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Belt & Road: Opportunity & Risk

The prospects and perils of building China's New Silk Road



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Belt and Road: What you need to know

- The Belt and Road Initiative (BRI) is a combination of two initiatives: a 21st Century Maritime Silk Road and a Silk Road Economic Belt. Both initiatives were announced by President Xi Jinping in 2013.
- BRI is also known as One Belt One Road (OBOR).
- The five major goals of the BRI are policy coordination, facilities connectivity, unimpeded trade, financial integration and people-to-people bonds.
- Existing bilateral and multilateral cooperation mechanisms will be used to accelerate the economic integration of countries along the route and support growth in trade.
- BRI is open to all countries and organisations, but, official maps and documents emphasise the importance of 60+ countries in Asia, the Middle East, Eastern Africa and Eastern Europe.
- The majority of investments so far have been in infrastructure, energy and mining, ranging from standard gauge railway in Kenya to hydropower projects in Cambodia and lignite coal deposits in Pakistan.
- The maritime “Road” will be a major opportunity for consumer and industrial firms as it accounts for 63% of the global population and 44% of its GDP, excluding China.
- The landlocked “Belt” connects two of the world’s largest economies; China and Europe. The route will emerge as a major logistics corridor and offers significant energy and mining opportunities.
- We estimate BRI projects linked to China will be worth USD 350 billion over the coming five years.

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Foreword



Ai Ai Wong
Global Executive Committee
Member
Baker McKenzie
Principal, Singapore
Baker McKenzie.Wong & Leow

The Global Perspective

The Belt and Road Initiative is a historic marshalling of capital and a remarkable geopolitical foray into establishing and strengthening multinational trade corridors. It is an enterprise unlike anything we have seen on this scale for decades.

It is also not without risk for those companies that are investing in and working on BRI projects.

Those risks include foreign investment restrictions, antitrust regulations, tax, local employment and environmental laws, as well as political risks in some jurisdictions. That said, the successful execution of major infrastructure and commercial projects is still a prize worth the challenges.

When examining BRI opportunities, it is important to seek out advisors whom you can trust with local issues, and who also understand and have a well established presence in the China market. Baker McKenzie is uniquely positioned to assist organisations in capturing opportunities arising from BRI, given our unrivalled on-the-ground presence in 29 of the BRI target countries throughout Asia, Europe, Africa and the Middle East, as well as our legal platform in China, which covers both PRC and international law.

We hope this report helps to spark further conversations on the BRI opportunities that may be applicable to your organisation.



Stanley Jia
Chief Beijing
Representative
Baker McKenzie

The Perspective From China

China's Belt and Road Initiative is and will continue to be the most important and impactful macro-economic undertaking in the world, for at least the next 10 years.

With an estimated US\$350 billion committed to BRI projects by China by 2022, it is easy to see why. Currently there are already more than 1,700 BRI projects either completed or in development.

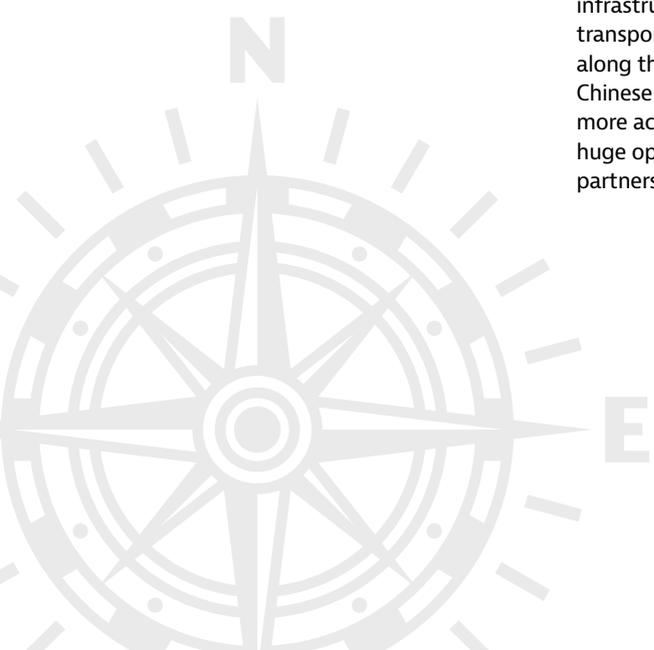
For those countries in South East and Central Asia, the Middle East, Eastern Africa and Eastern Europe designated as Belt and Road partners, the ability to readily fund infrastructure development is proving of huge benefit.

But this is just the beginning. As more infrastructure projects are completed, and transport and communication networks along the Belt and Road corridors strengthen, Chinese private companies will become much more active in BRI countries, in turn offering huge opportunities for local and international partners in a wide variety of sectors.

Indeed, while BRI was seen at its inception as predominantly the preserve of Chinese SOEs, funded by Chinese banks, and staffed by Chinese workers, the sheer scale and ambition of the initiative means there will be plentiful opportunities for those local and multinational companies that can work hand in hand with Chinese organisations for mutual benefit, particularly as this second wave of Chinese investment arrives.

This BRI report sets out to understand more clearly where these opportunities lie today and in the future, and also what the legal risks are for both Chinese and international companies as they tap into this momentous source of capital to create new ventures.

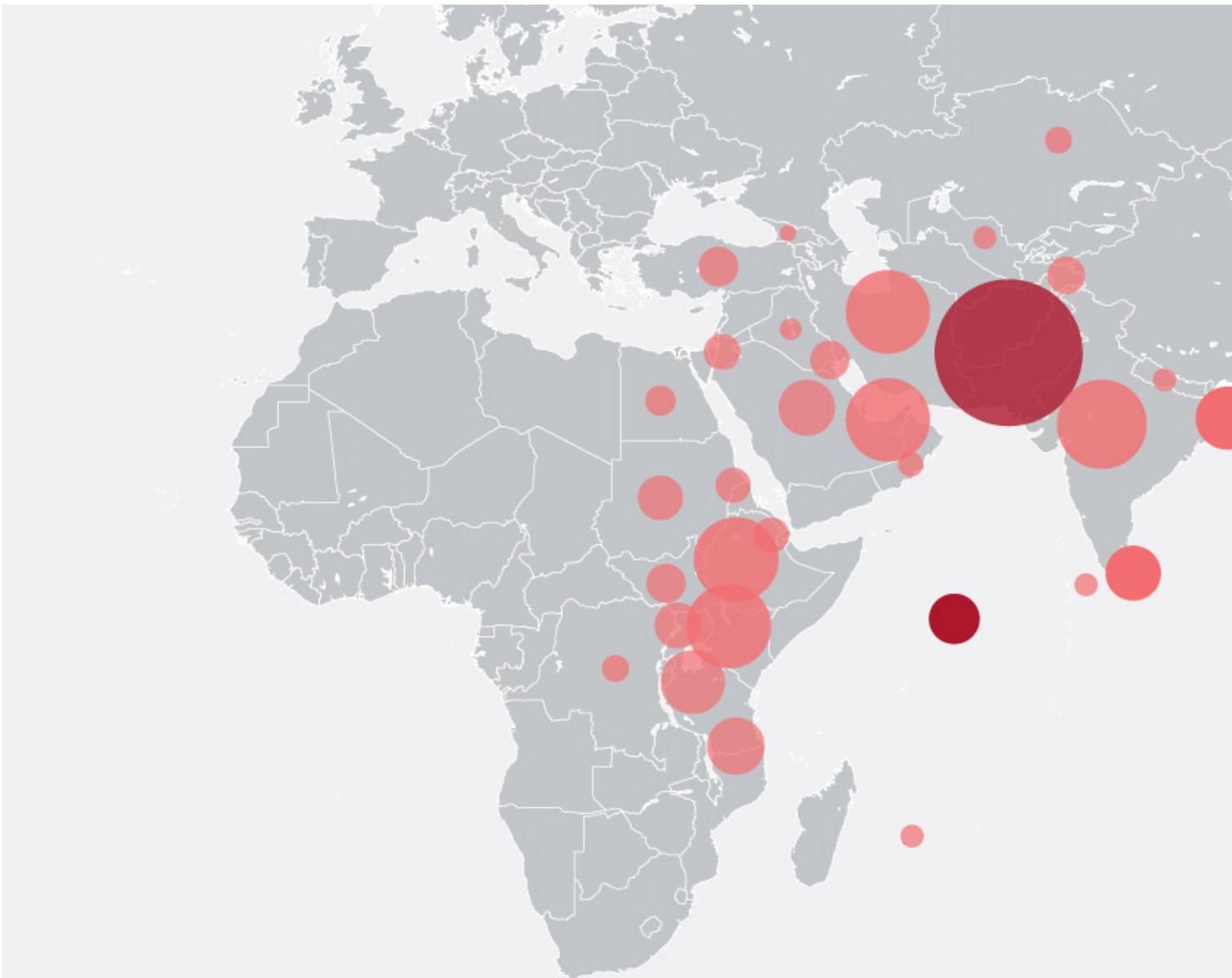
We hope the various forecasts and insights provided will be of value. As the law firm with the greatest presence along the Belt and Road, we also welcome any further queries you may have on supporting your BRI ambitions.



