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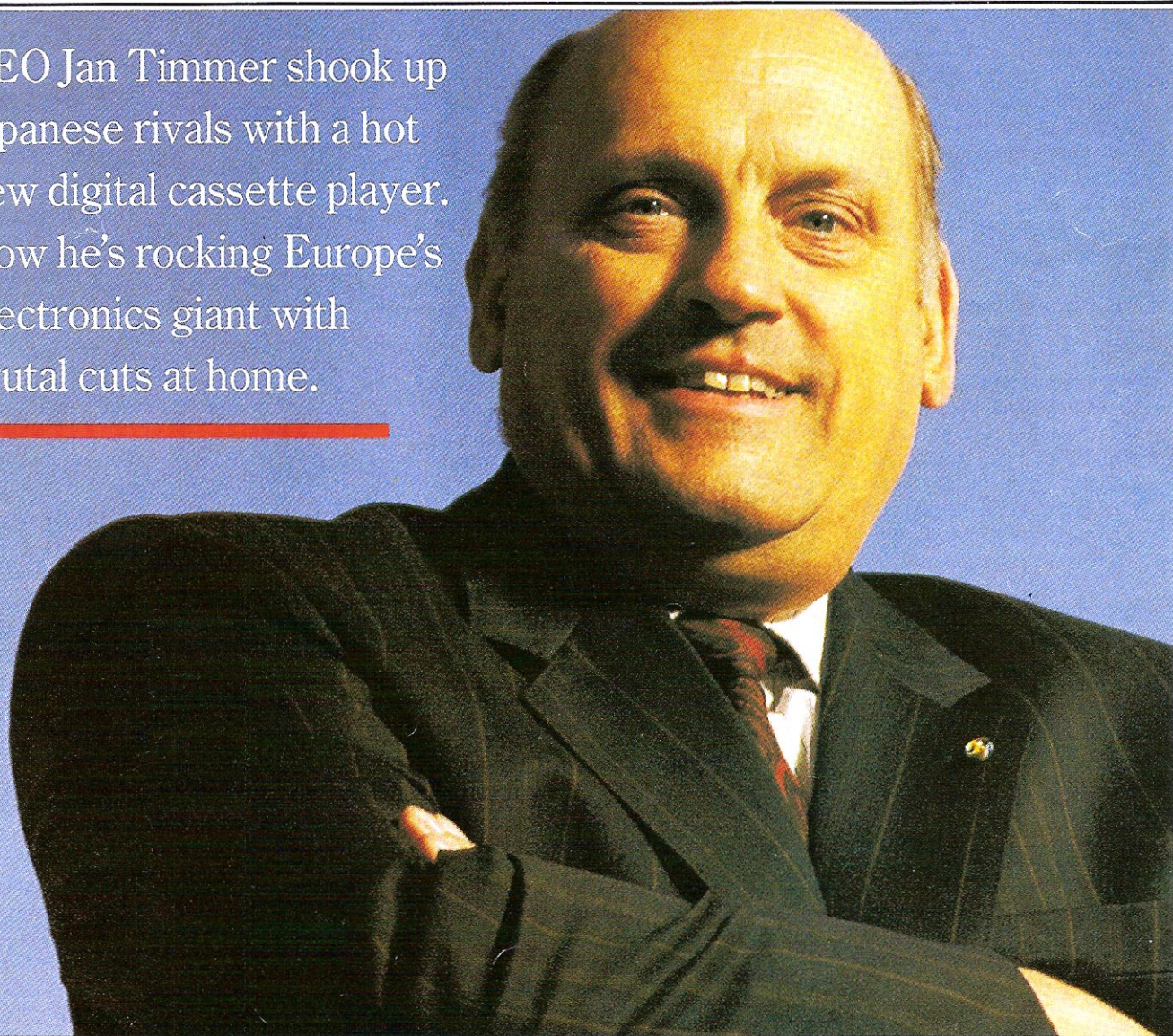
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# PHILIPS' BIG GAMBLE

CEO Jan Timmer shook up Japanese rivals with a hot new digital cassette player. Now he's rocking Europe's electronics giant with brutal cuts at home.



