Country Analysis: Porter's Diamond model

MMS SEM III 2022-23

Date: 1st Dec 2022

Porter's Diamond Model

Used by firms/businesses to analyze the external competitive environment

- Explains the relative strength of one business against another
- Explains why some industries are more advantageous than others in a particular region

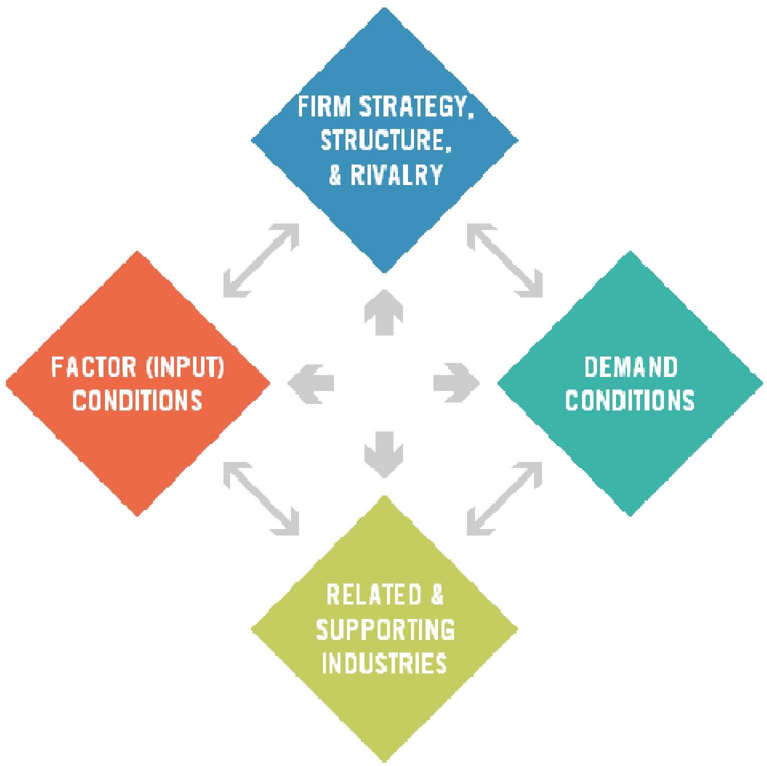
The Porter's Diamond model attempts to answer the following questions:

- Why does one nation become the most competitive for a certain industry (home base)? Example - Germany home base for Car manufacturing
- Why are companies from one country able to sustain competitive in a particular industry?

In the Porter's Diamond model the answers to these questions are the determinants of competitive advantage.

