



CREATING THE RIGHT TO WIN IN AUSTRALIAN REAL ESTATE A STRATEGIC PERSPECTIVE

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A Strategic Perspective

The rise of inbound real estate investment into Australia has been on an upward trajectory in the past few years in particular from China, Singapore, Malaysia, Japan and other emerging SE Asian nations. There have been a number of successful and unsuccessful entry attempts by overseas incumbents, and sometimes painful but necessary lessons learnt. So what can be learnt from these successes and failures?

We felt it necessary to begin with a helicopter strategic perspective for aspiring overseas developers looking to enter this stable, mature and safe market – Australia. What do successful local developers in Australia look like? How should new entrants enter this small, but attractive market? What are some strategic considerations? How should they create value in ways that others cannot? How do these overseas developers, many of whom have been hugely successful in their home countries, create the “right to win” in Australia?

We wish to acknowledge the conceptual framework proposed by my former employer, Booz & Co (Now Strategy&, part of the PwC Network of Companies) - Capabilities-Driven Strategy in the discussion here.

Background

A company's right to win in any market depends not just on external market positioning and not just on internal capabilities, but on a coherent strategy that aligns these factors at every level.

Three elements make up a capabilities-driven strategy

- Way to Play: How you choose to face the market and create value for your customers.
- Capabilities System: This system is made up of three to six distinctive capabilities, the key strengths that set your company apart from its rivals. These capabilities are ingrained into a company and cannot be acquired or lost over time. Each capability is ensured through the right combination of processes, tools, knowledge, skills, and organization, all focused on meeting the desired result.
- Product and Service Fit: Based on your chosen way to play and capabilities system, which elements in your portfolio will grow ... and

which should be foregone?

Many executives across industries and regions are struggling with developing and executing strategies successfully. The problem is that generations of executives have been asking the wrong questions. Instead of asking “Where should we go to grow?” they should be asking “Who are we? How do we create value in ways that others cannot?”

Way To Play

A company's way to play is an approach to creating value for its customers. A well-defined way to play is broad enough to allow flexibility and growth, but narrow enough to focus strategy and decision making.

It may involve being an innovator, a value player, an experience provider, and so forth. More than any other single factor, the way to play distinguishes a company from its competitors.

For instance, Walmart, the largest retail chain in the world, has taken its leading position with a precise and powerful way to play: being a big-box provider of everything from groceries to electronics to houseplants at “everyday low prices,” without special sales or discounts.

In the context of real estate in Australia, the success of many local companies revolves around several key factors:

- Providing some form of vertical integration in its operations. Lend Lease provides the full suite of functions from capital, funds management, development, design, construction, sales and property management. So do Mirvac and Stockland, two other large developers in Australia. Even mid-tier companies are rarely pure developers – most are combined professional developers, project managers and sales, or developers and contractors
- Building a strong brand and reputation for reliability and quality in the delivery of its projects AND also the quality of the end product. The market is highly professional and values integrity and

good project management, much more than hierarchical relationships

- Having a strong understanding local planning and design practices and end user preferences. Each state and capital city have very unique characteristics and are often treated as separate jurisdictions. Being localised in each state and capital city is crucial.

These are how current players operate. For an incumbent developer to master the above capabilities and knowhow will be a very long and arduous journey. There is no fixed or perfect way to succeed in Australia - both large corporations and small boutique developers have been very successful in their own right.

The key to creating a “way to play” lies in differentiation to create value. Our observation in Australia indicates that the industry has room for development in the following areas:

- Innovation in Design and Product. True innovators create a new market, rather than purely respond to a market need. Buildings are built to be lived in and enjoyed, and not only an investment or financial asset. Being design-driven in project management and approach, and creating sustainable market demand from the local buyer will build one’s reputation and customer loyalty. This challenges the conventional way in which buildings interact with people and users. It means thinking outside the box in the way buildings are planned and designed with the end user in mind. Being able to create a lifestyle trend through real estate innovation and capturing that value becomes crucial to sustain a distinctive edge. A good early example is the creation of communities on the outskirts of capital cities – housing, schools, amenities, infrastructure at an affordable price and targeted at young families and first home buyers who are increasingly finding it difficult to reside in established inner city suburbs. This creates a market trend for all first home buyers to at least consider this form of living, thus creating a sustainable model for developers.

- Technology. This relates to construction methodology, materials and the latest innovations in construction delivery, and also in after sales technological integration into the lives of residents and tenants. The progress of technology in real estate has traditionally been slow, but in today’s digital and connected age, technology should not merely be a sales tool, or play a supportive role in project delivery. Technology can be deployed in many ways – design co-ordination, project management, construction site management, sales and marketing and also property management.

One could argue that high density living will become a norm for Australians as population growth increases further. If this is indeed a phenomenon, the key for developers would be to create a desire to

live in high density and mixed-use environments and also enjoy the essential everyday wants of buyers. The service offering may extend beyond traditional property development services, but also to ongoing management services to residents and tenants. What can traditional developers offer to customers that also add value and complement their core businesses? This is a question worthy of some thought.

Making a conscious decision to be an innovator, or an experience provider depends heavily on the firm’s internal capabilities and what they are capable of doing better than anyone else in the industry.

Capabilities System

Capabilities are much more than just owning certain assets. Having access to the best people, talent, processes and systems are mere assets – things that firms have, but can be either easily acquired or lost to competitors. Capabilities are engrained into a company and cannot be lost or bought. They are distinctive and unique and no one is able to do it better. These are unique strengths of the firm.

