The Role of Diversification Strategies in Global Companies - Research Results

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Abstract

The aim of a paper is to present the result of studies and research on the extent of use of diversification strategies in global companies . The data contained the history of the oldest of the biggest 750 American companies and of 300 wordly companies.At the beginning an author discusses the value of popular strategy classifications like Ansoff's matrix, and analyzes its contemporary modifications.Then an extent of the use of diversification in a real world is identified. Four dimensions of diversification are considered:product,market,risk and technology . Finally,an author presents his own proposals on the typology of strategies.

Keywords: corporate strategy,diversification,Ansoff's matrix,strategic synergy

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One of fundamental problems facing the process of strategy formulation in a company is that quantity of potential strategic options is unlimited and extremely complex (Lancaster, Massingham, 1993). In order to systematize and facilitate the choice of strategies , they have developed the set of conceptual frameworks. They help to identify some promissing strategic options.

One of the most fundamental conceptual frameworks is famous H.I.Ansoff's matrix (1957). Although it is now over fifty years since the matrix was proposed, it is still very popular.Some improvements of the original idea were introduced by D.Aaker (1988),Thompson and Martin(1993) and Alterowitz and Zonderman(1988). Nonethless the reality of contemporary markets requires further verification of the idea of Ansoff's matrix and evaluation of the extent to which the matrix is compliant with strategic realities . There could appear following questions:

-to what extent products and markets can be used as basic strategic variables?

-to what extent the four strategies covered by matrix include real strategic choices in the market?

-to what extent these strategies are used by global companies?

- what could be potential ways of improving the idea of the matrix?

THE BASIC ANSOFF'S STRATEGIES

As it is widely known ,the matrix is based on the idea of two strategic variables , that help to select a strategy for a company with ambitions to grow. These are variables : products and markets. Both axes are divided in two subcategeries : old and new.In general strategies employed by companies really, at least indirectly, require to make some choices concerned with those variables. Also strategies included in a matrix: penetration,product development,market development and diversification, create logical options.

What occured be doubtful in the idea of Ansoff's classification of strategies?

At first, what occured was that some of strategies were not ideas homogenious enough and they required some modifications. It is especially diversification strategy, that necessitated the introduction of subcategory - related diversification, as different from unrelated diversification. In fact, it is not frequently that pure diversification can be observed in the market. When it happens that companies simultaneously offer new products , and they do this on new markets, diversification can be an effect of more inertia than of deliberately performed strategy. Pure diversification can also gradually evolve from related diversification.For instance,car manufacturer can assist its clients in financing buying new cars and evolving financial services start to be offered to other clients, than car buyers. In one of more recent books by Ph.Kotler (2009), as an example of pure diversification the case of German Hochtief is used.A company moved from construction industry to real estate market.In fact, this was rather related than unrelated diversification because of some obvious links between construction industry and real estate market.

Additional note should made here .Even if at a given time, there no links between elements of a company's portfolio, it is not necessarily an evidence of pure diversitification. Portfolio can be resultant of more inertia than of attempted strategy (Ansoff1965, Argenti 1974, Andrews 1987).

The next doubt is concerned with dychotomies: old versus new markets, and old products versus new products. Because in practice ,old and new products occured to be extremes, with real choices left somewhere in between, there was a need to adopt at least three level scales for products : old products,improved produtcs but related to old ones, and non-related technologies(Thompson and Martin,1993).Respectively for markets ,a scale could contain: old customers, new customers on old markets and new markets.

DIVERSIFICATION IN GLOBAL COMPANIES.

Research on the history of the biggest world companies has shown, that diversification is not popular strategy. Instead, continuing old portfolio with moderate modification, proves to be safe strategy.

First conclussion of the research is that contemporary market is dominated by old companies. From 750 companies listed in American Business 2007, as much as 28,9 per cent of companies originated before 1900 (!) and 59,1 per cent originated before WWII, as indicated in Table 1 in Appendix. Looking at the broader spectrum of global world it occurs that nearly half of 300 enteprices listed in World Business 2006 , dates back to XIX century and 72,3 per cent companies dates back to times before WWII ,as indicated in Table 2 Appendix. So it proves paradoxically, that in a real world it pays to be old.

The second conclussion is that those oldest companies (i.e. ones originated before 1900) prefered not to diversify, in terms of pure diversification.It is not frequently that a company moves to a new sector. Contrarily, companies use to differentiate their activities within previously served industries. Of the group of 138 companies only 34 per cent gained pure diversification after a century.

Is is especially companies located outside North America and Europe that have been exceptionally diversified. For instance Japaness giant Itochu, went from acting as a trading company to aerospace equipment,multimedia,electronics,steel and chemical industry and supplies of energy. Other company , Hutchison Whampoa ,Hong-Kong, started from importing consumption products and now it operates in port services,telecomunication,energy supplies and hotels.

