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A CHINESE SUCCESS STORY – HAIER AMERICA – PART I

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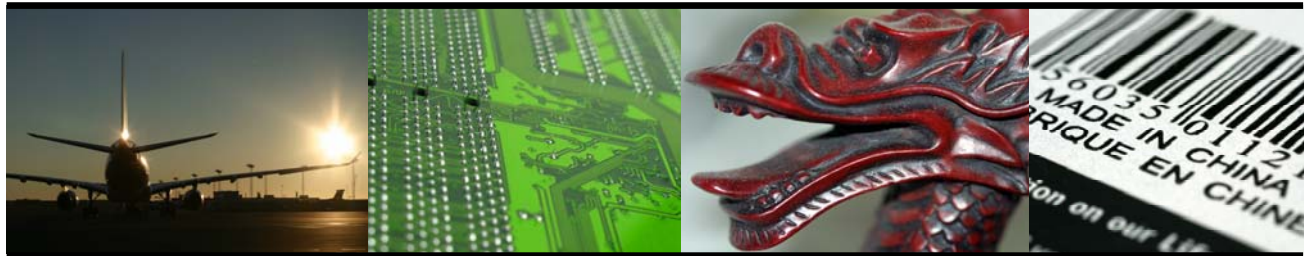
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A CHINESE SUCCESS STORY

HAIER'S PRESENCE IN NORTH AMERICA – PART 1

INTRODUCTION

China's trajectory is undeniably towards a more modern economy and form of government. In both respects, these solutions will be uniquely Chinese in their origin and structure. As the Chinese economy matures, the businesses contributing to its growth will have to become increasingly adept at the mechanisms they employ to access non-domestic markets. China's future is inherently limited if it can only exist as a dumping ground for low cost and low skill manufacturing. If China's economy is to mature, it must begin to create unique products and capture value in ways currently untapped globally. To do so will require businesses that mature from being captive producers to manufacturers with developed product design and marketing strategies. The act of employing increasingly sophisticated marketing strategies, business development activities, and product design assistance are all a part of the successful story from Haier North America.

CHINESE BUSINESSES MOVING UP THE VALUE CHAIN

A substantial portion of the existing flow of commerce between China and the world is one-directional. This is most easily seen by the record-setting trade deficits between the U.S. and China. When contrasting the success Toyota has experienced versus the limited success of Subaru or the much more problematic Jialing LandWind SUV entry into Europe, what separates Toyota from other domestic competitors was a strategy of owning their path to market, as well as exhibiting a willingness to take the time and spend the money to learn the unique needs of the North American market before entering. This observation seems overly simplistic for many; however, for most Chinese businesses, even those whose client list includes Dell and Hewlett-Packard, a history that has involved customers bringing them business without a need for active solicitation has made them unaware of the need to control and manage their own destinies. But this is beginning to change; as

Kenneth and Geoffrey Lieberthal said in a recent issue of the *HBR*, “A handful of Chinese companies are already strong competitors in global markets: Haier in white goods, Konka in TVs, Galanz in microwave ovens, and Huawei in telecommunications, for instance.” “The Great Transition”, *Harvard Business Review*, pgs. 7-8, 2004. Companies looking to emulate the success of Haier, Galanz, Huawei and Konka but who are unsure of how to penetrate the U.S. market on something other than price will form the second generation of competition for North American market share, a competitive landscape that will be shaped by more than price alone.

HAIER IN AMERICA

Most Chinese companies have initially been successful as someone else’s captive producer of a particular good. Haier’s story has been well chronicled in the media in large part because its story is one of the few successes of a Chinese company that has built its own brand and appears poised to be one of the break-out Chinese companies in control of its own destiny. Only 17 years ago, Haier was nearly bankrupt, a dilapidated factory only capable of producing poor quality refrigerators. In 2004, Haier is the second largest global refrigerator manufacturer, behind only Whirlpool. Global sales have reached \$7 billion, with 2004 sales approaching \$200 million in the U.S. In an interesting twist of almost poetic irony, the upstart Haier has recently become a pawn on the table of the Whirlpool-Maytag merger. In response to anti-trust concerns raised by the American Antitrust Institute and now being pursued within the government over the market share the new company would have, the two companies have responded that Haier’s burgeoning market share in the white goods segment is sufficiently large and growing as to not only allow the merger to go forward on the basis of pure market share, but as a matter of necessity for the two North American manufacturers.

