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BUSINESS Weekend

Powering ahead
Global carmakers set to expand presence in China
> AUTOMOBILES B8

Founders' dilemma
First-generation entrepreneurs face succession blues
> ANALYSIS B3

Snapshot:
H-share index: 10,282.65 +25.02 points, 0.24%
Top blue-chip mover: AAC Technologies -3.42%

Hang Seng Index
0.12%
Close 25,156.34
Up 30.79

Food for thought
HK must welcome disabled people into the workforce
> OUTSIDE IN B14

BELT AND ROAD

ROOM FOR ALL

Hong Kong trading houses say apart from mega infrastructure investors, they too can benefit from the huge opportunities in the mainland scheme linking 62 nations

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Hong Kong's small and medium-sized enterprises are hardly the typical players that stand to benefit from Beijing's "Belt and Road Initiative" where mega infrastructure investments are expected to dominate. But merchandise trading executives say they too can play a part.

Victor Fung Kwok-king, the honorary chairman of 110-year-old global merchandise trading powerhouse Li & Fung, said the initiative involved "much more than infrastructure building" in the 62 nations spanning across Central, South, Southeast and Western Asia as well as Europe and Africa.

"We need to ask the question of what happens after the infrastructure is built," he told the *South China Morning Post*. "There will be a rapid increase in trade, investment, people, culture and information flows, facilitated by a new form of multilateral institutions."

After three decades of "globalisation of production, enabled by supply chain outsourcing", Fung said the world would see rising globalisation of consumption as consumers in emerging markets became richer.

About two-thirds of global consumption still came from the 35 nations in the Organisation for Economic Cooperation and Development, but that proportion was a drop from 83 per cent in 1980, he said.

While the potential is huge, it will not be easy to capture the opportunities across the large number of developing nations with "totally fragmented markets with millions of small and medium-sized enterprises".

The initiative, which connects a belt of overland corridors and sea routes, also aims to boost financial and trade ties for the 62 countries that lie along the routes.

It would be a game of "business-to-small businesses" trading, Fung said, where the key lay in using information technology to enhance efficiency.

Although Hong Kong businesses are seen to be lagging behind their state-owned mainland counterparts in depth and breadth of knowledge and experience dealing with the belt and road countries, Fung said they had a "huge competitive edge" when it came to conducting international business.

"The availability of market data and information is not the end of the story; it is how one uses and interprets the information to build an understanding of a business opportunity that is more important," he said.

To bring value to belt and road business opportunities, Hong Kong people needed to gain a better understanding in the new markets than their mainland counterparts, and a better understanding of China than their belt and road business partners, Fung said.

What works in theory does not always apply in reality, not to say that there are no opportunities for SMEs. Successes have been few and far between, and the role of Hong Kong entrepreneurs as middlemen has evolved sparingly.

The only difference is the belt and road plan offers the Hong Kong entrepreneur a potentially bigger playing field across numerous geographies, rather than just the mainland 30 years ago.

To date, few SMEs have tracked successfully along the belt and road route.

"Playing the belt and road game is not easy as it is capital-intensive ... it costs a lot to travel there, and the cultural difference, language barriers, currency volatility mean it will take a long time to see results," said Joseph Chan Nap-kee, the chairman of Kaisun Energy Group.

The company, which bills itself as a "belt and road participant" in its communication materials, ventured into the coal-mining business in 2011 – two years before President Xi Jinping announced the trade initiative – by acquiring a few coal mines in Tajikistan in Central Asia.

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>
> JOSEPH CHAN, CHAIRMAN, KAISUN ENERGY GROUP

But the company, which also runs a mining machinery production business in Shandong province and a nascent related machinery leasing business in Central Asia as well as a zircon sand sourcing business in Vietnam, has remained in the red.

Much of the losses stemmed from the sharp depreciation of Tajikistan's currency, which was affected by the Russian rouble's decline as the country was highly reliant on the remittances of expatriates working in Russia, Chan said.

Another small investment into a bauxite project in neighbouring Kyrgyzstan was also written off in its books amid the commodities bust.

