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Billionaire Chung Shows Hyundai Luxury No Joke Chasing BMW: Cars

By John Lippert, Alan Ohnsman and Rose Kim - Mar 1, 2012
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Hyundai Motor Co. (005389) Chairman Chung Mong Koo crosses the stage for his New Year's address, his heels clicking as 600 employees wait in silence.

Wearing a blue pinstriped suit, blue sweater and red tie, the 73-year-old son of Hyundai's founder praises workers for building the world's fifth-largest automaker. Then he considers the year ahead. Europe's debt crisis will trim global growth, Chung says, yet he sees a bright side: Hyundai will have time to improve quality to take on the likes of BMW and Mercedes -- making a full-speed run at becoming what he calls an ilryu giup, a global top player, Bloomberg Markets magazine reports in its April issue.

"We have the unyielding will to make challenges into opportunities," he says. The throng assembled at Hyundai's Seoul headquarters applauds.

With unbridled ambition, clout unmatched in most executive suites and workers who labor more hours than almost any on earth, Chung has fashioned Hyundai Motor Group into South Korea's second-biggest chaebol and elevated the motor company to its centerpiece.

Hyundai and its Kia Motors Corp. (000270) affiliate are the most profitable of the world's top six automakers, with a combined operating margin of 9.21 percent. Chung has dashed preconceptions -- and jokes -- about Hyundai's quality by winning buyers from Mumbai to Los Angeles. Those customers kept factories that make Hyundai models humming at 104 percent of planned capacity last year.

Excel to Equus

Once known as the builder of cheap, utilitarian urban cars like the $4,995 Excel subcompact, Hyundai has emerged as an industry contender. It makes vehicles in nine countries with a 2012 lineup that includes the $12,545 Accent and the $59,000 Equus premium sedan. Its Elantra compact won acclaim in January when Detroit automotive journalists named it North American Car of the Year.

At the Namyang research center 30 miles (48 kilometers) southwest of Seoul, Hyundai is looking toward a future of luxury models and green technologies. Some 250 engineers dedicated to fuel cells hold hundreds of patents on the battery-like devices that combine hydrogen and oxygen to make electricity that will power cars and leave behind only heat and water.

'Working Night and Day'

As Hyundai's momentum grows, it's challenging conventional wisdom about management, governance and investor relations -- and evolving a model of capitalism that straddles East and West.

"Chung is working night and day to prove the Koreans are as good as anybody," says Kishore Mahbubani, dean of the Lee Kuan Yew School of Public Policy at the National University of Singapore. "This is drive and determination of the first order. It's helping shift the weight of history back to Asia."

Dead last in J.D. Power & Associates quality surveys in 1994, Hyundai Motor spent years as fodder for late-night comedians. Chung, whose father built postwar Korea's bridges and expressways, took over in 1998. He bought Kia from creditors during a bankruptcy auction that year and insisted his cars would match the quality of Toyota Motor Corp. (7203) He backed that claim with a 10-year engine warranty, still among the industry's longest.

In 2004, he scrapped the boxy look of a prototype for the Genesis luxury sedan in favor of a crouching, athletic style -- later luring Bavarian-born Peter Schreyer, the designer of Audi AG's TT Coupe, to overhaul Kia's lineup.

In 2005, as Korea's won strengthened against the U.S. dollar, Chung ordered cost cutting to ensure the automaker would earn money even if the won surged. The company opened its first U.S. assembly plant that year.

Jewel of the Chaebol

By 2011, Hyundai Motor had become the jewel among the 63 companies in the chaebol, the family-controlled conglomerate that reported 129.6 trillion won ($115.9 billion) in revenue in the year ended that April.

The carmaker's profit increased 35 percent to 8.1 trillion won in the 2011 calendar year; revenue climbed 16 percent to 77.8 trillion won. Operating profit margin was triple Toyota's 3.08 percent, according to data compiled by Bloomberg.

Investors are taking note. Hyundai Motor shares more than tripled since Lehman Brothers Holdings Inc.'s September 2008 bankruptcy, trading at 216,000 won on Feb. 29.

During that time, U.S. carmakers cut 100,000 jobs, or one in seven. General Motors Co. (GM) and Chrysler Group LLC struggled through bankruptcy as Toyota wrestled with an 8-million-vehicle recall for unintended acceleration, earthquakes and floods.

Riding the Surge

Vehicle sales at Hyundai and 34 percent-owned Kia climbed 56 percent from the end of 2008 through the end of last year, faster than those of any major automaker.

