

ANALYSIS OF THE COMPETITION ENVIRONMENT FOR REAL ESTATES

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Abstract: According to Porter's theory, five competitive forces determine the competition intensity of a trade, and change with the development of the trade. In a trade of intensive competition the majorities of the enterprises get low profit, and vice versa. Today the real estate market of China has entered the intensive competition era. In this paper, based on the study and analysis of the current market situations and competitiveness of the real estate enterprises in China, several factors related to the competition in real estate market is proposed to help the enterprises face the challenges under severe competitions.

Keywords: Real estate; Market; Economical environment; Competitive environment

1 Introduction

Michael Porter, professor of Harvard Business School, developed five competitive forces theory of Industry Structure, which is one of the main tools to analyze the market competition, and reflects the real estate market situation objectively, and helps enterprises realize the industry situation and the correlations of competitive forces.

According to the five competitive forces theory, the competitions in an industry not only exist in the competitors, but there exist five basic competitive forces, which are the threat of new market entrants, the threat of substitute products, the bargaining power of buyers, the bargaining power of suppliers, the competition within existing rivals. As showing in figure 1 below.

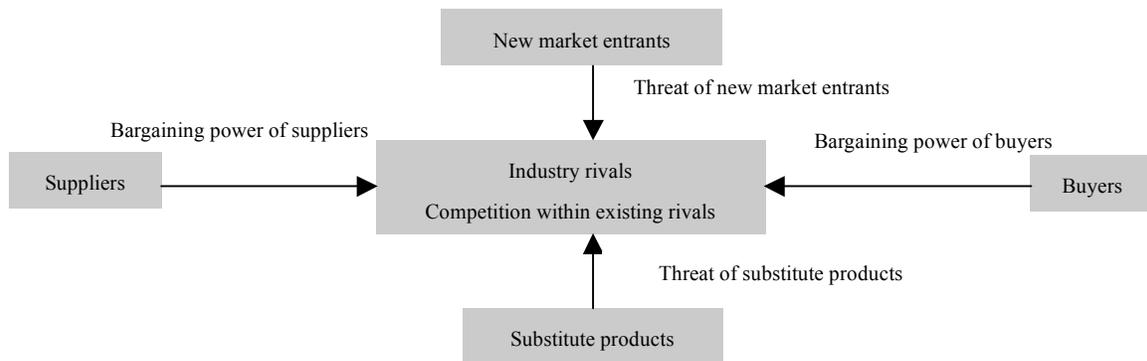


Figure 1 the structure of five competitive forces determining Industry profitability

The situation and comprehensive strength of the five basic competition forces determine the competition intensity of industry and the industry profitability. Moreover, the competition intensity determined by five forces is different between in industries, and changes with the development of the industry.

In an industry of intensive competition, the majorities of the enterprises get low profit, and vice versa. Today China's real estate market has entered the intensive competition era.

Next, the real estate market is analyzed by the five competitive forces influencing the industry structure, to research on the competition situation of China's real estate market.

2 The threat of new market entrants

The real estate market is a relatively unique market, and its uniqueness lies in the high-input, high-yield, and high-risk. Since the introduction of reform and opening up, real estate has been separated from the construction industry and has developed rapidly. There are 37123 real estate development enterprises as of

2004; the number is quite big in contrast to that of other country.

However, the development scale of many enterprises is small, and their strength is not strong enough to be said internationally competitive enterprises. Quantitatively, the annual average development volume is very small, and the market share of the largest domestic enterprises is only 0.5%. The real estate market is large potential for new entrants for the following reasons:

(1) The real estate industry as a pillar industry is of great importance to the national economy, which has attracted many enterprises to be involved in it. Bros Liu, as the Chinese mainland richest man listed in U.S. financial magazine “Forbes” in October 2001, set up their company based on animal feed, food, bio-based products in 1982, invested 3.0 billion into the real estate industry in 2001.

(2) In recent years, the good operating performance of the real estate industry have aroused widespread concern from other industries. In 2001 Mainland China 100 tycoons in regal list, 25 were engaged in the real estate. Therefore, many enterprises regard engagement in real estate as strategic decision for rapid development, and are stepping up into the real estate market.

(3) As a result of the differences of regional economic environment, potential entrants in different regions are also different. For example, Beijing will invest 150 billions RMB into Infrastructure construction for Olympics. Before 2008 there will be completed nine million m² of old urban areas, because of this, the potential entrants to Beijing has three obvious characteristics: there are more ecdemic enterprise, more laic enterprise, more foreign-funded enterprise. The Plan of "Great Beijing" World Town was announced, which will prompt bigger effect of the Olympics and accession to the WTO, make Beijing become a hot spot in North China, and attract more people into this market.

(4) There are only a few foreign enterprises participating in China's real estate market and less internationally renowned enterprises into the domestic market. As China's accession to the WTO, these enterprises will not ignore Chinese market and will be directly involved in it. For example, in the early December 2001, at the business meetings held in Singapore, China Shenyang delegation signed nine agreements with Singapore; there are five real estate projects.

