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A Short Guide to China's Belt and Road Strategy

China's Belt and Road initiative has caught global headlines and rightly so. But it has also left many confused. We answer seven common questions.

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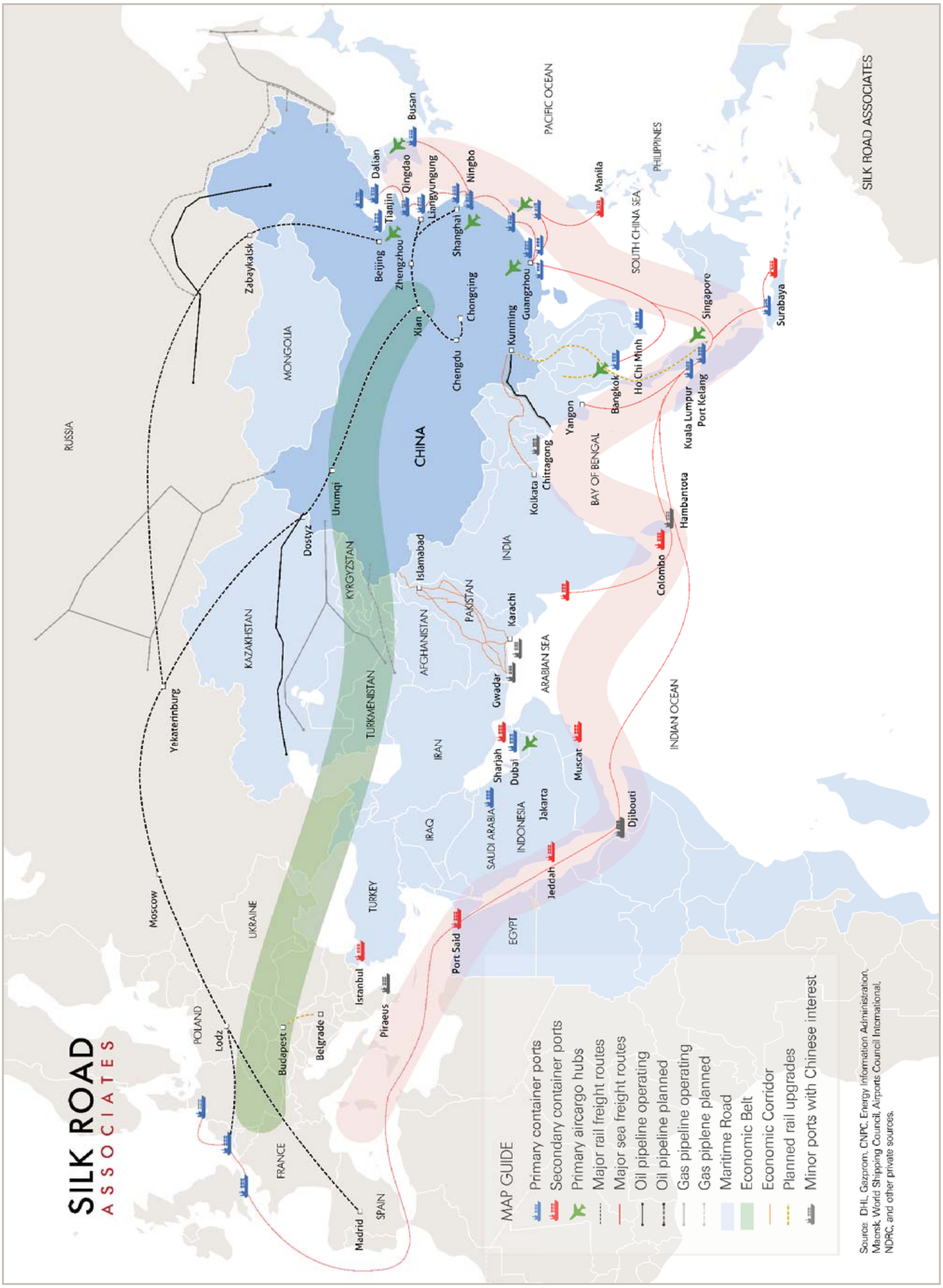
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MAP GUIDE
Primary container ports
Secondary container ports
Primary aircargo hubs
Major rail freight routes
Major sea freight routes
Oil pipeline operating
Oil pipeline planned
Gas pipeline operating
Gas piplene planned
Maritime Road
Economic Belt
Economic Corridor
Planned rail upgrades
Minor ports with Chinese interest
Source: DHL, Gazprom, CNPC, Energy Information Administration, Maersk, World Shipping Council, Airports Council International, NDRC, and other private sources.
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Jeddah
Port Said