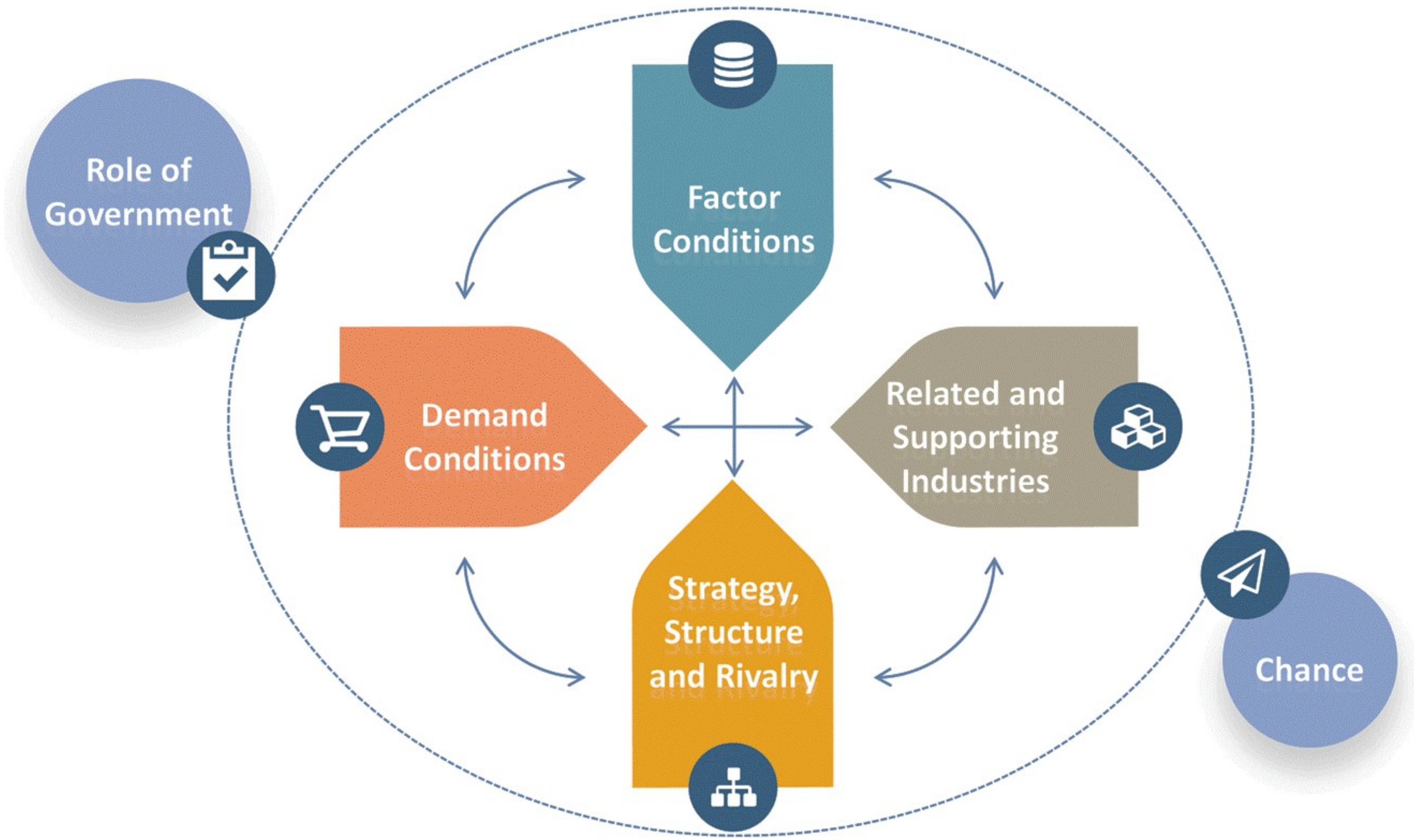
Porter's Diamond Model

As per the model there are four factors that determine national competitive advantage. Porter represented these four determinants as a diamond as you can see in the diagram. Now you can think of the four determinants as being the playing field for the industries of a particular nation and the four determinants are Factor Conditions, Demand Conditions, Related and Supporting Industries and Firm Strategy Structure and Rivalry.



Porter’s Diamond Model

The model also shows that there are two extra determinants that can influence any or all of the fourth determinants and these are Government policy and Chance conditions.



1. Factory Conditions (Input)

Factory conditions refer to the different types of resources that may or may not be present within a Nation. Resources include such things like human resources, capital resources, Natural Resources, infrastructure.

To understand the role of factory conditions we need to make a distinction between basic and advanced factor can do.

Basic factor conditions include things like natural resources and unskilled labor whereas Advanced factor conditions include things like skills labor, specialist knowledge, specialist capital.

Porter argues that basic factory conditions do not generate competitive advantage and that's because they can actually be obtained by anyone if they just apply money to the problem. Only advanced factory conditions can generate real true competitive advantage.

Example of an advanced factor – MIT produces graduates with very high computing skills and this in turn feeds a software competitive advantage for the United States. Another factor for the U.S. is having a large pool of venture capital seeking to invest in technology startups and this factor condition further bills competitive advantage for the IT or Tech industry in the U.S.

1. Factor Conditions

Basic factors: natural resources

Advanced factors:

human resources,
research capabilities

Highly specialized to an industry's particular needs.

Example: With the second largest proven oil reserves in the World Saudi Arabia is one of the largest exporters of oil worldwide however porter indicates that although basic factors may create the ground for international competitiveness they can never turn into real value creation without the advance factors.

DIAMOND MODEL | 4 Determinants of National Advantage

Start with basic factors of production. Then add:

- ❑ Cultivated Capabilities
- ❑ Knowledge Resources
- ❑ Cultural Adaptability
- ❑ Innovation Capability
- ❑ Time Zone Advantages

- ❑ Singapore & Logistics Hub
- ❑ Italy & High End Fashion
- ❑ India & IT skills

2. Demand Conditions

The main factor of demand conditions is really home market demand.

To have a competitive advantage for an industry, there must be very strong home market demand for the product or service that these companies are producing .

In fact the more demanding home market customers are, the greater the pressure on companies to innovate and to improve and these demand conditions create a competitive advantage for that Nation.

Over time, demand conditions include things like market size, market growth rate and also the market sophistication.

Another factor which can determine demand conditions is early home market saturation, so early home market saturation can encourage people to innovate to keep selling

