BUSINESS GROWTH STRATEGY

Growth Strategy Analysis: Samsung Electronics

Introduction

Samsung Electronics Co. Limited is the consumer electronics subsidiary of the Samsung Group, a conglomerate based in Suwon, South Korea. Samsung Electronics Co. plays in the consumer electronics, telecoms equipment, semiconductors and home appliances industry. It is a multinational company with 80 offices world-wide. Samsung enjoys the enviable position of being the No.1 smartphone company based on shipments and is also a well-known household name for appliances.[1]

Samsung's fiscal 4Q15 earnings missed analysts' estimates. The company's revenue growth slowed to just 1.1% YoY (year-over-year) during the quarter. Smartphone sales fell 3.8% YoY, while semiconductor sales rose 24% YoY. Samsung is making efforts to keep its core mobile business, which accounts for 45% of its revenue, profitable. While it still dominates the market, increasing competition in high- and low-end smartphone sales from Apple and China's Huawei, respectively, is taking a toll on its market share. The Semiconductor business accounts for 25% of the company's revenue and amid the slowing smartphone sales, Samsung is increasing its focus on its semiconductor business, which in 2015 showed a 24% YoY rise in sales but with profit growth slowing to 3.7%. The semiconductor business that accounted for ~50% of the company's operating profit in fiscal 3Q15 now accounted for 45% of operating profit in fiscal 4Q15. The business was plagued by falling DRAM (dynamic random access memory) prices, which lowered its margins. While Samsung reported a sharp fall in profit, rival Apple (AAPL) reported a record high profit in the same quarter. Despite a record profit, Apple reported its slowest growth in iPhone sales of just 1% YoY during the quarter. [2]

Analysis

Scenario Analysis Trends

The smartphone market is projected to move from 1.1billion units in 2105 to reach 2.2 billion units by 2020 and this will be driven by rising income levels and consumer spending in Developing countries, falling price of smart phones, cheaper mobile voice / data services, attractive price bargains for consumers due to increasing competition, strong demand from mobile professionals and data-centric consumers, introduction of faster data networks & third party application systems, transition of 3G to 4G $ increase in replacement demand for smartphones, expanding internet user base, increased corporate acceptance of smartphones as business class phones and growing popularity of multi-SIM smart phones. Asia Pacific is the largest and fastest growing market at 7.5% CAGR. China and India, the

two most populous countries with large sections of middle class consumers, continue to represent major markets for premium as well as low cost smartphones.[3]

Looking at the semiconductor industry, according to International Data Corporation, year-over-year growth in worldwide semiconductor revenues slowed from 7.1% in 2014 to 3.6% in 2015. Semiconductor revenues are estimated to reach $389.4 billion in 2019, growing at a compounded annual growth rate of 3.1% from 2014–2019. The US semiconductor industry accounted for 51% of the global semiconductor sales in 2014. This industry contributed over $65 billion to the US GDP (gross domestic product) from 1987–2011, according to research firm IHS Technology. However, competition is increasing from South Korea as the country boosts its semiconductor manufacturing capacity. The US continued to lead with a 52.4% share of the global semiconductor output in 2013. Intel and Qualcomm were the largest players in the US semiconductor space. For the first time, South Korea overtook Japan to become the second largest semiconductor producer in the world.

According to the Korean Ministry of Trade, Industry, and Energy, South Korea accounted for 16.2% of the global semiconductor output, whereas Japan accounted for 13.7%. Samsung and SK Hynix together hold a 70% share in the global DRAM (dynamic random access memory) market and 50% of the global NAND (negative-AND) flash market. DRAM and NAND are two forms of memory chips. The two companies are among the top five worldwide semiconductor companies in terms of revenue.[4]

