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

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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

GDP per Capita
CAGR: -6.1%

GDP per Capita
CAGR: +0.00%

GDP per Capita
CAGR: +1.4%

Index Values, 1980 = 1.00

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

<table>
<thead>
<tr>
<th>Inherited Prosperity</th>
<th>Created Prosperity</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Prosperity is derived from selling or exploiting <em>inherited natural resources</em></td>
<td>• Prosperity is derived from <em>creating valuable products and services</em></td>
</tr>
<tr>
<td>• Prosperity is <em>constrained</em></td>
<td>• Prosperity is <em>unlimited</em></td>
</tr>
<tr>
<td>• <strong>Government</strong> is the central actor in the economy as the owner and distributor of resource wealth</td>
<td>• <strong>Companies</strong> are the central actors in the economy</td>
</tr>
<tr>
<td>– Resource revenues allow <em>unproductive policies and practices to persist</em></td>
<td>– Prosperity can only be created by <strong>firms</strong></td>
</tr>
<tr>
<td>• <strong>Government’s role</strong> gravitates towards the <em>distribution of wealth</em> as interest groups seek a bigger share of the pie</td>
<td>• <strong>Government’s role</strong> is to create the <em>enabling conditions for productivity</em> and foster private sector development</td>
</tr>
</tbody>
</table>
Comparative Labor Productivity
Selected Countries

Source: EIU (2007), Saudi Arabia employee data (number persons employed) from ILO LABORSTA (2007)
Labor Force Mobilization
Selected Countries

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
Fixed Investment Rates
Selected Countries

- Turkey
- Indonesia
- US
- Morocco
- Saudi Arabia
- Bahrain
- Lebanon
- Yemen
- Kuwait
- Oman
- Egypt
- Pakistan
- Algeria
- Tunisia
- Syria
- Jordan
- India
- South Korea
- Indonesia
- Algeria
- Turkey
- Pakistan
- UAE
- Lebanon
- Kuwait
- Oman
- Yemen
- Libya
- Philippines
- Brazil
- Saudi Arabia
- China
- Qatar

Gross Fixed Investment as % of GDP (2006)

CAGR Gross Fixed Investment (as % of GDP), 1990 - 2006

Saudi Arabia’s Exports
Types of Goods and Services

<table>
<thead>
<tr>
<th>Export Type</th>
<th>Value of Exports, 2006</th>
<th>Growth Rate of Exports, CAGR 1998-2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Natural Resources Related</td>
<td>$201.2 Billion</td>
<td>24.0%</td>
</tr>
<tr>
<td>Non-Natural Resource Related</td>
<td>$19.0 Billion</td>
<td>11.3%</td>
</tr>
<tr>
<td>Semi-Processed Natural Resources</td>
<td>$36.4 Billion</td>
<td>20.3% CAGR</td>
</tr>
<tr>
<td>Processed Goods</td>
<td>$11.7 Billion</td>
<td>16.9% CAGR</td>
</tr>
<tr>
<td>Services</td>
<td>$7.3 Billion</td>
<td>5.6% CAGR</td>
</tr>
</tbody>
</table>

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

- Saudi Arabia
- Other countries
- Bahrain
- U.A.E.
- Qatar

Determinants of Competitiveness

Macroeconomic, Political, Legal, and Social Context

Microeconomic Competitiveness

- Sophistication of Company Operations and Strategy
- Quality of the Microeconomic Business Environment
- State of Cluster Development

- 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

- Local **rules and incentives** that encourage investment and productivity
  - e.g. salaries, incentives for capital investments, intellectual property protection

- **Vigorous local competition**
  - Openness to foreign and local competition

- **Sophistication of local customers and needs**
  - Strict quality, safety, and environmental standards

- **Access to high quality business inputs**
  - Natural endowments
  - Human resources
  - Capital availability
  - Physical infrastructure
  - Administrative infrastructure (e.g. registration, permitting)
  - Information infrastructure (e.g., transparency)
  - Scientific and technological infrastructure

- **Availabilty of suppliers and supporting industries**
- **Presence of clusters instead of isolated firms**

- 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)

Favorable

Unfavorable

Median Ranking, Middle East

Saudi Arabia per capita GDP rank: 48
Saudi Arabia Doing Business rank: 23

Saudi Arabia 2010 goal: 10

### Saudi Arabian Business Environment

#### Selected Advantages and Disadvantages, 2007

<table>
<thead>
<tr>
<th>Competitive Advantages Relative to GDP per Capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quality of electricity supply</td>
</tr>
<tr>
<td>Quality of port infrastructure</td>
</tr>
<tr>
<td>Air transport infrastructure quality</td>
</tr>
<tr>
<td>Reliability of police services</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Competitive Disadvantages Relative to GDP per Capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stringency of environmental regulations</td>
</tr>
<tr>
<td>Business costs of corruption</td>
</tr>
<tr>
<td>Buyer sophistication</td>
</tr>
<tr>
<td>Quality of management schools</td>
</tr>
<tr>
<td>Quality of private property rights</td>
</tr>
<tr>
<td>Absence of trade barriers</td>
</tr>
<tr>
<td>Decentralization of economic policymaking</td>
</tr>
<tr>
<td>Local equity market access</td>
</tr>
<tr>
<td>Quality of math and science education</td>
</tr>
<tr>
<td>Local availability of specialized research and training services</td>
</tr>
<tr>
<td>Quality of primary education</td>
</tr>
<tr>
<td>Financial market sophistication</td>
</tr>
<tr>
<td>Availability of scientists and engineers</td>
</tr>
<tr>
<td>Effectiveness of antitrust policy</td>
</tr>
<tr>
<td>Intensity of local competition</td>
</tr>
<tr>
<td>Quality of scientific research institutions</td>
</tr>
</tbody>
</table>

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

Variation in BCI score explains 82% of variation in GDP per capita.

