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Ji-Hwan Lee\*

## **Managing Diversified Firms through Socio-Cultural Mechanisms: A Focus on Korean *Chaebols*\*\***

Based on theoretical considerations, this article investigates the socio-cultural mechanisms through which diversified firms are effectively managed without loss of control. Empirical results from extensive questionnaire surveys in Korea and the U.S. show that socio-cultural mechanisms such as shared values and corporate-level training were significantly and positively associated with divisional performance. In addition, socio-cultural mechanisms appear to have unequal effects on the corporate performance in societies with different cultural contexts. Statistical results show that socio-cultural mechanisms worked better in *chaebols* than in large U.S. firms, possibly because such mechanisms positively interact with high-context culture.

Key words: **Diversified Firm, *Chaebol*, Socio-cultural Mechanism, Shared Value, Inter-divisional Interaction**

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## 1. Introduction

Theories from the strategy literature suggest that there is a limit to how much a firm can diversify, and, indeed, many large U.S. firms seem to have reached this limit in the early 1980s. The high level of diversification led to poor performance, and this, in turn led to massive wave of refocusing (Bowman/ Singh 1990; Markides 1995). However, in Korea, most business groups – called “*chaebols*” – have continuously expanded their scope of business, although such trend has been somewhat slowed down since the Asian Economic Crisis in 1997 ~ 1998 (Choi 1996; Choi/Cowing 2002). Moreover, the largest and most diversified groups such as Samsung, Hyundai, SK and LG have been among the most profitable economic entities. In fact, the existence of many highly diversified business groups in emerging economies including Korea has recently attracted the attention of strategy researchers. Studies on developing countries indicated that business groups can be functional substitutes for allocation failures in countries where market mechanisms are inefficient and the transaction costs are high (Leff 1978, 1979; Caves 1989; Granovetter 1995; Khanna/Palepu 1997, 2000).

However, comparative analyses focusing on the managerial – compared to the institutional (North 1990; Wan/Hoskisson 2003; Fauver et al. 2003; Peng et al. 2005) – side of diversification have been neglected in the literature on diversified firms. Suggesting that diversifiers in emerging economies may generate more benefits due to institutional voids (e.g., Khanna/Palepu 2000) does not necessarily mean that they can successfully diversify to a higher level than their counterparts in advanced economies. If diversifiers in emerging economies fail to manage diversification in a cost-efficient way, the benefits of diversification due to institutional voids will be offset or exceeded by the costs of diversification, thereby deteriorating performance. Furthermore, with the rapidly improving market mechanisms in emerging economies, the benefits due to institutional voids may well decrease themselves (Peng et al. 2005).

Bringing the management of diversification back into the picture, this paper tries to explain the seemingly puzzling performance of highly diversified *chaebols* through the lens of the organizational capabilities to maintain integration among numerous, diverse divisions operating in their own competitive fields. Specifically, I focus on the *socio-cultural* mechanisms, which have been increasingly emphasized these days compared to the *structural* ones. While relatively implicit and indirect, socio-cultural mechanisms such as shared values and corporate-level activities may work well to increase the level of integration and resource-sharing within a diversified organization, especially in a society with high-context culture (Hall/Hall 1990) like Korea.

In the empirical section of the paper, I test the actual relevance of the socio-cultural mechanisms to divisional performance with large-sample data obtained from mailing questionnaire surveys in Korea and the U.S.A. I also test whether successful Korean *chaebols* were better in leveraging the mechanisms so that they have been less vulnerable to the costs of diversification compared to large, diversified U.S. firms. The paper concludes with discussions about the empirical findings and limitations, as well as some implications.

## **2. Managing diversified firms**

As proposed for the first time by Penrose (1959), the main limitation to a firm's growth is a managerial one. Furthermore, when a firm pursues growth through diversification, the firm's ability to adapt its administrative structure to larger and broader scales of operation limits its infinite expansion. There are two primary sources of managerial costs of diversification. On the one hand, there are costs of coordinating multiple divisions to achieve synergies (e.g., corporate headquarters – or HQ hereafter – staff may intervene on divisional operations inappropriately, unless they have sufficient information, knowledge and experience on the operation of each division). On the other hand, there are costs associated with control loss as a firm's level of diversification increases (e.g., divisional employees may deliberately hide actual information on divisional-level operations to shirk responsibilities and consume corporate resources).

As Lawrence/Lorsch (1967) proposed in their seminal work, the interaction of the multidivisional structure with the expanding size of the firm hampers integration of different units. This may create conflicts and loss of direction, and leads to mechanic portfolio management. Theoretically, failure in integrating diverse divisions means loss of a critical rationale for running a diversified corporation, because, in that case, the corporation cannot achieve a competitive advantage through efficient exploitation of its excess assets or through creating an efficient governance structure (Hill 1994). The "parenting advantage" by a diversified firm can be accepted only when its performance is better than the aggregate performance that its divisions could realize when they were independent, stand-alone entities (Goold et al. 1994).

