Sustaining Infrastructure Business Through Improved Stakeholder Relations

Closing the infrastructure gap in emerging markets is critical to improving economies and ending extreme poverty. However, by their very nature, the infrastructure projects with the greatest potential to close such gaps—roads, railways, renewable energy generation among them—often come with elevated risk profiles.

In addition to technical and financing challenges, they may require access to environmentally sensitive or culturally significant sites. They may be located in remote places that haven’t experienced development. Or they could traverse densely populated urban centers, requiring relocation of homes and other structures. Failure to mitigate adverse impacts and build in value for local communities can elevate the level of opposition and threaten project progress.

A strong environmental and social risk framework that includes stakeholder engagement helps reduce project risks and enhance positive outcomes. This can minimize delays and disruptions, lower costs, increase access to finance as more investors place value on such measures, and improve public acceptance.

For Infrastructure Project Sponsors, Good Things Happen When Social Risks are Mitigated and Communities Share in the Benefits of Development

✓ Improved project planning and design by incorporating local knowledge to avoid costly re-routing or delay
✓ Heightened ability to meet project milestones on time and on budget
✓ Greater competitive advantage in public infrastructure bidding processes
✓ Increased access to financing from investors that prioritize above-ground risk management
✓ Reduced legal exposure and vulnerability to regulatory changes
✓ Enhanced reputation and greater public acceptance

By the Numbers: Infrastructure Projects Around the World

2.7 trillion
Annual worldwide investment in infrastructure projects

$2 trillion
Estimated annual infrastructure investment gap in developing countries

$300 billion
Estimated annual direct value losses due to poorly managed risks in infrastructure projects, including non-technical risks and the influence of environmental, social and governance factors¹

$9 billion
Value of IFC’s portfolio of committed infrastructure projects as of June 2015

Perceived Lack of Community Benefit at Heart of Kenya Wind Farm Conflict

"Any project that a community felt was of no benefit to it or had no relevance to the lives of its people was bound to be met with hostility."

That’s what renewable energy consultant George Frambo told Reuters Africa, in reacting to a 2015 report about local farmers’ opposition to a $144 million wind farm in Central Kenya.

Farmer concerns that the project would force them to sell their land resulted in two years of protests, delaying the ambitious project’s start. Conflicts got worse, reportedly because farmers did not believe that their issues were being addressed.

Ultimately, the sponsors pulled out and cancelled the project, costing investors $66 million, according to news reports.

Benefit-sharing programs reassure local communities that they will not be excluded from the positive impacts of the development that takes place on their lands.

THE CONTEXT: INCREASED LEVELS OF OPPOSITION

In some emerging market countries, all-important infrastructure projects are encountering increasing levels of local opposition and resistance, as affected communities give voice to their concerns about perceived or real negative impacts. In infrastructure, as in other sectors, experience has shown that meeting minimum local legal requirements is not enough. If sponsors do not engage with the community—and with other stakeholders—and if they do not take steps to address concerns, the ensuing dissatisfaction can escalate, causing delays, budget overruns, costly redesign and corrective action, negative publicity and damage to reputation.

THE PROBLEM: MULTIPLE STAKEHOLDERS, MULTIPLE ISSUES

The truth is that the realization of sweeping national infrastructure goals—better roads, more reliable energy sources, increased access to clean water and sanitation—can come with disruption, cost, and, in some cases, resettlement or loss of livelihoods for the local communities affected by the new facilities. At the broad economic level, such costs are outweighed by the promise of overarching long-term benefits to come, such as increased competitiveness and better access to markets, education, and health and social services infrastructure. But the affected communities might not see things in the same way, especially if their own cost-benefit calculus doesn’t seem to yield the same positive result.

Compounding the problem is project sponsors’ lack of awareness about the full range of social risks. While public and private developers typically have in place systems to explore and mitigate the array of financial, environmental, legal, and technical risks, they may not have the full picture. Further elevating these risks is the changing context for infrastructure projects today:

• More projects are proposed in high political and social risk environments.
• Competition for scarce land and water resources is increasing.
• Legacy of past mismanagement on other unrelated projects can negatively influence community views of new project proposals.
• Expanded access to information and global connectivity are driving a rise in civic activism: for example, nearly 90 percent of Myanmar’s people have cell phone access, even though roads and power remain largely undeveloped.

