



Zhang Ruimin
CEO and Chairman
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On
Haier's Rendanheyi 2.0

Co-hosted by Haier Group and the Economic Information Daily of Xinhua News Agency, the 10th Anniversary of the "Rendanheyi Win-win Model" and the 2nd Haier Global Forum on Business Model Innovation was held in Beijing on September 19, 2015.

*Mr. Zhang Ruimin, CEO and Chairman of the Board of Haier Group, delivered a keynote presentation titled "Rendanheyi 2.0: Building an Ecosystem to Co-create and Win Together." Mr. Zhang details how Rendanheyi has changed the face of Haier in the past decade, how the 2.0 version of this model is disrupting the traditional model, as well as the roadmaps, challenges, and goals involved in this process. Progress is being made at Haier through relentless trial and error. As the saying goes, **"There is no need to fear changes in the heavenly way, no need to emulate the way of the ancestors, and no need to seek the approval of others."***

Below is a translation of Mr. Zhang's remarks.

I visited many companies in Europe and the U.S. So far, I haven't seen any other company of our size, with tens of thousands of employees, conducting reforms at our scale. In the past decade, we have been alone on this journey but not really feeling lonely, thanks to the great support from scholars and experts from home and abroad. Most importantly, a great many businesses and business executives have also joined us on this journey.

Today, let me share with you what have learned along the way.

It's been ten years since *Rendanheyi* was first proposed. Now, we are entering its version 2.0. *Ren* refers to our employees; *dan* refers to our users. *Rendanheyi* means connecting our employees with our users. In its version 1.0, when we first came up this idea, we also proposed the "Market Chain" model. Essentially, the "Market Chain" model is about connecting the company with the market. The company should be connected with the market. But too often, they are disconnected. If you ask a company "Who is your client? What is the value you're creating for your client?" a lot of company leaders would have difficulties answering these questions, let alone their employees. That's why we started the initiative to connect our business with the market by reorganizing our internal structure into numerous independent, self-managing teams, or *ZZJYT*s. However, here is the problem: the original organizational mechanisms and frameworks have become constraints for further progress; we must completely reinvent everything we had before.

Today, by launching *Rendanheyi* 2.0, we are reinventing the traditional model and building a platform for co-creation and winning together. I will talk about three questions. First, why are we both building new models and breaking old models? Second, what are we building? Third, how are we planning to continue this journey?

CO-CREATING AND WINNING TOGETHER: REINVENTING THE TRADITIONAL MODEL

First, let me talk about what does it mean to co-create and win together from four angles.

First, find your niche. In the past, when companies tried to make a niche for themselves, they were very self-centered and focused exclusively on themselves. However, today, we realize that companies are neither self-contained nor omnipotent. We are a node in an interconnected web. A

computer becomes powerful once it is connected to the web. There are tens of billions of neurons in the human brain. Individually, they are not so smart, but when connected, they are very smart. When creating its niche, a company really is making a decision about whether it wants to keep its doors closed or open. Traditional companies work behind closed doors, having definite boundaries in terms of assets, workforce, and capacity. Today, companies are just nodes in an interconnected web.

Second, establish your value orientation. Traditional companies are customer-oriented. They compete on sales revenues and the number of customers buying their products. Fortune 500 companies are those 500 companies with the largest sales revenues. However, today, we are no longer customer-oriented, but user-oriented. There is a fundamental difference between a customer and a user. A customer is for a one-time transaction. A purchase. An exchange of money for a product. In contrast, a user is for continuous interaction and participation. A best-in-class experience.

Third, find your motivation. We mobilize our people around our goals. What counts is whether you can achieve the goal of creating new users. If you can, go ahead. If you can't, let someone else try. The goal is unchanged. In traditional companies, goals are tailored to people: "This guy is smart and we cannot let him go. If that's he's capable of, let's set the goal to his level of capability." This is how most companies think. How about mobilizing people around the goal? If everyone becomes an entrepreneur and makes their own investment in their business following initial VC investment, then all stakeholders' interest are bundled together.

