

THE DIVERSIFICATION DIVIDEND

How companies create higher shareholder value by not (only) focusing on their core business especially in times of uncertainty

MIDDLE EASTERN REPORT 2024

Stryber

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Introduction

Our previous study, The Power of Diversification[1] (2021), tracked over 1,800 listed companies across the United Kingdom, Europe and the United States between 2010 and 2019. In that study, we closely followed the businesses' varied degrees of actively diversifying revenue streams as a proxy for innovativeness and adaptability in the face of technological developments and changing customer preferences. We were interested to see how diversification efforts were received by the stock market and whether diversifying companies outperformed non-diversifying companies in terms of total shareholder return over a longer period of time.

We found that less than a third of the firms managed to establish new revenue streams in the 10-year period the analysis covers. However, when we looked at shareholder value, the "diversifiers" outperformed their non-diversifying peers – the "back-to-core" group – by up to 54% in median annual total shareholder return for the highest degree of diversification.

Across the pond, there are many successful and well-known examples for revenue diversification like Amazon. Amazon has gone through the roof since its 1994 origins as a humble online bookseller. Over the study period alone, Amazon not only added product lines to its e-commerce platform but also established additional revenue segments like cloud hosting. By 2019, Amazon Web Services alone accounted for 9% of its total revenues and 63% of profits.[2] Today, it is still the leader in cloud services, with a 32% market share.[3] The firm still continues its revenue diversification journey at an astonishing pace, currently boasting more than seven multi-billion dollar revenue streams.[4]

Such is the power of revenue diversification. It puts companies in strategic positions for growth across even the most unlikely market environments. Amazon could have never become one of the world's most successful companies simply by selling books.

But Amazon wasn't alone, and the strategy wasn't new. For this new study, we set out to see 1) how "diversifiers" fared compared to their "back-to-core" counterparts specifically on the European continent and 2) if our previous findings still held even in times of trouble such as the last four years. We were in for a treat.

1) https://www.stryber.com/resources/diversification-study

2) https://www.visualcapitalist.com/aws-powering-the-internet-and-amazons-profits/

3) https://www.statista.com/chart/18819/worldwide-market-share-of-leading-cloud-infrastructure-service-providers/

4) https://www.statista.com/chart/15917/amazon-revenue-by-segment/

We analysed a subset of 1,092 companies from our previous study that are listed in Europe. We looked into their stock market performance for the same period as used in our previous study, from 2010 to 2019. Among the 1,092 companies, stock market data was consistently available for 738 companies from 2010 through 2023. We followed these companies for four more years beyond 2019 to analyse how their total shareholder return developed over the turbulent COVID years and beyond.

We found that the European "diversifiers" that had expanded their revenue streams between 2010 and 2019 outperformed the non-diversifying group of companies by 16%. The "diversifiers" achieved an annual total shareholder return of 9.6% during that period, compared to 8.3% for their "back-to-core" comparison group. This constitutes a substantial diversification advantage.

The diversifying companies went into the COVID crisis with successful innovation efforts during 2010-2019 under the belt. While our hypothesis was that the diversification advantage would be more pronounced in times of trouble, we were surprised by how significantly it increased: the "diversifiers" generated a 53% higher annual total shareholder return than their peers in the 2020 to 2023 period. In absolute numbers, this group achieved 5.5% total shareholder return annually, while the "back-to-core" group only managed to reach 3.6%. This is significant: it not only shows that revenue diversification adds value in all economic environments, but *in particular* in times of increased uncertainty.

These uncertain times are far from over: climate change, fluctuating inflation, rapid interest rate jumps, wars in Ukraine, Gaza and other parts of the world, increasing political instability in many countries, including in the Western world, and the next black swan event could be looming around the corner. For business leaders, it is a moment to expand their offerings to accommodate unforeseen developments, or suffer hard consequences.

Adopting a strategic diversification mindset appears to be rewarded by higher stock market returns. In the following pages, we'll uncover why, in the latest findings from our research. Beyond stock-listed companies in Europe, we have analysed the impact of diversification on stock-listed companies in the Middle East. Throughout this report, we have explored several case studies to illustrate the power of diversification.



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„Our research demonstrates that diversification is not only a strategy for growth but also a hedge against market volatility. Companies that focus solely on their core business may see short-term efficiency gains, but they risk long-term value destruction.

On the other hand, if they have the capability to add new revenue streams, whether through M&A or venture building, they are better positioned to weather economic uncertainty and deliver long-term value to shareholders”



Hussam Khalil

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“Currently, we see economic diversification and growth to be top priorities in national strategies and on the minds and agendas of CEOs. Rightfully so, as the study we have conducted in the Middle East shows the power of diversification and its impact and correlation on shareholder return. We have been very active in the region in developing tailored diversification and growth strategies for our clients and helping them execute on that vision with our team of experienced strategists and entrepreneurs. Being able to support this vision through our global experience and strategic thinking, paired with excellent capabilities to put ideas into action, makes us especially confident in supporting the Middle East’s bright future.”

Enjoy reading, and please don’t hesitate to reach out!

Diverse business, strong returns: How diversified companies outpaced their peers in the Middle East

In addition to the scope of the first study published in 2021(accessible here), recently updated with data up to 2023, we extended the scope to cover 579 companies that are listed in the Middle East to understand whether the findings are replicable across regions.

