

# Diversification Strategy of Entrepreneurial Activity in Conditions of European Integration



Oksana Zghurska, Tetiana Somkina, Ruslan Dymenko, Tetiana Kapelyushna

**Abstract:** *The article defines the concept of «entrepreneurial risk» as a key element of effective entrepreneurial activity and an important component of management theory and practice. The mechanism of calculating the losses of entrepreneurial activity is determined and the causal-consequential connection of the degree of influence of business risks to the results of economic activity of the enterprise is reflected. The influence degree of various business risks on the results of economic activity of management subject is indicated. The concept of «diversification» as one of the of economic types process is substantiated. The identified diversification as one of the strategic alternatives to the development of the enterprise is emphasized, which allows obtaining additional economic benefits in the conditions of a complex market situation. The essence of the diversification process and the disadvantages inherent in the strategy of diversification are determined. Mechanisms of diversification strategy formation are substantiated. The main forms that are used in the risk management process based on the strategy of diversification are highlighted. The urgent questions of diversification strategy application by the countries of the European Union are emphasized. The efficiency of diversification strategy application on the example of activity of the largest corporations according to sales volumes on the world pharmaceutical market is considered. The dynamics of sales growth volumes of the world pharmaceutical market is shown. The significant synergistic effect of two or more enterprises is emphasized, which helps to save resources by reducing costs, combining complementary resources, growing market weight as priority areas for investment and the conquest of new markets. The experience of world leaders in implementing the diversification strategy as the driving force of the unceasing development of the world pharmaceutical industry has been analyzed. Taking into account the experience of foreign countries, the main directions of diversification strategy application by national enterprises of the pharmaceutical industry are analyzed. The importance of cooperation with foreign partners as the main strategic reference point in the development of national entrepreneurship is determined. The proposed conceptual knowledge-resource-market integration portfolio of diversification strategy of business activity, the advantage of which is to combine individual knowledge, resource potential and entrepreneurial capabilities to make an effective economic decision in order to profit and strengthen competitive advantages in the national and foreign markets.*

*It is emphasized on the importance of quality conformity of national products to European quality standards, as well as effective integrated approach to production activity, perspective recommendations on the diversification strategy for national entrepreneurship in the conditions of Eurointegration.*

**Keywords:** *entrepreneurial risk; diversification; diversification process; diversification strategy; integration.*

## I. INTRODUCTION.

The present is characterized by a change in innovative ideas of approaches and basic principles of diversification – the main effective strategy for further economic development of entrepreneurship. In the context of European integration, it is necessary to apply effective diversification strategies depending on how this approach is applied and the main long-term expectations and outcomes for national entrepreneurship. The present stage of formation and development of integration and cooperation processes is characterized by a revival and a gradual increase in the number of enterprises of various industries and forms of ownership. Thus, an effective business diversification strategy can significantly expand the specialization and activities of modern enterprises, promote vertical integration, relations renewal and new initiatives that, in the conditions of Ukraine's membership in the European Union, will provide national enterprises with stable competitive advantages both on the national and on the foreign markets. After all, in today's reducing conditions the demand for the main products of enterprises, the search for alternative functional-minded areas of activity of enterprises is extremely urgent.

## II. BRIEF LITERATURE REVIEW.

These Ukrainian and foreign scientists made a significant contribution to the development of the diversification theory and the main aspects of the diversification application method by enterprises: A.A. Tompson and A.D. Striklend (2006) [1], J. Grandell (1992) [2], L. N. Tepman (2007) [3], M. Eddowes and R. Stensfild (2009) [4], I. V. Ansoff (2009) [5], A. Smith (2007) [6], M. Porter (2008) [7], M.D. Korinko (2009) [8-9], W. Wan, R. Hoskisson, J. Short [10], D. A. Aaker (2002) [11], M. Gort (1962) [12], R. Pitts and H. Hopkins (1982) [13], G. Nemchenko (2003) [14], E.I. Boguslavsky and Y.S. Shibalkina (2012) [15], S. Alexandrov (2004) , L. Gaboueva and O. Tchepin (2006) [20], O. V. Baeva (2007) [21], C. Berri (1971) [22], M.A. Khvesik (2010) [23], V. Osadnik, V. (2001) [24]. However, despite the abundance of scientific works on the above-mentioned issues,