PICKING AN ENTRY POINT

The entry mechanism Haier employed in the U.S. was to focus on a segment of the market that



other white goods' suppliers had overlooked – the dormitory refrigerator. For most manufacturers, this product had been overlooked and held a stagnant place in their retail efforts. Haier saw an opportunity to put its know-how and manufacturing resources to good use and began targeting U.S. retailers including Wal-Mart, Lowe's, Best Buy, Home Depot, Office Depot, Target,

Sam's Club, Menards, and Bed Bath & Beyond with a limited product line – initially only a very price competitive dorm refrigerator. A product line most appliance manufacturers were willing to give away allowed Haier to get a toe hold into the increasingly competitive retail sector. With this established in 1999, Haier moved quickly to also making and selling washing machines, dryers, dishwashers, air conditioners and a variety of electronics (including plasma screen TVs).

Haier's competitive model has historically been predicated on price plus incremental innovation. They have introduced dorm refrigerators with locks in order to keep the food supply of college graduates under their own control. Many people are unaware that Haier has been one of the driving forces behind a derivative product sharing common design and parts with dorm refrigerator: climate controlled wine storage. What was once a novelty purchase is now becoming an increasingly common addition to new kitchens and is the perfect example of a Chinese company learning to innovate, not just make low priced equipment.



HAIER'S FUTURE

Haier's future is by no means certain, and their startling growth from no U.S. sales in 1999 to sales of \$200 million by 2004 may not continue in the future unless they make further alterations to their business plan. Among the more pressing challenges to Haier-America is whether they can clearly develop a brand that has staying power. This concern has been voiced by a number of

members of the investment community who follow both the appliance manufacturers and their retail customers:

“As a brand name, Haier doesn't work,” says Nicholas P. Heymann, an appliance industry analyst at Prudential Securities Inc. in New York. “People may buy their dorm refrigerator, but I don't think they'll spend a lot of money on an appliance from a company they've never heard of.” Haier wants to hit \$1 billion in U.S. sales by 2005. Last year it managed \$200 million.”

“Haier's Tough Trip from China”, Business Week, April 1, 2002

Haier must prove that it can increase their prices to retail customers in its quest for additional margin in order to continue funding internal growth, product development and marketing. Such a move would change their privileged position within the retail community and would lead to their customers actively seeking secondary sources, inevitably resulting in a true test of whether Haier's success in America is predicated on a unique contribution to the white goods market or whether its success was entirely based on low price.

Haier is instructive with respect to the copy and create paradigms. When Haier began its efforts in America in 1997, it could content itself to making inexpensive knock-off dormitory refrigerators; however, by 2004 the company had introduced wine cooling systems, refrigerated beer keg dispensers, and a host of related white goods such as window-mounted air conditioners and the much more complex line of flat screen televisions. Like any business looking to ensure its future, Haier realizes it will have to couple its low cost manufacturing position with a broader product portfolio, a skill that will only be realized by an aggressive bent towards product development:

“Thinking out loud one day last year, Michael Jemal¹ created the freezer of his dreams. It would open from the top but also have a bottom drawer that kids could reach into to grab an ice cream. The two compartments would have different temperatures--very cold for storage and not-so-cold for more frequently used products. And the whole unit would be small and stylish enough to be in the kitchen rather than banished to the basement or the garage.

It was just a back-of-the-napkin sketch that Jemal, who heads the U.S. sales arm of Chinese appliance maker Haier, outlined to Zhang Ruimin, the company's chairman and chief executive, during a visit to headquarters. Engineers, designers, and marketers, Jemal knew, would have to consider the idea first, then flesh it out, a time-consuming process. But the next day Zhang, barely able to control his glee, ushered Jemal into a conference room and unveiled a working model of Jemal's fantasy freezer. 'I knew he liked to work fast,' Jemal says, 'but I was still amazed.' Ten months later the waist-high Access Plus freezer, in an array of vibrant colors, was on sale at the Lowe's retail chain across America. And while the product went from concept to kitchen improbably fast, it is no rush job. Good Housekeeping has given the freezer its seal of approval."

"Haier Reaches Higher", Fortune Magazine, September 16, 2002

¹NOTE: Michael Jemal is the CEO and President of Haier-America.

The type of success Haier has had thus far in North America began with a cost advantage, but will be sustained only if Haier can continue to innovate in the face of other Chinese manufacturers who penetrate the retail community with low prices, emulating Haier's initial success. Few issues may be more critical to Chinese manufacturers looking to export their way to success than quickly escaping the copy paradigm. Companies stuck at this stage are likely to be exploited by their customers as the retail client knows that without their retail business, the Chinese company can not survive. While this is true of most businesses that serve the consumer through some form of retail outlet, for a Chinese OEM whose retail customer may amount to 90% or more of their total revenue, the loss of a retail customer can be unrecoverable. The Chinese OEM has no real leverage over the retailer unless it builds a brand name, and unless it creates a product that consumers specifically look for. This is the challenge Haier is soon to encounter.