



THE WILLIAM DAVIDSON INSTITUTE
AT THE UNIVERSITY OF MICHIGAN BUSINESS SCHOOL

***From Survival to Success: The Journey of Corporate
Transformation at Haier***

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Working Paper Number 207
July 1998

Comments Welcome

Presented in the Davidson Institute Research Workshop *Organizational Change in
Transition Economies*
Ann Arbor, Michigan
September 26-28, 1997

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**FROM SURVIVAL TO SUCCESS:
THE JOURNEY OF CORPORATE TRANSFORMATION AT HAIER**

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Abstract

Paper submitted for the
William Davidson Institute Conference:
Organizational Change in Transitional Economies

We appreciate the generous financial support of the China Europe International Business School in sponsoring this research project and the research assistance of Yang Lin. [vers980721]

INTRODUCTION

In a business environment that changes radically and rapidly, an organization's capacity to change is a critical success factor. In China's transition from a planned and administered economy to a competitive, customer-driven one, and from an isolated and protected market to a globally integrated one, the legacy enterprises face pressing needs to reinvent themselves. They must become more efficient in production, better in product quality and customer service, and faster in speed. For enterprises that are unwilling or unable to change, the consequences are clear -- losing market share, shrinking operating margin, going bankrupt and/or being acquired by a stronger company. Their inevitable future is a more open marketplace and more competition from domestic and international competitors. The ascent of Zhu Rongji as Premier and the

vigorous promotion of his accelerated reform program make clear that State-owned Enterprises that do not reinvent themselves for the new environment will not be dealt with by the State sympathetically. Though this is not the first assault in post-reform China on State-owned enterprises, this is surely one of the most serious.

This article examines a rapidly changing industry in China – consumer durables, specifically refrigerators -- where customer choice is significant and global competitors are emerging. The sector has specific features that make it an attractive focus for this study. Domestic enterprises producing consumer durables are under tremendous pressure to change. Very large international players have landed on China's shores and have attempted to build manufacturing capability and market share, hence the domestic industry squarely faces a potentially fatal competitive threat. At the same time, some of the domestic makers have already made a very successful response, whereas others have not. Finally, the domestic market grew very quickly in the first half of this decade, providing a platform for rapid growth for companies that successfully addressed the opportunity. In sum, the sector offers the opportunity to see the dynamics of international competitive pressure on the domestic industry and also analyze different responses within the group of domestic enterprises.

Specifically, in this article, we will describe and analyze how a reportedly successful player -- Haier Refrigerator Company -- was able to transform itself from a vulnerable and unprofitable operation into a competitive company increasing focused globally. The Haier story is a complex and shaded story, which is still emerging. It offers interesting evidence for the study of a reforming enterprise, bringing many tools of an innovative management team to a struggle with the burden of its own legacy.

By studying the refrigerator industry and Haier Refrigerator, this article aims to achieve three objectives¹:

- 1) to describe the evolving business perspective and orientation of a Chinese enterprise in a consumer industry that has been widely identified as a model of enterprise reform
- 2) to identify the drivers of change faced by Chinese enterprises in a consumer industry, both as perceived by the managers within the industry and evidenced by external data
- 3) to investigate the critical factors that determine the organizational capability of change in Haier Refrigerator Company

As we are only studying one company within an industry, the findings of this article should not and cannot be over-generalized. Nevertheless, as Haier is now a highly regarded company in China, it is identified as a model of corporate transformation for other enterprises, and as such can offer some useful insights. These insights touch on both the ideology of enterprise reform and the real mechanics of a successful example. The ways and means of successful enterprise reform will increasingly be codified in ideological statements by the leaders. They will not only address the national good to be achieved, but they will identify factors—we might even say “mechanics”—of success.

To accomplish our objectives, the article is structured in four sections:

- Section 1 analyzes key emerging trends in China’s enterprise reform and refrigerator industry
- Section 2 reports on our survey of Haier management and their perception of change forces

¹ This paper reports an ongoing study that examines two large enterprises in Chinese refrigerator industry. Haier, a highly successful Chinese firm in Qingdao, is used to compare with another refrigerator company in Shanghai which has changed from a market leadership position to a minor player in the industry. As data collection is not complete for the Shanghai enterprise during the writing of this article, only information about Haier is presented.

- Section 3 provides an overview of Haier Refrigerator and discusses the significant achievements Haier has presented to the world.
- Section 4 analyzes the critical success factors of organizational change at Haier, both from the internal perception of the process and an external analysis. Findings from both on-site interviews and a survey instrument are summarized.²

Section 1: Key emerging Trends in China's Enterprise Reform and Refrigerator Industry

China's state-owned enterprises and their behavior have been extensively discussed in both academic and journalistic publications. It is not a main focus of this paper. However, the intensity of the need for enterprise reform and China's commitment to making progress have been illuminated recently by the central position of enterprise reform at the recently concluded Fifteenth Party Congress. Not only was enterprise reform the leading issue in Jiang Zemin's public presentations around the Congress. The very reshaping of the central committee and politburo membership has widely been regarded as an effort to create a genuine leadership meritocracy capable of planning and implementing urgently needed reforms for state-owned enterprises. Subsequently in March, the ascent of Zhu Rongji to the Premiership was formalized, and the Chinese People's Political Consultative Congress enthusiastically endorsed "Boss" Zhu's

² A brief note on research methodology: Information presented in this article was collected through four sources: 1) library research on the analysis of refrigerator industry; 2) company publications of Haier Refrigerator; 3) interviews with five senior and middle managers in August, 1997; and 4) a survey research from 59 managers at Haier. Appendix 1 provides additional details about the research methodology.

ambitious program for reform, which was largely grouped under the campaign title “Seize the big, release the small.”

This is not the first time since Deng’s economic reforms were launched in the late 1970s that attention has been focused on the reform of State-owned enterprises. As the series of important Shanghai leaders consolidated their power in Beijing—Jiang Zemin, Rong Yiren, Zhu Rongji, Wu Bangguo, and others—the economic agenda has become the paramount agenda of the national leadership. But the process of enterprise reform has been unsteady, because the optimal balance of economic tradeoffs is yet to be found. Midway through 1998, the recent push is being softened. The state banks are again being called upon to aid ailing enterprises, long-awaited housing and health reforms are being delayed. Central planners are exerting active pressure on enterprises that have been profitable to create a kind of welfare takeover of struggling ones, and concern is being expressed about excessively rapid privatization of small and medium sized enterprises for a number of reasons. This evolving transitional situation inevitably sounds a call for study of the best of the genre in China search for solutions.

The stated policy to “release the small” constitutes a threat to the very existence of any but the largest State-owned enterprises. Over a decade ago as the first formations of enterprise reform policy were taking shape, the predecessor of Haier, Qingdao Refrigerator Company, was struggling to bring costs in line with production. It was an era when the risks of making losses was not great, yet new management brought in to reengineer the enterprise had sufficient vision to know a different era was approaching. Haier at that time was far short of a performance level that would place it among the top 1000 companies that the State eventually committed to maintain, and Haier’s new top management committed themselves to changing that. As policy toughened from the early 1990s, Haier was threatened with the end of easy credit from the State

banking system and the end to an array of visible and invisible subsidies and protections from the provincial and municipal government. Under the toughened approach to underperforming enterprises, unresponsive management faced the prospect of removal or the threat of consolidation into larger entities.

