

# Strategic Choice of Commercial Real Estate in China's First-Tier Cities in The Post-Epidemic Era

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**Abstract.** In recent years, affected by the Covid-19 and the current policy regulation of China's residential real estate market, the commercial real estate market has shown repeated fluctuations. During a historical period (2005-2015), thanks to the government's vigorous development of real estate and the influx of many people into large cities, commercial real estate in first-tier cities have experienced long-term prosperity. Some leading companies have earned high profits and occupied a large market share through the cycle of "financing - investment and construction - selling or operating - refinancing...". However, this phenomenon began to change in 2015. As the country adjusted its macro policies, financing costs continue to increase, the total area of new commercial real estate projects is decreasing year by year, and the market size of traditional commercial real estate is also shrinking, making people soberly aware that the prosperity and success of commercial real estate are deeply dependent on national development strategies, while depends on social and economic development and people's consumption habits. The study's results found that since 2019, the expansion scale and profitability of China's commercial real estate have both shrunk. On the one hand, residents' consumption ability and willingness have weakened due to the impact of Covid-19 and the business cycle. On the other hand, young consumer groups are no longer satisfied with a single business model; the upgrade of the consumption content and the rise of e-commerce shopping have had an impact on traditional commercial real estate, which forces companies to make corresponding adjustments to changes in the external environment when deciding long-term strategies. Using the PEST analysis tool to create a comprehensive and objective analysis of the current political, economic, social, and technological environment will help enterprises better judge external factors. Therefore, when formulating development strategies, they can better align their development plans with the country's new development strategy, earning strategic initiative and maintaining competitive vitality in the recent historical period.

**Keywords:** Covid-19, Commercial Real Estate, Business Strategy Adjustment.

## 1. Introduction

Since the outbreak of the Covid-19 epidemic in late 2019, the whole world, including China, has been severely impacted. As of July 28, 2022, the number of confirmed cases of Covid-19 in the world has exceeded 573 million [1]. According to economists at Oxford Economics, an international health crisis is enough to wipe out more than \$1 trillion in global GDP [1]. That will be the economic cost of widespread factory shutdowns, declining productivity, tourism, disrupted supply chains, and reduced trade and investment. The impact of the Covid-19 epidemic on the global economy can cost up to 35 trillion US dollars [1]. Moreover, since the outbreak of Covid-19, China's GDP growth rate has dropped from 6.75% in 2018 to 2.2% in 2020. Although it rebounded significantly to 8.11% in 2021. Since the continuous impact of the epidemic, caused the growth rate in the first half of 2022 to only 2.5% [2]. The ongoing epidemic has blocked the industry's recovery, while the management of lockdown control has caused the stagnation of real estate sales, land auctions, and project construction. Additionally, the measures such as banning gatherings and stopping dine-in have particularly affected commercial real estate. According to statistics, the average vacancy rate of commercial real estate in China's first-tier cities in 2019 was around 6.1%, and the average vacancy rate was achieved at 11% in 2020. Although there was a significant drop to 9.0% in 2021 [3], there is still a particular gap compared to before the epidemic. Furthermore, since 2018, the number of land acquisition, investment, and new construction projects by developers has been on the decline, especially under the impact of the internet business model and the Covid-19 epidemic. Many commercial real estates

in China's first-tier cities have to face the new window selection period to create long-term strategic planning.

## 2. Research

### 2.1 Overseas Study

Regarding commercial real estate, J.R.Knight and T.H.Paark based on the Value Chain theory, comprehensively analyzes the relationship between developers, investors, operators, and consumers involved in commercial real estate development and believes that only consumers have the ability and willingness to consume, the project can realize the commercial value in real [4]. Daldanise analyzed the factors that affected the development strategy of real estate companies and summarized them into two categories: internal and external factors. Internal factors include human resources, management, etc., while external factors include policies, market environment, etc [5]. Toivonen and Viitanen proposed that the social environment will significantly impact commercial real estate development, including political, economic, social, and cultural factors [6].

