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Understanding Samsung's Diversification Strategy: The Case of Samsung Motors Inc.

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In 1995, the Korean *chaebol* Samsung diversified into automobile manufacturing with the establishment of Samsung Motors Inc (SMI). The timing of this venture turned out to be rather unfortunate, as SMI's first car rolled off the Pusan production line in the middle of the Asian economic crisis. In serious financial distress, Samsung had to abandon SMI, selling it to Renault in 2000. This study explores the process of SMI's creation, and follows the changes in Samsung's strategic management during and after the crisis. Two questions are raised in the research: (1) How did Samsung come to invest in automobiles? and (2) How did the Korean crisis in general, and the crisis in the automobile market in particular, change Samsung's strategic decision-making process? Central to its diversification strategy were the chairman of Samsung and key members of the planning team at the Office of the Chairman. We find that non-economic influences prevailed over economic influences in the decision to pursue the diversification strategy, and that due in part to the strength of these influences, Samsung underestimated the market risk and overestimated the contribution its core competencies and synergy could make. Matters were made worse by the significant costs incurred in transferring Samsung's core competencies — its high quality reputation and culture — to the new business. By the time Korea finally emerged from the crisis, the finance team at the Office of the Chairman had taken charge of strategic management, increasing financial control and emphasizing internal efficiency.

Introduction

Research on corporate diversification has proliferated over the past several decades, providing both academics and practitioners with profound insights on the matter. Seldom, however, has the dynamic process of formulating and implementing diversification strategies in organizations actually been examined. The 'black box' of diversification may include such processes as how the

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management acquires the motivation to pursue diversification; how it is supported, resisted, and approved; and how resources for its implementation are allocated in organizations.

Research on *chaebols* (highly diversified Korean conglomerates) also suffers from the same problem, leaving many questions unanswered, such as why and how the *chaebols* became diversified. The *chaebols*' rapid expansion, however, became unsustainable when the Asian financial crisis spilled over into Korea in December 1997, forcing half of the top 30 *chaebols* into bankruptcy or debt workouts, and compelling the remainder to pursue sweeping changes.[1] These changes involved significant shifts in the corporate strategies and managerial philosophies that had been employed with great success for decades. They required a shift in emphasis away from external growth and towards operational efficiencies. There are now some concerns in Korea that the *chaebols*, once the nation's major driver of economic development, have lost their growth momentum.

Of all the pre-crisis diversification efforts, one stands out: Samsung's move into automobile manufacture.

Of all the *chaebol* diversification efforts that occurred before the crisis, one case stands out: Samsung's move into automobile manufacture. In fact, no corporate diversification in the history of the *chaebols* in Korea received more public attention than that of Samsung Motors Inc. (SMI). Although SMI's diversification followed the typical *chaebol* program for growth, it had to be sold to Renault due to its serious financial situation caused, in part, by the crisis. Since then, there have been significant changes in the strategic management process at Samsung. These, and the motivation behind the diversification, are analyzed in this article, which focuses on the following particular research questions:

1) How did Samsung come to invest in automobiles?
2) How did the Asian crisis in general, and the crisis in automobiles in particular, change Samsung's strategic decision-making processes?

It is hoped that finding the answer to the first question will pave the way for a deeper understanding of the *chaebols*' diversification process and why they are so highly diversified, and that the answer to the second question will lead to an understanding of the impact of the Asian crisis on the *chaebols*' current strategic management system and processes. In addition, while some organization learning studies have suggested that large firms seldom learn from crises and failure[2] we examine whether this assertion holds true for Samsung. As Korea's most influential chaebol, Samsung's major corporate strategies and management practices used to be widely benchmarked by other *chaebols*. This case study is thus believed to reveal some of the typical characteristics of the *chaebols*' strategic management system and process, although the usual limitations of a single case study still apply.

This study entailed making observations, conducting interviews, and reviewing internal and external documents to ascertain what happened at Samsung with respect to SMI, and why it happened. The study is also a piece of action research, since one of the researchers was for ten years a manager in the planning team of the Office of the Chairman at Samsung, in charge of formulating and implementing strategic plans for the launch and divestment of SMI, while the other was a chief researcher at the Samsung Economic Research Institute — the Samsung group's think-tank. The research was initially done inductively through the collection of data from internal and external documents, which were used to construct a chronology. The purpose of the preliminary research, which was bolstered by personal experiential accounts and informal interviews, was to reconstruct what actually happened to Samsung and SMI during the period. When the big picture had been ascertained the research issues were determined, and the relevant literature reviewed. An analytical framework that would guide the research was then constructed. To gather more detailed information for a refined research, additional in-depth interviews with key decision-makers were conducted. Finally, additional data were collected and analyzed to confirm and complement the interview findings.[3]

This study is organized as follows. First, the following section gives an account of the events that transpired in relation to Samsung's establishment of SMI, and then the theoretical framework that was formulated to guide the case analysis is presented. This framework was used as a basis for answering our two research questions. Finally implications for theory and practice and research limitations are discussed.

to mark its 50th anniversary [the chairman] announced the aim of transforming Samsung into a world-class corporation.

