

# STRATEGY FORMULATION IN DIVERSIFIED COMPANIES

# 8

*Thus far we have discussed about strategy making in a single-business enterprise. This unit specifically examines strategy-making in a diversified company. Although the strategy-making tasks in a single-business environment are applicable to a diversified company, some additional strategic issues are also involved. Strategy-making in a diversified company (in other words, corporate strategy-making) is, thus, a 'bigger-picture exercise' than the strategy-making in a single-business company.*

*In this unit, we address the issues, like, Meaning and nature of a diversified company, When should a company diversify its business?, How can a company diversify its business/choose the diversification path?, Related diversification and unrelated diversification, Strategies for entering into new businesses, Post-diversification strategies/strategic options for a diversified company, Evaluating the strategies of diversified companies etc..*

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## Lesson-1: Diversification of Business: Nature, Necessity and Approaches

### Learning Objectives:

After studying this lesson, you should be able to:

- Understand the meaning and nature of a diversified company.
- Decide when a company should diversify its business.
- Explain how a company can diversify its business

### Meaning and Nature of a Diversified Company

A diversified company consists of two or more individual business enterprises. The individual enterprises (or the lines of businesses) operate their businesses under a common umbrella, called parent company. The parent company is the diversified company. Its operations are usually carried on in a multi-industry environment, as opposed to a single-business company which operates in only one industry environment. As a result, managers of a diversified company (i.e., corporate managers) need to formulate strategies for several different business divisions/enterprises in diverse industry environments. They formulate ‘multi-industry, multi-business strategy.’

*A diversified company consists of two or more individual business enterprises.*

Examples of diversified companies include BEXIMCO, Bashundhara, Partex, Square, Meghna and 5M Group of Companies. It may be noted that in our country, a diversified company is popularly known as a ‘Group of Companies.’ As an instance, Partex Group consists of eleven different lines of businesses/business units. Every unit is a ‘strategic business unit’ (SBU).

*A diversified company is popularly known as a ‘Group of Companies.’*

### When should a company diversify its business?

Diversification aims at building shareholder value. This becomes possible when a diversified group of businesses can perform well under the auspices of a single corporate parent. In fact, diversification facilitates enjoyment of synergistic benefits (2+2=5 effect). However, diversification does not always yield beneficial results. It works well –

1. When a company runs out of profitable growth opportunities in its original or core businesses;
2. When a company possesses technological expertise and resources that are well suited for competing in different industries;
3. When a company wishes to establish a strong institutional image and that wish is supported by adequate manpower, physical and financial capabilities;
4. When a company has opportunities to add value for its customers;
5. When a company has the opportunities to gain competitive advantage by extending its business in complimentary products;
6. When a company finds it useful to transfer its existing competencies to new business arenas; and
7. When a company can avail of cost-saving opportunities that can be exploited by diversifying into closely related businesses.

## Approaches to Diversification of Business

*There are two approaches to diversify a company: (a) related diversification approach, and (b) unrelated diversification approach.*

When a company wishes to diversify its business, it has to choose the diversification paths. There are two approaches to diversify a company: (a) related diversification approach, and (b) unrelated diversification approach. When a company follows **related diversification approach**, it adds business units to the core business. A company under this approach always finds out those new businesses whose value chains have strategic fits with the value chain of the core business (present business). The company looks for strategic fits for transferring technical know-how from one business to another business and for cross-business collaboration, among others. On the other hand, when a company follows **unrelated diversification approach**, it adds any new business in any industry which has good prospect for making profit. Unlike the related diversification approach, unrelated diversification approach does not care for achieving strategic fits between the value chains of different businesses. The Company rather invests in new businesses in different industries with high profit opportunities. Financial gain is the main focus; strategic fit is a secondary consideration.

In this lesson, we will concentrate our discussions on related diversification approach. Lesson-2 will take care of the unrelated diversification approach.

### Meaning and Nature of Related Diversification

*Related diversification involves diversifying into a business activity which is related to the core (original) business of the company.*

Related diversification involves diversifying into a business activity which is related to the core (original) business of the company. The new business is operated in the same industry. Both the new business and the core business have some commonalities in their value chain activities such as production, marketing, etc. The value chains of both the businesses possess 'strategic fits'. It thus becomes possible to efficiently transfer key skills, technological expertise or managerial know-how from one business to another. Commonality and/or strategic fits in value chains also help the company achieve competitive advantage through lowering costs, sharing a common brand-name or creating valuable resource strengths and capabilities. In the language of Hill and Jones, "related diversification is diversification into a new business activity or activities by commonality between one or more components of each activity's value chain."

The core business of Akiz Group was 'bidi' manufacturing. When Akiz decided to produce cigarettes, it was a related diversification. In this case, we find marketing commonalities between the 'bidi' and cigarette businesses. Both the businesses are carried on in the tobacco industry. The competitive success of both the businesses depends on brand-positioning skills.

