

Belt and Road Initiative: Opportunities on the rise



HSBC

Belt and Road Initiative: Risks, Opportunities, Real Estate



Kee Joo Wong,

Regional Head of Global Liquidity
and Cash Management,
Asia Pacific, HSBC



Lance Kawaguchi,

Managing Director, Global Head –
Corporates, Global Liquidity and Cash
Management, HSBC

The scale of China's Belt and Road Initiative (BRI) is striking: involving nearly two thirds of the world's population, 68 countries and over 40 per cent of global GDP¹. But what are the risks and opportunities arising from BRI for corporate treasuries, particularly for those in the real estate sector?

First outlined by President Xi Jinping in 2013, BRI represents a further major boost to China's established policy of encouraging mainland businesses to venture outside China. There are three primary strands to the initiative:

- ♦ **Infrastructure:** the creation or improvement of the full spectrum of physical infrastructure, ranging from telecoms to ports
- ♦ **Financial:** lending and capital-raising
- ♦ **Policy:** customs, tax coordination, trade and investment partnerships

Annual trade between China and countries involved in BRI is expected to exceed USD2.5trn over the next decade². These trade channels already hit USD1.2trn in 2017, growing by 3.6 percentage points more than overall global Chinese trade growth in the process³. A key element in the economic impact of BRI is infrastructure: one estimate predicts that BRI countries have a total infrastructure investment need of around USD5trn⁴.

Certainly in the shorter term, many BRI opportunities will relate to infrastructure: rail, road, air and sea ports, or power, telecommunications, water and sanitation. "However, further down the line many of the larger infrastructure projects will act as catalysts for real estate developments along new or enhanced transport routes," says Kee Joo Wong, Regional Head of Global Liquidity and Cash Management, Asia Pacific at HSBC.

The effect of this BRI infrastructure investment on the real estate sector is already apparent from some early examples. The Khorgos Gateway BRI project is a case in point: in barely five years it has gone from empty sand to a combination of a cross-border free trade zone, dry port, 450-hectare special economic zone - and a new city⁵. This is a pattern already being repeated at other key BRI locations, such as the Sino-Oman Industrial City⁶.

"It is the growth of these new cities that represents much of the considerable real estate opportunity implicit in BRI," Lance Kawaguchi, Managing Director and Global Head of Corporates for Global Liquidity and Cash Management at HSBC. Once the infrastructure is in place to move goods and information efficiently, then new factories, warehouses and offices emerge to take advantage of this, along with the residential accommodation, shops and leisure facilities needed for factory/warehouse/office personnel. However, given the communication and logistics gains implicit in BRI, conventional retail stores (perhaps apart from those such as supermarkets) may be a smaller element. Instead, warehousing to service online shopping may be more prominent in the mix.

