ATLANTIS PRESS
Advances in Economics, Business and Management Research, volume 219
Proceedings of the 2022 2nd International Conference on Enterprise Management and Economic Development (ICEMED 2022)

The Risk Management in Belt and Road

Jing Qian

Arts and Social Sciences School, The University of Sydney, Australia
jqia8182@uni.sydney.edu.au

ABSTRACT

Due to the differences between the economic, political and cultural conditions of different countries, along with the Belt and Road (B&R), the risks encountered by enterprises in cross-border economic activities under the B&R framework may have a significant impact on enterprises. Therefore, it is necessary to manage these risks. Under the B&R framework, this paper analyzes the risks that enterprises may encounter in cross-border economic activities, and provides suggestions for enterprises in risk management.

Keywords: *The belt and road, risk, risk management, B&R framework*

1. INTRODUCTION

The emergence of "the Silk Road Economic Belt and the 21st century Maritime Silk Road" is the result of the joint action of internal and external factors. Internally, the growth rate of China's economy has changed from high speed to medium-high speed. The economic structure needs to be optimized and upgraded. First of all, since the reform and opening-up, China's productivity has changed from a serious shortage to the current overcapacity. China's domestic large-scale infrastructure is perfect. While the traditional export model is single, the market potential is relatively small, and the problem of overcapacity cannot be solved, all of these seriously hinders the further development of China's economy. The strategy of "Belt and Road" is conducive to opening up new export markets. Through capital export, we can solve the problem of domestic capital surplus and drive the consumption of domestic excess capacity. Secondly, China's oil, gas and mineral resources are heavily dependent on foreign countries. These resources enter China through maritime transport channels, which is single. Nowadays with the change of the international situation, the risk increases. The "Belt and Road" strategy has strengthened the cooperation of resources between China and the countries along the line and increased the acquisition of resources. Finally, most of the industrial infrastructure is concentrated in coastal areas. The central and western regions have excellent development potential. Even in the event of war, they are more threatened than coastal areas [1].

From the perspective of external reasons, the disadvantages of economic globalization are becoming more and more apparent. To be specific, the first advantage is about the dominant model. As several large capitalist developed countries have been dominating its model, most developing countries and countries with different social systems from the West have failed to participate in the operation of economic globalization under the common leadership. The second advantage is about the path. Protectionism and egoism have always existed in some countries [2].

Therefore, in order to solve the problems in economic globalization, China has put forward the strategy of "the Silk Road Economic Belt and the 21st century Maritime Silk Road". People share the same view on the risks faced by enterprises in cross-border economic activities along the Belt and Road, and there is growing concern about the Belt and Road. This paper analyzes the risks that enterprises may face in cross-border economic activities through the framework of the Belt and Road and provides solutions for practice.

2. RISK AND RISK MANAGEMENT

2.1 Risk

Before the discovery of the black swan in Australia, Europeans in the 17th century believed that swans were white. However, with the appearance of the first black swan, this unshakable view collapsed. Hence, the term "black swan" refers to a major, unforeseen and rare event. For example, Titanic in 1912, 9•11 event, the Brexit, COVID-19, and the recent Russian Ukraine war, all can be called the "Black Swans" [3]. Black Swan means unknown and uncertainty, while strangeness and

Copyright © 2022 The Authors. Published by Atlantis Press International B.V.
This is an open access article distributed under the CC BY-NC 4.0 license -http://creativecommons.org/licenses/by-nc/4.0/.

uncertainty imply risk. Different disciplines have different definitions of risk. Some disciplines see this as a lost opportunity. Risk is the possibility and probability of loss under certain conditions. Some disciplines believe that the uncertainty of loss can be divided into objective and subjective. Objective uncertainty can be measured by tools, while regulators are individuals' assessment of objective risks, which cannot be measured. Some disciplines define risk as to the difference between actual and expected results. In the financial field, this definition is borrowed. Risk is also defined as the difference between actual and expected returns in financial terms.

