Creating Spontaneity: The Evolution of the Samsung Group Under Lee Kun-Hee

by

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# Table of Contents

Acknowledgements............................................................................................................. 2  
INTRODUCTION.................................................................................................................... 3  
  Organization of the Thesis................................................................................................. 4  
  A Side Note....................................................................................................................... 5  
CHAPTER 1- Relationship Between Government and Lee Byung-Chul’s Samsung................. 7  
CHAPTER 2- Lee Byung-Chul’s Managerial Philosophy and Internal Power Relations................................................................. 17  
  The Secretariat.................................................................................................................. 17  
  Employment and Wage Policy......................................................................................... 20  
  Quantity Driven Management......................................................................................... 23  
CHAPTER 3- Success in Semiconductors............................................................................... 25  
CHAPTER 4- Succession, Inheritance, and Centralization of Power ................................. 37  
  Inheritance....................................................................................................................... 40  
  Centralization of Power................................................................................................. 41  
CHAPTER 5- The Frankfurt Conference- The Start of a New Era..................................... 45  
  Prevailing Economic and Governmental Environment.................................................. 45  
  Lee Kun-Hee’s Management Style from 1987 to 1993.................................................. 49  
  The Frankfurt Conference.............................................................................................. 50  
CHAPTER 6- The Relationship Between Government and Lee Kun-Hee’s Samsung........... 57  
  1997 Financial Crisis....................................................................................................... 61  
CHAPTER 7- Lee Kun-Hee’s Managerial Style and the Dispersion of Power ........................ 64  
  The 7-4 Working Scheme.............................................................................................. 64  
  Changes to Assembly Line Operation............................................................................ 66  
  Reforming the Secretariat............................................................................................... 68  
  The New Hiring, Promotion, and Compensation Policy................................................. 76  
  Lee Kun-Hee’s Return Reclusive Style of Management................................................ 80  
CHAPTER 8- Success in the LCD TV Industry................................................................. 84  
  LCD TV Industry............................................................................................................ 86  
Conclusion.......................................................................................................................... 91  
  A Digression into Evolutionary Economic Theory and the Future of Samsung: Will Samsung Inevitably Evolve into a Chandelerian Firm?.................................................. 93  
Research Bibliography...................................................................................................... 99
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INTRODUCTION

Speaking carefully and quietly, Lee Kun-Hee, who was the chairman of the Korean conglomerate, the Samsung Group, from 1987 to 2008, was always deferential to visitors.¹ He enjoyed listening to other people’s opinions, and he was quoted as having said, “It's my nature to detest revolution”.² For those not aware of Samsung’s history, some may go so far as to say that he was meek.

However, at the same time, Lee was a leader who not only had a clear and revolutionary vision for Samsung but someone who had the unwavering determination to carry it out. Within a span of a few years after becoming chairman, Lee would play a central role in a revolution within Samsung that would change the very nature of how it operated.

This thesis is a historical narrative that is mainly concerned with telling a story of the Samsung Group’s evolution as it ventured into the electronics industry. There is greater emphasis on tracing how the Samsung Group’s operational and decision-making mechanisms had changed, and how these changes were carried out.

The narrative will show that Samsung as a centralized, family managed firm evolved to a mostly decentralized firm run by professional managers.

Originally, the Samsung Group was micro-managed by chairman Lee Byung-Chul, the original founder of the firm, and was thus largely a centrally planned organization where many of the decisions were made at the very top. However, Samsung, under Lee Kun-Hee, had evolved to an organization where the decision making power was handed down to the individual executives of each affiliate under the Samsung Group.

Under this new framework, the executives and managers, utilizing their specific knowledge in engineering and technology, each pursued their own initiatives, essentially creating a spontaneous order of entrepreneurial ideas within the firm. The decisions within this spontaneous order were guided by Lee Kun-Hee’s over-arching vision of Samsung as a world-class, innovating firm.

This transition, however, was not a smooth one. Indeed, it is more apt to call it a revolution—as the change was abrupt and at a scale that changed the very essence of how Samsung operated. Driven by the urgency of Korea’s radically changing economic and political environment, Lee Kun-Hee used the centralized system created by his father, Lee Byung-Chul, to replace executives with those who follow his new vision and overhaul the very rules that the firm was running on.

**Organization of the Thesis**

Chapters one to three will focus on the “old” Samsung under the founding chairman, Lee Byung-Chul. Chapter one will show the political circumstances of Korea from 1950s to the late 1980s, and the relationship between the Korean government and Samsung during this time. Chapter two will detail the internal organization of Samsung under Lee Byung-Chul, including its managerial
structure. Chapter three will show an example of how this “old” Samsung had operated under this political environment given its internal organization by showing how it operated when it entered the semiconductor industry.

Chapters four to five cover the “interim” between the “old” Samsung and the “new” Samsung. Chapter four cover the issues of succession, inheritance, and centralized family control over managerial and investment decisions. Chapter five, by recounting the events surrounding Lee Kun-Hee’s Frankfurt Conference, reflects Lee Kun-Hee’s growing uneasiness and his sudden realization that he must take a more active role in making Samsung adapt to the radically changing circumstances of Korea.

Chapters six to eight are essentially the mirror to chapters one to three, except that they focus on the “new” Samsung under Lee Kun-Hee. Chapter six follows, briefly, the relationship between the Korean government and Lee Kun-Hee post 1987. Chapter seven examines the new managerial policies that Lee Kun-Hee had instituted, and the manner in which he dispersed his power. Chapter eight examines an instance of how this “new” Samsung operated as it entered the LCD industry for the first time.

In the conclusion, this thesis will place the narrative of Samsung within the theoretical context of evolutionary economic theory to develop a greater understanding of the evolution of firms. Specifically, while this narrative shows how Samsung had decentralized over time whether in the future, the firm will continue to decentralize or start to centralize.

A Side Note

There is an abundance of literature attempting to explain why Samsung Electronics was successful. The question as to why Samsung is successful is a
highly complicated one, with many different valid reasons—the pure amount of literature, which continues to grow yet to this day, draws attention to this fact.

However, the main purpose of this thesis is not to identify reasons as to why Samsung was successful. As previously noted, this thesis, instead, seeks to tell a narrative of the *how* Samsung has evolved, drawing particular attention to how the firm had fundamentally changed over time and the mechanisms through which these changes were carried out. Thus, while the narrative may implicitly provide some factors as to why Samsung was successful, this thesis is not concerned with providing an exhaustive list of such factors.
CHAPTER 1

Relationship Between Government and Lee Byung-Chul’s Samsung

After emerging from the Korean War of 1950-53, the Korean economy and politics were devastated. In this barren socio-economic landscape, President Rhee spearheaded efforts towards recovery. Commonly characterized as a predatory regime, Rhee’s presidency tended towards rent seeking behavior benefiting the government and the elites at the expense of the general population and economic growth.3

The chaebol, a term used for Korean conglomerates, first emerged under Rhee’s regime: in exchange for political favors, select businesses were given a diverse array of economic favors, such as import licenses, quotas, ownership of property owned by the Japanese during occupation (such as factories) at bargain prices, financial aid, cheap interest rate loans, and so forth.4 While there were major chaebol such as Samsung, Hyundai, and LG, there were more than forty-five chaebol by 1997.5

Lee Byung Chul, having owned a successful medium sized business exporting dried squid, failed to expand his operations any further during the

4 Ibid., 300.
5 San Jose State University, “The Chaebol of South Korea,” http://www.sjsu.edu/faculty/watkins/chaebol.htm#45.
Japanese occupation. However, his breakthrough came when Rhee became president following the Korean war: Rhee was a friend of Lee’s father. With Lee being particularly skillful at developing good relationships with government officials, before no time at all, Lee was able to develop a close relationship with Rhee and start building his empire. By 1960, Samsung had grown from a single exporter of dried seafood to a conglomerate with 16 affiliates.

One of the main characteristics that define chaebol is their tendency to diversity to many different industries in a short period of time. In the 1950s, Samsung diversified into producing sugar, flour, fabric, and chemical fibers. In the 1960s, Samsung entered financial services, life insurance, distribution, papermaking, and broadcasting. In 1969, Samsung Electronics was created in order to create low-end consumer electronics. The term “Samsung Group” is an encompassing term referring to the entire conglomerate. Samsung Electronics, for instance, was an affiliate of the Samsung Group, under the power of Lee Byung-Chul. This thesis is showing how the Samsung Group as a whole became decentralized, not that an individual affiliate became decentralized.

On May 16th, 1961, Park Chung-Hee carried out a military coup d’état, overthrowing Rhee and making himself president. Park received a Japanese education throughout the whole of his youth. In 1944, he excelled in his studies and was accepted to the prestigious Japanese Military Academy.

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7 Ibid.
8 Ibid.
9 Ibid.
Park’s regime, unlike that of Rhee’s, utilized central governmental planning to lead and develop Korea’s economy. That is, he aimed to make a developmental state. The Heavy-Chemical Industry drive (also known as the HCI drive), which was started through the Heavy and Chemical Industry Promotion Plan of 1973, was at the heart of Park’s initiatives. The HCI drive was an effort to develop Korea’s economy through promoting the heavy and chemical industry using low interest loans, financial aids, subsidies, government backed foreign loans, and special licenses.\(^{12}\) However, while, under the HCI drive, the *chaebol* were basically forced to choose between producing automobiles, electronics, and shipbuilding, the *chaebol* determined managerial policy.\(^{13}\)

As part of the HCI drive, the government chose firms that it would support, and then gave them special privileges. However these privileges, including cheap interest rates and subsidies, were contingent on the firm’s performance.\(^{14}\) In the instance that firm did not perform well, privileges were withdrawn, and in the worst-case scenario, the firm or affiliate in question was forced to merge to another company that was performing better.\(^{15}\)

However, the indicator as to whether the firm was performing well or not was not profit. Rather the government evaluated a firm’s performance on sales

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volume—in other words, how much the firm produced was essential. As shown by information in the Korean Stock Exchange of the 1970s, many of the top chaebol were just barely breaking-even in terms of profits.

Close to two weeks after his coup d’etat, on May 28, one of the first initiatives by the Park’s government was a purging campaign against corruption in business. The government specifically targeted and arrested businessmen that had conspired with the previous regime’s government.

However, Kim Jong-Pil, the founder of the Korean Central Intelligence Agency (later to be the prime minister of Korea from 1971 to 1975), soon convinced Park that instead of attacking the businessmen the government should work together with them to develop Korea. During this anti-corruption campaign, Lee Byung-Chul was abroad in Japan, worried that he would be arrested if he returned to Korea, as he was one of the top people on the campaign’s list. Once Kim messaged Lee that he would not be arrested, on June 26, Lee returned to Korea.

Before letting the Samsung head meet Park Chung Hee, Kim and Lee first met in a hotel room to further discuss matters. As Kim recalls later on, he saw Lee as a meticulous individual:

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19 Ibid.
20 Ibid.
21 Ibid.
Lee fully researched his projects from start to finish. He looked into every aspect in detail and even asked for opinions from Chairman Yoshihiro Inayama of the Japanese Business Federation. Then he would decide whether to start a new project.  

Lee met Park the following day, whereupon Park also asked Lee to help his regime foster economic growth in Korea. Park gave Lee three potential industries that Samsung could pursue as part of the HCI program: shipbuilding, cars, or electronics. Lee chose electronics.

While Park gave autonomy to the chaebol in making managerial decisions within their firm, the relationship between the government and the chaebol chairmen still continued. For instance, Lee often consulted Kim, the prime minister for advice. In 1971, when Lee wanted to build Samsung Everland, an amusement park, on government owned land, he consulted Kim. The latter personally went to the Korea Forest Service (KFS) to persuade it to sell the land to Lee. When the director of the KFS refused to budge, under grounds that selling the land was against the government’s policy of afforestation, Kim gave advice to Lee: buy double the plot area that you want to buy from the KFS, and exchange that plot for the KFS plot that you want. This advice worked well, and Lee was able to buy the plot of land he needed.

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23 Ibid.
24 Ibid.
25 Ibid.
26 Ibid.
27 Ibid.
Even outside of official business meetings, Lee and Kim were still “quite close” and were both members of the Wednesday Club, where they “regularly played golf”. Informal meetings like these were common. That is, the top chaebol, through their relationships with government officials, were able to bypass state run organizations run by governmental economic planners to pursue their own agenda. One can, as an additional example, observe the relationship between Prime Minister Kim and Chung Ju-Yung, the chairman of the Hyundai group.

Chung, the chairman of Hyundai, wanted his group to enter the automobile industry. However, when he proposed this to the EPB, it rejected the initiative, saying that Korea would not be able to export the cars. Chung then went to Park Chung Hee, to try and persuade him separately, but failed to do so. Chung then consulted Prime Minister Kim, who then brought Chung to the Blue House (the Korean equivalent to the US’s White House) again in order to persuade Park together. While Park initially was skeptical, recalling that “all the ministers disagree[d]” to the proposal, he gradually relented, allowing Hyundai to enter the automobile industry.

However, despite close communication and cooperative mindset between the government and the chairmen of chaebol, the government lagged behind in its support for the electronics industry, including the semiconductor industry. While the government formally announced electronics as one of the major target

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28 Ibid.  
29 Ibid.  
30 Ibid.  
31 Ibid.  
32 Ibid.
industries, electronics were deemed to be less important than the steel and chemical industries.\textsuperscript{33}

The government did not realize their misjudgment until 1981, whereupon the Blue House had created a special committee to research economic trends in the country. The committee recommended that in particular, computers, semiconductors, and telecommunications should be heavily subsidized.\textsuperscript{34}

Even considering growing governmental financial support, the Electronics Industry Association of Korea made the sharp criticism that cheap loans or tax perks were nowhere near enough to properly develop an electronic industry in Korea from scratch, and that infrastructural support was required.\textsuperscript{35}

Unsurprisingly, the initial major breakthroughs in growth in the electronic industry came, not from the \textit{chaebol}, but from private companies that had little to do with the government. Although the \textit{chaebol} had a wealth of funds, at least compared to other firms in Korea, they initially lacked the human capital and the know-how of firms that were more established in the semiconductor industry.