Business imperatives that faced consumer product companies had many elements. First was the need to acquire capital, but significant State-owned companies were generally prohibited from giving up more than 49% of their equity and surrendering management control. Second was the need to develop revenue from operations, but obsolete product and process technology and extreme labor burdens and regulatory costs made this difficult. Third was the need to answer China's call for the development of truly Chinese brands, to fend off the strategic assault of MNC brands that had already grabbed major share in non-durable consumer product markets, like soft drinks, detergents, and health and beauty aids.

The combined pressure of these imperatives made for an interesting scenario in the consumer durables sector. Many of the joint venture discussions with major international players turned out to be unattractive options for both sides and they failed. Several domestic players committed themselves to going it alone, and were able to buy in technology on a license basis or with a contractual joint venture with no equity dilution. Several studied the process of brand development and management, and resolutely committed to building market share under their own historical brand name badges. Finally, in a very significant reorientation of strategies from the late 1980s, enterprises managers turned from the single-minded pursuit of new capital through transfer of equity into foreign invested joint ventures to the exciting prospect of acquiring capital through IPOs on domestic, Hong Kong, or even foreign stock markets. In other

words, the management perspective in many enterprises was starkly reoriented toward product and process improvement, brand development, and finance.

In this historical moment, the achievements of successfully reforming enterprises were destined to gain great importance, as the new leadership searched for models at home to guide the mass of unreformed enterprises out of their present mire and into the next century. The Haier story is one of significant basic product and process improvement, strong brand development, and successful initial public offerings of Haier stock. The combination of exposure as a model enterprise and disclosure as a publicly traded company has also opened Haier for examination in a way that few other enterprises have been opened, and this has been much to our benefit for this research.

The refrigerator industry was an excellent sector from which a model enterprise could emerge, for the following reasons:

1) High growth and revenue.

With the increased purchasing power of Chinese consumers, demand of refrigerator grew rapidly in the last decade. Refrigerator demand followed the extremely steep demand curves that have been characteristic of market developments in China's urban markets. In spite of documented widening of the gap between income cohorts throughout the country, there is a high degree of homogeneity in buying behavior. Durable products like color televisions, cameras, VCRs, and refrigerators can ascend from single figure household ownership to 80-90% in China's coastal cities over a period as short as five years. This steep incline provides the opportunity for very fast market expansion, share shifts, and revenue development for reforming enterprises that badly need brand recognition and fast revenue enhancement. However, it also creates stress and danger in manufacturing sectors that lack forecasting capability, lack flexibility

to respond to dramatic changes in demand, and lack depth in their product portfolios. Lack of forecasting capability, manufacturing flexibility, and portfolio depth are legacy elements from a classic command economy past in which production volume was to dictated quota and the manufacturers took absolutely no market risk, responsibility, or initiative.

It is estimated that the annual sales of refrigerators grew by more than 20% every year, reaching 28.1% annual growth in 1994. The total demand for refrigerators in 1996 is estimated to be 13 million units. Like many sectors in China, in spite of –or maybe because of--the rapid growth in market, the industry immediately faced the problem of over-capacity. Production capacity of all refrigerator manufacturers in China is estimated to be 20 million units. Indeed by 1997, Haier and other manufacturers found themselves sitting on escalating inventories of finished goods, which began to erode their new found economic viability.

2) The industry is increasingly consolidating to a few key players

In 1995, there were 14 manufacturers who had an annual production capacity of more than 100,000 units. Altogether, these manufacturers accounted for 90.4% of the total market share and the top three producers accounted for 34.5% of the total market share.

In 1996, the number of manufacturers that produced more than 100,000 per year consolidated to 13. Following this consolidation, the remaining manufacturers accounted for 93.04% of the market share. In addition, the top three producers enjoyed 48% of the market share, with an annual production capacity of more than one million units in 1996. Based on estimated 1997 results, the market share enjoyed by the top three producers is even higher, accounting for 62.9%. As the industry becomes more concentrated, a large number of smaller

players are either merged, acquired, or closed. The principle of “releasing the small” is clearly at work.

Based on the monthly reports compiled by the Chinese National Statistics Society (1996), the market share of the top six players in 1996 is as follow:

Rongsheng	18.98%
Haier	17.54%
Xinfei	11.74%
Meiling	8.36%
Shangling	7.36%
Changling	5.76%

Total	69.74%

Using February 1996 as a starting period, Figure 1 summarizes the cumulative sales volume of the top six producers in 1996 and early 1997. Though Rongsheng is still the market leader, its position appears to be under intense assault by Haier which grew more rapidly in the last few years.

Insert Figure 1 about here

There is a crucial caveat to attach to this industry data. Share estimates are based on units shipped from the factory, and those numbers are significantly distorted by certain reporting practices. In the case of Haier, it appears that some of the significant finished goods inventory that did not actually reach end users was “sold” to the group holding company or possibly to other enterprises in the Haier group. The publicly traded company, Haier Refrigerator

Corporation, is only one member of the group, and Chinese accounting regulations do not require the disclosure of sales to related parties in a way that would uncover this kind of transfer. This is an important part of the evolving Haier story, because it suggests critical vestiges of pre-reform problems and behavior, and it indicates that Haier's management is far from comfortably secure in a trajectory toward market leadership and continued profitability.

3) Customer expectation and composition are shifting

Customer expectations when purchasing a durable product in China are both rising and diversifying as the market matures. Generally speaking, there are three major market segments with different customer expectations:

- **Customers in major cities:** This market has become quite saturated now. New purchases are generated from the formation of new families and the replacement of old refrigerators. As customers are more affluent in major cities, they are also more demanding in terms of both the functionality (e.g., computer control, disinfectant, no frost) and external design (e.g., color, style, size) of refrigerators.
- **Customers in second-tier and inland cities:** This market is about 50% saturated. The expectations for advanced functions are lower. The key concerns are price and basic functionality.
- **Customers in rural area:** This is an emerging market. The key customer buying criteria in this market are price, durability, and tolerance for unstable electric voltage.

To meet the diverse demand of customers, Haier currently claims to have more than 3,000 models of refrigerators. In addition, a new model is introduced every month nowadays. A future analysis of Haier's adaptation might well look at some of the underlying business

processes, including market analysis, product planning, and cycle-time management. Here again we have critical vestiges of pre-reform problems and behavior, with a large number of sub-scale models and an apparent inability to take out of production unprofitable or unmarketable products.

