CORPORATE DIVERSIFICATION AND PERFORMANCE

Wan Mohd Nazri Wan Daud[1], Norhana Binti Salamudin[2], Ismail Bin Ahmad[3]

[1]Lecturer at Faculty of Business & Economics, Universiti Pendidikan Sultan Idris. Tanjong Malim, Perak, Malaysia.
[2]Associate Professor of Finance at Faculty of Business Management, Universiti Teknologi MARA, Shah Alam, Selangor, Malaysia.
[3]Professor of Financial Economics at Faculty of Business Management, Universiti Teknologi MARA, Shah Alam, Selangor, Malaysia.

Abstract

Business diversification has drawn attention of strategic management and finance scholars. This study examines relationship between diversification effect on performance using multiple measures of performance namely accounting and market measurements. The study used panel data analysis for a sample of 70 Malaysian firms from various industries during the period 2001 to 2005. The evidence produces some interesting findings with regard to risk factors and effect on firm's performance while other factors are consistent with previous findings. In particular, firms that adopt the focused strategy perform better than those with diversified strategy. Different measures of performance used in the study produced varying results after controlling for risk, firm size and economic condition, using the inflation rate as a proxy.

Keywords: Corporate strategy, diversification, performance.

Introduction

The relationship between diversification and performance has been one of the most debated topics in the field of strategic management and finance (Ramasamy, Li and Veliyath, 2002; Santalo and Becewa, 2008). Diversification issue has been studied mostly in various developed countries (Campa and Kedia, 2002; Geringer, Tallman and Olsen, 2000; Rumelt, 1982) but limited evidence is available in emerging markets. Diversified firms have business operations in more than one industries (Hitt, Ireland and Hoskisson, 2005). Previous studies on diversification and performance relationship produced mixed findings which may suggest country-specific peculiarity. Therefore, the objective of this study is to examine the relationship between diversification strategy and firm performance in an emerging market, Malaysia.

Literature Review

Diversification and Firm Performance

Diversification is a strategic choice of a firm to improve performance. However, there are opposing views in previous studies examining diversification and performance relationship. The first view favors focused firms while the other favors diversified firms. Amit and Livnat (1988) suggest that both of these strategies are pursued based on two motives which are synergistic and financial motives. If firms have synergistic motive, they may pursue focused strategy but if they have financial motive, then the diversified strategy would be adopted. Nevertheless, pursuing these strategies to increase performance would not assure obtaining the expected result as debate over which strategy is most suitable remains ongoing. Therefore, the following section discusses empirical evidence from previous studies pertaining to selection of strategy to enhance firms' performance.

1. Evidence to Support Focused Firms

The first group of findings supports the focused proposition where firms should concentrate on their core business in order to perform better. Focused strategy is defined as business activities within firm's respective resources but products or services offered may differ from currently served (Johnson, Scholes and Whittington, 2008). Therefore, focused strategy is expected to enhance performance as business operation is relatively close to the existing business. This contention is supported by empirical evidence from developed countries (Denis, Denis and Yost, 2002; Zook, Allen and Smith, 2000; Zook and Rogers, 2001) as well as developing countries (Lin and Servaes, 2002; Mishra and Akbar, 2007).

All of them suggest that focused firms perform better than diversified firms because they are more efficient in converting underutilized resources to achieve maximum performance. Turner (2005) contends achievement of efficiency due to sharing of resources amongst related business divisions. Another reason is associated with market

power whereby focused firms could use predatory pricing to deter and eliminate competitors from their respective industries (Montgomery, 1994).

Similarly, Mishra and Akbar (2007) claim that focused firms could be advantaged in an efficient internal market as they are able to exploit synergy effect. Stimpert and Duhaime (1997) strongly rejected diversified strategy by demonstrating that such firms will experience low performance when they fail to implement strategic investment. Further, they conclude that high performance firms are unlikely to implement diversified strategy as they have better investment opportunities as compared to those with low performance.

Montgomery (1994) supports this view by showing superior performance of focused firms as opposed to diversified firms. Better advantage of focused firms could be the key factor that led United States' firms to diversify around their core business in 1980's (Rumelt, 1982). It seems that focused strategy was the appropriate diversification strategy to be implemented at that time.

However, Johnson et al., (2008) suggest two possible causes could deter performance of focused firms. The first cause could be time and cost related, making it difficult to determine the effect of synergy on firms. While the second cause could be unwillingness of managers to share resources as each business division has respective performance measurement to achieve and sharing of resources complicates such measurement.

