

Shattering the status quo: A conversation with Haier's Zhang Ruimin

Having built Haier into a global powerhouse, its CEO now wants to overthrow 100 years of organizational orthodoxy.

Zhang Ruimin's willingness to shatter the status quo in service of customers is by now the stuff of management legend. Indeed, early in his tenure at Haier Group—then known as Qingdao Refrigerator General Factory—Zhang issued sledgehammers to factory workers and directed them to destroy a batch of defective refrigerators they'd produced, a memorable and public signal that the old ways of working were unacceptable.

Fast-forward 37 years, and today Haier is a leading global appliance maker and a pioneer in both organizational and customer-centric innovation. The company Zhang built is a juggernaut with 99,000 employees around the world; revenues from Haier Smart Home, the company's listed home-appliance business, have grown more than 18 percent a year since 2015, and topped 209 billion renminbi (\$32 billion) in 2020. The company has made a string of acquisitions over the years, including the 2016 purchase of GE Appliances.

Through it all, Zhang has stayed focused on users—and has remained unafraid of making big changes to serve them better. Today, this has him in the midst of a radical organizational experiment in which Haier employees manage themselves and self-organize into thousands of microenterprises that respond directly to user needs. The approach has nurtured the organization's innovative and entrepreneurial instincts while sweeping away hierarchy, bureaucracy, and more than 12,000 middle managers. Similarly, Haier's HR department has gone from 860 employees to just 11 through the adoption of an HR shared services platform.

Zhang recently spoke over videoconference with McKinsey's Aaron De Smet, Richard Steele, and Haimeng Zhang. In a wide-ranging conversation, Zhang reflects on the liberating power of self-organization, the future of products and brands, and leadership lessons he's learned along the way.

The Quarterly: *As you assess Haier's evolution over the 37 years you've led the company, how do you reflect on your role?*

Zhang Ruimin: Leaders of other enterprises often define themselves as captains of the ship, but I think I'm more the ship's architect or designer. That's different from a captain's role, in which the route is often fixed and the destination defined.

For example, in the past, our destination was to build the enterprise into a walled garden. Today, however, our destination is [better thought of as] a rainforest [or a self-adaptive ecosystem], and our strategy and structure have changed. And perhaps in the future we'll need to reconstruct the entire ship for a completely new route. The point is that all enterprises must keep pace with the times. Fortune 500 enterprises have shorter and shorter life spans. My mission is to make sure Haier can always advance with the times.

The Quarterly: *What have been your biggest lessons as a leader?*

Zhang Ruimin: One was the arrival of the internet, especially the mobile internet and e-commerce. In that period, we didn't manage to keep up with the times. We spent too much time observing, even though we were right to observe that another age would come. E-commerce enterprises have a problem: they don't interact with users. They just give you a lot of things to choose to buy. Direct interaction with users is crucial, and e-commerce is still an extension of traditional thinking.

I saw that after the mobile internet there would be another age coming, and an even bigger market—the IoT [Internet of Things] market. The Fourth Industrial Revolution¹ will usher in the age of maximizing the value of *mental* labor, not manual labor, as in earlier times. Goods will be interconnected by the Internet of Things, and this creates different scenarios based on the customized needs of users. This is why, for more than ten years, we've explored an organizational model as a tool to totally transform the architecture of the enterprise to remove bureaucracy—all so we can better meet user needs.

The Quarterly: *Can you elaborate?*

Zhang Ruimin: Consider the smart home. This is not the product of a single enterprise or a single industry. It requires the involvement of different enterprises and different industries. Therefore, we like to say that products will be replaced by scenarios, and industries will be covered by overlapping ecosystems. Think of a car not as a car but as a computer on wheels. That means that in the future, products won't matter. What will matter is a scenario or setting. And that setting will be totally different, and the industry

¹Klaus Schwab, "The Fourth Industrial Revolution: What it means, how to respond," World Economic Forum, January 14, 2016, weforum.org.

cannot exist alone. It must be interconnected with a wider ecosystem. What users will want is a scenario, a setting with different functions. And there will be thousands, even tens of thousands of different compositions or settings.

We hope that we can be a leading player when it comes to ecosystem brands. Traditional brands focus on the upgrading of products, but we focus on the iteration or upgrading of user experiences. For example, for the smart home, if users can derive constant value from a set of solutions, they will pay ten times, if not more, than the price of a single home appliance. But to deliver that solution, we need to combine the products from many different vendors.