A Short Guide to China's Silk Road Initiative

China's Belt and Road policy is best understood as a mission statement for the country's comercial and political engagement with its near neighbours situated between Asia and Europe, or along the modern Silk Road.

China's Belt and Road has captured global headlines, and rightly so. The strategy will drive China's commercial and political relations with its near neighbours, from Asia to Europe, over the coming decade. It will add fuel to the steady rise of the Silk Road region as the world's centre of economic gravity.

The strategy is still evolving and that has created some uncertainty in the business community. But, in short, if you partner, supply, or compete with Chinese companies in the region, then the strategy matters.

In what follows I tackle some of the more common questions on Belt and Road. It isn't an exhaustive list, but it reflects my views of having worked in Asia and the Middle East for 20 years, and having tracked China's strengthening commercial engagement with the Silk Road region over the past decade.

There are two key reasons why the strategy has real business implications. The first is that Chinese companies have been increasing their investments in the Silk Road region for almost a decade in response to real market opportunities. In other words, Belt and Road is underpinned by market forces.

Beijing's financial and policy backing will only accelerate the change. There will be plenty of policy misfires and parts of the strategy may fail outright. But the country's sheer commercial scale and the tendency of Chinese companies to align themselves with official policy will result in a meaningful impact on the region.

1. Why introduce the strategy now?

China's GDP growth has slowed to its lowest rate in 20 years and the country's leadership is naturally worried. Beijing is trying to rebalance the domestic economy and also find new markets to sell excess supply and cushion overall growth.

TALKING POINTS

- The narrowest measure of the strategy covers more than 60 countries and 62 percent of the world's population, including Asia, the Middle East, and East Africa. The broader measure includes Europe.
- There are two components to the strategy: the "Silk Road Economic Belt" and "21st Century Maritime Silk Road". Together, they are called "Belt and Road".
- Chinese President Xi Jinping has made the strategy a centrepiece of his policy and so it has support at the highest level.
- The strategy is not a trade agreement. It is best viewed as a 'mission statement' describing China's commercial and political engagement with its near neighbours, from Asia to Europe.

WILL IT MATTER TO MY BUSINESS?

- The strategy will help shape China's commercial engagement with the Asia region. If you supply, partner, or compete with Chinese companies in the region, then the strategy matters.
- Beijing's policy support for the strategy is still evolving, but leading Chinese companies can be expected to enjoy greater support for any commercial activity that falls inside the country's Belt and Road strategy.

The Silk Road countries are part of the solution. They account for 42% of the world's economy. The region's GDP growth rate has averaged five percent over the past 10 years. It is only natural that China recalibrates its foreign market strategy to focus on its nearest and fastest growing opportunities.

The Silk Road countries also neighbour some of China's least developed provinces in the southern and western regions. By developing trade and transport links with Central and Southeast Asia, in particular, the country's leadership can further spur growth in those regions and so underpin social stability.

This sounds sensible. But the strategy will have a very different impact at a firm level as opposed to a country-wide level. The key issue for foreign business will be identifying the difference.

2. So should I be bearish or bullish towards the strategy's commercial implications?

For a start, I expect the strategy will have a greater positive effect on individual Chinese companies rather than the overall economy. These are the companies able to identify and execute opportunities in the Silk Road region and so reallocate some of their spare capacity to overseas markets.

