

## The Strategic Choice: Specialization or Diversification?

### ----Based on Case Analysis

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**Abstract:** Specialization and diversification are two strategic choices in the process of business operation. The current academic discussion on the two business strategies is becoming more and more serious. Some people believe that diversification can diversify business risk and is the inevitable choice for enterprise development. However, some people think that specialization can concentrate resources and realize economies of scale, which is the way of survival and development of enterprises. Based on the definition of specialization and diversification, this paper compares the advantages and disadvantages of the two strategies and then analyzes the relevant cases. It is believed that they both have advantages and disadvantages and both have successful cases. There is no contradiction between them. Enterprises should choose their own way according to their current situation and industry development situation.

**Key words:** Specialization strategy, Diversification strategy, Core competitiveness

### 1 Introduction

For a long time, whether the development of enterprises is based on " diversification" strategy or " specialization" strategy is a problem that confuses many entrepreneurs. In the middle of the 20th century, with the appearance of the third wave of mergers in America, some large companies in western countries have implemented diversified management through mergers, which set off a wave of diversified management. However, from 1980s, anti-diversification momentum appeared in the United States and western Europe, and business operation changed from diversification to specialization. Some scholars believe that only specialization can refine and strengthen the enterprise. Using excess income, cash flow from operating activities and Tobin Q as agency variables of company performance, Megginson et al. (2004) studied the relationship between business strategy and company performance, and the results showed that there is a positive correlation between company performance and the degree of specialization. If a company implements the merger and acquisition activities that lead to the decline of specialization, then in the third year after the merger and acquisition, the shareholder wealth will usually lose 18%, the net operating cash flow will decrease by 2%, and Tobin q will decrease by 9%. Chakraborti et al (2007) studied the relationship between business strategy and business performance in east Asia, and the research showed that the diversified business strategy in most countries was not conducive to the long-term development of enterprises. And Shen Hongbo (2007), a Chinese scholar, took Shenzhen and Shanghai listed companies as the object to study the relationship between listed companies' performance, anti-risk ability and diversification degree, and the research results showed that enterprises implementing specialized management strategies have better anti-risk ability. However, some people think that enterprises can be full of vitality and game to form

effective competition only by diversifying. Through the study of diversification strategy and performance of enterprises in India and Mexico group, Khanna and Palmpu (1997) found that due to the problems of government intervention and imperfect market mechanism in emerging market economies in varying degrees, enterprises can improve benefits by unrelated diversification development. Li Shu (2013) found that the degree of diversification was significantly negatively related to earnings volatility, it means that the higher the degree of diversification, the lower the earnings volatility, which showed that diversification could effectively reduce business risks and play a role in smooth returns.

Although many scholars have made relevant studies on the choice of enterprise's business strategy, the research conclusions are difficult to be unified. And most existing studies only analyzed its advantages and disadvantages from the perspective of the business strategy itself, but ignored the characteristics of the implementing enterprises. So it was only a general analysis of the business strategy, which is not conducive to draw objective research conclusions. Based on this, this paper adopts the method of case analysis to analyze different enterprises' business strategies, and objectively answer whether specialized or diversified business is more desirable, which can provide reference for enterprises' strategic choice.

## **2 Overview**

### **2.1 Specialization Strategy**

Diversification strategy and specialization strategy are a relative pair of concepts. The classification of enterprises from the perspective of status is "the proportion of sales of certain products to the total sales of enterprises". The product category of "certain products" is classified according to the four-digit industry standard in the international standard industry classification (ISIC). China can also adopt GB/T4754-2002 national economic classification standards. When this ratio is 95% to 100%, we call the enterprise professional. In the study of some other scholars, there are different definitions of professional operation. Hai Yang and Wang Gang (2004) believe that specialized operation means that the company chooses to develop in a business area and does not blindly choose to enter other industries, but only focuses on the development space of its choice. Sheng Hong (2006) believes that specialization is the type of operation that a person or organization reduces the different functions of its production activities. In other words, concentrate production activities on operations with fewer different functions. Cheng Huijie and Yu Jing (2005) argue that if the enterprise only engaged in the production and operation of a product or service, or only some parts of these products, or only to complete these activities of individual processes in a certain time, then it is called a specialized operation.

To sum up, this article defines enterprise operation as that enterprises engage in the operation of a single kind of products or services. The reason of limiting the specialization to "a kind of product or service" is based on such a judgment: the same kind of product homogeneity and the generality of the core technology (for service, it is the consistency of the service process). The specialization of enterprise management is the centralization and simplification of the types of products or services. The higher the degree of specialization lies, the more concentrated the product or service is.

### **2.2 Diversification Strategy**

Diversification was first proposed in the 1950s by Ansoff, a product and marketing specialist. Because of the different perspectives of observation and understanding, there are different definitions of diversification.

