

**Historical Review of Samsung's Innovations
and Further Steps**

By

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Bachelor of Law
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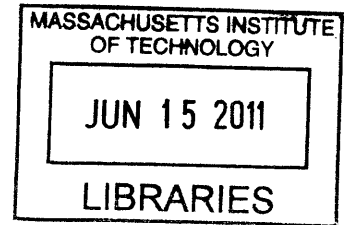
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ABSTRACT

Samsung Group has been growing rapidly for the last ten years, based on Korean exclusive historical and economic backgrounds. Especially, Samsung Electronics, the biggest subsidiaries in the Samsung Group has grown very fast in that period with the technological background – the features of the digital era and disruptive technology and the other background – Korean domestic situation also makes Samsung Group grow so fast. In the most adverse economic environment the Korean government supported Samsung Group entirely and their “Frankfurt Announcement” in 1993 was meant to get over Asian Financial Crisis in 1997.

Their distinctive factors to be successful are their structures, the triangle structure and the vertically integrated structure among the subsidiaries. The triangle structure stands for the ownership, future strategy office, and the professional CEOs of subsidiaries and it provides the fast decision making process and the vertically integrated structure helps Samsung Group finding the new opportunity.

I review their history and the backgrounds which influenced on them and diagnose their internal successful factors with the specific cases, and try to find out their factors by comparing them with LG Electronics, the domestic competitor which went through the same historical and economic situation and with Sony which used to be the insurmountable top company to Samsung Electronics and currently becomes the big competitor.

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Table of Contents

1.	Introduction -----	9
	1.1 The purpose -----	9
	1.2 Historical Review of the Samsung Group -----	10
2.	Background -----	14
	2.1 Technological Background -----	15
	2.1.1 The features of Digital Age -----	15
	2.1.1.1 Transition of Samsung mobile phones -----	18
	2.1.1.2 New trend, smart phones -----	20
	2.1.1.3 The disruptive technology -----	21
	2.1.1.4 Analysis -----	24
	2.2 Korean historical background -----	26
	2.2.1 Chaebol-----	27
	2.2.1.1 The planned support from Korean government -----	28
	2.2.1.2 Fast growth of the Korean economy -----	30
	2.2.2 Korean Financial Crisis in 1997 -----	32
	2.2.2.1 'Frankfurt announcement' in 1993 -----	35
	2.2.2.2 The results from the Asian financial Crisis -----	36
3.	The success factors -----	39
	3.1 Decision making process -----	39
	3.1.1 Triangle Structure -----	39
	3.1.1.1 The ownership -----	39
	3.1.1.2 The future strategy office -----	40
	3.1.1.3 The case of triangle structures –brand management -----	41
	3.1.2 Analysis -----	43
	3.2 Vertically Integrated Structure -----	45
	3.2.1 Affiliates with various businesses -----	45
	3.2.1.1 The case – TV and its components -----	45
	3.2.2 Finding opportunities for new businesses -----	47
	3.2.2.1 Blue Ocean strategy -----	48
	3.2.2.2 The trial for the new business -----	48
	3.2.3 Analysis -----	51

4. The comparison with competitors: LG and Sony -----	52
4.1 From their dream to their competitor: Sony in 2000s -----	55
4.1.1 Historical background : The transfer of power from the founders to professional executives -----	57
4.1.1.1 The founders' age -----	59
4.1.1.2 The professional CEO age -----	59
4.1.2 Its failure from the new trial structure -----	61
4.1.3 The current status of Sony -----	63
4.2 The historical competitor in Korea, LG -----	66
4.2.1 History of LG -----	67
4.2.2 The unexpected decline of its performance in 2010 -----	70
4.2.3 The advent of smart phones -----	71
4.2.4 Analysis of two companies -----	73
4.2.5 Brand Image -----	76
4.2.6 Analysis -----	78
5. Conclusion -----	79

List of Figures

Figure 1.1 The comparison with Samsung Electronics, Sony, and LG Electronics' Historical Market Values -----	9
Figure 1.2 Revenue and operating income of Samsung Electronics 2001-2010 -----	13
Figure 1.3 Samsung Electronics business unit revenue contribution in 2009 -----	13
Figure 2.1 Samsung Electronics' total revenue and its telecommunication division's revenue -----	17
Figure 2.2 Revenue growth rates of telecommunication equipment divisions of Samsung Electronics and LG Electronics -----	21
Figure 2.3 Korean GDP -----	28
Figure 2.4 Revenue of Samsung Electronics 1990-2010 -----	38
Figure 2.5 Net profit of Samsung Electronics 1990-2010-----	38
Figure 3.1 Market forecasting of Biopharmaceutical and Bio similar drugs -----	50
Figure 4.1 The comparison of Samsung Electronics, Sony, and LG Electronics' Revenues 2001-2010 -----	53
Figure 4.2 The comparison of Samsung Electronics, Sony, and LG Electronics' growth rates of revenues 2001-2010 -----	54
Figure 4.3 The comparison of Samsung Electronics, Sony, and LG Electronics' growth rates of revenues from 2001 to 2005 and from 2001 to 2010 -----	54
Figure 4.4 The comparison of Samsung Electronics, Sony, and LG Electronics' Operating Income 2001-2010 -----	55
Figure 4.5 Sales and operating income of Sony 2000-2009 -----	58
Figure 4.6 Sales composition of Sony 2000-2008 -----	58
Figure 4.7 Annual Revenues of Sony, Apple, and Nintendo 1998-2009 -----	64
Figure 4.8 Operating incomes of Sony, Apple, and Nintendo 1998-2009 -----	65
Figure 4.9 Ratio of operating income and revenues of Sony, Apple, and Nintendo 1998-2009 -----	65

Figure 4.10 Revenue and operating income of LG 2001-2010 -----	69
Figure 4.11 LG business unit revenue contribution in 2009 -----	69

List of Tables

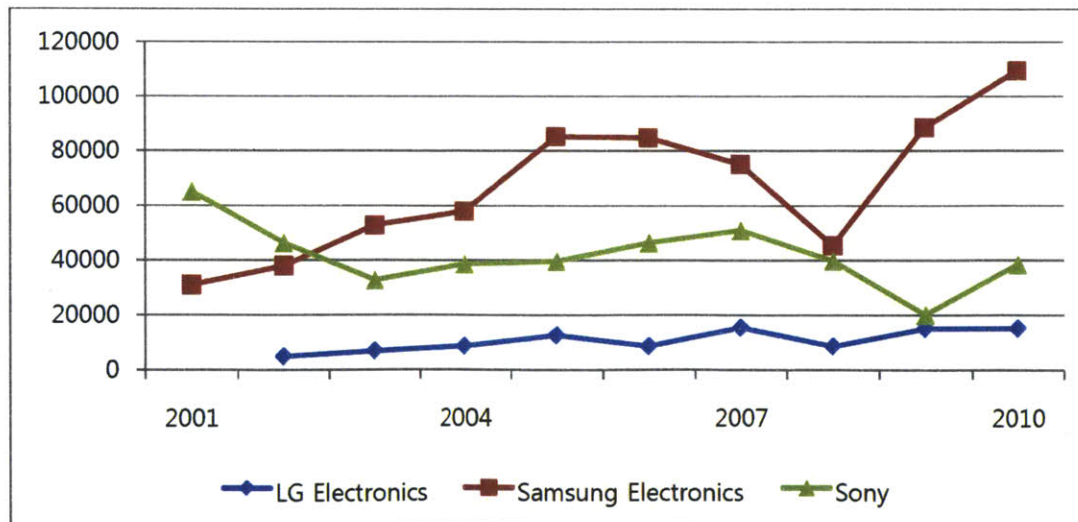
Table 2.1 Global Mobile Handset Shipments – Top 5 Vendors -----	16
Table 2.2 Global Mobile Handset Market share – Top 5 Vendors -----	16
Table 2.3 The reductions in values of Asian Countries’ currencies after the financial crisis -----	33
Table 4.1 2010 2Q Result of LG Electronics -----	70
Table 4.2 2010 4Q Result of LG Electronics -----	71
Table 4.3 Top Mobile Phone Vendors, Shipments, and Market Share in 2010 Q4 -----	73
Table 4.4 The financial highlights from 2003 to 2009 of LG Electronics -----	74
Table 4.5 2010 4Q Profit of LG Electronics -----	75

1 Introduction

1.1 The purpose

Samsung Electronics has exhibited tremendous growth in the last ten years. Before 2001, Sony's market value, (65,118.83 million US dollars) was twice that of Samsung Electronics (31,028.79 million US dollars); however, in 2002, Samsung Electronics surpassed Sony and the gap between the two companies has been increasing since then. According to the announcement at Samsung Electronics annual general meeting of shareholders in 2010, the consolidated revenue in 2010 recorded 154.63 trillion Korean won (136.9 billion US dollars), up 13% from 2009¹ and the consolidated net profit reached 17.3 trillion Korean won.²

Figure 1.1 The comparison with Samsung Electronics, Sony, and LG Electronics' Historical Market Values (million US dollars)



Source: Bloomberg

¹ Samsung to face challenges this year amid fierce competition. English. Xinhuanet.com. Available at http://news.xinhuanet.com/english2010/business/2011-03/18/c_13786029.htm

² New Business is the only way. Hankyoreh. Available at <http://www.hani.co.kr/arti/economy/it/471199.html>

Sony used to be the most innovative company in the world and they had many kinds of mega selling products, such as Walkman and PlayStation. Thus, Sony was an insurmountable barrier for Samsung Electronics; however, currently Samsung Electronics is widely considered even among the Japanese media as having caught up with Japanese electronics companies.

The objective of my thesis is to determine the factors behind Samsung's rapid success for the last ten years and how Samsung, when compared with Sony, will sustain their success in the future. In Chapter 1, I would like to briefly talk about the history of the Samsung Group and in Chapter 2, I'll show the external factors which make the products of Samsung Electronics successful in the market, following the trend of technology. Chapter 3 will introduce the internal factors behind their success based on Korean history and their own structure; furthermore, in Chapter 4, I'll compare Samsung with Sony which was also built by the charismatic founders and experienced the same external transition from the analog era to the digital era. In Chapter 5, I would like to compare Samsung with LG, their old rival in Korea.

1.2 Historical Review of the Samsung Group

The Samsung Group has been growing rapidly for the last seventy years. After the hard work and effort to make Samsung an industry leader in Korea, with diversified businesses in various industries, including chemicals, finance, textiles, hotels, and hospital, now Samsung Group has numerous internationally affiliated businesses comprising almost 60 subsidiaries, such as Samsung Electronics, Samsung Insurance Company, Samsung Heavy Industries, Samsung Construction & Trading, Samsung Everland (South Korea's first theme park), Cheil

Worldwide Agency (ranked #19 among the “World’s Top 50”), Shilla Hotel, and Samsung Medical Center.³ In this chapter, I would like to review the entire history of the Samsung Group briefly to explain how they expanded and diversified their business with the establishment of new affiliates.

Samsung was founded in 1938 by Byung-chull Lee (1910-1987) as a small trading company which sold groceries and noodles. After the Korean War ended, he built Cheil Jedang, a sugar refinery in 1953 and Cheil Mosik, a woolen mill in 1954. Samsung Electronics which has currently become the largest affiliate in the Samsung Group was established in January 1969 in order to expand and diversify their business. However, after the Korean War, Korea’s infrastructure was poor and both industrial and social capital negligible. Furthermore Samsung didn’t have the technological capability and sufficient resources to develop good quality products with. Therefore, although Samsung started the electronics industry, based on the success of Cheil Jedang and Cheil Mosik, they did not have technological capability at the time. As a result, they began the business by assembling mostly imported components. At the beginning, they produced black-and-white TVs while Japanese electronics companies produced color TVs. However, they improved their capabilities gradually by purchasing the technology from other foreign companies and developing by themselves and expanded their product lines to consumer electronics, such as microwaves, refrigerators and washing machines.

Yet the real turning point for Samsung Electronics was the decision to produce semiconductors. In 1973, Byung-chull Lee, the former chairman began to be interested in the

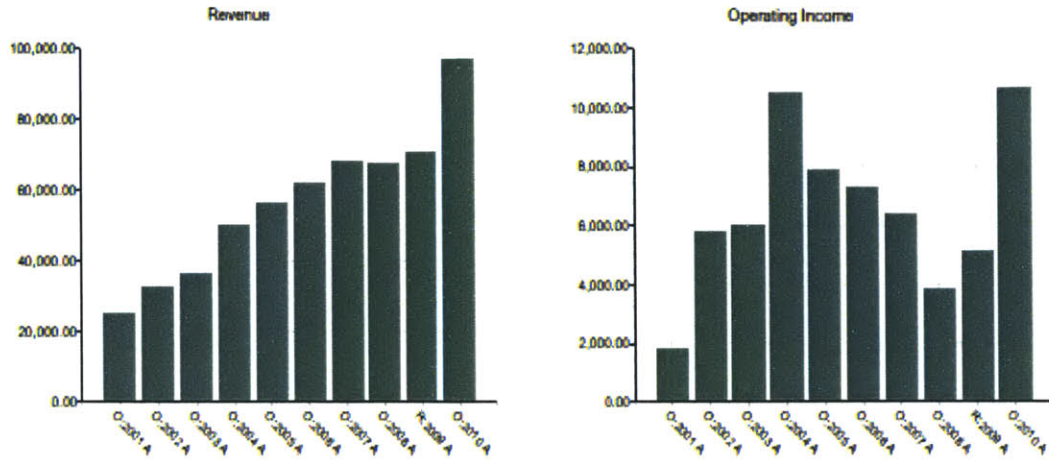
³ Samsung. Wikipedia. Available at <http://en.wikipedia.org/wiki/Samsung>

semiconductor industry because Samsung suffered from a lack of semiconductor component supplies, which were mainly imported from Japan, during the oil crisis. In 1974, Samsung Electronics acquired Korea Semiconductor which enabled them to assemble OEM products of other big semiconductor companies; however, the new business couldn't stop the production of poor quality goods due to the lack of technological capabilities. After struggling to gain technology expertise for a few years and building up industrial experiences, Byung-chull Lee decided to start producing memory chips which would be a crucial component and be related with most of the electronic devices in the future and was determined to focus on DRAM among the memory products, and thus invested huge capital, which turned out to be successful.

Starting with home appliances, Samsung Electronics has been growing into one of the biggest electronic companies in the world. Now they categorize two business divisions based on their products: digital media and communication (DMC) division and device solution (DS) division. The DMC division takes charge of the finished products, such as televisions (TVs), air conditioners, refrigerators, washers, cell phones, network systems, and computers. Its DS division produces semiconductors and liquid crystal display (LCD) products which are the components for the finished products, such as memory chips, hard disc drives (HDDs) and large scale system integrated circuit (LSI) products.⁴

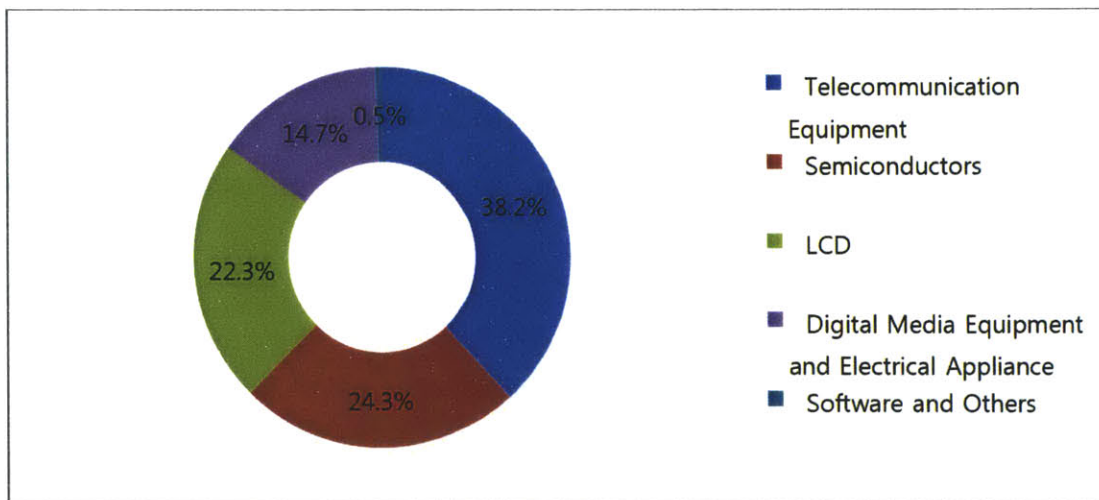
⁴ http://wrightreports.ecnext.com/coms2/reportdesc_COMPANY_C410P0400

Figure 1.2 Revenue and operating income of Samsung Electronics 2001-2010 (Million US dollars)



Source: Bloomberg

Figure 1.3 Samsung Electronics business unit revenue contribution in 2009



Source: Bloomberg

However, most of their products are related with consumer electronic products and their revenue mainly comes from export. Therefore, their performance depends on external factors, such as the exchange rates, oil prices and the global economic situation. Moreover, because many products of Samsung Electronics are based on standardized technology, other Asian electronic companies try to chase them just as Samsung Electronics followed Japanese companies in the past.