Take Wal-Mart again as an example. Their capabilities lie in a lean supply chain, category and assortment management, and strong vendor relationships operating together to form a unique strength of bring the right stock to the right customers at the right time.

In the context of the property industry in Australia, established companies develop strong capabilities in project management processes and systems, customer insight, the ability to manage and master stakeholder relationships, brand and reputation in the eyes of the general public and end user.

For a new overseas market entrant, developing similar capabilities will not only be a long journey, but also will not be differentiating with established competitors. This is not to imply that these capabilities and skills are unimportant. It means that for new market entrants to succeed, they will need to look at developing other unique capabilities in the longer term. So what are overseas developers good at, that local developers cannot replicate or buy? And how do these capabilities relate to the way to play?

In our view, overseas developers have a number of inherent advantages from their overseas business exposure.

- Established capital strength and access to even more diverse investor pools. The ability to congregate capital with trusted institutional investors and funds is a unique capability.

Being well funded is an asset and does not only mean one can deliver projects free from financial burden or risk. It also means that there is scope for longer term developments on a much grander and complex scale. These projects may be new communities, or major urban regeneration projects in partnership with Governments and planning authorities. Indeed, this is the approach that Lend Lease took when entering the UK market. They did not focus on piecemeal projects in the UK, but on larger scale complex urban regeneration projects that create a new neighbourhood and new end user demand.

- Strong customer loyalty in their home market, creating an established and eager buyer market. This customer loyalty is not geographically confined – they are highly flexible and have the ability to morph into something special. Coupled with other complementary services such as immigration, education, financial planning, and business services, overseas developers have the ability to provide a one-stop shop service to aspiring investors and immigrants. This is fast becoming a trend for developers – creating a platform of services where the end user can access quality projects and all their personal and family needs in one package.

- Deep experience with much larger scale and complex inner-city projects in their home country makes it ideal for overseas developers to undertake more complex projects in Australia, despite being in a different environment and legal system. This capability is not only the capital and courage to undertake large projects, but also the ability to influence stakeholders, forming a vision and engaging with international design expertise to bring value to the Australian development scene, which has predominantly been domestically focused. Inner city development experience overseas is a surely transferrable capability in Australia.

- Root source access to construction materials in their home country at a very competitive price for the same quality. Most construction materials in Australia are imported and supply prices are naturally inflated through the supply chain. As most developers are also builders and material suppliers and exporters in their home country, this becomes a distinct advantage in Australia. This relates to some form of vertical integration discussed earlier.

There may be other capabilities, by these four capabilities work hand in hand to support the way to play. Having access to strong capital, customer loyalty in their home country, experience in leading larger and more complex projects and economies in construction materials supports innovation in design and product that make incumbents unique from local established developers, large or small.

If incumbents are to become innovators in design and product

through the above four capabilities, what type of development should they pursue that fits in with these capabilities?

Product and Service Fit

In Australia, there are several types of development projects in the residential, commercial, retail, mixed use space – infill development projects in inner city or city fringe areas where land is scarce and governments have a plan to revitalize ageing areas, new land development projects creating communities, or capital city suburban projects, which are smaller and less complex in scale. The majority of small to mid-sized developers focus on the latter type – suburban residential projects. Some of the larger and more experienced developers focus on the first two types.

The above capabilities and way to play lends itself well to products which are larger and more complex in nature.

We are of the opinion that an incumbent developer looking to deploy their capabilities should target the following project types:

- Transport oriented node developments surrounding or above major railway stations geared towards high density living and working. These projects may comprise residential and commercial towers and retail podiums around emerging train stations to result in new town centres. They may be located along new planned rail infrastructure, or regeneration of existing rail precincts in line with Council and Government development priorities.

- Inner city regeneration or CBD extension projects requiring high density re-developments involving mixed uses – residential, commercial, retail, transport nodes.

Delivery of such projects will require co-operation with experienced partners and advisors, but the role of overseas developers should not be a passive investor. Rather, they should look to deploy their established capabilities in these projects, and help drive urban regeneration.

Coherence

The essence of having a sustainable strategy lies in coherence. Only a coherent company — one that pursues a clear strategic direction (way to play), builds a system of differentiating capabilities consistent with that direction, and sells products and services that thrive within that system — can reliably and sustainably outpace competitors.

Pursuing innovative and design driven development projects

led by technology is enabled by strong capital strength, customer loyalty, large scale project expertise and economies in construction material sourcing. These development projects may be transit oriented or inner city and CBD extension projects, requiring both innovation and a design driven approach to project delivery. Consequently, corporate systems, processes, training, and employee capabilities should be designed to align with this strategic direction. An opportunistic or ad-hoc approach to project selection will not result in a long lasting strategy and delivers sustainable edge over local Australian competitors.



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INVESTOR REPRESENTATION

On larger scale joint ventures or projects, negotiating development agreements, undertake commercial and technical due diligence and representing investors throughout the project will ensure their interest and risks are managed.

ABOUT US

STM Developments is a property development & advisory business based in Melbourne, Australia.

We work alongside developers and investors, providing site acquisition, feasibility analysis and project management services for residential and commercial projects. We initiate and participate in property development joint ventures as project proponent. We also act as investors' independent representatives as their point of contact for their co-investment projects and joint ventures.

Founder and Managing Director Simon Lee has more than 17 years of professional experience in all major facets of the development industry in Australia. He has successfully designed, led and managed major commercial, retail, mixed use and residential projects in Hong Kong and Australia ranging in value from \$4 million to \$20 billion. Simon is also an occasional guest lecturer and tutor at the Faculty of Architecture University of Melbourne.

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