Lesson 5. DEVELOPMENT DIRECTIONS: SPECIALISATION, DIVERSIFICATION, AND VERTICAL INTEGRATION

Basic references:

- Johnson, G., Whittington, R., Regner, P., Scholes, K., & Angwin, D. (2017). Exploring Strategy: Text and Cases. Pearson Education Limited.
- Thomson, A., Peteraf, M.A., Gamble, J.E., & Strickland, A.J. (2020).Crafting & Executing Strategy. Concepts and readings. McGraw-Hill Education.
- Rothaermel, F (2021). Strategic management , 5th ed. McGraw-Hill Education.

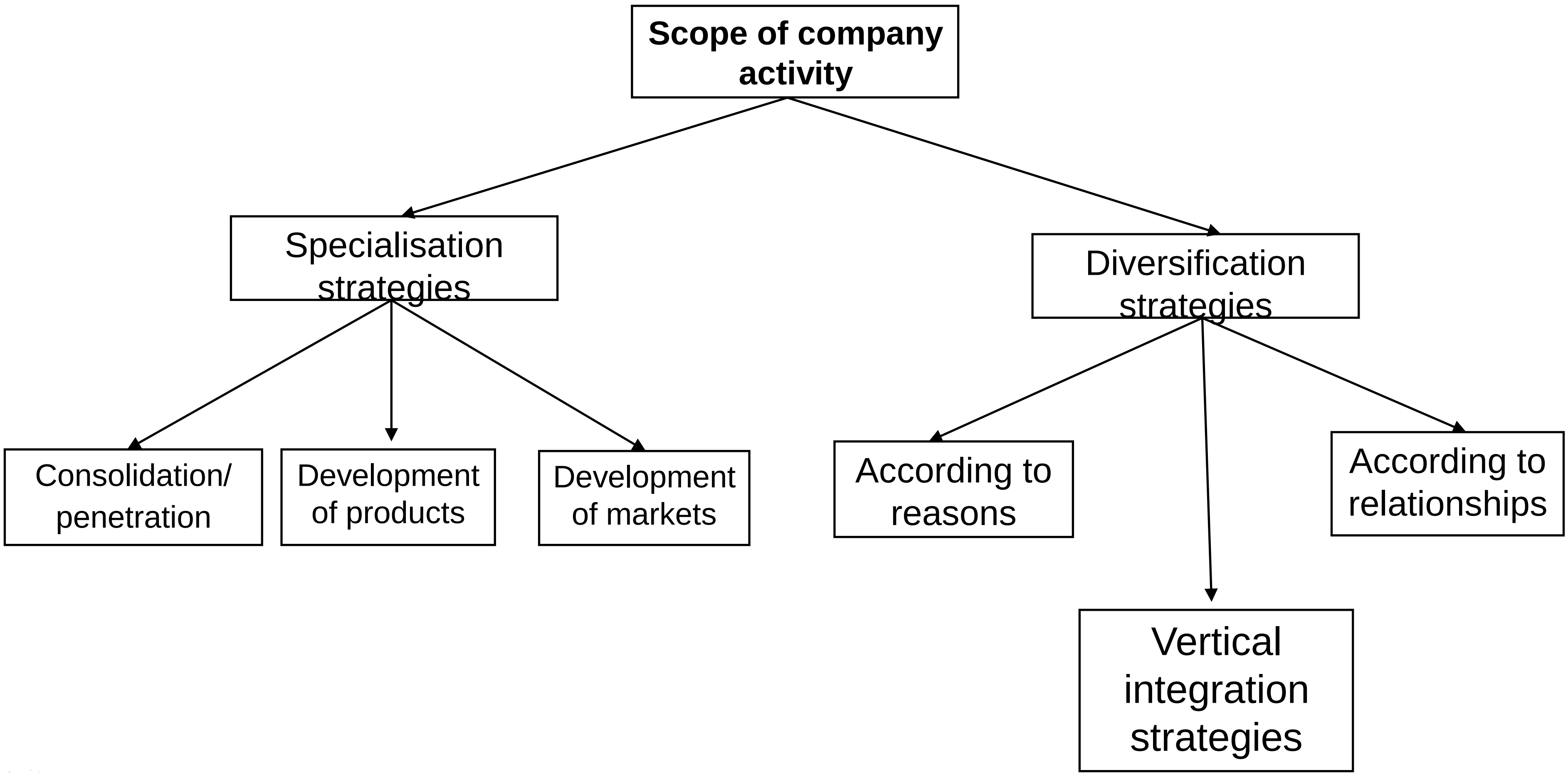
Lesson 5. DEVELOPMENT DIRECTIONS: SPECIALISATION, DIVERSIFICATION, AND VERTICAL INTEGRATION

