Diversification Policies – A Methodological Study

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1. Introduction

We believe that research into diversification is of great importance, because diversification is the dominant trend among modern firms. A number of works on diversification are already in publication, but we believe there is ample room for further study. In this paper we have chosen a methodological approach; we discuss, from a theoretical point of view, the necessity and inevitability of the formation of diversification policies, their classification, the various organizational structures used to implement them, and various problems connected with them.

2. A Survey of the History of Theory on Diversification Policies

It is well-known that diversification is one of the basic policies of management in modern firms. However, it appears that clear enough distinctions are still not drawn between different types of diversification – what they consist of and their significance – and between diversification and the activities of a diversified firm. We believe that this situation exists because the methodological criteria for making fine distinctions have not yet been sufficiently classified. Here we will look briefly at the development of theory on diversification. M. Gort defined diversification as, "an increase in the heterogeneity of *markets* served by an individual firm –––– an increase in the heterogeneity of output from the point of view of the number of markets served by that output."(1) While this is a rather abstract definition it could be said to be a good starting point for research on diversification. However first, such questions as – How do we define individual firms, markets and products, and heterogeneity? Why does this increase take place? – must be answered. From Penrose's discussion of diversification we conclude that when she talks about individual firms she is referring to specialized firms which have attained a monopolistic market position.[2]

When the diversification activities of these specialized firms increase in scale and complexity, the centralized, functionally departmentalized administrative structure, the administrative structure used to implement the earlier diversification moves, becomes too limited. At this stage the multidivisional administrative structure is formed, a more appropriate structure for carrying out further diversification.[3] In this way specialized firms are transformed into diversified firms. Thus diversification and the activities of a diversified firm cannot be regarded in the same light; to say that a diversified firm is a firm which carries out diversification, or that diversification policies are the management policies of diversified firms, is oversimplifying the matter.

Markets can be defined as markets for the sale of products or product lines. We may define increased heterogeneity as new markets and new products, but again we must be clear about what we mean by "new". R. Marris said that for meaningful diversification new products must not kill the demand for the firm's existing lines.[4] As for why the increase takes place, Penrose, Chandler, and Rumelt all said that it happens because firms seek opportunities to use their productive resources more effectively.[5]

In the discussion above we have, we hope, made it clear that it is mainly the diversification policies of large monopolistic firms that concern us when we study the content and significance of diversification activities. Having made this assumption, we must now make a further distinction concerning the content of diversification policies, between (1) spontaneous diversification – i.e. diversification in its earliest stage. This includes finding markets for waste products and by-products or introducing slightly different versions of existing products, in other words product diversification. (2) conscious diversification i.e. as a deliberate policy. By this we mean the above-mentioned diversification policies of large monopolistic firms, but this can be divided further into (a) partial diversification by a single product firm which had previously specialized in the production and sale of one particular product, and (b) diversification by a diversified firm (i.e. one which already produces and sells several different products). This can be divided into the diversification policies of the general office of the firm, and those of a division or subsidiary.

The distinctions between different types of diversification are also connected with the reasons or the necessity for diversifying. Because the types of diversification trend to be decided by the ways in which productive resources are used, there is a tendency for only product diversification to be regarded as important. However from Penrose and Chandler's discussions of diversification by "aquisition" it is clear that the company resources which can be used in diversifying are not limited to those directly related to production.(6) We believe that "business diversification" should be designated as a second major type, and that service diversification(7) should be recognized as a type of diversification which takes place outside the confines of the manufacturing industry.

Finally we would like to consider why, in discussions on the reasons or necessity for diversification, the use of company resources has been emphasized so often. Penrose gives us an indication in the following quote, "Existing markets may be profitable and growing, but all that is required to induce diversification is that they do not grow fast enough to use fully the productive services available to the individual firm."(8) There will probably be differences of opinion over how this is to be interpreted, but we see it as meaning that there is a tendency for the tempo of a firm's accumulation of capital to exceed the tempo of the increase in demand from existing markets, so that surplus capital created becomes idle. It is of course necessary to make use of this idle capital, and when it is used in a new way (i.e. which can be called both original and appropriate for the firm concerned), diversification takes place.

