THE STRATEGIC OVERVIEW: CAN PHILIPS SURVIVE WITH ITS RECENT SUBSTANTIAL STRATEGY CHANGES?

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This paper is dedicated to the strategic analysis of one of the most well-known Dutch brands in the world, Philips. The central, most important question here is whether the major change in its product strategy during the second decennium of the twenty-first century — from consumer electronics such as audio, television and lightning to healthcare sector — provides the sustainable competitive advantage that has comforted Philips for many years by now. After an overview of the company as such, the current strategy is explored through some relevant remarks about its market model, strategy and strengths, weaknesses, opportunities and threats (under SWOT analysis). The future strategy is described with some remarks about the value proposition of Philips, possible strategy changes, a suggested competitive advantage flowchart along with two successful examples of the strategic growth steps.

Keywords: strategy; business growth; business development; changes; Philips

Introduction

This paper provides a basic strategic analysis of one of the most well-known Dutch brands in the world, Philips. Even though this electronics multinational corporation has been

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THE STRATEGIC OVERVIEW: CAN PHILIPS SURVIVE

and still is frequently examined, some very recent developments on a global, external, political and economic levels caused some disquiet on the Euronext and New York Stock Exchange, and this fact alone makes it extra interesting to study the development of this company further. The mentioned above recent distress mainly comes from the disappointing quarterly financial statements of the company, its unfavorable exchange rates and increasing tensions in the world of trade, according to CEO Van Houten's press conference (NOS, 2018). Important question, however, is if the major change in the company's product strategy in the second decennium of the twenty-first century from consumer electronics (such as audio, television and lightning) to healthcare provides the sustainable competitive advantage that comforted Philips for many years.

The Company Overview

Koninklijke Philips NV, or Royal Philips (Philips) was founded at the end of the nineteenth century by Gerard Philips. The first products of this company were light bulbs. After a near bankruptcy soon after, Gerard's brother Anton joined the business. He has been always seen as the driver behind the quick expansion from lamps and light bulbs to electronics. The company became multinational just before the WWII.

Innovation has always been of great importance for Philips. Not always however did the innovative strategy provide success and/or competitive advantage. The Stirling engine developed just before WWII enabled selling more radios, however, it also turned out to be too expensive and later not necessary because of later quick development of transistor radios that did not need the engine of this type. Similarly, the first video cassette recorder, that was developed by Philips, was a disruptive innovative product but did not bring the company its sustainable competitive advantage simply because Japanese VHS system soon after came in much cheaper and also more compatible. For selling movies that could be watched at home, Philips developed the LaserDisc in the early 1980s. Here another failure scenario was about to happen, but Philips used a smart tactic this time by cooperating with its direct competitor Sony to launch the Compact Disc, a format that later would bring DVD and Blue Ray, the worldwide standards for media enough to provide some competitive advantage, in this case together with Sony.

Philips always had the image of the developer of innovative and even disruptive products but this fact did not provide sustainable competitive advantage. Until 2004 the marketing expression of the company was "Let's make things better". Research and development (R&D) was always above entrepreneurship for Philips, or at least it seemed so. To this day, Philips focuses mainly on R&D.

Philips employs approximately 74,000 people. It is active in more than 100 countries and its 2017 sales number was € 17.8 billion. Operating cash flow in the same year was € 1,9 bln and net income from continuing operations increased to € 1,028 mln (Philips, 2018).

Mission. Philips' global website shows that with its global reach and leading innovations, the company has a unique positioning among consumers and care providers delivering connected products and services supporting the health and well-being of people (Philips Global, 2018). In this context, the company's website also shows that new business models are pioneered, including technology managed services and software as a service and a product. Expansion through innovation is the key.

Vision. Continuing the abovementioned, the global website of Philips also shows a combined vision and mission, although the official statement seems to be a vision rather than a mission. The company publishes the following official statement: “At Philips, we are striving to make the world healthier and more sustainable through innovation, with the goal of improving the lives of 3 billion people a year by 2025” (Philips Global, 2018).

