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Analysis on Financial Risk Management of China Evergrande Group

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Abstract: Financial risk management is very important in the financial management of enterprises. Financial risk management in the real estate industry is related to the development and survival of enterprises. However, my country's financial risk management system is not perfect. This investigation report takes the financial risk management of Evergrande Group as the starting point, briefly introduces its characteristics, and details the current situation and causes of Evergrande Group's financial risk management around it. Then, through the analysis of the cash flow of Evergrande's financial statements and the analysis of various financial indicators, it describes in detail the financial risk problems that China Evergrande Group has recently existed, and studies the causes of the existing problems. This report also puts forward corresponding suggestions: improve the solvency and rational use of funds. Strengthen cost control and control cost budget. Establish a scientific and sound financial risk management system, use financial indicators in various aspects to carry out financial risk early warning, and improve risk early warning capabilities. It is hoped that these suggestions can provide reference for the healthy and sustainable development of the financial risk management of real estate enterprises.

1. Introduction

In recent years, the real estate industry has developed rapidly, and China's real estate industry will also enter a new stage of development. Financial risk is an inevitable product of the development of the real estate industry. Under the impact of the COVID-19 in recent years, the financial risk problem of the real estate industry has become more prominent. Against this background, the development of China's real estate industry has suffered some setbacks. On the one hand, the cash flow of real estate enterprises is hindered, and the pressure to repay debts has sharply increased [1]. On the other hand, the current debt ratio of the real estate industry is as high as 80%, basically reaching a historical high.

Due to the impact of the epidemic, many real estate companies have delayed sales and payments, but their debts have matured, resulting in high pressure on their cash flow and financial risks. In the severe market competition environment of the epidemic situation both domestically and internationally in recent years, the financial management of enterprises has faced unprecedented challenges [2]. The analysis of enterprise financial risk management is conducive to mastering the regularity of enterprise production and operation. Therefore, this report aims to analyze the current situation and causes of financial risks of China Evergrande Group, and based on this, propose corresponding suggestions for China Evergrande Group's financial risk management to promote the sustainable and healthy development of the real estate industry.

2. The Financial Risk Status of China Evergrande Group

2.1. Introduction to China Evergrande Group

China Evergrande Group ranks 138th among the Fortune Global 500 companies, with its business scope covering real estate, health, finance, sports, and tourism [3]. From the perspective of employment, China Evergrande Group currently has over 80000 employees, helping approximately 2.6 million people enter employment every year [4]. From the perspective of corporate assets, the total assets of China Evergrande Group are 2.38 trillion yuan, with an annual sales scale exceeding 600 billion yuan and a cumulative tax amount exceeding 230 billion yuan.

2.2. Analysis on Financial Risk Management of China China Evergrande Group

2.2.1. Financing risk

From Table 1, it can be seen that the asset liability ratio of China Evergrande Group fluctuates around 85%. Compared to the warning line of 80% for asset liability ratio, China Evergrande Group has exceeded its warning line. From the perspective of the real estate industry alone, it is more appropriate to maintain an asset liability ratio within the range of 60% -70%. However, China Evergrande Group's asset liability ratio is far higher than the appropriate level of the real estate industry's asset liability ratio [5]. This indicates that China Evergrande Group's short-term and long-term solvency is weak, and its financial leverage coefficient is high.

The relationship between financial leverage coefficient and financial risk is positively correlated. The high financial leverage coefficient of Evergrande Group indicates that it has a relatively high financial risk [6]. From the asset liability ratio, it can be seen that China Evergrande's business model belongs to the high debt financing model, which causes China Evergrande Group's debt level to be at a high level for a long time, posing a risk of fund chain rupture for China Evergrande Group.