4) Threat of global competitors

With the aspiration of China to join the World Trade Organization, local producers understand that competition from global competitors is inevitable and threatening. The pressure is tremendous to upgrade product quality, service, and technology on the one hand while reducing cost on the other. Moreover, several leading global players in Asia have already started their joint ventures in China, including Samsung in Suzhou and Matsushita in Wuxi. Non-Asian multinationals, including G.E., Amana, and Whirlpool, were increasingly active during the era of rapid market growth, some with multiple joint ventures and substantial investments of capital. Local players understand the future either requires deep change or will bring slow death. The combination of success by the domestic makers during the era of rapid growth and concern about the saturation of the market has brought about some abatement of competition, as several of the second wave of international players have either slowed development or closed down talks and left.

The threat of global competitors has forced a revision in the aspirations of enterprises like Haier, to grow beyond a business objective of building and protecting the domestic Chinese market to a broader goal of becoming global players themselves. This has been fueled by two important global themes. First, it is a common talking point of China's leadership that several of China's top enterprises will make it to the *Fortune 500* list through a rapid process of consolidation and growth. Second, management like that of Haier who have tasted the rapid

infusion of capital available through successful public offerings are increasingly interested in commanding recognition as global rather than Chinese players to ramp up access to capital markets all over the world. There is some indication that this has taken their attention off the very critical internal reform and organization rebuilding initiatives we are discussing here and imperiled the sustainability of the reform effort in the core enterprise itself. This is an issue that lurks behind our detailed discussion below and will be a thread in subsequent publications on Haier and the industry.

Section 2: The perception of change forces

Above we have discussed the environment in which Haier's management faced the necessity of reform and some of the overarching factors that have prompted action over the last decade. To understand the specific drivers for change as perceived from within the refrigerator industry, we asked the respondents at Haier to rank order nine possible drivers for organizational change in their company ("1" being most important, "9" being least important). The list includes both internal (*e.g.*, new top management or board) and external forces (*e.g.*, government mandated change). This component of the survey was not specific to the durable consumer goods sector nor is it specific to the Haier experience. The result is summarized as follow:

<u>Drivers for Organizational Change</u>	<u>Rank Score</u>
Challenges from competitors outside China (including joint ventures)	2.69
Driven by customer requirements	2.93
Challenges from Chinese competitors	3.09
Driven by technological changes	4.91

Transition from planned to market economy	4.98
New top management team or board of directors	6.20
Change in corporate governance (e.g., listed as a joint-stock company)	6.29
Learning from joint venture partners or competitors	6.35
Mandate and stipulation from government/supervising unit	7.56

The survey result provides information that reinforces our conclusion from the industry analysis. First, the key drivers for change are all related to market mechanisms, including competition from inside and outside China and evolving customer demands. This focus on market factors represents a significant transition from the first decade of economic reform, when China's state-owned manufacturers saw their salvation entirely in the acquisition of new technology. Under that focus, they considered their futures organizationally only in terms of government-mandated reorganization campaigns, like the management responsibility system implemented in the mid 1980s. Reorganized management focused primarily on the acquisition of new product technology and foreign capital. Few of the changes prompted by the reforms of the 1980s addressed the key change drivers identified in this research, especially the set of customer and market issues.

The rather low significance accorded to new top management and directors is the result of the many changes that were implemented during the sixth through eighth five year plans (1980-1995) and the poor results achieved in most instances. A shift to technically competent management has been under way for nearly two decades now, putting to rest the *red vs expert* debate of the late 60s and 70s. Nonetheless, the range of technical competence itself has been narrow. Most of the managers placed at the top of major SOEs had their technical competence rooted in engineering backgrounds, not business, finance, human resources, or corporate

organization. Significant organizational change was beyond them in all but the exceptional case. Those who made serious progress in organizational development were self-educated in the process or made exceptional use of opportunities for foreign cooperation.

It is noteworthy that the very bottom of the list of perceived change factors is the potential impact from policy and guidance by the government, especially the supervising industry ministries. Echoing the ancient adage “Don’t worry about there being a government in place; just worry about being governed by it,” Haier managers obviously believe that central planners cannot even plan to eliminate central planning. This last point makes very clear that there has been a major transition of management focus from factors in a planned context to those being proven out in a market-driven context, and that transition is rapid and profound at Haier..

Section 3: Haier: Overview of background and change

In this period of transition, Haier Refrigerator is clearly one of the most successful firms in transforming itself. The predecessor of Haier Refrigerator is Qingdao Refrigerator Company, a company which had been operating in the red and struggling with its survival in the early ‘80s. In 1984, Ruimin Zhang, a deputy general manager of the bureau that supervised the struggling, volunteered to take over management. He inherited a debt of RMB 1.47 million. It was not an uncommon practice for the supervising bureau to send new management down to a struggling SOE. But it was uncommon to experience the level of success Zhang achieved. Under his visionary leadership, the company achieved the following dramatic results between 1984 and 1995:

- Production volume: increased by 13,518 times
- Profit: increased by 71,370 times

- Sales revenue: increased by 1,245 times
- Sales revenue per employee: increased from RMB 2,401 to RMB 950,000
- Asset: from a debt of RMB 1.47 million to an asset of RMB 13 billion
- Staff: 1,200 to 12,386
- Quality standard: certified by ISO9001
- Corporate ranking: #107 among the 500 largest Chinese enterprises
- Brand name: The most preferred brand name in the appliance industry
- Export: Germany, Japan, and European Union

Though the refrigerator industry is a very competitive industry with a lot of players, Haier was able to quickly establish its strong market position in 1996 through a combination of various strategies: total quality management, customer service, and technological innovation.

The complete significance of Haier's transition is not told by these bullet points and figures alone. Having reached a sale figure of \$1.2 billion in 1997, Haier's management now has set a goal of being one of the top 500 companies in the world. To reach that goal, Haier intends to expand into a broader line of consumer electronics and potentially into pharmaceuticals. For resources to fund the expansion, Haier plans to go to capital markets in Hong Kong and New York. They have recently acquired West Lake Electronics as a foundation for consumer electronics business. They already have manufacturing plants overseas in S. E. Asia, and they currently have plans for plants in Mexico and South Africa. We can distill from these current events a list of significant qualitative achievements for Haier in managing their organizational change that distinguish them from unreformed SOEs:

- Developed and pursued a product diversification strategy
- Developed and pursued a geographic diversification strategy
- Created substantial, national equity in their key brands
- Developed a respectable corporate "face" and embarked on a global corporate image effort, including regular press exposure in channels like the *Far Eastern Economic Review*

- Executed an acquisition shaped by a product development strategy
- Established a presence overseas for business goals significantly beyond moving capital abroad
- Fashioned a capital markets plan driven by business expansion needs

It is not that less successful SOEs have not deployed product diversification, geographic diversification, created brands, or gone to markets, nor have recent development proven Haier to be flawless in its application of these strategic ideas. Haier has distinguished itself in level of foresight and coordination required to make these moves serve long-term business expansion goals. Consumer electronics are developing more slowly than expected, and the pharmaceuticals acquisition was clearly too much stretch of their basic competencies. Development plans were somewhat curtailed by mid 1998, as the management faced the reality of limited cash to fund expansion. The current year will be an important one for adjustment, and Haier's ability to withstand a downturn in their core revenue-generating business will prove out the stability of the reformed organization and management. Still, without generalizing as to what kind of entity Haier now is, in terms of ownership and structure, or speculating as to how it will emerge from this decade, these organizational achievements do demonstrate the profound transition that Haier management has achieved, from its origins in the Qingdao Refrigerator Company, the debt-ridden enterprise they were originally given to rescue.