(5) The threat of entrance from other area exists in many provinces and city of China. Beijing YinXin GuangHua real estate company that has developed " sunshine 100" Successfully, signed a contract of 1,500 acres land in Jinan; Newtown developers Panshiyi has scored 1,000 acres in HaiNan for the development and construction of Hainan Boao; Hong Kong Hutchison Whampoa signed with the Beijing Chaoyang District government an investment of 10 billion to develop 300 hectares land of Dongba. Therefore, the threat of potential entrants is very huge, and real estate enterprises must compete for limited market to meet the challenge of new entrants.

3 The threat of substitute products

China's real estate market is still in the formative age, and the target customers are constantly changing. This is because consumption patterns gradually changed from the public consumption before the reform and opening up, to personal consumption after it. However, personal consumers become increasingly critical, and the consumers' demands of commercial, business and others become increasingly high.

(1) The transformation of Consumer attitudes and the high-grade price of the real estate provide an opportunity for the substitute. For example, in the residential market, although the current houses are good enough, will be replaced by newer better housing if not quickly be sold.

People's demands always changes with their conception of property investment. According to real estate market transactions statistics in a coastal city during 1998-2000 made by Tianjin University, the size and price of the best sales are as follows : 1998, 75 m², 1.8 million ¥; 1999, 85 m², 2 million ¥; 2000, 100m², 2.5 million. The market clearly indicates a gradually increasing trend in the construction area. If the developers can not fully realize this, there will emerge a large backlog of small size housing.

But this is not static, it is necessary to know that "Home Ownership Scheme" doesn't mean "Home Ownership property". With the government policy's guidance and consumption's maturation, eventually the consumption stairs structure will come into being in the real estate market. The products should be composed of low-cost rental houses, ordinary rental houses, second-hand houses and commercial houses. Purchasers should be formed jointly by consumers and investors in accordance with a certain proportion, and the people

which have no purchase power may choose rental housing.

(2) Changes in the consumption level lead to the flourish of substitutes. For example, in the residential consumption, at the beginning of reform and opening up there is no luxury villa any more, but there are lot of villas now, which seize high-grade and ordinary residential market share. This situation will continue to occur for a long time.

(3)With the cars coming into family and transportation facilities improved, the real estate consumer attitudes are changing, and residential suburbanization trend will be more obvious. Residential suburbanization is an essential trend in the city development. With the city expanded, due to the land area is limited, the population density is increasing, which results in more cost of congestion. Furthermore, overcrowding leads to the deterioration of the environment, which forces out some resident and organs of the city. This trend has already occurred in many developed cities, and now has been evident gradually in China.

Whether people are willing to go to the outskirts for residence or not is based on the cost-effectiveness analysis, and an important factor is traffic fare. Therefore, lowering the traffic cost becomes the decisive factor for transfer to the outskirts or not. Although the trend of residential suburbanization is inevitable, it doesn't mean that developers build houses in the outskirts will certainly sell well; there still will be vacant houses, uncompleted residential flats. This shows that the market only accept the commodities that meet people's need. So developers should make decisions based on many aspects such as transportation, water, electricity, natural gas and other infrastructure as well as medical care, natural environment.

(4) After WTO accession, opening efforts have been stepped up, foreign institutions, private enterprises and individual enterprises was being in the volume growth, which increased employment opportunities and incomes for young people, and the enjoyment of the property for housing increases with it. Some real estate products with higher added values named as "compound house", will be in larger demand. It's a good example that the real estate project near Beijing CBD sells well.

(5) After WTO accession, Chinese residential manufacturization, standardization and industrialization will accelerate with the introduction of foreign advanced technology. And the residential manufacturization will contribute to the emergence of high-tech new-generation residential. The new-generation residences aren't obsolete in ten-twenty years, and can be transformed in thirty-fifty years, and can be used in 100 years. Today, we have the market conditions to develop new-generation residence, and whether it can start earlier or not, the key lies in the ability to innovate and market adaptability of the developerment enterprises.

4 The bargaining power of suppliers

Professor Michael Porter dissertated in his book of "competitive advantages" that "suppliers might put pressure on enterprises in some industries by use of the threat that increases the price or reduce the quality of the products or services". The supplies of the real estate industry are lands, building materials and equipments. At present, the suppliers of general building materials and equipments have weaker bargaining power, and those of the special materials and equipments have some bargaining power, but the land provider has high bargaining power.

The land belongs to nation, the developers purchase its tenure, and they are subject to the effects of national and local government's land policy, and so have been restricted in land acquisition. The cost of land acquisition is an important part of real estate total cost, and the land supply is limited, which makes the land suppliers have high supply-side bargaining power.

Although the government has introduced a number of policies to stabilize the real estate prices, but whether the prices of ordinary residence or high-grade is still rising, which follows that the second-hand house's price is also increasing dramatically. June 2006 new house's sales prices still rise largely in Beijing, compared with the same month in 2005, representing an increase of 11.2%. Therefore, real estate development enterprises are influenced deeply by the government land policies.

5 The bargaining power of buyers

Purchasers are the object of products or services. They could be individuals, families, organizations and government departments. So it is foundational and prerequisite for the enterprise's success to understand the bargaining power of buyers and to analyze their purchase behavior and characteristics. Real estate products

are high-grade consumer goods. It's a big decision to purchase real estate product whether for business or for individuals, therefore, they consider the prices very carefully.