### Justification for Related Diversification

Many companies prefer related diversification strategy to unrelated diversification strategy. There are several grounds for choosing related diversification strategy:

1. It has the potential of cross-business synergies. Value chain relationships between the core and new businesses produce the synergies. In other words, we can argue that a company may follow related diversification strategy when strategic fit exists between some or all of the value chain activities in both the core and new businesses. Along the value chain, cross-business strategic fit can exist in, for example, production activities, distribution activities, sales and marketing activities, supply chain activities, managerial and administrative support activities, and R&D activities. Cross-business strategic fits in production activities can be valuable when the company's expertise in such activities can be transferred to another business. If two or more businesses under the parent company can share the same distribution facilities (e.g., same distributor, dealers and retailers), the company is able to create synergistic effects. Businesses with closely related sales and marketing activities can perform better together because of reduced sales costs (reason: sharing of same sales force). Strategic fits in supply chain activities help in skills transfer in procuring materials in achieving stronger bargaining power in negotiation with suppliers, etc. when managerial know-how and competencies can commonly be used in different businesses, the company can achieve more competitive advantages. Similarly, sharing common technology or using same R&D facilities for more than one business is an important way to achieve competitive advantage.
2. It has strategic appeal because it allows a company to build stronger competitive advantage through skill transfer, lower costs, common brand name and better competitive capabilities.
3. It is possible to create 'economies of scope' through diversifying businesses into related areas. Scope of economies (as contrasted to 'scale of economies') occurs due to savings from cost reduction. Costs are reduced when cross-business strategic fits exist. Related diversification has the potential of achieving economies of scope. (It may be noted that economies of scale are achieved when unit cost of products are reduced as the volume of production increases). The greater the cost savings, related diversification may create opportunities to consolidate the value chain activities in different businesses.
4. It provides a sharper focus for managing diversification because of concentration in similar businesses.
5. It can result in greater consolidated performance than single-business concentration strategy. A stand-alone or independent enterprise cannot perform better than a company having related businesses.
6. It can create value by resource sharing between various businesses.
7. It involves fewer risks because the company moves into business areas about which top management already has some knowledge.

*If two or more businesses under the parent company can share the same distribution facilities the company is able to create synergistic effects.*

*Scope of economies (as contrasted to 'scale of economies') occurs due to savings from cost reduction.*

**When should a company concentrate on related diversification?**

Research evidence suggests that related diversification does not always yield more benefits than unrelated diversification. So, the question is: When should a company opt for related diversification? Experience shows that it is useful for a company to concentrate on related diversification:

1. When the core competencies of the company are applicable to a variety of business situations;
2. When the management of the company is capable enough to manage the affairs of several businesses simultaneously;
3. When trade unions do not create resistance to cross-business transfer of manpower and other resources;
4. When 'bureaucratic costs' of implementation do not outweigh the benefits derived from resource sharing between businesses. Bureaucratic costs arise in a diversified company mainly from coordination efforts that are required among different businesses of the company.

**Review Questions**

1. What do you mean by a diversified company? Make a list of ten diversified companies in Bangladesh.
2. What are the situations that justify diversification of a company's business?
3. What are the approaches to diversification? Explain briefly.
4. Distinguish between related diversification and unrelated diversification.
5. What do you mean by related diversification? What are the reasons for some companies' preferring related diversification to unrelated diversification?
6. Discuss the grounds for choosing related diversification strategy by a company.
7. When should a company concentrate on related diversification?

**Application Discussion Questions**

1. A company is engaged in such businesses as blades and razors, toiletries, toothpastes, stationery products, shavers, coffee makers and dry cell batteries. What approach has the company adopted for diversification?

## Lesson-2: Unrelated Diversification of Business

### Learning Objectives:

After studying this lesson, you should be able to:

- Understand the meaning of unrelated diversification.
- Distinguish between related and unrelated diversification strategies.
- Explain the situations when unrelated diversification strategy work well.
- Discuss the merits and demerits of unrelated diversification

### Meaning of Unrelated Diversification

*Unrelated diversification involves entering into new businesses that are not related to the core business of the company.*

Unrelated diversification involves entering into new businesses that are not related to the core business of the company. An unrelated diversified company has, under a single corporate umbrella, more than one business-units which operate their activities in different industries. The value chains of the businesses are dissimilar. As a result, no real potential exists for transfer of skills, technology or other resources from one business to another. As Hill and Jones remarked “Unrelated diversification is diversification into a new business area that has no obvious connection with any of the company’s existing areas.”

Bashundhara Group is a good example of an unrelated diversified company. Its core business is real-estate business. Gradually it has diversified into several unrelated business areas such as steel, tissue paper, LP gas, cement, etc. Partex is another example of unrelated diversified company. Because of their pursuing diversifying into broadly diverse industries, they are commonly called *conglomerates*.

### Distinction between Related and Unrelated Diversification Strategies

The main differences between related and unrelated diversification strategies are presented below:

1. Related diversification involves diversifying into businesses that are related to existing business. Unrelated diversification involves diversifying into totally new businesses.
2. A related diversified company can create value to shareholders by resource sharing and transferring skills between different businesses. Sharing resources and skill transfer are difficult in an unrelated diversified company.
3. In the case of related diversified company value creation is possible due to value chain commonalities. On the other hand, absence of commonalities in the value chains of different businesses prevents creation of value in an unrelated company
4. Related diversification does not require pursuing restructuring strategy for value creation. Unrelated diversification can create value by pursuing restructuring strategy.
5. Related diversification can create value in more ways than unrelated diversification.

6. Related diversification involves fewer risks than unrelated diversification because of management's knowledge about managing enterprises of same type.
7. Related diversified companies have to bear more bureaucratic costs than unrelated diversified companies. This is because in the case of former, bureaucratic costs arise both from the *number of business units* and from *coordination among business units*. Unrelated diversified companies need not have to achieve cross-units coordination. As a result, their bureaucratic costs arise only from the number of business units in their portfolio.

