

## ‘Adapting Business Models to Changing Markets’

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I’m delighted to be here at the Tsinghua Business School and to have a chance to meet with you.

Although it is some time since I completed my studies at Eindhoven Technical University in the Netherlands, I can well remember the tremendous excitement attached to advanced studies.

Much of what you are learning as MBA students concerns international – and mainly western – management theory and practise. So as future managers you look to the West for learning. My own experience was just the reverse. I looked to the East to learn.

During the 1980s I came to China frequently because of my management responsibilities. And so I tried hard to learn about Chinese culture while I was in Asia. I can tell you, what I learned has helped me enormously in my present job.

As students in the process of becoming Masters of Business Administration, you are all familiar with modeling exercises that require you to design a set of responses to changing business circumstances.

These exercises come in many forms. The project might be integration after a merger, or facing a new competitor in the home market. It might require handling a growth-rate that outstrips the available resource-base.

In each case, your professor’s objective is to put you in the executive’s chair to see how you respond to the test. To test your courage and flair in preparation for the real thing.

For a minute I will ask you to join me in a similar kind of exercise..... And at the end I will ask you: “is this a game you’d like to play for real?”



Let me set the parameters for your assignment.

We're talking about a global company, with around EUR 32 billion in annual sales and more than 160,000 employees. It's a broad-based technology group with a unique portfolio that spans lifestyle, healthcare and enabling technologies. In each category, the company in question is ideally positioned for the digital world.

The company has exposure to emerging markets – including China – where it has sales of US\$6.7 billion and exports some \$4 billion worth of goods and components. No problem here: growth is fantastic and you plan to increase your commitment.

But in developed markets there is a problem. Every technology provider is suffering from a temporary “digital glut” caused in part by the collapse of the dotcom boom, in part by a relentless “technology push” that is not matched by a “market pull” from eager consumers. Sluggish markets, overcapacity and increasingly fierce competition are forcing every producer to reassess underlying business models.

So here is your assignment: how do you adapt this company's business model to exploit changing markets worldwide? Your solution will win extra marks if you can pay special attention to three categories:

- High speed, continuous innovation
- A truly flexible organization with global brand recognition
- Creation of entirely new categories that redefine borders and generate sustainable new growth.

In case that sounds too easy, remember that along the way you may be confronted by outbreaks of terrorism or SARS, while you'll be subject to sometimes hostile scrutiny from the media and your shareholders. Governments and international trade bodies will intervene to trip you up. And of course, the competition intensifies every month.

The most relentless pressure of all is that you simply have to stay out in front. Only by taking the leadership role in shaping the future of your industry, can you have any real hope of determining the outcome.

OK. You've guessed it already .....this isn't just an assignment I copied from a business school textbook. It's what I know best and what I have to deal with out there in the University of Life.

And for some of you too, this will be more than an exercise. It could turn out to be your own life's work.



As China's technology companies (Examples Haier Group, Konka, Legend, or Huawei Technologies) move onto the world stage and become global brands, the same challenges await a new generation of business leaders.

This is of particular interest to those of you planning to make a career in consumer electronics. As China's CE companies increase their prominence, its executives will face all these tests and more.

And even if you are not planning a career in this field, I firmly believe that full understanding of effective business models is of vital importance in successful management in any area.

Adapting business models to the changing market is of interest to every MBA who will go on to manage a business in his or her career.

I gave you this introduction to explain why I think you might be interested in Philips.

And to tell you that I am interested in all of you. I see three types of people in today's audience.

- I see potential recruits who may choose to join our growing business teams in China. We already are the largest MNC in China and we have been growing at a rate of more than 20% per year. We want to enhance that position by increasing our R&D and transfer more business management activities to China. Incidentally, we're also committed to ensuring that within five years, at least 10 percent of our top management is Asian. We have a hiring program to attract the brightest and the best.
- I see potential partners. Some of you will before long have management positions in the leading Chinese companies with which we do business. One day you may be outsourcers, suppliers, or j/v managers.
- I see potential customers. You could be future trade buyers of Philips products, or retail buyers. It might be an MP3 player you're giving to a family member. It might be a million integrated chipsets for a mobile handset manufacturer, or an MRI scanner for a city hospital. Either way, I want you to know that Philips is a great brand, and we serve great brands.

We hope our lives will touch again.



To make this day stick in your memory, I want to tell you something about Philips. Something that may also be useful to your MBA studies.

So I'll tell the story of how we at Philips are reinventing our business from top to bottom. In the process we believe we are changing the whole industry.

The reasons for this big change are the same three test categories I cited in the business school exercise.

First, there has been a step-change in the pace of competition: the landscape has been fundamentally altered to the point where true innovators investing heavily in R&D have less and less time to enjoy the fruits of their labors before "me too" producers catch up.

The solution: high-speed, continuous innovation

Next, responding to these changes requires an organization that's truly global yet adapts design, manufacturing, and above all marketing, to local or regional conditions.

The solution: total flexibility

Finally, it's no longer enough to launch new products into increasingly saturated markets – leaders have to be able to launch whole categories and create entire new markets where none existed before.

The solution: products and services that redefine entire markets

These three core themes are the pillars supporting our business model.

First, let's explore the need for high-speed, continuous innovation. Innovation is essential to the long-term development of any company. But it's especially true in the fast-moving world of consumer electronics, where the rule is "innovate or die." This is because there has recently been a step-change in competition.

Let me give you an example. The DVD was arguably the most successful home electronics device of the last 50 years. Three years ago it was a rarity. Today it's a commodity – in some markets DVD players are given away free with other products.

Developing a product like this is much like climbing a mountain – once you're the first to do it everyone else wants to join in too. The increasing velocity of the innovation-to-commoditization cycle now challenges our entire industry. With so many "fast followers" in the marketplace, nobody can rest.



