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Analyzing the Strategy of Digital Transformation to Improve Company Valuation

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Abstract: Competition among firms has intensified due to technological advancements and societal progress. As a result, several companies are suggesting implementing digital transformation as a means to enhance the value of their enterprise and obtain a competitive edge. The objective of this study was to examine the influence of digital transformation on the financial worth of a firm. This research employs Midea as a case study to do a comprehensive analysis that combines the theories of cost-benefit and business model innovation. The analysis and observation are based on the data provided by the firm. This study not only broadens the research trajectory for researchers to investigate the enhancement of business valuation, but it also provides a point of reference for associated firms to improve their performance. This study not only broadens the research trajectory for academics to investigate the enhancement of business valuation, but also provides a point of reference for associated firms to improve their performance.

Keywords: Midea, Digital Transformation, Company Valuation.

1. Introduction

In the early 21st century, International Business Machines Corporation (IBM) put forward the conception of digital transformation, emphasizing the application of digital technology to enhance customer interaction and collaboration [1]. Since then, digital transformation has gradually become an important strategy for business and enterprise development. In recent years, with the continuous emergence of emerging technologies such as the Internet and artificial intelligence, the depth and rate of digital transformation have continuously advanced. The Global Digital Transformation Spending Guide predicts that global digital transformation investments will surpass $1.5 trillion in 2022 and surpass $3 trillion in 2026, exhibiting a five-year compound growth rate (CAGR) of approximately 16.7 percent from 2021 to 2026 [2]. Companies have increased their investment in digital transformation to enhance their competitiveness and innovation capabilities.

Since its inception, research on digital transformation has had a long tradition. For decades, one of the most popular ideas in this area has been the idea that digital transformation can increase a company's valuation. Sinkula analyzed organizational learning theory and discovered that the digital transformation of enterprises can increase employees' enthusiasm to acquire new knowledge, thereby improving the company's performance [3]. Qi and Cai pointed out that digital enterprises can effectively apply consumer data and production data to optimize their own production and decision-making processes, as well as improve production efficiency [4]. Loebbecke and Picot conclude that

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big data analysis can accelerate an enterprise's decision-making process, shorten its response time, and improve its overall operational efficiency [5]. Vial asserts that digital transformation is a process of organizational change [6]. In this process, enterprises change the path of their value creation by applying digital technologies, thereby improving the enterprise's internal operational efficiency and organizational performance [6].

While the literature mentioned above suggests that digital transformation can boost company valuation, the ongoing innovation of industry models and advancements in science and technology could potentially influence company valuation from various angles. Thus, people still need to conduct new research to fill the gaps in this area. It is of interest to know whether the above conclusion still holds true. This paper will use Midea as an example to analyze the impact of digital transformation on company valuation. While most of the previous studies have utilized quantitative analysis, this paper will employ qualitative analysis based on Midea's earnings in recent years and projected earnings for the next few years in order to analyze the above question. This study helps us explore feasible paths to enhance company valuation for economic development.

To further deepen the research on the topic, this paper will use the development of Midea as a starting point to identify the company's strengths and weaknesses. This will be achieved by horizontally comparing the company's performance in recent years with its expected revenue in the upcoming years. And further explore the reasons for its occurrence, and then, according to the problems, put forward some suggestions or solutions. Additionally, this paper will compare the performance data of similar competing companies in the household appliance industry, where Midea operates, to enhance the credibility and intuitiveness of the study's results.

2. Case Description

Midea is a leading company in China's household appliance industry, with a market share ranking among the top five in China [7]. In addition, Midea has a diversified product line: air conditioners, refrigerators (including a variety of types such as door-to-door series, multi-door series, Italian series, etc.), washing machines (drum washing machines, multi-wheel washing machines, etc.), kitchen appliances (range hoods, gas stoves, microwave donkeys, etc.), and small home appliances (rice cookers, electric heaters, water heaters, etc.). Among similar companies, it leads the industry in exports, with a 32 percent export share in 2023.

Before 2012, Midea had already occupied a large share of China's home appliance market, but it still had many urgent problems in its development. The primary issue is the inefficiency of the traditional production management approach, which makes it challenging to accurately monitor the production process and progress, leading to a prolonged production cycle and increased costs. Moreover, the company encounters inadequate supply chain optimization and delayed and inaccurate information transfer, leading to occasional inventory backlogs or out-of-stock situations. At that time, China's economic growth was slowing down due to structural adjustments, transformations, and upgrades, necessitating a shift from high-speed to high-quality development. In the home appliance industry, the state concurrently implemented policies aimed at bringing home appliances to rural areas and promoting energy conservation for the benefit of the populace. These initiatives not only established an industry orientation but also heightened market competition. The home appliance industry is highly competitive; market saturation and product homogeneity are more serious. Consumer demand for home appliances has also become more diverse, with a higher demand for brand and quality. Based on its own reasons and the current state of market development, Midea decided to initiate a digital transformation process. In 2012, Midea unified its information system across all six departments to achieve a common information platform. In 2015, Midea implemented the "intelligent manufacturing" strategy to enhance the level of production automation. In 2018, the goal was to create an industrial Internet platform through the use of 5G technology. Through digital

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transformation, Midea's valuation has increased. Midea pays income tax at the standard of a high-tech enterprise, and the company states that it will be able to continue to qualify as a high-tech enterprise in the coming year, which in turn will allow it to maintain the current preferential tax rate of 15 percent. Additionally, the company plans to reduce and maintain the depreciation rate at 8% through digital development. Midea's adoption of digital transformation has resulted in significant changes in corporate revenue (102.6-billion-yuan growth to 261.8 billion yuan), which in turn impacted its valuation.