Nevertheless, it is still unclear whether this strategy is the best approach to enhance performance in developed countries (Geringer et al., 2000) and developing countries (Nachum, 2004). Even Nayyar (1992) implies that difficulty in managing focused strategy would result in firms choosing to implement the diversified strategy instead.

2. Evidence to Support Diversified Firms

The second stream of evidence indicates that diversified strategy could be used to enhance firm performance, among them (Geringer et al., 2000; Gourlay and Seaton, 2004; Lee, Hall and Rutherford, 2003; Nachum, 2004). Diversified strategy seems to dominate corporate action from 1949 to 1974 in US as shown by Rumelt (1982). However, this behavior of US firms changed due to new control and policy introduced by the government in the early 1980's resulting in widespread sale of non-core asset.

Diversified strategy is identified if firms have operations in more than one industry (Santalo and Becerra, 2008). Three reasons have been mentioned by Amit and Livnat (1988) on why firms pursue diversified strategy: agency cost, cash flow and transaction cost. Agency cost arises from conflict of interest between managers and owners of firms. Nevertheless, Aggarwal and Samwick (2003) argue that managers could not get involved in an industry that is totally different from existing operations without the owners' permission. The second reason is associated with surplus funds available to firms. Extra money means firms are not tied to debt obligations; therefore, they could diversify their business with the expectation of improving performance (Hitt, Hitt and Hoskisson, 1992). Finally, the third reason is linked to transaction cost where certain assets could not be rented or sold, hence, diversified strategy becomes an option to efficient use of those assets (Amit and Livnat, 1988).

Kim, Hwang and Burgers (1989) contend that diversification may improve firm performance. Nachum (2004) advocates that firms in developing countries would be better off by adopting diversified strategy due to the presence of the commodity sectors. Most empirical studies relating to diversification and performance were done using manufacturing sector data particularly in developed countries. Therefore, result obtained in developed countries may not be applicable to developing countries. In addition, presence of market imperfections in developing countries could benefit diversified firms.

Furthermore, Geringer et al., (2000) who studied Japanese firms suggest that every country has their own uniqueness which could explain variation in the result obtained. Lee et al., (2003) found similar finding when they performed a comparative study between Korean and United States of America (US) markets during the period 1992 to 1996. Diversification creates positive results for Korean firms and vice versa for US firms. This finding seems to be the reason why firms in emerging markets pursue diversified strategy. It is possible that differences in executing diversification strategy brought about contrasting outcome between Korea and US. In contrast, Dundas and Richardson (1982) used US sample and claim that diversified strategy did not destroy performance.

3. Other Factors Affecting Performance

Contrasting evidence thus far may be due to different variables being used in respective studies. To date, various studies have examined variables that may explain firm performance. However, these studies offered mixed results. One major problem is the existence of market imperfections brought about by economical, political and operating environments in each country (Lee. 2003). Even different approaches used could affect result obtained (Kim, Hwang, & Burgers, 1993). Simmonds (1990) shows that breaking up the study period from 10 years (1975-1984) to two 5 year sub-periods (1975-1979 and 1980-1984) gave significant results. The economy encountered higher inflation and higher interest rate during the period 1975 to 1979. Where as, in the period 1980 to 1984, economic condition improved with decreased inflation and interest rate. Kracaw, Lewellen & Woo (1992) support those findings in which they mentioned that inflation variable influences performance.

Apart from inflation, leverage may also influence performance. However, literature has two sets of findings with regard to diversification and leverage relationship. The first set shows that leverage may be negatively related to performance (Akhtar, 2005; Mitton, 2007). While the second set put leverage as the factor to improve performance (Abor, 2005; Kovenock and Philips, 1995).

Even though researchers are divided on the effect of leverage, they have reached a consensus pertaining to influence of firm size on performance. Their evidence exhibits that large firms can utilize their resources efficiently and minimize downside risk, leading to improved firm performance (Mitton, 2007; Thomas, 2006; Tongli. 2005).

Besides that, risk is another important variable that attract little attention in the study pertaining to diversification issue. Risk needs to be controlled because the theory states that high risk is associated with high return. Kim et al., (1993) used variance of

return on assets as a proxy for risk to control the risk profile of firms and capture effects on firm performance.

Performance Measurement

Various studies attempted to determine the appropriate measure of performance that captures all performance goals. Different proxies used in these studies contributed to the ambiguous findings pertaining to diversification and performance relationship. Most literature employed accounting measure as a proxy of performance. Nevertheless, this measure has been criticized because it is subject to manipulation (Buhner, 1987).

