China’s Belt & Road Initiative
The Economics of a modern Silk Route and it’s benefits to Sri Lanka

May 2018
Foreword

Historically it is acknowledged that Sri Lanka’s strategic position in the middle of the maritime Silk Road offered the opportunity of promoting the country as a trading hub in the Indian Ocean. But this has not led to the country being better than Singapore or Hong Kong! Therefore, just the location is not adequate, measures need to be taken to optimize our location. Similarly, if action is not taken to benefit from BRI, we will still be left behind.

Within the past decade Sri Lanka has made significant progress in attracting infrastructure investments from China and jointly building the Belt and Road in Sri Lanka. Some of the key investments are:

- In 2011, the completion of the Norocholai Power Station at an estimated cost of USD 1.3bn, provided about 40% of the nation’s electricity supply and ended the history of frequent power cuts on the island.
- The Katunayake Expressway has brought great convenience to travelers and contributed to the convenience of tourists.
- The Colombo International Container Terminal (CICT), a Sino-SL joint venture, is the fastest growing container terminal in the world.
- The Hambantota port was constructed at a cost of USD 1.5bn by China and in 2017 the government entered into joint venture and a leasing arrangement for an industrial zone with Chinese companies to leverage this asset.
- The newly completed Moragahakanda Project, which is the biggest reservoir in Sri Lanka, has brought great benefits to local agriculture and people.
- As of the end of 2017, Chinese companies are estimated to have completed more than $15 billion in infrastructure projects in Sri Lanka such as those involving transportation, water, electricity, ports and other fields.
- The Colombo Port City is being jointly developed by a Chinese company and the Sri Lanka Port Authority, aiming to build a shipping, logistics, tourism and financial centre in South Asia, with a direct investment of $1.4 billion and a planned second level building complex of $13 billion.

The BRI is fulfilling a global demand for investment and development that can spur increased economic growth for both China and many other nations stuck in their development paths like Sri Lanka. I believe BRI has great potential for Sri Lanka and am very happy to promote this joint initiative on behalf of KPMG and ACCA.

Suren Rajakarier
Partner & Head of Audit
KPMG in Sri Lanka, and
Vice Chairman, ACCA Sri Lanka
What is the Belt & Road Initiative?

While visiting Kazakhstan and Indonesia in the autumn of 2013, President Xi Jinping proposed the development of the ‘Silk Road Economic Belt’ and the ‘21st Century Maritime Silk Road’, which are collectively known as the ‘Belt and Road’ Initiative. The initiative seeks to promote policy coordination, infrastructure connectivity, unimpeded trade, financial integration and people-to-people exchanges, in order to deepen political trust, further economic integration, and create a community of common interest, common responsibility and common destiny. The BRI promotes the redistribution of global wealth, bringing marginalised developing nations and emerging economies into the heart of globalisation. It seeks to develop new areas of the global economy and share the benefits of globalisation with more countries along the ‘Belt and Road’, thereby addressing the shortcomings and inherent contradictions of the traditional model of globalisation.

A key policy initiative of the Chinese composed of the Silk Road Economic Belt and the 21st Century Maritime Silk Road.

Large scale:
The area covered by the BRI encompasses a population of 4.4 billion people, or 62.55% of the world’s population, and represents almost 30% of global GDP.

Initial industry focus:
Railways, roads, ports, distribution networks, etc.

Emergence of new markets, as positive economic spillovers from projects stimulate economic growth both along the “Belt & Road” and within China.

Global initiatives:
The initiative currently encompasses over 70 countries. The objective is for the ‘new paradigm of globalisation’ that emerges to be open, inclusive, balanced and beneficial to all.

Strong financial backing.
“Belt & Road” projects will receive financial support from Chinese policy banks, the Silk Road Fund as well as multilateral development banks such as the Asian Infrastructure Investment Bank (AIIB) and the BRICS’ New Development Bank.

Source: KPMG China Outlook 2018
China’s global ambitions

Under the “One Belt, One Road” plan, President Xi Jinping is aiming to change the model of global trade and nurture geopolitical ties. The plan promises infrastructure investments that span 70-plus countries across Europe, Asia and Africa.