This study focuses on the organizational context that affects the performance of diversified firms. Here, "organizational context" refers to a comprehensive mechanism that underpins normal operations within an organization. It has been defined in several studies such as "blending of organizational structure, information systems, measurement and reward systems, career planning, and a fostering of common organizational culture" (Prahalad/Doz 1981: 5) and "sophisticated management systems, the corporate cultural milieu and people" (Hamel/Prahalad, 1983: 347). The following section identifies and examines two major dimensions of organizational context, i.e., structural and socio-cultural mechanisms.

### ***2.1 Structural mechanisms***

In his seminal work on the management of multibusiness firms, Chandler (1962) documented the key administrative problems created in the evolution of four large U.S. companies, and their response to those problems, which is represented by the emergence of the new organizational form: M-form (Multidivisional form) structure. The distinct characteristics of an M-form structure is that 1) responsibility for day-to-day operations is decentralized to the divisions, and 2) the HQ allocates capital resources between different strategic alternatives and monitor the efficiency of divisions. M-form structure was positively revisited and elaborated by Williamson (1975). He emphasized that corporate HQ should be concerned only with strategic and financial

controls giving each division enough autonomy to cope with its own business tasks.<sup>1</sup> Williamson argued against the intervention of HQ in the operations of the divisions, suggesting that when this happened we no longer had a true M-form structure but a “corrupted” M-form structure. Such a structural approach can be summarized as the idea of balancing control (centralization) and autonomy (decentralization), and have increasingly attracted attention with the rapid emergence of the multidivisional structure of large corporations.

The literature on the management of multinational firms may also offer similar insights to the management of multidivisional firms. For example, Bartlett and Ghoshal (1989) and Ghoshal/Nohria (1989) proposed that the “transnational” form of organization is effective because it allows each subsidiary the freedom to differentiate itself according to local demands but at the same time provides a dominant overall integrative mechanism. Here, the basic argument is to find ways to grant each division enough autonomy to make operational decisions suitable for its environment while, at the same time, making sure that integrative mechanisms are in place to exploit interdependencies. Again, one way to do this might be to grant operational autonomy to the divisions while maintaining central control over strategic and financial matters. In an empirical study on divisions of Taiwanese business groups facing strategic ambiguity, which demands conflicting needs for responsiveness and integration, Markides and Chu (1998) found evidence that divisions perform better when they are given a large degree of autonomy on operating decisions but are controlled by their HQ on strategic and financial decisions.<sup>2</sup>

On top of the notion of balancing control and autonomy, the contingency perspective helped to provide new understanding about the basic assumption for good or ill of corporate management. The essence of the contingency approach is that the appropriate management arrangements<sup>3</sup> might differ depending on the situation, that is, different businesses need different sorts of corporate management. According to the result of an empirical study of Taiwanese business groups (Chu/Markides 1997), corporate HQs can indeed use different administrative mechanisms – such as levels of divisional autonomy granted – towards different divisions, but business groups that adopted this differentiated approach did not outperform those that adopted a standardized approach. Among the possible reasons for the result is that the study did not take into consideration the “fit” between the administrative mechanism and each division’s characteristics. Actually, the fit or the optimality of a configuration is the essence of a contingency approach within a diversified firm or a business group (Hill 1990).

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<sup>1</sup> Financial control may be included in the category of strategic control, since decision makings on financial issues are dependent on strategic considerations to a great extent.

<sup>2</sup> These are corporate-level decisions (e.g., decisions on entry and exit, financing, or new investment), not concerned with business-level strategy or budgeting.

<sup>3</sup> The concept of management arrangements are similar to that of the structural context defined by Bower (1970) as the distribution of decision making responsibilities within the organization, along with the measurement systems used to assess the performance of business units and to decide the bonus for the divisional managers.

Hence, it has been suggested that a contingency approach is needed to ensure the fit between management arrangements and divisional situations. Haspeslagh (1982) urged corporate managers to think harder about the requirements of businesses with different strategic missions, and to tailor their administrative approaches to the needs of their businesses. Researchers on the internal control mechanisms of multinational firms also highlighted the significance of internal differentiation (Baliga & Jaeger, 1984; Ghoshal & Nohria, 1989), suggesting that the levels of delegation to different overseas subsidiaries should be based on contingency factors.

The above two streams in the literature eventually propose that one of the most crucial functions of HQ is to keep both the scope and strategic variety of the firms within manageable bounds (Hill 1990). In other words, the corporate HQ should achieve integration while giving autonomy to its divisions to strengthen their own competitiveness. Firms that can manage diversification in a more cost efficient way than others should be able to continue to diversify without adversely affecting performance. Above all, structural mechanisms such as strategic control and contingent compensation arrangements have been suggested, but the empirical results with regard to the effectiveness of those mechanisms are quite mixed (Lorsh/Allen 1973; Salter 1973; Ackerman 1970; Berg 1965, 1973; Vancil 1980; Kerr 1985; Pitts 1974, 1976, 1977; Govindarajan 1986, 1988, 1989; Gupta/Govindarajan 1986; Gupta 1987; Govindarajan/Fisher 1990).

