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**Chaebols, the engine of the Korean economy: a case study
of the Samsung Group**

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*A mamma e papà,
la mia forza, la mia ancora ed il mio sostegno più grande.*

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Introduction

During the 50s, the Korean market has gone through a great change: from being a country with an underdeveloped economy, with destroyed infrastructures because of the war, to be one of the most powerful countries globally. This great change happened because of the development of chaebols, the Korean business groups.

Chaebols have characterized the Korean economy since the beginning, in particular thanks to the help of the government that has always supported this type of Korean companies through loans, favourable reforms or positive attitude for each of their initiatives. From the moment they have been created, there have been years and years of continuous improvements, and thanks to a lot of aids from the outside, they have been able to position themselves in the global market as well.

There are five main chaebols that are the largest, the more diversified and the most powerful above all: Hyundai, LG, SK, Lotte and, largest of them all, Samsung. These five companies grew up during the second half of the 1900, stabilizing their market position worldwide, but in particular they have become the engine of the Korean economy, accounting for the greatest part of the nowadays Korean GDP. They have been able also to go through the IMF Crisis, the crisis that has characterized Asia from the 1997, even if other big chaebols did not survive, such as the Daewoo group.

The aim of this thesis is to analyse and to understand what lays behind the power of these Korean chaebols, that run the everyday life of this country. In particular, they have gone through a crisis, a lot of reforms and a lot of legal problems, but still their main characteristics, even if they are the most criticised, remain very similar to how they were at the beginning. No matter how many reforms the population claims and how many reforms the government apply, it looks like the chaebols have the power to decide whenever and whatever apply these reforms.

I have had the opportunity to spend one semester in Seoul, the capital of South Korea, and I could have seen how much these brands are integrated in the daily life of all the citizens of all ages. For example, almost all the Korean people own a Samsung telephone and even the main library of the university that I have attended,

the Yonsei University, take the name from this chaebol: the Yonsei-Samsung Library. The latter is fully equipped with a high-tech IT environment, completely furnished by Samsung itself.

Moreover, chaebols are extended not only vertically but also horizontally. This can be seen by the great number of department stores run by these groups such as for example the Lotte Department Store or the Hyundai Department Store, that are spread in all the capital and are the most used among the Koreans.

This is a clear example of how Koreans deal with chaebols. As a matter of fact, everything in their life makes you understand that they only use products or services made by these business groups. On the other hand, they criticize chaebols for being so powerful and for having so much influence over their life. That is why they ask for more reforms, not as in the past, since they have not been applied anymore, but real reforms that could really change the situation.

They basically live a sort of endless dualism in their mind, since from one side they keep on supporting chaebols, as something to be proud of, because they spread the name of their country worldwide. On the other side, they are afraid they can gain more and more power, destroying completely the remaining part of the Korean economy.

In the first chapter of this thesis, it is possible to understand how the structure of these chaebols is made. More specifically, there will be the explanation of how their corporate governance works, underlining the cross-shareholding system, that is one of the main characteristic of this type of groups, and it is also the one that is going through a lot of reforms. This chapter will also analyse the multiplex ties between Korean business groups, since these chaebols have used relationships among them to strengthen their position in the market. Moreover, another important aspect that will be explained is the relationship with the institutions, the greatest support for these groups, but in particular regarding the influence rent, so the extra-profits gained thanks to those rules of the market specifically designated for favouring chaebols. Finally, there will be an analysis of the situation of chaebols today, focusing on their reforms that have become a tool of political propaganda.

The second chapter will focus on the largest chaebol: Samsung. More specifically, it will go through its history, its corporate governance and its way to run the

business, giving an example to all the theoretical explanation given in the first chapter. As a matter of fact, there will be a focus on the legal problems that both the CEO and the chief executive to be, Lee Jae-Young, have had and their consequences in the group and in the country as well. Moreover, there will be an analysis of the so-called “Republic of Samsung” that is the way in which some people call South Korea, since this company completely runs each part of a Korean everyday life. It will be possible to understand the power of this group also thanks to the analysis of all the sectors in which Samsung operates.

Samsung Group is the best example to bring as a case study because it is the largest and the most powerful chaebol above all. Living for four months in South Korea, made me understand how people do not even know how to use, for example, other type of telephones. They do not even know some of the tools used by iOS such as Facetime. The only operating system they use and that they know is Android and they do not even consider buying or using a different type of system since they just keep on buying Galaxy phones, no matter how many scandals and legal problems the company go through. Even after the problem of the batteries of the Galaxy Note 7 that caught on fire, the group did not suffer of any decline in their telephones’ sales.

Finally, the last chapter, is a way to understand the main differences and similarities with the other groups in the world. The first comparison is with the keiretsu, the Japanese business groups. Even if these groups develop in countries with similar cultures and similar customs, the differences are quite a lot in particular if we consider the power and the influence that a chaebol has in South Korea and the one that a keiretsu has in Japan. The second analysis considers the western business groups, but in particular the best example for them: General Electric. The chapter will go through the corporate governance of it, its culture and its organizational structure, trying to figure out the main differences and the main similarities.

To conclude the study, the last paragraph will be focused on trying to understand why all the groups are so powerful, analysing in particular the factors that influence the success of a conglomerate and the power of their resources, and their successful way to exploit the resources that made them the most powerful companies worldwide.

Chapter 1: Inside Korean Chaebol

History of Chaebols

In 1945, after the Japanese liberation, Korea was left in a bad economic situation. During these years, American government took the control of this country, until 1948, privatizing properties previously owned by the Japanese governments and civilians. Greater problems arrived with the Korean war (1950-1953) because it destroyed a lot of these infrastructures left by the Japanese. Luckily Korea received U.S. aid, that helped the country to rebuild some of those infrastructures and to solve other problems, such as the raw materials' shortage (Long Le, 2016). This aid was so important also because it gave the opportunity to the Korean business to grow up and accumulate capital. Thus, to exploit this help and to stimulate the economy, Koreans decided to reproduce the Japan's economic development model and they established chaebols. Even if the greater reforms about the industry began around the 1960, the beginning of the entrepreneurial spirit in the political economy was in the 1950s, mainly thanks to those assets left by Japanese that had been taken by Korean businessmen (some of them, as said before, turned into the nowadays chaebols).

Before stepping into chaebols' history, it is important to underline that during those years, Korea was really dependent from import, and sometime the level of trade was so high that those countries became the best help to reconstruct Korea from the economic disaster left by the war. Despite this, South Korea decided to implement an Import Substitution Industrialization (ISI) strategy with tariffs and quotas on imports, in order to give more competitive advantage to domestic firms compared to foreign firms. Basically, the ISI helped the growth of the firms, but it did not help to improve the living standards of the population. This happened because eventually domestic firms started to charge higher prices and the main consequence had been suppressed consumption. Moreover, a lot of businessmen, through this policy, tried to maximize the profits exploiting the corruptions of several politicians. Thus, this behaviour brought to a lot of unproductive profit seeking activities that did not help the population at all (Cha, 2008).

Stepping back into the Korean chaebols history timeline, in 1961, the power shifted from the President Yun Bo-seon to the President Park Chung-hee. The latter decided to shift the strategy from Import Substitution to Export Promotion, even if ISI was not completely abandoned. His first directive was to nationalize all the banks and also to support chaebols through loans and export subsidies. The loans were given with an order of priority according to the sector in which they operated: first of all, the loans were given to the firms who produced textiles, steels and petrochemicals; after that, he helped also other sectors such as semiconductors and cars. This decision was made according to which firms operated in the most powerful areas of Korea and according to their export performance, thanks to which it could have become a competitive country worldwide for dominating the sectors of the export market. Basically, this opening to the world market helped a lot the Korean economy to be more disciplined, since it was subject also to the common law of the external trade that had to be respected by all the parties. Thanks to these changes the chaebols began to gain market share and, for this reason, they were chosen as the main instrument for the economic development. Consequently, chaebols began to grow and to become important and relevant inside and outside the country. In addition, the share of GDP of manufacturing rose from 9% to 27%, while the share of agriculture fell from 45% to 25% (Cha, 2008).

Since they were the most important mean for the implementation of the export-led industrialization (ELI), the government helped these firms as it could, with all the necessary instruments. For example, during the Vietnam War, because of the participation of Korea, chaebols had been able to implement their large scale chemical industries, because of the duty they had to supply the country with war-related products. Another example is the strengthen of the relationship between Korea and Middle East countries. This relationship helped Korea to export labour in these countries and to gain from it because the workforce in the Middle East was cheaper (Kwon, 1997).

During that period (from 1960 to 1970) all the strongest company of today economy had been built up and increased their position. In the table 1.1 is shown the ranking of the ten largest chaebols from 1960 to 1993, classified by total assets, and some of them are still today the strongest such as Samsung or Hyundai.

Table 1.1: Changes in the ranking of the ten largest chaebols by total assets, 1960-1993¹.

Rank	1960	1971	1977	1987	1993
1	Samsung	Samsung	Samsung	Hyundai	Hyundai
2	Samho	Lucky	Hyundai	Samsung	Samsung
3	Samyang	Hanjin	Lucky Goldstar	Lucky Goldstar	Daewoo
4	Gaepung	Sinjin	Daewoo	Daewoo	LG
5	Lucky	Ssangyong	Sunkyung	Sunkyung	Sunkyung
6	Daehan	Hyundai	Ssangyong	Ssangyong	Ssangyong
7	Dongyang	Korea Explosive	Korea Explosive	Korea Explosive	Lotte
8	Hwasin	Geugdong	Kukjae	Hanjin	Kia
9	Korean Glass	Daenong	Hanjin	Hyoseong	Korea Explosive
10	Geudong	Sunkyung	Hyoseong	Lotte	Hanjin

This growth for chaebols meant an extension in unrelated business, but also higher wages for employees in particular as a consequence to the increase of the bargaining power of trade unions. Thus, for exploiting the opportunities offered by chaebols, Koreans began to shift from rural areas to urban areas (Wash, 2017).

After Park Chung-hee's assassination in 1979, the new Korean government decided to make some changes. First of all, it stopped to provide loans to private firms and it eliminated also the interest differential. Secondly, it ordered "rescue package", as loans issued by banks and controlled by the State, in order to help companies that had difficulties (Long Le, 2016). On the other hand, these insolvent companies were mostly taken over by chaebols and the latter, eventually, successfully received special loans from the bank in order to have more help for restructuring those companies. In this way a lot of chaebols, like Hyundai, Daewoo and Samsung, gained more power. In particular they had been able to strengthen their position thanks to the three-low phenomenon: low exchange rates, low international interest rate and small petroleum price (Long Le, 2016). In addition, the value of the Korean won decreased against the U.S. dollar of about 21% and the exports increased to an average growth rate of 31% (Cha, 2008).

Taking advantage of this restructuration towards more high-tech oriented businesses, chaebols worked a lot in order to replace labour intensive work processes with automated production. This was the easiest way to weaken the bargaining power of trade unions (Kim, 1991; Lim, 1992). Table 1.2 shows the example of Hyundai Motor Company with the increase of the number of

¹ Source: Cho Dongseong, 1991; Dong-Ah Ilbo, 1993.

machineries from 1984 to 1991, in particular after the emergence of independent trade unions in Hyundai from 1987.

Table 1.2: Changes in the number of industrial robots in Hyundai Motor Company, 1984-1991².

Year	1984	1985	1986	1987	1988	1989	9. 1990	9. 1991
No.	24	18	23	258	39	298	289	151

At the beginning of 1990 there was more concern about globalization, so the new government tried to support it with new reforms. These reforms had the main purpose of deregulation and liberalization. This helped chaebols to have access to U.S. dollar credit from international lenders, that were more attractive compared to the domestic banks, since they offered lower rates. In addition, the currency risk seemed to be reduced because the South Korean won was fixed to the U.S. dollar. On the other hand, the international lenders were willing to provide credit because they knew that chaebols were profitable and that the Korean government would had never let them fail. The access to credit from abroad brought chaebols to be highly leveraged. Thus, their debt increased and they became more vulnerable to changes in U.S. monetary policy (Wash, 2017).

The problem arrived in 1994, when the Federal Reserve decided to raise rates to defend the U.S. economy from overheating. As we said before, the South Korean won was pegged to the U.S. dollar, so when the dollar started to appreciate towards the other currencies, also the won started to appreciate. The result was that the exported goods of South Korea became less competitive and firms became less profitable. Even if at the beginning South Korea did not feel the crisis, actually the economy began to fall year after year. Eventually chaebols were not able anymore to pay back their loans, and about 16 out of 30 top chaebols went bankrupt (Wash, 2017).

In 1997 South Korea had to accept a bailout from IMF and other developed countries. They had to respect the terms of these agreements and the most important ones were the austerity and the chaebols restructuring. For this purpose, companies had to cut salaries and to laid off some workers and chaebols had to sell some non-

² Source: Lee Young-hee, 1994.

core businesses to other chaebols with a discounted price. That is why the chaebols reputation drastically changed during the '90s, from the symbol of the Korean economic success to a great failure due to corruption. In August 1999, for example, the Daewoo group went bankruptcy, showing that the greatest help given to chaebols in the past was not applicable anymore. But we will talk about this crisis and this collapse later on.

In the 1998, thanks to the help of the IMF, the situation started to get better, at least it seemed to be better at the beginning. The Korean business environment became more globalized through the opening of the Korean Stock Exchange (KSE) to investors from all over the world. It brought to an increase in the direct financing in Korean companies through the stock market. It had consequences for chaebols, mostly because it was required for them a more transparent accounting system, that has never been so transparent, and it has always been characterized by a high level of corruption. Consequently, the government wanted chaebols to apply more transparency to their operations and financial statements in order to have a higher transparency of the investments and transactions with the affiliated companies. It wanted, eventually, that they focused more on the core business and made stronger cooperation with small and medium enterprises, in order to safeguard SMEs as well from failure and bankruptcy. They also had to focus on the mission of controlling shareholders and managers to avoid event of corruption and misconduct. In addition, the Korean government revised the Korean financing accounting standards for aligning them with the international accounting standards (IAS) (Sung, 2013). The Corporate Governance was then submitted to some changes: it got better thanks to the opening-up of M&A market, to the complete resolution of cross-debt guarantees and thanks to the limitation of the voting power of institutional investors.

Since the main objective was the increase of the transparency, all the companies had to allow the control of external auditors and include external members of the executive director committees during the decision-making process (Long Le, 2016). Eventually the situation looked effectively better, but we will analyse all these changes and reforms in the chapter below of the IMF Rescue Program.

Corporate Governance

A chaebol is an independent firm owned and run by family members, no matter how big it is and how many businesses it has. This word literally means a group or party of wealth: “chae” means wealth or fortune and “bol” means a group or party. Summarizing we can say that a chaebol has three main traits: first of all, it is made by many affiliates firms operating in different type of industries, it has administrative and financial control in the hand of the dominant family and the business group is responsible for a great part of the national economy (Sung, 2013). This last point regards the power that the chaebols have in the Korean economy. As a matter of fact, they account for the greatest part of the GDP of the country. In the table below, there is shown the shares of chaebols in the Korean GDP for the 2009, 2010 and 2011, first for the first 20 largest groups and second for the first 5 largest groups.

Table 1.3: Chaebols and their shares within the Korean GDP³.

		2009	2010	2011
Asset / GDP	20 largest groups	75.3%	78.6%	85.2%
	5 largest groups	46.5%	49.9%	55.7%
Sales/ GDP	20 largest groups	75.3%	78.6%	85.2%
	5 largest groups	46.5%	49.9%	55.7%

In addition, they are characterized by a centralized planning, paternalistic leadership and an aggressive entrepreneurial orientation, as we will see later on with their large investments in R&D.

As we mentioned before, the core business was built thanks to the acquisition of the enemies' properties during the 1950s, but also thanks to the aid from foreign countries, to lower interest rates and also because of the acquisition of import licensing and quota. The most profitable chaebols who managed to build their own identity and to set a strong market position are shown in the table 1.5, considering a horizon time going from 2002 to 2010, but these data are mainly confirmed also today (Long Le, 2016).

³ Source: KisLine, 2012. (Palich, 2000)

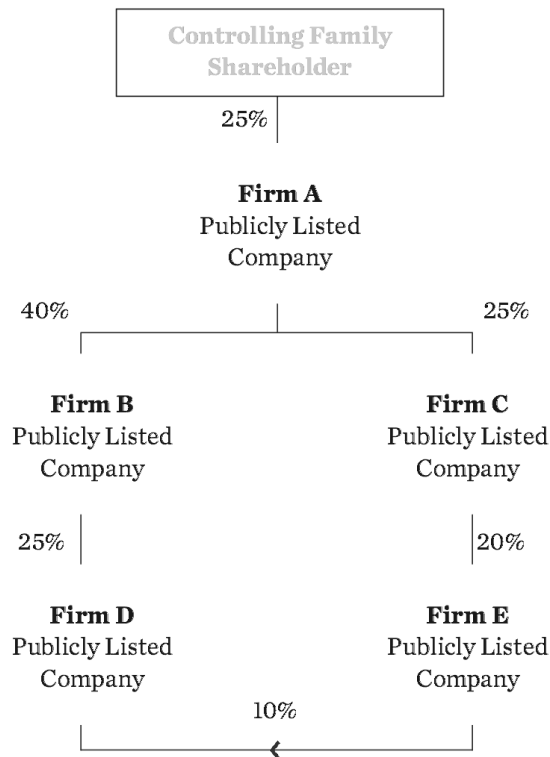
Table 1.4: Profitability of major Chaebols⁴.

Chaebols	Finance criteria	2002	2005	2008	2010
Samsung	Revenues	118.94	145.36	206.08	259.63
	Operation income	13.40	11.35	12.10	29.14
	Net income	9.66	9.12	9.42	23.45
	Margin (%) [*]	11.27	7.81	5.87	11.22
	ROE (%) ^{**}	23.90	15.36	11.10	19.28
Huyn dai Motor	Revenues	48.12	58.83	93.12	131.25
	Operation income	3.13	2.29	5.23	12.79
	Net income	1.90	2.82	2.00	10.13
	Margin (%) [*]	6.50	3.89	5.62	9.74
	ROE (%) ^{**}	14.14	14.36	6.69	22.39
SK	Revenues	43.40	48.29	88.8	90.70
	Operation income	3.88	4.86	4.45	5.2
	Net income	-4.69	3.38	1.74	2.72
	Margin (%) [*]	8.94	10.06	5.01	5.73
	ROE (%) ^{**}	-68.37	20.10	7.03	10.06
LG + GS	Revenues	79.11	91.08	139.4	154.07
	Operation income	4.69	4.75	8.55	10.22
	Net income	2.25	3.13	3.36	7.20
	Margin (%) [*]	5.93	5.22	6.13	6.63
	ROE (%) ^{**}	13.08	12.37	9.10	16.41
LOTTE	Revenues	16.22	24.49	33.15	47.35
	Operation income	1.19	2.16	1.70	3.14
	Net income	0.62	1.27	1.56	1.63
	Margin (%) [*]	7.34	8.82	5.13	6.63
	ROE (%) ^{**}	6.68	10.57	7.92	5.19

Speaking of the management of chaebols, they are popular in particular because the controlling family has always used a complicate system of reciprocal cross-holdings, in order to have the ownerships of all the affiliates that belong to the chaebol. In fact, in all the chaebols, the most important thing is to keep the power within the hand of the family members without shifting it to third parties, no matter how many subsidiaries the company gets or acquires. This complex structure brings to a problem: the separation between family controlling influence and actual ownership in those listed subsidiaries. To better explain this situation, we can make a simplified example, as shown in the figure 1.1, considering a controlling family that owns a chaebol with five affiliates (Killeen, 2016).

⁴ Source: Phuoc Cuu Long Le, Jong Ik Kim, Kunbae Kim, 2016.

Figure 1.1: Chaebol structure⁵.



Let's suppose that the controlling family shareholder control the 25% of the shares of firm A. The latter holds 40% of the shares of firm B that owns 25% of firm D. On the other side, firm A holds 25% of firm C, that owns 20% of firm E. In addition, firm E control 10% of firm D. Speaking of ownership, the family shareholder has an indirect ownership of firm D through firm A and B so the cash flows' rights are calculated as follow:

$$25\% * 40\% * 25\% = 2.5\%$$

More than that, the family shareholder owns firm D also thanks to firm A, C and E so we will have:

$$25\% * 25\% * 20\% * 10\% = 0.125\%$$

⁵ Source: W. Killeen, R. Kumar, 2016.

The total indirect ownership by this measure is 2.625%; thus, this is the measure of cash-flow rights.

Stepping into the voting rights, we are talking about the right of the controlling family of influencing the board's decision in firm D. The voting right is measured with the minimum percentage of the control chain, so from the firm B side we have that the lowest percentage is 25%. But we also have to consider the indirect control through the firm E, so the lowest percentage is 10%. Eventually we sum up 25% and 10% so the result is 35%.

In conclusion, we consider the separation that is calculated with the ownership minus the voting rights; so, we will have:

$$35\% - 2.625\% = 32.375\%$$

In this way, the family is able to maintain the power in all the chaebol, no matter how big it is.

In theory, the greater is the separation, the greater will be the potential misalignment between the controlling influence and the ownership in chaebol subsidiaries. The risks of this misalignment for other shareholders could be for example that the controlling shareholders could "tunnel" the profits from firms where they have less cash flow rights to firms where they have more rights (Jin, 2015). Some operations that can be classified in this type of phenomenon might be selling an asset at an inflated price to a group of company or providing a loan to a controlling shareholder guaranteed by a group company. Obviously, this structure helps also the chaebol to have access to cheap and already available capital, generated internally in the group, but this could always be a problem for external shareholders, since these profits could be used as dividends for them (Killeen, 2016). But we will discuss about this problem later on.

It is possible to measure the alignment in the companies calculating, as already done before, the direct and indirect family ownership stakes and the cumulative voting rights. These results are shown in the table below about the measurement of alignment of two chaebols in particular: Samsung and Hyundai Group, considering some of their affiliates.

Table 1.5: Measuring Alignment in Samsung and Hyundai Group⁶.

Descriptor	Krw (Tn)	% Market Cap	% Market Cap	% Market Cap	% Market Cap	% Market Cap	Krw (Tn)
Chaebol Company	Market Capitalisation	Treasury Shares	Direct Ownership (Cashflow Rights)	Direct + Indirect Ownership* (Cumulative Cashflow Rights)	Control (Cumulative Voting Rights)**	Separation (Control - Direct + Indirect Ownership)	Family Wealth***
Samsung C&T	26.5	12.3	31.1	31.2	39.4	8.2	8.3
Samsung Elect.	221.1	13.8	4.8	8.1	18.1	10.0	17.9
Samsung Life	19.7	10.2	20.8	26.8	40.1	13.3	5.3
Samsung SDI	8.0	0.1	0.0	1.6	19.6	18.0	0.1
Samsung SDS	12.9	0.0	17.1	21.4	48.9	27.4	2.8
Samsung Card	4.9	0.4	0.0	15.0	71.9	56.9	0.7
Hyundai Glovis	6.3	0.0	34.5	34.7	40.1	5.3	2.2
Hyundai Motor	29.5	6.0	7.5	9.1	28.2	19.1	2.7
Hyundai Mobis	25.1	2.9	7.0	8.4	30.2	21.7	2.1
Hyundai Steel	6.6	2.3	11.8	12.7	42.6	29.8	0.8
Kia Motors	16.7	1.1	1.7	4.0	35.6	31.6	0.7
Hyundai E&C	4.2	0.0	0	1.0	34.9	33.9	0.0
Hyundai Wia	2.3	2.3	2.0	3.9	40.7	36.8	0.1

* Includes indirect holdings from cross-holdings.

** Sum of voting rights from all holdings.

*** Family Wealth is cumulative cash flow rights as a % Market Cap.

The table considers the major chaebol companies and it shows the direct and indirect family ownership stakes and the cumulative voting rights. As we said before, the greater is the separation between these two measures, the greater will be the misalignment. As shown, Samsung C&T, Samsung Electronics and Samsung Life have a high level of cumulative family ownership. Moreover, they are material contributors to family wealth and show little separation between control and ownership. Speaking of Hyundai, we have Hyundai Glovis, Hyundai Motor and Hyundai Mobis that have the same characteristics. We do not have that alignment with other shareholders like we could have expected from those big companies (Killeen, 2016).

Regarding the organizational structure, Korean chaebols had developed from U-form firms to a sort of X-form firms, because they create more and more firms with external financial sources. As we know the U-form in an organizational structure adopted by firms in which the management is only a single unit that have the control of all the functional lines (marketing, production, personnel, finance), so a centralized structure. Instead, the X-form is an evolution of the U-form, that we have when U-form firms invest their sources for expanding in new business area, after understanding that is useless to invest them in the field in which they already are operating (Williamson, 1975), always maintaining a centralized structure. We

⁶ Source: Bloomberg Finance LP, 2016.

will analyse the difference with the M-Form, characteristic of American firms, in another chapter.

With these different shapes that a company can assume, we are basically talking about diversification. Diversification means expanding in other industries or across them and not through the value chain. The chance for superior profits are offered by the attractiveness of the new industry and the possibility to exploit the competitive advantage into those different industries. Chaebols have always been aggressive in developing new products and markets and undertaking also risky project. The diversification has begun since the first years of chaebols, the 1950s, when they acquired other enterprises and failing firms as well. Moreover, the government has always been used as a mean for sharing the risk since it has always been the first supporter of these companies with several loans and favouritism.

The diversification of chaebols is unrelated because they diversify in radically different markets even if they use the same brand. There are several reasons for diversification, such as avoiding the risk of a single product business since they diversify the portfolio, diversifying the risk. Other reasons are having the possibility to compete with other chaebols or to have growth opportunities outside the core business (in particular when the main business is declining, so it is necessary to look for other opportunities outside) (Park, 2008). Diversification reduces also the probability that a firm will experience lower performance, so firms make adaptive change to avoid performance fluctuations (Donaldson, 2000).

