

# Corporate Strategy

## Week 2: Diversification

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# Examples of Diversification

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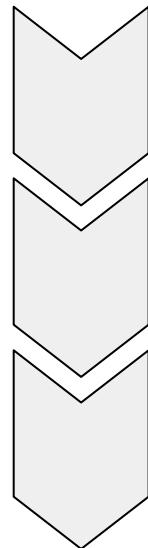
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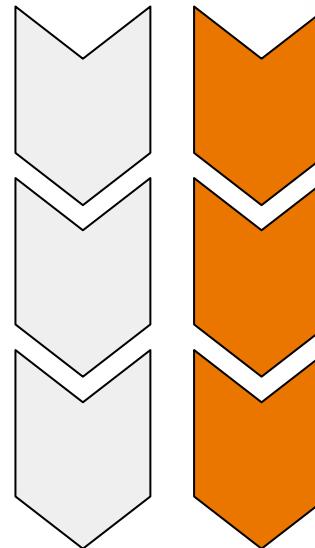




**Before**



**After**



**Design**

**Manufacturing**

**Distribution**

**Footballs** **Footwear**

# Understanding the Basic Modes of Diversification

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ALLIANCE

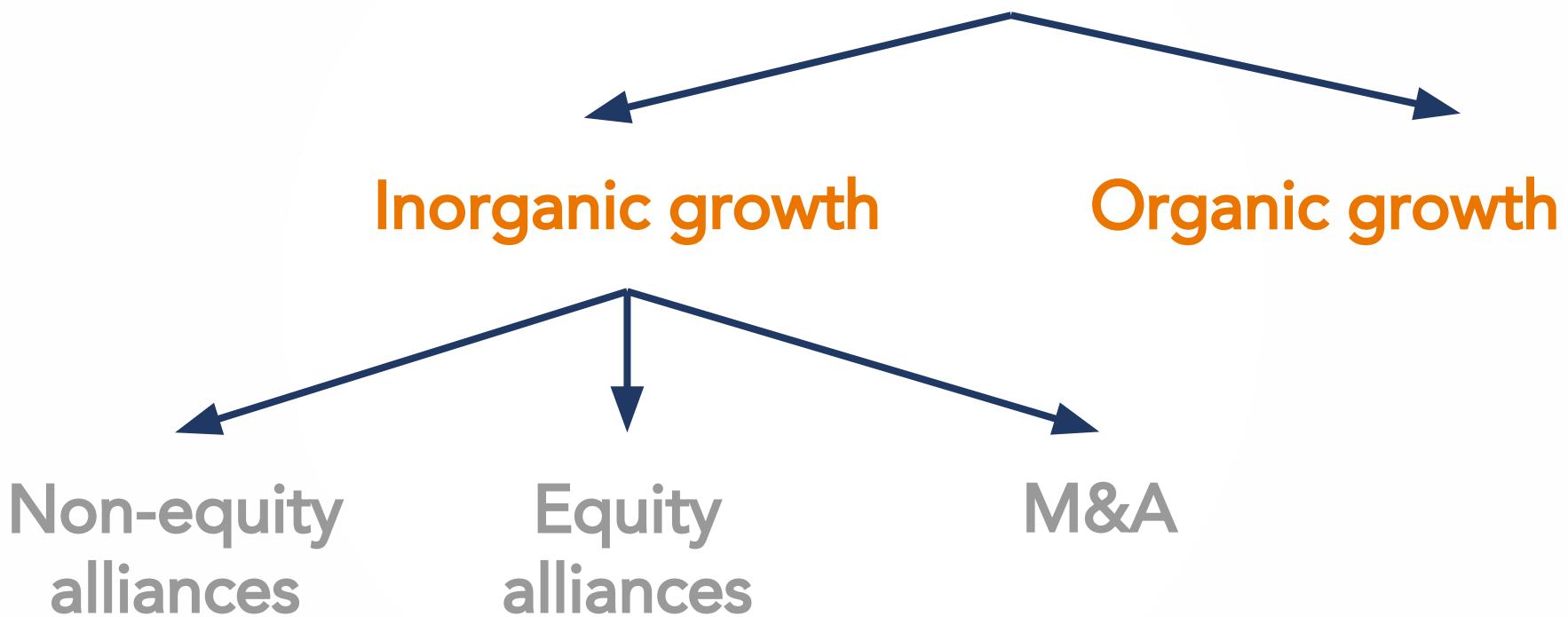


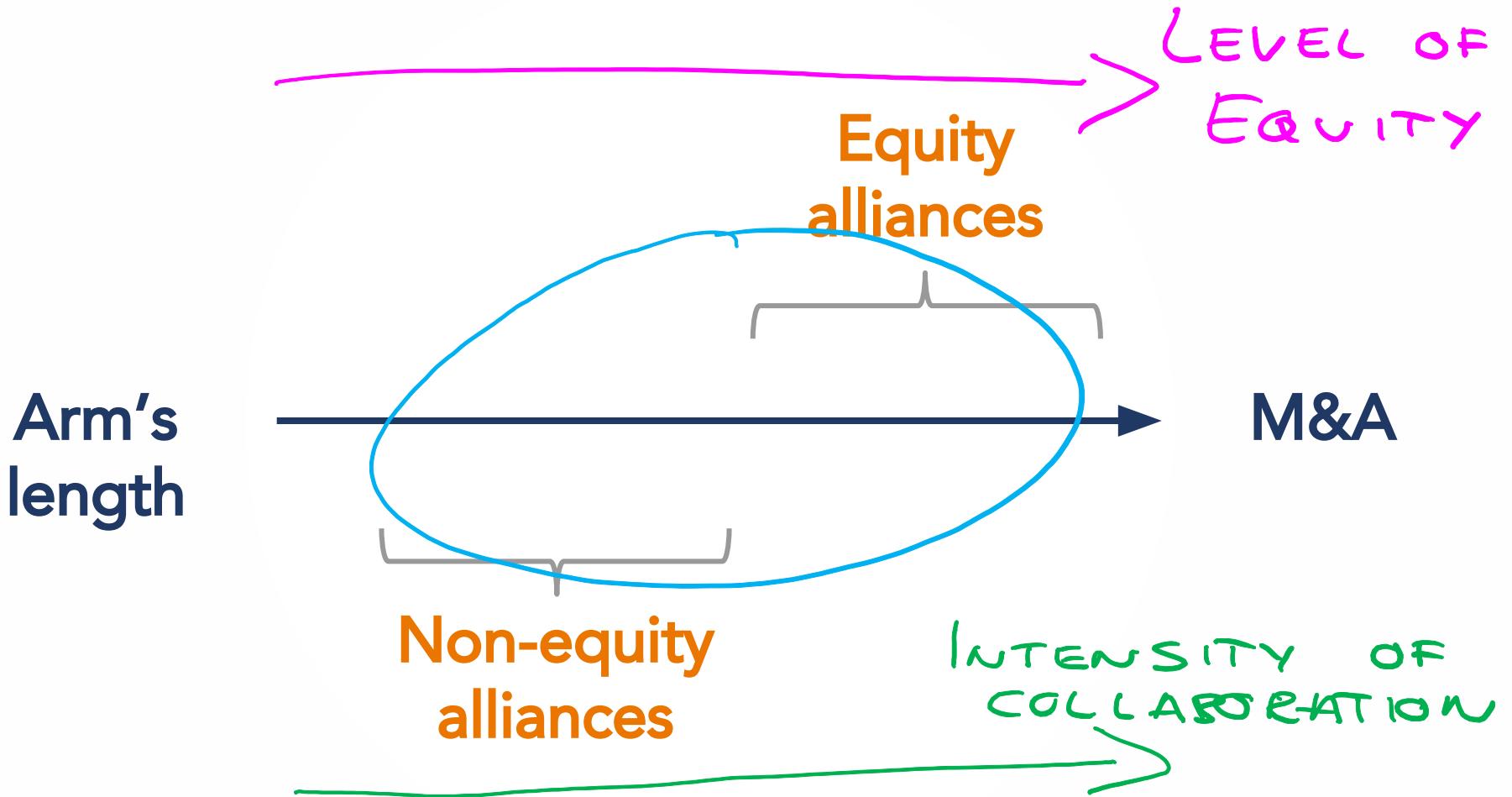
ORGANIC  
GROWTH

M & A



# Entering a new business





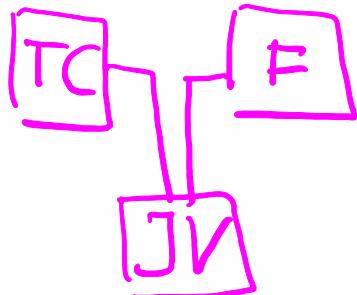
# Non-equity alliances



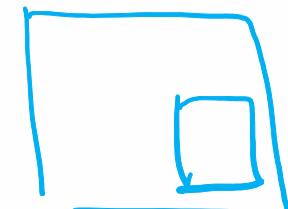
# Equity alliances



# Joint venture



# M&A

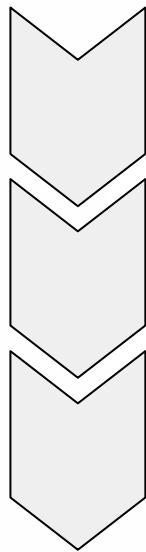


# Understanding the Diversification Test

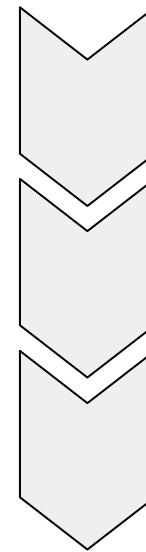
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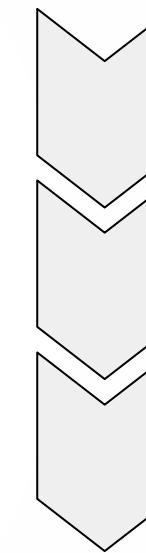
A



