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Philips versus Matsushita: A New Century, a New Round

Throughout their long histories, N.V. Philips (Netherlands) and Matsushita Electric (Japan) had followed very different strategies and emerged with very different organizational capabilities. Philips built its success on a worldwide portfolio of responsive national organizations while Matsushita based its global competitiveness on its centralized, highly efficient operations in Japan.

During the 1990s, both companies experienced major challenges to their historic competitive positions and organizational models, and at the end of the decade, both companies were struggling to reestablish their competitiveness. At the turn of the millennium, new CEOs at both companies were implementing yet another round of strategic initiatives and organizational restructurings. Observers wondered how the changes would affect their long-running competitive battle.

Philips: Background

In 1892, Gerard Philips and his father opened a small light-bulb factory in Eindhoven, Holland. When their venture almost failed, they recruited Gerard's brother, Anton, an excellent salesman and manager. By 1900, Philips was the third largest light-bulb producer in Europe.

From its founding, Philips developed a tradition of caring for workers. In Eindhoven it built company houses, bolstered education, and paid its employees so well that other local employers complained. When Philips incorporated in 1912, it set aside 10% of profits for employees.

Technological Competence and Geographic Expansion

While larger electrical products companies were racing to diversify, Philips made only light-bulbs. This one-product focus and Gerard's technological prowess enabled the company to create significant innovations. Company policy was to scrap old plants and use new machines or factories whenever advances were made in new production technology. Anton wrote down assets rapidly and set aside substantial reserves for replacing outdated equipment. Philips also became a leader in industrial research, creating physics and chemistry labs to address production problems as well as more

This case derives from an earlier case, "Philips versus Matsushita: Preparing for a New Round," HBS No. 399-102, prepared by Professor Christopher A. Bartlett, which was an updated version of an earlier case by Professor Bartlett and Research Associate Robert W. Lightfoot, "Philips and Matsushita: A Portrait of Two Evolving Companies," HBS Case No. 392-156. The section on Matsushita summarizes "Matsushita Electric Industrial (MEI) in 1987," HBS Case No. 388-144, by Sumantra Ghoshal (INSEAD) and Christopher A. Bartlett. Some early history on Philips draws from "Philips Group—1987," HBS Case No. 388-050, by Professors Frank Aguilar and Michael Y. Yoshino. This version was also prepared by Professor Bartlett. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

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abstract scientific ones. The labs developed a tungsten metal filament bulb that was a great commercial success and gave Philips the financial strength to compete against its giant rivals.

Holland's small size soon forced Philips to look beyond its Dutch borders for enough volume to mass produce. In 1899, Anton hired the company's first export manager, and soon the company was selling into such diverse markets as Japan, Australia, Canada, Brazil, and Russia. In 1912, as the electric lamp industry began to show signs of overcapacity, Philips started building sales organizations in the United States, Canada, and France. All other functions remained highly centralized in Eindhoven. In many foreign countries Philips created local joint ventures to gain market acceptance.

In 1919, Philips entered into the Principal Agreement with General Electric, giving each company the use of the other's patents. The agreement also divided the world into "three spheres of influence": General Electric would control North America; Philips would control Holland; but both companies agreed to compete freely in the rest of the world. (General Electric also took a 20% stake in Philips.) After this time, Philips began evolving from a highly centralized company, whose sales were conducted through third parties, to a decentralized sales organization with autonomous marketing companies in 14 European countries, China, Brazil, and Australia.

During this period, the company also broadened its product line significantly. In 1918, it began producing electronic vacuum tubes; eight years later its first radios appeared, capturing a 20% world market share within a decade; and during the 1930s, Philips began producing X-ray tubes. The Great Depression brought with it trade barriers and high tariffs, and Philips was forced to build local production facilities to protect its foreign sales of these products.

Philips: Organizational Development

One of the earliest traditions at Philips was a shared but competitive leadership by the commercial and technical functions. Gerard, an engineer, and Anton, a businessman, began a subtle competition where Gerard would try to produce more than Anton could sell and vice versa. Nevertheless, the two agreed that strong research was vital to Philips' survival.

During the late 1930s, in anticipation of the impending war, Philips transferred its overseas assets to two trusts, British Philips and the North American Philips Corporation; it also moved most of its vital research laboratories to Redhill in Surrey, England, and its top management to the United States. Supported by the assets and resources transferred abroad, and isolated from their parent, the individual country organizations became more independent during the war.

Because waves of Allied and German bombing had pummeled most of Philips' industrial plant in the Netherlands, the management board decided to build the postwar organization on the strengths of the national organizations (NOs). Their greatly increased self-sufficiency during the war had allowed most to become adept at responding to country-specific market conditions—a capability that became a valuable asset in the postwar era. For example, when international wrangling precluded any agreement on three competing television transmission standards (PAL, SECAM, and NTSC), each nation decided which to adopt. Furthermore, consumer preferences and economic conditions varied: in some countries, rich, furniture-encased TV sets were the norm; in others, sleek, contemporary models dominated the market. In the United Kingdom, the only way to penetrate the market was to establish a rental business; in richer countries, a major marketing challenge was overcoming elitist prejudice against television. In this environment, the independent NOs had a great advantage in being able to sense and respond to the differences.

Eventually, responsiveness extended beyond adaptive marketing. As NOs built their own technical capabilities, product development often became a function of local market conditions. For example, Philips of Canada created the company's first color TV; Philips of Australia created the first stereo TV; and Philips of the United Kingdom created the first TVs with teletext.

While NOs took major responsibility for financial, legal, and administrative matters, fourteen product divisions (PDs), located in Eindhoven, were formally responsible for development, production, and global distribution. (In reality, the NOs' control of assets and the PDs' distance from the operations often undercut this formal role.) The research function remained independent and, with continued strong funding, set up eight separate laboratories in Europe and the United States.

