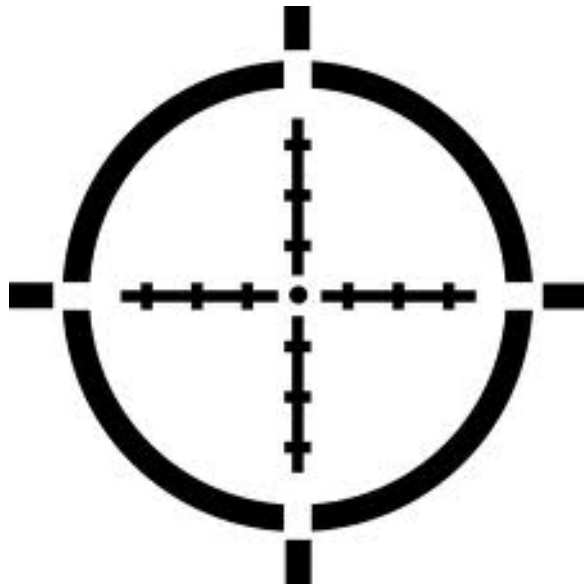


# Samsung

## Client Report

*DangerZone Consulting*



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## Company Background

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Samsung Electronics, LTD is a subsidiary of Samsung Group, the leading *chaebol* (family owned business conglomerate) in South Korea. In 1969, Samsung Group founded Samsung Electronics with the help of SANYO, then one of Japan's leading electronics manufacturers, which has since been acquired by Panasonic. Since then, Samsung has grown into the largest information technology company in the world by revenue.

Samsung's market strategy is vertical integration combined with aggressive research and development investment. Early on, Samsung produced consumer electronics with the help of Japanese manufacturers while simultaneously producing component parts for these items. Its flagship product was black and white televisions, though it soon diversified into the manufacture of other electrical appliances. Importantly, it merged early on with Samsung Group's semiconductor and memory manufacturer.

During its early growth period, Samsung could not compete with the technologically superior and better quality consumer items produced by the Japanese and Western companies, and it became a "budget" brand producer in most consumer electronics markets. At the same time, however, Samsung was becoming a world leader in developing and manufacturing semiconductors and memory.

In 1995, Samsung changed its strategy. It ceased the production of most of its "budget" consumer products, and instead invested heavily in new technology, while continuing to grow its semiconductor and memory businesses. By the early 2000's, Samsung was making continuous breakthroughs in memory and chip production, and was a leader in high-quality LCD television production. It has since then continued to invest in these areas, and has become the world's foremost developer and manufacturer of Organic LED (OLED) displays, which are predicted to replace LCD displays through efficiency, size, and cost advantages.

After solidifying its advantage in the component production market, Samsung then resumed its production of consumer products, becoming the world's largest manufacturer of mobile phones

in 2011. It has been the largest LCD manufacturer since 2002, and the world's largest television manufacturer since 2006. While semiconductor and memory manufacture remain integral to the company's business strategy, the majority of Samsung's profits are derived from the sale of consumer electronics and smartphone sales now account for 74% of Samsung's operating profit. As such, we have chosen to focus primarily on Samsung's competition in the smart phone market for our strategy development, and only secondarily on component manufacture.

Samsung's strategy of investing in vertical integration through the production of components has paid off significantly for the company. Many of Samsung's major competitors in consumer products are also its most important clients. For instance, Apple, a notorious mobile phone competitor, also relies on Samsung to produce the processor, memory, and displays for its phones. If Samsung can sustain its vertical integration strategy while continuing to offer competitive quality consumer products for low prices, they will be a dangerous competitor for any consumer electronics manufacture well into the future.

# Strategic Overview

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## Competitive Landscape

Samsung Electronics is the world's largest manufacturer of LCD screens, as well as memory chips. This has allowed them to cut costs on in production and become the world's largest smart phone manufacturer. In fact, they produce components so efficiently that they even bundle and sell these components to their major competitors in the smart phone market. Samsung's strategy of vertical integration, combined with a multi-tiered price discrimination strategy has led to overwhelming dominance in the smart phone industry.

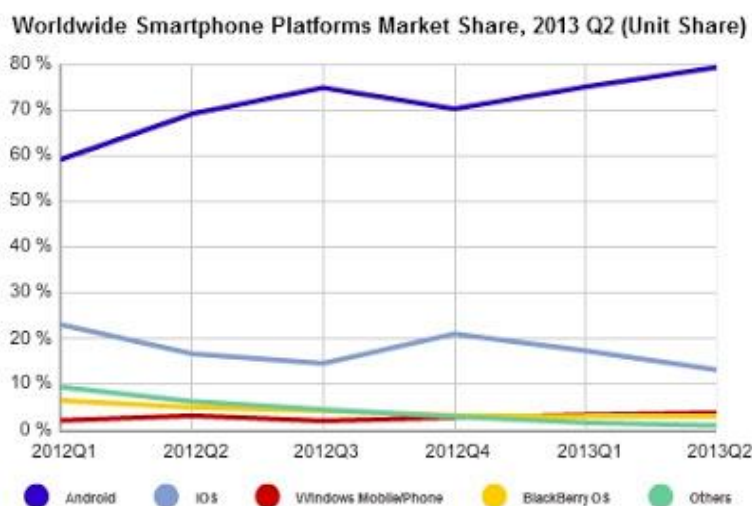
However, Samsung cannot simply rest on its laurels, nor are they doing so. They have clearly recognized the drive in the industry towards continuous innovation. Later this year, for instance, they plan to release their first waterproof flagship smart phone. While Samsung has often been criticized for a lack of form in its designs, the functionality of its phones is always top of the line, and the company has just as often been praised for their phones' innovative features and well-designed interface.

The most notable of these competitors are Apple, Google, and LG. While there are other phone developers that present strong competition, none of them are immediate threats to Samsung's competitive advantage. Apple is the most dangerous threat, with its extremely profitable and high-selling iPhone. Apple is the sole reason that it may not *feel* to the reader that Samsung dominates the smart phone market. The iPhone is the benchmark by which consumers judge a smart phone, and Samsung must deal with this threat first and foremost. Google's position in the smart phone market is precarious. They have recently sold Motorola, who they were subsidizing to produce their Nexus smart phone. However, Google continues to develop the Android operating system, which runs on all of Samsung's smart phones. Moreover, they are known for withholding the latest version of the Android OS from Samsung which they then put on purchased phones from many manufacturers for resale at a higher price. We will talk more about the relationship with Google in the proceeding section.

