

# An Analysis of the Causes of Evergrande Debt Crisis

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**Abstract.** Since August 2020, new regulations on real estate financing have been issued, emphasizing "the need to improve the marketization, standardization, and transparency of financing". Subsequently, the capital liquidity crisis caused by Evergrande's high debt and high turnover mode has become the focus of public attention in the market and has triggered the credit crisis of the real estate industry to a certain extent. This study is based on the public information such as the financial statements. To analyze and study the causes of the crisis, this paper will analyze the causes of the Evergrande Group crisis by comparing the previous financial statements of the company, using the balance sheet and comparing the profitability, and putting forward suggestions on the future liquidity and long-term development of Evergrande Group. The suggestions give inspiration to the same industry or enterprises in the same model. Warning the existing housing enterprises, Evergrande Group serves as the most negative example in textbooks, playing a warning role to prevent such a serious crisis from happening again.

## 1 Introduction

Since the reform and opening up, the rise of real estate has greatly increased the housing demand of the people. In just 30 years, nearly 10,000 real estate companies have been established. While raising the people's housing demand, there are also many problems. For example, Evergrande Group, a company that has borrowed money to develop, has caused great chaos to the country and its people. China Evergrande Group, a Hong Kong-listed company, founded in 1996, has more than 100,000 employees. The company originally owned four core companies, including China Evergrande New Energy Automobile Group Co., LTD., Evergrande Real Estate Group Co., LTD., Hengteng Network Group Co., LTD., and Evergrande Real Estate Group Co., LTD. Evergrande Wealth has suspended payments of all wealth management products since September 2021, when Evergrande notified the two banks to suspend interest payments on loans due on September 21. From the perspective of macro shareholding structure, Evergrande shareholding structure is very centralized. Being too centralized can lead to a brain drain, which means that a large number of brands and buildings cannot be highly regulated. Excessive debt and leverage diversification already led the vulnerable Evergrande Group step by step to the crisis. Evergrande Wealth has announced three solutions: cash installment payment, housing payment, and physical asset payment. The move has sparked a heated discussion in both the market and among the public. Since then, a large number of Evergrande Group business tickets have stopped the default payments. Therefore, Evergrande's capital liquidity crisis has further turned into the market trust

crisis and further spread in various industries. For example, the Sankeshu Group, as well as the famous decoration company Gold Mantis, fell into a liquidity crisis involving up to 40 billion yuan. At the same time, Evergrande's liquidity crisis has also led to a large number of real estate "rotten housing" that cannot be delivered in time. Since 2021, Evergrande Group has incurred contractual liabilities of about 215.8 billion yuan since making a profit. The average floor price in 2021 was about 9,000 yuan per square meter. For every 100 square meters, it was calculated four times. Approximately 1 million people are waiting for Evergrande to hand over the properties. This paper will review the timeline of Evergrande's "debt crisis," analyze the causes of Evergrande Group's crisis during the same period in the same industry, and propose suggestions and thoughts on Evergrande Group's crisis.

## 2 The beginning of the debt crisis

### 2.1 Capital structure

The shareholding structure of Evergrande Group is very rigorous and complex. It uses a multi-layer structure and double-tier overseas holding, so that enterprises can better finance overseas, hide information and reasonably avoid tax. Xu Jiaying first established Xinxin (BVI) Limited, controlling 59.84% of Evergrande Group's shares, while his wife Ding Yumei established Junrong Holdings Limited, controlling 5.05% of Evergrande Group's shares. The remaining shares are held by the public and investors. By using a Cayman Islands company to control Angi BVI, domestic commercial

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entities are controlled. Evergrande Group utilized hidden shareholding and shareholder names through British Virgin Islands companies. Evergrande Group used Cayman Islands registered companies approved by the stock exchange. By adopting the Xiao Hong Chou structure, corporate tax costs are reduced. By using this structure, Xu Jiayin has full control of Evergrande Group. In addition, Evergrande Real Estate Group Co., Ltd. (registered in the Cayman Islands) may carry out business restructuring before and after listing, which is also convenient for enterprises to adjust their business through the use of structure, and listing financing. It expands the company's business scope, further leading to the formation of a giant enterprise internal crisis so that the crisis of Evergrande gradually formed step by step [1].

Evergrande Group's financing is fast-paced. Financing methods include war, IPO, rights issue, and additional issuance channels, such as China Evergrande's financing. In addition to the first two rounds totaling \$830 million and personal investment structures, a large amount of market financing is approximately 108.7 billion yuan, with a significant portion of investments concentrated in real estate, property, automotive, food, and other e-commerce platforms through war and stock market financing [2]. Raising and other funds did not enter the actual operation, more to expand new products,

so that new products quickly raise funds in the market, resulting in a very tight use of funds.

