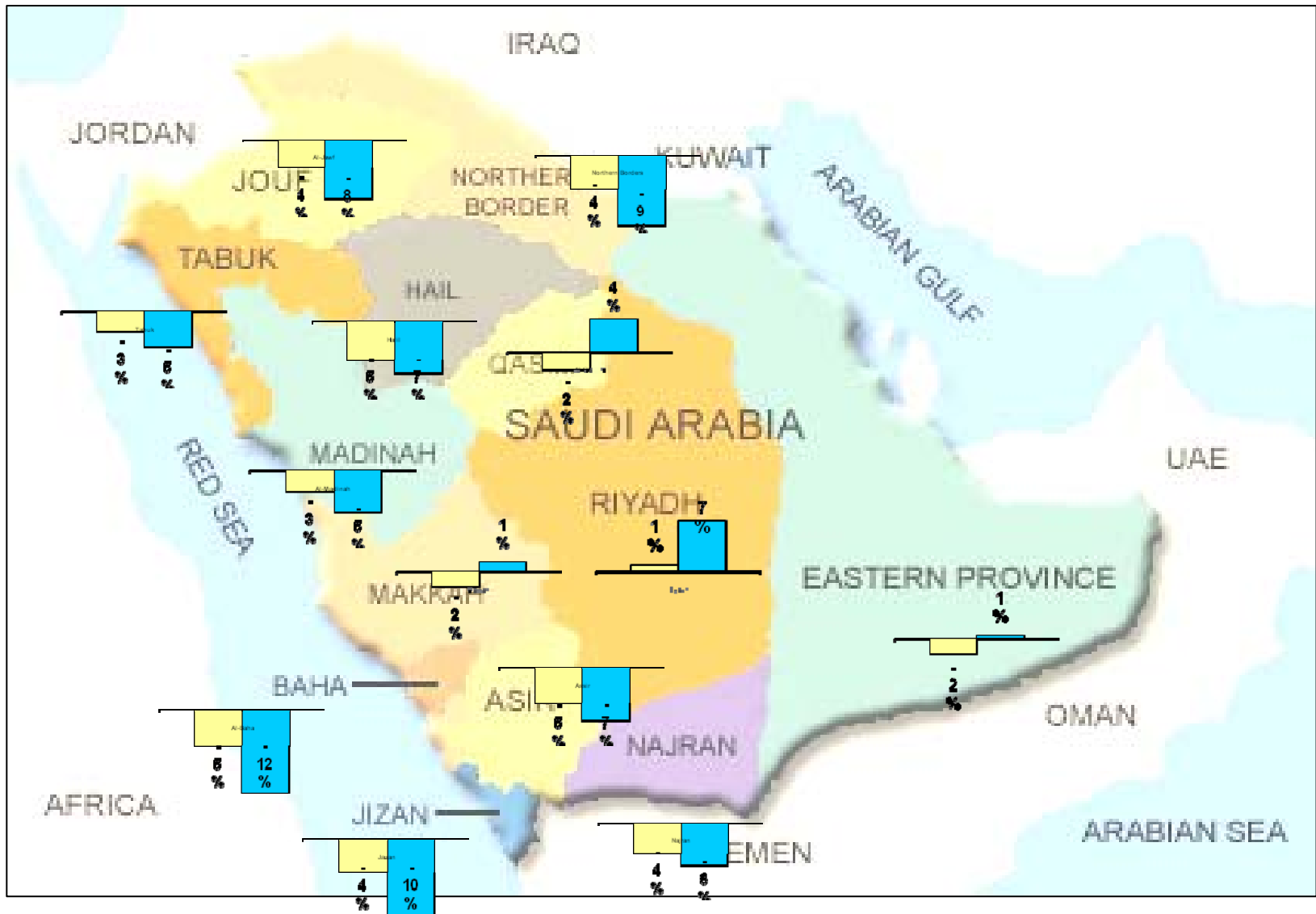
Note: Rank versus 127 countries; overall, Saudi Arabia ranks 48th in 2006 PPP adjusted GDP per capita and 51th in Business Competitiveness. Only 2007 data available.

