The Economist CORPORATE NETWORK

BRI BEYOND 2020

Embracing new routes and opportunities along the Belt and Road

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Preface

BRI beyond 2020: Embracing new routes and opportunities along the Belt and Road is an Economist Corporate Network (ECN) report, sponsored by Baker McKenzie. The ECN performed the research, conducted the interviews and wrote the report independently. The findings and views expressed in this report are those of the ECN alone and do not necessarily reflect the views of the sponsor. Yue Su was the report author. Pamela Qiu conducted the interviews and was the report editor. Waqas Adenwala contributed to the research. The design and layout of the report was done by Gaddi Tam. The cover was designed by Wai Lam.

The report's analysis includes in-depth interviews with experts who have on-the-ground views and experience of infrastructure projects in Asia. These remain anonymous unless specifically quoted. We would like to thank all participants and interviewees for their time and insights.

Participants in alphabetical order:

- Johan de Villiers, managing director, South-east Asia, ABB
- Rod Jackson, chief financial officer, Westpac International
- Sajal Kishore, head, infrastructure and project finance, Asia Pacific, Fitch Ratings
- Mun Loong Lau, head, project finance, group wholesale banking, CIMB Bank
- Allard Nooy, chief executive officer, InfraCo Asia
- Ben Simpfendorfer, founder and chief executive officer, Silk Road Associates
- Jang Ping Thia, chief economist, Asian Infrastructure Investment Bank
- Julian Vella, partner and Asia Pacific head of global infrastructure, KPMG
- Quan Zheng, director general, policy and strategy, Asian Infrastructure Investment Bank

November 2019

Introduction

China's Belt and Road Initiative (BRI) is undergoing a shift in branding since the second Belt and Road Forum (BRF) in April 2019. The forum was widely seen as China's effort to reboot the initiative and show its willingness to adopt a more inclusive, transparent and sustainable approach to projects which are part of the BRI. This is certainly a positive step for the future of the initiative. China now needs to act purposefully to improve the governance of the initiative and convince stakeholders that this indeed represents a new phase of maturity for the programme.

At the second BRF held in Beijing, president Xi Jinping said that the Chinese government would encourage local companies engaged in BRI projects to comply with international rules and standards, in areas such as project construction and procurement. He reiterated the importance of "green" investment, and that there would be "zero tolerance" of corruption. Mr Xi also stressed the practical benefits of the BRI for participating countries at a time when globalisation is fraying and the role of US global leadership has come under greater scrutiny.

Politically, the momentum behind the BRI remains firm. More than 130 countries are now reported to have signed BRI agreements (see Chart 1). These include countries in Central America and the Pacific—far beyond the traditional Silk Road routes. Although most major Western economies have been cautious about formally endorsing the BRI, a number of them have entered into agreements on "third-country co-operation" with China. For instance, the UK and China launched such a programme in June 2019, pointing to the UK's desire to maintain good relations with China amid the looming economic uncertainty created by Brexit.

Chart 1: Countries that have signed Belt and Road Initiative co-operation agreements

Note: As of April 2019.
Source: http://www.yidaiyilu.gov.cn

A multilateral approach is gaining ground

China is indeed keen to continue increasing international participation in the initiative and to advance a multilateral approach to the BRI. At the second BRF, foreign companies and banks were also promised access to BRI-related contracts. While it is still too early to evaluate how this has progressed, many participants and development partners are confident that these opportunities will indeed open up and mature.

Certainly there are positive signs that China is taking steps to restructure its approach to BRI projects, including adopting formal lending rules similar to those of the multilateral development banks (MDBs). In March 2019 the Ministry of Finance of the People's Republic of China signed a Memorandum of Understanding with several MDBs—including the Asian Development Bank, Asian Infrastructure Investment Bank, European Bank for Reconstruction and Development, European Investment Bank, New Development Bank and the World Bank Group – on collaboration on matters to establish the Multilateral Cooperation Centre for Development Finance (MCDF).

Quan Zheng, director general for policy and strategy at the Asian Infrastructure Investment Bank (AIIB), says that the AIIB is committed to playing a bigger role to improve the governance of all projects, including those related to the BRI. "We believe the overarching principles of BRI are sound. At its heart, BRI aims to uphold dialogue and consultation, facilitate joint contribution and realise shared benefits. We advocate for high international standards to ensure these principles will be translated into operational reality," says Ms Zheng.

Increasing the openness of BRI projects to international players is not just on the agenda of China's policymakers, but on that of those running the country's state-owned enterprises (SOEs) too. Chinese SOEs have come to the conclusion that it is far more difficult for them to operate in some of these markets on their own and are therefore increasingly willing to look for partnerships, says Allard Nooy, CEO from InfraCo Asia, an infrastructure and investment company. "Chinese SOEs want to absorb capability and learn expertise from international players in those markets where they want to be active. In the longer term they may have a vision to engage as a majority shareholder. At this point in time, however, they lack expertise in operating outside of China on developmental projects and they have come to the realisation that it's too risky to go alone."

This focus on international participation is an important step-change for the future of the BRI. As Chinese SOEs themselves recognise the need to develop more sustainable business operations and attract higher levels of private capital and external participation into their supply chains, they are keen to improve their understanding of how to bid and operate in global market environments.