### **When Should a Company Opt for Unrelated Diversification Strategy?**

Unrelated diversification strategy may work well in the following situations:

1. When the core functional skills of the company can hardly be used in the businesses other than the original business.
2. When the higher-level managers are skilled enough to acquire weak businesses and/or establish backward or forward linkages.
3. When the value created by adopting restructuring strategy is not surpassed by the bureaucratic costs of the implementation of strategy.
4. When a company sees that entering into a different industry offers a good profit opportunity.
5. When the prospective business in an industry other than the industry of core business has a significant growth potential.
6. When the company is least interested in exploiting strategic-fit relationship.

It may be noted that unrelated diversification is mainly undertaken for financial gain. Here strategic-fit is a secondary consideration. The underlying premise of unrelated diversification is that any business that has good profit prospects is a good business for further investment.

### **Merits and Demerits of Unrelated Diversification**

Unrelated diversification has both advantages and disadvantages. On the one hand, it helps in spreading business risks over a variety of industries and provides opportunities for quick financial gain. On the other, it surrenders the competitive advantage potential of strategic fits across the value chain activities of diversified businesses. More specifically the merits and demerits are as follows:

#### **Merits**

1. **Spreading of risks:** Unrelated diversification involves entering into new industries. Thus, it is possible to spread the business risks over different industries. Businesses with different technologies, markets and customers have the potential of absorbing risks related to investment of the company. However, research evidence indicates

that related diversification is less risky than unrelated diversification from financial point of view.<sup>3</sup>

2. **Profit prospects:** unrelated diversification provides an opportunity to enter into any business in any industry which has profit prospects. The company may acquire a business in another industry having high profit potentials.
3. **Opportunities to offset losses:** Because of investment in diverse areas of business activities, there is a possibility of offsetting losses in one business within the gains in another business in another industry. Cross-industry offsetting of losses is very dim in related diversification due to operation of businesses in the same industry. In a diversified company, cyclical downswing in one business can be counterbalanced by cyclical upswing in another business.
4. **Increase in shareholder value:** Astute corporate managers can increase shareholder value by taking over highly prospective businesses in different industries.
5. **Quick financial gain:** There are opportunities for quick financial gain if the parent company resorts to diversification through acquisition of businesses having under-valued assets and good upside potential. Financial gain can also be achieved if the new businesses can be acquired with a bargain-price.
6. **Greater earnings stability:** Unrelated diversification offers greater earnings stability over the business cycle. However, stability in earnings depends on managers' ability to avoid the disadvantages of unrelated diversification.

#### **Demerits**

1. **Unreliability in building shareholder value:** Management experts are of the view that unrelated diversification is an unreliable approach to building shareholder value unless corporate managers are exceptionally talented.
2. **Business-jungle and managerial difficulties:** When a conglomerate has a large number of diverse businesses, corporate managers may find it difficult to manage effectively the jungle of businesses. Difficulties may abound in selecting right managers, undertaking appropriate measures when problems arise, and making decisions when a business unit stumbles.
3. **Dangers in screening businesses through acquisitions:** Unrelated diversification through acquisition of other firms requires a sound screening from among the available firms. The diversifier-company may be at a loss if it fails to astutely screen out the unattractive firms by using such criteria as expected return on investment, growth potential, cash flow, environmental issues, government policies, etc. in reality, only companies with undervalued assets and companies that are financially distressed are good candidates for unrelated diversification.

4. **Risk of unknown:** A new business acquired by the diversifier-company is an unknown entity to the corporate managers. This may pose a risk to them. Any mistake in assessing industry attractiveness or predicting unusual problems (such as forcefully taking into possession by local terrorists in connivance with the owner-group) may prove fatal. Wisemen say: 'Never acquire a business you don't know how to run.'
5. **Insignificant contributions in building competitive strength:** Experience shows that a strategy of unrelated diversification cannot always create competitive strength in the individual business units.

**Review Questions**

1. What is meant by unrelated diversification?
2. What are the benefits that a company may enjoy if it follows unrelated diversification strategy?
3. Distinguish between related and unrelated diversification strategies.
4. Discuss the situations when unrelated diversification strategy work well.
5. Discuss the merits and demerits of unrelated diversification

**Application Discussion Questions**

1. Partex Group of Companies, a prominent diversified company of Bangladesh, has eleven different lines of business that consist of production of veneer boards, mineral water, condensed milk, etc. Is Partex a related or unrelated diversified company? Why do you think so?

## Lesson-3: Diversification Strategies [Strategies to Diversify a Company]

### Learning Objectives:

After studying this lesson, you should be able to:

- Identify the strategies that a company can follow for diversifying its business.
- Understand the meaning of internal start-up or internal new venture strategy.
- Explain acquisition strategy as a strategy for entering into new business.
- Discuss the nature of joint venture strategy and pinpoint its advantages and disadvantages.

### Introduction

A company may follow a number of strategies to diversify its business. The strategies for entering new businesses include: (a) internal start-up or internal new venture strategy, (b) acquisition strategy and (c) joint venture strategy. A company may follow any or all of these strategies for diversifying into related or unrelated businesses.

You will learn from this lesson the details about the internal start-up strategy, acquisition and joint venture strategies. Lesson-4 will provide you the details of strategic alliance strategy as a means of expansion of business by some companies.