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\* Correspondence Author

**Oksana Zghurska\***, Associate Professor, Department of Enterprise, Trade and Exchange Activities State University of Telecommunications, 03680, Solomenska st. 7, Kyiv, Ukraine

**Tetiana Somkina**, Professor, Doctor of Economic Sciences, Department of Enterprise, Trade and Exchange Activities; State University of Telecommunications, 03680, Solomenska st. 7, Kyiv, Ukraine

**Ruslan Dymenko**, Associate Professor without tenure, Head of the Department, PhD in Economic sciences, Department of Enterprise, Trade and Exchange Activities; State University of Telecommunications, 03680, Solomenska st. 7, Kyiv, Ukraine

**Tetiana Kapelyushna**, Associate Professor, Department of Enterprise, Trade and Exchange Activities State University of Telecommunications, 03680, Solomenska st. 7, Kyiv, Ukraine

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the issue of the main aspects of the diversification strategy, the approaches substantiation to the practical determination of application efficiency taking into account foreign experience in the economic activity of enterprises remains incompletely solved.

In the studies of prominent scientists, insufficient attention is paid to the main aspects of the method's application in the conditions of intensive integration processes of national entrepreneurship.

## III. THE PURPOSE

The definition of methodological approaches and practical recommendations for the diversification strategy of entrepreneurial activity in the conditions of European integration, which will promote the effective development of national entrepreneurship in the end. The main task of the study should be the further deepening of the theoretical and methodological provisions of the diversification process, taking into account foreign experience, which main objective is to increase the economic efficiency of national enterprises as a result of their diversification strategy.

## VI. RESULTS.

One of the objective positive trends in the development of entrepreneurship in Ukraine is European integration, that is, the formation and further strengthening of relations with the countries of Europe at all levels – interstate, interregional, and between individual economic entities. Eurointegration has a complex nature – economic, political, social, cultural, etc. Today, eurointegration is the strategic course of Ukraine to consolidate profitable single- and multilateral economic ties. Ukraine's accession to the European Union simultaneously obliges to pay attention to the influence of this process on creating new opportunities and prospects for obtaining positive results of activities by national enterprises, which, in turn, is impossible without the risks and threats of the activities of business entities.

Entrepreneurial risk is one of the key elements of entrepreneurial activity and an important component of management theory and practice. In many cases, it is simply not possible to avoid risky actions. The development of risk situations can result both in the occurrence of adverse consequences (losses, lost profits), and to positive results for the enterprise in the form of increased profits. Business risk arises in all kinds of activities related to the production of products, goods, services, their operations, commerce, and the implementation of socio-economic, scientific, and technical projects. This is a phenomenon, a sign and a property of activity, and not just a concept [1, p.326]. A risk that is characterized as a risk of a potential, probable loss of investment or a loss of income compared with the option designed for the rational use of investment is called investment risk. J. Grandell determines the risks of investment activity as «the probability of getting different from the expected result of investment activity as a result of exogenous and endogenous factors of influence» [2]. The expected result is the receipt of revenues and / or the achievement of certain social, technological, informational, innovative and other effects. In other words, the risk is the risk of an enterprise loss in the form of additional costs,

unforeseen forecasts, program of its actions or actual receipt of income significantly lower than those that were planned. Thus, a decrease in the amount of expected income, the so-called missed profit, is also included in the risk category.

Thus, any business activity inevitably involves costs, losses, while losses occur in the event of an adverse coincidence of circumstances, miscalculations and represent additional costs over planned. Losses, wastes, as is known, are not planned in advance, although in some cases they are considered as potentially possible (fig. 1).