These shifts in policy priorities and market approaches to the BRI are only just beginning to take shape. How might these shifts represent new routes and business opportunities for companies looking to engage more meaningfully with the BRI? What are the types of challenges and risks associated with the BRI, and how can companies mitigate or overcome them?

This report examines these questions. In the following sections we draw on the latest research, data and analysis from The Economist Intelligence Unit (EIU) as well as interviews with senior business leaders and subject matter experts to:

- Review and assess the current status and scope of the BRI
- Spotlight the sectors and regions that are primed for growth
- Present and assess common challenges and risks
- Identify key factors for winning opportunities along the BRI

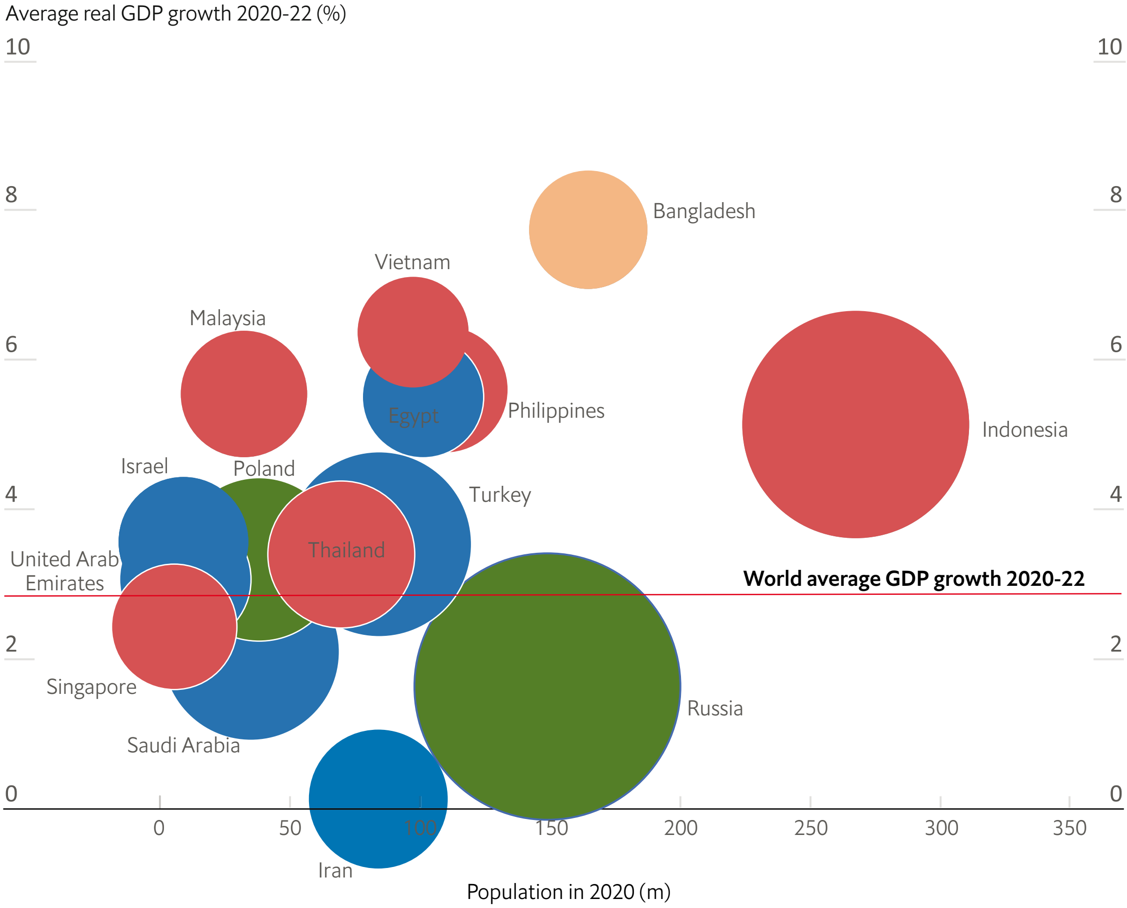
The BRI—beyond Asia?

The combined market potential of BRI countries is impressive. However, despite a broadening of participation in the BRI, trade and investment linked to the initiative is still concentrated in Asia.

The BRI bloc of countries—A big, bold future?

The objectives of the Belt and Road Initiative (BRI) go well beyond infrastructure to a broader trade, investment and economic growth story. China and 63 core BRI countries account for nearly 50% of the world's population and 30% of the global economy (measured by GDP at market exchange rates). Over the next five years, many of the BRI countries are also expected to outperform the global average in terms of economic and population growth rates. Chart 2 highlights the large BRI economies (such

Chart 2: Growth potential and market size
The 15 largest economies along the BRI*



