BDC STUDY

Diversify, Diversify, Diversify…

A Key Growth Strategy for Small and Mid-Sized Firms

November 2015

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Canada

FOREWORD

Diversification and Financial Performance: A Close Connection

This report was inspired by a single question that arose as oil prices fell to multi-year lows in early 2015: What relationship, if any, exists between diversification and financial performance among small and mid-sized businesses?

Based on a survey of nearly 1,000 Alberta businesses, this report finds that diversification—whether measured in terms of products and services, geography, or number of customers—correlates strongly and positively with financial success. Not only are the most diversified businesses by far the top performers, but even somewhat diversified firms are likely to outperform those that are undiversified.

Diversification is found to be independent of business age and positively associated with financial performance, regardless of business size. Put differently, diversification appears to be a strategy that many successful entrepreneurs utilize right from the start.

ABOUT THIS REPORT

This report is based on a March 2015 survey of Alberta-based businesses with between 5 and 499 employees. Almost 1,000 responses were received.

Small and mid-sized businesses in Alberta face an extra layer of challenges compared with their counterparts in other parts of Canada. The province's heavy dependence on the energy sector means that business conditions are unusually sensitive to price swings in a single, volatile commodity. The plunge in global oil prices has underlined that sensitivity over the past 18 months.

Against this background, the Business Development Bank of Canada launched a study earlier this year to examine whether Alberta-based firms that offer a range of products or services to a broad client base have an edge over those with a narrower focus. The question we sought to answer was: Do more-diversified businesses outperform their less-diversified counterparts, especially during market downturns?

Highlights

Overall

> Regardless of size, even modestly diversified businesses outperform their less-diversified counterparts. Small and mid-sized firms that are diversified in at least two ways (by customer, product or service, sector, location of markets, or location of operations) are far more likely to achieve strong financial performance.

> The most diversified firms experience by far the fastest growth in revenue and profits. While almost 7 in 10 fully diversified firms achieved high revenue and profit growth over the past three years, fewer than 2 in 10 undiversified firms managed to do the same.

> Diversification is unrelated to business age. Younger firms are just as likely to be diversified as older ones.

Sector-specific findings

> In the resources sector, financial success correlates strongly with having clients in more than one city. Similarly, a low reliance on any one customer is the biggest predictor of whether resources firms are confident about their prospects over the next 12 months, despite the downturn in oil markets.

> In construction, offering multiple product or service lines is mostly highly correlated with strong financial performance. As in the resources sector, construction businesses that do not rely heavily on any one customer are most likely to feel optimistic about the coming year.

> In manufacturing, firms that export are by far the most likely to have enjoyed fast growth in both revenue and profits.

This report contains profiles of five Alberta businesses that have reaped significant benefits from broadening their horizons beyond a single product, market or major customer. BDC consultants in Alberta have provided some practical advice for small and mid-sized businesses trying to navigate a resource-dependent economy.

This research was prepared by the Economic Analysis team from Marketing and Public Affairs.
Reliance on and use of this information is the reader's responsibility.

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INTRODUCTION

This study does not go so far as to suggest that all kinds of diversification benefit all firms. It does conclude, however, that some kinds of diversification correlate strongly with success in some sectors. It also suggests that, as a general rule, the most diversified small and mid-sized businesses grow faster than their less-diversified counterparts.

Is Diversification Related to Business Performance?

Diversification has a long and varied history as a research topic. In the world of finance, it was most famously studied by Nobel Prize-winning economist Harry Markowitz as far back as the early 1950s.[1] Markowitz's seminal work, commonly known as "modern portfolio theory," holds that diversified portfolios of investments outperform undiversified ones for any given level of risk. Accordingly, in finance, diversification is usually considered unequivocally beneficial.

In the world of business, subsequent studies have shown that modern portfolio theory applies only in a limited way to individual firms. From the perspective of large enterprises, several studies have shown that those that are somewhat diversified in products and services, sectors, or geographical region are likely to outperform those with a narrow focus, as well as those that are highly diversified.[2]

Put differently, optimal diversification for large businesses—unlike optimal portfolio diversification—appears to entail finding a "sweet spot" in which a firm is neither overly concentrated, nor spread too thinly. Thus, a car manufacturer would usually be better served by making other types of vehicles than by diversifying more narrowly by simply offering a wider range of cars. Furthermore, diversifying across the transportation sector would normally be more beneficial than moving into a totally unrelated sector.

What about small and mid-sized businesses, whose organizational constraints differ from those of large firms? For this type of business, diversification is arguably a more complex issue and one that has been researched less fully. For one thing, small businesses can have high risk exposure in ways that large firms do not. In some industries, for instance, small and mid-sized businesses often maintain significant exposure to a single major client. These industries, which include natural resources and aerospace, tend to be characterized by having just a few large firms at the top of the supply chain. High risk exposure can also arise from offering just one product or service line, even if a business has a broad customer base.

Not all small and mid-sized firms are undiversified, however, and diversification is not merely a function of size or age. Our survey shows that some small businesses decide early on that diversification is important. Similarly, while highly diversified businesses are—as one might expect—larger, on average, than their undiversified counterparts, diversification is positively linked with financial performance regardless of firm size.

1 Markowitz, H. Portfolio Selection. *The Journal of Finance* (1952).
2 See, for instance:
- Grant, R., Jammine, A., and Thomas, H. Diversity, Diversification and Profitability Among British Manufacturing Companies 1972-84. *Academy of Management Journal* (1988).
- Lubatkin, M. and Chatterjee, S. Extending Modern Portfolio Theory Into the Domain of Corporate Diversification: Does It Apply? *Academy of Management Journal* (1994).
- Zahavi, T. and Lavie, D. Intra-Industry Diversification and Firm Performance. *Strategic Management Journal* (2013).

I. TYPES OF DIVERSIFICATION

What does it mean for a small business to be diversified? This report examines five kinds of diversification stemming from the following common risks that small businesses encounter:

> **Depending on a single customer or client, to the point where the loss of this client would dramatically affect the entire business.**[3] In this study, "client-diversified" businesses are defined as those that do not run this risk. Their revenue base is sufficiently diversified that they would not be impacted significantly by the loss of even their biggest customer.

> **Concentrating the entire firm's resources on a single product or service line.** This is sometimes referred to as "obsolescence risk"—the risk that the firm's products or services are no longer marketable because of changes in tastes or technology. In this study, "product- or service-diversified" businesses are defined as those that have protected themselves against this risk by offering at least two major product or service lines.[4]

> **Operating in a single sector.** The fortunes of these firms are tied to the sector in which they operate, leaving them exposed to the risk of a sudden contraction in the sector's activity or, worse, its long-term decline. In this study, "sector-diversified" businesses are those that operate in at least two sectors, thereby mitigating this risk.