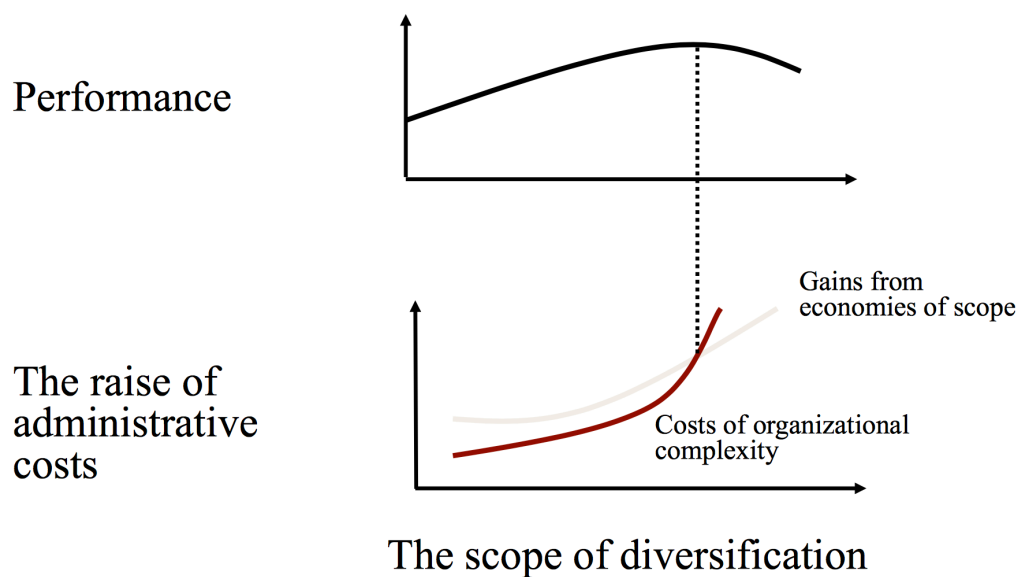
Moreover, there are some factors that push diversification that are externals or internals. The internal ones are the economies of scope and scale, the financial resources available that the company can invest, risk minimization, as already mentioned, and growth objectives. Considering the growth, it is more manager oriented because sometimes a great growth could destroy shareholder value, but still can satisfy managers. Regarding the risk reduction, it is important to underline that the diversification reduces non-systematic risk; it does not reduce systematic risk, that is related to market fluctuation. Moreover, also in this case, diversification does not create value for stakeholders in terms of risk reduction.

On the other hand, the external factors that push diversification are the market opportunities that can be exploited, demand decrease in original business, high

transaction costs and public policies, so opportunities not only from the environment but also from the regulator.

Talking about the economies of scope, it is demonstrated that the performance of diversification starts to decrease when the gains from the economies of scope that the company is achieving, by diversifying the business, are overtaken by the costs of the organizational complexity, as shown in the graphs below. That is why it is important to be careful about the complexity of managing such different businesses.

Figure 1.2: Diversification and Performance⁷.



Before entering into a new business, it is better to accomplish three tests, in order to be sure that the industry is a good one. The first test is the attractiveness test to analyse the industry in all its aspect in order to understand if the industry is profitable. The second one is the cost of entry test to analyse how much costs to enter into this new industry. These costs do not have to be higher of the potential profit in order to not cannibalize myself. The last one is the better-off test to analyse the opportunity costs and to understand if in the long-term is a good choice for investing this money. While the Cost of entry Test shows if the decision is a good one in term of costs in the short-run, the Better-Off Test is an analysis in the long-run (Grant, 2015).

⁷ Source: Palich, Cardinal, & Miller, 2000.

The greatest examples of diversification are the big chaebols like Samsung, LG and SK that always develop new products with new technologies. All the three entered in the telecommunication market when it emerged, and Samsung and LG have the highest market share in the mobile phones' sector. Moreover, if one large firm enters into a new sector, all the others will follow the leader.

Chaebols are so big and so powerful that control the distribution system as well. Vertical integration is a reality for chaebols since they control the greatest part of retail outlets in Korea, creating a vertical link between manufacturers and retailers. They tend to lock outside the foreign competitors because they are not so willing to sell their products in the same stores of the others, in particular from abroad. For example, there are a lot of department stores in Korea that are in the hand of chaebols such as Galleria owned by the Han Hwa Group and Shinsegye owned by Samsung (Lee, 2003).

Chaebols' Institution Based-View

As already mentioned, the government has had an important role in the development of Korean groups. In particular, thanks to some government's initiatives, some Korean firms have easily diversified aggressively into strategic industries, in order to take advantage of preferential credit allocation, tax benefits and government protection from foreign imports and investments (Steers, 1989). The economic size and concentration of chaebols have been both a cause and a consequence of Korea's government economic development policies (Ungson, 1997). In particular, chaebols have always been led by a strong entrepreneurial spirit, even with a lot of risks, thanks to the protection of the government with the belief that it would have never let the new venture fail (Song & Cho, 2000). In addition, the growth oriented economic development policies encouraged Korean chaebols to give more priority on growth rather than efficiency or profitability, because in this way chaebols could ensure this protection from government. This belief was sustained by the fact that in the history of government bailouts, the major parts have been given to larger chaebols. Thus, there is this belief that the larger is

a chaebol, the more likely the government would bail it out if necessary (Song & Lee, 2014).

Moreover, government has influenced also the decision of unrelated diversification of these business groups. For instance, in the 1980s, the Korean government announced a set of guidelines to support a specific industry and the chaebols showed a similar diversification behaviour towards this sector: the high-tech industry. A similar behaviour has been shown also for the entry of the top four chaebols into the semiconductor industry. In 1983, Samsung made investments in wafer fabrication of DRAMs. LG followed in the same year. Hyundai also announced a major investment in DRAM business in that year, even if previously it had never been involved in the electronics business. Eventually, in the 1986, Daewoo as well entered the semiconductor business by acquiring Zymos (Song & Cho, 2000). These are clear examples of isomorphism, a constraining process that forces one unit in a population to resemble other units that face the same set of environmental conditions (Hawley, 1968). More specifically, the institutional theory wants to explain why firms behave similarly. In fact, the institutional theory underlines the role of institutional pressures for social conformity that lead to isomorphism among firms in strategic decisions since organizations have to comply with rules and requisites in order to gain support and legitimacy from other actors in the field (Scott, 1995). According to the institutional theory, conformity to social expectations contributes to a firm's success and survival by enhancing this legitimacy (DiMaggio, 1983). Sometimes a firm even makes non-rational decisions just because they are shaped by its social context (Oliver, 1997). The isomorphism we are talking about, regarding Korean groups, is the mimetic one, according to which organizations shape their behaviour on that of other organizations in situations of uncertainty (Brunetta, 2017). These mimetic isomorphic pressures from rival firms affected diversification strategies. Thus, a dominant type of diversification strategies in an organizational field, will affect the future selection of diversification strategies of chaebols in the same organizational field. For example, if the greatest part of the firms in an organizational field adopt an unrelated diversification strategy, firms with different strategies in the same organizational field are also more likely to adopt an unrelated diversification

strategy in the future, because strategic interactions and competitive balance with competing firms affect the nature of competition and legitimization in the organizational field (Song & Cho, 2000).

As mentioned before, business groups sometimes make non-rational choices and sometimes this happens because of the historical limitations and the inertial force of habit (Oliver, 1997). Along the history of chaebols, there are a lot of examples of groups that put a lot of efforts in divesting an existing businesses, facing strong internal resistance as well as external legitimacy problems. As a result, highly diversified chaebols often held onto their existing strategies, even when excessive diversification could bring to managerial inefficiency and a lack of strategic focus (Song & Cho, 2000). This is confirmed by some scholars who have underlined that a firm is more likely to repeat a type of diversification that it has already adopted (Amburgey, 1992). To change this strategy, a solution could be changing the top management with the ability to overcome the organizational inertia (Tushman, 1985). This could be an opportunity for chaebols as well. In fact, even if the succession happens within the owner's group family, the new generation has gone through studies of modern management practices, that is why the management succession within a chaebol could be positively related to the change in diversification strategies (Song & Lee, 2014).

The government has tried to transform chaebols into focused business groups, in order to fight their excessive diversification, but it failed. In fact, they continued to pursue diversification, such as Samsung with its entry into the already overcrowded automobile industry. This is one of the best example of a clear obsession with growth at the expense of efficiency. It also happens that cross subsidization to from the core business to the new one, in order to help and favour the latter, could bring trouble to the competitiveness of the core business itself. That is why chaebols have to put as a priority the efficiency, by divesting and restructuring highly diversified businesses.

Another key element of the institution-based view are the influence rents. They are the extra profit that can be earned due to the fact that the institutional "rules of the game" are designed to favour an economic actor or group of actors (Ahuja, 2011). In fact, chaebols have always been helped by the government in order to be the

most powerful companies into the country, thanks to loans and reforms that have always favoured them. Moreover, the Korean market structure is still a kind of structure where only some designated companies can have the power and rule the market. More specifically, regarding the five market problems identified by Ahuja and Yayavaram (2011), the one that characterized the Korean market is the power asymmetry. It is clear that some actors have more power than others and this can restrict choices available to the other participant in the market. The institutions should intervene restraining or limiting the power of players within the market (Brunetta, 2017) even if, as we will see in the following chapters, the government is actually trying to limit the power of chaebols, but without success until this moment.

Chaebols have also acted in such a way to avoid or manipulate the institutions with the so called generic strategies. More specifically, a lot are the examples of generic manipulation strategies in particular the co-optation strategy, that is related to the manipulation of the decision-making of institutions. In fact, several are the cases of politicians' manipulation by CEOs through corruption, and some big companies even payed the consequences of these type of actions as we will see, later on, with the case of Samsung Group.

Strengths and Weaknesses

Weaknesses

As we have already mentioned before, one of the main shortcomings of chaebols is the lack of business transparency. This asymmetric information comes from the structure of the governance, since the CEOs in chaebols are both owners and managers. What happens is that sometimes the top managers, that have the larger ownership stakes into the chaebols, try to take away the stakes from the minority shareholders. This process is fuelled by this lack of transparency.

Moreover, a lot of chaebols, because of their organization, made by cross-subsidies, often keep unprofitable businesses, delaying their exits. The costs linked to these

delayed exits could bring to the collapse and bankruptcy of the entire group, like it happened for Daewoo and Ssangyong.

Another negative aspect of the chaebol is linked to its dimension. Since chaebols are really big groups, they have to underlie to a lot of bureaucratic accomplishment. Thus, the management's costs arise a lot. Another consequence of being a big group is the inefficient resource allocation, because sometimes the bureaucratic organization is not able to make fast decision in order to adapt to the changing environment (Park, 2008) and eventually managers could decide to allocate resources in a way to take advantages of this distribution.

Furthermore because of the easy access to domestic bank loans, chaebols often overinvest or make dangerous investments. In fact, data shows that chaebols have higher market-value based debt ratio than their non-chaebol counterparts (Kim & Paul, 2009) and that they continue to make capital expenditures even in declining industries (Ferris, 2003).

Talking about investments, sometimes the representative of the dominant family in the chaebol, that has the power of making the final decision, makes investment diversifications that are not in line with financial rationality. There are several reasons for this. One reason could be to avoid the economic or political risk of losing control over the chaebol. This is because it is clear that making an investment into a new brand rather than using the existing affiliates, enhance the possibility to transfer the power to a member of the family. Secondly, it could be done for increasing the reputation of the top manager inside the group, in order to be sure about the succession of the eligible heirs. This is linked with one of the most criticized shortcomings of chaebols that is the so-called nepotism. In all the chaebols, and basically this is also the main characteristic of this type of conglomerate, all the most important positions inside the group are occupied by family members and are not designated for meritocracy. Power is usually passed on to the eldest male son or the chosen heir (Sung, 2013).

Everything brings to the other pitfall that we can analyse: the problem of shareholders of internal trading or the so-called "tunnelling". As we mentioned before, this is one of the main risk for the shareholders of a chaebol. It consists in buying products from affiliated companies, even if other companies outside the

group offer better prices. Some scholars say that this is a clear evidence that chaebols seem to pursue profit stability rather than profit maximization (Sung, 2013).

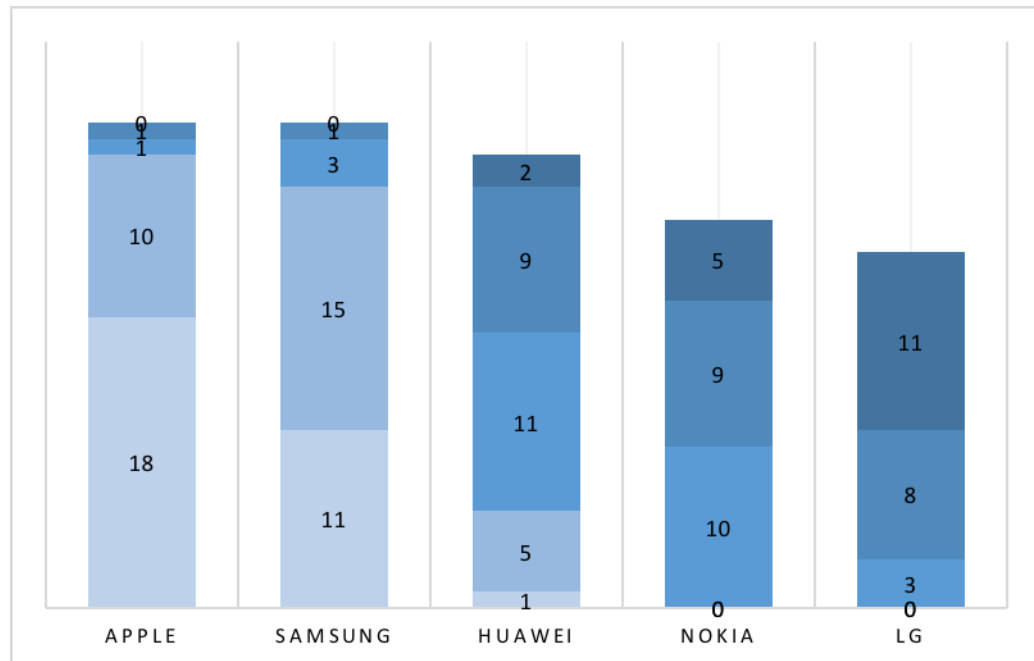
Another problem is the so-called “imperialistic management”, that is basically the highly autocratic decision-making by chaebols’ CEOs. This type of management could have some consequences on the performance of the business since the top managers do not utilize, so often as they could, the knowledge of the employees. On the other hand, this kind of governance is the clearest evidence of the strong commitment of the owners to the projects, because they invest a lot with huge financial capital, in particular in research and development in semiconductor and telecommunication products (Park, 2008).

Strengths

After having analysed the shortcomings of chaebols, we can now step into the strengths.

First of all, we have the strong brand name reputation and the recognition all over the world that allow an easier diversification. The brand name is an intangible asset and it can be exploited at the maximum level from chaebols, since its use does not reduce the brand’s resources (Caves, 1980). To demonstrate the power of the brand name, I have distributed a survey designed by myself through the web. In this survey, I have asked which have been the first four mobile phone brands they have thought as soon as they have read the question. The sample of people who answered to the survey belongs to an age range of 18-60 years old and the total number of answers is 30. According to the results of the survey, all the people who answered to the survey has responded with the brand Apple and Samsung. Apple has been nominated 18 times as first, 11 times as second and one time as third. As mentioned before, also Samsung is in all the answers of the respondents, as the first brand for 10 people, the second for 15 people and the third for 5 people. Also LG, the other Korean brand, has been nominated by the respondents 18 times (three times as third, five times as fourth and eleven times as fifth). In the graph below it is possible to see all the results of the survey.

Figure 1.3: Mobile Phone's Brand Recognition⁸.



Other benefits are the scale economies by large size and the scope economies deriving from synergy effects, since a synergy can produce a combined return on resources that is greater than the sum of individual parts (Grant, 2015).

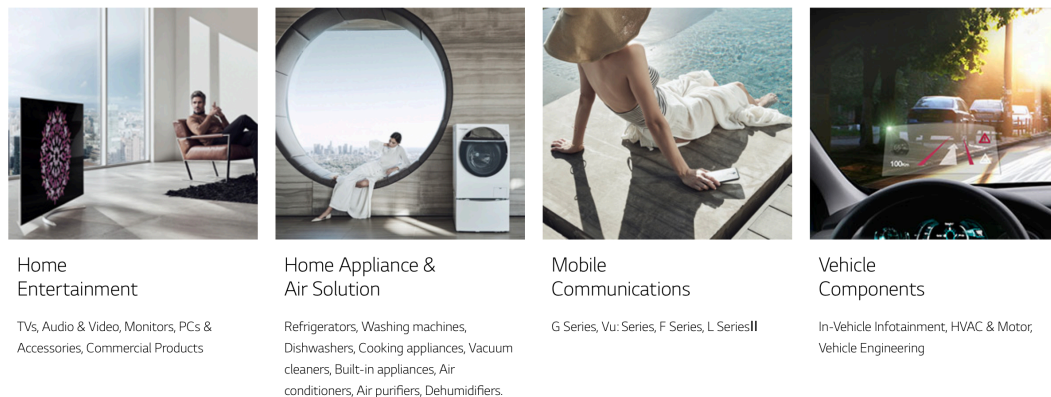
As we said when we have mentioned the weaknesses, sometimes it could happen that all the decisions are taken by the leaders. It is a weakness when the other employees are not involved in the decision-making processes, but it could be seen as a strength if we consider that the leaders in the chaebols could be a lot because of the different subsidiaries. A great number of leaders, means a great number of responses from people with a great knowledge and capacity. This positive aspect is strictly linked with another strength that is the improvements in capturing new business opportunities with a lot of knowledge in different fields of business (Barney, 1986; Robert, 1996; Knudsen, 1995; Nonaka, 1995).

Moreover, chaebols have an incredible level of entrepreneurship. This is clear from the number of new product lines that they launch every year, buying and merging with existing companies and entering new domestic and international markets. This is possible thanks to the great leadership and the great commitment of the management (Sung, 2013), but also thanks to the great importance that chaebols

⁸ Source: Author analysis on data provided by the brand recognition survey, 2018.

give to R&D (as we will see in the next paragraph). An example could be Samsung Group (but we will analyse it later), but also LG Corporation. LG works in several businesses such as electronic industry or chemical industry, but also in the telecommunication sector. In the figure below it is possible to see all the product lines developed by this chaebol.

Figure 1.4: LG Corporation's product lines⁹.



Despite the big size, chaebols are characterized also by the agility of decision making. All the CEOs of all the affiliates meet regularly with meetings in order to discuss about the succession of ownership and the decision about large scale investments.

The support of government is one of the key element of this type of groups together with the great number of affiliates. The presence of a lot of affiliates allows the chaebol to develop a high level of know-how and skilled labour, that can quickly move from a subsidiary to another, thanks to the flow throughout the group. In this case the internal market is the pillar of the company that helps the group to develop in those external market with limited capital and skilled labour, minimizing transaction costs (Sung, 2013).

Do chaebols support innovation?

There are two points of view according to the question if chaebols support innovation or not. The first one argues that the major shareholders only think about

⁹ Source: <http://www.lg.com/in/about-lg/our-brand>, 2018.

their own interests, creating problems for the minor shareholders. They argue that major shareholders basically only try to reach a short-term personal goal rather than a long-term company goal. On the other hand, others say that chaebols are able to reduce transaction costs and share risks thanks to internal transactions and, because of the highly centralized decision making, they can respond quickly to the market demand and to the opportunities.

More particularly, there is a study made by STEPI using data from the Korean Information Service that has analysed directly the differences in supporting the innovation between chaebols and independent companies. This study is divided into two periods: the first one before the financial crisis (1987-1997) and the second one after the crisis (2000-2003). This division has been made because after the crisis, the government changed some regulations concerning the chaebol system.

In the table below, it is shown that in the period before the crisis, chaebols were more willing to invest in research and development than independent companies. Even in the period after the crisis there are still differences in investments in innovation between the two types of organizations. Basically, these data show that chaebols, as great and big organization, have a lot of money and funds that can be used in investments for R&D's projects, even if they are expensive or risky. Obviously, they can invest more than an independent company with lower funds. To conclude, it is clear that chaebols contribute a lot to the growth of R&D and innovation in Korea (Sungchul, 2010).

Table 1.6: R&D expenditure and number of researchers by size of firm, 1997-2003¹⁰.

R&D activity	Small and medium enterprises			Large enterprises		
	1997	2000	2003	1997	2000	2003
<i>R&D expenditure</i>						
Amount (won billions)	1,090.2	2,106.4	3,425.4	7,755.1	8,148.2	11,084.2
Percentage of sales	2.82	3.14	3.57	2.07	1.81	2.05
<i>Number of researchers</i>						
Total	17,703	36,494	52,332	56,990	57,839	71,698
At the doctoral level	474	1,543	2,291	3,613	3,878	5,562

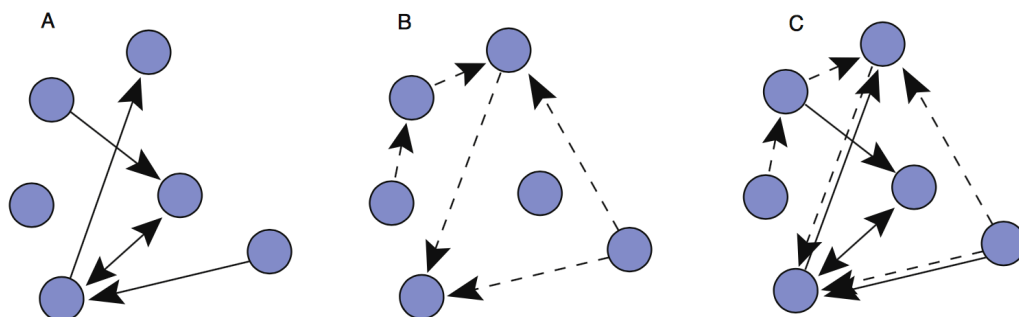
¹⁰ Source: MOST, various years.

Moreover, R&D investments has been regarded as a major device of organizational learning influencing diversification (Penrose, 1959). Other scholars pointed out that a firm needs to diversify its knowledge base through R&D investment in order to build up the “absorptive capacity”, which enables firms to assess the potential and successfully exploit new business opportunities. It also facilitates entry into a new business area (Cohen, 1990). Moreover R&D capital accumulated in a firm’s primary industry influences diversification decisions because firms attempt to transfer intangible assets built through R&D activities to new areas (MacDonald, 1985). In conclusion, R&D development are really important for chaebols, since it put the basis for the diversification.

Multiplex Ties Between Korean Business Groups

Multiplexity ties refer to any combination of two or more types of relationships. A multiplexity tie occurs when two or more parties share a relationship and the ties can be different such as friendship, love, affiliation but also information exchange, exchange of goods and capital (Simpson, 2015).

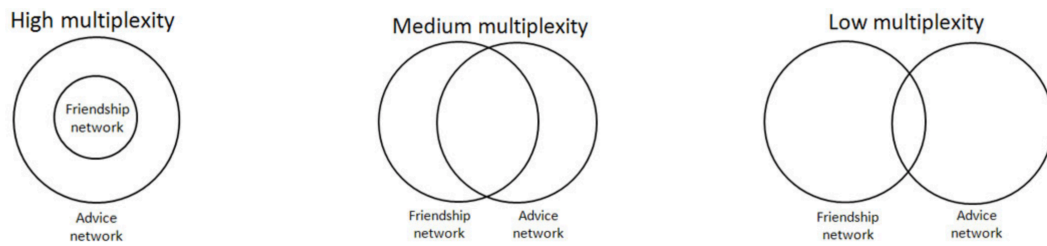
Figure 1.5: Slices of a multilayered network. Simplex view of relationship one (A), simplex view of relationship two (B), and multiplex view of both relationships (C)¹¹.



It could be a high, medium or low multiplexity according to the extent at which the two networks are more or less separated (Parker, 2015).

¹¹ Source: Simpson, 2015.

Figure 1.6: High, medium and low multiplexity¹².



More specifically there are two cases in which multiplexity could arise. The first one is when two actors are connected through different types of ties and each tie allows them to have different kind of interactions. It could happen when, for example, two CEOs belong to the same alumni association and this allow them to interact in an informal environment.

The second case happens when the two organization are linked by a single relationship, that still allows them to have different bases for interaction. A clear example is the marriage that creates kinship among the two organizations. This explains why multiplexity is so desirable, since through these relationships companies can create trust and interdependences between them (Han, Shipilov, & Greve, 2017). Moreover, it helps to facilitate mutual learning from partnering experiences (Beckman, 2002).

Multiplex ties have a lot of advantages but they also come with a cost. The problem lays in the fact that in the kinship relationships, individuals have unequal roles, such as for example the patriarch of the family with a distant cousin. This difference brings to inequality into the business relationship that will be characterized by the deference of a party towards the other. These differences can arise even in other cases not related with the kinship, for example when two companies connected by a board interlock may have a high-status board member who clearly favours the interests of one company over another. This imply that the company with the high-status board member will have a leading role over the other partner, that consequently will be less favoured. Thus, multiplex ties can have the so named “Trojan horses”, when the relationship has clear deference attitudes (Gimeno, 1996). A deference attitude that increases in particular because of the behaviour of

¹² Source: Parker, 2015.

the people at the bottom. As a matter of fact, more generally, individuals at the bottom of the social system show deference to the individuals at the top, and it is an expression of their willingness to accept worst terms of exchange. These acts of deference let the inequality to grow more and more (Castellucci, 2010).

Deference could be seen as a behaviour characterizing the past, but actually it is very contemporary and it still exists in a lot of business reality and we will see that with Korean chaebols.

The major source of deferential behaviour is culture. Some examples in which culture is clearly the reason of deference are when in India individuals from lower castes defer to individuals from the higher castes (Chen, 2015) or when women tend to defer to men in the Asian societies (Greenhalgh, 1985; Lee, Parish, & Willis, 1994).

