

# *Exploring Financial Strategy under Vanke's Asset-light Operation Model*

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**Abstract:** In recent years, real estate development enterprises have been adjusting their investment direction and management mode with national policies and economic development, especially under the macro policy of "housing and housing without speculation", real estate investment has plummeted; the drawbacks of the original asset-heavy operation mode of real estate industry, such as large capital occupation and long operation cycle, have been gradually exposed. Vanke, as one of the early transforming real estate enterprises, has drawn public attention to its financial strategy under its transformed asset-light operation mode. This paper interprets the financial data of Vanke in recent years to form an analysis of the effect of Vanke's strategic transformation and provide reference transformation experience for other enterprises in China.

## **1. Introduction**

### **1.1 Theoretical basis of asset-light operation model**

#### **1.1.1 The concept of asset-light operation model**

Light asset operation model is a value-driven capital strategy proposed by McKinsey & Company at the beginning of this century, which refers to an enterprise giving full play to its light asset resources and minimizing capital investment in heavy assets such as fixed assets under the condition of its limited resources. The company also makes use of its advantages in the value chain to realize the optimal allocation of resources, reduce the cost and risk of its own operations, improve its own enterprise value and core competitiveness, and achieve stronger profitability and sustainable growth.[1]

#### **1.1.2 Features of the asset-light operating model**

(1) High capital concentration

Companies will reduce their own investment in heavy assets and invest their main capital in high value-added business, such as design and development, brand marketing and after-sales service.

(2) Strong resource integration ability

Enterprises usually make use of their advantageous position in the industrial chain to strengthen their control over upstream and downstream enterprises on the one hand, and effectively integrate resources in the value chain system by merging and reorganizing some heavy assets enterprises on

the other hand, so as to pry the heavy assets resources of other enterprises with their own light assets resources and achieve the maximum utilization of resources.

### (3) Large value-added investment income

The goal of the asset-light operation model is to maximize the revenue and value of the enterprise. Under this model, enterprises can obtain sufficient operating cash flow by reducing fixed asset investment, and at the same time, they can obtain a large amount of financing resources such as "interest-free debt" from upstream and downstream cooperative enterprises by dominating the value chain.

## 1.2 Financial Strategy Concept and Content

### 1.2.1 The concept of financial strategy

Financial strategy is a series of plans for the capital activities of an enterprise from a global and long-term perspective, under the guidance of the company's strategy and in order to achieve its financial goals, taking into account the internal and external conditions of the enterprise.[2]

### 1.2.2 Classification of financial strategies

Financial strategy is mainly divided into investment strategy, financing strategy and dividend distribution strategy. Through the implementation of scientific and efficient financial strategies, we enhance the company's resilience in a complex environment and improve the overall coordination of the company in order to achieve the goal of maintaining the financial advantage of the company.

#### 1) Investment Strategy

Investment strategy mainly reflects the plan of a company to use available funds for project production and construction in order to pursue the desired return. Specifically at the operational level, it is to make the funds to be allocated rationally among multiple businesses or within one business, to exchange less expenses for higher returns, to control project risks, and to ensure that funds can be recovered in time to avoid losses.

There are different classification criteria for the investment strategy response of enterprises. First, according to the difference of investment objects, it can be divided into two kinds: one is internal investment, including investment in inventory, investment in fixed assets, investment in intangible assets, etc.; the other is external investment, including long-term equity investment, investment in financial assets, etc. Second, according to whether the investment return period exceeds 1 year, it can be divided into short-term investments or long-term investments. Short-term investments are usually held for less than 1 year, including the purchase of financial assets that can be quickly liquidated. Long-term investments are held for more than 1 year, including restructuring and mergers, and other ways of diversification. The results of the implementation of investment strategies are influenced by the changing external environment in addition to the company's own capabilities in all aspects.[3]

#### 2) Financing Strategy

Corporate financing strategy is the economic behavior of a company to obtain funds from specific sources in order to meet the financial needs of specific subjects. The objectives of financing strategy can be divided into three aspects: first, to meet the financial needs of business expansion, second, to make the financing cost as low as possible, and third, to make the financing risk low. The financing channels of enterprises are classified by cash flow characteristics and can be divided into debt financing and equity financing.[4] Debt financing generally requires mandatory interest payment and repayment is limited by a deadline, with the advantage of lower financing costs, while equity financing does not require regular payment of returns, but the financing process is

complicated and requires the payment of higher fees, and there is also the problem of diluting the equity and interests of the original shareholders. Enterprises need to choose a diversified financing method to take into account their own situation and bring into play the advantages of various financing methods.

