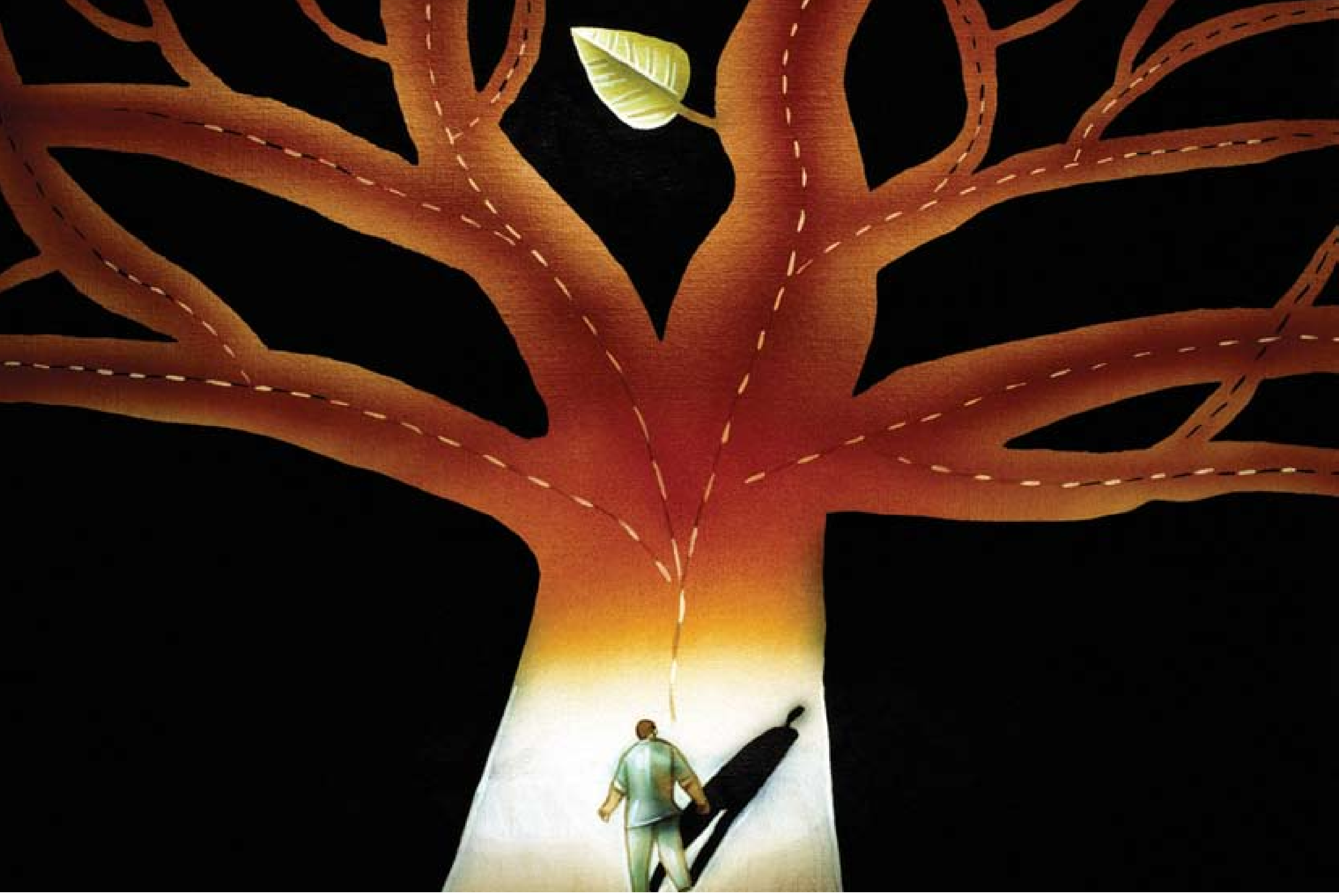


THE CASE FOR DIVERSIFICATION

When a business fails it is sometimes easy to claim that a company was 'too diversified'. One management expert, however, argues that this explanation can disguise a multitude of management sins.

The historical failures of expansion ventures by high-profile companies like David Jones and Burns Philp, according to management consultant Graham Kenny, reveal that poor planning, management, systems and processes are more likely to bring down a venture than diversification alone.

David Jones is now a highly successful high-end retail department store chain that increased profits by 25 per cent in 2008 to $147 million, on sales of $2.1 billion, and is aiming for 5–10 per cent profit growth despite a fragile retail market. Not bad for a company that started in 1838.

