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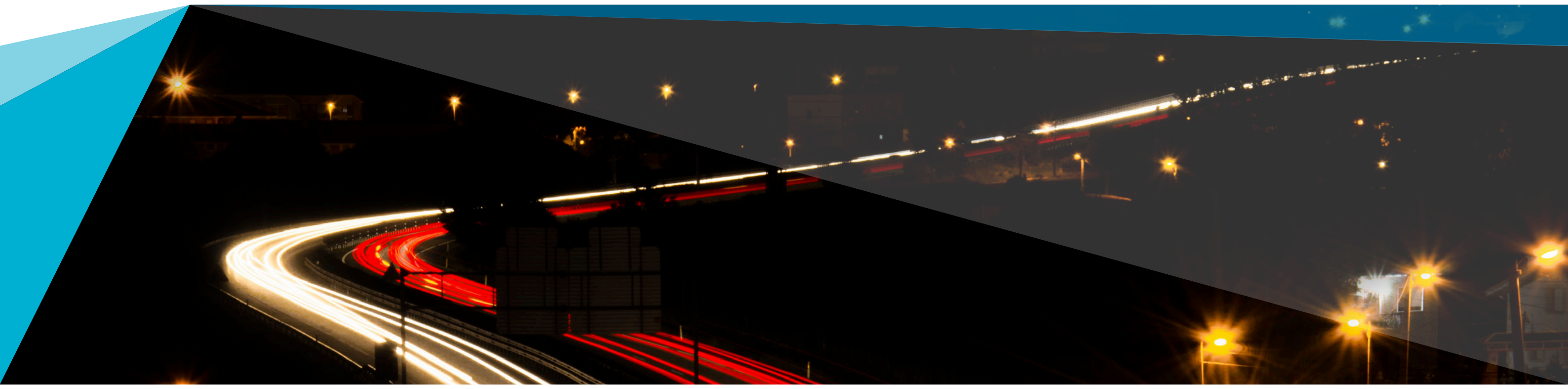
ASSET MANAGEMENT: OPTIMISING PERFORMANCE THROUGH EFFECTIVE RISK MANAGEMENT



In the latest in our series of commentaries on risk and infrastructure, Marsh & McLennan Companies' Infrastructure Practice seeks to provide an updated and holistic view on how best to enhance and protect the economic value of infrastructure investments around the world.

At Marsh & McLennan Companies, we focus on the ways in which infrastructure asset management can be improved through better risk management. Today, infrastructure assets are appealing to those institutional investors seeking more diversified sources of return. Too often, however, investors immediately head towards investments that, on the surface, appear to be the least risky and easiest to manage; such as, established brownfield assets with limited operational activities in mature regulated markets. This perspective can lead to tunnel vision: Investors ignoring greenfield projects simply because they don't fully understand their risk profiles, how to protect value, and/or how to strategically drive those assets, once acquired, to maximise returns and enhance shareholder value.

Effective risk mitigation and asset management strategies must be identified for each phase of a project. Practical tactics and real-world considerations include the following:

BIDDING PHASE

Transaction teams are under pressure to win projects, particularly with more money chasing fewer assets. Therefore, it is essential that the asset management team collaborates with the bid team from the beginning (or that both teams draw some members from the same pool). This ensures that assumptions made during the bidding process can be translated into operational realities in a risk controlled manner. In particular, the asset management team can provide clarity and lessons learned from other projects to ensure risks are limited. These lessons learned can also help improve competitiveness during the bidding process; for example, if the investor is aware of technology that had been beneficial for a previous project in terms of the operation of the asset, this information can be used by the bid team even during the prequalification phase to improve the investor's chances of being shortlisted.

PRE-CONSTRUCTION/CONSTRUCTION PHASE

The pre-construction and construction phase is critical in terms of laying the foundation for project success. There is a need during this phase for both effective structuring and risk management. Key project areas that require careful monitoring include the level of design changes (which, if excessive, will add to cost and schedule) and whether contractors are meeting compliance milestones. In addition, establishing robust and comprehensive contracts themselves, which parcel and assign risk to those counterparties most efficiently placed to take it on should be an early priority. Establishing clearly documented and enforceable contractual reporting arrangements, while at the same time proactively building a good relationship with contractors to ensure transparency and a steady flow of information from them to the SPV, is vital, in order to prevent small problems from turning into large ones. The relationship between the general contractor and local subcontractors must also be carefully structured.

In terms of in-house capabilities to manage projects, some investors have found it valuable during this phase to staff middle managers and technical resources with a construction background vertically across the project and map them to their counterparts on the contracting side. This ensures the investor has access to in-depth, real-time information on the project and any risks as they appear, and helps ensure knowledge retention at the investor level when the project moves into the operational phase. Although this may increase investor costs initially, there is a view by some that it is usually money well spent.

OPERATIONAL PHASE

In the context of an operating asset, detailed due diligence is important if the investor was not involved during the construction phase, in order to clearly identify potential risks. Asset management during this phase comes down to taking a broad view of the concept of governance, which may include providing the operating contractor with guidance on best practices as well as ensuring it has the right management talent in place. If an investor has broad exposure to infrastructure assets, it may be able to bring to the table insights gleaned from other projects and sectors, such as anticipating the evolution of regulatory frameworks.

The goal during the operational phase is to improve the quality of the asset, optimise operating and capital costs where possible, and ensure stable cash flows. With a long investment horizon, often 20 to 30 years, change often doesn't – and usually shouldn't – happen overnight. Instead, flexibility is important: While best practices can be leveraged, local differences must also be understood and respected, as not all markets will evolve at the same pace.

Project insurers also need to be made fully aware of risks. While it can be tempting to hide risks, as they make project financing more challenging, the long-term nature of infrastructure assets means that risks have many years over which to manifest themselves. Transparency and up-front collaboration to develop solutions can help to ensure an effective insurance package, which can ultimately enhance the investor's longer-term value proposition.

PROJECT MANAGEMENT CAPABILITIES

The final piece of the puzzle is ensuring that the investor has the right in-house capabilities for asset management. For investors that have decided to focus broadly on the infrastructure space, this has often meant building sufficiently deep benches of project managers with critically relevant skills and experience.

Moving from local to global also presents an asset management challenge for investors. There is rarely a direct substitute for local "boots on the ground" in managing overseas assets effectively, which has obvious implications for team size and footprint. Often, communication systems and processes must also be upgraded, and investment into enterprise software may make sense, to ensure that financial, commercial, and technical expertise is available on a single, shared platform anywhere it might be needed.

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Marsh & McLennan Companies has significant experience of advising clients investing in the infrastructure sector on a global basis. Oliver Wyman, Marsh, and Mercer have expert teams in place bringing together all aspects of strategic and risk advisory and insurance placement solutions for the benefit of the infrastructure investment community.

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