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EFFECT OF DIVERSIFICATION STRATEGY ON ORGANIZATIONAL PERFORMANCE OF MANUFACTURING COMPANIES IN UASIN GISHU COUNTY

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Abstract

Manufacturing sector play a significant role to the economy. Despite the key role the sector plays, it is experiencing performance challenges with many organizations reporting profit warnings. The purpose of this study was to determine the effects of diversification strategy on organizational performance of manufacturing companies in Uasin Gishu County. The specific objectives of the study were to establish the influence of horizontal diversification on organizational performance of manufacturing companies in Uasin Gishu County. The study was guided by the contingency theory and target population was employees of the 36 manufacturing firms in Uasin Gishu County. The population of the study comprised of 5662 employees of selected manufacturing firms in Uasin Gishu County. A sample of 374 employees was selected using stratified, proportionate and simple random sampling techniques. The study relied on a structured questionnaire as the main tool for data collection. A pilot study was conducted to test validity and reliability of the research instruments. The researcher tested content validity using expert judgment and used cronbanch's alpha coefficient to establish the reliability of each section of the questionnaire. The data collected was analyzed using descriptive statistics including mean, percentages and frequencies and inferential statistics. The study findings indicated that horizontal diversification ($\beta = 0.263$; $p< 0.05$) is significant factors that influence organizational performance of manufacturing companies. The study recommends that *manufacturing companies that wish to achieve economies of scale and redeem their financial position in the face of downturn or decline in the product life cycle should diversify its product lines to better meet customers' demands as well as to achieve profitability and expansion as well as increase performance.*

Keywords: Diversification, Strategy, Horizontal Diversification, Organizational Performance

INTRODUCTION

Companies today operate in an increasingly dynamic and challenging environment; organizations must be able to act quickly in response to opportunities and barriers (Baum & Mezias, 2012). How firms achieve and sustain firm's competitiveness is the most fundamental question (Misigo, 2017). Hunger & Wheelen (2015) suggests that a company needs to develop diversification strategies in order to effective performance and competitiveness in the market. A firm's diversification strategy selection is based on the careful evaluation of its resource and capability portfolios and reflects the market influence ((Hannan & Freeman, 2017). Barney further argues that determinants or sources of firms' performance are resources which are rare, valuable, inability to be imitated, and inability to be substituted (Masinde & Shitseswa, 2013).

According to Santos and Brito (2012), the performance of an organization can be analyzed comprehensively using profitability, social performance, environmental performance, customer and employee satisfaction, and firm growth. Profitability concerns the amount of revenue earned less costs incurred; social performance refers to how the business relates with its social environment with time while environmental performance concerns how the business relates with the environment with time. Poor performance results when the business' social relationships and environmental relationships dwindle instead of bettering. A business that is doing well should also show continued customer and employee satisfaction and/or where necessary growth in their numbers.

While focusing on the balanced score card theory Isoraite (2018) reiterated that performance of a firm or corporation can be measured by financial ratios like profitability and return on assets as well as by customer factors like customer base and their satisfaction; organizational learning and innovation and internal operational processes. The author argues that an organization that is performing well will show high organizational learning and acquisition of organizational abilities/skills.

Similarly, a well performing firm will offer internal processes that are more focused to delivering high yield/quality. Similar to internal processes, Rogers (2011) argued that the productivity of a firm can also indicate its growth or performance. For instance, a firm that shows improvement in production or one that shows higher yield could indicate enhanced performance. Diversification is a corporate strategy which aims to expand or grow a firms' operation by adding markets, products, services, or stages of production to the existing business. Diversification allows a company to enter lines of business that are different from their current operations. Moreover, diversification uses two approaches: either concentric or conglomerate diversification. Concentric diversification occurs when a firm acquires similar business options while conglomerate diversification occurs when a firm develops products or services beyond its current capabilities (Hitt, Hoskisson & Kim, 2013).

Further, firms choose to diversify in order to provide channels for growth, profits and employment. However, diversification is affected by high investment costs and environmental changes. Moreover, diversification is a way of reducing risk by investing in a mixture of assets or business ventures (Zhou, 2018). Besides, diversification is the venturing out by a firm into new business, new products or new markets to increase profits. As well, diversification is also the venturing of a firm into new lines of activity and businesses through a process of internal development that entails changes in the prevalent administrative systems (Hitt, Hoskisson & Kim, 2013). The main purpose of diversification is to allow an organization to grow (Thomas & Mason, 2016).