5.1 Definition of company activity scope

5.2 Strategies of development and growth of the company

5.3 Diversification strategies

5.4 Vertical integration strategies


Scope of company activity
Specialisation strategies
Diversification strategies
Consolidation/ penetration
Development of products
Development of markets
According to reasons
According to relationships
Vertical integration strategies

5.1. Definition of company activity scope

- **The activity scope delimits the current and future field of action of the company, the whole or the portfolio of businesses or activities in which it operates and wants to operate:**

- **Where to compete**
  - **Business = product + market**
  - **Business = technology + needs attended + market**

- **Dynamic perspective (Ansoff's Growth Matrix (1976):**
  - **Specialisation**
  - **Expansion**
  - **Diversification**

5.1. Definition of company activity scope

Ansoff's Matrix (1976)

Specialisation versus diversification:

- Set of strategic options that answer the question: where will the company compete?

- Defined at corporate level of strategy.

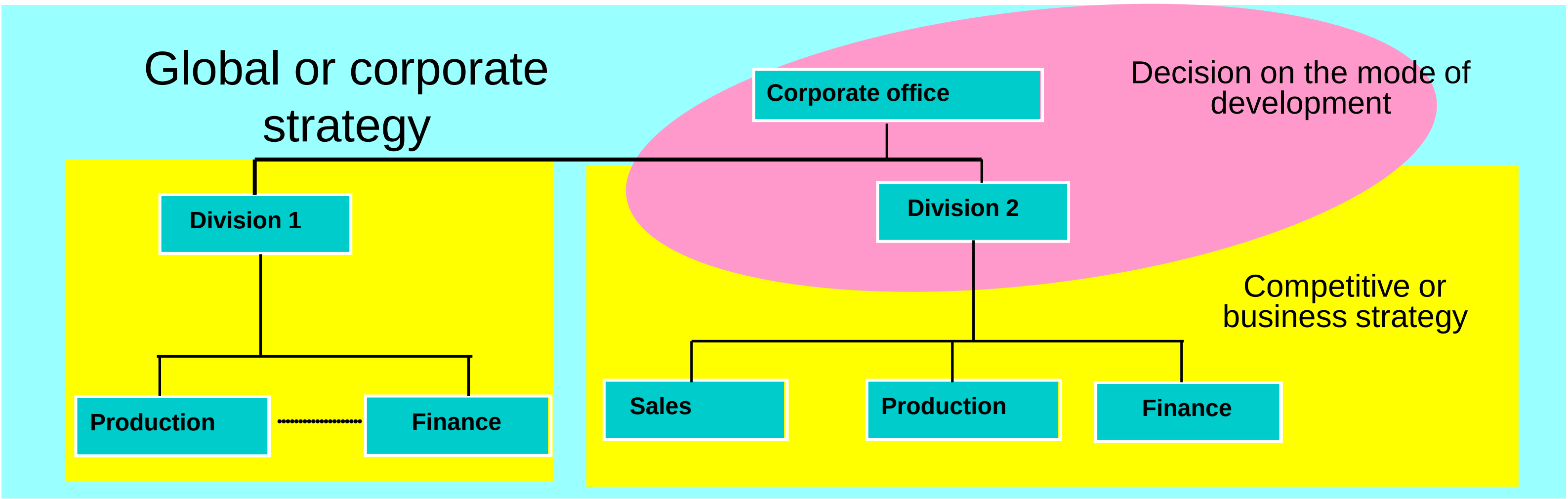
- Determine the degree of adjustment between scope of activity and distinctive capabilities of the company.
  - Specialised company versus diversified company.
  - Strategic options.
    - Specialisation: maintenance of the scope of activity.
    - Diversification: aggregation of businesses in field of activity that entails changing key success factors (KSF) and the company's capabilities.