## **2.2 Cultural mechanisms**

Admittedly, a firm is a social entity in which numerous participants and small groups are interrelated. Therefore, in addition to studies of the structural (and mechanic) approaches of management, research streams focusing on social and cultural aspects of organizations have steadily appeared in the management literature (e.g., Ouchi 1980; Deal/Kennedy 1982; Bensaou/Earl 1998). Research on multinational firms has also urged top management to use socio-cultural (other than structural) tools including corporate values and culture, and the positioning of key people (e.g., Hamel/Prahalad 1983; Nohria/Ghoshal 1994). In this paper, I apply these socio-cultural solutions to the management of diversified firms, and shed light on the factors that may contribute to mitigating the costs due to coordination needs and/or loss of control.

### *Shared values*

One of the invisible, but meaningful signs of higher integration might be the “shared” values, visions, goals, and the like among individuals and groups in an organization. A shared vision or a set of common values embodies the goals and aspirations of the members of an organization. It is not surprising that individuals in an organization tend to have their own goals that are only partially overlapping (Barnard 1939). However, with a shared vision, an organization can minimize divergent interests through the socialization process to internalize the organizational goals into the value system of its members (Parsons, 1956). A shared vision is a cognitive dimension of social capital (Nahapiet/Ghoshal 1998), and can be appropriated by the collectivity as a resource (Portes/Sensenbrenner 1993).

This theoretical framework can be applied to a diversified firm. As a firm has more diverse divisions, it is very likely to be more difficult for the top management to effectively allocate its resources and supervise its divisions because of the strategic variety of businesses and possible increases in shirking. Therefore, top management often relies upon formulaic financial criteria to control divisions in an attempt to overcome the bounded rationality problems associated with processing large amounts of information. One possible result of this “management by numbers” is a long-term decline in the competitiveness and profitability of these firms. However, high levels of shared values may alleviate the pressure on divisions to meet short-term financial objectives at the cost of long-term investment.

If divisional need is coherent with the corporate goal, the division is more likely to act as expected by its HQ in line with the whole firm’s interest. In such a case, the cost of diversification will be low thanks to the reduced need for supervision (Etzioni 1965). Creating strong shared values and beliefs between divisional managers and their HQ enables the HQ staff to grant more autonomy to divisions without fear that the divisions will pursue their own interests at the expense of the firm as a whole (Ouchi 1980; Markides/Chu 1998). Moreover, shared visions enhance the sense of mutual interdependence in the organization and can therefore lead to the creation of synergies with less coordination costs. Other manifestations of social and cultural control such as “clan control” (Ouchi 1980), and a strong corporate culture (Deal/Kennedy 1982) also emphasize the effectiveness of shared values in minimizing the opportunistic behaviors within an organization. The positive relationship between shared visions and firm performance has been demonstrated in recent studies on diversified firms (Markides/Chu 1998) and multinational corporations (Nohria/Ghoshal 1994).

Some Korean *chaebols* have tried to develop shared values from the very early stage of their growth. The strong shared values among Samsung’s numerous sub-organizations under its umbrella have been specifically centered on the Secretarial Office – currently, the Office for Corporate Restructuring –, i.e., the corporate HQ, and the people there. Like other *chaebols’* HQs, Samsung’s Office for Corporate Restructuring is not a legal entity. People in the Office belong to different affiliates officially, and their pay and other financial resources for operating the Office come from various affiliates, especially outstanding performers. Under the founder and late chairman Byung-Chul Lee’s strong belief in the importance of human resources, the Office has put higher priority on personnel management, specifically for executive managers. At the end of each year the Office assesses incumbent executive managers as well as candidates – mostly general managers or departmental heads in each affiliate – and announces the new executive constellations in each affiliate for a new year. The Office’s utmost efforts to maintain effectiveness and fairness in personnel management has enormously contributed to its power over affiliates. The Office keeps the career files of outstanding managers in the pool of high-performance talents. Although managers in the pool are generally accepted to have great caliber, the Office requires executive managers to have something more than just business capabilities. The Personnel Committee at the Office scrutinizes every aspect of current and candidate executives before placing them in the affiliates for a new year. The severe selection criteria include people-related skill as well as integrity in private life. People who may ruin Sam-



sung's reputation are ruled out of the list of new executive managers. Therefore, over and above business capabilities, Samsung's executives must pass the strict assessment by the Office to assure that they have strong shared values towards the whole group's long-run future.

Given that the Office for Corporate Restructuring is at the heart of managing Samsung based on the group's core values, it is not surprising that a number of managers who serves the Office are often sent out to the affiliates as CEOs or other top-level executives. As of June 2002, CEOs at about 12 Samsung's major affiliates including Samsung Electronics, Samsung Corporation, Samsung Heavy Engineering, Cheil Communications, Samsung Life Insurance, and Samsung Securities have experiences of working at the Office. During the tenure at the Office, the so-called "Office for Corporate Restructuring alumni" were accustomed to view phenomena, analyze issues, and make decision in the perspective of the whole group. Such embedded perspective facilitates the organic collaboration with the Office and other affiliates by encouraging them to create and offer opportunities that are advantageous to the whole group rather than protecting the interest of any particular affiliate. In a nutshell, the Office has been the champion of Samsung's values and vision, which were spread down to its affiliates naturally due to the corporate HQ's effectiveness and fairness in filtering and placing top managers within the group.