2 Background

Samsung has grown in the rapidly changing environment. Globally, technology has been developing radically since the invention of the computer and internet penetration and locally, the Korean economy has made the most progress after Japanese Rule and the Korean War and therefore, Korea is among the countries showing the fastest growth rate in the world.

To find out the reasons why something succeeds in a certain field, it is important to find out its unique characteristics as well as its personal background. In the same manner, it is also crucial to understand the backgrounds of Samsung and their features before explaining the factors behind their success.

In this chapter, I would like to divide the circumstances surrounding Samsung into their technology background which has had a big effect on all electronics companies in the world and Korea's historical background which had influenced them especially to narrow the scope.

2.1 Technological Background

In the late 20th century, the paradigm of technology radically shifted from Analog to Digital, which affected whether or not a company would succeed. In other words, a company which adopted the new wave of technology survived and those which didn't disappeared into history. Based on the transition to the digital era, Samsung Electronics got over their limitation as a late comer and succeeded with the "fast executioner" strategy in which they had been the first in the market with a copycat product whenever a new opportunity such as smart phones and tablet PCs presented itself.

The other back ground which made an impact on the success of Samsung was the disruptive technology. In 1988, Samsung Electronics had a chance to make up the loss from their semiconductors from the sales of 256K DRAM although the products weren't made by the state-of-the-art technology. This resulted in a spin-off from the disruptive technology and took them to a higher level in the industry.

2.1.1 The features of Digital Age

Samsung Electronics has been introducing as many kinds of mobile phones as possible rather than limited types of mobile phones per year since 1993 when 'Anycall', the brand name of Samsung mobile phone was launched. It was risky for Samsung Electronics, the late comer, to invest all the resources on only a few product models and thus, it had no choice but to use this strategy because it is very hard to predict the preference of customers in the rapidly changing electronics industry and furthermore, it wasn't able to lead the market or educate

customers at the beginning. Fortunately, this strategy worked well for Anycall, one of the representative brands in Samsung Electronics and in the 3Q of 2009, Samsung Electronics ranked second among mobile manufacturing companies in the world, following Nokia. Its total sales revenue was almost 71 billion US dollars and the revenue of telecommunication equipment was 27 billion US dollars in 2009.

Table 2.1 Global Mobile Handset Shipments – Top 5 Vendors

Global Handset Shipments (Millions of Units)	Q4 '08	2008	Q4 '09	2009
Nokia	113.1	468.4	126.9	431.8
Samsung	52.8	196.6	69.0	227.3
LG Electronics	25.7	100.8	33.9	117.9
Sony Ericsson	24.2	96.6	14.6	57.0
Motorola	19.2	100.1	12.0	55.1
Others	58.8	214.8	68.0	242.8
Total	293.8	1177.3	324.4	1131.9

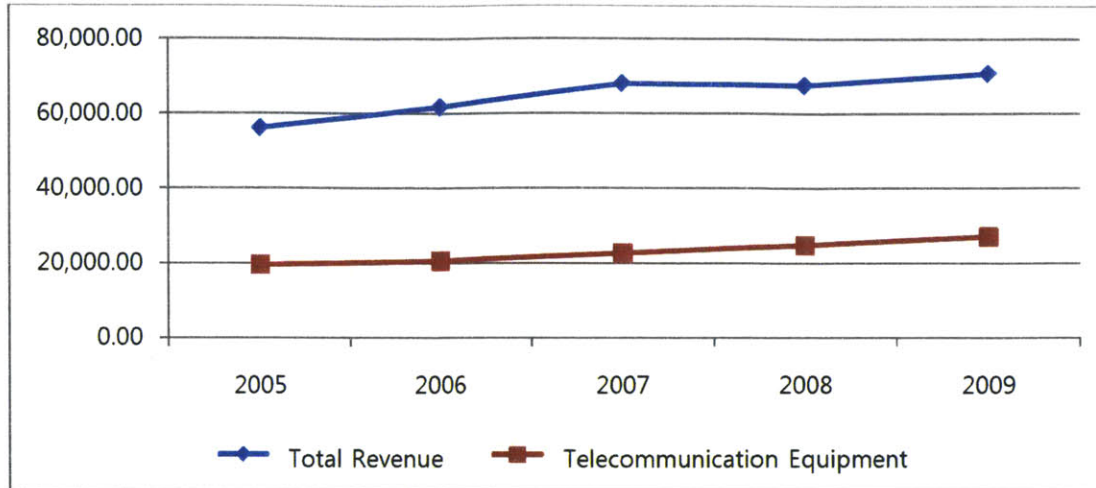
Source: Business Wire

Table 2.2 Global Mobile Handset Market share – Top 5 Vendors

Global Handset Marketshare %	Q4 '08	2008	Q4 '09	2009
Nokia	38.5%	39.8%	39.1%	38.1%
Samsung	18.0%	16.7%	21.3%	20.1%
LG Electronics	8.7%	8.6%	10.5%	10.4%
Sony Ericsson	8.2%	8.2%	4.5%	5.0%
Motorola	6.5%	8.5%	3.7%	4.9%
Others	20.0%	18.2%	21.0%	21.5%
Total	100.0%	100.0%	100.0%	100.0%

Source: Business Wire

Figure 2.1 Samsung Electronics' total revenue and its telecommunication division's revenue (million US dollars)



Source: Bloomberg

Their success results from the characteristic of the digital era. The era had come in the mid-1990s and its features confused business leaders of the analog age because the rules of the digital era are quite different from those in the analog era. In the analog era, experience, skills and accumulated know-how were essential to manufacture products with a competitive edge in the market. Also, the patent technology for a particular product was protected rigorously, together with a high entry barrier to keep their competitors from entering the market. Therefore, the business leader in the analog era was able to enjoy the benefits of having a monopoly status in the market.

However, after the advent of the digital era, technology kept developing and therefore, Samsung's interest moved from focusing on the specific end products to involving one of the components for finished goods. Samsung realized that finished goods appeal to customers

more than the electronic components in terms of the brand awareness and a more powerful brand is able to add value to the products. In addition, currently international organizations, such as ISO (International Standards Organization) or IEEE (Institute of Electrical and Electronics Engineers) establish the industrial standards for various electronic technologies. With standardization, even start-up companies can hire the components which adapt the same industrial standard technology as the market leaders for their products, and can perform as well as the competitors' can. Therefore, the arrival of the digital age narrows the technical gap between existing business leaders and start-up companies and as a result, the companies are forced to differentiate themselves by price competitiveness or customized products. Based on the features of the digital era, Samsung Electronics jumped into the mobile phone industry without advanced technology.⁵

2.1.1.1 Transition of Samsung mobile phones

At the beginning of the boom in mobile phones, the manufacturers thought that its size should be smaller and slimmer and therefore, competed with each other to develop compact mobile phones. However, soon, after the commoditization of mobile phone, customers required more than just slim mobile phones as everyone had compact and slim models. Therefore, it became important for the manufacturers to produce mobile phones with some functions which meet customers' needs faster and to reduce the costs compared to competitors.

To cope with the new preferences, Samsung Electronics started to produce mobile phones

⁵ Sea-jin Chang. *Sony vs. Samsung*. John Wiley & Sons, 2008, p.42

with additional functions which customers want to play with and take advantage of. They introduced more ringtones to play a variety of music which customers want to listen to, camera and megapixel monitors to show vivid pictures which customers want to take and see, games, calculator and even golf navigator. At the beginning, one mobile phone specialized in one specific function, such as 'music phone' with high-quality audio function and 'senior phone' with bigger keypads, given their poor eyesight.

In the mid-2000s it was the trend to adopt the design elements of electronic products to attract the attention of consumers and it was believed that the design of the mobile phones would also be an important factor to appeal to customers. Therefore, after securing the market share in the mobile phones industry, Samsung Electronics, whose mobile phones used to be characterized as having a solid appearance but rough design also focused on the design of the mobile phone and expected it to cater to customers' needs which are inclined to change fast. Thus, as a part of marketing, in 2007, Samsung produced the Giorgio Armani phone in collaboration with the Giorgio Armani designer brand, soon after LG, its biggest competitor in Korea introduced the PRADA phone in 2007 and more than 1 million units were bought. Therefore, Samsung mobile phones offered a wide range of products because not only was it hard to predict customers' needs beforehand but they also wanted to satisfy as many customers as possible even in a niche market. These trials succeeded because some of them hit a home run even though it is not easy to forecast market trends.

In addition, in the digital era, the lifecycle of electronics products is getting shorter as Jong-yong Yun, the former vice chairman of Samsung Electronics said. He stated, "Speed is the

key to all perishable commodities from sashimi to mobile phones. Even expensive fish becomes cheap in a day or two. For both the sashimi shop and the digital industry, inventory is detrimental and speed is everything.”⁶ Therefore, Samsung mobile division develops many different and new mobile phones every year and tries to follow the trend as fast as it can.

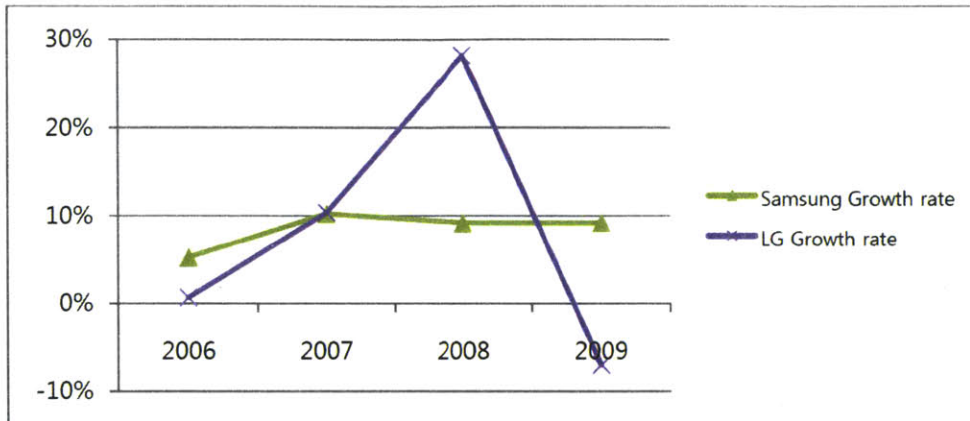
2.1.1.2 New trend, smart phones

When Apple introduced the new smart phone, iPhone, Samsung mobile division was not ready for the smart phone oriented market because of its huge success in the feature phone market. Although it anticipated that the new era for smart phones would come, Samsung Electronics didn't expect it would arrive so soon and moreover, that they would spread so quickly. One of the engineering developers in Samsung mobile phones division said that it usually takes more than one year from planning to release the new product in the market. However, it took three months for Samsung Electronics to finish the launch of the new smart phone with Android, OS (operating system) of Google for competing with Apple. In contrast, it seems that LG, the former third biggest mobile phone manufacturer in 2009, wanted to produce different and well-prepared smart phones to have a competitive advantage as a late-comer. However, despite its intention, LG struggled with poor sales of smart phones due to the delay in the introduction of Windows mobile of Microsoft. As a result, although LG was one of the top feature phone manufacturers worldwide, the company recorded a deficit of 2 billion US dollars in the 4Q of 2010 which was the first time it faced a deficit twice in a row since its founding. Besides, the fact that LG made a mistake in choosing Windows mobile for its smart phones shows that timing is very crucial in the electronics industry because its

⁶ R. Foroohar and J. Lee. *Master of the Digital Age*. Newsweek, Oct 18, 2004, p.E10

lifecycle is so short that even the industry leaders could fall flat on their faces.

Figure 2.2 Revenue growth rates of telecommunication equipment divisions of Samsung Electronics and LG Electronics



Source: Bloomberg

2.1.2 The disruptive technology

According to Professor Clayton M. Christensen of 'Innovator's dilemma (1997)' and 'The innovator's solution (2003)', there are two categories in innovation: sustaining innovation and disruptive innovation. Disruptive innovation is to create the new market and at the same time to destroy the existing market by introducing a product which is not as good as the current representative product. This shows the strategy with which the companies attract the attention of noncustomers first and undershot and overshot customers afterward with simple and convenient products at cheaper prices. On the other hand, sustaining innovation is the strategy with which companies improve established products to sell them at a higher price

than competitors' prices, by targeting the customers who would like to buy existing products with improved quality. Therefore, established companies tend to keep and obsess over their successful technologies because they are responsible for improving their products based on the technology which turns out to have been successful. Therefore, they are apt to focus on the expansion or vitalization of the established market and exert themselves to improve their technology. And then, the companies tend to make the mistake of producing over-qualified products at unaffordable prices at one point. At this moment, start-up companies are inclined to beat the existing companies by making inroads into the market with cheaper, simpler, and more convenient or brand-new products.

In his book, he used the capacity in hard disk as an example. He mentioned that the hard disk market changed dramatically in the last fifty years because disruptive innovation has happened continuously in this field. As the market for products with hard disk drives continues to expand and the products improve owing to the introduction of computers and its popularity, 8 inch hard disk drives became more popular than 14 inch drives and to increase the degree of integration within 14 inches was in vain because the price of 8 inch drivers became cheaper due to its higher supply which responded to a higher demand from the mini computers. However, right after the introduction of the 8 inch drive, the capacity of the 8 inch drive was found to be very low so that many people thought that it was impractical even though the drive was new. Therefore, Professor Christensen said in his book that it is more important to find out new segments, such as 8 inch drives than to focus on the existing ones.

In 1988 Samsung had the opportunity to experience the benefits of disruptive innovation. After its decision to manufacture DRAM, Samsung Electronics acquired advanced

technologies of 64K DRAM from Micron which was in financial trouble at the time. After years of hard work, 64K DRAM finally came out of the factory on September 1984; however, its price collapsed to 30 cents in 1985, which made Samsung Electronics lose 1 US dollar with the sale of each product. While many Japanese and U.S. companies including Intel withdrew or reduced their DRAM business due to the price crash, Samsung Electronics tried to develop 256K DRAM to reduce the technology gap between themselves and their competitors' and finally succeeded in producing 256K DRAM in the middle of 1987 and started to build new factories for the production of DRAM because their executives thought that "the profit in the boom period would come from the investment during recessions." At the end of 1987, the price of DRAM rose after the export restraint agreement between the U.S. government and Japanese manufacturers and the demand for 256K DRAM increased rapidly. However, at that time most Japanese and U.S. semiconductor companies were eager to develop and produce 1M DRAM based on sufficient resources and amicable external environment and already reduced the supply of 256K DRAM. However, the demand for 256K DRAM surged because the manufacturing of products with 256K was stuck due to insufficient supply of 256K DRAM. As a result, Samsung Electronics could make up for all their losses owing to the huge profits from the sales of 256K DRAM in 1988. And, the expanded manufacturing facility contributed to increase their sales volume and profitability.

