EFFECT OF DIVERSIFICATION ON THE FINANCIAL PERFORMANCE OF SELECTED FIRMS IN NIGERIA

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Abstract

This study determined the effect of firm diversification on financial performance of Nigerian firms. This study adopted Ex-Post Facto research design and covered ten years annual reports and accounts of these firms from 2008 to 2017. The data collected for the study were analyzed using financial ratios and the formulated hypotheses were tested with simple regression analysis with the aid of statistical package for social sciences (SPSS) 20.0. This study concludes that the financial performance of Nigerian firms is significantly affected by the product, hence there was a relatively statistical significant correlation between financial performance and related diversification but business diversification is not statistically significant. Therefore recommended that Nigerian firms management decision should ignore toward business diversification rather emphasize more on product diversification but against multi product strategy.

Keywords: Diversification, financial performance and Nigerian Firms.

INTRODUCTION

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 academicians (Kotler & Armstrong, 2008). Corporate diversification is one of the fundamental strategic alternatives available to organizations to sustain growth and search for higher profits. Li and Greenwood (2004) opined that companies whose products are threatened by environmental uncertainty or by declining phase of their life cycle curve will prefer to engage in diversification to overcome the risk arising from current industries. Furthermore, firms may engage in expanding its product line and activities to different sectors where environmental uncertainty is reduced and, profitability is higher, such that a company may confirm its survival which will make its cash flow more reliable.

Chen and Yu (2011) observed that increase in the performance of firms due to business diversification occurs when the marginal benefits are greater than the marginal costs of diversification. Firms with enough managerial and financial capacity could easily diversify into other industries since diversification is perceived as investment behaviour. Therefore, performance is a possible determinant of diversification decision.

Corporate diversification and firm performance have attracted much attention from scholars and investors in the past few decades yet most empirical works on corporate diversification have been concentrated on few developed countries such as China, U.S., Germany and U.K. while studies in the context of developing nation such as Nigeria are scarce. Studies have been conducted on the antecedents of diversification and the financial performance outcomes across the globe (Elango, Ma & Pope, 2008). Despite several attempts however, the issue to establish a consistent and clear relationship between patterns of diversification and performance and most of such attempts are inconclusive with conflicting results reported from some of the investigations (Johnson & Scholes, 2006). While Lei and Schmit (2009) have found that more diversified insurers have better financial performance, Hakrabarti (2007) concluded that diversification is associated with poorer performance for both affiliated firms and independent firms. Apart from the fact that the various attempts to demonstrate the effects of diversification on performance are inconclusive because of the conflicting evidence emerging from such studies, most of the investigations carried out so far are based on the experiences of companies in industrialized economies (Ade, 2012).

While most empirical studies on corporate diversification and firm performance focus on one aspect of diversification or the other, for instance, the studies of Wei-Chun and Tsung (2010), and Chia-Wen and Heng – Yih (2008) focused on foreign diversification and firm performance; Somnath and Saptarshi (2015) and Ade (2012) examined the nexus between product diversification and performance. Qiming, Yiping, Cheng and Xiaoguang (2016) and Anil and

Narender (1998) examine industrial diversification and firm performance. From the stand point of the various studies, no study has been seen to evaluate the nexus between foreign diversification and all the other aspects of diversification as they affect firm performance within the Nigerian context.

Statement of Problem

Corporate strategy of diversification either in product line, subsidiary, income or regional line is crucial for the firms to compete favourably and survive on the long run. Most empirical research found a positive relationship between diversification and corporate performance. But due to self-interest, inexperience, incompetence and opportunistic behavour of most managers, most diversification strategy leads to negative or low performance of companies in Nigeria (Ade, 2010). Most of studies on this area were conducted in developed countries such like; United States of America (USA) Germany, UK, and China. Studies that have explored the subject of diversification and financial performance in Nigeria are seen to be very limited, and have not captured variable like foreign diversification, hence, form the significance of this study.