Fourth, clarify your purpose. For entrepreneurs, the sky is the limit. Once you set your goal, it doesn't matter who the entrepreneurs are. Whoever is capable can join in. This is an important point. Entrepreneurship takes place on the Haier platform. The purpose is to win together, to maximize returns for all stakeholders, so that they can continue to collaborate, co-create, and share. According to Machiavelli, father of modern political philosophy, winning together is by no means a zero-sum game, but a process from which all stakeholders benefit.

Before we can co-create and win together, we must reinvent the traditional model. In the traditional management philosophy, the subject, object, and tool of management are the three key elements. The subject of management is the manager. The object is the people, assets, and properties that are managed by the manager. The tool is the set of measures and methods available to the subject in managing the object.

Now this model needs to be reinvented. The most important two types of people to any business are externally, its users, and internally, its employees. Our three visions are: to build a platform-based business, to provide personalized user experience, and to encourage employees to become entrepreneurs. Traditional hierarchical companies are being turned into platform-based businesses. To provide personalized user experience, we need to rethink the separation of production and sales. Production and sales are disconnected because plants only produce and products are sold through separate sales channels. To encourage employees to become entrepreneurs, we need to reinvent employment practices. In the past, employees are hired by the company. Today they come to a company not to be hired, but to start their own business. What does that mean? It means that today, we are not offering a job, but an opportunity for people to start their own business. Here is the relationship among our three visions: building a platform-based business is the necessary condition of our model. If we don't reinvent the old organizational structure, we won't be able to implement the new model. Providing personalized user experience is our objective. This is where all our efforts are directed. Entrepreneurial employees are the sufficient condition. Without maximizing employee initiative, it would be impossible to achieve our objective.

PLATFORM-BASED BUSINESS

1. Roadmap

Max Weber's hierarchical bureaucracy is a pyramid-like structure adopted by traditional companies, military and government organizations. Here at Haier, we are building an ecosystem for entrepreneurs. There are no hierarchies, only three categories of people. They don't have higher or lower positions or rankings. The only difference is the user resources they command and create. The first category is the platform owner, who takes care of the question: how many entrepreneurial teams the platform must host to achieve growth? The platform owner is neither an official nor a superior. Rather, this person is a servant responsible for watering and fertilizing the ecosystem. The second category is the micro-enterprise owner, who heads an entrepreneurial team that's growing on the platform. The third category is the employee-turned-entrepreneur. These people form an organization that is making concerted efforts to provide best-in-class user experience. Two circles have been formed: an interconnected ecosystem and a user community. Traditional companies use the cascade, top-down process. Now we are ecosystem interconnected with a user community. The user community doesn't need to be large. What counts are their popular opinion, and perhaps the opinion leaders among them. When these two circles are integrated into one, we will achieve best-in-class user experience.

This is different from traditional theories. Nobel laureate in economics Ronald Coase had a theory about the boundaries of companies: if you have a competitive product, expand production; otherwise, shrink your boundaries. Coase's theory was correct for his world. But that world had no Internet. In a hierarchy, whoever has more resources has broader boundaries. However, as today's companies are integrated with the Internet, to some extent, resources are infinite. In this sense, therefore, we are building a borderless ecosystem to co-create and win together.

2. Challenges

In this process, we are facing three challenges in terms of organization, marketing, and management. On the organizational front, our challenge is how to transform from the cascade process into an interconnected ecosystem. On the marketing front, the challenge is how to shift from customers of a one-time transaction to users enjoying a best-in-class experience throughout. On the management front, the challenge is how to decentralize and disintermediate, turning command-and-control functional departments into platforms for sharing and motivation, and enabling everyone to become a center and be at zero distance from the user.