2. Demand Conditions

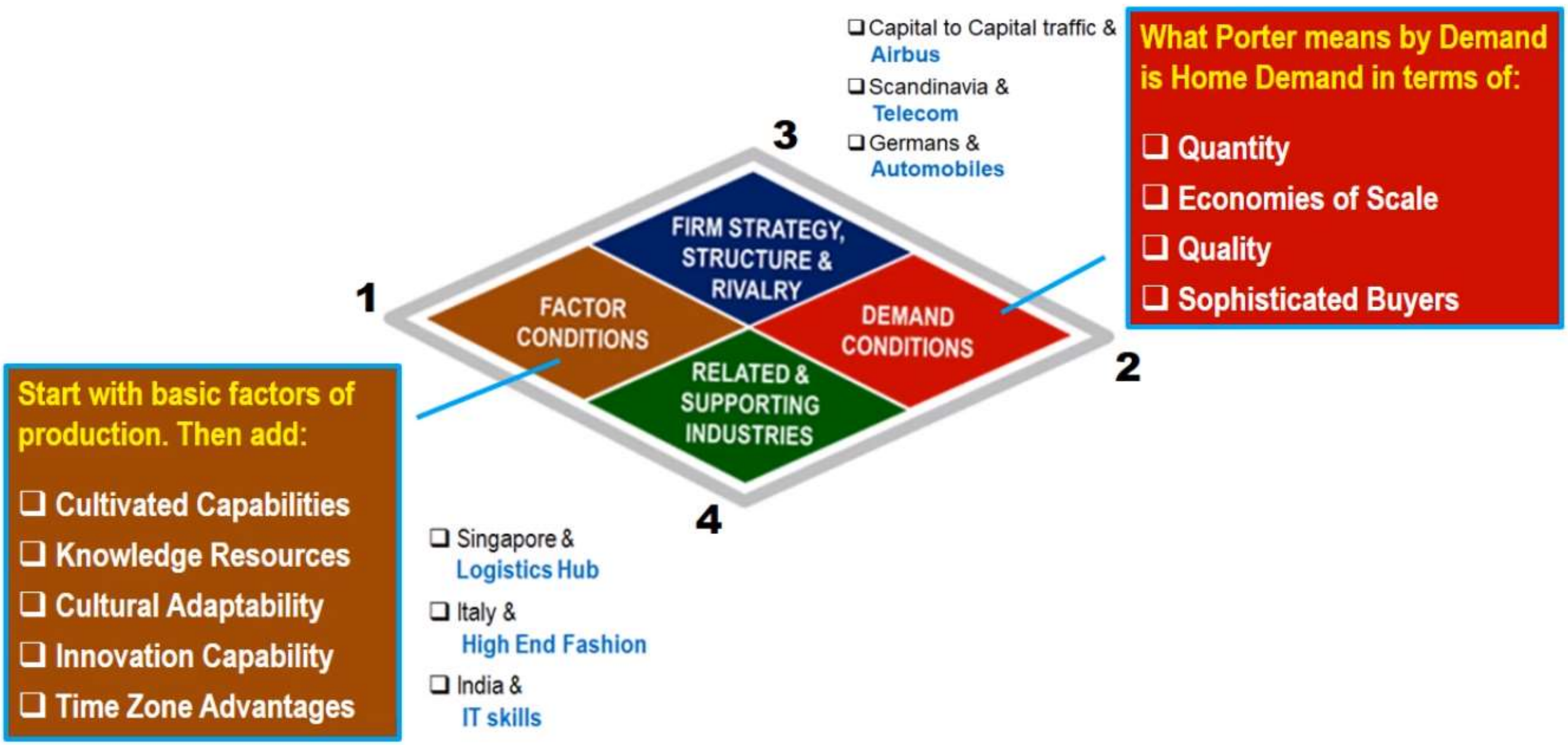
A clearer or earlier picture of emerging buyer needs

"early-warning indicators"

Spread of these tastes to the rest of the world

Media
Training foreigners
Political influence
Foreign activities of their citizens and companies

DIAMOND MODEL | 4 Determinants of National Advantage



The requirement of catering to large number of passengers flying between European cities, that created a consortium of European countries to come up with the Airbus, which obviously is a much wide body aircraft compared to the Boeing.

3. Strategy, Structure & Rivalry

The competitiveness of firms in one Nation is determined by how those firms set strategy and structure themselves.

It's also determined by how much competition there is between firms in the industry.

How firms are structured and set goals is going to differ from Nation to Nation and it's determined by a whole bunch of things including social factors, political factors, legal factors & whole bunch of other things.

Intense rivalry causes a drive to innovate.

Example- German car manufacturers BMW Mercedes and Volkswagen wouldn't be so successful without the existence of each other because the intense rivalry drives innovation and makes them successfully internationally.

Firm Strategy, Structure and Rivalry

Italy

lighting,
furniture,
footwear,
woolen fabrics

Germany

optics,
chemicals,
complicated machinery

Japanese Automobile Industry

In Italy successful international competitors are often small or mid-sized companies that are privately owned and operated like extended families. In contrast in Germany companies tend to be strictly hierarchical in organization and management practices and top managers usually have technical backgrounds.

DIAMOND MODEL | 4 Determinants of National Advantage

In Porter Diamond, Rivalry has exactly the same meaning as Rivalry in 5 Forces Model:

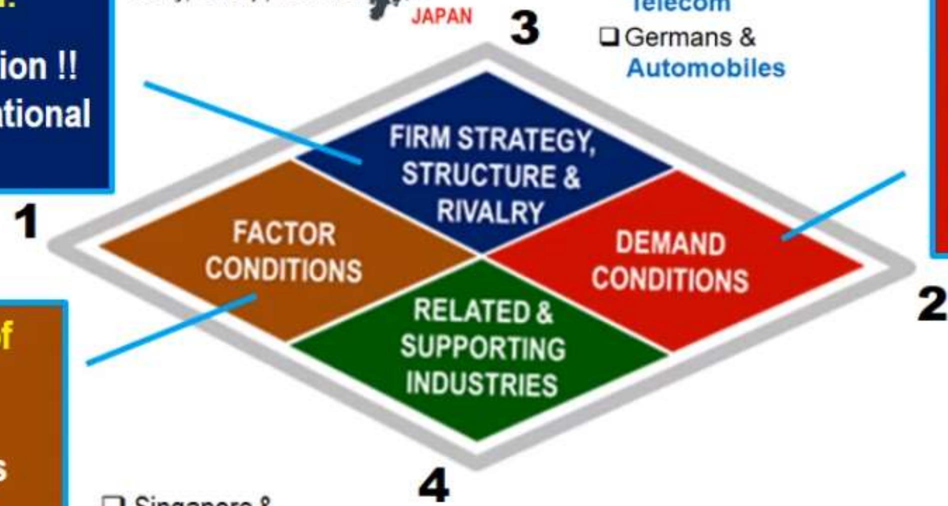
- ❑ But opposite implication !!
- ❑ Rivalry is good for National Competitiveness

