

# **DIVERSIFICATION STRATEGY IN SMALL AND MEDIUM-SIZED RETAIL**

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## **ABSTRACT**

The purpose of this paper is to assess the likelihood that small and medium-sized (SME) retailers diversify their business with the support of Internet and advanced information technologies. The goal is to understand how to match the motives and requirements for diversification with SME retailers' ability under the Internet applications.

**Key words: Diversification; Small and Medium-sized Retail; Distribution Channel.**

## **INTRODUCTION**

Diversification into a new market is one of the strategies used in the retail industry to respond to environmental change. However, much of the exciting literature focuses primarily on the performance of diversification strategy in large corporations. Recent growth in using the Internet and related communication technologies has fueled SMEs in choosing appropriate product markets and modes of entry. This paper aims to uncover the relationship between diversification strategy and SME retailers with the support of Internet and advanced information technologies. Specifically, the following two research questions will be addressed:

1. Is the likelihood that SME retailers diversify their products increasing, as the use of Internet and related technologies is more frequent?
2. What are the main considerations of SME retailers to diversify their products with the support of Internet?

## **DIVERSIFICATION**

### **Motives for Diversification**

As diversification has become an increasingly important corporate strategy, many studies have concentrated on the evaluation of its performance. However, the analysis of motives for diversification is the first step in formulating this strategy, which is closely related to the likelihood of diversification. The following several factors tend to drive the diversification decision (Bourgeois et al., 1999).

- To Grow.
- To efficiently utilize existing resources.

- To escape from unattractive product markets.
- To make use of surplus cash flows.

### **Requirements for Diversification**

After the analysis of motives for diversification, the next step is to examine its requirements. In this research, the requirements for resources and structure will be considered. Other factors, such as the top management team characteristics and industry regulation, are out of scope of this paper therefore will not be considered herein.

## **EFFECTS OF THE INTERNET ON SME RETAIL'S ABILITY TO DIVERSIFY**

### **Internet Distribution Channel and Firm's Growth**

The lack of investment and resources is one of the reasons for SMEs to seldom diversify their products in the traditional retail industry. Engaging in the Internet distribution channel causes the SME owners to rethink the firms' assets and the locus of competition.

From the perspective of tangible resources, selling products online is a cost-efficient way to do business (Holmes et al., 2004). Firstly, the cost of attaining information is reduced. Secondly, the larger supplier pool makes it possible to get the product at a lower price. Thirdly, the real estate-related cost is reduced. Finally, the advertise cost is reduced.

From the perspective of intangible resources, as broad bandwidth public communication infrastructures become widely available, the previously embedded information became public, and more subjective information can be conveyed remotely (Sampler, 1998). So, it is possible to yield valuable information about potential opportunities and to fulfill the goal of growth in size and portfolio for SME retailers.

In conclusion, I would expect that perceptions of the Internet's value is associated with in promoting business growth, as a result, it increases the likelihood of diversification. Thus, the first proposition is described as below:

*Proposition 1: The extent of dependence on the Internet distribution channel is positively related to the ability of achieving growth, so, the likelihood of diversification is high.*

### **Internet Distribution Channel and Customer Needs**

For SME retailers, the Internet is critical to improve the ability of meeting customer need. When a customer shops online, he/she has a personal account which includes private information, such as, name, address, habit and the cumulative purchasing records. It has changed the nature of competition in traditional retail industry, because e-retailer has not only accurate aggregated store-level purchase information, but also precise individual customer information. Such information can be used to inform a targeted customer about special offers or the introduction of an entirely new range of products (Sampler, 1998). The time-efficient searches and simple

operation of adding new product on the website make it possible for SME retailers to response customers' needs quickly. Thus, the use of Internet distribution channel will improve the ability of satisfying customers' needs; further more, the purpose of meeting customers' needs forces the small business retailers to introduce new products, which increases the likelihood of diversification. So, the second proposition is described as below:

*Proposition 2: The extent of dependence on the Internet distribution channel is positively related to the ability of meeting customer needs, so, the likelihood of diversification is high.*

### **Internet Distribution Channel and Exit Barriers from Unattractive Product Market**

Facing the unattractive market environment, some SME retailers may wish to exit the current product market. It is expected that the heavier dependence on the Internet distribution will release some exit barriers. The business focus of physical store is on the local customers. Due to their frequently visit, they are familiar with the style of physical store. If the SME retailers frequently change the product and style of their physical presence, it will seriously influence the trust and belief of local customers to the local store. In addition, the physical stores have investment on the current product to attract the customers in their physical store, such as, the shelf and other facility design. It makes them more difficult to exit from their current market. However, pure-play Internet firms are facing a global market, how to create an image for a product is a key to impact customer attitudes and reinforce satisfaction and loyalty (Filo and Funk, 2005). They have more flexibility to make their entry/exit decision.

Escaping from unattractive product market is one of the motives for diversification, as a result, it is expected that the likelihood of diversification will be increased. Thus, the third proposition is described as below:

*Proposition 3: The extent of dependence on the Internet distribution channel is positively related to the ability of exiting from unattractive product market, so, the likelihood of diversification is high.*

### **CONCLUDING REMARKS**

The primary purpose of this research is to assess the SME retailers' ability to diversify by using the Internet as a distribution channel. Specifically, based on the literature of motives and requirements for diversification, the application of Internet and advanced information technologies makes it possible for SME retailers to motivate and pursue the diversification strategy by satisfying its requirements. The goal is to understand how to match the motives and requirements for diversification with SME retailers' ability under the Internet applications. The growth of SMEs in a dynamic environment is especially important due to its huge percentage in the U.S. economy. With the support of e-commerce, SMEs have more freedom to enter into a new market in an active and flexible manner. Thus, SMEs are in the forefront of implementing E-commerce applications.

However, it should be pointed out that the efforts of Internet involvement are not equally effective for every SME retailers. SMEs' ability to diversify their business is a multi-faced and complex issue. The present work should be viewed only as a first step towards a better understanding of the main factors affecting SME retailers' ability to diversify and the possible interactions among them. As the extension of this paper, the propositions require further elaboration. In addition, specific contexts should be considered to conduct the empirical study in the future research. Clearly, more research is called for.

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