The discussion so far can be summarized by the following five points:

(1) The diversification policies of large firms have been the central object of research into diversification.

(2) There are two main types of diversification policy, both defined by the way in which they use idle capital: a) product/service diversification, or what we call "innovation-type diversification b) business diversification, or conglomerate-type diversification.

(3) Diversification policies are in effect capital accumulation policies based on new ways of using idle capital.

(4) The starting point for a diversification policy, both conceptually and historically, is a large, monopolistic, specialized or single product firm.

(5) At a certain stage in the diversification process the creation of a new and more appropriate administrative structure becomes necessary. The typical type of structure created for dealing with complex diversification is the multidivisional administrative structure.

3. Single Product Firms and the Formation of Diversification Policies

When we talk about single product firms here, we are referring to large monopolistic firms which have for their base the production and sale of one particular product. Although we use the term "single product", examples of firms which specialize in only one product line (e.g. Volkswagen or Ford, in the period when they produced only the Beetle and the Model T) are rare. Hence we will refer to such firms as "pure single product firms." Single product firms' special, or most important product-line (henceforth referred to as the major product), generally includes products which are not very different from the major product, but which are regarded as different by clients, and can therefore stimulate new demand. There are several examples of such firms in the "materials" industries (e.g. cement, raw silk, cotton thread, cotton cloth, paper (western), steel, coal, oil). Henceforth we will refer to these firms as "compound single product firms". They exhibit not only spontaneous diversification, but also partial conscious diversification; they could be said to be in a stage of transition, from single product to diversified firms.

Single product firms carry out a single product policy, and mostly use a functional administrative structure to implement this policy. The distinction between a single product firm and a vertically integrated firm hinges on the amount of intermediate products sold outside the firm. If all the intermediate products from the vertically integrated manufacturing processes are consumed within the firm and only finished products are sold, it is in effect a single product firm. If, however, the intermediate products are sold in large quantities, then it means that product diversification has already taken place. Thus we candivide vertically integrated firms into three types: (1) single product vertically integrated firms. (2) diversified vertically integrated firms (3) diversified firms (firms in which divisions or subsidiaries are in charge of intermediate processes).

Next we will discuss the formation of large single product firms. Chandler's research on the USA from the 1880s to the 1910s showed that it took place in one of two ways (paths). The first path was natural or internal growth (we might call this type of firm the "production and capital accumulation type"), the second was by mergers (what we might call the "concentration type"). Chandler summarized these developments as follows:

"The modern industrial enterprise followed two different paths to size. Some small single-unit firms moved directly into building their own national and global networks and extensive purchasing organisations and obtaining their own sources of raw materials and transportation facilities. For others, mergers came first. A number of small, single-unit family or individually owned firms merged to form a large national enterprise. The new consolidated enterprise centralized the administration of production and then intergrated forward and backward."(9)

He called the management strategies which corresponded with these two paths "the strategy of vertical integration" and "the strategy of horizontal combination."(10) He discussed many important firms in detail(11); here we will quote some of the better-known ones, first from those which took path one: (1) American Tobacco – tobacco (2) Diamond Match – matches (3) Crowell – oatmeal (4) H.J. Heinz, Campbell Soup – foodstuffs (5) Eastman Kodak – photographic equipment (6) Procter and Gamble – soap (7) Swift and Company – meat (8) Pabst – beer (9) I.M. Singer – sewing machines (10) McCormick – agricultural machinery (11) E. Remington and Sons – typewriters (12) General Electric, – electrical equipment (13) Coca Cola – soft drinks; secondly those which took path two: (1) Standard Oil – petroleum (2) The American Cotton Oil Trust – cotton oil (3) National Lead – lead (4) American Linseed – linseed oil (5) American Sugar – sugar (6) The Distillers Corporation – whiskey (7) National Biscuit – foodstuffs.(12) Chandler summarized the general characteristics of these large monopolistic firms as follows:

"The large industrial enterprise continued to flourish when it used capital-intensive, energy-consuming, continuous or large-batch production technology to produce for mass markets. It flourished when its markets were large enough and its consumers numerous enough to require complex scheduling of high-volume flows and special storage and shipping facilities, or when the marketing of its products in volume required the special services of demonstration, installation, after-sale service and repair, and consumer credit. It remained successful because administrative co-ordination continued to reduce costs and to maintain barriers to entry."(13)

Although single product firms try to maintain or strengthen the monopolistic position they have established, they can never completely eliminate competition. Competition between firms continues in the form of development of new products, full-line policies, quality improvements, advertising, reduction of costs, and vertical integration. Competition between divisions and industries continues in areas such as the development of new or alternative products, and entry into new sectors. Thus a part of the retained profits of single product firms are used for: (1) reduction of costs (2) improvements in products and technology (3) advertising (4) systematization of distribution channels (5) additional investment to maintain market share (6) promotion of exports (7) capital exports (8) use of by-products, waste products (9) full-line policies, in order to raise barriers to entry and thus maintain their monopolistic position. However, additional investment in equipment to an extent which would lead to over-production is avoided. This results in a part of retained profits becoming idle in the form of cash. Also, because of the anarchistic nature of capitalist economies, there is a tendency for demand to stagnate because of unbalanced development in such areas as:

(1) accumulation of capital (2) productivity (3) concentration of production (4) technological development, product development (5) demand (6) industrial structure (7) social standards (living standards, income levels, standards of values).

Stangnation of demand (measured by the rate of increase in demand over the previous year) can be divided into three types: (1) a decline in the rate of increase (2) remaining at the same level (2) an absolute fall in demand. (1) and (2) may cause capital (cash) to become idle as the additional capital invested to maintain the market share is liberated. (3) may cause cash, equipment, and labour to become idle. Thus there are three kinds of idle company capital: (1) short-term (due to business fluctuations) (2) circulatory (where revenue from sales of products is not immediately used for further production, but is retained for a time as cash.) (3) structural (caused either by a part of retained profits becoming idle or by stagnation of demand.) (3) can be further divided into a) idle cash b) idle productive resources (equipment and personnel).

It can be safely assumed that if stagnation of demand is caused by structural problems in a certain industry a firm will wish to pull the idle capital out and put it into a more profitable sector. In reality, however, a massive amount of capital is likely to be tied up in equipment, so that it is extremely difficult to achieve this. It was of course this factor that led to oligopolies, with the formation of cartels.

K.R. Harrigan and M.E. Porter enumerated the "exit barriers", i.e. the problems involved in pulling out of a declining industry: (1) the existence of durable and specialized assets (2) the high cost of exit (3) strategic considerations (the interrelationships involved in a group of businesses, access to financial markets, the structure of vertical integration) (4) information gaps (5) managerial resistance (6) social barriers (creation of unemployment, crippling of a local economy) (7) asset disposition (whether assets are retired or sold out can destroy or create exit barriers for competitors in a declining industry.[14]

Thus it becomes necessary either to add new products (while maintaining sales and production activities for the major product), or to enter a field which entails different management activities from those of the major business. When such a move is consciously planned and organized it can be said that a diversification policy has been formed. When an imbalance in capital accumulation occurs as a result of a single product policy, and creates idle capital, its use for the addition of new products or entry into a new sector becomes inevitable. Such product diversification consists of adding a product which is different from and therefore does not compete with the major product but which necessitates only an extension of the production and sales activities for the major product, and thereby adding a new market, earning new profits, and increasing capital accumulation. The advantages of this type of diversification are: (1) The firm gets patent fees and "founder's profit." (2) The managers directly supervise planning and control so that unity is easily achieved. (3) It enables the use of idle equipment and personnel. (4) It facilitates a full-line policy. Its drawbacks are: (1) Production and technology are limited by the skills of the personnel and the technology used in the major business. (2) Problems tend to arise in product development (inventions are not usually forthcoming and their practical application is difficult, time-consuming, and costly). (3) Capital becomes tied up. (4) There is a risk of products becoming out of date, and equipment obsolete.

