Comparison of Different Financing Methods of Real Estate Enterprises

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Abstract. Since China reform and opening, the real estate industry has gradually developed into a pillar industry of China's economy. In recent years, the Chinese government introduced a tightening policy to limit the expansion of the real estate bubble, but also put pressure on the real estate sector, financing problems are imminent. This article investigates the theme of China's real estate enterprises different financing methods. This study selects two Chinese listed real estate companies as the case, analyzes the relevant data in the financial reports published by the two companies contemporarily. It compares the advantages and disadvantages of different financing methods. According to the analysis, companies that pay attention to internal financing, develop diversified financing channels, have strong corporate strength, and have financing methods that respond to government policies are more capable of financing. These results shed light on helping the choice of financing methods of real estate companies in China and further exploration of financing modes.

Keywords: Greenland holding, Vanke, Real estate industry, Financing methods.

1. Introduction

Since China's reform and opening-up policy, the real estate industry has grown significantly and has become one of the key pillars of the Chinese market econ-omy. Due to the capital-intensive nature of real estate enterprises, they have greater capital requirements and longer capital utilization times than other enter-prises, which is matched by higher demand for financing structures [1]. Contemporarily, the Chinese government has stepped up its regulation of the re-al estate sector, with the introduction of the "three red lines" and the "real estate loan concentration management system" in 2020 and Premier Li Keqiang's gov-ernment work report in 2022. In 2022, Premier of China Li Keqiang stated in his government work report that he would adhere to the principle of "no speculation in housing", continuing the deep adjustments made to China's real estate industry over the years, with policies such as restrictions on purchases, loans and financ-ing curbing the unrestricted expansion of China's real estate bubble, while also putting heavy pressure on real estate companies, making the financing problems of real estate companies more serious and the capital turnover cycle longer. In the situation where the epidemic continues, the problem of real estate financing has intensified, and how to solve the problem of real estate financing plays a crucial role for the whole industry [2].

In 1984, Myers and Majluf proposed the theory of "internal financing-debt fi-nancing-equity financing", which was developed after the development of capital markets. In 1990, Harris and Raviv proposed the "Harris-Raisoff" model, based on their previous research, and then in 1992, Aghion and Bolivia proposed the "Harris-Raisoff" model and the 'Ahon-Bolton model. These two models form the basis of the control theory of corporate fi-nancing structure, the main idea of which is that the corporate financing structure not only determines the distribution of corporate income, but also the distribu-tion of corporate ownership [4]. 2022 Chinese scholar Liu Maoting analyzed the financial statements of several listed companies in China and found that Chinese listed real estate companies tend to have exogenous financing and generally have a large proportion of debt [5]. Such a financing structure is inextricably linked to the frequent defaults and even bankruptcies and liquidations of real estate com-panies in recent years.

In order to explore the impact of different financing methods on cor-porate financing effect, this paper compares and analyzes the financial data of two real estate companies in recent years. The rest part of the paper is orga-nized as follows. The Sec. 2 of this paper will introduce the current mainstream financing methods and their advantages and disadvantages. In Sec. 3 and Sec. 4, a comparative analysis of the financial reports of two Chinese listed real estate enterprises will be conducted to explore the impact of different financing struc-tures on the enterprises, and Sec. 5 and Sec. 6 will summarize the previous paper, point out the limitations and give some meaningful suggestions.

2. Financing Tools for Real Estate Enterprises

2.1. Inherit Funds

Enterprises use their capital funds, as well as their capital funds expanded through various routines as the basis for funding. The inherit capital funds are mainly the share capital of the shareholders of the enterprise, the new investment converted from the retained earnings accumulated from long-term internal operations. Besides, the replacement investment converted from the depreciation fund. Funds raised through this mode can be held by developers for a long time, at their disposal, and used flexibly and without repayment [6]. As the scale of investment continues to increase, the demand for funds will also become greater and greater. In addition, this financing method is not sufficient to meet the increasingly expanding capital needs of real estate enterprises.