## 2.2 The changes in regulation

Early on, Evergrande Group accumulated a large amount of land reserves and obtained bank loans. However, due to policy constraints (the "three red lines"), high debt levels prevented Evergrande Group from further expansion. In the early stages, the inability to fulfill bank loans led to a liquidity crisis caused by the company's high turnover and high debt. This crisis was exacerbated by the inability of numerous suppliers, construction contractors, and related industries to receive payments, leading to further crisis escalation. According to the 2021 data (see Table 1), Evergrande Group's financing costs increased from 8.63 to 9.64 and then to 9.02. Combined with policy impacts, Evergrande Group had crossed the third line, depleting liquidity and rendering it unable to redeem bank loans or issue timely financing instruments upstream and downstream. The "three red lines" refer to the committee's assessment of high debt, high leverage, and high turnover in Evergrande Group's business model. Given Evergrande Group's diversification and sudden transition to other industries, it became virtually impossible, resulting in difficulties in fund withdrawal and directly causing a liquidity crisis for Evergrande.

**Table 1.** Evergrande capital structure (¥billion).

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021H1
Total assets	3181	4745	7570	1350.9	1761.8	1880.0	2206.6	2301.1	2377.6
Actual total liabilities	2938	4149	6906	1301.3	1649.5	1701.4	1987.0	1950.7	1966.5
Total nominal liabilities	268.8	362.1	614.9	1158.3	1519.5	1571.4	1848.0	1950.7	1966.5
Nominal total asset-liability ratio (%)	77.22	76.31	81.23	85.74	86.25	83.59	83.75	84.77	82.71
Real total asset-liability ratio (%)	84.40	87.44	91.23	96.33	93.63	90.50	89.64	84.77	82.71
Average financing cost (%)	9.52	9.74	9.59	8.27	8.09	8.18	8.63	9.46	9.02

Data source: Evergrande 2021 financial report.

## 2.3 Evergrande diversified operation

Evergrande's business scope is mostly extensive, covering a wide range, including mineral water, grains and oils, automobiles, and finance. Despite having numerous successful brands, they have not achieved substantial profits. For instance, Evergrande Mineral

Water initially gained some success in sales through extensive advertising efforts. However, due to issues with product quality, distribution channels, and pricing strategies, Evergrande Mineral Water faced challenges. Pricing inconsistencies and significant fluctuations in distributor prices led to losses for some distributors, diminishing trust in Evergrande. As a result, sales were affected, and in some cases, failed to cover marketing costs, ultimately resulting in financial deficits. Because

the whole department except for the real estate products have economic profits, the rest of the products and brands are basically in a loss state. In the long run, Evergrande Group's diversification is a failure, in terms of debt repayment and profitability. The working capital ratio of Evergrande (see Figure 1) decreased from 1.52 after 2016, and the quick ratio decreased from 0.62 to 0.33, significantly higher than the market level. The asset-liability ratio of Evergrande has been growing continuously since 2016. However, Evergrande's debt repayment ability is not clear (see Figure 2). Since 2017, the debt repayment index has plummeted from a peak of 30% to 5%. Since the three red lines, a large number of

enterprises in the same industry have generally reduced their debts to protect themselves, but Evergrande continues to adhere to diversified development. In terms of profitability. According to the profitability analysis, after the diversified investment strategy, its profitability did not show an upward trend, especially after 2018, all the profit data declined significantly, and the payback up of Evergrande BBB 1 products is not optimistic. After Evergrande sold some of its lower profitability assets in 2017, its profitability rebounded significantly, indicating that Evergrande's blind diversified investment did not improve its profitability [6].

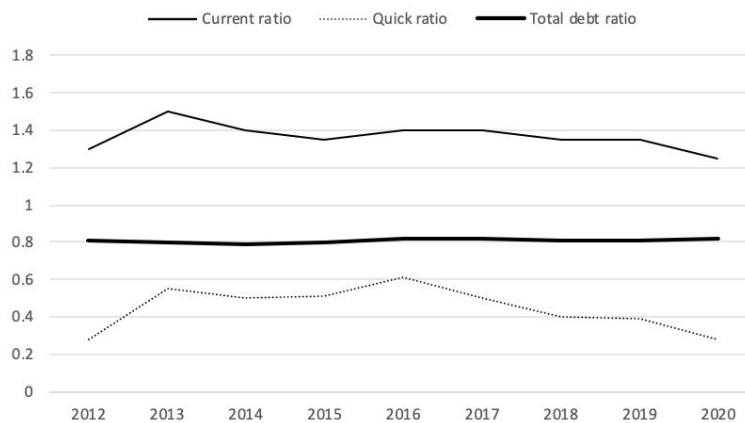


Fig. 1. Liquidity ratios of Evergrande (Photo/Picture credit: Original).

