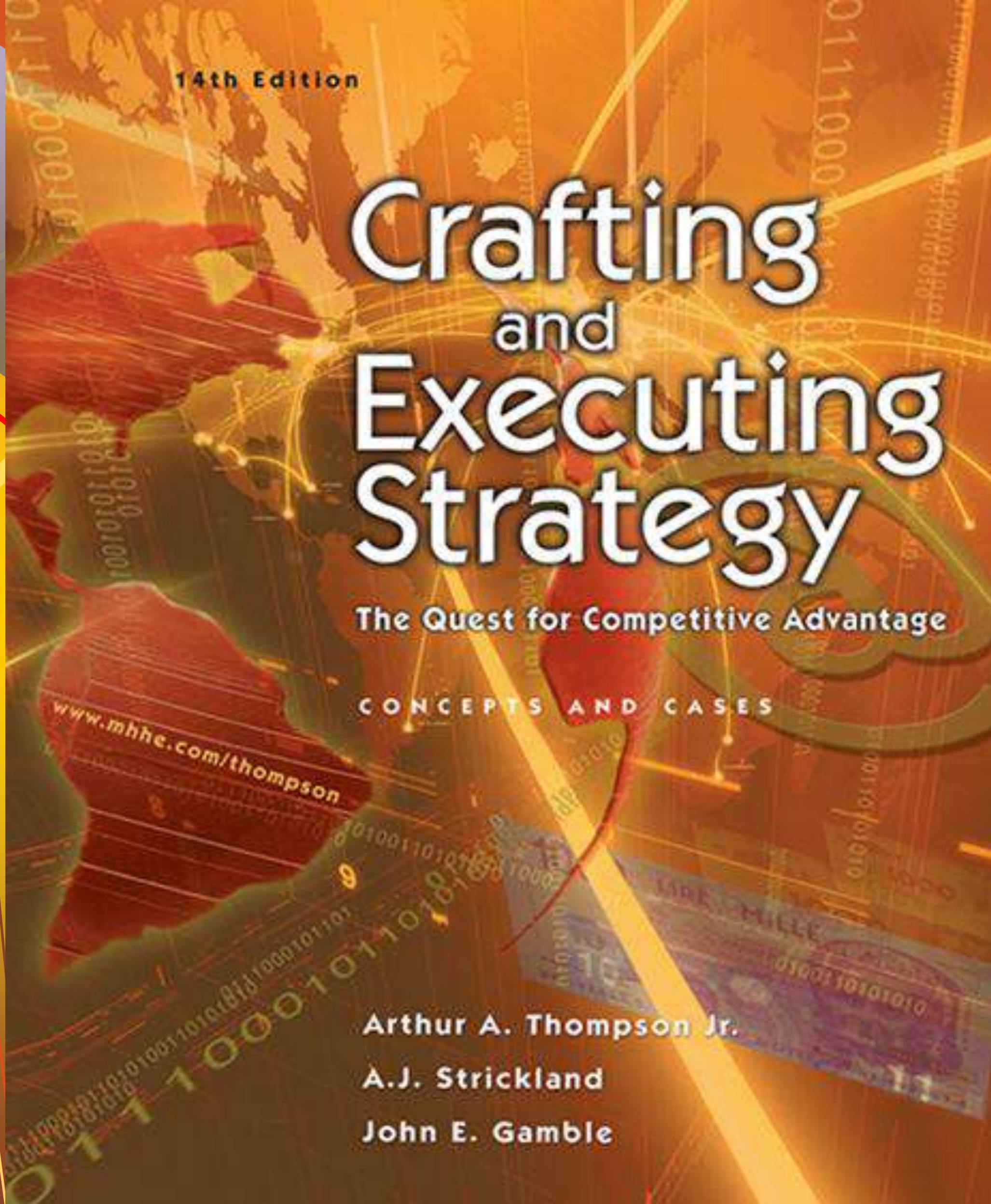
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Chapter

9

Diversification

Strategies for Managing a Group of Businesses

Screen graphics created by:
Jana F. Kuzmicki, Ph.D.
Troy State University-Florida and Western Region

"To acquire or not to acquire: that is the question."

Robert J. Terry

"Make winners out of every business in your company. Don't carry losers."

Jack Welch
Former CEO, General Electric

Chapter Roadmap

- When to Diversify
- Strategies for Entering New Businesses
- Choosing the Diversification Path: Related versus Unrelated Businesses
- The Case for Diversifying into Related Businesses
- The Case for Diversifying into Unrelated Businesses
- Combination Related-Unrelated Diversification Strategies
- Evaluating the Strategy of a Diversified Company
- After a Company Diversifies: The Four Main Strategy Alternatives

Diversification and Corporate Strategy

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

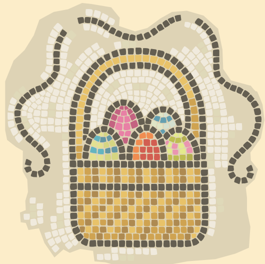
Four Main Tasks in Crafting Corporate Strategy

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

Competitive Strengths of a Single-Business Strategy

- Less ambiguity about
  - "Who we are"
  - "What we do"
  - "Where we are headed"
- Resources can be focused on
  - Improving competitiveness
  - Expanding into new geographic markets
  - Responding to changing market conditions
  - Responding to evolving customer preferences

Risks of a Single Business Strategy



- Putting all the “eggs” in one industry basket
- If market becomes unattractive, a firm’s prospects can quickly dim

- Unforeseen changes can undermine a single business firm’s prospects
  - Technological innovation
  - New products
  - Changing customer needs
  - New substitutes

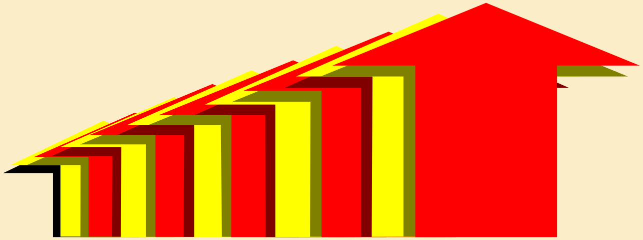
When Should a Firm Diversify?

- It is faced with ***diminishing growth prospects*** in ***present business***
- It has opportunities to ***expand*** into industries whose ***technologies and products complement*** its present business
- It can ***leverage existing competencies and capabilities*** by expanding into businesses where these resource strengths are key success factors
- It can ***reduce costs*** by diversifying into closely related businesses
- It has a ***powerful brand name*** it can transfer to products of other businesses to increase sales and profits of these businesses

Why Diversify?

- To ***build shareholder value!***

1 + 1 = 3



- Diversification is capable of building shareholder value if it passes three tests:
  1. **Industry Attractiveness Test**—the industry presents good long-term profit opportunities
  2. **Cost of Entry Test**—the cost of entering is not so high as to spoil the profit opportunities
  3. **Better-Off Test**—***the company's different businesses should perform better together*** than as stand-alone enterprises, such that company A's diversification into business B produces a 1 + 1 = 3 effect for shareholders

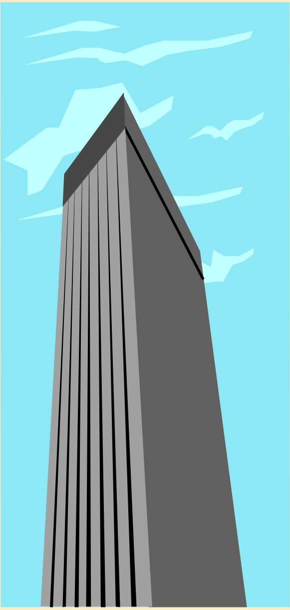
 McGraw-Hill/Irwin

Strategies for Entering New Businesses

- Acquire existing company
- Internal start-up
- Joint ventures/strategic partnerships

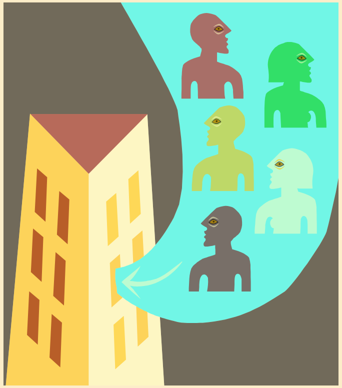
Acquisition of an Existing Company

- Most popular approach to diversification
- Advantages
  - Quicker entry into target market
  - Easier to hurdle certain entry barriers
    - **Acquiring technological know-how**
    - **Establishing supplier relationships**
    - **Becoming big enough to match rivals' efficiency and costs**
    - **Having to spend large sums on introductory advertising and promotion**
    - **Securing adequate distribution access**



