The Economist CORPORATE NETWORK

BRI BEYOND 2020

Partnerships for progress and sustainability along the Belt and Road

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Contents

Preface

BRI beyond 2020: Partnerships for progress and sustainability 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 and Pamela Qiu were the report authors. Pamela Qiu also conducted the interviews and was the report editor. Zheng Shiyu contributed to the research and Waqas Adenwala provided editorial support. 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
- Scott Dunn, vice president, strategy and growth, AECOM
- Rajeev Kannan, executive officer and head of investment banking, Asia Pacific, Sumitomo Mitsui Banking Corporation
- Sajal Kishore, head, infrastructure and project finance, Asia Pacific, Fitch Ratings
- Mun Loong Lau, head, project finance, CIMB Bank
- Lawrence Wu, president and executive director, Sunseap

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Introduction

April 2019 was a milestone month for the Belt and Road Initiative (BRI). Xi Jinping, China's president, signalled a strong commitment to develop a more inclusive, transparent and sustainable approach to BRI projects at the second Belt and Road Forum (BRF). Many observers and market participants now refer to discussions at this BRF when they speak of the positive developments unfolding under the initiative.

In April, the world's first film featuring the BRI, "Common Destiny", was also unveiled at the Beijing International Film Festival. The documentary is an international joint effort by veteran filmmakers from many countries, including China, the UK and the US. The plot revolves around six distinct individuals from all corners of the globe, whose lives have been transformed through the initiative over the past six years.

The overarching messages that audiences are meant to draw from the BRF and "Common Destiny" are similar. First, the vision for the BRI is to connect communities across international borders to realise shared benefits. Second, China is keen to actively engage with people through the public and private sectors to participate in the initiative. Third, the BRI is not only about building "hard" infrastructure, but is, importantly, also about developing "soft" infrastructure—from creating jobs and industry to principles and norms around sustainable development.

Chinese officials have regularly communicated BRI's goals of broader inclusivity to corporate executives since the initiative was officially launched in 2013. Until recently, however, political observers, market analysts and industry captains tended to shrug this off as just talk as they believed that the BRI was mainly intended to benefit Chinese interests.

This is noticeably changing. "In the early stages of the BRI, it was very much seen as a government-to-government initiative, one that will promote Chinese manufacturing, Chinese construction and/or Chinese financing. Increasingly, however, it has become quite clear that China is serious about a multilateral approach to the BRI. We are observing that there is a lot more engagement from China's private sector and state-owned enterprises, and they want to engage with global infrastructure players like us," says Rajeev Kannan, executive officer and Asia Pacific head of investment banking at Sumitomo Mitsui Banking Corporation.

As the BRI progresses, a critical—almost existential—question will be that of the initiative's sustainability, from a financial perspective as well as from the environmental, social and governance (ESG) perspective. In the coming decades, most of the world's infrastructure investment will be hosted by the Belt and Road region, which will have a profound impact on resources, the climate and the environment.

It is clear that China is determined to use the BRI to push ESG considerations to an unprecedented level, in a move displaying green leadership. Mr Xi's keynote speech during the second BRF highlighted how environmental concerns need to underpin the initiative "to protect the common home we live in" by adhering to open, green and clean approaches.

However, there is much to do to achieve this vision. Success will require collaboration between multiple diverse stakeholders across boundaries. For instance, a huge hurdle facing the BRI in terms of ESG, particularly when it comes to the success of green financing, is that investors do not have a single set of principles which defines a green investment. Different standards being applied in different BRI recipient countries create huge risks for companies seeking investments, as it could lead to further funds being denied during the project's lifecycle. To provide companies with a common standard to benchmark their investments, a global ESG framework with internationally accredited standards must be developed.

As interviewees for this report have shared, although the development of commercially viable partnerships for BRI-related projects still faces many challenges, there have also been successes. This paper showcases examples of how such partnerships are formed to allow projects to be financed profitably and delivered effectively. We explore the opportunities in sustainable finance and green projects along the BRI. We also discuss how companies can nurture their own ecosystem of partnerships, alliances and networks to support them as they prepare for a range of new investment prospects opening up along the Belt and Road.

Co-financing for growth

According to our data, the majority of projects under the umbrella of the BRI are in the transport, telecommunications or utilities sectors. Given that these are often classified as national strategic assets, there is usually a strong dependence on the public sector for funding and operation of such infrastructure. Sajal Kishore, head, Asia Pacific infrastructure and project finance at Fitch Ratings, points out that a majority of Asia's large-scale infrastructure projects in these sectors—whether they are considered BRI-related or not—are being funded by public finance, rather than from commercial entities.