¹ <https://www.gfmag.com/magazine/june-2018/one-belt-one-road-many-impacts>

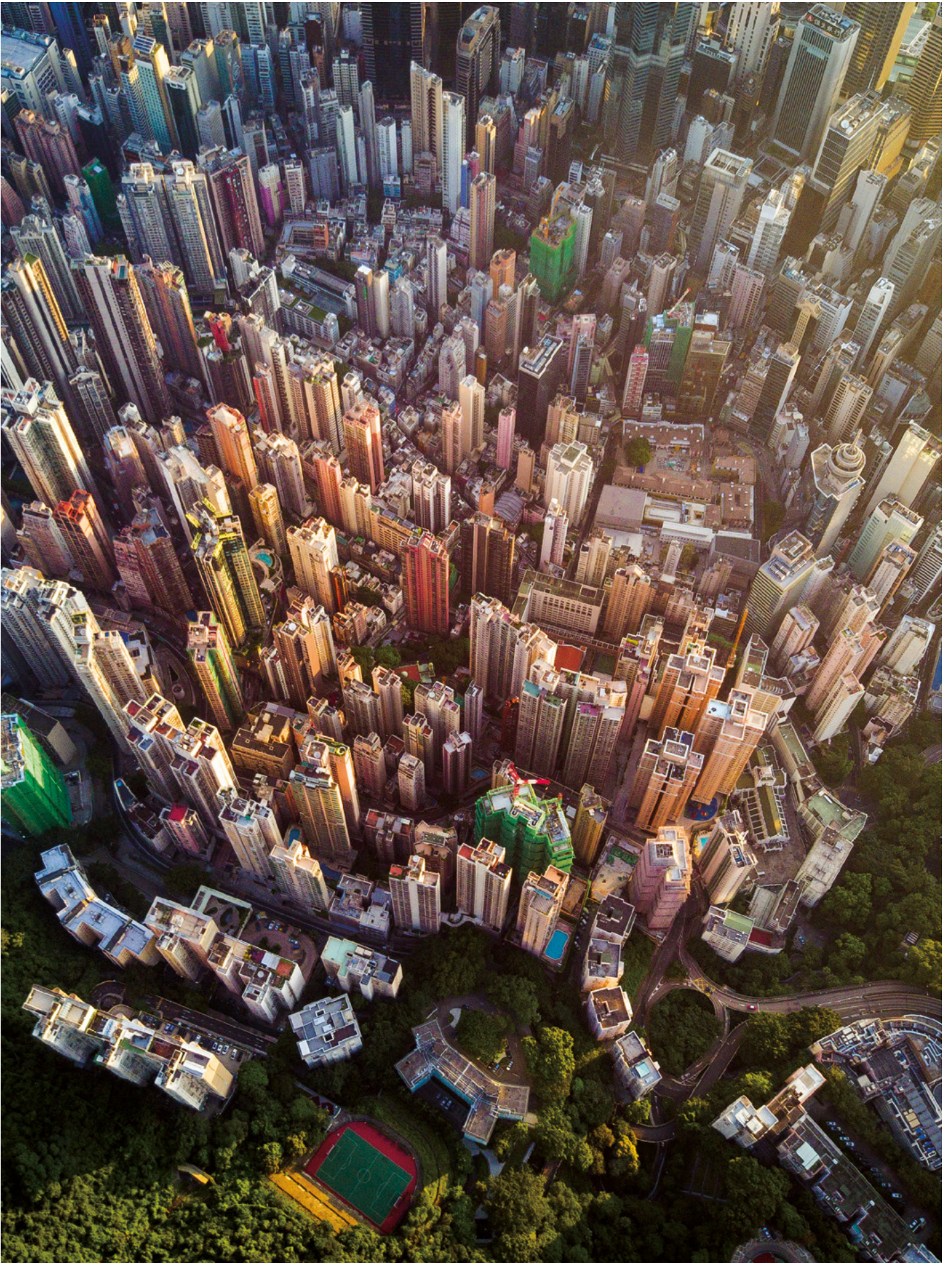
² http://www.xinhuanet.com/english/2015-03/29/c_134107329.htm

³ http://www.xinhuanet.com/english/2018-03/11/c_137032080.htm

⁴ <https://www.pwccn.com/en/research-and-insights/belt-and-road/brochure.html>

⁵ <http://geographical.co.uk/people/development/item/2979-along-the-new-silk-road-khorgos-where-east-meets-west>

⁶ <https://emerge85.io/Insights/omans-coastline-is-the-next-stop-on-chinas-belt-and-road/>



Supply chain

Many corporates, both from mainland China and elsewhere, are understandably interested in taking advantage of this BRI real estate opportunity. However, this will create a variety of challenges and opportunities for their treasuries. Even though BRI infrastructure will boost transport links, there will still be a need to source materials locally as much as possible when building new real estate in order to minimise unnecessary transport costs. Corporates are therefore likely to find themselves dealing with multiple new local suppliers for commodities such as sand, gravel or cement in each BRI location in which they build.

One potential issue with this is that (especially in more remote locations) many of these suppliers may be relatively small. They could therefore struggle in terms of working capital capacity when fulfilling additional BRI-related business, thus creating operational risks, such as delivery delays/disruption or supplier insolvency, for their new corporate customers.

“One possible remedy for this potential problem is supply chain financing (SCF), which also presents possibilities for improving days payable outstanding (DPO),” says Lance Kawaguchi. “Nevertheless, many banks will struggle to deliver this comprehensively and consistently under BRI, especially in multiple locations, some of which are extremely remote.”

