

# Lessons from China

BY THOMAS W. LIN

**H**aier Group is one of China's fastest-growing companies and one of the world's top brands. Twenty-two years ago, the firm was a nearly bankrupt refrigerator factory in Qingdao, and now it's the world's fourth-largest white-goods manufacturer. On May 17, 2006, for the third consecutive year, Haier Group was named one of the world's 100 most recognizable brands in a global name-brand list edited by the World Brand Laboratory. The only Chinese brand on the list, the firm was ranked 86th after such household names as Google, Wal-Mart, and Microsoft, which were the top three.

How did Haier achieve its success? Haier Group fits a 1999 Gallup survey profile of what makes a successful company: Customer service, product quality, operating efficiency, and speed to market are among the top seven keys to success. Haier excels in all these areas. Here I'll provide a snapshot look at the company's history and then describe the firm's unique and effective performance-management systems.

## THE COMPANY

According to the October 2003 issue of the *Harvard Business Review*, Haier Group is one of the five Chinese "National Brands to Watch." In 1984, when Haier's CEO Zhang Ruimin took over the company from a government official, it had total assets of \$300,000, a net loss of \$178,000, sales revenues of \$421,000, and 600 workers. Haier was incorporated in 1984 and initially produced household refrigerators. Qingdao Haier Refrigerator Co., Ltd., was listed on the Shanghai Stock Exchange on November 19, 1993 (Stock no.: 600690; website: [www.haier.com](http://www.haier.com)), and it changed its name to Qingdao Haier Co., Ltd., in 2001. In 2004, Haier Group's global sales hit \$12.1 billion with a growth rate of 68% during the previous 20 years.

In 2002, the firm had total assets of \$2 billion, 30,000 employees, more than \$100 million in profit, and sales revenues of \$8.7 billion with home-appliance products such as refrigerators, air conditioners, microwaves, and washing machines. During this year the firm also expanded to small



## HAIER GROUP HAS ACHIEVED EXTREME SUCCESS THROUGH UNIQUE PERFORMANCE-MANAGEMENT SYSTEMS.

appliances, televisions, and even computers and cell phones. In that same year, the firm captured 50% of the U.S. market for small refrigerators and 60% of the U.S. market for wine coolers.

The firm now manufactures a wide range of household electrical appliances in 96 categories with 15,100 specifications, exports products to more than 160 countries, and has established 58,800 sales outlets globally. In 2000, the firm opened a \$35 million refrigerator factory in Camden, S.C. Haier products have made it to Wal-Mart and many other national and regional chains, and, in 2002, Haier opened its American headquarters in New York City. This move indicated the firm had entered into a new phase for globalization of product design, manufacturing, and sales and that it was determined to strive for long-term development in the United States. In the 2002 U.S. market, Haier had a 30% market share for 230-liter and undersized refrigerators and a 35% U.S. market share for refrigerators in the 230- to 280-liter range. Haier has also been successful in European markets, with

a 10% market share in Europe's air conditioning market in 2002.

Today, Haier is recognized worldwide. The latest Euro-monitor statistics on company sales show that it is fourth among the global white-goods manufacturers and has the largest world-market brand share for refrigerators. The firm placed first on the list of the 10 top Chinese world-class brands published in August 2005 by the *Financial Times*. On April 6, 2006, CEO Zhang Ruimin placed first in *Fortune's* ranking of China's 25 most powerful people in business.

Figure 1 shows that the firm's annual average global business sales growth rate was 68% from 1984 to 2004 with Haier's global sales hitting \$12.1 billion and its brand topping all Chinese trademarks in a nationwide survey.

### PERFORMANCE-MANAGEMENT SYSTEM

Haier's performance-management system consists of:

- ◆ Daily OEC management evaluation of factory workers,

- ◆ 6S footprints on the factory floor,
- ◆ Racetrack model of recruiting and promotion,
- ◆ 80-20 management responsibility principle,
- ◆ SST market-chain-based compensation system,
- ◆ Ways to appraise high-performance managers and how to deal with low-performance managers, and
- ◆ Individual monthly SBU profit and loss statements for each employee.

