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The Belt and Road Initiative

Twists and turns on the BRI path point to risk management as a top business priority

China's Belt and Road Initiative (BRI) was launched by Xi Jinping as a landmark, long-term, whole-of-state project aimed at increasing trade and development by connecting Asia with Africa and Europe through land, sea and — later — digital networks. At the initiative's six-year mark, Baker McKenzie leaders discuss how much progress has been made and how priorities have changed. Sharing their observations are Bee Chun Boo, partner in Baker McKenzie's Mergers and Acquisitions Group in Beijing; Mark Lim, Head of the Finance and Projects Practice Group of Wong & Partners in Kuala Lumpur; Singapore-based Martin David, Head of the Projects Practice, Asia Pacific, at Baker McKenzie; and Mini vandePol, Asia Pacific Head of the Global Compliance & Investigations Group.

How do you see BRI evolving today?

Mark Lim:

Before the general election in Malaysia in May 2018, there was a lot of optimism about BRI. Major investments came in. Afterwards, the present government raised concerns about the motivation behind some of the Chinese investment in large infrastructure projects in Malaysia. Those concerns notwithstanding, there were positive expectations that Malaysia couldn't miss out on this opportunity. So, the present government continued with its pursuit of Chinese investment through government-to-government conversations and diplomatic visits from senior development officers in other countries to China and Malaysia.

Now, the optimism is coming back and People's Republic of China investors are still interested in Malaysia. For instance, they've made a lot of inquiries about the Large Scale Solar (LSS) program, which is supporting the development of large-scale solar power plants to increase renewable energy. The third round of the project, called LSS3, was launched earlier this year.

Bee Chun Boo:

Chinese companies have been focused on Asia Pacific, especially Southeast Asia. They are also looking actively at opportunities in Africa, due to the abundance of opportunities there and to the fact that there is less competition from other foreign investors in Africa. For example, several infrastructure projects including roads, ports and rail systems have been started in regions in East and West Africa. We are also seeing increased investment activity in Latin America compared to the last two to three years. Eastern Europe and Central Asia continue to attract their fair share of BRI investments, although these investments tend to be smaller.

Martin David:

The issue that is now confronting Chinese companies is the lack of quality projects on offer in Southeast Asia. It is a common problem also facing their international counterparts. Perhaps having learned from some of their experiences with early projects — which have not been without problems and issues many Chinese companies are getting wiser and more experienced in assessing the quality of the projects. They are also increasingly reluctant to play the percentages game, which you have to do when you are bidding for projects. The cost of preparation of bids, coupled with the potentially long odds to secure a winning bid against a large number of competitive bidders, has pushed many to look at ways to find projects with no or limited competition. Government-to-government projects are one way around this, but they are relatively few and may not always provide attractive returns. So, I expect steady growth in BRI projects rather than an acceleration of activity, as Chinese companies and lenders take a more studious and cautious approach to development.

How have investments and deal structures changed for BRI infrastructure projects?

Mark Lim:

The scale of BRI infrastructure projects has shifted lately, from mega projects to more mid-size investments. The Malaysian government has cut down on large infrastructure projects, pointing to heavy debt inherited from the previous administration and debt-funded contracts.

As a result of the continuing trade tensions between China and the US, Chinese investors have shown a lot of interest in entering joint ventures with Malaysian corporates. Malaysian tentative partners are interested, but also cautious about what will change if the trade war suddenly ends. Will the Chinese investors just pull out? What would they do if the promised investments did not materialize?

Also, the Malaysian government wants to see a commitment that partnerships with China will benefit the local economy. Previously, Chinese investors came in as engineering procurement construction contractors on large infrastructure projects, getting the work done and then moving on. They seldom employed Malaysians to perform the work, and they brought their own products to supplement the project. So, there was no value to the country. Now, the message to Chinese investors is that if they share their knowledge and bring in their technology, they're welcome to invest in Malaysia.

Bee Chun Boo:

Megadeals continue to play a dominant role in BRI investments, but Chinese investors often find that these transactions are more difficult to implement successfully and quickly, as they involve a lot of public scrutiny and political considerations. So, midsize deals are becoming more attractive to Chinese investors.

Another trend is the move from 100% deals to joint venture deals, where the Chinese party takes either a majority stake or a minority stake. Accordingly, Chinese investors have increased their vigilance in due diligence to ensure that they identify the right local partner. However, in certain cases, the Chinese investor is not able to pick and choose their local partner, e.g., when the partner is a local, state-owned company.

In addition to the changing structure of BRI deals, the type of funding for BRI projects is changing. In the past, we saw the Chinese policy banks being the main financiers for BRI projects. They still play an important role in financing BRI deals, but other financial institutions, such as PRC and foreign commercial banks, are also providing significant financing to BRI transactions. This demonstrates that the private sector is becoming more prominent in funding BRI deals.

The governments of the Association of Southeast Asian Nations (ASEAN) have made investment in transport a top priority, according to a Baker McKenzie review of 850 infrastructure projects excluding power. The region has recognized that transport bottlenecks are slowing down growth, so transport accounts for 50% of total projects.

