



ACADEMIC DEPARTMENT OF FINANCE

How do international institutions and boards of directors overcome difficulties in sustainable investing in emerging markets? The evidence from Russia

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Abstract

This paper builds on necessity of creating a system of ESG indicators to account for the specific nature of private-public partnerships (PPPs) to enable institutional, private and public market participants to conduct a comprehensive analysis of their investment activity. Those ESG indicators are required not only for feasibility studies of the project during start-up period, they are even more required at the later stages to monitor the effectiveness of the project implementation by boards of directors and by the wide range of stakeholders. A specific methodology of calculating an ESG rating of a PPP project is developed and applied to two prominent business+ cases from Russia. The paper pays special attention to the operations of international financial institutions (the IFIs), such as European Bank for Reconstruction and Development (the EBRD), which play a significant role in launching PPP programs for many developing countries. On the basis of real life case studies for emerging capital markets, paper contributes to the literature by developing PPP- adjusted ESG rating that is relevant for board's decision-making and monitoring specific types of long term investments.

Keywords: *private-public partnerships (PPP), ESG rating, sustainable development, sustainability reporting*

1. Background of the study
2. Aim and Objectives
3. Methodology
4. Business Cases
5. Key findings

Background of the study

Definition of a PPP

Public-private partnerships (PPP) are “arrangements whereby private parties participate in, or provide support for, the provision of infrastructure, and a PPP project results in a contract for a private entity to deliver public infrastructure-based services” (Grimsey and Lewis, 2004)

Infrastructure in this definition is asset-based and refers to both economic infrastructure (e.g., motorways, railways and bridges) and social infrastructure (e.g., schools, social housing, hospitals and prisons) (Grimsey and Lewis, 2004).

Characteristics of a PPP



The use of **long-term infrastructure contracts** (Hodge and Greve, 2007)



Full or partial financing of object's construction by **private investor with own and borrowed funds**, and deferred investment's compensation by the state is possible (Yescombe, 2007)



Allocation of risks and responsibility between partners, transfer of certain risks to the private sector (Yescombe, 2007)



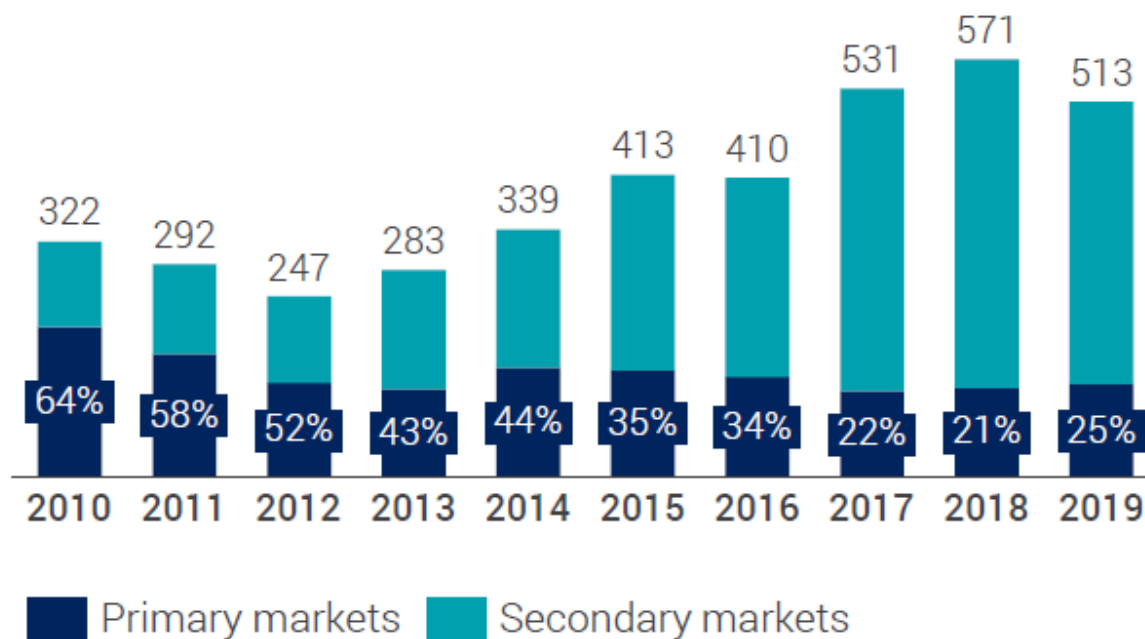
Obligatory **property participation by public party** (portable property, land plot and other)