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# PHILIPS' BIG GAMBLE

## CEO JAN TIMMER SETS HIS SIGHTS ON DOMINANCE IN CONSUMER ELECTRONICS

**W**hen Jan D. Timmer took over as chief executive officer of century-old Philips Electronics last July and promised a revolution, many rivals doubted it would ever happen. But suddenly, the makeover of the troubled Dutch technology giant is in full swing. Once notorious for its slow-footedness in pushing products out of its labs, Philips under Timmer's sharp prodding has stolen a march on Japanese electronics rivals with a splashy new recording medium: the digital compact cassette (DCC), an audiotape system with crystal-clear sound.

Then, on July 23, Timmer rattled more cages when he struck a deal to sell off Philips' money-losing minicomputer division with its \$1 billion in sales to Digital Equipment Corp. for \$300 million to \$350 million. The message? He's dead serious about unloading the laggards in Philips' motley portfolio of businesses (table). While DEC thinks its getting a good deal, the sale will rid Timmer of a major headache (page 17). Too small to survive on its own, Philips' minicomputer unit had racked up about \$250 million in losses in recent years. "Philips will sleep a lot easier with this one behind them," says an investment banker involved in the deal.

**SHOCK THERAPY.** Timmer, who has earned a reputation as a freewheeling turnaround specialist in his 38 years at Philips, is moving into high gear on the biggest, riskiest project of his career. To revive the faltering \$28 billion company, which suffered a \$2.2 billion loss last year from restructuring charges, the

burly 58-year-old is in the midst of cutting \$1.2 billion in costs by slashing 55,000 jobs—nearly 20% of the work force (page 18). As if the firings weren't enough, Timmer has also cooked up a sweeping reeducation program known as Operation Centurion. It's shock therapy to focus managers' minds on something that has been neglected at Philips for years: profits.

To fire up those profits in the 1990s,

turning to Japanese, American, and European rivals to provide technology too expensive for Philips to develop by itself. All told, it shapes up as a radical restructuring that will either restore Philips to its role as a global powerhouse or relegate it to a has-been. "Timmer's our very own Schwarzkopf," says a senior staff manager, "and he's driving a tank through the place."

**LEADING PLAYER.** Hanging on Timmer's efforts is the future of the West's biggest major maker of consumer electronics. Philips is the only European company besides Siemens that's still a leading player across a broad spectrum of electronic technologies. If Philips can't stake out a place in the sun for itself in the competitive 1990s, then Europe's indulgent research subsidies and trade policies, which have greatly benefited Philips over the last decade, will have been for naught. And increasingly, Japanese and American giants will have the European playing field to themselves. "We have to prove that Europe is not a second-rate power in electronics," says Einar Kloster, a director on Philips' management board.

Philips is hardly Europe's only technology giant in a restructuring

mode. Groupe Bull, Thomson, and Olivetti are all suffering problems of overcapacity in the face of a burgeoning single market. But none calls for as vast an overhaul as Philips, whose technologies range from consumer electronics and electric lighting to office machines and medical X-rays. "It's the most challenging management problem in Europe by a very long shot," says James Golob, an analyst at S.G. Warburg Securities in London.

Timmer will be riding a tiger as he strives to score big hits with his hot new products. The financially weakened Philips no longer has the muscle to ab-

**TIMMER WITH PHILIPS' HOT NEW DIGITAL COMPACT CASSETTES: JAPANESE RIVALS WERE STUNNED**



Timmer is betting more than \$2.5 billion on the DCC and other

cutting-edge technologies. He's leaning on Philips' vaunted labs to spring high-definition TV, multimedia personal computers, and an ambitious entertainment and education system known as CDI over the next couple of years. At the same time, he is retrenching in businesses that once were the company's big hopes, such as computers, semiconductors, and appliances. And in a series of rapid-fire moves, he is





**PHILIPS HAS ALREADY  
PLOWED \$250 MILLION  
INTO HDTV  
TECHNOLOGIES**

ther existing CDs or cassettes. But Sony's is the first CD system that can record music.