The bank most likely to be able to provide this most effectively will be one that has a global physical network presence and that banks a broad size spectrum of businesses. Apart from various other attributes, a bank with these capabilities is also likely to be able to expedite SCF implementations because it may already banking some of the local suppliers involved.

Cash and liquidity management

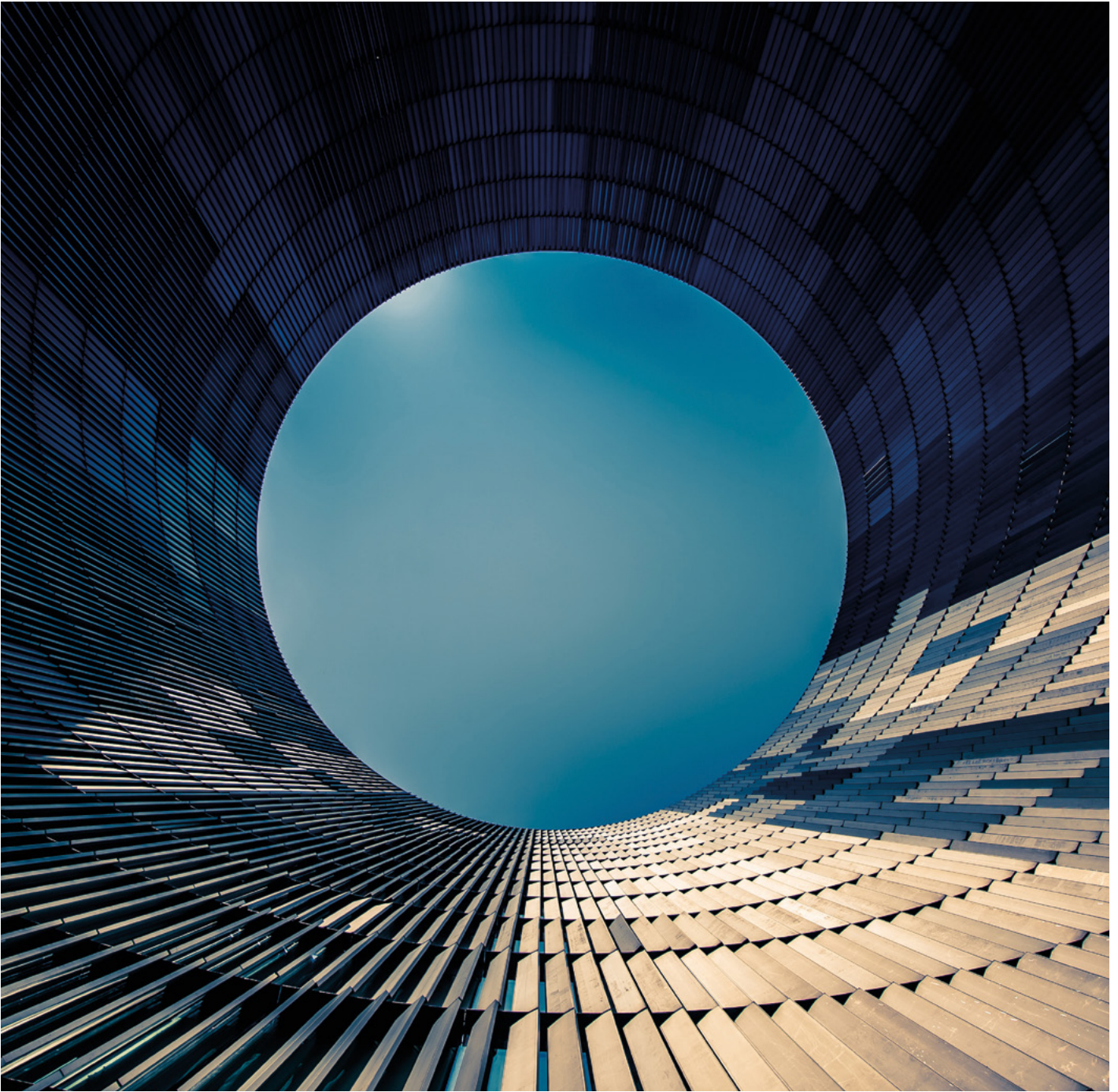
A bank’s global physical network presence is also integral to the quality of cash and liquidity management support it can provide for real estate and other corporates involved in BRI projects. The simplicity and efficiency of only having to deal with a single consistent banking partner across multiple jurisdictions is considerable. Furthermore, if the bank can seamlessly combine this network with sophisticated cash and liquidity management capabilities, then corporate treasurers will benefit from a combination of comprehensive coverage and centralised visibility/control. Depending upon local regulation, they may also be able to take advantage of functionality such as payables/receivables on behalf of, plus opportunities to improve working capital.