Focus on **the specification of project outputs** rather than project inputs, and the integration or “**bundling**” of different functions into a single contract such as design, construction, financing, maintenance and/or operation (Grimsey and Lewis, 2004)

Total infrastructure investment with private participation (2010-2019)

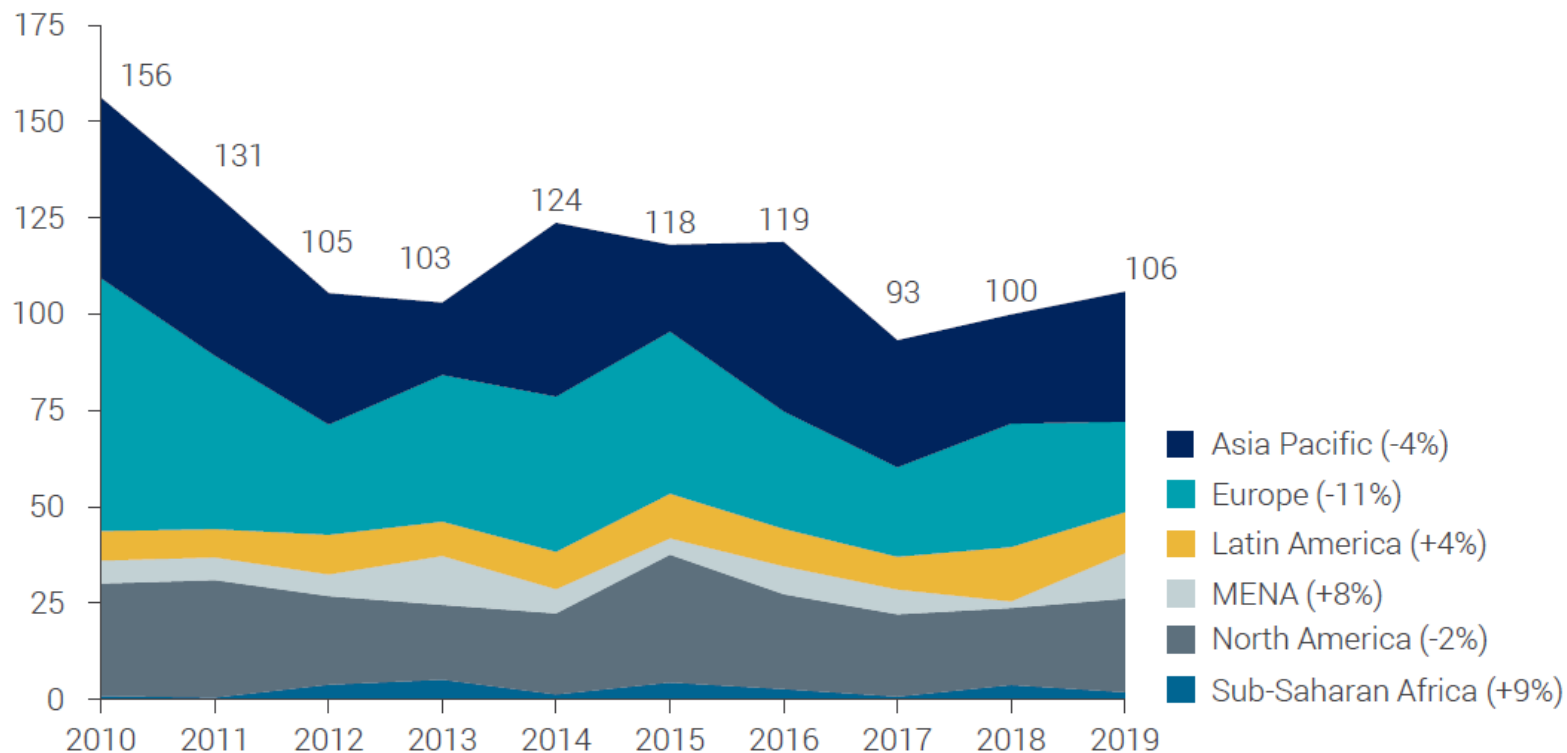
Total infrastructure investment with private participation (USD bn)



Source: IJ Global and GIH calculations

Private infrastructure investment by regions (2010-2019)

