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The CCCI-Aecon Deal: An Integral Part of China's National Strategy

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Introduction

Canada's national debate on the proposed takeover of Aecon Group by CCCC International Holdings Limited (CCCI) can be centered on a simple but fundamental question: Is this takeover of Aecon by CCCI, the international investment arm of the Chinese state-owned enterprise (SOE) conglomerate CCCC, an everyday firm-to-firm acquisition? A negative answer should lead to our government's disapproval of the deal.

My answer to this question is an absolute NO. I believe that the CCCI-Aecon deal is not a plain commercial case but an integral part of China's national strategy. My explanation will focus on three straightforward points:

1. First, who is CCCC and CCCI?
2. Second, what is China's national strategy for its SOEs?
3. And finally, how does the CCCI-Aecon deal fit into China's national strategy?

1. Who is CCCC and CCCI?[1]

CCCC, the parent company of CCCI, stands for China Communications Construction Company Limited. CCCC was incorporated in 2006, resulting from the 2005 merger between China Road and Bridge Corporation (CRBC) and China Harbour Engineering Company (CHEC). CRBC was originated from the foreign aid office set up in the 1950s within China's then transportation department, and CHEC was established in 1980 as one of the only five SOEs authorized at the time for doing business overseas. Despite the merger, CCCC has kept both CRBC and CHEC as independent subsidiaries for their "matured" international platforms.

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CCCC soon took over Shanghai Zhenhua Port Machinery Company (ZPMC), another SOE that specializes in manufacturing cranes and large steel structures. Notably, in 2010, ZPMC acquired the Houston-based Fried & Goldman, a leader and innovator in offshore rig design, to help enhance CCCC's early stage design capabilities and expand its business into manufacturing offshore drilling equipment (Marine Log 2010).

Also in 2010, CCCC absorbed the National Real Estate Development Corporation Group, another SOE (founded in 1981), to become one of *only* 16 central SOEs that were allowed to stay in the real estate industry. Central SOEs are those state-owned enterprises that fall under the direct control of SASAC (State-owned Assets Supervision and Administration Commission of the State Council). CCCC further expanded its real estate business through share acquisition of a major domestic private developer.

"CCCC seeks to attain global superiority by acquiring the top foreign brands, cutting-edge technologies and human capital.... [with its] foreign acquisitions backed by government financing."

In 2012, CCCC created CCCI in Hong Kong (CCCC International Holding Limited), with a registered capital of US $500 million, as conduit for its overseas business, including cross-border mergers and acquisitions, real estate development, and various financial operations. CCCI was first assumed full control of F&G through internal restructuring and then acquired the Australia firm John Holland in 2015 as its second sole subsidiary; it wants to do the same to Aecon.

With such government funded merges and acquisitions, CCCC's total assets exploded from 79 billion yuan in 2005 to 850 billion yuan in 2017, an almost ten-fold increase within 14 years! CCCC entered Fortune Global 500 in 2008 and has since upped its ranking from 426th to 110th by 2017, with its total revenue having reached $61.9 billion in 2016. CCCC can now boast of being the world's number one engineering and construction company in port construction, highway and bridge design and construction, dredging, container crane manufacturing, and offshore drilling platform design.

Over the past decade, CCCC built the Malta dry dock, the China-Pakistan economic corridor infrastructure, Sri Lanka port city, Mongolian-China railroad, and infrastructure for air and naval bases on disputed islands in the South China Sea, where China has recently installed military jamming equipment. Surprisingly, CCCC openly prides itself for its island building in the South China Sea and seems eager to promote island building as its niche business.

In summary, CCCC is massive and well-resourced, mainly through domestic mergers among its SOE siblings and selective acquisitions of foreign private entities. CCCC seeks to attain global superiority by acquiring the top foreign brands, cutting-edge technologies and human capital. One of its ambitions is to become the top international company in ocean construction, ranging from island building to exploiting seabed resources. And, as indicated above and further explained below, CCCC's foreign acquisitions have been backed by government financing.