Recording industry observers say this new audio war may lead to the kind of showdown in which Matsushita Electric Industrial Co.'s VCRs vanquished the Sony Betamax in the early 1980s. If the history of the compact disk, introduced by co-developers Philips and Sony in 1982, is any guide, whoever wins this battle will also reap sales of speakers, receivers, and other audio components—a market the Japanese have dominated for years.

Philips is counting on the DCC to juice up the flagging cassette market, where sales dipped last year for the first time. Cassette tapes account for 46% of the recording industry's \$7.5 billion revenues, so soft sales worry not only Philips' audio division but also its PolyGram recording subsidiary.

In short, Philips knows it cannot afford to botch this one. So it bent over backward to line up world leader Matsushita to co-develop and manufacture the DCC, as well as music-industry leaders EMI, Warner, Bertelsmann, and its own PolyGram to provide the cassettes. It also signed the rock band Dire Straits to promote the technology on their world tour later this year. In a sign that Philips may eventually win out, even Sony recently said that it, too, might license the DCC in addition to pushing the Mini Disc. "So far," adds Paul Gluckman, managing editor of *Audio Week*, "Philips has made all the right moves."

**STOLEN THUNDER.** To make sure the DCC succeeds, Timmer has personally taken charge of the project under a new management effort aimed at moving products to market faster. Aside from VCRs, Philips has invented other promising technologies such as digital videodisks and medical CAT scanners—only to have savvier marketers and nimbler manufacturers steal its thunder. The main






sorb the kind of big loss it took on its bungled entry into VCRs in the early 1970s. The cash-cow lighting division, once milked to fund research, has had its margins trimmed in a price war with Siemens and General Electric. Interest charges on debt of \$7.5 billion sucked up 88% of last year's operating profits. And bankers, who granted a fresh \$2 billion loan last December, are holding Timmer to strict financial covenants.

**'ANOTHER CLIFF?'** The savings from lay-offs and asset-shedding alone almost guarantee improved earnings through 1992. First-quarter profits of \$68 million showed signs of life surprisingly early. And although the net margin will still languish below 2%, analysts expect profits to hit \$500 million for 1991. That includes the roughly \$175 million net gain from the July sale of its 47%-owned joint venture in household appliances with Whirlpool Corp. The rebound in Philips' stock, by 60% to \$16 in the past 15 months, makes it one of Europe's hottest performers, though it still is at about half its 1986 peak. But unless Timmer's big gamble pays off and Operation Centurion boosts productivity, "Philips could walk off another cliff by 1993," warns James Capel & Co. analyst William T. Coleman.

The management shake-up hits just as Timmer is ready-

ing a stream of risky new consumer-electronics technologies for the 1990s. Among these products, none has more immediate potential than the digital compact cassette. Due out next spring in home, portable, and car models, a DCC packs 90 minutes of sterling sound on tape using a revolutionary technique. The DCC's great selling point is that buyers will be able to play their old, ordinary, analog-tape cassettes on the new machines. The chief rival, a portable compact-disk system called Mini Disc from Sony Corp., cannot play ei-

## HOW PHILIPS IS SLASHING ITS PORTFOLIO

Division	Share of total 1990 revenues	Share of total 1990 operating profit
 <b>CONSUMER PRODUCTS</b> TVs, audio, CDs, VCRs; PolyGram; personal and home appliances	45%	75.0%
 <b>PROFESSIONAL PRODUCTS &amp; SYSTEMS</b> <b>FOR SALE:</b> Telecoms, defense, medical electronics, automation, PCs <b>SOLD:</b> Data processing to DEC for \$350 million	23	0.8
 <b>LIGHTING</b> Industrial, consumer, auto	15	18.5
 <b>COMPONENTS</b> Picture tubes, materials <b>FOR SALE:</b> Semiconductors	13	-0.5
 <b>MISCELLANEOUS</b> Matsushita components, Grundig electronics <b>SOLD:</b> Appliances to Whirlpool for \$610 million <b>CLOSED:</b> Du Pont optical disks	4	6.4
<b>OTHER INCOME</b>	0	-0.2

DATA: COMPANY REPORTS, BW





**PHILIPS HEADQUARTERS IN EINDHOVEN: TIMMER IS SHAKING UP A HIDEBOUND MANAGEMENT**

reasons: interdepartmental squabbling and top management's failure to set priorities. To overcome this management paralysis, Timmer early last year set up a new committee to oversee the promotion of so-called concern products that affect the whole company.

