The Globe: The Paradox of Samsung's Rise

by

- Tarun Khanna,
- Jaeyong Song,
 and
- Kyungmook Lee

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Summary. Reprint: R1107N Twenty years ago, few people would have predicted that Samsung could become a world leader in R&D, marketing, and design. Fewer still would have predicted success given the path it has taken: grafting Western business practices onto its...more

As today’s emerging giants face the challenge of moving beyond their home markets, they have much to learn from the pathbreaking experience of South Korea’s Samsung Group, arguably the most successful globalizer of the previous generation.

Twenty years ago, few people would have predicted that Samsung could transform itself from a low-cost original equipment manufacturer to a world leader in R&D, marketing, and design, with a brand more valuable than Pepsi, Nike, or American Express. Fewer still would have predicted the success of the path it has taken. For two decades now, Samsung has been grafting Western business practices onto its essentially Japanese system, combining its traditional low-cost manufacturing prowess with an ability to bring high-quality, high-margin branded products swiftly to market.

The two sets of business practices could not have seemed more incompatible. Into an organization focused on continuous process improvement, Samsung introduced a focus on innovation. Into a homogeneous workforce, Samsung introduced outsiders who could not speak the language and were unfamiliar with the company’s culture. Into a Confucian tradition of reverence for elders, Samsung introduced merit pay and promotion, putting some young people in positions of authority over their elders. It has been a path marked by both disorienting disequilibrium and intense exhilaration.

Like Samsung, today’s emerging giants—Haier in China, Infosys in India, and KoÃƒ§ in Turkey, for instance—face a paradox: Their continued success requires turning away from what made them successful. The tightly integrated business systems that have worked in their home markets are unlikely to secure their future in global markets. To move to the next level, they, too, must reinvent themselves in ways that may seem contradictory. And when they reach new plateaus, they will need to do so again.

For seven years, we have traced Samsung’s progress as it has steadily navigated this paradox to transcend its initial success in its home markets and move onto the world stage. It is a story we believe holds many important lessons for the current generation of emerging giants seeking to do the same.

The Rise of a World Leader

Founded in 1938, the Samsung Group is the largest corporate entity in South Korea, with $227.3 billion in revenue in 2010 and 315,000 employees worldwide. Best known for its flagship, Samsung Electronics (SEC)—producer of semiconductors, cell phones, TVs, and LCD panels—the group’s highly diversified businesses span a wide range of industries, including financial services, information technology services, machinery, shipbuilding, and chemicals.

By 1987, when Lee Kun-Hee succeeded his father as only the second chairman in the company’s history, Samsung was the leader in Korea in most of its markets. But its overseas position as a low-cost producer was becoming untenable in the face of intensifying competition from Japanese electronics makers, which were setting up manufacturing plants in Southeast Asia, and rising domestic wages in South Korea's newly liberalizing economy.