A short history of Samsung Motors, Inc. (SMI)

In 2006, Samsung was Korea's leading *chaebol*, both in terms of total assets ($233.8 billion) and the number of its affiliates (58).[4] Samsung had been founded on March 1, 1938 by the late Chairman Byung-Chull Lee, who passed away in 1987. He was succeeded as chairman by his son Kun-Hee Lee, at which point Samsung was the number two *chaebol* behind its arch-rival Hyundai. In 1988, to mark the 50th anniversary of Samsung's founding, Kun-Hee Lee announced the 'second foundation' of the company, with the aim of transforming Samsung into a world-class corporation. In the same year, he launched Samsung General Chemical Co., his first diversification project as the new chairman.

He also prepared to launch a long been overdue project — Samsung's entry into the automobile business. In 1994, lacking critical know-how about automobile production, Samsung leveraged a previous business relationship to forge a technology licensing agreement with Nissann and Samsung Motors Inc (SMI) was established in the following year. Table 1 summarizes the major historical events leading up to this watershed event.

Many argued that Samsung could never establish a sustainable position in such a saturated industry. By the 1980s, Korea already boasted the world's fifth largest automotive industry, fragmented among four competitors. Samsung's first passenger car rolled off its Pusan production line in March 1998, just three months after the economic crisis had begun. This crisis, and the resultant political upheavals, adversely affected SMI in various ways, not least of which was the steep fall in the demand for automobiles, as shown in Figure 1.

In 1998 SMI sold only about 45,000 cars, many of them bought by Samsung Group employees themselves, and SMI's performance deteriorated sharply, losing about $192 million in the first two quarters of the year alone. The economic crisis transformed the competitive landscape of the entire Korean automobile industry. Kia Motors, the second largest automobile manufacturer in Korea, collapsed in 1997 along with six other major *chaebols*.

Kia was put up for auction in June 1997. Samsung concluded that the only viable option for SMI was to acquire the floundering company, expecting this move to resolve over-capacity and over-investment in the industry. However Samsung withdrew from the final round of bidding on October 19, and Hyundai emerged as the winner. This meant that Samsung was finally abandoning SMI, whose viability was highly questionable without the merger, and the group announced it would place SMI in court receivership for liquidation. Two-thirds its US$3.7 billion debt was personally assumed by the chairman, and the remainder by the company's affiliates. With its debt problem eliminated, SMI's 'clean' assets were sold to Renault for US$562 million, and the joint venture Renault-Samsung Motors was born in the year 2000. The sale of SMI caused controversy in Korea, with some critics arguing that its assets had been sold at a price far below their true value. It was estimated that Samsung had poured more than US$4 billion into the construction of its Pusan

Table 1. Chronology of Samsung Motors Inc.

Year	Events
1978	Acquisition of Shinjin Automobile Co. considered
	Toyota and Volkswagon approached for technical alliance
1984	Joint venture negotiated with Chrysler
1987	Fiat and VW approached for technical alliance
1989	Honda approached for technical alliance
1990. 6	Samsung Heavy Industries (SHI) enters technology licensing agreement with Nissan-Diesel (Truck)
1990. 7. 6	SHI submits technology licensing report to government
1992. 7. 4	Government officially accepts the report
1992	BMW approached for technical alliance
1993	Peugeot approached for technical alliance
1993	Group Supreme Operation Committee's approval to enter automobile industry
1994. 4. 26	Technology licensing agreement reached with Nissan (passenger cars)
1994. 12. 7	Government accepts technology licensing report
1995. 3. 28	SAMSUNG MOTORS INC (SMI) ESTABLISHED
1996. 11	Construction and tooling of auto plant completed
1997. 11. 21	GOVERNMENT OFFICIALLY ANNOUNCES NATIONAL ECONOMIC CRISIS
1998. 3	First passenger car rolls off assembly line (Model: SM5)
1998. 1.13	Five Principles of Restructuring announced at Presidential Residence
1998. 2. 25	President Dae-Jung Kim inaugurated
1998. 4. 1	Government prohibits bank loan guarantees by chaebols to affiliates
1998. 10. 7.	Seven industries designated for "Big Deals"
1998. 10. 19	Samsung abandons plan to acquire Kia
1998. 12. 7	"Big Deal" between Samsung and Daewoo agreed at Office of the President
1999. 3. 23	Samsung signs MOU with Dawoo on "Big Deal"
1999. 6. 30	SAMSUNG FILES FOR COURT RECEIVERSHIP
1999. 8. 16	Daewoo group liquidated
2000. 4. 27	Renault signs LOI
2000. 9.	RENAULT-SAMSUNG MOTORS ESTABLISHED

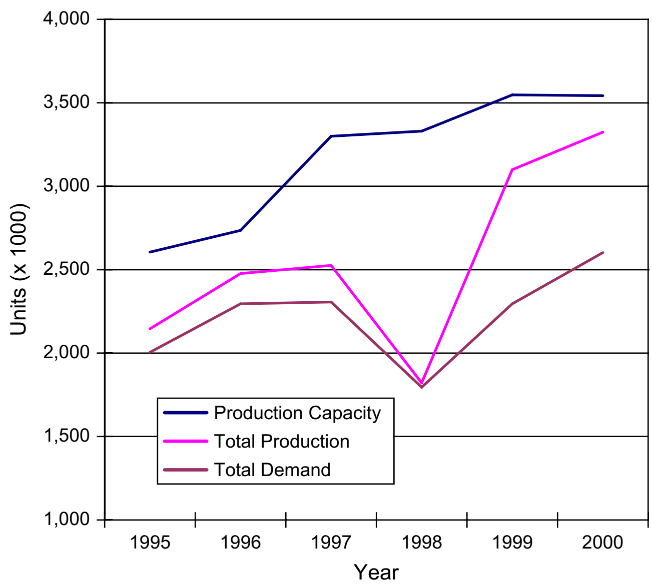

Figure 1. Production Capacity, Actual Production, and Total Demand in the Korean Automobile Industry (1995–2000)

production facility alone, and that the deal allowed Renault to obtain a state-of-the-art manufacturing facility on attractive terms and debt-free.

