Chapter 1
Points of Departure

Research into corporate diversification occupies an important place in the history of strategic management research. Ever since Igor Ansoff discussed the strategy of diversification back in 1957 in his framework of generic corporate strategies, numerous academics, coming from a variety of disciplines, have tried to uncover some of the mysteries of diversification. They have published their research efforts in thousands of books and articles, which includes the seminal works of Chandler (1962), Gort (1962) and Rumelt (1974). Yet, despite the immense size of both conceptual and empirical work, the aggregated result of diversification research is quite disappointing. For one thing, little can be said unambiguously about the implications of diversification on the performance of firms. Also, there is still no all-embracing theory of diversification that explains the success or failure of individual diversification projects. As a result, after almost 40 years of research, strategic management researchers can offer managers only some general clues based on their research into the diversity-performance nexus.

This piece of research is yet another attempt to answer some of the questions that surround diversification. However, it does so by studying diversification in a way that differs fundamentally from mainstream diversification research. We will argue that the perspective and the research methodology predominantly employed in diversification research are jointly responsible for the unsatisfactory results obtained so far. The present project is one of the firsts to explore corporate diversification from the perspective of those who are responsible for, or involved in, a diversification project. We will refer to this perspective in this research as a cognitive perspective. A cognitive perspective aims at comprehending managers’ thinking processes, understanding the conceptual systems they employ and depart from, fathom their intentions and decipher the knowledge they possess and the knowledge they develop through learning (cf. Stubbart and Ramprasad, 1990; see also Weick, 1979b; Lakoff and Johnson, 1998).

In doing so, the present research project aims to identify factors that may profoundly influence the course or outcome of diversification projects but which
are currently not fully recognised as such in theories and studies of corporate diversification and diversity. For this purpose, we will develop a cognitive research methodology and examine in detail how (owner-)managers in three different companies talk about, and manage ‘their’ diversification projects. We have chosen to concentrate our empirical research on small and medium-sized enterprises as these offer excellent opportunities to study diversification projects from a cognitive perspective. Studying diversification in small and medium-sized firms holds an extra advantage as research into corporate diversification has hardly paid any attention to these firms.

This introductory chapter offers the reader an understanding of the grounds from which the present piece of research departs. After a review of the various conceptualisations of diversification the strategic management literature offers, the chapter defines what we mean by ‘diversification’ in this project. Next, it discusses the main motives for firms to diversify as recognised in the literature on corporate diversification. This discussion shows that companies may diversify for a range of valid reasons and benefit in several ways from it. The chapter then goes on to outline the fundamental causes of the unsatisfactory outcome of diversification research so far. Subsequently, the fact that diversification by small and medium-sized enterprises has hardly been studied is highlighted as an additional shortcoming of diversification research. Together, these causes have directed the present research project in a number of ways: by suggesting the goals it aims to achieve and the methodological approach it takes. The core of our approach is that we conceptualise diversification in this research as a process of organisational learning and take a cognitive perspective to study it. The chapter ends with an outline of the way this research is organised.

A history of conceptualising diversification

A review of the extensive literature on diversification yields a wide and diverse range of conceptualisations and accompanying definitions. On a more general level there seems to be widespread, albeit largely intuitive consensus among management theorists and managers on the meaning of diversification. Following Ansoff (1957, 1958), diversification commonly refers to ‘entering new markets with new products’. A closer look into the current variety of conceptualisations and definitions, however, reveals several major differences. As the differences often and increasingly went unnoticed, some ten years ago Reed and Luffman (1986) warned researchers and managers of the ‘growing confusion’ about diversification. They argued that as a result of many simplifications and generalisations, clear sight of the specific benefits which diversification strategies offer ‘[have] been lost within the vagaries of fashion’. Their argument is well illustrated by Peters and Waterman’s (1982) advice to
managers to – ‘stick to their knitting’ – which made all diversification moves suspect for a long time (and still does to many).

Since we take the warning of Reed and Luffman (1986) seriously, we start with a historical overview of the most important ways in which diversification researchers have conceptualised this concept. The following overview first shows that some authors – most notably Ansoff – emphasise the act of diversification, while others stress the resulting heterogeneity in a firm’s business portfolio. Second, it turns out that the relatedness among the businesses in a firm’s business portfolio has always been a central concept in definitions of diversification. Finally, in recent years researchers have moved their attention from the content of the diversification strategy sec towards a more managerial-oriented perspective on diversification. Specifically, there is an increasing emphasis on how managers conceive their diversification strategies and diversified portfolios, and on what they learn in the course of a diversification project. Each of the following five subsections discusses a particular conceptualisation of corporate diversification. Besides illustrating the broad variety of views on diversification present in the literature, our aim is to define what we mean by diversification in this research project.

**Conceptualisations stressing the act of diversification**

Ansoff (1957, 1958) was one of the first to discuss the strategy of diversification in scientific management literature (remarkably, at that time Ansoff was director of Lockheed’s Diversification Department). The essence of his work can still be found in most strategic management textbooks, usually as a kind of general list of strategic options open to firms (see e.g. Jauch and Glueck, 1989; Pearce and Robinson, 1994; Johnson and Scholes, 1999). By confronting present and new product missions with present and new product lines, Ansoff created a two-by-two matrix in which he distinguished four generic corporate product-market strategies (see [Figure 1-1](#)). In this product mission/product line matrix, diversification implies the simultaneous departure from present product lines and present product missions or markets. A certain product mission describes the specific job a product is intended to perform and in doing so a product mission defines the market boundaries for a product. A product line refers to the physical and performance characteristics of a certain product.

Some years later Ansoff (1965) elaborated the diversification strategy by constraining a diversification matrix. [Figure 1-2](#) shows that, according to this matrix, diversification can either be horizontal, vertical, concentric, or conglomerate. Horizontal diversification entails moving into other industries at the same stage of the industry chain. When a firm diversifies vertically it generally incorporates a function previously provided by a supplier (backwards) or a customer or distributor (forward). In the case of concentric diversification, a firm seeks to use its knowledge and capabilities in other industries often at a
Three things are particularly worth noticing when considering Ansoff’s notion of diversification. First, by defining diversification as the entry of firms into new markets with new products, Ansoff (1957, 1958) clearly emphasizes the act of diversification. Many of Ansoff’s contemporaries adopted his definition of diversification but most of them did it in more loose terms. For example, Steiner (1964: 11) defines diversification as the ‘entry into new product lines, processes, services, or markets’. In similar terms, Penrose (1959: 109) states that a firm diversifies if it embarks upon ‘the production of new products . . . which are sufficiently different from other products it produces to imply some significant difference in the firm’s production or distribution programmes’. The latter means that diversification may increase the number of ‘basic areas’ of production in which a firm operates. Penrose deliberately remains vague of what she means with ‘sufficiently different’ or a ‘basic area’. She argues that attempts to define diversification more accurately are unnecessary if the purpose is to analyze the process of diversification (as she intended).

