

Original Paper

Analysis on the Investment Strategy Problems and Countermeasures of Gree Electric during the Transformation Period

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Abstract

This paper analyzes Gree's internal and external capital investment, starting from the perspective of strategic transformation and based on the analysis of financial data, compares the changes of Gree's internal and external investment activities before and after the transformation, and explores whether Gree's investment strategy is conducive to Gree's diversified strategic transformation, as well as the problems existing in the investment strategy and effective improvement measures.

Keywords

Investment strategy, Strategic transformation, Gree electric appliances

1. Introduction

Since the founding of the People's Republic of China, especially since the reform and opening up, China's manufacturing industry has continued to develop rapidly. It has built an independent and complete industrial system with a complete range of industries. It has effectively promoted the process of industrialization and modernization, significantly strengthened the comprehensive national strength and supported the status of a world power. However, compared with the world's advanced level, China's manufacturing industry is still large but not strong, and the task of transformation, upgrading and leapfrog development is urgent and arduous. In view of this, this paper first analyzes the internal and external environment of Gree Electric to judge its development opportunities and challenges. Then, the company's business scope, core competitiveness and other basic elements are understood to judge the advantages and disadvantages of the company's strategic transformation. Then select the period of Gree's strategic transformation as the key analysis period, based on the financial data analysis of the statements, discover the changes in Gree's investment activities from the figures, so as to explore

whether Gree's investment strategy is in line with the company's overall strategy and whether there are any problems, and put forward feasible suggestions on its investment strategy in combination with the current internal and external environment and the transformation progress.

2. Basic Information of Gree Electric

2.1 Company Introduction

Zhuhai Gree Electric Appliance Co., Ltd. was established in 1991 and was listed on the Shenzhen Stock Exchange in November 1996. At present, the Company has developed into a diversified industrial group with industries covering air conditioning, high-end equipment, living goods, communication equipment and other fields. The products are exported to more than 160 countries and regions. Relying on technological innovation, the company has applied for registration of more than 700 national patents, successfully developed high-end technologies such as GMV digital multi-connected multi-connected, centrifugal central air conditioner, and pioneered the international leading ultra-low temperature heat pump central air conditioner in the world, filling the domestic gap and breaking the technological monopoly of refrigeration giants such as the United States and Japan. The company takes "innovation" as its business philosophy, takes "building a leading air-conditioning enterprise in the world and" achieving Gree's world brand for a century "as its vision".

3. Analysis of Gree's Investment Strategy in the transition Period

For Gree Electric, air-conditioning has always been its main product, and the annual revenue from sales of air-conditioning accounts for about 80% of the main business revenue. Under the current situation that the market gradually tends to be balanced and saturated, competitors such as Meimei and Haier have been chasing after them. Starting from the long-term interests of the enterprise, relying solely on a single product to support the future development of the enterprise has a high operating risk and does not conform to the development law of the enterprise. Therefore, in 2014, Gree first used the "Big Pine" brand to promote Gree's small home appliances across the country, and started the pace of diversification. At the 2016 Made in China Summit Forum, Dong Mingzhu officially announced Gree has entered the "era of diversity". This paper selects 2014 as the dividing line, and takes 2010-2014 as the reference period before Gree's strategic transformation and 2015-2019 as the reference period for Gree's strategic transformation.

3.1 Analysis of Inward Investment Activities

According to Gree's statement items, the operating assets necessary for production and operation such as inventories, receivables, receivables, fixed assets and intangible assets are taken as the key analysis items for internal investment.