Table 1: Asset liability ratio

2017	2018	2019	2020
86.3%	83.6%	83.8%	84.8%

Source: Company annual report

2.2.2. Liquidity Risk

According to the quick ratio and current ratio analysis table in Table 2 and Table 3, the current ratio of China Evergrande Group in 2016-2019 was about 1.4, and the current ratio in 2018 was the lowest in the last four years, about 1.36. The highest is 1.52 in 2016. It is generally believed that when the current ratio is 2, the solvency is relatively strong. In recent years, China Evergrande Real Estate Group's current ratio has been below 2, indicating that China Evergrande Real Estate Group's current ratio is low and cannot repay its debts as scheduled [7]. This indicates that in recent years, China Evergrande Real Estate Group's solvency has fluctuated and has somewhat weakened. The appropriate value of quick ratio is 1 [8]. In recent years, the quick ratio of China Evergrande Real Estate Group has shown an overall downward trend, but they are all about 0.6, all less than 1, indicating that Evergrande Real Estate Group has poor short-term solvency.

Table 2: Current ratio

2019	2018	2017	2016
1.37	1.36	1.40	1.52

Source: Company annual report

Table 3: Quick ratio

2019	2018	2017	2016
0.49	0.52	0.61	0.74

Source: Company annual report

2.2.3. Cash Flow Risk

In 2019, Evergrande Real Estate Group had negative cash flow from investment activities, indicating that the company may have suffered losses due to improper investment.

The net cash flow from operating activities is also negative, reflecting that the revenue generated by Evergrande Group through sales is lower than the cost expenditure, indicating that Evergrande's operating activities have gradually consumed its cash in recent years, posing risks to its operations [9]. The net cash flow of Evergrande's financing activities is positive, indicating that it has funds to support its development. However, from the overall positive and negative cash flows of each cash flow, the net cash flow of Evergrande Real Estate Group's investment activities from 2017 to 2020 was negative, and the net cash flow of operating activities alternated between positive and negative, indicating that Evergrande Group will spend the accumulated monetary funds before, which will affect the capital chain. This causes China Evergrande Group to not know whether it can repay the debts due in the next period, increased risk of debt repayment [10]. So China Evergrande Group will use the cash flow from financing activities, and the inflow of funds from financing activities will increase China Evergrande's liabilities. Its business activities are mainly supported by funds raised by the enterprise, and it is not a start-up enterprise, and there is no reason why its focus is to expand the market share of the enterprise and therefore raise funds to invest a large amount of funds.

Imagine that if its investment and operational activities continue to be in a state where it cannot make ends meet, the company's liabilities will continue to increase, and its pressure will also increase, leading to higher financial risks. In conclusion, the main cash flow risk faced by Evergrande Group is that it increases current liabilities to make up for the shortage of working capital and reduces its short-term solvency.

3. Causes of Financial Risks in China Evergrande Group

3.1. Causes of Financing Risks

The financial budget of Evergrande Group does not specifically increase its fundraising risk. A reasonable and scientific financial budget enables enterprises to develop more healthily. If the financial budget is not specific enough, it will increase the pressure on enterprise fund management. Bringing the enterprise into financial crisis. As a real estate development enterprise, Evergrande Group requires a large amount of funds throughout its production and operation activities. However, its financial budget in financial risk management is not specific, resulting in unreasonable use of funds and a shortage of funds that cannot support its production and development. In order to solve the shortage of funds, Evergrande chose financing, resulting in an increasing asset liability ratio and an unreasonable capital structure, Increased financing risks for enterprises.

Evergrande did not make a financial budget based on the actual market situation in its budget, nor did it have a specific budget for the flow of funds, including cost budgeting and future benefits.

On the other hand, Evergrande Group's financial budget neglects specific projects and does not combine the funding budget of specific projects with the capital budget. It is extremely unreasonable to simply use the budget of the entire department to replace the budgets of each project, resulting in unclear development costs, interest expenses, loan amounts, and generated profits in each project, making the fund utilization plan for each project unreasonable, leading to Evergrande falling into a crisis of fund shortage, The shortage of funds has led Evergrande to continuously raise funds, resulting in a misaligned asset liability ratio and raising funding risks.