2.2. Bank Loans

The development of real estate projects in China is highly dependent on bank loans, which have always been the main means of financing for real estate devel-opment enterprises. Bank loans are mainly in the form of development loans, merger and acquisition loans, land reserve loans, working capital loans, operating property loans, and policy loans. Banks have high requirements for a real estate company's brand, project progress, and future earnings, and usually require the company to provide appropriate deposits or collateral, and will lend on a limited basis [7]. For Chinese real estate companies, bank loans are convenient, the real economic cost is low, financial leverage is high and debt servicing pressure can be avoided by adjusting the debt structure of long-term and short-term liabilities. However, ascribed to a series of macro-control policies introduced by the state in recent years for real estate financing mainly targeting bank credit, real estate enterprises have tightened their credit facilities, which is an important reason for the sudden tightening of the capital chain of real estate enterprises [8].

2.3. Bonds

The credit bonds issued by real estate enterprises can be divided into corporate bonds, corporate bonds, short-term financing bonds, medium-term notes, and directional instruments. In 2016, the document "Opinions on Corporate Bond Review and Implementation of Real Estate Control Policies" strictly restricted the issuance of corporate bonds by real estate enterprises for commercial real estate projects. Since the beginning of 2016, many of China's real estate enterprises have raised bonds overseas, more than half of which are denominated in US dollars, with most of the overseas financing costs exceeding 10%. Because of more restrictions on the use of issuing corporate bonds and high financing costs, the scale of issuance has been modest [9].

2.4. Equity Financing

It mainly consists of two aspects: financing at the group level through perpetual bonds and preference shares; and asset management plans issued by trusts, private equity, and other institutions at the project company level, with the platform company or real estate enterprise buying back the equity in the asset management plan and returning the principal and interest of the loan after the project is com-pleted. It can effectively reduce financial leverage and is one of the important financing means for real estate enterprises. At present, real estate enterprises are restricted in their access to financing through the explicit equity and debt model.

3. Company Profile

3.1. Greenland Holdings

Greenland Holdings Group Limited (Greenland Holdings, code 600606) is a large multinational conglomerate established on 18 July 1992 with an initial registered capital of RMB 20 million and headquartered in Shanghai. The company type Greenland Holdings is a state-controlled, mixed-ownership listed company with an overall listing on the A-share market in China and a controlling interest in a Hong Kong-listed company. Greenland Holdings is the first real estate-based conglomerate in China to enter the Fortune Global 500, ranking 142 in 2021. Greenland Holdings has always been oriented towards "publicization, capitaliza-tion, and internationalization", and insists on the simultaneous development of "going out" and "coming in". It has formed a global enterprise pattern with real estate and infrastructure as its main business and finance and energy as its inte-grated development.

3.2. Vanke

Vanke Enterprise Company Limited (Vanke Group, code 000002) was founded in 1984 and listed on the Shenzhen Stock Exchange in 1991, with its main business scope being the development of real estate and provision of property services. Vanke Group was first listed in Fortune's "World's 500" in 2016 and has contin-ued to make the list for the next four years, achieving the best result of 208th place on the list in 2020. Over the years, Vanke Group has become a leading pro-vider of urban and rural construction and living services in China, with its strate-gy of "developing with the city and with its customers" and actively developing other businesses around the scenes of people's better lives.

4. Analysis of Financing Methods

4.1. Analysis of the Inherit Funds Financing

The characteristics of own funds that can be used at one's disposal and do not need to be repaid make own funds a better choice for financing real estate enter-prises. In addition to shareholders' investment, it is mainly the surplus reserves and undistributed profits of the enterprise. At the same time, the Chinese gov-ernment stipulates that the proportion of own funds for real estate funding needs to be greater than 30% of the total amount of their projects, to improve the anti-risk ability of real estate enterprises. As can be seen from the Fig 1, the values of surplus reserves and undistributed profits of the two real estate companies are generally on an upward trend from 2017 to 2021, which indicates that real estate companies have gradually increased the proportion of internal financing to meet their long-term stable development as external financ-ing is becoming increasingly difficult for them. As illustrated in Fig. 2, Vanke Group's funds have increased more significantly, and since the tightening of the borrowing policy for real estate enterprises has quickly paid attention to adjusting its financing methods and increasing the proportion of internal financ-ing, so Vanke Group's risk resistance is also higher than that of Greenland Holdings.

