



## CONCEPT PAPER

### Introduction – The Qing Dynasty and the Self-Strengthening Movement

The Needham<sup>1</sup> question asks: ‘Why did Chinese science and technology, after first pulling ahead of Europe, fail to keep pace with Europe’s?’ Prior to the fifteenth century, the flow of technology was overwhelmingly East to West – these include inventions such as paper, the compass, gunpowder, the blast furnace, among others. Yet, by the start of the sixteenth century, Western Europe had not just caught up with the East, it had begun overtaking it.

The Qing Dynasty of China (1644-1912) was in power as the technological gap between the East and the West widened considerably. As it faced a series of external and internal crises – most prominently, the First Opium War with the British, the Taiping Rebellion and the Boxer Rebellion within China – the Qing recognised the need to modernise their economy and military. To this end, the Qing responded with the ‘Tongzhi Restoration’, which aimed to introduce modernising policies into China. A major part of the Tongzhi Restoration was the ‘Self-Strengthening Movement’.

The most prominent proponent of the Self-Strengthening Movement was army general Li Hongzhang who, amongst other things, organised the formation and development of Western-style military academies, oversaw the development of some private capitalist enterprises, and developed a Chinese foreign policy with Western nations. However, the advocates of the Movement were not republican

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<sup>1</sup> The Needham Question was posed by Joseph Needham, a British biochemist, historian of science and Sinologist most known for his research on the history of Chinese science and technology, culminating in the multi-volume *Science and Civilisation in China*. Needham's work was the first of its kind in Europe to praise Chinese scientific contributions and provide their history and connection to global knowledge, in contrast to a more European-biased perspective.

revolutionaries or radical social reformers; they hoped to strengthen China by preserving Qing rule and maintaining traditional Confucian values whilst embracing Western military and industrial practices.

Indeed, despite the perfect storm in which the Qing Dynasty found itself, it could not let go of its prevailing traditions, steeped in a Confucian ethic that may not necessarily have been optimal for the changes that the Qing were attempting to make. Put another way, it attempted to use new hardware, but it did not update its software. And so, in the face of a new global paradigm, despite recognising the need to modernise, the Qing reverted to tradition. *What can that teach us today?*

### **A Global Perfect Storm**

The ongoing Covid-19 pandemic and the wake of its destruction. War in Ukraine. Inflation in the United States not seen since the 1980s. Zero-Covid policy measures in China. An ever increasing risk of stagflation. Social fissures appearing in nearly every country in the world. Geopolitical tensions rising, particularly amongst global powers. And, on top of all of that, a climate crisis that grows more ominous day by day.

In the animated series *South Park*, life on Earth forms the basis of an intergalactic reality television series, watched by aliens from across the universe, called ‘Earth’. If those aliens are watching ‘Earth’ at this present moment<sup>2</sup>, this has to be a particularly dramatic period in the series. At this moment in time, we find ourselves right in the midst of a ‘perfect storm’ of events, all of which contribute to immensely challenging times for all of us.

Indeed, we would have to go back to World War II to find a world in which all the geopolitical and economic powers were facing threats to their economic development and prosperity. In present day terms, the United States is facing runaway inflation, with 2021’s messages of ‘transitory inflation’ long blown away. In May 2022, United States inflation rose to 8.6%, its highest level since December 1981. The Federal Reserve has responded with steep interest rate hikes in the hope of bringing inflation back down to its target 2% over the longer-term. But that might still be some time away. The market consensus estimates inflation to be at 4% in the next two years and 3% over the next five years. And if growth does not pick up – a decent likelihood given rising interest rates – we may find ourselves in a stagflation situation.

The war in Ukraine between Russia and Ukraine has triggered monumental consequences globally. For one, Ukraine and Russia are major exporters of wheat, barley, corn, and cooking oil. Disruptions to the supply chains of these goods are driving up global food prices with countries scrambling to ensure adequate food supplies for their citizens. Furthermore, the United Nations has projected that more than eight million people might flee Ukraine and seek refuge in other countries. Providing support for refugees is crucial, but this necessarily stretches already tight resources in host countries. On top of that,

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<sup>2</sup> Assuming quantum entanglement is at work here.

Russia is the second-largest producer of natural gas and the third-largest producer of oil; sanctions placed on Russian oil will see spikes in oil prices, thus increasing energy costs throughout the world.