This was a year after President Dae-Jung Kim's official announcement that South Korea had fully recovered from the Asian currency crisis. By the end of 2002, Renault-Samsung Motors had bounced back, reaching break-even point in its earnings thanks to its low financial burden and he superior quality of its sedan, which now accounts for 30% of the Korean large-size car market segment.

Analytical framework

The introduction to this article asks the following specific questions: (1) How did Samsung come to invest in automobiles? and (2) How did the Korean crisis in general, and the crisis in automobiles in particular, change Samsung's strategic decision-making processes? In other words, this study aims to determine the primary motivation behind Samsung's diversification, and then to elucidate the company's strategic management process in relation to this diversification. The analytical framework used in this study is shown in Figure 2.

To construct the framework, the corporate strategy literature was first reviewed, and the two major influences on corporate strategy (i.e., in this case, diversification) were identified as economic and non-economic factors (as shown in the upper part of Figure 2). In this section, both factors will be examined and compared to identify which had the dominant influence on the diversification decision. Although much previous research on diversification has identified motivations from the perspective of economics, there are some important works that examine diversification from a non-economic perspective. For example, it has been suggested that institutional changes in the U.S., such as the strengthened federal government's antitrust policy in the 1950s, generated strong incentives for corporations to diversify.[5] Research has also shown that corporate diversification was very much an 'organizational fad' in the U.S. in the 1970s, pursued with the use of such popular tools as portfolio planning.[6] This perspective is especially relevant in explaining the extreme diversification of business groups such as the Korean *chaebols* and the Japanese *keiretsu*, which operated in very different socio-cultural and institutional environments (especially with respect to government and industrial policy) to Western firms. Some researchers have even argued that the institutional traits of the *chaebols* help explain their economic success and organizational fitness.[7]

many chaebols *were accused of exercising excessive market power through cross-subsidization*

On the other hand, the economic motivations for diversification can be broadly classified into two: market power and synergy.[8] Although the agency problem is another important motivation for diversification, we have excluded it from our analysis because we thought the symptoms of agency problems would not be easy to find in the strategic management process. The pursuit of market power and synergy, on the other hand, can be easily identified. For example, many *chaebols*, including Samsung, are frequently accused of exercising excessive market power through cross-subsidization, in which the 'deep-pocketed' flagship company subsidizes a new subsidiary. In addition to such anti-competitive motivations, Michael Porter's view of strategy as gaining a favorable position in an attractive industry, which is consistent with the assertion that Porter's view originates from the market power perspective, was also included in this category. [9] As for the synergy perspective, two theories were drawn on. First, the resource-based view was adopted to examine whether Samsung leveraged its existing resources and capabilities to start its passenger car business. Second, transaction cost theory was adopted to see whether transactional synergy had been obtained in the mobilization of Samsung's resources for diversification purposes.[10]

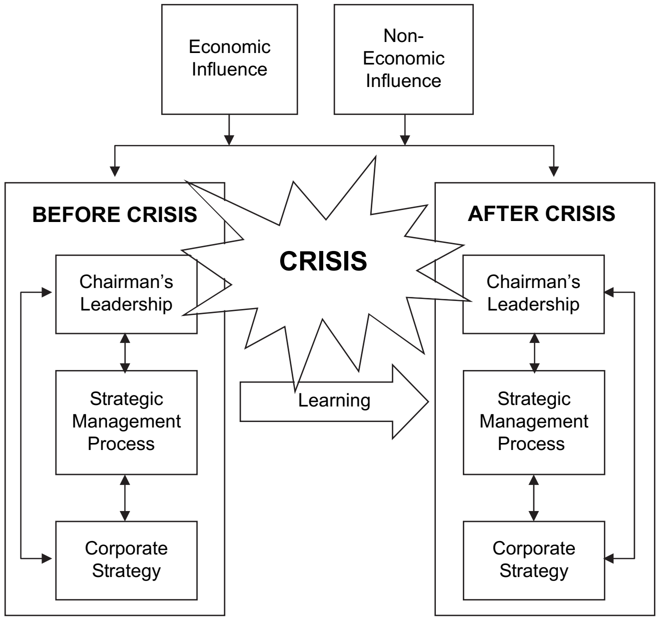

Figure 2. Analytical Framework

Although economic and non-economic factors are both important drivers of corporate strategy, the internal organizational process involving how these two factors are conceived, interpreted, resisted, and formalized in an organization are looked into in this study, as shown in Figure 2. First of all, as the chairman of Samsung was the single most influential figure in setting the strategic direction of the entire group, the chairman's leadership was separated from other company's strategic management process components to allow for a closer examination. His leadership was treated as the mediating concept connecting the company's corporate strategy with its organizational process, breathing vitality and energy into both.[11]

The strategic management process may also include both formal and informal processes, which are influenced by organizational inertia, culture and internal politics. At Samsung, group-level strategy was formulated at the corporate headquarters, formerly called the Office of the Chairman. It can be expected that in such a large *chaebol,* with its long and illustrious history, organizational inertia in the form of core rigidity may influence both formal and informal strategic planning, and that a strong organizational culture will impede or facilitate the formal and informal strategic management process. Finally, the strategic direction of the corporation will depend on who assumes power as a result of internal political processes.[12]

the strategic direction of the corporation will depend on who assumes power

The impact of the Asian crisis on Samsung's strategic management process was also analyzed, as shown on the right side of Figure 2. Keeping track of the changes inside Samsung during the transition period allowed us to identify what Samsung learned in terms of maintaining its 'fitness' in the midst of the changing environment.[13] Specifically, we examined the changes that the new strategic management process and leadership had undergone in their efforts to deal with the economic and non-economic influences on corporate strategy. The following sections detail how this framework was used to address our two research questions.

