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**The New System of Innovation
Founded by the Haier Group and
the Theory of Grassroots Innovation
in *Mass Flourishing***

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The New System of Innovation Founded by the Haier Group
and the Theory of Grassroots Innovation in *Mass Flourishing*
Edmund Phelps *

A novel system of innovation has been designed by Zhang Ruimin, Chairman and CEO of the Haier Group of companies in Qiangdao, and put into practice over the past few years at Haier. The early experience with the application of this system suggests that it will continue to be applied for the foreseeable future.

I

What is new here is what Chairman Zhang and others in the Haier Group call its “employment model,” termed the “Rendanheyi model.” The advance brought by this model is that it serves to motivate employees to use their abilities to conceive and develop new ideas for use by the company in which they are employed and possibly other companies in the Haier Group. A lengthy memorandum from Haier sent to me on July 26, 2021 states that “Haier’s Rendanheyi model is devoted to creating an environment that drives its employees to innovate, and it has worked remarkably well in Haier’s experience.” (p. 10)... “[It] drives employees to innovate around user’s needs...to ensure sustainable, upward growth momentum at Haier.” (p. 2). In this model, “any employee can compete to join a project with a competitive proposal; and employees are no longer passively executing orders, but rather active entrepreneurs and partners with decision-making powers.” (p. 1) ... “everyone can become his own CEO...” (p. 3)¹

An important step forward from my perspective is the policy to draw when needed on the creativity and inside information of one or more *employees* to solve a problem faced by the company rather than to hire one

¹ “Haier’s Rendanheyi Model: Reinventing the Institution and Rediscovering Human Value,” Haier Group, Qiangdao, August 2021.

or more outsiders. That policy will often be better for the company than hiring outside experts. Using the employees to solve the problem may have the further benefit that it raises *their* morale and the morale of much of the company's workforce while, in contrast, hiring outsiders does not; it may undermine morale.

The prevailing impression at Haier is that the comparative performance of the Haier Group, while already at a high level in previous years, reached new heights in the past few years. Annual reports by the Haier Group show profit rising in the past four years (though it was not the first such rise.)

In a nation where a large number of companies come to achieve innovation from such a "drive," an appreciable acceleration of productivity growth could result and the nation as a whole would benefit. A spread through much of the economy of this new company policy toward its workforce might bring a significant increase in the nation's economic growth.

It was a joy for me to see that the rationale of Haier's new management model had something in common with the theory behind the rise of innovation in my book *Mass Flourishing*. We both recognize that in a company as well as in a nation, the acquisition of a significant rate of indigenous innovation requires drawing on the creativity of the people involved. Chairman Zhang was aware of this common element. In a phone call last month he began the conversation with the remark that he had read *Mass Flourishing* three times in the course of developing the Rendanheyi model.²

² Beijing, September 2, 2021.

Both theories depart from the neoclassical theory of innovation. For one thing, the neoclassical theory, originated by Spiethoff and extended by Schumpeter, did not recognize that people have an innate desire and ability to *create* – to imagine and conceive, products or methods. That desire and ability can be traced as far back as the prehistoric *Homo sapiens* who conceived and managed to create a usable flute (found in a south German cave) and the Neanderthals before them, who evidently took pleasure in drawing figures on the wall of the caves they lived in. Thus, creativity was displayed even in prehistoric times.

Another thing: A great *many* of the advances made when massive innovation arose in the 19th century were the ideas of *ordinary people* – to use a term appearing in *Mass Flourishing*. The jobs that people had – in farms, fisheries, factories, offices and other places – helped point them toward new and better methods and in some cases, new products. Florence Nightingale’s organization of hospitals, Thomas Edison’s incandescent bulb, and Wilbur and Orville Wright’s airplane are some examples.

Yet the theory on which the Rendanheyi model rests is *not* identical to the theory in *Flourishing*. The former model calls for one or more employees in a company to volunteer to meet an existing need perceived by the management. In contrast, the model sketched in *Flourishing* envisions that in the typical company any employee (and the manager too) may conceive a new method or new product that may prove to address an unmet need or create a new demand. The theory in *Flourishing* does not describe an employee being recruited, or invited, to try to solve a problem conceived by the managers.

