Two tales of one city: Samsung, Daewoo, and lessons on large-scale transformation
By Donald Sull

Many emerging market companies expand beyond their home markets to diversify cash flows, hit growth targets, achieve economies of scale, or access global capital markets. Despite compelling reasons to expand abroad, the process of globalization remains difficult and fraught with risk. As they expand beyond their home markets, emerging market companies must woo customers with different preferences; battle entrenched competitors desperate to protect their home turf; navigate unfamiliar regulatory terrain; and nurture an ecosystem of suppliers, distributors, and alliance partners.

When emerging market champions struggle to globalize, their failure is often attributed to ignorance, complacency, or arrogance. While these may play a role, failure to globalize often results from a more fundamental dynamic. The very commitments that enable an emerging market company to succeed at home to harden over time, reinforced by success in the local market. These hardened commitments, in turn, channel the company’s efforts to globalize into well-worn grooves. As emerging market companies expand into new markets, they often fall prey to active inertia, the tendency of firms to respond to different market conditions by persisting in, or even accelerating, activities that worked in the past.

To succeed, executives must make a set of commitments that together constitute an organization’s success formula. An organization’s success formula, which is sometimes referred to as its business model, consists of five categories of commitments. Strategic frames are the shared cognitive models that help organization members interpret new data, measure success, and define how to compete. Processes are the recurrent procedures used to get work done, including both informal and formal routines. Resources refer to tangible and intangible assets that create economic value, such as brand, technology, real estate, expertise, etc. Relationships are the enduring associations forged with external individuals and organizations, including customers, regulators, suppliers, distributors, and other partners, who contribute to an organization’s success. Values are the shared norms that inspire and unify employees and constitute the core of its corporate culture.

This bundle of commitments, taken together, constitute a firm’s success formula. Strong commitments confer several advantages. Clear strategic frames focus employees on what matters most, well-honed processes confers efficiency, deep relationships attracts external fund and create switching costs for customers, while investing in tangible and intangible resources help firms create, capture and sustain economic value. Initial success reinforces management’s belief that they should fortify their success formula. With time and repetition, people stop considering alternatives to their commitments, and take them for granted. The individual components of the success formula grow less flexible.

When firms face a new external conditions, such as a disruptive technology in their core market or different requirements in a new market, their response is channeled into well-worn grooves. They respond to changed circumstances with more of what worked in the
past. Inertia is often equated with delayed or half-hearted response to environmental change. Companies suffering from active inertia, however, often respond quickly and vigorously to new circumstances, unleashing a flurry of initiatives. Their frenetic activity is not adaptive, however, because it is constrained by hardened commitments that are no longer appropriate to the market conditions.

To adapt to changed circumstances, such as entering new markets or responding to disruptive shifts, executives must avoid the temptation to respond within the confines of existing commitments. Rather, they must step evaluate their current commitments to determine which are hindering the firm from effective adaptation, which will remain critical in the future, and what new commitments will be required to thrive in new conditions. Based on their analysis, managers must generally transform their success formula, changing some commitments while maintaining others.

This chapter will explore some lessons on how to lead a successful transformation drawn from a comparative case study of Samsung and Daewoo. These two chaebol, or family-controlled confederations of diverse operating businesses, evolved over parallel histories and forged similar success formulas. Samsung and Daewoo both relied on close relationships with the government for funding and protection in the Korean market. In their early years, both groups focused on fulfilling demand in Korea, and drove volume to achieve scale economies rather than winning through high quality or brand.

As recently as 1993, Samsung and Daewoo were comparable on several dimensions. Of Samsung’s 18 major lines of business, 14 overlapped with Daewoo’s portfolio companies, including construction, shipbuilding, telecommunication devices, consumer electronics, and display devices. When the results of their major businesses were consolidated, the two groups were comparable in terms of assets ($26 billion for Samsung, $25 billion for Daewoo), book equity ($7 billion for both groups), and profitability ($345 million for Samsung and $289 million for Daewoo).

The chairmen of both groups launched ambitious strategies within a few months of one another. In March 1993 Daewoo chairman Woo-Choong Kim launched the group’s “Global Management Initiative” which set out the group’s aggressive plan to expand abroad. In June of that year, Chairman Kun Hee Lee unveiled his vision of “New Management” in a meeting of Samsung’s top executives in Frankfurt, Germany. Both visions articulated a vision for taking their respective groups to global leadership. Over the rest of that decade, both groups implemented their globalization strategies.

