From Istanbul to Rio

We hope you will consider joining the McKinsey Global Infrastructure Initiative's 2014 meeting in Rio de Janeiro, May 28-30.

Last November, in Istanbul, we convened the inaugural gathering of leaders from companies, countries, cities, capital providers and global institutions with the ambitious idea of co-creating new methods of delivering infrastructure for the 21st century.

This report distills some of what we heard in Istanbul: the ideas, the experiences of participants, and possible next steps. Its intention is to stimulate us to keep the issues in our thoughts and move them forward, and to inspire others to join our progression toward solutions as we rethink infrastructure.

At our Rio de Janeiro meeting, we intend to continue our movement toward improved infrastructure development around the world, unlocking greater economic growth and supporting more stable, healthy and secure communities for all.

Sincerely,

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Pillar 1: Deciding what to build

The discussions in Istanbul addressed infrastructure planning and how policymakers and the private sector can improve it through better decision making. Participants aligned on three broad areas for action.

Breaking down silos between the public and private sectors
Better planning and decision making requires bringing together and collaborating with all the relevant actors in the sector. Infrastructure is a cross-disciplinary industry, needing engagement of all stakeholders throughout the life cycle of an asset. An iterative process should align needs, address concerns and develop solutions as infrastructure is planned, financed, designed, built and operated. New models are needed to manage relationships between the private and public sector.

Citizen needs and voice of the public
Citizen involvement should be active from the early stages of the planning process. Public buy-in is needed for infrastructure projects that will fundamentally change their lives. Their early involvement in the process will ensure that the benefits of the project will be understood and widely communicated, thus influencing future behavior. Participants stressed the importance of understanding and communicating the benefits of infrastructure projects across society as a whole, rather than assessing and valuing infrastructure assets discretely and in isolation.

Clarity, continuity and accountability in regulation
Infrastructure planning needs stable political support over a period lasting longer than a typical government term. This is particularly important if the private sector is involved in the financing and delivery of infrastructure. To involve the private sector successfully, projects need to provide a predictable rate of return for investors throughout their life span, with any risks clearly allocated on the basis of a transparent framework. Independent planning agencies can also enhance stability.

“Inrastructure lays the foundation for future growth.”
—His Excellency Ali Babacan, Deputy Prime Minister of the Republic of Turkey
Passing on more cost to the end user
Istanbul participants unanimously agreed that more cost needs to be passed on to end users of infrastructure. Benefits include demand management and revenue streams linked more tightly to assets, thus making them more attractive to private investors. Implementation has had mixed success due to unanticipated outcomes, political sensitivities and social equity considerations. Technology can help stimulate the required shift to charge end users.

Improving regulation
Improved regulation was highlighted as critical in making better use of existing assets and a key catalyst for innovation. Introducing regulation that considers capital expenditure and operating expenditure (or “totex”) holistically was also seen as an important step forward.

Introducing new technologies
The role of new technology prompted much debate. “Smart” metering in water and electricity and Google mapping in traffic management were cited as positive, but rare, success stories. A new approach is needed that can “unlock” greater value from technology as a means to improve infrastructure productivity.

Pillar 2: Optimizing existing infrastructure
Discussions focused on how to make better use of existing infrastructure assets. Four main levers were explored in depth.

Tightening operations and maintenance
Several experts shared how this approach increased the productivity of their infrastructure assets. London squeezed 10–20 percent more capacity out of its metro and bus system, and Hong Kong’s MTR redesigned its maintenance approach and saved over US $600 million. Participants see no single magic solution and affirmed that success requires skilled and experienced managers.

“MTR redesigned its maintenance approach to extend the usable life of key assets on the Hong Kong transit system, and in doing so also saved over US $600 million of investment.”

—Raymond Ch’ien, Chairman, MTR Corporation
Pillar 3: Smarter, faster, better, cheaper

This pillar focused on why the infrastructure sector has largely failed to achieve the productivity improvements seen in other sectors. Three themes emerged.