LG presents an entirely different form of threat to Samsung. They are the third largest smart phone vendor in the world, but their market share is only a fraction of Samsung's, and they have not yet released a market-shaking product. LG's threat stems from one of Samsung's strengths – as part of the largest *chaebol* in South Korea, Samsung has tremendous influence with the government and consequently impacts the daily lives of the population to the point where many proclaim that Samsung is South Korea. LG, however, has been creeping in on Samsung's territory for nearly fifty years, and the two companies do not cooperate. If LG is able to steal some of Samsung's government influence, Samsung could face much greater competition on the home front for access to resources.

### Operating System Overview

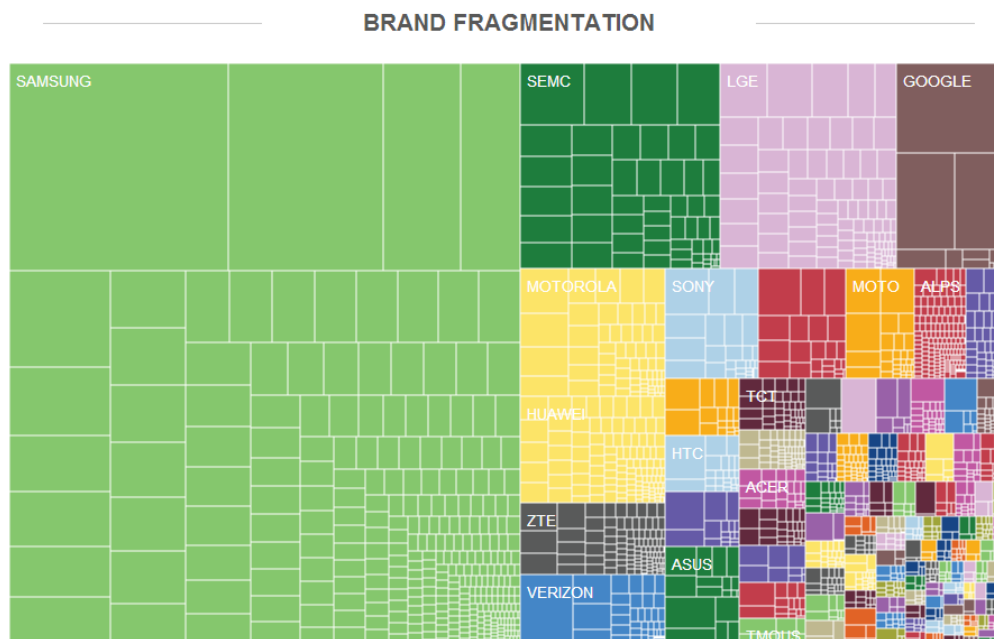
<sup>1</sup>A smart phone's operating system is such an integral component of the user experience that consumers often treat it as a hardware component. Thus it is no surprise that the features and quality of the operating system are essential to phone manufacturers. Android vendors do not have much of a choice, however, as the other major operating systems available are either proprietary or unsupported by most app developers. This has caused Android to blossom into an overwhelming market leader.



As we can plainly see from the graph left, the Android operating system is the dominant smart phone operating system. Despite strong sales from the iPhone, because almost every other major smart phone vendor uses Android, they are simply being outsold.

<sup>1</sup> Data from International Data Corporation (IDC), [www.IDC.com](http://www.IDC.com)

Breaking it down further, we can see that not only is Android the dominant operating system, Samsung is by far the largest vendor of phones running this operating system. The graph below<sup>2</sup> helps visualize just how massive Samsung's market share is, with nearly 47.5% of the market. For comparison, the next largest phone producer is Sony with a 6.5% market share.



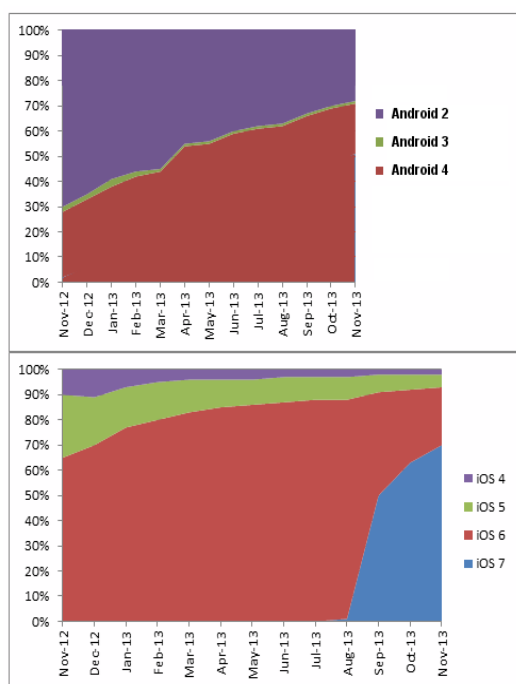
Still, the operating system battle is not firmly won. Despite the clear sales success of the Android OS, it is doubtful that these sales are driven by Android itself rather than the price and quality of the phones that the OS runs on. Because early on Google was intending to release its own smart phones, which they would develop their own extended functionality for, Android is comparatively a barebones operating system, lacking much of the features that iOS has. This strategy is also why they were reluctant to provide most major phone manufacturers the latest version of Android. Consequently, hardware vendors used their own resources to develop their own extended functionality, integrated with the operating system.

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<sup>2</sup> “Android Fragmentation Report July 2013,” <http://opensignal.com/reports/fragmentation-2013/>

Because these upgrades were so imbedded within the operating system, a number of problems developed. The first problem that arose was that it became difficult for phone manufacturers to support the upgrading of consumers' operating systems. The new versions of Android were conflicting with the features that the manufacturers had integrated into the OS. This leads into the second problem where 3<sup>rd</sup> party app developers, major contributors to the OS "environment," required dramatically more resources to develop an app for Android than iOS; developers first had to figure out how to develop an app for Android, then they had to support different versions of android because consumers couldn't upgrade, then within those versions they had to figure out which hardware upgrades could interfere with their apps and make exceptions for those.