USD billions



Source: IJ Global and GIH calculations
 Note: CAGR growth rates for 2010–2019

Problem 1: Key stakeholders of a PPP

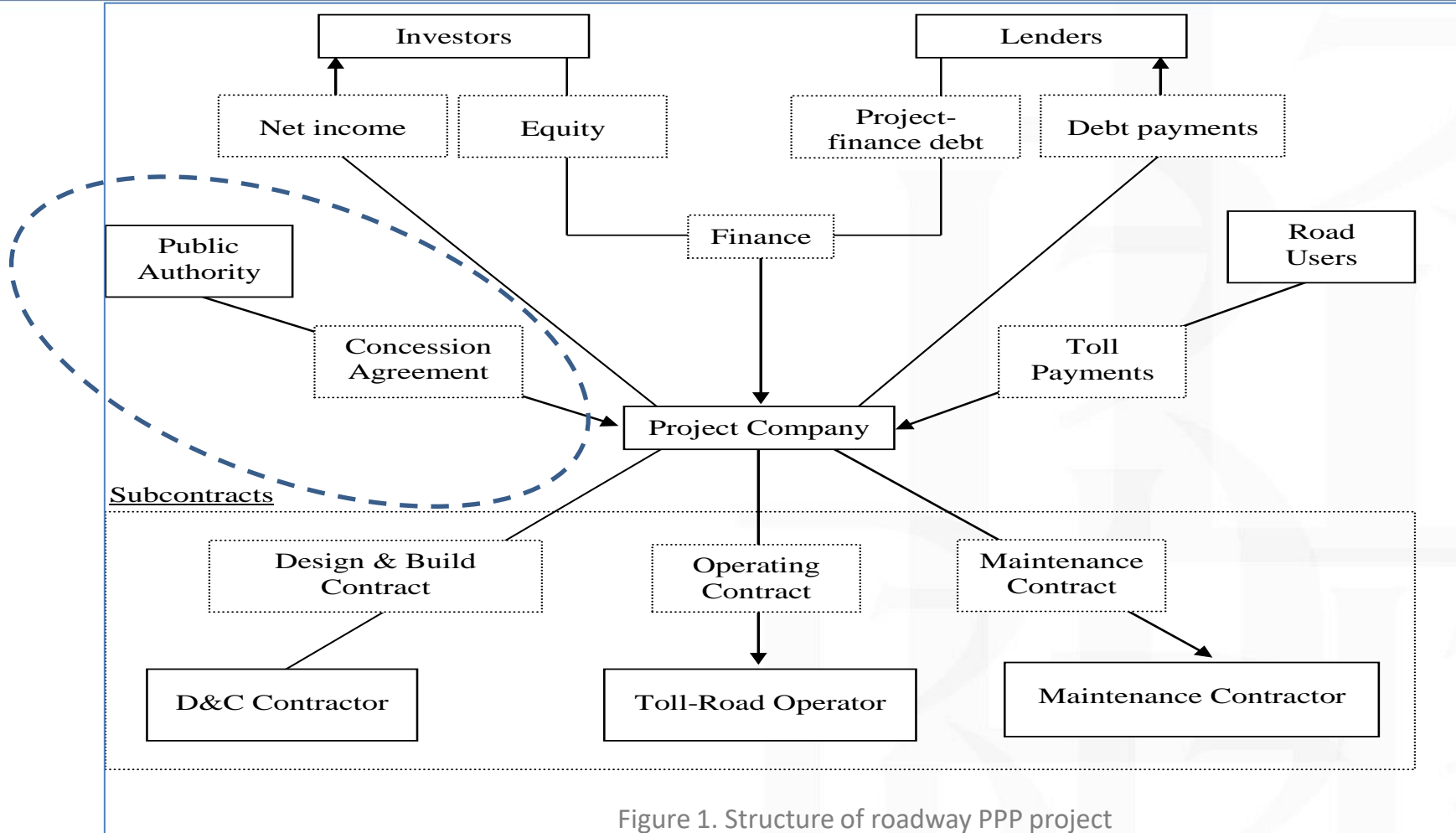


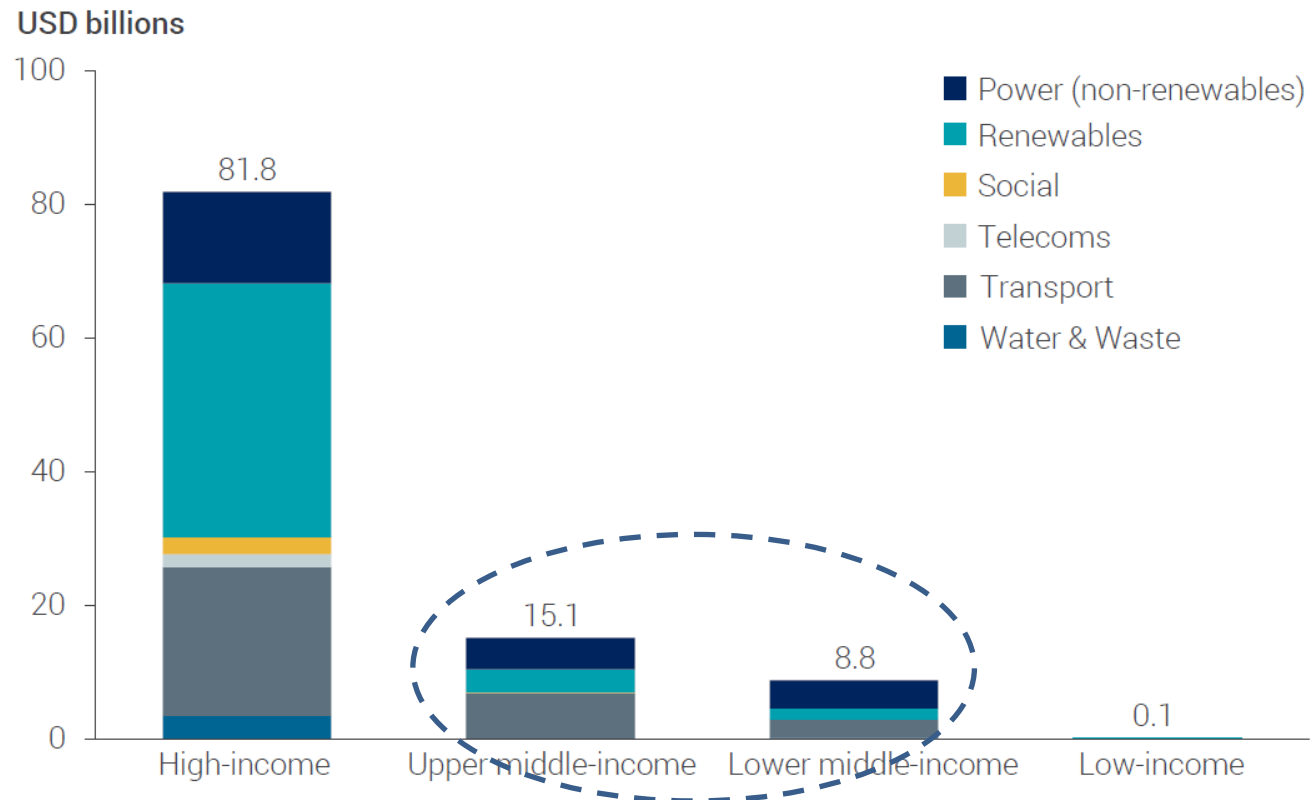
Figure 1. Structure of roadway PPP project

Source: Yescombe 2007

Problem 2: Private infrastructure investment by Country Income Group, by sector (2019)

"In high-income countries, private infrastructure investment in renewables has intensified. This drives the ranking of renewables as one of the top areas of global private infrastructure investment."

Global Infrastructure Hub



Source: IJ Global and GIH calculations Note: World Bank Income Group classifications 2020–21

