Diversification
Worth the risk?

Branson and Stelios believe in eggs in many baskets and have spent much of their careers absorbing the failures in pursuit of big wins. **Doug Ross** sets out a plan for getting it right

Whether your business is as small and perfect as a single hummingbird's egg or as plentiful as a nest of ostrich eggs, it requires the intense husbandry of a good parent bird.

In an environment buffered by change, businesses need their 'parents' to be constantly vigilant; always ready to absorb and adapt to change. For successful incubation, outside factors like temperature and the proximity of predators need to be monitored and parental behaviour adjusted to lessen or take advantage of their impact.

The most consistent demand on management is the ability to read market changes and adapt the organisation to survive them. A good management team will not only survive change, but turn it to the organisation's benefit, successfully growing the business nest egg to leave competitors behind.

BRANCHING OUT

Diversification uses change as an opportunity to grow the business. It is also a risky strategy because instead of relying on the technical, financial and merchandising resources of the original product line, it involves a company acquiring new lines and/or markets, skills, techniques and facilities. However, the potential for rapid and expansive growth can make the risk worthwhile.

A defensive diversification strategy is born in response to a fluid business environment. If a current product provides no further growth opportunities, it will stagnate and lose market share in the face of rivalry. At this point, management must spread the organisation's risk in a contracting market to regain a competitive footing.

With an offensive diversification strategy, an opportunistic and alert management team can use retained revenue to grasp prospects for greater profits, leaping into gaps in the market and conquering new positions.

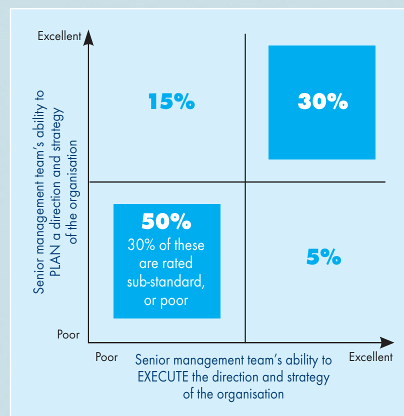
RELATED DIVERSIFICATION: KEEPING IT ON THE FARM

The animated movie *Chicken Run* is a feature-length example of related diversification. Mrs Tweedy owns a chicken farm from which she sells eggs. Frustrated by Mr Tweedy, who is convinced the chickens are organising a revolt, and the unreliable egg-laying of the birds, she plans a diversification strategy to grow the business and maximise profits. She invests in a pie-making machine, retrains Mr Tweedy to maintain it and launches a marketing campaign for Mrs Tweedy's homemade chicken

pies. The machine is sabotaged by the chickens who mobilise and escape.

A triumph of animated livestock, then, but a sad end to a good diversification strategy. It had all the elements required for success: meticulous planning; careful reinvestment of existing company resources to buy the pie machine; clever redeployment of employee skills (using Mr Tweedy to maintain it) and effective marketing and branding, with billboards that advertised the health benefits of Mrs Tweedy's new product line.

Mrs Tweedy's failure was her poor leadership. She failed to pitch her idea successfully to all the necessary stakeholders. Her promises to shareholders, customers and employee (Mr Tweedy) were sound, but the chickens did not share her vision. Understandably, in this case.



UNRELATED DIVERSIFICATION: EGGS IN MANY BASKETS

A savvy stockbroker will always recommend that his clients invest in a balanced share portfolio to spread the risk. In other words, if one basket is dropped, the eggs in the others remain unbroken.

An organisation with capital to invest may well take the same approach and diversify outside of its recognised area. This requires a leadership team with a sharp eye on the business environment, ready to take risks where opportunities arise.

Even better is a leader who can read the trend of a developing market and position the organisation to take advantage of opportunities before they arise and before the competition steps in. When asked about the secret of his unparalleled success, Canadian ice hockey champion Wayne Gretsky, aka 'The Great One', replied: "I skate to where the puck is going to be."

The downside of this type of diversification is that you need to pull in expertise from areas outside of the existing competencies of the business. This may require heavy investment in human and technical resources. And management must ensure that focus and commitment to the core business does not suffer as a result.

Despite the risky nature of unrelated diversification, there are many examples of firms practising this with great rewards: Richard Branson, from music to travel, mobile phones and fashion; the Disney Corporation from cartoons to movies to theme parks.

STRATEGIC LEADERSHIP

Without the insights and energies of the Tweedys and Bransons, the success of any diversification strategy is unlikely. The vital success ingredient is able, insightful leadership.

Research by our consultancy firm, Square Peg, has identified two crucial components in leadership which are often lacking: planning competency and execution competency, as represented in the figure (above).

The need to develop leadership can be addressed in terms of mechanical skills (leaders' competencies in strategy and planning, industry knowledge, technical and other skills) and dynamic skills (competencies in interpersonal and communications skills; personally displaying the organisation's behaviours and values; developing an approach that minimises personal agendas; influencing others to do the work rather than doing it themselves).

Our research shows that it is dynamic skills that require the most enhancement to address the gaps in competencies of many of today's leadership teams.

THE RIGHT ENVIRONMENT

There's no point trying to grow orchids in the Outback. Regardless of the diversification strategy, to successfully grow a business, a leadership team must ensure the conditions are right for growth to take place. The following factors will contribute to this:

- Intrepreneurialism: an intrepreneur is an employee who undertakes and operates a new venture and assumes accountability for the risks involved. Employees that are empowered and energised in an interpreneurial environment are more inclined/able to identify and implement opportunities to improve the business.
- Leverage of your brand: if a business brand has been nurtured, developed and marketed successfully, it will have the personality and equity to allow diversified expansion. This was the case with Canon, which was able to diversify from photographic equipment to a new range of office equipment.
- Letting your leaders get on with their work: limiting bureaucracy so leaders can get on with their work creates a high-value organisation. Employees require clear, fast processes so they can make rapid decisions. Only employees that have been entrusted to take risks can be expected to cope with the demands of diversification.
- Knowing and reviewing your success formula: a success formula is a common-sense statement of how an organisation will achieve success and profit on a sustainable basis. As the company meets new challenges, the original idea gets adjusted – how are new products introduced and launched; how are new managers found and trained?

WORTH THE RISK?

The decision to diversify will always be a calculated risk. In terms of a growth strategy, it is possibly the riskiest option there is, but it is also the one that can provide the greatest rewards. If the right eggs are spread around the right baskets – leadership, environment and opportunity – at the right time, the prospects are excellent for successful organisational growth.

Doug Ross is managing director of Square Peg International, a boutique consultancy firm that focuses on the people aspects of change in organisations. He specialises in areas related to mergers, acquisitions, joint ventures and cultural alignment.

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