

Face Changes by the Use of Management Ideas-Take China Evergrande Group as an example

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Abstract: *Chinese housing industry is heavily driven by political power through industries' policies and recent ten years are witnessing great changes in this area. Hence, how an organization responds to these changes properly in order to stay competitive position is a big issue. This paper explores how the Evergrande Group should face the political changes by use of frameworks and theories in the field of business model, strategy and leadership and reveals the close connection among these subject areas. Most importantly, several personal recommendations about better adaptation to political changes on behalf of the Evergrande Group are provided in this paper, which may shed light on the future operation of the organization.*

Keywords: political changes; the Evergrande Group; business model; strategy; leadership

1. Introduction

Located in Guangzhou, China, Evergrande Group is a leading organization in Chinese housing industry which is composed of several professional subsidiaries including Evergrande Real Estate Development Company, Evergrande Architecture Design Institute, Evergrande Construction Company and Evergrande Property Management Company. As a typical project-based company, Evergrande Group currently owns more than 400 mega projects in over 170 Chinese cities, which shows its company strength (Evergrande.com, 2015).

Chinese housing industry is heavily driven by political power through industrious policies and recent ten years are witnessing great changes in this industry. Hence, how an organization responds to these changes properly in order to stay competitive position is a big issue. This paper uses management frameworks and theories to analyze the Evergrande Group from the perspectives of business model, strategy and leadership in the hope of providing meaningful suggestions to the further improvement of the organization.

2. Political Changes

In 2003, real estate industry was officially considered to become the 'pillar industry' of China, followed by a series of industrial supporting policies as well as expansionary policies which boosted the real estate industry effectively. In particular, facing the global financial crisis in 2009, Chinese Government further loosened both of the monetary and fiscal policies in order to stimulate consumer's spending on housing. The result of this policy saw great success and it managed to drag Chinese economy out of the crisis rapidly. However at the end of 2009, several industrial structure adjustment policies were issued by Government to restrain the rapidly soaring housing price. Especially the policy about 'the second home' drew great attention from potential consumers, according to which, housing investors had to face higher interest rate of payment if they wanted to buy another apartment, so this policy impaired the desire to purchase to a large extent. And then, the year of 2011

witnessed a bunch of the severest macro-regulations in housing industry including quota policy, limited credit and price, etc. Though some positive policies were issued during 2014, the market has still been in depression. Under such a frequently changing and restrained political environment, housing price did present a downward trend while potential buyers were still likely to adopt a wait-and-see attitude towards housing consumption.

These political changes reflect several points. Firstly, Chinese Government still holds the planned economy thinking about administrative intervention on real estate market, which increases the market fluctuation to some degree. Moreover, policies are amended in a relatively fast pace and any predictions of real estate industry become impossible to be accurate. Most importantly, excessive policy changes undermine the government authority and low level of public trust leads to the contagion of wait-and-see attitude. Under this circumstance, how does the Evergrande Group make a response?

3. What Can be Done

Business Model

Business model, as is defined by DaSilva and Trkman (2014), can be interpreted as a combination of resources which generate value through transactions and this statement implies that business model is underpinned by the Resource-Based View (RBV) and Transaction Cost Economics (TCE). This part will apply TCE's perspective to analyse the Evergrande Group's reaction to adapt the political changes and next part will employ RBV to illustrate strategy.

To monitor the cost becomes a more urgent task when organization is confronting with contractionary policies and it is not an exception for the Evergrande Group. Apart from production cost, transaction cost is relatively not easy to be perceived (Coase, 1988) and it would become more significant for the Evergrande Group to stay competitive during disadvantageous time if the organization succeeded in cutting its transaction cost. The Evergrande Group started

to control transaction cost by introducing a Vertical Integration Model -- it established an integrated project-delivering system comprising a real estate company, an architecture design institute, a construction company and a property management company. This sort of internalization enables the Evergrande to act as several project actors simultaneously (i.e. the client, the designer team and the contractor) and have the capacity to deliver projects independently. More importantly, a smooth information channel was built through this business model which granted each part of the Evergrande Group a platform to exchange information and add value, and the transaction cost could be dramatically reduced accordingly (Dunning, 2003). Each industry has a business cycle and these several years are seeing a downward trend of the real estate industry due to political intervention. On the contrary, industries like tourist industry, culture industry, sports industry and finance industry are protected to expand by Chinese government and they enjoy a bunch of supportive policies. In this situation, Transboundary Operation Model was also adopted by the Evergrande Group as a solution to policy constraints apart from the Vertical Integration Model. On one hand, the Group can reap the benefit through moving into other industries from economies of scale as well as economies of scope (Teece, 1980; Lambrecht, 2004); on the other hand, transaction cost can be diminished because the previous selling network can be replanted into other industries and information is relatively easy to access. Among all the industries the Evergrande has moved into, finance industry is the one with supreme significance because those political changes also restrained companies' financing capacity and this may be fatal to capital intensive organisations like the