China's Belt and Road Initiative (BRI)

The BRI in perspective

The BRI is a multi-decade initiative that will reshape China's commercial engagement with the world. The initiative will nurture China's multinational champions; build infrastructure across Asia, Africa, Europe and the Middle East; and create new markets for Chinese and foreign products. It is the next stage in China's efforts to "Go Global" and expand its commercial and political influence.



BRI must also be put in context.

The initiative is not taking place in a vacuum, but is part of a larger and even more powerful dynamic: the rise of the modern Silk Road. The Silk Road region's share of global GDP has risen steadily over the past two decades, with trade and investment between the Silk Road's 60+ economies growing steadily during the period. It is this momentum that China's BRI seeks to tap into, to the country's benefit.

Since President Xi Jinping's announcement of the policies of a 21st Century Maritime Silk Road and Silk Road Economic Belt in late 2013, otherwise known as Belt and Road, the initiative has gradually gained traction. At the same time, however, the broad scope of the policies has also created some confusion. This report, therefore, explains not only the initiative from a strategic perspective, but also offers a view from the ground to help understand what the BRI means in practice.



The Belt and Road are two different opportunities

There are important differences between the Belt and the Road with implications for both Chinese and foreign firms. **The Belt is a land corridor** that passes through Central Asia before reaching Europe and connects two of the world's largest economies, China and Europe. The route will emerge as a major logistics corridor and will create new opportunities for Central Asia and Eastern Europe as both a transshipment hub and commodities supplier.

The maritime Road is a densely populated consumer and industrial opportunity. Like the landlocked Belt, it also connects China and Europe, but differs in that the Road passes through Southeast Asia, South Asia, the Middle East and East Africa, a region that is home to 42% of the world's population and 25% of its GDP, excluding China. It is here that multinationals from all countries will find significant opportunities over the coming decades, irrespective of BRI's success.

BRI and China's strategic priorities

What are BRI's strategic priorities?



Support China's "Go Global" policy

BRI will accelerate the internationalisation of Chinese firms and create world class multinationals and supply-chains.



Strengthen China's geopolitical role

BRI strengthens China's economic and political role in the region and as far as Europe. It was also seen as a counterpoint to TPP.



Increase exports to BRI countries

China's exports to the BRI countries are growing at a faster rate than exports to Europe and the United States. BRI seeks to accelerate this rate of growth.



Strengthen the RMB's global role

So far there is little evidence that BRI has strengthened the renminbi's role. In fact, capital controls have arguably reversed recent gains.



Promote industrial restructuring

BRI will force Chinese firms to compete internationally, adopt best practices, improve transparency and employ foreign workforces.



Reduce industrial oversupply

China suffers from excess supply in most industrial products. The BRI is seen as an opportunity to sell such product to other markets.



Source: Silk Road Associates

Multi-decade initiative to improve connectivity

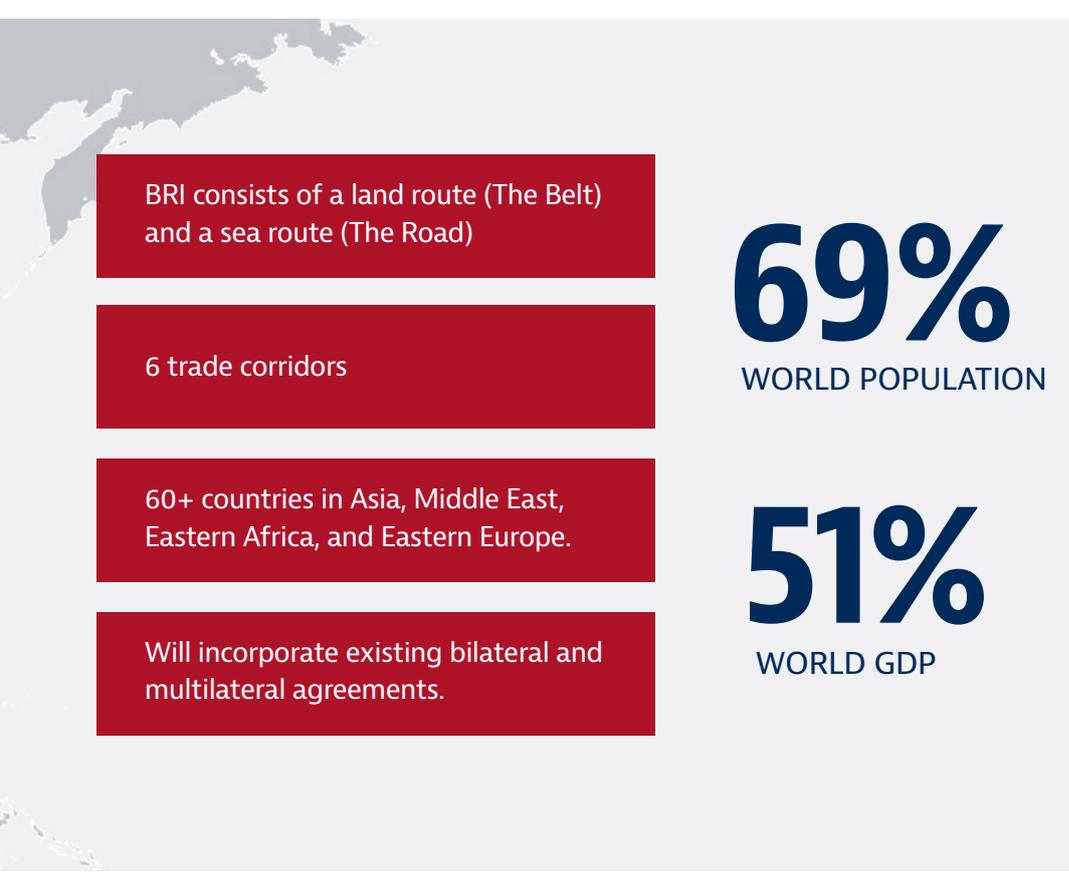
The BRI is better understood as a mission statement rather than a policy document, since it lacks a list of member countries and a precise definition of what a BRI project is. The initiative may, however, develop a more structured form over time, but for now, the initiative simply recognises that China needs to both strengthen its engagement with the Silk Road region, home to two-thirds of the world's population and half its GDP, as well as assume a leadership role.

The BRI does have broad strategic aims; **the most important one for foreign companies being China's ambition to build world-class companies, which will be an extension of the 1990s "Go Global" policy.** The Chinese government also expects

that BRI will support industrial restructuring as Chinese companies learn to compete on the global stage, adopting international best practice, acquiring world-class technologies, and building scale in foreign markets.

Not all these aims are achievable in the short-term. For example, officials talk of the BRI helping China to sell more products overseas and reduce its excess capacity, but this overlooks the fact that China's largest provinces are bigger than 60+ BRI economies and recent capital controls have also slowed the pace of renminbi internationalisation, with little evidence to date of EPC contracts or acquisitions being funded in renminbi.

Nevertheless, China's influence over the region's supply chain will grow. Chinese equipment manufacturers have enjoyed increased exports to BRI countries supporting both infrastructure-related projects and more general demand. Chinese developers are building industrial parks, from Malaysia to Ethiopia, as Chinese manufacturers look to lower cost jurisdictions for production, avoid high import tariffs, and meet local content requirements.



BRI consists of a land route (The Belt) and a sea route (The Road)

6 trade corridors

60+ countries in Asia, Middle East, Eastern Africa, and Eastern Europe.

Will incorporate existing bilateral and multilateral agreements.

69%
WORLD POPULATION

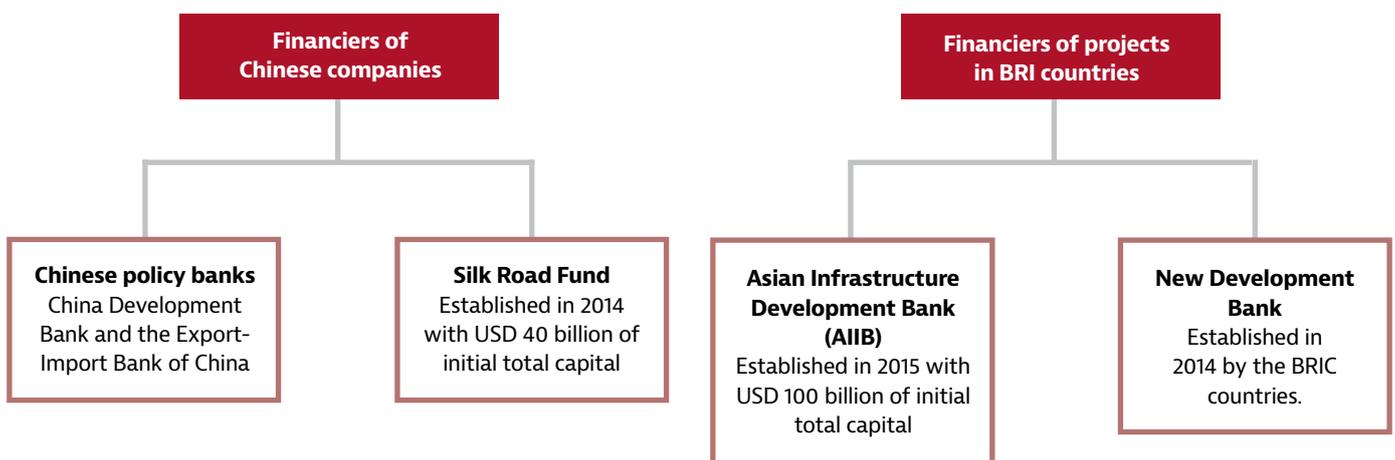
51%
WORLD GDP

Who are the key players to-date?

