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<table>
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<tr>
<th>Title</th>
<th>China real estate industry transformation: how to succeed in “silver age”</th>
</tr>
</thead>
<tbody>
<tr>
<td>Author(s)</td>
<td>Huang, Kai (黃凱); Guo, Jia (郭家); Yuan, Yujing (袁玉京); Zhang, Yue (張越); Yan, Li (嚴莉)</td>
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EF4491 Real Estate Economics and Finance

Group Project Report
Semester B 2017/18

China Real Estate Industry Transformation
- How to Succeed in “Silver Age”

HUANG Kai
GUO Jia
YUAN Yujing
ZHANG Yue
YAN Li
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New Business model

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1. Introduction

In the past 10 years, because of the rapid growth of China economy, population dividend and urbanization, China real estate market grew rapidly with an annual increase of 26% and the overall market size enlarged 16 times. However, the world has changed. Real estate industry started its “Silver Age” and housing companies are facing more challenges. It is important to understand and rethink the business model of real estate companies and transform it when necessary.

1.1 Background Research

Macroeconomic outlook

From 2000 to 2011, with the background of the high economic growth rate with over 10% growth rate of GDP in China every year. However, from 2012, on the demand side, the growth rate of China economic reached its peak and started to decline. In the future, China economic will develop in a slower and more stable way. On the supply side, housing development area per capita in China is close to the level of developed countries and the space for future development and rising is relatively limited.

As a result, a considerable number of housing enterprises are affected by the slowdown of macroeconomic growth and facing the pressures of falling trading volume and profitability as well as high stock levels.

Government Policy

China real estate market demonstrates 3-year or 6-year market cycle and Chinese government apply countercyclical policy in order to stabilize real estate market. When the real estate market heats up, there will be a corresponding tightening policy introduced; while price of housing market is low, there will be a rescue policy introduced.

In terms of first-tier and second-tier cities in China, in order to curb overheated real estate market, government has imposed a series of policies. One of them is to limit households from purchasing. The other is to raise the threshold of real estate enterprises to bid for land. The
requirement of size, scale and past experience becomes higher and higher. At the same time, property, which is not available for sale but only for rent, appeared and increased in the market. Gaining land becomes more expensive and difficult.

As a result, more and more large and medium-sized housing enterprises have begun to increase their land reserves and activate inventory stocks through acquisition of SMEs.

**Social and demographic**

The demographic dividend gradually recedes. In the future 10 years, the natural growth rate of country’s population will fall to a lower level at 0.45% (Ke, Ping, & Ge, 2012).

The growth rate of urbanization will slow down. In the past 10 years, the annual growth rate of urbanization is in the high level of 1.4%. In the coming 10 years, the urbanization growth rate is estimated to be 0.9% taking the urbanization process of developed countries such as America, Japan and Korean as reference. It is estimated that by 2020, the urbanization rate in China will reach or approach to 60% and the urbanization process will enter the end phase.

As a result, the rigid demand for housing from new urban population reached its peak in 2013 at 55,442 (10,000 people, square meters, 10,000 square meters) and declined year by year. It is estimated that rigid demand is 39,849 and 36,409 in 2018 and 2019 respectively (Ke, Ping, & Ge, 2012).

**China is now on the way to an aging society.** By the end of 2015, the number of people aged 60 and over reached 220 million, accounting for 16.1% of the total population. It is expected to exceed 25% by 2030. At the same time, the increase in life expectancy per capita and the veteran will also increase the demand of retirement property and Health related facilities and medical services

In addition, the customer demand also continues to change. With the increasing pursuit of quality of life, people have following expectations:

- Various and complete types of facilities such as adequate parking space, pleasant greening, etc.

- School district housing or other complementarity quality education resources
1.2. Current situation analysis

**Supply analysis**

From supply side, the cost land becomes higher and government improve the requirement of bidding for land.

**Demand analysis**

From the demand side, the potential market for new houses starts to reduce and the market about property management services increases. The driver of growth changes from incremental expansion into stock optimization. The sales area of commercial and residential building in china is only increased 6.5% in 2015 (compared 15% in the past three years). The increasing rate of new houses decrease. The newly-started development area decreased by 14% in 2015. In addition, in the first-tier cities in china such as Beijing, Shanghai and Shenzhen, the transaction volume of secondary-hand houses has exceeded new houses gradually from 2014. That means, in the past, housing enterprises earned profit from development of new house with 80% revenue from development of real estate and sale but now they have to find ways to generate profit from real estate stock by operating and managing asset.

**Company analysis**

From the company side, because of the process of resources acquisition in the past 10 years, the real estate stock is surplus now.

Take all the factors into consideration, real estate companies are suffering falling profitability before restructuring. From 2010 to 2017, the average operating profitability of Chinese listed real estate companies dropped from 22% to 13%. This leads to higher demands on future cost control and turnover speed (Meng, et al., 2016).

**Business model**

The value chain of real estate industry can be divided into three parts according to production process (Figure 1)
1. **Front-end product manufacturing**: mainly including construction of new houses and renovation of existing homes.

2. **Mid-end**: real estate finance and urban support such as infrastructure.

3. **Back-end**: Agencies, property services.

The structure of revenue before restructuring:

- Development of real estate and sales 80%
- Property management 1.5%
- Rental and lease 1.5%
- Others 17%

It shows that the major revenue from development of real estate and sales.

![Figure 1. Traditional Real Estate Business Model](image)

Based on above analysis, housing companies should consider about revenue from property management and operation of real estate as new growth driver. Also, they need to deal with challenges in land and financing.
2. Objective

2.1 Objective

We try to seek Real Estate Transformation Model by which real estate industry can continue to earn profit, grow and satisfy customer demand.

There are four sectors that have been identified as holding great promise for transformation. They are:

(1) Light-asset operating
(2) Industry-city integration
(3) Financialization
(4) Self-holding housing
2.2 Evaluation method

In this report, housing enterprises which have tried transformation in above sectors are selected for case analysis. By analysing their operation, evaluation the results, recommendation for future transformation will be generated.

In this report, the success of transformation is evaluated based on the “Rating Method for Real Estate Development” from China Securities Index Co., Ltd.

