

# “Samsung's Competitive Innovation and Strategic Intent for Global Expansion”

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## ARTICLE INFO

Renee Kim (2007). Samsung's Competitive Innovation and Strategic Intent for Global Expansion. *Problems and Perspectives in Management*, 5(3)

## RELEASED ON

Monday, 03 September 2007

## JOURNAL

"Problems and Perspectives in Management"

## FOUNDER

LLC “Consulting Publishing Company “Business Perspectives”



NUMBER OF REFERENCES

0



NUMBER OF FIGURES

0



NUMBER OF TABLES

0

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## SECTION 4 || **Practitioner's Corner**

### **Samsung's Competitive Innovation and Strategic Intent for Global Expansion**

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#### **Abstract**

Samsung Electronic Company (SEC), founded in 1969, has reigned as not only the largest manufacturing company in Korea, but also one of the leading global competitors worldwide. SEC can be considered as one of very few companies that “manage to go beyond mere imitation of global competitors, leverage resources, accelerate the pace of organizational learning and manage to attain seemingly impossible goals” (Hamel and Prahalad, 1989), that is to become a global market leader. SEC's case of management and performance record is introduced in this paper to illustrate how effective management approaches that match its core strategic intent generate lasting outcomes in a company. Hamel and Prahalad's four approaches to competitive innovation are used as a framework to discuss SEC's management strategies.

**Key words:** competitive innovation, management strategies, performance, Samsung, strategic intent.  
**JEL classification:** M16, M21, N80, O32.

#### **Introduction**

The global market place is characterized with reduced trade barrier, intensified competition, shortened product life cycle, and deepening industrial segmentation. In this fast-paced business environment, companies fiercely seek to secure core competence to obtain and sustain their competitive advantages. This competitive dynamics is more apparent in high technology sector such as computers, communication and electronics. Samsung Electronic Company (SEC), founded in 1969, has reigned as not only the largest manufacturing company in Korea, but also one of the leading global competitors worldwide. Since the introduction of monochrome television sets in 1971, Samsung has grown on average 38 percent a year, broadening its product range from simple consumer electronics and home appliances to advanced information and communication equipment, computers and peripherals and semiconductors (Yu, 1999).

SEC is the world's leading supplier of digital CDMA phone hand-sets, with 26% of the market and the leading maker of dynamic random access memory (DRAM) chips, static random access memory (SRAM) chips, computer monitors and LCD TVs (Arensman, 2001). In 2005, SEC had sales of US\$79.6 billion and operating profits of US\$ 7.48 billion. This is a remarkable achievement, given that the initial conditions for SEC in technology, market potential, industry infrastructure and labor skill were highly unfavorable and foreign competitors from the US, Europe and Japan have already aggressively dominating the world consumer-electronics markets (Yu, 1999). SEC is a good example that illustrates that a business's initial resource endowment is an unreliable predictor of future global success.

SEC can be considered as one of very few companies that “manage to go beyond mere imitation of global competitors, leverage resources, accelerate the pace of organizational learning and manage to attain seemingly impossible goals” (Hamel and Prahalad, 1989), that is to become a global market leader. While other dominant Western and Japanese companies progress in marginal rate,

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SED leaps forward with innovative management and growth strategy. What underlies SEC's growth and management strategies is worthwhile to pay attention to, as it will shed light on what is required in pursuing a global market leadership. Not only is it an intriguing question to raise, but also this assessment provides a benchmark for other mediocre companies that are entrenched in low-cost, low-price strategy and survival mode.

The objective of this paper is to answer the following questions: What are SEC's core strategic intent?; How did SEC integrate its strategic intent to its operation and management to achieve global competitiveness?; and What are areas of SEC's management that need to be improved in order to obtain and sustain its global market leadership? To answer these questions, Hamel and Prahalad's framework is applied. Hamel and Prahalad (1989) describe how Japanese companies became leading global companies with four managerial strategic approaches and obtained competitive advantages and leadership in their paper, "Strategic Intent". These four managerial strategic approaches are revisited and examined in the light of SEC's circumstances.

The paper is organized as follows. It starts with discussion of the concept of strategic intent and Hamel and Prahalad's four strategic approaches, followed by section on SEC's strategic intent and SEC's strategic approaches for competitive innovation. The paper ends with discussion and conclusion about how SEC obtained competitive innovation and what needs to be improved for further growth.