Only the leading brands such as Philips can create genuine innovation through investment in R&D – but we must accept too that we have less and less time to enjoy the fruits of our innovation.

That puts us on a treadmill of accelerated innovation, propelled in Philips' case by almost US\$3,6 billion a year spending on R&D.

Philips has more than 95,000 patents and is recognised as one of the world's leading innovators. We played a leadership role in bringing the world CD, CD-ROM, CD-RW, DVD, DVD+RW etc.

Given this level of investment, you understand why we attach great importance to a current, serious issue, namely the need to protect and enforce intellectual property rights.

Next, Flexible Organizations. In the last two years we have made the transition from being a largely verticalized manufacturing organization into a center of excellence for marketing and technology.

The consequences of our seeking a much more flexible structure to sustain our leadership are very visible here in China. We have created multiple alliances or partnerships here.

For example, Philips is a world leader in mobile phone technology. Three out of every five handsets used worldwide have either a Philips chipset, a Philips display or Philips audio components. But we no longer manufacture complete handsets. That's the responsibility of our alliance partner CECW here in China.

For Philips, flexibility is about the switch from manufacturing to marketing. It's also about adapting design, marketing and technology capabilities to regions and markets. We need different business models for different regions, while our technology base remains global.

Everywhere, global enterprises are moving away from being vertically integrated manufacturing monoliths to focus on sales and marketing, with technology leadership. In the process we are, I believe, becoming pioneers with quite a different approach to that of our main competitors in the CE business.

Flexibility is about the way we in the CE industry relate to others – competitors, industry peers, customers and suppliers. So we are testing out new business models based upon alliances and partnerships.



I sometimes describe this as “cooperative competition.” For instance, we have alliances with Sony and with Microsoft, although we compete in some markets. And in Europe we partner with Motorola to develop system-on-a-chip solutions that will speed the introduction of 3G and 4G mobile phones. We pool our R&D and manufacturing resources – but still compete head-to-head in consumer markets. That’s flexibility.

My final theme is the creation of new categories rather than individual products. Launching whole new categories outside the traditional boundaries of CE and creating new markets where none existed before.

Let me give you an example – and make a small confession.

Philips invented the audio-cassette. That was a great new product. But Sony took our audio-cassette and invented the Walkman personal stereo. That was a whole new category. Now the confession: If I had the choice, I would rather claim that Philips had invented the Walkman!

Fortunately Philips now has such a product itself; it’s called Senseo a complete new way of making coffee. It is an absolute top hit in Europe and we will launch it in the US next March. One day China will be the launch market for such a type of product.

New categories aren’t just about products. They can result from a blend of products and services.

In our own technology field, we are learning that the coming of broadband telecommunications services to the home is creating a hugely powerful combination of information, entertainment, hardware and connectivity.

That means telecommunications and cable companies, Hollywood studios, and providers of in-home entertainment systems, are busy forging alliances. In Europe, Philips is now present as a service provider in all the leading EU economies.

Last week we announced an alliance with France Telecom to develop and market fixed telecommunications as well as multimedia products. This will improve people's daily lives in their future digital homes. Consumers get a combination of Philips products such as home networks and connected entertainment and communication technologies. along with France Telecom's broadband service and installation.



We work with many other telcos and content providers, packaging their services and entertainment with our equipment give us a whole new marketplace in the world of “PC-less broadband” – and a different revenue model based on long-term partnerships. So we’re not selling boxes any longer: we’re service platform providers. That’s a whole new category that didn’t exist before.

Creating new categories is also about putting different parts of your business together in new and innovative ways. I’ve talked about our participation in the world of consumer electronics.

But Philips is also one of the world’s top three providers of medical diagnostic equipment, including MRI and CT scanners, X-ray equipment and advanced patient imaging devices. We are number one in cardiology, with more than 2.5 million heart procedures carried out each year using our equipment.

It should come as no surprise to learn we are drawing upon our leadership both in medical systems, and our deep understanding of consumer needs, to develop a wholly new “health category” designed to meet a growing global need for personalized healthcare.

We are all becoming more conscious of our personal health and the steps we must take to ensure our long-term “wellness.” We want to participate in our treatment, if only to save money. We want to stay out of hospital. And if we do get sick, we want treatment in the home.

That’s the backdrop to a new category which we believe could be one of the largest of all “emerging markets” of all. Empowered consumers looking after themselves with the help of an array of small user-friendly machines straddling the world of medical diagnostics and consumer electronics.

No one is better-placed to make these devices than Philips.

Already, we are providing remote monitoring services for patients in Germany and other European nations with heart problems. Our heart defibrillators designed for use by ordinary citizens are helping save lives at thousands of locations in the United States.

In developing countries there is huge need for telemedicine and remote monitoring to bring modern healthcare to rural areas. We are already working with the authorities here in China to improve healthcare in the Northeast.

Conclusion



I have spoken enough about Philips. Now it's time to speak of you.

Earlier I mentioned that I saw three kinds of people in this audience: future recruits, future business partners, and future customers.

The first category is especially important to us. I have great admiration for the Tsinghua Business School. As a member of your school's governing board, it would give me a special pride if some of you also become future colleagues.

There's no shortage of challenges and we need the very best people. Earlier on I said I would ask you: "Is this a game you'd like to play for real?" If the answer is yes, then please think about a career with Philips.

But however our future relations turn out, there's another way I'd like to see all of you ... as friends. We at Philips have a tremendous admiration for the way all Chinese people – but especially its managerial class – have brought the country through anxiety and turbulence to stability and peaceful expansion. And all in such a short time and at such a pace.

It has been and continues to be an invigorating ride – one I am sure will continue as the students of today become the leaders of tomorrow.

Thank you all.

Can I take your questions now?