The Quarterly: *How is this thinking reflected in Haier's operating and organizational models?*

Zhang Ruimin: I think the operating model and the organizational model are interconnected and are mutually promoting. Since the industrial revolution more than 100 years ago, the American model—a bureaucratic model—has prevailed. What we want to do is to overthrow the old models. In our *Rendanheyi* model, the value of each individual is reflected in the value they create for users. Establishing our model disrupts everything traditional, such as hierarchy and bureaucracy, because everyone has direct contact with the users, the end consumers.

The Quarterly: *How do you define Rendanheyi for an English-speaking audience?*

Zhang Ruimin: *Ren* is a Chinese word that means people or person. We mainly use it to refer to employees within an organization. *Dan* means orders, and here it represents the needs or demand of users. *Heyi* means integration. So, we're talking about the fact that everyone, every employee, gets to create value for users. Whatever your value, it is mirrored in the value you create for users. For example, typically an R&D person works without worrying about the final sale [of the product]. But in our model, everyone, including R&D people, must be responsible for the final sale—or lack of sales—of the product they develop. With *Rendanheyi*, we're talking about a virtuous cycle built around creating value for users.

The Quarterly: *How does the model disrupt traditional bureaucracy and hierarchy?*

Zhang Ruimin: We removed the intermediate layer of more than 12,000 employees. After bureaucracy was eliminated, the organization was no longer hierarchical. It became a decentralized, distributed network. The intent is to create an experience for users, instead of just selling products, as we previously did.

To this end we apply a microenterprises structure. Currently we have 4,000 microenterprises, which coalesce with one another to form ecosystem microcommunities—or EMCs. Among our 300 self-organizing EMCs, we have more than 100 start-ups, four of which are already publicly traded companies.

The Quarterly: *What do the EMCs look like in practice?*

Zhang Ruimin: In our distributed network, EMCs can be divided into two categories. One is the “solution EMC.” The other one is called the “experience EMC.” Traditional functions like R&D or manufacturing are replaced by the solution side. The traditional marketing functions have been replaced by the experience EMCs.

Experience EMCs have direct contact with users; they know exactly what users want. And they convey user feedback to the solution EMCs, whose job is to create solutions to satisfy the user needs that have been identified.

The Quarterly: *How does this benefit the company?*

Zhang Ruimin: New development cycle times shorten dramatically. What once took half a year can now take a couple of months or less. If the two sides can cocreate value for the users, they share the upside profit. Collaboration is essential, because if they fail to create value for the users, they don't get paid at all. In other words, we have a Nash equilibrium within the whole enterprise, meaning that people within those two parts or different parts will not undermine each other.² Unlike traditional organizations, in which people in functional areas occupy different silos and don't talk to each other, the only boss in our EMC approach is the user. Everybody keeps an eye on user demands.

The Quarterly: *How do user demands get translated into innovation at Haier? What's the mechanism?*

Zhang Ruimin: We don't appoint microenterprises. They self-organize freely, typically with about ten people who have chemistry [working together]. But they must find an opportunity, a bright spot in the market. For example, last year when the pandemic broke out here in China, four employees failed to buy enough masks because there was a big shortage. They also saw this as a business opportunity; they set up a microenterprise and quickly created a big market across the nation for the raw materials for facial masks.

The Quarterly: *How do you manage risk amid such decentralization?*

Zhang Ruimin: Solving for consistency is important when you have self-organized entities with all the powers. Having an ecosystem microcommunity means that EMCs must work together with other microenterprises. Alone, they cannot meet user experience goals consistently. There may be quarrels, even disputes among them. But [by working together] toward the same goal, they are on the same page because [in the end] they are paid not by the company, but by the users.

The Quarterly: *And what about securing investment?*

Zhang Ruimin: If EMCs and microenterprises want to go public during their entrepreneurship phase, they will have 100 percent of their shares held by Haier at

² Nash equilibrium, named for American mathematician John Forbes Nash Jr., is a decision-making theorem within game theory. It states that players achieve a desired outcome by not deviating from their initial strategy.

the beginning. During [this phase], investors will also emerge, and over time the equity structure will change. Haier's share will be diluted. In some microenterprises, Haier holds more than 50 percent; in others, it holds less.

But we have a requirement here. Within a certain period of time, if you cannot manage to attract sufficient social capital—I'm sorry, but your entity will have to be dismantled or dismissed. If you need human resources, you don't need to apply to the group. You can try to secure what you need from the outside. If you have very good start-up projects, people will join.

In this way, we open up the whole system. Our microenterprises, after becoming EMCs, and the EMCs, during the process of going public, [must] continuously become public enterprises or [form a] society-based relationship, not a walled garden or a closed enterprise. We are a big, open enterprise which functions as an incubator.

