Impact of socio-political risks on project finance deals: South African case study

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ABSTRACT

The failure to address socio-political risks leads to a lack of infrastructure investment, which is largely supported by project financing. The purpose of this research study is firstly to identify the key socio-political risks associated with project finance deals in South Africa and their effects and, secondly, to identify and recommend mitigating measures or strategies for the identified risks.

To gain deeper insights, an exploratory qualitative study was conducted using semi-structured interviews with thirteen participants (project finance experts and practitioners). The key socio-political risks identified within South Africa were found to originate from Government and Intrastate. Research findings show that Political Risk Insurance as a mitigation measure or strategy is gaining relevance within the South African context. Interestingly, there were no mitigations implemented to address the effects of the sovereign credit downgrade. There were concerns highlighted regarding the effectiveness of a government guarantee and the value of community shareholding as mitigations to socio-political risks within the project finance structure.

Future research studies are recommended; firstly, regarding mitigation measures to address the effects of the sovereign credit downgrade and secondly, a study that focuses on the effectiveness of government guarantees to mitigate political risks.

Keywords
Socio-political risks
Mitigation measures or strategies
Political instability/ uncertainty
Policy uncertainty
Sovereign credit ratings
DECLARATION

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other University. I further declare that I have obtained the necessary authorisation and consent to carry out this research.

____________________________________
Karabo Mokale Ramela
6 November 2017
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CHAPTER 1: PROBLEM DEFINITION AND PURPOSE

1.1. Introduction

Worldwide infrastructure investment and development has a long-term impact on economic growth. Total Global infrastructure investment requirement by 2030 is estimated to range between US$57 trillion and US$67 trillion (Esty, Sesia, & Chavich, 2014)

Historically, investments in infrastructure were funded with public finances. Public deficits, increasing public-debt-to-GDP ratio, public sector’s inability to spend efficiently and misallocation of resources due to political interferences, have led to the public sector’s inability to continue financing infrastructure investment. Due to the lack of capital investment from the public sector, project finance for infrastructure has become more attractive to the private sector (OECD, 2014).

South Africa has embraced project finance in the form of Private Public Partnership (PPPs) projects from as early as 1997 in the national road systems, to prison PPPs in 2000-1 and the most recent Renewable Energy Independent Power Producer Procurement Programme (REIPPPP) (Akintoye, Beck, & Wiley, 2009; export.gov, 2017).

The characteristics of project finance include the financing of the projects on a non-recourse or limited-recourse basis to cash flows on which the financiers place significant reliance (Finnerty, 2013; Grath, 2013).

Literature emphasises the importance of considering socio-political risks situated in emerging markets pertaining to project finance ventures, particularly when the project financing occurs in periods when the prices for raw materials are rising (Esty et al., 2014; Gatti, 2013). Political risks largely arise due to government actions, such as changes in laws which may hinder projects and the expropriation of projects by the host government. The consideration of political risks in project finance creates an incentive for host governments to expropriate projects. However, during periods of fluctuating commodity prices, the incentive to expropriate diminishes and does not disappear but remains a key factor to the host government. Furthermore, developing countries’ GDP is significantly dependant on revenues arising from natural resources.

An applicable case example is the Chad – Cameroon Petroleum pipeline project where the Chad government pressurised the project company to renegotiate the revenue agreement with the government.
Byoun and Xu (2014) describe political risk as government action which hinders a project and results in the private sponsor becoming unwilling to proceed with investing in the project. This in turn results in adverse effects on the economy of the host country caused by divestment in infrastructure investment.

Esty et al. (2014) highlight recent global political risk events emanating from projects in the form of expropriation and change in laws or policies with nationalisation of projects and amending revenue sharing arrangements. Esty et al. (2014) further accentuate that some tools which mitigate political risk in project finance have been reported to be losing their effectiveness and the requirement for innovative solutions given the complex environment and the prominence of political issues.

Esty and Megginson (2001), and Hainz and Kleimeier (2012) also reveal the narrow perspective that studies of political risk have taken, such as the impact of political risks on the loan syndicate structure and participation of development banks. Other project stakeholders require consideration and attention to the enhancement of current mitigation tools and techniques as well as innovative solutions.

1.2. Problem Background
The failure to address significant project finance risks, particularly socio-political risks such as expropriation or change in laws and policies or civil unrest, may result in a lack of investment in infrastructure or projects failing within economies, such as South Africa and consequently having an adverse effect on the development of the country’s economy.

Key social risk factors that impact project finance include terrorism, demonstrations, riots and insurrection by the project’s host society (Khattab, Anchor, & Davies, 2007). Key political risk factors that impact project finance are categorised into investment risks, change-in law risks and quasi-political risks (Gatti, 2013).

The strength of the project rests on its ability to service debt obligations and provide an attractive return to the equity investors (Finnerty, 2013; Grath, 2013). Gatti (2013) emphasises that the funding priority should not rest on the soundness, credit worthiness and collateral provided by sponsors. Priority largely rests on the project’s ability to service and repay its debt and to reward the project sponsors’ capital invested coherently with the risk profile of the project.

In a Master in Business Administration research project, Rezvanian (2013) studied the process of extracting risks and relevant allocation and mitigation methods for financing cross-border projects and concluded that there is a wide gap between what has been
informed by theory and the advice given by practitioners to mitigate different risks of cross-border financed projects. This was largely due to different tools utilised, different country’s laws and regulations involved, different companies (private or state-run) and different structures used to organise project teams. Most interview respondents (project finance experts and practitioners) stated that political or sovereign risks are one of the most significant risks in projects.

Socio-political risks manifesting will not only have an adverse effect on the project in the form of losses for equity investors but also lead to loan defaults for lenders and the host country’s economy suffering as a result. Recent examples of political risk events occurring in project finance deals include nationalisation of projects such as the Chad – Cameroon pipeline and Repsol, Argentina’s largest energy firm (Esty et al., 2014).

Within a South African context, an example of socio-political risks displayed includes Eskom (the state-owned power utility) refusing to sign Power Purchase Agreements for awarded bids in rounds 3.5, 4 and 5 of Renewable Energy Independent Power Producer Procurement Programme (REIPPPP), which resulted in delays and adverse effects on the economics of the project (Yelland, 2017b). Another example refers to the Draft Integrated Resource Plan (2016) which was gazetted by the (Department of Energy, 2014). One of the areas of significant public interest with regards to this document is the energy mix, within which has resulted in negative reports in the media (Lilley & Yelland, 2017; Yelland, 2017a).

1.3. Problem Statement
The failure to mitigate socio-political risk results in a lack of infrastructure development and an adverse effect on the country’s economy. Given the importance of addressing socio-political risks in project finance deals and a narrow perspective of study undertaken in current literature, a deeper understanding of the impact of socio-political risks within an evolving South African context is required, together with associated mitigating tools or strategies.

1.4. Research Motivation
The need to conduct this study is substantiated by the significance of socio-political risks within a project finance context, which is critical in deciding whether to engage in a particular project within emerging markets (Okanlomo, 2016). The significance thereof is further extenuated by the evolving socio-political landscape in South Africa.
Rezvanian (2013) also concluded in his research project on project finance that there is a wide gap in risk mitigation between what is informed by theory and the advice given by practitioners to mitigate different risks of cross-border projects.

The need for more research is further highlighted by a study led by Professor Esty of Harvard Business School, which mentions that some of the tools used to mitigate political risk have been gradually losing their effectiveness (Esty et al., 2014). This study continues by stating that there is a need for more innovative solutions to be developed to counter an increase in inexperienced players and the burgeoning, complex environmental and political issues.

From an academic perspective, it is critically important to highlight the limited literature which pertains to socio-political risks in project finance and, moreover, limited research into South Africa’s evolving socio-political landscape. The existing research pertaining to socio-political risks in project finance by Esty and Megginson, (2001) and Hainz and Kleimeier (2012) is focused on a narrow lenders’ perspective and is reactionary in nature by assessing the impact of loan syndicate structures and participation of development banks as a response to socio-political risks.

This study will thus not only contribute to the body of research globally in project finance as an area of finance, it will also contribute within a local context to both practice and academia given the existing disparity between theory and practice in project finance.

1.5. Research Scope

Following from the introduction of the research problem and the related motivation for research, this study focuses on the impact of socio-political risks on project finance deals. The selected context is South Africa, which comprises of the following:

- South African-based projects with foreign entities participating in the project structure
- South African-based projects with local entities participating in the project structure

Given that political risks differ from project to project, from one country to another and change over time, it is, in practice, difficult to achieve a general understanding of the risk and its impact on firms (Khattab et al., 2007; Kwak, Chih, & Ibbs, 2009).
This motivates for a more feasible scope, in a South African context, for this study, which is coupled with consideration towards the confidential nature of the project information.

1.6. Research Objective
The overall objectives of this research comprise of the following:

- To identify key socio-political risks associated with project finance deals in South Africa and their effect
- To identify and recommend mitigating measures or strategies for the identified socio-political risks.
CHAPTER 2: LITERATURE REVIEW

2.1. Introduction
This section sets out to describe and define project finance and project risks that are associated with project finance. The subsequent sections of this chapter move to discuss the theory and literature review of socio-political risks within a South African context and within project finance.

2.2. Project Finance

2.2.1. Defining Project Finance
The Basel Committee on Banking Supervision (2015) and Grath (2013) relate project finance to larger projects (private- or public-sector-driven), such as factories, power plants, larger construction or infrastructure projects, and to some which are of national interest in the buyer’s country. The feasibility or bankability of the projects are generally to a high degree based on the revenues of the project itself, mostly secured by their assets and less by the creditworthiness of the buyer, as this party is frequently only a single-purpose company or a partnership with limited equity (Finnerty, 2013; Grath, 2013; The Equator Principles Association, 2011; Weber, Staub-Bisang, & Alfen, 2016; Yescombe, 2013).

Gatti (2013) and Weber et al. (2016) further explain project finance along the following five distinctive features:

1) A project company or special purpose vehicle (SPV) is established to be financially and legally independent from project sponsors.

2) Lenders have limited or no recourse to the sponsors.

3) Project risks are allocated between parties in the transaction, with the objective of allocating to those with the best fit to manage and control the allocated risk(s).

4) Cash flows from the SPV must be sufficient to cover operations and debt service payments. Only after covering these costs will funds be availed to distribute dividends to sponsors.

5) Sponsors give collateral to lenders in the form of security for receipts and assets linked to managing the SPV.
Yescombe (2013) adds the following to these five features of project finance by incorporating the long construction and operating periods supported by long-term financing, which is generally more debt than equity and results in high leverage (usually 70-90% of project’s capital costs), reducing the overall financing cost of the project.

To summarise the above definitions and features, project finance relates to large projects, which are broadly infrastructure related. Capital raising for these projects is on a non-recourse or limited recourse basis and the strength of the project rests on its ability to service debt obligations and provide an attractive return to the equity investors.

### 2.2.2. Importance of Project Finance

The prominence of project finance in the form of PPPs, which require private sector involvement, emanated from the post-world war period and the outcome of the global financial crisis in 2007/8 that placed the public sector under more pressure to reduce public sector debt while meeting their infrastructure development requirements (Demirag, Khadaroo, Stapleton, & Stevenson, 2011; Grimsey & Lewis, 2002).

Esty (2003) describes agency cost, debt overhang and risk management as the key factors which motivate for the use of project finance in projects and elaborates these motivating factors as follows:

- **Agency cost:** Large tangible assets with high free cash flows are susceptible to costly agency conflicts. The project company structure, which isolates the asset, in project finance applies joint ownership and high leverage to discourage costly agency conflicts among participants.

- **Debt overhang cost:** Project finance solves the leverage-induced underinvestment by allocating project returns to new capital providers in a way that cannot be replicated using corporate debt.

- **Risk management:** The project company structure in project finance reduces the possibility of risk contamination, where a failing asset drags project sponsor into distress.

Approximately 158 project finance deals with a total debt of US$59 billion (3% only of the global total) have been implemented in Sub-Saharan Africa between the period 2003 to 2013, which represents a small portion of the global project finance market (globally over 5,000 projects raised US$2 trillion) (Dornel, 2014).
Given the abovementioned points, which highlight the importance of infrastructure development to the global economy and the significance of project finance as means to deliver those infrastructure requirements, the Banking Association of South Africa (2016) further reported that investment and finance for infrastructure development is crucial for the economic growth of South Africa, indicating that a 1% increase in infrastructure will increase long-term GDP by 1.3% and employment by 0.7%.

2.2.3. Structure of Project Finance deals
The key features of project finance are highlighted by Gatti (2013), Weber et al. (2016) and Yescombe (2013), mainly referring to the standalone nature of the project company as an SPV, the limited or non-recourse nature of the debt financing and risk allocation among the project parties is highlighted in Figure 2.1 by the number of contracts and arrangements that are typically in place within the project finance structure.

*Figure 2.1. Typical project finance structure*

![Diagram of typical project finance structure](source: World Bank Group, 2016)
2.3. Project Finance Context in South Africa

South Africa embraced project finance in the form of PPPs from as early as 1997 in the national road systems (N3 and N4 toll roads); to two prison PPPs and tourism concession for the South African National Parks in 2000-01 (Akintoye et al., 2009). Notable milestones of project finance activities include the Gautrain Rapid Rail Link Project and the South African REIPPPP.

The concession of the Gautrain Rapid Rail Link Project was awarded to Bombela Concession in 2005 following a bidding process, with lenders (Standard Bank and Rand Merchant Bank) committing to fund R3.1 billion to the project and operations commencing on 8 June 2010, which was in time for the 2010 FIFA World Cup (Gautrain, 2017).

An update provided by the Independent Power Producers Office (IPP Office, 2016) to stakeholders of REIPPPP reported that against the backdrop of global commitments by countries at the United Nations Convention on Climate Change, the South African government established the Integrated Resource Plan 2010, which provided the country’s preferred energy mix to meet electricity requirements until 2030 and informed Ministerial decisions determining energy capacity, which comprises 14 725 Megawatts (MW) for Renewable Energy Independent Power Producers (IPPs) and 15 390 MW for Non-Renewable Energy IPPs. The IPP Office (2016) further reports that the following milestones regarding REIPPPP from 2011, being the first round of the programme to date 64 projects accounting for 4 006 MW across four bid windows (rounds 1,2,3,3.5) have been procured.

2.4. Project Finance Risks

2.4.1. Risk Identification

In project finance, Yescombe (2013) broadly categorises project risks. Firstly, into commercial risks, which are those inherent in the project itself, or the market in which it operates; secondly, macro-economic risks, which relate to external economic effects not directly related to the project (i.e. inflation, interest rates and currency-exchange rates) and thirdly, regulatory and political risks, which relate to effects in government action or political force majeure events such as war and civil disturbance.

Risk identification of project risks may be conducted in many ways. From risk checklists with categorisation of the project risks into three levels (macro, meso and micro) to another method that follows a more intuitive approach by identifying project risks based on the different phases within the project life cycle (construction, operational phase, as
well as risks common to both phases) (Bing, Akintoye, Edwards, & Hardcastle, 2005; Gatti, 2013). The latter method, which categorises project risks into macro, meso and micro levels, explains each level as follows: the macro level is often associated with political and legal conditions, economic and social conditions; the meso level includes risk events occurring within the system boundaries of the project and the micro level comprises largely of risks emanating from stakeholder relationships. Table 2.1 details the risk factors at each level with related examples.

**Table 2.1**  
*Adapted categorised catalogue of project risk factors*

<table>
<thead>
<tr>
<th>Risk meta-level</th>
<th>Risk factors and examples</th>
</tr>
</thead>
</table>
| **Macro level risks** | **Political and government policy**  
Expropriation or nationalisation of assets; Poor public decision-making process  
**Macroeconomic**  
Poor financial market; Inflation/ Interest rate volatility  
**Legal**  
Legislation change; Change in tax regulation  
**Social**  
Level of public opposition to project; Lack of tradition of private provision of public services  
**Natural**  
Force majeure; Geotechnical conditions |
| **Meso level risks** | **Project selection**  
Land acquisition; demand level for project  
**Project finance**  
Availability of finance; High finance costs  
**Residual risk**  
Residual risk  
**Design**  
Design deficiency; Unproven engineering techniques  
**Construction**  
Construction time delays and cost overruns  
**Operation**  
Low operating productivity; Operational cost overrun |
| **Micro level risks** | **Relationship**  
Organisation and co-ordination risk  
**Third party**  
Third party liability; Staff Crises |

Source: (Bing et al., 2005)
2.4.2. Risk Allocation

Project finance arrangements are largely founded on the transfer of risks between the public and private sectors. The transfer of risks to the private sector is accompanied by a profit incentive, while the principal objective of the public sector is to achieve value for money in the services provided by the project (Grimsey & Lewis, 2002).

Gatti (2013) emphasises the importance of risk identification and risk mitigation. He further describes three basic strategies that the project company can put in place to mitigate the impact of a project risk:

1) Retain the risk - A firm usually tries to implement internal procedures for the control and prevention of the risk.

2) Transfer the risk by allocating it to one of the key counterparties – In this way each player has the incentive to respect the original agreement to avoid the negative effects determined by the emergence of the risk in question.

3) Transfer the risk to professional agents whose core business is risk management (insurers). Some risks are so remote or so difficult to address that any one of the project counterparties is open to bear them.

The second strategy (allocating project risks to key counterparties) is stated by Gatti (2013) to be the cornerstone of project finance design. It is an intuitive principle which allocates rights and obligations of the SPV using key contracts and agreements as effective risk management tools.

Research by Bing et al. (2005) conducted to explore the preferences in risk allocation within the UK’s project finance construction projects, refers to risk allocation as a primary measure of assignment between the projects’ direct participants, that is, between the public and private sector and excludes the end-users. If both parties bear a certain risk outcome together this is called a shared risk allocation mechanism.

Kwak et al. (2009) conducted an analysis of PPPs over a 20-year period where they concluded that risk allocation strategies in practice vary from project to project and from country to country; generally, governments would retain risks associated with the environment within which the project is located, while some would be allocated to private sector and others shared by both public and private sectors.

In summation of the above literature, allocation of the identified project risks to appropriate parties is critical in ensuring that the project remains viable for both public and private sector players. It is also important to note that risk allocation should be
done on a case-by-case basis as the significance of project risks differ from one project to the next.

2.5. Socio-Political Risks

2.5.1. Defining Socio-Political Risks
Socio-political risks broadly comprise of both social and political dynamics. These dynamics have increasingly affected the sustainability of infrastructure projects and forced decision-makers involved in projects, such as within the Keystone XL pipeline in North America, the Belo Monte Dam in Brazil and the Bujagali Dam in Uganda, to change their plans because of opposition of a socio-political nature (Naderpajouh, Mahdavi, Hastak, & Aldrich, 2014).

This section defines both dynamics individually and provide context to socio-political risks within project finance and discusses literature in project finance pertaining to socio-political risks.

2.5.2. Social Risks
Social risks broadly comprise aspects relating to human rights, labour rights, consumer protection and local communities (Weber et al., 2016).

In a research study into understanding and managing risks in large engineering projects, Miller and Lessard, (2001) term social risk as social-acceptability risks. Social-acceptability risks refer to the prospect of opposition that the project will face emanating from local groups, economic-development agencies and influential pressure groups.

Cohen, Reichl and Schmidthaler (2014) highlight social risks in several projects stemming from local resistance or discontent, which in many cases are significant barriers to infrastructure investment and development. Within a project finance context Cohen et al. (2014) expand social risks from the perspective of acceptance by the community at large. The application of the definition is not in terms of actions taken by residents or lack of opposition, but rather on the set of outcomes and aspects which leaves the local community in a better position than it was before the project completion. Examples of outcomes which are perceived to be “negative” include safety concerns, noise, pollution, diminished views, landscape destruction and procedural injustice. Examples of “positive” outcomes are economic development, energy supply security, greening benefits, community compensation, personal compensation and
procedural justice. Project parties will have an incentive to reach social acceptance through the most cost-effective means. This is likely to put monetary compensation as a last resort and prioritize changing elements of the project or promoting positive aspects of the project on residents.

In summary, interpretations of social risks within a project finance context based on the above literature review, given the long tenor of the project finance, buy-in or support from society is important for sustainability of the project.

2.5.3. Political Risks

Political risks relate to political force majeure, which become apparent in the form of political violence affecting the project, e.g. war, terrorism or civil unrest and investment risks that mainly affect cross-border project investments, change in law and quasi-political risks. Yescombe, (2013).

