Course Work 1
Assessed Reading

Corporate Diversification and Organisational Structure: A Resource-Based View

The article stresses the importance of the relationship between diversification and performance in the related businesses. It is argued that "related diversification enhances performance only when it allows business to obtain preferential access to strategic assets - those that are valuable, rare, imperfectly tradable, and costly to imitate." To be more precise, strategic assets are those that offer important source of long run competitive advantage; which are imperfectly tradable, imperfectly substitutable and imperfectly imitable. Subsequently it goes on to say that eventually the advantage will "decay as a result of asset erosion and imitation by single business rivals." And in the long term it is only "competences" which will facilitate building new strategic assets that will allow corporation to sustain profits above average. "Both short and long–run advantages are conditional, however, on organisational structures that allow the firm's divisions to share existing strategic assets and to transfer the competence to build new ones efficiently."

Although there is a lot of academic research into the relationship between diversification and performance, there is still confusion regarding the nature of this relationship. The following aspects of the problem are emphasised throughout the article:

1. Exactly what kind of relatedness between two businesses can allow the business to reap improved returns by diversifying across them, relative to the profits available to single-business rivals in both industries?
2. Is the ability to reap this potential diversification benefits on the diversifier's adopting a particular organisational structure?

Resource based view of the firm is used to explain strategic relatedness. The authors also argue that existing measures of diversification (ie. Standard Industrial Classification count and Rumelt's diversification categories) are likely to fail in identifying the opportunities for profitable diversification. That is because; measures do not take into account which strategic assets are common across the two businesses

Economies of scope
Allows a number of Strategic Business Units (SBU) to exploit any synergies between the number of units to achieve cost or differentiation advantage (or both) over an undiversified rival. However, this requires the corporate center to set up a mechanism which will acknowledge the shared strategic assets to the SBUs involved. As resource sharing and transfer of skills occurs along the value chain, costs are reduced and/or better differentiated products produced.

Standard Industrial Classification count and Rumelt's diversification categories suffer from limitations as they do not take into account whether those strategic assets shared could be obtained at an equivalent or even lower cost by non diversifiers. Therefore, relatedness that is based on common inputs does not necessarily mean superior performance: whether it does so depends on whether non diversifiers can access the critical input in some other way.

Further it goes on to discuss that diversification enhances performance if it allows a business to gain a preferential access to skills, resources, assets or competencies which can not be purchased, imitated or substituted by the non-diversifiers. In addition, it says that no single source of diversification advantage can persist indefinitely, because non-diversified competitors will eventually eliminate the competitive advantage either by substitution or replication. The diversifiers will have to invest continuously to increase the strategic assets (for example, skills which are impossible to imitate or replicate), and maintain superior returns.

Core Competencies as Catalysts to Asset Building
The most important strategic asset for any company is an accumulation of knowledge through experience. Such an asset is impossible to imitate or substitute for competing single business firms. Therefore, diversified companies have a significant advantage over non-diversified in the sense that diversifiers can transfer their skills and experience among similar value chains, for example to other SBU within their related diversified business.

"Core competence accumulated by one division, in effect, acts as a catalyst in building new strategic assets for another division. Competences can also act as catalysts in the process of adapting and integrating assets that a division has accessed by other routes such as acquisition or alliance." Thus companies with similar buyers or channels, or similar value activities like government relations or procurement can enjoy "dynamic relatedness" through asset sharing. Moreover, as this type of relatedness increases, performance of businesses systematically improves.

Organisational Structure and Strategic Relatedness
An organisation must apply such an organisational structure that will allow more efficient realization of benefits of sharing activities and transformation of skills between the SBU involved. The best suited organisational structure in such a case is the Centrally Multidivisional form structure (CM-form). CM-form structure allows a firm's corporate center to get involved in the operating facilities of the SBUs and become active in exploiting relationships or transferring skills and competences across them. However, it also enables the employees at the SBU to act independently and responsibly in terms of their own tasks at the units.

Strategic Relatedness

- Customer assets: brand recognition, customer loyalty, installed base
- Channel assets: established channel access, distributor loyalty
- Input assets: knowledge of imperfect factor markets, loyalty of suppliers and financial capacity
- Process assets: Proprietary technology, product or market specific functional experience, and organisational systems
- Market knowledge assets: Accumulated information on competitors, market response to the business cycle

Further they discuss structural indicators used for three of the main classes of strategic assets: customer assets, channel assets and process experience assets.
Customer asset indicators

- Media expenditures – developed brands in parent market can be transferred to another area of the sister market
- Infrequency of purchase – strategic relatedness will generally be higher between two markets when two products in both are infrequently purchased.

Channel asset indicators

- Channel dependence – distribution relationships are a critical asset. Strategic relatedness will also tend to be higher among markets that share similar levels of channel dependence.
- Push marketing – two markets will be more closely strategically related if they direct a similarly high proportion of their marketing efforts towards their distributors.

Process Experience Asset Indicators

- Industry skill level – in businesses in which skilled staff members are important source of advantage, human capital and systems to generate and manage. Thus a pair of businesses that share the need to develop an effective base of skilled employees with experience working together will have a high strategic relatedness.

The article then comes to the Hypothesis, Data and Methodology which talks about measuring the strategic importance of the assets and whether these assets are related. It goes on with various Hypothesises and concludes with the following results:

- Firms operating in portfolios of business that shared similar opportunities to exploit brand building and marketing and channel management skills gained significant benefits from related diversification.
- Those firms that not only have followed the relatedness strategy but also adopted the CM-form structure performed well when they diversified in high-skill-workforce business. However, the empirical results show that CM-form structure is helpful for some types of relatedness and irrelevant for other types. Thus there is a much more complicated matter in regards to diversification and structure which are to be explored further.

Overall, the article is useful; however, it is too detailed. Nevertheless, I think that the article deserves 6 out of 7, because it is sometimes too complex with all of its empirical research, yet still useful. It shows that for corporation to be successfully diversified does not mean that the company only has to have many different businesses. It means that, diversification has to be only in strategically related businesses. As this way not only a risk of failure decreases but it also creates strategic advantages as it enables the parent and the sister company to share valuable activities and transfer inimitable skills among themselves. In addition, the firm must have an organisational structure which will enable the sharing and transferring of these strategic assets. At the beginning they mention that CM-form structure is the optimal way of sharing and transferring those assets. However, after their empirical research they conclude that there must be more research made into the role of CM-structure in allowing the firm to accumulate and cross-utilize strategically important assets.

Bibliography

1. C. Markides and P.Williamson, Corporate Diversification and Organisational Structure: A Resource-Based View, Academy of Management Journal, 1996, Vol. 39, No. 2, 340 – 367

2. H. Mintzberg and J.B. Quinn, Chapter 13, The Strategy Process: concepts, contexts and cases, Edition 1996, Prentice-Hall, Inc.