China State Construction Engineering Corporation (CSCEC) is a good example. The company is already building projects around the world, whether it's residential flats in Myanmar or highways in Pakistan. It will clearly benefit from Belt and Road, as will the company's vast domestic supply chain.

The Asian Infrastructure Investment Bank (AIIB) and Silk Road Fund will support the process, funding the type of critical infrastructure projects that Chinese companies excel at building. If so, they will bring their supply chain and bankers alongside them, further spurring China's regional expansion.

These are the firms that foreign companies need to be monitoring. They may be looking for foreign suppliers or partners as they tap unfamiliar markets. They may also emerge as new competitors. Irrespective, they are a critical development in so far as they represent the next wave of Chinese outbound expansion.

3. Will the strategy save China's economy and keep growth ticking at above 6%?

I am less optimistic, however, that the strategy will cushion domestic GDP growth from slowing much below its current rate. That might have worked in the 1990s, but not today, as China's economy is simply too big relative to the region

For a start, the five Chinese provinces of Guangdong, Jiangsu, Shandong, Zhejiang, and Henan rank among the Silk Road's 10 largest economies. Only India, Indonesia, Korea, Turkey, and Saudi Arabia make the list. To put it another way, Guangdong has a GDP ($1,060 billion) larger than 60 Silk Road economies.

That's a big difference in scale. Yet if Guangdong province can't solve China's overcapacity problems, it's tough to see how exporting the country's excess supply to smaller economies such as Kazakhstan (GDP of $203 billion) or Pakistan (GDP of $250 billion) will as they simply can't buy that much cement or steel.

Even some Chinese companies might find that foreign markets simply aren't large enough. I heard just this complaint from a glass manufacturer in Shandong already exporting to Algeria and Mongolia. His sales were profitable, they just weren't a 'like-for-like' replacement for his large domestic market.

4. Why does the strategy seem to be just media hype with few details?

The term 'Belt and Road' is confusing for many. The fact it describes two separate policies, the "Silk Road Economic Belt" (丝绸之路经济带), linking China with Europe, and the "21st Century Maritime Silk Road" (21世纪海上丝绸之路), connecting China to Southeast Asia, Africa, and Europe, doesn't help.

My advice is to ignore the exact meaning of the slogan and simply view the strategy as a 'mission statement' to describe Beijing's intention to deepen the country's commercial, economic, and political relations with near neighbours, including Asia, the Middle East, East Africa, and Europe.

The challenge for foreign businesses will be filtering out the noise and identifying which parts of the policy are most likely to succeed and then asking which Chinese companies are best positioned to take advantage of any favourable policy or market access offered by the strategy on a deal-by-deal basis.

5. Why do individual provinces appear to be designing their own strategies?

Recently while in Almaty, my Chinese fixer remarked to me that he had received 30 municipal- and provincial-level Chinese delegations in recent months. “They swamped local officials”, he remarked.

That is no surprise as I saw Chinese delegations do much the same in Saudi Arabia in the late 2000s. It is also partly deliberate as Beijing allows local governments to design strategies that best suit their competitive advantage, whether that's rail freight trade in Chongqing or financial services in Shanghai.

This means focusing exclusively on Beijing's policy announcements is not enough, especially with respect to the activities of Chinese firms backed at the provincial level. Foreign businesses will need to further drill into the detail to understand which Chinese provinces are developing strategies of importance.

6. So why should I bother to take the strategy seriously?

Beijing has not created a new reality, but is simply following market forces as the Silk Road region has been rising for nearly a decade: Chinese firms have been investing in Kazakh gas facilities, shipping goods to Europe by train, and building ports in Sri Lanka for at least the past five years, if not longer.

The development is also evident in the data. The Silk Road's share of global GDP, excluding Europe and Japan, rose from 29% to 44% between 2000 and 2015, and will continue to rise in the coming decades.