It seems as if Samsung Electronics didn't intend to extend the production of 256K DRAM to aim at the benefits from their competitors' obsession to improve the technology which turns out sustainable innovation. However, as a start-up company without the core technology and sufficient funds, Samsung had no choice but to choose a strategy with which manufacturers are able to enjoy the benefits from competitors' losses. Because it is easy for many successful

companies, the rate at which new technology is developed to exceed the rate at which customers need products using the new technology, it is possible for a start-up company to rush into the competition aiming at the low-end market given the massive demand. In other words, the products armed with high technology seem over-qualified and unaffordable for customers and have been neglected in the market. Therefore, to be successful in the market, it will be more efficient for the companies to encroach on the low-end market through disruptive innovation and improve the technology step by step than to attack the most attractive market with the over-qualified technology. Given its internal condition and external environment, Samsung Electronics chose the right strategy so that they could develop their capability based on their success in the low-end market.

2.1.3 Analysis

In the digital era, it is very hard for companies to differentiate their products because they can put the same components into their goods as their competitors do in theory. Therefore, the companies should jump into the market at the right time, which becomes their core competency after all. Thus, this technological background makes it possible for Samsung Electronics to use the “fast follower” strategy which successfully delivers competitive products very fast.

Fast follower strategy makes it possible for the company to enjoy the benefits of the second mover in the market because they don't need to go through trial and error and to save the resources, comparing with the first mover which has to invest huge money in R&D. However, they should enter into the market very fast to win the competition with other newcomers.

Traditionally, Samsung Electronics learned from the leading company whose customers' demand was sufficient and succeeded to follow the first mover rapidly. This success was based on their organization structure which is vertically integrated and shares their distribution channels. Their unique structure which produces from the components to the finished goods in electronics makes it possible for them to assemble parts into a complete product which they want to follow very fast. And the other merit of them is the existing distribution channel. Each division has its own sales team; however, they share the sales forces and resources region by region in the global market. Therefore, they have a confidence in introducing their new products and providing them rapidly and widely.

The other capabilities to be successful as a fast follower are the fast decision making process and execution process because the timing when the company enters into the market is very crucial to compete with the first mover and other newcomers. In addition, they run the conservative financial portfolio and have the sufficient capability to begin their new business whenever they want. In practice, Samsung Electronics has higher reserve ratio, 9,358.63% in 2010 than other competitors, comparing with 57% of Elpida, Japanese Semiconductor Company and -46% of ProMOS, Taiwan Semiconductor Company.⁷

Although Samsung wants to be seen as an innovator and tries to achieve it, given the risk of being an innovator and creating a new market, "fast executioner" strategy based on the features of the digital era still plays a major role in Samsung Electronics strategy. However, they should watch out for other competitors and the new comers who can also take advantage

⁷ 31.6 trillion Korean won stored in the barn of Korean top 10 companies. Joongangilbo. Available at http://article.joinsmsn.com/news/article/article.asp?total_id=5304660&cloc=olink|article|default

of the strategy.

In addition, there is another reason for Samsung Electronics to pay attention to the new comers, such as Chinese companies and other Asian companies, because they try to make inroads into the market and want to enjoy the benefits from the disruptive technology as Samsung Electronics did. Therefore, the lessons from the technology still have meaning for them because the situation is reversed now and Samsung Electronics has taken the place of Japanese companies of that time. As we can see from the example of iPhone or iPad, the popular products among customers don't always have the high technology. Therefore, they should keep their eye on the ball to keep the balance between technology and products.

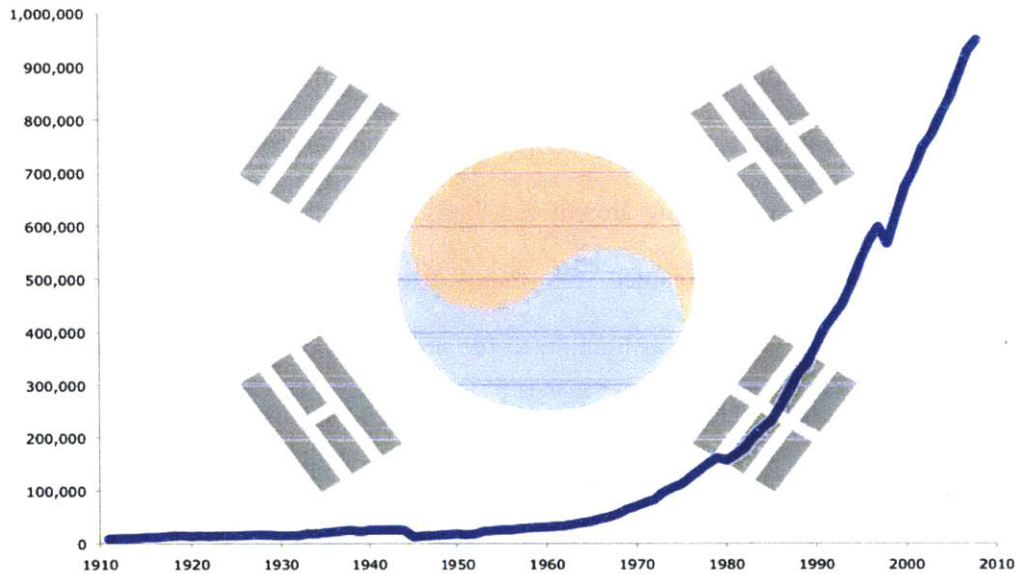
2.2 Korean historical background

Because of the era of Japanese Rule and the Korean War, the Korean government had to use a planned economy strategy and Korea began its industrialization which was led by the government. While improving their economic situation, the government promoted the big companies and they came to be called, "chaebols." Samsung Group is one the chaebols in Korea; however, although many chaebols disappeared or were reduced in scale after the Asian financial crisis, the Samsung Group has grown to become the biggest company in Korea. In this chapter, I would like to introduce "chaebol," the unique form of a business conglomerate in Korea and the Korean economic history and how these factors have influenced Samsung Group until now.

2.2.1. Chaebol

Chaebol is the conglomerate business structure of Korea which is controlled by the founder's family members and has multi-sector businesses. They have been famous for their passion to diversify their business from producing toothpaste to ship building. Their efforts have contributed to Korea's fast economic growth and Samsung Group is one of the Chaebols in Korea. Chaebols have been blamed for many reasons, such as the irresponsible misdistribution of wealth and the obstruction to the promotion of small and medium sized businesses which are evaluated as making the market healthy. However, the Korean economy was very poor; the GNP was only \$67 in 1953 after suffering from the Japanese Colonial Rule and the Korean War. The Korean government had to find and choose its comparative advantage and to concentrate it on its full strength to survive. In this unusual circumstance, a chaebol which is evaluated as very unique appeared in Korea and most large companies in Korea, such as Samsung, Hyundai, and LG became famous for the term "chaebol". In this chapter, I would like to introduce the historical background of Korea after the Korean War and will explain why chaebols appeared in Korea.

Figure 2.3 Korean GDP



Source: Wikipedia

2.2.1.1 The planned support from Korean government

After the Korean War, with the country divided into two, South Korea couldn't help but choose the assembling and processing industrialization strategy because South Korea lost mineral and energy resources, most of which were buried in North Korea and many of the facilities in North Korea which had built during the Japanese Colonial Rule. In other words, the South Korean government, without the raw materials and the fine facilities had no choice but to pursue export-oriented industrialization, which means that the raw material was imported and the end products were exported after the assembling and processing, using Korean cheap labor. In addition, because there was no social and industrial infrastructure and capital at that time, it had to depend on offshore procurement of other than raw materials.

Moreover, the domestic market was immature and thus, the demand for consuming supply was very low and the rate of savings was also very low. Therefore, in 1962, the Korean government announced an outward-looking development strategy from the long-term perspective and this strategy created the fundamentals for the appearance of Chaebols.

As long as the company followed an export-oriented strategy, the facilities had to be modern and over a certain size according to foreign investors' requirements and its products had to try to meet the international standard, so that the Korean government provided the certificate of payment to foreign creditors for the companies. The Korean government also took political action to purposely let Korean banks lend to the companies at loan rates lower than a family loan rate because they didn't have enough funds to invest for themselves. The government had the control power to allocate the rights to various privileges and decided whether it gave the right to one particular company or not. The value of the right depended on the external growth rate of the company, which made them focus on not the profit rate but the growth rate. In addition, the government criteria focused on the company's past performance, which made the entry barrier higher, so that the environment was not friendly for start-up companies. Furthermore, for a bank loan, companies mortgaged their real estate to the bank and therefore, they expanded their businesses and increased their affiliates to maximize the credit lines competitively and pursued opportunities to get more funds and benefits. In addition, the other reason why they had to depend solely on loans from banks is that companies couldn't raise funds from issuing their stock until 1980 when the stock market was open and the condition for issuing stocks was not yet readied in Korea.⁸

⁸ Dae-gun Lee. The developing process of Korean economy and the enterprise, *SKKU*

2.2.1.2 Fast growth of the Korean economy

To expand their territory, the big companies started diversification which wasn't related with the existing businesses to develop new markets, not based on their accumulative technology. The reason for the tendency was government regulation. The Korean government limited the competition in the main industrial sector and thus, increased the entry barrier there because it didn't want Korean companies to compete with each other because it thought that the competition in the same sector would lead to cannibalization among Korean companies. At that time, therefore, once the company entered a new market, it could enjoy the benefits as a market leader. Based on the preconception, many companies tried to start non-related diversification.

While expanding their business, large companies also had to face worldwide competition to export their products. However, they didn't have the developed technology and thus, most of their products were the standardized types as in a mature market, so that the production method is to support mass production with limited kinds of goods and they tried to price competitively. Therefore, many Korean companies diversified their business into small electronics and textile businesses in which the production process is quite simple and there is no need for experienced skills, such as in shipbuilding, and in which the price competitiveness is more important than quality to be competitive in the world, and steel and semiconductor in which their technology is included in the facility.

Furthermore, funding for the companies was very unstable and risky because the government wielded absolute power to distribute the funds and it was illegal in Korea for companies to

establish their own banks until 2010. Therefore, the companies also entered into the financial business, such as insurance and securities, other than banking to raise money stably and established department stores and hotels to create instant cash flow. Besides, the companies found a way to raise money by mutual investment among affiliates, so it was another reason for them to accelerate the establishment of their new businesses.

However, while the companies had expanded rapidly, their owners didn't lose their power to control the whole affiliate because the companies mainly depended on external funds. Although it was able to raise money by issuing stock after the Korean stock market opened in 1980, the companies knew that by issuing stocks, their control power over their companies would weaken. Therefore, they raised the funds from external loans and by mutual investment, not by investing their own equity or by issuing stocks, so that their manner toward raising funds made it possible for their owners to control the whole company. And their control power with a relatively low percentage of the company share was one of the reasons why they are called, 'chaebol.'⁹ In practice, Kun-hee Lee owns only 1.66% of all the shares of Samsung Electronics.

These characteristics and structure have made the chaebols thrive more effectively and efficiently. First of all, it became possible for chaebols to jump into new businesses without restriction. Although new businesses usually entailed risk, its structure with many affiliates acted as a hedge against risk, so that managements were able to rush into the market if they thought that the business would be profitable from the long-term perspective. Secondly, they were able to afford to spend time and resources on nurturing and managing human resources

⁹ Pilgyu Baik, Hosuk Lee, Hyunchul Ko. Korean capitalism of transition period and entrepreneurship, *SERI*, 1996, p.70

very well. When they wanted to start a new business, they needed experts armed with the technology and the knowledge in the field; however, it cost them money and time to hire and train them for the new business. However, a chaebol usually has its own human resource division to manage the whole organization and thus, they are able to get the supply with manpower without added burden, based on the economies of scale. In addition, they can avail of the advantage of switching their employees working in other existing divisions into the new business, so that they can save time and the expenses for training. Thirdly, they are very good at gathering information and using them effectively for their advantage. Because a chaebol is also inclined to have a central information division, it is much easier for them to collect the information and they enjoy the benefits from making full use of it. Based on this ability to gather and use the information, Samsung is famous for following the trend rapidly, such as entering into the LCD and mobile phone markets after the success from semiconductors, all of them known for being promising businesses with huge profits. One of their competitive edges, a great sense of investment timing, originally comes from the ability to gather the information and to analyze it. Based on the features of Chaebol, the Samsung group had diversified their business from sugar refinery to shipbuilding and had expanded to 65 affiliates since their founding. With Korean government support, the Samsung group had grown so fast that they could be one of the leaders of the 'miracle of Han river.'¹⁰

2.2.2 Korean Financial Crisis in 1997






In July 1997, the Asian financial crisis started in Thailand because the baht, its main currency had collapsed. After that, on August 1997, the crisis spread to Indonesia and the Philippines

¹⁰ Han River is the famous river in Korea, which runs through central Seoul. 'The miracle of Han River' refers to South Korea's rapid economic growth after Korean War.

and it landed in Malaysia on September 1997. In November 1997 the Korean government admitted that the Asian financial crisis had hit Korea's economy and applied to the IMF (International Monetary Fund) for a bailout in December 1997.

Some blame for the Asian financial crisis has been placed on chaebols. Although the reasons for the crisis are still controversial in Korea, the results from the crisis were quite clear. The exchange rate of 'won,' its main currency, skyrocketed and thus, the foreign debt which had mounted for a long time also soared and as a result, Korean companies' debt to equity ratio surged. Soon, the short-term foreign debt was approaching and many Korean companies were in danger of bankruptcy and in practice, in September 1998 the news papers reported that over 23,000 companies went bankrupt within ten months after the bailout and that more than 1.57 million workers, who were laid-off since the crisis¹¹, were still looking for jobs. And then, Korean banks were also in trouble because of their massive loans of capital. These results from the crisis had an effect on consumer debt and furthermore, on national debt.

Table 2.3 The reductions in values of Asian Countries' currencies after the financial crisis

Currency	Exchange rate (per US\$1) ⁽²⁰⁾		Change
	June 1997	July 1998	
 Thai baht	24.5	41	⌊ 40.2%
 Indonesian rupiah	2,380	14,150	⌊ 83.2%
 Philippine peso	26.3	42	⌊ 37.4%
 Malaysian ringgit	2.5	4.1	⌊ 39.0%
 South Korean won	850	1,290	⌊ 34.1%

Source: Asian Development Bank

¹¹ One year after IMF. Dongah Ilbo. 1998.11.3. p.3

To overcome the financial crisis, the Korean government asked the big major companies to follow the five restructuring guide lines: “down-scope to focus on core businesses, the reduction of debt to equity ratios to below 200 percent by the end of 1999, the dismantling of cross-credit guarantees among subsidiaries, management transparency, and greater management accountability.”¹²

To meet the government’s guidelines, the management of Samsung group focused on the divestiture of their affiliates, based on the chairman’s empowerment to dispose all, except electronics and financial affiliates such as insurance and securities. Thus, after organizing the restructuring team, they decided to sell the affiliates without any growth potential and concentrate on their core competency, such as semiconductor and TFT-LCD for the future. Other companies, such as Hyundai and LG went through the process of selling off their unprofitable affiliates and Daewoo which expanded its affiliates right after the crisis was dismantled.

Compared with Daewoo which was the second largest Korean conglomerate before the Asian financial crisis and other major companies which went on a downward path since the crisis, Samsung group became the largest Korean conglomerate after the crisis. The reason for their success despite the crisis can be found in their efforts to change themselves since the Frankfurt announcement in 1993.

¹² Linsu Kim. *Crisis, National innovation, and Reform in South Korea*. MIT Japan Program , p.7
Available at <http://dspace.mit.edu/bitstream/handle/1721.1/16570/JP-WP-01-01-52148227.pdf?sequence=1>

2.2.2.1 'Frankfurt announcement' in 1993

In spite of the painful crisis, Samsung Group's success came from the 'Frankfurt announcement' in 1993, which is still famous for the unique slogan, "Change everything, except your wife and children." After Kun-hee Lee succeeded as chairman in 1988, he asked the management and employees to change and innovate to make Samsung Group successful. However, they were already complacent because they had grown so fast that the organization had become bulky. Therefore, they preferred not to challenge the competitive business environment anymore and were inclined to maintain the status quo, so that there was no growth momentum there. However, because he didn't have a base of support during the first five years, he had to watch the situation and prepare for the future during that time. In 1993, he went on a business trip abroad to see the true and real status of Samsung products and was badly disappointed with their position in the world. Samsung products were displayed in a corner of the store at a much cheaper price than the price of domestic goods and nobody wanted to buy Samsung Electronics products again once they tried them. Despite the sore truth, the management and employees were confident and proud of the idea that Samsung was the number one in Korea and they only focused on getting bigger and expanding the affiliates. However, they soon had to admit that it was a delusion. Hence, he gathered the key persons in Samsung group at Frankfurt and for 40 days had them listen to lectures and discuss the current situation and suggest improvements. And then, he demanded that they should focus on quality rather than quantity with the awareness of a crisis situation which can bring everything down overnight. His points were to have the Samsung group recognized as the leading company in the world by focusing on system integration for information sharing, globalization and complexity with the best quality products and services. Thus, the Samsung

group built the infrastructure for information sharing, increased overseas investment for globalization and reorganized the substructure. Furthermore, they began to focus on human resource management, internal education and performance-oriented culture.