We split the companies into two types:
Diversifiers: companies that added at least one revenue stream during the relevant periods
Non-diversifiers: companies that did not add any new revenue streams (considered as focusing on their core business) during the relevant periods

To assess performance of diversifiers vs. non diversifiers, we have reviewed their performance over the following periods:
Period 1: 2010 - 2019
Period 2: 2020 - 2023

For these periods, we have analysed two key metrics of Total Shareholder Return (TSR):

Median annualised TSR (for the full Middle Eastern dataset): We evaluated the progression of performance of all 579 companies (stock-listed in the Middle East) from period 1 to period 2. Our focus was on distinguishing between diversified and non-diversified companies across the Middle East region. In the first period diversified companies had a median TSR of 3.1% and in the recent period they achieved 6.3%. This showed that diversified companies exhibited a median total shareholder return (TSR) percentage improvement (from period 1 to period 2) of 104%, significantly outpacing the 40% improvement observed in non-diversified companies.

Average annualised TSR (subsets): To mitigate the influence of extreme outliers, similar to our approach in the overarching study, we excluded companies that fell outside of one standard deviation from the mean TSR for 2020-2023. After this adjustment, the results indicate a TSR improvement of 49% for diversified companies, compared to 25% for non-diversified companies, confirming a sustained superior performance from one period to the next.

Further analysis focused on top performers, defined as companies whose TSR was more than one standard deviation above the mean, encompassing a total of 63 companies. This subgroup analysis showed that diversified companies not only had a higher average TSR of 52% during 2020-2023 compared to 47% for non-diversified companies, but they also demonstrated greater absolute improvement across the two periods. Specifically, diversified companies registered an actual change of 55 percentage points in TSR from the first to the second period, versus 47 percentage points improvement for non-diversified companies.

In the following, we want to demonstrate three case studies from the Middle East: e& (United Arab Emirates), Ma'aden (Saudi Arabia), and Elsewedy Electric (Egypt). These are exemplary for businesses that successfully managed to stay constantly attuned to the pulse of time and to leverage company resources and core competencies in a considerate way to future-proof their revenue streams.

From traditional telecommunications to a whole ecosystem: e&'s strategic evolution to becoming a global technology group

Originally established as a telecommunications service provider, e& (formerly known as Etisalat) embarked on its journey by offering voice and data services. Over the years, e& has significantly broadened its horizon, venturing into new domains beyond traditional telecommunication services. This strategic diversification has been instrumental in transforming e& into a comprehensive tech ecosystem, encompassing various sectors including digital services, fintech and entertainment, among others.

In its formative years, e& focused on solidifying its core telecommunications offerings. However, recognizing the dynamic nature of the digital landscape and the evolving needs of customers, e& gradually began to explore adjacent markets. This exploration was driven by a clear vision to leverage its technological capabilities and vast customer base to enter new markets that complement its existing portfolio.

The shift towards diversification gained momentum with the advent of digital transformation. e& capitalised on this trend by introducing innovative digital services that addressed emerging consumer demands. For instance, e& ventured into the realm of digital entertainment, financial services, and smart home solutions, thereby expanding its value proposition through both building its own additional streams and a number of strategic acquisitions. Investments like StarzPlay Arabia, a streaming platform that's become the second largest in the region, and Careem (excluding ride-hailing operations), a digital ride-hailing platform that has grown rapidly into a super app network of payments, food and grocery delivery, and other digital businesses, have been highlights in this period of expansion. In addition, it also completed various acquisitions (e.g. of ServiceMarket, an online platform for household services, or Smartworld under e& enterprise).

Through this strategy, e& has now diversified its operations around five main verticals:

- e& UAE: Concentrating on the group's telecommunications services within the UAE, providing local customers with mobile, broadband, and TV services.
- e& international: Managing the group's telecommunications and technology services outside the UAE, aiming to expand and strengthen its global presence.
- e& life: Focusing on integrating technology into daily life through digital services that enhance lifestyle experiences for individual consumers.
- e& enterprise: Offering comprehensive business solutions, including cloud computing, cybersecurity, and advanced communication services to enterprise customers.
- e& capital: Investing and managing promising solutions that capitalise on emerging trends and opportunities within the digital landscape with significant market potential and synergize with company's portfolio

This strategic pivot was not without its challenges. e& had to navigate through complex technological advancements, regulatory environments, and changing consumer preferences. Nevertheless, the company's commitment to innovation, coupled with its willingness to experiment and learn from setbacks, has been a cornerstone of its diversification strategy. This approach echoes the belief that embracing failure is essential for breakthrough innovation.

The outcomes of e&'s diversification strategy have been commendable. The company has not only strengthened its core telecommunications business, but has also successfully established itself in new, high-growth digital markets. This strategic evolution has contributed to e&'s sustained financial performance, delivering an annualised total shareholder return of 12% from 2010 to 2019 and sustaining strong returns post 2019, reinforcing its position as a leading player.

Today, e& stands as a testament to the power of strategic diversification. By continuously exploring new avenues for growth and embracing the digital revolution, e& has set a benchmark for others in the industry. Its journey from a traditional telecommunications provider to a diversified technological ecosystem exemplifies the significance of adaptation and innovation in the face of changing global dynamics.

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From mineral to marvel: Ma'aden's strategic development for pioneering the mining industry

Ma'aden, otherwise known as the Saudi Arabian Mining Company, was established in 1997 with a focus on capitalising on Saudi Arabia's rich mineral resources. Initially centred on gold mining, Ma'aden embarked on a journey to diversify its business operations, recognizing the potential for growth beyond its original scope.