Evergrande Group. In order to tackle this issue, the Evergrande Group went so far as to become the fifth shareholder of Hua Xia Bank in 2014 through merger and acquisition. This move decreases the financing cost directly and also contributes to control the transaction cost. My suggestion towards this business model is to further expand financing channels by seeking for more opportunities about direct financing because of the relatively low interest rate and minimal transaction cost (unnecessary to communicate with individual investors). Except for issuing an IPO, financial innovation tools like asset-backed securities (ABS) and asset-backed notes (ABN) are also desirable alternatives. Transboundary Operation Model reflects the advantage of economies of scale and economies of scope (Teece, 1980; Lambrecht, 2004) and the prolonged industry chain is presented in Figure 1.

Interestingly, 'business model' is a term which is pervasive in academia while often confused with 'strategy'. Some scholars (e.g. DaSilva and Trkman, 2014) hold the idea that business model influences the operation in a short-term perspective and strategy focuses on the long run. And Casadesus-Masanell and Ricart (2010) point out that 'business models are reflections of the realized strategy' to clarify their difference. From this point of view, an organisation exposed in political changes should have a clear strategy to guide its direction of development and amend the business model when necessary, which also illustrates the interaction between business model and strategy. Therefore the following section will proceed with my analysis within the framework of strategy.

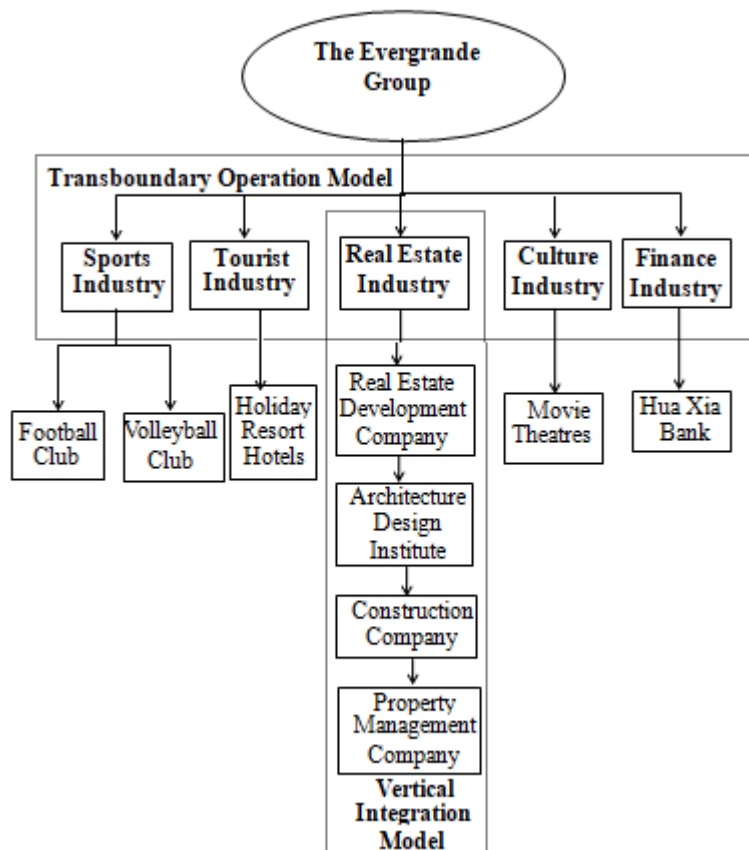


Figure 1: Industry Chain of the Evergrande Group

Strategy

Barney (1991) demonstrates that the firm resources are critical for implementing strategies successfully in pursuing of a sustained competitive advantage, which is also the seminal work of the Resource-Based View (RBV). Land is always considered as a sort of scarce resource in populous countries like China. For a project-based organization, owning construction lands is the prerequisite to deliver projects. Therefore, it can be concluded that the land is one of the most important resource of real estate companies.