5.2. Company development and growth strategies

- Distinction:
  - Growth: increasing size of company
  - Development: progressive evolution of company
- Relationship between growth and dimension:
  - Business identity factor: classification of company according to size: micro, SME, large
  - Competitiveness factor: economies of scale, cost reduction (justification of mergers in certain sectors)
  - Contingency factor: relationship between size and organisational structure of company

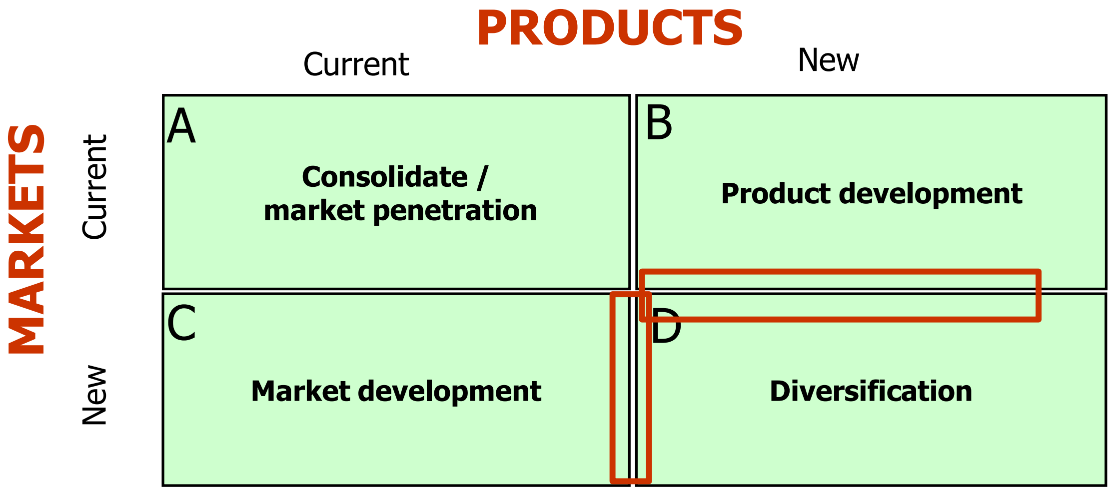
Development/growth modes

- Decisions on development mode can be considered at the corporate level and at competitive level of strategy: objectives can be set at corporate level and/or competitive level.