Section 4: Haier's Corporate Transformation

Our research demonstrates that Haier's distinct ability to conceive, initiate, and sustain organizational changes can be attributed to four key factors: corporate autonomy, visionary leadership, corporate culture, and management systems.

1) Corporate autonomy

Since 1984, Haier was able to enjoy a relatively high degree of managerial autonomy for several reasons. First, Ruimin Zhang, Haier's widely applauded savior, came from the supervisory bureau that oversaw the creaky Qingdao company. Therefore, he was well connected to the supervisory bureau, and he was able to obtain strong support from it. Second, Haier was a collectively owned enterprise rather than a state-owned enterprise. Hence, it faced relatively less stringent control and meddling from the government. Third, Haier was listed as a joint-stock company in 1993. As a result, it was able to enjoy an even higher degree of managerial autonomy than before, with primary accountability of top managers only to the Board of Directors.

Haier was quite fortunate to be allowed to operate in a relatively autonomous environment, and the management used the opportunity well. In turn, we believe the ability for Haier to gain more and more autonomy is attributed to the credibility and effectiveness of its senior management, so their development benefited from a virtuous circle of increasing success and autonomy. As the senior management team was able to deliver results year after year, Haier could gain the trust and respect from key stakeholders locally and in Beijing to run the operation in a more autonomous and commercial way. This exemplified the process of "corporatization" and "commercialization" that was basic to the reform ideology.

2) Visionary leadership

Ruimin Zhang is a strong and visionary leader. Instead of simply talking and preaching, he is walking and practicing what he believes. Instead of being satisfied with a local brand name

and local standard, he consistently aimed for a global brand name and world-class standard. Instead of being complacent and arrogant, he always nurtured a sense of urgency and crisis within the company.

The role modeling effect of Zhang as a formidable leader can be illustrated through several incidents. When Haier was just started, the enterprise provided very low wages and no bonus to its staff. However, Zhang was able to inspire his staff through his own hard work and personal commitment to the company. To give an example, even during the Chinese New Year Eve (an almost impregnable break time for family re-union), Zhang sacrificed his family time and traveled to different parts of China to develop new business opportunities.

Between 1984 and 1990, Haier emphasized total quality management. To ensure employees conform to the standardized process of production, Zhang developed "Thirteen Principles of Management." When employees failed to manufacture refrigerators consistent with the quality standards, Zhang showed them how those sub-standard refrigerators should be treated.

On one occasion, Zhang found out that there were 76 refrigerators that failed to meet the quality standards of the company. Then, he gathered all employees in the assembly hall. In front of all employees, he asked the workers who produced those refrigerators to destroy them in public. That unprecedented event was quite shocking to many employees as such a practice was unheard of at that time in China. By doing so, Zhang sent a powerful message to all employees: refrigerators that do not meet the quality standards are totally unacceptable. As a result of his commitment to total quality management, Haier won the "National Quality Award" in 1988.

Since the early '90s, Haier has set its goals to become a global player, not just a major player in China. In 1992, the company was certified by ISO9001. The company also starts to export its products to mature markets such as Germany and Japan. The senior management

believes that if the company can develop its market in those countries, it will also be competitive in China. As Wenjie Zhou, the deputy general manager, emphasized, “It is not good enough to establish our brand name in China. We need to develop a global brand name. Nowadays, there is no such a distinction between a global market and a Chinese market. The same is true in Europe, U.S., and Southeast Asia. If we need to survive as a viable enterprise, we need to be able to compete effectively anywhere in the world. Bearing the global market in mind, our pressures for improvement are tremendous.”

In order to help other senior managers look beyond the horizon and understand the urgency in spite of current business success, Zhang and Zhou often present facts and data for other senior managers to discuss and diagnose the business challenges. “Through a period of discussion on those facts and data, our management team can usually develop a consensus regarding the required strategies to address the issues and, more importantly, a sense of urgency to implement them,” Zhou said.

Zhang has received more international press and attention than any other large enterprise manager in China. He has sought this, having read the works of high profile international CEOs and recognized the importance of putting a “face” on a global company. This interest in external exposure is itself a sharp turn from normative manager behavior, and it exemplifies many of his personal and professional characteristics. Among these are his interest in being part of a global coterie of recognizable CEOs, his willingness to take the risk of a high level of international exposure, and his willingness to invite international scrutiny of Haier’s performance.

3) Corporate culture

Haier has a distinctive culture that is highly customer-oriented and performance-driven. Its emphasis on pre-, mid-, and after-sale services has won the “Five Star Diamond Award” presented by the American Quality and Service Society (Haier, 1996). As a matter of fact, it is the first Asian corporation to receive such an award.

In addition to a comprehensive approach to customer service,³ Haier has worked to develop a culture that focuses on customers. But how can such a customer-driven culture be created and maintained? One key strategy is to reduce the psychological distance between employees and customers. For instance, Haier requires that all employees go to sell products, listen to customers and understand competitors’ products on a periodical basis. For middle and senior managers, they are required to maintain customer contact on a weekly basis. For lower level managers, they are required to do so on a monthly basis while all other employees commit to do so on an annual basis. “The key emphasis of such customer contact is not just to see and listen, but to bring customer problems back to the company,” Zhou elaborated.

In addition, Haier employees are not allowed to say “No” to their customers. The customer is always correct. Even if they are wrong, they are to be treated as if they are correct. This level of customer orientation starts within the company. All along the production process chain, users in the next step of production are treated as customers of those in who have added value earlier. If the internal customers are not satisfied with the products, they can reject them, and the suppliers are obligated to apologize to the customers.

Developing a culture that focuses on customer satisfaction has been an elusive goal, not only for reforming domestic enterprises but for many international joint ventures as well. In the

³ Haier offers comprehensive customer service. First, customer orders can be made by telephone. Then, on-site customer installation and education will be provided. After one week, a service person will be sent to the customer

past, China's economy of scarcity has focused management attention on developing supplier loyalty rather than developing customer loyalty. This element in Haier's declared culture gets strong emphasis from Zhang, recognizing the difficulty of instilling the value in a durable and measurable way.

Haier also creates a strong performance-driven culture. If employees have strong track record of performance and high potential, they can be promoted rapidly regardless of seniority and the nature of their personal relationships with senior managers. For instance, Wenjie Zhou, the current deputy general manager of Haier Refrigerator, was actually a fresh graduate who joined the company in 1988. With less than 10 years, he was promoted several times to the current senior management position. Another good example is Mr. Bai who joined the company in 1995 and was promoted twice to the Deputy Director of Personnel in 1997.