### 2.2 Chinese Domestic Study

Compared with foreign, Chinese commercial real estate research started later. In recent years, industry profits have declined under the control of national policies. However, with the acceleration of the Chinese urbanization process, more and more companies have set foot in the commercial real estate field. The leading companies have played a significant role in driving the industry, and the industry has become more mature. Unlike traditional real estate, commercial real estate combines the interests of developers, investors, and consumers. When Yuqing Zhang studied the external environment, the main factors considered were the urban environment, spatial planning, and national policies [7]. When studying commercial real estate competition, Yazhen Li divided the external environment into the industry and macro environment and used PEST theory to comprehensively study four aspects: technology, society, politics, and economy [8]. Sen Zhang pointed out that the factors affecting commercial real estate can be divided into two types: internal and external, and the specific forms are local culture, residents' consuming power, and social environment [9]. Cheng Duan started from the difficulties of project operation and maintenance of commercial real estate (taking shopping malls as an example), and gives suggestions on applying Internet marketing and promotion theories at the practical operation level [10]. Dajian Shi conducted an example study on optimizing commercial real estate operation management based on the value chain theory [11]. These studies aim to find out the long-term development strategy path of enterprises and provide suggestions for the healthy development of the industry.

Under the complex and changeable external environment and the increasingly fierce internal market competitions, how to transform and break through commercial real estate and find a new strategic direction is a critical issue that needs to be studied and solved in the real estate field. Particularly with the development of China's urbanization, small and medium-sized cities and even the new satellite cities around the first-tier cities have brought new opportunities to commercial real estate operations. Therefore, it will undoubtedly give birth to a new commercial real estate development model. In view of the background of the post-epidemic era, this essay attempts to analyze the development dilemma faced by commercial real estate from the perspective of the macro environment, research and explore the strategic options for the transformation and development of commercial real estate in the future. Simultaneously, combining the factors include the planning and development of first-tier cities, the renovation of old urban areas, the construction of satellite new cities, and the national natural space planning the strategic layout, exploring, and putting forward opinions and suggestions on new commercial real estate development models involved the layout of community commerce, innovative business format planning, and internet operation in the post-epidemic era.

### 3. Data and Method

#### 3.1 Data

The data in this article comes from the research report of China Real Estate Association from 2020 to 2022, the special issue of real estate published by China Construction Daily News in recent years, the data analysis of academic reports published by China Real Estate News, and the relevant data released by the Beijing Urban Master Plan 2016-2035. Consulting these academic journals, scholarly papers, and government reports provide a solid theoretical foundation for the research process and analyzes data for this essay.

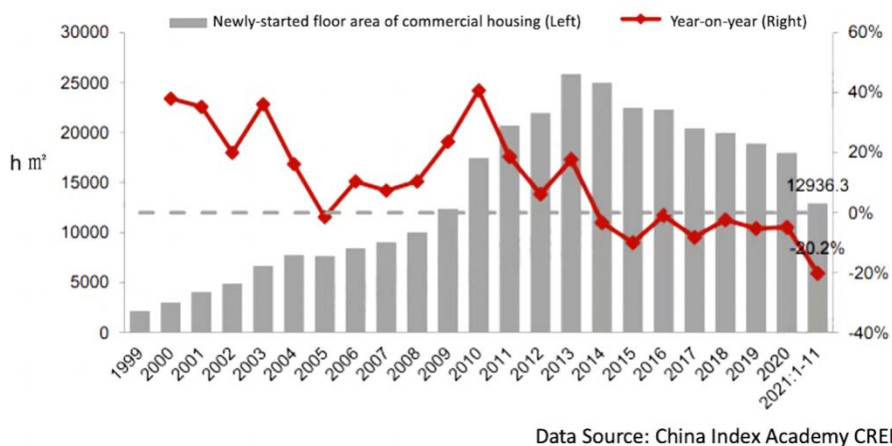
#### 3.2 Method

The PEST analysis model is an effective tool for analyzing the macro environment [12], which is a method of investigating external factors in organizations. Each letter represents a factor; they are political factors, economic factors, social factors, technical factors [13]. This essay is conducted on the theoretical basis of the PEST model, anti a professional and objective analysis of the external environment of commercial real estate enterprises in China's first-tier cities, helping commercial real estate accurately locate future strategic choices.

