DIVERSIFICATION STRATEGY, A WAY TOWARD THE COMPETITIVE ADVANTAGE

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Abstract

Today, each country's entity is originated by production and in production; the product's diversity has an important role. The increasing significance in explaining the changes in the form organizations and industries, has led to a significant advancement in different areas of social sciences. In this article, diversity is divided into two parts: "related diversity" and "unrelated diversity".

Key words: diversification strategy, Related Diversity, Unrelated Diversity

Introduction

Many of the current organizations in the world are moving toward expanding and improving their business environment. One of the reasons may be meeting customers' multiple needs. By meeting costumers' multiple needs, managers attempt to make them more loyal to their organizations. For this reason and other technical ones such as raw material procurement and the final product's distribution system inside organizations, many organizations have decided the diversification strategy. Diversification strategies can influence the competitive balance in an industry. In diversity analysis, there are two key elements including risk and output.

One way to reduce risks is to diversify investments. Investment companies can reduce risks by investing in different assets and forming a portfolio. In Iran, few researches have been conducted about the relationship between product diversity and manufacturing companies' performance.

Explanation of Diversification Concept

In the latter half of the twentieth century, due to the vulnerability of specialized companies to rapid and unexpected changes of the environment, "diversity" has become an essential basic for companies' growth and survival. According to Hall, diversity is a kind of strategy which is often used for expanding the company's market or increasing sales and profits [2]. According to Nayyar, companies have diversity if they work simultaneously in more than one business.

So, the diversity strategy can be defined as "the extent of participating in different businesses and the main model of relationships among different business of the companies [5]. In sum, there are two precise definitions:

- Diversity is a tool to expand the basis of companies' commercial activities.

- Diversity is an extent in which institutions are working in different businesses simultaneously [8].

Related Diversity- The related diversity is reached when a company has different business units which are related to each other in some ways (for example: similar businesses). In this kind of diversity, the units are common. Or they are jointly used by related businesses in that company. Overall, there are tangible and intangible relationships among different business units. The related diversity leads to the reciprocal transfer of information between organization managers and department managers. It causes organization managers in organizations with related diversity compared to organizations with unrelated one, to have more information about their department managers [9].

Unrelated Diversity- In the unrelated diversity, a company is diversified in the areas that have little similarities to each other. Overall, this kind of diversity causes companies to collect cash flows from departments and reallocate them to the departments [9]. In other words, the unrelated diversity strategy is the result of diversification among different industries [7]. According to Kochart, the difference between related and unrelated diversity is exactly connected to the sources of assets available to the company. Existence of special assets, especially assets which have tactic natures, will more lead to the related diversity than the unrelated one. Companies with a high amount of intangible assets (special and non-flexible assets) attempt to invest these sources in their related activities. In 1974, Ramlet classified business activities from the amount and type of diversification points of view. The two key scales for this classification are specialty rate (SR) and relation rate (Rr). The specialty rate is defined as follows:

The ratio of income of the company's biggest business to the total income of the company in a definite year.

The relation rate is the ratio of income of the biggest activity group relating to the total income of the company. The related activity is an activity which has a relationship with the current activity area of the company. According to this classification, Ramlet classifies companies from the diversity point of view into three categories [6]:

- Single product companies (single business) $SR \geq 0.95$
- Companies with medium diversity $0.7 \leq SR < 0.95$
- Companies with a high amount of diversity $SR < 0.7$

Silva Lopes describes 4 classes of diversity investment in the related diversity as follows:

1. New investments in similar products
2. Investments which lead to the vertical integration of complementary activities. This integration may forward or backward.
3. Investments which lead to the globalization through increasing the participation in foreign markets and similar products.
4. Investments which lead to the formation of intangible assets like marketing knowledge, patented technology, product differentiation, and management capability.

