Infrastructure: Too important for business leaders to ignore

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Infrastructure spending could be much more productive, boosting global growth and business efficiency. Corporate leaders should be agitating for change.

Every business leader has a stake in the infrastructure sector. Each executive who passes through an airport or takes a train feels the impact of the sector's efficiency—or deficiency. All companies that ship goods or communicate with clients and customers have an interest in the state of the physical and digital infrastructure that surrounds them. Consumers feel the pain when prices for imported goods increase as a result of bad infrastructure, and exporters suffer as their business opportunities become limited. Good infrastructure drives the productivity of companies; bad infrastructure holds them back.

The business leader who worries about government debt or exchange rates or the viability of the pension system or whether schools and universities are turning out enough skilled people should be similarly concerned about the state of the world's infrastructure. The challenges are huge. Take the poor state of roads in many countries as just one example. In the United States, road congestion is costing the economy an estimated $121 billion a year.[1] The economy of India loses up to $7 billion a year as a result of its roads' poor quality.

Simply to keep pace with anticipated global GDP growth, $57 trillion must be spent on infrastructure over the next 18 years. That's more than the entire worldwide stock of infrastructure on the ground today—and nearly 60 percent more than has been invested around the world over the past 18 years. Tackling maintenance backlogs, future-proofing infrastructure to cope with a potentially changing climate, and meeting development goals such as all-weather roads for transporting goods to market and access to clean water would cost a great deal more.[2]

This huge bill looks prohibitive at a time when many governments are highly indebted and capital is tight. Most discussion is focused on the funding of infrastructure. That debate is necessary but not sufficient. What's also needed

is a dialogue about the way infrastructure is planned, built, and operated—in short, its productivity.

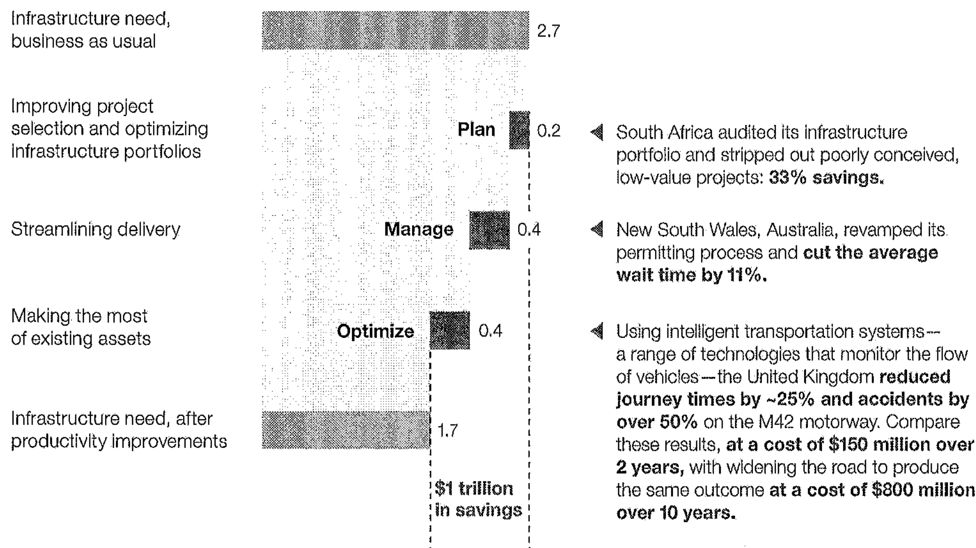
Many examples of best practice around the world could help countries get more infrastructure for less. Insights from over 400 studies show that there is scope to boost infrastructure's productivity and realize savings of 40 percent on the global infrastructure bill, or $1 trillion a year (exhibit). There are three major ways to reap these large cost savings: making better choices about projects to invest in, streamlining their delivery, and making the most of infrastructure that's already in place.

Better choices could save $200 billion a year worldwide. Governments and other stakeholders need to ensure that any proposed project is linked to their economic- and social-development objectives instead of building infrastructure for its own sake. They must also develop their ability to evaluate costs and benefits and to prioritize projects systematically. South Korea's Public and Private Infrastructure Investment Management Center cut the nation's

Exhibit

Raising infrastructure productivity, which is already under way in some countries, could eliminate the need for more than a third of the world's infrastructure spending between now and 2030.

Global infrastructure investment, projected yearly average, 2013–30, $ trillion



Source: McKinsey Global Institute analysis

infrastructure bill by $60 billion (1 percent of GDP) between 1999 and 2006 as a result of rejecting almost half of the projects it reviews, compared with only 3 percent in previous years.

Streamlining delivery could save up to $400 billion a year and accelerate the completion of projects. There is a huge opportunity to speed up approvals and land acquisitions, to structure contracts so that they encourage innovation and cost savings, and to strengthen collaboration with contractors. In Australia, for instance, the state of New South Wales cut approval times by 11 percent in just one year.

Finally, instead of rushing to build new capacity, we can make more of what's already there. This, too, could save $400 billion a year. Intelligent transportation systems that manage road congestion and demand can double or triple an asset's use—typically at a fraction of the cost of adding the equivalent physical capacity (though politicians will sometimes have to persuade voters of the benefits). Smart grids, for instance, could help the United States avoid $2 billion to $6 billion a year in power-infrastructure costs and also reduce the likelihood of outages that cost the economy tens of billions of dollars for each event.

Bringing these opportunities to life will require a radical overhaul of the fragmented way the infrastructure sector works—a root cause of its poor productivity. Mistrust, which tends to center on the issues of financing and construction, hampers some discussions about collaboration between the public and private sectors in the infrastructure sphere. A more productive sector will emerge in the future if its stakeholders accept much broader public–private collaboration that embraces all aspects of the challenge, including planning and delivery. This isn't a pipedream: Chile, the Philippines, South Korea, and Taiwan are developing frameworks that give private players a greater role in planning projects and portfolios. A growing number of unsolicited proposals by private contractors to governments may improve the efficiency of many projects.

Beyond the immediate and direct actions required of public-sector stakeholders and engineering and construction companies, investors can exercise pressure to boost the efficiency and quality of the planning, tendering, and contracting structures of infrastructure projects and of the way they are managed. The reward will be a longer pipeline of bankable and less risky projects. And it's in the interest of all businesses—even those outside the infrastructure sector—to engage proactively with governments so that infrastructure productivity rises. Business leaders of all stripes should be agitating for action in three areas:

- Engage in a broad stakeholder dialogue about the planning of infrastructure projects and hold

governments accountable for their objectives, outcomes, and costs—not just access and availability.

- Vigorously make the case against subsidies—in particular, those for water and energy. Consumers and businesses now relying on them can be supported in more economically efficient ways, and eliminating them won't tilt the competitive field against any particular player, because this move would affect all businesses equally. Removing subsidies clarifies the business case for infrastructure-efficiency measures.

- Support the levying of additional user fees, already used by ports and airports, in road and rail transportation. Such fees can support dramatic productivity improvements. Suitable pricing can not only help finance important maintenance and capacity-extension work but also serves as an important signal of what businesses and consumers are willing to pay for the infrastructure they use.

The opportunity to be smarter about every aspect of infrastructure is huge. The potential savings and the magnitude of the resulting growth dividend make this an issue global business leaders can no longer afford to ignore. o

[1] David Schrank, Bill Eisele, and Tim Lomax, *2012 Urban Mobility Report*, Texas A&M Transportation Institute, December 2012.

[2] For more on this research, read the full McKinsey Global Institute report, *Infrastructure productivity: How to save $1 trillion a year* (January 2013), on mckinsey.com.

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