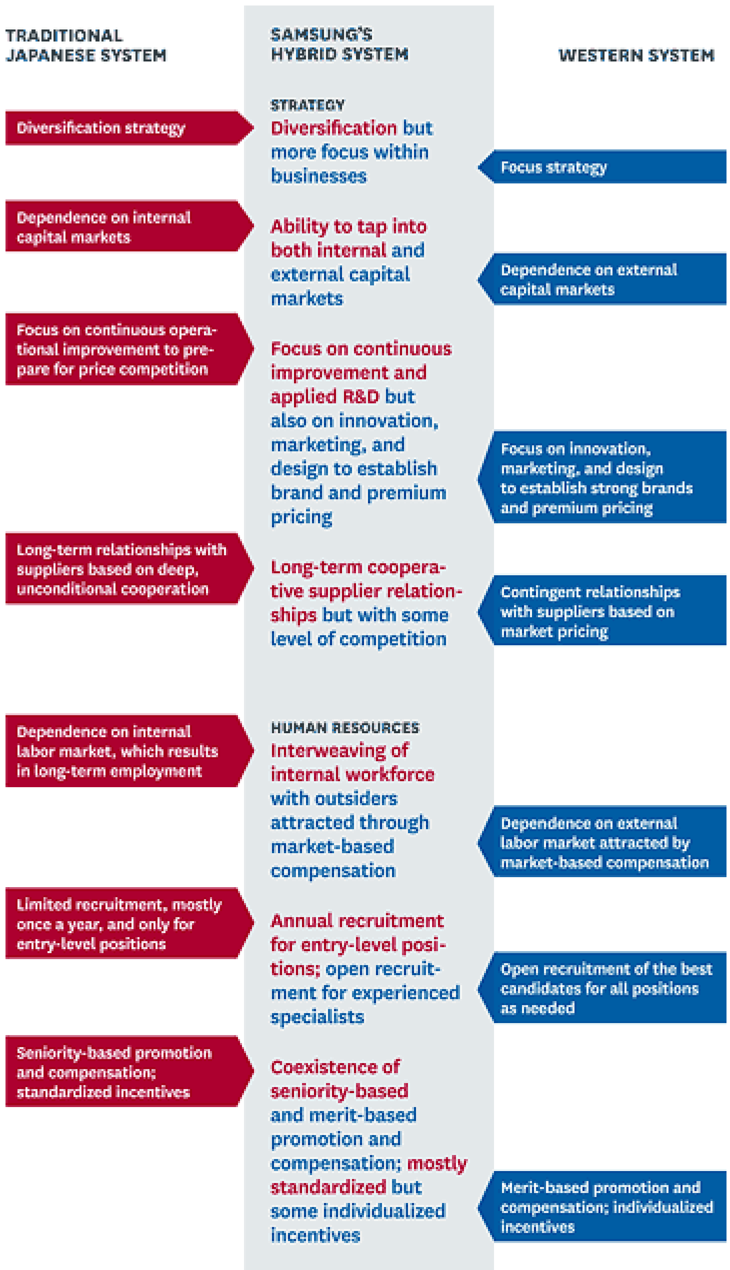
In the early 1990s, Lee spotted an opportunity in the reluctance of Japanese companies—the analog market leaders—to adopt digital technology, which consumers were flocking to in cameras, audio equipment, and other electronic products. This opened the door for Samsung to surpass its rivals if it developed the agility, innovativeness, and creativity to succeed in the new digital market.

For those qualities Lee looked to the West. In 1993, he launched the New Management initiative to import Western best practices related to strategy formulation, talent management, and compensation into Samsung's existing business model. The aim was to markedly improve marketing, R&D, and design while retaining core strengths in manufacturing, continuous improvement, and plant operations. Execution of this mix-and-match strategy took three broad forms:

- A formal process to identify, adapt, and implement the most appropriate Western best practices.
- Steady efforts to make Samsung's culture more open to change by bringing outsiders in and sending insiders abroad.
- Intervention by Lee to protect long-term investments from short-term financial pressures.

In this way, slowly and steadily but not always smoothly, Samsung has built its hybrid management system as a series of experiments, first in SEC and eventually throughout the Samsung Group (see the exhibit "Seeking the Best of Both Worlds: Samsung's Hybrid Management System").

Seeking the Best of Both Worlds: Samsung's Hybrid Management System



Imagine introducing a focus on innovation into a company optimized for continuous process improvement. Or merit ...

The results have been impressive: By 2004, SEC was delivering startling profitability numbers—$10.3 billion (almost 19%) on $55.2 billion in revenue—making it the world's second most profitable manufacturer, behind Toyota. Since then, even in the wake of the recent global economic crisis, SEC's profits have been higher than those of the five largest Japanese electronics firms (Sony, Panasonic, Toshiba, Hitachi, and Sharp) combined. The company achieved record profits of about $14.4 billion on $138 billion in revenue in 2010, compared with $11.7 billion for Intel, $0.86 billion for Panasonic, and a net loss of $3.2 billion for Sony. From obscurity in the 1990s, the Samsung brand rose to number 19 on the 2010 Interbrand global ranking, with a value of $19.4 billion. But it wasn’t easy.

A Tightly Fitting System

Samsung’s Japanese roots are strong: When the company was founded, South Korea was a Japanese colony. Samsung’s first chairman, Lee’s father, was educated in Japan, and the company built its corporate muscle in industries—consumer electronics, memory chips, and LCD panels—that Japan once dominated. Accordingly, Samsung rose to prominence in its home market under the Japanese model of unrelated diversification and vertical integration in pursuit of synergies. Diversification suited South Korea’s weak external capital markets because it allowed the company to rely on internally generated cash from one operation to fund the others.