> **Serving customers all located in a single city or town.** As a result of having such geographically limited markets, these businesses are likely to perform only as well over the long term as the area in which they operate. "Client-geographic diversified" firms in this study are those whose regular clients are located in at least two cities, and which are therefore less exposed to geographic risk.[5]

> **Operating in a single physical location.** While their customers are not necessarily all located in the same area, these businesses are usually constrained by a heavy dependence on a single location for office and factory space, foot traffic (e.g., in the case of retailers) and skilled labour. "Business-geographic diversified" firms in this study are those that operate in at least two cities or towns, and are accordingly less exposed to these risks.

3 BDC. *The Five Do's and Five Don'ts of Successful Businesses* (2014).

4 For a discussion of the interplay between product and geographic diversification among larger firms, see Hitt, M., Hoskisson, R., and Kim, H. International Diversification: Effects on Innovation and Firm Performance in Product-Diversified Firms. *Academy of Management Journal* (1997).

5 Additional analysis is undertaken at the country level for both types of geographic diversification.

2. SURVEY OVERVIEW

The survey was conducted by telephone in March 2015 by Nielsen Consumer Insights (see Appendix A for a full description of survey methods). It targeted businesses based in Alberta, established for at least three years, and with between 5 and 499 employees. Businesses in all sectors except utilities and public administration were eligible to complete the survey. In total, 998 complete responses were received.

Respondents are grouped in seven broad sectors (see Appendix B for the full survey questionnaire):

Resources	- Agriculture, forestry, fishing and hunting - Mining and oil and gas extraction (including support services)
Trade, accommodation and food services	- Accommodation and food services - Retail trade - Wholesale trade
Professional services	- Information and communication technologies (ICT) - Professional, scientific and technical services - Finance, insurance, real estate and leasing
Manufacturing	- Manufacturing
Construction	- Construction
Education and health care	- Health care and social assistance - Education services (from "other" category in questionnaire) - Childcare (from "other" category in questionnaire)
Other	- Transportation and warehousing - Arts, entertainment and recreation (from "other" category in questionnaire) - Other services (from "other" category in questionnaire) - Other

3. RESEARCH FINDINGS

The survey results suggest that certain types of diversification are far more common than others among small and mid-sized businesses in Alberta (chart 1).

A majority of businesses report that they are diversified with respect to:

> offering a range of product or service lines;

> having clients in different cities; or

> not depending heavily on a single client.

On the other hand, most are not diversified when it comes to:

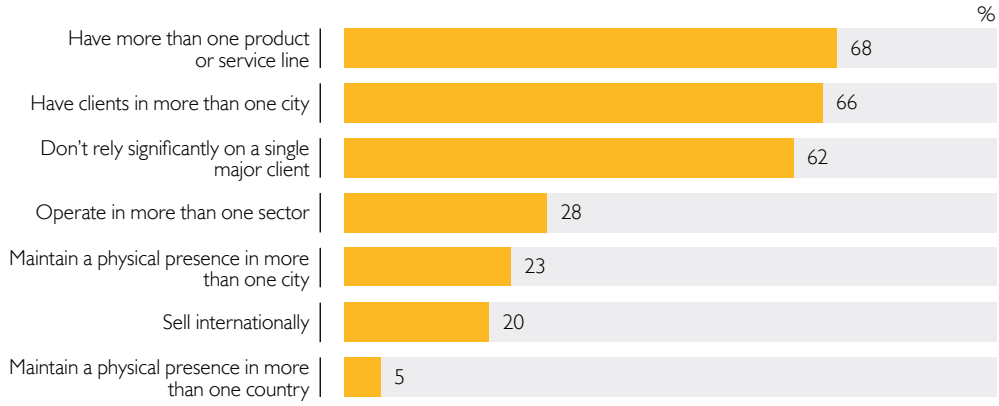
> operating in multiple sectors;

> having a physical presence in more than one city; or

> selling internationally.

While it is encouraging that most Alberta businesses diversify in at least one way, the proportion of firms exposed to even the most basic risks is significant. This research suggests that roughly a third of Alberta businesses offer a single product or service line, while almost 4 in 10 rely heavily on a single major client.

Chart 1: The degree to which small and mid-sized businesses in Alberta are diversified (proportion of businesses that...)



The type and extent of diversification vary widely across sectors. Most retailers, for example, are diversified in both products and customers, while resource-based and professional services firms are far more likely to be geographically diversified. These sector-specific tendencies make it difficult to generalize about a particular type of diversification using the overall sample. Even so, it is possible to draw three important conclusions about small-business diversification in Alberta:

1. **Regardless of size, diversified businesses experience stronger financial performance.** Perhaps the single most important finding of this survey is that even a modest degree of diversification is associated with superior financial performance among both small and mid-sized businesses. Our survey results show that small firms that have diversified in at least two ways are more likely to achieve fast average annual revenue and profit growth (charts 2 and 3). Among mid-sized firms, diversification is an even clearer predictor of financial performance: Not a single firm that is diversified in fewer than two ways reports achieving high revenue growth (chart 4).

Chart 2: Diversified small businesses (5 to 99 employees) are far more likely to experience fast growth in market share

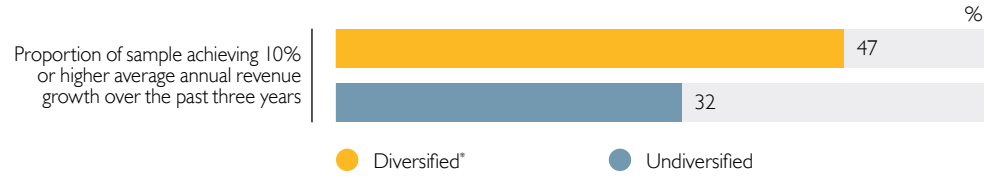


Chart 3: Diversified small firms are also far more likely to experience fast growth in profits

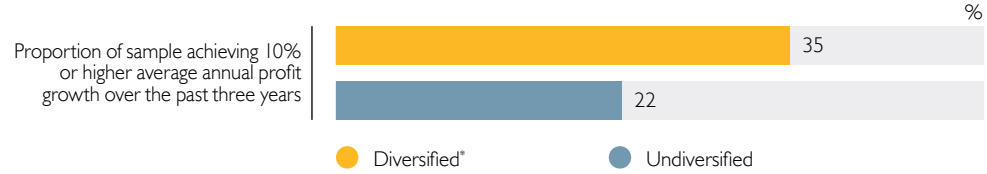
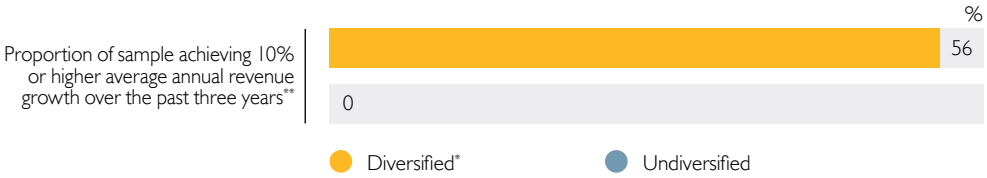


Chart 4: All fast-growth, mid-sized businesses (100 to 499 employees) are at least modestly diversified



* Defined as being diversified in at least two ways
** Statistically significant at the 10% level

MIQUELON METER SERVICES

MIQUELON METER SERVICES SPREADS ITS WINGS

Blake Patras, President of Miquelon Meter Services, an Edmonton-based manufacturer of gas and liquid measurement equipment, knows a thing or two about international diversification. "Our latest numbers show that close to 50% of our sales are coming from outside Canada," says Patras. "And that's spread out overseas, not just to the U.S." In fact, Miquelon's biggest growth market is currently Southeast Asia, where Patras spends a significant amount of time developing new business.