Now, participating managers have their marching orders set from above—even if it means swallowing losses in one unit for the good of the project. Timmer plays the final arbiter in any disputes. "If this means a total reappraisal of our corporate culture, we must all be prepared to withstand the tremors of a culture shock," Timmer tells managers at Operation Centurion "mind-setting" seminars.

If anyone can shake up stuffy, hidebound Philips, Timmer probably can. Unlike some other Philips managers, Timmer is constantly on the move, crisscrossing Europe promoting Philips' new products. He speaks Dutch, English, German, and French, but he finds himself speaking more English than his native language because he spends so much time traveling and trying to reshape Philips' global operations.

A baker's son, Timmer left his small Dutch village at age 19 for an accounting job at Philips' headquarters in Eindhoven, then spent a dozen years in foreign posts. He credits being far away from the insular Philips bureaucracy as a key factor in exacting changes that

his predecessors could not put through.

As managing director of Philips' shoestring Ethiopia affiliate at age 30, for instance, Timmer learned an appreciation for controlling costs when cash ran so short that he had to get loans from a buddy running the local Royal Dutch/Shell Group subsidiary to meet the monthly payroll. "The harsh realities of money had a profound influence on me," he once told BUSINESS WEEK.

**PAYBACKS.** Timmer's no-nonsense methods paid off in turnarounds: first in Philips' South African operations in the 1970s, then at London-based PolyGram in the early 1980s. But it was the ailing consumer-electronics division, which he took over in 1987, that provides the closest model for his current companywide remake.

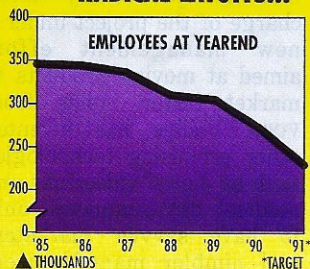
When he took over, the division was, like most of the company's units, a bloated organization that had great difficulty getting its product ideas to market. At a cost of \$250 million, he cut 10,000 jobs in two years, consolidated dozens of redundant manufacturing lines, and tied compensation to performance. To shorten the lag time in product development caused by "remote-control management," he shipped some business units out of Eindhoven to be closer to their development and manufacturing operations.

In a revolutionary move for Philips, Timmer began targeting products to different consumer segments, such as boom boxes for teens and the recently launched Easy Line of stereos for older audiences. He also for the first time held his managers accountable for achieving profits on par with Philips' global rivals. The payoff: Consumer-electronics operating margins, excluding highly profitable PolyGram and restructuring charges, jumped to 5.6% last year from 4%, estimates Warburg's Golob.

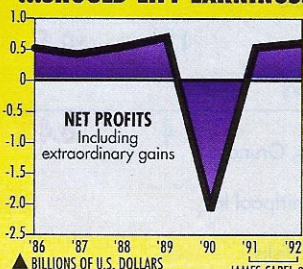
Now, Timmer is ap-

## TIMMER'S TURNAROUND PLAN

### RADICAL LAYOFFS...



### ...SHOULD LIFT EARNINGS...



### ...AND BOOST EFFICIENCY

1990 average sales per employee

SONY	\$240,200
MATSUSHITA ELECTRIC	\$228,600
GENERAL ELECTRIC (U.S.)	\$196,020
PHILIPS	\$97,660
SIEMENS	\$96,540

DATA: COMPANY REPORTS, BW



plying to the whole company what he learned peddling boom boxes. During the last year, a Timmer-directed series of Operation Centurion weekend seminars has gathered groups of top brass from around the world to brainstorm on mining more profits from their operations. "They come back as if they'd had a religious experience," says one manager. "They hang up mottoes in their offices like 'Your client is your boss.'"

