

## **Business Model Innovation as Strategic Renewal Process: A Case of China's Most Innovative Firm**

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### **Abstract**

To survive in today's hypercompetitive business environment, firms from every sector must rely on innovation. Innovation is one of the main drivers of a firms' strategic renewal process. Strategic renewal process often calls for business model renewal which is only possible through business model innovation. Business model innovation is relatively new concept in business literature. This article is an attempt to highlight the business model innovation process of one of the most innovative firms of our time from China. Over the last thirty years, this firm went through multiple strategic renewal processes by reinventing its business model inspired by the technological changes. In doing so, this firm aims to change the whole white goods manufacturing industry as we know it today.

### **Keywords**

Business model innovation, Strategic renewal, China.

## Introduction

In the uncertain and challenging journey of long term survival, firms must go through strategic renewal process. Firms may go through strategic renewal process intentionally because of internal growth plan or may be forced by the externalities such as competition, changes in business process, changes in customers' demand, changes in business environment (laws and regulations) etc. (Barden-Fuller and Volberda, 1997). Earlier "strategic self-renewal" was generally considered as a transformation of activities related to environment, objectives, strategy and/or structure to ensure long term survival (Chakravarthy, 1984). Today, strategic renewal is mostly associated with strategic change and emerged around evolutionary and ecological perspectives of strategy making (Floyd and Lane, 2000). Floyd and Wooldridge (2000) define strategic renewal as *"a managerial process associated with promoting and accommodating new knowledge and innovative behavior which results in change in an organization's product-market strategy and/or its core capabilities"*(p.24). In this definition, they emphasize that renewal not only relates to changes in product-market domains, but also to changes in strategically relevant capabilities. Zahra (1996) defines it as means of revitalizing a company's business by innovation and changing its competitive profile. It also means building or acquiring new capabilities and then creatively leveraging on them to create competitive advantages. According to Sharma and Chrisman (1999:19) *"Strategic renewal refers to the corporate entrepreneurial efforts that result in significant changes to an organization's business or corporate level strategy or structure. These changes alter pre-existing relationships within the organization or between the organization and its external environment and in most cases will involve some sort of innovation. Renewal activities reside within an existing organization and are not treated as new businesses by the organization."* Most recent definition of strategic renewal came from Agarwal and Helfat (2009). They postulate that strategic renewal involves the process, content, and outcome of replacement or change of attributes of an organization that can substantially affect its long-term prospects. From all these well acclaimed definitions it becomes clear that strategic renewal involves innovation as well as changes in fundamental business strategy of a firm and thus, naturally, largely determined by business model innovation. But what is business model

innovation? We try to answer this question in the next section and then in the subsequent sections we delve deep into a real-world case of using business model innovation as strategic renewal process. Before concluding the paper, we discuss another important issue which is “the enablers” of business model innovation.

### **Business Model Innovation**

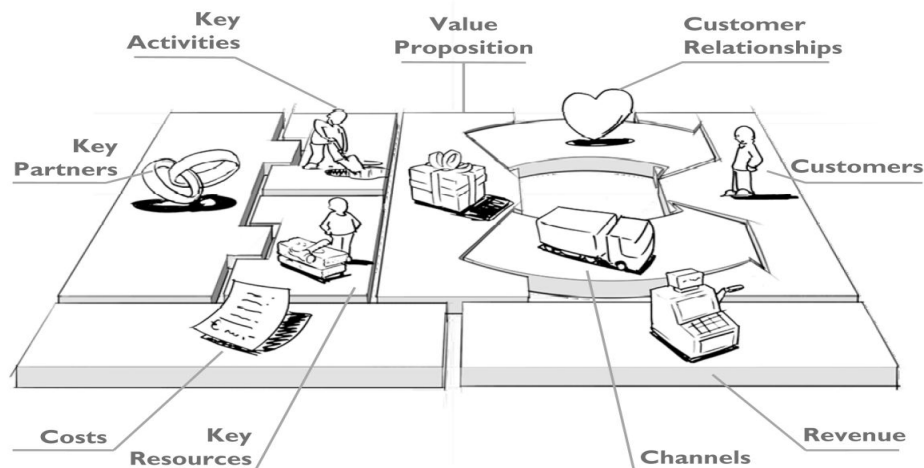
Before getting into business model innovation, it is useful to understand what is business model *per se*. Business model is a relatively new concept in business literature; yet it has become very influential in micromanagement research (Spieth et al., 2014). The original definitions associated business model with an operative activity in the context of information technology (Wirtz et al., 2016). In fact, the concept got considerable attention during the e-businesses boom in the mid-90s. Before the internet boom, most companies operated in a similar way: providing different products or services to customers. As the deregulation process and the technological change around the world took place, it was natural that the business models became more important. New ways of differentiating from competitors, other than just the different functions of the offering, were needed (Serrat, 2012). However, Business models have been in existence longer than the emergent of the scientific concept, and can be traced back in the mediaeval times (Baden-Fuller & Morgan, 2010).