Another *chaebol*, SK, also made huge investment to strengthen shared values among the group's constituents from the early years of its history. SK's unceasing efforts are vividly symbolized by two major initiatives, SKMS (SK Management System) and SUPLEX (Super-Excellence) Quest, which nowadays almost accompany the group's identity. While Samsung has established strong shared values by placing managers with talent and vision into various divisions, SK has tried to form and disseminate clear management guidelines, through which people can communicate and interact with each other in different levels and divisions. SKMS is SK's all-inclusive management doctrine, and SUPLEX Quest is a tool to practice SKMS. They have played the role of a critical leverage in maintaining ties among dissimilar affiliates including acquired ones.

SKMS was initiated by the late chairman Mr. Jong-Hyon Chey in 1975, just over one year after he took up the management of the group. He formulated the "Principles of Business Management" and instructed the Office of the Chairman for Management and Planning – currently, Corporate Management Office – to define and systemize basic business concepts and management factors based on these principles. Whereas SKMS consists of intellectual and mental guidelines of SK's management, SUPLEX is a tool to help managers and other employees to practice and drive SKMS. SK coined SUPLEX, an abbreviation for "super-excellent" meaning the highest performance level attainable with human capabilities. It came out of the needs to put forth the very best efforts beyond any ever put forth before rather than merely emulating current leading companies. SK people recognized that otherwise they would forever trail global leading companies, and never make a world-class company themselves.

SKMS and SUPLEX Quest have made major contribution to SK's successful diversification. Whenever SK established or bought a new company, they have been the axis of integration. People at SK Corporation and SK Telecom, which were originally government-owned and bureaucratic companies, also had to be accustomed to SKMS



and SUPEX Quest right after the takeover. CEOs of SK's major affiliates – 14 companies among 62 in 2004 – gather every two weeks in a confidential meeting called “SUPEX Quest Committee,” which is the most authoritative body for group-level decision-making. It puts great priority on coordination among diverse affiliates or business units (rather than direct intervention in their operations), trying to prevent each affiliate from selfish activities.

On the basis of the above theoretical considerations and anecdotal evidence, I develop the following hypothesis for a statistical test in the next section.

Hypothesis 1a: There is a positive relationship between shared values and divisional performance.

While cultural mechanisms such as shared values may be a positive factor that contribute to the performance of diversified firms, their effects could differ in dissimilar cultural contexts. As the comprehensive work conducted by Hofstede (1983; 2004) identified, societies where collectivism rather than individualism is emphasized, people are born into collectives, such as extended families, with tight ties with each other. In those societies, collective performance and solidarity are more valued than individual achievement and freedom. Hall and Hall's research (1990) also argued that long lasting relationship and deep personal mutual involvement are more valued in a society where high-context culture is dominant, while relationship tends to have short duration and heterogeneity between individuals are widely accepted in low-context culture.

These studies lead me to hypothesize that, in Korea, where the business system is based more on collaborative and coordinated relationships between economic actors than on contracts and legal obligations (Whitley 1999), cultural dimensions such as shared values among within-group constituents are more likely to affect the output of an organization. In other words, because strong shared values are quite an “expected” feeling to most constituents in Korea, the performance of a given diversified firm may vary a lot according to the actual atmosphere in that organization. In contrast, the performance of diversified firms in low-context culture such as U.S. may be more likely to be dependent on factors related to the individual interests and explicit incentives. Thus, I test whether *chaebols* have capitalized on the above mechanism more than large U.S. firms, thereby being able to reduce managerial costs associated with a high level of diversification more effectively.

Hypothesis 1b: Shared values make a greater contribution to divisional performance in *chaebols* than in large U.S. firms.

#### *Inter-divisional interactions*

Inter-divisional interactions in an organization conceptualize more visible mechanisms for social integration than shared visions. The need for using mechanical tools to control divisions will diminish when individuals in different divisions have more opportunities for collaboration and communication, and understand each other and/or the HQ staff well. Therefore, divisions can be given much autonomy and still be kept integrated within the whole group (Markides/Chu 1998).

Transfer or rotation of divisional managers may help top management teams of diversified firms to overcome a single “dominant logic” (Prahalad/Bettis 1986) by ac-

cumulating experiences in strategically dissimilar business fields. Social interactions among different divisions blur the boundary of those divisions, and individuals may gain easier access to other division's information and resources. Consequently, chances are that effective coordination of different divisions can be achieved at a lower cost. In many cases, corporate-level training also provides employees to see senior managers and executives from other divisions. It often provides good opportunities for employees to be picked up and transfer to other divisions within the business group, while maintaining informal ties with their former divisions. The existence of a virtual internal labor market within the business group keeps employees from denying cooperation with other divisions.

Samsung's Office for Corporate Restructuring has developed an advanced internal training system that is often admitted to excel other educational institutions – including business schools – for management in the country. Therefore, being an executive manager at Samsung gives him/her an invaluable credit of being one of the best management talents in the country. That credit is of course quite effective even after he/she has left Samsung for another job. The credibility on managerial capabilities of so-called “Samsung Man” makes it difficult for other stakeholders to resist the Secretarial Office's right and authority in personnel management. As far as high quality managers are provided, no stakeholders in an affiliate can easily ignore the role of the Office for Corporate Restructuring regarding personnel management.

