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Sustaining Economic Growth in China *Bridging the Digital Divide*

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Ladies and Gentlemen, Good Evening;

It's a pleasure to return to China. And a special pleasure to be back in Beijing.

I used to come here regularly during 1997 and 1998 as part of my responsibilities for Philips in Asia. But China moves fast and since then, many things have changed.

Including the leadership. Which explains why I was here in Beijing exactly two months ago for a meeting with Premier WEN JIABAO in the Great Hall of the People. I was told later that I was one of the first three foreign chief executives to have this great privilege.

That meeting certainly started a very important learning process for us at Philips, and is the reason why I'm here today. What we learned from talks with Premier and other members of the leadership, is now guiding and informing Philips in the development of our own China business strategy.

This week members of the executive board and management committee of Philips are here with me to deepen our commitment to China. We're here to learn more.

In the process we are discovering what international companies – and especially technology providers – can do to help sustain economic growth in China. And so the theme of my talk tonight is what the international business community can do for China, and what China can do for our community.

I plan to share with you some thoughts on China's likely development in the coming years.



From Premier Wen I learned something of the development agenda of the Chinese leadership. And about the solid foundations now being laid to ensure sustainable economic growth into the future. We received a series of pointers to the areas where MNCs and technology providers could usefully work with the government.

Here is a brief sample:

- China is committed to achieving as smooth and peaceful integration with the global economy as possible – including WTO implementation.
- The new leadership will continue the “open door” policy, and a stable political and investment environment encouraging continued partnership with multinational companies.
- Balancing development between urban and rural areas to spread benefits of economic growth is a high priority
- Improving infrastructure development – especially healthcare, is high on the agenda too.

I hope to deal with all these themes in more detail in a minute, but right now I just want to emphasize the importance of the first point.

China has so much to offer the world.... and we of the business community also have much to offer China in terms of sharing our experience and smoothing the way onto the international stage.

It is in everyone’s interest that China’s progressive integration into global markets and world affairs should continue to be seen as an opportunity, rather than some imagined and poorly-defined threat. We must not allow any misunderstandings to disrupt such a win-win scenario.

As I said, we at Philips are committed to China and we have some quite ambitious objectives: 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 are convinced the 21st century is the Century of Asia.

Now, China is a country that’s famously hard to read. Plenty of foreign businessmen have tried to move too fast. Plenty have been too slow. And plenty have gone home in despair without seeing much more than the inside of a hotel room.

I can tell you: Like many of you here tonight, I’ve been there too.



Waiting in a Beijing hotel room for the phone to ring. Wondering if we really had the right personal connections. Wondering if my interpersonal harmony was strong enough to satisfy my Chinese counterparts. And wondering whether I would have sufficient stamina once those marathon negotiating sessions finally did start.

Well, we survived. And we thrived. So today, what makes us so bullish?

Let me say something about the reasons that brought us to a state of confidence implicit in this commitment—and why we believe China's economic growth is sustainable. More than sustainable. With the twin drivers of globalization and added-value industrialisation, we believe China is set for even more impressive take-off.

Philips first put down roots here in China 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 it 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 in Best, near Eindhoven.

We formed our first China joint venture in 1985. Today we employ around 18,000 people here. We have invested over US\$2.5 billion here, including our Shanghai R&D labs serving all of East Asia. Our annual sales in China are around US\$ 6.7 billion and we're a leading supplier of small domestic appliances, lamps and computer monitors. Above that we have significant market positions in medical systems and semiconductors. As such we are the largest multinational company in our area of activities.

Like many of the international companies that you represent, we first came to China looking for a competitive manufacturing base. We found it and today have 32 wholly-owned enterprises and joint ventures around the country. Exports have been growth at 27% a year on a compounded basis for the last six years. In fact we exported around US\$ 4 billion of goods and components last year.

But we also found something more important: a huge market with aspirations for better quality of life and phenomenal growth. With average aggregate GDP growth of 9% a year since 1978 that has quadrupled per capita income in half a lifetime, China has created a vast consumer market almost from a standing start. No wonder we're here.



