

# Chinese residential real estate industry analysis



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During last several decades especially last 10 years, a great development has been seen in the Chinese residential real estate industry. From the eastern wealthy cities such as Shanghai to the developing cities which in the western part of China, the residential real estate industry has become an important part of the economy. According to national research the sales of Chinese residential real estate in 2009 was nearly 4.4 trillion RMB which account for nearly 13.11% of total GDP. More than millions of people were employed in this sector. This report conducted two famous tools-PEST analysis and Porter's 5 forces to analyze the remote environment and the competitive forces of the chosen industry. The PEST analysis analyses the remote environment in terms of four aspects: political/legal, economic, social, and technological, while the Porter's 5 forces model examines the competitive environment including new entrants, competitors, substitutes, suppliers and buyers. The purpose of the report is to reveal how the remote environment and competitive arena have effects on the industry and the players within the industry.

## **2. Industry background**

Residential real estate is the mainstay field in our national economy and plays a decisive role. It is closely related with our national economy and our people's livelihood. From the open-and-reform policy on real estate in our country develops rapidly and shows great liveliness.

The Chinese residential real estate market developed into the embryonic stages in 1980s. A few residents who lived in the city began to accept the concept of the living house as a commodity, the sales of residential house as commodity began to rise. But under the circumstance of planned economy

system, the develop speed in this industry is still very low. Because many people still hold the concept of “welfare housing” which means the employees can get the living house from the government or the enterprises for free. Enter the 1990s, the investment in residential real estate market appeared a fast growth momentum. Many real estate develop enterprises grew up during this period of time. Only in 1992, the amount of Chinese real estate enterprises increased by from 2243 to 11432. Although the numbers of real estate companies declined in 1996, however since 1997 the quantity shows a steady growth trend until today. According to some research there are over fifty thousands real estate enterprises in China. A lot of famous real estate enterprises emerged such as Poly Chonghai and Vanke which is the largest real estate operator in the world in 2010. The ups and down of the numbers of real estate agency can reflect the development of this industry in some extent. Since 2000, accompanied by the continuously growth of Chinese national economy, the development in this industry became more quickly than ever before.

Source: Journal of the Chinese Statistical Association

As we can see from the graph above, the brown line shows the sales of housing area in China increased dramatically from near 3 billion in 2001 to over 9 billion 2009. Moreover, we can learn from the blue line that the amount of money supply (M2) went up from 2. 2 billion to over 12 billion which means that many credits have been invested in this market and it still increase by nearly 20% every year. According to economic regular pattern, under the market economy condition, the money without exception will flow into high-profit industry, this is an inevitable trend. This means the huge

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development in this industry has attracted many attention and investment in last 10 years.

However, like many other countries, China also has experienced a process of quickly increase in the residential asset price during last several years.

According to YU(2010) The average residential house price increased 52.57% in China, in some big cities, the price went up over 100%.

Source: The data are from the National Bureau of Statistics, PRC, January 2003 to March

2009. Output is generated by Eviews 7.

From the graph above, we can see that the average residential house selling price in China was nearly 5000RMB in 2010 which doubled the number of 1998. But this is just the average price of the whole China including the western poverty provinces, in some big cities in the eastern part of China, the price is much higher, take Shanghai as an example, the average residential house selling price in 2010 was 45887 RMB. The price increased so quickly and for many city residents, their income for nearly 30 years still can not afford to buy a living apartment in the some cities, so many economists argue that maybe there is a bubble in China's residential housing price.

### **3. Pest analysis of the residential real estate operate industry**

The pest analysis is a tool used to analysis and describes a framework of macro-environmental factors used in the environmental scanning component

of strategic management. The Pest stands for political factors, economical factors, social factors and technological factors.

