Strategic Management for Competitive Advantage
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Lecture: 16
Diversification – II

Welcome to the course strategic management for competitive advantage, we were discussing the module strategy formulation and strategic choices.

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So, in the last lecture, we were discussing about diversification. Now, we will continue it further.

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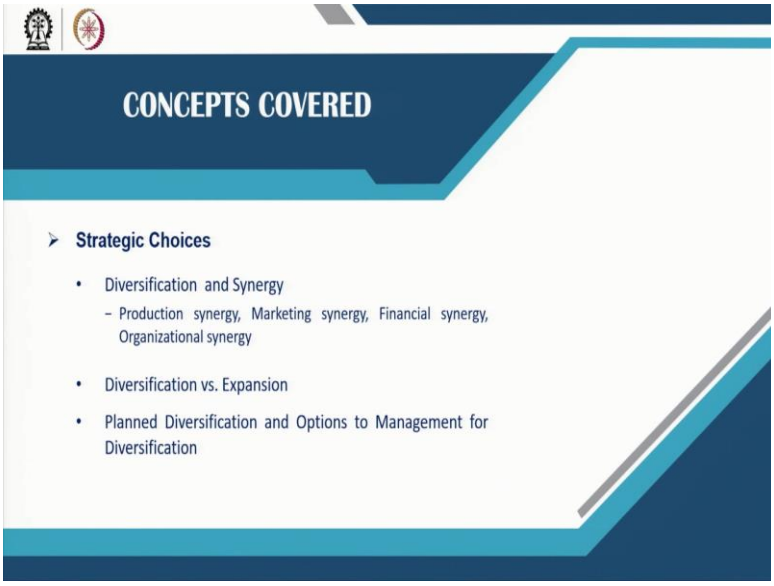

So, in today's lecture, we will be covering the concepts that say diversification and synergy, what are the different synergies that we will be discussing are production synergy, marketing synergy, financial synergy and organizational synergy, and when the synergies are positive, then only you will get the leverage for the diversification, we will also discuss about diversification versus expansion, when should we go for diversification or we should go for expansion. Further, we will cover plan diversifications and what are the options for management for diversifications. So, all these will be covering in today's lecture.

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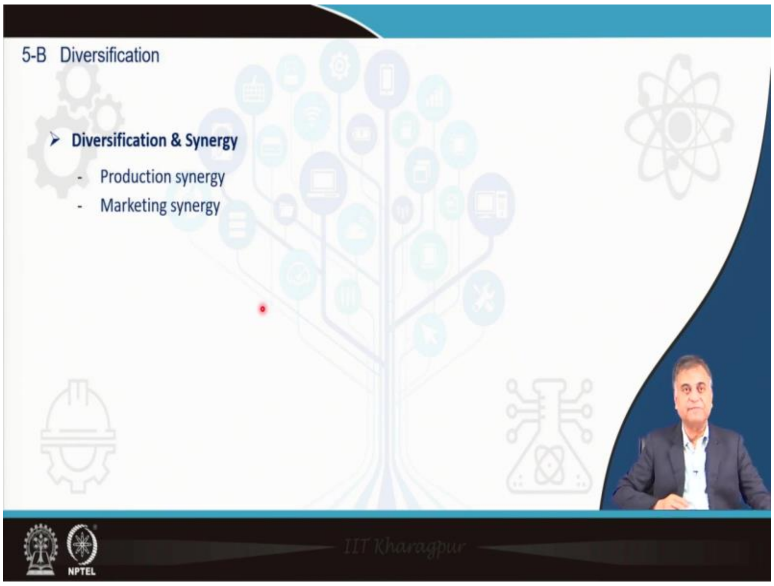

Now, next, we will be talking about diversification and synergy, you know, synergy, all of us have talked about it in previous classes. What is a synergetic effect, if two or more products you are producing separately, it consumes more resources. Now, these two or more products, if you are producing at the same manufacturing facility using the same manufacturing facilities and processes, same resources and all, you have a synergistic effect. So, this is called the synergic effect.

So, there are four types of synergy effects for the diversifications you can think of, one may be production synergy, and another may be marketing synergy. So, first, we will talk about these two. Then we will go for the next two synergies. What is production synergy? Production synergy is when two or more products you are producing using the same or the available or the similar manufacturing facilities that you are having it and similar manufacturing processes or you are using those resources also.