Zhou reported to us,

At Haier, we treat everyone as a talent. Everyone is provided a fair opportunity to excel. It is like a horse-racing game. Everyone can participate in the game. If you run fast and ahead of others, you can have many opportunities to succeed.

In addition to targeted recruitment at top universities in China, Haier also maintains a high potential talent pool (with clear performance criteria to be met) and extensive training and development programs. As a matter of fact, after the first initiative on total quality management, from 1984 to 1990, Haier has continuously identified "people-based management" as its major initiative since 1991. By creating an environment where employees can excel, Haier can leverage people as its source of sustained competitive advantage. This is a very unusual level of

to ensure the proper operation of the refrigerator. After one month, a customer survey will be sent to solicit suggestions and feedback from customers.

attention to performance-related, as opposed to entitlement-related, human resource issues in a Chinese enterprise.

Haier's evaluation and reward systems also reinforce the performance-driven culture. First, every employee is appraised monthly for their performance. Employees are classified as excellent, satisfactory, and probationary, and their bonus is tied to such classification. Second, production teams are also appraised monthly and classified into four categories: "Meet the standard," "Can be trusted," "Exempted from inspection," and "Self management." The evaluation category of the production team determines the level of bonus of its team members.

There is also a rather unique stick in this carrot and stick process. Haier has an innovative practice, called the "Big Footprint" to deal with poor performers. Every day, Haier will identify "the worst worker" at each production team. The "worst worker" is then required to stand on the big footprints in his/her production area for a period of time to meditate and reflect for his/her poor performance. Haier believes that the primary reason for poor performance is more related to employee mindset than competency. The "Big Footprint" allows the poor performers to reflect on and reform their mindset and behaviors.

Here again, developing a culture that focuses on performance strongly backed by incentives has been an elusive goal, not only for reforming domestic enterprises but for many international joint ventures as well. In the past, Chinese organizations have focused on the durability and comprehensiveness of the relationship between the individual and the work unit, the *danwei*. An imperative to maintain economic and social stability drove an organizational culture that emphasized a sense of community, equality, and security at the expense of any differentiation for performance. Collectives and local township enterprises have been forced by

competitive pressures to address performance enhancement seriously, but few have brought the clarity to the process that Haier has.

4) Management systems

In addition to the corporate autonomy, visionary leadership, and corporate culture, Haier understands the importance of using management systems to institutionalize corporate transformation. Figure 1 illustrates Haier's model of growth and transformation in the last 12 years.

Haier conceptualizes growth and transformation as an uphill movement which is affected by four forces (see Figure 2). First, there are two forces that keep the company growing and changing: the incentive system (F1) and the self-management system (F2). However, there is a third force that can lead the company to go down or go back: the inertia and laziness of people (F3). Finally, there is a fourth force that can lead the company to go astray: deviation from corporate goals (F4). All these forces are fully considered when Haier initiates organizational changes. Paying considerable attention to the durability of the changes they are implementing, Haier focuses its evolving management systems at each stage so that changes are sustained.

Insert Figure 2 about here

In looking at the brief history of corporate transition Haier, Zhishu Hu, the Personnel Director, summarized the four stages of organizational evolution as illustrated in Figure 2. At Stage 1, employees were undisciplined and no management system was in place. The key focus of this stage is to change from random processes to standardized processes. During this stage,

Zhang issued a code of "Thirteen Principles of Management" that need to be followed by every employees. At Stage 2, after processes were established, the key focus was to build a consistent management system to integrate various processes and practices. At Stage 2, principles of total quality management was adopted. The new set of management practices led the company to win numerous national awards, including the National First Class Enterprises award and the National Quality Award. At Stage 3, the management system was further deployed and became more sophisticated, following the ISO 9001 framework. As a result, Haier refrigerators passed the ISO 9001 certification, a goal dear to most Chinese enterprises. At Stage 4, the management system was further enhanced from sophisticated level to advanced level, adopting the OEC approach of self-management from Japan. This lead to the certification of ISO 9001 of the company and other changes in management systems.

As we examined the change efforts at Haier, we were surprised that the company had adapted and utilized so many good leadership and management practices advocated in Western countries. Zhang has proven himself to be not only s a visionary leader who can inspire and lead the company to change continuously. He is also unusually capable of identifying and understanding management science and practices from outside China, and he is willing to blend such practices with legacy management practices into what, so far, has been a successful alloy. Such visionary leadership was strengthened by Zhang's institutionalization of an explicit leadership process, embodied in a team (through the development and promotion of high-potential talent) and solid management systems at different stages. Finally, Haier developed a corporate culture that drives the company to be customer and performance oriented.

But Haier is not a familiar multinational and Haier's native environment is not a familiar environment. So the theme of selection and adaptation of global practices becomes one of

critical relevance. As deployed at Haier, how are the change management strategies different from those prevalent in the West?

Based on the interviews and company publications, we tend to conclude that there are more similarities than differences in managing change, even though the difficulty of doing so in China is easily underestimated. The difficulty derives from the restricted autonomy most enterprises experience as a result of the ownership system, government interference, and an array of institutionalized elements from the legacy of four decades of socialist management and central planning.

Furthermore, external environmental elements like the poor social/welfare infrastructure can impose crushing costs on an enterprise regardless of its capability or stage of development. A serious shortage of visionary leaders like Ruimin Zhang conspires with the obdurate, conservative mindset of employees to foster organizations that are inward-focused, relationship-oriented, risk-averse. Such organizations focus on entitlements rather than performance, and they are not positioned to develop capability in any significant degree. Among the unfortunate outcomes of this set of obstacles is that competent individuals capable of creating real value in the system frequently structure their efforts toward personal gain rather than organizational benefit.

Table 1 summarizes some major barriers of organizational change in China that were identified by respondents at Haier.

Insert Table 1 about here

Haier's example demonstrates that a business-oriented culture and organization can be defined in China by leadership that is strong, charismatic, and competent. The extent to which it can be developed and sustained remains uncertain, although Haier's experience to date suggests that the tools to do so are rapidly being improved. At the very least, Zhang demonstrates that a highly capable CEO-level executive can be motivated and oriented toward contributions to organizational development. Any examination of the interview data argues that the ability of the leadership team to lead organizational changes in the midst of numerous external and internal obstacles is critical.

