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Diversification

CONCENTRIC DIVERSIFICATION

Concentric diversification occurs when a firm adds related products or markets. The goal of such diversification is to achieve strategic fit. Strategic fit allows an organization to achieve synergy. In essence, synergy is the ability of two or more parts of an organization to achieve greater total effectiveness together than would be experienced if the efforts of the independent parts were summed. Synergy may be achieved by combining firms with complementary marketing, financial, operating, or management efforts. Breweries have been able to achieve marketing synergy through national advertising and distribution. By combining a number of regional breweries into a national network, beer producers have been able to produce and sell more beer than had independent regional breweries.

Financial synergy may be obtained by combining a firm with strong financial resources but limited growth opportunities with a company having great market potential but weak financial resources. For example, debt-ridden companies may seek to acquire firms that are relatively debt-free to increase the lever-aged firm's borrowing capacity. Similarly, firms sometimes attempt to stabilize earnings by diversifying into businesses with different seasonal or cyclical sales patterns.

CONGLOMERATE DIVERSIFICATION

Conglomerate diversification occurs when a firm diversifies into areas that are unrelated to its current line of business. Synergy may result through the application of management expertise or financial resources, but the primary purpose of conglomerate diversification is improved profitability of the acquiring firm. Little, if any, concern is given to achieving marketing or production synergy with conglomerate diversification.

One of the most common reasons for pursuing a conglomerate growth strategy is that opportunities in a firm's current line of business are limited. Finding an attractive investment opportunity requires the firm to consider alternatives in other types of business. Philip Morris's acquisition of Miller Brewing was a conglomerate move. Products, markets, and production technologies of the brewery were quite different from those required to produce cigarettes.

Without some form of strategic fit, the combined performance of the individual units will probably not exceed the performance of the units operating independently. In fact, combined performance may deteriorate because of controls placed on the individual units by the parent conglomerate. Decision-making may become slower due to longer review periods and complicated reporting systems.

DIVERSIFICATION: GROW OR BUY?

Diversification efforts may be either internal or external. Internal diversification occurs when a firm enters a different, but usually related, line of business by developing the new line of business itself. Internal diversification frequently involves expanding a firm's product or market base. External diversification may achieve the same result; however, the company enters a new area of business by purchasing another company or business unit. Mergers and acquisitions are common forms of external diversification.

INTERNAL DIVERSIFICATION.

One form of internal diversification is to market existing products in new markets. A firm may elect to broaden its geographic base to include new customers, either within its home country or in international markets. A business could also pursue an internal diversification strategy by finding new users for its current product. For example, Arm & Hammer marketed its baking soda as a refrigerator deodorizer. Finally, firms may attempt to change markets by increasing or decreasing the price of products to make them appeal to consumers of different income levels.

Another form of internal diversification is to market new products in existing markets. Generally this strategy involves using existing channels of distribution to market new products. Retailers often change product lines to include new items that appear to have good market potential. Johnson & Johnson added a line of baby toys to its existing line of items for infants. Packaged-food firms have added salt-free or low-calorie options to existing product lines.

It is also possible to have conglomerate growth through internal diversification. This strategy would entail marketing new and unrelated products to new markets. This strategy is the least used among the internal diversification strategies, as it is the most risky. It requires the company to enter a new market where it is not established. The firm is also developing and introducing a new product. Research and development costs, as well as advertising costs, will likely be higher than if existing products were marketed. In effect, the investment and the probability of failure are much greater when both the product and market are new.

EXTERNAL DIVERSIFICATION

External diversification occurs when a firm looks outside of its current operations and buys access to new products or markets. Mergers are one common form of external diversification. Mergers occur when two or more firms combine operations to form one corporation, perhaps with a new name. These firms are usually of similar size. One goal of a merger is to achieve management synergy by creating a stronger management team. This can be achieved in a merger by combining the management teams from the merged firms.

Acquisitions, a second form of external growth, occur when the purchased corporation loses its identity. The acquiring company absorbs it. The acquired company and its assets may be absorbed into an existing business unit or remain intact as an independent subsidiary within the parent company. Acquisitions usually occur when a larger firm purchases a smaller company. Acquisitions are called friendly if the firm being purchased is receptive to the acquisition. (Mergers are usually "friendly.") Unfriendly mergers or hostile takeovers occur when the management of the firm targeted for acquisition resists being purchased.

