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Back from the brink

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The financial crisis that brought international banks, corporate legends and some governments to, or over, the brink of failure has abated. The immediate aftermath was a recession that still reverberates throughout the world's largest and smallest economies.

Carl Steidtmann, chief economist with Deloitte Research, Deloitte Services LP, foresees a longer-term aftermath that will be no less than a "great transformation" affecting every country and industry around the world.

The transformation, says Steidtmann, is a broad application of Stein's Law, which states simply that if something cannot go up forever, it will stop. For the global economy, this means that trade imbalances could not continue to deepen and the "shop 'till you drop, buy until you die" mentality of the U.S. consumer had to end:

For the rest of the world, dependence on U.S. consumers as a source of demand is coming to an end. For the global economy, this will free up resources...to expand domestic demand and build infrastructure. While the transition to this new economic dynamic will not be easy, the global economy that will emerge will be much more stable.¹

Further underlying this transformation are a variety of forces, including what John Hagel of Deloitte LLP at the Deloitte Center for the Edge calls the Big Shift, which is changing the very foundation of the economic environment. "Normal," says Hagel, "May in fact be a thing of the past."²

In response, national, regional and local governments need a new vision and strategy. It will not be enough to re-stake yesterday's claim in today's economic landscape. To be competitive, 21st Century governments must stake a new claim in the new landscape.

This requires finding new avenues for growth, simultaneously focusing internally --- on domestic policies to meet changing and ever-increasing domestic needs --- and externally, to maintain and increase competitiveness so that industries, companies and workers can compete on the world stage successfully.

Governments cannot afford to favor one at the expense of the other. In fact, policies that support national competitiveness can accelerate economic growth to meet domestic needs. Alternately, policies wholly-focused on immediate internal needs can impair competitiveness and mean stagnant or even declining long-term growth.

The Institute for Strategy and Competitiveness at Harvard Business School explains it this way, "Economic policy and social policy have been largely separate agendas involving different participants. Many see the two as conflicting agendas because of the flaws in the capitalist system. However, there is no inherent conflict between capitalism and social needs. A productive and growing economy requires rising skill levels, a proliferation of new companies, safe working conditions, healthy workers who live in decent housing in safe neighborhoods, and a sense of opportunity. Social and economic policy must be integrated in addressing society's ills and ensuring true progress."³

Private companies are adapting and adjusting to the transformation. A corporate CEO can readily point to the many levers used to sustain competitiveness and gain market share – efficiency, pricing, quality, and innovation.

To be competitive, 21st Century governments must stake a new claim in the new landscape.

Governments can be no less aggressive in seeking comparative advantages and catalyzing the private sector to create the growth and innovation that bring jobs and prosperity. A country's education, tax, immigration and energy policies, just to name a few, affect its' national competitiveness. A competitive government will capitalize on opportunities inside and outside its borders and enact policies that benefit one without, at the very least, impairing the other.

Countries have levered specific advantages such as geography, language and tax policy. Panama's narrow isthmus was an ideal point to build a canal that serves as a gateway for world commerce. India focused investment in telecommunications and combined this with an English-speaking population⁴ to launch a foothold in global services. To encourage foreign investment and increase domestic employment, some countries reduce corporate taxes.

U.S. diplomat Joseph P. Kennedy is reported to have said that "when the going gets tough the tough get going." This is a time for the tough, competitive government to evaluate how it will remain competitive in the face of transformation and what Hagel calls "an age of near-constant disruption."⁵

The Big Shift: Positioning for Growth in the Midst of Disruption

For government and industries, the forces of near-constant disruption are measurable and rapid, and they provide an opportunity for future growth. These forces can be explained through the three waves of "The Big Shift"⁶ that are part of the great transformation of the global economy.

Simply put, these waves—the foundation, flow and impact waves—will bring even more structural change and competitive pressures. And these waves provide a framework that governments can use to assess comparative advantage and stake new claims in the new economic landscape.

