



Research Article

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A research on the innovative route of Chinese real estate business model under the background of industrial structure adjustment—based on the case study of the Evergrande group

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ABSTRACT

Chinese real estate enterprises which undergo a time of dramatic changes are confronting a series of complex and unprecedented problems including a slow economic growth, the adjustment of industrial structure and the elimination of outdated capacity. Under this circumstance, the innovation of business model is the key to obtain competitiveness for these enterprises. Based on the elements of the business model which involve value proposition, value creation, value maintenance and value network, this paper, taking the macro-environment changes into consideration and with the Evergrande Group as an example, presents an innovative route to real estate business model and illustrates the cycle process of innovating business model.

Key words: evergrande group; business model; real estate enterprises; innovative route

INTRODUCTION

Insufficient domestic demand and weak external demand result in severe overcapacity in China. In order to improve the situation, Chinese government is working positively on the adjustment of industrial structure. Under this circumstance, Chinese real estate enterprises are faced with problems such as money squeeze, turnover drop and the government macroeconomic regulation and control. All these problems lead to the insufficient or even the broken cash flow to these enterprises. Besides, Amit and Zott's research reveals that business models of the enterprises play an important role in innovation and value creation. Studies about the business model focus on how to maintain competitiveness and increase enterprise value. There are many definitions about the term "business model" in China and abroad. After making a comparative study of the definitions, Osterwalde points out that business model, which is made up of many elements and is formed on the basis of these elements, is a conceptual tool to explain the business logic of a specific enterprise. Thus, business model is used to explain how the enterprises expand the market, transfer value, create relational capital, gain profit and maintain cash flow through creating customer value, establishing internal business structure and forming relationships with partners. Changes of the macro-environment urge Chinese real estate enterprises to innovate their business models to improve competitive edge. According to Weng's study, among the 50 famous global enterprises which change the world, 31 enterprises survive and develop depending on the innovation of business model. Most of these enterprises change their business model every 2 to 4 years on their own initiative. To sum up, the study on how to innovate business model of Chinese real estate enterprises under the background of industrial structure adjustment is of necessity.

2. LITERATURE REVIEW ON BUSINESS MODEL INNOVATION THEORIES

The concept of business model innovation can be traced back to Schumpeter's concept of technological innovation. In Schumpeter's view, the generalized technology innovation includes almost all aspects of enterprise management innovation involving product innovation, process innovation, market innovation, the source of supply innovation and the innovation of organization and management. Among them, market innovation, the source of supply

innovation and organization management innovation can be incorporated into the category of business model innovation. So far, studies on business model innovation both at home and abroad can be mainly divided into three categories including: studies on the definition of business model innovation, analyses on the innovative route of business model and the evaluations of business model innovation.

2.1 DEFINITION OF THE BUSINESS MODEL INNOVATION

Magretta who combines business model innovation and value chain theory considers that a new business model is the adjustment of the existing value chain. That is to say, it is an innovation of the two basic activities in the value chain (one is related to the manufacturing business, another is related to the sales business activities) Siggelkow describes the adjustment process as enlargement, enforcement and elimination. He thinks that when the adjustment exceeds certain limit it turns into the business model innovation. Michael and Morris point out that business model has a life cycle which includes the norming stage, strengthening and consolidation stage, adaptation stage, modification stage and the reengineering stage. The business models of the enterprises will evolve from the base layer to the unique layer and finally to the rule layer. Besides, with changes of the business environment, the effective commercial mode must face adjustment. Mitchell and Coles, taking the constituent elements of business model into consideration, put forward that the basic elements of the business model are 5W2H, namely, the stakeholders of the enterprises, products or services provided by the enterprises, where and when the products or services to be provided, reason for the enterprise existence, means of exchange and the price paid. If only one of these seven elements makes the enterprise toward the good direction, this can be called the improvement of the business model. If four or more elements have been changed, it becomes the revolution of the business model. When it comes to the business model innovation, it refers to the business model revolutions which are totally new and have not been applied in the industry. This kind of unprecedented business model transformation process is called business model innovation.

