RECESSIONARY CHALLENGES IN REAL ESTATE BUSINESS

MR.SANDEEP.R.SAHU &
MR.SHREEKUMAR MENON
Department of commerce
SMT MMK College of Commerce & Economics, Bandra

Abstract

The Global Credit Crises that began like a small fire in the US housing finance market in 2007 spread and became a forest fire that first engulfed the US, then the Western economies, and eventually the rest of the world, including India. The crisis is clearly the deepest and the most widespread economic meltdown that the world has faced since the Great Depression. Indian industry started experiencing the real impact of the global financial meltdown from the last quarter of 2008. The Indian economy, which was on a robust growth path up to 2007-08, averaging at 8.9 per cent during the period 2003-04 to 2007-08, witnessed moderation in 2008-09, with the deceleration turning out to be somewhat sharper in the third quarter. IT industries, financial sectors, real estate owners, car industry, investment banking and other industries as well are confronting heavy loss due to the fall down of global economy. ***The Real Estate Business has seen 62 per cent decline in revenues, 58 per cent decline in PBDIT, and 78 per cent decline in net profit, between March 2008 and March 2009. This decline has been accompanied by a significant fall in the property prices in India.*** *The importance of the real estate sector in India cannot be understated given the strong forward and backward linkages that it generates. The sector has demand implications for intermediate inputs like steel, cement, etc., while keeping afloat the whole construction industry including transport and other intermediate labour services. Given its importance for the economy it is worthwhile to see how adverse expectations are playing a role in this sector and what the possible solutions are.*

Introduction

"March 16, 2008: Bear Stearns is acquired for $2 a share against its 52-week high of $134. July 14, 2008: Oil hits $145 a barrel and then collapse to $34 within six months. September 15, 2008: Collapse of Lehman Brothers. November 20, 2008: Dow Jones at a record low of 7,449 points. June 1, 2009: General Motors files for bankruptcy. We are living in a time that has seen unprecedented volatility. From boom to bust in a matter of months".

To begin with let us define the term Recession; 'recession is a decline in a country's gross domestic product (GDP) growth for two or more consecutive quarters of a year. A recession is also preceded by several quarters of slowing down'.

An economy which grows over a period of time tends to slow down the growth as a part of the normal economic cycle. An economy typically expands for 6-10 years and tends to go into a recession for about six months to 2 years. A recession normally takes place when consumers lose confidence in the growth of the economy and spend less. This leads to a decreased demand for goods and services, which in turn leads to a decrease in production, lay-offs and a sharp rise in unemployment.

The Real Estate industry in India witnessed unprecedented growth in a relatively short span of time. With most companies having seen only the upward swing, the economic downturn proved to be a litmus test. Companies with stronger fundamentals and ability to make quick strategic decisions continued to operate, though with reduced visibility and size of operations, the weaker ones found it challenging to retain their position and image as a Real Estate developer.

As has been said, "Businesses with the right strategy and vision come out stronger from times of depression".

In order for Companies to gear up to face the challenge, it is imperative to understand how the real estate market has been impacted. There is an overall slowdown in demand across India as has been experienced by industry players. Property prices and rentals are correcting which have led to the erosion in market capitalisation of many listed players like DLF and Unitech. Many current projects of real estate developers have been stalled due to lack of funds and investors either do not have funds to invest or are reluctant to do so. Consequently, companies are forced to sell of the properties at a lower value. This scenario is ascertained by the fact that finding buyers is also proving to be a challenge. Increasing input costs has led to margin shrinkages, in fact, companies with ordinary supply chain management have stalled their projects.
Rising costs, lack of capital, reluctance of buyers have all contributed to the current scenario. This paper aims to analyse various strategic initiatives by companies to combat the existing times and sustain their businesses through future turbulent times.

Review 0f Literature

1. Wade Robert[2] in his article "Steering Out of the Crisis" mentioned that the global financial and economic crisis has discredited many established ideas about how societies should run their economics, and the impact of this discrediting will last well beyond the recovery. He also emphasis that the crisis provides opportunities for advancing a social democratic vision of a moral society, with more of a balance between economic democracy and political democracy, especially in finance.

2. Thornton Grant[3] in his article "Sustaining and building businesses during economic slowdown" specify that the Real Estate industry in India witnessed unprecedented growth in a relatively short span of time. With most companies having seen only the upward swing, the economic downturn proved to be a litmus test. He also focus that the Companies with stronger fundamentals and ability to make quick strategic decisions

continued to operate, though with reduced visibility and size of operations, the weaker ones found it challenging to retain their position and image as a Real Estate developer.