Also Mitsui&Co Japan, originated in production of alcohol, cash& carry and banking , and today it is active in metal and chemical industry,energy supplies,machinery and electronics and in information technology.Other examples are those of Tata Group,India or Suire Pacific,Hong-Kong.

In Europe , a good example of pure diversification strategy company is Siemens.This company even before WWI was highly diversified- it was successful in telecommunication,electromedical equipment,elevators ,electrical trains,construction(it built the tube in Budapest). That diversification was more typical strategy in Far East or old Germany requires some interpretation. A hypothese could be, that pure diversification is more viable strategy under such conditions as :big govermental protection and low local competition. This could be an explanation not only for local popularity of pure diversification in the past times, but it also explains popularity of conglomerates in newly transformed economies (for instance, in Poland).

Most companies preferes differentiation within previously served sectors.This is the most typical situation of financial services. In most situations a bank, at best, enters insurance market,or an insurance company enters banking sector.In general half of companies –50 percent continue acting in the same business, even if the technological nature of a business changed. For instance, a company that started with telephones, today is in telecommunication business.

Remaining part of wordly companies ,16 per cent, have employed a related diversification strategy.Good example here is Withbread company,UK.This company started as a brewery and now it operates restaurants , hotels, and fitness centers. Other example is Japanesse company Kao Corporation, who like Procter&Gamble,started for soap and then it developed activities in personal care products , it also shows that pure diversification is not quite popular. Johnson and Martin calculate that more that 20 percent of U.S. biggest companies used pure diversification (Thompson and Martin 1993) .They also indicate that after 80' popularity of diversification has decreased .

DIVERSIFICATION VERSUS OTHER MATRIX'S STRATEGIES.

At first glance, it looks that strategies other than diversification –penetration ,market development and product development are consistent concepts .However, from the view point of strategic tools employed, these strategies are far from being consistent.

Market penetration.The idea of increasing sales of the same products on the same markets is realistic strategy more at first stages of products life cycle ,than later on. Simply, good products that face no direct competition and that are supported by adequate marketing efforts, should secure growth of sales.

Later on in life cycle, because of potential competition, an increase of sales requires growing market share. Before, at the introduction stage, the so called natural growth required no specific competition strategy. However an essential increase of market share, would require leaving the idea of sellling exactly the same things to exactly the same markets, what is assumed in the idea of penetration.

Typical tools of penetration are price cuts,more intensive distribution,convincing the customers to use the product more frequently etc. Most of such tools in fact mean some modification of an offer- including product's position in consumers' mind. Penetration tools called by Waterman and Peters „sticking to the knitting" (1982),like investing in brand names or just better doing what has been doing so far ,mean real modification of an offer.

Transforming customers into „heavy users" market segment means some modification of a market.

In long run penetration would mean deep change of the product or the market.

Product develoment strategy .The idea of selling new products on an old market sounds clear. However in practice, what is a problem with product development strategy, is the unclear category of new products.There are various classifications of new product, and in the light of these classification it seems inappropriate to confront old with new product. Typical succesful product development strategies like these of LVHM company , in fact contain strategies of broadening an old brand name of a company on products that are new for brand name owners,not for the world. In other situations, product development strategies are based on such tools like: product enrichment,product line extension,and finally new products.

Conclussion regarding product development strategy, is that instead of confronting old products with new products ,one should consider different levels of changes in a product.

Market development strategy.This strategy is frequently considered as one of limited risk strategies. From formal view point, it contains either expansion to new foreign markets, or only to new segments. It is mainly to this last version of market development,that low risk can be linked. Expansion on foreign markets contains some its versions with really low risk (for example, indirect exporting) and versions with very high risk (greenfield operations) . From the view point of consinstency of a strategy, it looks that simple extending old products on new markets is only partially possible. In fact, even exporting requires a lot changes in products (labeling, conforming to local ecological standards etc.).

Finally we can conclude that strategies included in Ansoff's matrix do not cover real choices to be made by a company. Instead of penetration,diversification,product development and product development, real choices are concerend with some levels of differentiation.

MATRIX OR TWO COORDINATES ?

The idea of limiting the choices on products and markets, to alternatives- old and ones ,is not convincing .Also are not convincing, the dychotomic scales employed in the matrix.So there is a solution proposed in the literature ,that provides for substituting axes of the matrix ,by products and markets as coordinates (Alterowitz & Zonderman 1988).It is obvious however, that this solution is good more as a didactical concept than a precise tool.

PRODUCTS AND MARKETS AS STRATEGIC VARIABLES

Accepting the coordinates, instead of the matrix, leaves still an open question about appropriatness of the very variables: products and markets.