DIVERSIFICATION: VERTICAL OR HORIZONTAL?

Diversification strategies can also be classified by the direction of the diversification. Vertical integration occurs when firms undertake operations at different stages of production. Involvement in the different stages of production can be developed inside the company (internal diversification) or by acquiring another firm (external diversification). Horizontal integration or diversification involves the firm moving into operations at the same stage of production. Vertical integration is usually related to existing operations and would be considered concentric diversification. Horizontal integration can be either a concentric or a conglomerate form of diversification.

VERTICAL INTEGRATION.

The steps that a product goes through in being transformed from raw materials to a finished product in the possession of the customer constitute the various stages of production. When a firm diversifies closer to the sources of raw materials in the stages of production, it is following a backward vertical integration strategy. *Avon's* primary line of business has been the selling of cosmetics door-to-door. *Avon* pursued a backward form of vertical integration by entering into the production of some of its cosmetics. Forward diversification occurs when firms move closer to the consumer in terms of the production stages. Levi Strauss & Co., traditionally a manufacturer of clothing, has diversified forward by opening retail stores to market its textile products rather than producing them and selling them to another firm to retail.

Backward integration allows the diversifying firm to exercise more control over the quality of the supplies being purchased. Backward integration also may be undertaken to provide a more dependable source of needed raw materials. Forward integration allows a manufacturing company to assure itself of an outlet for its products. Forward integration also allows a firm more control over how its products are sold and serviced. Furthermore, a company may be better able to differentiate its products from those of its competitors by forward integration. By opening its own retail outlets, a firm is often better able to control and train the personnel selling and servicing its equipment.

Since servicing is an important part of many products, having an excellent service department may provide an integrated firm a competitive advantage over firms that are strictly manufacturers.

Some firms employ vertical integration strategies to eliminate the "profits of the middleman." Firms are sometimes able to efficiently execute the tasks being performed by the middleman (wholesalers, retailers) and receive additional profits. However, middlemen receive their income by being competent at providing a service. Unless a firm is equally efficient in providing that service, the firm will have a smaller profit margin than the middleman. If a firm is too inefficient, customers may refuse to work with the firm, resulting in lost sales.

Vertical integration strategies have one major disadvantage. A vertically integrated firm places "all of its eggs in one basket." If demand for the product falls, essential supplies are not available, or a substitute product displaces the product in the marketplace, the earnings of the entire organization may suffer.

HORIZONTAL DIVERSIFICATION.

Horizontal integration occurs when a firm enters a new business (either related or unrelated) at the same stage of production as its current operations. For example, Avon's move to market jewelry through its door-to-door sales force involved marketing new products through existing channels of distribution. An alternative form of horizontal integration that Avon has also undertaken is selling its products by mail order (e.g., clothing, plastic products) and through retail stores (e.g., Tiffany's). In both cases, Avon is still at the retail stage of the production process.

DIVERSIFICATION STRATEGY AND MANAGEMENT TEAMS

As documented in a study by Marlin, Lamont, and Geiger, ensuring a firm's diversification strategy is well matched to the strengths of its top management team members factored into the success of that strategy. For example, the success of a merger may depend not only on how integrated the joining firms become, but also on how well suited top executives are to manage that effort. The study also suggests that different diversification strategies (concentric vs. conglomerate) require different skills on the part of a company's top managers, and that the factors should be taken into consideration before firms are joined.

There are many reasons for pursuing a diversification strategy, but most pertain to management's desire for the organization to grow. Companies must decide whether they want to diversify by going into related or unrelated businesses. They must then decide whether they want to expand by developing the new business or by buying an ongoing business. Finally, management must decide at what stage in the production process they wish to diversify.

Conglomerate diversification

Type of diversification whereby a firm enters (through acquisition or merger) an entirely different market that has little or no synergy with its core business or technology.

Ex: Imagine you were able to maximize your opportunities, minimize your risks and achieve performance breakthroughs. You're probably thinking – "that would be great, how do I do it?" Well it's simple but this simplicity demands critical thinking and diligent effort. So if you're interested, let's find out how. Achieving this level of performance requires a deliberate strategy with a performance management and measurement system that enables you to scan the business horizon, focus your time, energy, knowledge, relationships and resources and execute courses of action that possess the highest pay-off, lowest costs and easiest implementation trajectory. You may wonder whether such a strategy formulation is worth your time and effort, especially if you're in a quickly changing business environment. This issue came up in a discussion with leading business writer and consultant *Seth Godin*. We concluded that business strategy drives growth and prosperity for businesses, both large and small. *Godin* said that for example *Howard Shultz*, founder and head of *Starbucks Coffee*, could have decided to open and run only a few stores, but you better believe that to grow *Starbucks* like he has he had to have a business strategy.

