

**Remarks By Anne M. Mulcahy
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Thank you for that wonderful introduction and warm reception. I'm delighted to be here and especially pleased to have the opportunity to speak on the topic of research and innovation.

Innovation is part of our DNA at Xerox. If it wasn't, I doubt I would be here addressing this distinguished audience. If Xerox didn't have such a rich heritage in research and innovation, I would probably be back in the United States still trying to turn Xerox around. I'll explain what I mean by that in just a few minutes.

What I'd like to do with our time together is:

- Briefly discuss our legacy in innovation.**
- Explain how that helped us turn Xerox around so quickly and so effectively.**
- Talk about our investments in research – including those we make here in Europe.**
- And leave plenty of time for questions.**

I'll start with our legacy in innovation. It all began with a man named Chester Carlson – the grandson, by the way, of four Swedish grandparents who emigrated to America in the mid-19th Century. Chester Carlson, as it turned out, was a quiet man with big ideas and even bigger dreams.

When Chester Carlson invented xerography in 1938, his motivation was deceptively simple -- in his words "to make office workers a little more productive and

office work a little simpler and less tedious." That modest motivation created an entire industry and propelled Xerox on a journey Chester Carlson would have loved. All of us who have followed are in his debt.

It took Chester about sixteen months to invent xerography and another sixteen years to get financial backing for his idea. Joe Wilson, the one man who took an interest in xerography when other companies like IBM took a pass, built a company on Chester Carlson's vision. Joe's foresight some forty years ago is meaningful even today. Joe once said...

"We want to constantly give people new dimensions to the ways they communicate, to make increasing knowledge more broadly useful. To say that we are in the communications business suggests an obligation to a world in which people can communicate. It suggests the need for freedom and peace, and it demands the end of ignorance. If humanity is to progress, knowledge must spread freely throughout the world. We are central to that aim."

The echoes of Chester and Joe Wilson are represented in Xerox's vision statement today. We are focused on "helping people find better ways to do great work ... by constantly leading in document technologies, products and services". This is not only our mantra, but also our mission.

We do that with a team of more than 11 hundred people including the scientists who invent new technology, the experts who create the patents and intellectual property, and the managers who deliver the technology to Xerox customers.

Xerox has grown its global patent portfolio to more than 46 thousand, underscoring our leadership and legacy as one of the world's top technology innovators.

Our patent portfolio is rich with industry-making and industry-changing inventions including the plain-paper copier, full-and highlight-color xerographic imaging, the first laser printer, on-demand printing technology, solid-state lasers, electronic paper, chemical toner and much, much more.

And to think it all began with Carlson's patent for xerography, issued to a quiet man with big ideas and even bigger dreams. It's quite a legacy.

(Pause)

That brings me to the second item I wanted to discuss with you – how innovation helped us turn Xerox around so dramatically over the past few years. Unless you've been living on another planet, you undoubtedly know that Xerox has been through a period of enormous challenge and change.

Back in 2000, we were in pretty tough shape. In fact, we were very, very close to bankruptcy. A lot of people gave us up for dead. Over the course of three very difficult years, we took more than \$2.5 billion out of our cost base ... sold more than \$4 billion of non-strategic assets ... and reduced worldwide employment by about 20 percent.

But I'm pleased to say that we're back. We're in good financial health. We're getting stronger every day. And we're building momentum in the marketplace. In 2000, Xerox lost \$273 million. In 2003, we made \$360 million.

As proud as I am of our financial turnaround at Xerox, what gives me even greater satisfaction is the progress we have made on strengthening our core business to ensure future growth. Even as we dramatically reduced our cost base, we maintained research and development investments. In fact, we didn't take a single dollar out of R&D in our core business -- not one.

As you might imagine, this was not a universally applauded decision. Our financial advisors thought that slashing R&D was a no-brainer. The bankers thought I didn't understand the problem. The bankruptcy lawyers thought I was in over my head. But we bit the bullet and invested anyway.

A lot of people have asked me how we managed to do that – to dramatically reduce costs in order to survive, yet protect our research and development investments to insure a steady stream of new products and technology today and tomorrow.

To me, it's a curious question. To me, there is no real choice. What kind of a victory would it have been to save the company, but trade-off our future? What kind of a victory would it be to avoid financial bankruptcy only to face a technological drought?

No, the answer was to do both – save Xerox today and position it for success tomorrow. And that's precisely what we have done. We're glad we did. Over the last two years, we have brought to market more than 40 new products as well as a rich portfolio of smart document-related services. These investments are already paying off. In fact, more than half of our revenues last year came from offerings that were introduced in the past two years.

If we hadn't done that – if innovation wasn't part of our DNA – I'm afraid we would still be cost-cutting our way to survival. Instead we're investing in innovation as a way back to growth and greatness. I think there is a powerful lesson there for all of us. Decreasing investments today puts tomorrow's growth at risk – whether you're a company or a country. Even in the worst of times you have to invest in the best of times.