The Foundation Wave

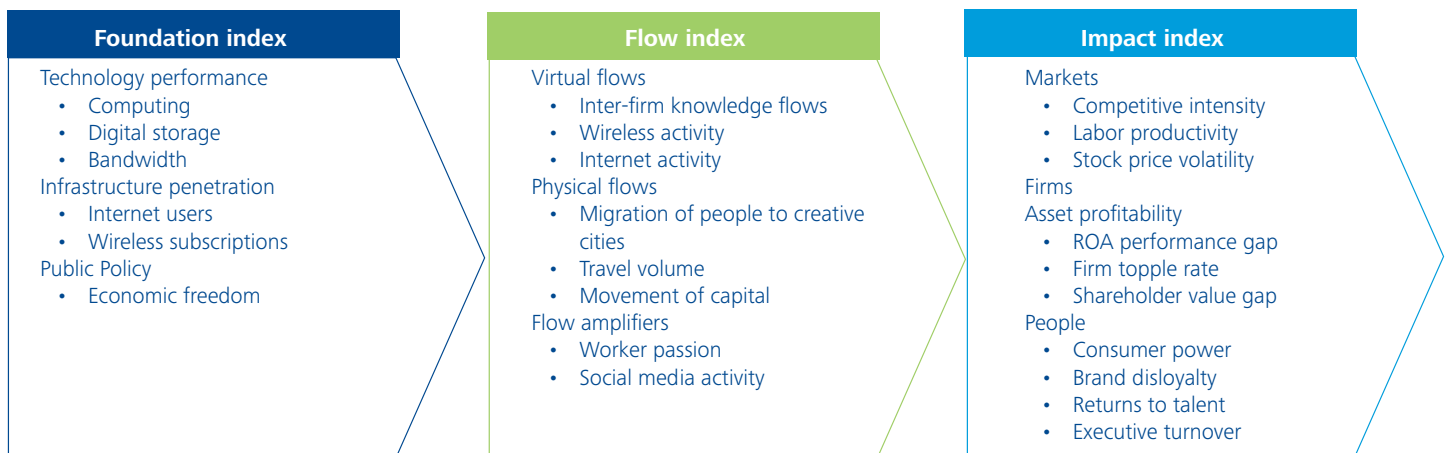
The first wave of the Big Shift is what Hagel calls the foundation wave, two fundamental changes at the very core of transformation: the trend towards economic liberalization and the expanding digital infrastructures that enable vastly greater productivity, transparency and connectivity. By all measures, economies that continue to invest wisely in a stronger foundation will be more competitive in the future.

It is possible to measure the depth of the foundation wave. We can physically measure a country's digital storage and bandwidth capacity to assess computing capability. We can measure transactional capacity, through internet and wireless use as a percentage of population. And finally, we can measure regulatory efficiency, whether public policy inhibits or encourages information transfer and economic freedom.

One existing measure is issued each year by the World Economic Forum (WEF) in its' "Networked Readiness Index"—a ranking of the information technology environment of 134 countries.⁷ This Index provides a relative comparison of each country's position on the foundation wave.

WEF rankings show that the top five "network ready" countries for the past two years have been the same: Denmark, first, followed by Sweden, the United States, Singapore and Switzerland. It's not the size of an economy that matters – it's the readiness to use technology within the economy.