The cascade process is commonly used in multinationals, from conceptualization, to survey, development, validation, delivery, maturity, and exit. This is a very closely monitored process involving many complicated procedures and steps. However, it is company-centered process that doesn't involve the user. At Haier, we use an iterative R&D process, and its starting point is to create value for the user. Here's the biggest difference between the two processes. In the former model, one relies only on their own resources. In the latter, everything is focused on creating value for the user. Do you still have sufficient resources? No. You need to get access to more. Also, this is an interconnected process where every move occurs simultaneously. The biggest change is from the absence to the presence of user participation. Professor John Little of MIT is the inventor of the Little's Law, according to which, three things are critical to the growth of a company: user traffic, user loyalty, and user volume. We need more user traffic and more of their time spent on the platform. When users perceive the value of being connected to the platform, user volume will grow.

The second challenge is how to turn customers of one-time transactions into users enjoying best-in-class experiences throughout the process. For instance, recently, sales of a water purifier-cum-beauty device have tripled thanks to co-creation. The team behind this product used to work behind closed doors. But then, it decided to co-create with users. This is how product R&D looks like today. If you work with the user to tailor your products to needs of say, children or women, those products are more likely to sell. But this is not where the question ends. We've built a platform that engages many different stakeholders, including other brands. Our platform is different from other e-commerce

platforms. Some say that there are three categories of platforms: aggregation platforms, e.g. an e-commerce platform for business transactions to take place; social platforms, such as Facebook; and mobile platforms, such as a supply chain. We want to build a platform for everyone to co-create, win, grow, and be rewarded. For instance, Haier's "water quality map" covers 240,000 communities in both rural and urban China, including 1.43 million villages and townships. You can access information about local water quality even in remote regions such as Lanzhou. This is a great resource. We are building huge network and a platform for all stakeholders to make profits.

The third challenge has to do with functional departments. Many visitors to Haier ask this question: how are we dealing with the functional departments? Functional departments work to fulfill their functions. How do we align those employees with our users? At Haier, we are turning these functional departments into two platforms: a platform for sharing, and a platform for motivation. The platform for sharing should be flexible yet orderly. The platform for motivation should plan and prepare to win. An example of a platform for sharing is the finance platform. An indicator of its efficiency is the number of employees served by a financial professional. In the past, that number was 50, and now it's 350. The volume of transactions processed has also increased tenfold. Because this platform for sharing relies on information technology instead of people, its efficiency is greater and there is no chaos.

In 2000, Peter Drucker delivered an address to a *Forbes* conference for CEOs of American companies. He was 90 years old and had trouble sitting straight. He said that there was only one thing he had to tell everybody: "No one in your company knows less about your business than your CFO." Why? Everybody thought the CFO knows the business best. Drucker said a business owner is focused on the future of the business, rather than its past. However, financial statements from the CFO are just a detailed description of the past, and he knows nothing about the future. Planning and preparing to win means setting a goal and then find the capable people to achieve it.

Figuratively speaking, what we are doing at Haier is to turn traditional functional departments from a thermometer into a thermostat. In the past, those departments only focused on reading the temperature and couldn't do anything about changing the status quo. Being a thermostat means being able to change the status quo. Say, it's 35 degrees now. I want it down to 25 degrees, plus or minus less than one degree.

3. Goals

The goals of a platform-based business are: First, turn hierarchical command and control into an entrepreneurial platform. Second, shift the mission of the business from maximizing long-term profits to becoming a shareholder of micro-enterprises. We started with more than 2,000 micro-enterprises. Today, many of these are no longer virtual businesses, but have now grown into a full-fledged, registered company. Haier is only one of their shareholders. Unlike other shareholders, Haier is the platform on which these micro-enterprises run. Haier provides the platform, not to command and control them, but to help everyone collaborate to create best-in-class user experience.