Problem 3: Corporate ESG rating irrelevance, the case of ASSET4

ASSET4 ESG Data and Framework

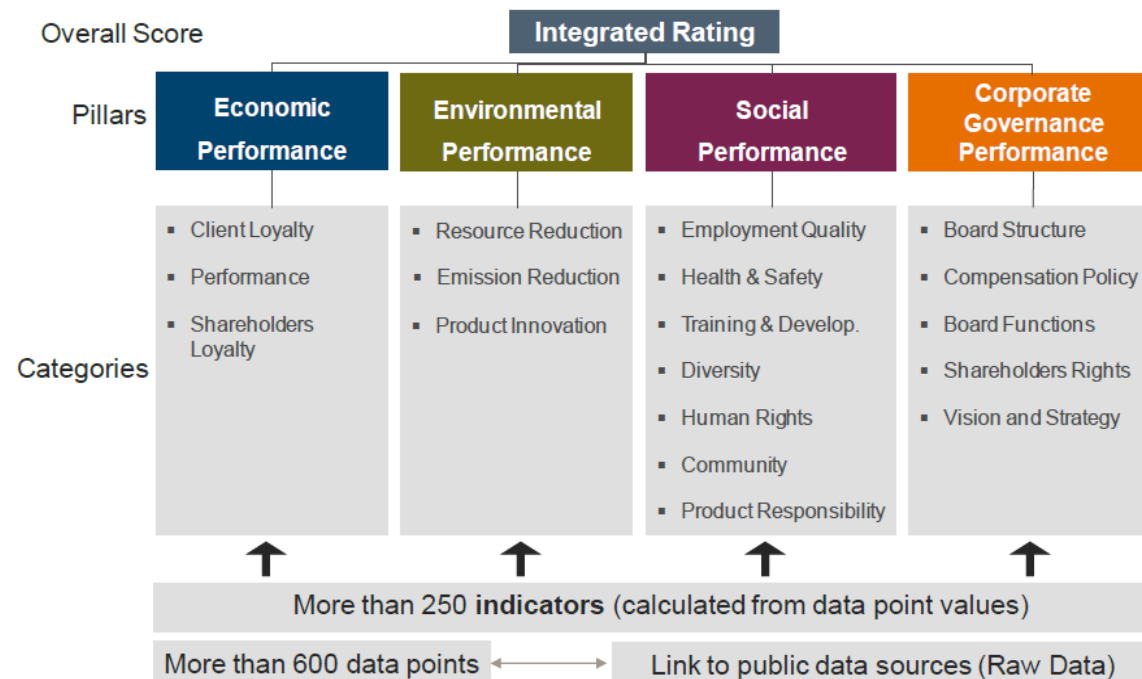


Figure 2: Overview of ASSET4 ESG data and framework. Over 250 indicators are rolled up into the category scores, which are subcomponents of the four pillars. The overall company score, called the *Integrated Rating*, is derived from a roughly equal-weighted blend of the four pillar scores.

Source: Starmine Research Note, Thomson Reuters 2010

Aim and research questions

Aim

Development of a PPP-adjusted ESG rating which might be efficient to enable institutional, private and public market participants to conduct a comprehensive analysis of their investment activity

Research questions:

- ✓ What specific issues could be addressed when analyzing sustainability considerations of a PPP project?
- ✓ How to measure those specific issues if they're measurable and how to include the estimate to an integrated rating of ESG impact?
- ✓ What failures in corporate governance practices are encountered in emerging markets in implementing sustainable investing, how those difficulties might have been overcome, and what reporting gaps prevent an efficient ESG analysis of the projects?

Main steps of the research

1

Literature review and discussion of the current research available on sustainability in PPPs

2

Analysis framework: development of the methodology of a PPP-adjusted ESG rating

3

Case Study: the findings from the application of the developed ESG rating to 2 real life case studies, and recommendations for overcoming sustainability failures in PPPs

4

Results' analysis and discussion: conclusions and limitations of the research

Literature review

Blocks	Topics	Articles/Reports	Main findings
sustainability	<ul style="list-style-type: none"> - sustainability - Sustainable Development - “three-pillar” concept - strong and weak sustainability debates - sustainability of what? 	<ul style="list-style-type: none"> - O’Riordan (1988) - Bossel (1999) - Carter (2007) - Neumayer (2003), - Devolder and al. (2015) - Kiewiet and Vos (2007) 	<ul style="list-style-type: none"> - “three-pillar” concept (social, ecological, economic) is popular among proponents of weak sustainability approach - The strong sustainability approach requires introduction of “governance mechanisms” measurements
sustainability in PPPs	<ul style="list-style-type: none"> - ways of introduction sustainability considerations during implementation of PPP projects - assessment of sustainability based on case study approach 	<ul style="list-style-type: none"> - L. Keeys, M. Huemann (2017) - Villalba-Romero F., Liyanage C., Roumboutsos A. (2015) - Hueskes M., Verhoest K., Block T.(2017) 	<ul style="list-style-type: none"> - The three pillars, i.e. economic, social and environmental, are used to measure sustainability of PPPs implemented in developed markets (Greece, UK, Portugal, Spain) - Sustainability considerations might be efficiently implemented in tender documentation, project agreement, design documentation
ESG rating	discusses existing ESG ratings	- Weber, Staub-Bisang, Alfen 2016	- There is no specific ESG rating applicable to PPP project
corporate governance in PPPs	reviews the recent research papers on the problems of introduction efficient corporate governance practices in the companies implementing PPP projects	- Stafford A., Stapleton P., 2016	<ul style="list-style-type: none"> - an SPV is set up for each project with governance becoming the responsibility of the SPV Board - neither government officials, nor independent directors on the Board - hierarchical chain of companies reduces the transparency of financial reporting performed by private investors