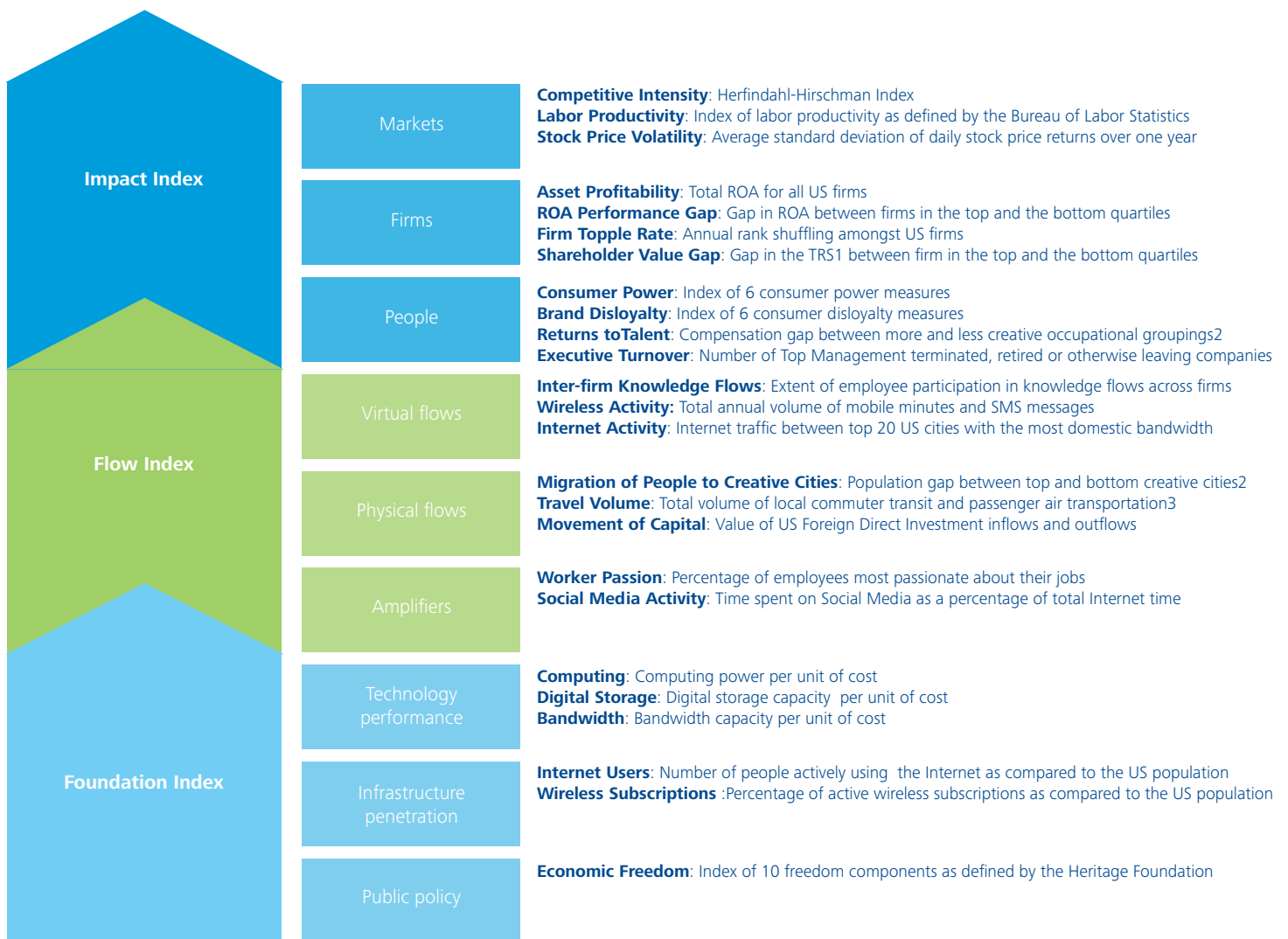
The Big Shift Index metrics



Source: Deloitte

To assemble the list of 25 shift index metrics, we carefully analyzed more than 70 potential metrics, using a process detailed in Exhibit 90 of The 2009 Shift Index.

The Shift Index consists of 25 indicators within three indices that quantify the three waves of the Big Shift – the Foundation Index, Flow Index and Impact Index



1. TRS – Total Return to Shareholders
 2. Creative Occupations and Cities are defined by Dr. Richard Florida, "The Rise of the Creative Class", 2004
 3. Measured by the Bureau of Transportation Statistics Transportation Services Index
 4. Source: Deloitte analysis



Government can play both a direct and indirect role in stimulating technology use and innovation. Government must prioritize and procure information technology, even under short-term budget pressures. And direct government expenditures to promote technology development, support for research institutions and private-public collaboration can stimulate demand and commercial viability for new businesses. In turn, these businesses generate the growth that increases long-term revenues to help meet domestic needs.

The third component of the foundation wave – economic freedom and ease of doing business – is similarly examined in various indexes. Governments can promote entrepreneurship and rapid technology adoption indirectly – through tax policy and research grants, for example – and directly, by effective regulations, consistent rule of law and promoting trade. Government can develop and implement policy drivers that increase competitiveness.

The Flow Wave

The second wave of the Big Shift—the flow wave—is the increasing movement of knowledge, talent and capital around the world.⁸ This provides options for leveraging the foundation changes for future growth. Economic liberalization and a strong digital infrastructure aren't ends in themselves; they are a pathway for the flow of knowledge, talent and capital that boost productivity and create jobs.