3. Chandramouly Anjana and Kannan Swetha[4] in their article on "Time for a realty check" say that realty is one of the worst hit sectors in the economy but recession is not all bad. It seems as if recession is a death sentence passed on our country as many companies grew during recessionary periods. They would like to seize the moment and understand what the opportunity is.

4. Bardhan Ashok[5] in his article "Housing and the Financial Crisis in the US" said that the source of the current economic crisis lies in the housing and housing finance sectors, the so-called subprime crisis should be seen as a symptom of deeper structural and politico-economic problems of today's globalized capitalism, rather than the primary cause of the broader crisis. Considering growing financial complexity and regulatory requirements, and issues of equity and fairness. **He expects a greater role for government institutions in the future**.

5. Sobha Developers[6] organized "Sobha Home Mela" February this year in Bangalore with about 1,500 units on display across 18 projects including villas, row houses, luxury apartments, semi-luxury apartments and plots. Many other developers are still marketing through above-the-line initiatives, Sobha Developers has decided to look below.

6. Pericho Prabhu, Vice-President, Orange Properties, which has cut down ad spends by nearly 30 per cent. He instead of giving discounts and slashing the prices like other builders, we offer a 700-sq-ft flat free on the purchase of any flat. The 'buy one flat, get one free' scheme for the Orange Resorts project was devised obviously to beat the recession as no one had ever thought of offering a flat free with the purchase of a flat.

Objectives of The Study

Following are the objectives of the study:

1. To study the impact of Global recession on India's real estate sectors foreign direct investment flows, rate of growth, sales and profit after tax (PAT) and
2. To analyse various strategic initiatives by companies to combat the existing times and sustain their businesses through future turbulent times.
3. To give suitable conclusion & suggestion.

Hypotheses of The Study

1. There is no significant impact of recession on Indian real estate market (Ho)
2. Global recession has a definite impact on development of Indian real estate market (Ha)

Research Methodlogy

The study is primarily based on secondary data collected through journals, periodicals, Websites and newspapers

Results and Discussions

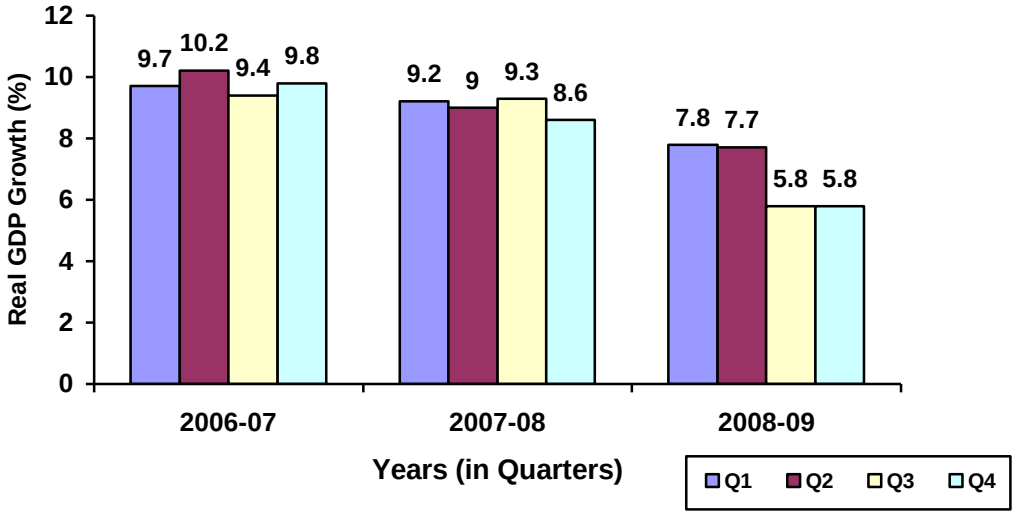
The real estate market in India remains unorganized, fragmented and characterized by small players with a local presence. The growth of the real estate sector is attributed to various factors such as growing economy, growing business needs etc. However, this boom is restricted to areas such as commercial office space, retail and housing sectors. The major concerns of this sector namely are skill shortage, non-availability of statistics, lack of low cost-affordable housing, lack of sustainability and to meet a future that might have downturn due to oversupply.

The industry is presently facing a major resource crunch – an obvious lack of qualified and skilled people. Coupled with this manpower shortage is the shortage of availability of relevant statistics, which has created an ambiguity as to how much construction activity is actually taking place and one can't gauge the demand and supply trends accurately.

