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Corporate Diversification as a Determinant on Firm Value: A Case of Mumias Sugar Manufacturing Firm in Kenya

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Abstract:

The central theme of the research was to establish the corporate diversification as a determinant on the firm value, a case of Mumias sugar manufacturing firm in Kenya. Using a sample size of (n=306) respondents from different departments the study specifically aimed at; determining the relationship between corporate cultures as a driver of diversification with the firms value for Mumias sugar company. Simple random sampling and stratified sampling was used to come up with the required size of employees who participated in the study. On the other hand, and purposive sampling was used in getting the required managers who were to be used in the study. Primary data collection instruments included the use of questionnaires and interview schedules while secondary instruments included using already exist. The study will adopt cross sectional survey method to collect informing literature from Mumias Sugar manufacturing firm. Test and re-test of the questionnaire was done to ensure construct validity and revision of questionnaires ensured content validity. To ensure reliability of the research instruments, the study attained a Cronbach's Alpha Coefficient of 0.855, which was higher than the recommended 0.7 in social sciences Data analysis will be done using Statistical Package for Social Science version (SPSS 20). Descriptive and inferential statistics were used in this study. The findings will be presented in form of frequency tables and cross tabulation. The outcome of this study was a positive relationship between corporate culture and firm value. The outcome of this study is useful to the management, share holders, employees and customers of Mumias sugar Company. Moreover, the findings also form a basis of reference by interested parties in future.

Key words: Corporate diversification, firm value, sugar firms**1. Introduction**

Manufacturing firms diversifying their offerings to include services and products has been a raising phenomenon over the last decades (Morrison, 2005). As competition in manufacturing industries intensified, creating pressures on product margins, manufacturing firms started to differentiate by complementing and enriching their initial product offerings with services (Oliva and Kallenberg, 2003). In addition, manufacturing firms diversifying into services might experience additional growth in terms of revenue and profit.

The diversification strategy is a considerable and interesting topic of study in the literature of firm valuation, but there is significant divergence on whether or not diversification creates long-run competitive advantage (Markides and Williamson, 1994). Nowadays, there is a debate in the strategic management literature about the role played by corporate diversification as a value maximization strategy for shareholders. A firm diversifies when the benefits of diversification overcome its costs, and it stays focused when the opposite occurs. On the one hand, some theoretical arguments point to diversification as a value-increasing strategy for the firm. For instance, Fluck and Lynch (1999) argue that diversification permits the financing of marginally profitable projects that cannot get financed as stand-alone units.

Matsusaka (2001) shows that the firm chooses to diversify when the gains from searching for a better organizational fit outweigh the costs of reduced specialization. On the other hand, the evidence obtained in the corporate finance literature, such as the point that multi-segment firms trade at a discount, in relation to a portfolio of single-segment firms, have led researchers to believe that diversification destroys value (Lang and Stulz, 1994; Berger and Ofek, 1995; Rajan, Servaes, and Zingales, 2000; Whited, 2001; Lamont and Polk, 2001, 2002). As such findings are not conclusive; there is an open door to the investigation about the diversification strategy. Furthermore, recent research on the effects of different levels of diversification on firm value has driven to a curvilinear relation. The curvilinear model posits that some diversification is better than none (Palich, Cardinal and Miller, 2000).

The economic literature has focused on the impact of different levels and types of diversification on firm value. To examine this impact is fundamental to distinguish between related and unrelated diversification. Firms that follow the related diversification try to exploit economies of scope through the sharing of physical and human resources across similar lines of business. In contrast, unrelated diversification pursues the search and achievement of economic advantages by being able to distribute capital and other financial resources in an internal market more efficiently (Helfat and Eisenhard, 2004). As a result, it is not unanimous the evidence regarding which type of diversification is better, although diversification into related business is frequently argued to provide better value and then it must be preferred by the firm (Bettis, 2003).