2.2.2.2 The results from the Asian financial Crisis

Right after the bail-out announcement, on 21 November 1997, the Samsung group organized the restructuring team and on 26 November 1997 they announced the business plan that they would downsize 30% of the group, reduce 50% of expenses, cut 10% of employees' salaries, and reduce 30% of investment. Moreover, they had to sell some affiliates to foreign companies, such as HomePlus, a chain of large discount department stores to Tesco and the construction machinery division of Samsung Heavy Industries to Volvo at a discounted price. Thus, the number of affiliates which used to be 65 before the crisis became 45 and the number of employees which used to be more than 170,000 came down to 110,000.¹³

Most of the Korean companies suffered from the crisis; nonetheless, Samsung was the least hit among them owing to the changes made from the Frankfurt announcement in 1993. The other companies had still run the numerical value-oriented businesses and had thought that they had to expand their business to keep the hegemony for the continued success.

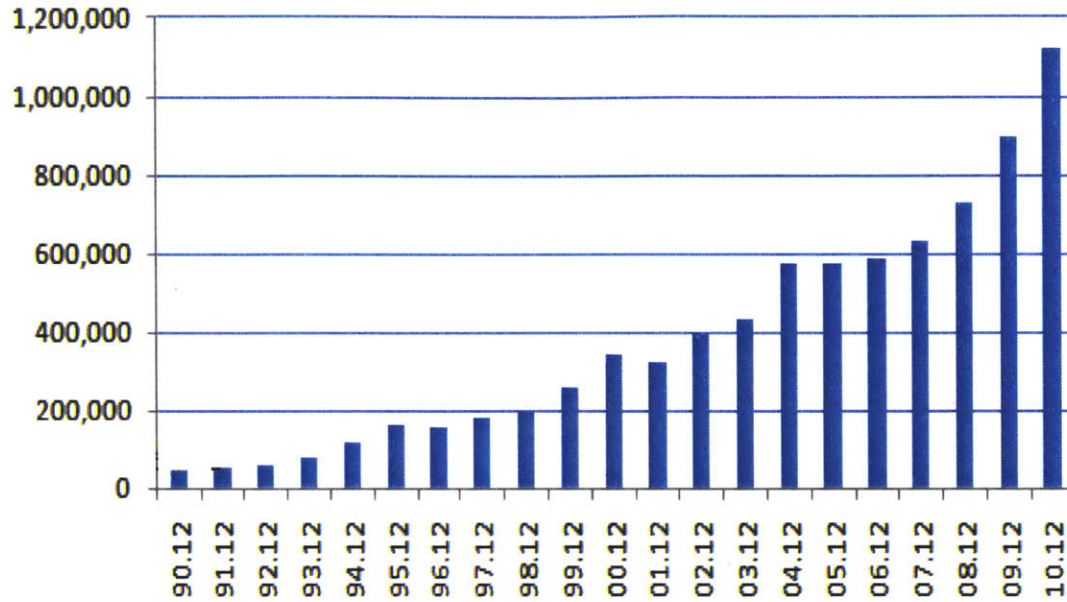
On the other hand, after the announcement in 1993, Samsung tried to run their business by focusing on quality, so that they began to dislodge the people who led the growth driven

¹³ IMF financial crisis and Samsung's rebirth. Ajukyoungje.
Available at <http://www.ajnews.co.kr/view.jsp?newsId=20100304000001>

atmosphere and Samsung began to hire people who were good at managing the whole system in key positions. While the whole structure was also being restructured, they sold off businesses which didn't have potential and weren't their primary industry and thus, reorganized, based on the semiconductor and mobile phones which are very lucrative. Furthermore, they decided that even though a business had a surplus, if it didn't align with their future vision, it was disposable by sale. Therefore, even the electric power semiconductor, which showed a gain of around one hundred million US dollars profit in 1998 and which was built by the personal investment of Kun-hee Lee was sold to Fairchild semiconductor. After this painful restructuring, they boldly closed down 34 businesses, including small electronics and pagers and 52 kinds of goods from 1997 to 1998 and reduced the inventory to half; bonds to 67% of 1997 and the number of employees to 63% of 1997 figures at the end of 1999.¹⁴ During this period, they attempted the transformation from a home appliance producing company to an electronic company with advanced technology. Throughout the process, for ten years, Samsung recorded extraordinary growth figures, increased the total sales by 4 times from 35.7 billion US dollars in 1992 to 137 billion US dollars in 2002 and the net profit by 66 times from 230 million US dollars in 1992 to 15 billion US dollars. Therefore, this one step ahead restructuring activities are believed to be the groundwork to cope with the financial crisis and the fact became implanted in their minds that the restructuring is not just a one-time thing but an ordinary system to cope with changes in the external environment.

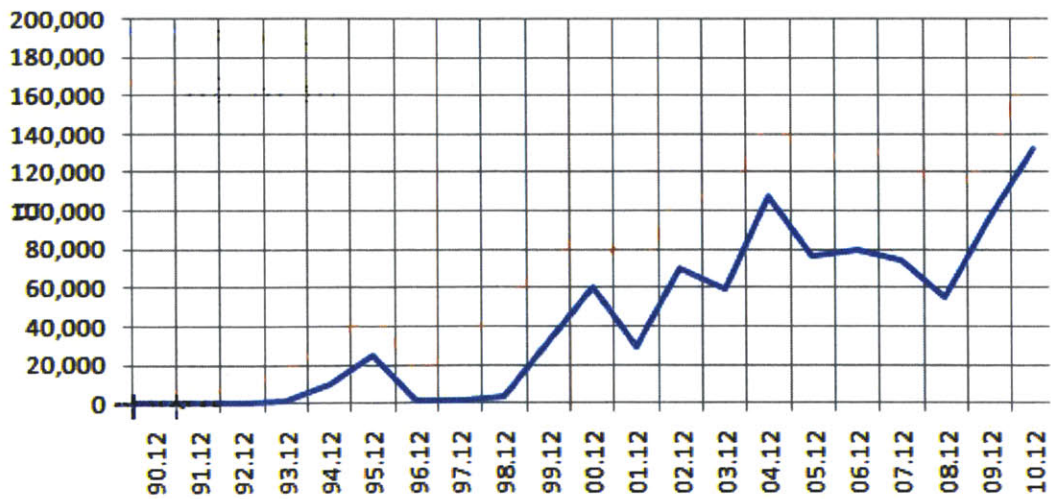
¹⁴ <http://www.hankyung.com/news/app/newsview.php?aid=2002031745541&intype=1>

Figure 2.4 Revenue of Samsung Electronics 1990-2010 (Korean won)



Source: <http://haiclass.egloos.com/10688188>

Figure 2.5 Net profit of Samsung Electronics 1990-2010 (Korean won)



Source: <http://haiclass.egloos.com/10688188>

3 The success factors

3.1 Decision making process

Many media reported that the comparative advantage of the Samsung group came their triangle structure: the chairman's leadership, the future strategy office (former Strategic planning office) and the competence of their affiliate CEOs. It is evaluated that the group has been successful based on understanding the strategic positioning and executions. In this chapter, I would like to explain the triangle structure in detail and introduce the examples of their strategic positioning and executions.

3.1.1 Triangle Structure

The fundamental reasons for the successful strategies of the Samsung Group come from the balance of its triangle shaped control power. Each vertex stands for charismatic ownership, former Strategy & Planning Office (former Restructuring Office), and the CEOs of each affiliate.

3.1.1.1 The ownership

First of all, the leader Kun-hee Lee, the chairman of Samsung Electronics is known for his charisma and his impact on the entire economy and society in Korea is huge. However, he is not usually in the limelight and seems like a recluse. He rarely goes to the office and usually stays at home which is actually his office and is widely known to work at night. All of the

information about him is highly likely to reinforce his charisma and exude mystique. Nevertheless, in practice, he is considered a very practical and a well-informed man with a broad vision. He empowers the executives of the former Restructuring Office and the CEOs of each affiliate, which makes them responsible and at the same time, builds the system in which the rewards for success are great. He also suggests the long-term vision for affiliates' future to make up for the limitation into which it is easy for the CEOs to fall, when they pursue short-term goals and performances. Furthermore, his charisma and his determined leadership carry forward the bold decision to invest during a recession. Compared with Samsung's drastic investment right after the financial crisis, LG, one of their large competitors in Korea didn't invest much during the same period because many executives didn't agree with the idea even though the owner and chairman insisted that they needed to invest to get the gains after the recession.

3.1.1.2 The future strategy office

The future strategy office (former Strategy & Planning Office which succeeded former restructuring office) is a unique and famous department of Samsung Group, which comprises a legal team, public relationship team, planning team, human resources team, finance team, business consulting team and secretarial team. Its members used to work for each affiliate, all of whom had an excellent performance and everyone has much confidence in the fact that they belong to the most powerful organization in the Samsung Group and are very loyal to the company. And 47% of their affiliates' CEOs had the experience of working in the former restructuring office.

Among the teams, the business consulting team is evaluated as the most unique organization. Their main role is to check management efficiency, which is very distinctive and indigenous to Samsung Group. While many companies have the team inspect corruption or illegal activities among their employees' and focus on how to punish them, the restructuring office's consulting team which is called 'management diagnosis team' in Korean, means not only bringing corruption and other issues to light but also preventing the employees from committing dishonest or unlawful actions. This team's role was based on the basic concept that if corruption was prevented, the company could stop unnecessary loss and the investigation conducted after the corruption is like a prescription after death. Besides, the inspection was highly motivated to seeking out an outstanding workforce who had escaped their managements' attention.

The other central role of the organization is to find the core competency of each affiliate and what it should do to improve the status quo. Based on this investigation, the team suggested the business planning and strategy and furthermore, the future vision from the objective third party's view. Therefore, the staff of each affiliate who used to be defensive while being investigated bevsmr active in dealing with it because it could be a good chance not only to find a way of improving their affiliate's profits but also to show their own performance, which might lead to fast promotion.

3.1.1.3 The case of triangle structures –brand management

Samsung used to manufacture products, to export by shipping, and to sell as cheaply as

possible and they advertised respective products according to each region. Therefore, the total number of the advertising agencies hired by Samsung foreign branches was before the financial crisis and they didn't show the image of the whole Samsung group at all. After the Frankfurt announcement, Kun-hee Lee, the chairman ordered an upgrade of their C level image to A level.

The public relationship team decided to introduce CI (Corporate Identity) and to establish the brand image and raised one hundred million US dollars for the marketing of the whole group. Based on the analysis of the business consulting team in which the problem was that the Samsung image was that of 'cheap price,' 'lower quality,' and 'a copy,' the public relationship team elected to take the bull by the horns to establish the smart and fine image of Samsung Electronics. Thus, it placed consumers in developed countries on the priority list and attempted to give them the message that their products are digitalized which stood for state-of-the-art technology at that time, with the united slogan for the Samsung group, 'Samsung DIGITall – everyone is invited.'

The chairman also suggested that the partnership of the Olympics could be used as an important brand marketing tool after the announcement in 1993. He emphasized that it would be the best chance to change the whole image of Samsung group if its image would be matched with the image of the Olympics. After he became a member of IOC in 1996, the idea became true, so that Samsung became one of the sponsor companies in the 1998 Nagano Winter Olympic Games after a two-year-effort by the public relationship team. This effort made Samsung build up its brand image and reach #42, with the value of 5.2 billion US

dollars in brand value rank in 2000, compared to its #75, with a value of 3.1 billion US dollars in 1999. In the 2002 Salt Lake Winter Olympic Games, Samsung devoted its strength to planning and implementing the marketing strategy and it worked very well and thus, the sales in United States increased by 20%, compared with the figure in 2001 and the brand awareness was also raised by 89%.¹⁵ These results contributed to the image that Samsung products are of high-quality, which led to the synergy between their image and their products.

3.1.2 Analysis

There are two important media to mix and connect the three vertexes because the structure is not the vertical relationship as the term, 'triangle structure' shows. And, they are the shared information and the weekly meeting for CEOs and executives of the future strategy office.

In the Samsung group, it is very common for all the members to gather information through as many of the channels as possible so they can share the information from the important issues in industry to worldwide trends about everything. Samsung Economic Research Institute which was established in 1987 provides the executives with 'CEO information,' the weekly magazine about the trends in the industries and the important international media reports since 1995 and opened the online site which gives the general reports and information about the entire economy to everybody since 1997.¹⁶ In addition, shared information helps the three vertexes to be glued together, which places them on the same page.

¹⁵ Brand management of Samsung. Hankyung.

Available at <http://www.hankyung.com/news/app/newsview.php?aid=2002040709551&intype=1>

¹⁶ History of SERI. Seriworl.org. Available at <http://www.seriworld.org/07/wldHistory.html#history3>

In reality, in 1983 Chairman Lee Kun-hee made the decision to begin producing semiconductors despite some opposition and the semiconductor factory was completed in six months. On the one hand, the Strategy & Planning Office had played the role of staff to execute the decision, using the emergent and deliberate strategies, and on the other hand, it had been a path finder preparing for the future in cooperation with Samsung Economics Research Institute (SERI) and a coordinator to deal with the conflicts between the subsidiaries. For example, in 2002, there was a competition between Samsung Electronics and SDI (display business industry) for the right to produce TFT-LCD and the Strategy & Planning Office managed the argument very efficiently¹⁷. Likewise, this Office dealt with the disagreements between subsidiaries, prevented the overlap of investment in the same business, and amplified the synergy using the complementary relationship between subsidiaries. Based on the direction of former Strategy & Planning Office, the CEOs of subsidiaries are responsible for their performances and have a meeting every Wednesday at 8:00 AM to discuss the issues and agenda of the whole group.

Nowadays the market is changing very rapidly and it is almost impossible to forecast the future. Therefore, it is very important to choose the right strategy at the right time and thus, the role of the chairman as a decision maker is critical and that of the staff also becomes important to help the decision maker select the right strategy. Samsung has been evaluated as being good at moving quickly to start a new business or at expanding the existing business, which shows that it is very good at gathering and analyzing information and based on the

¹⁷ The conflict between Samsung Electronics and SDI. Hankyoreh.
Available at <http://www.hani.co.kr/section-004100021/2002/04/p004100021200204161926007.html>

information, the chairman's decision making is very resolute and prompt. Moreover, the company should take account of their priority and order during the decision-making process. The most important issue is to combine the planning blueprint and execution because it should maintain the flexibility for the unpredictable future. Therefore, the company should reconsider their status occasionally and change themselves to cope with the flow of the environment and being a leader. According to this, Samsung Electronics has had a good structure for a fast decision-making process and execution and therefore, the triangle management is evaluated well from the point of reducing risk and building core competence.

3.2 Vertically Integrated Structure

3.2.1 Affiliates with various businesses

The structure of Samsung Electronics is based on the balance of each division, such as semiconductor, mobile phones, and digital home appliances. The business fluctuations in the IT industry are so unpredictable that it seems risky to put all the resources of the company into one singular item. From this perspective, Samsung has the comparative advantage to spread the risks by diversifying their businesses and to cooperate with each other.

3.2.1.1 The case – TV and its components

One of the best selling Samsung Electronics products in 1995 was the 'Plus One TV' which had a 12.8:9, screen, compared with the usual 12:8 proportion. The development of this

product was based on the co-operation amongst Samsung Group's affiliates: SDI, Samsung Corning and Samsung Electro-Mechanics. To show a little more on the 8mm screen, SDI produced the picture tube, Samsung Corning did the glass bulb and Samsung Electro-Mechanics did the key components.