Analysis of current situation

Market model. Philips is acting under imperfect competition and can be seen as an oligopolistic multinational. Due to the long-term relations with suppliers, customer loyalty and innovative products and services that went through long R&D processes, the conditions to enter the market are not easy. This is especially true for all kinds of healthcare and related activities. These products and services have unique features, non-price tactics like long-term partnership agreements with hospitals are difficult to compete, price control exists and because of the niche character of this market, competition is limited.

Lighting market is already more difficult to share under oligopoly despite the 70 percent market share and the strong brand Philips has in this field.

Electronics is definitely under monopolistic competition, moreover now that the ever-powerful multinational is drifting away from that market. This highly competitive market makes price control difficult, the Philips products were not unique and as can be seen in many electronics retail stores with lots of brands and the threatening numbers of counterfeit products, the market is relatively easy to enter.

Goals and objectives. The global website shows clear financial objectives. Operational and strategic initiatives should deliver 4 to 6% of organic growth and an average of 100 basis point improvement in adjusted earnings before income tax, depreciation and amortization (EBITDA) over the period of 2017 to 2020. Strategic objectives are less concrete but still measurable. Growth in core businesses, portfolio extensions, customer and operational excellence should financially result in revenue growth, margin expansion, increased cash flows and improved return on invested capital.

The abovementioned objectives should, at least according to what is written on the website, be driven by new geographic growth opportunities and stimulation of innovative value-added integrated solutions, including mergers and acquisitions (M&A) and also inorganic growth. Tactics should result in the continuous lead in digital transformation, improving customer experience and operational excellence and productivity. The ultimate goal is increased shareholder value.

Strategy & Strategic development. Philips has been and still is changing its focus from consumer electronics to healthcare electronics. In the annual report of 2017 (Philips, 2018), it is explained that limits to resources, population ageing and the rise of chronic diseases, especially heart diseases, are driving up the demand for value-based healthcare. This seems to be the key answer to the question why Philips has chosen to shift to the products that monitor and manage health, both in house and in community settings. At the same time, active digitalization of the healthcare sector overall made the decision makers change from standalone products to the solutions combining systems, smart devices, software and services, thus creating special value for patients as customers.

Generic competitive strategy. As per classical Porter's Generic Competitive Strategies model (Porter, 1980), the strategy of Philips moved from broad differentiation to rather

THE STRATEGIC OVERVIEW: CAN PHILIPS SURVIVE

focused differentiation. With consumer electronics such as television sets and audio devices, Philips competed for brand loyalty through the most desirable features. It also faced difficulties while meeting customers' needs, being confronted with copycats and clearly overstretched on developing new, eventually not always successful features like the mentioned above Stirling engine, video system and LaserDisc. The chosen market of the healthcare sector is a niche one. It has a set of features customized as per the selected target group and it is not easy for competitors to enter this market.

Two remarks have to be made here however. Firstly, this market rapidly increases with the initiatives from Google, Apple and the direct competitors of Philips, such as Siemens. Secondly, Philips is aiming for the healthcare market in the broadest way possible. This means that it also continues to focus on home healthcare electronics such as electric shavers and toothbrushes. For these types of products Porter's broad differentiation strategy is still applicable. Philips still has to focus on providing better and more unique products.

Unlike Porter, who stated that it is important for sustainable competitive advantage to clearly choose one of the strategies instead of staying "stuck in the middle" to become overtaken by competitors, Philips dared to choose for both. As long as the company meets its goals and maintains its competitive advantage with both strategies, not much can be argued against this way.

International strategy. Philips is an obviously multinational company. It has manufacturing sites all around the world and is selling its products all around the world. Exporting from the countries where national currencies were weak has recently caused lower than expected profits for Philips. Over one of the recent quarters, the profit on the operating income improved 40 basis points instead of the expected 100 (CNBC, 2018). As Philips CEO Van Houten explained to CNBC, around the world there will always be foreign currency headwinds. As long as these are not structural, and this is seldom the case according to Van Houten, Philips will compensate those hiccups in the long run. For the same reason, currency issues are, in the case of Philips, not seen as a real, serious threat.