### **What is Strategic Intent?**

Hamel and Prahalad (1989) state that competitiveness of Western companies decline gradually as they focus heavily on strategic fit between resources and opportunities and on strategy hierarchy, while Japanese companies continue to reinvent their market position with innovative competitiveness and surpass Western companies. What truly drives innovative competitiveness of Japanese companies in their strategic intent of becoming the global leader, "an obsession with winning at all levels of the organization and then sustained that obsession over long-term". This strategic intent is the foundation of their approach to strategy and management as it envisions a desired leadership position; establishes the criterion the organization will use to chart its progress; and encompasses an active management process by communicating the value of the target and operational definitions; guides resource allocation in response to external and internal changes. A company with strategic intent envisions future with global market leadership by folding the future back into the present and addressing tomorrow's opportunities, while other companies focus on shareholders' wealth and today's problem.

Hamel and Prahalad note that Western companies had misstep in their approach to competitor analysis by focusing on the existing resources of present competitors and consider companies as threat if they have resource to erode margins and market share. This mindset naturally leads to setting strategic objectives of making marginal improvement to competitors' technology and business practices, playing the same game better. Hamel and Prahalad differentiate global competitors as the ones that look into the resolution, stamina or inventiveness of potential competitors. Thus, instead of having competitive imitation, global competitors would form competitive innovation by fundamentally changing the rule of the game.

Hamel and Prahalad suggest four approaches to competitive innovation that were present in Japanese companies' global expansion:

1. Building layers of advantage;
2. Searching for loose bricks;
3. Changing the terms of engagement;
4. Competing through collaboration.

In the next section, each of these approaches is elaborated in terms of Samsung Electronics Co. (SEC)'s experience.

## **Samsung Electronics Company (SEC)'s Approaches to Global Expansion**

### ***Samsung's Strategic Intent***

In the 1970s and 1980s, SEC was an industry follower playing a catch-up game with a clear benchmark of Western and Japanese companies to imitate, thus it was simpler for SEC to set its strategic planning of what to do and how to do them. For example, during the 1970s, SEC managed to win the market by the *best pricing strategy*, capitalizing on the advantage of low cost production, then in the 1980s moved onto developing competitive advantage in *manufacturing efficiency and competence* to emphasize the quality. By mid 1990s, SEC caught up with major industry players with accelerated rate of technological advancement and now SEC is posing as a global market leader in various major market segments. Standing at the edge of technological progress, SEC's strategic planning is quite different from what they used to be 10-20 years ago. For example, now SEC has 8 different business units (called growth engine), in which SEC intends to maintain market competitiveness such as DTV, Displays, Memories, Mobile communications, Printers, System LSI, Mass Storage and Air control system. Clearly, SEC diversified horizontally into wider spectrum of business and its strategic planning changes accordingly, striving for continuous delivery of innovative technologies and products in these areas. SEC's current strategic planning clearly exhibits emphasis on *technological leadership* in all aspects of its business operation.

However, what remains the same is SEC's strategic intent. Since the beginning of its existence, the original strategic intent of SEC was to become a major global competitor with a premium brand position in the global market. SEC's CEO Lee continues to pursue a future without limits by overcoming its constraints of limited resources in the early period and by reinventing the rule of game in the current market platform. SEC made "a sizable stretch for the organization beyond the limits of its current capabilities and resources; creates an extreme misfit between resources and ambition". Because of the ambition and vision carried out by SEC leadership, there was consistent pursuit of technological progress and excellence, which was supported by continuous resource allocation and investment to R&D. In the following section, the case of SEC regarding how it obtains competitive innovation and arrives to industry leader position throughout the past three decades is closely illustrated.

### ***Four Approaches to Competitive Innovation: the Case of SEC***

The first approach to achieve global competitiveness is to *build layers of advantages*, which implies continuous expansion of competitive advantage, ranging from low wage costs to adding global brands. SEC used this approach progressively for past three decades. Given the poor endowment of resources, SEC set initial strategic platform for growth, which is quite different from current one. SEC in 1970, aimed to "catch-up" dominant companies in Western countries and Japan by: 1) investing in production systems; 2) acquiring the necessary technology know-how; 3) becoming competitive in world markets (Yu, 1999).

To achieve these strategic platforms, SEC expanded its production system in systematic "reverse order". SEC continues to add layers of advantages by entering into market segment in which it can compete on technological capabilities. For example, SEC selected television segment as an initial target market to enter, which was at the declining stage in advanced countries taking advantage of its abundant labor force and cheap labor costs, then introduced color television sets, which was at mature stage. For the second stage, SEC narrowed the technology gap by producing VCRs and microwave ovens that were at growth stage in 1980s, then in 1990s, SEC made major strategic move to enter DRAMs and DVD segments which were at the introductory stage.