Forecast investment from China 2017-2021 in billions

Maximum

Minimum

Source: The New York Times
Belt & Road Initiative - Countries

Around 70+ Countries

North Asia
- China
- Mongolia
- South Korea

Central Asia
- Kazakhstan
- Kyrgyzstan
- Tajikistan
- Turkmenistan
- Uzbekistan

Southeast Asia
- Brunei
- Cambodia
- Indonesia
- Laos
- Malaysia
- Myanmar
- Philippines
- Singapore
- Thailand
- Timor-Leste
- Vietnam

South Asia
- Afghanistan
- Bangladesh
- Bhutan
- India
- Maldives
- Nepal
- Pakistan
- Sri Lanka

Middle East
- Bahrain
- Egypt
- Iran
- Iraq
- Israel
- Jordan
- Kuwait
- Lebanon
- Oman
- Palestine
- Qatar
- Saudi Arabia
- Syria
- Turkey
- UAE
- Yemen

Europe
- Albania
- Armenia
- Azerbaijan
- Belarus
- Bosnia and Herzegovina
- Bulgaria
- Croatia
- Czech Republic
- Estonia
- Georgia
- Hungary
- Latvia
- Lithuania
- Macedonia
- Moldova
- Montenegro
- Poland
- Romania
- Russia
- Serbia
- Slovakia
- Slovenia
- Ukraine

65% of the global population
over 1/3 of global GDP

Source: HKTDC & KPMG analysis
ACCA Report: The Belt and Road Initiative- Reshaping the global value chain

Five priorities for cooperation

POLICY COORDINATION
- Promoting intergovernmental cooperation
- Building a multilevel intergovernmental mechanism for macro policy exchange and communication

FINANCIAL INTEGRATION
- Deepening financial cooperation
- Promoting systems for monetary stability system, investment and financing, and credit construction across Asia

CONNECTING INFRASTRUCTURE
- Planning and building connected infrastructure
- Aligning technical standards
- Creating an infrastructure network that connects all sub-regions in Asia, and connects the continents of Asia, Europe and Africa

UNIMPEDED TRADE
- Removing barriers to investment and trade
- Discussing free trade areas with countries and regions along the B&R

PEOPLE-TO-PEOPLE BONDS
- Inheriting and promoting the spirit of friendship and cooperation along the Silk Road
- Carrying out extensive cultural, academic and talent exchanges

Source: ACCA report-The Belt and Road Initiative: Reshaping the global value chain
An online survey was carried out by KPMG in Sri Lanka to assess the awareness level in Sri Lanka about the BRI and to understand if companies have strategies to optimize benefits arising from these investments.

The survey was conducted online during January to March 2018 among senior executives representing Sri Lanka’s top companies. The respondents also represented a wide spectrum of sectors.

Questions related to:

Business and Financial Planning
- Does your organization have plans to scale up capacity to meet any growing demand due to the Belt and Road Initiative? If you agree, do you plan to scale up the production capacity of your organization? When will you consider making changes in the business due to the Belt and Road Initiative as part of your strategy?

People Strategy
- Do you consider that the executives in Finance Function will need new skills, new knowledge and different behavior in the finance function with reference to the Belt and Road Initiative?

Governance Model
- Where in the present governance structure would the Belt and Road Initiative reside with respect to business opportunity?

Risk Management
- Is there a need to develop a risk management mechanism in your organization with reference to the anticipated growth in the business which may arise due to the Belt and Road Initiative?

ESG Matters
- Is your organization taking any steps to ensure that the environment remains protected due to expansion in operations related to the Belt and Road Initiative?
Does your organization have plans to scale up capacity to meet any growing demand due to the Belt and Road Initiative?

If you agree, do you plan to scale up the production capacity of your organization?

When will you consider making changes in the business due to the Belt and Road Initiative as part of your strategy?

Over 50% of the respondents have plans to capitalize from BRI and will consider a strategic change in the next 1-5 years.
How long do you think it will be before businesses in #SriLanka consider the Belt and Road Initiative as part of their strategy?