In its formative years, Ma'aden concentrated on strengthening its core mining activities. The company's strategic foresight led to the exploration and development of other valuable minerals, including phosphate, aluminium, and industrial minerals. This diversification was not merely an expansion of its portfolio in terms of further commodities, but a calculated move to position itself as a leading global mining company and key player in the global phosphates market, and become the world's largest supplier of aluminium to the global automotive industry.

The transformation of Ma'aden was methodically aligned with technological advancements and the

evolving needs of the global market. The company's leadership understood the importance of innovation and adaptability in an industry often characterised by challenges and volatility. By venturing into integrated mining and refining operations, Ma'aden was not only able to increase operational efficiency and build a world-class integrated mining value chain, but also add value to the Saudi non-oil economy and its stakeholders.

The ethos of Ma'aden reflects a culture of perseverance and calculated risk-taking. The company's willingness to explore uncharted territories and invest in large-scale projects is a testament to its commitment to growth and excellence. In addition to its organic development, Ma'aden has continuously been expanding its business through strategic partnerships, joint ventures (e.g. with SABIC) and acquisitions (e.g. of Mauritius-based fertiliser company Meridian Group in 2019). It also has been investing in new technologies (e.g. through partnerships with Barrick Gold Corporation and Ivanhoe Electric) to help unlock the vast potential of Saudi Arabia's mineral wealth. This combination of "build" and "buy" enabled Ma'aden to become one of the fastest-growing mining companies in the world today.

This strategic expansion has not only enhanced Ma'aden's portfolio but also contributed to the stability and diversification of the Saudi economy. The company's success in navigating the complexities of the mining sector and capitalising on opportunities has yielded substantial returns for its shareholders. Ma'aden delivered an annualised TSR of 11% from 2010 to 2019. Confirming the success of their strategy, TSR remarkably increased to 38% over the last four years. Before its IPO on the Saudi Stock Exchange (Tadawul) in 2008, Ma'aden was wholly owned by the Saudi Government (today, the Public Investment Fund holds <70% of Ma'aden's shares). Ma'aden's robust performance and resilience in the face of global economic fluctuations underscore the effectiveness of its diversification strategy and its role as a catalyst for economic development in Saudi Arabia, being ranked among the top 10 global mining companies based on market capitalization.

Today, Ma'aden stands as a testament to visionary leadership and strategic diversification. Its journey from a national mining company to a global powerhouse mirrors the ambitious economic transformation goals of Saudi Arabia. With a clear focus on sustainability and innovation as manifested in Ma'aden's Strategy 2040, the company is poised for continued growth and success in the global mining industry, while contributing to the prosperity of Saudi Arabia by supporting the achievement of its Vision 2030 and beyond.

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- https://www.maaden.com.sa/en/investor/report

From Cables to Global Energy Solutions: Elsewedy Electric's Dynamic Expansion

Founded in 1938, Elsewedy Electric began its journey as a modest family business in the electrical equipment trade. Over the years, the company embarked on a bold path of diversification, significantly broadening its scope beyond its original focus.

In its early years, Elsewedy Electric concentrated on electrical cables and accessories, establishing itself as a key player in the Egyptian market. However, recognizing the potential for growth and sustainability in diversification, the company ventured into new sectors. Today, Elsewedy Electric's portfolio spans across various segments, including electrical products like transformers, telecom infrastructure, products and solutions for wind energy generation, energy measurement and management.

This expansion was not merely opportunistic; it was a deliberate strategy to align with technological advancements and evolving customer demands. Elsewedy Electric's approach to innovation and diversification reflects a deep commitment to staying true to its core values while embracing change. The company culture encourages experimentation and learning from failures, a philosophy that has underpinned its steady growth.

In recent years, Elsewedy Electric has faced the challenges of a volatile global environment with resilience. By diversifying its product lines and geographic presence, the company has built a balanced portfolio that mitigates risks associated with unforeseen global events. This strategic foresight has been crucial for Elsewedy Electric, allowing it to navigate uncertainties effectively.

The results of Elsewedy Electric's diversification efforts are evident in its robust financial performance and significant contributions to the energy and infrastructure sectors. Elsewedy Electric delivered an annualised TSR of 15% from 2010 to 2019, a figure which increased to 33% over the last four years. With operations in over 100 countries and a reputation for delivering complex turnkey projects, Elsewedy Electric has positioned itself as a global leader in integrated energy solutions.

This strategic diversification has not only enabled Elsewedy Electric to expand its market reach but also to drive innovation, demonstrating the importance of adaptability and courage in today's dynamic business landscape.

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In the following section, we're referring to our larger dataset (based on European stock-listed companies) which was the basis for the 2021 study, now updated by recent data. This provides a robust sample and timeframe to derive key insights, taking into consideration that strategic diversification of businesses requires time to materialise in new revenue as well as shareholder returns.

Executive Summary

This study compared the diversification of revenue streams against shareholder performance for 1,092 listed companies in Europe for 2010-2019 and followed a subset of 738 companies for four more years, for 2020-2023. It found that when markets were buoyant in 2010-2019, the businesses that had consciously added revenue streams during this period delivered 16% superior median annual total shareholder returns.

However, it was during the turbulent COVID years and beyond that the investment truly paid off. Companies who had already added one or more revenue streams, in other words went into the COVID crisis with successful preceding diversification, outperformed those that hadn't – by a striking 53%.

