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How stakeholder management and ESG ratings becomes an essential focus for new Large Complex Projects

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Too often developers of Large Complex Projects (LCPs) tend to focus all their attention on the project development, such as engineering matters, but omit one of the most important aspects yet vital to its success: the stakeholder (1). This common misstep, of not bringing enough soft skills into a LCP, is often linked to high project failures rates and is also rapidly becoming a financial risk for projects due to their poor performance on increasingly popular ESG (2) Ratings, which in turn influence the financing capability of the owner.

Managing stakeholders on a LCP differs from that of a normal project given the element of scale (and as a result much more impacts on environment and local community) which requires a different approach more respective of ESG principles. On a project of this scale, any mistake on how the stakeholders are governed and ethically handled can quickly escalate to catastrophic failure.

This article captures the fact that due to their sheer size, LCPs offer an unmatched opportunity for practicing and promoting good governance (CSR) when it comes to stakeholders' engagement. If appropriately covered, this will in term become a significant added value to the overall project reflecting positively on ESG Ratings which are scrutinized by global investors and other stakeholders as an indicator for financial success, stability and continuity.

(1) In this context the stakeholders will be defined as groups of individuals significantly implicated with the project, not just in terms of financial involvements (e.g. shareholders) but also those most impacted either positively or negatively by such a project

(2) Environmental, Social and Governance (ESG) refers to the three central factors in measuring the sustainability and societal impact of an investment in a company, projects, or business. These criteria help to better determine the future financial performance and perception of companies

What is a Large Complex Project (LCP)?

While a multitude of construction projects are taking place around the world at any given time, a handful of them is large and complex. Typically, large complex projects would be defined as operating on very significant budgets (not uncommonly in the USD billion-dollar range), large in scale, technologically and logistically challenging. Currently, projects falling under this category may include large bridges, tunnels, energy power plants, petrochemical infrastructures, highways, railways, mining sites, piping installations, roads or, as a matter of fact, any other projects where complexity stems from their very large scale.

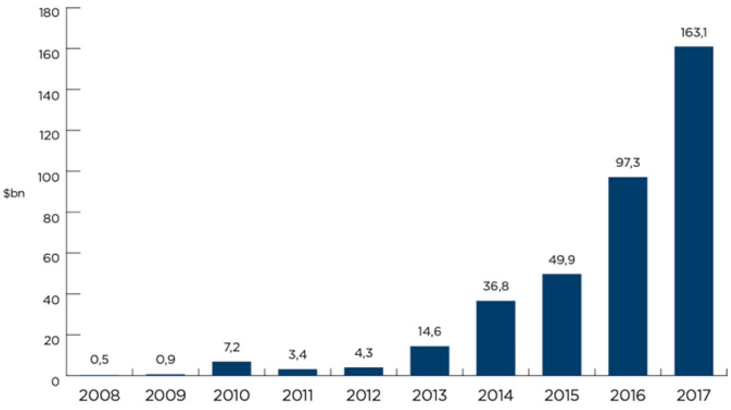
The importance of CSR integration on a LCP

Social and environmental awareness have tremendously increased over the years especially as a result of serious law cases (and very expensive ones) against LCP project developers who were involved with major disasters (e.g. Genoa Bridge Collapse) or social failures which significantly negatively impacted the reputation of these companies. Furthermore, the increased occurrence of serious global socio-environmental disasters is shifting global opinion on the need for stronger CSR and broader sustainability considerations. This aspect has already become a predominant pressure for major project developers and forced many companies to drastically shift their management practices to align with ESG expectations.

Many companies have had to drastically shift their management practices to align with ESG expectations, which also influences financing capability.

It is a fact that stakeholders are increasingly scrutinizing any sizable projects and the companies which finance them for their overall compliance to regulations but also much beyond in terms of how they benchmark in governance against other similar projects. Such ESG benchmarking which is compiled by financial institutions and other stakeholders will continue to significantly alter perception and how the project and shareholders are to perform.

Case study: ESG Investment Trends in Europe



Source: European SRI Study 2018

The above trends in the EU are also reflected in other markets such as Asia and the Americas. All seem to indicate that ESG is here to stay for instance through the actions of major financial players such as Blackrock, JP Morgan or the European Central Bank announcing much stronger emphasis on ESG considerations and going towards mandatory measures that will penalize those companies who do not perform according to ESG expectations. The era of being able to hide one's activities from public scrutiny is truly over in this interconnected world and developers of LCPs should be fully aware of this; good governance and the integration of CSR at all levels of a project is no longer a “good to have” but a “must-have” to ensure a successful projects outcomes and overall continuity of the companies that finance them.

