stars insights: 10 May 2019

"E-Commerce is not a Competitor but a Partner for the Retail Property Industry"

In an exclusive stars interview, ***Henry CHENG****, Co-Founder, CEO and Executive Director of Chongbang Group, tells us what it takes to survive in China's real estate market: constant innovation. When e-commerce disrupted the retail property industry, Henry came up with the formula "online plus offline" to stay ahead of his competition and he continuously focused on getting online retailers offline. The interview was conducted by stars alumnus Patrick RENZ of foraus, the Swiss Forum on Foreign Policy, on the sidelines of the 6th stars Singapore symposium.*

Patrick Renz: Mr. Cheng, what is innovation to you and where in the real estate sector do you see innovation happening?
Henry Cheng: To answer this question, I need to go back 26 years, the year I first came to mainland China. As most other real estate markets in the world, the one in China was highly localized. There was and is no such thing as China's real estate market, you have to look at it from a much more granular level. At that level I found an industry that was in its infancy, growing very fast and without a clue of where to go. This experience taught me that I have to be very focused to be successful. I had to innovate and do something that my competitors were not doing. Innovation was necessary to survive. Many of the projects I did were first of its kind. When e-commerce and online retail arrived, I realized that they are not competitors but partners for the retail property industry. I was probably the first one to coin the phrase "online plus offline" instead of "offline to online". It is an overlapping relationship and my focus was to get online retailers offline. Today, traditional offline retailers are gone, but Alibaba, JD and most of their competitors have offline shops.

If e-commerce and online retail are no threat, what are the real challenges for the retail property industry in Shanghai?
The real challenges are rising costs, competition, the lack of talent and a misalignment between what investors want and what the industry needs. This is especially the case in places like Shanghai. Land prices and salaries have increased dramatically over the last twenty years. Additionally, where you had no competitors in a several kilometre radius a couple of years ago, you now have numerous within close vicinity that all cater for a group of consumers that has not increased as much as the number of shopping malls. The lack of talent becomes especially obvious whenever I am building a new team. Lastly, there is a clear misalignment between investor demands and industry needs. Retail property has to be a certain size and a long term investment as you need to build your customer base and establish yourself in a certain location. However, long term and big money translates to more risks and large investors such as institutional investors are usually not willing to take such risks.

At this symposium, we heard a lot about disruption from new technologies, new business models etc. What was disruptive in your industry that forced you to adapt?
One example is the "online plus offline" formula. By combining online and offline retail, two of the basic KPIs in our business have been disrupted. One is the turnover rent. In the old days, traditionally in a lease agreement, we had a base rent and a turnover rent (a turnover rent is a percentage of the tenant's sales) and we would take whichever is higher. 60-70% of our rental income would come from base rent and the rest from

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turnover rent. But with online retail, most sales are made on mobile phones and there is therefore no way that we can accurately track the sales of our tenants. Another basic KPI that was disrupted is the occupancy cost ratio (rent paid vs. sales of a business). In the past, we used it to assess the well-being of our shopping malls. A healthy benchmark would have been if the tenants rental account for 15-20% of their income. However, without the ability to track our tenants' sales, this KPI became irrelevant. Today, we have a much simpler business. We mostly just charge a base rent and no longer a turnover rent. To assess the health of our shopping malls, we rely on my 30 years of expertise which taught me that if tenants pay their rent on time, they must be making money.

Your logo is a green heart, symbolizing the Chinese character for passion and underlining your company's commitment to innovation. Seeing the green heart, my first reaction to it was that your company must be environmentally conscious. What role play environmental considerations and climate change in your company's business?
Environmental and climate change considerations are very important to our business and we now subscribe to GRESB (which assesses and benchmarks the Environmental, Social and Governance performance of real assets, providing standardized and validated data to capital markets). We currently have three stars in the GRESB rating and our objective is to achieve four stars in the next two years. Our efforts started about three years ago and in many criteria, we are currently number one in our sector in China. Also, our three global institutional shareholders require a certain level of commitment to green building.

Larry HU, head of greater China economics at Macquarie said in August 2018 that "property is the country's biggest risk in the next 12 months, much greater than the U.S.-China trade war". Also considering the obvious differences between retail and residential real estate markets, do you agree with him?
You can't generalize for an industry like real estate and a market like China. I don't know what he meant by property, but it's definitely not retail projects. Probably he meant residential, but even then I would not agree with his assessment. Of course, a lot of residential properties have been built and sold in China, but unlike in the West, most people do not buy property with a big mortgage, they pay with cash. I would not dispute that the volume of the residential real estate market is massive and maybe alarming, even for a country like China. The risks however come from the financing side and not the size of the market itself. Since most people have bought with their savings and not borrowed money, I see the risks as rather small. The situation can't be compared to the mortgage problems that led to the financial crisis in 2008.

***Henry CHENG** has over 30 years of experience in real estate development. Co-founded by Henry in 2003, Chongbang Group is an investor, developer and manager of retail-anchored mixed-use projects in Shanghai and major cities in the Yangtze River Delta. Its highly focused business strategy, its holistic approach to property development and its proven ability to compete on innovation are well recognized by the industry and the investment community. Before co-founding Chongbang Group, Henry was Executive Director of Hongkong's Shui On Group and Managing Director of Shui On Properties.*

The views expressed here are solely those of the interviewee and they do not necessarily represent or reflect the views of the stars Foundation.

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