2. Statement of the Research Problem

The corporate diversification-performance linkage has managed to capture most scholarly attention - especially in the Financial Economics and Strategic Management fields - since value creation has been put at the top of the objectives which should guide firms' activity (Jensen, 2010) and even the main *raison d'être* of enterprises. The issue of diversification has assumed a centrality and universality in the contemporary management process. Diversification has become an increasingly important aspect of doing business in the world today (Elango and ma 2003).

Bacerra (2004) explain conceptually and provide empirical evidence that No relationship (positive, negative or quadratic) exist between diversification and performance .The empirical evidence emerging from various studies about effect of diversification on performance have yielded mixed results that are inconclusive and contradictory. As such findings are not conclusive ,there is an open door to the investigation about diversification strategy .Further recent research on the effect of different levels of diversification on firms value has driven to a curvilinear relation ,The curvilinear model posits that some diversification is better than none (palich, cardinal and miller ,2000).

Mumias sugar company being the leading producers of sugar in Kenya that is sold locally and little exported has diversified into commercial co-generation, ethanol production and bottled water (Mumias sprinkles) to ensure diversification of revenue streams to caution itself from the anticipated price wars from sugar imports from Comesa countries considered to be low cost producers upon the expiry of the Comesa safeguard on sugar February 2015. Thus the question of whether diversification improves or worsens firm's value is still worthy of further research .such as the one being undertaken in this research. The study of corporate diversification, as Martin & Sayrak (2003) has emphasized, still plays a fundamental role in understanding the modern economy.

3. Study Objectives

The general objective of this study was to examine the impact of diversification strategy on firm value for Mumias sugar company Limited. Specifically, the study sought to:

- To determine corporate culture as a driver of diversification with the firms value for Mumias sugar company.
- To determine the effect of product and consumer knowledge relatedness as drivers of diversification on firms value for Mumias Sugar Company.
- To determine the effect of competition and government regulation on the relationship between diversification and firms value for Mumias Sugar Company.

4. Significance of the Study

The findings of the research study will be useful to Mumias sugar manufacturing firm. Further, the findings will be of importance to the stakeholders in the sugar industry namely customers, employees, shareholders and the community at large. The study will also contribute to extant literature on diversification strategy on firm value.

5. Scope of the Study

The study was carried out in Mumias Sugar Company Limited. The study covered time frame of three years: from 2010 to 2012. The period was chosen due to the availability of information that was to be used in the study. The employees of the sugar manufacturing firms were targeted as the study respondents.

6. Conceptual Framework

The variables were corporate diversification and firm value. The constructs under corporate diversification were corporate culture, product knowledge relatedness and customer knowledge relatedness. On the other hand, firm value constructs in the study included shareholders value, firm profitability and market growth.