This is a problem that continues today and is the primary reason why there are fewer apps in the Google Play app store than in the iOS app store. Although Android has far more users, the number of apps available for download is fewer, and the average quality of those apps is demonstrably lower. Below is a chart<sup>3</sup> showing version fragmentation, from which the reader should be able to draw that Apple users much more rapidly adopt a new OS version.



### Summary

We address this problem further in our strategic recommendations, but we can see that finding a solution to this situation presents Samsung with an opportunity both for huge cost savings and revenue growth. Directly, they could reduce the amount of money and time they have to spend developing their own features for Android and supporting developers. Indirectly, they can boost the success of the Google Play store by reducing app development costs and support requirements, which will drive the sale of more Android phones.

<sup>3</sup> "Android Fragmentation Report July 2013," <http://opensignal.com/reports/fragmentation-2013/>

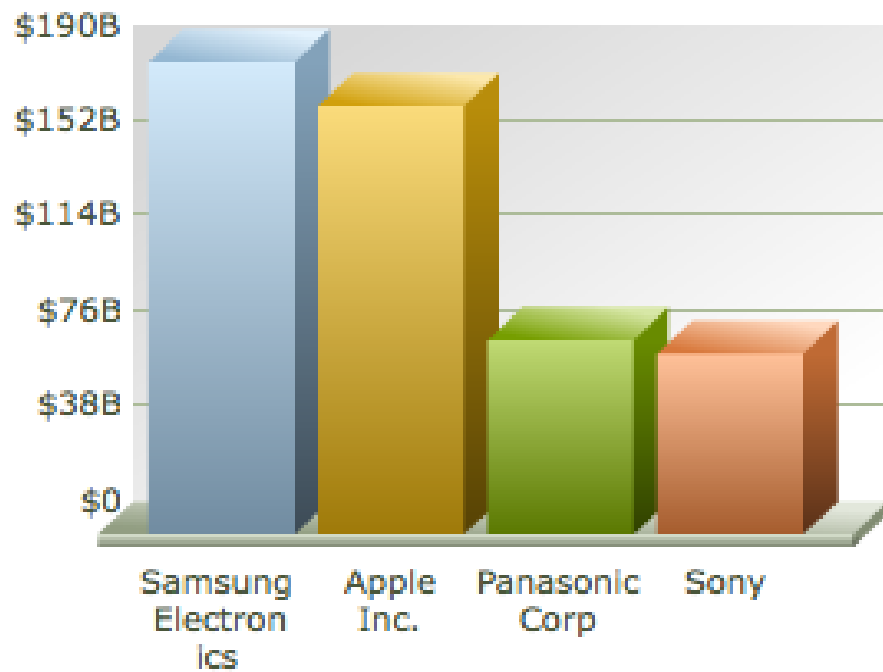


# Financial Analysis<sup>4</sup>

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## 2013 Annual Sales

2013 was a great year for Samsung. Samsung had the highest sales of any company in the world involved in consumer electronics, information technology and mobile communications, or device solutions businesses worldwide. Samsung had revenues of about \$190 billion. In the fourth quarter alone Samsung sold a record 86 million smartphones and took 29.6 percent of the global smartphone market, beating out Apple who took 17.6 percent. Global smartphone shipments grew 41 percent in 2013; a record 990 million smartphones were sold. Samsung sold 319.8 million units, 32.2 percent of total sales, up from 30.4 percent in 2012.<sup>5</sup>



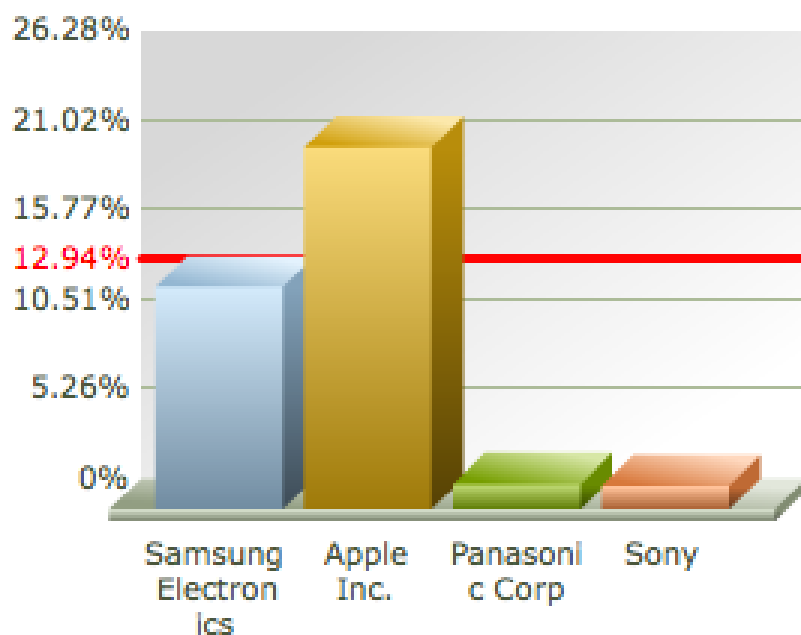
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<sup>4</sup> Figures from Hoover's Financial Database

<sup>5</sup> "Samsung Sets New Smartphone Sales Record in Fourth Quarter, Widens Lead over Apple: Report." *Reuters*. Thomson Reuters, 28 Jan. 2014.

## 2013 Net Profit Margin

Samsung has lower profit margins than top competitor Apple. Smartphone sales have already begun to shift from the tech savvy consumer to the mass market, lowering profit margins for the entire industry. Samsung and Apple are being forced to make their high-end smartphones more affordable to revive sales. Samsung offers premium models at lower prices to increase demand, and they also include more features and packages for less money. Although this strategy squeezes margins, it may be beneficial in the long run if it enables Samsung to keep expanding its market share, gaining the upper hand on Apple. Samsung targets a completely different consumer base than Apple. The average selling price of the iPhone is \$649, far higher than the average price of \$247 for Android phones, Samsung's biggest selling product. Samsung has lower profit margins because it targets a different consumer base than Apple. Apple has been very successful in its premium positioning, and it is unlikely that Apple will go mass-market. Targeting the mass market allows for higher sales volume, but Samsung cannot command as high a premium as Apple.<sup>6</sup>



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<sup>6</sup> "Samsung and Apple Struggle for Higher Profit Margins - Tech2." *Tech2*

## 2013 Liquidity and Solvency<sup>7</sup>

Samsung is a very liquid company, and it should have no problems paying its debt. Huge sales and a growing volume of cash ensure that Samsung will have the capital for both acquisitions and research and development.