Since investors made investment decision based on accounting numbers, better results should lead to higher share prices (Dubofsky & Varadarajan, 1987). However, the evidence is mixed where accounting measure of performance support undiversified firms in contrast to market measure of performance which favor diversified firms (Dubofsky & Vadarajan, 1987, Hitt and Ireland, 1986). The reason for dissimilar evidence may suggest existence of market imperfections as well as different proxies used for accounting measure (Lee et al., 2003).

Proxies for accounting measure proposed in the literature include return on equity (Syed & Rao, 2004), return on sales, return on invested capital and compound sales growth (Simmonds, 1990). Both studies did not find significant relationship between diversification and the mentioned variables. However, the results are significant with return on assets, another proxy for accounting measure of performance (Simmonds, 1990).

As a result, most studies incorporated return on assets as accounting measure. Bettis (1981) informs that return on assets is widely used by practitioners and academicians because it controls for differences in firm's financial design. Due to ambiguity in results when using accounting measure of performance, some studies have adopted market measure as an alternative proxy.

Even though both measurements may have limited capability to measure performance, at least multiple measures (accounting and market measures) could capture almost all firm performance goals. Therefore, it seems necessary to incorporate multiple measures to examine diversification and performance relationship (Aleson and Escuer, 2001; Lu and Beamish, 2004; Simmond, 1990; Tongli et al., 2005). According to Tongli et al., (2005), a single measure that satisfies all performance criteria is not available and multiple measures may be appropriate to establish the robustness of findings.

Theoretical Framework and Methodology

This study uses panel data estimation method. Data were extracted from Worldscope. Focused firms are identified when total sales from one particular industry are above 95%. Firms that do not meet these criteria are classified as diversified.

Rumelt (1982) used the same approach by classifying firms that adopt focused strategy when they reported 95% or more total sales in one industry. This present study also encounters problem whereby the segment description in the financial statement

were dissimilar from the two digits SIC code for industry. Therefore, the SIC codes were corrected to reflect the industry segment characteristics.

The data randomly selects 260 *syariah* compliant firms out of 584 *syariah* compliant firms on Main Board of Bursa Malaysia as at 31 November 2006. List of syariah compliant firms was obtained from Bursa's website. We eliminated the financial sector because the capital requirement for these firms are regulated by relevant authorities, thus, it may bias the findings in this study. Subsequently, this study also eliminates firms for which Worldscope does not provide sales breakdown, although it may operate in a single or multiple business segments.

The study period is for five years from 2001 to 2005. A short study period is desirable because firm strategy keeps changing over time and thus extending the period would reduce the number of firms with a stable strategy. Short study period ranges between three to four years performed by previous studies among others (Buhner, 1987; Singh, Davidson & Suchard, 2003; Syed & Rao, 2004). The justification is that firms rarely maintain the same strategy over long period of time.

Research Design

The regression estimation technique is used to establish possible relationship between diversification and performance. This explains which factors have influence on firm performance in the Malaysian context. Thus, it provides some evidence with regard to factors influencing behavior of Malaysian firms. This section discusses variable definitions used as proxies for diversification, control variables and performance. They are briefly explained as follows:

1. Performance variables

Two types of performance measurement used in this study are accounting based return on assets (ROA) and market based using market-adjusted return.

a. Accounting Measure

Most literatures have employed accounting measure of performance by using return on asset (ROA) as a proxy. According to Bettis (1981), this ratio is under management control, even though it is broadly used by practitioners and academicians. Khanna and Palepu (2000) used the same ratio in assessing performance in India. Thereby, this study adopts ROA to measure performance, defined as follows,

$$\textit{Return on Assets (ROA)} = \frac{\textit{Net Income after taxes but before extraordinary items}}{\textit{Total Assets}}$$

b. Market Measure

The data for share prices are gathered from DataStream for the period 2001 to 2005. The market adjusted return is used as a proxy for market measure of performance (Tongli et al., 2005).

i. Market Adjusted Return = Share Return - Emas Index Return

ii. $\text{Share return} = \frac{SPn - Spi \times 100}{SPi}$

Share return = percentage change of share price over intial value
SPi = Beginning of year share price
SPn = End of year share price