Second, and closely related to the preceding observation, Reed and Luffman (1986) note that Ansoff’s classification does not embrace all forms of diversification but refers to growth by diversification exclusively. Ansoff (1965: 132) himself is fairly explicit about this as he, for example, speaks of ‘growth vectors in diversification’ (see also the title of Figure 1-3). Instead of a means to
grow, managers may choose diversification for other, fundamentally different, reasons such as escaping declining prospects in current businesses (cf. Rumelt, 1974) or carrying out a change of corporate direction (cf. Glueck, 1980). Whereas in such situations firms may entirely abandon existing product lines, they will not do so when they seek to exploit growth opportunities. Even more important, if a firm plans to grow, diversification is but one alternative out of a range of possibilities and often not the most obvious.

Finally, like any strategic choice, Ansoff sees the process in which a firm enters into diversification primarily as a ‘rational’ decision process. In the course of this process, he argues that management teams establish goals, analyse the environment, and, using a variety of analytical models, develop several alternatives from which they choose. In doing so, Ansoff artificially distinguishes the formulation of a strategy from its implementation (Mintzberg, 1990a/b). Various studies show that this dichotomy is misleading. These studies suggest that strategies largely emerge out of incremental processes in which thinking, acting and reflecting in interaction establish (perceived) patterns of consistency (see e.g. Mintzberg, 1978; Mintzberg and Waters, 1982). For this reason, Normann (1977) and Mintzberg (1990b), amongst others, argue that a better understanding of processes of diversification requires the exchange of the ‘rational’ decision perspective for a learning perspective.
Conceptualisations stressing the heterogeneity resulting from diversification

Because Ansoff (1957, 1958, 1965) focuses on the growth strategies of individual firms, his classification of diversification strategies is not comprehensive. Mindful of Penrose’s (1959) remark regarding the aspired accuracy of definitions, this may not cause any problems when studying individual companies but problems are certain to arise when the focus shifts to the extent to which (samples of) firms are diversified. As Chapter 2 will show, there is a long-standing tradition in diversification research to measure and compare the degree to which firms are diversified. This kind of research has produced numerous definitions and classifications of diversification (see e.g. Pitts and Hopkins, 1982).

Being one of the first to conduct comparative research into diversified firms, Gort (1962) defined diversification as an increase in the ‘heterogeneity of output’ as indicated by the number of separate markets a firm serves. To determine this he argued that products belong to separate markets if their cross-elasticity of demand is low and if production and distribution processes are to a considerable extent dissimilar (note the similarity with Penrose’s (1959) definition). However, as this kind of data was (and still is) not really readily available, Gort consulted the Standard Industrial Classification (SIC) system instead to ascertain the separateness of markets. In the years to come, multitudes of researchers would follow him (see e.g. Rhoades, 1973; Utton, 1977; Bass et al., 1978; Jacquemin and Berry, 1979; Gorecki, 1980; Song, 1982; Hill and Hansen, 1992).

Gort argued that although ‘there are many exceptions to this’ a classification of industries ‘in most instances’ corresponds to classifications based on products, production processes or raw materials. It is this particular assumption, explicitly justified by Gort but implicitly assumed by many researchers, that has occupied diversification researchers for many years (see e.g. Montgomery, 1982; Varadarajan and Ramanujam, 1987; Hall and St. John, 1994). Discussion among researchers has focused on the problems of using SIC-codes and the implications for measuring the extent of diversification ‘correctly’. Consider for example a manufacturer of earthenware cups that decides to embark into the production of plastic and metal beakers as well. Following the SIC-codes, this decision implies a considerable strategic move transforming the firm suddenly into a conglomerate covering three different branches of industry on the SIC 2-digit level. The basic problem is that any diversity measure based on SIC-codes lacks a theoretical base on how diversification decisions affect corporate functioning.

Definitional problems like these induced Rumelt (1974; see also 1982) to work out an alternative system of diversification strategies which was initially developed by Wrigley (1970). During the years Rumelt’s system has clearly
outstripped Ansoff’s classification in research, for one thing because it does not depend on a firm’s motives for diversification. Peters and Waterman (1982) popularised the main results of Rumelt’s research in their advice to limit diversity and ‘stick to the knitting’ (note that this advice only has limited meaning in Ansoff’s classification of growth strategies). We only reproduce the core of it here in order to grasp its essence. At the basis of Rumelt’s system stands the definition of a diversification strategy as a firm’s ‘commitment to diversity per se, together with the strengths, skills or purposes that span this diversity, shown by the way in which business activities are related to one another’ (Rumelt, 1974: 29). This definition gives rise to a number of observations.

Like Gort (1962), Rumelt (1974) too was interested in the heterogeneity of a firm’s business portfolio that results from an act of diversification rather than in the act itself. However, as he argued that diversification can hardly be defined in general terms, he studied the historical diversification pattern of individual firms. Figure 1-3 shows two examples of diversification patterns. To reconstruct such patterns, Rumelt focused on ‘business activities’ instead of ‘industries’ (or ‘markets’) as most researchers before him had done.

Whereas industry-based definitions assume the perspective of an external analyst, ‘business’ definitions start from the perspective of the firm and allow for greater specificity (cf. Pitts and Hopkins, 1982). Rumelt used independent judges to determine the number of ‘strategically independent’ businesses. He further selected three measures of diversity (the specialisation ratio, the related ratio, and the vertical ratio) to divide firms into one of several (sub)categories of diversification patterns. Figure 1-4 shows the four primary categories, which all but the ‘single business’ have subcategories. In fact, the examples of diversification patterns in Figure 1-3 are two subcategories of the primary category ‘dominant business’. 
Conceptualisations stressing a managerial perspective

Despite Rumelt’s (1974) alternative approach, Galbraith and Kazanjian (1983, 1986) criticise all categorisation schemes and definitions that are based upon aggregate business-level assessments (like those of Ansoff). They argue that such schemes ignore the operational side of diversification and are for that reason of little help to managers who are considering specific diversification strategies. As they put it, ‘the schemes are not implementation oriented’ (Galbraith and Kazanjian, 1986: 49). To meet these needs, Galbraith (1983) developed a framework in which he conceptualised strategic diversity in the tradition of the resource-based view of the firm. By suggesting that the extent of diversification is a function of a firm’s resources, the resource-based view is particularly helpful in explaining the direction of diversification expansions (see e.g. Penrose, 1959; Wernerfelt, 1984; Montgomery, 1994).

