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“Going Out” to Capture Belt and Road Opportunities (Expert Opinion 5): A Co-investment Example of Going Global

Chinese mainland enterprises are increasingly looking to make direct investment overseas in order to explore new markets or to obtain access to labour or other resources. Companies have undertaken such moves on their account as well as via mergers and acquisitions. According to one Hong Kong-based investment house, however, equity co-investment or other forms of joint-stock partnership could provide additional options for those mainland investors who are eager to expand their overseas businesses while managing the risk involved. Through cooperation with co-investors, mainland enterprises could not only enjoy the benefits of risk sharing among the investment partners, but also be furnished with additional synergy that could help them move beyond their business constraints, thereby reaching new business frontiers through capitalising on the strengths of their co-investment partners.

Alternative Mode of Investment

Alex Downs: Via co-investment partners, Chinese mainland enterprises could be given the option of enhancing their businesses beyond their original operations.

Alex Downs is the Director of Ironsides Holdings Limited, a Hong Kong-based private equity investment firm that sources funds from Hong Kong, the US and other territories. The firm invests directly into private companies and projects in a number of areas, including health-care, agriculture, logistics and technology. Its current investments cover - among others - the Southeast and Central Asian regions, which are within the remit of China's Belt and Road Initiative.

Interviewed recently by HKTDC Research, Downs said: "Chinese enterprises seem to prefer taking a controlling stake when conducting investment in overseas projects or companies. There is, however, always the choice for them to have a much bigger presence in the overseas markets and explore new business opportunities via cooperation with their foreign counterparts, something that could result in decent profits with reduced risks.

"Chinese enterprises could reduce their overseas investment risks by cooperating with experienced equity co-investment partners. With minority equity participation, these partners could effectively undertake feasibility studies, due diligence and long-term sustainability analyses for the cooperation projects in question. In the case of investment in certain emerging economies along the Belt and Road, further engagement of local or other experienced partners would be an option for those mainland investors concerned about the risks stemming from loose local regulations and immature legal systems, less transparent local ownership requirements, imperfect or partial local business and market information, troublesome labour arrangements and other cultural issues.

More importantly, via their co-investment partners, Chinese mainland enterprises could be given the option of enhancing their businesses beyond their original operations." In this regard, Downs cited the example of an agricultural investment made last year. In this instance, Ironsides was heavily involved in helping the company to re-brand and re-focus its core business model as part of the investment programme. This helped the mainland enterprise expand its reach into the international market.

Downs also discussed a number of the current opportunities available to support heavy industry, such as coal mining operations on the Chinese mainland. In this instance, a co-investor could become a pivot, allowing the mainland mining operation to divert its excess capacity into investment projects in Southeast Asia. This could see them fundamentally refocus their company, with the help of experienced international partners, into new and profitable business projects beyond coal mining. Such co-investments could reduce the risk associated with investments, while also solving the overcapacity problem affecting many mainland companies. Ultimately, this would enable them to continue their operations and assure them of profitable growth.

Synchronising the Interests of Different Partners

Assessing the pro and cons, Downs said: “Ultimately, Chinese enterprises may not have the controlling stakes in such co-investment models, with success resting on the participants’ contributions and the effective cooperation among the partners. On the upside, the Chinese enterprises would be given the opportunity to participate in a bigger project and have access to markets beyond that of their original business, thus generating sustainable incomes from their overseas investment. This would be a viable option for those ‘going-out’ enterprises without enough experience, exposure and/or resources. Of course, they would have to determine whether to get a majority control in a smaller-scale project by sole investment or whether to take a smaller stake in a bigger project and go global with co-investment partners, and probably with lower risks.”

Downs noted that China is on course to solve its overcapacity problem, while looking along the Belt and Road to seek for further growth impetus. In this regard, private equity firms based in Hong Kong, such as Ironsides, would be able to help Chinese mainland enterprises to relocate their excess capacity via investment in Asia and other Belt and Road countries. This is down to the fact that investment firms in Hong Kong have the advantage of vast business connections both on the Chinese mainland and internationally. As a result, they have access to a variety of different companies, all of which are looking for growth opportunities.

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With free flow of information and familiarity with Chinese and foreign business environment, Hong Kong investors have a considerable understanding of the business needs of a variety of mainland and overseas companies. They are thus in the ideal position to help combine the strengths and resources of Chinese and foreign partners, and to align their interests in order to jointly enter new markets, move up the value chain, and re-allocate resources, when required, to drive businesses forward.

Source: http://beltandroad.hktdc.com/en/market-analyses/details.aspx?ID=475601