Methodological framework

- ✓ Defining the main environmental, social and political issues of the local society (social polling performed by WCIOM in 2019, research center Romir in 2016);
- ✓ Defining the criteria allowing to evaluate the project's influence on above mentioned issues;
- ✓ Assessment of infrastructure projects based on chosen criteria;
- ✓ Adjustment of the score on the reliability of the sources, the novelty and applicability of the obtained information

ESG rating: environmental criteria

Criteria	Indicators	Type of indicator
Air pollution	<ol style="list-style-type: none"> 1. Emissions level during construction phase 2. Car exhaust emissions after start-up of the operation phase in attraction zone 	<ul style="list-style-type: none"> ▪ Performance-based / Pr ▪ Performance-based / Pr
Waste recycling	<ol style="list-style-type: none"> 3. Quality (level) and speed of waste recycling 	<ul style="list-style-type: none"> ▪ Practice-based / Pr
Rivers and lakes pollution	<ol style="list-style-type: none"> 4. Escalation of pollution of the rivers and lakes in attraction zone 	<ul style="list-style-type: none"> ▪ Performance-based / Pr
Deforestation	<ol style="list-style-type: none"> 5. Square meters of cutted trees, negative impact on protected nature territories 	<ul style="list-style-type: none"> ▪ Performance-based / Pr + Pub

ESG rating: social criteria

Criteria	Indicators	Type of indicator
Unemployment	6. Quantity of the new permanent working places (direct effect)	<ul style="list-style-type: none"> Target-based / Pr
Traffic jams	7. Shortening journey time, traffic congestion impacts	<ul style="list-style-type: none"> Target-based / Pr
Human resources	8. Respect of labour rights and labour law	<ul style="list-style-type: none"> Practice-based / Pr
Noise levels	9. Level of noise load during construction and operation phases	<ul style="list-style-type: none"> Performance-based / Pr
Housing policies	10. Number of residential buildings demolished in the project's attraction zone	<ul style="list-style-type: none"> Practice-based / Pub + Pr

ESG rating: governance criteria

Criteria	Indicators	Type of indicator
CSR policy	11. Transparency and openness of CSR policy, level of disclosure of ESG related information in annual reports	<ul style="list-style-type: none"> Practice-based / Pr
Construction standards	12. Number of court suits related to disrespect of construction standards	<ul style="list-style-type: none"> Practice-based / Pr
Corruption	13. Number of cases (court suits) of asset misappropriation	<ul style="list-style-type: none"> Practice-based / Pub + Pr
Contract governance	<ul style="list-style-type: none"> Implementation of sustainability considerations in tender documentation and PPP agreement 	<ul style="list-style-type: none"> Practice-based / Pub

2 real life projects selected for the Case Studies

Western High-Speed Diameter in Saint Petersburg



Public partner
City of St. Petersburg


- The Grantor has constructed northern and southern connection roads which are now being operated as unique toll road together with central section, which is the object of PPP
- Capital grant from the public partner has amounted to above \$1 bln
- The public partner performed project preparatory works



Private partner
Magistral of Northern Capital


- The consortium comprise VTB Capital, Gazprombank; Astaldi (Italy), İçtaş İnşaat (Turkey)
- The lenders are VTB, Gazprombank and EBRD, EDB
- EBRD initially owned a minority stake in concessionaire company, then sold to VTB
- Total amount of senior debt is above \$2 bln
- Concessionaire issue sustainability report on a regular basis