Table 1. Operating Assets Required for Production and Operation from 2010 to 2019 Unit:

RMB100 Million										
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	
Inventory	115.6	175	172.4	131.2	85.99	94.74	90.25	165.7	200.1	240.8
Advance payment	25.6	23.16	17.4	14.99	15.91	8.479	18.15	37.18	21.62	23.96
Accounts receivable	11.99	12.27	14.75	18.49	26.61	28.79	28.24	58.14	77	85.13
Fixed assets	55.28	77.09	127	140.3	149.4	154.3	176.8	174.8	183.9	191.2
Intangible assets	10.49	16.22	16.35	23.7	24.8	26.56	33.55	36.04	52.05	53.06
Subtotal	218.96	303.74	347.9	328.68	302.71	312.869	346.99	471.86	534.67	594.15
Rate of growth	38.72%	14.54%	-5.52%	-7.90%	3.36%	10.91%	35.99%	13.31%	11.12%	

According to the data analysis, Gree's total growth rate of operating assets gradually decreased to a negative number during 2010-2014, reflecting the slow growth of operating assets to a negative growth state, among which "inventories" and "prepayments" were the main influencing factors causing this trend. Gree's prepayments are mainly related to materials and equipment, which indicates that after a long period of rapid development, Gree's production and market strategy rates have reached a relatively saturated state, entering a bottleneck stage. The Company's investment in internal production and operation decreased. From 2015 to 2019, the investment in production and operation began to increase.

Gree has always paid attention to its ability of independent innovation, and has always been at the front end of the industry in mastering and breaking through core technologies. It is obvious from the report data that the Company has been maintaining steady growth in research and development expenditures, intangible assets and other projects. As can be seen from the new projects in the construction in progress from 2015 to 2019, Gree has started to invest in "green engineering", "intelligent equipment" and "mould engineering" and has taken the high-end route of "Da Mei Shu Zhi Jian".

Table 2. Additional Construction in Progress from 2015 to 2018

Year	Projects
2015	Changsha HVAC Project, Wuhan Gree Project
2016	Lingda compressor project, Gree headquarters project, Gree Dasong (Suqian) project, Wuhu precision manufacturing project
2017	Intelligent Equipment Engineering, Hangzhou Gree Engineering and Hunan Green Engineering
2018	Tianjin Green Project and Zhuhai Mold Project

3.2 Analysis of Foreign Investment Activities

According to the statement items of Gree Company, from the strategic perspective of the Company, the

long-term equity investment, especially the investment real estate, is taken as the analysis scope of the external investment, excluding the transactional financial assets sold or repurchased for the near term, among which the associates and joint ventures in the long-term equity investment are taken as the key analysis objects.

Gree's investment in associates and joint ventures did not change steadily during 2010-2014. The growth rate of long-term equity investment alternated between positive and negative, and most of Gree's acquisitions and mergers of subsidiaries were for air-conditioning production, sales and technology research and development. From 2015 onwards, Gree's investment in long-term equity investment grew steadily. In 2018, the growth rate soared, directly increasing by more than 2 billion. In 2019, the amount of long-term equity investment also showed a multiple growth. From the data, it can be seen that Gree's new long-term equity investment is mainly concentrated in 2018. The industries involved in the equity assets of the investment include chips, automobiles and mobile phones, and the scope of its operation is all related to technology development. The business combination under Gree's non-identical control is mainly related to production investment such as precision moulds.

Table3. Long-term equity investments, 2010-2019

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Long -term equity investment	0.2179	0.1688	0.2816	0.9757	0.9221	0.9546	1.039	1.104	22.51	70.64
Growth rate of long-term equity investment		-22.53%	66.82%	246.48%	-5.49%	3.52%	8.84%	6.26%	1939%	213.8%

Table4. Additional Associates and Joint Ventures from 2015 to 2019

Year	The name of the company	Industry	Scope of business
2019	Henan Yuze Car Rental Co., Ltd.	leasing industry	
2018	Wuhan Digital Design and Manufacturing Innovation Center Co., Ltd.	Research and experimental development	Technical development, technical consultation, etc. of mechanical parts and integral equipment in the field of intelligent manufacturing
2018	Hunan Guoxin Technology Co., Ltd.	Semiconductor Technology promotion and application services	Technical development, technical consultation and technical services in the field of power semiconductors
2018	Zhuhai Ronglin Equity Investment Partnership (Limited Partnership)	Business services	Equity investment, investment management
2016	Huateng Gree (Hong Kong) Limited	Private company limited	

4. Gree Electric Investment Strategy Issues in the Transition Period

From the above data analysis, it can be clearly seen that Gree has been increasing its investment both internally and externally during the transition period, adopting an expansionary investment strategy. Judging from Gree's diversified corporate strategy, the expansion investment strategy is in line with the overall strategy of the company. However, judging from Gree's current financial data, there are still some problems in the projects involved in its internal productive investment and external equity investment.

