



STRATEGY AND COMPETITIVE ADVANTAGE IN DIVERSIFIED COMPANIES

“. . .to acquire or not to acquire: that is the question.”

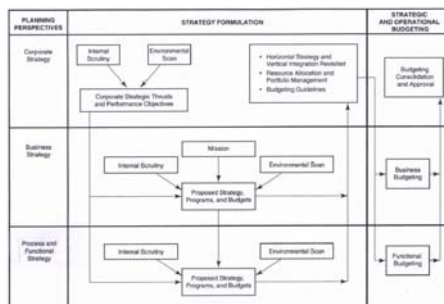
Robert J. Terry

“Fit between a parent and its businesses is a two-edged sword: a good fit can create value; a bad one can destroy it.”

Andrew Campbell, Michael Gould, and Marcus Alexander



Formal Frame work for strategic planning



Corporate strategy

CORPORATE STRATEGY – THE TEN TASKS





Diversification and Corporate Strategy

- A company is **diversified when it is in two or more lines of business**
- **Strategy-making in a diversified company** is a **bigger** picture exercise than crafting a strategy for a single line-of-business
 - A diversified company needs a **multi-industry, multi-business strategy**
 - A **strategic action plan** must be developed for several different **businesses** competing in **diverse industry** environments



Four Main Tasks in Crafting Corporate Strategy

- Pick **new industries** to enter and decide on **means of entry**
- Initiate actions to boost **combined performance** of businesses
- Pursue opportunities to **leverage cross-business value chain relationships** and **strategic fits** into competitive advantage
- Establish **investment priorities**, steering resources into most attractive business units



Competitive Strengths of a Single Business Strategy

- Less ambiguity about “who we are”
- Energies of firm can be directed down one business path and keeping strategy responsive to industry change
- Less chance resources will be stretched thinly over too many competing activities
- Resources can be focused on building competencies and capabilities that make the firm better at what it does



Competitive Strengths of a Single Business Strategy (continued)

- Higher probability innovative ideas will emerge
- Top executives can maintain hands-on contact with core business
- Important competencies more likely to emerge
- Ability to parlay experience and reputation into
 - Sustainable competitive advantage
 - Prominent leadership position



Risks of a Single Business Strategy

- Putting all the “eggs” in one industry basket
- If market becomes unattractive, a firm’s prospects can quickly dim
- Unforeseen changes can undermine a single business firm’s prospects
 - Changing customer needs
 - Technological innovation
 - New substitutes



When Does Diversification Start to Make Sense?

Strong competitive position, rapid market growth -- **Not** a good time to diversify

Weak competitive position, rapid market growth -- **Not** a good time to diversify

Strong competitive position, slow market growth -- Diversification is **top priority** consideration

Weak competitive position, slow market growth -- Diversification merits **consideration**



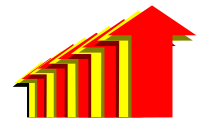
When to Diversify?

- **Diminishing growth** prospects in present business
- Opportunities to **add value** for customers or **gain competitive advantage** by broadening present business to include complementary products
- Attractive opportunities to **transfer** existing **competencies** to new businesses
- Potential **cost-saving opportunities** to be realized by entering related businesses
- **Availability** of adequate financial and organizational **resources**



Why Diversify?

- To build **shareholder value**
 - $1 + 1 = 3$
- Diversification is **capable** of increasing **shareholder value** if it passes three tests
 1. Industry Attractiveness Test
 2. Cost of Entry Test
 3. Better-Off Test





Strategic Management Principle

To create shareholder value, a diversifying firm must get into businesses that can perform *better* under common management than they could perform operating as independent stand-alone enterprises!



Related vs. Unrelated Diversification

Related Diversification

Involves diversifying into businesses whose value chains possess competitively valuable "strategic fits" with the value chain(s) of the firms present business(es)



Unrelated Diversification

Involves diversifying into businesses where there is no deliberate effort to seek out businesses having strategic fit with the firm's other business(es)

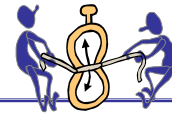


Figure 9.1: Strategy Alternatives for a Company Looking to Diversify



What is Related Diversification?