The major issues that plague this industry is tremendous shortfall of middle class housing as majority of the developers are involved in developing high class housing. So, there is a dearth of low cost affordable units.

Recession in US economy has caused great impact on Indian real estate business. The real estate industry was a booming industry in pace with information technology (IT) industry. Demand for it space and from high net worth individuals had created opportunities for the this sector

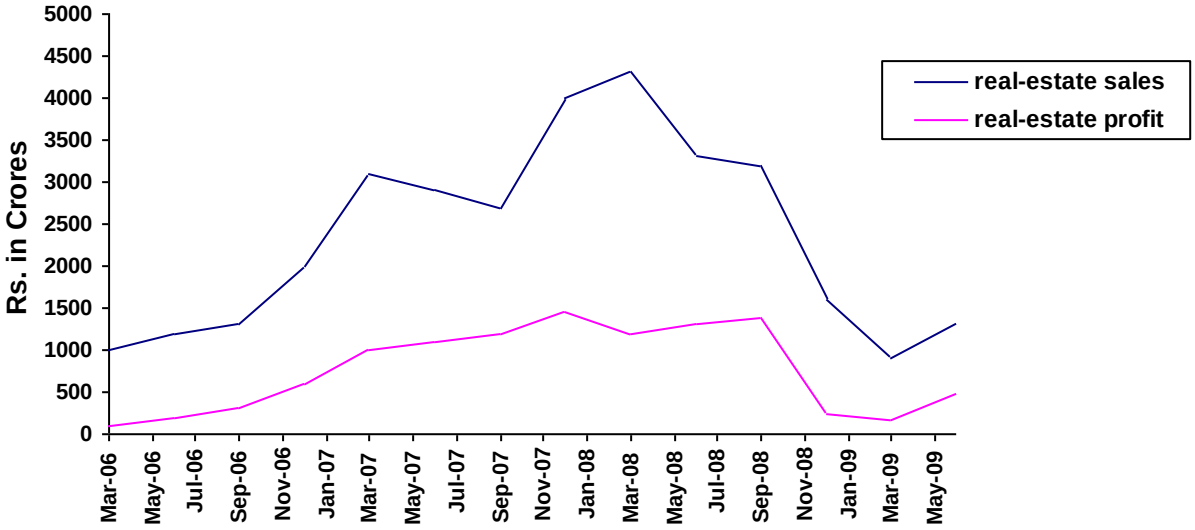
Figure 1: Quarterly Estimates of GDP At Constant (1999-00) Prices-Growth Rates[7]



Source: Reserve Bank of India Bulletin

The Indian industry has dealt with economic slowdowns in the past but this one is in the nature of contagion effect of the western recession. The full spectrum of the shades of the contagion is not evident in the GDP growth trend. Numbers alone would indicate that economic slowdown, so far, has been barely a two-quarter phenomenon. In figure 1, the real slowdown was seen only in the last two quarters of 2008-09. Sales growth respectively dropped to 9.5 per cent and 1.9 per cent in Q3 and Q4 with much worse impact on the net profits that respectively fell by 53.3 per cent and 19.9 per cent.

Figure 2: Sales And Profit After Tax Trend of India Real Estate Sector[8]



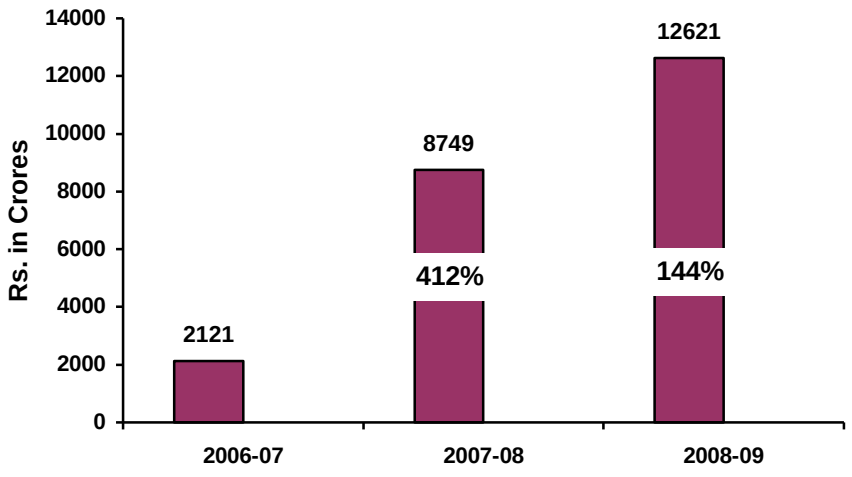
The trend in sales and net profit of "worst affected" Real Estate is given in figure 2. The Real Estate has been 62 per cent decline in revenues, 58 per cent decline in PBDIT, and 78 per cent decline in net profit, between March 2008 and March 2009. This decline has been accompanied by a significant fall in the property prices in India. However, the sector shows a moderate recovery in the quarter after March 2009.