Objective

1. *To ascertain the effects of product diversification on financial performance of selected Nigerian firms.*
2. *To determine the effect of business subsidiary diversification on financial performance of non-financial firms quoted on the Nigerian selected firms.*

REVIEW OF RELATED LITERATURE

Conceptual Framework

Diversification

Corporate diversification refers to a firm's strategy of entering and competing in new product markets. Diversification allows firms to maximize value by enhancing the scope of markets and industries in which they compete and supply product offerings to newer customers (Purkayastha, Manolova, & Edelman, 2012). In the Rumelt framework, the extent of diversification is defined according to a fourfold taxonomy based on the percentage of revenue derived from various products. These include single-product firms, dominant-product firms, related product firms and unrelated product firms. The two types of diversification strategies that are of interest to us in this study are related–product diversification and unrelated-product diversification.

According to Rumelt (1977), related–product firms derive less than 70 percent of their revenues from a single product domain and the remainder of their revenues is from a related product domain. These firms are characterized by medium heterogeneity of customers, same product similarity, medium unit interdependence, both internal and external acquisitive diversification modes and a fast rate of diversification growth.

Product Diversification

Research on product diversification–performance linkage has recently gone beyond an examination of product diversity at the corporate level, to a more micro level of study, such as within-industry and within-business (Li & Greenwood, 2004; Stern & Henderson, 2004). A need to better understand the value-creation mechanisms of product diversification strategy prompted this refocus. In contrast, research on the product line diversification strategy of multinational firms has tended to remain at the corporate level, focusing only on its impact on corporate performance without considering the possible variations of such a strategy in a firm's individual host-country markets. Although multinational firms enjoy a competitive advantage in integrating a global value chain, national environments and institutions remain as powerful constraints on a concerted global strategy, and exert strong influences on the survival of foreign subsidiaries (Kostova & Zaheer, 1999).

Business Diversification

Another stream of literature emphasizes the strategic role of the business subsidiary as an influence of performance (Anderson & Anders, 2002). The greater the strategic interdependency between subsidiary and parent, the more likely the subsidiary will be to receive support and resources from the parent to maintain high performance. Subsidiaries that play key strategic roles for their parents, e.g. as having regional, product or functional mandates, will have a direct claim to resources within the multinational company, whereas subsidiaries that are auxiliary portfolio investments have fewer opportunities of gaining additional resources from headquarters should a crises erupt (Subranmaniam & Watson 2006). Also the strategic intent/ investment motive behind establishing the subsidiary may influence performance. Some subsidiaries may have a strategic intent of accessing local markets, while others may have as their strategic intent to supply export markets and/or other subsidiaries with components (Dunning & Sarianna, 2008). As the latter type of investment impacts the global operation of the multinational company directly it can be expected to have higher performance than e.g. market seeking investments.

Firm Performance

The success of an organization has an important role in our daily lives, hence, a successful organization represents a key ingredient for developing nations such as Nigeria. Continuous performance is the focus of any organization because only through mirror of performance organizations are seen to grow and progress. Thus, organizational performance is one of the most important variables in management research and arguably the most important indicator of organizational performance (Wahla, ShahSyed & Hussai, 2012).

Return on equity (ROE) represents profitability of shareholders of the firm after meeting all expenses and taxes (Horne & Wachowicz 2005). ROE is net earnings per dollar/ naira equity capital. Higher ROE means better managerial performance. But higher ROE can be due to financial leverage. Higher leveraged firms have higher ROE which increases risk too (Ross, Westerfield & Jaffe 2005). Usually ROE is higher for high growth companies. ROE = Net Profit / Shareholders' Equity.

Review of Empirical Studies

Cummins, Weiss, Xie, and Zi (2010) examined economies of scope in the U.S. insurance industry over the periods 1993–2006. They find that property–liability insurers realize cost scope economies, but they are more than offset by revenue scope diseconomies. On the other hand, they find that life–health insurers realize both cost and revenue scope diseconomies and conclude that strategic focus is superior to conglomeration in the insurance industry.