The emas index is used to calculate market return. Emas index is effective because it comprises of all listed firms on Main Board of Bursa Malaysia. In addition, this study randomly selected sample from all listed firms on the Board

iii. $\text{Index} = \frac{MPn - Mpi \times 100}{MPi}$

Emas Index Return = percentage change of emas index return over initial value
MPi = Beginning of year emas index
MPn = End of year emas index

2. Independent and Control Variables

The second objective of this study is to find the impact of independent variables on firm performance. These variables have been tested in developing countries but not in Malaysia in the context of diversification. The existence of different country characteristics may be possible factors that affect performance (Geringer, Tallman & Olsen, 2000; Kim et al., 1993; Lee et al., 2003). Therefore, this study incorporates the following variables as control variables:

a. Firm Size

Antecedent proposition always advocate the impact of firm size on performance. Tongli et al., (2005) assert that large firms can use their resources efficiently and minimize downside risk, which in turn, could improve firm performance. Similar research done by Chang and Thomas (1989) propose that large firm size could determine the success of diversified strategy. The following definition is used to measure firm size:

Market Value (MV) = *Share price x number of shares outstanding*

Firm Size = *Ln (MV)*

b. Risk

Another factor that has an impact on firm performance is risk. General theory of investment states that high return is associated with high risk. Past studies have shown that diversified strategy tend to have high risk as compare to focused strategy (Barton & Gordon, 1988; Kim et al., 1993; Montgomery and Singh, 1984). However, the evidence from research done by Kim et al., (1993) is perplexed whereby high return could be achieved by having low risk, thus providing another dimension for risk and return association. Therefore, there is a need to understand the effect of risk on diversification strategy in Malaysian firms. Thus, the following variable has been used as a proxy to measure risk.

Risk = *Standard deviation of ROA*

c. Inflation

External factor has been anticipated to have influence on firm's performance. This factor has been quoted in numerous studies (Chathoth, 2002; Kracaw et al., 1992; Norhana, 1988) which used a number of proxies to measure external factor, for example term spread, gross domestic product, interest rate and inflation rate. Therefore, this study used inflation index as a proxy. The rationale being that the nature of this study is related to industrial diversification that focuses on number of products produced by firms. Since inflation index gauge the increase of product's price, therefore, it may suit the feature of this kind of study.

d. Leverage

There is contrasting evidence with regard to using leverage in the firm. Thus, the understanding over choice of financing remains a mystery (Myers, 1984). Similar findings establish in Ghanaian market whereby mixed evidence is provided by Abor (2005) over short term and long term leverage. According to Abor (2005), short term leverage is associated with high performance in contrast to long term leverage. Therefore, this study would like to investigate the effect of leverage on firms that implement diversification. Thus, the following proxy has been used:

$$\textit{Debt to Equity Ratio} = \frac{\textit{Standard deviation of ROA}}{\textit{(Long-term debt + Market value of equity)}}$$

Method of Estimation

The study investigates the characteristics of firms using descriptive statistics and also Pearson correlation to differentiate between focused and diversified strategies. The following estimation is then conducted to understand the relationship between dependent and independent variables:

Diversified firms

$$Y= \alpha+ \beta1\ sizeit + \beta2\ inft + \beta3\ lev\ it + \beta4\ riskit + eit \qquad ...Eq\ 1$$

Focused firms

$$Y= \alpha+ \beta1\ sizeit + \beta2\ inft + \beta3\ lev\ it + \beta4\ riskit + eit \qquad ...\ Eq\ 2$$

Overall firms

$$Y= \alpha+ \beta1\ sizeit + \beta2\ inft + \beta3\ lev\ it + \beta4\ riskit + \beta5\ sdit + eit \qquad ...Eq\ 3$$

Estimation Results

Descriptive statistics for the whole sample as well as that of focused and diversified strategy groups are presented. This is followed by the effect of diversification strategy on performance which is the ultimate objective of this research. Table 1 summarizes the firm characteristics and diversification measures for the sample firms. The mean of market adjusted return (MAR), return on asset (ROA), leverage (LEV), size (SIZE), risk (SROA) and inflation (INF) are 0.04, 3.96, 62.3, 12.41, 4.38 and 1.74 respectively. In this study, multiple measure of performance (market adjusted return and return on asset) have been used to comprehend the relationship between diversification and performance as suggested by Dubofsky and Varadarajan (1987).