In their study of the evaluation and management of China’s political risks in project finance, Shou Qing Wang, K Tiong, Ting and Ashley (2000) describe political risk as the risk of government actions, at central, provincial and local government level, that may endanger a project. Government actions include changes in laws and policies, corruption and expropriation or nationalisation of the project without compensation.

Political risk can be government actions called ‘regulatory takings’ imposed in various forms: e.g., the local government may force the project company to pay higher taxes or to lower prices (e.g. highway tolls), or impose restriction on transferability of cash flows. Consequently, the private sponsor may be unwilling to go ahead by itself (Byoun & Xu, 2014).

Gatti (2013, p. 55) further categorises political risk into the following:

i. Investment risks – Relating to limitations on the convertibility or transfer of currency abroad. Other examples include the host government’s expropriating a plant without paying an indemnity, or nationalising a plant, or the breakout of war, revolt, or civil war.

ii. Change-in-law risks – Any modification of legislation that can hinder project operations.
iii. Quasi-political risks – Includes all disputes and interpretations regarding contracts already in place that emerge from a political, regulatory, or commercial background.

2.5.4. South African context

This section looks at the sovereign credit downgrade and socio-political instability as aspects that highlight and contribute to South Africa’s evolving socio-political landscape.

2.5.4.1. Sovereign Credit Downgrade

Sovereign Credit Ratings are measures of relative likelihood that a government will default on its financial obligations (Cantor & Packer, 1996). Not only do the credit ratings ease access to international capital markets for the sovereign, it also affects the ratings of entities within the same country (Larraín, Reisen, & Von Maltzan, 1997).

In their seminal work Richard Cantor and Frank Packer, with the objective of understanding the determinants and impact of sovereign ratings, describe the factors that underlie the determined sovereign credit rating by agencies (e.g. Moody’s, S&P and Fitch) to incorporate social, economic and political factors (Cantor & Packer, 1996). Thus, outcome of a sovereign credit rating does reflect socio-political risk factors within a country.

Consideration and relevance of socio-political risks originating from a sovereign credit rating emanates from events that occurred within South Africa where rating agencies S&P and Moody’s downgraded South Africa in April and June of 2017 respectively (Trading Economics, 2017). Rating downgrades are known to raise the cost of debt and result in reduced or reprioritised investments and lower reliance placed on credit markets for financing (Almeida, Cunha, Ferreira, & Restrepo, 2017; Larraín et al., 1997).

2.5.4.2. Socio-Political Instability

Income inequality increases socio-political instability and ultimately decreases investments (Alberto & Perotti, 1996), given that income inequality is viewed as a proxy for socio-political risks within a country.

From 1993 to 2008 South Africa’s income inequality increased (Leibbrandt, Finn, & Woolard, 2012) and currently South Africa has one of the highest levels of income
inequality (OECD, 2016). This in turn highlights socio-political instability and the extent of socio-political risks within a South African context.

2.5.5. Literature on socio-political risks in project finance

2.5.5.1. Syndicate Structure in relation to socio-political risks

Based on research by Esty and Megginson (2001), which was conducted as a quantitative study on 495 tranches spanning the period beginning in 1986 and ending in 2000 from 61 countries amounting to a total value of US$151 billion. Esty and Megginson (2001) view political risk as a proxy for a costly default due to either strategic or liquidity reasons and explain that syndicate structure is caused by both debt concentration and syndicate size. The study concluded that syndicate structure is a function of political risk.

It is important to note that the Esty and Megginson (2001) study was focused on an aspect of project finance deals, being the aspect of project lending and the composition of the loan syndicate as a response to the political risks pertaining to the project.

2.5.5.2. Development Banks within Syndicate Structures and socio-political risks

Hainz and Kleimeier (2012) conducted a study on how political risk influences the choice between project finance and full-recourse loans and the syndicate structure of these loan contacts. It was concluded that in politically risky countries, project finance loans are more likely to be used and development banks are more likely to participate in loan syndicates. Furthermore, Hainz and Kleimeier (2012) remark that development banks stretch their political umbrellas over projects.

Similarly, to Esty and Megginson’s (2001) study, Hainz and Kleimeier (2012) are narrowly focused on the participation of a specific type of lender in the loan syndicate in projects within politically risky projects.

2.5.6. Socio-political risks: project finance context

Political risks in a wider context contain societal, political and legal dynamics (Khattab et al., 2007; Naderpajouh et al., 2014).

Using Gatti’s (2003) categorisation of political risk, an example of civil unrest (political force majeure), which falls into the investment risks category highlights socio-political
risks emanating from a societal aspect. Thus, political risks and socio-political risks will be referred to synonymously in conducting this study.

Khattab et al. (2007) further argue the best approach to understanding the concept of political risk is to classify events according to their source in Table 2.2 below, which groups threats or risk factors according to their respective sources being, host government; host society and intrastate/interstate.

**Table 2.2**

*Political threats (risks) linked to the source of threats (risks)*

<table>
<thead>
<tr>
<th>Source of threats</th>
<th>Threats</th>
</tr>
</thead>
</table>
| 1) Host government | Expropriation or confiscation  
Contract repudiation  
Currency inconvertibility  
Ownership and/or personnel restrictions  
Taxation restrictions  
Import and/or export restrictions |
| 2) Host society | Terrorism  
Demonstrations, riots and insurrection  
Revolutions, *coups d'état* and civil wars |
| 3a) Intrastate | Threats from inter-governmental institutions |
| 3b) Interstate | Wars  
Sanctions |

Source: (Khattab et al., 2007)

### 2.5.6.1. Examples of socio-political risks manifesting in project finance deals

Prior to the Global Financial Crisis in 2007-8, project companies in the Oil and Gas sector were confronted by socio-political risks emanating from host governments. Examples include the US$4 billion Chad–Cameroon Pipeline project in which the Chad government pressurised the project company to renegotiate their revenue agreement and the US$20 billion Sakhalin II oil and gas project in Russia during 2001, which forced the project company to relinquish a significant stake to a state-backed gas group (Esty et al., 2014).
An example from within the African continent outside of the oil and gas sector, which was due to social opposition, is the Bujagali Dam project in Uganda (Naderpajouh et al., 2014). The project is a 250MW hydropower generation facility with a separate but associated interconnection project and the socio-political risks that arose resulted from social and cultural issues that affected the communities around the project, e.g. unresolved resettlement, compensation issues and inadequate consultations (IRM Compliance Review Panel, 2008).

A South African example of socio-political risks is currently highlighted with Eskom (State Owned Power Utility) refusing to sign Power Purchase Agreements for awarded bids in rounds 3.5, 4 and 5 of REIPPPP, which delays and affects the economics of the project (Yelland, 2017b). Another current example for South Africa is in the Draft Integrated Resource Plan 2016, which was gazetted by Department of Energy, (2014). The Draft Integrated Resource Plan 2016 replaces the Integrated Resource Plan 2010 referred to under section 2.3 of this study. One of the areas of significant public interest with regards to this document is the energy mix, within which has resulted in negative reports in the media (Lilley & Yelland, 2017; Yelland, 2017a).

2.5.6.2. Mitigating measures or strategies for socio-political risks in project finance

Socio-political risks are a critical consideration in project finance, thus suitable mitigating frameworks should be implemented (Esty et al., 2014; Okanlomo, 2016; Rezvanian, 2013).

Table 2.3 summarises the mitigation measures or strategies for socio-political risks in project finance. The most common mitigations are through political risk insurance, direct agreements with host governments and government guarantees.

Despite the commonalities highlighted in Table 2.3, it is also important to emphasise the fact that studies by Esty and Megginson (2001) and Hainz and Kleimeier, (2012) were respectively studies of responses to the significance of socio-political risks in the form of the lenders’ syndicate structure and the participation of development banks within the project structure.
### Table 2.3

*Consolidated literature on mitigations to socio-political risk in project finance*

<table>
<thead>
<tr>
<th>Literature Title and Author(s)</th>
<th>Mitigation measures or strategies to socio-political risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principles of Project Finance  &lt;br&gt;(Yescombe, 2013)</td>
<td>Political Risk Insurance, Guarantees and Government Support Agreements</td>
</tr>
<tr>
<td>Project finance in theory and practice: designing, structuring and financing private and public projects  &lt;br&gt;(Gatti, 2013)</td>
<td>Political Risk Insurance and Direct Agreements with Host governments</td>
</tr>
<tr>
<td>Modelling Social Opposition to Infrastructure Development  &lt;br&gt;(Naderpajouh et al., 2014)</td>
<td>Application of the proposed interactional model, which focuses on the power dimensions of interactions</td>
</tr>
<tr>
<td>Risk management in project finance: A financier’s assessment framework  &lt;br&gt;(Okanlomo, 2016)</td>
<td>Political risk insurance and other types of guarantees</td>
</tr>
</tbody>
</table>
| Evaluation and Management of Political Risks in China’s BOT Projects  <br>(Shou Qing Wang et al., 2000) | 1) For Change in Law: Government Guarantees in tariff adjustments or extension of concession period.  
2) For delay in approvals: Establish one-stop agency for approvals  
3) For expropriation risk: combination of international financing and insurance policies |

### 2.6. Conclusion of Literature Review

This literature review has highlighted the role of project finance in infrastructure development; the significance of socio-political risks within the project finance context; and disparity in project risk mitigation, particularly of socio-political risks, between theory and practice.
CHAPTER 3: RESEARCH QUESTIONS

3.1. Introduction

This chapter draws on the purpose of the study explained in Chapter 1 as well as the different themes arising from the literature reviewed in Chapter 2.

Literature in project finance by Gatti (2013), Khattab et al. (2007) and Yescombe (2013) includes risk events emanating from the project’s host society, such as terrorism, demonstrations, riots and insurrection as elements of political risk. Thus, the term socio-political risk is applied in this research study to ensure that the audience reflects on both social and political risk factors.

Based on the review of current literature, limited research has been carried out on project finance specifically focusing on South Africa (Rabinowitz, 2008). A research study by Rezvanian (2013) which focused on the risk allocation and mitigation methods for financing cross-border projects indicated that political risks are crucial in cross-border project financing. The study concluded that researchers should assess these risks and identify suitable mitigation frameworks that should be considered by South Africa (Rezvanian, 2013).

Another study by Hainz and Kleimeier, (2012) focused on political risk in project finance only insofar as the participation of development banks within the project lending syndicate structure. Both studies reveal the requirement to understand political risk as far as mitigation is concerned and the need to understand political risk beyond specific financiers, in this case development banks.

Esty et al. (2014) highlight that some tools to mitigate political risk in project finance are losing effectiveness as a requirement for innovative solutions given the complex environment and the prominence of political issues.

Furthermore, a great amount of literature has focused on multiple political risk variables which may affect the economic growth of a country or the amount of investment in that country, concluding that democracy and levels of political violence do not indicate the real political risk to investors (Demirag et al., 2011; Okanlomo, 2016). The reviewed literature further challenges researchers to consider the properties of the political system that are relevant to private sector-driven growth, meaning that they must look at the political variables that are important in making an investment decision, which variables are crucial to the investment decision, the success of the project and risks that are under the influence of the financier (Demirag et al., 2011; Okanlomo, 2016).
Another study by Hainz and Kleimeier, (2012) focused on political risk in project finance only insofar as development banks participated in the project lending syndicate structure. Both studies reveal the requirement to understand political risk as far as mitigation is concerned and the need to understand political risk beyond specific financiers, in this case development banks.

Therefore, this research study seeks to identify the key socio-political risks that affect project finance from the investment decision phase, throughout the entire project lifecycle and to also use the identified socio-political risks to come up with a mitigation framework that can be applied in project financing in South Africa. The aim is to address the gap in the literature that was explained above, and this will be achieved by answering the below research questions:

3.2. Research Question 1
What are the main socio-political risk factors that affect project finance in South Africa?

The aim of research question 1 is to understand the main socio-political risks that affect project finance in South Africa. As mentioned in Chapter 1, project finance is one of the mechanisms that can be used for infrastructure development, economic growth and for creating employment in South Africa (Demirag et al., 2011; Okanlomo, 2016). This research question will further examine socio-political risks that affect project finance from the investment decision phase, throughout the entire project cycle of the project.

3.3. Research Question 2
How are socio-political risk factors affecting project finance in South Africa?

Research question 2 seeks to investigate how and the extent to which, socio-political risks affect progress in infrastructure development supported by project finance (Dornel, 2014). This research question will further determine the perception of financiers of the political risks in South Africa and the extent to which political risks affect project finance with focus on recent changes in South African economical space.
3.4. Research Question 3
What are the mitigation measures that can be applied to mitigate socio-political risks?

Research question 3 aims to understand how socio-political risks are assessed and the strategies applied to mitigate those risks. The result of this research question will be the development of a mitigation framework that can be applied in the process of project finance as recommended by Esty et al. (2014) and Rezvanian (2013) that future research should focus on the assessment of political risks and identify suitable mitigation frameworks that should be considered in South Africa.
CHAPTER 4: RESEARCH METHODOLOGY

4.1. Introduction
This chapter provides an overview of the methodology applied in this research. Chapter 2 gave the theoretical basis for this research, further informing the basis for the interview questions and Chapter 3 gave an overview of the research questions. Research in business is important because it gives insight into the state of implementation of a specific topic in business practice (Zikmund, Babin, Carr, & Griffin, 2013). The findings of this research will help business to make more informed decisions thus ensuring that organisations remain relevant and competitive (Zikmund et al., 2013). To ensure the credibility of the research, the researcher followed the literature on the best available methodologies to be applied for the research topic. The scientific approach of the research must be impartial, structured and robust (Zikmund et al., 2013).

This research applied a qualitative method to assess the impact of socio-political risks in project finance within South Africa. Zikmund et al.(2013) defines qualitative research as a methodological approach that gains understanding through views or ideas, motivations and fundamental explanations using non-numerical information. Qualitative data analysis involves conducting research in a manner of asking questions and applying an approach that is tailored to the specific problems. It involves the examination of unquantifiable data to reach a conclusion, through the analysis of data. The main advantage of applying this method of analysis is that the participants were free to answer open-ended questions, allowing further probing for clarification (DeLyser & Sui, 2013). Participants also had the ability of responding to questions using their own words rather than forcing them to adhere to fixed responses (DeLyser & Sui, 2013). Open-ended questions are meaningful because they induce responses and are illustrative in nature.

According to Saunders and Lewis, (2012), there are three main types of research, namely descriptive, exploratory and explanatory research. This research study applied the exploratory approach. Exploratory studies aim to gain insight on a specific topic and seek to understand a new perspective on that topic. This type of research involves gathering new information through either literature in the form of secondary data or gathering new data through interviews in the form of primary data (Saunders & Lewis, 2012). The rationale for the selecting a qualitative research design is provided next.
4.2. Research Methodology and Design

Exploratory research is about discovering general information about a topic that is not understood clearly by the researcher (Saunders & Lewis, 2012). As this study explored the impact of socio-political risks on project finance transactions, a qualitative research design provides a deeper understanding into the various aspects of the risks associated with project finance transactions.

A qualitative research design was appropriate for this study because it addressed the following research needs relating to this topic. Firstly, the findings in the literature review reveal studies on the impact of socio-political risks in project finance which were conducted from a narrow perspective, that is, from a lender's perspective and more specifically on the impact of socio-political risk on the loan syndicate structure and participation of development banks. Secondly, the study allowed the researcher to gain insight into current mitigation tools and any innovative solutions applied in practice with regards to addressing socio-political risks.

The primary goal of qualitative research was to gain an understanding of a complex phenomenon in a natural context and the generation of new questions, hypotheses, or theories (Suter, 2012). Saunders and Lewis (2012) describe qualitative data as non-numerical data categorised into text and non-text data (e.g. audio, images and video). The suitability of the design is largely substantiated by the inherent sensitivity of project finance information. Rezvanian (2013) also motivates for a qualitative exploratory research approach to be a suitable approach due to the need for insight into expert knowledge in the field of project finance.

This research study thus applied a qualitative inductive approach by taking from the views and opinions of experts and practitioners in project finance.

According to Saunders and Lewis, (2012), there are three ways of conducting an exploratory study, which are:

- searching for academic literature,
- interviewing experts in the subject and
- conducting interviews
Thirteen semi-structured interviews with project finance experts and practitioners were conducted. The interviews comprised open-ended questions to test the research questions pertaining to this study. Invitations were sent to more than twenty potential participants. Thirteen as a number of interviews is sufficient, given that according to Szulanski, Bowman, Winter, Grant, Spender, Kogut, & Argote (1999) saturation is reached from twelve interviews.

The relationship between the research problem, research questions, literature reviewed, data collection and analysis methods has been reflected in the consistency matrix (Appendix 1).

4.3. Research Approach

Due to the inherent sensitivity of project finance information, semi-structured interviews with the thirteen project finance experts and practitioners were to record their views on socio-political risks, mitigation methods applied and information for future research and application in Project Finance.

An overview of the process pertaining to the interviews is highlighted below:

i. Participants were selected using snowballing techniques through a network of acquaintances.

ii. Participants were contacted with context provided on the research together with consent letter and confirmation of their participation.

iii. Appointments were confirmed with participants that agree to partake in the research.

iv. All interviews were conducted on an individual basis as opposed to groups to encourage participants to express their perspectives.

The informed consent letter and interview schedule for all interviews are included in Appendix 2 and 3 respectively.

4.4. Population and Unit of Analysis

Saunders and Lewis (2012) define a population as a complete set of group members. According to Creswell, (2012), the researcher has to identify the study population that provides information in the form of answers to the research questions. Zikmund et al. (2013) defines population as any complete group of organisations that share common traits. A population does not necessarily have to consist of people, but can also be a
set of organisations or institutions or places. The population for this study is defined as project finance practitioners and experts in South Africa who are exposed to project finance transactions or have been involved in project finance transactions within the last five years.

The unit of analysis for this study were the opinions and views of the participants who were interviewed on the impact of socio-political risks on project finance transactions. It was expected that the insights gained from these participants would fulfil the objectives of the research as identified in Chapter 1 and enable the assessment of the impact of socio-political risks in project finance within a South African context using semi-structured face-to-face interviews.

4.5. Sampling method and size

The selected sample was based on purposive sampling to get a particular representation and account of the views or opinions of the person being interviewed (Silverman, 2006). The sample in this study was drawn from the population of the individual experts and practitioners of project finance in South Africa.

Purposive sampling was chosen as it is the most regularly used form of non-probability sampling to collect qualitative data. Individuals who were chosen to participate in the interviews were identified on the basis that they were well positioned to answer the research questions and met the research objectives (Saunders & Lewis, 2012). Moreover, the chosen individuals had personal experiences to share (Creswell & Poth, 2017) as they had experience in project finance transactions.

The sample selection was purposive in nature and implemented across financiers, e.g. bankers and investors. Furthermore, they were selected for the following reasons; (i) project finance structures are generally highly leveraged at 70-90% (Yescombe, 2013), thus the relevant deal experience within the country is centralised in their favour; (ii) their source of funding is from both domestic and international capital markets, which influences their decision making within project finance deals; (iii) their involvement in the project spans from making the investment decisions and throughout the project life cycle and (iv) the roles of the selected sample within project finance deals in SA spans across financing (debt, equity, mezzanine) and giving advice.

To determine the appropriate participants to interview, the participants’ current position and project finance experience as experts and practitioners in the South African environment was considered. All the participants were required to have project finance experience of five (5) years or more.
The sample selection was purposive in nature and was made across four different sector groupings pertaining to project finance within South Africa, which comprised Power and Infrastructure, Mining and Manufacturing, Oil, Gas, and Transport, Information and Communication Technologies.

The number of participants who represented each sector grouping and their respective positions and gender are represented in Table 4.1 below.

