

The Chinese-style Crowdfunding Business Model Case Study (2): The Mirador High-End Apartment Project in Seattle, USA

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Summary

Create World International (HK) Investment Management Limited was established in 2005. It has been involved in real estate since 2007. The company invested US\$150 million in 2014 and partnered with a United States real estate development company to jointly develop a premium apartment project in Seattle, USA. The current chairman of Create World Group, Mr. Yang Hongpeng, claimed the success of this project would not be possible without the guidance of the crowdfunding idea.

First, the crowdfunding model provides investors with a platform where they can take what they need and focus on what they excel in. For example, with the Seattle project, the investors' primary interests are on the return of their investments and obtaining a US green card. While some investors are more concerned with monetary returns, others are more focused on obtaining a US green card. The ability to meet different investor demand is the key to attract investors.

Second, crowdfunding unites investment, production and consumption organically, which helps to market the product and lower the level of risks for investors.

Mr. Yang stressed credibility is the key to initiate a project. In the process of crowdfunding, the core initiator needs to take the lead in investing and bears the risk in order to attract more investments. This is different from the traditional "one share, one vote" view. The core initiator's ability to bear the risks and to share the profits is an indispensable factor to attract investors in early stages.

Company Profile

A. Brief History

Create World International (HK) Investment Management Limited, had created the Mirador high-end apartment project based in Seattle, USA. Create World Group was founded 20 years ago and they have many subsidiaries around the world including but not limited to: Create World Coal Chemical, Hollyfield Holding, and Create World Huijin Investment. This company is a conglomerate focusing on international trade, coal chemical industry, investment, international education, and real estate development. Its businesses span across Europe, United States, Hong Kong, and Mainland China. Some of their typical partners include Shaanxi Yanchang Petroleum Group, Yulin Zhuoyue Energy, Daqing Oilfield Chemical, Shandong Yankuang Group, Shenhua Group, Datang Power, Flowserve Fluid Equipment Co. Ltd (USA), among others.

Create World Group began to get involved in China's real estate industry in 2007. They have a business philosophy of "people-oriented, beneficial to the local economy." Their real estate projects have won many accolades and enjoyed good sales due to their excellent quality and reasonable price.

B. Scale

Create World Group invested US\$150 million and had partnered with renowned US developer Daniels Real Estate in 2014. Together they had developed the Mirador high-end apartment project in Seattle. The project was located in the heart of the bustling business district of Bellevue, Washington. Three of the top 20 richest people including Bill Gates in the United States lived 5 minutes away from the apartment project.

C. Competitive Advantage

The interviewee, Mr. Yang Hongpeng, admitted that, even though the project initiator was well-capitalized and possessed real estate development experience in China, the company did not have an advantage in development of US real estates. The Mirador project did not have much advantage other than a prime location. In addition, it did not have an advantage in its human capital due to it being in the early phase of the development. They relied on the ideas and methodologies of the Chinese-style crowdfunding. As a result, the project attracted hundreds or even thousands of investors and users.

Interviewee Profile

Mr. Yang Hongpeng was born in November 1968. His ancestors came from Zhenlai County in Jilin Province. Mr. Yang received his undergraduate degree from Beijing University of Chemical Technology and his EMBA at Guanghua School of Management, Peking University. He is the current chairman of Create World Group and a member of Jilin City Chinese People's Political Consultative Conference (CPPCC).

Mr. Yang is also a philanthropist. He is very enthusiastic about public welfare and charity work. As seen through his role as Vice President of the Canada China Sports Foundation, and he also has set up a RMB 3 million scholarship towards his alma mater, Beijing University of Chemical Technology.

Q & A

1. What is your understanding of the business model of Chinese-style crowdfunding? You are Vancouver 1029 Cafe's No.12 shareholder. Could you also share with us your experiences there?

Mr. Yang: On October 29, 2014, some of my friends from a Canadian crowdfunding website held a "flash gathering" at University of British Columbia. This event gave birth to the 1029 Cafe in Vancouver. There are currently 102 shareholders. Mr. Liu Yi was the first shareholder, whereas Professor Zhang Jiawei was the second shareholder and also serves as the chief architect of the corporate structure. 1029 Cafe was established following the model of the Chinese-style crowdfunding and also a replication from the Peking University 1898 Cafe. All shareholders collaborate according to the crowdfunding model, which is: "one share, one vote"—equal responsibilities, rights and obligations. However, this arrangement also creates problems in operations. Operation cannot always be "crowdsourced" as some times it requires professionals to manage it. We have tried many ways to solve this problem, and we are still working on it. My view is there must a person (executor) that can make specific business decisions regardless of the principle of "one share, one vote."

1a: How did you choose who this executor was?