While CSR should be incorporated at all levels of the project, it is especially important when dealing with the stakeholders. There are different avenues by which CSR can be incorporated into stakeholders’ management procedures and a good way to realize which actions are the most meaningful is to analyse the most common indicators used in ESG Ratings. Sustainability Reports are increasingly used as an indicator and source of information to derive such ratings, so it is a good idea for a LCP or the companies behind them to produce such detailed reports

A critical step: understanding who the key stakeholders are

It should be a prerequisite of any LCP to start with a materiality assessment that, amongst other important planning aspects, addresses specifically who the main stakeholders of the projects are and how they will be handled to comply with ESG guidelines. This step is not to be underestimated as failure to do so could lead to catastrophic failure regardless of how well other aspects of the project are managed.

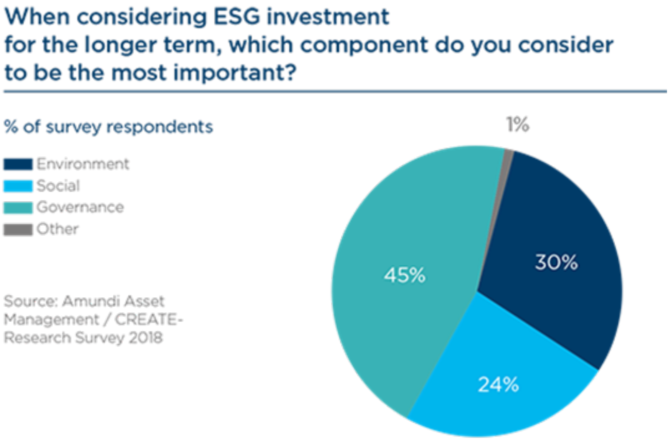
Typically, this stage of the management process would need to take place early on in the development phase and involve the senior management team to brainstorm and clearly define who these key stakeholders are. While some key stakeholders will be the same on any given projects, often some are unique to a specific project and must not be omitted. Once identified, a customized ESG approach can be put into place to manage them throughout the different phases of the project. It is a common mistake to have a single ESG strategy for all the stakeholders when in fact each needs its specific management approach. At this stage what is also required is to prioritize the level and frequency of involvement with the stakeholders according to the project scope and objectives.

General framework

While there is no one size fits all stakeholder ESG management plan when it comes to a LCP, the below is a generic approach that offers four important golden rules that need to be kept in mind at any given time while undertaking a LCP:

- Satisfying the stakeholders: as long as the stakeholders are kept satisfied, there are usually no issues that could alter the project. Stakeholders’ satisfaction is not an easy task and requires precious time allocation and energy,
- Managing the stakeholder closely: by this, it is meant that every stakeholder needs its customized management approach. For instance, communities would need to be managed very differently than shareholders,
- Monitoring the stakeholders: While the development of the project needs to be monitored so are the stakeholder behaviours and actions. Scanning the Media Channels and keeping up to date with stakeholders’ movements is crucial to react on time and appropriately,
- Keeping the stakeholders informed: the best way to keep a close working relationship with any of the stakeholders is to be as transparent as possible and to keep communications flowing.

It is important to highlight that the above four points are interlinked with various levels of prioritization which often will shift at different stages of a project lifecycle. A project is dynamic in nature and adjustments in management procedures are inevitable.



Environment, Social and Governance are becoming omnipresent terms in the asset investment world with a relatively equal level of importance. Any project or company that ignores this trend is heading for catastrophic failure in the medium term (Graphic source: Amoundi Asset Management). A study by Caravel Group and Melbourne Business School has found major project governance teams are dysfunctional, lack the skills and experience to govern major projects and as result poor governance is a major cause of LCPs failures.

In this paper, we will address the most common stakeholders which any LCP adhering to good governance principles (ESG) should incorporate into their core planning.

Important stakeholders 1: local communities

Because of their nature, it is not unusual for a LCP to take place in remote areas where local communities have unique and vulnerable lifestyles and living conditions. Some typical examples would include mining projects in isolated areas such as islands, dense jungles or remote inland villages. But also generally isolated communities due to difficult terrains (e.g. mountainous areas), extreme weather or areas away from mainstream transportation routes. However, communities' disturbances also commonly occur in developed countries as a result of LCP's because of the impact on social, purchasing power etc. For example, major power plants or industrial facilities.

