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THE REAL ESTATE INDUSTRY AND JOINT VENTURES IN CHINA

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Introduction

The Chinese real estate industry showed unprecedented rapid growth between 1991 and 1995 (the 8th 5-year plan) which resulted from the furthering of the open-door policy. This expansion of the real estate market, accompanied by fast economic development, increased the status and role of the industry and lead to its fundamental established in the national economy. From 1979 to 1995, the total investment in housing was US\$1, 250 billion, and from 1996 to the year 2000, it is planned to invest US\$750 billion in the real estate industry with emphases on residential projects and infrastructure (Real Estate News, March 97). Over the last five years, the average growth rate of the Chinese economy has been above 8%, and this increasing economic development has generated a massive demand in the housing market and real estate industry generally. This paper reviews the real estate industry during last 5-year-plan (from 1991-1995) by investigating its development, generated by the fast growing economy, and problems, due to an unsound market system and incomplete market regulations. It also analyses the industry's current situation and its development between 1996 and the year 2000 (the 9th 5-year plan).

As a consequence of this massive economic expansion, an increasingly large number of foreign investors have become involved in the lucrative market. The joint venture (JV), both as a management strategy and as a project system, has actively been used in the real estate market as a means by which China can attract foreign investment, technology and expertise, and at the same time, foreign partners can expand their operations into the Chinese market. However, joint ventures in China, as complex projects, involve massive amounts of data. This is particularly so because of economic reforms and continually improving laws and regulations in China, as well as a lack of mutual understanding between Chinese parties and foreign investors. Therefore, many problems have been encountered by joint ventures in China, due mainly to lack of information and poor planning. This has resulted in an increasingly large number of joint ventures being plagued by time and cost problems, resulting in dissolution and liquidation (Freeman, 1996). Consequently, the success of joint venture projects in China has been hindered, which in turn has discouraged many foreign investors who would like to venture into the Chinese real estate market.

The second aim of this paper is to analyse the current investment environment for foreign investors and to recommend ways in which they may improve their performance in

China's real estate market. This information will eventually be used to assist research into the development of a model for the simulation of a joint venture.

1. The Chinese' Real Estate Industry

Economic Environment

The real estate industry is a guiding industry, with the potential for high profits, which leads and effects other industries' development. General speaking, the real estate industry's development depends on economic outgrowth. In China, the real estate industry embraces: land development; building construction; property management; land use-right (assigning and transferring); mortgage loans; and the corresponding marketing of the real estate. Not only must development of the real estate industry keep pace with the national economic development but it must also be closely related to the economic capacity of the market place. The industry has become increasingly independent and has rapidly developed since 1987, with the number of property projects expanding at an unprecedented rate in 1991, 1992 and 1993.

With the assurance of a high return on investment and in the absence of empirical information, most subsequent investment was blindly put into high-class property, such as commercial projects and luxurious apartments. After the middle of 1994 to towards the end of 1995, the property market started to shrink and a large number of properties were unsalable, which resulted in rising vacancy rates, falling prices and falling rents. If investment is too high based on the prevailing output -to-capital ratio, property prices will be effected leading to short term economic disequilibrium (Ball&Wood, 1996). This may explain why it is important that real estate development should match the growth rate of the nation's economic development. Excessive development has also caused some environmental and public service difficulties, such as increased air pollution, traffic congestion, insufficient water supplies, an overburdened security force, inadequate fire protection, and poorly maintained property. Such problems lend support to the findings of researchers (Schwab & Hamilton, 1996; Tse, 1996) that high capital gain in the past produces rather lower than expected future appreciation.

To curb the problems associated with a relatively over-heated real estate market, the Chinese government has taken a firm hand by restructuring the economy in order to make the real estate industry one of its pillars. The main policies are: controlling the scale of new projects' scale; assigning land to ordinary residential housing; allowing major projects such as "An Ju Projects" to be completely free of tax; strengthening infrastructure; and providing more information to facilitate the selling, buying and leasing processes.

Demand and Supply

Even though US\$102billion was invested in property during the 8th 5-year plan period, the housing shortage in China is still serious, especially in urban areas (Economic Daily, 25th Jan. 1996). The floor space per capita in urban areas was only 7.7 sq. m. in 1995 and

more than 4.2 million families are currently living in crowded conditions (under 5 sq. m/per capita). Despite the poor living conditions, the desire for home ownership is increasing. According to a survey carried out in 1996, 45% of urban citizens want to own their properties (China Information). Demand for reasonable quality and affordable residential housing has exceeded supply, since long before the open-door policy. In order to catch up with the demand, the government intends to maintain a growth rate of 15% and 18% for the construction industry and the real estate industry respectively (China Land News, 7th March 1996). By doing this, it is anticipated that the floor space per capita in urban areas will reach 8-9 sq. m. by the year 2000.