3. Analysis on Problems

3.1. Reasons on Technological Innovations and Applications

During the digital transformation process, Midea developed and used technology, resulting in an increase in its share price. By adopting intelligent manufacturing technology and automated production lines, Midea increased production efficiency, resulting in lower labor costs and production mistakes. Midea designated its Nansha facility as a "lighthouse factory" for 2020. The Nansha factory has been utilizing new industrial technologies such as the Industrial Internet, and as a result, Midea's Nansha factory's production capacity has increased significantly from 300,000 sets of home appliances per month to 900,000 sets of home appliances per month, a threefold increase that has improved Midea's corporate efficiency and performance levels.

Midea has now built a "2+4+N" worldwide R&D network with 35 R&D facilities across the world, resulting in a "four-tier R&D system" that includes a global R&D architecture and a scientific talent system. According to the "T + 3" supply chain management model, each cycle takes three days to complete, from order to delivery of products [8]. Midea Group has transformed and upgraded supply chain management around the primary order delivery chain by using pull-through synergy and diagnosing marketing, planning, procurement, manufacturing, logistics, quality, and other areas. Supply chain innovation has increased production efficiency by 83%, decreased production losses by 68%, and enhanced logistics efficiency by 60%. Digital operations enhance supply chain management while lowering inventory and transportation costs. These changes have a direct influence on the company's profitability and cash flow, enhancing its intrinsic value.

Zhang discovered a significant positive correlation between technology growth option metrics and cross-sectional stock returns through a regression analysis of monthly corporate stock returns [9]. The cost-benefit theory also suggests that increased efficiency reduces Midea's costs, whereas digital transformation enhances its profitability and optimizes its cost structure.

3.2. Reasons on Reconfiguration of the Business Model

Digital transformation has reorganized Midea's business model, leading to an increase in its share price. The digital revolution has prompted a reconstruction of the business model, and Midea has reinvented its conventional sales and marketing approach by building a digital marketing platform and e-commerce platforms. This not only broadens sales channels, but also improves consumer engagement and data collection capabilities, resulting in additional streams of income and growth for the organization, thereby increasing valuation. Midea Group began its digital transformation of the organization in 2012, spanning a wide range of business situations from procurement to service based on the link between users and enterprises. Simultaneously, Midea Group has steadily built an independent R&D department, an intelligent production and logistics management system, the Midea Cloud Sales APP, and first-rate after-sales protection services using its own computing methods, data, and processing capacity. The key concept of Midea Group's digital high-level design is the flexible use of digital technology throughout the whole process, from sales to supply, guaranteeing that the entire value chain operates at high quality.

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In addition, Meiyun Intelligent Digital is a member of Midea Group, established in 2017. Meiyun Intelligent Digital has many years of management and practical experience from Midea Group, a Fortune 500 company, and it can provide enterprises with intelligent production software and efficient digitalization solutions for the whole value chain. Currently serving more than four dozen sub-sectors, Meiyun Intelligent Digital's product positioning involves the application of intelligent manufacturing, the Internet of Things, and other related core technologies, and it consistently provides a variety of corresponding product services for enterprises. Meiyun Intelligent Digital has cultivated the "consulting + product + implementation" of the enterprise's all-around process digital solutions, which in turn generates enterprise management practices, data assets, and cloud services for the community and helps enterprises realize intelligent full-value-chain change. Based on the theory of business model innovation, Midea has optimized its sales channels to individual buyers through the Meiyun App and broadened its cooperation channels with enterprises from various industries through Meiyun Intelligence, discovering new sources of income and growth points and increasing the valuation of the enterprise.

Researchers have also discussed the important role of business model optimization in enhancing company valuations. Wang and Ma, for example, argue that Haier Company has kept a relatively fast pace and improved its development speed while maintaining the company's scale through business model innovation, demonstrating that this innovation significantly enhances the company's valuation [10]. Midea also boosted the company's valuation by reorganizing its business model.

3.3. Reasons on Improving Customer Experience

Through digital transformation, Midea has improved the consumer buying experience, which in turn has boosted the company's sales revenue and increased its valuation. Midea provides personalized service and product recommendations through digital channels to enhance customer satisfaction and loyalty. Midea responds to customer needs in real time, enhances customer service levels, and fosters word-of-mouth and customer acquisition. On the one hand, the design of Midea air conditioning takes into account the user's family class and life goals, drawing inspiration from brands such as COLMO, Midea, Hualing, and others. This approach enhances the accuracy of customization for various user groups. On the other hand, it also takes into account the unique characteristics of different spaces. This allows for customization of the product's appearance, air flow, space scenes, professional services, and other multi-level features. This approach truly transforms air-conditioning products from the traditional "thousands of people, one size fits all" to "thousands of people, thousands of faces."