2.2 ANALYSIS ON THE INNOVATIVE ROUTE OF BUSINESS MODEL

Analysis on the innovative route of the business model will make the business model innovation process change from the "intuition-oriented" to the "creative and rational-oriented" one. At present, studies on the innovative route of the business model both at home and abroad are mainly based on two aspects, namely the value chain and the component elements or the classification system of the business model. In the analysis based on the value chain, Paul Timmers puts forward a classification system which is based on the interactive mode and the integration of the value chain. He points out that the systematic approach to build business model includes the decomposition of the value chain and the reconstruction of it. The construction and implementation of a typical business model require the identification of the value chain elements, the interactive mode and the latest development of technology. In the analysis based on the component elements or the classification system of the business model, the first step is to find the component elements or to conclude the reasonable classification of the existing business model. And the next step is the methods study on the business model innovation based on the component elements or the classifications. This step will provide methodology guidance for the design of business model and help enterprises develop practical business model innovation strategies. At present in China, Li Dong's research in this field is relatively mature. He adopts the Meta method to conduct the principal component synthesis analysis and the iteration analysis on the basic management strategies of the enterprise and on the component elements of the business model mentioned by other researchers. Based on the new principal component and through hierarchical clustering, three basic elements including customer value proposition (CVP), cost structure innovation and profit protection mode innovation are obtained. And next is the analysis of the innovative route of the business model under the macro-environment changes.

2.3 ASSESSMENT ON THE BUSINESS MODEL INNOVATION

At present, assessments on the business models both in China and abroad can be divided into two kinds: one is beforehand assessment which will predict by forecasting the profitability and applicability of the business model the performance that it may have after implementation; another is called ex post assessment. It is an analysis on the changes which are brought after the implementation of a business model. It is no longer a forecast but an assessment on the actual effect. In the beforehand assessment, Hamel mainly evaluates the business model from the perspective of the potential for wealth because he considers that a good business model must be able to create higher profits than the average ones. In his opinion, efficiency, uniqueness, matching and profitability are the four aspects to evaluate the business model. Gordijn thinks that in the assessment of the business model, the key lies in the analysis on the flow of value between the different participants. So he invents the profit/utility sheet as an assessment tool. Morris considers that the matching of the business model which includes internal matching and external matching plays an important role in evaluating the business model. In terms of ex post assessment, Afuah and his fellow researchers also evaluate the potentiality of the business model from the perspective of profitability. They think the evaluation of the business model can be divided into in three steps: the first step is to investigate the present earning performance which mainly involves the evaluation of income and cash flow of the business model; the second step is to measure

the profit forecast factors, which includes the assessments on the profit margins, market share and revenue growth rate; the third step is to measure the constituent factors of the business model, which involves ten parts and each part including a complete set of evaluation index. Drawing lessons from Kaplan, Duboson and Torbay adopt the balanced scorecard method to evaluate business model. The author of this thesis thinks that in the upsurge of the overseas merger and acquisition, Chinese enterprises who eagerly step to globalization should first use the ex post assessment methods to assess the present business model. And once the enterprises find that the current business model has no potential or the indexes cannot satisfy the enterprises' expected profit or the market share, they should take proactive measures to consider whether they need to conduct business model innovation. In forming a new business model, beforehand assessment must be conducted. Then, in a certain period, the assessment cycle which consists of ex post assessment – beforehand assessment – ex post assessment will be repeated to ensure that the present business model has been in a state of potential and under control through the constant innovations and changes.

3. INNOVATIVE ROUTE DESIGN ON CHINESE REAL ESTATE ENTERPRISES

3.1 BACKGROUND

Since the market-oriented reform on the real estate industry in 1998, China's real estate market has been developing rapidly. With the continuous development of the real estate market, Chinese real estate enterprises have been rising sharply too. During this period, China's real estate market has been through twists and turns: a large number of real estate enterprises, for example, the famous real estate enterprise "Shun Chi Real Estate", closed down because their business models can not adapt to the market environment. Since the financial crisis in 2008, China's real estate market growth has been falling back with lots of emerging problems like the increasing difficulty in financing and financing cost and the slow down of the money collecting rate. Faced with all the difficulties, the Evergrande Group, through constantly improving its business model, has kept more than ten years of rapid development. Thus, it is necessary to study and draw lessons from its business model innovation. Recently, the Group has conducted a lot of mergers and acquisitions, making the development of the Group more diversified. But whether this kind of development mode can adapt to the increasingly complex market environment is still a subject which needs further study both for the academic and corporate circles.