The rating method includes three major aspects:

<table>
<thead>
<tr>
<th>Aspects</th>
<th>Metrics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business strength</td>
<td>Operation Environment</td>
</tr>
<tr>
<td></td>
<td>Business scale</td>
</tr>
<tr>
<td></td>
<td>Industry position</td>
</tr>
<tr>
<td></td>
<td>Operation results</td>
</tr>
<tr>
<td>Financial strength</td>
<td>Gross profit</td>
</tr>
<tr>
<td></td>
<td>Return on equity (ROE)</td>
</tr>
<tr>
<td></td>
<td>Net debt ratio</td>
</tr>
<tr>
<td></td>
<td>Total debt to EBITDA ratio</td>
</tr>
<tr>
<td></td>
<td>EBITDA to interest ratio</td>
</tr>
<tr>
<td>Financial flexibility</td>
<td>Liquidity</td>
</tr>
<tr>
<td></td>
<td>Financing capacity</td>
</tr>
</tbody>
</table>
3. Case Study

3.1 Light-asset Operating: Wanda Commerce

3.1.1 Introduction

Company history

Established in 1988, Wanda Group has grown into the world largest real estate company. In retrospect, Wanda Group always act as the pioneer, transforming its business with perfect timing, ahead of its competitors. In thirty years, Wanda Group went through four big strategic transformations of its business. The first strategic transformation occurred in 1993 at that time, Wanda Group changed from a local company in Dalian to a nationwide company. In 2000, its focus changed from residence only, to the combination of residence and commercial real estate. From 2006, the company took its third strategic transformation. Taking the advantage of its successful real estate business, Wanda Group became a comprehensive company, including business in hotel, cultural and tourism industry. Then, in 2015, the chairman WANG Jianlin changed his operation model in real estate from heavy-asset to light-asset, specialized on operation and management of real estates.

In 2002, Wanda Commercial Real Estate (short for Wanda Commerce in the following paper), a sub-brand of Wanda Group was established, tackling the real estate business particularly. This subsidiary corporation runs four main businesses. The main business is investing and operating of commercial center, which is Wanda Plaza. Other three businesses areas are high-end hotel, office and residential building, and management. The transformation in 2015 mainly took place in Wanda Commerce, which makes it our analysis object.

Heavy-asset operating model (the whole industrial chain model)

The heavy-asset operating model is a concept without a specific standard definition. In general, it refers to a business model that firms invest a huge amount of money in operation, such as building factories, and buying equipment and raw materials, which makes fixed
assets and spends take a significant part of the total assets and spending. (LI, 2015) In this model, firms gain profit by maintain economies of scale.

- Source of fund: from cash flow of company including operating activities and financing activities. In practice, Wanda borrows money from bank to take land and build its residential buildings.
- Business operation: Wanda Commerce took in charge of all aspects in the value chain, including investment, planning, construction, operation and management, and kept a lot of fixed assets before 2015. This is a particular heavy-asset operating model, which is also refers to whole industrial chain model, or Hong Kong model. (CHENG, 2017)
- Source of revenue: Sales revenue, which takes account of 80% of total revenue according to 2013 annual report. With a raising land price and housing price, the company’s revenue from holding the land and selling of apartments can easily overwhelm its total costs in construction. As for commercial buildings, Wanda always builds a big shopping mall in the central, and several office buildings or residential buildings around it, forming a Wanda Plaza. At the early stage, Wanda sales properties to support the construction of the shopping center and collects rents from shops after the mall opens.

Wanda Commerce maintained a good performance by keeping the above model, until 2015, when the problem of this model became significant.

Motivation of transformation

Focusing on the commercial real estate, which has the characteristic of high initial investment, low return ratio and long investment return period, Wanda Commerce fixed a lot of capital on its Wanda Plaza project. (LI, 2015) This pattern helped Wanda Commerce grow into an international cooperation; however, many business indicators of Wanda Commerce, such as ROE and debt-to-asset ratio, had developed with an unwished trend in recent years. It indicates that both financial ability and profitability of the company got worse.

Furthermore, Wanda Commerce faced another tough problem, which is the saturated market in first and second-tier cities. The success of Wanda Plaza, the core business of the company,
in traditional model was based on the huge customer flows and appreciation for holding properties in first and second-tier cities. With a saturated market, Wanda Commerce needed to expand its business to small cities. However, small cities could neither provide enough customer flows nor enough property appreciation, which means Wanda Commerce had limited room to adjust if it kept the former developing model. Then, it is urgent for the company to transform.

The shortage of fund. The net cash flow decreased from 359 billion in 2011 to -89.5 billion in 2014. In addition, that period was exactly the rapid growth period of Wanda with more than 20 new development projects every year.

3.1.2 Transformation

Noticing the down trend of its traditional business, chairman WANG Jianlin announced the transformation plan of Wanda Commerce in 2015. On 14 Jan, Wanda Commerce signed an investment framework agreement with Guangdaanshi and other three companies. (Wanda Commerce, 2015) According to this agreement, the four companies will invest 24 billion RMB to construct 20 Wanda Plazas. It indicated the transformation of Wanda Commerce.

Overview of the light-asset operating model (the specialization model)

Asset-Light Business model is a model where by the company has relatively few capital assets compared to its operation (Liou, 2015). The key point of this model is the separation of ownership and management.

- Source of fund: from partners. Wanda is no longer responsible for raising fund.
- Business operation: All Wanda Plaza projects after 2015 are light-asset operation.

According to its Chairman Statement from 2016 annual report, there are two kinds of Wanda Plaza operation, investment projects and cooperation projects. For investment projects, partners are responsible for raising fund while Wanda is responsible for gaining land, early-stage regulating, attracting shops, some construction and the later-stage management. For cooperation projects, partners are responsible for raising fund and buying land, Wanda is responsible for early-stage regulating, attracting shops, some construction and the later-stage management. Meanwhile, it also changed
its engineering management system, outsourcing some construction procedure with supervision right.

- Source of revenue: Transforming from sales to rental income. (From 2013 annual report, sales income and rental income take account of 80% and 6.91% of total income respectively). In the practice of cooperation projects, Wanda Commerce will take 30% of the total rent, which is a high percentage, compared with general figure from 15% to 20% worldwide. (Wanda Commerce, 2016).

There are a lot of advantages of light-asset model. After this change, there is no need to pledge its properties for high interest bank loans for land and construction, which solves the fund rising and debt problem. Moreover, it also saves time and manpower occupied in the whole construction period. After the transformation, company profit from rental income, thus, customer flows or property price will not be the consideration of Wanda Plaza. Instead, the company only need to collect rent from shops in Wanda Plaza. Even in the worst case, Wanda Commerce will not lose money.

**Practices**

**For existing projects**

In 2017, Wanda Commerce sold its 77 high-end hotels to R&F Properties, in order to collect cash and get rid of heavy assets with low profitability. Meanwhile, the company also lowered the registered capital for 88 existing Wanda Plaza and hotels, from more than 100 million to 50 million. Although the actual effect of cutting registered capital is insignificant, still, it shows the determination of Wanda’s light-asset plan. (Nanfang Media Group, 2017)

**For new projects after 2016**

In 2016, 21 out of 50 new opened Wanda Plazas have already followed this light-asset model. At the end of 2016, Wanda signed another 90 light-asset Wanda Plazas with other partners. In 2017, 47 new light-asset Wanda Plazas were established. From 2020, Wanda Commerce will no longer be a residential development company, after it finished all the current projects. (Wanda Commerce, 2015) Instead, it will become a commercial property developer and
management service company. At that time, the transformation procedure will be accomplished.