Sources:
2. all figures from IFC infrastructure site except estimate of losses, (Irom J. Villegas paper, p. 2
3. Source: www.reuters.com/article/kenya-windpower-protests-idUSL5N0YB4ID20150521
This changing context means that project sponsors need to carefully identify the range of potential social risks and impacts, as well as the universe of stakeholders who might be affected by a proposed project. They also need to engage with them to understand their concerns and address their expectations. A failure to do so will increase the project’s risk profile.

THE RESULT: SPIRALING COSTS

When projects identify potential social risks late or are embroiled in conflicts with stakeholders, costs mount. One independent survey of 15,000 capital-intensive projects worldwide found that sustainability issues eroded the value in 25 percent of the projects, including projects put on indefinite hold, construction delays or stalled production lasting more than a week, and cost overruns of 20 percent or more. In this analysis, problematic projects were less likely to have in place mechanisms to assess social impacts or to implement stakeholder engagement practices that would address concerns, compared to projects without problems.5

Addressing Stakeholder Concerns is a Financial Imperative

- Unforeseen community conflicts resulting in the realignment of a proposed public transmission line project in South America could triple project costs—from $8 million to $24 million—rendering the project unviable for private participation.

- Plans for the 6-gigawatt Myitsone dam on the Irrawaddy River in Myanmar were suspended in 2011 due to social conflicts. The developer had already invested hundreds of millions of dollars when the project was halted.

- After protests over local access to land and other issues, a federal judge in Mexico halted installation of turbines at what would have been one of the largest wind farms in Latin America, Mareña Renovables.

- A 2013 study by KPMG of infrastructure projects in India revealed that community resistance is the primary reason for delays in land acquisition and site handover, causing schedule overruns in the pre-execution phase.7

Poor Relationships Impact Projects

When company-community relationships go sour, projects can be affected in a variety of ways. Some costs—such as reputation damage and negative publicity—may be difficult to quantify. Others are quite clear. These can include:

- **Redress costs:** fines and settlement costs, costs of administrative proceedings or litigation, increased social and environmental obligations, clean-up and remediation costs

- **Lost productivity:** construction delays, temporary shutdown or disruption of operations

- **Capital costs:** property value losses, including theft, damage to equipment, property or infrastructure

- **Project modification:** design modifications potentially add 10-20 percent or more to total project cost, according to anecdotal evidence and a study from the Harvard Kennedy School 6

MANAGING RISK AND FINDING OPPORTUNITY: HOW STAKEHOLDER ENGAGEMENT & BENEFIT SHARING HELPS

Companies can manage stakeholder risks by proactively assessing and managing environmental and social impacts throughout the life of the project. Adhering to international good practices such as IFC Performance Standards and implementing benefit-sharing programs are key.

5 IPA Global, Presentation to IFC 7th Annual Sustainability Exchange, November 2016.


A growing body of evidence demonstrates that project sponsors who work to manage expectations and address stakeholder concerns in ways that yield local community benefits are able to increase the likelihood of a positive project outcome. In emerging markets in particular, where infrastructure projects are frequently located in communities with unmet social needs, benefit-sharing programs—local job creation, local supplier set-asides, income generation programs, small business development programs, local government capacity building—reassure local communities that they will not be left out of the benefits that come from development on their lands.

Meanwhile, among international investors, there’s increased understanding and a rising consensus that managing potential project impacts and engaging in meaningful community outreach and enfranchisement are key to good returns on their infrastructure investments. International financial institutions and other large institutional investors are demanding better and more proactive management of stakeholder concerns and of environmental and social risks as a prerequisite to investment. Without such safeguards in place, project sponsors may have a harder time finding the financing they need to get their projects off the ground.

**Investors Care about Sustainability & Stakeholder Engagement**

- In response to investor demand, the London Stock Exchange issued guidance for good practices in Environmental, Social and Governance reporting, which now forms a core part of the investment decision process.
- **1,500 signatories, with a total of $600 trillion assets** under management are signatories to the Principles for Responsible Investment, incorporating sustainability considerations into their investment framework.
- According Forbes magazine, in the United States, assets under management using sustainability analytics are estimated at more than **$8 trillion, a 33 percent increase since 2014**, representing one out of every five dollars under professional management.
- According to ImpactAlpha, 18 Dutch financial institutions, managing more than **€2.8 (53) trillion in assets, announced their intention to align their investments with the Sustainable Development Goals to maximize their “SDG investing” around the world. Six of Sweden’s largest institutional investors followed suit. Major funds in Australia, Canada and elsewhere are taking similar action.**

**For Power Line Project in Caucasus, Benefits of Community Engagement Outweigh Costs**

Disregarding social risk management and community engagement issues as a way to save money up front ultimately could wind up costing the project more in the long run. The sponsors of this project understood that a change in mindset was needed: from “transaction cost” to investment in “project viability.”