	Samsung Electronics	Apple Inc.	Panasonic Corp	Sony	Industry Median	Market Median <sup>1</sup>
<b>Current Ratio</b>	1.86	1.68	0.96	0.85	1.31	1.47
<b>Quick Ratio</b>	0.97	1.40	0.55	0.57	0.96	1.00
<b>Leverage Ratio</b>	1.49	1.68	4.27	6.46	2.36	5.60
<b>Total Debt/Equity</b>	0.12	0.14	0.95	0.80	0.25	0.93
<b>Interest Coverage</b>	125.04	229.15	8.54	50.16	16.22	5.81

If Google and Samsung implement a more cooperative strategic business plan, as described in the strategic recommendations section below, Samsung can greatly profit from it. Samsung, not Google, will produce all of the smartphones and Google, not Samsung, will provide custom operating system and software development support. This should also benefit Google because having a platform that is easier to develop on will grow the Android market, thus increasing profits for Google as well. The end goal would be for Samsung to produce smartphones with Google producing operating systems that can compete with IOS operating systems. Currently the iOS operating system is around half as costly to develop for, so it has a much stronger App market. Making the Android environment similar will grow Samsung and Google's consumer base and increase market share even more.

In terms of the balance sheet, Samsung has been significantly increasing assets since 2010. Samsung has also seen significant growth in cash since 2010. This will allow them to keep pouring money into research and development. Samsung has cash and cash equivalents of nearly \$16 billion. Analysts expect Samsung to use this money for acquisitions in areas like software

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<sup>7</sup> "Financial Statements for Samsung Electronics Co Ltd (005930)." *Businessweek.com*.






















and medical equipment.<sup>8</sup> The increase in cash since 2010 is due to the fact that Samsung's revenue now comes from a different place. The source of revenue used to be Samsung's chip and components divisions, but now its huge profit comes largely from smartphones, which generate more cash because they don't require as much capital investment. The smartphone sector of Samsung's sales accounted for 74% of Samsung's operating profit. Three years ago, the mobile-phone segment accounted for only 25% of operating profit.

It should be noted that Samsung's balance sheet might not be completely factual. Samsung is not traded on United States stock exchanges, and thus is not subjected to the same financial scrutiny as it otherwise might be. There has been embezzlement of funds from Samsung executives. Also, many of the company leaders have been involved in corruption scandals. Thus, the stated values may be more or less than they actually should be.

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<sup>8</sup> "Samsung's 'Good' Problem: A Growing Cash Pile," *The Wall Street Journal*. Dow Jones & Company

## Historical Assets<sup>9</sup>

Currency in Millions of US Dollars	As of:	Dec 31 2010 Reclassified USD	Dec 31 2011 Restated USD	Dec 31 2012 USD	Dec 31 2013 USD	4 Year Trend
Assets						
Cash And Equivalents		9,426.2	14,143.8	18,090.5	15,677.4	
Short-Term Investments		12,161.4	11,693.1	17,834.1	36,748.1	
<b>TOTAL CASH AND SHORT TERM INVESTMENTS</b>		<b>21,587.6</b>	<b>25,836.8</b>	<b>35,924.7</b>	<b>52,425.5</b>	
Accounts Receivable		18,438.7	21,065.9	22,971.2	24,056.5	
Notes Receivable		9.2	--	82.0	14.9	
Other Receivables		2,075.3	2,186.2	2,708.4	2,779.7	
<b>TOTAL RECEIVABLES</b>		<b>20,523.3</b>	<b>23,252.1</b>	<b>25,761.7</b>	<b>26,851.0</b>	
Inventory		12,866.0	15,130.5	17,085.4	18,421.1	
Prepaid Expenses		2,118.7	2,242.6	2,177.9	2,380.7	
Other Current Assets		2,016.8	2,373.0	3,064.3	6,550.6	
<b>TOTAL CURRENT ASSETS</b>		<b>59,112.3</b>	<b>68,835.0</b>	<b>84,013.9</b>	<b>106,628.9</b>	
Gross Property Plant And Equipment		111,225.9	128,974.9	144,708.6	162,488.9	
Accumulated Depreciation		-60,236.8	-69,245.2	-78,778.3	-89,808.5	
<b>NET PROPERTY PLANT AND EQUIPMENT</b>		<b>50,989.0</b>	<b>59,729.7</b>	<b>65,930.3</b>	<b>72,680.4</b>	
Goodwill		550.1	503.9	552.4	539.6	
Long-Term Investments		10,951.2	11,964.2	13,486.5	12,183.0	
Deferred Tax Assets, Long Term		1,082.1	1,716.6	2,422.2	4,449.4	
Deferred Charges, Long Term		322.1	455.4	579.8	724.6	
Other Intangibles		1,803.5	2,270.8	2,458.3	2,567.9	
Other Long-Term Assets		4,469.4	4,513.3	4,874.2	6,316.3	
<b>TOTAL ASSETS</b>		<b>129,279.8</b>	<b>149,988.9</b>	<b>174,317.6</b>	<b>206,090.0</b>	

<sup>9</sup> "Financial Statements for Samsung Electronics Co Ltd (005930)." *Businessweek.com*.

# Five Forces Analysis

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## Internal Rivalry: High

The smart phone industry began its boom in the late 2000's. Recently, the boom has slowed and the industry is now at a point where there is significant pressure for companies to take customers away from their competitors. The mobile phone industry is rather concentrated as the largest 3 companies make up nearly 53% of the market, while the largest 10 companies make up 72% of all international sales. Samsung leads the industry with a 32% market share, followed by Apple and Huawei at 16% and 5%, respectively. With the market being dominated by a few firms, these companies must do anything and everything to stay one step ahead of their competitors. Companies seek to stay ahead through customer lock in, technology development, and product differentiation; but as shifts in the market occur, these tactics are proving to be less sustainable.