Despite the similar beginnings, the Daewoo and Samsung stories had very different endings. Daewoo globalized without transforming its success formula, accumulating massive operating losses in the process, which it covered with short- and long-term debt. By 1998, Daewoo’s interest burden was twice its operating profits. The next year, Korea’s Financial Supervisory Commission rejected Kim’s request for financial support to restructure the balance sheets of Daewoo’s largest affiliates. In July, 1999 Kim sent a farewell letter to all Daewoo employees then fled the country when warrants were issued for his arrest. Korean prosecutors accused him of mastering the biggest fraud in history,
as well as embezzling $2 billion. The Daewoo businesses were forced into financial workout, where creditors oversaw the sale of assets.

Even as Daewoo was dismantled and Chairman Kim fled the country, Samsung’s flagship Electronics business was emerging as an unequivocal global leader. By 2003, the Samsung brand was among the 25 most valuable brands in the world (ahead of Dell and Nike). Samsung Electronics was at the cutting edge of such leading technologies as flat panel displays, semiconductors and cellular phones, and was fourth among all companies in the world in patents granted in the U.S. The combined revenues of the Samsung Group’s affiliated companies exceeded $100 billion, and the group’s listed subsidiaries accounted for over one-quarter of the total market capitalization of the Seoul stock exchange. This chapter will explore the differences between Daewoo and Samsung, and draw broader lessons about leading successful large-scale transformation.

**Active inertia and globalization at Daewoo**

Few cases better illustrate how active inertia limits a firm’s ability to globalize than South Korea’s Daewoo Group. Woo-Choong Kim founded Daewoo Industrial in 1967 with only five employees, but had great aspirations for his enterprise from the start. The name Daewoo means “great universe” in Korean. Within 15 years of its founding, Daewoo had fulfilled its founder’s grand ambitions, emerging as one of South Korea’s largest chaebol. By the early 1980s, Daewoo had emerged as one of the four largest chaebols measured by assets and revenues. Samsung and Daewoo—as the second- and third-largest chaebols, respectively—were frequently compared to one another by the business press and government agencies such as Korea’s Fair Trade Commission.

Daewoo’s dramatic rise began in 1970, when Kim—through sheer persistence—convinced major U.S. retailers, including Sears, J.C. Penney, and Montgomery Ward, to purchase inexpensive textiles from his firm. While calling on his new American customers, Kim learned that the U.S government was planning to establish a quota for textile imports and would likely set percentage allocations for foreign suppliers based on their recent market shares. Kim bet all of Daewoo’s limited resources on an effort to increase its share of U.S. textile imports, sacrificing product quality and profits in his quest for volume. When quotas were set in 1972, Daewoo was allocated nearly a third of South Korea’s share, and this quota provided a steady cash flow to fund future growth. Daewoo’s success as an exporter also qualified it for subsidized financing, bank loans, and permits for capacity expansion from the South Korean government.

Kim established the key commitments that composed Daewoo’s success formula in the first few years of the group’s life. Daewoo would emphasize quantity over quality, pursuing strong revenue and share growth at the expense of profitability, and it would invest comparatively little in resources such as brand and technology. It would also cultivate a close relationship with the South Korean government to secure cheap funds and protection from competitors. Kim benefited in this regard from his personal ties with South Korea’s ruler, General Chung Hee Park, who had been a student of Kim’s father. In addition to his personal relationship with General Park, Kim forged close ties with the
government by hiring former government officials and state bankers as executives. He also hired heavily from Kyunggi High School and Seoul National University, which had historically produced most of Korea’s government officials. In the late 1980s, for example, 13 of South Korea’s 17 governmental ministers were graduates of Seoul National University, and seven were alumni of Kyunggi High School.

Kim’s close relationship with the Korean government paid handsome dividends. General Park’s government provided Daewoo with loans at 6% to 9% annual interest during a period when inflation ranged between 8% and 42% annually and private banks (which were, along with government-controlled banks, major sources of financial resources for Korean firms) charged interest rates exceeding 40% for corporate borrowers. Kim used the profits from textile exports and access to subsidized capital to expand rapidly during the 1970s of through acquisitions. And Kim’s personal values—relentless perseverance and fearless risk taking—permeated Daewoo’s corporate culture.

