

# RESEARCH ON THE COST MANAGEMENT MODE OF CHINESE REAL ESTATE ENTERPRISES

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Keywords: Real estate enterprises, Cost management, Mode research.

Abstract: The real estate industry is now going through a painful period. Many far-sighted companies are hence grasping this opportunity firmly to strengthen their internal organs. One important way of internal improvement is cost management. Based on the empirical researches on leading real estate firms (Vanke, China Sea, Pearl River, and Country Garden) over many years, this paper integrates effective cost management modes for China's real estate industry. Every mode introduced in this paper is developed into the following part: Enterprise Characteristics; Mode Characteristics; Mode Advantages; Mode Disadvantages; Applicable Enterprises, etc.

## 1 INTRODUCTION

The real estate industry is now going through a painful period. Many far-sighted companies are hence grasping this opportunity firmly to strengthen their internal organs. One important way of internal improvement is cost management. Based on the empirical researches on leading real estate firms (Vanke, China Sea, Pearl River, and Country Garden) over many years, this paper integrates effective cost management modes for China's real estate industry. Every mode introduced in this paper is developed into the following part: Enterprise Characteristics; Mode Characteristics; Mode Advantages; Mode Disadvantages; Applicable Enterprises etc.

## 2 RESEARCH ON VANKA'S COST MANAGEMENT MODE

### 2.1 Enterprise Characteristics

Typical enterprises of this mode include Vanka, Wanda, Excellence Group, and Eontime. They always focus on real estate development and management while outsource other core activities such as design and construction.

### 2.2 Mode Characteristics

The mode characteristics of Vanke could be concluded as giving priority to macro cost control, while giving consideration to the progress and quality of a project.

- A target cost management system which sets a corresponding target cost for every project is established. This system benefits the overall process of project development.
- Dynamic cost accounting. Dynamic costs are computed in the following situations: making a contract, changing certificates, settling a contract, paying for a contract, and non-contractual expenditures. By adopting dynamic cost accounting, the latest happening in the project could be reflected in time.
- Cost management work is done according to standard operating procedure.
- The method of cost accounting is consistent with its principle. However, it is not required that cost accounting be extraordinarily accurate.
- Overall situation consciousness is emphasized because cost is not only the responsibility of Cost Department.
- Focus on the control of total cost.
- Under the framework of total cost, responsibility costs are assigned to specific departments' specific activities according to their separate division of labour. Correspondingly, supervising and inspecting

system, together with performance evaluation system is then deployed to reduce the costs of every division, and enables every division to exert subjective initiative.

- Major materials are purchased via tender offer and adopt a JIT approach.
- Cost-effective analysis is adopted to decide whether a cost could improve the value of a product. If can, the cost is spent effectively and otherwise it is ineffectively. By using the cost-effective analysis, the company could avoid every possible ineffective cost and spend their money where it counts.
- Aggregate all the data of developing projects into a cost pool. Data of excellently managed projects could be set as standards to conduct a feasibility study for new projects or guide the development process of new projects.

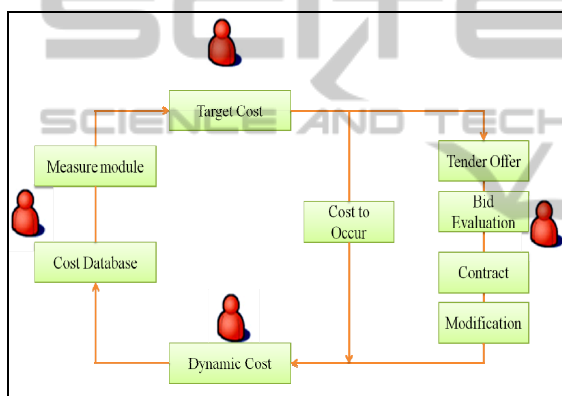


Figure 1: How a closed loop for cost management is formed.

### 2.3 Mode Advantages

- A closed loop of cost management is established, which promotes the cost management level to improve. (Figure 1)
- Is beneficial for the macro-control of the overall group. The group could formulate uniform rules which are executed strictly in the development process of projects.
- Meanwhile, combined with some professional real estate information analysis tools such as UFIDA, a fast copy effect could be realized by solidifying the group's rules and defining relative guidelines on project management in the software. Therefore, software could be used to help enterprises to guide their behaviours.
- The establishment of a cost pool makes the feasibility study on new projects faster and more effective.

### 2.4 Mode Disadvantages

This mode of cost accounting lacks precision, thus limits the range of cost control.

### 2.5 Applicable Enterprises

The Vanke cost management mode could be applied to pure real estate enterprises without affiliated construction enterprises or enterprises that lack actual construction experiences.