At Samsung, group-level events such as corporate athletic activities are often organized to increase integration among the constituents. Outsiders viewed it as a ritual when around 100,000 employees of Samsung and their families – even local employees at overseas subsidiaries – gathered at Olympic Stadium in Seoul in September 1994 to boost their corporate community spirits. Corporate education often involves hard physical training. When Samsung was entering the semiconductor business, 200 people from different affiliates boarded together at a place for three months, and even had an extreme running of 64km – symbolizing 64K DRAM. They are the people who created Samsung's semiconductor legend, and are now the key managers at Samsung Electronics. “During the program, we built up so-called ‘let's do it together, and we can do it together’ spirits,” recalls an ex-participants.

Training programs at SK Groups' corporate training center, SK Academy, aim largely to develop and teach the ideas of SKMS and SUPLEX to newcomers to the group after acquisitions or recruitments. Regardless of the positional level, all employees and executives are required to study and discuss SKMS and SUPLEX at SK Academy administrated by the Corporate Management Office. Understanding and even memorizing SKMS and SUPLEX is a must for promotion to a higher position at most SK companies. SK sees that cooperation within a company is relatively well attained, while coordination among different affiliates entails longer hours for problem-solving and even tends to threaten the whole group's survival. An executive at SK Telecom believes, “With SK's recognition that inefficient communication often hinders coordination among different organizations, SKMS and SUPLEX have made it possible for managers in different affiliates to have a clear definition of each management field and increase the efficiency in communicating with each other.”

SKMS and SUPEX are written and taught in English and Chinese as well according to SK's increasing global presence, even though SKMS does pinpoint the importance of adaptation to the local environment. SK Academy runs a special training program called SUPEX Tour, for which local employees – mainly Chinese at the moment – at offshore branches or subsidiaries are flown in Korea to study SKMS and SUPEX and hopefully share the group's values and vision.

On the ground of the above arguments and observations, I develop the following hypothesis to test the effects of inter-divisional interactions in four aspects, i.e., rotation of managers, collaboration between divisions, communication between divisions, and corporate-level training programs.

Hypothesis 2a: There is a positive relationship between inter-divisional interactions and divisional performance.

Here once again, I also test whether *chaebols* – as organizations in a high-context culture – could capitalize on the above mechanism more than large U.S. firms, thereby having been able to reduce managerial costs associated with a high level of diversification more effectively.

Hypothesis 2b: Inter-divisional interactions make a greater contribution to divisional performance in *chaebols* than in large U.S. firms.

### 3. Empirical analyses

Before addressing my empirical methods, it might be useful to touch an issue here about the difference between *chaebols* and U.S. diversified firms in term of organizational structure, and to clarify the aim and focus of this paper. Although *chaebols* are undoubtedly classified as “diversified” firms, their typical organizational structure is somewhat different from that of U.S. diversified firms. In the U.S.A. a diversified firm normally has multiple divisions within a legal corporate boundary or has almost 100% shareholdings of its subsidiaries, whereas in Korea *chaebols'* subsidiaries are legally independent entities that are affiliated with each other through hierarchical control pyramids (Hwang 1999). In a typical hierarchical pyramid, owner families are the largest shareholders of a few core companies virtually functioning as holding companies, and those core companies own the largest share of other affiliates. This “chained” ownership as well as cross-shareholdings among affiliates allows owner families to enjoy “leverage effect” in controlling a huge business group without owning majority shares of all affiliates.

This type of structure is not unique in Korea, but quite common in many developing countries as well as in some advanced countries such as Canada, France and Belgium (Ghemawat/Khanna 1998). Nor does it have to allow *chaebols* to have a more efficient control mechanism; It is actually an empirical question. A hierarchical control pyramid is also not immune to the costs of coordination and control occurring in the process of diversification. Even though most *chaebols* have shareholding structure different from that of U.S. diversified firms, this paper does not aim to verify in general the relative efficiency of a hierarchical pyramid vis-à-vis a pure M-form structure (Williamson 1975). Despite the difference in shareholding structure between *chaebols* and U.S. diversified firms, the theoretical development regarding the management of diversification can be applied to both types of structures – i.e., a hierarchical pyramid

and a pure M-form – because firms with either type of structure constantly face a common issue of managing diversified organizations.

### 3.1. Sample

Every year, the Fair Trade Commission of the Korean government publishes a list of the top 30 big business groups according to the amount of aggregate assets held by all affiliates of each business group.<sup>4</sup> The report released in April 1998, based on the figures as of the end of 1997, identified 804 companies affiliated with the top 30 *chaebols*.<sup>5</sup> Those affiliates are considered divisions of *chaebols*. I developed and sent questionnaires to the top managers of 525 companies. 279 companies were excluded due to difficulties in obtaining information on addresses, names of top manager, or basic financial statements. Most of the excluded companies were quite small in terms of size, and many of them were not on operating normally – i.e., they were soon to be closed, or just established.

Out of 525 questionnaires sent out, 129 (24.6%) were returned from 28 *chaebols*, and 116 (22.1%) of them were usable. I tested for response bias by comparing the size (sales in 1997) and profitability (return on sales in 1997) of affiliates whose managers responded to the questionnaire (129 affiliates) versus affiliates whose managers did not (396 affiliates).<sup>6</sup> The test detected no bias between the two groups.