In 1959, Penrose, a British scholar, published her monograph on enterprise growth theory. She thought: corporate diversification is engaging in new products production under the condition of not completely abandoning the original product line, and these new products has obvious difference with the original products on the production or distribution. In 1962, Chandler, a famous American economic historian, published his monograph "strategy and structure". By studying the decades-long history of Dupont, GE, Standard Oil and Sears, he argued that diversification is an increase in the final product line. Chandler for the first time put forward the following famous strategies, "Structure following strategy" and "the company's strategy will determine its structure". Therefore, the corresponding adjustment of organizational structure is the key to the success of enterprise diversification. In 1974, American scholar Rumelt published the "strategy, structure and economic performance", and defined the concept of diversification strategy as: 1) the enterprise itself has diversified nature; 2) the strategy of the new activity associated with the original activity by combining the limited strength, skill or goal. "If a company's products are of limited use, then this enterprise is a specialized enterprise," said Hiroshi Ono, a Japanese scholar, in his monograph on corporate strategy and structure in Japan in 1984. And if there is a variety of uses for an enterprise product, then this enterprise is a diversified enterprise.

To sum up, this paper defines the diversification of enterprises as that the business scope of an enterprise exceeds its original business field. Its basic characteristics are the best combination of enterprise ability and market opportunity on the basis of measuring enterprise ability, enterprise risk and enterprise profit. It shows that the enterprise is mainly engaged in one kind of business area, the other industry is the auxiliary development, or develops in the multiple business areas, it develops in the relevant business domain, or in the completely unrelated business area expansion.

### **2.3 A Comparative Analysis**

As two different ways of enterprise management strategy, diversification strategy and specialization strategy have their own advantages and disadvantages. The advantages of specialized management strategy are mainly reflected in the core competitiveness, while the advantages of diversification are mainly reflected in the dispersion of risks. Both of them have advantages, and both of them inevitably have some disadvantages. They are listed below for comparison, as shown in table 1.

**Table 1 Comparison of Specialization and Diversification**

	Definition	Advantages	Disadvantages
Specialization	Enterprises engage in the operation of a single kind of products or services.	(1)Core competitiveness (2)Economies of scale (3)Target market	(1)Weak ability to resist risks (2)Easy to miss investment opportunities (3) Idle resources
Diversification	The business scope of an enterprise exceeds its original business field.	(1) Spread risk (2)Resource utilization (3)Revitalize capital stock	(1)Loss of economies of scale (2)Increase in business management scale (3)Difficult to form business features

As listed in table 1, both business strategies have advantages and disadvantages, so it is difficult to determine which is right, and it is uncertain whether specialization or diversification is more suitable for enterprise development. The following will analyze related cases, aiming to further explore the specialization and diversification strategy.

## **3 Case Analysis**

### **3.1 Specialization Strategy Case**

Nokia is the representative of continuous innovation in high-tech field. In Finland, Nokia's hometown, the penetration rate of mobile phones ranks among the highest in the world. Nokia has done a series of industries such as pharmacy, home appliances, computers and pagers. In 1992, under the leadership of CEO Ollila, Nokia made radical changes to focus its business on telecommunications, which promoted the development of Nokia's mobile communications industry. Nokia has a so large number of mobile patents around the world that making any part of the mobile phone will meet Nokia's patents. Nokia makes money not only by selling its phones but also by transferring its technology. Nokia's strategic reform took place in the development stage of specialized operation mode, which mainly focused on core business. (1) Nokia's specialized strategy made all of its resources focus on the development of the mobile phone industry, which avoided the lack of resources in various industries and promoted the movement of the mobile phone industry in the direction of high, smart, and pointy. (2) Nokia laid the emphasis of enterprise operation and development on the most advantageous part of the value chain, which gives Nokia a firm grasp of its core competitiveness. The competitive advantage and development potential of the high-tech industry have created a favorable external environment for Nokia's success.

Although Nokia's mobile phone business has now been acquired by Microsoft, the results and brilliance it once created proved the charm of a specialized business strategy. Obviously, the specialized strategy can also make the enterprise create brilliant and go to the peak. If the enterprise that pursues the specialized strategy wants to develop, it should give enough attention to the specialized strategy of core business. On the one hand, the enterprise's core business has certain popularity and customer recognition in the market, once a lot of important resources are devoted to new business, core business development will be hindered, and the owned market share and customers will be likely to run off due to the decline of products competitiveness. On the other hand, the new business needs a lot of capital investment in the early stage of development. Without the core business to create a steady stream of cash flow, it is impossible to develop by only relying on the company's own capital. Specialized operation enables enterprises to serve the narrow strategic object with higher efficiency and better effect, which forms core competitiveness. To develop relevant or non-related businesses, the core business of enterprises should maintain the high level of rapid development, which is a must for enterprises to maintain sustainable development.