Customer lock in used to be aided through contracts with actual providers, such as Verizon or AT&T. The phone providers would make customers lock in a 2-year contract with the company. The major clause of these contracts was a phone upgrade at the beginning of the contract. Phone service providers would significantly discount high-end phones when customers agreed to the 2-year service lock. Without the contract extension, phones would be drastically more expensive and see minimal sales at full retail price. For better or worse, these contracts were a phone manufacturer lock in mechanism as well, as the switching costs embedded in the contracts would be high enough to prevent consumers from switching or upgrading phones. Recently, there has been a trend among mobile service providers to eliminate contracts and switching fees. Thus, price wars between mobile service providers cause competition amongst phone manufacturers to escalate drastically. As more customers forego contract renewals and enter into the new non-binding short-lived service contracts, the phone manufacturer lock-in goes by the wayside.

As the smart phone industry ages, technological advancement becomes key. Customers will be drawn to phones they feel offer the most functionality and the best operating system. Samsung has done well in keeping up with and in some instances leading the smart phone industry in technology development. Unfortunately, these advances do not sustain themselves and are short-

lived. Competitors will copy any advances and quickly apply them to their own devices. Coupling the constant upgrades with non-binding contracts, the competition to win customers as a phone manufacturer escalates, as the new-and-improved phones soon become outdated technology.

Similar to technological advancements, product differentiation also is short-lived. Samsung and its competitors keep a close eye on features the public reacts positively to. Whether it is screen size, picture quality, voice interactions, or social media integration, phone producers always want to have the best. Thus, with product differentiation being so transient, companies in the industry cannot keep a long-term competitive advantage through product differentiation.

Internal rivalry in the smart phone industry is high. During the years of the smart phone boom, companies could find ways to improve technology and cut prices to sustain a competitive advantage in the industry. The top competitors in the industry now must do everything possible to steal rival's customers and take more of the existing market share.

#### **Threat of New Entrants: Low**

Entry in to the mobile industry is difficult given the existence of numerous barriers to entry. The mobile industry has high capital requirements both for operating and especially for entry. A company seeking entry into the mobile industry would not only have to fund the purchases of each component, but also would need to develop their own research and development programs to be competitive.

The inner workings of a phone have become so intricate and compartmentalized that anyone hoping to break into in the mobile industry would need substantial capital to purchase all the parts. Additionally, because Samsung already makes the processors for most of the companies in the industry, any potential entrant would more than likely have to go through Samsung. Thus, Samsung would exhibit significant control over this particular entrant.

Currently, the two major operating system competitors are iOS (Apple's system) and Android (Google's System). If a new company were to try and enter the market, they would either need to develop their own system or buy the rights to use one of the current operating systems. Both

of these paths require significant capital that most potential entrants do not possess. Over time, though, this cost will fall and Samsung will need to be able to offer competitive operating system capabilities when these new low cost systems do arrive.

Any potential new entrant would need to establish a competitive brand name while achieving economies of scale to even be considered competitive in the smart phone production market. In order to do so, the new entrant would have to find a way to attain the components, materials, and processor needed for a smart phone without infringing upon any existing patents. Thus, the new entrant would more than likely need to purchase these goods from the same suppliers as their competitors, who probably purchase on a much larger scale thereby reducing the total costs. The start-up capital required to make such bulk purchases is immense, thereby creating a strong barrier to entry into the industry.

Even if the entrant were able to attain the needed capital, they would then incur issues such as customer loyalty and switching costs. Currently, smart phone companies do a good job integrating different aspects of consumers' lives with their product, such as the iPhone interacting with iTunes, iCloud, Gmail, etc. As noted earlier, without a 2 or 3-year contract renewal, switching costs between smart phones is incredibly high. Smart phones companies have achieved a level of customer loyalty as well as high switching costs that create another large barrier to entry.

### **Bargaining Power of Buyers: High**

Buyers have high levels of bargaining power simply because the mobile phone industry is so competitive. Additionally, buyers have substantial access to market information and can use this information as bargaining power. Companies that produce phones differentiate their products through hardware and software components, operating systems, camera quality, screen size and resolution and more. These aspects are also used by the consumer as bargaining power over smart phone producers.

As competition between service providers increases and phones become more alike, buyers will be able to choose which service and which phone to purchase with minimal cost differences. Thus, as switching and lock in costs decrease, buyer bargaining power increases.



Historically, service providers tried to lock in customers with 2 or 3-year service contracts that came with a phone upgrade. Service providers would secure customer lock in with astronomical switching costs and cancellation fees. However, there has been a recent trend toward eliminating all switching costs. This would allow buyers to gain leverage over smart phone producers through the credible threat of switching phones on a whim. This leverage has its advantages, but also poses a new issue to potential buyers. By cancelling switching fees and trending toward the elimination of long-term contracts, buyers lose the heavily discounted prices of phones.

### **Bargaining Power of Suppliers: Low (for Samsung)**

Samsung is unique in that their individual supplier bargaining power of suppliers is largely irrelevant because Samsung is its own supplier for most components. Samsung manufactures its own processors, memory and storage components. Additionally, Samsung also supplies its own raw materials.

In the industry, however, the bargaining power of suppliers is high because the supplier's components and materials are crucial to the buyer's marketplace success. For companies who do not supply their own components, they would not be able to compete or exist without the processors, memory chips and other raw components that are used in smartphone production. Thus, suppliers of these components are even more vital to smart phone makers than mobile service providers who sell their phones.

The only leverage smart phone manufacturing companies have over their suppliers is the threat of reverse-vertical integration. The manufacturers could threaten to start producing their own processors and raw components. However, both they and their suppliers know this process would be extremely costly. Still, Apple, for example, is trending towards vertical integration, threatening both Samsung's component sales and their comparatively low smart phone prices.

Samsung has a significant edge in supplier power over their competitors because they supply their own components. By producing the processors and components for not only their own phones but some of their competitors as well, Samsung's supplier bargaining power is guaranteed to remain very low.