For each stage, SEC carefully selected its pricing strategies to match its market positioning. In other words, SEC initially positions itself as low end and low quality producer, supplying substitute for brand name television sets and raises price of its products as the quality and design improve. SEC's strategic choice of starting low end was based on three environmental conditions prevailing at the time: low national income and limited purchasing power of the local market; a joint-venture partners that was unwilling to share technologies in high-end product ranges; and the availability of a niche export market (in the US) for low-end models (Yu, 1999).

SEC recognizes the importance of changing its corporate and brand image in order to consolidate its market position as a major global competitor, and took over a global marketing program in 1999 to transform SEC from a relatively low-profile manufacturing-oriented company to a world-class marketing-oriented global company. Despite its market leadership in memory chip sector for a decade, SEC had a far lower profile than Sony, Philips and Nokia in consumer and telecom products. In 2001, SEC increased its advertising and marketing budget by 30% to \$400 million, launched a CRM program; in 2004 SEC spent US\$200 million on global branding initiative to raise SEC brand equity, which cover more than 50 countries (Savage, 2005). SEC is “busy building global-brand umbrella that will ease market entry for a whole range of businesses; recognizing the importance of economies of scope as much as economies of scale in entering the global markets”.

The second approach to competitive innovation is to ***search for loose bricks***, exploit the benefits of surprise, by staking out under-defended territory of larger, more powerful rivals. SEC underwent a sequence of reverse engineering in attaining necessary technologies for its products as it had joint-venture and licensing agreements with various competitors; in 1971 SEC had joint-venture with Sanyo of Japan to produce its first television sets; entered licensing agreement with Toshiba in 1981 for microwave ovens; with Philips in 1982 for color TV technology (Samsung, 2006). During these growth phases, SEC aggressively studied and explored the critical technologies of dominant competitors required for its electronic products. As Hamel and Prahalad state, SEC “begins with a careful analysis of the competitor’s conventional wisdom to search for loose bricks”.

Along this process, SEC chose to position itself as low-end commodity product supplier, as SEC’s first product choice (monochrome televisions) was insensitive to brand name but highly price-elastic. SEC continued its strategy of low-end commodity marketing throughout expansion into color TVs, VCRs, Microwave segments, and DRAMs, given its low profile of brand image and technological expertise. This strategic choice implies that SEC intends to “build a base of attack just outside the market territory that industry leaders currently occupy” (i.e. the “low end” in consumer electronic market).

However, SEC’s strategic intent was not to remain as commodity supplier, but to become the dominant leader in the consumer electronics and IT markets. This underlying objective was illuminated in SEC’s serious efforts to develop its own product design competence. SEC progressively increased its in-house R&D budgets and stepped up its efforts to assimilate advanced foreign technologies and to develop new products (Hobday, 1997, p. 12). By mid 1990s, SEC has narrowed to less than one year the gap with U.S. and Japanese companies in new product development and even ahead of competition for some categories (Yu, 1999).

SEC committed significant proportion of its resources to unproven technology in mid 1980s, investing \$300 million to acquire DRAM technology for low-end PCs and other volume consumer goods, although the business was a chronic money loser ( Chacko et al., 1999). SEC lost money on 256k DRAM because of market downturn and price decrease in the period of 1984-1986. However, CEO Lee continued SEC’s pursuit to become a competitive player in the DRAM market. In 1987, SEC started mass production of one mega-bit DRAM and delivered volume shipments in 1998 to start making profits. Now, SEC bolsters market leadership in DRAM market (Samsung, 2006); keeps its DRAM lead by investing heavily in R&D and in new plants and equipment (Arensman, 2001). This is an example of how SEC contained competitive risks within manageable proportions to beat the competitors by not imitating them but by pursuing competitive innovation.

SEC progressively created its core competence in technology for various categories, such as PCs, TVs, DVDs, DRAM and communications, while competitors fixated on their own markets, missing the major threats coming from SEC’s horizontal diversification. Thus, SEC built a base of operations in under-defended territory and used that base to launch an expanded attack.