To date, funding for BRI-related projects has been largely reliant on public finance through the Chinese policy banks, such as the Export-Import Bank of China (EximBank), China Development Bank (CDB) and China Export & Credit Insurance Corp (Sinosure). By the end of 2018, the CDB's outstanding international businesses in countries along the BRI stood at more than US$105bn, accounting for 34% of the bank's overall international businesses[1]. Meanwhile, by the end of April 2019, the EximBank had extended about more than Rmb1trn (US$149bn) in financing to BRI projects[2]. Multilateral development banks (MDBs) such as the Asia Infrastructure Investment Bank (AIIB) and the Asian Development Bank (ADB) have also provided financing for projects.

However, the limits of the public purse have left significant infrastructure gaps across the developing world. There is a strong need to attract private-sector investments into infrastructure in a systematic and sustainable way. As the BRI progresses and expands its reach, international commercial banks will play a critical role in complementing mainland Chinese funding channels, particularly banks that can offer a complete suite of financing options across their international banking networks. This expertise is particularly important when raising funds privately because many companies are too small and inexperienced to go down the public-finance route successfully. Furthermore, private funding can often be much quicker to secure and less complicated. Private banks also have a stronger investor base as they can utilise their advisors' often extensive network of clients, thus helping to match the needs of the borrowers with that of the lenders.

Bumps and swings

However, structural issues around the bankability and commercial viability of large-scale infrastructure projects continue to hold back the mobilisation of private capital into the sector. This is particularly true for countries along the Belt and Road, which are mostly comprised of developing economies characterised by high levels of country and market risk. Domestic and bilateral political issues, as well as regulatory and legal challenges, continue to represent significant risks for financiers of infrastructure projects in these countries.

Currency volatility and risk also continues to be a cause of serious concern for private-sector investors. Especially for projects with currency mismatches in their revenue and financing streams, significant depreciations could jeopardise project profitability. Although a significant number of

[1] https://www.reuters.com/article/us-china-finance-cdb-bri/china-development-bank-provides-over-190-billion-for-belt-and-road-projects-idUSKCN1R8095

[2] https://www.reuters.com/article/china-bank-beltandroad/chinas-eximbank-provides-more-than-149-bln-for-belt-and-road-projects-idUSL3N2202TI

large-scale infrastructure ventures are being financed in US dollars, revenues are often earned in local currency, which could be subjected to large swings in external investor and market sentiment.

"What we hope to see moving forward is more local currency financing," says Mun Loong Lau, head, project finance, of CIMB Bank. "Take a toll road or a power station, for example, which has a local client base and generates cash flows predominantly in local currency. If we could raise the funds for its investment in local currency, that will certainly make it less risky."

Mr Kannan of Sumitomo Mitsui Banking Corporation concurs: "Having enough liquidity in local currency is a big challenge in many emerging markets. While we can assume a US dollar currency risk in certain countries, we won't be able to in all. In the latter cases, there either has to be a hedging solution for it, or there has to be a local funding structure."

Funding triangles

One possible way to develop a local funding structure is to work with the MDBs, which often have the ability to take longer-term exposures and can lend counter-cyclically. For example, the AIIB has recently started to offer local-currency financing in certain emerging markets, to help shield borrowers from the swings of foreign-exchange markets. The initiative started in July 2019 and currently covers Indonesia, Thailand, Turkey, Russia and India, but is expected to gradually broaden its geographical reach.

Indeed, the MDBs can play a critical role in reinforcing public infrastructure investment and sharing some of the funding risk to support commercially viable projects. Their support often reassures private-sector investors and encourages international banks to participate. In Asia, the Indonesia Infrastructure Finance (IIF) is just an example of how these different entities have come together in an effective way to improve private sector participation in infrastructure development. The IIF is a partnership between Indonesia's Ministry of Finance, MDBs (such as World Bank and Asian Development Bank) and the private sector (Sumitomo Mitsui Banking Corporation). Supported by long-term subordinated loans from MDBs, strong capitalisation from the shareholders and access to local and international capital markets, the IIF has provided long-term debt and unfunded support to various infrastructure projects in Indonesia.

Co-investing for sustainability

Large-scale infrastructure and logistics projects have traditionally been at odds with environmental interests. The building of airports, roads and railways, which includes the use of heavy machinery and the production of harmful waste, can lead to the destruction of natural habitats and a loss of biodiversity. According to the World Bank, approximately 70% of global greenhouse gas emissions come from construction and operations of infrastructure and buildings. Given that the bulk of BRI projects are in infrastructure, one central issue is finding a sustainable approach to the silk roads over the next few decades.

Sustainable finance has an especially significant role to play. Lenders and investors who fund infrastructure projects along the BRI are now rapidly reaching a consensus that green finance should be prioritised. For instance, since November 2018 China has worked with the City of London Corporation's Green Finance Initiative to create the Green Investment Principles (GIP) for the Belt and Road. This set of voluntary principles calls for lenders, investors and corporates that invest and operate along the BRI to ensure their projects are aligned with the requirements of environmental sustainability and the United Nations Paris Agreement. The World Economic Forum, the UN-supported Principles for Responsible Investment network, the Belt and Road Bankers Roundtable, the Green Belt and Road Investor Alliance, and the Paulson Institute were also major contributors to the drafting of these principles.