Throughout the 1970s and 1980s, Kim fortified the commitments that constituted Daewoo’s success formula. In exchange for favorable subsidies and permits from Park, Daewoo invested in industries the government targeted for growth in its five year plans for economic development, including heavy machinery, shipbuilding, chemicals, automotive parts, and consumer electronics. Daewoo expanded aggressively in each industry, competing through high-volume production rather than leadership in brand, quality, or technology. General Park provided Kim with access to potential acquisition candidates and, in some cases, urged Daewoo to acquire ailing companies over Kim’s objections. Success was measured in terms of revenue growth, not profits.

During the 1980s, Daewoo’s success began to attract widespread attention in Korea and abroad. During the mid-1980s, Kim won the International Business Award from the International Chamber of Commerce, received an honorary doctorate from two prestigious Korean universities, and was listed as one of the 50 most fascinating businesspeople by Fortune magazine. In 1989, Kim published Every Street is Paved with Gold, a book that codified Daewoo’s success formula and advised other managers to make similar commitments. Sales of Kim’s book surpassed the 1 million mark in record time, earning the book a place in Korea’s Guinness Book of Records for the shortest time to sell a million copies. Two years later, Kim donated the royalties from his book sales to construct a building bearing his name at the College of Business and Economics of Yonsei University, from which he had graduated.

All went well until 1979, when Park was assassinated, and major shifts in the political and regulatory climate threatened Daewoo’s position in Korea. Subsequent governments opened South Korea’s product and capital markets to the outside world and withdrew much of the support for Daewoo and the other chaebol. It soon became clear that two decades of heavy investment by the leading chaebol had caused significant overcapacity in many domestic industries. At the same time, Daewoo was caught in a competitive vise. Chinese exporters were undercutting it on price, and Japanese firms leveraged superior technological acumen and brand strength to win share in high end markets.
Kim and other Daewoo executives saw the market shifts—the developments were impossible to miss—but responded by accelerating actions consistent with Daewoo’s historical success formula. They expanded the company aggressively, confident that the government would bail them out in case their bets failed. They continued to court South Korean politicians. The company also choose to globalize, but did so in a way consistent with how they competed in South Korea. Kim repeatedly told employees and journalists that world-class quality was not a prerequisite to competitive success in global markets. He argued that Daewoo could continue its growth by targeting countries, like Korea in earlier decades, that did not value high-quality products. Kim observed:

*It is not true that only those firms having globally first-class products will survive in global markets. America and Europe are not the only markets. In fact, there are a lot of countries in the world where firms can dominate the markets with products of less technical sophistication. With Daewoo’s current level of technology, we can make at least 70% of the products that are globally traded.*

Kim did launch initiatives to increase quality and technological innovation, but failed to follow through on these programs. In 1990 Kim announced a group-wide quality improvement program, which yielded impressive initial results. Defect rates at Daewoo Shipbuilding, for example, decreased 80% between 1991 and 1992. The group-level program ended two years later, before the initiatives were embedded throughout the organization. In August 1993, Kim announced a plan to achieve world-class technology by building a group-level research center and employing over 600 researchers with Ph.D. by 1995 and 2,000 by the year 2000. Daewoo did build an Institute for Advanced Engineering in 1995 but by two years later had just over 200 researchers with PhDs. Samsung Electronics, in contrast, had 598 researchers with doctoral degrees, LG Group had 536, and Hyundai Group had 356 in their research institutes that same year.

In March 1993 chairman Kim launched Daewoo’s “Global Management Initiative” which set out the group’s aggressive plan to expand abroad. In selecting which markets to enter, Kim sought countries with limited domestic production and relatively unsophisticated demand in terms of product quality. He also sought nations, including Vietnam, China, India, Poland, Romania, the Sudan, and Kazakhstan, in which the government played an active role in economic policy. Kim personally participated in negotiations with government officials in every country Daewoo entered.

In Uzbekistan, for example, Daewoo agreed in 1993 to build a green-field automobile factory and export half its production. The Uzbekistan government, in exchange, provided a free factory site, eliminated tariffs on manufacturing equipment, invested in necessary infrastructure, guaranteed Daewoo’s loans, and imposed tariffs on imported automobiles. The close relationship between Daewoo and the government caused some commentators to joke that the country should be renamed “Daewooistan.” Critics argued that Daewoo’s global management constituted “a global diffusion of an undesirable tradition of Korea, the cozy relationship between business and government.”