Like in most comparative studies, identifying an equivalent sample was a crucial task of this study. Given the focus of this study in diversification of large business entities, I chose the U.S. sample from the list of *Fortune* 500 U.S. firms in 1998. Among them, 78 firms operating in more than three 2-digit SICs, except those whose primary businesses were financial service, were chosen. A total of 510 questionnaires were posted, 92 (18%) from 43 firms were returned, and 78 (15.3%) of them were usable.

In the U.S. case, however, response bias could not be tested in the same way I did with *chaebols*. Unlike *chaebols'* affiliates, U.S. diversified firms' divisions are rarely legally independent entities that produce their own financial reports. Although some firms report their financial status by major industry segments, it hardly corresponds to financial status by divisions because multiple divisions often contribute to financials of an industry segment. Therefore, it was difficult to compare financials of divisions whose managers responded to the questionnaire with divisions whose managers did not. Alternatively, as a sub-optimal choice, I compared the size (sales in 1997) and profitability (return on sales in 1997) of firms in which at least one divisional manager responded to the questionnaire (43 firms) versus firms in which no divisional managers at all did (35 firms). The results showed no response bias.

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<sup>4</sup> This survey excluded government-owned corporations and financial service groups.

<sup>5</sup> Therefore, I regard “a business group (*chaebol*)” and “its affiliates” in Korea as equivalents to “a firm” and “its divisions” in the U.S.A., respectively.

<sup>6</sup> At the end of the questionnaire I included auxiliary questions about respondents name, position, company, and contacts. In case they didn't reveal the information, I identified the company to which any specific respondent belonged by looking at reference numbers I had inserted in each questionnaire.

In reality, it was not expected that many responses would be received directly from top managers. Therefore, in both countries, I asked top managers (or their secretaries who were supposed to receive the questionnaires) that if the top managers could not fill out the questionnaires, they should pass them onto executive directors or seniors managers who had been in the company for more than three years. This alternative way of data collection was proved to be reliable and valid (Shortell/Zajac 1990).<sup>7</sup>

### 3.2 Measures

I measured each variable for my empirical analysis as follows. First, divisional performance was measured by respondents' perceptions. Although it could involve problems due to the subjectivity of the answers, previous empirical studies employed such a subjective measure because divisional managers' perception may well to represent the actual performance of the organization he/she is in charge of (Gupta/Govindarajan 1986; Hill 1988a, 1988b, 1988c; Markides/Chu 1998). Accounting performance such as industry-adjusted ROS was widely used but also had limited utility, because divisions may emphasize other criteria than profitability according to their own strategic missions within the firm (Govindarajan/Fisher 1990). In addition, I found difficulty in obtaining accounting performance of divisions of U.S. firms because most of them do not produce separate financial reports for their divisions. Therefore, instead of accounting performance, I measured performance by respondents' perceptions in two ways: 1) how the respondent would rate the performance of his/her own subsidiary, relative to that of the major competitors; 2) how much the group HQ seems to be satisfied with the performance of the respondent's subsidiary. These two scales ranged in value from 1 to 5, where higher values represent better performance.

Next, "shared values" was operationalized by ten items that represent the extent to which divisional members recognize the existence of strong and distinctive values towards the integrative organizational context of the firm or business group.<sup>8</sup> A five-point scale was used to ask the respondents to indicate the degree of agreement, ran-

<sup>7</sup> I included in the questionnaire three questions to see if the Asian financial crisis at the end of 1997 resulted in any significant change in *chaebols'* organizational context. Their answers showed no change.

<sup>8</sup> The items asked in the questionnaire are (In the Korean questionnaire, "group" was substituted for "firm"):

- 1) We prefer internal promotion to recruiting someone from outside my firm for a mid-level position.
- 2) When deciding the replacement or promotion of an individual, the candidate's personality and attitude are critical factors for consideration.
- 3) We know what kind of people will succeed and what kind of people will fail in my firm.
- 4) We can clearly feel the existence of strong corporate culture.
- 5) We know clearly what our corporate culture is.
- 6) Outsiders often point out the strength of our corporate culture.
- 7) Different divisions have different cultures in my firm.
- 8) Our employees display high level of commitment to the whole firm.
- 9) We have corporate-level events that are held regularly (e.g., athletic competition).
- 10) People in my firm use special terminology and ways of communication which may be difficult for outsiders to understand.

ging from “Strongly disagree” (=1) to “Strongly agree” (=5). Finally, as mentioned earlier in the paper, “inter-divisional interaction” was operationalized in terms of four dimensions: rotation of managers, collaboration between divisions, communication between divisions, and corporate-level training program. The level of collaboration was measured by the responses to four questions, while the levels of communication, rotation of managers, and corporate-level training programs were quantified by the responses to three questions, respectively.<sup>9</sup> Again, a five-point scale was used to ask the respondents to indicate the degree of agreement, ranging from “Strongly disagree” (=1) to “Strongly agree” (=5).

### 3.3 Results

Descriptive statistics and bivariate correlations for all samples are shown in Table 1. Reliabilities of multi-item scales measured by Cronbach’s alpha are also noted where applicable and every coefficient has acceptable value. Meanwhile, Tables 2 and 3 show descriptive statistics for Korean and U.S. samples, respectively.