Internal Startup

- More attractive when
  - Parent firm already has most of needed resources to build a new business
  - Ample time exists to launch a new business
  - Internal entry has lower costs than entry via acquisition
  - New start-up does not have to go head-to-head against powerful rivals
  - Additional capacity will not adversely impact supply-demand balance in industry
  - Incumbents are slow in responding to new entry



Joint Ventures and Strategic Partnerships

- Good way to diversify when
  - Uneconomical or risky to go it alone
  - Pooling competencies of two partners provides more competitive strength
  - Only way to gain entry into a desirable foreign market
- Foreign partners are needed to
  - Surmount tariff barriers and import quotas
  - Offer local knowledge about
    - **Market conditions**
    - **Customs and cultural factors**
    - **Customer buying habits**
    - **Access to distribution outlets**

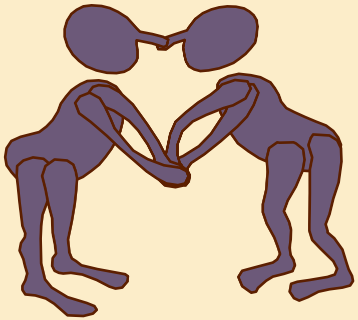
Drawbacks of Joint Ventures

- Raises questions
  - Which partner will do what
  - Who has effective control
- Potential conflicts
  - Whether to use local sourcing of components
  - How much production to export
  - Whether operations will conform to local or foreign partner's standards
  - Extent to which local partner can make use of foreign partner's technology and intellectual property

Related vs. Unrelated Diversification

Related Diversification

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



Unrelated Diversification

Involves diversifying into businesses with no competitively valuable value chain match-ups or strategic fits with firm's present business(es)

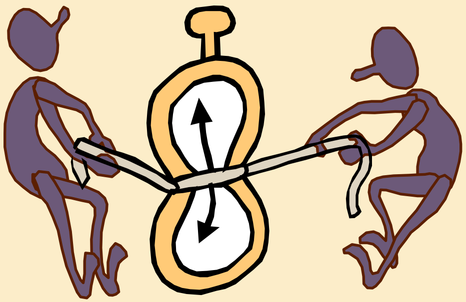


Fig. 9.1: Strategy Alternatives for a Company Looking to Diversify

Diversification Strategy Options

Diversify into Related Businesses

- Enhance shareholder value by capturing cross-business strategic fits:
  - Transfer skills and capabilities from one business to another.
  - Share facilities or resources to reduce costs.
  - Leverage use of a common brand name.
  - Combine resources to create new strengths and capabilities.

Diversify into Unrelated Businesses

- Spread risks across completely different businesses.
- Build shareholder value by doing a superior job of choosing businesses to diversify into and of managing the whole collection of businesses in the company's portfolio.

Diversify into Both Related and Unrelated Businesses

What Is Related Diversification?

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

- Capturing the ***"strategic fits"*** makes related diversification a ***1 + 1 = 3 phenomenon***

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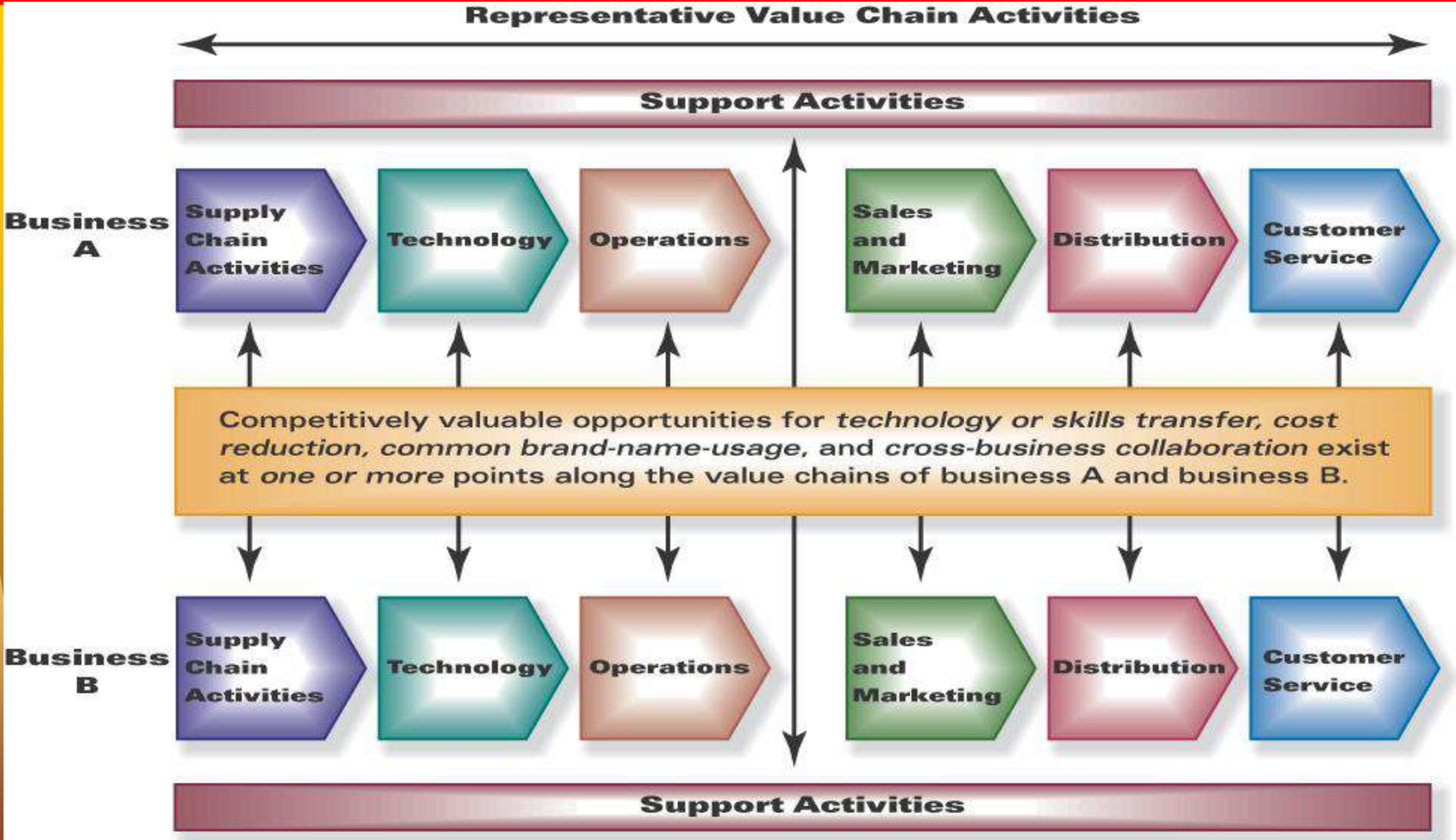
Core Concept: Strategic Fit

- Exists ***whenever one or more activities*** in the ***value chains*** of ***different businesses*** are sufficiently similar to ***present opportunities*** for

  - ***Transferring*** competitively valuable expertise or technological know-how from one business to another
  - ***Combining*** performance of common value chain activities to achieve lower costs
  - ***Exploiting*** use of a well-known brand name
  - Cross-business ***collaboration*** to create competitively valuable resource strengths and capabilities

Fig. 9.2: Value Chain Relationships for Related Businesses



Strategic Appeal of Related Diversification

- Reap ***competitive advantage*** benefits of
  - Skills transfer
  - Lower costs
  - Common brand name usage
  - Stronger competitive capabilities

- ***Spread*** investor ***risks*** over a broader base
- Preserves ***strategic unity*** in its business activities
- Achieve ***consolidated performance*** greater than the sum of what individual businesses can earn operating independently

