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## **MOVING A COMPANY WITH THE TIMES**

### What Makes Haier Unique?

Change is the only constant in the brave new world of global competition. Organizations that do it well flourish; those that do not can find themselves looking at their possible demise. Either way, change is inevitable: change in offerings, change in locations, change in strategy, and ultimately change in the organization itself. None of this is easy or natural. Jack Welch of GE was famous for saying, “When the rate of change outside [an organization] exceeds the rate of change inside, the end is in sight,” and IBM’s former CEO, Sam Palmisano, observed, “Organizational culture thrives only to the extent that it is open to being re-created.”<sup>1</sup> But change, especially big change, is difficult, and frequently it is something that all too many organizational actors hope can be avoided, or at least minimized, at all costs. Not surprisingly, those who succeed in orchestrating big change are regarded with admiration by students of business; those who do it more than once are considered exceptional.

This book is about transformational change—the reinvention of a corporate business model and culture not once but at least three times within thirty years. Since change for change’s sake is never a good idea, and certainly not noteworthy enough to merit book-length attention, this book is also about the context in which big strategic change takes place: the whys and wherefores that mandate and shape change. And it is about change leadership as well—the hows—because big change is never easy to accomplish,

and when it is successful, it is inevitably the result of leaders' ability to create a vision and mobilize the workforce to take this vision seriously and move determinedly toward the desired objectives.

## Haier Group

This is a book about transformational change in an old-economy, mature industry. This is not about change in high-tech razzmatazz but about change in household appliances, where margins are thin and innovations few. It's about management fundamentals, such as quality, brand, and supply chains. And the overriding message is that you can't discount the potential for transformational change in any industry or any geographical location. The leadership of any organization must be prepared for the challenge of creating such change, no matter what the industry or location.

Household appliances have been produced in the port city of Qingdao, on China's northeast coast, for quite some time. In the 1920s, a refrigerator factory was built in the city, and over time, after the founding of the People's Republic in 1949, this evolved into a collective factory administrated by the municipal authorities of Qingdao. In 1984, this same factory, which at that point was possibly best known for its poor quality and indifferent work ethic, was placed under the leadership of a young municipal official, Zhang Ruimin, and allowed to experiment with a variety of managerial initiatives that form the basis for much of the story that follows. By 2012, Haier, as it had come to be known, was one of the world's largest producers of refrigerators. It had broadened its product line to include air conditioners, mobile phones, computers, microwave ovens, washing machines, and televisions, and it had the world's largest brand share in major *home appliances*, 8.6 percent,<sup>2</sup> creating what was likely China's most recognized global brand. Haier is also one of the world's biggest refrigerator producers in terms of both brand and market share.

How Haier achieved all of this, and how it did it in such a relatively short period of time despite fierce competition from

incumbent global heavyweights, is the central story of this book and one that speaks to the power of business model innovation undertaken at Haier. Despite the company's reputation for innovation that has resulted in the creation of one new product after another, we believe that the real innovative power at Haier speaks to a competency that is far more powerful than just products. It is instead the ability to innovate, and continue to innovate, the business model and the corporate culture that supports it. This is the key to understanding Haier's unparalleled success over more than three decades and potential for the future.

### **Transformational Change in an Emerging Market**

This is also a book about innovation in emerging markets. It is not about IBM or GE, or any of the other familiar, big-name, well-established multinational corporations. This is a book about Haier, a domestic Chinese player that has succeeded not only in defending its home market against stronger, better-endowed foreign competition, but also in opening up new markets on a global stage, something that very few other BRIC (Brazil, Russia, India, and China) firms have accomplished.

Globalization could well be the biggest story of the twenty-first century, yet it has been almost entirely depicted from the perspective of Western multinationals. Obvious as it might be, the challenges and strategies of the emerging markets' champions are virtually invisible. It is as if globalization was a one-way street. But the truth is that globalization is increasingly a two-way story, with BRIC-based enterprises arising to both protect their domestic markets and enter global markets as bona-fide contenders. This book offers an unusual opportunity to get into the details of one such BRIC-based competitor to see how these organizations do it. The lessons here, however, are universal in their applicability. This is particularly important because we have been waiting for several decades for managerial lessons

to emerge from the Chinese competitive space, and we believe that there are some to be found in Haier's experiences.