Motivation for diversification

Non-economic motivations: Competitive imitation and legitimacy-seeking

The non-economic motivations for Samsung's diversification are presented first, as our analysis of the data leads us to believe that these prevailed over economic motivations in Samsung's decisions. First of all, there is the question as to whether Samsung's strong competitive rivalry with Hyundai motivated its decision to enter the automobile industry. This requires us to review Samsung's earlier history vis-à-vis its arch-rival Hyundai, which in the 1980s had pushed Samsung off the top-ranking *chaebol* spot it had enjoyed during the 1960s and 1970s. (Table 2 shows the rankings of the top five *chaebols* from the 1960s to the 1990s.)

Samsung and Hyundai had only relatively recently become direct competitors in a number of industries. Hyundai started as a construction company in 1950 and later diversified into heavy industry, including automobiles (1967) and shipbuilding (1973), which played central roles in its subsequent business portfolio expansion. Samsung, which focused on high-tech industries such as electronics (1968) and semiconductors (1974), also invested in heavy machinery and the petrochemical industry, establishing Samsung Heavy Industries (1974), Samsung Shipbuilding (1977), and Samsung Petrochemical (1974).

Unlike the 1960s and the 1970s, when business was heavily regulated by the government, the 1980s and 1990s was a period of liberalization and privatization. There was necessarily a much greater degree of uncertainty in the business environment, and the *chaebols* reacted primarily by entering the same major industries.[14] Hyundai followed Samsung's example by diversifying into high-tech during the 1980s, establishing Hyundai Electronics (1983), Hyundai Media Systems (1988), and Hyundai Information & Communications (1989). It is important to note that one of the reasons for Hyundai's success in 1980s and 90s was the way it effectively imitated Samsung's business portfolio during the 1980s. The tension between the two companies was heightened in 1988 when both diversified into petrochemicals with Samsung General Chemical and Hyundai Petrochemical. Given such a history of competitive dynamics, we believe the strong rivalry between the two *chaebols* compelled them to imitate each other's business portfolio. By 1990, the two groups' business portfolio had become quite similar, except for Hyundai's dominance in automobile business. Mr. Kun-Hee Lee was very aware that this was an area which gave Hyundai a great advantage over Samsung, and internal documents and interviews with key executives at Samsung confirmed that Samsung entered the automobile business in the hope of being able to curb Hyundai's dominance in this industry.

The second important non-economic influence behind Samsung's entry into the automobile business was 'legitimacy seeking'. A brief review of the history of the leadership of *chaebols* chairmen suggests a recurring desire to prove their managerial prowess by embarking on ambitious expansions.[15] To a large degree, the *chaebols*' phenomenal record of growth in the past was a result of their chairmen taking big risks which paid off when many had judged them impossible. For instance, under former Chairman Byung-Chull Lee, Samsung plunged into the supposedly already-saturated semiconductor industry, and successfully emerged as a world leader. Hyundai's legendary Chairman Joo-Young Chung met similar success with his massive investment in the shipbuilding industry, again, despite severe opposition. The past was full of examples of *chaebol* chairmen becoming truly charismatic leaders by making major contributions to their corporation, and even to the national economy.

The past was full of examples of chaebol *chairmen making major contributions to their corporation, and even the national economy.*

After succeeding his father, Chairman Kun-Hee Lee's first project was the establishment of Samsung General Chemical Co, a foray that unfortunately ended in failure. His next 'big bet' was on the automobile industry, which, being highly capital intensive and having a significant spillover effect on the national economy, he saw as an appropriate challenge to 'prove' his leadership credentials.

Table 2. Top Five Chaebols

Ranking	1960	1972	1984	1996
1	**Samsung**	**Samsung**	**Hyundai**	**Hyundai**
2	Samho	LG	LG	**Samsung**
3	Kaepung	Hanjin	**Samsung**	LG
4	Taihan	Shinjin	SK	Daewoo
5	LG	Ssangyong	Daewoo	SK

This was his quest to score a major success, matching those of other *chaebol* chairmen, and thus become recognized nationally as a great business leader, in turn increasing his legitimacy both inside his organization and beyond. The following quote from the chairman seems to confirm this motivation (which was also confirmed in other interviews):[16]

> *I started the passenger car business because I believed that it would surely be an important strategic business in Korea after 10 or 20 years. I know that we cannot make money in the first five or six years even though we invest 10 billion dollars. However, I know that the 10 billion dollars would surely raise the national competitiveness of our automobile industry in the long run.*

Economic motivation: Market power vs. synergy

It is all too easy, with hindsight, to assess Samsung's diversification into the overcrowded automobile industry on the edge of the economic crisis as an overly risky venture. This section looks at the economic reasoning behind Samsung's entry, and examines the two economic motivations of market power and synergy.

