Challenges and opportunities created by China’s economic growth

Philips publications November 2005
The rapid rise of China creates opportunities for businesses and economies around the globe, as long as they are willing to accept the challenge and adapt actively to the changing reality. Gerard Kleisterlee, President and CEO of Royal Philips Electronics addressed this challenge in his speech at the EFQM (European Foundation for Quality Management) Forum on October 4, 2005 in Cardiff, UK.
Ladies and Gentlemen,

It is a great honor addressing this distinguished audience here today. I think the theme of this gathering – where next for European business? – is spot-on and very timely.

China is on the European agenda of course, as the EU-China business summit held at the end of 2004 in the Hague under the Dutch EU presidency illustrates and I am sure that Great Britain, will keep it on the agenda as well, now it has taken up the EU presidency. Because the need for Europe to change, to increase its competitiveness, to strengthen its knowledge-based economic activities has become extremely urgent.

As Philips is one of the largest foreign investors in China, I was asked to focus on the consequences of China’s rise for European business and I will gladly do so. Over the last couple of decades, China has stunned the world with its breathtaking economic growth.

How should Europe, both its governments and its companies, react to this huge transformation of China?

It is all too human to observe the rise of China with some apprehension. What are the risks, what are the threats? As the CEO of a truly multinational company, I am hearing this question all over the globe, from Tokyo to New York, from New Delhi to London.

China has an enormous and low-cost labor pool, excellent higher education, rapidly expanding R&D and an impressive infl ow of foreign investment. As the cost differences between China and developed countries are very significant, some observers see China as a giant vacuum cleaner that will eventually suck up all European and American jobs. Isn’t China therefore a major economic threat to Europe and the US?

I understand this reaction, but I disagree with it. I think we should see China’s dramatic development not as a threat, but as a unique opportunity for the rest of the world. We can all profit from China’s rise, as long as we
are willing to accept the challenge and to adapt actively to the changing reality.

China’s rise is a fundamental part of the globalization of economic relations over the last decades. Globalization, with its phenomenal increase of international investments and trade, is not a zero-sum game, where the gain of one country automatically means an equivalent loss for another. Globalization is about the creation of win-win situations where all countries can benefit from increased international flows of capital, goods and services.

Many Asian countries, too, are apprehensive about China’s rise. But rapid economic development in these very countries shows that the doom-scenario to describe the implications of China’s transformation is wrong.

A growing market
China is not only a competitor but also a rapidly growing market for products and services, a real growth engine for the world economy. Other opportunities for new, mutually beneficial relationships spring from the rapid internationalization of many Chinese companies. They develop their own global brands, they form alliances with non-Chinese companies, sometimes they opt for outright acquisitions. TCL’s joint venture with Thomson and Lenovo’s deal with IBM are good examples.

For many European companies, China has become a vital supplier base. European consumers benefit from China’s low labor costs in the form of cheaper products. Win-win cooperation in R&D between European companies, Philips included, and Chinese companies and universities has grown rapidly in the last decade. I think, therefore, that we should draw two conclusions from China’s rapid rise. One, we have to adapt our economies in Europe to the new situation, concentrating more on knowledge-based, high-added value activities. Two, China’s transformation offers tremendous opportunities.
Only if we hold on to old ideas and ways, the opportunity turns into a threat. Immobility is not an option, we simply need to change. Change means opening up to the future, embracing new opportunities. That feels good. But change also means to let go of the past. And that can sometimes be painful, as we feel that old certainties and comfort are being lost. But whether we like it or not, we cannot get away from the consequences of globalization and digitalization.

A rapidly changing world calls for a clear course of action and vision. Implementation of this vision, the actual navigation of the course that has been charted, must not be hindered by clinging to the past. This is true for companies as well as for countries. At Philips, a company with close to 160,000 employees and over 30 billion Euro in sales worldwide, we have pro-actively adapted our company to this global age and, in the process, we have built up a very successful business in China.

First of all, we have clearly defined the areas where we can maintain or acquire a competitive edge. We now focus on Healthcare, Lifestyle and Technology, and we have adapted our portfolio accordingly. Healthcare is the area where we want to achieve most of our future growth. We have expanded our Medical Systems division through acquisitions and organic growth, and we have created a whole new business unit, Consumer Health & Wellness, to grasp the many opportunities in these areas.

We are very excited about our possibilities to contribute to the modernization of China’s healthcare system with appropriate products and solutions. China’s healthcare market, already the third biggest in the world, is rapidly growing due to an aging population, increasing healthcare coverage and growing government investments. Talking about opportunities! However, we do not only want to serve the Chinese market itself. We want to make China a global competence center
for economy- to mid-range medical systems, using China as an export base to other developing and emerging markets in Asia and beyond.