Akai, Brother, Canon, Casio, Citizen, Hitachi, Mitsubishi, NEC, Nikon, Panasonic, Sony, Sharp, Toshiba

- ❑ Capital to Capital traffic & **Airbus**
- ❑ Scandinavia & **Telecom**
- ❑ Germans & **Automobiles**

What Porter means by Demand is Home Demand in terms of:

- ❑ Quantity
- ❑ Economies of Scale
- ❑ Quality
- ❑ Sophisticated Buyers



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- ❑ Italy & **High End Fashion**
- ❑ India & **IT skills**

4. Related and supporting Industries

The success of one industry can be dependent on the success of related industries or suppliers within that Nation. The presence of internationally competitive suppliers can be helpful to the company, using those suppliers and that's because it gives cost-effective access to inputs and alongside this, it gives early access to new products and encourages the rapid sharing of information perhaps because they share the same language

Having lots of related industries within a Nation, sometimes results in brand new industries and that happens, where the related industries can share resources.

For example car manufacturers in Germany could share access to a wind tunnel and this use of sharing resources within a Nation can create a competitive advantage as it increases the barrier to entry for competitors.

Related and Supporting Industries

Industrial production does not take place in isolation

Suppliers,
Component manufacturers,
Distributors

Shenzhen, China

Tencent 腾讯

HUAWEI

dji PHANTOM PILOT

Makeblock

Example - Shenzhen a city bordering Hong Kong and SouthEast evolved into an innovation and manufacturing hub for the electronics industry. It has cultivated an ecosystem to support the manufacturing supply chain including thousands of component manufacturers, assembly suppliers & distributors.

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- ❑ USA, Computers & all **R&S Industries**
- ❑ Chennai, Automobiles & **Ancillary Industries**

National advantage occurs when R&S INDUSTRIES emerge around a key industry (industry clusters)

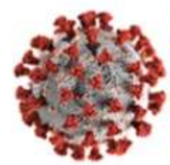
- ❑ These supplier are themselves globally competitive sub-industries
- ❑ Eventually they create a national advantage for the Original Downstream industry

To Complete the Model, Porter added 2 more variables that impact all 4 determinants

Chance & **Government**

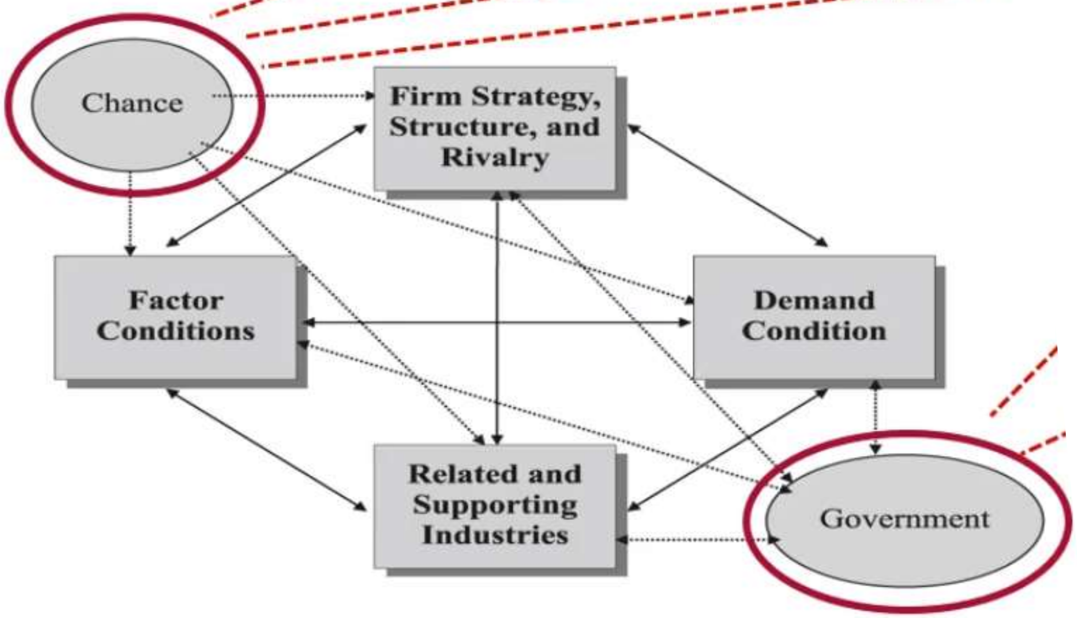
*Events outside the scope of **Firms** or **Governments** that play a key role in influencing competitive advantage*

- **Inventions**
- **Technological Discontinuities**
- **Input Cost Shifts**
- **Financial Market Crises**
- **Wars** ***& Now …***



COVID 19

A pure **CHANCE** event that will significantly alter Global Business Dynamics



Limitations of Porter’s Diamond model

Some argue that Porter’s Diamond Model ignore some important factors:

- Fails to consider the attributes of the home country’s largest trading partners
- It is not applicable to most of the world’s smallest nations
- Ignores the role of multinational corporations influencing the competitive success of nations

