Successful corporate diversification strategies

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Study of rationale behind corporate diversification, its implication and implementation falls under the subject of Strategic Management. Strategic management deals with the long term goals of the corporation. Managers take strategic decisions to react to the changes in the market place and the competitive environment. Decision making at this level is highly unstructured and are generally considered on case by case basis. The cost of corporate diversification is very large hence managers have to make an informed decision to ensure the continued success of their business.

Introduction & Statement of purpose

An attempt will be made to identify the factors that motivate companies to diversify. Using historical data and examples we will try to understand the different diversification strategy, companies employ. However, is it that particular set of strategy more effective than others? Is diversification more common in a particular industry sector? Should a company diversify when it is successful and have surplus wealth or should they diversify when their business is not doing well? Should all the business eventually diversify? Does diversification help companies to minimize risk? These are some of the questions that will be tacked in this final management project. Globalization has brought about new challenges and opportunities for the companies around the world. Phenomenon such increase in competition, softening of trade barriers and advancement in technology and transportation has forced companies to come up with strategies to position them on the path of sustained growth. Despite being acknowledged as an important topic, very few researches have been undertaken to explore the key drivers behind successful diversification decisions.

Literature Review

The idea of corporate diversification is not new, over the last few decades there have been quite many companies which have diversified its business, some succeeded while others failed. Due to the lack of any influential ideas and frameworks, it is still a puzzle for many general mangers as to what constitute a successful diversification strategy. Academic researchers have also divided themselves in two opposing schools of thought. There are some who describe corporate diversification as a value destroying practice whereas others consider it as a value creation process. According to Michael Porter (1987), diversification records of thirty three large, prestigious U. S. companies from 1950 to 1986 show that most of them had divested many more acquisitions than they had kept. Instead of creating value, it has led to dissipation of shareholder value.

Establishment of business school in 1950's and 60's provided manager the necessary general management skills, basic management principles applicable to all kinds of enterprise was the prime focus. Acquisition of unrelated business and growth of conglomerates, served as an opportunity to experiment new ideas and business models. Success of U. S. conglomerates such as Textron and ITT encouraged other European and Asian companies to try out diversification strategy. However instead of applying management principles and following a process of thoughtful evaluation, emphasis was more on the acquisition of companies whose assets were worth more than their stock price. During this period, popular view suggested that managers of the large conglomerates possessed the skills to manage their extensive business operations. Effective application of

key management principles like managerial accounting, rigid financial control, detailed budgets and frequent interaction amongst managers were thought to be mantra for successful diversified business. All these seem to justify the fact that diversification, if managed properly would lead to corporate success.

As we approach the 70’s, things started looking quite different. Stock prices of conglomerates begin to fall; in some cases it was as high as fifty percent as compared to only nine percent decline in the Dow Jones Industrial Average over the same period. Even General Electric who pioneered in developing and using sophisticated management practices to manage their diverse portfolio encountered a period of “ profitless growth” from 1965 to 1970. Continued trends illustrating the failure of diversified business forced conglomerates to divest and think about new ways to manage their diversity. Suddenly it was becoming very difficult to manage such diversified business. Managers were confused as to which part of their business should they concentrate. The senior managers began contemplating about on their “ corporate strategy”. By late 1970’s formal strategic planning systems and frameworks were put in place, the irony was that it was focused at business unit level and did very little to guide managers handling different business. However Andrews (1980) listed identification of the businesses in which the firm would compete as the main task of corporate strategist, and this became the convention of corporate strategic management. Consulting Groups such as Boston Consulting Group came up with new techniques of portfolio planning that helped executives in allocation of resources amongst different business. Growth/Share matrix and attractiveness/business position

matrix etc are still the most widely used strategic frameworks, used to assess the corporate position and opportunities in a particular business. However the problem with portfolio management was found soon. Philippe Haspeslagh (1982) found that organizational framework was an important variable explaining the corporate performance. Different kinds of business had to be managed differently and most companies were missing the right organizational mix/integration/adaptation to run their diversified business efficiently.

During 1980-90's, weak performance of many conglomerates drew harsh criticism from prominent management strategists and thinkers like Michael E. Porter. In a bid to restore the faith in diversified businesses, executives turned their attention to " Value based planning", motivating them use financial tools such as discounted cash flow, ROE and hurdle rates to improve the stock price and deliver the stockholder expectation. It still did not answer how managers can add value to diversified portfolio. Peters and Waterman (1982) ushered a new wave of corporate view on diversification – Stick to the knitting. They observed that successful conglomerates never diversified widely. They specialized in particular sector and focused on building knowledge and skills in those areas.

As we fast forward to 1990-2000's the main issues for corporate manager were organizational restructuring, identification of core portfolios and adding values in them. Three philosophies have received support in current management thinking: 1. Limit diversification to business with synergy 2. Diversification should be able to exploit the core competence 3. Build a

portfolio that fit within the organizational structure and that has compatible management style at all levels.

Methods

The research topic will first be explored from an academics point of view, facts and data about diversified conglomerates will be collected from the business/management databases. Management frameworks will be applied to test the hypothesis whether diversification strategy is in line with current academic thinking and whether companies diversified in the right business. List of both successful and unsuccessful diversification will be considered. Websites of the companies can be used as a reliable source to collect information about their different portfolios. Attempts will be made to contact the researchers and academician, who can provide us an updated view on the current diversification scenario.