Ade (2012) examined the performance of a sample of Nigerian companies in relation to specialization, related, unrelated and mixed product market diversification strategies. Using the Panel Regression analytical technique involving correlation, F-statistics and descriptive statistics, the result showed that there were significant performance and growth differences between firms utilizing related diversification strategies and those utilizing unrelated diversification strategies ($F = 147.4405$, $p < 0.05$).

Iqbal, Hameed and Qadeer (2012) examined the impact of diversification on firms' performance in Pakistan. The data was collected through secondary research and Stock Exchanges sites were the source of information to collect the data of the companies. Total of 40 companies were selected on the basis of Specialization Ratio (SR). Companies whose information were available and remained in the same category for the entire 5 years (2005-2009) were included in the sample. The results of this study showed that there is no positive relationship between diversification and firms' performance.

Nwankwo (2013) investigated the agricultural financing options in Nigeria and their implication on the growth of Nigerian economy. Using the ordinary least square method, the study revealed that agricultural financing had significant impact on the economic growth of Nigeria. The result further indicated that loan repayment rate has negative and significant impact on the growth of Nigerian economy over the years.

Enyim, Ewno and Okoro (2013) applied econometric tests such as unit root, cointegration, error correction model and Grange causality test to examine the relationship between banking sector credit and performance of the agricultural sector in Nigeria. The findings show that government expenditure on agriculture has insignificant impact on agricultural productivity.

Olaleye (2013) used a thirty (30) years dataset of Oil, manufacturing and agricultural share of total exports of Nigeria as independent variables and per capita income as the dependent variable which is used to capture economic development and welfare. This paper also analyzed theories and several attempts by the government at export diversification, some still ongoing and others not effective due to the changing need of the economy. The result estimation shows that all the variables used in the study are stationary at first differenced and also the Johansen co-integration test confirm the existence of a long run relationship between the variables. Msoo, Akaakohol and Goodness (2014) examined the socioeconomic characteristics that influence the decision to diversify and also the welfare effect of diversification on farm households in Makurdi, Benue State. A total of 120 farm households were sampled using a simple random technique. Structured questionnaires were used in collecting the data. The ordinary least square (OLS) model was used to analyze the welfare effect of diversification while the Logit model was used to analyze the determinants of diversification. These results have important implications for policy, economic growth and development. Udih (2014) used primary and secondary sources of information extracted from five (5) banks and ten (10) agricultural enterprises in Delta State, Nigeria to investigate the impact of banks credit on agricultural development. Empirical findings were carried out using percentage ranking, mean, standard deviation and Pearson product moment correlation. Mashiri and Sebele (2014) looked at diversification as a corporate strategy and its effect on firm performance using Conglomerates in the Food and Beverages Sector listed on the ZSE. Data was analyzed using SPSS computer package. Three competing models were derived from literature (the linear model, Inverted U model and Intermediate model) and these were empirically assessed and tested. The research study indicated an important answer, which is diversification and performance were linearly and positively related. Arawomo, Oyelade and Tella (2014) contributed to the evolving literature by examining the extent of export diversification in Nigeria and also analyzed the impact of foreign direct investment on it. Two major methods of export diversification: export count (horizontal) and Herfindahl Index were used. Nigeria's exports flows based on 4-digit SICT product classification were used. The Generalized Moment Methods (GMM) was used to analyze our specified model. Empirical analysis showed that foreign direct investment discourages export diversification in Nigeria, while domestic investment promotes it. Caroline, Ireen and Cleopas (2014) examined the role of export diversification on economic growth in South Africa. The study employed vector error correction model to determine the effect of export diversification and possible factors on economic growth. However, the authors revealed that export diversification and trade openness are positively related to economic growth, while real effective exchange rate, capital formation and human capital have negative long-run relationship with economic growth. Muttaka (2015) examined the effect of Nigeria's oil dependency on economic growth. He observed that Nigeria has wasted much of its opportunities to break away from underdevelopment despite its massive natural and human resources endowment due to heavy reliance on her huge crude oil resources, regrettably mismanaged, as the major source of revenue. He found that of all the other drivers, good governance remains a prerequisite in building an enabling environment for such diversification.