So with that as introduction let's go through a step-by-step process for developing a business strategy with a performance management and measurement system for your business. Let's call it a "Grand Strategy" because it equates to a necessary precursor for all subordinate strategies and systems whether they be marketing, innovation or otherwise. There are 12 steps to this Grand Strategy process. The first 11 steps of this process are best developed as a living document with your top management team and a facilitator at an off-site meeting to avoid distractions. And step twelve, "Execute, Adjust, and Execute" requires strong top management commitment, support and involvement.

Step One. Ask "what's your 'Theory of Business'?" As philosophers tell us, there is nothing as practical as good theory. Briefly answer these four questions to uncover yours.

What business are you in and where are you now?

Where are you going?

How will you get there?

How will you know you've arrived?

Step Two. Create a clear expression of your intangible business resources. These intangibles form an intellectual and emotional grounding for your *Grand Strategy*. They drive your business and business relationships. Without them, you won't be able to commit the time, energy and tangible resources that move your business forward. These intangibles are:

Values – high level concepts that you pour your life into regardless of financial return because they define you and your business. Some examples are family well being, charity and goodwill toward others, honesty and integri ty, and making a difference in the world.

Beliefs - key principles that state your assumptions about the cause and effect relationships that drive you and your business. For example, if we provide excellent products and services that please our customers at a competitive price, we will be a profitable business.

Attitudes – emotional orientations exhibited by you and your business toward others that affects how you view them and treat them, and in turn how they react to you and your business. Attitudes result in either positive or negative expressions such as "most people tend to be fair if treated fairly" or "most people will take advantage of you if you let them.

Capabilities – inherent knowledge and relationships that support getting work done for you and your business. For example, such things as patents, suppliers and customer data bases, production processes, sales force knowledge,

knowledge about competitors, technological expertise and customer relationships fit here.

What are your Values, Beliefs, Attitudes and Capabilities? List them.

Step Three. Write a "Mission Statement." This statement provides you with the articulation of your business purpose or reason for being. Answering the following four questions in a satisfying amount of detail provides compelling background information from which you can extract a hard hitting mission statement to move your business and Grand Strategy forward.

- Why are you in business?
- What does your business do and how does it do it
- Who does your business, who supports it, who benefits from it and who, if

  anyone, suffers from it?
- How many different kinds of resources are involved in your business, how much do they costs and how much profit do you expect to make from them?

Answer these questions and notice the power of their focusing affect on your business. From your answers, develop a condensed and hard hitting *Mission Statement*.

Step Four. Perform an "Environmental Scan" by asking and answering the following questions:

1. What industry are you in (retail, wholesale, finance, manufacturing, durable or non-durable goods and so on) and what are its trends?

2. Potential competitors? What relevant advantages and disadvantages do they possess?

3. Who are your suppliers and potential suppliers? What mutual interests do you share with them? What natural conflicts exist?

4. Who are your customers and potential customers and who are their customers? What segments do they fall in?

5. What are the demographics that impact your business – age groups, ethnics, economic status? What are their differences in terms of needs and preferences?

6. What is the regulatory environment and how does it affect your business?

7. What are the emerging technologies and how might they affect your business?

8. Who are your stakeholders (employees, suppliers, customers, investors and community) and what are their expectations?Answer these Environmental Scan questions in order to possess the necessary business intelligence and insight to proceed to the next step.

Step Five. After you complete your scan, then perform a *SWOT Analysis*. SWOT stands for "Strengths," "Weaknesses," "Opportunities" and "Threats."

Your Strengths and Weaknesses are internal. Your Opportunities and Threats are external.

The areas for you to explore under each *SWOT Analysis* category are:

Strengths or Weaknesses

1. Customer Service
2. Products
3. Systems and Processes
4. R&D
5. Cash Flow
6. Employee Training
7. Employee Loyalty
8. Others?

Opportunities or **Threats**

1. Emerging Products and Services
3. Technological Change New Markets
4. Competitive Pressures
5. Supplier Relationships
6. Economic Conditions
7. Others?