Types of Strategic Fits

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

R&D and Technology Fits

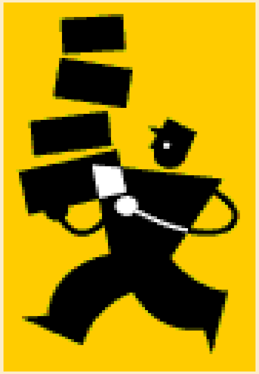
- Offer potential for ***sharing common technology*** or ***transferring technological know-how***

- ***Potential benefits***
  - Cost-savings in technology development and new product R&D
  - Shorter times in getting new products to market
  - Interdependence between resulting products leads to increased sales

Supply Chain Fits

- Offer potential ***opportunities*** for ***skills transfer and/or lower costs***

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



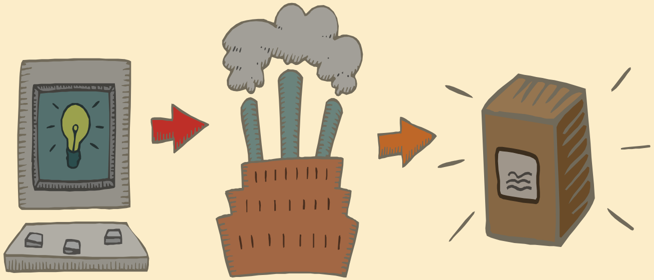
Manufacturing Fits

- Potential source of competitive advantage when a diversifier's ***expertise*** can be beneficially ***transferred*** to another business
  - ➔ Quality manufacture
  - ➔ Cost-efficient production methods

- ***Cost-saving opportunities*** arise from ability to perform manufacturing/assembly activities jointly in same facility, making it feasible to
  - ➔ Consolidate production into fewer plants
  - ➔ Significantly reduce overall manufacturing costs

Distribution Fits

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



Sales and Marketing Fits: Types of Potential Benefits

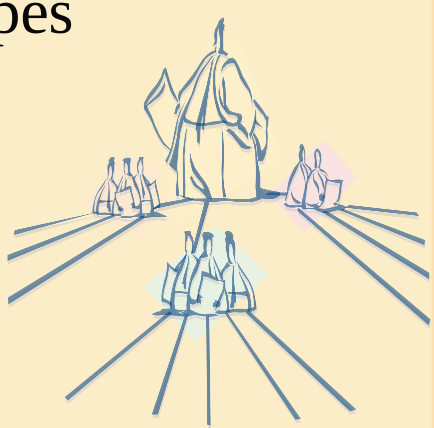
- ***Reduction*** in ***sales costs***
  - ➔ Single sales force for related products
  - ➔ Advertising related products together
  - ➔ Combined after-sale service and repair work
  - ➔ Joint delivery, shipping, order processing and billing
  - ➔ Joint promotion tie-ins

- Similar sales and marketing approaches provide opportunities to ***transfer selling, merchandising, and advertising/promotional skills***
- ***Transfer*** of a strong company's ***brand name and reputation***

Managerial and Administrative Support Fits

- Emerge when ***different business units require comparable*** types of
  - Entrepreneurial know-how
  - Administrative know-how
  - Operating know-how

- ***Different businesses*** often entail ***same*** types of ***administrative support facilities***
  - Customer data network
  - Billing and customer accounting systems
  - Customer service infrastructure



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Core Concept: Economies of Scope

- Stem from ***cross-business*** opportunities to reduce costs

  - Arise when costs can be cut by operating two or more businesses under same corporate umbrella

  - ***Cost saving opportunities*** can stem from interrelationships anywhere along the ***value chains*** of different businesses

Related Diversification and Competitive Advantage

- ***Competitive advantage*** can result from related diversification ***when a company captures cross-business opportunities to***

  - ***Transfer*** expertise/capabilities/technology from one business to another

  - ***Reduce costs by combining*** related activities of different businesses into a single operation
  - ***Transfer*** use of firm's ***brand name reputation*** from one business to another
  - ***Create valuable competitive capabilities*** via cross-business collaboration in performing related value chain activities

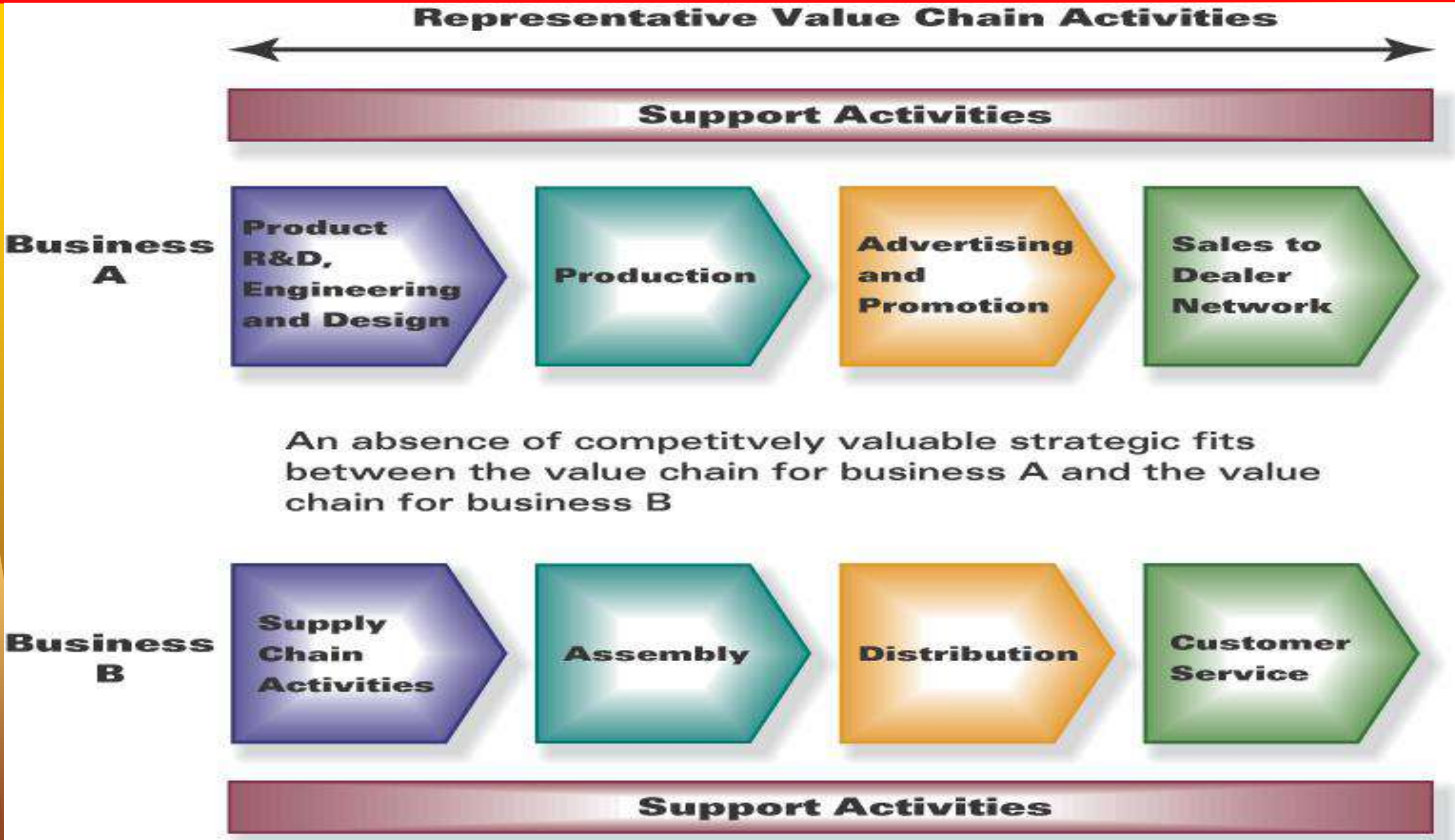
Potential Pitfalls of Related Diversification

- Failing the ***cost-of-entry test*** may occur if a company overpaid for acquired companies
- Problems associated with passing the ***better-off test***
  - Cost savings of combining related value chain activities and capturing economies of scope may be overestimated
  - Transferring resources from one business to another may be fraught with unforeseen obstacles that diminish strategic-fit benefits actually captured

What Is Unrelated Diversification?