Ultimately, it was the joint venture company, Korea Semiconductor Inc, not a \textit{chaebol}, that had developed the wafer-processing capacity, vital for the development of semiconductors, in 1975.\textsuperscript{36} While the KSI gave the much-needed


\textsuperscript{34}\textsc{Tony Fu-Lai Yu and Yan Ho-Don, \textit{Handbook of East Asian Entrepreneurship} (New York: Routledge Publishing, 2014), 337.}


\textsuperscript{36}\textsc{Ibid.}
kick-start to the Korean electronics industry, due to financial issues, Samsung Electronics bought the company in 1978.\textsuperscript{37}

The government soon started to provide infrastructural support, but it lagged behind the \textit{chaebol} own initiatives. For instance, the government had finally created a space for the Samsung, Goldstar, and Hyundai to cooperate through the Electronics and Telecommunications Research Institute. However, it was created in 1988, \textit{after} Samsung had already occupied the top spot globally in terms of market share in DRAM production.\textsuperscript{38}

But this space was unsuccessful. The purpose of space was to encourage cooperation amongst the \textit{chaebol} in order to develop the new 4M DRAM. However, the project had limited success as the leading firm, Samsung at the forefront of the competition, was unwilling to reveal advanced secrets to its competitors.\textsuperscript{39} Due to strong rivalry research was carried out independently in each \textit{chaebol}’s private laboratory, with no \textit{chaebol} willing to voluntarily exchange its researchers, though formally prompted.\textsuperscript{40} The \textit{chaebol} only continued to participate in these exchanges as a formality in order not to upset the government.\textsuperscript{41}

Other than its efforts to create these cooperatives, the government chiefly relied on its program of credit incentives and subsidies.\textsuperscript{42} In contrast, Taiwan’s government provided not only funds, but infrastructural aid to promote the industry, by forming the Industrial Technological Research Institute. The ITRI was a publicly run R and D institute. In the case of Taiwan, the government

\textsuperscript{37} Ibid.
\textsuperscript{38} Ibid., 30.
\textsuperscript{39} Ibid.
\textsuperscript{40} Ibid.
\textsuperscript{41} Ibid., 33.
\textsuperscript{42} Ibid., 32-33.
continued to play a pivotal role in bolstering Taiwan’s semiconductor industry by providing institutional support for the new industry.\(^{43}\)

When thinking of the *chaebol*, one of the first things that comes to mind is government intervention. This tendency to attribute the success of Samsung Electronics to government intervention is understandable. The Korean government in the latter half of the twentieth century had played a central role in the economy, and had supported the *chaebol* in various ways. The *chaebol* were given numerous, and significant, advantages that normal firms did not have.

However, while this tendency is understandable, this chapter starts to show that the role the Korean government played in the success of Samsung in the electronics industry was more limited than one may initially think. This was especially the case when the government lagged behind in providing infrastructural support in an infant industry—in this case, the semiconductor industry—which lacked certain institutional elements.

The Korean government had the tendency to use a one-policy-fits-all approach, using similar policies across different industries. However, this tendency to not use tailored policies for each unique industry limited the ways in which the government could help in the semiconductor industry. This was especially troubling, since the semiconductor industry required institutional and infrastructural developments that had previously not existed in the company.\(^{44}\)

Thus, this draws further attention to the *chaebols’* ability to adapt and change themselves through their own resources. Within structured set of allowed actions instituted by the government, there was still great diversity in how each different *chaebol* could have acted, decisions that determined whether the

\(^{43}\) Ibid., 28.
\(^{44}\) Ibid., 32.
particular a chaebol succeeded or failed. This picture becomes clearer in chapter 3. But first, it is important to define how the Samsung operated internally first.
Lee Byung-Chul made it a point to take part in every employment
interview possible, regardless of the potential position of the employee. But not
only did he participate in the interviews, Lee micromanaged the firm and
concerned himself with the employee-level concerns as well. He made sure to
have an open-door policy in which any employee could directly discuss
suggestions and concerns. Lee also made rounds one to two times a day in the
factories to meet the workers and watch them work.

The Secretariat
However, micromanagement got more complicated as the conglomerate expanded. Thus, Lee Byung-Chul, in 1959, roughly twenty-one years after Samsung’s founding, created the Secretariat in order to increase coordination within the group. The Secretariat, also known as the Executive Office of the Chairman’s Secretary, or later in 1998, the Strategic Planning Office, was essentially an empowered version of a human resources (HR) department, with centralized control of administrative functions over all the Samsung Group’s

47 Ibid.
affiliates. It also functioned as the “go-between” for the chairman and the rest of the company.

One of the divisions within the Secretariat was the management team, which focused on issues pertaining to the strategic planning and financial investment aspects of the Group’s operation.\footnote{Marco Orru, Nicole Woolsey, and Gary Hamilton, \textit{The Economic Organization of East Asian Capitalism} (California: Sage Publications, 1997), 233.} Reportedly, the chairman, the Secretariat’s management team, and the executive of a particular affiliate (there were 16 affiliates by the 1960s) met one to two times per month.\footnote{Ibid., 233.} While it was common in Japanese conglomerates for all executives to meet all at once in such meetings, in Samsung, the chairman and the executive met one-on-one.\footnote{Ibid.}

Each Samsung affiliate came up with its own business proposition (along with projections) and ran it through the Secretariat.\footnote{Ibid.} In the case that the proposition was accepted, the Secretariat continued to monitor the project.\footnote{Ibid.} If the affiliate performed at least up to 95\% of its projection, or there was a reason for poor performance out of the control of the affiliate in question, then the secretariat did not intervene further.\footnote{Ibid.} However, in the case that the firm was underperforming, the secretariat had the power to deal out penalties to the executives responsible, such as demotion.\footnote{Ibid.}

There were other teams apart from the management team, such as the strategy team, communication team, and human resources team.\footnote{Hye-Yeon Chung, “Samsung’s New Control Tower Says Company Fails Without Transmission,” \textit{The Monthly Chosun}, January 2011.} Altogether the teams had the function of hiring workers, training workers, performing audits and
other accounting assessments, and dealing with public relations.\textsuperscript{57} As will be shown in chapter 8, accounting and financial administrative ability was an important ability to be recruited in the Secretariat, especially as the Secretariat not only was charge of formal accounting practices. As a result of its financial expertise, it was also responsible for taking care of more delicate practices, such as matters relating to slush funds and illegal transfers of the Lee’s family wealth (for inheritance purposes).

The Secretariat controlled a centralized Human Resources department that took care of the hiring, training, and promotions of the employees.\textsuperscript{58} Specifically, the Secretariat chose potential employees who had recently graduated from university, trained them for two months, and sent the employees to various affiliates within the Samsung group.\textsuperscript{59} The Secretariat used loyalty rather than the potential performance as the main criteria for hiring prospective employees. The employee-training program also focused on fostering loyalty to the Samsung Group as a whole, as opposed to developing job-specific skills.\textsuperscript{60} While the individual Samsung executive took part in the hiring process, the Secretariat had the power, and more importantly, used this power, to dictate who was hired or not. As noted previously, Lee Byung-Chul personally participated in the interviews whenever possible.

\textsuperscript{57} Ibid.
\textsuperscript{60} Ibid.
Lastly, entities like the Secretariat tended to hire based on connections, often requiring three “guarantors” both inside the company and three “guarantors” outside the company to provide recommendations.\(^{61}\) One reason for this emphasis was such that loyalty was maintained: by getting into a firm through connections, one was held accountable by their recommenders.\(^{62}\) To reach a high position in the Secretariat specifically, the employee had to start from an entry-level position in the Secretariat and move up from there to reach the executive positions.\(^{63}\)

Consequently, much of the decision-making took place at the top of the hierarchy, between Lee Byung-Chul and the Secretariat, and was a centralized process. The hierarchy only provided opportunity for one-way feedback, and did not provide ample opportunity for Lee Byung-Chul and the Secretariat to utilize the expertise of the executives and management—a point that becomes clear in chapter 8. While Lee and the Secretariat could intervene in decisions of the executives, the executive could not intervene in the decisions of Lee or the Secretariat. Furthermore, the Secretariat aimed to recruit and train prospective employees that demonstrate loyalty to the Samsung Group and its chairman.

**Employment and Wage Policy**

Many of the major cultural values in Korea have the roots in Confucian philosophy. For those holding Confucian values, ideally, the environment must embrace and foster “harmony” amongst its people.\(^{64}\) Consequently, the model of choice in Korea was the hierarchical, vertical relationship between “senior”

\(^{61}\) Ibid.
\(^{62}\) Ibid.
(sunbae) and “junior” (hoobae). \(^\text{65}\) The junior must be obedient and must respect their seniors, while seniors, in turn, must look after their juniors.\(^\text{66}\) Regardless of effects on efficiency, this kind of relationship, when perfectly followed, fostered harmony and prevented conflicts from appearing.

This cultural norm was institutionalized within companies in the form of job grades. With the chairman and Secretariat at the top of the hierarchy, executives (such as presidents and vice-presidents of an affiliate) are between the chairman and the managers in the hierarchy. In regards to the hierarchy of managers and employees, employee could progress through eight job grades, called jie-keub: boo-jang (deputy general manager), kap-kua-jang (manager I), eul-kua-jang (manager II), dae-lee (assistant manager), and sa-won (staff I, II, and III).\(^\text{67}\)

Compensation levels vary by year, meaning that seniority played an essential role in determining whether one had higher pay or not.\(^\text{68}\) Less important factors were performance evaluations, gender, and educational level.\(^\text{69}\) In regards to supervisor evaluations and relationships to executives, assuming that Confucian values were prominent within Samsung, one could reasonably assume that loyalty and obedience—specifically, the ability to follow direction—would have been seemingly important informal criteria (criteria not explicitly stated) in the evaluations. In other words, even though highly profitable affiliates at Samsung

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\(^{65}\) Ibid.
\(^{66}\) Ibid.
\(^{68}\) Ibid., 144-147.
were given higher year-end bonuses, there was no “official system” that explicitly linked compensation to performance.\textsuperscript{70}

However, two other components, excluding the base salary rate, also determined one’s total salary: allowances and bonuses. Allowances were given to those that had families, had done overtime, remained loyal to the company for a long time, and many other similar criteria.\textsuperscript{71} For white-collar workers who have worked in Samsung during 1993, base pay made up 42.2% of the total wage, allowances 18.5%, and bonuses 39.3%.\textsuperscript{72}

Lastly, employees tended to stay in one company for a lifetime.\textsuperscript{73} Korean firms, Samsung included, had a particularly hard time firing employees because of Korea’s laws at that time. In fact, the Korean Labor Standards Law prohibited layoffs until 1997, when the National Labor Relations reformed how layoffs were addressed. Under this new law, layoffs were only possible in instances of authorized economic or technical causes, such as poor financial performance or overhaul in company structure.\textsuperscript{74}

Consequently, just as how there was only one-way feedback between the Secretariat and the executives, the one-way feedback mechanism characterized the rest of the hierarchy to the last level. Due to the seniority based wage system, incentives were not strictly centered on maximizing performance.


\textsuperscript{72} Ibid.


\textsuperscript{74} Ibid., 9.
Quantity Driven Management

Management emphasizing quantity over quality was a great advantage to Samsung during the Park Chung-Hee era. As noted previously, the government provided varying degrees of financial benefits to chaebol based on how many goods it created, as opposed to its profitability or the quality of its products. Companies that created a larger volume of goods gained greater financial support from the government.

Lee Kun-Hee, criticizing this preoccupation with quantity driven management during meeting in 1991, observed what it was like: “in response to my emphasis on technology, managers simply increased the number of both R and D employees and R and D projects recklessly, without considering R and D efficiency”\textsuperscript{75}. Considering issues such as marginal costs versus marginal benefits was not an important consideration under quantity driven management.

On a different note, two external factors were crucial in supporting the success of this type of management: 1) Park Chung Hee’s financial support of quantity driven management, and 2) relatively low wage levels compared to other countries. Regarding the first point, as noted in chapter 2, chaebols that had high market share, regardless of profit levels, were given better privileges. In regards to the second point, relative wage levels are essential for companies like Samsung that were mass-producing low-value added goods that were quite similar to their competitor’s good. Consumers are only buying such goods due to price differentiation, not product differentiation.

When Korea’s wages rise relative to other countries, the chaebol are faced with two choices in order to survive. The first option is to stick with quantity

driven management and either build factories outside of Korea or buy better technological capital. A second option is to focus on quantity-driven, value-added management.

Thus, the Samsung Group was managed as a highly centralized organized firm, with the decision-making power lying with Lee Byung-Chul and the Secretariat, focusing on quantity driven management. Due to governmental regulations, it was difficult for firms to fire their employees. Employees typically worked for the same companies for an extended period of time. The hiring practices and training programs, which were one of the functions that the Secretariat had taken care of, highly emphasized loyalty. Likewise, once the employee was employed, efficiency still remained a secondary factor in determining compensation.
CHAPTER 3

Success in Semiconductors

On February 1983, in a speech known as the “Tokyo Declaration”, Lee Byung-Chul declared in Tokyo that Samsung would enter the semiconductor industry. By making this declaration, Lee Byung-Chul had surprised much of Korea. Many chaebol believed that the memory chip industry was highly risky because of the great initial investments in capital required followed by swift paces in innovation. Success was contingent on quickly creating the next generation of products before competitors do. New lines of products quickly became obsolete as other firms rapidly created more advanced innovations.

The risk was especially high for latecomers like Samsung. Since there was not enough domestic demand for the memory chip business in Korea, Samsung ultimately had to compete with foreign companies (the likes of Intel, NEC, Motorola, Toshiba and Hitachi) that had already accumulated years of experience in the industry, and create memory chips that are of international standards.

One reason why Lee Byung-Chul had chosen to enter the semiconductor industry was through his frequent visits to Japan. Lee often visited Japan, and maintained a strong network of relationships with the firms there. Through these

78 Ibid.
visits, he was impressed by the high standards of their electronics industry, but also felt that Korean firms would be able to replicate these results as well.\(^{81}\) Another potential reason, as noted in chapter 1, was increased governmental subsidies for the semiconductor industry starting from 1981.