<table>
<thead>
<tr>
<th>Sector Groupings</th>
<th>Positions</th>
<th>Number of participants</th>
<th>Gender of participants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Power and Infrastructure</td>
<td>Executive: Power and Infrastructure Finance</td>
<td>1</td>
<td>Male</td>
</tr>
<tr>
<td></td>
<td>Executive: Power and Infrastructure Finance</td>
<td>1</td>
<td>Female</td>
</tr>
<tr>
<td></td>
<td>Senior Transactor: Infrastructure Finance</td>
<td>1</td>
<td>Male</td>
</tr>
<tr>
<td></td>
<td>Executive VP: Power and Infrastructure Finance</td>
<td>1</td>
<td>Male</td>
</tr>
<tr>
<td>Mining and Manufacturing</td>
<td>Senior Deal Maker: Basic Metals and Mining</td>
<td>1</td>
<td>Male</td>
</tr>
<tr>
<td></td>
<td>Deal Maker: Basic Metals and Mining</td>
<td>1</td>
<td>Male</td>
</tr>
<tr>
<td>Oil and Gas</td>
<td>Senior Project Development Manager: Basic and Speciality Chemicals</td>
<td>1</td>
<td>Female</td>
</tr>
<tr>
<td></td>
<td>Deal maker: Basic and Speciality Chemicals</td>
<td>1</td>
<td>Male</td>
</tr>
<tr>
<td>Transport, Information and Communication Technologies</td>
<td>Principal - Infrastructure (Transport, Logistics, ICT) and Private Equity</td>
<td>1</td>
<td>Male</td>
</tr>
<tr>
<td>Various Sectors</td>
<td>Transactor VP: Project Finance</td>
<td>1</td>
<td>Male</td>
</tr>
<tr>
<td></td>
<td>Senior Credit Analyst</td>
<td>1</td>
<td>Male</td>
</tr>
<tr>
<td></td>
<td>Chief Credit Officer</td>
<td>1</td>
<td>Male</td>
</tr>
<tr>
<td></td>
<td>Associate Principal: Direct Investments</td>
<td>1</td>
<td>Female</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>13</td>
<td></td>
</tr>
</tbody>
</table>

Various communication methods were used to contact the project finance experts and practitioners to request interviews with them, such as e-mail and telephone.
4.6. Data gathering process

Data was collected through semi-structured face-to-face interviews; a technique that enabled the researcher to probe about a set topic using pre-set questions (Saunders & Lewis, 2012). Interview guidelines were prepared to guide the interview and consent letters were completed and signed by all participants.

Yin (2016) highlights that the interactions between researcher and participant should be carefully scripted in the following steps:

First, the researcher will use a formal questionnaire that lists every question to be asked. Second, the researcher will formally adopt the role of an interviewer, trying to elicit responses from an interviewee. Third, the researcher as interviewer will try to adopt the same consistent behaviour and demeanour when interviewing different participants.

Interviews were recorded and transcribed to enable analysis.

The interview process began with formal introductions and a reminder of the informed consent. A brief description of the title of the research, context and scope of the research was provided. Following this, the interview questions were posed to participants in a non-leading manner allowing the participants to respond based on their own personal views and their own understanding of the question being asked. During the interview process, audio recordings and supplementary notes were taken as well as observations be made.

4.7. Analysis approach

There are two approaches to using theory in the analysis of qualitative data, that is, the inductive and deductive approach (Saunders & Lewis, 2012). For this research, an inductive approach will be applied. The intention was to analyse data to answer the research questions and meet research objectives (Saunders & Lewis, 2012).

Qualitative data analysis for this research study was conducted using the content analysis technique. Content analysis, as defined by Stemler (2001), is a systematic and replicable technique in which words are compressed into fewer content categories based on specific rules in coding. The analysis process involved listening to the audio recordings from the interviews, reviewing the transcripts and reviewing the notes that were taken. In parallel to this process, codes were generated and assigned to the features of the data (Zikmund et al., 2013). Themes were developed through identification of important constructs, opinions or ideas, which are related to the
research questions (Saunders & Lewis, 2012). The analysis was conducted for each question. Each concept, opinion, or idea from the data was captured and the number of times it was repeated was captured. These concepts were then rated according to the number of times they were mentioned. The insights from each interview was related to and analysed in the context of the research questions in Chapter 3 (Saunders & Lewis, 2012).

4.8. **Trustworthiness (validity and reliability)**
Reliability and validity of the data collected through qualitative measures are crucial (Saunders & Lewis, 2012). It is possible that in the process of this research there might have been respondent biases, which may obscure the results. Additionally, there may also be an effect of the researcher’s biases on the processing and analysis of the data (Saunders & Lewis, 2012). To limit these biases, the same questionnaire was used for the interviews with the interviewees to ensure consistency. It was significantly important for the interviewer to limit their own views and experiences. Furthermore, an independent person reviewed the analysis of the data to eliminate any errors or bias from the analysis.

4.9. **Research limitations**
Inherent and anticipated limitations include the following:

- Non-probability sampling is non-statistical; the results do not validly represent the sentiments of the entire population.

- The sample was limited to individuals located in Gauteng, South Africa. Based on the restricted sample, geographical bias could influence the participants’ responses.
CHAPTER 5: RESULTS

5.1. Introduction
This chapter presents the results of the research study in accordance with the research questions formulated in Chapter 3. This section gives a presentation of the findings from the analysis of data collected through a semi-structured interview process.

5.2. Results for Research Question 1
What are the main socio-political risk factors that affect project finance in South Africa?

Project finance is one of the mechanisms that can be used for infrastructure development, economic growth and for creating employment in South Africa (Demirag et al., 2011; Okanlomo, 2016). The main objective of this research question was to understand the main socio-political risks that affect project finance in South Africa. This research question further investigated the socio-political risks affecting project finance from the investment decision phase, throughout the entire project cycle of the project.

5.2.1. Understanding the key socio-political risk factors affecting project financing in South Africa when making investment decisions throughout the project life cycle
The first interview question dealt with understanding the key socio-political risk factors affecting project financing in South African when making an investment decision throughout the project life cycle of a project. All the participants were required to draw on recent events and describe the key socio-political risk factors identified or experienced when making an investment decision with specific focus to South African projects. Table 5.1 below illustrates the common themes that emerged in terms of the key socio-political risk factors identified.
Table 5.1

Understanding the key socio-political risk factors affecting project financing in South Africa when making investment decision

<table>
<thead>
<tr>
<th>Rank</th>
<th>Constructs</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Political Climate/Landscape</td>
<td>16</td>
</tr>
<tr>
<td>2</td>
<td>Intergovernmental Relations and Coherence</td>
<td>13</td>
</tr>
<tr>
<td>3</td>
<td>Community Involvement and Interest</td>
<td>12</td>
</tr>
<tr>
<td>4</td>
<td>Regulatory Changes and Uncertainties</td>
<td>8</td>
</tr>
<tr>
<td>5</td>
<td>Payment Guarantee</td>
<td>6</td>
</tr>
<tr>
<td>6</td>
<td>Floating Exchange Rate</td>
<td>5</td>
</tr>
<tr>
<td>7</td>
<td>Security of Tenure</td>
<td>4</td>
</tr>
<tr>
<td>8</td>
<td>Infrastructure</td>
<td>3</td>
</tr>
<tr>
<td>9</td>
<td>Stability in National Treasury</td>
<td>3</td>
</tr>
<tr>
<td>10</td>
<td>Environmental Impacts Assessment and Management</td>
<td>3</td>
</tr>
<tr>
<td>11</td>
<td>Geographical Location</td>
<td>3</td>
</tr>
<tr>
<td>12</td>
<td>Uncertainties related to Coordination</td>
<td>3</td>
</tr>
<tr>
<td>13</td>
<td>Government-Societal Relationships</td>
<td>3</td>
</tr>
<tr>
<td>14</td>
<td>Transformation and Black Empowerment</td>
<td>2</td>
</tr>
<tr>
<td>15</td>
<td>Displacement of Communities</td>
<td>2</td>
</tr>
<tr>
<td>16</td>
<td>Land Reform Discussions</td>
<td>2</td>
</tr>
<tr>
<td>17</td>
<td>Corruption</td>
<td>2</td>
</tr>
<tr>
<td>18</td>
<td>State of Economy</td>
<td>2</td>
</tr>
</tbody>
</table>

In analysing the main constructs, the participants had differing views on the key socio-political risks that generally affect project financing in South Africa. Many of the participants identified the political climate or landscape as the key socio-political risks. Participant 1 was of the view that the political climate in South Africa was crucial in project finance irrespective of the project type highlighting that “That being said, that asset class whether energy or infra would typically require, even from an equity perspective, some sort of a dated view on the investment geography and obviously the political climate that goes with that”. Participant 1 further adding to the notion of political climate, mentioning that it was applicable from both a funding and lending perspective commenting that, “and similarly from a lending perspective, the nature of the asset requirements long-dated debt and stability from a political perspective is fundamental.
on structuring any project finance deal”. Similarly, participant 2 referred to the issue of political interference because of vested interests, articulating that “We tend to see that a lot. Politicians also have got vested interests of their own. So sometimes they may facilitate projects going through, hoping that there’s something in it for them later on and if there isn’t clearly, they can derail the project”. Participant 8 made an interesting comment on the fact that political risks in South Africa were also linked to political uncertainties, specifically linking this perspective to the mining sector, highlighting the perception of investors that

Then investors are feeling very wary of investing in South Africa given the level of political uncertainty, policy uncertainty. Especially in areas such as the mining sector and of late in the renewable energy space. In the renewable energy space there’s been issues regarding the tariff that the power utility is willing to pay to these entities. It’s been uncertain and such; the program has come to a halt.

Some of the participants were of the notion that intergovernmental relations and coherence was a key socio-political risk when it came to project financing in South Africa. Many of the participants were concerned that generally there was a misalignment in interests between intergovernmental institutions which demonstrated some level of uncertainties in project financing. Participant 4 referred to a particular case related to the adoption and procurement of renewable energy, specifying how the lack of coherence in government led to a delay in the implementation of projects, pronouncing that,

But I think that if you look at the program, I think where it’s been unsuccessful and bear in mind that up until recently I think that the REIPPPP program specifically has been fantastically successful. I think where it stalled is because of these political risks where there’s not necessarily a concurrency between government departments, with Eskom, with NERSA.

Participant 4 further added on uncertainties related to a lack of coherence between government institutions, that “And because of that it makes it very difficult for even South African investors, let alone international investors, really to understand the landscape and to commit to the program as a whole when you have so much uncertainty”. Similarly, Participant 7 referred to the inconsistencies in messages between government departments specifically in the energy sector, reasoning that
there is quite a bit of mixed messages, at least in the energy sector, between the regulators. between Eskom, between the department and even between the IPP Office when we talk about renewables, so that mixed message can result in a lot of concern and I think that is more of a, that is a political risk and so what that leads to from the bank point of view, we want to make sure that the project that we do has the full support of government so that a change in government is not necessarily going to change risk appetite for the project.

Participant 6 further reiterated on the notion of different messages from the same government mentioning that “I think transparency clarity on - and inconsistent messages from different spheres of government in terms of the program, creates that uncertainty in that space too. So, I think, again obviously uncertainty is perhaps the main driver of that.”

Some of the participants were of the view that projects in South Africa were generally characterised by community involvements and interest which were considered by investors as a risk. Participant 11 mentioned how the nature of projects in South Africa are generally required to be communicated clearly to communities, which is something that was considered a risk by funders because it meant that the project developer had to get buy-in from the communities, with Participant 1 articulating in detail that

from a project perspective in the sense that the communities surrounding the project need to have a sense of ownership and also belief that they are gaining from it in some way, in terms of employment, ownership of the project in terms of the benefits that will come, so the benefits are electrification, the benefits are that these project are supposed to make money and part of that revenue is supposed to come to us as a community.

Participant 4 mentioned the issue of jobs, that as a project developer one had to ensure job creation for local communities, and if this did not happen then it led to a dissatisfaction of the communities, cautioning that,

we should benefit because it’s our land, our resource in some way and if project companies don’t make sure that they deploy funds of the project during construction as well, providing jobs or up-scaling people in the surrounding communities and not importing skills or jobs because that causes a lot of unrest.
Participant 8 highlighted an example where communities were not happy with the project developer as the project was not seen to benefit the communities, highlighting that

There have been projects where … it was one renewable energy project where they barricaded the project site and work could not continue because they felt they were not given the opportunities that they believe they’re entitled to because it’s their land and it’s a South African project so there shouldn’t be foreign nationals benefiting from something that is South African.

Further attributing the unrest of communities to poverty, reiterating that

So those are the main risks, they are very real because of poverty, because of single income homes, because of teenage pregnancy, alcoholism, a myriad of issues and if those are not taken care of by the project company in terms of creating programmes, educational programmes, health programmes, to benefit the communities.

5.2.2. Determining whether there had been any project financing transactions that had been reviewed and declined due to socio-political risks in South Africa

The second interview question required participants to assess and describe, based on their current and previous projects, whether there had been any project financing transactions that had been reviewed or declined as a result of socio-political risks in South Africa. Many of the participants referred to actual projects they had been involved in their work experiences. Figure 5.1 provides an overview of the responses (yes or no) from participants and Table 5.2 gives an overview of the themes based on their experiences that informed their views.
Figure 5.1 Overview of responses

Table 5.2
Determining whether there had been any project financing transactions that had been reviewed and declined due to socio-political risks in South Africa

<table>
<thead>
<tr>
<th>Rank</th>
<th>Constructs</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>No - Stakeholder Engagement</td>
<td>8</td>
</tr>
<tr>
<td>2</td>
<td>Yes - Political Interference</td>
<td>4</td>
</tr>
<tr>
<td>3</td>
<td>Yes - Involves displacement of Communities</td>
<td>4</td>
</tr>
<tr>
<td>4</td>
<td>Yes - Non-Compliance to Regulation (PFMA)</td>
<td>4</td>
</tr>
<tr>
<td>5</td>
<td>Yes - Bad Credit Profile</td>
<td>4</td>
</tr>
<tr>
<td>6</td>
<td>Yes - Lack of Government Support</td>
<td>3</td>
</tr>
<tr>
<td>7</td>
<td>Yes - Environmental Impacts</td>
<td>3</td>
</tr>
<tr>
<td>8</td>
<td>Yes - Risk Averse</td>
<td>3</td>
</tr>
<tr>
<td>9</td>
<td>Yes - Social Exclusion</td>
<td>3</td>
</tr>
<tr>
<td>10</td>
<td>Yes - Corruption</td>
<td>3</td>
</tr>
<tr>
<td>11</td>
<td>No - Mitigation of Risks</td>
<td>2</td>
</tr>
<tr>
<td>12</td>
<td>Yes - Regime Change</td>
<td>2</td>
</tr>
<tr>
<td>13</td>
<td>No - Low number of Finance Transaction</td>
<td>2</td>
</tr>
</tbody>
</table>

Nine of the thirteen participants have experience of project finance transactions which were declined because of socio-political risks in South Africa. Participants that have experience of declining project finance transactions due to socio-political risks attribute the decision to factors such as political interference, projects involving displacement of
communities, non-compliance with regulations and a bad credit profile of project sponsors.

Participant 7, as one of the nine participants with a perspective that they had declined project finance transactions due to socio-political risks mentioned that “But the answer to that question is, yes” when asked about declined project finance transactions because of socio-political risk. When prompted on the reasons for this, participant mentioned the issue of political interference using an example to emphasise her point emphasising that

> You know where we started was a very robust set of documentation that was released to the market that had very clear structure on how things would work; what the expectations were; where government stood; where treasury stood and as time has passed, that understanding has somewhat dissipated to a degree largely because of political interference on one hand and I guess the market sentiment around being able to take a long-term view on the outcome of the general political landscape in South Africa.

This viewpoint was highlighted by Participant 13 who also made reference to the energy sector, highlighting the fact that funders in the energy sector were currently not committing to funding in the renewable space due to the politics in this area, mentioning that

> I think a number of the sponsors in the renewable energy space that we speak to and that we have frequent interaction with, have indicated that they will sit out this current round, but they are honestly reconsidering scaling down and not participating in future rounds due to politics, which is a massive blow for the country.

Further mentioning the impact of such a scaling down, commenting that “I mean the more competition there obviously is amongst the bidders, the lower the tariff for electricity in future rounds and that feeds through to the consumer at the end of the day”

Some of the participants were of the view that project financing was outrightly declined or reviewed if it involved the displacement of communities. Participant 12 referred to a project had not started because it involved the relocation of communities, narrating that

> We've got a project similar to that that I've been involved in. It has been approved, but the approval has been on the condition that we are able to
meet these socio-political risks within the community. So currently it has been a year, nothing has happened on that project purely because the issue is around relocating people from the area that they are. This is a coal mine setup.

Further supporting this notion, the participant mentioned the issues that had to be reviewed for the project, citing that

… so it has been in principle, the project, but the current issues that have to be resolved over the past year, has been the issues around the community.
How do we deal with the community? Are we able to get a better space where they can still do the farming that they've been doing, or are we able to compensate them through the projects?

Contrary to most of the responses indicating that they had project finance transactions declined due to socio-political risks, some of the participants shared that they had not experienced declined transactions, attributing this view to the importance of stakeholder engagement in project development. Participant 2 mentioned the fact that his organisation was partly controlled by government which meant that they were not permitted to decline projects based on socio-political risks, highlighting that

The reality is that if you are the IDC you can’t necessarily decline on that basis. What it does is that you’re required to engage and sometimes you do get listened to, you’re required to engage those parties. Because one way or another government has got control over, so government has got control over municipalities at some stage, government has got control over those municipal people who may derail or even the politicians themselves.

He added that his organisation ensures there is engagement with stakeholders, as a solution to ensure project funding, emphasising that

So the expectation is that you need to find a solution that can’t necessarily derail. Admittedly some of these municipalities and people, when you come as the IDC they might listen and try and cooperate … But the net result of that it just means it just makes the whole project development cycle longer than it needs to be because there’s an engagement.

Participant 10 made reference to an example where they had to work with the municipalities to ensure that communities were involved through engagements,
specifically highlighting the importance of transparency regarding the benefits of the project to the community, exclaiming that

and the municipality, even though that place is licensed, but because that activity was not being carried out, the municipality has to engage the people to say do you allow us to allow this person to set up their own plant here. When people start hearing plant, now they think okay, so someone got a tender and why are we not benefitting from it.

5.2.3. Determining whether there are socio-political risks that financiers deemed only applicable solely to South Africa

The third interview question prompted participants to reflect on whether there were socio-political risks that financiers deemed only applicable solely to South Africa. The question was phrased in a manner that allowed the participants to elaborate on the response. Furthermore, the participants were encouraged to specifically elaborate on their responses applying practical examples based on their experience.

The participants had mixed views on the process of whether there were socio-political risks that financiers deemed solely applicable to South Africa. Refer to Figure 5.2 below for the overview of the participants perspectives.

*Figure 5.2. Determining whether there are socio-political risks that financiers deemed only applicable solely to South Africa*

![Pie chart showing Yes and No responses]

Table 5.3 below presents the main constructs that came from the interviews:
Table 5.3

*Determining whether there are socio-political risks that financiers deemed only applicable solely to South Africa*

<table>
<thead>
<tr>
<th>Rank</th>
<th>Constructs</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>No - Perceived Stable and Favourable</td>
<td>18</td>
</tr>
<tr>
<td>2</td>
<td>Yes - Community has an Activists Approach</td>
<td>9</td>
</tr>
<tr>
<td>3</td>
<td>Yes - Weak Border Control</td>
<td>7</td>
</tr>
<tr>
<td>4</td>
<td>No - Risks are similar to other Countries</td>
<td>6</td>
</tr>
<tr>
<td>5</td>
<td>Yes - Transformation and Black Empowerment Requirements</td>
<td>6</td>
</tr>
<tr>
<td>6</td>
<td>Yes - Policy Changes</td>
<td>5</td>
</tr>
<tr>
<td>7</td>
<td>Yes - Lack of Government Support</td>
<td>5</td>
</tr>
<tr>
<td>8</td>
<td>Yes - Political Uncertainty</td>
<td>2</td>
</tr>
</tbody>
</table>

The participants were of the view that generally South Africa was considered stable and favourable in financing when compared to other countries, especially within the African continent. Participant 1 explained that even though South Africa was currently perceived to be risky in terms of the political outlook, funders generally had confidence in the country further commenting that these particular political issues were not solely applicable to South Africa, highlighting that

> So in as much as there is concern around the long-term political outlook for South Africa, there’s still a fair bit of confidence on the basis that there’s a sound financial system for all intents and purposes, the large state-owned entities are fairly self-sufficient to a degree in terms of their own liquidity position.

