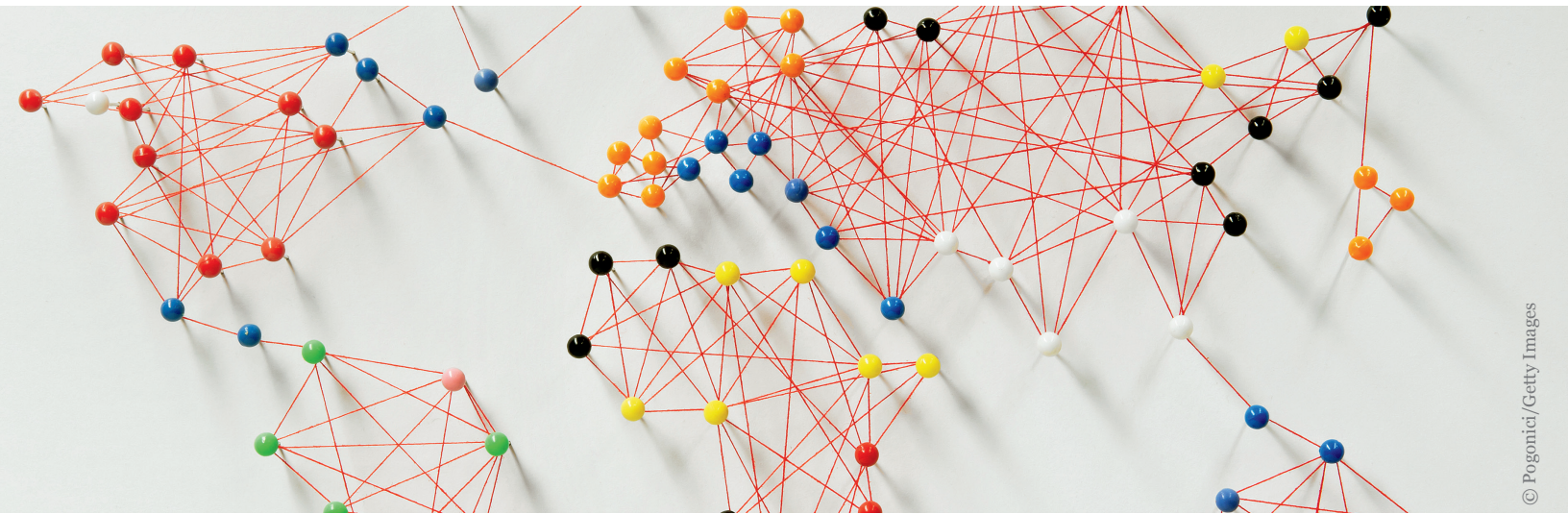


AUGUST 2015



© Pogonici/Getty Images

CORPORATE FINANCE PRACTICE

Mapping the value of diversification

Expanding your focus tends to add more value in emerging economies than in developed ones.

Francisco Caudillo, Skief Houben, and
JehanZeb Noor

Executives are always looking for ways to expand their businesses, and diversification is one approach they regularly ask about. The answer is always unambiguous: diversifying, in itself, is neither good nor bad; what matters is whether a company can add value. Although more than 70 percent of large companies around the world already operate in more than two industries, our research finds that creating value through diversification is a lot easier in emerging economies than in developed ones.

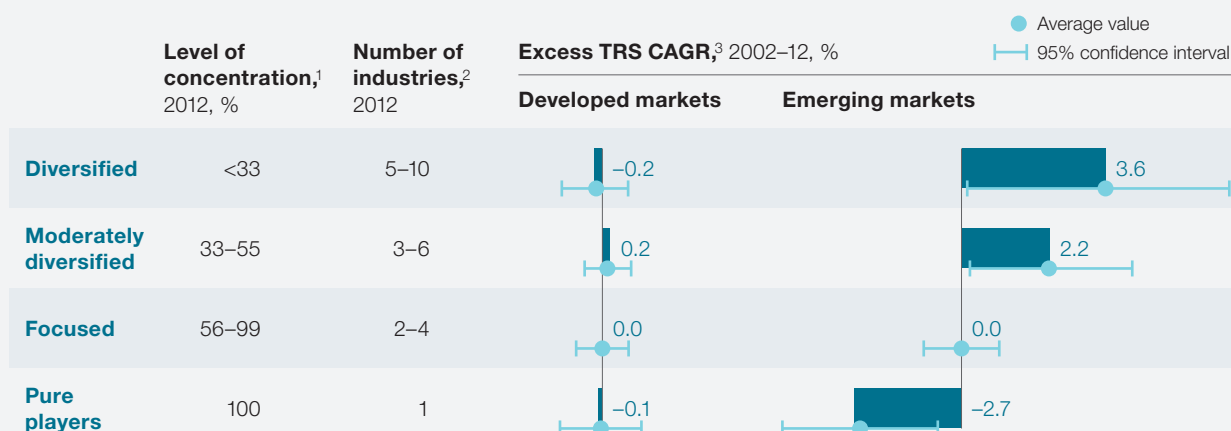
In fact, when we compared the returns of more than 4,500 companies around the world¹ with their level of diversification,² we found that in emerging

economies, the most diversified companies created the highest excess returns, 3.6 percent, compared with -2.7 percent for pure players (Exhibit 1).

By contrast, in developed economies, we uncovered almost no difference in excess TRS for any degree of focus or diversification.

As we so often find, cause and effect are not clear. However, underlying market and ownership structures could play a role. For instance, the fierce competition for capital in developed economies probably ensures that market dynamics allocate resources to the best owners, so diversification without cash synergies across businesses confers little or no advantage. In contrast, many

Exhibit 1 Diversification creates more value in emerging economies than in developed ones.



Note: n = 4,576 global companies with revenues >€1 billion in 2012, excluding financial industries.

¹Level of diversification calculated by Herfindahl-Hirschman Index (measures level of concentration by summing the squares of the revenue shares of a company's activities).

²Based on the Standard Industrial Classification system.

³Excess TRS calculated as company TRS minus reference TRS based on 10 high-level industries (Global Industry Classification Standard) per developed or emerging market.

Source: McKinsey analysis

Exhibit 2 Respondents from diversified companies in the emerging world report that they have structural advantages that help them create value.

% of emerging-market respondents; multiple answers allowed, n = 149



Source: McKinsey Quarterly survey on growth beyond the core, Nov 2014

diversified companies in emerging economies are family owned or controlled, which can ensure opportunities to reinvest, better access to local and regional governments or to regulatory insights, and the ability to attract talent (Exhibit 2). That translates into higher revenues, profits, and returns to shareholders. ■

Francisco Caudillo is a specialist in McKinsey's Miami office, **Skief Houben** is an associate principal in the Amsterdam office, and **JehanZeb Noor** is a principal in the Chicago office.

Copyright © 2015 McKinsey & Company.
All rights reserved.

¹ Companies with 2012 revenues over €1 billion, excluding financial companies.

² Using the Standard Industrial Classification system.