As noted earlier, Porter's view of strategy as 'positioning in an attractive industry' can be considered a market power view. From this point of view, the Korean automobile industry at the time of Samsung's entry was not at all attractive. Numerous data shows that the domestic automobile industry was already bedeviled by overcapacity, and its growth had already been decelerating significantly after 1995, well before the economic crisis. For the first time, replacements accounted for more sales than first-time purchases, indicating that the domestic market had reached maturity.[17] In the 1990s, the Korean automobile industry experienced a general deterioration in overall profitability, with average ratios of operating income to sales remaining at 4.9% between 1991 and 1997, down from 6.1% in 1981-90.[18] Of the four major automobile manufacturers in the market at the time, Hyundai was the only one with positive cumulative net profits figures between 1991 and 1997. Clearly, industry attractiveness alone cannot explain Samsung's decision to diversify.

Another element of diversification which relates to market power is the anti-competitive practice of cross-subsidization, a way of leveraging their market power of which the *chaebols* had been publicly accused in the past. Indeed SMI was heavily dependent on Samsung's other affiliates for financial support, and although the details cannot be discussed here, it is worth noting that the Korean Fair Trade Commission had slapped a substantial penalty on Samsung in 1998 for providing preferential financial aid across seven affiliates, including SMI.[19]

Samsung believed the reputation of its brand name and its established culture of high quality could be transmitted to SMI, and would help overcome its late mover disadvantage

Samsung's diversification can also be interpreted from the perspective of synergy. To examine this possibility, we first tried to identify sources for economy of scope, such as the sharing of resources and capabilities between SMI and other affiliates. We also sought to ascertain whether mobilization of resources for diversification yielded significant reductions in transaction costs. After analyzing several important internal documents and interview findings, we were able to identify important motives concerned with sharing capabilities. First, Samsung believed that one of its core competences – the reputation of its brand name, and its established culture of high quality that stemmed from its dedicated and highly competent managers – could be transmitted to SMI, and would be adequate to overcome its late mover disadvantage and eventually allow SMI to excel over the established players. Second, Samsung expected that leveraging the capabilities of Samsung Electronics would produce transactional synergies with SMI. From the perspective of transaction cost theory, internal transactions with Samsung Electronics should have incurred significantly lower transaction costs, and the following excerpts from an internal report to the chairman reveal Samsung had such intentions before entering the automobile business.[20]

1 *External Factors Supporting Investment*
   1) *Korea's economic growth in the 21st century will be led by the electronics and automobile industries*
   2) *Comparative advantage in automobile manufacturing is shifting from Western countries to Japan, and from Japan to other Asian countries including Korea.*

2 *Internal Factors supporting Investment*
   1) *In the near future, the automobile industry will ultimately converge with the electronics industry, in which Samsung already has great advantages. SMI can also realize synergies with Samsung's affiliates in the machinery and chemical/materials industries as well as Samsung Electronics.*
   2) *Although the market seems saturated, the existing manufacturers are failing to meet the demand for quality passenger cars. With technology licensed from Nissan, Samsung could produce high-quality sedans to satisfy this unmet need.*

Chairman Kun-Hee Lee was especially optimistic about the possibility of convergence between automobile and electronics industry, expecting it to yield transactional synergy as the following quote suggests:[21]

> *In the automobile industry, 30% of all parts are electrical or electronic, a proportion expected to increase to 60% or 70% by 2010 – greatly blurring the distinction between the 'automotive' and 'electronics' industries.*

The discussion thus far on the motivation for diversification is summarized in the second column of Table 3.

Strategic management process before the crisis

Strategy formulation process

This section examines the internal strategic management processes triggered by the motivations for diversification. Judging from the analysis so far, Samsung's diversification seemed to be prompted initially by both competitive imitation and legitimacy-seeking motives. We also found these influences were amplified by the unique role played by the chairman's office in the organization. The Office of the Chairman was created in 1959 to control and coordinate the activities of Samsung's various affiliates. Supporting and assisting the chairman, it wielded considerable power and authority over the group's affiliates, and most other Korean *chaebols* quickly imitated Samsung's organizational structure and established their own corporate head office.[22] The Office of the Chairman at Samsung had several teams

Table 3. Analysis of Samsung's Entry into Automobile Business

Type of Influence	Motivation (+/−: Strength of Influence)
Non-Economic	1. Competitive imitation (++)
	2. Legitimacy-seeking (++)
Economic	1. Market power
	1) Positioning (−)
	2) Cross-subsidization (+)
	2. Synergy
	1) Resource sharing (+)
	2) Low transaction cost (+)

and, when SMI was established, the two most influential were the planning and finance teams. The planning team crafted and implemented long-term strategies including diversification, while the finance team managed capital matters at the group level and exercised financial control over the affiliates. Under competitive pressure from Hyundai, the planning team at the Office of the Chairman submitted a report to the chairman in 1990, giving an in-depth analysis of the differences between the two powerful *chaebols'* business portfolios, concluding that Samsung would never catch Hyundai up without entering the automobile business.[23] The chairman's intention to enter the market for reasons of competitive rivalry with Hyundai seems to have been reinforced by this internal strategic management function.

The chairman's [motivation] of competitive rivalry with Hyundai was reinforced by internal strategic [opinion] of the planning team.