While the formal corporate-level structure was represented as a type of geographic/product matrix, it was clear that NOs had the real power. NOs reported directly to the management board, which Philips enlarged from 4 members to 10 to ensure that top management remained in contact with and control of the highly autonomous NOs. Each NO also regularly sent envoys to Eindhoven to represent its interests. Top management, most of whom had careers that included multiple foreign tours of duty, made frequent overseas visits to the NOs. In 1954, the board established the International Concern Council to formalize regular meetings with the heads of all major NOs.

Within the NOs, the management structure mimicked the legendary joint technical and commercial leadership of the two Philips brothers. Most were led by a technical manager and a commercial manager. In some locations, a finance manager filled out the top management triad that typically reached key decisions collectively. This cross-functional coordination capability was reflected down through the NOs in front-line product teams, product-group-level management teams, and at the senior management committee of the NOs' top commercial, technical, and financial managers.

The overwhelming importance of foreign operations to Philips, the commensurate status of the NOs within the corporate hierarchy, and even the cosmopolitan appeal of many of the offshore subsidiaries' locations encouraged many Philips managers to take extended foreign tours of duty, working in a series of two- or three-year posts. This elite group of expatriate managers identified strongly with each other and with the NOs as a group and had no difficulty representing their strong, country-oriented views to corporate management.

Philips: Attempts at Reorganization

In the late 1960s, the creation of the Common Market eroded trade barriers within Europe and diluted the rationale for maintaining independent, country-level subsidiaries. New transistor- and printed circuit-based technologies demanded larger production runs than most national plants could justify, and many of Philips' competitors were moving production of electronics to new facilities in low-wage areas in East Asia and Central and South America. Despite its many technological innovations, Philips' ability to bring products to market began to falter. In the 1960s, the company invented the audiocassette but let its Japanese competitors capture the mass market. A decade later, its R&D group developed the V2000 videocassette format—superior technically to Sony's Beta or Matsushita's VHS—but was forced to abandon it when North American Philips decided to outsource, brand, and sell a VHS product which it manufactured under license from Matsushita.

Over three decades, seven chairmen experimented with reorganizing the company to deal with its growing problems. Yet, entering the new millennium, Philips' financial performance remained poor and its global competitiveness was still in question. (See Exhibits 1 and 2.)

Van Riemsdijk and Rodenburg Reorganizations, 1970s

Concerned about what one magazine described as “continued profitless progress,” newly appointed CEO Hendrick van Riemsdijk created an organization committee to prepare a policy paper on the division of responsibilities between the PDs and the NOs. Their report, dubbed the “Yellow Booklet,” outlined the disadvantages of Philips’ matrix organization in 1971:

Without an agreement [defining the relationship between national organizations and product divisions], it is impossible to determine in any given situation which of the two parties is responsible. . . . As operations become increasingly complex, an organizational form of this type will only lower the speed of reaction of an enterprise.

On the basis of this report, van Riemsdijk proposed rebalancing the managerial relationships between PDs and NOs—“tilting the matrix” in his words—to allow Philips to decrease the number of products marketed, build scale by concentrating production, and increase the flow of goods among national organizations. He proposed closing the least efficient local plants and converting the best into International Production Centers (IPCs), each supplying many NOs. In so doing, van Riemsdijk hoped that PD managers would gain control over manufacturing operations. Due to the political and organizational difficulty of closing local plants, however, implementation was slow.

In the late 1970s, his successor CEO, Dr. Rodenburg, continued this thrust. Several IPCs were established, but the NOs seemed as powerful and independent as ever. He furthered matrix simplification by replacing the dual commercial and technical leadership with single management at both the corporate and national organizational levels. Yet the power struggles continued.

Wisse Dekker Reorganization, 1982

Unsatisfied with the company’s slow response and concerned by its slumping financial performance, upon becoming CEO in 1982, Wisse Dekker outlined a new initiative. Aware of the cost advantage of Philips’ Japanese counterparts, he closed inefficient operations—particularly in Europe where 40 of the company’s more than 200 plants were shut. He focused on core operations by selling some businesses (for example, welding, energy cables, and furniture) while acquiring an interest in Grundig and Westinghouse’s North American lamp activities. Dekker also supported technology-sharing agreements and entered alliances in offshore manufacturing.

To deal with the slow-moving bureaucracy, he continued his predecessor’s initiative to replace dual leadership with single general managers. He also continued to “tilt the matrix” by giving PDs formal product management responsibility, but leaving NOs responsible for local profits. And, he energized the management board by reducing its size, bringing on directors with strong operating experience, and creating subcommittees to deal with difficult issues. Finally, Dekker redefined the product planning process, incorporating input from the NOs, but giving global PDs the final decision on long-range direction. Still sales declined and profits stagnated.

Van der Klugt Reorganization, 1987

When Cor van der Klugt succeeded Dekker as chairman in 1987, Philips had lost its long-held consumer electronics leadership position to Matsushita, and was one of only two non-Japanese companies in the world’s top ten. Its net profit margins of 1% to 2% not only lagged behind General Electric’s 9%, but even its highly aggressive Japanese competitors’ slim 4%. Van der Klugt set a profit objective of 3% to 4% and made beating the Japanese companies a top priority.

As van der Klugt reviewed Philips' strategy, he designated various businesses as core (those that shared related technologies, had strategic importance, or were technical leaders) and non-core (stand-alone businesses that were not targets for world leadership and could eventually be sold if required). Of the four businesses defined as core, three were strategically linked: components, consumer electronics, and telecommunications and data systems. The fourth, lighting, was regarded as strategically vital because its cash flow funded development. The non-core businesses included domestic appliances and medical systems which van der Klugt spun off into joint ventures with Whirlpool and GE, respectively.

In continuing efforts to strengthen the PDs relative to the NOs, van der Klugt restructured Philips around the four core global divisions rather than the former 14 PDs. This allowed him to trim the management board, appointing the displaced board members to a new policy-making Group Management Committee. Consisting primarily of PD heads and functional chiefs, this body replaced the old NO-dominated International Concern Council. Finally, he sharply reduced the 3,000-strong headquarters staff, reallocating many of them to the PDs.