Table 1: Rate Of Growth At Factor Cost At 1999-2000 Prices (Per Cent)[9]

	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
Agriculture, forestry & fishing	10	0	508	4	4.9	1.6
Mining & quarrying	3.1	8.2	4.9	8.8	3.3	3.6
Manufacturing	6.6	8.7	9.1	11.8	8.2	2.4
Electricity, gas & water supply	4.8	7.9	5.1	5.3	5.3	3.4
Construction	12	16.1	16.2	11.8	10.1	7.2
Trade, hotels & restaurants	10.1	7.7	10.3	10.4	10.1	9
Transport & communication	15.3	15.6	14.9	16.3	15.5	9
Real estate & Financing	**5.6**	**8.7**	**11.4**	**13.8**	**11.7**	**7.8**
Community, social & personal services	5.4	6.8	7.1	5.7	6.8	13.1
Total GDP at factor cost	8.5	7.5	9.5	9.7	9	6.7

Source: Central Statistical Organization

Figure 3: FDI Equity In Indian Real Estate Business[10]



Source: RBI's Bulletin August 2009 (Table No. 46 – Foreign Investment Inflows)

Above Table no 1 reflects how the steady growth rate of real estate sector was slowed down in year 2008-09 due the recessionary trend prevalent in the economy .this proves our hypothesis (Ha) that recessionary effects were responsible for downtrend in the real estate sector and null

hypothesis is rejected from the observations made. In figure 3, it is seen that FDI equity in Indian Real Estate Business is increasing but in reality it is not so. In the year 2007-08 it is increased by 412 per cent and in 2008-09 it is only increased by 144 per cent. So it is not rise as it is accepted by the Real Estate Market.

Strategies To Cope Up With The Above Situation

Challenging times present an opportunity for Companies to capture market share by outperforming competitors. A quick analysis of the market conditions and quicker response to mitigate existing risks differentiates companies.

There can be multiple reasons why some companies continue to tread well while some companies falter badly, when faced by serious challenges. But, invariably, the most significant role here is played by the strategic decisions taken by the company.

When the global economic crisis, compounded by the local economy issues, started hitting real estate demand in India, different companies reacted in different ways.

1) Financial Decisions

Initially, developers were reluctant to reducing real estate prices in order to revive demand. However, with no immediate respite and growing pressure to cut down losses, a gradual slash down in prices was introduced.

The worsening situation of credit availability led developers into liquidity crunch. Many developers succumbed to borrowing at a very high cost, Private Equity which was once easily available became a very distant option.

2) Diversification of Business

Recognizing the need of developing multiple streams of revenue, some cash-rich developers vertically diversified (or attempted to diversify) their businesses into telecommunications, financial services, insurance, etc. Horizontal diversification into services related to property management and leasing also surfaced up as a preferred strategy for dealing with the downturn.

Owing to increased competition in metropolitan cities, developers opted to diversify geographically as well. Tier II and Tier III cities thus came under their radar. Interestingly, one can easily find developers cheering their strategy of foraying in smaller cities, which are relatively less-affected of the ongoing economic turbulence.

Maintenance of high equity

As part of long term strategy, instead of selling off properties, developers began to enter onto lease agreements with larger companies for commercial space. The long term rental arrangement, though at reduced rates, guaranteed a steady stream of income.

3) Cost Control

In the wake of controlling cost like most other sectors of the economy, Indian real estate companies also embarked upon various cost cutting strategies. Capital intensive projects that had no impact on company's revenues in the short term were either put on hold or scaled down, and even cancelled. IT related projects were among major ones in this case.
However, some significant projects such as those including the use of IT to improve investor access to information are important, and most developers appear to agree on this. Therefore, projects meant for maintaining a fair interface between the company, investors and customers hold water, especially during the turbulent times.
A number of companies also downsized their extra manpower. However, in many instances, this was not done in a thoughtful manner, thereby putting companies on the risk of losing essential talent in exchange of short term cost savings.
A number of real estate companies in countries such as the US and the United Kingdom (UK) don't hesitate in outsourcing their marketing activities after carrying out the necessary due diligence. This acts as a measure to infuse efficiency and cut unnecessary costs involved in many of the related processes.