### 1. Internal Start-Up Strategy/Internal New Venture Strategy

When a company adopts internal start-up strategy, it diversifies into a new business through forming a new company. The newly-created company operates its businesses under the corporate umbrella. Creating a new company means investment in new production facilities, scouting of suppliers, establishing links with the intermediaries, developing a customer base, selecting and training employees for the new business, etc. Everything for the company is done anew.

*The newly created company operates its businesses under the corporate umbrella.*

As an entry strategy, a company can adopt internal startup (or internal new venture) strategy under the following circumstances:

1. When a company possesses a set of resources and capabilities (competencies) in its existing business. The existing competencies can be recombined to enter a new business area. We can cite the example of IBM – the computer-giant in the world. IBM had produced only mainframe and mid-range computers until 1981. It recombined its competencies in 1981 to enter the PC business. It started utilizing its core resources and capabilities in computer design, sales and after-sales services.
2. When a company wishes to create market opportunities in related areas by using its own (proprietary) technology. As an entry strategy, new venturing is a choice for most science-based companies,

American business stars such as 3M, Intel, and DuPont expanded their businesses with their internally generated innovations.

3. When a company enters a newly emerging industry where no competitors with required competencies exist. Pursuing an internal startup strategy is the only option to a company that wants to enter into an embryonic industry.
4. When a company has adequate time at its disposal for developing a business from the scratch. Some companies prefer internal new venturing when time is not an urgency for building up a new business.
5. When internal new venturing costs less than acquisition (or taking over an old business).
6. When the supply-demand balance in the industry will not be affected due to adding new production capacity.
7. When a company has all or most of the skills needed for competing effectively in the market. When a company need not compete against powerful competitors in the market because of the existence of numerous small firms.

## **2. Acquisition Strategy**

*It is very difficult and even unpromising to adopt an internal startup strategy as an entry strategy.*

In many cases, it is very difficult and even unpromising to adopt an internal startup strategy as an entry strategy. Because it takes long years to develop knowledge resources, scale of operation and market reputation. Alternatively, some companies diversify via acquisition of an existing company. The 'to-be-acquired' company may be either a reputed, well established firm or a weak firm but has a high potential of profit. If a company acquires an already established firm, it can move directly to build up market position. Acquisition 'offers an effective way to hurdle such entry barriers as acquiring technological experience, establishing supplier relationships, becoming big enough to match rivals' efficiency and unit costs, having to spend large sums on introductory advertising and promotions to gain market visibility and brand recognition, and securing adequate distribution'.<sup>4</sup>

Standard Chartered Bank took over the operations of Grindlays Bank in South Asia and South-East Asia in 1999. It was an acquisition strategy of Standard Chartered Bank. In mid-2005, Standard Chartered Bank acquired the operations of American Express Bank in Bangladesh. The acquisition strategy in both the cases helped the Standard Chartered Bank enjoy the market reputation of Grindlays Bank and American Express Bank as well as acquire their resources and capabilities.

### **An acquisition strategy works well when companies –**

- a. Lack important competencies required to compete in the business area where they want to enter;
- b. Speed is important and they need to move fast (acquisition is a quicker way to establish market presence and generate enough cash flow);

- c. Contemplate to enter into businesses with less risk than internal startup, as they acquire “known profitability, known revenues and known market share, all of which reduce uncertainty”.<sup>5</sup>
- d. Find that the to-be-acquired firm enjoys significant protection from barriers to entry into the industry concerned (acquisition is favored when entry barriers are many and difficult to overcome).

However, evidence shows that acquisition strategy does not work well in many situations. It fails to add value to the parent company and even dissipates shareholder value. Many acquisitions destroy rather than create value.<sup>6</sup> When acquisition strategy fails, it fails because (i) companies often experience difficulties when trying to integrate divergent corporate cultures, (ii) companies overestimate the potential economic benefits from an acquisition, (iii) acquisitions tend to be very expensive and (iv) companies often do not adequately screen their acquisition targets.<sup>7</sup>

*Many acquisitions destroy rather than create value.*

### 3. Joint Venture Strategy

Joint venture acquisition involves creation of a new company (or new venture) jointly by two or more companies. The companies that join together to form a joint venture are called partner-companies (or simply partners). The new company, that is, the joint venture is owned by the partners. Some companies use joint venture as a vehicle to enter into a new business area. The major purpose of joint venture is to enable the partner-companies to share risks and costs involved in new venture. A company having ‘some of the skills and assets’ for the establishment of a new business-firm can join another company having ‘complimentary skills and assets’ to build up the new business.

*The companies that join together to form a joint venture are called partner-companies.*

A joint venture can be local or international. A local joint venture is created by usually two or more local companies within the same country. For example, if 5M Group of Companies of Dhaka jointly with the Bakunpasha Technology Limited of Comilla forms a new company, namely, 5M-Bakunpasha Limited, it will be a local joint venture. On the other hand, if 5M Group and Sysmatic Corporation of USA establish in Dhaka a new company with the name of 5M (Bangladesh) Limited, it will be an international joint venture. In 1990, IBM and Motorola (both in the USA) set up a local joint venture to provide communication services over radio waves; and Fuji of Japan and Xerox of USA established an international joint venture to produce photocopiers for the Japanese market. Most joint ventures have a 50/50 ownership-stake, although deviation from this ratio is not uncommon.

*A joint venture can be local or international.*

#### The advantages of joint venture

Joint venture strategy has several advantages that the partner-companies can enjoy. The advantages are that”

1. It allows the partners to share risks and costs of building a new business.
2. It creates an opportunity to combine skills and assets of partner-companies necessary to establish successful new venture.