Concerning South Korea, the tie we will consider is the marriage, more specifically the marriage between ownership families of business groups. First of all, marriage has been historically one of the best way to increase information exchange, coordination and trust among economic actors (Granovetter, 2005). It is one of the best way to secure long-term inter-group collaboration (Kerbo, 1995) and exchange of product knowledge, coordinated bidding and pricing (Ingram & Lifschitz, 2006). The hierarchy in the family relationship in Korea comes from the traditional Confucian value system. A key aspect of Confucian culture is the asymmetry of gender roles that puts male in a privileged position. More specifically, a son inherits the parents' wealth and social status and he is responsible for taking care of the oldest. On the other hand, the daughter has not the duty of taking care of her original family, but in the same time she is deprived of the property rights. Basically, sons are the descendants of the family while daughters have to re-build their own identity and economic sources through marriage and fully integrate into the husband's family (Greenhalgh, 1985). All these attitudes will bring to deference that in personal relationships will matter if it affects business outcomes.

Social relationships are important because they often influence the structure of competition in a market, in particular because chaebols, that serves many markets, will encounter much more competitors (Baum, 1999). Having a trusted partner in a market will reduce both costs of entry and exit from that market. More specifically,

entering a new market means having some costs, such as learning how to compete in that market, understanding who are the customers and competitors and how to deal with government regulations (Day, 1983). Other relevant costs are the access to distribution channels, the cost advantages connected to the relationship with suppliers or the financial resources needed to start the operations (Grant, 2015). Moreover, the competitors who are already in the market could attack the new entry in order to dissuade him from expanding its presence in that market (Fudenberg, 1986; Kreps, 1982). The costs of exit can show up when the competitors that are still in that market attack the chaebol that is trying to exit from that market because of its weakened position, since it has probably already transferred all the resources to the new market, lowering the value of the assets which that firm could sell (Han, Shipilov, & Greve, 2017). Other exit costs are related to the scale and scope economies or to the cost structure, because when the cost structure is based more on fixed cost, it is harder for the company to dismiss the assets, and the losses will be higher (Grant, 2015).

Thus, creating a marriage tie, will help the group, because it allows to have a trusted partner in the market that will allow the reduction of both entry and exit costs.

At first glance, both sides of the marriage should benefit from this support. Actually, because of the asymmetric roles in the family between husband and wife we analysed before, the group of the husband will be allowed to strengthen its position through increased entry into or exit from the common markets while the group of the wife will only support the activity of the husband's chaebol and will remain passive in its own market position. This behaviour leads to the ideals of the Confucianism according to which the husband's family is doing a "favour" to the wife's family by choosing her as a bride. It is considered a favour because the husband's family is giving a new identity to the woman that will not inherit the one of her own family, as explained before. That is why the chaebol of the wife has to support the chaebol of the husband, in order to repay the favour (Han, Shipilov, & Greve, 2017).

The way in which the wife's chaebol can help the one of the husband are quite a lot. First of all, the wife's chaebol can provide information to the husband's chaebol about potential market expansion opportunities, which includes insights into the

most attractive markets in which the wife's chaebol is operating, as well as the identities of the most reliable customers and suppliers in those markets. Moreover, the chaebol of the wife will not attack the husband's chaebol when it will enter and the latter will also be defended from others possible attacks. That is why, after marriage, a business group owned by a husband's family increases the probability of entering the markets occupied by the business group which is owned by a wife's family (Han, Shipilov, & Greve, 2017).

The wife's chaebol can support the husband's one not only in entering a market but also in exiting from those market in which her group is working. For example, the husband's chaebol will be willing to sell some assets present in that market and will seek if the wife's chaebol is interested in purchasing any of the assets, such as factories, distribution networks or buildings. It does not mean that the husband's group is selling failing businesses. It could sell well-performing businesses as well, but at a price enough high to cover the costs of reallocating resources across markets (Han, Shipilov, & Greve, 2017).

As mentioned before, the wife's chaebol would help the husband's chaebol in entering the market in which it operates even if it means that the value of its chaebol will be reduced. On the other hand, the wife's chaebols will not enter a market in which the husband's chaebol is operating in order to not reduce its value and the value that it can take from that market. In the meanwhile, the wife's chaebol will not exit from a market in which the husband's chaebol operates, in order to not deprive it from a friendly competitor with which it can cooperate. That is why the chaebol owned by the husband's family is much more likely to enter and exit common markets, as compared to the chaebol owned by the wife's family. Moreover, the two chaebols can agree to work together in order to attack other competitors in the common market and the wife's chaebol will never be an allied of another chaebol if it would mean attacking the chaebol of the husband, in order to not create stronger, more or new competition for the husband's chaebol (Han, Shipilov, & Greve, 2017).

Some interviewed Korean executive confirmed these processes. One of them spoke about the example of a marriage between two people belonging to two families that owned chemical companies. First of all, they stopped aggressive competition

against each other in the chemical business. But also, the husband's chaebols reconfigured its presence in chemicals' markets whereas the wife's chaebol supported this behaviour, without changing its competitive position (Han, Shipilov, & Greve, 2017).

Another senior manager confirmed the importance of this kind of relationships because mainly chaebols' executives prefer to work with people that they trust, with who they have a tie (Han & Shipilov, 2017).

This explanation does not want to point out that chaebols show deference to each other. The deference lays behind. This means that their CEOs' deference in the personal domain reflects the business domain by affecting these groups' collaboration in market entry and exit, favouring one group over another. In this way, also the bad aspects of multiplexity come out, even if historically it has always been seen like something that enable actors to deepen their understanding of each other and build relationship based on trust (Beckman, 2002). Historically, this kind of relationships are explained like a way to facilitate knowledge transfer (Rogan, 2014), to allow the sharing of customers (Ingram & Roberts, 2000) and also they increase the probability of the firms' survival (Ingram & Lifschitz, 2006). It is not about denying these benefits, it is about underlying that there are also negative aspects, since a part could control operations of another by exploiting a deference relationship (Han, Shipilov, & Greve, 2017).

There are a lot of examples of marriage tie. One of them is the marriage, in the 1950s, between the LG family and the Samsung one, when Lee Kun-hee's younger sister married a man from the Keumsung household (Shen, 2015). Samsung had no experience back then in high tech, while LG was a dominant, in particular in the radio electronics industry. By marrying the LG family, Samsung could expand itself and enter into the electronic industry. Thanks to this strong relationship between owner families, Samsung could expect a deep knowledge and intangible assets from LG in that market. In this way, Samsung could learn of the radio industry and the distribution networks easily, quickly and deeply, using this knowledge to become competitive. Another example is the marriage tie between Tae-Kwang and Lotte established in 1986. After that, Tae-Kwang entered the sports and amusement industry, in which Lotte was already present. Lotte, as well, entered into the

manufacturing of textiles and financial services where Tae-Kwang was already present (Korea Information Service, 1989). Samsung has also set other marriages with Dongbang Corp., Life Corp., Dong-ah Corp. and Meewon Corp. LG as well has gone through other marriages such as the ones with Daelim Corp., Pyeunksan Corp., Kukdong Corp, Doosan Corp., Hyundai, Hanjin and Kumho Corp. (Bennedsen, 2014).

Marriage is not the only type of relationship that can occur among chaebols' family members. Another one is the alumni networks (Siegel, 2007), that are based on the attendance at the same school or university and bring members together on a regular basis. Another way of reuniting some chaebols' members are the industry association, such as the Federation of Korean Industries (FKI), which membership is open only to large chaebols and large firms that are unaffiliated to a chaebol (Han & Shipilov, 2017). Obviously, these types of relationships are less strong than kinships so executives do not expect much reciprocal learning or support from these ties. But still these ties could be a help in some ways such as when firms need to coordinate prices in advance. This coordination is only possible in industry associations. Another way in which they help each other is through an exchange of favour such as one chaebol's exit from a market can be rewarded by reducing competition in another market. Sometimes it also has happened that some chaebols, who were already operating in too many markets, decided to exit some industries, giving up that markets to other chaebols which executives were members of the same alumni clubs or industry associations. In this way, the executive of the chaebol who exits the market will expect to be returned the favour from that friend one day (Han & Shipilov, 2017). An example of this reciprocal industry exits is in 1990 with TaePyungWang and Daewoo. They both were members of the FKI, but their CEOs did not belong to the same alumni club. A year later, Daewoo exited the industry of chemicals manufacturing while TaePyungYang remained there. The following year, TaePyungYang left the auxiliary financial services and insurance industry while Daewoo continued operating in that industry (Korean Information Service, 1990-1992).

Obviously, the tie will be stronger if the two CEOs are simultaneously members of both industry and alumni associations for example, since there are more

opportunities for them to develop trust, compared to those CEOs who only meet in a single group (Han & Shipilov, 2017).

This explains also some reasons of entering and exiting a market. It is not only about economic reasons such as looking economies of scope, but there are also social reasons behind. Basically, social relationships shape multimarket contact between firms (Han & Shipilov, 2017).

A New Era for Chaebols?

The IMF Crisis

The structure of chaebols had been strongly hit by the crisis between 1997 and 1998: the so-called IMF Crisis. The first signs of problems in Korea arrived in 1996. The evidence was in the current account deficit that grew from 2% of GDP in 1995 to 5%, and the rate of growth for exports had slowed from 31% to 15% (Adelman, 2009).

In fact, all these problems became bigger, giving the birth to the IMF Crisis of 1997 that brought to a lot of issues in particular for some chaebols that looked “too big to fail”.

This crisis involved a lot of aspects, from the foreign debt exceeded of 150 billion dollars to the rising of the unemployment of 2 million workers.

The financial situation of domestic firms and financial institutions was getting worst, and it brought to market failure and a lot of bankruptcies.

Moreover, the national foreign exchange reserves were consumed of 3.9 billion dollars, and the consequence had been a stop for the economy (Lee, 2000).

Basically, all the weaknesses of chaebols came out, from corruption to the great number of loans they had, and this brought to the destruction of some of them that had not been able to fight back their weaknesses. In fact, not all the chaebols had been able to go through the crisis, that is why a lot of them went bankruptcy, even one of the strongest: the Daewoo Group.

The figure below can briefly explain what happened during this crisis mainly to the chaebols, but also to the Korean economy in general.

Figure 1.7: The IMF Crisis¹³.

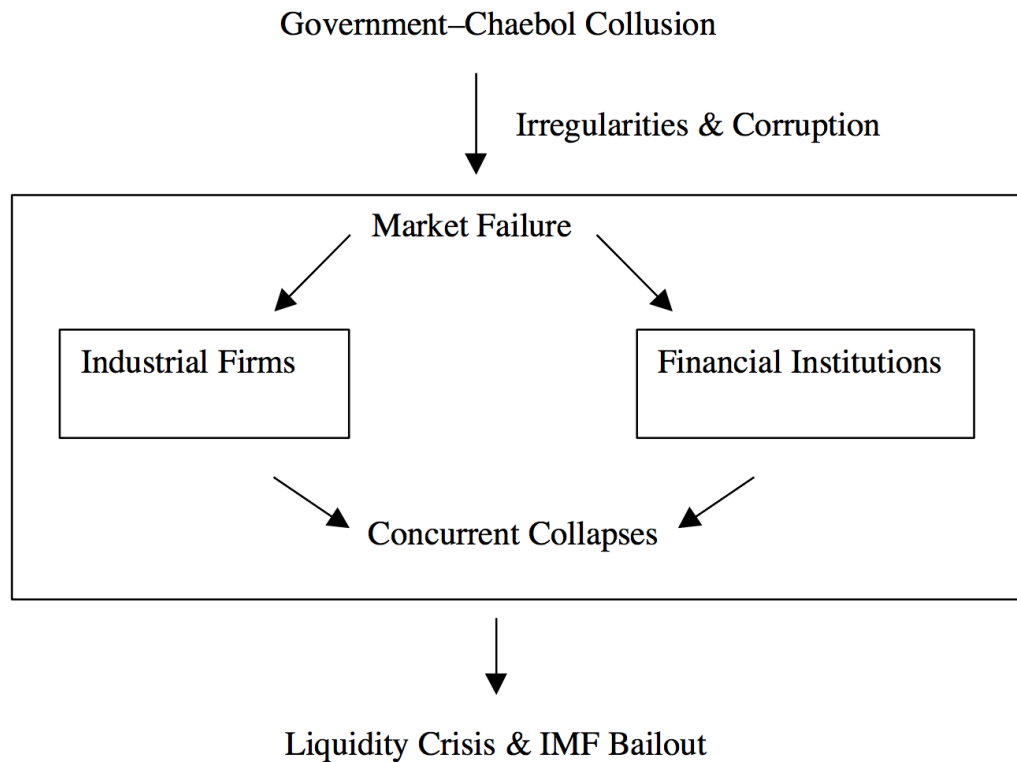


Table 1.6: The IMF Shocks (Dec. 1997), Before and After¹⁴.

	Before IMF Shocks 1997.6	IMF Shocks 1998.12	After IMF Shocks 1999.12
GDP growth rate (%)	7.00	- 5.80	13.00
Unemployment (%)	2.10	8.6	6.30
Interest Rate (%)	11.45	31.32	4.74
Exchange Rate(W/\$)	888.10	1,964.80*	1145.40
Stock Market Index	765.20	280.00*	984.50
Foreign Reserve(billions)	33.30	3.9*	74.10

*indicates highest or lowest records after breakout of IMF crisis in December 1997.

For analysing step by step this crisis we have to start from the first problem: overinvestment. Chaebols made too many investments in areas characterized by strong competition, where there was a very low return on investments. This

¹³ Source: Lee, 2000.

¹⁴ Source: Bank of Korea, 1997-1999.

happened also because mainly competition among chaebols have always been for market share and size rather than for profit, and this can be listed as the main reason why they made so many wasteful overinvestments.

Basically, if the domestic savings can support strong investments, a high investment rate is not a problem. This was not the situation of South Korea, since savings, as a proportion of GDP, remained 2 to 6% below the rate of investment, and this gap was even greater during these years.

Another problem was the way in which the investments were funded. The greatest part of investments was possible because it mainly came from debt-form financing or domestic and foreign sources. Chaebols maintained debt ratios over 400% and their interest payment costs out of sales exceeded 6% as compared with 2 to 3% of competing firms in other countries.

Also, the Non-Performing Loan (NPL) ratio of 1998 can be used as a clear demonstration of the failure since it was equal to 21% (Lee, 2000).

As we already mentioned, another problem was the management of chaebols, considered as one of the reason for the IMF crisis. In fact, the power of the chaebols was monopolized by the founder or by family members, without considering the opinions of minority shareholders. Linked to this misalignment between top management and minority shareholders, there was the low level of transparency, consequence of a poor auditing system. Moreover, the development of capital market stopped, and that brought to an increase in the dependency from banking credits as the major source of funds. Thus, this increased the instability in the economy (Lee, 2000).

Stepping back to the overinvestments problem, it occurred also because of the support of credit expansion from the financial sector, with both domestic financial institutions or through foreign sources. Part of the fault was in the hand of the government, since it acted as one of the decision-maker of the financial resources' allocation and it had a strong control of financial and real sector until the crisis emerged. For example, it controlled the interest rates or the business scope of the financial institutions and it brought to the lack of discretion in credit allocation of financial institutions.

Table 1.7: Characteristics of the Major Business Groups¹⁵.

July 1997						
	Group	In-group Ownership (%)	of which; Family Ownership(%)	No. of Subsidiaries	Total Asset (\$ bill.)	Liability Ratio (%)
1	Hyundai	56.2	14.6	57	53,597	436.7
2	Samsung	46.7	4.2	80	51,651	267.1
3	LG	40.1	6.1	49	38,376	346.5
4	Daewoo	38.3	7.1	30	35,455	339.5
5	SK	44.7	14.6	46	22,927	383.8
6	Ssangyong	42.0	4.5	25	16,457	409.4
7	Hanjin	41.4	21.1	24	14,309	555.8
8	Kia	30.6	21.0	28	14,287	519.0
9	Hanwha	33.0	6.3	31	10,967	751.4
10	Lotte	22.8	3.4	30	7,774	192.2
11	Kumho	40.1	2.3	26	7,468	481.8
12	Halla	49.5	19.0	18	6,640	2,065.4
13	Dongah	54.2	12.0	19	6,458	354.7
14	Doosan	49.7	13.8	25	6,370	688.2
15	Daelim	34.2	9.1	21	6,177	423.2
16	Hansol	37.3	4.1	23	4,346	291.9
17	Hyosung	44.9	14.2	18	4,131	370.1
18	Dongkuk	51.0	18.5	17	3,956	218.4
19	Jinro	45.8	17.5	24	3,951	3,075.0
20	Kolon	45.1	8.6	24	3,910	318.0
21	Kohap	39.4	8.6	13	3,690	590.5
22	Dongbu	47.8	14.6	34	3,677	251.5
23	Tongyang	50.1	6.1	24	3,445	307.8
24	Haitai	30.9	6.0	15	3,398	658.5
25	Newcore	98.7	36.4	18	2,798	1,225.6
26	Anam	42.0	10.0	21	2,659	478.5
27	Hanil	37.4	12.2	7	2,599	576.8
28	Keopung	59.0	17.5	22	2,477	347.6
29	Miwon	52.5	16.3	25	2,238	416.9
30	Shinho	36.9	13.6	25	2,158	489.3
	Average	43.0	9.3	819		
	Total				348,364	386.7

In group ownership is the average, weighted by capital, of family ownership (shown in second column) in each company in the group plus the shares of subsidiaries.

On the other hand, we have depositors that were not worried about their savings since they were sure that no one would have ever let the financial institutions to fail. Moreover, they also shifted their funds to the failing financial institutions, that

¹⁵ Source: Fair Trade Commission.

offered higher interest rates to avoid liquidity problem after the crisis. This kind of market brought to behaviour of moral hazard in the management of financial institutions, for making high risk investments.

Talking about the currency, the Korean won did not suffer a currency attack by currency speculator. As said before, the problem was in the financial institution, that built up a financial structure that was not strong enough to face the market, in particular talking about the foreign debt structure (Lee, 2000).

Table 1.8: Short-term Foreign Debt and Foreign Reserves¹⁶.

	(\$ billion)			
	1997.12	1998.12	1999.12	2000.6
Short-term Foreign debt(1)	63.9	30.7	38.1	47.5
Foreign Reserves(2)	8.9	48.5	74.1	90.1
(1) / (2)	716.6%	63.3%	51.5%	52.7%

As a result of the crisis, a lot of financial institutions closed and some others went under a process of recapitalization. This brought to the bankrupt of a lot of highly leverage firms, including some chaebols. The survivors of the crisis had to go through a strong process of restructuration.

The IMF Rescue Program

The International Monetary Fund (IMF) is an international organization “working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth and reduce poverty around the world” (IMF, 2014). This organization was the main reason of the several reforms applied in South Korea after the crisis of 1997. In fact, the IMF, in return for a loan given to South Korea for covering its debts, asked for the application of these reforms.

First of all, the government had to strengthen fiscal and monetary policies in order to reduce inflation and budget deficit. Moreover, taxes were also increased and

¹⁶ Source: Bank of Korea, 1997-2000.

funds had to be used for the welfare of the country, to protect themselves from the probability of an increase in unemployment (Park, 2002).

The second reform was about changing some functions of the State with the objective of creating a smaller but more efficient government. This new organization had been built thanks to the transfer of some functions from ministries to local governments or to private sectors and with a stricter control over economic policymaking to the executive and prime minister (Kim, 1999).

The third reform concerned the labour market. A massive laying-off with a cut in wages would only have helped the country to rise from the crisis. Basically, the labour market flexibility was a must for the industrial restructuring (Kim, 1998). To have trade unions from its side, the government created the Tripartite Commission on Industrial Relations in the 1998 to involve trade unions in decisions regarding more flexibility in the labour market. Eventually the trade unions agreed on the unavoidable laying off because of restructuring, but in return they had the permission to be part of political activities and they also obtained a \$US4.4 billion funds to compensate job losses as a consequence of restructuring process (Park & Park, 2000). Eventually, all these drastic actions in the labour market brought to good results since they helped the economy to recover its high growth rate.

The fourth reform was about the financial sector. The most important objective to pursue was increasing the foreign competition in the financial sector in order to increase the performance of this sector and to shut down the troubled institutions. The survived institutions were re-capitalized by the government in order to have a better-capitalized and market-oriented financial sector (Choong, 2001; Haggard, 2000; Kim, 1998; Park, 2002). The IMF also wanted to guarantee full independence for the Bank of Korea (Kim, 1998) and it would have been combined with a new institution: The Financial Securities Commission (FSC), with the role of auditing the entire financial sector (Park, 2002).

The IMF program had been criticized though because people have appointed that the rescue program built up by this organization did not suit the Korean economy. They said this because Korea was suffering from private debt and microeconomic problems, not from public debt or macroeconomic problems, and the IMF program could have helped the country in the short-run but not in the long-run (Lee, 2000).

Actually, the Korean economy had survived the crisis in the best way possible thanks to the inflow of IMF, succeeding also in repaying debts to foreigners in order to have again their trust and to still have the chance to attract foreign capital (Lee, 2000).

As mentioned before, one of the main objectives of the reform was having a more market-oriented economy. To pursue this objective, the state had to act more like a regulator rather than a facilitator of development, like it did in the last years with chaebols. Thus, it had to think more about solving structural problem such as monopolies, economic disparities among regions, cost structures and barriers to higher efficiency (Kim, 2003; Kong, 2000). Eun Mee Kim (1997) has described this change as a shift from a comprehensive developmental state (CDS) to a limited developmental state (LDS). A comprehensive developmental state is “plan-rational” rather than “market-rational”. Basically, the state is more focused on development rather than regulation. So, for example, it ensures that firms have access to a good level of capital and technology and it provides assistance by mediating between national and international firms and by promoting international trade. Because of the growth of the complexity of the economy, for the state, it became more difficult to accomplish all these objectives, that is why it is more useful to have a more regulatory role. This kind of role is the characteristic of the LDS (Kim, 1997; Kim, 1999).

This reform helped the country to recover and it stabilized the economy. It is clear from the development of the economy in 1999, which has been growing compared to the previous year as shown in the table below that consider a time horizon of 1996-1999.

Table 1.9: Rate of Growth from 1996 to 1999¹⁷.

Year	1996	1997	1998	1999
Rate of growth	6.8	5.0	-6.7	10.7

In the figure 1.3. it is possible to see the trend of the GDP per Capita after the recovery of the financial crisis.

¹⁷ Source: Korea Focus, 2000.

Figure 1.8: South Korea's Economic Recovery After 1997¹⁸.



Talking about companies, the restructuring had been done also through banks, holders of the majority of the firms' debt. This process had the aim of improving the ability of companies to repay. We will talk deeply about it in the next chapter.

Restructuring Chaebols

Eventually the reform took in consideration also chaebols and their corporate governance. The changes required in the managerial style of chaebols were mainly five:

- enhancement of management transparency;
- capital structure improvement;
- greater accountability by owner managers;
- cancelation of mutual loan guarantees among chaebol affiliates;
- business consolidation into core competence areas (Mo, 2003).

In the 1999, the government added three more rules that the Chaebols had to respect:

¹⁸ Source: World Bank, 2007.

- prevent industrial capital from dominating finance;
- discourage circular investment between chaebol affiliates;
- prohibit nepotistic transfer of management or ownership to family heirs (Yanagimachi, 2004).

These structural changes reflected the two long-term political objectives of the post-crisis period: the first one was moving the Korean economy toward a more liberal, market-driven economy and the second one was strengthening financial sector resilience to market fluctuations (Powers, 2010).

Chaebols were forced to change in particular from the public opinion that have always seen them as the main reason for the crisis because of their incautious lending and expansion.

According to the IMF the main reason for the crisis had been the low profitability, a result of over-capacity and over-investment in industries such as shipbuilding, automobiles, electronics and semiconductors. The proposed solution for this problem was the elimination of surplus production capacity, so eliminating some plants and equipment, and the injection of public funds to recapitalise chaebols in return for an end to the practice of mutual debt guarantees between chaebols' affiliates (Cumings, 1998; Choi, 2002; Lim, 2003; Shin, 2000).

One of the main objectives of the government was the reduction of the debt ratio. The problem was that the government wanted to reach this goal with all the means it had, in order to lower it under the 200% in the shortest time possible. This brought the government to use false tactic such as the circulatory investments. Circulatory investments happen when company A invests into B, B into C, C into B and B into A. In this way, no actual investment has been made, but capital appears increased on the book. This could give more power and control to the owner of the chaebol and again minority shareholders would be ignored (Lee, 2000).

Eventually the reforms were not that successful as hoped and this failure happened for several reasons, such as the existence of the before mentioned circular shareholding, that brought a lot of ambiguity and complexity, or the poor regulation enforcement.

Basically, the change in the chaebols was only a surface change, but the structure remained the same since the inter-unit dependence and the control of family was

still strong. The Samsung Group showed the highest ratio of inter-unit trading. Samsung's 159 units reported 148.17 billion won in total sales, of which 61.73 trillion won, or 41.7%, came from intra-group transactions. Internal trading by the Hyundai Group stood at 38.1%, followed by the LG group at 38.0% and the SK Group at 36.1% (Lee, 2000).

Because of the failure in restructuring chaebols, the government had to think something else to make the economy survive. That is why the government issued 64 trillion worth government bonds to be used for resolving bad debts and restructuring financial institutions. Eventually the economy still remained unstable because of the lack of investments companies, merchant banks or security dealers in the country. The situation got worst with the fall of Daewoo group. The problem was that all the financial institutions were linked in some way to this chaebol. The fall of Daewoo Group has produced debts estimated to be equal to 90 trillion won. As a result, a lot of financial institutions came back to the situation of insolvency experienced with the IMF Crisis. It happened because of a mistake of not closing immediately the Daewoo Group after the IMF Crisis, delaying in this way the incumbent disaster (Lee, 2000).

The Daewoo Group Collapse

Daewoo Group was one of the top South Korean chaebols. It was founded in 1967 and before the 1997, so before the Asian financial crisis, it was the second largest conglomerate in Korea after the Hyundai Group. There were about 20 divisions under the Daewoo Group, from automobiles and electronics to financial services and construction and some of them still survive today as independent companies.