To link PDs more directly to markets, van der Klugt dispatched many experienced product-line managers to Philips' most competitive markets. For example, management of the digital audio tape and electric-shaver product lines were relocated to Japan, while the medical technology and domestic appliances lines were moved to the United States.

Such moves, along with continued efforts at globalizing product development and production efforts, required that the parent company gain firmer control over NOs, especially the giant North American Philips Corp. (NAPC). Although Philips had obtained a majority equity interest after World War II, it was not always able to make the U.S. company respond to directives from the center, as the V2000 VCR incident showed. To prevent replays of such experiences, in 1987 van der Klugt repurchased publicly owned NAPC shares for \$700 million.

Reflecting the growing sentiment among some managers that R&D was not market oriented enough, van der Klugt halved spending on basic research to about 10% of total R&D. To manage what he described as "R&D's tendency to ponder the fundamental laws of nature," he made R&D the direct responsibility of the businesses being supported by the research. This required that each research lab become focused on specific business areas (see **Exhibit 3**).

Finally, van der Klugt continued the effort to build efficient, specialized, multi-market production facilities by closing 75 of the company's 420 remaining plants worldwide. He also eliminated 38,000 of its 344,000 employees—21,000 through divesting businesses, shaking up the myth of lifetime employment at the company. He anticipated that all these restructurings would lead to a financial recovery by 1990. Unanticipated losses for that year, however—more than 4.5 billion Dutch guilders (\$2.5 billion)—provoked a class-action law suit by angry American investors, who alleged that positive projections by the company had been misleading. In a surprise move, on May 14, 1990, van der Klugt and half of the management board were replaced.

Timmer Reorganization, 1990

The new president, Jan Timmer, had spent most of his 35-year Philips career turning around unprofitable businesses. With rumors of a takeover or a government bailout swirling, he met with his top 100 managers and distributed a hypothetical—but fact-based—press release announcing that Philips was bankrupt. "So what action can you take this weekend?" he challenged them.

Under "Operation Centurion," headcount was reduced by 68,000 or 22% over the next 18 months, earning Timmer the nickname "The Butcher of Eindhoven." Because European laws required substantial compensation for layoffs—Eindhoven workers received 15 months' pay, for example—the first round of 10,000 layoffs alone cost Philips \$700 million. To spread the burden around the globe and to speed the process, Timmer asked his PD managers to negotiate cuts with NO managers. According to one report, however, country managers were "digging in their heels to save local jobs." But the cuts came—many from overseas operations. In addition to the job cuts, Timmer vowed to "change the way we work." He established new performance rules and asked hundreds of top managers to sign contracts that committed them to specific financial goals. Those who broke those contracts were replaced—often with outsiders.

To focus resources further, Timmer sold off various businesses including integrated circuits to Matsushita, minicomputers to Digital, defense electronics to Thomson and the remaining 53% of appliances to Whirlpool. Yet profitability was still well below the modest 4% on sales he promised. In particular, consumer electronics lagged with slow growth in a price-competitive market. The core problem was identified by a 1994 McKinsey study that estimated that value added per hour in Japanese consumer electronic factories was still 68% above that of European plants. In this environment, most NO managers kept their heads down, using their distance from Eindhoven as their defense against the ongoing rationalization.

After three years of cost-cutting, in early 1994 Timmer finally presented a new growth strategy to the board. His plan was to expand software, services, and multimedia to become 40% of revenues by 2000. He was betting on Philips' legendary innovative capability to restart the growth engines. Earlier, he had recruited Frank Carrubba, Hewlett-Packard's director of research, and encouraged him to focus on developing 15 core technologies. The list, which included interactive compact disc (CD-i), digital compact cassettes (DCC), high definition television (HDTV), and multimedia software, was soon dubbed "the president's projects." But his earlier divestment of some of Philips' truly high-tech businesses and a 37% cut in R&D personnel left the company with few who understood the technology of the new priority businesses.

By 1996, it was clear that Philips' HDTV technology would not become industry standard, that its DCC gamble had lost out to Sony's Minidisc, and that CD-i was a marketing failure. While costs were lower, so too was morale, particularly among middle management. Critics claimed that the company's drive for cost-cutting and standardization had led it to ignore new worldwide market demands for more segmented products and higher consumer service.

Boonstra Reorganization, 1996

When Timmer stepped down in October 1996, the board replaced him with a radical choice for Philips—an outsider whose expertise was in marketing and Asia rather than technology and Europe. Cor Boonstra was a 58-year-old Dutchman whose years as CEO of Sara Lee, the U.S. consumer products firm, had earned him a reputation as a hard-driving marketing genius. Joining Philips in 1994, he headed the Asia Pacific region and the lighting division before being tapped as CEO.

Unencumbered by tradition, he immediately announced strategic sweeping changes designed to reach his target of increasing return on net assets from 17% to 24% by 1999. "There are no taboos, no sacred cows," he said. "The bleeders must be turned around, sold, or closed." Within three years, he had sold off 40 of Philips' 120 major businesses—including such well known units as Polygram and Grundig. He also initiated a major worldwide restructuring, promising to transform a structure he described as "a plate of spaghetti" into "a neat row of asparagus." He said:

How can we compete with the Koreans? They don't have 350 companies all over the world. Their factory in Ireland covers Europe and their manufacturing facility in Mexico serves North America. We need a more structured and simpler manufacturing and marketing organization to achieve a cost pattern in line with those who do not have our heritage. This is still one of the biggest issues facing Philips.

Within a year, 3,100 jobs were eliminated in North America and 3,000 employees were added in Asia Pacific, emphasizing Boonstra's determination to shift production to low-wage countries and his broader commitment to Asia. And after three years, he had closed 100 of the company's 356 factories worldwide. At the same time, he replaced the company's 21 PDs with 7 divisions, but shifted day-to-day operating responsibility to 100 business units, each responsible for its profits worldwide. It was a move designed to finally eliminate the old PD/NO matrix. Finally, in a move that shocked most employees, he announced that the 100-year-old Eindhoven headquarters would be relocated to Amsterdam with only 400 of the 3000 corporate positions remaining.