- Involves ***diversifying*** into businesses with
  - ➔ ***No*** strategic fit
  - ➔ ***No*** meaningful value chain relationships
  - ➔ ***No*** unifying strategic theme
- ***Basic approach*** – ***Diversify*** into ***any industry*** where potential exists to ***realize good financial results***
- While industry attractiveness and cost-of-entry tests are important, better-off test is secondary

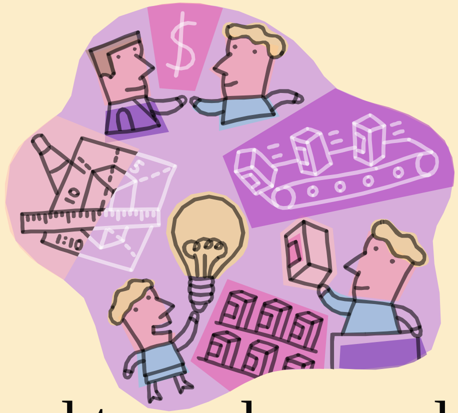
Fig. 9.3: Value Chains for Unrelated Businesses



Acquisition Criteria For Unrelated Diversification Strategies

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

Attractive Acquisition Targets



- Companies with ***undervalued assets***
  - Capital gains may be realized
- Companies in ***financial distress***
  - May be purchased at bargain prices and turned around
- Companies with ***bright growth prospects*** but ***short on investment capital***
  - Cash-poor, opportunity-rich companies are coveted acquisition candidates

Appeal of Unrelated Diversification

- Business risk scattered over different industries

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

Building Shareholder Value via Unrelated Diversification

- Corporate managers ***must***
  - Do a superior job of ***diversifying*** into new businesses capable of producing ***good earnings*** and ***returns on investments***
  - Do an excellent job of ***negotiating favorable acquisition prices***
  - Discern when it is the ***"right" time*** to ***sell*** a business at the ***"right" price***
  - ***Shift*** corporate ***financial resources*** from poorly-performing businesses to those with ***potential*** for ***above-average earnings growth***
  - Do a good job ***overseeing businesses*** so they ***perform*** at a ***higher level*** than otherwise possible

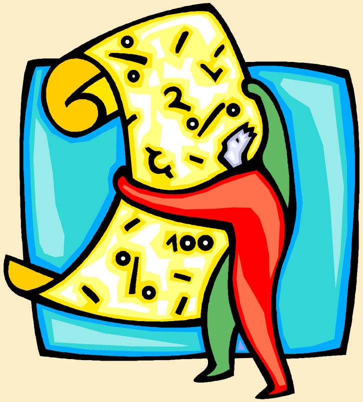
Key Drawbacks of Unrelated Diversification

Demanding Managerial Requirements

Limited Competitive Advantage Potential

Unrelated Diversification Has Demanding Managerial Requirements

- The greater the number and diversity of businesses, the harder it is for managers to
  - Discern good acquisitions from bad ones
  - Select capable managers to manage the diverse requirements of each business
  - Judge soundness of strategic proposals of business-unit managers
  - Know what to do if a business subsidiary stumbles



Likely effect is 1 + 1 = 2, rather than 1 + 1 = 3!

Unrelated Diversification Offers Limited Competitive Advantage Potential

- Lack of cross-business strategic fits means that unrelated diversification offers no competitive advantage potential beyond what each business can generate on its own
  - Consolidated performance of unrelated businesses tends to be no better than sum of individual businesses on their own (and it may be worse)
  - Promise of greater sales-profit stability over business cycles is seldom realized

Combination Related-Unrelated Diversification Strategies

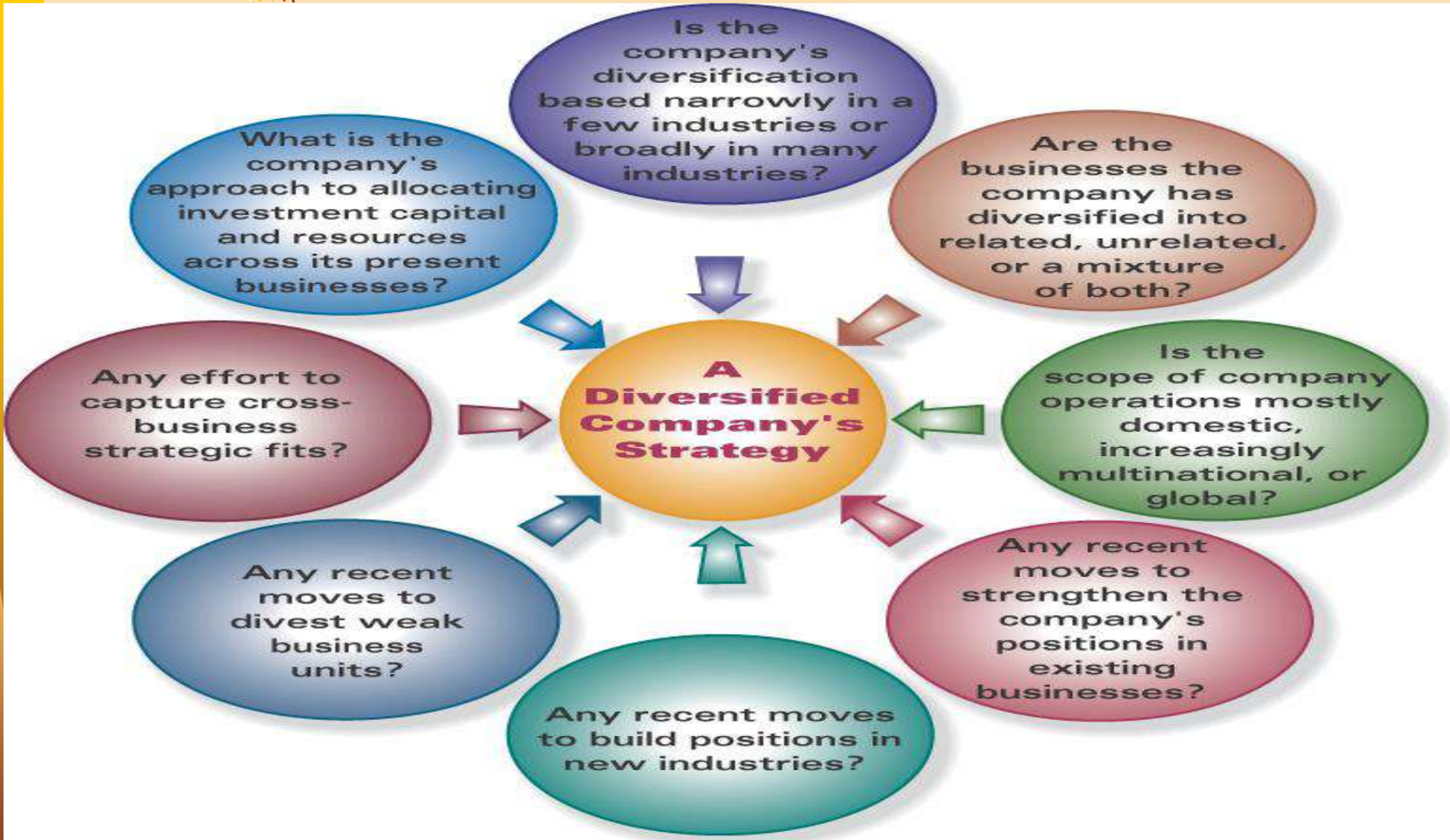
- *Dominant-business firms*
  - **One major core business accounting for 50 - 80 percent of revenues, with several small related or unrelated businesses accounting for remainder**
- *Narrowly diversified firms*
  - **Diversification includes a few (2 - 5) related or unrelated businesses**
- *Broadly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

Diversification and Shareholder Value

- ***Related Diversification***
  - ➔ A ***strategy-driven approach*** to creating shareholder value

- ***Unrelated Diversification***
  - ➔ A ***finance-driven approach*** to creating shareholder value

Fig. 9.4: Identifying a Diversified Company's Strategy



How to Evaluate a Diversified Company's Strategy

Step 1: Assess long-term attractiveness of each industry firm is in

Step 2: Assess competitive strength of firm's business units

Step 3: Check competitive advantage potential of cross-business strategic fits among business units

Step 4: Check whether firm's resources fit requirements of present businesses

Step 5: Rank performance prospects of businesses and determine priority for resource allocation