Further adding that even though there was uncertainty in the market, this did not discourage funders specifying that

> There is a reasonable degree of comfort around the fact that as much as there is a lot of political noise, uncertainty, divestment, etcetera, there is still a democracy and a judiciary that works, and a lot of those things are a whole lot more relevant across the continent where those things are show stoppers on day one saying, well we can’t even consider an opportunity in this market or that because we just don’t even have sight beyond 24 months.
Participant 3 reiterated the fact that South Africa was considered to have a sound regulatory environment when compared to other countries which made it more favourable, emphasising that

*The other thing is that as much as all of this uncertainty is around, we also have a very sound regulatory system that allows us to be able to do these transactions in this market whereas in other markets there isn’t even a regulation that’s developed enough to allow this type of investment.*

Participant 4 echoed this viewpoint comparing South Africa to other countries mentioning that,

*Just to give you a sense, I think that South Africa, because those documents are generally bankable and because you’re dealing with sophisticated people who’ve done this before, who’ve got expertise, who are very happy to pay for good advice and understand that advice ... You don’t have a lot of the other constraints that you’re having if you’re doing a deal in Nigeria or Ghana or everywhere. You’re literally on negotiating every PPA from scratch and there’s a whole lot of political risk regime and then they change the view from a government guarantee to a Put-Call Option Agreement or whatever the new World Bank lend initiative is.*

Some of the participants believed South Africans were considered activists in terms of expressing themselves especially when it came to issues that communities disagreed with. Participant 3 referenced this notion of an engaged society mentioning that,

*So although you can look at other countries on the continent that are unstable, South Africa is not unstable. South Africa is stable, but within that stability it is characterised by what, maybe for the lack of a better term, what I would call militant and very engaged citizens.*

Further using an example of the recent fees must fall campaign, declaring that “*So when they are not happy, South Africans, when they are not happy about something, they make their views known, very clearly. I mean we have talked about Fees Must Fall*”. Participant 5 added on this notion, highlighting the number of protests in South Africa maintaining that “*South Africa is very sensitive, from a – and is very engaged. So, because of that there are all these protests that are happening. Essentially every day it is happening*”. Participant 2 also echoed the fact that there was a project that was recently stalled simply because it was linked to service delivery commenting that
In a place somewhere there is a protest that is linked to service delivery and that service delivery in a way would be linked to some infrastructure development, and, as an infrastructure DFI of a country, we obviously are concerned if things like that happen.

Some of the participants were of the view that South Africa had unique issues related to weak border control. Participant 9 was concerned regarding the issue that in South Africa it was difficult to plan in terms of infrastructure development because of immigrants that could not be accounted for, distressing that

"Certainly, I think part of the challenge that you have, which one would say it is specifically South African, no one actually can quantify the level of required infrastructure investment in South Africa, specifically because it is quite difficult to ascertain the level of population within this country. There has been a significant inflow of undocumented people from the neighbouring countries into South Africa."

Participant 9 further adding how this was impacting planning, remarking that "So, obviously, from a planning perspective that complicates issues for government in terms of figuring out how many hospitals, how many schools, the level of road infrastructure that is needed in order to keep the economy running". Participant 11 further reiterated this issue of weak border control, stressing that

"So I think that is one of the issues that, from a project finance perspective, but I think that is more of a government issue than a concern from a lender, from an investment perspective. So, I would say the influx of people presents a challenge which ultimately may be a risk to certain projects."

5.2.4. Determining the top five socio-political risks of project finance in South Africa and the source of the socio-political risks based on three categories, namely Government, Society, Intrastate/ Interstate

The fourth interview question prompted the interviewees to list top five socio-political risks of project finance in South Africa and the source of the socio-political risks based on three categories, namely Government, Society, and Intrastate. Most of the participants found this question quite interesting. The participants identified their top five risks and allocated them to the three categories and in some cases linking it to two or more categories. The views of the participants based on the analysis is summarised on the Table 5.4.
Table 5.4

Determining the top five socio-political risks of project finance in South Africa and the source of the socio-political risks based on three categories, namely Government; Society; Intrastate/ Interstate

<table>
<thead>
<tr>
<th>Rank</th>
<th>Constructs</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Social and Civil Unrest (Government, Society and Intrastate)</td>
<td>29</td>
</tr>
<tr>
<td>2</td>
<td>Political Instability/ Uncertainty (Government and Society)</td>
<td>23</td>
</tr>
<tr>
<td>3</td>
<td>Policy Changes and Uncertainties (Government and Intrastate)</td>
<td>15</td>
</tr>
<tr>
<td>4</td>
<td>Sustainability of SOE (Government and Intrastate)</td>
<td>10</td>
</tr>
<tr>
<td>5</td>
<td>Volatility in the Currency (Government)</td>
<td>10</td>
</tr>
<tr>
<td>6</td>
<td>Community Investment (Society)</td>
<td>10</td>
</tr>
<tr>
<td>7</td>
<td>Lack Intergovernmental Alignment and Coherence</td>
<td>9</td>
</tr>
<tr>
<td>8</td>
<td>Labour Force Issues Incl. Unionisation (Government)</td>
<td>8</td>
</tr>
<tr>
<td>9</td>
<td>High Influx of Foreigners (Government and Society)</td>
<td>6</td>
</tr>
<tr>
<td>10</td>
<td>Provincial Overlapping (Intrastate)</td>
<td>6</td>
</tr>
<tr>
<td>11</td>
<td>Negative Economic Outlook (Government and Society)</td>
<td>6</td>
</tr>
<tr>
<td>12</td>
<td>Security of Tenure (Government and Intrastate)</td>
<td>6</td>
</tr>
<tr>
<td>13</td>
<td>Lack of Capacity and Expertise (Government and Society)</td>
<td>5</td>
</tr>
<tr>
<td>14</td>
<td>Private-Public Sector Partnerships (Government and Society)</td>
<td>5</td>
</tr>
<tr>
<td>15</td>
<td>High Unemployment Rate (Society)</td>
<td>3</td>
</tr>
<tr>
<td>16</td>
<td>Efficient and Inclusive Infrastructure (Government)</td>
<td>3</td>
</tr>
<tr>
<td>17</td>
<td>Bilateral Agreements (Government)</td>
<td>3</td>
</tr>
<tr>
<td>18</td>
<td>High Utilities Debt (Government)</td>
<td>2</td>
</tr>
<tr>
<td>19</td>
<td>Procurement Issues (Government)</td>
<td>2</td>
</tr>
<tr>
<td>20</td>
<td>Corruption (Government)</td>
<td>2</td>
</tr>
</tbody>
</table>

Interestingly, most of the risks identified were linked to the government as the source. The participants were of the view that business formed part of the society, hence in some cases society referred to business as the source. Based on the frequency count, most of the participants were of the view that social and civil unrest was one of the most significant socio-political risks. Participant 5 mentioned the issue of labour unrest in the country, distressing that

*So civil unrest I mean labour unrest is one thing that we’ve seen. So, there’s been quite a few, in fact a number of our existing projects we’ve seen quite a number of instances of labour unrest where our clients have had to declare events, you know strikes and so forth.*
Participant 5 further adding that this was common in the projects financed by his organisation, highlighting that “I suppose the sort of labour unrests strikes is definitely one that you can highlight as seen it on a number of the deals that we are working on”. Participant 6 further relating to social unrest linked to labour issues mentioning that

Labour on pretty much all the projects or on many of the projects that we’ve been involved in the round three, they’ve had a delay of different levels of severity at some stage or another due to community unrest; due to the areas where the project is being built, being unhappy about service delivery, regarding the project is not doing enough to alleviate their socio-economic conditions and the likes. Which has said, it has different levels of severity, but it’s definitely something that needs to be taken into account and that can trip a project over.

Participant 7 further aligned this factor to society mainly because society was responsible for determining the government hence they were the source mentioning that

I suppose society feeds into government, right. Society determines who government is. So ja, I think, you know and again, it all, it sort of all builds up. The extent to which the levels of this, what’s the word? Unhappiness and discontent about so many communities and people out there, sort of feed and drive more radical and drastic changes, you know the more uncertainty that brings about as to where are things headed and to what will policy eventually be, to curb that and to address the concern of a growing number of fairly satisfied citizens.

Some of the participants were of the view that one of the top five risks were related to political instability or uncertainties and this factor was linked to government and society as the source. Participant 6 commenting on the issue of political instability, remarked that “So I think political risk, as I said, the one that I touched on earlier from government is policy uncertainty. I think that’s probably the biggest one that we’re dealing with”. Participant 7, in reiterating her point with an example mentioning the recent cabinet shuffle, stressed that

So obviously if you look at Nenega for instance, the Pravingate and all of that, if you just have a look at the spike in reference rates for funding instruments, that picks up the minute that you have these sorts of shocks
into the structure, so it becomes more expensive and less economical for sponsors to get these projects away. So that's definitely an area where it's coming in.

Participant 8 further reiterated this point on political unrest linking it to both government and society, highlighting that

Okay, so I think the risk, one of the risk will be political unrest and then the source will be a combination, right. So, it's a combination of the government failing to provide adequate housing, adequate jobs to that society. And then the other one would be, like I said, it would be policy uncertainty. And then the source would be government.

Participant 9 echoed this point of political instability, articulating that

Because policy stability, it is very important. So, you need to understand the direction that the governing political party is taking from the regulatory environment, from a regulatory perspective, for example. But my sense is for as long as you are embarking on a long-term project it will be naïve to actually get derailed by a short term political phenomenon.

Some of the participants were of the view that policy changes and uncertainties were quite a big issue in the context of South Africa. Participant 4 believed that changes in policy were a big issue, mentioning that “The number one risk I think is general political policy uncertainty and I'm not going to go into why that is, it's pretty self-explanatory. But it is very difficult when you don't understand the rules of the game”. Linking his views to an example, Participant 4 underlined that

So the IRP hasn't been finalised, so this can't be done. This now seems to be questions if the IPP office staying in DoE, is it moving to CEF. NERSA seem to play ball, Eskom clearly has its own agenda, which to me is the biggest socio-political risk in South Africa right now.

Participant 5 revealed the fact that policy was unclear especially in terms of the energy sector, saying that

So it's a misalignment of government policy and if you look at what's happening now with the renewal energy program, you know Eskom doesn't want to sign and government say you must sign. That's exactly what has happened, it's a misalignment between how the government sees
something happening in terms of their sort of policy versus what Eskom wants to do as generator. So, it’s quite prevalent in our sort of economy.

Participant 13 further echoed the issue of policy changes, reiterating that

*It’s not only necessarily related to REIPPPP it’s what the black ownership requirement is. What is the local content requirement? The more you change the rules, that’s fine as I’ve said the private sector will adapt to that, but understand that you can’t keep changing it. It becomes very difficult.*

5.3. **Results for Research Question 2**

**How are socio-political risk factors affecting project finance in South Africa?**

The main objective of this research question was to determine the manner and the extent to which socio-political risks affect progress in infrastructure development supported by project finance. This research question further sought to understand the perception of financiers on the political risks in South Africa and the extent to which political risks affect project finance, particularly focusing on recent changes in South African economical space.

5.3.1. **Understanding whether the financier’s perception of South Africa’s political risks restricted the provision of project finance**

The fifth interview question encouraged participants to firstly indicate whether the financier’s perception of South Africa’s political risks restricted the provision of project finance and then further probed on the reasoning for this view. The results of interview question 5 are summarised in Table 5.5 below. The highest-ranking concept based on frequency count was related to the fact that socio-political risks reduced the financiers’ appetite to invest, the second highest ranking construct was linked to the fact that financiers were not keen to invest long term and the third highest ranking construct was related to the fact that the risks basically led to a delay in project execution.
Table 5.5
Understanding whether the financier’s perception of South Africa’s political risks restricted the provision of project finance

<table>
<thead>
<tr>
<th>Rank</th>
<th>Constructs</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Yes - Reduces Appetite to Invest</td>
<td>20</td>
</tr>
<tr>
<td>2</td>
<td>Yes - Investors not keen to Invest Long-Term</td>
<td>13</td>
</tr>
<tr>
<td>3</td>
<td>Yes - Delay in Project Execution</td>
<td>6</td>
</tr>
<tr>
<td>4</td>
<td>Yes - Investors not keen to Partner with Government</td>
<td>3</td>
</tr>
<tr>
<td>5</td>
<td>No - It will not affect Project Finance</td>
<td>3</td>
</tr>
<tr>
<td>6</td>
<td>Yes - Reduces Investment Amount</td>
<td>2</td>
</tr>
<tr>
<td>7</td>
<td>No - Political Risk Insurance</td>
<td>2</td>
</tr>
<tr>
<td>8</td>
<td>Yes - Increases Project Costs</td>
<td>2</td>
</tr>
</tbody>
</table>

Many of the participants were of the view that socio-political risks reduced appetite to invest, with Participant 3 mentioning that it reduced the amount of capital to be financed, mentioning that “I think it is, to some extent, it reduces the amount of capital that is made available and other players, especially if they are foreign players – some of them even reduce their investment earmarked for a country. Or some of them even exit”. Participant 13 mentioned how this reduced the appetite of lenders or investors, highlighting that

This risk will affect the project finance in terms of, it reduces the appetite from investors or lenders to finance projects here in South Africa and the other impact is that it increases the cost of funding, so if the appetite is there, but then it’s going to be more expensive to finance the project, so those are the 2 primary impacts of this risk.

Participant 6 further added the fact that financiers were not keen to invest in South Africa due to uncertainties, articulating that

I would think so. As I said, I think from a financier's perspective and whether there is debt or equity, I think the uncertainty that the increase in the level of uncertainty makes it less an attractive – ja, it detracts from the attractive, it takes away from the attractiveness from South Africa as an investment destination, the whole uncertainty.
Participant 6 further explained how that would affect the projects, mentioning that “project finance as you know is a game where you want a feeling of certainty. The more uncertainty there is, the higher risk premium, you would require and the fewer bankable projects you have at the end of the day”.

It was concerning to learn that financiers were not keen in investing on long term projects simply because of the current political landscape. Participant 1 sharing the difficulty in investing in long term project mentioning that

but it’s becoming more and more difficult to raise the required appetite for some of these things because even those pension funds are starting to say, well 15 years, 20 years, we don’t know. As much as the structure would tell you that you’ve got a fair level of certainty around an annuity of cash-flow, the political noise kind of starts making you doubt that assumption.

Participant 13 reiterated this point mentioning that “from an investor point of view, yes, for example, a lot of international banks don’t want to have more than a 5-year or a 10-year exposure to South Africa because they’re concerned about the political risk and they’re concerned about the credit rating of the country”. Participant 13 further highlighting the impact of this notion recapping that

that means all of the projects in South Africa have to be funded from the local banks, the local banks also get concerned about being overly reliant on government because these projects finances typically, not always, but the large programs typically have a government element in them … because policy stability is very important. So, you need to understand the direction that the governing political party is taking from the regulatory environment, from a regulatory perspective, for example.

Some of the participants were of the view that socio-political risks were affecting project implementation. Participant 5 captured this so perfectly articulating that,

it doesn’t limit it because the project finance evaluation process is such that you’re going to require such an intensive legal sign-off that you need to be comfortable that the whole procurement process is being done properly, that ultimately the relevant policies supporting the implementation of these transactions. So, all of those, if anything it slows things down.

Participant 5 linking project execution to misalignment in policy, adding that
So we’re not closing deals, we have not closed a REIPPPP deal for the last year and a half because of this misalignment in policy and that’s a worrying factor. We want to lend but we’re being prevented from providing private capital to develop infrastructure because of this misalignment in policy that is actually happening.

Participant 9 further commenting on project implementation delays, echoing that

So I think one cannot ignore current political developments, but unless the regulatory environment pertaining to that particular type of project that I want to embark on is uncertain, it is almost unlikely that a project will be derailed as a consequence.

5.3.2. Understanding the stage in the project life cycle where socio-political risks are most prone (Bid, Construction or Operational phases)

This question sought to establish from the participants the stage in the project life cycle which was most prone to socio-political risks. Most of the participants were of the view that the construction phase was the most prone to socio-political risk, followed by Bid-phase and the third highest ranking was operational stage. Table 5.6 below highlights the several themes that emerged during the analysis of data pertaining to this interview question.

Table 5.6

Understanding the stage in the project life cycle where socio-political risks are most prone (Bid, Construction or Operational phases)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Constructs</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Construction Phase</td>
<td>25</td>
</tr>
<tr>
<td>2</td>
<td>Bid Phase</td>
<td>16</td>
</tr>
<tr>
<td>3</td>
<td>Operational Phase</td>
<td>10</td>
</tr>
<tr>
<td>4</td>
<td>All Stages</td>
<td>3</td>
</tr>
</tbody>
</table>

In analysing the top three ranking views expressed by the participants, a theme that emerged strongly was the notion that the construction phase was most prone to socio-political risks, with the participant expressing their views as follows:

Construction, I think that’s inherently the riskier part of the project we have the least margin of error. That’s probably second, you know having a three-
month-long labour unrest, having a say, take the mining strike of a year or two ago – if you were developing a project finance or a mine in that period as a project finance, you probably would have, you would have been dead in the water. – Participant 6

If the construction – again, it is almost similar to the operation that could be the worse, because then now, depending on what exactly it is, you might have put in part of the money and you are busy with construction and then now there are delays, and those are delays who will cost the project more money. – Participant 8

If you look at a social unrest, I think that’s more in the construction phases where particularly because a lot of these plants are in the very rural areas, where there’s not a huge amount of industrial development. And suddenly this massive plant thing goes up in the middle of nowhere and they think well, we’re not benefitting from this. – Participant 10

So, the labour unrest, one, is normally when you have construction that is when you obviously see those happening. Labour is going to use the opportunity to try and negotiate a better arrangement once a project is up and running. – Participant 13

Typically, what happened before because you’re going to be speaking to contractors, going to make some assumptions around what it costs to pay labour for work, but this is going to really happen once you’re in construction? – Participant 5

The second most ranking constructs were related the fact that the bid phase was most prone to socio-political risks, with the participant highlighting their views as follows:

The big risk around policy uncertainty actually affects you in a way between bid and close, I think that’s been the big - and typically if you look at Rounds 1 and 2 of REIPPPP, you’ve typically seen about a twelve month, maybe a little bit longer period between when a project is announced its winner and the closing. – Participant 4

So, at bid stage, so going into bid now versus 3 years ago, as a financier I’m going to be asking how big an impact does political risk have on my decision? Does it impact my credit risk view of my off-taker? Does it impact my view that I’m willing to underwrite a longer dated deal that I would have
done 3 years ago quite easily without even asking? Yes, definitely. That would be at bid stage. – Participant 1

The misalignment it can happen, it’s happened at the bidding phase. You have had lots of bidders who have put lots of money in developing bids, appointing advisors, now they’re in limbo. So that has happened at bid phase. – Participant 5

The third highest ranking constructs were related the fact that operational phase was most prone to socio-political risks, with the participant highlighting their views as follows:

I would say it would be mostly prevalent at the production stage of the project. So, when a project is starting to generate the cash-flows, that’s when you would start seeing an interest from the political parties to basically get their fair share of the earnings coming out of that project. – Participant 8

It’s mostly in the operation phase. These risks will manifest themselves, especially the community issues which I would say is a big one here in South Africa, and it usually manifests itself during the operational phase of the project. In the early stages it will appear to be fine, there will appear to be support or engagement, once the project is operational, then the risk raises its head. – Participant 13

5.3.3. Understanding how has South Africa's credit downgrade earlier in the year (2017) affected project finance transactions

This research question sought to determine whether how South Africa’s credit downgrade earlier in the year (2017) affected project finance transactions. One the most prominent factors highlighted by the participants was related to the increase in the cost of finance. Table 5.7 below gives an overview of how South Africa’s credit downgrade earlier in the year (2017) affected project finance transactions
Table 5.7
Understanding how has South Africa’s credit downgrade earlier in the year (2017) affected project finance transactions

<table>
<thead>
<tr>
<th>Rank</th>
<th>Constructs</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Increased Cost of Finances</td>
<td>16</td>
</tr>
<tr>
<td>2</td>
<td>Discouraged Investment</td>
<td>6</td>
</tr>
<tr>
<td>3</td>
<td>Business as Usual</td>
<td>5</td>
</tr>
<tr>
<td>4</td>
<td>Increased Hedging Costs</td>
<td>4</td>
</tr>
<tr>
<td>5</td>
<td>Increased Project Costs</td>
<td>4</td>
</tr>
<tr>
<td>6</td>
<td>Difficult to Quantify</td>
<td>3</td>
</tr>
<tr>
<td>7</td>
<td>Affected Project Implementation</td>
<td>2</td>
</tr>
<tr>
<td>8</td>
<td>Reduced Accessibility to Funding</td>
<td>2</td>
</tr>
</tbody>
</table>

Many of the participants were of the view that the recent downgrade in South Africa increased the cost of finances. The participants were of the view that the impact of the downgrade was not that big, with Participant 1 highlighting his views that “The impact has been fairly small on the basis that outside of the fact that you may be pricing in a little bit more of government risk that slightly would increase the cost of debt, but it’s largely business as usual, to a large degree.” Participant 2 was also of a similar view, highlighting the increased in interest rates, emphasising that “the impact has been fairly small on the basis that outside of the fact that you may be pricing in a little bit more of government risk that slightly would increase the cost of debt, but it’s largely business as usual, to a large degree.” Participant 3 explained in detail the impact of the downgrade mentioning that “and those downgrades have had a direct impact on how much in terms of investment comes into the country. Into project finance, and the works”. Participant 3 further adding concerns related to the banking sector, mentioning that

But it also works in the same way for even banks and other investors, because no investor in a jurisdiction can be better rated than this one. So, all the banks have been downgraded, everyone has been downgraded. So, the cost of funding, for everyone, has increased, it increases because of the downgrades.
Some of the participants were of the view that the downgrade specifically discouraged investment in the country. Participant 7 mentioned how the downgrade affected access to funds in the international market articulating the issue as,

so in the context of when we do projects, we typically deal with international banks or international development finance institutions such as the European Investment Bank. They have minimum requirements that you need to be investment grade to participate with you, okay, so there are some transactions that we do where they provide funding and we guarantee them or stuff like that, because our rating is down, they are unable to assist us with that. So, although we are still rated investment grade by Moody’s, we are not investment grade by S&P and Fitch and they take the lowest rating.