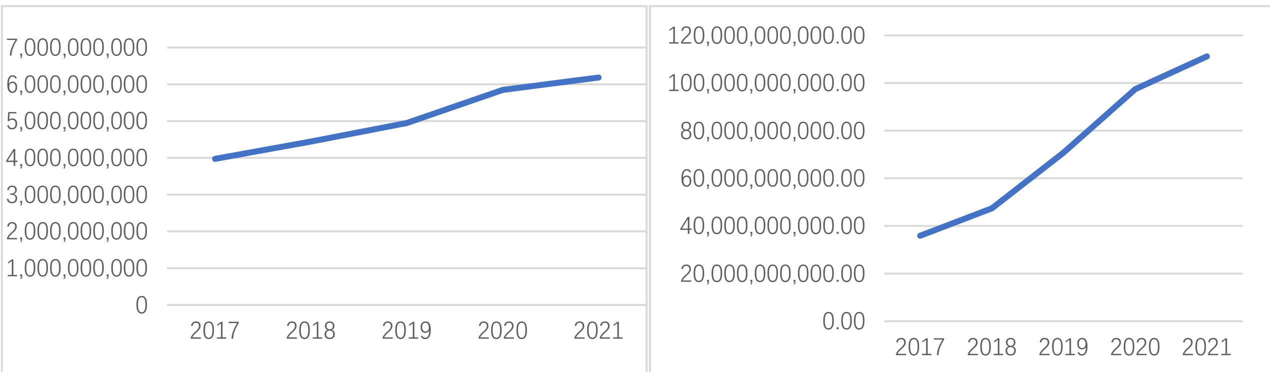

Fig. 1 Greenland Holdings' (left) and Vanke's (right) surplus reserve

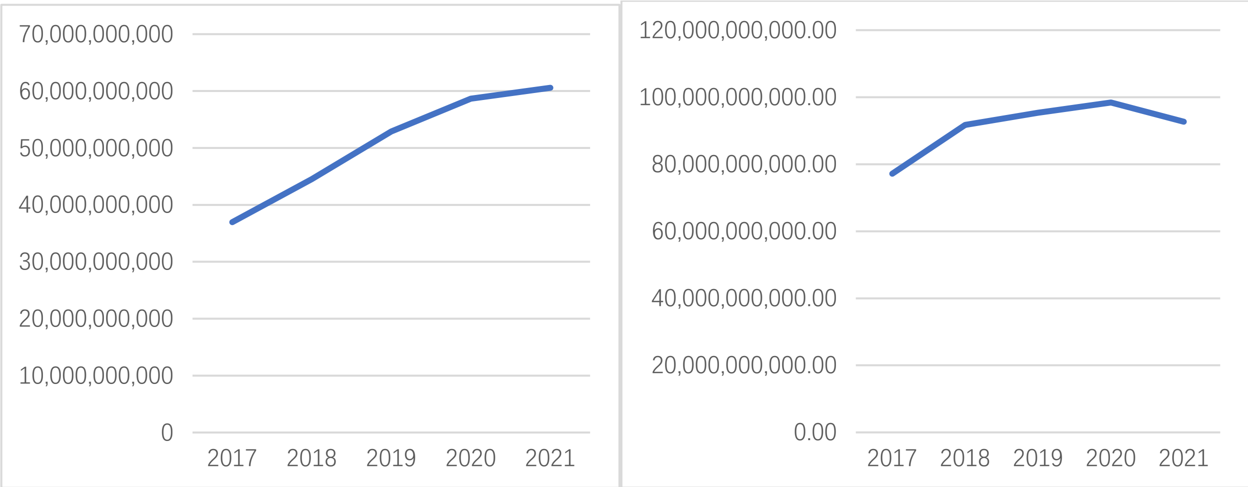

Fig. 2 Undistributed profit of Greenland Holding (left panel) and Vanke (right panel).

4.2. Analysis of Loans from Banks

Borrowings accounted for the majority of the cash inflows from financing activi-ties of both property enterprises [10]. As the state's borrowing conditions for real estate enterprises have increased, the proportion of bank borrowings of the two real estate enterprises to the cash inflow from financing activities for the year has decreased year by year (as depictde in Fig. 3 and Fig. 4), and it has become in-creasingly difficult for real estate enterprises to borrow from banks. Vanke Group's borrowing ratio has been relatively low compared to that of Greenland Holdings, thanks to the expansion of its corporate scale and wider financing channels. Greenland Holdings, on the other hand, has long been more dependent on bank borrowings, which has made it a lot more difficult for Greenland Hold-ings to raise funds when faced with the increasingly difficult situation of bank borrowings.