“I’m quite comfortable Hyundai will continue to outperform its peers in a highly competitive market,” says Christopher Yip, an analyst in Hong Kong for Baltimore-based T. Rowe Price Group Inc. Yip’s firm began investing in Hyundai Motor in 2004 and held 650,612 shares on Sept. 30.

Chung is riding the surge. The value of his public stockholdings in five companies in the Hyundai chaebol was $6.01 billion on Feb. 29. The shares of his only son and heir apparent, Chung Eui Sun, 41, totaled $2.4 billion, Bloomberg data show.

In its growth drive, Hyundai Group has stirred up some investor concerns. Standard & Poor’s complained in August that Chung’s crossholdings in chaebol companies let him handpick directors. Shareholders question whether last year’s $4.4 billion purchase of Hyundai Engineering & Construction Co. (000720), which builds subways in the Philippines and power plants in Iraq, was a stroke of business acumen or a ploy to gain the upper hand in a family feud. And no one can assess how Eui Sun will perform when he becomes chairman because his father keeps him on a tight leash.

‘Total Control’

Even with these caution flags, Maryann Keller, who covered the auto industry for Wall Street firms for four decades, says one shouldn’t count Hyundai out.

“Nobody should underestimate Chung,” says Keller, who’s now an independent consultant in Stamford, Connecticut. “He has total control, and he’s determined to use great design and leading-edge technology so he won’t get left behind.”

Ultimately, Chung may do in cars what Korea’s No. 1 chaebol, Samsung Group, has accomplished in televisions: push Japanese rivals into decline, says Kei Nihonyanagi, a Barclays Capital analyst in Tokyo. From 2004 to 2010, Sharp Corp. and Sony Corp. (6758) cut their LCD TV prices by almost two-thirds to match Samsung, Nihonyanagi says.

“The key management issue for Japanese automakers is to again surpass Hyundai in cost and quality,” he says.

‘Japanese Were Complacent’

Mazda Motor Corp. Chief Executive Officer Takashi Yamanouchi knows the Hyundai juggernaut. He says the Japanese underestimated Chung and then further lost out when the yen strengthened 27 percent against the dollar from Lehman’s demise to March 1. That meant they couldn’t block Hyundai with low prices.

“As Hyundai came out with high-quality products, the Japanese were complacent,” Yamanouchi says.

Volkswagen AG (VOW) CEO Martin Winterkorn praises Hyundai for doing what his company can’t. In a video that’s gone viral, Winterkorn was filmed in September seated in Hyundai’s i30 hatchback at the Frankfurt Motor Show and lauding the adjustable steering column.

“Nothing rattles,” he says. “Why can they do it? BMW can’t. We can’t.”

‘Stop the Koreans’

The ever-ambitious Chung is making a run at Bayerische Motoren Werke AG (BMW), the world’s top luxury-car seller. At the Chicago Auto Show in February, the company showed off a concept car that hints at its strategy for building a direct competitor to the BMW 3-Series, the top-selling premium compact. The Kia GT features a low-slung front end and a 3.3-liter V-6 engine generating 390 horsepower -- just 40 hp less than the 6.2-liter V-8 in Chevrolet’s base-model Corvette.

Hyundai’s Genesis sedan comes with a 3.8-liter, 333-hp V-6, an eight-speed automatic transmission and a $34,200 price tag. Similar models from BMW and Daimler AG (DAI)’s Mercedes cost at least $5,000 more.

“Genesis has taken away enough buyers from other brands to establish Hyundai as a real player in the luxury market,” says Alexander Edwards, president for automotive research at San Diego-based Strategic Vision Inc. “In five years, if history is any guide, BMW and Mercedes could be asking, ‘How are we going to stop the Koreans?’”

Fuel Cells

Hyundai is already challenging Daimler -- the inventor of the first mass-produced internal combustion engine 127 years ago -- in an area where the German company claims leadership: fuel cells. By the end of 2012, Yang Woong Chul, vice chairman for research, expects Hyundai to produce 2,000 fuel-cell vehicles a year at about $100,000 apiece, or twice the price Toyota plans to charge when its cars come out in 2015. Hyundai could match Toyota’s price by 2015, when production could grow to 20,000, he says.