Entry into a new sector consists of adding a completely new unit outside the realm of the current divisions for a product or sales line which does not compete with the major division, and thereby entering a new market, earning new profits and increasing capital accumulation. Its advantages are: (1) Idle capital can be used promptly (e.g. to buy out other companies, or for mergers). (2) There is no limit on the kind of technology that can be added. (3) By buying venture businesses the risks and expenses involved in product development can be avoided. (4) When a holding company is used, large companies can be bought out with a small amount of capital. Its drawbacks are that the new divisions' relations with the major business tend to be tenuous, and it can prove difficult to plan and carry out a unified diversification policy.

How resources are used is largely determined by the type of capital involved. Idle cash[15] tends to be used primarily for divisional or conglomerate type diversification, and secondarily for product diversification by, for example, investment in product and technological development and supplying additional working capital. The latter can include (1) investment necessary to convert technological developments into new products (2) moving into a field closely related to the major business managerially (3) moving into a field with low but steady profits (4) moving into a field with potentially high profits (5) moving into social or national projects, where immediate profits cannot be hoped for.

Where idle productive resources are used solely for product diversification it will be for the development of products in which (1) equipment can be used (2) personnel can be used (3) both equipment and personnel can be used.

We have already divided diversification policies into two main types, based on the reasons for their formation. In the table below they are divided into numerous types, based on their character – the kind of firm involved, their objectives, the conditions they must meet, their timing, and the methods used to implement them. These types are strictly theoretical and may not actually exist in reality, but we have aimed to express the essence of diversification policies.

TABLE – Diversification Policy Categories

CRITERIA	CATEGORIES
1. Relationship with Production Technology of Major Business	(1) Related (2) Unrelated
2. Relationship with Markets of Major Business	(1) Related (2) Unrelated
3. Object of Diversification	(1) Product Diversification (2) Service Diversification (3) Business Diversification
4. Method of Implementing Diversification	(1) Internal growth (2) Acquisition (3) Merger (4) Joint venture
5. Marketing Policy	(1) Full-line Policy (2) Vertical Integration (3) Divergent
6. Timing of Diversification	(1) During an Expansion Phase (2) During a Recession
7. Type of profits aimed for	(1) Short-term profit maximization (2) Long-term steady profits (3) Objectives other than profitability
8. Target	Stress on (1) Growth (2) Profitability
9. Method of Financing Diversification	(1) Self-financing (2) Additional issues of shares (3) Issues of bonds (4) From loans
10. Type of Capital Used	(1) Cash (2) Productive Resources
11. Administrative Structure	(1) Functional (2) Multidivisional (3) Holding Company
12. Cuses of Diversification	(1) Technological Revolution (2) Demand Structure (3) To deal with competition (4) Idle capital

TABLE – Diversification Policy Categories (continued)

CRITERIA	CATEGORIES
13. Merits	(1) effective use of productive resources (2) expansion of markets (3) effective control of subsidiaries (4) increase overall profitability (5) overcome business fluctuations (6) improve employees' morale (7) improve ability to raise capital (8) save major business (9) maintain employment
14. Which firms, industries	(1) Manufacturing (2) Mining (3) Agriculture (4) Commerce (5) Finance (6) Transportation (7) Large firm (8) Small/Medium-size firm
15. Product Policy	(1) Development of New Products (2) Acquisition of New Products
16. New Business/Product's Relationship with Major Business	(1) Assists Major Business (2) Helps maintain Major Business (3) Substitutes for Major Business (4) Eases Reliance on Major Business
17. Industrial Structure	(1) Expanding Industry (2) Mature Industry (3) Declining Industry

R. P. Rumelt divided diversification strategies into nine categories: (1) Single Business (2) Dominant Business: (a) Dominant-Vertical (b) Dominant-Constrained (c) Dominant-Linked (d) Dominant-Unrelated (3) Related Business: (a) Related-Constrained (b) Related-Linked (4) Unrelated Business: (a) Unrelated-Passive (b) Acquisitive Conglomerates.(16) Rumelt used revenues from end products as a percentage of total revenues for his criteria in deciding the "diversification posture" of firms. He categorized them according to the degree of diversification – the stage of diversification they had reached. Thus he based his classification on a quantitative measure of diversification rather than a qualitative assessment; it is not what could be called a theoretical approach. One curious outcome of this is that a single business strategy is defined as a type of diversification strategy.

