

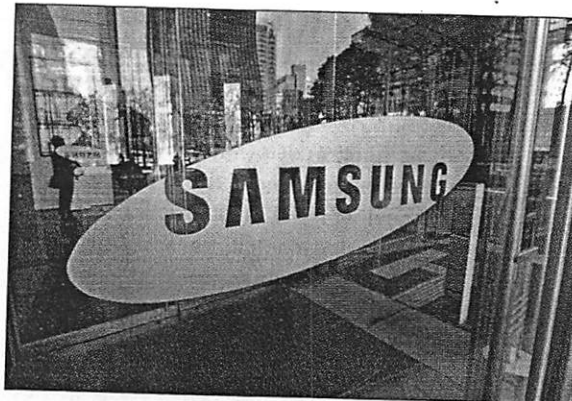
Samsung
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Struggling Samsung Electronics

WITH SOME \$200 BILLION in revenues in 2015, Samsung is one of the biggest conglomerates globally and the largest *chaebol*¹ in South Korea. (U.S. conglomerate General Electric had some \$150 billion in revenues in the same year.) Established in 1938 by Lee Byung-chul as a trading company selling noodles and dried seafood, Samsung has since diversified into various industries, including electronics, chemicals, shipbuilding, financial services, and construction. As a result, Samsung is widely diversified with over 80 standalone subsidiaries. The conglomerate accounts for a fifth of all South Korean exports.

In 1987, Lee Kun-hee, the youngest son of the founder, took over as the chairman of the conglomerate. His strategic intent was to make Samsung a world leader in high-tech industries such as consumer electronics. To execute his strategy, Lee Kun-hee focused first on gaining market share by invading markets from the bottom up with lower-priced products at acceptable value. Over time, quality and consumer perception became more important. Samsung's image, however, was overshadowed by Sony and Motorola, the undisputed world leaders in consumer electronics and mobile phones during this time. During a 1993 trip, Lee Kun-hee saw firsthand how poorly Samsung's electronics were perceived in the United States and Europe, and he vowed to change that. Back in Korea, to show his disappointment and determination alike, he destroyed 150,000 brand-new Samsung cell phones in a large bonfire in front of all 2,000 employees of Samsung's Gami factory. Many employees credit this as the pivotal moment in redefining Samsung Electronics' strategic focus and initiating a successful turnaround.

Samsung Electronics increased spending significantly on R&D as well as on marketing and design. Meanwhile, Lee Kun-hee was undertaking a complete overhaul of the conglomerate's structure to change Samsung's sclerotic culture. To a culture that deeply values seniority, he introduced merit-based pay and



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promotion. Lee Kun-hee, who holds an MBA degree from George Washington University, hired Western managers and designers into leading positions and sent homegrown talent to learn best business practices from other firms wherever they could be found. Lee Kun-hee also set up the Global Strategic Group to assist non-Korean MBAs and PhDs with a smooth transition into their positions in a largely homogenous cadre of Korean executives. Once economies of scale due to a larger market share could be reaped, he moved Samsung to the high end of the market, offering premium consumer electronics such as flat-screen TVs, appliances, semiconductors, and mobile devices such as its famous Galaxy line of smartphones.

In 2007, Apple introduced the iPhone, redefining the entire category of mobile phones and setting the standard of how smartphones looked and felt. Samsung played catch-up again, ratcheting up spending on R&D

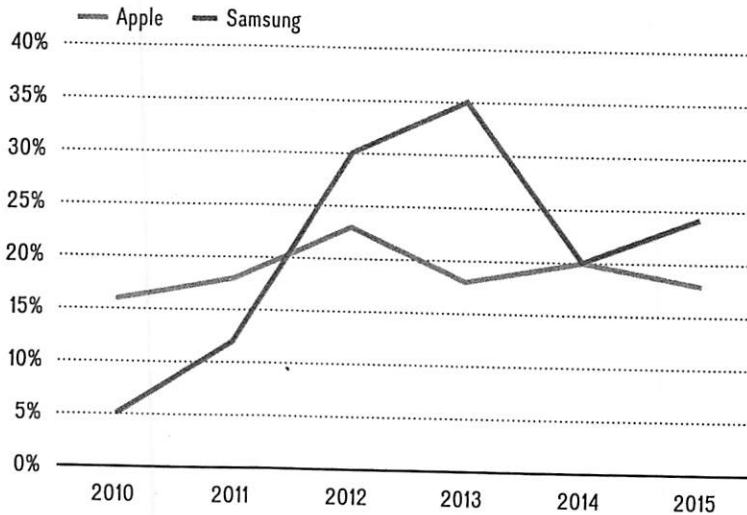
Frank T. Rothaermel prepared this MiniCase from public sources. He gratefully acknowledges the contribution of Ling Yang on an earlier version and James Hoadley for research assistance on the current version. This MiniCase is developed for the purpose of class discussion. It is not intended to be used for any kind of endorsement, source of data, or depiction of efficient or inefficient management. All opinions expressed, all errors and omissions are entirely the author's. Revised and updated: July 29, 2015. © Frank T. Rothaermel.

and marketing. In particular, Samsung Electronics applied its time-tested "follow first, innovate second" rule. Being a key component vendor to other leading technology companies including Apple, Samsung Electronics saw what directions other companies were taking. Within a short time, it had overtaken Motorola, HTC, Blackberry, Nokia, and even Apple to become the number-one vendor of smartphones in the world and the largest technology company by revenues globally

(see Exhibit MC26.1). By 2012, with the release of its Galaxy S III phone, Samsung had successfully imitated the look-and-feel of the Apple iPhone. Today, Samsung Electronics is the crown jewel of the Samsung business empire, with its mobile division contributing some 75 percent of the conglomerate's overall profits.