### 3) Dividend distribution strategy

A dividend distribution strategy is a long-term directional plan for the distribution of a company's profits that have been earned in previous years. Dividend distribution affects the amount of internal capital retained by the company and investors' expectations of the stock price of the listed company. With a higher dividend distribution policy, the company will have less internal capital and higher financing size and cost, but investors will have higher expectations for the company's stock and the stock price will remain at a higher level. A lower dividend distribution policy will have the opposite effect. So there are two general objectives of dividend distribution strategies: first, to try to meet future funding needs; and second, to maintain investors' expectations of high dividends on stocks.

## **2. Background analysis of real estate companies**

### **2.1 External Environment**

#### **2.1.1 Industry background**

The GDP of the real estate sector continued to climb from 2006 to 2017. In 2009, the total investment in China's real estate industry accounted for 5.4% of the total GDP, which was raised to 6.1% in 2013 and increased to 6.5% in 2017. With the macro-control of China's real estate policy and the global outbreak of the new crown epidemic in 2020, the real estate industry has been subject to unprecedented impact, and the property market has gradually bid farewell to the previous golden era of rapid development.

#### **2.1.2 Land price surge**

In the stage of rapid economic development in China, as urbanization continues to accelerate, housing prices in the real estate industry continue to rise, the demand for land continues to increase, and the demand for land resources is greater than the supply, resulting in the rising prices of land concession transactions in China.

### **2.2 Internal Environment**

#### **2.2.1 Long operation cycle, large investment amount**

Generally speaking, real estate enterprises develop product projects, which need to go through project planning and design, land acquisition, development and construction and sales services, etc., and their project operation cycle is generally long. At the same time, a large amount of capital needs to be invested in each link, and the capital occupation cycle is long.

#### **2.2.2 Higher operational risk**

Due to the long project operation cycle and high product unit value, real estate enterprises usually have a high gearing ratio and are easily affected by the external environment. When encountering a downturn in the real estate market, it is easy to bring problems such as inventory backlog and poor capital turnover to enterprises.[5]

### **3. Transformation Practice of Vanke Group's Light Assets Operation Mode**

#### **3.1 Vanke Group Overview**

Vanke Group was established in Shenzhen in 1984 and listed on the Shenzhen Stock Exchange A-share in 1991 (stock code: 000002). After experiencing various development periods in the real estate market, Vanke has become a leading enterprise in China's real estate market by closely assembling its more than 30 years of development experience with the background of the times. 2016 Vanke entered the list of Fortune 500 for the first time and has been on the list one after another for four years since then, and its ranking even rose to 208th in 2020.

#### **3.2 Implementation Path of Vanke Group's Asset-Light Strategy**

In recent years, with the increase of national macro-control, real estate enterprises are facing the problems of economic structure transformation and deepening of urbanization process. With its keen insight, Vanke took the lead in putting forward the slogan of "asset-light, operation-heavy and ultimate service" in 2013, and started the transformation to an asset-light profit model.

##### **3.2.1 The implementation of the "small stock manipulation" strategy**

The "small shareholding" refers to the fact that Vanke does not take a controlling stake in the newly acquired cooperative projects, and its equity ratio can even be as low as 10%, but the projects are still managed by Vanke's team, giving full play to its own professional research and development capabilities, management system and brand marketing advantages to achieve the goal of leveraging a large amount of income with a small investment.

Under the strategy of "small share manipulation", Vanke can reduce its own capital investment and give full play to the role of capital leverage, so that the enterprise can obtain a higher return on investment.

##### **3.2.2 "Internet + real estate" thinking**

In recent years, Vanke has cooperated with a number of Internet companies across the border in the real estate industry and property services, using Baidu's big data and cloud computing technology to analyze modules used in property marketing, adjusting stores, and also providing personalized and customized services.

Vanke's core business contains property services business, Vanke property named Vanke Cloud, the main positioning is a space technology service provider, in 2020 to achieve full-caliber operating income of 18.2 billion yuan, an increase of 27.36%, the management area has reached 566 million yuan, of which 47% from Vanke, the company's operating income and management scale is also the first in the industry, the competitive advantage is obvious, with the Internet thinking synergistic integrated Multi-business to improve efficiency, based on information technology strategy, build a unified information platform and reconstruct business processes.