### Evaluating Factory Workers

Haier's incentive policies are openness and fairness. It adopts a point system for production workers using the OEC management 3E card. Haier's Human Resources Management Director Wang Yingmin explains the OEC acronym: "O stands for Overall; E stands for Everyone, Everything, and Everyday; C stands for Control and Clear. OEC means that every employee has to accomplish the target work every day. The OEC management-control system aims at overall control of everything that every employee finishes on his or her job every day, with a 1% increase over what was done the previous day." Employees are required to fill out an OEC 3E Card daily. This is a Microsoft Excel file with items of production quantity, quality, defective product material used, technology level, equipment evaluation, safe operation, and labor discipline evaluation.

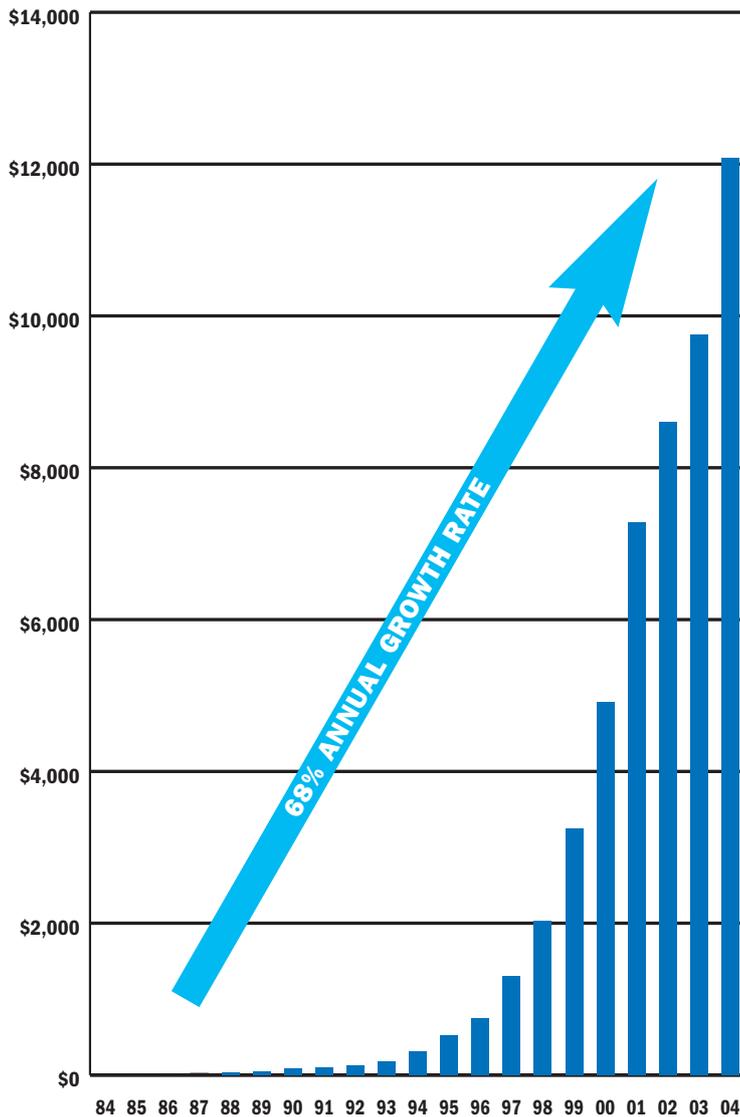
If an employee earns more points on the 3E card than required, he or she makes a higher wage and bonus, and both management and the employee know his or her daily wage and why.

The firm also uses quality-check coupons to provide an additional incentive mechanism.