Timmer is also taking dead aim at Philips managers' traditional ploys for justifying unnecessary expenditures: "We must stop labeling something 'stra-

tegic' as a cover-up for malperformance," he lectures in internal memos supplied by former employees. "We must learn the real value of money, because we use far too much cash."

Likewise, Timmer is demanding a rethink of Philips' product portfolios. Insiders estimate that most divisions lose money on as much as 30% of their products because Philips always insisted on carrying a complete spectrum. A grab bag of marginal lines, from medical electronics and phone switches to semiconductors is being combed for targets to merge, sell, or scrap. So far, for ex-

ample, a money-losing line in nuclear-medicine imaging devices is being killed. Before selling the minicomputer division to DEC, Timmer was already curtailing its own manufacturing in favor of reselling outsider's machines.

In the same spirit, Timmer is pressing for more cost-sharing alliances for even the most critical technologies—a sharp reversal from past go-it-alone tendencies. That was at the top of his agenda in a secret summit last May with Thomson's Alain M. Gomez, Olivetti's Carlo De Benedetti, and other top European electronics chiefs. "For 95 years, we did

## DEC EXPECTS BIG THINGS FROM PHILIPS' MINIS

**F**or a year now, slumping European operations have given U.S. computer makers nightmares. And none more so than minicomputer maker Digital Equipment Corp., which gets 40% of its \$13 billion in revenues and the bulk of its profits there. So, to make sure its profit engine doesn't sputter out, DEC is on a European spending spree that is on a par with that of the acquisitive Japanese.

The U.S. minicomputer company made its biggest play on July 23 with an agreement in principle to acquire Philips Electronics' \$1 billion minicomputer business. The purchase, at a bargain-basement \$300 million to \$350 million price, signals that DEC is no longer counting on growth from within to pull it out of its profit slump. Now, its brightest hope is to rekindle Europe, where revenue growth, although still robust, has slipped to 14% from the 25% rate of just two years ago. DEC's strategy, says Sanford C. Bernstein & Co. analyst Barry F. Willman, is simply to "buy business."

**SWEET DEAL.** The price was right for Philips' money-losing minicomputer unit. At just 30¢ to 35¢ for every dollar of sales, the deal costs half what DEC paid in December to acquire its 65% stake in its German joint venture, Digital-Kienzle Computer Systems. Philips' customers are largely small to midsize companies whose computer purchases are projected to grow at a rate of 12% to 14%, vs. 4% to 6% among large corporations. With Digital-Kienzle, and

now with the Philips bid, "we're looking for growth opportunities," says Wolfgang Jaeger, DEC Europe vice-president for strategic alliances.

DEC's plan is to turn Philips' minicomputer business into a reinvigorated distribution network. It would inherit Philips' customers, many in small retail banks and in countries such as Austria and Spain where DEC's current presence is minimal. Philips' customer base

way," says Paul Lethbridge, a vice-president at market researcher INTECO Corp. European computer leaders IBM and Germany's Siemens could just as easily win over Philips' mini customers. DEC's latest restructuring charges also lend some urgency: With its U.S. operations hamstrung by recession and slower growth in Europe, DEC has laid off workers and closed plants to stanch the red ink.

The Maynard (Mass.) company's bid for Philips' unit comes amid a tough restructuring of struggling European computer makers. Last November, Fujitsu Ltd. acquired Britain's ICL and later added Nokia Data to its European subsidiary. DEC has been among the most energetic of the Americans. In addition to the \$230 million spent for its stake in Digital-Kienzle, DEC recently bought up a small British financial-software house to aid its move into financial services. All told, DEC stands to add about \$1.3 billion in annual revenues from its European acquisitions. What's more, the company is now exploring joint research with Italy's Olivetti. And as a part of their talks, DEC and Philips are considering ties in PCs and semiconductors.

To make the transatlantic plan work, DEC will not only have to hold on to Philips customers, it will also have to learn how to become a good European citizen. As part of the deal, DEC will pick up 7,000 Philips employees, all of whom want job guarantees. Before any deal can close, DEC must come to such an agreement with the employees' union—a foreign notion for nonunionized DEC. But DEC is betting that it will be able to restore some sparkle to one of the many Philips businesses that went flat.