The Japanese hierarchical labor model also suited the Korean context. The institutions underpinning South Korea’s managerial labor markets were underdeveloped, making mobility across corporations rare. The absence of a well-developed stock market and of sufficient competition for talent, combined with a strong Confucian tradition of respect for elders, led to a seniority-based compensation and promotion system. (For a fuller discussion of the logic behind Samsung’s original business model, see “Why Focused Strategies May Be Wrong for Emerging Markets,” Tarun Khanna and Krishna Palepu, HBR July–August 1997.)

To compete outside its home markets, Lee knew, Samsung would need to move beyond its well-integrated system to engage with non-Koreans in non-Korean contexts. That meant introducing practices inconsistent with the status quo.

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Lee did not underestimate how unsettling that would be. Accordingly, he took great care to change only what needed to be changed and to ensure that Samsung adopted the most appropriate practices in a way people could understand and embrace. The company established new organizations to seek out and adapt best practices from abroad. Lee advocated directly for the practices he deemed most critical and solicited employees’ input in the development of each. Results were carefully measured. If resistance was too strong, the company delayed adoption, modified the practice, or—as was the case with stock options—abandoned it.

In this way, Samsung injected some highly incompatible business practices into its business model. Beginning in 1997, for instance, the company slowly introduced into its seniority-based pay structure a merit-based compensation system modeled after the best practices of General Electric, Hewlett-Packard, and Texas Instruments. The amount an excellent performer could be given relative to a poor performer in the same job increased each year, up to a differential of 50%. Similarly, Samsung took steps to allow high performers to advance more rapidly through its seniority-based promotion system by steadily shortening the minimum number of years they were required to stay at a particular level.

Other processes could be adapted and adopted more globally. GE's Six Sigma, for example, fit well with Samsung's continuous improvement culture. But at GE only managers and specialists were involved in the system, whereas at Samsung the entire rank and file participated. Samsung similarly adopted a socialized profit-sharing program, modeled after HP's, in which all employees, not just top and general managers (as at many Western companies), are eligible for a bonus based on a percentage (up to 50%) of their salary.

This careful approach to importing Western business practices reduced disruption but also slowed progress. So, in a company where the chairman's authority coexisted with a need for consensus in the managerial ranks, Lee sought to increase receptivity to ideas from elsewhere. This he did in two ways: by bringing new thinkers in from outside and by sending insiders abroad.

Bringing Outsiders In

It is perhaps an indication of the insularity of Samsung's culture that for decades, the only outsiders the company recruited were ethnic Koreans. As far back as 1983, when it entered the memory chip business, the company had hired ethnic Korean engineers and executives away from Intel, IBM, and Bell Labs. These people had played crucial roles in Samsung's ascent in less than a decade to global leadership in the chip industry. But when Lee tried to extend the approach to Samsung's senior executive ranks—what the company refers to as S-level talent—the newcomers met with a formidable wall of resistance.

And little wonder. Because promotions at Samsung had always come from within, the newcomers were perceived to be (and actually were) taking advancement away from incumbents. Not surprisingly, incumbent managers closed ranks, setting the newcomers up to fail by withholding important information, exaggerating their mistakes, and excluding them socially.

To be fair, this reaction was in part justified: At first, some of Samsung's recruits had a poor grasp of what was expected of them, and sometimes they were actually more junior than the company had intended. What's more, success is contextual—to some degree S-level hires had performed well in their previous jobs because of their familiarity with the system. The tightly knit nature of Samsung's culture was a separate issue that needed special attention.

Take the case of Eric Kim, who in 1999 was recruited to be SEC's chief marketing officer. Nowadays, most senior SEC executives recognize Kim as the person who initiated the "Samsung DigitAll: Everyone's Invited" marketing campaign and established the strategy that turned Samsung into a truly global brand.

SEC CEO Yun Jong-Yong threw his weight behind Kim from the start, declaring to his other senior executives, “Some of you may want to put him on top of a tree and then shake him down. If anybody tries that, they will be severely reprimanded.” Nevertheless, through it all, Kim had a hard time getting support from other senior people. “Though Yun fully supported me and asked other senior executives to help me, they were reluctant to do so in my first two years at SEC,” he told us in a 2004 interview. “Now they help me on my task-related issues, but I still feel that I am emotionally isolated from them.” In conversations we had in 2004 with senior executives at SEC, several were still downplaying Kim’s contribution to the dramatic improvement of SEC’s brand. Three months after those conversations, when Kim’s contract ended, he left SEC to become the chief marketing officer at Intel.