"It takes a lot of perseverance and sometimes multiple trips abroad to find new business," says Patras, "but I've managed to build new business links in every country I've been to, and we've opened up to that many more markets." While he doesn't think anyone should go in believing that doing business in other countries is easy, Patras sees international diversification as a must for Miquelon to grow. "You can't just grow indefinitely in any one market," he says, "but if you open your business up to new markets, it's a really good way to grow longer term."

What are Patras's secrets to achieving global success? Partnering with provincial and federal government trade missions and Export Development Canada has been instrumental, he says. "Businesses should be prepared and get all of the help they can in trying to diversify geographically. Utilize all avenues federally and provincially, because they will make your life a lot easier."

For more information about Miquelon Meter Services, visit www.miquelonmeter.com.

2. **Overall, the most diversified firms are the top performers.** A clear relationship emerges between financial performance and the extent of diversification, with the starkest differences between firms that are most and least diversified (charts 5 and 6). While almost 7 in 10 fully diversified firms report achieving high revenue growth over the past three years, fewer than 2 in 10 undiversified firms have managed to do the same.

Chart 5: The most diversified businesses are the top performers in terms of market share growth

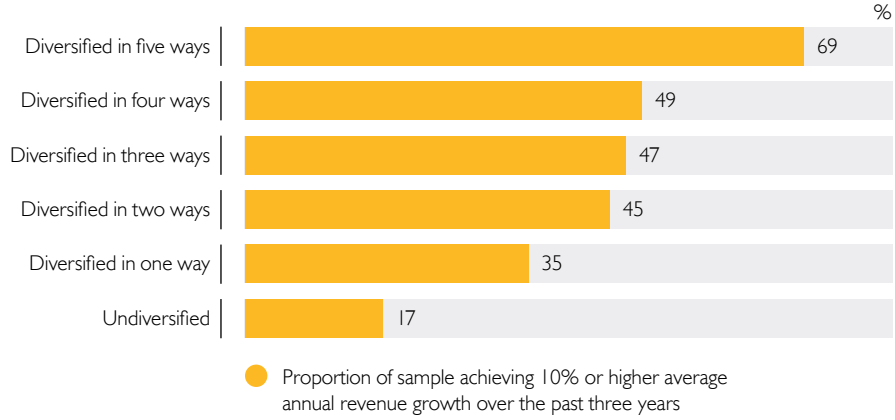
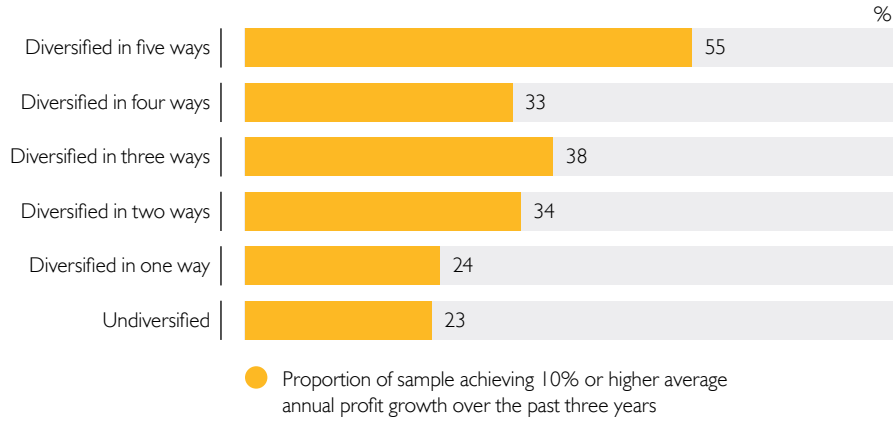
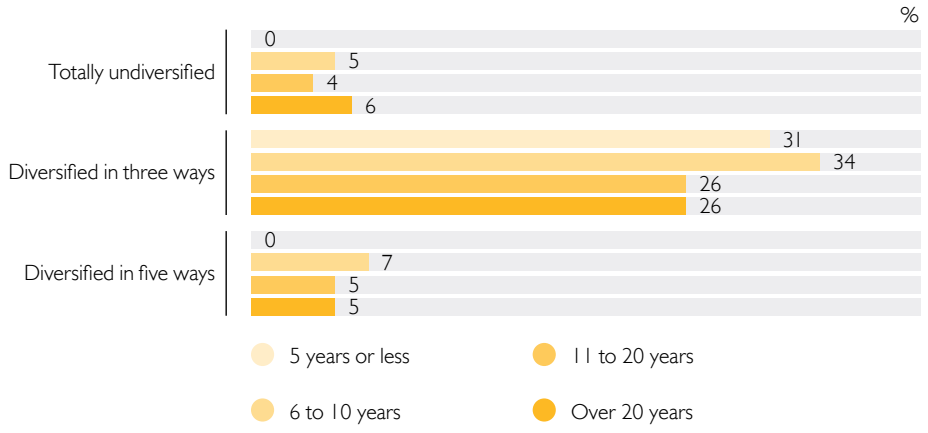


Chart 6: Similarly, the most diversified businesses have achieved the strongest growth in profits



3. **Young firms are just as likely to be diversified as older firms.** Surprisingly, age is not a statistically significant factor in determining the degree to which businesses are diversified. The cohort where firms are most likely to be diversified in all five ways is the "6 to 10 years" age bracket. The "over 20 years" group is most likely to be diversified in just two ways. While the relatively small "5 years or less" cohort contains no businesses that are fully diversified, it also contains none that are totally undiversified. In any case, the differences between age groups are mostly small and not statistically significant (chart 7). In short, young firms appear to diversify just as much as older firms, suggesting that the individual entrepreneur's mindset is paramount.