Chinese government statements indicate that 50 Chinese SOEs have invested or participated in nearly 1,700 projects in countries along the Belt and Road region over the past three years.

Major players include: China Communications Construction, China State Construction Engineering, PowerChina, Sinomach China Railway Construction Corporation, China Railway Group, CNPC, State Grid.

Who are the major financiers?



China will not fully fund BRI. By 2030, we expect that over half of BRI-related projects will be funded by private capital, multilateral banks and foreign governments.

The Belt and Road Forum

Background information:

- May 14-15, 2017, Beijing
- 1500+ delegates from 130+ countries, 4000+ reporters worldwide
- Government leaders from 29 countries
- Next Belt and Road Forum to be held in 2019

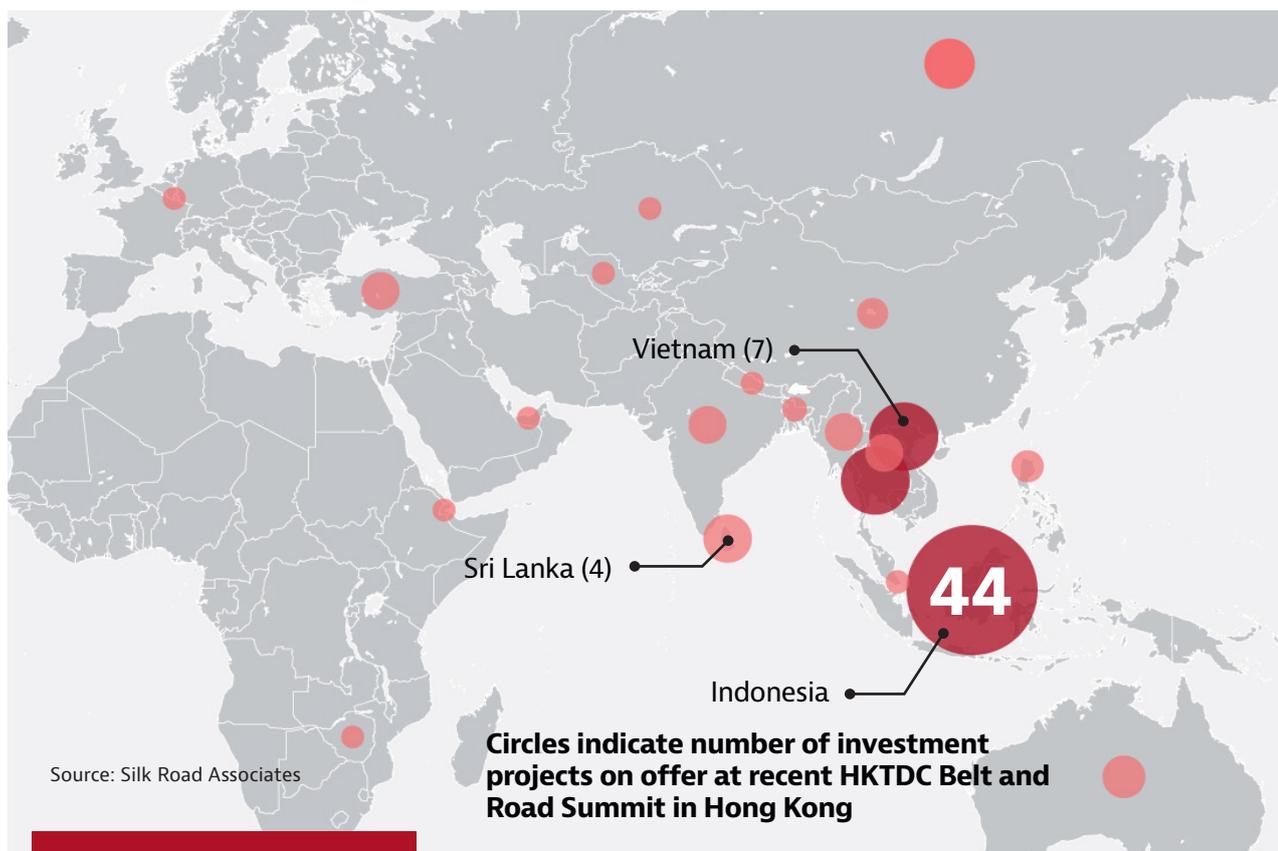
Achievements:

- Memorandum of Understanding with Mongolia, Pakistan, Nepal, Croatia, Montenegro, Bosnia and Herzegovina, Albania, East Timor, Singapore, Myanmar, Malaysia

- Upgrade Cooperation Agreement with 30 countries
- China-Euro Railway Agreement with Belarus, Germany, Kazakhstan, Mongolia, Poland and Russia
- China announced it will hold a China International Import Expo starting from 2018
- The Silk Road Fund will receive an additional RMB 100 billion of funding.
- China pledged RMB 380 billion in loans from two policy banks and will encourage Chinese financial institutions to increase lending by RMB 300 billion in the coming years.

Project Pipeline at Hong Kong's Belt and Road Summit

Investment projects shared by project sponsors



Capital required Projects

6	>\$1bn
23	\$100mn to \$1bn
43	<\$100mn

*Not all deals stated capital requirement

"Notwithstanding the tightened regulations, strategic deals and transactions by SOEs have continued and we'll likely see more in Southeast Asia, where deal sizes tend to be relatively small and often fly under the threshold of the capital controls. Nonetheless, both buyers and sellers must remain vigilant towards the latest legal and regulatory developments to ensure that deals aren't jeopardised by a change in a regulatory stipulation."

Brian Chia

Partner, Kuala Lumpur
Wong & Partners

BRI will focus on the region's larger markets



Share of BRI region's GDP, excluding China

TOP 5

46%

BRI GDP

TOP 10

66%

BRI GDP

INDIA
RUSSIA
INDONESIA
KOREA
TURKEY

INDIA
RUSSIA
INDONESIA
KOREA
TURKEY
SAUDI ARABIA
IRAN
THAILAND
TAIWAN
POLAND

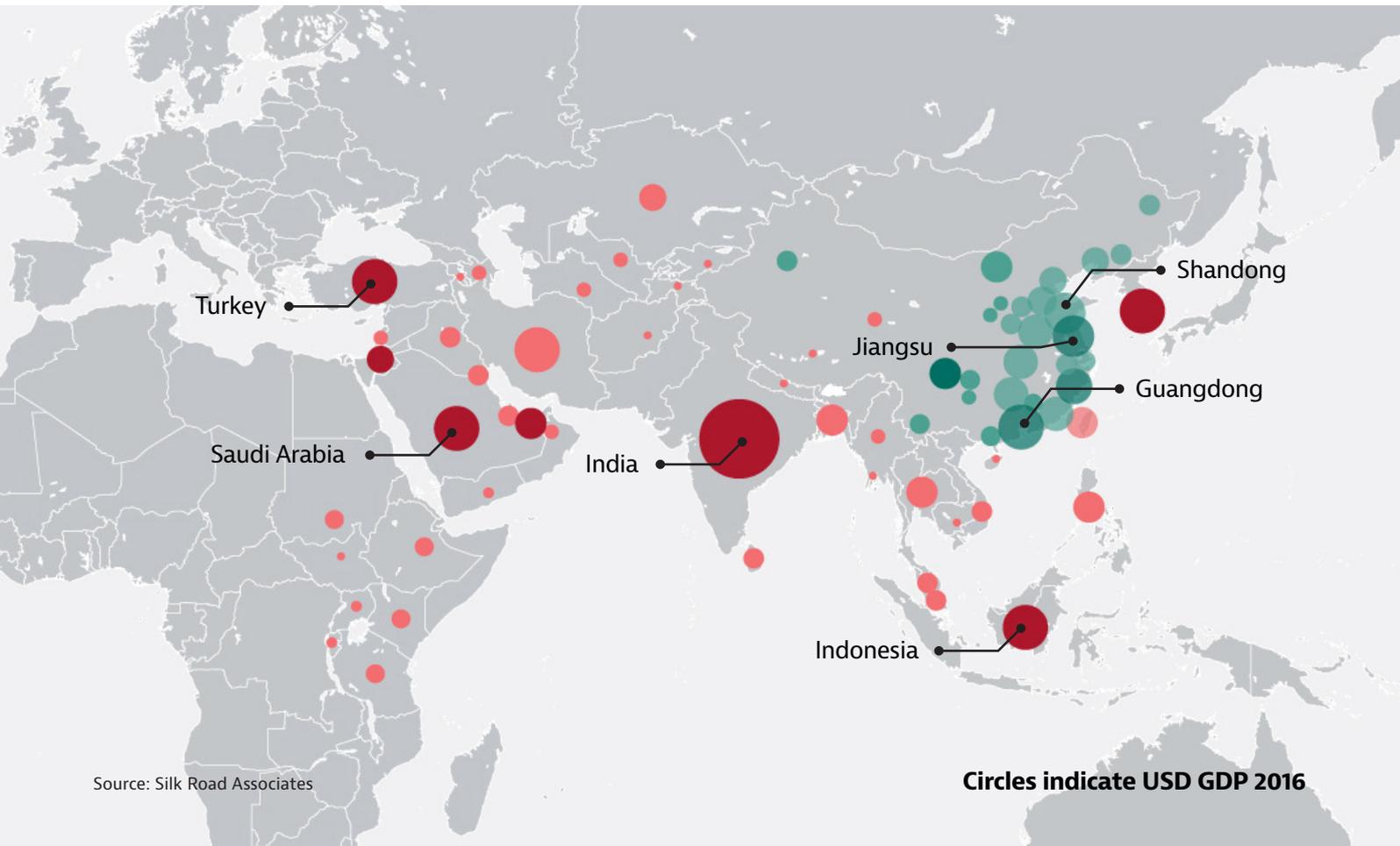
- The BRI region's 10 largest markets will account for over half of the region's opportunities.
- These markets are more open to local and foreign players.
- Chinese SOEs have struggled to win large market share in many of these markets.
- They will need **foreign partners, suppliers, or technologies to win on a sustained basis.**