The data also revealed that the ability of an organisation to diversify is more impactful than the absolute level of diversification. The number of revenue segments per company did not show a consistent linear relationship with total shareholder return. Interestingly, however, the companies that seemingly focused on their core business (reduction of an average of 0.9 revenue streams during 2010-2019), correlated with an underperformance of 6% of annual total shareholder return compared to the median across all firms. This effect was even more pronounced during the follow-up period of 2020-2023 with a destruction of 14% in annual total shareholder return.

Our research indicates that diversifying revenue streams leads to a higher return for shareholders. We have attributed this to three factors:

1) Modern Portfolio Theory, which, at its core, is the simple recognition that although nobody can see into the future, diversification protects against uncertainty, 2) strategy and governance, wherein successful companies have found a way out of the "Innovator's Dilemma"[5], the dominant challenge that explains why over 70% of companies in our sample failed to diversify in the first place, and 3) market appreciation, as investors value successful diversification with higher demand and hence seem to drive share prices.

In our study, we found many examples of diversification that paid off, but we also found some outliers like Bang & Olufsen. Despite the company's great past successes and increase in the number of revenue streams in 2010-2019, it had a negative total shareholder return. The problem in this instance was that during their attempt to focus back on the core, Bang & Olufsen missed out on important shifts in consumer preferences and failed to expand the product and services portfolio accordingly. For comparison, Hermès has found a successful way to navigate volatile environments through the ambition and courage to build a resilient portfolio. If you want to read more about these two case studies, please refer to our European report here.

5) The term was coined by Harvard professor and businessman Clayton Christensen with his book "The Innovator's Dilemma – When New Technologies Cause Great Firms to Fail"

Key takeaways:

- During the pandemic and beyond (2020-2023), companies that had added one or more revenue streams during 2010-2019, i.e. went into the pandemic with preceding successful diversification efforts, delivered an annual total shareholder return 53% higher than companies that had not diversified before the start of the pandemic
- In the calmer time before COVID from 2010 to 2019, the diversifying companies already outperformed the non-diversifying ones by 16% in terms of annual total shareholder return, hence diversifying risk can help businesses perform consistently in different market environments
- Looking at that time before COVID from 2010 to 2019, firms who focused on the core and did not diversify in this period eliminated an average of 0.9 revenue streams. This “back-to-core” strategy correlated with a significant destruction of annual total shareholder return relative to the whole sample of companies. The value destruction was highest during the turbulent years of 2020-2023 with a 14% lower annual total shareholder return
- Only just under 30% of companies in our sample managed to diversify their revenue streams *at all* during 2010-2019, pointing to a lack of organisational capability to overcome the “Innovator’s Dilemma”
- There were also some instances of ill-advised revenue diversification efforts, which led to growth stagnation and to significant total shareholder return underperformance. This highlights the need for strategic experience, the right governance, and skilled planning in driving revenue diversification

What separated the COVID winners from the losers?

The need for revenue diversification came sharply into focus during the 2020-2022 pandemic, as entire sectors found themselves without income streams.

Particularly at risk were travel and tourism. With lockdowns tightening, air traffic nose-dived by nearly 40%[6], and unsurprisingly 64 airlines went bust[7]. As the sector plummeted, it created a profitability black hole, sucking add-on services, like car rental firm Hertz, into bankruptcy too.

But it wasn't just travel and tourism that crumbled during the pandemic. Companies that had over-relied on in-person sources of revenue fell like dominoes. Shared office space WeWork was made redundant by the rise of remote working. The likes of Golds Gym were outpaced by home sports gear such as Peloton bikes. And retail giants like Debenhams, JCrew and Bed, Bath and Beyond could not survive the lack of footfall.

The ripple effects of the pandemic also hampered profitability. The high interest rates led to the collapse of major banks including Credit Suisse and Silicon Valley Bank, and a tightening of liquidity. By the end of 2023, corporate bankruptcies in the EU surged.[8] Today, the number of English and Welsh companies filing for bankruptcy has hit a painful 30-year high.[9]

By contrast, pockets of brands survived or even thrived during COVID. Although some may have suffered heavy losses - or subsidiary fatalities, as in the case of Virgin Atlantic - they are still here today. Some companies like Uber even became "pandemic winners", reaping unparalleled rewards.

So what separates the winners from the losers? We believe this phenomenon can be explained with a well-established theory from the world of Finance, which has been empirically proven many times over: Modern Portfolio Theory.

Modern Portfolio Theory, as first stipulated by Harry Markowitz, formulises a concept that most of us know instinctively: "don't put all your eggs in one basket". When we invest money, we shouldn't plunge all our wealth and life savings into one stock. Instead, Modern Portfolio Theory guides us to invest into

6) https://www.spglobal.com/marketintelligence/en/news-insights/blog/industries-most-and-least-impacted-by-covid-19-from-a-probability-of-default-perspective-january-2022-update

7) https://edition.cnn.com/travel/article/pandemic-airline-bankruptcies/index.html

8) https://www.reuters.com/markets/europe/bankruptcies-eu-highest-since-2015-eurostat-says-2023-08-17/

9) https://www.bbc.com/news/business-68140635

a diversified basket of assets, ideally a market portfolio, hence the unparalleled rise of ETFs as investment vehicles.

It is the same for businesses. We can infer from Modern Portfolio Theory that we should ensure to hold different businesses with different sources of value and income streams in order to be successful in different market environments. If one business goes down, another should go up to even out the overall performance.