**The project**

150 km-long 220 Kv power transmission line in the Caucasus

**The sustainability strategy**

Robust sustainability risk management framework, including a six-person community outreach team

**Annual cost for stakeholder engagement**

$200,000

**Estimated company savings**

from prevention of losses due to potential construction stoppages caused by community conflicts

$150,000 per day

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Promoting Benefit Sharing in Infrastructure Projects

IFC’s Infrastructure & Natural Resources Advisory team engages with infrastructure companies throughout the world and works to address sustainability challenges in those projects, sectors and countries that are priority for IFC. We offer a range of solutions ultimately aimed at mitigating IFC client social and environmental risks and at ensuring that development benefits are shared with communities. By helping clients understand and manage risks we also give other investors comfort and increased confidence in their investments.

SPOTLIGHT ON RENEWABLES

Renewable energy is an increasingly large share of IFC’s power business, reflecting rapid technology advances and cost reductions that have opened doors in emerging markets. Over the past five years, IFC has invested in more than 150 renewable energy projects worth $7 billion. Renewable projects can yield significant benefits for countries and communities that have long lacked access to affordable and reliable power. They also come with heightened social risks:

• A wide array of social and environmental impacts, especially in hydropower
• Challenges with social acceptance and rising civic activism
• High expectations for benefits such as employment and contracting opportunities
• Limited local benefit in the form of lower-cost energy despite national-level benefits
• Taxes and royalties that do not always trickle down to the local level

IFC’S GROWING TRACK RECORD OF EXPERIENCE: IMPROVING BENEFIT SHARING IN RENEWABLES PROJECTS

IFC’s advisory team is engaged in renewables projects around the world, in addition to its efforts aimed at building the international knowledge base with global studies on good benefit sharing practices in the hydropower, wind and solar sectors.
AGL HYDROPOWER, GEORGIA: COMMUNITY INVESTMENT & LIVELIHOOD PROGRAMS

AGL’s $416 million project is one of the largest infrastructure investments to date in this country. It is located in the Ajara highlands, a remote area with little economic opportunity. As the project neared completion, most local residents employed by the project were likely to lose their jobs. The IFC team worked with AGL and its contractors to develop a two-year community investment strategy that addresses workforce demobilization and loss of livelihoods. The strategy aims to build livelihoods for an estimated 1,500 families around AGL’s operations. The team continues to work with AGL on a local supplier development program and a small and medium enterprise development program linked with the Adjara tourism initiative.

SECTOR-WIDE HYDROPOWER INITIATIVE: BENEFIT SHARING IN MYANMAR & NEPAL

In Myanmar, the government has set a target of increasing the electrification rate to 50 percent by 2020. However, a combination of factors, including lack of developer capacity and policy environment limitations, could pose obstacles for the sustainable development of this sector. Here, IFC’s advisory team is working collaboratively with IFC’s Environmental and Social Department to address the hydropower sector’s sustainability challenges. Similar collaborative efforts are underway in Nepal, which also faces sector-wide capacity issues, in addition to on-going earthquake recovery efforts. Here, the team is supporting a new study by the Environmental and Social Department that assesses the challenges and opportunities in offering hydropower company shares to local communities—an innovative benefit-sharing mechanism to which a growing number of companies have committed.

MEXICO WIND FARMS: INDUSTRY ENGAGEMENT AROUND SOCIAL RISKS AND BENEFIT SHARING

Mexico’s Isthmus of Tehuantepec is one of the world’s most prolific wind resources. It also is one of Mexico’s poorest regions. Building on an initial 2011 engagement with nine wind farm developers active in the region, the IFC team is collaborating with the World Bank on a new, multi-pronged effort that brings together industry players and public sector representatives. The goal is to identify needed changes in policies, practices, and standards to ensure that benefits from wind industry development reach local communities.

IFC INFRASTRUCTURE & NATURAL RESOURCES ADVISORY CONTACTS

Veronica Nyhan Jones  +1 202 473 7940  vnyhanjones@ifc.org
Maria Arsenova  +1 202 473-5290  marsenova@ifc.org
Sunrita Sarkar  +1 202 458-2724  SSarkar4@ifc.org