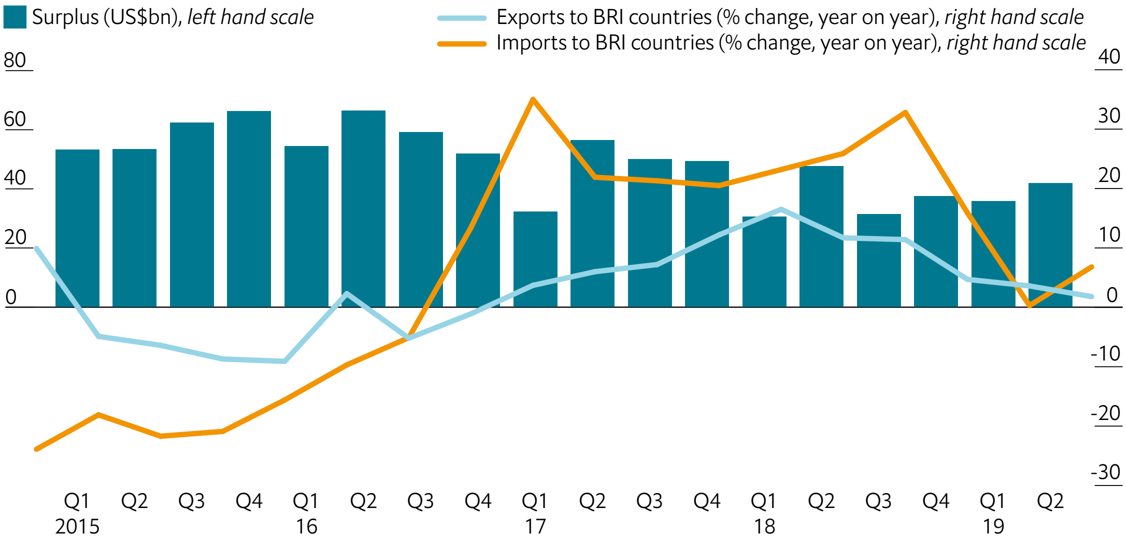
Note: The size of the bubble reflects the size of nominal GDP in 2020
Countries are colored by the geographical area where the country is located

* Core BRI countries (63 economies excluding China)

as Indonesia, Russia, the Philippines and Saudi Arabia), as well as those that are clocking up high economic growth rates (including Vietnam, Malaysia, Bangladesh and Israel).

The BRI has supported China in diversifying its economic and trading relations hips. Indicators tracked by the EIU suggest that China's economic activities with countries along the BRI route have steadily increased since 2013, when the initiative was launched. Take trade, for example: China's merchandise exports to and imports from the countries along the BRI route constituted 30.1% and 28.2% respectively of the totals in April-June 2019 (see Chart 3), up from 26.5% and 24.4% in full-year 2013.

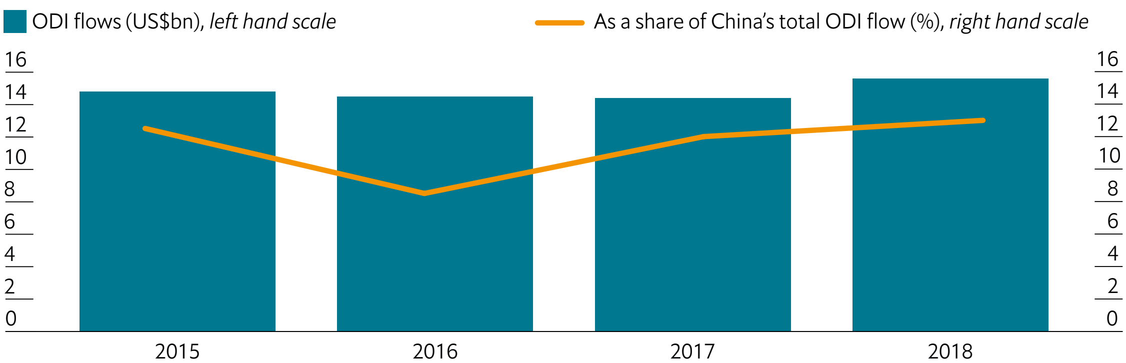
Chart 3: China's merchandise trade with countries along BRI route



Source: The Economist Intelligence Unit; General Administration of Customs of the People's Republic of China

China's overseas direct investment (ODI) in BRI countries has also steadily increased, both in absolute value and as a proportion of the country's total ODI flows (see Chart 4). However, it is important to note that less than 13% of Chinese ODI is in BRI countries, of which nearly 65% goes to South-east Asian countries (based on 2017 data). This suggests that, despite the government's emphasis on the BRI as a cornerstone policy, the reality lags behind the rhetoric, with the BRI still playing a small and limited role in China's engagement with the world.

Chart 4: China's ODI in BRI countries



Note: ODI data cover only non-financial flows.
Source: Ministry of Commerce of the People's Republic of China