Paradoxically, vacancy rates for residential property dramatically increased in 1995 with a 53.46% increase over the vacancy rate for 1994 (see table1).

Year	1994	1995
Investment (billion RMB)	256	315
Sold Area(million sq. m)	72.3	76.3
Vacancy Area (million sq. m)	32.6	50.1
Residential vacancy area (million sq. m)	25	39
Sources: Real Estate Report 1995		
Note: 1US\$=8.4 RMB		

An important benchmark for rationalising the growth of the real estate market is effective demand. Due to low incomes, the majority of people can not afford high-grade and high price buildings. Therefore, it is a policy of the government policy to place much greater emphasis upon the development of affordable housing and associated infrastructure.

Housing Finance

Housing finance is an organic combination of real estate and finance. Its function is to provide the financing regard for the process of construction, circulation and consumption, by raising funds through different means (Zhou, Chan & Liu, 1992). Formerly, credit was only granted to developers to purchase land and develop property, and very little credit was supplied to individuals. Consequently, the majority of people couldn't afford to buy the private houses and so living conditions could not be improved. After a period of rapid real estate expansion, the market became unable to absorb the newly completed units, especially residential property, because the financing system lagged far behind development of the real estate market. As a result, funds invested in the real estate market couldn't function normally, which caused enormous losses to developers, financing departments and individuals.

According to international practice (China Information, April 1998), housing prices are 3-6 times greater than a family's yearly gross income, or a house can be bought after paying the mortgage for between 10 to 15 years. Housing prices in Shanghai increased 10 fold during the 10 years from 1985 to 1994. By contrast, the income of a citizen increased only 5 fold during the same 10-year period, going up from US\$89.00 to US\$417.00 per annum.

Of the total investment in property, land fees and tax constitutes 39%, the construction cost constitutes 51% and others accounts for 10%. In 1996, the government concluded that one of the main reasons for the relatively high cost of houses, was the additional cost of constructing associated facilities, such as schools and kindergartens (in particular, the relatively high taxes and fees attached to such properties), which are apportioned to the cost of each housing project. The implementation of an austerity policy for high-grade projects, the strengthening of relevant laws and regulations, the establishment of a housing accumulation fund, and the introduction of mortgages has improved the real estate market. A decline of interest rates also proved to be an effective way to encourage people to own their own properties.

Brokerage and Professional Manpower

Most of the marketing activities associated with real estate are carried out by brokerage organisations or individuals. It is evident from a wide range of policies, introduced at both national and local level to absorb excessive supply in the market, that a market system has been established at an elementary level. In order to strength its revival and further develop the real estate market, there is a pressing need to speed up the implementation of brokerage services.

The Chinese Ministry of Construction pointed out emphatically in 1996 that the establishment of brokerage management should be a priority. Firstly, it was decided that those who specialise in property management should obtain the necessary professional knowledge and qualifications, and hold valid licenses. To this end, the Ministry of Construction established a professional qualification examination system for property evaluators and brokers. Up to the end of 1996, more than 3,000 people had obtained their real estate estimator qualifications (Real Estate News, 5th June 1996). Secondly, imposing more stringent requirements for setting up relevant organisations. This is considered necessary because many problems have been encountered due to organisations having acted improperly. The government has placed the onus on educators and professional bodies to take the lead in influencing practice. This will be achieved by disseminating knowledge through professional training and by providing professional examinations. At present, the real estate brokerage function is in the process of being separated from government functions. Real estate operations, including trade, consultancy, evaluation, brokerage, notarisations and insurance, have become important factors in improving the prosperity of the real estate market.

2. Foreign Involvement in China's Real Estate Industry

Investment environment

A cornerstone of the Chinese open-door policy is to attract foreign investment, technology and expertise through joint venture arrangements with foreign partners (Walker, 1987). The joint venture, both as a management strategy and as a project system, has actively been used in many industries all over the world (Smith, 1994). It is

also a major means by which China can achieve its aims, and foreign partners can expand their operation into the huge and lucrative real estate market. According the Real Estate News (1997), 20% of real estate's 20000 enterprises had been involved with foreign organisations by the end of 1996.