Central in Galbraith’s (1983; see also Galbraith and Kazanjian, 1986) framework stands the concept of ‘centre of gravity’. This concept connects a firm’s strategic development with the particular stage in the industry chain in which the firm started its operations and was successful for the first time. According to Galbraith, the latter is crucial as each stage in an industry chain requires different resources and has different success factors. The business lessons learned at ‘their’ stage and in ‘their’ industry shapes the organisation of the company and the mind-sets of its managers. It is at this stage where the firm establishes its centre of gravity as a kind of anchor from which management will...
induce strategic changes. Galbraith particularly stresses the contrasting characteristics of upstream and downstream stages (see Figure 1-5). Whereas the former reduce a multitude of raw materials to a few standard commodities, the latter produce a variety of products to meet distinct customer needs. As a result, the bases of competition, organisational structures, dominant operations, and key managerial processes tend to differ fundamentally between upstream and downstream companies.

The concept of centre of gravity offers a novel perspective on diversification strategies. It suggests that in addition to the degree of relatedness between industries, the stage at which a firm enters another industry matters. To Galbraith the latter is clearly the more important. He contends that related diversification can only occur when a firm enters a related industry at the same centre of gravity. In contrast to an intermediate or unrelated diversifier who has to learn an entirely new way of doing business, a related diversifier ‘only’ has to get acquainted with a new business in a new industry. As the number of businesses away from a firm’s centre of gravity as well as the distance between the these businesses and the centre increases, managerial problems grow progressively; the more so if diversification involves a move from upstream to downstream stages or vice versa.

Just as Rumelt’s classification (1974, 1982), Galbraith’s (1983) framework also allows for a description of the gradual development of diversified companies over time. The concept of centre of gravity thereby highlights the role of a company’s top-management, whose role is fully ignored by Rumelt (as well as by Ansoff). It is interesting to note that Illiritz and Zeithaml (1995) found support for Galbraith’s hypothesis that managerial relatedness may be more important than other kinds of relatedness in achieving high performance. Furthermore, by talking about the mind-sets of managers and the lessons they learn in ‘their’ stage, Galbraith implicitly focuses attention on the intertwined importance of managerial learning and cognition. The authors in the next subsection take these notions one step further in their conceptualisations of diversification than Galbraith.
Overlooking the variety of definitions that have been reviewed so far, the fuzziness of both industry and business boundaries touches the heart of the problem of defining diversification. Ansoff’s ‘product mission’ (1957, 1958), Penrose’s (1959) ‘basic area’, Gort (1962) ‘markets’, the categorisation of industries based on SIC-codes, Rumelt’s (1974) ‘business activities’ and Galbraith’s (1983) ‘industry’ and ‘stages’ are all difficult to define exactly. What is the ‘paper’ industry and when is a company to be called a ‘paper’ company? Should an industry be named after the materials it uses or after the products it produces? Likewise, should we name a company after the products it produces or after its centre of gravity? The fact that most firms use a variety of raw materials and semi-manufactured products and turn these into a host of different products extends these problems considerably.

Moreover, given these problems, Mintzberg (1988) argues that it makes little sense to talk about a single chain of what in fact is a network of interrelated stages. That which we call an ‘industry’ is actually a ‘node’ where inputs and outputs from many ‘industries’ meet in a specific business. Mintzberg therefore argues that industries and businesses are not the result of negotiation between researchers but the creation of managers. This view matches closely with that of Abell (1980).

Abell (1980) sees businesses originating as companies make unique choices on three dimensions: (1) the customer group describes who is being satisfied, (2) the customer functions describe the customer needs or what is being satisfied, and (3) the technologies describe in a broad sense how customers are satisfied. Abell proposed these dimensions on the basis of Ansoff’s (1965) remark that a given type of customer will frequently have a range of unrelated (or related) product missions. The dimensions leave substantial room for segmentation of customer groups, differentiation of offerings across these groups, and differentiation from competitors. To illustrate his point, Abell’s three-dimensional space for a hypothetical publisher. To define diversification in Abell’s three-dimensional space is less straightforward than in any of the schemes above. Outright, unrelated diversification is clear as it involves simultaneous changes along the three dimensions. Defining related diversification, however, is much more subtle and dependent on the way management conceptualises each single business as well as any particular set of businesses (Mintzberg, 1988; Ginsberg, 1989). In search of competitive advantage, managers, can and will, continually modify their businesses by
redefining, recombining, and reconfiguring them. These processes of conceptualisation and modification are essentially cognitive in nature:

‘All businesses have popular conceptions. Some are narrow and tangible, such as the paper clip or canoe business. Others are broad and vague, such as the so-called transportation or financial services businesses, and this can range to the ethereal, such as the business of reducing function. All of these, no matter how tangible, are ultimately concepts that exist only in the minds of actors and observers . . . It therefore becomes possible, with a little effort and imagination, to redefine a business . . . and so change how it is conducted.’  (Mintzberg, 1988: 55)

So, according to Abell (1980) and Mintzberg (1988), the definition of a business, and thus of diversification, exists in the mind of the beholder and
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results from (managerial) sense-making. The business activities in a firm and the relations settled between them are the result of active, ongoing sense-making of its management. In this view, only the management of a diversifying company can fully indicate what is ‘new’ and ‘different’ to a business and therefore they are the only ones to mark a newly added business as diversification. Precisely for this reason, Stimpert and Duhaime (1997) asked top managers of diversified companies for their perception and understanding of the relatedness in their portfolio of businesses. In a similar piece of research, Nayyar (1992) mailed a self-administered questionnaire to CEOs of large service firms and found ‘little evidence of any similarity’ between measures of corporate diversification: measures based on internal data differed significantly from those based on externally available data. To explain this difference, Nayyar, among other things, points to the possible importance of intangible linkages between businesses that are invisible to outsiders. We argue that the latter directly results from managerial sense-making which differs from sense-making by external analysts.

Mintzberg (1988) incorporated the element of managerial sense-making in his framework of corporate generic strategies. Firms may distinguish, elaborate and extend their core business(es). Whichever they pursue, Mintzberg argues that once in a while management will have to reconceive the core business(es) by redefining and reconfiguring the portfolio of businesses. Figure 1-8 shows the levels of content of strategy as distinguished by Mintzberg.
classifies diversification as an extension of a firm’s core business(es). If firms extend their core business(es) they encompass other businesses within their organisation. Like in Figure 1-8, this means linking up the circle(s) representing the core business(es) with other circles. Mintzberg furthermore distinguishes between diversification strategies on the one hand and chain integration strategies on the other, although he notes that the distinction between these two is not always obvious. To him diversification refers to businesses that are not in the same chain of operations. Related diversification is based on some common competence or asset while unrelated diversification is not. In the case of ‘chain integration’ a firm extends its operating chains downstream or upstream.

