



## Involving Large Contractors in Enhancing Social Performance During Construction

### → Target Audience

This guidance note is aimed at two types of business audiences with operations in developing countries: (i) engineering services companies, in particular business development directors and engineering, procurement and construction managers; and (ii) the proponents of large-scale capital projects, especially supply chain managers and those involved in external and community affairs.

### → The Issue

With major capital projects, negative local social and economic impacts and risks are generally at their most acute during the main construction works. These problems are heightened in regions of the world afflicted by low levels of economic development, chronic poverty and weak governing institutions. Here, social impacts can include physical relocation, loss of cultural property, economic 'boomtown' effects from the influx of migrant workers, degradation of natural resources (water, forests etc.) material to local livelihoods, and the transmission of infectious diseases from construction workers.

Concurrently, through direct employment and procurement, the construction period of capital projects in undeveloped areas offers a relatively short yet exceptional opportunity for local economic benefits. If fully realised, these opportunities can help counter project-related social risks and enhance the reputation of both the contractor and the project proponent. This reality is increasingly exploited by government ministries through new forms of '**local content**' conditionality tied to transactions agreed with private investors. As local content requirements become more stringent, both the project proponent and their main contractors are being driven to innovate to ensure that weak capacity in the local supplier market does not pose a commercial risk. Managed well, such innovation can also be positioned as a strategy for increasing short-term commercial returns and promoting long-term business growth.

Ultimate responsibility for the effectiveness of both types of social performance management – ie. negative impact mitigation and local content maximisation – rests with the project proponent (or occasionally with a government agency, such as for some aspects of asset compensation). However, in cases where the majority of construction work is outsourced to contractors, it is critical that the proponent and its principal contractors collaborate to implement a co-ordinated social performance strategy. The strategy needs to be based on clearly defined tasks that correspond to who is best placed to implement the required management measures.

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### → Guidance on Contractor Involvement

With tight profit margins, the scope for contractors to devote their own resources to enhancing social performance on capital projects is limited.

More pragmatic is to accept that large engineering, procurement and construction (EPC) contractors are uniquely positioned in terms of their close interface with local society and their international expertise, and that deployment of these competencies to assist in enhancing the project's social performance has a market value.

One obstacle to realising this proposition is the sometimes poor appreciation by the project proponent of the wide range of value-adding roles that EPC contractors can play in both mitigating negative social impacts and maximising local content. In this respect, greater use could be made of early contractor involvement (ECI), post contract award discussions and project partnering, to bring a broader range of social performance issues into the main body of EPC contracts.

Guidance is offered below on the division of roles for EPC contractors and project proponents in enhancing social performance during the construction phase of capital projects.

#### Pre-Tendering

##### Project Proponent

- Develop **pre-qualification bid standards** that gauge EPC contractors for their capabilities in local social impact mitigation and local content optimisation, relevant to the economic status of the project region.
- For those social impact mitigation measures to be outsourced to contractors, assess the **risk of contractors failing to deliver**. For high risks, either strengthen the pre-qualification criteria or contractual incentives, or retain management responsibility.
- Identify aspects of the **early civil works** that offer opportunities for on-the-job training to affected communities.
- Include in the tender documents a fixed sum for the bidders to propose their own **innovation in social performance**, ie. beyond minimum requirements.

##### EPC Contractor

- Incorporate 'social performance' as a topic in pre-bid project **risk (and opportunities) assessments**, with an emphasis on the potential to add value to, or put at risk, the social management objectives of the project proponent (see Briefing Note 1 on *Project Risk Analysis and Social Performance*).
- Catalogue the full range of **internal business competencies** – design and engineering, skills/competency development, technology transfer, performance management, logistics

management, contract management etc. – and assess the potential for deployment of these competencies to enhance the project’s overall social performance.

- Initiate a **database of sub-contractors** and suppliers and their relevant skills/capabilities, divided according to their presence at the national, provincial, municipal and affected-community levels.