### 3.1.3 Evaluation

In this part, this paper will evaluate the effects of the transformation by comparing business indicators before and after the transformation. The evaluation will be divided in two parts, which are the financial ability and profitability.

#### Financial ability

**Debt Repayment Ability**

<table>
<thead>
<tr>
<th>Year</th>
<th>Total assets (billion)</th>
<th>Total liabilities (billion)</th>
<th>Debt-to-asset ratio</th>
<th>EBITDA (billion)</th>
<th>EBITDA to interest ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>689.105</td>
<td>4462.53</td>
<td>0.6476</td>
<td>39.200</td>
<td>4.32</td>
</tr>
<tr>
<td>2016</td>
<td>751.146</td>
<td>5277.7</td>
<td>0.7026</td>
<td>54.574</td>
<td>4.76</td>
</tr>
<tr>
<td>2015</td>
<td>639.560</td>
<td>4536.63</td>
<td>0.7093</td>
<td>50.040</td>
<td>3.79</td>
</tr>
<tr>
<td>2014</td>
<td>564.294</td>
<td>4091.48</td>
<td>0.7251</td>
<td>50.502</td>
<td>4.08</td>
</tr>
<tr>
<td>2013</td>
<td>431.044</td>
<td>3171.72</td>
<td>0.7558</td>
<td>48.434</td>
<td>4.94</td>
</tr>
</tbody>
</table>


Before the transformation, Wanda Commerce faced a severe debt problem. Its debt-to-asset ratio is around 74%, which is higher than the industry average, 65%. (LIU, 2017) With government marco control, it is hard for real estate firms to sale properties or borrow from bank. Wanda Commerce puts a lot of efforts, even sold some of its equities to lower its debt-to-asset ratio, and finally reaches the industry average level in 2017. Meanwhile, the recovery of interest coverage ratio suggests that the company is more capable to pay back its interests. Together, this paper believes that Wanda Commerce’s debt repayment ability has been improved after the transformation.
Financial flexibility

<table>
<thead>
<tr>
<th>Year</th>
<th>Liquid assets /billion</th>
<th>Liquid liabilities /billion</th>
<th>Liquidity ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>277.7</td>
<td>215.3</td>
<td>129%</td>
</tr>
<tr>
<td>2016</td>
<td>292.8</td>
<td>284.1</td>
<td>103%</td>
</tr>
<tr>
<td>2015</td>
<td>264.9</td>
<td>274.2</td>
<td>97%</td>
</tr>
<tr>
<td>2014</td>
<td>261.3</td>
<td>235.5</td>
<td>111%</td>
</tr>
<tr>
<td>2013</td>
<td>196.3</td>
<td>180.3</td>
<td>109%</td>
</tr>
</tbody>
</table>

Source: Annual Report of Wanda Commercial Management Group Co. Ltd.

Liquidity is important for real estate firms, which shows its financial flexibility. The above table indicates that before the transformation, the liquidity ratio for Wanda Commerce drops from around 110% to less than 100%. Under the new development model, the liquidity ratio recovers to 129%, which can be seen as a progress; however, normally, only companies with more than 200% liquidity ratio can be seen as companies with excellent financial flexibility. It means that the liquidity of Wanda Commerce still has room to increase, and the company still faces some short-term liability risk.

In conclude, the financial ability of Wanda Commerce is improved after the transformation, but far from assured. The company still somehow faces operational pressure and potential debt problems.

Profitability

This paper uses return on equity ratio to manage its profitability.

ROE

The decreasing ROE shows that the transformation does not stop company’s dropping profitability; however, it may not be a totally disappointed fact. According to Dupont analysis, ROE can be separated into three parts, which are profit margin, asset turnover and equity multiplier. The statistics for relative figures are as below.
<table>
<thead>
<tr>
<th>Year</th>
<th>ROE</th>
<th>Profit Margin</th>
<th>Equity Multiplier</th>
<th>Asset Turnover</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>0.0947</td>
<td>N/A</td>
<td>2.8377</td>
<td>N/A</td>
</tr>
<tr>
<td>2016</td>
<td>0.1467</td>
<td>0.2978</td>
<td>3.3625</td>
<td>0.1465</td>
</tr>
<tr>
<td>2015</td>
<td>0.1712</td>
<td>0.2753</td>
<td>3.4400</td>
<td>0.1808</td>
</tr>
<tr>
<td>2014</td>
<td>0.1834</td>
<td>0.2327</td>
<td>3.6377</td>
<td>0.2168</td>
</tr>
<tr>
<td>2013</td>
<td>0.2459</td>
<td>0.2867</td>
<td>4.0950</td>
<td>0.2265</td>
</tr>
</tbody>
</table>


The dropping trend of profit margin is stopped by the transformation. It can be explained by the revenue structure of Wanda Commerce. As planned, the company will gradually exit the real estate development market, which has shown on the dropping of the weight of property selling.

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hotel management</td>
<td>Revenue /billion</td>
<td>%</td>
<td>Revenue /billion</td>
<td>%</td>
<td>Revenue /billion</td>
</tr>
<tr>
<td>Hotel management</td>
<td>3.215</td>
<td>3.705</td>
<td>4.008</td>
<td>3.716</td>
<td>4.963</td>
</tr>
<tr>
<td>property Leasing and management</td>
<td>Revenue /billion</td>
<td>%</td>
<td>Revenue /billion</td>
<td>%</td>
<td>Revenue /billion</td>
</tr>
<tr>
<td>property selling</td>
<td>Revenue /billion</td>
<td>%</td>
<td>Revenue /billion</td>
<td>%</td>
<td>Revenue /billion</td>
</tr>
<tr>
<td>property selling</td>
<td>74.981</td>
<td>86.410</td>
<td>91.748</td>
<td>85.053</td>
<td>102.515</td>
</tr>
<tr>
<td>others</td>
<td>Revenue /billion</td>
<td>%</td>
<td>Revenue /billion</td>
<td>%</td>
<td>Revenue /billion</td>
</tr>
<tr>
<td>others</td>
<td>0.095</td>
<td>0.110</td>
<td>1.763</td>
<td>1.634</td>
<td>3.143</td>
</tr>
<tr>
<td>total</td>
<td>Revenue /billion</td>
<td>%</td>
<td>Revenue /billion</td>
<td>%</td>
<td>Revenue /billion</td>
</tr>
<tr>
<td>total</td>
<td>86.774</td>
<td>100</td>
<td>107.871</td>
<td>100</td>
<td>124.203</td>
</tr>
</tbody>
</table>

\(^1\) Wanda Commerce did not publish its sales figure in 2017 report.
Before 2015, property selling took over 85% of total revenue. The construction costs kept rising; however, under government control, housing price did not have much room for increasing. Thus, the profit margin of Wanda Commerce was affected. After 2015, the percentage of property selling in total Revenue has been dropped, which means the effect of government control on Wanda Commerce is declining. Then, profit margin goes up again.