Each employee has a quality-check coupon booklet that contains red coupons for rewards and yellow coupons for penalties. The booklet lists all quality problems the firm has detected and provides guidelines for checking each defect. If an employee failed to find and check a quality problem that was later found by his or her team member during a cross-check or by the superior during a managerial check, the employee will lose a red coupon and receive a yellow coupon that will count against that day's wage and bonus.

As further motivation, each employee earns a daily grade for actual performance and progress toward achieving his or her target. Workers see the daily evalu-

**Figure 1: Haier Revenue from 1984 to 2004**  
(millions)



ation results the next day on the factory's bulletin boards. The employees who are acknowledged as the best workers for three consecutive days have the honor of telling their experiences to fellow workers. The employees who become the best workers most frequently in one month are considered the best workers of the month. They have more opportunities to attend job training and enjoy social benefits, while employees who become the worst workers most frequently in one month are demoted to probation workers. Each month, both the best and the worst employees have their names publicized on the firm's bulletin board. Each employee also receives a red smiling face (excellent), green face

with neutral expression (average performance), or a blue sad face (poor performance) monthly.

Beyond acknowledging the best and worst employees, Haier implements the 10-10 principle. In a team, 10% of the members are the best, and 10% are the worst, so to improve the team's overall performance Haier encourages the 10% best to help the 10% worst.

### 6S Footprints on the Factory Floor

Haier's workers in China and in U.S. factories are imbued with the disciplines of a 6S daily routine, as Figure 2 shows. An adaptation of the 5S quality-control movement from Japan, 6S takes its name from the initials of five Japanese words: seiri (discard the unnecessary), seiton (arrange tools in the order of use), seiso (keep the worksite clean), seiketsu (keep yourself clean), and shitsuke (follow workshop disciplines). Haier added a sixth, the English word "safety."

To promote the 6S routine, small yellow 6S squares are painted on every factory floor. At the beginning of each workday, team leaders stand inside the squares to give a briefing on that day's work and relay any news to the employees. At the end of each workday, some workers will be called to stand on the footprints to criticize themselves for making some errors during the day, and the best employees will stand inside the squares to offer insights on their good work.

### Racetrack Model of Recruiting and Promotion

Haier has a job-rotation policy for management positions in which the average stay in a management position is

three years and the maximum is six. The firm uses a job system that's based on the racetrack concept for new job openings and promotions. All employees can apply and compete for work-related races such as job openings and promotions, but winners have to keep racing to defend their current jobs. The company keeps a talent pool of managers based on monthly performance results. These talent pool managers have a higher chance of being promoted, but some managers may be eliminated from the talent pool during each quarter's review. Every month, the Human Resources department publicizes the job openings and the requirements and conducts strict performance reviews, written examinations, and interviews. As a result, a number of motivated and experienced line workers keep moving into management positions, and a number of young college graduates obtain managerial positions after being trained in the low-level line positions.

### 80-20 Management Responsibility Principle

Approximately 20% of Haier's employees are in managerial positions. The 80-20 management responsibility principle says the 20% of employees who are managers are responsible for 80% of the company's performance results. But it doesn't necessarily directly translate to an 80:20 ratio of fines or bonuses. For example, one employee in the washing machine division made a mistake that produced a defective product. After the investigation, this worker was fined \$6.25 while the manager in charge was fined \$37.50.

### Compensation System

In 2001, Haier created a unique transaction job-recording system between two of the activities in the market chain called SST: Claim Compensation, Claim Payment, and Stop!