**Threat of Substitutes: High**

For Samsung, almost any smart phone that performs the same functions is considered to be a substitute. The previous stated condition for a substitute essentially includes the entire smart phone market. Any device running on the Android OS not made by Samsung, such as the Motorola Droid series, is a potential substitute for a Samsung phone. Beyond smart phones running on Android, the Apple iPhone, Windows phones and Blackberries, all of which run on different operating systems are also direct substitutes because the phones' functionalities are almost identical to that of a Samsung smart phone. All of these products are abundant and in high demand with similar costs, thereby making the market highly competitive in terms of internal substitutes.

Outside of the smart phone market, the industry threat of substitutes is minimal. Potential substitutes to a smart phone include tablets, PDA's, and laptops. The popularity of tablets has been increasing significantly over the past few years, but they are generally too bulky to be considered a direct substitute to a smart phone. Additionally, tablets generally lack the traditional mobile phone calling functionality, making them an inadequate substitute. Laptops realize the same problems as tablets in that they cannot perform the basic telephone function of smart phones, as well as being beyond bulky making mobility difficult. Thus, there is no true substitute to a smart phone causing buyers' propensity to switch to be quite low.

The only potential substitutes to Samsung or any other company's smart phones are known as "dumb" phones. This label captures all phones that simply function as calling and texting devices. Phones in this category lack one of the major operating systems and the expensive hardware of the smart phone, severely limiting their capabilities. Overall, these products are inexpensive and serve as a substandard product. Consumer switching costs to these devices are essentially zero in monetary value, but high in terms of product differentiation stemming from the lack of features of dumb phones. Today, lower-end smart phones can be purchased for similar prices to these basic phones, and sometimes come free with certain contract extensions making the "dumb" phone substitute threat minimal.

In its brief history, the smart phone industry has struggled to find a need for complements. Smart phones do so much by themselves that relying on integrating features with other products seemed to be more of a hassle than beneficial. Thus, few complements exist for smart phones. The primary complement that exists is a data repository and manipulation center, such as a PC or Mac, that allows users to store and manipulate the contents of their smart phones without having to use the inadequate smart phone interface.

The interface between these two platforms is usually created by software, which creates two differing market approaches. One approach is to decentralize this interface, as Android has done, and allow smart phone manufacturers and other developers to create many interface choices for users to pick on their own. This yields a much more robust suite of possible features that users can pick from, but may require the use of more than one piece of software and generally extra management. The other approach, which might be defined as the Apple or Microsoft approach, is to only allow the device to communicate with one subset of non mobile platform through a specific interface. Theoretically, this reduces the management required by the user and increases cross platform stability and security, but at the price of user optimization.

Apple has done extremely well at integrating the iPhone with the Macbook as well as with their new AppleTV product. As long as each device recognizes the others, videos can be streamed freely between them and information can be shared wirelessly. Given each device's specialties, the interaction can provide more features and more mobility when needed. The power of the iCloud to wirelessly synchronize data across multiple platforms should also not be underestimated. In order to combat this threat, Samsung should build alliances with the companies that form Apple's opposition. Samsung already has strong ties with Google that it should continue to exploit to develop cross platform support, and it should seek to form ties with Microsoft who would likewise enjoy giving Apple a bloody lip on the user environment front. Combining Samsung's market dominance and these two developers dominance in the complementary market should be able to pose stiff opposition for Apple.

# SWOT

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## Strengths

1. High degree of vertical integration
  - a. Largest memory manufacturer in the world
  - b. Largest LCD screen manufacturer in the world
  - c. Makes bundled components for its most major competitor (Apple)
  - d. Releases software along with its phones that is usually good
2. Phones are high quality
  - a. Always the highest/top 2 or 3 ranked phones on CNET.
  - b. New phones released frequently
  - c. Innovative – waterproof Galaxy S5
3. Pricing strategy allows for huge market capture
  - a. Many phones for various price points
  - b. Phone quality varies in speed and other factors
4. Good branding and advertising
  - a. Evidenced by recent Oscar “stunt”
  - b. Comparison to Apple
    - i. Apple is all about style and “ease of use”
    - ii. Samsung’s brand is competitive
5. “Samsung is South Korea”
  - a. Government integration
  - b. Resource pipeline is easy to access and huge

Samsung’s greatest strength is in its vertical integration. It is both the largest memory manufacturer and LCD display manufacturer in the world and this allows it to efficiently and cheaply manufacture component parts. While other dedicated manufacturers make individual components cheaper, Samsung can make all of the major components for a phone and then bundle and sell those components to phone vendors. This ability has allowed them to become

Apple's primary phone component manufacturer, which means its greatest competitor actually relies on it for supply chain stability. Higher up vertically, Samsung develops its own software for release on its phones in addition to the stock Android operating system. These features are generally well received, and help to add value and distinguish Samsung phones from other phones using Android.

On CNET, the most popular internet cell phone review website, Samsung always dominates the top ten phones charts, ranked both by review scores and by popularity. Their phones are not only high quality and reliable; they also release many different phones which are appropriately priced based on their capabilities. This affords them huge market penetration which no other competitor can match. Consumers choose Samsung phones for their flexibility and their quality at a given price point. Though they are often criticized for lacking form compared to their rivals, Samsung phones are almost always cheaper for the same quality, and often have greater flexibility and features.

Although its brand image may be "cheaper" compared to Apple, Samsung clearly has no problem selling phones. It also is clearly focused on branding itself as a competitor in the high-quality phone market with its latest stunt at the Oscars. Additionally, Samsung is making gains in brand recognition and consumer confidence. "The inaugural quarterly Brand Dependence™ index, focused on technology and consumer electronics, reveals that Microsoft and Samsung topped the list of technology brands that consumers say they can't live without and relate more to themselves."<sup>10</sup>

Samsung also benefits from its relationship with the South Korean government. Although Samsung does not wield any official government authority, its influence is staggering, and for good reason. Samsung's profits are about equal to the South Korean government budget, and make up nearly 20% of the South Korean economy. While the government has recently been

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<sup>10</sup>Shaughnessy, Haydn. "Why Apple Is Losing Ground To The Samsung Brand." *Forbes*. Forbes Magazine

careful to distance itself slightly from Samsung in the public eye, there can be no doubt that the company still holds tremendous power. According to *Bloomberg Businessweek*, South Korea is referred to in some circles as “The Republic of Samsung.”<sup>11</sup> The government routinely steps in to help Samsung internationally, and there is no reason to think that they have reduced their efforts given Samsung’s importance to the economy.

