

BUSINESS DIVERSIFICATION OPPORTUNITIES FOR SMALL AND MEDIUM ENTERPRISES IN LATGALE REGION

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Abstract.

Purpose and aim of the study: *The present research aims to identify and assess business diversification opportunities for small and medium enterprises in Latgale region.*

Design / Methodology / Approach: *The research also conducted an expert survey, and all the experts indicated that the introduction of new products/services is an important and very important opportunity for small and medium enterprises to grow. In addition, most of the experts indicated that implementing a diversification strategy by a company would contribute to reducing/diversifying risks thereto.*

Main Findings: *The research identified the following disadvantages that could arise from business diversification: a decrease in quality (all available resources and attention are redistributed to several industries/products of diversification) and a lack of resources (human, technical and financial), depending on the kind of diversification strategy and the specifics of the company's economic activities.*

Originality: *The research gives insight into the theoretical aspects of diversifying the economic activities of enterprises and analysed development opportunities for small and medium enterprises in Latgale region.*

Implications: *With the rapid growth of the market, small and medium enterprises need be able to effectively adapt to changing conditions, and consequently business diversification becomes important for such enterprises.*

Keywords: *small and medium enterprises, business diversification, Latgale region.*

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Introduction

Small and medium enterprises (SMEs) play a significant role in the growth of the national economy and in contributing to the business environment (Pedraza, 2021; Liepaja Special Economic Zone, [s.a.]). They represent a major source of business skills, innovation and employment, a driver of job creation and global economic growth, accounting for 90% of the

total businesses and more than 50% of employment worldwide. The role of SMEs in economic growth in Latgale region is particularly important because Latgale is one of the economically weakest regions of Latvia, where the business environment is less developed than that in the rest of Latvia, affecting product sales and investment in the region. To foster increase in the performance of SMEs in Latgale region, the enterprises need to expand their economic activities. By diversifying its economic activities, the enterprise increases the competitiveness, diversifies the risks, and exploits the available resources in a more efficient way (Le, 2019). Business diversification is a relatively important factor in the development of SMEs in Latgale region because in this way, the enterprises reduce their risks and gain opportunities to operate in new markets. Diversifying economic activities lead to an increase not only in the enterprise's financial performance but also in overall economic growth in the region (Latgale Planning Region, 2022).

The present research aims to identify and assess business diversification opportunities for small and medium enterprises in Latgale region. The research topic represents business diversification by small and medium enterprises in Latgale region.

To achieve the research aim, the following specific research tasks were set:

1. To give insight into the theoretical aspects of business diversification and the kinds of strategy for implementing it.
2. To analyse the development of and business diversification opportunities for small and medium enterprises in Latgale region.

The following hypothesis was put forward: implementing a diversification strategy by the enterprise reduces the impact of risks on the performance. The novelty of the present research involves identifying and assessing business diversification opportunities for small and medium enterprises in Latgale region in the period 2017-2023. The research examined the nature of business diversification and strategies for diversifying economic activities, analysed development opportunities and support mechanisms for small and medium enterprises and conducted an expert survey on development opportunities for small and medium enterprises in Latgale region.

The research employed the following methods: the monographic method to objectively explain the data obtained, logical construction to draw conclusions based on other authors' knowledge and data, as well as analysis, synthesis, induction and an expert survey.

Research results and discussion

1. Concept and nature of business diversification

The term diversification has different meanings in the theoretical literature. For the first time, the concept of diversification was described by Gorts as a process that reduces the impacts of adverse conditions in one of the economic activities of the firm on the firm's overall performance. Thus, it reduces the risks associated with unpredictable changes in the firm's profitability across industries (Gorts, 1962). Today, researchers use the term diversification to refer to a strategic choice for business expansion (Le, 2019) to increase the variety of final products, vertical integration and the number of "core areas" of economic activity in which the firm is engaged (Penrose, 1995), a method for firm expansion applied when choosing an industry in which to operate (Liangding et al., 2007), as well as dispersion of the concentration of financial, operational or geographical risks (Hayes, 2022a).

As regards the reasons for diversification, Ansoff grouped them into four categories (Ansoff, 1957):

- first, the company cannot achieve the intended goal due to its expansion strategy;
- second, the company has too much surplus, which far exceeds the expansion needs;
- third, the company has more than an expansion strategy when new market opportunities are more profitable;
- fourth, the prospects for expansion and diversification are uncertain in the particular case (Kannan & Saravanan, 2012).

Whenever a company faces a decrease in market opportunities and stagnant sales in its core business, it is a signal to diversify. Other key factors are as follows:

- the company has a strong and well-known brand that could be transferred to another company's product;
- by diversifying the business in a closely related area of economic activity, a new opportunity for cost reduction emerges;
- the company can expand into industries whose technologies and products complement its current business.