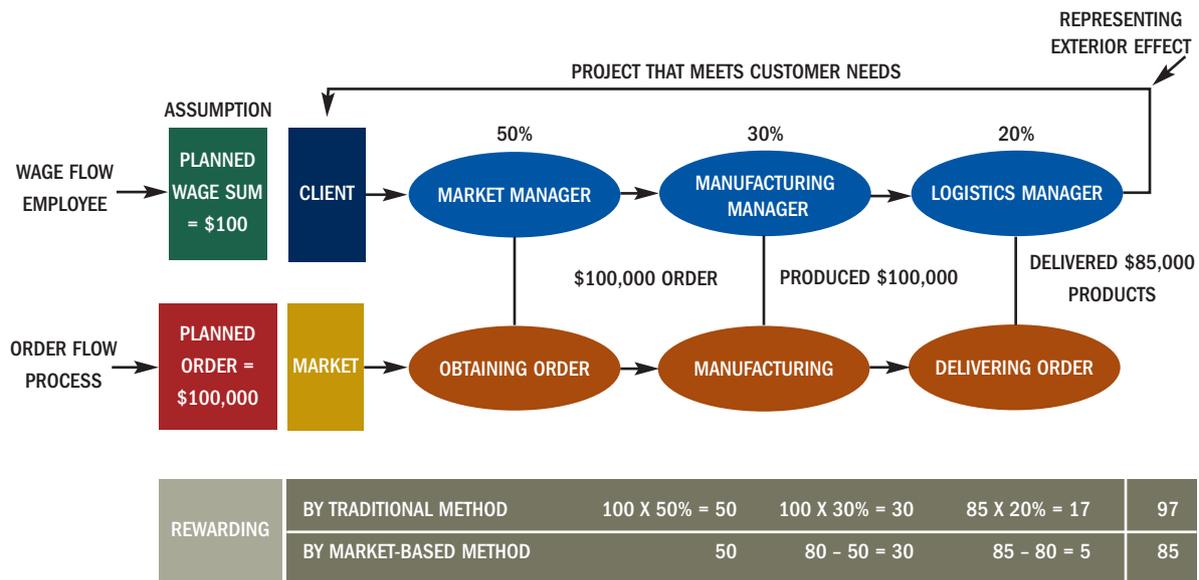
◆ **S (Suo Chou): Claim to the downstream activity party for compensation.** If an upstream activity employee can perform his or her activity or job well, he or she should claim compensation from the employee (i.e., his or her internal customer) downstream in the market chain. For example, the logistics department follows a product division's monthly and weekly production plans to deliver materials to various production workstations and makes a daily or weekly "claim" to the product division for the service provided according to the contract price.

◆ **S (Suo Pei): Claim to the upstream activity for payment.** If an upstream activity employee doesn't perform his or her activity or job well, his or her next downstream

Figure 2: 6S Footprints on the Factory Floor



**Figure 3: Traditional vs. Market-Chain-Based Performance and Compensation Distribution Systems**



activity employee (i.e., his or her internal customer) should claim payment from him or her. For example, if the logistics department delayed the delivery of materials, then that product division can make a claim for its loss.

◆ **T (Tiao Zha): Stop.** If there is neither a claim for compensation nor a claim for payment, the computer system will stop the process. The responsible party should pay the claims. The final decision on whether or not to pay for any job is up to the downstream activity customer because at Haier the customer is always right! For example, whether there is a production delay or material delivery delay, the responsible party should pay the claims.

The following example compares the traditional vs. market-chain-based performance and compensation distribution systems. Assume that one \$100,000 customer order requires the cooperation of three departments: marketing, manufacturing, and logistics, with the effort of 50%, 30%, and 20%, respectively. Also assume that both the marketing and manufacturing departments obtained and produced the target \$100,000 order, but the logistics department delivered only \$85,000. Both the traditional and market-chain-based performance and compensation are shown in Figure 3. Under the traditional system, the logistics manager is expected to receive \$17 in compensation ( $\$85,000 \times 100/100,000 \times 20\%$ ), but under the market-chain-based system, the logistics manager can receive only \$5 in compensation, as Figure 4 explains.