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<sup>11</sup> Yang, Jun. "Samsung's Family Feud." *Bloomberg Business Week*. Bloomberg, 07 June 2012.

## Weaknesses

1. Dependence on Apple for component sales
2. Brand is unfocused, potentially unclear.
3. Samsung phones don't have exceptional compatibility with other devices, nor as well developed ancillary services compared with Apple's phones.
4. Authority questioned internally and externally

Samsung's most immediate weakness is its dependence on Apple for component sales. Apple represents somewhere between 3% and 8% of Samsung's total sales, and Apple is dependent on Samsung for about 40% of their phone components.<sup>12</sup> This is in many ways a benefit for Samsung, but as Apple is a direct competitor of Samsung's in the smart phone market, they will only choose to stay with Samsung for as long as they can offer the best price and quality. Relying on a competitor for billions of dollars in profit is not only a good strategy if it leads to some long run end.

This presents a problem if the long run strategy is merely to remain competitive rather than to eliminate the competitor, and is reflective of Samsung's unfocused strategy and brand. While Samsung is making great strides with both brand value and trust, its message remains unclear. According to Interbrand, who listed Samsung's brand as one of the strongest in 2013, "Samsung is evolving its brand to stand for more than just innovation and strives to live up to its internal ambition of enhancing the lives of its consumers." We feel, however, that Samsung's brand still has far to go if it wants to unseat the iPhone as the industry standard.

Samsung also misses out on a key selling point that is one of Apple's best features. The iPhone has compatibility of some form or another with all other devices that run on iOS. Samsung relies on third parties to provide a semblance of this information storage and sharing capability, but the result has led to a much more convoluted system than the one Apple offers. While the utility that

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<sup>12</sup> Kim, Miyoung. "Analysis: Friend and Foe; Samsung, Apple Won't Want to Damage Parts Deal." Reuters. Thomson Reuters, 27 Aug. 2012.

these applications provides is in total greater and provides users more options than what Apple provides through iTunes and the iCloud, these applications are not nearly as well integrated as Apple's features. By losing the compatibility race, Samsung loses an important strategy in horizontal integration.

Last, although Samsung wields great influence at home, that influence is not permanently guaranteed. The most direct challenge to Samsung's political authority is LG, who has been a competitor in almost all of Samsung's industries for the last fifty years. They have even been successful in their entrance into the smart phone market, and crucially have taken over Google's production of smart phones with the latest Android operating system. LG presents not only a rising competitor, but also a challenger to Samsung's access to resources at home. Furthermore, internal shocks within Samsung itself, and scandals associating Samsung with government corruption such as the family spat in 2012 or the Chairman's corruption scandal in 2008 scare other Korean companies and officials and prevent them from cooperating with the company. This internal weakness could potentially be Samsung's downfall.



## Opportunities

1. Hardware
  - a. Producing more kinds of hardware to offer in the bundle
  - b. Producing more of the things they already offer
    - i. Economies of scale
    - ii. Making alliances with the Taiwanese semiconductor manufactories
2. Software
  - a. Improving the OS that runs on the phones
    - i. Partnering with Google to allow the latest OS to run on all Samsung phones
    - ii. Continuing to develop own software
    - iii. Potentially hiring more talent from the United States
  - b. Improving software compatibility
    - i. Partnering with Windows and/or Lenovo to develop this
    - ii. Developing coding standards with Google
3. Branding
  - a. Don't play Apple's game! Do not let them be the benchmark.
  - b. Need a focused message
    - i. Combine what consumers expect from Samsung phones, and what Apple can't offer:
      1. Pricing for their budget
      2. Reliability
      3. Compatibility with Windows
      4. Competitive form
4. Emerging Markets
  - a. Africa

Samsung has an excellent opportunity to sustain a competitive advantage in hardware production. Not only are they the world's largest producer of memory and LCD screens, they are also consistently on the cutting edge of developing new related technologies. There are two paths that Samsung can take that would help them sustain this hardware edge.

First is an extension of their current hardware bundling strategy; that is they can produce more components to include in their bundle. Samsung has already made strides towards this by becoming the world's 3<sup>rd</sup> largest producer of processors, most of which are dedicated for mobile devices. By pursuing the bundling strategy, they can grow their processor line without taking huge losses from lack of economies of scale, and they need to only produce chips that are competitively priced to other manufacturers', rather than undercut their prices. Although Samsung has been struggling to compete with Intel and AMD, they should absolutely continue this development in order to make their component bundle more valuable.

The second strategy Samsung can pursue is reducing their costs through economies of scale, which certainly applies to the hardware manufacturing industry. They can produce the hardware themselves, which is tough given the fluctuating demand, and they can make alliances with companies that produce similar components. These alliances will allow them to share the costs of technology development as well as fixed capital costs, and even more importantly it can cut search costs and smooth out revenue income if they are able to distribute sales and production appropriately. Good targets for alliances such as this are the Taiwanese semiconductor manufacturing, which produce similar hardware components for Lenovo.

Samsung should also continue developing their phone operating systems. They can do this in a number of ways, the most effective of which is partnering with Google to allow the latest operating system to run on Samsung's highest end phones. The real efficiency, advertising benefits, and perceived value added to the customer will allow their phones to compete much more effectively with the iPhone. Furthermore, if the alliance deepens, Samsung can reduce its OS development investment and Google can reduce its phone vending investment, resulting in capital gains to both parties.

Failing this alliance, Samsung should continue to develop its own software. Because Google needs Samsung to sell its operating system, Samsung's development of its own software can be used as leverage to get Google to meet their demands. It is well known that Samsung has been working on creating its own operating system, but actually using that system instead of Android would be inefficient. It should continue to invest in its development, but it should use this investment as leverage over Google rather than actually use it. Instead, it should continue to develop custom versions of Android and apps for Android to avoid too much expense. It should highly consider investing in talent in the United States as Google appears to be losing ground in hiring the best OS developers.

We also recommend that Samsung invest significantly in improving compatibility with Windows. It is possible that Microsoft is too invested in Windows Mobile to afford Samsung this advantage, but partnering with them would be the most effective path towards achieving this goal. Failing this, there is probably much that a PC manufacturer can do to help push this along. Samsung has a good relationship with Lenovo, who is the largest PC vendor in the world, and a partnership between the two of these would surely yield desirable results.