The signing ceremony of the GIP, attended by large global lenders and investors, was held during the second BRF in April 2019. Since then, 30 global institutions have signed up to the GIP, including all major Chinese banks engaged with the BRI and some of the largest financial institutions from the UK, France, Germany, Switzerland, Belgium, Japan, Singapore, Hong Kong, Pakistan, Kazakhstan, the UAE and Mongolia.

"Any transaction which needs financing from international community will have to meet certain ESG standards," says Mr Kishore of Fitch Ratings. Given that the BRI projects are indeed seeking such multilateral participation, this could drive a new philosophy from China's construction companies and push them to adopt ESG principles and standards.

Mr Kannan of Sumitomo Mitsui Banking Corporation believes that this shift in attitudes is already spreading swiftly across Asia, including China. "This awareness of the need to take an ESG approach is certainty gaining traction. Chinese construction companies have realised they cannot do transactions now without meeting these standards."

China rising to the occasion

Many studies and projects illustrate China's commitment to green projects and finance across regions in recent years. For instance, research by Greenpeace, a non-governmental environmental organisation, found that Chinese investments in renewable energy projects in BRI countries surged from 2014 to 2019. These investments have come in the form of equity investments, engineering, procurement, construction, financial support and equipment exports. The results are quite impressive. For example, China is expected to drive more than a third of the world's total wind-power capacity by 2020.

At the end of 2018 the balance of green credit from the Export-Import Bank of China, one of China's major policy banks, exceeded Rmb250bn (US$35.6bn). The bank has also adopted the green credit standard into the entire credit issuance process. Along the BRI, it has supported renewable energy projects such as the Karot hydropower project in Pakistan, the Adama wind power project in Ethiopia, and the solar cell and solar module production line project in Penang, Malaysia.

China's commercial banks are also actively issuing green credit for BRI projects, most prominently by issuance bonds in overseas branches. This also underlines the increasing co-operation in financial services across markets under the initiative. Industrial and Commercial Bank of China (ICBC), China's largest bank, issued the first Belt and Road green climate bond, worth US$2.15bn, in Luxembourg in 2017. This was also the first issuance by ICBC out of its green bond framework, and raised proceeds have been dedicated to finance BRI projects linked to renewable energy, low carbon and low emission transportation, energy efficiency, as well as sustainable water and wastewater management.

In April 2019 ICBC also issued the world's first green Belt & Road Inter-bank Regular Cooperation bond ("BRBR" bond) denominated in US dollars, euros and renminbi, with a total equivalent amount of US$2.2bn. The bond is of three-year and five-year maturity, and the funds raised will be used in the construction of the Belt and Road green projects. The bond was issued by ICBC's Singapore branch in line with the international and China Green bond guidelines, and underwritten by 22 institutions in more than 10 countries and regions along the BRI.

It's not just ICBC. Overall China's green bond market is among the largest in the world. According to estimates by international financial institutions HSBC and BNP Paribas, China's share in global green bond issuance has risen from only 2.4% of the world total in 2015 to more than 23% in 2017. In 2018, China issued over US$30bn worth of green bonds, putting the country in second place globally behind the US bond issuance. These bonds ensure all proceeds go to finance green projects only and provide lower financing costs to green projects compared to financing from conventional bonds.

Still sorting out the standards

Sceptics, however, argue that questions persist about the proliferation of "green" standards. Over 130 of the world's largest banks and asset managers have signed up to the Green Bond Principles, which are guidelines that specify what is green, stipulate reporting requirements and recommend the use of external reviewers. One option is certification offered by the Climate Bonds Initiative (CBI), an NGO. Others opt to get a second opinion from a specialised environmental consultancy such as Vigeo Eiris, or from a large auditor like EY or KPMG. The CBI reckons 85% of bonds issued in 2017 have undergone an external review.

Meanwhile, the overall perception is that China's standards need to be improved if it wants to be taken seriously as a green superpower. China's central bank, for instance, has its own standards for the Chinese market. Unlike the Principles or the CBI, for example, it regards investments in "clean coal" as green. Until Beijing aligns its principles guiding its environment investments abroad with global standards, it will continue to face international criticism about its lack of sustainable growth and investment strategies. This is especially true when its continued export of dirty-energy technology, such as coal-fire plants, undercuts the credits it gets for going green.

Local factors remain critical

That global initiatives—including the BRI and its related collaborations—are increasingly focused on sustainable infrastructure development is certainly a significant step in the right direction. However, governments must also make bolder changes at the national level to ensure green and clean solutions become a reality for their countries.

"It is encouraging that China is prioritising investments in renewable energy under the Belt and Road Initiative. However, whether clean energy projects are successful in BRI countries also depends on local market conditions, rather than solely on the strength of China's high-level policy commitments. When we evaluate a project, there are many on-the-ground factors that motivate whether or not—or how to—put a renewable energy source into the grid for a province or a country. These decisions are really driven more by details specific to that jurisdiction, such as how favourable the local regulatory and policy environment is, or how independent the existing power market is," says Lawrence Wu, president and executive director of Sunseap, a renewable energy solutions provider.