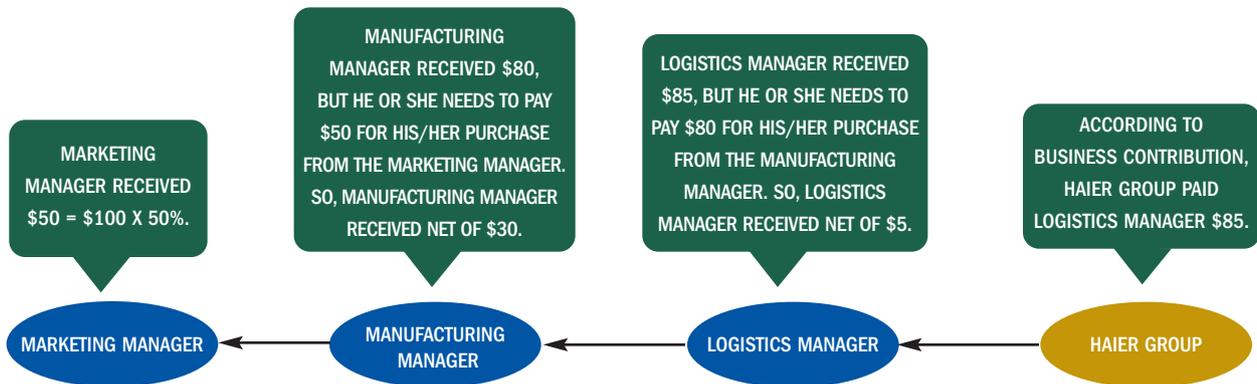
### Appraising Managers

Each manager’s performance is reviewed weekly according to several quantifiable goals and qualitative criteria such as process improvement and innovation. At month-end, managers receive a grade of A, B, or C. These grades are openly displayed at the company cafeteria entrance, with a green or red arrow indicating that a manager’s performance improved or regressed that month. All promotions and/or demotions are also published in the weekly newsletter called *Haier Ren Bao*.

High-performance managers are put in the talent pool for future promotions and given opportunities for extensive training. The 80 best mid- to upper-level managers are sent to case- and brainstorming-based training courses at Haier University every Saturday morning conducted either by CEO Zhang Ruimin or President Yang Mianmian.

How does Haier deal with low performers? The company classifies low performers into three categories. First, if a person needs to make minor improvements, the employee or manager is put in an online pool for training. Second, unqualified people get demoted if they can’t accomplish the production tasks or if they seriously break the regulations while being reviewed. Third, the company can fire the worst performers. In Haier, dozens of employees are fired every month because they don’t meet the company’s requirements: “Whoever tarnishes the

**Figure 4: Market-Chain-Based Compensation Distribution Flowchart**



brand of the company will be dismissed by the company.”

In addition, mediocre people get moved around in the firm. Haier encourages elderly employees whose knowledge and abilities don’t enable them to meet the requirements of their positions to transfer to the firm’s managerial positions in the service sector. The company then gives them adequate training for these positions, which don’t call for much expertise or skills. On the other hand, this enriches the job of the transferred employees, motivates them, and increases the efficiency of human resources utilization.

### Individual Monthly SBU Profit and Loss Statements

Every employee is a strategic business unit (SBU), which means that each employee is an independent profit center with the responsibility to make a profit. Each employee generates his or her revenue by providing the best service to the employee who works at the next step downstream and incurs expenses or costs by receiving services or resources from the employee who works at the previous step upstream. The following January 2003 data is from the Technical Equipment Business Division’s Information Plastic Subdivision’s Painting Plant:

*Mr. Liu, a painting worker, updated an SBU profit and loss statement called a “resource passbook” in his workplace every day. On December 29, 2002, he used 11.96 kilograms of paint to paint TV boxes while the budgeted volume was 11.87 kilograms. If the paint were converted to money, it meant he lost \$0.84. According to the 10% ratio, he owed \$0.08 to his company. On January 5, 2003, however, he used 13.91 kilograms for painting while the budgeted volume was*