It is necessary to assess the planning team's core capabilities to understand its role in the formation of SMI. Supporting Samsung's rapid diversification from the 1960s to the 1980s, the planning team had emerged as the growth engine of Samsung. As it expanded into various industries, it accumulated generic diversification capabilities, such as intelligence gathering for new business opportunities, formal long-term planning skills, new business establishment, and resource mobilization from its affiliates. Through its repeated success, the planning team's core capability of managing growth became institutionalized within the organization, and was part of the team's everyday reality. In short, past diversification experiences had made an indelible impact on the mind-set of the planning team, strongly informing and maintaining the team's cultural persistence for growth.[24]

The planning team's growth-oriented culture was reinforced by its repeated successes, eventually giving rise to organizational inertia, with the team effectively becoming closed to differing opinions and challenging ideas.[25] Thus, while there were risk factors involved in entering the saturated auto market, such information was not emphasized in the organization. The team probably believed that it would still be possible to thrive in a structurally unattractive industry by leveraging its core competences and developing new ones.[26] The planning team sought to persuade decision-makers opposed to its vision by gathering any positive economic data it could find to support its case, and, in 1993, commissioned the Nomura Research Institute - a Japanese consulting and research firm − to produce a feasibility study on the Korean passenger car industry. Contrary to the conventional wisdom that the domestic market was already saturated, Nomura predicted that the market's long-term market growth would be adequate to accommodate one more player.

Encouraged by this professional advice, the investment decision was finally put to the 'Supreme Operation Committee', composed of the Samsung group's most influential senior executives.

Committee members from Samsung Electronics initially opposed the investment idea, expecting that most of the investment funds would be drawn from profits generated by their semiconductor division. In spite of its initial reticence, this team was ultimately persuaded as to the feasibility of the plan, and gave its formal agreement to the diversification project in 1993. The planning team could proceed with the next diversification process, with strong backing from the chairman.

the strategy was implemented at an incredible speed

Strategy implementation process

Once the organization reached its consensus, the strategy was implemented at an incredible speed. Only two and a half years after the conclusion of the technology transfer agreement with Nissan, Samsung had completed construction and tooling of a state-of-the-art production facility and was ready to produce cars, a remarkable feat only possible because Samsung could fully leveraging its market power and synergy. The process of how these advantages are created is presented here.

First of all, cross-subsidization in various forms, such as direct subsidy and debt guarantees, was instrumental toward procuring the necessary capital at low cost. Second, two types of synergy — economies of scope and reductions in transaction costs — enabled Samsung to create competitive advantage at the group level. Resource sharing and mobilization, for example, were not just planned for, but actually realized between different affiliates. Without such a significant economy of scope, the production line would have required much more time to complete, and at a higher cost. In terms of human resource sharing, by January 1998 2,024 employees out of SMI's total workforce of 3,482 had been transferred from other affiliates, including 636 from Samsung Electronics.

the most 'dynamic capability' underpinning [the move into automobiles] was the managerial capability of the planning team.

Although this resource sharing greatly facilitated the new business launch, the most 'dynamic capability' that underpinned all these advantages was the managerial capability of the planning team.[27] Throughout Samsung's long history of diversification, they had accumulated significant know-how in the launching of new businesses, and team members now behaved as if they were 'internal entrepreneurs' in marshalling and mobilizing resources. With their strong 'visible hands' endorsed by the chairman, they coordinated resource contributions from different affiliates in Samsung to achieve their intended synergies.

While their efforts to transfer Samsung's reputation and culture of high quality to SMI met with success, it was at an enormous cost. From the start, Chairman Lee encouraged planners to envision a large-scale and world-class manufacturing facility, and massive investments were made in building a 'perfect' manufacturing facility which enjoyed state-of-the-art hardware and substantial human resources. More than 1,300 SMI line workers and engineers from the 90 Korean suppliers were sent to Japan in 1995 to receive intensive technical training at Nissan plants, while over 200 Nissan engineers and technicians were dispatched to the Pusan plant to train Samsung employees and local suppliers. As a former SMI executive put it, the prevailing atmosphere at that time was of '*a total commitment from top managers to line workers to build perfect automobiles.*' Unfortunately the cost of transferring the corporate reputation and culture of high quality proved to be too high, and rendered SMI highly vulnerable to external shock.

Last, but not least, Samsung managed to reduce transaction costs by procuring various parts and supplies internally. Figure 3 shows that 27.5% of total parts and supplies were sourced from affiliates, of which 90% were sourced from Samsung Electronics and Samsung Electro-Mechanics,

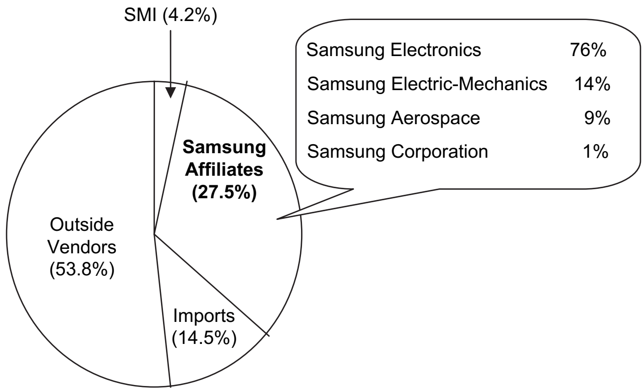

Figure 3. SMI's Part Procurement Transactions with Samsung Affiliates

supporting the chairman's view that there was a strong transactional synergy between the automobile and electronics industries that could be exploited.