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Martin David:

There is definitely a change from BRI projects developed six years ago. Investment in and lending to BRI projects is no longer the exclusive domain of Chinese state-owned enterprises and lenders. We are seeing more involvement from international (i.e., non-Chinese) companies and financial institutions. This is in part due to the realization dawning on Chinese developers and lenders that there are advantages to involving international organizations in projects in BRI countries. They bring with them experience in and knowledge of doing projects in many BRI countries.

Chinese developers are also looking for more competitive sources of funding and are wanting to move away from Chinese lenders' early approach of requiring corporate guarantees to underpin financing of projects. They now see the benefit of limited or nonrecourse project financing and the competition that using international lenders brings to the lending terms. Chinese financial institutions are now facing competition for projects, and while there will always be a role for Chinese lenders in BRI projects, we are entering a phase where international and Chinese financial institutions will lend alongside each other.

Read more on **BRI trends and analysis** from Baker McKenzie experts.

What are the sources of risk for BRI infrastructure projects?

Mini vandePol:

As our **survey of 600 business leaders in Asia Pacific** showed, handling compliance and regulatory requirements has become the top concern for businesses, especially if they operate in multiple markets. At the top of the list is compliance in areas such as anti-bribery and anti-corruption, trade sanctions, data privacy and cybersecurity.

These are the risks that every business involved in a BRI project is grappling with and trying to manage in an effective, practical way. While these risks are omnipresent, they can be estimated and planned for so as not to create unpleasant surprises or an unwelcome crisis. Coming up with a risk management plan is a sound long-term solution. Also, benchmarking what other companies are doing is useful, since no company has all the answers.

Commercial solutions that involve taking a shortcut around compliance requirements may be tempting to businesses in the short term. However, such shortcuts end up creating long-term, significant risks. For instance, it is extremely high risk for a company to engage a third party to manage government approvals and to shorten the compliance timeframe or complexity, without performing adequate due diligence or controls around the third party considered for engagement. We have seen corruption payments made by third parties to governments in order to obtain permits and licenses. This later resulted in a continued demand for improper payments when inspection or audits by government compliance bodies failed, or, in more extreme circumstances, when there were health and safety risks as a result of the inadequate compliance measures.

Additionally, the level of enforcement of anti-bribery laws is on the rise by several bodies (e.g., by China, by other BRI countries, by the UK's Serious Fraud Office, or by the US' Department of Justice). Recent guidance from these bodies makes it clear that there will be careful scrutiny of transactional projects to determine their risk profile and the adequacy of the risk management and mitigation measures undertaken by companies. We are working closely with majority and minority BRI JV partners and corporates to enhance their anti-bribery and corruption compliance processes and satisfy various stakeholders, such as development banks where the funding is dependent on the existence and implementation of a credible compliance program.

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Martin David:

The risks facing developers of projects in BRI countries are fundamentally the same whether the developer is Chinese or non-Chinese. The differences, however, lie in the approach to developing the projects and the sources of financing. Chinese lenders have traditionally sought to mitigate lending risk through corporate guarantees instead of lending against project risk. But we are seeing this change, with more conventional limited and nonrecourse structures being pursued, and Chinese companies not being ready and willing to give parent guarantees.

Factors perhaps not often considered are the cultural issues that confront the Chinese in doing business in a BRI country. Chinese businesses are not used to what is often a very different approach to project development. Therefore, getting the approach right and getting in agreement with the key project stakeholders, such as governments, utilities, regulators, etc., is something that can make the difference between failure and success.

Chinese companies are now recognizing the value of having a strong local partner to support them with these relationships and in the development of the project. But this bridge building takes time. For many Chinese companies unfamiliar with the legal and regulatory terrain and the political dynamics of an emerging BRI market, the so-called country risk sits at the forefront of their investment considerations. Therefore, having a good understanding of the market with a supportive local partner is increasingly a critical part of their decision-making process.

How is risk being managed?

Mini vandePol:

Companies have to consider the trade sanctions between China and the US, the increasing number of individuals who have been blacklisted and sanctioned and the restriction on the flow of money. The last thing you want is that your money gets paralyzed due to circumstances out of your control. It's something that companies need to consider mindfully at an early stage, in a very proactive manner.

Bee Chun Boo:

Chinese companies have undertaken several measures to ensure they are managing risks better in BRI jurisdictions. One is updating their internal compliance manuals to take into account the laws and regulations in the jurisdictions where they conduct business. Another trend is greater emphasis on proper due diligence and stronger reliance on local professional firms. Chinese investors are also more focused on ensuring that their personnel in BRI jurisdictions are properly trained on the risks that may exist in those jurisdictions.

Conclusion

Considering the magnitude of the BRI, twists and turns were inevitable. Since 2013, elections and trade tensions have reshaped the political landscape, and financial realities have reduced the scale of projects and created the need for more funding sources. At this point in time on the BRI's trajectory, compliance issues are calling for intensive risk management. These and future new developments will demand more adjustments in the year ahead.