2.2 Risk management

Risk itself is a neutral word, neither good nor bad. Companies have to take risks in order to stay in business. Therefore, for companies correctly identifying and dealing with risks can become the source of profits. Traditionally, successful companies must bear the risks required to achieve their goals and avoid the risks that prevent them from achieving its goals. In order to become a successful company, it requires the company to manage risks rather than avoid risks (sometimes the profits of the company can be significantly reduced by avoiding risks) [4].

Risk management is the behavior of optimizing the risks generated by the company or organization's projects. Risk management has only one goal: to maximize the interests of shareholders. The evolution of risk management can be roughly divided into three main stages.

The first stage is the advent of risk management. Before 2000, the emergence of dice meant opportunities and risks. In the 18th century, insurance companies began to emerge and modern risk management emerged in 1955.

The second stage is the early development stage of risk management. Before 1970, scholars generally believed that risks were unfavorable for enterprises and should be avoided. However, with the development of quantitative evaluation and other fields, people have begun to realize the importance of risk management and separate risk management from market insurance. Therefore, the concept of financial risk management came into being [5].

The third stage is the rapid development stage of risk management. The emergence of stocks and derivatives has promoted the rapid development of risk management.

The method or process of risk management can be summarized into four steps: identifying risks, predicting the possibility of risks, evaluating the possible impact of risks on relevant projects and taking corresponding measures to deal with risks [6].

3. RISK OF CROSS-BORDER COOPERATION BASED ON B&R

3.1 Introduction about the belt and road

In September and October 2013, Chairman Xi Jinping of China jointly proposed the construction of "the Silk Road Economic Belt and the 21st-century Maritime Silk Road ("The Belt and Road" for short, abbreviated as B&R)" with other countries during his visits to Kazakhstan and India.

The goal of B&R is, within the framework of the international cooperation of the Belt and Road Initiative, all parties adhere to the principle of extensive consultation, joint construction, and sharing, and jointly respond to the challenges of the world economy. B&R's cooperation content is policy communication, facility connection, smooth trade, capital financing and integration of people.

According to the public data from China's National Bureau of Statistics, China's trade volume with countries along the B&R line increased from 25% in 2013 to 27.4% in 2018. In addition, China's direct investment in B&R countries has been on the rise. From 2013 to 2016, M&A (mergers and acquisitions) transactions in B&R countries reached US $6.3 billion, which had a positive impact on cross-border M&A in transportation, mining, and energy industries [7]. Based on the B&R framework, enterprises' cross-border cooperation activities are increasing year by year. Therefore, enterprises need to manage the risk of cross-border activities.

3.2 Risks and related cases of enterprises in cross-border activities

There are many methods to classify risks in academia. Based on the B&R framework, this paper divides the risks that enterprises may encounter in cross-border activities into two categories: direct risks and indirect risks.

3.2.1 Indirect risk

Indirect risk refers to the factors that indirectly affect the difference between the actual income and expected income of an enterprise. Political risk is a kind of indirect risk. It refers to the uncertainty brought by the changes in the political environment of the host country or the political relations between the host country and other countries to the economic interests of foreign-invested enterprises, such as the correct replacement of the host country, war, social unrest and violent conflict in the host country, and the deterioration of the relationship between the host country and a third country. This risk is a critical factor in cross-border economic activities, and whether the predetermined goal of the enterprise can be achieved on schedule. In addition, it is difficult to adopt indirect risk through risk management [8].