Akewushola (2015) examined the impact of Information and Communication Technology (ICT) on the performance of 12 selected Nigerian firms that are pursuing a strategy of related product-market diversification. Related diversification was measured by the extent of diversification arising from involvement in several industries of the same industry group. The study concludes that the performance impact of related-market diversification is not the same for all firms and is largely relative and determined and moderated by the intensity of ICT in a firm.

Karthik, George and Singla (2015) takes a step forward to address that call by arguing that the underlying relationship between ID and P is contingent upon product diversification (PD) of the firm. In particular, we hypothesize and provide evidence that the ID and P relationship is positively moderated by PD when the firm has both high levels of both ID and PD or low levels of both ID and PD.

Onodugo, Benjamin and Nwuba (2015) found how diversification of the economy will enhance stable and viable economic growth in Nigeria. It was found that for the economy to be diversified there has to be a very serious paradigm shift in economic policies and political will to implement such changes in policies. Furthermore, the data show that the neglect of agriculture has, in addition, led to the constant depreciation in GDP of the country. Hence this clarion calls for urgent diversification of the Nigerian economy.

Godwin and Ubong (2015) using the error correction mechanism (ECM) revealed the extent to which export diversification can influence economic growth in Nigeria. The results further indicate that by diversifying the economy, encouraging large scale industrialization of the non-oil sector, emphasizing deepening technology in trade and investment and an improvement in agricultural sub-sector among other factor, will further enhance sustainability in growth. Onur and Ihsan (2016) ascertained whether there is a difference between types of diversification and performance comparing Turkey, Italy and Netherlands. The data of 166 firms in Netherlands, 265 firms in Italy and 128 firms in Turkey were analyzed. The data of 2007-2011 was used in the research. Return on Assets (ROA) and Return on Sales (ROS) for financial performance and Entropy Index for diversification were used. According to the results, there is no correlation between total entropy and a performance criterion ROA and ROS in Italy and Netherlands. On the other hand, in Turkey, it is understood that there is a low-level positive correlation between total entropy and firm performance.

Makhoha, Namusonge and Sakwa (2016) examined portfolio diversification on financial performance of banks. Mixed research design was used and data collected using questionnaires and interviews on 43 commercial banks in Kenya and 133 managers randomly selected. It was established that portfolio diversification significantly and positively influenced financial performance of commercial banks in Kenya and that diversification of investments had enabled increase in profits and performance in the past years.

Rop, kibet and Bokongo (2016) investigated the Impact of portfolio diversification on financial performance of commercial banks in Kenya. The study employed an exploratory research design whereby secondary data was collected using data collection sheets for secondary data and interviews were conducted to collect primary data from a sample of 40 banks. The study concluded that much work was needed to promote diversification of bank portfolios.