Very often business models are mistakenly confused with strategy. While there are similarities, they are two different concepts. Chesbrough and Rosenbloom (2002) indicate that business models concentrate more on creating and delivering value whereas strategy focuses on value capture than. Casadesus-Masanell and Ricart (2011) use a metaphor: “*Strategy is designing and building the car, the business model is the car, and tactics are how you drive the car.*” So, business model creates fundamental building blocks of actions of a firm to achieve the goals and objectives directed by strategy. If the strategy of trip by road is to reach the destination as fast as possible, the vehicle should be a Ferrari or Lamborghini. On the other hand, if the strategy of the trip is to reach the destination any time and enjoy the scenery by the road, the best vehicle this time would be a rikshaw. So, different strategies might need different business models.

Researchers of business models are sometimes divided in their opinions on the meaning and contents of business model. Teece (2010) defines business model as “*how a firm delivers value to customers and converts payment into profits*” (p.172). According to this definition, business model is the architecture of value creation process. Zott and Amit (2010) indicates that business model is the system of interdependent activities of a firm that transcends the focal firm and spans its boundary. Gambardella and MacGahan (2010) define business model as a mechanism of turning ideas into revenue at reasonable cost.

Osterwalder and Pigneur (2010) in their book named *Business Model Generation - A Handbook for Visionaries, Game Changers, and Challengers*, discuss about business model which is widely acclaimed. They indicate that business model provides with the rationale of how an organization creates delivers, and captures values. In the book, they also discuss about the method of business model creation and how it could be easily understood and described. To do so, Osterwalder and Pigneur (2010) propose a new tool called “Business Model Canvas” which is consist of nine basic building blocks (figure 1). A business model designer needs to consider all these blocks when she develops a new business model. In the middle of the canvas the core of the business model is: the ‘Value proposition. To the left of the core, there are four blocks related to efficiency, which are ‘Key partners’, ‘Key activities’, ‘Key resources’, and ‘Cost structure’. To the right, there are rest four blocks which are related to value adding activities which are: ‘Customer relationships’, ‘Channels’, ‘Customer segments’ and ‘Revenue streams’.

**Figure 1: Business Model Canvas (Osterwalder & Pigneur, 2010)**



Volberda et al. (2013) mention five key elements in describing and evaluating business model of any firm. The five elements are: focus, channel, key activities, key resources, and revenue model.

A well-defined business model is valuable for any firm, regardless of the size or the age (Magretta, 2002). Most often strategic renewal process involves business model innovation which could also be termed as business model renewal or change which usually brings more stability in the business. Though business model innovation is much needed given the ever changing market condition inspired by technological changes, large established firms find it very difficult to change or innovate their business models as they get stuck in the rigidity and inertia of respective existing operations (Doz & Kosonen, 2010). However, According to Cucculelli & Bettinelli (2015) established firms that innovate their business model can benefit much from positive performance effects. There are two ways business model innovation: finding an entirely new business models, or modifying the existing business model for better. Constantly looking for both the options is important instead of just concentrating on one the two (Skarzynski & Gibson, 2008).