Improving the quality of the S-level recruits—and their reception inside the company—was no small task, and Lee thought expansively about how to address it. Beginning in the early 1990s, Samsung sent international recruiting officers (IROs) abroad to familiarize themselves with foreign talent. And in 2002, Lee made 30% of the annual performance appraisal of Samsung affiliates’ CEOs dependent on hiring and retaining S-level talent. Thus motivated, Yun, for instance, took steps to ease newcomers into the organization by having them serve in an advisory capacity in their first months to get to know something of their colleagues, the culture, and the business before taking up their posts. He also instituted a formal mentoring program in which he met at least quarterly with each S-level recruit to give and receive feedback.

Samsung’s efforts to recruit and retain non-Korean MBAs and PhDs were hindered by cultural, social, and political tensions, all of which were magnified by the language barrier. To help assimilate these recruits, Lee in 1997 ordered group headquarters to set up a unique internal management consulting unit, the Global Strategy Group (GSG), which reports directly to the CEO. Its members—non-Korean graduates of top Western business and economics programs who have worked for such leading global companies as McKinsey, Goldman Sachs, and Intel—spend fully two years in GSG and are required to learn rudimentary Korean before taking up their posts. Even so, many of them have eventually been assigned to overseas subsidiaries, usually in their home countries.

Cultural fit is a hard nut to crack. Of the 208 non-Korean MBAs hired into GSG since it was created, 135 were still working for Samsung as of December 2010. The most successful are those who have taken the greatest pains to fit into the Korean culture (see the sidebar “Advice from a Returning Executive”).

Advice from a Returning Executive

Choi Chi-Hun, a graduate of Tufts with an MBA from George Washington University, spent 19 years working at GE, six at ...

Still, the rate of acceptance has been steadily rising. Before GSG, no non-Korean MBAs worked at SEC for more than three years, but fully 32% of the non-Korean MBAs recruited to SEC the year GSG was established were still with the company three years later. Over the next 10 years, that figure rose to 67%. The effect of these employees on the organization has been something like that of a steady trickle of water on stone. As more people from GSG are assigned to SEC, their Korean colleagues have had to change their work styles and mind-sets to accommodate Westernized practices, slowly and steadily making the environment more friendly to ideas from abroad. Today, SEC goes out of its way to ask GSG for more newly hired employees.

Sending Insiders Out

In the late 19th century, the Japanese imperial government sent its elite officers overseas to study successful Western practices and institutions. They brought back, among other innovations, the British postal system, the French judicial system, the American system of primary education, and the German military organization, adding innovative features of their own to suit the local environment. Samsung acts similarly, sending high potentials to Japan for advanced degrees in engineering; to the United States for further education in marketing and management; and to Singapore, Hong Kong, and New York for training in high finance. On returning home, these employees fill key positions and, in implementing what they have learned, become important change agents.

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Squarely in this tradition is Samsung's regional specialist program, arguably the company's most important globalization effort. Each year for more than two decades, Samsung has sent some 200 talented young employees through an intensive 12-week language-training course followed by one full year abroad. For the first six months, their only job is to become fluent in the language and culture and to build networks by making friends and exploring the country. In the second six months, they carry out one independent project of their choice. Initially sent mainly to developed countries, in the past 10 years they've gone more often to emerging regions, especially China and, most recently, Africa.

Like their colleagues who have trained abroad, the specialists come back to major posts at headquarters or in the business units at home and abroad. In those roles they disseminate information about how successful foreign companies operate, and they advocate for and experiment with best practices.

It would be hard to overestimate the value of the connections regional specialists forge. One of the first specialists, for example, went to Thailand in 1990, where he became fluent in the language and established relationships with prominent local figures. He stayed on to earn an MBA at the Sasin Graduate Institute of Business Administration at Chulalongkorn University, the same school that many of Thailand's prime ministers and high-ranking government officials and corporate CEOs have attended. From his immersion he gained a comprehensive understanding of the country's regulations and tax systems. His close ties enabled him to introduce SEC's TV, audio, and video products to Thailand's elite and to recruit a vice president of Hitachi to Samsung at a time when Hitachi was a market leader and Samsung was virtually unknown.