**Conceptualisations stressing the process of organisational learning**

Building upon the preceding notions of managerial conceptualisation, several authors have stressed that diversification is in essence a process of organisational learning (e.g. Normann, 1977; Miles, 1982; Kazanjian and Drazin, 1987; Ginsberg, 1990; Mintzberg, 1990b). Central to this process of
learning is the development of knowledge and skills for managing new businesses and competing in new domains (cf. Miles, 1982). Kazanjian and Drazin (1987) state that during this developmental process, diversifying companies learn both on a cognitive and a behavioural level. On a cognitive level, they develop and refine new ways of conceiving and reconceiving individual businesses and relationships between businesses. Normann (1977), for example, argues that a vague vision about a new business will gradually develop into a more concrete business idea as an organisation learns about the new business. On a behavioural level, this cognitive development will lead to institutionalising new skills and practices, which become embodied in the organisational systems and processes and in the people working in the organisation. Part of the organisational knowledge, skills and practices are those developed by top-management to manage the (new) strategic variety resulting from diversification. Prahalad and Bettis (1986; see also Bettis and Prahalad, 1990) refer to these as the ‘general dominant management logic’.

The learning perspective on diversification highlights (at least) three important elements of diversification. Firstly, diversification is in essence a process of organisational learning during which knowledge and skills are developed to deal with a new business and its environment. Secondly, the process of diversifying is a process of experimentation, which contrasts with the implementation of a detailed plan. By way of illustration, in his research on the six largest U.S. tobacco companies, Miles (1982: 155) observed that the diversification attempts of these companies were preceded by long periods of experimentation and learning (up to fifteen to twenty years):

‘Each firm approached the initial occasion of diversification experimentally. They all tended to begin with small resource commitments and with businesses that were closely related to their traditional operations. By trial and error, they gradually built a base of knowledge about diversification and a repertoire of skills for choosing and managing their new domains before committing themselves to a full-blown diversification strategy.’

Thirdly, relatedness between new and existing businesses should (also) be perceived in terms of (dis)similarities of required knowledge and skills rather than in terms of products and SIC-codes. The latter may not serve as good indicators of the ultimate success of a diversification attempt. For example, as Prahalad and Bettis (1986) argue, the strategic variety of the diversified portfolio may be too great and require too many, fundamentally different ‘dominant logics’. We will go deeper into the learning perspective on diversification, and research that has been undertaken from this perspective, in Chapter 2.
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Diversification: A working definition

The preceding historical overview makes clear that through the years corporate diversification has been conceptualised from different angles and defined in fairly distinct ways. We discern three, partially parallel, streams of development in the conceptualisations of diversification over time. Firstly, the initial focus on the act of diversification shifted via a broad attention to the heterogeneity that result from (a series of) diversification movements towards a focus on the process of diversifying. As will become clear in Chapter 2, the broad attention to the heterogeneity in firms’ portfolios is still predominant in diversification research today and indicates that there is a difference between the way diversification is conceptualised in the (management) literature and in diversification research. Moreover, it is interesting to note that Penrose (1959) already pointed to the importance of the process of diversifying forty years ago.

Secondly, over the years the governing perspective on diversification has shifted from that of an external analyst (including researchers of diversification) to a managerial one. The emphasis that is more recently put on the process of organisational learning by several authors can be considered as a specific interpretation of the latter.

Thirdly, whereas all five types of conceptualisation focus on the relatedness between new and existing businesses, they clearly differ in the kind of relatedness they stress. Over time the emphasis has shifted from a focus on tangible similarities (e.g. product, technology) to a focus on more intangible relatedness (e.g. required knowledge and skills). Ansoff (1957, 1958) points to the relatedness in terms of technology and marketing. Gort (1962) examines similarities in demand and products and production and distribution processes. Rumelt (1974) considers strategic relatedness in terms of strengths and skills. Galbraith and Kazanjian (1983, 1986) emphasise the differences between stages in the industry chain and stress the prevailing mind-sets of managers. Finally, authors like Mintzberg (1988; 1990b), Abell (1980) and Miles (1982) consider the relatedness in terms of required knowledge and skills.

Together the three developments in conceptualising diversification indicate that diversification has moved from the domain of external analysts and researchers studying diversification towards the domain of managers responsible for diversification projects. Increasingly, authors on diversification recognise that both tangible and intangible forms of relatedness between new and existing businesses are subject to and result from managerial sense-making, whereby the process of sense-making entails a learning process. We infer from this that relatedness is in essence a cognitive concept. Managers mentally and socially construe businesses and the kind of relatedness between these businesses (although in doing so they will be influenced by governing opinions about businesses and relatedness between businesses). The only valid way to identify separate businesses therefore is to ask managers themselves about the
relatedness between new and existing businesses (see e.g. Nayyar, 1992; Stimpert and Duhaime, 1997). Tangible relatedness between businesses like similarities in markets served, the resources used or technologies employed are at best proxies of diversity instead of its determinants. To us this approach meets Pitts and Hopkins (1982) request for the measurement of diversity in ‘managerially meaningful’ terms. It also avoids some important disadvantages of measuring relatedness from an external perspective, in particular problems that result from the definition of categories which enclose only a certain set of similarities, and the assignment of firms to these categories.

Our sympathy in this research project clearly lies with approaches that emphasise managerial sense-making, which in essence reflects a process or managerial and organisational learning. According to this view, we speak of diversification if the management of the diversifying company construes a new business as fundamentally different from its existing businesses, be it in tangible or in intangible terms. Moreover, we distinguish between diversification on the one hand and diversity or degree of diversification on the other (cf. Pitts and Hopkins, 1982; Grant et al., 1988; Ramanujam and Varadarajan, 1989). Diversification then refers to the entry of a firm into what its management considers as new businesses outside its existing business(es). Diversity describes the extent to which a firm is simultaneously active in businesses which its management construes as fundamentally different. It is a measure of the heterogeneity in a company’s activities; diversification thus increases a firm’s diversity. Finally, the process of diversification encircles the thinking and actions taking place between the very first embryonic ideas on the new business and the moment the new business is seen as a full, established one. We have used this conceptualisation of diversification to select case studies in this research project. However, to link up to the majority of diversification studies, we will also characterise the diversification projects in the companies we studied in terms of the other conceptualisations discussed in the foregoing pages.