Step 6: Craft new strategic moves to improve overall company performance

Step 1: Evaluate Industry Attractiveness

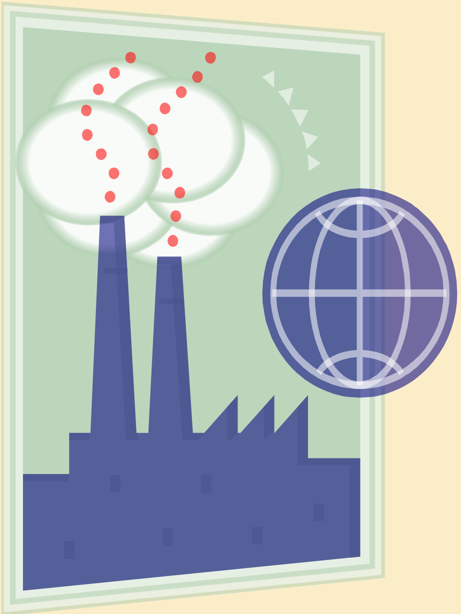
Attractiveness of ***each*** industry in portfolio

Each industry's attractiveness ***relative*** to the others

Attractiveness of ***all*** industries as a group

Industry Attractiveness Factors

- Market size and projected growth
- Intensity of competition
- Emerging opportunities and threats
- Presence of cross-industry strategic fits
- Resource requirements
- Seasonal and cyclical factors
- Social, political, regulatory, and environmental factors
- Industry profitability
- Degree of uncertainty and business risk



Procedure: Calculating Attractiveness Scores for Each Industry

Step 1: Select industry attractiveness factors

Step 2: Assign weights to each factor (sum of weights = 1.0)

Step 3: Rate each industry on each factor, using a scale of 1 to 10

Step 4: Calculate weighted ratings; sum to get an overall industry attractiveness rating for each industry

table 9.1 Calculating Weighted Industry Attractiveness Scores

Industry Attractiveness Measure	Importance Weight	Industry A Rating/Score	Industry B Rating/Score	Industry C Rating/Score	Industry D Rating/Score
Market size and projected growth rate	0.10	8/0.80	5/0.50	7/0.70	3/0.30
Intensity of competition	0.25	8/2.00	7/1.75	3/0.75	2/0.50
Emerging opportunities and threats	0.10	2/0.20	9/0.90	4/0.40	5/0.50
Cross-industry strategic fits	0.20	8/1.60	4/0.80	8/1.60	2/0.40
Resource requirements	0.10	9/0.90	7/0.70	10/1.00	5/0.50
Seasonal and cyclical influences	0.05	9/0.45	8/0.40	10/0.50	5/0.25
Societal, political, regulatory, and environmental factors	0.05	10/1.00	7/0.70	7/0.70	3/0.30
Industry profitability	0.10	5/0.50	10/1.00	3/0.30	3/0.30
Industry uncertainty and business risk	0.05	5/0.25	7/0.35	10/0.50	1/0.05
Sum of the assigned weights	1.00				
Overall industry attractiveness scores		**7.70**	**7.10**	**5.45**	**3.10**

Rating scale: 1 = Very unattractive to company; 10 = Very attractive to company

Interpreting Industry Attractiveness Scores

- Industries with a score much ***below 5.0*** do not pass the attractiveness test
- If a company's industry attractiveness scores are all ***above 5.0,*** the group of industries the firm operates in is attractive as a whole
- To be a ***strong performer,*** a diversified firm's principal businesses should be in attractive industries—that is, industries with
  - A good outlook for growth ***and***
  - Above-average profitability

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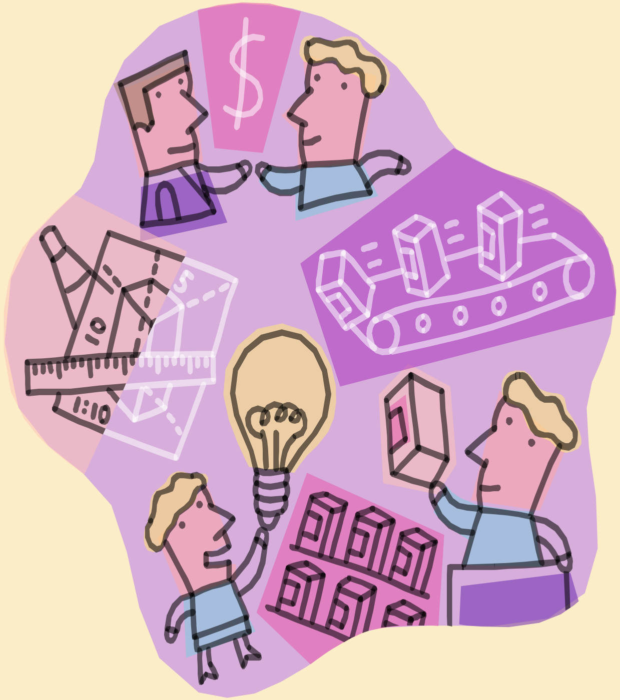
Step 2: Evaluate Each Business Unit's Competitive Strength

- ***Objectives***

→ Determine how well each business is positioned in its industry relative to rivals

→ Evaluate whether it is or can be competitively strong enough to contend for market leadership



Factors to Use in Evaluating Competitive Strength

- Relative market share
- Costs relative to competitors
- Ability to match/beat rivals on key product attributes
- Ability to benefit from strategic fits with sister businesses
- Ability to exercise bargaining leverage with key suppliers or customers
- Caliber of alliances and collaborative partnerships
- Brand image and reputation
- Competitively valuable capabilities
- Profitability relative to competitors

Procedure: Calculating Competitive Strength Scores for Each Business

Step 1: Select competitive strength factors

Step 2: Assign weights to each factor (sum of weights = 1.0)

Step 3: Rate each business on each factor, using a scale of 1 to 10

Step 4: Calculate weighted ratings; sum to get an overall strength rating for each business

table 9.2 Calculating Weighted Competitive Strength Scores for a Diversified Company's Business Units

Competitive Strength Measure	Importance Weight	Business A in Industry A Rating/ Score	Business B in Industry B Rating/ Score	Business C in Industry C Rating/ Score	Business D in Industry D Rating/ Score
Relative market share	0.15	10/1.50	1/0.15	6/0.90	2/0.30
Costs relative to competitors' costs	0.20	7/1.40	2/0.40	5/1.00	3/0.60
Ability to match or beat rivals on key product attributes	0.05	9/0.45	4/0.20	8/0.40	4/0.20
Ability to benefit from strategic fits with sister businesses	0.20	8/1.60	4/0.80	8/0.80	2/0.60
Bargaining leverage with suppliers/ buyers; caliber of alliances	0.05	9/0.90	3/0.30	6/0.30	2/0.10
Brand image and reputation	0.10	9/0.90	2/0.20	7/0.70	5/0.50
Competitively valuable capabilities	0.15	7/1.05	2/0.20	5/0.75	3/0.45
Profitability relative to competitors	0.10	5/0.50	1/0.10	4/0.40	4/0.40
Sum of the assigned weights	1.00				
Overall industry attractiveness scores		**8.30**	**2.35**	**5.25**	**3.15**