Diversification strategies require new skills, new techniques and new facilities**.** Lowe (2014) identifies keys to diversification strategies a business as creation of a distinctive and superior customer experience, the development of one-to-one relationships with consumers, adding value to the product or service, ability to differentiate according to customer relationships, and provision of a unique experience for each customer. Implications of diversification strategy are such that the nature of the value chain is different than with cost leadership and different corporate values and behaviors are emphasized than with cost leadership.

Firms that adopt diversification strategies enjoy benefits that may include: brand loyalty which creates higher switching costs and results in insulation from competitive pressures. New entrants have to spend heavily to overcome customer loyalty (Comanor, 1976). Diversification strategies also can benefit firms from reducing direct competition. Differentiations can reduce customers' sensitivity for other features offered by competitors, resulting in the brand being embedded in the mind of consumers. This provides higher margins for the firm as can counter supplier and buyer power as they lack alternatives.

There are different types of diversification that firms can pursue when they consider to head this direction. There is horizontal diversification where the firm may consider acquiring, developing new products or offering new services that could appeal to the company´s current customer groups. In this type of diversification, the firm relies on sales and technological relations to the existing product lines..

Studies examining influence of diversification strategies on firm performance showed mixed findings. Many researchers have been done on the relationship between diversification strategies and firm performance, however there has been no agreement on this relationship as many researchers have concurred (Marinelli, 2011). There is still disagreement as to whether diversification increases or reduces firm performance. The relationship is still controversial, contradictory and inconclusive (Mashiri & Sebele, 2014; Santalo & Beccera, 2008). These researches have not yet reached definitive and interpretable findings to determine whether diversification strategies create or destroy firm's value.

Statement of the Problem

Competition among firms is getting harder day by day due to many organizational and environmental reasons such as globalization, deregulation, increasing global and domestic competition, and new technologies. Enhancing performance is crucial for firms based in developing countries that view the global marketplace as a means to ensure growth, survival or competitiveness. Despite its importance in creating and sustaining organizational competitiveness, the source of differentiation is not well understood (Porter, 1998). Manufacturing sector like any other sector requires committed employees in order to contribute significantly towards economic growth. Manufacturing added value in Kenya was reported at 10.03% in 2016 GDP. Although manufacturing companies in Kenya are small, they are the most sophisticated in East Africa (World Bank report, 2016). Getting effective diversification strategies in pursuit of the organizational objectives is one of the problems facing most firms in the service sector (Timming, 2015). Quite a number of manufacturing firms in counties such as Uasin Gishu (Ken-Knit, Rivatex, Raiply Woods and Pyramid Plastics) have not been performing well (Kenya Association of Manufacturers ([KAM], 2017). Organizations should place a high value on diversification strategies as it allows organizations improve their operations hence its profitability. Despite the importance of diversification strategies to manufacturing companies, a number of disadvantages have been fronted against diversification strategy. One disadvantage of diversification is that it could lead to over extension of a company's resources. Other opponents of diversification strategy have also argued that there is cost increase associated with diversification. Some authors have also mentioned that under diversification, the business may need added infrastructure and employee training, matters that will eat into the business revenue. Other disadvantages of diversification are lack of expertise and reduced innovation as posited by some scholars. This means that there isn't a universally accepted position about the relationship between diversification and organizational performance. This research therefore sought to assess the effects of diversification strategy on organizational performance of manufacturing companies in Uasin Gishu County.

Research Objective

To establish the effect of horizontal diversification on organizational performance of manufacturing companies in Uasin Gishu County.

Research Hypothesis

H_{01}: Horizontal diversification has no significant effect on organizational performance of manufacturing companies in Uasin Gishu County.

THEORETICAL REVIEW

The study was based on The Market Power Theory developed by Treacy and Wiersema in 1995. The theory was developed on the idea is that business quality can be created by market forces. The winning of competition in the industry from this philosophy viewpoint is a positive effect of a multi-segment strategy (Christingrum, 2015). By reducing competition on the market because of its dominance, diversification strategy can increase market share in the industry, so that diversification will have positive effects on corporate performance. Diversified companies are less competitive than other businesses; they have a conglomerate force to maximize their flexibility (Christingrum, 2015). Unless a company holds large positions in a number of markets, it cannot have monopoly control. An industry extending the range to other industries primarily for purposes of rivalry (Yuliani et al. 2013) outlines three potential market power sources.

The theory is based on seven assumptions that is any sellers in the market each of whom produce a low percentage of market output and cannot influence the prevailing market price each firm in this market is a price taker -i.e., it has to take the market price. Many individual buyers - none has any control over the market price Perfect freedom of entry and exit from the industry. Firms face no sunk costs and entry and exit from the market is feasible in the long run.