A typical case of political risk is the port of Darwin, Australia. In mid-2021, after tearing up the B&R agreement between China and Australia, Australia terminated the 99-year lease contract of Darwin port signed with China. Darwin port is located in the northwest coast of Australia. It is Australia's nearest port to Asia. As the port often encounters natural disasters such as tornadoes and thunderstorms, the nearby coastal buildings have been seriously damaged, so the economic benefits of the port have been poor. Ten years ago, Australia planned to spend money to repair Darwin port, but failed. In 2015, Australia signed an agreement with China Landbridge group to lease Darwin port for 99 years at a price of 506 million Australian dollars. As China's capital investment and construction, the economic benefits of Darwin have gradually improved, and its importance in Australia has gradually increased. By 2019, the annual revenue of Darwin port has quadrupled However, by the Australian Ministry of defense reviewed this win-win cooperation in mid-2021 in mid-2021. This review is behind the game between China and the United States.

The second step in risk management is to evaluate the risk, while political risks are usually assessed by using quantitative methods. The use of quantitative methods to assess political risks is generally divided into five categories: "rank ordering approach", "the decision tree approach", "multiple region analysis", "discriminatory analysis", and the "integrated approach" [9]. Of course, a framework for assessing political risks can also be established. However, this paper argues that managing political risk is challenging. Nevertheless, enterprises can see the policy environment of the countries along the line on the official website of B&R. One reason may be that political risks may appear and disappear for a short time, and they disappear before they can be identified. There are many countries along the B&R route, and their development levels are different. Some of these countries have important strategic positions and rich energy resources. They are hot spots in the game of great powers. Their unstable domestic political order machine and frequent ethnic and religious conflicts exacerbate the risk of cross-border economic activities with these enterprises.

3.2.2 Direct risk

Direct risks refer to the factors that directly affect the difference between the actual income and expected income of an enterprise, which can be seen intuitively through figures. Exchange rate risk is a kind of direct risk.

Exchange rate risk refers to the increase or decrease in the value of assets (or creditor's rights) and liabilities (or liabilities) denominated in foreign currency during a certain period of cross-border economic activities, which affects the difference between the actual income and expected income of the enterprise. Due to political risks, countries' exchange rates and B&R line are usually more volatile than mainstream currencies (such as the US dollar and Euro). The large fluctuation of exchange rate indicates that the exchange rate risk of countries along with the B&R line is very high [10], which require enterprises to strengthen exchange rate risk management in cross-border economic activities with enterprises in countries along the B&R line under the framework.

Therefore, under the B&R framework, how do enterprises manage exchange rate risk when conducting cross-border economic activities? There are three types of cross-border economic activities of enterprises. The first category of country may be rich in resources, superior geographical location, stable political environment, relatively developed economy, and the currency value of the country's currency is relatively stable. The second category is the country that has rich natural resources or essential geographical location, but due to various reasons, the political situation is unstable, resulting in the country's underdeveloped economy and significant currency fluctuations. The third category is the countries that have neither rich natural resources nor critical geographical location, unstable political situation and backward economic development.

When enterprises conduct cross-border economic activities in the first type of countries or regions, they can use natural hedging to hedge exchange rate risk. This method determines the economic growth and currency trend of a region, borrows devalued currencies for financing, and invests in assets with currency appreciation. This simple operation can obtain value-added income denominated in local currency and obtain additional benefits. However, using this method requires enterprises to strategically judge the medium and long-term trends of exchange rate, as well as macroeconomic and international financial knowledge. Therefore, higher requirements are put forward for enterprises adopting this method.

When conducting cross-border economic activities in the second type of countries or regions, in addition to the above natural hedging methods, enterprises can also choose the currencies of the first type of countries to hedge exchange rate risk through commercial terms such as US dollars, euros and RMB. Based on the B&R framework, RMB is a good choice. The role of RMB in the countries along the B&R exceeds that of non-B&R countries [11].

For a variety of reasons, enterprises must carry out cross-border economic activities in the third type of countries or regions. People, which are participated risk management in enterprise, should be aware of the political risks in that region. Furthermore, they should withdraw their capital immediately and stop losing money in time in stormy conditions.

In addition, enterprises can also use different financial instruments to hedge exchange rate risk. The key to

hedging exchange rate risk is to lock in the risk of exchange rate fluctuations [12].