Because such a project will inevitably become a major disturbance to the normal way of life of these communities, either through a positive or a negative impact (inevitably a combination of the two), it is essential to engage with communities at the earliest stage to prepare for the changes to come in the short and long term.

Some typical positive impacts on local communities may include Job creation, development of micro-business activities often significant (shops, entertainments, food and beverages…), development of new transportation routes, and creation of schools. On the other hand, some typical negative impacts may include significant environmental degradation sometimes irreversible, noise, increased crimes and general disturbances to an otherwise peaceful way of life.

> Case study: New Caledonia, a remote overseas French Territory in the Pacific has been exploited by mining companies for many years especially targeting particularly rich Nickel reserves. Despite some short term obvious economic benefits, overall the impacts of the mining industry in this remote island have been significant with permanent destruction of some of the most endemic and biodiversity rich ecosystems on Earth. Local communities have also suffered from poor exit strategies following mine collapse or change of hands. It is a good example of LCPs where negative impacts have far exceeded the benefits and that is often the case with mining projects in particular.

LCP unique EGS challenge with communities

On a LCP, the main challenge when managing communities ethically is to end up with significantly more positive aspects than negative. This can be achieved by spending time to understand the needs of these communities and how the project could best address them through customization. A typical issue with poorly managed LCPs is to address the needs of the communities in the short term only while the project develops and to leave these communities deprived when the project comes to an end (e.g. a mining project can abruptly end when resources become scarce or that the share price of the minerals becomes too low to continue profitable exploitation). Such an approach is unsustainable and can truly be devastative for local communities in the medium to long term which will nowadays reflect poorly on ESG Ratings.

Important stakeholder 2: The regulators (local governments)

All major licensing approvals should normally be granted before beginning a LCP. While this seems an obvious statement, there are still many examples of LCP projects which start and eventually come to a sudden and complete stop within the development or sometimes even after completion due to noncompliance identified with local regulations. This scenario is often seen in the mining or oil and gas projects because the sites are exploited by foreign companies in project host countries with regulations that differ from those of the familiar Commonwealth laws.

As a general rule, any project to be undertaken in an overseas territory should comprise an initial in-depth understanding and planning surrounding all local regulatory requirements. This will be crucial to adapt to the overall development plan accordingly. Often this prerequisite is overlooked, and the complexity underestimated as all regulatory requirements must be scanned including the right to undertake the project in the first place but also everything else in between (e.g. pollution control measures, noise limitations, vibrations allowances, working hours…). Not meeting employee's minimal legal due diligence tends to reflect particularly poorly on ESG Ratings.

Case study: Apple, the global IT Company has one of the world's most established brands. Yet a decade ago it was involved with a series of overworked and underage employment practices in countries like China which has severely affected its reputation at the time to the point of forcing the company to close some operations and relocate operations to other countries. It is a good example of how a company with simingly flawless operations and end product can be brought to a standstill due to poor governance.

In the context of involvement with the stakeholders, organizing initial meetings with the local regulators and subsequently with lawyers is a must on any LCP. Depending on the scale of the project, budgeting and time allocation for project lawyers is a wise investment.

LCP unique ESG challenges of dealing with regulators

In the context of a LCP the difficulty relies upon identifying the local regulations that will affect the project which requires an in-depth knowledge of all aspects of the project but also the ability to foresee any risks in terms of a possible regulatory breach. This task will typically require a strong legal and risk management team and a good synergy between the two which is not easy to manage and put into place. The key guiding principle to remember here is that the efforts and setbacks put into avoiding any noncompliance will be far less than having to deal with a major one which in terms could indeed bring the project to a rapid end.

Case study: A prominent example is the BP Deep Water Horizon oil spill and multibillion-dollar lawsuits that followed as well as large scale environmental impacts. BP's reputation and performance on ESG ratings have greatly suffered from this single incident.

Important stakeholders 3: the shareholders

Shareholders are often the most if not the only stakeholders that are been fully taken care of. Yet, often on a LCP they are not managed to the extent they should be. Shareholders on a LCP can refer to different categories of financing mechanisms: i) on most projects, several companies partner into the project thus providing corporative finance. The representatives on the LCPs are usually the CEOs or key senior management staffs such as CFOs ii) another category is financing bodies which can be broad in nature from development banks, banks, investment firms and governments iii) last but infrequent (especially on larger projects) would be individual contributors or an alliance of individuals.