Strategic management process after the crisis

The 1997 financial crisis triggered a fundamental change in Samsung's strategic management process. The most notable change was the shift in control of making strategic decisions from the planning team to the finance team. In the same way as the IMF and Korean government tightened national financial controls, the financial team now assumed the leading role in formulation of the group's strategy. The shift in power was readily apparent over the issue of the plan for SMI to acquire the troubled Kia motors. The night before Samsung's bid for Kia, there was an intense debate among the key decision-makers at the Samsung group headquarters, including core members of the planning and finance team. Unlike the growth-oriented planning team, the finance team had traditionally been conservative in making major investment decisions. Key finance team executives strongly opposed the planning team's proposal to acquire Kia, arguing that further expansion during such an economic crisis was extremely risky. Their assertion proved persuasive to the chairman, and Samsung decided to withdraw from the bidding. SMI executives interpreted the decision as a sign that Samsung was finally relinquishing hope for SMI's future.

Two key members of the planning team resigned and left Samsung after the team's failure to see through the acquisition of Kia. From then on, the finance team emerged as the most influential unit in the Samsung group after only the chairman himself, and assumed the planning team's traditional strategic planning function. In 1998, the Office of the Chairman changed its name to the 'Corporate Restructuring Headquarters'. In addition to financial management at the group level, the finance team exerted considerable influence on important strategic decisions that affected the entire Samsung group. It would not be an exaggeration to state that Samsung's strategic management process changed entirely after it failed to make a success of SMI, and its planning team was disbanded. All affiliates' major strategic investment plans now had to gain finance team approval before being reported to the chairman. The finance team also coordinated the formulation of the 'Long-term Group Strategy', previously a core task of the planning team.

After the finance team took power, Samsung's entire corporate culture was re-oriented. Instead of external growth, the focus was on internal efficiency.

The entire corporate culture of Samsung became re-oriented, and, instead of external growth, headquarters began to focus on internal efficiency at each affiliate. Economic and quantitative managerial methods such as EVA (Economic Value Added) and Six Sigma quality controls were introduced and strongly promoted. From 1999 the finance team started to apply EVA in evaluating its affiliates' performance and tightened its financial control over their activities. The new headquarters strategic planning philosophy in turn influenced the strategic management process at each of the affiliates. There was little discussion of ambitious diversification projects such as SMI, since it was apparent throughout the group that such initiatives would be screened out at headquarters. Although a few investment projects were initiated by individual affiliates, they were much smaller in scale than the diversification projects typically pursued before the crisis. From the managerial point of view, the new change enabled more decentralized decision-making for the group as a whole, since the visible hand of headquarters now seldom intervened in affiliates' management for resource mobilization or cross-subsidization purposes. In short, the previous strong behavioral control that required conformity with central authority now gave way to financial control that emphasized efficiency.

In 2006, Samsung renamed the Corporate Restructuring Headquarters as the 'Strategic Planning Office', reduced the number of teams from five to three and slashed staff numbers from 147 to 99. The finance and management consulting teams were merged and renamed the 'Strategic Support Team', while the planning and PR teams were incorporated into one joint team. The new strategic support team now formulates long-term strategy for the group, identifies new business opportunities, and conducts internal auditing of affiliates. Previous finance team members who became part of the new strategic support team still play critical roles in the core strategic management process today, whereas the new 'Planning & PR team' is responsible only for brand strategy and the Samsung Group's corporate identity.

Implications and conclusion

A single case cannot fully reflect all the important strategic changes in the *chaebols* that occurred over the past decade. However, the facts that Samsung is the leading and most representative of Korea's *chaebols,* and its managerial practices have been so widely imitated by other groups, suggest that this case may help to understand the *chaebols*' strategic management in general. The short history of SMI should interest both theorists and practitioners interested in the recent history and developments of the Korean chaebols.

There seem to be at least three theoretical implications for academics. First, this study may be one of the few qualitative studies to examine the detailed strategic management process inside the Office of the Chairman of a *chaebol*. Our analysis confirms the view that non-economic influences play important roles in Asian business groups' strategic management process. For example, we were able to identify mimetic and legitimacy-seeking motivations to diversify, and also examine how they were reinforced by organizational inertia in the strategy formulation process. It should also be remembered, however, that in implementing its diversification strategy, Samsung took advantage of its market power and synergy, as economic perspectives predicted, and this study provides details about how these are actually created and transferred in *chaebols*. It was due to both these advantages that Samsung was able to launch SMI so quickly. The Office of the Chairman was the command tower in this process, mobilizing resources from its affiliates and supplying them to SMI at its discretion, as well as creating group-level synergy by mediating internal transactions between the affiliates and SMI, significantly reducing the transaction costs and times. At the same time, it shared its own generic capability of launching and managing a new business with SMI. Such coordinating efforts exerted by many *chaebol* headquarters have played central roles in their rapid growth, contributing positively to Korea's past rapid economic development.

Second, the results of the study show that Samsung has learned from the economic crisis it had gone through, and from the failure of its diversification efforts. This is contrary to the results of recent empirical studies, which suggest that companies learn little from their failures, and that companies learn less from their large failures than from their small ones. This happens when managers see their large failures as having idiosyncratic and exogenous causes, and when there are social and technical barriers to learning from large organizational failures.[28]

How did Samsung overcome the social and technical barriers to its learning?