A



B



$V(A)$

<

-

$C_m(B)$

+

$V_m(AB)$

## The diversification test:

$$V(A) < -C_m(B) + V_m(AB)$$

m: diversification mode

$V_m(AB)$ : value of A and B if jointly operated

$C_m(B)$ : cost of entry

$V(A)$ : value of A if not jointly operated

$C_n(B)$

Bargains

Yes

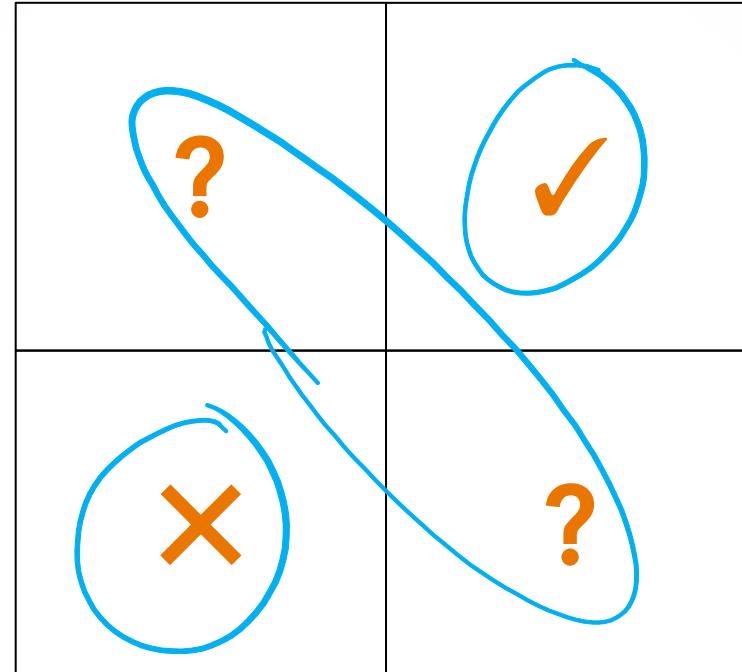
No

No

Yes

Synergies

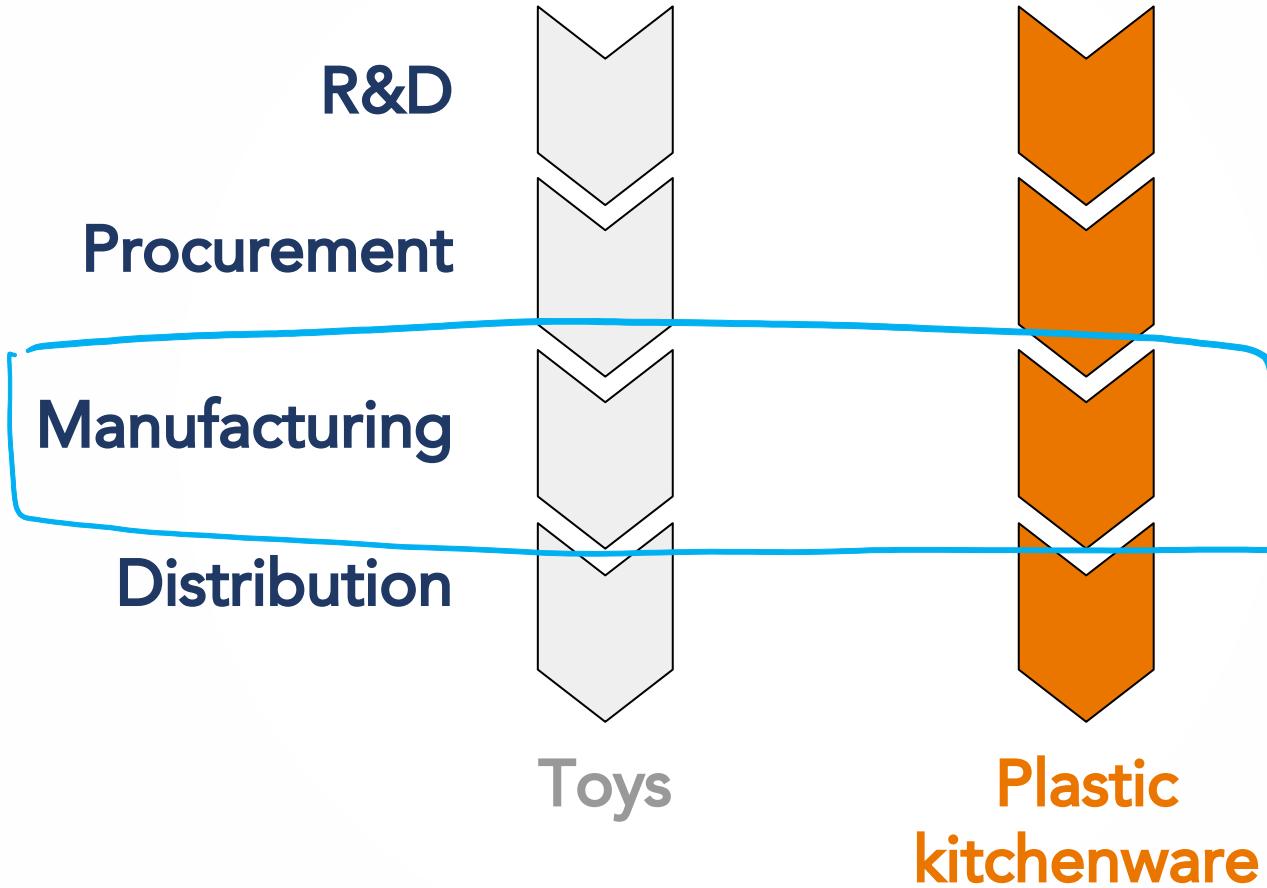
$V_m(AB)$



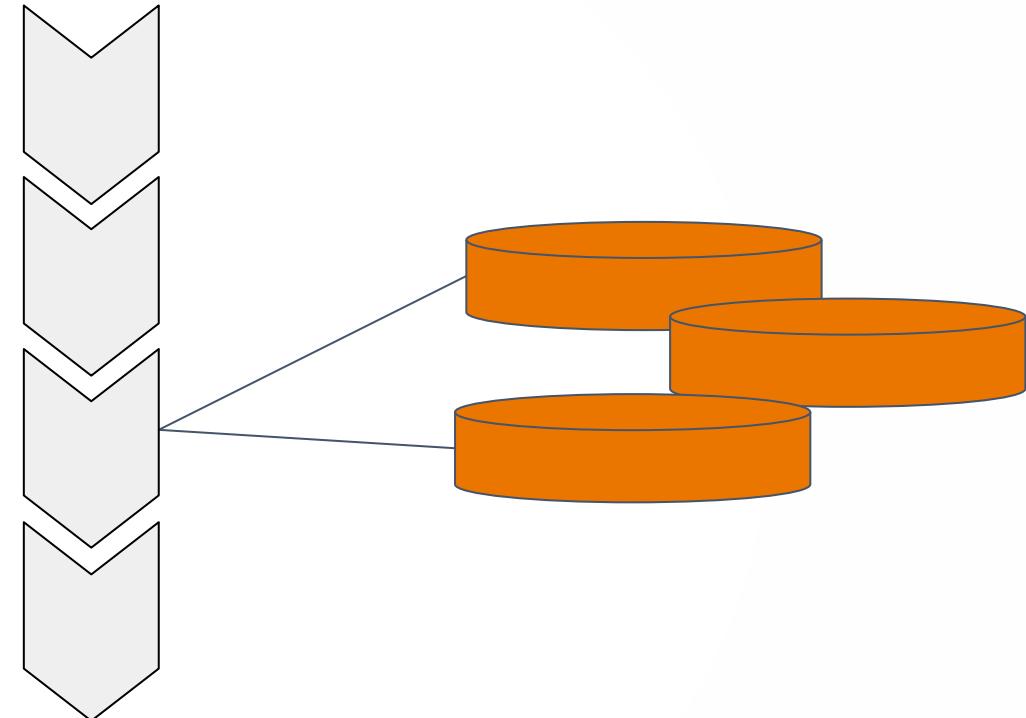
# Understanding Synergies

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R&D  
Procurement  
Manufacturing  
Distribution