Silk Road Associates data analytics also indicates that Chinese SOEs have generally found it tougher to compete in the BRI region's larger markets, where Korean and Japanese or American and European firms are entrenched and the playing field is more level. Foreign firms should be initially considering their opportunities or risks in these markets before considering whether to look to the BRI region's smaller markets.

Multilateral banks, such as the AIIB, Asian Development Bank and the World Bank, will also remain major financiers of BRI-related projects. The AIIB, for instance, has recently funded a range of projects including road projects in India and gas pipelines in Azerbaijan. Foreign companies can more easily bid for such opportunities as tendering and procurement processes are open and transparent.

Firms in Europe or the United States also have reason to focus on BRI, as the initiative is part of the Chinese government's broader ambition of nurturing the rise of world-class Chinese multinationals. Chinese companies may seek to accelerate their regional and global expansion by acquiring firms in Europe or the United States, either for technologies or a target's global footprint and brand reputation.

China and the BRI region compared



Belt and Road countries



Chinese provinces

“Multilateral banks are increasingly focusing their investments on projects that deliver ‘green’ outcomes. For example, one of the AIIB’s three thematic priorities is sustainable infrastructure. Its Sustainable Energy for Asia Strategy seeks to align support with member country nationally determined contributions under the Paris Climate Agreement and sets out a clear framework for the bank to invest in energy projects that will increase access to clean, safe and reliable electricity for millions of people in Asia.”

Martijn Wilder

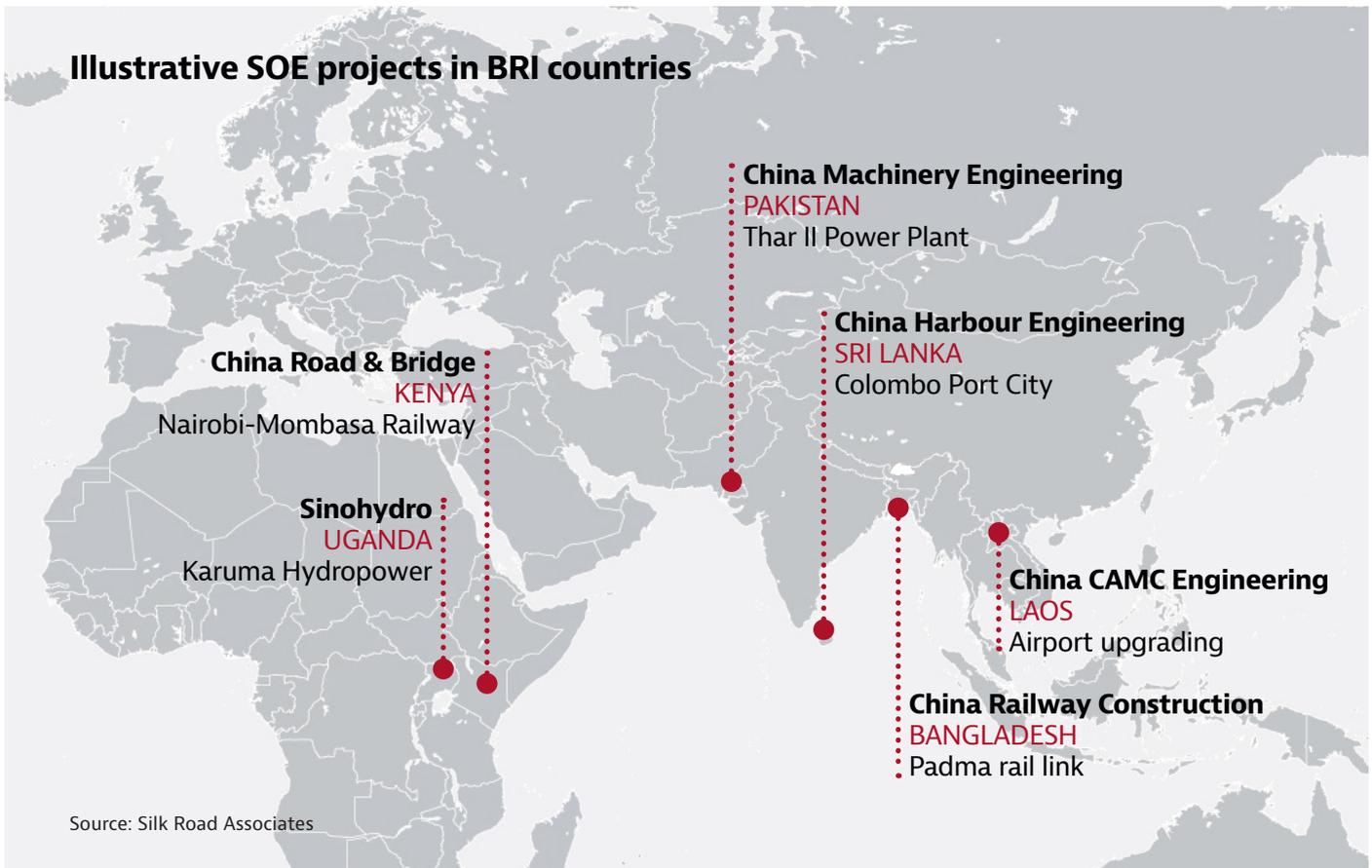
Partner, Sydney
Baker McKenzie

What is important to Chinese companies?

- Forty Chinese State Owned Organizations (SOEs) have multiple projects in BRI markets, while many more have at least a single project. The number participating in BRI will only increase in the coming years.
- So far Chinese SOEs have excelled in road, bridge, railway and energy projects in more challenging markets. Large real estate construction projects are also proving to be another emerging success story.
- The landlocked “Belt” connects two of the world’s largest economies; China and Europe. The route will emerge as a major logistics corridor and offers significant energy and mining opportunities.
- **By 2025, we expect to see BRI spreading substantially into other sectors** that benefit from improved infrastructure, including technology, manufacturing, real estate, logistics and warehousing.
- **BRI’s impact will not be felt evenly.** Small economies, as well as select mid-sized economies, in the BRI region will be the first to feel the impact, as the effect of major projects spread to the broader economy and bring them substantial benefits.
- China’s influence over the regional supply chain will grow. Developers are investing in industrial parks across the BRI region to tap cheap labour, avoid high tariffs, and meet local content requirements.
- Chinese firms will increasingly seek to **monetise the land** surrounding major infrastructure projects as an alternative means of funding projects, creating real estate opportunities in turn.
- We estimate BRI projects linked to China will be worth USD 350 billion over the coming five years.
- **AIIB** will invest in BRI-related opportunities that align with its sustainable infrastructure priorities, but will not support Chinese companies specifically.
- **The Silk Road Fund** will invest to support Chinese companies, but has a global mandate.

USD 350 billion
invested over
next five years





Learning to Compete

Chinese SOEs have enjoyed early success, but will nevertheless face challenges: a major construction firm was removed from a project in Malaysia owing to its safety record; another was blacklisted by the World Bank; yet another struggled with labour strikes in Kenya. Foreign competition is also fierce: Japanese firms have won high-speed railway deals in India, while Turkish firms have won airport construction contracts in Kuwait.