According to Lee Kun-Hee, his father, like many other entrepreneurs in Korea at the time, was initially against the idea of entering this industry:

> 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.\(^{82}\)

In 1974, while Lee Kun-Hee was still an executive in TongYang Broadcasting and JoongAng News, Lee Kun-Hee invested his own funds, not the company’s, to acquire a firm unrelated to Samsung: the Korea Semiconductor Company, a small-scale chipmaker.\(^{83}\) Using this company and his trips to Japan, Lee learnt more about the industry and felt that Samsung was well suited to creating semiconductors.\(^{84}\) After many years trying to persuade his father, Lee Kun-Hee finally convinced his father to enter the semiconductor business in 1983, when the former was still a vice-chairman, under the condition that the former will full responsibility for losses and failures.\(^{85}\)

\(^{81}\) Ibid.
\(^{84}\) Ibid.
Just as Prime Minister Kim recalled, Lee Byung-Chul was a meticulous and careful individual. Before making the final decision, Lee Byung-Chul made his own efforts to familiarize himself with the industry. He created two task forces to investigate the potential of Samsung entering the semiconductor industry.\textsuperscript{86} The first group was to collect data and compile more information through interviews with Korean experts on the topic.\textsuperscript{87} However, this first attempt yielded scant results, as many Koreans were not well acquainted with this industry at all.\textsuperscript{88}

Thus, the second task force was given the task of going overseas to Silicon Valley and conduct research.\textsuperscript{89} This task force, supposedly, yield positive results—positive enough, at least, to persuade Lee Byung-Chul to enter the industry.\textsuperscript{90}

This survey into Silicon Valley yielded two further recommendations. The first was that Samsung should create a Research and Development center in Silicon Valley in order to get access to up-to-date information on trends in the industry and recruit potential engineers interested in working for Samsung.\textsuperscript{91} The second recommendation was that Samsung should focus on VLSI, short for Very Large Scaled Integrated units in particular.\textsuperscript{92} Of the diverse types of semiconductors available, Lee Byung-Chul chose the DRAM chip in particular, because the technology for it was standardized compared to other types of semi-

\textsuperscript{88} Ibid.
\textsuperscript{89} Ibid.
\textsuperscript{90} Ibid.
\textsuperscript{91} Ibid.
\textsuperscript{92} Ibid.
conductors, meaning that Samsung could easily acquire this technology through licensing from Japanese and American firms.93

Furthermore, DRAM chips had a natural affinity to Samsung’s ability to mass produce low-value added goods. Unlike other types of semiconductors, DRAM chips are “capital intensive, low-profit margin business that places a premium on production skills and requires a minimum of design innovation”.94

Once the task forces concretely established that Samsung could profit from entering this market, Lee Byung-Chul committed a significant sum of money to the project from the beginning. He made an initial investment of $500 million dollars into getting state-of-the-art facilities to support the project.95 However, from 1983 to 1987, Samsung was making high losses due to the high capital costs.96 From 1984 and 1984, the total capital costs were three times the total revenue earned through semiconductors throughout the two years.97

Samsung was able to cushion the high entry costs to the semiconductor industry due to its interlocking corporate groups. If one affiliate in the conglomerate lacked funds, other affiliates in the conglomerate supported the former.98 There are two main benefits to having this option. The first, as noted above, is the ability cushion high initial investments required. The second is the advantage of counter-cyclical spending (spending more during recessions), which

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93 Ibid.
96 Ibid.
98 Michael, Schuman. “South Korean chip makers face crunch. Added to falling DRAM prices are fears that firms' chaebol owners will drain funds into new projects,” The Globe and Mail, April 25, 1996.
allowed Samsung to use other affiliates to support its semiconductor through recessions and invest steadily through downturns.99

As noted by an electronics analyst in 1994, looking back into Samsung’s growing prominence in the DRAM production industry, “consistently out-spent the Japanese in development costs and has also been able to turnaround new products at a faster rate”.100 For instance, when the early PC market recession in the US affected the global DRAM market, the price of DRAMs dropped from $3 per unit to $0.30 per unit in 1985.101 Yet, Samsung was able to carry on with its investments at consistent, pre-recession levels, until the market recovered in 1987.102

However, there were downsides to having the option of using its interlocking corporate groups. On one hand, sharing profits amongst its affiliates reduced the ability of Samsung to focus on developing its core capabilities. On the other hand, was the problem of over-investment. For example, in 1996, Samsung overinvested in the industry when it was undergoing a supply-side glut, making Samsung to make significant losses.103 By the end of the same year, Samsung experienced a major plummet in value: its stock value decreased by 58% and the company’s market value was reduced by $4 billion.104 Later in the same month,

99 Ibid.
100 Ibid.
102 Ibid.
Kim Kwang-Ho and thirty-two other Samsung executives stepped down as part of the “restructuring process”.105

At the time that Samsung entered the industry, Samsung relied on its telecommunications division and Samsung Electronics, its two most successful affiliates to finance the necessary capital.106 Initially, the semiconductors division was separate from Samsung Electronics. Samsung Electronics was actually an affiliate that first only concentrated on consumer electronics such as television and washing machines. In fact, the research and production of semiconductors was first performed under a different affiliate: Samsung Semiconductors and Telecommunications Co.

It was not until early November, 1988, that the Samsung Semiconductors and Telecommunications Co. merged with Samsung Electronics, such that the semiconductor division could be further supported from profits from its consumer electronics affiliate.107

The first three-line semiconductor factory was built in 1983, and was called the Giheung Semiconductor Complex.108 The construction of semiconductor is time intensive because the semiconductor factories require a “clean room” for their procedures, normally taking around three years for the room’s complete construction.109 However, with residences created around the complex

105 “Ibid.
109 Ibid.
coupled with around-the-clock shifts, construction was completed in six months.\textsuperscript{110}

Samsung started by creating 64K DRAM production. While there were downsides to being a latecomer in the industry, there were upsides to it well: it was possible to license technology from other firms. This was especially an important consideration for companies like Samsung at the time, which was still focused on low-value added mass production of goods, as opposed to innovation and design.

To create 64K DRAMs, Samsung licensed technology from a small US firm, Micron Tech. It then designed its chips in its design centers located in Silicon Valley, and produced the chips in its factories in Korea.\textsuperscript{111} In fact, Samsung did not have its own in-house R and D departments at the time, but relied on the Silicon Valley design center instead, (named SST International Inc) which would develop ideas for products.\textsuperscript{112}

Following relative success in producing 64K DRAMs, Samsung started to produce other types of semiconductors, such as the 256K DRAM, in October 1985.\textsuperscript{113} In April 1985, the 64K SRAM was developed followed by the 1M DRAM in July 1986. In February 1988, the 4M DRAM was developed, followed by the 16Mb DRAM in August 1990, the 64Mb DRAM in October 1992, and the first 256 Mb DRAM in August 1994.\textsuperscript{114} \textsuperscript{115}

\begin{thebibliography}{9}
\bibitem{110} Ibid.
\bibitem{112} Ibid.
\bibitem{113} Ibid.
\end{thebibliography}
Samsung’s break in the DRAM industry came in 1987, when it had started producing 256K DRAMS. In 1987, in response to the Japanese “dumping” their semiconductors in the US markets by creating high volumes of semiconductors and selling them for low prices, the US government reacted by enacting anti-dumping duties. In response, the Japanese firms promised, that in return for the US taking back the duties, they would decrease production of their chips and thus increase their prices. As a result, with Japanese scaling back on production of their 256K DRAMs, Samsung took advantage of the opportunity and grabbed the attention of the US technology firms that were looking for alternate sources of 256K DRAMs.

Samsung was continually able outspend its competitors. However, unlike many American and European firms in the semiconductor business at the time, many major Japanese producers of semiconductors were conglomerates, Keiretsu, with the capacity to also take advantage of their interlocking corporate groups, just as Samsung had done. Thus, such an advantage was only relevant against American and European companies. Yet, Samsung still out-invested Japanese firms. For instance, in 1995, while the Japanese firms invested around 50 to 100 billion yen in the production of 16Mb drams, Samsung was able to invest 167 billion yen in the process.

Samsung was able to outspend its Japanese competitors because the Japanese were focusing on diversifying their portfolios in the semiconductor

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117 Ibid.
118 Ibid.
119 Ibid., 15.
industry as a whole. That is, while Samsung may have spent more money on DRAMs than the Japanese competition, the Japanese firms had other types of semiconductors that they had to invest in throughout their diverse portfolio.\(^{121}\) As an executive at a microchip company had noted: “The percentage [of DRAM production over total semiconductor production] for Japanese firms used to be about 90 percent 10 years ago, but recently it has fallen to about 40 percent since Japanese makers have diversified their product lines.”\(^{122}\)

That is, Samsung’s success in this chip industry was a qualified one. It had great success in only a narrow type of memory chip production, one that had a natural affinity to its abilities in mass production of low-value added goods.

Samsung continued to license technology from other firms, even for technology other than DRAMs. For instance, to create its 16K SRAM and 256K ROM chips, Samsung licensed the technology from the Japanese firm Sharp.\(^{123}\) However, from 1992, Samsung stopped borrowing technology from foreign firms, and started to develop its own chips. In October 1992, it created the world’s first 64Mb DRAM in October 1992, and the world’s first 256 Mb DRAM in August 1994.\(^{124}\) Once Samsung had developed familiarity with the industry, it became more independent.

Hyundai, a major Korean chaebol head-to-head with Samsung in many industries, was similar to Samsung in that it not only had the ability to take advantage of its interlocking corporate directories, but in that it also had similar

\(^{121}\) Ibid.
\(^{122}\) Ibid.
opportunities to get significant state support. However, despite the similar governmental perks Hyundai had enjoyed, Samsung had, very clearly, outcompeted Hyundai in DRAM production. By 1994, it was Samsung, not Hyundai, that had occupied the top spot globally in terms of market share in DRAM production.125

Hyundai adopted SRAMs as opposed to DRAMs as its main focus. However, SRAMs were the high-risk, high pay-off options compared to DRAMs. While DRAMs were dominated by Japanese competition at the time, Hyundai avoided Japanese competition by entering the SRAM industry.126 Yet SRAMs required greater technological sophistication than DRAMs.127 While just like Samsung, Hyundai created a design center in Silicon Valley, it relied on just the design center and itself (as opposed to other firms) in producing the SRAMs.128

Having difficulty designing the SRAMs, Hyundai switched to producing DRAMs in 1985.129 By this time, however, Samsung was already two years into the industry.

As a result, there are multiple observations that one could notice from this chapter. First, Samsung had a defined but limited success in the chip-making industry in general. It is a common occurrence to depict the Tokyo Declaration and Samsung’s following success in the DRAM industry as a “key milestone in the history of Samsung Electronics, as it transformed the company from a

126 Ibid., 30.
127 Ibid.
128 Ibid.
129 Ibid., 22.
producer of a low-end consumer appliance to a high-tech powerhouse”\textsuperscript{130}.

However, the success in DRAM was only a miniscule step forwards towards becoming the “high-tech powerhouse” it would be in the future.

Instead of succeeding in the industry due its own innovative and design capacity, which would be vital in its climb to become the technology powerhouse, Samsung had stuck to a type of chip that required a minimum of such capability. It had not only focused on a chip that gave a premium on mass-production ability and discipline, but also borrowed technology from other firms until the early 90s. Samsung had not developed a defined innovative capacity that would allow it to compete in the frontier of the technological industry until Lee Kun-Hee takes over Samsung—as it would be shown in chapter 8. In other words, Samsung was proficient in borrowing technology from other firms and outspending its competitors once it had borrowed the necessary technology.

Furthermore, the combination of Samsung’s ability to outspend many foreign companies through the support of its affiliates and the decision of Japanese producers to diversify their portfolio to other types of memory chips were decisive factors in Samsung’s success.

Second, in this chapter, one could further observe the mechanisms of the decision making process within Samsung. Lee Byung-Chul had the final say on the decision to enter the semiconductor industry, and he entered the industry as a result of considering: 1) his son’s willingness to absorb the risk of entering the industry, 2) increased government support for the industry, and 3) his personally created task forces which researched the industry in both Korea and the US.

Third, while the government’s HCI drive was a good fit for chaebol entering the semiconductor industry, since the DRAMs were mass-produced and exported abroad, it does not differentiate the success of Samsung over Hyundai in the industry. One could note the decisions of individual chaebol played a vast role in determining the success of the chaebol in a particular industry: one could just compare Samsung’s decision to go into DRAMs and Hyundai’s decision to go into SRAMs.
CHAPTER 4

Succession, Inheritance, and Centralization of Power

The young Lee Kun-Hee was always deferential to those he met. However, when the topic was about cars, he loved to boast about how he recently raced his Porsche 200 mph around the track.\textsuperscript{131} In contrast to his austere father, not only did Lee Kun-Hee enjoy his supercars, he loved watching movies and playing with his dogs.\textsuperscript{132} While Lee Byung-Chul was still chairman of the Samsung Group, Lee Kun-Hee had made himself a reputation throughout Samsung as someone who was not serious: someone who liked to fun.\textsuperscript{133} These initial impressions would soon drastically change however.

Lee Kun-Hee was born in 1942 in the Korean county of Uiryeong, as the third eldest son amongst seven other siblings. Following his father’s footsteps, Lee graduated with a bachelor’s degree in economics from Waseda University in 1965.\textsuperscript{134} Then, in one year, by 1966, he earned an MBA from George Washington

\textsuperscript{133} Matthew Lynn, "Eccentric Tycoon Dispenses Kindness," The Sunday Times, (October 23, 1994)
University. At first, as his third eldest son, it was likely that he would not be the one to head Samsung. However, in September 1966, discord occurred within his family. Recalled as the “Saccharine Smuggling Incident,” the second eldest son, Lee Chung-Hee was arrested for smuggling 50 tons of saccharine into Korea, an act that was illegal under the Park Chung Hee regime. The saccharine was smuggled because Samsung required it for one of its fertilizer plant.

Pressured by public outcry that government officials have not been keeping corruption under control as promised, Park Chung-Hee responded promptly: not only was Lee Chang-hee arrested, Lee Byung-Chul was required to resign from his position as chairman in the Samsung group and Samsung’s Hanguk Fertilizer company was donated to the government. Consequently, the eldest son, Lee Maeng-Hee, ascended to become the chairman of the Samsung Group, a position which he occupied for seven years until 1973.

However, as Lee Byung-Chul notes in his autobiography, “I gave part of the group’s management to my oldest, Maeng-hee. And before even six months had gone by, the entire group was in chaos.” In particular, his “aggressive” and “self-righteous” attitude caused discontent among employees, and he later became...

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138 Ibid.
labeled as “mentally ill”. An incident in 1969 sealed the deal: Lee Chang Hee sent Park Chung Hee a letter, informing the latter about his father’s slush funds.

Lee Byung-Chul, however, suspected that Lee Chang-Hee conspired with his eldest brother, Lee Maeng-Hee, for sending that letter, crossing them both off the succession list for chairmanship in the Samsung Group.

While the eldest and second eldest son lost favor with their father, Lee Kun-Hee had suddenly become the perfect position to become chairman. As Lee Byun-Chul recounts in his memoirs:

I had initially planned to give the mass communications [the JoongAng Ilbo and Tongyang Broadcasting Company] to Kun-hee, my third son, but since he was working so hard for integrated management, I decided to bequeath management of Samsung to the third son.

Immediately after graduating from George Washington University, in 1966, Lee Kun Hee began his training as the executive director of the Tongyang Broadcasting Company and the JoongAng Daily Ilbo. The Tongyang Broadcasting Company created under JoonAng Ilbo, the latter of which was a newspaper company owned by the Samsung Group.