After having explored the ‘what’ of diversification in the preceding sections, we now turn to the ‘why’ of diversification.

**Motives for diversification**

About thirty years ago, diversification was considered a sure and even necessary route to corporate success. Characteristic for the spirit of that time is Steiner’s (1964: 11) adage ‘diversify or die’. He argued that ‘in the long run, a firm that does not diversify will fade and die. Not every manager understands this’. In a similar vein, Judelson (1968: 7) stated that ‘it is academic for a major company to wonder whether it should diversify’. He goes on to argue that companies should actively pursue diversification and grow into conglomerates if possible:
‘[the conglomerate] is destined to become the bulwark of the economy of the future, even as it is bolstering the economy of today’ (1968: 13). Both Steiner and Judelson considered the exploitation of available managerial potential as the main rationale behind diversification. ‘The conglomerate is the end and continuing result of the managerial revolution’, Judelson contends (1968: 13). Unfortunately for their arguments, many conglomerates either went bankrupt or were taken over and split up during the seventies and eighties. As a result, the popularity of diversification declined considerably. The new adages became ‘stick to the knitting’ (Peters and Waterman, 1982) and ‘back to the basics’ (Lewis, 1984). From the eighties onwards, managers became more careful in enlarging their business portfolio. Looking at the diversified portfolios of the vast majority of companies quoted at the stock exchange, it has, however, never restrained companies from diversifying and we contend that it will never do so.

Companies nowadays diversify for a variety of reasons. In particular authors that have examined diversification from an economic perspective consider some of these reasons as legitimate while they classify others as ‘irrational’. Morck et al. (1990), for example, contend that managers use the diversification strategy to pursue their own personal goals instead of seeking to meet company objectives like maximisation of shareholder value or continuity in the long term. According to Shleifer and Vishny (1989) managers tend to diversify as a means to make manager-specific investments, as opposed to firm-specific ones, which offer them higher salaries and more freedom in formulating strategic policy. In a similar vein, Amihud and Lev (1981) put forward that managers may turn to strategies of diversification to lower their own, largely undiversifiable ‘unemployment risk’ (e.g. the risk of losing their job, their professional reputation, etc.). To protect shareholders against the dangers of these value-reducing strategies, it is argued that managers should have significant ownership stakes in their company (Jensen, 1986; Shleifer and Vishny, 1989).

Opposed to these ‘irrational’ reasons, the strategic management literature on diversification considers a variety of motives as ‘valid’ or ‘legitimate’. These reasons show that firms may diversify for both proactive and defensive reasons and pursue various goals with it. We have grouped the variety of diversification motives into six main categories:

1. To **survive poor performance and declining prospects** in its current businesses (e.g. Reed and Luffman, 1986). In these cases, the markets on which a firm sells its products (or delivers its services) pass beyond lifecycle maturity and start to shrink, its products are pushed away by substitutes or technological breakthroughs have rendered them obsolete and management does not see any possibility to catch up. Rumelt (1974: 82) refers to this motive as the ‘escape paradigm’.

2. To **reduce exposure to business risk** and secure a higher stability in its earnings (e.g. Amit and Livnat, 1988). In such instances, managers
generally want to combine businesses that are ‘counter-cyclical’, i.e. react
differently to particular economic cycles (Dess and Miller, 1993). Note that
this is a typical strategic management motive. The literature on corporate
finance states that stockholders can more easily (and cheaper) achieve such
risk-reducing effects themselves. An exception to this rule concerns the
increased debt-capacity that may result from diversification (Lewellen,
1971; Amit and Livnat, 1988).

(3) To pursue growth opportunities outside the company’s current domain
(e.g. Ansoff, 1965; Reed and Luffman, 1986). This motive may hide a host
of different reasons. Firms may decide to diversify as the markets in which
they are currently operating do not offer opportunities to expand. It may
also be stimulated by repeated requests of existing customers or be an
offspring of the firm’s R&D program.

(4) To exploit economies of scale and scope and increase efficiency (e.g.
Penrose, 1959; Williamson, 1975; Besanko et al., 1996). According to the
resource-based view, rent-seeking firms have an incentive to diversify to
exploit underused resources. Teece (1980, 1982) argues that this will only
occur if market failures (e.g. significant transaction costs) do exist and
unused resources cannot be sold efficiently in the market; see Amit et al.
(1989) for evidence of this argument. Specific, indivisible physical assets,
technological know-how, organisational skills and brand names are
examples of production factors that are generally difficult to sell in the
market and give rise to economies of scope (Douma and Schreuder, 1991).
Together these factors often constitute a firm’s ‘core competencies’.

(5) To pursue ‘conglomerate power’ (e.g. Hill, 1985; Montgomery, 1994).
Firms may outperform non-diversified firms not because they are more
efficient, but because they exploit their so-called ‘conglomerate power’.
Conglomerates may yield power in three ways: cross-subsidisation, mutual
forbearance, and reciprocal buying (Edwards, 1955; Montgomery, 1994).

(6) To decrease the dependence on a limited group of suppliers or customers
(e.g. Harrigan, 1985; Krijnen, 1992). This may be done either by
controlling the operating chain upstream or downstream through a strategy
of vertical integration or by enlarging the number of distinct customer groups.

A number of comments are in place with respect to the foregoing motives for
diversification. Firstly, the preceding motives for diversification are interrelated
and not necessarily mutually exclusive (cf. Reed and Luffman, 1986). In
practice, decisions to diversify are often based on a combination of motives
instead of just one. For example, a desire to reduce the exposure to business risk
is perfectly compatible with an aim for growth.

Secondly, Luffman and Reed (1986) note that diversification is hardly ever
the most obvious strategic alternative. In many instances, firms may realise the
objective they pursue in a much easier way than through diversification. For
example, technological disadvantages can also be offset by merging with a competitor and market penetration is often a faster and much cheaper way to utilise excess capacity. Only if these routes are not available or preferred does diversification become a viable alternative. This is, for example, the case if the management of a company likes to stay independent or competition is too severe in the markets in which it currently operates. Hence, the validity of a certain motive is closely connected to the objectives pursued, the competitive environment in which a firm operates and the viability of alternative options.

Thirdly, the power of any of these motives for explaining the current practice of diversification does not increase with the degree to which a motive is marked as legitimate in literature. In fact, the opposite may be true. For example, based on their finding that managers of management-controlled firms engage to a greater extent in risk-reduction activities than managers of owner-controlled firms, Amihud and Lev (1981) conclude that the former more often diversify for ‘irrational’ reasons.