Next we will discuss the major factors that hasten the formation and implementation of diversification policies, beginning with business fluctuations. In expansion phases firms tend to concentrate their efforts on maximising earnings from their major business. If at the same time they hold back investment on equipment the amount of cash becoming idle will increase, and this will expedite new product development or entry into new sectors. In periods of recession both cash and productive resources become idle. This encourages the development of products that sell relatively well in slack periods and entry into major business-related sectors.(17) If it is a structural recession or a long-term recession diversification may be a condition for survival.(18) Anti-monopoly laws, because their object is to restrain Gulliver-type firms (i.e. firms with an overwhelmingly large market share), tend to encourage the use of idle capital for new product development and entry into new sectors.(19) Finally, as P.F. Drucker points out,(20) tax legislation tends to make firms reinvest capital in their businesses, and hence diversify, in order to avoid taxation on distribution of profits to investors.

Next we will enumerate some "practical guidelines" for diversification policies(21): (1) The top management at the general office should take the iniative in and accept all responsibility for diversification policies. It could be said that the success or failure of diversification depends on whether or not they clearly show they are prepared to do this. Superior analytical ability, discernment, and decisiveness are demanded on the part of the top management. Also they should establish internal and external channels for information concerning diversification, and make fullest possible use of the general staff. (2) Application of the skills used in the major business activity. (3) Entry into technological areas and markets related to the major business. With regard to (2) and (3), without a full understanding of the major business diversification will not be a success. Furthermore, entry into areas closely related to the major business's technology and markets means that its potential can be fully exploited. Appropriate choice of either (4) acquisition or (5) internal growth. This is a question of correct response to the opportunities available. In either case a certain amount of capital, and technological and managerial ability are required. (6) The use of the joint venture. Drucker particulary emphasizes this: "The joint venture is the most flexible instrument for making fits out of misfits."(22) In other words it is a very effective way of spreading the risks involved in diversification, and management knowhow can be acquired from partners in the venture. (7) Divestment of unsuccessful diversification attempts. Diversified sectors which do not perform well should be abandoned at an early stage. If this is not done the whole firm will be adversely affected. (8) The development of diversification management techniques. The problems created by increased size and complexity require new techniques, such as product portfolio management. The use of (9) the holding company or (10) a multidivisional administrative structure. When diversification is still relatively simple and on a small scale it can be managed by a functional administrative structure, but when it becomes extensive and complex the use of a multidivisional structure is advisable. To manage a business in a completely new field it is best to use a holding company.

Finally in this section we will briefly discuss the possible effects of diversification policies, first within the firm. They might (1) promote expansion (2) increase profitability (3) seasonal fluctuations in profits and differences in the profits of different divisions/subsidiaries are balanced out. (4) "activate" idle capital (5) stimulate improvements in management strategy and control techniques (6) lead to improvement in the training and control of managers (7) encourage reduced reliance on the major business (8) lead to improved price and marketing policies and techniques (9) accelerate development of products and technology (10) lead to improved personnel management techniques (11) lead to improvements in obtaining, processing, and communication of data (12) promote acquisition of or merger with other firms, and/or sale of subsidiaries. In the economy as a whole they might (1) lead to the reformation of monopolies (in either the major or the new business) (2) promote innovation (3) cause unbalanced development (4) lead to the reorganization of the industrial structure (5) cause large firms to enter sectors which had been the province of small or medium size firms. (6) lead to acquisitions and mergers (7) increase competition between firms and industries.

4. Administrative Structures for Implementing Diversification Policies

The earliest diversification policies were those of single product firms, and were implemented by a functional administrative structure. Rumelt divided the organizational structures for the implementation of diversification policies into five categories(23): (1) Functional (2) Functional with Subsidiaries (3) Product Division (4) Geographic Division (5) Holding Company. If, however, we accept Chandler's view (in his well-known discussion on product diversification and the formation of product divisional administrative structures)(24), we have to work on the assumption that there are only two types of organizational structure appropriate for implementing diversification policies – the multidivisional administrative structure and the holding company.(25) It is possible for a functional structure to implement a diversification policy (e.g. a full-line product policy) when the managers at the central office are able, in terms of both quality and numbers, to carry out satisfactorily the management activities for that policy. When, however, diversification takes place on a large and complex scale, it cannot always be organized within the framework of the original administrative structure. If the burden of the managers at the central office increases to the extent that it cannot be handled by the staff there, a new administrative structure is called for.