SCENARIO ANALYSIS: UNCERTAINTIES

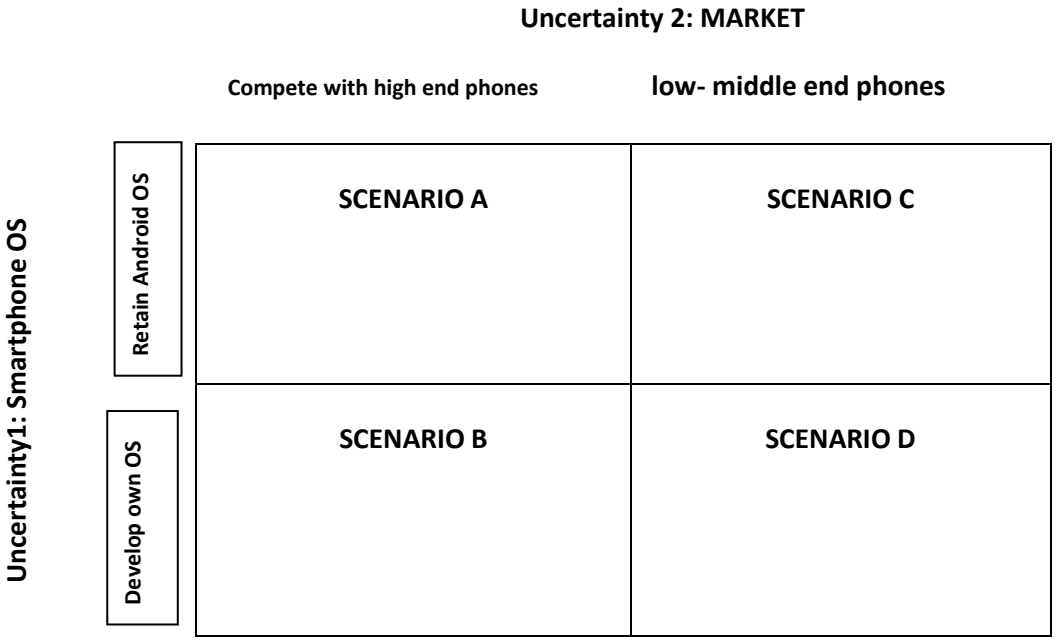
There are a number of uncertainties affecting the smartphone industry. One uncertainty is the future of the smartphone operating systems. Currently, 45% of mobile handsets use android, 18% use Apple IOS, 20% use windows and the rest are split between RIM, Tizen and others. [5] However, according to arstechnica.com, the fight for a third place smartphone OS has been lost by everyone. The writing is on the wall for BlackBerry 10. The Fire Phone was a colossal flop. Firefox OS phones are dead. Sailfish OS, Ubuntu, and Tizen aren't going anywhere.[6] This leaves us to debate on whether the decision for Samsung to go out and use its own OS – Tizen on some of its electronics is a good idea.

The second uncertainty is the growth and potential in the low to middle income emerging markets while the developed markets are saturated leading to slow growth. The growth in the emerging markets comes with increased competition and reducing margins as compared to the matured developed markets that have large margins. Should Samsung use its high end phones in the developing markets to target profits, but what happens to the volume it gets from the low to middle range handsets?

Another uncertainty is component suppliers seem to be in a safe position. This has been yet another peculiar theme that was observed in 2015. While the non-Apple smartphone makers continue to bleed, the component suppliers have been in a much safer position. Sony, for example, has continually said in its earnings as to how its image sensor division is doing very well and this was further proved now with

Sony's acquisition of Toshiba's image sensor business. Similarly, semiconductors now account for a larger part of Samsung's profits than the smartphone business which was once its cash cow.[7]