Knowledge Flows

Knowledge flows are the tacit, innovative ideas and information that build new companies, vibrant cities and growing economies. They are physical as well as virtual. In the past, knowledge stocks – explicit information and data – were pro-

tected as a proprietary resource. Now, with the connections and collaboration possible through the digital infrastructure, knowledge flows are becoming a crucial source of value.

A competitive government will understand that companies need to be an integral part of knowledge flows, and through policies and programs foster the digital infrastructure and the gathering of talent and capital. Professionals, scientists and investors will migrate to “clusters” where they collaborate, share and invent.

Talent and Capital Flows

This doesn't negate the common wisdom that the world is flat, that technology enables any country, anywhere, to innovate and participate in global markets. Yet people still move—within a country to find a new or better job, or closer to universities and industrial centers. The world may be flat, but location, location, location still matters a great deal.

Economist Richard Florida offers this view. He says that, “By almost any measure the international economic landscape is not at all flat. On the contrary, the world is amazingly ‘spiky.’”⁹ Face-to-face meetings and business relationships built on trust and social interaction still matter. “Economic horsepower and cutting-edge innovation”¹⁰ are concentrated across a small number of cities and regions; these are the “spikes” driving the world economy.

The question for government leaders is: How do you attract and retain that horsepower; how do you become a 21st century spike?

More and more people are clustering in urban areas—what Florida calls the world's demographic mountain ranges. In the world's more developed regions, 74% of the population lived in urban areas in 2005¹¹; that is projected to increase to 81 per cent by 2030.¹² Urbanization in less developed regions will be much more pronounced.¹³ Population density is not a precise indicator, but it suggests that human and economic activity will cluster in areas where people expect to find jobs and opportunity, where innovation, ideas and freedom are welcomed, incubated and encouraged.

Many recent technology advances have originated in “innovative ecosystems” or clusters like the Silicon Valley in Northern California, where creative people and scientists found like-minded people and capital, and turned their ideas into economically viable products and companies.

A cluster can be even more concentrated than a valley or a city; it can be an address. Some of the world's smartest people go to work at 1600 Amphitheatre Parkway, what's known as the Googleplex, in Mountain View, California. They go to Google—not just for the massage chairs, the food cafes and stock options—but because they want to be around other smart people who are creating the products of the future.

Businesses will be formed where talent – innovators, implementers and investors – congregate to share, hone and turn ideas into practice. These “creative people cluster not simply because they like to be around one another,” says the economist Florida, “They and their companies also cluster because density brings powerful productivity advantages, economies of scale, and knowledge spillovers.”¹⁴

The competitive government will seek to encourage these clusters, to attract the knowledge, talent and capital flows that are an essential part of the transforming global economy.

And there is a potential here for a public catalyst. Data shows that between 2000 and 2006, OECD government research and development budgets expanded by a 6.8 percent annual average, certainly faster than GDP.¹⁵ The technology sector has “has always relied heavily...on public, industry and university partnerships for long-term basic scientific research.”¹⁶

If we go back to the Silicon Valley example, the presence not only of Stanford University but of the Xerox Palo Alto Research Center helped solidify the knowledge, talent and capital flows. The firms of the future are often concentrated close to where they can benefit from public and industry-funded research and development. This, combined with government technology procurement and regulatory reforms to assure a certain business environment, can create a comparative advantage.

Clusters can thrive everywhere. In early August the *Wall Street Journal* profiled New Zealand native and film-maker Peter Jackson. Jackson was collaborating on a film project with Steven Spielberg through a live, video link between Hollywood and Wellington.¹⁷ This exemplifies the flat and spiky world. Technology enabled this real-time communication across five time zones - a flat world, and a spiky world where film production knowledge, talent and capital are concentrated in California and New Zealand.

Harnessing knowledge, talent and capital flows has the potential to reverberate throughout an economy, including sparking innovation to reinvigorate manufacturing, service and trading sectors.

The Impact Wave

The third wave of the Big Shift—the impact wave—follows the first two.¹⁸ It demonstrates the consequences of stronger foundations, knowledge, talent and capital flows, and the changes in countries, markets and individuals that harness these forces as the old makes way for the new.