For product diversification a multidivisional structure is appropriate, while for business diversification the use of a holding company is appropriate, if it cannot be put into an existing product division. What is particularly interesting is that the multidivisional structure has proved to be the more appropriate of the two in most cases. According to Rumelt,[(26)] of 235 firms surveyed in 1949, 182 (77.4%) had functional structures (including those with subsidiaries), and 41 (17.4%) divisional structures (including both product and geographic division). The remainder were either holding companies or their structure was not known. In 1959, when 233 firms were surveyed, nearly half – 113 (48.5%) – had divisional structures, and 114 (48.9%) had functional structures. By 1969 those with divisional structures were in the majority. Of 198 firms surveyed only 48 (23.2%) had functional structures compared with 148 (74.7%) with divisional structures.

The same trend can be seen among Japan's large firms. Four Japanese scholars[(27)] found that of 118 firms surveyed in 1963, 84 (71.2%) had functional structures (including some with a partially divisional system) and 34 (28.8%) divisional structures. In 1968, 78 (66.1%) had functional structures and 40 (33.9%) divisional structures, and by 1973 nearly half – 49 (41.5%) – had divisional structures and 69 (58.5%) functional structures.

Thus, when compound single product firms reorganize their administrative structures in order to carry out diversification it is no longer possible to classify them as single product firms; their structure and function are clearly those of a diversified firm.

5. The Duality of Diversification Policies in Diversified Firms

By diversified firms we mean large monopolistic firms which produce and sell a veriety of products, firms which have two basic elements: (1) a diversification policy (2) a multidivisional administrative structure or a holding company. Thus we believe that Runmelt's figures in the preceding section show not only the spread of the multidivisional structure, they can also be interpreted as the evolution of the diversified firm. Of the 198 firms surveyed in 1969, for example, 148 (74.7%) were already clearly diversified firms, and 43 (23.2%) were either single product firms or were in a stage of transition from the latter to the former.

Here we will briefly discuss how capital accumulation takes place in firms with a multidivisional administrative structure, using a product divisional structure as an example. First, a separate division is formed for each product throughout the firm's production process. The production of each product is carried out completely independently by the division concerned. Each division also carries out its own management activities for purchasing, production, sales, finances, and development, just like an independent firm. It is easy to measure the performance of these divisions because they are run on a self-supporting basis. The criteria are usually R.O.I. (return on investment) or the ratio of profits to sales, or in some cases market share. Each division head is in charge of the management activities for all operations in his division, so that the top management of the general office, freed from such responsibilities, can concentrate on making long-term plans for, and dealing with problems concerning the entire firm. With such division of management responsibilities it becomes possible to successfully carry out large-scale, complex diversification policies. Policy-making – forecasting demand trends and planning new product development accordingly, deciding whether to acquire new firms, or divest unprofitable sectors – requires considerable time and energy on the part of the top management.

How then does a diversified firm employing a holding company structure operate? Because control is effected "economically" (i.e. by holding the subsidiaries' stock), and the aim is profits rather than diversification, it is not as easy to achieve unity as it is with a multidivisional administration structure. The general office cannot formulate an overall production plan and control all the divisions according to it; instead it controls its subsidiaries' activities by using its powers as shareholder to influence appointments and dismissals of directors and budget decisions. This means that the firm as a whole cannot adapt quickly to market changes and technological developments. Also the fact that the holding company's structure tends to be very simple means that achievement of unity in areas such as policy formation is difficult, and channels of information are often imperfect. Thus if this kind of firm is to have a chance of success the following conditions must be met: (1) The directors appointed to manage the subsidiaries must have a deep sense of loyalty to the general office, as well as being professional managers. (2) The subsidiaries must be very stable (either because they enjoy a strong monopolistic position, or because market fluctuations and technological changes are negligible). (3) It must be possible to continue to acquire additional companies which are both profitable and have growth potential. (4) It must be possible to divest badly-performing subsidiaries without delay. (5) The holding company must always have the capital available to buy a sufficient portion of any new share issues by subsidiaries, in order to maintain its control over them.