The declining of equity multiplier is consistent with the drop of debt-to-asset ratio. Although it leads to the declining of ROE, it is a must for the company to lower its debt level to follow the government policy and prevent future debt problem.

The only problem that need to pay attention is the low asset turnover ratio. It implies that the company need to further improve its usage of assets. In fact, the company has already moved. For instance, Wanda Commerce rearranged its parking lot and advertisement board system, in 2016, and increased 400 million RMB income in one year. (Wanda Commerce, 2017) The asset turnover ratio may rise in the future after the all adjustments are finished.

To conclude, in order to lower liability level, equity multiplier is sacrificed, which is a must. Under this precondition, although the transformation has not turned ROE back to its original position yet, it does have some effect, which is the increasing of profit margin.

Although the adjustment is not perfect, it increases the financial ability of Wanda Commerce, and improves profit margin, which is a critical part of profitability. Moreover, there are also other achievements that do not appear in the previous table. For instance, the new model can help Wanda Commerce to expand its business even fast than before. It can also help Wanda Commerce to get rid of the industry fluctuations and negative effect of governmental policy and get more stable cash flow. This paper believes that the transformation of Wanda Commerce’s operation model from the whole industrial chain model to the specialization model is successful in general.

---

2 Wanda Commerce did not publish its sales figure in 2017 report.
3.1.4 Conclusion

Feasibility analysis

The success of Wanda Commerce can be traced to four characteristics.

First of all, before the transformation, the company has business in the whole industrial chain, including Wanda Commercial Planning Institution, commercial properties management team. When Wanda Commerce decided to transfer its business model, the above parties played a significant role in the procedure. The planning institution enables targeted design for each WANDA Plaza, including market demand, potential tenants, customer demand and the regional regulation, which will help Wanda Commerce maximize profit.

The second advantage of Wanda Commerce is the particular method for inviting tenders. Different with the traditional “construct first, invite tenders next” model, Wanda Commerce reverses these two steps. By doing so, all the shops can participate in the plan of the plaza, which will ensure their satisfaction of the facilities in Wanda Commerce. It also ensures the high occupancy rate of Wanda Plaza.

This way of inviting tenders is hard to copy, because it is based to the reputation of the brand, Wanda. It has become a consensus that a Wanda Plaza can drive the formation of a city center, which also indicates the potential high customer volume. (LI, 2015) Thus, Wanda has attracted more than 1.5 thousand of different brands to open shops in Wanda Plaza. There are so many interested brands, that Wanda need to introduce a policy to restrict total number of branches for the same brand in all Wanda Plazas, in order to protect free competition. (Wanda Commerce, 2015)

The brand reputation also brings a good relationship with government. Similarly, local governments also see the agglomeration effect caused by Wanda Plaza. The establishment of Wanda Plaza can bring big brands inside of small towns and boost the economic performance of the city, which becomes an achievement in the governmental work performance. Consequently, local governments are willing to let Wanda move in. This good relationship with governments gives Wanda Commerce an advantage in bidding for lands. Although Wanda Commerce is no longer responsible for bidding for lands after the transformation, the
brand of Wanda Plaza can also help investors to get land with high cost efficiency. As a part of brand reputation, it attracts a lot of investors to cooperate with Wanda on its Wanda Plaza project.

In conclude, Wanda has the ability to make high-quality targeted design for each project. Together with its special model for inviting tenders, brand reputation, and good relationship with local governments, Wanda Commerce can attract both shops and investors to the Wanda Plaza, which enables its success in transforming to a light-asset operation model.

**Recommendations to other companies**

Taking Wanda Commerce as an example, this paper believes that real estate companies with two essential characteristics can consider imitating Wanda model, transferring to light-asset firms. First of all, the enterprise should have a leading position in real estate planning or management. Moreover, it should also have a good brand reputation to invite investors and shops. Therefore, this pattern can only be imitated by famous brand proficient in planning and management.
3.2 Industry-city Integration – China Merchants Property Development CO., LTD

3.2.1 Introduction

China Merchants Property Development CO., LTD (CMPD) was established in 1984 as a subsidiary of China Merchants Group (CMG) which is one of the state-own giants. It was one of the largest real estate developer in China, offering residential properties in China, covering Shenzhen, Beijing, Shanghai etc. Referring to the fiscal year 2014 annual report, the total assets exceed CNY 151 billion and market cap is around 3 billion. The company generated 4.26 billion net profit with 37.97 billion sales. In late 2015, it went private and merged with Shekou Industrial Zone Holdings Company Limited (SKIZ). The successor was relisted in Shenzhen Stock Exchange named China Merchants Shekou Industrial Zone Holdings Company Limited (CMSK). This flagship company is involved in the comprehensive urban development and is claimed to be the Group’s core asset integration and business collaboration platform in China.
3.2.2 Transformation

Industry-city integration

(Figure 1. "Industry + Townships" Industry and Townships Integration, retrieved May 2, 2018, from http://www.vastiud.com/en/index.php?m=&c=article&a=lists&category=14)

The industry-city integration refers to the philosophy that coordinates the development of industry and expansion of the urban area. The industry is the secondary and tertiary industries while the city means the functions it possesses with the people, residence, infrastructure, public facilities, social security, and ecological surroundings within it. (Shao, 2015)

The undesirable performance alerts the management of CMPD and it is imperative to develop a platform which can integrate and utilizes the resource provided by the CMG including massive land reserve, ports development rights, and financial services. It is beneficial for the CMPD to differentiate to focus on the industry-city integration strategy.
New Business model

CMSI is committed to being China’s leading urban and industrial park developer and operator and has established the development mode of “front Port, mid Zone, back City”. Based on “Industry-Internet-Finance-City Integration” development, it coordinates its major business of the development and operation of communities, industrial parks, and leisure cruises, and provide diversified products and services with full life-cycle coverage, including residential and, commercial complexes, data centers and business parks, a regional industrial belt, a cruise terminal, office buildings, hotels and service apartments, and senior living and healthcare for senior citizens. It is providing a comprehensive solution for urban development and industrial upgrades.

Front Port, mid Zone, back City Model
Post-transformation Performance (2016)

<table>
<thead>
<tr>
<th>Port</th>
<th>Park</th>
</tr>
</thead>
<tbody>
<tr>
<td>Port/Logistics/Cruise-focused</td>
<td>Incubation/Commerce/Supporting-Facility-focused</td>
</tr>
<tr>
<td>• 5 Cities offering cruise business</td>
<td>• 12 industrial parks developed and operated nationwide</td>
</tr>
<tr>
<td>• 758 cruise liners received in 2016</td>
<td>• 21 start-up incubators</td>
</tr>
<tr>
<td>• 3,864 million person times of cruise passengers received in 2016</td>
<td>• 1,145 companies incubated accumulatively</td>
</tr>
<tr>
<td></td>
<td>• 100% coverage of field testing and measurement</td>
</tr>
</tbody>
</table>

City

Life/Commerce/Supporting-Facility-focused

- 36 cities covered in residential community development and operation
- 28,3007 million square meters of residential property under management
- 170,000 households served
- 5 points up in household satisfaction degree on a year-on-year basis

CMSK dedicates to the interrelated development of “Ship, Port, City, Tourism, Shopping and
Entertainment”, to realize the characteristic business mode "Port-Park City" of CMG be put in place and to be duplicated to other regions, therefore to create the most focusing community in cities.

