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Summary

Overview of Managing Change and Cultivating Opportunity

The Case for a Capability Index

A study by KPMG International and researchers from the Overseas Development Institute on the need for a Capability Index to measure developing countries' capacity to manage change.

Foreword

Countries do not respond to change in the same way. Indeed, around the world there are examples of economies that are better able to manage change and capitalize on new opportunities than their neighbors and peers. Equally, recent history has demonstrated that some developing countries possess a stronger capacity to react and respond to economic crises and natural disasters than others. This difference in the ability to manage change is determined by what we refer to as a country's '**capability**'.

At the 2010 World Economic Forum (WEF), an informal discussion took place around the need for a reliable and appropriate method for assessing the capabilities of a developing country to cope with, respond to – and as required – proactively stimulate positive change. In response, KPMG International, in cooperation with researchers from the Overseas Development Institute (ODI), have proposed a number of key determinants that impact a country's capability to manage change, and have reviewed over 30 existing indices[1] to assess this ability.

A new Capability Index would equip key stakeholders (such as development agencies, developing country governments, business, research institutes and NGOs) with a critical tool to identify important areas that require focused improvement within developing countries to improve the capability to manage change.

We hope this paper will provide a foundation to stimulate further discussion within governments and the development community, and encourage decision-makers to join our initiative to create a comprehensive Capability Index.

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The full report, Managing Change and Cultivating Opportunity can be found at: www.kpmg.com/ids

1 Detailed results can be found at: http://www.odi.org.uk/resources/download/5246.pdf

Dealing with Shocks and Managing Change

The 'Capability' of Developing Countries

A key leadership challenge facing developing countries – and in fact all countries – is dealing with economic shocks and managing long-term change. Shocks like the food, fuel and financial crises of recent years, disrupt development and slow progress in reducing poverty. Development itself – urbanization, industrialization, demographic change – is equally disruptive.

Some countries manage these challenges well. Some do not.

CASE 1 – Leadership

Singapore

In the 1960s, Singapore was a poor country with few resources, similar to many low-income countries. At US$400, its income per capita was on par with Ghana. Since then, incomes in Singapore have risen significantly. Now, with the highest gross domestic product (GDP) per capita and best competitiveness scores in Asia, Singapore demonstrates the importance of investment in education, good quality physical and knowledge infrastructure, and appropriate incentive structures. By deliberately upgrading skills and infrastructure over time – in a way that is consistent with private sector needs – Singapore's government has facilitated a transformation in the types of economic activity that are undertaken. This demonstrates how governments can proactively stimulate structural change, resulting in impressive growth and development.

CASE 2 – Proactive Development

St. Lucia

St. Lucia is another case of well-managed change. Before 1965, there was almost no tourism industry. In order to reduce dependence on bananas and sugar – in the face of changes in international preferential trading arrangements that would erode St. Lucia's competitiveness in those products – a conscious decision was made to diversify by developing the tourism industry. The government provided generous incentives and access to the best beaches in order to attract investors and focused on infrastructure development. This paved the way for the development of Rodney Bay Marina, which allowed for the creation of a yachting industry worth US$50 million per year. In addition, the institutional infrastructure has been established to organize large events (carnivals, jazz and flower festivals, sports events, etc.), capitalizing on cultural assets. Overall, the tourism industry is now worth approximately four times the value of the banana sector.

CASE 3 – Financial Management

Bolivia

In the recent global financial crisis, the ability of developing countries to respond rapidly and effectively depended partly on the existence of fiscal 'space' and macro-economic stability. In Bolivia, for example, the continuous current account surpluses witnessed prior to the global financial crisis brought about an impressive increase in the stock of foreign exchange reserves held by the Central Bank of Bolivia, increasing it from US$1.1 billion at the end of 2004 to US$7.8 billion in September 2008. This meant that Bolivia was in a much better position to weather the storm and continue important spending programs.

CASE 4 – Governance and Institutions

Tanzania

Governance is also important. In Tanzania, strong political will, as well as good quality and flexible institutions, led to the adoption of effective and timely policy interventions. For example, a broad consultative mechanism involving the Ministry of Finance, the Central Bank and other stakeholders was put in place in March 2009 to discuss the impacts of the global financial crisis and suggest mitigation measures. As a result, a special rescue package (the biggest in sub-Saharan Africa) was adopted.