When we talk about the diversification policy of a diversified firm we are usually referring to a policy or strategy of the general office (e.g. in the case of a product diversification policy they make decisions on technological problems involving products or on full-line policies for the entire firm, or in the case of a business diversification policy they decide which new areas to enter and how much should be budgeted for each project), and the division (or subsidiary) involved is in effect a single product organization (i.e. a genuine single product organization). However as the number of divisions (or subsidiaries) in a diversified firm increases, the possibility arises of a change in the nature of the product policies of these divisions (subsidiaries). They may, for example, find that adding new products to their existing ones is necessary from the point of view of their market strategy. Eventually each division may develop its own full-line policy. When things reach this stage diversification policies are taking place on two levels – for the entire company by the general office, and within the divisions (subsidiaries) themselves. Drucker, talking about this "duality" of diversification policies wrote, "A diversification strategy should include a plan which defines the role of each business within the entire enterprise. Diversification strategy – like any other strategy – must serve as the basis for specific goals, specific targets, specific assignments to specific businesses . . . Each business within a diversified company, indeed each product line and each distribution channel, needs its own plans, goals, and strategies. Each needs to set clear objectives and to measure results against expectations."[(28)] Berg says, similarly, but in a more abstract fashion, "An essential prerequisite to understanding and prescribing for strategic planning in a conglomerate company is to view the process as a multilevel activity. . . . . . Viewing strategic or long-range planning as an activity separate from and independent of short-range planning and current profit goals is both misleading and dangerous."[(29)]

The creation of the SBU (strategic business unit) at General Electric (USA) was, we believe, a rather desperate attempt to solve problems such as lack of unity and various inefficiencies which stemmed from the duality of their diversification policies. It was hoped that the SBU would enable the development of new products quickly in response to increasingly rapid market and technological developments and the creation of new divisions for new products, provide a more flexible system of communication between the general office and divisions (subsidiaries) and between division and division, and facilitate the investigation of new divisions and the possibilities of entry into new sectors.[(30)]

It is inevitable that a diversified firm's diversification policies become increasingly complex. Nevertheless, Drucker's well-known statement on the basic principles of business, "Because it is its purpose to create a customer, any business enterprise has two – and only two-basic functions: marketing and innovation."(31) probably applies even more to the diversified firm.

6. In Conclusion

We have attempted to show that diversification is the dominant trend among today's large enterprises, and that their diversification policies are in fact a means of increasing capital accumulation by making original and appropriate use of idle capital. It is used for product/service diversification (innovation type diversification) or business diversification (conglomerate type diversification).

Harrigan and Porter wrote, "Companies that can view an industry's decline as an opportunity rather than just a problem, and make objective decisions, can reap handsome rewards."(32) Diversification policies are by their nature dialectical; they involve both crises and opportunities, and are at the same time passive and active, negative and positive.

Footnotes

(1) M. Gort, Diversification and Integration in American Industry, 1962, pp. 8–9. For an excellent introduction to Gort, see Ichirō Tamanaga, Keieitakakukaron, 1970, pp. 45–100.
(2) E. Penrose, The Theory of the Growth of the Firm, 1959, pp. 112–3. p. 131, p. 138.
(3) Chandler described how the formation of a new, more appropriate administrative structure became necessary in many large American firms – A.D. Chandler, Jr., Strategy and Structure, 1966, pp. 387–94.
(4) R. Marris, The Economic Theory of 'Managerial' Capitalism, 1964, pp. 121, 131. The point about not competing with existing lines is extremely important. A.P. Sloan said that one of the three of General Motors' product policy decided upon in May 1921, a typical example of a full-line policy, was, "– that there should be no duplication by the corporation in the price fields or steps." – A.P. Sloan, Jr., My Years with General Motors, 1964, p. 65.
(5) Penrose talks about using productive services fully (op. cit., p. 111), Chandler about making use of existing facilities and managerial talent (Chandler, The Visible Hand, 1977, p. 473), and Rumelt about using a firm's skills and strengths (R. Rumelt, Strategy, Structure and Economic Performance, 1974, p. 10).
(6) Penrose, op.cit., pp. 127, 142; Chandler, The Visible Hand, p. 474.
(7) Service diversification has already been referred to in other works. Chandler, for example, refers to insurance companies and banks developing a full line of policies and services (The Visible Hand, p. 472), and Drucker discusses diversification by banks, railways and retailers (P.F. Drucker, Management, 1974 pp. 690–1, 697, 710).
(8) Penrose, op.cit., p. 145.
(9) Chandler, the Visible Hand, p. 286.
(10) Chandler, op.cit., p. 315.
(11) Chandler, op.cit., pp. 287–314.