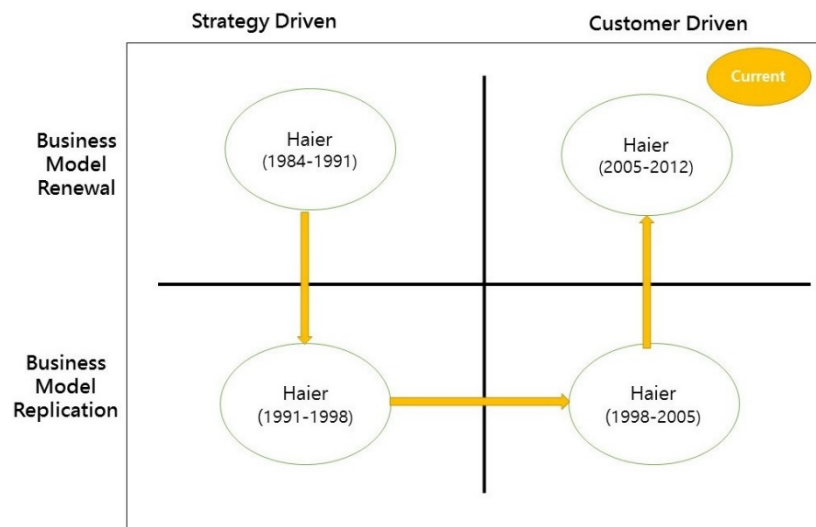
Rest of this article is about the business model innovation story of **Haier Electronics**- a manufacturer of household appliances (white goods) from China. Haier is considered one of the most innovative firm not only in China but also in the whole world. Success story of Haier is not a success story of traditional Chinese firm supported by the government. Though the inception of Haier was with the support from government initially but its global success is due to its unique strategies and continuous innovation and renewal of business model in according with the changes of internal and external environment home and abroad. Harvard Business Review (HBR) published seventeen articles/cases on Haier's business transformation over the last couple of decades. In the next few sections, we have tried to illustrate all these business model innovations the firm has gone through and find out the enablers of these innovations.

### **Brief Company Overview**

Built in the port city of Qingdao, on China's northeast coast in the 1920s, Qingdao Haier was possibly best known for its poor quality and indifferent work ethic. In 1984 the firm was placed under the leadership of a young municipal official, Zhang Ruimin, and allowed to experiment with a variety of managerial initiatives that form the basis for much of the story that follows. However, plagued by inefficiency and uncontrolled costs, Mr. Zhang's factory was verging on bankruptcy in his early days in leadership (Agtmael, 2007). But through innovation and rapid response to customer tastes and needs, the company succeeded to create competitive advantage and sustained it (Khanna & Palepu, 2010). By 2012, Haier, as it had come to be known later, was one of the world's largest producers of refrigerators. It had broadened its product line to include air conditioners, mobile phones, computers, microwave ovens, washing machines, and televisions. According to Euromonitor's Major Appliances Global Brand Rankings, Haier has world's largest brand share in major *home appliances* (9.8%) creating what is likely China's most recognized global brand. In 2014 Haier Electronics' revenue touched \$10 billion (Exhibit 1 of Appendix).

### **Transformation of Business Model**

Since 1984 Haier has gone through five stages of business model transformation. In these five stages, company saw three different business models. Fifth stage is still in work in process and the fourth new business model is expected to be soon in place. The four stages of business model transformation are illustrated in exhibit 3 of appendix. Putting all these stages in Business Model Innovation Matrix (Volberda et al. 2013) we can visualize the business model innovation process of Haier (Figure 4).

**Figure 4: Business Model Innovation Matrix (Haier)**

### **Stage 1, 1984–1991: Brand Building through Focusing on Quality and Manufacturing Excellence**

After Mr. Zhang was given total responsibility of Haier, he completely changed its business model. He emphasized on manufacturing excellence and brand building. At that period, no Chinese manufacturer of home appliances focused its attention to quality product and Mr. Zhang took this opportunity and turned Haier's attention to brand building through excellent quality products. This strategic change was the base of the future growth of Haier.

### **Stage 2, 1991–1998: Diversification—Eating the Stunned Fish**

Due to early success of Haier, many other manufacturing firms of different products such as radio, television etc. were brought under the leadership of Mr. Zhang (Fischer et al., 2013). He took this opportunity to diversify the business of Haier. He replicated the Haier model in these newly found firms and transformed those to standard quality production system. No new business model was in work in this stage.

### **Stage 3, 1998–2005: Business Process Reengineering and Market Chains**

In this period of time two important issues had pushed Haier to rethink its Business Model. One issue was China's inclusion in WTO. It was both opportunity and threat for Haier. Due to the

China's WTO membership, Haier saw opportunity of foreign market expansion as well as threat from foreign competitors. Another issue was, Haier's customers were growing more demanding and diverse. Only quality was not enough to retain their loyalty. As response to these issues, Haier reinvent its business model (exhibit 3) and incorporated better customer service, fast response and product reengineering, and created new market channel to reach customers.