Source: Institute for Strategy and Competitiveness, Harvard University (2007)

Geographic Influences on Competitiveness



Saudi Arabia's Provinces



% Social Security recipients below/above national average
 % Labor force participation above/below national average

Source: Saudi Arabian Monetary Authority (SAMA) report, 2007

The Neighborhood

Middle East



- Economic coordination among neighboring countries can significantly enhance competitiveness
- Integration with neighbors offers greater opportunities than participation in broader economic forums

The Process of Economic Development

Shifting Roles and Responsibilities

Old Model

- **Government** drives economic development through policy decisions and incentives



New Model

- Economic development is a **collaborative process** involving government at multiple levels, companies, teaching and research institutions, and private sector organizations

- Competitiveness must become a **bottoms-up process** in which many individuals, companies, and institutions take responsibility
- **Every** community and cluster can take steps to enhance competitiveness
- The **private sector** must become more engaged in competitiveness to improve rapidly

Towards a Competitiveness Agenda for Saudi Arabia

- Create a **culture of productivity** in Saudi Arabia
- Continue improving political and legal **stability and transparency**
- Pursue a sustained program to upgrade the **Saudi business environment**, sequencing priorities based on binding constraints
- Upgrade **company sophistication** and foster **entrepreneurship** and the **development of SMEs**
- Pursue a comprehensive policy for **cluster development**
- Expand **information, openness, and transparency** throughout the economy
- Develop and implement distinct **strategies for each Saudi Arabian province**
- Achieve **regional economic coordination and integration** with Arab neighbors



- Achieving competitiveness will require a **sustained effort** over a decade or more

Address the Weaknesses and Binding Constraints in the Business Environment

- Business regulation
- Financial markets
- Stringency of quality, safety and environmental standards
- Openness of competition
- Market information
- Education and skills development
- Innovative capacity

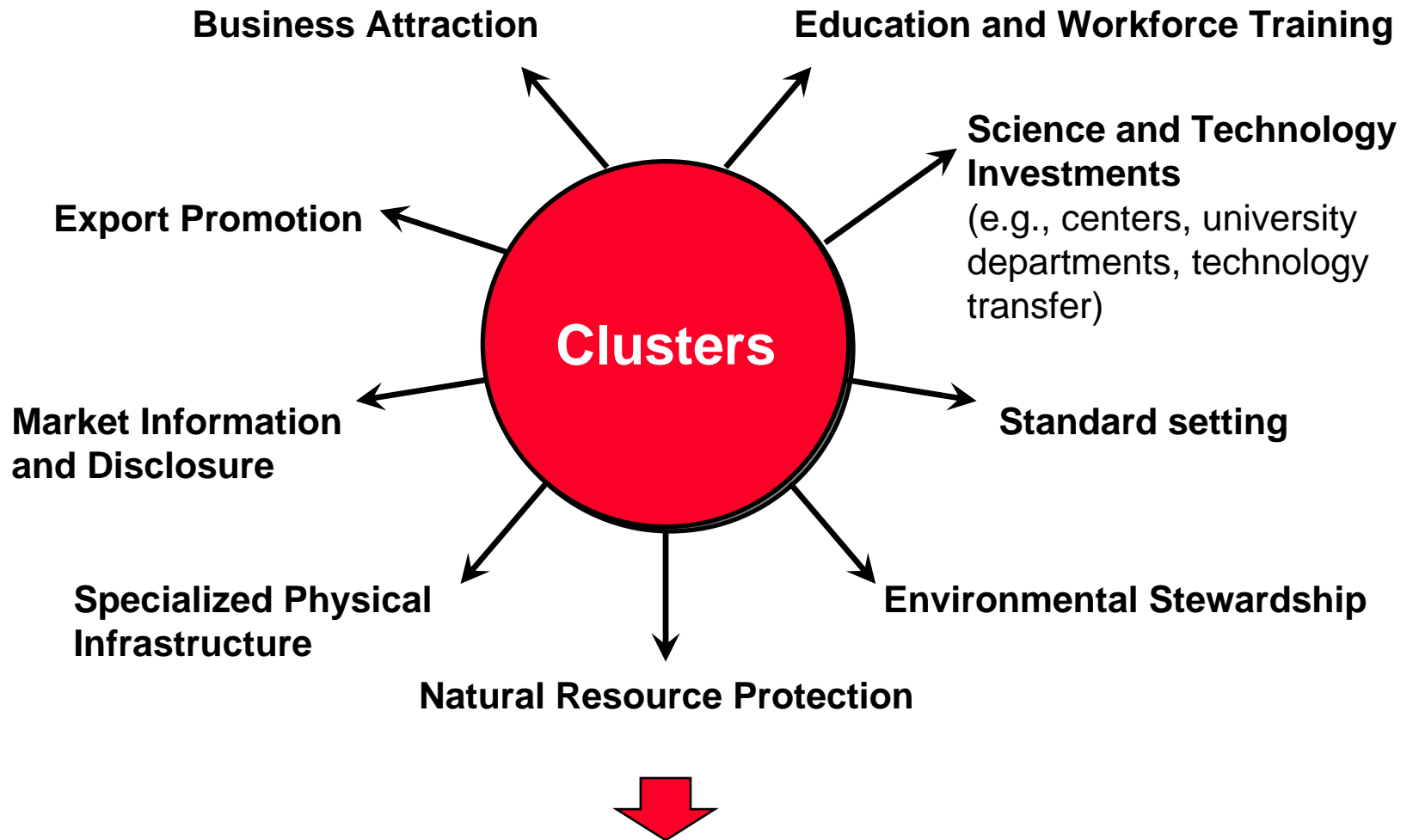
Upgrade Company Sophistication and Foster Entrepreneurship