**Fig. 1. Causal and consequential connection of business impact degree risks on the results of the enterprise's business**

In order to assess the probability of certain losses caused by the development of events in unforeseen circumstances, it is necessary, first of all, to have information on the origin of all possible types of business losses and be able to calculate them in advance or measure them as probable forecast values. In this case, there is an estimate of each type of loss and total in both quantitative and qualitative terms. Understanding the nature of losses in economic practice allows to assess the negative impact on the performance of any risky solution and improve the effectiveness of the risk management process in the enterprise as a situational characteristic of its activities. The main task when implementing this strategy is to choose the optimal and effective solution by diversifying economic activity, which determines the renewal (differentiation) of production, and the way out of the enterprise beyond the main activity, penetration into new branches and spheres of the economy. If we take into account the definition of M. Eddow that «... diversification is one of the types of economic process, the main essence of which is the development of several non-interconnected or service industries» [4, p.182], diversification as a development process can be considered the activity of the enterprise, connected with the increase of the range of species and penetration into new spheres of activity, the development of new industries and the expansion of the range of goods. At the same time, diversification is a strategy that allows the company to use current benefits in new spheres of activity under conditions of significant variability in the business environment [5, p.365]. A. Smith notes that «any kind of entrepreneurship is associated with market fluctuations, therefore, enterprises must diversify their activities», that is, the generalization factor of the diversification process is determined, taking into account that the general economic laws of the development of society are always the basis for determining the diversification direction on the basis of not only economic laws and factors, but also social ones [6].

As is well know, diversification, as well as any economic process, besides the advantages, also has certain disadvantages, namely, as noted by M.

Porter, they are: «the complexity of finding the reserve funds and enterprises for acquisition, the need for new knowledge and skills of managerial the lack of a methodological basis for taking into account the relationship between business diversification and operational risk, that is, ensuring an acceptable ratio between profitability and risk level» [7, p.215].

Diversification, as we know, allows us to reduce the risk magnitude, but not to avoid it. Under these conditions, overall performance decreases, as the company would be able to generate higher profits, focusing on the most profitable direction, but in such a situation, the risk would be also the largest. This ratio is determined by each enterprise itself, and it depends, first of all, on the extent to which the owners of the enterprise are actually at risk [8, p.14].The general risk consists of three components:

- 1) Investment risk (its degree) is defined as the deviation of the actual profitability from the expected (average) value (investment risk).
- 2) Non-systematic (own) risk, it is inherent in a particular enterprise and subject to reduction as a result of diversification. That part of the overall risk, which can be reduced by diversification (unique risk).
- 3) Systematic (not diversified) risk, that can not be reduced by further diversification (fig. 2).

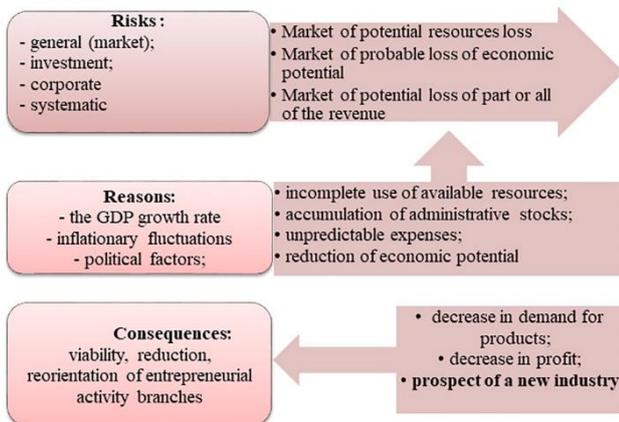


Fig. 2. Scheme of business risks influence on the results of economic activity

Systematic (market, non-diversified) risk occurs due to external events that affect the market as a whole. The systematic risk accounts for a quarter to a half of the total risk of any investment. In addition, systematic risk simultaneously affects all enterprises, it can not be eliminated (reduced) by diversification [9, p.72].Formation of diversification strategy is a definition of concrete ways and objectives, distribution of money amount between different production lines in the most favorable and safe proportions. Such a division reduces the non-systematic risk, provides increased production efficiency and provides a stable competitive position both in the national and foreign markets. Diversification processes are a strategy to reduce the risk, as well as make it predictable and manageable. Minimizing entrepreneurial risk based on this strategy means that this enterprise is not limited to any one kind of activity, but invests its capital either in different risk areas of