## 3 RESEARCH ON CHINA SEA'S COST MANAGEMENT MODE

### 3.1 Enterprise Characteristics

Typical enterprises such as China Sea, Tiantai, etc. adopt this cost management mode to focus more on the management of real estate development. These enterprises are all transformed from construction companies so they are good at construction management.

### 3.2 Mode Characteristics

This mode is characterized by an elaborate system on cost management and control, specific as follows.

- A unified budget management system for the overall group is established to control the whole process of project development. This system sets up corresponding budgets for every specific item according to the categories and standards for budgets.
- Budgets are assigned to specific departments' specific activities according to their separate division of labour. Correspondingly, supervising and inspecting system, together with performance evaluation system is then deployed to reduce the costs of every division, and enables every division to exert subjective initiative.
- Budget control concerns the following aspects: making a contract, changing certificates, settling a contract, paying for a contract, and non-contractual expenditures
- Annual capital plan and monthly capital plan are drawn up by project and functional department. Approved capital plans strictly control the payment flow of projects.
- Budget control is as detailed as to every department and every item.

- Budget pre-warning. This system supports an early warning for the execution of budget control. For example, if an early warning mode is pre set, as long as a user overruns his or her principle project by 80%, the early warning would prompt out.
- Bill of quantities is need when concluding a contract.
- Project schedule is formulated according to bill of quantities and tasks. Periodically, actual accomplished work amount will be confirmed. Besides, the bill of quantities will also be referred to when paying for a project.
- Comprehensive material management. Strategic cooperative partnership with major suppliers is established to reduce purchasing costs drastically. Material requisition list is required when employing materials. For oversupplied materials, deductions are applied using progressive rates or excess progressive rates, and deduction threshold as well as mark-up percentage is set to guarantee the maximum use of materials.

### 3.3 Mode Advantages

- A complex and volatile project management process can be changed into a controllable process by establishment management, task decomposition, contract management, progress confirmation, and payment flow.
- By using budget management, capital plan and tender offer management, the company could integrate limited resources so as to improve the effective utilization rate of resources.
- In the process of the project, by utilizing investment estimation management, project cost management and dynamic cost projection, the company could timely evaluate the input-output relationship about the project.
- The goal of standardizing project management work, optimizing management procedures, and realizing overall control could be attained with the help of information tools. The level of project management could be therefore improved because information is more visualized, procedures are more transparent, and motions are more standardized.
- Coordinate and manage overall project resources from a group's view. These resources include financial resources, human capital resources, supplier resources, project development management experiences and so on.

- Scale duplication of project development management.

### 3.4 Mode Disadvantages

Among all the cost management modes in real estate enterprises, this mode characterized by an elaborate system has the highest requirement for professional cost management. Apart from the necessary cost analysis skills, project skills and financial skills for development enterprises, construction techniques are also needed.

### 3.5 Applicable Enterprises

This mode could be applied to real estate enterprises with higher level of project management experience and construction experience.

## 4 RESEARCH ON PEARL RIVER'S COST MANAGEMENT MODE

### 4.1 Enterprise Characteristics

Typical enterprises such as Pearl River would prefer this cost management mode, which focuses more on real estate development and management, and contracted their construction work to affiliated construction companies.

### 4.2 Mode Characteristics

This mode is characterized by a moderate flexible target cost control system. This system emphasizes on the details of a project, especially the control of certificate changes.

- A target cost management system is established. Meanwhile, in order to reduce the period for a project, construction work is doing while budgets are still making.
  - Dynamic cost accounting. Dynamic costs are computed in the following situations: making a contract, changing certificates, settling a contract, paying for a contract, and non-contractual expenditures. By adopting dynamic cost accounting, the latest happening in the project could be reflected in time. Besides, company can frequently check whether it is beyond the target cost.
    - The principles concerning the distribution of costs among different regions/time include: a.

Benefit Principle, which allocates costs according to benefits; b. Equal Principle, which allocates costs equally among all the regions; c. Territorial Principle, which allocates costs to where the project is located. (Table 1)

- Since Pearl River is listed in Hong Kong, it accepts various methods of cost apportionment, such as Chinese accounting rules, Performance Requirement for Hong Kong Listed Companies etc.). This is beneficial for different purposes of management. (Table 1)

Table 1: Examples of various cost distribution principles under different accounting rules.

Projects	Internal Control Assessment	Chinese Account-ing Rules	Performance Requirement for Hong Kong Listed Companies
“Municipal Planning Road Project”	Benefit Principle	Benefit Principle	Territorial Principle

- A quota system (benchmark price) is introduced according to the types of products. Generally, products from the same regions are applied with the same quota. Quota added by indicative data could quickly result in an initial version of target costs, which is beneficial for a quick feasibility research decision.
- Regional companies employ a capital demand plan based on their actual demand for operation and management. This capital plan includes annual capital plan and monthly capital plan.