The third thing – and this perhaps in the long term is most important – that we found in China was a group of allies and industry partners. Everywhere in the world, Philips partners with great brands to supply components such as displays, optical drives, LEDs or chipsets. It's no different in China, where some of our partners are well on their way to being recognized as top global brands. I'll cite Haier, Lenovo and TCL as examples.

In many markets we are known primarily as a producer of TV sets. In fact we are a TV, Audio, Lighting, Medical, and Semiconductor company. We also produce domestic appliances such as the famous Philipsave. We're an integrated technology provider with a strong focus on our customer base. I like to describe our central activity as "technology for people."

We play across a uniquely broad spectrum of technology activities and for almost a century we have been a strongly international company. Our focus on lifestyle, healthcare and enabling technologies brings us into constant contact with consumers everywhere.

This is the backdrop of our technology presence in China, and this sets the stage for the ways we and other technology providers can contribute to the challenge of sustaining economic growth.

At first glance, China hardly needs external help when it comes to growth. With a growth rate three times that of the United States and an inflow of foreign investment that last year exceeded America's, you could also teach us Europeans a few things about growth.

By 2008 China's GDP is forecast to have overtaken France and Britain to almost equal Germany's GDP. By 2020, China's GDP is forecast to be as large as that of the United States today.

Traditionally, the locomotives of global economic growth have been identified as the United States and the IT industry. But both those assumptions are being challenged by China's extraordinary progress. China is replacing IT as the dominant factor in driving the global economy.

And a recently published survey [Bank Credit Analyst of Canada, cited in Economist 15th Nov 2003] claims that China in fact contributed one quarter of all global growth in the period 1995-2002, compared to just 20% from the US.

In short, it would seem China can teach all of us something about economic growth.



But let's dig a little deeper into the nature of China's economic growth.

It's clear what has driven the economy is the globalization process. As China replaces Japan as the workshop of the world, per capita income has risen dramatically. In turn, the industrial activity demanded by globalization has been the stimulus for rapid urbanization, especially in coastal regions.

And now industrialization itself is changing rapidly, thanks to increasing productivity and higher technology inputs. In other words, continued growth and urbanization depends on open access to international markets.

Also, IT adoption is laying the groundwork for a surge in future productivity. For instance, China already has 460 million phone subscribers (fixed-line and mobile) with new subscribers joining at the rate of five million *a month*.

From the outside, it looks like a virtuous circle. Hundreds of thousands of university graduates are coming into the workplace. White collar staff in the United States cost 6 times more than in China; blue collar workers in the US are paid 40 times more than those in China.

Inflationary pressures are modest. In fact some economists speak of a deflationary model resulting from the high level of household savings and availability of low cost capital for business.

Inevitably, China also faces challenges to the economic growth model.

Firstly, external pressure is mounting for the leadership to permit the Renmenbi to appreciate in relation to major trading currencies. Such pressure for external trading partners may result from an imperfect understanding of China's real policy objectives.

It is our understanding that China does not intend to pursue a trade surplus for its own sake, but to struggle for balance. WTO implementation will mean lower tariffs and much greater imports. In fact imports are already rising at a faster pace than exports. So two-way trade will restore the balance naturally.

Currently a lot of discussions are going as to the appreciation of Renmenbi. As a businessman we of course appreciate consistency of policy and stability of the currency and both are major factors when making future plans.



Next, the leadership is very much aware of the potential threat to economic growth caused by regional economic imbalances.

Massive development along coastal provinces where industrial infrastructure is concentrated, contrasts with less developed hinterland and more rural economies.

The Pearl River Delta (including Hong Kong), for instance, sustains a regional GDP of US\$ 344 billion and exports of US\$ 156 billion – all from the labours of a population numbering 119 million.

By contrast the Southwestern region – with a larger population of 137 million, sustains a regional economy of just US\$ 72 billion.

Bottlenecks are already visible in some coastal areas where the frantic pace of construction cannot keep up with demand. In coastal cities there is competition for scarce resources like hospital beds.

Meanwhile migration from the interior to the coast may help to keep labour costs down, but it brings other problems in its wake. In rural areas there is urgent need for better schooling, access to IT, and local healthcare.