**Research on diversification: A critique**

We started this chapter with the observation that diversification has emerged as a central topic in the history of strategic management research. Although scholars have paid extensive attention to conceptualising diversification – which is illustrated by the preceding historical overview –, empirical work on the diversity-performance nexus has clearly dominated diversification research (cf. Ramanujam and Varadarajan, 1989; Datta et al., 1991). Enclosing hundreds of published studies, the size of empirical diversification research is impressive. However, several authors have criticised the aggregate outcome of this research and marked it as unsatisfactory if not disappointing.

The variation in results of empirical studies is so large that it often leads to confusion and contradicting interpretations. Chapter 2 presents an overview of these findings and interpretations. It shows that some studies conclude that diversified firms with closely related business activities achieve the highest performance (e.g. Rumelt, 1974; Bettis and Mahajan, 1985). Other studies, however, reach the opposite conclusion and conclude that conglomerates, with a low degree of relatedness between their businesses, perform best (e.g. Michel and Shaked, 1984; Luffman and Reed, 1984). Still another group of studies did not find any relation between the degree of diversification and performance (e.g. Gort, 1962; Bettis and Hall, 1982; Varadarajan and Ramanujam, 1987). Moreover, incorporation of context factors failed to elucidate the nebulous diversification picture. For example, studies that investigated the moderating effect of market structure found that it exerts an even greater influence on firm performance than a firm’s diversification strategy (e.g. Bettis, 1981; Christensen and Montgomery, 1981; Wernerfelt and Montgomery, 1986).
Widely divergent and confusing results like these have led to quite severe judgements on diversification research. Consider for example the following quotations. In a critical evaluation of the many ‘myths’ around diversification, Leontiades (1989: 5) states that: ‘Progress thus far in developing a testable explanation of the diversification movement of business firms during the last decades or so […] is practically nil’. He goes on to argue that conflicting findings of different diversification studies have compounded to the confusion around diversification. In a similar vein, Datta et al. (1991: 545) conclude after an extensive review of the research on the diversification-performance nexus that ‘after almost 25 years of fairly intensive research and investigation, very little can be said with certainty on the diversification-performance relationship’. In their overview of the diversification literature, Ramanujam and Varadarajan (1989: 537) reach a similar conclusion and they add to it: ‘It is difficult for us not to conclude […] that much room remains for breakthroughs in this seemingly oversaturated topic of inquiry’. All in all, criticism is severe and a complete and coherent theory that explains the success and failure of individual diversification attempts is still lacking.

The criticism on diversification research is staggering, especially if we take the size of the empirical research into account. How could this happen? How is it possible that while so many scholars have studied diversification, the yields are so poor and so confusing? Where did it go wrong? Or has diversification research never been on the right track? Based on an analysis of previous diversification research (see Chapter 2), we consider four fundamental causes responsible for the unsatisfactory outcome of research into diversification so far. Close attention to these causes is important if only because they hold several clues for improving diversification research.

**Causes of disappointment**

Firstly, the mainstream of diversification research has predominantly applied ‘coarse-grained research methodologies’ (see Harrigan, 1983). Such methodologies use cross-sectional data and are especially helpful in testing hypotheses and identifying general relationships. They do, however, not fit with the many exploratory and explanatory research questions that still need to be answered about diversification (cf. Grant et al., 1988). For example, why do some firms succeed in diversifying into (seemingly) unrelated business activities, while others meet so many difficulties in entering (apparently) closely related business areas? We contend that while our knowledge of diversification is still in an embryonic state of exploration and explanation, the mainstream of diversification research has leapfrogged these essential steps and already rushed into the mature, theory-testing phase.

Secondly, although mainstream diversification research has studied an impressive number of moderating context factors, research attention has been
highly fragmented. We have identified only four main industry variables and ten main organisational factors that were found to moderate the relationship between diversity and performance (see Chapter 2, Table 2-6). However, because the majority of studies have only incorporated one or two moderating variables in their research design, the aggregate and interacting influence of these factors remains largely unknown. In addition, mainly due to the coarse-grained research methodologies that were predominantly employed in research on diversification, these factors have not been studied in depth. As a result, the main research findings are both rather superficial and relate to an aggregate level. Moreover, there are no guarantees at the moment that all moderating factors are known. Although understandable from an empirical research perspective, it is sometimes difficult to escape the impression that the availability of databases had a decisive influence on the variables studied.

Thirdly, partly due to the preceding causes, current knowledge of the process in which diversification strategies come about, is extremely limited. Diversification studies have focused on the diversity-performance nexus and mainly studied diversification after it has taken place instead of during its development (cf. Kazanjian and Drazin, 1987). Several recent studies (on diversification and related topics) show that this can be a serious shortcoming as the process can have a profound influence on the outcome (e.g. Dundas and Richardson, 1982; Burgelman, 1983; Jemison and Sitkin, 1986; Haspeslagh and Jemison, 1991). As a consequence, diversification research has not developed any theories that explain the success or failure of individual diversification projects.

Fourthly and finally, most researchers have studied diversification from the perspective of an external analyst. In doing so, they have implicitly imposed their view of the world on the diversification projects studied, often stressing the importance of economic-technical aspects of diversification – i.e. content and context factors (cf. Mintzberg, 1988; Ginsberg, 1989). However, not researchers but managers influence and steer the process of diversification. Their ‘ingrained way of perceiving the world’ (Mintzberg, 1987: 16) reflects the cognitive dimension of diversification strategies. In taking the perspective of an external analyst, the cognitive dimension is completely lost.

The diversification strategy in SMEs

If we consider the companies that were studied in the mainstream of diversification research, we have to add an important shortcoming to the critique on diversification research in the preceding section. Diversification researchers have focused their efforts primarily on large, multinational firms that are quoted on the stock market. As a consequence, a substantial (empirical) literature on diversification in large firms exists while the literature on small and medium-
sized enterprises (SMEs) is nearly non-existent. Only recently a few (survey) studies have examined diversification among SMEs. Although these exploratory studies highlight only a limited number of aspects of diversification, they make crystal-clear that diversification is not the sole domain of large companies. Based on these studies we estimate that roughly one third of all SMEs are diversified to a greater or lesser extent (STRATOS, 1990; Robson et al., 1991; Gankema et al., 1994; see Chapter 3 for the basis of this estimation). Considering both the distinctive features of SMEs and the few diversification studies conducted among SMEs, we argue that diversification by SMEs and large firms may differ fundamentally. We will deal with both shortly in the following pages and refer to Chapter 3 for a more extensive treatment of past research into diversification (and growth) by SMEs.

