



毕马威全球中国业务

KPMG Global China Practice


Charting the course of 'Belt and Road' cooperation together

Enhancing international private
capital participation in 'Belt and
Road' infrastructure projects

Synopsis







2008 was a watershed year in the world economy. The global financial crisis marked the end of the 'Great Moderation', a period characterised by relative macroeconomic stability which began in the 1980s, and the beginning of a new era of lethargic growth and decelerating investment and trade worldwide. In response, many countries stepped up their investment in infrastructure construction and renewal to stimulate domestic demand, and relied on infrastructure connectivity to develop new markets. While this led to a new phase of growth in global infrastructure development, countries also faced funding shortfalls.

Against this backdrop, China proposed the 'Belt and Road' Initiative (BRI) in 2013 with the aim of strengthening infrastructure connectivity among countries along the 'Belt and Road'. China has contributed towards bridging the global infrastructure investment gap by proposing the establishment of vehicles such as the Asian Infrastructure Investment Bank (AIIB) and the Silk Road Fund. All of this has helped inject new momentum into infrastructure development around the world.

Globally there will be a large infrastructure investment gap for the foreseeable future. China alone cannot meet the tremendous demand for infrastructure investment across the 'Belt and Road' region. This is why taking steps to enhance the participation of international private capital¹ in infrastructure projects in countries along the 'Belt and Road' will be of utmost importance in the implementation of the BRI over the coming five years.

¹ In this report, the term 'private capital' includes equity capital from non-state owned companies, loans from commercial banks, financing raised through financial products on the capital markets, and capital raised from insurance and pension funds.

KPMG, the Institute of Market and Price of the National Development and Reform Commission (NDRC) and China International Contractors Association (CHINCA) formed a joint research team to understand the current situation with regards to the participation of international private capital in 'Belt and Road' projects. We carried out five overseas study tours as well as more than 20 interviews with CHINCA member companies engaged in engineering contracting or consulting services.





Our research and interviews showed that providers of international private capital are interested to participate in the construction and operation of infrastructure in countries along the 'Belt and Road' and have capabilities, knowledge and experience that could assist the Chinese Government and other national governments in the region as they work to improve infrastructure connectivity. At the same time, it is imperative for Chinese companies to work with providers of international private capital, not only to help bridge project funding gaps, but more importantly to learn from their experience of managing, constructing, financing and operating infrastructure assets in order to improve the success of 'Belt and Road' projects.

Notwithstanding this, most respondents reported that because of the higher risks associated with 'Belt and Road' infrastructure projects and various institutional constraints or capability limitations faced by participants, it is difficult to raise project financing on acceptable terms, manage financial risks and achieve sustainable, profitable returns.

Given these challenges it is not surprising that most potential providers of international private capital have chosen to remain on the side lines, adopting a 'wait-and-see' approach towards participating in 'Belt and Road' infrastructure projects.

Our research suggests that deficiencies in institutional systems, capacity, capabilities, experience and service models are variously exhibited by the Chinese Government and governments of countries along the 'Belt and Road', Chinese and foreign companies, multilateral institutions and professional firms. These and other factors make it challenging to de-risk 'Belt and Road' projects, which results in providers of international private capital taking a cautious approach towards financing them.



Challenges for governments

Building institutional capacity and favourable policy environment

For the Chinese Government, coordination of the functions within government with responsibility for implementing 'Belt and Road' projects could be streamlined. The systems for strategic planning and promoting of projects need to be improved, and new mechanisms need to be developed for undertaking projects in commercially viable ways. Institutional and policy obstacles to state-owned enterprises undertaking overseas projects should be removed.

Many countries along the 'Belt and Road' have weaker institutions and less favourable business environments; complex political landscapes; unpredictable policies, laws and regulations; and higher financial, currency, credit and compliance risks.



Challenges for companies

Building the foundations for successful cooperation

Chinese companies are still developing their investment and financing capabilities and lack experience of working with international private capital.

