

3 CORPORATE DIVERSIFICATION

3.1 Corporate Diversification: An Introduction

Diversification is of central concern for corporate management and represents one of the most important strategic decisions. It is a critical engine for growth and affects a firm’s profit potential, risk exposure, and internal culture, as well as its resources, skills, and capabilities.\(^{329}\) As Very (1993) put it, “diversification is sometimes the only way to achieve growth for a company, or the only way to survive when sales and profitability of the core business are declining.”\(^{330}\) Diversification has been subject to ongoing academic debate for decades and is at the heart of the strategic management discipline.\(^{331}\) With roots going back to the pioneering work of Ansoff (1957), Chandler (1962), and Gort (1962), research on corporate diversification has sparked interest far beyond the field of strategic management and attracted scholars in disciplines like industrial economics, finance, and sociology.\(^{332}\) It led to the publication of a vast body of academic studies and “has become the dominant research stream in the field of strategic management.”\(^{333}\) Despite the great strides that scholars have made in explaining diversification, many questions remain. The intent of this chapter is fourfold. It aims to (i) develop an understanding of the concept of corporate diversification based on the comprehensive literature in the field, (ii) provide a broad overview of the academic research on diversification, (iii) discuss the motives and limits to diversification, and (iv) outline the relationship between diversification and firm performance.

3.1.1 Definition of Diversification

For all the attention devoted to corporate diversification research over the years, a generally accepted measure or definition is lacking.\(^{334}\) Scholars have defined diversification in a variety of ways and developed individualized operationalizations, which have produced an array of interrelated definitions and concepts.\(^{335}\) Depending on the academic position, diversification has been referred to as a firm’s move to enter new markets and industries, serve new customer segments, offer new lines of products, employ different types of resources, and expand its


\(^{331}\) See Bowen and Wiersema (2005), p. 1153.

\(^{332}\) See Ramanujam and Varadarajan (1989), p. 523 as well as the work of Ansoff (1957), Chandler (1962), and Gort (1962).


\(^{335}\) See Pitts and Hopkins (1982), p. 620.

operations internationally. Furthermore, the literature distinguishes between the diversification move itself and the resulting diversity of the firm’s operations.336

In “Strategies for Diversification” Ansoff (1957) offers one of the earliest conceptualizations and discusses two general directions of diversification, namely, diversification into new products (product development) and into new markets (market development). In his view, diversification thereby refers only to the concurrent implementation of both “growth vectors” – the “simultaneous departure from the present product line and the present market structure.”337 As shown in Figure 6, only when the firm penetrates new markets with its new products does Ansoff refer to a “diversification” strategy. This view is shared by Chandler (1977, 1990) in his contributions about the expansion of American companies in the post-World War II era.338 Gort (1962), in turn, refers to diversification as “an increase in the heterogeneity of output” and “the number of markets served by that output.”339 His definition largely overlaps with the popular conceptualization of diversification as the number of different industries a firm is active in and the share of revenue it generates from these industries.340 Building on the work of Chandler (1962) and Rumelt (1974) on the link between strategy and structure, Ramanujam and Varadarajan (1989) furthermore emphasize that diversification necessarily involves changes in “administrative structure, systems, and other management processes.”341

As Weiss (2009) points out, a typology of corporate diversification can identify three general forms that will be briefly addressed in the following: (i) related and unrelated diversification; (ii) horizontal, vertical, and conglomerate diversification; and (iii) domestic and international diversification.342

342 See Weiss (2009), p. 29.