38% In the next 1 to 5 years
23% In the next 5 to 10 years
31% More than 10 years
8% Won't impact our business
People Strategy

Will executives in finance function require new skills and knowledge in the finance function with reference to the Belt and Road Initiative?

- Strongly Agree: 26%
- Agree: 52%
- Neutral: 22%
- Disagree: 11%
- Other: 6%

Do you consider that the Finance Executives should attend a short course on business, Chinese language and culture?

- Strongly Agree: 18%
- Agree: 48%
- Neutral: 19%
- Disagree: 11%
- Other: 4%

Do you consider that there is a marked difference in personal ethical styles of the people of China and Sri Lanka?

- Strongly Agree: 26%
- Agree: 63%
- Neutral: 11%
- Disagree: 4%
- Other: 6%

Need for additional skills & knowledge was identified by more than 75% of the respondents
#Skills considered required to deal with changes and challenges arising due to the Belt and Road Initiative.

- Communication: 66.7%
- Taxation: 55.6%
- Leadership: 40.7%
- Business Analyst: 44.4%
- Financial Analyst: 33.3%
- Forensic Audit: 33.3%

Sectors covered in the survey:
- Banking & Finance
- Building & Construction
- Logistics & Transport
- Hospitality & Leisure
- Technology & Telecommunication
- Consumer & Retail
Governance Model

Where in the present governance structure would the BRI reside with respect to business opportunity?

- Board of Directors: 48%
- Risk Management: 30%
- Audit Committee: 18%
- Management: 4%
- Other: 3%

Do you agree that owing to changes related to the BRI, there shall be any need to change the governance structure in your organization?

- Strongly Agree: 11%
- Agree: 41%
- Neutral: 41%
- Disagree: 3%
- Other: 4%

What actions could the Board consider?

- Consider the larger market place and competitor position under the 5 year plan and how this can be addressed to maintain and grow market share.
- Review the projects and understand where are the opportunities e.g. through joint venture and alliances.
- Use networks to strengthen and deepen our Chinese networks.
- Ensure that the organization is in a position to comply with local investment, sustainability and employment policies.
- Investigate which Chinese projects have been approved.

Source: KPMG China Outlook 2018
Governance Model

Boardroom discussions

Boardroom Questions

1. What strategy review has our business undertaken to assess the opportunities under China’s 13th 5 Year plan?

2. What is the outlook for our current business in the Chinese economy?

3. How will the ongoing economic transition affect our existing businesses in China: positively and negatively?

4. What does the Belt & Road initiative mean for our companies?

5. Which subsidiaries and alliances do we have along the Belt and Road?

6. How strong and effective are our relationships in China to enable us to win work?

7. In which sectors and regions will provide the greatest opportunities and where are we best placed to take advantage of them? How do we hear of new opportunities?

8. Do we know what the key criteria are for us to win work in China? For example, do we comply on local investment, sustainability, employment?

9. What are the opportunities for co-operation between Chinese companies and us in our home markets, their respective home markets and/or in third countries? Do we have market knowledge?

10. Are there any planned Chinese infrastructure projects with which we can form an alliance?

11. Should we consider moving some of our supply chain along the Belt and Road?
Risk Management

Is there a need to develop a risk management mechanism in your organization with reference to the anticipated growth in the business which may arise due to the BRI?

- Strongly Agree: 31%
- Agree: 42%
- Neutral: 8%
- Disagree: 4%
- Other: 15%

If you agree with this statement, please elaborate on the kind of changes needed.

We are in the Civil Construction Industry. We have to focus on many technical risk aspects such as design, construction etc.

Yes, since the Telecommunication sector needs to absorb the expansion at the same time mitigate the risk of failures in service provisioning and sustaining.

As in any new initiative, with new growth come challenges such as whether the organization has the required resources to leverage from this growth, how does it obtain these resources. Is this growth permanent, are organizational and management changes required to capitalize on this? What are the related risk and what are the opportunities?

On Forex transactions, imports exports risk management need to be developed.
Is your organization taking any steps to ensure that the environment remains protected due to expansion in operations related to the BRI?

If you agree with this statement, please elaborate on the kind of changes needed.