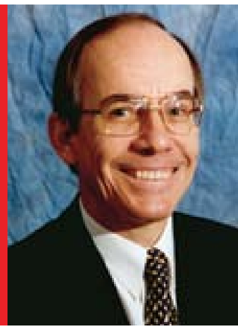
But, according to Kenny, in the mid-1990s David Jones lost its way. It slid downmarket and took on the likes of retailers Target and Kmart. The resultant deterioration was clear, as store clutter, overstocking and mixed messages became obvious to customers. As a result, DJs was punished financially.

In 1997, a new CEO, Peter Wilkinson, immediately set about repositioning the company in its traditional place. This involved a refocus of its product range, the closing of several stores, a reduction in inventory and an emphasis on cost controls. DJs was rewarded by its customers with an immediate return to form.

However, just as things started to look up in the department store's core business, its management and board started to look for further growth opportunities.

Foodchain was to be a major component of DJs's growth thrust with each store incorporating a cafe, bakery, patisserie, deli, seafood provedore and butcher. With high-quality meals for all occasions, wine and 4000 convenience items, these one-stop shopping

> "Diversification can deliver a silver bullet for growth but only when management has done its homework."
>
> *Graham Kenny, Strategic Factors*



locations were designed to provide competitively priced food by accessing a broad supply base.

Unfortunately it just didn't work, Kenny says. As *The Sydney Morning Herald* reported in September 2002, David Jones management failed to achieve competitive advantage in key areas and suffered the consequences. It took a $78-million hit on its venture.

A spicy tale

By 2006, Burns Philp was Australia's 95th largest company by market capitalisation, yet in December 2006, it was delisted, having been acquired by the Rank Group. From 1984 to 1996, searching for relatedness between its activities, Burns Philp sold businesses and investments worth $1.3 billion and bought businesses worth $1.7 billion. By the end of this restructure, the company was concentrated on three areas: yeast, antibiotics and spices.

However the diversification program via sale and acquisition proved spectacularly unsuccessful.

In 1987, Burns Philp purchased an Italian antibiotics business. Investing $295 million, the Italian business was finally sold for $44 million in 1995.

Between 1992 and 1994, it spent $500 million on spice company acquisitions in North America and Europe. Its US spice market competition, McCormick & Co, with a 30 per cent market share, fought back, as did a competitor in Germany. Management had misread the situation, not realising that McCormick was prepared to 'fight to the death'.

Burns Philp head office's attention on business-unit needs was dissipated. Ian Clack, Chief Executive at the time, said, "We did the best job we could with the management we had, but we didn't bring in enough new management to do the job." After a $700-million write-down, the company was near collapse.

On the positive side, during this same period, Burns Philp was employing its proprietary technology in yeast to turn what was a 1 per cent share of the world market in 1981 into a 16 per cent share in 1995, becoming the global leader.

Review

Kenny says that in cases like Burns Philp, it is tempting to take the simplistic view that highly diversified firms are prone to failure. Instead, he believes the real drivers for failure include:

> lack of effective management at the division level
> expansion overseas, with the cultural and regulatory differences and complexities this implies
> expansion via acquisition, with all the consequent organisational integration requirements
> failure to exercise effective due diligence in acquisitions
> lack of understanding of the industries that companies get in to
> too rapid expansion, resulting in head office staff being stretched
> lack of management discipline, that is, an inability to put in place the measures, systems and processes essential for success.

Diversifying successfully

Kenny says that it is too easy to write off corporate failures to diversification alone, and through his own research of successful diversified firms, had identified similarities in their success:

> the establishment of a supportive corporate centre
> selection of capable division managers
> installation of appropriate performance measures
> setting of effective incentives
> aligning of the corporate culture
> securing of competitive advantage
> buying well and integrating.

Kenny points out that diversification has often been treated as management's leper, leading to a turning off of management minds to the growth opportunities that diversifying a business can yield. Diversification can deliver a silver bullet for growth but only when management has done its homework and not become carried away by the glamour and excitement of expansion and acquisitions. MT

Graham Kenny is Managing Director of the management consultancy, Strategic Factors, and author of the book *Diversification Blueprint*, available through AIM bookstores.

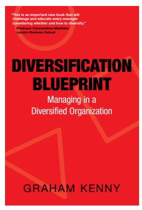


ILLUSTRATION: GETTY IMAGES