But this process is also part of a learning curve that supports China's ambition of creating world-class multinationals and accelerating the pace of industrial restructuring. In much the same way that Chinese firms learned to compete with foreign competitors after China's WTO-entry in 2001, they will similarly learn to compete in the global market as they seek to win competitive bids and learn how to manage the unique risks of operating abroad.

How can Chinese SOEs expand their BRI opportunities?

BRI is a new initiative, but leading **Chinese contractors have been winning projects in BRI countries for a decade or longer.** For example, China State Construction Engineering has been building major residential and commercial buildings in the UAE since the early 2000s, and Sinohydro was constructing hydropower dams in Laos from the late 1990s. Both companies are world-class and would still be winning deals in the BRI region today.

The fact that leading Chinese SOEs are starting from such an established position means the BRI is more likely to succeed. This comes as no surprise because the Chinese government has a history of introducing policies that recognise the success of select companies or regions, and then providing more government and financial support to further their activities. To this end, Chinese SOEs have warmly welcomed the initiative.

The number of Chinese SOEs participating is also growing. Silk Road Associates estimates that more than 40 Chinese SOEs have signed contracts or completed multiple projects in the BRI region since 2012, while many more have at least a single deal. BRI will supercharge their business over the coming decade and it is critical for foreign companies to understand whether such firms are potential partners, suppliers or competitors.

Chinese private firms are the next wave

Chinese SOEs are also only the first stage of BRI. **Chinese private-owned firms (POEs) will increasingly account for a growing**

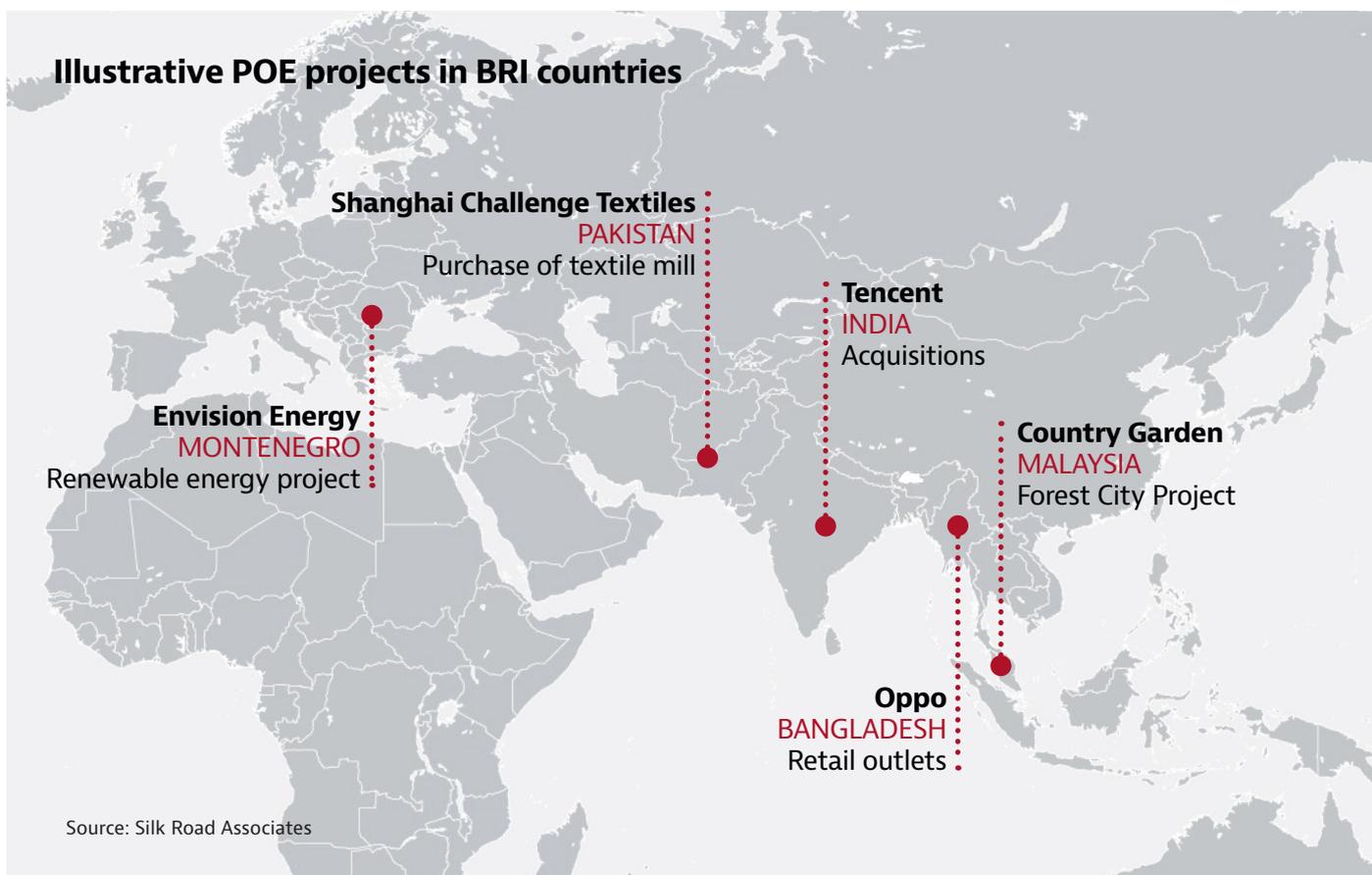
share of outbound activity. Many are already winning deals in BRI markets:

Oppo is a Dongguan-based smartphone manufacturer with retail outlets across Asia; Country Garden is a Shunde-based real estate developer building large-scale projects in Southeast Asia; Tencent is a Shenzhen-based internet firm buying start-ups in India.

Entering the BRI region is certainly an attractive prospect for private Chinese firms. As growth slows in the China market, many

firms are looking for new opportunities, while others are recognizing that their products and price points are ideally suited for BRI consumers. This particularly applies to Chinese manufacturers involved in the production of smartphones and household facilities. Furthermore, many Chinese companies are still looking to set up manufacturing facilities in the BRI region in response to rising costs in their own country.

Chinese private firms are increasingly active



Private Chinese firms will also benefit from the improvement in infrastructure across the region.

One example of how these firms will gain advantages from developments in other parts of the region includes the plans of a private Chinese developer who will benefit from new rail links when building a planned industrial park near Nairobi in Kenya, which will serve both local and neighboring markets.

Another example is a Chinese manufacturer building a factory in Gazipur in Bangladesh and who will consequently benefit from the upgrades to the road leading to Chittagong's ports.

Opportunities for Chinese private firms (POEs)



Slower growth will push POEs abroad

Chinese POEs are typically most active abroad when growth slows at home and as they look for alternative markets for either sales or margin growth.



Chinese property developers should be major winners

Chinese developers are able to build at scale and low cost in challenging markets. They will increasingly compete in the BRI region with firms such as Dubai's Emaar.



The BRI region's demand for smartphones is huge

Chinese smartphone manufacturers are leading the charge abroad as the BRI moves quickly to mobile technologies and the cost of Chinese products falls sharply.



BRI will encourage factories to shift offshore

Factories are already moving at the margin to escape higher costs. More may follow if only to serve domestic markets. But most will retain large capacity in China.



Chinese equipment suppliers

Chinese equipment manufacturers are already exporting to BRI markets. They will benefit as more Chinese SOEs go abroad and bring their supply-chains with them.



BRI will benefit electronics and technology products

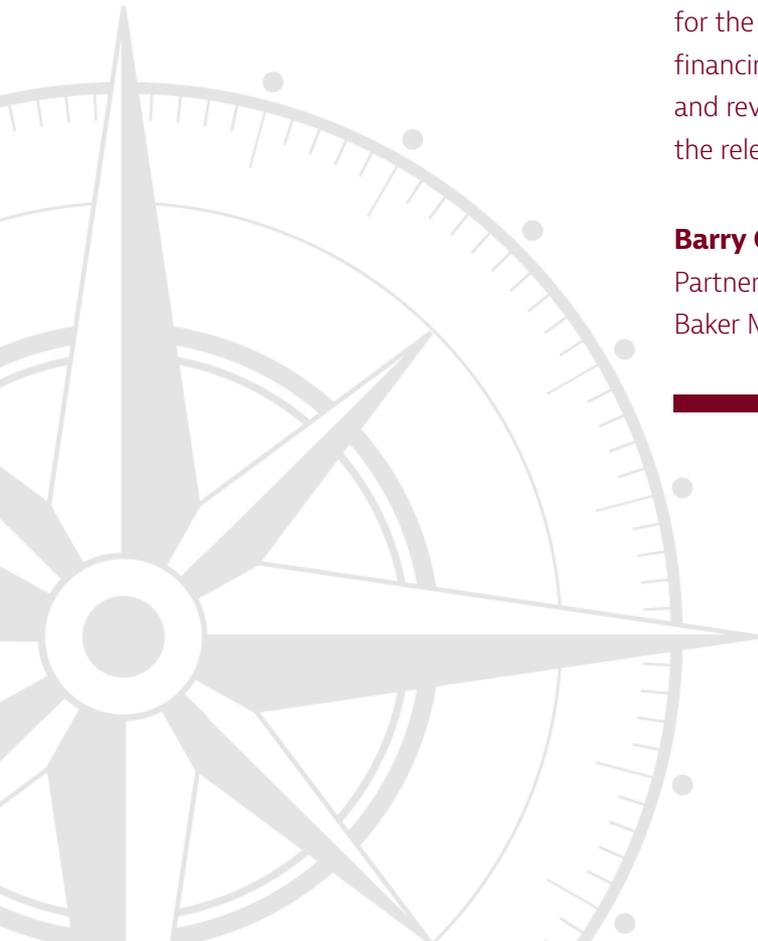
Investments in power and ICT will boost the BRI region's demand for Chinese electronics and technology products, such as smartphones and increasing Internet of Things.