#### **Stage 4, 2005–2012: Zero Distance to the Customer—The ZZJYT**

Internet and global customer base as well as global competition forced Haier to rethink their business model for the third time in 21 years. This time Haier came up with the business model they called it ZZJYT – zero distance to the customer. We have discussed this business model in section 3.

#### **Stage 5, 2012 --: Network Strategy**

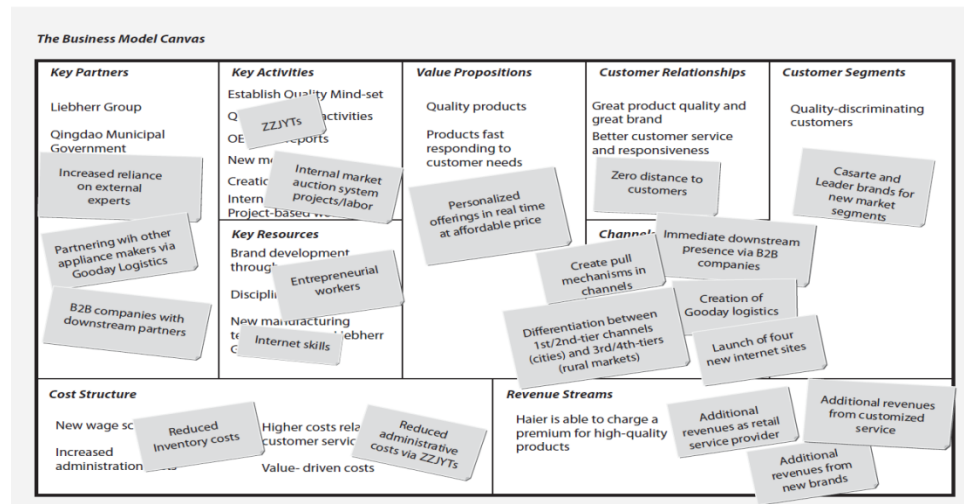
After just one year of announcing ZZJYT business model, Haier announced its move for Network Strategy. Immense impact of IT in business operations and to reach more and more customers each and every corner of the world (ultimately reaching **Zero Distance to the Customer** goal), Haier is marching forward to become a fully service company from a manufacturing one. More about this is discussed in section 6.

#### **Current Business Model**

Few companies have succeeded in building organizational structures that enables the simultaneous execution of existing successful business models while also inventing new ones for tomorrow. This is where Haier has shown its most impressive performance. A culture of continuous organizational innovation has enabled Haier to change its business model repeatedly to develop and sustain its competitive advantage over its competitors. Haier's current business model building process started in 2005. In 2012, it got the final shape (figure 2).



Figure 2: Haier's Business Model Canvas: Zero Distance to the Customer—The ZZJYT



Source: Adapted from Fischer et al., 2013.

Though just after one year of establishing this model, Haier started its process to reinvent the business model for fourth time in its history through Network Strategy (Fischer et al., 2015). This process is still going on. Through the Network Strategy, the company targets to fully utilize the ever-changing IT environment to reach closest to customers and thus implementing the current business model objective: **Zero Distance to the customer (ZZJYT<sup>1</sup>)**. Major elements of Haier's current business model and the inter-relationships among these elements are demonstrated in the Figure 3.

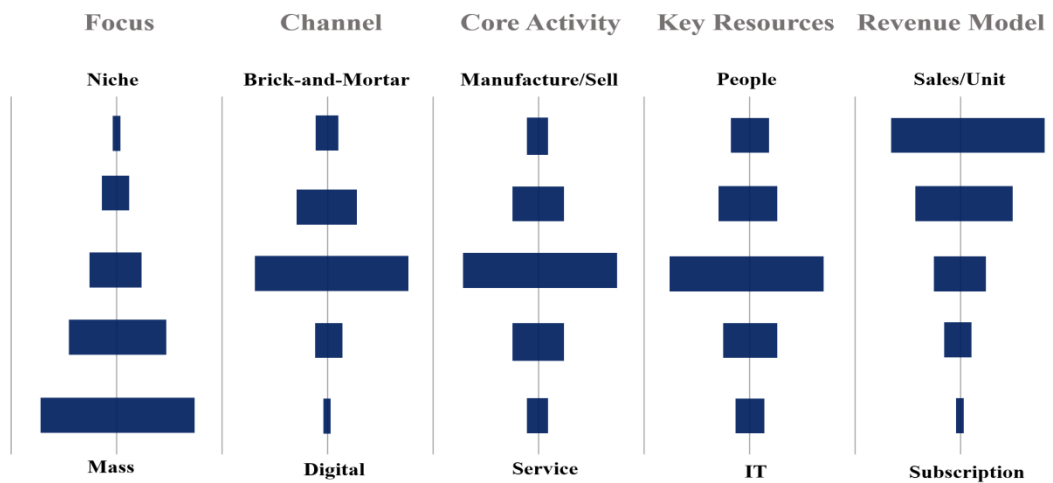
**Focus:** Current focus of the firm is moving away from niche to mass market through mass customization. Haier aims to deliver every home appliance need of its customers. It is working to remove the second tier (mainly middle management) of three tiers organizational structure minimize the distance between organization and customers.