Mulwa and kosgei (2016) used an ex post facto design to investigate the impact of diversification, solvency and credit risk on financial performance on banks using panel data from 43 banks in Kenya over nine years. The findings of the study indicate that income and asset diversification negatively and significantly affects the commercial banks ROA while geographical diversification positively and significantly affects ROA and ROE. Also, a significant positive moderation impact was found between geographical diversification and ROE. Ranka, Vladimir and Dragan (2017) provide empirical evidence on the relation between line-of-business diversification and performance for the insurance companies that operated in the republic of Serbia in the period 2004–2014. The research results show that the relation between risk-adjusted returns measured both by return on assets and return on equity and line-of-business diversification and performance measured by entropy is significant and positive, which means that diversified insurers outperform undiversified insurers. Manyuru, Wachira and Amata (2017) investigated the impact of corporate diversification on the value of firms listed at the Nairobi Securities Exchange (NSE). Panel regression techniques were used as the estimation methods. The study finds that industrial diversification reduces firm value, but geographical diversification does not have a significant impact on firm value. When examining each industry individually, the study established that industrial diversification enhanced firm value in the agricultural industry but did not significantly influence firm value in the other industries. Humera, Rohail and Maran (2017) examined the relationship between gender diversity among corporate board and firms‟ financial performance using 100 non-financial companies in Malaysia. This study uses data from 2009 to 2013. Return on equity measures the financial performance. Gender diversity measured by the number of females on board. This study incorporates descriptive statistics, correlation testing, and regression analysis. However, the results of gender diversity have a positive impact on performance (ROE).

Musembi and Jagongo (2017) determined the relationship between diversification and firm performance has formed the subject of many researches but many researchers have disagreed on the nature of the relationship between diversification and performance. Maurizio, Tiziana and Javier (2018) evaluated the effect of diversification strategy on corporate value for a sample of Italian companies. It accounts for both the level of diversification and relatedness components. Empirical analyses how a U-shaped curvilinear relationship between diversification and value. In contrast to the main-stream literature, our results highlight that related diversification has a negative effect, while unrelated diversification is a value-creating strategy. Ogbonna (2018) examined the relationship between private sector development and economic diversification from 1999Q1-2016Q4. Employing time series analysis with data drawn from Nigeria, the results indicate that the level of private sector investment is a significant determinant of economic diversification both in the short- and long-run. Equivalently, quality of infrastructure, violent conflicts, quality of governance, and openness are also important determinants of economic diversification in the short- and long-run.

Odeleye and Olunkwa (2016) examined the relationship between export diversification and economic growth in Nigeria. The study used an annual time series data for the period 1981-2015 and employed Ordinary Least Square (OLS) methods involving Error Correction Mechanism (ECM), Co-Integration, and Over-Paramatization and Parsimonious model. The results of the study revealed that contributions of agriculture and manufacturing sectors to export is negative; signifying that export diversification has negative effects on Nigeria's economic growth. Ayobola, Ekundayo, Muibi (2018) examined the relationship between resource endowment and export diversification and its implication for economic growth in Nigeria based on data from 1981 to 2015. The study concludes that specialization is preferred to diversification for Nigeria in the current circumstance. Because of the contradictory results concerning the relationship between diversification and performance, the question of whether diversification improves or worsens firm performance is still worthy of further research such as the one being undertaken in this study. In addition, despite the existence of these studies, very little attention has been given to the developing countries. Besides, the impact of diversification on firm performance has not received adequate research attention in Nigeria. Hence, the key issue to sustain growth in Nigeria is not in the number of productive sectors but in their efficiency.

METHODOLOGY

Research Design

The study adopted the Ex-post facto research design based on secondary data that was collected from annual financial reports of the selected listed firms on the Nigerian Stock Exchange.

The population of this study comprise of selected manufacturing firms on the Nigerian Stock Exchange operating under different sectors.

A total of twenty (20) firms were randomly selected out of population of one hundred and the number of firms that satisfied the above situation formed our data source for the test periods 2008 to 2017.

Method of Data Analysis

The correlation analysis was used to evaluate the associational relationship between the variables and to check for multi-collinearity. The simple regression analysis was used to evaluate the

effect of the independent variables on the dependent variable. It reveals the degree of influence and effect the independent variable has on the dependent variable.
The model premised on the main objective and anchored on the sub-objective.

Model Specification
This can be econometrically express as

$$ROE_{it} = \beta_0 + \beta_1 PRODIV_{it} + \varepsilon_{it}$$
$$ROE_{it} = \beta_0 + \beta_2 BUSDIV_{it} + \varepsilon_{it}$$

Where:
PRODIV = Product Diversification
BUSDIV = Business Diversification
ROE = Return on equity

ANALYSIS OF DATA
Hypothesis One
H_0^1 Product diversification has no significant effect on the financial performance of Nigerian firms.