Peter Drucker, the twentieth-century management gurus' guru, predicted as long ago as 1997 that China would be a source of fresh, new managerial insights in much the same way that Japan's industry revolutionized the way we all thought about organizations in the early 1980s.<sup>3</sup> Interestingly, but not surprisingly, Japan's contributions were largely from the operations world, where Japanese companies had built their competitive strengths for succeeding in the global marketplace. The fact that Toyota, for example, is so strong today as a global player is largely dependent on its ability to build reliable, affordable cars, and the reason that it can do this is directly traceable to the management thinkers—both academics and practitioners—who created new approaches to considering operations and supply chains.

What about China, then? Where should we look for a rich source of Chinese managerial secrets? The shelves of international bookstores are already loaded with Sun Tzu's *Art of War* and other similar works of classical thought, but these, in and of themselves, are not a practical source of business insight. Interesting as they may be, they have not had a profound impact outside China (or, we suspect, even inside). Similarly, we are told by China scholars that China excels in building effective interpersonal relationship networks (*guanxi*) within the cultural context of hardworking, face-conscious, bureaucratic, bargaining-oriented, and harmonious approaches to business. Insightful as such learnings might be, once again they are too vague and too culturally specific to gain our attention in the way that Drucker likely imagined.

Where China truly does have something to offer the rest of the world in terms of managerial insight is in the organizing and leading of faster-paced operations and customer relations by some of its most interesting enterprises, and it is here that Haier has some experiences that the rest of us might benefit from. Speed matters today as perhaps it has never mattered before,

and the Chinese economy is, arguably, the fastest in the world at both the macro- and microlevels. Repeatedly we hear of instances where the Chinese elements of a multinational corporation are easily outpacing their foreign colleagues in taking on new projects and moving them to successful completion, often through the coordination of multiple partners in pursuit of the same goal. It is in such examples of organizational redesign, such as fast-moving project management, that we believe we should be looking for the Chinese Drucker. The story you are about to enter is very much about how one successful organization is outperforming all sorts of worthy competitors, foreign and domestic, on the basis of being smarter about its customers and faster in its activities, and building an organizational culture that strives to achieve these objectives in a consistent and reliable fashion by getting more contributions out of the talent it employs.

### **Strategy Is Choice and Execution**

This is also a book about how managerial choices come together to produce the strategic outcomes—speed, customer-centricity, the leveraging of talent—that an organization desires. Strategy can be many things to many people, but if we reduce it to its essentials, strategy is about choice—the choices you make, and the choices not made—and about execution, for without execution, choices are only dreams.

Faced with competitive uncertainty, firms make choices, or they don't. Either way, their behavior in a marketplace is the outcome of such decisions. Successful firms either make better choices than their rivals or make the same choices and execute better and as a result outperform the others. A great strategy is marked by two characteristics:

- The choices made are appropriate for the competitive situation that the firm is in.
- The choices that are made can be executed.

This is at the heart of everything we look at from this point on: What choices were made? Were they appropriate to the world around the enterprise? What were the competitors doing? And how well did the firm in question execute?

## **Choosing the Purpose of the Business**

Probably the first and foremost choice to be made by any commercial organization reflects the purpose of the business. This sets the stage for everything that comes next; it speaks to the philosophical soul of the enterprise. Ironically, however, despite the importance of such philosophical foundations, it is more typical that whenever change (and culture) are discussed in organizational settings, it is structural change that receives all the attention, probably because of the tangibility of the changes being instituted and their visibility. In discussions of grand strategy, frequently the implicit view accepted is, “Traditional companies are ends in themselves, and the individuals joining them are means for their growth and perpetuation.”<sup>4</sup> Only after structure is determined do we turn our attention to the organization’s *physiology*—the roles, decision-making processes, information flows, and so forth that determine how the organization moves. After this, finally, and only if there is any energy left, does the conversation get around to the matter of organizational purpose (probably because frequently it is so vague and ambiguous as to be meaningless). We think that this is a mistake. We believe, in fact, that the emphasis should be perfectly reversed: purpose first.<sup>5</sup> Then, and only after all of this is said and done and agreed on, should we examine physiology and, finally, structure.

The focus should always be on real managers making real choices, and this requires a fundamental understanding of the purpose that drives an enterprise. Despite this, in so many of the firms that we observe, too little attention is given to reflection regarding the purposes that the business serves and what

it hopes to accomplish as a result. Consequently, too many managers we see find themselves unable to escape the tyranny of strategic inertia: they keep doing what they've always done, only now they do it bigger, faster, or cheaper. Frequently in such instances, choice gives way to extrapolating legacy. Yet as one consulting firm has observed, this is not the only way to work and choose; it is only the most familiar:

The most common template for large-scale modern business design, the multidivisional corporation, is not the only way to do it. The multidivisional form, first realized by General Motors in 1920, has become the standard form today. While phenomenally effective in some ways, the multidivisional form also has significant weaknesses when it comes to innovation.