The impact of diversification on the company's value manifests itself as the creation of new lines of business within the company through the process of internal development. Some researchers have found that implementing diversification in a company contributes to its growth and performance, reduces the impact and probability of risks, increases the company's sales revenue and expands its market share, thereby increasing its profits.

Researcher H. Igor Ansoff introduced the term diversification strategy as a separate business strategy (Vogl, 2018). A diversification strategy could be defined as business expansion or entering new markets that are different from the company's current product lines or markets. Another definition of a diversification strategy is as follows: a strategy implemented by managers to achieve business growth by entering a new industry and making above-average profits by taking advantage of the opportunities that emerge (Anil & Yiğit, 2011). A diversification strategy is a company's strategy to increase its growth by changing or expanding the products the company produces or offers for sale (MasterClass, 2022).

Some researchers have concluded that a diversification strategy involves expanding the company's economic activity or product line, redistributing its resources to achieve growth, gaining an advantage over competitors and earning higher profits.

2. Business diversification strategies and the kinds thereof

Some researchers (Al Sayegh, 2010; Vogl, 2018; Anil & Yigit, 2011; Xie et al., 2021) distinguish several kinds of diversification strategy, indicating that organizations expand the boundaries of their operations by focusing on their technical capacity or market position, or both, leading to horizontal, vertical, concentric or conglomerate diversification (Dhir, 2015). Horizontal diversification closely relates to the company's core business but is outside its current market and product line (Anil & Yiğit, 2011). Horizontal product diversification means introducing new but unrelated products into the company's product range. Implementing a horizontal strategy helps the company increase the quality of both current and new products. If the company analyses its entire current product line before coming up with a new product, it gives an opportunity for the company to improve the current products and reduce production costs. Introducing new product lines requires the company to access new markets and distribution channels (WallStreetMojo Team, [n.d.]). This provides an opportunity for cooperation with other regions or market segments. Implementing horizontal diversification can lead to a negative result, i.e. the company might fail to attract new customers, and there might also be difficulty in managing the product introduced.

Vertical diversification represents a growth strategy, as the companies diversify their business operations throughout the supply chain (Kriya Formerly MarketFinance, 2022). The company expands forward or backward in the supply chain or production process. During vertical integration, a business combines two or more stages of production that are usually managed by other companies (StudySmarter, 2023). Such a strategy brings

benefits such as lower production costs, higher delivery quality, development of product distribution channels and higher profits (Borad, 2023), yet the strategy can create disadvantages such as difficulty in managing resources, lower efficiency and profitability and could cause an increase in production costs (Hayes, 2022b).

Concentric diversification refers to a company expanding its current product range to supply related products or services. However, such a strategy requires the company to supply products that are more in line with its core business (Kriya Formerly MarketFinance, 2022). Concentric diversification is also called linked diversification. Under the strategy, the company introduces a new related product that is similar in nature and in terms of production, consumption, price distribution and promotion (Khan, 2012). The strategy involves dealing with another industry that benefits from access to the company's core competencies. Under the strategy of concentric diversification, the company can diversify into a related business (Wilfred et al., 2014). Applying this particular approach, the company seeks to increase its market share by introducing a series of new products that could not only attract the attention of current customers but also attract new customers (Tatum, 2023).

Implementing a concentric diversification strategy by a company can bring advantages such as full use of the company's infrastructure, an increase in market share as well as cost savings, whereas the disadvantages could be an increased risk factor, as well as the possibility of harming current business operations (Bhasin, 2022a; Bhasin, 2022b).

Conglomerate diversification means that the new activity is completely unrelated to the parent company, and the purchase and exploitation of equipment and technologies does not depend on the technological or other competencies. The most common reasons for this strategy are to reduce risk, increase total profits, raise new capital or cash, attract new customers or become a bigger force in capital markets (Mint Tools, 2022).

The key advantage of the conglomerate diversification strategy is the reduction of dependence on a particular market or product line, whereas the disadvantage is the higher probability of risks, as well as the fact that the new structure is too unrelated to the current business.

A company that has decided to implement a diversification strategy needs, before the implementation, examine the kinds of diversification strategy and their advantages and disadvantages and choose the most suitable strategy according to the company's current position in the market and current resources and goals, so that the diversification strategy is consequently effective and profitable.