In April and May 2022, Shanghai, the commercial hub of China and its largest port, was locked down for two months. In late June 2022, China President Xi Jinping reaffirmed China's zero-tolerance approach to Covid-19. According to President Xi: 'We would rather temporarily affect a little economic development, than risk harming people's lives, safety and physical health, especially the elderly and children.' Of course, given the size and scale of the Chinese economy, 'a little economic development' goes a long way. According to the *Financial Times*, an online survey of 16,500 SMEs published by Peking University, Ant Group and MYBank found that 40% did not have enough spare cash to last another month. The unemployment rate in China's 31 largest cities has surpassed pandemic highs to reach 6.9% in May 2022. In terms of growth, the consensus estimate of China's 2022 GDP growth has been cut from 5.1% at the start of 2022 to 4.2% in June 2022.

The perfect storm of these events has seen the World Bank cut its forecast for global GDP growth in 2022 to 2.9% from 5.5% in 2021. But of course, economic challenges are not the only challenges that matter. Intertwined with economic challenges are political and social challenges such as widening inequality, geopolitical tensions, greater fractionalisation of domestic politics, ongoing human rights abuses, and much more. Top all of that with a pandemic which rages on with ever more infectious variants, as well as a global climate crisis that is not 'some time away', but is at our front door, and we find ourselves in the eye of a global perfect storm. And much like the Qing Dynasty in the 1800s, we must figure out how to respond. *Do we hold on to our traditions – which may have served us well in a certain period of time – or should we try something new?*

### **Malaysia and the Aftermath of Crises**

Malaysia has not typically had the best of recoveries following major economic crises. In the decade prior to the Asian Financial Crisis, Malaysia's GDP growth came in at a remarkable 9.3%. Following the Asian Financial Crisis and up to the Global Financial Crisis in 2008, Malaysia's growth averaged 5.5%. Post the Global Financial Crisis and up to the Global Pandemic, our economic growth remained stagnant at 5.4% while our GDP per capita, in Dollar terms, declined from USD 11,103 in 2013 to USD 10,413 in 2020. As such, at least in terms of GDP growth, we have never fully recovered from the Asian Financial Crisis (although, certainly, some moderation of growth from 9% plus per annum was expected).

The difference between this Covid pandemic crisis and previous crises is that those previous crises never required intermittent lockdowns. This form of public health intervention had different consequences for different types of nations, depending on their stage of economic growth. For Malaysia and other middle-income nations like it, it was devastating.

A 2020 study by economists at the World Bank<sup>3</sup>, finds that, ‘In high-income countries, one of every three jobs is amenable to home-based work, while in low-income countries only one of every 26 jobs can be done at home ... Telecommutable jobs are highly unequally distributed across space, not only across but also within countries. They are less prevalent in lagging regions.’

This is complemented by an August 2020 study by Charles Gottlieb at the University of St Gallen<sup>4</sup> and others that demonstrates declines in employment from lockdowns are hardest on middle-income nations. According to the authors: ‘While workers in rich countries have a substantially higher ability to work from home, which mitigates declines in employment and GDP, poor countries concentrate employment and value-added in essential sectors [primarily agriculture] that are not shut down. Middle-income countries see the largest declines as they feature relatively large employment shares in non-essential sectors and relatively low work from home ability.’

In Malaysia, the Services sector makes up approximately 58% of GDP and 61% of the labour force. Going a level deeper, a 2017 Khazanah Research Institute report by Allen Ng, Tan Zhai Gen and Mohan Mahadeva shows that the bulk of employment in Malaysia’s services sector is in wholesale, retail, food and beverage, and accommodation — more than double the second largest sub-sector, business services and finance. In a related paper, two of the authors, along with co-author Tan Theng, argued that Malaysia has structurally shifted towards a more labour-intensive model that is ‘skewed towards medium- and low-skilled workers with lower labour productivity, more traditional service sub-sectors rather than high-tech manufacturing, and smaller firms rather than larger enterprises.’

In non-pandemic times, this poses a long-term structural issue which Malaysia needs to overcome if it is going to be successful at shifting its economic structure towards higher value-added, higher productivity work and economic activity. This is no surprise. What Covid-19 has highlighted, however, is precisely how vulnerable this makes Malaysia’s workforce and firms to a pandemic. More broadly, this also makes the country vulnerable not only to shocks such as pandemics, but also any shock that may halt production — think of climate change effects such as floods or, in a more extreme scenario, wars.