##### **3.2.3 "Business Partner" system**

In the process of light asset operation, it is necessary to cooperate with other enterprises, and at this time, it is more necessary for employees to share the benefits and responsibilities with the enterprise, so that they can carefully supervise and be responsible for the project. At the same time, Vanke Group has tens of thousands of excellent employees, and its abundant human resources are also an advantage of light asset transformation.

### **3.2.4 Continue to promote "real estate finance" restructuring and innovation**

Vanke continues to transform itself into a financial service provider and securitize real estate assets. When developing commercial properties in 2015, Vanke chose the model of "REITs + commercial operation" and cooperated with Penghua Fund to successfully issue the first public REIT in China - Penghua Qianhai Vanke REITs. 5.031 billion yuan to jointly establish two commercial real estate investment funds with Zhaoyin Capital and Changjiang Zhaoyin, namely Zhaoyin Growth One Investment (Shenzhen) Partnership (limited partnership) and Zhaoyin Growth Nine Investment (Shenzhen) Partnership (limited partnership), which are used to invest and acquire 42 mature commercial real estate projects owned by the company to accelerate Vanke's investment operation in the field of commercial real estate through the power of external capital and asset-light operation. The investment and operation of Vanke in the field of commercial real estate through the power of external capital.

## **4. Implementation of financial strategy in Vanke Group's asset-light operation model**

The section introduces the implementation model of financial strategy formulated under Vanke's asset-light operation model, and discusses three aspects of financial strategy: investment strategy, financing strategy, and dividend distribution strategy.

### **4.1 Investment Strategy**

Investment strategy is the most critical component of the company's financial strategy system. The final investment choice of the company's investment, whether it is internal or external investment, should serve the company's development strategy.

After Vanke encountered a bottleneck in its development, it urgently needs to expand new business and investment projects to capture more market share, reduce investment risks and balance business layout. During the investment process Vanke focuses on the combination of light asset investment and industrial chain, taking into account the differentiation strategy in investment strategy to enhance the core competitiveness of the enterprise itself.[6]

#### **4.1.1 Expansion of industrial chain and integration of investment areas**

Based on Vanke's real estate residential projects, we invest in projects with high quality development potential. Specifically, tourism real estate, retirement real estate and education real estate are all investment directions with great potential for market development, which can also promote the company's scale operation and thus achieve the purpose of diversifying and reducing the company's operational risks.

#### **4.1.2 Small share manipulation to enhance Vanke's investment ability**

"As shown in Table 1, the positioning of the two partners in the "small stock manipulation" project is actually the complementary advantages of the resources of the two partners. The partner has a large equity share and provides most of the capital, so Vanke Group can reduce the capital occupation rate of the project development, while the partner shares the credit degree resources and procurement resources provided by Vanke in the financing and procurement, so as to reduce its own cost pressure. During the project development and sales stages, the partner does not interfere with the specific management process of the whole project, and Vanke ensures the smooth progress of the project with its mature project operation experience.

Table 1: Table of the positioning of the two partners of the "Small Cap" project

Enterprise	Partner companies	Vanke Group
Shareholding ratio	More than 50%, holding	Less than 50%, minimum can be 10%
Resources provided	Substantial project funding	Small amount of capital, management operation experience, brand marketing ability, financing channels, procurement channels
Cooperation Positioning	Project developers	Project Developer + Operator

## 4.2 Financing Strategy

Financing activities are the basic conditions for Vanke's normal operation, and the good or bad financing strategy directly affects the funds available for the enterprise to implement other strategies. Enterprises in the asset-light mode of operation generally have a low gearing ratio and can have a large amount of cash reserves to reduce their operational and financial risks. However, because the real estate industry is capital-intensive, the company's own endogenous financing can hardly meet its actual development needs, so it still needs external financing to solve the problem. Therefore, Vanke solves the problem of capital shortage through fundraising strategies such as stocks, bank credit financing, bonds, and trust funds (REITs).

1) Based on the concept of asset-light operation model, Vanke has listed on the stock markets of China and Hong Kong in an IPO in order to achieve large-scale operation, forming an "A+H" model to increase the financing channels of Vanke and maintain the stability of its own equity structure.

2) In October 2013, Vanke participated in the IPO of Huishang Bank, purchasing 884 million shares with 3.43 billion Hong Kong, accounting for 8.28% of its total, and finally became the largest single shareholder of Huishang Bank. After taking a stake in Huishang Bank, Vanke can obtain more financing amount from the bank by lowering the loan restriction conditions or increasing the loan amount, saving the time required for financing negotiation and other processes, which can effectively reduce its own financing cost and improve the efficiency of capital use.