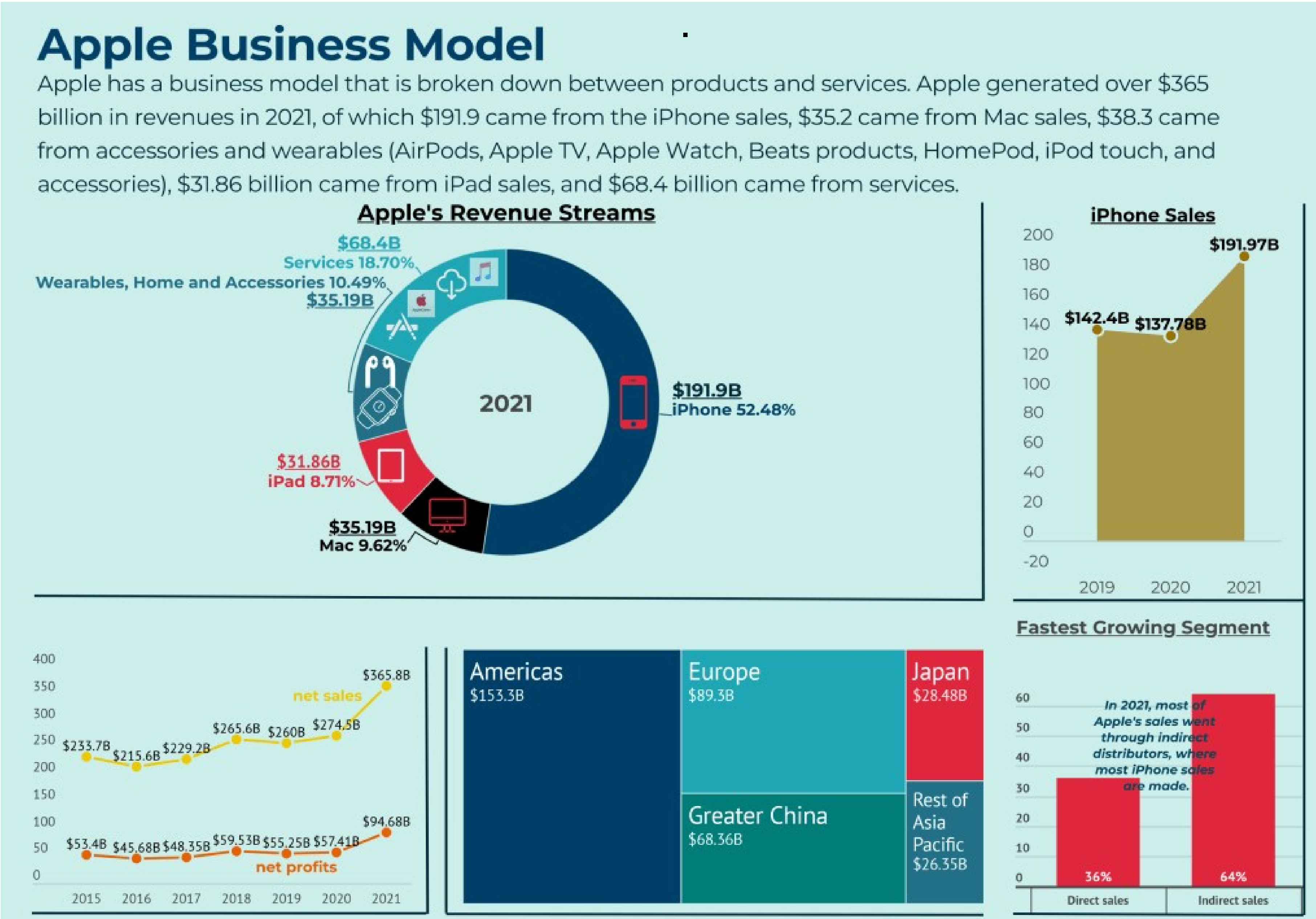
Others believe that the model is so general that it lacks value.

They argue that trying to explain all aspects of trade and competition ends up explaining nothing because it is insufficiently precise.

Application Example

- German high power car manufacturing industry → eg. BMW
  FRS: Strong rivalry between lots of manufacturers → compete and keep developing more innovative products
- **DC:** No speed limits in Germany → home buyers want more powerful cars → Industry tries to develop innovative engines to cater for this need
- **RSI:** Iron and steel industry, high level of education and training in the workforce, banks, and component suppliers and IT infrastructure
- **FC:** Skilled engineers from renowned universities, government focus on scientific research
- **Government:** Supported and funded scientific research, launched the construction of more roads and canals in the 19th century

Porter’s Diamond model example



Porter's Diamond model example - Apple

1. Firm Strategy, Structure, and Rivalry - Apple was founded in arguably the most innovative and entrepreneurial country in the world, with early rivals such as IBM, Xerox, Commodore, and Tandy all competing for a slice of the emerging consumer electronics market. Today, Apple's business strategy consists of hardware expertise, superior design, enhanced customer experience, and the integrated Apple ecosystem.
2. Factor conditions – Apple is based in Silicon Valley, California, so the company has access to a vast, skilled workforce. However, most product assembly occurs in China where labor is cheaper.
3. Demand conditions – the company enjoys significant demand for its innovative technology products around the world. Provided the company can continue to execute its strategy, this demand is likely to be sustained.
4. Related and supporting industries – as noted earlier, Apple benefits from the increased collaboration that occurs between related companies in Silicon Valley. Apple also has a simple but effective supply chain, purchasing components from suppliers and then shipping them to China for assembly. It works with a small number of key suppliers, which means it can facilitate better relationships with each.