Scholars have also demonstrated that optimizing the customer experience has a significant role to play in business growth. Wang and Wang actively enhance customers' digital experience by citing Suning Xiaodian's strategic layout to realize the great development of smart retail and the new retail model that focuses on community business operations with the goal of satisfying customer needs [11]. It demonstrates that enhancing the customer experience is the fundamental starting point for the digital transformation of traditional enterprises [11].

4. Suggestions

4.1. P Suggestion on Technological Innovations and Applications

The current home appliance sector is undergoing significant standardization and intense rivalry. To uphold Midea's dominant position in the market, it is imperative for Midea to persist in its pursuit of innovation. Midea should continue to increase research and development spending.

This paper proposes that Midea establish a dedicated fund to incentivize internal workers to engage in advanced technology research and collaborate with universities and scientific research

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organizations to address technological challenges. Midea should prioritize the integration of environmental protection and energy-saving technology into its products in response to the current worldwide demand for a sustainable lifestyle. Midea should invest in research and development to improve the efficiency of energy-saving motors and control systems, thereby reducing the energy consumption of its products. Furthermore, it should investigate the use of novel eco-friendly materials for environmental preservation.

4.2. Suggestion on Reconfiguration of the Business Model

As the economy and society progress, there is an increasing need for home appliances. Therefore, it is of extreme importance to restructure the business model in order to enhance the company's income and valuation. To meet the needs of consumers who want a complete smart home experience, it can introduce a range of different products and high-quality services. It can follow Apple's approach of not only offering essential home appliances but also expanding into smart home accessories and services, like smart security systems and solutions for managing home energy [12]. Furthermore, the implementation of customization and personalization services can be initiated, drawing insights from Dell's tailored manufacturing approach. This would offer consumers a wider range of customization choices, encompassing the aesthetics and design of household appliances as well as functional configurations, to cater to the distinct preferences of individual users. In addition, Midea has the capability to implement a membership system and a loyalty program [13].

Establish a membership system for Midea based on Starbucks' membership system, offering benefits such as points, discounts, and the right of first refusal to increase user loyalty and repurchase rates, as well as brand dependence and credibility [14]. Apple, Dell, and Starbucks have contributed to higher valuations by reforming their business models described above. By modeling its business model after the three companies, Midea could also increase its valuation to a certain extent.

4.3. Suggestion on Improving the Customer Experience

Based on the study conducted thus far, it can be concluded that Midea's valuation will only increase if it constantly improves the customer experience. Hence, this paper proposes that Midea should establish a proficient sales and customer care staff capable of providing precise and comprehensive responses to consumer inquiries regarding products, as well as offering tailored purchasing guidance. Additionally, it is imperative to build a streamlined after-sales service structure that promptly addresses customers' post-purchase requirements and offers swift and efficient repair and maintenance services.

Using the development of China's telecommuting industry as an example, it can be observed that the increasing convergence of services provided by various service providers. This convergence presents a fantastic opportunity to optimize the customer experience, thereby establishing a differentiated brand image and a unique competitive advantage [15]. The household appliance industry, where Midea operates, follows suit.

5. Conclusion

This paper examines Midea as a research object within the global context of enterprises undergoing digital transformation. Midea had become a leader in China's household appliance industry before 2012. However, the significant issue of low production capacity remains unresolved, prompting Midea to initiate a digital transformation in 2012. Midea divided its digital transformation into three phases: in 2012, it started to unify the information system across different departments; in 2015, it started to enhance the level of enterprise automation; and in 2018, it initiated the construction of an industrial internet platform. The report analyzes the reasons behind Midea's efforts to increase its

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corporate valuation through digital transformation, offering suggestions from three aspects: technological innovation, business model transformation, and customer experience improvement. It finally concludes that digital transformation can increase the company's valuation.

By examining specific company cases, this paper demonstrates how digital transformation can enhance company valuation. This serves as a theoretical foundation for scholars to investigate methods of enhancing enterprise valuation. Additionally, it offers guidance for companies in similar business situations to the United States, enabling them to model their own valuations. However, this paper still has some limitations, such as the subjective nature of the qualitative analysis of the results and the difficulty of making direct comparisons with other companies, which could potentially compromise the reliability and generality of the conclusions. This information, which does not cover all relevant factors and variables, results in an insufficiently in-depth assessment of the impact of digital transformation on company valuation. Therefore, the subsequent research should establish clear assessment criteria to reduce subjectivity and enable different researchers to arrive at more consistent conclusions. Information should also be collected comprehensively to assess relevant variables by collecting data through multiple channels, such as industry reports, market research, and internal company data collection.

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