### **A Rebel with a Cause? The Macro Complexities of Development**

As the saying goes: ‘A ship in port is safe, but that is not what ships are for.’ Like it or not, we are in the midst of this perfect storm, with no end in immediate sight. And given what we know about Malaysia’s experiences after recent crises, we must be extra vigilant in figuring out what we do. From an economic perspective, we need to recognise the urgency in evolving the structure of the Malaysian economy. While we may have grown on the basis of low-cost competitive manufacturing or FDI-driven

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<sup>3</sup> Garrote Sanchez, D., Gomez Parra, N., Ozden, C., Rijkers, B., Viollaz, M., & Winkler, H. (2020). ‘Who on Earth Can Work from Home?’ World Bank Policy Research Working Paper, No. 9347.

<sup>4</sup> Gottlieb, C., Grobovsek, J., Poschke, M., & Saltiel, F. (2021). ‘Working From Home in Developing Countries’ European Economic Review, Vol. 133, 103679.

investments, this growth strategy is no longer feasible at Malaysia's current stage of economic development.

In a recent book, *The Power of Creative Destruction*, French economist Philippe Aghion and his two co-authors<sup>5</sup> make the point that, while it is common to see lower-income countries transitioning towards becoming middle-income countries, the next step in the transition is far too rare<sup>6</sup>. One explanation for the trap, as provided by the book, is that countries such as Malaysia which transition to middle-income status via a 'learning' model struggle to move towards an economic model that is based on innovation. The inertia which arises from the combination of institutional, political, cultural and infrastructure development associated with learning from the technological frontier makes it difficult to pivot towards a new combination. *As such, if our 'tradition' is focused on a learning model, but we now need an innovation model, can we pivot appropriately?*

We would like to think that the answer is a straightforward 'yes', but reality is far too unforgiving. There are serious trade-offs to make in decision-making; when resources are scarce and are likely to get scarcer, the complexity of trying to *have our cake and eat it* also increases significantly. For instance, many of the long-term structural reforms which Malaysia requires will need substantial resources. *But how do we balance between those necessary reforms and also the necessity of supporting our fellow community members in going through their daily lives? What is the appropriate 'societal discount rate' for the future?*

At a more macro level, it is also important not only to understand that the status quo is no longer feasible, but the ways in which it is no longer feasible. Since the Industrial Revolution, the birthplace of modern economic growth, economies have grown by producing new things and, in particular, more sophisticated products<sup>7</sup>. We have seen this in the United States, in Western Europe and in the East Asian Tigers like Korea, Taiwan and Japan. That is how Malaysia has grown as well. Our export composition in the 1960s is unrecognisable from our export composition today, but, unfortunately, that radical change has seen only incremental changes in the past couple of decades, in line with our own premature deindustrialisation<sup>8</sup>.

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<sup>5</sup> Aghion, P., Antonin, C., & Bunel, S. (2021). [The Power of Creative Destruction: Economic Upheaval and the Wealth of Nations](#). Cambridge, MA: Harvard University Press.

<sup>6</sup> A paper by IMF economists Fuad Hasanov and Reda Cherif in 2019 makes the point that between 1960 and 2014, only 16 out of 182 economies globally reached high-income status. This is, as the term is commonly known, the so-called middle-income trap.

<sup>7</sup> In economic history, the focus has primarily been on manufacturing because, prior to widespread internet, goods were the only things that could be easily traded internationally. As such, there arose a very sophisticated and detailed way of standardising the labelling of goods for international trade, against the backdrop of international organisations such as the WTO. However, with the internet, it is not just goods that can be easily exported, **it is also services**. A company can export computers, or it can export SAAS services, and both count as exports.

<sup>8</sup> Ng, A. (2017). 'The Times They Are A-Changin: Technology, Employment and the Malaysian Economy.' [KRI Discussion Paper 1/17](#).