As can be observed with the likes of WeWork, Blockbuster and Kodak, relying on one single revenue driver often does not last forever. At some point, all markets are at risk of dipping and if you don't have another revenue source in another market, the whole business is at risk of collapse.

Apple is currently valued at $2.67[10] trillion. But if the brand had stopped building revenue streams after its 1984 Macintosh, it would never have made billions from iPods, iPhones, iTunes, Apple Watches, video streaming services, finance programs like Apple Wallet or Apple Pay... It simply would have become another Kodak.

10) https://finance.yahoo.com/quote/AAPL/ as at 11th March, 2024

While the first revenue driver can be a strong platform to build from, and provide funds to create new revenue streams, it usually will not sustain itself indefinitely. Our latest research adds further weight to this well-established theory.

"The evidence is compelling: One revenue source usually doesn't last forever."

Study findings



For our analysis, we distinguished between companies that do and do not diversify their revenue streams. So what counts as diversification? If a company added at least one revenue stream during the 2010-2019 research period, we categorised it as “diversifying” or a “diversifier”. Likewise, if a firm did not add any new revenue streams, they were marked as “non-diversifying” or “back-to-core” for the purpose of this study.

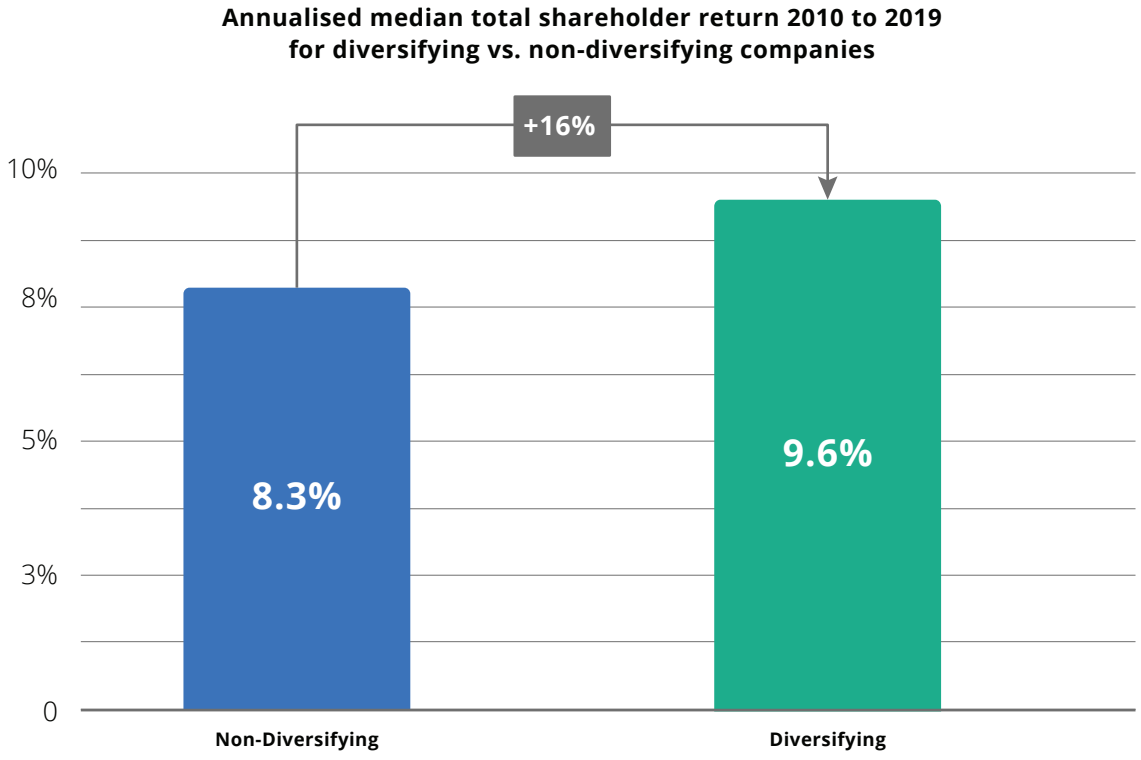
Finding 1: 2010-2019 was a relatively calm and overall highly profitable time for shareholders, yet with a clear diversification dividend

Probably one of the least surprising findings from our updated study is that annual total shareholder returns for the companies we analysed were quite high in 2010-2019.

"Back-to-core" companies delivered median annual shareholder returns of 8.3% over this ten-year time period, while "diversifiers" recorded 9.6%. The diversification advantage was 16%, corroborating the findings from our prior study (see chart 1).

Regarding the high shareholder return for the ten-year period, there are easy-to-grasp explanations for this. The 2010s were characterised by one of the longest running bull markets in history. By contrast, 2020-2023 has been synonymous with lockdowns, political instability, civil unrest, worrisome inflation, wars, supply chain disruption, climate catastrophe and bank-swallowing interest rates. Undoubtedly, this has been reflected in the performance of listed companies.

Chart 1



Notes: " Includes 1,092 companies that were actively trading in Europe 2010-2019.
The values shown represent the median of all the individual annual total shareholder return rates within each group; the medians are not weighted by market capitalisation of the individual stocks; all stocks are weighted equally. "Diversifying" refers to companies that introduced new revenue streams between 2010 and 2019, in contrast to "non-diversifying" companies that did not.
Source: Refinitiv Datastream, Stryber Analysis

"During and after COVID, diversifiers achieved a median annual total shareholder return 53% higher than their non-diversifying counterparts. This diversification advantage was more than 3-fold greater than during the ten years of economic stability preceding the pandemic."