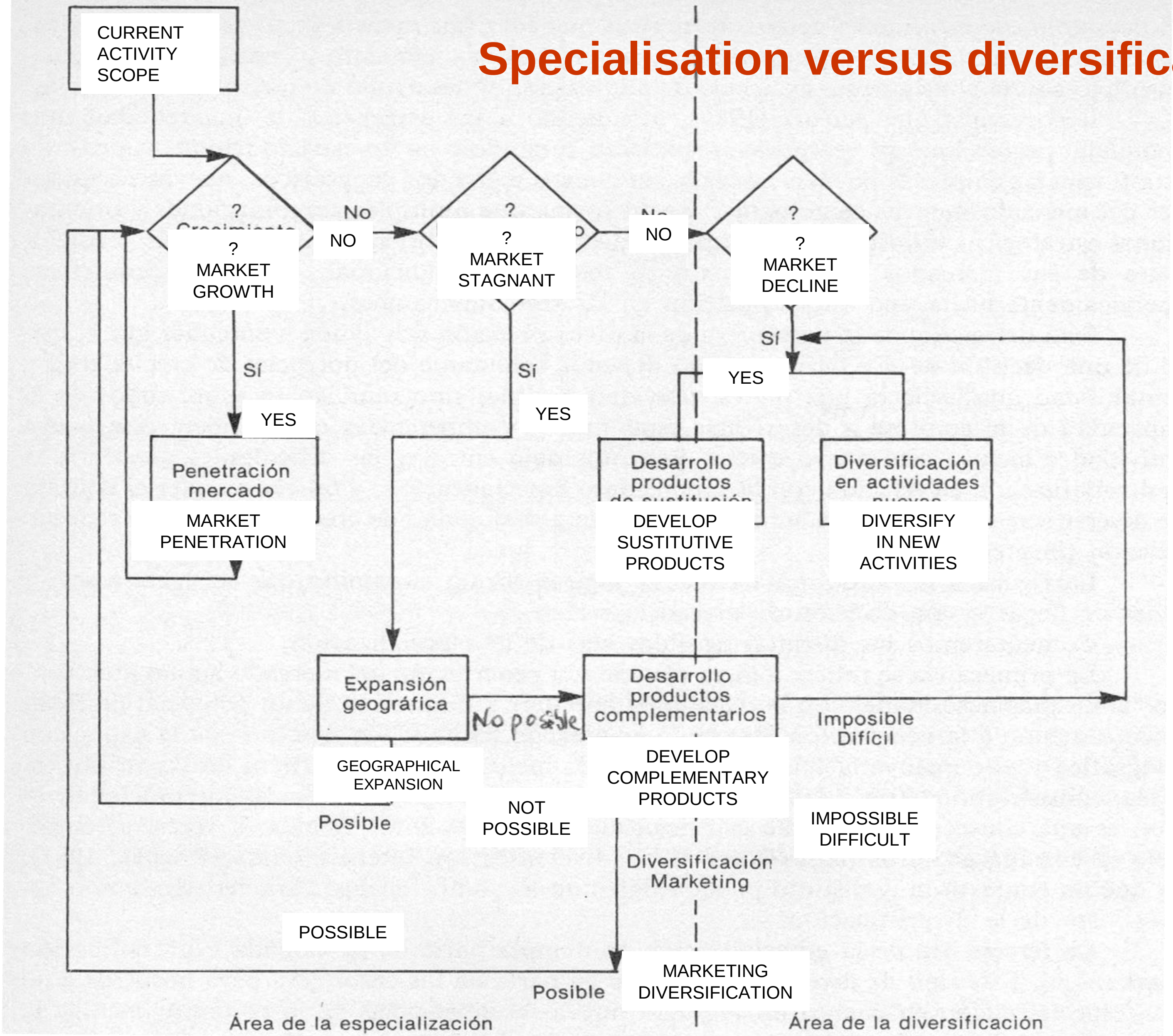
Specialisation versus diversification

A. Consolidation / market penetration
B. Product development or expansion
C. Market development or expansion



◆ Diversification of marketing frontier of specialisation.

Specialisation versus diversification:



POSSIBLE

SPECIALISATION AREA

DIVERSIFICATION AREA

Specialisation strategies

A. CONSOLIDATE / PENETRATE
- Options that protect or develop current position without modifying scope of activity
- Keep current product-market binomial:

A1. MARKET CONSOLIDATION:
- Protect and strengthen position in current markets with current products (maintain market share).
- Does not mean ‘do nothing’ (the situation in the market and the position of competitors may change).
- Do resources and capabilities fit market needs?

A2. MARKET PENETRATION:
- Improve position in current markets with current products (increase market share).
- Ease of penetrating market depends:
    - On the nature of the market
      Life cycle of sector (introduction, growth, maturity, and decline)
      Existence of unattractive market segments for leaders
      On key resources and capabilities of the company: innovation, quality...

Specialisation strategies

B. PRODUCT DEVELOPMENT OR EXPANSION

- Required capabilities:

    - Analysis and understanding customer needs and possible changes
    - Creativity to meet needs:
        - R+D capacity to meet needs
        - Ability to acquire and adapt products of others (reverse engineering)
    - In the long term, it is necessary to develop or acquire new capabilities.
    - It is necessary to decide the modality of access to innovation or new capabilities:
        - Internal development / licensing / learning / acquisition of innovations
        - Concept of product development continuum

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Product development continuum

External development strategies

Alliances

Joint ventures

Purchase technology or expertise by acquiring the developer

Internal development strategies

Migrations of existing products

Enhancements to existing products

New internally developed products

Internal ← Cost of product development → Shared

Lengthy ← Speed of product development → Rapid and/or existing

High ← Risk of product development → Shared

Specialisation strategies

C. MARKET DEVELOPMENT OR EXPANSION

- Aspirations of company exceed opportunities offered by markets in which it is present.
    - Ways to develop markets:
        - Entry in segments where it was not present:
            - May require new capabilities.
        - Entry into new national and international territories:
            - Ability to analyse markets
            - Languages
            - Cultural aspects
            - May require new capabilities (namely distribution)

