

A New Strategy Sweet-spot: The Global Diversified Configuration¹

Dr. Rajnish Karki

RAJNISH KARKI & ASSOCIATES

L – 1/13, Hauz Khas Enclave

New Delhi 110016 INDIA

+(91-11) 41654982 46113750

rajnish@karkiassociates.com

I hesitated to testify for the viability of organisations that are trying to go global simultaneously across multiple businesses, in my book on the strategic management of Indian companies. The book was taking shape in 2005/06, when the big overseas moves of the groups such as the Tatas, Mahindras and Birlas, were yet to be made. The conventional strategy theory has been all against unrelated diversification, and doing so at the global level and by organisations from a newly internationalising country, would have been considered nothing sort of theoretical heresy.

The situation turned upside down in just about half a decade, for three reasons. Firstly, the efficient capital market hypothesis, which underpinned the case against unrelated diversification, came emphatically erroneous and inadequate during the global financial crisis. The hypothesis argued that the companies need not try to mitigate risks through diversification, as the capital markets can do so much better. It was anyway a simplistic explanation of corporate diversification as the hypothesis limited itself to the consideration of financial risks, largely ignoring the risks and the synergies related to market demand and supply, organisation and governance.

The attempt of Harvard researchers Krishna Palepu and Tarun Khanna to justify unrelated diversification in emerging markets, around inefficiencies in capital and institutional markets was essentially an example of stretching a weak theory. The need and the reasons for unrelated diversification are more at the firm level, with managers trying to harness new opportunities and safeguarding their

¹ Published in Corporate Dossier (The Economic Times), dated 20th August 2010, in a slightly abridged version under the title “Global Diversified: Anathema a decade ago, now a great strategy”

organisations from downturns and for future. Indian economy that saw explosion of new opportunities since the early-1990s was a hotbed for unrelated diversification, and a majority of medium and large organisations did so.

The second reason is the empirical evidence, in the form of what the Indian organisations actually did and why. The best example is the Tatas, which made bold moves for significant global positions across businesses. In beverages, it was the logical extension of the intent shown with Tetley acquisition in late-1990s, and in hotels and software, the deeper penetration into overseas markets. In case of steel, chemicals, commercial and passenger vehicles, the intent was to secure competitiveness as the businesses could become vulnerable very soon, because the markets had integrated globally and there was consolidation into a few players worldwide.

Tatas are clearly embodying the ‘global – diversified’ strategic configuration, as the moves are underpinned by group-level synergies and resources. No single business, even Tata Steel, could have taken the risks and raised requisite funds. The moves were helped by the group-level deal making and managerial skills, the long-term orientation to businesses, the values of professional trust and personal care towards members, and the image of Tatas as a socially responsible and charitable institutions’ owned organisation. The scenario is completed by TCS that the group could always fall back upon for internal funds and by the world-view and conviction-laden leadership of Ratan Tata.

The configuration is replicated across many Indian organisations, although with some lag and with some features specific to a particular group. For example Mahindras, besides rapidly expanding automotive and farm equipment business internationally, mobilised group-level financial and managerial resources to scale-up its software business. Similar is the case of aluminium business in Aditya Birla, transformers in Avantha and consumer products in Godrej groups. Acquisitions have become the dominant vehicle for global expansion, given the advantages of stepped and quick scale-up, the wide availability of assets overseas due to divestments by private equity players and corporate restructuring, and the sharp improvement in fund mobilisation abilities of Indian companies.

The third reason for the forceful and rapid emergence of ‘global – diversified’ configuration is the sharp shift in the mindsets. It’s the way the developed countries and Indians, have come to see themselves and each other. Mindsets get shaped over decades and centuries, with the underlying social, political, demographic and economic changes. These changes at multiple levels often coalesce together into a “tipping point”. Such a point appears to have been reached somewhere around 2009, a few months after the global financial crisis. The contrast between the developed countries and the India, China and few developing countries, in terms of the current situation and more importantly the prospects over coming years and decades, couldn’t be starker.

One of the finest trend-spotters, The Economist, in a survey titled “The World Turned Upside Down” (17th April 2010), argued for organisations from India and other developing countries being the source of business innovation and new management paradigms in the future. Till just about a decade ago, the business and management used to be a one-way street, predominantly from the US, with the Indian organisation seeking to learn and follow the best practices. Not only that the Indian organisations such as Airtel, TCS, Narayan Hrudalaya and Bharat Forge are innovating something new, but they are also being recognised as the very best, which hold management lessons for the world.

The shift from being “followers”, more importantly to be perceived and recognised to be one, the Indian organisations have the opportunity and the space to be “leaders and pioneers” in management. And the “global – diversified” configuration is one such pioneering construct. It aligns well with the nature and evolutionary trends of Indian organisations, which are largely family-owned and which imbibed diversification orientation during license-control era and embellished it further around the new opportunities thrown open since early-1990s. The configuration also aligns with the mindset of being the global leaders, who are confident and able to follow their convictions, and in turn break new ground in the practice and theory of management in the world.

The three reasons together make the “global – diversified” a viable and effective configuration for Indian organisations. However it would be appropriate for a certain type of organisations, for instance, those with multiple businesses and where most of the businesses are considerably integrated into global markets. It is among the more risky configurations, as the number of influencing variables is higher and the dynamics is more complex and fast changing. The configuration will call for a tight alignment between the three components – strategy, organisational framework and values, and leadership. A successful organisation ought to get about two components right before launching onto the ‘global – diversified’ configuration, and allow the space for the third to fall into place.