3.2. Causes of Financing Risks

3.2.1. Policies Lead to Weak Financing Capacity and High Difficulty in Financing

The change in real estate financing management policies has made Evergrande's financing more difficult. The three indicators of Evergrande Group, namely asset liability ratio, net debt ratio, and cash to debt ratio, are not up to standard. According to policy regulations, Evergrande Group will not be allowed to increase its debt in the next year. This not only limits the bank loans and bond issuance scale of Evergrande Group, but also increases its financing costs, leading to an accelerated increase in Evergrande's liquidity risk.

3.2.2. Intense Competition, Low Product Profit Margins, and High Financing Costs

Against the backdrop of the "no speculation in housing" policy and fierce industry competition, Evergrande Group's product sales efficiency has slowed down, products cannot be sold in a timely manner, inventory has increased, Evergrande's profitability has decreased, and the profit margin is low, resulting in weaker profitability. The decline in asset quality results in insufficient cash flow to allow operating expenses to proceed normally, thereby increasing liquidity risk. The profit margin of the real estate industry is showing an overall downward trend, but due to the increasing difficulty of financing, Evergrande Group has had to expand its financing methods, resulting in an increase in financing costs and a decrease in profit margin, further exacerbating Evergrande Group's liquidity risk.

3.2.3. Unreasonable Diversification Strategy Consumes Resources and Increases Debt Ratio

The investment volume of group enterprises is huge. If the utilization rate of funds is low and the liquidity of assets is poor, it will induce asset risk and increase the overall financial risk. Under the diversification strategy, Evergrande Group's investment quantity is increasing. The diversified development strategy without clear goals requires long-term capital investment to support its mergers and acquisitions, and this aimless diversification makes the correlation between industries of Evergrande Group weak, The failure to leverage the synergistic effects of diversification has resulted in the diversified industries of Evergrande Group being mostly in a state of loss, resulting in the need for continuous funding to support its development in the Evergrande real estate business. Evergrande Group has had to consume existing resources in exchange for funds to develop diversification, leading to a further increase in its debt ratio and increased liquidity risk.

3.3. Causes of Cash Flow Risk

In the entire process of real estate investment and construction, cost management is a key measure to control the effective capital investment of real estate enterprises. However, many real estate enterprises do not effectively manage and control a series of cost consuming projects in the cost management process, which does not match the construction capital requirements with the construction goals, causing significant capital waste. The development of Evergrande Group projects requires high costs, strict cost control can reduce development costs and bring greater benefits, but if cost control is not rigorous enough, it will lead to increased costs, increased demand for funds, increased financial pressure on the enterprise, and certain financial risks. The costs required by Evergrande Group in the project development process mainly come from land use costs, employee employment costs, and fixed asset costs. Due to the fact that costs during the project development process change with market changes, it increases the difficulty of cost control. The materials required during the project development process are different, and the material procurement costs for each period are different, resulting in a certain deviation between the material costs and the cost budget.

During the development of the project, employees also received materials in different quantities from the budget, resulting in additional expenses. In terms of employee compensation, each stage of the project requires different employees, resulting in a certain deviation in employee compensation costs. The deviation in both material procurement costs and employee compensation costs will bring certain difficulties to cost control, and Evergrande's cost control is not rigorous enough, resulting in a shortage of funds and increasing Evergrande's cash flow risk.

The biggest problem that real estate enterprises need to deal with in financial management is fund management risk. As a well-known real estate enterprise in China, Evergrande Group requires a large amount of funds for its operation. If development projects cannot be completed on time as planned, funds will be trapped in unfinished projects, bringing financial crisis to the enterprise. There is a cash flow risk in the capital operation of Evergrande Group. The fund management system in Evergrande's financial risk management is not perfect. Evergrande's fund management model has not been adjusted in a timely manner with the development of the enterprise and social environment. Evergrande needs more professional economic management talents to adjust its fund management model.