*18.78 kilograms, and he earned \$14.88 that day.*

*Mr. Wang, a leader in Mr. Liu’s team, has a resource passbook, too. The only difference is that he does not use paint as the criterion. Instead, he uses a utilization ratio. On December 29, 2002, Mr. Wang’s team still owed \$0.65 to his company; on January 5, 2003, they already earned \$14.88!*

*Mr. Zhang Yongxun, a person who is in charge of steel plate purchasing, started to prepare his SBU profit and loss statement in 2002. He has been acting as a steel plate profit unit by growing sales of steel plates from \$112.5 million in 2002 to \$225 million in 2004 and increasing profit from \$1.24 million to \$4.47 million.*

What is the magic that significantly changed these employees’ data? According to Wang Yingmin, “We are using an innovative SBU profit and loss statement, resource passbook management system.” An employee resource passbook is similar to a bank passbook since there are debits and credits in both of them. In this case, the credit side is the company, which provides budgeted resources to employees according to operations standards; the debit side is the employee, who uses the company’s resources. Basically, the company provides fixed amounts of resources, and the employee has the authorization to use the resources. In the long run, it’s in the employee’s best interests to have a resource passbook with more credit than debit. The final result is the connection between the self-managed market effect and the employee’s individual income.

**Table 1: SBU Profit and Loss Statement for the Air Conditioning Product Department Manager**

ITEM		AMOUNT			
		BUDGET	ACTUAL		
1. Breakeven sales revenue					
Revenues	2. Last year same-month sales revenue				
	3. This month sales units				
	4. This month sales revenue				
	5. Deductions	5.1 New product sales discount			
		5.2 Old product discount			
		5.3 Sample item discount			
		5.4 Inventory loss			
5.5 Damage of goods loss					
6. Market-chain revenue = 4 - 5					
7. Cost of goods sold					
8 Gross profit = 6 - 7					
Expenses	9. Fixed expenses	9.1 Advertisement expense			
		9.2 Fixed-quota expense			
		9.3 Labor expense			
		9.4 Individual minimum wages			
		9.5 Delivery expense			
	9. Total fixed expenses				
	10. Variable expenses	10.1 Target achievement reward expenses	10.1.1 Reward on monthly data		
			10.1.2 Reward on annual profit data		
		10.1 Total			
	10.2 Platform expense				
10. Total variable expenses					
10. Total expense = 9 + 10					
11. Appreciation	11.1 Gain from selling old products				
	11.2 Appreciation reward by exceeding target amount				
	11.3 Appreciation reward by accelerating inventory turnover				
	11.4 Value-enhanced product appreciation reward				
	11. Sum of appreciation				
12. Sum of profit = 6 - 7 - 9 - 10 + 11					
Individual commission	13. = Profit x Y%				
<b>Definitions</b>					
1. Breakeven sales revenue = total fixed expenses / contribution margin ratio					
5.4 Inventory loss: Purchase price x (ending inventory quantity - beginning inventory quantity)					
5.5 Damage of goods loss: Bad quality return and product loss during delivery					
7. Cost of goods sold: Sales units x unit purchase price					
9.2 Fixed quota expense: Product manager's business expense for product sales, including trip, communication, phone, etc.					
9.3 Labor expense: Compensation for product manager's team or employees (every month the compensation will be materialized according to last month's actual sales result)					
9.4 Individual minimum wages: Each month's standard fixed labor wages and fringe benefits					
9.5 Delivery expenses to other internal business units that helped to sell products					
10.1.1 Reward on monthly data: Monthly target achievement reward that is fulfilled this month					
10.1.2 Reward on annual profit: This month's share of the yearly target achievement reward					
10.2 Platform expense: Allocation of expenses from supporting departments					
13 Profit x Y%: Profit x individual commission percentage Y					

Figure 5 shows an SBU flowchart for a client manager.