Finding 2: The outperformance of the "diversifiers" in annual total shareholder return has more than tripled during COVID and the subsequent times of crisis

Businesses that added at least one revenue stream between 2010 and 2019 fared a whopping 53% better in median annual total shareholder return during and after COVID than those that didn't (see chart 2). This is a more than 3-fold increase in the diversification advantage compared to the 16% in finding 1. "Diversifiers" achieved a median 5.5% annual total shareholder return, outperforming their "back-to-core" counterparts who managed only 3.6%. The data from this period, when compared with the 2010-2019 period, is strikingly consistent in showing that revenue diversification is linked to higher total shareholder return, even in the toughest of market environments.

The underlying mechanics behind this substantial boost in diversification advantage during times of uncertainty is exemplified by the Swedish companies Husqvarna and Indutrade. Husqvarna, founded in 1689, evolved over the years from manufacturing guns to today producing outdoor power products and currently has three divisions: 1) forest & garden 2) watering & smart garden 3) construction. At the start of the COVID pandemic, the construction division suffered due to the economic downturn. The other two divisions, on the contrary, profited and saw sales increase due to the extra time people had on their hands to care for their gardens. The group CEO Pavel Hajman distils Husqvarna's approach to success as: "We are constantly re-inventing ourselves, identifying and capturing market opportunities to further future-proof our company."[11,12]

Indutrade was able to buffer against the market shock by being an industry conglomerate built through acquisitions. the company managed to come out of the 2020 turmoil with a 4% growth in sales and, even more noteworthy, with a 12% higher EBITA margin compared to 2019. CEO Bo Annvik summarises the firm's strategy as: "Our diversified structure, with more than 200 companies in various sectors and geographic markets, provides us with a very good spread of risk, which creates the prerequisites for stability, despite the challenging market conditions. This type of breadth lowers dependency on any single segment or market. It also makes it easier to persevere in difficult times."[13]

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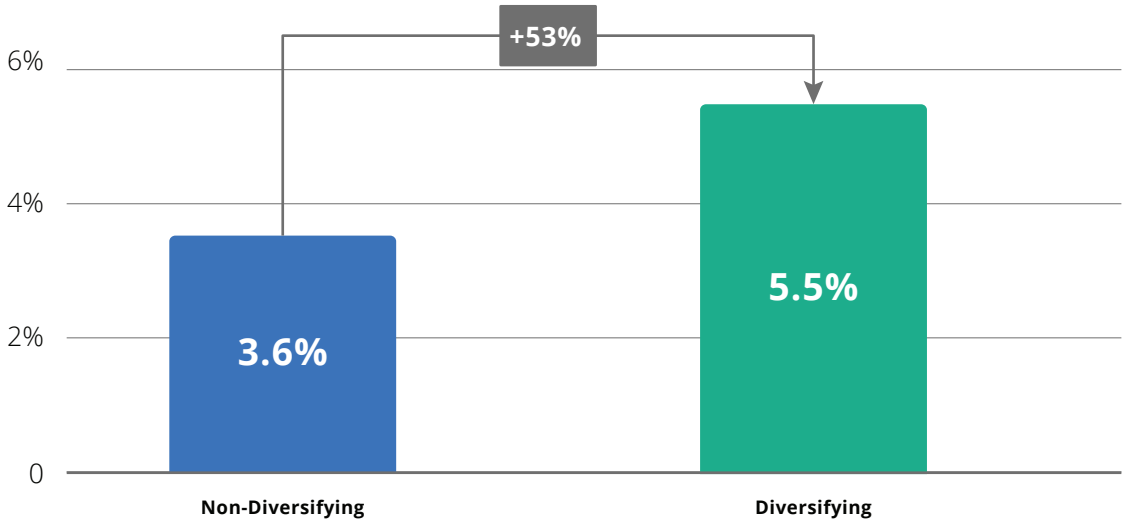
11) https://www.husqvarnagroup.com/sites/husqvarna/files/pr/202103236380-1.pdf

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13) https://www.indutrade.com/globalassets/press-kit/annual-reports-eng/eng_indutrade_ar-210319.pdf

Chart 2

Annualised median total shareholder return 2020 to 2023 for diversifying vs. non-diversifying companies



Notes: Includes 738 companies that were actively trading 2010-2023 as a subset of the 1,092 companies that were analysed for the period 2010-2019. The values shown represent the median of all the individual annual total shareholder return rates within each group; the medians are not weighted by market capitalisation of the individual stocks; all stocks are weighted equally. "Diversifying" refers to companies that introduced new revenue streams between 2010 and 2019, in contrast to "non-diversifying" companies that did not.

Source: Refinitiv Datastream, Stryber Analysis

Finding 3: Focusing on the core business seems to hurt total shareholder returns, especially compared to diversifiers

Delving into the diversification efforts of our study sample revealed an interesting finding: continued diversification is more impactful than absolute diversification. We did not see a consistent linear correlation between the average number of revenue streams per company and the median annual total shareholder return.

It is the businesses' ability to establish and maintain new revenue streams – or the delta in revenue streams – that is the better proxy for successful growth and adaptability; over 2010-2019, the group of "back-to-core" businesses eliminated an average of 0.9 revenue streams. Linked to that was a 6% lower annual total shareholder return compared to the median across all companies. Over 2020-2023, the destruction of shareholder value was even stronger with -14.2% compared to the median (see chart 3).