Kim continued to set aggressive growth targets as part of Daewoo’s global management initiative and measure success in terms of sales growth (rather than profit). The total
number of global “networks” was planned to grow from 175 in 1993 to 650 by the year 2000. Global networks referred to all branch offices, research institutes, and construction sites, as well as foreign subsidiaries. The number of global networks exceeded the number of affiliates because each affiliate could have multiple subsidiaries, foreign subsidiaries, and so on. Daewoo planned to expand the number of countries in which the group operated from 70 in 1993 to approximately 150 by 2000. Kim also set the goal of increasing the group’s revenues from 26.4 trillion won (including foreign subsidiaries’ 5.5 trillion won of revenues) in 1993 to 138 trillion won (including 57 trillion won of foreign subsidiaries) by 2000.

Kim continued to rely on debt to fund growth. Daewoo borrowed as much as $47 billion to fund the investments, exceeding the foreign national debt of several of the countries where the group operate. But while local governments could guarantee loans, they couldn’t guarantee consumers’ demand for Daewoo’s products. By the mid-1990s, several of Daewoo’s operations were running well below capacity. In the wake of the IMF bailout of South Korea in 1997, Daewoo, like the other chaebols, faced a sharp increase in interest rates and the cost of servicing dollar-denominated debt.

In the wake of Korea’s economic crisis, Kim resisted calls to decrease the Daewoo debt by divesting assets. Rather, he viewed the financial crisis as an opportunity to acquire valuable assets at bargain prices. In December 1997, for example, Daewoo acquired the assets of Hankook Electric Glass and in January 1998 the assets of Ssangyong Motors, as those companies faced near bankruptcy. Daewoo also increased its foreign direct investment during this period.

Domestic banks were reluctant to lend to fuel Daewoo’s expansion. As a result, the affiliate companies turned to global capital markets. The Daewoo affiliate companies thus had to issue corporate bonds and short-term commercial paper to fund acquisitions and expansion. In 1998, the borrowings from issuing commercial paper and bonds increased by approximately US $14 billion, and by late 1998, the average annual interest rate on Daewoo’s commercial paper and bonds was 3% to 5% higher than the average paid by other chaebols. Daewoo’s interest expenses increased from 3 trillion won in 1997 to 5.9 trillion won in 1998, nearly double its 1998 operating income of 3 trillion won. In July of 1999, Kim visited Korea’s Financial Supervisory Commission (FSC) to request financial support to restructure the balance sheets of the group’s largest affiliates. Although the FSC provided some financial assistance, it was insufficient to prevent Daewoo’s collapse, and Kim fled the country.

Chairman Kim saw the changes impacting Daewoo, recognized the need to go global, developed a strategy to expand abroad, and aggressively executed his plan. Unfortunately, his actions to take Daewoo global were channeled by the group’s existing commitments into well-worn grooves. As the chaebol expanded abroad, Daewoo forged relationships with government officials, pursued a strategy of low quality and high volume, framed their strategy in terms of revenue growth, failed to invest in technology or brands, diversified its resource base across different businesses, and valued risk taking
and persistence above all else. While these commitments had served Daewoo well for decades in Korea, they were poorly suited to the new situation.

The Daewoo story is a cautionary tale that illustrates a key point about expanding beyond a firm’s domestic market. Successful globalization often requires more than simply opening overseas offices or exporting products overseas. Leaders must evaluate whether the set of interwoven commitments that enabled their historical success will work in the future. If the answer is no, executives must actively transform the company’s success formula—unpicking historical commitments that are hindering adaptation, reinforcing those that remain critical to future success, and making the new commitments when necessary.

Transforming a system of interdependent commitments is difficult. Employees and managers are familiar with existing ways of doing things and resist changing their behavior. To the extent the success formula continues to work, employees are reluctant to fix a system that is not seen as broken, especially if the alternative is unclear. Even a company’s success formula with a poor fit to current circumstances confers advantages, including the efficiency of commitments that have co-evolved over time and the external legitimacy of conforming to historical industry norms. The interdependency among component commitments renders piecemeal change difficult and systemic transformation daunting.

Finally, executives are reluctant to reverse historical commitments to the extent that such reversals might be construed as an admission that they were wrong in the past. After publishing a bestseller extolling Daewoo’s success formula, changing those commitments would be a public reversal for Kim. The long list of obstacles to successful execution may suggest that transformation is impossible for established organizations. Active inertia, in this view, is inevitably fatal. It is, however, possible to successfully transform historical commitments and adapt to changed circumstances, as the Samsung case illustrates.

**Successful transformation at Samsung**

Samsung’s origins were similar to those of Daewoo. Lee Byung Chull founded Samsung in 1938 to export dried fish and produce to China. When North Korean troops invaded in 1950, Lee was forced to abandon his operations in Seoul for the duration of the war. After the war ended in 1953, Lee rebuilt his company virtually from scratch and by 1959, Samsung had emerged as one of the largest business groups in South Korea. When General Park came to power in 1961, he charged Lee and 10 other prominent businessmen with treason for allegedly bribing officials in the preceding administration—a charge that carried the death penalty.

