Factors Influencing Specialization vs. Diversification Decision Making: An Empirical Study

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ABSTRACT

This paper explores the role of various economical, financial, and strategic forces influencing firms towards diversification and specialization decision making within the Saudi Arabian manufacturing industry. Surveying 100 decision makers in the industrial cities of Riyadh using questionnaires developed for both groups, the study attempts to identify the factors that had the greatest impact on firm performance based on firm returns on investment. Several factors were found significant; first, attempts of specialization were found associated with risk avoidance and managers craving to achieve industry dominant economic features, whilst results show an increased concern among diversified firm decision makers towards changes in import and export policies and regulations. Moreover, industry type was found effective in managerial responses as they weigh the role of the factors presented to the direction of the expansion made.

Keywords: Business and Strategy, Decision Analysis, Diversification, Manufacturing, Saudi Arabia, Specialization

INTRODUCTION

One noted business trend of the 20th century was the expansion of the small and medium sized manufacturers forming into large scale or multinational corporations (Chen, Hu, & Zhang, 2010). Expansions can take several forms (Wang et al., 2009). Most common approaches are Diversification and Specialization: 1) Diversification, by introducing new products and diversifying businesses into new fields of business (or applying economics of scale) and 2) Specialization, by specializing and enhancing current production line capabilities.

The decision to diversify or specialize depends on many factors economical / financial, technological and strategic. Today, more than ever, the above decision has become crucial and it is a critical success factor of the expansion strategy of manufacturers in order to establish better grounds and sustain growth in face of world free trade and local / international com-
petition (Bartkus & Hassan, 2009; Gompers et al., 2008).

Moreover, this decision has been the subject of many research and business initiatives (Zeleny, 2010; Nooraie, 2011). However the success rates of either of the above expansion strategy have varied, not only across time but also among regions (Michalopoulos, Georgiou, & Paparrizos, 2009). Continues changes in the business environment have many consequences on summarizing specific factors for decision makers to consider in regards to expansion decision making.

This difficulty is based also to the complexity to define both strategies (Kang et al., 2011; Markides & William, 1996). Scholars have long argued about the definitions of specialization and diversification in business applications. Table 1 presents the most common definitions that can be found in the literature.

Different definitions can be found in the dictionaries.

Bruche (2000) considered the topic of diversification and specialization too complex to generalize despite the great number of theories and empirical work applied in the field. In the 90’s, Ernest and Lee (1993) in recognition of the inherent issues argued that the definition of diversification (as in firms operating in more than one product / business line) is outdated and international / market diversification has now replaced that narrow prospective. Trellis (2005) identified three meanings for diversification. The first is “to give variety to, or to vary.” The second is “to extend business activities into disparate fields,” and the third is “to distribute investments in order to average the risk of loss.” It is obvious that each of these meanings provides a separate rationale for diversification. Additionally, Cengage and Helms (2006), as well as, Kotelnikov (n.d.) brake down diversification to two forms: 1) Vertical (or Concentric) diversification: as in companies moving into related areas of their supply chain (usually when volumes justify launching new operations) and 2) Horizontal (or Conglomerate) diversification: as in expanding operations to supply new products to diverse markets aside from those served in the primary business.

Based on the above challenges, this paper explores the role of various economical / financial, technological and strategic forces influencing firms towards diversification and specialization decision making within the Saudi Arabian manufacturing industry. Following the trend “Bigger is Better,” and due to a strategic shift by the government towards diversifying sources of income after relying heavily on oil production for decades, sources of capital in Saudi Arabia have been attracted towards industrial projects in an attempt to enhance stability, competiveness, and profitability of the manufacturing industry before officially entering the World’s Free Trade Organization where recent studies by the Saudi Industrial Development Fund (SIDF, 2009) revealed that 38% of locally manufactured products have recorded low competency levels against imports.

Surveying decision makers in the industrial cities of Riyadh using questionnaires developed for both groups and statistical analysis on the data retrieved, the study attempts to clarify the conditions and circumstances in which deci-

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<th>Specialization</th>
<th>Diversification</th>
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<td>“Specialization in an economic sense refers to individuals and organizations focusing on the limited range of production tasks they perform best” (Hall, 2009).</td>
<td>“A risk-reduction strategy that involves adding product, services, location, customers and markets to your company’s portfolio” (Hall &amp; Lee, 1993).</td>
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<td>“Organizations each concentrating their productive efforts on a rather limited range of tasks. Specialization entails focusing on a narrow area of knowledge or skill or activity” (Johnson, n.d.).</td>
<td>“Diversification is the process of purchasing stocks, bonds, and other investments from a variety of different companies and funds so that you have a representation of different industries and market sectors” (Stone, n.d.).</td>
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