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Influence of Unrelated Diversification Strategy Components on Corporate Performance: Case of Sameer Group in Kenya

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Abstract: *Corporate diversification is one of the fundamental strategic alternatives available to organizations to sustain growth and search for greater profits. Companies whose products are threatened by the environmental uncertainty or in decline phase of their life cycle curve can prefer to engage in diversification to overcome the risk arising from current industries. Expanding its product line and activities to different sectors where the environmental uncertainty is reduced and, profitability is higher, a company may confirm its survival which will make its cash flow more reliable. Utilizing case study research design, the research sought to establish the influence of unrelated diversification strategy components on corporate performance of Sameer Group in Kenya. Stratified random sampling technique was used in selecting the sample for the study. The main data collection instrument for the study was questionnaires. Findings indicated that the general economic environment, efficiency view, firm characteristics and co-insurance effect were significantly related to corporate performance.*
Keywords: *Corporate performance**,** Diversification, Unrelated diversification, Strategy*

I. Introduction

The increasingly changing business environment, which is characterized by fragmented markets, rapid technological changes and growing dependence on non-price competition, has forced many firms to be innovative in all areas of business activity. Corporate strategy is crucial for any organization to succeed in a turbulent environment. The gains from portfolio diversification in reducing volatility and subsequently investment risks have been widely accepted. Today, many globally successful investors share a common component of investment strategy – a diversified investment portfolio (Brainard & Fenby, 2007). Corporate diversification has long been regarded as a strategic tool for organizations to sustain growth and profitability (Hakrabati, 2007). Unrelated diversification strategy is an important component of the strategic management of a firm, and the relationship between a firm's diversification strategy and its economic performance is an issue of considerable interest to managers and academics (Kotler & Armstrong, 2008).

The competitive strategy of the firm in the business environment characterized by uncertainties in the market is an important management decision. Companies whose products are threatened by the environmental uncertainty such as political, economic, social, technological and legal factors can prefer to engage in an unrelated diversification to overcome the risk arising from current industries (Strickland & Thompson, 2003). The tyre market has witnessed increased number of players since 2005 when the government reduced import duty from 25 % to 10% in favour of transporters in partner States under the East African Community external tariff. As a result, this entry of new competition in the form of imported tyres and independent traders has greatly impacted on Sameer's operating cost. This impact has been felt in the form of declining sales volumes which translates to declining profits. This according to Sameer's Annual Report (2009-2014) has posed a challenge to Sameer over the period since its sales remained static and profit dropping from 25% to 19.8% prompting it to diversify its business. This study sought to explore the influence of unrelated diversification strategy components on the corporate performance of Sameer Group in Kenya?

1.1Sameer Group in Kenya

Sameer, under the name Firestone East Africa Limited, was established in Kenya in 1969 by Firestone Tyre and Rubber Company of the USA and the Government of Kenya to produce tyres for the East African market. The company's corporate identity changed to Sameer Africa Limited in April 2005. This change created an independent tyre producer based in Kenya that aims to supply the East African and COMESA markets (Sameer Annual Report, 2013). Sameer Group is an industrial conglomerate, active in a diverse range of businesses which include agriculture, finance, export processing, energy and power, information technology (IT), telecommunications, construction, manufacturing, and transportation businesses in Africa. It produces processes, and markets tea and coffee; involves in horticulture, forestry, dairy farming, and crops of medicinal value activities; develops and operates an export processing zone in Kenya; provides various financial services and products for individuals and businesses in the areas of local trade, imports/exports, and agriculture in Nairobi and the Coast Province of Kenya.

II. Literature Review

2.1 Theoretical Framework

This study was informed by the resource-based theory which provides a rationale for corporate diversification. The type of diversification strategy strongly depends on the resources specificity of the company (Chatterjee & Wernerfelt, 2011). Additionally a resource that can only be used in one product is not suitable for diversification into unrelated businesses. In the resource-based approach, or managerial expertise have the potential to create value when shared across businesses (Miller, 2006). Consequently, the usage of the same resources or capabilities under different circumstances can result in economies of scope and in economic quasi rents, which allows the company to generate sustainable competitive advantage and higher performance. In particular, unique path dependent resources, which are in short supply in the marketplace, can be leveraged across related product lines and provide higher rents. For instance physical or tangible resources, such as plant and equipment are highly inflexible because they only can be used in a few similar industries. Therefore, if a firm has a high degree of excess of physical capacity, it is very likely that the firm will engage in related diversification (Chatterjee & Wernerfelt, 2001). Financial resources have the highest degree of flexibility and suitable for related and unrelated diversification. However, there is a difference between the effects of the availability of internal funds and equity capital. In general, managers use internal funds for unrelated diversification.

