FACULTY OF JURIDICAL SCIENCES

Lecture-10

National Competitive Theory (Porter's Diamond)

The Porter Diamond, properly referred to as the Porter Diamond Theory of National Advantage, is a model that is designed to help understand the competitive advantage that nations or groups possess due to certain factors available to them, and to explain how governments can act as catalysts to improve a country's position in a globally competitive economic environment. The model was created by Michael Porter, a recognized authority on corporate strategy and economic competition, and founder of the Institute for Strategy and Competitiveness at the Harvard Business School. It is a proactive economic theory, rather than one that simply quantifies competitive advantages that a country or region may have. The Porter Diamond is also referred to as "Porter's Diamond" or the "Diamond Model."

- The Porter Diamond model explains the factors that can drive competitive advantage for one national market or economy over another.
- It can be used both to describe the sources of a nation's competitive advantage and the path to obtaining such an advantage.
- The model can also be used by businesses to help guide and shape strategy regarding how to approach investing and operating in different national markets.

Michael Porter's Diamond Model (also known as the Theory of National Competitive Advantage of Industries) is a diamond-shaped framework that focuses on explaining why certain industries within a particular nation are competitive internationally, whereas others might not. And why is it that certain companies in certain countries are capable of consistent innovation, whereas others might not? Porter argues that any company's ability to compete in the international arena is based mainly on an interrelated set of location advantages that certain industries in different nations posses, namely**:** Firm Strategy, Structure and Rivalry**;** Factor Conditions**;** Demand Conditions; and Related and Supporting Industries**.** If these conditions are favorable, it forces domestic companies to continuously innovate and upgrade. The competitiveness that will result from this is helpful and even necessary when going internationally and battling the world's largest competitors. This article will explain the four main components and include two components that are often included in this model: the role of the Government and Chance. Together they form the national environment in which companies are born and learn how to compete.

How the Porter Diamond Works

The Porter Diamond is visually represented by a diagram that resembles the four points of a diamond. The four points represent four interrelated determinants that Porter theorizes as the deciding factors of national comparative economic advantage. These four factors are firm strategy, structure and rivalry; related supporting industries; demand conditions; and factor conditions. These can in some ways also be thought of as analogous to the eponymous forces of Porter's Five Forces model of business strategy.

Firm strategy, structure, and rivalry refer to the basic fact that competition leads to businesses finding ways to increase production and to the development of technological innovations. The concentration of market power, degree of competition, and ability of rival firms to enter a nation's market are influential here. This point is related to the forces of competitors and barriers to new market entrants in the Five Forces model.

Related supporting industries refer to upstream and downstream industries that facilitate innovation through exchanging ideas. These can spur innovation depending on the degree of transparency and knowledge transfer. Related supporting industries in the Diamond model correspond to the suppliers and customers who can represent either threats or opportunities in the Five Forces model.

Demand conditions refer to the size and nature of the customer base for products, which also drives innovation and product improvement. Larger, more dynamic consumer markets will demand and stimulate a need to differentiate and innovate, as well as simply greater market scale for businesses.

Porter’s Diamond Model clusters

Porter uses the concept of clusters of identical product groups in which there is considerable competitive pressure. Businesses within clusters usually stimulate each other to increase productivity, foster innovation and improve business results. Companies operating in such clusters work according to Porter Diamond Model.

In addition, they have the advantage that they can move very well on the international market and that they can maintain their presence and handle international competition. Examples of large clusters are the Swiss watch industry and the Hollywood film industry.

Porter’s Diamond Model, an international advantage

Organizations can use the Porter’s Diamond Model to establish how they can translate national advantages into international advantages. Porter’s Diamond Model suggests that the national home base of an organization plays an important role in the creation of advantages on a global scale.

This home base provides basic factors that support an organization, including government support but they can also hinder it from building advantages in global competition. The determinants that Michael Porter distinguishes are:

1. Factor Conditions

This is the situation in a country relating to production factors like knowledge and infrastructure. These are relevant factors for competitiveness in particular industries. These factors can be grouped into material resources- human resources (labor costs, qualifications and commitment) – knowledge resources and infrastructure.

But they also include factors like quality of research or liquidity on stock markets and natural resources like climate, minerals, oil and these could be reasons for creating an international competitive position.

2. Related and supporting Industries

The success of a market also depends on the presence of suppliers and related industries within a region. Competitive suppliers reinforce innovation and internationalization. Besides suppliers, related organizations are of importance too.

If an organization is successful this could be beneficial for related or supporting organizations. They can benefit from each other’s know-how and encourage each other by producing complementary products.

3. Home Demand Conditions

In this determinant the key question is: What reasons are there for a successful market? What is the nature of the market and what is the market size? There always exists an interaction between economies of scale, transportation costs and the size of the home market.

If a producer can realize sufficient economies of scale, this will offer advantages to other companies to service the market from a single location. In addition the question can be asked: what impact does this have on the pace and direction of innovation and product development?

4. Strategy, Structure and Rivalry

This factor is related to the way in which an organization is organized and managed, its corporate objectives and the measure of rivalry within its own organizational culture. The Furthermore, it focuses on the conditions in a country that determine where a company will be established. Cultural aspects play an important role in this.

Regions, provinces and countries may differ greatly from one another and factors like management, working morale and interactions between companies are shaped differently in different cultures. This could provide both advantages and disadvantages for companies in a certain situation when setting up a company in another country.

According to Michael Porter domestic rivalry and the continuous search for competitive advantage within a nation can help organizations achieve advantages on an international scale.

In addition to the above-mentioned determinants Michael Porter also mentions factors like Government and chance events that influence competition between companies.

5. Government

Governments can play a powerful role in encouraging the development of industries and companies both at home and abroad. Governments finance and construct infrastructure (roads, airports) and invest in education and healthcare.

Moreover, they can encourage companies to use alternative energy or alternative environmental systems that affect production. This can be affected by granting subsidies or other financial incentives.

6. Chance events

Porter also indicates that in most markets chance plays an important role. This provides opportunities for innovative companies that are not afraid to start up new operations. Entrepreneurs usually start their companies in their homeland, without this having any economic advantages, whereas a similar start abroad would provide more opportunities.

Porter’s Diamond Model advantages

By using Porter’s Diamond Model, an organization may identify what factors can build advantages at a national level. The Porter Diamond Model is therefore often used during internationalization efforts.

Michael Porter is of the opinion that all factors are decisive for the competitiveness of a company with respect to their foreign competitors. By considering these factors a company will be better able to formulate a strategic goal.