The survey instrument deployed at Haier sought details of the process of organizational change and the underlying change capability at Haier. This is also a step in assessing the extent of change and its sustainability. The survey instrument was administered among the managerial staff, and it included parameters of organizational change familiar around the world. The survey instrument was constructed based on change models suggested by several leading scholars on change management in the U.S. (Kotter, 1996; Ulrich, 1996). Nine critical dimensions or factors in change management are identified. The implicit assumption behind the change models suggested by Kotter (1996) and Ulrich (1996) is that corporations need to be effective in managing all these change dimensions in order that change initiatives can be successful. The nine change dimensions used in the present study include:

Dimension 1: Activate a change agenda

Dimension 2: Build a powerful coalition

Dimension 3: Create a compelling vision for the future

Dimension 4: Develop shared commitment

Dimension 5: Enable the workforce

Dimension 6: Fight quick victories

Dimension 7: Guarantee system alignment

Dimension 8: Hold people accountable for change progress

Dimension 9: Institutionalize change efforts

For each dimension, we developed two or three indicators to describe the observable behaviors that are essential in each dimension. After receiving the surveys from the respondents, a reliability analysis was used to assess whether these indicators can be scaled according to the dimensions we originally conceptualized. The overall result is encouraging. First, in six out of the nine dimensions (Dimensions 4-9), the behavioral indicators can be scaled appropriately into the dimensions as we originally intended (all Alpha coefficients exceed .75). Second, reliability analysis indicated that behavioral indicators of both Dimensions 1 and 2 should be combined in order that the reliability coefficient is acceptable. Third, the two behavioral indicators used in Dimension 3 were slightly different from the original three indicators we conceptualized. Appendix 2 lists the behavioral indicators used in the revised eight dimensions of change management.

Insert Figure 3 about here

Figure 3 indicates that Haier's capability of organizational change is quite strong. First of all, on a 5-point scale, Haier scores much higher than "3" in all eight dimensions. Especially, Haier scores very high in its capability to create a compelling vision for the future (i.e., the vision of a global player in a global market) and to institutionalize change (by integrating the change

initiative as part of corporate culture and overall business initiative). Most of other change dimensions score around 4.1 which is considered as good by Western standard. The only dimension that is relatively low is the ability of Haier to fight quick victories in order to sustain the momentum of change. By looking at individual behavioral indicators of the dimension, it is found that Haier scores low not because of its inability to demonstrate visible results in a reasonable period of time, but because of its leaders' negligence in sharing and celebrating results widely. As a result, employees may feel exhausted in part by the need to keep working on one organizational change after another. Based on this model, Haier's strengths and weaknesses in managing change can be systematically assessed and diagnosed. It is interesting that the weaknesses are not unrelated to three of the top four barriers to change identified by Haier itself, corporate governance, complex relationship networks, and the caliber of management staff. Solutions to these weaknesses will require sustained cultural change within Chinese organizations. On the other hand, the strengths have their cultural roots as well. The two strongest capabilities in Haier's profile are the ability to create a vision and the ability to launch campaigns for change, both well-documented and essential strengths of leadership in China in any capacity.

CONCLUSION

Though the present study focuses only on Haier in China's refrigerator industry, the article sheds light on several important observations about organizational change in China:

- 1) Some consumer industries like refrigerator are undergoing rapid changes through the consolidation of key players, increasing and diversifying customers expectations, and intensification of competition from both local and global competitors;

- 2) Change is inevitable for many companies in those industries in order to survive and succeed;
- 3) Major barriers of change in China are related to the ownership structure of Chinese enterprises, traditional mindset of Chinese people, and lack of good visionary leaders.
- 4) In spite of these obstacles, companies like Haier are reinventing themselves to be more customer and competition-oriented. Leadership teams, a defined corporate culture, and management systems are found to be critical at Haier.

As China continues to become integrated into the global economy, Chinese enterprises are operating more and more in a globally competitive way. In spite of the cultural, political, and economic heritage of enterprises in China, it appears that business leaders in China are fairly receptive to organizational systems and management styles in more developed countries like the U.S., Western Europe, and Japan. Our study indicates that many critical factors in managing organizational change in the U.S. are also observed in China's more progressive companies like Haier. Compared with our previous research in China (Yeung, 1986), Chinese enterprises have made significant progress in their journey.

As external observers, we developed an understanding of change at Haier that resonated with what was perceived by Haier management but differed in some ways as well. Whereas a sweeping change of top SOE managers has not in and of itself brought the degree of enterprise reform China's leaders seek, we believe in Haier's case that the intelligence, energy, and effort of chief executives like Ruimin Zhang are an absolutely necessary ingredient in the change prescription. This is true enough in any market. It will prove to be even more so in China, where there remains a deep cultural orientation toward loyalty and respect for leaders, a commitment to following the examples and dictates of powerful leaders, and a closer identification among managers and workers to individual leaders than to corporate institutions. In this respect, we

expect much of China's enterprise reform agenda to depend on the quality and visionary leadership of the CEOs who emerge to take control of individual enterprises.

Haier's managers expressed cynicism about the effectiveness of government mandated and directed changes. At the same time, it needs to be said that the outcome of their own transitional process is clearly the result of governmental policy trends that brought market forces to the environment in which Haier has developed. Whereas the government is not perceived as having been effective in creating a new enterprise architecture and directly fostering reform, it has permitted the evolution of enough competition that market-driven processes of filtering success from failure and driving change from market feedback are underway. Further, the government is getting out of the way of business development in distribution and retail, permitting producers like Haier to meet and understand their customers. This is highly novel for Chinese enterprises. It is only in a world of evolving competition that any state-owned entity can foster the organizational change necessary to become world-class in performance, in manufacturing efficiency, and in customer service.

Three points are not to be missed here, points that are both clear and critical. First, policies that have opened China's markets have contributed more to enterprise reform and development in China than policies that have been protective. Secondly, policies that have provided wider latitude for Chinese enterprises to build out their activities along the value chain have been more conducive to profound reform than policies that have perpetuated subsidy and allocation practices. Happily, it is on these points that our research findings and the most recent pronouncements of party leaders appear to converge. We are hopeful that the success of Haier in meeting competition will encourage leaders to stay the course of reform through market competition and forestall the temptation to build any new great walls. National leaders are now

tasked to move from talking and preaching to walking and practicing. In China, we expect the course of that journey will be neither straight nor easy.

The third point is a reminder that Haier's story is continuing to unfold. Management and the enterprise as a whole are not totally divorced from their pasts, both in terms of strengths and weaknesses, and the immediate environment still contains many hazards to enterprise reform. Many of these are outside the reach of an organizational change agenda, but can inflict damage on a company like Haier during a delicate transitional period. Among these are national and regional macroeconomic developments, potentially poor integrity in domestic commercial obligations, and social issues that might emerge from the powerful reform agenda. In recent financial reports and changes in the ownership arrangements among group companies, Haier has shown signs of stress and strain, but they remain relatively small countertrends against a twelve year trend of progress and gain.