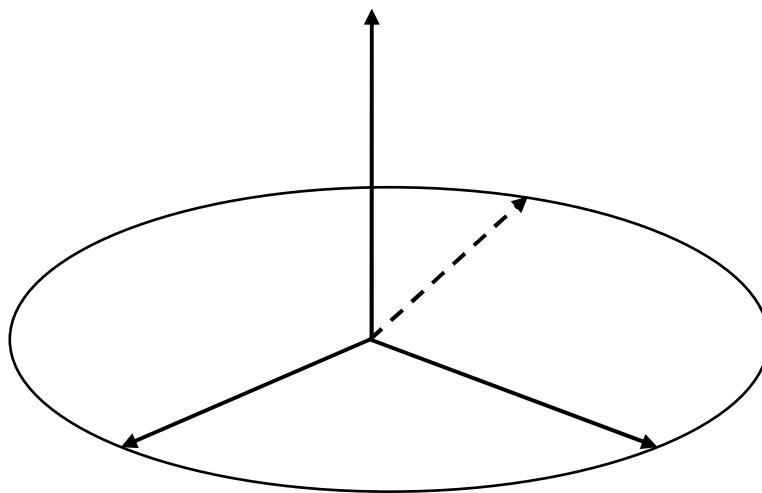


Figure 1 Real Estate Enterprises Business Model Innovation Graph

3.2 BUSINESS MODEL INNOVATION

(1) Business model innovation under the background of industrial structure adjustment. Mark W. Johnson proposes that business model consists of four elements, namely the customer value innovation, profit model, key resources and key process. Based on the characteristics of the real estate enterprises business model and the existing classification method and taking the component elements of business model and the innovative route design of the classification system into consideration, the author of this thesis considers that the constituent elements of the business model are: value proposition, value network, value creation and value maintenance. The value proposition which includes target customers and value content is the unique value that the products or the services of the enterprise will bring to the consumers. It is the sum of a series of vested interests that the customers can perceive. The value network which mainly involves network form and value orientation can potentially provide enterprises with access to information, resources, market, technology, and the possibility of scale and scope economy through studying. It will help the enterprises achieve strategic goals, such as risk sharing, value activities or organization function of outsourcing and the improvement of the organization ability. The value creation including revenue model

and cost management refers to a series of business activities and their cost structure in producing and supplying the products or services that meet the needs of the customers. It reflects the enterprise's main investment. The value maintenance mode mainly involving partnerships and insulation mechanism is the distribution and transmission activity through which the products and services of the enterprises are delivered to the customers in a creative mode. It aims at making the target customers buy or get familiar with the enterprises' products or services. The author of this thesis thinks that under the adjustment of the industrial structure, the enterprises are entering a new market. It is not feasible to transform the business model through the profit protection means like the formation of trade barriers and the government subsidies. So the author puts forward the real estate enterprise business model innovation graph shown in figure 1 under the background of the industrial structure adjustment:

In the diagram, the value proposition, value maintenance and value creation are put in the same coordinate level, thus forming the innovation surface. The value network is established on the basis of the three elements. In the situation of severe overcapacity and the unfinished industrial structure adjustment, the author thinks that the focus should be first placed on the expansion of the X axis, W axis and Z axis. And after these three points reaching a certain level, the expansion of the Y axis should be implemented.