As we have seen, all chaebols suffered because of the 1997 Crisis, happened under the Korean government of President Kim Dae Jung, unable to manage the financial sector. The problem came from the first support of chaebols: the government. The Korean government found itself in deficit, thus cheap and unlimited credit were severely restricted. At the end of 1997, the four largest Korean chaebols (Hyundai, Daewoo, Samsung and LG) had a debt of nearly five times their equity. On one hand Hyundai, Samsung and LG were putting effort in making this debt lower, on the other hand Daewoo took on 40% more debt. In 1999, Daewoo Group, with

interests in more than 100 countries, went bankrupt, with debts of about 80 trillion won (US\$84.3 billion) (The Economist, 1999). The Chairman Kim Woo-Jung has been arrested in 2006 for fraud, illegally borrowing and smuggling.

This collapse shocked many Koreans, despite Daewoo's long-standing financial problems. This reaction happened because of the mainstream thought that chaebols were too big to fail. This belief brought too many bankers and investors to keep on wasting money on investments, even if it was clear that Daewoo was unable to repay those loans. After this crisis, the perception of too-big-to-fail changed a bit, so the large Korean conglomerates were not considered anymore the safest investment. That is why investors and banks began to finance other opportunities such as small firms.

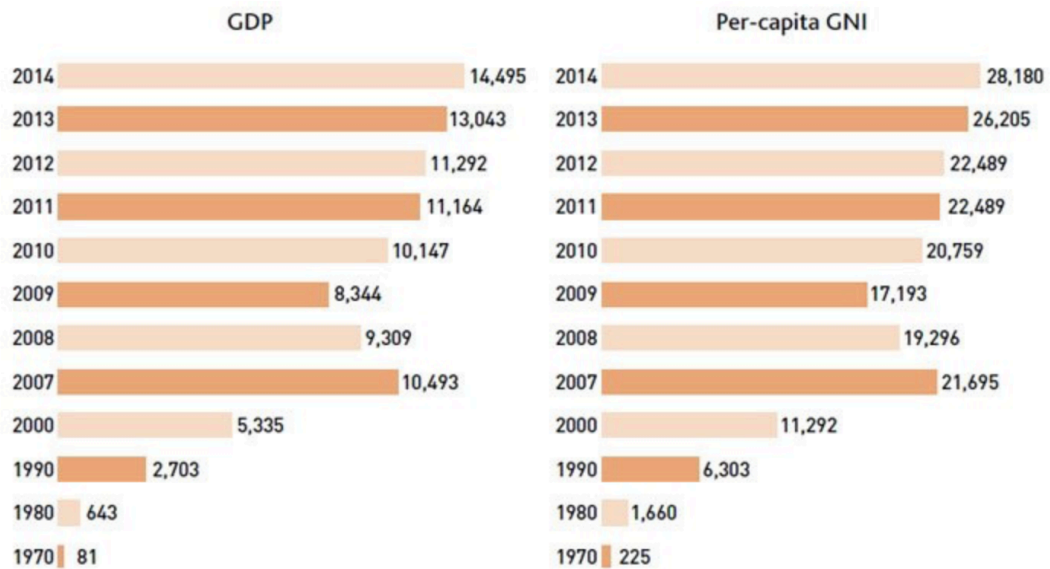
Going deeper into the reason of the collapse, it is important to underline that there are several people to be blamed but first of all, the main fault is of the chairman Kim Woo Chong. He was completely confident that the President Kim Dae-Jung would have never let Daewoo Group collapse, because he helped the President a lot with his campaign. Moreover, this confidence brought him to make more mistakes, such as refusing to accept the proposal of the government to sell Daewoo Motor in return for saving the other Daewoo units. He had never listened to his subordinates which gave him suggestions on how to save the company. Eventually he also refused the help given by the two best policymakers of that time: Financial Supervisory Service's (FSS) chairman Lee Hun Jae and chief economic advisor Kang Bong Kyun. They tried to convince Daewoo's CEO to implement a reform in order to save the group, in particular they suggested to sell some of the units in order to repay the debts. Kim refused to do that, and he also refused the ultimatum given by FSS' chairman Lee to implement the reform plan. Because of these continuous refusal, the government was obliged to liquidate the group (Lee, 2014).

Chaebols Today

Even today chaebols receive a lot of critics, even if they are the reason why South Korea is the world's fifth largest exporter with the 11th largest gross domestic product (GDP). This is clear in the graph below that shows the growth of the GDP

from the 1970 to 2014. According to the data, it has grown from a GDP per capita of \$67 in 1953 to \$27,970.5 in 2014 (Go-Business, 2016).

Figure 1.9: GDP per capita¹⁹.



The major critics are about the political and business scandals but in particular because of the lack of growth of small companies. About it, it is important to underline that between 2011 and 2014, just 0.01% of South Korea's small companies grew into midsize ones (Kim, 2017).

Still the main power of chaebols today is export, even if some economist thinks that the South Korea's export dependency could bring to some problems such as a state of stagnation for the country, according to Mauro Guillen, management professor at the Wharton School at the University of Pennsylvania.

This high level of export could be a problem, but on the other hand it can bring a lot of advantages.

In data, South Korea's exports are increasing day by day, and it is evident if we compare April 2016 with April 2017. From the table below we can see a rise of 24.1% (Cetus News, 2017). The table shows the current account balance that is a country's net trade in goods and services, plus net earnings and net transfer

¹⁹ Source: Bank of Korea, 2014.

payments to and from the rest of the world during the period specified (the figures of the table are calculated on an exchange rate basis).

Moreover, the country has a trade surplus of more than \$98 billion, the fourth-largest in the world after China, Germany and Japan (OEC, 2015).

Table 1.10: Current Account Balance^{*20}.

RANK	COUNTRY	CURRENT ACCOUNT BALANCE	DATE OF INFORMATION
1	<u>EUROPEAN UNION</u>	\$387,100,000,000	2016 EST.
2	<u>GERMANY</u>	\$296,000,000,000	2017 EST.
3	<u>JAPAN</u>	\$175,000,000,000	2017 EST.
4	<u>CHINA</u>	\$162,500,000,000	2017 EST.
5	<u>KOREA, SOUTH</u>	\$85,140,000,000	2017 EST.
6	<u>NETHERLANDS</u>	\$82,440,000,000	2017 EST.
7	<u>TAIWAN</u>	\$79,000,000,000	2017 EST.
8	<u>SWITZERLAND</u>	\$67,330,000,000	2017 EST.
9	<u>SINGAPORE</u>	\$59,790,000,000	2017 EST.
10	<u>ITALY</u>	\$52,830,000,000	2017 EST.

The main products exported by the country are cars, ships, refined petroleum, liquid crystal display panels, industrial machinery and telephones.

Table 1.11: Exports of South Korea²¹.

Machines	Transportation	Plastics and Rubbers	Chemical Products 7.0%	
		7.1%		
	20%	Instruments	Textiles	Food stuff
		6.0%	2.7%	1%
39%	Metals	Mineral Products	Precious metals, Paper Goods, Miscellaneous	
	8.5%	5.4%	3.3%	

²⁰ Source: Central Intelligence Agency, 2016.

²¹ Source: Massachusetts Institute of Technology, 2015.

China, United States, Vietnam, Hong Kong and Japan are the main customers of Korean's exports, in particular China and United States with respectively 26% and 14%, related to the money that South Korea earns from exports (OEC, 2015).

In 2016, trade accounted for 78% of South Korea's GDP and this is a clear evidence of how much the Korean economy is dependent on chaebol-produced exports, such as steel, electronics and cars (TWB, 2016).

Some economists still keep on blaming this high level of exports (seen as a weaknesses) and the lack of intervention of governments (TWB, 2016). According to them, the government is supporting a state based on a chaebol-centred economic structure that does not allow the development of the Korean economy. To lessen this dependence, a solution could be the raise in the domestic demand but it would not be easy considering the demographic problem that Korea is facing consisting in being the oldest country according to the working-age (Guilford, 2013).

Stepping back to the power of chaebols, it is important to underline that their power is evident for the fact that sales revenue earned by the top ten chaebols account for 67.8% of the country's GDP (Premack, 2017). The problem is the lack of SMEs, that usually are accounted as a source of innovation and job creation, but in Korea the greatest part works as suppliers and subcontractors of chaebols (Connell, 2014). For this reason, in 2013, the Korean government announced the "creative economy action plan", in order to eliminate financial and regulatory barriers to entrepreneurs and SMEs to promote their development. The plan included tax incentives to stimulate angel investment, new funds to support start-ups and also the creation of an "entrepreneur visa" to encourage highly skilled foreigners to start businesses in Korea (Connell, 2014). Despite this plan, the businesses have failed to take advantages of all the government programmes to support SMEs and have shown also a lack of innovation. According to Hong Seong-chul, a researcher at the Korean Small Business Institute, even if the South Korean government has put a lot of effort into supporting SMEs, the problem is the lack of promotion; thus, some SMEs do not use what the government offers because they are not aware of it so they should find a better way to communicate with each other (Kang, 2014). The adverse Korean economy has brought the SMEs to expand overseas. The Bank of Korea reports that SMEs have begun joining the FDI outflow since 2010. In fact, overseas

investments are seen as the best option to overcome the domestic business burdens such as high wages, high corporate tax rates and the irrational regulations in South Korea. But this exposes companies that are not so strong to the external market, and they will need more protection in order to compete with foreign contractors. To prevent this unintended outflow of SMEs from South Korea, a better environment for business should be established by connecting SMEs, workers and the government (Choi, 2018).

Even if SMEs struggle to develop and start-ups struggle to raise, there are still some of them that have been able to grow up such as Baedal Minjeok, a restaurant delivery app, Zig Bang, an apartment search app, or Coupang, a home-delivery service, and are able to grow despite the existence of chaebols, attracting also investments from companies as Goldman Sachs (Crunchbase, 2017).

One of the most famous South Korean company, that began as a start-up, is the company Kakao Corporation. This company covers several sectors completely different from each other, more or less like chaebols. It provides apps for mobile chatting, blogging, gaming, video and music sharing and also a taxi service. It owns also several shops (more than 21 shops distributed in all the country) where it sells its own gadgets and it also provides theme cafés.

Figure 1.10: Kakao Inc²².

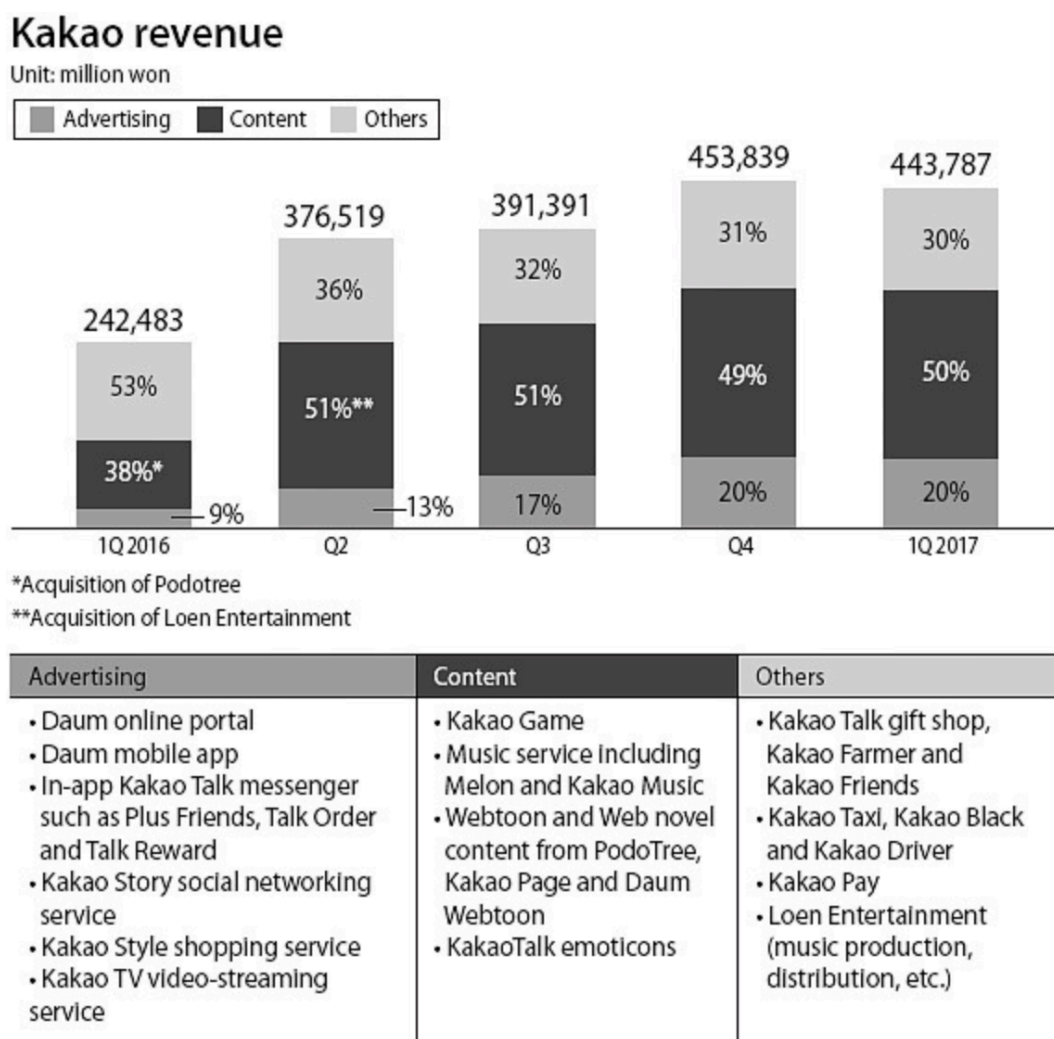


Source: KakaoFriends Website, 2018.

In terms of numbers, Kakao Talk, the app used for messages, has 41.49 million of monthly active users in South Korea, compared to the most used platform worldwide Facebook that in South Korea has about 16 million of users. Pointing out that we are talking about 41.49 million in a country of 50.61 million.

It offers 20 different apps and it is also a profitable company. In the first quarter of 2017, Kakao had about \$393 million in revenue and \$34 million in operating profit (Kim, 2017).

Figure 1.11: Kakao Revenue²³.



Even if these cases of successful start-ups exist, people still complain about the power of chaebols and request every day for other reforms. In particular critics

²³ Source: Kim, 2017.

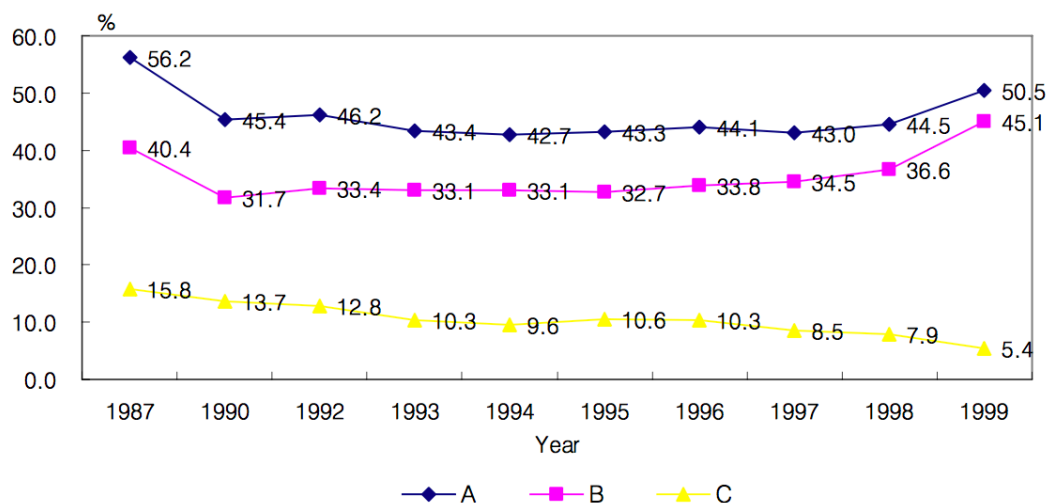
appoint that the ownership of the family should be reduced and its structure should be simplified. In a chaebol, the ownership will be always given to a family member, even if there are other candidates outside the family that are more qualified. The change should include the dependence among affiliates as well, for example the batteries of Samsung's Galaxy Note 7 were made by a Samsung subsidiary and LG Electronics uses LG Display for its tablets, televisions and phone screens (Swider, 2017).

Critics say that the Korean government has enough funds to adopt a fiscal policy that can support the temporary problems that the reform could bring. Because, according to Park Sangin, professor of the Seoul National University, the problems would occur only in the short-run, while after some time the economy would improve.

But still the problem lays in the action of the past. All the reforms made until today were focused on drastically changing chaebols. It is a big mistake because it is important to not give up on all the advantages of all chaebols, trying to improve and strengthening the corporate governance.

For example, in the figure below it is shown how the interlocking institutional ownership has increased from 44.5% in 1998 to 50.5% in 1999.

Figure 1.12: Ownership trend of the 30th largest chaebols²⁴.



Note: Interlocking institutional ownership (A) = In-group shareholding (B)+Owner (and his family) shareholding (C)

²⁴ Source: Korea Fair Trade Commission, 2000.

This is completely the opposite of what we could expect if we consider the 1997 and the 1998 the years of the reform, where such tendency should have decreased. It is the confirm that the change happened on the surface but they keep on managing the firm as before, without considering the reformed promoted by the government and IMF.

According to Yu-Kyeong Kim, the core reform in corporate governance lies in solving inefficient allocation by strengthening manager-monitoring and investor-protection functions. The inefficient allocation of resources is the result of that competition mentioned before among chaebols for size rather than for profits. In fact, a company is supposed to pay dividend when they do not have any investment opportunity to make profit more than the opportunity cost. Actually, in chaebols the chairman usually decides to reinvest those resources within the business groups in order to expand always more the company. Mainly, all of these investments should be simply controlled. In-group shareholders should be stable shareholders in order to be the type of active investors that can monitor the management.

Koreans have shown their disappointment with the election of Moon Jae-In in May 2017, that has promised to the country to reform chaebols even if until now nothing has changed so much.

The reform will not be easy anyway. Chaebols are part of the Korean economy and they are so much integrated into the economic, political and social structure of the country that it would be difficult to change them. As we have seen, other reforms had been made during the history of this country, without real results or at least without long-term results. On the other hand, supporters of chaebols appoint that chaebols are the engine of the Korean economy, so changing them would mean damaging the country's economy.

Chapter 2: Samsung Group

History

Samsung was founded by Lee Byung-Chul in 1938 as a trading company in Daegu, South Korea. At the beginning, it was a small trading company, with only forty employees. The company only produced dried-fish and noodles.

Figure 2.1: the first company of the Samsung Group²⁵.



When the company began to grow up, he moved its head office to Seoul in 1947 and in 1951 he established Samsung Moolsan (now Samsung Corporation).

In 1947 Samsung's founder also invested jointly with Hyosung Group's founder, Cho Hong-Jai, in a new company called Samsung Trading Corporation. This firm grew up but after some years the two investors separated because of the differences in the management style. Despite this, the trading firm grew to become the present-day Samsung C&T Corporation (Lee, 2009).

The problem arrived with the Korean War since Lee Byung-Chul was forced to leave Seoul. He moved to Busan and in 1954 he founded Cheil Industries Inc. that has always been the largest woollen mill in the country.

²⁵ Source: Samsung website, 2015.

Year after year, Samsung kept on diversifying in different areas, for example in 1958 the company Ankuk Fire & Marine Insurance had been acquired (renamed Samsung Fire & Marine Insurance in October 1993) and in 1963 there had been the acquisition of DongBang Life Insurance (renamed Samsung Life Insurance in July 1989). Lee Byung-Chul was a firm believer in industrialization, so he wanted Samsung Group to become the industry leader in almost all the sectors (Samsung, 2018).

That period has not only been characterized by several acquisitions, but also by new establishments. In 1966 Joong-Ang Development has been established (today it is called Samsung Everland) and during these years we also have the entrance in the electronics industry, in 1968, when Samsung-Sanyo Electronics has been established (called Samsung Electro-Mechanics in the 1975 and merged with Samsung Electronics in 1977). The 70s had been great years for this chaebol. First of all, in 1970 Samsung-Sanyo invested a lot for new innovative products and it started to produce black-and-white TV (model: P-3202), as shown in the figure below. Moreover, in the 1972, Samsung-Sanyo began the production of black-and-white televisions for domestic sale (Samsung, 2018).

Figure 2.2: the first Samsung black and white TV²⁶.



In the 1978 Samsung Electronics produced 4 millionth black-and-white TV and in 1979 it expanded its production with the beginning of mass production of microwave ovens.

²⁶ Source: Official Samsung USA Google+ Page, 2014.

During the 80s Samsung began the production of air conditioners and personal computers, but it also established sales subsidiary in Germany. In the meanwhile, Samsung BP Chemicals was founded.

After Lee's death in 1987, Samsung Group was separated into four business groups:

- Samsung Group;
- Shinsegae Group (discount store, department store);
- CJ Group (food, chemicals, entertainment, logistics);
- Hansol Group (paper, telecom).

Today these separated groups are independent and they are not part of or connected to the Samsung Group (Ko, 2000).

Moreover, during these years, Samsung began to invest heavily in research and development, that helped the company to expand year after year in the global electronic industry. About that, it established a television assembly plant in Portugal in 1982, and the years later also in New York, Tokyo and England.

One of the most important event happened in the 1988 when Samsung Semiconductor & Telecommunications Co merged with Samsung Electronics. Then, home appliances, telecommunication and semiconductors had been selected as core business line.

During the 90s Samsung began to develop in mobile phones' business. In 1992 Samsung Electronics developed mobile phone system and in 1996 it developed the world's fastest CPU (Central Processing Unit), called the Alpha chip.

Meanwhile the group was growing up not only on the electronic side, but also on the construction side, showing how much its presence was strong not only for its core business but for the other businesses as well. About that, Samsung's construction branch won some contracts to build important constructions all around the world such as one of the two Petronas Towers in Malaysia, Taipei 101 in Taiwan and the Burj Khalifa in United Arab Emirates (Grant, 2010).

A great step has been in 1995, with the Samsung's creation of its first liquid-crystal display screen and it grew up as the world's largest manufacturer of liquid-crystal display panels.

Concerning the 1997 Asian Financial Crisis we talked about in the previous chapter, Samsung did not have great losses compared to other major Korean conglomerates.

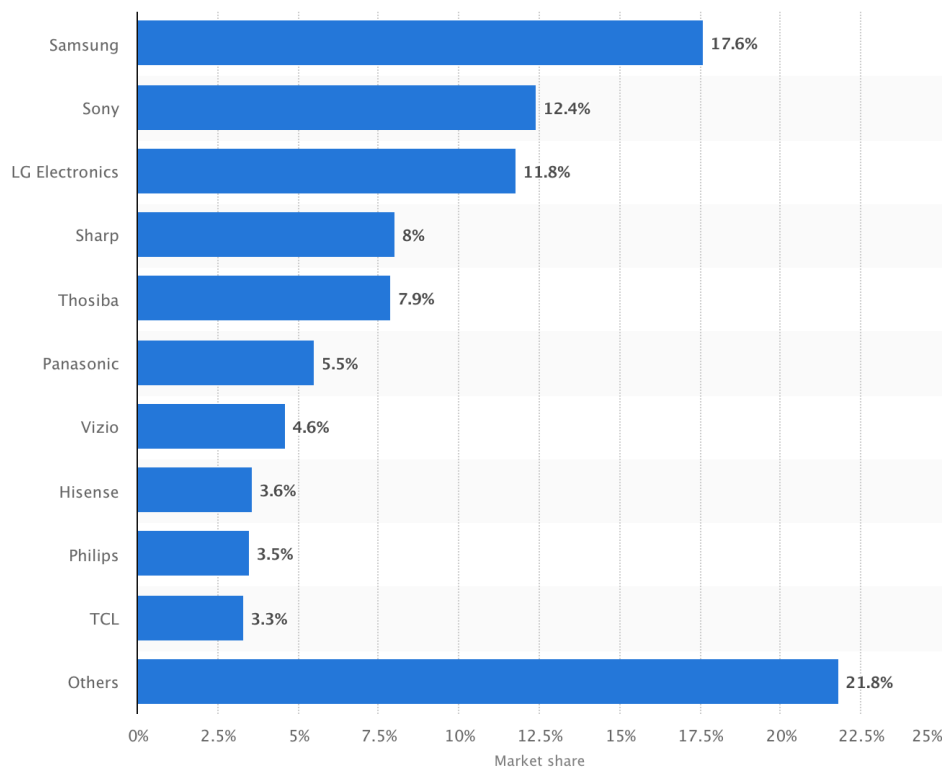
However, Samsung Motor had been hit by it because it was sold to Renault at a significant loss.

A lot of objectives had been reached in the 2000s. For example, in the 2001 Samsung Electronics had been ranked No. 1 of world's Top 100 IT Companies by BusinessWeek and in 2007 Samsung Electronics attained No. 1 worldwide market share position for LCD for the sixth year in a row.

In the graph below it is shown the market share of LCD TV brand in 2010. It has always been one of the most profitable businesses for Samsung thanks to which it has taken advantages in particular from the fact that it acted as a first mover (but we will discuss more about it in the paragraph below).

As shown in the graph 2.1, Samsung had the 17.6% of market share in LCD TV in 2010, a percentage pretty high compared to the other companies such as Sony that had 12.4% of market share, positioning itself at the second place, and also compared to the Korean competitor LG Electronics, that we can find at the third place, with 11.8% of market share.

Graph 2.1: Worldwide Market Share of LCD TV brand in 2010²⁷.



²⁷ Source: Statista, 2011.

In 2012 Samsung Electronics became the world's largest mobile phone maker by unit sales, overtaking Nokia, which had always been the market leader since 1998.

Table 2.1: Global Cellphone Suppliers (shipments in millions of units)²⁸.