At present, CMG’s companies are involved in the development and operation of cruise home port in Tianjin, Qingdao, Shanghai, Xiamen, and Shenzhen, in the forms of sole proprietorship, equity participation or joint development; CMG is the biggest cruise and port operating entity in China which received most cruise passengers accounting for 85 % of the total passengers.

**Selection of cities**

In order to decide the cities list to invest in, companies analysis all kinds of aspects including the population, industry, environment and wealth. Then, by combining the land market and trend of real estate market of targeted cities, the volume of investment is set. The selection of shenzhen with park as key connection as well as shekou with port as key operation is essential to success.

**Integrate resources for development**


Cooperation with government. In 2017, the company cooperated with Hubei Province government to set up Industrial Park with theme of health. Government is responsible for land and development of infrastructures while the company is responsible for design and operation, etc.
Revitalize project-affiliated industry for operation

On 12 November 2016, as the SuperStar Virgo of Star Cruise entered the port, the Prince Bay Cruise Homeport was put into operation. The Prince Bay port district was built into a “marine portal” covering cruise service, tourism, finance, trading, and logistics to provide customers exceptional services. CMSK wholly owns one 220,000 GT cruise berth in the Prince Bay Cruise Homeport and owns one 100,000 GT cruise berth, twelve 800 GT high-speed passenger ship berths (with two berths-in-wait) and one 20,000 GT passenger and freight roll on/roll off shipment berth. Enjoying the benefits of locating in the free trade zone, the Prince Bay area will build a cruise ecosystem by integrating the operation of “cruise, port, city, tourism, shopping, and recreation”.

3.2.3 Evaluation

3.2.3.1 Business strength

Business environment

CMSK runs the business in three major sectors, including industrial park development and operation, residential community development and operation, and cruise industry construction and operation.

Cruise industry

Referring to CCYIA, the number of tourists visiting China by cruise shot up after 2012 while in 2016, CMSK already served around 85% of the total amount. The government also introduced policies to invigorate the cruise industry.
Industrial park

At present, there are the problems that oversupply and serious homogeneity in the market. In China, every city has 4.8 provincial-level or higher industrial parks on average. Park companies tend to attract investment by lowering rents and selling prices, which may jeopardize the overall profitability of the park.

The future development would focus on the short-term regional adjustment, long-term upgrade, and transformation. In the short-term, the central and western regions of China are suitable for the development of processing parks, and the eastern coast is suitable for R&D ones. In the long-term, due to the limited profitability of processing parks and the continuous increase in the proportion of high-precision industries, the development trend of industrial parks is the transformation from processing-oriented to R&D-based. The most public company runs R&D-oriented parks and they keep diversifying their portfolio. In the future, the proportion of R&D-oriented listed park companies will further increase

Scale & Business performance
In this case, “sales” will be used to represent the scale of the company while the growth rate of the sales is a sign of business performance.

After the merge, the newly established company held more land reserve, capital as well as the resources CMG wants to integrate. As a result, the total scale of the increased significantly and the performance is varying at a reasonable range.

### 3.2.3.2 Financial strength

After the restructuring, both ROE and PM rose and the difference shrunk, though just a little, showing that better capital structure is adopted to optimize the shareholders’ return. The D/E ratio hiked slightly while the total debt/EBITDA remained flat meaning that the company managed to generate substantial operating cash while expanding their business by debt. Overall, the restructuring is beneficial in terms of profitability as well as stability.
3.2.3.3 Financial flexibility

Liquidity

![Current Ratio Graph]

Due to expansion by leveraging, the company accumulated a large amount of short-term debt. However, considering the substantial operating case generated, the leverage is reasonable and have the positive impact on the ROE at this stage.

Financing ability

![Interest exp./Total debt Graph]

Supported by the CMG, one of the largest state-own corporate, CMSK’s financing cost did not vary a lot after it gets back to the normal track in 2017. The financing cost did not jump
even CMSK enlarged their debt amount.

3.2.4 Conclusion

The industry-city integration creates synergy by co-development between the industrial area and the residential community. CMSK innovates the “front Port, mid Zone, back City” development model and managed to duplicate in different cities to offer multi-formed quality products and services. After transformation, CMSK succeeded to expand its business and optimize its business model by integrating the resources of CMG. Comparing to the conventional real estate development, this model balances the functional relationship between industry and city which realizes the ecological functions and improves the overall upgrading and development of the city. Meanwhile, the company focus on industry-city integration could benefit from the strong growth in the sunrise industry and a diversified portfolio helps in controlling the risks. However, industry-city integration is a strategy that requires a tailor-made solution for different cities/industry area. The government also plays an important role in the co-development of industry and city. Without the buttress of giants like CMG, who could provide comprehensive resources including substantial land reserve, financing solution, policy etc. it is could be risky to transform into the industry-city integration oriented developer.
3.3 Fosun Property

3.3.1 Introduction

Fosun Property is a subsidiary under the Fosun Group. Established in 1992, now Fosun is one of the largest real estate companies in international market.

Before 2014, the major business of Fosun Property had already spanned multiple fields, including development, integration and service of real estate. Nevertheless, during last decade, like many other real estate companies, Fosun Property also faced increasing problems in their real estate business.

After the financial crisis in 2008, the global market greatly depressed. To promote the market, many countries, including China, carried out a series of loose monetary policies. From 2008, the People’s Bank of China decreased the interest rate for four times and reserve ratio for three times. As a result, the housing market in China also developed quickly. In 2009, the year-to-year growth of commercial residential building increased for 75.5%. Meanwhile, the loose monetary policy also pushed up the inflation rate and excessive-debt risk. In 2009, the average housing price in China increased for around 20%. The CPI and PPI also increased to 5.8% and 2.5% in the beginning of 2010 (Feng, 2015). As a result, during these two years, Fosun Property greatly expanded its business. For example, from 2008 to 2010, the total equity of Fosun Property increased from 30,043.1 to 44,999.1 million RMB. The investment property under Fusun Property also increased from 429 to 2551.2 million RMB.

However, such inflated market did not last for too long. The GDP growth rate and the European Debt Crisis drew the attention of government back to the housing market. With the decreasing of interest rate and reserve ratio, the housing market appeared to shrink from the beginning of 2012. What’s worse, in 2015, the Federal Reserve decided to increase the interest rate of the US treasury bond, which further shocked the international financial market. All these shocks, along with the following shrink of financial conditions and real estate regulation, lead to a quick depression of real estate market in China after 2013 (Feng, 2015). Inevitably, the business of Fosun Property also be affected. For example, from 2010 to
2014, the total debt increased from 43,935.4 to 95,834.2 million RMB, the debt ratio also increased from 49.4% to 55.9%. What’s more, from 2009 to 2012, the total pre-tax revenue decreased from 8,175,525 to 6,277,993 thousand RMB.