By early 1998, he was ready to announce his new strategy. Despite early speculation that he might abandon consumer electronics, he proclaimed it as the center of Philips' future. Betting on the "digital revolution," he planned to focus on established technologies such as cellular phones (through a joint venture with Lucent), digital TV, digital videodisc, and web TV. Furthermore, he committed major resources to marketing, including a 40% increase in advertising to raise awareness and image of the Philips brand and de-emphasize most of the 150 other brands it supported worldwide—from Magnavox TVs to Norelco shavers to Marantz stereos.

While not everything succeeded (the Lucent cell phone JV collapsed after nine months, for example), overall performance improved significantly in the late 1990s. By 1999, Boonstra was able to announce that he had achieved his objective of a 24% return on net assets.

Kleisterlee Reorganization, 2001

In May 2001, Boonstra passed the CEO's mantle to Gerard Kleisterlee, a 54-year-old engineer (and career Philips man) whose turnaround of the components business had earned him a board seat only a year earlier. Believing that Philips had finally turned around, the board challenged Kleisterlee to grow sales by 10% annually and earnings 15%, while increasing return on assets to 30%.

Despite its stock trading at a steep discount to its breakup value, Philips governance structure and Dutch legislation made a hostile raid all but impossible. Nonetheless, Kleisterlee described the difference as "a management discount" and vowed to eliminate it. The first sign of restructuring came within weeks, when mobile phone production was outsourced to CEC of China. Then, in August, Kleisterlee announced an agreement with Japan's Funai Electric to take over production of its VCRs, resulting in the immediate closure of the European production center in Austria and the loss of 1,000 jobs. The CEO then acknowledged that he was seeking partners to take over the manufacturing of some of its other mass-produced items such as television sets.

In mid 2001, a slowing economy resulted in the company's first quarterly loss since 1996 and a reversal of the prior year's strong positive cash flow. Many felt that these growing financial pressures—and shareholders' growing impatience—were finally leading Philips to recognize that its best hope of survival was to outsource even more of its basic manufacturing and become a technology developer and global marketer. They believed it was time to recognize that its 30-year quest to build efficiency into its global operations had failed.

Matsushita: Background

In 1918, Konosuke Matsushita (or “KM” as he was affectionately known), a 23-year-old inspector with the Osaka Electric Light Company, invested ¥100 to start production of double-ended sockets in his modest home. The company grew rapidly, expanding into battery-powered lamps, electric irons, and radios. On May 5, 1932, Matsushita’s 14th anniversary, KM announced to his 162 employees a 250-year corporate plan broken into 25-year sections, each to be carried out by successive generations. His plan was codified in a company creed and in the “Seven Spirits of Matsushita” (see Exhibit 4), which, along with the company song, continued to be woven into morning assemblies worldwide and provided the basis of the “cultural and spiritual training” all new employees received during their first seven months with the company.

In the post-war boom, Matsushita introduced a flood of new products: TV sets in 1952; transistor radios in 1958; color TVs, dishwashers, and electric ovens in 1960. Capitalizing on its broad line of 5,000 products (Sony produced 80), the company opened 25,000 domestic retail outlets. With more than six times the outlets of rival Sony, the ubiquitous “National Shops” represented 40% of appliance stores in Japan in the late 1960s. These not only provided assured sales volume, but also gave the company direct access to market trends and consumer reaction. When post-war growth slowed, however, Matsushita had to look beyond its expanding product line and excellent distribution system for growth. After trying many tactics to boost sales—even sending assembly line workers out as door-to-door salesmen—the company eventually focused on export markets.

The Organization’s Foundation: Divisional Structure

Plagued by ill health, KM wished to delegate more authority than was typical in Japanese companies. In 1933, Matsushita became the first Japanese company to adopt the divisional structure, giving each division clearly defined profit responsibility for its product. In addition to creating a “small business” environment, the product division structure generated internal competition that spurred each business to drive growth by leveraging its technology to develop new products. After the innovating division had earned substantial profits on its new product, however, company policy was to spin it off as a new division to maintain the “hungry spirit.”

Under the “one-product-one-division” system, corporate management provided each largely self-sufficient division with initial funds to establish its own development, production, and marketing capabilities. Corporate treasury operated like a commercial bank, reviewing divisions’ loan requests for which it charged slightly higher-than-market interest, and accepting deposits on their excess funds. Divisional profitability was determined after deductions for central services such as corporate R&D and interest on internal borrowings. Each division paid 60% of earnings to headquarters and financed all additional working capital and fixed asset requirements from the retained 40%. Transfer prices were based on the market and settled through the treasury on normal commercial terms. KM expected uniform performance across the company’s 36 divisions, and division managers whose operating profits fell below 4% of sales for two successive years were replaced.

While basic technology was developed in a central research laboratory (CRL), product development and engineering occurred in each of the product divisions. Matsushita intentionally under-funded the CRL, forcing it to compete for additional funding from the divisions. Annually, the CRL publicized its major research projects to the product divisions, which then provided funding in exchange for technology for marketable applications. While it was rarely the innovator, Matsushita was usually very fast to market—earning it the nickname “Manishita,” or copycat.

Matsushita: Internationalization

Although the establishment of overseas markets was a major thrust of the second 25 years in the 250-year plan, in an overseas trip in 1951 KM had been unable to find any American company willing to collaborate with Matsushita. The best he could do was a technology exchange and licensing agreement with Philips. Nonetheless, the push to internationalize continued.

Expanding Through Color TV

In the 1950s and 1960s, trade liberalization and lower shipping rates made possible a healthy export business built on black and white TV sets. In 1953, the company opened its first overseas branch office—the Matsushita Electric Corporation of America (MECA). With neither a distribution network nor a strong brand, the company could not access traditional retailers, and had to resort to selling its products under their private brands through mass merchandisers and discounters.