In the **Diamond** Model ...

A Complex game kicks off

SELF-REINFORCING INTERPLAY OF ADVANTAGES

- ❑ **Absolute Strength of one determinant not enough unless reinforced by others vectors**
- ❑ **This reinforcement ensures only Few Industries develop as Competitive for any Nation**
- ❑ **Simply put, no country in the world can be a net exporter of everything !!!**

Country Analysis: Country Risk Analysis

MMS SEM III 2022-23

Date: 24th Nov 2022

Country Risk Analysis - Definition

Country risk represents the potentially adverse impact of a country's environment on the MNC's cash flows.

Country risk can be used:

- To monitor Countries, where the MNC is presently doing the business
- As a screening device to avoid conducting business in Countries with excessive risks
- To improve, the analysis used in making long-term investment or financing decisions

Country Risk Analysis - Objectives

- Identify the common factors used by MNCs to measure a country's political risk
- Identify the common factors used by MNCs to measure a country's financial risk
- Explain the techniques used to measure country risk
- Explain how MNCs use the assessment of country risk when making financial decisions

Video on Country Risk Analysis

https://www.investopedia.com/terms/c/countryrisk.asp

Country Risk Analysis – Political risk

1. Definition of Political risk - is the potentially adverse impact of a country's political environment on an MNC's cash flows

2. Some Adverse Impacts:
   1. A terrorist attack
   2. A major labor strike in an industry
   3. A political crisis due to a scandal within a country
   4. Concern about a country's banking system that may cause a major outflow of funds
   5. The imposition of trade restrictions on imports

Political Risk Factors

1. Attitude of Consumers in the Host Country:
   - Some consumers may be very loyal to homemade products
2. Attitude of Host Government:
   - The Host government may impose special requirement of taxes, restrict fund transfers, subsidize local firms, or fail to enforce copyright laws
3. Blockage of Fund Transfers:
   - Funds that are blocked may not be optimally used

Political Risk Factors (Cont.)

4. Currency Inconvertibility:
   - The MNC parent may need to exchange earnings for goods
5. Wars:
   - Internal and external battles, or even the threat of war, can have devastating effects
6. Bureaucracy:
   - Bureaucracy can complicate businesses
7. Corruption:
   - Corruption can increase the cost of conducting business or reduce revenue

Financial Risk Factors

Indicators of Economic Growth:

- A country's economic growth is dependent on several financial factors:
  a. Interest Rates
  b. Exchange Rates
  c. Inflation etc.

Current and Potential State of the Country's Economy:

- A recession can severely reduce demand
- Financial distress can also cause the government to restrict MNC operations

Types of Country Risk Assessment

- A Macro-assessment of Country Risk is an overall risk assessment of a country without consideration of the MNC's business

- A Micro-assessment of Country Risk of Country Risk is the risk assessment of a country as related to the MNC's type of business

- The overall assessment of Country risk thus consists of:
  - Macro-Political risk
  - Macro-Financial risk
  - Micro-Political risk
  - Micro-Financial risk

Techniques of Assessing Country Risk

- A Checklist approach involves rating and weighting all the identified factors, and then consolidating the rates and weights to produce an overall assessment
- The Delphi Technique involves collecting various independent opinions without group discussion and then averaging and measuring the dispersion (Standard deviation) of those opinions.
- Quantitative Analysis techniques like regression analysis can be applied to historical data to assess the sensitivity of a business to various risk factors
- Inspection Visits
- Combination of Techniques

Techniques of Assessing Country Risk (Cont.)

- Inspection Visits involve travelling to a Country and meeting with Government officials, firm executives, and/or consumers to clarify uncertainties
- Combination of Techniques: Often, firms use a variety of techniques for making Country risk assessment

  - For example, they may use a checklist approach to develop an overall Country risk rating, and some of the other techniques to assign ratings to the factors considered.

Developing A Country Risk Rating

A Checklist approach will require the following steps:

- Assign values and weights to the Political risk factors
- Multiply the factor values with their respective weights & sum up to give the Political risk rating
- Derive the Financial risk rating similarly
- Assign weights to the Political and Financial ratings according to the perceived importance
- Multiply the ratings with their respective weights, and sum up to give the overall Country Risk Rating

Developing A Country Risk Rating (Cont.)

- Different Country risk assessors have their own individual procedures for quantifying Country risk
- Although most procedures involve rating and weighing of the factors, the number, type, rating, and weighting of the factors will vary with the Country being assessed, as well as the type of corporate operations being planned
- Firms may use Country risk ratings when screening potential projects, or when monitoring existing projects
- For example, decisions regarding subsidiary expansion, fund transfer to the parent, & sources of financing, can all be affected by changes in the Country risk rating

Developing A Country Risk Rating (Cont.)

Variation in Methods of Measuring Country Risk:

- Note that the opinion of different risk assessors often differ due to subjectivities in-
  - Identifying the relevant political and financial factors
  - Determining the relative importance of each factor
  - Predicting the values of the factors that cannot be measured objectively

Comparing Risk Ratings among Countries

One approach to comparing political and financial ratings among Countries is the Foreign Investment Risk Matrix (FIRM)

a. which displays the financial (or economic) on one axis and political risk on the other axis by intervals ranging across the matrix from “poor” to “good.
b. Each country can be positioned in its appropriate location on the matrix based on its political rating and financial rating.