3. It enables the partners to pursue opportunities that are somewhat peripheral to the strategic interests of the partners.
4. It can be a useful way to gain access to a new business which is very complex and uneconomical for a single company to pursue alone.
5. It is a formidable way to enter into a foreign market when market entry is restricted by government. Joint venture with a local partner in foreign country is helpful to overcome tariff barriers and import quotas.
6. International joint venture is a fruitful means for strengthening a company's competitiveness in world market.
7. Both local and international joint venture are helpful in facilitating joint research efforts, technology sharing, joint use of production facilities, marketing one another's products, and in joining forces to produce components or assemble finished products.

**Disadvantages/pitfalls of joint venture strategy**

A joint venture strategy offers many opportunities, no doubt. But it is not without drawbacks. Let us highlight some of the major difficulties with this strategy:

- Complications arise in dividing the share of control between the partners. The partner-companies run the risk of giving technical know-how away to their counterparts. Any partner may capitalize on that know-how to compete directly with the other partner.
- Conflict over how to run the joint venture can tear it apart and result in business failure.
- In the case of international joint venture, conflicts may arise over the use of local materials export volume, operating procedures, use of foreign partner's technology by local partner, etc.

**Review Questions**

1. Make a list of the strategies that a company can follow for diversifying its business.
2. What is internal start-up strategy?
3. What are the circumstances that warrant internal start-up for expansion of business by a company?
4. What is acquisition strategy? Explain with examples.
5. When does an acquisition strategy work well?
6. Explain the concept of joint venture strategy. Can a joint venture be international?
7. Discuss the advantages of joint venture.
8. What are the pitfalls of joint venture as a strategy for entering into new business?

**Application Discussion Questions**

1. Company A and Company B have created a new company C with 50/50 equity participation. Is it a joint venture or a strategic alliance or an acquisition? Give your arguments.
2. Suppose, Basundhara Group has established a fertilizer factory in Rangpur. Its core business is real estate. Is it Basundhara's new venture strategy or acquisition strategy?

## **Lesson-4: Strategic Alliance as a Diversification Strategy**

### **Learning Objectives:**

After studying this lesson, you should be able to:

- Explain the concept of strategic alliance.
- Discuss the merits and demerits of strategic alliance as a strategy.
- Explain the reasons for the failure of strategic alliance in certain situations.

### **Meaning of Strategic Alliance**

*A Strategic alliance is a collaborative arrangement between two or more companies.*

Strategic alliances are also known as strategic partnerships. A Strategic alliance is a collaborative arrangement between two or more companies. It does not entail forming a new organizational entity. The partners in Strategic alliances have no formal ownership ties like joint venture. According to Thompson and Strickland, “In recent years, strategic partnerships/alliances have replaced joint ventures as the favored mechanism for joining forces to pursue strategically important diversification opportunities because they can more readily accommodate multiple partners ... than a formal joint venture”. The success of strategic alliances mostly depends on effective cooperation among the partners and successful adaptation to change. The collaborative arrangement must result in win-win outcomes for all partners to ensure ultimate success. Japan’s Toyota has developed a network of alliances with its suppliers of parts and components. In the USA, General Electric Company has formed over 100, IBM over 400 and Oracle over 15000 Strategic alliances. On an average, every large company in the USA is involved in around 30 alliances. The giants in mobile phone technology such as Nokia, Motorola and Erickson have developed strategic alliances to maintain global market leadership.

### **Major advantages of strategic alliances**

Many companies turn to Strategic alliances for one or more of the reasons cited here.

#### ***Within National Boundary:***

1. To avoid more costly process of building own capabilities by a company to access new opportunities.
2. To substantially improve competitiveness.
3. To collaborate on technology or development of a new product.
4. To overcome deficits in their technical and manufacturing expertise.
5. To acquire altogether new competencies.
6. To improve supply chain efficiency.
7. To gain economies of scale in production and distribution.
8. To improve market access through joint marketing agreements.
9. To open up expanded opportunities in an industry through collaboration with partners.

**Outside the National Boundary:**

1. To build a market presence in the foreign markets.
2. To capitalize on technological and information age revolution through collaborative partnerships with other sound companies.
3. To assemble more diverse skills, resources, technological expertise and competitive capabilities than a company can assemble alone.
4. To gain access to technology and expertise in a cost-effective way.
5. To bundle competencies and resources across the countries that are more valuable in a joint effort than when done separately.
6. To acquire valuable resources/capabilities through alliances that a company could not otherwise obtain on its own.
7. To gain 'inside knowledge' about unfamiliar markets and cultures in foreign countries.
8. To access valuable skills (such as manufacturing skills, fashion design skills, software design skills) that are concentrated in particular countries (e.g., Italy is famous for fashion design, competencies and Japan has an enviable reputation for efficient manufacturing skills).

**Reasons for failure of strategic alliances**

A study in the USA revealed that about two-thirds of the Strategic alliances were not successful.<sup>8</sup> The major reasons for unstable alliances are as follows:

- a) Inability of the partners to work together.
- b) Failure or delay in responding and adapting to changes in the internal and external environment.
- c) Lack of willingness on the part of the partners to renegotiate the terms and conditions of alliances.
- d) Failure of the partners to value the skills and resources each partner brings to the alliances.
- e) Rivalry between partners in the marketplace.