Many local companies from countries along the 'Belt and Road' are still relatively unfamiliar with international private capital. Lacking equipment, technology and experience, and operating in less developed business environments, these companies lack the core capabilities to be able to cooperate effectively with foreign partners.

Companies from developed economies, meanwhile, do not yet have a good understanding of 'third-country market cooperation', and a mechanism for facilitating this form of cooperation with Chinese companies is needed. It is also the case that the business models used by these companies may not be suitable for the higher risk investment environments in countries along the 'Belt and Road'.



Challenges for multilateral institutions

Improving the mechanisms for participating in 'Belt and Road' infrastructure projects

The mechanisms through which multilateral institutions participate in 'Belt and Road' infrastructure projects can be improved. There is scope for engaging in more meaningful cooperation on projects and an urgent need to innovate new ways for multilateral institutions to support these projects.

Multilateral financial institutions (MFIs), in particular, need to increase their engagement with 'Belt and Road' infrastructure projects directly and work to develop synergies with other MFIs and international providers of private capital.

Mechanisms are needed for international professional firms to connect and work with relevant Chinese Government agencies around projects. There should also be more cooperation between professional firms across different disciplines to more effectively harness the specialist skills of each party.



Based on our interviews, research and analysis, we recommend that the Chinese Government, as the initiator of BRI, and governments of countries along the 'Belt and Road' work with Chinese and foreign companies, multilateral institutions and professional firms to create institutional capacity, policies, mechanisms and business environments which are more supportive of private capital investment; share and mitigate project risks on an equitable basis; take coordinated actions to ensure sustainable returns on projects; and jointly build a market mechanism which is conducive to international private capital participating in 'Belt and Road' infrastructure projects.





The guiding role of governments in the 'Belt and Road' infrastructure market

Governments need to create mechanisms for institutional capacity building. For its part, the Chinese Government can make it easier for international private capital to participate and invest in 'Belt and Road' projects by making real improvements in terms of the strategic planning for these projects, how the projects are prioritised and brought to market, and how the projects are structured so as to generate commercial returns for participants.

National governments of countries along the 'Belt and Road', meanwhile, should work to make their domestic infrastructure markets attractive to international private investors by building institutional capacity and market mechanisms; ensuring political and social stability; and implementing mechanisms to support the operation of their domestic infrastructure markets by reducing investment risk.

Chinese and foreign governments should work toward policy innovation that further expands government-led investment and financing channels. For example, this could be achieved by encouraging multilateral development finance institutions to increase their investments in the development and operation of 'Belt and Road' infrastructure, or

by establishing and using government-related fund vehicles such as funds established to provide foreign assistance, government-initiated equity funds or offshore Renminbi (RMB) funds. Governments of countries along the 'Belt and Road' should actively explore new ways of providing financing to projects.

Governments should also establish platforms for multilateral communication and cooperation. This could include the Chinese Government entering into strategic agreements with developed countries to cooperate in third-country markets, or entering into cooperation agreements with governments from developed countries and governments from countries along the 'Belt and Road' to promote greater private capital investment in local infrastructure.

This could also include creating information dissemination and sharing platforms that seek to attract international private capital to 'Belt and Road' projects by bringing government bodies, industry associations and market actors together.

Other measures should also be considered such as providing credit support to 'Belt and Road' infrastructure projects through guarantees or other instruments; jointly establishing funds for infrastructure investment; establishing commercial rating agencies specifically for 'Belt and Road' countries and projects; and easing the listing requirements on selected international stock exchanges for companies doing 'Belt and Road' projects.







The leading role of companies in the 'Belt and Road' infrastructure market

Chinese and foreign companies should establish market-based risk management mechanisms across the entire life cycle of infrastructure projects. For example, companies should improve their ability to identify risks in the project preparation phase, including by engaging external advisors to undertake comprehensive *ex ante* assessments and due diligence investigations on potential partners and rigorous assessments of the financial feasibility and funding and financing plans for proposed projects. This should include an assessment of the tax, legal, environmental, social responsibility and other implications across the full life cycle of a project.