2.2 Empirical Review

Hoskisson (2004) and Hill et al. (2002) found that unrelated diversifiers required competitive arrangements. Hill and Hoskisson (2004) argued that unrelated firms achieve financial economies by risk reduction, portfolio management and internal capital markets. Teece et al. (2004) studied how environments affect firm structure. They suggested that, with low path dependence, slow learning and weak selection, conglomerates persist, but in environments with rapid learning and colliding technological trajectories, networked firms may arise.

Wernerfelt and Montgomery (2006) found that industry profitability and industry growth, the two dimensions of industry attractiveness, have different implications for unrelated diversification (which they termed as inefficient) firms. They suggested that unrelated firms would be better off in high growth industries. Hitt, Ireland and Hoskisson (2009) noted that an unrelated multiproduct diversification strategy is frequently used in efficient and developed markets (such as the UK and the US), as well as in emerging markets (such as China, Korea, Brazil, Mexico, Argentina, and India).

Lubatkin and Chatterjee (2004) tested similar models, suggesting that unrelated diversification strategies would be associated with less attractive risk and return profiles but that related or constrained diversification strategies would be associated with more attractive risk and return profiles. These studies showed some support for the predicted curvilinear relationship between diversification strategy and firm performance. It was concluded that these relationships were temporarily stable through swings in business economic cycles.

Boot and Schmeits (2000) focus on managerial complexity in a conglomerate as a key variable in choosing the scope of diversification. They explain managerial complexity in terms of resource misallocation. These authors study the impact of market discipline, internal discipline, internal incentive problems, and product market rents to identify a class of financial synergies that compensate for ineffective market discipline. The scope of diversification is expected to be decided by considering the positive diversification effect of co-insurance, the negative incentive effect of co-insurance and, finally, the negative incentive effect of reduced market discipline.

Early industrial organization studies investigated the impact of total diversification on firm performance. The results of these studies were inconclusive (Gort, 2002). In recent years, new studies began to attempt to separate the effects of unrelated diversification on performance (Blocher, 2001). Using large cross-sectional samples, unrelated diversification was found to have a strong negative impact on performance because managers of conglomerate firms could not manage anything and everything well; the costs of managing a diverse portfolio of business lines soon outweighed the realizable gains. For this study, unrelated diversification is expected to have a negative impact on performance.

In the strategy literature, Chatterjee and Wernerfelt (2001) empirically investigate whether firms diversify in order to utilize surplus financial and non-financial resources. The major difference in their approach to the finance literature is that they consider the linkage between the type of surplus resources and the relatedness of diversification. They compute a diversification index that measures movements in firm business concentration away from its core business across time. This index is then regressed on proxies for physical, tangible, and intangible resources. They find that firms with higher levels of intangible resources tend to diversify in a more related fashion while firms with greater financial resources (liquidity) tend to pursue unrelated diversification.

Their empirical analysis includes cross sectional regressions as per the previous literature (Denis, et al. (2007) and also fixed-effects regressions using several years of panel data. In a cross-sectional framework they find results consistent with Denis, et al. (2007) that unrelated diversification is decreasing in managerial incentives. However, when controlling for unobserved firm-specific factors in the fixed-effects regressions they find a positive relation between incentives and unrelated diversification consistent with May (2005) and opposite to Denis, et al. (2007). While May (2005) attributes this relation to the risk-aversion motive, Aggarwal and Samwick (2003) show that their empirical results are due to the private benefits (empire building, prestige, etc.) explanation rather than managerial risk aversion.