Chart 7: Business age and degree of diversification are unrelated



SUPREME MEN'S WEAR

HOW SUPREME MEN'S WEAR SETS ITSELF APART FROM THE COMPETITION

It's no secret that retail trade has been transformed by the Internet. Consumers are able to buy almost everything online; as a result, profitably selling mainstream consumer goods, as retailers have done for generations, has become increasingly challenging.

How has Calgary's Supreme Men's Wear, a retailer of fine men's clothing for almost 70 years, overcome these obstacles and continued to flourish? Darren Biedermann, owner of Supreme, attributes much of his business's success to two things. First, Supreme offers a unique range of luxury items and is not competing in the same mass-market space as other retailers. Second, Supreme produces two proprietary brands, Supreme and Biedermann. Both are exclusively made in Canada and have grown to the point that they now account for nearly a third of Supreme's revenue.

"Product and service diversification is where our competitive edge kicks in," says Biedermann, who foresaw increased competition between retailers selling mass-market items years ago. "Stores are all slowly starting to look the same. We want our clients to stand out from the crowd."

To ensure that his business continues to offer a strong value proposition, Biedermann has gone to great lengths to find distinctive fashions. "I surround myself with very passionate people," he says, "and we aim to provide our clients with a welcomed deviation from the predictable in our industry. Even though we've been around since 1948, it is paramount that Supreme stays on the edge of fashion."

What's next for Supreme? "We intend to step more into manufacturing and, of course, e-commerce," Biedermann says. "Right now, we house a successful luxury clothing line that other retailers would be interested in selling. I have always wanted to put my name on the finest shirts on the planet, and now they are being proudly produced here in Canada. We are also building Supreme's online store, with new developments towards that launch daily. I believe that e-commerce is essential to secure any retailer's future."

For more information about Supreme Men's Wear, visit www.suprememenswear.com.

Strategies for Small and Mid-Sized Businesses

It is rare for a business strategy to achieve the goals of lower risk and higher growth simultaneously. Diversification is an exception, but deciding when and how to act can be difficult. BDC's Calgary-based consultants have the following advice for business owners on how to develop a diversification strategy:

> **Leverage the business's core strengths.** When looking at how to diversify their business, entrepreneurs should start by asking whether they are creating synergies. Can existing assets such as offices and other buildings, machinery, or staff be used for other purposes without adding cost? Does the diversification strategy ensure that the business capitalizes on skills it has already developed?

> **Address weaknesses.** Entrepreneurs should constantly stress test their business. What would happen if it were to lose its biggest client, or if an economic shock or new disruptive technology were to hit demand for a particular product or service? Can the business protect itself from the biggest risks it faces? The solutions may not be hard to find—they could be as simple as gaining a few more regular clients, or adapting an existing product or service.

> **Ensure that financial resources can sustain existing operations.** Any sound diversification strategy must ensure that existing operations will not be compromised. There are lots of ways to diversify, and entrepreneurs should carefully consider the least expensive and complicated options. There may be ways of opening new markets with relatively small changes to existing products or services. Similarly, the ease of doing business in foreign markets varies greatly; think carefully from the start about the time, money and other resources involved.

The survey included questions that sought to uncover why some businesses choose to diversify while others do not. Businesses that are diversified in at least two ways were asked about their reasons for doing so, while those that are not were asked why they have not diversified more.

How Do Businesses Decide Whether to Diversify?

Why some businesses diversify…

The two most common reasons for diversifying are "growth" (25%) and "survival" (11%) across the overall sample. Although not always statistically significant, an interesting pattern emerges at the sector level as to which of these reasons is considered more important. "Growth" is the most common answer given in sectors with a high concentration of relatively small customers, such as trade, accommodation and food services, and professional services. On the other hand, "survival" is more common in sectors with a few, very large potential customers, such as resources, and education and health care.

One possible interpretation is that in sectors with a few large customers, small and mid-sized businesses feel that they need to offer a wider range of products and services to remain competitive; in sectors with lots of smaller customers, diversification is not viewed as a means of survival, but simply as a means of exposing the business to a wider range of markets.

…and others don't

By far the most common reasons businesses do not diversify are that they see "no need" or they have "no interest" (27%), while rationales such as "lack of funds" are relatively uncommon (8%). Given these responses, we hope that the findings of this report will inspire at least some to take a second look at the possible growth and risk mitigation benefits of expanding their customer base, or developing new product and service lines.

W.A. GRAIN & PULSE SOLUTIONS

LEAVING NO STONE UNTURNED: W.A. GRAIN & PULSE SOLUTIONS

Started just eight years ago as a single processing facility handling a single product—peas—for export, W.A. Grain & Pulse Solutions has since grown by leaps and bounds. The company now operates four food processing facilities and ships a wide range of farm products. It exports to no fewer than 22 countries, operates across three provinces and is continuing to grow.

How has W.A. Grain been able to achieve such impressive growth? In part, the business has grown by diversifying in almost every conceivable way.

"Spreading out our risks and being represented in a big geographic area limits our exposure to risk," says Chris Chivilo, President of W.A. Grain. "And because we're well-diversified, if one crop or one region does poorly, we just concentrate on other crops or other areas to keep our volumes up."

In other words, while diversification can be a tool to limit overall business risk, it can also be used to provide additional avenues for growth. Today, W.A. Grain is looking to move away from its conventional commodities focus by going into health foods. "There is a growing market for things like organic and gluten-free products," says Chivilo, "and it will allow us to move away from being solely focused on volume in traditional agricultural commodities."

Chivilo has a word of advice to other businesses: "Ensure you research the new market, or whatever it is you're looking at, to make sure it's right for your company. Before looking to diversify into health foods, we commissioned a feasibility study that identified things like the key markets, customers, countries and products that people were buying currently. It gave us the confidence and the information we needed before moving ahead."

For more information about W.A. Grain & Pulse Solutions, visit www.wagrain.ca.

4. SECTOR-SPECIFIC FINDINGS

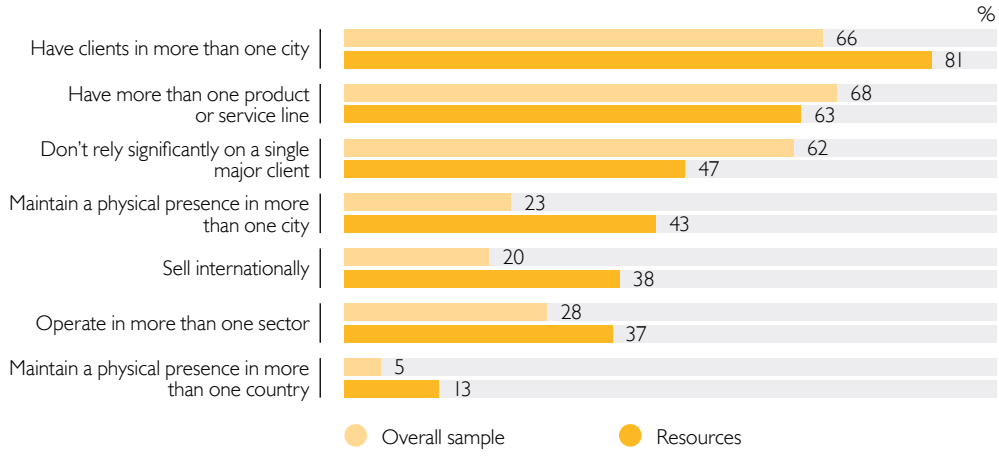
Some of the survey's most revealing results relate to three specific sectors of the Alberta economy.