“Apart from day to day cash and liquidity management, corporates in the real estate sector also have to determine the most efficient way to transfer the substantial capital sums required for BRI projects to the relevant countries,” says Kee Joo Wong. “Furthermore, if those funds are not immediately deployed, they will also be looking for ways to optimise yield on them in the meantime.”

Security of funds is clearly vital here, so selecting a bank with a robust credit rating and extensive experience of efficiently routing high value cross border payments across multiple jurisdictions is important. This would be true for any treasurer, but even more so for treasurers of the state-owned Chinese corporates expected to be prominent BRI participants, as they have the additional responsibility burden of handling state and not just corporate funds.

With regard to optimising yield, a significant number of BRI countries have regulations preventing the use of certain liquidity management tools, such as notional pooling. Therefore any partner bank for corporates involved in BRI real estate projects will ideally be able to provide alternative solutions that optimise the interest return on balances aggregated across multiple jurisdictions, while still complying with local regulations.



**Regulation**

More generally, regulatory compliance will be a challenge for corporates in the real estate sector. This applies in many respects, but one obvious example is the initial investment in BRI real estate projects, which will typically involve the deployment of substantial sums at a local level and where the methods and corporate entities used to accomplish this have significant regulatory implications. Again, this is an area where a bank with an extensive physical presence is well-positioned to provide support. This applies particularly to Chinese corporates with no prior overseas experience, but also to corporates more generally.

An additional regulatory challenge is diversity. Many of the 68 countries involved in BRI are in Asia, where financial regulations (such as those relating to FX or liquidity management) vary widely from country to country. This is challenging enough on a single country basis, but is exponentially more so where a corporate is involved in projects in multiple BRI countries. In this situation, treasuries will be trying to develop secure processes and structures that are as consistent as possible for efficiency, whilst still maintaining compliance with individual countries' regulatory requirements. Therefore, a bank that can pull together local regulatory knowledge from multiple locations and fuse it with cash and liquidity management expertise for delivery to corporate treasurers can help de-risk the regulatory aspects of BRI participation.

**Long term strategy**

Apart from anything else, the sheer scale of BRI and its associated infrastructure build will make it a long term initiative/ investment for corporates in sectors such as real estate, which may require structural changes to treasury functions. For instance, in order to be able to manage the myriad financial activities associated with BRI, some treasuries may need to establish regional treasury centres, such as in Hong Kong or Singapore for Asian BRI activities.