Lee escaped execution, however, by winning an audience with Park and convincing him that Samsung and the other chaebols could help rebuild Korea’s economy. Along with Daewoo’s Kim and a dozen other prominent executives, Lee cofounded the Federation of Korean Industries in 1961 and served as its first chairman. The federation members
worked closely with government officials to develop the country’s five-year economic plans. Lee and the chairmen of the other leading chaebols, in turn, followed the government’s lead in their strategic planning. In 1967, Samsung introduced its first “five-year management plan,” which targeted the industries supported by the government’s economic planners.

Like Daewoo, Samsung grew rapidly throughout the following decades. The group entered a variety of unrelated businesses including advertising, resorts, shipbuilding, life insurance, and petrochemicals. Samsung executives focused throughout this period on rapidly increasing revenue growth rather than profits through diversification. Larger chaebols (as measured by revenues and assets) were more likely to receive government support for subsequent expansion, and government-subsidized financing reduced the need to generate operating cash flow to fund investments and acquisitions.

Employees often referred to the groups’ shared set of values as “the Samsung spirit.” Chairman Lee believed that Samsung existed to help Korea recover after the war. Well into the 1960s, Lee attended the final round of interviews for all candidates for managerial positions to determine whether they shared the values of helping Korea recover. Lee also emphasized an ethic of persevering against all odds and often rallied employees with the phrase “the only way is forward.”

When Lee Byung Chull died in 1987, his third-born son, Lee Kun Hee, succeeded him as chairman. The 45-year-old (hereafter referred to as Lee) had studied business at Waseda University and received his MBA from George Washington University in Washington, D.C. Lee joined Samsung’s broadcasting affiliate in 1966 and in 1978 became the vice chairman of the Samsung Group. Lee was an early advocate for Samsung’s entry into the semiconductor business, although he had to overcome his father’s initial skepticism. Lee recalled:

*After the oil shock in 1973, I was keenly aware that Korea lacked abundant natural resources. The only weapon we had to compete with firms in advanced countries was our brains. We had to go into high-tech businesses, so I visited the U.S. and Japan and found people using computers everywhere, and I became convinced that semiconductors would be needed everywhere. But my father was opposed to this highly risky business.*

Four months after succeeding his father as chairman, Lee declared Samsung’s “second foundation” during the celebrations surrounding the group’s 50th anniversary. Lee pledged to restructure Samsung’s portfolio to focus on businesses capable of producing world-class products by the twenty-first century. In 1991, Lee announced that Samsung would divest its profitable department store and paper businesses because they were considered inconsistent with the chairman’s vision. Although disposing of the affiliates took place over several years, the affiliates were managed independently of the group soon after the announcement.

Lee also committed to establishing Samsung as one of the world’s top five electronics firms. To gain scale in that sector, Lee merged Samsung’s electronic, semiconductor, and telecommunications affiliates to create Samsung Electronics in November 1988. Samsung also sharply increased spending in electronics research and development and
opened the group’s Advanced Technology Research Center in January 1990. In 1992, Lee announced Samsung’s intention to produce automobiles by 1998. Lee viewed automobiles as a logical extension of the group’s focus on electronics and noted that electrical and electronic parts were forecast to constitute 60% to 70% of a car’s total value by 2010.

In the early 1990s, Lee grew increasingly worried that Samsung was not moving quickly enough to become a global leader. In an essay distributed to all employees, Lee later recalled:

*I had emphasized the necessity of change and innovation since my inauguration. Although some years had passed, nothing had changed. The inertia of the 50 long years of Samsung history was too hard to break. I often felt cold chills from my premonition of crisis, suffered from insomnia, and lost 25 pounds between the summer and winter of 1992. I felt that the entire Samsung Group—not just a few affiliates—would disappear if nothing changed.*

In 1993, it looked as if Samsung might suffer the same fate as Daewoo. Samsung, in that year, was a successful Korean competitor, led by a chairman who recognized the need to globalize, seemed trapped by “the inertia of 50 long years of Samsung history [that] was too hard to break.” Despite their similar beginnings, the Daewoo and Samsung stories had very different endings within a decade. Yet, Samsung’s leadership team successfully transformed the group to compete effectively in global markets. The contrast between Samsung and Daewoo illustrates four critical lessons for emerging market companies attempting to globalize, and more broadly for large complex organizations attempting fundamental transformation of their success formula.