*By Gary McWilliams in Boston*



**A DEC DELIVERY IN FRANCE: EUROPE PROVIDES 40% OF ITS REVENUES**

will also help DEC move away from slow-selling minis and instead peddle software and consulting as companies move off Philips' defunct mini line onto DEC machines.

But DEC will have to move fast. Philips has always sold at the periphery of its customers' business, selling computers that automate bank branch offices rather than headquarters, for example. "Philips is big in the financial and retail sectors but not in any controlling



everything on our own," says Peter Groenenboom, senior vice-president for video products. "Now the technology jumps are too big and risky. Timmer realized from day one that without European scale to match Japan's billions, we'll go under."

**CHIP SEARCH.** One big dilemma is keeping up to speed in semiconductors. Soon after he took over, Timmer pulled out of the so-called MegaProject—a joint development with Siemens, starting in 1984, aimed to help Europe catch up with the Japanese in memory chips. After sinking nearly \$1 billion into the project over five years, Japanese and

American rivals beat Philips to market with cheaper versions. Timmer finally pulled the plug last year, accounting for a large chunk of the component division's \$766 million in restructuring charges.

Philips brass used to say they needed the MegaProject to make chips for such leading-edge technologies as HDTV. Now, some Philips insiders advocate buying the chips from others or farming out production—perhaps to an American or Japanese rival. But some competitors warn that outside production would make Philips vulnerable in times of chip shortages. And buying technol-

ogy on the open market means Philips could lag behind rivals in churning out compact, powerful consumer gadgets.

The answer may point to some further linkup with Matsushita. Philips has held a 35% stake in its Japanese components subsidiary since 1952, and Japanese sources say that Matsushita is keen to help Philips recover—if only to pave the political way for its own expansion in the European market. On July 16, Matsushita President Akio Tanii confirmed rumors that he was negotiating a joint venture or other pact to help out Philips' ailing, U.S.-based chipmaking unit, Signetics Corp., which analysts es-

## 'I NEVER THOUGHT THEY WOULD FIRE ME'

**W**il H. Iding comes from a Philips family. His father started at Philips Electronics in the 1920s. So did his mother. His brother and four sisters all worked for Philips. Iding, 50, is a 27-year veteran of the company, the only employer he ever had. "I graduated on a Friday from the university," says the engineer, "and on Monday, I started with Philips."

Then the unthinkable happened: The Dutch electronics giant ran aground as foreign competition and bloated management cut into its technological edge and its profits. President Jan D. Timmer last summer ordered 55,000 workers cut. Suddenly, this past January, Iding learned he would be out of his \$75,000-a-year job as a manager in the lighting division by Oct. 31.

**COMPANY TOWN.** Although Philips' move is hardly shocking compared with U.S. layoff practices, Iding and fellow employees long believed they were immune. "I never thought they would fire me," says the wiry engineer, looking wistfully around the living room of his mortgaged house. And no wonder. For most of Philips' 100-year history, the company's practice was to hire more and more workers, promising jobs for life. And in Eindhoven, the quintessential company town, Philips is at the heart of things, giving discounts at its

bakeries, grocery stores, pharmacies, and appliance stores. But now, many of the 25,000 Philips workers in Eindhoven, out of 260,000 worldwide, will be let go.

Philips is able to make such unprecedented cuts in the Netherlands and elsewhere in Europe in part because of the

bucks to an American worker, but layoffs shock European professionals who never thought they would have to start all over again.

No one knows better than its employees that the company went overboard on bureaucracy and benefits and needed a thorough overhaul. What Iding and others resent is that Philips waited for the problems to reach a crisis before managers took action—and then had little time to solve problems creatively. "When they need more money from the banks or shareholders, they cut people," said a middle manager in plastics operations. "That's all they know." Adds Iding: "People do not have a chance to figure out the best way to [make cuts], and there's a good chance management will get it wrong."