There are things that seem “obvious” about organization design that are in fact not so obvious at all. Some things that we take for granted as fundamental are in fact only optional.<sup>6</sup>

We believe that the difference between “obvious” and “optional” is best discerned by starting with a reexamination of the purpose of the business.

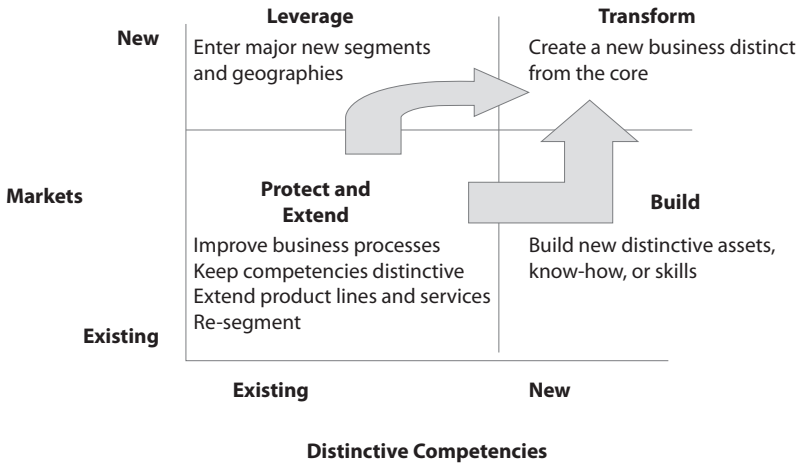
At this point in our conversation, Peter Drucker reappears, as it was he who asked more than a half-century ago: What is our business? And what should it be? The question, now so familiar as to appear trite, is in fact of fundamental importance. What the firm believes about its purpose, or its mission, and how clearly it is able to articulate those aspirations, is a necessary starting point for addressing the next question: How will we go about achieving this? Our task, then, in analyzing any company's approach to strategic change is not only to keep all three of these choices—purpose, physiology, and structure—in mind but also to be equally attentive to the sequence in which these choices are being made.

## Choosing How to Grow

To grow or not to grow? The choice, in practice, is not such a big one because most firms instinctively vote for growth. How to go about growing, however, is a much more important choice because there are many ways to attempt it. Here, capabilities and resources are critical. There is no reason to believe that all firms in the same industry will make the same choices because they are all starting out from different places in terms of capabilities or resources, or both, but in some way their choices have to reflect the common market that they are all competing in, and they have to be executable in a way that fulfills the dream that the choices were based on. An MIT study of globalization conducted only a few years ago acknowledged the variety of possible paths to competitive success: “There were winners (and losers) in every sector in every country but in none of them did *a single best model* [italics added] emerge” which led the authors to conclude, “It’s not an industry that’s important, it’s a firm’s *capabilities*.”<sup>7</sup>

Colleagues of ours have in fact portrayed the enterprise growth model as being one of either defending and, possibly, extending the existing market (traditional growth) or moving out in pursuit of new competencies or new markets (figure 1.1).

We should acknowledge that the choice of protecting and extending versus growth is a nontrivial one. It is perfectly fine in many instances to remain within the protect-and-extend quadrant and to grow, organically or not, along with the market you are part of. All too frequently, however, such a choice is complicated by outsiders who are penetrating your domestic market because they see it as a means for their growth. This in fact happened in many domestic Chinese markets in the late 1980s and early 1990s, which created a strategic decision point for the Chinese incumbents about whether to settle for sharing their domestic market or instead to aspire to a larger role on the global stage. One of the most important lessons of the work by Chakravarthy and Lorange, however, is that any movement out

**Figure 1.1 Enterprise Growth Model**

Source: Adapted from Bala Chakravarty and Peter Lorange, *Profit or Growth?* (Upper Saddle River, NJ: Pearson, 2008). ©2008 by Pearson Education Inc. Used by permission.

of the protect-and-extend quadrant should be done thoughtfully and carefully and never in a diagonal path requiring, simultaneously, both new market and new capability development.<sup>8</sup> Growth becomes clearly an either-or choice regarding new markets or new capabilities so as not to overwhelm the limited attention budget of any managerial team.