(1) The purchaser's bargaining power has changed. Private consumption-oriented buyers will use more time to "bargain". As the real estate market is also being standardized, the developers are lack of unified management of the price; and so the price competition among enterprises become increasingly fierce, as a result of this, the buyers in the real prices has increased bargaining power.

(2)The developers give large price fluctuations rights to the distribution staff, and their income have a direct relationship with the sales performance, which leads to the difference of the price in the same property. The buyers realize the “prices flexibility” in the process of buying property, and that the buyer bargaining power is enhanced.

(3) The Medias constantly report the irregularities of certain developers, and warned consumers against real estate consumer traps, which make some buyers misunderstand the market and lower confidence in developers. These indirectly lead to the buyer bargaining power increased.

(4) The new market entrants have increased, and they often take price war for more market share, which increases the buyers' bargaining power.

6 The competition between industry rivals

Competition within the industry usually refers to that the real estate rivals provide the same or similar properties to the consumer in the same area. They focus on the market outlet in order to achieve greater market share. The competitive intensity within the real estate industry depends largely on the number of competitors, the balance of power, product differentiation, market supply and demand. When the number of industry competitors is large, their power is at the same level, the difference between real estate products is smaller, and market oversupply exists, the competition within the real estate industry will be very intense. Competition means include the price war, the advertising war, the property management, product improvement and increased services.

Competition between industry competitors is the most important one of the five mentioned above. Generally speaking, the customers need more than one business groups, and the enterprises carry out their business activities under the siege and restrictions of competitor groups, which come not only from the domestic market, but also from other countries and regions. The competitions exist not only within the real estate industry, and some enterprises outside the industry may adopt other cooperation with existing enterprises to compete. The contentions not only determine their market position, but also directly affect their profitability, and so it is necessary to analyze the competition situation within the industry.

(1) There are 24378 real estate development enterprises in domestic market, which is big number. Normally, in an industry there are more enterprises and more intensity will be. It's not only because many enterprises must take a place in markets determined by the total demand, but also because every enterprise has the view that it itself is only a minor participant, hence its price or other investment strategy for the whole industry have minimal impact, and they will take a separate action. In such cases, cooperation between enterprises will become more difficult, which also intensified competition.

(2) Although there are many real estate development enterprises, but their development capacity per year is very small, and the market can't be dominated by one or few large enterprises, and they can't adjust their prices and other tactics to affect others. Especially when major competitors have almost the same strength, the competition between will become more fierce. In fact, the number of enterprises within the industry and their relative size reflect the industry concentration, normally measured by the market share some major development enterprises occupy. Higher is the industry concentration, the number of enterprises within the industry is relatively smaller. When one or a few large enterprises occupy most market share, competition will relative ease.

In figure 2, the former three enterprises are the top three real estate enterprises in America. The last three are the top three domestic enterprises. The figure shows that the market share of the largest enterprises in America is higher than that of domestic real estate enterprises; there isn't an enterprise that has market impact power in the domestic real estate industry, and so the competition is more fierce.

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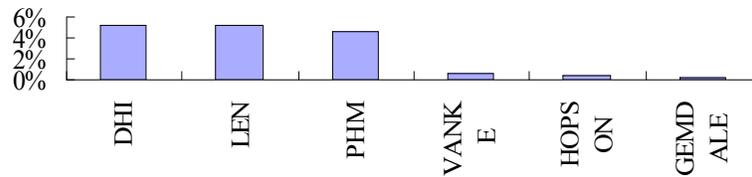


Figure-2 the comparison in the market share of three largest real estate enterprises between China and America

(3) When the products or services provided to customers are lack of difference, the customers may choose a substitute for it, which will stimulate the enterprises to lower price for survival. This situation also exists in current domestic real estate market, and it is one of the reasons causing a large backlog of housing. On the other hand, the products of strong differences clearly take an advantage in market competition, and just because of this, Beijing Newtown projects has become the best sales in Beijing real estate market.

(4) With the competition growing, the quantity and relative strength of the enterprises are constantly changing. industry concentration is also increasing, and the relatively weaker competitors will continue to be excluded from the industry. Relevant legislation and government policy will make adjustments with the market conditions constantly. For example, Tianjin abolished the licenses of more than 350 real estate development enterprises from 2000 to 2005, and supported the former 20 enterprises, which made market competition more standardized and orderly.

(5) The competitors bring enormous pressure to the real estate enterprises, at the same time, their behavior also increases the impetus for them to develop. Competition is often an important stimulus factor to reduce costs, improve qualities for enterprises. E.g. Shenzhen Vanke is growing up in the fierce market competition.

7 Conclusions

China's real estate market is of great competition companied with huge potentials. If the real estate enterprises want to survival in the fierce competition market, they need a comprehensive and detailed analysis urgently for the market characteristics and developer's competition environment. This paper used the five competitive forces theory developed by Professor Michael porter, made a systemic analysis for China's real estate market and competitive environment, and hopes to do some help for real estate enterprises responding to the fierce market competition.

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