In some BRI countries the consumption of fossil fuels is still being subsidised, which puts renewables at a competitive disadvantage. Subsidies are slowly being reduced, but not quickly enough. As Mr Wu points out, "Malaysia, Indonesia and Vietnam have cut their fossil fuel subsidies in recent years, but the playing field isn't level yet. The price of producing renewable energy has fallen substantially in recent years to the point where they can compete head-on with fossil fuels. But as long as these subsidies remain, the contest still can't be considered fair and is unsustainable in the long run."

It is absolutely paramount, therefore, that the governments of BRI countries truly embrace the importance of an ESG approach to infrastructure development. "If tenders are being issued without specifying standards that are based on social and environmental goals, then obviously the principles will not be adopted by the construction company," argues Mr Kannan.

China's renewable interests

China's interests in renewable energy projects are extensive. We outline two case studies below to illustrate how China is collaborating with local and external funders to develop renewable energy projects.

Case study 1 The largest photothermal plant in the world is coming to Dubai

In July 2018 China's Silk Road Fund announced that it will jointly invest in a US$4.3bn photothermal power station with Dubai Electricity and Water Authority, and ACWA Power. The project involves the construction of two power stations by Shanghai Electric Generation Group and will have a total capacity of 950 MW. China's ICBC, Bank of China, Agricultural Bank of China, China Minsheng Bank and Standard Chartered Bank were some of the main financial backers, providing a syndicated loan of US$2.5bn for the project. The project is planned under the Dubai government's 2050 Clean Energy Strategy, and is also one of the key projects developed in the Middle East region under the BRI. Upon completion, it will be the world's largest photothermal power-plant project.

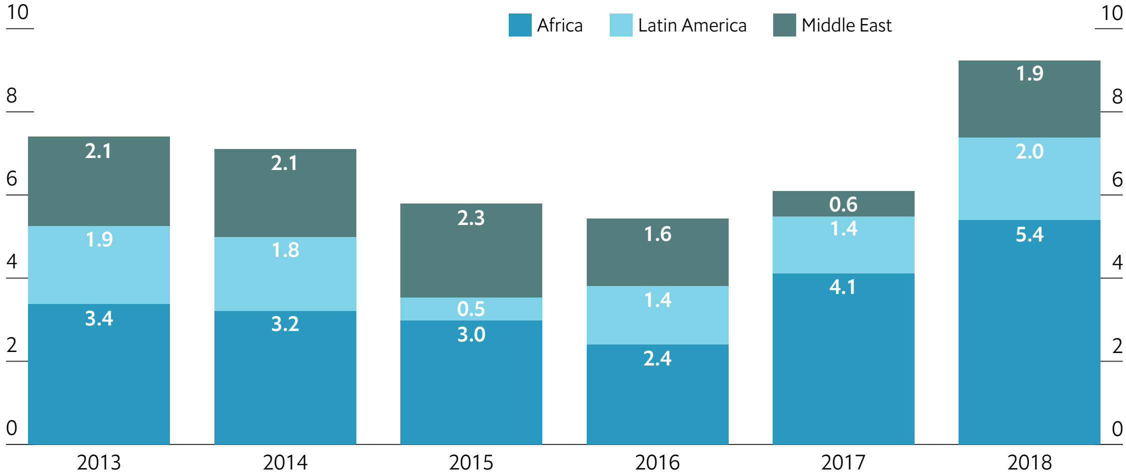
Case study 2 Developing a range of clean energy solutions in Brazil

During the 11th BRICS Summit, in November 2019, China's State Power Investment Corporation (SPIC, a major electricity generation company of mainland China), Grupo Prumo (a company controlled by EIG Global Energy Partners) and Siemens AG (a German company) signed a memorandum of understanding to jointly develop energy projects in Brazil. The three parties also signed an agreement stating their intention to co-operate on the development of the Gás Natural Açu (GNA), a gas-fired power project in the state of Rio de Janeiro. According to the agreement, SPIC will provide equity financing, design, construction and operation management of the GNA project with Prumo and Siemens AG and carry out the project in four phases. According to the latest information, GNA Phase I is expected to start commissioning by March 2020 and the development of GNA Phase II is already under way. Upon completion, GNA I and GNA II will have 3 GW of installed capacity—ready to supply energy to up to 14m households—making it the largest gas-to-power project in Latin America.

SPIC's engagement in Brazil's clean-energy sector started since 2016, after it acquired Pacific Hydro, an Australian renewable energy company that already operated in Brazil. SPIC's Brazilian subsidiary, SPIC Brasil, now holds a number of wind and hydro power generation assets, located in the states of Paraíba and Goiás. The company is also exploring photovoltaic, wind, hydrogen and comprehensive smart energy in Brazil, leveraging its technology and experiences in power station investment, construction and operation.