We are still in the exploratory stage because the Chinese-style crowdfunded cafe model is an innovative business model. We all share the same rights and obligations since the coffee shop is based on the “one-share-one-vote” model. We recruit people in the community, but we also recruit from our own team (i.e., our shareholders). We selected and set up a team to carry out business operations. We do not expect our cafe to make a lot of money, but we do need to maintain minimal operations. We have secured our management team, through which they will handle the business operations and results should be better than if we were to continue running the operations ourselves.

Aaron (Mr. Yang’s friend): In fact, according to 1029 Cafe’s original crowdfunding model, the coffee shop and the platform should be run independently. The main purpose of the 1029 Cafe is to provide shareholders with a platform. The 102 shareholders will stay on this platform up to one to three years. Each shareholder’s success or failure is up to their own business rather than the platforms. It is a bonus if the coffee shop is profitable. When the cafe was recruiting the shareholders, there was no promise made of a substantial profit, so the shareholders were made aware of the minimal profits that will occur. In fact, the shareholders wanted another benefit as to being a part of the platform, for example, showcasing their projects, investments and many other ideas on there. In a nutshell, why are you interviewing Mr. Yang? I think one of the reasons you are is that Mr. Yang had personally showcased his success on his platform through his projects in Seattle and his other ongoing projects. However, we should focus on the cafe’s platform function, rather than simply focus on the cafe’s profitability.

Mr. Yang: The framework of Chinese-style crowdfunding model provides a platform. 1029 Cafe is that platform, where everyone shares the same rights, responsibilities and obligations. Therefore, the 102 shareholders’ biggest interest lies in the full utilization of this platform.

2. Which part of your operations utilizes the business model of the Chinese-style crowdfunding?

Mirador, our high-end apartment development project in Seattle utilized the business model of the Chinese-style crowdfunding, which was taught by Professor Zhang Jiawei. We adopted this model mainly on two levels. At the first level, which is the shareholder level of the company, we had handpicked nearly 20 investors with resources to become the “initiator shareholders,” with four of them being chairpersons of listed companies. Secondly, the funds of the development came from hundreds of investors. Investors put a certain amount of capital into the company, in which the company pooled their resources together to develop this project.

The main interests for investors are the considerable returns on investment and obtaining US green cards. The US government is committed to raising the employment rate. For instance, according to the current US policy, if a person invests in the United States and creates 10 job opportunities for two consecutive years, that person will have the opportunity to obtain a green card.

3. How do you apply the concept of Chinese-style crowdfunding to your real estate project?

Mr. Yang: The American real estate industry has its peculiarity. Past and present presidents of the United States are concerned about employment indicators, which most Americans are concerned as well. The USA federal government wants to create jobs in order to reduce unemployment rates. It seems the goal to reduce unemployment is pretty straightforward. Over

the years, the government always releases data on the unemployment rate, and the economic indicators that directly affect that number. Similar to China, the USA is also looking for ways to attract more investments. Anyone who invests in the US or creates jobs in the US has the opportunity to obtain an American green card. The condition for obtaining the green card is that one must invest first in the USA and at least employ 10 Americans for two consecutive years. This is quite similar to China's investment attraction programs.

In our point of view, this is the concept of funding. If you invest \$500,000 alone, it is very difficult for you to create 10 employment opportunities for two consecutive years. For example, if you invest \$500,000 to open a cafe, you hire ten waiters, and let them work for two years—there are many cafes that are not profitable—then there is the possibility that all the \$500,000 will go towards wages. It is very difficult to make money this way. However, if there are 10 people and they were to contribute \$500,000 each, then that will be 5 million dollars made available which can go towards the construction of a building, or to open a large café with a higher chance to become profitable. As a result, a new type of investment agency was created in the USA, in which they needed special licenses to operate. Investors pool their money into these agencies, resulting in hundreds putting their money into one agency; essentially what they are doing is crowdfunding. These specialized investment agencies invests the money provided into an American project, for example it can go towards the construction of a new building. Our Mirador project consists of two buildings, once completed it will employment opportunities for many Americans. The jobs created are not only limited to the construction of the building, but also towards the opportunities found within the production chain.

For example, we had 100 investors, each putting in \$500,000, which amounts to the total of 50 million US dollars. By how much did we increase employment opportunities? We had created a total of one thousand employment opportunities. The US government will approve a hundred families' applications for immigration through investment. In fact, this process is also another form of crowdfunding. Based on the context in China called *ji zi jian fang*, which literally means to “raise funds to build apartments.” A simple analogy is, by raising funds to build apartments in Beijing and you will be given Beijing *hukou* (registered permanent residence). What will happen if the US investment immigration program were to happen in Beijing? Many people would want to have Beijing *hukou*, but it is difficult to obtain. So how are we going to achieve it? For example, individuals may raise funds to invest in a real estate project in Beijing. Let's say there are 100 people, if each person were to contribute US\$500,000 (equivalent to 3 million Chinese yuan) each, it will total to 300 million yuan. And say we are the initiator of this project. We will then construct this building in Beijing in accordance with the approved building plan. After the building is constructed, each investor will be given a Beijing *hukou*. After all the units are sold out, we take the 300 million yuan from the sales and give it back to the investors. If the units don't sell, we will give each investor a unit. This is *ji zi jian fang*, or fund-raising to build apartments. We may think of this as the Chinese-style crowdfunding. The difference between the Chinese-style crowdfunding and the traditional crowdfunding is that the Chinese-style crowdfunding is carried out off-line, meaning face to face interactions, rather than on-line. We also pay special attention to foster networking among investors and create synergy between social circles. This way it lays the foundation of finding potential investors for the next project.