### 4. Results and Discussion

#### 4.1 Case Description

China's commercial housing is entering the stock era. According to the report '2021 China Commercial Real Estate Annual Report' and figure 1 below released by the China Index Academy. From 1999 to 2021, along with the urbanization process, benefit from the country's policy support to vigorously develop real estate in a certain period, the new construction area of commercial buildings nationwide has reached 3.228 billion square meters, with an average annual compound growth rate of 26.6%. At the same time, an inflection point appeared in 2014. After 2014, the newly developed area decreased year by year. From January to November 2021, the year-on-year decrease was 20.2% [14].



**Figure 1.** Newly-started floor area and year-on-year change of national commercial using housing from 1999 to November 2021 [14]

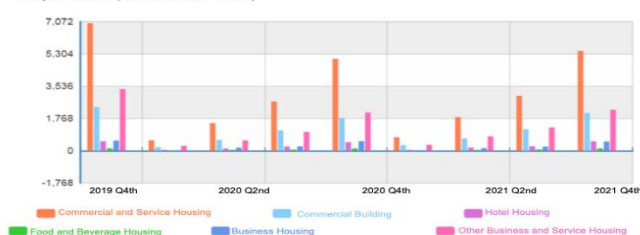
Under the government's policy of "stabilizing land prices, housing prices, and expectations," the growth rate of China's real estate development investment was relatively stable in 2019. However, the sudden outbreak of Covid-19 at the end of the year caused the entire industry, primarily commercial real estate, to suffer huge losses. According to the data released by the National Bureau of Statistics of the People's Republic of China, the total investment in real estate development in 2020 was 14.144295 trillion yuan, of which the total investment in commercial real estate development

was 1307.606-billion-yuan, accounting for 9.2%. In 2021, the total investment in real estate development was 14760.208 billion yuan, of which commercial real estate is 1244.476-billion-yuan, accounting for 8.4%, down 8.6% year-on-year. From 2019 to 2022, Chinese commercial housing investment has dropped from 1.32 trillion to 1.24 trillion, a drop of 6%. Data released by the National Bureau of Statistics of the People's Republic of China (Table 1 and Figure 2) show that from the fourth quarter of 2019 to the fourth quarter of 2021, the project cost of commercial real estate housing has shown a downward trend [15].

**Table 1.** Project Cost of Various Commercial Housing Properties (Unit: Billion Yuan) [15]

Quarter Project Cost	2021 Q4th	2021 Q3rd	2021 Q2th	2021 Q1th	2020 Q4th	2020 Q3rd	2020 Q2th	2020 Q1th	2019 Q4th
Commercial and Service Housing	5481.43	3010.14	1846.41	741.19	5039.28	2701.17	1517.68	571.35	7000.02
Commercial Building	2074.85	1185.56	681.34	300.73	1805.81	1123.41	597.35	196.01	2400.44
Hotel Housing	522.96	247.09	178.70	53.87	472.91	234.03	126.78	52.90	526.31
Food and Beverage Housing	126.57	75.42	50.89	22.43	126.56	65.46	54.91	18.98	132.95
Business Housing	507.35	228.15	143.70	32.41	530.01	241.42	171.50	36.12	558.54
Other Business and Service Housing	2249.70	1273.92	791.77	331.74	2103.99	1036.84	567.14	267.35	3381.78

Project Cost (Unit: Billion Yuan)