"The appropriate financing arrangement is obviously an important element for each major Belt and Road transaction. A large proportion of the financing arrangements can be expected to come from Chinese banks and financial institutions. As Chinese banks and financial institutions have become more and more sophisticated, it is essential for the investors to ensure that the transactions are 'bankable,' with financing and security structures for the lenders affecting local assets and revenues that comply with, and are well protected by, the laws of the relevant local jurisdiction."

Barry Cheng

Partner, Hong Kong
Baker McKenzie





What is important to international companies?

- BRI is not only for Chinese companies; **major BRI-related opportunities exist for international companies.** Consequently, willing collaboration is critical whether you are a partner, supplier, investor or adviser.
- There is no need to focus on all of BRI's 60+ markets. **Ten markets account for 66% of the BRI region's GDP,** excluding China. These 10 markets will account for the greatest share of commercial opportunities.
- Foreign companies have already entered into **profitable partnerships** with their Chinese counterparts in the BRI region. More partnerships will follow, especially where tenders are competitive and fiercely contested.
- Foreign companies have opportunities to **supply products to Chinese contractors** where environmental standards are high or projects demand more advanced technologies.
- BRI will have a multiplying effect as China's competitors, especially Korea and Japan, compete more fiercely for projects, creating a larger set of opportunities for foreign companies. It is not just Chinese companies which must remain open to all opportunities, foreign companies must as well.
- The multilateral banks (MDBs), such as the World Bank, are still major financiers of BRI-related infrastructure. US and European companies will find it easier to participate in such projects.
- Foreign companies will find growing opportunities to help Chinese partners manage their risks in BRI countries as BRI project sponsors start to take a tougher stance on Chinese participation.
- Chinese firms have found it harder to win deals in the more mature and competitive markets in Southeast Asia and the Gulf. This is where opportunities for foreign firms will be greatest.

Opportunities for international companies in BRI



Partnerships

Chinese contractors have entered joint ventures or collaboration agreements to create a more compelling proposition, such as China State Construction Engineering's joint venture with Korea's Ssangyong Engineering in the UAE. Others are looking to tie up with local players, such as China Fortune Land and Vietnam's Tin Nghia Corporation, to help acquire land, navigate local regulations, or manage relationships with local governments and communities.



Acquisitions

Chinese contractors are looking to acquire leading technologies from around the world to compete in the BRI region's biggest markets. Shanghai-based Envision Energy recently acquired Bazefield, a Norwegian provider of wind-farm management systems. These types of technologies will be especially critical in markets where Chinese SOEs are looking to win competitive tenders or are required to meet strict environmental standards.



Supply

Foreign companies also have opportunities to supply products to Chinese SOEs, especially where environmental or safety standards are high. Honeywell China not only manufactures products in China for Chinese clients, but also sells the same product to Chinese EPCs working on BRI projects abroad. GE China similarly partners with Sinomach in Africa, supplying technology to the company and jointly bidding on opportunities.



Financing

So far, Chinese policy banks have funded much of BRI. This will change, however, as BRI grows in scale and policy banks grow weary of taking losses on select early investments. The opportunities for foreign asset managers, traditional and alternative, will grow as Chinese companies seek alternative sources of finance and seek help structuring projects in a manner that will attract Chinese private capital and, importantly, global capital. This will include opportunities for more sustainable and climate finance.



Professional Services

Professional service firms will be critical for Chinese firms seeking to mitigate risks. Project due diligence, business structuring, contract negotiation, labour and tax regulations, and insurance requirements are all critical to a firm's successful offshore activities. Managing CSR obligation is especially critical for BRI given that large infrastructure projects may relocate communities, harm the environment, and draw the attention of social activists.

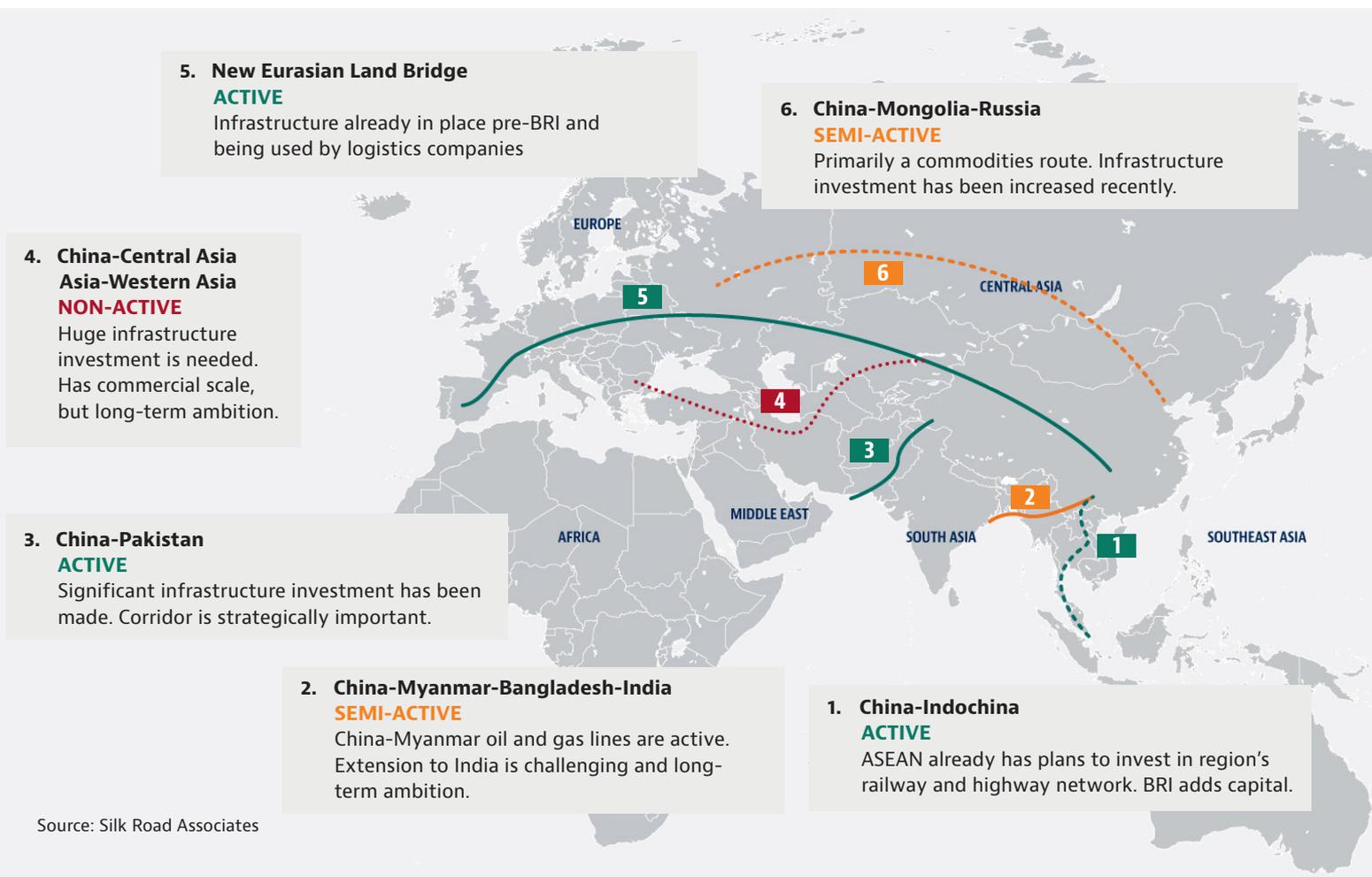
"I truly believe the Belt and Road will be the project defining relationships between Europe and China (and many of the countries in between) in the next 20 years. Although there has been a slowdown in China outbound investments due to closer government scrutiny on some acquisitions, Belt and Road related projects will continue to be actively supported.

Expect building of transportation infrastructure and logistic parks, but also investments in energy and industrial projects along the routes. In addition to Southeast Asia, I believe we should also watch the countries crossed by the 'Belt' and the New Eurasian Land Bridge, which reaches deep into Europe after crossing several landlocked areas as well as the Westernmost regions of China, which will now be more open for business than before."