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142 Lucinda Shen, “Meet Samsung's billionaire Lee family, South Korea's most powerful dynasty,” The Business Insider, June 2015.
Lee Byung-Chul, at the age of 77, passed away in 1987 due to lung cancer. Two weeks later, his son, Lee Kun-Hee was elected as the chairman of the Samsung Group.

**Inheritance**

Before 1987, the year that Lee Kun Hee became the new chairman of the group, Samsung Foundation of Art and Culture and Samsung Mutual Aid were the majority shareholders in rest of the subsidiaries. After Lee Byung Chul’s death, the shares were distributed amongst the family and the non-listed Samsung Life Insurance Co. Ltd (previously known as Dong Bang Life Insurance). Samsung Life Insurance was not listed in the stock exchange until 2010.

For the owners of chaebol, including Lee Byung Chul, their main concerns in regards to inheritance was to minimize the taxes put on such funds. At the time, shares donated to non-profit organizations were actually exempt from such taxes. Consequently, Lee Byung Chul transferred the shares of the main Samsung subsidiaries to these non-profit Samsung organizations. Then, Lee Kun Hee bought these shares back from the non-profits. While the total assets of the conglomerate numbered around $10.81 billion, Lee Kun Hee ended up

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146 Ibid.
149 Ibid.
150 Ibid.
paying only $17 million in inheritance taxes.\textsuperscript{151} It was not until 1990 that the Korean government addressed this loophole in their inheritance laws.\textsuperscript{152}

**Centralization of Power**

Samsung and many other *chaebol* used a cross-ownership structure.\textsuperscript{153} In this type of structure, also known as circular management, cross-shareholding, or core company domination, there is at least one company that acts as the engine for the rest of subsidiaries.\textsuperscript{154} Such a company has the ability to control the rest of the group through investments.\textsuperscript{155} The CEO in this structure is not the majority shareholder of the entire group. In fact, the CEO has only a small percentage of this share. However, the CEO and his family would have be a majority shareholder of the core company, giving him an indirect, but absolute, power to control rest of the group and how the group makes investments across different subsidiaries. As Hattori notes, while Lee Kun Hee’s “stock ownership is not overwhelming, he is still the top decision maker for the whole group”.\textsuperscript{156}

In the typical company, the number of shares that one holds is proportionate to the control one has over the managerial and financial decisions of the company.\textsuperscript{157} At one end of the scale, one has *dispersed ownership* (DO),

\textsuperscript{151} Ibid.
\textsuperscript{152} Ibid.
\textsuperscript{157} Lucian Bebchuk, Reinier Kraakman, and George Triantis, “Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Creation and Agency Costs of
where, as its label suggests, the shares, thus the decision-making capability, is dispersed amongst various shareholders. On the other hand, we have a controlled structure (CS), where a very small group or individual, holds a majority of the shares, and also has a tight control over rest of the company.

However, through three different CS structures, it is possible to have a scenario when one could have absolute control over the decision making in the company, while retaining only a small percentage of the shares. These three cases fall under the heading of the controlling minority structure (CMS).

These three cases are: Dual Class Share Structure, where two or more different kinds of shares are issued, each giving different types of voting rights; Stock Pyramids and Holding Companies, where the central planner holds a majority of shares in a holding company, which then holds a controlling majority of shares in the main company; and Cross Ownership, where “voting rights used to control a group remain distributed over the entire group rather than concentrated in the hands of a single company or shareholder”. Samsung falls under the third category, as shares are held under different members of Lee Kun Hee’s family who altogether have majority shares in key companies that allow them to maintain control over the entire group.

Disentangling the web of relationships between the firms and the detailed mechanisms through which ownership of shares in a certain firm leads to a controlling shares in another is a very complex process. This is especially the case for a conglomerate like Samsung that has so many affiliates. The important takeaway however, can still be grasped without this specific knowledge: through using

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Ibid.
Samsung Everland, Samsung Life Insurance, and Samsung Electronics, which in turn, hold shares in other subsidiaries and affiliates, Lee Kun-Hee and his family, owning only 3.7% of the total shares in the Samsung Group, was still able to exercise control of its affiliates.

This general concept of how cross-shareholding works in Samsung is shown below:


As Bebchuk notes, when the number of shares that one has is not proportionate to the degree of power that one has over the firm, moral hazard results. First of all, under CSM structures, like for DO structures, the current

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159 Lucian Bebchuk, Reinier Kraakman, and George Triantis, “Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Creation and Agency Costs of
decision makers do not have to worry about hostile takeovers or other challenges to its decision making process. However, in the case of DO structures, the benefits and costs that occur due to one’s decisions for the firm are internalized.

However, this is not the case for CMS firms. Rather, CMS firms as a whole suffer from moral hazard in that the principal decision makers for the firm, having only a small percentage of the shares, can engage in risky behavior it because the costs accrue to other shareholders in the company.

This chapter has briefly explored the processes through which the chairman of Samsung was determined and the mechanisms through which the Lee family was able to maintain complete control over managerial decisions and the flow of financial investments within the chaebol.

The heir to lead the Samsung Group was determined within the family by the previous head. Tradition plays a role in determining who was eligible: by default, the eldest son would be the one to head the chaebol, and performance seems to be a secondary consideration. However, in the case that the potential heir seemed highly incompetent, Lee Byung-Chul still had the final say as to whether that heir in question would actually be chosen.

The question of inheritance was a complex and delicate affair. In order to maintain the cross-shareholding structure of the firm, which was the basis of the Lee Byung-Chul’s and Lee Kun-Hee’s centralized power, proper management of the shares between each of Lee’s family and executives was crucial. As noted in chapter 2, the job of managing Lee’s shares such that he maintains control over the Group was one of the main jobs of the Secretariat.

CHAPTER 5

The Frankfurt Conference- The Start of A New Era

In Samsung’s main headquarters in Korea, there is a sacred room. No photos are allowed inside it, and people are scarcely allowed more than a whisper. Chairs are aligned in rows to face a simple, round dining table at the end of the room, just wide enough in circumference for one person to sit in and face the audience. At first glance, it seems like any other vintage conference room or banquet hall one would find in a typical business hotel in the 1990s. However, this particular room holds special meaning for Samsung. This was a room recreated based on Samsung’s “Frankfurt conference of 1993,” which would be the start of Lee Kun-Hee’s revolution of Samsung.

Prevailing Economic and Governmental Environment

By 1987, when Lee Kun-Hee was elected president, many people at Samsung were optimistic. Following the major decrease in Japanese supply of 256K DRAMS, Samsung Electronics was able to fill in the demand by U.S firms that were frantically looking for a firm that could substitute for the decreased supply. This optimism only grew through to the early 90s.

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However, Lee did not share these strong optimistic sentiments. Lee felt a strong sense of emergency, an emotion that one could observe from his quote on the urgency of reforming Samsung:

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.161

To Lee, failure to reform to the changing circumstances did not only imply a drop in market share: it implied that the “entire Samsung Group… would disappear”. He envisioned Samsung as a world-class company creating high quality products and competing at the frontier of technological innovation.162

As previously noted, quantity driven manage partly hinges on low wages in order to outcompete similar firms in the particular industry. However, from 1985, Korea wages started to rise. Following the Korean economic liberalization in the 1980s, real wages actually doubled between 1985 and 1995, due to the rise of labor disputes.163 In fact, before economic liberalization, blue-collars were given much less wages in compared to white-collar workers due to government

enforced wage ceilings and controls that were instituted in order to lower production costs.¹⁶⁴

This increase in wages was associated with lower profits for chaebol in general, putting many chaebol in a more vulnerable position before the Asian Crisis of 1997.¹⁶⁵ Furthermore, new developing countries such as China and Indonesia that had relatively lower wages compared to Korea were starting to enter the market.¹⁶⁶

The rise in wages can be examined in the graph below:

![Graph showing outgoing foreign direct investment and real wage](source: Chang Se-Jin, Financial Crisis and Transformation of Korean Business Groups: The Rise and Fall of Chaebol, (Cambridge: Cambridge University Press, 2003), 15.)

¹⁶⁶ Ibid., 16.
Radical changes occurred not only to the economic circumstances surrounding the *chaebol*, but also to the political circumstances. Following the assassination of Park Chung-Hee in 1979, Chun Doo-Hwan, previously the Army Chief of Staff, became president in 1980.\(^{167}\) Similar to Park Chung-Hee, Chun remained committed to the HCI export-led growth embraced by Park.\(^{168}\) Led by economic advisors, Chun led the ailing Korean economy to the “miracle year” of 1982, where GDP growth levels were at an all time high.\(^{169}\) While real wage levels decreased during 1980 and 1981, in the miracle years, wages started to rise.\(^{170}\)

Although Chun had started to liberalize the Korean economy to some extent, as he was head of state, true liberalization started with Roh Tae-Woo who had become president in 1988. Roh explicitly aimed to rein in the *chaebol*, and reduced the special privileges that the *chaebol* enjoyed over other firms, such as the subsidies and lower interest rates.\(^{171}\)

Consequently, Lee Kun-Hee’s feeling of restlessness and urgency, not shared by many in Samsung due to the recent success in the semiconductor industry, was justified by the rising wages and decreasing government support for the *chaebol* in general. It is difficult to say whether Lee Kun-Hee had directly observed these changes and was compelled to move away from quantity-driven management as a result of it. Regardless, Lee’s vision of a Samsung focusing on


\(^{170}\) Ibid.

\(^{171}\) Ibid.
quality driven management instead of quantity driven management was a vision that fit in with the shifting economic and political circumstances.

**Lee Kun-Hee’s Management Style from 1987 to 1993**

Ever since Lee Kun-Hee had become chairman in 1987, he put “repeated emphasis” on quality-focused management. However, according to Samsung’s executives who worked under Lee at the time, Lee did not create new rules or institutions during this period before the Frankfurt conference. In fact, he was more of a hermit. Constantly emphasizing that, "Incentive is the greatest invention humankind ever made. With proper use of incentive, capitalism has turned out to be the winner in the confrontation with communism,” he trusted the presidents of the affiliates to make the decisions by themselves.

Rather than running the company, he seemed more concerned with meeting guests at his home. According to the Vice President of Samsung Electronics at the time, he “was the type of person who liked to listen to what others said”. Consequently, while Lee himself stated that he “repeated emphasis” on qualitative management, one could imply that he meant more of a ‘tap on the shoulder’, than any kind of formal restricting of the company. Despite the great sense of uneasiness he felt, he trusted that his executives would act when he conveyed his vision only in words.

174 Ibid.
175 Ibid.
The Frankfurt Conference
In the beginning of 1993, after years of encouraging and prodding his executives to make a tour of the world to see how Samsung Electronics was performing in the world market.\footnote{Laxmi Nakarmi and Rober Neff, “Samsung’s Radical Shakeup,” \textit{Bloomberg Business}, February 27\textsuperscript{th} 1994.}

Close to the end of his tour, he was sorely disappointed. Things were worse than he expected. For instance, when he and 23 other executives (including the then Samsung Electronics President, Kim Kwang Ho) visited Southern California in February 1993, he had found that Samsung’s TVs were accumulating dust at the back of the store, while the Sonys and Panasonics were in great demand.\footnote{Jay Yarrow. "This Bizzare Story About a Three Day Speech in a German Hotel Explains Samsung’s Culture." \textit{Business Insider} 2013, http://www.businessinsider.com/how-samsung-became-the-biggest-electronics-company-in-the-world-2013-3.} To Lee and his executives, consumers clearly considered that the goods produced by Samsung were no use buying.

This was not a new problem. Even in 1991, two years before Lee and his executives travelled the world, the Samsung TV manufacturing plant in Suwon with its 16 assembly lines created 15,000 TVs per day, each TV was worth only $135 compared to the average $474 of a Japanese TV.\footnote{Bertrand Marotte, “South Korea: An Economy With Many Glaring Contradictions,” \textit{The Gazette (Quebec)}, December 21, 1991.} Scott Jung, the head of Samsung's overseas planning department, stated: "We don't have the Japanese or U.S. sophistication yet and we're losing out on the price advantage… It's the sandwich effect".\footnote{Ibid.}
On June 4, 1993, Lee convened his top management in the Okura Hotel in Tokyo. Present in the meeting were Samsung Electro-Mechanics President Yoon Jong-Yong, the Samsung Group Senior Secretary Lee Soo-Bin, and Samsung Electronics Senior Design Advisor Tamio Fukuda. In the meeting, the executives had a discussion on new technology. After the meeting, Lee allowed the President and Secretary to leave. However, he invited Fukuda and a couple of other Japanese senior advisors, advisors whom Lee handpicked and recruited himself, to his hotel guestroom.

“Tonight, you should tell me straightforwardly how you feel about Samsung Electronics,” Lee asked the advisors. The advisors, though initially surprised by Lee’s suggestion, one after another, started to open up and began to honestly speak of the worries that they harbored regarding Samsung Electronics, continuing until 5am the following morning.

Later that month, fatigued and disappointed, but having finished the required work in Tokyo, Lee got on to the plane to Frankfurt. While on the plane, he opened up his brief case to find a disturbing report. Fukuda, his trusted advisor, had written the report, detailing all the problems that he noticed in the

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181 Ibid.
183 Ibid.
company. Later referred to as the “Fukuda Report”, Lee had gone through this report multiple times before he reached Frankfurt.\(^ {186}\)

The Fukuda Report specifically noted how the problems that Samsung was experiencing were mostly internal. Particularly, there were problems with inefficiency, poor communication (including coordination between departments), and poor division of labor.\(^ {187}\) Furthermore, the managers and designers seemed “estranged”.\(^ {188}\) The report then recommended the new mindset that the workers needed, and what structural changes were needed within the company in order to improve the situation.\(^ {189}\)

Lee had continuously emphasized quality over quantity to his executives and employees ever since he became chairman of Samsung in 1987. But he realized at this moment, that the Samsung Electronics of 1993 had failed to absorb his new philosophy at all although they had seemed so agreeable to it. Reading the report, he started to question himself and his methods so far: “Is quality management a goal so difficult to attain? Six years of effort have achieved little.”\(^ {190}\)

But the Fukuda Report was not the end to Lee’s worries. In Tokyo, just before he got unto the plane to Frankfurt, he received a video from the SBC, the Samsung Broadcasting Center. The SBC was the in-house broadcasting team a

\(^{185}\) Ibid.
\(^{186}\) Ibid.
\(^{188}\) Ibid.
\(^{189}\) Ibid.
part of the Samsung Group’s Secretariat. Upon arriving at his hotel room in Frankfurt, Lee played the video and was shocked by its contents. The video was recorded using a hidden camera, and showed unedited scenes of factory workers in an assembly line constructing Samsung washing machines. The conditions were dismal. For instance, the video showed that when the lids did not fit properly unto the washing machines, the assembly line workers roughly cut the lids by hand, and then packaged them in this condition to sell these products to the customers.