3. Trends in the development of small and medium enterprises in Latgale region and expert assessments of business diversification opportunities for small and medium enterprises in Latgale region

SMEs make up most of the businesses and employment in Latvia, which is also relevant to Latgale region. SMEs are an essential driver of regional development, contributing to economic growth and employment. In 2021, 10% of the total companies in Latvia were registered Latgale region, while the trend shows that from 2017 to 2021 in Latgale region, the number of companies decreased by 1966 or 10.3% (Official Statistics Portal, 2022a; Official Statistics Portal, 2022b). Most of the companies employed up to 9 employees, accounting for 93.4% of the total companies in Latgale region. The companies represented mostly local and family businesses operating in several market sectors. In Latgale region, 4.1% of the total companies employed 10-49 employees, only 0.67% employed 50-249 employees, while only 0.01% employed 250 and more employees (Official Statistics Portal, 2022c; Official Statistics Portal, 2022d). It could be concluded that theoretically in Latgale region (there were data only on the number of employees, while annual turnover and balance sheet data were missing for a full analysis), the SME category comprised 99.95% of the total number of companies.

A survey of experts having experience with and knowledge of SMEs in Latgale region was conducted to identify development opportunities for SMEs in Latgale region. The Google Forms platform was used to create a survey and obtain answers from the experts. The persons who had experience with SMEs in Latgale region, such as enterprise owners, persons in leading positions, lecturers as well as other persons who could share their experience and give recommendations on SMEs, were identified as experts. The expert survey was conducted in the period from 20 April 2023 to 20 May 2023. A total of 20 questionnaires were sent and 13 questionnaires were received. The survey had four closed-ended and three open-ended questions. An analysis of the data revealed that the occupations of the respondents included positions such as a lecturer, a business consultant, a project manager, a leading researcher, a professor, farm owners and business managers, as well as there was a representative of the administration of the Rezekne Special Economic Zone and a representative of the Latgale Regional Department of the Central Finance and Contracting Agency (CFCA). The experts surveyed mainly represented national institutions, educational institutions, owned companies as well as financial support institutions. Answering the question about their experience with SMEs in Latgale region, the respondents had indicated many years of experience in company management (on average 15), experience in support organizations and

public administration, project management and business consulting, as well as experience in knowledge and technology transfer.

In the experts' opinion, the most useful support opportunities for SMEs in Latgale region were national support programmes, as well as European Union support programmes, whereas less important were expert-mentor consultations.

The most important factors that could hinder the development of SMEs in Latgale region, according to the experts, were business risks, low consumer demand, as well as the long distance of infrastructure from Riga.

In the experts' opinion, the most important support opportunities for SMEs in Latgale region were the attraction of financing, the expansion of foreign trade, as well as the introduction of new products/services.

To identify how business diversification affected the performance of companies, the experts were asked to note, in their opinion, the main advantages that a company could get from diversifying its economic activities. The most experts (43%) believed that the main advantage that a company could get from diversifying its activities was risk mitigation and diversification. The fewest experts answered that the main advantages were higher competitiveness (7%) and higher consumer buying power (7%).

It could be concluded that, according to the experts, the most significant advantage that a company could get from diversifying its economic activities was risk reduction or diversification. If there was a downturn in one of the industries in which the company operated or the performance of the company decreased, the economic activities could be diversified at the expense of another industry, which created some stability and reduced the impact of negative economic processes on the company.

Implementing a diversification strategy by a company could also create disadvantages. The most significant disadvantages faced by the company when diversifying its economic activities, according to the experts, were a lack of resources (38%), as well as a lack of financing (31%). The experts pointed out that in order to diversify the company's economic activities, it was necessary to invest substantial resources, namely, equipment, human resources, knowledge as well as funds. However, a very few experts indicated consumer distrust of a new product (8%) and a lack of innovative ideas as disadvantages (8%).

It could be concluded that, according to the experts, the most significant disadvantages faced by a company when diversifying its economic activities were a lack of resources, as well as a lack of financing, which was an important factor in the development of the company. By investing resources in an additional industry, the company took the risk of decreasing the performance of the current industry and contributing to the new industry incompletely.

Conclusions

The term diversification means expanding the kind of economic activity, engaging in another industry or creating new products, thereby reducing the impacts of risks and other negative factors on the company's performance.

Companies decide to diversify in order to increase their profits and confidence in market power, protect the company against financial shocks as well as effectively use the excess resources of the company.

A diversification strategy involves expanding the company's economic activity or product line, redistributing its resources to achieve growth, gaining an advantage over competitors and earning higher profits. The choice of a diversification strategy is affected by the company's available resources and position in the market.

Small and medium enterprises, making up most of the total enterprises, are important contributors to the national economy, are actively involved in the creation of new jobs and new products and also contribute to the development of the business environment.

In 2021, 10% of the total companies in Latvia were registered in the Latgale region, while the trend shows that from 2017 to 2021 in the Latgale region, the number of companies decreased by 10.3%.

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