FIGURE 1: UNCERTAINTIES IN THE MOBILE PHONE SECTOR

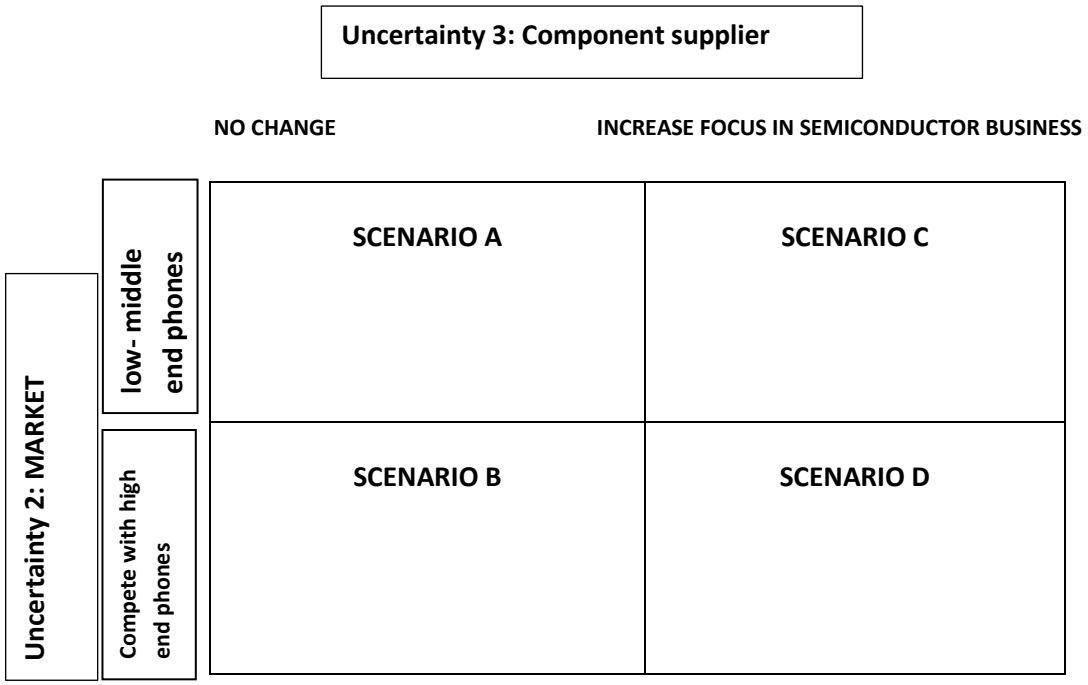


*e.g. New geographic markets, new products e.g. wearables

Samsung currently occupies Scenario A and C and has started dabbling in Scenario D with the Tizen OS. Scenarios A & C have given Samsung the market lead it currently enjoys. However, it is getting heavy competition from Apple in the high end models and from Huawei, Lenovo and Xiaomi amongst others in the low to middle range handsets. The growth strategy in Scenario A would be to come up with a phone with a great design, longer battery life than the iphone to compete in the premium sector, great customer service and also giving it value add that one would not get with the iphone 6. Samsung has just launched the S7 and hopes that this will compete with the iphone 6. In Scenario C, the strategy would be to come up with more affordable handsets that use the latest technology at lower costs and these handsets should continue to be compatible with other devices e.g laptops and google Apps. In Scenario B, Samsung has developed Tizen, but it is yet to use it in a high end smartphones. With the coming in of IOT and the need to be compatible with other devices, Samsung should ensure that it has other devices that are compatible with the handset e.g smart TV and Smart watches. Samsung has done very well in this area and is currently leading in the Smartwatch sector. It has put Tizen in one of its new Smart watches and also in some of its new LED TVs We are yet to see the impact of this on both the Smartwatch and LED TV markets. Consumers who buy expensive handsets want to feel that they are in a class of their own, so they may welcome the Tizen OS if it proves to be robust enough. In Scenario D would mean having the Tizen Os in the low – middle range handsets. Samsung has already introduced

this OS to its Z-series of Smartphone. The best strategy would be to try it out in one market, assess before rolling it out to the rest of the world.