During the period between 2003 and 2009, targeting the abundant potential of appreciation, the Evergrande Group utilized the supportive policies and purchased numerous construction lands in nearly 170 medium and small-sized Chinese cities as a ‘first mover’. These lands in remote areas contributes to the organization’s sustained competitive advantage in terms of resource heterogeneity and immobility (Barney, 1991). Through this strategy, the Evergrande Group did achieve great success for initial capital accumulation and brand itself as a high-profile organization. After 2009, the policies became disadvantageous to housing industry, and under such a circumstance, I believe the top management of the Evergrande should accordingly alter its targeting strategy into focusing on mega-cities market because markets like Beijing and Shanghai are mainly driven by users rather than investors or speculators. As a result, housing markets in mega-cities are likely to shrink in the face of political regulations within a minimal extent and thus the resource can stay valuable for the Group. The theoretical background to my recommendation can be found in Barney’s (1991) framework which provided a set of criteria to evaluate resources, i.e., value, rareness, imperfect imitability and substitutability and these criteria perfectly reconcile the characteristics of mega-cities’ lands. Hence, this strategic transition may turn out to be significant to sustain the competitive advantage according to this tool. Meanwhile, resource reconfiguration like this action reveals the potential of dynamic capabilities within the organisation, which also becomes one source of sustained competitive advantage (Teece *et al.*, 1997; Eisenhardt and Martin, 2000). Ambrosini and Bowman (2009) even claim that strategy is about building dynamic capabilities to respond to existing and future contingencies in this changeable world.

Targeting strategy has been discussed under the perspective of RBV and the following part will probe into the organization’s decision-making strategy from the use of the Commander Model and the Collaborative Model in response to political changes. The Commander Model presumes the CEO with arbitrary power and adopts an incremental approach which addresses the changed environmental condition through planning modifications to the current strategy (Bourgeois III and Brodwin, 1984). Conversely, the ‘group wisdom’ is highlighted in the Collaborative Model and the CEO employs brainstorming in search for a comprehensive decision (Bourgeois III and Brodwin, 1984).

Before the year of 2009, the Evergrande Group adopted a kind of rigid decision-making strategy that the CEO acted as

the ‘commander’, analysed situations and issued the command to his ‘soldiers’, which highly depended on the CEO’s personal capability. This model accommodates to the Commander Model to some extent, however, the Commander Model has some unrealistic assumptions that weaken its usability, one of which would be the requirement of perfect information for strategists and manager (Bourgeois III and Brodwin, 1984). On the contrary, asymmetric information is dominating the real world -- terms like ‘moral hazard’ and ‘adverse selection’ are prevailing. To summarise, the Commander Model is too theoretical and idealised but it still contributed to the initial success of the Evergrande Group. The reasons could be the favorable political environment before 2009 and the remarkable individual capability of Xu Jiayin -- the CEO as well as the founder of the organisation, who managed to lead the Evergrande towards the right direction without making any fatal strategic mistakes during that time. When encountering restrained industrious policies after 2009, the Evergrande Group had developed into a huge organisation where a CEO with bounded rationality could never identify all the situations especially in complex and unstable political environment. Therefore I recommend the Evergrande Group to innovate its decision-making strategy by employing the Collaborative Model because it does not require perfect information and fits more in complex, less stable environments, where organisation’s activities cannot be totally managed by one executive (Bourgeois III and Brodwin, 1984). In detail, the new decision-making strategy will have to involve more organisational members and a three-layer decision-making system which comprised board of directors, decision committee and managers may be have great value of use. The shift of decision-making strategy may be imperative but it is not easy for an incumbent to forgo part of his authority (Teece, 2010). Once succeed, the result could be beneficial in the long run in several aspects (as shown in Table 1). Yet, this new strategy also has some deficiencies and the asymmetric information is the outstanding one. According to the Agency Theory (Eisenhardt, 1989), here I further recommend that an outcome-based contract is also requisite to decrease the potential risk and boost subordinates’ working enthusiasm (Burnes, 2014).

Table 1: Benefits of Three-Layer Decision-Making Strategy

Aspect	Description
Morale	Morale will be boosted because more people participate into decision-making process.
Efficiency	Managers have more power to manage the daily operation.
Comprehensiveness	More comments can be taken into consideration, which makes the final decision more resistant to potential risks.

Clearly, strategy requires to vary with political changes but strategy cannot change spontaneously -- it needs the authority to pull the trigger. In many situations, a leader is the best option to put new strategies into force and some scholars even claim that a leader’s mission is to press for change (e.g. Kotter, 2001). On the contrary, once a leader

changes his leading style, the organisation's strategy may also alter. This statement reveals the interaction between strategy and leadership and therefore, the next section will discuss the Evergrande Group's response to political changes within the leadership area.

Leadership

What is the major factor which distinguishes successful organizations from their less successful competitors? An effective leadership could be the answer especially for organizations in a dynamic environment (Kelley, 1988; Northouse, 2013). So it is worthwhile carrying on this analysis from the perspective of leadership.