Resources

The resources sector includes not only energy, but also farming, mining and forestry. Businesses in this sector typically supply highly standardized commodities.

Based on the survey results, Alberta's resource-based firms are far more likely to have customers located in different cities and countries, but more than half depend heavily on a single major client (chart 8). They are also among the most likely to offer a single product or service line. Nearly one in four resource-based respondents depends on both a single client and a single product or service line.

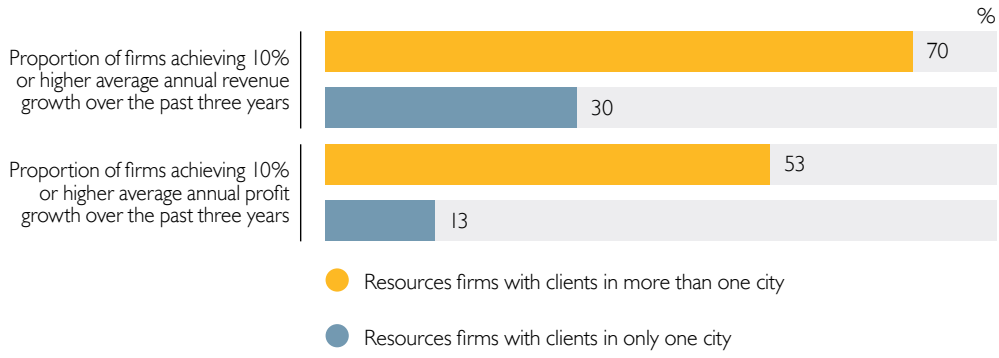
Chart 8: Resources firms are among the most geographically diversified, but more than half depend on a single major client for survival



Diversification and business performance in resources

The type of diversification most closely tied to strong financial performance is not the number of customers or product or service lines, even though many resource-based firms appear exposed to risk in these areas. Instead, a mix of customers by city appears to be the strongest predictor of success (chart 9).

Chart 9: Having clients in multiple cities is the biggest predictor of whether resources firms have fast growth in revenues and profits



Resources firms with a low dependence on a single customer are most optimistic about their prospects over the next 12 months. Those with a healthy mix of customers are roughly twice as likely to rate their business prospects as 7 out of 10 or higher (chart 10). Given that the survey was conducted in the midst of a major downturn in oil markets, customer diversification may be a better predictor of stability in times of crisis than it is a predictor of growth during economic upturns.

Chart 10: Not depending significantly on a single major client is the biggest predictor of optimism in the resources sector

BIRCH MOUNTAIN ENTERPRISES

HOW BIRCH MOUNTAIN ENTERPRISES EXPANDED ITS CLIENT BASE

"We increased the number of major clients we had because we could see the growth that was happening in this region," says Chris Wilson, CEO of Birch Mountain Enterprises, an Aboriginal-owned oilfield services firm based in Fort McKay, Alberta. Birch Mountain has grown in the past decade from having a single service truck to having a fleet of 100 heavy-duty trucks servicing several of the biggest companies in the oil sands.

"Our fleet was built on our reputation among the smaller players in the region, and that's what allowed us to get big enough that some of the majors would even consider looking at us," says Wilson. "And then when we got our first really big client, we just focused on building our reputation with them. Reputation and experience is what allows you to grow your client base successfully."

Wilson says that risk mitigation is the biggest benefit of diversification. "It takes time to get multiple big clients and long-term contracts," he says, "and there is a lot of competition out there. But once you have them, you have some security for the future."

Looking ahead, Birch Mountain plans to continue diversifying, geographically, and into new services and sectors. But while Wilson believes that diversification is crucial, he cautions that it's not easy and takes a lot of direct management involvement. "As an owner or manager, you have to be directly involved in every new thing you start up," he says, "and it has to bring you some kind of excitement. You can't just hire people to develop really good ideas."

For more information about Birch Mountain Enterprises, visit www.bmel.ca.

Customer diversification strategies in the resources sector

The biggest challenge that many small resources businesses face in attracting a wider mix of customers is managing multiple contracts, especially when they are big. BDC consultants offer the following suggestions:

> **Small contracts are often the most efficient way of diversifying.** Obtaining big contracts can be time-consuming and costly. It is generally easier to land small contracts, especially with new clients. Expanding gradually through small contracts also allows a business to manage its growth more effectively.

> **The purpose of diversification is not only to grow, but also to manage risk.**[6] As a rule, resources firms should rely on a single customer for no more than 20% of total revenue. While sticking to this limit can be difficult, proven strategies include seeking new relationships with key project or procurement managers; expanding the range of products or services offered; and taking on subcontracting work from firms that already provide the same services on a larger scale.

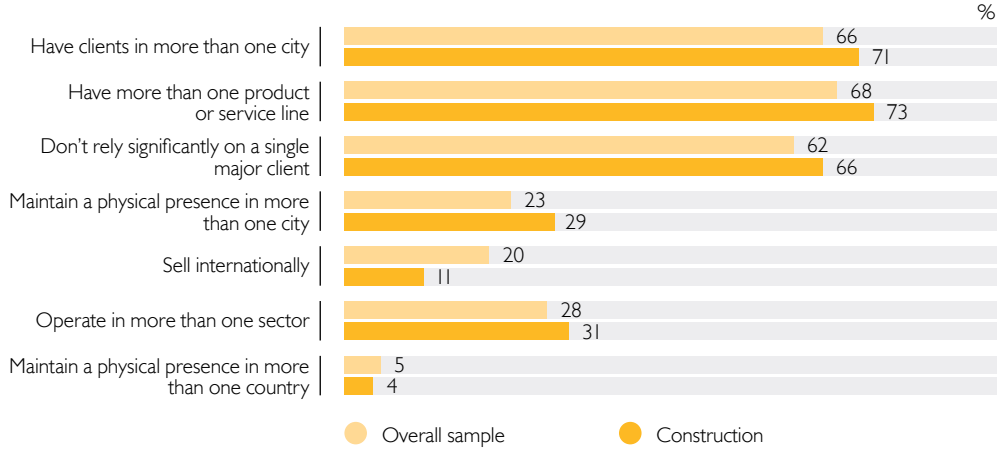
> **Beware of allowing new relationships to harm existing ones.** It is not uncommon for resources firms to spread themselves too thinly when trying to grow, especially if they try to land big contracts. This can jeopardize the existing client base rather than expanding it. One way to manage this risk is to gauge the confidence level within the company. In other words, is management confident that existing operations can be maintained as the client base grows? If not, it is likely too soon to be hunting aggressively for major contracts.