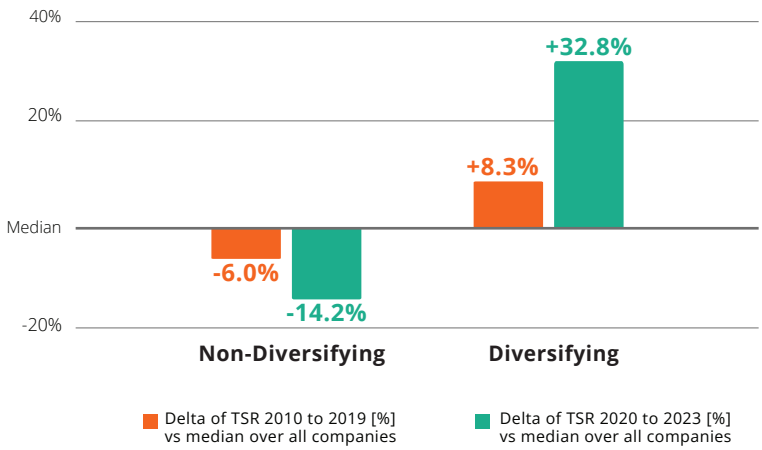
In large companies, an underlying common problem is "active inertia"[14], as described by the Harvard Business Review. The issue is not that the firms don't react to threats to their business model; threats are actually clearly identified by its leadership and plenty of action is taken, but only with tried-and-tested methods and under wrong assumptions about the reality.

Meanwhile, the "diversifiers" boosted their revenue streams by 1.8 over 2010-2019 and were rewarded with a 8.3% higher median annual total shareholder return than that of all companies for the same period. Over 2020-2023, they even achieved an impressive 32.8% advantage (see chart 3).

14) https://hbr.org/1999/07/why-good-companies-go-bad

Chart 3

Median annual total shareholder return (TSR) for diversifying vs. non-diversifying companies, compared to the respective median over all companies



Notes: "Diversifying" refers to companies that introduced new revenue streams between 2010 and 2019, in contrast to "non-diversifying" companies that did not. Includes 1,092 companies for the period 2010 to 2019 and 738 companies that were actively trading from 2010 to 2023, providing a view among the companies monitored up to 2023.

Source: Refinitiv Datastream, Stryber Analysis

“Companies that focus on their core business seem to destroy shareholder value.”

Finding 4: Adding new revenue streams requires an organisational capability that the majority of companies lack

As we have outlined so far, diversification serves as a crucial factor in boosting shareholder value and forms the bedrock of sustainable business success, especially in times of uncertainty. Yet only 29.7% of the companies in the sample of this study managed to successfully diversify their business during 2010-2019. While the relative youth of some companies might account for a small portion of this shortfall, the main cause is that established firms often grapple with a distinct challenge: a lack of organisational capability that hinders them from effectively executing diversification strategies, thereby limiting their ability to capitalise on the benefits it offers, demonstrating the “Innovator’s Dilemma”.

What could be the reasons for the diversification dividend?

Diversifying companies actively looked for attractive opportunities and managed to successfully add new revenue streams through Mergers & Acquisitions (M&A) or building new business models. This strategy was rewarded with a higher total shareholder return. There are a few underlying mechanisms that could explain this link:

Modern Portfolio Theory:

Spreading out the risk by investing in multiple revenue streams is at the heart of Harry Markowitz’s Modern Portfolio Theory. It also added valuable flows of lifeblood to the businesses we analysed, sustaining the firm from different places at different times.

Being active in different verticals, audiences, and geographies proved vital over the COVID years and beyond, bolstering returns by 53%.

Organisational capabilities:

As we have outlined, active and passive inertia pose significant risks when it comes to maximising shareholder returns and ensuring a company’s sustained value and prosperity. What is needed are clear and deliberate strategic moves into new territories. An essential consideration in this process is adjacency; while successful diversification demands courage and to depart from familiar paths, it does not mean placing random bets. Instead, it encourages leveraging unfair advantages and unique competencies. What’s more, the strategic moves will only be effective when allowed to unleash their full effect within the right governance to support diversification.

Market appreciation:

When the market sees something it likes, it is quick to react. Shareholders value companies that push in new directions and actively innovate. We already found this link in our previous diversification study[15] where the top performers in terms of 10-year diversification already show stock market outperformance after the first 3 years. The new data shows that this is especially relevant in times of changing market conditions and increased speed of technological change.

15) https://www.stryber.com/resources/diversification-study

Case studies



The evidence strongly suggests that new revenue streams bring more shareholder value. However, there is one vital ingredient that can make or break a successful implementation: strategy.

Firms who diversify without strategy are effectively gambling, which becomes evident in the in the following case studies, that unveil two very different business approaches.

Hermès have made continuous revenue diversification the cornerstone of their business strategy since the early days in the 19th century. The company has doubled down on diversification in the last 20 years. This leadership mindset was rewarded by the market, and empowered the business to quadruple its revenue from €2.4 billion to over €11 billion in the years since 2010. Over the past decade and a half, shareholders have also enjoyed average returns of over 20%.

By contrast, Bang & Olufsen recently has struggled to diversify strategically. In an attempt to go back to their core strengths, they have been pursuing a “leaner, faster, stronger” strategy. The strategy, however, has yet to restore the former radiance of the brand and reestablish a highly sought-after, attractive product portfolio.