Rating scale: 1 = Very weak; 10 = Very strong

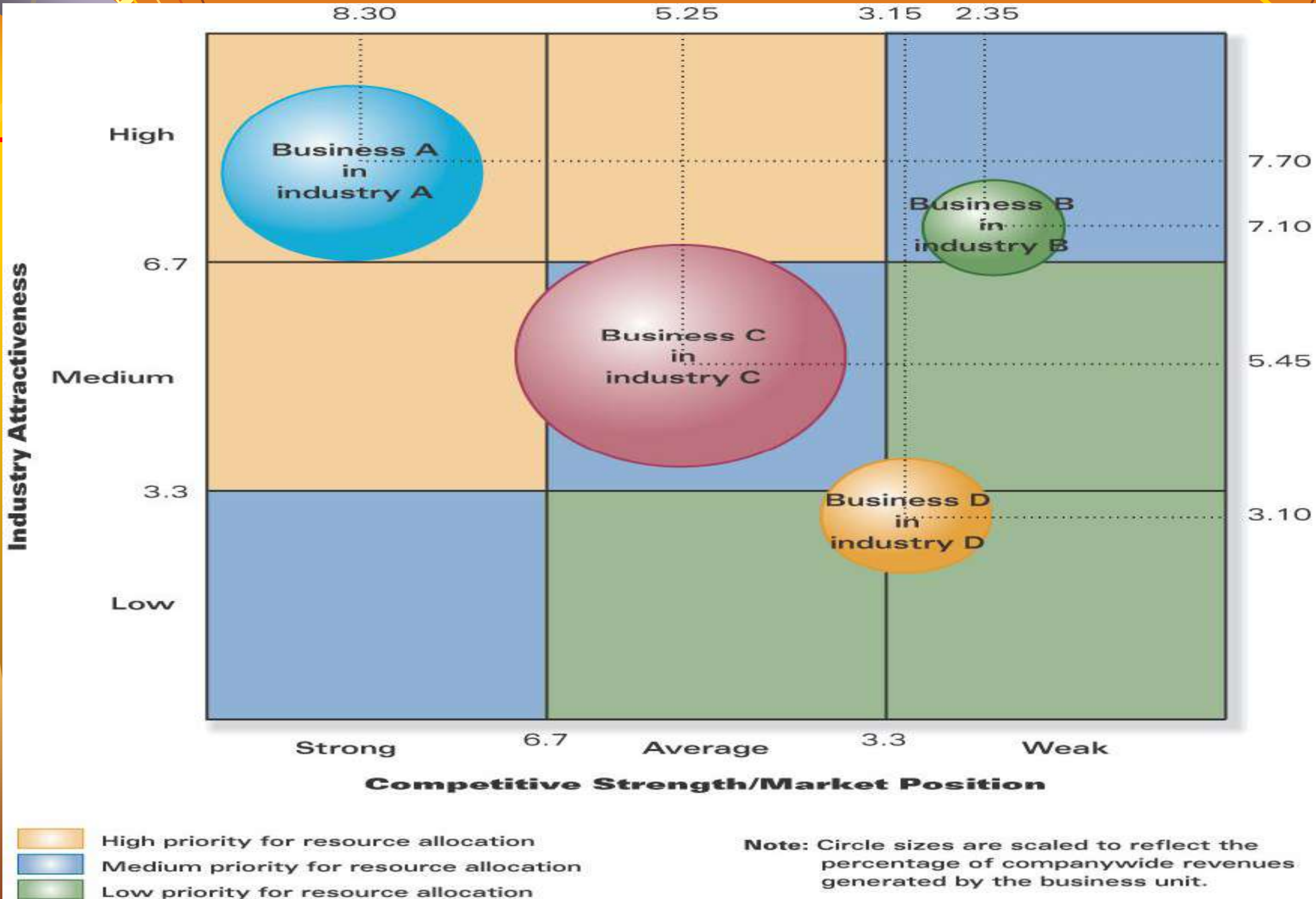
Interpreting Competitive Strength Scores

- Business units with ratings ***above 6.7*** are strong market contenders
- Businesses with ratings in the ***3.3 to 6.7 range*** have moderate competitive strength vis-à-vis rivals
- Business units with ratings ***below 3.3*** are in competitively weak market positions
- If a diversified firm's businesses ***all*** have scores ***above 5.0,*** its business units are all fairly strong market contenders

Plotting Industry Attractiveness and Competitive Strength

- Use ***industry attractiveness*** (see Table 6.1) and ***business or competitive strength scores*** (see Table 6.2) to plot location of each business in matrix
  - ➔ Industry attractiveness plotted on vertical axis
  - ➔ Competitive strength plotted on horizontal axis
- Each ***business unit*** appears as a ***"bubble"***
  - ➔ Size of each bubble is scaled to percentage of revenues the business generates relative to total corporate revenues

Fig. 9.5: Industry Attractiveness-Competitive Strength Matrix



Strategy Implications of Attractiveness/Strength Matrix

- Businesses in ***upper left corner***
  - Accorded top investment priority
  - Strategic prescription – ***grow and build***
- Businesses in ***three diagonal cells***
  - Given medium investment priority
  - ***Invest to maintain*** position
- Businesses in ***lower right corner***
  - Candidates for ***harvesting or divestiture***
  - May, on occasion, be candidates for an ***overhaul and reposition*** strategy

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Appeal of Attractiveness/Strength Matrix

- Incorporates a ***wide variety*** of ***strategically relevant variables***
- Stresses ***concentrating corporate resources*** in ***businesses*** that enjoy
  - ➔ High degree of industry attractiveness ***and***
  - ➔ High degree of competitive strength
- ***Lesson*** – Emphasize businesses that are market leaders or that can contend for market leadership

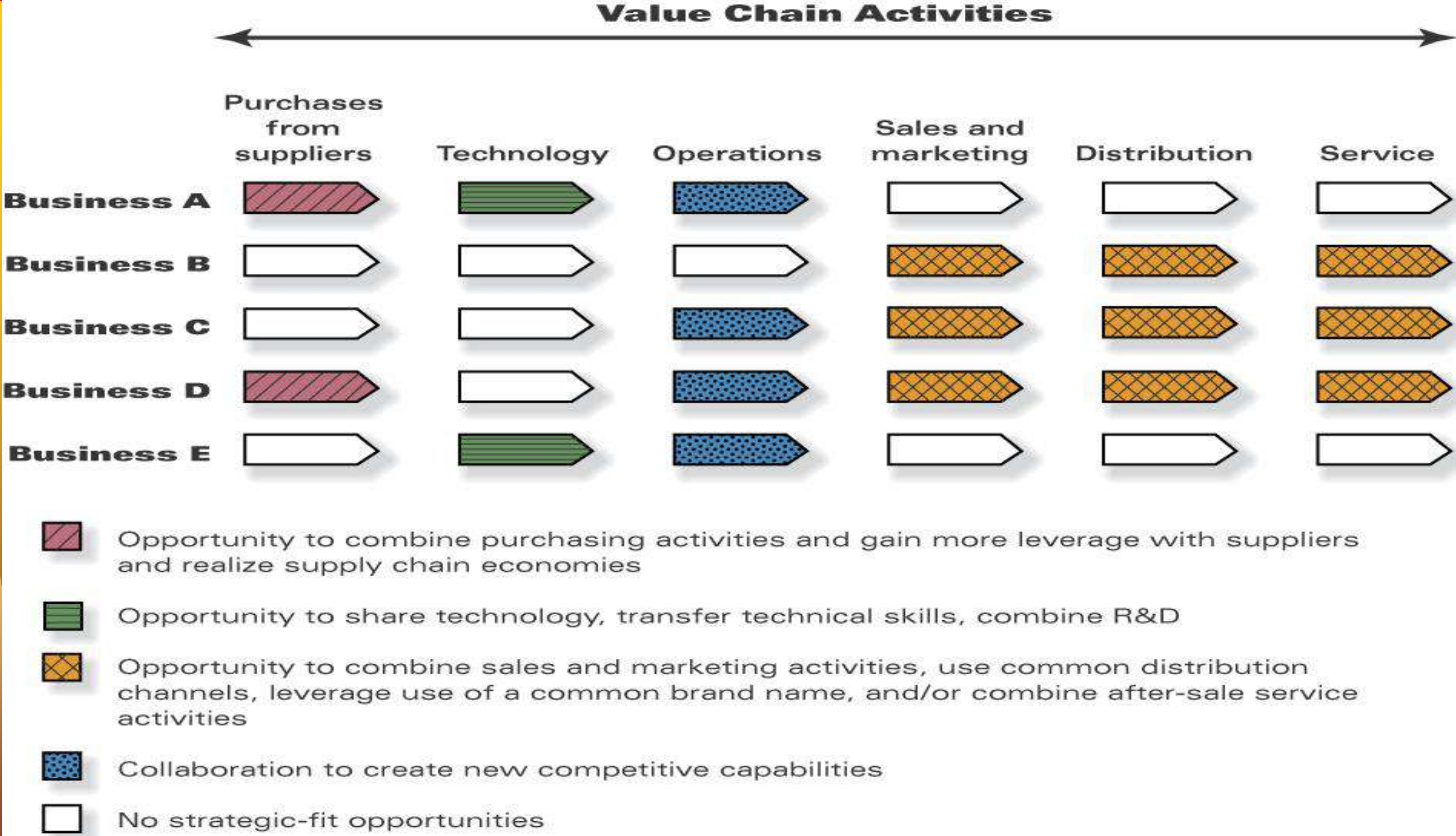
Step 3: Check Competitive Advantage Potential of Cross-Business Strategic Fits