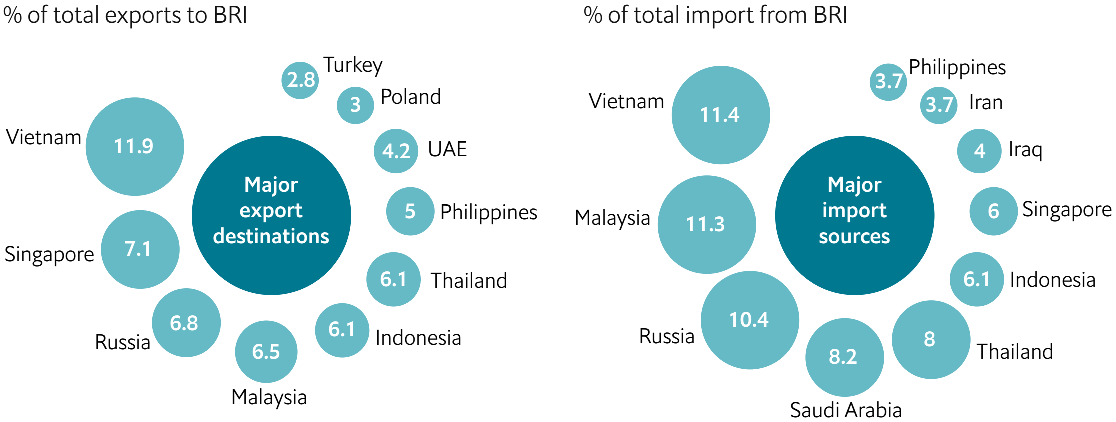
The heart of the BRI remains in Asia

Despite the broadening of participation in the BRI, trade and investment linked to the initiative is still concentrated in Asia, and especially in the countries of the Association of South-east Asian Nations (ASEAN). China's major trading partners among the BRI countries are Vietnam, Singapore and Malaysia (see Chart 5). We continue to expect further deepening of economic relationships between China and these ASEAN markets after 2020.

Beyond ASEAN, China has developed strong commercial ties with countries with large resource reserves, such as Russia, Saudi Arabia and the UAE. These relationships are likely to strengthen as China actively seeks out alternative supply chains in commodities against the backdrop of the US-China trade war. For instance, a visit by Mr Xi to Russia in June 2019 led to an agreement between China and the Russia-led Eurasian Economic Union, which may help to better align the economic interests of the two powers in Central Asia.

China is also one of Africa's key partners in terms of loan finance, investment and trade. The deepening of the BRI in Africa will increasingly become a core pillar of engagement between China and Africa. The latest triennial Forum on China-Africa Co-operation, held in Beijing on September 3rd-4th 2018, saw delegations from almost all African states in attendance, including many heads-of-state (such as South Africa, Egypt and Kenya). Mr Xi unveiled loan and investment commitments of US$60bn over the next three years, with a significant portion geared to addressing Africa's large infrastructure deficit. In July 2019 China launched a Belt and Road Fund for Africa, providing US$1bn in capital to focus on funding infrastructure, high-technology and e-commerce projects.

Chart 5: China's major BRI trading partners, 2018



Source: The Economist Intelligence Unit; General Administration of Customs of the People's Republic of China

Beyond infrastructure?

The majority of BRI projects continue to be in infrastructure construction, but there is a rising trend of Chinese participation in other areas. This includes efforts to develop the "Digital Silk Road" as well as to build local industrial capacities and sustainable environments more generally.

"What is clearly happening is the involvement of Chinese construction companies in broad infrastructure projects across South-east Asia," says Johan de Villiers, managing director for South-east Asia at ABB, a European industrial technology company. "It is growing month by month. And our involvement, our business with these companies, is growing month by month." ABB, observes Mr de Villiers, has decades of experience of co-operation with engineering and construction companies from China and believes that the strong growth of ODI in ASEAN markets is a natural development.

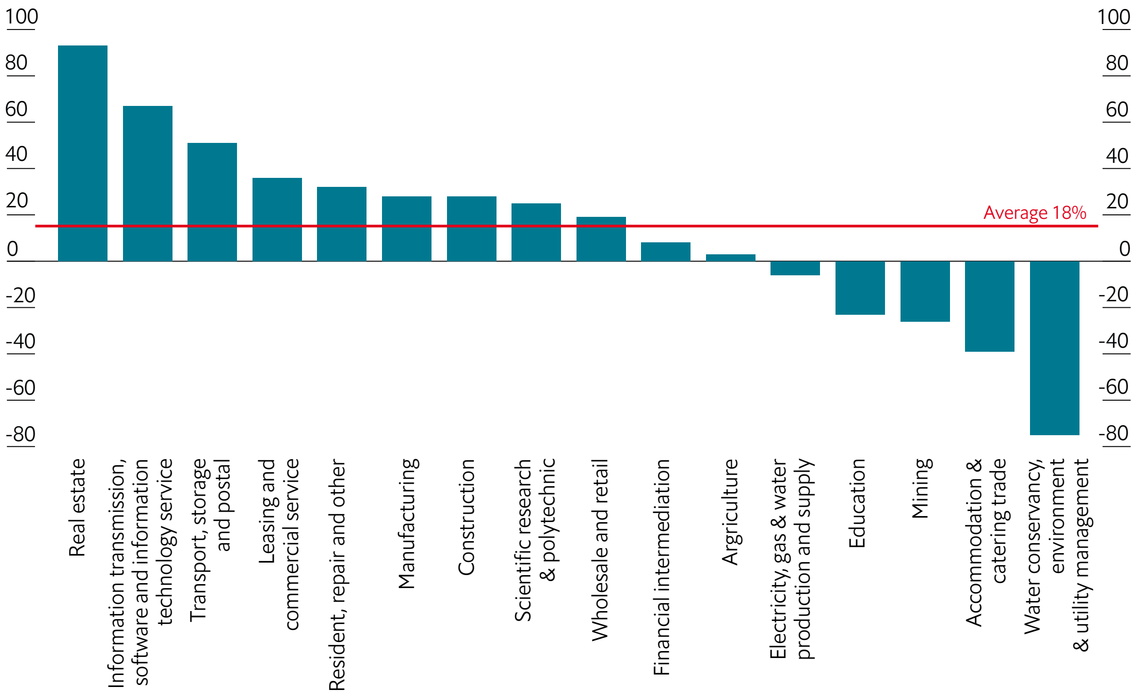
"The Chinese have for the past decade been building some of the world's best transport infrastructure—airports, ports, rail and road networks. They will continue contributing significantly to these sectors in South-east Asia," says Mr de Villiers. "There will also be strong and rising Chinese engineering, procurement and construction (EPC) involvement in the resources sector, such as of the construction of petrochemical plants, oil and gas facilities and mines. Looking ahead, another sector that will increasingly come into view will be digital infrastructure, such as data centres. Investments here are from a very low base, but growing."