And so we keep on investing. Today that investment is about 5 to 6 percent of revenue and it's invested in labs not just in the United States, but also in Canada, Europe, and in Japan with our partner Fuji Xerox.

As you can imagine, the range of Xerox businesses drives a necessarily wide scope of research needs. Our research efforts include the physical and materials sciences where we study such components as toner molecules, photoreceptor materials, fusers and lasers pushing these sciences to new limits when required. As Herve Gallaire – our head of innovation – likes to say: we play with science, we develop technology, we expand the limits of the possible.

Our objective at Xerox is to foster a research environment that discovers technology for:

- **Use in Xerox products and services**
- **Licensing opportunities**
- **And investment opportunities through spin-offs, IPOs or technology sales.**

In other words, we encourage our scientists and inventors to explore. If that occasionally takes them far afield, we can live with it. Let me give you just two of many recent examples of non-product based innovation:

- Xerox PARC is working in collaboration with the Scripps Research Institute to create technologies in biomedical science. The first joint breakthrough is a system for detecting and monitoring cancer through blood testing at unprecedented speeds, enabling early diagnosis of cancer and other illness.
- Our Canadian Research Centre has developed a semi conductive ink that can be used to print the semiconductor channels of transistors – a major breakthrough for the manufacturing of printed plastic transistors.

Some of our very best work is being done right here in France – at our research center in Grenoble. It was established a little more than a decade ago to focus on the emerging reality that the nature of the document itself was changing – from paper to electronic, from analog to digital, from static to dynamic. Grenoble was created to both anticipate and shape the document of the future, to help people move freely from paper to digital and back again, to unleash the knowledge contained in documents, to make documents smarter.

Having a Xerox research center in Europe take the lead on this work made perfect sense to us for a variety of reasons. Let me give you just one very powerful one. There is an old joke that helps make the point:

“A person that speaks many languages is a linguist. A person who speaks two languages is bi-lingual. A person who speaks one language is an American.”

People from 15 different countries speaking more than 30 different languages work at our Grenoble labs. One of their deep competencies is linguistics. And that is critical to pushing the frontiers of document technology.

Increasingly our customers are turning to us for global solutions to their document related problems. Europe, it seems to us, uniquely advantaged in this respect. You’ve been dealing with Pan European technology and language issues for decades. Making the leap from Pan European solutions to global solutions is not such a stretch.

Our scientists in Grenoble are doing some of the best work anywhere in routing documents across the hall and around the world ... translating them into multiple languages ... embedding them with intelligence ... and generally making documents smarter.

One important breakthrough is powerful software that’s smart enough to read an electronic document ... decide how it should be classified by subject ... and route it to the right person’s e-mail address or on-line document management system.

Our Xerox scientists in Grenoble are also working on information retrieval and content analysis and developing tools to improve how people work. They are also looking at ways of capturing the expertise of skilled workers and making that knowledge available to others. And they are always doing it in the tradition of Chester Carlson – to help people.

One very relevant example is the work we are doing with the European Patent Office. They handle patent records for 27 European nations. They have a staff of 5 thousand people who have published more than a million patent applications. Keeping track of it all is an awesome task and an even greater responsibility.

We are helping the European Patent Office by scanning six million pages of paper into digital form -- building the largest and most accurate database of patent information in the world. At every step, there are human beings handling all those documents. When a patent application comes in, someone has to read it and decide which department should handle it. For the patent office, that's a time-consuming and expensive process. For the reader, it's hard to stay awake.

So they're using software to pre-classify patent applications and automatically route them to the right department. Employees are now processing more applications in less time. And many of them have been freed to do more interesting work.

This is not just a process upgrade going on behind the scenes. It's the answer to a mandate issued by the major nations of Europe. That's why their most recent annual report begins by talking about this initiative, which they call "Mastering the Workload." Here's a quote from that annual report:

"Mastering the Workload is more than just a label for a process; it is the mission of making Europe the world's leading knowledge-based economy."

Those are powerful words. And we're proud of them. Our research scientists here in France are at the frontier of making documents smarter and office workers more productive.

(Pause)

Over the past half-century, businesses, universities and governments have poured hundreds of billions of dollars into technology. And let's be frank – the return on that investment hasn't always lived up to the promise. That's because the old world of "I-T" was made up of what I like to call a little "i" and a big "T". The focus was always on the technology.

We're changing that. Our view of I-T is made up of a big "I" and a little "t". The focus is on what really matters – information and what our customers do with it.

Those of us in the information industry need to focus not on hardware and technology for the sake of technology, but on reducing cost and complexity while improving the customer experience. And the customer experience is more about solving problems than acquiring technology.

I believe that's a good note on which to end my remarks and open it up for dialogue ...