Immediately after watching this video, Lee Kun Hee called the Samsung Secretariat. Lee Hak-Soo, a mid-level employee of the Secretariat, answered the call. Lee Kun Hee shouted through the phone, "What have you been doing all this time? How little you have changed despite my repeated emphasis on quality management. From now on, I will be in charge." He demanded that all directors and presidents come to Frankfurt, immediately, and that even though Fukuda provided the report based on his concern for the company, Lee also asked that 10 million yen be sent to Fukuda. According to an executive who was nearby at the time, Lee continued to shout for an hour, and ordered the Secretariat to record the phone call and distribute it to the rest of the group.

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191 Ibid.
192 Ibid.
195 Ibid.
continues to replay this recording at training sessions for executives as a reminder of how important quality is to Samsung.\footnote{197}

Never having witnessed such a livid Lee Kun Hee before, two hundred of Samsung’s executives quickly flew to Frankfurt. These two hundred executives included not only executives of Samsung Electronics but executives of other Samsung affiliates as well.\footnote{198} This demand was shocking for the executives. Confused, but feeling that this conference should not take more than a few days, they left for Frankfurt.

The conference, however, lasted for two weeks. All two hundred executives convened in June 7, 1993, at the Falkenstein Grand Kempinski hotel in Frankfurt. The main conference lasted for three days, breaking only at the end of each day to allow the executives to get some sleep, as Lee Kun-Hee outlined his vision of the future Samsung through the “New Management Initiative”: the company must no longer be content with being a domestic leader—it must set its eyes on the international horizon. Following the three days Lee Kun Hee began to address small groups of executives at a time.\footnote{199} As Hyung Myung- Kwan recalls:

Normally, he was the type of person who liked to listen to what others said. During the period surrounding the Frankfurt Declaration, however, he became a quite different person. Most top managers of the Samsung Group who were ordered to rush to Los Angeles, London, and Frankfurt expected to stay for a few days. After two weeks, we had to start washing our underwear ourselves and hang them on the hotel veranda, to which the hotel management protested. x

\footnotetext{197}{Song-Hong Kim and In-Ho Woo, “Change Everything You Got, Except for Your Family; Chairman Lee’s Iron Will Turns Samsung into New Firm,” \textit{The Korea Herald}, May 31, 2003.}
\footnotetext{198}{Ibid.}
\footnotetext{199}{Ibid.}
On June 10, three days into first day of the conference, Lee Kun-Hee gathered his closest executives to ask for their opinions on his speech that day. Lee Soo-Bin’s answer to Lee, which proved to be fatal later on when Lee Kun-Hee was restructuring Samsung, was a sentiment that a majority of Samsung employees shared: “I'm sorry, Sir, but quantity also matters. I think quality and quantity are just like the two sides of a coin.” Lee Kun-Hee, shocked and upset by the comment, threw away the spoon he had in his hand, and dashed out of the hotel room, leaving silence in the wake. This episode, which also happened to be recorded and recalled as the “spoon incident”, was replayed at future executive meetings to demonstrate Lee’s commitment to quality over quantity.

After the conference, he turned his speech into 200-page book, distributed to all employees. Those who could not read were given cartoons depicting the speech instead. Samsung bought all the ornaments and furniture from the conference room in the Frankfurt hotel in order to recreate the very same room in its headquarters.

In his speech, Lee Kun-Hee emphasized to his executives that they must “change everything but [their] wife and children.” To Lee Kun-Hee, this was no over-exaggeration by any means. He believed that, for Samsung to achieve worldwide prestige, its employees must change in a fundamental way, down to

201 Ibid.
202 Ibid.
203 Ibid.
205 Ibid.
206 Ibid.
207 Ibid.
their very mental and physical habits—as Lee emphasized, each employee must internalize the phrase “change must begin with me.” They must become different people. Yet, as one could probably predict, this was no simple feat. People cannot suddenly change overnight, as habits and experiences accumulated over decades cannot be easily reverted. While the Frankfurt Conference of 1993 signified a new beginning for Samsung, it had taken more extreme measures than words to change the employees of Samsung.

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CHAPTER 6

The Relationship Between Government and Lee Kun-Hee’s Samsung

Following president Roh Tae-Woo, chaebol increasingly seemed like economically inefficient entities. At this point, there was a fundamental change in the cooperative relationship between the government and the chaebol, as the government took a stronger stance in trying to rein in the chaebol. However, at the same time, chaebol dominated the Korean economy, and the government had to tread carefully in carrying out these initiatives aiming to reform the chaebol.

The Korean government and the chaebol had to play a delicate balancing game. Each needed the other. Yet, increasingly conflicting goals meant that the government had to see to what extent it could reform the chaebol without hurting the government and the economy, while the chaebol had to experiment with what extent the could break government regulations while not incurring sanctions.

For Roh’s government, there were three clear-cut problems with the chaebol other than inefficiency. First, since chaebol often received privileged interest rates, smaller firms had to pay for high interest rates, up to rates of thirty percent. Second, the emphasis on market share over profits was problematic. "When you go after market share and not profit, you don't generate enough capital," said a banking analysis in 1991. "So you have to go back to the banks.

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210 Ibid.
again and again. This indicated high debt to equity ratios, which the government found problematic. Therefore, Korean banks, "which act[ed] in cartel fashion to promote selected companies" had to constantly deal with bad debt.  

Third, many of the chaebol, each being involved in so many different sectors, actually overlap quite a bit in the sectors that they have in common. The result is "wasteful duplication" of goods. Interestingly, it is noted that it is a "time honored tradition" to enter the same industry as their competitors.

Roh Tae Woo, once becoming president in 1988, instituted a new policy requiring chaebol to reduce their focus to three sectors. Otherwise, the government imposed stiff credit limits on chaebol that do not follow this rule. While the next president, Kim Young Sam had enforced similar policies that tried to limit the chaebol's ability to diversify, and further added measures such as: a financial sector deregulation program, restriction of policy loans (when the businesses could borrow from state owned banks for very low interest rates), and abolishment of aliases in transactions (which chaebol used considerably for shareholdings). However, government attempts to force the chaebol to focus on a few core industries proved difficult.

At first, the chaebol seemed to abide by these new rules by dropping some subsidiaries. For instance, in 1993, Samsung reduced the number of its subsidiaries from 48 to 34, going to the extent of dropping its two core

\[\text{\footnotesize{211 Ibid.}}\]
\[\text{\footnotesize{212 Ibid.}}\]
\[\text{\footnotesize{213 Ibid.}}\]
\[\text{\footnotesize{214 Ibid.}}\]
\[\text{\footnotesize{215 Ibid.}}\]
\[\text{\footnotesize{216 Ibid.}}\]
\[\text{\footnotesize{217 SN Vasuki, "The Samsung Revolution," Business Times (Singapore), February 1994.}}\]
capabilities: foods and textiles.\textsuperscript{218} However, this behavior seemed to demonstrate more of a move to earn favors with the new president rather than one due to allegiance to the law. In fact, Hyundai and Samsung, soon after, announced plans to diversify, and then took over other businesses clearly not counted in their core capabilities. For instance, Samsung soon took over two state-run businesses: Korea Fertilizer and Chemicals, and the Seohyung station shopping mall\textsuperscript{219}.

Earning favor with the new President seemed to be purely a means to further self-interest. While Lee Kun-Hee was at the forefront of Kim Young-Sam’s new business policies, appearing as a full supporter of Kim Young-Sam’s policies, he would quickly, for instance, turn to diversify to a new industry. For instance, when Lee Kun-Hee had clearly become Kim Young-Sam’s new favorite, Lee used to advantageous position to attempt a takeover of Kia Autos, much to Kim’s discontent\textsuperscript{220}.

One reason why these government initiatives were failing was due to the power that the \textit{chaebol} had in the economy. Forcing sanctions on them would hurt the entire Korean economy—in spite of stricter government laws, \textit{chaebol} concentration of wealth only increased: the combined share of the top ten \textit{chaebol} of the entire economy grew from 15.1\% in 1974 to 32.8\% in 1984.\textsuperscript{221} Arresting the executives and chairmen of the \textit{chaebol} would only cause internal disruption within the \textit{chaebol}, again, potentially hurting the Korean economy when the \textit{chaebol} hold such a high concentration of wealth.

\begin{thebibliography}{99}
\bibitem{218} Ibid.
\bibitem{220} Ibid.
\end{thebibliography}
An additional factor that could possibly explain the failure of these initiatives is simply corruption. On December 5, 1995, former president Roh Tae-Woo (president from 1988 to 1993) along with the chairmen of Daewoo and Samsung were charged with bribery in connection to a slush-fund scandal\textsuperscript{222}. Roh was charged, specifically, for accepting $370 million in bribes, funds deriving from the Chaebol. Lee Kun Hee was charged with paying $10 billion won to Roh in order to secure a license that allowed Samsung to begin production in the automobile industry—a license that was rejected at first earlier in the 1990s\textsuperscript{223}. While the funds also suggested that executives of many other Chaebol, such as Hyundai, were involved in the slush-fund, they were not charged as the funds which they had given were “insignificant”\textsuperscript{224}.

Lee Kun and the chairman of Daewoo were not arrested, however, as their arrest, according to prosecutors, would have significantly slowed down the economy\textsuperscript{225}. Observers of this incident were surprised that Lee was charged with bribery, as he had, on the face of it, enjoyed good relations with the former president during his term, and should not have had to offer “donations” in order to gain particular privileges\textsuperscript{226}.

Another initiative that the government had tried to implement after Kim Dae Jung became president in 1998 was the policy of “financial burden sharing”. Under this policy, in case where a certain business decision fails for a chaebol, the

\textsuperscript{223} Ibid.
\textsuperscript{224} Ibid.
\textsuperscript{225} Ibid.
\textsuperscript{226} Ibid.
chairman was required to pay for a considerable part of the resulting debt.\textsuperscript{227} This seemed to be a policy designed to combat the moral hazard created by cross-shareholding while not disrupting the economy by hurting the operations of the \textit{chaebol}— compared to, for instance, arresting the chairman.

Samsung and the many other \textit{chaebol} did not greatly reduce their number of affiliates and change the ways that they traditionally operated (under the Rhee and Park regime) until after the financial crisis of 1997, prompted not by legal sanction, but by economic necessity.

Thus, when Lee Kun-Hee became chairman in 1987, government support for \textit{chaebol} was on a decreasing trend. The Park Chung-Hee government at least provided subsidies or tax breaks, even though it did not provide the necessary infrastructural aid, when Samsung entered the semiconductor industry in 1983. However, following Roh’s government, the state attempted to force the \textit{chaebols} to become more independent entities, and refrained from giving them special privileges. While economic liberalization of Korea was a gradual process, one could observe that government support for \textit{chaebol} was at its peak during the Rhee and Park regime.

\textbf{1997 Financial Crisis}

By 1997, the World Bank had heralded Korea as an “Asian Miracle”, drawing attention to its per capita income growth: while per capita income was at $82 in 1961, it grew to $10,315 by 1997.\textsuperscript{228} However, in the midst of this period


\textsuperscript{228} Se-Jin Chang. Financial Crisis and Transformation of Korean Business Groups: The Rise and Fall of \textit{Chaebol}. Cambridge: Cambridge University Press,
of optimism, something was awry. Earlier in 1997, some of the top chaebol, such as Hanbo and Kia, went bankrupt.\textsuperscript{229} In Korea, it was unheard of for the top chaebol to go bankrupt—usually, the government rescued the chaebol from bankruptcy.

Beginning with the crisis with Thailand’s currency, a foreign exchange crisis began to unfold over the rest of Asia by July 1997. As unstable foreign exchange rates drained the foreign investment from Korea, following the bankruptcy of multiple to chaebol, the Korean government introduced the “anti-bankruptcy agreement”. They further increased interest rates to 25 percent. By December 1997, approximately 3,500 firms in South Korea were going bankrupt per month.\textsuperscript{230}

Many of the Chaebol were particularly vulnerable during from the crisis, as they experienced a steep drop in profits even before the crisis hit, particularly due to the inability to compete in both low-end and high-end exports, despite great success in DRAM manufacturing.\textsuperscript{231} Korea was losing its competitive edge in low-end, quantity intensive labor as economic liberalization and growing labor disputes doubled real wages between 1985 and 1995.\textsuperscript{232}

However, unlike many of the other Chaebol, Samsung was prepared. In April 1996, Lee Kun Hee, in a flash of insight, predicted that the extreme fluctuations in the industries are suggestive of an acute financial downturn in the near future. Consequently, Lee and the executives spent two months creating detailed emergency plans, which consisted of downsizing and restructuring the

\textsuperscript{229} Ibid.
\textsuperscript{230} Ibid., 4.
\textsuperscript{231} Ibid., 16.
\textsuperscript{232} Ibid., 16.
firm, along with a new risk management system, taking into consideration the worst-case scenario.

When the financial crisis of 1997 actually erupted, Samsung quickly put the plans it had devised earlier into use. While managers were given a greater scope of autonomy, methods of evaluation were adopted to match Western standards. Furthermore, many of Samsung’s affiliates were sold, based on profit levels, so that the company could put more focus on core capabilities and put less emphasis on diversification. While Samsung had sold off its businesses in construction machinery, power devices, retile, and defense industry, it also sold off its semi-conductor plant in Bucheon, which was still generating high profits, in order to put more of its resources into the DRAMs industry.

Not only were many of its branches sold, it also introduced many mergers. Samsung became a minority shareholder in the aerospace, power generation, and ship engine industries, while withdrawing from the satellite, machine tool, camera, and bathtub industries. Additionally, it spun off 231 firms that were in the audio systems, camcorder, clothing, and retailing industries. Lastly, it divested 28 companies, including JoonAngIlbo (a newspaper company), Hanil Cable TV, Daehan Fine Chemicals, and Hantok Chemicals.

234 Ibid.
236 Ibid.
237 Ibid., 52.
CHAPTER 7

Lee Kun-Hee’s Managerial Style and the Dispersion of Power

Following the Frankfurt Conference, Lee Kun-Hee had reformed core aspects of Samsung, including its working hours, factory procedures, the Secretariat, and its compensation policy.

The 7-4 Working Scheme
Under the old Samsung, employees worked around 10 hours to 12 hours per day, preferring to draw out their work over longer hours. This behavior was in fact, common not only to Samsung, but also to many businesses in Korea. In fact, it was an honored tradition central to Korean business culture, where leaving early before one’s superior was a sign of significant disrespect to the superior and disloyalty to the company.