China going out

China's overseas direct investment flow in Africa, Latin America and the Middle East regions
2013-2018 (US$bn)



Note: Latin America calculations exclude the British Virgin Islands and Cayman Islands, as these territories serve mainly as offshore centres to facilitate cross-border business and investment, mediating funds for investment globally
Source: Ministry of Commerce of the People's Republic of China

Our previous report, *BRI beyond 2020: Embracing new routes and opportunities along the Belt and Road*, highlighted that trade and investment linked to the initiative are still concentrated in Asia.

However, China's overseas direct investment (ODI) in non-Asian markets is certainly significant. (As figures for BRI trade and investment flows are unavailable, a good proxy to help us understand China's economic relationships with the world can be gleaned from its ODI flows.) The bulk of China's non-Asian ODI in emerging markets over the period 2013-18 has landed in Africa, which attracted a total of about US$21.4bn in Chinese investment since the BRI was launched. The top recipient countries in that region over the period were South Africa, Zambia and Kenya.

In comparison the Middle East region has absorbed about US$10.6bn in Chinese ODI in 2013-18, with the UAE, Israel and Turkey emerging as the top three destinations. Latin America gained US$9.3bn in the same period, with Brazil, Argentina and Venezuela gaining the most investment from Chinese investors.

Beyond these traditional developing zones, a new region is attracting attention as a growth area for the Belt and Road: the polar ice caps. In early 2018 the Chinese government published its first policy document outlining its Arctic strategy and also linked these plans with the BRI. China has stressed that it will play by international rules and co-operate with the Arctic Council (its members include polar great-powers to reckon with: the US and Russia).

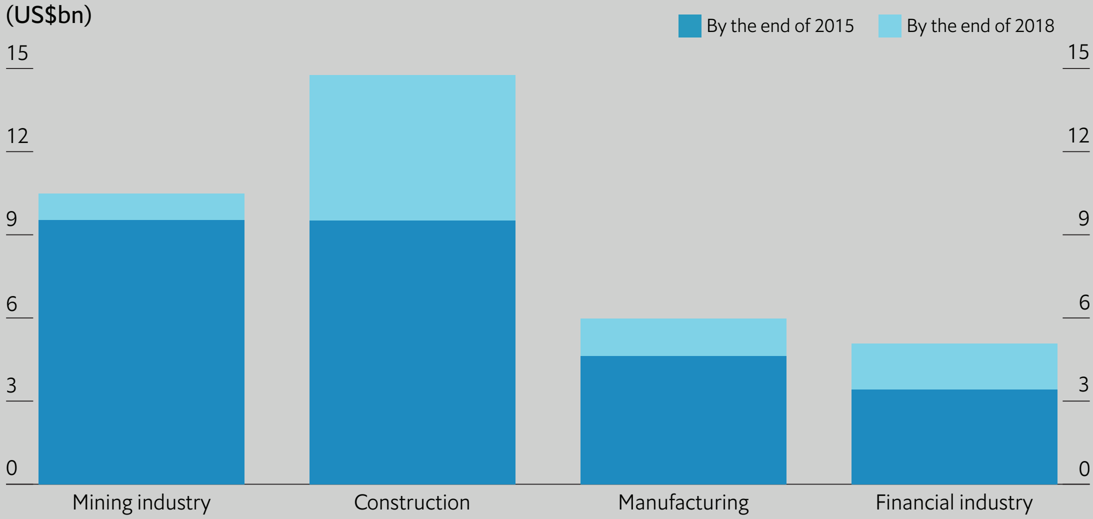
China's ambitions in the Arctic are fuelled by a wide range of interests. It wants to conduct research there on how melting ice caps affect weather patterns, which could help China devise responses to problems such as water scarcity. China is also keen to tap into the Arctic resources that will become easier to procure as the ice cap retreats, from rare earths and minerals to oil and gas. As the ice melts, it may become more feasible for cargo ships to sail through Arctic waters. China is interested in this possibility as such routes could cut several thousand kilometres off journeys between Shanghai and Europe in the coming decades. China is thinking of building ports and other infrastructure in the Arctic to facilitate shipping. State-linked firms in China talk of building an Arctic railway across Finland. So far, China's biggest investments in its Arctic vision have been in Russia, including a gas plant that began operating in Siberia in December 2018.

The interest from Chinese firms could be good news for many Arctic communities. Few other investors have shown themselves willing to stomach the high costs and slow pay-offs involved in developing the far north. But Chinese involvement attracts criticism, too. The main concern is that China's ambitions will result in a gradual rewiring of the region's politics in ways that give China more influence in determining how the Arctic is managed. Green interest groups who would rather see the Arctic kept pristine also fear that Chinese money could encourage projects that damage the environment.