The literature on SMEs pays ample attention to the characteristics of SMEs in order to differentiate these from large (multinational) firms. SMEs have been defined in many different ways, using a variety of criteria (see e.g. Zwart, 1991; Storey, 1994). By far the most common way to define a SME is based on the number of employees. Firms that employ less than 100 people are generally considered as small while firms that employ between 100 and 500 people are marked as medium-sized. However, to us the more important characteristics are independent from the criterion of size. Firstly, the concentration of ownership in the hands of its director(s), gives the ‘owner-manager’ a key position in the firm. His personal characteristics, abilities and skills, experience and education are all of crucial importance to the development of his company (see e.g. Begley and Boyd, 1987; Bird, 1988; Davidson, 1991). The owner-manager’s position is incomparable to the position of top-managers in large firms. Secondly, SMEs face important limitations in resources and often have deficiencies in functional skills (Siropolis, 1990; Weinrauch et al., 1991). The importance of this characteristic is, for example, also apparent from Churchill and Lewis’ (1983) stage model of small business growth in which restrictions with regard to finance, personnel, systems and business resources are central elements.

The few studies on diversification in SMEs illustrate the existence of some important differences with large firms. By way of illustration, Lynn and Reinsch (1990) found that personal reasons were by far the most important for owner-managers of SMEs to diversify. Among these, ‘benefiting a spouse’ and ‘providing variety’ were mentioned most often. Shareholders of large firms will almost certainly not accept such motives and mark them as ‘irrational’. But are they for SMEs? Lynn and Reinsch also found that mainly due to capital limitations most SMEs diversify through internal development. In contrast, for large firms acquisition seems to be a more common way to diversify (see e.g.

1 Wherever we refer to the male pronoun ‘his’ or ‘he’, the reader is invited to read the female equivalent ‘her’ and ‘she’ as well.
In the first part of this chapter, we have discussed how conceptualisations of diversification have changed in the past forty years and indicated that a cognitive approach with a focus on processes of learning builds upon the most recent ones. We then paid attention to motives for firms to diversify their business activities, which threw some light on the strategic contexts in which diversification takes place. Subsequently, we criticised the mainstream of diversification research and identified some fundamental causes for its disappointing results and pointed to near absence of research on diversification by SMEs. We are now ready to formulate the rationale for the present research including its purpose and goals.

The rationale of this research project: purpose and goals

It is not by coincidence that diversification is such an important topic in strategic management and so extensively studied. Although managers have become more careful about starting up diversification projects, the strategy of diversification still is an important element of the strategic repertoire of companies. The large majority of firms quoted on the stock exchange are diversified to a greater or lesser degree and, as indicated in the preceding section, a substantial part of SMEs is too. As we have explained in the foregoing chapters, managers may have several reasons for diversifying outside their current business(es). However, whenever they decide to diversify their portfolio of business activities, be it voluntarily or out of sheer necessity to save their company’s life, the mainstream of diversification research does not seem to offer a lot of help to them. Given the widely divergent research results, research efforts are more likely to be confusing than directive to managers.

In our view, the main reason for this is that mainstream diversification research has concentrated on explaining the relationship between portfolio diversity and firm performance. In line with this, researchers have largely based their inquiries on theories of diversity, which offer explanations for the existence of multi-product firms (see e.g. Teece, 1982). Studying diversification after it has taken place fully corresponds to such a focus but has not resulted in building theories that explain the success or failure of individual projects. In the absence of such theories, after almost 40 years of research, strategic management can only offer managers some crude and general clues on how to diversify. Examples of such general clues concern the adoption of a multidivisional structure and the importance of carefully managing intangible assets such as managerial knowledge. Following the distinction made above between diversity (the extent to which a firm is active in various businesses) and diversification...
(the entry of a firm into new businesses), we will call such a theory, a theory of diversification (as opposed to a theory of corporate diversity of which there are several; see Chapter 2).

Several studies indicate that such a theory will meet a strong managerial need. Biggadike (1976), for example, found that it took entrant businesses of large U.S. companies on average as long as eight years to reach profitability. Porter (1987) examined more than 3,600 diversification attempts undertaken by 33 leading U.S. companies over the 1950-1986 period. More than half of these attempts were divested within five to ten years after starting them up or acquiring them. A replication study by Douma (1991), enclosing 242 new ventures of ten large Dutch companies in the period 1966-1981, largely confirmed Porter’s results. These findings make Porter’s (1987: 45) conclusion that this ‘paints a sobering picture of the success rates of [diversification] moves’ sound like an understatement.

Problem situation

So, diversification is an accepted and recurrent strategic option to managers but considerable risks for failure are involved with it. Although previous diversification research has made some substantial contributions, there are still a lot of basic questions with respect to the process of diversification that are waiting for an answer. We contend in this research that diversification research can make considerable progress by changing its dominant research approach. The four causes of disappointment, which we identified in the foregoing pages, contain several important clues for this redirection. Most importantly, instead of testing a limited number of content issues from a researchers’ point of view, there is a need to explore the process and context of individual diversification projects from the perspective of the managers involved. Such a direction matches with recommendations made by Grant et al. (1988) and Ramanujam and Varadarajan (1989), amongst others:

‘To gain insight into the complex interactions between strategy, organisation, and environment, detailed examination of the experiences of individual firms is needed.’ (Grant et al., 1988: 796)

‘We need a more daring approach that shows a willingness to wrestle with admittedly difficult process and context issues instead of continuing to be fixated on the more tractable but overworked content issues.’ (Ramanujam & Varadarajan, 1989: 544)

Moreover, studying diversification projects from the (biased) perspective of the managers responsible for, and involved in, these project links up with the most recent conceptualisations of diversification that stress learning processes of managerial sense-making. We therefore argue that if we want to say anything meaningful about what is going on during the process of diversification, we
cannot but take more than serious notice of the thinking processes, conceptual systems, intentions and personal knowledge that inform their actions. If we do not, we as researchers only and fully trust upon our own (biased) perspectives and thoughts (which did not bring us any further than where we stand right now).

For these reasons, this research project is based on the presumption that taking a cognitive perspective holds the potential of gaining valuable insights into the complex interactions between factors that determine the ultimate success and failure of diversification projects (including the definition of success and failure itself). Recall that we defined a cognitive perspective on the first page of this chapter as a research perspective that aims at comprehending managers’ thinking processes, understanding their conceptual systems that they employ and depart from, fathom their intentions and deciphering the knowledge they possess and the knowledge they develop through learning (cf. Stubbart and Ramprasad, 1990; see also Weick, 1979b; Lakoff and Johnson, 1998). Together, these insights throw light on their processes of sense-making.