Among theories or frameworks within this area, the leader-follower approach is one concerning on how the leader and follower develop an interpersonal relationship over time (Burnes, 2014). This approach sets the premise that different relationship will be developed between the leader and each subordinate, i.e., the leader will adopt a close and trusting relationship with a small part of subordinates and a more distant and formal relationship with respect to others (Kerr *et al.*, 1974). It can be claimed that dividing the working people in organisation is the key to this approach and Handy (1989) addresses this issue by proposing the Shamrock Model which classifies the members of an organisation as three parts just like the shamrock plant with three interlocking leaves. According to his model, an organisation is constituted by three distinct subordinate groups: a small group of specialist 'core' workers, a contractual fringe and a flexible labour force. Policies restrain the industrious development and indeed intensify the competition between different organisations. The Evergrande Group could therefore employ this model as a response to political changes -- classifying employees and treating them with different leadership behaviours. Specifically, top management members and key persons like department managers and professional experts make up the core workers who need to be treated as the cornerstone of the Evergrande Group and it is their high-caliber performance that drives the organisation into greater success. As the CEO, Xu Jiayin is supposed to care more about these essential subordinates through appropriate ways of rewarding or building friendship with them. Promotions, lateral career moves or personal training programs are attractive for these core members (Kotter, 2001). To carry out certain tasks in the process of delivering a project with an income based on results from contracts, contractors form the contractual fringe. Different from those general contractors which need to be supervised properly, contractors of the Evergrande Group does not require extra supervision -- they themselves are part of the organisation through the adoption of vertical integration model. The flexible labour force refers to those who are working on a part-time basis like salesperson and normally they are not indispensable for the daily operation of the group. However, the Evergrande Group has been trying to create a home-like atmosphere for them -- they are accommodated and have ample activities to blend into the organisation. The result turns out to be extraordinary: people quite enjoy the sense of

belonging and work harder to achieve or exceed their objectives. Some of the part-time workers even began to work exclusively for the Evergrande Group because of this caring leadership.

Instead of focusing on leadership behaviour, contextual approach concentrates on leadership style and incorporates change as a variable (Hughes *et al.*, 2009). This theory divides the environment state into two kinds which are convergent and divergent state. And transactional management should be used within convergent state; transformational leadership within the other (Burns, 1978). As the leader of the Evergrande Group, charismatic and visionary, Xu Jiayin should be portrayed as a typical transformational leader in the face of political changes. I believe he has the courage to overturn the status quo and brings about changes in organisation. The essence of this kind of leadership is the requirement of high commitment and trust from subordinates and Xu Jiayin can use some tools like public speech and private conversation to boost the moral and ethical values into higher level.

4. Conclusion and Recommendation

From some frameworks or theories in subject areas of business model, strategy and leadership, this paper explores the Evergrande Group's response to political changes in Chinese real estate industry within recent years and concludes that management ideas are with dramatic value of use to help an organisation analyse its operational situation and stay the competitive position. Besides, close connections between these three subject areas are perceived during the analytic process, which is presented in Figure 2.

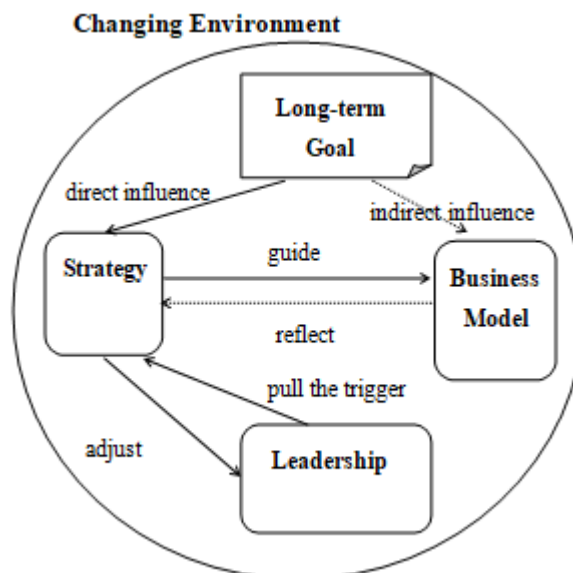


Figure 2: Connections between Different Subject Areas

Meanwhile, several personal recommendations about better adaptation to political changes on behalf of the Evergrande Group are provided in this paper and are also classified as follows:

- a) Carry on using the Vertical Integration Model.
- b) Innovate the Transboundary Operation Model through

- further expansion in finance industry.
- c) Shift targeting strategy from small cities to mega-cities.
 - d) Adopt Three-Layer Decision-Making strategy with outcome-based contracts.
 - e) Classify employees according to the Shamrock Model and treat different parties with different leadership behaviour.
 - f) Employ transformational leadership in divergent state.

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