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The Evergrande Scandal: Corporate Mismanagement, Financial Overreach, and Their Global Consequences

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Abstract: The Evergrande scandal is a striking example of corporate mismanagement and financial overextension, reflecting deep-rooted systemic weaknesses in corporate governance and regulatory oversight in China's real estate development industry. This paper explores the factors that underpin Evergrande's rapid growth, with a particular focus on its aggressive borrowing strategy and inability to maintain financial discipline. We examine how this unsustainable growth model, fueled by excessive debt, led to a liquidity crisis that threatens not only China's real estate market but also global financial stability. Through a comprehensive analysis of financial indicators, corporate governance practices, and the regulatory environment, this study provides insights into the broader economic impact of Evergrande's collapse. Finally, the study highlights the urgent need for a stronger regulatory framework to prevent similar crises and safeguard financial stability at home and abroad.

Keywords: Evergrande, Scandal, Financial Indicators

1. Introduction

1.1. Research background

In 2021, China Evergrande Group collapsed in one of the biggest financial scandals in modern Chinese corporate history. As one of the world's most indebted real estate developers, Evergrande's liquidity crisis raised alarms in domestic and international markets, sparking concerns about systemic financial risks. The company's business model, which relied on heavy borrowing to finance expensive real estate projects, coupled with weak corporate governance, ultimately led to its inevitable decline—even though it was profitable. The crisis not only destabilized China's real estate sector—which constitutes a significant portion of its economy—but also rippled across global markets due to the interconnected nature of modern finance.

1.2. Research motivation/objective + research problem

The motivation for this research arises from the need to critically analyze how Evergrande's corporate governance failures, financial mismanagement, and regulatory gaps contributed to its downfall. The objective of this paper is to dissect the root causes of Evergrande's collapse, focusing on its aggressive borrowing practices, governance failures, and the broader impact on global financial markets.

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1.3. Literature review + research gap

While there is a wealth of literature on corporate governance and financial mismanagement, the existing body of work often fails to connect these issues comprehensively in large-scale crises like Evergrande's collapse. Prior analyses have explored regulatory failures or corporate debt in isolation, leaving a gap in understanding how these elements interact. This research aims to bridge that gap by providing a holistic examination of Evergrande's financial strategies, regulatory environment, and corporate governance failures, focusing on their global implications.

1.4. Organization of the paper

This paper is organized into five sections. Section 1 introduces the background, motivation, and research problem. Section 2 provides an in-depth analysis of Evergrande's business model and financial structure, focusing on the causes of its liquidity crisis. Section 3 analyzes Evergrande's financial performance and its impact on the real estate sector. Section 4 examines the regulatory environment and the broader implications of the crisis. Section 5 offers conclusions and recommendations for future research and policy.

2. Overview of Evergrande’s financial crisis

2.1. Ever grande's business model

The rapid rise of Evergrande was driven by a high-leverage business model, which became increasingly unsustainable over time. Established in 1996, Evergrande Real Estate operated within the real estate development industry, leveraging external capital to fund its projects. The company’s diversified investments spanned unrelated industries, such as electric vehicles, cultural tourism, and healthcare, but these ventures proved costly and unprofitable [1].

2.2. Off-balance-sheet financing and wealth products

In an attempt to cover its liquidity shortfalls, Evergrande used off-balance-sheet financing through Evergrande Wealth. It is a wealth management fund. This platform raised over ¥40 billion from approximately 100,000 investors, but much of this capital was misused to fund real estate projects rather than proper financial investments. Public trust in Evergrande began to deteriorate as financial products failed to deliver returns, contributing to the company’s mounting debt crisis [2].

2.3. Diversification and debt load

Evergrande’s diversification into non-core industries, coupled with its reliance on aggressive borrowing, worsened its financial standing. The company’s debt-to-assets ratio increased to 96.33% by 2016, signaling a dangerous reliance on external financing. Efforts to reduce this ratio were ineffective, and Evergrande’s financial structure remained fragile, with liabilities continuing to grow [3].

2.4. The course of the crisis

In September 2020, China’s “three red lines” policy restricted real estate developers' borrowing, and Evergrande immediately faced a liquidity crunch. The company’s failed attempts at restructuring through a backdoor listing, combined with growing pressure from creditors, culminated in widespread lawsuits by 2021. Evergrande’s reputation plummeted as suppliers and local governments publicly

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disclosed overdue payments and legal actions. By July 2024, the company's stocks in Hong Kong were suspended due to unresolved regulatory and financial issues.

