

DIVERSIFICATION BLUEPRINT

Managing in a
Diversified Organization

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Diversification has become the leper of management: something you certainly don't touch. As a result, stock markets have become great punishers of diversifiers, hitting them with a "conglomerate discount" in share trading. The message has gone out: diversification is bad, focus is good. The former has even been lampooned as "di-worsification."¹ So, managers and boards are frightened to stray from "core business," even though this concept proves illusive in practice. Books and articles have been written about how businesses should "stick to their knitting" and profit from their core² – a tradition that goes back at least to 1982, with Tom Peters' and Robert Waterman's book, *In Search of Excellence*.³

As a consequence, managers and their boards are basically faced with two prospects:

1. Stay focused, don't risk reprimand from colleagues, peers or the market; stick with the prevailing view against diversification,

or:

2. Be game and diversify, risking derision if something goes wrong.

It's a no-brainer. Best to avoid diversification altogether.

But organizations should be concerned about the cost of avoiding diversification, as the pendulum has swung too far to the focused side in organizational thinking. This swing leads to:

- a turning off of minds to diversification possibilities,
- a lack of awareness of methods to manage diversification,
- poor management of diversified organizations in all sectors, not just business, and,
- missed opportunities to grow a company and shareholder value.

This book is about how to diversify *and* succeed. It's addressed to three groups of managers:

1. Those who are afraid to diversify because of the critics and nay-sayers, and the reputation diversification has acquired,
2. Those who, in spite of the controversy, choose to run diversified organizations anyhow, but could run them better, and
3. Those who have no choice, e.g., they operate in the public-sector setting where diversification is mandated, but they could do a better job.

To all of you I say, "read on." There's much to be learnt in these pages from the workings of both diversified and focused successes – as well as diversified failures.

A DISCOVERY

From the research I've conducted for this book, I've come to appreciate that diversification *is*, in actual fact, widespread, even though the message against it has gone out, and some have heeded the call. It seems that diversification is almost the inevitable consequence of doing business – of running organizations.

Take, for example, your local real estate agent. That office is involved in two businesses: property sales and property management. The customers, employees, competitors, required skills and even technology in sales are quite different from those in rentals. Yet the business may only have two staff, the owner and one employee. The owner looks after sales, because large amounts of money ride on each transaction, while the employee manages the rentals, the more routine side. This is diversification *and* divisionalization in action. And with a staff of only two!

Take as another example our own small company – again

diversified. We operate three businesses under one structure: one in management consulting, one in management education, through which we conduct public seminars, and a third in the development of software for performance measurement. They each have separate brands, but are within the one company.

As yet a further example, take a building client of ours. With 250 staff, this company has diversified beyond construction to office and shop fitouts, to facilities management and maintenance, and, more recently, to property development. And so the list may go on until we get to General Electric, with over 300,000 employees spread around the world in a wide range of businesses.

Diversification in *business* appears to be more far-reaching than its critics appreciate.

But that's only the private sector. How about a not-for-profit organization that cares for adults with mental disabilities? Its clients live in suburban homes under the 24-hour supervision of a carer. It also operates a sheltered workshop, winning relatively simple packing contracts so that its clients can be usefully employed. But its diversification goes further: respite services are provided to family members who have someone with mental disabilities living at home.

In the public sector, diversification examples are also numerous. Look at any local government organization – a city, shire or municipal council – and note its diversity. One city council that my company has worked with has revenue of many millions and over 7,000 employees. It has so-called "business-units" in works, transport, water, city business development, parking, venue hire, waste services – the list goes on. As does the diversification and the complexity.

A FIELD IN LIMBO

In spite of all the discussion on the topic, managers are cut adrift in this diversification sea.

In 1993, Michael Goold and Kathleen Luchs reviewed four decades of management-thinking on the question of diversi-

fication. As they put it: “In the 1960s, the spectacular performance of a few successful conglomerates seemed to prove that any degree of diversification was possible ... In the 1970s, many diversified companies turned to portfolio planning, aiming to achieve an appropriate mix ... In the 1980s, many corporations restructured and rationalized, basing their strategies on ‘sticking to the knitting’ and eschewing broad diversification.”⁴ Their question was the old chestnut: how should managers approach diversification?