The Quarterly: *This is an intriguing model for organizing a company. Why have so few companies adopted something like this?*

Zhang Ruimin: We have eight research and development centers for *Rendanheyi* around the world, including in Silicon Valley. Companies try to learn from us and say it is quite difficult to replicate our model. I reply that adopting our model requires giving up powers, including decision making, hiring and firing, and setting compensation. You must delegate all those powers to the microenterprises themselves. One boss asked me how he could control his employees without those three powers. Well, I believe that giving up that control is actually an important part of the model.

[Many] leaders have linear mindsets. There are rules and steps: first step, second step, third step. Step by step. First, we make them understand that *Rendanheyi* is nonlinear. They think this is difficult. Removing bureaucracy is also difficult, and [leaders] are afraid the company will be chaotic if they remove bureaucratic systems. What we tell them is, "First, you should understand the purpose of *Rendanheyi*; then take into consideration your local situations."

Some enterprises start by changing their organizational structure. Others start by changing some business units into entrepreneurship organizations. We tell them, "You can start with a template, instead of starting *Rendanheyi* everywhere. And after success in some small places, you can scale up *Rendanheyi* in your organization." For example, when we acquired an appliance business in the United States, we turned the enterprise units into templates, a composition of small enterprises. One ME [microenterprise] for air conditioners, an ME for washing machines. During the COVID-19 outbreak, it had double-digit growth in terms of revenues and profits against a backdrop of very low incomes and revenue in the United States.

The Quarterly: *Can you say more about the kind of leadership that's required to work in this way?*

Zhang Ruimin: Because we don't have middle management, the mechanism is a distributed network. The larger platform provides conditions for the development of smaller ones. There are no orders or mandates from superiors. All the MEs need to create their opportunities. We call this the "three selves"—self-organization, self-emergence, self-evolution—in which self-emergence is the identification of new demand, usually by frontline workers.

The Quarterly: *A lot of management thinking today is focused on the "human imperative," and being more human-centered. Do you think self-organization is necessary for organizations to truly become more people-centric?*

Zhang Ruimin: People-centric organizations have two features. The first feature is autonomy. The second is self-organization. In a traditional enterprise there is no autonomy; leaders manage workers with different tools to improve efficiency. We don't have managers. We only have employees. All employees are their own managers, and everyone is their own autonomous person. This is very important.

I think the biggest problem for enterprises is to transform traditional enterprises into self-organizations. Self-organization is subversion of all verticals or industries. *Rendanheyi's* EMC approach is a self-organization system. In the Fourth Industrial Revolution, all employees will be value creators or entrepreneurs. This is the basic condition to meet the call of the times, and without self-organization, you will not be keeping pace.

The Quarterly: *How do you think your experience as a CEO is different from most? What have you done differently to create and nurture such an innovative company?*

Zhang Ruimin: I didn't mean to create such a model. In fact, back in the 1980s we were mainly learning from the Japanese management model, the Toyota model. We almost replicated their model identically. And then in the 1990s, we copied or emulated the Six Sigma model. But after those introductions, I found that it was difficult to actually communicate or interact with users. Another issue was that I realized no company can maintain an excellent level of growth for a long time. We can't [aspire to be] an empire, because empires falter. And simply relying upon selecting a best successor cannot solve the problem.

Therefore, I thought that we shouldn't build the enterprise into a walled garden. Instead, we should become a tropical rainforest, which means that we always have plants that die every day, but new plants are created every day, so [the enterprise] can live on. Each tree, each plant can be very prosperous. Of course, we have this problem of how to be uniform, to [ensure] those trees do not grow in an orderless way. That is something I'm focusing on.

The Quarterly: *Thank you for your time today. Any final thoughts?*

Zhang Ruimin: In one of your articles you mention three questions companies need to ask: “Who are we? How do we operate? How do we grow?” I like these questions but have my own personal perspective. In the end, I think that enterprises most need to answer the three questions that the French painter Paul Gauguin raised in the title of his painting “Where do we come from? What are we? Where are we going?” These questions need to be asked and answered again and again to make sure the enterprise is advancing with the times. Q

Aaron De Smet is a senior partner in McKinsey’s New Jersey office, **Richard Steele** is a partner in the New York office, and **Haimeng Zhang** is a senior partner in the Hong Kong office.

The authors wish to thank Richard Straub, president of the Global Peter Drucker Forum, for his contributions to this article.

Copyright © 2021 McKinsey & Company. All rights reserved.