Floor Space Completed (Unit: Million Square Meters)



**Figure 2.** Comparison of Project Cost and Floor Space Completed from Q4th of 2019 to Q4th 2021 [15]

In 2021, the total sales area of commercial buildings in China was 90,455,500 square meters, and in 2020, the total sales area was 92,884,600 square meters, while this value was 10,172.87, 11,932.95, and 128,381,400 square meters in 2019, 2018, and 2017, respectively. It can be speculated that, on the one hand, investors are more cautious in the layout of commercial real estate due to the Covid 19. On the other hand, after the 19th National Congress of the Communist Party of China meeting, the government encourages the development of commercial residences to control the rise in housing prices, which has squeezed the industrial resources of commercial real estate. Moreover, cash is

critical to the survival of an enterprise; in the case of sluggish sales, the capital cycle of enterprises becomes longer, and profits decline, resulting in a decline in investment willingness (for enterprises with investment ability). For enterprises with heavy debts, when the resumption of work and production is affected by the Covid-19, once the capital chain breaks and the projects that have already started cannot be completed on time, they will fall into a vicious circle of stagnant operation and overdue debts. It should be noted that Covid-19 has also changed people's consumption habits. Since 2020, residents' per capita disposable income has increased year by year (32,189 yuan in 2020, an increase of 2.1% compared with 2019; 35,128 yuan in 2021, up 8.1% from 2020). The per capita consumption expenditure of residents has been a negative increase for more than 1/3 of the time (21,210 yuan in 2020, a 4% decrease from 2019; 24,100 yuan in 2021, a 12.6% increase from 2020), according to the latest 'Questionnaire Survey Report on Urban Savers in the Second Quarter of 2022' released by The People's Bank Of China, in the second quarter of this year, only 23.8% of residents were inclined to consume, but 58.3% were inclined to save money into the bank [16]. The main reason is that under the epidemic, people have increased their household savings in a targeted manner to resist risks and try not to go out as much as possible. Currently, consumption activities are significantly reduced, and retail, catering, beauty, and other service industries are suspended, resulting in massive pressure on commercial real estate rental recovery, and the short-term demand has dropped sharply. Under the pressure of capital turnover, companies must make new adjustments to strategic decisions such as investment planning, new projects, and profit models.

## 4.2 Case Description

To comprehensively analyze the commercial estate's external environment, the PEST model has been implemented to analyze it from four aspects, including Political, Economic, Social, and Technological.

### 4.2.1 Political

Due to the rapid development and aggressive expansion of the real estate industry in recent years, the Chinese government and relevant departments have issued a series of policies to regulate the market and ensure the continuity and stability of its development. In 2020, The People's Bank Of China and the China Banking and Insurance Regulatory Commission put forward indicators for the real estate industry, requiring that the asset-liability ratio after excluding advance receipts should not exceed 70%, the net debt ratio should not exceed 100%, and the cash-to-short-term debt ratio should be greater than 1. Then, in 2021, the Chinese government continues to deepen the reform of the administrative examination and approval system again, establish a standardized, efficient examination and approval operation mechanism, improve the efficiency of administrative services, and achieve a one-stop examination and approval. Under the influence of these industrial policies, the growth rate of scale and profit has declined, while the land dividend has gradually disappeared. Furthermore, under the new "dual circulation" development pattern with the construction of the domestic economic cycle as the main direction, the market has shown a recovery trend [17]. The main reason is that under the normalization of Covid-19, with the successive introduction of government bailouts and financial support policies, the economy has recovered, and the demand suppressed by Covid-19 has gradually been released. The continuous development of the financial, internet, and service industries has provided commercial real estate stable demand support. Based on the urban development strategy that combines the reduction of development and the increase of stock efficiency, Beijing issued the "Beijing Urban Renewal Action Plan (2021-2025)" in August 2021, aiming to promote the establishment of a benign urban self-renewal mechanism. By 2025, Beijing will encourage the renovation of about 5 million square meters of inefficient old buildings and complete the upgrade of 22 traditional business districts. Format adjustment, quality improvement, and brand building of business districts and commercial properties will continue stimulating the city's consumption vitality.