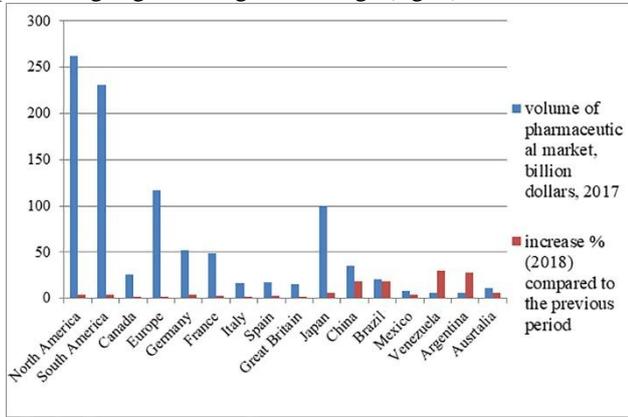
its use or expands the number of risky investments similar types [10].We can distinguish the main forms that can be used in the risk management process based on the diversification strategy:

- Restructuring of the company, which involves the transformation of its internal structure, the creation of new divisions, the launch of new products, etc.
- Acquisition of new divisions or industries, transport and logistics enterprises, real estate objects, which can be realized in relatively short terms.
- Construction of new large objects during a long but effective period of time.
- Stock exchange operations, which allows them to change into a more profitable portfolio structure of securities.

The first three forms of diversification are widely used in the risk management process of real economy. They involve the implementation of additional investment projects of the appropriate type as the main condition for the implementation of each of them. The amount of required initial investment or additional capital investments actually represents that initial price that has to be paid for implementation of the applied method of management risks minimizing [15, p.185]. In general, diversification means the simultaneous implementation of several investment projects within the framework of the above-mentioned directions, the useful results of which (products, services provided, etc.) are implemented in different markets, and the joint implementation of these projects allows both to reduce the risks of their implementation, and increase these risks. The choice of diversification type is carried out depending on the expectations of managers or owners about the future development of economic conditions. In anticipation of the favorable development, it is possible to recommend to increase risks due to diversification, in anticipation of unfavorable development of this situation – to reduce risks of project implementation.Each business entity has certain advantages and disadvantages of implementing one or more activities types. In the European Union, much attention is being paid to diversification at the time of takeover and merger, but it is less common than the products diversification within a firm that has less negative effects and is more effective than results. Enterprises conduct reorganization of activities through mergers and acquisitions to achieve a synergistic effect [16].According to the Mergers & Acquisitions Journal, 72% of all mergers and acquisitions do not pay back on their funds. Newly created enterprises, as a result of mergers or acquisitions, lag behind their development indicators from other similar representatives of this market and are forced to again split into independent corporate units. As practice shows, the strategy of diversification requires a clear and thought-out action plan, which is created taking into account all the peculiarities of each enterprise that needs to be reorganized. The unconsciousness of this strategy leads to bankruptcy and forces companies to carry out rehabilitation measures aimed at restoring the necessary level of profitability [17]. Consider the effectiveness of diversification strategy on the example of the largest corporations in terms of sales in the global pharmaceutical market.

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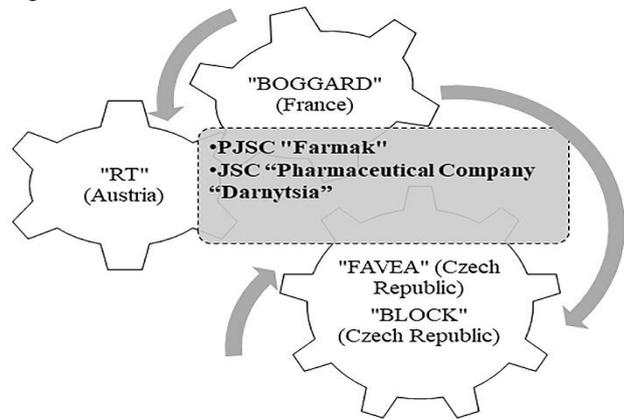
For 12 months – until October 2018 – the Pfizer corporation became a definite leader; the 2nd place was taken by the Novartis, the 3rd, 4th and 5th places – the Astra Zeneca, the Merck & Co and the GlaxoSmithKline respectively [17]. It should be noted that, according to analytical forecasts, significant changes in the world pharmaceutical market occurred after the expiration of the patent protection period of pharmaceutical products for 2011-2014, which led to increased competition among leading companies for a promising segment of genetic drugs (fig. 3).