### **3. 1 Political/Legal**

The residential real estate industry is one of the dominant industry of the Chinese national economy and be placed in a pivotal position in today's modern economical and social life. After about 20 year's development, this industry in China is transforming from the government housing plan system to the commercial housing market method. But as a result of its importance in the national economy, the residential real estate industry is always influenced by the state's macroeconomic policies.

#### **3. 1. 1Land supply**

It is different from the private land system in the western countries, the Chinese constitution stipulates that the land in the Chinese city and town area is belong to the central and local government, in other words, it is state-owned property. The land in the rural area is collectively-owned. Unger this circumstance, the land demander such as the residential real estate operator and the purchaser of the residential house only can purchase the use-right for a number of years. For example, an ordinary city resident can only keep the house he bought for 70 years.

The land supply policies have a notable impact on the residential real estate market. In order to accelerate the development of the Chinese economy, the government carried out a serious of loose land supply policy, so the development in this sector was very fast from 2000. For example, only in

Beijing, the land supply for the residential real estate sector is over 1500 hectares in 2006.

Moreover the by selling the land use-right to the operator is an essential way for the central and local government to increase its revenues. It is dangerously that the government becomes more and more rely on the sales of land. The loose land supply policies lead to the over-developed in the residential real estate sector in some extent. So after the 2008 financial crisis, the central government realized the dangerous signal in the residential real estate industry such as the over-investment in this sector, the fast growing housing prices. In order to stabilize the national economy in the global economical recession, it is priority to stabilize this sector which account for nearly 10% of the GDP. The main channel is to decrease the land supply from the government.

### **3. 1. 2. Government macroscopic readjustment and control policy**

Ye et al. (2006) argue that the macroscopic readjustment and control policy in the residential real estate industry in China has went through three stages since the reform and open policy was carried out in 1979.

The first stage is from the 1979-1990 the transition from the national welfare housing system to partial welfare housing system. The second stage is from 1990-2005 the transition from noncommercial to market-based housing control policy. And the last one is from 2005 to now on be the transition from unitary to multiple and comprehensive policy measures. After the development of the three stages the Chinese government more or less has

shaped a macroscopic control policy covering from the land management, investment management to the public finance and some other aspects. So after then the residential real estate policy has already become an important way for the government to realize the macroeconomic control in this industry.

In 2005, the Chinese central government realized some problems in the residential real estate market such as the over-investment in this sector, the fast grow property price, the panic purchasing of living house and so on. In order to achieve the fast, healthy and orderly development of the residential real estate industry, the state council published a statement of 8 national measure rules to regulate the order in the residential real estate market. Some details of the statement are as follows:

1. To strengthen macro-planning of commodity housing and improve its structure, all districts would have to confirm total investment value, programs, and progress of construction of commodity housing by 2006.
2. To improve low-cost housing in towns and cities, as well as to ensure a sufficient housing stock to satisfy the basic housing needs of low-income families, the coverage of low-cost housing would be enlarged and low-cost housing would become a responsibility of city and town governments.
3. To better monitor the property market, the system for disclosing market information was to be improved, policy transparency increased, and better media guidance provided.

Although the government carried out these 8 measures but the residential housing prices still increased very fast especially in the big cities. So in 2006, only after one year later, the state council released another statement which contains another 6 policies continues to cool down the residential real estate market. For instance, it is ruled that the houses which the area is less than 90 square meters should account for at least 70% of the total area the residential real estate operator developed. And if the individuals sell the house in the next 5 years since they buy the house, they will be charged property transition tax.

The financial crisis which began in 2008 in United States harmed the residential real estate industry in China hugely. So in order to improve the healthy development in this sector, the government continued to carry out 3 more rules to cheer this industry up.

In April 2010, the state council released new national 8 measure rules according to the new situations in the residential real estate market. Some measures such as follows:

1. Minimum down-payment for second home purchases from 50 percent to 60 percent of the property's value and approved the launch of property taxes in Shanghai and Chongqing.
2. The government will provide at least 100, 000 affordable apartments and give housing subsidies to 20, 000 low-income families this year. Low and medium-income families can start applying for about 10, 000 low-rent apartments at the end of the year.