The relationship between China and Africa is maturing under the BRI

China has been an increasingly important stakeholder in Africa's infrastructure development. Moreover, in the recent years there has been a notable shift in the pattern of China's overseas direct investment in the region, with a repositioning of its focus from the mining sector to Africa's construction, manufacturing and financial services sectors (see chart below). These investments are supporting Africa's efforts to diversify its economy and reduce its over-reliance on natural resources for growth. According to Lin Songtian, China's ambassador to South Africa, China is investing in more than 30% of Africa's infrastructure projects and 80% of the region's telecommunication project construction to facilitate industrialisation, urbanisation and sustainable development.[3]

Top four industries of China's ODI stock in Africa at the end of 2015 vs 2018
(US$bn)



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

[3] https://city-press.news24.com/Business/china-is-africas-best-bet-says-ambassador-to-sa-20190922

Political and policy commitments between China and Africa have strengthened and expanded in their scope since the BRI was launched. During the 2018 Forum on China Africa Cooperation (FOCAC), an official forum between China and all states in Africa, Mr Xi proposed eight major areas for nations to collaborate on: industrial promotion, facility connectivity, trade facilitation, green development, capacity building, health and hygiene, humanities exchanges, and peace and security. Since then, there have been further announcements signaling continued interest to deepen this bilateral relationship, including a desire from African nations to leverage on the BRI. In August 2019, for example, the Southern African Development Community (SADC) affirmed its plan to link the BRI with its industrialisation strategy, especially on the construction of the infrastructure.[4]

These developments in fact build on the foundations that have already been established over the past decade. In sub-Saharan Africa, for example, Chinese companies have supported the construction of three major economic zones, including Zambia-China Economic and Trade Cooperation Zone, Eastern Industrial Zone in Ethiopia and China-Nigeria free trade zone. Such investments are helping to create jobs and develop local industry. The Eastern Industrial Zone in Ethiopia, for instance, has spurred more than 10,000 jobs for local people during the past 10 years since its establishment, and has boosted the country's manufacturing exports. Ethiopia is keen to replicate these investments and establish 15 such industrial parks. Much of this would be supported by China.[5]

Meanwhile trade between China and Africa continues to thrive. In 2018 China's trade with Africa increased by 19.7%, a pace of growth that is considerably higher than China's average trade growth with the world (12.6%). These strengthening trade links are in part a result of favourable financial incentives offered to Africa by China. For example, 33 of the poorest countries in Africa export 97% of their exports to China with no tariffs and no customs duties.[6] It is important to note that bilateral trade is still heavily centred on China's import of Africa's natural resources. Nevertheless, in recent years China has modestly increased its import of manufacturing products from more diversified economies such as South Africa.

Green pillars

As Africa reduces its over-dependence on natural resources for boosting economic growth, it also needs to ensure it develops other industries in a sustainable way. To this end, China and Africa have agreed to work together on improving Africa's capacity for green, low-carbon and sustainable development, and to roll-out more than 50 projects during 2019-2021 on clean energy, wildlife protection, environment-friendly agriculture and low-carbon development.[7]

At present China's investment in Africa's power sector is predominantly in coal-fired power stations and hydroelectric power stations[8], which are often more harmful to the environment than other clean energy solutions. However, there are signs that Chinese companies are becoming more invested in various green energy projects across the region. In April 2018 CHINT Electric, a Chinese electrical engineering company, announced plans to invest in a solar farm in Gwanda, Zimbabwe.[9] In July 2019 China's Zhongkai International Company launched a $9m ethanol processing plant in Zambia. In October 2019, China National Building Materials Corporation won a bid in Angola to build a PV solar energy integration project, which will become the first integrated and the largest optical storage project in Angola after completion.[10]

[4] http://www.xinhuanet.com/english/2019-08/05/c_138283451.htm

[5] http://www.xinhuanet.com/english/2018-12/27/c_137702154.htm

[6] https://baijiahao.baidu.com/s?id=1610023321760614069&wfr=spider&for=pc

[7] https://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1593683.shtml

[8] https://www.power-technology.com/comment/chinese-investment-in-africa-2019/

[9] https://www.herald.co.zw/52m-for-gwanda-solar/

[10] http://www.ne21.com/news/show-117502.html

Great potential, but risks too

Policy documents released by China's Ministry of Commerce suggest that China is keen to expand its manufacturing footprint in Africa. Some priority sectors include cement, automotive, steel rolling, textiles, chemicals, pharmaceuticals, food and beverage, electronics and assembly and construction machinery.

Although Africa's untapped manufacturing and consumer markets represent significant potential opportunity, China's investments will be constrained by the challenges inherent in the region's business environment. Poor governance effectiveness, currency risks, complex regulatory systems and high levels of corruption will continue to pose hurdles to investment. To navigate the market opportunities, companies—from China and elsewhere—will need to be fully prepared and equipped to deal with potential legal and regulatory disputes.