2. What is China's national strategy for its SOEs?

China started its SOE reform in earnest in the early 1990s, initially to improve the sector's efficiency with a two-fold approach. The first was breaking up the monopoly of some major SOEs to facilitate intra-industry competition; a good example being the break up of the State Power Company, which employed 2 million employees and controlled both nationwide power generation and distribution. The second was unloading those SOEs that were either extremely inefficient or non-essential (or both) by liquidating them or selling them at a frequently token price. During this process, millions of SOE employees were let go without adequate compensation, and the state assets "shrank" in alarming speed.

In 2003, the government founded SASAC (State-owned Assets Supervision and Administration Commission of the State Council), with a clear goal of preserving and growing the state capital. SASAC has since been on mission to recreate super SOEs through shuffling state capital and restructuring (mainly merging) its SOEs. The table below shows the results.

From 2003 to 2017, the number of central SOEs has been halved from 196 to 98, and the number of such SOEs entered the Fortune Global 500 increased from 6 to 48. Their total assets also grew by more than 700 percent from 8.8 trillion to 75 trillion yuan. Note that China's GDP grew only by 400 percent over the same period. Not to mention that the SOEs' profitability as a whole has been notoriously low while its debt-to-assets ratio equally high. As shown in the table, the higher the growth speed associated with an SOE group, the higher is the group's debt-to-assets ratio. In contrast, the debt-to-assets ratio for the private sector dropped over the same period and is much lower than that of any SOE groups. It is no secret that state-owned banks are the main lenders to SOEs.

	2003	2017	Change*
Number of Central SOEs	196	98	- 50%
No. of those entered Fortune Global 500	6	48	+ 700%
Total assets of SOEs - Nationwide:	19.7 trillion yuan (d/a ratio: 59%)***	151.7 trillion yuan (d/a ratio: 65.7%)*	+ 570%
- Central SOEs	8.8 trillion yuan (d/a ratio: 57%)	75.1 Trillion yuan (d/a ratio: 68.0%)*	+718%
- CCCC	79 billion yuan (2005) (d/a ratio: 84.3%)*	850.2 billion yuan (d/a ratio: 75.8%)*	+976%
Reference:			
- China's GDP	13.7 trillion yuan	82.7 trillion yuan	+ 402%
- Private sector d/a ratio	60%**	51%** (2015)	- 15%
- Return on assets: SOEs vs. private sector	2% vs. 6% (for industrial firms only)	2.9% vs. 10.2% (2016)	NA

Sources:
Various official publications in Chinese and CCCC's financial reports
** Author's estimate.*
***Wang Tao 2018, Figure 8.*
d/a ratio = debt to assets ratio.

In other words, the growth of China's SOEs, particularly the central SOEs, exceeded that of the overall economy. Given the infamous low profitability of SOE sector (with its overall return on assets below 3 percent in 2016 vs. over 10 percent for non-SOEs), it is obvious that the rapid growth of the SOEs is funded by the Chinese government, through both direct appropriation and state-bank lending. SOEs form an integral part of China's national strategy for global expansion; that is a major reason why China has created monstrous SOEs through internal mergers in the first place.

For example, in its 2015 guidelines on deepening SOE reform (Central Committee of the Communist Party of China; State Council 2015), the government states that its SOEs had been largely integrated into the market economy. In addition, most central SOEs have emerged as backbone SOEs that are powerful and influential in both domestic and international markets, thanks to their "core competiveness." This clearly reveals that China has been intentionally using SOEs as its agents to compete in the global market and to take advantage of its open and free system.

Unfortunately, efficiency concerns and the lack of innovation continue to plague China's SOEs. Against this backdrop, alongside the 2015 guidelines, the government also promulgated "Made in China 2025." This is the first of China's three 10-year Actions Plans to make China a global manufacturing power house and to obtain controlling shares of the global production chains. In the State Council's Notice on issuing this document, the most relevant to the CCCI-Aecon deal is the government's call for "exploring how to utilize the industrial funds, state capital, and other channels to support our high-speed rail, power equipment, automobiles, engineering and construction, and advanced industrial capacity to go global and to conduct overseas investment and mergers and acquisitions" (State Council of the People's Republic of China 2015).