So, then this is called you have a production synergy. In these, the same available manufacturing facilities are being utilized more so, your capacity utilization of your capital asset increases, it means your cost also synergy you get it comes down. For example, if you look at it, for example, if you have seen the AC refrigeration, cooler, these manufacturers demand is very high during the summer, it operates in full capacity that time, but in winter or the different parts of the year, they have do not have that full utilization they have spare capacities.

So, now if an AC manufacturer or refrigerator manufacturer, if they want to produce a room heater or the oven or some other product in winter or some other parts in the year. So, it is you can say it is having a production synergy. So, it will be useful for the organizations as a whole, because the synergy effect will get you more revenue, more profit and more utilization. This is called production synergy. And similarly, there is one more it is called Marketing synergy. Marketing synergy is a new product, you are using your existing sales and distribution channel for its marketing.

So, there is a synergy in it, and this sales and distribution marketing synergy is most visible. So, I will give you an example, like say badminton, racquet and the shuttlecock these are the two products, these use different technology, but they can be when they are related products, they can be marketed together using the same distribution channel even they can be marketed under the same brand name also if it requires tennis ball similarly, and tennis racket is the same.

So, these are called the marketing synergy, and you find many products if a company comes, so, making a distribution channel or the distribution network marketing network for one or two products, will not be economic, because it requires an extensive network going through the rural areas and all.

So, that is why you will find a group of similar products use the same marketing network like say cold drinks, cigarettes, then consumer goods, they use the same marketing network or dealer networks and all because it is not economic to develop an intensive, extensive network for one or two products, it will always be better to have a number of products this is called Marketing synergy.

There may be some products which are related to each other but cannot be marketed together. Take the case of washing machine and detergent is sold in the appliance stores, but the detergent is sold in the grocery even the products or similar related they cannot be sold together. Anyway, this is a marketing strategy.

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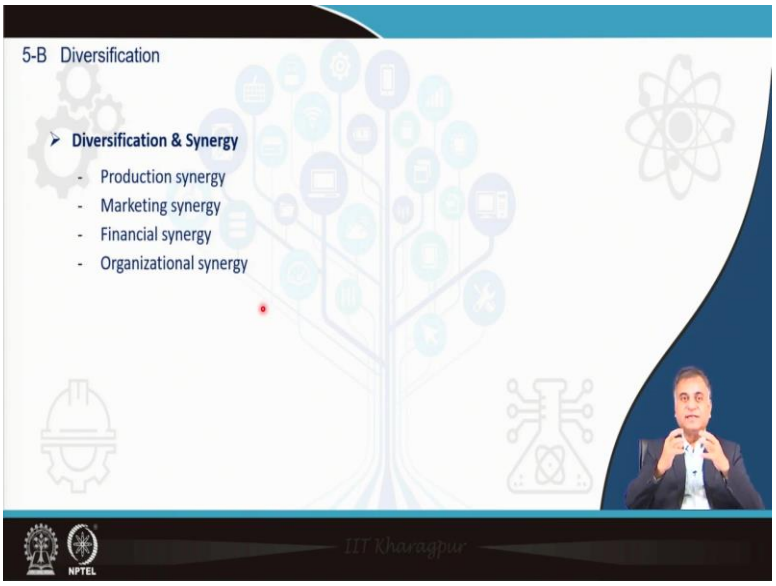

I have to explain the other two are the financial strategy and organizational strategy. What is financial strategy? Financial strategy is, suppose a company may identify its product based on its cash flow and working capital requirement. For example, say AC manufacturer or fan manufacturer, their demand is very high during summer. So, capacity utilization during that period is very high, but what happens when they are in winter or some other time. So, their capacity utilization is not high. So, their sales also drop down during winter.

So, did they face some financial crunch? So, to avoid those financial crunches, then what do they do? They give discounts for selling those fans, ACs. So, that there is some cash flow is there alternatively, some organizations go for some businesses or products, which have shorter cyclic periods.

Shorter cyclic period and gives a quick return. They go for such products and businesses, for example, the small time traders if you find small time traders, they use these financial synergies very often like if you see the small book shops and all bookstores book shops and all they are for peak time is for selling books at the beginning of the academic session but at the mid of the academic session, and other times they are have a lien prepared is not much So, they feel the financial crunch.