*I. Move beyond abstraction to visceral understanding of what vision means.* Research on organizational change emphasizes the importance of a compelling vision to guide transformation. Vision alone, however, does not account for the differential outcomes at Samsung and Daewoo. Lee announced Samsung’s “New Management,” his vision for globalization, within a few months of Kim’s launch of Daewoo’s “Global Management Initiative.” Both chairmen laid out visions of moving beyond Korea to compete on the global stage.

Visions fail to galvanize transformation, in part, because they never move beyond abstract aspirations, such as “globalization,” “excellence,” “innovation,” or “sustainability.” Many Korean executives agreed with the importance of globalization in theory, but their worldview remained intensely local. Their mindset was captured by the route maps found in the in-flight magazine of Korean Air, which showed Seoul as the center of the globe with routes extending outward in all directions. The problem, of course, was that only a small fraction of the planet’s population saw the world the same way.

To motivate and guide action a vision must move beyond the abstract and resonate for leaders at a visceral level. An intuitive understanding of the gap between where a company is and where it wants to be provides the motivation for change. A visceral understanding of what global (or innovative or sustainable) looks like in practice informs
leaders’ judgment in prioritizing activities and allocating resources to make progress in achieving the vision. Finally, a gut-level understanding of what the aspiration would mean concretely helps managers to communicate what the company is trying to achieve, and why it matters.

Lee had a deeply ingrained understanding of global markets and competition based on his personal experience of studying in Japan and the United States, and travelling widely. Kim, in contrast, had studied and spent the vast majority of his professional career in Korea, and lacked any first-hand experience of global markets. When Lee talked about the importance of globalization, he spoke from a deep well of experience and personal conviction. For Kim, in contrast, globalization remained an abstraction divorced from his own experience.

For a transformation to gain traction, it is not sufficient that a few leaders at the top possess a visceral understanding of the company’s overarching vision. It is equally important that the middle managers charged with executing that vision share their understanding. Lee wanted to ensure that his key leaders shared his gut-level understanding of what global competition entailed, and the gap between Samsung and global leaders. He orchestrated a series of meetings that provided middle managers with first hand experience of what customers outside of Korea expected, and what the best global rivals had to offer.

In early 1993, Lee convened a meeting of 23 senior executives of Samsung Electronics in Los Angeles, their first meeting outside of Seoul. Before the meeting began, Lee took the managers to visit local electronics retailers, where they were dismayed to find their products stacked in corners gathering dust, while market leaders like Sony enjoyed prominent position and commanded a price premium. Dismayed by the gap between their self-image and how American consumers perceived their products, the Samsung executives realized, based on first-hand experience, the gap between their products and the world’s best in terms of quality, technology, and brand. In the next seven months, Lee arranged similar meetings for Samsung’s top 1,800 executives in Japan, Europe and the U.S. so they too could see Samsung as others saw them. The visits to foreign electronics retailers helped jolt Samsung executives out of their parochial mindset, and instill a deep global perspective throughout the ranks.

New metrics can also reinforce a visceral understanding of what company’s vision really means. At Samsung, Lee insisted that managers stop benchmarking their division’s performance against other South Korean companies like Daewoo and Hyundai. Instead, performance was measured against the world’s best performers in each segment. To deepen managers’ understanding of what it took to compete globally, Lee not only shifted who was benchmarked, but also what metrics would measure success. To emphasize the innovation and quality necessary to compete against the world’s best players, the metrics used to evaluate Samsung managers were shifted from unit volumes and sales growth, to proxies for innovation (e.g., percentage of revenues from new products, patents applications filed, patents granted) and product quality (e.g., defect rates, product recall rates).
Gaining a visceral understanding of what global (or sustainable or innovative) means in practice generally represents a rude awakening to local leaders. They must grapple with the magnitude of the gap between where they are and where they aspire to be. They must also acknowledge the scope of activities necessary to close that gap. In going global, for example, Samsung need to be competitive not only in product markets, but also in markets for assets, talent, capital, technology, and raw materials and across a range of competencies including operations, governance, post merger integration, information technology. Key leaders require the intellectual honesty to stare the facts in the face and humility to accept the reality that they have a very long way to go before they close the gap with the best in the world. They also need the emotional resilience and energy to make that journey.