Furthermore, direct risks include tax and project delays. In cross-border economic activities, enterprises may fail to complete the project for various reasons, and project delay will also affect the difference between the expected income and the actual income of the enterprise. When calculating the expected income, the enterprise may not consider the tax policy of the place where the economic activities are located. For example, profits in the region need to be taxed. This will also give an impression of the difference between the expected income and the actual income of the enterprise.

4. CONCLUSION

Direct risk and indirect risk are interrelated. Although it is difficult to control indirect risks through enterprise risk management, if multiple parties cooperate, they can also manage indirect risks and reduce direct risks.

For enterprises, first of all, they should formulate scientific and reasonable competitive strategies, so as to formulate an appropriate expected income target. Secondly, enterprises should strengthen cooperation with the government and other departments to improve their risk management ability. The government can provide valuable information, data and materials for enterprise risk identification and risk assessment, and provide basis for enterprise risk management.

For financial institutions, they should strengthen cooperation, develop relevant financial instruments, encourage enterprises to use financial instruments to hedge risks and reduce the cost of enterprises in cross-border economic activities.

Under the B&R framework, the government takes the lead in establishing industry chambers of Commerce to share information, benefits, and risks of the industry to provide information and resources for enterprises in specific cross-border economic activities. Furthermore, the local governments and enterprises should formulate and improve relevant economic policies. For example, governments can formulate relevant preferential policies and provide certain financial subsidies for enterprises.

Taken together, based on the B&R framework, enterprises need to manage possible risks when conducting cross-border economic activities. When an enterprise carries out risk management, all participants shall provide necessary support and help.

REFERENCES

[1] Johnston, Lauren A. 2018. "The Belt And Road Initiative: What Is In It For China?". Asia &Amp; The Pacific Policy Studies 6 (1): 40-58. doi:10.1002/app5.265.

[2] Johnston, Lauren A. 2018. "The Belt And Road Initiative: What Is In It For China?". Asia &Amp; The Pacific Policy Studies 6 (1): 40-58. doi:10.1002/app5.265.

[3] Taleb, Nassim Nicholas, and David Chandler. 2007. The Black Swan. Prince Frederick, MD: Recorded Books.

[4] Khour, Nabil. 2009. "Financial Risk Management: Introduction". Canadian Journal Of Administrative Sciences / Revue Canadienne Des Sciences De L'administration 16 (3): 171-171. doi:10.1111/j.1936-4490.1999.tb00192.x.

[5] Al-Thani, Faisal F, and Tony Merna. 2013. Corporate Risk Management. Hoboken, N.J.: Wiley.

[6] Dionne, Georges. 2013. "Risk Management: History, Definition, And Critique". Risk Management And Insurance Review 16 (2): 147-166. doi:10.1111/rmir.12016.

[7] Zhang, Chi, Ivan Kandilov, and Mark Walker. 2021. "Belt And Road Initiative And Chinese Cross‐Border Mergers And Acquisitions". The World Economy. doi:10.1111/twec.13233.

[8] Fight, Andrew. 2004. Understanding International Bank Risk. Chichester: Wiley.

[9] Leavy, Brian. 1984. "Assessing Country Risk For Foreign Investment Decisions". Long Range Planning 17 (3): 141-150. doi:10.1016/0024-6301(84)90017-7.

[10] Cui, Yixi, Zixin Liu, Ziran Li, Kun Guo, and Yishan Sun. 2020. "Research On Multiscale Features And Integrated Forecasting Of The Belt And Road Exchange Rate Index". Concurrency And Computation: Practice And Experience 33 (6). doi:10.1002/cpe.6053.

[11] Cai, Wanlin. 2020. "Determinants Of The Renminbi Anchor Effect: From The Perspective Of The Belt And Road Initiative". International Journal Of Finance &Amp; Economics. doi:10.1002/ijfe.2328.

[12] Weithers, Tim. 2011. Foreign Exchange. Hoboken: John Wiley & Sons, Inc.