4) Focus On Customer Satisfaction

The ongoing condition of economic contraction has also resulted in improved services to the customer. In order to shed off an image of being non-transparent and unorganised, a number of developers increased their focus on customer satisfaction.
A customer was provided the facility of checking the status of construction of his property by logging on to a website. Earlier, this was possible only after visiting the site and following up with the concerned officials.
With such initiatives, developers are fast changing their image as professionally managed corporate houses, committed for meeting customer expectations and empathetic in resolving the concerned issues.

Conclusions & Suggestions

Owing to the correction in real estate prices and re-aligning of business strategy, as per the ongoing business environment, has resulted in some signs of revival in the Indian real estate sector, in the recent past. A stable political scenario has also boosted confidence in the Indian capital markets, and the overall business environment. This was further complemented with the Indian economy managing to achieve a growth rate of 6.7% during 2008-09, despite recession in the global economy.

At the first instance, such positive indicators reinforced the potential of Indian domestic economy, while uplifting sentiments otherwise enshrouded by negative movements on the front of employment and deepening financial crisis in the global economy.

These small packs of positive developments slowly flowing into the economy have also started generating interest amongst customers, and some developers have experienced improving situation in terms of demand of real estate in select pockets. The recent situation, however, has sent the message home. The Indian real estate companies are urged to focus on customer satisfaction. The industry is no more dominated by a developer, putting customer expectations at the backstage and carrying on operations at his own sweet will.

More significantly, the ongoing correction in the real estate market has indicated towards its fundamental strength wherein it tends to correct itself with any excesses on the front of prices, and other demand relating factors. Nevertheless, real estate companies are fast-learning to lay emphasis on retention of existing customers and acquire new customers. The present times have been calling for a fair level of flexibility, which even the real estate companies have been expecting from their suppliers and service providers. At the same time, many developers have found a viable strategy in forging collaborations – leading to cost benefits, synergies, and mutual strength. The potential areas of collaboration include supply chain, procurement, production and brand promotion.

Nevertheless, this phase of market consolidation is a real opportunity where weaker players will be defragged and stronger ones will increase their market share through well-thought business strategies, and further tighten their belts for high growth in the future. The Budget 2010 presented a mixed bag for real estate sector in India. However, it has failed to address some of the key demands of the real estate developers, including infrastructure status to the real estate sector, relaxation of external commercial borrowings to fund projects, provision of separate deduction of Rs. 1 lakh for housing loan repayment or increasing the overall 80C deduction to Rs. 2 lakhs etc.the key to growth of this sector lies in growth of disposable income with the population and willingness of property developers to build affordable homes for middle class.

"It is said, that success is not about how high you rise, but about how high you bounce back when you hit rock-bottom. Real Estate companies today are at that strategic inflection point, where they must define new imperatives to be successful once again. Bridging the gap between the customers and themselves, taking a harder look at resource-sapping processes, and above all gaining agility and flexibility as organizations, will be the stepping stones to success."
- Vinamra Shastri
Head – Strategic Services & Partner, Grant Thornton India

References

1. Maniwani Harish, "Annual Report in Annual General Meeting", Hindustain Unilever Limited, July 3, 2009. http://www.hul.co.in.
2. Wade Robert, "Steering Out of the Crisis", Economic & Political Weekly, Mumbai, March 28-April 3, 2009, pg. 39.
3. Thornton Grant, "Sustaining and building businesses during economic slowdown" Indian Real Estate, July 2009

4. Chandramouly Anjana and Kannan Swetha, "Time for a realty check", The Hindu Business Line, May 2009. http://www.thehindubusinessline.com/catalyst/2009/05/28/stories/2009052850020100.htm
5. Bardhan Ashok, "Housing and the Financial Crisis in the US", Vikalapa The Journal for Decision Makers, Indian Institute of Management, Ahmedabed, July-September 2009.
6. http://www.thehindubusinessline.com/catalyst/2009/05/28/stories/2009052850020100.htm.
7. Performance of Private Corporate Business Sector during the first half of 2008-09, "Reserve Bank of India Bulletin, January 2009, pg.117.
8. *Ibid* pg 61.
9. Choudhari Nidhi, "Research Paper on Global Recession and its impact on Indian Financial Markets", August 2009.
10. Foreign Investment Inflows, Table No. 46, RBI's Bulletin August 2009.