Now, brainstorm to generate ideas under each category/area. Generate as many as ideas as possible. Using your best judgment, select the top six ideas in terms of relevance and importance for improving the performance and competitiveness of your business. Next, translate the top six selected ideas into goal statements. For this translation process, use the following format: action verb + (restated idea) in order to (object). For example, a goal statement would look like this: "Increase customer satisfaction in order to reduce customer losses and defections."

Step Six. Determine your "Strategic Focus." Business is becoming more and more competitive. Let's call this phenomenon "Hyper-Competition." From it we see the time lapse between finding a competitive edge and having it copied shrinking. *Hyper*-Competition demands that you differentiate. This differentiation starts with you selecting a Strategic Focus for your business. Otherwise your products and services become commoditized.

Strategic Focus breaks down into the following three disciplines:

Customer Intimacy - emphasizes paying close attention to customers desires and providing them with total, not to be beaten service and solutions. *Ritz* Carlton Hotels and Nordstroms lead with this discipline.

1. Product Leadership – emphasizes R&D and providing the best technology and quality available in products. Intel and Starbucks lead with this discipline.

2. Operational Excellence – emphasizes efficient operations and costs controls to provide the lowest costs. *Wal-Mart* and *Southwest Airlines* lead with this discipline.

Picking one of these as your lead focus represents a smart thing to do. This imperative does not mean that you don't try to do well in the other two. It means that you don't try to do all three equally well. Trying to be all things for all customers puts you on a path to failure because customers will not behave in a way that profits your business. Business is just too hyper-competitive for you to succeed doing all three better than anyone else.

So now look at your: Theory of Business; Values, Beliefs, Attitudes and Capabilities; Mission Statement, Environmental Scan and SWOT Analysis, and then make a judgment call. Pick your Strategic Focus and lead with it.

Step Seven. Seek performance breakthroughs. You begin this process by selecting your *Strategic Focus* and limiting your goal statements to the top six.

These top six goals represent your "Strategic Goals" for achieving performance breakthroughs.

If you look at the time you spend on your business, you find it can be broken down into three categories. These are:

- Administrative and Operations – the time you spend keeping the routine day to day business running
- Crisis – the time you spend solving unanticipated problems
- Breakthrough – the deliberate time you spend on creative efforts to improve performanc

What happens is that the first two time categories grow to occupy all your time and they push out your breakthrough time. Maintaining a Strategic Focus combined with developing Strategic Goals to execute amounts to the only workable solution to this challenge. Now, incorporate this thinking into the succeeding steps of your Grand Strategy process.

Step Eight. Understand and apply "Cause and Effect Relationships." Let's discuss the dynamics of Cause and Effect Relationships among your Strategic Goals. There are four basic "Perspectives" that provide the framework for linking your goals in to your Grand Strategy. These Perspectives are:

- Human Capital – the people talent in your organization and the systems and process that directly enable them to be productive. A good way to look at the people part is that it's what goes home at night.

- Structural Capital – the systems, structures and strategies that the organization owns and produces value with. It stays in the organization when you turn off the lights.

- Customer Capital – the relationship, level of satisfaction, reputation, potential for referrals and loyalty which your organization enjoys with its customers.

- Financial Performance – the level of economic return provided to you and your owners relative to investment. Performance under this perspective is also

compared to alternative investments like T-Bills.

Step Nine. Develop a "Strategy Map." Let's start by looking at an example.

A Harvard Business Review article, The Employee – Customer Profit Chain at Sears, Jan-Feb 1998, chronicled a transformation of Sears.

Step Ten. Translate your Strategy Map goals into "Key Performance Measures" (KPMs) and perform a "Gap Analysis." First, translate your goals into measurable terms. In some cases, a goal may already be stated in measurable terms. But you often have to break goals down and restate them in measurable terms. For example, the Structural Capital Goal of "Create and Maintain Well Stocked and Attractive Shelves" may be broken down and restated as the KPM "Mystery Shoppers Rating for Store Product Display and Appeal."