The third approach to competitive innovation is to ***change the terms of engagement*** refusing to accept the front-runner’s definition of industry and segment boundaries. When SEC entered television market, the market was already at declining stage, which could have been viewed as shrinking

market according to traditional framework. However, SEC refused to accept the segment boundaries and “create new space instead of searching for niche within the existing industry space by entering the high definition television market earlier than its counterparts. While Japanese suppliers were reluctant to build larger LCDs in the mid-1990s, SEC was more responsive on both size and price, making faster investment decisions than its Japanese competitors, who tend to practice a slower, consensus-based management style (Arensman, 2001). In 2005, SEC maintains its number one position in LCD business in terms of total sales revenue (Samsung, 2006).

SEC commands technology leadership by launching innovative products such as 50-nanometer 16GbNAND flash memory and Mobile WiMAX, next generation wireless communication technology (Samsung, 2006) and set industry standards; also creates “digital convergence” by combining its core strengths in semiconductors, communications, displays and entertainment into new products such as 3G, cell phone with a built-in MP3 audio player (Arensman, 2001). This strategic objective shows that SEC is aiming to “capture the economies of scope of global brand investment through inter-business coordination”. SEC lagged in mobile industry when it entered this business in 1994, however, SEC is reinventing the rules of the game with these converged devices and beating its competitors.

The last approach to competitive innovation is to *use collaboration* to calibrate competitor’s strengths and weaknesses. SEC entered the consumer electronics market with little technology and know-how. SEC managed to enter into licensing agreements with foreign companies such as Toshiba and Philips that owed the patents and manufacturing rights, and reverse-engineered and internalized competitor’s technology and know-how. SEC also used: 1) acquisition of high-tech companies in advanced countries; 2) strategic alliance with competitors to accelerate the pace of technology improvement and development. For example, SEC purchased LUX of Japan (1994); major share of AST Research of the US (1995); technology sharing arrangement with Toshiba, NEC, Motorola, Digital, SGS-Thompson and Siemens (Samsung, 1996). In the mid-1990s, SEC managed to raise its technological capability to comparable levels to other industry players, which enable it to negotiate strategic alliance on a more equal basis, removing the company’s image as a “junior partner” (Hobday, 1997, p. 12).

Collaboration with foreign industry leaders allows SEC to narrow the gap with Japanese companies at an accelerated rate. This rapid progress during the growth period is also made by the synergy effect of: 1) heavy investment and activities of in-house R&D at SEC; 2) leveraging on multiple technology sources, such as licensing, strategic alliances, R&D center in foreign markets, foreign subsidiaries of SEC; and 3) introduction of effective knowledge management (KM) model to the company. SEC used KM concept as an important means of R&D innovation (Kwak et al., 2004). SEC established Samsung Institute of Advanced Technology (SAIT) center in 1987 as SEC’s central R&D facility. SAIT uses three major performance measurement metrics: 1) patent quality and quantity; 2) R&D contribution to business performance; and 3) R&D efficiency and speed, which are consistent with SEC’s value and strategic intent. This ensures alignment between SAIT’s R&D innovation activities and SEC’s competitiveness.

#### ***SEC’s CEO Leadership and Management***

Hamel and Prahalad point out that companies that are successful in creating competitive advantages do the following to engage the entire organization:

***Create a sense of urgency:*** CEO Lee has pushed the company relentlessly during the 1990s to reinvent itself as a more innovative, customer-oriented company (Arensman, 2001). For example, in early 1990s he staged rallies at which workers were encouraged to smash poor-quality products with hammers and told to: “change everything except your wife and children”.

***Provide employees with the skills they need to work effectively:*** SEC is well known for its effective new employees training program, in which new employees go through four weeks in-house training at the training center to transform college graduate to “warrior workers” loyal to the organization, so called “Samsung-man” (Kearney, 1991). The training assimilates military training

culture, and provides employees with information on the history, organization, vision of SEC as well as technical aspects and general management.

SEC human resource (HR) policy is also considered to be progressive and effective. SEC reformed its traditional human resource (HR) policy in 1995 from seniority based promotion to performance and creativity based one in order to stimulate productivity and creativity while lowering labor costs for the organization. This is facilitated by points system used for annual performance appraisal, which allows the HRM team to quantitatively assess employees' skills and performance. SEC is considered to be most progressive in its HRM policy among Korean Chaebols, as it has the highest ratio of non-family member executives in its top management (Healy, 2001).

***Establish clear milestones and review mechanisms to track progress:*** SEC set up an internal business appraisal mechanism to ensure profitability and ROI. In this frame, new investment must be recouped within four years, while upgrade investments have just two years to break even. These benchmarks function to screen out numerous projects for failing to meet the requirements and to selectively focus on projects that are viable in short-term as well as in long-term.