PERSONALIZED USER EXPERIENCE

1. Roadmap

In the mass production model, production and sales are separate. Products are manufactured in factories, distributed to stores, and eventually sold by the stores to customers. Today, although we have e-commerce platforms, they have only replaced offline brick-and-mortar stores. Factories still have to sell products through these platforms. In the Internet era, the focus of the user is shifting from the purchase to the experience. Although e-commerce platforms are better than brick-and-mortar

stores in that they provide more variety for the customer to choose from, they don't really provide an experience. At Haier, we are building "connected factories" to create a seamless, transparent, and visualized user experience. These connected factories enable seamless interaction with the user, provide transparency in its manufacturing processes, and visualize these processes on the user's mobile devices. Will we be able to not only eliminate offline stores, but also online stores?

Yesterday at Haier, I had the opportunity to talk with Mr. Jeremy Rifkin. I was particularly struck by an idea in his *The Third Industrial Revolution*. The idea is that continentalization is the next stage of globalization. Initially, it might sound like a paradox: Globalization is about the entire world. Is continentalization a step backward? No. Continentalization is about shift from mass production to mass customization.

Making a product smart isn't just about adding smart components; it's more about interacting with the user. Smart, connected products have three components: physical, smart, and most importantly, connectivity. In a sense, the first two components aren't fixed. The more important thing is to achieve connectivity with the user. The most important thing is to connect the company with the user.

2. Challenges

There are two challenges in creating personalized user experience. Both challenges have to do with the Experience Economy. In the past, we were in a sales economy where the sales were key. Now we've entered the Experience Economy. In the book *The Experience Economy*, co-authored by B. Joseph Pine II, there is remarkable quote: "goods [are] tangible, and services intangible, experiences are memorable." Some of our products are of best quality and comes with great services, but do not provide an experience. So there is no iteration and no interaction with the user. In the Experience Economy, it's critical to turn customers into participating users. And that's not the end of it. Eventually, we need to create a user community for interactive value creation: all users gather and talk about things that interest them. The second challenge is the visualization of the experience. Some believe Industry 4.0 is all about replacing humans with robots. But this is just automation and not the essence of an Internet-driven company. When automation boosts efficiency, where is precision? In an Internet-driven company, we need not only efficiency, but also precision. Without precision, there is no visualized experience and this is not really an Internet-driven company.

Let me elaborate on these two challenges one by one. First, how do we turn customers into participating users and then create a user community? Our smart oven is a case in point. The ultimate goal for this product is to create a baking circle. That is to say, the focus is no longer on the oven itself, but on the baked goods, on how to bake better. Users help spread the word about this product, even though they aren't really talking about the oven itself. In this process, there are iterative upgrades to the oven. Connectivity is all about connecting all users together and also incorporating baking ingredients into an ecosystem.

The second challenge is about how to shift focus from automation to connected factories. Germany's Industry 4.0 is not about automation. There is a 2-dimensional strategy to judge whether it is successful. "End-to-end information integration." What does it mean? From the low end to the high end. The "low end" refers to all sensors, drivers that collect and transmit data in a company to the "high end," or all financial indicators. If there is both high efficiency and high precision, and if you produce 100 products and are able to sell 100, then you will see superb financial performance. We also have 2-dimensional strategy, but it's different. Our x-axis is the y-axis of Germany's Industry 4.0, representing the company's value. It is about providing smart service that covers the entire value chain. Our y-axis is about providing best-in-class user experience: co-creating and winning together. Shareholders create value for users and also share that value together.

In a connected factory, everything is automated, so you can turn the lights off. In Germany, it's called a "lights-off factory." This is difficult to achieve but what's more difficult is mass

customization. You need to ask the user what they want because otherwise nobody is going to tell you. So, what is the most difficult problem that we're trying to tackle? If there are 10,000 different requests from 10,000 different users, can we develop 10,000 different products for them? That's impossible. However, we cannot assign a certain product to a user because they won't buy it. Therefore, we need a user community and opinion leaders to put forward ideas.