5.3. Diversification strategies

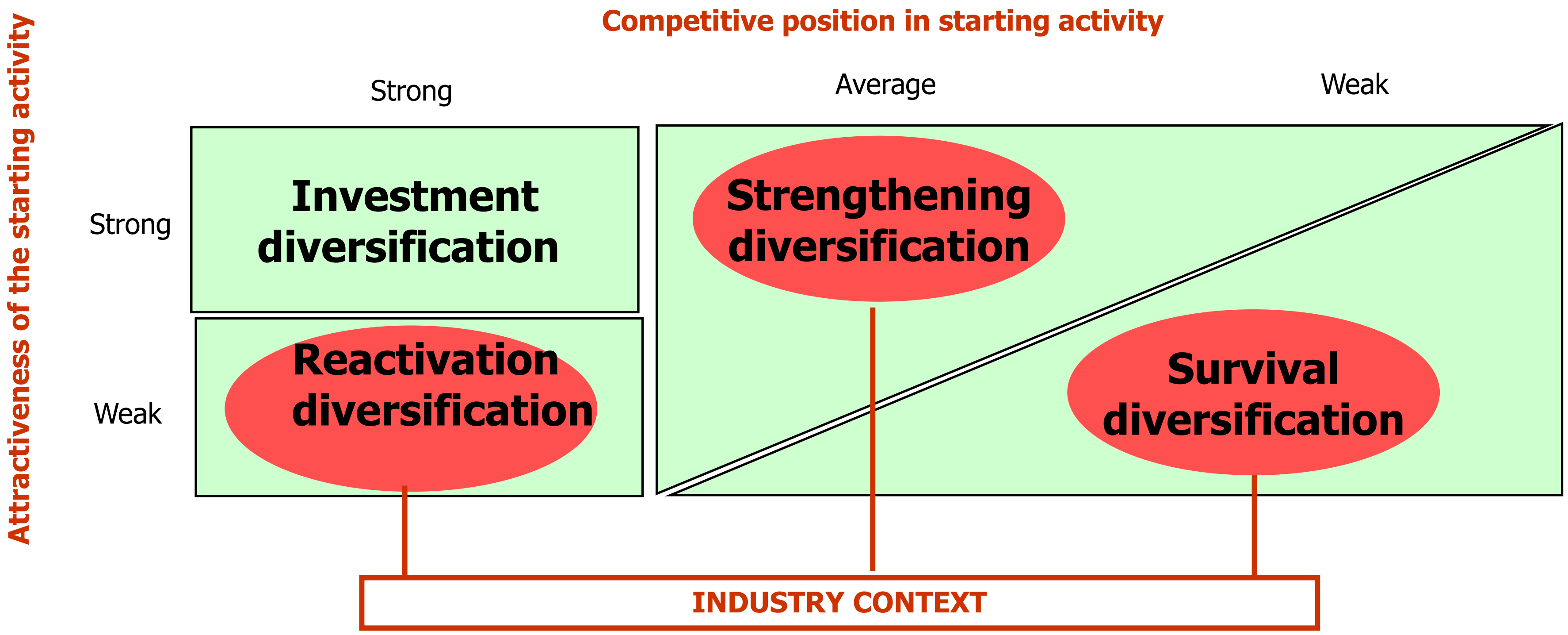
- Reasons for diversification
  - Maturity and/or decline of company's current activities (portfolio logic)
  - Investment opportunities for financial surpluses and/or other under-utilised capacities
  - Decrease in global risk (depends on type of diversification)
  - Strengthening company's competitive position

5.3. Diversification strategies

- Disadvantages of diversification:
  - Increase in organisational complexity and likely change in divisional structure.
  - Possible difficulties arising from integration and coordination of businesses.
  - Possible difficulties in organisational learning (new abilities).

5.3. Diversification strategies

◆Types of diversification: depending on reasons for diversification:



5.3. Diversification strategies

- Types of diversification
- Depending on relationships and synergies between businesses:

Types of synergies	Acc to types of synergy	Same line of products?	Where?
Marketing	**RELATED DIVERSIFICATION** •CONCENTRIC •HOMOGENEOUS	**V I RELATED VERTICAL DIVERSIFICATION**	**FORWARD V I** **BACKWARD V I**
Techno-productives		**RELATED HORIZONTAL DIVERSIFICATION**	
Financial	**UNRELATED DIVERSIFICATION** • PURE • CONGLOMERAL • HETEROGENEOUS		
Management			

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5.3. Diversification strategies