Table 1: Descriptive Statistics

Diversification strategy: Firm characteristics and diversification measures					
	N	Minimum	Maximum	Mean	Std. Deviation
Mar	350	-.85	3.15	.0364	.42615
Roa	350	-93.47	27.50	3.9615	9.42166
Lev	350	-921.18	2450.29	62.3013	201.28429
Size	350	10.23	15.68	12.4093	1.11836
Sroa	350	.35	38.51	4.3756	5.45962
Inf	350	1.09	2.97	1.7400	.65693
Sd	350	.00	1.00	.5000	.50072

Meanwhile, one sample t-test for respective diversification strategy is presented in Table 2. A one sample t-test compares the mean of one sample to a fixed estimate in which the result exhibits here used 0 as comparison of mean for respective strategy. Variables that produce result far from 0 could be stated as significant evidence for this study. The evidence indicates that the results are significant except for market adjusted return.

Table 2: One Sample T Test; T-test = 0

Variables	Focused firms (N=35) Mean (differences)	Diversified (N=35) Mean (differences)	Whole sample (N=35) Mean (differences)
MAR	.0481	.0247	.0364
	(0.136)	(0.446)	(0.1111)
ROA	5.0748	2.8482	3.9615
	(0.000)***	(0.000)***	(0.000)***
Leverage	55.3051	69.2974	62.3013
	(0.000)***	(0.000)***	(0.000)***
Size	12.4261	12.3926	12.4093
	(0.000)***	(0.000)***	(0.000)***
Risk	3.9480	4.8031	4.3756
	(0.000)***	(0.000)***	(0.000)***

*** Significant at 1 percent level
** Significant at 5 percent level
* Significant at 10 percent level

Table 3: Pearson Correlation of diversification measures and independent variables

	MAR	ROA	LEV	SIZE	SROA	INF	SD
MAR							
ROA	0.196***						
	(0.000)						
LEV	0.154***	-0.018					
	(0.004)	(0.738)					
SIZE	-0.012	0.291***	-0.108***				
	(0.827)	(0.000)	(0.043)				
RISK	0.018	-0.534***	-0.001	-0.191***			
	(0.741)	(0.000)	(0.990)	(0.000)			
INF	-0.396***	0.011	-0.012	0.055	0.000		
	(0.000)	(0.843)	(0.828)	(0.306)	(1.000)		
SD	0.028	0.118**	-0.035	0.015	-0.078	0.000	
	(0.608)	(0.027)	(0.516)	(0.780)	(0.143)	(1.000)	

*** Correlation is significant at the 0.01 level (2-tailed).
** Correlation is significant at the 0.05 level (2-tailed)
* Correlation is significant at the 0.10 level (2-tailed).

A simple bivariate correlation of the variables is exhibited in Table 3. This table provides the Pearson's correlation coefficient for the selected variables. The highest correlation coefficient is 0.534 which indicates that multicollinearity between variables does not exist. The reason being that social science researchers normally used bivariate correlation higher than 0.80 as a benchmark for identifying multicollinearity between variables. Single, double and triple star shows significant correlation between variables at $p = 0.10$, $p = 0.05$ and $p = 0.01$ respectively.

Table 4 illustrates differences between focused and diversified strategy. The study shows that focused firms have high market adjusted return than diversified firms even though it is not significant. Nevertheless, mean value for focused firms are better than diversified firms. Thus, the evidence may suggest that focused strategy is creating more value to shareholders as compared to diversified strategy. At the same time, accounting measure of performance for focused firms is significantly higher than diversified firms. Thus, the evidence may suggest that focused strategy is creating more value to shareholders as compared to diversified strategy. At the same time, accounting measure of performance for focused firms is significantly higher than diversified firms.

Table 4: Comparison of focused and diversified firms

Variables	Focused firms (N=35)	Diversified (N=35)	Whole sample (N=35)
	Mean	Mean	Mean (p-value)
MAR	.0481	.0247	0.02343 (0.545)
ROA	5.0748	2.8482	2.22657
			(0.006)***
Leverage	55.3051	69.2974	-13.99234
			(0.526)
Size	12.4261	12.3926	0.03343
			(0.772)
Risk	3.9480	4.8031	-0.85514
			(0.037)***

*** Significant at 1 percent level
** Significant at 5 percent level
* Significant at 10 percent level

It is interesting to note that focused strategy also has significantly lower risk than diversified strategy. As for leverage and size, there is no significant difference between focused or diversified firms. There is no statistical difference for inflation for focused or diversified firms.

In Table 5 on next page, the results of regressions from the estimation models are presented. The regression output is generated through OLS technique which demonstrates findings for focused and diversified firms as well as the effect of diversification strategy on performance. The tested variables that consist of leverage, size, risk and inflation reveal mixed findings in measuring performance.