As the financing arm of the project, the shareholders need to be kept constantly updated of the project schedule and any incident that may alter the deadlines. In this regard, the relationship that a project team should adopt with the shareholders is a transparent one by which regular updates are fed to them.

LCP unique ESG challenge with shareholders

In terms of the shareholders the challenge on a LCP will be strong analytical and decision-making skills to update the shareholders on critical issues that may affect the project finance, completion dates (and now increasingly reputational aspects). On the other hand, shareholders have a responsibility towards a project ESG performance and to follow internationally accepted standards. Often it has been documented that poor social and environmental performances of a project were directly instructed by shareholders to speed up a project execution or to cut costs along the way. With greater scrutiny on projects governance, shareholders are increasingly in the spotlight and under pressure to ensure the execution a project on budget and schedule but also following good governance.

Case study: in 2019 the Brumadinho dam owned by mining company Vale collapsed in Brazil killing hundreds of people. Subsequent analysis indicated that shareholders giving priority to project deadlines over safety was to blame for the disasters. The days of shareholders immunity in such incidents is over and accountability is increasingly scrutinized.

Important stakeholder 4: the project employees

Depending on the type of projects, these could be contractors, part-timers or often on a LCP permanent staffs considering the size of the projects which are often to last in the long term. It is commonly said that the workforce is the most valuable asset of a project or company; that is especially true with a LCP. Often this type of project will require a large number of foreign workers typically on low pay wages as is often seen in the construction industry. Also worth mentioning is the fact that often a LCP will employ a significant number of people from local communities which is usually well perceived in areas where job creations may offer community relief.

A LCP must manage this workforce in the most ethical way possible which includes proper welfare, working hours and industry competitive remuneration. Many LCPs in recent years in Asian countries and the Middle East have been put into scrutiny due to poor handling of their workforce including a high occurrence of deaths and accidents. Furthermore, providing leading employment conditions on a LCP project will not only reflect on the perception of the project to the stakeholders but also attract top talents thus reducing its failure rate.

LCP unique ESG challenge for employees

When it comes to the workforce, the key challenge on projects of this scale is to balance productivity, safety and well-being of the employees simultaneously without making any compromises along the way. This requires budgeting and planning and poor management will be reflected negatively in ESG ratings.

Case study: As a recent case study Singapore has been in the spotlight following the COVID 19 crisis regarding the living conditions of its foreign workers in dormitories which are sending shockwaves across the world to the point of affecting share prices of certain Singaporean listed companies. Sometimes it only takes an unforeseen happening to bring issues to light that would otherwise remain unseen. Such unlikely events need to be incorporated in LCPs risk management strategies as low occurrence but high impacts.

Important stakeholder 5: the observers (Media, NGOs and government agencies)

This stakeholder despite increasingly omnipresent is often neglected on LCPs. Because of the large size of LCPs, they are likely to be scrutinized by the above group of stakeholders with often unwanted consequences.

For instance, the NGOs have more and more importance because they have critical regard on the LCPs, often about the unsustainable environmental practice or unethical behaviour towards the employees. The world as changed dramatically in recent time with fast and long-distance communications becoming omnipresent (i.e. the fourth industrial revolution). Information flows and spreads quickly globally through diverse Media channels and in particular social media either intentionally or unintentionally. Examples of leakage of confidential information are all too common on LCPs with often serious consequences on the project outcome.

LCP unique ESG challenge with observers

When it comes to managing the Observers on the LCP, the reality is that there is not much that can be done apart from practising good governance and taking advantage of the Observers networks to benefit the project and how it could reflect positively in ESG ratings.

While they will not be covered in this article, some common other key stakeholders on a LCP also include suppliers, end-users, contractors, industry associations and many others. Again, it is important to highlight the importance to fully understand who the main stakeholders are so as to manage them under a good governance plan.

Conclusion

The success of a LCP cannot be achieved without seriously incorporating the stakeholders into the overall project management plan. Furthermore, the rise of ESG ratings is becoming a key factor of assessment of a project success no longer just in terms of profitability but increasingly on social and environmental grounds. The future of entire companies during and beyond project executions is now shifting to how it is perceived by society and how fit it becomes to evolving market conditions. ESG is here to stay and a megatrend only on the horizon. Managing the stakeholders on LCPs under good governance in no longer a “good to have” but a “must have”.

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