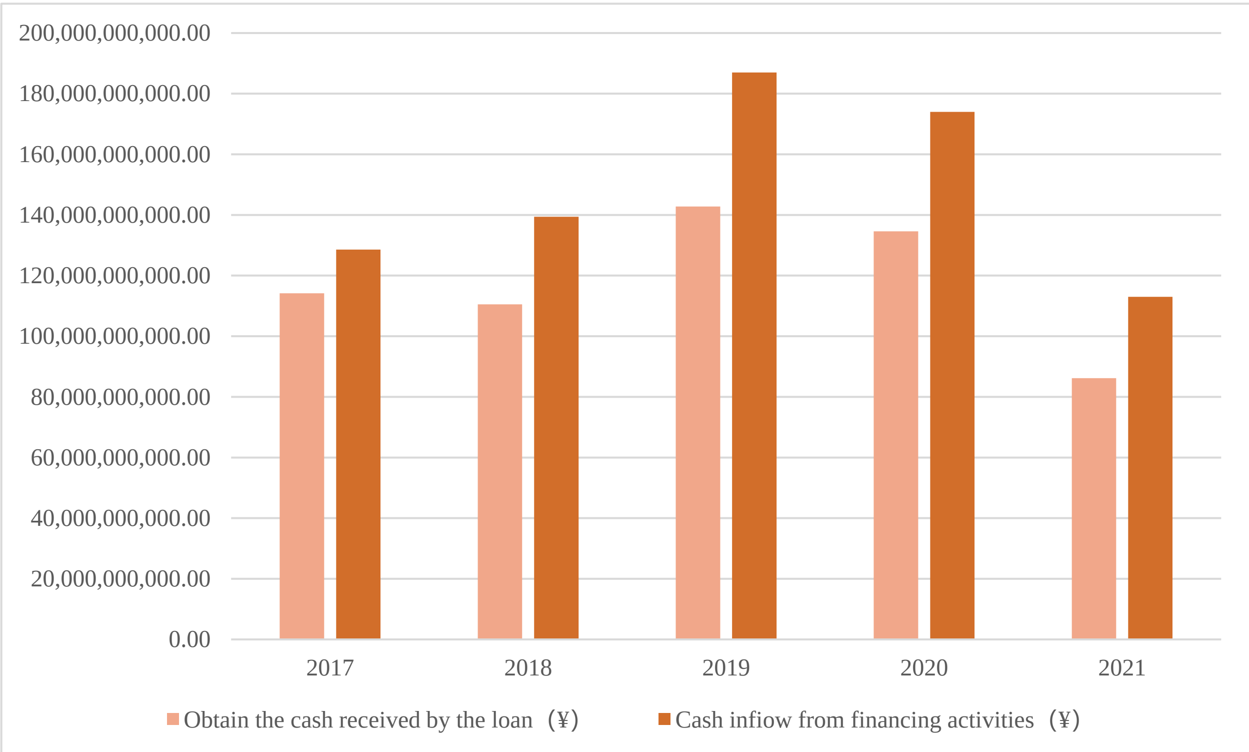

Fig. 3 Cash inflows and borrowings.

