



GSA China workshop

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Climate Change Capital[®] 

Chinese Financial Infrastructure

Banking

■ Supervisory Bodies:

Peoples Bank of China – China’s central bank

China Banking Regulatory Commission

■ Banks

▶ Big six state-owned/state-holding commercial banks

- The Industrial and Commercial Bank of China (ICBC),
- the Agricultural Development Bank of China (ADBC),
- the Bank of China (BOC),
- the China Construction Bank (CCB),
- the Bank of Communications (BOCOM), and
- the China Development Bank (CDB).

■ Policy Banks.- Established to take over government-direct spending functions – CDB and ADBC

■ Second tier Commercial Banks – smaller commercial banks – generally healthier in terms of asset quality and profitability. They have much lower non-performing loan ratios than the big six.

■ As part of Chinas economic stimulus package of November 2008, the government plans to remove loan quotas and ceilings for all lenders, and increase bank credit for priority projects, including rural areas, small businesses and technology companies.

Chinese Financial Infrastructure

Trusts and investments corporations

- Financial institution, combining characteristics from the private equity, asset management and banking sectors – until recently closed to foreign investors.
- China's trust industry has been something of a weak link in the financial sector. The trust sector is still small compared to other areas of the finance industry with assets entrusted of approximately RMB 600billion as of September 2007.
- Expected to become a more significant funding channel for other institutions as well as a force in China's booming wealth management industry.

Stock Exchanges

- Established in 1990 China's stock market today has capital approaching RMB 3,705.6 billion, 1,377 listed companies and 72.16 million investors.
- The creation of this market has promoted the reform of government-owned corporations and the change of their systems, enabling a stable transition towards a market economy.
- The change has stimulated medium and small-sized state-owned enterprises to adopt the shareholding system during the transition from planned to a market economy.

Chinese industry – Iron, steel and cement

I&S

- About 75% of the CO2 emissions from the steel industry are related to the combustion of coal in primary integrated steel mills.
- Efficiency of iron and steel plants is closely linked to the technology used in the facility, the size of the plant and the quality of raw materials.
- In 2007 state-owned enterprises dominate the output of crude steel and pig iron with the share of 60% and 55% respectively
- Examination of the top ten private steel producers in China reveals that many of these producers are substantially owned and controlled by the Chinese government and/or are subject to substantial government intervention.
- For those big iron and steel companies in China debt financing through local banks are the most popular way to satisfy their investment requirement. Foreign capital is used if the partners can provide up/downstream business, raw materials, advanced technologies, management experiences, etc.

Cement

- The Chinese government has mandated the elimination of 250 million tons of outdated cement production capacity by 2010. Accelerating industry consolidation and creating stronger companies to take up a larger market share.
- Restricted by access to capital, medium and small enterprises find it difficult to expand, providing the opportunity for large enterprises to merge and acquire them.
- Mergers and acquisitions in the cement industry have become a recurrent transaction in China since 2006.
- Integration of the cement industry will continue to be promoted. Currently the output of the 12 biggest cement companies accounts for 25% of the national output.

Financing Energy Efficiency in China

- Improving energy efficiency holds one of the keys to sustaining China's economic growth with reduced energy needs and lessened local and global environmental impacts.
- Its energy-intensive manufacturing industries, accounting for about 50 percent of total final energy consumption, operate at significantly higher levels of energy intensity than international best practices.
- China has stepped up its efforts to improve energy efficiency. In November 2004, the National Development and Reform Commission (NDRC) issued the nation's first Medium and Long Term Energy Conservation Plan (2005 to 2010 and 2020), highlighting 10 energy conservation programmes targeting the country's major energy-consuming sectors.
- China has pledged to reduce the energy intensity of GDP by 20 percent from 2005 to 2010
- Estimated energy conservation investments needed to achieve the 20 percent energy efficiency target surpass US\$50 billion— most of it in industrial sectors.
- Nevertheless, there continues to be a heavy bias toward energy-intensive expansion-oriented investments in the industrial sector

Financing Energy Efficiency in China

- Debt Financing
 - ▶ Debt financing can be a challenge, particularly for smaller enterprises. In response to this lack of financing, the IFC/GEF China Utility-based Energy Efficiency Finance Program (CHUEE) was established
 - ▶ Three key barriers that have impeded the development of the lending market (debt financing) for medium and large-sized industrial energy efficiency investments
 1. Highly technical and unfamiliarity with this type of investment
 2. Difficult to assess the positive cash flow c.
 3. Insufficient institutional capacity, especially at the national level, to address the pressing needs of scaling up energy efficiency investments.

Financing Energy Efficiency in China

- Energy Saving Companies (ESCO) financing
 - ▶ Energy Saving Companies (ESCO) financing.- ESCOs cooperate with technical institutes, technology experts and financiers with implementation/execution capacity to form a special purpose entity focused on energy savings.
 - ▶ Currently the main lines of business for ESCO's in China have been:
 1. Boiler improvement – installation of new and more efficient boilers.
 2. Waste heat recovery – many more companies operating in this space although they have a lack of capital
 3. Building and energy efficiency – this is a difficult and very competitive market
 - ▶ Key Barriers for ESCOs in China
 1. Access to Capital.- Local commercial banks do not understand the ESCO business model and are not prepared to lend against future cash flows, preferring asset based collateralisation.
 2. Policy Barriers.- There are still policies to be finalised and set in place to support ESCO businesses (e.g. unresolved tax issues with service fee arrangements).
 3. Contract enforceability.- enforceability of the service agreements and the reliability of counterparties. A culture of renegotiation raises serious risks for ESCO companies.
 4. Standards for the industry have not been established by related authorities.

Private Equity in China

- Over the past five years, China's private equity market has been the fastest-growing in the world.
- Private equity investors normally lend a lot of expertise to the companies they invest in. They often assist the company in improving its operations, strategy, marketing and financial management.
- Private equity investments in China generally take the form of minority growth capital or pre-IPO investments in businesses where the Chinese founders or management have controlling or significant stakes.
- The renewable sector has had an excellent development so far in China. The government has provided the correct environment for it:
 - ▶ Solid policy framework – targets
 - ▶ Renewable energy law – basic principles and the obligation to purchase power from renewable sources
 - ▶ Incentives – feed-in-tariffs
 - ▶ Implementing programmes

Foreign Investment

- Private equity firms can find significant barriers to enter the Chinese market
 - ▶ Lengthy government approval process for major transactions has in the past stalled or frustrated many.
 - ▶ Inability to obtain majority ownership in any reasonably-sized, state-owned company
 - ▶ Lack of debt financing to leverage equity investments has forced a departure from time tested investment models that generate outsized returns based on the availability of cheap debt.
 - ▶ Exit strategies – it is not easy for private investment to get out.

- Loans tend to benefit big state-owned or stock-holding companies (e.g. I&S sector).

Final Considerations

- The financial package to deploy and diffuse specific energy efficient technology will depend on the structure and strategies of particular businesses in a given sector.
- Sectoral approaches will only drive investment if targets are ambitious and allow for adequate incentives and rents.
- The financial tools already exist. It is the right environment and clearly designed incentives that will attract investment into specific sectors
- A financial package to diffuse technologies will vary from transaction to transaction, yet access to different tools inline with business/industries needs is essential to allow investment flows and diffusion of technology.
- If international guarantees or concessional loans are to leverage private investment, access to this financial tools must be simple, effective and accessible to entities implementing projects.
- Concessional loans can help pay for the incremental cost of cleaner technology. Yet, this will not always be sufficient, access to all tools is essential, including a strong carbon price signal.

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