However, even if we were to reverse that trend, the options available to us – and to those developed countries at the periods of their own industrialisation – are more limited. Global environmental and ecological concerns make it impossible, nor desirable, for countries to lay waste to natural resources in the way we once did. Whether it is clearing natural resources and forests, or using fossil fuels with complete impunity, or even attempting more protectionist policies, these options are largely closed to developing countries around the world. This is despite the fact that developed countries have all become rich via such methods. The economist Ha-Joon Chang describes this as rich countries ‘kicking away the ladder’<sup>9</sup> for developing countries. So, we need to develop our economy and our nation, but the policy space is more restricted. *What constraints are we willing to push, who are we willing to defy, and how do we ensure a more just development strategy globally?* These are extremely complex problems.

### **A Rising Tide Lifts All Boats – From Alpha to Beta Activism: Sustainability, Impact, Transition**

At the micro level, the story is similar as well. In the public listed space, the Malaysian market – and therefore Malaysia’s public listed companies – suffer from low growth and are, with very few exceptions, in old economy, mature sectors such as utilities and construction. Among the stocks with the largest market capitalisation, liquidity was low with share turnover of only 27% in 2019 versus, say, the Thai Exchange’s share turnover of 64%. Returns have also been poor with low 10-year earnings growth, leading to poor average Total Shareholder Returns.

If one were to invest in the Malaysian market, Modern Portfolio Theory (‘MPT’) tells us that we can reduce our individual portfolio risks by eliminating company-specific risks<sup>10</sup>, leaving only non-diversifiable market risks<sup>11</sup>. In other words, MPT tells us that investors cannot influence or impact the market, only regulators or policymakers can. As such, investors can really only worry about *alpha*. Putting this into perspective, *alpha* influences only 6% to 25% of overall variability in returns. Systemic risks, or *beta*, drives 75% to 94% of variability in returns!

The world in which the MPT was formulated is no longer the world today. The MPT was introduced, in 1952, for personal or retail investors at a time when institutional investors made up approximately 8% of the market. Today, institutional investors make up 80% of the market. This new world in which there is a tremendous concentration of shareholder capital, with large fund sizes and diversified deployment, means that investors can now impact systemic market risks. And thus, from Alpha Activism, where firms worked to influence a single company’s strategy, institutional investors can now pursue Beta Activism, which targets issues that will reduce overall market risk to achieve better long-term risk-adjusted returns.

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<sup>9</sup> For more, please refer to Ha-Joon Chang’s ‘Kicking Away the Ladder: Development Strategy in Historical Perspective’ and ‘Bad Samaritans: The Myth of Free Trade and the Secret History of Capitalism.’

<sup>10</sup> Also known as idiosyncratic risks or Alpha ( $\alpha$ )

<sup>11</sup> Also known as Beta ( $\beta$ )

To be more specific, Beta Activism focuses on market-wide topical issues such as climate change, board governance, gender and racial diversity, and values (as opposed to strict shareholder value) amongst others. Massive Institutional Investors can individually drive this, or in coalitions – including with regulators and exchanges. For instance, the New York Pension Funds launched a Boardroom Accountability Project which encompasses board independence, climate competence, and gender and racial diversity for board seats and CEO appointments. In Malaysia, large institutional investors have made important announcements about their voting policies and sustainable investment policies, which is a great start; the next step is whether they can form a stronger coalition to drive systemic change in the Malaysian markets which have come under scrutiny in recent times for ESG issues such as coal generation, workers' rights and deforestation.

But even those issues are not as straightforward as they may seem. Every decision we make has trade-offs, intentional or otherwise. An effort to provide clean cooking stoves in Malawi to replace charcoal-based stoves seemed like a good idea to reduce indoor pollution – but what the clean stove providers did not know was that those smoky charcoal stoves were keeping away mosquitoes, particularly the anopheles mosquito which brings about malaria. Thus, when we think of issues such as coal-based powerplants, we must be clear that while the objective is certainly to transition away from them towards more renewables-based power generation, how should we go about that transition? If we immediately shut down those powerplants or divest away from such companies, what happens to the workers in those plants and their families? And a more unscrupulous fund manager might swoop in at lower valuations for those plants too! The idea that we should try to protect all stakeholders in this transition is known as a 'just transition'. *But as ESG rating providers and global activists place pressure on companies to go green, how do we ensure that we can commit to a just transition?*