As recently as 2005, Honda Motor Co. (7267) said it was spending $1 million for hand-built fuel-cell prototypes. Yang predicts costs will decline to less than $50,000 as production increases. If he's right, and if governments support fuel cells with hydrogen-pumping stations, they could become the first full- blown replacement for internal combustion engines.

Christian Mohrdieck, Daimler's director for fuel-cell development, says his company confirmed its fuel-cell supremacy with 18,600-mile, four-continent test drives last year.

"If we didn't do anything on fuel cells or hybrids, then you may imagine our company just makes reliable cars," Yang says. "We don't want to remain that way. We like to be a technically innovative company."

Helicopter to Dangjin

Chung, a vigorous septuagenarian who has been test-driving fuel-cell prototypes, sets a pace that keeps Hyundai hopping. He arrives at the 21-story twin-towers headquarters at 6:30 most mornings, prompting executives to rush to their desks by 6:20. Salarymen, the middle managers in gray or black sweaters, leave after sundown.

Engineers feel pressure 6,000 miles away in Costa Mesa, California. Erwin Raphael, director of engineering and quality at Hyundai Motor America, says his department responds almost daily to queries from Chung and other executives about existing or potential problems. In a similar Chrysler job, Raphael heard from top management once or twice a quarter, he says.

Chung personally heads monthly quality reviews with senior executives -- and sets high expectations.

"Every engineer, any quality problem they have, they have to bring it up in front of the chairman," Yang says. "They have to come with solutions."

'Like a Tank'

When Hyundai Steel Co. (004020), the sister company that supplies metal for a third of Hyundai vehicles, was building three blast furnaces, Chung supervised. He took a helicopter 40 miles to Dangjin three or four times a week to oversee the $8 billion effort, says Cho Won Suk, senior executive vice president.

On a smoggy January afternoon in Dangjin, ore carriers from around the world line a dock on the Asan Bay. Conveyor-borne buckets drag out iron, coal and limestone. Blast furnaces tower like 20-story Thermos bottles. Trucks with steel for Chung's cars rumble through the gate.

Chung is reprising the strategy of Henry Ford, another innovator who owned the steps of production. Without furnaces, Hyundai would be at the mercy of Posco (005490), Korea's largest steelmaker, and of a fluctuating won that could make importing expensive, says Kim Gyung Jung, an analyst at Eugene Investment & Securities Co. in Seoul.

"He's like a tank," Kim says. "His insight is very strong."

In the Pines

Key ingredients of Hyundai's strategy are on display among the pine forests of the American South.

Here, Hyundai imports components from Asia and snaps them together with low-wage firms, including chaebol member Hyundai Mobis (012330), the world's No. 8 automotive supplier. With 2,650 workers making 1,370 cars each day, the Montgomery, Alabama, Hyundai Motor plant has the highest productivity of any North American vehicle assembly factory, an entrance-hall banner citing Harbour & Associates announces. Ron Harbour, president of the Harbour & Associates unit of Oliver Wyman, declined to comment.

At nearby Hyundai Mobis, some 1,000 workers build chunks of cars called modules -- a chassis with suspension and brakes or a cockpit with a steering wheel, an air conditioner and air bags. A quarter of the value of Hyundai vehicles is tied up in the modules, more than at any competitor, senior production control manager Chung Daero says.

Cleaning Up

On a December afternoon, Mobis trucks loaded with modules head to Hyundai Motor every few minutes. Robots deliver them to assembly lines and fit them into partially built vehicles without human contact.

Mobis saves Hyundai money by paying workers $11 an hour to start, compared with $15.50 at Hyundai Motor, 11 miles away.

After importing chassis components from Korea and radios from China, 34 percent of the value of Elantras sold in the U.S. originates in the U.S. or Canada; Toyota's Avalon leads the industry at 85 percent from those two countries.

At the Kia plant in West Point, Georgia, gray buildings sprawl for almost a mile along Interstate 85. Inside, workers use forklifts, robots and stamping presses from Chung's companies to build sedans and SUVs. Brooms with employees' names rest near posters that say "Cleanliness is the first step to zero defects."

Veloster Frenzy

Hyundai demands such attention to detail in its 20 assembly plants worldwide. It also requires workers to adjust on the fly. In the 1970s, special Toyota teams labored for months to save workers incremental steps between tasks on assembly lines. Hyundai, in comparison, leans toward frenetic re-engineering. That approach paid off last year, when Hyundai introduced a non- hydraulic dual-clutch transmission on the $18,060 Veloster hatchback.