The empirical studies of Mayer and Whittington (2003), McGrath and Nerkar (2004) have found evidence of unrelated diversification. For instance, in hi-technology industries, McGrath and Nerkar (2004) have found significant diversifications in the pharmaceutical industry. Furthermore, other hi-technology studies have found that organizations leverage their resources and experiences into increasingly unrelated product markets. Moreover, earlier and even more recent empirical evidence (Campa and Kedia, 2002; Villalonga, 2004) has found that unrelated diversifications perform at a premium.

2.3 Corporate Performance

Corporate performance can be measured by financial aims attainment. In the same manner Ho, (2008) pointed out that performance can be evaluated by efficiency and effectiveness of aim attainment. Venkatraman et al, (2006) cited that corporate performance can be assessed by financial performance namely, return on assets, growth of sales, profit, organization effectiveness, and business performance. Similarly, Delaney et al, (2006) asserts that organization performance can be evaluated by quality service and products, satisfying customers, market performance, service innovations and employees. That corporate performance can be appraised by the following dimensions of performance: return of investment, margin on sales, capacity utilization, customer satisfaction and product quality. In the same way, Green et al, (2007) identified that return on investment, sales and market growth, and profit are important factors that be measured by organization performance. According to these researchers, there are many factors in this study that can be measured by performance such as market share, financial performance, efficiency and effectiveness of an organization's performance, and human resource management.The intermediate model of the diversification performance relationship implies that diversification yields positive returns that diminish at the margin as firms diversify further away from their core business (Markides,2002). Firms first choose to diversify in related areas so that they can leverage existing assets and competencies. Consistent with the resource view of diversification this form of diversification is most profitable to the firm and is generally preferred to unrelated diversification. Once related diversification opportunities are depleted, firms are forced to enter unrelated activities where their competitive advantage is substantially less. Profit maximizing firms continue to diversify to the point where marginal benefits are equal to marginal costs.

III. Research Methodology

The study adopted a case study research design as it sought to investigate in-depth of an individual, group institution or phenomenon. The primary purpose of a case study is to determine factors and relationships among the factors that have resulted in the behaviour under study. The study adopted stratified sampling technique in selecting the sample for the study in which a sample of 50% was taken of the population in each stratum to achieve a desired representation from the various sub groups in the population. The target population of interest in this study was Sameer Group Kenya which consisted of top, middle and low level managers from all the departments namely Marketing & Business Development, Sales, Human Resource, Planning, Procurement & Logistics, ICT and Manufacturing. A semi structured self administered questionnaires were used for collecting primary data. The questionnaire was piloted for validity and cronbach's alpha coefficient used to test the reliability of the measured scales giving a cronbach's alpha coefficient above 0.70 minimum acceptable threshold. 85% of the questionnaires that were administered were returned which represents a reliable response rate. Descriptive analysis was done to identify patterns in the data while regression analysis was done to establish the relationship between the dependent and independent variable.

IV. Findings and Discussions

4.1 Efficiency View

The study found out that to a greater; top managers are able to monitor each strategic unit more effectively through access of information and as a result help in reducing the overall costs, managers become more efficient at allocating capital and labor across their business units than would external markets and cost scope economies is achieved from the sharing of fixed production costs across several businesses within the firm. These findings conforms to those of Herring and Santomero (2004), that is, diversification provides "one stop shopping" convenience for customers who are willing to pay for the extra convenience of financial supermarkets

4.2 General Economic Environment

The study revealed that the company adopted the diversification due to the availability of resources and institutions as they significantly impact on a company's, the degree of environmental munificence influenced a company's diversification strategy, since different opportunities and constraints are available to the company and that the company pursue unrelated diversification in order to better control sanction opportunistic behavior. These findings conform to those of Ramanujam and Varadarajan (2009) which acknowledged that the general economic environment has an effect on a company's decision to diversify. Hence general economic environment played a major role in corporate performance.