### **Conclusions: Competitive Innovation of SEC**

SEC has risen to global leadership over the past 30 decades with ambitions that were out of all proportion to their resources and capabilities. SEC had a strategic intent of becoming the global leader in electronics-good and IT from the commencement of the business, which has been the essential driving force for its impressive growth and track records. SEC's growth can be viewed into three different stages with different strategic planning. Initially SEC did not have critical technologies that are necessary to be competitive in the consumer-electronics market, while it had a high-quality labor force, a very low wage level, and substantial support from Korean government's economic planning and policies. Given this condition, SEC at its initial growth stage carefully selected electronic product segments (i.e. TVs, microwave ovens) in the declining stage of the product life cycle, in order to give the least threatening profile to the industry leaders who were supplying the technology (Yu, 1999). Thus, SEC managed to gain the technology suppliers' trust to form joint venture to acquire necessary technologies. These market segments were appropriate choice for SEC from marketability standpoint, as Korean domestic market was small and TVs and microwaves were exportable items. Also, given lack of brand image, SEC chose to supply commodity type products in the low-end price range to build the base for SEC to become competitive, without being seriously challenged by other players.

After acquiring technological competence and competitiveness, SEC transformed itself from commodity product supplier of mass production for export market to supplier of brand name high-end products, supported by advanced in-house R&D center (i.e.SAIT) and flexible manufacturing system. At this second growth stage, SEC was seriously challenged by two major external shocks. The local and world markets have started a profound transformation under: 1) the newly emerging world economic order characterized by the WTO system; and 2) the economic turmoil triggered by the Asian financial crisis started in 1997 (BusinessWeek, 1998).

Upon these major external challenges SEC made major reforming move. First, SEC reformed its HRM to improve effectiveness and performance of its human resource in 1995 by changing employee performance measurement system, which became more in line with Western standards. This is considered to be quite a radical move among Korean business circle, as most Korean companies promote and reward their employees based on seniority, and managers in Korean companies are unwilling to give their subordinate unfavorable evaluations. Thus, Korean culture prevails in employees' performance appraisal system with strong emphasis on group harmony (so called "In Wha", which is parallel to Chinese "guanxi") and teamwork (Alston, 1989), and it is difficult for Korean companies to update their HRM according to international standards to compete with the world's most competitive firms in the global market.

Second, SEC had effective crisis management of the Asian financial crisis and emerged from this experience stronger and better focused than before. By late 1997, SEC's debt totaled US\$9 billion – more than 70% of it in foreign currency loans, and SEC responded to this situation with a major restructuring plan that made the company to exit dozens of business, slashed its debt to reduce unnecessary costs (Arensman, 2001). SEC reduced its inventory and accounting receivable by more than \$2.5 billion to improve its balance sheet and reallocated resources to more useful purposes, and reduced its workforce by one third- laying off 30,000 workers worldwide. SEC could focus on fewer and more strategic business from this move with strong financial status and stability. SEC reduced its debt to equity ratio from 223% in 1997 to 43% in 1999 and further to 20% in 2001 (Samsung, 2002).

At its third growth stage (current stage), SEC emphasizes raising equity value by initiating global branding program since 1999. SEC is positioned 20<sup>th</sup> (US\$ 15 billion in value) in the Interbrand and Businessweek annual ranking of the 100 Top Global Brands, and placed 7<sup>th</sup> among global IT companies (Samsung, 2006).

From management strategists' perspective, SEC's performance is noteworthy as "it is the result of a very carefully crafted strategy following an evolutionary learning process from simple to more complex technologies, and taking advantage of synergy effects by synchronizing the strategy variables of different dimensions, all supported by SEC's highly disciplined corporate culture" (Yu, 1999). SEC's case should be assessed, particularly by those in developing countries with limited resources and business environments as SEC's managerial strategies and its strategic intent appears to be highly effective in brining its performance.

One aspect of SEC's management that needs improvement is corporate governance issue. Although SEC's management benefited from decisiveness of SEC's founding Lee in carrying aforementioned strategies and his visions for global leadership, SEC CEO Lee appears to be limited by his personal interest of passing the chairmanship to his son, which is severely criticized by dissatisfied shareholders. To be a true global leader, SEC would have to improve governance and transparency of its organization. Hamel and Prahalad's paper provides a sound base for discussion of what is required in management strategies to obtain competitive innovation and to become a true global leader.

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