Still, Kaisun is not giving up. It now plans to become a middleman for online merchandise trading between Central Asian and Southeast Asian wholesalers buying Chinese-made sportswear, heavy-duty workwear and eventually coal-mining machines.

The company has set up a subsidiary in Fujian province to conduct bulk procurement of mainland-made clothing, and will provide quality checks, logistics and export custom clearance services to the wholesalers in the buying nations.

Riding on the popularity of online sport games in Southeast Asia, Kaisun also plans to launch online tournaments and gatherings for the players, and profit from entrance fees, advertising and site rental income.

Another Hong Kong company bridging the opportunities between the mainland and belt and road economies is Mega Capital Group, which is privately owned.

It set up MCH Halal International two years ago to expand its international halal products trading business.

Halal products generally refer to food, drink, pharmaceuticals, health care and cosmetic products whose production processes are in accordance with Islamic law. They must not contain alcohol, animal blood, pork and pig products, and the method of slaughter of all meat sources must comply with the law.

Chief secretary Vivian Lau said Mega Capital, which has businesses in the property, logistics, finance, insurance and trading sectors, had studied the halal products market for six years before launching its business plan after Beijing announced the initiative in 2013.

"The initiative, which calls for closer economic relations with belt and road nations, many of which are Muslim ones, is a perfect match with our plan," she said.

"With a population of two billion, the Muslim market is huge, but the opportunities are bigger than that since halal products are also consumed by non-Muslims for health and lifestyle reasons."

Lau would not say who owns Mega Capital, except that it is backed by a Southeast Asian businessman of Chinese descent.

MCH helps halal food producers in the mainland expand their exports into Southeast Asia and the Middle East, and also brings foreign halal products into the greater China market.

The company also serves as the greater China agent for eHalal.com, a business-to-business trading platform set up a year ago by the Malaysian government to allow companies to promote and trade halal products.

Mainland halal exports are minuscule and the country accounts for only 0.1 per cent of the world's consumption of US$3.2 trillion of halal products, so there was room for growth, Lau said.

In the Middle East, MCH signed in January a memorandum of understanding with the government-backed Dubai Multi Commodities Centre for MCH to import coffee grown in Yunnan province by state-owned Yunnan State Farms Group for global distribution.

The aim was to build Dubai as the third international coffee trading centre after London and New York, Lau said.

How did the firm muscle its way into an unfamiliar market like halal products?

Lau said besides hiring experts of halal products and sending local staff overseas to receive training in halal institutions, Mega Capital's background and Southeast Asian ties had helped.

HOW TO AVOID LEGAL PITFALLS IN OVERSEAS DEALS

Increasing infrastructure construction in emerging markets along the route of Beijing's "Belt and Road Initiative" will lead to heightened legal risks in project financing and execution, according to a dispute resolution expert.

Some emerging market nations and their state-related entities may not be used to abiding by contractual terms in their commercial dealings, and may see a claim of "sovereign immunity" as justifiable when faced with legal proceedings.

"For some of these governments and their related entities, it may be the first time that they are entering into a significant foreign-funded project," said Paul Teo, a partner and head of arbitration for Greater China at international law firm Baker McKenzie.

"They may be unfamiliar with the structure and operation of the contractual terms, and they may not be comfortable dealing in such a contractual setting," said Teo, who also advises companies on the avoidance and resolution of cross-border disputes.

China could invest US$313 billion to US$502 billion in the 62 nations in Central and South Asia, Africa and the Middle East – along the Silk Road Economic Belt and the 21st Century Maritime Silk Road – in the next five years, according to a Credit Suisse research report.

Most of the investment may go to infrastructure projects in India, Russia, Indonesia, Iran, Egypt, the Philippines and Pakistan.

As much of the funding will be provided by Chinese commercial and policy banks, including the China-led Asia Infrastructure Investment Bank, risks of project failure and how the lenders can protect themselves are increasing concerns.

The report conceded that it would take time for China and the recipient countries to iron out details of how contracts should be structured to protect all parties' interests.