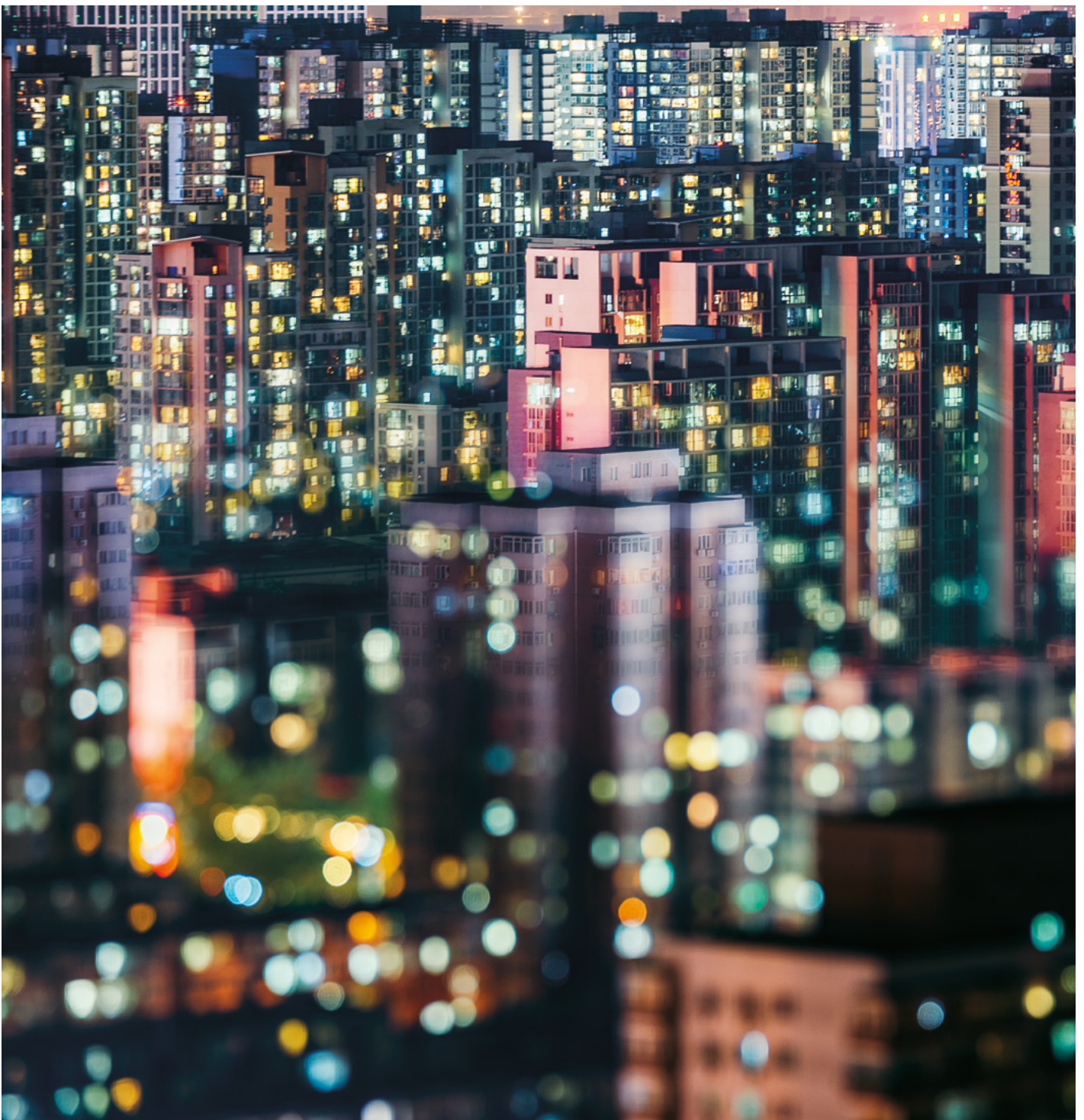
A related issue for many treasuries is that while they may have had to handle opening in a new country before, with BRI they may now find themselves having to start supporting operations in multiple new countries near-simultaneously. For a department such as treasury, which is usually lightly staffed, this is a major additional workload of extreme long term strategic importance. As a result, support from a partner bank with the right expertise and network might spell the difference between success and failure.

This applies across multiple disciplines and activities, such as establishing a new regional treasury centre, devising optimal bank account structures, or integrating new country entities into ERP systems. Furthermore, this will not be a one-off need: BRI-related requirements and the associated environment will change over time. Therefore, any suitable banking partner will also need to be able to support treasury in the long term in implementing best practice, as well as in adapting to any changes in regulation or other environmental factors.

Conclusion

There seems little doubt that BRI represents a major economic and commercial opportunity, with major BRI infrastructure projects likely to act as the catalyst for a wave of real estate activity. Nevertheless, from a corporate treasury viewpoint, this represents an exceptional challenge. Potentially multiple new jurisdictions - each with its own regulations, risks, financial infrastructure and business practices - will have to be accommodated in existing treasury structures and strategy, or new ones developed for the purpose.

For real estate (and other) corporate treasuries, this will be an immense task, but one that can be appreciably reduced with the support of a bank with an extensive physical network and solution set - but also one with a long term, partnership-centric mindset.





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