3) Vanke continues to innovate financing tools to obtain financing funds, such as "real estate fund + Internet" crowdfunding platform financing, Vanke's good reputation and brand effect attracts public REITs, etc.

With its brand and credit advantages, Vanke has made reasonable use of a variety of financing methods, so in terms of financing, Vanke accounts for a far superior advantage over its peers, which has laid a good foundation for its development.

## 4.3 Dividend Distribution Strategy

Vanke generally adopts either cash or stock to distribute dividends. As far as the company's common stock in the stock market is concerned, the dividend payout rate can reflect the earnings of investors. Vanke's dividend policy is reflected in many aspects, but the basic principle of dividend policy is to keep the dividend distribution and company's earnings in line with each other. Next, Vanke's dividend distribution data from 2011 to 2020 will be analyzed.

From Table 2, it can be seen that Vanke's annual dividend distribution amount and annual net profit change simultaneously, and the high dividend distribution is closely related to the company's annual earnings; if the enterprise's annual earnings are high, the dividend distribution is relatively generous, and vice versa, the dividend distribution decreases. In 2015, Vanke's net profit of the enterprise continued to rise from the implementation of the asset-light operation model, and both

cash dividends and undistributed profits showed an upward trend, indicating that Vanke's relevant financial strategies are implemented well.

Table 2: Vanke Group Incentive Distribution Table 2011-2020 Unit: RMB billion

Year	Net Profit	Cash Dividend	Undistributed earnings	Dividend Payout Ratio	Profit Retention Rate	ROIC
2011	11.60	1.43	18.93	0.12	0.88	10.83
2012	15.66	1.98	26.69	0.13	0.87	11.93
2013	18.30	4.52	36.71	0.25	0.75	11.23
2014	19.29	5.52	41.99	0.29	0.71	10.77
2015	25.95	7.95	52.60	0.31	0.69	13.11
2016	28.35	8.72	61.20	0.31	0.69	11.43
2017	37.21	9.94	77.17	0.27	0.73	11.48
2018	49.27	11.81	91.72	0.24	0.76	12.00
2019	55.13	11.81	95.35	0.21	0.78	11.53
2020	59.30	14.52	98.42	0.24	0.76	10.92

## 5. Analysis of Vanke Group's performance under its asset-light operation model

### 5.1 Business segment expansion and integration of investment areas

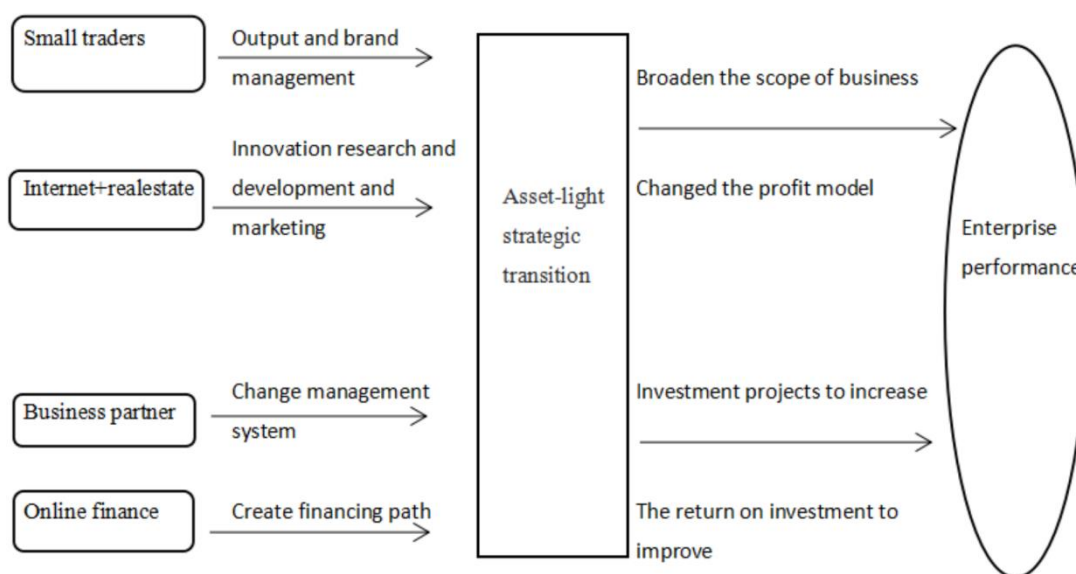


Figure 1: Path diagram of the impact of asset-light transformation on performance

Under the asset-heavy model, Vanke is mainly a residential developer, relying on land appreciation for profit, as shown in Figure 1 Under the asset-light model, Vanke Group's business is widened extensively and profit-making channels are increased. The transformation from asset-heavy to asset-light operation is not only a change of operation mode, but also combined with the transformation of corporate development blueprint.