4. Suggestions on Financial Risk Management of Evergrande Group

4.1. Reduce Funding Risks

The current fierce competition in the real estate market is beyond doubt, and many companies have relatively tight capital chains. Evergrande Group should strengthen its financial budget and formulate specific financial budget tables in all aspects of capital flow. The specific budget is not only reflected in the specific plan in the early stage, but also in the execution results of the specific financial budget table. Therefore, "enterprises should do a good job in supervising internal funds". Ensure that funds are applied to the appropriate areas according to the financial budget table to avoid wasting funds. In terms of borrowing methods, there are many ways to borrow today, not just bank loans. Therefore, choosing a reasonable borrowing method can effectively save borrowing costs and is the correct way to reduce borrowing risks.

Different fundraising situations use different fundraising methods. The applicability of various borrowing methods varies, and a scientific and reasonable plan should be made before borrowing. The selection should be based on the characteristics of various borrowing methods and the characteristics of the enterprise's own fund use, such as the amount of borrowing, the usage period, and the urgency of the usage situation. If the funds used for borrowing are used reasonably and scientifically, it not only improves the borrowing ability of the enterprise, but also increases its income. Evergrande Group should choose appropriate borrowing methods and develop a reasonable debt repayment plan.

4.2. Reduce Liquidity Risk

Strengthen the efforts of equity financing, and expand the scale of equity financing through capital market operations while ensuring corporate control.Further improve liquidity and alleviate financial pressure by introducing investment.

Reasonable financing to reduce financing costs. Optimize product sales channels, accelerate the sale of sedimentary assets, improve Evergrande Group's profitability, enhance its hematopoietic function, ensure asset quality, and increase product profit margins. Reasonably raise funds, develop a reasonable financing plan, avoid unlimited financing, and reduce financing costs.

"The current diversification strategy implemented by Evergrande has reduced the overall profit quality of the Group, and has not yet played the synergistic effect of improving the added value of real estate business.", The company continued to accelerate the expansion of its scale beyond the scope of its financial resources, which led it to continuously raise working capital in order to expand its business, increasing the pressure on the company to repay its debts and increasing its financial liquidity risk. Enterprises should control the pace of diversified layout, carefully select diversified industries, leverage synergies, and not expand recklessly. "Evergrande Group should clarify its diversification strategic goals, scientifically control the pace of diversification strategy, and reduce liquidity risk.

4.3. Reduce the Risk of Fund Recovery

Understanding and analyzing the market is beneficial for Evergrande to further improve its investment and sales methods, reduce the loss of Evergrande Group funds in investment, increase investment returns, increase sales volume, accelerate sales returns, alleviate financial pressure, and adjust capital structure. Understand and analyze market demand, launch different products based on different customers, and increase sales volume. For projects under construction, market demand should be analyzed to understand customer preferences and increase sales advantages.

At the same time, attention should also be paid to diversifying marketing channels, combining online and offline, and enhancing marketing effectiveness through grid brand advertising. Launch purchase discounts, such as visiting customer discounts, giving small gifts, reimbursing transportation expenses, offering simple meals to attract customers and increase marketing opportunities. Improve marketing performance, accelerate sales revenue collection, and reduce financial risks.

The quality of assets is related to the strength of their liquidity. For example, if the liquidity of inventory is poor, if the enterprise does not control inventory well, it will cause inventory backlog, leading to an excessive proportion of inventory in the total funds, reducing the liquidity of the enterprise's assets. Therefore, inventory should be well controlled. In terms of accounts receivable, the many problems faced by accounts receivable are mainly caused by imperfect management of accounts receivable. Therefore, to scientifically handle accounts receivable, it is necessary to start from its management perspective. Credit sales is a commonly used sales method by Evergrande Group in its real estate business. However, if an enterprise blindly sells on credit and fails to understand the customer's credit status during the credit sales process, it may result in uncollectible accounts receivable upon maturity, increase the company's bad or doubtful debts, affect the liquidity and safety of the company's assets, and generate financial risks. So while selling, Evergrande Group should also strengthen its attention to the collection management of the enterprise, establish a credit management system from a management perspective, understand customer credit status, and implement scientific collection plans based on different customers to avoid excessive bad debts.