But as geopolitics is at the core of the initiative, Teo pointed out that the Chinese parties may be persuaded to partially give in to the demands of the emerging nations.

"Based on the current mood and practice, a lot of the large multilateral banks, even some of the private banks, may give deal facilitation more weight than strict insistence on the full suite of contractual rights and remedies to address scenarios of default," he said.

Increasingly, it is common for the parties to stipulate in contracts that certain pre-agreed and specific categories of assets belonging to the borrowing nations will be subject to "enforcement", should the dispute go to arbitration or court against the national borrower and their state-related entities.

Teo said that given the popularity of international arbitration, many disputed parties end up agreeing to arbitration over litigation.

"This is where many problems can arise. If you do not word the dispute resolution clause properly in the contract, the whole provision could be found to be uncertain and unenforceable," he cautioned.

"Without a clear jurisdiction clause, the process will be open-ended and risky. You could potentially find yourself having to answer a case before a local court in a developing jurisdiction where you cannot be sure if the proceedings will be transparent and fair," Teo said.

When it comes to project execution, Teo said good project management and contract administration were key.

"They will help ensure that the project is completed on time, within budget and to satisfactory quality, while at the same time allowing legal claims and disputes to be resolved expeditiously."

A scenario in which potential disputes can arise is when the project owner's design is not spelled out in sufficient detail in the contract, resulting in delays and claims.

Cases of losses incurred by Chinese contractors due to project design alteration include the light-rail project in Mecca, on which China Railway Construction Corporation booked a 1.39 billion yuan (HK$1.6 billion) loss in 2010 as costs ballooned 30 per cent after the Saudi Arabia government substantially increased its demands on the project.

Another is a pipeline-laying project by Sinopec Oilfield Service, which last year incurred a 3 billion yuan loss due to an "unexpected" change in design by the Saudi Arabian project owner. In March, Sinopec officials lamented that the process of seeking compensation was tougher than they had expected..

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Trade flows

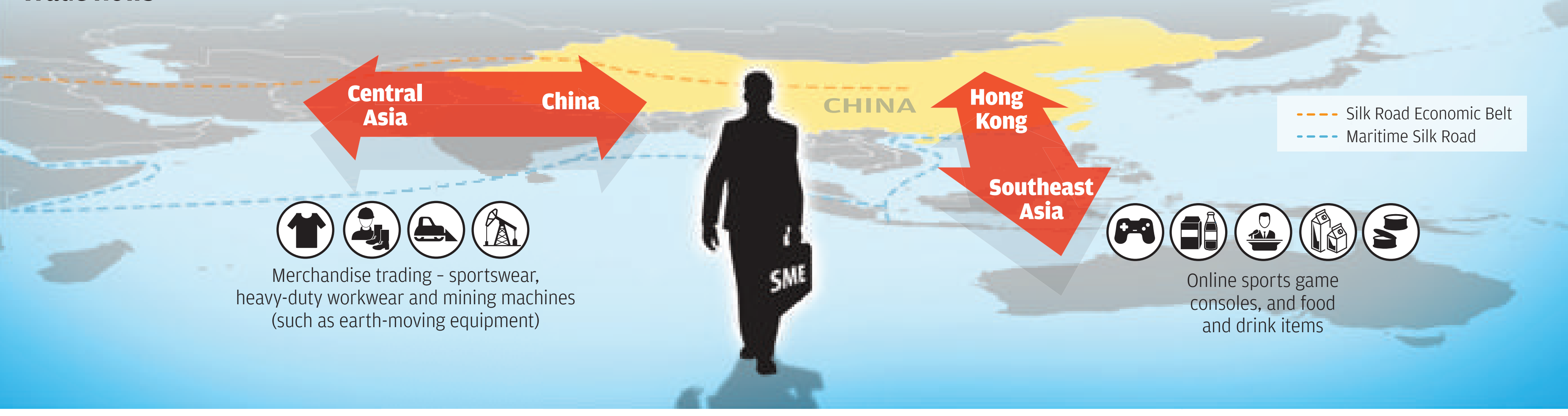

Illustration: Henry Wong