As a result of Chakravarty and Lorange's work, it seems clear that some firms choose to enter new markets with existing competencies, while others apply new competencies in existing markets. Neither path is necessarily superior to the other, provided the choices are both appropriate with respect to opportunities and realistic relative to the firm's execution capabilities. What is interesting for our purposes is to see how such choices are made, what their implications are for execution requirements, and what eventual alterations are necessitated within the organizational cultures involved.

In the story that you are about to embark on, what you will see is that Haier was forced to protect and hope for market extension for its place in the domestic Chinese market in the 1980s, in response to the incursion of Western household appliance companies led by Whirlpool. In fact, the domestic Chinese home appliance industry was hardly coherent and well defined at the time, and Haier was not much more than a local player in Qingdao. So Haier's story is a multifold decision story, where choices ultimately go beyond protect and extend to consider strategic moves based on which markets to enter and which capabilities need to be established. With each such choice, the firm fundamentally changed and, with it, the established organizational culture also needed to change. As a result, as we survey Haier's past three decades, we will repeatedly revisit its articulation of its purpose, the business model that it created in response, the culture that it believed it needed to reinvent in order to achieve its mission within a changing competitive context, and ultimately the structure it had to construct in order to do this effectively.

### **Anticipating What We Will Learn from Haier**

Haier has been an amazing success story in home appliances, particularly white goods (household appliances such as refrigerators and washing machines were initially white in color and so the term *white goods* has come to be associated with that specific part of the broader household appliance industry). The company enjoyed success first in the Chinese market and then in the global marketplace, and it has maintained this reputation for three decades. If we look at the reasons for this success, at least five big headlines must be acknowledged:

- *Innovation*: Haier has consistently led the white goods industry in product, business model, and corporate culture innovation.

- *Fast*: Haier has consistently moved faster than any other competitor, foreign or domestic, in its industry.
- *Customer-centric*: A major part of its claim to being an innovation leader and a fast mover has been its ability to connect with its customers, listen to them, and respond appropriately.
- *Talent engine*: Throughout its thirty-year history, Haier has been a magnet for Chinese talent and has worked to liberate that talent so that it can contribute more to the achievement of Haier's aspirations.
- *Leadership*: Without the exceptional leadership that Haier has had, none of this would have been conceivably possible.

These are all outcomes, however. Everyone wants to be “innovative” or “fast” or “customer-centric,” yet most fall short of their aspirations. What Haier has done is to make the right managerial choices to raise the likelihood of actually achieving these aspirations. What is instructive as well is that all of these outcomes are interconnected in a way that ensures mutual reinforcement and amplification. In the chapters that follow, we map the managerial choices that have shaped Haier's culture and will argue that part of Haier's genius has been that the choices it has made, even at the most granular level, are focused directly on the vision that is driving its strategy and that each choice is in concert with each of the others, mutually reinforcing them all.

One thread in particular that runs through all three decades of Haier's choice making is a consistent desire to unleash the talent employed as a means of differentiation in a competitive market that is flirting with commoditization, so that Haier truly does become, in fact as well as in aspiration, faster, more innovative and, as a result, more customer oriented. The bottom line is greater value for the customer, which drives shareholder value as well. The motor that drives this is the creation of unique autonomous, self-organizing microbusinesses, which Haier refers to as

ZZJYT<sub>s</sub> (*Zi Zhu Jing Ying Ti*, which can be translated as “independent operating unit”). They are run as small profit-and-loss centers that foster both a greater expression of individual talent, through the release of entrepreneurial energies, and a more precise distribution of incentives and rewards for those who contribute. Although such initiatives are not new to the business world, it is both the scale of this effort (Haier had eighty thousand employees in 2012) and the tightly integrated and mutually reinforcing architecture of the approach that attracted our attention.

This is not pursuing being faster or more customer-centric for its own sake. Quite the contrary: Haier desires to be fast, innovative, and customer-centric in order to achieve its vision and mission of “becoming the industry leader and providing competitive beautiful residence life solutions to customers.” Perhaps even more interesting is that as challenging as these aspirations may be by themselves, to desire to achieve all of them within the organizational culture of a large, traditional Chinese firm in a mature industry is hard to imagine. It is truly something that Jim Collins, author of *Good to Great*, might refer to as a “Big Hairy Audacious Goal.”<sup>9</sup> When you add in the more than two thousand years of China’s Confucian tradition, as well as the legacy of China’s Maoist dogma, it seems impossible to even conceive of such an achievement. Then, in defiance of all of this, add as well the belief that China’s abundant talent should be the idea engine that achieves all, and you have what seems to be a mission impossible. However, we will see throughout this book that what Haier has achieved is not impossible. It is the result of well-thought-out and well-designed change leadership interventions.