Another issue that might not be structural either but is still taken seriously by Philips, is the trade war between China and the USA. In an explanatory statement concerning Philips quarterly reports, Van Houten clarified that if tariffs reach 25 percent and higher, the company must consider moving production (NRC, 2018). Considering the generic strategies and the limited options to adjust prices especially for the products like toothbrushes and shavers, but also bigger medical systems such as MRI and CT scanners and knowing that moving production locations would only take little effort and only a time frame of a few quarters according to Van Houten in his statement, the potential change sounds logical. Moving production to alternative locations elsewhere in the world would mean producing locally, at the already existing factories, and also selling locally, in both China and the US.

Transnational approach. Apart from the described above tactical steps taken due to external crises, Philips thinks globally and acts mostly globally, in the majority of cases, especially in what concerns healthcare products and services for hospitals. Standardization of international healthcare products and services is a starting point that is profitable by default. However, most of today's electronic products are customized for the local markets. Also, the company often chooses for local decision-making and uses local marketing methods and distribution channels. China is a good example of a country where local R&D centers are being developed and incorporated by Philips.

Corporate social and environmental responsibility. Corporate social and environmental responsibility is also worthwhile mentioning since this is an aspect of Philips' strategy. Information about Philips' social and environmental projects can be found on its official web site and also on multiple other sites in the Internet. CSR is an important and integrated part of the annual reports by Philips while environmental reporting was first included back in 1999. To be able to make a positive contribution to society, apart from own research, the United Nations Environmental Program (UNEP) is used as a source, as are other international institutions like the World Bank, World Economic Forum (WEF) and the World Health Organization (WHO). Furthermore, Philips actively engages in work with other stakeholders such as labor unions, non-governmental organizations (NGOs), UNICEF, Amnesty International and Greenpeace. A variety of events and activities mentioned in Philips' annual reports underlines the success of these strategic steps. At the same time, the Dow Jones Sustainability Index (DJSI) ranked Philips the second (as of 2017) of all the listed companies in the healthcare category. According to the index makers, the company scored very well on environmental reporting, climate strategy, talent attraction and retention and health outcome (ROBECOSAM, 2018).

SWOT analysis.

Table 1 presented our SWOT analysis for Philips presented as a matrix.

Table 1 - SWOT analysis of Philips
(Source: Philips Global, 2017-2019)

Strengths Strong R&D Market leader in several different categories Strong Performance & Liquidity	Weaknesses Rapid introduction of new products Poor forecasting of the market demand
Opportunities Economic growth Ageing population Scaling hospitals	Threats Scarce workforce Competition at the electronics market Counterfeit market

Strengths. As it was already stated in the introduction, R&D is the key area for Philips. It gives this company the possibility to create extra value for customers and provides competitive advantage through development of innovative products. Philips does not forget to include organizational R&D by including innovation effectiveness and efficiency studies.

Partly because of the differentiated focus on healthcare, the company is now the market leader in cardiac care field, in acute care and home healthcare products but also in energy efficient lighting products. As per Porter's Five Forces (Porter, 2008), this competitive market leader strength could provide Philips extra bargaining power when it comes to negotiations with its suppliers.

Over 2017 (just like in many years before that, actually) Philips demonstrated solid financial performance. In 2017, the company reported to be generating sales in the amount of €17.8 bln. This is a good driver for the attraction of investment and thus funds for further

THE STRATEGIC OVERVIEW: CAN PHILIPS SURVIVE

growth and expansion. Improvement of liquidity numbers, also shown in the company profile, added to that.

Weaknesses. The focus on R&D and quick coming up with innovative new products has caused several recalls for Philips. Back in 2016 and 2017, for example, the company faced a major recall of lamps because of fire risks and then also of the X-ray devices because of software issues.

The second weakness that must be mentioned here is that despite the focus on the urgent healthcare needs of the population, it seems that Philips is not very successful in predicting market demand as it was demonstrated with the failure of innovative products described in the Introduction section. A careful, continuous and thorough analysis of the market for sales would be indispensable.

Opportunities. Economic growth after the global financial & economic crisis is an opportunity for Philips. Consumers are spending more now, and also both public and private sectors are starting to have more budget for spending on healthcare innovations, according to the statistics on health expenditures as percentage of gross domestic product (GDP) worldwide (World Bank, 2018).

The ageing population is a serious threat when it comes to labor market development. However, it is also an opportunity for Philips. With the increasing life expectancy worldwide and the collaterally growing number of chronic diseases, the company can be now focusing on this market and is currently heavily investing in this segment.