This assumption means that all firms in a perfectly competitive market make normal profits in the long run. Homogeneous products are supplied to the markets that are perfect substitutes. This leads to each firm being price takers with a perfectly elastic demand curve for their product. Perfect knowledge consumers have all readily available information about prices and products from competing suppliers and can access this at zero cost in other words; there are few transactions costs involved in searching for the required information about prices. Likewise, sellers have perfect knowledge about their competitors and perfectly mobile factors of production land, labour and capital can be switched in response to changing market conditions, prices and incentives. We assume that transport costs are insignificant.

Hitt, Hoskisson& Kim (2011) states that market power refers to a company's relative ability to manipulate the price of an item in the marketplace by manipulating the level of supply, demand or both. Tavana (2014), states that a company with substantial market power has the ability to manipulate the market price and thereby control its profit margin, and possibly the ability to increase obstacles to potential new entrants into the market. Firms that have market power are often described as "price makers" because they can establish or adjust the marketplace price of an item without relinquishing market share.

The theory was relevant to the study because cross-subsidization may allow a corporation to use excess profit from one industry to join another, and thus offer this new enterprise an advantage, reciprocal forbearance, companies may come across on an alternate market for less extreme competitive transactions. Diversification was designed to counter competition, a means of creating market power, on the basis of the market power sense. This strategy seeks primarily to boost cost effectiveness and enhance finances (Yuliani et al 2013).

EMPIRICAL REVIEW

Yaser (2010) on a study on horizontal diversification and firm performance in India acknowledges that while horizontal diversification helps firms achieve economies of scope; the benefits of this strategy might be offset by several disadvantages. The consequence is the inability to manage and make the most of present competencies to deliver the desired results. The study also indicated that, through innovation; firms may become more responsive to customer. This is not only likely to give the firms a competitive advantage but also enable them create new markets for their goods and services.

Eukeria & Sebele (2014) examined horizontal diversification as a Corporate Strategy and Its Effect on Firm Performance: A Study of Zimbabwean Listed Conglomerates in the Food and Beverages Sector. Three competing models were derived from literature (the linear model, Inverted U model and Intermediate model) and these were empirically assessed and tested. The study established that through horizontal diversification organizations created value and justified their existence as they were able to build and leverage the unique resources to gain competitive advantage, increase profitability, market value of the companies ultimately improving shareholder value.

Wanjira, Ngoze and Wanjere (2018) examined horizontal diversification strategy adoption and the performance of state-owned sugar firms in western Kenya. The findings indicated that there is no significant relationship between adoption of horizontal diversification strategy and performance of sugar firms. It was therefore concluded that there is no relationship between adoption of horizontal diversification strategy and sugar firms' performance. The study recommended that in the current competitive business situation, firms have to strive to open other revenue streams to keep afloat. However, the sugar firms must analyze the effect of horizontal diversification on firm performance. Maina, (2016) examined the effect of horizontal diversification strategies as a determinant of performance of Real estate companies in Nairobi City County in Kenya. The study concluded that horizontal diversification positively affects firm performance although not statistically significant. The study therefore recommended that real estate companies should come up with good policies such as guidelines on per unit cost allocation of diversified product and risk management strategies to aid in better management of the risks involved in the whole diversification process.

RESEARCH METHODOLOGY

Research Design

This study adopted a descriptive research design. Descriptive research design involves collection of information from a large population and concentrates on the respondent's views in order to get relevant information about the dependent and independent variable using questionnaires to achieve the research objectives. This design is deemed appropriate as it gives a description of a group of people, phenomena or an event based on the influence on another variable.

Target Population

This study targeted all the permanent employees of selected manufacturing firms in Uasin Gishu County registered under Kenya association of Manufacturers 2018. KAM membership constitutes 40 per cent of manufacturing value-add industries in Kenya and comprises of small, medium and large enterprises (KAM, 2017). The size is measured by their total assets. Large-sized firms are the firms with total assets of above Kshs.100 million, medium-sized have between Kshs40 Million and Kshs100 million by total assets; whereas small firms are those firms having assets under Kshs 40 Million (KAM, 2017). According to KAM (2020), there were a total of 36 manufacturing firms operating in Uasin Gishu County. However,the study selected seven firms, the firms were chosen because as Awino (2007) indicated, these firms are likely to exhibit an elaborate contingency philosophy and human resource best practices. The 7 selected manufacturing firms represented the total population for this study with a population of 5662 permanent employees.