(For example, an annual capital plan is formulated according to the following procedures: Every November, the company would draft next year’s capital plan based on the market forecast, sales targets and project progress. The Project Sales and Planning Department would put forward next year’s sales plan, other operating revenue plan, selling expenses budget and operating expenses budget. The Financial Department would predict next year’s sales revenue actual collection plan. The Project (or Regional) Development Department proposes the capital demand plan; The Project Engineering Department comes up with next year’s progress plan and capital demand plan. The Project Office raises next year’s administrative expenses budget. When drafting out corresponding plans and budgets, each department should communicate adequately and reach consensus with regional functional departments. Approved by company’s general

manager, all these budgets and plans could become the basis for the Financial Department to formulate the “Annual Capital Plan”. )

- Approval authority is strictly controlled in case that out-of-control risk breaks out.
- Every month, the quantities of work are evaluated in a simplified way. Pearl River estimates the overall quantities one at a time, while Vanke and China Sea aggregates every specific project’s quantities in to the overall quantities.
- Project Development Life Cycle is relatively flexible. For example, projects planned to be completed in first phase may be postponed many times. Besides, two or more projects could be combined into one phase to complete.

### 4.3 Mode Advantages

- This mode forms a stratified central management of information resources for headquarter, regional companies, and project companies.
- This mode unifies each piece’s accounting system and operating procedures, so that the group management could conduct a real-time data inquiry to strengthen their supervisory force.
- This mode enhances company’s capital management, enabling it to reflect real-time capital account information to control the payment flow.
- The adoption of the quota system is beneficial for new projects’ feasibility research.

### 4.4 Mode Disadvantages

Due to the lag behind between target cost and actual business, this mode has the disadvantage of limited target cost control force.

### 4.5 Applicable Enterprises

This mode could be applied to real estate enterprises with moderate flexibility.

## 5 RESEARCH ON COUNTRY GARDEN’S COST MANAGEMENT MODE

### 5.1 Enterprise Characteristics

Typical enterprises such as Country Garden would

prefer this cost management mode, which focuses more on real estate development and management. Meanwhile, this mode covers all the cycles in real estate development, including design, construction, decoration, gardening, hotel, school, tourism and so on.

## 5.2 Mode Characteristics

This mode is characterized by a unified capital management and material supply concentration system.

- Low land price with large-scale investment strategy. Companies using this mode always choose second-tier and third-tier cities as their base areas, with an average land price of RMB 174 per square meter. Correspondingly, the ratio of land cost to average sales revenue is maintained at 7 to 8 percent.
- Design cost is controlled. Take Country Garden as an example, it owns a special design institute with hundreds of houses. For example, they have as many as 100 classic town houses. Taken into consideration local climate and custom, their design covers all types of houses. Their blue prints contains sufficient information such as the location of a switch which enables the client to touch more comfortably, or the most reasonable wide of a gap between a door and a wall, and also how a ceramic tile could be paved. All these means that Country Garden could simply enter into construction procedures just according to their blueprints with few adjustments or even no adjustments.
- Materials supply management is centralized. Bulk commodities are bought through Group purchasing centre to reduce material costs.
- Low cost results in high turnover rate. Project price is normally half than other comparable projects, average daily batch sales rate is as high as 78%, and average annual stockpile rate is only 2.5%.
- Low sales price also effectively reduces sales expenses. In the first half year of 2007, settlement revenue is increased by 48% while sales expenses only increased 45%, and marketing expenses only increased 36%.
- The business chain of Country Garden is perfectly integrated. Not only product design, but also building construction, estate management and hotel management are all well considered. These large buildings always take up more than thousands of acres, which could

significantly reduce purchasing cost and realize a large-scale duplication.

- The centralized management of capital enables the company to monitor the movement of money more effectively. By utilizing information tools, the company could check its capital situation cross banks and cross departments could know the real-time balances of its accounts, could have fast control over every subsidiary's capital flow, and could also monitor major capital movements so as to automatically supervise abnormal situation. These functions enable the company to form an overall management of capital.

## 5.3 Mode Advantages

- The Country Garden Mode covers all the possible cycles in real estate development, including project orientation, house design, construction and building material, decoration, marketing and estate management. Profits from every link in the value chain are seized to reduce costs and improve development speed.
- Fast duplicating and scaled manufacturing are realized through this mode.

## 5.4 Mode Disadvantages

Since this mode covers every connecting and interacting cycle in the real estate development, it is rather challenging for a company to manage and control.

## 5.5 Applicable Enterprises

This mode would be very suitable for enterprises that have business on all the process of real estate development.

## 6 CONCLUSIONS

With the increasing competition among companies and the current economic situation, real estate companies should adopt scientific cost management approaches to improve their cost management quality. Additionally, they should take advantage of cost management methods to bring benefits and effectiveness to themselves. Only by this way, can real estate enterprises successfully go through the current crisis and enjoy a healthy sustainable long-term development.

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