

Strategy 'Core' or 'Non-core'¹

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Leaders and strategist in Indian business have reasons to be perplexed. After being fed with virtues of sticking to the core for over a decade, there seems to be a fly in the whole proposition. In the last few months, many media features have carried passionate arguments for doing the opposite. Of merits, and even necessity, of diversifying into new and unrelated sectors for companies operating in India. The proponents of both 'core competency' and 'non-core or diversification' are interestingly academicians of Indian origin, based in the United States. The success and contribution of Michigan based C K Prahalad and Harvard based Krishna Palepu and Tarun Khanna, marks the coming of age of Indian academicians in the strategy discipline. While this could be a matter of justifiable pride, there are serious flaws in the way the propositions are propagated in our context and in the way Indian managers take to them.

C K Prahalad developed the 'core competency based' strategy proposition around 1990. It exhorted companies to find one or very few things they are good at and to focus their resources for enhancing that competency. The companies should build their business and organisation around harnessing this core competency, and even the largest of companies should divest out anything that didn't fit. The strategy proposition was based on the sustained success of some companies in 1980s, mainly from Japan and South-east Asia. It was well articulated, especially choice of the word 'core', and forcefully presented. The proposition caught on in America in early 1990s, as an explanation for poor performance of diversified companies and as a rationale for clipping away weaker business areas. Definition and the approach, for a company to find its core were tantalisingly vague, leading to wide-ranging interpretations. Companies chose 'core' competencies that suited them, in order to push through painful decisions internally and to gain brownie points with investors. Though highly popular, core competence proposition was rarely considered rigorous enough, with glaring exceptions like General Electric

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in United States. Korean chaebols and a majority of developing country corporations were major anomalies.

Core competency proposition was clearly mistimed for the Indian context of the 1990s, with economic reforms giving major thrust to removal of excruciating restrictions on growth and diversification, opening-up of new areas for private sector, and deregulation of capital markets. The Indian context was similar to US of 1960s and 1970s, when strategy propositions that encouraged growth and diversification were proposed and were popular. Arguably many Indian companies needed to exit some of the businesses they had entered during the license – control era, but the driving logic was matching resources with opportunities and competitive scenario, rather than existence of a core competitive capability. Indian companies had operated in highly restrictive and protective environment for nearly four decades, and primary agenda was of learning to compete perhaps for the first time in their existence and simultaneously developing requisite competencies, not one but many and mostly without any existing area of unassailable strength against competition. The required strategic approach for Indian companies in 1990s, but more importantly the underlying reasons, was not in tune or consonance with core competency proposition.

Palepu and Khanna tried to address the inadequacies of core competencies proposition in late 1990s, by collecting evidence on thriving diversified corporations in developing country or emerging markets, including India, and tried to reason for their success. Explanation was the lack of efficient markets in developing countries, which allows and even necessitates diversification for continued success of companies. While based on the efficient capital markets premise of finance theory, the term is expanded to include labour and commercial markets. As the markets are inadequate and inefficient, developing countries companies need to allocate capital, evolve manpower skills and create framework for commercial transactions, themselves. This requires certain minimum size to be viable and the existence of many different businesses to be effective. It's a sound logic for explaining the success of huge and highly diversified conglomerates like Samsung and Hyundai.

Efficient markets, capital, skills or commercial, is an ideal type or a theoretical construct, and in real life the efficiency is a matter of degree. Efficacy of a proposition can be borne out in the Indian situation, by the existence of stated market conditions and by the anecdotal or otherwise evidence of proposed type of corporate strategies. Current regulatory framework and functioning of Indian capital markets is not grossly inferior to that of US capital markets, based on the parameters like market capitalisation as a percentage of gross domestic product, daily turnover as a proportion of market capitalisation and number of securities listed and on the comprehensiveness of regulatory framework and trading instruments available. Irregularities noticed in last couple of years in both US and

Indian capital markets, further point not only far from efficient state but also not much difference in between. Skills markets are certainly not underdeveloped in India; with well-identified sources of manpower to provide various skills, fairly high mobility of both executive and blue collar personnel, and sharp improvement in the match between the compensation and the risk and contribution levels. Legal framework for commercial transaction and contracts is comprehensive in India, while the enforceability and the speed remains an issue. But business entities, from smallest to multinational corporations, are able to develop a combination of emotional, social and legal contracts to function with virtually any kind of serious handicap in the country. Transaction costs of such contracts, for instance in jewellery and food sector, is likely to be lower than elaborately drafted and negotiated American contracts.

The explanatory factor for diversification of Indian corporations, is historical or opportunistic, and not viability or high costs of transaction in capital, skills or commercial markets. Tatas with their administrative services and with wide-range of diversification can be cited as validating the proposition, but pooling and transfer of managerial skills rarely happened and of funds only to a limited extent, in what was till recently a loosely coupled group. Similarly, if Tatas moved into high potential software services so did Wipro and Infosys, and also if Reliance moved into high investment telecom so did Bharti. Finally, by all counts there has been a dramatic improvement in efficiency of the markets in last one decade, which according to the proposition should have lead to unravelling of diversified conglomerates in India. This has not happened at an aggregate level, and the change in diversification profile of Indian companies in this period is driven primarily by their micro factors related to competition, resources and opportunities and much less by the macro level socio-economic efficiencies.