#### 4.2.2 Economic

With the adjustment of industrial structure, the growth rate of China's economy is slowing down, and this effect is gradually passed on to the consumer side and affects business activities. The latest data released by the National Bureau of Statistics shows that in July 2022, the total retail sales of social consumption was 3,587 billion yuan, a year-on-year increase of 2.7%, a decrease of 0.4% from June, and a month-on-month increase of 0.27%. Divided by various types, the commodity retail was 3,217.6 billion yuan, a year-on-year increase of 3.2%; the catering revenue was 369.4 billion yuan, a decrease of 1.5%. According to statistics, in the first half of 2022, the national per capita consumption expenditure will actually increase by 0.8%, of which the consumption of urban residents will actually increase negatively. At the same time, resident deposits increased by 10.33 trillion yuan, a year-on-year increase of 2.9 trillion yuan, an increase of 38.7%. The "2020 China Retail Rent Index Research Report" shows that in 2021, the total retail sales of social consumption in Beijing was 1,371.64 billion yuan, a year-on-year decrease of 29.9%; commodity retail sales was 1,284.47 billion yuan, a year-on-year decrease of 7.1% [18]. It is not difficult to see that the impact of the Covid-19 on offline consumption is significant, and online consumption cannot completely make up for the lack of offline consumption. The most direct reason is that the epidemic has stimulated changes in people's psychology and promoted the saving behavior of risk prevention.

#### 4.2.3 Social

The epidemic has changed people's thinking and behavior since people consciously reduce going out and socializing offline, which is also recasting social habits. The 2020 young people's consumption search big data released by Baidu shows that the consumption-related trends of young people have changed significantly. The search data for live-streaming shopping and saving financial management have risen by 167% and 46% respectively, while shopping has dropped by 33% [19]. The impulse to consume ahead of time has been suppressed. People pay more attention to capital reserves, education and training, and health management. Moreover, the rise of online consumption patterns has given individuals more choices in consumption. After the direction of real estate regulation has been gradually clarified, the development trend of commercial real estate has become more and more distinct, from the traditional layout centered on "Trading Area" to "Humanity" as the core. The city's development in the past has formed the CBD, the gathering of people, and the driving force of consumption; the developed degree of urban commerce is representative of the urban economy and consumption. With the development of e-commerce, traditional shopping malls have lost some customers, but community commerce is becoming a "blue ocean" of the industry. In foreign countries, community commerce accounts for more than 60% of the total social consumption and retail sales; however, currently, it does not exceed 40% in China, which has enormous development potential. From the perspective of land availability, compared with urban centers and sub-centers, there are more plots in community centers, and this phenomenon is more pronounced in first-tier cities. Covid-19 has significantly shortened people's living radius, and there is a strong demand for community commerce represented by fresh food and daily necessities, further highlighting community commerce's value. The proportion of community business in China's commercial real estate will continue to increase, becoming a significant model. Under such circumstances, companies in first-tier cities must change the single profit model of combining rental and sales in the past and develop in a diversified direction. Some commercial centers make profits through cultural and creative activities, such as K11 in Shanghai, Parkview Green Fangcaodi, and the SKP-S shopping mall in Beijing. Some focus on earning income from online channels, including operating online shopping malls and live streaming; all have become a new profit model for commercial real estate projects.

#### 4.2.4 Technological

Under the influence of intensified internal competition and increased uncertainty in the external environment, commercial real estate faces many challenges. At the same time, emerging technologies have also changed the commercial real estate industry chain and created new opportunities.