Value chain

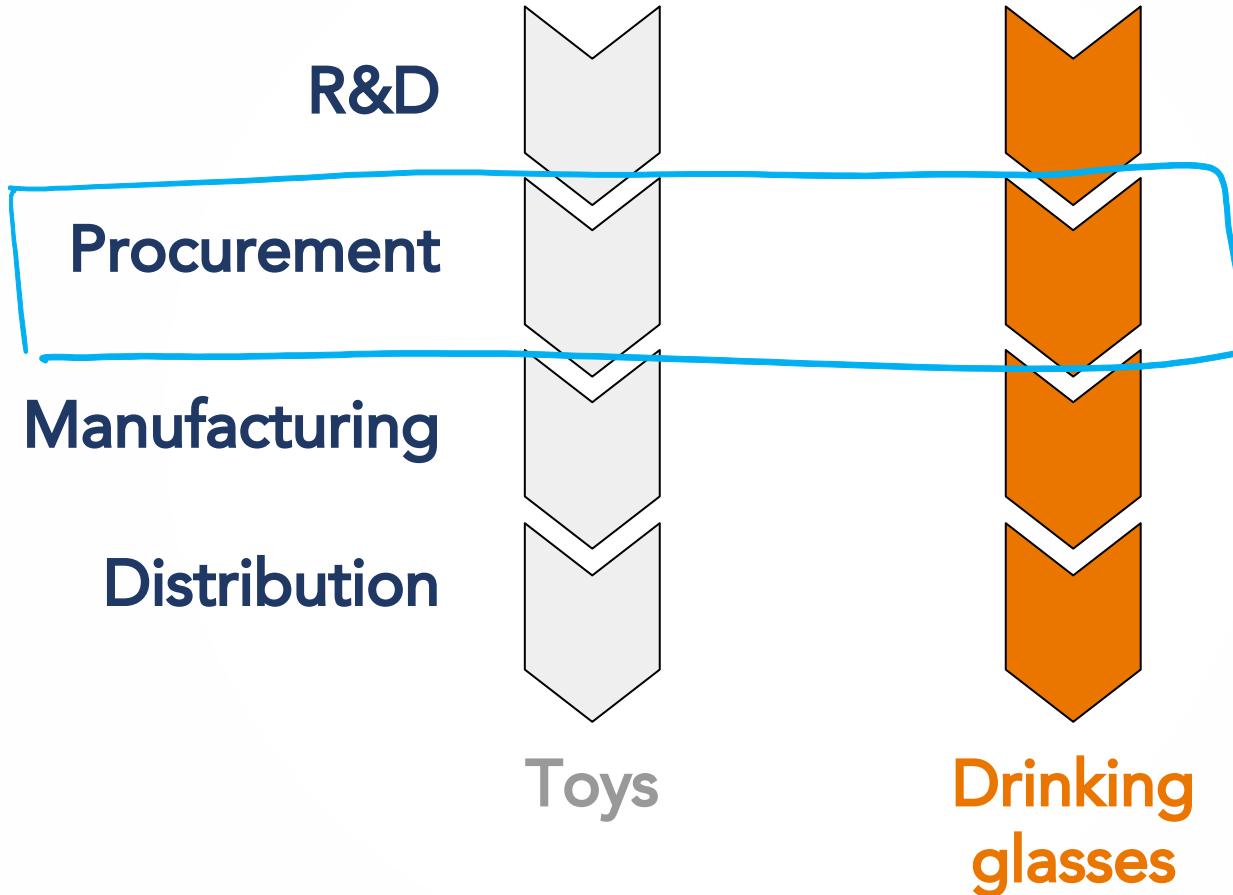
Resources

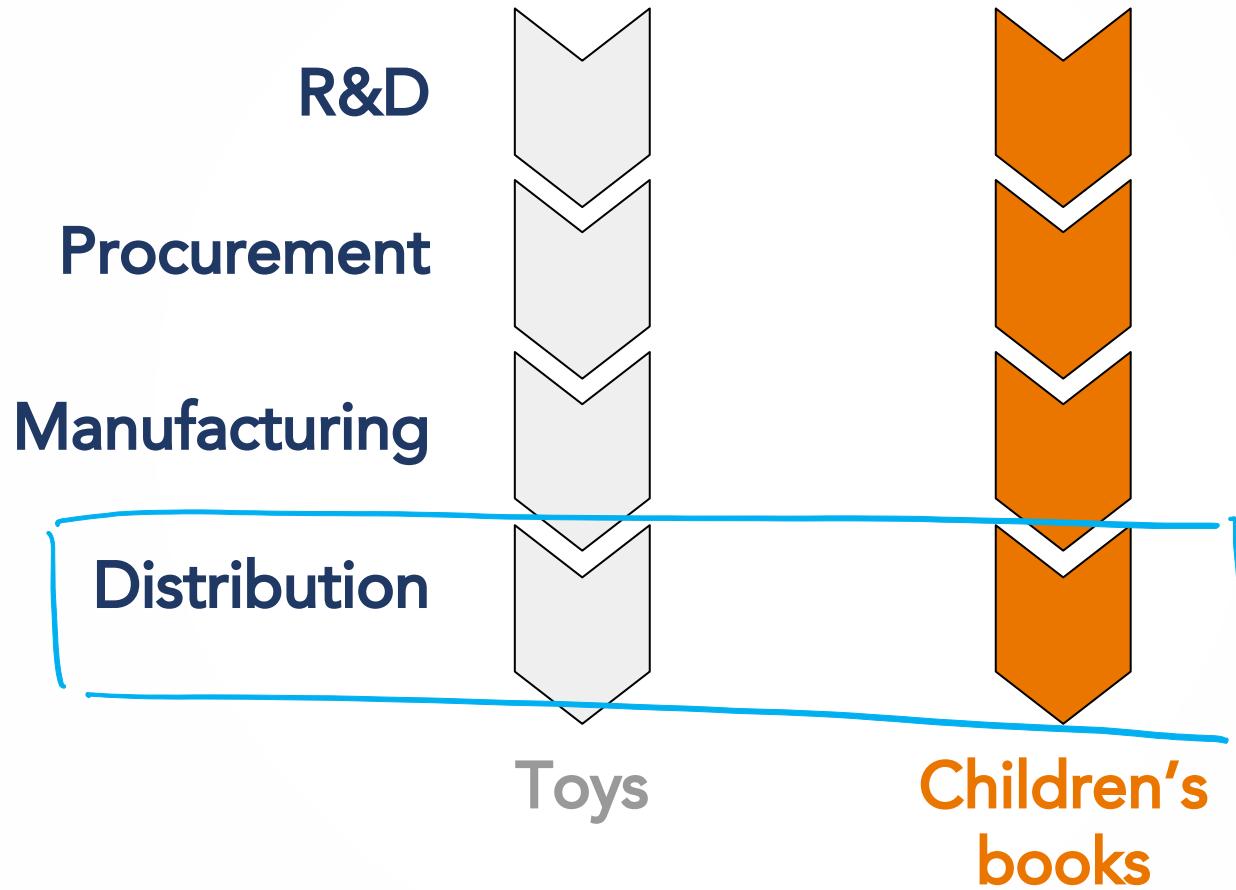
Modification of resources	High	Customization      Consolidation
Low	Connection	Combination