4.3 Firm Characteristics

It was noted that majority of the respondents were of the view that the company through its firm characteristics; seeks for growth opportunities, the size and scope of a business group, and its scale in existing industries, lower its cost of entry into other product-markets and increase the chances for competing future first-mover advantages in multiple product-markets, Capitalizing new investment opportunities, benefits from a lager scope which broadens their knowledge base thus increase absorptive capacity to assimilate market opportunities, uses profits in industry where they have scale advantages to invest in new promising markets or sell those businesses at a higher price to finance their new investments in the promising markets, has a higher level of absorptive capacity that allows it to more fully capture the benefits of simultaneous exploitation and exploration, has a positive performance feedback that reinforces the persistency of using a diversification strategy in future, benefits from organizational slack, which increases the incentives for firms to take risk and pursue unrelated diversification.

The findings are supported by those of Rothaermel & Alexandre, (2009), that is, a higher level of absorptive capacity allows a firm to more fully captures the benefits of simultaneous exploitation and exploration. A large scope of a firm implies a broader and more diverse knowledge base, which further increases an organization's absorptive capacity to assimilate market opportunities, and can enhance the firm's capability to further diversify into unrelated product markets.

4.4Co-insurance Effect

The study found out that co-insurance effect enhances debt capacity and results in increased debt usage for product-diversified firms, the company diversifies due to co-insurance effect that has a positive influence on the company debt capacity due to the reduction in the volatility of firm revenues and profits and the company diversify due to increased total borrowing capacity combined with the effect of tax-deductible interest payments. The result supports Lewellen (2008) argument that "combining businesses with imperfectly correlated cash flows provides a reduction in operating risk thereby enhancing corporate debt capacity".

4.5 Regression Analysis

The data findings analyzed showed that other factors held constant, a unit increase in efficiency view will lead to 0.230 increase in corporate performance; a unit increase in general economic environment will lead to 0.293 increase in corporate performance; a unit increase in firm characteristics will lead to 0.314 increase in corporate performance; while a unit increase in co-insurance effect will lead 0.135 increase in corporate performance. At 5% level of significance and 95% level of confidence the general economic environment had 0.023 level of significance, firm characteristics had 0.018 level of significance, efficiency view had 0.024 level of significance while co-insurance effect had 0.013 level of significance. Further firm characteristics had the highest positive influence on corporate performance followed by general economic environment, efficiency view and co-insurance effect respectively.

The Equation ($\mathbf{Y} = \beta\ 0 + \beta\ 1\ X1 + \beta\ 2\ X2 + \beta\ 3\ X3 + \beta\ 4\ X4 + E$) becomes:

Corporate Performance = 1.531 + 0.23 Efficiency View + 0.293 General Economic Environment + 0.314 Firm Characteristics + 0.135 Co-Insurance Effect.

Table 1: Model Summary

R .	R Square	Adjusted R Square	Std. Error of the Estimate	R Square Change	F Change	df1	df2	Sig. F Change
.846	.716	.709	.49959	.716	8.180	4	46	.000

a. Predictors: (Constant), Co-insurance Effect, General economic Environment, Efficiency View, Firm characteristics

Table 2: Anova[b]

Model	Sum Of Squares	df	Mean Square	F	Sig
Regression	8.166	4	2.042	8.180	.000
Residual	11.481	46	.250		
Total	19.647	50			

a. Predictors: (Constant), Co-insurance Effect, General economic Environment, Efficiency View, Firm Characteristics
b. Dependent Variable: Corporate Performance

Table 3: Coefficients

Predictors:	B	Std. Error	Beta	t	sig
Constant	1.531	. 551		2.997	.004
Efficiency View	.230	.088	.223	2.614	.024
General Econ Environment	.293	.125	.325	2.350	.023
Firm Characteristics	.314	.128	.357	2.453	.018
Co-insurance Effect	.135	.046	.131	2.935	.013

a. Predictors: (Constant), Co-insurance Effect, General economic Environment, Efficiency View, Firm Characteristics

5.3 Conclusions

In line with the objectives, the study concludes that the proposed framework of the study was able to demonstrate strong explanatory power. Notably, the study provides evidence for the direct effect of unrelated diversification strategy components on corporate performance as suggested by the literature. General economic environment and firm characteristics emerged as a stronger predictor of corporate performance at Sameer group. The study further concluded that the establish regression model was significantly good for foresting and could be used for prediction of corporate performance in firms who have embraced unrelated diversification strategies in Kenya.

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