3. Goals

The goal of personalized user experience is to integrate production and sales, in other words, combining the producer and the consumer. I call this "negation of the negation evolved." Small workshops sell what they produce. When they scale, production and sales are separated because they cannot handle both given increased volume. In the Internet era, we are again selling what we produce. That's my vision for Haier's connected factories. But this is not the ultimate goal, which is integrating production and sales, or what Mr. Rifkin calls the integration of producers and consumers into prosumers. A sharing economy is the foundation for achieving this goal. Yesterday, when talking with Mr. Rifkin, I mentioned an article in this month's *Forbes* magazine, which says that in the U.K, the U.S., and Canada, one-fourth of the population have joined the sharing economy and this number is expected to double in 12 months. I said his prediction is about to come true and asked him if he's proposing a new economic indicator other than GDP, because GDP will certainly go down in a sharing economy. In a sharing economy, we shift from ownership to access. I don't have to own a car; I just need access to one. In the past, the value of goods lies in whether it can be exchanged. Today, even without an exchange, there is still value: the sharing value.

ENTREPRENEURIAL EMPLOYEES

1. Roadmap

A large American company once helped us develop our HR system using the "select, train, deploy and retain" model. When people come and seek jobs, we first select among applicants, then train them, and then deploy them, and if they are good, we want to retain them. Now, we are reinventing that system and building a dynamic partnership: employees are no longer just hired to implement, but are becoming entrepreneurs and partners in our business. This is shift from passivity to proactivity. What is this called a dynamic partnership? Do you have a share of the business regardless of whether you are doing a good job? No, if you're doing a good job, you can retain or even increase your share in the business. If you're not capable to push any other, the money is refunded to you. This is just like trading in the stock market. The ultimate goal is to encourage entrepreneurship, self-organization, and self-motivation. A new book came out this month. It's titled *Bold*. A quote from it says: "Today the world's biggest problems are the world's greatest opportunities." Entrepreneurialism means our employees need to look for opportunities on their own. If they find one, they can self-organize and get self-motivated. In this kind of organization, there is no leader. Then where does the motivation comes from? The users.

2. Challenges

There are three main challenges in encouraging employees to become entrepreneurs: how to change their perception of their roles, how to help them shift roles, and how to help them find new sources of income.

First, the perception of the role needs to be changed from an implementer with a job title to an independent, empowered entrepreneur. Delegation, decentralization, and empowerment are trending in the corporate world. Today, our people are given the power to make their own decisions, hire their

own people, and distribute their own profits. For instant, our ThundeRobot gaming laptop is a business started by three young people. They discovered a popular demand for premium gaming laptops in the market and the lack of products to fulfill this demand. Based on thousands of user comments, they developed a new gaming laptop with improved hardware and performance, which quickly rose to the top of this market segment. In this process, they used a lot of external resources.

The second challenge is how to help our people shift their roles from employees to dynamic partners. For instance, our *Kuaidishun* logistics project team has been able attract VC investment and get a high valuation... on one condition: they need to double their results within a year. If they can achieve this goal, more VC investment will come. If they cannot, their own investment will be lost. This dynamic partnership is tied to the team's market performance.

The third challenge is how to help our people find new sources of income. What is the source of income for employees in a traditional company? It is their job positions. Although there are various job evaluations, your pay is most directly related to your job. At Haier, we are no longer paying our employees. They have to earn their salary from the value they create for users. Otherwise, they will have to leave. Some teams aren't able to make profits or create value for users. Their platform owners will make a judgment about whether there is hope. If there isn't, those teams will have to leave to make space for others. If there is still hope, the platform owner will have to pay those team members until they can pay themselves.

3. Goals

Ultimately, we encourage employees to become entrepreneurs because people are not a means to an end, but an end in themselves. Germany philosophy Kant said it. We must never consider ourselves or others just a means to an end, because we are the end in ourselves. Karl Marx made a similar observation: workers are not using the tool, instead they are used by the tool. That's when workers on an assembly line become an appendage to the assembly line. Our goal is to let everyone become their own CEO, or what Drucker said.