**Fig. 3. Dynamics of sales growth of the global pharmaceutical market**

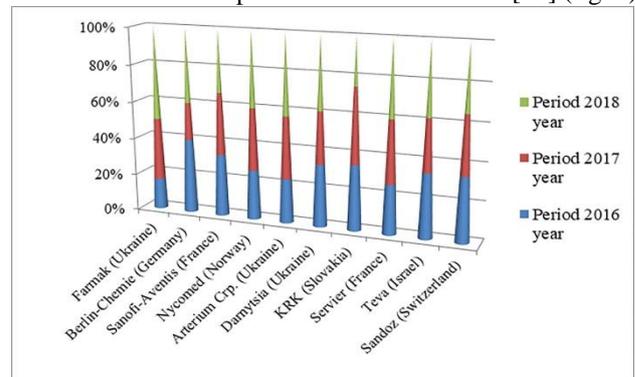
According to KPMG's international audit firm, American pharmaceutical companies are using a diversification strategy through mergers and acquisitions of large companies in one industry to obtain and enhance the synergy effect, that is, the complementary effect of the assets of two or more companies, the aggregate result of which far exceeds the amount the results of the individual actions of these companies. The synergetic effect in this case may arise from saving through cost savings, the combination of complementary resources, and the growth of market weight [19]. After all, strategic acquisitions are a priority area for investment and the conquest of new markets. Thus, the pharmaceutical company «Sanofi» has already acquired the biotechnology company «Genzyme» to expand its growth base. Ukraine is now among 17 world leaders in the pharmaceutical industry and has a significant base for the development of pharmaceuticals. However, the lack of health care reform, transparency issues, limited margins and market fragmentation slow down the flow of foreign investment into the Ukrainian pharmaceutical market. Today, national pharmaceutical companies, seeking to strengthen their position in the market, use marketing methods of Western partners and produce new drugs through the formation of international partnerships with foreign companies. Foreign pharmaceutical companies are entering the external market to increase profits by expanding sales, as well as the introduction of new patent pharmaceuticals in many countries. The share of sales of pharmaceutical products by leading Western European companies in foreign markets exceeds 50% [20, p.184]. A common occurrence is the conclusion of agreements on the joint promotion of products and the use of distribution networks in order to implement large scientific projects. Thus, thanks to effective partnership relations with such companies as «Farmak» PJSC, «Pharmaceutical Company «Darnytsia» with the leading European engineering

companies, such as «RT» (Austria), «FAVEA» (Czech Republic), «BLOCK» (Czech Republic), «BOGGARD» (France), managed to implement balanced strategic development and the active introduction of new production capacities in the infrastructure of their own firms [17] (fig. 4).



**Fig. 4. Scheme of active cooperation of pharmaceutical industry leading enterprises of Ukraine and the European Union**

Analyzing the world experience and systematizing it, it can be argued that the leading pharmaceutical companies in the volume of medicines pharmaceutical sales in the period of 2018 was the national company «Farmak», which moved from the 2nd to 1st position compared with the I quarter of 2017 due to the faster average annual growth rate of retail sales in monetary terms (+38%). Next are the «Berlinchemie/Menarini Group» and «Sanofi-Aventis» [19] (fig. 5).



**Fig. 5. Dynamics of the world pharmacy drugs sales in the period 2016-2018 (in percentile submission).**

Figure 5 shows that the level of consolidation remains low during the analyzed period, since there is only a redistribution of market influence among industry leaders. In 2018, the distribution segment increased the volume of supply in the hands of the top five companies. Still, for today, the main problem for Ukrainian pharmaceutical companies remains the reorientation of production in accordance with the requirements of GMP (Good Manufacturing Practice, eng. «Good Manufacturing Practice»). The specifics of the pharmaceutical industry lies in the fact that the development of analogues of foreign production requires time and considerable costs, and the procedures for registration and obtaining permits for the production of new products are complex and lengthy.