- Involves diversifying into businesses whose **value chains** possess competitively valuable "strategic fits" with the value chain(s) of the present business(es)
- Capturing the "strategic fits" makes related diversification a $1 + 1 = 3$ phenomenon



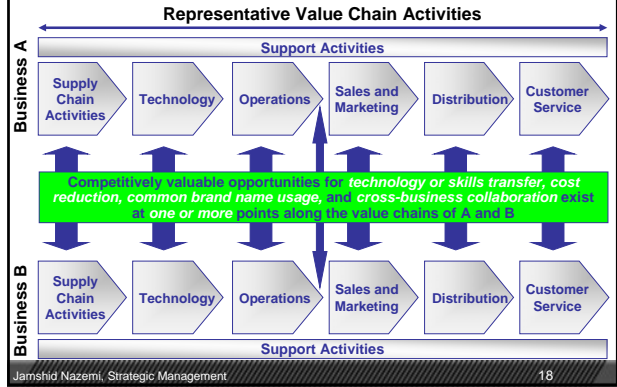


Concept: Strategic Fit

- Exists whenever **one or more activities** in the **value chains** of different businesses are sufficiently **similar** to **present opportunities** for
 - Transferring** competitively valuable **expertise or technological** know-how from one business to another
 - Combining performance** of common value chain activities to achieve **lower costs**
 - Exploiting** use of a well-known **brand name**
 - Cross-business collaboration** to create competitively valuable **resource strengths** and **capabilities**



Figure 9.2: Value Chains for Related Businesses



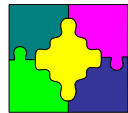
Strategic Appeal of Related Diversification

- Reap **competitive advantage** benefits of
 - Skills transfer
 - Lower costs
 - Common brand name usage
 - Stronger competitive capabilities
- Spread** investor **risks** over a broader base
- Preserves **strategic unity** in its business activities
- Achieve **consolidated performance** greater than the sum of what individual businesses can earn operating independently



Types of Strategic Fits

- Cross-business **strategic fits** can exist anywhere along the value chain
 - R&D and technology activities
 - Supply chain activities
 - Manufacturing activities
 - Distribution activities
 - Sales and marketing activities
 - Managerial and administrative support activities





R&D and Technology Fits

- Offer potential for sharing common technology or transferring technological know-how
- Potential benefits
 - Cost-savings in technology development and new product R&D
 - Shorter times in getting new products to market
 - Interdependence between resulting products leads to increased sales



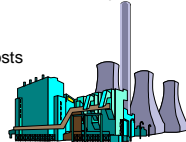
Supply Chain Fits

- Offer potential opportunities for skills transfer
 - Procuring materials
 - Greater bargaining power in negotiating with common suppliers
 - Benefits of added collaboration with common supply chain partners
 - Added leverage with shippers in securing volume discounts on incoming parts



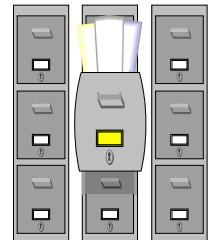
Manufacturing Fits

- Potential source of competitive advantage when a diversifier's expertise can be beneficially transferred to another business
 - Quality manufacture
 - Cost-efficient production methods
 - Just-in-time inventory practices
 - Training and motivating workers
- Cost-saving opportunities arise from ability to perform manufacturing/assembly activities jointly in same facility, making it feasible to
 - Consolidate production into fewer plants
 - Significantly reduce overall manufacturing costs



Distribution Fits

- Offer potential cost-saving opportunities
 - Share same distribution facilities
 - Use many of the same wholesale distributors and retail dealers to access customers





Sales and Marketing Fits: Types of Potential Benefits

- Reduction in sales costs
 - Single sales force for related products
 - Advertising related products together
 - Combined after-sale service and repair work
 - Joint delivery and shipping
 - Joint order processing and billing
 - Joint promotion tie-ins
- Similar sales and marketing approaches provide opportunities to transfer selling, merchandising, and advertising/promotional skills
- Transfer of a strong company's brand name and reputation



Managerial and Administrative Support Fits

- Emerge when different business units require comparable types of
 - Entrepreneurial know-how
 - Administrative know-how
 - Operating know-how
- Different businesses often entail similar administrative support facilities
 - Customer data network
 - Billing and customer accounting systems
 - Customer service infrastructure



Concept: Economies of Scope

- Stem from **cross-business** cost-saving opportunities
 - Arise from ability to **eliminate costs** by operating two or more businesses under same corporate umbrella
- Exist when it is **less costly** for two or more businesses to operate under centralized management than to function independently
- **Cost saving** opportunities can stem from interrelationships anywhere along businesses' **value chains**



Related Diversification and Competitive Advantage

- **Competitive advantage** can result from related diversification if opportunities exist to
 - **Transfer** expertise/capabilities/technology
 - **Combine** related activities into a single operation and **reduce costs**
 - **Leverage** use of firm's **brand name reputation**
 - Conduct related value chain activities in a **collaborative fashion** to create valuable **competitive capabilities**