3. Analysis of financial performance

3.1. Debt-to-asset ratio

Evergrande's debt-to-asset ratio reached 136.94% in 2022, highlighting significant over-leveraging that contributed to its financial downfall. This unsustainable financial structure prevented the company from meeting its obligations and triggered a liquidity crisis.

3.2. Equity ratio and profitability

Evergrande's equity ratio turned negative in 2022, reflecting a loss in shareholder value as liabilities exceeded equity. The company's return on equity (ROE) decreased to 5.99% in 2018, indicating a significant decline in profitability.

3.3. Liabilities and liquidity

Evergrande's total liabilities grew to ¥263.955 billion by 2022, creating enormous repayment pressure. The liquidity ratios for 2022 and 2023, at 0.69 and 0.71, respectively, and the debt-to-assets ratio reached 0.767 in 2022, indicate the company's inability to meet short-term obligations, leading to further financial distress.

4. Analysis of regulatory and implications

4.1. The "three red lines" policy

China's "three red lines" policy places strict limits on borrowing by real estate developers based on three key financial metrics: debt-to-asset ratio, net debt ratio, and cash-to-short-term debt ratio. Evergrande's failure to meet any of these requirements severely limited its ability to obtain new loans and accelerated its financial collapse.

The company's financial mismanagement, aggressive borrowing practices, and reliance on off-balance-sheet financing led to one of the worst corporate bankruptcies in recent history. Future research should focus on the global impact of this massive corporate bankruptcy, especially in the context of interconnected financial markets.

4.2. Growth phase: 2010 - 2015

1. Revenue Growth: Evergrande's revenues continued to grow, driven by the booming real estate market in China. They reported strong sales, mainly from residential property development.

2. Profitability: The company remained profitable with healthy margins, enabling it to reinvest profits in new projects. For example, in 2014 and 2015, Evergrande reported solid revenues and operating profits, which helped maintain investor confidence.

3. Debt Accumulation: However, Evergrande also began to accumulate debt during this phase. Despite high revenues, the company began to rely more on debt to finance further expansion and land acquisitions. This was initially manageable but set the stage for future problems.

4. Diversification: By 2015, Evergrande began to move into new areas, such as electric vehicles, healthcare, and finance, to diversify beyond real estate. On November 5, 2009, Evergrande Real Estate was listed on the Hong Kong Stock Exchange. In 2015, it acquired Hong Kong New Media Group and renamed it Evergrande Health. In November, Guangzhou Evergrande Football Club

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landed on the New Third Board. In December, Evergrande Culture landed on the New Third Board and entered the Chinese capital market. Although these projects have bright prospects, the initial investment is huge, which further increases the company's debt burden.

4.3. 2016 - 2019: debt-fueled expansion

Evergrande's dominance in the real estate sector has grown over the years, but its debt load has also increased significantly. Key trends during this period include:

Record sales: Evergrande's residential sales peaked during these years, and the company became one of China's largest real estate developers by volume.

Massive debt growth: However, the company's debt has surged. In 2016 and 2017, the company borrowed heavily to fund further real estate projects and diversification efforts, and total liabilities surged. The debt-to-asset ratio continued to rise, but the company was able to make interest payments as China's real estate market remained strong.

Profit Margins Narrowing: By 2018, despite record sales, profit margins began to narrow as debt-servicing costs increased. In 2018, for instance, Evergrande's debt levels were above $100 billion, and the company started to experience stress due to the increased cost of financing.

Warning Signs: Analysts started raising concerns about Evergrande's reliance on debt to fuel its operations and acquisitions, noting that this strategy was unsustainable if the Chinese government introduced stricter regulations or if market conditions worsened.

4.4. Analysis of Evergrande's financial crisis

4.4.1. Analysis of Evergrande's business model

The high debt and leverage of Evergrande Group is a common operating mode in the industry.