Our joint venture with local Chinese company Neusoft – a good example of mutually beneficial cooperation brought about by globalization! - is a cornerstone of this strategy. Together, combining forces and technologies, we will develop and manufacture economy- and mid-range Magnetic Resonance (MR), Computed Tomography (CT), Ultrasound and X-Ray equipment in China.

Our increased focus on healthcare was not our only answer to a changing world. We also decided at an early stage to concentrate on R&D, intellectual property and marketing & sales in the consumer electronic industries. That’s where the value is and where an innovative high-tech company with a strong brand and European roots such as Philips can differentiate itself from low-cost competitors.

Open Innovation
Philips’ increased focus on R&D and intellectual property (IP) is also visible in and beneficial to China. Our efforts help to increase China’s knowledge-economy. We have 15 R&D-centers in China, where we employ 900 people. In the spirit of Open Innovation, we cooperate closely with Chinese universities, research centers and companies, transferring knowledge to them. For us, China is not just a workshop, or a marketplace - it’s also a center of innovation for new products and services with global application. We are committed to increasing our R&D efforts in China.

We help Chinese authorities in their efforts to define, implement and promote a solid system of Intellectual Property Rights in China, for example, through the three IP-academies we have set up at three Chinese universities. Philips needs such a solid IP-regime, but so does the ever-growing number of innovative Chinese companies that want to protect the
fruits of their own R&D. Obviously, the implementation of IP-law in China is not yet as efficient as we would like it to be. But when you consider how long it took the Western world to achieve the level of IP awareness that China has reached in just 25 years, I think we must be truly appreciative of the progress made. It also shows the true interest of China to deepen the dialogue with Europe on issues like IP and corporate governance, as also laid down in the joint statement of the recent China-EU Summit meeting in Beijing last September.

**Sense and simplicity**

As a much more market-driven company, we also defined a new brand promise, ‘sense and simplicity’. In every market, we want to think up the type of products that consumers want: meaningful, advanced products and solutions that are easy to use and designed around the customer. That often means the adaptation of a product or solution to local circumstances or preferences. We are very pleased to see that the values contained in this brand promise – ‘sense and simplicity’ – are also a good practical basis for harmonious and respectful business dealings in China.

As said, for us, China is much more than just the world’s workshop for consumer electronics. And as we pursue new opportunities such as cost-effective medical diagnostic devices or remote learning aids for rural schools, we find China to be an ideal partner.

China thinks long-term – and China also thinks big. By 2020, China’s GDP will have quadrupled. As a respectful and responsive partner, Philips also tries to think long-term and to think big. Over the last couple of decades, our strategy has been to grow with the country. And we have been successful. It’s not just our innovative power, our knowledge of the local market and our network of contacts. What really sets us apart is our willingness and capacity to adapt, our eagerness to learn from our local partners and our emphasis on mutual respect as the basis for a long-term, win-win partnership.
History helps us, because Philips first put down roots in China back in the 1920s. In fact, not so long ago a piece of our shared history came to light. Philips delivered an early X-Ray machine to China, for the Emperor’s personal use. Decades later, the same machine was found in a storage room of the Forbidden City and returned to Philips by the Chinese government. It now has a place in the product demo room of our Medical division.

We are proud to be the largest multinational company in China as measured by overall sales, as well as being one of the largest investors in China. We formed our first China joint venture in 1985 – currently, we have around 35 legal entities in the country between joint-ventures and subsidiaries. Today, we employ around 20,000 people in China and our total business activity is around 9 billion US$. Two thirds of that is export sales and supplies. We are a top-three player in just about every market sector where we are present in China.

Sustainable growth
We have important non-financial targets too: to be the most admired multinational company in China. We define ‘most admired’ in terms of company reputation among customers and employees.

Philips is now perfectly placed to join China in its new quest for rapid, but sustainable economic growth that respects social and environmental harmony. Sustainability – the balancing of economic, social and environmental interests that is now emphasized by China’s government – is part of our company’s DNA. Not only as a business philosophy, also through many products and solutions we offer. Philips is famous for its energy-saving products. Installations based on our UV light technology for water and air purification are up and running worldwide. What’s more, through pilot projects in China and India, we are testing our distant healthcare and distant learning solutions.
Ladies and Gentlemen, this far into my speech, I think it is clear to you that China offers great opportunities to companies as a market, as a location for manufacturing and as an R&D base. I would suggest you try to look at China through the same glasses. Don’t close your eyes for the new realities, but try to benefit from them.