(2)Actual operation on the innovation surface of the business model – a case study of the Evergrande Group. On November 15, 2009 the Evergrande Group appeared on the Hong Kong stock exchange. After that the Evergrande Group underwent a rapid expansion, reaching a new high in the sales volume at that year. However, in the year before, affected by the financial crisis, the Group, with a lack of cash flow and the risk of capital fracture, failed in coming into the market and was faced with bankruptcy. Therefore, this paper studies the business model innovation of the Evergrande Group from 2008. Throughout the past five years, the innovative measures that the Group has taken on the innovation surface which is formed by the Z, W and X axes (shown in figure 1) are as follows:

First is the value proposition mode innovation in the Z axis. The Evergrande Group incorporates the credibility of the brand, service brand and sports brand factors into the approval of the target customers. The Group puts the quality of the products and the services it provides together with the corporate reputation, trying to enhance the brand reputation from the credibility level. Through oral spreading, the credibility of the enterprise and the reputation of the brand are both improved. Moreover, service brand factor mainly refers to the entire service management which starts from the customers getting in touch with the products. The after-sales service of the products mainly refers to the property management. The problems and suggestions put forward by the customers, as long as the Group can solve or thinks they are reasonable, will be adopted or solved promptly. Through establishing cooperation relationship with sports brand, the Group enhanced its competitiveness and made its brand value rise sharply. In terms of the value content, the measures that the Group has taken are still focus on the product quality and social benefit, which is short of appeal relatively.

Second is the value creation mode innovation in the W axis. In terms of the revenue model, the Group implements large-scale reserves, fast development and high sales strategies. With the massive reserves, multiple projects and the opening quotation featuring low prices, the Group recoups the funds quickly. In such a mode of income, though the sales profits increase significantly, the cash flow of the Group has some problems. So the Group takes measures to optimize its cost management mode. The measures mainly include implementing standardized operation mode, trying hard to lower the management risk and ensuring the effective control of the cost. To be specific, the measures are product standardization, operation standardization, management standardization, standardization of project selection and material selection, standardization of bidding, project management standardization and standardization of marketing. These specific standardized measures help the Group step on a new stage in the management, making the cost of production very clear. Based on these measures, the Group develops the project development cost control system which through scientific measurement could make explicit provisions both for every standardized step of the production and the project schedule. Owing to this system, the project cycle is shortened; the cost of the project materials and the labor cost are reduced; the cash flow tension is eased and the high speed developing revenue model of this enterprise is thus guaranteed.

Third is the value maintenance mode innovation in the X axis. In terms of the cooperation relationships, the Group has established full cooperation relationships with all the partners in the upstream and downstream of the real estate enterprises. In construction materials and equipments, the enterprise established strategic cooperation with the Kohler Company in the U.S. In the product design, the Group established cooperation with Atkins. In terms of the choice of construction unit, the Group cooperates with the China State Construction Engineering Corporation (CSCEC). When it comes to the product decoration, the Group cooperates with the Gold Mantis Company in Soochow, China. In the choice of the marketing agency, the Group cooperates with the E-House (China) and the Hopefluent Enterprises. In the property services, the Group established win-win cooperation with the DTZ Company. In the insulation mechanism, the biggest advantages of the Group are its insulation of the brand and financing

advantages. The implementation of the financing modes which include preferred convertible stock financing, loan guarantees, project financing, public financing and the priority of bill financing help the Group run smoothly in carrying out strategies in the maintenance of the partnership and in the value proposition as well as the value creation.

Fourth is the business model comparison with competitors. The author of this paper summarized the definitions of the Z axis (value proposition), W axis (value creation) and X axis (value maintenance) defined respectively by the Wanda Group, Vanke Group and the Country Garden Holdings Company (see table 1). The above analysis proves that all the successful real estate enterprises share one thing in common that is they all have an explicit business model which will change with the macro-economic environment. These successful business models are characterized by a supporting system which includes corresponding knowledge structure, brand capital and channels and the loyalty of customers. The above mentioned three companies have different core competitiveness. If the Evergrande Group wants to imitate the diversified development strategy of the Wanda Group, learns the high-quality goods strategy as well as the property management experience of the Vanke Group and at the same time can not meet the low cost and high efficiency of the production like the Country Garden Holdings Company, the business model of the Evergrande Group will be fuzzy and could be copied. The author of this paper considers that the Evergrande Group should evaluate and adjust its business model timely to find the value activities which could form new core competitiveness, thus forming its distinctive brand features.