6 BDC (2014) found that nearly one in six small businesses run into financial difficulty because they lose a single major client.

Construction

As the second-biggest sector in Alberta, construction plays a key role in the province's economy. It performs relatively well on all diversification measures except international diversification (both business and client) (chart 11).

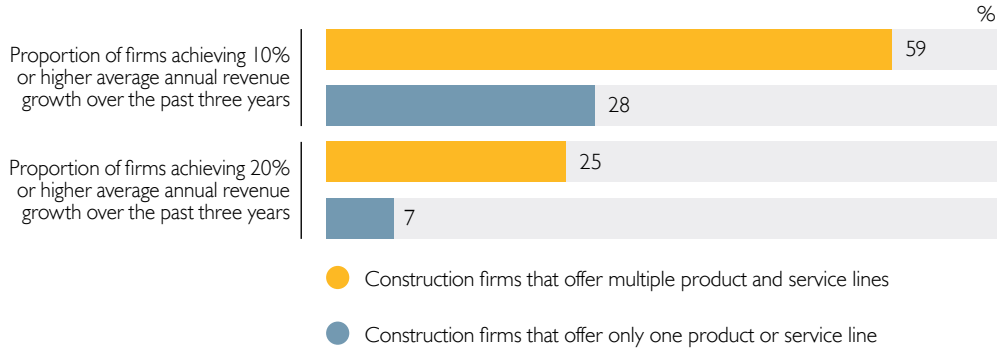
Chart 11: Compared to other Alberta businesses, construction firms are more likely to diversify in every way except internationally



Diversification and business performance in construction

Construction firms with multiple product or service lines report by far the strongest financial performance (chart 12). Moreover, as with resources businesses, construction firms with multiple major clients are generally more optimistic about their prospects for the coming year (chart 13).[7]

Chart 12: Financial performance of construction firms based on product or service diversification



7 Arcand, A., Burt, M. and Crawford, T. *Fuel for Thought: The Economic Benefits of Oil Sands Investment for Canada's Regions*. Ottawa: The Conference Board of Canada, 2012. This study found that construction was the sector most heavily impacted by investment in Alberta's oil and gas sector. Many resources and construction firms are likely to have experienced similar conditions at the time of the survey.

Chart 13: Level of optimism among client-diversified and -undiversified construction firms

Product and service diversification strategies for construction firms

Companies of all sizes and in all sectors are well-advised to focus on expanding their range of products and services. From Coca-Cola's acquisition of the Minute Maid juice company in 1960 to Apple's expansion into music products and services starting in the early 2000s, even the world's biggest and best companies have proved the benefits of remaining flexible by expanding the range of products and services they offer. Firms in the construction sector may wish to consider the following:

> **The best diversification strategies are based on existing human capital and organizational capabilities.** Thus, it usually makes sense to move into product and service lines that management knows well. Industry connections can be useful in this regard. Firms should also try to use existing buildings, machinery, equipment, and other physical assets and infrastructure to support new product lines. The same applies to existing marketing and supply channels.

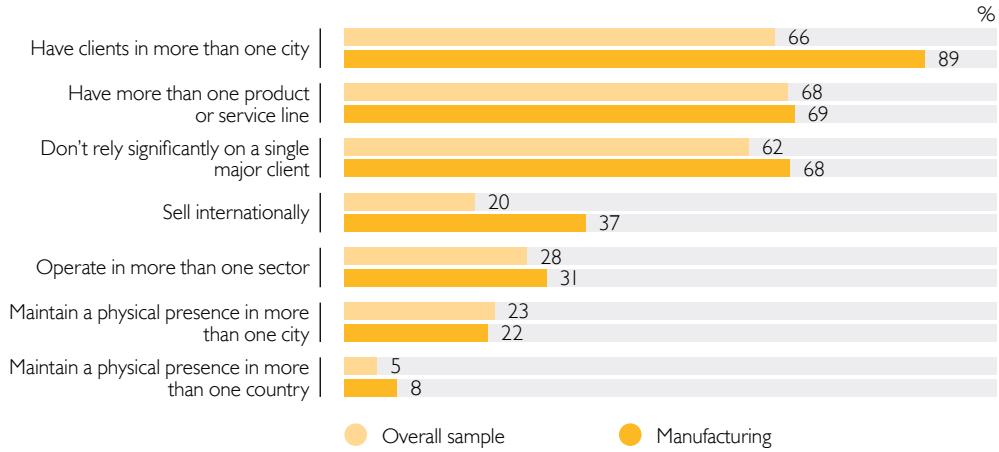
> **Putting diversification on the front burner when business is slow can help conserve resources.** To minimize the costs of diversification, it is usually preferable to develop and launch new products and services during times when normal business activity is slow.

> **Look for partners.** Diversification is much easier with a partner that also has an interest in bringing the new product or service to market. Possible candidates include businesses in related sectors, universities and technical schools interested in helping with product development, and government programs and agencies that provide grants or financing for new product development.

Manufacturing

Manufacturing is Alberta's most geographically diversified sector and the most diversified overall, based on the measures used in the survey (chart 14). Nearly 4 in 10 respondents in the manufacturing sector are active exporters, while 9 out of 10 have customers in other parts of Canada.

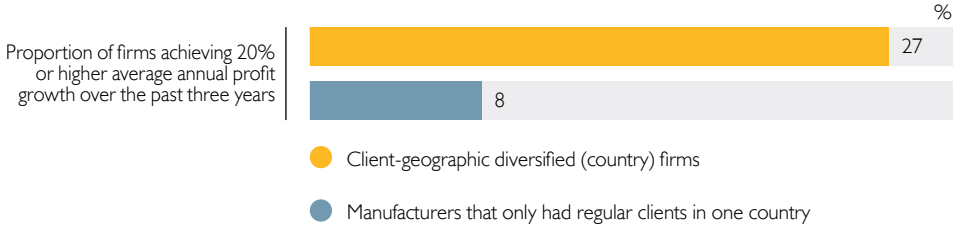
Chart 14: Manufacturing businesses are by far the most internationally diversified



Diversification and business performance in manufacturing

Among manufacturers, only exporting correlates with strong financial performance, in the form of fast profit growth (chart 15). Fewer than 1 in 10 manufacturers that have not done business abroad report annual profit growth of more than 20% over the past three years. By contrast, one in four exporters report annual profit growth of 20% or more.