The idea came from the chairman who likes to watch the documentary program on TV. In 1995, he heard that the TV screen only showed 80% of what TV broadcasting stations sent to the air and suggested the idea to develop TVs with wider and longer screens. The four electronic related affiliates organized the task force team which consisted of 55 engineers and invested 22.7 million US dollars. They had regular meetings and checked the outputs. To explain in more detail, the key components made by Samsung Electro-mechanics were assembled into the picture tubes made by SDI and then, the tube was put into the TV set made by Samsung Electronics.

This mutual assistance system paid off with the success of the 34 inch flat screen TV, 'Itron' in 2000. SDI and Samsung Corning jointly developed the 34 inch flat screen using the new technology and Samsung Electro-Mechanics improved the key component with shorter length. Therefore, Samsung Electronics released 'Itron' which had 10 cm shorter depth than TVs of Japanese competitors with 34 inch flat screen. One of the executives in Samsung explained the results, saying that it didn't take a long time to release the new products in the market because the engineers in the set division and the key components cooperated organically.

Furthermore, the three electronic affiliates supplied the components to Samsung Electronics

very stably, which supported their growth in the TV industry in the 1970s and 1980s and helped the company to get over the handicap as a late comer. This also is an example that shows the full use of the vertically integrated structure.

This mutual assistance system also promoted the growth of three affiliates. Since the Frankfurt announcement, the sales revenue of SDI had increased to 53% for five years and that of Samsung Electro-Mechanics was 77% during the same time.¹⁸ At the beginning of their manufacturing, Samsung Electronics bought all the products even though their quality was not good enough. This made it possible for them to build the facilities and to invest in R&D, building up their fundamentals and enjoying the benefits from economies of scale. However, once the affiliates were on track, the quality and the prices of the products which Samsung Electronics required became so rigid that many executives recalled that Samsung Electronics demanded products with 95% of production yield when they managed to manufacture products with 50% of the yield. However, he also said that the most demanding customer made the companies develop and improve their technology. Moreover, the fact that Samsung Electronics brand value rank improved also benefited the affiliates because it was easier for the vendors to trust the companies which supplied their products to Samsung Electronics.

3.2.2 Finding opportunities for new businesses

¹⁸ <http://www.hankyung.com/news/app/newsview.php?aid=2002041440661&intype=1>

3.2.2.1 Blue Ocean strategy

The Blue Ocean Strategy has been a popular theory and says that a company which is going to be the first to find a new opportunity, one which will create new demands and growth with higher margin, will succeed. However, the strategy is criticized because it is not a brand-new and the strategy has been discussed in the academic world for a long time. The successful cases of blue ocean strategy are in retrospect many examples of failure in finding that the “blue ocean” could exist. Nevertheless, I think that the effort to find a new business model and the strategy for the endeavor itself are still meaningful to the company which has many kinds of subsidiaries, such as Samsung Group.

The theory suggests some methods to create a market out of the competition. First of all, the company should find businesses that have the same objective even though their function and form are different from each other. For example, restaurants and movie theaters have different business models for management; however, the business models are similar for customers in the context that people want to enjoy their evenings. And businesses with a similar strategy could boost the chances to unveil a new opportunity. Based on the theory, Samsung Group can take advantage of different businesses of the subsidiaries to create a new business opportunity.

3.2.2.2 The trial for the new business

Recently, Samsung Group announced that they will invest around \$60 million in the solar cell industry and they are vertically integrating the subsidiaries related with the solar cell - from

producing raw material to building power houses. For integration, it is likely that based on the semiconductor and display technology and internal experts, Samsung Electronics will be the main player, Samsung Fine Chemicals and Cheil Industries will supply raw materials, Samsung Corning Precision Materials will supply components, and Samsung C & T will build a power house.

Samsung has also jumped into the bio health industry lately, expecting it to increase steeply and rapidly and to feed on Samsung in the future. Samsung Medical Center will cooperate with Samsung Techwin to develop bio and healthcare related business and it seems that Samsung Techwin will produce diagnosis equipment. Therefore, these investments will definitely reduce the cost of raw materials and marketing & sales expenses, making it effective and efficient to create new opportunities, and reinforce their competitiveness, by sharing a common objective and strategy.

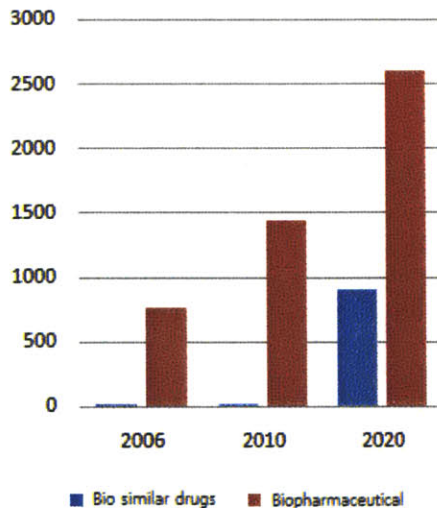
In February 2011, Samsung announced to the media their new three step blueprint for the bio medical and drug business which says that in the first step, they will produce the bio medical instruments and drugs as a CMO (contract manufacturing organization), in the second step, they will manufacture bio similar drugs by 2016 and in the third step, they will finally create their own bio products through R &D.

Bio similar is a variant of a biopharmaceutical which is based on cells and tissues of living organisms that is marketed following the expiry of the original patent.¹⁹ Biopharmaceutical drugs are effective for patients; however, its price is not affordable. Therefore, the value of

¹⁹ Biosimilar. Wiktionary. Available at <http://en.wiktionary.org/wiki/biosimilar>

Bio similar drugs which could be substituted for biopharmaceutical drugs with cheaper price surges up in the market, lowering the price to 40% on average. The size of bio medical and drug industry which was 76.2 billion US dollars (11.9% of total medical and drug industry) worldwide has increased to 144.2 billion US dollars (16%), almost twice and is expected to be 260 billion US dollars (22%) in 2020.²⁰ Above all, the patent of blockbuster biopharmaceutical drugs will expire in 2013 and bio similar will attract the attention of the related companies. Experts anticipate that the size of bio similar market will increase to 90.5 billion US dollars in 2020.

Figure 3.1 Market forecasting of Biopharmaceutical and Bio similar drugs



Source:

<http://www.edaily.co.kr/news/NewsRead.edy?SCD=DA14&newsid=02460006596154128&DCD=A00105&OutLnkChk=Y>

²⁰ Why Samsung is tempting to Biosimilar business. Edaily. Available at <http://www.edaily.co.kr/news/NewsRead.edy?SCD=DA14&newsid=02460006596154128&DCD=A00105&OutLnkChk=Y>

After Kun-hee Lee, the chairman of Samsung Group returned to his position, Samsung decided to start this remarkably bright business, which was aligned with its established strategy of being a fast follower. Furthermore, the features of bio similar business fit Samsung's corporate culture very well. The characteristics of the bio similar industry are similar to those of Samsung whose powerful merits are to invest immensely at the right time and to reduce the cost effectively, benefiting from economies of scale. And, it has been successful worldwide in the electronics business, such as semiconductors, TVs and mobile phones. To be more concrete, the biopharmaceutical business structure is very similar to that of semiconductors because the biopharmaceutical industry needs a huge investment to build the facility and to recruit qualified human resources at the beginning and has to build the fine manufacturing processes as bio similar drugs exhibit high molecular complexity and are quite sensitive to changes in manufacturing process unlike the more common small-molecule drugs²¹ and therefore, the minute difference in processes makes the structure of protein or shape of sugar molecules different. Therefore, as they did at the beginning of the semiconductors in 1980s, Samsung does what they can do amidst a new business opportunity.

3.2.3 Analysis

Their expansion to various businesses has made them cope with the new trends rapidly. Therefore, they have been able to receive the components which they need for the new products smoothly and they also can customize the components. It seems like the NIH (Not Invented Here) Syndrome; however, they are separate businesses and can even make a contract with the companies outside of Samsung. For example, the semiconductor division is

²¹ <http://en.wikipedia.org/wiki/Biosimilar>

supplying Apple with their NAND flash for their products which are in competition with those in the other division of Samsung Electronics. The relationship between the subsidiaries in which they cooperate with each other and at the same time they provide a tension to each other makes Samsung Electronics competitive.

4 The comparison with competitors: LG and Sony

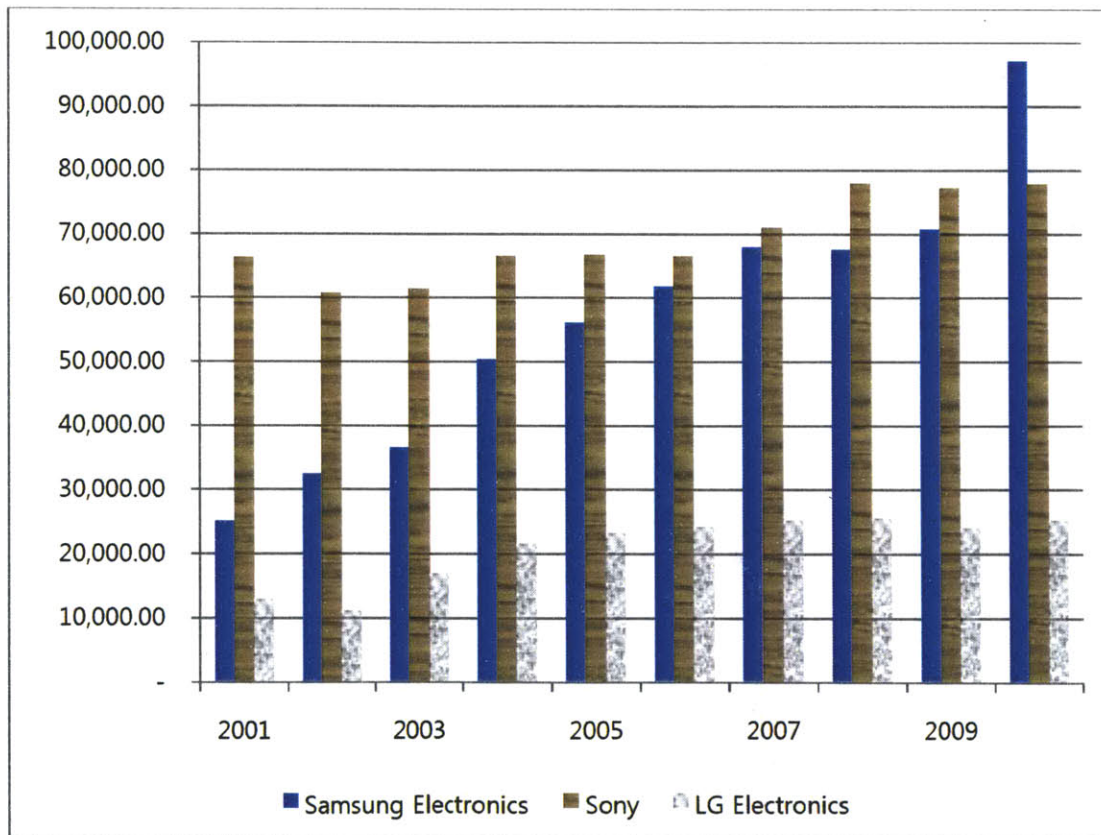
In 2001, although all three companies, Samsung Electronics, LG Electronics, and LG produced similar electronic products, Sony's status was totally different from those of the others. Sony ranked 20th among the best global brands and their brand value was 15,005 million US dollars while Samsung ranked 42nd and their value was 6,374 million US dollars and LG didn't rank in the top 100 brands. However, in 2010, Samsung ranked 19th with the value of 19,491 million US dollars while Sony dropped out to 34th with the value of 11,356 million US dollars.

This change reflects Samsung Electronics rapid growth in their revenue and operating profits, compared with those of Sony. The revenue in 2001 of Samsung Electronics grew 123% to 2005 and 287% to 2010, respectively while that of Sony grew 0.63% in 2005 and 17.41% in 2010, respectively. Therefore, even though the revenue of Sony was more than twice that of Samsung in 2001, the revenue of Samsung Electronics surpassed that of Sony in 2010 and the operating income of Sony was in deficit in 2009 and they didn't recover their loss until 2010.

LG Electronics and Samsung Electronics began to move to the industry around the same time as late comers; however, the growth rates were significantly different and the revenue of

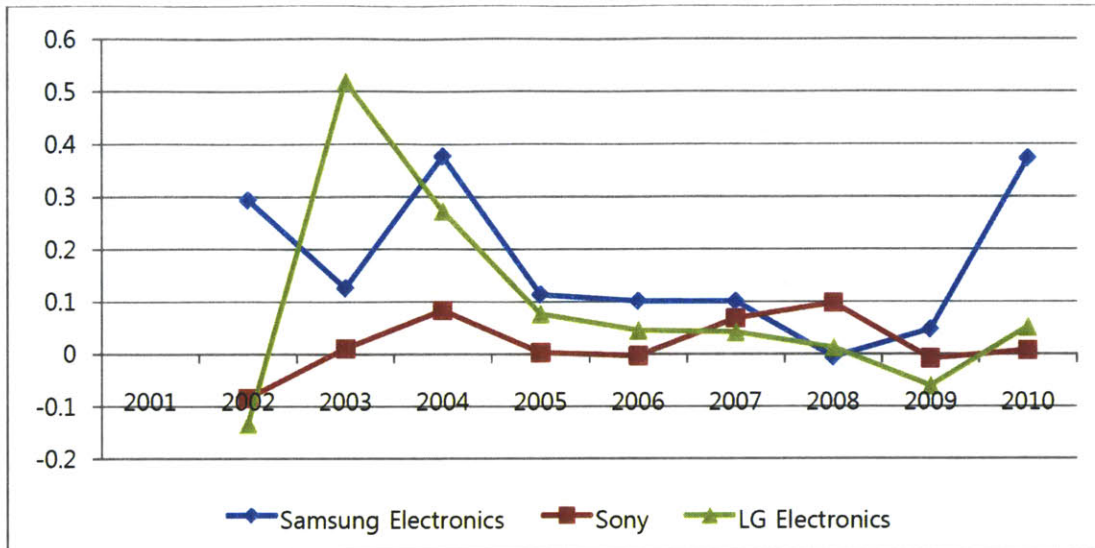
Samsung Electronics grew three times faster than that of LG Electronics for the last ten years on average. And in 2010, LG recorded a deficit in operating income and on the other hand, the operating income of Samsung Electronics increased almost 110% from 2009. In this chapter, I would like to find out how Samsung Electronics took different actions from the other two companies for the last ten years, through comparisons with the two companies.