## **What You Will Learn in Each Chapter**

Strategic initiatives must be appropriate to the world around the organization, and in this instance the world that we will look at is that of the white goods sector of home appliances. This is an increasingly concentrated, old-economy, mature

industry in Western markets, where product offerings have flirted with being close to having undifferentiated commodity status and price competition has been severe. The opening of China promised some new opportunities to this industry, but over the thirty-year span of our review, Chinese competitors have evolved, resulting in an increasingly competitive environment in the domestic market, and the global one as well, which has become much more highly contested and complicated. Chapter 2 explains this world in detail in order to establish the industry context in which Haier's strategic reinvention of its business model and corporate culture has taken place.

Beginning as the Qingdao Refrigerator Factory, a collectively owned enterprise in a coastal town in northeast China, today's globally recognized Haier Corporation has reinvented its business model and corporate culture at least three times in as many decades. One way to think of this is that we've seen at least three different Haiers during that period. In chapter 3, we add flesh to the skeleton by describing the nature of Haier over this span of time and why and how these changes occurred. The chapter provides a rich narrative of the business model reinvention path that Haier has been on for three decades.

Haier's story of continuing reinvention has also been one of persistent pursuit of talent liberation. As we approach the latest reincarnation of Haier's corporate culture, there are six key themes that run through every aspect of the experiment:

- The unleashing of talent through the creation of self-organizing, autonomous work units that essentially run the business
- The coupling of freedom and control through the use of strategic income statements for each autonomous work unit
- The self-governing of the autonomous work units
- The linking of individual value creation to the total corporate value added

- Creating a capacity for responsiveness and improvisation (spontaneity) based on preestablished and contractually binding expectations
- The establishment of a self-correcting governance system

In chapter 4, we go through each of these principles in careful detail as we set out the logic underpinning the entire cultural reinvention effort. These are the first-order aspirations that management has chosen to drive the overall objective of unleashing talent in order to be more innovative and to move faster.

Many organizations contend that they are becoming more customer-centric, more innovative, or faster (or all of these), but all too often, careful investigation reveals business as usual. In such cases, the aspirations of leadership will not be realized. What we find worthy of note with respect to Haier is that its leaders really are trying to execute on their aspirations. Chapter 5 represents an attempt to provide sufficient granularity in understanding Haier's approach to organizational design and governance so that readers can appreciate the managerial choices that Haier has made to compete in demanding markets. We believe that this chapter provides unique insight into how a major, innovative Chinese global player conducts its business at a level of detail that has not been seen elsewhere. The chapter includes numerous illustrations and examples of how Haier's goal of "zero distance with the customer" is being achieved, as well as notes from the field in the form of coauthor Fang Liu's firsthand experiences within one of Haier's self-organizing, autonomous work units.

We believe that Haier's activities should be seen with reference to some thoughts on what benchmark high-performing organizations are doing and have done. Much of this literature comes out of the popular business press and offers a mythology of successful corporate performance. We summarize this mythology in chapter 6 and use it to consider how well Haier's business model development agrees with what might well be considered

best practices of high-performing organizations. In addition, this chapter looks at four other reference organizations that have also attempted to unleash the talent they employ through large-scale cultural reinvention: ABB, Nash, Oticon, and the Morning Star Company. We tell their stories and compare them with Haier's experiences. Our conclusion is that not only are Haier's reinvention experiences at the cutting-edge of what the management profession currently regards as "thought leadership with respect to change management," but they also reflect a coherent and well-thought-out approach to cultural architecture for increasing the probability of achieving its strategic aspirations.

Underlying much of what Haier is trying to achieve with the strategic initiatives chronicled in this book is an attempt to fashion a truly strategically agile organization. Any such effort inevitably invites a comparison of the efforts taken and the admonitions of the Nobel Prize laureate economist Ronald J. Coase regarding the relationship between increased organizational complexity and increased transaction costs. In chapter 7, we conclude that Haier has crafted a new form of hybrid organization that emphasizes benefits from organization over Coasean transaction costs and mixes market incentives with controls in a novel fashion. Most firms will likely choose not to go down the path that Haier is exploring, or at least not to go down this route as far as Haier has chosen; nonetheless, the Haier experience provides a valuable reference point for adaptation in the never-ending search for a superior organizational approach.

There is much to be learned about business model innovation, what it takes to really invent and reinvent a new corporate culture, and what it's like to work within a Chinese global organization. In chapter 8, we review all that we have learned from the Haier experience and summarize it in an easy-to-recall format.

