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FUTURE OF MICHIGAN

Roundtable: The challenges, risks and rewards of diversification

In October, *Crain's Detroit Business* and **Honigman Miller Schwartz and Cohn L.L.P.** invited experts from business and academia to discuss the challenges of diversification and how successful businesses approach it.

The discussion was moderated by Publisher **Mary Kramer**. Also participating from *Crain's* were Executive Editor **Cindy Goodaker** and reporter **Ryan Beene**.

Roundtable participants were:

- **Tricia Sherick**, partner, commercial law, bankruptcy and reorganization, **Honigman Miller Schwartz and Cohn L.L.P.**, Detroit.
- **Tobias Schoenherr**, assistant professor, supply chain management, **Michigan State University**.
- **Sriram Narayanan**, assistant professor, supply chain management, **Michigan State University**.
- **Todd Sachse**, president, **Sachse Construction & Development Corp.**, Birmingham.
- **Ken Rogers**, executive director, **Automation Alley**, Troy.
- **Constance Blair**, president, **The Venture Cos.**, Warren.

Mary Kramer: Let's start with the professors from Michigan State. I know you are in the early stages of your research (see story, opposite page) and you haven't done your survey yet, but in terms of case studies, what kinds of things are you looking for, or what kinds of companies have you found so far that play to this theme of the kinds of business decisions that are made to diversify and survive?

Tobias Schoenherr: Having diversification written on your mission statement is one of the keys. Integration into your supply chain is another.

So we are looking at companies that are able to survive, that are able to venture out in different businesses. We are looking at what enabled them, what capabilities need to be present to diversify to be successful.

Kramer: What are the main challenges that you think companies face as they look at diversification?

Schoenherr: A lot of companies probably are stuck in the business that they have been doing, and they didn't think about that early enough, so now they are scrambling to survive.

I think companies that are successful have thought about diversification from the first day on. Branching out to other customers not only in Michigan, but also nationally. Looking at other fields of business where they could kind of fall back to if the primary field of business isn't successful anymore.

Kramer: Todd, maybe you can share a little bit about what you were talking about from your early days from the get-go of being in construction and contracting.

Todd Sachse: Our approach has always been that we want to always diversify both geographically and product type. Because we know that in any industry there is ebb and flow. If you take automotive, there may be years where SUVs were big and then they are not so big, or front-wheel drive or rear-wheel drive. So if you are only a Hummer, that is going to be very difficult for you.

We have always taken the position that we will build anything that starts with an A, and everybody pauses: an office, a shopping center, a restaurant, an apartment complex, you know. We have been saying that for 17 years.

Just take, for example, a couple things that may be obvious to anybody. There was a condo craze. So when there was a condo craze, we were building tons of condos. If we were only condo builders, we would be out of business. If we were only industrial, we would be out of business.

There was a period of time when we did a ton of office interior work. If you go back into the late '90s, office building was experiencing huge growth in southeastern Michigan. The influx, the building of new office buildings and tons of business coming in, and it was a boom and we did a lot of that. But when we were doing that, we always recognized this isn't going to last forever because nothing does, and anybody that thinks that it does is just being naive.

The biggest challenge when you talk about diversification is most clients want to hire "the expert." The customer wants to hire the vendor that only does that and specializes in that. No different than medicine. You know, if you have something wrong with your right eye, you want to go to a right-eye specialist. It is the same thing in business.

So what we do is when we go to sell a client, all of our marketing material is focused only on our experience with that client's area. If we are going after a retail project, we only talk about our retail experience.

Kramer: So you have just-in-time marketing material.

Sachse: That's exactly how we do it.

Growth stories

Kramer: Can you give us kind of a sense of your growth? You started 17 years ago?

Sachse: I rented a 10-by-10 office in somebody else's office and got a phone number and said, "Hello,



"Having diversification written on your mission statement is one of the keys."

Tobias Schoenherr, Michigan State University

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MSU STUDIES HOW COMPANIES WEATHER ECONOMIC STORMS

The marketing and supply chain management department at **Michigan State University** is undertaking research on how small and midsize companies react to periods of economic turbulence and is looking for companies to participate.

The project, "Weathering the Storm: Surviving and Thriving in an Uncertain and Turbulent Marketplace," is expected to provide researchers and managers with several outcomes:

- Identification of the major options available to managers when facing a period of significant market turbulence.
- Identification of the conditions most conducive to the successful pursuit of these major options.
- Assessment of the relative effectiveness of the options.
- Guidelines for how to deal with periods of significant market turbulence.

The research team is interested in soliciting the participation of firms and their management teams for short interviews and on-site visits. All information gained from these interviews will be kept strictly confidential and only aggregate results will be reported.

For more information, please contact **Steven Melnyk, Sriram Narayanan** or **Tobias Schoenherr** at (517) 353-6381 or at wts@bus.msu.edu.