Retailing : Carrefour

5.4. Vertical integration strategies

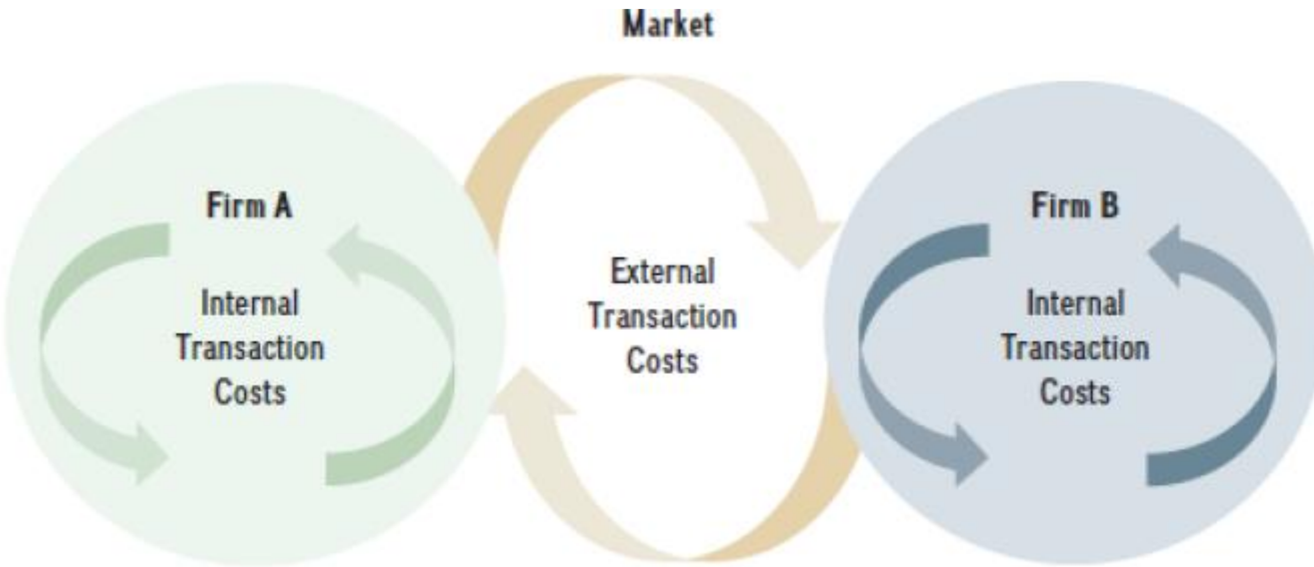
https://knowledge.wharton.upenn.edu/article/vertical-integration-works-for-apple-but-it-wont-for-everyone

- Concept:
  - Decision to outsource or internalise
  - Extension of company's value chain
  - Reduce transaction costs for company
- Variables:
  - Breadth: number of activities other than company’s own
  - Number of value chain stages covered
  - Modality: degree of integration of each activity
  - Form of integration: horizontal-vertical and total-partial
- Disadvantages:
  - Requires large amounts of capital.
  - Reduces flexibility of company in long term.
  - Promotes situations of monopoly or oligopoly.
  - Increases fixed production costs of company.