II. Link vision to drivers of economic value creation. Transformation attempts are often framed in terms of visions that are appealing and exciting. Unless these visions are linked to the drivers of economic value creation, however, they are unlikely to be sustained, at least in for-profit companies. Chairman Kim’s strategy for globalization had, at best, a tenuous link to economic value creation. Daewoo sacrificed profits for volume, while failing to capture potential economies of scale because production, marketing, and distribution were fragmented globally. Measuring success in terms of unit and revenue growth, rather than cash flow generation, masked the group’s value destruction, which was funded by short- and long-term debt. Kim’s vision was truly global—within a few years Daewoo had operations in more than a dozen countries around the world—but it was unmoored from value creation.

Forging a clear linkage between the transformational vision and the drivers of value creation is critical for three reasons. First, a hard-nosed focus on economic value creation provides the cash required to cover the costs of transformation, which include disinvestment from profitable operations that do not support the vision and investments that will only pay off in the future. Second, anchoring a vision in terms of how a company will increase customers’ willingness to pay or cut comparative costs makes it easier to sell within the organization. Finally, translating vision into measurable drivers of value creation provides clear criteria for prioritizing activities and allocating scarce resources.

Samsung’s strategy to globalize was clearly linked to the drivers of economic value creation in their target industries. Lee commissioned studies to evaluate what was required to compete globally in each of the group’s major businesses. In late 1993, Lee announced that Samsung would merge or divest more than a dozen companies deemed incapable of producing world-class products or services. Among the divested companies was Cheiljedang, the sugar manufacturing business that was one of the first Samsung companies and had been closely associated with the group and Lee family for 40 years. Lee divested other profitable ventures including paper, textiles, department stores, amusement parks and a mining venture in Alaska where Samsung lacked the competencies, resources, or market position to compete on the global stage.
Lee decided to focus Samsung on technology-intensive business including displays, consumer electronics, and semiconductors. Through extensive analysis, as well as first hand research, Samsung’s consumer electronics team learned that customers’ willingness to pay a premium for these goods depended on high quality, a strong brand, and a constant flow of technological improvements. Beginning in 2003, Lee declared the key objectives for Samsung Electronics to be improving product quality to world-class standards, building a global brand, and leading in relevant technology. These were ambitious objectives given where Samsung started, but they were also clearly linked to the drivers of customers’ willingness to pay, and hence economic value creation.

Transformation poses not only strategic and organizational challenges, but also thorny financing issues. Focusing on the soft side of transformation—the cultural and behavioral aspects—while ignoring the financial implications can derail an otherwise sound change effort. When he could no longer secure government funding, Kim issued over $10 billion in high-yield bonds to finance his global expansion, leaving his company vulnerable when expected profits failed to materialize. The finance function in Samsung, in contrast, was tenacious in asking the hard questions, dislodging necessary cash, and lining up sources of financing matched to the time horizon and risk profile of the group’s transformation.

III. Make transforming commitments. Transforming commitments are binding actions, such as capital expenditure, disinvestment, or personnel decisions, that remake an organization’s success formula by increasing the cost (or eliminating the possibility) of persisting in the status quo. An entrepreneur’s early commitments define an organization’s success formula, and later investments can reinforce the business model, but transforming commitments explicitly aim at remaking the bundle of interconnected frames, processes, resources, relationships, and values that shape behavior within an organization.

In established organizations, change initiatives are often viewed as a passing fad. Middle managers pay lip service to the new vision, avoid changes in behavior, and hope that the initiative will pass. Kim’s initiatives to increase product quality and research in Daewoo suffered just this fate. After initial progress, both efforts ran out of steam within a few years. Absent decisive actions by leaders, the gravitational pull of an organization’s historical success formula will drag the company back into the status quo. Decisive actions not only convince employees and external stakeholders that top executives mean business. They also serve as a wake up call that signals not only the company is in a crisis, but also that management has a way forward.

To pull employees out of active inertia, leaders need to make irreversible commitments to the transformational vision and the drivers of economic value creation that support that vision. Samsung’s Lee took a series of quick and decisive actions that forced Samsung forward and prevented it from sliding back into the comfort of familiar activities. After divesting legacy companies that could not compete globally, Lee reconfigured the composition of the senior management team. Nine of Samsung’s senior most executives were relieved of operational responsibility and shifted to advisory positions, while over
one hundred junior managers were promoted over their bosses. This wave of promotions was the largest since Samsung’s founding and was particularly surprising because the junior managers were promoted over the heads of executives who had been critical to Samsung’s historical success.

