The Experience of Century 21 in the China Residential Real Market and the Lessons for India.

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The foray of the Century 21 brand into the residential agency space in China has a number of lessons for other players in the region. The C21 experience is now 14 years in the making, and as the business went public in 2009 we have 5 years of audited results to review.

The brand entered the market in 2000 with an aggressive franchise roll out under the leadership of Bill Hunt, a US expat who had run various operations throughout Australasia for the brand in previous years.

The investment levels to date have been estimated north of $325m USD. After the initial rounds of private funding the float on the NYSE in 2010 raised $250m,and within 2 years there was a play by Chinese on line and primary sale company E House to take 35% of the business for an additional $25m, but this appears not to have concluded due to conflicts with the brand licence.

The business is now on notice by the NYSE for delisting due to the it's stock price value falling below the floor cap of $50m. They have been close to this a number of times in the past and a company press release says they will challenge the notice on this occasion.

For the first $50m the C21 brand built a network that was close to 1,500 franchise offices strong across 23 markets in China (according to C21 press releases at the time it was 3,000 but this figure is believed to be well overstated). So this equates to a cost of $33,000/office in set up with an annual operating loss in 2006 of around $1,900 per franchise store.

The issues for management seemed to be in the collection of the royalty fees and in having confidence to manage the brand and growth in the market if they stayed in a wholly franchise model. At this point the average gross fee yield per office was around $3,700/annum.

Rather than stay as a franchisor only business the decision was taken to roll out company stores (initially in Beijing) and wind back the franchise network, eliminating the low and non performing stores. They did this through their initial footprint in Beijing plus the acquisition of the DTZ networks in Shanghai (20 offices), and Shenzhen (30 offices). This allowed them a starting point in these cities as well as giving them access to some skilled manpower and IP in the transactional field.

So in late 2006 company stores were commenced as well as mortgage services. As described above they were set up in the 3 key zones (Beijing, Shanghai, Shenzhen). The plan was to have large volumes of stores over a relatively smaller geo area catering to the denser city populations, basically 200 stores per zone. At the peak there were 589 company stores but the numbers now stand at less than half this with 260 open today.

After the clean out in 2006/07 the franchise business continued to decline from a 1,500 stores in 2006 and 32 regions in 2010, to only 670 stores in 24 regional areas by the end of 2013.

From an outside perspective it's hard to understand the logic of the high density 3 city network of company stores. The sheer volume of stores in tight geo locations left them very exposed to a market downturn, which in China can be market related or caused by regulatory changes – neither of which is controllable (or overly predictable) by the operator.

In the Initial phase the numbers seemed to be working, with 2009 (the year prior to the float and while the sales road show was underway) showing a healthy bottom line of over $17.2 million for the group with the company stores averaging profitability of $67,000 or 20% of revenues. Costs were in line with international standards and the model seemed sound.

It has to be said that the numbers for 2009 are well out of step with the results of both the preceding years and most of the history since. Obviously the financials were managed to extract the best results for the road show and IPO, but the greater effect seems to have been the regulatory and market changes at this time and the effect it had on how the company could control costs, particularly its labour and premises costs.

The 44% labour and commission costs of 2009 have never got below 60% in subsequent years and today sit at 64%. This is the difference between profit and loss for the group. Incomes have risen steadily from $85m in 2009 to $145m in 2013 (58% growth over 4 years)and this has been done in a market that has seen falling commission rates in primary sales and severe government control of the secondary and primary markets in an effort to reduce turnover and 'cool' the market.

The problems seem to have been cost related rather than income based.

If you reviewed the numbers in 2009 it would have been reasonable to assume that a store break-even was in the mid $200,000 range, as they were showing a 19.7% profit at average store revenues of $338,000. However in 2013 they clocked average store revenues of $526,000 and still booked a loss of around $50,000 per store. This seems primarily due to the previously described blow out in labour costs and also a 50% jump in admin and marketing costs.

In late 2012 and early 2013 the group seemed to be turning the corner with three quarters of profitable trading out of four. Unfortunately the last 3 quarters have again seen them slip into significant losses ($15.8m) with labour numbers back up as well as higher costs in administration and operations. This was most likely caused by the further contraction of the store numbers and the hangover of costs from leases and labour that resulted. Given the tightening market due to the regulatory changes they have probably also had to increase their marketing spend to keep sales moving.

So what are the lessons ?

I think firstly you need to look at the basic model. As a franchisor only they lacked the control to grow the business revenues, but when the decision was made to lead with company stores it was far too aggressive, as can be seen from the shrinking footprint since 2010.

