

STRATEGY CAPSULE 12.1

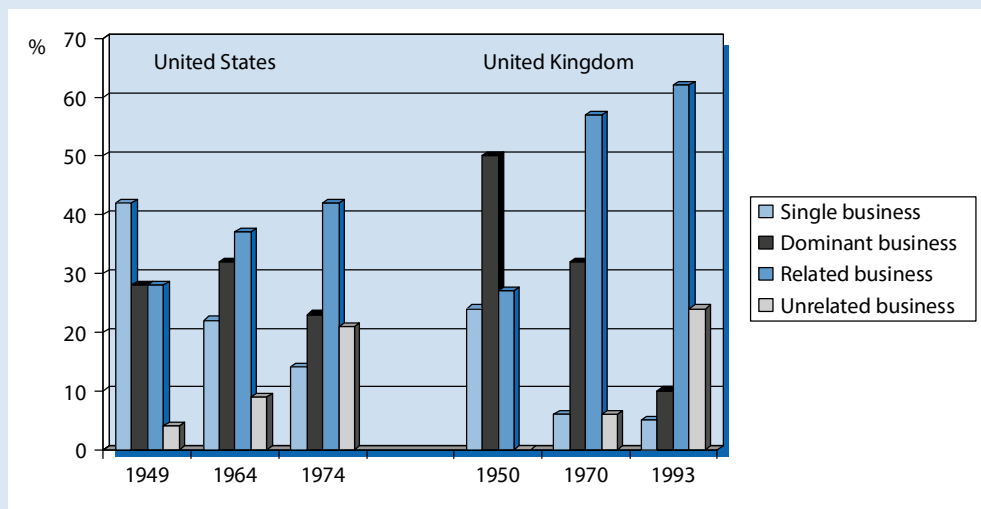
Trends in Corporate Diversification Over Time

Diversification has followed the same trend as that of corporate scope more generally (see Chapter 10, Strategy Capsule 10.1). For most of the 20th century—and especially during the 1960s and 1970s—large companies in all the advanced industrial nations diversified beyond their core business.² The 1960s also saw the emergence of a new type of company—the *conglomerate*: a highly diversified company assembled from multiple, unrelated acquisitions. These included ITT, Textron, and Allied Signal in the United States and Hanson, Slater Walker, and BTR in the United Kingdom. Their existence reflected the belief that top management no longer needed industry-specific experience: the new techniques of financial and strategic management could be applied to any business.³ Figure 12.1 shows the growing number of highly diversified US and UK firms (both “related business” and “unrelated business”) during the latter part of the 20th century.

After 1980, the diversification trend went into reverse as companies divested their “noncore” businesses. Between 1980 and 1990, the average index of diversification for Fortune 500 companies declined from 1.00 to 0.67.⁴

The main driver of this trend was a shift of corporate goals from growth to profitability—typically companies’ diversified businesses were less profitable than their core businesses. Evidence of a “conglomerate discount”—that the stock market was valuing diversified companies at less than the sum of their parts—resulted in diversification in general becoming viewed as the enemy of shareholder interests.⁵ CEOs came under increasing pressure from both institutional shareholders, including pension funds such as California’s Public Employees’ Retirement System, and hostile takeovers launched by private equity groups. Kohlberg Kravis Roberts’ \$31 billion takeover of the tobacco and food giant RJR Nabisco in 1989

FIGURE 12.1 Diversification strategies of large US and UK companies during the late 20th century



Sources: R. P. Rumelt, “Diversification strategy and profitability,” *Strategic Management Journal* 3 (1982): 359–370; R. Whittington, M. Mayer, and F. Certo, “Chandlerism in Post-war Europe: Strategic and Structural Change in France, Germany and the United Kingdom, 1950–1993,” *Industrial and Corporate Change* 8 (1999): 519–550; D. Channon, *The Strategy and Structure of British Enterprise* (Cambridge: Harvard University Press, 1973).

demonstrated that even the largest US companies were vulnerable to attack from corporate raiders.⁶

In Chapter 10, we observed that volatile, uncertain conditions increase the decision-making burden on top management, making large, complex companies less agile than specialized companies. At the same time, the growing availability of private capital encouraged many diversified companies to spin off their growth businesses in order to tap funding from external capital markets.

However, many companies still view diversification as an opportunity for value creation. The tendency for digital technologies to erode market boundaries and create hardware/software complementarities has encouraged technology leaders such as Alphabet, Amazon, Alibaba, Baidu, and Rocket Internet to continuously expand their product ranges. In more mature sectors, an emphasis on providing “customer solutions” is similarly

encouraging firms to offer bundles of complementary products and services. In many instances, these diversification initiatives are occurring through collaboration with other companies rather than through conventional diversification.

In the emerging markets of Asia and Latin America, the leading companies tend to be highly diversified—and often family controlled. These include Tata and Reliance in India, Charoen Pokphand (CP) in Thailand, Astra International in Indonesia, Sime Darby in Malaysia, and Grupo Alfa and Grupo Carso in Mexico.⁷ We shall consider the reasons for these differences in diversification patterns between mature and emerging countries later in the chapter.

Figure 12.2 summarizes the trends in diversification strategy since the middle of the last century and points to the influence of corporate goals and developments in strategic management concepts and tools on these trends.

FIGURE 12.2 The evolution of diversification strategies, 1960–2018