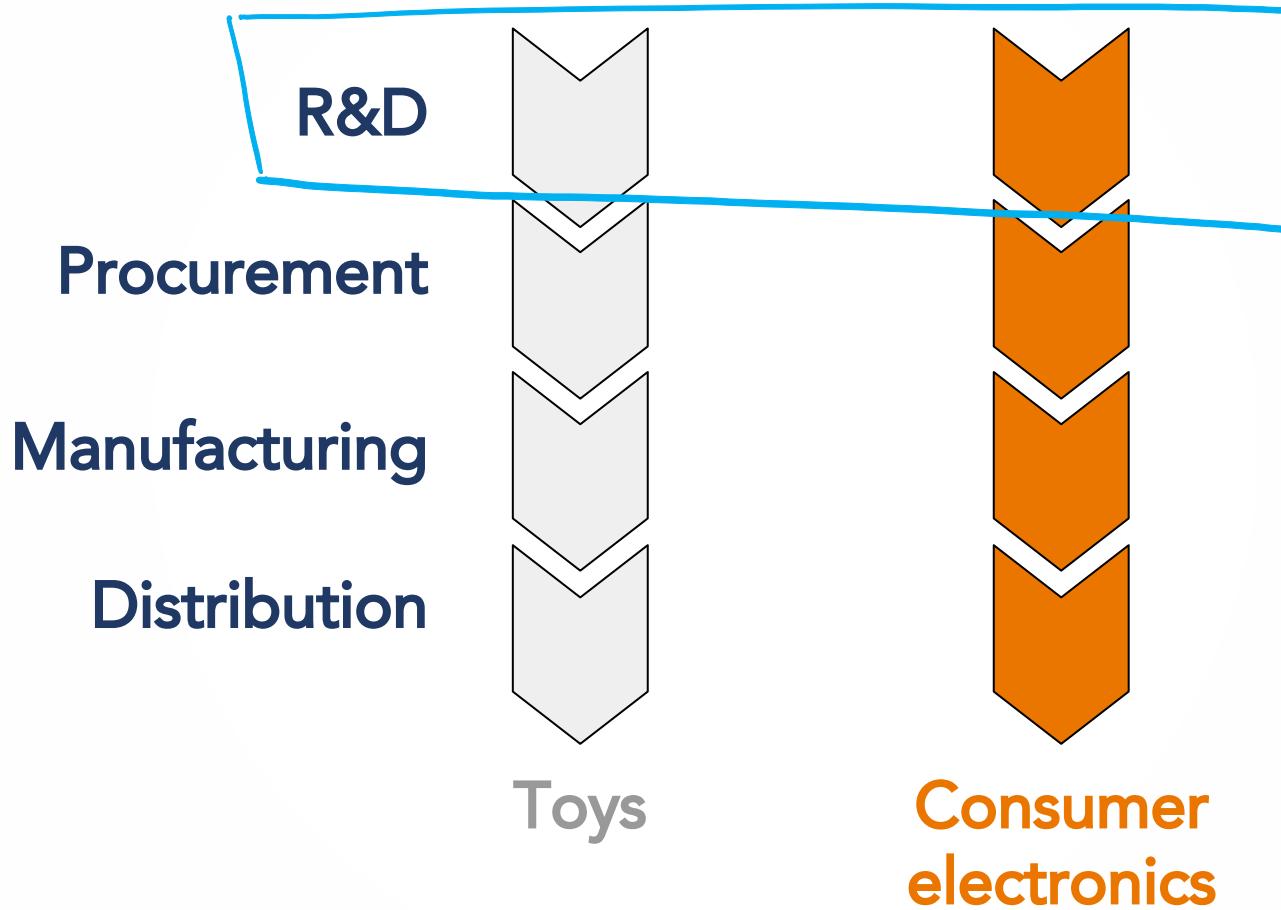
Low

High

Similarity of resources







# A Five-step Approach to the Diversification Decision

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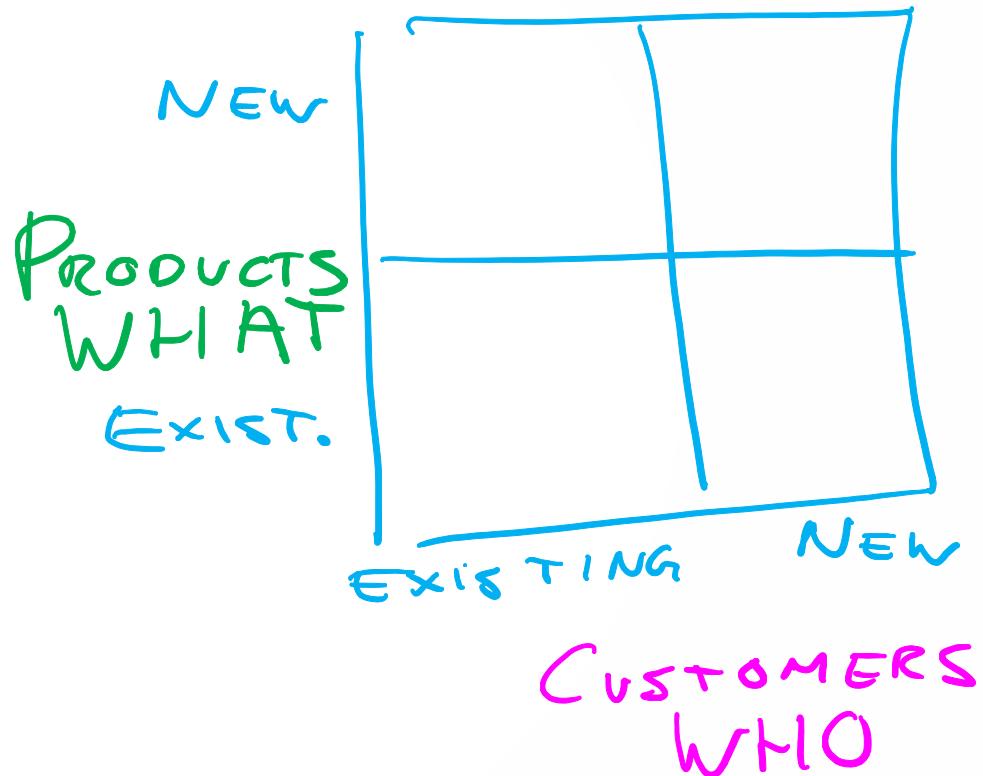
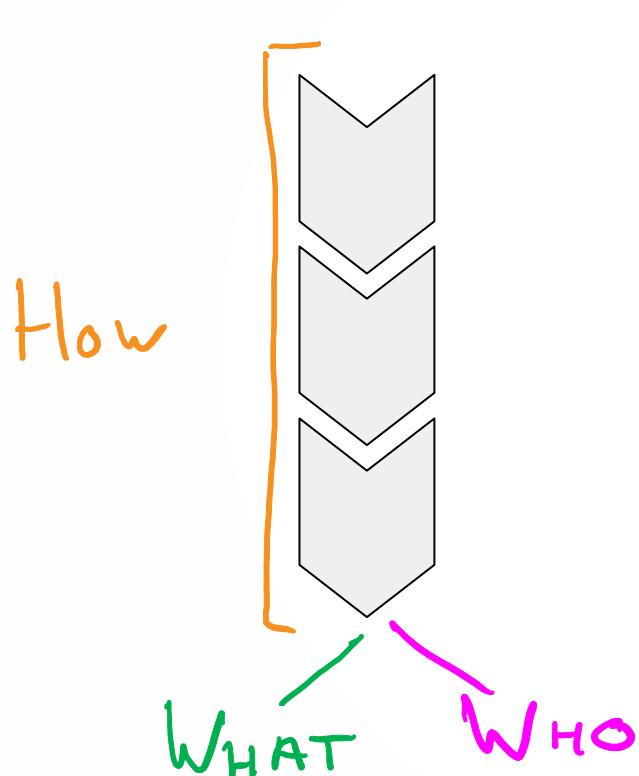
