

Strategies for Diversification By H. Igor Ansoff The Red Queen said, "Now, here, it takes all the running you can do to keep in the same place. If you want to get somewhere else, you must run at least twice as fast as that!" All of this has important implications for diversification, as suggested by the Brookings study: "The majority of the companies included among the 100 largest of our day have attained their positions within the last two decades. They are companies that have started new industries or have transformed old ones to create or meet consumer preferences. The companies that have not only grown in absolute terms but have gained an image of the product missions. Each objective is designed to improve some aspect of the balance between the overall product-market strategy and the expected environment. The specific objectives derived for any given case can be grouped into three general categories: growth objectives, such as 1, 2, and 3 above, which are designed to improve the balance under favorable trend conditions; stability objectives, such as 3 and 4, designed as protection against unfavorable trends and foreseeable contingencies; and flexibility objectives, such as 5, to strengthen the company against unforeseeable contingencies. A diversification direction which is highly desirable for one of the objectives is likely to be less desirable for others. For example: C If a company is diversifying because its sales trend shows a declining volume of demand, it would be unwise to consider vertical diversification, since this would be at best a temporary device to stave off an eventual decline of business. EUR If a company's industry shows every sign of healthy growth, then vertical and, in particular, horizontal diversification would be a desirable device for strengthening the position of the company in a field in which its knowledge and experience are concentrated. e If the major concern is stability under a contingent forecast, chances are that both horizontal and vertical diversification could not provide a sufficient stabilizing influence and that lateral action is called for. e If management's concern is with the narrowness of the technological base in the face of what we have called unforeseeable contingencies, then lateral diversification into new areas of technology would be clearly indicated. Measured Sales Goals Management can and should state the objectives of growth and stability in quantitative terms as long-range sales objectives. This is illustrated in EXHIBIT V. The solid lines describe a hypothetical company's forecasted performance without diversification under a general trend, represented by the sales curve marked Si, and in a contingency, represented by Sa. The dashed lines show the improved performance as a result of diversification, with S3 representing the curve for continuation of normal trends and S4 representing the curve for a major reverse. Growth. Management's first aim in diversifying is to improve the growth pattern of the company. The growth objective can be stated thus: Strategies for Diversification 119 Under trend conditions the growth rate of sales after diversification should exceed the growth rate of sales of the original product line by a minimum specified margin. Or to illustrate in mathematical shorthand, the objective for the company in EXHIBIT V would be: $S_3 - S_i \geq p$ where the value of the margin p is specified for each year after diversification. EXHIBIT V. DIVERSIFICATION OBJECTIVES SALES VOLUME T-Time Some companies (particularly in the growth industries) fix an annual rate of growth which they wish to attain. Every year this rate of growth is compared to the actual growth during the past year. A decision on diversification action for the coming year is then based upon the disparity between the objective and the actual rate of growth. Stability. The second effect desired of diversification is improvement in company stability under contingent conditions. Not only should

diversification prevent sales from dropping as low as they might have before diversification, but the percentage drop should also be lower. The second sales objective is thus a stability objective. It can be stated as follows: Under contingent conditions the percentage decline in sales which may occur without diversification should exceed the percentage drop in sales with diversification by an adequate margin, or algebraically: $S_1 - S_2 \geq S_3 - S_4$ Using this equation, it is possible to relate the sales volumes before and after diversification to a rough measure of the resulting stability. Let the ratio of the lowest sales during a slump to the sales which would have occurred in the same year under trend conditions be called the stability factor F . Thus, $F = 0.3$ would mean that the company sales during a contingency 120 Harvard Business Review amount to 30% of what is expected under trend conditions. In EXHIBIT VI the stability factor of the company before diversification is the value $F_1 = S_2/S_1$ and the stability factor after diversification is $F_3 = S_4/S_3$, both computed at the point on the curve where S_2 is minimum. Now let us suppose that management is considering the purchase of a subsidiary. How large does the subsidiary have to be if the parent is to improve the stability of the corporation as a whole by a certain amount? EXHIBIT VI shows how the question can be answered: On the horizontal axis we plot the different possible sales volumes of a smaller firm that might be secured as a proportion of the parent's volume. Obviously, the greater this proportion, the greater the impact of the purchase on the parent's stability. On the vertical axis we plot different ratios of the parent's stability before and after diversification (F_3/F_1). The assumed stability factor of the parent is 0.3. Let us say that four prospective subsidiaries have stability factors of i.e., 0.9, 0.75, and 0.6. If they were not considerably higher than 0.3, of course, there would be no point in acquiring them (at least for our purposes here). EXHIBIT VI. IMPROVEMENT IN STABILITY FACTOR AS A RESULT OF DIVERSIFICATION FOR $F_1 = 0.3$ RATIO OF STABILITY FACTORS F_3/F_1 - STABILITY OF GBP/GBP/STABILITY BGBP FOR B D/VBR.S/F/CAT/C 1 OT. * > 0.000