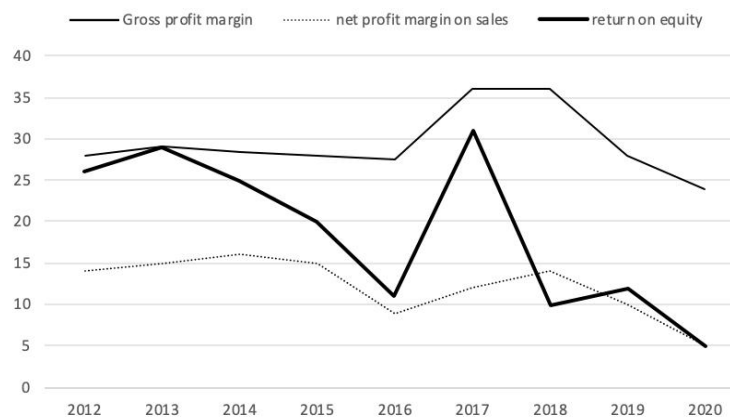


Fig. 2. Profitability ratios of Evergrande (Photo/Picture credit: Original).

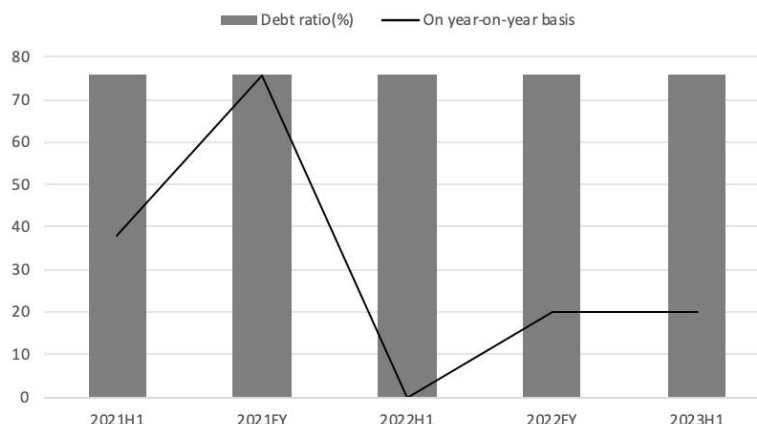
### 3 Consequences

#### 3.1 Company comparison during the same period

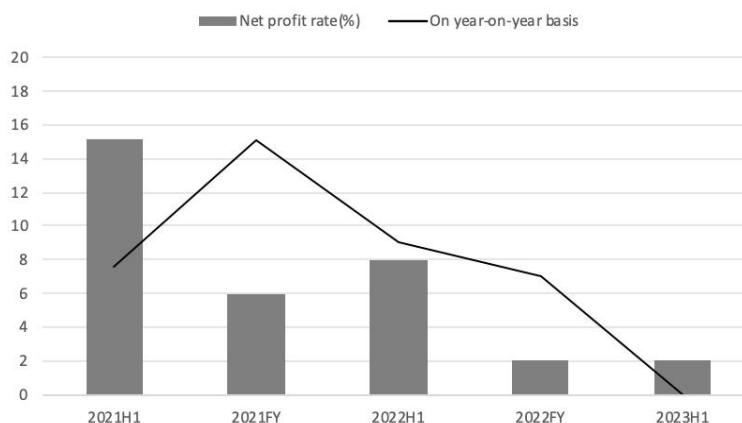
Compared to high-debt and low-debt models, real estate companies should anticipate market trends and reduce their debt levels. Within the same real estate company, Evergrande encountered the three red lines in 2021,

signalling the onset of a liquidity crisis. Compared with the same period of Jinmao Group, the outcome is not ideal.

Jinmao Group predicted the market in advance and sold some assets to trust companies to let Jinmao set. From 2021 to 2023, the debt is just over 75%, which belongs to a healthy housing enterprise, and the three red lines are all passed (see Figure 3). Even if Jinmao Group is a healthy enterprise, the profitability of Jinmao Group is also in a downward trend due to the market and policy relationship, according to Figure 4.