4.4. Reduce Cash Flow Risk

To reduce the cash flow risk of Evergrande Group, it is necessary to reduce its financial pressure. Cost control can effectively reduce the financial pressure on Evergrande Group. Cost control, as an important component of financial management in real estate enterprises, should increase risk prevention and control measures. In terms of control measures, cost control is not simply to reduce its costs, but to reduce unnecessary losses in cost use through effective cost control. Firstly, Evergrande Group should strengthen cost control based on cost forecasting.

The cost should be concretized based on the bill of quantities, the progress requirements in the development and construction process should be refined, and the specific technology, equipment, and materials needed in each progress link should be specified. How much manpower, time, and materials are needed. Calculate the investment in quantity. Combining specific cost control calculation methods, predict specific costs based on the original historical foundation and future development status, form a project cost budget framework, and budget costs more specifically and accurately. Secondly, cost control alone is not enough for cost forecasting, and it is also necessary to scientifically and reasonably implement cost forecasting plans.

We should establish a cost prediction execution supervision and incentive mechanism, regularly check the effectiveness of cost prediction execution, and implement the cost prediction management plan to the greatest extent possible. Not only does it need to be implemented, but it is also necessary to reflect on the cost budget plan after implementation, evaluate it in a timely manner, clarify its deviations from specific practices, adjust it in a timely manner, investigate and handle the excess costs, which is conducive to formulating a more reasonable cost budget and better implementing the cost budget plan, doing a good job in cost control, reducing the financial pressure of Evergrande Group, and reducing the financial risk of Evergrande Group.

Build an appropriate financial risk management system based on the company's own situation, analyze specific problems, predict potential problems, and strive to reduce losses to an acceptable range. Firstly, establish a comprehensive financial risk warning system. Only by doing a good job in risk prevention and promptly identifying the causes of financial risk problems can enterprise groups promote their long-term and stable development. Improving financial risk warning can effectively prevent risks for enterprises and improve their overall risk resistance. Secondly, establish and improve an internal control system. Enterprises must implement effective internal control to achieve their business objectives. Financial internal control also plays a certain role in controlling financial risks. Enterprises should establish a sound internal control system, do a good job in financial risk management, and establish strong barriers to resist risks. When risks arise, enterprises will not suffer huge financial losses. Evergrande Group should take risk reduction as its main goal, establish and improve its internal control system, and protect the safety of enterprise property.

5. Summary and Reflection

This article analyzes the financing risk, liquidity risk, cash flow risk and other risk factors of Evergrande Group, as well as the correlation between various financial indicators, and proposes corresponding suggestions for Evergrande Group.As one of the top 500 enterprises in China, Evergrande Group's financial risks mainly include unreasonable capital and debt structures, and blind fundraising under financial pressure, resulting in weak debt repayment ability. Secondly, in operational activities, even though the sales status of completed projects was not very good, a lot of funds were still invested in ongoing projects, lacking feasibility analysis of investment projects, leading to resource waste. Moreover, it has too much inventory and slow sales receipts, resulting in high financial pressure and weak operational capabilities, as well as liquidity and fund recovery risks. Thirdly, Evergrande Group's investment and operating activities are both negative, resulting in insufficient cash flow.

By addressing the potential financial risks of Evergrande Group, We have proposed scientific borrowing and optimized the capital structure; Strengthen sales and increase profit margins; Suggestions such as cost control, specific budgeting, and establishing a financial risk management mechanism are aimed at improving the financial risk management capabilities of Evergrande Group, enabling it to develop more healthily, and also promoting the healthy development of the real estate industry.

The existence of risks is objective, as they can pose a threat to the operation of the enterprise and potentially bring profits to the enterprise. Therefore, strengthening risk control has always been a key focus of enterprise management. Financial risk management plays an important role in the development of Evergrande Group, and doing a good job in financial risk management is conducive to the healthy development of Evergrande Group.

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