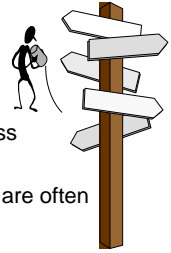
Capturing Benefits of Strategic Fit

- **Benefits don't occur just because a company has diversified into related businesses !**
 - Businesses with sharing potential must be reorganized to coordinate activities
 - Means must be found to make skills transfer effective
- Benefits of some **strategic coordination** must exist to justify sacrificing business-unit autonomy
- **Competitive advantage** potential exists to
 - Expand resources and strategic assets and
 - Create new ones faster and cheaper than rivals



What is Unrelated Diversification?

- Involves diversifying into businesses with
 - **No** strategic fit
 - **No** meaningful value chain relationships
 - **No** unifying strategic theme
- Approach is to venture into "any business in which we think we can make a profit"
- Firms pursuing unrelated diversification are often referred to as **conglomerates**

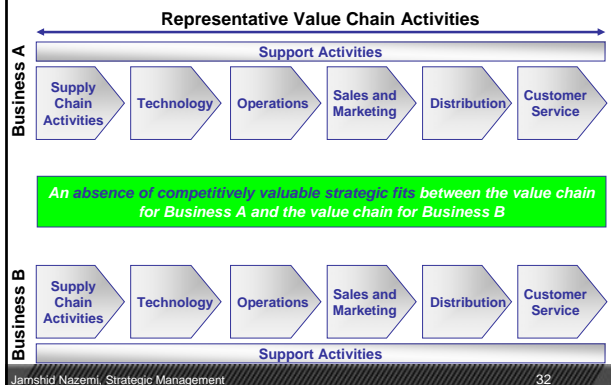


Basic Premise of Unrelated Diversification

Any company that can be acquired on good financial terms and offers good prospects for profitability is a good business to diversify into!



Figure 9-3: Value Chains for Unrelated Businesses





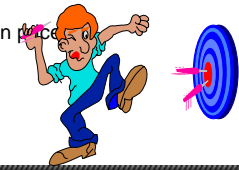
Acquisition Criteria For Unrelated Diversification Strategies

- Can business meet corporate targets for profitability and ROI?
- Will business require substantial infusions of capital?
- Is business in an industry with growth potential?
- Is business big enough to contribute to the parent firm's bottom line?
- Is there potential for union difficulties or adverse government regulations?
- Is industry vulnerable to recession, inflation, high interest rates, or shifts in government policy?



Attractive Acquisition Targets

- Companies with undervalued assets
 - Capital gains may be realized
- Companies in financial distress
 - May be purchased at bargain price and turned around



Appeal of Unrelated Diversification

- Business risk scattered over different industries
- Financial resources can be directed to those industries offering best profit prospects
- Stability of profits -- Hard times in one industry may be offset by good times in another industry
- If bargain-priced firms with big profit potential are bought, shareholder wealth can be enhanced



Drawbacks of Unrelated Diversification

- Difficulties of competently managing many diverse businesses
- Lack of strategic fits which can be leveraged into competitive advantage
 - Consolidated performance of unrelated businesses tends to be no better than sum of individual businesses on their own (and it may be worse)
 - Likely effect is $1 + 1 = 2$, rather than $1 + 1 = 3$
 - Promise of greater sales-profit stability over business cycles seldom realized



How Broadly Should a Company Diversify?

- Two questions should guide **unrelated diversification** efforts
 1. What is the **least** diversification it will take to achieve acceptable growth and profitability?
 2. What is the **most** diversification that can be managed, given its added complexity?

Need to strike a balance between too few different businesses and too many different businesses!



How Many Unrelated Businesses Can a Company Diversify Into?

- With **unrelated diversification**, corporate managers have to be shrewd enough to
 - Discern good acquisitions from bad ones
 - Select capable managers to run many different businesses
 - Judge soundness of strategic proposals of business-unit managers
 - Know what to do if a subsidiary stumbles



