MANAGEMENT FOCUS

Philips in China

The Dutch consumer electronics, lighting, semiconductor, and medical equipment conglomerate Philips NV has been operating factories in China since 1985 when the country first opened its markets to foreign investors. Then China was seen as the land of unlimited demand, and Philips, like many other Western companies, dreamed of Chinese consumers snapping up its products by the millions. But the company soon found out that one of the big reasons the company liked China—the low wage rates—also meant that few Chinese workers could afford to buy the products they were producing. Chinese wage rates are currently one-third of those in Mexico and Hungary, and 5 percent of those in the United States or Japan. So Philips hit on a new strategy: keep the factories in China but export most of the goods to the United States and elsewhere.

By 2003, Philips had invested some $2.5 billion in China. The company now operates 25 wholly owned subsidiaries and joint ventures in China. Together they employ some 30,000 people. Philips exports nearly two-thirds of the $7 billion in products that the factories produce every year. Philips accelerated its Chinese investment in anticipation of China's entry into the World Trade Organization. The company plans to move even more production to China over the next few years. In 2003, Philips announced it would phase out production of electronic razors in the Netherlands, lay off 2,000 Dutch employees, and move production to China by 2005. A week earlier, Philips had stated that it would expand capacity at its semiconductor factories in China, while phasing out production in higher-cost locations elsewhere.

The attractions of China to Philips include continuing low wage rates, an educated workforce, a robust Chinese economy, a stable exchange rate that is linked to the U.S. dollar (it has a managed float), a rapidly expanding industrial base that includes many other Western and Chinese companies that Philips uses as suppliers, and easier access to world markets given China's entry into the WTO. Philips has stated that ultimately its goal is to turn China into a global supply base from which the company's products will be exported around the world. Today more than 25 percent of everything Philips makes worldwide comes from China, and executives say the figure is rising rapidly. Several products, such as CD and DVD players, are now made only in China. Philips is also starting to give its Chinese factories a greater role in product development. In the TV business, for example, basic development used to occur in Holland but was moved to Singapore in the early 1990s. In the early 2000s Philips transferred TV development work to Suzhou near Shanghai. Similarly, basic product development work on LCD screens for cell phones was recently shifted to Shanghai.

Philips is hardly alone in this process. By the mid-2000s more than half of all exports from China came from foreign manufacturers or their joint ventures in China. China was the source of more than 80 percent of the DVD players sold worldwide, 50 percent of the cameras, 40 percent of all microwave ovens, 30 percent of the air conditioners, 25 percent of the washing machines, and 20 percent of all refrigerators.

Some observers worry that Philips and companies pursuing a similar strategy might be overdoing it. Too much dependence on China could be dangerous if political, economic, or other problems disrupt production and the company's ability to supply global markets. Some observers believe that it might be better if the manufacturing facilities of companies were more geographically diverse as a hedge against problems in China. These critics' fears gained some substance in early 2003 when an outbreak of the pneumonia-like SARS (severe acute respiratory syndrome) virus in China resulted in the temporary shutdown of several plants operated by foreign companies and disrupted their global supply chains. Although Philips was not directly affected, it did restrict travel by its managers and engineers to its Chinese plants.[11]

location into a high-cost location. Many Japanese corporations had to grapple with this problem during the 1990s and early 2000s. The relatively low value of the yen on foreign exchange markets between 1950 and 1980 helped strengthen Japan's position as a low-cost location for manufacturing. Between 1980 and the mid-1990s, however, the yen's steady appreciation against the dollar increased the dollar cost of products exported from Japan, making Japan less attractive as a manufacturing location. In