### **3.2 Diversification Strategy Case**

GE's diversified approach. General Electric Company is the world's largest electrical and electronic equipment manufacturing company and the multinational company providing technology and services business, involved in household appliances, consumer electronics, aviation, power distribution products, energy, finance, business, finance, consumer, medical, lighting, media and entertainment, oil and gas, rail transportation, security, water treatment and other industries. It accounts for about a quarter of the value of the American electrician industry. GE is made up of a number of diversified basic business groups, and if ranked separately, there are 13 business groups that can be ranked among the fortune 500. GE is committed to the world's leading position in every area of its business. GE has made remarkable achievements with excellent products, advanced technology and excellent service.

The success of GE diversification strategy demonstrates that diversification strategy is feasible and can help enterprises to succeed. The success of GE's diversification strategy can be summed up as: first, the new

business should have a considerable industry appeal. The industry diversified enterprises ready to enter should belong to the sunrise industry. Enterprise should choose those industries that have a large development potential and a good prospect to develop, these industries with larger growth space and stable returns are worth to risk investing. Secondly, core competence is the prerequisite for the success of enterprise diversification. Only when acquiring the core competitive advantage and having a foothold in its strengths, the enterprise can be involved in other areas. Finally, enterprise diversification should choose the right time. It is not always possible for enterprises to diversify, whether to develop diversified businesses depends on the growth and growth environment of the enterprise at that time. If an enterprise with good core expertise has a very mature development in a certain field, and has the remaining resources to seek a greater return on investment, then it is perfectly possible to develop by a single to multiple industry development strategy.

From the above two cases, it can be seen that the strategic choice of specialization or diversification is the key to the survival, profitability and development of enterprises. Generally speaking, enterprises choose to specialize and diversify two different business development strategies at different stages of development. But in reality, both strategies have the experience and lessons of success and failure, and it is difficult to judge by good or bad. Therefore, it is very important to make scientific decisions according to the actual situation of enterprises and internal and external environment.

#### **4 Market Analysis of Specialization Strategy**

Although the successful cases of specialization strategy are not rare, there are still many questions about whether the market of specialized business strategy is really limited. As is known to all, since China joined the world trade organization, China's economy has grown by leaps and bounds. "Made in China" has gone into the world, and people are talking about it. China's products have gone beyond the domestic market to the world market. Moreover, with the acceleration of economic globalization, the world market is gradually forming, which is not only an opportunity but also a challenge for all countries. The formation of the world market means that the market for products is broader, but it also means that the competition is more intense. In any case, it is beneficial to the economic development of all countries in terms of the market. In the current era of economic integration, the market is infinitely expanding, and the market itself is formed spontaneously, which is a very fair platform for any economic subject. The unlimited and equal nature of the market determines that the market share that each enterprise can achieve is entirely dependent on its own ability, so long as it has the ability to occupy the market.

Moreover, with the support of core competence, professional operation can maintain long-term competitive advantage, and the future development direction and competitive advantage of the whole enterprise depend on the core competence the enterprise has. The competition essence between enterprises is the long-term battle of core competence, enterprises with the core competence will be able to get sustainable competitive advantage in the competition, and grasp the initiative of the long-term competition. In the information age, any enterprise, singly depending on one or some functional strategy, can only get a temporary advantage. Only by pursuing the core competence can the enterprise be established in the long run.

To sum up, in an unlimited, open and equal market, with the support of core competitiveness, specialization strategy can maintain long-term competitive advantage and be able to continuously upgrade products according to market needs, and develop new products or enter new business areas. Also, it can

provide unique product, and adapt to the rapidly changing demand market more flexibly. So the enterprise has the market competitiveness, and the specialization is not limited to the market.

## 5 Conclusion

Specialization and diversification strategy are not opposed and they both have advantages and disadvantages. Specialization simply translates strategic core competencies into a core product or service, which is reflected in a final product or service, exclusive but lacking in liquidity. Diversification is the transformation of strategic core capability into a variety of core products or services, which can be reflected through a variety of final products or services, with strong liquidity but lack of depth. "The core focuses on everything", and the long-term development of an enterprise depends on its ability to identify, nurture, develop and maintain strategic core competencies. Both GE and Nokia are excellent companies. GE is the most typical one of the non-diversified companies, but it is almost impossible to find a better company than GE in the world, whether in the area of power equipment, medical devices or financial services. And Nokia is the model for mobile phones, which is the undisputed model of the mobile phone industry. There is no right or wrong between specialization and diversification. The key is whether to grasp the core competence and expand on the basis of core competence. Companies should always focus on core competencies and should not move away from core businesses and into new industries. Enterprises can diversify under specialization. An enterprise can realize relevant diversification and provide its customers with extensive service by building its own core competitiveness and being around this core competitiveness. Develop diversification on the basis of specialization, and insist on its core competence in diversification. Specialization and diversification strategy are two kinds of business strategies that are not contradictory. Enterprises should choose their own way according to their current situation and industry development situation.

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