China-Arab economic cooperation on a fast-track

In 2016 China surpassed the US and the UAE to become the largest investor in the Arab world. That year, China invested US$29.5bn in Arab countries and its share of total direct foreign investment in the region reached 31.9% (according to figures published by the Arab Investment and Export Credit Guarantee Corp)[11]. In 2018 alone direct investment from Chinese companies in Arab states totalled US$1.2bn, roughly a 380% increase from 2010 levels and bilateral trade value between the two sides reached $244.3bn, representing a year-on-year growth rate of 28%.[12]

China has evolved as a pioneer in developing clean energy in the region. In June 2019, Silk Road Fund, a government established fund to promote the BRI, announced that is acquiring a 49% stake of ACWA Renewable Energy Holding, a renewable energy arm of Saudi Arabia's ACWA Power. This deal provides Silk Road Fund access to projects across the Middle East and North Africa (MENA) region.[13]

As Middle East is transitioning to a post-oil economy, which aims to diversify income from oil industries, Chinese investors are actively looking for opportunities in non-oil industries. China has also ramped up efforts to explore opportunities from local strategic initiatives such as Smart Dubai 2021 and Saudi Arabia's National Transformation Program 2030. At the fourth China-Arab States Expo in September 2019, non-oil industries had extensive discussions to collaborate across sectors such as infrastructure, healthcare, advanced technology, modern agriculture, logistics, tourism and digital and internet economy.

[11] https://www.middleeastmonitor.com/20170724-china-is-largest-foreign-investor-in-middle-east/

[12] https://www.chinadaily.com.cn/a/201909/06/WS5d72e134a310cf3e3556a374.html

[13] https://www.paulsoninstitute.org/green-finance/green-scene/chinas-growing-green-engagement-in-mena/

People-to-people bridges along the BRI

At the heart of the BRI is an ambition to create better connections between countries. The building of physical infrastructure is clearly the most visible pillar of this project. Equally important, however, has been the people-to-people networks that are being strengthened through the BRI.

Indeed, investing in people has been a vital ingredient in the formula of companies who have been successful in seizing opportunities along the BRI's expanding economic corridors. "Investing in country teams that really understand the culture, language and business practices across the respective local markets makes all the difference," says Johan de Villiers, South-east Asia managing director of ABB, a European industrial technology company. "In the context of the BRI, we have a strong local team in China that works very closely with Chinese engineering, procurement and construction (EPC) companies. The team will identify potential projects as early as possible, understand who the interested Chinese EPC bidders are, and then engage them in China. We then also bring in the local team in the country (where the BRI project is to be developed), where we will often have operated for many decades and so experiences to share, highlighting the aspects to be considered, so as to work as a real partner to help them be successful in their business."

Moreover, at the same time as developing deep local roots are essential, so is the ability for this local intelligence to be connected across the world. Scott Dunn, vice president at AECOM, shares how the global infrastructure firm has created "overseas investment desks" in Asia, allowing it to strengthen its capability in capturing the overseas direct investment (ODI) wave across the region. "An important pillar in our ODI strategy has been our overseas investment desks—groups of talent focused on companies going overseas. They are typically native language speakers who have strong local connections, and they have extensive experience working with state owned enterprises (SOEs). We have these teams in China, Japan, Korea, and so on, engaging with that country's SOEs or conglomerates, supporting them in their journey as they come out of their home markets and expand overseas. Crucially, they actively coordinate with our other offices around the world. In BRI-related projects, for example, they create the bridges between our colleagues in the Greater China area and wherever the project is to be based, but also connect our expertise elsewhere in accordance to the demands of the project."

By investing in organisational changes, companies can better align their teams and strengthen their capability within and outside China. As the BRI opens up to greater international participation, organisations also need to form deeper connections externally to be successful in capturing the increasing opportunities. This is also true for Chinese companies. In the box below, we outline an interview with a senior executive (who declined to be named) heading up a regional office for a Chinese SOE in the architectural design and construction sector. Given the wide range of BRI projects and the approaches to them, this account may not represent a consensus view from Chinese SOEs. However, it illustrates how one such large enterprise perceives the BRI and is building the partnerships it needs to benefit from the new opportunities the programme brings.

A view from China

These insights are drawn from an interview with a senior executive who leads a regional office for a Chinese SOE in the construction sector. He has been involved in several Belt and Road projects since 2016, mainly in the Middle East and South-east Asia.

Since the BRI was officially launched, how has your company benefited from new opportunities along BRI?

The BRI has helped us gain access to more overseas opportunities at a time when China's domestic construction market has become fiercely competitive and both margins and cash flow have deteriorated as a result. Not only does the BRI bring in more projects, these contracts also tend to be paid on time, possibly because of the government's backing and its commitment to BRI-related projects.

From your observations or experience, how have Chinese SOEs and other Chinese firms approached BRI projects? Is this approach changing?

Many SOEs partner with local companies (where the project is based) which are either owned by Chinese immigrants or have had experience working with Chinese SOEs. These prior connections support better sharing of information on projects. A trustworthy local partner is critical, as they support us with local labour and other local logistics, liaising with the local government and maintaining the project.