As a result of changes taking place today in the pharmaceutical industry, one can expect some reduction of the number of pharmaceutical companies in Ukraine. Those enterprises are successfully restructured and can withstand fierce competition and would be able to compete on international markets [21, p.108]. Today Ukrainian pharmaceutical companies are trying to diversify assortment of products in order to meet the needs of consumers, and reorient to the production of generic drugs for the creation of their own brands, each year improving the quality and range of products. However, in a context of fierce competition, the strategy of product promotion is an important component of the company's success. And for the leaders of the pharmaceutical market it is one of the most problematic areas of activity. That is why the combination of experience and knowledge of Western partners in the field of marketing techniques and technologies of drug manufacturing and Ukrainian market knowledge will promote successful partnership in the form of alliances or the formation of joint enterprises for the implementation of science-intensive projects. The main strategic guideline for the development of national pharmaceutical companies today should be cooperation with foreign partners, where the best form of international partnerships in this case are joint ventures, alliances, agreements on marketing or product promotion. In turn, the export motivation of multinational corporations while adjusting production in Ukraine will maintain a scientific base that needs to be restructured in line with new market trends. And the development and implementation of pharmaceutical novelties will significantly expand the portfolio of companies at the expense of author's development and new promising drugs. So, the creation of alliances is most promising today in those therapeutic areas where the most active are the basic development of new drugs, namely: oncology, cardiology, neurology and psychiatry, gastroenterology, diabetes, etc. The market for veterinary medicines is also in the growth stage, which promotes the activation of such major manufacturers as Pfizer, Abbott Laboratories and Novartis AG and the formation of such forms of international partnerships as joint ventures and alliances for the development and implementation of new products [17]. The basis for forming long-term partnerships of national pharmaceutical companies with foreign companies should be the harmonization of the basic technical requirements with the requirements of the European Union, preservation of the scientific base, which requires the attraction of significant investments in the development of the pharmaceutical industry. A logical continuation of such a strategic approach, which does not fully assess the exact components of the enterprise as a system, as well as the elements of the environment, are particularly important in the implementation of diversification of production at the enterprise – is a situational approach. As part of a situational approach, there is no clearly defined moment in which enterprises should diversify. As a solution to this question, the definition of the degree of necessity of diversification of the enterprise's production is used. Hence the danger of an overly optimistic assessment of the possibility of developing enterprise competition both in the national and foreign markets [22, p.377]. This danger can be significantly

reduced by integrating knowledge-based, market-based and resource-based approaches. The concept, which combines effective scientific and technological developments and inventions, as well as resources that provide sustainable competitive advantages of the enterprise, is a science-intensive resource-market portfolio. In general, the integration of these approaches improves the analysis of the actual strategic position of the enterprise. Solutions with excess capacity are adopted on a wider information base. The feature of this approach is that here the type of diversification is dependent on the scientific base and the flexibility of resources. By concentrating on its strengths, the company has the ability to act immediately in many industry markets and to some degree insure against unplanned risks and cyclical fluctuations (fig. 6).



**Fig. 6. Conceptual knowledge-resource-market integration portfolio of the diversification strategy of entrepreneurial activity**

The integration of knowledge-intensive, market-based and resource-based approaches should be seen as a dominant component for implementing a diversification strategy that needs to be continuously developed, updated, and refined, depending on the conditions that «dictate» the market environment. A significant advantage of this approach is to combine individual knowledge and entrepreneurial capacity to make an effective business solution for developing and implementing a diversification strategy. Thus, the comparison of surplus resources and needs allows more accurate analysis of the real strategic position of the enterprise [24]. Therefore, an effective integrated approach to production, justification of promising strategic management recommendations and, most importantly, the diversification of entrepreneurial activity, is the key to the success of any business entity in the context of rapid and promising European integration processes. Proceeding from the fact that the pharmaceutical market of Ukraine is represented by pharmaceutical manufacturers, each of which has experience of work, reputation, price policy, product range, niche orientation, different approaches to treatment, etc., it is worth stressing the most acute issue facing them – compliance with quality standards and product promotion on the market. In turn, for Eastern European producer groups, there is a problem of positioning in local markets, for new generic companies – an increase in production, for innovative producers – the need of JV for the development and product sales, and for niche companies – the distribution of drugs. Combining all processes within a single drug production cycle is complicated due to the inadequacy of the production infrastructure of most Ukrainian enterprises to the requirements of GMP (Good Manufacturing Practice – part of the quality assurance system),