I am Sachse Construction.” And it just kind of grew from there. We grew the old-fashioned way, you know, get up early, do the right thing every single day, and the phone rings. That is really what it was all about and pretty much still is.

Kramer: So what is the size of your company now?

Sachse: We do anywhere from \$40 million \$60 million a year.

Kramer: Connie, you are another example of someone who has diversified. What did you have first and how did it grow?

Constance Blair: We also are 17 years old, and we started off as an engineering firm, system safety and software engineering primarily for the government, and that was because that was the first person that hired us. I started my company with \$76, which was all the money I had in the world at the time, and worked out of my home.

I went to see everybody I knew, and finally somebody gave me a job and it was somebody at Tacom. Unfortunately they gave me a job that I didn't have any skills to do, so I had to hire somebody to do the job because it was an engineering task. They liked what I did, and we grew organically from that.

We got up to about 42 engineers probably in the first couple of years and then realized that we were just a puppy mill. We were training great young engineers, and the automotive companies were stealing them. So I went back to my first background.

My skill set is logistics, and I decided that it was going to be something that was always needed. Everything gets shipped somewhere.

As people started outsourcing, that was great because they would outsource to us, but then people started insourcing because they felt that they wanted to keep jobs in-house and offer their employees stability. So what we had to do was we had to provide services that they could not do for themselves.

We went into specialty packaging, and we became a customs bonded warehouse initially. Then we upgraded to a foreign trade zone after that because these are limited, so everybody can't become a foreign trade zone. We provided them with services that they could not do.

And then as the market began to shift, I realized that the big box stores had their own distribution centers, and I thought, well, I am already a distribution center. The only piece I am missing is the big box store. So I took a look at **Home Depot**, **Lowe's**, **Office Max**, **Office Depot** and **Best Buy**, and I realized that I was in a \$300 billion marketplace, and only 8 percent of it was captured by the larger companies, and the rest was kind of scattered to the wind. So I thought, well, I will take the other \$292 billion and do something with that.

Then, I went into industrial supply. We do everything from drywall to screws and nails and tools and saws, just about anything you can imagine, and also we do office supplies, which every business needs.

So we set up a distribution network, and we became our own customer because we are already in the distribution business. So we distribute through our own distribution network worldwide to consumers.

Our primary customer is the government. It seems with every business that we start our primary customer is always the government. We work with all agencies — agriculture, energy, interior, defense. It doesn't matter to us, they all have green money.

One of the things that was an offshoot of the supply business was the facility management company **Evergreen Ventures** that we started, and that was basically because we thought we could probably use our own supplies. We are not very big, but we picked up the **Detroit Medical Center**, which was a big coup for us.

We started making a name for ourselves, and one of the things our customers started asking us for were green supplies. They wanted to green their business. So we went into the green business, and that's how **Ecogreen Ventures** became a business.

So we have kind of just organically changed with the marketplace and with what our customers are looking for. So over the course of 17 years, we have become multiple companies under one corporate umbrella.

Kramer: I know you are involved in NDIA, the **National Defense Industrial Association**, and because a lot of your business comes from the government, were the programs that the government had for women-owned enterprises helpful? Did that sort of help to get your foot in the door or not?

Blair: Not really. One would think so, because when I first started off, I went through the 8(a) program. But it took me so long to figure out how to work the program that I had to make money before I could pass that learning curve. So it really didn't benefit me that much.

I don't want to discount the programs because the programs themselves are great. What it takes is somebody who has the ability to deal with the details of it all.

There are other mandates. For example, we check pretty much all the blocks. We are woman-owned, minority-owned, service-disabled-veteran-owned, disadvantaged. We get to check all the blocks. So there are advantages to some companies and government agencies to using businesses that have those designations because they are protected classes, and they have mandates to have a certain amount of their business go to businesses like that. But all other things have to basically be equal before you can even compete for those.

Kramer: And so how many companies now, how big are you?

Blair: We are about \$60 million, about five or six companies.

Kramer: And it sounds like your model is “I can do that. If you need that, I can do that.”

Blair: We say we will do anything for a buck. I always tell people I am in the oldest profession in the world — sales.

Sachse: One of our sayings is “just say yes.” Anytime a customer asks you something, say yes. The first word that comes out of your mouth is yes. It is amazing what that does to the relationship instantly.

Can you move that wall and have it all done by tomorrow? Yes. Now you may then follow it up with what it is going to take to actually achieve that or what it is going to cost, and the client might then say oh, forget it.

The first project we did out of town was hey, can you build this store in California? Yes. And then I hung up the phone and asked myself how I was going to do that.

How do you build an entrepreneur?

Kramer: So, Ken, here are two great case studies on either side of you. How do their stories fit in with what you are seeing, and how do you get more of these? How do we get more of these people?