1. Finding synergies
2. Identifying resource gaps
3. Identifying candidates
4. Ally or acquire
5. Organic or inorganic growth

# Step 1: Finding Synergies

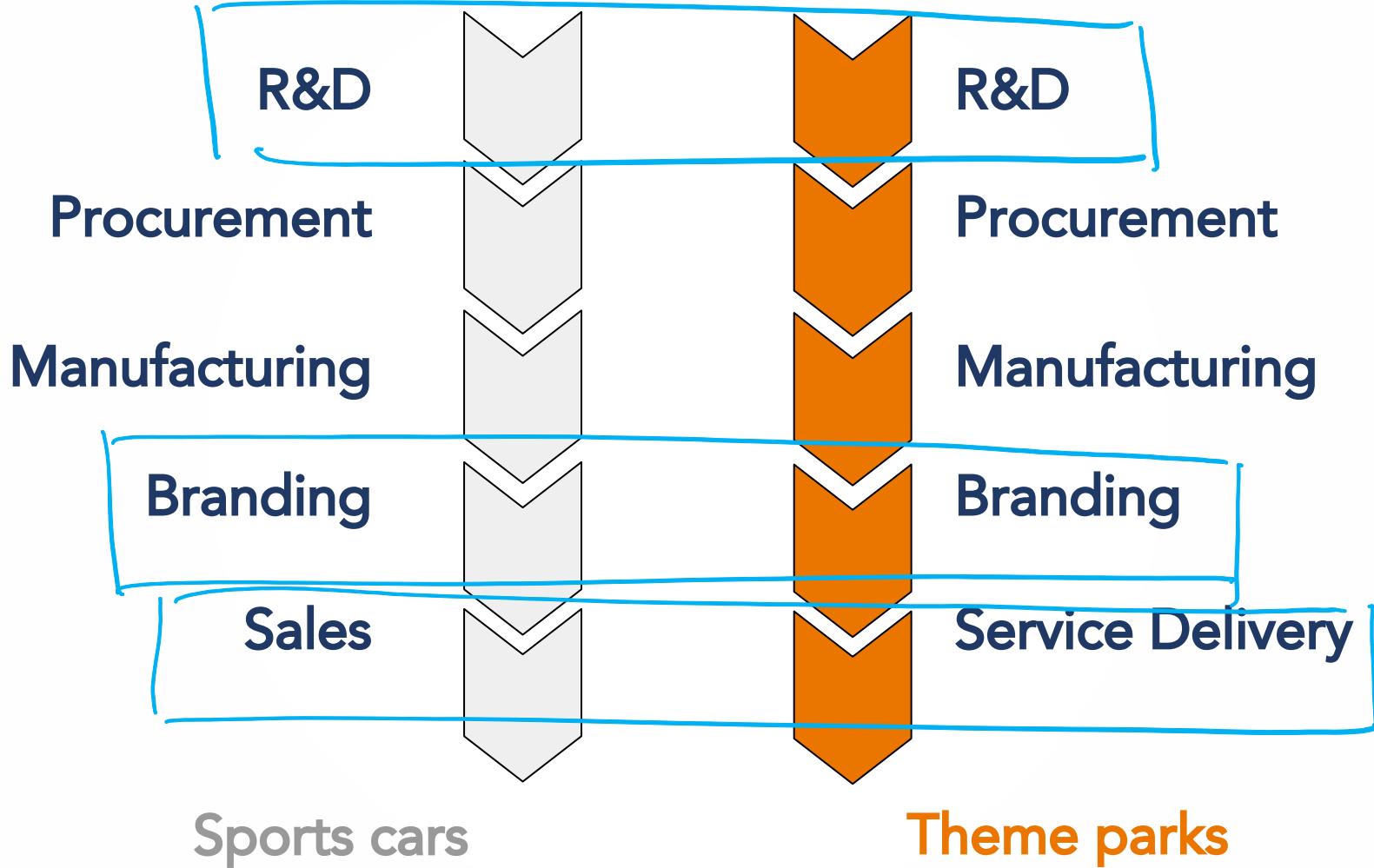
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# Step 2: Identifying Resource Gaps