This implies how effective diversification efforts can be, if done deliberately, continuously and based on an underlying strategy. Feel free to refer to the European report here for full details.

Conclusion: It's now or never

When threatened with stressful situations, it is natural to respond with fight, flight or freeze instincts. But as we have seen with the companies who did not build new revenue streams, both active and passive inertia can be disastrous. It leaves firms woefully unprepared to deal with turbulent market environments like those endured over the past years and surrenders the opportunities entirely to competition. The consequence of 53% lower annual shareholder returns for companies who "focus on core" speaks a clear language.

All signs are pointing to more rough times ahead. After all, protectionism, the flaring up of new conflicts and a looming economic downturn are factors that could easily lead to a decline in global trade, investment, and economic growth. Now is the time to act.

As we emphasise in the study, leaders who employ a portfolio logic with the right mindset and strategic diligence will be rewarded by the market, and swiftly so. For some, it will be an opportunity to shine. We could see the new Amazons (7+[16] overarching revenue streams), Apples (6+[17]) and Indutrades (8+[18]) emerge. For others, it could spell the end.
In 2024, business leaders cannot shy away from future-proofing their firm with revenue diversification. It's now or never.

16) https://www.statista.com/chart/15917/amazon-revenue-by-segment/

17) https://www.statista.com/statistics/382136/quarterly-segments-revenue-of-apple/

18) https://markets.ft.com/data/equities/tearsheet/profile?s=INDT:STO

What's next?

Areas for further research

Correlation does not equal causality, and therefore we cannot be certain that the higher performance of the diversifying companies was caused by the diversification itself. However, the correlation alone is striking: companies that diversified did better financially. It seems reasonable that those companies are more actively adapting to market situations.

Further studies could examine the causality by looking into the relationship between different types of diversification and stock market performance on a more qualitative level.

Also, the correlation could be further examined within different industries. Some of the most striking examples we found are in similar industries, which could point to underlying industry-wide growth drivers.

This quantitative study was limited to Europe. This version, highlighting case studies of successfully diversified companies and key takeaways for the Middle Eastern region, was published with regard to the Dubai FinTech Summit in May 2024, organised by the Dubai International Financial Centre (DIFC).

Methodology

We analysed sales and total shareholder return data from Refinitiv Datastream for 1,092 listed companies in Europe from 2010 to 2019 and for a subset of 738 listed companies for the extended period up to 2023. The regional sample sizes for the subset of 738 companies are: UK 163, France 87, Germany 79, Switzerland 64, Scandinavia 126, rest of Europe 219.

Total shareholder return [%] is, as per the Refinitiv Worldstream Return Index (RI) variable, defined as the increase in stock price over a certain period plus the dividend payout, assuming reinvestment of dividends.

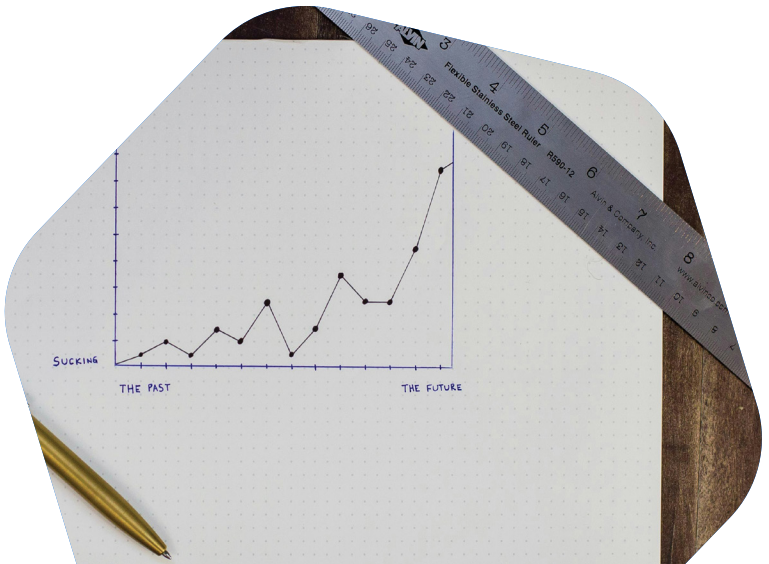
Our research focused on listed companies with the largest market capitalisation where stock market data was available for the periods between 2010-2019 and 2020-2023.

We analysed five points for every company. First, we calculated the relative amount of revenues in 2019 generated by business segments that did not exist in 2010. We followed the reporting of revenue segments in companies' annual reports.

While, as an example, Netflix started testing online streaming prior to 2010, it was first incorporated in the 2012 annual report. This is common practice: ideate, test and iterate new business models until one creates enough traction to become a standalone segment.

Secondly, we analysed the average annualised total shareholder return for each company between 2010 and 2019 and – where available – between 2020 and 2023.

As a next step, we segmented the companies into two groups, determined by the level of revenues in 2019 generated from new segments that did not exist in 2010: 0% (no revenue from new segments) and over 0% (revenue from at least one new segment). We then calculated the medians of the annualised shareholder returns and the means of the number of revenue segments for the two groups and compared these two metrics across the groups.



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About Stryber

Stryber is a leading strategic growth consultancy and corporate venture builder. By developing new ways to grow new business, Stryber empowers its clients to think like strategists and build like experienced entrepreneurs. With a record of successfully growing client portfolios on a large scale through impactful ventures, the advisory firm's data-driven approach and holistic strategy framework have acted as the foundation for 100+ new businesses created so far.

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