Fortunately, Fosun Proper was not unprepared for such market change. In 2014, to generate new growth point, after three-year preparation, Fosun Property launched its transformation project.

3.3.2 Transformation

The major strategy of the transformation of Fosun Property is the Mode of “1+1+1”: Insurance plus Industrial Advantage plus the “Hive City”. This mode, according to the description of the managers of Fosun Property, is a “new real estate industry chain, which make use of the investment of real estate and the management platform, promote the industry to combine with insurance and finance by cross-border integration”. In other words, Fosun is trying to combine all of its businesses into one industrial chain. The whole strategy was majorly based on the conception of the “Hive City”. Thus, this mode was also named as “the Hive Mode” (Sheng & Ann, 2015).

Features of the Hive Mode

The major features of the Hive Mode can be divided into three dimensions: Financialization, Internationalization and Industrialization.

Financialization.

The Hive Mode is to build communities which allows residents to live, consume and work together. Such communities will have the functions of both “industry and employment”. There are five components in the Hive Mode, including finance, cultural, health, tourism and material trading.

Among them, finance is probably the most important part in the Hive Mode because it is the way to realize all the components. Different from normal investors, Fosun Property believe there are arbitrage chances exist due to the mismatch of market. Thus, it is building “finance real estate” to search for “higher return with lower risks” (Hou, 2017). According to the state
of its managers, Fosun is now “doing the real estate business in the way of investment”. Based on its own financial platform, such as Fosun Finance or Fusun Insurance, and the cooperation with some third parties, such as China Minsheng Banking Co., (中國民生銀行), Fosun’s financial hives are built by investing different CBDs. In those CBDs, multiple industries, such as financial or medical industries, were put together. For example, in 2014, Fosun established its first financial hive in Shanghai: The Bund Finance Center (BFC), a multi-functional business center with office building, hotels, shopping malls and tourism.

**Internationalization**

As for foreign market, Fosun also actively search for a way to be “internationalized”. The transformation strategy is carried by purchasing or investing real estates with higher potential profits and build them into “hives” (Wang & Wu, 2016). For example, in 2013, Fosun purchased the Liberty 28 in New York and Lloyds Chambers in London; in 2014, it purchased and integrated the IDERA Japan and Front Terrace in Tokyo (Zeng, 2017). Since the self-orientation of Fosun is “long-term investor”, it would be hard for it to generate long-run foreign market size without localized teams. Thus, with those properties, Fosun established “its platform companies as the bridgehead”; then based on those platforms, the business was extended into inland market. Afterwards, those companies were combined into the “globalized investment team”, which can further improve Fosun’s global investment ability (Chen, 2015). As for future, Fosun is planning to extend its market to more emerging markets, such as Russia, Brazil or India. By connecting the hives all around the world, Fosun will establish its new real estate industry chain.

**Industrialization**

Industrialization of Fosun is to increase its industry depth. To achieve this, Fosun decided to integrate its industries under its global distribution by building the Hive Cities. Fosun Property is unique because of the multiple industries under Fosun Groups, such as insurance and healthcare. Based on this, Fosun tried to introduce those industries into its Hive Cities to promote both the daily consumption and industrial production. For the one thing, more industries could better fulfil the residents’ needs. For another, the combination of real estate
projects and city resources could improve the efficiency of city management.

**Transformation of Profit Mode**

As a result, Fosun is now transforming its profit model from traditional development-sale method to multi-sources method.

Firstly, Fosun Property invested or purchased plenty of domestic and foreign international business centers and hold them for medium or long period. Those properties brought a large size of incomes, including rental fees or tourism income, to Fosun every year. For example, in 2016, the total income from these investments was around 18,097,765 thousand RMB, making up of around 24.47% of its total income.

Secondly, those investment also provide arbitrage opportunities to Fosun Property. By investing with lower price and selling with higher price, large size of revenue could be generated from such trading (Zeng, 2017). For example, in 2017, Fosun sold two foreign properties in Australia and England, which involved around 1,900 thousand RMB.

Lastly, by establishing Hive Cities, Fosun greatly promoted its relative industries, which also lead to an increasing size of revenue. Such growth not only provided more capital for Fosun to extend its investments, but also generate more employ positions, which could be even more valuable for the long-term development of both the company and society.

**3.3.3 Evaluation**

Certain progresses were achieved by the transformation of Fosun Property. Those progress could be evaluated by the rating of real estate companies. According to the guidance of the China Chengxin (Asia Pacific) Credit Regulating Company Limited (the CCX), the real estate company rating could be accessed in three dimensions: the business strength, the financial strength and the financial flexibility.

**Business Strength**

Business strength refers to the company’s business environment, as well as the scale advantage and market position in the environment, and the business strategy. Those figures reflected the non-financial conditions in a quantitative way.
Business Environment

The major markets of Fosun Property are in China and some developed countries, such as England, Australia or America. For the foreign countries, according to the report of WTO in 2017, those markets were basically secure and developing healthily, regardless of certain systematic risks. As for domestic market, from 2014, China entered a period with steady growth. Although the development of housing market greatly slowed after the macro-control, with the launching of the thirteenth Five-Year Plan, the need for domestic investment increased rapidly. Also, the improvement of disposable income and living standard led to an increasing need for consumption upgrading. Generated by such growing needs, there will be more opportunities for Fosun to practice its Hive City strategy. Therefore, basically, the business environment is favorable for Fosun Property.

Scale

According to the guidance, scale is an important figure to measure the comprehensive strength of a company. The CCX agreed to use sales amount to access this factor.

Referring to the annual report of Fosun Property, from 2014 the beginning of transformation to 2017, the total sales amount increased 61,738,449 to 88,025,169 thousand RMB. The detail is as follow (Unit: Thousand RMB):

<table>
<thead>
<tr>
<th>Year</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Sales</td>
<td>61,738,449</td>
<td>78,696,889</td>
<td>73,966,562</td>
<td>88,025,169</td>
</tr>
</tbody>
</table>


The positive scale growth is obvious here.

Besides, from 2014 to 2017, the total equity, which can be another figure of company size, increased from 75,684.5 to 136,412.3 million RMB, which complied with the growth of total sales amount and proved the growth of company scales. (Unit: Million RMB)
Total Equity

<table>
<thead>
<tr>
<th>Year</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>75,684.5</td>
<td>99,553.1</td>
<td>122,873.8</td>
<td>136,412.3</td>
</tr>
</tbody>
</table>


**Business Performance**

Business performance refers to the ability to carry out the company’s strategy. The CCX agreed to use the fluctuation of revenue to access this figure.