**Channel:** To create Zero distance to customer, Haier is reinventing its logistic channel. Through customer pull system, Haier aims to establish zero inventory (Just In Time) system where every product has its customer waiting for it even before it is ready. This system is supported by

<sup>1</sup>Under new business model, all the departments of Haier are autonomous business units and referred to as ZZJYTs (ZiZhuJing Ying Ti, literally translated as independent operation unit) (Fischer et al., 2013)

Haier's own GoodMart Logistic and huge customer data base gathered over time through its expanded IT network. Haier is using its IT facilities to develop and deliver its service whenever and wherever customer wants.

**Figure 3: Business Model Elements of Haier**



Source: Developed based on information available in Annual Reports and Website.

**Core Activities:** Haier is changing itself from manufacturing and selling company to service provider. As the Chairman of the firm **Zhang Ruimin** is quoted in Fischer et al., (2013:72) “*We hope we won’t be selling products to them, rather, we will find their new needs and fulfill these needs. This is what we mean by selling solutions rather than products*”. Now selling a product is not the end of the job, it is just the beginning for Haier.

**Key Resource:** From the beginning of Zhang era, people have been considered the key resource of the firm. It remains same as of today. However, due to the immense importance of IT for the survival and future growth, Haier recognized the importance of IT well early. The firm believes that both IT and people will remain the key resources to face the upcoming challenges of future world.

**Revenue Model:** Sales per unit remain the main revenue model for Haier. If the new business model introduced widely, a dramatic change of revenue model is expected. Subscription or service based model could be more dominant contributor to overall revenue.

### **Enabler of Business Model Innovation in Haier**

In every stage of business model transformation and innovation, there are some enablers which force the changes and make these changes possible. For Haier, the inception of business model innovation was in 1984 when Mr. Zhang was in top leadership of the firm. It was his firm will to change and strong leadership and management quality to implement the change throughout the organization that enabled the first business model innovation for Haier. Later two stages of business model innovations were mainly pushed by industry and customers. Though leadership played same pivotal role as before in coming up with the changes. In the fourth stage technology (IT) and competition forced leadership to go for another round of changes. In the current stage (fifth) again IT, competition and changing industry environment forced leadership and management to come up with innovations and changes even if a new business model had just been established. As usual Haier leadership launched Network Strategy toward a new business model largely dependent on IT infrastructure. So, it is evident that though all the external enablers (industry, competition, customers, technology etc.) force for business model innovation, it is the leadership of a firm which is the ultimate enabler of such. And most of the cases leadership of large complex firms fail to see these forces. However, for Haier the case was different. Every time when a change was necessary for Haier, Mr. Zhang could sense it and prepared the firm for the changes. Mr. Zhang has strong preference for western management style and Japanese production system. However, according to Fischer et al. (2015) Zhang did not develop this management approach on his own. From the beginning, he displayed a fervent curiosity about management and high performance, and he studied the work of leading scholars and observers, especially eminent management writer Peter Drucker. In his different speeches, Mr. Zhang was quoted as saying: *“The only thing that we know is that we know nothing”* and *“If you don’t overcome yourself, you will be overcome by others”*. All these reflect in Mr. Zhang’s strong leadership and management philosophy for changes.