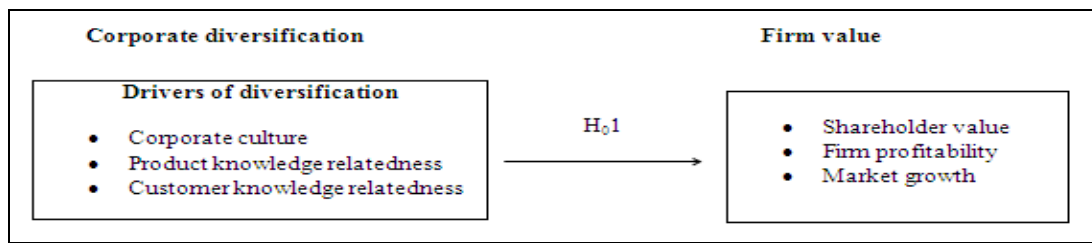


Figure 1: Conceptual Framework
Source: Study conceptualization, 2014

7. Literature Review

The reason to diversify is the logical starting point for us to understand the performance of the diversified firms. There are four most important lines of theories among this research scope: transaction cost economics theory, resource-based view, market power theory and agent theory. Just as the contradictory evidences at the empirical level, the theoretical studies provide incoherent arguments about the relationship between diversification and firm value. Transaction costs theory is an economics discipline to explain the organization patterns and economic performance outrange of traditional economics. The basic idea of transaction costs theory about the nature of a firm is that, all the economic activities are contract behavior, and the firm is an agent that is involved in an economic exchange instead of just a production function. While the behavior of the agent is confined by opportunism and bounded rationality, market transaction also induces costs, especially when combined with uncertainty, imperfect and asymmetrically distributed information, and small number of traders. Since the firm is a contract structure that supplants imperfect market exchange, the boundary of a firm is the logical result of cost-effective choice between organizational manipulate and market process. As to the question why a firm develops into other lines of business, there is a large volume of researches in the vertical integration, which can be included as broadly defined diversification Williamson (1971, 1990) develops a profound perspective about corporate diversification.

Teece (1980, 1982) tries to come up with a general rationality of diversification following Williamson's analyst. He pays more attention about the intangible resources, such as Know-how, and organizational skills. He argues that when these specialized and indivisible intangible resources are exchanged through market, the transaction costs are so significant that it is rational for the intra-firm governance. Thus, diversification is an alternative to take the place of market to exploit the intangible and indivisible firm resources. Silverman (1999) provides another explanation about why firm diversifies.

He discusses the properties of firm's rent-generating resources, and concludes that when these highly tacit resources are exchanged through market process, the transaction will incur high contractual hazards such as license royalties, secrecy, and learning curve advantage problem Jones and Hill (1988) present an extensive picture about strategy structure choice. In their opinion, internalization, no matter vertical integration, related diversification or unrelated diversification, is the balance between the economic benefit gains from reduction of transaction costs and the economic costs incurs from managing hierarchies.

Generally, resource-based theory observes firm in the lens of resources view, instead of in lines of product or market. This theory takes a firm as a collection of sticky and imperfectly imitable resources or capabilities which enable it to successfully compete against other firms (Wernerfelt, 1984; Barney, 1991). Different from transaction costs economics, resource-based firm theory is a strategic theory about how a firm can exploit the resources to achieve its economic goals or a sustainable competence advantage over its rivals. Thus, this stand of research views diversification as a strategy used by a firm to profitably deploy and exploit its resources.

The early answer to why firms diversify in resource-based theory can be traced back to Penrose's (1959) theory of the growth of the firm, in which she argues that diversification is the response to the excess capacity in productive factors or resources. Without mentioning the source of the excess capacity, and without answering why firm choose external expanding of firm's scope instead of growing internally, Teece (1980, 1982), Nelson and Winter (1982) and Lippman and Rumelt (1982) develop Penrose's theory by enlarging the scope of resources from only the physical things to the intangible resources such as services, knowledge and skills.

This enlargement facilitates the argument that the resources, especially intangible ones, have special characteristics, for example, indivisible, leading toward the conclusion that diversification is the response to (1) thanks to market failure, transaction costs and other Coasian considerations, there is no perfect market environment to trade such resources, (2) transfer of these systemic resources might require the transfer of organizational as well as individual knowledge. Thus, the resources are leveraged by diversification instead of rentals or sales (Wernerfelt, 1995). Silverman (1999) find that firms with broad resources bases tend to diversify, and they tend to diversify into industry that have the similar R&D, advertising and capital expenditure intensities to those of the firms' existing businesses, and firms tend to enter the markets where the resources requirements match their resource capabilities.

In this literature the function played by culture is that of "social control." According to O'Reilly (1989), most individuals care about the people who surround them. Thus, if we share a common set of expectations with the people we work with, we are under their control whenever we are in their presence. In this respect, 5 cultures complement more traditional control systems, such as incentives. This notion is close to Kreps (1990) and Erhard et al (2007), who emphasize one particular value: integrity, defined as "the quality or state of being complete; in an unbroken condition; sound."

We choose to use the O'Reilly and Chatman (1996) definition for two reasons. First, this definition is similar to the one now prevailing in neoclassical economic models that use culture (e.g., Guiso et al (2008) and (2010) and Tabellini (2008)). Second, this value component of culture is easier to measure and thus facilitates our empirical task values are simply the reputation that a company has developed over time. Thus, corporate culture does not change the preferences of individuals; it only alters their incentives in a

repeated game. By contrast, in Hodgson (1996) a corporate culture is able to modify the preferences of individuals and induce them to internalize some norms.