**Table 1: Means, Standard Deviations, Pearson Correlations, and Reliabilities<sup>a</sup> (All Samples)**

	Mean	s.d.	1	2	3	4	5	6
1. Shared values	3.64	0.45	(.78)					
2. Rotation	2.96	0.93	.47**	(.86)				
3. Collaboration	3.46	0.71	.54**	.49**	(.72)			
4. Communication	3.64	0.71	.64**	.46**	.59**	(.88)		
5. Training	3.31	0.92	.51**	.47**	.54**	.52**	(.85)	
6. <i>Chaebol</i> (dummy)	0.60	0.49	.17*	.43**	.07	.01	.17*	
7. Performance	3.60	0.93	.37**	-.12	.10	.15	.19**	.25*

<sup>a</sup>  $n = 194$ ; Where applicable, Cronbach’s alpha is noted in parentheses on the diagonal.

\*  $p < 0.05$

\*\*  $p < 0.01$

<sup>9</sup> The items asked in the questionnaire are as follows:

- 1) We share information on customers and suppliers with the corporate HQ and other divisions.
- 2) We have R&D centers that belong to the whole company, not to a particular division.
- 3) We share R&D outputs with other divisions.
- 4) Conflicts between divisions are mediated by the corporate HQ.
- 5) We have a corporate magazine and a corporate newsletter.
- 6) The meetings between divisional managers and corporate HQ are generally effective.
- 7) Managers from different divisions get together and talk to each other often.
- 8) We have a formal rotation system for divisional managers.
- 9) We are accustomed to transferring engineers and managers between divisions.
- 10) People show hostility to a new manager transferred from another division.
- 11) The corporate HQ is committed to organizing training sessions for employees to help them adapt to their new working environment.
- 12) People in my division participate in corporate-level training sessions regularly.
- 13) We have corporate-level training centers.



**Table 2: Means, Standard Deviations, and Pearson Correlations<sup>a</sup> (Korean Sample)**

	Mean	s.d.	1	2	3	4	5
1. Shared values	3.70	0.48					
2. Rotation	3.29	0.71	.50**				
3. Collaboration	3.50	0.65	.69**	.61**			
4. Communication	3.65	0.66	.74**	.53**	.67**		
5. Training	3.43	0.91	.61**	.47**	.60**	.59**	
6. Performance	3.50	0.97	.52**	.43**	.34**	.37**	.52**

<sup>a</sup>  $n = 116$ \*  $p < 0.05$ \*\*  $p < 0.01$ **Table 3: Means, Standard Deviations, and Pearson Correlations<sup>a</sup> (U.S. Sample)**

	Mean	s.d.	1	2	3	4	5
1. Shared values	3.54	0.39					
2. Rotation	2.47	1.00	.40**				
3. Collaboration	3.40	0.80	.34**	.44**			
4. Communication	3.63	0.80	.53**	.48**	.52**		
5. Training	3.12	0.91	.30**	.43**	.47**	.45**	
6. Performance	3.73	0.86	.15	-.11	-.07	-.06	-.12

<sup>a</sup>  $n = 78$ \*  $p < 0.05$ \*\*  $p < 0.01$ 

Tables reporting the results of the OLS regression analyses on divisional performance are presented in Table 4. The equations include many interaction terms for testing my hypotheses. Some studies address the multicollinearity issue when interaction terms are included in the regression equation (Dewar/Werbal 1979; Drazin/Van de Ven 1985). However, it is not a serious problem when we are more interested in testing the significance of interaction than in measuring the exploratory power (noted as  $R^2$ ) of the equation (Allison 1977; Arnold 1982).

Table 4 shows the results of regression analysis for the hypotheses regarding socio-cultural mechanisms. Specification 1 proves that the level of shared values existing in a division is significantly and positively associated with divisional performance, strongly supporting Hypothesis 1a. Hypothesis 1b that expected the interaction effect of shared values and *chaebol* dummy is also supported (Specification 2), while the level of shared values alone is now not significant.

Among the four variables to capture inter-divisional interactions, only corporate-level training is significantly and positively associated with divisional performance in the full sample (Specification 3). As far as the interaction between inter-divisional interaction and *chaebol* dummy is concerned, rotation of managers among divisions and corporate-level training were proved to be significantly and positively associated with the performance of *chaebols'* divisions (Specification 4). The results were basically the same when I included shared values and inter-divisional interaction together in a regression equation (Specifications 5 and 6).