Marco Marazzi

Partner, Milan
Baker McKenzie

BRI's six trade corridors – opportunities for investment



“Central and Eastern Europe (CEE) is a strategically significant region for the Belt and Road Initiative, both culturally and geographically. When approaching the European market, Chinese investors will often enter CEE before expanding to the more mature markets in Western Europe. We can see this approach in the Wanhua-Borsodchem transaction where a Chinese company decided for Hungary as the first step in their ‘go-global’ plan. We have also seen strong Chinese investment in the development of infrastructure that improves connectivity between Asia and Europe and within Europe, such as the Budapest-Belgrade railway. This is a landmark project for China as they build a presence in Europe, and an important part of the Belt and Road Initiative framework as CEE countries form some of its key intersections.”

Dr. Zoltán Hegymegi-Barakonyi

Managing Partner, Budapest
Baker McKenzie

Implications for outbound investment from China

China's strategic focus

In August, the State Council, National Development and Reform Commission, Ministry of Commerce, People's Bank of China and the Ministry of Foreign Affairs issued a joint statement setting out **China's national policy on outbound investment**. Under the new guidelines, China does not plan to regulate outbound investment by way of a stringent administrative approval system but rather opts for a recordal system approach, which simplifies and speeds up the filing process.

Similar to inbound investments, the new guideline says China will adopt a "negative list" approach when accessing cross-border projects. These investments will be divided into three categories including **encouraged investments** (those relating to the Belt and Road initiative, tech and manufacturing, natural resources, and other fields), **restricted investments** (high-risk countries, real estate, hotels, cinemas, projects that do not comply with technology, environmental, energy or safety standards) and **prohibited investments** (those harmful to China's national interests such as unapproved military technology, gambling, pornography and investments that are banned under any international trade pact or treaty).

Attracting Chinese investment

For Chinese companies, this new edict has immediately been embraced. For organisations looking at attracting Chinese funds, the best course of action is to position assets firmly in category one (C1). This will engender far less onerous scrutiny from the Chinese side, although many of those C1 assets may also be subject to greater scrutiny from the target's own regulators.

This new guidance should also dispel any cynicism surrounding the impact of the BRI as a driving force behind Chinese investment. It is the first type of investment to be "encouraged" and is, therefore, highly likely to be one of the most important global macro-economic drivers over the next 10 years and beyond.

International companies will also benefit from BRI

Foreign companies will also find opportunities to participate in BRI. For a start, helping Chinese firms to manage their risks in the BRI region will be critical, especially for the smaller SOEs and privately-owned firms that are unable to rely on strong government to government relationships to smooth over any issues. Moreover, many Chinese firms are already partnering with reputable local and foreign partners to help win deals and manage risks.

Global players must similarly recognise that they do not need to start operating in all the BRI's 60+ markets, especially smaller, less stable countries, to participate in the initiative. **More important are the BRI region's 10 major markets that account for 66% of the region's GDP, including India, Russia, Indonesia, Korea and Turkey.** Most foreign companies are already active in these markets, meaning there is little change in strategy.



For further information on these trends, see our report **"Asia Pacific Mega-Trends and Legal Solutions"**

www.bakermckenzie.com/SimplifyingBusiness

Regional opportunities: what you need to know

Asia

- Chinese private firms are focused on Asia's rising middle-class and established distribution networks. They see the region as an area with potential in terms of electronics, internet and real estate.
- Korean and Japanese firms are already well-established in Southeast Asia. Chinese competitors will need support from local partners, especially when dealing with the private sector.
- Vietnam is already tightly integrated with China's supply chain. But there are still huge opportunities for further improvement in road and rail links, all underpinned by robust commercial activity.
- Malaysia is emerging as a regional hub for Chinese industrial companies seeking to tap Southeast Asia's growing markets. This will in turn feed the country's real estate scene.
- China's construction projects in Bangladesh may be transformational for the country's already large clothing sector. Chinese private investment in the country's manufacturing sector is accelerating.

Africa

- Various African countries along the BRI have the potential to provide major opportunities for investment. These countries particularly include Kenya, Tanzania, Ethiopia, Djibouti and Egypt.
- East Africa is a more integral part of BRI owing to Djibouti's ports, Ethiopia's manufacturing, and the region's existing plans to connect rail, road and energy networks.
- Egypt offers a significant opportunity for Chinese firms, but they will need to collaborate with local players and the multilateral banks to avoid major challenges.
- Key opportunities will be transactions related to major projects in the power and infrastructure sector and related financing. China's construction of power plants and transmission lines in East Africa will be a game changer for local industry. Port connectivity will also improve significantly in the next five years.
- Watch for China's smartphone and household electronics brand owners to expand in Africa as they look to repeat their success in Southeast Asia and South Asia.

Europe

- BRI will accelerate Chinese acquisitions of European industrial technologies and companies, as Chinese firms look to accelerate their expansion in the BRI region.
- Rail freight between China and Europe is already growing. Logistics multinationals, such as DHL and DB Schenker, are major drivers, not least because of Germany's pivotal hub role.
- China's plans to export products through the Greek port of Piraeus into Eastern Europe will spur greater investment into Southern European's transport infrastructure, logistics and warehousing.
- Hong Kong and Singapore will compete for BRI business. But London and other major European capitals should, however, also look to support Chinese firms in Eastern Europe, Africa, and the Middle East.
- Europe's historical trade and investment ties to Africa and the Middle East make the region a critical part of BRI and yet another reason to acquire European companies.

United States and Canada

- American multinationals earn a growing share of global revenues from the BRI region. Global boards must be thinking about what BRI means for their business, both good and bad.
- Chinese technology firms will increasingly compete or collaborate with American peers who are also looking to capture growth in big, fast-growing countries such as India or Indonesia.
- American design & engineering companies are already winning contracts servicing Chinese contractors in the BRI. This may create an entry point for collaboration in the United States.
- As Chinese firms expand abroad, a growing number are expected to seek patent protection for products they hope to sell into select BRI markets where IP rights are more strictly enforced.
- BRI will accelerate Chinese acquisitions of United States and Canadian industrial technologies and companies, as Chinese firms look to accelerate their expansion in the BRI region.

Industry sector opportunities: what you need to know

Technology, Media and Telecommunications

- Chinese investment in TMT across the region, alongside rising incomes, will contribute to a surge in demand for smartphones and internet-based services. Expect growth to be explosive.
- China's leading private firms have the cash flow to fund their expansion into BRI markets. They are not reliant on government funding and will leverage their distribution partners to grow.

Consumer Goods and Retail

- China's investment in roads, railway and power across Africa will support household incomes and spur the already growing organised retail and food service sectors.
- Watch for China's FMCG brands to venture abroad having already captured large parts of China's market shelf. Southeast Asia offers the easier entry point.

Industrial, Manufacturing and Transportation

- Watch for leading Chinese companies to accelerate their acquisition of technologies and companies that accelerate their global expansion strategy. BRI provides a rationale to Chinese regulators.
- The rise of domestic protectionism coupled with BRI will see more Chinese manufacturers look to build local plants, especially in large markets such as India and Indonesia.

Financial Institutions

- So far Chinese policy banks have funded much of BRI. This will change, however, as BRI grows in scale and policy banks grow weary of taking losses on select early investments.
- Chinese securities companies will look to make acquisitions or arrange tie-ups as a way of building regional businesses. Southeast Asia and South Asia will be the initial focus.

Energy, Mining and Infrastructure

- Chinese investment in energy will account for the majority of BRI projects. Land acquisition is easier in relation to construction of new roads or railways, especially in densely populated countries.
- As BRI grows in scale, Chinese contractors will have to rely more on market mechanisms rather than government relations to win work and settle contract disputes in the infrastructure sector.



Challenges in the BRI region

Looking before you leap

China's BRI is accelerating the country's rise in regional and global economic influence. High-level political negotiations and government contracts have percolated down to the business level, with companies in Belt and Road target countries seeking to leverage on Chinese investment by partnering with Chinese companies on strategic greenfield projects.

Local content requirements are imposed by many target jurisdictions for Chinese investors to source locally for human resources and raw materials. Choosing a trustworthy local partner with robust local connections can help Chinese investors fulfil some of these requirements. To reduce exposure to reputational risk, Chinese investors need to set aside costs for protectionist tariffs, the interests of the local community, and growing environmental protection concerns.

Although political risk insurance can cushion businesses from geopolitical instability, it is inevitable that Chinese companies, both SOEs and POEs, will face challenges as they build bigger businesses in the BRI region. This is part of the industrial restructuring process, an outcome actively sought by Beijing, and a process that will result in more internationalised and competitive businesses. There are eight key areas where Chinese firms can expect to face challenges and should proactively seek the advice of skilled advisers to mitigate risks.

In view of rising political and economic sensitivities, Chinese investors that are directly or indirectly owned, controlled or even influenced by a government should consider foreign investment review regulations as a threshold issue. Even private investors headquartered in countries with state-directed economies should expect elevated national security scrutiny.