The contrasts between economic expectations in China's rich coastal areas and those in more rural provinces of the hinterland, are reminiscent of what back in the 1980s used to be known as the "East-West" or "North-South" split between richer and poorer nations.

On one side stood countries with developed infrastructures, educated populations, access to capital and above all to technology. On the other side stood nations burdened by decades, even centuries of underdevelopment.

Lately, economists have come to recognise that what really divides the "haves and "have-nots" is access to communications and digital technology. Those with access to such technology can catch up fast. Those without it experience much slower growth.

So people have begun talking about "The Digital Divide." In a large, complex economy such as China's, the best way to secure sustainable economic growth is to accelerate access to the benefits of technology.

There is a magnificent prospect here: China developing – as we know it surely will – into a country with a much more equal spread of wealth and the benefits of national prosperity, including high quality services such as health and education.



This is why we're here: for a century, Philips has been associated with improving the quality of people's lives. And we continue this tradition here in China.

Ladies and gentlemen;

This brings me to tonight's central question.

What can western companies – especially technology providers – do to help China sustain economic growth?

I can best answer this question by returning to that list of priorities we learned about from our discussions with the leadership. And by telling you in each case what we at Philips are trying to do.

Firstly, we recognize and applaud China's policy of peaceful development and integration into the international community. We encourage international businesses to continue seeing China as an opportunity rather than a threat, and we are working with the authorities here to promote this.

We do what we can to understand this country's needs – hence the presence in Beijing of almost all our senior executives this week.

Next, the policy of continued partnership with multinational companies is bearing fruit through more joint venture businesses. As I mentioned, we at Philips are determined to double our sales over the next four years and that means new ventures. In fact you'll be hearing news tomorrow of an important joint venture agreement that we will be announcing in the semi-conductors area, for implantation in the Northeast. Other developments in the healthcare field will follow shortly.

Continued partnership and the open door policy has other consequences.

In particular, greater confidence in steps now being taken to improve protection of intellectual property rights has convinced us to move a much greater portion of our research and development effort into China. We already have 60 scientists working at our Philips Research East Asia unit in Shanghai. China is an important focus for our worldwide R&D effort that employs 3,000 people and absorbs EUR 3.2 billion a year. Now we are planning to shift an important part of that here.

The trigger was reassurance at the highest levels that intellectual property rights are top of the government's agenda. And that infringement of IP rights will attract severe penalties.



Nobody likes making licensing or royalty payments. But they are a fact of international business life. And just about every developing country finds that as it begins to produce more complex products itself, safeguards are needed for its own industries. China's leading companies now have considerable intellectual property in need of protection, just as we do.

Next, balancing development between urban and rural areas to spread benefits of economic growth. This is a subject I've already referred to. But I will tell you what we at Philips are doing.

We are exploring a number of areas where we can assist the leadership achieve its policy goal - - particularly in terms of remote learning or e-learning for schools and remote medicine. One region of special interest is the Northeast, where we have two projects running.

For example, education in outlying areas is a key project for the Chinese leadership, and digital television for e-learning will play a key role.

China has already adopted digital broadcasting standards for cable TV and the next step is to adopt standards for digital terrestrial television (DTT).

We see DTT as the bridge across the Digital Divide, providing services that are currently only available to people that can use, understand, and afford PCs that may have costly broadband connections. DTT brings education to everyone without a PC. All you need is a screen.

Philips has plenty of experience with DTT in Europe, where we have an agreed standard in place (the Multimedia Home Platform). Cities such as Berlin and Barcelona are going all-digital and we can bring our know-how to China.

Lastly comes the policy goal of improving infrastructure development - particularly in the area of healthcare.

In case you didn't know, Philips is one of the world's top three suppliers of diagnostic and imaging systems. We specialize in cardiology, oncology, acute care, and women's health. In fact, 2.5 million heart procedures are carried out each year using our scanners and hospital imaging equipment. Philips Medical Systems is well on its way to representing one third of our overall business.

We are working closely with the authorities in terms of healthcare partnerships in the areas of manufacturing and development. This cooperation with China's



authorities will, I am confident, be of mutual benefit as Philips develops new technologies specifically aimed at improving wellbeing and healthcare for needy populations.