4.1 The Horizontal Diversification Investment is Insufficient

Gree began to gradually expand its products from small appliances in 2013, and the company began to accelerate the transformation in smart home in 2016, and started the pace of horizontal diversification. After several years of development, Gree's sales of small home appliances still did not increase significantly as a percentage of its operating income. Compared with the United States, Gree's expansion of small home appliances was very slow.

Table 6. Share of Small Household Appliances in Operating Income from 2010 to 2019

Year	2016	2017	2018	2019
Gree	1.59%	1.55%	1.91%	2.81%
Meide	27.21%	41.02%	39.60%	39.35%

Although Gree has deployed and planned its investment strategy in horizontal diversification, it has not invested enough, for example, it has invested less in the construction of sales channels.

Table 7. Sales Expenses 2016-2019 Unit: RMB100 Million

Year	2016	2017	2018	2019
Gree	164.80	166.60	189.00	183.1
Meide	176.8	267.4	310.9	346.1

Judging from the sales expenses, Gree's sales expenses are far lower than those of Midea. Gree has always focused on air conditioners. Gree has established a complete sales channel for air conditioners. However, after Gree began to implement the diversification strategy, the newly added products did not have a matching sales channel. As can be seen from the data in the table, Gree's sales expenses have not changed significantly in the past three years. Gree Air Conditioner can not rely on online and KA channels, but products such as household appliances and mobile phones have to rely on these. Beauty's products are covered with countless retail outlets, ranging from specialty stores to life supermarkets. Beauty's life appliances can be bought everywhere, while Gree's retail outlets are far less beautiful. For Life Appliances, Gree's investment in offline and online sales channels is not enough, there is no suitable sales channel, and no one cares for the best products.

4.2 The Risks Involved in Foreign Investment are Relatively High

Table 8. Income from Investments in Associates and Joint Ventures Unit: RMB100 Million

Year	2016	2017	2018	2019
money	803.4	648.7	56.05	-2098

From the previous data analysis, it can be seen that Gree's external equity investment has increased year by year in the past three years, especially in 2018 when it invested heavily in the chip and mobile phone industries. However, in the long-term equity investment, the investment income of associates and joint ventures has decreased year by year, and the decreasing range has gradually increased. By 2019, the direct decrease will be negative. This shows that Gree's foreign investment project has not been effective in the short term. If we want to continue to develop the mobile phone and chip industry, we still need to continue to add a large amount of investment, and the payback period of the project is long. Gree has neither appropriate sales channels nor strong technical support in the mobile phone industry, so Gree still has a long way to go if it wants to continue to build an internet of things mobile phone with corporate characteristics. For the chip industry, the research and development stage requires a large amount of capital. If Gree invests in both mobile phones and chips, the turnover of working capital may be problematic. Once the funds do not work properly, they are likely to be exposed to financial risks.

4.3 Insufficient Investment in Research and Development Expenses and Introduction of Research and Development Talents

Table 9. Research and Development Expenses in 2010-2019 Unit: RMB100 Million

Year	2017	2018	2019
Gree	36.18	69.88	58.91
Meide	72.7	83.77	96.38

At present, Gree Company has about 90,000 employees, including more than 14,000 scientific and technological research and development personnel and more than 30,000 skilled workers. Midea has more than 10,000 scientific and technological research and development personnel. The scientific research personnel of both companies account for about 10% of the total number of employees. Huawei, which already owns its own chips, has as many as 80,000 research and development personnel, accounting for 45%. This shows that Gree's research and development team still has a lot of room for improvement.