So, what do they do? They go for products or businesses which have a small cycle period like Diwali, or the puja festivals and all they will bookshops come to towns to cloths or garment shops, they sales, those garments, clothes and all even for Christmas they will sell those Christmas product Diwali, Diwali product so, that is a that is the financial synergy, they run different businesses to for a shorter cyclic period to get quick returns, this is what call financial synergy.

The last one is organizational synergy. Some organizations have existing skills, those skills they have acquired over the years suppose a manufacturing company they have acquired some manufacturing skill, oil and gas industry professionals, have acquired some skill those skills company can take leverage for say a manufacturing company, though they can go for consultancy, they can go for trading. So, they can utilize those skills in a different business consultancy business and all. So, these are the organizational synergy.

Take some companies, those are in having R&D some chemical companies are there, there have strong R&D. Those are actually in R&D centres, they are utilizing twin purposes. One is they hold those R&D and all in house product development in house improvement of the products and all say 60 per cent to 70 per cent of their time they use it for the R&D for in house research and another 40 to 30 per cent they may go for the open contract for the market.

They will do the research for the other companies from the market, they get it in that what happens the company utilizes its staff more productively more purposefully, and in the process, they earn revenue and also they can improve their R&D, they can buy the latest equipment, the latest machinery, latest software tools, latest analytical tools, So, that they are updated at the state of the art of things in the R&D. So, this is called organizational synergy.

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So, these are the four types of synergy. Now, we will be talking about diversification versus expansion. What is this diversification and expansion when one goes for diversification, when a company goes for expansion, there must be some criteria for it, we will be discussing that. Firstly, what we will be talking about the diversification is that expansion, expansion is a comparatively an easy route as far as implementation is concerned, then the diversification because expansion is you know that similar type of product or similar type of business, you are the or same or similar type of business you are in.

So, you have the managerial experience, you have the marketing experience, you have the operational experience, everything you know, so, it is a for implementation point of view, it is easier for a company, and it is also less risky since you are operating you have knowledge about that industry, that product, that business it is less risky for it. So, how would you choose you will go for diversification or expansion, these are some of the factors one is the likely return is the ROI return on investment for both diversifications and expansion.

You find out the ROI for both for a long-term ROI, not the short term. So, that will indicate which option is better for you then you also look for the market growth rate, whether the new products that you want to diversify that growth rate vis - a - vis is your, the products for the expansion business, that growth rate, you compare these two growth rates, then the market size, what will be the total market size that will give you the how many years you will be the sustaining and all.

So, market size is also for both you determine then marketing capability for a product, which you are doing it is the similar product, you know you have may have the marketing capability. For a new product, you have to develop that marketing capability, you keep that thing in mind also, when you are doing for the likely return you consider for both the cases the taxation part, the depreciation part the fiscal deficit part that invests the incentives given by the government for the new product or new businesses. All those things also you take into account while you find out.

So, then you also look for the supply and demand gap for both newly diversified products, what are the supply and demand gaps today and, in the future, how they will go and for the expansion markets, what is the demand-supply gap, you compare both and then take a decision. Lastly, there is the experience curve advantage that you get for the expansion is your same or similar product.

So, if you have been handling it for a long, you have the experience for that. So, your unit cost may be less. So, the experience curve advantage is mostly found in expansion, not diversification. Then you also look for the brand image if the new product has a better brand image than your existing product or similar products or more brand image you compare and take a decision on this. So, these are some of the factors you consider when you choose whether to go for diversification or expansion.

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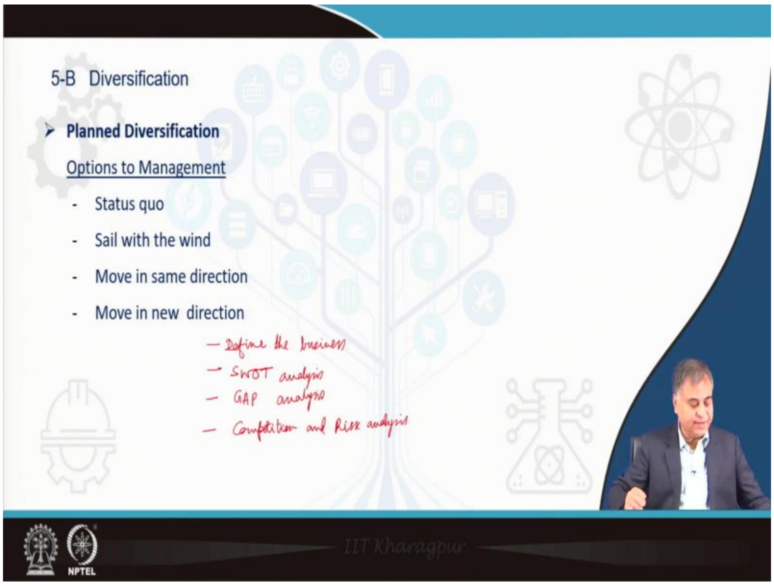