During the 1960s, pressure from national governments in developing countries led Matsushita to open plants in several countries in Southeast Asia and Central and South America. As manufacturing costs in Japan rose, Matsushita shifted more basic production to these low-wage countries, but almost all high-value components and subassemblies were still made in its scale-intensive Japanese plants. By the 1970s, protectionist sentiments in the West forced the company to establish assembly operations in the Americas and Europe. In 1972, it opened a plant in Canada; in 1974, it bought Motorola's TV business and started manufacturing its Quasar brand in the United States; and in 1976, it built a plant in Cardiff, Wales, to supply the Common Market.

Building Global Leadership Through VCRs

The birth of the videocassette recorder (VCR) propelled Matsushita into first place in the consumer electronics industry during the 1980s. Recognizing the potential mass-market appeal of the VCR—developed by Californian broadcasting company, Ampex, in 1956—engineers at Matsushita began developing VCR technology. After six years of development work, Matsushita launched its commercial broadcast video recorder in 1964, and introduced a consumer version two years later.

In 1975, Sony introduced the technically superior "Betamax" format, and the next year JVC launched a competing "VHS" format. Under pressure from MITI, the government's industrial planning ministry, Matsushita agreed to give up its own format and adopt the established VHS standard. During Matsushita's 20 years of VCR product development, various members of the VCR research team spent most of their careers working together, moving from central labs to the product divisions' development labs and eventually to the plant.

The company quickly built production to meet its own needs as well as those of OEM customers like GE, RCA, and Zenith, who decided to forego self-manufacture and outsource to the low-cost Japanese. Between 1977 and 1985, capacity increased 33-fold to 6.8 million units. (In parallel, the company aggressively licensed the VHS format to other manufacturers, including Hitachi, Sharp, Mitsubishi and, eventually, Philips.) Increased volume enabled Matsushita to slash prices 50% within five years of product launch, while simultaneously improving quality. By the mid-1980s, VCRs accounted for 30% of total sales—over 40% of overseas revenues—and provided 45% of profits.

Changing Systems and Controls

In the mid-1980s, Matsushita's growing number of overseas companies reported to the parent in one of two ways: wholly owned, single-product global plants reported directly to the appropriate product division, while overseas sales and marketing subsidiaries and overseas companies producing a broad product line for local markets reported to Matsushita Electric Trading Company (METC), a separate legal entity. (See Exhibit 5 for METC's organization.)

Throughout the 1970s, the central product divisions maintained strong operating control over their offshore production units. Overseas operations used plant and equipment designed by the parent company, followed manufacturing procedures dictated by the center, and used materials from Matsushita's domestic plants. Growing trends toward local sourcing, however, gradually weakened the divisions' direct control. By the 1980s, instead of controlling inputs, they began to monitor measures of output (for example, quality, productivity, inventory levels).

About the same time, product divisions began receiving the globally consolidated return on sales reports that had previously been consolidated in METC statements. By the mid-1980s, as worldwide planning was introduced for the first time, corporate management required all its product divisions to prepare global product strategies.

Headquarters-Subsidiary Relations

Although METC and the product divisions set detailed sales and profits targets for their overseas subsidiaries, local managers were told they had autonomy on how to achieve the targets. "Mike" Matsuoko, president of the company's largest European production subsidiary in Cardiff, Wales, however, emphasized that failure to meet targets forfeited freedom: "Losses show bad health and invite many doctors from Japan, who provide advice and support."

In the mid-1980s, Matsushita had over 700 expatriate Japanese managers and technicians on foreign assignment for four to eight years, but defended that high number by describing their pivotal role. "This vital communication role," said one manager, "almost always requires a manager from the parent company. Even if a local manager speaks Japanese, he would not have the long experience that is needed to build relationships and understand our management processes."

Expatriate managers were located throughout foreign subsidiaries, but there were a few positions that were almost always reserved for them. The most visible were subsidiary general managers whose main role was to translate Matsushita philosophy abroad. Expatriate accounting managers were expected to "mercilessly expose the truth" to corporate headquarters; and Japanese technical managers were sent to transfer product and process technologies and provide headquarters with local market information. These expatriates maintained relationships with senior colleagues at headquarters, who acted as career mentors, evaluated performance (with some input from local managers), and provided expatriates with information about parent company developments.

General managers of foreign subsidiaries visited Osaka headquarters at least two or three times each year—some as often as every month. Corporate managers reciprocated these visits, and on average, major operations hosted at least one headquarters manager each day of the year. Face-to-face meetings were considered vital: "Figures are important," said one manager, "but the meetings are necessary to develop judgment." Daily faxes and nightly phone calls between headquarters and expatriate colleagues were a vital management link.

Yamashita's Operation Localization

Although international sales kept rising, as early as 1982 growing host country pressures caused concern about the company's highly centralized operations. In that year, newly appointed company President Toshihiko Yamashita launched "Operation Localization" to boost offshore production from less than 10% of value-added to 25%, or half of overseas sales, by 1990. To support the target, he set out a program of four localizations—personnel, technology, material, and capital.

Over the next few years, Matsushita increased the number of local nationals in key positions. In the United States, for example, U.S. nationals became the presidents of three of the six local companies, while in Taiwan the majority of production divisions were replaced by Chinese managers. In each case, however, local national managers were still supported by senior Japanese advisors, who maintained a direct link with the parent company. To localize technology and materials, the company developed its national subsidiaries' expertise to source equipment locally, modify designs to meet local requirements, incorporate local components, and adapt corporate processes and technologies to accommodate these changes. And by the mid-1980s, offshore production subsidiaries were free to buy minor parts from local vendors as long as quality could be assured, but still had to buy key components from internal sources.