Trends evident in the data support ABB's experience. The majority of BRI projects are in infrastructure construction, especially in the real estate, information and communications technology (ICT), and transport sectors. The breakdown of China's investment to all BRI countries by industry is not available. However, we believe an industry breakdown of China's ODI investment in the ASEAN region serves as a good proxy to identify BRI investment trends by sector (given that nearly 65% of China's BRI flows end up in ASEAN). And as Chart 6 shows, ASEAN's real-estate, ICT and transport sectors have benefited from exceptionally strong Chinese ODI growth, which averaged rates of over 50% annually in 2013-17. However, manufacturing, leasing and commercial services are also starting to stand out in terms of their ability to attract Chinese investment, reflecting that country's ongoing interest in expanding its production and commercial footprint across the ASEAN region.

Beyond sectoral shifts in investment, another important development with regard to some recent BRI investments is Chinese companies' more holistic engagement with projects. The interviewees for this report shared various examples—ranging from a steel plant project in Serbia to a soda ash factory in Turkey—in which Chinese SOEs have not just played a role in constructing physical infrastructure but, importantly, have also helped to build domestic industrial capacities and created job opportunities for the local communities related to these BRI projects.

Indeed, there is growing evidence to show that Chinese SOEs are keen to go beyond their traditional participation in the EPC stage of BRI projects. This shift in approach by Chinese SOEs to think about a longer-term engagement with projects—one which incorporates not just the construction phase

Chart 6: Chinese ODI flows to ASEAN by industry
Average annual growth, 2013-17 (%)



Source: Ministry of Commerce of the People's Republic of China

but also the commercial operation phase—will ultimately raise the professional standards of these ventures. Importantly, as Chinese companies deepen their capabilities to provide integrated solutions across different stages of an infrastructure project's life cycle, this will lead to enhanced quality of projects that takes into account the environmental, social and governance (ESG) factors as well.

Demands from investors for project developers to take an ESG approach to infrastructure are increasing. The rising emphasis on environmental sustainability and transparency in particular are expected to intensify even further in the near future. As both China's authorities and companies are keen to attract commercial finance to BRI-related projects, the motivation for China to develop "green" BRI investments will remain one of the long-term priorities for the programme.

The rise of the "Digital Silk Road"

By the end of April 2019, a total of 16 countries had signed Memorandums of Understanding (MoUs) on co-operation with China on the construction of the "Digital Silk Road". This is a result of a Chinese-led effort since 2015 to strengthen internet infrastructure, space co operation and cloud computing and to jointly develop common technology standards among the BRI countries.

So far, several notable strategic cross-border and multilateral projects have been launched, such as the China-ASEAN Information Harbor and China-Africa Online Silk Road Construction. China has also facilitated the building of more than 30 cross-border land cables and over ten international submarine cables. It is also exploring possible co operation in other areas such as tele-healthcare and mobile payments, and is promoting a Chinese-constructed and -operated global satellite navigation system along the BRI.

Other positive developments in constructing a digital Silk Road include the agreement between China, Japan and Thailand to co-invest in Thailand's Eastern Economic Corridor (EEC), a flagship project in that country's Thailand 4.0 strategy. Under the ECC, Thailand plans to build the Eastern Economic Corridor of Innovation (EECi, a large research and development park), the Digital Park Thailand (EECd) and the Smart Park, with support from Chinese investment. By the end of 2018 China had invested Rmb12.6bn (approximately US$1.8bn) in the EEC, establishing manufacturing facilities, research centres and operational hubs.[1]

Malaysia is also benefiting. In April 2019 the country welcomed a project for an artificial intelligence (AI) hub to be created with the help of Chinese AI unicorn SenseTime, with total investment of around US$1bn. The park, viewed as Malaysia's first AI park, is expected to help local businesses in the technology sector to develop robots and speech-recognition systems and to foster tech talent. The park would be built

Huawei's smart-city and 5G footprint

Note: Countries shaded in blue denotes those where Huawei is participating in 5G or smart-city projects
Source: International Cyber Policy Center

[1] http://economists-pick-research.hktdc.com/business-news/article/International-Market-News/Alignment-of-BRI-and-Thailand-4-0-Triggers-Bumper-China-Investment/imn/en/1/1X000000/1X0AEDYZ.htm

jointly by a Malaysian tech company, G3 Global, and China Harbor Engineering to foster the development of Malaysia's capabilities in robotics, AI and big data.[2, 3]

Huawei, the Chinese technology giant at the forefront of US-China technology tensions, has also leveraged partnerships under the BRI to offset some of the headwinds it is facing as a result of the US-China trade war. This has supported Huawei in winning 104 smart-city and fifth-generation (5G) projects (see Chart 6), of which 84 are located in countries that have signed BRI bilateral agreements with China. Notably, in July 2019 Huawei announced plans to invest US$3.1bn over three years to develop 5G networks in Italy, a country that had signed a BRI MoU just four months earlier, in March.