Branding is probably where Samsung needs the most investment. While they have been increasing brand value, they still have problems competing with Apple. In the smart phone market, the iPhone is still the benchmark of performance, quality, and service. Despite Samsung's phones receiving higher reviews, Samsung's better customer service, better pricing, and better availability, consumers still buy iPhones in huge numbers. We conjecture that this is because of the iPhone being perceived as a luxury good, and because Samsung appears to consumers to be playing Apple's game. In other words, if consumers had to pick which phone was better without having tried either, Apple's would be the victor.

If Samsung wants to stop Apple from being the benchmark, they are going to need a focused and effective brand. While the current slogan, "Imagine" is powerful and conveys the right message it's hard for consumers to translate it into what that means for a smart phone. Samsung should continue to develop actually innovative features for their phones, such as the new waterproof Galaxy S5. They should then launch a strong ad campaign emphasizing their comparatively

excellent pricing and reliability. Improving compatibility with Windows would also make for a welcome advertising point.

Last, Samsung needs to push the envelope of where smart phones are traditionally sold. While they have thus far been used mostly in advanced countries and have been popular in developing nations as a luxury good, we believe Samsung has an opportunity to be a major supplier of smart phones to developing nations in Southeast Asia and Africa. Both of these regions are seeing huge expansion of the cell phone market. While Samsung would have trouble selling its highest end phones there, they might be able to sell their low to mid range phones there as high-end products. They would likely encounter difficulty with network coverage over most of these regions, and to remedy this, might consider partnering with Huawei or another large infrastructure investor to develop these services.

## Threats

1. Vertical
  - a. Below
    - i. Threats to bundled hardware
      1. Taiwan
      2. Global foundries
    - ii. Incredibly cheap hardware leads to smart phones that cost next to nothing
      1. Investigate
  - b. Above
    - i. Google delivers incomplete software because they are competitors
    - ii. Superior technology
2. Horizontal
  - a. Competitors' superior branding
    - i. Apple's style
    - ii. Google's software
    - iii. Microsoft's compatibility
  - b. Competitor pricing
    - i. Luxury phones that steal market share in China
  - c. New entrants
    - i. Huawei stealing market share in China
    - ii. Cheap phone developers making super cheap smart phones.

Samsung's most potentially lethal threats are to its vertical integration strategy. From below, it faces a number of hardware manufacturers that have already demonstrated the capability to compete with Samsung both on price and quality. The most dangerous of these competitors is Silicon Valley based Globalfoundries, which is able to produce semi-conductors with excellent quality and efficiency. Other threats are from large Taiwanese semiconductor manufacturers who, when they do not win on price, can compete with Samsung for huge Chinese clients like Lenovo and Huawei with tax incentives and government subsidies. On a higher level, they are also challenged from below by small companies who have claimed to be able to produce decent

quality smart phones at very low prices. This is a dangerous threat for Samsung, whose dominance is based on being able to price discriminate to lower tiers.

From above they are threatened by software and OS developers who can either degrade the quality of the software that runs on Samsung's phones, purposefully or otherwise, or charge Samsung huge fees for use. Opposite to that, Samsung is threatened by other phone and software developers who make better products than those on their own phones, or products exclusive to other phones. For instance, if Facebook or another hugely influential company decides to make a product exclusive to the iPhone, Samsung's sales could take serious damage. If Samsung continues to be on the cutting edge of phone development, and maintains their relationships with app developers, they will certainly be able to minimize these threats.

Samsung faces its most obvious threats from its competitors. Apple's combination of form, style, and brand are difficult to match. Google's software production and innovation are renowned, but they have never been fully committed to their relationship with Samsung. LG and other smaller companies are meanwhile encroaching on Samsung's lower tier territory with excellent quality phones at low prices.

One of Samsung's largest markets is in China and other East Asian countries. Apple, however, is a tough competitor in the smart phone market there. The Chinese have a noted predilection for luxury items, and Apple's iPhone is perfectly suited for sale in that market niche. Samsung still dominates the lower tiers, but it could face serious competition in that section of the market from newer companies with promising low priced alternatives.

# Strategic Recommendations

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## Samsung's Primary Goals

- 1) Forming a stronger alliance with Google
- 2) Solidifying and maintain its component manufacturing edge
- 3) Focusing the brand
- 4) Continuing customer-driven innovation
- 5) Expanding to developing markets

## Strategic Summary

By far the most important recommendation we have for Samsung is to strengthen its relationship with Google. With Google's perceived shift away from the production of its own smart phone, Google faces less of an incentive to restrict both Samsung's access to the latest version of Android and Samsung's involvement in the Android development process. Samsung is already capitalizing on this, with its new flagship S5 running the latest version of Android. However, Google has recently demanded that Samsung reduce the amount of features it itself attempts to phones running Android, as they were unnecessary and slowed the operating system down.

Though it may be hard for Samsung to begin to rely on Google, they should invest their trust in the other company. In the future, Samsung may be able to request Operating System features for Google to develop, and Samsung will be able to cut its own operating system and application development teams entirely. This will save costs for both companies, and hopefully drive revenues from a better user environment created with more 3<sup>rd</sup> party apps. In the short run, Samsung can use its own OS development team to leverage Google to develop features that it wants, while in return reducing the number of features it develops on its own. The crucial first step will be for both companies to create a road map to the ideal future, including strict coding standards and coding territories that allow for a better development environment.

The other goals deal with maintaining Samsung's considerable competitive advantage. Preserving their edge in component manufacture should be foremost among these goals. Although they are unlikely to lose such an edge in the near future, they should deal with threats to their dominance before bargaining costs become too high. Forming alliances with other component manufacturers will help share technology, contracting, and search costs, and hopefully increase the value and decrease the price of Samsung's component bundle. Focusing the brand and continuing customer-driven innovation will help Samsung push for even greater sales in regions that it already does well in, and we believe that Samsung is a strong candidate for expansion into emerging markets with their reliable and comparatively cheap smart phones. Combining these strategies will enable Samsung to kick Apple from its perch as the de facto smart phone standard setter.