Company	Q4 '11 Shipments (Millions)	Q1 '12 Shipments (Millions)	Q4 '11/Q1 '12 Quarterly Growth
Samsung	106	92	-13%
Nokia	114	83	-27%
Apple	37	35	-5%
LG	18	14	-23%
RIM	14	11	-21%

Samsung has always exploited its opportunities and strengths in order to grow up always more, on the other hand it has also overcome a lot of difficulties such as the scandal of its CEO, Lee Kun-Hee, in 1997 and 2008 (respectively for bribing a former South Korean President and for tax evasion) but also the latest arrest of his son, Lee Jae-Young.

The arrest of Samsung's Heir

Samsung faced some problems in 2014 when its chief executive to be, Lee Jae-Young, had been charged with bribery and embezzlement, in particular linked to some cases of bribery with the president Park Geun-Hye. One of the charges was the payment of \$36 million to charitable foundations operated by Choi Soon-Sil (a close friend of President Park) in return for her influence to win government approval for a merger (Premarck, 2017).

On August 25th of 2017 he was sentenced to 5 years in jail (BBC, 2017). But the 5th February 2018, he was freed shutting down all those hopes of reformers according to which chaebols were not powerful anymore. This release has been quite controversial because it triggered a lot of arguments. For example, Chung Sun-Seop, head of Chaebol.com said: "It is regrettable to see the judiciary going back to the past, with no real changes made in the problematic business practices of corporate Korea". Major

²⁸ Source: IHS iSuppli, 2012.

critics have seen this release as a great setback for all the reforms made until that moment. To feed all these arguments there has been the election of Moon Jae-In in May 2017 that made the chaebols' reform as his key economic agenda (Choi, 2018). The election of President Moon increased the hope for real changes in the corporate governance of these type of companies since it has always been by the side of transparency in the business sector, no matter how much Samsung and the other chaebols generate for South Korea in terms of GDP (Ryall, 2017).

With this election, all the conglomerates need to find another way to have preferential treatment from the government, in particular without illegal acts, even if it would be really difficult considering the protests of citizens. These protests go completely against the mainstream thought about Samsung: the greatest part of population was convinced that what was good for Samsung was good for South Korea as well. This also allowed the father of Lee Jae-Yong, Lee Kun-Hee, to avoid legal punishment twice, for bribing a former South Korean president in 1997 and for tax evasion in 2008. The factors that has pushed people to think that actually chaebols are not so strictly linked with the country's economy have been some data, such as the increase of profits followed by a decrease or a stagnation of the number of workers employed by these companies. Specifically, about Samsung, its operating profit rose by 128% (USD \$6.12 billion), while the number of Samsung's workers was stagnant (Choi, 2017). So, this is the reason why the number of people that requires a reform is increasing day by day and this brought to the election of President Moon with the 78% of votes (Ryall, 2017). The problem is that for many Koreans, the sentence of Lee's freedom has been seen as a setback to the President promise to reduce the power of chaebols, in particular after the first sentence of five years of prison for Samsung's Chief Executive, that increased hope in the population for a limit in these powerful empires.

On the other hand, there are still supporters of chaebols that believe that Mr. Lee will be able to improve and keep on reforming Samsung's corporate culture, satisfying also those ones who ask for reforms. For instance, it has already provided new measures for increasing shareholders' returns. He is also planning to introduce outside directors at the annual shareholders' meeting, to better reflect the interests of minority shareholders (FT, 2018). In fact, Samsung is trying to improve its Corporate Governance, increasing transparency and shareholders' value at the same time as well, with the decision of

bringing in Samsung C&T a French Executive as a new outside director. His name is Philippe Cochet and he has worked for General Electric as a former Chief Productivity Officer (CPO). The expectations on him are quite high, since the company expects him to provide professional advice about governance and business, but also his figure will be helpful to send the message of the commitment of the chaebol to reform and improve its Corporate Governance (Herh, 2018).

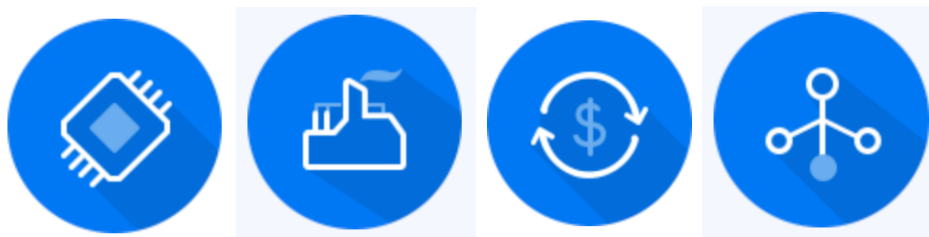
Heading back to the arrest of Lee Jae-Young, a lot of people thought that Samsung would have not survived to such a scandal and in particular without a leader. On the opposite side, analyst Geoffrey Cain said: “The withdrawal of the Galaxy Note 7 proved to be a bigger setback for the company. As long as the recently launched Galaxy 8 sells well, Samsung does not have to worry about the company’s immediate future. In fact, Samsung was able to score record profits in the last quarter while Lee was already under investigations”. Stephen Nagy, a senior associate professor of international relations at Tokyo’s International Christian University, appointed that Samsung has the capabilities to isolate this problem and move on because it is such a big organization that can easily overcome to this accident.

Despite the first changes that it is possible to see, there are still a lot of Koreans that protests, asking for the end of a system where the founding families of chaebol can control listed companies even if they have sold the majority of the stock to outside investors. As explained before, the new generation of CEOs is more willing to accomplish these reforms rather than their predecessors. They have a management that is less authoritarian and they understand better the shareholders capitalism. Thus, even if the Lee’s release has been seen as a bad move, it still could be something positive in the long-term because it could help the group to take the distances from the scandals of the past and the negative publicity generated from that (Choi, 2018).

Samsung Group Affiliate Companies

Samsung Group respects all the characteristics of a chaebol as explained in the first chapter. In particular it is a company highly diversified, that operates into different businesses.

Figure 2.3: Symbols of Samsung Group's Businesses²⁹.



The first business to consider is the one related to Electronics. The affiliated companies that work in this sector are:

- Samsung Electronics;
- Samsung Display, global leader in the display industry that brings LCD and OLED to small-medium and extra-large products;
- Samsung SDI develops new energy solutions by manufacturing the world's leading secondary cell products, PV and ESS (Energy Storage Systems);
- Samsung Electro-Mechanics, that produces high-tech integrated components of electronics and mechanical devices such as passive component or module (camera module and wireless LAN);
- Samsung SDS, a service of information and communication technology (ICT);
- Samsung Corning Advanced Glass, that produces OLED glass substrates.

The second business to take into consideration is the one of machinery and heavy industries. The companies that work in this sector are:

- Samsung Heavy Industries, that is the world leader shipbuilding;
- Samsung C&T Engineering Construction Group, a leading company for engineering, procurement and construction, offering experience across architecture, civil engineering and housing development;
- Samsung Engineering, provides procurement, construction and project management specialist for global markets.

The third business we are going to talk about is the one of financial services. There are several companies in this industry:

- Samsung Life Insurance, that is the largest insurance company in South Korea;

²⁹ Source: Samsung Group's official website, 2018.

- Samsung Fire & Marine Insurance, that offers insurance policies and services across regions;
- Samsung Card, that deals with integrated financial service, promoting healthy spending and everyday convenience;
- Samsung Securities, provides asset management services to individual investors through market-leading products and solutions and it is also the leading Korean financial investment company;
- Samsung Asset Management, is specialized in investment trust and mutual fund management, advisory and related products and services;
- Samsung Venture Investment, that invests in future-oriented business but it also provides management and technical support.

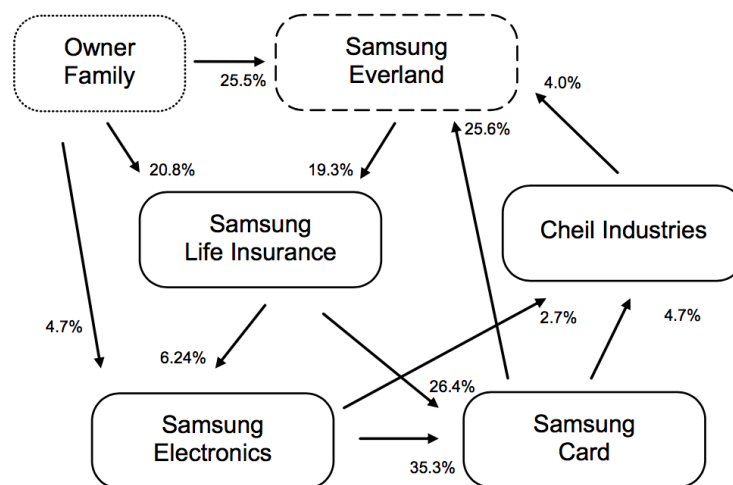
All the other companies could be grouped in a more general category of service since they belong to several and too different specific businesses:

- S-1 Corporation, works with professional security;
- Samsung Economic Research Institute, provides analysis on macroeconomic development, global issues and industry trends;
- Samsung Medical Center, that is a patient-centered hospital;
- Samsung Biologics, that develops biopharmaceutical products;
- Samsung Bioepis, that contributes to the development of the pharmaceutical industry;
- Samsung Welstory, is about food service;
- Samsung Fashion, owns successful brand in the fashion industry such as Beanpol and 8seconds;
- Samsung Resort, that offers services such as resort, golf, food and beverage and landscaping.

As explained in the first chapter, chaebols are controlled by a single chongsu, which is an unofficial manager that makes the final corporate decision for the entire conglomerate and he is basically the representative of the whole family. In Samsung, Lee's family can control all the group thanks to the mechanism of cross-shareholdings, that we have explained in the first chapter, that is basically one of the main element of a chaebol. The Lee's family can control all the group just by having the 1.67% of the overall group shares and this is the key aspect of the cross-shareholding method. This

happens thanks to the main means through which Lee family can have the control that is Everland, an amusement park private firm (Sung, 2013). Thus, basically, Samsung Everland is the holding company that holds a controlling stake in Samsung Life Insurance, which owns a stake in Samsung Electronics and other affiliates. This system of circular shareholdings allows Samsung vice chairman Lee Jay-Yong, who holds 25% stake in Samsung Everland, to maintain control over the group's electronics and financial units (Herald, 2014). This cross-shareholdings operated in the Samsung Group is briefly shown in the figure below.

Figure 2.4: Cross-Shareholding of Samsung in Percentage³⁰.



Samsung Everland is not the most famous unit of the Samsung Group but still its figure is crucial inside the cross-shareholding structure. As said before, it is the way through which the family can control all the group. In fact, the Lee family control the group through their key four holdings: Samsung Everland, Samsung Life, Samsung C&T and Samsung Electronics. Samsung Everland is the most important because it owns Samsung Life and Samsung Electronics (Phillips, 2014).

Some problems will arise because of the intervention of the South Korea's antitrust agency that has stated that it would tighten the rules on cross-shareholdings. As a matter of fact, Samsung Group affiliate Samsung SDI will be forced to sell Samsung C&T shares worth about 522 billion won (Lee & Coates, 2017). Samsung will have six months to comply with the new guidelines once they will be finalised and this will help

³⁰ Source: Kisline, 2012.

the overall job of the government to implement the reform to reduce the power of chaebols.

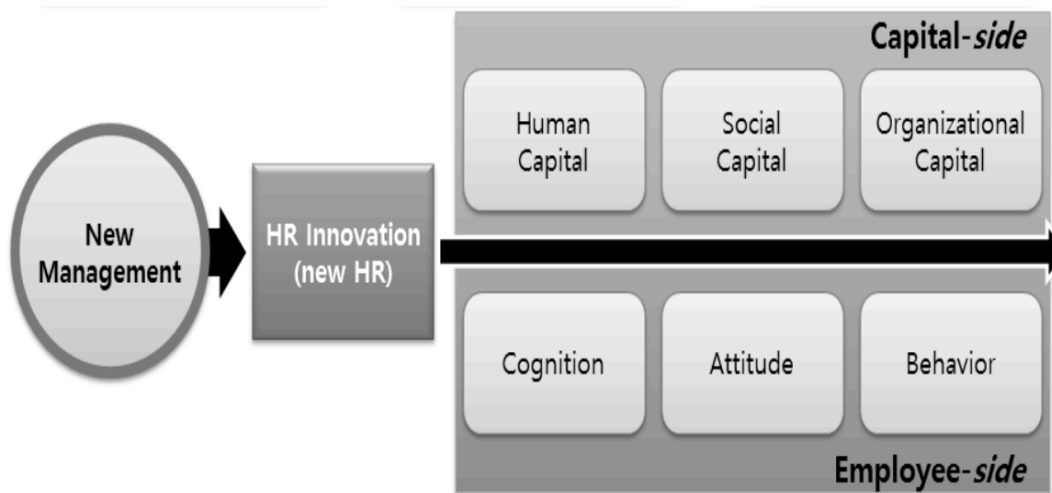
Corporate Governance

One of the factors that allowed the success of Samsung has been the effective and efficient use of resources such as the human resources, technology, marketing manufacturing and design departments (Jung, 2014). This sharp growth happened in particular because of the new management style of the second chairman, Lee Kun-Hee. This new management style has been introduced in the Frankfurt meeting in 1993, a meeting required from the chairman himself. He asked for it because he wanted an improvement in the group, since he understood that the quality of Samsung's product was not so high as he asked from his employees and factories. He found out about some quality problems thanks to a video where there was shown some employees working on the construction of washing machines by Samsung. The video showed that when the lids did not fit properly in the washing machines, the assembly line workers cut the lids by hand and then they packaged the product, ready for being sold to customers (Song, 2014). That was only a single episode of a greater quantity of problems to solve. Basically, there were a lot of problems linked with inefficiency, poor communication, also between departments, and poor division of labour (Park, 2012) and Mr. Lee wanted to solve all of them.

The episode of the video about the factory of washing machines has been the trigger for Mr. Lee to decide to hold this conference for making some changes. He wanted to transform Samsung from a manufacturer based on low cost advantages to a global performer with a strong brand value and high-quality products (Jung, 2014) recognized worldwide.

The key of this new management system was being an open management, promoting the creativity and the autonomy of employees and the transparency with customers, in order to improve both the relationship with the employees but also with the customers. The Open HR management system wanted to put at first place the promotion of equal opportunities and employees' skills.

Figure 2.5: New Management and New HR Model³¹.



From the figure above it is possible to understand better the new type of management. In particular the new HR system wanted to improve from both capital and employees' point of view with several changes. In particular:

- it promoted the employees' skills, knowledge and capabilities through recruitment and education (we are referring to the Human Capital);
- this new system wanted to improve also the social capital, thus wanted to help employees in building relationships and promoting the right cooperation for the final goal;
- eventually, always talking about the capital-side, it also promoted the Organizational Capital with the development of new work processes and new organizational cultures.
- from the employees' side, it wanted to increase the cognition of employees in order that they can be able to understand where the company is heading to, which are the main priorities and goals;
- it wanted also to enhance the employees' attitude in their work;
- eventually all these changes would have brought to a new behaviour for the employees, that was more conscious, and directed by this new management system (Youndt, 2004).

³¹ Source: Youndt and Snell, 2004.

The new Human Resource Management system was not the only change made by Mr. Lee. He gave a lot of importance to marketing, understanding its importance in the value chain of the group and this helped a lot the success of the company. Mainly, Samsung has developed an approach strongly oriented towards customers in order to understand and realize their needs and wants, to create loyalty and fidelity. Samsung has also understood the importance of selling well-designed products and services in order to give emotional and functional benefits to its customers (Jung, 2014). In this way, it has had the chance to increase its brand recognition and loyalty, anticipating and satisfying the requests of all customers globally (as demonstrated also in the survey in the figure 1.12).

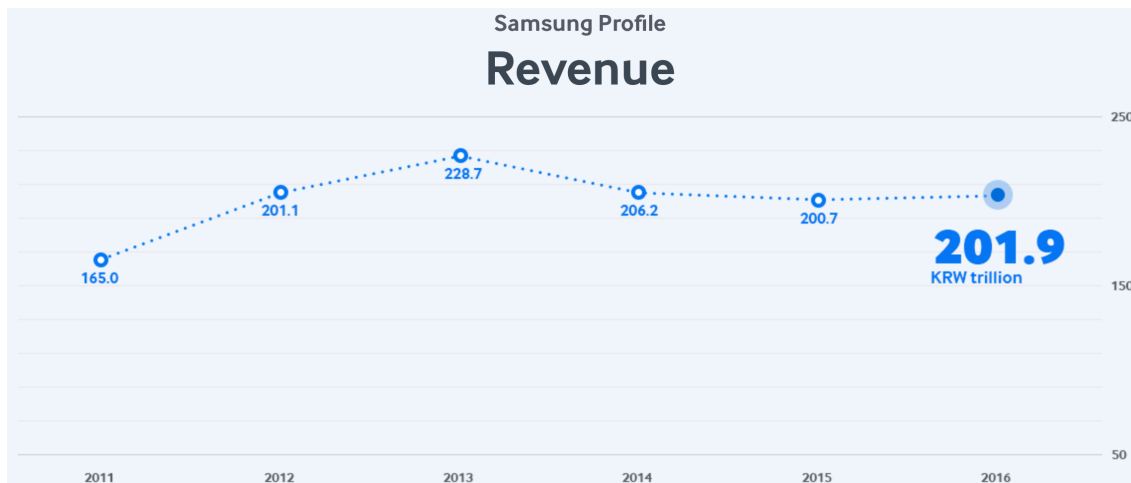
Thus, chairman Lee put all his effort to improve the image of the brand from low level brand to a high-quality brand.

He also put a lot of effort in transforming a company driven by exports to one led by foreign direct investment (FDI) and joint ventures. Concerning this new approach, during the 90s, Samsung entered into joint ventures with the right partners abroad for manufacture, televisions, refrigerators and video equipment. He used FDI also to establish headquarters in other places of the world such as China, Europe, North America or Singapore. That is how by 2005, Samsung Group had established 64 manufacturing and sales subsidiaries and 13 R&D centres around the world (Bennedsen, 2017).

In this way, Lee Kun-Hee has been able to accomplish a lot of goals to help the group with some of its main problems. As a matter of fact, he has been able to reduce Samsung Group's debt of \$15 billion in 1997 to \$4.6 billion by 2002. In the meanwhile, net margins rose from a negative 3% to a positive 13% in the same time horizon. Moreover, it recorded net profits of \$5.9 billion on sales of \$44.6 billion in 2002, compared with the \$2.8 billion in profits and the \$28 billion in sales in 1999 (Khanna, 2011).

All the effort put by Lee Kun-Hee in reforming his own group are shown in the graph below. The graph shows the trend of the revenues of Samsung Group from 2011 to 2016, that started from 165.0 KRW trillion in 2011 and reached 201.9 KRW trillion in 2016.

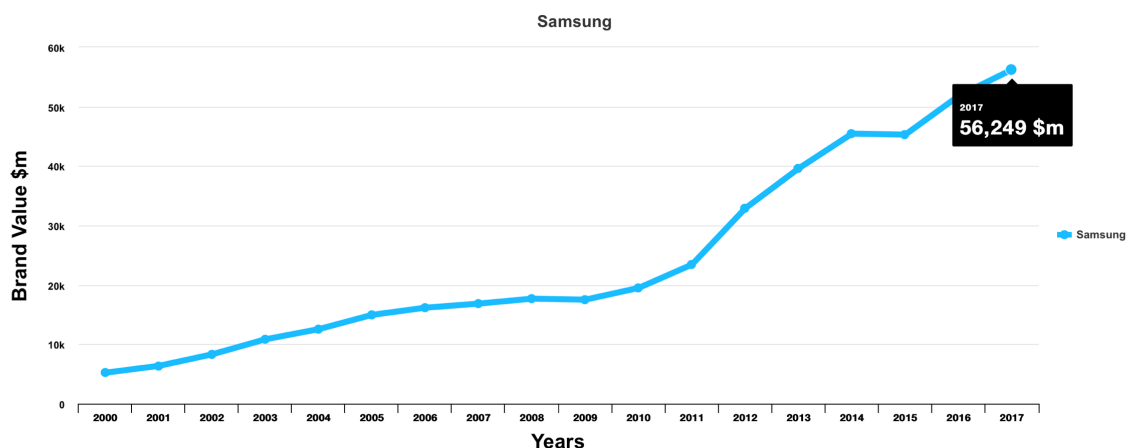
Graph 2.2: Samsung Group's Revenue³².



Samsung Groups has grown a lot not only in terms of revenues but also in terms of Brand Value, since, as mentioned before, Lee Kun-Hee has given a lot of importance also to the brand recognition, thanks to a management oriented to customers' needs and wants.

In particular the brand Samsung has grown up during the last years, positioning itself in the ranking of Best Global Brands, reaching in the 2017 the 6th position (Interbrand, 2017). In the graph below it is shown the growth of the brand value in terms of million dollar from 2000 to 2017, growing from 5.223\$m in 2000 to 56.249\$m in 2017.

Graph 2.3: Samsung's Brand Value³³.



³² Source: Global Strategy Group Official Website, 2016.

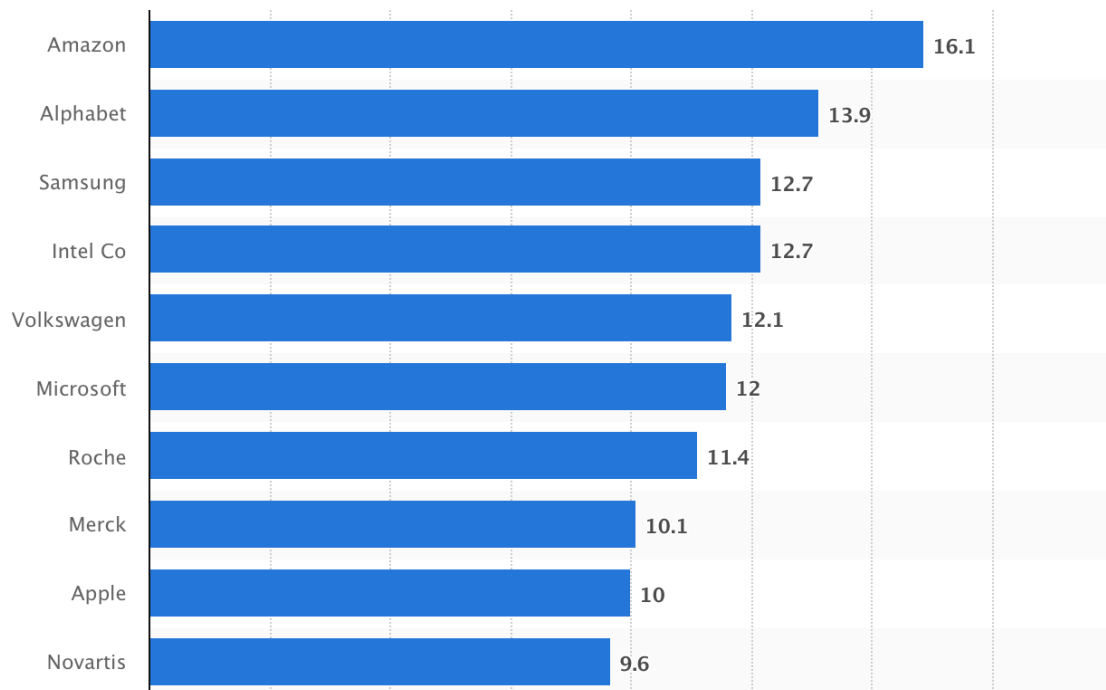
³³ Source: Interbrand, 2017.

Strengths and Weaknesses

Strengths

One of the greatest strength of Samsung is the high level of expenditure in research and development. It has always invested a lot in it since the beginning, thanks in particular to the high level of efforts put by Lee Byung-Chul with high investments in this field even during the first years of the company. In this way, the company can have from its side a strong portfolio among all the technology companies, that has developed year after year. As a matter of fact, innovation and investments in R&D are fundamental in gaining and keeping the market share, in particular into the technology industry that keeps on changing day by day and sometimes it is important to exploit the first mover advantages. In the graph below it is shown the ranking of the ten companies with the highest spending on research and development in 2017 (in billion U.S. dollars) and Samsung is at the third place (Statista, 2018).

Figure 2.6: Top 10 Companies with the Highest Spending in R&D³⁴.



³⁴ Source: Statista, 2018.

As mentioned before, the wide product portfolio of Samsung, that includes goods as mobile phone, tablet, TV, pc, printer, camera, home appliances and a lot of other products, among its key rivals, is the result of its high spending in research and development. Moreover, it also holds a significant market share in almost all the product categories, as the original founder of the group had always wanted. His main objective was, in fact, to have a high market share in all the industry in which he developed the group.

Another strength is the high number of patents owned by Samsung. In this way, Samsung has been able to protect its own invention. The following table shows the number of patents granted for each company in the U.S. during 2014-2016. In particular Samsung Electronics is at the first place with a total of 15499 patents, considering the time horizon 2014-2016, that is much more higher compared to the other companies such as Apple, for example, with only 6041 patents, or Microsoft with 7635 patents (Jurevicius, 2018).

Table 2.2: Utility Patents Granted in the U.S.³⁵.

Company	2014	2015	2016	Total
Samsung Electronics	4,936	5,059	5,504	15,499
Apple	2,003	1,937	2,101	6,041
Microsoft	2,829	2,408	2,398	7,635
Intel	1,573	2,046	2,779	6,398
Amazon.com	741	1,136	1,662	3,539
LG Electronics	2,119	2,241	2,426	6,786

The patents are a legal instrument used from companies to protect innovation and they are the best way to defend the position and the innovation from being copied by rivals. As shown in the table below, Samsung has one of the strongest patents portfolio in the technology industry.

³⁵ Source: U.S. Patent and Trademark Office, 2017.

Samsung has also a lot of first mover advantages regarding products like dual screen mobiles, 65k TFT/LCD colour phone, thinnest and lightest note pad, but also in terms of new advanced features for refrigerators or air conditioner (Bhasin, 2018). Being a first mover allows the company to exploit the lead time that is the time lag between the entrance of the first inventor and the one of the early entrant. The lead time has to be used to build unique competences and market position in such a way to transform temporal advantage into cost advantage.