How infrastructure is different from other sectors

Differences between the infrastructure and manufacturing sectors affect the level of productivity improvements the infrastructure sector is able to attain. Key dissimilarities cited include the “bespoke nature of megaprojects,” more standards and regulations, and the complex physical environment surrounding infrastructure projects in large cities. Many agreed, however, that despite the challenges, the infrastructure industry has not kept pace with innovation in other sectors. Lack of standardized procedures was seen as a frequent impediment.

There are proven ideas for improvement that need to be more widely adopted

Inspired by the Broad Group’s construction of a 30-story hotel in 15 days, participants discussed the promise of increased “modularization” of infrastructure projects, using standardized items to reduce lead times. The adoption of a standard operating procedure for infrastructure projects was suggested, as was using more sophisticated evaluation tools for contracts. Strengthening competition and overcoming cross-border obstacles were also considered desirable. These are tested techniques that have not been widely adopted.

Enablers for implementation

Key enablers for implementation include improved stakeholder education outside the industry, increased capacity for skills and innovation, and wider acceptance of broader definitions of infrastructure. An example of such acceptance is the understanding that “soft” infrastructure, such as wetlands, is an important, low-cost tool for protecting communities against storm water.

“"We need more willingness to explore ways to standardize construction, to do more offsite, and to have a much stricter approach to organizing the supply chain.”

—Uwe Krueger, CEO, Atkins PLC
Encouraging progress has been made in brownfield, but greenfield remains challenging

Due to a stable regulatory framework and a record for well-designed projects, brownfield projects have succeeded in attracting financing and support from many governments in developed countries. However, private financing for greenfield projects in emerging economies—where most of the need is—remains difficult.

Countries need to reduce legal, political and regulatory uncertainty

Investors cited three essential conditions they look for when investing: stable political leadership; thoughtful prioritization of infrastructure needs that incorporate public input; and a stable legal and regulatory framework. While many of these issues could be attributed to emerging markets, developed countries carry risk as well.

Different types of financing are suited to different stages of a project

Participants highlighted the unwillingness of private investors to finance early-stage infrastructure projects as too many risks are parceled into such offerings. Investors argued that government sponsors and development banks were best suited to take early-stage risks, with private capital following at a more mature stage. In addition, not all infrastructure projects are suited to private financing.

Private finance cannot solve the issue of how to fund infrastructure

Participants expressed that government sponsors sometimes blur the distinction between funding and financing, resulting in expectations that investors will provide capital in replacement of user fees or governmental payments. Most agreed that irrespective of the financing solution, an identifiable, predictable source of funding should be available to repay the financial investors.

“We invest to make a return to pay for the public pensions of millions of retirees. If we can do good by doing so, all the better, but our primary motivation is return.”

—Mark Wiseman, President and CEO, Canada Pension Plan Investment Board
Many critics highlight the world’s infrastructure challenges. Few deliver solutions.

McKinsey & Company’s Global Infrastructure Initiative, convened in partnership with The Abraaj Group and in affiliation with Albright Stonebridge Group, gathers the most senior leaders in infrastructure to drive a critical global discussion about the future of infrastructure and how to optimize the required global investment of US $3 trillion annually. The Global Infrastructure Initiative is a movement of committed leaders, dedicated to unlocking economic growth and supporting more stable, healthy and secure communities.

Building on the success of the inaugural event in Istanbul, the second meeting in Rio de Janeiro will focus on overcoming the recurring obstacles that arise on a global basis, and devising ways to accelerate the timely delivery of essential infrastructure. The agenda will explore the latest data, global best practices, and innovative approaches required to plan, finance, build and operate the infrastructure needed to support a world of 9 billion people. Our purpose is to identify a set of tangible near-term actions that will remove bottlenecks and deliver change within the infrastructure industry.

All eyes will be on Brazil as it prepares to host the 2014 Football World Cup and the Rio 2016 Olympic Games. With an unprecedented infrastructure transformation underway, Brazil offers an optimal location for our meeting in Rio de Janeiro, one of the world’s most spectacular and vibrant cities.

We invite you to join us in Rio for the 2014 Global Infrastructure Initiative. For more information go to www.GlobalInfrastructureInitiative.com.