The paradox is that large governments and companies with the most influence in the past, which could be most influential in the future, are perhaps the least able or likely to change and adapt to the new. There’s an interesting comparison to be made—and possible lesson, too—in Hagel’s finding that big companies are losing leadership positions twice as fast as they used to, what he calls an “increased topple rate.”¹⁹ This suggests that those, in either the private or public sector, who don’t respond swiftly face the greatest risk of being left behind.

The foundation, flow and impact waves of the Big Shift are already at work in the public sector.

The foundation wave is seen in direct spending and indirect incentives, as government invest in technology infrastructure to provide more people access to knowledge and information.

The flow wave is evident as workers seek employment in technology-based industries and relocate to where those jobs are; meanwhile millions collaborate and share information online, and participate in social media sites and networking.

The paradox is that large governments and companies with the most influence in the past, which could be most influential in the future, are perhaps the least able or likely to change and adapt to the new.

Until now companies and countries have created considerable economic value by growing larger and more efficient. Rapidly changing digital infrastructure and economic liberalization have altered the equation. As stability gives way to change and uncertainty, institutions must increase not just efficiency but also the rate at which they learn and innovate. In other words, scalable efficiency must be replaced by scalable learning.

The impact wave is evident in multiple government reforms – from electronic transfer payments to electronic health records that save costs and lives.

Fully leveraging the benefits of these waves requires going beyond strictly cyclical thinking. We should not expect pressures to ease as the current economic downturn dissipates. On the contrary, these foundational changes have systematically and significantly reduced barriers to entry and movement, leading to a doubling of competitive intensity.

Another parallel between the Big Shift and a competitive government is the concept of “scaleable learning” as opposed to “scaleable efficiency.”²⁰ Until now companies and countries have created considerable economic value by growing larger and more efficient. Rapidly changing digital infrastructure

and economic liberalization have altered the equation. As stability gives way to change and uncertainty, institutions must increase not just efficiency but also the rate at which they learn and innovate. In other words, “scaleable efficiency” must be replaced by “scaleable learning.”

The pattern of grassroots activism flowing upward to influence public and private sector decisions will accelerate. Learning will take place at all levels – government, community, household and individual – and increasingly affect public discourse and policy. If information is more available and provides better understanding of government actions, an enlightened population can identify problems more quickly. The robust debate of the blogosphere and social media can help the competitive government be ever more competitive.

Sampling of national rankings for the Big Shift Index proxies

Rank	Foundation index				Flow index	Impact index	
	Technology performance		Infrastructure penetration		Public policy	Physical flows	Markets
	Computing	Bandwidth	Internet users	Wireless subscriptions	Economic freedom	Social media activity	Competitive intensity
1	United States	United States	United States	United Arab Emirates	Hong Kong	China	Germany
2	China	United Kingdom	China	Qatar	Singapore	United States	Taiwan, China
3	Japan	Germany	Japan	Estonia	Australia	Brazil	Austria
4	Germany	Netherlands	India	Bahrain	Ireland	United Kingdom	Netherlands
5	Brazil	Canada	Brazil	Hong Kong SAR	New Zealand	Korea	United States

The above table was compiled using information from the following sources:
 Technology Performance, Computing, Personal Computers 2008, Economist Intelligence Unit
 Technology Performance, Bandwidth, International Internet bandwidth>Mbps (most recent) by country 2004, Nationmaster.com
 Infrastructure Penetration, Internet Users (Total), Nationmaster.com 2006, 2007
 Infrastructure Penetration, Wireless Subscriptions, International Telecommunication Union, World Telecommunication Indicators, June 2009; national sources
 Public Policy, Economic Freedom, The Heritage Foundation, 2009
 Physical flows, Social media activity, Active internet users managed a social media profile, Universal McCann, Power to the People - Social Media Tracker Wave 4
 Competitive Intensity, Growth of overall productivity of Labor, EIU,2008

Public leaders need to decide which assets, policies, programs and practices have the greatest potential to generate long term growth and shed those that do not. The public sector must keep coming back to the most basic question of all: What business are we really in?