**Fig. 3.** Solvency ratios of Jinmao Group (Photo/Picture credit: Original).



**Fig. 4.** Profitability ratios of Jinmao Group (Photo/Picture credit: Original).

However, due to the healthy debt ratio and the advance prediction of the policy, Jinmao Group has been operating normally, and there has been no large number of commercial bills to stop the payment, or stop the payment of bank loans.

Compared with Evergrande Group, the current situation of Jinmao Group is very ideal [7]. In the process of operation, enterprises should pay great attention to the policy trend, and pay more attention to the internal operation of the enterprise. For example, for Evergrande Group, the equity is too central and is not effectively allocated [8]. If the equity of the enterprise is not effectively distributed, it will lead to improper project management, difficult project promotion, and high personnel liquidity. Today, a large number of companies make full use of their resources and capital by using equity records and motivating employees at low cost. For example, Huawei Group can use equity incentives to effectively improve the utilization rate of funds and obtain the talents needed for diversified operations [9]. Huawei utilizes an employee union holding system to link employee performance with company performance, effectively enhancing the company's operational and innovation capabilities. By holding 99% of the shares through the union, employees are encouraged to innovate and collaborate. Through legislation, the union enjoys dividends without decision-making responsibilities, ensuring the interests of the decision-making body are safeguarded. If Evergrande

Group takes the same measures, it may enable a large number of construction sites and affiliated brands to get a large number of talents, reduce the management cost, reduce the operating cost of enterprises, and reduce the tax burden cost, so that Evergrande can smoothly pass the policy transformation and market trough.

### 3.2 Consequences of the debt crisis

Under the mode of high debt and high turnover, Evergrande Group led to the capital liquidity crisis due to the three red line policies. Due to the liquidity crisis, a large number of ongoing projects were forced to stop construction. By the end of 2022, Evergrande has contract liabilities of 721 billion yuan [3]. If calculated at 1 million yuan per house, Evergrande and 720,000 houses have been sold, but they have not been delivered yet, which will affect millions of people. The real estate enterprises are unfinished, but the loans of buyers are still in progress, and a large number of buyers have encountered unfinished houses. A large number of unfinished buildings reduce the confidence of residents in buying property, but also reduce the confidence of the market and consumers, greatly accelerating the desolation of the real estate market. If Evergrande Group goes bankrupt, it will have a huge impact. For example, a large number of employees are laid off, a large number of non-performing assets are difficult to dispose of, and a large number of investors lose all their money [10].

Evergrande Group has up to 123,000 employees. Most of these employees have housing loans. If they lose their jobs, they will face the risk of a housing shortage, which will hit the market again, and increasing bank losses may lead to the birth of a huge financial crisis [11]. A large number of overdue bank loans will lead to the bank stock price decline, such as the double blow is likely to make banks have a liquidity crisis. If there is a liquidity crisis, there will be a subprime crisis as in the United States in 2008. If a giant group falls, it is very likely to lead to a series of industry thunderstorms, leaving the market in a chaotic state and reducing consumer confidence. Under high leverage, bankruptcy is not only the interruption of supply but also a large number of non-performing assets in the market. Enterprises such as Evergrande Bank will fall into a cash flow liquidity crisis. It leads to a large number of real estate-related industry closures tide.

## 4 Conclusion

In recent years, with the rise of housing prices, the state has constantly adjusted its real estate policies. In recent five years, Evergrande has maintained a debt ratio of 60%. It reflects that Evergrande BBB 1 itself is a business model with high debt and high leverage. There are also differences in the internal governance of the company. It can be seen from the equity structure of Evergrande. 76% of the equity makes Xu Jiayin have absolute control over Evergrande, which limits its diversified development to a large extent. From this, one is that entrepreneurs should constantly improve their quality. To be able to accurately predict the future development form and respond in advance. Second, it pays attention to the cash flow situation of enterprises. It depends on the needs of the investment, construction, or production, builds an effective fund operation and management mechanism, scientific and reasonable pre-management of funds, avoids short loans and long use, and the rupture of the capital chain. To focus on the core business, it avoids blind diversification. In the process of business diversification, it tries to choose the industry with strategic synergistic development characteristics with the original business. Fourth, in line with the direction of national policy regulation, it is important to correctly understand the advantages and disadvantages of various financing methods. By effectively combining these methods, diversified financing channels can be achieved, optimizing the capital structure and avoiding the rupture caused by excessive borrowing risks in the financial chain. Fifth, enterprises should focus on their core business, which will enhance their core competitiveness. Enterprises should avoid excessive reliance on financial innovation tools, adjust accounting items to lower the enterprise's asset-liability ratio, and prevent over-expansion.

## Authors Contribution

All the authors contributed equally and their names were listed in alphabetical order.

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