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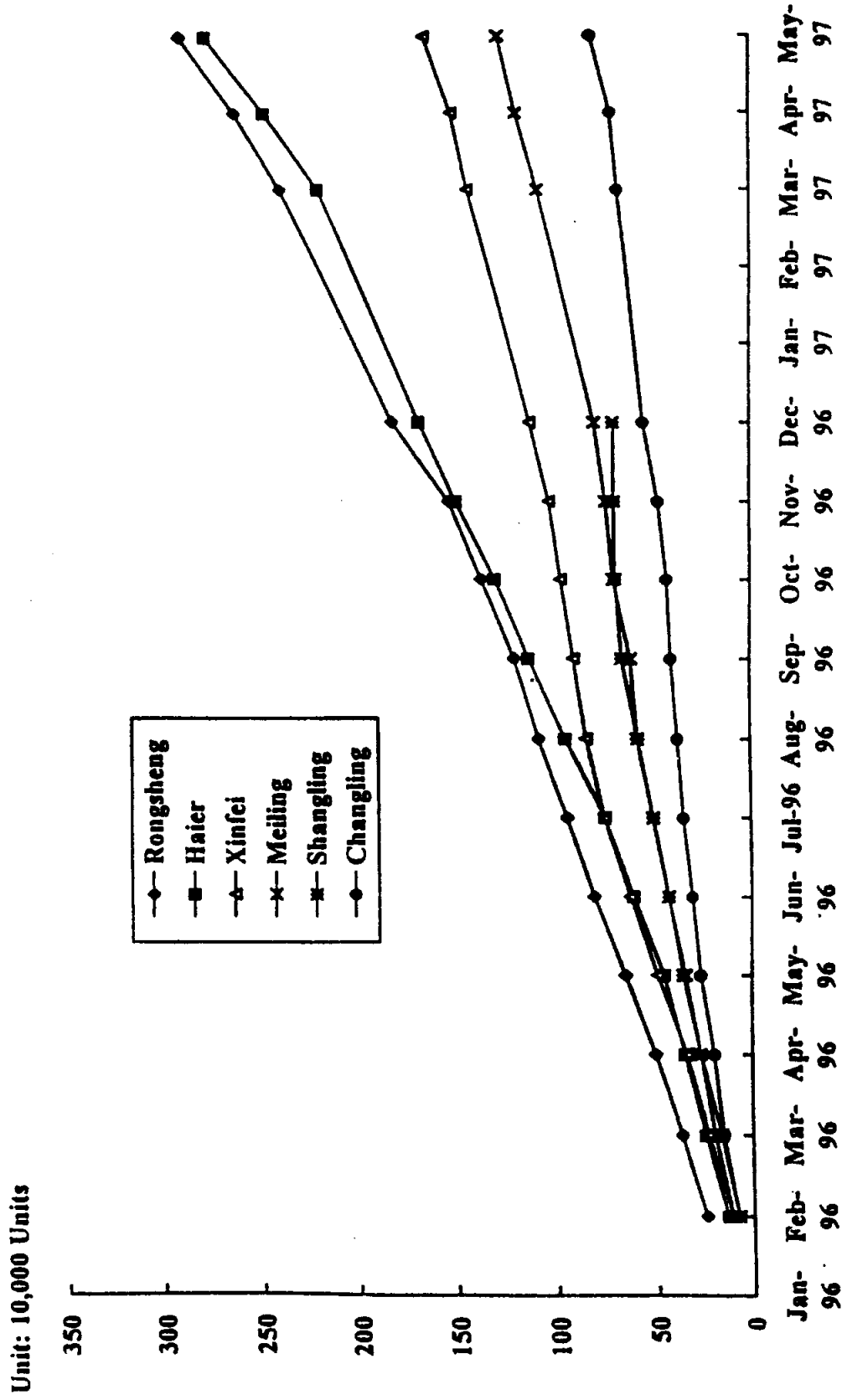
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Figure 1: Cumulative Sales Volume Among Six Leading Refrigerator Companies in China
 (February, 1996 - May, 1997)