The Government's Business

The government's business is to provide domestic services, and these days that means greater demands from a thinner pocketbook. After meeting the physical needs of food, water, shelter, government can turn to higher needs of the mind and spirit such as education, technology and creativity.²¹ One clear way to meet these higher needs is through directly challenging and catalyzing private sector growth, on the local and regional as well as the national level.

In some cases, the benefits to national competitiveness may be an unintentional consequence of internal policies aimed at other objectives.

For example, secure technology networks that deflect cyber attacks also provide an edge to define standards that sustain economic activity. Education policies that create a skilled workforce attract foreign investment, creating jobs and fostering innovation. New roads and bridges that lessen rush-hour traffic jams also provide arteries for the movement of commercial goods. Secure, reliable financial systems attract capital that invests in domestic companies and supports the high-skilled financial services industry. Upgrading ports in developing countries brings more trade in not only food, but other imports and exports as well.

Government's Choice

As the Heritage Foundation explains in the introduction to its Index of Economic Freedom, "In a period of slowing economic growth in many parts of the world, popular pressure for governments to act to fix the situation can be enormous. In responding to such pressures, it is vital that leaders understand the real causes of negative economic developments and undertake actions that will fix them rather than exacerbate them."²²

For a competitive government, those actions will meet the needs of its people by a broad worldview and policies that foster favorable conditions for national competitiveness and, in turn, domestic growth.

The Big Shift provides a framework for comparative assessment, to position for that growth. This includes looking at technology readiness, regulatory freedom, scientific achievements, and retaining and attracting talent and capital --- building the programs and policies that will bring higher productivity and increased standards of living.

As the transformation continues, every entity – private and public – needs to create and encourage institutions that capture knowledge flows rather than stocks. The technology of a flat world means that distance is not a barrier; ideas can be shared rapidly and seamlessly. And a spiky world means that creative talent will congregate wherever the right incentives and structure exist. A competitive government will see the benefits to economic growth and social policy if they congregate within its borders.

Public leaders need to decide which assets, policies, programs and practices have the greatest potential to generate long term growth and shed those that do not. The public sector must keep coming back to the most basic question of all: What business are we really in?

Endnotes

For more information, go to www.deloitte.com/brink

- ¹ Deloitte Review, Issue 5 2009; "The Great Transformation" by Carl Steidtmann
- ² John Hagel III, John Seely Brown and Lang Davison, "The Big Shift, Measuring the Forces of Change," *Harvard Business Review*, July-August 2009 ³ <http://www.isc.hbs.edu/society.htm>
- ³ <http://www.isc.hbs.edu/society.htm>
- ⁴ Need gut-check here, don't want to sound like all the world should speak English...
- ⁵ John Hagel III John Seely Brown and Lang Davison, "The Big Shift, Measuring the Forces of Change" *Harvard Business Review*, July-August 2009
- ⁶ *ibid*; John Hagel III John Seely Brown and Lang Davison, "The Big Shift, Measuring the Forces of Change, The 2009 Shift Index" Deloitte Center for the Edge, Deloitte Development LLC, 2009
- ⁷ The Global Information Technology Report 2008-2009, Mobility in a Networked World (World Economic Forum and INSEAD, 2009), pg. 17.
- ⁸ Hagel, Seely-Brown and Davison
- ⁹ Richard Florida, "The World is Spiky" *The Atlantic Monthly*, October 2005
- ¹⁰ *Ibid*.
- ¹¹ United Nations, Department of Economic and Social Affairs, Population Division (2006). World Urbanization Prospects: The 2005 Revision. Working Paper No. ESA/P/WP/200
- ¹² *Ibid*.
- ¹³ *Ibid*.
- ¹⁴ Richard Florida, "The World is Spiky" *The Atlantic Monthly*, October 2005
- ¹⁵ The Global Information Technology Report 2008-2009, Mobility in a Networked World (World Economic Forum and INSEAD, 2009), pg. 103
- ¹⁶ *Ibid*.
- ¹⁷ "The Fellowship of Peter Jackson," *The Wall Street Journal*, August 8, 2009
- ¹⁸ Hagel, Seely-Brown and Davison
- ¹⁹ *Ibid*.
- ²⁰ *Ibid*.
- ²¹ Based on the i-government POV
- ²² Heritage Foundation 2009 Index of Economic Freedom Executive Summary

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