Figure 4.1 The comparison of Samsung Electronics, Sony, and LG Electronics' Revenues 2001-2010 (million US dollars)



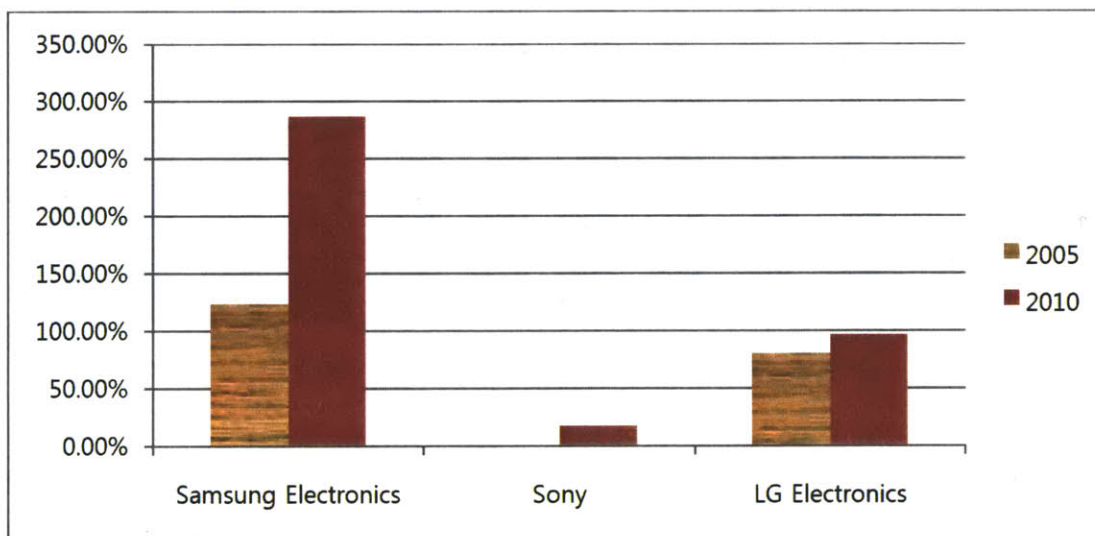
Source: Bloomberg

Figure 4.2 The comparison of Samsung Electronics, Sony, and LG Electronics' growth rates of revenues 2001-2010



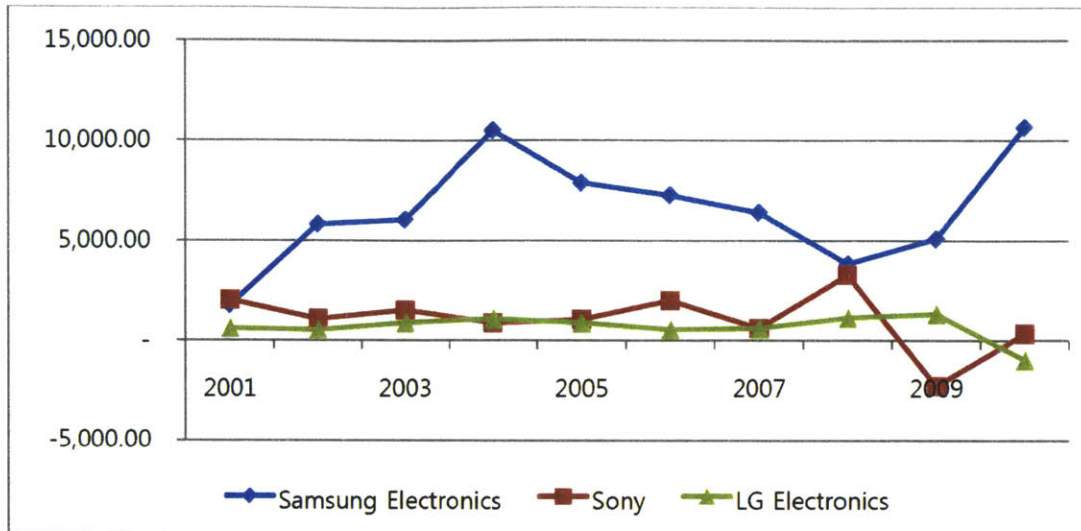
Source: Bloomberg

Figure 4.3 The comparison of Samsung Electronics, Sony, and LG Electronics' growth rates of revenues from 2001 to 2005 and from 2001 to 2010



Source: Bloomberg

Figure 4.4 The comparison of Samsung Electronics, Sony, and LG Electronics' Operating Income 2001-2010 (million US dollars)



Source: Bloomberg

4.1 From their dream to their competitor: Sony in 2000s

In 1997 and 1999, *BusinessWeek* had nominated Nobuyuki Idei, the former chairman of Sony as one of the top 25 executives of the year. But in 2004 the magazine put him on the list of the worst managers of the year. One of the best managers of the year became one of the worst managers in five years.

Rosenzweig's Halo Effect explains this rapidly changing evaluation of one person, Nobuyuki Idei. Halo Effect is used in many fields, such as social psychology, marketing, and advertising etc. From a psychological perspective, it is defined as a cognitive bias where people tend to judge the whole object even though they just see one aspect of it. For example, when people meet a good-looking person, they tend to think of him / her as being nice and

smart. In management studies, Halo Effect explains how the performance of a company distorts the way people think about the reasons for success or failure of the company and this affects its performance data itself. Therefore, the effect lowers the quality of data and thus, erodes the ability to find the right reasons for results. Especially the members of the media are inclined to fall into the Halo Effect to assess a companies' success or failure, so the assessment tends to be superficial and focus on their short-term performances and it is also apt to evaluate the leaders based on the performance of the companies for the period itself. However, the leaders must have their own rational reasons why they made those decisions in certain situations.

Therefore, it is meaningful for Samsung to learn from not only what Sony and Idei did and currently do but also why they did and do as a contemporary of Samsung because I don't think that the executives in Sony were obsessed with its legacy and had a complacent attitude about Sony's future.

However, it is not simple to compare the Samsung Group with Sony because they have different histories, businesses, structures and missions, etc. Nevertheless, both of them were built by very charismatic founders after World War II and they have influenced the whole business for a long time. Therefore, there are some implications for the Samsung Group to learn from the change of Sony's top executive generation and its effects on the company. And both of them have focused on the electronics industry which is very vulnerable to changes in the external environment and in addition, both of them aim at globalized companies. Therefore, even though some media evaluate that Samsung surpasses Sony, there are some implications in this and some lessons for Samsung Electronics to learn from Sony's recent

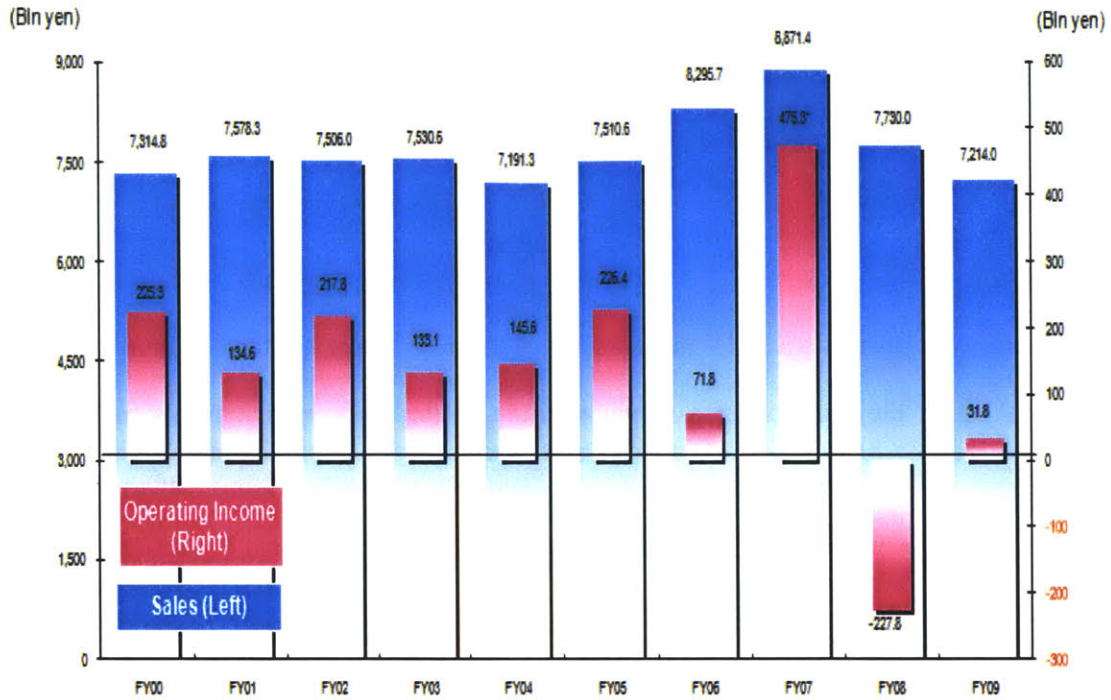
slump. In this chapter, I would like to find the reasons why Sony made the decisions which turned out to be failure later and introduce what it does currently.

4.1.1 Historical background

: The transfer of power from the founders to professional executives

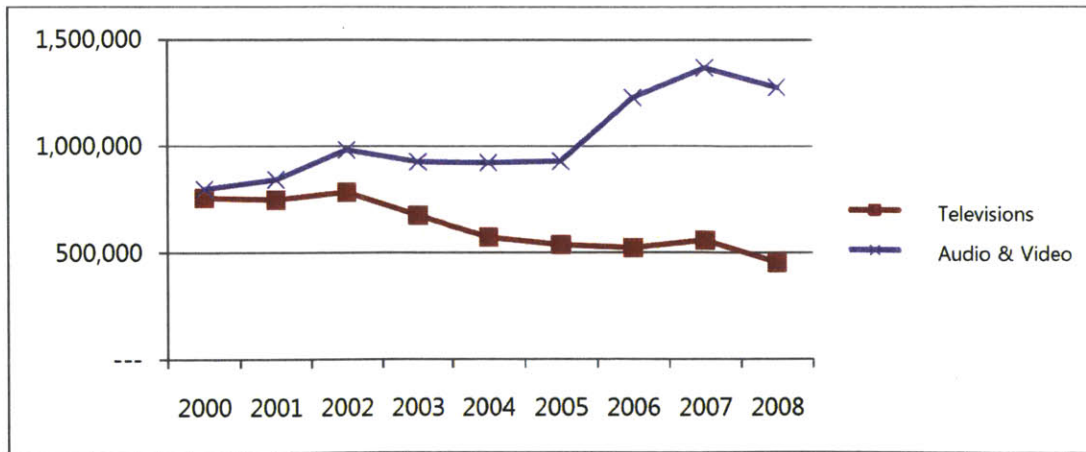
According to the sales and operating income of business segments of Sony, the poor performance of its audio and TV businesses was the main reason for the downturn of Sony's sales although they had taken a strong position in the electronics industry traditionally. According to "Sony vs. Samsung" written by Professor Sejin Jang, Sony wasn't able to cope with the changes in technology trends from the analog age to the digital age and to create the synergy further through the digital convergence between electronic products and contents including movies and music. In this chapter, I would like to focus on the reasons why Sony didn't follow or lead the market trends and get the benefit from the digital convergence even though it had its ownership of the contents, film and music.

Figure 4.5 Sales and operating income of Sony 2000-2009 (Japanese Yen)



Source: Sony

Figure 4.6 Sales composition of Sony 2000-2008 (Million Japanese Yen)



Source: Sony

4.1.1.1 The founders' age

When a company tries to introduce the new products into the market, it seems to create bigger chances for success to follow the intuitive decision of a leader than to accept the majority decision. Morita who was one Sony's founders had been considered as a leader with an excellent intuition and determination and Ibuka, the other founder of Sony had been evaluated as a genius engineer to convert Morita's idea into reality. Their effort to make their company successful had continued to thrive with a variety of hit products.

However, Sony didn't burst onto the market all of sudden and they also had a hard time at the beginning. In 1956, Morita visited the distributor in New York with Sony's new transistor radio and the distributor said to Morita that if the label of his brand put on Sony's products, he would buy the 100,000 radios which amounted to many times of Sony's revenue at that time. Many people of the company wanted to accept the orders because of lack of cash; however, Morita thought that it was more important to build their brand firmly from the beginning and accepted the small number of orders with Sony's label. And when he was interviewed in his retirement ceremony, he pointed out this event as the most proud decision he had made for his company. In addition, the story that he pushed forward the production of Walkman in spite of the inside opposition also shows that Sony's driving force came from the founders' intuition and determination.

4.1.1.2 The professional CEO age

In 1982, Norio Ohga succeeded Morita as Sony president and his decision making process

was very similar to that of Morita despite the fact that he was not the founder. Besides Ohga's, decision regarding PlayStation led to success which mainly resulted from his decision against the inside objection was very similar to that in the case of Walkman and thus, Ohga used to emphasize the success and be proud of the story. His management style was so dictatorial that his tenure as president and chairman used to be called, "the tyranny of Ohga."²² And then, Ohga selected Nobuyuki Idei to be the new president of Sony in 1994. While Ohga had the full confidence from Morita from the beginning, Idei was nominated president owing to the 'elimination method'²³ which was to eliminate the one by one among the internal candidates, finding the disqualifying reason. Thus, Idei was not a convincing nominee of other candidates and executives because his performance was not prominent and his style was not charismatic. Therefore, after Idei was appointed as the president, he tried to restructure Sony's system and set up the "company system."²⁴ This gave the discretionary managing power to each leader of the group to control its business and they took their own responsibility for the performance, which made the groups like independent companies and also made the leaders like the owners. The change of system seemed to contribute to the improvement in their performance; however, the performance of Sony went downward after the collapse of IT bubble in 2001. And Idei's "network strategy" became the target of the criticism from the engineers who wanted to develop the new products and used to be the elite group in Sony; however, they were excluded from the main stream after Idei. Furthermore, Idei was so confident in the expectation that the demand for CRTs would be maintained for a while and OLED (Organic light-emitting display) would be the dominant future display that they didn't invest in developing LCD and PDP. However, the real trend of display market didn't happen as they expected. Therefore, in 2003 Sony had to establish the joint venture company with Samsung

²² Tateishi, Y. *Sony Inside Story*. Tokyo: Kudansha, 2006, Chapter2

²³ Jang, Sejin *Sony vs. Samsung* p.141

²⁴ Jang, Sejin *Sony vs. Samsung* p.108

Electronics which Sony used to consider as the less qualified product company, “S-LCD” to meet their LCD demand.²⁵

Recently Sony’s struggle seemed to originate from the unprepared transition of the next generation. Ohga didn’t care for the candidates for the next president of Sony and appointed Idei according to the “elimination method.” Because Idei didn’t have the base to support him, he had to create a new structure, the “company system” to gain the control power over the company and tried the “network strategy” which didn’t need to rely on the engineering focused groups. However, while the strategy which depended on the network effect should have built a cooperative system between the business groups to be successful, the company system made each business group compete with each other and tended to impede their collaborations. In the next chapter, I would like to explain Sony’s new structure by taking two failure examples in detail.

4.1.2 Its failure from the new trial structure

The “company system” adopted the EVA (Economic Value Added) to evaluate the performance of each business group. EVA was proper to the group business with the products which were in the existing and mature market because it calculates how much its economic activity per year which deducted all the expenses including the opportunity costs adds to the value of the company. Therefore, it was not appropriate to apply EVA to evaluate the investment in new products from the long-term perspective. However, the leaders used EVA to show off their performances to get the better compensation, so that they tended to reduce

²⁵ Jang, Sejin Sony vs. Samsung p.50

the R&D investment, didn't propel the project for new products, and were inclined to maintain or expand their successful product lines.²⁶

For example, the other reason why Sony didn't focus on the LCD and PDP production was EVA. Sony had succeeded in WEGA TV based on the Trinitron CRT and invested 20 billion Japanese Yen in the Braun tube factory for the CRT TV in Pittsburgh in 1993.²⁷ Therefore, it might be difficult for the management of TV business group to change their plan without considering the sunk cost and to invest in LCD and PDP although they already realized the new trend of the flat TV screen and were able to predict that it will take time to develop and to commercialize QLED.

The "company system" and EVA made the business group become a silo structure. The leaders focused on their own short-term performances and thus, they didn't help and collaborate for the performance of Sony. Furthermore, Sony HQ didn't have the control power to let them work together, so that each business group tried to introduce the similar products and competed against each other.

For instance, in 1999, Sony introduced two kinds of music players, "Memory Stick Walkman" and "VAIO Music Clip." However, despite the similarity of the two products, the divisions which developed them were different, "Personal Audio Company" and "VAIO Company" and didn't cooperate with each other when they developed the products. Therefore, Sony couldn't introduce an innovative product, such as iPod of Apple and resulted in the cannibalization between their products. Moreover, in spite of the huge success of iPod and

²⁶ Jang, Sejin Sony vs. Samsung p.114

²⁷ Jang, Sejin Sony vs. Samsung p.51

iTunes, Sony didn't take advantage of Sony Music; on the contrary, Sony Music obsessed with protecting the legal rights of its music contents and the personal audio company didn't offer any incentive to them, so that it couldn't set up an open platform for their customers and provided the tool only for ATRAC, its exclusive music file format, not for mp3, the widely used format.

While many Japanese companies, such as Sony and Hitachi experienced the transition from the founder generation to professional CEO generation, many Korean companies, such as Samsung and Hyundai were still run by the founders' family. However, the nepotistic family-run enterprises have been under pressure to delegate their autocratic management power to the professional CEOs for a long time. In the Samsung Group, there is doubt that Jae-yong Lee, the son of Kun-hee Lee will lead the Samsung Group very well like his father and grandfather did after he succeeds as the chairman. Some people blame his expected succession because his father, Kun-hee Lee doesn't own the majority of shares in Samsung Electronics and he owns the stake by the cross-shareholding among Samsung affiliates. However, in the light of the transition of Sony, it is not easy to tell them simply to change their management style.

