

Related Diversification at Intel

Although Intel has had a small presence in the communications chip business since the 1980s, for a long time it languished as the company focused all of its attention and resources on the booming business of making microprocessors for personal computers. According to managers at Intel, “feeding the processor monster” consumed all of the company’s financial resources. Although Intel was generating high profits and significant positive cash flows, it took the strategic decision to reinvest those cash flows in the design of new generations of its highly successful X86 microprocessor architecture and in large-scale (and expensive) fabrication facilities to manufacture microprocessors in very high volumes. The decision seemed logical: Intel had the dominant position in the microprocessor market, its primary customers (personal computer makers) were growing by leaps and bounds, and demand for its microprocessors was soaring. Indeed, had Intel not made these investments, it may have opened the door to competitors in the microprocessor business, such as AMD.

All this changed at a contentious strategy meeting of Intel’s top executives in September 1996. Intel’s executives came away from that meeting with two important insights. First, the personal computer industry would approach market saturation in several developed markets by the early 2000s. This meant that the growth in demand for Intel’s microprocessors would slow. Therefore, Intel needed to find a new growth driver. Second, the executives decided that with the advent of the Internet, “communications was going to be the driver for everything in the future, that all computing was connected computing and that connectivity had as important and strategic a role to play as the microprocessor did.” Moreover, it was clear that demand for products of the communications industry such as communications network gear, which needed advanced communications chips, was accelerating rapidly.

Intel’s executives decided that they could probably boost the company’s return on invested capital by diverting some cash flow away from the microprocessor industry and use it to build a strong position in the rapidly growing communications chip industry.

This was seen as a different industry because the product technology was different, the production technology was different, the customers were different, and the competitors were different. Intel believed however, that because the communications chip industry was closely related to the microprocessor industry. Intel could attain a competitive advantage by transferring its leading-edge technology honed in the microprocessor industry, and manufacturing and marketing capabilities to the communication chip business.

Once the decision was made to enter the communications chip industry on a significant scale. Intel had decided how best to execute the strategy. The company managers decided that the only way they could quickly gain scale economies and established a sustainable competitive advantage in this booming market was for the company to buy the required technological fabrication facilities, and sales forces. It could then improve the performance of the acquired businesses before transferring its

competencies to them. So, Intel went on an acquisition binge. Between January 1997 and June 2001, it made eighteen major acquisitions of companies total of \$8 billion. These acquisitions include the purchase of communications chip business of Digital Equipment Corporation for \$625 million, Level One Communications (which made high-speed networking and telecommunications chips) for \$2.4 billion, DSP (a maker of chip sets for cell phones) for \$1.6 billion, and Giga A/S of Denmark (a maker of optical networking chips) for \$1.25 billion.

As a result of these acquisitions, by mid-2001 Intel became the fourth largest global company in the communications chip industry, behind only Lucent, Motorola, and Texas Instruments, with revenues of \$2.5 billion. Unfortunately, Intel and all these other companies were hard hit by the slump in global demand for telecommunications equipment that began in 2000 and continued through 2001-2002. As of mid-2002, Intel was losing money in its communications chip business, and revenues were declining. In contrast, although revenues in its microprocessor business had also slipped by 20 percent, it was still making strong profits in that area. Only time will tell whether Intel's diversification move will have been a profitable use of the company's financial resources or an ill-timed entry into a difficult business where the company has no competitive advantage.