- Create a national campaign to **foster entrepreneurship** and **support SME development**
- Expand corporate **disclosure**
- Strengthen **corporate governance**
- Introduce best practices in terms of **operational efficiency**
 - Utilization of information technology
 - Quality improvement and certification
 - A culture of learning and innovation
- Upgrade **human resources**
- Create more focused Saudi **business groups**
- Improve **private sector institutions** and **expand the role** of the private sector in economic development

Create a Comprehensive Policy for Cluster Development

- The **Industrial Development Strategy** has an explicit focus on cluster development
- Current cluster development policy should **extend to the entire economy**, including domestic industries and all the provinces
- Realign **government economic development policies** around clusters

Clusters and Economic Policy



- Clusters provide a framework for **organizing the implementation** of public policy and public investments towards economic development

Create a Comprehensive Policy for Cluster Development

- The **Industrial Development Strategy** has an explicit focus on cluster development, a major strength
- Cluster development policy should **extend to the entire economy**, including domestic industries and all the provinces
- Realign **government economic development policies** around clusters
- The **Economic Cities** program should be directly tied to the cluster development program
- Science-based clusters will be slow to develop. The focus should be on making existing and emerging Saudi clusters **more knowledge intensive**

Diversifying the Saudi Arabian Economy

Grow exports in
related clusters

Leverage **unique Saudi Arabian strengths** and
niche positions

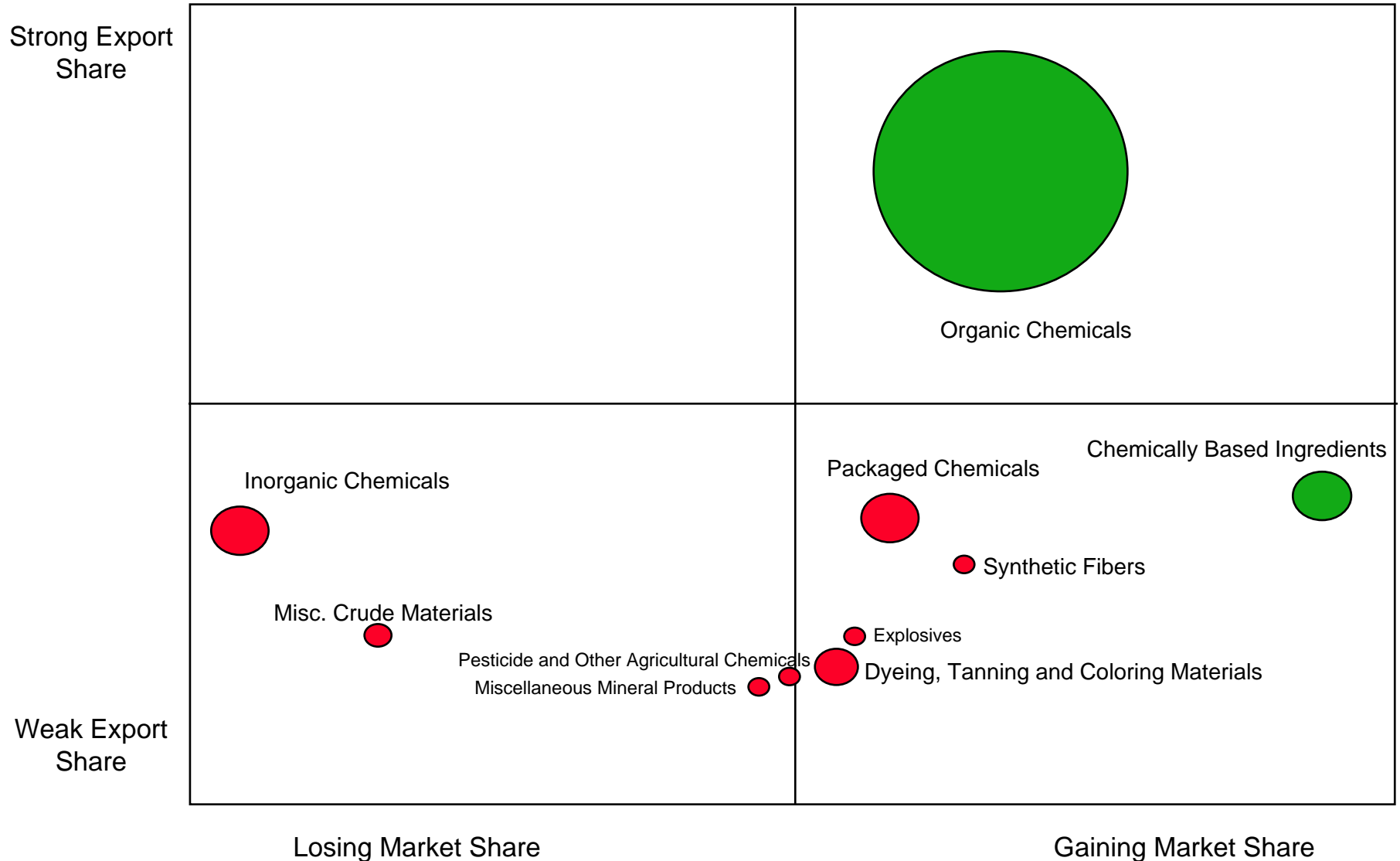
Leverage the large
domestic market

Widen participation in
existing clusters

Upgrade
existing export products

Growth Opportunities within Clusters

Saudi Arabian Chemical Cluster

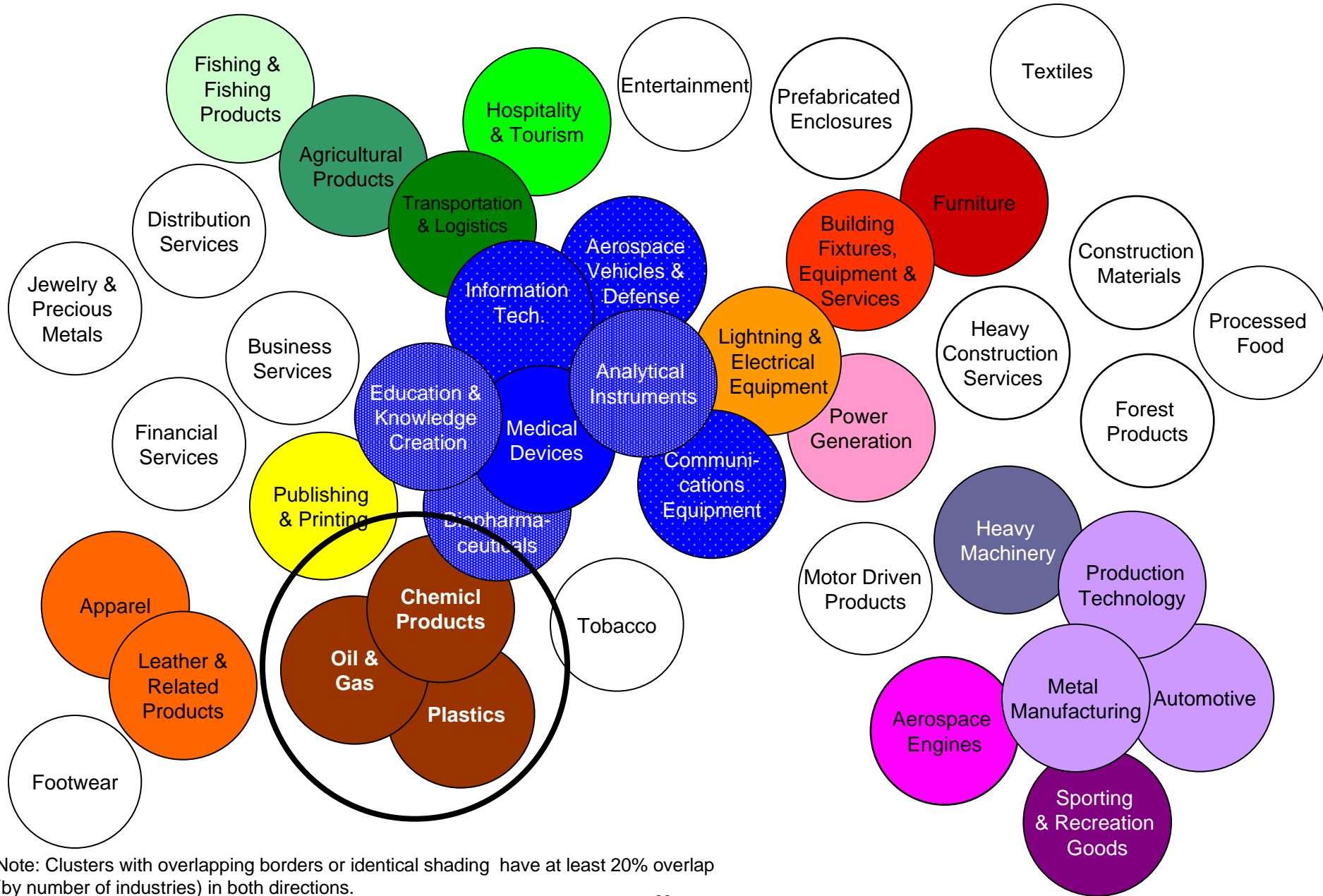


Grow Current Niche Positions

Leading Saudi Arabian Export Industries outside of Clusters, 2005

Industry (Processed Products)	Cluster	Market Share	Change in Market Share	Export Volume
Carpets and other textile floor coverings, woven	Textiles	5.6%	3.7%	142,479
Sheep, lamb skin leather	Leather and Related Products	3.9%	2.6%	42,787
Other forms of unvulcanized rubber	Construction Materials	3.0%	2.9%	15,971
Drawn, blown glass in sheets	Building Fixtures and Equipment	2.4%	1.6%	7,020
Asbestos-cement and fiber-cement materials	Construction Materials	1.9%	0.2%	47,977
Cast, rolled glass in sheets	Building Fixtures and Equipment	1.8%	-6.3%	14,633
Portland cement, aluminous cement and similar products	Construction Materials	1.7%	-0.4%	129,918
Bridges and bridge-sections	Prefabricated Enclosures and Structures	1.6%	-4.0%	8,387
Towers and lattice masts	Prefabricated Enclosures and Structures	1.6%	-0.9%	19,143
Miscellaneous articles of pulp, paper and paperboard	Forest Products	1.5%	0.4%	218,347