[2] http://www.globalconstructionreview.com/news/chinas-sensetime-help-build-1bn-ai-park-malaysia/

[3] https://qz.com/1602194/an-ai-park-in-malaysia-shows-chinas-belt-and-road-is-evolving/

Balancing benefits and risks

The often risky political, economic and operating environments in Belt and Road countries pose a challenge for companies searching for profit along the BRI. Companies looking to engage with the BRI should search for investment opportunities in countries that offer the right balance of opportunity and risk—and proactively manage those risks.

According to the EIU's operational risk assessment, the average operational risk in BRI countries is higher than the global average. In the assessment, the EIU examines a comprehensive range of threats that businesses across 180 markets face. While the type and intensity of risk varies between countries, BRI countries tend to record significantly higher political stability risks, government efficiency risks and legal and regulatory risks than non-BRI countries (see Table 1).

Companies that are keen on opportunities along the BRI must therefore prepare and formulate a clear approach to managing risks such as:

- corruption and bribery;
- sudden changes in local laws, regulations or policies;
- delays due to political events or over-bureaucratic and inefficient governments;
- security threats and breaches, including cyber theft.

Table 1: Risk scores of subsectors

		World average	BRI Average
1	Overall Evaluation	46	47
2	Government effectiveness risk	58	**62**
3	Legal & regulatory risk	50	**54**
4	Political stability risk	46	**53**
5	Infrastructure risk	49	50
6	Labour market risk	51	49
7	Financial risk	47	48
8	Foreign trade & payments risk	41	43
9	Security risk	40	41
10	Tax policy risk	39	36
11	Macroeconomic risk	37	35

Note: A higher score indicates a higher level of risk; BRI countries do not include China.

Source: The Economist Intelligence Unit Operational Risk Service

Given the environment of higher financial and operational risk in BRI countries, the cost of poor planning is high: it can result in either direct investment losses, or indirect losses through project delays and renegotiation. In Kenya, for instance, construction of a Chinese-financed coal-power plant was halted in June 2019 over environmental concerns and amid opposition from local residents. In the same month, Ghana cancelled an MoU on a US$22bn railway project due to an alleged breach of confidentiality. Also in June, Chinese and local workers clashed at Bangladesh's Kalapara power plant construction site, causing the death of one Chinese worker. The incidents reflect tensions between China's approach to managing its international projects and the interests of local communities.

Beyond local risks, companies must also consider possible geopolitical risks. For instance, international pressure of the BRI has threatened to disrupt economic links between China and Israel as they aim to complete a free-trade agreement by end-2019. In 2015 Shanghai International Port Group won a concession to run Israel's Haifa port from 2021. However, pressure from the US has caused Israel to reassess the deal, pushing it to vote on a resolution in August 2019 to increase its oversight of Chinese investments.

Looking for sweet spots

One starting point for companies looking to engage with the BRI is to search for investment opportunities in countries that provide the right balance of opportunity and risk. Our assessment indicates that a select group of BRI countries are "high opportunity, low risk", as shown in the bottom-right quadrant of Chart 7.

Malaysia and Singapore in particular stand out as attractive BRI destinations, providing an investment environment that offers substantial opportunities as well as low levels of risk. Although there have been political tensions between Malaysia and China in the past, the bilateral relationship is currently strong (see box article below). Furthermore, the country scores highly in the opportunity pillar, owing to a favourable outlook for economic growth and export manufacturing as well as open policies towards foreign investment (several China-backed infrastructure projects are already under way in Malaysia).

Chart 7: China Going Global Investment Index: opportunity and risk matrix

Source: The Economist Intelligence Unit

A rocky relationship back on the road

On the eve of the second Belt and Road Forum in April 2019, China and Malaysia concluded a renegotiation of the terms of the East Coast Rail Link (ECRL) that had been suspended for almost a year. In the revised agreement forged by Daim Zainuddin, Malaysia's special envoy on the issue, the total distance of the railway was shortened by 40 km from 688 km, and the cost of its first and second phases was reduced to Rm44bn (US$10.7bn), from Rm65.5bn. This brought the cost per kilometre of track down by just over 30%.

These new terms represented a considerable win for the present government of Malaysia led by prime minister Mahathir Mohamad, who had pledged to push ahead with infrastructure improvements for the country while keeping a lid on public debt. It also demonstrated to the Malaysian population that Dr Mahathir's is able to negotiate effectively with major powers such as China on matters of national interest.

At the same time the deal also was also seen as a diplomatic victory for China. Apart from reviving the agreement on the ECRL, Malaysia also revived the US$34bn China-backed Bandar Malaysia project, a mixed-use and transit-oriented property development in Kuala Lumpur, which had been cancelled in 2017. The resolution of these disagreements on what was seen as key BRI projects ensured that China avoided a political embarrassment before the BRF and also helped it to secure Dr Mahathir's attendance at the event.