Source: Chinese National Statistics Society

Figure 2: Evolution of Management Systems at Haier

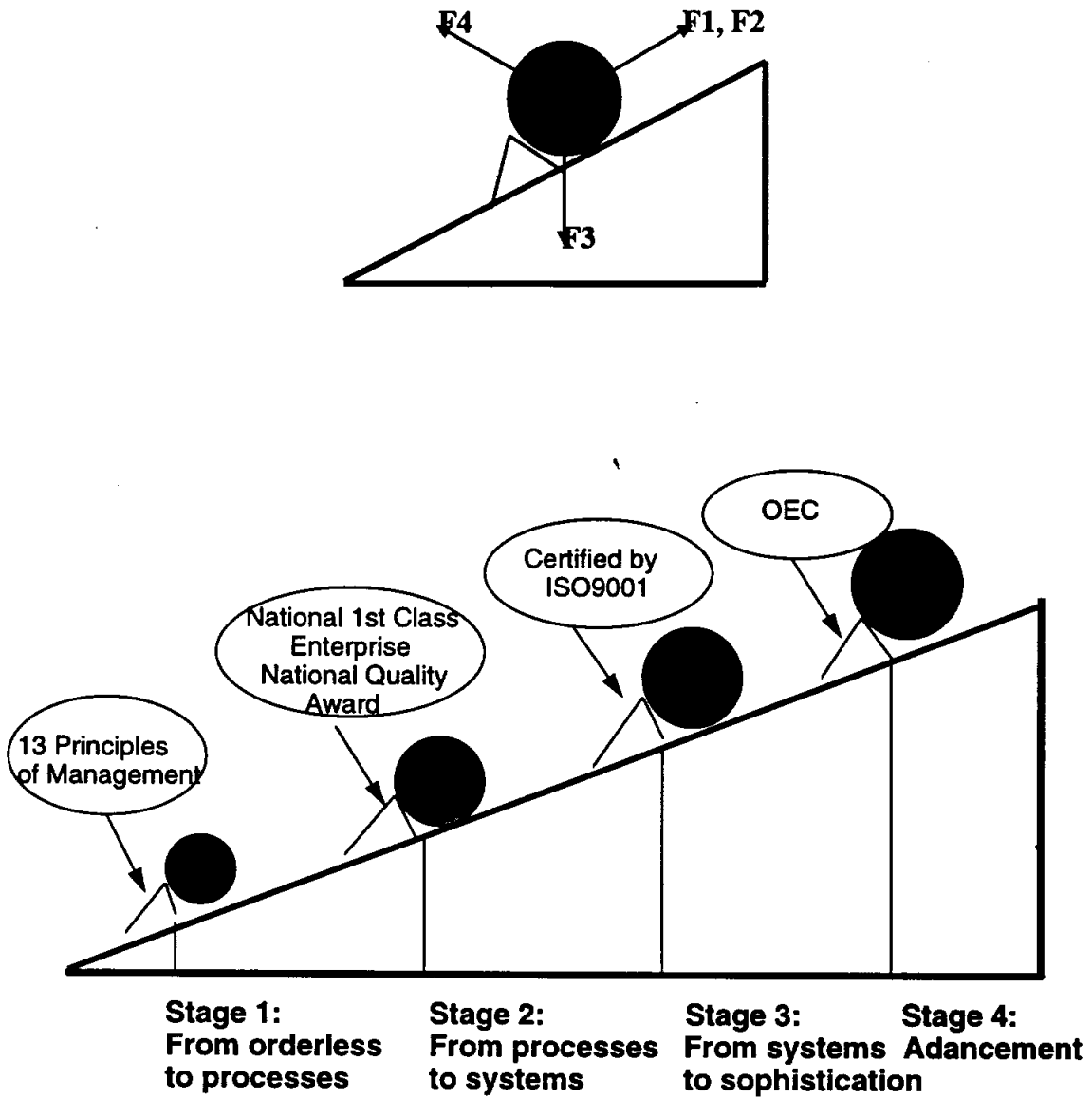


Figure 3: Profiling of Organizational Change Capability at Haier

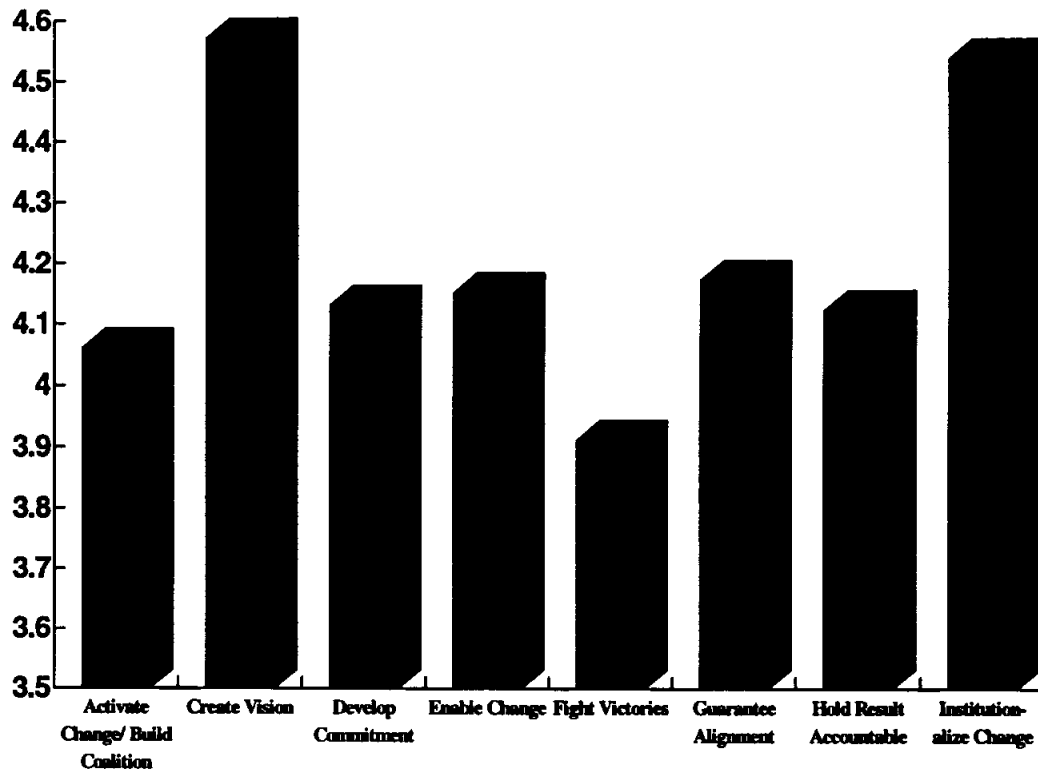


Table 1: Barriers of Organizational Change in China

Barriers to Organizational Change	No. of Respondents	% of Total Valid Responses
Ownership structure and corporate governance	17	27%
Existing mindset of Chinese people	10	16%
Low caliber of management staff	9	14%
Complex relationship and network among people	8	13%
Unclear and overlapping roles between government and enterprises	6	9%
Lack of effective incentive/reward system	5	8%
Low caliber of employees	4	6%
Corruption	3	5%
Focus on superficial rather substantial issues	2	3%

Appendix 1: Research Methods

1) On-Site Interviews

An one-on-one interview was conducted on August 13, 1997 with five managers in Qingdao, China. Each interview lasted approximately 60-75 minutes. A semi-structured interview format was used by the research team (the lead author and a research assistant) to understand the company history, major change initiatives, and critical success factors for these initiatives. All interviews were conducted in Mandarin, tape-recorded and then fully transcribed. Interviews were conducted with the following individuals:

Mr. Zhou, Wenjie	Deputy General Manager, Haier Refrigerator Company
Mr. Xu, Hongtai	Deputy General Manager, Haier Refrigerator Sales & Marketing Company
Mr. Hu, Zhishu	Personnel Director, Haier Refrigerator Company
Mr. Ming, Guoqing	Chairman, Trade Union of Haier Refrigerator Company
Ms. Wei, Mei	Deputy leader, Organizational Effectiveness and Quality Assurance Team

2) Survey Research

A total of 70 surveys were sent to our contact person at Haier for distribution. The contact person was instructed to distribute the surveys to all levels of management at a proportional ratio. Though we intended to use a stratified sampling strategy, it appears that the sample is biased toward senior and middle management.

A total of 59 surveys were returned, representing a response rate of 84%. The breakdown of the respondents by levels is as follows:

Level	No. of Respondents	Percentage
General Manager, Deputy General Manager	7	12%
Divisional Manager or Head	27	46%
Department Manager	20	34%
Section Manager or Production Team Leader	2	3%
Others	3	5%

Total

59

100%

Appendix 2: Dimensions of Organizational Change

Question: Overall speaking, to what extent the following statements accurately describe the leadership behaviors during organizational change in your company?
(1= To very little extent; 5= To very large extent)

Dimension 1: Activate Change and Build Powerful Coalition (Alpha = .74)

- Our leaders create a need for change that exceeds the resistance to change
- Our leaders can anticipate future opportunities and threats that impact continued business success
- Our leaders create meaning from data to support change
- At least one of our senior leaders will personally lead and champion a change effort
- Our leaders can develop a shared assessment of business reality among themselves
- Our leaders can build a powerful coalition for change

Dimension 2: Create a Compelling Vision (Alpha = .74)

- Our leaders can anticipate future opportunities and threats that impact continued business success
- Our leaders can create a compelling vision that energizes others

Dimension 3: Develop a Shared Commitment (Alpha = .81)

- Our leaders can communicate the vision clearly and consistently to employees, customers, and stockholders
- Our leaders demonstrate behaviors consistent with the change
- Our leaders can manage and overcome key stakeholders' resistance

Dimension 4: Enable Change and Mobilization (Alpha = .82)

- Our leaders enable and empower employees to change (e.g., through communication and training)
- Our leaders can remove obstacles to change (including both people and outdated systems)

Dimension 5: Fight Quick Victories (Alpha = .79)

- Our leaders can demonstrate visible results of change in a reasonable period of time
- Our leaders share and celebrate results widely

Dimension 6: Guarantee System Alignment (Alpha = .88)

- Our leaders develop a new generation of leaders consistent with change
- Our leaders are able to redesign HR and management systems to sustain change
- Our leaders ensure employees have competencies to do their new job

Dimension 7: Hold People Accountable for Results (Alpha = .76)

- Our leaders establish milestones toward change objectives
- Our leaders hold people accountable for change results
- Our leaders track progress regularly

Dimension 8: Institutionalize Change (Alpha = .77)

- Our leaders are able to leverage symbols, language, and culture to embody change
- Our leaders are able to integrate the change to overall business processes and initiatives
- Our leaders are able to share learning across different business units and/or change initiatives