Other metal structures and parts	Prefabricated Enclosures and Structures	1.4%	1.0%	266,167
Rubber, textile yarn, cord	Textiles	1.3%	1.3%	3,841
Jute, other textile bast fibers	Textiles	1.2%	1.2%	105
Preparations for hair	Biopharmaceuticals	1.1%	0.3%	86,847
Goat or kid skin leather	Leather and Related Products	1.1%	0.8%	6,561
Silk	Textiles	1.1%		3,444
Sands, natural not metal bearing	Construction Materials	1.0%	0.8%	10,976
Paper and paperboard, corrugated, creped, crinkled	Forest Products	1.0%	0.7%	34,473
Gold, non-monetary, excluding ores	Jewelry, Precious Metals and Collectibles	0.9%	0.9%	478,006
Prefabricated buildings	Prefabricated Enclosures and Structures	0.9%	-1.0%	53,163

Growth Through Related Clusters



Note: Clusters with overlapping borders or identical shading have at least 20% overlap (by number of industries) in both directions.

Develop Distinctive Strategies in each Saudi Arabia Province

- Regional development should follow a **hub and spoke model** to link rural areas to the nearest urban center
- Improving **social service delivery** and **physical infrastructure** across all provinces are important preconditions for regional economic development
- Each region needs a **distinctive economic plan** that reflects its location, assets, and existing economic activity
- Economic policy formulation and implementation should be **gradually decentralized**
- **Government capability** in each province needs to be upgrading over time