Then, lastly, we will go for the planned diversification. How do you go for a planned diversification there are many options to the management. The options to the management, maybe status quo, what is status quo, like you do not you try to maintain where are you in your try to go the as it is going on. So, you do not have any plan, and you think that your profitability will remain the same and it will be status quo, and it will continue indefinitely at that rate that is the status quo option to the management.

Another option is to sail with the wind means everybody is going to that some craze said that industry. So, the company is also going for that industry like nowadays, you will find that AI, MAL, Data analytics, this artificial intelligence machine language, Big Data, Data Analytics, everyone is going towards that.

So, the company is also rushing to that area sales with the wind, in the 2000s, you must have heard the dot com Bubble burst. So, everybody was going for the dot com companies. So, you also go to the dot com company, everybody is going for the BPO and all So, BPO everybody was going for biotech. So, you are going for also the biotech business everybody was going for before that shipping. So, you are also going for that that is called sail with the wind.

Then the third one is the move in the same direction. The same directions mean horizontal integration or concentric diversification. So, you are moving into the same business, similar business type of products business. So, this is called the move in the same direction. And lastly is move in a new direction.

This is the planned way you have to move in new directions means you have to have a proper planning proper due diligence, then only you will go for the new directions for going for the new directions, what you need, you need some of the three are a few areas a few things you have to go step by step, what are the steps you have to define, define the business then, you do the SWOT analysis that is situational analysis, you do the gap analysis, gap analysis, then you do the competition and risk analysis.

So, you do all this in the planned way. You define the business, you carry out the situational analysis, you find out gap analysis, then competition and risk analysis, take your decisions, that is the planned way of move in the new direction.

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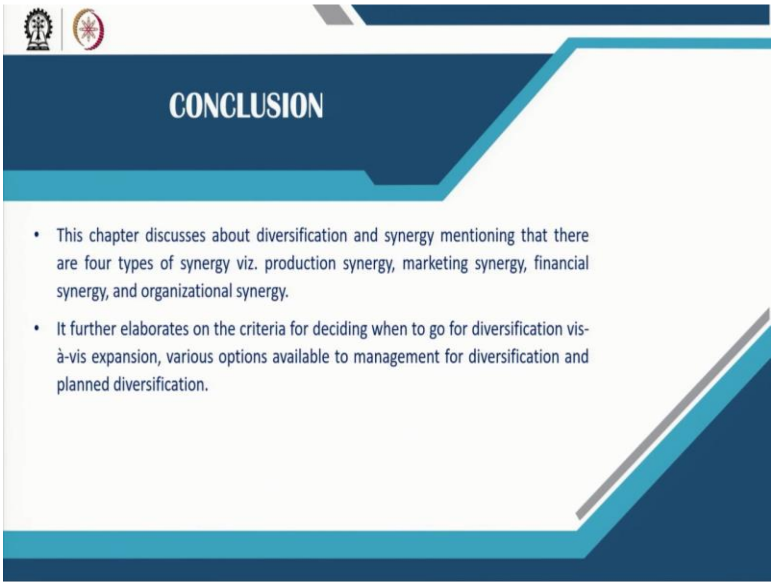

To summarize today's discussion. So, what have we learned? We have learned about diversifications and synergy and mentioned that there are four types of synergy, namely production synergy, marketing synergy, financial synergy and organizational synergy. Further, we have discussed the criteria for deciding when to go for diversification vis-a-vis expansions. We have also discussed various options available to management for diversification and particularly planned diversifications.

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These are some of the reference books available, which you can refer to and enrich further. Thank you very much for attending the class.