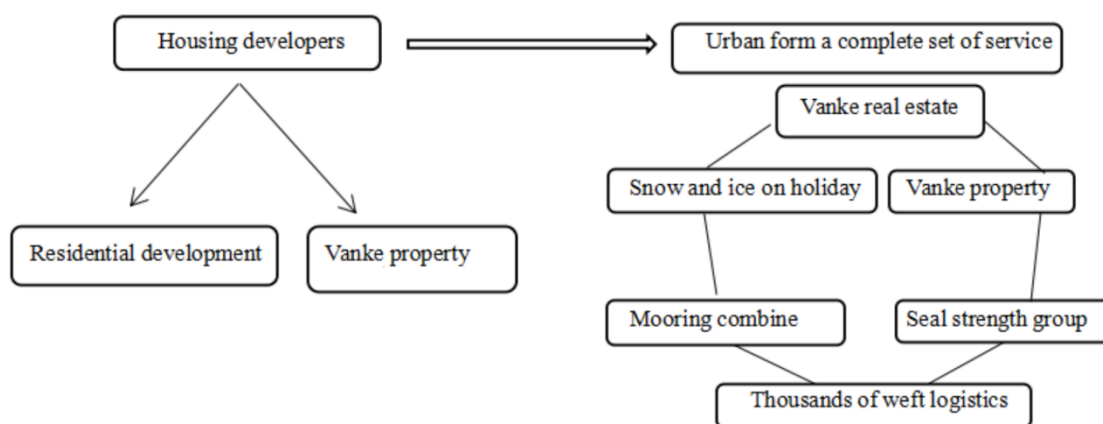


Figure 2: Vanke Group Business Segment Chart

According to the "Management Review and Development Outlook" in Vanke's 2013-2019 Annual Report, Vanke's step-by-step transformation from a residential developer to an urban support service provider can be clearly seen, and now Vanke Group has formed a diversified business segment, as shown in Figure 4. As shown in Figure 2, Vanke's business has broadened from residential real estate to commercial real estate and consumer real estate, with multiple businesses in parallel.

## 5.2 Operating income

The residential real estate and property business, which has been the main business for a long time, broke through the bottleneck of development and achieved revenue growth by relying on light asset resources such as brand and management under the effect of asset-light transformation. As shown in Figure 3, revenue from the property business grew rapidly from NT\$1.99 billion to NT\$12.7 billion.

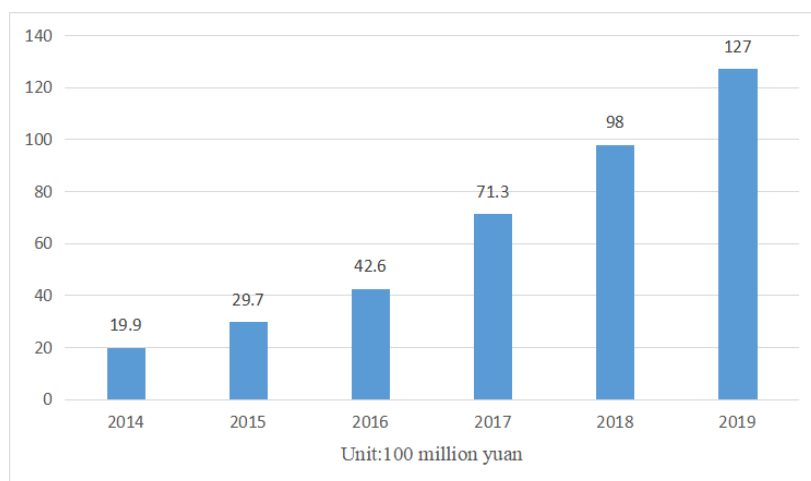


Figure 3: Vanke's property service revenue chart, 2014-2019

Since 2016, Vanke has been actively developing its long term rental apartment business, forming a unified operation brand "Po Apartment", which has been laid out and built in 14 core cities nationwide, with a total of 110,000 units opened by the end of 2019.