### **Current Business Model Strategy**

Haier's current business model is in **renewal** stage. The main strategy of this stage is **Network Strategy**. One important step of this network strategy is to eliminate the middle tier of current organizational structure (Exhibit 4 in appendix). This will make the organization flatter and keep the frontline management and in effect, the customers very close to the organization which will make the **Zero Distance to Customer** goal a reality. The new business model will be based on the current (stage 4) service focused business model into platform enterprise that will make it possible to provide customized services to ensure that the end-users get the best home appliance experience possible. In this new model, Haier will no longer be an organization with boundaries but instead an open platform between value-chain partners or even nontraditional suppliers for that matter. In this open system, customers are co-creators of value. Haier is working to take R&D and even manufacturing outside of its present organizational boundaries gradually. With this new platform, the reinvention of Haier will not be closed but open to the whole society. And we believe this futuristic strategic approach of Haier will change the whole household appliance industry concept as we know it today.

### **Conclusion**

Haier's business model innovations over time are different in such that the company is from an old-economy and mature industry. This change is not about high-tech razzmatazz but about change in household appliances, where margins are thin and innovations few. This change is about management fundamentals and philosophy. Important take away from Haier case is that you cannot ignore the potential for transformational change in any industry or any geographical location. The leadership of any organization must be prepared for the challenge of creating such change, no matter what the industry or location. Through a culture of continuous organizational innovation, Haier seems to be well prepared for the challenges of the future.

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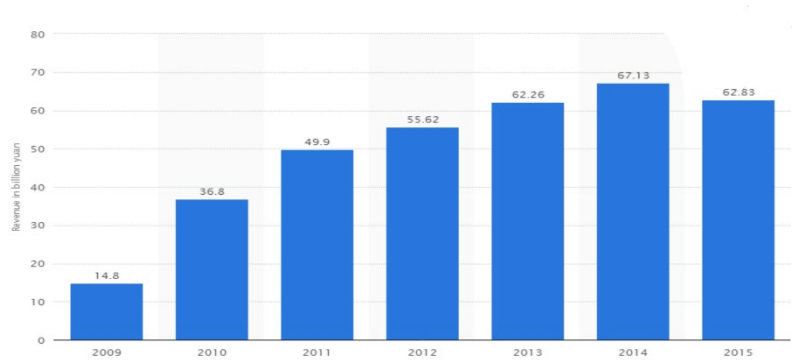
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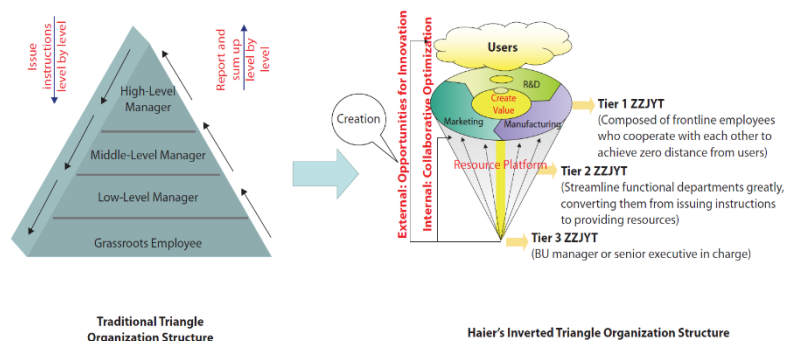
## Appendix

### Exhibit 1 Haier Sales Revenue (2009-2015)



Source: Annual Report of the company

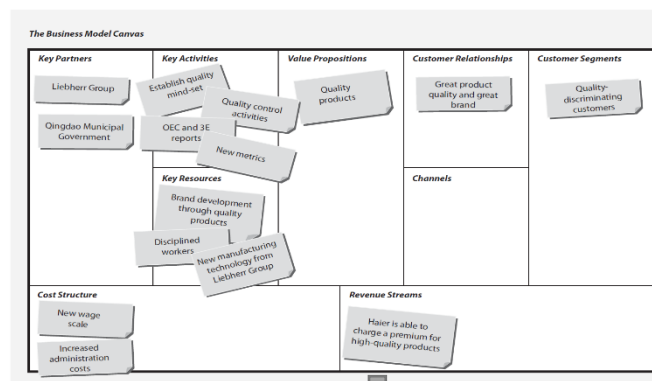
### Exhibit 2 Haier's Inverted Triangle Organization Structure



Source: Fischer et al. (2013)