Observing real decisions concerned with penetration and other strategies, one can easily find that they are not reduced to decissions on products. Penetration can be based on price decreases, more intensive distribution or better communication.

For instance Europe's giant airliner Ryanair ,after years of experience, has rediscovered the need to adopt mass press advertising to support company's internet communication.

Any strategic instruments directed to consumers, accompanying eventual changes in product attributes ,in fact ,are elements of marketing mix. So the way from penetration to diversification, goes through changes in marketing mix. In broader sense however, they mean changes in value offered to consumers (Doyle 2000 ,Nilson 1992).So product as a variable can be substituted by value for consumers.

Market as a strategic variable also requires some revision.Simply there is limited potential for the company to keep finding out new markets. Much bigger potential is concerned with redefinition of markets ,ones previously served by a company.In practice, the company continues to deal with the same markets on which it introduces new structures. It is especially true in the case of global markets. They create one spectrum , although one highly divided internally. So conclussion is that strategic decision variables are more market segments ,than markets. The segment targeted by the company can be either a part of an old market, or sometimes it can be a part of outside market.

SOME OTHER DIMENSIONS OF DIVERSIFICATION.

What constitutes fundamental Ansoff's strategies in a real world ,are not only variables like products and markets that are of external nature ;external, in a sense that they are important for customers. They are also internal variables like first of all ,resources of a company.

Decision to diversify or not to diversify is, in fact , the decision on the use of resources or key competencies (Aaker 1988). The slow penetration is nearly fully based of exisiting resources that can be easily identified and valued. Ambitious penetration is justified by more key competencies than resources.For instance, price penetration is justified directly by ability of a firm to reduce costs, apart from having special financial situation. This ability may be concerned with, for instance, technological superiority of a firm and its key technological competencies.

True diversification means departure from company's resources and key competencies. It means resigning from effects of synergy in a company's portfolio.In fact, as it happens in conglomerate diversification, the only synergy may be sometimes ,the so called financial synergy (deWitt & Meyer 2007).

Pure diversification would necessitate to predict acquiring new competencies by a company. It seems that the departure from company's resources required by diversification, explains why this strategy is not so popular in a real world.Also it seems that popular examples of unsuccessful diversification, like Mobil's acquisition of Montgomery Ward, Coca-cola acquisition of Columbia Pictures and General Motor's acquisition of Data Information Services, all were examples of departing too far from key competencies (Best,1997).

It may happen that a special occasion appears in the market, and special resources are not required from a company to gain the success. For instances, it can be a company to be acquired at low cost.
The next dimension of diversification is the risk resulting from the departure from company's resources and its key competencies.
Taking a risk concerned with diversification may be justified in various ways. One of convincing justifications seems to be long range reducing the risk of continuing an old portfolio of a company, in the light of changing environment (Krupski 2005). So it is argued that it pays to take some risk to avoid a bigger risk. However, indicated in the paper phenomena of longevity of low diversified companies, shows that reducing the risk is possible not only through pure diversification.Various forms of differentiation on existing markets also provide an essential ground to reduce the risk.

Summary.Traditional, based on products and markets typology of strategies presents very general framework of strategic choices . It stresses some important interrelated strategic variables and it offers some introductory strategy categories. However both variables and categories of strategies require some revision.
Successful company should primarily base its strategy on value for consumers in given market segments.There is big potential for diferentiating both value offered and segments served.
Traditional models of strategy types based on Ansoff's matrix underapperaciate penetration and overaprreciate diversification.Real choices are and should be concerned with some levels of differentiating either consumer value or market segments , according to market conditions. Choices should be determined, on one side by resources and key competencies already developed by a company ,and on the other side by potential risk concerned with eventual possesing new resources and competencies that would be required.

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Appendix

Table 1. Time period when today's biggest American companies were established

	Until 1900	1901-1910	1911-1920	1921-1930	1931-1940	1941-1950	1951-1960	1961-1970	1971-1980	1981-1990	1991-2000	2001-
Number of companies	217	47	71	79	29	49	47	63	65	55	26	2
Per cent of total	28,9	6,3	9,5	10,5	3,9	6,5	6,3	8,4	8,7	7,3	3,5	0,3

Source: Calculations based on data :*Hoover's Handbook ofAmerican Business 2007*, Austin:Hoovers&DB Company

Table 2. Time period when today's biggest world companies were established

	Until 1900	1901-1910	1911-1920	1921-1930	1931-1940	1941-1950	1951-1960	1961-1970	1971-1980	1981-1990	1991-2000	2001--
Number of companies	139	19	20	26	16	21	18	19	7	11	4	-
Per cent of total	46,3	6,3	6,7	8,7	5,3	7,0	6,0	6,3	2,3	3,7	1,3	-

Source: Calculations based on data:*Hoover's Handbook ofWorld Business 2006*,Austin:Hoovers& DB Company