- ***Objective***
  - Determine ***competitive advantage*** potential of value chain relationships and strategic fits among sister businesses
- Examine ***strategic fit*** from two angles
  - Whether one or more businesses have valuable strategic fits with other businesses in portfolio
  - Whether each business meshes well with firm's long-term strategic direction

Evaluate Portfolio for Competitively Valuable Cross-Business Strategic Fits

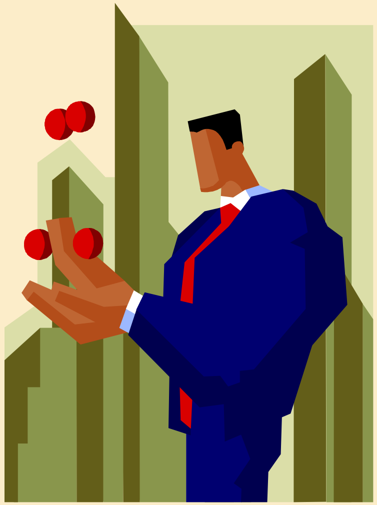
- Identify businesses which have ***value chain match-ups*** offering opportunities to
  - Reduce costs
    - **Purchasing**
    - **Manufacturing**
    - **Distribution**
  - Transfer skills / technology / intellectual capital from one business to another
  - Transfer use of a well-known and competitively powerful brand name from one business to another
  - Create valuable new competitive capabilities

Fig. 9.6: Identify Competitive Advantage Potential of Cross-Business Strategic Fits



Step 4: Check Resource Fit

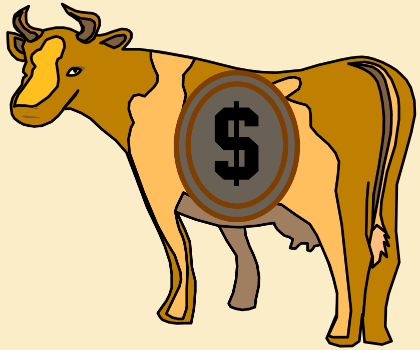
- ***Objective***
  - ➔ Determine how well firm's resources match business unit requirements



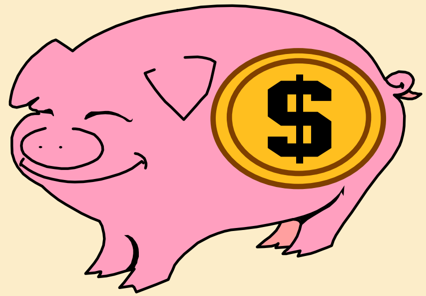
- Good ***resource fit*** exists when
  - ➔ A business adds to a firm's resource strengths, either financially or strategically
  - ➔ Firm has resources to adequately support requirements of its businesses as a group

Check for Financial Resource Fits

- Determine ***cash flow*** and ***investment requirements*** of business units
  - Which are cash hogs and which are cash cows?



- Assess ***cash flow*** of each business
  - Highlights opportunities to shift financial resources between businesses
  - Explains why priorities for resource allocation can differ from business to business
  - Provides rationalization for both invest-and-expand and divestiture strategies

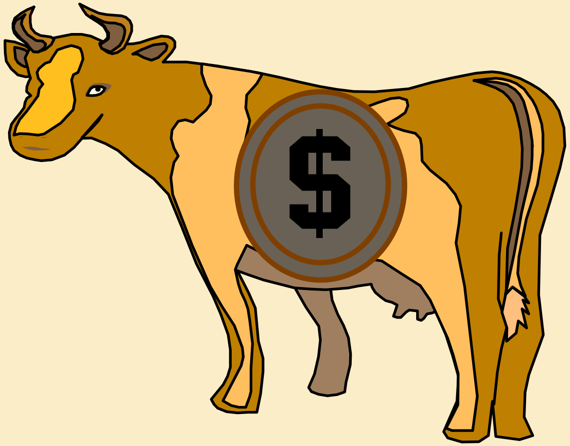


Characteristics of Cash Hog Businesses

- ***Internal cash flows*** are ***inadequate*** to fully fund needs for working capital and new capital investment
  - Parent company has to continually pump in capital to ***"feed the hog"***
- ***Strategic options***
  - Aggressively ***invest*** in attractive cash hogs
  - ***Divest*** cash hogs lacking long-term potential

Characteristics of Cash Cow Businesses

- Generate ***cash surpluses*** over what is needed to sustain present market position
- Such businesses are valuable because ***surplus cash*** can be used to
  - ➔ Pay corporate dividends
  - ➔ Finance new acquisitions
  - ➔ Invest in promising cash hogs

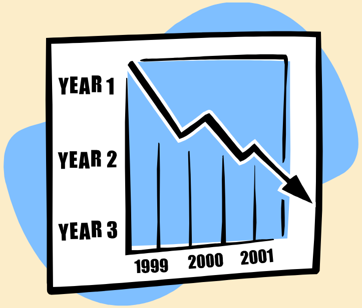


- ***Strategic objectives***
  - ➔ Fortify and defend present market position
  - ➔ Keep the business healthy

Good vs. Poor Financial Fit

- ***Good financial fit*** exists when a business
  - Contributes to achievement of corporate objectives
  - Enhances shareholder value

- ***Poor financial fit*** exists when a business
  - Soaks up disproportionate share of financial resources
  - Is an inconsistent bottom-line contributor
  - Experiences a profit downturn that could jeopardize entire company
  - Is too small to make a sizable contribution to total corporate earnings



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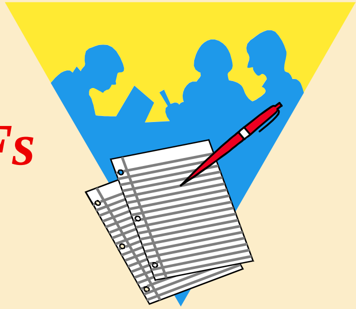
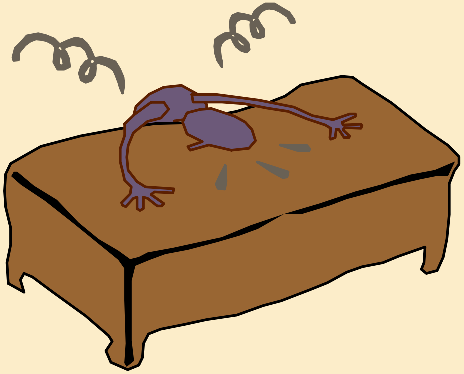
Check for Competitive and Managerial Resource Fits

- Involves determining whether
  - ➔ ***Resource strengths*** are well ***matched*** to ***KSFs*** of industries firm is in
  - ➔ Ample ***resource depth*** exists to support resource requirements of all the businesses
  - ➔ Ability exists to ***transfer competitive capabilities*** from one business to another
  - ➔ Company must invest in ***upgrading its resources/capabilities*** to stay ahead of efforts of rivals



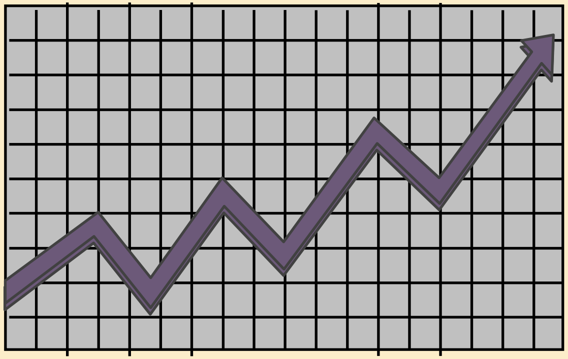
A Note of Caution: Why Diversification Efforts Can Fail

- Trying to ***replicate*** a firm's ***success*** in one business and hitting a second home run in a new business is ***easier said than done***
- ***Transferring*** resource ***capabilities*** to new businesses can be far ***more arduous*** and ***expensive*** than expected
- Management can ***misjudge difficulty*** of ***overcoming resource strengths of rivals*** it will face in a new business



