INTERVIEW

Contentious Debate? It Works at Philips

A technology powerhouse masters the "strategic conversation"

Royal Philips Electronics, based in the Netherlands, is one of the world's largest electronics companies and Europe's largest with annual sales of about $28.8 billion (€31.8 billion) in 2002, and 164,000 employees in more than 60 countries. The principal lines of business are lighting, consumer electronics, domestic appliances, semiconductors, and medical systems (Exhibit 1).


John McClure

When Gerard Kleisterlee became president and CEO in April 2001, he wanted to stimulate cross-business unit cooperation and develop a "One Philips" approach on a range of key strategic initiatives. With Kleisterlee as the sponsor, John McClure, Philips' senior vice president for corporate strategy, worked with Mercer Management Consulting to develop what is now called "strategic conversation"—a systematic process to enable debate and decision-making on the key themes and initiatives that will define Philips' future.

To date, Philips has run a dozen strategic conversations about issues such as how it should maintain leadership in the optical storage market, what display technologies and businesses it should focus on, what its strategy should be in China, and what the future broadband connected home will look like. McClure spoke recently with David Sovie, a Paris-based director of Mercer, and John Campbell, editor of Mercer Management Journal*. Sovie can be reached at david.sovie@mercermc.com.*

What was the catalyst for using the process of strategic conversations?

In the [previous CEO] Cor Boonstra era, Philips was run as a set of disparate businesses, where as long as you delivered your bottom line, no one cared about collaboration or group-level profitability. Kleisterlee's agenda is around "One Philips," looking at things more holistically. He wants overall common strategies for key technology areas.

The traditional strategy-setting process could not achieve that?

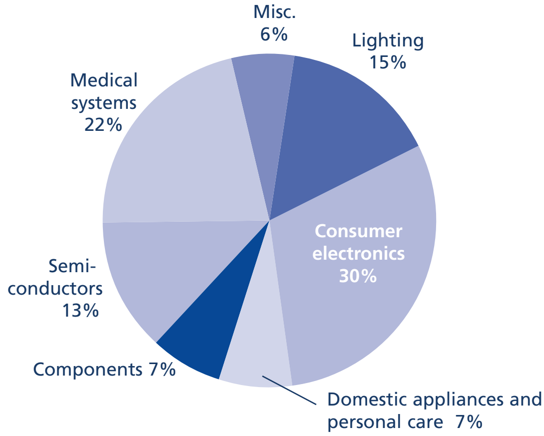
The traditional strategy process is very linear, using the artificial constraint of the calendar to set up guidelines for each business. It's not suited to looking at an issue that cuts across different divisions or different operations within the company and identifying what's needed in order to effect change or come to a common understanding. To do that, you have to weigh tradeoffs among the different businesses. So it's critical to get the whole picture.

As an example, take the first strategic conversation we held around optical storage technology such as CD and DVD recorders. Philips had multiple irons in the fire—we had standard-setting efforts, we were getting patent licensing revenues, we were a component supplier to other firms, we made semiconductor chips for consumer electronic devices, and we were also a leading marketer of branded end-products.

So we had multiple frames of reference and strategies for what is essentially one big activity across the company. How do you align all of those pieces? You can't do it within the traditional strategy setting, because each of those businesses was trying to maximize its own profitability, return, and market share without looking at an integrated picture.

Exhibit 1 **Philips at a glance**

2002 sales per sector as a % of total sales



Total €31.8 billion

How do you get started with a strategic conversation, and how many people participate?

The first step was to get our "board of management" to agree that this was important. On behalf of the board, I wrote letters to all of the businesses involved, saying that I need the person who knows the most about the topic of the effort to be a member of a working team for the next three to four months—not the highest-level executives, but the content experts. It might be a business owner; it might be a researcher, or a scientist, or someone else. You need the people who are in this business day in and day out, who know what's going on, and for whom a decision will have a clear effect.

In terms of size, you don't want to get too big. We usually have ten to 12 people from the businesses. We manage the overall project using three to four corporate strategy team members, often supported by a small team from Mercer, who facilitate meetings and do a lot of the research, interviews, and data analysis. So we keep the overall working team to no more than 20 people.

What are the key elements and steps of the process?

The process is built around a series of structured team meetings held roughly every two weeks, each lasting a day or two.

The first meeting usually focuses on defining the market—its size, what it includes and what it does not, the important trends, and competitive analysis. The second session focuses on issues like: What is our current course and speed? What is our position in the market? Where is the value in this business today, and where is value migrating? What are the key levers and actions Philips should consider?

Usually by the third session, we're starting to prioritize these value levers and to build several internally consistent scenarios. What if we did strategy X? What are the impacts on each of our different businesses? We usually come out with four or five different scenarios to evaluate. It's easy to say at one end that we exit the business altogether, and at the other end that we make multi-billion dollar investments to be the world leader. But those are unrealistic, so we have to come up with fairly sophisticated scenarios of what bets we can make and what our position in this business could be over time.