Leverage shows positive relationship with market measure of performance. The

finding indicates that leverage has been used to improve firm performance. Similar finding has been presented by Kovenock and Philips (1995) that leverage can be utilized to increase performance in a single industry. The evidence may suggest that utilization of high level of debt may send signal to investors that the firms are pursuing strategy to improve performance. Thus, investors bought shares in these particular firms. Based on the above data, it seems to suggest that focused firms perform better than diversified firms.

Table 5: OLS Estimation Result

	Diversified		Focused		Overall	
	ROA	MAR	ROA	MAR	ROA	MAR
Leverage	0.0023	0.0001	0.0007	0.0008***	0.0003	0.0003***
	(0.0025)	(0.0001)	(0.0038)	(0.0002)	(0.002)	(0.0002)
Size	2.2378***	0.02423	1.5235***	-0.01	1.6603***	0.012
	(0.5331)	(0.0278)	(0.5485)	(0.0264)	(0.3821)	(0.53)
Risk	-0.4377***	-0.0009	-1.0202***	-0.0018	-0.8467***	-0.0021
	(0.1352)	(0.0070)	(0.0965)	(0.0046)	(0.0779)	(0.5955)
Inf	-0.2986	-0.2907***	0.2424*	-0.2195***	-0.0020	-0.257***
	(0.8556)	(0.0446)	(0.9171)	(0.0441)	(0.6346)	(0.000)
SD					1.4508***	0.0294
					(0.8343)	(0.4815)
N	35	35	35	35	70	70
R^2	0.198	0.204	0.432	0.212	0.329	0.182
Adj.R^2	0.179	0.185	0.419	0.194	0.319	0.170
DW	1.539	2.173	2.191	2.256	1.812	2.198

Figures in parentheses denote "Standard Error" values of the regression coefficients.
*** Significant at 1 percent level
** Significant at 5 percent level
* Significant at 10 percent level

Meanwhile, size is significant to explain the performance of diversified as well as focused firms. This fact suggests that size has a positive effect on firms' performance whereby large firms has an ability to effectively use their resources to increase performance. Overall, this evidence seems to be consistent with other research in developed countries (Buhner, 1987; Simmonds, 1990). Tongli et al., (2005) also found significant size effect on firm performance in smaller domestic market, that is Singapore. They state that large firms are able to use their resources efficiently and have limited downside risk.

As for risk effect on performance, one unanticipated finding was that risk and performance is negatively correlated. This contradicted with the usual belief in portfolio

theory whereby high return is associated with high risk. In this case, the study shows that high return could be achieved through low risk. This result is in agreement with Kim et al., (1993) findings which showed with a certain diversification posture, high return – low risk association could be obtained.

The above result also demonstrates that inflation is inversely related to market measure of performance for focused and diversified firms. This evidence seems consistent with other studies that suggest inflation has an effect on market measure of performance due to investors being more sensitive to market related information than the accounting measure of performance (Kracaw et al., 1992).

Similar evidence here also support those view with an additional finding that focused firms are correlated positively with accounting measure of performance even though it is only significant at 10% level. This fact perhaps suggest that focused firms may benefit from increasing inflation rate, thus, reflecting their accounting information.

The last factor considered is diversification strategy. Based on the above information, diversification strategy appears to be positively correlated with performance only for accounting measure. It seems that diversification strategy does not have an effect on market performance, which may suggest that investors do not buy shares based on announcement of strategy adopted by those firms. This evidence is consistent with those of Buhner (1987) and Dubofsky and Varadarajan (1987) between accounting measure and market measure of performance where both produced contradictory findings.

Conclusion

The study began in exploring characteristics of firms that pursue diversification strategy – focused or diversified strategy. General finding of this study seem consistent with the literature whereby focused strategy enable firms to achieve high performance particularly for accounting measure of performance. Based on the above facts, accounting measure of performance is also significantly affected by risk and firm size.

Meanwhile, market measure of performance is sensitive to level of leverage in the firm and high inflation. Thus, the finding of this study lends support to the findings by Simmonds (1990) which indicate the effect of inflation on performance of Japanese firms. The most interesting evidence is related to the risk and return relationship which may shed some light to ambiguous findings by Kim et al., (1993) where high return could be achieved through low risk.

Since the study is preliminary in nature, future research should use large sample as well as to include additional variables in order to have better understanding of the association between diversification and performance.

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