4. What are the benefits to the investors for participating in this type of crowdfunding?

Mr. Yang: In general, there are two benefits. In principle, it will generate returns for the investor. First, after funds are used, something that produces profits will be generated, such as the apartment building we are currently constructing: if the building appreciates in value, then the investors will have a 20% return on their investment. Second, investors participating in this crowdfunding have the opportunity to obtain American green cards for their families.

We were the lead investor of this crowdfunding project. Why did we choose to do it? Our main focus is to go through the program design, raise money through crowdfunding, finish the construction in the US, and deal with immigration-related matters. After the project is completed, we take away the profits generated from building and selling the apartments, and we give the green cards to you: we all get what we want. In crowdfunding, you must take into consideration the different demands of every person. If you only create benefits for yourself but not for others, your business will not succeed. Even when raising money from a hundred people to operate a cafe, at least each person gets C\$10,000 store credits to buy coffee from the cafe. Everyone can achieve his or her dream through this platform that is otherwise difficult to achieve individually. In fact, if you do this Chinese-style crowdfunding perfectly right, in the process of raising funds and soliciting investors, you have the ability to turn them into your final consumer. So your investors become your consumers. This is the best result.

For example, if I am in the health supplements industry, and I currently need a million US dollars to bring this product to market. I first find one hundred people willing to become shareholders by investing a million dollars each. I then produce the product and give it to each of them. If they like the product, they will become our consumers and voluntary advertisers to the product. If we do not take this approach, we will have to look for a market and try to sell the product to others. In my understanding of the Chinese-style crowdfunding, turning your investors directly into your consumer group means success.

5. What other models are available? Why did you choose this model?

Mr. Yang: Other options include the introduction of external capital for venture capital investment, or fund investments. We made Chinese-style crowdfunding our final choice based on the following three reasons:

- (1) The biggest advantage of crowdfunding incidentally solves the problem of finding customers.
- (2) Crowdfunding is beneficial to product promotion. Each investor has his own social circle. Investors will share the products with their circle of friends, thus promoting the product.
- (3) If we use crowdfunding, it is less likely there will be disagreements in the development process. This model requires consensus on future development direction from the very beginning so there will less likely a change in direction.

6. So far, what are the main benefits this model has brought to your company?

Mr. Yang: This model helps the company transform investors into consumers. Crowdfunding can effectively address common problems in funding, production and consumption. For example, in the Mirador real estate project in Seattle, we were able to find a core initiator even before the project started.

7. So far, what do you think are the problems and challenges that this model has brought to your company?

Aaron: First of all, the Chinese-style crowdfunding model requires things to be conducted offline. Raising human capital and intellectual capital should be a priority. A key point is that the core initiator should have credibility! We are learning from Professor Zhang Jiawei the core ideas of crowdfunding, rather than mechanically copying his formula. What are the benefits and risks of this project? They will manifest themselves in due course. But at the present, the project has been a success so far.

Mr. Yang: I think for any crowdfunding project, the initiator first has to be driven by his self interests, and this way he has the incentive to complete it. Interests are paramount. If there are no interests, the projects will not be feasible. The initiator, while satisfying their own interests, must also see to that the other participants in the project satisfy theirs too. Only when all the parties are satisfied can this project be a success and its experience replicable. In other words, the interests of all parties involved in crowdfunding should be met in the process.

Aaron: There is a disadvantage in using Chinese-style crowdfunding, for example when each participant's profit margin are not very high. Why a low profit margin? It's because there are many participants involved in the crowdfunding process. Therefore, the profits are divided too thin among investors. The project initiator has to have an open mind, that is, he needs to be willing to distribute parts of the profits to small investors. If he is close-minded and wants to pocket all the profits and benefits for himself, then the crowdfunding will not be successful.