Technology is one of the essential engines to promote the remodeling of the commercial real estate industry value; real estate technology has improved the resilience of the entire industry from the dimensions of a personalized experience, efficient operation, safety and health, and digital drive. In terms of a personalized experience, it mainly uses big data push to provide users with fast customized services and increase user viscosity. The efficient operation aspect is primarily based on the internet and artificial intelligence application, relying on the "data center" to control energy consumption, reduce costs, and be more green and energy-saving. Regarding safety and health, according to the concept of healthy and low-carbon development, green buildings have become the vane of the industry. In addition, under the requirements of Covid-19 prevention and control, with the help of infrared temperature measurement and non-contact access control technology to accelerate the resumption of work and production. It is foreseeable that after Covid-19, the relative protective hardware and management standards will gradually change from "additional items" to "necessary items." In terms of digital drive, the level of digitalization will become a watershed in the competitiveness of enterprises. In addition to software and hardware upgrades, employee skills, data integration, and workflow will constitute the strength of enterprises. In the short term, the vacancy rate of shops continues to rise due to excess supply and mismatch of project locations and operational capabilities. New retail formats and the COVID-19 pandemic have made companies pay more attention to omnichannel sales, digital operations, and technology to help improve the consumer experience.

## 5. Suggestion

It is foreseeable that, affected by the slowdown in economic growth and the "long tail effect" of the epidemic, the path for commercial real estate to shorten the investment cycle, generate economies of scale and gain market advantages through a rapid increase in land holdings and rapid project establishment is no longer sustainable. Under the background of the construction of a domestic and international dual-cycle development pattern proposed by the Chinese government and the urban renewal strategy currently being implemented by local governments, enterprises should change the single profit model of the only building, renting, or selling in the past. Enterprises have to pay more attention to the revitalization and maintenance of stock resources, optimize the holding projects, build brands with value spillover effects, and find compelling scenarios for connecting merchants and consumers. Moreover, with the circumstance that people prefer online consumption and have social needs, strengthen cooperation with retailers to accelerate the layout of community commerce, develop a multi-dimensional and omnichannel operation model with the help of internet technology, and provide consumers with accurate, efficient, convenient service to better occupy the market and win the initiative.

### 5.1 Suggestion 1

Establish a differentiated scene brand image. Commercial value can only be realized when consumers recognize it. In recent years, some commercial projects have taken cultural attributes as important content, and they are committed to giving users different feelings in terms of brand image and design, which consumers favor. Nowadays is an important node in the transformation and upgrading of business models. Brands that can quickly respond to the real needs of the digital era are scene-based brands. So far, many brands have enjoyed the dividends brought by the scene, not only the small innovative brand such as HARMAY but also the century-old store such as Yunnan Baiyao. Moreover, driverless technology (which only appeared in science fiction works in the past) and new commercial centers can represent urban culture and regional characteristics. Unlike traditional enterprises that focus on the formation of scale advantages, scenario-based operation brings higher resource conversion efficiency to the brand [20], which is an effective weapon for enterprises to fight against the uncertainty of the external environment.

## 5.2 Suggestion 2

Emphasis on diversified business operation. The impact on both the supply and demand sides will continue in the post-epidemic era. On the demand side, consumers consciously avoid offline consumption and pay more attention to personal savings, all inhibiting consumption recovery. On the supply side, affected by the reduction of migrant workers and rising raw material prices, the market has been affected in the recovery process. This change in the external environment is like a double-edged sword, bringing crisis but also containing opportunities. On the one hand, the traditional store model has been greatly impacted, and Haidilao Hot Pot closed 300 stores in 2021. On the other hand, companies such as GENKI FOREST and Ramen Talk quickly entered through e-commerce channels. With the help of new retail channels, they avoided traditional competition with an asset-light model and built brand awareness in a way more recognized by young people. Ramen Talk has achieved a leap in sales from 3 million to 1 billion in 4 years. This strategy of targeting the differentiated needs of young groups and attaching great importance to online marketing inspires commercial real estate to accelerate the exploration of online and offline integration, forming a new omnichannel development model. Commercial real estate should use the scene-based and personalized needs of consumers as the main driving force to attract customers. Based on a particular theme, an attractive experience area should be set up in offline scenes to enhance the sense of experience through rich activities and facilities, creating an integrated business ecosystem [20]. The online platform focuses on using big data as the support to provide full-process property services, attracting merchants to settle in, reducing the vacancy rate of shops, and improving space utilization efficiency.