Last but not least, the upscaling in size and the lacking budgets of hospitals and restricted financing by banks in many Western countries can be also considered as an opportunity by the decision makers of Philips. Since 2008, Philips has been aiming for long-term partnership and service agreements with hospitals all across the world. The examples include the US, Ireland, Germany, Saudi Arabia, Australia and Philips' home country — the Netherlands. The company not only offers products and services but is also willing to financially invest in hospitals and also provides assistance to healthcare institutions so that they can get funding from banks and investors. According to a recent interview by Philips' CEO Van Houten, the long-term frame agreements with healthcare institutions such as hospitals already provide 30 percent of revenues (Van Lent, 2018).

Threats. A clear threat for Philips is limited availability of skilled labor. Due to the continuous development and introduction of new products, services and agreements specifically with regard to healthcare and all over the world, this multinational company always needs highly skilled labor. Among other things, the ageing population, especially in the EU, causes even more scarcity in demand. Fig. 1 below shows that even though well qualified, labor force in the age until 54 will be decreasing critically until 2025.

As shown in the Future Strategy section hereafter, Philips acknowledges this threat and tries to act accordingly.

Another threat, applicable specifically to the global electronics market, is the highly competitive nature of this market. Direct competitors are numerous and include LG, Whirlpool, Samsung, Panasonic, Sony and Sharp. Even though these competitors have always been on the market, the fact that Philips is less concentrating on electronics but still hanging on to this market makes the competitors — who still are focusing primarily on electronics — a real threat.

For the same reason, the counterfeit threat should not be underestimated either. The Organization for Economic Co-operation and Development (OECD) has published a study

in which it concluded that imports of counterfeit and pirated goods are worth nearly half a trillion US\$ a year. For Philips particularly, fake technical parts of electronics and also healthcare parts are damaging the business (OECD, EUIPO, 2016).

Figure 1 - Growth of population and labor force by age groups in EU-28+ (2015 to 2025)

Analysis of Future Strategy

Value Proposition and Surviving

Although the value proposition regarding products is strong because of the aforementioned concentration on R&D and thus innovation and the niche market Philips is now successfully operating in, the company must be prepared to modify certain aspects of its current business model to accommodate a variety of influential factors that can be best highlighted when divided into political, economic, social, technological, legal and environmental elements under PESTLE analysis.

A full PESTLE analysis has not been done for this paper, but we can still single out most vital political, economic and technological factors that are playing a huge role and are thus worthwhile mentioning. They are also the key factors for the survival tactics of Philips.

Political factors. As described before, the trade war between China and the USA causes concerns for the decision makers IN Philips. It seems that the company is able to quickly adjust its operations by relocating production to other, already existing factories. According to Van Houten, the only major adjustments that have to be made in the situation of such relocation is modification of production lines (NRC, 2018).

Brexit is another concern that could have a significant impact on international tariffs. Same applies to regional political conflicts in the Middle East and the migration provoked by these ongoing conflicts. Philips acknowledges these latter developments, although a clear strategy to manage these uncertainties would be extremely difficult to develop.

Technological. Philips acknowledged in its annual report as of 2017 that the healthcare business environment is highly dynamic. Thus, the focus should be on fundamental changes through further digitalization via the Internet and cloud-related activities. Potential acquisition and partnerships, apart from Philips' own slower R&D, are already part of Philip's strategy.

Economic. With the rapidly increasing healthcare market, Philips is now focusing on now new competitors will enter it and drastic events such as price fluctuations will

THE STRATEGIC OVERVIEW: CAN PHILIPS SURVIVE

eventually take place. If Philips does not prepare for these potential tactical changes, this could have substantial negative affects on the aforementioned growth ambitions, financial condition and operating results of the company (Philips, 2018). Possible strategies are now being chosen for broad differentiation and ongoing concentration on the already strong innovative value proposition and through that — on customer loyalty, once again, keeping an open mind about potential drastic product strategy shifts, following every relevant trend at the market.