Since 2017, Vanke has been providing logistics real estate services to major domestic e-commerce companies and couriers, etc. Its main platform "Vanwei Logistics" has acquired 138 projects and cooperated with more than 850 customers.



In the field of consumer real estate, Vanke is actively developing the ice and snow resort business. The three ice and snow projects it operates are running smoothly and have received a total of 390,000 visitors. In addition, Vanke has also ventured into the fields of retirement and education, forming a diversified product service pattern.

Vanke's transformation to light assets has enabled the company to leverage its brand, management and services and other light assets to carry out businesses such as long-term rental apartments, logistics real estate, pensions and education, which can be seen that Vanke is continuously improving its product lines in its light asset transformation.

It can also be seen from the new business that the asset-light transformation has also transformed Vanke's profit model from relying solely on land value-added earnings to relying on land value-added on the one hand, and relying on light asset resources such as brand and management services to collect management fees and service fees on the other hand, increasing the profit channels as shown in Figure 4, and the corresponding business income also shows an overall upward trend.

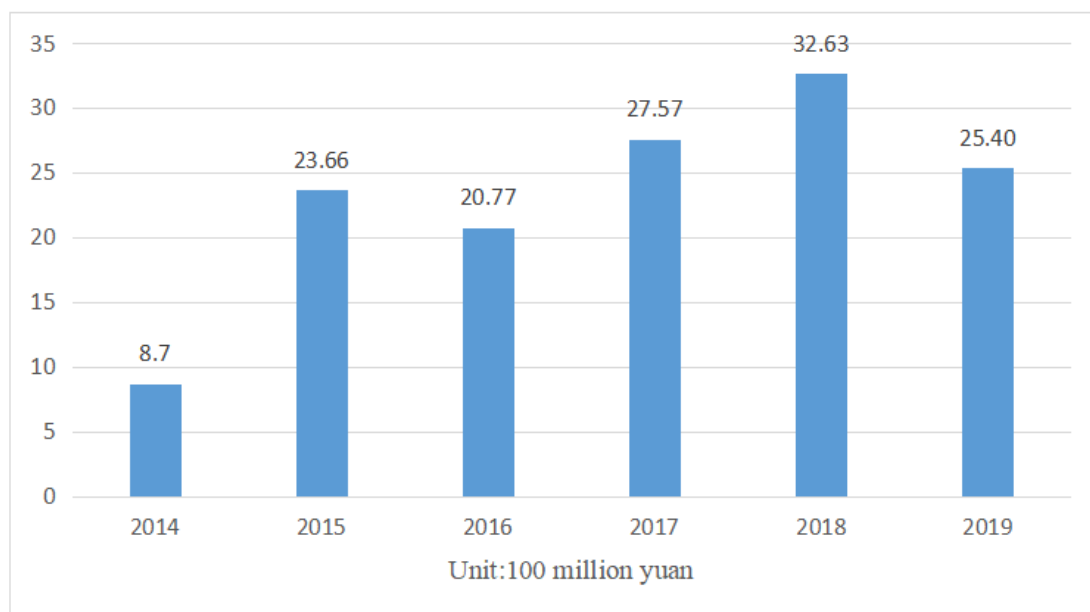


Figure 4: Vanke's Other Business Revenues, 2014-2019

It can also be seen from the new business that the asset-light transformation has also changed Vanke's profit model, from relying solely on land appreciation to relying on land appreciation, and then relying on brand, management services and other asset-light resources to charge management and service fees, increasing the profit channels.

## 6. Conclusion

This paper uses Vanke as the research object to carry out the study of financial strategy and performance under the asset-light operation model, and after the analysis of the above contents, the following conclusions are drawn.

First of all, Vanke's transformation into an asset-light operation model is successful. After Vanke transformed to the asset-light operation model, it actively adjusted its asset structure and iterated on its business segments to achieve the goal of maximizing profits. Under the asset-light operation model, enterprises have more ways to raise funds, such as issuing funds and bonds, instead of relying only on traditional bank borrowings. Vanke maintains the core business of the enterprise while actively expanding new businesses, diversifying the business operations and accelerating the

liquidity of the enterprise to a certain extent.

Secondly, after Vanke transformed its asset-light operation model, it implemented a reasonable financial strategy and actively adjusted to changes in the internal and external environment of the enterprise, which helped maintain its superior competitive position in the industry and ensure its sustainable development.

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