The participant added the fact that South African banks were restricted from being an account bank and agent as result of the downgrade, expressing that

In addition, they are refusing to allow Standard Bank to, or any South African bank to act as account bank and agent, because we are viewed as junk. So that means in a bank you will, when we do project finance, it’s not just to do the project finance and have a loan in our book and have the fees, a banking environment is all about an auxiliary.

Participant 13 further reiterated the notion of the impact of the downgrade as

... and it has had a direct impact on the financial markets, and by so doing it, it has got a direct impact on funds that are available for product finance. Specifically, for us, as a bank, you know that we are sub-sovereign, so if the country is downgraded we also can down grade it. Before a downgrade, it is now under water. Because the required return cost of funding is high now.

Surprisingly some participants were of the view that the downgrades did not have an impact on project financing, describing it as business as usual. Participant 5 mentioned that the downgrades had not impacted on project financing, expressing that “it’s affected it to you know the limits points as far as I’m aware it hasn’t affected the limits and then at the end of the day we as a South African bank I think we have got our own assessment of what we will continue to do in the context of the downgrade”. Participant 6 explained that his expectations of the downgrade were extremely bad, however to his
surprise the downgrade did not affect project financing as much as he thought it would, reiterating that

so actually less than what we thought. We at first when the downgrade came through with all the all the developments, I think the sense was that there's going be a notable change, most probably anticipation or the expectation was for the worst. But I think it's still to a large extent business as usual.

Further echoing this view was Participant 8, adding that “It hasn't affected us specifically, but I think what it may have an impact on most certainly is our ability to sort of lend long-term or longer term and the pricing most certainly has changed”.

5.3.4. Understanding how new government policies affected project finance transactions

This question sought to establish from the participants how new government policies had affected project finance transactions. The main constructs that emanated from the participants are summarised on the table below.

Table 5.8
Understanding how new government policies affected project finance transactions

<table>
<thead>
<tr>
<th>Rank</th>
<th>Constructs</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Created Uncertainties</td>
<td>15</td>
</tr>
<tr>
<td>2</td>
<td>Attracted and Enabled Investment</td>
<td>7</td>
</tr>
<tr>
<td>3</td>
<td>Reliance on certain Institutions for Implementation</td>
<td>7</td>
</tr>
<tr>
<td>4</td>
<td>Provides Direction and Clarity</td>
<td>7</td>
</tr>
<tr>
<td>5</td>
<td>Reluctance to Invest</td>
<td>6</td>
</tr>
<tr>
<td>6</td>
<td>Created Confusion</td>
<td>3</td>
</tr>
</tbody>
</table>

Most of the participants were of the view that new policies created uncertainties, specifically referring to the new policies related to the energy sector. Participant 2 referred to the Integrated Resource Plan and how it had created uncertainties in the energy sector stressing that
When it comes to the IRP, the uncertainty thereof in terms of the energy mix. Initially the plan was that there'll be more renewables in it and Eskom as it stands is going to be a buyer. But I think there's a lot of uncertainty there so never mind the policy ones, but when it comes to implementation of the policy that's where the uncertainty lies.

Participant 6 referred to the mining charter and how the charter had been published and then recalled, explaining how this uncertainty in the mining charter had affected finance in the sector,

Yes. And then, so the Mining Charter is perhaps the most pronounced, is perhaps the one that I would say in our area had the biggest impact, the lead up, there was talk for quite a while about a revised charter that would address some of the uncertainties in the past. Then all of a sudden, without a word of warning, a new charter was released that just around, on so many different fronts just is not practical; had far-reaching consequences much further than what was not negotiated, but what was communicated to the market and debated with industry before its release; and then for it to be sort of pulled back in, I think it was about a month after its release.

Participant 6 further emphasising the impact of the new policies, cautioning that

And as I said, ja, that uncertainty just, it chases capital away. Capital especially for a longer term project finance, want certainty, wants to know what it is that wants to have a fair view on what the lay of the political landscape will be for the tenure of the investment.

Participant 8 further reiterated this point, mentioning that

Generally investors, of late, have been reluctant to putting money into South Africa. Even home-grown entities themselves, they sit with large cash piles. So, you need to get them to invest, but the issue is they’re not sure of the direction or the political direction that the country’s taking. So far it has been negative. Investors have been reluctant to invest because of uncertainties.

Echoing the uncertainties, Participant 13 further emphasised that

It creates uncertainty. Large-scale projects are long term investments, and these latest policies that are coming from government have created
uncertainty and project finance does not like uncertainty because it’s long term, so that’s how it’s been affecting, so it’s almost changing the rules of the game or the rules of the game are not clear so that has been the effect of these latest policies from government.

Surprisingly some of the participants believed new policies attracted and enabled investment, with Participant 10 mentioning that the new policy was attracting investments in energy projects mentioning that

You know one of the things with investors, investors [indistinct] look at opportunities and to what extent they make money. But in general, because of the perception, personally, my view, definitely to say, I think currently most of the projects, I worked on a number of projects in the solar space, and I’ve worked on projects in the mining space.

Participant 10 further added that the increase in investments in the mining sector were related to energy, reiterating that

but on the energy side, because we are looking at it so closely, project finance is still instrumental and so strong in as far as non-renewable energy is concerned. Obviously there needed to be a timing to say, to what capacity do we require this and non-renewable energy, say, then renewable energy side, because remember, most of our projects are in the renewable energy sector.

Participant 12 further recapped on this point of increase in energy related project, expressing that “I know with the renewable, it had a positive impact. So, the IRP will help us get the economy using more gas, that’s it. The renewables really had a positive impact. With oil and gas and NDP, there’s no certainty about what the government wants”.

Some of the participants were of the view that new policies introduced a new dynamic that required project financiers to be reliant on certain institutions for implementation. Participant 2 mentioned how the policy had forced reliance on certain institutions for implementation, even though the institutions did not have the required capabilities, stressing that

It relied on power utility’s buying power for the country. So, the power utility, even though the policy is there, says we’ll have so much renewables; it has come to a standstill because there’s no implementation. Power utility has
got no capacity to do it or sometimes their willingness. I doubt its willingness, it’s more capacity.

Participant 4 mentioned how the policy had placed reliance on certain institutions, but the policy was not quite clear on which institution is responsible for what, saying that

There’s some issue around the license because it’s higher than one megawatt you need a license and you need to go to Energy Regulator. The Energy Regulator is deferring it to the Power Utility and the Power Utility is making a decision and they’re deferring it back to Energy Regulator So four megawatts of solar which could be fed into the grid or at least – even if it’s not fed into the grid at least it can reduce the requirement from the grid, is not being utilised because there’s this policy uncertainty.

Some of the participants were of the view that new polices created direction and clarity with Participant 5 highlighting that “I think it’s going to confirm a large part of the existing generation mix and probably say well we need some new clear or whatever the case might be. So, we will not do anything that is not aligned with government policy”.

Participant 7 further added on this notion, mentioning that

so if we go with the IRP, I think the IRP was extremely positive initially for the program, I think the fact that there was a clear cut policy saying, this is what we’re going to do now, this is what we’re going to do next year, this is what we’re going to do in 5-years, this is what we’re going to do in 10-years, I think that was extremely positive because then it enabled people to take investment decisions.

Some participants mentioned that new policies discouraged investors, making them reluctant to invest with Participant 8 expressing concern that

Generally investors, of late, have been reluctant to putting money into South Africa. Even home-grown entities themselves, they sit with large cash piles. So, you need to get them to invest, but the issue is they’re not sure of the direction or the political direction that the country’s taking. So far it has been negative. Investors have been reluctant to invest.

Participant 9 further added

I would not say it is – I think the decision or the inaction by government to finalise the fourth phase of the renewable energy deals, if any has raised
the level of scepticism. You know scepticism between investors and the South Africa economy, specifically in dealing with government.

5.4. Results for Research Question 3
What are the mitigation measures or strategies that can be applied to mitigate socio-political risks?

The objective of Research question 3 was to understand how socio-political risks are assessed as well as the strategies applied to mitigate those risks. Participants were requested to draw on their personal experiences and share what mitigation measures they had applied while working on previous projects. Participants were further requested to reflect on what mitigation measures they believed were no longer effective and make recommendations on what they understood to be more relevant and effective mitigation measures to be applied for future use in project finance transactions.

5.4.1. Understanding how socio-political risks are assessed and what strategies are used to mitigate these risks for project finance transactions in South Africa

This interview question requested participants to share how they believed socio-political risks need to be assessed in project finance transactions in South Africa. A summary of the various assessment measures and mitigation strategies recommended by participants is presented in the below table.

**Table 5.9**
*The Assessment of socio-political risks and strategies used to mitigate project finance risks in South Africa*

<table>
<thead>
<tr>
<th>Rank</th>
<th>Constructs</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Perform effective due diligence</td>
<td>9</td>
</tr>
<tr>
<td>2</td>
<td>Ensure community is involved as a key stakeholder</td>
<td>8</td>
</tr>
<tr>
<td>3</td>
<td>Ensure the involvement of local leadership (incl. government stakeholders)</td>
<td>5</td>
</tr>
<tr>
<td>4</td>
<td>Ensure compliance with lending regulations</td>
<td>4</td>
</tr>
<tr>
<td>4</td>
<td>Assess impact on political and economic landscape of the country</td>
<td>4</td>
</tr>
<tr>
<td>6</td>
<td>Careful consideration of potential risk during debt structuring</td>
<td>3</td>
</tr>
<tr>
<td>7</td>
<td>Apply various hedging techniques to minimise interest/exchange rate risk</td>
<td>3</td>
</tr>
<tr>
<td>8</td>
<td>Reducing financial exposure</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>--------------------------------------------------------------------------------------------</td>
<td>---</td>
</tr>
<tr>
<td>9</td>
<td>Reducing duration risk of investments</td>
<td>2</td>
</tr>
<tr>
<td>10</td>
<td>Assess impact on multiple dimensions of business</td>
<td>2</td>
</tr>
<tr>
<td>11</td>
<td>Tighten conditions of approval</td>
<td>2</td>
</tr>
<tr>
<td>12</td>
<td>Tighten and monitor drawdown conditions</td>
<td>1</td>
</tr>
</tbody>
</table>

Most participants agreed that performing effective due diligence was a significant measure in assessing socio-political risks for project finance transactions in South Africa. Expressing his views Participant 1 stated that “so asking the right questions early on, making sure we’ve got the right local partners. Making sure that people have the right networks”. Adding the view that performing due diligence was key to the early identification of risks was Participant 3 who argued “but on a general basis the best thing is to have varying due diligence around the projects, so that you can be able to identify the risks upfront, So I think due diligence is the biggest thing that you need around this up front”. He further added his personal experiences on how he assesses socio-political risk by saying “so when we look at a project, finance structure, and it has got some of these things, then it is about us applying ourselves way up front, to say: What are the risk that are involved here? And we are very thorough with our due diligence”. Adding a similar view was Participant 5 who expressed the importance of performing thorough due diligence at the onset of project finance deals. He expressed his views by stressing “We sort of, I don’t want to say we need to be more intensive in our due diligence around regulation and law because you should be from the outset, it’s not something that you must just do because of any sort of change in rating of a country”. Highlighting the importance of due diligence around projects that involve communities, the participants stressed the importance of a due diligence process that specifically looked at the community involved as well as took into consideration any tribal land issues that could be involved. Explaining this notion Participant 13 argued “you assess them during due diligence phase. For example, a project that’s located in communal or tribal land, the mitigants can come in various ways”.

The second highest ranking assessment measure and mitigation strategy that was identified by participants was ensuring community involvement as a key stakeholder during the assessment phase of project finance transactions. It was not surprising that all participants who had this viewpoint shared similar views with Participant 6 pointing out that “I think that’s necessarily a lender-specific measure that’s introduced, but the program introduce that to ensure meaningful engagement with the communities, meaningful development of the surrounding community”. Adding to the fact that the
scope of community involvement needs to span the entire value chain of the transaction, Participant 8 stated that

you would make sure that the people employed by the projects are coming from the community. You would make sure that as far as you can, the materials, the raw materials used in the projects are sourced from the community. So, you need to make sure that the projects also benefit the community, and by doing so, that would be one of the most effective mitigants, and then over and above that, if you feel that the level of political risk is still too high, then you can source things like political risk insurance.

As the participants highlighted their views, they expressed the importance of getting the buy-in from communities by making sure they are made to feel a part of the project. As Participant 9 explained

I think it is important that you party now with the locals. You need to party now with the locals, and the locals being government, the locals being local communities. And you need to party now beyond compliance, I think that will help. So, you need to make locals feel that they own, and they are part of the project. And the success of the project benefits them, as opposed to coming into some of these areas and try and milk it in isolation.

Participant 13 echoed a similar viewpoint, pointing out that

one of the mitigants would be to include the community via a community trust or a tribal council, we try to include them in the shareholding ownership of the project, other mitigants would be that the project must generate income that will be used to provide services in the community, so that must be defined in the project, that a certain portion of the project income will go towards community income or community projects, so that would be some of the mitigants that you put in place.

The involvement of local leadership including local government stakeholders was highlighted by participants as being a key mitigation measure in ensuring the success of project finance transactions. Participants shared their opinions on the importance of involving local leadership from a political standpoint and in dealing with potential socio-political risks with Participant 1 arguing that
making sure that you’ve got local leadership involved, you know all of those things make a big difference in managing the direct impact of the social aspects of any project. And then really from a long-term perspective is saying well, as an institution, you’ve existed for 100 odd years. The country has seen a lot more turmoil in its past and it came out of it okay, and as an institution the plan is that we need to be here for another 100.

In considering areas that are subject to political instability, Participant 7 shared that

so if there is uncertainty on government long term support for a program that we want to project finance, what the bank will do is they will go and engage with government stakeholders, and there is a situation where we’re going to be doing that one, so that’s how you mitigate it.

Adding their views in support of the involvement of stakeholders, participants explained why it was important to ensure a partnership between government and communities as well as the importance of being guided by well-established government processes. Participant 10 articulated his views by saying

so politically as well, the government has to provide and support. I guess it’s still the same point where I said the community has to be involved. So, if the community is also involved in those projects you mitigate those impacts where and there’s buy-in from the community.

Participant 10 further added that

I think this will be mitigated by maybe government policies where, when you’re running a project you can imagine when we’ve got a ten-year project but the people who initiated that project have got a five-year term so there’s discontinuity in the process. So, I would say the government policy would allow, maybe a system that allows continuity within maybe the political offices or political projects that is not owned by individuals but by institutions.

Another key mitigation measure or strategy that was pointed out by participants was the importance of ensuring compliance with lending regulations in the establishment of project finance deals. Participant 5 explained his organisation’s process by saying

the sort of process we got to undertake is really just to make sure that the regular to environment that we are sort of working in is actually fully legal
compliant if you can put it that way, that the procurement process conforms with all laws and regulations.

Adding to this view was Participant 8 who explained that “you would do a project analysis, build a base case, calculate the returns, and then you would also assist the regulatory environment in that country”, while Participant 11 also added “you look at the regulatory framework, you look at the judicial system and then you look at the capital markets, you make your assessment on those”. It was not surprising that assessing the impact on political and economic landscape of the country was also discussed by participants as being a key assessment measure. Expressing his views, Participant 11 said “I’d say you look at the political environment, look at the economic landscape of the country, GDP per capita which will then inform your employment or unemployment rate and skills level of that country”.

5.4.2. Assessing what securities are typically required because of socio-political risks for project finance transactions in South Africa

This interview question prompted participants to share what they believed to be the nature of securities that are typically required by lenders in project financing deals; particularly for risks that are socio-politically related. A summary of the views of participants on past experiences as well as what they believed to be adequate security is presented in the below table.

Table 5.10
*Socio-political risk securities that are typically required because of socio-political risks for project finance transactions in South Africa*

<table>
<thead>
<tr>
<th>Rank</th>
<th>Constructs</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Political Risk Insurance (PRI)</td>
<td>5</td>
</tr>
<tr>
<td>2</td>
<td>Government Guarantees</td>
<td>4</td>
</tr>
<tr>
<td>3</td>
<td>Off-take Agreements</td>
<td>3</td>
</tr>
<tr>
<td>3</td>
<td>Strong project resources including community members (Human Capital)</td>
<td>3</td>
</tr>
<tr>
<td>5</td>
<td>Capital Adequacy</td>
<td>2</td>
</tr>
<tr>
<td>6</td>
<td>Immovable assets</td>
<td>1</td>
</tr>
<tr>
<td>7</td>
<td>Direct agreements</td>
<td>1</td>
</tr>
<tr>
<td>8</td>
<td>Projected Project Cash Flows</td>
<td>1</td>
</tr>
</tbody>
</table>
Given the currently high uncertainty in the South African political climate, it was not surprising that Political Risk Insurance (PRI) was viewed by participants as being the most significant security measure to be considered by lenders during project finance transactions. As Participant 7 explained:

> you can, on insurance, you can mitigate the risk of strikes a little bit with business interaction insurance but that kicks in usually after 60-days, and it depends on the situation but a lot of that can be insured. If we talk for international lenders, it’s actually a lot easier to mitigate political risk, because from their point of view, they can go to MIGA, which is the world bank, they can go to the private market, they can go to ATI, etcetera, and they can get a policy that says if a political event happens, that the world bank or whichever is the policy holder will pay them out and then the world bank will have a loan against the government of South Africa to recover that money.

Participant 8 shared a similar viewpoint and stated that:

> the only other way you can mitigate is really through PRI and then also what I've seen in the renewable energy space is that, but that's more of a payment thing where if power utility, for instance, is unable to pay you, then you're basically getting a guarantee from the government that they will honour those payments.

Another participant shared a slightly different view, pointing out that while PRI's were important; the idea of such a security was potentially a waste of money. As he expressed this viewpoint Participant 9 stated that:

> I think if you are looking at things like PRI's but in South Africa, that is not very, that is not very dominant. I think it, again it depends on your views around political dynamics, because sometimes you might just be wasting good money for nothing on political risk insurance, specifically within South Africa.

Although he conveyed this view, he conveyed what appeared to be mixed views by later arguing “but, yes, I guess if I were to be asked to embark on a large, long-dated project financed deal in the mining sector at the moment, I might be tempted to consider insurance policy that covers me against regulatory changes. Ja".
Government Guarantees ranked second highest in terms of frequency count with participants expressing somewhat mixed views on government guarantees. While most participants agreed that the backing of government was a necessary security consideration in project finance deals, they questioned whether government would actually pay out in the event of a socio-political risk becoming a reality. As Participant 7 explained,

so I guess, to be honest, I think there is very little you can secure related to that as a South African lender, so yes, we get guarantees from government under our document, under our IPP’s, for example, when we finance a power project in South Africa and we’re buying from Eskom, we get government to stand behind Eskom’s obligations. But in a proper political risk scenario, the question is, is government actually going to pay out, and there’s nothing that you can do about it, you can take them to the court but if the constitution changes in the country, the courts won’t adhere to that payment. So, there is very little that, it all comes down to how bad the political risk is in terms of procurement, there is nothing that can be done if it was procured incorrectly and the court set aside the contract, you lose everything. Because your contract wasn’t valid to begin with, if you look at strikes, yes, you have the assets and security, I guess the way we control that rather is we will only pay for value.

Other participants expressed views that they believed in the event of socio-political events occurring, government guarantees would prove beneficial with Participant 8 saying “but that’s more of a payment thing where if power utility, for instance, is unable to pay you, then you’re basically getting a guarantee from the government that they will honour those payments”. Participant 10 added

so it would be a government guarantee because ultimately I think the government plays a key role in – remember the national project finance is that you want to have more players. You also want to have support from. So, by that nature government has to have a strong guarantee with the other promoters because you’re probably going to use tax money to repay that. So, I think that is the security that you require.