From the analysis of the political aspect we can learn that the Chinese government involve in the residential real estate industry frequently. The political policies have a huge impact on this market.

### **3. 2 Economic**

The economic environment mainly includes two aspects: the macroscopic and microscopic environment. In China, the development of the residential real estate is closely related to the macroscopic environment. The cycle of domestic real estate industry has obvious concern with GDP growth, fluctuations in these two aspect are basically the same.

#### **3. 2. 1 Economic situation**

The 2008 financial tsunami put a great pressure on the development on the Chinese national economy. But through effectively macroscopic control policy, China achieved a great improvement in the economy growth in 2009 and 2010.

Figure: the GDP growth of China in 2009 and first two quarters in 2010

In 2009, the Chinese GDP grew at the speed of 6. 2%, 7. 9%, 9. 1% and 10. 7% respectively. In the first two quarters the GDP grew at 11. 9% and 10. 3% and outnumbered Japan as the second largest economy in the world.

As mentioned above, the development of the Chinese residential real estate has a closely relation to the development speed of the national economy. Its development trend and macro economic development has the positive correlation.

National economy develop speed

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The situation of the residential real estate

Lower than 4%

shrink

4%-5%

Stagnant, even retrogress

5%-8%

Stable development

8%-10%

Rapid development

10%-15%

Hyper growth

Chart: the relation between the development of national economy speed and the real estate industry.

Source: 'real estate market analysis and practice'

### **3. 2. 2 Currency and bank credit policy**

The currency and banking credit policy for the residential real estate enterprise is relatively loose between 2000 and 2007. From 2003-2007, in order to control the growth of the banking credit, the Chinese central bank increase the interest rates and the deposit reserve ratio several times for the

several main commercial banks in China. Moreover, the central bank raised the down payment ratio for the housing loans from 20% to 30%. However, the residential real estate operator still can get loans from the commercial banks easily when compared to the enterprises in other industries. Because of the fast growth of the resident saving in last two decades, there is a great pressure on the commercial banks for how to use this large amount of saving. Compared to other industries such as manufacturing or retailing, the loans for the booming Chinese residential real estate sector is low risky and can bring higher profits for the commercial banks. In order to achieve more profit, the commercial banks provides more loans for the real estate companies although it is opposite to the central bank's policy to control the over-investment in the residential real estate industry. According to the national statistics, between 2003 and 2007, the whole industry got over 500 billion RMB from the commercial banks.

However from 2007, the central continued to increase the deposit reserve ratio to 17.5% which was nearly double the number of the beginning of 2007. Moreover the down payment ratio and interest rate for the residential real estate operator is much higher than before. So it has an obvious inhibition for the source of funds to the real estate market.

### **3. 2. 3 The influence of foreign direct investment (FDI)**

In recent years, much of funds flow into the Chinese residential real estate market from overseas. This is influenced by four factors. The first one is the positional of the appreciation of RMB, the second one is the economy growth speed difference between the Chinese market and overseas market especially the western developed market, the third one is the exception of <https://assignbuster.com/chinese-residential-real-estate-industry-analysis/>

the increase about the Chinese domestic market inflation and assets price and the last one is the financial crisis, because of the financial tsunami, the risk for the investors in the American and European residential real estate industry is much higher than ever before. In order to secure the property and get higher profit, the booming Chinese market is an excellent choice for the foreign investors. The foreign capital inflows make the Chinese foreign exchange reserve increased a lot in last several years. In 2009, the foreign exchange reserve of China is nearly over 2 trillion dollars, which is as two times as the second largest foreign exchange reserve economy, Japan. Most part of the foreign capital was inflow into the real estate and stock market of China. Only a limited amount of capital was invested in other industries. This year, the Chinese CPI index continued to increase and lead to the increasing exception about the inflation of the Chinese economy. So more and more foreign capital came to Chinese market, especially the residential real estate market and these foreign plays a more important role in this sector which accelerates to growth speed of this industry.