## 5.3 Suggestion 3

Strengthen the project operation ability of enterprises. Since the high-leverage and high-debt model is unsustainable under the new policies, the asset-heavy model is no longer the best choice, while the asset-light model with low risk and high return is favored. Many companies have made efforts to improve management and control efficiency, deepen sales channels, and gradually transform from a developer model to an operator model. Unlike residential properties, commercial real estate needs to obtain rental income through continuous and stable operations and realize the preservation and appreciation of projects. Therefore, the operation level is crucial to the success of commercial real estate projects, and commercial operation services have a broad market space. Leading enterprises have accumulated operational experience by creating high-quality projects, cultivating excellent operation teams, and forming brand effects. On this basis, they have actively expanded third-party projects, carried out asset-light operation businesses, and achieved scale expansion. In terms of the development strategy of the asset-light business, some companies choose to adopt the strategy of "emphasizing both light and heavy," taking asset-light operation as a supplement to heavy-asset business and gradually expanding the scale of asset-light business. Another part of the company chooses to divest the asset-light operation business segment and go public independently, expand financing channels, expand business scale, and grow faster and independently under the supervision of the market, such as POWERLONG, CR MIXC LIFESTYLE, and the Wanda Commercial Management, etc [14].

## 5.4 Suggestion 4

Pay more attention to sinking the market. The sinking market possesses enormous potential. In the long run, people's material consumption and spiritual consumption are in the process of continuous upgrading. During the epidemic, the WeChat video account surpassed the traffic of other social media platforms in a short period through several online concerts, indicating that in the overall unoptimistic environment, it is more important to discover the market that others cannot notice. By deploying community business, the response time can be shortened, and the combination of online and offline business operations can be better realized. According to the report about Chinese Post-95 consumer groups released by Accenture, Generation Z pays more attention to delivery speed. More than 50% of the interviewees said they hoped to receive the goods on the same day they placed the order, and

7% hoped to have them delivered within 2 hours. This is exactly in line with the trend of consumption scenarios shifting from "trading area" to communities, with the change in consumption habits of the leading consumer groups. Therefore, commercial real estate companies should focus on convenience and efficiency, expand the real-time retail market in the community, and use a small and complete physical store plus an online selling model to connect online and offline through efficient logistics and distribution to serve consumers better.

## 6. Conclusion

At present, the entire real estate market is entering the era of stock. Commercial real estate not only has the characteristics of capital concentration in the real estate industry but also is deeply dependent on consumer groups, therefore, it will be more affected under such a complicated post-epidemic era. Affected by the overall economic situation and Covid-19, both producers and consumers are more conservative (the former restricts the scale of investment, the latter restricts consumption behavior), and real estate developers cannot simply expand the scale of projects to increase investment profits, so, under this case, determining the future development strategy is particularly important for commercial real estate companies. This paper starts by analyzing the macro environment, adopts the PEST method to analyze the possible impact of current policy, economic, social, and technological factors on the future development of commercial real estate, and strives to find an effective path between enterprises and consumers. The analysis believes that from a strategic choice perspective, enterprises should pay more attention to building a scene-based brand, adopt a diversified operation method to improve the consumer experience, use an asset-light model to quickly achieve market coverage, deploy community commerce to seize the sinking market space, and reduce costs to improve the efficiency of investment methods to obtain continuous operating income, and to win long-term development by operating methods that are closer to the needs of consumers.

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