Organising economic activity: firms vs markets

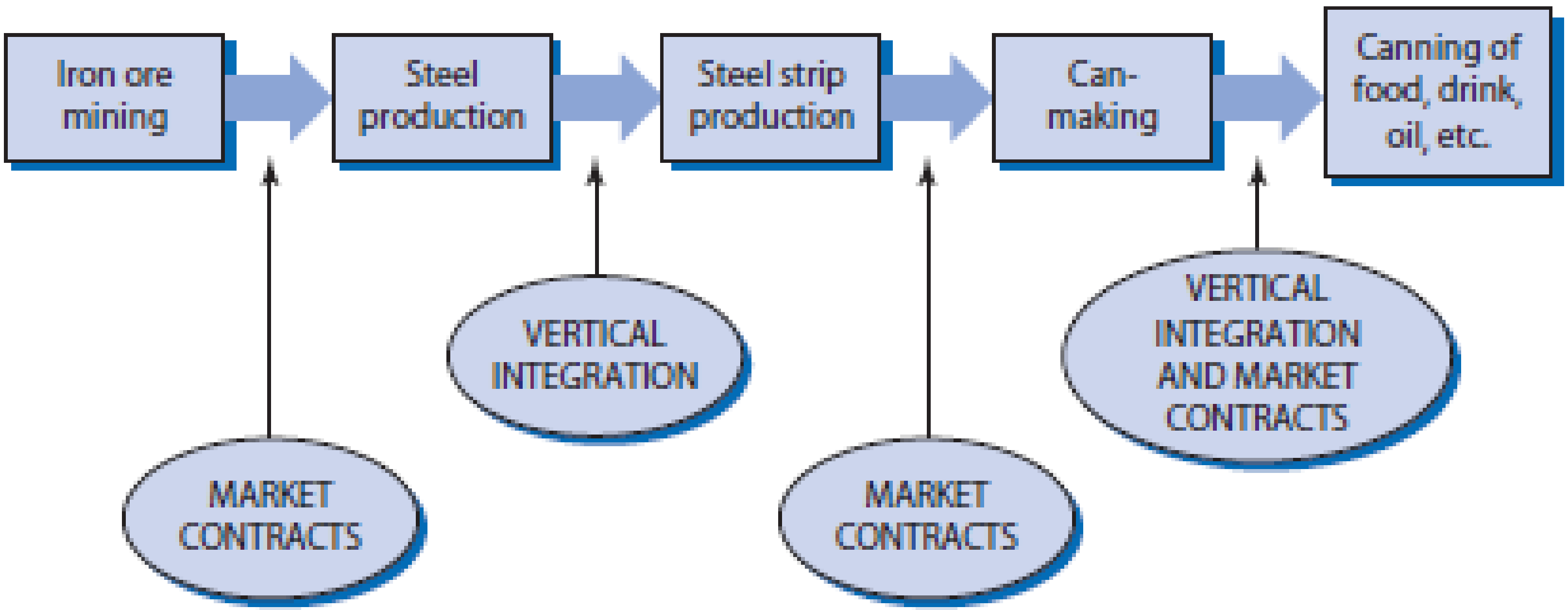
	Firm	Markets
Advantages	• Command and control - Fiat - Hierarchical lines of authority • Coordination • Transaction-specific investments • Community of knowledge	• High-powered incentives • Flexibility
Disadvantages	• Administrative costs • Low-powered incentives • Principal–agent problem	• Search costs • Opportunism - Hold-up • Incomplete contracting - Specifying & measuring performance - Information asymmetries • Enforcement of contracts

Organizing economic activity: firms vs markets



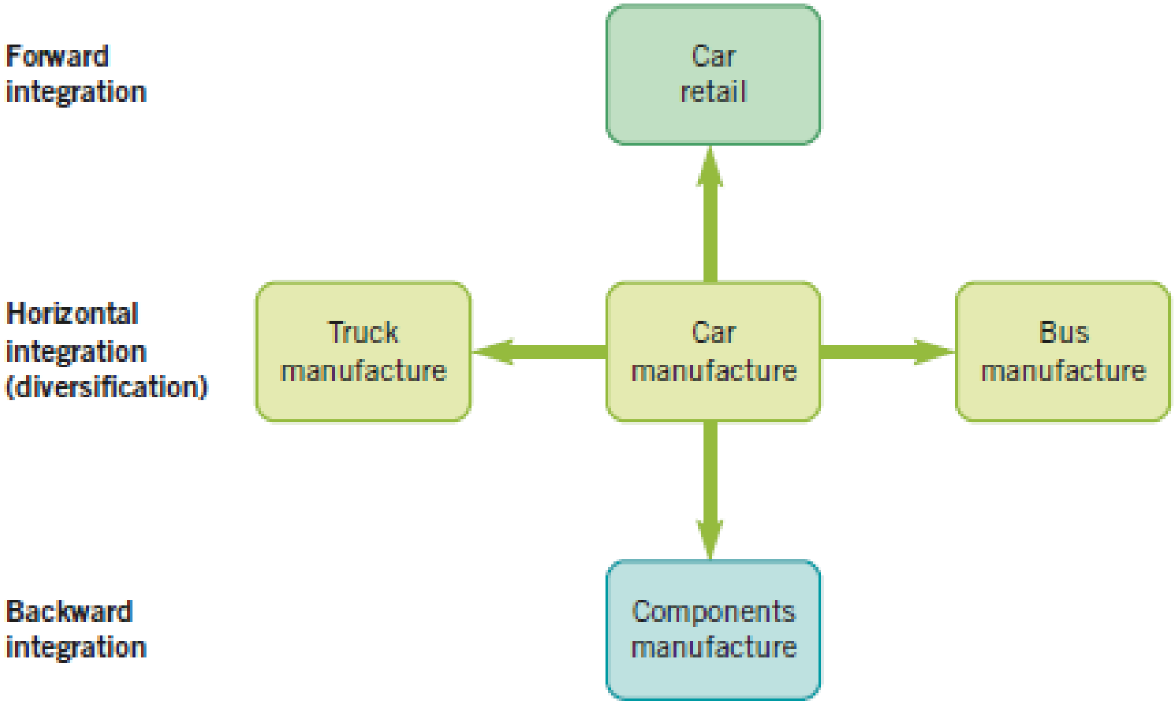
Transaction cost economics
Theoretical framework in strategic management to explain and predict boundaries of firm, and central to formulating corporate strategy that is more likely to lead to competitive advantage.
Internal transaction costs
Costs of organising an economic exchange within a hierarchy - also called administrative costs.
External transaction costs
Costs of searching for a firm or an individual to contract, and then negotiating, monitoring, and enforcing the contract.