Step 5: Rank Business Units Based on Performance and Priority for Resource Allocation

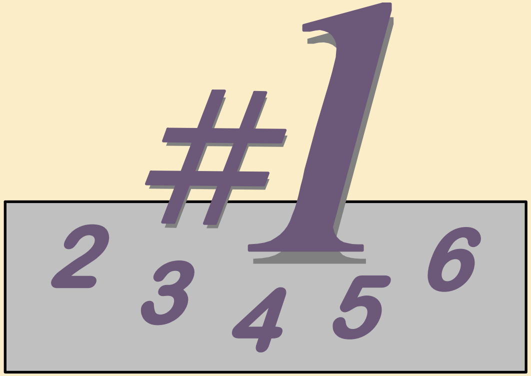
- Factors to consider in ***judging business-unit performance***



  - ➔ Sales growth
  - ➔ Profit growth
  - ➔ Contribution to company earnings
  - ➔ Return on capital employed in business
  - ➔ Economic value added
  - ➔ Cash flow generation
  - ➔ Industry attractiveness and business strength ratings

Determine Priorities for Resource Allocation

- ***Objective***
  - → "Get the biggest bang for the buck" in allocating corporate resources



- ***Approach***
  - → Rank each business from highest to lowest priority for corporate resource support and new capital investment
  - → Steer resources from low- to high-opportunity areas
  - → When funds are lacking, strategic uses of resources should take precedence

Fig. 9.7: Strategic and Financial Options for Allocating Financial Resources

Strategic Options for Allocating Company Financial Resources	Financial Options for Allocating Company Financial Resources
Invest in ways to strengthen or grow existing businesses	Pay off existing long-term or short-term debt
Make acquisitions to establish positions in new industries or to complement existing businesses	Increase dividend payments to shareholders
Fund long-range R&D ventures aimed at opening market opportunities in new or existing businesses	Repurchase shares of the company's common stock
	Build cash reserves; invest in short-term securities

Step 6: Craft New Strategic Moves - Strategic Options

- ***Stick closely*** with ***existing business lineup*** and pursue opportunities it presents
- ***Broaden*** company's ***business scope*** by making new acquisitions in new industries
- ***Divest*** certain businesses and ***retrench*** to a narrower base of business operations
- ***Restructure*** company's business lineup, putting a whole new face on business makeup
- Pursue ***multinational diversification,*** striving to ***globalize*** operations of several business units

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Fig. 9.8: Strategy Options for a Company Already Diversified

Strategy Options for a Company That Is Already Diversified

Broaden the Diversification Base

- Acquire more businesses and build positions in new related or unrelated industries.
- Add businesses that will complement and strengthen the market position and competitive capabilities of business in industries where the company already has a stake.

Divest Some Businesses and Retrench to a Narrower Diversification Base

- Get out of businesses that are competitively weak, that are in unattractive industries, or that lack adequate strategic and resource fits.
- Focus corporate resources on businesses in a few, carefully selected industry arenas.

Restructure the Company's Business Lineup

- Sell off competitively weak businesses, businesses in unattractive industries, businesses with little strategic or resource fit, and noncore businesses.
- Use cash from divestitures plus unused debt capacity to make acquisitions in other, more promising industries.

Pursue Multinational Diversification

- Offers two major avenues for sustained growth—entering more businesses or entering more country markets.
- Contains more competitive advantage potential than any other diversification strategy.

Strategies to Broaden a Diversified Company's Business Base

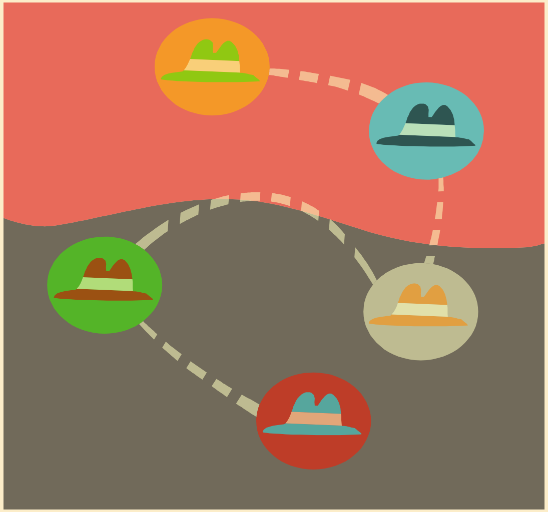
- ***Conditions*** making this ***approach attractive***
  - Slow grow in current businesses
  - Vulnerability to seasonal or recessionary influences or to threats from emerging new technologies
  - Potential to transfer resources and capabilities to other related businesses
  - Rapidly-changing conditions in one or more core industries alter buyer requirements
  - Complement and strengthen market position of one or more current businesses

Divestiture Strategies Aimed at Retrenching to a Narrower Diversification Base

- ***Strategic options***
  - Retrenchment
  - Divestiture
    - **Sell it**
    - **Spin it off as independent company**
    - **Liquidate it (close it down because no buyers can be found)**

Retrenchment Strategies

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



Conditions That Make Retrenchment Attractive

- Diversification efforts have become too broad, resulting in difficulties in profitably managing all the businesses
- Deteriorating market conditions in a once-attractive industry
- Lack of strategic or resource fit of a business
- A business is a cash hog with questionable long-term potential
- A business is weakly positioned in its industry
- Businesses that turn out to be “misfits”
- One or more businesses lack compatibility of values essential to cultural fit

Options for Accomplishing Divestiture

- ***Sell it***
  - ➔ Involves finding a company which views the business as a good deal and good fit
- ***Spin it off*** as independent company
  - ➔ Involves deciding whether or not to retain partial ownership
- ***Liquidation***
  - ➔ Involves closing down operations and selling remaining assets
  - ➔ A last resort because no buyer can be found

Strategies to Restructure a Company's Business Lineup

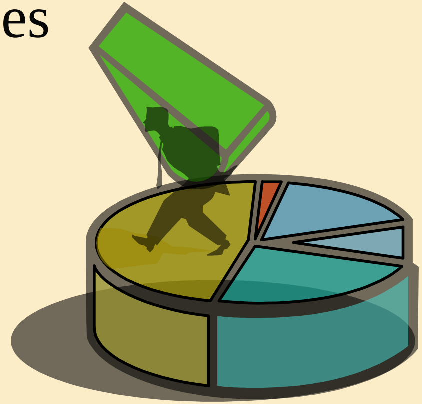
- ***Objective***

  - Make radical changes in mix of businesses in portfolio via both

    - **Divestitures and**
    - **New acquisitions**

  in order to put on whole new face on the company's business makeup

Conditions That Make Portfolio Restructuring Attractive



- Too many businesses in unattractive industries
- Too many competitively weak businesses
- Ongoing declines in market shares of one or more major business units
- Excessive debt load
- Ill-chosen acquisitions performing worse than expected
- New technologies threaten survival of one or more core businesses
- Appointment of new CEO who decides to redirect company
- "Unique opportunity" emerges and existing businesses must be sold to finance new acquisition

Multinational Diversification Strategies

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

Appeal of Multinational Diversification Strategies

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

  - Enter additional businesses

  - Extend operations of existing businesses into additional country markets

Opportunities to Build Competitive Advantage via Multinational Diversification

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

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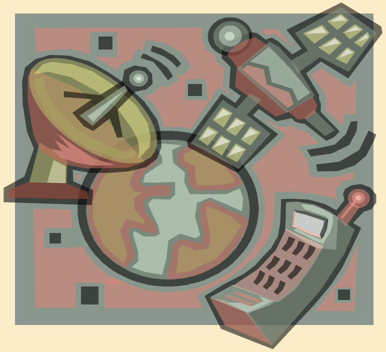
Competitive Strength of a DMNC in Global Markets

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



Competitive Power of a DMNC in Global Markets

- A ***DMNC*** has a strategic arsenal capable of ***defeating*** both a ***domestic-only rival*** or a ***single-business rival*** by competing in
  - ➔ Multiple businesses and
  - ➔ Multiple country markets
- Can use its multiple profit sanctuaries and can employ cross-subsidization tactics if need be