

SEPTEMBER  
OCTOBER 2016

# Director Journal

A publication of the Institute of Corporate Directors

icd.ca



# TOMORROW'S BOARDROOM

← *How to make it relevant to skeptical entrepreneurs* →

By Virginia Galt

08 **ED BARRETT**  
Keeping the lights on

17 **NFP BOARDS**  
Dicey stepping stones

22 **FAMILY ENTERPRISES**  
Handing down diversity



# Killing the black swans

## Driving predicatability in major capital projects

This article was first published in the Director Journal, a publication of the Institute of Corporate Directors (ICD) in September 2016

Major capital projects are notoriously difficult to execute. All too often, we hear of important infrastructure projects that have hit delays, gone over budget or – worse – never materialized at all. And all too frequently, management and their boards of directors place the blame on so-called ‘Black Swan’ events: simply put, the unpredictable.

But are these events really unpredictable? And what can boards of directors do to improve the predictability of their major capital projects? To find out, Stephen Beatty, KPMG’s head of infrastructure for the Americas and India, sat down with John Beck, founder and executive chair of Aecon Group Inc., the Canadian construction and infrastructure development company.

**John Beck:** I’ll admit that there are certainly events in the life cycle of any construction project that could be considered totally unpredictable “Black Swan” events: terrorist actions, dramatic political change, one-in-a-thousand-year natural disasters such as floods or earthquakes. These are events that are terribly hard to predict and mitigate. But I would argue that – when it comes to the execution of a project from day one through to the end of the concession period – Black Swans should be extremely rare.

**Stephen Beatty:** I think if we dig into most Black Swan events in recent history, the vast majority would be exposed as events that were, in fact, almost entirely predictable. Even political risk – and we have certainly seen projects across Canada impacted by political change – can largely be predicted, managed and priced into construction projects. I think that in most cases, the problem is less about the predictability of risk and more about the understanding of the unique risks that come with these massive capital projects. It is project scale that appears to drive this, in both public and private sector projects.

**Beck:** Absolutely. My experience working with governments at all levels is that there are few managers or project and corporate board members that have any real experience overseeing a major capital project. And that is completely understandable: for most boards, these projects are once-in-a-lifetime events and few directors have any first-hand experience managing a project of this complexity from an operational perspective. But that means that – more often than not – the right questions are not being asked of management to ensure that risks are being properly identified, managed and priced.

**Beatty:** Having that first-hand experience is critically important and fundamental to boards asking the right questions and having the right information to discharge their duties and protect the company’s shareholder interests. I’m sure that many of the directors of companies that have suffered delays on capital projects have – in hindsight – wondered why they hadn’t been aware of or fully informed of all of the risks.

**Beck:** I do believe, however, that we are seeing a concerted effort by the institutions – whether municipalities, provinces, regions or the federal government agencies – to improve their understanding and capabilities for structuring, executing and managing major capital projects. But I think there is still some way to go before they have the depth, the staffing and the capability to match the private sector. In some cases, it will require the board of directors to essentially outsource those decisions to an independent organization that is more focused on creating the right balance between private and public sectors.

**Beatty:** It really comes down to both sides (owner and contractor) committing to becoming a more competent counterparty to the other and striving to achieve a stronger appreciation for what the other side is going through and what they need to achieve. That also holds true for the transfer of risk; boards need to be thinking carefully about who is the right party to hold various project-related risks and they need to be asking the right questions about how those decisions drive project predictability. But that requires boards to know what questions to ask in order to fully understand the risks.

**Beck:** The whole concept of risk transfer is a critically important aspect for boards and central to capital project predictability. But I think that the market has started to stray from the initial idea of private sector risk transfer, which was to distribute the risk to the party that was in the best position to control it. Today, the common perception is that as much risk as possible should be transferred to the private sector and there isn't always a clear understanding of what the cost of that decision is. In other words, how much are you paying for that insurance policy?

**Beatty:** We often see situations where contractors are being asked to take on and price risks that really would be more appropriately covered through an insurance policy or carried by another entity. And, again, the challenge comes back to the board, which needs to be asking the right questions and probing the margins of the risks as projects are being structured and bids are being prepared to ensure that decisions at the front end aren't simply creating opportunities for conflict and delays at the back end. Boards really need to be looking at their risks from the inside out, and then from the outside in, if they hope to properly understand their risks and appropriate mitigation strategies.

**Beck:** Ultimately, I believe this comes down to experience. My advice to any board of directors considering a major capital project in the near future is to recruit a director with first-hand experience leading or overseeing a successful project of similar size and scope. The bottom line is that you really can't predict certain events until you have lived through them. And very few directors have lived through them. For the vast majority, these are uncharted waters.

**Beatty:** This is really a natural evolution of the capabilities and makeup of the board. All boards go through cycles where different types of expertise are needed to help guide organizations through critical phases in their long-term strategy. The only difference here is that boards need to be thinking about their risks at least five years ahead of a major capital project, which means that getting someone with experience on board early will be critical.

**Beck:** I would also advise boards to invest in a program or initiative aimed at improving their own education around capital projects. Bring in as many experienced professionals as you can find to share their own experiences and lessons learned. Work with your contractors at the preparation stage to tap into their experience and understanding of the risks. Visit the sites to see some of the risks and future challenges for yourself. Most importantly, leverage independent advisors who can bring experiences from other projects, in other jurisdictions, to bear.

**Beatty:** If you are a director with a major capital project coming up in the next five years, you really need to be able to take a dispassionate gaze in the mirror and be willing to recognize the things you don't know. And then you need to set about building the board and acquiring the management skills you need to achieve your long-term goals. This is about having the right information and the right experience to identify predictable events before they.

This article originally appeared in the *Director Journal*, a publication of the Institute of Corporate Directors (ICD). Permission has been granted by the ICD to use this article for non-commercial purposes including research, educational materials and online resources. Other uses, such as selling or licensing copies, are prohibited.

PHOTO LEFT: STEPHEN BEATTY, KPMG  
PHOTO RIGHT: JOHN BECK, AECOM GROUP

