MINORITY SHAREHOLDERS WATCH GROUP
BADAN PENGAWAS PEMEGANG SAHAM MINORITI BERHAD
(Incorporated in Malaysia – Registration No.: 200001022382 (524989-M)

New Straits Times, Business Times – Thursday, 2 November 2023

RISKS AND OPPORTUNITIES

THE DIVERSIFICATION STRATEGY

DEVANESAN EVANSON

RECENTLY, glovemaker Careplus Group Bhd announced its foray into the manufacturing and assembly of energy-efficient vehicles.

Careplus said it was seeking opportunities to diversify into viable businesses given the challenges faced by all major glove players in the market. This market was in a red ocean fraught with oversupply and low average selling prices.

There was some scepticism on how it would fund its diversification into an industry far removed from glove manufacturing and the expertise of its new partners.

On Oct 25, Careplus, at its extraordinary general meeting, explained to shareholders its reasons for diversifying into the electric vehicle industry. The explanation must have been convincing since 99.99 per cent of shareholders voted in favour of the diversification.

Diversification is a strategic choice companies make to enter new business sectors, aiming to spread risk, capture new opportunities and create long-term value.

While diversification can be a powerful growth strategy, it comes with risks and opportunities.

Risks of diversification

1. Financial risk: One of the primary risks associated with diversification is financial. Entering a new sector requires significant capital investment, which can strain a company's financial resources. If the new venture does not perform as expected, it can lead to financial losses that affect the core business.

2. Operational challenges: Each industry has its unique operational requirements, and transitioning into a new sector often involves a steep learning curve. Inefficiencies or mistakes in operations can lead to increased costs and decreased profitability.

3. Market risk: Market conditions can change rapidly, and diversifying into a new sector can expose a company to unexpected market risks. For example, economic downturns or shifts in consumer preferences can negatively impact the performance of the newly diversified business.

4. Brand and reputation risk: A company's reputation is a valuable asset. Diversifying into a sector with different values or ethical considerations can pose a risk to the company's brand if not managed carefully. Negative perceptions about one business can spill over and affect the entire brand.

5. Cultural misalignment: Different industries may have distinct corporate cultures and norms. A lack of cultural alignment can lead to issues in integration, employee morale and teamwork, which can ultimately affect the success of the diversification strategy.

Opportunities of diversification

1. Risk mitigation: Diversification can reduce the company's reliance on a single market or industry. This is particularly important in industries prone to cyclical fluctuations. By spreading investments across various sectors, a company can better weather economic downturn.

2. Revenue growth: Diversification offers the opportunity to tap new sources of revenue. This can result from cross-selling products or services to existing customers, entering emerging markets, or capitalising on synergies between the diversified businesses.

3. Innovation and learning: Diversifying into a new sector often requires acquiring new skills and knowledge. This can lead to innovation and the development of new capabilities that benefit the entire organisation. Learning from different industries can foster creativity and a competitive edge.

4. Global expansion: Diversification can provide opportunities for global expansion. A company can leverage its existing resources, such as distribution networks or supply chain capabilities, to enter international markets more effectively.

5. Portfolio balancing: Companies can balance their portfolios to ensure a mix of businesses that are at different stages of their life cycles. While some sectors may be mature and generate steady cash flow, others may be high growth, offering the potential for substantial returns.

Successful diversification strategies

1. Thorough market research: Prior to diversifying, extensive market research is crucial to understand the dynamics, potential risks and opportunities of the new sector. This includes evaluating market size, competition, customer behaviour and regulatory factors.

2. Synergy identification: Seek sectors where synergies can be leveraged between the core business and the new venture. This can lead to cost savings, cross-selling opportunities and enhanced overall performance.

3. Risk management: Implement robust risk management practices to mitigate potential downsides. This includes financial contingency plans, monitoring of market conditions and a well-defined exit strategy if the new venture underperforms.

4. Talent and leadership: Ensure the right talent and leadership are in place to drive the diversified business. This may involve hiring experts from the new sector or training existing employees to bridge the knowledge gap.

5. Balanced portfolio: Maintain a balanced portfolio of businesses to ensure a mix of cash cows and growth opportunities. This diversification strategy minimises the impact of business cycles and economic downturns.

6. Flexibility and adaptability: Companies should be flexible and adaptable, ready to adjust their diversification strategy in response to changing market conditions or new opportunities. Agility is key to success.

Diversification can be a powerful strategy for companies seeking growth and risk mitigation, but it has its challenges. To succeed in diversification, companies must carefully assess the risks, undertake thorough market research, and develop strategies that leverage synergies and innovation.

Maintaining a flexible and adaptable approach is also essential in a constantly evolving business landscape.

Successful diversification can lead to revenue growth, portfolio balancing and enhanced competitiveness, ultimately creating long-term value for the company and its stakeholders.

However, a poorly executed diversification strategy can turn a venture into "diworsification", resulting in financial setbacks and damage to the brand's reputation.

The writer is chief executive officer of Minority Shareholders Watch Group.