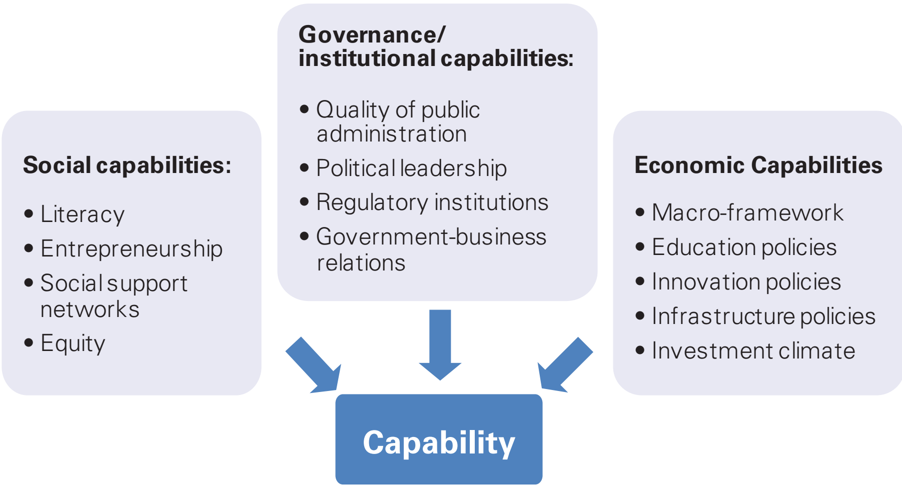
What do Singapore, St. Lucia, Bolivia, and Tanzania have in common? Along with many other countries – they demonstrate the ***capacity to manage change***. We call this a country's ***'capability'***.

Modeling and Measuring Capability

A country's capability can be understood in terms of three categories of factors (Figure 1):

1. **Economic capabilities** – relating to economic policies and frameworks
2. **Governance and institutional capabilities** – relating to the capacity of government, and the institutional arrangements that have been established
3. **Social capabilities** – relating to the characteristics of a society, such as literacy, social support networks and equity

The Dimensions of Capability – Figure 1



While there are many existing indices which capture some relevant factors, there are none which bring together all required elements to examine a country's overall capability. The WEF's Global Competitiveness Index, the World Bank Governance Indicators, and the World Bank's Country Poverty Impact Assessment all provide a range of indicators that could be drawn on to examine the capability to manage change, but they do not capture all of the relevant factors.

Our analysis shows there are some important dimensions of capability which are not adequately captured by existing indices, such as:

- R&D policies and institutional arrangements
- Effectiveness of state-business relations
- Policies that may contribute to economic diversification
- Social safety nets for households
- Safety nets for businesses affected by economic shocks
- Risk management capabilities
- Entrepreneurship
- Family/community support networks

Towards a Capability Index

In order to determine a country's capacity to manage change, or ***capability***, KPMG and researchers from ODI are planning to work together to develop a new Capability Index for developing countries. Why should this also be an important consideration for governments, advisors, development agencies, donors and investors?

A Capability Index could:

- Enable developing countries to benchmark their progress over time
- Help inform development agencies and donors which countries are better prepared to cope with change
- Help donors target, prioritize, and design their assistance accordingly
- Assist governments, donors, and their advisors to spot and mitigate potential areas for improvement
- Provide input into policy and regulatory development
- Inform investors looking for growth opportunities and minimize risks, facilitating further private sector development
- Enable further academic analysis to strengthen the global understanding of the determinants of capability in different situations

Realigning Axles, Not Reinventing Wheels

At the 2011 World Economic Forum and beyond, KPMG International and ODI researchers will discuss the value of measuring country capability through the development of a Capability Index, convening authorities representing a range of stakeholders to participate in frank discussions around the need and development of a Capability Index.

KPMG and researchers from ODI recognize the need for such broad-based discussions. The creation of this index, including the appropriate definition of key indicators, determinants, and factors that would form its basis, is critical. As such, they are actively seeking input from governments, development stakeholders and other interested parties.

To learn more about this initiative, review research findings, or provide input, please contact one of the Overseas Development Institute (ODI) or KPMG representatives below:

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The full report, *Managing Change and Cultivating Opportunity,* can be found at:
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