**Table 4: Multiple Regression Results for Divisional Performance<sup>a</sup>**

Variable	1	2	3	4	5	6
	H1a	H1b	H2a	H2b	All variables	Including interaction terms with <i>chaebols</i>
<i>Chaebol</i> <sup>b</sup>	-.36***	-2.92***	-.36**	-	-.44***	-2.73**
Shared Values	.83***	.34			.93***	.64**
Shared values × <i>Chaebol</i>		.71**				.25
Rotation			.06	-.07	.02	-.12
Rotation × <i>Chaebol</i>				.44**		.47***
Collaboration			-.04	-.01	-.13	-.02
Collaboration × <i>Chaebol</i>				-.16		-.32
Communication			.07	.03	-.18	-.10
Communication × <i>Chaebol</i>				.05		-.11
Training			.24***	-.09	.18**	-.09
Training × <i>Chaebol</i>				.55***		.47***
$R^2$	.17	.20	.09	.23	.20	.29
Adjusted $R^2$	.16	.18	.07	.19	.17	.25
F	19.55***	15.30***	3.96***	5.91***	7.67***	6.75***

<sup>a</sup>  $n = 194$ <sup>b</sup> Dummy variable: 1 = *chaebol*, 0 = U.S. firm\*  $p < 0.1$ \*\*  $p < 0.05$ \*\*\*  $p < 0.01$ 

#### 4. Discussion and conclusion

This article examined the relationship between organizational context and performance of diversified firms. Among numerous dimensions that consist of organizational context in a large, diversified firm, the level of decentralization must be one of the most fundamental ones. Given the imperatives to allow divisional autonomy to the extent that the divisions can respond timely to the environmental changes and strategize effectively in their own competitive field, maintaining integration in the corporate level is getting more and more elusive.

My empirical results showed that socio-cultural mechanisms such as shared values and corporate-level training appeared to have a positive effect on divisional performance. The empirical analyses also tell us that the socio-cultural mechanisms for balancing empowerment and integration have worked better in *chaebols* than in large U.S. firms. Shared values among divisions as well as corporate-level training and rotation of managers were more significantly associated when used in *chaebols*. This implies that *chaebols* that had higher level of shared values and used corporate-level training and rotation of managers more actively have been very likely to outperform those that did not. Another possibility could be that in U.S. firms organizational context and the role of HQ in the corporate level are less important than the capabilities in, for example, product innovation or cost leadership in the divisional level. If this is true, diversified firms will be less viable in the U.S.A. unless they have some other mecha-

nisms that have not been captured by academic research. Exploration of those possibilities will be a valuable agenda in the future research.

Previous practices and research have developed various management arrangements – with regard to performance appraisal, incentive bonus, etc. – for granting autonomy without losing control. Although the structural approach might be easier to implement than cultural one, its effectiveness hardly tends to capitalize due to opportunistic behavior and even cheating by numerous people within an organization. While trying to find out how to overcome those mechanic tools, managers need to increasingly adopt cultural ones. Anecdotal evidence in this paper shows that *chaebols* that have made deliberate efforts to build up and maintain strong shared values have been quite successful in managing diversity among different divisions. Thoughts are still around that many *chaebols*' successful diversification was assisted by institutional voids and/or government support in the emerging economies settings (e.g., Khanna/Palepu 1997). Nonetheless, it should not be overlooked that competitive *chaebols* began to make huge invest in establishing control mechanisms to integrate diverse divisions and maximize the advantage of being diversified business firms from the early years of their growth.

Despite every attempt I made to reach the above findings, there still exist some limitations, especially those inherent to the statistical analysis. First, the divisional (affiliate) level statistical tests do not sufficiently address the relationship between diversification and performance in the corporate (business group) level. While *chaebols* consist of legally independent affiliates with own governance structure including board of directors, each *chaebol* behaves like one large firm. Given the limited number of *chaebols* not so enough to run statistical equations as well as the increasing size gap between larger and smaller *chaebols*, it would not be easy to generalize the results from corporate level quantitative studies for the time being. Nonetheless, as we expect to have more reliable “consolidated” financial statements of *chaebols*, it would be worth trying to gather and analyze quantitative data in the level of an entire *chaebol* (rather than that of affiliates), especially in view of the internal managerial mechanism coordinated by HQs.

Second, given the probable dynamic and bilateral interactions between variables, possibility of reverse causal relationship between several variables also needs to be examined. For instance, contrary to the causality shown in regression equations, divisions with good performance somehow could have high levels of shared values. In a similar vein, *chaebols*' exceptional performance due to some other behind factors (say, crony capitalism) during a certain period could affect institutional uniqueness and management practice. Such possibilities of reverse causality will be able to be examined by developing and testing additional hypotheses based on observation through more in-depth methods such as ethnographical study. In addition, testing hypotheses with richer data for multiple time points would also contribute to conducting more rigorous analyses and extruding robust results.

Third, it is possible that differences between people in the manner of responding to questionnaire could have affected the survey results, creating a serious problem in comparison. If there remains a systematic difference between Korean and U.S. managers in willingness to reveal their own situations and views, the statistical results may

be biased. Although I obtained a good deal of respondents to minimize bias due to such a discrepancy, it would have been quite useful to check such a possibility by asking some other auxiliary questions for measuring attitude or disposition of managers in the two countries with different cultures.

Throughout the paper, I focused on the managerial competence of the organizations. The future of large, diversified *chaebols* will be largely dependent on their competences in managing diversity rather than numeric levels of diversification. As the institutional context in developing economies evolves and the transparency of economic activities improves, diversifiers' advantage due to institutional voids will dwindle. Accordingly, managerial competences will become a more critical lever to create values in the future. *Chaebols* lacking those competences may well suffer from declining performance as many U.S. conglomerates experienced in the early 1980s, and will be forced to refocus or fail. At the same time, we should also remember that well-managed, premium conglomerates do exist all over the world including advanced economies, and that refocusing is not a panacea for all diversified firms.

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