With more firings to come, an enervating malaise has set in throughout the company. Absenteeism and even reported suicides are on the rise. "You don't know if you'll lose your job tomorrow," says William Bax, a worker at a Philips TV-screen factory. "And there are still too many bosses."

But few are voicing their anger. Several executives insisted on anonymity because they still hope to persuade Philips to place them elsewhere in the company. Crit Pingen, an official

with the Federation of Dutch Workers, whose members include 9,000 Philips employees, thinks reality still hasn't sunk in for most of the sacked workers. Says Pingen: "These guys won't believe it until they're finally out on the street."

*By Patrick Oster in Eindhoven*



**FORMER PHILIPS MANAGER IDING'S SEVERANCE PACKAGE IS BIG, BUT . . .**

Continent's social safety-net laws. Dutch law, for example, mandates that Iding will get at least 80% of his salary for about three years. Philips will kick in only 25% of that amount. And in France or Germany, where Philips workers also got pink slips, the benefits are similar. This may sound like big



timate may have lost Philips as much as \$1 billion over the past 20 years. In any case, in the rush to cut costs, "Philips will become increasingly dependent on outside suppliers and put its long-term independence at risk," predicts a Dutch industry executive close to the company.

**NEW VIDEO.** That's a chance that Timmer apparently is willing to take. Too many other imperatives are tugging at his purse strings, chief among them HDTV. With bread-and-butter sales of conventional TVs stagnating in the key industrial markets in recent years, Philips is counting heavily on a shot in the arm from HDTV's cinema-like video quality and lush stereo sound to protect its No. 1 standing in Europe. It has already plowed \$250 million into development and will probably spend another \$1.5 billion or more by the mid-1990s—not counting joint research with Thomson, NBC, and the David Sarnoff Research Center on a standard for U.S. HDTV. But the payback is far from certain.

So far, Philips, along with Thomson, has headed off the Japanese by lobbying the European Commission to adopt a transmission standard known as MAC. But a severe backlash from broadcasters, who will be saddled with huge switching costs, threatens to undo the deal. And a two-year delay in the takeoff of MAC means Philips won't recoup much of its investment until 1995, if then.

Another big absorber of research-and-development funds is Compact Disc-Interactive, or CDI, which former executives estimate has already sucked up \$500 million. A follow-up to Philips' stunning success in CD technology, this seductive new medium flashes text, graphics, sound, and video stored on an optical disk onto a TV screen. Using their CDI sets, which are expected to sell for \$1,000, toddlers will be able to tour *Sesame Street* house-by-house and play tunes on Big Bird's jukebox. Their parents will be able to play the St. Andrews golf course while getting tips from their favorite pro. Philips and Nintendo Co. have also teamed up to develop special CDI machines for video games.

