Who Dares Lose Strategic Focus!

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Growth is vital for all firms to sustain the dynamic environmental shocks and leverage the emerging prospects. However Indian family firms are often accused of being conservative and averse to pursuing growth via acquisition or starting businesses in new industries or venturing internationally.

Be aware! While chasing growth and hoping to reap rewards, you may be about to compromise your strategic focus.

Consider Hitachi, a Japanese multinational corporation specialising in high technology and services. With sales of $96 bn in 2009 it is the third largest technology company worldwide, with diverse interests making everything from hard disk drives to high-speed trains to nuclear power stations. Hitachi is sometimes referred to as the "GE of Japan", however unlike its American counterpart, it has suffered a miserable recent record posting combined losses of $10.6 bn over the past five years.

On May 31, 2010, Nakanishi, the newly appointed President, presented his transformational turnaround plan. This plan, the "2012 mid-term management plan" involves infusing *strategic focus* by launching 3 key initiatives: 1) concentrating investment of key business fields by realigning the business portfolio and investing $6.5 bn in R&D in the next two years; 2) promoting global localisation by strengthening locally led project control centres while maintaining Japan as a strong business base; and finally, 3) rigorously cutting costs by reducing procurement costs and centralising low value-added functions. Through greater strategic focus, Nakanishi is expecting 8% sales growth and 5% net profit by 2012. But can strategic focus deliver these kinds of performance improvements? What is the effect on economies of scope and efficiencies?

Recent research by Ewan Rawley at Wharton[1] explored why firms become less efficient as they increase their scope of activities. Logically, when family firms diversify they can achieve economies of scope. There are many business groups in India who one could argue this by pointing out that they can capture efficiencies e.g. distribution, transactional, financial efficiencies. However, attempts to infuse coordination across diverse areas and business units can be expensive. Rawley' study found that the costs that arise from managing task interdependencies offset economies of scope benefits, and that the cost of reorganising business unit activities further constrained realising economies of scope. The implication is that decisions to diversify – whether that be horizontal, vertical, geographic, or M&A – need to fully account for the related costs of coordination and costs to overcome organisational rigidities. In situations where these costs are not offset by the diversification premium, a more viable route to profitable growth may be through *strategic focus*.

A Harvard study conducted by Robert Huckman shows that focussed firms are high-performers.[2] Huckman points out that as firms diversify, they consider dividing an operation into specialised units that share some critical assets as the solution to keep the firm focussed. The challenge however lies in maximizing the positive and minimizing the negative spillovers from sharing. For family firms added complexity may emerge, as they may have to guard the family cohesion and minimize political conflict. One solution for diversified family firms may be to give (a) each business unit – whether it is managed by family or non-family member- clear objectives that support the overall family and business strategy, (b) carefully design boundaries between unit to allow just the right amount of interaction, and (c) the family patriarch and CEO to actively manage units to promote operational excellence that comes from focussed expertise.

Our note is a salient reminder to Indian family firms that pursuing diversification while maintaining performance levels associated with strategic focus can be an uphill battle, as Hitachi has experienced.

Many Indian family firms have pursued diversification while ignoring the importance of staying focussed. Soon they will be faced with the challenge of regaining such focus. Launching initiatives similar to Hitachi in order to gain greater strategic focus is tempting. This in turn, Indian family firms must remember, has its own set of unique challenges, including the need to establish clear business unit objectives that support the corporate strategy, while defusing intra firm and family tensions and reducing duplicative investments through intelligent and efficient coordination. Only time will tell whether Hitachi can get this strategic balance right and generate superior performance.

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[1] *Rawley, E. (2010) Diversification, Coordination Costs, and Organizational Rigidity: Evidence from Microdata. Strategic Management Journal. Forthcoming.*

[2] *Huckman, Robert S. (2009). Are you Having Trouble Keeping Your Operations Focused? Harvard Business Review. 87 (9). 90-95.*