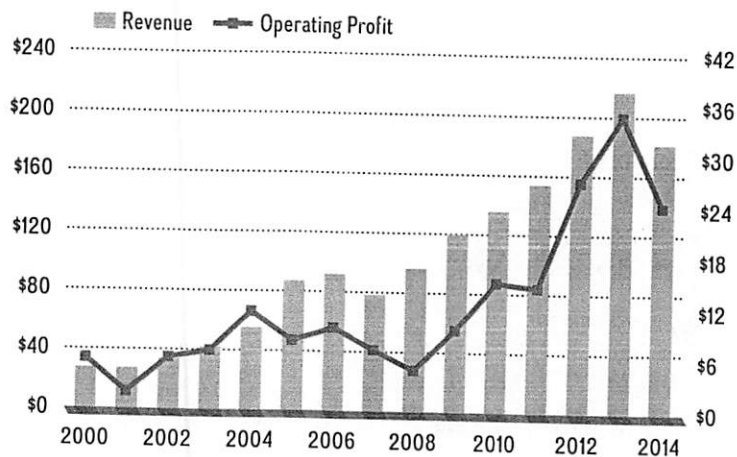
Although Samsung gained a temporary competitive advantage, in recent years it stumbled, with revenues and profits down sharply (see

EXHIBIT MC26.1 / Global Smartphone Market Share (in %), 2010-2015



Source: Adapted from Cheng, J., and M.-J. Lee, "After Galaxy smartphone debacle, Samsung questions game plan," *The Wall Street Journal*, May 11, 2015.

EXHIBIT MC26.2 / Samsung Electronics' Revenues (left vertical axis) and Operating Profits (right vertical axis), 2000-2014 (\$ billions)



Source: Depiction of data from Samsung's annual reports and Market Watch, 2000-2014.

Exhibit MC26.2). Samsung's competitive advantage was built in large part on its "follow first, innovate second" rule. Although it sells fewer phones than Samsung, Apple's profit margin per phone is much higher. With the introduction of the iPhone 6 in 2014, Apple pulled away from Samsung. With the larger screen on the iPhone 6 Plus, Apple also negated Samsung's lead with its successful Galaxy Note phablets. Since the iPhone 6 and iPhone 6 Plus were introduced, Apple has captured a greater share of the high end of the market. Although Apple's market share in the global smartphone industry is less than 20 percent (see Exhibit MC26.1), it captures a whopping 92 percent of all the profits generated in the industry! In addition, Apple and Samsung have been locked in ongoing court battles over infringement among the various smartphone models. Samsung lost a high-profile case against Apple in a California court, where damages were reduced later to some \$500 million.

Samsung Electronics not only lost market share on the high end of the mobile phone market, but also on the low end. Chinese technology companies Lenovo, Huawei, and Xiaomi are becoming more and more popular. In particular, the Chinese start-up Xiaomi, which has only been in existence since 2010, has challenged Samsung and Apple in consumer markets with huge growth potential such as China. By 2014, Xiaomi, often described as China's Apple, had become the number-one seller of smartphones in China by units. Similarly, by launching new smartphones quickly, almost like fashion accessories, India's Micromax had become the number-one seller in its home market.

In summary, Samsung stumbled badly. It is squeezed in the middle. On the high end, it has fallen behind Apple, which continues to pull away with its innovation and design to set new standards for the most profitable segment of the market. On the low end, upstarts from China and India are capturing leading positions in markets with huge growth potential. Samsung's downward spiral coincided with Lee Kun-hee's heart attack in 2014, which left him incapacitated. The 73-year old Lee Kun-hee had ruled Samsung with an iron fist: No strategic or personnel decisions were made without his approval.

Soul-searching about Samsung's future has begun in Seoul. In 2010, Lee Kun-hee set the strategic intent that Samsung should quadruple its revenues from

\$100 billion to \$400 billion by 2020 (which would be more than the revenues of Apple, Google, Microsoft, and Amazon combined). In 2015, the company sent a survey to all its employees to ask whether the conglomerate's goal of being a \$400 billion company by 2020 should be changed.

In addition, the turf battle for Samsung's top job also has begun, with many observers convinced that Lee Kun-hee's son, Lee Jae-yong (who goes by Jay Lee), is the heir apparent. The younger Lee holds the position of vice chairman. At the same time, Samsung Electronics currently has an unusual leadership structure with three co-CEOs (Kwon Oh-Hyun, J.K. Shin, and B.K. Yoon) each acting as the leader for their respective division (components, mobile, and consumer electronics). The involvement of the Lee family in Samsung is persistent throughout the conglomerate, however, with descendants of the company's founder serving in multiple leadership positions. Should Lee Jae-yong get the top job at Samsung Electronics, he will have his work cut out for him to turn around the struggling conglomerate and especially Samsung Electronics, its flagship division.

DISCUSSION QUESTIONS

Corporate Strategy

1. What makes Samsung a conglomerate? What type of diversification does Samsung pursue? Identify possible factors such as core competencies, economies of scale, and economies of scope that were the basis of its past success as a widely diversified conglomerate (*chaebol*). Why is Samsung as a conglomerate struggling today?
2. Despite being a widely diversified conglomerate, Samsung prefers vertical integration: in-house design and development teams, manufacturing in large company-owned factories, and coordinating a sprawling global supply chain. In contrast, Apple concentrates on the design (and retail sales) of high-end mobile devices, while it outsources its production to Foxconn and others. Do you think Samsung's high degree of vertical integration contributed to its recent problems? Why or why not? Explain.

Business Strategy

1. Lee Jae-yong, the 46-year-old grandson of the Samsung founder and heir apparent, was educated