Diversifying for Profitability: How Expanding into New Products, Markets and Regions Can Build Sales and Business Longevity

A white paper discussing how different types of diversification, based on listening to customer needs, can drive a successful strategy.

"Should we diversify?" This question comes up time and again in boardrooms and leadership meetings across America. When business is booming, the answer may seem obvious. During tough economic times, it can be harder to say "yes" to investing the time, money and resources necessary for expanding into new products, markets and regions.

Diversification might feel like a daunting task, but it's often a significant driver for improving a company's ability to meet customer demand, enhance market position and grow long-term profitability.

UNDERSTANDING THE NEED TO DIVERSIFY

Just ask Joe McAleese, president and CEO of Bendix Commercial Vehicle Systems in Elyria, Ohio. A producer of air brake and filtration systems for heavy-duty commercial vehicles, Bendix has used multiple diversification strategies to mitigate the impact of participating in a primarily cyclical market.

"In the trucking industry we serve, there are four large original-equipment customers," says McAleese. "The industry follows the economy and is very cyclical. To survive, our company has made a conscious effort to diversify across customers and markets so that we have different business cycles over time."

While depending on a single market is risky, so is relying on a small customer base. According to McAleese, there are three main reasons why companies need to expand the number of customers with whom they do business. Diversifying will:

- 1. Reduce the risk of failure. If a manufacturer relies on only a few large customers, losing just one customer could be disastrous for business.
- **2. Decrease pricing pressures**. Customers are likely to apply intense pressure for lower prices if they discover how heavily a supplier relies on them for business. It might be tempting to reduce prices to keep a major customer, but that is ultimately detrimental to sales and profitability.

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3. Increase a company's competitiveness. Focusing on one or two customers can constrain a company's thinking and growth prospects. According to McAleese, "Your one big customer may not be on the leading edge of market needs or technology. When you respond only to what they want, it may not be what's best for your entire customer base."

DIVERSIFICATION STRATEGIES

Getting more customers – and more business from existing customers – can be achieved through a variety of methods, including horizontal, vertical and geographical diversification.

Horizontal Diversification

With horizontal diversification, manufacturers expand their portfolio with new products and services, thereby increasing sales among existing and new customers in their target market segments. In addition, they may choose to leverage their abilities in new industries.

In either case, companies must ensure that their diversification strategy is based on core competencies, meets customer needs and is financially lucrative.

That's how Bendix successfully diversified into both new products and markets. The company started as an air brake manufacturer in the early 1920s. Today it sets trucking industry safety standards with a full line of comprehensive air brake systems.

"Safety is central to our product diversification strategy," says McAleese. "The Bendix brand is very well known for safety, and that comes with a quality message as well. Our key focus is improving on-vehicle safety and reducing the number of annual highway deaths involving heavyduty vehicles. The question is, if that's your focal point, then how do you execute it?"

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For Bendix, the answer was to apply its commitment to safety and quality into products such as compressors, valves, anti-lock brake systems, stability systems and drive assistance systems. Bendix also moved to a modular product focus, adding more value to truck builders by supplying integrated assemblies rather than individual parts.

The company has also grown by applying its core competencies to adjacent markets, including specialty vehicles like refuse trucks. "Their customer requirements are the same, so it was easy for us to understand and enter that market," says McAleese. "While specialty vehicle producers use the same products, their demand doesn't necessarily cycle with truck builds, so that's an opportunity for us."

Vertical Diversification

With vertical diversification, manufacturers build capabilities by expanding into different levels of their supply chain or distribution channels.

Forward vertical diversification in the supply chain occurs when a company can add customer value in terms of product performance and customer service. When companies integrate backwards, value is realized from taking costs out of the process.

"I'm not a big fan of going backwards and integrating what our suppliers are doing," says McAleese. "Our customers don't buy from Bendix because of the things being done in our supply chain. Instead, they are buying from us because of the knowledge we have and what we're doing in our operations to improve safety on the road."

Often companies find that great results come from putting resources into growth opportunities rather than cost-out measures. McAleese believes that the best financial returns come from finding out what customers are currently doing and what they dislike most about what they do, then managing those activities for them. That way, the manufacturer moves itself forward in the supply chain and is considered more integral to the customer's business.

"In our case, we're good at delivering product 100% on time and dealing with supply chain complexity," he says. "So as our product approach migrated from components to more integrated systems, we were able to take inventory out of our customers' facilities. Now we provide them with a more complete system and are managing that system's supply chain complexity for them. We've also expanded the real estate we take up on a single truck. It's helped us grow our business, gain profitability and become much more valuable to our customers."

Geographical Diversification

Expanding outside home markets is often the most challenging type of diversification, but it can yield outstanding results.

To succeed, research target countries, be selective about opportunities and understand that the most profitable regions are not always the easiest places to do business.

McAleese's advice is to pick the low-hanging fruit, but remember that there are other places your company can make more money. Bendix had operations in the U.S. and Mexico in 2002 when it was acquired by Knorr-Bremse Group, a global leader in braking technology based in Germany. Since then, Bendix has leveraged its parent company's existing infrastructure to penetrate European markets. Because Europe's heavy truck market is considered mature, however, McAleese believes his company's future growth opportunities lie in Asia.

"It's harder to go where you don't have infrastructure and capital," he says. "But right now, companies in China and India are demanding better products and looking for local supply of high-quality products. For us, we have to play in those regions – not just to export back to our existing markets, but to really build our company over the long-term."

INORGANIC EXPANSION

Particularly when entering an unfamiliar region, joint ventures, acquisitions and strategic alliances can be effective entry points. They can also propel a manufacturer into complementary products and technologies that lie just outside its existing core competencies.

Whether an inorganic growth investment is intended to expand at home or abroad, McAleese recommends carefully examining everyone's goals prior to closing the deal.

"What's important is the strategic intent of the companies involved," he says. "Do they think the same way? Are they interested in long-term growth or just how much money they'll make next quarter? If you have differences in company philosophy, spirit and culture, it's very difficult to make things work. But they're extremely effective if you're on the same page. We've made acquisitions that have helped us improve our products, opened us up to new customers and built our brand."

GETTING STARTED

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For a manufacturer with little or no current diversification, it can be difficult to know where to begin. McAleese recommends looking at the existing customer base. If a company only has a few major clients, then it should immediately look at diversifying its customer base. If the company already has several customers, then it should approach them to talk about growth opportunities.

"Understand what their core competencies are and where the opportunities are for you to fill in the gaps," says McAleese. "They might need a different widget, assembly or process work that you're not currently offering."



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Once customer needs are established, manufacturers should go through an annual strategic planning process looking three to 10 years out. The plan should cross-reference customer needs with market data to ensure a fact-based approach to diversification and capital investments. It also should include growth objectives and a priority list of how resources will be deployed to achieve those goals.

McAleese added that keeping customers involved in the planning process is crucial. At Bendix, his team routinely gets customer feedback to ensure that they are on the right track when it comes to new product development, diversification opportunities and service levels.

"We have to have an intimate knowledge of our customers and their end-users to know how to prioritize our own growth activities," says McAleese. "The only reason we exist is because they are willing to buy what we are offering. Remember, the path to growth and profitability is directly through your customers."

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