Dr Mahathir later stated his "full support" for the BRI, in sharp contrast to his earlier criticism. While at the BRF, he oversaw the signing of a Malaysian-Chinese deal to develop a US$1bn artificial intelligence park in Malaysia. A few months later, in August, Malaysia announced that it would launch a special channel for Chinese investment, focused in particular on its manufacturing sector—another sign of the ever-friendly relations between the two countries.

Bringing down the risks, bringing up the valuations

Conducting detailed market feasibility studies and rigorous project risk assessments will aid an understanding of the various risk profiles and help companies to manage down the risks. When engaging in BRI projects, it is particularly important to build strong partnerships with local companies, develop in-depth legal and regulatory expertise, understand political risk and manage risk throughout the project's life cycle.

Despite various roadblocks, it is worth highlighting that many BRI projects have been successfully completed. In many cases, establishing good project management and developing strong stakeholder partnerships was critical for projects to overcome their hurdles and continue progress. By contrast, projects which did not plan for multiple risks or scenarios were more likely to suffer from costly delays or had to be abandoned entirely.

To identify some of the key success factors for BRI-related projects, we analysed the list of BRI projects tracked by the China Global Investment Tracker, a publicly accessible project base, which monitors and maps the global activity of Chinese companies. We examined how companies involved in such projects managed political stability risk, government efficiency risk and legal and regulatory risk (which tend to be higher in BRI countries as discussed) throughout the project's life cycle.

Through our analysis we find that Chinese companies and international companies looking to participate in BRI-related projects need to formulate a strategy that considers four important themes:

1) Building strong collaboration with local companies
2) Developing legal and regulatory expertise
3) Understanding political risk
4) Managing risk throughout the project's life cycle

We feature two case studies to illustrate these themes.

Case study 1 Shaking up the telecoms sector in the Philippines

In early July 2019 Dito Telecommunity Corporation officially started operating in the Philippines. Formerly known as Mislatel, it is a consortium of three companies comprising China Telecommunication Corporation (China Telecom), Udenna Corporation and Chelsea Logistics Corporation (a subsidiary of Udenna Corporation). The latest entry of Dito Telecommunity Corporation breaks the long-held duopoly of Philippine Long Distance Telephone Company (PLDT) and Globe Telecom in providing telecommunications services in the archipelago.

However, Dito Telecommunity Corporation's journey to win its place in the telecommunications sector was fraught with challenges. In November 2018, shortly after it was announced that then-Mislatel had won the bid to become the Philippines' third teleco, the Senate of the Philippines heard complaints about the awarding of the bid to a consortium because China Telecom held a majority share.

Issues raised included the integrity of the selection process and national security concerns. Opposition members of the Philippine Congress claimed that providing China Telecom access to the Philippines' communications infrastructure could be a "Trojan horse" and give China access to state secrets. Philippino politicians and lawmakers scrutinised Mislatel's franchise and its partnership and ownership structure with China Telecom. This process delayed Mislatel's license approvals and forced Mislatel to postpone its plans for the commencement of its commercial operations. The consortium had planned to launch its operations in late 2020, provided it got the necessary approvals by March 2019.

However, signs of a breakthrough appeared in time for an official signing at the second Belt and Road forum on April 25th 2019, where China Telecom, Chelsea Logistics, and Udenna Corporation signed a US$5.4bn investment deal to develop Mislatel. Several business leaders from the Philippines, China, and other Asian nations witnessed the signing. Shortly after, on May 20th 2019 the Congress of the Philippines approved the acquisition of Mislatel by the consortium led by Udenna Corp.

KEY TAKEAWAYS: Without the strong backing of Udenna Corp, China Telcom would have not been able to push through their investment into the Philippines. Moreover, given the intense scrutiny from Philippino lawmakers, Mislatel needed strong legal and regulatory expertise to contend with these challenges. As the project was held back in large part because of political factors – which could lead to uncertain outcomes – the consortium had to navigate the politics and manage these risks carefully.

Case study 2 Getting the Jakarta-Bandung high speed rail up to speed

The 140-kilometre rail line to connect Jakarta and Bandung, two of Indonesia's largest cities, via the country's first high-speed train link is aimed at cutting the travel time between them from about four hours to just around 40 minutes. As one of the flagship projects of Joko Widodo (known as Jokowi), Indonesia's president, as well as of the China's Belt and Road Initiative, there was strong political support from the governments of both countries and high expectations of its success.

The journey started in 2015 when Jokowi's government awarded a US$5bn Jakarta-Bandung high-speed rail contract to China Railway Group over a Japan-led consortium. At the beginning of 2016, the project broke ground. However, over the next two years the project faced many hurdles, resulting in lengthy delays. It was only in May 2018 that Kereta Cepat Indonesia-China (KCIC)—the project consortium comprising four Indonesian companies and five Chinese companies—finally signed an order to officially commence development of the rail line.

As with almost all infrastructure projects involving the building of an extensive rail line or long toll road, land acquisition was a particular challenge. Given the number of individual land parcels that needed to be acquired, it was necessary to get buy-in and approvals for construction across multiple political constituencies. It was also costly and complicated to move so many people on one of the most densely populated islands in the world.