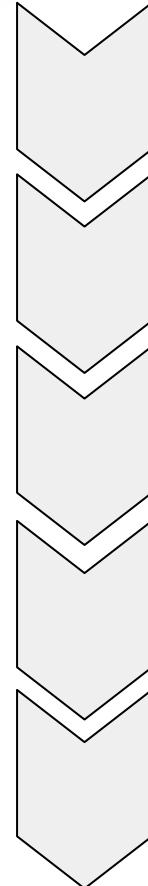
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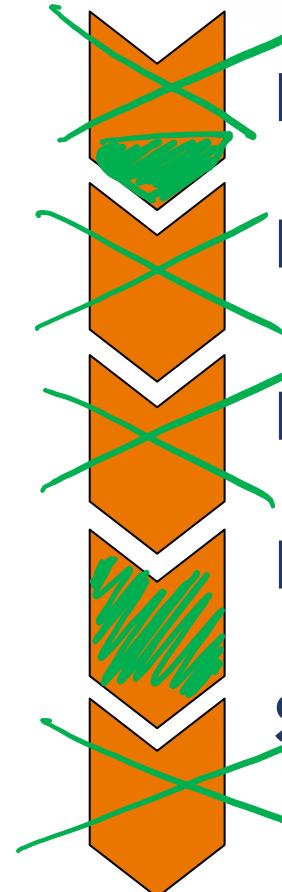
R&D  
Procurement  
Manufacturing  
Branding  
Sales

Sports cars



R&D  
Procurement  
Manufacturing  
Branding  
Service Delivery

Theme parks



# Step 3: Identifying Candidates

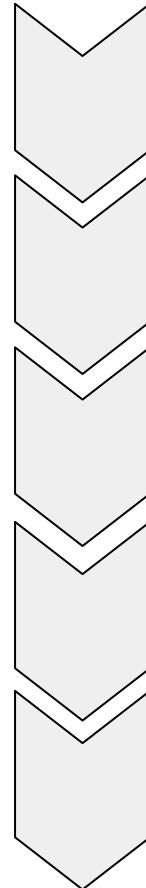
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1. Finding synergies
2. Identifying resource gaps
3. **Identifying candidates**
4. Ally or acquire
5. Organic or inorganic growth

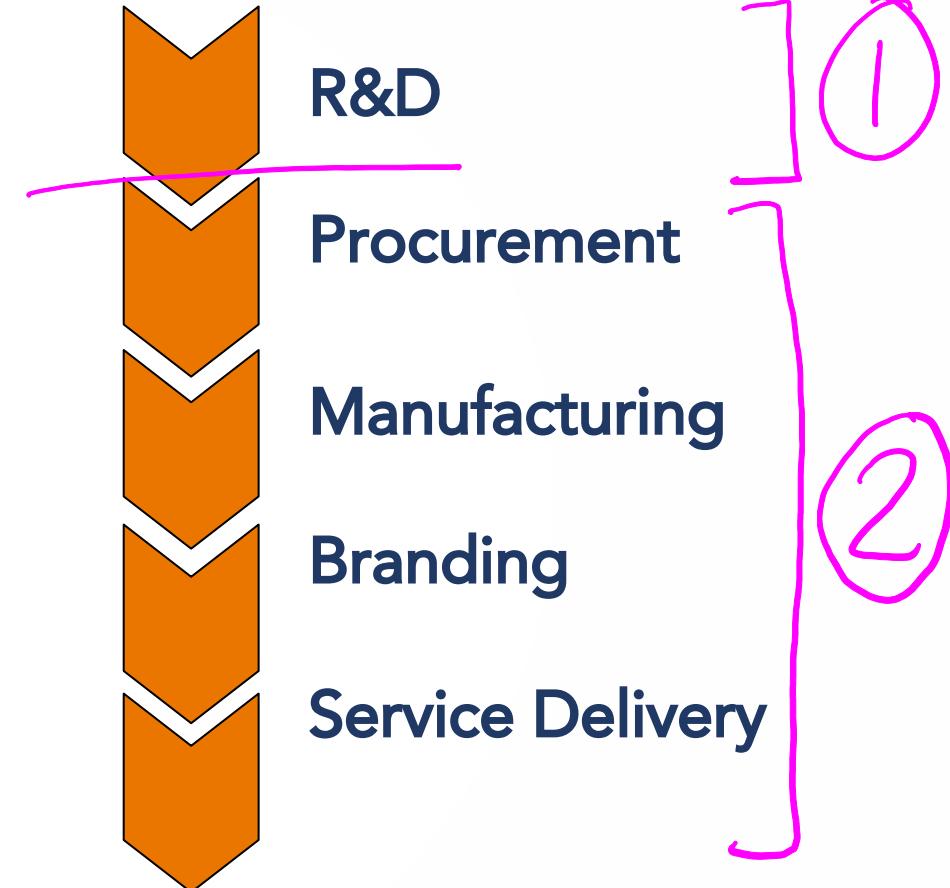
R&D  
Procurement  
Manufacturing  
Branding  
Sales