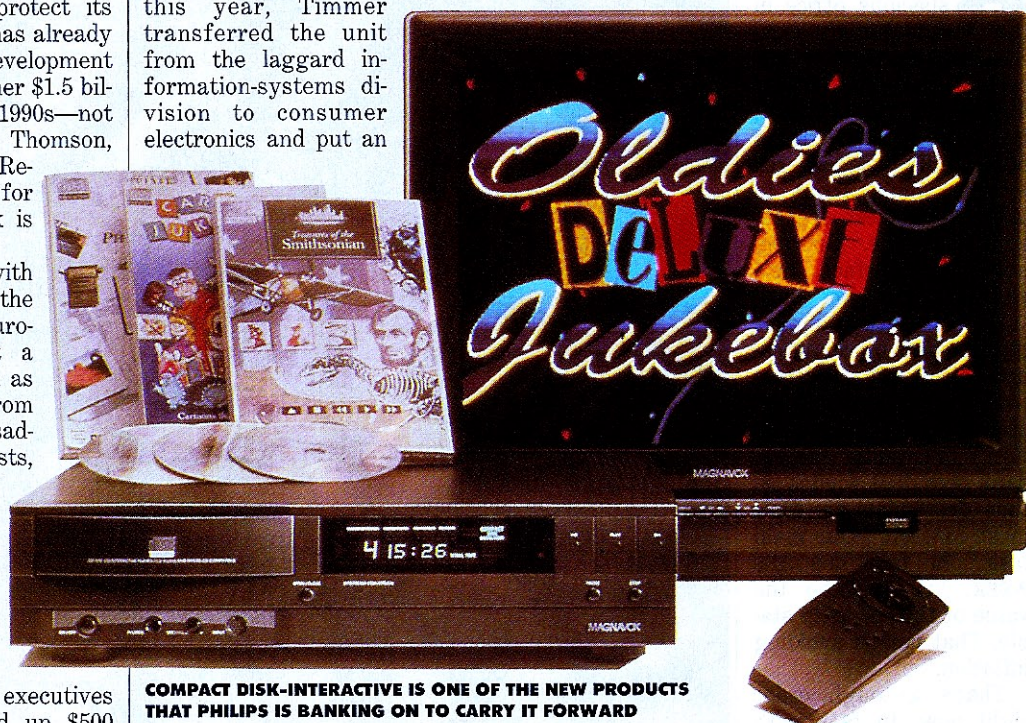
After seven tortuous years of fits and starts, Philips will finally launch CDI in the U.S. and Japan in October, and in Europe in 1992. But Philips will have to count on sales of the programming software more than on the players themselves—just as it makes more from PolyGram's CDs than from CD players. Unfortunately, the delays have turned off many potential suppliers. There is also no assurance that couch potatoes want to interact with their TVs, as CDI

requires. "It will take four to five years to change human behavior," says Gaston Bastiaens, a Timmer protégé who's in charge of CDI. "That's a big opportunity but also a big risk."

Philips' CDI also runs the risk of competition from similar new features now emerging on multimedia personal computers—from Tandy, IBM, AT&T and others. To hedge its bets, Philips early next year will bring out its own new line of MPCs, used for everything from job training to splashy business presentations. Its success, however, hinges on executing ambitious plans to turn around its ailing PC business first. Early this year, Timmer transferred the unit from the laggard information-systems division to consumer electronics and put an

ket. Indeed, company insiders say the revamped unit will again start looking for a potential partner this summer, after being rebuffed last year in merger talks with Olivetti.

The high risk of Philips' consumer lineup puts all the more pressure on Timmer to make sure the newly set profit goals and work habits of Operation Centurion turn out to be more than just rhetoric. Philips' Japanese rivals say privately that the financially weakened Dutch have been backed into a corner where they desperately need to score a big hit but have only a handful of new products. The Japanese, in con-



**COMPACT DISK-INTERACTIVE IS ONE OF THE NEW PRODUCTS THAT PHILIPS IS BANKING ON TO CARRY IT FORWARD**

audio-products whiz, Leigh Robinson, in charge. Robinson is counting on Philips' expertise in optical disks, video, and other consumer technologies to give its MPCs an edge. "The computer market is coming closer and closer to our skills," he says.

**PARTNER QUEST.** He's already finding some success pushing PCs through mass outlets such as Montgomery Ward & Co. and Dillard Department Stores Inc. in the U.S. under the Magnavox brand. But that strategy is hardly unique, and analysts say Philips' lagging market share of less than 2% is a weak base from which to grow in a cutthroat mar-

trast, believe they have the financial strength to experiment across the board to find the products of the future. In their view, the odds are against Philips. "Philips' choices are limited," says an official of one big Japanese rival. "They have little freedom to experiment."

Timmer knows the Philips way well enough not to take any chances. From the consultants he hired to lead Operation Centurion training seminars, say company union officials, he gets regular reports on his own managers to make sure that staff cuts are being made on the basis of performance rather than cronyism. "Timmer says it's now or never. If he fails, Philips dies," says Rudiger Jost, a company researcher, who is chairman of the Philips workers' council in Germany. "And then we're all out on the street." As the old saying goes, there's nothing like the sight of a noose to focus the mind.

*By Jonathan B. Levine, with Patrick Oster in Eindhoven, Neil Gross in Tokyo, and Gail Schares in Bonn*

**'Philips' choices are limited,' says an official of one big Japanese rival. 'They have little freedom to experiment'**