Lee also made large and sustained investments to achieve the company’s objectives of building a global brand and world-class technology. Samsung’s annual spending on global advertising increased more than five-fold between 1993 and 1999. Annual investments in research and development increased three-fold over that same time period. Samsung funded much of this increased spending with the proceeds from asset disposals. Taken together these bold actions signaled to the organization that Lee meant business. Sticking to business as usual or waiting for the new initiatives to blow over was not an option.

IV. Maintain transformation momentum. A large scale transformation typically requires a decade to complete. Changing an organization’s success formula is difficult, frustrating, and stressful for the managers who must lead the charge. Sustaining effort would be easier if progress were steady and even, but it rarely is. In the Samsung case, for instance, Lee believed that Samsung had little to show for the first six years of his change effort. Even after making transforming commitments beginning in 1993, the relationship between investment and result was not linear. Samsung began its heavy investment in research and development in 1993, but innovation (measured by the number of US patents granted) did not increase significantly until six years later. Nor was progress smooth. Group level net income trended upwards throughout the 1990s, but experienced volatility driven in large part by the prices of semiconductors.

The loss of momentum has a differential impact on employees depending on their level of enthusiasm for change. In most organizations, a small minority—10-15%—will wholeheartedly embrace change, while a comparable group will vehemently oppose new practices. The majority of employees will sit on the fence, and wait to see how events unfold. If initial change initiatives falter, the advocates will lose credibility and confidence and may leave the organization, while the opponents are emboldened and may grow more obstreperous. The silent majority will increase the threshold required for them to personally commit to change. A loss of momentum not only delays transformation, it makes it harder to accomplish at all.

One way to maintain momentum is by plotting progress over time. Achieving global leadership required hundreds of changes—large and small—to every aspect of Samsung’s success formula, including strategic frames, processes, relationships, resources and values. The new product development process, for example, was shifted from backward engineering and copying existing products to designing cutting edge products superior to rivals’ offerings. Manufacturing processes were improved through quality programs, including a “line stop program” in which any employee could stop the entire production line when they discovered a product defect, and the line could not be restarted until the source of the defect was identified and eliminated.
No company can, or should, try to change all elements of their success formula simultaneously. Rather they should prioritize the most important changes, make those, then move on to others. Samsung did just this. As importantly, the leadership communicated these changes in a consistent manner over time. Every year, senior leaders would show a chart divided into three columns. The left-most column listed changes the company had successfully made, the middle column highlighted the initiatives prioritized for that calendar year, and the right-most laid out important changes that the company would tackle in the future. This simple graphic helped managers and employees recognize progress and better understand how the distinct initiatives fit into the big picture.

Leaders can also use external crises to maintain or accelerate momentum. The Korean Won crisis of 1997 hit Samsung hard. The group’s consolidated debt was approximately $38 billion at then-current exchange rates, $28 billion of which was classified as current, and the debt-to-book equity ratio stood at 366% at year end. While his counterparts at other chaebol saw the crisis as a disaster, Lee saw it as an opportunity to accelerate changes within Samsung. He explained to executives in December 1997: “So far, I have strongly appealed that we need to change. But we haven’t changed enough because we didn’t share a sense of crisis. Now everyone feels that the crisis has come, and we have a good chance to use the crisis to improve our competitiveness.”

Lee used the financial crisis to driver a series of hard decisions. In 1998, he reduced the size of the secretary’s office from 250 to 150 employees to enhance the autonomy of the four sectors and the affiliated companies. Between April 1998 and April 2000, Samsung divested affiliated businesses from 61 to 45. Divestments included Samsung’s sale of its construction machinery division to Volvo, the forklift business to Clark, and the Bucheon memory chip fabrication plant to Fairchild, which Lee himself had acquired in 1974. Samsung reduced the number of employees from 267,000 in 1997 to 161,000 in late 1999 through disposal of affiliates, downsizing, and outsourcing. Samsung eliminated transfer prices across affiliates and required them to buy and sell at market prices. Debt guarantees across affiliates were completely eliminated by April 2000.

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2 For in-depth discussion of Dae Woo, see Donald Sull, Choelsoon Park and Seonghoon Kim, 2004, Samsung and Daewoo: Two Tales of One City, Harvard Business School case study 804-055.
6 Korea Industrial Technology Association.
7 Choi and Park.
9 “Was the Legend of Kim Woo-Choong an Illusion?” The Hankyorem, April 1999.
11 Lee Kun Hee, Read the World with Your Own Thinking (Seoul: The Dong-a Ilbo, 1997) (in Korean).