Risk management. The 2017 annual report by Philips clearly explained how its risk management policy tries to address various strategic risks. An executive committee supported by functional experts is responsible for identifying critical risks and appropriate responses to them. The company sees it as a value-creating activity and oversees protection of the proposition value and supports process excellence, one of the drivers for the objectives and increased shareholder value as described in the Objective and Goals section.

R&D centers around the world, skilled labor, continuous international presence, enough cash flow to be able to rapidly take strategic steps if necessary and also access to alternative funding are resources in this process (see Fig. 2 above). The value proposition should consist of innovation, product and service development, labor excellence and also process and efficiency excellence. This phase should lead to continuous competitive advantage, which is presented through clearly chosen but flexible strategies, competitive product and service lines, engaged employees and optimal performance. The process of objectives, goals and strategies evaluation should be continuous.

Strategic growth examples

Lighting as a service. A recently published study (PR Newswire, 2018) worthwhile mentioning here is about a forecast stating that Philips product is still strong but it does not focus on lighting, or at least not as much as before. Recently, Philips has separated its lighting activities into Signify Holdings and agreed on a license agreement for Signify to continue using the Philips brand for its products (Rondolat, 2018). The study shows an interesting outcome from focusing on an initiative called “Lighting as a Service” (LaaS). Under such a business model, lighting is not sold but rather serviced. It means that both public and private sectors are offered a monthly paid service agreement for which they get continuously updated and upgraded (LED) lighting. The initiative is a joint development of manufacturers including Signify and service providers of lighting. According to (BIS Research, 2018), LaaS is expected to grow at a rate of return needed for the investment to grow further (CAGR) of 40.8% (between 2018 and 2025) globally to reach a US\$3.59 billion market. Apart from a reduction in carbon footprint which is strived for by both public and private sectors, customers will see substantial energy savings and thus cost reductions. This initiative can be seen as a very interesting tactic which is part of Philips’ growth strategy. Even though competitors are also part of this deal, Philips still holds a strong position which guarantees customer loyalty and competitive advantage at the lighting market.

Attraction of skilled labor

In a book on cultural change and leadership in organizations published back in 2012, Jaap Boonstra used the example of Philips to explain the crisis Philip’s Human Resource department experienced due to the extremely competitive job market conditions (Boonstra, 2013). The HR department was then unable to address the demand for top talent and put the

existence of the entire department on the line because it added insufficient value to the business process. This situation resulted in drastic changes in Philips' work practices' structure and culture. As already mentioned in this paper, highly skilled labor is (and was back in 2012) essential to the company. For this very reason, this topic was made part of the general strategy. As a tactic, recruitment of skilled labor was brought into focus, the customer in this case was the demanding departments within Philips. This tactic assumed more budget and a better examination of what was needed throughout the company. Ultimately, in the long term this tactic provided more and better candidates.

More tactical examples of the strategy adjustment are the development of owned recruitment centers and partnerships with external recruiters, including investments in talent schools and relations with universities all around the world.

Conclusion

By shifting from the well-known electronic and home appliances market to a niche healthcare market with unique innovative digital and connecting medical systems for the public and private sectors and at the same time still offering lighting under a different name and still serving the home electronics market with products like shavers and toothbrushes, Philips is moving these days from a broader differentiated strategy to a partly focused differentiated strategy. This strategic change has been forming new strengths, weaknesses, opportunities and threats.

To meet the chosen objectives and goals and ensure sustainable competitive advantage, a continuous strategy analysis is indispensable. A suggested strategic business model shows that the most important resources such as state-of-the-art R&D centers, skilled labor, global presence and enough financial resources should lead to innovative product development and structural labor, process and efficiency excellence. The competitive advantage in this case could include competitive product and service lines, engaged labor, optimal performance and through that — loyal customers. The process and efficiency excellence should include the continuous strategy evaluation and also protection of strategies' flexibility. Philips would then be capable of rapidly adjusting strategies and taking necessary steps to deal with critical political, economic, social and technical circumstances. For example, monitoring the niche healthcare market and timely recognition of threats can be now captured and more easily dealt with.

Another example is the tactical step Philips has taken for its lighting activities by jointly developing lighting services instead of lighting products. Environmental issues are thus well addressed. Obviously, further continuation of the chosen path seems to be feasible here.

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THE STRATEGIC OVERVIEW: CAN PHILIPS SURVIVE

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