By the fourth session, we're working on how to quantify the scenarios and put some financials behind them. We need to rigorously debate whether we believe in scenario A versus B versus C.

By the fifth meeting, we're trying to summarize this in a way that tells a coherent and consistent story for the board.

There are clear milestones and desired outputs or deliverables for each session, and between sessions there are individual homework assignments and analyses taking place.

What are the roles of the board and the CEO?

There is a reason we call this a strategic conversation. At the end of the process, we take the CEO and our board of management plus the 20 people from the team and lock them in a room for four to six hours. They can't leave without making a set of critical decisions.

Before the meeting, each participant will have read a lot of background material. In the meeting itself, we present a set of scenarios in terms of the financial implications, both the investment required and the net present value return. Even more important, each scenario has a set of conditions, whether environmental, or technological, or something else: What you need to believe if you choose scenario A are the following conditions. Then they discuss all the options, query the experts in the room, have an active debate, and come to some agreement.

Can you describe some tangible decisions that have resulted from strategic conversations?

For our display strategy, we looked at all of our investments underway. We found that we were spending too much on the old CRT television technology and not nearly enough on the fast-growth, flat LCD [liquid crystal display] TV market. We also discovered that we had four separate LCD TV development programs eating up a lot of money, which in the end would have delivered basically the same thing but with different architectures. We decided to consolidate our development efforts, expand our range of LCD televisions, and increase marketing communications budgets. As a result, we significantly increased our market share in LCD televisions, and our display panel joint venture, LG. Philips, is now the world's leading supplier of LCD panels for televisions.

In our wireless connectivity project, we decided that WiFi or the 802.11 technology standard was going to be the long-term winner, especially in audio and video applications. We realized that we had a hole in our semiconductor division in this area, and we went out and made a small acquisition to plug this capability gap. We also ensured that our connected consumer electronics products support the WiFi technology standards.

A different type of issue we took on was our strategic plan in China. We discovered that Philips was the second-largest multinational operating in China, a $6 billion business. We had no idea, because it was spread out over hundreds of wholly-owned foreign entities. This strategic conversation allowed the board to reach a decision that we're going to manage China as a single entity with the P&L responsibility and management that go along with it.

This process has also helped build much better collaboration and teaming across divisions. In our first optical storage case, we gathered the team in a room for the first meeting, and it was obvious that most of them thought this was a waste of time. I gave my speech that we have three months to come up with the storage strategy for Philips. A guy from one of the divisions said, "Fine, you take my strategic plan, his strategic plan, her strategic plan, staple them together, and give them to the CEO." I said, "That's great, really easy. The only problem is that *you'll* have to present that to the board and explain why this is Philips' optical storage strategy." So he took his seat and acknowledged that maybe we needed to do a little more work. At the end of the project, this same guy was the biggest advocate of the strategic conversation process; he went around saying, "Every important initiative should go through this process."

When would you recommend that other companies use strategic conversations?

It's certainly useful for companies with multiple divisions that are all impacted by the same technology, the same customer segment, or the same macro trend. In fact, in designing the strategic conversation process, we learned from the experiences of both Johnson & Johnson, which has done a similar process on macroeconomic issues such as health care reform, and IBM, which has a need to align its hardware, software, and services divisions across a wide range of issues.

Even at large companies without multiple divisions, there are occasions when you need to make a very big decision and you want a range of subject matter experts with different backgrounds or experiences. For example, I could see a drug company using a strategic conversation to help with drug development if it had a whole set of drugs based on a similar disease or chemical.

It's also extremely useful when you see different camps forming around a key strategic issue. One camp says we should turn left, another says right, and a third says go straight. You need to reach consensus in a logical way.

Are there any pitfalls or cautions to keep in mind?

Don't use strategic conversations lightly. For one thing, at Philips the process now has a set of expectations about generating results. Also, it's intensive and it takes up a lot of senior-level time; for instance, the CEO and his direct staff have to budget five or six hours in a day for him to review material and attend a meeting. Team members must dedicate at least five or six full days to attend the working sessions. This has to be a CEO-sponsored effort in order to get the best people to participate.

One mistake we made in the first two strategic conversations was to present too much information to the board and the CEO at the meeting. We tried to take them through all of the market sizing and the key issues, and after about three hours everyone's eyes glazed over. We learned to put together a very detailed document they would read before the meeting. It's roughly a couple of hundred pages of in-depth knowledge. In the meeting itself, you only have to present the highlights. The good thing is that the CEO does read the document and he will ask questions of other people, and it becomes obvious who is faking it and who is not. Everyone there has to know the issues and the underlying data, so they have something relevant to say on the day.

I'll add that we still run a yearly strategy review process, which looks at the businesses in a vertical manner. Strategic conversation is an overlay on an ad hoc basis, but it doesn't take the place of normal strategy planning. ❖