Companies should also work with professional firms to help governments of countries along the 'Belt and Road' develop standard contracts the terms of which would be followed during each stage of the construction, delivery and operation of projects.

This will help to institutionalise best practices and avoid unnecessary project risks.

Companies should make full use of sovereign and commercial guarantees; take out appropriate insurance coverage to protect their investments; and engage professional firms to conduct periodic reviews throughout the project to identify and mitigate risks. These measures would form a multi-layered risk mitigation system.

Companies should diversify their financing channels, including by partnering with Chinese and foreign sovereign funds and development finance institutions to provide credit enhancement for projects and facilitate project financing. Equity funds should be established to invest in different countries or types of infrastructure in order to increase the portion of project funding which is financed with equity.

Chinese and foreign companies should also make use of the various innovative financial products which have been developed with international financial centres and take advantage of the internationalisation of the RMB to raise funds for 'Belt and Road' projects. For example, this could include issuing bonds and shares related to these projects on international exchanges, establishing infrastructure equity funds and developing different types of asset-backed securities.

Companies should also develop new models of cooperation. Chinese companies need to recalibrate their approach to developing and operating overseas projects; strengthen their capacity to deploy capital effectively in international business; and develop innovative new models which are appropriate for conditions in countries along the 'Belt and Road'. At the same time, Chinese companies need to pay more attention to their corporate social responsibilities and work to build a positive image in international markets in order to earn "social license" from local communities.

Chinese companies should establish mechanisms for cooperating with different foreign companies, including local partners that are accustomed to the business climate of their home countries, as well as established international companies, including consulting firms and financial institutions. This can help projects to be delivered more effectively and gain greater acceptance by international stakeholders and local communities.

Chinese companies should also collaborate with leading foreign companies and institutions in research and development activities and in efforts to train and develop local talent in 'Belt and Road' countries.

Chinese companies should cooperate more with foreign companies by complementing each other's strengths to enter new third-country markets and developing reasonable and efficient ways to divide the work on infrastructure projects.



The coordinating role of multilateral organisations in the 'Belt and Road' infrastructure market

Multilateral organisations can support the governments of China and other countries along the 'Belt and Road' as they work together to build risk management systems. For example, multilateral organisations could participate in the joint development of a 'Belt and Road' infrastructure investment risk identification and assessment system; the creation of a 'Belt and Road' infrastructure investment risk prevention and control network; and the establishment of various risk mitigation mechanisms for countries along the 'Belt and Road'.

Multilateral organisations can also lend their reputation, resources and networks to support efforts by the Chinese Government and governments of countries along the 'Belt and Road' to build systems that can help safeguard international private investment in 'Belt and Road' infrastructure projects. For example, multilateral organisations could work with

development finance institutions, multilateral investment guarantee agencies, as well as local and global financial institutions to establish a 'Belt and Road' infrastructure financing centre that would offer advice about how to access project preparation funds and project financing structures and products.

They could also work in coordination with the Chinese Government and international commercial institutions to accelerate the development of infrastructure financing guarantee mechanisms that would help de-risk private investment in 'Belt and Road' projects.

Multilateral organisations can work together with the governments of China and developed countries, as well as international firms, to provide a comprehensive range of services tailored to the special characteristics of building and operating 'Belt and Road' infrastructure.



These could include, for example, assisting governments of countries along the 'Belt and Road' with institutional capacity building and improving their investment environment; helping the Chinese Government and governments of countries along the 'Belt and Road' to establish a 'Belt and Road' infrastructure project pipeline; and

leveraging their existing global networks to introduce high-quality project opportunities to companies in both China and developed countries, effectively promoting third-country market cooperation at a project level.

The supporting role of professional firms in the 'Belt and Road' infrastructure market

Professional firms from China and abroad can use their international infrastructure project experience to provide a suite of specialist advisory services tailored to the needs of governments, companies and international private capital investors in the 'Belt and Road' infrastructure market.