How do we build a platform to help everything fully realize their potential? When an egg is broken from the outside, it becomes food for human consumption. But if is broken from the inside, it witnesses the birth of a new life. Our task is to help every employee incubate and one day break away from their shells.

FORGING AHEAD THROUGH RELENTLESS TRIAL AND ERROR

How do we make progress through trial and error? I believe in self-exploration, self-criticism, and self-transcendence.

I have traveled to the U.S. and Europe to look for an example that we could follow. I couldn't find one. In China, we didn't have our own management theories or models. We learned practically everything from other countries. In the early stages of our economic reforms and in the 1980s, we learned from Japan's lean management. Then, we learned from GE's American model. When it comes to reinvention of those models, there is no example to learn from.

Recently, I read *Holacracy: The New Management System for a Rapidly Changing World* by Brian J. Robertson. He invented this model and started to gain recognition from the management circles in the U.S. in 2007. It's been 8 years since 2007 – not a short period of time. But large companies aren't practicing this holacracy yet. An article in this month's Harvard Business Review points out two problems with holacracy: an ever-expanding circle of power, and incessant meetings that hurt efficiency. I read this article and realized the biggest difference between that model and ours is: in that model, not everyone is an entrepreneur; instead, guided by leaders, they form internal organizations, much like small circles in a large circle. That creates a problem. Small circles follow

instructions from the large circle, instead of listening to the market. It also has bylaws for top-down implementation. The bylaws are over 10,000 words. We don't have that. We believe that our reinvention should not be, and cannot be, top-down. I mean, our expedition is indeed a very challenging one. Our story has been made into a Harvard Business School case study titled "Haier: Zero Distance to The Customer." Our experience has also been taught at Japanese and European business schools. We are heading in the right direction. It's only the journey is very difficult. So we must keep on making progress by trial and error.

We need to dispense with successful practices in the past. In the past, Haier was able to stand out amongst competition because we had a strong execution culture: a decision can be executive effectively through multiple layers. However, what we need today is not an execution culture, but an entrepreneurial culture. Someone good at implementing may not be good at starting a business. In the 1980s, Japanese companies got ahead of American companies because they were such great team players and implementers. At the end of the Second World War, General MacArthur said that Japan had the world's best soldiers and worst generals. When Renault acquired Nissan, a similar remark was made: Japan had the world's best workers and worst executives. In the past, we had over 200 processes. They were detailed but also very linear and rigid. Very rigid roadmaps and requirements. With decentralization and disintermediation, we are building a networked, collaboration ecosystem that features non-linear management.

How do we achieve self-transcendence? The key is to rapidly replicate pilot models. How do we establish pilot models? They are those achieving 100% growth. Overall, currently we aren't achieving much growth: some teams are growing, some are not. Therefore, we need to speed up in replicating pilot models. For example, how do we achieve best-in-class user experience in our truck-based micro-enterprises? We're also investing in a sharing economy to promote the sharing of vehicles.

Wang Anshi was a famous but failed political reformer in China's Northern Song dynasty. This is how he summarized the challenges of being a reformer: **"There is no need to fear changes in the heavenly way, no need to emulate the way of the ancestors, and no need to seek the approval of others."** What is the relevance of this quote for today? "There is no need to fear changes in the heavenly way." The world has changed and we have entered the Internet era. Don't fear this change. We must forge ahead, because if we shrink back and wait, there will be no way out. "There is no need to emulate the way of the ancestors." The management models and philosophies of the traditional era, such as Adam Smith's division of labor, Taylorism, and assembly lines, are no longer relevant. We cannot afford to stick to the classics. We must innovate. "There is no need to seek the approval of others." People gossip and disapprove, but we must try our best regardless. A river goes through a long and arduous journey and eventually it will reach the sea. In this age of the Internet, time and tide wait for no man. We must keep pace with it and forge ahead!