My suggestion then is to ‘follow the money’ if trying to understand the strategy's implications. Beijing may look to back select strategic but non-profitable projects. But Chinese firms will for the most part invest money where there is a profitable return (i.e. high speed passenger trains across Central Asia will not make the list).

What does Belt and Road mean for my business?

A strategic decision makers check-list

Page 6

7. This isn't just about China. Don't forget Japan, Korea, and Turkey.

Though China's strategy has captured global headlines, it isn't the only country that will benefit from the region's rise. Indeed, many countries have their own well established Silk Road strategies.

Japan is the best example. Its corporate sector is already well entrenched in many Silk Road countries and Japanese Prime Minister Shinzo Abe has been a regular visitor to the region over the past two years. This is especially true in Southeast Asia where Japanese companies are often the dominant foreign player.

Japan isn't alone. Turkey enjoys strong ethnic ties to Central Asia and Turkish construction companies, already contest fiercely with their Chinese peers. Korean companies are similarly tough competitors; just consider the $20 billion nuclear deal a Korean-led consortium won in the UAE in 2009.

Such deals are often overlooked, but they are equally impressive and underscore that foreign businesses shouldn't be focused on Belt and Road at the expense of the broader Silk Road opportunity.

What does Belt and Road mean for my business?

A strategic decision-makers checklist

How can decisions makers incorporate the policy into their strategic planning? How can they organise across the Silk Road region to make sure local offices are aligned around identifying opportunities and sharing them internally? Here are some suggested questions for your next strategy offsite.

How to identify the implications for our markets?

- Who is responsible for gathering market intelligence on the regional implications of Belt and Road? How is this intelligence shared with the regional leadership team?
- How can we motivate our local offices from Bangkok to Karachi to identify and communicate emerging opportunities or threats with our China business lines and leadership team?

Do we understand the implications for our competition and operating model?

- What is the possibility that our firm will face greater Chinese competition in the Belt and Road markets? Have we communicated these risks to our local offices?
- Have we engaged in strategic dialogue with our Chinese partners or suppliers about how they are responding to Belt and Road opportunities?
- Have we educated global HQ about Belt and Road and its potential immediate and long-term implications for our regional business?

Do we have the right management structure and capabilities?

- Do we have employees with the capabilities to operate effectively across multiple Belt and Road countries? How can we make best use of them in China and elsewhere?
- How might we better align the firm with China's Belt and Road policy? In what ways can we be helpful to China's central and local government leadership, and their regional ambitions?

ABOUT THE AUTHOR

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Ben has worked in Asia and the Middle East for the past 20 years. He advises a range of Fortune 500 multinationals on their commercial strategies in Asia and the Middle East. He provides global boards and regional leadership teams with intelligence on the region's fast-changing value-chains, business models, and management approaches.

Ben was previously chief China economist at RBS and senior China economist at JPMorgan based in Hong Kong. He started his career in Beirut during the early 1990s where he worked as a management consultant. He later joined Dun & Bradstreet based in London as the firm's Senior Analyst for the Middle East & North Africa assessing commercial and political risk.

Ben speaks Mandarin and Arabic. He is author of *The Rise of the New East* (Palgrave: 2014), examining commercial opportunities and complexities in the Asia market, and *The New Silk Road* (Palgrave: 2009), exploring China's commercial ties with the Middle East. He also writes a regular column for Forbes and features on CNBC, Bloomberg, and CNN.

Ben is a regular speaker at economic forums, corporate and industry conferences in Beijing, Shanghai, Singapore, Dubai, Riyadh, London and New York, among more than 20 cities around the world.

ABOUT SILK ROAD ASSOCIATES

Silk Road Associates provides strategic advisory and intelligence services to Fortune 500 multinationals and leading Asia-based companies, helping our clients stay competitive in Asia's fast moving markets.

Our next generation approach to tackling Asia's commercial scale and complexity is based on a process refined over the past 20 years by our team of Asia and Middle East experts.

Combining our proprietary data analytics and specialist networks, we provide unique insights into the region's complex value-chain, helping clients respond rapidly to changes in the business landscape.

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