The Foreign Investment Risk Matrix (FIRM)

Reducing Exposure to Host Government Takeovers

1. Use a Short-Term Horizon
   - Recovering cash flow quickly
2. Rely on Unique Supplies or Technology
   - In this way, the government will not be able to take over & operate successfully
3. Hire Local Labor
   - The local employees can apply pressure on their government
4. Borrow Local Funds:
   - The local banks can apply pressure on government
5. Purchase Insurance
6. Use Project Finance

Getting Help in Assessing Country Risk

Some international organizations evaluate the country risk on behalf of their member nations.

For example, the Organization for Economic Co-Operation and Development (OECD), as part of its arrangement regarding officially supported export credits, publishes an updated list of countries and their associated risks for the purpose of setting interest rates and payment terms.

In addition, the major credit rating agencies— Standard & Poor's (S&P), Moody's, and Fitch—all have their own lists of sovereign ratings, which also analyze fundamentals such as effectiveness of institutions and government, economic structure, growth prospects, external finances, and fiscal and monetary flexibility.

Large investment-management firms also rate country risk in their specific business lines. BlackRock Inc., for example, publishes the BlackRock Sovereign Risk Index (BSRI), a quarterly sovereign risk index that tracks current risk levels and trends.

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COUNTRY RISK ASSESSMENT MAP

Q3 2022

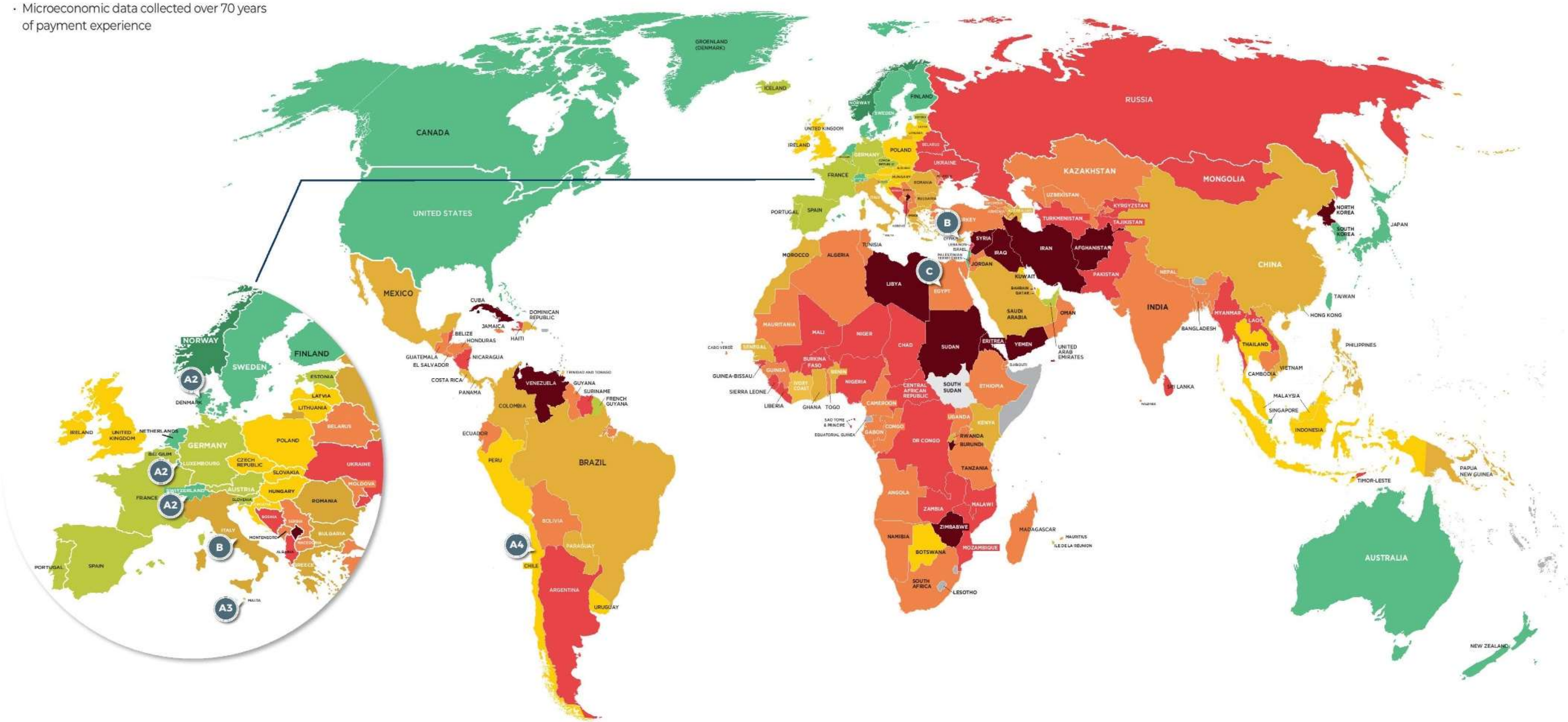
162 COUNTRIES UNDER THE MAGNIFYING GLASS