(12) Chandler, op.cit., pp. 315–44.
(13) Chandler, op.cit., p. 347.
(14) K. Harrigan and M. Porter, "End-game Strategy for declining Industry" in *Harvard Business Review*, 1983, July–August, pp. 113–116.
(15) Chandler, talking about the conscious diversification policies of American firms in the 1920s and 1930s, writes, "And in nearly all cases they were financed from retained earnings." – op.cit., p. 473.
(16) Rumelt, op.cit., pp. 11–32. The basic criteria for his categorization can be summarized as follows:
  a) Single Business – one in which 95% or more of a firm's revenues can be attributed to its largest single business, Dominant Business – 70–95%, Related Business – less than 70%.
  b) A Related-Constrained Business is one in which there is a strong interrelationship between all the business activities, a Related-Linked Business is one where the relationship with the major activity is tenuous, and an Unrelated Business is one that has diversified without regard to relationships between new businesses and current activities.
  c) His first criteria for classifying diversification strategies is the "specialization ratio" (described in a) above), the second is the "related ratio" – the proportion of a firm's revenues attributable to its largest group of related businesses, and the third is the "vertical ratio" – the proportion of the firm's revenues that arise from all by-products, intermediate products, and end products of a vertically integrated sequence of processing activities.
(17) Penrose, op.cit., pp. 138–9.
(18) Penrose, op.cit., p. 142.
(19) N. Berg, "Strategy Planning in Conglomerate Companies", in *Harvard Business Review*, 1965, May–June, p. 79.
(20) Drucker, op.cit., p. 691.
(21) Some of these were inspired by Drucker, op.cit., pp.679–727.
(22) Drucker, op.cit., p. 720.
(23) Rumelt, op.cit., pp. 38–40.
(24) Chandler, Strategy and Structure, pp. 387–94; Takaaki Suzuki, "Jigyōbusei Kanrikeiseikatei no Kisoteki Kōsatsu" in *Keizai Ronshū* No. 27, pub. Daito Bunka University 1977, and "A.D. Chandler no Keieikanrihattatsuron" in *Keizai Ronshū* No. 29, 1979.
(25) One advantage of the holding company – that "diversification can be introduced into management" – was pointed out by Kaichirō Nishino in Kindaikabushikigaisharon, 1935, pp. 176–8. Holding companies can be divided into two types – pure holding company administrative structures, and operating holding company administrative structures. When we discuss them from a theoretical viewpoint, however, we are referring mainly to the former.
(26) Rumelt, op. cit., pp. 175–224.
(27) Nihon Kigyō no Takakukasenryaku, by Hideki Yoshihara, Akimitsu Sakuma, Hiroyuki Itami, and Tadao Kagono, 1981, pp. 267–70.
(28) Drucker, op.cit., pp. 697–8.
(29) Berg, op.cit., pp.91–2.
(30) These units were created as links between existing divisions, to liaise their activities, and thus, for example, expedite new product development. For details see Hiroyuki Itami, Keieisenryaku no Ronri, 1982, pp. 266–7; Kazuichi Sakamoto, Gendai Kyodaikigyō no Kōzōriron, 1983, pp. 227–240.
(31) Drucker, The Practice of Management, 1954, p. 37.
(32) Harrigan and Porter, op.cit., p. 120.