An example of social barrier is a strong organizational culture with little tolerance for failure, while technical barriers to learning increase when the multiple causes of a large failure are deeply embedded in a large organization. How did Samsung both avoid attributing its failure to exogenous causes (such as the Asian economic crisis), and at the same time overcome the social and technical barriers to its learning? We suggest that the existence of organizational politics between the planning and finance teams of Samsung facilitated the company's learning process. If there were no internal competition between the planning and finance teams, learning might not have occurred at all, or might have taken much longer. The fact that there were two alternative views as to the best strategy for dealing with SMI, and that the influence of one group, which had predominated for some years, was overtaken by the views of the other in the debate about the Kia auction, meant that Samsung not only had two clear views to learn from, but could also quickly adopt the second view, with its culture of conservatism and efficiency, as a new pattern, and thus leave the other behind more cleanly. The positive role of internal power and politics in facilitating organizational learning has not been discussed much in the existing literature on this subject: this study suggests that researchers may need to pay attention to the possibility of the interplay of these forces serving as a vehicle for organizational learning.

Thirdly, the fit between the environment and the organization was examined dynamically over time. The environment not only influenced the structural characteristics of the organization, but also changed the strategic management process at Samsung. In an environment of high industry growth, the planning team took charge of Samsung and exercised strong behavior control under a centralized structure. When Korea experienced an extreme economic downturn, the finance team emerged and exercised greater financial control under a more decentralized structure. It is important to note that Samsung maintained its 'fitness' to the new environment by learning from the crisis and by changing its strategy, structure and processes over time.[29]

Although the Asian economic crisis seems to have been largely responsible for Samsung's failure, a number of important managerial issues may also have played a role in the matter. We believe that the case has the following managerial implications for practitioners. The first and most direct lesson top managers can derive from this case is that underestimating the underlying economics when making a strategic decision can lead to disastrous consequences. With non-economic motivations, such as competitive imitation and legitimacy-seeking, prevailing at Samsung, sound economic reasoning was not possible. Under these strong non-economic influences, Samsung overestimated its internal core competencies and group-level synergy, and underestimated the danger of entering an already overcrowded industry. Samsung seemed to believe that it could thrive in an unattractive industry by leveraging its core competencies, such as its quality-focused organizational culture, and by creating synergy with its affiliates. Although there was evidence of opportunities for economies of scope and synergy, these were not sufficient to overcome the low market demand. To make matters worse, the cost of establishing a high-quality production facility in Pusan was too high. Managers often commit critical mistakes by assuming that they can easily transfer their company's intangible core competencies, such as reputation and culture, to other units. This study, however, clearly shows that sharing and transferring intangible assets can sometimes incur too great a cost.

in going through restructuring processes during and after the crisis, many chaebols have lost their engines for growth.

Second, it seems that, in going through the restructuring process during and after the crisis, many Korean chaebols have lost their engines for growth. Samsung's successful growth in the past was in part due to the synergies it created at the group level, and one of the planning team's core competences was in creating and sharing competitive advantages at the group level. The term 'group level' implies that resource mobilization and coordination occurred across different affiliates - each of them separate corporations themselves - and this group-level synergy was lost when the more efficiency-based financial management team assumed primary control of the strategic planning process. However, the change is positive in that headquarters no longer threaten its affiliates' autonomy in the name of creating synergy. The buzzwords among the *chaebols* since the economic crisis have been 'restructuring', 'downsizing', and 'efficiency'. The more conservative-minded *chaebols* have started to seek advice from professional consultants, who have exhorted them to cut costs and streamline operations. (It is not surprising that consulting was one of the fastest growing industries in Korea in the late 1990s.) Sweeping restructuring in the effort to improve efficiency continued well after the crisis had passed. Samsung has gained much by pursuing efficiency, with restructuring and downsizing allowing it to refocus its energy, although the drive for internal efficiency may stifle the source of growth there and in many *chaebols*. As Michael Porter succinctly warned a decade ago, operational efficiency may only be a necessary but not a sufficient condition for a good strategy.[30] Some have also suggest that, since Western firms are more experienced at playing the efficiency game, Korean firms must pursue strategies that involve both growth and efficiency if they expect to compete effectively on a global scale.[31]

As most of the industries in which Samsung is engaged are becoming ever more mature, Samsung is now seeking a new 'blue ocean' to lead the growth of the group.[32] Without group-level initiatives, momentum for growth must be found among the affiliates themselves, but, since the final approval on diversification ultimately rests with the finance team, the possibilities for growth through this channel may be limited. In June 2006, Chairman Kun-Hee Lee announced 'Creative Management' as the new management paradigm for Samsung, his first management paradigm shift since the 'New Management' paradigm in 1993. Although there are differing opinions as to what the chairman actually meant by creative management, it may be an effective substitute for the traditional growth strategy as initiated at the Office of the Chairman. Given the organizational changes experienced so far, with more autonomy going to affiliates and less group level decision making in the pursuit of synergy, it seems unlikely that the 'Creative Management' will be implemented uniformly by the strong and visible hand of headquarters. Rather, as creativity cannot be ordered, the new paradigm will be one that is voluntarily accepted by the affiliates.

The implications and conclusion drawn should be interpreted with the following limitations in mind. First, being a single case study, special care must be taken when generalizing this research, even to other *chaebols*. Second, the agency view was not explicitly considered in our analysis because of the difficulty of identifying concrete evidence of agency cost in the strategic management process alone. Third, some important information on Samsung is confidential and could not, therefore, be released.

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