One of the most successful innovations was to give overseas sales subsidiaries more choice over the products they sold. Each year the company held a two-week internal merchandising show and product planning meeting where product divisions exhibited the new lines. Here, overseas sales subsidiary managers described their local market needs and negotiated for change in features, quantities, and even prices of the products they wanted to buy. Product division managers, however, could overrule the sales subsidiary if they thought introduction of a particular product was of strategic importance.

President Yamashita's hope was that Operation Localization would help Matsushita's overseas companies develop the innovative capability and entrepreneurial initiatives that he had long admired in the national organizations of rival Philips. (Past efforts to develop such capabilities abroad had failed. For example, when Matsushita acquired Motorola's TV business in the United States, its highly innovative technology group atrophied as American engineers resigned in response to what they felt to be excessive control from Japan's highly centralized R&D operations.) Yet despite his four localizations, overseas companies continued to act primarily as the implementation arms of central product divisions. In an unusual act for a Japanese CEO, Yamashita publicly expressed his unhappiness with the lack of initiative at the TV plant in Cardiff. Despite the transfer of substantial resources and the delegation of many responsibilities, he felt that the plant remained too dependent on the center.

Tanii's Integration and Expansion

Yamashita's successor, Akio Tanii, expanded on his predecessor's initiatives. In 1986, feeling that Matsushita's product divisions were not giving sufficient attention to international development—in part because they received only 3% royalties for foreign production against at least 10% return on sales for exports from Japan—he brought all foreign subsidiaries under the control of METC. Tanii then merged METC into the parent company in an effort to fully integrate domestic and overseas operations. Then, to shift operational control nearer to local markets, he relocated major regional headquarters functions from Japan to North America, Europe, and Southeast Asia. Yet still he was frustrated that the overseas subsidiary companies acted as little more than the implementing agents of the Osaka-based product divisions.

Through all these changes, however, Matsushita's worldwide growth continued generating huge reserves. With \$17.5 billion in liquid financial assets at the end of 1989, the company was referred to as the "Matsushita Bank," and several top executives began proposing that if they could not develop innovative overseas companies, they should buy them. Flush with cash and international success, in early 1991 the company acquired MCA, the U.S. entertainment giant, for \$6.1 billion with the objective of obtaining a media software source for its hardware. Within a year, however, Japan's bubble economy had burst, plunging the economy into recession. Almost overnight, Tanii had to shift the company's focus from expansion to cost containment. Despite his best efforts to cut costs, the problems ran too deep. With 1992 profits less than half their 1991 level, the board took the unusual move of forcing Tanii to resign in February 1993.

Morishita's Challenge and Response

At 56, Yoichi Morishita was the most junior of the company's executive vice presidents when he was tapped as the new president. Under the slogan "simple, small, speedy and strategic," he committed to cutting headquarters staff and decentralizing responsibility. Over the next 18 months, he moved 6,000 staff to operating jobs. In a major strategic reversal, he also sold 80% of MCA to Seagram, booking a \$1.2 billion loss on the transaction.

Yet the company continued to struggle. Japan's domestic market for consumer electronics collapsed—from \$42 billion in 1989 to \$21 billion in 1999. Excess capacity drove down prices and profits evaporated. And although offshore markets were growing, the rise of new competition—first from Korea, then China—created a global glut of consumer electronics, and prices collapsed.

With a strong yen making exports from Japan uncompetitive, Matsushita's product divisions rapidly shifted production offshore during the 1990s, mostly to low-cost Asian countries like China and Malaysia. By the end of the decade, its 160 factories outside Japan employed 140,000 people—about the same number of employees as in its 133 plants in Japan. Yet, despite the excess capacity and strong yen, management seemed unwilling to radically restructure its increasingly inefficient portfolio of production facilities.

In the closing years of the decade, Morishita began emphasizing the need to develop more of its technology and innovation offshore. Concerned that only 250 of the company's 3,000 R&D scientists and engineers were located outside Japan, he began investing in R&D partnerships and technical exchanges, particularly in fast emerging fields. For example, in 1998 he signed a joint R&D agreement with the Chinese Academy of Sciences, China's leading research organization. Later that year, he announced the establishment of the Panasonic Digital Concepts Center in California. Its mission was to act as a venture fund and an incubation center for the new ideas and technologies emerging in Silicon Valley. To some it was an indication that Matsushita had given up trying to generate new technology and business initiatives from its own overseas companies.

Nakamura's Initiatives

In April 2000, Morishita became chairman and Kunio Nakamura replaced him as president. Profitability was at 2.2% of sales, with consumer electronics at only 0.4%, including losses generated by one-time cash cows, the TV and VCR divisions. (Exhibits 6 and 7 provide the financial history for Matsushita and key product lines.) The new CEO vowed to raise this to 5% by 2004. Key to his plan was to move Matsushita beyond its roots as a "super manufacturer of products" and begin "to meet customer needs through systems and services." He planned to flatten the hierarchy and empower

employees to respond to customer needs, and as part of the implementation, all key headquarters functions relating to international operations were transferred to overseas regional offices.

But the biggest shock came in November, when Nakamura announced a program of “destruction and creation,” in which he disbanded the product division structure that KM had created as Matsushita’s basic organizational building block 67 years earlier. Plants, previously controlled by individual product divisions, would now be integrated into multi-product production centers. In Japan alone 30 of the 133 factories were to be consolidated or closed. And marketing would shift to two corporate marketing entities, one for Panasonic brands (consumer electronics, information and communications products) and one for National branded products (mostly home appliances).

They were radical moves, but in a company that even in Japan was being talked about as a takeover target, observers wondered if they were sufficient to restore its global competitiveness.