Step Eleven: Financial Performance Goals are usually stated in measurable terms so use these terms for your Financial Performance KPMs as appropriate. On Customer, Structural and Human Capital Goals, you usually have to restate them in KPM terms with a number, percentage or ranking. Some examples of KPMs follow:

Step Twelve. Execute, Adjust, Execute. A Fortune Magazine study in June 1999 found that many CEOs were fired because they failed to execute their strategy. Things really have not changed much since then. As a friend, Mike Kipp, a consultant from Nashville, Tennessee, says "All organizations are perfectly designed to achieve the results they are getting." Don't confuse creating your *Grand Strategy* with taking action. Now the *Grand Strategy process* demands real work and organizational change. Otherwise improvement won't occur and things might even get worse. Execution and appropriate adjustments are imperative or you've only done an academic exercise.

Grand Strategy Steps

Summary

- **Step One.** Answer "what's your *Theory of Business*?"

- **Step Two.** Identify your *Values, Beliefs, Attitudes and Capabilities*.

- **Step Three.** Write your *Mission Statement*. **Step Four.** Perform an *Environmental Scan*.

- **Step Five.** Perform a *SWOT Analysis*.

- **Step Six.** Determine your *Strategic Focus*.

- **Step Seven.** Seek Performance Breakthroughs.

- **Step Eight.** Understand and Apply *Cause and Effect Relationships*.

- **Step Nine.** Develop a *Strategy Map*.

- **Step Ten**. Translate goals into *KPMs* and Perform *Gap Analysis*.

- **Step Eleven**. Prepare a *Scorecard* to track and drive Your *Grand Strategy*.

- **Step Twelve.** Execute, Adjust, Execute

Entrepreneurship

It is the act of being an entrepreneur, which can be defined as "one who undertakes innovations, finance and business acumen in an effort to transform innovations into economic goods". This may result in new organizations or may be part of revitalizing mature organizations in response to a perceived opportunity. The most obvious form of entrepreneurship is that of starting new businesses. In recent years, the term has been extended to include social and political forms of entrepreneurial activity. When entrepreneurship is describing activities within a firm or large organization it is referred to as intra- preneurship and may include corporate venturing, when large entities spin-off organizations.

According to Paul Reynolds, entrepreneurship scholar and creator of the Global Entrepreneurship Monitor, "by the time they reach their retirement years, half of all working men in the United States probably have a period of self-employment of one or more years; one in four may have engaged in self-employment for six or more years. Participating in a new business creation is a common activity among U.S. workers over the course of their careers." And in recent years has been documented by scholars such as David Audretsch to be a major driver of economic growth in both the United States and Western Europe.Entrepreneurial activities are substantially different depending on the type of organization and creativity involved. Entrepreneurship ranges in scale from solo projects (even involving the entrepreneur only part-time) to major undertakings creating many job opportunities. Many "high value" entrepreneurial ventures seek venture capital or angel funding (seed money) in order to raise capital to build the business.

Organizational Politics

Organizational politics have been defined as ―actions by individuals which are directed toward the goal of furthering their own self interests without regard for the well-being of others or their organization‖ (Kacmar and Baron 1999, p. 4). Research suggests that perceptions of organizational politics consistently result in negative outcomes for individuals (Harris, Andrews, and Kacmar 2007). According to Harris and Kacmar (2005), politics has been conceptualized as a stressor in the workplace because it leads to increased stress and/or strain reactions. Members of organization react physically and psychologically to perceptions of organizational politics, physical reactions including fatigue and somatic tension (Cropanzano et al. 1997), and psychological reactions include reduced commitment (Vigoda 2000) and reduced job satisfaction (Bozeman et al. 2001)

Strategy Formulation	**Strategy Implementation**
Strategy Formulation includes planning and decision-making involved in developing organization's strategic goals and plans.	Strategy Implementation involves all those means related to executing the strategic plans.
In short, Strategy Formulation is placing the Forces before the action.	In short, Strategy Implementation is managing forces during the action.
Strategy Formulation is an Entrepreneurial Activity based on strategic decision-making.	Strategic Implementation is mainly an Administrative Task based on strategic and operational decisions.
Strategy Formulation emphasizes on effectiveness.	Strategy Implementation emphasizes on efficiency.
Strategy Formulation is a rational process.	Strategy Implementation is basically an operational process.
Strategy Formulation requires co-ordination among few individuals.	Strategy Implementation requires co-ordination among many individuals.
Strategy Formulation requires a great deal of initiative and logical skills.	Strategy Implementation requires specific motivational and leadership traits.
Strategic Formulation precedes	Strategy Implementation.

Strategy Implementation follows Strategy Formulation.