The risks on the cost side haven't been managed well enough given the regulatory environment the business operates in – risk management in China (and other parts of Asia) is about understanding the potential consequences of often sudden and significant changes in legislation that is specifically aimed at controlling market forces. This coupled with laws that make it difficult to shed staff and exit leases has crippled them.

The per store franchise revenues continue to be low at only $2,985/store in 2013 ($250/month) which is 30% less than the per store revenues in 2007, and barely 30% of the per store revenue at

the peak in 2008 (although this is helped by a large contraction of store numbers). So interestingly the push of company stores and the increased market control has done nothing to lift the franchising income. This may well be because the company stores and franchised businesses are generally in different regional areas, so there is little synergy. Coupled with this the market rumour is that there is a great deal of animosity between the franchise businesses and the company – essentially a perceived lack of support leading to a disgruntled network.

This is the most common problem faced with networks, particularly new ones. The franchise network needs to feel supported and part of the 'family'. One of the best positive examples of this I have seen recently is the growth of the LJH Indonesia business. It has achieved outstanding results in the last 2 years through a concerted effort to deliver services to the network and get the vast majority of franchise partners on board.

If you don't have this culture then you are bound to see massive under reporting of fees and large delinquent accounts from the network.

For India (and other parts of Asia) I think we need to look at models that have at least a basic corporate Hub that can competently build primary relationships and market presence for the brand. Once you have established brand presence and have workable localised operating systems you can then push a franchised network off that hub and then assist the network to grow their revenues.

This is the only way to get the royalty income to the sorts of numbers you need to see for a viable business. You need excellent support to get your network using the systems you have and you need good audit processes to ensure compliance. A rising minimum fee is also a sensible idea given the issues with audit and reporting.

The other seemingly obvious point is to have a more traditional hub and spoke model where the franchise offices get more value and a synergy from the corporate presence. In a perfect world you are probably best with just a single corporate hub per region that both leads the transactional business as well as providing franchise support.

The LJH Indonesia experience of the last couple of years has also shown that sustainable growth from a solid base is a good strategy.

Century 21 China								
Revenues ($m USD)	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Company Store Income	-	21.9	29.9	78.9	73.1	81.6	100.1	114.2
Franchise revenues	5.56	5.4	8.2	2.6	2.6	3.7	2.2	2
Mortgage Services	-	-	1.5	4.3	3.7	3.6	4.1	6.1
Primary & commercial	-	-	-	-	-	7.1	13.7	22.7
Total Income	**5.56**	**27.4**	**39.6**	**85.7**	**80.4**	**96.1**	**120.1**	**145**
Expenses								
Com & Agent costs	12%	44%	55%	44%	60%	71%	61%	64%
Op costs (rent etc)	26%	42%	54%	18%	38%	49%	23%	21%
Admin & Marketing	105%	53%	38%	16%	33%	36%	24%	27%
Profit/Loss ($m USD)	-2.83	-10.55	-19.12	17.2	-24.8	-54.7	-9.4	-13.7
Company offices	-	143	296	233	589	406	318	260
Regional Franchise areas	23	23	28	30	32	31	27	24
Franchise offices	1500	1300	950	792	911	831	642	670
Total network	1500	1466	1246	1072	1500	1237	960	930
Employees			11,000	14,900	20,800	14,900	12,100	13,000
Listings			4.7m	6.1m	6.7m	8.0m	8.0m	7.7m
Transactions Co/stores			5,861	17,301	*16,000*	*18,133*	*24,212*	*27,378*
Statistics								
Employee/office			8.8	13.9	13.9	12	12.6	14
Listings/office			3,772	5,690	4,466	6,467	8,333	11,492
Listings/employee			471	409	321	537	661	592
Ave Income/Co store/annum		1,53,147	1,01,013	3,38,626	1,24,108	2,16,985	3,57,861	5,26,538
Ave Profit/co store/annum				67,167				
Percentage profit/turnover				19.70%				
Income/Co employee/annum			11,300	24,069	9,011	16,749	28,402	37,610
Income/employee/month			942	2,005	751	1,396	2,366	3,134
Transaction/store/annum			19.8	74.3	*27.2*	*44.7*	76.1	105.3
Transact/employee/annum			2.3	5.4	2.6	*3.7*	6	7.5
Transact/employee/mth			0.19	0.45	*0.22*	*0.31*	0.5	0.63
Net earn per transaction			5,102	4,560	*4,570*	*4500*	*4700*	*5000*
Gross fees per franchise store	3,707	4,154	8,632	3,283	2,854	4,452	3,427	2,985
Note : Blue figures are estimates as data unavailable to verify								