Exhibit 1 Philips Group Summary Financial Data, 1970-2000 (millions of guilders unless otherwise stated)

	2000	1995	1990	1985	1980	1975	1970
Net sales	F83,437	F64,462	F55,764	F60,045	F36,536	F27,115	F15,073
Income from operations (excluding restructuring)	NA	4,030	2,260	3,075	1,577	1,201	1,280
Income from operations (including restructuring)	9,434	4,044	-2,388	N/A	N/A	N/A	N/A
As a percentage of net sales	11.3%	6.3%	-4.3%	5.1%	4.2%	4.5%	8.5%
Income after taxes	12,359	2,989	F 4,447	F1 025	F532	F341	F448
Net income from normal business operations	NA	2,684	-4,326	N/A	328	347	435
Stockholders' equity (common)	48,473	14,055	11,165	16,151	12,306	10,047	6,324
Return on stockholders' equity	42.8%	20.2%	-30.2%	5.8%	2.7%	3.6%	7.3%
Distribution per common share, par value F10 (in guilders)	F2.64	F1.60	F0.0	F2.00	F1.80	F1.40	F1.70
Total assets	86,114	64,683	61,595	62,863	39,647	30,640	19,089
Inventories as a percentage of net sales	13.3%	18.2%	20.7%	23.2%	32.8%	32.9%	35.2%
Outstanding trade receivables in months sales	1.5	1.5	1.6	2.0	3.0	3.0	2.8
Current ratio	1.2		1.4	1.5	1.7	1.8	1.7
Employees at year-end (in thousands)	219	265	273	345	373	387	353
Wages, salaries and other related costs	NA	NA	F17,582	F21,481	F15,339	F11,212	F5,890
Exchange rate (period end; guilders)	2.34	1.60	1.69	2.75	2.15	2.69	3.62
Selected data in millions of dollars:							
Sales	\$35,253	\$40,039	\$33,016	\$21,802	\$16,993	\$10,098	\$4,163
Operating profit	3,886	2,512	1,247	988	734	464	VA
Pre-tax income	5,837	2,083	2,380	658	364	256	VA
Net income	5,306	1,667	-2,510	534	150	95	120
Total assets	35,885	32,351	30,549	19,202	18,440	11,186	5,273
Shareholders' equity (common)	20,238	8,784	6,611	5,864	6,044	3,741	1,747

Source: Annual reports, Standard & Poor's Compustat, Moody's Industrial and International Manual.

Note: Exchange rate 12/31/2000 was Euro/US\$, 1.074

Exhibit 2 Philips Group, Sales by Product and Geographic Segment, 1985-2000 (millions of guilders)

	2000		1995		1990		1985	
Net Sales by Product Segment:								
Lighting	F11,133	13%	F 8,353	13%	F 7,026	13%	F 7,976	12%
Consumer electronics	32,357	39	22,027	34	25,400	46	16,906	26
Domestic appliances	4,643	6	--	--	--	--	6,644	10
Professional products/Systems	--	--	11,562	18	13,059	23	17,850	28
Components/Semiconductors	23,909	28	13,714	17	8,161	15	11,620	18
Software/Services	--	--	9,425	15	--	--	--	--
Medical systems	6,679	8	--	--	--	--	--	--
Origin	1,580	2	--	--	--	--	--	--
Miscellaneous	4,035	5	2,331	4	2,118	4	3,272	5
Total	83,437	100%	61,462	100%	F55,764	100%	F 61,266	100%
Operating Income by Sector:								
Lighting	1,472	16%	983	24%	419	18%	F 910	30%
Consumer electronics	824	9	167	4	1,486	66	34	1
Domestic appliances	632	7	--	--	--	--	397	13
Professional products/Systems	--	--	157	4	189	8	1,484	48
Components/Semiconductors	4,220	45	2,233	55	-43	-2	44	1
Software/Services	--	--	836	22	--	--	--	--
Medical systems	372	4	--	--	--	--	--	--
Origin	2,343	25	--	--	--	--	--	--
Miscellaneous	-249	-3	423	10	218	10	200	7
Increase net attributable to a sector	-181	-2	(835)	(20)	-22	-1	6	0
Total	5,434	100%	4,044	100%	2,260	100%	F 3,875	100%

Source: Annual reports

Notes:

Conversion rate 112/31/00y 1 Euro, 2.2037 Dutch Guilders

Totals may not add due to rounding.

Product sector sales after 1990 are external sales only; therefore, no eliminations are made; sector sales before 1985 include sales to other sectors; therefore, eliminations are made.

Data are not comparable to consolidated financial summary due to rounding.

Exhibit 3 Philips Research Labs by Location and Specialty, 1987

Location	Size (staff)	Specialty
Eindhoven, The Netherlands	2,000	Basic research, electronics, manufacturing technology
Redhill, Surrey, England	450	Microelectronics, television, defense
Hamburg, Germany	350	Communications, office equipment, medical imaging
Aachen, W. Germany	250	Fiber optics, X-ray systems
Paris, France	350	Microprocessors, chip materials, design
Brussels	50	Artificial intelligence
Briarcliff Manor, New York	35	Optical systems, television, superconductivity, defense
Sunnyvale, California	150	Integrated circuits

Source: Philips, in *Business Week*, March 21, 1988, p. 156.

Exhibit 4 Matsushita Creed and Philosophy (Excerpts)

Creed

Through our industrial activities, we strive to foster progress, to promote the general welfare of society, and to devote ourselves to furthering the development of world culture.

Seven Spirits of Matsushita

Service through Industry
Fairness
Harmony and Cooperation
Struggle for Progress
Courtesy and Humility
Adjustment and Assimilation
Gratitude

KM's Business Philosophy (Selected Quotations)

"The purpose of an enterprise is to contribute to society by supplying goods of high quality at low prices in ample quantity."