Initially we wanted to bring in our own team of technicians who are familiar with the particular techniques we employ in our construction. However, as the logistics involved soon proved to be too burdensome and costly, we decided to train the local labour instead.

This local partnership model is a change from the initial approach, where a Chinese SOE partners with another Chinese SOE which has had experience operating in overseas markets. The main problem in this old approach is that it creates additional bureaucratic layers and fosters inefficiency, while providing limited value-add to the actual project.

What are the challenges you have faced in engaging in BRI projects?

Finding a trustworthy local partner is definitely the toughest part. There is a fine balance between finding companies which are close to the local government and the possible complications resulting from the local partner being too close with the government such that any grievance that may arise in the future will not be fairly handled.

What are your views on the future of the BRI, and what opportunities or risks this may bring?

One priority for China's government at the moment is to maximise the number of "good and presentable" projects which could become poster-children for the BRI. Opening up the BRI certainly brings new opportunities, but the risks could also increase. For example, projects could become exponentially more complex as the number of stakeholders increase. The speed at which decisions are made could also become much slower as more parties get involved. Nevertheless, the development of the initiative is likely to see new types of businesses emerge, such as specific consultancy services and a demand for skills training and transfer.

Conclusion

As more roads are being developed and new connections are being created under China's Belt and Road Initiative, challenges will no doubt remain. A big economic—but also political—concern for the BRI is its cost; and the danger that the tens of billions of dollars in loans and investments are not simply fostering growth, but unsustainable debt too.

Moreover, the scale of the effort to make the BRI a success is truly massive. A railway, port or a power plant ought to make countries more accessible, and to act as a node for commerce. But for it to prove effective, much more will be needed: better roads to link it to existing transport networks, new urban centres around the stations, a reliable electricity grid and freer trade with other countries. China cannot achieve this alone, but will need to work closely with local governments, businesses and communities. Our research has shown that there are reasons to believe these partnerships are expanding and deepening across countries.

A large factor in determining the BRI's success will depend on whether its projects can be de-risked, and developed as bankable, commercially viable and sustainable ventures. By raising the programme's professional standards, this will attract higher levels of private sector finance and investment as well as pull together resources across multiple stakeholders to create better outcomes across the project lifecycle. As this report has also shown, there are some promising signs in all these areas.

If the BRI is successful, the benefits are projected to be impressive. A recent study by the World Bank concluded that BRI transportation projects could lift global GDP by 3%. That is larger than the benefits that are usually shown to be generated by free-trade agreements. It could indeed bear out China's notion that it is trying to build the roads that let trade happen.

The potential of China's silk road ambitions, meanwhile, continues to astound. The latest extension of the programme, the "polar silk road" or "ice silk road", has caused both excitement and anxiety across the international community, similar to the BRI itself which evoked these dual-emotions when it was first officially announced in 2013. As Mr Dunn of AECOM highlights, a polar silk road could have a profound impact on connectivity, shipping routes and centres of manufacturing activity in the years to come.

Indeed, as we conclude the report, we remind our readers that the Belt and Road Initiative is a decades-long journey. In Mr Xi's words, this is China's "project of the century"—and it is only just off the starting block. Six years in, perceptions are already being re-shaped on both sides of the bridge. On the one side, Chinese corporates are just warming to the idea of learning the ropes from their international partners so as to build up their expertise in operating outside their comfort zone and home markets. On the other side, international firms are finally becoming more convinced that the promised land of new opportunity opening up along the BRI is indeed coming up on the horizon.

The walks on these new bridges will not be strides in the park. For international institutions looking to form partnerships with their Chinese counterparts and vice versa, it is imperative to be clear with all parties involved on what the potential areas of conflict and concern are, right from the beginning. As Mr Kannan of Sumitomo Mitsui Banking Corporation says, "In the past people were sometimes unwilling to openly discuss the full scope of challenges when embarking on infrastructure projects in emerging markets. It is essential for all market participants to be clear that the principles of bankability, viability and sustainability must be upheld in all projects where the private sector gets involved—whether related to the BRI or not."

Our research reports have found that the following areas have the highest potential for growth and private sector participation under the BRI: transport, telecommunications, utilities, digital infrastructure, renewables and clean energy. While the traditional investments in these sectors will continue to drive the bulk of growth in BRI projects, new considerations for the smart city era will emerge. Interviewees for this report shared that they are observing how future trends of mobility and changing consumer behaviour are having an impact on infrastructure—from how driverless cars and electric vehicles are transforming patterns of traffic, to how the internet of things is creating systemic cyber risks for telecommunications networks.

Hence one thing is for sure: ever-expanding opportunities and fresh new risks will arise in the next phrase of the Belt and Road Initiative. An organisation's best bet to position themselves strategically for the long run will have to include the following pillars: investing to strengthen internal collaboration and external partnerships; embedding teams in deeply rooted people-to-people networks; developing an acute awareness of both the geopolitical and local market developments; and taking an environmental, social and governance (ESG) perspective on all projects to ensure stakeholder support in the years to come.

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