There is another commonality between the two models. In both the companies in the Haier Group and the companies described in *Flourishing*, there are apt to be *non-material* rewards from innovating – rewards that are hugely important for a great many people. The experience of imagining and creating can give meaning to work beyond the paychecks and so can the experience of helping out the company in which one belongs and the town in which one lives. These profound rewards, which are enjoyed by anyone engaged in such work bring an extraordinary sense of meeting challenges, of self-expression and personal growth. These *non-material* rewards are for many people just as important as the *material* rewards of work – maybe *more* important for some people. In the book *Dynamism* (a follow-up to *Flourishing*), my research team and I provide statistical and econometric evidence that a relatively high rate of innovation in a country is a reliable predictor of a relatively high “life satisfaction” and “job satisfaction.”

I would comment that, although work is *not* important to the *culture* of many countries, work *was* – and perhaps *still is* to a degree – central to a *meaningful life* in America, as described in several Hollywood films, such as *A Star is Born* (in both the 1937 and 1954 versions). *Dynamism* notes that “the American Dream – a dream held by many Americans – is best interpreted as a hope of *succeeding at something* in one’s life.” (p. ix).

In contrast, the neoclassical theory developed by Joseph Schumpeter (in the 1910s) and extended by Robert Solow (in the 1950s) saw only the innovations that were mere (commercial) applications of the discoveries by scientists and explorers around the world: It completely overlooked the indigenous innovations springing from new ideas bubbling up inside the nation’s economy – and bringing innovations for decades in much of the West. Neoclassical theory also overlooked the non-material rewards to

people engaged in innovating – also the employees participating in a company developing an innovation.

II

If companies in much of the Chinese economy –the private sector, at least – begin looking to their employees to solve their problems, that would raise morale over much of the country’s labor force. It would be *uplifting*, as my friend, the Finnish philosopher Esa Saarinen, would say. Innovation would increase in all or most companies in the economy.

This advance in management of companies in the Haier Group differs from what I believe to be the development in companies that was so striking in America. In my conception of what developed there, an employee of the company (and, of course, the head of the company) might occasionally conceive a better way of making something or a better thing to make. What emerged in the West was the rise of a continuing *supply* (per month or per year) of new ideas coming from employees, from company leaders and even from a few people arriving in the economy. In contrast, what has developed in the Haier Group, in my understanding, is the occasional *demand* for new ideas from within the companies – rather than from outside experts.

This managerial development by Chairman Zhang and colleagues is a rightward *movement up* the (unchanging) innovation supply curve, which is pulling up innovation achieved in companies. The development in America that I describe in *Mass Flourishing* was a rightward *shift* of the *supply curve* of innovation: The new ideas were not necessarily – and perhaps not generally – a response to a need to address a problem. Of course, each of these developments can be expected to lift the rate of innovation.

It is quite clear that, as is commented in the letter I have read, the Rendanheyi model is conceived – and it has been operating – “to address the management dilemma of large organizations, crack the management conundrum of the Internet era, and develop a management model unique to the Internet of Things (IoT) era.” (ibid, p. 4).

Yet it seems clear that this management technique could be extended to some other industries with some expectation of success. I would suppose that some of the high officials of the Haier Group have already given some thought to such extensions of the Rendanheyi Model to other industries or sectors of the economies in which Haier operates.

One other comment. Haier presents the Rendanheyi Model as driving its employees to “innovate around user’s needs.” (Ibid p. 2) I would add that a nation needs *in addition* people in the economy who have the imagination and the talent to *create* demands that never existed before and were never imagined before. That is a big part of innovation in human history.

I will end on an historical note. China’s economy is coming to operate – as the Haier Group does – on a system like that of the Rendanheyi Model – in which company leaders identify problems requiring new solutions, or innovations. In contrast, America’s economy came to operate from the late 1860s to the late 1960s on a system in which participants in the economy from the grassroots to the privileged conceive of new methods or new products. What made such an outpouring of innovation possible in my thesis was the values of the people – their desire to strike out on their own (called individualism), their restlessness to explore and to test themselves (called vitalism) and their desire for self-expression such as exploring and creating the new. Unfortunately, those values – handed down by the Renaissance and

the Enlightenment – appear to have been in a decline over most of America in the past several decades.

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