However, Lee encouraged employees to start being more efficient, and made employees get the same amount of work done as they usually would, starting at 7am and ending at 4pm. This initiative, although implemented before the Frankfurt Conference, was not fully enforced until after the conference.

Many executives voiced concerns about this initiative. As Lee recalls: “Frankly, even I hesitated for some time, listening to those who posed reasonable opposition

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238 Ibid., 47.
240 Song-Hong Kim and In-Ho Woo, “Going to work at 7: wake up call for sleeping Samsung; 7-to-4 workday scheme marks starting point of Lee's bold reform for his business empire,” The Korea Herald, June 5th, 2013.
to the adoption of the 7-to-4 workday. However, I finally decided to stay the course despite such doubts, because I really wanted my employees to be T-type workers." By “T-type” workers, Lee is referring to types of employees who not only specialize in one thing, but also have wide range of abilities and interests.

According to Lee Hak-Soo, this new enforced schedule “was the first sign of a series of measures taken to induce mental transformation through forced behavioral transformation.” As President Pae Chong-Yeul, the Planning Team Leader at the Secretariat also noted: "the new work day system was a multipurpose scheme. By allowing Samsung employees to reduce the time for commuting, it increased efficiency. It also allowed them to study after work and spend time with their families." Lastly, a radical change in schedule would force the employees to think that it was time to significantly change their mindset.

But, forcing employees to divorce themselves from this time-honored tradition was difficult. While the company closed at 4pm, many employees lingered after the closing hours in order to work, having trouble adjusting to the new schedule. Not only did Lee have to order the Secretariat to create a task force to keep the employees on schedule, he had to resort other measures. He also personally called each senior executives of the various work groups, pleading

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241 Ibid.
242 Ibid.
243 Ibid.
244 Ibid.
them to leave the office by 4pm.\textsuperscript{246} When all of these efforts failed, Lee Kun-Hee started to cut after 4pm.\textsuperscript{247} The last measure did the job.\textsuperscript{248}

**Changes to Assembly Line Operation**

Samsung’s factories are clustered within complexes.\textsuperscript{249} With its own recreational and residential area, this complex seemed like a city of its own.\textsuperscript{250} For instance, Samsung’s Suwon complex had approximately 25,000 employees.\textsuperscript{251} While all workers ate regularly at one of the six cafeteria areas located within the complex, around 8,000 of the workers returned to one of twenty rent-free apartment buildings located in the southwest area of the complex.\textsuperscript{252}

Each of these 18 factories had its own designated products, including microwave ovens, refrigerators, color television sets, videocassette recorders, light bulbs, watches, audio equipment, vending machines, and computers.\textsuperscript{253}

Before the 1990s, there were severe wage inequalities between those that had received a college-level education and those who did not. Blue-collar workers were given much lower pay as a result of ceiling and wage controls created by the Korean government in order to lower production costs.\textsuperscript{254} Around 1993, however,

\textsuperscript{247} Ibid.  
\textsuperscript{248} Ibid.  
\textsuperscript{250} Ibid.  
\textsuperscript{251} Ibid.  
\textsuperscript{252} Ibid.  
\textsuperscript{253} Ibid.  
following the rise of labor unions in Korea, companies such as Samsung created a payment system that was fairer to blue-collar workers.

In 1995, 100,000 Samsung cordless telephones were burned in front of the factory. Surrounded by banners that stating “Ensure Quality”, 2,000 workers gathered in front of Samsung’s factory in Gumi as they watched the mountain of products getting burnt to ashes. A while before, Lee handed out cordless telephones made by Samsung as a New Year’s gift for 2,000 employees. These employees complained of the quality of the phones: it was difficult to make phone calls when they are such poor quality. Lee, seemingly having made his point to the employees how poor Samsung’s phones are, recalled all cordless telephones, and suspended assembly lines until higher quality phones could be made. He proceeded to destroy 100,000 cordless phones that were recalled in front of his factory.

Even in 1995, two years following the New Management Initiative, the factory workers had not yet fully embraced Lee’s ideals. As during Lee Byung Chul’s time, employees still allowed defects to pass through in order to keep the lines running, as disruptions in the assembly lines greatly hindered speed. Following this episode of burning the phones, Lee’s directly intervened in relating to factory-level processes, passing the policy of “curtain stop”. This policy demanded that assembly lines and stores that were producing defects were closed until the defects were eliminated.

257 Ibid.
Reforming the Secretariat

After declaring the New Management Initiative in the Frankfurt Conference, one of Lee’s first targets was the Samsung Secretariat—in particular, Lee Soo-Bin, the head of the division. As noted in chapter 2, the Secretariat performed vital functions in coordinating and administering all the affiliates within the Samsung Group.

A hundred days following the conference at Frankfurt, the top management created a document titled, “What to Do Regarding the Promotion of the New Management System,” which included recommendations on reforming the secretariat, the criteria for evaluating employees, and education of employees regarding the New Initiative. The top managers included Samsung Electronics Chairman Kang Jin-goo, Samsung Electronics Vice Chairman Kim Gwang-ho, Lee Soo-bin [head of the Secretariat], and Samsung Engineering & Construction President Hyun Myung-kwan. However, it was most likely that Lee Soo-Bin was not included in the drafting of the report, as one of the reports main clauses included suggestions as to who could replace Lee Soo-Bin as head of Secretariat.

The top management noticed Lee Kun-Hee’s skepticism of Lee Soo-Bin’s ability to carry out the former’s vision—a skepticism that only grew stronger when Lee Soo-Bin, had honestly contributed his opinions on his support for quantity driven management during the “spoon incident”. Thus, the report suggested three members who could replace Lee Soo-Bin. The report also recommended that two members, Lee Hak-Soo, should handle matters related to the New Initiative, and Bae Jong-Ryul, who was well acquainted with running a

258 Sung-Ho Kim and In-Ho Woo, “Do They Need Higher Authority than Chairman?,” The Korea Herald, June 3, 2003.
259 Ibid.
260 Ibid.
real business, should support the new head executive of the Secretariat.\textsuperscript{261} These two members would also be responsible for selecting team leaders in their 40s who had demonstrated competence in regards to foreign affairs.\textsuperscript{262}

While the research and selection of potential candidates were left to the core executives, Lee Kun-Hee was in charge of the final decision. Upon reviewing this report, Lee Kun-Hee selected Hyung Myung-Kwan to become the head of the Secretariat. In particular, Lee Kun-Hee wanted an outsider to Samsung—someone who had not entered Samsung immediately after graduation and had cemented strong relationships within the company ever since.\textsuperscript{263} Hyung Myung-Kwan, was previously a member of a government agency, the Board of Audit and Inspection, until he became a member of the Samsung Group in 1978 as a middle-aged man, first as part of the Jeonju Paper, then as president of Samsung Engineering and Construction.\textsuperscript{264}

Hyun Myung-Kwan was then called to Lee Kun-Hee’s residence for an interview. Pleased with Hyun’s answers to his questions, especially in regards to how Hyun wished to have more autonomy given to Samsung’s executives, Lee formally offered Hyun to become the head of the Secretariat.\textsuperscript{265} Hyun, although hesitatingly, accepted the offer. Lee Soo-Bin, the former head of the Secretariat, was transferred to head Samsung Securities, an affiliate of the Samsung group.\textsuperscript{266}

\textsuperscript{261} Ibid.  
\textsuperscript{262} Ibid.  
\textsuperscript{263} Ibid.  
\textsuperscript{264} Ibid.  
\textsuperscript{265} Ibid.  
\textsuperscript{266} Ibid.
It was shocking for Samsung to witness Lee replace Lee Soo-Bin, the original executive director of the secretariat, with Hyun Myung-Kwan.\textsuperscript{267} As noted previously, to become the secretariat’s director, the employee had to start from an entry-level position in the secretariat and move up from there to reach the executive positions. Lee Kun-Hee was challenging structures and traditions that had existed since the beginning of Samsung’s founding.

As soon as Hyun was appointed head of the Secretariat in 1993, Lee first instructed Hyun that the latter should promote projections to increase innovation within the group, without having to consult or check with Lee.\textsuperscript{268}

In a recent interview, when asked to recall an incident of self-regulated management, Hyun Myung-Kwan recalls an incident that would have caused "uproar" in other chaebol during the time:

> In 1994 or so, Samsung took over Korea Fertilizer. Our bid price was about 20 billion won higher than the price submitted by Keumgang Korea Chemical, a Hyundai Group company, I remember. Reporting the matter to Chairman Lee who was traveling overseas, I said I felt very sorry about the wide margin in the price. He said, 'Don't worry. What is important is that we now have what we want.' Just imagine how great an uproar there would have been in a similar case experienced by other business groups. This shows that Samsung Group presidents are allowed a great deal of authority in decisions. They discuss important matters with the Secretary's Office, but the final decision is theirs to make."\textsuperscript{269}

In this passage, it is hard to pinpoint where the “autonomy” in the incident, as the whole incident as a whole is poorly explained and vague. However, it seems that the final decision to bid 20 billion higher than Hyundai was made without the input of Lee Kun-Hee, as he was abroad and unavailable. When Lee

\textsuperscript{268} Ibid.
\textsuperscript{269} "On Reform Front,” \textit{The Korea Herald}, June 3, 2003.
Kun-Hee was told of the issue, he was not upset, but trusted that the executives made the correct decision.

Lastly, the point that Hyun makes regarding how “[Samsung Group Presidents] discuss important matters with the Secretary's Office, but the final decision is theirs to make,” shows how the Secretariat now had limited authority over the decisions of the presidents of the individual affiliates. This limitation of the Secretariat’s authority was perfectly in line with Hyun’s philosophy of giving greater autonomy to the executives of each affiliate.

Yet, executives still discussed their projects with the Secretariat. While the Secretariat’s role in decision making shrunk greatly after the New Management Initiative, it did not mean that the Secretariat became a useless entity. It retained its function of being the eyes of the Samsung Group’s chairman, as a reliable source of information as to what was going on in the Group—whenever the Chairman was interested in the information.

Hyun had later had observed that, “Lee Kun-Hee [had] once expressed his concerns that intervention by the Secretary's Office in the decision-making process drove away the atmosphere of creative thinking”. It is thus not surprising that, upon selecting the head of the Secretariat as an individual who wanted to give greater authority to executives, Lee, in October 23, 1993, had the Secretariat was downsized. Furthermore, the Secretariat started to give greater preference to hiring younger executives experienced in dealing with international trade.

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270 Ibid.
273 Ibid.
Yet, even though Lee Kun-Hee and the Secretariat dispersed the power to make decisions to those lower in the hierarchy, it did not mean that they lost this power forever. One case in which Lee Kun-Hee and the Secretariat used their power was when an affiliate or individual failed to see the bigger picture. For instance, the Secretariat was also nicknamed the “control tower for the New Management Initiative”, had great power when it came to carrying out the Lee Kun-Hee’s vision displayed in the Frankfurt Conference. Furthermore, as noted before, Lee Kun-Hee was able to easily replace high-level executives such as Lee Soo-Bin.

Lee Kun-Hee and the Secretariat also asserted their power in times of emergency. If one could recall from chapter 8, following the financial crisis of 1977, Lee Kun-Hee played a central role in determining the plans for the crisis. On the other Lee Hak-Soo, the head of the Secretariat during 1997, played a central role in coordinating the affiliates and reforming the Samsung Group as whole: he was known as the “brains” behind this major restructuring process when the Samsung Group had to make decisions behind what affiliates to keep, and what affiliates to sell.

In December 1996, Hyun Myung-Kwan was demoted to the position of vice-chairman of the Samsung C and T Corporation, the construction affiliate of the Samsung Group. Lee Hak-Soo replaced Hyun Myung-Kwan, although the circumstances of the demotion are unclear.

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274 Ibid.
Lee Hak-Soo had formally climbed ranks through the Secretariat the formal way. He was the also one to answer Lee Kun Hee’s enraged phone call shortly before the Frankfurt Conference, when Lee Kun-Hee had watched the video of the hand-cut lids in his hotel. As a side note, despite similar last names, Lee Hak-Soo and Lee Kun-Hee are not relatives.

Lee Hak-Soo first joined the Samsung Group as an employee of Samsung’s clothing and chemical subsidiary, Cheil Industry. Acknowledged for his financial prowess, Lee Hak-Soo then joined the Samsung Group’s Secretariat in 1987. Following the Frankfurt conference, Lee Hak-Soo became the head of the Samsung Fire and Marine Insurance branch. In August 1996, Lee Hak-Soo, was placed back into the Secretariat as Deputy Chief Secretary, replacing Hyung Myung-Kwan to became Chief Secretary four months later, early in 1997, to became the “No.2” of the Samsung Group and Lee Kun Hee’s close confidante and right hand man.

Lee Hak-Soo while being known as the loyal retainer to Lee Kun-Hee due to his twenty-four years of service to the family, is known as the “lonesome dove” of the company. Friendly to subordinates, but a man known to often keep to himself, Lee Hak-Soo seldom dines with company employees in fear that doing so would draw attention away from the chairman, Lee Kun-Hee. At the other end,

278 Ibid.
279 Sung-Ho Kim and In-Ho Woo, “Sometimes, we need guts to close a business'; For Samsung's successful restructuring, Lee even considered giving up non-core affiliates,” The Korea Herald, September 23, 2003.
280 Ibid.
282 Ibid.
subordinates are afraid to ask Lee Hak-Soo to a meal, assuming that the latter does not have the time to do so.\textsuperscript{283}

Samsung Officials say that Lee Kun-Hee, who was solemn for a while upon returning from a forty-day overseas trip due to legal problems, finally relaxed and managed a smile for the first time upon seeing Lee Hak-Soo. Officials recognized this moment as displaying the “level of trust Chairman Lee has in Lee [Hak-Soo]”.\textsuperscript{284}

Due to allegations of secretive wire-tapping and slush fund fraud, the Secretariat was further downsized to 99 employees in 1996, before Lee Hak-Soo became the head of the division.\textsuperscript{285} The Secretariat in this period was known also as the Samsung Restructuring Office, but it still retained its function as the central control tower of the New Management Initiative overlooking all of the Group’s affiliates.\textsuperscript{286}

As Lee Hak-Soo and the Secretariat was responsible for overseeing Lee Kun-Hee’s family assets, prosecutors frequently called him to court as the perceived mastermind behind Samsung’s scandals of political bribing, tax evasion, illegal transfers of wealth, and illegal bond transactions.\textsuperscript{287} Continually under fire by the government and the public for scandals such as managing slush

\textsuperscript{283} Ibid.
\textsuperscript{284} Ibid.
\textsuperscript{285} Kim Yoo-Chul, “Samsung Control Fades Out After 50 years,” \textit{Korea Times}, April 22\textsuperscript{nd}, 2008.
\textsuperscript{287} Kim Chung-Hyo, Samsung, Media Empire, and Family (New York: Routledge Publishing, 2016), 93.
funds and illegal transfers of Lee Kun-Hee’s family assets, the Secretariat, after 50 years, was finally abolished in April 2008.\footnote{Kim Yoo-Chul, “Samsung Control Fades Out After 50 years,” \textit{Korea Times}, April 22\textsuperscript{nd}, 2008.}

On April 2008, Hyun Myung-Kwan, the previous head of the Secretariat, also confessed that “he has kept some 280,000 shares of Samsung Life Insurance Co. under so-called borrowed name accounts and that the real owner of the shares is Samsung Chairman Lee Kun-hee”.\footnote{Ibid.} Korean prosecutors have repeatedly emphasized that this illegal action of faking account names was for the purpose of storing slush funds for the group.\footnote{Jin-Seo Cho and Young-Jin Oh, “Lee Hak-Soo—Lonely No.2,” \textit{The Korea Herald}, November 3\textsuperscript{rd}, 2006.} Regardless of whether the accusation of storing slush funds was true or not, the Secretariat clearly still played a central role in making decisions about delicate financial matters.