4.1.3 The current status of Sony

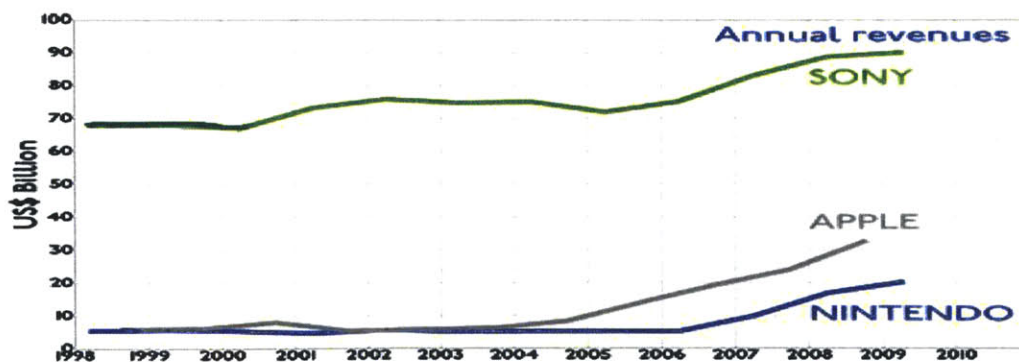
On January 9, 2001, Steve Jobs introduced the 'Digital hub strategy' at MacWorld, in San Francisco. He said, "The Mac would evolve into becoming the center of the digital lifestyle of the 21st century."²⁸ Ten months later, on November 12, 2001, Kunitake Ando, the former

²⁸ Steve Jobs introduces the "Digital Hub" strategy at MacWorld 2001. Apple Mobizone.

chairman of Sony, also introduced the ‘Ubiquitous value network’ at COMDEX in Las Vegas. He said, “Sony aims to build a powerful, new hardware platform where both PC and non-PC consumer electronics devices will be seamlessly connected, leading to new forms of consumer enjoyment.”²⁹ Even though the way of presentation was different, the basic idea is the same. They would make the customers use their devices freely by connecting with whatever they wanted.

After ten years, Apple has grown into the most successful company in the world while Sony had a tough time during these ten years and suffered from the a deficit operation until 2009 although it started to turn a relatively small profit in 2010. Prior to this, Sony was a very successful company and the market share of Apple was relatively low in spite of its brand awareness in 2001. What Apple had was Mac computers, Mac operating system and few applications while Sony produced not only electronics from TV to game players but also music and movies.

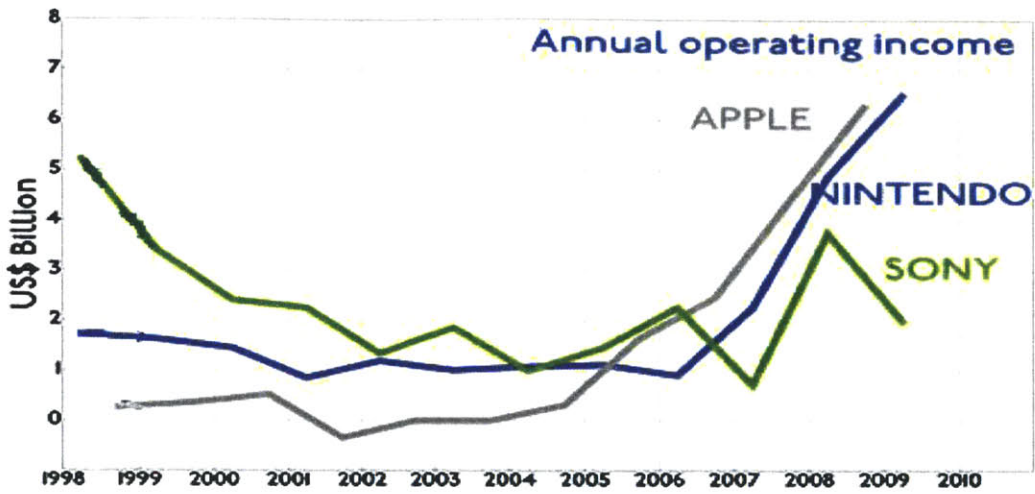
Figure 4.7 Annual Revenues of Sony, Apple, and Nintendo 1998-2009



Source: www.eutotechnology.com

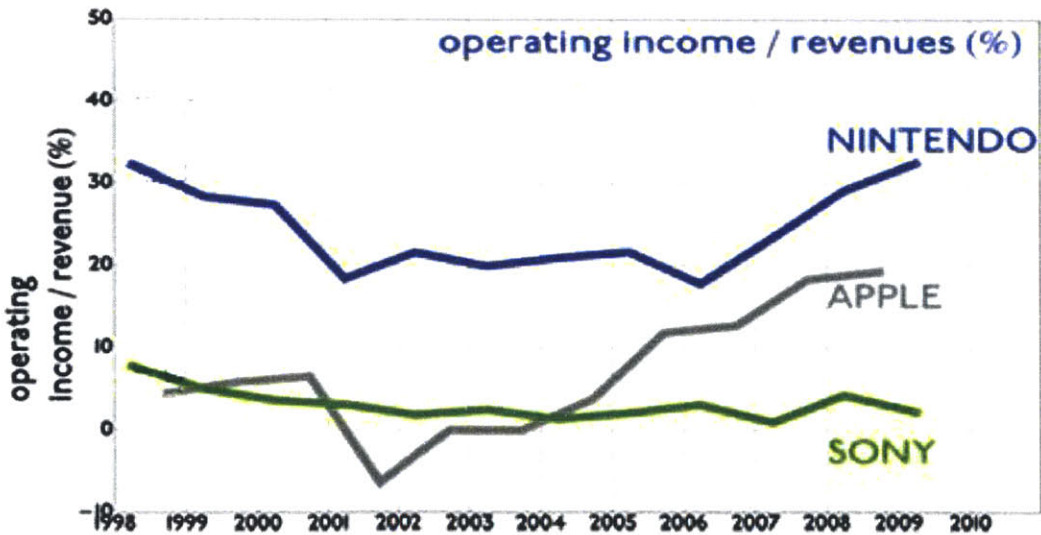
Available at <http://www.applemobizone.com/archives/14748>
²⁹ Press Releases of Sony. Sony Homepage.
 Available at http://www.sony.net/SonyInfo/News/Press_Archive/200111/01-1113AE/

Figure 4.8 Operating incomes of Sony, Apple, and Nintendo 1998-2009



Source: www.eutotechnology.com

Figure 4.9 Ratio of operating income and revenues of Sony, Apple, and Nintendo 1998-2009



Source: www.eutotechnology.com

What was the reason why Sony failed in the ubiquitous value network? There are too many reasons to try to explain and one of them is that Sony tried to predict the future and to lead it even though it is getting harder to forecast the future since the digital era. It is highly likely that making predictions will entail a risk that the future won't work out as well as expected. Furthermore, the harder it is to forecast accurately, the higher the risk will be.

It seems like Sony had a plan where all their electronic products would be connected with the Internet and the data storage device and digital TV and game player would play the role of a 'hub' which controls other electronic devices and the consumers would enjoy the music and movies produced by Sony via Sony's devices. Nonetheless, the future didn't work out as well as Sony expected. Besides, Sony has a variety of competitors because they had a number of businesses from TVs to game consoles. Therefore, Sony has to compete with Toshiba and Matsushita in data storage devices; with Samsung and LG in TVs; and with HP and Dell in PCs; their competitors are growing rapidly and seem to enjoy the benefits as late comers in the Digital era.

These situations which used to be surrounding Sony still exist and Samsung also faces a similar situation. It is getting hard to predict the market and the competitors which include the traditional competitors, such as Sony are running after them.

4.2 The historical competitor in Korea, LG

Samsung and LG have been in stiff competition in Korea for a long time and according to one of the papers of SER, only Samsung and LG still maintain their status among the ten

companies that existed in 1964 in Korea. Although the competition between them has been very fierce for a long time, they not only followed and blamed each other but also did their best to produce better quality products to beat each other in the competition. These efforts as good competitors contributed to their synergy for them to be successful in the global market. However, LG electronics has been struggling since 2010. In this chapter, I would like to find out the reasons why LG electronics went downhill sharply in 2010 and is still suffering, compared with Samsung Electronics with the same external environment. In addition, I would like to introduce how the two companies have managed their brands respectively and how the rivalry has created a synergy effect. Prior to this, I'll briefly introduce the history of LG.

4.2.1 History of LG

In-Hwoi Koo established the Lak Hui (pronounced “lucky”) Chemical Industrial Corp. in 1947 which is currently known as LG Chemical and it became the first mover to the plastic industry in Korea in 1952. In 1958, it established Goldstar Co., Ltd. which is currently LG Electronics Inc., based on its success in the plastic business and it produced Korea’s first radio in 1959. Following the rapid economic growth in Korea, Goldstar focused on home appliances to supply to Korean customers and produced many of Korea’s first electronic products, such as electric fans, refrigerators, black and white TVs, air conditioners, washing machines, and elevators in 1960s. And Lak Hui Corp. was famous for hygiene related products, such as soaps, laundry detergent, and toothpaste.³⁰

³⁰ LG. Wikipedia. Available at <http://en.wikipedia.org/wiki/LG>

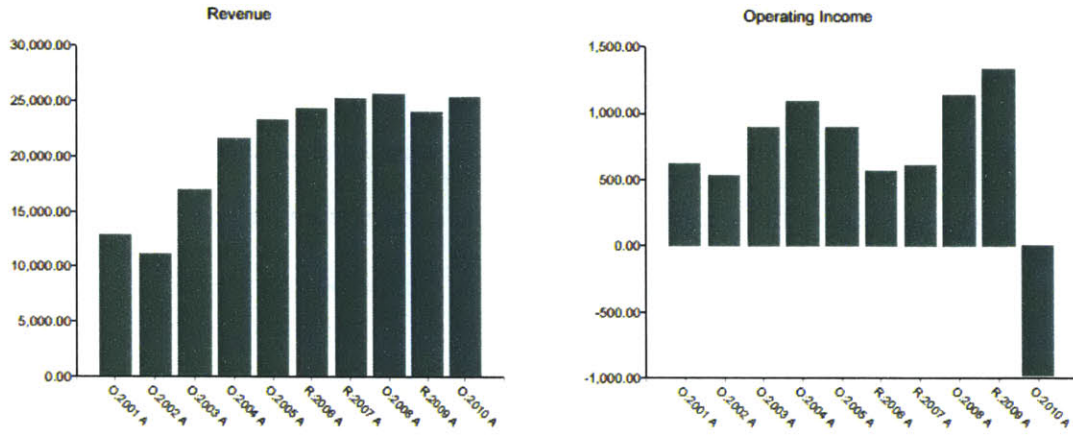
After Cha-Kyung Koo, the son of In-Hwoi Koo became the second chairman in 1969, they started to expand their territory worldwide and Goldstar's exports reached 100 million US dollars in 1978. In the 1980s, Goldstar tried to expand their products to cutting-edge ones, such as color TVs, VCRs, and computers and invested in semiconductors in 1989. This merged with Hyundai Hynix in 1999 because LG was forced to restructure their subsidiaries by the Korean government after the Asian financial crisis. In 1995, Lucky Goldstar changed its name to LG and Bon-Moo Koo, the son of Cha-Kyung Koo was sworn in as the third chairman of LG group and LG Electronics Inc. established the LG-IBM PC Company in 1996.

In 2003, LG launched LG Corp., its comprehensive holding company which has the system in which the holding company doesn't interrupt the subsidiaries' business and investments to get out of the blame of the circulatory investments between subsidiaries.³¹ However, LG which was based on the cooperation between Koo family and Huh family was divided into two companies, LG and GS in 2005. While LG focuses on electronics, chemicals, and telecommunications, GS specializes in energy, distribution, and construction, such as GS Caltex, the second largest Korean refiner, GS retail, GS shop, GS EPS, GS Global, GS sports and GS E&C.³² Although their separation was evaluated as successful, their brand power and their vertical integration based on the relationship among their subsidiaries weakened. Among LG subsidiaries, LG electronics is the biggest and it comprises Home Entertainment, Mobile Communications, Home Appliances, Air Conditioning, Business Solutions, and Others.

³¹ <http://www.lgcorp.com/about/history/history05.jsp>

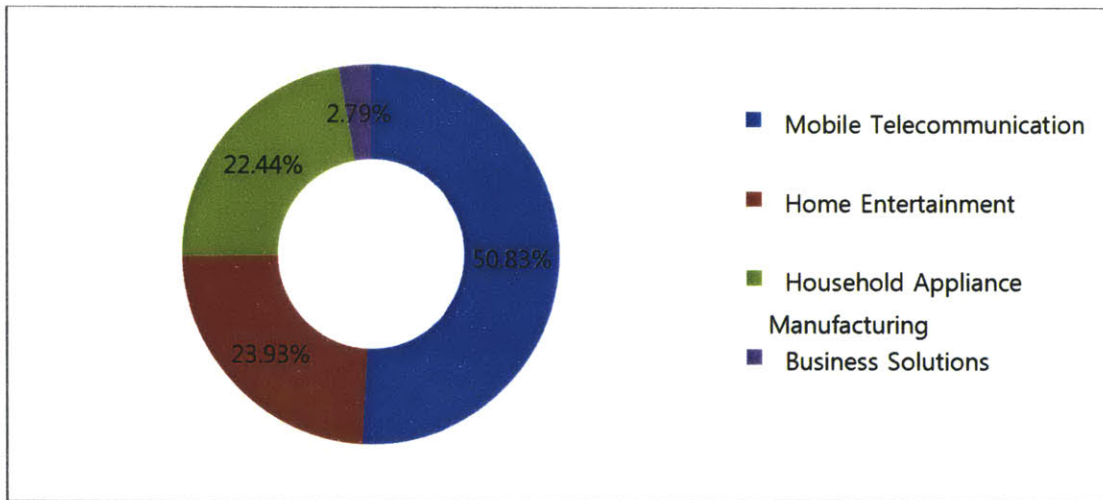
³² <http://www.gsholdings.co.kr/eng/about/affiliate/default.asp>

Figure 4.10 Revenue and operating income of LG 2001-2010



Source: Bloomberg

Figure 4.11 LG business unit revenue contribution in 2009



Source: Bloomberg

At a personal level, the relationship between the two companies used to be very close. The hometown of the founders was the same, and therefore, they had known each other since their

childhood, even the son of In-Hwoi Koo, the founder of LG group married the daughter of Byungchull Lee, the founder of Samsung Group. However, the relationship between the two companies has been competitive since 1969 when Samsung entered into the electronics business. As a current example, the two companies were engaged in a fierce battle over their own 3D TV via media in April 2011. Such intense criticism for each other resulted in a public insult to one engineer of LG Electronics by one of the executives of Samsung Electronics and ended with an apology from Samsung Electronics and the executive.

4.2.2 The unexpected decline of its performance in 2010

In July 2010, LG Electronics reported a deficit in mobile communications in the 2Q of 2010. Although they recorded revenue of 3,373 billion Korean won from their mobile phone business and the revenue increased by 5.8% compared to 1Q of 2010, their operating income marked a deficit of 120 billion Korean won.