Ford Motor Co. (F) had already selected the same transmission and then tumbled in Consumer Reports' reliability survey because of jerky shifting at low speed.

Alarmed, two dozen Hyundai engineers began reprogramming onboard computers that control gear shifts, Raphael says. They worked around the clock for three weeks straight before the Veloster went on sale, accomplishing up to 18 months of normal development. Shin Jong Woon, the automaker's quality vice chairman, got daily reports and test-drove modified cars.

By January, Velosters were selling so fast that Hyundai had a 13-day supply compared with the industry average of 34 for all 2012 models, according to automotive website Cars.com.

On a grander scale, Hyundai is shaking up notions about management and governance. And, along with Samsung, it's evolving a form of capitalism that blends the competition of the West with the government backing of Asia, notably China.

Rich and Glorious

For decades after World War II, U.S.-style capitalism -- rooted in private enterprise and lightly regulated markets -- towered over the world economy. In 1989, as the Berlin Wall fell and the Dow Jones Industrial Average (INDU) embarked on an 11-year climb that quintupled its value, economist John Williamson of the Institute for International Economics dubbed the embrace of free-market economics the Washington consensus.

Even as Williamson spoke, a competing system was taking hold in Asia. In 1992, a quote attributed to Chinese leader Deng Xiaoping -- "To be rich is glorious" -- helped unleash long- dormant potential. By 2004, China's economy was growing 9.5 percent annually, almost triple the U.S. pace.

At the Foreign Policy Centre in London, journalist Joshua Cooper Ramo coined the phrase Beijing consensus. He chronicled China's willingness to experiment with private property and free enterprise to the extent the regime's need for political stability would allow.

Korea's Path

Korea navigated its own distinctive path, says Yasheng Huang, a business professor at Massachusetts Institute of Technology's Sloan School of Management.

Beginning in the 1950s, a succession of presidents showered cheap financing and favorable tax policies on Hyundai and the other chaebols they chose as cornerstones of national growth. Hyundai Group founder Chung Ju Yung used a government-sponsored loan to buy 82 acres (33 hectares) in the southeastern city of Ulsan for what is now the world's largest automotive assembly plant.

Government support continues today. In the past two years, South Korea signed free-trade agreements that eliminate tariffs on automotive exports into the U.S. and European Union. Japanese automakers still pay tariffs of 2.5 percent into the U.S. and 10 percent into the EU, Yamanouchi says.

Unlike its Chinese counterparts, Hyundai was determined to export, forcing the company to hone its skills head-to-head with entrenched competitors like GM in their home market.

"Export meant you were operating in an extremely competitive environment," Huang says.

'Top-Down Management'

Hyundai also copied the Japanese, says John Shook, chairman of the Cambridge, Massachusetts-based Lean Enterprise Institute, which consults on efficiency. The Chinese, in comparison, were slow to export or establish global brands; the U.S. and Japanese were buffeted during the recent recession, he says.

"State capitalism, or the support they receive from Korea's government, is part of the Hyundai story," Shook says. "Their top-down management system has obvious advantages in terms of speed."

Some investors say Korea's capitalism needs more Western- style governance and transparency.

Kim Byung Kwan, an analyst at Mirae Asset Securities Co. in Seoul, worries about Chung's purchase last year of Hyundai Engineering.

Coffee Shops

"We're concerned about Hyundai buying companies that really don't affect its core motor business, because we don't know what they're going to buy next," Kim says. Affiliates of Kim's company, including Mirae Asset MAPS Investment Management Co., owned 595,428 Hyundai Motor shares on Sept. 30.

As presidential politics heat up before the December election, Koreans are questioning whether chaebols have too much clout and whether their ties to government are too strong. At Hyundai, a

Seoul court in 2007 convicted Chung of selling chaebol securities to his son at below-market prices. First, the elder Chung received a three-year suspended sentence. Then in 2008, Korean President Lee Myung Bak, a former Hyundai executive, pardoned him.

Last year, a company for which Chung's eldest daughter, Chung Sung Yi, acts as an adviser set up coffee shops in Hyundai headquarters and at a company-owned resort. Some Koreans blasted Hyundai for nepotism and crowding out entrepreneurs. President Lee in January asked all large conglomerates to respond to such grievances. Hyundai will run the shops as nonprofits, spokesman Frank Ahrens says. Chung was unavailable to comment for this story, Ahrens says.

'Complex Group Ownership'

Standard & Poor's complained about governance in August.

