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It's time to break your company's cycle of expand-contract-repeat.

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Focus and diversification are often presented as a choice: You can have one or the other. Which strategy is right for you? It's an unfortunate question that puts most companies on a time-wasting merry-go-around. For every CEO who touts her strategy to create a laser-focused company, there's a successor waiting in the wings to launch a new era of growth and expansion. And for every CEO attributing strength and stability to his company's wide-ranging portfolio, there's a successor waiting to usher in a period of profitability and retrenchment.

Take Coca-Cola. Facing stalled growth in the 1960s and '70s, the company pursued diversification—even going so far as to purchase Columbia Pictures in 1982. Only a few years later, management decided to "focus" by exiting "non-core" businesses (Coke sold its last stake in Columbia Pictures in 1989), and this worked beautifully for its sparkling beverages business. Fast forward to today: The company is seeking diversification into new businesses such as energy and sports drinks because growth in its main business has again stagnated. And around and around we go.

The good news, though, is that focus and diversification can successfully coexist. In fact, with the right strategy, each can increase the benefits the other brings to a company. But for this to work, you have to redefine what you mean by focus and rethink your reasons for diversification.

It's common to think of focus as how broad or narrow your range of businesses is. But this misses the point. Instead, you should think about focus in terms of how much your businesses materially benefit from the distinctive capabilities that make your company better than any other at its way of creating value.

A narrow company operating in related markets can be unfocused. For example, think of oil and gas companies, with their portfolios of exploration, production, refining, and retailing businesses. Few if any of these companies have capabilities that are both distinctive and relevant to every one of their businesses. Although their portfolios comprise businesses operating in highly related markets, each business requires very different capabilities to win in its own particular market. It's nearly impossible for the leaders of these companies to focus their efforts at building a coherent platform of enterprise capabilities that confer real advantage to every one of their businesses.

The opposite case can be made about broad companies: They can be focused even though their businesses compete in unrelated markets. For example, most businesses in Berkshire Hathaway's empire benefit tremendously from its preeminent capital deployment capability, Danaher deliberately goes after businesses that can benefit the most from its famous "Danaher Business

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System," and UTC has a portfolio of businesses with one important common denominator—they all benefit greatly from its ACE program (Achieving Competitive Excellence). All three companies could be called conglomerates. But they are also highly focused companies.

Using this definition of focus, there are only two reasons to diversify. The first is to use your company's way of creating value and its distinctive capabilities to generate new avenues for profitable growth. This is what Berkshire, Danaher, and UTC are doing whenever they acquire a new business. They are not doing it for the reasons that too many other companies diversify: to enter "attractive" markets in order to improve their financial profile (higher growth rate, better margins, or lower volatility of earnings). This is financial engineering, not strategy, and it always leads to lack of focus.

The second reason is to strengthen your company's current business, by enhancing either its capabilities or its value proposition. Disney's acquisition of Pixar in early 2006 is a great example of the former, because it addressed a massive capabilities gap in Disney's animation business. Disney is often referred to as an entertainment conglomerate, with its theme parks, toy stores, Broadway shows, television programs, and more. But in fact the company is focused: Its original business is animation, which creates and popularizes the characters that feed all its other businesses (with a few major exceptions, such as ESPN). But the emergence of digital technology threatened this essential business, as companies such as Pixar were able to drastically reduce the cost of animation and enhance what it could do. So, although Disney brought a lot to Pixar, Pixar helped Disney fortify a distinctive capability that brings coherence to its massive entertainment complex.

Lego gives us an example of how diversification can enhance the value proposition of your current business. The company has had two big diversification drives in its recent history. The first, which ended in the early 2000s, was motivated by financial engineering and nearly bankrupted the company. The second started around 2004, and has made Lego the largest toy company in the world. This time around, every new area that Lego entered—amusement parks, education, virtual model construction, and movies—has helped to increase the engagement of children and parents with Lego building blocks. The company had few capabilities to bring to these new businesses, but those businesses have done wonders for Lego's toy business.

When you define focus in the right way and have the right reasons for diversifying, your moves to grow beyond your current business are much less likely to put you on the merry-go-round. Instead of diversifying away from your base, you'll diversify for it. Instead of diversifying to improve your financial profile, you'll diversify because you are so focused. And instead of diluting what makes your company great, you will enhance it. +

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