More specifically, Samsung has been able to exploit learning curve. As a matter of fact, this is the process through which, by accumulating experience and technical competence, who uses a certain technology learns to be more effective and efficient (Grant, 2015).

Samsung has also been able to exploit the growing economy of Asian market by, for example, setting up manufacturing plants in India, in order to reduce logistics and supply chain costs (Bhasin, 2018).

Weaknesses

One of the weaknesses of Samsung is the product cannibalization. It has launched a series of Smartphones in 2016 (31 new models (Josh, 2017)) that could bring to cannibalization, that is “the process by which a new product gains sales by diverting them from an existing product” (Heskett, 1976). Thus, basically, sometimes the growth of a new product is gained at the expense of other existing products and having too many smartphone models lowers economies of scales and increases costs.

More problems exist in the smartphones’ sector. As a matter of fact, Samsung has to face Apple Inc.’s marketing capabilities for this product, but it also has to consider some new Chinese competitors that are catching up Samsung in this market. For example, between 2014 and 2015 Huawei’s share grew by 48.1% and Xiaomi’s share grew by 29.4% (IDC, 2017). The power of Apple and the growing one of Huawei are clear also in the survey showed in the figure 1.12. Apple has been considered by all the participants, while Huawei has been mentioned from 28 people on a sample of 30.

Moreover, Samsung has to focus to several products since it has a more diversified portfolio compared to its competitors. For example, only the company Samsung

Electronics serves four different industries with many different products in them, so sometimes it could lose its focus when it has to compete with too many companies in too many different products' area. In the next paragraph, we are going to analyse this wide portfolio, considering almost all the Samsung Group.

Portfolio Analysis

Samsung Group has a wide product and service portfolio, as mentioned below in its strengths. It is possible to analyse this great portfolio through the BCG matrix, a tool used as a support to managerial decisions that gives information about the company's competitive position and it helps to define priorities in terms of resources allocation among different businesses.

First of all, the main dimensions of this matrix are two:

- the relative market share, as internal dimension;
- the market growth rate, as external dimension.

The dimension of the relative market share concerns how competitive is the business of that product comparing to the one of other competitors. The vertical line of the matrix divides the businesses with a stronger internal power from the ones with a lower relative market share.

On the other hand, the market growth measures the attractiveness of external environment. The horizontal line of the matrix divides businesses that have a higher growth rate from the ones who have a lower growth rate.

There is also a third dimension considered that is the business contribution, once the company has understood where to place the businesses in the matrix. Representing the businesses with a circle could be helpful, since the areas of the circles will represent the revenues of that business (that is the parameter of the business contribution).

In the matrix, the businesses may be allocated in four different categories that are:

- stars, are those businesses that belongs to an evolving industry which offers growth prospects to the businesses. This is the reason why companies are more willing to invest in those products to gain a larger market share and to have a stronger position in the market, compared to the ones of the competitors. For Samsung, the products that belong to this category are mobile phones and

televisions. The market for these products keep on growing and it needs investment to face competitors;

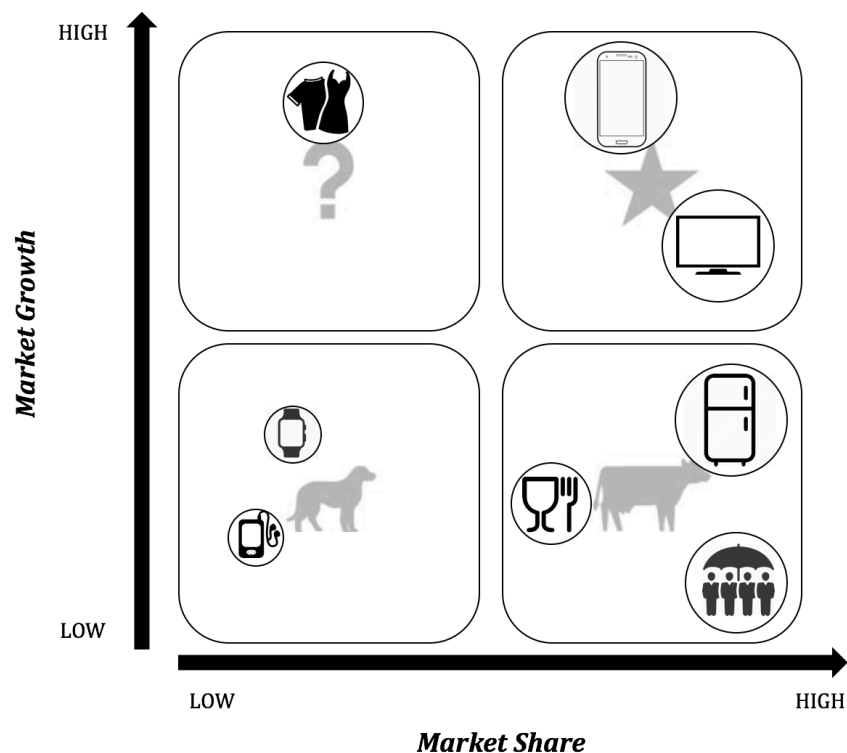
Samsung keep on investing in R&D, adding always new features to these products in order to make them look more appealing to the customers.

- question marks are those products or businesses that are still in the phase of development. They have a low market share that makes the future of these businesses slightly uncertain. Investing in them is a hard decision because they could become stars but also dogs. A business that could belong to this group is the one of fashion. Samsung Group owns brand such as 8seconds that is growing up day by day in Korea. This is an example of a company that has decided to invest into a question mark business to see if it can become a star. Apparently, the brand 8seconds is growing successfully, in a way to face also important brand such as Zara, the third largest fashion brand in Korea. At the moment, they are focused in expanding in Korea, but they are planning the expansion in the Chinese market as well (Asia, 2017);
- the third category is made by the cash cows. The products of this group do not need high investments, nevertheless the return on investment is high. For the Samsung Group, the insurance service could belong to this category. It does not need investment for R&D, thus for new technologies, but still it is a profitable business for the group and it is also expanding globally in other countries such as U.S., Japan, U.K., China, Vietnam and Myanmar (Samsung Life, 2018). It is possible to see a similar situation for the food industry with Samsung Welstory. For this sector as well, they do not need high investments for new technologies, nevertheless they are earning from this business thanks to the global expansion in China and Vietnam (Samsung, 2018). To mention also products of the most known Samsung's businesses, in this category we can list the home appliances business. On one hand with these products the company can reach a global audience, on the other hand these products do not need a lot of investments in term of creativity and they do not offer new technology frequently. Despite this, Samsung is putting its effort in keeping on finding new additional features such as the Family Hub refrigerators, from which it is possible to listen to the music, watching televisions and looking inside the fridge without opening it

(Newsroom, 2017). In this way, the company can achieve a greater market share and maintaining it in the long term;

- the last category are the dogs. They do not generate cash and do not absorb it. The best strategy for this type of products would be dismissing them in order to have more resources for other products category, like the question marks. They basically do not offer any significant growth to the organization in term of sales or market share. An example could be the smart watch. It has some problems in its functionality and this is the main reason why it is not the main preference of buyers compared to other brands (Rogowsky, 2013). Samsung MP3 as well could be listed in this category since this business is not so profitable anymore as some years ago.

Figure 2.7: Samsung Group's BCG Matrix³⁶.



³⁶ Source: Author analysis based on data of paragraph "Portfolio Analysis".

The Republic of Samsung

Sometimes South Korea is defined as the Republic of Samsung, and it is not really a joke. As we have seen in the portfolio analysis, the businesses in which this chaebol operates are so many that this group follows people from when they are born until they die. A Korean can be born in a Samsung-owned medical centre, grow up learning to read and write with the help of Samsung tablets and go on to attend the Samsung-affiliated Sungkyunkwan University. They could live in a Samsung-built apartment complex, equipped with the company's appliances and electronics, they can have shopping with their Samsung credit card and finally they could even end up at a Samsung funeral parlour when they die. (Ullah, 2017).

This chaebol has a strong presence in the everyday life of the greatest part of population, but it also influences a lot the economy of the country. As a matter of fact, it is not an exaggeration to say that when Samsung has troubles, the South Korean economy is weakened (Borowiec, 2016). Besides that, no matter how many problems this chaebol has to face, such as the arrest of Jay Y. Lee or the problem related with the burning Galaxy Note 7, Samsung is still Samsung and it is still doing well. In fact, this group is always topic for discussions because of corruption, compensation for workers or because of the before mentioned problem of the Galaxy Note 7. But despite all of this, Samsung is standing strong. Because everybody knows that, even if people criticized Samsung, they would accept immediately if the company would offer them a job. In fact, according to Lee Cheol-haeng, head of the corporate policy team at the Federation of Korean Industries, many Koreans have a dual mind about chaebols: they state that they hate chaebols, but they want their sons to work for one. Their hate is not unmotivated since it comes from long years of nepotistic and monopolistic business model.

In the same time they also appreciate chaebols because they have made South Korea an economic power and thanks to their product they have enhanced the standards of living (Katzman, 2017).

The dual mind people have is endless. Critics say that Samsung knocks out smaller businesses, limits choices for Korean consumers and sometimes colluding with fellow giant. People are also upset and disappointed for all the government support that the company has received. But in the same time everybody trusts the Samsung brand. It is

considered to have the friendliest after-sales service, because the company contacts customers to ask for their level of satisfaction and it collects all the complaints. The customer satisfaction is then a key element of this group. Another reason of the strength in South Korea is the familiarity that people have with the brand, more specifically with Android phones, that basically are considered as all Galaxy. People who are used to Samsung products simply purchase more and more Galaxy phones (Koo, 2017).

As we have seen, critics are a lot but Samsung is not the only company that survived to so many problems in a successful way. For example, even if culture gives a lot of importance to ethical business, companies such as Starbucks, Nike and L'Oreal are still doing well, then it is not a surprise that Samsung still stands strong even if its products exploded or if their owners were arrested (Koo, 2017). Moreover, Samsung is helped a lot by media because journalists, dealing with a company that is responsible so much for the national economy, feel the patriotic duty to boost the company's fortune with enthusiastic and positive coverage (Borowiec, 2016).

All this explains why it is impossible to destroy or to shut down this group. It still accounts for the greatest part of the GDP in Korea and it is more powerful even of all the other chaebols together (LG Electronics, SK Group and Hyundai Motor). This company is continuously pushed to apply more transparency to its businesses but actually it is up to them to choose whenever they want to use this kind of governance. Koreans do not realize it, but they are in the hand of this huge organization.

Chapter 3: Conglomerates Around the World

Japanese Conglomerates: Keiretsu

Conglomerates are not a unique characteristic of South Korea. They are common in other countries as well, such as India, China, Japan or U.S. In this chapter, we are going to analyse the Japanese conglomerates, which name is keiretsu, trying to understand their characteristics, the differences and the similarities with chaebols.

History and Corporate Governance

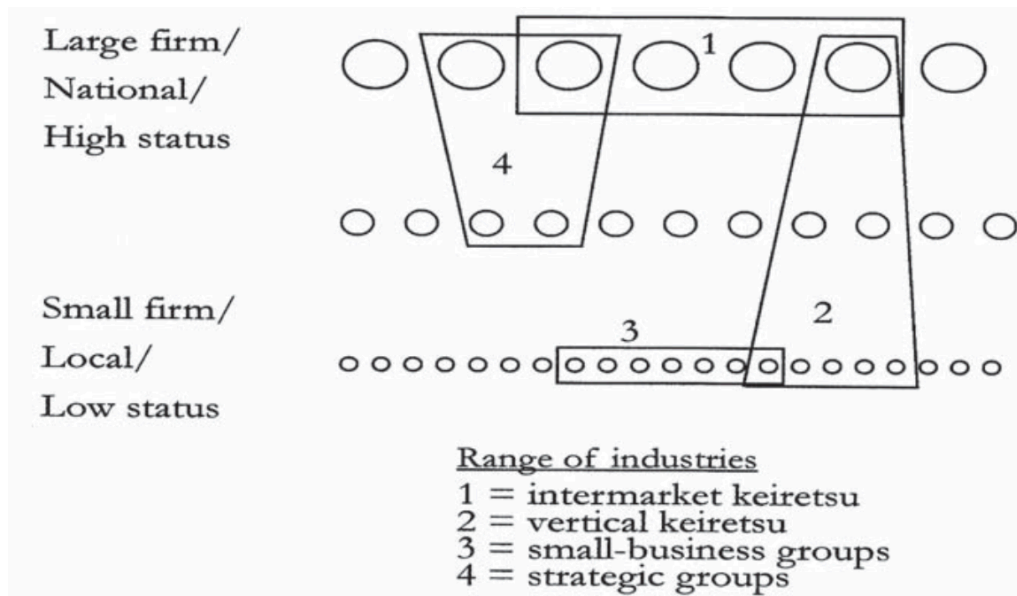
Keiretsu are large corporate groups with the characteristic to be built around a major commercial bank. A lot of the most famous Japanese companies belong to one of these groups, such as Nissan Motor or Mitsubishi Electric (Huh, 1993).

In the past, keiretsu were called zaibatsu and, like chaebols, they had a strong influence over the Japanese economy. The four largest zaibatsu groups (Mitsubishi, Mitsui, Sumitomo and Yasuda) controlled about one-fourth of the total paid-in corporate capital at the end of the World War II. To reduce the concentration of the economic power in Japan, the Allied Forces dissolved the zaibatsu groups after World War II. Currently, there are six large keiretsu in Japan, named the Big Six: Mitsui, Mitsubishi, Sumitomo, Fuyo, Sanwa and Dai-Ichi Kangyo. On one hand, the first three have origins from zaibatsu, on the other hand, the other three have been created after the war. The ones created after the war, but also the zaibatsu shaped after the war, are the nowadays keiretsu. The main difference between the zaibatsu and the keiretsu is that the pre-war zaibatsu were controlled by holding companies held by founder family members while the keiretsu have a more widespread ownership and are structured around a commercial bank (Huh, 1993).

Keiretsu are characterised by a strong relationship among three subjects: government, banks and businesses. This relationship is often called the “iron triangle” (Gerald, 2014). In particular, we have two types of organizational structure for this type of groups: the inter-market corporate groups, which is more horizontal in nature, and the second one that is more vertical in nature (Gerlach, 2004). In the horizontal corporate group, the centre of the network is the main bank which lends money to the companies that belong

to the group, holds equity position in the companies and acts as a monitoring entity. To this group belongs the Big Six listed before. On the other hand, we have the vertical keiretsu, characterized by the formal relationship buyer-supplier. This kind of formal relationship has as a consequence a formal hierarchy. Generally, they are made up by one very large company and a lot of small companies subservient to it. Usually, vertical keiretsu are less influenced by a bank and they are more common in the electronic and automobile industries, even if lately almost every other field has its own vertical keiretsu, including advertising, publishing, broadcasting and other non-manufacturing businesses (Jun, 2009). In the figure below it is shown the structure of the inter-market and vertical corporate group.

Figure 3.1: Structure of the Inter-Market and Vertical Corporate Group³⁷.



The horizontal and the vertical keiretsu are not the only type of companies existing in Japan. As shown in the figure above, there are also the small-business groups and the strategic groups. The small-business groups are usually formed by the suppliers of low status that reduce the cost thanks to the information sharing. The strategic business groups are formed between large firms at national level and medium-sized firms in order to create synergies for having more efficiency (Debnath, 2013).

³⁷ Source: Gerlach, 2004.

In the table below, there are listed the member firms of the most important corporate groups. Regarding these groups, it is important to underline that six of the Japanese groups have been integrated into four groups (Mitsubishi, Mitsui-Sumitomo, Fuji-Daiichikangyo and UFJ): Daihatsu is now under Toyota Group and Sanyo merged with Panasonic in 2011.

Table 3.1: Member Firms of Corporate Groups³⁸.

Categories of JCG	Representatives	
Kigyo-Shudan	Mitsubishi Group	Mitsubishi Bank, Meiji Life, Mitsubishi Corp, Mitsubishi Construction, Mitsubishi Steel, Mitsubishi Motors, Mitsubishi Electric, Nikon, NipponYusen, Kirin
	Mitsui Group	Mitsui Bank, Mitsui Life, Mitsui Corp, Mitsui Construction, Mitsui Mining, Mitsui Oji Paper, Toyota Motors, Mitsui Eng&Ship, Toshiba, Mitsui OSK Line
	Sumitomo Group	Sumitomo Bank, Sumitomo Life, Sumitomo Corp, Sumitomo Construction, Sumitomo Chemical, Sumitomo Heavy Industries, NEC
	Fuyou Group	Fuji Bank, Yasuda Life, Marubeni, Taisei, Showa Denko, Kubora, Nissan Motors, Hitachi Co, Oki Electronics, Canon, Sapporo
	Sanwa Group	Sanwa Bank, Nippon Life, Nissho, Iwai, Toya Construction, Hitachi Chemical, Hitachi Mental, Daihatsu, Sharp, Suntory, Orix
	DKB Group	Daiichi Kangyo Bank, Asahi Life, Itoh Chu, Seibu Dept, Sankyo, Kawasaki Steel, Isuzu Motors, Hitachi Co, Fujitsu, Yokohama Rubber
Vertical Keiretsu	The Automobile Industry: Toyota Group, Nissan Group, Honda Group, Daihatsu Motors, Isuzu	
	Electronics: Hitachi, Toshiba. Sanyo, Panasinic (Matsushita), Sony	

Speaking about the type of management, the Japanese practice is strongly focused on customers, similarly to chaebols but at a higher level, thanks to which it is created the value for the company. In this way, also the shareholders can have their desired value. In particular, the Japanese companies have been able to lower the price of products without giving up on quality. Thanks to this system, the Japanese groups have been able to gain new market share and acquire those customers who could not afford the products and

³⁸ Source: Ministry of Economy, Trade and Industry.

serviced offered by Western companies because they were too expensive. In fact, the prices of many household products were unreachable by average working people until the Japanese products arrived in the global market. Some people could think that this decrease in prices without lowering the quality would have been possible only through labour exploitation, but actually labour exploitation in Japan was absolutely at a lower level compared to the Western Countries (Debnath, 2013).

Speaking about the employees, the most used practice in the Japanese firms are the non-material incentives. As a matter of fact, if we speak about the substantial salary of employees and employers, the average salary of CEOs in Japan is much lower compared to the salary of the CEOs in U.S., as shown in the table 3.2. This happens because the Japanese CEOs rely more on non-material incentives of not being responsible for their action in front of the owners of the company. On the other hand, this is what actually happen for the greatest part of the Western CEOs (Crystal, 1992; Matsumoto, 1991).

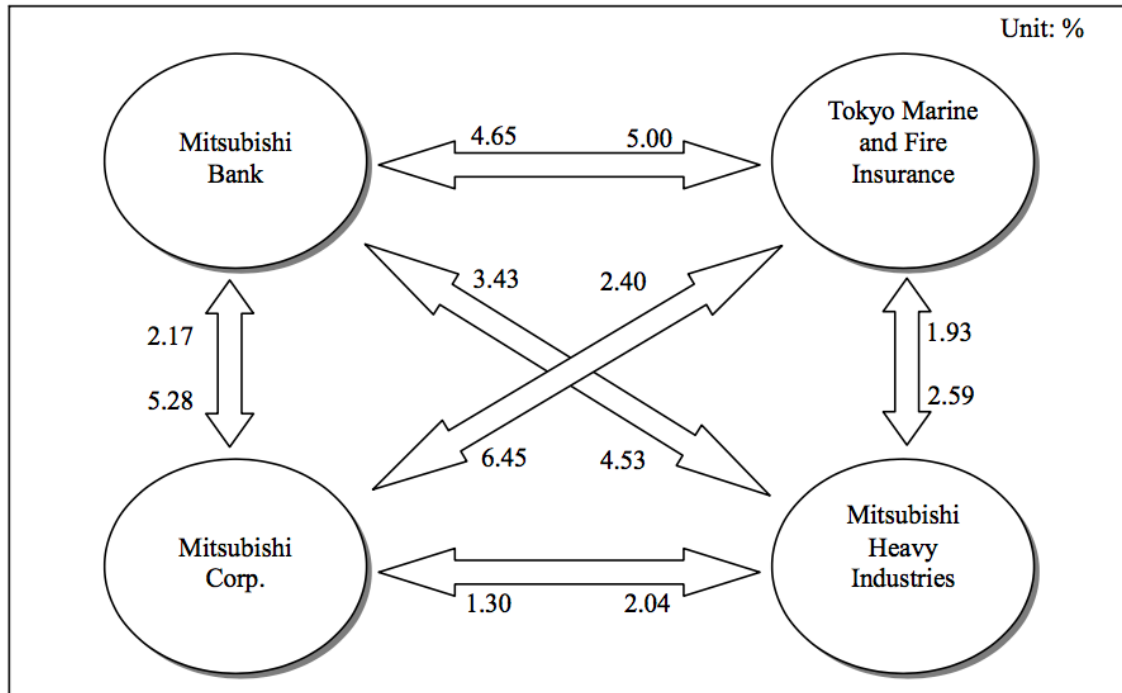
Table 3.2: CEO wages³⁹.

	Japan	US
CEO Compensation	US\$310,000	US\$1.4 million

Another feature of keiretsu is their ownership structure, that is pretty similar to the one of chaebols, and is characterized by cross-shareholdings. Its main objective is to protect each group of the company mainly from outside control or takeover threats. In the Mitsubishi Group, for example, the shares of Mitsubishi Corporation are held by its member companies, such as Mitsubishi Bank, Tokyo Marine and Fire Insurance and Mitsubishi Heavy Industries. More specifically, Mitsubishi Bank holds 5.28%, 5.00% and 4.53% of Mitsubishi Corporation's, Tokyo Marine and Fire Insurance's and Mitsubishi Heavy Industries' shares, respectively. Mitsubishi Corporation, Tokyo Marine and Fire Insurance and Mitsubishi Heavy Industries hold 2.17%, 4.65% and 3.43% of Mitsubishi Bank's shares respectively (Kim, 2007). This crossholding of shares in the Mitsubishi keiretsu is shown in the figure below.

³⁹ Source: Crystal, 1992 and Matsumoto, 1991.

Figure 3.2: Crossholding of Shares among Four Major Mitsubishi Group Firms⁴⁰.



As a result, Mitsubishi Group companies account for about one-third of its total portfolio (Jun, 2009).

Advantages and Disadvantages

Advantages

One of the advantages of Japanese groups is the protection of the banks. Basically, when there is not a clear owner of the Japanese companies, the bank becomes the main owner because it owns the greatest number of shares in the member firms. This imply that whenever the groups are in financial troubles, the banks are ready to help them (Bebenroth, 2004). For example, in the 1970s, the Sumitomo Bank helped Mazda Motors that had some troubles. The bank provided new and refinanced loans, it sent skilled managers and negotiated for lower prices for steel and other auto inputs (Miwa, 2003). The influence of the main banks brings corporate groups to be more competitive. The banks push the groups to be more productive and, as soon as the member firms see the

⁴⁰ Source: Kim, 2007.

increasing demand in the market, they increase the market production and, as a consequence, they increase also their market share. When the market share increases, these firms can lower their prices, which make them more competitive globally (Jeng, 2005). Japanese keiretsu are also particularly famous because of the way in which they increased the efficiency of the supply chain. As a matter of fact, thanks to the reduction of costs due to the relationships among firms inside a keiretsu, the efficiency of the supply chain has grown a lot with also the invention, by the automobile keiretsu, of the just in time inventory system. The just in time is a system based on the minimization of production stock level in order to gain economic benefits, such as costs' reduction, and to reduce the risk of the obsolescence of raw materials. To use this system, an optimal organization is required because it is necessary to be efficiently linked with the suppliers, but even if it is a difficult method, it is widely used because of its reduction of operating margins (Sciarelli, 2014).

The participation of the banks has as a consequence also on the strict monitoring of the member firms. In fact, after a firm in a group becomes the largest borrower of a bank, it is necessary for the bank to monitor the members company's managerial behaviour and this allows that the managers behave in the most efficient way for the company (Bebenroth, 2004).

Disadvantages

One of the main disadvantages of the Japanese Corporate Groups are the internal relationships within the group. This because any firms inside the group, if it needs a loan, will refer to its partner bank, without seeking for better offers that it could find outside in the open market (Bebenroth, 2004).

This isolation from the global market is evident also in the strong relationships among the different firms of the group. As a matter of fact, there is a strong inclination in helping each other without even taking in consideration the global market (Murillo, 2013). This has been a great obstacle for Western investments to settle among Japanese competitors, that goes completely against the liberal market competition, to which the Anglo-American are used to. This could preclude Japanese enterprises from adopting more cost-effective sourcing strategies at the global standards (Gerlach, 1997).

Moreover, as we mentioned before, the Japanese keiretsu rely a lot in the help of banks. They basically know that they can easily access capital, thus they are more willing to make their debt increase and to go through too much risky strategies.

Comparison with Korean Chaebol

The most important difference between keiretsu and chaebol concerns the position of the bank in the group. In the Japanese Corporate Groups, banks monitor, discipline and sometimes even control the firms. In this way keiretsu are more efficient in running business operations and can rely more in risky investment projects (Okabe, 2004). Moreover, the strict control of banks over the group means that there are also less chances of inappropriate selfish behaviours by the management.

On the other hand, chaebols are family-owned groups. The lack of a Japanese style bank system (since in Korea commercial bank are not allowed to be part of a chaebol groups by law) allowed the family owners to take completely the control of the groups. This has also brought to have more chance of inappropriate selfish behaviour by the owners, thus by the family members (Debnath, 2013).

In addition, keiretsu are controlled by professional managers. This imply that chaebols have a more centralized structure and keiretsu more decentralized (Doral, 2010). The consequence is that chaebols lack of an external monitoring functioning, as it appears in keiretsu, because the firms of a chaebol are controlled by the group's central planning office, which is in turn controlled by the group's founding family members (Okabe, 2004).

Regarding the high quality of the products considering the prices, in the past both Japanese and Korean groups were able to sell low price products, but the Japanese ones had a higher quality compare to the Koreans. With the passing of the years, the Koreans have been able to come out as well with higher quality products at a lower price, improving from this point of view (Debnath, 2013).