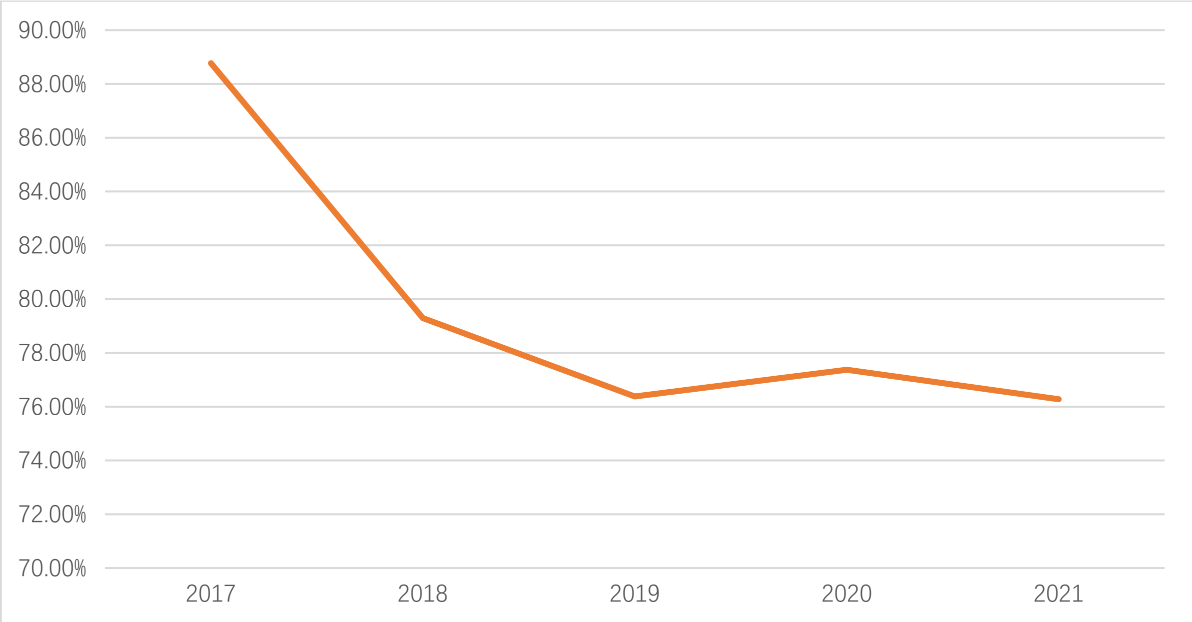

Fig. 4 Ratio of borrowings to total financing.

4.3. Analysis of Equity Financing

Although equity financing can, to a certain extent, disperse corporate control, the proper use of equity financing to raise funds can also help real estate companies to raise funds better. Greenland Holdings only underwent an M&A restructuring with Shanghai Jinfeng on 29 June 2015, issuing 11,649,834,296 new shares with limited selling conditions. After the change, the registered capital was approxi-mately RMB12,168 million. As of the end of 2021, Vanke Group had 9,724,196,533 A shares in issue, representing 83.65% of the total shares of the Company, and 1,901,186,842 H shares in issue, representing 16.35% of the total shares of the Company. the total market capitalization at the end of 2021 was approximately HK$34,488 million. Vanke Group has actively expanded its financing channels by transferring all its B shares to H shares through equity transfer. Offshore financing and scrip financing can also be seen in Vanke Group's equity financing process, which has enabled Vanke Group to rapidly expand its market capitalization through three equity changes.

5. Limitation & Prospects

There are two limitations to this paper. Firstly, the case data is selected from the annual financial reports of the two companies, which may be different from the actual data within the companies. Owing to the implementation of the new ac-counting standard on income, the data of the account of pre-receipt of housing is biased and it is difficult to analyze the financing method of pre-receipt of hous-ing. Secondly, in terms of case selection, only two companies were selected for study in this study and the financing recommendations given may not apply to all real estate companies. It is hoped that more progress can be made in the future in terms of property information disclosure to facilitate scholars' research on the operating conditions of enterprises. Moreover, it is also hoped that more scholars will research real estate financing methods in the future to help China's real es-tate industry flourish.

6. Conclusion

In summary, this paper investigates the financing modes of the two companies on the basis of the financial data of the two companies. Specifically, This paper discusses the functions of internal financing, bank loan, Bond financing and bank loan in the financing of two real estate enterprises, and gives some suggestions on financing of real estate enterprises. According to the analysis, Real estate company should focus on expanding financing channels and diversifying financ-ing. Diversification of financing channels can help real estate enterprises expand the scale of financing, reduce risks and obtain healthy and sustainable financing. Besides the importance of internal financing and strengthen the use of internal funds, Real estate company ought to improve their strength and enhance their financing capacity. The strength of the enterprise will affect the bank's assessment of the enterprise's credit, thus affecting the issu-ance of bank loans. Additionally, the real estate company should respond positively to the relevant national policies and change the way of financing on time. Real estate enterprise financing should respond to the government's call, and with the support of government policies, enterprises can develop better in China. Nevertheless, this study has some shortcomings and drawbacks. The financial data published by the enterprise may be different from the actual data, and the two selected cases may not represent all the real estate companies. In the future, it is hoped that the industry information disclosure system can be more perfect, more scholars put into the research of real estate financing, for the development of real estate. Overall, these results offer a guideline for choosing the financing way and the establishment financing strategy of real estate companies.

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