Entering China: What Hong Kong Property Developers Err [1]

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Many Hong Kong property developers are known to be enormously rich by world standards and widely experienced in land and property development. Global forces, coupled with market opportunities, ethnical affinities and geographical advantages, have encouraged them to expand their activities to mainland China in recent years. However, most of them have apparently been outperformed by the less experienced and capital-deprived local developers in the mainland Chinese property development markets. Our study reveals that the investment returns of our surveyed China subsidiaries of major Hong Kong developers were much lower than those of the mainland Chinese counterparts listed in the China stock exchanges. For instance, the weighted average returns-on-equity of 35 mainland Chinese development companies amounted to about 8.94% in 2000, while the Hong Kong subsidiaries generally achieved less than 2%. This paper explores why these Hong Kong developers have been less successful in securing as profitable returns from their land development projects on the Chinese mainland as they have in their home base.

We argue that their unsatisfactory investment performance in mainland China is the outcome of a mismatch between market environment and business strategy. In many instances, Hong Kong developers tend to export their 'Hong Kong model' in developing land in the mainland Chinese markets and they have failed to adapt their strategy and practices to fit the Chinese context. This 'Hong Kong model', which we characterise as a 'production-based strategy', has led to their rise to pre-eminence in the home base. The success of this strategy rests upon the continual rise in land prices. The costs of land, and the timing of land acquisition and subsequent property sale, are paramount to a developer in weathering the cyclical property market. In the home market, Hong Kong developers mostly compete on quantity of rather than on quality of production. This strategy is compatible with the unique setting of the Hong Kong property market, which is characterised by limited land supply, disciplined government, few dominant competitors and strong property demand (before the Asian financial crisis).

In contrast, mainland China is a transitional market that contains many structural problems including fragmented government authority, deficiencies in the legal infrastructure, lack of transparency in government policies, and paucity of market information. However, these contextual factors affect both the mainland and Hong Kong developers, and they do not, therefore, explain their differential investment returns from working in the same market. We argue that the ultimate problem lies in the strategy of the Hong Kong developers in the mainland market. There are five key areas of pitfalls:

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(a) *Business strategy & development approach.* Hong Kong developers hoard land in mainland China; but its values do not appreciate as expected due to the huge supply of land. The perceived scarcity of urban land is unjustified with the continued improvement in urban infrastructure. Developers have tended to underestimate the fierceness of local competition. They have entered the China market mostly based upon gut feelings and herd instincts. The need for formal and thorough market research has often been neglected.

(b) *Staff management.* Many Hong Kong developers have not assigned their most reliable and capable staff to their Chinese offices. These appointees lack the authority to make important decisions on the spot. Many decisions have to be referred back to the Hong Kong headquarters. The decision making process is slow and bureaucratic. Furthermore, the wages of these appointees are much higher than those of the local executives. The failure to localise the supervisory staff increases the office overhead costs, impedes efficient communication within the Chinese offices, undermines their quality of management and weakens the commitment of the mainland subordinates.

(c) *Relations with local partners.* In mainland China, foreign developers have to form joint ventures with local enterprises in undertaking land development projects. Many Hong Kong developers have paid little attention to the importance of teaming up with good local partners. They are often eager to spend much more on identifying sites than they are willing to spend on comprehensive evaluation of the corporate strengths and weaknesses, strategic objectives, management philosophies, and business expertise of their prospective local partners. It turns out that the synergies of the two parties are just as important as the site characteristics in determining project success.

(d) *Construction management.* Hong Kong developers are generally 'land-oriented' rather than 'development-oriented'. They have failed to pay adequate attention to project management and construction efficiency. As a result, construction delays and cost overruns become the two key reasons leading to project failure in mainland China.

(e) *Relations with government authorities.* Hong Kong developers have maintained good social connections with the top leaders of the governments. Even so, guanxi has to be supplemented by tangible business accomplishments and project outcomes. Project delays and trouble-making during the course of development have tended to jeopardise social ties. Furthermore, fragmentation of local development control implies that good guanxi must be maintained at all levels of the government authority, rather than only with the top echelon of the bureaucracy.

We conclude that successful developers in mainland China must take a ‘ market-based approach’ that is sensitive to local market demand as well as to the local environment. Local knowledge and understanding of local culture are essential. Staff empowerment, commitment to the local market, and efficient internal communication are critical to enhance quick decisions. Localisation and recruitment of mainland staff to senior managerial positions are possible ways to improve performance. Teaming up with co-operative local partners provides a competitive advantage. It is also vital to maintain good working relationships and to secure the mutual trust of authorities at all levels of government. Finally, successful land development projects require strong project management of the entire development process, with attention to the management of the time, cost, and quality of projects.

Our evaluation indicates that, despite increasing cross-border investments in mainland China, successful land and property development remains a *local* business: it requires local knowledge, local manpower, local resources and, not the least, commitment to local market. The heterogeneity of the property market between different Chinese cities remains. The superiority of the 'Hong Kong model' is not universally applicable. Mere financial strength does not guarantee project success. The key lesson is that a wholesale transplant and export of Hong Kong practices by land developers without appropriate adaptation to the Chinese property market is destined to bring on financial difficulties, if not business calamities.

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