The above discussions unveil the fact that Strategic alliances would sustain then the partners become serious in ongoing commitment, mutual learning and close collaboration on a continuing basis. Also, high dependence on alliance for essential skills and capabilities may prove fatal for a company. Each company must develop its own expertise for attaining market leadership.

*High dependence on alliance for essential skills and capabilities may prove fatal for a company.*

We have thus far discussed about the entry strategies for a company that intends to diversify its present business. Companies follow these strategies to diversify their current business. We now turn to discussion of the strategies that the already-diversified companies need to follow to improve its performance and market position, i.e., post-diversification strategies.

**Review Questions**

1. Why do companies go for strategic alliance? Are there any demerits of strategic alliance? Discuss.
2. How does a company gain outside the national boundary when it enters into strategic alliance with other companies?
3. What are the major reasons for the failure of strategic alliance?

**Application Discussion Questions**

1. The mobile operators in Bangladesh such as Grameen Phone, AKTEL, BanglaLink, TeleTalk and CityCell are mutually cooperating each other in using their networks and other facilities. Is this cooperation a joint venture or strategic alliance? Give your arguments in favor of your opinion.

## Lesson-5: Post-Diversification Strategies [Strategies of a Company after Diversification]

### Learning Objectives:

After studying this lesson, you should be able to:

- Discuss the corporate strategies that a diversified company may consider for improving its performance.
- Clarify the meaning of divestiture strategy and explain when a company should follow this strategy.
- Explain the harvest strategy, liquidation strategy and turnaround strategy.
- Discuss when turnaround strategy will be effective.
- Understand the actions that the turnaround strategy may include.
- Decide when a company should consider restructuring strategy.
- Discuss the conditions that prompt a diversified company to undertake restructuring strategy.
- What is a multinational diversification strategy? What are the ways that multinational diversification strategy offers for building competitive advantage?

### Introduction

The strategies that we have discussed in Lesson-3 are the principal ways to diversify a single-business company. In this lesson, we would discuss the strategies that a diversified company may adopt to strengthen its position and performance.

### Strategy Options for A Diversified Company

Once a company gets diversified, it becomes a critical obligation on the part of the corporate managers to manage the affairs of the diversified lines of business effectively. In order to improve the performance of different lines of businesses, a diversified company may consider any or a combination of the following corporate strategies:

- Divestiture Strategy
- Harvest Strategy
- Liquidation Strategy
- Turnaround Strategy
- Restructuring Strategy
- Multinational Strategy

#### 1. Divestiture Strategy

Divestiture strategy is the strategy of selling off a business unit or a division of a unit because of its failure to fetch enough profits for the company or because of its dim prospect of profitability and growth in the future or for some other reasons. Divestment or selling off a business unit to 'independent investors' is called spinoff. Sometimes, a business unit is sold off to its own management – commonly known as

*Divestment or selling off a business unit to 'independent investors' is called spinoff.*

‘management buyout’. Company’s own managers buy the unit. Usually the managers raise cash by issuing bonds and then use the cash to buy the shares/stocks of the business unit.

*If a business unit is sold off to its own management that is known as “management buyout”*

It was found that some companies had difficulties in managing a large number of business units. They have divested certain business units to focus their resources on the core business. Divestiture strategy enables a company to narrow down its diversification base through divesting some business units that have no (or little) strategic fit with its main businesses or that have no ability to make substantial combination to the earnings of the company.

## **2. Harvest Strategy**

*Harvest Strategy is known as ‘asset reduction strategy.’*

Also known as ‘asset reduction strategy’, harvest strategy entails decreasing the investment in a business unit and extracting the investment as much as it can. The company tries to harvest all the returns it can. It reduces the assets to a minimum. When a company adopts harvest strategy, it halts investment in a business unit to maximize short term cash flow from the unit. Subsequently, the unit is liquidated.

## **3. Liquidation Strategy**

*Liquidation strategy is usually adopted when it becomes difficult to find a buyer for a losing unit.*

Liquidation strategy is the strategy of writing off a business unit’s investment. This strategy is usually adopted when it becomes difficult to find a buyer for a losing unit. Generally, the business units that are weak (financially or in terms of managerial performance) follow liquidation strategy. If turnaround is not possible, liquidation (or divestiture) strategy is the last resort.

## **4. Turnaround Strategy**

*Turnaround strategy is the strategy of reverting a weak business unit back to profitability.*

A company in a weak competitive position may apply turnaround strategy. Turnaround strategy is the strategy of reverting a weak business unit back to profitability. This strategy aims at restoring a losing business unit to profitability. In order to make a poor company profitable, management may redeploy additional resources, instead of divestment or liquidation. However, the company must have enough resources and capable managers to turn the business unit around. Lee Iacocca applied turnaround strategy to regain the position of Chrysler Corporation (one of the giant American car manufacturers) in 1990s and was tremendously successful. This strategy works best when ‘the reasons for poor performance are short term, the ailing businesses are in attractive industries, and divesting the money-losers does not make long-term strategic sense.’ Turnaround strategy may include the following actions:

- a. Selling or closing down a losing unit having a poor prospect.
- b. Changing the present strategy and adopting a different business-level strategy.
- c. Creating a new venture to earn greater returns.
- d. Undertaking measures for cost reduction.

It may be noted that turnaround strategy can be applied for both a single-business company and a diversified company.