Table 4.1 2010 2Q Result of LG Electronics (Consolidated)

Consolidated Sales and Profit by Division

(Unit : KRW bn)

		1Q'10	QoQ	2Q'10	YoY	2Q'09
Home Entertainment	Sales	5,156	↑ 4.0%	5,361	↑ 19.0%	4,504
	Op. Income	182		28		268
Mobile Communications	Sales	3,422	↑ 5.8%	3,619	↓ 29.5%	5,136
	Op. Income	24		-133		633
Handset	Sales	3,140	↑ 7.4%	3,373	↓ 30.8%	4,874
	Op. Income	28		-120		620
Home Appliance	Sales	2,381	↑ 14.3%	2,722	↑ 16.5%	2,337
	Op. Income	207		185		178
Air Conditioning	Sales	1,172	↑ 38.9%	1,628	↑ 0.3%	1,623
	Op. Income	43		59		152
Business Solutions	Sales	1,261	↓ 7.7%	1,164	↑ 14.7%	1,015
	Op. Income	34		-16		26

Source: <http://www.lg.com/global/ir/reports/earning-release.jsp>

In 4Q of 2010, the already high deficit of their mobile phones was aggravated and therefore, the operating income of their mobile communications in 2010 recorded a deficit of 709 billion Korean won. Yong Nam, the vice chairman of LG Electronics resigned in September 2010 and Bon-Joon Koo, the grandson of the founder and the brother of Bon-Moo Koo, the chairman of LG Group was appointed as the vice chairman. The fact that they didn't follow the new flow of their market, into "smart phones" rapidly, was figured as the cause of the deficit.

Table 4.2 2010 4Q Result of LG Electronics (Consolidated)

Consolidated Sales and Profit by Division
(Unit : KRW bn)

		3Q'10	QoQ	4Q'10	YoY	4Q'09	FY10	YoY
Home Entertainment	Sales	5,359	↑ 15.8%	6,205	↑ 4.7%	5,928	22,082	↑ 12.5%
	Op. Income	123		-122		99	211	
Mobile Communications	Sales	3,224	↑ 10.9%	3,576	↓ 14.7%	4,191	13,841	↓ 23.9%
	Op. Income	-326		-274		-6	-709	
Handset	Sales	2,971	↑ 12.0%	3,328	↓ 15.2%	3,924	12,811	↓ 24.9%
	Op. Income	-304		-262		9	-658	
Home Appliance	Sales	2,750	↑ 2.5%	2,819	↑ 13.7%	2,479	10,673	↑ 11.9%
	Op. Income	67		78		12	538	
Air Conditioning	Sales	1,107	↓ 17.6%	913	↑ 50.5%	606	4,820	↑ 12.2%
	Op. Income	-52		10		-28	60	
Business Solutions	Sales	1,192	↑ 1.9%	1,215	↓ 7.8%	1,317	4,832	↑ 4.3%
	Op. Income	-7		47		42	59	

Source: <http://www.lg.com/global/ir/reports/earning-release.jsp>

4.2.3 The advent of smart phones

In 2009, LG Electronics and Microsoft agreed on a strategic collaboration in the Mobile

World Congress in Barcelona, Spain, which included that some 50 types of their smart phones would adopt Microsoft Window Mobile OS as its platform by 2012. At that time, Apple, the new leader of smart phones had a closed policy regarding their OS and therefore, the hardware companies, such as Nokia, Motorola, LG, and Samsung had to find an operating system for developing their smart phones. Therefore, Samsung Electronics tried to develop “Bada,” their own OS and the consortium of Nokia, Sony Ericsson, and Siemens succeeded in developing “Symbian” and in loading their smart phones with their own OS. “Android” of Google spread quickly and they provided other manufacturing companies with their “Android” for free. Therefore, the competition among hardware companies using “Android” restarted along with the competition between Apple and the others.

If the speed of diffusion of the smart phones with “Android” had been as slow as LG expected, or if MS hadn’t postponed the introduction of their Windows Mobile OS, the agreement between LG Electronics and MS would have been evaluated as successful. However, the smart phones spread very quickly and MS continued to postpone introducing their operating system. Therefore, LG Electronics which seemed to stick to the agreement with MS went back to their past glories and upgraded their successful feature phones, such as a “New” Chocolate Phone and a Prada “2” Phone in the second half of 2009.³³

In contrast, Samsung Electronics which also lagged behind the new trend brought out one of their strong points, “the fast follower strategy” in the first half of 2010. They tried to adapt themselves to the new trend as soon as possible and thus, reformed “Omnia,” their smart phone series against iPhone of Apple, which wasn’t evaluated as well-made by the public.

³³ How LG lost the smartphone race. CNNMoney.com.
Available at http://money.cnn.com/2011/02/15/news/international/lg_smartphone_failure.fortune/index.htm?iid=EL

Nevertheless, these efforts prepared them to take off on their Galaxy series after all and Samsung Electronics succeeded in maintaining their market share from 2009 to 2010, compared with the decline in the market share of LG mobile phones.

Table 4.3 Top Mobile Phone Vendors, Shipments, and Market Share in 2010 Q4 (Units in Millions US dollars)

Vendor	4Q10 Unit Shipments	4Q10 Market Share	4Q09 Unit Shipments	4Q09 Market Share	Year-over-year Change
Nokia	123.7	30.8%	126.8	37.2%	-2.4%
Samsung	80.7	20.1%	68.8	20.2%	17.3%
LG Electronics	30.6	7.6%	33.9	10.0%	-9.7%
ZTE	16.8	4.2%	9.5	2.8%	76.8%
Apple	16.2	4.0%	8.7	2.6%	86.2%
Others	133.4	33.2%	92.8	27.3%	43.8%
Total	401.4	100.0%	340.5	100.0%	17.9%

Source: CNET, <http://mtrtechnews.blogspot.com/2011/01/apple-drops-from-dominating-position-in.html>

4.2.4 Analysis of two companies

Since the advent of the digital era, the speed of change in technology has accelerated. However, LG Electronics wasn't able to follow it rapidly even though they noticed the new trends in the mobile phone industry. The problem results from their leadership that is misaligned with the new era.

Yong Nam, the former vice chairman was specialized in marketing as a professional. After his appointment in 2007, they focused on listening to the customers and tried to satisfy them and their strategy matched with the characteristics of feature phones, which led to the success of LG mobile phones. Besides, they had to adopt the strategy which was effective for the short term profit to overcome the global financial crisis in 2008, such as marketing and the design of UI (User Interface). Therefore, LG Electronics succeeded in increasing their net profit from 483 billion Korean won in 2008 to 1,615 billion in 2009.

Table 4.4 The financial highlights from 2003 to 2009 of LG Electronics

Financial Highlights	2003	2004	2005	2006	2007	2008	2009
	KRW bn	KRW bn	KRW bn	KRW bn	KRW bn	KRW bn	KRW bn
Sales	20,177	24,659	23,774	23,171	23,502	27,638	30,513
Operating Profit	1,062	1,250	915	535	565	1,227	1,615
Net Profit	663	1,546	703	239	1,222	483	2,052
Total Assets	11,277	13,235	14,036	13,230	14,336	17,338	21,577
Total Liabilities	7,773	8,218	7,874	7,295	7,127	8,931	11,417
Total Shareholder's Equity	3,505	5,017	6,162	5,935	7,209	8,407	10,160
ROE	20.4%	36.3%	12.6%	3.9%	18.6%	6.2%	22.1%
EBITDA	1,680	1,917	1,726	1,242	1,254	1,910	2,246
Capex	830	1,274	1,322	821	628	645	940

Source: <http://www.lg.com/global/ir/financial-information.jsp>

However, it is evaluated that their great performance in 2009 was based on cost cutting and success in marketing, which led them to be passive in putting their efforts and resources into preparing for their future. Therefore, they missed the right timing in waiting for MS's operating system and preparing the best smart phone to beat their competitors because they

didn't want to make the mistake by turning their direction drastically at a certain point. This intention of the management was highly related with their characteristic because professional managers regard the short term performance as important and prove their abilities through their performance to the public. In both 3Q 2010 and 4Q 2010, LG Electronics recorded a deficit in operating income in a row for the first time in their history.

Table 4.5 2010 4Q Profit of LG Electronics

Profit				
<small>(Unit : KRW bn)</small>				
	<u>3Q'10</u>	<u>4Q'10</u>	<u>4Q'09</u>	<u>FY10</u>
Operating Income	△185	△246	114	176
EBITDA	148	82	485	1,474
Net Profit	8	△256	362	1,282

Source: <http://www.lg.com/global/ir/reports/earning-release.jsp>

In contrast, Samsung Electronics is good at following the new trends fast. However, their management style is considered as conservative because they missed the chance to be the first mover. For example, they didn't accept Google's offer to take "Android" as their products' platform and therefore, Google turned to HTC which became the first manufacturing company to accept "Android." Nevertheless, once the management decides to jump into the business, Samsung Electronics puts their plan into action swiftly, based on their various

components which are supplied by their subsidiaries. As this comparison between Samsung Electronics and LG Electronics shows, a decisive leadership of the management with a fast decision making process is essential to compete in this era.

4.2.5 Brand Image

Samsung changed their logo in 1993 and LG also redid their logo and its brand name from “Lucky Goldstar” to LG in 1995 to boost their brand power in the global market. While LG built their image as “friendly” after the change, Samsung created their brand as “the first one in their industry” and their slogan was “Nobody knows the second player,” which was criticized even among employees because they thought that their image wouldn’t appeal to the public as being as friendly as that of LG and may even be considered repulsive. Therefore, Samsung transformed their image in their campaign to friendly ones, such as “Samsung, reliable friend (1997),” “Samsung, another family member (1997),” and “Samsung, trust in which we can do together (1999).” In contrast, in 2002, LG tried to change their image to “LG, the first player,” which used to be Samsung’s brand image because their management wanted to deliver their image to the public as being not just good, but strong. It seems very ironic and at the same time, it also shows well how competitive the companies have been and how fierce their competition has been.

In their competition, Samsung seems to beat LG in terms of brand awareness. While Samsung’s rank has been going up steadily for the last ten years since it ranked 42nd in 2001 and last year it ranked 19th in Best Global Brands Ranking for 2010 of Interbrand, LG didn’t

rank among the top 100th.³⁴ Moreover, according to “Brand stock,” Korean national brand rank survey, “Anycall,” the brand name of Samsung mobile phone ranked 1st eight years in a row in 2010³⁵; however, any product of LG doesn’t rank in the top 20 in this survey.

What have Samsung done to build up their brand awareness? First of all, their performance improved a lot in that period and is believed to have contributed to their brand power because a good image of the company is based on their good products and performance. In addition, the success in their mobile phones and TVs contributed to Samsung’s image. Despite their huge success in the semiconductor industry, it was hard for consumers to link the good quality of Samsung semiconductors with Samsung’s brand due to the characteristics of the product. Compared with semiconductors, the mobile phones and TVs have the ability to influence the brand awareness of customers and thus, their good quality can boost their brand power.

The other reason is that Samsung has focused on sports marketing through the Olympics and supported promising players, such as Seri Park, female LPGA player and Bongju Lee, the winner of Boston Marathon 2001 to increase their brand awareness and to boost their brand power. The successes of prominent Korean players who are sponsored by Samsung have been improving their image worldwide.

Although LG started the sports marketing first in the Asian Games in 1986 by putting up their billboard, the gap between them began increasing after Samsung’s Frankfurt decision and

³⁴ Best Global Brands 2010 Rankings. Interbrand.

Available at <http://www.interbrand.com/en/best-global-brands/best-global-brands-2008/best-global-brands-2010.aspx>

³⁵ Domestic number brand is Anycall and then who is the next one? Newspim

Available at <http://www.newspim.com/view.jsp?newsId=20101227000139>

became wider after the Asian financial crisis. While Kun-hee Lee, the chairman of Samsung was eager to invest in marketing through the Olympic Games after the Frankfurt decision and continued it even after the crisis, LG didn't have any strength left to invest in their brand management because during the financial crisis, LG card, one of LG's subsidiaries was sold off owing to poor management and subsequently, LG gathered their energies to overcome the crisis. After the crisis, LG has been trying to customize their sports marketing strategies for each country's characteristics, such as table tennis in China and soccer in Brazil. However, their efforts didn't help to increase their status systematically in global competition. Furthermore, the other reason is the distraction of the LG brand, after their separation in 2005. Therefore, this separation decreased the brand exposure of LG, which had an influence on their brand.

4.2.6 Analysis

It is historically natural for a rivalry between LG and Samsung to exist, and nowadays, the competitors passionately try to have a bigger market share worldwide and to achieve better performance than others. It has been controversial whether the rivalry particularly in the domestic market is good for the companies' growth and development. However, as Michael Porter said in his book, "On competition (1998)" a strong rivalry in the domestic market accelerates to create each company's core competency and tries to make it powerful. Because competition in the domestic market is highly likely to be fierce; the more competitive the market becomes, the more innovative the companies are getting. However, Porter also mentioned the concern that it is easy for the domestic market to make the competition overheated, which could result in only slanderous attacks. And in a fierce competition, the

competitors tend to follow their competitors' products and strategy, rather than to create their own strategy and to invest in R&D, which leads to a price war without developing new technology and to a decrease in the profits in the end.

In terms of brand management, Samsung Electronics and LG Electronics had competed intensively and had created a synergy effect; however, the situation changed a lot after Kun-Hee Lee became an IOC member and Samsung Electronics began sponsoring the Olympic Games. This contrast also reflects how important the leadership of the owner and the organization which executes the strategy through fine plans are, even to create and increase an intangible asset.

5 Conclusion

Samsung Group has an exclusive domestic background and gets on the right tide of new technology to have been successful for the last ten years. Based on the technological background – the features of the digital era and disruptive technology, Samsung Electronics which is the biggest subsidiary in the Samsung Group has grown very fast for the last ten years. Owing to the chance to take advantage of disruptive technology, Samsung Electronics had the confidence in their business to overcome the loss of the semiconductor business in the late 1980s, which gave them the opportunity to take off for their future. Besides, the other background – Korean domestic situation also makes Samsung Group grow very fast. In the most adverse economic environment the Korean government supported Samsung Group entirely and “Frankfurt Announcement” in 1993 was meant to get over the Asian Financial Crisis in 1997, which accelerated their growth rate.

The distinctive factors that make Samsung Group successful are their unique structures, the triangle structure and the vertically integrated structure among the subsidiaries. The triangle structure which comprises the ownership, future strategy office, and the professional CEOs of subsidiaries provides the fast decision making process to cope with the rapidly changing circumstances and the vertically integrated structure helps Samsung Group finding the new opportunity, from the development of new TV products to alternative energy business and bio medical business, which has contributed the success of Samsung Electronics

LG is one of the Korean chaebols, so that they share the same domestic background as Samsung Group. However, they didn't follow the new trend of their major business, the mobile phones recently and the mistake resulted in their deficit of the whole company in 2010. This reflects that the hesitation in one moment greatly impacts on the company in the digital era and it is very crucial to make the decision making process rapidly.

Compared with that of Sony, the ownership of Samsung Group still belongs to the founder's family, so that they didn't go through the political problem surrounding the ownership. However, Sony had the problem with their structure after the new professional CEO was appointed and wanted to change their structure of the organization. The new structure brought the silo effect, which made the investment overlapped and each division compete within the company. Moreover, they seem to be proud of themselves in their technology and products and thus, lagged behind the flow of the digital era.

The success of the Samsung Group mainly results from their organization structure and the

decision making process to cope with the transition to the digital era. In addition, the characteristic of their culture and employees also contributed to their success. Their initial goal for their businesses has been based on the patriotism through donating their benefits to the society and providing job opportunities. Their employees used to be very loyal to the company and many of them used to be willing to sacrifice their personal life and to devote to pursue the success of their company, which supported their structure and evaluated to lead the success. And the company compensated their effort by providing honor and wealth and for example, if the employees are promoted to the executive level, their salary tends to surge and the benefits from the company become upgraded a lot.

However, the situation has become different. Other competitors, such as Chinese electronic companies can also enjoy the benefits from the fast follower strategy as the late comers in the digital era. Moreover, the conservative characteristics of their employees in which the employees are inclined to stay in the same company as their lifelong workplace has changed to what is influenced by Western culture and thus, they are as loyal as much their seniors were and don't want to sacrifice themselves. In addition, as the size of Samsung Groups increases, the number of the experienced employees from outside of Samsung Group also increases. Therefore, their own culture is getting to be diluted and furthermore, the employees who entered the company as new comers feel an even greater sense of frustration because they might think that promotion opportunities and the benefits could be reduced. Therefore, I think that it is time to contemplate a way to reinforce their culture with their various members other than the present compensation program, whether they should build up the brand new culture or they should find out the new method to spread their own culture to a variety of employees to succeed in the more furious competition.

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