Sports cars



R&D  
Procurement  
Manufacturing  
Branding  
Service Delivery

Theme parks



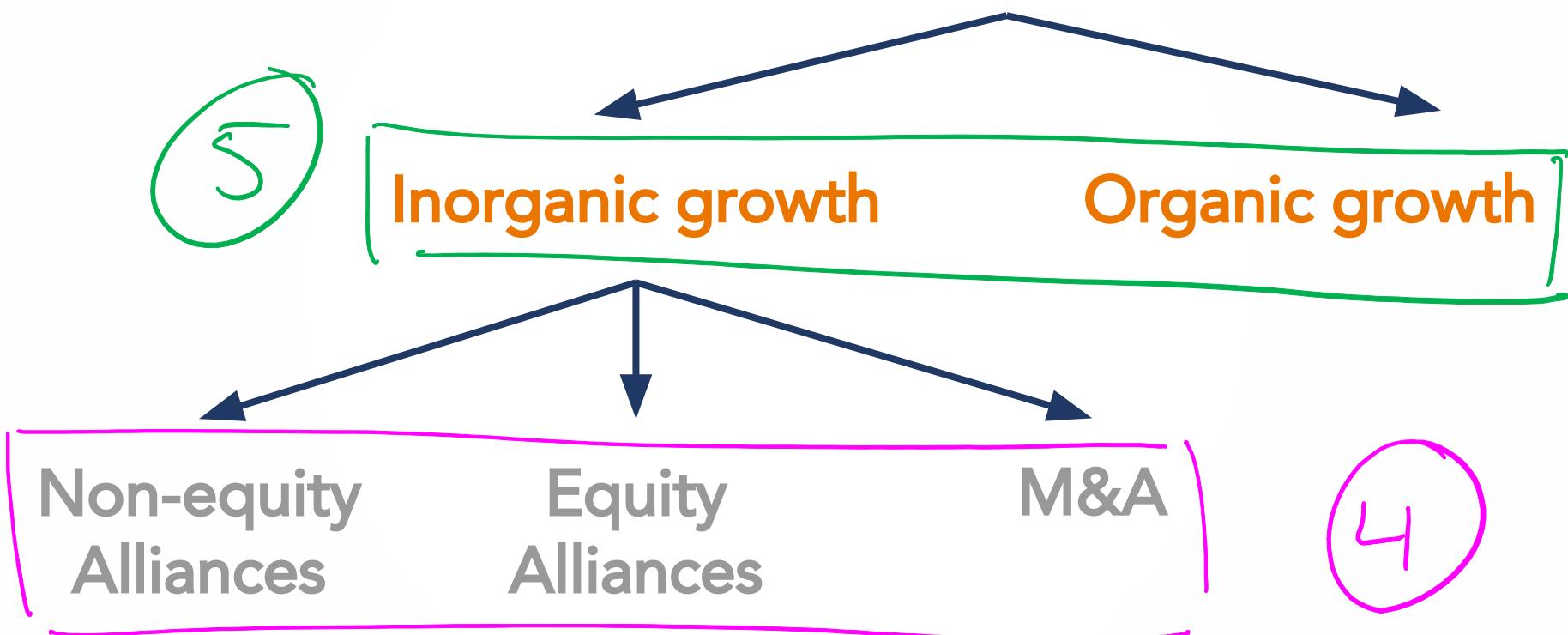
# Step 4: Ally or Acquire

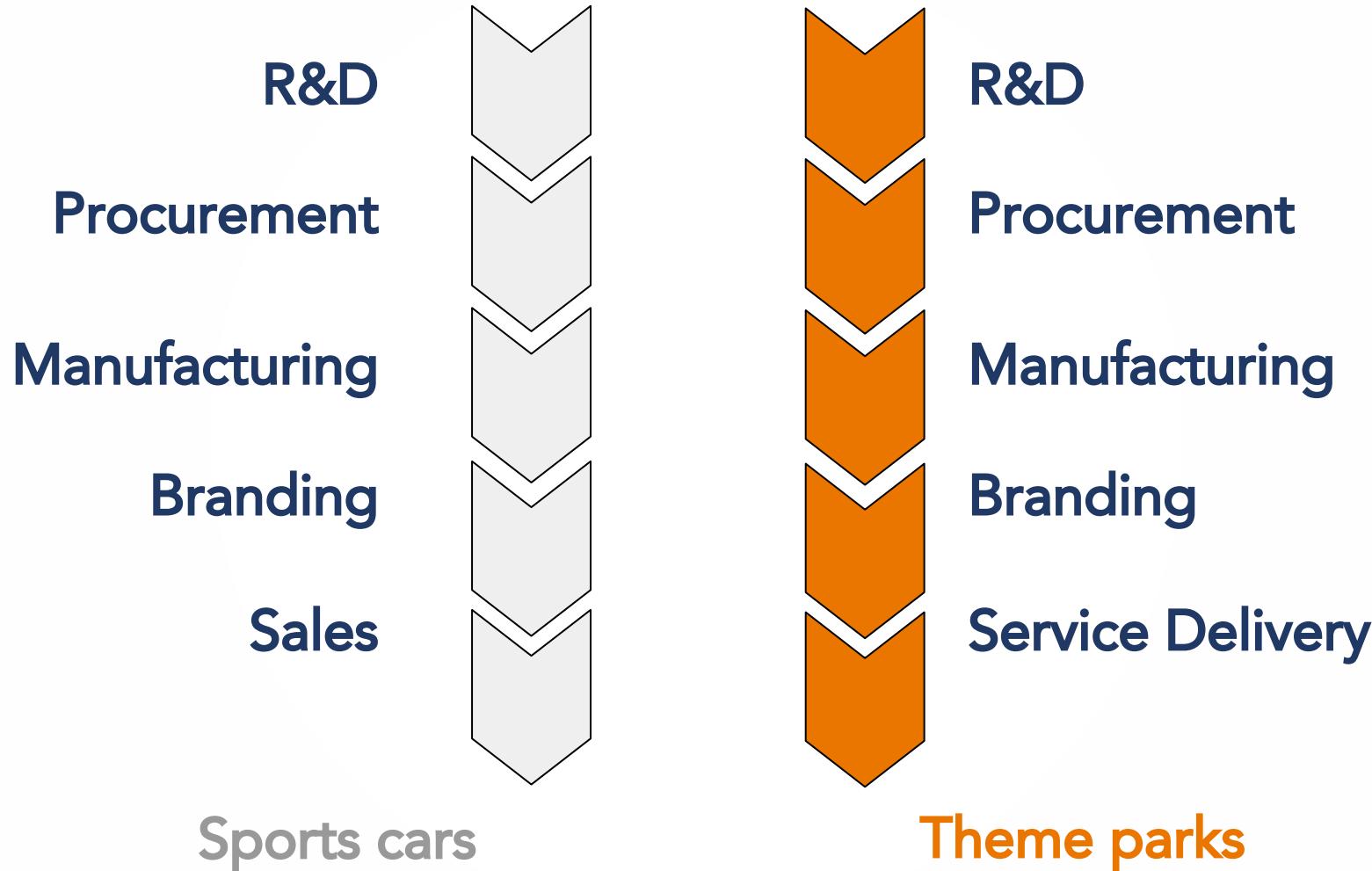
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1. Finding synergies
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- 4. Ally or acquire**
5. Organic or inorganic growth

# Entering a new business





Benefits of equity ownership	Key questions
Coordination	<b>Is there a need for a close working relationship or extensive knowledge sharing between partners?</b>
Cooperation	<b>Is there a need for a relationship specific investment? Are the gains from synergies one-sided between partners?</b>
Exclusivity	<b>Is there a benefit from excluding rivals from access to the resources of the partner?</b>

Costs of equity ownership	Key questions
Control premium	Will it be expensive to induce the partner to give up control?
Uncertainty	Is there significant uncertainty regarding the quality/value of the assets being accessed from the partner?
Motivation	Is the employee motivation in the partner firm likely to drop?