the lack of proper control over the quality of substances, marketing techniques, etc. Thus, Western partners favor only certain types of cooperation with Ukrainian drug manufacturers in the framework of multi-level partnerships with the possibility of medium-term cooperation in the allocation of working groups within a separate project; exchange of patents and licenses in accordance with the contribution of each participant in the partnership; production co-operation based on the technological cycle; cooperation in marketing or distribution. Therefore, for the successful cooperation of Ukrainian pharmaceutical companies with foreign partners, it is necessary to create an effective partnership model that would ensure the fulfillment of the tasks set, and was consistent with the goal and strategic guidelines for the development of the individual enterprise.

### V. CONCLUSIONS.

Based on the foregoing, it can undeniably be asserted that for Ukrainian enterprises the best result in partnership with foreign companies can be achieved in the event of a proper choice of an effective diversification strategy and a certain cooperation model. The most important thing to achieve this is, first of all, the optimal use of available and resources, which are an integral part of the modernization of production and investment attractiveness for the European Union. The positive result of such activity is:

- increase of sales volumes for national producers;
- reduction of state expenditures for the purchase of medicines;
- growth of revenue and receipt of cheap foreign drugs analogues for Ukrainians.

At the same time, the import substitution policy is very important for the state today – the increase of own medicine production process, production of the most necessary drugs for the population in order to provide it with high-quality national medicines. The fact remains that the leading pharmaceutical companies of the country should influence the formation of the pharmaceutical regulatory framework and its harmonization with the relevant European requirements, norms and standards. A striking example in this case is JSC «Pharmaceutical Firm» Darnytsia», which has been fruitfully cooperating with leading European pharmaceutical companies for several years now, which promotes better cooperation both at the enterprise level and at the state level. In future, the development of international partnerships in the pharmaceutical industry is to increase the scientific potential of the country to form a powerful business environment, to concentrate companies and to create alliances that will further Ukraine's integration into the world economic space.

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## AUTHORS PROFILE

**Oksana Zghurska,**

PhD in Economics,  
Associate Professor of Department of Enterprise, Trade and Exchange  
Activities  
State University of Telecommunications, 03680, Solomenska st. 7, Kyiv,  
Ukraine  
e-mail: [oksana.zgurska@ukr.net](mailto:oksana.zgurska@ukr.net)  
ORCID ID: <http://orcid.org/0000-0003-3878-3007>

**Tetiana Somkina,**

Professor, Doctor of Economic Sciences,  
Department of Enterprise, Trade and Exchange Activities;  
State University of Telecommunications, 03680, Solomenska st. 7, Kyiv,  
Ukraine  
e-mail: [t.v.semkina@ukr.net](mailto:t.v.semkina@ukr.net)  
ORCID ID: <https://orcid.org/0000-0002-7663-4136>

**Ruslan Dymenko, (the corresponding author)**

Associate professor without tenure, Head of the Department, PhD in  
Economic sciences,  
Department of Enterprise, Trade and Exchange Activities;  
State University of Telecommunications, 03680, Solomenska st. 7, Kyiv,  
Ukraine  
e-mail: [drainc@ukr.net](mailto:drainc@ukr.net)  
ORCID ID: <https://orcid.org/0000-0002-6980-8038>

**Tetiana Kapelyushna,**

PhD in Economics,  
Associate Professor of Department of Enterprise, Trade and Exchange  
Activities  
State University of Telecommunications, 03680, Solomenska st. 7, Kyiv,  
Ukraine  
e-mail: [oksana.zgurska@ukr.net](mailto:oksana.zgurska@ukr.net)  
ORCID ID: <https://orcid.org/0000-0001-7490-6751>