Organizing economic activity: firms vs markets



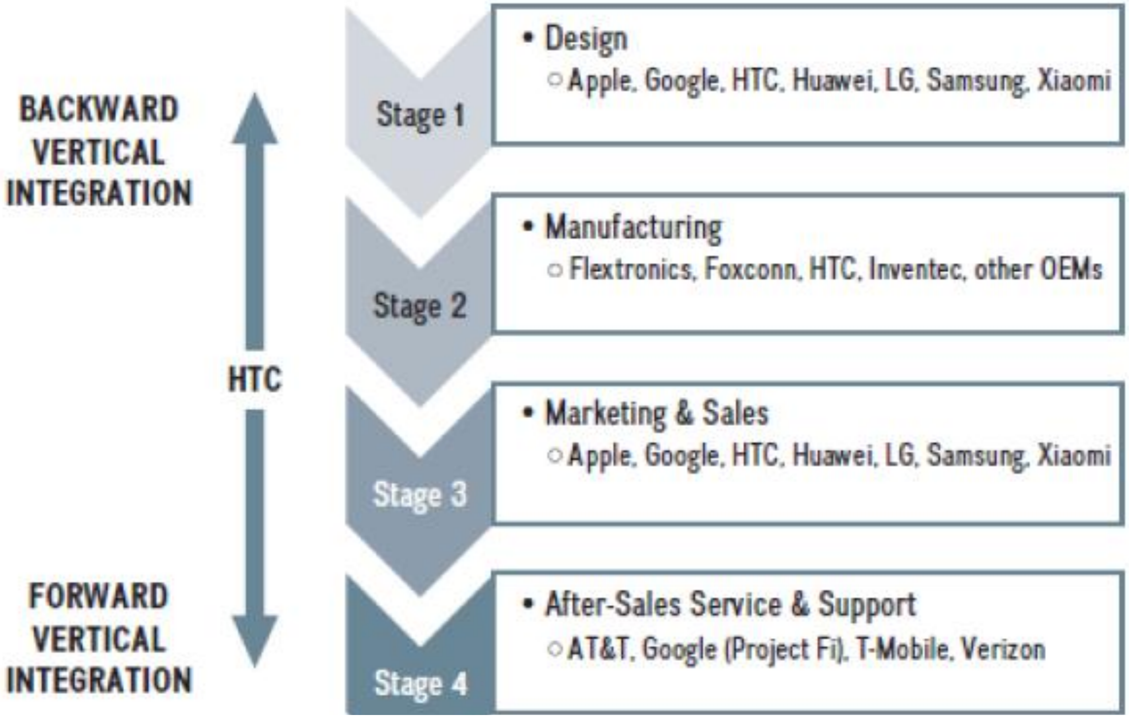
The value chain of steel cans

5.4. Vertical integration strategies



5.4. Vertical integration strategies

Example of backward and forward vertical integration



This is an example of the industry value chain for smartphones. HTC evolved from a no-name OEM in stage 2 up to a player in design, manufacture, and sale of smartphones (stages 1 and 3). Now sells innovative smartphones under HTC brand.