Table 1 Business Model Comparison

Business Model Comparison	Wanda Group	Vanke Group	Country Garden Holdings Company
Value proposition innovation (Z axis)			
Target customers	Diversified customers	Mainly urban white-collars	Mainly the customers who have urgent needs
Value content	Integration of commerce and housing	Product quality and property management	Product quality and landscaping
Value creation innovation (W axis)			
Revenue mode	Large-scale reserves, fast development and high sales strategies; diversified development	Stable development; relatively concentrated relevant industries	Getting land in the urban fringe at a low price; large-scale development; low price selling
Cost management	Refined cost management; large-scale purchase to lower the price	Refined cost management; bidding mode	Refined cost management; Multiple suppliers
Value maintenance innovation (X axis)			
Partnerships	Win-win cooperation	Win-win cooperation	Win-win cooperation; Helping the weak ones
Insulation mechanism	Brand & financing advantages	Brand & financing advantages	Brand & financing advantages

(3) Innovative route model building. In the above case study, with the description on the changes of the business model of the Evergrande Group, the author elaborates how the innovative route which is formed by the business model element method is implemented in the actual operation of the innovation surface. In China, there are a majority of real estate enterprises of different scales, financing ability and core competition ability. The application of the innovation methods should be different, but the innovative route on which every enterprise must depend during its development has a general law. Based on this, the author chooses the business model element method in studying the innovative route of the business model and classifies the component elements. Taking the necessary conditions for the business model innovation into consideration, the author considers that the innovation should be conducted on the basis of science and rigorous beforehand assessment and ex post assessment. So the author puts forward the innovative route model under the background of the macro-environment changes (see figure 2).

The model describes the innovative route of the business model. First, due to the macro-environment changes, the enterprises should pay attention to the business model assessment. That is to say, they should employ the ex post assessment method to evaluate their present business models. According to the research results of the relevant studies on the business model, tools that can be used in evaluating the present model include balanced scorecard, earning performance, profit forecast and the component elements of the business model. If the result of the assessment matches with the expectation of the enterprise, which means the present business model is still workable, the enterprise could preserve the original one in a certain period of time. If there is a gap between the assessment result and the enterprise's expectation, the enterprise will know the current business model is not workable and it must take measures to innovate the model. According to the business model element method, the enterprise should do the following things. First is the value proposition innovation which includes redefining the customers and making clear the profits that can be given to the customers. Second is the value creation and value maintenance

innovation which involves finding new profit point, solving the problem of how to optimizing the cost structure by using the resources advantage of the new environment. When the enterprise completes the customer value innovation and the profit pattern innovation, it can take advantage of the profit protection, namely grasping the key resources and key process, to consolidate the situation of getting high profits. After that, the enterprise could carry out the value network innovation. When the business model innovation is completed, the enterprise should employ the beforehand assessment in which the profit/utility sheet or the four elements analysis can be used to evaluate the new business model. If the result shows that the model is feasible, then it can be put into practice. If the result indicates the model is not feasible, the innovation should be carried out once again. It is important to aware that the process of business model innovation is a circular one featuring continuous improvements. With the constant changes of the macro-environment, a business model will certainly be replaced by new ones.