"The question of whether a buyer is a state-owned enterprise can be murky. It bleeds over from ownership to interest very quickly because the moment you have any hint of foreign state involvement on some level — whether it's the source of money, involvement in governance or even commercial dependence, such as the fact that a company in China is a supplier to the Chinese government — that can be enough to create the nexus of foreign government influence. Sometimes it's hard to distinguish what's state-directed from what's private."

Arlan Gates

Partner, Toronto
Baker McKenzie

"Chinese clients, whether SOEs or private entities, are increasingly more aware of risk, and of the importance of trying to structure ring-fenced, bankable projects. We're very well placed to advise them of such risks, not only from a mainland-China compliance perspective, but also, given the breadth and depth of our offices, along every step of their investments overseas."

Norman Bissett

Foreign Legal Consultant, Jakarta
Hadiputranto, Hadinoto & Partners



Read more about foreign investment review in Baker McKenzie's publication, **"Rising Scrutiny: Assessing the global foreign investment review landscape"**

www.bakermckenzie.com/RisingScrutiny



The China Banking Regulatory Commission has issued guidance to banking sector financial institutions not only to actively and thoroughly implement BRI strategies, but to pay attention to and improve their overseas operations' environmental and social risk management in the process.

"We suggest that Chinese financial institutions involved in domestic and overseas BRI projects, and their clients and partners, particularly those operating in the energy resources, agriculture, forestry, farming, major infrastructure and project construction sectors, should be aware of these institutions' requirement for environmental protection, including the requirements for environmental impact studies and their robust CSR strategies."

Bee Chun Boo
Partner, Beijing
Baker McKenzie

Legal and political risks

- China's leading contractors have decades-long experience in BRI countries, but second-tier firms do not. Second-tier firms will need reputable partners and good advice if they hope to succeed.
- There are major differences in legal regimes practised across the BRI region, including common law (Singapore and Malaysia), continental law (Central Asia) and Islamic law (Middle East).
- Foreign companies may not have adequate legal protection in BRI countries where legal regimes are undeveloped and have low credibility, and where social and judicial corruption is rife.
- Chinese companies can rely too heavily on government relations and the local Chinese embassy to solve legal problems. The problem with this, however, is that BRI governments can change and bilateral relations can worsen.
- Chinese companies must avoid being used by BRI governments as a stalking horse or a screen to conceal the fact that local favourites have already been chosen for specific projects.
- Chinese and foreign companies must avoid capture by "rent-seeking" local business tycoons who seek to use a multinational's brand value and reputation for their own purposes.
- Select BRI countries do suffer from political instability, civil unrest, or even armed conflict, and all companies will, therefore, require a robust business continuity plan and good security intelligence.
- Environmental and social issues are growing considerations, especially for infrastructure projects. It is critical to engage local communities early in the process and demonstrate how a project will benefit them.

"Before engaging in any new BRI project, investors need to assess carefully its commercial viability, which affects, amongst other things, their ability to obtain financing for the project. As governments tighten regulatory and legal requirements and scrutiny, Chinese investors in particular have to factor in the increasing cost of compliance."

Bee Chun Boo
Partner, Beijing
Baker McKenzie

BRI project risks: Baker McKenzie can help



1. Project selection

Most BRI countries do not have an existing pipeline of projects that have passed a rigorous selection process. Chinese contractors may commit to projects that carry significant delay risk, especially in smaller, more frontier, markets. Project sponsors may equally push unviable projects on Chinese contractors and banks, creating potential risks. Developing rigorous project feasibility capabilities will be key to winning high-quality and profitable projects.



2. Project financing

Chinese policy banks, such as China Development Bank and China Eximbank, have no intention of fully funding BRI, and, therefore, Chinese officials have already started searching for ways to attract more private capital to projects. As the BRI grows in scale, Chinese EPCs will increasingly need to structure projects in a manner attractive to private capital, rather than relying on Chinese policy banks to fill the gap. Many EPCs do not have such financial experience and could benefit from a strong partner or adviser.



3. Project life cycle

Infrastructure projects are multi-year projects. Governments may change half way through construction, local workforces may need to be managed in countries with strong union representation, or land acquisition may stir opposition from local communities. Managing risks throughout the life cycle of a project will be a critical challenge and will again benefit from a reputable local partner and informed advice from the pre-planning stage to completion.



4. Legal and regulatory risk

There are major differences in legal regimes practised across the BRI region — common law, continental law and Islamic law — making it challenging to replicate projects between countries. Undeveloped legal regimes may create barriers to investment and social or judicial corruption pose further problems when legal disputes arise. While some companies still rely heavily on government relations to settle legal disputes, bilateral relations could worsen and should not be relied on.



5. Political and security

Chinese contractors have enjoyed initial gains in the region's smaller, less stable markets. Many of these markets may have a history of political turbulence or armed conflict. Power Construction Corporation faced such a challenge in 2012 when South Sudanese rebels kidnapped 12 workers. Political risks may encourage companies to ultimately focus more on the region's Top 10 more stable markets.



6. M&A due diligence

Chinese firms will increasingly look to acquire BRI companies to accelerate market access. But the M&A process is challenging, as BRI firms may be profitable because the current owner has strong government relationships, not because of the underlying business. Privately-held firms can also easily inflate their true operating activities. Cultural integration post-transaction is also tough, as BRI firms typically have strong local cultures compared to a global firm.



7. Financial exposure

Chinese banks have limited experience assessing credit risk in the BRI region, and this is part of the reason why demands for sovereign guarantees or credit insurance are so high. But guarantees and insurance are no substitute for good due diligence, and Chinese banks will need to either develop internal capabilities or find ways to collaborate with local and global banks who have local insights or greater experience in assessing credit issues in the BRI region.



8. Labour and Corporate Social Responsibility

For many Chinese firms, labour relations, environmental protection and CSR are new challenges, especially in countries where political opposition and environmental and social activism is robust. Foreign governments are increasingly requiring comprehensive environmental and social impact assessments and compliance with stringent environmental and workplace laws. Governments may not be willing, or have the ability, to intervene if standards are not met or disputes arise, forcing Chinese contractors into the high-risk situation of having to negotiate directly with labour unions or local communities. Project delays can result in cost overruns and also make it harder for a contractor to win future projects in that country.



Conclusion

China's BRI is a multi-decade initiative that will improve economic connectivity and cooperation between two-thirds of the world's population. As a result it is a highly complex initiative, and the challenge of working across 60+ countries, ranging from frontier to developed markets, is historic. While Chinese firms have enjoyed some early successes, they will face a growing number of complexities as the initiative expands in scope.

Seeking the support of skilled advisers and local partners will help to reduce those complexities by providing a contractor or investor with deep local knowledge. As this new initiative develops, the question that arises is "where will the greatest change and complexity come from in the next few years?"

For a start, Chinese contractors and investors will find themselves working across a growing number of BRI countries. Success in one country does not necessarily imply success in another, especially where legal and regulatory differences are significant. To build truly global businesses, Chinese companies will need to rely on skilled

advisers and local partners to navigate these often ambiguous and conflicting legal and regulatory differences.

The BRI's expanding scale also means that the number of projects on offer will rise, but is unlikely to be fully matched by Chinese policy bank funding. There will also be growing pressure on Chinese contractors and investors to select and structure projects in a way that mitigates risks and attracts foreign capital. The ability to manage projects through the entire lifecycle will similarly emerge as a growing test of a Chinese company's BRI capabilities.

In the meantime, the number of acquisitions will grow as Chinese companies seek to accelerate their regional expansion. In this, they are behaving no differently to other global players. However, conducting due diligence in many BRI countries is uniquely challenging, whether this involves determining the true operations of a target or receiving approval from foreign government agencies. Financial lenders will also seek to better understand the risks of financing such transactions.

The BRI's success will also depend on less quantifiable challenges, such as labour relations and social and environmental concerns. Political instability is similarly an issue in certain countries. These are often new challenges for Chinese firms, and turning to a reputable partner can help to mitigate risks. It also means that the emergence of strong partnerships will be an inevitable development and a critical success factor for firms in the BRI region.

To this end, the evolution of the BRI over the coming decade is likely to be the result of a more genuinely global effort. Chinese and foreign parties will build stronger relationships, recognise how they can learn from each other, and ultimately benefit from closer collaboration. From Sinomach in Africa to China Fortune Land in Vietnam, a growing number of companies are finding ways to work with foreign partners. In doing so, they are building a more robust foundation for the BRI.

Baker McKenzie offices throughout the Belt and Road



Founded in Chicago in 1949, Baker McKenzie opened its second office in Caracas in 1955. At a time when many firms were focused on their local markets, we were helping clients do business globally, something that has grown exponentially over the past six decades, and today we are proud to have more than 4,200 lawyers in 77 offices across 47 countries.

We realize that in today's dynamic and fast-moving global economy, every single one of our clients is presented with a huge array of opportunities, challenges and complexities. Our unique culture enables our 13,000 people to understand local markets and navigate multiple jurisdictions, working together as trusted colleagues and friends for the true benefit of our clients.

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