As the Chairman of the conference states in the flyer introducing this meeting, maybe many of us in Europe have only seen the tip of the iceberg of China’s transformation. So try to find out more, dive deeper, so you won’t crash into the iceberg, but profit from it. Enhance your knowledge about the possibilities of the Chinese markets, of partnerships with Chinese companies. Go there and invite Chinese companies over. Read, listen, experience. The one thing we cannot do is put our head in the sand.

So, for European companies, the only really valid answer to China’s transformation is an entrepreneurial answer, looking for opportunities. But what should Europe as a whole do to react to the competitive challenge posed by China and, for that matter, other Asian countries and the US? The answer is: focus on knowledge.

As your foreign secretary has pledged in his white paper on the eve of the UK presidency of the EU, Europe must become more dynamic and focused on innovation. Today, we must accept that Europe’s destiny is to be part of the future “knowledge economy” and that the consequence of our high standard of living is that we have to specialize in high-end, knowledge-based jobs. Let’s face it, the transfer of commodity manufacturing to Asia is not going to stop any time soon. Outsourcing and off-shoring is here to stay. This trend didn’t start with China and it won’t end there. As I have said before, certain R&D activities will also be established in the east, not in the west.

Adapt to new realities
Europe’s citizens should not expect from European companies that they go against the tide and maintain existing European
jobs at all cost. In our global economy, that would be suicidal for the companies and disastrous for Europe's long-term future. What citizens can expect, though, is that Europe's companies deal with painful transformations in a socially responsible way. That is exactly how Philips deals with it.

But, just as importantly, we should look rationally and enthusiastically at what we can win in this age of globalization instead of fret about what we are bound to lose. There is a general consensus that the way in which we organize our economy around knowledge and knowledge-application will be crucial for the future welfare of our society. It is knowledge that will have to keep Europe afloat. The role of other sources of value creation, such as industrial production, is diminishing and will continue to diminish, partly due to our high labor and location costs.

There has recently been widespread concern about the lack of dynamism in our economy and society. Western Europe has frequently been depicted as a somewhat stuffy open-air museum, a region that is in danger of being crushed between the economic power of a flexible, dynamic America on the one hand, and, on the other, Asia with its explosive expansion, led by superpowers like China and India.

I wouldn't be that pessimistic. Europe has met major challenges before, but Europe does need to get its house in better order urgently. Within a short space of time, our competitive position has weakened and our productivity has fallen behind. As a result, so did our growth and prosperity. Our society seems at risk of slowly coming to a grinding halt.

In the late nineties, people started to realize this on a wide scale, which led to much critical European self-analysis. It seems clear that a lack of entrepreneurialism is part of the European problem. For example, we are not very good at translating our often excellent research at universities and research institutes in viable, promising, innovative commercial projects.
We need to organize our economies around knowledge and innovation, but innovation requires entrepreneurial thinking. It sometimes seems, however, that entrepreneurial thinking has ceased to be a part of the European DNA. Thinking in this way does not come easily to everyone. We find, for example, that young people in the European education system are still taught too much of yesterday's knowledge and there is not enough incentive for them to explore new territory themselves, to push the boundaries. Hardly anywhere do you find entrepreneurship as part of the standard curriculum, not in secondary education, higher education or university education.

I know that discussions about entrepreneurship are being held within many universities. To make our economy more dynamic we need to increase cooperation between industry and educational and research institutes, so that we achieve a better return on our existing knowledge, giving rise to new activities.

We must also remove the barriers that block the full development of our entrepreneurial potential. This means that we have to lessen the burdens on business, especially on small- and medium sized enterprises. We have to accept, too, that we cannot maintain the same inflexible labor markets that took shape in Europe in the decades following World War 2. In this respect, the UK has been a great example for the rest of Europe of how to adapt to new times and how to foster entrepreneurial activities.

**Focus on innovation**

Five years ago, the European Union launched its Lisbon agenda to make Europe the world's most competitive, knowledge-based economy by the year 2010. As Philips, we agreed and still agree with most of the Lisbon proposals: less red tape, more flexible markets, bigger efforts in R&D, more cooperation between business and universities, take away barriers within the internal market. Unfortunately, during the first five years, progress was
patchy at best. In many respects, we have only fallen further behind. We therefore wholeheartedly supported the relaunch of the Lisbon agenda by the Commission earlier this year and we sincerely hope that the Commission and especially individual governments will translate their words into positive action.

Does this mean that we have to give up old certainties, that we have to give up some security? Sure, but let me be very clear. Europe’s backward-looking sense of security is increasingly a false sense of security. In the current economic climate, and in view of the speed at which major transformations are taking place, certainty and security – at least in the material sense – are a thing of the past. Clinging to these values is like maintaining an illusion, and thus holding back desirable change. To put it bluntly: the longer we wait, the less money there will be left to provide any form of security to future generations. That is not the most efficient approach to take and it is certainly not a sign of solidarity.