8. Research Methodology

A cross sectional research design that involved qualitative method will be used, Creswell (2003) observed that by using a cross-sectional survey design one gets qualitative description of trends, attitudes and opinions of the population. This is also because; in practice there is no research that can be purely quantitative given that there is always subjective infiltration. According to Amin (2005) the cross-sectional survey design helps one to collect information from respondents at once without repetitively visiting them.

8.1. Study Area

The study was carried out in Mumias Sugar Company Limited, Kenya.

8.2. Study population and sampling technique.

A Sample of 306 respondents was chosen according to Kreijce& Morgan, (1970). The table helped to determine the sample size (n) from a given population (N) at a 95% confidence level and 5% margin of error. However due to convenience and inaccessibility of some respondents two departments were exempted and these included the agriculture department and the factory department from the research. Therefore a sample of 306 respondents will be selected for the study from the departments of Commercial, Finance, General, Human resource and Information technology.

This study employed a variety of sampling methods. It used a non- probability sampling which is purposive sampling methods. Purposive sampling was used in selecting the top management because they are needed in providing key information regarding the diversification of Mumias Sugar Company. Sekaran (2003) and Amin (2004) argued that in purposive (judgmental) sampling, the researcher chooses subjects who in his/her opinion are likely to supply information relevant to the research problem, On the other hand random sampling technique will be used to select from the relatively big number of respondents in.

8.3. Data Collection instruments

Primary data was obtained from the questionnaires and interview schedules as research instruments. Self-administered questionnaire were administrated by the researcher and filled by the members of staff of Mumias Sugar Company. The questionnaire will contain closed-ended questions. The questions offered will be based on a Likert-scale rating to ask the respondent how strongly he/she agreed or disagreed with a statement or series of statements. As (Kothari, 2004) states structured questionnaires are used as the main instrument of primary data collection because this study covers a number of subjects and the nature of the research which has both quantitative and qualitative data.

The interview guide was used for interviewing key informants who were knowledgeable and experienced about the subject matter (Diversification strategy and Business value) as recommended by Oppenheim (2001). These were the managers of all the departments in at Mumias Sugar Company. Open-ended questions in the interview guide will allow the researcher to get the required answers that are unanticipated and potentially helpful in avoiding issues later in the process. These questions will develop trust and are perceived as less threatening, allowing for an unrestrained or free response. However, they were time-consuming and this may led to difficulty in developing general statements or assumptions (Musaazi, 2006).

8.4. Reliability and Validity of research instruments

Golafshani (2003) states that the extent to which results are consistent over time and an accurate representation of the total population under study is referred to as reliability and if the results of a study can be reproduced under similar methodology, then the research instrument is considered to be reliable. The reliability of a study has to do with the degree to which the measuring instruments used in the study yield consistent results or data after repeated trials Mugenda and Mugenda (2003). A test -retest technique was used to measure reliability of the data. According to Mugenda (2003) this involved the administering the same instrument twice to the same group or subject and after keeping the initial conditions constant, administer the same test to the same subject after few weeks and then correlate the scores to obtain correlation coefficient . If the correlation coefficient is high the instrument is said to yield data that have test – retest reliability.

Reliability Statistics	
Cronbach's Alpha	Number of Items
0.855	56

Table 1: Reliability test
Source: Research data 2014

Validity is the degree to which result obtained from the analysis of the data actually represents the phenomenon under study Mugenda and Mugenda (2003). According to montetee etal (1990) validity refers to the accuracy of a measuring instrument in measuring the variable that it is intended to measure. According to Orodho (2004), validity can be defined as the extent to which a measuring instrument provides adequate coverage of the topic under study or in simple terms, the degree of relevance the instruments are towards the research. The use of in-depth questionnaire will enable the researcher to probe more based on the responses of the respondents.