In 1996, Evergrande Real Estate was established, belonging to the real estate industry and Evergrande Group. Evergrande Group was established in 2006 and listed in Hong Kong in 2009. It has eight sectors and four listing platforms, providing diversified financing channels in the capital market. Evergrande started from real estate, formed its own unique value proposition and marketing strategy, and gradually diversified, with resource advantages such as brand, operation, management, customers, land, and government relations. In recent years, the development of the real estate industry has entered a platform period, and real estate enterprises have begun to diversify their layout, transforming the single business of building houses and selling houses into comprehensive construction services. Although the diversified development of housing enterprises is the general trend, it is not advisable to blindly diversify the strategic layout. Evergrande Group mainly focuses on real estate, and at the same time, it is involved in cultural tourism, health, automobile, sports, banking, insurance, and other unrelated fields.

The core industry of the group is Evergrande Real Estate, while other affiliated industries, such as Evergrande Automobile, Evergrande Football, and Evergrande Wealth, are losing money. According to the financial report data of Evergrande Automobile, from 2018 to 2022, the accumulated loss was 98 billion yuan, and the assets were 68.7 billion yuan. Evergrande needs to invest a lot of money to support the entry into a new industry and turn losses into profits. It is difficult to meet the capital needs of related industries only by relying on the operating cash flow generated by real estate business. Therefore, Evergrande had to borrow heavily to meet the capital demand of a diversified business strategy. At the turning point of industry cycle changes, other competitors are cutting costs, selling inventories, improving asset turnover speed, and reducing investment in the asset-liability ratio to maintain their financial stability.

The financial products of Evergrande Wealth are mainly sold to senior managers and employees, their relatives and friends, suppliers, builders, and other customers who use the Internet for

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development. According to statistics, the scale of Evergrande's wealth is as high as 40 billion yuan, involving nearly 100,000 investors. Evergrande has a deep relationship with it. Evergrande made its first investment in 2016. In 2019, Evergrande increased its holdings again, spending 13.2 billion yuan to increase its holdings of 2.2 billion shares, accounting for 36.4%, and became the controlling shareholder.

When Evergrande Group was in full swing, it was Evergrande Life Insurance on the one hand and Evergrande Wealth on the other, and it was also the largest shareholder of Shengjing Bank, the largest bank in Northeast China. Evergrande Group uses the financial institutions it controls to "transfuse blood" for Evergrande. Evergrande Group requires employees to persuade their families and friends to buy corporate wealth management products. As Evergrande Group enjoys a high reputation as a Fortune 500 company, many employees have successfully persuaded their relatives and friends to buy wealth management products by taking advantage of this advantage. However, these funds have not been used for financial investment, and most of them have flowed into some falsely packaged enterprises of Evergrande Group and then entered various real estate projects. On the surface, these financing entities are general building materials and engineering enterprises, but their authenticity is in doubt, and their relationship with Evergrande Group has not been confirmed. Financial products should be put on record. To achieve the purpose of earmarking, investors' money must be remitted to the trustee's account. However, the definition of Evergrande's financial products is vague and far from financial products, which is more like a "private fund". Evergrande Group lacks a supervision mechanism and misappropriates customers' funds. The public has doubts about Evergrande's financial products, investors' trust in Evergrande has declined, and a crisis of trust has emerged in Evergrande, further aggravating the debt crisis of Evergrande [2].

Geng Yifan pointed out that due to Evergrande's diversification strategy, its debt level continued to rise, which not only affected the core competitiveness and market position of Evergrande's main business but also affected the synergy effect has not yet played a role in increasing the added value of real estate business, which reduced the overall profit quality of the Group, increased its risk of debt and debt repayment pressure, and increased its future operating risks and instability. The road to reducing debt has a long way to go [3]. Since its establishment, Evergrande has always adopted the strategy of winning by scale, with the words "high debt, high turnover, and low cost" surging forward, especially the debt expansion model.

The real estate development and operation, mainly includes land acquisition, development, pre-sale, and property delivery. Evergrande has been implementing the strategy of scale expansion, but the required funds do not come from internal financing. Using external financing to continuously increase land reserves will involve the use of trust funds, which will lead to high financing costs and increase financial risks. The development link includes the construction cost, and the operation cost chooses to borrow from the bank, which leads to the pre-payment of expenses and the post-payment of income. Housing enterprises generally tend to pre-sell, sell faster houses, and receive accounts in advance, which will also make the debt ratio of housing enterprises reach the highest.