For example, consulting firms could assist the Chinese Government and governments of countries along the 'Belt and Road' in their efforts to build a 'Belt and Road' infrastructure project pipeline by assessing the financial feasibility and funding and financing plans for proposed projects. They can assist companies to undertake feasibility analysis and due diligence reviews of proposed projects covering areas including tax, finance, legal, engineering, operational and public relations. These firms could also establish commercial platforms that leverage their global resources to provide specialist consulting services to

all parties involved in building and operating 'Belt and Road' infrastructure projects.

These firms are well-positioned to assist with the creation of an information-rich 'Belt and Road' infrastructure project financing ecosystem. Internationally-renowned consulting firms can assist companies screen, evaluate and structure projects, making it easier for them to obtain financing from providers of international private capital.

Financial services institutions can leverage their own networks to assist companies seeking to raise capital for 'Belt and Road' infrastructure projects both in domestic and international markets.



Advisory firms can also participate in the process of creating 'Belt and Road' infrastructure project investment risk mitigation and management systems, such as through financing guarantee and financing risk compensation mechanisms.

Professional firms can continue to play a bridging role between government and business and support the establishment of mechanisms for cooperation between government and companies. For example, by publishing research and organising events, consulting firms can help the international community develop a more complete understanding of the way in which the BRI is being implemented.

By cooperating with think tanks, companies and international private capital, these firms can research 'Belt and Road' infrastructure project financing from different perspectives including capacity building, creating new financing channels and risk management, with the objective of providing pragmatic policy recommendations to the Chinese Government and national governments from 'Belt and Road' countries.

They can also work closely with industry associations to hold events to promote 'Belt and Road' projects, with the aim of encouraging governments, companies, development finance institutions and private capital to increase their engagement around specific project opportunities.





Looking forward

“We welcome the participation of multilateral and national financial institutions in BRI investment and financing and encourage third-market cooperation. With the involvement of multiple stakeholders, we can surely deliver benefits to all.”

**President
Xi Jinping**

2019 is the first year of the second five year period of development of the BRI. The Second Belt and Road Forum for International Cooperation was successfully held in Beijing on 25-27 April 2019. In his keynote speech at the opening ceremony of the Forum, President Xi Jinping said “[w]e welcome the participation of multilateral and national financial institutions in BRI investment and financing and encourage third-market cooperation. With the involvement of multiple stakeholders, we can surely deliver benefits to all.”² The convening of this Forum marks the beginning of the next phase of development of the BRI during which the Chinese Government will focus on “priorities and project execution, move forward with results-oriented implementation... and jointly promote high-quality Belt and Road cooperation.”³

2. ‘Keynote Speech by H.E. Xi Jinping President of the People’s Republic of China At the Opening Ceremony of the Second Belt and Road Forum for International Cooperation’, Ministry of Foreign Affairs of the People’s Republic of China, 26 April 2019, https://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1658424.shtml

3. Ibid.

Looking forward, we hope to see governments, companies, multilateral organisations and professional firms working together to develop a pipeline of 'Belt and Road' infrastructure projects; formulate policies, rules and standards for these projects; promote fair competition; and establish platforms for public-private cooperation in the promotion, financing and delivery of 'Belt and Road' infrastructure projects. The result will be a robust market mechanism characterised by information transparency, rules-based governance, fair competition and public-private synergy. This should enable providers of international private capital to participate more effectively in 'Belt and Road' infrastructure projects while making them more comfortable about investing in

these projects, more willing to contribute to the ongoing development of the 'Belt and Road' infrastructure market and more confident in the institutional and policy support for their investments. In this way, attracting more international private capital to infrastructure projects in countries along the 'Belt and Road' will help transform a "beautiful vision" into a "tangible reality" and promote more results-oriented implementation of projects and substantive 'Belt and Road' cooperation in the coming five years.

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