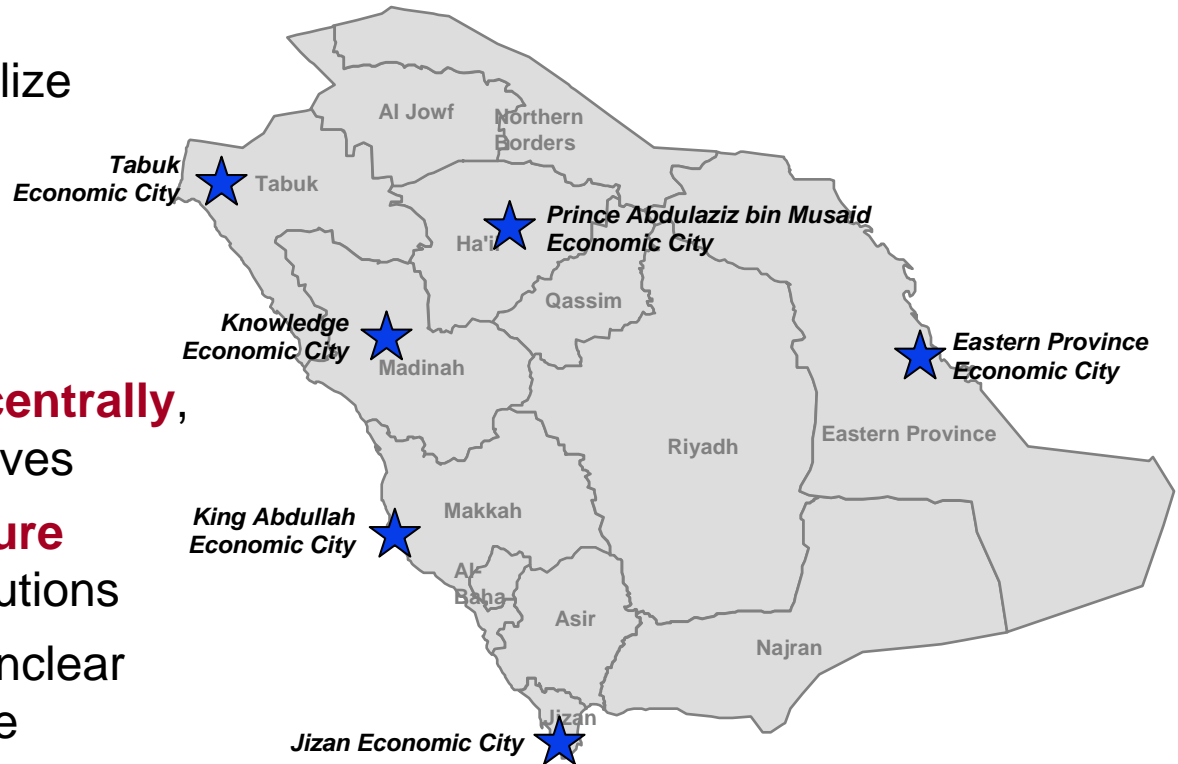
Enhancing the Economic Cities Concept

- The economic cities can become an **important tool** for Saudi Arabian development
- However, they also symbolize the **challenges** that the country needs to address



- They have been planned **centrally**, not by the regions themselves
- They focus on **infrastructure** rather than skills and institutions
- Economic cities have an unclear relation to **clusters** and the **surrounding regional economy**
- They ask for private sector action but have been designed by the **government**

Proposed Locations for Economic Cities



Develop a Regional Competitiveness Strategy with Arab Neighbors

- The **Gulf Cooperation Council** can be an important complement to competitiveness efforts at the national level
- Many aspects of the business environment can be **enhanced** by coordination and integration with neighboring countries
- The region needs to shift from rhetoric to **action**
- Due to its size and resources, Saudi Arabia should take a **leadership role**

Defining an Economic Strategy for Saudi Arabia

National Value Proposition

- What is the **unique competitive position of Saudi Arabia** given its location, legacy, existing strengths, and potential strengths?
 - What roles in the world, the broad economic area, and the neighborhood?
 - What unique value as a business location?
 - For what range and types of businesses, activities in the value chain, and clusters can Saudi Arabia be competitive?

Towards a Strategic Positioning for Saudi Arabia

Strengths to Build Upon

- Natural resource endowments
- Largest and most populous economy in the Middle East
- Location between Europe, Asia, and Africa
- Distinct cultural traditions
- Significant accumulated capital



- Saudi Arabia has outlined an **ambitious action agenda** to enhance competitiveness
- It will be important to set **priorities** and **sequence steps** to reflect the realities of Saudi Arabia's economy
- **Fundamental changes** in the capabilities and attitudes of many Saudi citizens will be needed to achieve the desired transformation of the Saudi Arabian economy