The authors’ conclusion, based on the research to that time, was that “evidence on the performance of companies pursuing more or less related diversification strategies is ambiguous and contradictory ... no firm relationship between diversification strategies and performance has been discovered.”⁵

In 2000, another two researchers, Aswin van Oijen and Sytse Douma, expressed a similar view when they wrote: “In spite of many years of experience and research, the jury is still out on the merits of product diversification. The notion that firms should limit themselves to a few core businesses has gained wide acceptance. However, ... highly diversified firms can still be very successful. The strategic management literature does not offer much support here. It is quite a challenge to find a subject that has been studied more often than the link between diversification and performance. Nevertheless, the findings of these studies remain inconclusive.”⁶

From 1993 to 2000 to the present day, the field remains in limbo. So what do managers and academics do?

The latter generally continue to seek to identify those special conditions under which diversification succeeds or fails. This search becomes increasingly refined and narrow – even focusing on and comparing different ways of measuring relatedness and their “construct validity.” Nothing wrong with all of this except that it starts to move away from the big question.

Posed by practitioners, this big question, like most, is simple: should I diversify or not? Well ..., says the academic with considerable hesitation – and the manager’s attention is

lost. While the academic world is the world of the average score, gleaned from research and multiple cases, the practitioner universe is that of the singular: *my organization, here and now*.

Michael Chaney, the previous CEO of one of the successful diversifiers, Wesfarmers, has thrown us a challenge:

“When I did an MBA in the late 70s there was a debate about whether you should be a conglomerate or a focused company and I have never paid much attention to the debate because it misses the point. If you look at the ASX [Australian Securities Exchange] over the past 20 years, the two companies that have done the best in terms of shareholder returns are Wesfarmers and Westfield. You couldn’t get two more different companies, with diametrically opposed strategies. Westfield is the focused property company that ran out of opportunities in Australia and went international, while Wesfarmers was the diversified company that stayed at home by diversifying more. Anyone who says a diversified company is worse than a focused company has to explain these two companies.”⁷

I agree. As Richard Rumelt observed in one of the field’s seminal works, *Strategy, Structure and Economic Performance*, “The heterogeneity of the major categories [of diversification] indicates that performance differences are not really related to diversity per se, but are more a function of the firm’s strategy for dealing with growth and diversity.”⁸

UNROLLING THE BLUEPRINT

In this book I take a fresh look at diversification and hope to renew your perspective by reviewing the management practices of several firms that have made it a winner for them over at least a decade. I’ve selected General Electric, Wesfarmers, Bidvest and ITC to show the way when it comes to diversification success. But, as a comparison, I’ve also looked at why focused companies succeed, firms like McDonald’s, David Jones and Westfield. Moreover, I have thrown into the mix a diversification failure: Burns Philp; a high-profile

diversifier that didn't make the grade: Berkshire Hathaway; as well as academic research and various consultants' reports that tell us why diversification has succeeded or why it hasn't and shouldn't. In choosing my sample of firms, I've also been careful to have a variety of countries in which the companies are headquartered. Thus Australia, India, South Africa as well as the United States are represented.

Managers have every right to be confused by "diversification." So Chapter 2, "What is Diversification?," examines the dilemma that managers face in dealing with the term. The chapter provides a working definition and illustrates diversification's many and varied dimensions.

Chapter 3, "Identifying Successful Diversifiers," lays out the criteria that I employed to select the diversified firms presented in Chapter 4. The chapter discusses investor-versus-economic performance in making assessments and stresses the importance of the measure, "return on equity." The chapter also explains why a firm needed to exceed a return on equity benchmark of 14 per cent every year for at least the last 10 years to be selected.

"The Diversified Exemplars" is Chapter 4. This outlines the functioning of the chosen successful diversifiers: General Electric, Wesfarmers, Bidvest and ITC, each of which is headquartered on a different continent and conducts different businesses. In addition to describing each firm in detail, the chapter presents their 10-year revenue, profit and return-on-equity performances.