Lee Hak-Soo’s formal job was as the “head of the Secretariat”. However, Lee Hak-Soo was also, informally, the chief advocate and loyal supporter of Lee Kun-Hee. Not only was he responsible for answering prosecutors’ questionings or facing politicians in inspections carried out by the National Assembly in Lee Kun-Hee’s stead, he was the one to accompany Lee Kun-Hee to the US when the latter was receiving treatment for cancer.\footnote{“Samsung Chairman Returns Home,” \textit{Korea Times}, April 6, 2000.} \footnote{“Samsung Chief Resigns Under Cloud of Scandal,” \textit{Los Angeles Times}, April 22, 2008, accessed April 7, 2016, \url{http://articles.latimes.com/2008/apr/22/business/ff-samsung22}.} When Lee Kun-Hee resigned in April 2008 over a tax evasion scandal, Lee Hak-Soo also turned in a resignation statement.\footnote{Ibid. 291}
In this section, the narrative has shown how as the decision making power was deferred to heads of the individual affiliates within the Samsung Group, the purpose of the Secretariat grew more clearly defined as an entity that took of matters that required Lee Kun-Hee’s complete trust: observing the events that were going around in the firm and taking care of delicate financial matters, such as matters relating to managing Lee’s assets.

However, as noted throughout this section, Lee Kun-Hee and his Secretariat made the decisions when it came to emergencies or failure of executives and employees to see the larger picture.

The New Hiring, Promotion, and Compensation Policy

The new payment scheme instituted by Samsung in 1993 put greater emphasis on productivity and skills as opposed to seniority. Base pay was split into two categories: common pay and merit pay.\textsuperscript{294} The level of common pay increases every year regardless of productivity.\textsuperscript{295} Merit pay was further split into two categories: non-performance based and performance based. Non-performance based merit pay increased annually regardless of performance, and was the scheme used for lower level employees.\textsuperscript{296} Performance based merit pay, used for all higher level employees was based on performance, measured by grades received in the one competence evaluation and two performance evaluations.\textsuperscript{297} The direct supervising manager determines the performance grades, while higher-


\textsuperscript{295} Ibid.

\textsuperscript{296} Ibid.

\textsuperscript{297} Ibid.
level manger in the division or the executive determine the competence grades are determined. Upon determining the final grade, managers met with their subordinates to discuss how the latter could improve.

Furthermore, as for managers and staff-level employees, high-level executives were no longer compensated based on seniority. Instead, high-level executives were paid wages based on contribution to the Economic Value Added (EVA), essentially the profits of the organization. Since 2002, CEOs were also evaluated on how well they were able to recruit and retain skilled managers and employees, including those from abroad who had experience in major companies.

The higher the employee’s position, the greater the role that merit played, and thus, one’s productivity, plays. Furthermore, due to merit pay, well-performing employees could actually earn greater pay than their superiors. By 1994, according to a Samsung survey, 70% of the employees agreed to the change in wage incentives.

Under Lee Byung-Chul, the Secretariat hired members based on connections and loyalty. For instance, employees were trained in-house upon graduation from university, usually recommended by employees who were

298 Ibid.
299 Ibid.
300 Lee Jee-Eun, “” The Korea Herald (December 21, 1993).
303 Ibid.
already working within Samsung, and stayed in Samsung for the rest of their lives. However, this emphasis on loyalty in hiring policies also gradually disappeared.

While the practice of hiring Korean engineers and managers from Intel, IBM, and Bells (while offering them salaries higher than the CEOs of companies that they previously worked in) technically started when Samsung entered the semiconductor business in 1983, this emphasis on outside talent only grew to play a more prominent role after Lee Kun-Hee had become chairman.304 In 1993, all of Samsung’s new hires were new graduates from high schools or universities.305 By 2012, however, 30% of the new hires had already worked in another company beforehand.306 Furthermore, the hierarchy of employees consistently change through the “annual year end personnel reshuffling”.307

Each affiliate had its own human resources (HR) department, which it had full responsibility and autonomy over.308 In regards to the specific hiring practice, while university-level education was no longer required, employees must sit a separate aptitude exam, make a presentation on a free theme of choice, and get interviewed by both a relevant Samsung executive and an external professional.309

As a result of all these changes, the tradition of hiring based on insider connections also greatly diminished over time. In fact, as Hyun Myung-Kwan notes, “at Samsung, there has been a tradition that those with a close relationship

305 Ibid., 88.
306 Ibid.
307 Ibid., 46.
309 Ibid., 143.
to the chairman are excluded from management. Even a person of ability sometimes finds it difficult to scale the corporate ladder if he or she has a close relationship with the chairman.310 In fact, many of the Lee Kun-Hee’s close personal friends working at Samsung ended up quitting the company on their own due to poor opportunities for advancement.311

However, performance driven hiring and compensation practices came at a cost: loyalty to the entire Samsung Group became a less important consideration. Thus, Lee Kun-Hee had also created compensation based on collective performance, making compensation also reliant on evaluations by fellow affiliates, divisions, and teams.312

This section has shown how the hiring, training, and promotion decisions regarding employees were made by the individual affiliate as opposed to the Secretariat (even though Lee Kun-Hee still made the decisions about hiring or promoting high level executives).

This section had also shown matters related to the decreasing loyalty for the Samsung Group as a whole, due to the new importance of performance in hiring, training, and compensation evaluations. Employees working in Samsung were no longer those who have worked for the company for their entire lives. Employees who had worked in other firms for significant periods of time were also recruited in large amounts. Furthermore, compensation depended on performance, incentivizing individuals and affiliates to pursue selfish interest at

311 Ibid.
the cost of the larger organization. Lee Kun-Hee had constrained this latter problem by adding collective categories of evaluations into the evaluation report.

**Lee Kun-Hee’s Return Reclusive Style of Management**

While Lee Kun-Hee continued to play a central role in reshuffling high level executives, he returned to his reclusive style of management that he had used previous to the Frankfurt conference, after he had instituted all the necessary changes. Thus, as a chairman, his unofficial title became the CVO, or, the “Chief Visionary Officer”.\(^{313}\) He removed himself from the day-to-day practices of the firm, and instead, focused on shaping a vision of the company and its long-term goals.

In fact, he rarely visited the headquarters at all and did not attend the board meetings.\(^ {314}\) In contrast to his father’s open door policy, he purposefully worked from home, usually only being available by telephone in emergencies, to encourage executives to work things out for themselves.\(^ {315}\) He occasionally, however, had lunch with top executives in order to discuss the NKN news, and discuss how the events described in the news might affect Samsung, and how Samsung should plan for the future according to these events. Since by tradition none of the executives dared to eat during this lunch (except the chairman himself), executives quickly ate their lunch early before the meeting in the Samsung’s basement, where lower-ranked employees usually ate. Matters not relating to the over-arching vision of the company were left purely to the top-level


\(^{315}\) Ibid.
executives.

One of his main principles was, “Once you appoint a person, trust him and let him take charge.”³¹⁶ Staying at his house or having lunch with a guest at Shilla Hotel for most times, only a few executives had the chance to talk directly with the chairman.³¹⁷ In the rare instance that the chairman contacted one of his executives, it was an unexpected call. As Lee Ki-Tae, the president of Samsung Electronics Telecommunications recalled:

One evening last summer, I was taking a stroll with my wife in our neighborhood, when the chairman's secretary called me to say that the chairman would like to talk to me. The chairman asked me how I was doing, if there was anything particularly difficult to handle, how development of new products was going, and which brands of wines were good at the time.³¹⁸

Most of these calls were pep-talks and words of appreciation.³¹⁹ However, Lee Kun-Hee sometimes called abruptly with sudden questions on a certain project or hiring policy, and would also shock his executives with “surprise decision[s]”, to reshuffle the organization.³²⁰

Furthermore, as the president of Samsung SDI recalled, soon after he hired new core employees, Lee Kun-Hee abruptly called him to ask where he had hired

³¹⁷ Ibid.
³¹⁸ Ibid.
³¹⁹ Ibid.
³²⁰ Ibid.
these core employees. While Lee Kun-Hee trusted decision making to his employees, this trust did not mean that Lee did not keep track of what was happening around in the firm.

One could thus infer that the executives did not have complete autonomy in the negative sense. They still had “rules” that they had to follow: they had to keep to Lee Kun-Hee’s vision.

In conclusion to this chapter, we observed the changing power dynamics of the three major “players” in the Samsung Group (Lee Kun-Hee, the Secretariat, and the executives/employees), and thus, necessarily observe a greater division of labor between the three players that had not existed in the old Samsung under Lee Byung-Chul. In particular, through this chapter alone, one can detail the powers of two of these three plays: Lee Kun-Hee and the Secretariat.

Lee Kun-hee, unlike Lee Byung-Chul, used his power throughout the New Initiative to reshuffle major executives and create infrastructural change that emphasized efficiency over loyalty to the Group and seniority. However, once these structures were set, Lee Kun-Hee returned to his reclusive style of management that characterized the post-1987 and pre-Frankfurt era. He deferred his power to Secretariat and his executives, although he continued to make major decisions in the hiring of high-level executives or intervened in cases of emergency.

The Secretariat under Lee Kun-Hee, unlike the Secretariat under Lee Byung-Chul, also deferred power to the high-level executives. However, it functions became more focused as an entity that carried out functions which

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321 Ibid.
required Lee Kun-Hee’s trust. These functions included keeping up discussions with executives and observing the events occurring within the firm, and dealing with delicate financial matters.

The type of relationship between Lee Kun-Hee and Lee Hak-Soo, the head of the Secretariat—based fundamentally on loyalty, like that of vassal to lord—was a type of relationship that was becoming rarer as the Samsung Group became increasingly focused on performance over loyalty.

The picture of the new power dynamics within the firm will become clearer with the next chapter, which will consider the role of the third player, the executives. The next chapter will also give an example of how these new power dynamics operated within the Samsung Group under Lee Kun-Hee when it had taken its first step into the LCD industry.
CHAPTER 8

Success in the LCD TV Industry

Not only had Lee Kun-Hee completely restructured the Secretariat, Lee Kun-Hee also played a critical role in making “engineer-managers” become CEOs of their own divisions.\(^{322}\) The engineer-managers, occupying key positions throughout Samsung Electronics, would determine the fate of the Samsung Group.

Yun Jong Yong was one of such engineers. Upon graduating with a degree in electrical engineering from Seoul National University in 1966, Yun immediately joined the Samsung Group, performing administrative functions in the Secretariat.\(^{323}\) In 1969, upon the creation of the infant Samsung Electronics, Yun joined the affiliate, holding various positions related to the production of televisions and VCRs, and even briefly managing a Samsung branch in Japan.\(^ {324}\)

In 1985, through sixteen years working in the affiliate, noticed a severe lack of efficiency within the organization, and started his project of promoting industrial engineering, which the Institute of Industrial Engineering defines as, “[drawing] upon specialized knowledge and skill in the mathematical, physical, and social sciences together with the principles and methods of engineering analysis and design to specify, predict, and evaluate the results to be obtained from such systems”.\(^ {325}\)

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\(^{324}\) Ibid.

\(^{325}\) Ibid.
When Yun was promoted again in 1988 to become the vice chairman of Samsung Electronics, he tried to spread the philosophy of industrial engineering to all aspects of Samsung Electronics—not only applying to its R & D capacities, but also to its manufacturing, handling, engineering, and assembly line procedure as well.\(^\text{326}\)

However, up until this moment, his initiatives to promote industrial engineering were not working well. He had come across the same problem as Lee Kun-Hee when the latter was attempting to instill his novel vision throughout the company. As Yun recalls: “There was resistance because people thought this was very cumbersome in the beginning. The introduction of the new tools entailed big changes, and I think people are intrinsically adverse to change.”\(^\text{327}\)

The critical moment came following 1996, when Yun became president of Samsung Electronics after the retirement of the previous president, Kang Jin-Ku.\(^\text{328}\) Following the financial crisis of 1997, and driven by emergency, Yun fired employees, cutting close to half of the senior managers in the affiliate, replacing them with younger thinkers more willing to embrace his vision.\(^\text{329}\) Not only was Yun awarded by the Institute of Industrial Engineers for his creative use of industrial engineering to weather the financial crisis, in his first year as CEO of Samsung Electronics, the company had experienced a 100 percent increase in productivity.\(^\text{330}\)

\(^{326}\) Ibid.
\(^{327}\) Ibid.


\(^{330}\) Ibid.
Furthermore, Yun, also like Lee Kun-Hee, trusted in giving more autonomy to his employees, increasing potential for creativity result from individual initiative. As quoted from Yun himself, “I believe the organization should be simple, speedy, and autonomous. By autonomous, I mean empowering the employees.”

Thus, Yun had mostly completed his project of making Samsung electronics an efficient and creative space following the 1997, when he was able to, almost conveniently, fire all the employees that were resistant to the change. At the same time, Samsung Electronics developed as a space for efficiency and creativity, ultimately becoming the “laboratory” within the larger Samsung Group.

**LCD TV Industry**

While Yun Jong-Yong was carrying out his own revolution of industrial engineering within Samsung Electronics, another independent development was taking place in a different Samsung affiliate: Samsung SDI. Samsung SDI was an affiliate that focused on displays and batteries.

Samsung is currently known for its place in three industries: semiconductors, LCDs, and smartphones. The individual to spearhead the initiative into the LCD industry was not Lee Kun-Hee or the Secretariat, but Kim Soon-Taek, the president of Samsung SDI.