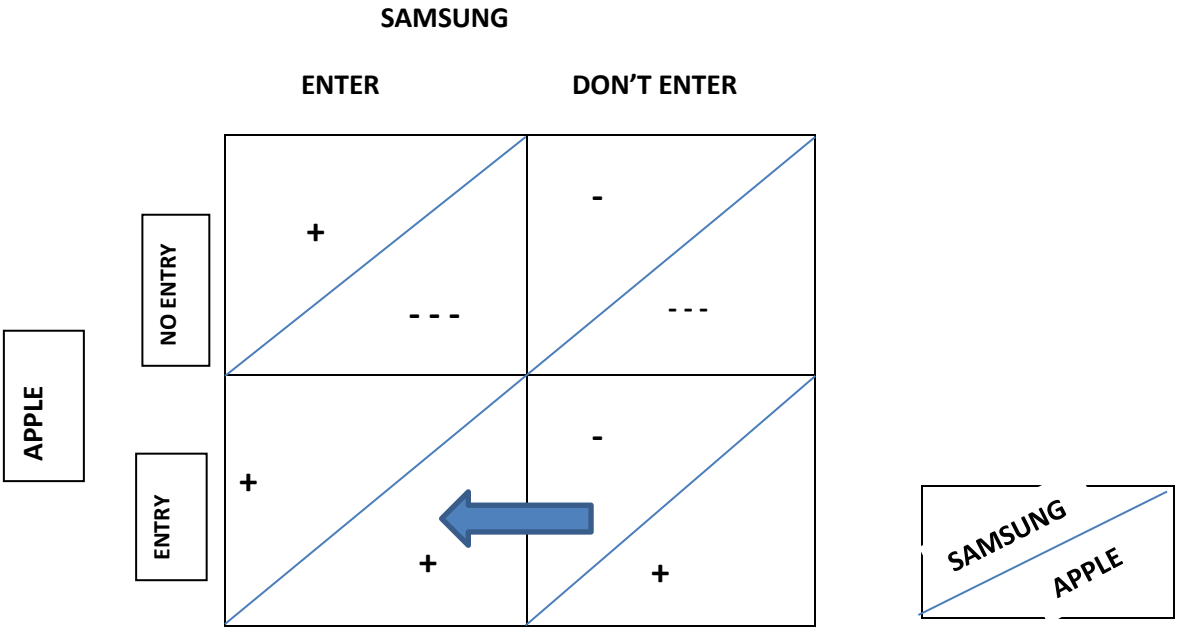
FIGURE 2: UNCERTAINTIES IN THE MOBILE PHONE SECTOR



In Scenario A, Samsung focuses on the low – middle end phones and keeps running the business the way it is currently in the semiconductor business. However with the competition it is getting, it will soon start losing market share if it does not undertake an aggressive price strategy. The growth strategy would be to cut costs in order to maximise on profit. Samsung could consider buying out Huawei, but this would not hinder the other competitors like Lenovo, Xiaomi and others that are using the Android OS. In scenario B, Samsung would focus on high end phones and not change anything that it is doing in the semiconductor business. The growth strategy would be to compete on design, storage capacity and battery life of the handset and come up with a differentiating factor from the rest of the handsets including iphone. The use of Tizen in these high end handsets may be the answer. In scenario C Samsung focuses on the low – middle end phones and also more on the semiconductor. The growth strategy in the semiconductor industry would be to make alliances with foundries in the semiconductor business and also with competitor SMART phone companies so that they can supply them with components. Samsung should also put more R&D into making cheaper and more advanced components for the smartphones and other devices. If this strategy succeeds, Samsung will grow through its semiconductor business supplying both its own handsets and competitors. In scenario D, Samsung focuses on high-end handsets and also adds focus to its semiconductor business as discussed above. Samsungs growth strategy would be to capitalise on the margins in the high-end smartphone sector and put more resources into the semiconductor business so that it can supply its competitors too.

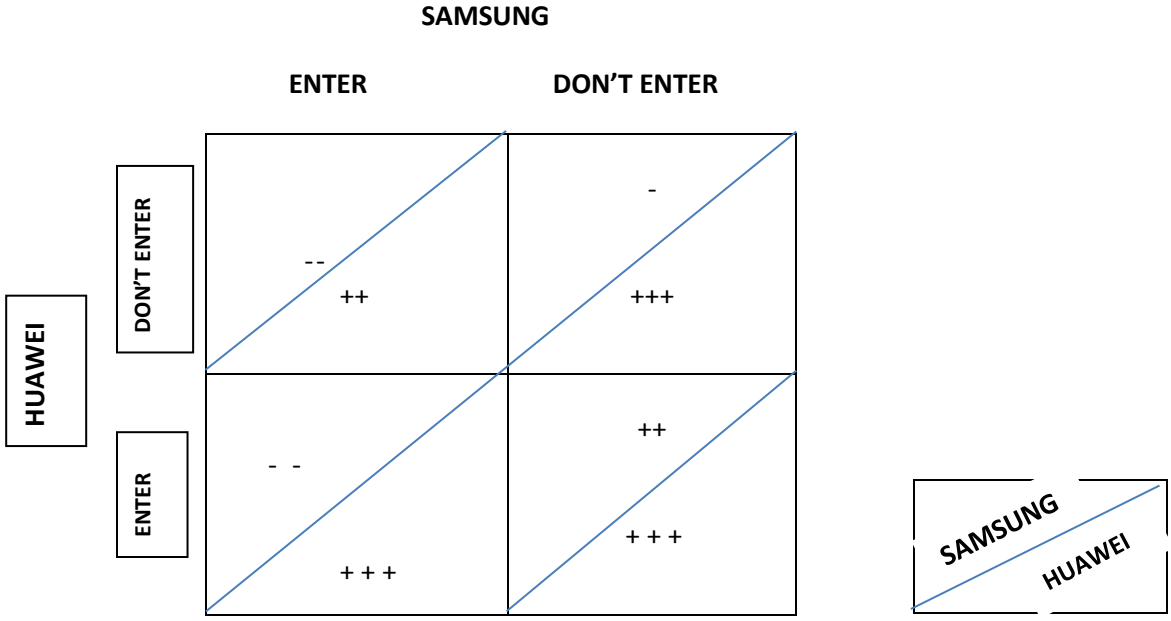
GAME THEORY ANALYSIS

FIGURE 3: OWN OS – Samsung Vs Apple



APPLE already has its own OS, while Samsung has just introduced Tizen Os. Therefore the market is currently in the right bottom corner and is moving to the left bottom corner. This shows that this move would be a good option in the high end sector.