Chapters 5 to 11 move to prescription and tender seven levers that you can pull to get diversification to work. These are: establish a supportive corporate center; select capable division managers; install appropriate performance measures; set effective incentives; align the corporate culture; secure competitive advantage; buy well and integrate. Each chapter reviews how the successful diversifiers manipulate each lever, looks at other corporate examples beyond the four exemplars and considers other publications on each topic.

We can also learn much about being successful from observing failure – what not to do. So Chapter 12, "Diversifi-

cation Goes Pear-Shaped," reviews the unsuccessful attempts of Burns Philp to diversify. This company went from highly diversified to more focused, but still faced ruin. The chapter identifies several drivers of its demise, but none of them, in the final analysis, was specifically product diversification. The chapter concludes that we may hasten to judgment in cases such as this, wrongly accusing diversification for firm failure.

Chapter 13, "Dabbling in Diversification," examines a further unsuccessful attempt to diversify. While the department-store chain, David Jones, has gone on to great success, it had to overcome the repercussions of its diversification dalliance. This took the form of Foodchain, which not only cost the company millions, but led to significant management and board changes. The case leads to a re-examination of the very basics of competitive advantage.

Chapter 14 takes a good look at a corporate icon – Berkshire Hathaway. "Diversification Genius?" analyzes the performance of the company over a 10-year period to try and discover how, in spite of not meeting the ROE benchmark of 14 per cent once in the last decade, it has made its founder, Warren Buffett, a very wealthy man. The answer lies in great self-promotion and in not paying dividends!

Chapter 15, "The Focused Message for Diversifiers," reviews the history and performance of two focused successes – McDonald's and Westfield. It addresses the question: What is it that successful focused companies do that divisions and business units within diversifiers can learn from? "Much," is the answer. The chapter reveals how focusing on an organization's key stakeholders and the strategic factors relevant to each is critical.

How we regard something affects how we react to it. Chapter 16, "Adopting a Different View," challenges you to think differently about diversification, not simply adopting a head-office perspective. Such a corporate view involves the search for relatedness among the divisions of a diversified organization. As the chapter demonstrates, this turns out to be a hollow quest. The alternative is a business-unit perspec-

tive, which brings into focus corporate support and business-unit competitive advantage.

Writing this book has been a wonderful learning experience for me and I hope, through your reading it, a useful one for you too. The last chapter, "Diversification Lessons," lays out nine broad lessons that this book and its accompanying research have produced.

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Also Franco, L.G. 2004. The death of diversification? The focusing of the world's industrial firms, 1980-2000. *Business Horizons*, July-August, 41-50.
 - 2 Zook, C. & Allen, J. 2001. *Profit from the core*. Boston: Harvard Business School Press. Zook, C. 2004. *Beyond the core*. Boston: Harvard Business School Press.
 - 3 "Sticking to the knitting" is a reference to the phrase used originally by Peters, T.J. & Waterman, R.H. 1982. *In search of excellence*. New York: Harper & Row. They suggested that successful corporations did not diversify widely but stayed with what they knew, their industry.
 - 4 Goold, M. & Luchs, K. 1993. Why diversify? Four decades of management thinking. *Academy of Management Executive*, 7(3): 7-25, p.7.
 - 5 Ibid, p.15.
 - 6 Van Oijen, A. & Douma, S. 2000. Diversification strategy and the roles of the center. *Long Range Planning*, 33: 560-578.
 - 7 Quoted in Arbouw, J. 2004. The NAB's strategic acquisition. *Company Director*, July: 8-13.
 - 8 Rumelt, R.P. 1974 (1986). *Strategy, structure and economic performance*. Boston: Harvard Business School Press.

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First published in 2008 by
President Press
PO Box 702
Mosman NSW 2088
Australia
Fax: (Sydney) 612 9969 2596
E-mail: contact@presidentpress.com
Website: www.presidentpress.com

National Library of Australia
Cataloguing-in-Publication entry:

Kenny, Graham (Graham Kevin)
Diversification blueprint : managing in a diversified organization / Graham Kenny.

Includes index.
Bibliography.
ISBN 9780980384413 (hbk.)

Diversification in industry.
Multiproduct firms.
Production planning.

658.5038

Design and layout by Simon Leong Design (SLD-1053), Sydney
Printed by Griffin Press

10 9 8 7 6 5 4 3 2 1