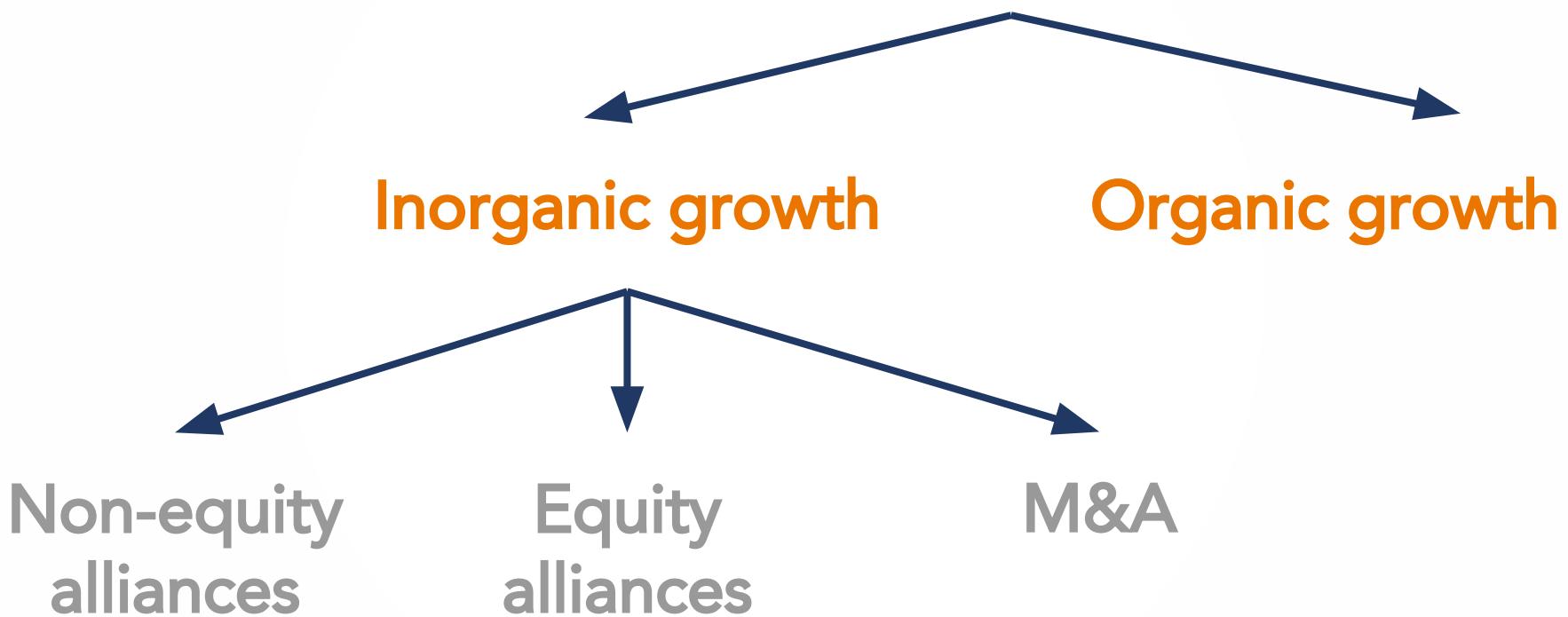
# Step 5: Organic or Inorganic Growth

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3. Identifying candidates
4. Ally or acquire
5. **Organic or inorganic growth**

# Entering a new business



# Entering a new business

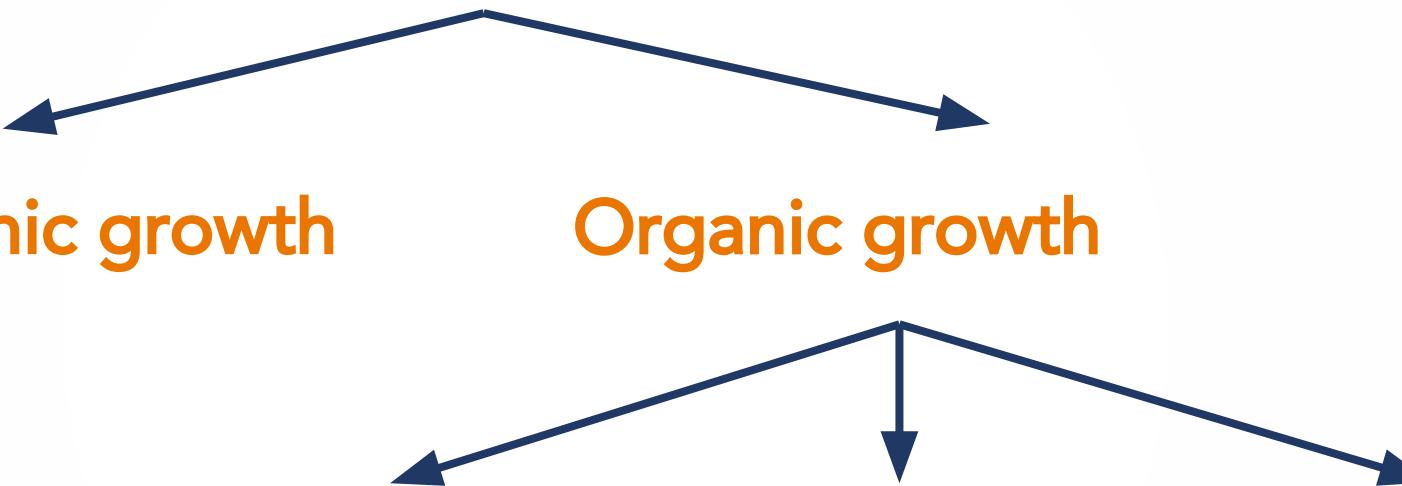
Inorganic growth

Organic growth

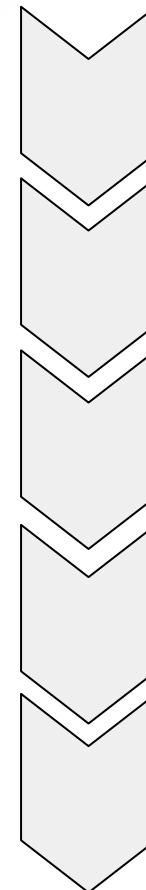
Easy to  
copy

Easy to  
catch up

Easy to  
substitute



R&D  
Procurement  
Manufacturing  
Branding  
Sales



Luxury cars

R&D  
Procurement  
Manufacturing  
Branding  
Service Delivery



Theme parks

Issue	Key questions
Easy to copy	Are legal hurdles to copy the resource absent (e.g. patents)? Has the resource been codified or is it independent of people? Is it clear how to build resources?
Easy to catch up	Do you own the related resources that can help? Are network effects present when investing in this resource?
Easy to substitute	Can you substitute the potential partner's resource with a different resource?

# Concluding the Five-step Approach to the Diversification Decision

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