Healthcare has risen quickly up the policy agenda since this year's SARS epidemic. This highlighted the need for improved hospital facilities in urban areas and better healthcare in China's rural communities.

There is a revolution going on in healthcare, enabled by new generations of digitalised diagnostic equipment. Just as importantly these machines are supported by new healthcare IT systems that collate this diagnostic data, track patient records, and ensure smoother flow of patients to their doctors or clinicians. Systems like our Digital Diagnost are already helping hospitals to clear patient care backlogs.

For rural areas, telemedicine - including basic monitoring and diagnosis plus booking of visits through a unified regional service center - will revolutionise care at village level.

You can all call this enlightened self-interest. Global companies like ours stand to benefit from the creation of a wider, deeper China market, with new consumer centers springing up away from coastal areas.

As a global consumer electronics company, we're as interested as anyone in seeing a growing population of well-educated, healthy consumers keen to enrich their leisure time with information and entertainment in the home.

Above all, we believe that China has a number of very special characteristics that are highly compatible with the broader **Philips Vision of the Digital Future**.

Let me tell you about this vision. You probably know that as a company we're committed to 'making things better.' That means improving the quality of life by bringing meaningful technologies into the home, the workplace - or anywhere people need information, entertainment or utility such as education or health services.

This vision covers all three of our key areas - lifestyle, healthcare and enabling technology. But it's especially visible in consumer electronics.

Our understanding of consumer needs and wants - based on decades of what we call customer intimacy - has emphasized two major trends that are changing the way we live:



- The emergence of new devices that are smarter, less obtrusive and more intuitive.
 - The development of wireless technologies and broadband communications.
- These trends underpin the Connected Planet – our vision for consumer electronics markets.

Connected Planet is the driving vision for an entirely new category, which has not only products but also services, a category for which Philips has all the necessary strengths.

Connected Planet is a linked environment of devices and home appliances that can speak to one another, creating greater personalized control, productivity and convenience—in other words, a more comfortable living environment for people.

This isn't just about leisure and more screen-based entertainment – though it includes that too – but about helping people improve the quality of their lives by integrating experiences, functions and objects around them. All with the help of technology that's smart and meaningful.

Everything we do in the home - - accessing information, entertainment and data relating to work, health, or the functioning of property and assets – we will be able to do on the move.

Connected Planet is just part of a “bigger picture” that we are seeing gaining rapid acceptance in the United States and Europe. In some important respects, Asia is not the follower but the leader in grasping the Connected Planet principle.

We know, for instance, that the world's fastest take-up of broadband communications in the home is in Korea. And that Asia's absorption of technologies based on combinations of broadband and wireless communications is likely to be faster than elsewhere. That is why we chose Singapore for the Philips Connected Home Project. We're leading a major project with other industry players to convert more than 300 real households in Singapore into Connected Homes.

Naturally, we expect Connected Planet to have significant impact with more prosperous consumers in China's coastal cities.

But Connected Planet extends beyond the consumer lifestyle space to help us fulfil our mission of 'making things better'. What we are seeing is a move toward technology and well-being, and that explains our increased presence in all healthcare categories.



For instance, one of the most powerful new categories lies in the area of personal healthcare. The rising costs of hospital-based healthcare, plus increasing empowerment of patients-as-consumers, backed by their very natural desire to stay at home, is going to fuel an explosion in demand for personalized diagnostic and monitoring devices.

I've tried to give a brief outline of the issues facing our executive board and general management committee as we travel through China this week. Some experiences are unique to Philips, but many are shared by every MNC doing business here.

As I said, it's primarily a learning experience – about public policy, about strategic questions, and about China's economic prospects.

As we've seen, sustaining economic growth in China is more than simply sticking in the fast lane and just hoping things will turn out well.

It's about spreading the benefits evenly to achieve truly sustainable economic and social development.

And it's about championing China in international markets. Provided China ensures that the playing field of its domestic market is open, level, and fair then we should welcome new players into the global arena.

Finally, it's about using modern technology tools to spread these benefits more quickly, cheaply and efficiently than was considered possible even a short time ago.

Of course, we'll continue to do what we've done for a century: bring meaningful innovations to consumer markets to promote what we call "technology for people."

Thank you very much.