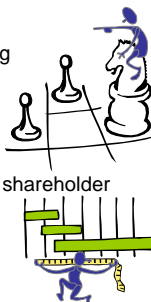
Diversification and Shareholder Value

• Related Diversification

- A **strategy-driven** approach to creating shareholder value

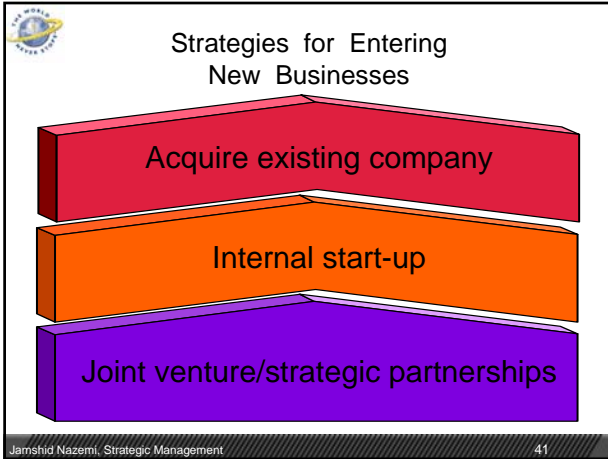
• Unrelated Diversification

- A **finance-driven** approach to creating shareholder value



Combination Related-Unrelated Diversification Strategies

- Dominant-business firms
 - One major **core business** accounting for 50 - 80 percent of revenues, with several small related or unrelated businesses accounting for remainder
- Narrowly diversified firms
 - Diversification includes a **few** (2 - 5) related or unrelated businesses
- Broadly diversified firms
 - Diversification includes a **wide** ranging collection of either related or unrelated businesses or a mixture
- Multibusiness firms
 - Diversification portfolio includes several **unrelated groups of related businesses**



Acquisition of an Existing Company

- Most popular approach to diversification
- Advantages
 - Quicker entry into target market
 - Easier to hurdle certain entry barriers
 - Technological inexperience
 - Gaining access to reliable suppliers
 - Being of a size to match rivals in terms of efficiency and costs
 - Getting adequate distribution access

Jamshid Nazemi, Strategic Management 42

Internal Startup

- **More attractive when**
 - Ample time exists to create a new business from ground up
 - Incumbents slow in responding to new entry
 - Less expensive than buying an existing firm
 - Company already has most of needed skills
 - Additional capacity will not adversely impact supply-demand balance in industry
 - New start-up does not have to go head-to-head against powerful rivals

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Joint Ventures and Strategic Partnerships

- **Good way to diversify when**
 - Uneconomical or risky to go it alone
 - Pooling competencies of two partners provides more competitive strength
 - Foreign partners are needed to surmount
 - Import quotas
 - Tariffs
 - Nationalistic political interests
 - Cultural roadblocks
 - Lack of knowledge about markets of particular countries

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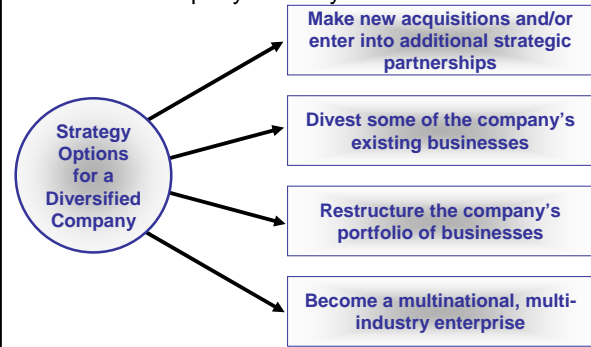


Drawbacks of Joint Ventures

- Raises questions
 - Which partner will do what
 - Who has effective control
- Potential conflicts
 - Control over strategy and long-term direction
 - How operations will be conducted
 - Control over cash flows and profits
 - Personalities and cultures of partners



Figure 9-4: Strategy Options for a Company Already Diversified



Strategies to Broaden a Diversified Company's Business Base

- Conditions making this approach attractive
 - Slow grow in current business
 - Eminently transferable resources and capabilities to other related businesses
 - Unexpected opportunity arises to acquire an attractive company
 - Rapidly-changing conditions in one core industry are blurring boundaries with adjoining industries
 - Desirable conditions favor new acquisitions to complement and strengthen market position of one or more of present businesses



Divestiture Strategies Aimed at Retrenching to a Narrower Diversification Base

- Strategic options
 - Retrenchment
 - Divestiture
 - Spin it off as independent company
 - Sell it
 - Leveraged buyout





Retrenchment Strategies

- **Objective**
 - Reduce scope of diversification to smaller number of “core “ businesses
- **Strategic options** involve **divesting** businesses
 - Having little strategic fit with core businesses
 - Too small to contribute to earnings