"Hyundai operates under a complex group ownership structure, and Chung wields disproportionately strong control," Sangyun Han, an S&P analyst in Hong Kong, wrote.

The interlocking companies include Hyundai Motor, which owns 34 percent of Kia. Kia, in turn, owns 16.9 percent of Mobis, the parts company, which owns 20.8 percent of Hyundai Motor. Because the companies essentially control each other, no outside shareholder is strong enough to name board members. That means Chung controls Hyundai Motor's board even though he holds just 5.2 percent of the stock, Han says.

Han says crossownership is one reason S&P hasn't moved faster to boost the automaker's debt rating from BBB, or two steps above junk. He pointed to the Hyundai Engineering purchase to illustrate what he calls undisciplined financial policies.

'May Not Help Shareholders'

After Chung won the company by outbidding his brother's widow in a duel played out in Korean headlines, he promised to invest $8.9 billion to quintuple sales. Han, though, says Chung may have been driven by a family rivalry rather than a clear rationale for an automaker owning a company that, unlike Hyundai Steel, plays only a small role in making cars.

"There's not a lot of transparency, which makes it hard to track motivations of management," says Rolf Kelly, an analyst at Thornburg Investment Management Inc. in Sante Fe, New Mexico, whose company owned 2.5 million Hyundai Motor shares on Nov. 30.

The purchase may be a good investment, Kelly says. "But there's obviously some interest in propping up family companies," he says. "This may not help shareholders."

Chief Operating Officer Kim Seung Tack says family management makes it easier to reach decisions and invest for long-term goals, like fuel-cell research, instead of short-term profits.

Pushing Eui Sun

Han questions what will happen when Chung steps down or dies. Even though Eui Sun was Kia president from 2005 to 2009 and is Hyundai Motor vice chairman, investors can't assess how he'll perform because his father's lieutenants always assist him, Han says. Chung, who had a difficult relationship with his own father, pushes Eui Sun to get him ready, Yang says.

"To lead this big, big group, the son cannot be treated better or mildly," he says.

Eui Sun, who holds an MBA from the University of San Francisco, is starting to take the stage with English-language speeches at auto shows. In private, though, he refers to his father as chairman, a person who knows him says.

"There's instability in management in the sense it's highly dependent on one strong figure," Han says. Eui Sun declined to comment for this story.

Yang, who joined Hyundai from Ford in 2004, says hard work drives Korean society.

"We put the highest priority on the company," he says. "Second is family. Third is me. In Western countries, it's the other way around."

'More Pressure'

Even after Chung said in January that expansion would slow this year, employees haven't relaxed, Yang says.

"We have to make 6.5 million vehicles with the quality of a BMW or Mercedes," he says. "It's giving us more pressure."

That pressure boiled over on Jan. 8. An engine plant employee named Shin Seung Hoon in Ulsan set himself on fire and died. The Hyundai Motor Workers Union says Shin became distraught after making the one complaint Hyundai least wanted to air publicly -- that his bosses were pushing him to stop protesting poor quality.

COO Kim blames labor unrest on social ills rocking Korea, including a growing gap between rich and poor. He says union leaders aren't making better progress because they're busy promoting political candidates.

“Sometimes they do not represent employee concerns like fringe benefits or working conditions,” he says.

Long Hours

Union spokesman Kim Gi Hyuk says members agitate for change because Korea’s government is dedicated to helping corporations make bigger profits -- an area where Korean capitalism may hurt workers.

“This causes employment instability, long working hours and low wages,” he says.

Koreans worked 2,193 hours on average in 2010, the Organization for Economic Cooperation and Development found. That compares with an average of 1,778 in the U.S. and 1,419 in Germany.

Chung, in his January address, warned of tougher competition ahead. GM sold 9.03 million vehicles last year, enough to reclaim its No. 1 global sales ranking. Net income soared to $9.19 billion, the most in its 103-year history. Toyota expects a 21 percent sales increase during 2012.

As Chung spoke, he displayed small signs of fallibility. He slurred a few words slightly and didn’t correct himself after announcing a 2012 sales target of 700,000 vehicles when he meant 7 million.

By the time Eui Sun takes over, Chung may have completed a 100-story chaebol headquarters he’s planning along the Han River. Hyundai may have gained recognition as a leader in fuel- cell technology for the 21st century.

What would remain for Eui Sun is to harness the Korean- style capitalism that his grandfather and father helped invent, even with Toyota and GM poised to roar back.

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