

Diversification

Chapter 4

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Choosing between modes of diversification

Entering a new business

External sources

- Non equity alliance
- Equity alliance
- Acquisition

Internal sources

- New products development; R&D investments

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- The choice between internal and external development is also referred as organic vs. inorganic growth
- Organic growth: the firm build up new resources and capabilities that the value chain already entails on its own
- Inorganic growth: it allows to access ready-made resources, relevant for the value chain of the new business

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- The more a market is mature; the greater is the pressure to engage in diversification and synergies
- The optimal decision is when the net present value of the joint business is greater than the standalone value of the old business, minus the cost of entering in a new business (governance costs)
- Bargains and synergies are required to increase the net present value of the investment

A five-step approach to the diversification decision

- How to diversify?
- Comparing between internal and external growth mode, basing on the following questions

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- I. Are there potential synergies between the old and new business?
 - trade-off between bargaining and synergies

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II. Identify resource gap

- What the desired resources or capabilities needed to diversify into a new business are in order to operate in the new business

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III. Identify candidates for resources acquisition through inorganic growth

- If there's any other company holding those resources, than, it's a target to potentially acquire. Otherwise, the only choice left is organic growth.

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IV. Optimal partner-mode combination for inorganic growth

-choice between equity, non-equity alliances and acquisition

V. Compare with value from organic growth

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- Diversified companies normally account for the 50% of national economies
- Related diversifier do better than single-business firms and unrelated diversifier. They can easily implement better synergies
- Relatedness should be also considered in terms of value-chain, instead of products or customers
- Vertical integration can be seen as a particular form of diversification (within business)