At the same time, with the rapid expansion of the debt scale, the debt scale increased from 49.9 billion to 1.98 trillion in 2019. Vertically, the debt ratio of Evergrande has been rising for many years and even climbed to 96.33% in 2016. After 2017, Evergrande began to make a strategic shift from the "three highs and one low" mode to the "three lows and one high" mode. The debt ratio of Evergrande declined slightly and gradually decreased to 89.64% in 2019. Horizontally, housing enterprises belong to heavy asset industries, with large initial investments and long payback periods.

Therefore, the debt ratio is much higher than that of other industries, and the average asset-liability ratio is about 70%. Evergrande's liabilities mainly come from loans from financial institutions, which will generate more interest. However, part of Vanke's liabilities come from accounts received in advance, so it does not need to repay interest, but only needs to repay the principal when due.

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Therefore, the debt repayment pressure is less than that of interest-bearing bonds. After deducting the influence of accounts received in advance, the debt ratio is greatly reduced. Therefore, the debt ratio of Evergrande in the real estate industry has been far ahead, which needs special attention.

Through a brief analysis of Evergrande's balance sheet, it is not difficult to find that Evergrande's asset-liability ratio far exceeds the average level of real estate enterprises and is more like a financial company. However, with the policy pressure of the real estate industry, in the past, the business thinking of housing enterprises tended to increase in scale, but it did not conform to the current business operation mechanism. According to the regulatory requirements of the three red lines, Evergrande is in the red zone, and it is unable to continue to replicate the past path of gaining cost and gross profit advantages through high debt expansion.

4.4.2. The course of the Evergrande crisis

4.4.2.1. The initial stage of crisis

In September 2020, due to the financing constraint of the "three red lines" policy, Evergrande Group lost the financing channel of bank loans and immediately faced huge debt pressure and tight cash flow. Evergrande Group hopes that the reorganization of Shenfang will succeed, realize backdoor listing, and open up new equity financing channels. On September 24th, a letter of help titled "Report of Evergrande Group Co., Ltd. on Asking for Support for Major Asset Restructuring Projects" triggered a nationwide hot discussion. The letter admitted that if Evergrande Group failed in backdoor borrowing, it would need to repay the principal of strategic investors of 130 billion yuan and pay dividends of 13.7 billion yuan, which would have a serious impact on the survival of Evergrande Group and may even lead to systemic financial risks.

Because the reorganization of Shenfang involves the reform of state-owned enterprises, it has a complex transaction structure, especially the huge scale of the target to be acquired, which leads to a long game process for all parties involved in the reorganization. On November 8 of the same year, Shenfang released the announcement of "Proposal on Stopping Planning Major Asset Restructuring", which marked the failure of Evergrande's plan to borrow Shenfang from the back door, which triggered a severe crisis of confidence in Evergrande Group. Standard & Poor's downgraded the rating of Evergrande Group from "B+/ stable" to "B+/ negative". In 2020, Evergrande plans to reach a supplementary agreement with the original 130 billion yuan investors. After several rounds of negotiations, the 125.7 billion yuan strategic investors agreed to sign the supplementary agreement.

After solving the problem of 130 billion yuan strategic investors, Evergrande Group began to save itself. From November 2020 to June 2021, Evergrande actively carried out various capital market activities, including promoting Evergrande's property to land on the China-Hong Kong Stock Exchange, repaying debts of HK$ 16.1 billion in advance, implementing external financing of RV Group, and selling shares of Evergrande, to gain buffer time.

4.4.2.2. Crisis outbreak stage

In June 2021, Evergrande encountered unprecedented challenges, and a large number of suppliers and affiliated companies issued statements to expose Evergrande. If Sanshu disclosed that the bills of Evergrande Group were overdue, Guangfa Bank, Shaoyang Housing and Construction Bureau, Leo, and some local state-owned enterprises and governments also publicly stated that they were launching lawsuits against the debts of the subsidiaries of Evergrande Group. These successive lawsuits have caused Evergrande Group to be overwhelmed; the company's reputation has plummeted, and the trust of investors has also decreased. In August, the central bank and China Banking and Insurance Regulatory Commission interviewed relevant senior executives of Evergrande Group and asked them to take action. On September 8th, Evergrande Fortune issued a statement announcing that it would

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completely suspend its financial services to customers. Five days later, Evergrande Group offered three different repayment modes: one was to provide customers with cash installment payment; The second was to provide customers with physical assets; The third was to offset the final payment of the house purchase. Since then, Evergrande Group can only maintain its operation by selling assets and has to substantially reduce the selling price of houses nationwide to exchange cash from the market. Many default events led to the collapse of Evergrande's reputation, and the stock price fell sharply, deeply falling into the debt crisis.