The project was originally planned to start operation by the end of 2019, but has been delayed to 2021. Estimated costs have also been pushed higher, from its initial investment plan of US$5.1bn to its current estimate of US$6.1bn. These delays and additional costs have lowered the project's profitability.

Nevertheless, after overcoming these initial hurdles, construction for South-east Asia's first high speed train does seem to be now finally progressing well. In September 2019 it was reported that PT Wijaya Karya tbk, the company leading the project from the Indonesian side, expects 53% of the line to be completed by the end of 2019 and 90% to be finished by 2020.

KEY TAKEAWAYS: The journey to develop the Jakarta-Bandung high-speed rail line highlights the critical need for companies looking for profitability in BRI projects to conduct robust feasibility studies to back up the business case for it. The assessment of the project's commercial viability over its life cycle must involve an analysis of the impact on profitably in the event of implementation problems, and include a buffer for these contingencies. Having an acute awareness of the various vested interests across the different political constituencies is also core to succeeding in reaching an agreement among the stakeholders. Finally, given the discrepancies in policy between the central, regional and local government in areas such as land acquisition and construction approvals, it is important to have a detailed understanding of both the national and sub-national legal, regulatory and policy frameworks to anticipate potential disputes.

The devil is in the details

In the BRI economies, many of the major hurdles to implementing infrastructure projects are down to local governance and capability. Often, expertise is lacking. Inconsistent regulations or processes for approvals between the national and state authorities—on land-acquisition, for example—also get in the way. Moreover, as rules are sometimes unclear, the legal and regulatory burden is sometimes high or uncertain. Companies must plan for these scenarios.

"Before we proceed on any project we first do a very detailed risk assessment, one that involves a review of the chances that the project will stall and not proceed. We look at the track record and performance of the contractor or our partner and how we expect their involvement to contribute or add an element of risk to the project," explains Mr de Villiers of ABB. "Sometimes we say: 'No thank you, the risk is too high for us to get involved.' But other times we say we can find ways to manage these risks. We try to manage this in a highly disciplined way."

Ultimately, a solid risk identification, mitigation and management approach needs to run through the entire project life cycle. As Mr Nooy of InfraCo says, by looking at a "project's lifetime costings" investors are likely to need to commit to more resources upfront, but that will ultimately bring stronger returns over the long run. "We might need to invest higher capital expenditures initially and bear a higher setting-up cost, because we look at the fuller picture and take a long term project life perspective. We factor in the project's future operational and maintenance costs, and make sure we fulfill the International Finance Corporation (IFC) performance standards. We invest in reporting on how we are meeting the IFC's high level of environmental, social, governance, health and safety standards. We do this because it's the right thing to do as far as safeguards are concerned, and because ultimately this will lead to higher asset values."

Conclusion

The latest Belt and Road Summit was held in September 2019, organised by the government of Hong Kong Special Administration Region and the Hong Kong Trade Development Council. The summit aimed to promote collaboration and explore cooperation and business opportunities relating to the BRI. The event attracted more than 5,000 attendees from corporates, banks and professional services from over 60 countries across Europe, Africa and Asia. It is clear that as the initiative turns six this year, many governments, corporations and investors continue to be attracted to the opportunities of the BRI, actively seeking ways to participate and benefit from the global project.

However, while the opportunities for investment are attractive, managing risk along the BRI is absolutely critical for projects to be successful. Given the environment of higher financial and operational risk in BRI countries, the cost of poor planning can be high. Through our analysis for this report we find that companies which have been more effective in maneuvering challenges faced in BRI projects have worked hard to:

- establish a strong business case for the project, including an assessment of the commercial viability of the project but also its impact on environmental, social and governance factors;
- understand the project's full risk profile over its life cycle, and find ways to manage these risks down in a systematic way;
- develop strong partnerships with local companies, local governments and regulators;
- build strong capabilities in legal and regulatory expertise in those markets;
- devise performance metrics and milestones for the project, and track the progress of these indicators in a disciplined way;
- plan for alternate scenarios and formulate exit-mechanisms in case this becomes necessary.

Through our research and interviews we also find that there is a distinct shift in the market where Chinese companies are now increasingly receptive to bringing in external expertise and feedback to help them improve the professional management and long-term commercial viability of their projects. The long-term implications for stronger linkages between companies from different sectors are therefore positive and expansive. There is great potential to create a value-added chain of trade in goods and services along the BRI that goes beyond infrastructure development. This could include collaborations in project financing, engineering consultancy, sustainable infrastructure management, insurance and legal advisory as well as various other types of professional services.

In our next report, we examine how companies can nurture their own ecosystem of partnerships, alliances and networks to support them as they prepare for the range of new investment opportunities opening up along the Belt and Road.

About Economist Corporate Network

The Economist Corporate Network is The Economist Group's advisory service for senior executives seeking to better understand the economic and business environments of key global markets.

Delivering independent, thought-provoking content, The Economist Corporate Network provides clients with the information, insight, and interaction that supports better-informed strategies and decisions. The Network is led by experts with in-depth knowledge of the geographies and markets they cover. Its membership-based operations expand across Asia, the Middle East, and Africa.

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