However this foreign capital is very sensitive about the economic environment, once the economic situations in their own countries or the other countries take a turn for better. This foreign capital especially the hot currency will leave the Chinese market and bring turbulence to the Chinese residential real estate market. So in 2009, The national reform and development commission and the department of commerce released a statement called the ' CATALOGUE FOR THE GUIDANCE OF FOREIGN INVESTMENT INDUSTRIES' to restrict the foreign investment into the Into the secondary market and real estate agent or broker company.

### **3. 3 Social**

China is the largest developing country in the world. The Chinese national economy has been keeping growth at 10% for more than 30 years. But the real GDP per capital is only nearly 4000 dollars which means there is a huge gap when compared to some western countries. The current stages of the national economy and the demand for the development of the economy determine that the residential real estate industry will continue to be the consumption hotspot. So the real estate industry will enter high growth phase correspondently.

#### **3. 3. 1 Population environment**

The market is made up by the individuals who have the desire to buy and the ability to pay. The amount of population directly affects the potential capacity of the residential real estate market. As we all know that, China is a country with large population of over 1. 3 billion and about 0. 6 billion people live in the city and town area. This is provides a huge market for the Chinese residential real estate industry. Most part of people who was born in the 1970s and 1980s which is a high period for baby born were gain a foothold in the city and town area. These people have a huge demand for the living area, their purchasing power is huge than the previous generations because their economic conditions are much better and they can get support from their parents.

Take the largest city in China, Shanghai, for example

FIGURE 1 Shanghai Resident Population Growth Forecast from 2005 to 2010

As the largest city in China, Shanghai attracts many people come to live here, the population grew from 17.7 million in 2005 to over 19.1 million in 2010. So, as we can see, because of the quick expand of the population scale and the increasing outside population entry, the demand for the residential house will see a huge trend of rising in the next several years which provide a good opportunity for the residential real estate enterprise to develop themselves.

### **3.3.2 Urbanization**

In the area of research about urban development history, the American urban geographer Ray. M. Northam invented the 'Northam's Curve'. This theory mentions that there are two important turning points in the process of the urbanization level, one is 30% which represents the national economy enter the stage of high-speed development, the other is 70% which means the economy enter the mature stage. The process of urbanization and the development of the residential real estate have internal relations. When the urbanization level reaches 30%, the investment in the residential real estate begin to accelerate. When the urbanization reaches the level of 50%, the investment in this sector will reach the peak and keep high investment rate until the level of 70%. According to national research the urbanization level reached 38.4 in 2004 in China. The investment in Chinese residential real estate industry began to show a quick rise trend. In 2010, the urbanization level in China is nearly 40% and it is forecasted that the level will climb to 70% in 2050. It is described in the figure2 as follows

FIGURE 2 China's Urbanization Trend Curve with the Development of the Real Estate Cycle

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As a result of the rapid development of the Chinese economy, there is a large amount of population move into the city and town from the rural area in the next several decades. This will definitely make the housing what a basic element of human lives become relatively scarce and provide a huge market for the residential real estate industry.

### **3.3.3 Family structure**

There is a great change in the family structure in China compare to 30 years ago. The family is much smaller than before, a usual Chinese family is made up of three people today in most Chinese cities, this is a result of the one-child policy which has been carrying out for 30 years. Moreover, the thoughts of younger generations is very different from their parents, they prefer to live alone after work or marriage. This is also lead to the increasing demand for the housing real estate.

### **3.4 Technological**

The residential real estate is a capital intensive and knowledge intensive industry. It is characterized as a industry with high technology, high technological standard and requirements. With the development of modern technology and the coming of information age, more and more companies begin to focus on technology innovation. Moreover, with the increasing income of the residents, the Chinese ordinary people's requirement for the living condition is much higher than before, this new requirements put more push more pressure on the residential real estate operators to improving the technological standards.