Participants also highlighted Off-take Agreements as being a security that is commonly considered for project finance deals with Participant 3 explaining “Yes. Yes. But we normally take a full security packet on the project finance transaction”. He further
added that “We will take security over project bank accounts. Project agreements, so whether it be off-take agreements”. Participants 4 and 5 expressed similar viewpoints saying

well look, I guess it’s difficult to kind of take security I suppose but what you typically would do is - obviously from a government point of view you’ve got the normal regime. So, it’s a power utility off-take and you’ve got a back-stopper government for default … If you look at, and you know project finance is about cash flow lending. It’s really about looking to the power utility and its ability to meet its on-going payment obligations. So, we’ll make that assessment if we believe that they are putting in play more generation than what they need, it’s a little bit of all those factors.

Most participants agreed that it was important to have strong project resources in the form of financial and human capital as a security measure for socio-political in project finance transactions. Talking about the importance of financial security, Participant 1 expressed the view that

Some real senior level engagement at power utility level, at treasury level to say, well government, what do we need to get out of this as a country and what are the things we need to get right to make sure we can deliver that as a country, as opposed to it being one-sided saying, right the country needs power. It needs to come at a price. We need the money from banks. I think that, and this may be too philosophical a point of view, but my real sense of it is that there’s no way that we can stop being involved in investment in these type of projects, because again, we’re a South African bank in South Africa and we need to have some sort of responsibility around playing a part in its development and development that it very dearly needs across infrastructure.

Adding to the financial aspect, Participant 13 stressed that “mostly in project finance, as a lender or investor, your security is firstly the project cash flows or secondly the project assets but of course securities they normally come into play when the project is struggling so mitigants are trying to prevent that in the first place”. On the importance of human capital and having people with the right skills on projects as a security measure, Participant 10 stated that “and also other securities, operational, to say maybe you’ve got strong technical partners that you know that this project can run”.

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5.4.3. Understanding which mitigation measures or strategies to socio-political risks in South Africa’s project finance transactions are expected to be in place when making the investment decision

This interview question sought to understand from participants what key mitigation measures or strategies to socio-political risks they believed were expected to be in place when making the investment decision. Table 5.11 below presents a summary of the results of the interview question.

**Table 5.11**

*Mitigation measures or strategies to socio-political risks in South Africa's project finance transactions expected to be in place when making the investment decision*

<table>
<thead>
<tr>
<th>Rank</th>
<th>Constructs</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Good community representatives</td>
<td>7</td>
</tr>
<tr>
<td>1</td>
<td>Buy-in from Key Stakeholders</td>
<td>7</td>
</tr>
<tr>
<td>3</td>
<td>Government Guarantees</td>
<td>6</td>
</tr>
<tr>
<td>4</td>
<td>Favourable due diligence results</td>
<td>4</td>
</tr>
<tr>
<td>4</td>
<td>Flexible contractual agreements with Government/Firms</td>
<td>4</td>
</tr>
<tr>
<td>6</td>
<td>Off-take Agreements</td>
<td>2</td>
</tr>
<tr>
<td>7</td>
<td>Thorough Analysis and a sound justification for the project</td>
<td>2</td>
</tr>
<tr>
<td>8</td>
<td>Political Risk Insurance (PRI)</td>
<td>2</td>
</tr>
<tr>
<td>9</td>
<td>Make conservative and flexible investment decisions</td>
<td>1</td>
</tr>
<tr>
<td>10</td>
<td>Projected Project Cash Flows</td>
<td>1</td>
</tr>
<tr>
<td>11</td>
<td>Immovable Assets</td>
<td>1</td>
</tr>
</tbody>
</table>

In understanding the mitigation measures to socio-political risk that are expected to be in place when making the investment decision, the views of participants were consistent with the mitigation measures they believed were necessary as a general principle for the assessment and mitigation of socio-political risks in project finance transactions in South Africa. Having good community representatives as a mitigating measure was one of the two highest ranked factors according to the number of mentions by participants. Expressing his views Participant 4 articulated that

*good community liaison officers, good management, people who’ve potentially have done this before, have seen issues before, have dealt with issues before. And sometimes having a bit of a check on how the money is funnelled to an extent, to the community.*
What was interesting in Participant 4’s response was that he also expressed a conflicting view pointing out that while he believed it was important to get good community stakeholders, it was an area he felt could potentially cause problems or chaos, as he put it, “but we don’t really get involved in that level because I think that has its own – you can go down a rabbit hole there. So, we don’t typically do that”. Participant 6 added to the discussion on community stakeholders as a mitigation measure for socio-political risks by specifically talking about projects that influence the mining sector. He opined that if a mine had to be opened, it would be important to establish the ownership of the land and the relations with surrounding communities. In expressing this view, he argued

\[I\ \text{think you need to establish that first. What would I expect socially and politically to be in place? I think if I think from a mining side specifically, a question and an aspect that we want certainty or a fair degree of certainty and want to know you know what the lay of the land is, is the relationship of the mine with the surrounding communities.}\]

Other participants pointed out the importance of the projects that were being embarked upon as they were beneficial to communities and they believed that this was certainly one way to avoid avert any socio-political risks playing out. Stating this viewpoint, Participant 8 said

\[as\ I\ said\ earlier,\ you\ need\ to\ structure\ a\ transaction\ such\ that\ the community benefits.\ So,\ make\ sure\ that\ you\ are\ employing\ people\ from\ the community.\ Make\ sure\ that\ you\ are\ sourcing\ raw\ material,\ as\ far\ as\ you\ can,\ in\ and\ around\ the\ country\ and\ that\ community.\ Make\ sure\ that\ the community has a reasonable shareholding in that project so that it can benefit.\ And\ make\ sure\ that\ whoever\ is\ sitting\ as\ the\ shareholders,\ as having part of that shareholding is representative of the community and that the money does actually flow to the community.\]

Adding to a similar viewpoint was Participant 10 who spoke specifically about those projects that required communities to relocate stating that

\[the\ relocation has to happen but the way you mitigate is to have buy-in within the community. So, the community must buy-in and understand why they are being moved. So, we can see that even through just educating people we are mitigating that.\]
The involvement of communities as shareholders in key projects also emerged as a key theme that was important in ensuring the success of projects due to the interest that community would have. Explaining this viewpoint was Participant 13 who highlighted that

*here in South Africa, it's mainly community ownership in projects, so it's the shareholding of communities in projects, so that is typically the main mitigating strategy for project finance. Communities where the community risk is high, has been identified as high and the best mitigating strategy is to include them in shareholding especially using the provisions of black economic empowerment here in this country because we have those provisions in our constitution, we don't have those jurisdictions in other countries, so we can use those provisions to earmark part of the shareholding to the community.*

A similar theme that ranked equally high was that of getting buy-in from key stakeholders. As participants pointed out, the extent of involvement of key stakeholders prior to the start of projects played a role in circumventing some socio-political risks. Explaining the importance of getting key stakeholder buy-in was Participant 9 who said

*obviously to the extent that you can have any development recourse; that helps. To the extent that you have got shareholders, shareholders that are reflective of the socio diversity of the country that helps. To the extent that you have got government fully behind the project that helps also. Ja.*

Participants agreed that obtaining government guarantees at the time of making the investment decision was played an important role in putting mitigating measures in place for potential socio-political risks. Participant 1 added

*so I think now we, you're probably going to try and exclude dependency on taking risk purely on utilities on provincial governments for that matter. I think that we would want to look at a lot more direct, call it security, or direct guarantee / obligation from treasury itself rather than being able to take a view on utilities because everything around that is becoming a lot more questionable.*

Participant 3 said “a lot of these processes have a government leg to it, when they have an agreement with a governmental part” referring to the notion that most project finance deals often include the involvement of government to a certain extent. Sharing
his experiences on a different project was Participant 11 who explained how having
government guarantees in place played a role in his project by saying that

well, the project was a success, we opened it, but we still haven’t seen our
money. So that was pure assessment and that’s how we chose to mitigate.
What to note is that there was actually regime change and they did want to
change hands of the people who were there previously, and we had
Mozambican partners and shareholder. Now the incoming people wanted
to kick them out and put themselves in, that’s what happens but because of
how it was structured and the agreements we had, while it produced a
delay in the project, it still mitigated the project from those types of events
where the project has taken your money and you’ll never see your money.

The discussion on ensuring favourable due diligence results as part of the decision-
making process was raised by participants again with participants agreeing that lenders
needed to make sure of the financial sustainability of projects as well as of the
governance structures that are in place before making investment decisions.
Participant 1 thought that the following was important:

... long-term financial sustainability, quality of governance, all those kind of
things. And that would be the key in my mind, I think, a change that we
would probably look for. And the other one being building in triggers in that
if there are external or if government continues along a path which results
in further downgrade and divestment, to make sure that we give ourselves
enough triggers to either make the right adjustment in appetite or price.

The importance of flexible contractual agreements with government and firms was
raised by participants who agreed that agreements had to be flexible enough to allow
lenders or some stakeholders to change the terms of agreements if the need arose.
Articulating this perspective, Participant 2 said

You know you try and, let’s say when one comes to security of tenure for
instance, you can go to the government and tell them why you want a
longer contract, because it can’t work for you [indistinct] the finance. You
negotiate with them and they probably will listen to you and they may grant
you what you want. So, most of the time we do get that.
5.4.4. Assessing how newly identified socio-political risks are handled, when they appear during the life cycle of the project

This interview question required participants to reflect on current and previous projects that they have been involved in and share their views on how newly identified socio-political risks were handled when they appeared during the lifecycle of the project. Many of the participants could refer to actual projects they had been involved in while sharing their views. The table below gives an overview of the themes that emanated from the interviews.

Table 5.12

<table>
<thead>
<tr>
<th>Rank</th>
<th>Constructs</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Apply the mitigation strategies already defined within the organisation</td>
<td>8</td>
</tr>
<tr>
<td>2</td>
<td>Be dynamic enough to change project approach</td>
<td>6</td>
</tr>
<tr>
<td>3</td>
<td>Have dialogue and negotiations with relevant stakeholders to understand root cause</td>
<td>4</td>
</tr>
<tr>
<td>4</td>
<td>Maintain a Risk Log</td>
<td>2</td>
</tr>
<tr>
<td>5</td>
<td>Take a Proactive Approach in actively identifying some of the potential risks</td>
<td>1</td>
</tr>
<tr>
<td>6</td>
<td>Use the benefit of flexible contractual agreements</td>
<td>1</td>
</tr>
<tr>
<td>7</td>
<td>Seek the help of government or the country’s legal framework</td>
<td>1</td>
</tr>
</tbody>
</table>

It was not surprising that most participants pointed out that there were already mitigation strategies put in place within their organisations with most citing that they reverted to applying those mitigation strategies already defined within the organisation in the event of a socio-political risk occurring during the lifecycle of their projects. Participant 1 argued that

*as these things arrive there’s a clear kind of process that defines how you go about dealing with them. In terms of the broader things, the one is, I think generally a larger consciousness around trying to be a lot more proactive around identifying the possibilities of some of these risks. Trying to anticipate different scenarios and plan for those scenarios. But at the same time make sure that you are having the right type of engagements...*
throughout the lifecycle with the right stakeholders to make sure that you see the train coming.

One of the participants pointed out that mitigation strategies naturally had to be in place before the start of a project because once it had commenced, not much could be done. In expressing this view Participant 6 explained that

*I think a lot of this, to answer your question, I don’t think there’s so much that you can do once the project is live, once the project is up and running, I think the tools that you have are limited then. I think a lot of that is addressed in the documentation and the project, in putting the project together, in finalising the agreements and all of that.*

Giving examples of what actually would happen in the event of socio-political risks occurring on certain projects, Participant 9 stated that

*then you would either have to extent the turnout or the construction phase, if you are still in the construction phase, or rework the models and things like that. But there is a project versus construction periodically, depending on the nature of the project, then you would have to relook at things on a monthly basis, quarterly basis to check progress.*

while Participant 12 pointed out that an insurance claim would be the mitigation measure in the event of a labour unrest saying "*Yes, it is something that comes up say there’s like a major labour unrest or whatever, that’ll happen, and we will have insurance*". Also adding to the view that alternative measures had to be considered, Participant 12 went to the extent of saying

*you know you don’t have a choice, so you will have to make it work under the nationalised government, what else you are going to do. It’s either you shut this thing down or you operate it and that’s the will of the government of the day, so I would keep it going because you’re going to lose more money if you close this thing down.*

Participants also agreed that it was important to be dynamic enough to change the project approach in the event of socio-political risk occurring during the lifecycle of a project. Emphasising this point was Participant 3 who highlighted "*I think in that case then what we would do is, because you are in already, so have to look at it differently, so say, what can be done to get to a point where you can continue with the project as*
originally envisaged?”. Adding to this notion was Participant 6 who pointed out that while these cases needed to be handled on a case by case basis, he believed that projects were by design robust enough to change course when required to. He articulated his view by saying

I think it’s on a case-by-case basis. But I think if you draw through it all, if I think of political, let me think of an example. A political risk that manifest itself. I think to a large extent if I think of political events of late, I think by design the projects are fairly robust and can withstand quite a bit of stress in that regard.

Talking about the importance of dynamism and flexibility of contracts, Participant 5 explained how a risk was mitigated on a project that he was involved in saying “so although it was an issue we had negotiated adequate contract arrangements such that our project company would not be affected by this new risk that suddenly popped up. It was actually an EPC risk issue”.

The importance of having continuous dialogue and negotiations with stakeholders was agreed upon by participants as being important towards handling socio-political risks that were identified during the lifecycle of a project with Participant 10 arguing that

So as you go through a project I think you don't have all the solutions. As you go through the process you see risks, you see some obstacles. But the way it is also handled is, the risk obviously fall in a category where there are advisors, there are partners there who are running the project. So, it’s also addressed at that point in time when it comes it is addressed as a risk and potential mitigants are looked at that point in time. Because as you progress you are bound to see new challenges and you have to sit through those challenges as a project committee or any other body which is specific to that function.

Adding a similar viewpoint was Participant 8 who stated

I think it would be general because I have seen where a political risk issue has appeared. I’ve never seen a transaction where the fanciers will start shutting down the project and pulling out. Usually it becomes more of a negotiation between the different parties, so it will be the project financiers, it will be the government, it will be the community leaders, and try and get
into some sort of a political agreement. Usually the project financiers will be required to give up something to appease the leaders.

Of importance in the handling of risks that occur in projects is the maintenance of a risk log which ensures record-keeping of the risks identified or those that manifest themselves. If used correctly a risk log can be used as input to the assessment of risks for new and upcoming projects. Articulating her view on the documentation of risks, Participant 1 indicated that

so at transaction level, everything would be documented on day one around how you go about dealing with risk as they appear. You know it’s typically, as a financial institution you’re going to have a whole heap or rights that allow you to do many things to protect your position, to protect your exposure, to make some changes and those are on a transaction by transaction basis.

While Participant 6 added

I don’t think there’s so much that you can do once the project is live, once the project is up and running, I think the tools that you have are limited then. I think a lot of that is addressed in the documentation and the project, in putting the project together, in finalising the agreements and all of that.

5.4.5. Understanding if there are any mitigation measures or strategies that have been implemented in project finance transactions in South Africa as a response to the sovereign credit downgrading earlier in 2017

This interview question encouraged participants to reflect on the sovereign credit downgrade that took place in South Africa in 2017. The interview question sought to understand if there were any risk mitigation measures that had been implemented in project finance transactions in response to this downgrade according to the opinions of participants. A summary of the views of participants in response to this interview question are reflected in the below table.

Table 5.13
Mitigation measures or strategies have been implemented in project finance transactions in South Africa as a response to the sovereign credit downgrading earlier in 2017
<table>
<thead>
<tr>
<th>Rank</th>
<th>Constructs</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>None that I am aware of</td>
<td>6</td>
</tr>
<tr>
<td>2</td>
<td>Explore the possibility of re-pricing transactions</td>
<td>2</td>
</tr>
<tr>
<td>3</td>
<td>Access to political, commercial and credit risks (SINOSURE)</td>
<td>1</td>
</tr>
<tr>
<td>4</td>
<td>Adopting a more conservative investment approach</td>
<td>1</td>
</tr>
<tr>
<td>5</td>
<td>Apply more effective due diligence as a future measure</td>
<td>1</td>
</tr>
<tr>
<td>6</td>
<td>Ability of lenders to not bear the cost but instead pass it onto the project</td>
<td>1</td>
</tr>
</tbody>
</table>

Most of the participants indicated that they were not aware of any mitigating measures that had been implemented in project finance transactions in response to the 2017 sovereign downgrade. Participants such as Participant 5 openly admitted “not that I’m aware of. I think it is more about as I said to you what limits an institution will have for the sovereign. Those haven’t changed as far as I’m aware in our case”. Further expressing the view that the downgrade came as no surprise Participant 5 added “The sovereign downgrade has been expected for a while, it’s not a surprise. Our bank at least has been preparing for it like for two years. People keep saying it’s likely to come”.

Other participants expressed their views as follows:

*I can’t think of anything that you can do, you can only price that in.*

*No. Talking from experience.*

One of the participants was rather indistinct in answering this interview question but spoke about the exploring the possibility of re-pricing transactions. It was not clear if he was referring to what his organisation had done in response to the downgrade or whether he was anticipating what could be a potential solution in the event of another downgrade taking place. In answering the question Participant 4 indicated “yes, I do think that you are going to start seeing, is you are going to have downgrade pricing”. The question was evidently difficult for some participants to answer with Participant 8 going to the extent of saying

*I’m trying to think hard here. Usually, but that’s not a great mitigant, usually what you would have is, in the finance documents you can put in a trigger*
to say if the rating of South Africa falls below investment grade, for instance, you’ve got the right to re-price the transaction to make sure that the economics of the project still work. But that’s more of a return argument.

One of the participants pointed out that some companies were said to have acquired political, commercial and credit risks (SINOSURE) insurance as a measure against the political instability in South Africa. As she pointed out, Participant 7 said

we believe that it’s because, behind the scenes they are purchasing Sinosure [Chinese State-Owned Enterprise that provides Export Credit Insurance] cover because they are concerned about the political risk in South Africa. Sinosure as an ECA typically won’t go longer than 15-years, I think what we are seeing is reduced tenors, I think South African banks are concerned about tenor and I think international banks are even more so, so I think that is some of the, that’s kind of the impact that people are, that’s how people are mitigating it.

Another participant shared his experience about some projects that have been impacted by the sovereign downgrade and explained how applying more effective due diligence as a future measure would benefit the cost of funding. As he explained this view, Participant 13 indicated that

We have experienced that, one or two projects have now failed because of this downgrade but obviously going forward, as part of the projects you are seeking to finance, your due diligence has to be robust in terms of assessing the sensitivity of the project to the cost of funding.

5.4.6. Evaluating which mitigation measures or strategies to socio-political risks in South Africa have lost their effectiveness

This interview question prompted participants to evaluate which mitigation measures applicable to socio-political risks they deemed to have lost effectiveness in protecting project finance deals against risk in South Africa. The question encouraged participants to reflect on their experiences on current or past project. Table 5.14 below presents a summary of the responses by interview participants.

Table 5.14
Evaluating which mitigation measures or strategies to socio-political risks in South Africa have lost their effectiveness
The opinions of participants were varied in nature with several participants debating the value of community shareholding as a mitigation measure. Most of the participants pointed out that they believed community shareholding was not always effective as a mitigation measure. Expressing some of his concerns Participant 2 argued

*but by its very nature that structure and equity players that cash flows are not guaranteed. So how then does the money trickle down to the communities? And then there was an issue on who sits on the Trustees Board so I come back to those connected people. Then if money goes to the Trust, so the Trust because you fund the cash out in the vendor debt, the community doesn’t quite see it.*

He questioned the way funds were being handled in the management of some community related projects. Also in opposition of the effectiveness of community shareholding as a mitigating factor was Participant 8 who stressed

*I think previously, project financiers have been playing or lip-service to the whole transformation issue. There is one project, there is one mine, the chrome mine project where the project financier had promised the community that they will have certain shareholding.*

Adding to this dispute was Participant 13 who expressed the view that

*Yes, the community shareholding mitigant that we’ve applied in a number of project finance transactions is also losing its effectiveness of late. We’ve also been noticing that communities become divided or factionalised or*
some community members feel it’s only benefitting a certain group of members of the community.