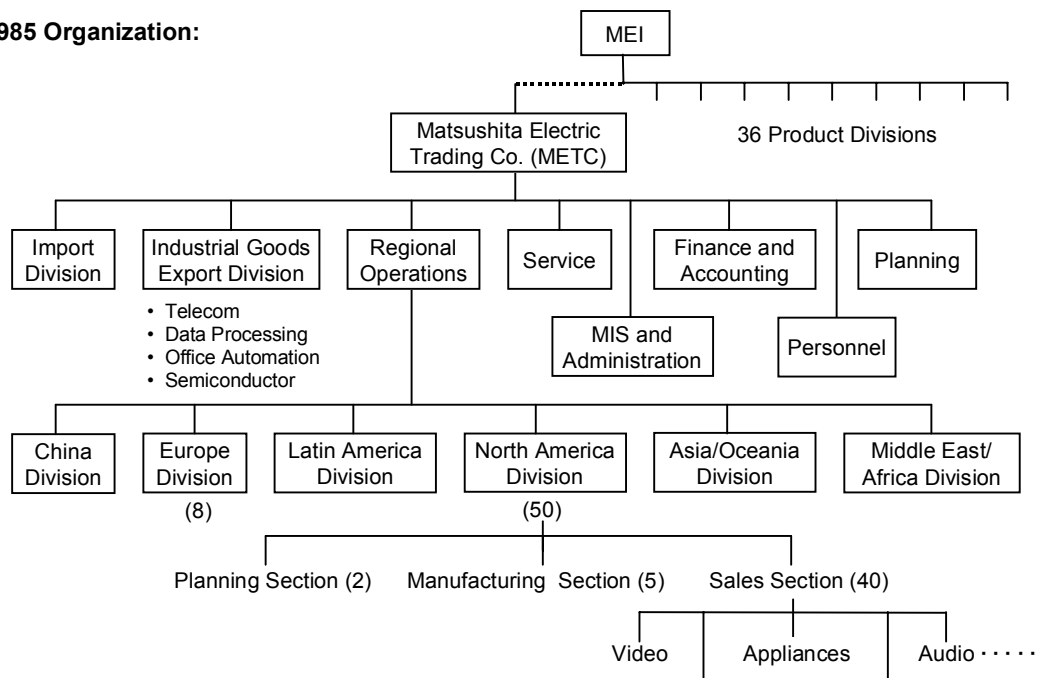
"Profit comes in compensation for contribution to society. . . . [It] is a result rather than a goal."

"The responsibility of the manufacturer cannot be relieved until its product is disposed of by the end user."

"Unsuccessful business employs a wrong management. You should not find its causes in bad fortune, unfavorable surroundings or wrong timing."

"Business appetite has no self-restraining mechanism. . . . When you notice you have gone too far, you must have the courage to come back."

Source: "Matsushita Electric Industrial (MEI) in 1987," Harvard Business School Case No. 388-144.

Exhibit 5 Organization of METC, 1985**1985 Organization:**

Source: Harvard Business School Case No. 388-144.

Note: () = number of people.

Exhibit 6 Matsushita, Summary Financial Data, 1970-2000^a

	2000	1995	1990	1985	1980	1975	1970
In billions of yen and percent:							
Sales	¥7,299	¥6,948	¥6,003	¥5,251	¥2,916	¥1,385	¥932
Income before tax	218	232	572	723	324	93	147
As % of sales	3.0%	3.3%	9.5%	13.7%	11.1%	6.0%	15.8%
Net income	¥100	¥90	¥206	¥116	¥125	¥32	¥70
As % of sales	1.4%	1.3%	3.4%	4.1%	4.3%	2.3%	7.6%
Cash dividends (per share)	¥14.00	¥13.50	¥10.00	¥9.52	¥7.51	¥6.82	¥6.21
Total assets	7,955	8,202	7,851	5,076	2,470	1,274	735
Stockholders' equity	3,684	3,255	3,201	2,084	1,092	575	324
Capital investment	355	316	355	288	NA	NA	NA
Depreciation	343	290	238	227	65	28	23
R&D	526	379	346	248	102	51	NA
Employees (units)	290,446	255,397	198,239	175,828	107,057	82,859	78,924
Overseas employees	143,773	112,314	59,216	38,380	NA	NA	NA
As % of total employees	50%	42%	30%	22%	NA	NA	NA
Exchange rate (fiscal period end; ¥/\$)	103	89	159	213	213	305	360
In millions of dollars:							
Sales	\$68,862	\$78,069	\$37,753	\$24,890	\$13,690	\$4,572	\$2,588
Operating income before depreciation	4,844	6,250	4,343	3,682	1,606	317	NA
Operating income after depreciation	1,501	2,609	2,847	2,764	1,301	224	NA
Profit income	2,224	2,678	3,667	3,396	1,520	273	408
Net income	941	1,017	1,482	1,214	584	135	195
Total assets	77,533	92,139	49,379	21,409	11,636	4,206	2,042
Total equity	35,767	36,575	20,131	10,153	5,129	1,690	900

Source: Annual Reports; Standard & Poor's Compustat; Monex ya Industrial and International Manuals.

^a Data prior to 1937 are for the fiscal year ending November 20; data 1988 and after are for the fiscal year ending March 31.

Exhibit 7 Matsushita, Sales by Product and Geographic Segment, 1985-2000 (billion yen)

	2000		1995		1990		1985	
By Product Segment:								
Video and audio equipment:	¥1,706	23%	¥1,827	26%	¥2,159	36%	¥2,517	48%
Home appliances and household equipment	1,305	18	—	—	—	—	—	—
Home appliances	—	—	516	13	802	13	763	14
Communication and industrial equipment	—	—	1,787	28	1,375	23	849	16
Electronic instruments	—	—	893	13	781	12	573	11
Batteries and kitchen-related equipment	—	—	374	4	312	5	217	4
Information and communications equipment	2,175	28	—	—	—	—	—	—
Industrial equipment	817	11	—	—	—	—	—	—
Components	1,818	21	—	—	—	—	—	—
Others	—	—	520	8	573	10	372	7
Total	¥7,682	100%	¥6,948	100%	¥8,003	100%	¥5,291	100%
By Geographic Segment:								
Domestic:	¥3,698	51%	¥3,456	50%	¥3,382	56%	¥2,659	50%
Overseas	3,984	49	3,493	50	2,621	44	2,632	50

Source: Annual reports

Notes: Total may vary due to rounding.