Chart 15: Over a quarter of manufacturing firms that export achieved fast growth in profits in the past three years



LED IN ACTION

ONLINE ADVERTISING BRINGS NEW BUSINESS TO LED IN ACTION

"When we first started out, we were focused on our immediate area in Alberta," says Berwin Lewis, President of LED in Action, which makes industrial-use LED products in Pincher Creek. "But last year, 47% of our sales came from outside Canada." Especially noteworthy is that many of LED in Action's customers, including coal mines and steel mills, operate in remote parts of the world.

How did this small-town Alberta business go from serving mainly local clients to garnering almost half of its sales abroad, in places as far afield as Africa?

"It actually started with Google AdWords," says Lewis, "and then through word of mouth. But Google AdWords is really a very powerful tool." Connecting with international clients is only the first hurdle, and Lewis says that flexibility in terms of product offering has also been essential to the company's export success. "Originally, we were just in Canada, which has very few 480-volt inputs. When we started getting calls from the U.S., where 480-volt inputs are everywhere, we had to adapt our products to work in their market. Adapting our products based on differing voltage standards has been a big challenge."

Asked for his advice to other businesses looking to export, Lewis says that he would recommend hiring a specialist in online advertising. "If we'd had somebody whose sole focus was online advertising—optimizing every dollar spent on things like AdWords—that would have made life easier starting out. Now we have somebody who does that every week. Getting the relevant information to the relevant market is really important, especially for a small company that nobody has really heard of."

For more information about LED in Action, visit www.ledinaction.com.

Geographic diversification strategies for manufacturers

Entering a foreign market is perhaps the most important—but also most daunting—step in the growth of a small or mid-sized manufacturer. It exposes the business to markets like the U.S. and China that are many times larger than Canada, creating new business risks. Following are some recommendations for aspirant exporters:

> **Consider which activities, if any, should be provided directly in the foreign market.** Not all activities can or should be provided from head office. Those such as marketing, sales and delivery can often be arranged more cheaply and efficiently in the market where the products are being sold. This is especially true of functions that can be easily outsourced.

> **Remember that exporting is the ultimate competitiveness test for your business.** Selling products and services internationally can be the equivalent of adding rocket fuel to a small or mid-sized business, resulting in a big boost to sales and profit growth but also the risk of a costly flame-out. Selling abroad demands a high degree of operational efficiency. Firms must be able to offer products and services that are either of a higher quality or more cost-competitive than those already selling in the foreign market. Don't forget to include shipping and transaction costs in the calculation.

> **Beware of going it alone.** There are a host of government and private sector bodies that specialize in helping Canadian firms to export successfully. Leveraging the expertise of these entities can save huge amounts of time, energy and financial resources.

CONCLUSION

To sum up, diversification could be a valuable tool to reduce risk and improve business performance.

Our survey indicates that small and mid-sized Alberta firms that pursue diversification have generally achieved improved financial performance. In some sectors, diversification also appears to be associated with higher confidence among entrepreneurs in their businesses' future prospects.

Given that the survey was conducted during an economic downturn in Alberta, the benefits of diversification may be especially apparent when business conditions are difficult.

A second important finding of this study is that diversification has little to do with a firm's age. Rather, it appears to depend on the mindset of the entrepreneur.

Larger firms tend to be more diversified, but even mid-sized companies tend to have stronger financial performance when they offer a wide range of products and services, have multiple large customers, or expand their geographic horizons. Businesses of all sizes would thus be well-advised to consider whether they are sufficiently diversified.

While broadening a business's horizons typically takes time and financial resources, this report shows that it is manageable. Help is available for entrepreneurs wishing to move in this direction, and many successful Alberta businesses—such as those featured in this report—have been able to grow faster and improve their resilience through relatively modest changes in their operations.

The bottom line is that diversification can offer business owners an attractive way to hedge their risks, even in Canada's most resource-focused province.

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APPENDIX A: METHODOLOGY

The research for this study was conducted in three phases. First, a review of the business and financial economics literature relating to diversification was conducted. The purpose of this review was both to establish a better understanding of the existing research in the area of business diversification, and to inform the development of the survey questionnaire (see Appendix B).

Second, following the development of the questionnaire, Nielsen Consumer Insights was enlisted by BDC to survey approximately 1,000 Alberta businesses with between 5 and 499 employees. Businesses in all sectors except public administration and utilities were eligible to complete the survey, provided that they were headquartered in Alberta. Quotas were set such that the sample was equally divided between businesses that had 5 to 9, 10 to 19 and 20 to 499 employees; results were then weighted according to Statistics Canada's census data. Surveys were conducted via telephone from March 2 to March 26, 2015, and 998 complete responses were received from a sample universe of 24,527.

Statistical analysis consisted primarily of Pearson's chi-squared tests and Fisher's exact tests, in which businesses that were more and less diversified were compared based on financial performance and optimism for the coming year. Except where noted otherwise, all results presented in this report are significant at the 5% level, and in many cases the 1% level.

The third and final stage of this research relates to the strategies for small and mid-sized businesses. Based on the statistical findings of the survey, questions were sent to BDC's consultants in Calgary in relation to business diversification. The strategies in this report reflect the most broadly applicable strategies that were provided in response to these questions.

APPENDIX B: SURVEY QUESTIONNAIRE

TELEPHONE SURVEY

Alberta diversification study – March 2 to March 26, 2015

Q.1 Is your company's head office located in Alberta?

- ❍ Yes
- ❍ No
- ❍ I prefer not to answer

Q.2 How many **employees** does your company have?

- ❍ None
- ❍ 1 to 4
- ❍ 5 to 19
- ❍ 20 to 49
- ❍ 50 to 99
- ❍ 100 to 499
- ❍ 500 or more
- ❍ I prefer not to answer

Q.3 What is your company's **main sector of activity**?

- ❑ Accommodation and food services
- ❑ Agriculture, forestry, fishing and hunting
- ❑ Construction
- ❑ Finance, insurance, real estate and leasing
- ❑ Health care and social assistance
- ❑ Information and communication technologies (ICT) services
- ❑ Manufacturing
- ❑ Mining, oil and gas
- ❑ Professional, scientific and technical services
- ❑ Public administration
- ❑ Retail trade
- ❑ Transportation and warehousing
- ❑ Wholesale trade
- ❑ Utilities
- ❑ Other, please specify:
- ❍ I prefer not to answer

Q.4 Please complete the following statement: "If we were to lose our biggest client, **the impact on our operations** would be…"

- ❍ Limited or insignificant
- ❍ Somewhat significant
- ❍ Significant
- ❍ Very significant
- ❍ I don't know
- ❍ I prefer not to answer
- ❍ Does not apply to my business

Q.5 **a)** To what extent do you agree with the following statement? "Our business has a variety of product or service lines; we don't depend on any one type of product or service for survival."