- Strongly Agree: 29%
- Agree: 41%
- Neutral: 15%
- Disagree: 4%
- Strongly Agree: 4%
- Other: 4%

We will need to consider minimum disruption to the environment during service provisioning - cable settling and tower building.

We are about to initiate ISO standards related to waste management & food production which is common in many of our overseas ventures.

The is beyond the scope of most companies with the government having larger party to play in this regard.
If Special Economic Zones (SEZs) are created under the BRI, would your organization consider either expanding into such SEZ or shifting to any such SEZ to obtain benefits related to such schemes?

- Strongly Agree: 4%
- Agree: 7%
- Neutral: 30%
- Disagree: 48%
- Other: 11%

Do you consider that an increasing flow of infrastructure development due to the BRI, goods from China shall pose an increased direct threat to the products manufactured in Sri Lanka?

- Strongly Agree: 22%
- Agree: 8%
- Neutral: 22%
- Disagree: 11%
- Other: 37%
## Chinese Belt & Road investment by country (2005 - 2016)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Investment (US$ Bn)</th>
<th>% of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Russia</td>
<td>28.1</td>
<td>13.7%</td>
</tr>
<tr>
<td>2</td>
<td>Kazakhstan</td>
<td>18.1</td>
<td>8.8%</td>
</tr>
<tr>
<td>3</td>
<td>Malaysia</td>
<td>17.2</td>
<td>8.4%</td>
</tr>
<tr>
<td>4</td>
<td>Singapore</td>
<td>15.3</td>
<td>7.5%</td>
</tr>
<tr>
<td>5</td>
<td>Indonesia</td>
<td>13.4</td>
<td>6.5%</td>
</tr>
<tr>
<td>6</td>
<td>Pakistan</td>
<td>10.7</td>
<td>5.2%</td>
</tr>
<tr>
<td>7</td>
<td>Iraq</td>
<td>9.8</td>
<td>4.8%</td>
</tr>
<tr>
<td>8</td>
<td>India</td>
<td>7.2</td>
<td>3.5%</td>
</tr>
<tr>
<td>9</td>
<td>Israel</td>
<td>6.4</td>
<td>3.1%</td>
</tr>
<tr>
<td>10</td>
<td>Vietnam</td>
<td>6.2</td>
<td>3.1%</td>
</tr>
<tr>
<td>11</td>
<td>Myanmar</td>
<td>5.5</td>
<td>2.7%</td>
</tr>
<tr>
<td>12</td>
<td>Israel (Europe)</td>
<td>5.3</td>
<td>2.6%</td>
</tr>
<tr>
<td>13</td>
<td>Egypt</td>
<td>5.2</td>
<td>2.5%</td>
</tr>
<tr>
<td>14</td>
<td>Iran</td>
<td>4.7</td>
<td>2.3%</td>
</tr>
<tr>
<td>15</td>
<td>Mongolia</td>
<td>4.6</td>
<td>2.2%</td>
</tr>
<tr>
<td>16</td>
<td>Laos</td>
<td>4.4</td>
<td>2.1%</td>
</tr>
<tr>
<td>17</td>
<td>Turkey</td>
<td>4.3</td>
<td>2.1%</td>
</tr>
<tr>
<td>18</td>
<td>Saudi Arabia</td>
<td>3.7</td>
<td>1.8%</td>
</tr>
<tr>
<td>19</td>
<td>Sri Lanka</td>
<td>3.6</td>
<td>1.8%</td>
</tr>
<tr>
<td>20</td>
<td>Hungary</td>
<td>3.6</td>
<td>1.8%</td>
</tr>
</tbody>
</table>

Source: AEI, Minsheng Securities
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The China Desk was established to support Chinese companies in Sri Lanka and to facilitate upcoming Chinese investments. Colombo Port City and Hambantota Port Manufacturing Zone (HPMZ) are major investments for Sri Lanka. KPMG’s China Desk will assist Chinese Investors in all areas to establish their business seamlessly. KPMG will provide access to relevant Ministries, Regulatory bodies, Board of Investment, Taxation, Audit, Payroll, Business Registration, apply for Visas, Real estate and Executive search.

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