About the diversification, the Korean chaebols are more diversified of the Japanese keiretsu. Many keiretsu are vertical oriented (like Toyota), and even if some other groups are made of many firms, they are all oriented around a core activity. Considering the keiretsu that are horizontal, then more diversified than the vertical ones, they are still

more oriented towards a core activity, that is completely different from the way of doing business of a chaebol (Kennett, 2004).

As we already said, Japanese keiretsu are organized around main financial institutions, so the main banks have an important role in the corporate governance. In Korea, the chaebols, besides the power of the owner family, are under central banking system that are controlled by the government, that is more willing to support the biggest groups that in this way control most of the exports and foreign investment in this economy (Gerald, 2014).

Moreover, both the Japanese and South Korean people have historically seen keiretsu and chaebol as an important figure into their economies. But as we already mentioned for chaebols, in both countries they have lately faced a lot of criticism regarding the structures of leadership and business operations. The keiretsu, in particular, have been criticized for centralizing all power to the top firms, where they are able to exploit smaller firms in the same network by forcing low prices. Eventually, the profits gained from the largest firms come with the expense of the smaller ones (Wu, 2018).

U.S. Conglomerates: General Electric Case Study

Stepping into the West part of the world, we can talk about General Electric as the greatest example of Western conglomerate. Bringing this company as a case study is the best way to understand the existing differences among the western conglomerates and the Korean ones. In the next paragraphs, we are going to analyse the different characteristics of this company, looking at the strengths, the weaknesses, the differences and the similarities with the Korean chaebols.

General Electric's Background

General Electric was born in 1890 thanks to Thomas Edison, who established Edison General Electric Company. During that period, a competitor emerged: the Thomson-Houston Company. The latter became a dominant company in electrical innovation but, since both business expanded, they had difficulties in producing complete electrical installations relying only on their own patents and technology. That is the reason why, in

1982, Edison General Electric Company merged with Thomson-Houston Company. The new company was called General Electric Company.

Some of the first Edison's businesses are still part of GE nowadays, such as lighting, transportation, industrial products, power transmission and medical equipment (GE, 2018).

After this merger, the company made different acquisitions and, in particular, it has been able to expand even beyond its main and original business. Nowadays General Electric has a product portfolio that goes from plastics to nuclear reactors, from consumer electronics to jet engines. But we will speak about the different businesses later on.

In 1981, Jack Welch became CEO and radically restructured the company. He wanted to improve the performance of the employees, so he pushed them to be better than the best, aiming to reach the position of leader in each business. He wanted the company to be the number one of all the sectors in which it was operating. To do that, the company went through a lot of acquisitions and divestments as well. Welch decided also to reduce the layers of managements, making the company flatter and he focused as well on the internationalization with global programme such as Six Sigma. In 1980, the year before Welch became CEO, GE recorded revenues of \$26.8 billion; in 2000, the year before Welch retired, revenues were nearly \$130 billion (Inkpen, 2014).

In 2001, Jeff Immelt became CEO right after Welch. According to him, a CEO should shape the company culture, pick new businesses and be involved in them, beside choosing great people. A CEO should find the right and the most efficient way to allocate resources. There is also a clear difference between Immelt and Welch regarding to the way in which they have looked at the culture. When Immelt became CEO, almost two thirds of GE's revenues were in the US. That is the reason why he has decided to bring some revenues also from the outside, moving, for instance, his senior leaders out, like Vice Chairman John Rice that was moved to Hong Kong. Immelt has always wanted a culture of local decisions thanks to senior managers placed all over the world (Bradt, 2011).

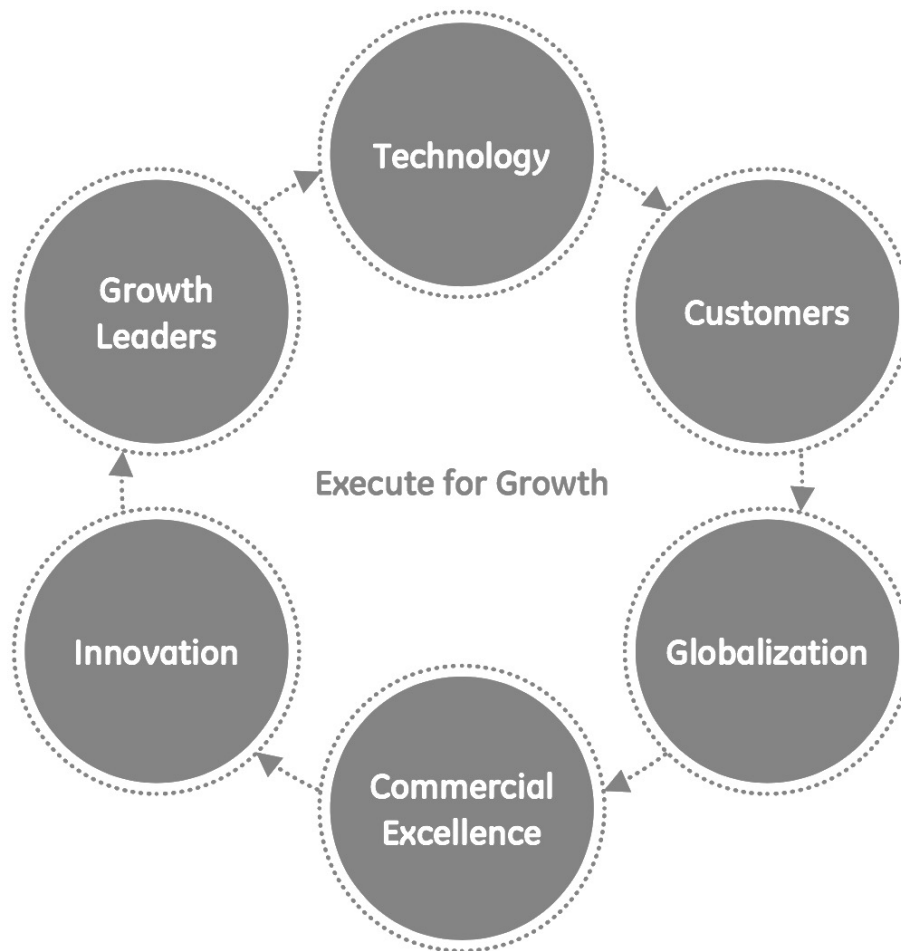
It is clear that one of the main objective of Immelt was to strengthen GE's global presence, but he also wanted to create a more collaborative culture. Thanks to this CEO, there were as well other acquisitions and divestments, strengthening, on the other hand, the presence in the businesses where the company was already entered.

General Electric's Strategy

General Electric has always worked for being a successful company in particular for the way of doing business of its CEOs. First Jack Welch has worked a lot for the efficiency and the strength of the company. After him, Jeff Immelt succeeded in September 2001 with the aim to push geographical expansions and acquisitions, adding something to the company without losing anything. Among all the initiatives, he really cared about formalizing the main elements of the company in one of the annual report. As a matter of fact, as all the companies, also General Electric has its own pillars. In particular, those pillars have been explained in the letter to the shareholders of the CEO Jeff Immelt in the 2003 Annual Report. These five keys point are:

- technical leadership; technology and innovation have to be the main element of the company because technical leadership produces high-margin products, makes the company more competitive and creates new markets;
- services; thanks to the high level of technical leadership, General Electric has been able to create jet engines, power turbines, locomotive and medical devices, thanks to which they can provide high-margin services for years;
- customer focus; one of the main successes of General Electric is its “vertical selling”. Through vertical collaborations, General Electric is able to create deeper partnerships with its own customers. Moreover, they focus on always being able to satisfy the customers’ outcomes through the improving of products’ productivity;
- globalization; it is a core competency of General Electric. It has been able to sell products outside the US for over 100 years and one third of their leadership team is global;
- growth platforms; one of the main strengths of General Electric is the ability to identify the trends of the market and the environment and to develop new ways to grow. Moreover, they follow a strict model for growth: first of all, they segment broad markets and launch with a small platform acquisition; then they transform the business model using their growth initiatives, such as services and globalization. The last step is to apply their financial strength to invest in organic growth or acquisitions.

Figure 3.3: GE Growth Strategy (a Six-Part Process)⁴¹.



The CEO letter also underlined the importance of being leader in each business for market share, value and profitability. He focused as well on the importance of sharing finance and human resource processes under one leadership development foundation and one global research infrastructure in order to achieve the best results with a common culture. It is important as well that the culture of the company matches with the expectations of long-term investors (Immelt, 2007).

At General Electric's Annual Leadership Meeting in 2008, Jeff Immelt described the four strategic principles to achieve growth:

- invest in leadership businesses; one of the most important element that drives the growth of this company is the successful portfolio. This is the reason why they want to keep on investing in it, trying always to define the best mix to capture

⁴¹ Source: Immelt, Letter to Investors, 2007.

market opportunities, in order to have a portfolio that keeps generating faster growth, has more balance and creates a stronger competitive advantage;

- execution and financial discipline; the main aim was to focus on these elements in order to create a process with the objective of the excellence to increase the margins and the returns even if the environment is not helpful;
- growth as a process; the main element of General Electric is the focus on the growth of the company. Working on the growth of the company allows to have higher revenues but also to increase the trust of the investors in the group;
- great people; General Electric has always given a lot of importance to the human resources into its environments. As a matter of fact, having people with great talent is a way to gain competitive advantage but also to develop a good leadership team (Inkpen, 2014).

Another key element of General Electric's strategy is sharing among the several businesses. As a matter of fact, sharing the best practice is something positive for both side of the relationship: for who spread the best practice, but also for who received it. For example, they had an aircraft company as a customer who was willing to buy from General Electric, but they also wanted GE Capital to be involved in order to help them to control some of their money. In fact, thanks to the participation of GE Capital, the aircraft company became more creditworthy because it knew that the company had the financial capital to stay in business and support their products. Basically, the customer wanted GE engines because the engines were good and they wanted GE Capital because it created legitimacy for them (Inkpen, 2014).

Another way of sharing resources is through the moving of GE managers in operational roles either within a business or across businesses, in order to use them as a means to share ideas and transferring best practices (Inkpen, 2014).

Another main element of this company is change. In particular General Electric introduced the Change Acceleration Process, that helps leaders to manage change and prepares them to guide the other employees to drive change. Jack Welch, in particular, described change as something necessary to compete against the others, that could arrive in the market with another product that can satisfy better the customers' need, that in the meanwhile can change as well. That is why the company has to be fast and adaptable to these changes for not being weak and vulnerable. The change is also something that is

never ending and people have to understand that it is a continuing process, not a singular event (Stratford, 1993). What Jack Welch always said to its employees was to not look at the competitors because they probably have the same challenges. The company has to look outside the business for new ideas because change is in the GE's DNA and if you are not comfortable with change, then GE is not your place (Inkpen, 2014).

General Electric's Culture

General Electric has always stabilized which are the main traits that a leader should have in this company. He has to be curious and be open to ideas from anywhere, he has to be passionate for excellence, be resourceful and accountable in order to develop a profitable company. He should be able to set aggressive goals and reward progress and he should be communicative and team working with all the employees. But in particular he has to look at change as an opportunity and not as a threat.

In particular according to Jeff Immelt, there are five growth traits: the external focus, so he should be able to defines success according to the market, considering also the external impact of business activities and decisions on customers and investors and he should be able to anticipate customers' needs and ensure that they are met; imagination and creativity, that means being able of generating new ideas and having the courage to make these ideas concrete; decisive and capable of clear thinking, so basically being able to communicate clearly and to simplify strategies into specific actions; inclusiveness, so he should be able to have a good connection with the employees and he should be able to energize the team, promoting as well an appealing working environment, where everybody is accepted; eventually he needs to have a deep domain expertise, thus he should learn from the impact of decisions and actions and he should demonstrate leadership in several and different occasions (Brokav, 2012).

The great environment in this company has been underlined by Dennis Dammerman, former GE Vice Chairman and CFO as well. He underlined how the hierarchy is becoming flatter and also the cooperative atmosphere is clear in what they called the CEC, Corporate Executive Council Meeting, where the leaders of the several businesses meet to share insights, best practices and warnings in a friendly atmosphere. He pointed that

GE is not a classic conglomerate and to understand that, is enough to assist at one of those meetings (Dammerman, 1998).

General Electric has also bet a lot on flattening the hierarchy of the company in order to centralize functions. This change has been made in 2002, when Jeffrey Immelt eliminated the position of the chairman of GE Capital and instead he decided that the four business-unit heads of GE Capital had to report directly to him. In this way Immelt flattened the organization, reducing the number of reporting levels between the unit heads and the CEO. He explained that the reason behind this decision laid in the fact that he wanted more contact with the financial-services teams. With this type of structure, the leader of the four businesses interact directly with the CEO, and this has allowed faster decision making and execution (Wulf, 2012).

Strengths and Weaknesses













Strengths

One of the main strengths of General Electric are the research and development processes. Those strong processes are one of the main competitive advantages of General Electric and it enables the company to have a rapid innovation and to develop products that always meet the changing demand of the market. This is one of the key point of the strategy of the company. In this way, the conglomerate is able to maintain the technological leadership in its field (Kissinger, 2017).

Another strength is the strong brand. As we already mentioned in the previous chapters, having a strong brand is very important to be competitive in the nowadays market. We have seen for Samsung how much is important having a brand that is recognizable worldwide and it allows the company to be trusted and accepted by all its customers. The same happens with GE brand, that is strong enough to attract and retain customers. It is a success and a key factor in the implementation of the differentiation generic competitive strategy since it allows the creation and the development of trust and loyalty in the customers.

In the figure 3.3 it is shown the Best Global Brands Ranking of 2017 made by Interbrand and we can see that General Electric is at the eleventh position.

Figure 3.4: Best Global Brands 2017 Ranking⁴².

01  +3% 184,154 \$m	02  +6% 141,703 \$m	03  +10% 79,999 \$m	04  -5% 69,733 \$m
05  +29% 64,796 \$m	06  +9% 56,249 \$m	07  -6% 50,291 \$m	08  +48% 48,188 \$m
09  +10% 47,829 \$m	10  -11% 46,829 \$m	11  +3% 44,208 \$m	12  +5% 41,533 \$m

The third strength to consider is the wide product portfolio. The diversification of this company is a way to strategically spread risk and minimizes the conglomerate's business vulnerability to industry-specific decline or stagnation.

Weaknesses

The greatest weakness of General Electric is the strong dependence on suppliers of raw materials. GE is highly dependent on multiple third parties, contract manufacturers and commodity markets for the supply of raw materials. This dependence imposes limits on General Electric's performance because it affects the vulnerability to price and supply fluctuations of raw materials. Moreover, any disruption in deliveries or problems with the agreement can put GE's operations in trouble and could affect the revenues.

Another problem is the significant amount of debt level that GE has. This high level affects the company's operations and everyday a significant amount of money is spent on payment of interest on the borrowings. The company's substantial debt limits also its ability to obtain additional financing to fund future working capital (Bhasin, 2018).

⁴² Source: Interbrand, 2018

General Electric's Businesses

As mentioned before, General Electric operates in several and different businesses. The most important ones that characterize the conglomerate are eight and are the following:

Figure 3.5: General Electric's Businesses⁴³.



- GE Aviation produces commercial, military and business and general aviation jet as well as electrical power and mechanical systems for aircraft (GE, 2017);
- GE Healthcare is a provider of medical imaging equipment, managing hardware, software and biotech (GE, 2017);
- GE Renewable energy provides hydro, wind and solar technologies globally, also to the most remote communities;
- GE Transportation provides digital-rail ecosystem, from shipper to receiver, from ports to intermodal terminals, from main line locomotives and railcars to train yards and operation centres (GE, 2017);
- Back Hughes is a GE company that produces oil and gas; more specifically it provides integrated oilfield products, services and digital solutions (GE, 2017);
- GE Lighting is the division that is specialized in producing the best lighting solutions for every space (GE, 2017);

⁴³ Source: CEO Letter, 2017.

- GE Capital is the financial services division of the group and it provides several financial services for commercial aviation, energy and support for GE's industrial business unit, as we have seen in the example mentioned before of the aircraft company;
- GE Power is the division that provides power generation that help make power more affordable, reliable, accessible and sustainable (GE, 2017).

This final composition of General Electric has been created after having faced a lot of acquisitions and divestitures. In particular, GE exited most of its insurance, materials, equipment services, entertainment and industrial platforms businesses.

First of all, concerning the most important acquisitions that made GE what it is today, the group invested in one of the largest renewable-energy businesses in the world. It also diversified its healthcare business by investing in life sciences and healthcare IT. This company also created a new high-tech industrial business called Enterprise Solutions and made several investments in financial services businesses in global markets. The most upfront acquisitions are Vetco Gray, a company that produced products for the upstream oil and gas industry and, in 2014, Alstom, the French engineering company (Inkpen, 2014).

As there are successful acquisitions, there are unsuccessful acquisitions as well. To list some of them, there is the acquisition of the brokerage firm Kidder Peabody in the mid-1980s. This acquisition was a failure because of the different cultures and values of the two companies. More specifically, Kidder Peabody had a system based on individual risk-taking and incentive compensation and it was not on the same line and level of General Electric's culture (Inkpen, 2014).

GE also created NBC Universal in 2003 via the 80% acquisition of Vivendi's film and television unit, which included Universal Studios and theme park. NBC Universal was divested in 2012 because Immelt knew that the next step would have been entering the Internet business and he did not want to make this step because he thought they were not particularly skilled in that (Immelt, 2014; Inkpen, 2014).

To conclude it is understandable that in Western countries, a firm becomes a conglomerate thanks to merger and acquisition of several enterprises that operate in unrelated lines of business or also related. As we have explained, General Electric

operated in different areas and is a common stock traded company in the New York Stock Exchange. The General Electric board monitors and controls all subordinates. More than two-thirds of their directors are independent under the New York Stock Exchange guidelines. As opposed to chaebols, there is no dominant owner or owner family; moreover, some room for the autonomy of professional CEOs is allowed, and a strict governance system prevail, concerning the role and the responsibility of a board of directors (Murillo, 2013).

Organizational Structure

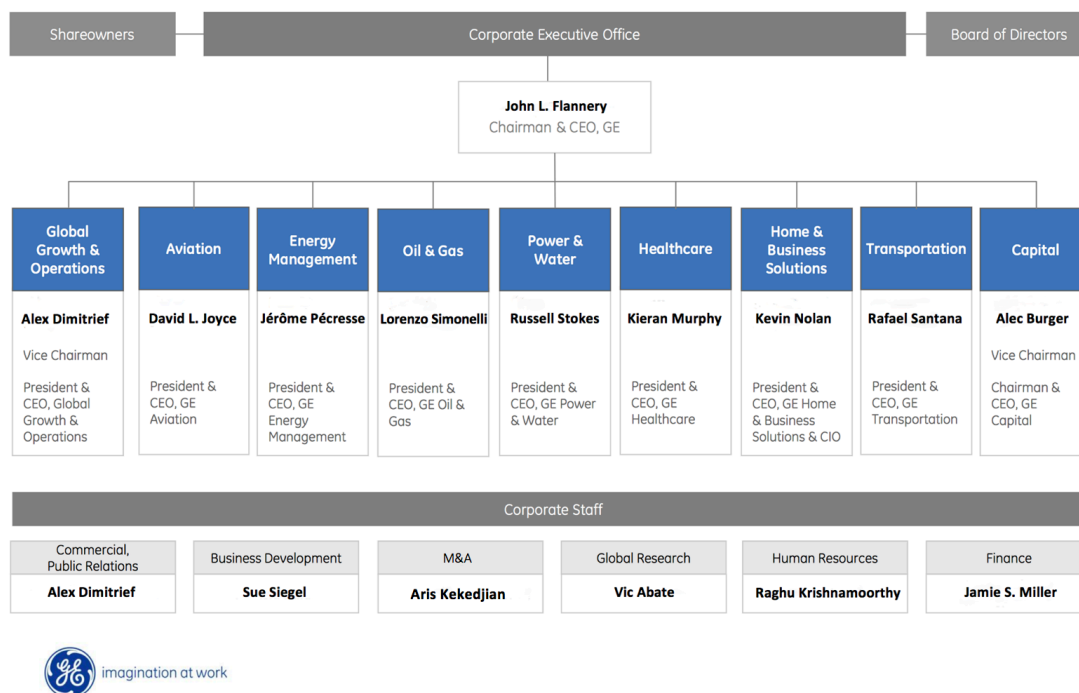
The main difference between the American conglomerates (in this case General Electric) and the Korean ones is the organizational structure, more specifically regarding the type of divisions they have.

As we mentioned before, chaebols are characterized by an X-form that is basically a developed U-form (unitary form), that is centralized but diversified. On the other hand, General Electric has a multidivisional organizational structure, thus the so-called M-form. On one hand the U-form resembles a highly centralized administrative structure, while on the other hand the M-form reminds more a decentralized organization (Qian, 2006).

Thanks to the M-form structure, the company's management emphasis is on supporting separate but interconnected operations in various industries. Moreover, thanks to this structure, the internal control is improved and the delegation of operating responsibilities to semiautonomous divisions reduces the need for top executives to deal with day-to-day operational issues and reduces need for coordination between business units (Williamson, 1975). As a matter of fact, in the M-Form the top manager works as an oversight among all the CEOs, while in the U-Form the top manager is the authority coordinator (Bustamante, 2016).

The figure below represents the updated organization chart of 2018, with John Flannery as the CEO and all the others top managers for each of the several divisions that are part of this company.

Figure 3.6: GE Company Organization Chart⁴⁴.



The Power of Conglomerates

As we have already seen for chaebols, conglomerates have always been one of the main topic of discussion regarding corporate strategy. They are seen as the key element of a lot of economies but sometimes they are also seen as a problem. That is the reason why a lot of scholars questioned why conglomerates exist, how they can be so powerful and how they can add value to the several businesses.

The most important aspects that worth to be analysed are the organizational processes within the firm and the way in which these are aligned with the ownership structure. This alignment is fundamental for the ability of the firm to deliver value (Anand, 2005). As a matter of fact, sometimes analysis about the strategies of conglomerates focus more on business mix rather than on organizational processes. Actually, the latter are a key element to analyse, in order to understand which are the real organizational processes in place that allow the firm to deliver value. Another mistake is to ignore the alignment between organizational processes, ownership structure and business mix in the analysis

⁴⁴ Source: General Electric, 2018.

of the choice of businesses. In fact, not all the businesses fit the ownership structure or the organizational processes of the conglomerate, creating natural restriction in the choice of the next business. Choosing the new market without considering this, could bring to strategies mistakes (Anand, 2005).

On the other hand, organizational processes and ownership structure could undermine the conglomerate. As a matter of fact, many people questioned if really conglomerates are positive for the economy or not. This happened because many characteristics of business groups are offset by a lot of negative aspects such as, for example, the legal separation of businesses (with subsidiaries that are often publicly traded in order that each business has its own board) that is undermined by having a complex cross-equity holding; or the concentrated ownership (that we have already seen being the characteristic of chaebols, so that often is in the hand of families) offset by the associated costs of the reduction of financial transparency and poor corporate governance; the high debt-to-equity ratios (also characteristics of a lot of Korean groups) can be a problem if we consider the cross-guarantees debt that can increase bankruptcy risks, like it happened for a lot of chaebols during the before mentioned Asian financial crisis in 1997 (Anand, 2005).

These are the reasons why, even if it looks like the environment is helping the group in running the economy, like for example when the market does not work well and the group can easily enter thanks also to its strong brand, actually it is not easy to add value and still be among the most powerful companies nowadays.

In the past, not everybody understood the power of this kind of organization. In fact, among the several conglomerates that existed in the past in the United States and in Europe, only some of them still exist today. During the 1980s, they had been laid down by their poor performance, and the thought that focused firms were better than conglomerates at creating value was spreading quickly (Ramachandran, 2013). But the power of these organizations has shut down some of these thoughts, showing how nowadays can be difficult for some standalone companies to be competitive in those markets where a firm of the conglomerate operates (like it happens in South Korea, as mentioned before).

General Electric is one of those companies that, as already said, continue to exist and to add value. It is not a coincidence that all the strategies implemented by Welch and Immelt

were closely aligned with the organizational processes. In particular there are three alignments that should be underlined:

- alignment of organizational processes with the choice of businesses; Welch really cared about the portfolio selection and he was really aware to understand when it was the time to divest a business even if he spent much effort, time and money on it. For example, GE, in 1986, purchased an 80% stake in Kidder Peabody in a bid to enter the investment banking business, but as soon as the firm got involved in insider trading charges, even if it attempted to shape Kidder with GE strategies, the company decided to divest this division (Sherman, 1988);
- alignment of initiatives with each other; GE has always given a lot of importance on the sequence of initiatives. For example, first it is important to develop a best practice, and once it has been developed it can be shared among the different businesses. It is important to not jump the important steps in order to have a consistent plan of the progression and to be more careful in monitoring the effectiveness of each phase before stepping into the following one;
- alignment with ownership structure; the confidence of the board is a key element in managing such a large organization. Welch have always been confident of his own capabilities knowing that if he had been chosen for managing such a complex organization, then the reason lays behind the fact that he has the ability to do that (Anand, 2005).

These are clear examples that the factors that influence the success of a conglomerate are several. It is not only about their strategy but it concerns also the environment, the consistency of their choices and the capabilities of filling the gaps in the markets. The consequence is that such big and complex organizations, not only have to care about the competitors, but they also have to consider the continuous improvement in the functioning of markets and also the internal organizational challenges (Anand, 2005).

Conclusion

At the end of this work, there are some concepts that need to be summarized and underlined.