Don’t misunderstand me. I am not saying that Europe should blindly copy other countries or regions. We have our own social model and it is definitely not all bad. We will have to find our own way forward. But only action and confident change, not inaction and fear, can save the European social and economic model by adapting it to modern times.

So where do we see good examples of how Europe should proceed? What is the strength that Europe can build on in the future?

Fortunately, there are still many industries where Europe is at the forefront of development. Good examples are the car industry, aeronautics, medical systems, lighting, telecommunications, software-intensive systems and machine-tools. Commoditized manufacturing may go east, but there is definitely a future for Europe in high added value manufacturing. Obviously, high added value manufacturing and a solid effort in R&D reinforce one another. If we get it right, there are great opportunities to gain new business
for these sectors globally. First and foremost in China, where there is a strong demand for goods and services that the country needs in its modernization effort.

We should strengthen our knowledge-based activities with a decided strategy of open innovation, clusters of excellence and public-private partnerships in R&D. Open innovation means getting rid of the 'Not Invented Here' syndrome, embracing cooperation in research with other companies as well as universities. Open Innovation means actively pursuing cooperation in the innovation process.

Public-private partnerships in R&D foster open innovation and Philips is a strong supporter of joint research programs such as Medea in micro-electronics and ITEA in software-intensive systems, both Eureka-programs in which we actively participate. Clusters of excellence generate this cooperation, as is well-proven in Silicon Valley, still the world’s most famous and successful cluster.

**High-tech regions**

Here in the UK, Cambridge offers a good example of a cluster of excellence with a tremendous capacity to create value. On the European continent, one example among many others of an ever more successful cluster is the cross-border triangle formed by Leuven in Belgium, Eindhoven in The Netherlands and Aachen in Germany.

Today, Leuven’s IMEC (Inter-University Micro Electronics Center) is Europe’s leading independent research centre in microelectronics and nanotechnology. It was created almost out of nowhere with two basic ingredients: vision and enthusiasm. Philips, which already has a research facility within the Center, is supporting new research on the newest and smallest generations of semiconductors.

Not only in Leuven, but all over Europe Philips is playing its part in Europe’s transformation by creating knowledge-based jobs in research, high-added value
manufacturing, marketing and branding. Currently over 75% of our R&D spending is carried out in Western Europe.

It is true that well under 50% of our manufacturing sites are now based in Europe, but I would like to emphasize the quality of these plants. To name just a couple of examples: we produce special lighting units for cars in Germany and high-end diagnostic medical equipment in The Netherlands. And we continue to invest in semiconductor wafers at the Hazel Grove site near Salfords here in the UK. Over the last few months, we have announced investments of 35 million euro in our Turnhout lighting plant in Belgium and of 40 million euro in LCD backlighting technology that will basically favor our plant in Roosendaal in The Netherlands.

So you can see that, whatever happens in the commodity sector, we are committed to maintaining a strong European presence in High Value Added Manufacturing.

I should also mention the High-Tech Campus in Eindhoven, of course. We initiated the High Tech Campus as a prime example of Open Innovation clustering, as we share our facilities with scores of other companies, from established names such as IBM, SUN Microelectronics, Atos Origin and ASML to promising start-ups. There are currently some 4,000 people working at the Campus – but this number is expected to rise to 7,000 or 8,000 by 2008. It represents a EUR 600 million investment, with 25 new buildings including 25,000 square meters of lab space and an 8,000 square meter clean room. It is the heart of the Eindhoven region where 40% of all R&D activities in the Netherlands takes place.

The Campus is well on its way to becoming a hotbed of new activities and innovative businesses, where the level of cross-pollination generates an almost tangible enthusiasm. Here, experienced researchers suddenly feel rejuvenated, revitalized by so much innovative energy. This is the very kind of élan that Europe needs.

Ladies and Gentlemen, allow me to finish with a plea for Europe. I cannot avoid the
impression that, in recent years and in many European countries, Europe’s image has been the victim of fear of the unknown, fear of change. It is tempting, but dangerous, in times of globalization to fall back on the old and the familiar. We should remember, however, that European integration offers us great opportunities. More enthusiasm about this process of integration is called for.

The European Union, with all its shortcomings, helps us as Europeans to set out a joint strategy in a rapidly changing business environment and to promote our joint interests via joint projects. We at Philips were already involved in developing a vision for Europe back in the 1980s, at the time of Jacques Delors. And now we need a vision once again, we need to look forward once again. Lots of work still has to be done to perfect our European market – I am thinking, for example, of the discussion concerning the EU services directive – but a huge amount has been achieved in the past twenty years. If we want to retain our European values and way of life in today’s global market, a united Europe is indispensable.

Thank you very much for your attention.