As of July 31st, 2024, China Evergrande's Hong Kong stocks were in a "dormant state" of long-term suspension. If the company still fails to issue an audit report or solve problems such as illegal transactions within the deadline, it will face delisting.

Table 1 shows the key nodes of the Evergrande debt default event.

Table 1: Key nodes of Evergrande debt default event

time	event
June 2020	Some commercial tickets of Evergrande Group are overdue.
August 2020	The state throws out three red lines for housing enterprise financing, and Evergrande Group steps on all three red lines.
September 2020	Evergrande Group denied the reorganization of the network transmission.
November 2020	Evergrande Group and Shenfang A issued separate announcements, announcing the termination of their restructuring plans.
June 2021	Evergrande Group's "Yuelongtai" project in Xuchang, Henan stopped working.
July 2021	Yixing Sub-branch of China Guangfa Bank Co., Ltd. applied to freeze the deposits of Evergrande Real Estate Bank.
August 2021	Loan extension of several banks of Evergrande Group
August 2021	Evergrande Group accepted interviews with the People's Bank of China and China Banking and Insurance Regulatory Commission.
September 2021	Evergrande Fortune suddenly announced that it would suspend payment of all wealth management products.
January 8, 2022	The interest of 314.1 million yuan on the bond "20Evergrande 01" issued by Evergrande Real Estate was not paid normally, so it was extended.

4.4.3. Financial analysis of Evergrande group

The asset-liability ratio of Evergrande Group has always been high after listing. As can be seen from Table 2, its asset-liability ratio has been rising from 2009 to 2012. The sharp decline in 2013 was mainly due to the perpetual debt issued by Evergrande Group at that time, which was regarded as its capital, thus reducing the asset-liability ratio. However, the interest rate of perpetual bonds issued by Evergrande Group keeps rising, which greatly increases the debt burden of enterprises. Since then, the asset-liability ratio of Evergrande Group has been very high, indicating that the plan of reducing the debt of Evergrande Group has not yet been realized, thus continuously triggering the debt crisis [4,5].

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Table 2: Assets and liabilities of Evergrande group in 2009-2020

Year	Total liabilities (100 million yuan)	Contract liabilities (100 million yuan)	Liabilities excluding contractual liabilities (RMB 100 million)	Total assets (100 million yuan)	Asset-liability ratio (%)	Asset-liability ratio excluding contract liabilities (%)
2009	499.14	243.06	256.08	630.71	79.14	40.60
2010	830.86	240.81	590.05	1044.52	79.54	56.49
2011	1,441.66	316.14	1125.52	1790.23	80.53	62.87
2012	1,972.99	448.33	1524.66	2389.91	82.56	63.80
2013	2,688.06	390.00	2298.06	3481.48	77.21	66.01
2014	3,620.84	473.48	3147.36	4744.62	76.31	66.34
2015	6,148.93	830.61	5318.32	7570.35	81.22	70.25
2016	11,583.36	1949.61	9633.75	13508.68	85.75	71.32
2017	15,195.44	2675.55	12519.89	17617.52	86.25	71.06
2018	15,714.02	1855.86	13858.16	18800.28	83.58	73.71
2019	18,480.40	1297.05	17183.35	22065.77	83.75	77.87
2020	19,507.28	1857.46	17649.82	23011.59	84.77	76.70

5. Conclusion

Due to the debt crisis caused by high debt and leverage, its asset-liability ratio far exceeds the average level of real estate companies, making it more like a financial company. In June 2021, Evergrande Group faced unprecedented challenges as a large number of suppliers and affiliated companies issued statements exposing Evergrande Group. Following this, Evergrande Group experienced debt defaults.

The highlight of this article is that it reveals the business model and financial situation of Evergrande Group through case analysis, and conducts a more in-depth study on its development mode.

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Ziyi Zheng and Aoyu Chen contributed equally to this work and should be considered co-first authors.

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