

A small business diversifies by adding gutter cleaning services

A friend of mine operates a small business in the San Francisco Bay Area: B&B Window and Gutter Cleaning¹. B&B Window and Gutter Cleaning was founded ~20 years ago as B&B Window Washing. About 5 years into its history, the founder made the strategic decision to diversify into gutter cleaning services.

There were two primary objectives B&B Window Washing was trying to pursue when they decided to diversify into gutter cleaning. First, window washing is a decently seasonal business. While commercial clients wash year-around, high-end homes tend to skip the rainy winter months of the SF bay area. Since gutter cleaning is also seasonal but with an inverse peak and trough, it was appealing to stabilize revenue. Second, B&B Window Washing found a good portion of their clients needed both window washing and gutter cleaning services. B&B didn't want those clients of theirs to have to contract with another "home services" company, who might be willing to wash their windows as well. B&B would rather their clients had no need to contact another closely related and possibly competitive company.

An alternative way B&B could have tried to achieve their objectives without increasing the scope of the company would have been to contract with an existing gutter cleaning company. B&B could have either just referred clients to the gutter cleaning company, or perhaps contracted with them as a sub-contractor. To evaluate whether incorporating gutter cleaning services directly into the B&B was the best decision, we can compare associated administrative costs with the transaction costs that would have been realized in a subcontracting relationship.

Key sources of administrative costs (weak incentives, principal-agent problem, and lack of dynamism) incurred by providing gutter cleaning services are all small for B&B. Since the same crew of workers does both services, incentives are virtually unchanged, and the principal-agent

¹ <https://www.bandbwindowandguttercleaning.com/>

problem is non-existent. There is likely a small loss in dynamism, but since window washing and gutter cleaning are stable services, this is not a large cost.

Key sources of transaction costs in a subcontracting relationship would have been much higher. The adverse selection cost would have been a factor, as information asymmetries would appear from B&B's lack of knowledge about gutter cleaning. The moral hazard cost would have been significant, as the subcontractor, when operating under the B&B brand, would have been motivated to cut corners as much as possible. Finally, the hold-up problem would have also presented costs as B&B would be so deeply reliant on this subcontractor, and the switching costs to a different subcontractor so high, that B&B would be vulnerable to opportunistic maneuvers by the subcontractor (e.g., demand a larger percentage of revenue from the job).

Considering these relatively low administrative and relatively high transaction costs, we conclude that B&B made the better decision to bring gutter cleaning in-house, rather than use a subcontractor.