### Pre and Post Contract Award Discussions

#### Project Proponent

- Retain a recourse to **Variations to Contract** in circumstances where the complexities of involving the main EPC contractor in achieving effective social impact mitigation or enhancing local economic benefits have been substantially underestimated.
- Refrain from including **Time of the Essence** clauses in the contract in relation to social performance, such as if the contractor fails to perform to a certain date, there is an automatic breach of contract. Good social performance is rarely enhanced by excessive time pressures.
- Refrain from incentivising the contractor by setting **Value of Work Done (VOWD)** targets for social performance in the contract which might be open to abuse, eg. requiring a signed MoU between the contractor and unrepresentative community leaders.

#### Joint Proponent-Contractor

- Prioritise all potential local social and economic impacts and risks and **delineate management responsibility** between the project proponent and contractor based on the ‘best man for the job’.
- Apply client-contractor ‘**partnering principles**’ to: (i) provide clarity on the proponent’s social performance objectives; (ii) negotiate workable contractor incentive schemes for social performance; and (iii) identify engineering design opportunities that integrate the project proponent’s own programmes on community investment and local business development with the contractor’s management of construction and procurement.
- Prior to construction, jointly develop a **strategic procurement strategy** aimed at maximising the local economic benefits of the construction phase, including, for example:
  - (i) skills enhancement and training/apprenticeship programmes for local people;
  - (ii) capacity building for local suppliers to compete for contracts on the project (ie. by raising companies from ‘just below’ to ‘just above’ the necessary technical requirements) – this might involve technology transfer, affordable finance (such as ‘bond’ schemes), knowledge of bidding procedures and regulatory navigation, and basic training in business management;
  - (iii) partner with government training or business facilitation services and/or with development finance institutions; and
  - (iv) align temporary civil works (eg. access roads, bridge strengthening, water abstraction) with the infrastructure priorities of affected communities and with the economic development plans of local municipalities and provinces.
- Agree **small work packages** and related **model minor construction and service contracts**, designed to optimise local firm participation.
- For larger work packages involving international (off-shore) expertise, develop longer-term model construction and service contracts that encourage **joint ventures with local firms** and which promote on-the-job skills and technology transfer.

- Agree how the main contractor will **systematically and periodically report** back on local content and local economic performance.
- Agree a procedure for managing **community grievances** and suppliers that avoids confusion between the role of the project proponent and the main contractors.

### During Construction

#### Project Proponent

- **Monitor** the contractors’ performance in contributing to good external stakeholder relations, effective impact mitigation, local content compliance and innovation, and long-term local economic sustainability. The aim should be to identify problems early and assist the contractors to raise their performance.

#### EPC Contractor

- Involve the project proponent’s supply chain and community liaison managers in construction and procurement management to the extent that the project speaks to local stakeholder with ‘**one voice**’.

#### Joint Proponent-Contractor

- Drawing on a prior agreed **demobilisation plan**, jointly inform local employees and communities of the measures being taken to reduce the negative socio-economic effects that arise at the end of construction.

## → Conclusion

A key to achieving a sound social performance during the construction phase of capital projects is to have high pre-qualification standards for social performance that encourage prospective bidders to draw on their international experience in similar economic and social host environments. This needs to be combined with rewards for contractor performance against KPIs linked to the project proponent’s own needs for a project-level ‘social license to operate’ and a corporate-level ‘social license for growth’.

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The Social Performance Management Unit of Shell International in London and the programme on Business and Development Performance of the Overseas Development Institute, have collaborated in the preparation of a number of social performance guidance notes. This Briefing Note draws substantially on a longer Shell Guidance Note: ‘Social Performance during Construction: Involving Contractors in Impact Management’.



This series of briefing notes provides information to engineering service companies operating in developing countries. The notes aim to assist contractors to enhance their social performance, be that: to deliver effective management of the negative local social, cultural and environmental impacts of project activities; or extend employment, training, infrastructure and business support benefits to communities and suppliers.