A cognitive perspective enables us to examine managerial issues concerning diversification from an emic or insider’s perspective as opposed to an etic or outsider’s view. It offers the possibility to ask a whole set of new questions. By way of illustration, which factors do managers of diversifying firms see as important and crucial to the success of their diversification projects? How do they conceive the problems they face? How do they manage the diversification project and deal with problems and (environmental) changes? How do they evaluate the performance of the diversification project and when do they find it a success or a failure?

Because we consider the lack of attention paid by researchers to diversification by SMEs as an important shortcoming, we have deliberately chosen to concentrate our empirical research upon diversification by SMEs. Growing SMEs are important creators of (new) employment and economic wealth (see e.g. Sengenberger et al., 1990; van der Horst and de Lind van Wijngaarden, 1998; CBS, 1999) and, as noted in this chapter, diversification may entail an important contribution to the growth of SMEs. If only for this reason it pays to study SMEs. As an additional advantage, their smaller size and (expected) number of people involved in diversification projects enable us to study three (smaller) diversification projects instead of just one large one. The nature of the research methodology that follows on from the proposed research approach (see further on) is quite research intensive, partially because it is oriented towards individual managers. In large firms many managers at various organisational layers are often involved in diversification projects (compare e.g. Burgelman, 1983). The many interactions among these managers hide a complex (and intriguing) social process. By focusing upon the individual, a cognitive perspective undervalues the social processes between individuals.
Purpose and goals

The main purpose of this research project stems directly from the notions in the preceding sections:

- The identification of organisational and contextual factors that in interaction shape the course of diversification projects and determine their ultimate success or failure within small and medium-sized enterprises, and the examination of the process in which these factors interact.

In realising this purpose, this research intends to contribute to a theory of diversification that explains the success and failure of individual diversification projects and offers managers advice on how to diversify. In pursuing this purpose, we will especially be aware of factors that were not, or only incidentally, considered in previous diversification studies. Given the research approach dominant in these studies and the results of previous process-oriented research (see e.g. Miles, 1982; Burgelman, 1983; Jemison and Sitkin, 1986), we expect such factors to be closely related to the process of diversification, in particular to the learning processes managers go through during the course of a diversification project.

The present piece of research is aimed at two different audiences. The goals for each of these groups are derived from the purpose formulated above. For an academic audience, on the basis of the insights and themes that emerge from this research we aim at generating a set of hypotheses that may serve as a starting point for further (possibly hypothesis-testing) research. For a managerial audience, we want to offer a new perspective on diversification strategies. A cognitive perspective and the focus on the process of diversification helps us in reaching this goal. A new perspective on diversification may inform and help managers to draw their own conclusions and implications for the diversification projects they are involved in. As researchers we are not in a position to advise managers on their own diversification strategies; especially not when research is based on a few case studies only. It is our task as researchers and theorists to describe what managers are doing and try to make sense of it by categorising what we see, relate it to earlier findings and theories, and present this back to practitioners.

Towards an alternative research approach

The moment we established the purpose and goals of this research, an additional goal emerged. A cognitive perspective on diversification to study learning processes requires research methodology that differs fundamentally from that employed in the mainstream of diversification research. In the absence of such
ready-made methodologies, we have to develop some ourselves. The literature on organisational learning and managerial and organisational cognition in particular, offers some excellent building blocks which we can use to compose the research methodology we need. In addition to the above purpose and goals related to corporate diversification, we therefore add the following, methodological goal:

*The development of research methodology that enables us to examine the process of diversification from a cognitive perspective and register the processes of (organisational) learning taking place.*

The *research strategy*, in the context of which the research methodology has to be used, originated from the main purpose of this research and the analysis of and critique on previous diversification research. The focus on individual diversification projects in their own contextual setting, the explicit attention to the process of diversification and the cognitive perspective requires that we study diversification *while* it is happening instead of after it has happened. This fact combined with the exploratory nature of the research point in the direction of *case studies* as the preferred research strategy (*cf.* Yin, 1989). Eisenhardt (1989: 548) argues that case studies are extremely useful when a fresh perspective is needed: ‘it is particularly well suited to new research areas for which existing theory seems inadequate’ (Eisenhardt, 1989: 549; see also Harrigan, 1983). Through the intimate linkage with empirical evidence, case studies allow for the inductive development of testable, relevant, and valid theory. Finally, registering the (organisational) learning processes taking place during the course of a diversification project led us to develop a *longitudinal* case study research design (*cf.* e.g. Schön, 1983).

**Organisation of this research project**

The two kinds of goals, related to the diversification strategy on the one hand and the research methodology on the other, are closely intertwined throughout this research. One may even consider this research as either a cognitive piece of research on diversification within SMEs or as a research paper on the development and evaluation of a cognitive methodology (with diversification as a relatively arbitrary subject to test it upon).

The research is organised into three parts. The first part introduces the theoretical background. Chapter 2 reviews previous diversification research by discussing the results of mainstream diversification research on the diversity-performance nexus and the insights gained by (some) research that has investigated (parts of) the process of diversification. This chapter also reviews main theories of diversity. Whereas Chapter 2 concentrates on corporate diversification in general, which is mostly focused on large firms, Chapter 3
deals more specifically with the diversification strategy in SMEs. Because we could only draw upon a few studies, we extended Chapter 3 to research on growth strategies in SMEs. Our aim in these chapters is to identify topics and conclusions (groups of) scholars agree on. Chapter 4 develops the conceptual foundation of a research methodology for charting processes of organisational learning from a cognitive perspective. For this purpose, it discusses main findings from the field of organisational learning on the one hand, and organisational and managerial cognition on the other.

The second part of this research project presents the empirical research. Chapter 5 develops the research methodology we employed in this project. It grounds our selection of cognitive mapping techniques and it founds the case study design. Subsequently, Chapters 6 through 8 offer three case studies of diversifying companies. Each of these companies pursued a new business activity its management considered as fundamentally different from the business activities they were used to. As we will indicate in Chapter 5, the three case studies differed in many respects, both in terms of the characteristics of the company and the particulars of the diversification strategy pursued.

Chapter 9 comprises the third part of this project. This chapter compares our findings across the three case studies and links it to results of previous research and theory as discussed in the first four chapters. Based upon these confrontations the chapter formulates the contribution of the present research to the research into diversification in general and to a theory of diversification in particular. Finally, the chapter evaluates the research methodology employed by shortly discussing some of the strengths, dilemmas and flaws of this research project.