3. How does the CCCI-Aecon deal fit in China's national strategy?

In its December 2017 official report (SASAC 2017), the SASAC summarized CCCC's most distinctive strength as "being always on the same page of the national strategy while mastering the industrial and market trend."

The same report quoted CCCC's board chairman, Mr. Liu Qitao, that "CCCC has set its mission as the investor of the state capital." He emphasizes that the CCCC headquarters should provide a solid financial platform so as to be always ready (financially) whenever the acquisition target appears. In this regard, the CCCI-Aecon deal is the implementation of CCCC's mission as the investor of state capital. Like all other Chinese SOEs in their overseas acquisitions, CCCC is not aiming for profit but rather market share for its international influence, particularly in developed countries.

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But how does CCCC make these deals? Mr. Liu said candidly, "Entering the market of developed countries shouldn't start from ground zero." What they have done is "to keep an eye on the top five companies in the targeted country, patiently waiting for the buying opportunity." As soon as the target appeared on their radar screen, they made the offer immediately. This was how CCCC took over Houston-based Fried and Goldman and Australia's John Holland. And it's how it's trying to acquire Aecon now.

In Mr. Liu's words, acquiring John Holland realized CCCC's plan to enter Australia's high-end market; acquiring Brazil's Concremat allowed CCCC to break into the tightly sealed South American market; and transforming Houston-based Fried & Goldman through capital infusion (and further acquiring Aecon) helps enhance CCCC's ability to structure its business in the North American high-end market. Obviously, CCCC sees acquiring Aecon as a critical move on its international chessboard: Aecon's technical specialty would help expand CCCC's business scope and acquiring Aecon would enable CCCC to acquire similar western firms.

Of course, as a commercial strategy, nothing is wrong with what Mr. Liu had said. The question here is who in our free market economy can afford such a grand strategy without the backing of state capital? China's dominant force in exercising such a strategy has created an unfair game in our free market system.

In Mr. Liu's words: "We are already the first-class international contractor. What we are doing now is not fighting for scale, but for supply chain and even more for soft power such as human capital, science and technology, and management and control." Does this sound like a commercial statement or a political one? Keep in mind that Mr. Liu the board chairman of CCCC is also the party secretary of CCCC – an official position in every corner of China that commends everyone else and sees through the implementation of the national strategy set by the party.

Conclusion

China has a clear national strategy to dominate the world, which is the core of its so-called "China Dream." Despite our genuine hope and accommodation for its peaceful rise, China has seen the western world as a rival and even a hostile one. Its SOEs including CCCC have seen their global expansion as a success in their "dance with the wolf" (to use Mr. Liu's original working) since China joined the World Trade Organization in 2001. The danger lies in our laziness in strategic thinking and refusal to take a long-term view.

We could harm ourselves if we insist on opening our doors widely to a state who does not believe in private property rights and the free market system. China is using its SOEs, in the disguise of commercial entities, to tear our system apart by acquiring our top-brand companies one by one. That is not something that we should calmly accept.

About the Author

Duanjie Chen, an independent scholar with a PhD in economics, is a Munk Senior Fellow at the Macdonald-Laurier Institute. Previously, she was a Research Fellow at the School of Policy Studies, University of Calgary and Research Associate and Associate Director with the International Tax Program at the Rotman School of Management, University of Toronto. For nearly three decades, she served as a consultant to various international organizations, national government bodies, and business and non-profit organizations. She has published extensively in the area of public finance.

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Endnotes

1. The details about CCCC presented in section 1 (Who is CCCC and CCCI?) are largely drawn from the December 2017 issue of the SASAC Report (see SASAC 2017).

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