The data gathered from the pilot study will then be subjected to Cronbach's alpha a coefficient of reliability that gives an unbiased estimate of data. Cronbach's alpha is a coefficient of reliability that gives an unbiased estimate of data, (Zinbarg, 2005). Both reliability and validity should be high to be desirable (Golafshani, 2003).

8.5. Data Analysis

Data collected will be edited, coded, and tabulated for accuracy, reliability and ease of analysis and presentation using the SPSS software program. The analysis of qualitative data will be through a thematic and content analysis approach. This will involve generating percentages, graphs and frequency tables. Inferential statistical tools especially Pearson's correlations, was used to investigate the relationships and contributions of independent variables that is, diversification strategy and firm value of Mumias Sugar Company.

9. Findings and Discussions

9.1. Preliminary findings

From the findings 63.3% were male respondents while 36.7% were female respondents. It was an indication that more males participate in this study than females. The study sought to find out the age brackets of the respondents by asking them to indicate their age group. This was to help determine the age distribution for the respondents. Their responses are shown in Table 2 below. The results show in the age brackets of 26-30 years we had 45.7%, followed by 31-35 years (40.8%), 36-40 years (6.2%) and 21-25 years constituted 7.3% of the sample. From these results, it implies that majority of the respondents (87.9%) were in the age bracket of 26-35 years.

The results illustrated that 19.4% had post graduate qualifications, 59.2% had degrees, 19.7 had diplomas and 1.7% had other qualifications. This shows that the majority of the respondents could fill the questionnaires. From the results 24.6% of the respondents had been working for over 6 years, 75.1% had been working for a period of 4-6 years, and 0.3% had been working between 1-3 years

9.2. Hypothesis testing and discussions

Simple regression analysis beta (β), this is equivalent to the Karl Pearson correlation coefficient (r) was used to determine the effect of corporate diversification on firm value of Mumias sugar manufacturing firms. The hypothesis was tested at 0.05 % significance level, with 95% confidence, which is acceptable in social sciences.

The study set out the following research question;

Is there a relationship between corporate cultures as drivers of diversification with the firms' value for Mumias Sugar Company?

Karl Pearson's product moment correlation coefficient was used to check whether there is a relationship between the variables. The results were as shown in the table below.

Model Summary						
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate		
1	.575 ^a	.331	.328	2.02222		
a. Predictors: (Constant), Corporate culture						
ANOVA ^a						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	580.138	1	580.138	141.864	.000 ^b
	Residual	1173.654	287	4.089		
	Total	1753.792	288			
a. Dependent Variable: firm value						
b. Predictors: (Constant), corporate culture						
Coefficients ^a						
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	5.959	.648		9.203	.000
	Corporate culture	.571	.048	.575	11.911	.000
a. Dependent Variable: firm value						

Table 2: Regression results of logistic outsourcing and performance of sugar firms

The regression results between the mean of logistic outsourcing and the mean of firm performance (P) had a beta term $\beta=0.602$ at $p=0.01$. In the hypothesis criteria, we were to reject H_0 if $\beta \neq 0$. However, from this results, the value of beta $\beta=0.602 \neq 0$. The study

therefore rejects the null hypothesis and logistic outsourcing had a positive statistically significant relationship to the performance of sugar firms.

10. Summary, Conclusion and Recommendations

The results show that there is a positive significant relationship between corporate culture and firm value ($r=0.575$, $p\leq 0.01$). This implies that there is a significant positive relationship between corporate culture and firm value. The results show that 33.1% of firm value can be explained by corporate culture ($r^2 = 0.331$).

The following recommendations were made based on the findings and conclusions of the study:

- Based on the research findings, the study recommends that a firm to aggressively engage in nurturing a good corporate culture since it has a positive impact on the firm value.
- Sugar firms should proactively participate in enhancing product and consumer knowledge relatedness since it has a positive effect on the firm value.
- Lastly, firms should work on competition and government regulations since they have a positive moderating effect on the relationship between diversification and firm value.
- The firms should utilize outsourcing in order them to focus on their core businesses.

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