She says that according to this kind of classification of related diversity assets, totally four levels of diversity can be observed among companies:

- Companies without or with less diversity
- Companies with medium diversity

- Companies with high diversity
- Complexes or companies with unrelated diversity

Companies whose sales are at least 80% due to one main business are considered as companies without or with less diversity. These kinds of companies extensively focus on one centralized activity. Companies with medium diversity are companies which are diversified to some extent, but yet achieve their income from one business. In such companies, 70% to 80% of sales are reached by one business. In companies with high amount of diversity, none of the business activities attribute more than 70% of the company's sales to themselves, and finally, companies which are called complex or have unrelated businesses, are diversified in areas without any physical resource and common knowledge and are just common in financial resources.

From geographic diversity point of view, companies are divided into three parts:

The first group) Companies with low geographic diversity.

The second group) Companies with medium geographic diversity.

The second group) Companies with high geographic diversity.

Companies which less than 20% of their sales are done in outside the continental central office are considered as companies with low geographical diversity. This rate for companies with medium geographical diversity is 20-25%, and for companies with high geographical diversity is more than 35% [4].

Theories about diversity of productions in the organization

1) **Efficiency theory-** This notion implies that the purpose of using diversity strategy is to achieve synergism. In this study, synergism is defined as a reality which is achieved through "economies of scale" and "economies of scope" in production, marketing of raw materials, research and development, and engineering by integrating commercial units. Financial, operational and managerial synergism is formed when different commercial units' performance and activities are complementary.

2) Exclusive theory- This theory implies that companies use the diversity strategy to achieve the marketing power. Assumptions of this theory indicate that different companies use the diversity strategy to take advantage of business units' financial assistance, limit the competition in several markets simultaneously, and prevent competitors to potentially enter their markets. These three advantages of the exclusive theory support the reciprocal ideas and relationships of competitors.

3) Value theory- This theory considers attainments of managers who have more information about stock exchange and insecure potential value of the target company. Assumptions of this theory indicate that the company has valuable and unique information for increasing the quality of the total business through integrating, achieving and diversifying the part of business which has a potential value, and makes value by integrating the business.

4) Empire building theory- This theory implies that managers follow their personal purposes rather than increasing the value of shareholders by using the diversity strategy.

5) Process theory- This theory indicates that strategic decisions are considered as the results of internal processes of the company, such as the organizations' routine flows or the political power in the decision making process rather than a completely reasonable option.

6) Offensive theory- Holdrens and Sheiham (1985) have defined the term "offensive" as follows:

"A company owns a rich business and transfers its monies to the parent company".

7) Disruption theory- This theory indicates that diversity incentives are occurred due to the economic disruption. Gaat (1969) believes that the economic disruption makes a lot of changes in individuals' expectations, and increases the total degree of unreliability[10].

Trawin (1990) has argued that the value theory, empire building theory and process theory are accepted more than others. This author has also mentioned that the most dominant theory, efficacy theory has achieved a limited credit [9]. Generally, many economists consider the diversity strategy a useful one. They believe that diversity is a tool to expand the company's borders toward addressing the coordination problems in some markets and strategies which connect companies in terms of consumers and suppliers. Another function of diversity, especially the unrelated diversity is to achieve a proper tool to manage risks. This issue emerges in the financial incentive to create diversity [2]. In the diversification strategy, costumers' loyalty to the brand will compensate low price of competitors. In this strategy, valuable differentiations in costumers' products and services decrease costumers' sensitivity to the price. In this strategy, there is an ability to defend against newcomers, because for overtaking a product, the new product should be better than the previous one and new productions and services must be equal to the previous ones from efficacy point of view, and also must have a lower price to overcome the current products and services, which achieving these two categories by newcomers to a specific industry requires time and money.

Conclusions and Suggestions:

Diversification, especially the unrelated diversity, in a stage of large companies' life cycle is an important strategy in development of enterprises.

It is suggested that if top managers have the tendency to use the diversity strategy, first they should measure their current status, strengths and weaknesses, and opportunity-threat points, and then if they considered the diversity suitable for the organizations' purposes, they should expand their business area with a clear visibility. Results of each diversification and centralism options may emerge soon; so, it is suggested that managers should consider the time gap and not judge too soon in order to decide the efficacy and effectiveness of the chosen strategy.

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