### **3. 4. 1 Energy saving and environmental protection**

For a long time the Chinese residential real estate operator pay more attention to how to build beautiful and larger house for the city residents. But as the Chinese real estate market become more and more mature, the popularity of the environment protection awareness and the requirements of sustainable developments. More and more operators tend to build environmental buildings by using modern technology. From the environmental residential buildings development trend, there are three main aspects. The first one is, for the buildings palisade structure, the constructor should use more heat insulation materials. The second is, for the heating, lighting and some other systems in the buildings, the energy saving equipments should be frequently used. The last one is, using more renewable energy source such as solar power and wind energy.

### **3. 4. 2 Information age**

With the development of modern information technology, some intelligence buildings are emerged in some cities. The owners of these buildings can control the whole house by only a laptop or even a simple mobile phone. For example, they can open the heating system or lock down the windows even they are far away from home.

Besides, because of the modern Internet, the lifestyle of many people has changed, the living buildings are no longer a home for everyone. Many humans choose to work at home, the house is also a workplace for them.



## **4. Porter's 5 forces Analysis of the competitive environment**

Chinese residential real estate market is a mature market with lots of players. But this industry is basically dominated by three kinds of companies, the state-owned company, the private-owned company and the foreign-owned enterprises. The competition within the residential real estate market is quite intensive and fierce. Many famous real estate operators have emerged in last 20 years such as Vanko, Ever Grande, Zhonghai and Poly.

Michael Porter (1980) developed a framework for industry competitive analysis, consisting of five different competitive forces which refer to microenvironment. The frame work is shown in the figure below:

### **4.1 Rivalry among existing competitors**

Chinese residential real estate industry is full of opportunities and challenges, as results of the high profits and vast potential for future development, a lot of enterprises have entered in this industry. According to porter's theory, the enterprise in most industries tend to have a close connection. The competition strategy which carries out by all the enterprises is all aim to gain advantages over its rivals. The competition between the enterprises is always display in the area of pricing, advertisement, after-sale service and so on. As for the enterprises in Chinese residential real estate market, the core competitions are main focus on the amount of land reserve, sales strategy and management strategy.

Apart from the fierce competition among the native real estate enterprises such as Vanko, Zhonghai and Ever Grande, there has been an explosion of overseas real estate companies enter the Chinese market, for instance, the

Yanlord land group from Singapore and the Hines real estate from America. Among these competitors in Chinese residential real estate market, Vanko, with its formidable influence, is viewed as the market leader. The Ever Grande, the new emerging real estate operator, because of its successful publicity strategy and innovation spirit, is viewed as a strong challenger for the Vanko group. Moreover, the state-owned company, Zhonghai and Poly. The private-owned company, SOHO Beijing and the overseas groups such as Yanlord, Hines, Shuion are all great competitors in this industry.

Vanko, as the market leader, accomplished sales of nearly 110 billion RMB, followed by the Poly and Zhonghai with sales of 66.6 billion and 57.8 billion respectively. The Evergrande group and SOHO Beijing also achieved 52.7 billion and 49.9 which is very close to the top 3 giants. There are 3 factors contributed to the success of Vanko. The first one is specialization. Vanko is a residential real estate operator which was founded in 1988. In the next 10 years it has investment in many industries such as manufacturing, fast food, retail, this develop strategy direct leads to the capital dispersed, the complex of business structure and problems of management chaotic. So from 2001, Vanko began to abandon the other business and tend to only focus on the residential real estate market. The second reason is Vanko is always keep a large amount of land reserve, because of the over-investment in the residential real estate industry, the government began to decrease the land supply in 2006, many real estate operator's business met problems as result of shortage of land reserve. The land for the real estate company is like the bullet for the army. Without of land reserve means no land to operate. But Vanko always keep a land reserve of nearly 40 millions square

meters every year. The last reason is the quality of the house which was operated by Vanko is always guaranteed. The slogan of this company is to build the most safe house for the clients. So many customers have a brand loyalty for Vanko.