Table 1: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.052[a]	.003	-.002	.44138

a. Predictors: (Constant), ROE

Table 1 above shows that the Model revealed the value of R^2 = 0. 003 and Adjusted R^2value is -.002, this suggests that the model explains about 0.02% of the systematic variations in the dependent variable. This means that the regression explains 0.02% of the variance in the data.

Table 2: ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.124	1	.124	.637	.425[b]
	Residual	45.588	234	.195		
	Total	45.712	235			

a. Dependent Variable: PRODIV
b. Predictors: (Constant), ROE

Table 3: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.738	.029		25.670	.000
	ROE	.000	.000	-.052	-.798	.425

a. Dependent Variable: PRODIV

In table 2, it reveals that the F-stat (0.637) and p-value (0.425) indicates that the hypothesis is statistically significant, hence f-sat is less than the p-value.

In table 3, the regressed coefficient correlation result shows that an evaluation of the financial performance of the explanatory variable (Beta Column) shows that product diversification is significant (Sig.= 0.425). Therefore, we reject the null hypothesis and uphold alternative hypothesis which state that there is a significant effect of product diversification on return on equity of Nigerian firms.

Hypothesis two

H_{02} Business diversification has no significant effect on the financial performance of Nigerian firms.

Table 4: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.927[a]	.859	.850	.24415

a. Predictors: (Constant), BUSDIV

The above Table 4 shows that the Model revealed that the value of R^2 of 0.859 and Adjusted R^2value is .850, suggests that the model explains about 86% of the systematic variations in the dependent variable. This means that the regression explains 86% of the variance in the data.

Table 5: ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	6.153	1	6.153	103.225	.000[b]
	Residual	1.013	217	.060		
	Total	7.166	218			

a. Dependent Variable: ROE

b. Predictors: (Constant), BUSDIV

Table 6: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.032	.123		8.407	.000
	BUSDIV	.040	.004	.927	10.160	.000

a. Dependent Variable: BUSDIV

In table 5 above, F-value is greater than Sig. at 95% confidence interval (103.225>.000) showing that business diversification has effect on financial performance of Nigerian firms. We reject H_O and accept the H_I hypothesis which says business diversification has significant effect on the financial performance of Nigerian firms.

In table 6, the regressed coefficient correlation result shows that an evaluation of the financial performance of the explanatory variable (Beta Column) shows that business diversification is not significant (Sig.= 0.000). Therefore, we reject alternative hypotheses and uphold null hypothesis which state that there is no significant effect of business diversification on financial performance of Nigerian firms.

Discussion of Findings

The results obtained from the analysis of product diversification agree with the findings of Cummins and Nini (2002), Doukas and Lang (2003), Pavic and Pervan (2010) and Luciana and Paulo (2014). However, our result lends credence to prior empirical studies of Mark (2001) Li and Greenwood (2004), Iqbal Hameed and Qadeer (2012), Onur and Ihsan (2016). This may account for the outcome of our result such that a nonlinear model should be adopted. Furthermore, as noted by (Aulakh, Kotabe, & Teegen, 2000), emerging-market firms appear to incur a greater proportion of diversification costs as these firms are often plagued by issues relating to inferior product perception.

Conclusion and Recommendations

This study concludes that the financial performances of Nigerian firms are significantly affected by the product while business diversification was not significantly affected; hence business diversification is very much less productive in terms of contributing to companies return on equity. Hence there was a relatively statistical significant correlation between financial performance and related diversifications. The implication is that a high degree of diversification does not seem to improve performance in terms of performance.

Drawing from the conclusion, firms management decision should ignore toward business diversification rather emphasize more on product diversification but against multi product strategy.

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