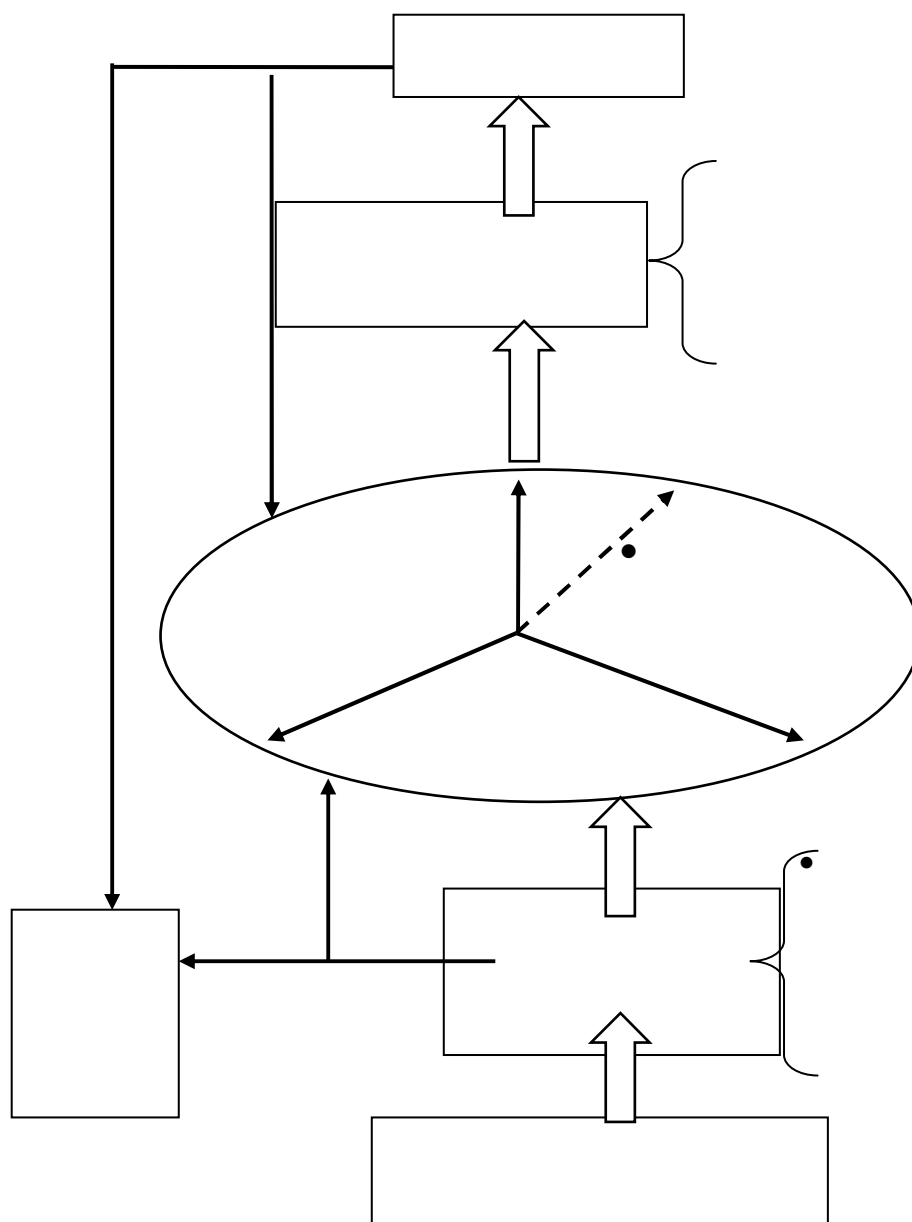


Figure 2 Innovative Route Model under the Background of the Macro-environment Changes

4. Conclusions and suggestions for further study

Combining the business model element method with the beforehand and ex post assessments, this paper puts forward the innovative route model for the enterprises. Based on the case study of the Evergrande Group, the paper also elaborates on how to create the innovation surface by using the innovative route, providing suggestions to the Chinese enterprises on business model innovation. The conclusions of this paper are as follows.

- (1) Owing to the fact that Chinese real estate enterprises are entering a new macro-environment, the enterprises

should first pay attention to the innovation surface which is made up by the value proposition, value creation and value maintenance during the process of business model innovation which is based on the business model element method. And after achieving certain improvements in the innovation surface, the focus should be then put on the value network mode innovation.

(2) Chinese real estate enterprises, faced with a series of complex and unprecedented problems including a slow economic growth, the adjustment of industrial structure and the elimination of outdated capacity, are in an era of rapid changes. Thus, the enterprises must carry out sufficient analyses before conducting business model innovation to find the necessary conditions for innovation. They should first choose an assessment method which suits the development of them and then carry out the rigorous business model evaluation, forming the cycle process of business model assessment, business model innovation, reassessment and readjustment.

(3) The development of China's real estate enterprises is not the same. Based on following the steps of the innovative route, different enterprises should choose different methods which suit them to build their innovation surfaces.

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