Mr. Yang: Regarding how to allocate returns of investment: it must be agreed upon in advance, and the legal work needs to be sound, otherwise it is very likely to cause problems. Once the initiator realizes his expected interests cannot be met, he will pursue other interests. For example, say there is a crowdfunding project where there are 100 investors. Each contributed US\$100,000 to a total of US\$10 million. If the initiator, after he has done his calculations, finds he has overpromised in terms of return, he may try to weasel out of the deal. This situation can be avoided if everything is agreed in advance and the legal work is sound. Why will the initiator entertain the idea of running away with the money? One possibility is that this person is a fraud from the beginning—he wants to con people out of their money—this is beyond our discussion today. What we are talking about is a scenario where the distribution scheme for returns is not designed properly. In the end, it cannot achieve the returns promised to investors. Since the initiator wants to pursue his best interests, he might take the money and run away with it. The selection of the initiator is most critical in crowdfunding. The person needs to be solid and trustworthy. If not, the project will likely fail, and failed projects can turn out to be scams.

Aaron: Another core problem is that the initial designs of Chinese-style crowdfunding call for “one share, one vote”, which is in Yang Yong's earliest theory. In application this is not necessarily the case. Why? People may adopt the “one share, one vote” to run a coffee shop or a platform company, but if Mr. Yang uses this model to crowdfund his real estate project, nobody would be interested. People would think: since this project is not mine, how do I know if you are going to do a good job running this project? When it comes to crowdfunding a project, the initiator must first make a commitment. The initiator should make a lead investment—a certain percentage of the total project cost. If there is a loss, the initiator's lead investment should incur the loss first. After that has been depleted, then other investors' capital will incur losses. If this is not the design, many people will not participate in this kind of projects. In the preliminary stage, most of the invested funds come from the initiator. That's why the initiator should be well capitalized.

Mr. Yang: What “one share, one vote” means is that on a certain platform the rights, the obligations, and the interests are the same for every share. For example, let’s say a coffee shop has 100 investors. On the coffee shop platform, everyone’s rights, obligations and interests are the same. This is essentially what “one share, one vote” means. But when it comes to the operation of the coffee shop, or the promotion of a particular project, “one share, one vote” is not a good design. If it were adopted, nobody would be doing any actual work. So, one may use “one share, one vote” on a platform, but not on a specific project. For example, with our project of immigrating to the US through investment, we had hundred investors putting their money into the company. These one hundred investors had the same equity and the same obligations. They got to know other investors through this platform, and obtained opportunities to invest in other projects. However, it would be impossible for everyone on this platform to participate in the specific operations of the company. Each investor has invested some money, but investment did not equate to managing the company. There is a need for an “administrator” to manage specific things.

8. If you could choose again, will you still choose this model? If so, what would you have done differently?

Mr. Yang: Yes, I will. So far, the project has been running relatively satisfactorily. On the surface, each investor’s demands are all different; but essentially they have the one same demand—their return on investment. There are many kinds of returns on investment, getting a green card or getting money. In this sense, everyone needs to have an open mind (and should not discriminate between different forms of return). For example, we are now doing a second project, an apartment building. The land purchased has been completed, and now we are recruiting partners. It is a project in the US, and soliciting investors takes a few steps: first, our company is the initiator or the lead investor. As the lead investor, we have to pay the first part of capital. We have to take the risks and it is necessary. One has to pay money to buy the land first, and bear the risks of the entire project (such as certain local laws mandate one cannot build buildings that exceed a certain height). After that, we solicit investors, mainly within the Chinese circles. We had good talks with Ping An (Ping An Insurance, Ping An Trust), Shanghai Xintiandi, as well as investors from listed companies. Our principle is “no premiums” in soliciting to investors. We will spend 10 million US dollars to buy the land, then we recruit ten investors, each one pitching in 1 million US dollars, that way increasing our shareholders to ten. These ten shareholders are “one share, one vote” in terms of their equity holdings. Afterwards, we have to set up a management team, which will be created by us, Create World Group. It has to be us who creates the management team even if we have the minority share in the project because we have to explain the roles and rules carefully before investors are fully committed to the projects. Everyone has to proceed in accordance to the rules of the game.

Where is our interest, then? First, I will charge a 2% investment management fee, and other than that they get a fixed return of 8%. We will only charge the fee if we managed to help investors make money. If the project fails to provide a return, then the loss will have to first come from our 10%. I take the risk, but I am also entitled to its possible benefits. The founding ten shareholders’ investment is Series A. The ten shareholders’ investment philosophies and interests are aligned, and their motives for investment are also aligned. We openly solicit other investors who have certain kinds of needs. For example, some people need to buy a house, and the price they get now for being an investor will certainly be different from the price they would have to pay if

they were to buy after the house has been constructed and listed. Another need/demand is a green card. It also has value: currently, a US green card is worth about US\$200,000 – 250,000.

9. Finally, based on your experience, could you please summarize the main factors that determine the success or failure of a Chinese-style crowdfunding model?

Mr. Yang: As the initiator, one has to always be mindful of sharing the profits with everyone. This has to a matter of principle, and the profits need to be real profits, not false promises. One must share the real profits with everyone.