First of all, compared with the United States, Gree spends less on research and development, showing a downward trend in 2018-2019. Considering Gree's current diversified process, such data shows a

negative trend. It is known from the notes to the statements that nearly 80% of Gree's research and development expenses are derived from labor expenses. From the amount of research and development expenses, it can be seen that Gree still needs to continue to attract research and development talents.

5. Suggestions on Gree's Investment Strategy

First of all, Gree Electric should make it clear that air conditioning will always be the main business. With the advancement of urbanization, the upgrading process of residents' consumption has accelerated and the demand for upgrading has increased. Therefore, in the long run, there is still room for a significant improvement in the air-conditioning market. Gree Air Conditioner not only ranks first in the domestic market, but also ranks first in the domestic air conditioner field with a market share of 21.9% in the world. Gree's diversification strategy does not mean that it should abandon its specialization. In the field of air conditioning, Gree should still maintain its competitive advantage and cannot relax its investment in production and operation. In the following transformation process, Gree Electric should continue to adopt the strategy of focusing on relevant diversification and supplemented by non-relevant diversification.

5.1 Continue to Increase Horizontal Diversification and Investment in Research and Development Funds

No matter what kind of strategic transformation Gree carries out, we must not slacken our efforts in operating productive investments. From the above data analysis and operating environment, it can be seen that the high-end equipment and smart home field will be the development trend of home appliance industry in the future. Small household appliances and precision moulds are both key projects in Gree's horizontal diversified deployment, and Gree has made certain technological progress through its efforts in recent years. However, Gree's sales volume in the small household appliances and precision moulds segment is not high and the number of customers is not large, indicating that there is still much room for development. Gree still needs to continue to increase its investment in horizontal diversified internal production and operation and expand the market of these businesses. For high-end equipment, Gree should continue to increase its investment in research and development and production, master the core technology, and continue to improve in intelligent equipment, CNC machine tools, precision molds and other aspects.

5.2 Increase the Investment in Sales Expenses and Improve the Existing Sales Channels

For small appliances and other industries where Gree has dabbled in products such as mobile phones and chips, Gree needs to invest funds as soon as possible to set up sales channels suitable for its small appliances and other diversified products in order to better promote them. Gree can learn from Haier's "one man, one man" model and Midea's "T+3" model to create a more diversified sales channel for itself.

5.3 Seize the Opportunity Brought by Novel Coronavirus's Sudden External Environment

As a result of the sudden outbreak in novel coronavirus, the gap in the pharmaceutical industry has

suddenly increased. Recently, Gree plans to invest 20 million yuan to establish Zhuhai Gejian Medical Technology Co., Ltd. The business scope of the Company includes the design, manufacture and sale of protective equipment for medical personnel, ultraviolet disinfection equipment, physiological parameter analysis and measurement equipment and infection control equipment for operating rooms. The big health industry is a field that pan-Internet companies have been laying out in recent years. Gree Electric did some laying out and preparation in terms of hardware and technology in the early stage. With its own accumulation of technology in home appliances, Gree Electric can be used in medical devices such as air purification products. At present, the global epidemic situation is continuously developing. According to Gree's financial statements in the first quarter, it can be seen that the outbreak of the epidemic situation has had a direct impact on Gree's main business. Due to the isolation measures in various regions, the staff were unable to install the air-conditioning system, which made Gree's operating income in the first quarter very dismal and even affected the company's stock price. However, in the long run, the epidemic is gradually under control and the impact of the quarantine measures on Gree's main business is gradually disappearing. The first half of each year is itself the off-season of sales of Gree Air Conditioner. Compared with the United States, the depreciation cost, labor remuneration and sales expenses of Gree per month are low. Therefore, in the long run, the outbreak of novel coronavirus will not cause too much impact and obstruction to the development of Gree. Based on the fact that Gree is currently in a diversified transition period, as the opportunity brought by the outbreak is the key that Gree's management needs to grasp, whether Gree can choose a good investment direction for deployment according to the current economic situation and national policies is of vital importance to Gree.

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