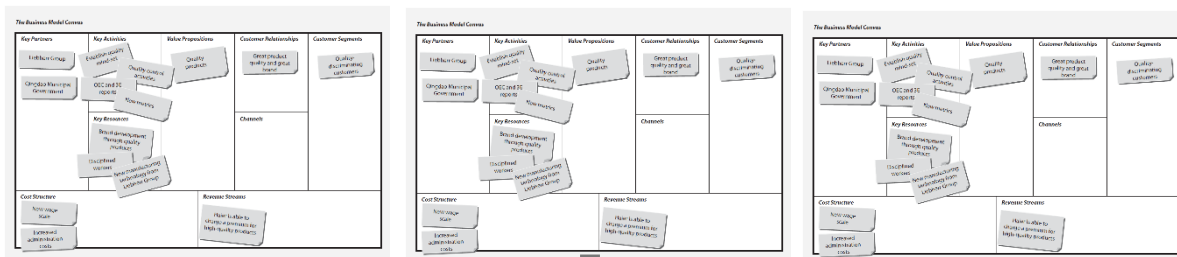
### Exhibit 3: Business Model Transformation of Haier

#### Stage 1

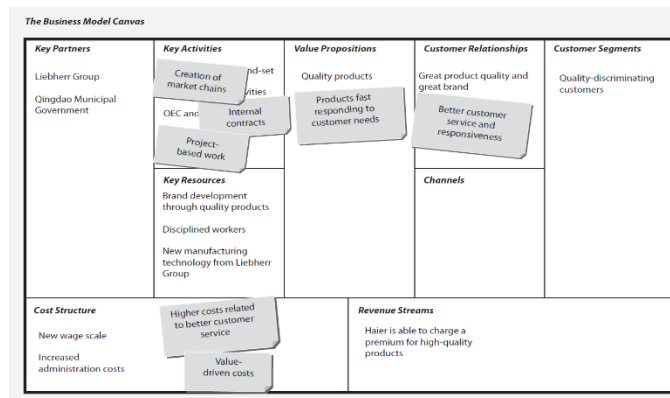




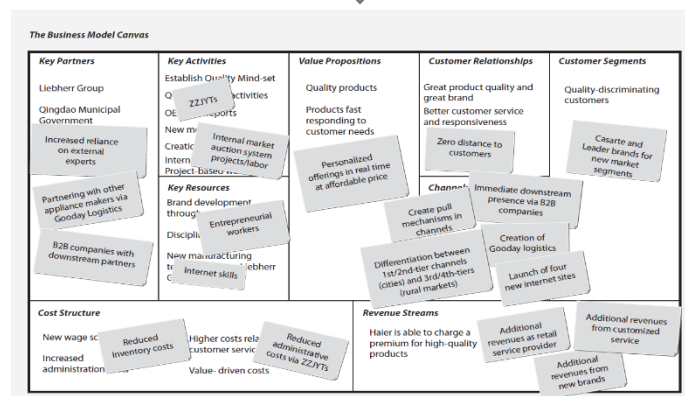
## Stage 2



## Stage 3

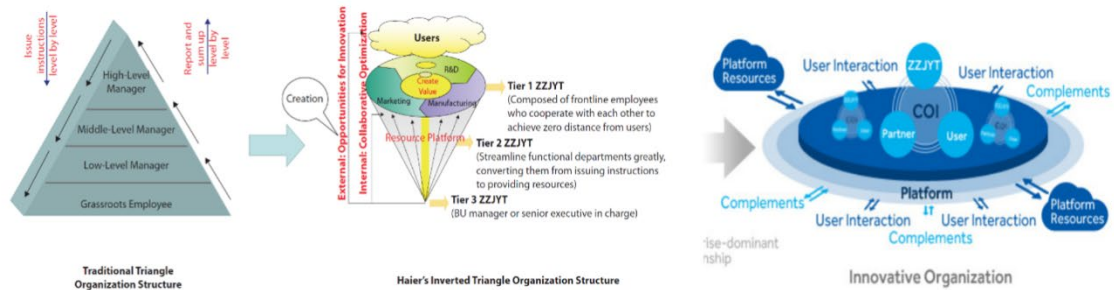


## Stage 4



Source: Based on information of company website, annual reports and Fischer et al. (2013)

### Exhibit 4: Stage 5 Transformation of Haier through Network Strategy



Source: Based on information of company website and Fischer et al. (2013)