First of all, in the first chapter, it is demonstrated how chaebols are powerful and how their power has grown year by year. The strongest have been able to overcome also the IMF crisis and every day they demonstrate how much power they have in their hand. No matter how many reforms try to limit their power, they still can manage the group in the way they want, keeping the control in the hand of the ruling family. The first chapter shows data about the market shares of these chaebols, giving proof about their importance in the economy of the country. In particular the five most powerful chaebols, Samsung, Hyundai, Lotte, SK and LG account for the greatest part of the GDP of South Korea since a long time and even if some reforms have been applied, the situation does not look as it will change soon. Behind the great success of these groups there are the capabilities of the ruling families that have understood the best way to keep and to maintain the control over an empire with just a little amount of shares, through the cross-holdings system. In addition, their way to manage the chaebol is successful because of the centralized planning and the paternalistic leadership, that allow them to always have control of what is happening in the chaebol and to manage it in the most efficient way. This is demonstrated in particular in the second chapter, with the Samsung example, when Lee Kun Hee decided to reunite the top managers in Frankfurt to solve the problem of quality they had in the company. He wanted to be the best and he could not accept quality shortcomings in his chaebol. That is why he decided to give a lot of importance to resources, in particular to the human resources, switching the way of doing business of the conglomerate.

Moreover, all the chaebols have been able to exploit all the opportunities and the help given by the government that, as we have seen, has always supported these groups with aids but also with the creation of a friendly and supportive environment where the chaebols could work as they wished.

The figure of the government is fundamental because it has been the reason behind a lot of strategic decisions taken by chaebols. First of all, the aggressive diversification has

been made mainly because of the presence of the government as a mean for sharing the risk, since at the beginning the government would have never let the group fail. Beside it, the government has influenced a lot of diversification strategies because of its guidelines, issued to support specific industries. These are only the most relevant reasons why the government is one of the main trigger behind the success of chaebols, even if, in contrast to the past, now it is trying to limit this success, even if without real consequences. As a matter of fact, despite the several reforms, in particular those ones that the chaebols were obliged to follow after the IMF Crisis, the things have always changed only on the surface, but actually the Korean conglomerates have always been able to modify their structure and governance as it was better for them, only with several adjustments.

From their side, they have the strong brand name, that is recognizable worldwide, but also a great number of talented people, with a high knowledge that are able to improve and develop the performance of the group. Still, the population have a lot of faith in some new changes. More specifically, they believe that the new management that will take the place of the old ones (always maintaining the family line succession) will be more modern thanks to the new studies and will allow to overcome the organizational inertia, first of all, but also will be able to meet the request of the citizens and of the government that ask in particular for more transparency.

This is probably only one of the few things that they can obtain nowadays, because changing the rule of the game now is really difficult, almost impossible. As a matter of fact, chaebols always find new ways to be stronger and more powerful, such as creating relationships among them like weddings, to secure long-term inter-group collaboration. They have been able to exploit this kind of relationship to become more powerful and to gain more knowledge about market in which they had never thought to enter, because of their low skills in it. Now they can also think to enter those market in which they do not have high capabilities thanks to this way of tightening relationships among different groups.

With the new management system, there are more chances according to which they could give less importance to growth and more importance to efficiency and profitability, in particular because of the step back that the government has made regarding the aid that has always given to chaebols. This could bring to a priority in focusing on the most successful businesses, by divesting or restructuring the most failing business in the group.

This move could apparently look as a reduction in their power, but actually it could make them more powerful since they will focus more on what they are good in, maintaining the control over the country.

As a matter of fact, they will be able to maintain the power no matter what thanks to the so-called phenomenon of the “Republic of Samsung”. This is the clear example of the Koreans dualistic mind. Their patriotism has always brought them to think at Samsung, and at other chaebols, as something to be proud of, since it has spread the name of the country globally in a positive way. In fact, South Korea is well known worldwide for its high-tech technologies and this reputation is mainly due to Samsung. This is the main reason why Koreans have always trusted and believed in the chaebols’ brand name, helping them by being their most loyal and faithful customers. Moreover, Koreans recognize that chaebols made South Korea an economic power, and it is not only about the Korean’s reputation, but also about the enhancing of the living standard, thanks to the quality of the products sold by chaebols. Basically, Koreans know that chaebols provide high quality products, but some of them are not so favourable to these groups because they monopolize all the market and they do not give choice when customers want to buy products. For example, if a Korean would like to buy a laptop, he can only choose between Samsung and LG (beside Apple) and this could be dangerous if one or two huge companies raise the price, since they have no choice other than those.

We understand that the continuous asking for reforms does not come from an unmotivated hate. This is the results of long years of nepotistic and monopolistic business model that keep the country in their hands, controlling it without limits. And this has brought the country to vote for Moon Jae In as a president, that made the reform of chaebols the key element of his political agenda.

Although he has been elected especially for this point, he is still not doing any movements regarding the reform of chaebols. On the other hand, as already said, changes are really difficult and it is almost impossible to eliminate or change deeply chaebols, and it is clear looking at the initiatives taken along the history. A lot of reforms have been done during those years, but nothing really changed.

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Summary

ABSTRACT

Korean conglomerates, known as chaebol, have a big influence on the country's fast-growing economy nowadays. The aim of this study is to analyse the chaebols structure, its growth into the Korean market, thus the way they came to power, how this type of organization tries to face threats and exploit opportunities and which has been its impact on the society. The analysis will consider as an example the most successful Korean conglomerate that is the Samsung Group. Moreover, it will also analyse the Western conglomerates (considering as an example General Electric) and the Japanese ones, the keiretsu, underlining common things, differences, positive and negative aspects.

CHAPTER 1

A chaebol is an independent firm owned and run by family members. The founder family owns it, no matter how big it is and how many businesses it has.

Chaebols were born and developed during the '50s, after the Japanese liberation and thanks to aids given by the American government, when some Korean businessmen took the control of those assets left by the Japanese. Through the history, chaebols have been helped a lot by the government. It all started when the power shifted from President Yun Bo-seon to Park Chung-hee in 1961. The latter focused a lot on export promotion and decided to support chaebols through loans and export subsidies, giving priority to those chaebols who operated in the most competitive sectors. Thanks to him, the Korean market was opened to the world market and it helped the chaebols to grow and to become important either inside and outside the country. This growth for chaebols meant an extension in unrelated business, thus they started to diversify and to gain more power.

At the beginning of 1990, the concern about globalization was growing up, so the new government tried to support it with reforms about deregulation and liberalization. This helped chaebols to become more international and to obtain helps from international lenders as well, since they knew that chaebols were profitable and that the Korean government would have never let them fail. The problems arrived in 1994, when the dollar started to appreciate towards the other currencies, and since the won was pegged

to the U.S. dollar, also the won started to appreciate. The result was that the exported goods of South Korea became less competitive and firms became less profitable. The economy began to fall year after year and a lot of chaebols had not been able to pay back their loans, so they failed. During this crisis of 1997, the IMF Crisis, all the weaknesses of chaebols came out. The first problem was the overinvestment in areas characterized by strong competition with low return on investments. These investments were also mainly funded by debt-form financing sources and their debt ratio was higher than 400%. Another problem was the management of chaebols, because the family members monopolized the conglomerate, without considering the opinion of the minority of shareholders. There was a very low level of transparency and, as a consequence, a poor auditing system. Moreover, the development of capital market stopped, and that brought to an increase in the dependency from banking credits as the major source of funds. Thus, this increased the instability in the economy. To recover from this crisis, the International Monetary Fund (IMF) helped the country with a bailout and with a package of reforms that it asked to be respected. The reforms were mainly about the restructuration of chaebols. As matter of fact, they asked in particular to apply five changes:

- enhancement of management transparency;
- capital structure improvement;
- greater accountability by owner managers;
- cancelation of mutual loan guarantees among chaebol affiliates;
- business consolidation into core competence areas.

In the 1999, the government added three more rules that the chaebols had to respect:

- prevent industrial capital from dominating finance;
- discourage circular investment between chaebol affiliates;
- prohibit nepotistic transfer of management or ownership to family heirs.

Chaebols were forced to apply these reforms in order to conform with the public opinions that started to think that the Korean conglomerates were the main reason for the crisis. Eventually, the change happened only on the surface because the deep structure of chaebols remained the same of the beginning.

Regarding the structure of chaebols, first of all it has to be noticed that the main characteristic of them is that they are owned and controlled by one family, that is the

founder family of the group. No matter how big it is and how many businesses it has, the control is always in the hand of the family members. The planning is completely centralized and they are able to maintain the control through a complicated system of cross-shareholdings, according to which the family member needs to have only a little number of stakes in one of the business to be able to control all the group. But we will see how it works later on with the case of Samsung Group.

The chaebols are the most important element of the Korean economy. About that, they account for the greatest part of the Korean GDP, as it is possible to see in the table below, with data for 2009, 2010 and 2011.

Table 1

		2009	2010	2011
Asset / GDP	20 largest groups	75.3%	78.6%	85.2%
	5 largest groups	46.5%	49.9%	55.7%
Sales/ GDP	20 largest groups	75.3%	78.6%	85.2%
	5 largest groups	46.5%	49.9%	55.7%

Another important characteristic is the aggressive diversification of chaebols. One of the main reason of this kind of diversification is the government. As matter of fact, chaebols have always lean on the protection of the government, that is why they had always been pushed by a strong entrepreneurial spirit, even if it took a lot of risks. Moreover, the government has influenced the decision of this unrelated diversification with several guidelines, for example those issued in the 1980s, to support specific industry. As a consequence, chaebols started to diversify in those industries supported by the government. These same steps towards these businesses is the clearest example of mimetic isomorphism, since all chaebols started to behave in the same way and to diversify in the same industries.

Concerning the environment in which chaebols operate, the rules of the market seem to be designed in order to favour these companies. In fact, chaebols have always been helped by the government in order to be the most powerful companies in the country, thanks to loans and reforms that have always favoured them. Moreover, the Korean market structure is still a kind of structure where only some designated companies can have the power and rule the market. Looking at the asymmetric information in the Korean market,

it is clear that some actors have more power than others and this can restrict choices available to the other participant in the market.

But chaebols have not only been helped by the government and by the environment to diversify, they actually have found a way to expand themselves without asking aids or helps to the institutions. Chaebols are expanding always more thanks to the multiplex ties between their groups. Multiplex ties can be of different types, such as friendship, affiliation, exchange of information, but the strongest one is the marriage. Thanks to the marriage, chaebols can enter market that before they did not even consider, because they were not skilled enough to be a player of the game. Through the marriage, the chaebol of the husband can enter the market of the chaebol of the wife, having from its side a protector and an aid in that unknown market. One example is the marriage, in the 1950s, between the LG family and the Samsung one, when Lee Kun-hee's younger sister married a man from the Keumsung household. Samsung had no experience back then in high tech, while LG was a dominant, in particular in the radio electronics industry. By marrying the LG family, Samsung could expand itself and enter into the electronic industry. Thanks to this strong relationship between owner families, Samsung could expect a deep knowledge and intangible assets from LG in that market. In this way, Samsung could learn of the radio industry and the distribution networks easily, quickly and deeply, using this knowledge to become competitive. This is one of their greatest strength but there are also others.

As a matter of fact, from their side, chaebols have a strong brand reputation name. For example, the brand Samsung has been demonstrated as to be one of the most famous and powerful worldwide, even in the global ranking of brands.

Another strength is the strong level of entrepreneurship. This is clear from the number of new product lines that they launch every year, buying and merging with existing companies and entering new domestic and international markets. This is possible thanks to the great leadership and the great commitment of the management. An example could be LG Corporation. LG works in several businesses such as electronic industry or chemical industry, but also in the telecommunication sector. The large size of these conglomerates allows to exploit the scale economies and the scope economies deriving from the synergy effects.

The shortcomings of chaebols, on the other hand, are linked to their structure as well. First of all, the large dimension could be a problem sometimes because of the great number of bureaucratic accomplishment and thus the management's costs could arise a lot.

Secondly, sometimes the aggressive growth seeking of chaebols can bring to keep unprofitable businesses into the group, delaying the exits. The costs linked to these delayed exits could bring to the collapse and bankruptcy of the entire group, like it happened for Daewoo and Ssangyong. Linked to the objective of growth and of gaining more power, there is the other weakness of chaebols that is the investments diversification, that sometimes are not in line with financial rationality. These investments are usually made for not losing the control over the chaebol, in order to enhance the possibility to transfer the power to a member of the family. Nepotism is, in fact, another element that is strongly criticized, since in all the chaebols all the most important positions inside the group are occupied by family members and are not designated for meritocracy. Power is usually passed on to the eldest male son or the chosen heir. This brings to one of the main problems for the less powerful shareholders of chaebols that is the so-called "tunnelling", since controlling shareholders could "tunnel" the profits from firms where they have less cash flow rights to firms where they have more rights. This phenomenon could bring also to the buying of products from affiliated companies, even if other companies outside the group offer better prices.

Besides the shortcomings and the several critics that they receive, chaebols are the reason why South Korea is the world's fifth largest exporter with the 11th largest gross domestic product (GDP). As a matter of fact, the main power of chaebols today is export, even if some economists think that the South Korea's export dependency could bring to some problems, such as a state of stagnation for the country. According to them, the government is supporting a state based on a chaebol-centred economic structure that does not allow the development of the Korean economy. To lessen this dependence, a solution could be the raise in the domestic demand but it would not be easy considering the demographic problem that Korea is facing, consisting in being the oldest country according to the working-age.

Stepping back to the power of chaebols, it is important to underline that their power is evident for the fact that sales revenue earned by the top ten chaebols account for 67.8%

of the country's GDP. This brings to the problem of the lack of SMEs, that usually are accounted as a source of innovation and job creation, but in Korea the greatest part works as suppliers and subcontractors of chaebols. The government has tried to support the development of SMEs with incentives, but it failed and, according to some scholars, it is mainly due to the lack of promotion, since SMEs are not aware of the aids given by the government. This is not a news since, until now, the greatest part of the reforms has not been applied. For example, the interlocking institutional ownership has increased from 44.5% in 1998 to 50.5% in 1999, even if we could expect the opposite if we consider the 1997 and the 1998 the years of the reform.

Koreans have shown their disappointment with the election of Moon Jae-In in May 2017, that has promised to the country to reform chaebols, even if until now nothing has changed so much.

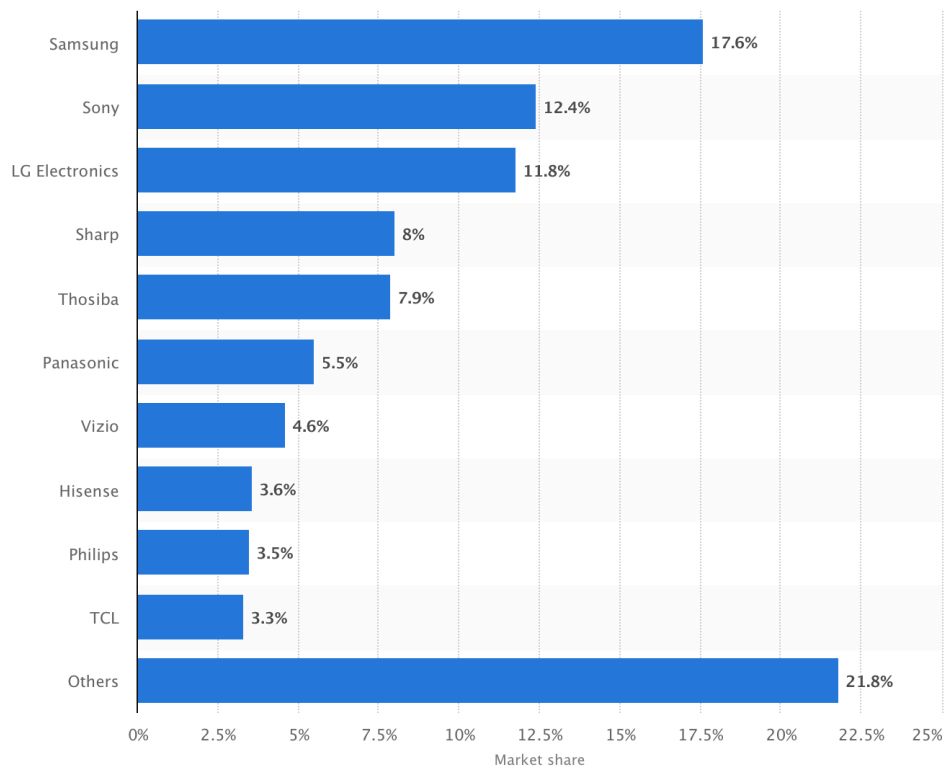
The reform will not be easy anyway. Chaebols are part of the Korean economy and they are so much integrated into the economic, political and social structure of the country that it would be difficult to change them. As we have seen, other reforms had been made during the history of this country, without real results or at least without long-term results. On the other hand, supporters of chaebols appoint that Korean conglomerates are the engine of the Korean economy, so changing them would mean damaging the country's economy.

CHAPTER 2

Samsung was founded by Lee Byung-Chul in 1938 as a trading company in Daegu, South Korea. Across the years, he made a lot of acquisitions and investments, diversifying in different areas such as Life Insurance or Heavy Industries. This group gave a lot of importance to research and development and it helped the company to expand year after year in the global electronic industry. It has been able to maintain a growth in almost all of its businesses: first of all, the electronic one, but also the construction one, confirmed by the contract for building such as the Petronas Towers, Taipei 101 and the Burj Khalifa. A great step has been in 1995, with the Samsung's creation of its first liquid-crystal display screen and it grew up as the world's largest manufacturer of liquid-crystal display panels. In the graph below it is shown the market share of LCD TV brand in 2010. It has

always been one of the most profitable businesses for Samsung, thanks to which it has taken advantages in particular from the fact that it acted as a first mover.

Graph 1



In 2012 Samsung Electronics became the world's largest mobile phone maker by unit sales, overtaking Nokia, which had always been the market leader since 1998.

Samsung Group respects all the characteristics of a chaebols explained in the first chapter. In particular it is a company highly diversified, that operates into different businesses. It works in sectors such as high-tech, electronic, energy, communication, heavy industries, engineering construction, insurance, financial services, investments, medical, food, fashion and resorts.

In Samsung, Lee's family can control all the group thanks to the mechanism of cross-shareholdings, even with 1.67% of the overall group shares. The main means through which Lee family can have the control is Everland, an amusement park private firm.

Thus, basically, Samsung Everland is the holding company that holds a controlling stake in Samsung Life Insurance, which owns a stake in Samsung Electronics and other affiliates. This system of circular shareholdings allows Samsung vice chairman, Lee Jay-

Yong, who holds 25% stake in Samsung Everland, to maintain control over the group's electronics and financial units.

One of the factors that allowed the success of Samsung has been the effective and efficient use of resources. In particular, the real growth of Samsung Group happened thanks to the second chairman, Lee Kun-Hee, that really focused on the quality of products, and he wanted to transform Samsung from a manufacturer based on low costs' advantages to a global performer with a strong brand value and high-quality products. He promoted employees' skills and knowledge, he gave a lot of importance to marketing and he developed an approach strongly oriented towards customers in order to understand and realize their needs and wants. He managed to improve the image of the brand, from low level brand to a high-quality brand. He also put a lot of effort in transforming a company driven by exports to one led by foreign direct investment (FDI) and joint ventures. He used FDI also to establish headquarters in other places of the world, such as China, Europe, North America or Singapore. That is how, by 2005, Samsung Group had established 64 manufacturing and sales subsidiaries and 13 R&D centres around the world. In this way, Lee Kun-Hee has been able to reduce Samsung Group's debt of \$15 billion in 1997 to \$4.6 billion by 2002; net margins rose from a negative 3% to 13% in the same time horizon. Moreover, it recorded net profits of \$5.9 billion on sales of \$44.6 billion in 2002, compared with \$2.8 billion in profits and \$28 billion in sales in 1999.

Beside all these successes, Samsung has faced a lot of problems due to legal issues. In 2014, its chief executive to be, Lee Jae-Young has been charged with bribery and embezzlement. On August 25th of 2017 he was sentenced to 5 years in jail, but the 5th February 2018, he was freed shutting down all the hopes of the reformers about the decline of chaebols. This release has been quite controversial because it triggered a lot of arguments. On one hands, some critics saw it as a great setback for all the reforms made until that moment. In particular for many Koreans, the sentence of Lee's freedom has been seen as a setback to the President Moon Jae-in promise to reduce the power of chaebols. They protest in particular asking for the end of a system where the founding families of chaebol can control listed companies, even if they have sold the majority of the stock to outside investors.

On the other hand, there are still supporters of chaebols that believe that Mr. Lee will be able to improve and keep on reforming Samsung's corporate culture, satisfying also those ones who ask for reforms. For instance, it has already provided new measures for increasing shareholders' returns. He is also planning to introduce outside directors at the annual shareholders' meeting, to better reflect the interests of minority shareholders. In fact, Samsung is trying to improve its corporate governance, increasing transparency and shareholders' value at the same time as well, with the decision of bringing in Samsung C&T a French Executive as a new outside director. It is clear then that the new generation of CEOs is more willing to accomplish these reforms rather than their predecessors.

But still, no matter what, the Koreans live in the so-called "Republic of Samsung", since the businesses in which this chaebol operates are so many that this group follows people from when they are born until they die. Besides that, no matter how many problems this chaebol has to face, such as the arrest of Jay Y. Lee or the problem related with the burning Galaxy Note 7, Samsung is still Samsung and it is still doing well.

All this explains why it is impossible to destroy or to shut down this group. It still accounts for the greatest part of the GDP in Korea and it is more powerful even of all the other chaebols together (LG Electronics, SK Group and Hyundai Motor). This company is continuously pushed to apply more transparency to its businesses but actually it is up to them to choose whenever they want to use this kind of governance. Koreans do not realize it, but they are in the hand of this huge organization.

CHAPTER 3

Conglomerates are not a unique characteristic of South Korea. They are common in other country as well, such as India, China, Japan or U.S. In particular the Japanese conglomerates, which name is keiretsu, are large corporate groups with the characteristic to be built around a major commercial bank. Keiretsu are characterised by a strong relationship among three subjects: government, banks and businesses. In particular, we have two types of organizational structure for this type of groups: the inter-market corporate groups, which is more horizontal in nature, and the second one that is more vertical in nature. In the horizontal corporate group, the centre of the network is the main bank, which lends money to the companies that belong to the group, holds equity position in the companies and acts as a monitoring entity. On the other hand, we have the vertical

keiretsu, characterized by the formal relationship buyer-supplier. Generally, they are made up by one very large company and a lot of small companies subservient to it. Usually, vertical keiretsu are less influenced by a bank and they are more common in the electronic and automobile industries.

Speaking about the type of management, the Japanese practice is strongly focused on customers, similarly to chaebols but at a higher level, thanks to which it is created the value for the company. In this way, also the shareholders can have their desired value. In particular, the Japanese companies have been able to lower the price of products without giving up on quality. Another feature of keiretsu is their ownership structure, that is pretty similar to the one of chaebols, and is characterized by cross-shareholdings. Its main objective is to protect each group of the company mainly from outside control or takeover threats.

As already mentioned before one of the main characteristics of Japanese groups is the protection of the banks. Basically, when there is not a clear owner of the Japanese companies, the bank becomes the main owner because it owns the greatest number of shares in the member firms. This imply that whenever the groups are in financial troubles, the banks are ready to help them. The participation of the bank also increases the efficiency of the company because the bank will strictly monitor the company and it will push the group to be more productive. This imply an increase in the market production, so in the markets share. When the market share increases, these firms can lower their prices, which make them more competitive globally. This is a big difference with chaebols, since Korean groups are not controlled by banks but by the family members. As a matter of fact, chaebols are under central banking system that are controlled by the government, that is more willing to support the biggest groups that in this way control most of the exports and foreign investments in this economy. In addition, keiretsu are controlled by professional managers. This imply that chaebols have a more centralized structure and keiretsu more decentralized.

Stepping into the Western conglomerates, the most successful one is General Electric. This conglomerate diversifies in several businesses, such as aviation, health care, renewable energy, transportation, oil and gas, lighting, financial services and power.

Its success is mainly due to the two great CEOs it had in the past: Jack Welch and Jeff Immelt. The first one focused a lot on the geographical expansion and acquisitions, while

Jeff Immelt continued the work of Welch, trying to underline the pillars of the company: technology, customers, globalization, commercial excellence, innovation and growth leaders.

A key element of this group is sharing among the businesses; sharing resources, as for example moving GE managers, will help the company to share ideas and transferring best practices. Another main element of this company is change: the company has to be fast and adaptable to market changes for not being weak and vulnerable. As a matter of fact, the characteristic of being adaptable to changes is one of the main strengths of General Electric, together with the strong research and development processes, in order to have a rapid innovation and to always develop products that always meet the changing demand of the market. It also has a very strong brand, that attract and retain customers and it allows the creation and the development of loyalty in customers.

The main difference between the American conglomerates (in this case General Electric) and the Korean ones is the organizational structure. More specifically, chaebols are characterized by an X-form that is basically a developed U-form (unitary form), that is centralized but diversified. On the other hand, General Electric has a multidivisional organizational structure, so the so-called M-form, more decentralized.

CONCLUSION

In conclusion, it is demonstrated how chaebols are powerful and how their power has grown year by year. The strongest have been able to overcome also the IMF crisis and every day they demonstrate how much power is in their hand. No matter how many reforms try to limit their power, they still can manage the group in the way they want, keeping the control in the hand of the ruling family.

Moreover, the figure of the government is fundamental because it has been the reason behind a lot of strategic decisions taken by chaebols. First of all, the aggressive diversification has been made mainly because of the presence of the government as a mean for sharing the risk, since at the beginning the government would have never let the group fail. Beside it, the government has influenced a lot of diversification strategies because of its guidelines, issued to support specific industries. It has also helped a lot chaebols with loans, aids and a supportive environment where the chaebols could work as they wished.

It is really difficult to change this situation in particular because of Koreans. A lot of them criticize this reality, stating that they do not have any other choices beside the products offered by chaebols and still they see their monopoly in a bad way. On the other hand, the same people appreciate their products and are proud of the way in which chaebols spread the Korean reputation worldwide, as one of the most advanced countries in high-tech. This explains why Koreans live with this dualistic mind about the reality of chaebols.

But still, as already said, changes are really difficult and it is almost impossible to eliminate or deeply change chaebols, as we have seen along the history. A lot of reforms have been done during those years, but nothing really changed.