Another consideration in the sustainability equation for firms is sustainability as a point of *additionality*, and not of risk management. This means firms investing in building goods or services which actively try to create Impact. Funds that invest in such firms are called Impact Investors. Thus, this goes beyond a negative screening (for instance, do not invest in chemical weaponry) and towards a positive screening – is what I am investing in going to create socioeconomic impact for society beyond its financial returns? *How do we measure that? And how do we think of balancing between both returns?* Some funds demand both – but if the socioeconomic impact is extremely high, but the financial returns less so ... *what do we do?*

Beta activism is a powerful tool which can help us to better drive collective action among our firms at the level of the market. And given that the various ESG ratings providers are not exactly correlated with one another – a forthcoming article by economists at MIT finds that ESG ratings correlations between six different providers range from 0.38 to 0.71<sup>12</sup> – we need to figure out what works best for our context. Much like economic development, the sustainability transition works differently for developing countries relative to developed countries as well. We cannot impose developed country standards on developing countries. How Beta activists can support the complexity of decision-making in markets

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<sup>12</sup> Berg, F., Kolbel, J.F., & Rigobon, R. (Forthcoming). 'Aggregate Confusion: The Divergence of ESG Ratings.' Review of Finance.

and firms towards a just transition, towards greater Impact, and towards a more sustainable future is an exciting proposition.

### **Imagine All The People – Towards Inclusive Development**

In a far-ranging study on the impact of the pandemic on inequality, Harvard economist Stefanie Stantcheva<sup>13</sup> finds that, amongst others, low-income workers were more vulnerable to unemployment shocks, with remote work (work-from-home) favouring high earners; richer households accumulated more savings during lockdowns; poorer regions saw higher Covid-19 mortality; women were more likely to lose their jobs and absorbed more of the additional childcare burden; and students from low-income backgrounds and less parental education were the hardest hit in terms of education.

We saw many of these trends in Malaysia as well. For instance, millions of EPF savers, the large majority of whom were from lower-income households, withdrew their retirement savings to fund their present survival. Nearly 37% of Malaysian students did not own a device which could help them access remote learning in 2020. Throughout 2020, Malaysian women were far more likely to lose their jobs, while taking on a greater burden of childcare (22.4 hours versus 14.5 hours for men) and housework (18.6 hours versus 11.7 hours for men) on a weekly basis. This lens on gender is crucial. Swedish writer and financial journalist, Katrine Marçal, points out in her book, *Mother of Invention: How Good Ideas Get Ignored in an Economy Built for Men*, the lockdowns of the pandemic disproportionately affected the parts of the economy where women work.

It is difficult to imagine progress in reining in these inequalities without the promise of more economic growth, particularly inclusive growth. Towards this end, along with Harvard colleague Dani Rodrik<sup>14</sup>, Stantcheva lays out a policy matrix which suggests appropriate policy tools to simultaneously reduce inequality and create good jobs. In it, they suggest dividing policies by *pre-production* (opportunities to participate in production), *production* (efficiency of the labour market), and *post-production* (redistribution policies), further segmenting it by policies which target bottom incomes, the middle class and top incomes. As such, if, for instance, the government would like to pursue policies for the middle class at the production stage, it could select from a menu of feasible options which are more targeted than blanket policies which may or may not impact the target recipients.

Furthermore, recall that, in Malaysia, the bulk of our workforce belong to the services sector, primarily in more traditional services. The vast majority of these workers are employed in SMEs, which employ 7.3 million workers in Malaysia (nearly 50% of the workforce). And while the larger listed space requires serious Beta Activism<sup>15</sup>, we must not neglect the growth of SMEs as well. In other words, if we are to achieve inclusive development in Malaysia, we really need to focus on growing Malaysia's

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<sup>13</sup> Stantcheva, S. (2022). 'Inequalities in the Times of a Pandemic.' *Economic Policy*, vol 37(109), pages 5-41.

<sup>14</sup> Rodrik, D., & Stantcheva, S. (2021). 'A Policy Matrix for Inclusive Prosperity.' *NBER Working Papers*

<sup>15</sup> And Alpha Activism, in all fairness



SMEs. Indeed, as Dani Rodrik<sup>16</sup> writes: ‘Instead of focusing on the most productive segment of firms, the next generation of growth strategy will have to target small- and medium-sized firms with potential to enhance both productivity and employment and which are mostly in services. Traditional “industrial policies” will have to be modified and extended to parts of the informal economy. Economic growth will be possible only by raising productivity in smaller, informal firms that employ the bulk of the poor and lower-middle classes.’

