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Diversification is a Business Development Strategy Allowing a Company to Enter Additional Lines of Business

KEYWORDS

Dr Keyurkumar M Nayak

Director Laxmi Institute of Management, Sarigam

What is Diversification?

Diversification is a business development strategy allowing a company to enter additional lines of business that are different from the current products, services and markets.

In the current conditions of dynamic markets and strong competition, a successful instrument of risk management is to avoid focusing on a single product, service and/or their distribution to a single limited market. When implemented wisely it contributes to keeping the company stable even in hard times since the *economic downturn* usually occurs simultaneously in all sectors and all markets.

Diversification of business activities brings competitive advantages allowing companies to reduce business risks. That is why it is a great tool for business development. However, its successful implementation requires profound *knowledge* and thorough preliminary assessment of the company and its environment. And, although sometimes diversification is difficult for the small companies, it can prove to be inevitable when their original markets become unviable

Types of Diversification

Diversification is a strategic approach adopting different forms. Depending on the applied criteria, there are different classifications.

Depending on the direction of company diversification, the different types are:

- ***Horizontal Diversification***

acquiring or developing new products or offering new services that could appeal to the company´s current customer groups. In this case the company relies on sales and technological relations to the existing product lines. For example a dairy, producing cheese adds a new type of cheese to its products.

- ***Vertical Diversification***

occurs when the company goes back to previous stages of its *production cycle* or moves forward to subsequent stages of the same cycle - production of raw materials or distribution of the final product. For example, if you have a company that does reconstruction of houses and offices and you start selling paints and other construction materials for use in this business. This kind of diversification may also guarantee a regular supply of materials with better quality and lower prices.

- ***Concentric Diversification***

enlarging the production portfolio by adding new products with the aim of fully utilising the potential of the existing technologies and marketing system. The concentric diversification can be a lot more financially efficient as a strategy, since the business may benefit from some synergies in this diversification model. It may enforce some investments related to modernizing or upgrading the existing processes or systems. This type of diversification is often used by small producers of consumer goods, e.g. a bakery starts producing pastries or dough products.

- ***Heterogeneous (conglomerate) diversification***

is moving to new products or services that have no technological or commercial relation with current products, equipment, distribution channels, but which may appeal to new groups of customers. The major motive behind this kind of diversification is the high return on investments in the new industry. Furthermore, the decision to go for this kind of diversification can lead to additional opportunities indirectly related to further developing the main company business - access to new technologies, opportunities for strategic partnerships, etc.

- ***Corporate Diversification***

involves production of unrelated but definitely profitable goods. It is often tied to large investments where there may also be high returns.

Related Diversification

Related Diversification is the most popular distinction between the different types of diversification and is made with regard to how close the field of diversification is to the field of the existing business activities.

Related Diversification occurs when the company adds to or expands its existing line of production or markets. In these cases, the company starts manufacturing a new product or penetrates a new market related to its business activity. Under related diversification the company makes easier the consumption of its products by producing complementing goods or offering complementing services. For example, a shoe producer starts a line of purses and other leather accessories; an electronics repair shop adds to its portfolio of services the renting of appliances to the cu tomers for temporary use until their own are repaired.

Experts have formulated two basic fields in relation to:

- Opportunities for sharing *resources*: when all kinds of tangible and intangible resources can be shared or "copied" and the same trademark can be used.
- Opportunities for strategic integration: when the integration of marketing strategies of two businesses brings benefits and the integrated efforts provide additional competitive advantages.

This type of diversification is used mostly by small businesses because it is less risky. In the majority of cases it does not require big investments and owners feel more secure because they know the opportunities and threats in the field of their main business activities. However, sometimes this diversification does not bring the expected results and profits. Most often the reason for this is the underestimation of accompanying problems and the need of *knowledge* and skills in the field of change management, cultural differences, human resource management (layoffs, quitting, promoting, hiring) and so on. However, the reason for not meeting the results and expectations of the diversification may be the overestimation of the expected benefits and profits from the synergy, during the preliminary analysis.