Economic co-operation and exchange between countries is a world-wide trend. Absorption and utilisation of foreign investment is the most direct method of realising such co-operation and exchanges. By employing this method, not only can China make use of foreign capital to supplement its financial shortage in the process of economic development, but can simultaneously acquire advanced technology, modern equipment, and scientific managerial knowledge and experience.

At present, China's investment has existing and potential advantages. The existing advantages are mainly in the form of government support along with preferential tax treatment, low labour and material costs; this helps enterprises with foreign investments to increase their competitiveness and business profits. The potential advantage is the ever-expanding domestic market (Li, 1988). In the foreseeable future China will continue to be a country that absorbs foreign investment and technology as it further expands its production force and continuously enlarges its domestic demand.

The special regulation "Provisions of the State Council of the People's Republic of China for the Encouragement of Foreign Investment," issued in 1987 and renewed in 1996 is designed to further improve the investment environment so that the absorption and utilisation of foreign investment can achieve better results.

A recommended way to improve JV's performance--Modelling

However, it may be difficult to enter the Chinese market due to a lack of familiarity with China's system and a poor understanding of local conditions. Moreover, China is going through a transitional period from a planed economy to a market economy. Many problems have been encountered by joint ventures in China; both foreign investors and their Chinese partners, have suffered, due mainly to lack of information and poor planning. This has resulted in an increasingly large number of joint ventures being plagued by time and cost problems resulting in dissolution and liquidation (Freeman, 1995). Consequently, the success of joint venture projects in China has been hindered, which in turn has discouraged many foreign investors who would like to venture into the Chinese real estate market.

A significant number of problems have been identified in the following areas: financially mismatched systems; different objectives of the two parties; technology transfer and intellectual property protection; labour and management; marketing and operations; land and construction; culture and behavioural impediments; administrative impediments; insufficient laws and regulations; and environmental protection (Scott & Hao, 1995). A common thread in the problems is lack of information.

Although joint ventures have been the most popular way of doing business in the Chinese real estate market (Chen, 1993), joint ventures, as complex projects, involve massive amounts of data. This is particularly so because of economic reforms and continually changing laws and regulations in China, as well as a lack of mutual understanding between Chinese parties and foreign investors. On the demand side, the complexity and volatility of Chinese market forces means that joint ventures require more targeted and more current information to survive and to gain a competitive advantage. Information plays a key role in overcoming difficulties when striving for better real estate joint venture performance. Dasso, Shiling and Ring (1996) also suggest that information is generally captured and disseminated rather slowly in real estate markets. Market information is extremely important to an investor who is considering developing or purchasing a property.

The information needed, and the data available for real estate joint ventures, is variable in amount, quality, reliability and value (Hao, 1996). As the effort, time and cost involved in assembling the necessary information is often prohibitive, joint venture partners need to concentrate their efforts on collecting data, which will make the most effective contribution to the successful outcome of the project and is relatively easy to obtain.

Therefore, there is an urgent need for a model to identify the most significant items of information that affect the performance of joint venture projects. This will utilise an appropriate computer program to analyse the gathering, synthesising, and dissemination of data required by interested parties involved in real estate joint venture projects. The model will enable the process of a complex project to be simulated using different input parameters and assumptions. The model will also meet the need of joint venture partners for early identification of potential problems, and suggest ways in which information related difficulties might be avoided or solved.

Conclusion

In any country, an industry's rise and decline essentially hinges on government policies. This is particularly so for the Chinese real estate industry because, as China is still under the doctrine of socialism, government plays a key role in restructuring the economic system and shaping the investment environment. Moreover, because so many different aspects of the economy affect the real estate industry, it is particularly vulnerable to government intervention. However, the increasing demands of international practice and foreign investment in the market are sending a powerful message to the government and market professionals. With continuing improvement being made to the country's legal framework and market procedures, along with government support, the real estate market is making steady progress.

With such variant and prolific information necessary for its operation, the real estate industry can be said to be information dependent. Joint ventures, as complex projects, also have to deal with an enormous amount and variety of data. Therefore, the amount and diversity of information generated and exchanged during the lifetime of a real estate joint venture project may well be overwhelming. Timely and accurate information is

important, as it forms the basis on which decisions are made and progress is achieved. In order to facilitate a better understanding of real estate joint venture projects in China, the provision of joint venture projects in general needs to be examined in a systematic way. Development of a model is recommended not only to demonstrate the importance of relevant, accurate, reliable, and easily accessible information, but to also identify the most significant items of information that affect the performance of a real estate joint venture project in China.

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