According to the annual report of Fosun Property, the change rates of revenue before and after the transformation are calculated as follow. The change rates are based on the pre-tax revenue because the tax rate was not controlled by the transformation strategy (Unit: Thousand RMB):

<table>
<thead>
<tr>
<th>Year</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>-20.46%</td>
<td>-9.52%</td>
<td>56.73%</td>
<td></td>
</tr>
</tbody>
</table>

Table: The Change of Pre-Tax Revenue Before the Transformation

<table>
<thead>
<tr>
<th>Year</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>30.16%</td>
<td>27.37%</td>
<td>0.607%</td>
<td>41.09%</td>
<td></td>
</tr>
</tbody>
</table>

Table: The Change of Pre-Tax Revenue After the Transformation

After further calculation, the standard deviation of the revenue change rate before the transformation was around 41.76. After transformation, the standard deviation decreased to 17.18, which indicated a steadier revenue situation generated by the transformation.

**Financial Strength**

The financial strength is a series figures to measure the financial ability of certain real estate company. The figures are listed as follow:

<table>
<thead>
<tr>
<th>Year</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
According to the table, it is not hard to notice that after the beginning of transformation in 2014, the gross margin, EBITDA and EBITDA Interest Cover all greatly increased. At the same time, the gearing ratio rapidly decreased from 55.9% to 52.4%. As a result, the Fosun Property’s financial strength significantly developed after launching the transformation.

**Financial Flexibility**

Lastly, the financial flexibility is also an important figure to measure the company’s liquidity and capital resources. The higher the financial flexibility, the better the company can do to deal with the change of market. This assessment can be divided into two dimensions: the liquidity and financing ability.

As for the liquidity, the total amounts of liquid assets from 2011 to 2017 are listed as follow (Unit: Thousand RMB):

<table>
<thead>
<tr>
<th>Year</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount of Liquid Assets</td>
<td>9,277,877</td>
<td>24,423,237</td>
<td>19,099,719</td>
<td>142,817,035</td>
<td>162,698,142</td>
<td>206,983,861</td>
</tr>
</tbody>
</table>

According to this table, the total amount of liquid assets significantly increased after 2014. Thus, there is a growth of the liquidity ability of Fosun Property after the transformation.
Limitation

Although above analysis basically generated a favorable comment on the transformation of Fosun Property, there are certain limitation should be taken into further consideration.

Firstly, due to the limitation of the annual report, it is hard to acquire enough information to measure every figure accurately. For example, in the financial flexibility analysis, it is difficult to decide the overall financing ability from those annual reports precisely. Thus, further investigations could be necessary for a more reliable and detailed analysis.

Secondly, above is only one of the rating methods for real estate companies. There could be more ways to make judgment about the transformation. For example, the contribution to social welfare or the environment friendliness could also be vital when judge a company to be successful or not.

Lastly, currently, Fosun’s transformation project has run for only 3 years, which is a relatively short period for real estate market. What can be observed now are only some short-term effects. Therefore, subsequent observation should be conducted in the future. It is important to see if this transformation could lead to sustainable development for Fosun in the long-run.

3.3.4 Conclusion

As far as we considered in this research, the transformation of Fosun Property is basically successful. By financialization, internationalization and industrialization, Fosun smoothly combined its multiple industries together and changed its profit mode to a more sustainable and favorable direction. After the transformation, Fosun Property’s comprehensive strength, including the financial ability and flexibility, was continually increased. It is reasonable to believe that Fosun escaped from the restriction of traditional real estate companies and successfully established its own development method.

This case also has some implication for practice. Nowadays, many real estate companies are searching for a way to transform. When deciding the future direction, instead of blindly copy
the strategies of large companies, it is always wise to evaluate the company’s own advantage as well as the actual needs of market. What’s more, it is also important to get out of the mindset. By combining real estate with multiple industries and allowing them to support each other, greater benefits could be generated for both the relative industries and real estate itself.
3.4 Self-holding Property - VANKE

3.4.1 Introduction

After the golden times of real estate industry, the real estate market transforms from incremental market to stock market. Endless relevant limitations on development of real estate have squeezed the profit space and increased the intensity of competition in traditional real estate industry. The corporations are eager to expand to other business industry to keep profitability. In recent years, the land in auction of huge cities mostly has subsidiary limitations on how to develop the commercial land. The most frequently referred word is “self-holding”, which means that the developer cannot sell the house property to the customer and it can only rent the houses to the market. Therefore, self-holding housing is the direction of transformation for huge real estate corporations. Moreover, property management, as a business occupies over ninety percent of the whole business life of real estate, has also shown its sustainable profitability after China government implementing tighter real estate politics to suppress the high-speed increase in house price.

In traditional real estate business model, the developers ask banks for huge loan to bid for land and following development. Before the houses’ construction completed, the sales department would start the selling to recover the capital chain. There are various risks during the business line including the bank loan, financing, permission on land development, construction speed, and sales volume. Any incidents during the process would result in business risks which may cause bankrupt. If the company cannot directly sell houses to the customers, it will be more difficult to cover the initial expenses. Therefore, how to maintain the profitability under the “self-holding” requirement is an emerging problem for developers to solve.

Real estate industry requires strong capital chain for entry companies. In the environment that it is difficult to get bank loan for real estate business, property management as the related business has shown its advantages. It requires lower initial capital and generates continuous profits as long as the residents need services. The more obvious benefit it brings to the company is that if the property management is satisfactory to the customers, the brand effect
of the real estate company can produce more future profits. Nowadays, the house buyers not only consider the location of the houses but also the quality of corresponding property as it would generally affect their life quality. In China, most huge real estate corporations have their own property subsidiary companies. Even some companies are famous and popular for its high-quality property management like VANKE and GREENTOWN.

In the following, we will introduce **VANKE as a successful example of expanding business area in both housing renting and property management**. And we will use the financial report to explain why self-holding property and property management are good choices.