## 5. Restructuring Strategy

Restructuring strategy involves divestment of one or more business units of a diversified company and acquiring new business units. Thus, the business makeup of the diversified company takes a new shape. This strategy calls for reorganizing the business portfolio of the company. For this purpose, ailing business units are sold off and prospective new business endeavors are undertaken. For example, if a diversified company, over a 4 or 5-year period time, sells off 2 units, closes down 3 weak units, and adds 4 new lines of business to its business-portfolios, these efforts of the company can be called restructuring strategy.

*In Restructuring Strategy ailing business units are sold off and prospective new business endeavors are undertaken.*

Thompson and Strickland have identified seven conditions that prompt a diversified company to undertake restructuring strategy:

- a. When the long-term performance prospects of the company have become unattractive.
- b. When one or more of the company's business-units have been facing hard times.
- c. When a newly-appointed CEO decides to restructure the company.
- d. When the diversified company wants to build up a strong presence in a potentially attractive new industry.
- e. When the company needs huge cash for acquiring a very prospective business and so needs to sell off some units.
- f. When environmental changes force the company to shake-up the existing portfolio to improve corporate performance.
- g. When changes in markets and/or technologies compel the company to split the company into separate pieces rather than remaining together.

## 6. Multinational Diversification Strategy

A company may follow a strategy of diversifying its business into foreign markets. When a company faces hard times in the domestic market or finds a high prospect in foreign markets, it may undertake a multinational diversification strategy. Multinational diversification strategy warrants a cross-country collaboration and strategic coordination. This strategy becomes effective when it results in competitive advantage and increased profitability.

*Multinational diversification strategy warrants a cross-country collaboration and strategic coordination.*

Multinational diversification offers several ways to build competitive advantage:<sup>8</sup>

1. Full capture of economies of scale and experience curve effects.
2. Opportunities to capitalize on cross-business economies of scope.
3. Opportunities to transfer competitively valuable resources from one business to another.
4. Ability to leverage use of a well-known and competitively powerful brand name.
5. Ability to capitalize on opportunities for cross-business and cross-country collaboration and strategic coordination.
6. Opportunities to use cross-business or cross-country subsidization to outcompete the competitors.

**Review Questions**

1. What are the corporate strategies that a diversified company may consider for improving its performance? Discuss them in a nutshell.
2. What do you mean by divestiture strategy? When should a company follow this strategy?
3. Explain the harvest strategy, liquidation strategy and turnaround strategy.
4. When is the turnaround strategy effective? What are the actions that the turnaround strategy may include?
5. When does a company consider restructuring strategy? Discuss the conditions that prompt a diversified company to undertake restructuring strategy?
6. What is a multinational diversification strategy? What are the ways that multinational diversification strategy offers for building competitive advantage?

**Application Discussion Questions**

1. Suppose a unit of Beximco has fallen 'seriously ill' due to poor performance and it has been classified as 'Dog' based on an analysis using the BCG Matrix. What strategy would you suggest for this unit?

## Lesson-6: Evaluating the Strategies of Diversified Companies

### Learning Objectives:

After studying this lesson, you should be able to:

- Identify the techniques for evaluating a diversified company.
- Discuss the various techniques for effective analysis of diversified companies.

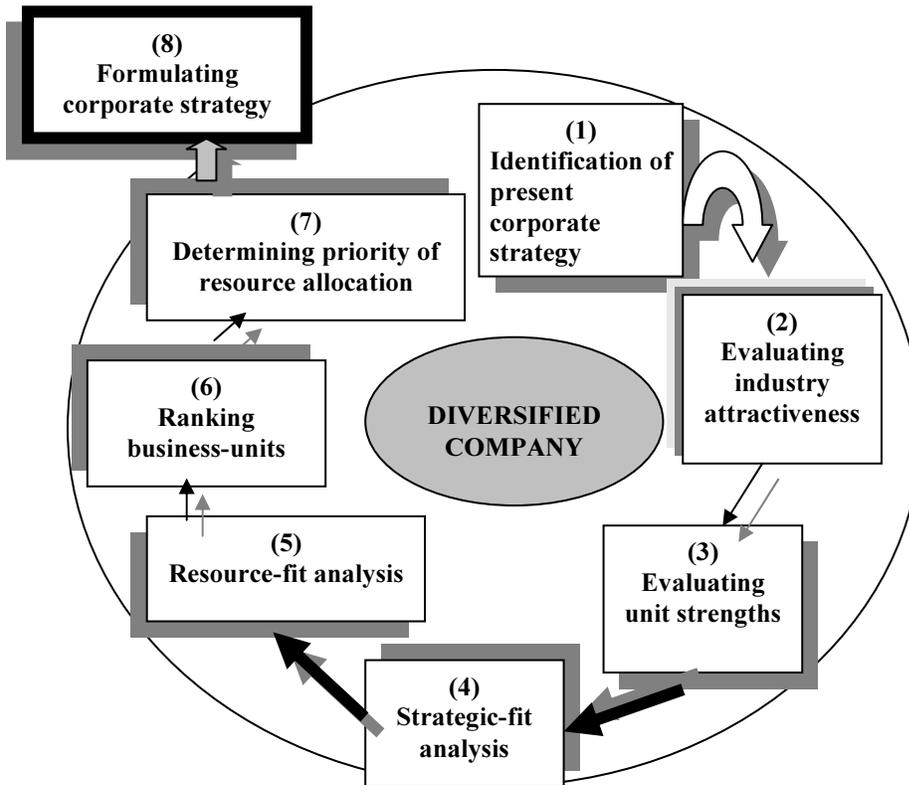
### Introduction

Whatever strategies a diversified company chooses for strengthening its position and performance, they should be properly analyzed and evaluated. Some systematic procedures need to be followed so that corporate managers can assess the potential and present caliber of the various business-units under the corporate umbrella. Such analysis and evaluation would help them decide what strategic actions they should take in order to improve the strengths of their business-units.