Here's how the SBU flowchart works:

- ◆ The client manager's superior SBU is the commodity manager who provides supporting platforms including motivation platform/capital-flow platform and customer relationship management (CRM) platform of commodity flow. The client manager's suppliers are the product departments, and his/her markets are clients or customers served.

- ◆ The vertical bridges around a client manager are target process flows. The client manager and his/her superior set the business strategic target jointly; the item below the client manager is the supporting platform(s) (e.g., commodity flow, physical flow, quality management, cash flow, and incentive system) provided by the commodity manager to coordinate with various supporting departments to support/help this client manager to accomplish his/her strategic target.

- ◆ The horizontal bridges around a client manager are order process flows. Customer orders, according to specific target value(s), are shown on the right side, and product department resources that support orders are shown on the left side.

- ◆ Performance evaluation is connected with the target (annual) and customer orders (daily information clearance and performance report).

Six monthly evaluation items for a client manager include:

1. Money return is the sum of the cash amount received from all monthly customer sales. Money return of each customer is the total monthly invoice amount of a particular customer.

2. Customer success rate is the actual number divided by the budget number. (The budget number is the forecasted number of targeted customers, while the actual number is the number of monthly 100% money return target-achieved customers.)

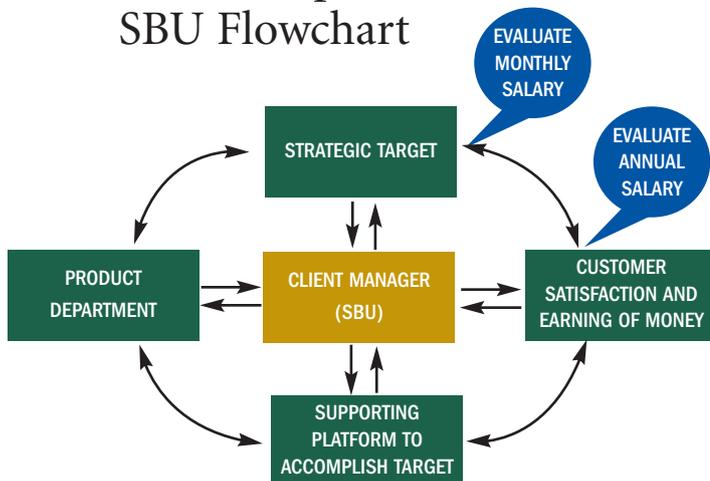
3. Money return balance means the return speed achieving 334 standard—the money returned 30% before the 6th, 30% before the 16th, and 40% before the end of the month.

4. Order performance is the actual monthly money return minus the budgeted monthly money return.

5. Product-mix balance is the percentage of Haier's product sales that achieve 100% target for each product.

6. Client share percentage is a particular client's total sales revenue derived from selling Haier products only

**Figure 5: Example of an SBU Flowchart**



divided by that client's total sales revenue derived from selling all companies' products.

Table 1 presents the SBU Profit and Loss Statement for the Air Conditioning Product Department Manager.

## SUSTAINABILITY

Haier has come a long way from a nearly bankrupt company to a worldwide brand. The firm's performance-management system implementation has led to the following outcomes: satisfied customers, efficient and effective processes, motivated and prepared employees, and sustainable revenue and profit growth. Haier will continue to excel and achieve its short-term goal of becoming one of the world's top three white-goods manufacturers. In this current competitive market economy, many companies have much to learn from Haier's performance-management systems. ■

*Thomas W. Lin, Ph.D., is a professor of accounting and the Leventhal International Faculty Fellow in the Marshall School of Business at the University of Southern California in Los Angeles. You can reach him at (213) 740-4851 or [wmlin@marshall.usc.edu](mailto:wmlin@marshall.usc.edu).*

*The author acknowledges the financial support provided by the IMA Foundation for Applied Research and the Center for International Business Education and Research at the University of Southern California's Marshall School of Business and would like to thank Haier University President Zou Xiwen for providing the tables, which were originally in Chinese.*