### 3.4.2 Transformation

**Self-holding housing**

The dramatic increase in house price has prevented many young people to afford their own houses. Mostly they need their parents and grandparents to pay part of the down payment for them. People have complained about the unreasonable housing price for a long period and the government has already introduced many regulating politics on suppressing the housing price. “Self-holding” is one of the restrictions and it commands that the real estate companies can only rent out the houses instead of selling. It cools down the passion of developers in ramping the housing price and provides an alternative for the young people who cannot afford buying houses. Different from previous house leasing market, self-holding houses are built for renting and it accompanies with corresponding services and property management which is customized for renters. It can also avoid the agency problem and conflicts between owners, agents and renters. Compared to developed countries, China’s homeownership rate has reached ninety percent which is pretty high compared to the United States’ around sixty percent. Below is the table showing the homeownership rate by country.
Influenced by traditional concept, Chinese prefer to buy houses instead of renting houses. However, the young people hold different views that if they cannot afford their own houses, renting houses is acceptable. Therefore, Chinese housing rental market has broad development space. In the environment that government promote the same rights of both rental and buying houses, housing rental market would attract more investors. Below is the chart showing the capital volume in Chinese rental market from 2011 to 2017. The unit is trillion yuan. It can tell that there is great profitable potential in housing rental market.
VANKE is the first domestic real estate developer to enter the housing rental market. VANKE’s business plan on entering the rental market has started from 2007 and in 2008, “WanHui building”, the first rental housing demonstration project which aims at low-and-middle-income family, started operations. From 2014, VANKE has promoted rental housing business in large-scale and set up the object of “being the leading rental housing corporation”. According to the latest financial report of VANKE Co., Ltd., VANKE has integrated the long-term rental housing business and created the brand called “Boyu”. Until now, Boyu has collected over 100,000 rental houses resources and over 30,000 rental houses are in operation. In 2018, Boyu plans to collect 100,000 more rental houses and open 50,000 rental houses. Self-holding housing project is easier to get political support from labor department, city regulating department and other government departments compared to sale housing projects. In China, political support is important for real estate companies. VANKE’s self-holding land area ranks first in real estate industry. According to the incomplete statistics, until June 2017, VANKE has payed around seventeen billion yuan on five self-holding lands, which proves its determination to expand business in housing rental market.

However, there are some negative news about VANKE’s housing rental business recently. In Beijing, the first rental housing project, “Feicui Shuyuan”, has started advanced rent to the public. The rental expenses shocked the public as the lowest rental cost for a ninety-square-meter house is fifteen thousand yuan per square meter and it requires that the renters have to settle all the ten-year rental expense in one-off payment, which is 1.8 million yuan. The high development cost and management expenses contribute to the high rental price partly. VANKE wants to quickly recoup the capital by charging high rental payment. Nonetheless, the market reactions are not that positive. In the first quarter financial report of 2018, VANKE announced that its sales increased by 68.5 percent compared to 2017. Besides, VANKE would take rental business as the core business. VANKE, as the leader in China’s real estate industry, still need to struggle to find a way out to maintain the profitability under the “self-holding” limitations, although it has strengths in good reputations, great land stock, and strong capital chain.
Property

With the development of economy and culture, residents care about various elements when considering buying houses, including location, transportation as well as property management service. The market of property management has developed steadily, and the analysts expect that the market capital would exceed trillion amount, which is a new blue ocean for real estate investors. The property management area has increased continuously, and market concentration ratio increased as professional property companies occupies more market share.
Most high-quality property management services are provided by real estate developers like VANKE, Poly and Country Garden. VANKE Service is the subsidiary corporation of China Vanke Co., Ltd. China Vanke Co., Ltd. was set up in 1984 and stepped into real estate industry in 1988. After two years, it set up its own property company, VANKE Service. Until the end of December 2017, VANKE Service has expanded business in eighty cities and generates 7.13-billion-yuan income for VANKE, which increased by 67.28 percent compared to last year. It proves that property service is more sustainable than real estate in profitability. Below is the table of VANKE’s operating income and cost in 2017, and the unit is 10,000 yuan.

<table>
<thead>
<tr>
<th>Industry</th>
<th>Operation Income</th>
<th>Operation Expense</th>
<th>Operation profit margin</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>Change</td>
<td>Amount</td>
</tr>
<tr>
<td>Main business</td>
<td>24,013,964.88</td>
<td>0.73%</td>
<td>15,917,782.49</td>
</tr>
<tr>
<td>-Real estate</td>
<td>23,301,306.18</td>
<td>-0.48%</td>
<td>15,338,519.17</td>
</tr>
<tr>
<td>-Property</td>
<td>712,658.70</td>
<td>67.28%</td>
<td>579,263.32</td>
</tr>
<tr>
<td>Other business</td>
<td>275,746.15</td>
<td>32.78%</td>
<td>90,209.10</td>
</tr>
<tr>
<td>Total</td>
<td>24,289,711.03</td>
<td>1.01%</td>
<td>16,007,991.59</td>
</tr>
</tbody>
</table>

According to the real estate industry analysis report, the increase speed of sales amount has declined and even becomes negative. Comparatively, the statistics of property industry show good performance. Setting up their own professional property management department is economic friendly in reducing the administrative cost. Besides, it is convenient to build their own brands’ reputation to improve the competitiveness. VANKE’s commercial housing projects are famous for its matched property management service in the industry. High-quality property has brought indirect benefits to sales. VANKE service has merged with
many small property companies to improve its service scope. The normalization of their operation model and concentration of management improve the efficiency and proficiency of VANKE Service. VANKE Service has ranked first among the property companies for eight years. Over ninety percent of its business are from VANKE’s own housing projects, and it is a good try to expand business to others’ housing projects. Some small-size real estate developers cannot afford to set up their own property management team, and they need to invite other professional property companies to manage the daily operations of the housing projects, which provide business opportunities to VANKE Service.

3.4.3 Conclusion

Self-holding housing is a risky transformation direction and only large real estate corporations with good credit rating and strong capital chain can manage the self-holding housing projects. However, if the developers want to increase their land stock, sometimes they are forced to enter the self-holding stage to bid for the land. The problem needs to be solved is that how to find the balancing rental model which is both acceptable to developers and renters. For example, reducing the rental period and allowing installment are good choices.

Property management is a sustainable business sector for small-and-medium-size real estate companies to reduce the capital risk. The initial cost is lower compared to the business model of buying land, developing, and selling. Chinese government has increased the difficulty of acquiring commercial land, and many small real estate companies are squeezed out of the market for limited capital sources. Operating property management by themselves can also avoid the agency conflicts among residents, developers and outside property companies, increasing the satisfaction of residents towards the housing projects.
Conclusion

The external and internal situation of real estate market has changed after 2013. With the background of economic growth slowdown, process of urbanization, disappear of population benefits, the future growth driver of real estate market change from increasing volume into optimization of stock. In addition, the problems such as surplus stock, shortage of fund and decreasing profit of traditional model further drives real estate enterprise to transform its business model.

Wanda has transformed from heavy-asset operating to light-asset operating. Brand reputation together with the ability of well or innovative management and operation are key to success. China Merchants Property Development Co., Ltd. has transformed to industry-city integration operation with “Front Port, Mid Zone, Back City” Model. The ability of integrate resources especially land and enhancing operation performance are important factors. Fosun Property serves as a case of financialization while VANKE is as a case of better operation of self-holding housing and property.

For objective of successful transformation, a company can consider light-asset operation and financialization to deal with fund. In order to access to more land, as indicated in light asset and industry-city integration, cooperating with government or companies owning surplus stock is recommended. After development and sale of new real estate, better operation and property management satisfying diversified customer demand can improve operation performance. The profit from operation and property management such as rental income will be the new growth diver in the future. Selecting the suitable transformation model based on the situation and advantages of companies, real estate enterprises will be well prepared for the future.
Reference


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