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The Upside Of Concentrating Risk

This is a lesson about diversification. When I was an investment banker, a lot of my business was to persuade companies to buy or to sell all, or part, of their business. The truth is that more often than not, many of these diversification strategies failed. Actually, it was quite good news if you were a banker, because people wanted you when they were collecting with glee, and equally they needed you when they were divesting disappointedly.

But I think there's a very interesting lesson that comes out of this, because if you look at some of the world's great businesses - Coke is an obvious example - through thick and thin they have stuck to the "knitting". Look how successful they've been compared to, for example, some of the world leaders that almost forced themselves into bankruptcy during the internet boom. Actually, putting your eggs in one basket and watching that basket damn closely - an old edict, in fact, of Andrew Carnegie when he built his steel business - is really a very successful strategy.

So there's an irony here that if you concentrate risk, you can argue that you reduce it; because the intensity of focus and understanding on that business is, frankly, a much better strategy than the safe insurance policy of diversification. If one thing holds true in business, it's that the proof of the pudding is in the eating: results are actually what count. So, if you have a great diversification strategy and it works, fine. If you have a great, strong focus, stick to the "knitting", all-eggs-in-one-basket strategy, and that works, fine.

But I think history has shown that there are more examples of truly great success over long periods of time of the latter rather than the former. I think the lesson is that there is an irony, in that increased risk concentration can actually decrease the risk which superficially it creates.

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