Ken Rogers: At the Alley we are constantly on the alert for entrepreneurial types. We have an entrepreneurial center. We have funded 26 new companies in the last two years. They have created 150 new jobs. We are in the process of still utilizing the funds that are available. We have advised another 600 individuals involved in the creation of companies in the last three and a half years.

It isn't just finding the opportunities to get them started, it is keeping them going, and we made a mistake in that area probably. We didn't really track them after the funding the way we should have. It is not just about the money to start them out. It is about the problems that come as it moves forward, as they are growing that business.

We have transferred some staff around internally, and I have someone dedicated to tracking all of our investments in these companies on a day-to-day basis. So if they need something, if they are stuck somewhere, we are going to move that ball forward. We are going to find a solution and try to help them grow that business.

Kramer: Are there any common issues where they get stuck? If you have 26 companies, you have a track record, right?

Rogers: It is all about the money when you get down to it. When someone comes to us and makes an application for technology funding, we are going to take the experts in that field, take that technology there and have them look at it. If they pass on it, but they say that is a good investment, we are going to make that investment. For us it is about \$200,000 to \$300,000 as startup funding. We will help them at that point go to VCs and other areas to find additional funding.

The biggest problem the startup companies have is that second-stage money. I've got this thing going, I have some track record, but I have a contract that I need funding to fulfill. And if that money is not available, they are stuck.

It is one thing to make the investment in the startup. It is the next thing to get them to the next phase, because that is really when the commercialization process really accelerates.

Kramer: Tricia, you are nodding.

Tricia Sherick: Yes. I definitely see that from our clients, it is access to capital. The traditional lending sources, because of the problems in the capital markets, just aren't there. For them to put money into an existing company that is struggling with its diversification efforts, it is very much a tough sell.

What "real entrepreneurs" do

Cindy Goodaker: Tobias and Sri, Todd has talked about the difference between having technical expertise to actually having a business model. I think some of the things you have been looking at in the supply chain management program is the difference between having a technical expertise in a company and applying that technical expertise to another industry. That it is not just as simple as having, you know, as knowing how to make the widget and learning how to make the new widget. There are other things you need to know.

Sri Narayanan: This goes back to the idea of "core competence." (Translating technical expertise into broader strategy) does require some amount of thinking skill and a little bit more foresight. And to some extent in our research what we are trying to look at is what is the foresight part and the awareness part among entrepreneurs.

The other thing which I feel is also to some extent important is some culture of innovation from within the firm. If you look at the auto companies, one of the strategies that we are looking at in our research is many of these companies want the status quo because the supplier is big, and we keep teaching to our own students that you should build great relationships with your suppliers.

Schoenherr: I wanted to discuss what you mentioned with the culture, that the entrepreneurial spirit needs to be there. That is one of the most important preconditions of being able to diversify, that there is a buy-in from top management and also from the employees.

So these competencies or credibilities, they need to be present. You can't just go in with a consultancy and diversify a company. It needs to be present. It is a whole philosophy that you approach business with, and if that is not present, then the companies are less likely to diversify successfully.

Sachse: You keep on describing what a real entrepreneur does, because you are talking about the core competency. You know, the core competency could simply be, as Connie was saying too, just to know how to make money. If you have the ability to know how to make money, now you have to bring in people that have specific core competence, great financial people. Maybe it is the engineers, maybe it is, you know, in my business a great project manager, a great superintendent who know how to do their jobs.

One of our core values is strive for excellence by constantly raising the bar. Because we are always changing what we do, we are always trying to figure out a better way, a smarter way, a more efficient way. I think the culture of many, particularly large companies, who just do it the way they have always done it, means the world just passes them by.

Blair: And you can't afford to do that for very long. The failure to change is what stifles many businesses. Entrepreneurs get bogged down with it and small-business people do just as much, but we can adapt much more quickly because we don't have so many people and layers.

Sachse: It is cultural. There are large companies that empower their people all the way through the entire organization to take risks, and the risks are celebrated.

Blair: And they empower them to make decisions.

Sachse: And they are allowed to make mistakes, and you learn from those mistakes. That was not the culture certainly in southeastern Michigan with the Big Three. No one would ever make a decision. Everybody was afraid to. And if they did make a decision, they would make the safest possible decision they could.

Sherick: I think you're beginning to see the auto industry adapting. I think sometimes you need a force to drive the change, and I think that's the positive part of what we've been going through, that it is forcing people to look at their companies and their business and their culture and make changes in order to survive.

Ryan Beene: Tricia, I wanted to ask you something. From your work with your clients in their efforts to diversify, what have been some of the traits of those who have been successful?

Sherick: I think it comes down to companies who are willing to take a risk, who are resourceful, who rely on their contacts, but who also are always thinking about the next thing.

It really is about understanding your core competency, but figuring out how to take that core competency and apply it someplace else.