### Techniques for Analyzing Diversified Companies

Strategic analysis of diversified companies involves several steps (Figure-8.1). Managers need to follow these steps while evaluating the strategies of their companies. We provide here a description of these steps.

*Strategic analysis of diversified companies involves several steps.*



**Figure-8.1: Eight-step process of strategy evaluation in diversified companies**

### **Step-1: Identifying the present corporate strategy**

The strategy makers' first task in strategy evaluation of a diversified company is to clearly understand the present strategy and business makeup of the company. For this purpose, they examine the extent of related or unrelated diversification, scope of operations (domestic to multinational to global), moves to add new businesses, moves to divest weak/unattractive business-units, moves to boost performance of key business-units, moves to strengthen existing business positions, extent of cross-business strategic fit benefits, resource allocation priorities among different business-units, etc.

### **Step-2: Evaluating the industry attractiveness**

It is necessary for the strategies to evaluate the attractiveness of each industry in which company's businesses are being carried on. Such evaluation should focus on the following:

- a) Attractiveness of all industries relevant to the company's businesses to determine each industry's prospects for growth and profitability, competitive conditions and market opportunities, and the extent of matching company's capabilities with industry's technology/resource requirements;
- b) Each industry's attractiveness relative to the others in order to estimate ranking of the industries from most attractive to least attractive; and
- c) Attractiveness of all industries as a group to determine how appealing the mix of industries is.

### **Step-3: Evaluating the competitive strengths of each of the business-units**

The strategy makers need to evaluate the strength and competitive position of each business-unit under a diversified company to determine the strongest and weakest units. Strategists usually consider such factors as relative market share, ability to compete on cost ability to strongly negotiate with the key suppliers and customers, technology and innovation capabilities, matching of unit's competencies with industry key success factors, and profitability relative to competitors.

### **Step-4: Strategic-fit analysis**

The strategy makers in a diversified company determine the potential for competitive advantage of value chain relationships. They also examine the strategic-fit among the existing business-units. From this analysis, they can understand whether a unit has a valuable strategic-fit with other businesses. If it is found that good strategic fits exist among the business-units, the strategy makers can conclude that the company has a competitive advantage potential.

### **Step-5: Resource-fit analysis**

This analysis is done to determine the extent of matching of a unit's resource strengths with the resource requirements of its present business lineup. Resource-fit exists when business-units add to a company's

resource strengths financially or strategically, and when a company has adequate resources to support the resource-requirements of all business-units as a group.

**Step-6: Ranking business-units**

At this step, strategy makers evaluate the units on the basis of performance prospects. They look into sales growth, profit growth, contribution to company earnings, return on investment, cash flow generation, etc. Usually, strong business-units in attractive industries have better prospects than weak businesses in unattractive industries. Business-units (subsidiaries) with bright performance prospects are good candidates for corporate resource-support.

**Step-7: Determining priority for resource allocation**

This step involves ranking the business subsidiaries in terms of priority for resource allocation. Strategy makers need to determine which business-units should have top priority for corporate resource-support, and which ones should get low priority. Then they should determine the basic strategic approaches that need to be undertaken for each unit. The alternative approaches, as suggested by Thompson and Strickland, may be *invest-and-grow* (aggressive expansion), *fortify-and-defend* (protect current position by strengthening and adding resource capabilities in new areas), *overhaul and reposition* (make major competitive strategy changes to move the business into a different and ultimately stronger industry position), or *harvest-and-divest*.

**Step-8: Formulating a corporate strategy**

Using the information gathered at the previous steps, strategy makers can now proceed toward formulating (or crafting) corporate strategies. Their strategic moves would aim at improving the overall performance of the diversified company. Based on relevant information and personal judgments, the strategists may consider divestment for certain units, making new acquisitions, restructuring the portfolio, stay with existing units, or alter the pattern of corporate resource allocation.

**Review Questions**

1. Make a list of the techniques for evaluating a diversified company.
2. Discuss the various techniques for effective analysis of diversified companies.

**Application Discussion Questions**

1. Visit a business-unit under a diversified company which is known for its poor performance. Find out the reasons for its poverty in performance and then suggest whether a turnaround strategy can be undertaken to revert back to profitability.

**NOTES**

1. Strategic fit between two businesses exists whenever one or more value chain activities of both the businesses are sufficiently similar. Complete strategic fit occurs when the similar value chain activities help in the transfer of expertise/technological know-how, combining related activities of both, exploiting common use of a brand-name and cross-business collaboration.
2. Hill and Jones, *Strategic Management, op.cit. p. 297.*
3. M. Lubakin and S. Chatterjee, "Extending modern portfolio theory into the domain of corporate diversification: Does it apply?" *Academy of Management Journal*, 37 (1), 1994, pp. 109-36.
4. Thomson and Strickland, *op.cit.*, pp. 299-300.
5. Hill and Jones, *op.cit. p. 327.*
6. D.J. Ravenscraft, and F.M. Scherer, *mergers, Sell-offs and economic efficiency* (Washington DC: Brookings Institution, 1987
7. Hills and Jones, *op.cit. p. 328.*
8. Thomson and Strickland, *op.cit. pp. 308-309.*