Saudi Arabia's Ranking

Global Competitiveness Index
Business Competitiveness Index

35
51
Enhancing Cluster Development
Tourism Cluster in Cairns, Australia

Public Relations & Market Research Services

Food Suppliers

Property Services

Maintenance Services

Travel agents

Tour operators

Restaurants

Attractions and Activities
  e.g., theme parks, casinos, sports

Hotels

Airlines, Cruise Ships

Government agencies
  e.g. Australian Tourism Commission, Great Barrier Reef Authority

Educational Institutions
  e.g. James Cook University, Cairns College of TAFE

Industry Groups
  e.g. Queensland Tourism Industry Council

Local retail, health care, and other services

Local Transportation

Souvenirs, Duty Free

Banks, Foreign Exchange

Local Retail,\nhealth care, and other services

Sources: HBS student team research (2003) - Peter Tynan, Chai McConnell, Alexandra West, Jean Hayden
Competitiveness Master - 2007-11-14.ppt

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The Houston Oil and Gas Cluster

Upstream

- Oil & Natural Gas Exploration & Development
- Equipment Suppliers (e.g. Oil Field Chemicals, Drilling Rigs, Drill Tools)
- Specialized Technology Services (e.g. Drilling Consultants, Reservoir Services, Laboratory Analysis)

Downstream

- Oil & Natural Gas Completion & Production
- Subcontractors (e.g. Surveying, Mud Logging, Maintenance Services)
- Business Services (e.g. MIS Services, Technology Licenses, Risk Management)
- Specialized Institutions (e.g. Academic Institutions, Training Centers, Industry Associations)
- Oilfield Services/Engineering & Contracting Firms

- Oil Transportation
- Gas Gathering
- Oil Trading
- Gas Processing
- Oil Refining
- Gas Trading
- Oil Distribution
- Gas Transmission
- Oil Wholesale Marketing
- Gas Distribution
- Oil Retail Marketing
- Gas Marketing
National Cluster Export Portfolio
Saudi Arabia, 1997-2005

Saudi Arabia's Average World Export Share: 1.92%

Change in Saudi Arabia's world export market share, 1997 – 2005

Exports of US$1.2 Billion = 


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## Improving Company Sophistication
### Relative Position of Saudi Arabian Companies, 2007

<table>
<thead>
<tr>
<th>Competitive Advantages</th>
<th>Competitive Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relative to GDP per Capita</td>
<td>Relative to GDP per Capita</td>
</tr>
<tr>
<td>Control of international distribution 19</td>
<td>Extent of staff training 77</td>
</tr>
<tr>
<td>Production process sophistication 32</td>
<td>Reliance on professional management 71</td>
</tr>
<tr>
<td>Value chain breadth 34</td>
<td>Degree of customer orientation 69</td>
</tr>
<tr>
<td>Prevalence of foreign technology licensing 62</td>
<td>Extent of marketing 68</td>
</tr>
<tr>
<td>Extent of regional sales 61</td>
<td>Prevalence of foreign technology licensing 62</td>
</tr>
<tr>
<td>Extent of incentive compensation 56</td>
<td>Extent of marketing 68</td>
</tr>
<tr>
<td>Breadth of international markets 52</td>
<td>Prevalence of foreign technology licensing 62</td>
</tr>
<tr>
<td>Capacity for innovation 49</td>
<td>Extent of regional sales 61</td>
</tr>
<tr>
<td>Nature of competitive advantage 49</td>
<td>Extent of incentive compensation 56</td>
</tr>
<tr>
<td>Willingness to delegate authority 47</td>
<td>Breadth of international markets 52</td>
</tr>
</tbody>
</table>

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.

Geographic Influences on Competitiveness

- World Economy
- Broad Economic Areas
- Groups of Neighboring Nations
- The Neighborhood
- Nation
- States, Provinces
- Regional Economies
- Metropolitan Areas
- Rural Areas
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

<table>
<thead>
<tr>
<th>Old Model</th>
<th>New Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>• <strong>Government</strong> drives economic development through policy decisions and incentives</td>
<td>• Economic development is a <strong>collaborative process</strong> involving government at multiple levels, companies, teaching and research institutions, and private sector organizations</td>
</tr>
</tbody>
</table>

- 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

- Strong Export Share
  - Inorganic Chemicals
  - Misc. Crude Materials
- Weak Export Share
  - Losing Market Share
    - Pesticide and Other Agricultural Chemicals
    - Miscellaneous Mineral Products
  - Gaining Market Share
    - Packaged Chemicals
    - Synthetic Fibers
    - Explosives
    - Dyeing, Tanning and Coloring Materials

Source: International Cluster Competitiveness Project, Institute for Strategy and Competitiveness, Harvard Business School
### Grow Current Niche Positions

**Leading Saudi Arabian Export Industries outside of Clusters, 2005**

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

Note: Exact physical location of Economic Cities still to be determined
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