He is hardly alone. Another regional specialist, who went to Indonesia in 1991, used his language fluency and personal networks to establish a sales subsidiary whose sales doubled annually for three consecutive years. A third, sent to Bangalore in 2009, devoted his project to aiding a rural community there and then applied the intimate knowledge he had gained to the development of home electronics that Samsung could sell in the region.

Regional studies are markedly out of fashion these days in business schools, as discipline-based research in economics, political science, sociology, and the like has taken precedence. This has had the inadvertent effect of diminishing geographic intelligence—a global institutional void, we argue, that Samsung is a leader in filling. In fact, Samsung's experience suggests that it may be time for Western companies and business schools to place more emphasis on developing strong regional connections and expertise.

What Only the Chairman Can Do

Samsung's globalization efforts have taken substantial investments of time, money, and executive will. Some S-level hires took the IROs 10 years to recruit. SEC spends about $100,000 over and above annual compensation to train and support each regional specialist, not to mention the opportunity costs and turnover risks the company incurs by taking elite employees away from key positions for 15 months. These investments—which require fundamental trade-offs between the short and the long term and between cultural fit and domain expertise—have been made in good times and in bad, often over the objections of Samsung's top managers. That would not have been possible without Lee's unambiguous and consistent involvement.

Five years after the launch of the S-level recruitment program, support for it from Samsung Group affiliates' CEOs was distinctly lukewarm and would probably have remained so had Lee not tied so much of their compensation to its success. The Global Strategy Group, known within the company as the "chairman's project," would probably not have survived the Asian financial crisis—so deep it helped usher the Daewoo Group into bankruptcy—had Lee not funded it even in the face of Samsung's own record-breaking losses.

David Steel, executive vice president of SEC and the highest-ranking person to come out of the GSG, noted that the commitment of top management and the support of the managerial ranks are both necessary for the success of a program like this. Much of the chairman's influence is transmitted symbolically. But the substance and symbolism of that support are no small thing.

Lee's long-term focus has been essential to his most recent initiative: the development of Samsung's design expertise, a capability the chairman believes will be critical for the company's continued growth. Just as many never imagined that Samsung could become a dominant global player, many question its design aspirations. But Lee set the agenda back in 1996. That year Samsung established and funded the Samsung Art & Design

Institute in collaboration with Parsons the New School for Design in New York. A substantial number of graduates of the intensive three-year training course have joined Samsung as designers. Following that lead, SEC has established design research institutes in the United States, the United Kingdom, Italy, Japan, China, and India. Each year SEC sends 15 designers abroad to prominent design schools for one to three years to learn cutting-edge trends. As a result, SEC has won a panoply of design awards. Combining this design excellence with its traditional technological competence has allowed the once low-cost imitator to sustain a high-price strategy for its TVs and cell phones.

As long and hard as the company's transition has been, the hybrid model has brought Samsung not to a pinnacle but to another plateau, which it will once again need to transcend. To keep steadily moving upward, it will have to reach a higher level of diversity and decentralization—to become a Brazilian company in Brazil, for instance, not a Korean company that does business in Brazil. It will need to find new models for new practices so it can once again move beyond its current strengths and deal with further paradoxes that may arise. That's an effort that bears watching, not only by the new generation of emerging market companies but also by Western competitors, which someday may reach the limits of their ability to impose Western culture on the rest of the world.

The HBR Blog Network has run commentaries on this article from Tony Elumelu, Federico R. Lopez, Gokhan Erun, and Anand Mahindra and Rajeshwar Tripathi.

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- **Tarun Khanna** is the Jorge Paulo Lemann Professor at Harvard Business School, the director of Harvard's Lakshmi Mittal South Asia Institute, and the author of *Trust: Creating the Foundation for Entrepreneurship in Developing Countries* (Berrett-Koehler, 2018).
- JS

  Jaeyong Song (jsong@snu.ac.kr) and

- KL

  Kyungmook Lee (kmlee@snu.ac.kr) are professors at Seoul National University in South Korea.