FIGURE 4: OWN OS – Samsung Vs Huawei



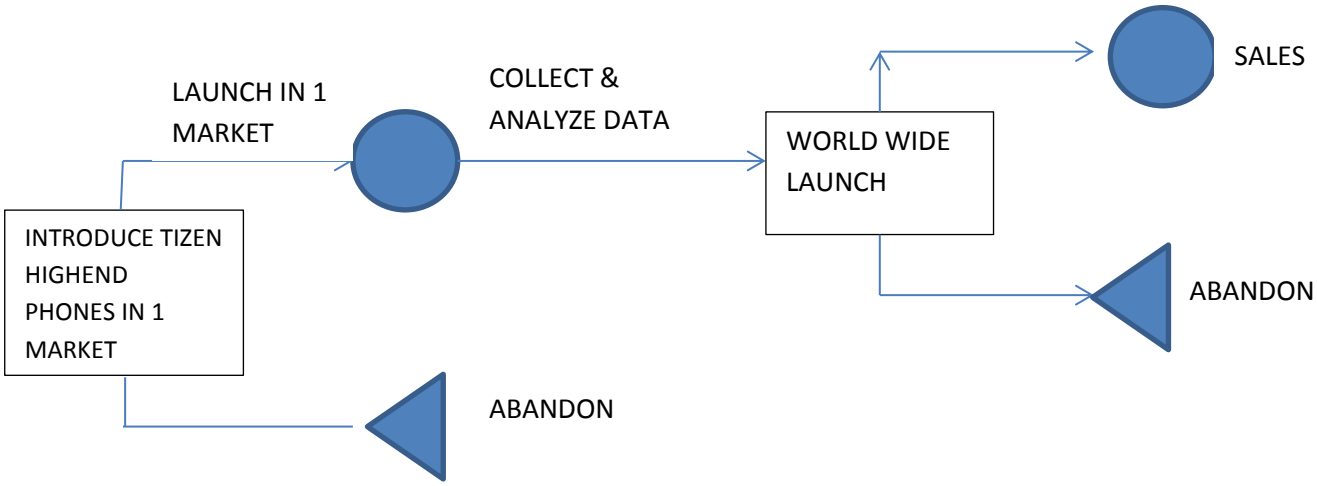
Currently the smartphone market in the low and middle end is in the right bottom corner. Samsung has started work to move to the bottom left corner, but we see that this would lead to a loss in revenue for Samsung as Huawei would steal more share from Samsung. I think that it is too soon to move to the Tizen OS for the low –middle range of smartphones. We need the success of the high – end handsets to trickle down.

SYTHESIS OF FINDINGS

Scenario D in figure one (Introduce Tizen OS to high end phones) will give remarkable growth despite arstechnica.com thinking that the Tizen OS is not going anywhere. Samsung management has the determination and persistence to see the success of the Tizen OS through. However, they should try it out in selected markets and if it does well, then they can roll it out all over. (Figure 5) Following the success in the high end handsets, the Tizen OS will be able to do will in the middle range handsets too for starter. Fortunately Samsung has introduced the Tizen OS into its new smartphone and LED TVs. This strategy is further supported by figure 3 & 4 that show that Samsung stands to gain by introducing the Tizen OS to the high end handsets, but should not rush to take it to the lower end handsets. Both Scenario C & D should be considered in figure 2 so that Samsung continues to gain form the margins of the high-end handsets, volume of the low end handsets while the growth in the semiconductor industry will cushion the smartphone industry in the event of any lost profits. Samsung has already developed Tizen and is trying it out in its smartwatches and new LED televisions. Samsung should continue to do this on a small scale and see how it takes off before it rolls out this OS on all it SMART phones.

In summary Samsung should retain its focus on both the high end and low – middle range smartphones, but improve on its high end handsets to compete with the iphone. The introduction of Tizen OS to the high end handsets would help the growth in this range. Samsung should pursue an aggressive price strategy with the lower end smartphones, while equipping them with great technology and should not rush to launch the Tizen OS in this sector. Since the profits within the smartphone industry are dwindling, Samsung should grow its semiconductor business so that it can cushion its smartphone performance and hence improve total earnings.

FIGURE 5: OPTION ANALYSIS FOR SAMSUNG'S TIZEN OS LAUNCH



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