As to the Evergrande group and SOHO Beijing group, the competitive strategy is a little different. The SOHO has always been devoting to develop high-end house in big cities, so the residential real estate projects which operated by SOHO are always fashionable and luxury. The Evergrande group, as a new emerging real estate operator, the publicity strategy is very successful. For example, it support a famous football and volleyball club in China, carried out a serious plan about the TV advertisement which help the customers to get to familiar with the company.

#### **4. 2 Threat of new entrants**

If a company intends to enter the Chinese residential real estate industry, the main problems come from the enterprise itself. That is the enterprise must guarantee it has enough economic power to realize its normal operation after it enter this market, because of the residential real estate industry has characteristics of high amount of investment, high risk, long funds gathering cycle and long supply chain. So once an enterprise enter this marker, especially the residential real estate, if the money runs out, it is hard to operate the project and the investment of human resource, funds, materials will also be sacrificed. The quitting cost is very high. So the enterprises when they decide to enter the Chinese residential real estate market, they should be very careful. Although they decide to enter the

market, a lots of companies choose to enter the second-line or third-line cities which with lower competition.

After China joined the WTO in 2001, the barriers for the foreign investors to enter the Chinese real estate market are much lower than before. In order to attract more foreign investment to accelerate the economy growth, the foreign companies enjoy the same treatment with the Chinese companies in tax and some other aspects. So for many small residential real estate operators, as a result of short of funds, lots of them will be eliminated. The foreign real estate will get more and more market share in the next 10-20 years.

#### **4. 3 Threats of substitutes**

In general, there are no substitutes for the residential real estate, because the living house is the mainly living condition for all the people. But under the Chinese circumstance, there is a substitute for the commodity house which called the ' indemnificatory apartment'. This is a kind of apartments which are built by the government, providing for the lower-income family who can not afford to buy a commodity house because it's high price. But, in fact, these apartments are situated in the edge area of city, they can not meet the residents requirements for the living conditions such as transportation, shopping and meals. So in the residential real estate market, the position of the commodity house is still unbreakable.

#### **4. 4 Bargaining power of suppliers**

According to the difference of the bargaining power, the supplier can be divided into two categories. The one category is the government and the

bank, the other category is made up with the raw material supplier, the construction company and so on.

The scarcity of the land and the government's completely monopoly of the land leads to the lacking of price elasticity of land. So the residential real estate enterprises always at a disadvantage place during the negotiation with the government, they have to get the land-use right with high cost. Banks, as the fund supplier for the real estate operator, follow the government policy, possessing the initiative to provide loans to the real estate company, including the size of the loan, the interest rates, so the currency supply plays a key role in the residential real estate market. As to the raw materials suppliers and the construction company, the residential real estate enterprises at the core locations of the whole supply chain, the real estate operator can compress the costs, so the bargaining power of them is weak.

#### **4.5 Bargaining power of buyers**

The strong or weak of bargaining power of the buyers will lead to the price competition among the real estate enterprises and then influence the company's level of profit. In general, in Chinese residential real estate market, the demand has been exceeding supply for many years. in the city and town area, especially those big cities such as Shanghai, Beijing, Guangzhou, with the improvement of the living standards, there is a vast emerge of the rigid demand for the living house. At the same time, the wealthy people take the residential real estate as a good way to rise to investment value.

Moreover, because of the widening gap between rich and poor in China, more and more wealth are gathering by few people, the residential real estate operators always focus on the demand of these buyers, so the residential real estate market always turn to the middle and higher class and the low cost housing for the lower-income family is few. Although some enterprises operate some low cost house, the lower-income family still can not afford to buy an apartment.

Because of the high de