Kim was born in 1949, and had earned an undergraduate degree in Economics after attending Kyungpook National University. Upon graduating,

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he worked in Cheil Industries, a Samsung affiliate. In 1978, Kim transferred to work in the Secretariat, before taking the position of vice-chairman of Samsung Electronics. He then transferred to become vice-president of Samsung SDI in 1999, and was promoted to become its president in 2000.

Officials of the Samsung Group have stated confidently that, “Without Kim, the Samsung SDI of today may not have existed”. Kim singlehandedly transformed Samsung SDI from a “television tube maker to a display manufacturer and then to rechargeable battery maker”.

In 1999, Samsung SDI’s main source of revenue was its Braun tube division, which made up to 80 percent of the affiliate’s revenue. Kim, however, stating that, “The market for LCD panels now looks limited but it will grow rapidly in the future. The company will fail unless it transforms itself,” invested a more than 10 percent of its annual revenue to the production of LCD, PDP, and AMOLED displays, a considerably large amount for fields that had an uncertain future due to limited demand as next-generation products. Not only did LCD panels have an uncertain market, LCD production, as opposed to DRAM manufacturing in the 1980s and 1990s, was a “leading edge” technology that required capabilities in innovation and design.

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333 Ibid.
334 Ibid.
335 Ibid.
336 Ibid.
337 Ibid.
338 Ibid.
339 Ibid.
Upon setting up a new office in southern Seoul, far away the Samsung Group’s main headquarters, Kim and his team started on their new project. Unlike Samsung Electronics under Yun Jong-Yong, who purposefully made sure to “empower the employees” by giving them significant autonomy, Kim operated SDI as a centralized organization that was loyal to the interests of the whole Samsung Group.

One could get some sense of this as he emphasized the group, as opposed to the individual: “Kim always asked his subordinates whether a decision at Samsung SDI conformed to Samsung’s group-wide interests. He decisively gave up any new business projects that could have conflicted with group-wide interests, even if they were expected to produce immediate profits for the company.” Furthermore, Kim was known for his “field-oriented management style, micromanaging operations.” According to article citing officials, “he visited plants as frequently as possible and enjoyed playing the role of an on-the-job superintendent”.

While Lee Kun-Hee, as continuously noted, played the role of a reclusive visionary, he had one other main function apart from his role of hiring executives: the role of coordinating the independent initiatives of each separate affiliate.

Following Samsung SDI’s gradual success in LCDs, Lee Kun-Hee observed a poor division of labor occurring between Samsung Electronics and Samsung SDI, as he noted:

342 Ibid.
343 Ibid.
344 Ibid.
The LCD business requires a frontier spirit. Samsung SDI is diligent like a farmer, but its corporate culture doesn’t fit creative work. The production process for LCDs is similar to that of semiconductors, so we can’t leave the business to Samsung SDI just because they’re displays. This business also requires huge investment, and Samsung SDI doesn’t seem to have that capacity.”

Thus, Lee Kun-Hee transferred the LCD division in Samsung SDI to Samsung electronics: while the LCD industry had potential, it was under the wrong affiliate. The fact that Lee was immediately able to transfer this division to Samsung Electronics, even though they were both publicly traded company, draws emphasize to the amount of power that Lee had over the Samsung Group.

This chapter has completed the picture of how the power dynamics and macro-level division of labor had operated under the Samsung Group of Lee Kun-Hee. The loyal Secretariat, with its careful observation and responsibility over the more financial matters, acted as the continual “go between” between Lee and the Secretariat.

On the other hand, given greater autonomy following the New Management Initiative, executives of the individual affiliates were able to pursue their independent initiatives to a complete degree, whether it meant replacing employees with those accepting of scientific management or pouring investments

346 Ibid.
347 Ibid.
into a frontier industry (LCDs) with an unknown market. These executives who had worked in their respective affiliates for long periods of time had specialized knowledge in their respective areas.

Lee Kun-Hee, continually observing matters, relying on the Secretariat as the consistent and trusted source of information, rarely intervened in the individual initiatives of the executives. However, in the case such as the above where individual initiatives generated by separate affiliates created inefficiency within the larger Samsung Group, Lee Kun-Hee played the additional role of coordinator between these affiliates. By 2004, Samsung had established itself as the market leader in the LCD market.\(^{348}\)

Conclusion

In the early 2000s, Masuko Oguro was one of the engineers working in one of Samsung’s video camera factories, located in Suwon. One day, her superiors told her, along with many of her acquaintances, that Lee Kun-Hee, the chairman of Samsung, would be arriving. Additional instructions came with this reminder.

Workers had to hide the cars that they rode to work behind the factory, in case the sight would offend Lee Kun-Hee. Furthermore, mints were prepared in the bathrooms so that their breath would not smell. Lastly, they were reminded not to look down from the factories windows when Lee Kun Hee’s car arrived. “Looking down” at the chairman was not allowed.

On the day of Lee Kun-Hee’s arrival, guards stood by the road to greet the chairman. A red carpet was prepared and laid on the ground as well. Oguro noted to reporters: "Samsung is a religion, and Chairman Lee is a god.”

When Lee Kun-Hee became chairman at the age of 45 in 1987, he was a foil to his father. While Lee Byung-Chul was an austere and authoritarian figure, Lee Kun-Hee was known to like his share of fun. In a span of a little more than 10 years, however, Lee Kun-Hee was thought of as a “god”. As previously noted, Samsung even has a sanctuary dedicated to Lee Kun-Hee, with the perfect replication of the Frankfurt Conference. Not only are photographs banned from the room, nothing more a faint whisper is allowed in the room.

350 Ibid.
351 Ibid.
While the idea of Samsung as cult and religion is an interesting topic in itself, a more compelling issue results from the anecdote above: even through the early 2000s, Lee Kun-Hee continued to have a powerful presence through the Samsung Group. Not only his executives, factory workers working far from Seoul in the modest county of Suwon recognized the sheer presence, even divinity, surrounding Lee’s persona.

The presence that Lee Kun-Hee continued to exude is compelling given the narrative so far. Samsung under Lee Byung-Chul was mostly a top-down, hierarchical organization micromanaged by Lee Byung-Chul and the Secretariat. Lee Byung-Chul alone made final decisions, whether it was to enter the consumer electronics and semiconductor industry or hiring a prospective employee. If Lee Byung-Chul were to be called a god by his employees, it would not be that surprising.

However, following the Frankfurt Conference in 1993, Lee Kun-Hee, revolutionized Samsung by utilizing the centralized system created by Lee Byung-Chul, reshuffling not only major executives, but making fundamental changes that impacted how decisions were made and carried out within the firm. Lee created a spontaneous order within the firm itself. While these engineer-manager executives had the autonomy to pursue their own initiatives, allowing the Samsung Group to tap into the knowledge of these experts, the spontaneity created as result made it close to impossible to predict the Samsung Group’s future trajectory.

With most of the decision-making left to his executives, Lee receded back into the shadows. Yet, Lee Kun-Hee was still considered a god by those within Samsung, even though the firm had essentially turned into a professionally
managed firm. This paradox is resolved when one considers the other half of the narrative developed alongside the story of the forced decentralization of the firm.

While Lee Kun-Hee refrained from interfering in the day-to-day decisions of his executives, his presence in the firm was powerful, but in a more subtle way. The selflessly loyal Secretariat essentially acted as the “eyes” of Lee Kun-Hee, and was a reliable source of information for Lee. While the Secretariat not longer made the major decisions, executives still had to discuss their projects with the Secretariat. Thus, it was not an uncommon occurrence for Lee Kun-Hee to suddenly call executives in the middle of the day with sharp questions about projects they were pursuing—even though the executives did not recall discussing the issues with the chairman. Executives were further put on guard when Lee would announce a “surprise decision” to reshuffle executives.

Then comes an essential point. Continually observed and always in risk of getting demoted, executives did not have complete autonomy that allowed them to do whatever the wanted. Thus, while Lee never specified what the executives should do, executives had to make sure that they were in line with Lee Kun-Hee’s vision. Never given explicit commands, but having to keep within the bounds of Lee’s vision of Samsung as a world-class, quality driven, and innovating firm, the executives of the new Samsung did not have time to become complacent. Even though Lee Kun-Hee was almost never in the Samsung headquarters in person, he was there in the non-material sense.

A Brief Digression into Evolutionary Economic Theory and the Future of Samsung: Will Samsung Inevitably Evolve into a Bureaucratized Firm?

Under Lee Kun-Hee’s charismatic leadership, Samsung had evolved from a heavily centralized to a heavily decentralized firm. In sharp contrast, Langlois
argues that centralization and bureaucratization of a firm is almost inevitable. That is, as routines crystalize under a new system, Chandler’s “visible-hand” of managerial capitalism takes hold of the firm. Thus, considering Langlois argument, is it safe to assume that Samsung will inevitably revert to something close to the highly hierarchical centralized and centralized firm it was before? I will argue, using the narrative established in this thesis, that this process of centralization asserted by Langlois is not inevitable.

First of all, however, it is important to provide a deeper explanation of Langlois’ argument. In his work, “Personal Capitalism as Charismatic Authority: the Organizational Economics of a Weberian Concept,” Langlois argues that charismatic authority gradually fades away and is replaced by the bureaucratization of the firm.

This work is particularly relevant to this thesis’ narrative as Lee Kun-Hee is an archetype of the charismatic entrepreneur, or the “personal capitalist”, that Langlois mentions in the work. According to Langlois, the charismatic entrepreneur is one who breaks the “routines” of a firm. Such a being defies the rules of an existing system and revolutionizes the organization, creating an entirely new system of rules that have not existed before.

At the same time, the charismatic entrepreneur, by revolutionizing the system, at the same time, coordinates the old system to changing circumstances:

Even fully charismatic authority can be rational… This is so because charismatic authority solves a coordination problem in a situation of “chaos” in which rights, roles, and responsibilities are in flux.  

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353 Ibid. 18.
Lee Kun-Hee fits perfectly into this definition. Lee Kun-Hee had revolutionized Samsung, defying the typical routines that defined the “old Samsung”, fundamentally changing how it operated. At the same time, Lee had created coordinated Samsung to Korea’s radically changing environment.

Langlois then makes an interesting note about the tendency of charismatic entrepreneurship. As Weber’s story of charismatic authority recounts, charismatic authority fades away to bureaucracy as the initially revolutionary vision provided by the charismatic leader becomes “routine” and is easily processed into a rational-legal framework.

Charismatic entrepreneurship follows a similar fate. Once the visionary coordinates the firm with the changing environmental circumstances, the visionary is no longer necessary. At this point, the new system created by an initially revolutionary vision crystalizes into routines. Following this development, based on this new vision, the visible hand of managerial capitalism (the managerial aspect is the bureaucratic counter-part in Weber’s story) takes hold of the firm. Langlois calls this process “progressive rationalization”.354

This process of “progressive rationalization”, Langlois notes, is inevitable: “At the level of each entrepreneurial organization, charismatic authority, having destroyed the traditional, must eventually give way to bureaucracy”.355 Langlois does not seem to be implying that firms would get bigger (which would go against his Vanishing Hand hypothesis), but more that of “extending hierarchical control”.356

354 Ibid., 10.
355 Ibid.
356 Ibid.
It is possible to observe this kind of progression in many companies. Take the case of Bloomberg L.P for instance. When the Bloomberg L.P was first created (it started off from scratch with five people), it ran on a flat managerial structure with very little top-down management. However, as the division of labor regarding production of the Bloomberg Terminal became routinized, Bloomberg witnessed increasing bureaucratization within the company, as a centralized human resources department began to take over many functions that individual executives normally had in order to increase division of labor and increase efficiency. Doing so was easier as processes were standardized, making it easier to determine what type of employee was required.

Furthermore, increasing firm size made managing the firm much difficult and thus increased managerial concerns. For instance, while the director of the Sales Team in the company initially had to add increasing layers to the division, creating additional titles such as “sales managers” and “team leaders”, to an originally flat structure. That is, Bloomberg L.P starts as a decentralized organization that increasingly more centralized.

However, with the case of Samsung, we observe a quaint progression, quite the opposite of what was observed with Bloomberg L.P. While Samsung had started as a highly centralized organization under Lee Byung-Chul, it actually decentralized, developing a spontaneous order overseen by Lee Kun-Hee’s charismatic leadership. As opposed to the “progressive rationalization” that Langlois refers to, we observe that change that goes in the opposite direction.

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Personally, I think it would be apt to call Samsung’s scenario a case of “progressive decentralization” instead.

One may question how this “progressive decentralization” was possible, and why Samsung did not follow the path of Bloomberg L.P. This question is quite easy to answer if we return to one of the fundamental points of this thesis, shown by its narrative: Lee Kun-Hee used a highly centralized system that was already put in place by his father, Lee Byung-Chul, in order to create his “new” Samsung. In sharp contrast, when Bloomberg started the organization, he started from scratch, and did not have the same centralized apparatus that Lee Kun-Hee had when the latter had become chairman. He was unable to create the institutional structures that could prevent bureaucratization.

On the other hand, Lee Kun-Hee was able to use the highly centralized system created by his father in order to create the basic infrastructure that would maintain a spontaneous order and stop it from devolving in a centrally planned entity. This is similar to the process of “gardening” that occurs in the economy mentioned by Adelstein. The government can use its centralized power in order to create fundamental institutions, such as private property rights, to support markets—which are in turn spontaneous orders. Lee Kun-Hee essentially “gardened” Samsung in order to create and maintain a spontaneous order within the firm.

Consequently, the progression of the firm is determined by two factors. The first factor is whether the starting point of the firm is as a centralized or decentralized organization. Given that the firm started as a centralized

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361 Ibid.
organization, the charismatic authority as the choice to create a spontaneous order or maintain the centralized organization.

Thus, provided that the formal and informal institutions that Lee Kun-Hee had set up to support the spontaneous order within the Samsung Group are not intentionally destroyed, it seems highly unlikely that the Samsung Group will naturally return to its greatly hierarchical and centralized origins.

Closing Remarks
The main concern of this thesis was in tracing the development of the Samsung Group as a highly centralized to a highly decentralized organization (or conglomerate). In particular Lee Kun-Hee utilized the centralized apparatus developed by his father in order to shape the Samsung Group to his vision. A spontaneous order was created within the group as a result, with experts in their own fields independently pursuing their own initiatives guided by Lee Kun-Hee’s vision of Samsung as a world-class, innovating, and quality driven firm.

In contrast to Langlois’ argument, it does not seem likely that the Samsung Group would naturally became a hierarchical and bureaucratic structure as long as the informal and formal institutions supporting the spontaneous order do not crumble. As a topic of future research, it would be interesting to study a firm that does follow Langlois’ vision of progressive rationalization, and examine the exact mechanisms through which this change occurs.
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