Conditions That Make Retrenchment Attractive

- Diversification efforts have become too broad
- Difficulties encountered in profitably managing broad diversification
- Continuing losses in certain businesses
- Lack of funds or resources to support operating and investment needs of all businesses
- Misfits cannot be completely avoided
- Unfavorable changes in industry attractiveness
- Diversification may lack compatibility of values essential to cultural fit



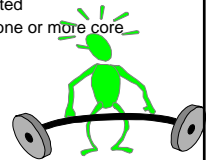
Options for Accomplishing Divestiture

- Spin it off as independent company
 - Involves deciding whether to retain partial ownership or forego any ownership interest
- Sell it
 - Involves finding a company which views the business as a good deal and good fit
- Leveraged buy out
 - Involves selling business to the managers who have been running it for a minimal equity down payment and loaning balance of purchase price to new owners



Corporate Restructuring and Turnaround Strategies

- **Strategy options** for a diversified firm with **ailing** subsidiaries
- Why consider these options?
 - Large losses in one or more subsidiaries
 - Large number of businesses in unattractive industries
 - Bad economic conditions
 - Excessive debt load
 - Acquisitions performing worse than expected
 - New technologies threatening survival of one or more core businesses





Corporate Restructuring Strategy

• Objective

- Make radical changes in mix of businesses in portfolio via both
 - Divestitures and
 - New acquisitions



Conditions That Make Portfolio Restructuring Attractive

- Long-term performance prospects are unattractive
- Core business units fall upon hard times
- New CEO takes over and decides to redirect where company is headed
- “Wave of the future” technologies emerge prompting a shakeup to build position in a new industry
- “Unique opportunity” emerges and existing businesses must be sold to finance new acquisition
- Major businesses in portfolio become unattractive
- Changes in markets of certain businesses proceed in such different directions, it’s better to de-merge



Corporate Turnaround Strategies

• Objectives

- Restore money-losing businesses to profitability rather than divest them
- Get whole firm back in the back by curing problems of businesses in portfolio

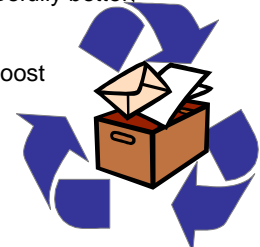
• Most appropriate *where*

- Reasons for *poor performance* are *short-term*
- Ailing businesses are in *attractive industries*
- *Divesting* money-losers doesn't make *long-term* strategic sense



Turnaround Strategies: The Options

- Sell or close down a portion of operations
- Shift to a different, and hopefully better, business-level strategy
- Launch new initiatives to boost revenues
- Pursue cost reduction
- Combination of efforts





Comment: Trend in Diversification

The present *trend toward narrower diversification* has been driven by a growing preference to gear diversification around creating strong competitive positions in a few, well-selected industries as opposed to scattering corporate investments across many industries!



Multinational Diversification Strategies

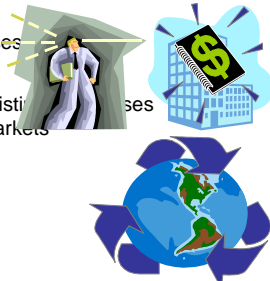
- **Distinguishing characteristic**
 - Diversity of *businesses* and *national markets*
- Presents a **big** strategy-making **challenge**
 - Strategies must be conceived and executed for each business, with as many multinational variations as appropriate



Appeal of Multinational Diversification Strategies

- Offer two avenues for **long-term growth** in **revenues** and **profits**

- Enter additional businesses
- Extend operations of existing businesses into additional country markets



Opportunities to Build Competitive Advantage via Multinational Diversification

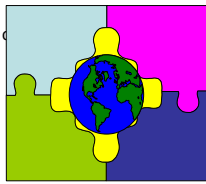
- Full capture of economies of scale and experience curve effects
- Capitalize on cross-business economic synergies
- Transfer competitively valuable resources from one business to another and/or from one country to another
- Leverage use of a competitively powerful brand name
- Coordinate strategic activities and initiatives across businesses and countries
- Use cross-business or cross-country subsidization to out-compete rivals





Competitive Strength of a DMNC in Global Markets

- **Competitive advantage** potential is based on
 - Using a related diversification strategy based on
 - Resource-sharing and resource-transfer opportunities among businesses
 - Economies of scope and brand name benefits
 - Managing related businesses to capture important cross-business strategic fits
 - Using cross-market or cross-business subsidization sparingly to secure footholds in attractive c



Competitive Power of a DMNC in Global Markets

- A **DMNC** has a strategic arsenal capable of defeating **both a domestic-only rival** or a **single-business rival** by competing in
 - Multiple businesses **and**
 - Multiple country markets