A UNIQUE METHODOLOGY

- Macroeconomic expertise in assessing country risk
- Comprehension of the business environment
- Microeconomic data collected over 70 years of payment experience

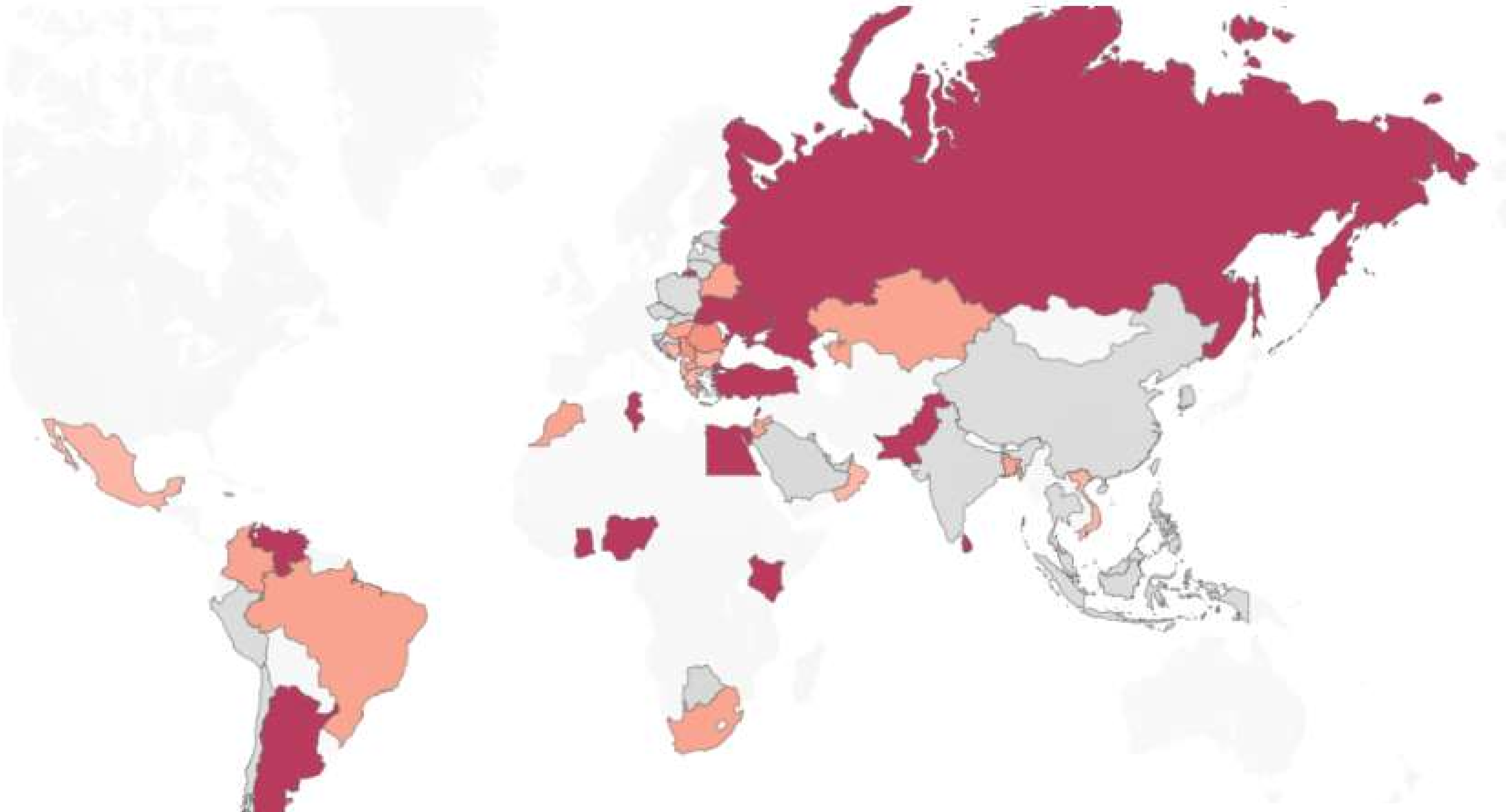
BUSINESS DEFAULTING RISK	A1	A2	A3	A4	B	C	D	E
	VERY LOW	LOW	SATISFACTORY	REASONABLE	FAIRLY HIGH	HIGH	VERY HIGH	EXTREME

UPGRADES DOWNGRADES



https://www.coface.com/News-Publications/Publications/Country-Risk-Assessment-Map-Q3-2022

CFR Sovereign Risk Tracker



India

CFR Sovereign Risk Index	**1**
Current account	-2.1% of GDP
External debt	19% of GDP
Short-term debt and current account	37% of reserves
Government debt	56% of GDP
Fiscal balance	-6.6% of GDP
Foreign currency debt	13% of GDP
Political instability index	-0.6
Credit default swap spread	147 bps

Sri Lanka

CFR Sovereign Risk Index	**10**
Current account	-4.4% of GDP
External debt	57% of GDP
Short-term debt and current account	720% of reserve
Government debt	98% of GDP
Fiscal balance	-11.5% of GDP
Foreign currency debt	57% of GDP
Political instability index	-0.3
Credit default swap spread	6,809 bps

> Risk management should be an enterprisewide exercise and engrained in the business culture of the organization.