Moscow-St. Petersburg “Neva” toll road, section 6



Public Partner
SC Avtodor

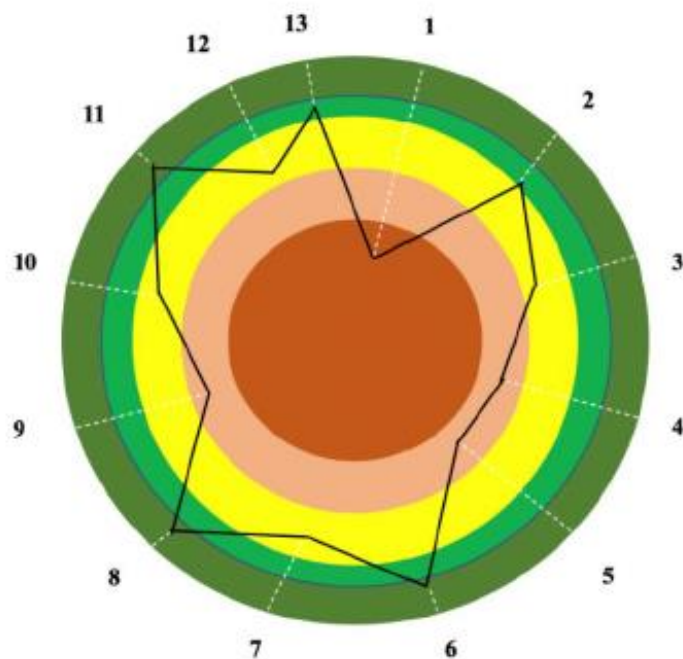
- Russian Federation in the name of SC Avtodor (the Grantor)
- The Grantor has performed project preparatory works
- Capital grant from the public partner has amounted to above \$1 bln
- SC Avtodor has commissioned the whole toll road “Neva” in 2019



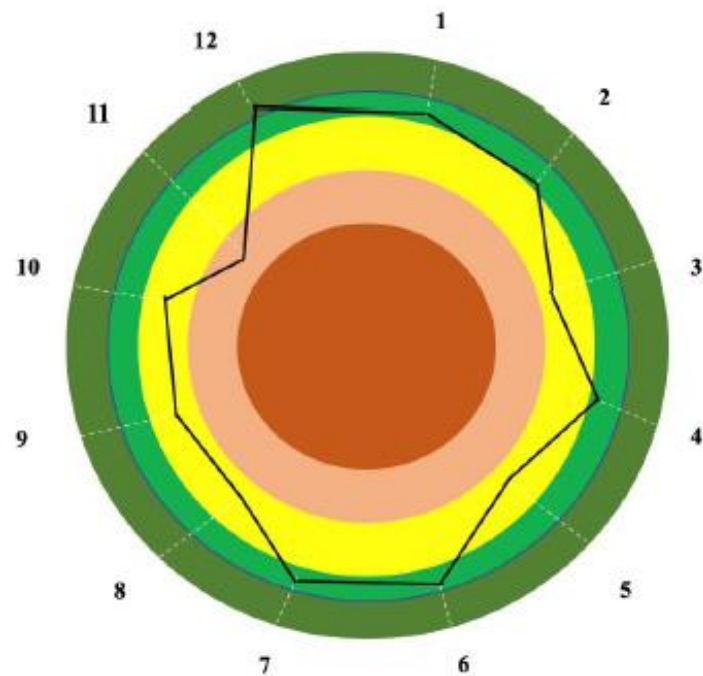
Private Partner
Transstroy-mekhanizaciya

- The subsidiary of the leading contractor Mostotrest
- The project didn't attract bank debt and didn't issue bonds
- The whole private portion of construction budget is financed through sponsor's own funds (near \$100 mln)
- Investor has performed and published a report on negative

Graph 1 «Sustainable polygon for WHSD»



Graph 2 «Sustainable polygon of M-11 highway»



Source: prepared by author

Expectations

- WHSD rating could be higher than that of the M-11 due to advanced CoGo practices: CSR policy in place, BoD, EBRD on the Board (**not confirmed**)
- Reporting limitations couldn't provide for the full picture (**confirmed partially**)
- There is high disrespect of sustainability issues due to regulations limitations (**confirmed**)
- Evaluation and publication of the ESG rating for a PPP could significantly improve the governance practices including the efficient communication of the sustainability matters (**confirmed**)

Actual Results

- Overall rating for both of the projects is 3 out of 5 (very low)
- The positive role of IFI lies in the aspects of timely problem communication and stakeholders involvement in the search of the efficient solutions
- The involvement of IFI doesn't protect against environmental threat, more active role of the state is required
- There is wide room for improvements at the state regulation level as well as at the private business practices for the coming years

**Thank you for your
attention!**