It was interesting to hear the views of some participants who openly expressed their observations that socio political risk factors were never considered in South Africa before hence they could not answer the question. As Participant 1 shared her views, she indicated that

so like I was saying earlier on, in the context of any transaction in this market 5 years ago, we would never be having the conversations around long-term sustainability of the country, long-term political views of the country whereas we’re having those conversations now.

Adding to the list of factors that were deemed less effective, participants noted the trust structures that had been set up but appeared to lack transparency. As Participant 2 shared his observations, he said

So you could set up a trust structure which IDC then funds, and we’ve got people within IDC that advises on what is the meaning for shareholding. But by its very nature that structure and equity players, cash flows are not guaranteed. So how then does the money trickle down to the communities? And then there was an issue on who sits on the Trustees Board, so I come back to those connected people.

One other participant pointed out that they believed government guarantees were not always effective. As he stressed the point Participant 3 said “Ja, that is if the sovereign is no longer good for its word. And that’s the way I know it, close to that. Ja, not in – not in South Africa”.

5.4.7. Evaluating which mitigation measures or strategies participants proposed to replace the less effective mitigation measures or strategies

This interview question requested participants to propose mitigation measures or strategies that they believed would be suitable to replace less effective mitigation measures or strategies. A summary of the various proposed measures and mitigation strategies recommended by participants is presented in the Table 5.15.

Table 5.15
Which mitigation measures or strategies are proposed to replace the less effective mitigation measures or strategies
<table>
<thead>
<tr>
<th>Rank</th>
<th>Constructs</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Engaging and appointing the correct stakeholder for Community Shareholding as a risk mitigation measure</td>
<td>4</td>
</tr>
<tr>
<td>2</td>
<td>A formalised approach to ensure effective allocation of resources to projects</td>
<td>3</td>
</tr>
<tr>
<td>3</td>
<td>Tighter compliance to lending regulations</td>
<td>2</td>
</tr>
<tr>
<td>3</td>
<td>Tighten lending regulations in respect of Environmental impact</td>
<td>2</td>
</tr>
<tr>
<td>5</td>
<td>Ensure Community Shareholding as a mitigation measure caters for various aspects of the community</td>
<td>1</td>
</tr>
<tr>
<td>6</td>
<td>Reliance on projected cash flows from project as a basis</td>
<td>1</td>
</tr>
<tr>
<td>7</td>
<td>The provision of a clearer sovereign downgrade regime</td>
<td>1</td>
</tr>
<tr>
<td>8</td>
<td>Factor in risk pricing to the structuring of project finance deals</td>
<td>1</td>
</tr>
<tr>
<td>9</td>
<td>Investing in early education programmes that will empower youth and reduce the high rates of poverty</td>
<td>1</td>
</tr>
</tbody>
</table>

Again, the theme of community shareholding was dominant in answering this interview question with participants pointing out that engaging and appointing the correct stakeholders for community shareholding as a socio-political risk mitigation measure was a key factor for consideration in future project finance transactions. Sharing his viewpoint Participant 13 highlighted that

_of late, what we think is far more effective is the community services. Basically the project promoters, with our involvement as project financiers, that each community has its own unique requirements or needs such as infrastructure like roads, bridges, water services, it could be schools, it could be hospitals, so rather than giving shareholding … because the shares are normally held via a trust and the trustees will either be the tribal leaders, chiefs and those sort of people and that’s where the miscommunication between the trustees and the community tends to happen, however, if a project bypasses the shareholding, then try to identify within that community, what do the community members require, each and every member, what are their key requirements._

Adding to this outlook was Participant 8 who stressed “I think making sure that you elect the community leaders into the board. That those community leaders, when for
instance, dividends are distributed, they account back to the board as to what was done with that money”.

Participants also raised the view that a formalised approach to ensuring effective allocation of resources to projects was a socio-political risk measure that would work well in protecting future project finance transactions in South Africa. In articulating his view, Participant 4 stated

   And I do understand that, I think where there’s been a lot of, we certainly have seen it on some of our projects. And I’m talking about really, really top notch performing projects. Where the Trust was never set up, so the DFI never appointed Trustees and it wasn’t set up properly and the money just sits in an account. It’s incredibly frustrating because there’s money there that’s available to go to this community and it just sits there because of the admin issues.

Tighter compliance with lending regulations was highlighted by participants as being a socio-political risk measure that could be used to replace less effective mitigation measures. Participant 10 expressed his views on the notion of tighter compliance by saying

   I was just thinking along that but to say the contract, not all contracts but obviously it’s one of the measures, the mitigant that sometimes when we are in the program, first to get that contract. That procurement process is now compromised … It can be at the first phase of maybe when you’re starting a project do you want the different partners then that program and processes as much as we’re going to get a solid contract; but the program and processes now may not point to the right person, the best person at a cheaper price.

One participant made an interesting and not so commonly mentioned suggestion on tightening lending regulations in respect of environmental impact as mitigation measure for socio-political risks. As he articulated his argument, Participant 5 spoke about environmental compliance funds saying

   The world is changing and there’s more climate change considerations coming into place. The government I don’t think has thought about that as extensively as it should. We’re moving, we are sort of a mixed economy and a lot of the sort of DFI’s and international finance institutions sort of see
us as having to comply with International norms when it comes to environmental issues and climate change, and if anything, we are seeing a lot more focus on the impact on the environment and what we do.

5.5. Conclusion
The results from the fifteen interview questions were presented in this chapter. The constructs that emerged from the interviewing process will be tested against existing literature through analysis of interview data on the topic of the impact of socio-political risks on project finance in South Africa.
CHAPTER 6: DISCUSSION OF RESULTS

6.1. Introduction to the Results Discussion
The previous chapter presented the results from the fifteen interview questions with thirteen project finance practitioners and experts. In this chapter, the constructs and data that emerged from the interview process will be discussed in light of the theory presented within the literature review in Chapter 2. The discussion will be divided into three sections according to the research questions identified in Chapter 3.

6.2. Results Discussion

6.2.1. Section 1: Main socio-political risk factors
Research question 1 asked: “What are the main socio-political risk factors that affect project finance in South Africa?”. The question sought to understand the main socio-political risks associated with project finance within a South African context. The question further considered socio-political risks from investment phase and throughout the project's life cycle.

6.2.2. Understand the key socio-political risk factors affecting project financing in South Africa when making investment decisions and throughout the project life cycle
The interview results identified political climate or landscape, intergovernmental relations and coherence, as well as community involvement and interests as key socio-political risks affecting project finance in South Africa. Given the long-term nature of project finance as an asset class, stability of the political climate or landscape in South Africa is crucial from both a funding and a lending perspective. In addition to political stability, the participants emphasised policy uncertainty as a key socio-political risk factor for project finance within a South African context. The general misalignment of interests between intergovernmental institutions is also viewed as a key socio-political risk factor, with examples incoherent messages which resulted in uncertainty for project finance investments. Community involvement and interests were highlighted as a key socio-political risk factor by participants as project developers are required by funders to attain buy-in from communities.

Political risks within a project finance context contain societal, political and legal dynamics (Khattab et al., 2007; Naderpajouh et al., 2014). Gatti (2013) categorises
political risks in project finance into investment risks, change-in-law risks and quasi-political risks, while Khattab et al. (2007) emphasised the importance of understanding political risks in project finance by linking the risk factor or threat to its source.

The key socio-political risk factors identified by participants, namely political climate or landscape, intergovernmental relations and coherence and community involvement and interests are consistent with current literature as they are influenced by both the political and social dynamics applicable to political risks within a project finance context. The sources of key socio-political risks identified by participants are as follows: Political climate or landscape (Government and Society); Intergovernmental relations and coherence (Government and Intrastate) and Community involvement and interests (Government, Society and Intrastate).

6.2.2.1. Determining whether there had been any project financing transactions that had been reviewed and declined due to socio-political risks in South Africa

Most participants had responded that they had declined project finance transactions in South Africa due to socio-political risks, the decision being attributable to political interference, projects involving displacement of communities and non-compliance with regulations.

Literature highlights the significance of socio-political risks within a project finance context and its importance in deciding whether to engage in particular projects within emerging markets (Cohen et al., 2014; Esty et al., 2014; Okanlomo, 2016; Rezvanian, 2013). Furthermore, the reviewed literature challenges researchers to consider the properties of the political system that are relevant to private sector driven growth, meaning that they have to look at the political variables that are important in making the investment decision, variables that are crucial to the investment decision, the success of the project and risks that are under the influence of the financier (Demirag et al., 2011; Okanlomo, 2016).

Feedback from participants is consistent with the literature as the significance of socio-political risks and the decision to engage in projects was attributable to socio-political risks such as political interference and projects involving displacement of communities. The socio-political risks attributed to declining to partake in the project finance transaction is a contribution towards the body of knowledge regarding project finance in South Africa and particularly in understanding the properties of a political system that are crucial to the investment decision.
6.2.2.2. Determining whether there are socio-political risks that financiers deemed only applicable solely to South Africa

Mixed views were presented by the participants on whether there were socio-political risks that financiers deemed solely applicable to South Africa.

Some participants were of the view that South Africa was generally perceived to be stable and favourable for financing, especially when compared to other African countries. Despite concerns around South Africa’s current political outlook, this did not discourage funders as the country has a sound regulatory environment, which positions South Africa more favourably when compared to other African countries. Thus, participants were of the view that the existence and significance of socio-political risks in South Africa when compared to other African countries is perceived to be the inverse, e.g. applicable to other countries and not South Africa.

Other participants perceived that there were socio-political risks that are only applicable to South Africa based on the view that South Africans were considered activists and an engaged society, especially regarding issues in which communities disagreed by undergoing service delivery protests and the recent “fees must fall” campaign in tertiary education as examples of an activist and engaged society.

Literature has challenged researchers to consider the properties of a political system that are relevant to private sector driven growth, meaning that they have to look at the political variables that are important in making the investment decision, variables that are crucial to the investment decision, the success of the project and risks that are under the influence of the financier (Demirag et al., 2011; Okanlomo, 2016).

The feedback from the participants is a contribution towards the body of knowledge insofar as understanding that there are mixed views regarding the distinctiveness of socio-political risks in South Africa when compared to other countries.

6.2.2.3. Determining the top five socio-political risks of project finance in South Africa and the source of the socio-political risks based on three categories, namely Government, Society, and Intra/Interstate

Participants identified most of the socio-political risks to be linked with the government as a source. The top five socio-political risks by participants are tabulated below. Social and civil unrest is the highest ranked, which is largely emanates in the form of labour issues with society at the centre as they form the constituency that elects government. Examples of political instability or uncertainty include the recent cabinet reshuffles in the South African government where the country had three different Ministers of
Finance within a period of a few days, which had an adverse effect on reference rates for funding instruments. Policy changes and uncertainties were highlighted with examples in the form of the IRP, which is yet to be finalised and the constant change in policies relating to the local content requirement, which are constantly changing and making it difficult in providing a conducive environment for project finance.

Table 6.1

*Top five socio-political risks affecting project finance and their related source(s)*

<table>
<thead>
<tr>
<th>Ranking</th>
<th>Socio-political risk</th>
<th>Source(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Social and Civil Unrest</td>
<td>Government, Society and Intrastate</td>
</tr>
<tr>
<td>2</td>
<td>Political Instability/ Uncertainty</td>
<td>Government and Society</td>
</tr>
<tr>
<td>3</td>
<td>Policy Changes and Uncertainties</td>
<td>Government and Intrastate</td>
</tr>
<tr>
<td>4</td>
<td>Sustainability of SOE</td>
<td>Government and Intrastate</td>
</tr>
<tr>
<td>5</td>
<td>Volatility in the Currency</td>
<td>Government</td>
</tr>
</tbody>
</table>

Linking each threat or risk factor to its source assists in understanding political risks within a project finance context (Khattab et al., 2007). According to the top five socio-political risks in Table 6.1, Government and Intrastate appear to be the most common sources of the top socio-political risks affecting project finance in South Africa, when linked to the key socio-political risks in 6.2.1 regarding the current instability of the political landscape, policy uncertainty and incoherence between government institutions.

6.2.2.4. Section Summary: Research Question 1

Research question 1 was posed in order to understand the main socio-political risks affecting project finance in South Africa, with further consideration to the socio-political risks during the investment phase and throughout the project life cycle.

The main socio-political risks affecting project finance in South Africa highlighted in this study are summarised in Table 6.2 together with the related source of the risk.
Table 6.2  
**Summary of main socio-political risks affecting project finance in South Africa**

<table>
<thead>
<tr>
<th>Socio-political risks</th>
<th>Source(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political Instability/ Uncertainty</td>
<td>Government and Society</td>
</tr>
<tr>
<td>Policy Changes and Uncertainties</td>
<td>Government and Intrastate</td>
</tr>
<tr>
<td>Misalignment of interests between intergovernmental institutions</td>
<td>Government and Intrastate</td>
</tr>
<tr>
<td>Sustainability of SOE</td>
<td>Government and Intrastate</td>
</tr>
<tr>
<td>Social and Civil Unrest</td>
<td>Government, Society and Intrastate</td>
</tr>
</tbody>
</table>

Based on the findings summarised in Table 6.2, the most common sources of socio-political risks affecting project finance in South Africa originate from Government and Intrastate.

Socio-political risks in project finance in the South African context are emphasised as being the most significant risks by participants who remarked that their awareness of project finance transactions that have been declined due to socio-political risks fall into the categories, political interference, projects involving displacement of communities and non-compliance with regulations.

Participants had mixed views regarding the distinctiveness of socio-political risks being applicable to South African and not necessarily to other countries.

Feedback from the participants was largely consistent with literature, specifically regarding the significance of socio-political risks in deciding to engage in projects and contributing to the body of knowledge insofar as understanding the properties of the political system that are crucial to the investment decision (Cohen et al., 2014; Demirag et al., 2011; Esty et al., 2014; Okanlomo, 2016; Rezvanian, 2013).

### 6.2.3. Section 2: The effect of socio-political risk factors on project finance

Research question 2 “**How are socio-political risk factors affecting project finance in South Africa?**” sought to determine the manner and the extent of socio-political risks on the progress of infrastructure development supported by project finance. This research question further incorporated the perception of financiers on political risks in
South Africa and the extent to which they affect project finance, with a focus on the recent changes in the South African economic landscape.

6.2.3.1. Understanding whether the financier’s perception of South Africa’s political risks restricted the provision of project finance

Most of the participants were of the view that socio-political risks associated with South Africa have reduced the financiers’ appetite for investing in project finance, and as a result financiers are not keen to invest in the long term.

Relevant literature in this regard by Demirag et al. (2011) and Okanlomo, (2016) emphasises the need to consider the political variables that are important in making the investment decision, variables that are crucial to the investment decision, the success of the project and risks that are under the influence of the financier.

Feedback from participants is consistent with literature and further explains that the perceptions of the financiers on socio-political risks ultimately result in reduced appetite and ultimately a restriction in the provision of project financing.

6.2.3.2. Understanding the stage in the project life cycle where socio-political risks are most prone (Bid, Construction of Operational phases)

A strong theme that emerged from the participants was the notion that the construction phase was mostly prone to socio-political risks, with examples largely emanating from social unrest in the form of labour and community protests. The Bid phase was the second most ranking phase that is prone to socio-political risks largely due to the recent experiences in REIPPPP where the period between bid and financial close was extended largely due to policy uncertainty.

Similarly, with literature applied in 6.2.2.1, the above feedback from participants is a contribution to the body of knowledge insofar as the phases in which socio-political risks are mostly prone to manifest, in this context during the construction phase, followed by the bid phase.

6.2.3.3. Understanding how South Africa’s credit downgrade earlier in the year (2017) affected project finance transactions

Participants highlighted the increase in the cost of finance as one of the most prominent factors. The second most prominent factor is that the downgrade discouraged investment in the country by limiting access to funds from the international
markets and restricted South African banks from undertaking more roles within the project finance structure, such as account bank and agent.

Literature relating to sovereign credit ratings describes the outcomes of a credit downgrade as resulting in an increased cost of debt and reduced or reprioritised investments away from the downgraded jurisdiction (Almeida et al., 2017; Larraín et al., 1997).

Thus, participants and literature regarding the impact of the sovereign credit downgrade were aligned.

6.2.3.4. Understanding how new government policies affect project finance transactions

Most participants were of the view that new policies have created uncertainties, specifically referring to the new policies within the mining and energy sectors in South Africa.

Policy uncertainty has also been viewed by participants as one of the top five socio-political risks in project finance within South Africa under 6.2.1.4.

It is imperative to highlight the coherence between literature from Esty et al. (2014); Okanlomo (2016); Rezvanian (2013) and participants’ feedback under 6.2.1.2 insofar as the significance of socio-political risks on the decision to engage in projects, in this case socio-political risks arising from policy uncertainties.

6.2.3.5. Section Summary: Research Question 2

The objectives of Research question 2 were to determine the manner and the extent of socio-political risks on the progress of infrastructure development supported by project finance. The question further sought the perception of financiers on socio-political risks in South Africa and the extent to which they affect project finance, with a focus on recent changes in the South African landscape.

Participants’ feedback was mostly consistent with literature, which also included findings which were contributions to a new body of knowledge insofar as understanding the variables that are critical to the investment decision.

The introduction of new policies affecting project finance in South Africa has resulted in policy uncertainty. Given the emphasis of policy uncertainty as one of the main socio-political risks affecting project finance in South Africa under 6.2.1.5, it is also critical in deciding to engage in projects. Moreover, the financier’s perception regarding socio-political risks does affect the appetite towards investing in project finance.
The impact of the sovereign credit downgrade in South Africa has resulted in increased cost of finance and further discouraged investment into the country by limiting access to funds from both international and local capital markets.

6.2.4. Section 3: Mitigation measures or strategies that can be applied

Research question 3: “What are the mitigation measures or strategies that can be applied to mitigate socio-political risks?” was posed with the objectives of understanding how socio-political risks are assessed and the related strategies to mitigate those risks.

6.2.4.1. Understanding how socio-political risks are assessed and what strategies are used to mitigate these risks for project finance transactions in South Africa

Most participants highlighted the importance of conducting an effective due diligence process, which included specific consideration for the communities around the project. Participants further emphasised ensuring community involvement as a key stakeholder in the assessment phase of the project finance transaction, which needs to span across the entire value chain of the project finance transaction. The buy-in and involvement of community and local leadership, including local government stakeholders was highlighted as a key mitigation measure to ensuring the success of the project finance transaction. Another key mitigation measure or strategy pointed out by participants was ensuring compliance with lending regulations in the establishment of project finance deals.

Firstly, the literature refers to the existence of various methods in which risks are assessed, ranging from risk checklists with categorisations of the project risks to other more intuitive methods based on different phases in the project life cycle (Bing et al., 2005; Gatti, 2013). The Bujagali Dam project in Uganda is a case in point within project finance where socio-political risks associated with the communities around the project manifested and ultimately had an adverse effect on the project (IRM Compliance Review Panel, 2008; Naderpajouh et al., 2014). Literature also proposes the implementation of an interactional model, which focuses on the power dimensions of interaction as mitigating tool for such risks emanating from communities (Naderpajouh et al., 2014).
There is consistency between the views of participants and literature regarding the existence of the various methods applied to assess project risks and with the mitigation measures or strategies applied within a South African context.

6.2.4.2. Assessing what securities are typically required to mitigate socio-political risks for project finance transactions in South Africa

Participants emphasised Political Risk Insurance as the most generally required security measure to be considered by lenders, particularly with the current levels of uncertainty arising from South Africa’s political environment. Government guarantees were highlighted by participants, albeit with mixed views where some participants questioned whether government would pay out if socio-political risks become a reality and other participants believed that the government guarantee to be beneficial to the overall project structure. Participants also highlighted offtake agreements as a commonly considered security in project finance along with the full security packet, which included taking over project bank accounts. Most participants agreed on the importance of having strong project resources in the form of financial and human capital as a security measure for socio-political in project finance transactions.

The literature refers to Political Risk Insurance, government guarantees and various forms of direct agreements with the project host governments as common mitigating measures or strategies for addressing socio-political risks in project finance (Gatti, 2013; Shou Qing Wang et al., 2000; Yescombe, 2013).

It is important to note the coherence between literature and feedback from the participants. Additionally, given the current political environment within South Africa, the inclusion of Political Risk Insurance is gaining relevance and the mixed views from project finance practitioners and experts regarding the effectiveness of a Government Guarantee from the South African government as a mitigation measure or strategy.