- ❍ Strongly agree
- ❍ Agree
- ❍ Somewhat agree
- ❍ Somewhat disagree
- ❍ Disagree
- ❍ I don't know
- ❍ I prefer not to answer

b) How closely related are the product and service lines that your company offers? Are they…

- ❍ Very closely related
- ❍ Somewhat closely related
- ❍ Somewhat unrelated
- ❍ Very unrelated
- ❍ I don't know
- ❍ I prefer not to answer

Q.6 **a)** Does your business, including any affiliates, operate in more than one sector?

- ❍ Yes
- ❍ No
- ❍ I prefer not to answer

b) How closely related are the sectors in which your company operates? Are they…

- ❍ Very closely related
- ❍ Somewhat closely related
- ❍ Somewhat unrelated
- ❍ Very unrelated
- ❍ I don't know
- ❍ I prefer not to answer

Q.7 **a)** In how many **cities** does your business **maintain a physical presence**?

- ❍ Enter number:
- ❍ I don't know
- ❍ I prefer not to answer

b) In how many **countries** does your business **maintain a physical presence**?

- ❍ Enter number:
- ❍ I don't know
- ❍ I prefer not to answer

Q.8 **a)** In how many **cities** are your regular clients or customers located?

- ❍ Enter number:
- ❍ I prefer not to answer
- ❍ I don't know

b) In how many **countries** are your regular clients or customers located?

- ❍ Enter number:
- ❍ I prefer not to answer
- ❍ I don't know

Q.9 Why did you decide to **diversify** your business?

- ❍ Be as specific as possible:
- ❍ I prefer not to answer
- ❍ I don't know

Q.10 Why have you **not diversified** your business more?

- ❍ Be as specific as possible:
- ❍ I prefer not to answer
- ❍ I don't know

Q.11 To what extent has client diversification been **instrumental to your business's success** so far?

Not instrumental 0	1	2	3	4	5	6	7	8	9	Very instrumental 10	Don't know	Prefer not to answer
❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍

Q.12 To what extent has product and service diversification been **instrumental to your business's success** so far?

Not instrumental 0	1	2	3	4	5	6	7	8	9	Very instrumental 10	Don't know	Prefer not to answer
❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍

Q.13 On top of your company's main sector of activity, in which sectors does your business operate?

- ❑ Accommodation and food services
- ❑ Agriculture, forestry, fishing and hunting
- ❑ Construction
- ❑ Finance, insurance, real estate and leasing
- ❑ Health care and social assistance
- ❑ Information and communication technologies (ICT) services
- ❑ Manufacturing
- ❑ Mining, oil and gas
- ❑ Professional, scientific and technical services
- ❑ Public administration
- ❑ Retail trade
- ❑ Transportation and warehousing
- ❑ Wholesale trade
- ❑ Utilities
- ❑ Other, please specify:
- ❍ I don't know
- ❍ I prefer not to answer

Q.14 To what extent has sector diversification **been instrumental to your business's success** so far?

Not instrumental 0	1	2	3	4	5	6	7	8	9	Very instrumental 10	Don't know	Prefer not to answer
❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍

Q.15 To what extent has business location diversification **been instrumental to your business's success** so far?

Not instrumental 0	1	2	3	4	5	6	7	8	9	Very instrumental 10	Don't know	Prefer not to answer
❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍

Q.16 To what extent has diversification in terms of the location of your customers and clients **been instrumental to your business's success** so far?

Not instrumental 0	1	2	3	4	5	6	7	8	9	Very instrumental 10	Don't know	Prefer not to answer
❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍

Q.17 Are you planning to **diversify your operations** beyond where they are today within the next three years?

- ❍ Yes, definitely
- ❍ Yes, probably
- ❍ No, probably not
- ❍ No, definitely not
- ❍ I don't know

Q.18 In which area(s) do you intend to diversify?

- ❑ Client diversification
- ❑ Product and service diversification
- ❑ Sector diversification
- ❑ Business location diversification
- ❑ Client-geographic diversification
- ❍ Other, specify:
- ❍ Not applicable/I prefer not to answer
- ❍ I don't know

Q.19 **a)** How much is your business **directly** exposed to oil and gas prices?

Not exposed 0	1	2	3	4	5	6	7	8	9	Very exposed 10	Don't know	Prefer not to answer
❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍

b) How much is your business **indirectly** exposed to oil and gas prices, meaning that it is affected through supply chains or as a result of income earned in the oil and gas sector?

Not exposed 0	1	2	3	4	5	6	7	8	9	Very exposed 10	Don't know	Prefer not to answer
❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍

Q.20 How many **years** has your company been in operation?

- ❍ Less than one year
- ❍ One to three years
- ❍ Four to five years
- ❍ Six to 10 years
- ❍ 11 to 20 years
- ❍ More than 20 years
- ❍ I don't know
- ❍ I prefer not to answer

Q.21 If you were to allocate 100 points across the different **types of sales** your company makes, what proportion would you say would go towards 1) other businesses, 2) retail customers, and 3) government and/or other types of customers?

- ❑ Other businesses: _____%
- ❑ Retail customers: _____%
- ❑ Government and other: _____%
- ❍ I don't know
- ❍ I prefer not to answer

Q.22 What was your company's **average annual revenue growth** over the past three years?

- ❍ Negative
- ❍ 0% to 4.9%
- ❍ 5% to 9.9%
- ❍ 10% to 14.9%
- ❍ 15% to 19.9%
- ❍ 20% or more
- ❍ I don't know
- ❍ I prefer not to answer

Q.23 What was your company's **total revenue** for the last financial year?

- ❍ Less than $500,000
- ❍ $500,000 to $1,999,999
- ❍ $2 million to $4,999,999
- ❍ $5 million to $9,999,999
- ❍ $10 million to $19,999,999
- ❍ $20 million or more
- ❍ I don't know
- ❍ I prefer not to answer

Q.24 What was your company's **average annual profit growth** over the past three years?

- ❍ Negative
- ❍ 0% to 4.9%
- ❍ 5% to 9.9%
- ❍ 10% to 14.9%
- ❍ 15% to 19.9%
- ❍ 20% or more
- ❍ I don't know
- ❍ I prefer not to answer

Q.25 How optimistic are you regarding your business's performance in the next 12 months?

Very pessimistic 0	1	2	3	4	5	6	7	8	9	Very optimistic 10	Don't know	Prefer not to answer
❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍	❍

Q.26 If need be, would you allow BDC to contact you for a more in-depth interview for this project?

- ❍ Yes
- ❍ No, I am not interested

Q.27 Do you give us permission to send your individual answers to BDC? You can rest assured that this information will never be used for telemarketing purposes.

- ❍ Yes
- ❍ No

Q.28 Are there any other aspects of this topic that you would like to comment on?

- ❍ Nothing to mention
- ❍ Comments:

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