Doing this requires us to take a measured approach to economic growth, particularly on technology policy. While digitalisation and technology can increase the productivity of these firms, we need to understand two key issues. First, what is stopping firms from adopting such technologies, if indeed it may be useful to them? Second, what might be the impact on workers? A blind and one-track approach to ‘automation’, common in policy discussions on technology, is unhelpful. In this respect, Dani Rodrik adds: ‘Steering technological change in a direction that is friendlier to environment and labour must be a key element of new industrial policies. In emerging economies, the question is whether industrial policy should copy leading economies or instead look for approaches better suited to their own countries’ stages of development, as well as focus on new priorities such as supporting vulnerable groups, gender equality, reduced fossil energy use or the development of green technologies for new types of agriculture, housing, and transport.’

In short, technology is not something that is entirely imposed upon us. We must choose what technology makes sense for our needs at a given time. As Marçal puts it: ‘What we choose to invest in a society says a lot about what we value – and what we do not.’ Given Malaysia’s serious unemployment and underemployment challenges, exacerbated by the pandemic, why should we be automating away jobs? Instead, we should look for labour-augmenting technology, i.e., technology which helps workers be more productive instead of replacing them. One example is a worker who uses a manual screwdriver in carpentry. Imagine instead if we gave that worker an electric screwdriver. The work would go much faster, but the key point is that, in either case, the worker is still necessary – just that the worker is more productive with the electric tool. These are the kinds of labour-augmenting approaches – technology which increases the productivity of individuals – that we must seek.

But beyond that, we must be inclusive. In Marçal’s fascinating book, she puts forth a devastating tale of how much progress we may have impeded by ignoring the female lens. This includes things such as suitcases on wheels, the electric car, and computing. There are other lenses as well which are typically marginalised. We must do our best to ensure participation by all. Stephen Jay Gould, the late American evolutionary biologist and palaeontologist, puts it well: ‘I am, somehow, less interested in the weight and convolutions of Einstein’s brain than in the near certainty that people of equal talent have lived and died in cotton fields and sweatshops.’

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<sup>16</sup> Rodrik, D. (2022). ‘Prospects for Global Economic Convergence under New Technologies.’ [Brookings Report](#).

## **Putting it all together – KMF 2022**

In the movie version of *The Lord of the Rings: Fellowship of the Ring*, the following conversation takes place between Frodo Baggins the hobbit and Gandalf the wizard in the Mines of Moria:

Frodo: I wish the Ring had never come to me. I wish none of this had happened.

Gandalf: So do all who live to see such times, but that is not for them to decide. All we have to decide is what to do with the time that is given to us.

While things are not yet as extreme as that of an overlord attempting to take over the world, the truth is that we are in a perfect storm of exceedingly challenging global events. How we move forward will determine whether we achieve the inclusive development that we so desperately seek. Our ‘Collective Brain’ – the package of norms, behaviours, culture and institutions – which impacted how we worked, lived and grew together, through good and bad, will need to adapt and evolve along with our new world. And there is always a chance to do it better. But in doing so, we must understand the complexities of the decisions we have at hand, and to understand that there is not a one-size-fit-all solution to our problems across the world. We must be inclusive in our decision-making, taking on lenses which we have historically ignored, the clearest example of which is gender.

Nearly a century ago, the Qing Dynasty reverted to tradition. That may be an option, but we risk much by not moving our ship forward as well. The world has changed irreversibly; every single nation, and indeed every individual, is grappling with how they move forward. We live in a world of experimentation. We should be forward-marching in our steps and courageous in our convictions.

### **The Panels**

Since the inception of KMF, themes have been discussed ranging from a new context where uncertainty is normality to whether or not good stewardship based on the political economy of location, environment, and demographics can overcome geography as destiny; to the juxtaposition between Artificial Intelligence and Human Intelligence; to building our Collective Brain and, most recently, to how we can ‘Craft Our Collective Narrative’ to achieve more inclusive development outcomes for markets, firms, economies and, most importantly, societies.

The KMF 2022 theme is: *‘Development and its Complexities: Steering Our Way Through a Perfect Storm’*. In upholding KMF traditions, panel discussions will continue to be organised along four core sessions: how various markets globally are affected; what the theme means to firms, and society at large; what are the imperatives of leadership and people.