6.2.4.3. Understanding which mitigation measures or strategies for socio-political risks in South Africa’s project finance transactions are expected to be in place when making the investment decision

The views expressed by the participants were consistent with the mitigation measures or strategies which they believed were necessary as a general principle for the assessment and mitigation of socio-political risks in project finance transactions in South Africa. These mitigation measures or strategies included good community
representatives, buy-in from key stakeholders, government guarantees; favourable due diligence results and flexible contractual agreements with governments and firms.

Mitigation measures or strategies reflected in literature highlighted under 6.2.3.1 and 6.2.3.2 are largely consistent with the feedback from the participants. The notable difference between is the addition of flexible contractual agreements with governments and firms by the participants.

6.2.4.4. Assessing how newly identified socio-political risks are handled, when they appear during the life cycle of the project

Most participants pointed out that there were mitigation strategies that were already put in place within their organisations with most citing that they reverted to applying those mitigation strategies already defined within the organisation in the event of a socio-political risk occurring during the lifecycle of their projects. Participants also highlighted the importance of being dynamic enough to change the project approach in the event of socio-political risk occurring during the project life cycle.

Given the consistency between literature and participants insofar as risk assessment methods, risk allocation and mitigation measures extend to the views expressed by the participants when newly identified socio-political risks appear during the project life cycle. It is also important to highlight the specific emphasis by participants to ensure that flexibility of contractual agreements with governments and firms.

6.2.4.5. Understanding whether any mitigation measures or strategies have been implemented in project finance transactions in South Africa as a response to the sovereign credit downgrading earlier in 2017

Most participants have indicated that they were not aware of any mitigating measures that had been implemented in project finance transactions as a response to the 2017 sovereign downgrade.

Demirag et al. (2011) and Okanlomo (2016) emphasise the need to consider the political variables that are important in making the investment decision, variables that are crucial to the investment decision, the success of the project and risks that are under the influence of the financier.

The feedback provides an indication that mitigation of the increased cost of finance resulting from the sovereign credit downgrade is currently not crucial in the project finance context in South Africa.
6.2.4.6. Evaluating which mitigation measures or strategies for socio-political risks in South Africa that have lost their effectiveness

Participants expressed an assortment of opinions with some questioning the effectiveness and value of community shareholding as a mitigation measure, which is largely influenced by the vendor financing structure that ring-fences cash flows due to the community until the debt is settled, and mismanagement of funds due to communities. Other interesting views of participants were the views that socio-political risk factors were never considered within the South African context in project finance over the last five years.

Literature led by Professor Esty of Harvard Business School accentuated that some tools to mitigate political risks in project finance have lost their effectiveness (Esty et al., 2014).

Although there are mixed views from participants largely influenced by South Africa’s history over the last five years, which according participants socio-political risks were never considered. The changing socio-political landscape in South Africa presents a case to highlight the significance of socio-political risks and related mitigating measures or strategies. Thus, the effectiveness and value of community shareholding as a mitigating measure requires further consideration.

6.2.4.7. Evaluating which mitigation measures or strategies participants proposed to replace the less effective mitigation measures or strategies

Strong views were expressed by participants emphasising, firstly, the importance of engaging and appointing the correct stakeholders for community shareholding and, secondly, formalising the approach of ensuring effective allocation of resources to projects. Another interesting view, which was not common from the views expressed by research participants, was a suggestion to tighten lending regulations in respect to environmental impact as a measure to mitigate socio-political risks.

The literature referred to under 6.2.3.6 by Professor Esty further highlights the requirement for innovative solutions to mitigate political risk in project finance given the complex environments and prominence of political issues. According to literature, risk allocation is an intuitive principle and differs between projects and countries.

Given the questions around the effectiveness and value community shareholding in South Africa’s project finance context as a mitigating measure to socio-political risks, feedback from the participants is consistent with the literature, which proposes new
innovative solutions within a South African context emphasising the importance of appointing and engaging the right stakeholders and tightening lending regulations regarding environmental impact as a mitigation measures. The proposed mitigation measures add to the body of knowledge in project finance within a South African context.

6.2.4.8. Section Summary: Research Question 3

The objectives of Research Question 3 were to understand how socio-political risks are assessed and the related strategies to mitigate those risks.

Socio-political risks are assessed by conducting a due diligence process with specific consideration to community involvement across the project value chain.

Key mitigation measures or strategies applied include (i) buy-in and involvement of the community and local leadership, including local government stakeholders, (ii) the inclusion of Political Risk Insurance, which is gaining relevance given the current levels of political uncertainty within the South African environment, and (iii) government guarantees, albeit with mixed views on government’s ability to pay out should the event arise. The key mitigations compared between literature reviewed and participants are summarised in Table 6.3 below.

Surprisingly, there are no mitigations applied within South Africa’s project finance as a response to the increased cost of debt financing arising from the downgrade of the sovereign credit rating.

It is also important to note that the effectiveness and value of community shareholding within South Africa’s project finance is questionable. The following suggestions were made as mitigation measures to improve those that are currently applied: (i) engaging and appointing the correct stakeholders for community shareholding, (ii) formalising the approach of ensuring effective allocation of resources to projects, and (iii) another interesting view, is the recommendation to tighten lending regulations in respect to environmental impact as a measure to mitigate socio-political risks.
Table 6.3

*Literature Review vs Participants: Mitigation measures or strategies*

<table>
<thead>
<tr>
<th>Mitigation measures or strategies to socio-political risks</th>
<th>Literature Review</th>
<th>Participants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political Risk Insurance</td>
<td>(Yescombe, 2013)</td>
<td>✔️</td>
</tr>
<tr>
<td></td>
<td>(Gatti, 2013)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Okanlomo, 2016)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Shou Qing Wang et al., 2000)</td>
<td></td>
</tr>
<tr>
<td>Community buy-in and involvement (incl. local leadership)</td>
<td>(Naderpajouh et al., 2014)</td>
<td>✔️</td>
</tr>
<tr>
<td>Direct Agreements with Host Government/Government Guarantees</td>
<td>(Yescombe, 2013)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Gatti, 2013)</td>
<td></td>
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<tr>
<td></td>
<td>(Okanlomo, 2016)</td>
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<tr>
<td></td>
<td>(Shou Qing Wang et al., 2000)</td>
<td>?</td>
</tr>
</tbody>
</table>

6.3. Conclusion on Results Discussion

This chapter has analysed the constructs and data that emerged from the interview process with project finance practitioners and discussed in view of the theory presented within the literature review in Chapter 2. The discussion within this chapter was divided into three sections according to the research questions identified in Chapter 3. The aim of the researcher was to answer each question by comparing participants’ views with the literature, as well as utilising the views shared or insights during the interview process.

Based on the results of discussion in this chapter between research questions one and three, there were mitigation measures or strategies with mixed views concerning their effectiveness. These views place motivation for further research within the field of project finance, which will be discussed in Chapter 7.
CHAPTER 7: CONCLUSION

7.1. Introduction
The previous chapter analysed the constructs and data that emerged from the interview process with project finance practitioners and experts. The discussion was conducted in view of the theory presented within the literature review in Chapter 2 and divided into three sections according to the research questions identified in Chapter 3.

This chapter will provide a brief overview of the research problem and objectives before going into the principal findings of this research. Thereafter, the limitations of the research complete the chapter with implications for future research and recommendations to stakeholders.

7.2. Central Research Problem
An inability to address socio-political risks may result in a lack of infrastructure investment, which is usually supported by project financing. The need to conduct this research is highlighted by the significance of socio-political risks within a project finance context and the critical nature of the risks in deciding to engage in a project.

The significance of socio-political risks highlights the importance of understanding the main socio-political risks that are relevant to the South African environment and the related mitigating measures and strategies.

7.3. Research Objectives
The central research problem points out the need to conduct a research study on the impact of South Africa’s socio-political risks within project finance. The objectives of this research were twofold.

The first objective was to identify the key socio-political risks associated with project finance deals in South Africa and their related effect. This objective was met with the identification of risk factors such as: political instability and uncertainty; policy changes and uncertainties; misalignment of interests between intergovernmental institutions; sustainability of SOEs; social and civil unrest; and volatility in the exchange rates. Their related effect was emphasised by the significance of socio-political risk in deciding to engage in projects.

The second objective was to identify and recommend mitigating measures or strategies for the identified socio-political risks. This objective was also met by proposing the following measures or strategies to mitigate socio-political risks: buy-in and
involvement of the community and local leadership, and the inclusion of Political Risk Insurance. In the process of noting mitigations, areas for future research were also identified and are proposed in the latter sections of this Chapter.

7.4. Principal Findings

The principal findings of this research study show the main socio-political risks affecting project finance in South Africa to be as follows: Political instability or uncertainties; Policy changes and uncertainties; Misalignment of interests between intergovernmental institutions; Sustainability of SOEs; and Social and Civil unrest and volatility in currency. Government and Intrastate were common sources of the main socio-political risks affecting project finance in South Africa.

These socio-political risks are most prone to the construction and bid stages of the project life cycle. The related effects of the main socio-political risks result in reduced appetite towards project finance and ultimately to divestment in infrastructure development.

Key mitigation measures include: buy-in and involvement of the community and local leadership, including local government stakeholders; Political Risk Insurance; Government Guarantees; and compliance with lending regulations.

Due to the current levels of political uncertainty in South Africa, Political Risk Insurance is gaining relevance. Political uncertainty is also one of the main socio-political risks affecting project finance in South Africa. Views on Government Guarantees as key mitigating measure or strategy in project finance within a South African context were inconclusive as there were concerns raised regarding government’s ability to pay.

Surprisingly, there are no mitigations applied within South Africa’s project finance as a response to the increased cost of debt financing arising from the downgrade of the sovereign credit rating.

The effectiveness and value of community shareholding within South Africa’s project finance as a mitigation is questionable. Proposed mitigation measures or strategies to improve those currently applied comprise: Engaging and appointing the correct stakeholders for community shareholding; Formalising the approach to ensuring effective allocation of resources to projects; and Tightening of lending regulations regarding environmental impact as a measure to mitigate socio-political risks.

7.5. Limitations of Research
Although findings of this research project may be generalised to a range of project financing transactions within South Africa, the researcher is cognisant to the fact that risk profiles of projects differ between projects.

The views of the project finance experts and practitioners are inherently subjective in nature and influenced by their knowledge, experience and geographical bias based on location within South Africa.

7.6. Recommendations to Stakeholders

Aligned with the results discussed in the previous chapter, recommendations derived from this research are divided into two: firstly, for academia as areas of future research and secondly, for stakeholders that practice in project finance.

7.6.1. Areas for Future Research

Majority of the interview participants highlighted that mitigations to address the effects of a sovereign credit downgrade were not implemented. Proposed future research is to conduct a study focused on specific mitigations generally applied to address the effects of the sovereign credit downgrade and their related effectiveness.

Given the mixed views from the interviews, which questioned the effectiveness of government guarantees and specifically government’s ability to pay out in the event the risk manifests, a future research study is suggested that will focus on the effectiveness of a government guarantee as a mitigating measure or strategy to political risks.

Esty et al. (2014) state the need for more innovative solutions to be developed as inexperienced players and complex environmental and political issues increase. Thus, future research is encouraged in this regard to further contribute to the body of knowledge within this area of finance.

7.6.2. Suggestions for Project Finance Stakeholders

The wide gap between theory and practice of risk allocation and mitigation and the need for more innovative solutions to be developed as complex environments and political issue increase are issues that require active involvement from project finance experts and practitioners.
Infrastructure investment supported by project finance is a requirement to grow economies. The most common form of project finance in recent time is in the form of PPPs. Both public and private sector are required to collaborate effectively to deliver the required infrastructure. Thus, the associated risks should be addressed accordingly by both sectors with alignment or coherence in achieving the objectives of delivering the required infrastructure.

7.7. Chapter Conclusion
This chapter has addressed the main research problem and research objectives as set out in Chapter 1. The study highlighted the significance and impact of socio-political risks in South Africa’s evolving landscape. The main socio-political risks identified within South Africa originate from Government and Intrastate. Political Risk Insurance as a mitigation measure or strategy is gaining relevance in South Africa. Interestingly, this research study found that there were no mitigations implemented to address the effects of the sovereign credit downgrade. This research study further found that there were questions concerning the effectiveness of a government guarantee and the value of community shareholding as mitigations to socio-political risks within the project finance structure. In closing, the following have been proposed for future research: specific mitigation associated with the sovereign credit downgrade and related effectiveness; and a study on the effectiveness of a government guarantee to mitigate socio-political risks.
REFERENCES


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Appendix 1: Consistency Matrix

<table>
<thead>
<tr>
<th>QUESTIONS</th>
<th>LITERATURE REVIEW</th>
<th>DATA COLLECTION TOOL</th>
<th>ANALYSIS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Research Question 1:</strong> What are the main socio-political risk factors that affect project finance in South Africa?</td>
<td>(Khattab et al., 2007) (Demirag et al., 2011) (Gatti, 2013) (Esty et al., 2014) (Cohen et al, 2014)</td>
<td>Semi-structured interviews Question 1, 2, 3, 4, 5</td>
<td>Thematic content analysis on open ended questions to determine the main socio-political risk factors that affect project finance in South Africa.</td>
</tr>
<tr>
<td><strong>Research Question 2:</strong> How are socio-political risk factors affecting project finance in South Africa?</td>
<td>(Larrain et al., 1997) (Demirag et al., 2011) (Esty et al., 2014) (Almeida et al., 2017)</td>
<td>Semi-structured interviews Question 6, 7, 8, 9</td>
<td>Thematic content analysis on open ended questions to determine the how socio-political risk factors that affect project finance in South Africa.</td>
</tr>
</tbody>
</table>
| Research Question 3: | What are the socio-political risk measures that can be applied to mitigate socio-political risks in South Africa? | (Shou Qing Wang et al., 2000)  
(Demirag et al., 2011)  
(Gatti, 2013)  
(Yescombe, 2013)  
(Esty et al., 2014)  
(Naderpajouh et al., 2014) | Semi-structured interviews  
Question 10, 11, 12, 13, 14, 15 | Thematic content analysis on open ended questions to determine the mitigating measures or strategies to socio-political risk factors that affect project finance in South Africa. |
Appendix 2: Informed Consent Letter

My name is Karabo Ramela and I am doing my second year Master of Business Administration at the Gordon Institute of Business Science, University of Pretoria. As part of my studies I will be conducting research in project finance focusing on the impact of socio political risks on project finance deals from industry experts and practitioners.

The purpose of this research study is to identify the key socio-political risks that affect project finance from the investment decision phase, throughout the entire project cycle of the project and to also use the identified socio-political risks to come up with a mitigation framework that can be applied in project financing in South Africa.

The purpose of this letter is to ask for your assistance as an expert/practitioner involved in this topic to be a participant in the interview process of the research. Your input in this regard, based on your experience on the subject matter, will certainly assist in adding value to our research. The interview questions are designed to gain more knowledge on this subject matter. I would, therefore, appreciate your assistance in availing yourself for an interview.

Our interview is expected to last about an hour and will help us understand how socio-political risks impact project finance deals. Your participation is voluntary, and you can withdraw at any time without penalty. The data and results of this research will not be confidential; however, it can be used without identifiers. If you have any concerns, please contact my supervisor or me. Our details are provided below.

Student: Karabo Ramela
16393059@mygibs.co.za
076 344 1547

Supervisor: Amir Rezvanian
arezvanian@gmail.com
079 890 3813

Signature of Participant: ……………………………………
Date: ……………………………………………………………

Signature of Researcher: …………………………………
Date: ……………………………………………………………
Appendix 3: Interview Schedule

SECTION 1: PARTICIPANT INFORMATION

1. Name and Surname
2. Title (Mr/Ms/Mrs/Dr/Prof)
3. Designation in Organisation
4. Years of Experience in Project Finance
5. Email address
6. Telephone number

SECTION 2: ORGANISATION INFORMATION

7. Company Name
8. Nature of the Business
9. Physical Address
10. Telephone number

SECTION 3: INTERVIEW SCHEDULE

What are the main socio-political risk factors that affect project finance in South Africa?

1. Based on your experience, what are the key socio-political risk factors that generally affect project financing in South Africa when making investment decisions and throughout the project life cycle?

2. Are there any project financing transactions that you have been working on which have been reviewed and declined due to socio-political risks in South Africa? Elaborate.

4. Are there any socio-political risks that financiers deem only applicable to South Africa which are not necessarily applicable to other countries?
5. In your experience, list the top five socio-political risks of project finance in South Africa and name to the source of the socio-political risks using any one of the three categories, Government; Society; Intrastate/Interstate?

**How are socio-political risk factors affecting project finance in South Africa?**

6. In your knowledge, does the financier’s perception of South Africa’s political risks restrict the provision of project finance? Please elaborate

7. At what stage in the project life cycle are socio-political risks most prone (Bid, Construction or Operational phases)?

8. In your experience, how has South Africa’s credit downgrade earlier in the year (2017) affected project finance transactions?

9. How have new government policies affected project finance transactions, e.g. Integrated Resources Plan applicable to Energy generation?

**What are the socio-political risk measures that can be applied to mitigate the socio-political risks?**

10. In your opinion, how are socio-political risks assessed and what strategies are used to mitigate these risks for project finance transactions in South Africa?

11. What securities are typically required because of socio-political risks for project finance transactions in South Africa?

12. In your experience, which mitigation measures or strategies to socio-political risks in South Africa’s project finance transactions would you expect to be in place when making the investment decision?

13. In your view, how are newly identified socio-political risks handled, when they appear during the life cycle of the project?

14. Are you aware of any mitigation measures or strategies have been implemented in project finance transactions in South Africa as a response to the sovereign credit downgrading earlier in 2017? Please explain

15. In your knowledge, which mitigation measures or strategies to socio-political risks in South Africa have lost their effectiveness?

16. Which mitigation measures or strategies would you propose to replace the less effective mitigation measures or strategies?
## Appendix 4: Research Participants

<table>
<thead>
<tr>
<th>No.</th>
<th>Name and Surname</th>
<th>Organisation</th>
<th>Role/Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Vusumuzi Dube</td>
<td>Industrial Development Corporation</td>
<td>Deal maker: Basic &amp; Speciality Chemicals</td>
</tr>
<tr>
<td>2</td>
<td>Vishu Lakhoo</td>
<td>Industrial Development Corporation</td>
<td>Senior Project Development Manager: Basic &amp; Speciality Chemicals</td>
</tr>
<tr>
<td>3</td>
<td>Tino Chadyiwa</td>
<td>Industrial Development Corporation</td>
<td>Dealmaker: Basic Metals &amp; Mining</td>
</tr>
<tr>
<td>4</td>
<td>Ali Mnisi</td>
<td>Industrial Development Corporation</td>
<td>Senior Deal Maker: Basic Metals &amp; Mining</td>
</tr>
<tr>
<td>5</td>
<td>George Kotsovos</td>
<td>Standard Bank</td>
<td>Executive VP: Power and Infrastructure Finance</td>
</tr>
<tr>
<td>6</td>
<td>Sherill Byrne</td>
<td>Standard Bank</td>
<td>Executive: Power &amp; Infrastructure Finance</td>
</tr>
<tr>
<td>7</td>
<td>Aadil Cajee</td>
<td>Standard Bank</td>
<td>Executive: Power &amp; Infrastructure Finance</td>
</tr>
<tr>
<td>8</td>
<td>Daniel Zinman</td>
<td>Rand Merchant Bank</td>
<td>Senior Transactor: Infrastructure Finance</td>
</tr>
<tr>
<td>9</td>
<td>Nthumeni Wanga</td>
<td>ABSA</td>
<td>Chief Credit Officer: ABSA CIB</td>
</tr>
<tr>
<td>10</td>
<td>Johan Koorts</td>
<td>ABSA</td>
<td>Transactor: Project Finance</td>
</tr>
<tr>
<td>11</td>
<td>Bothwell Manikai</td>
<td>Development Bank of Southern Africa</td>
<td>Principal - Infrastructure (Transport, Logistics, ICT)&amp; Private Equity</td>
</tr>
<tr>
<td>12</td>
<td>Tshepiso Mufamadi</td>
<td>Public Investment Corporation</td>
<td>Associate Principal: DI</td>
</tr>
<tr>
<td>13</td>
<td>Nkululeko Mbalula</td>
<td>Stanlib</td>
<td>Senior Credit Analyst</td>
</tr>
</tbody>
</table>
Appendix 5: Ethics Clearance

Dear Karabo,

Please be advised that your application for Ethical Clearance has been approved.

You are therefore allowed to continue collecting your data conditional to the below:

We wish you everything of the best for the rest of the project.

Kind Regards

GIBS MBA Research Ethical Clearance Committee