Sampling Size and Sampling Technique

Sampling is the process of choosing units of the target population which are to be included in the study in such a way that the selected elements represent the population (Cohen, Manion & Morrison, 2011). Sampling is employed in research because it is often not possible to question every member of the target population. Mugenda and Mugenda (2008) assert that the sampling enables a researcher to secure a representative group to gain information about an entire population when faced with limitations of time, funds and logistics constraints. To get the representative sample, the study utilizedSlovin's formula (Dionco-Adetayo, 2011) for determining a sample of a finite. The formula is given below:

$$n = \frac{N}{1 + N(e)^2}$$

Where: n = sample size

N = population

e = margin of error or error tolerance

The study adopted the 5% margin of error as recommended by Singh &Masuku (2014). The sample size of the employees when the error margin is 5% is 374 given that their target population is 5662 employees.

Stratification procedures were used to ensure subjects are drawn from the 7 targeted manufacturing firms. Proportionate sampling was employed when determining the number of employees from each firm. Proportionate random sampling was used because it gives all members of a population equal chance to be selected (Sekaran & Bougie, 2010).

Table 1 Sample Size

Category	Employees	Sample Size
Rivatex Company Limited	466	31
Almasi Beverages	347	23
Eldoret Grains	597	39
Unga Group Ltd	770	51
New KCC	961	64
RaiPly Woods	1415	93
Ken-Knit	1106	73
Total	**5662**	**374**

Research Instruments

The researcher used self developed questionnaires as primary data collection instrument (Yeasmin& Rahman, 2012). A questionnaire is a tool that consists of a number of questions printed or typed in a definite order on a form or set of forms, sent to persons concerned with a request to answer the questions and return the questionnaire (Kothari & Garg, 2014).

Data Processing and Analysis

For statistical analysis, Pearson moment correlation was used to determine the linear relationship between the local ownership structure and non performing loans of commercial bank. Simple Regression model was used to assess the association between local ownership structure and non-performing loans among commercial banks. Regression Analysis is a statistical modeling technique used to identify meaningful, stable relationships among sets of data. The application of analytical procedures is based on the premise that, in the absence of known conditions to the contrary, relationships among information may reasonably be expected to exist. Regression measures the causal relationship between one dependent and one independent variable. Multiple regression analysis measures the effects of multiple independent variables on one dependent variable.

The regression model was as follows:

$Y=\beta_0+\beta_1X_1+\varepsilon$………………………………..…………..Equation 1

Where:

Y represents the dependent variable (Financial Performance)

β0 represents the constant

β_1**…**represents the coefficient of independent variables

X_1 represents horizontal diversification

RESEARCH FINDINGS AND DISCUSSIONS

Correlation Analysis

The combine effect of independent variables on the dependent variable was established through correlation analysis. The decision rule for correlation was in accordance to Saunders (2003) who postulated that that r=1 shows a Perfect linear correlation, 0.9 < r < 1 indicates Positive strong correlation, 0.7 <r < 0.9 Positive high correlation 0.5 < r < 0.7 Positive moderate correlation, 0< r < 0.5 Weak correlation r=0 No, relationship and -1 <r = < 0 Negative relationship. This is presented in Table 2.

Table 2 Correlation Analysis

		Organizational Performance
Horizontal Diversification	Pearson Correlation	.915**
	Sig. (2-tailed)	.000

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

From the study the results indicate that horizontal diversification r=0.915 and p < 0 .01 had positive high correlation with organizational performance. This implies that when horizontal diversification, is positive, organizational performance of manufacturing companies is also positive hence, they lead to enhancement of performance. From the study it was noted, the above table was at 99% level of confidence (significant at the 0.01 level (2-tailed), since a unit change in horizontal diversification leads to 0.915 unit change in organizational performance of manufacturing companies.

Multiple Regression Analysis

The study sought to establish the effect of horizontal diversification, on organizational performance of manufacturing companies in Uasin Gishu County. The results of multiple regression analysis are shown in Table 3.

Table 3 Multiple Regression Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.786[a]	.618	.614	.47536

a. Predictors: (Constant), horizontal diversification, vertical diversification, conglomerate diversification, concentric diversification
b. Dependent Variable: Organizational Performance

From Table 3, R= 0.786, R- square = 0.618, adjusted R- square= 0.614, and the SE= 0.47536. The coefficient of determination also called the R square is 0.618. This implies that the effect of the predictor variable (horizontal diversification) explains 61.8% of the variations in performance of manufacturing companies. This implies that a 1 unit change in the predictor variable (horizontal diversification) has a strong and a positive effect on performance of manufacturing companies. This study therefore assumes that the difference of 38.2% of the variations is as a result of other factors not included in this study.

Assessing the Fit of the Multiple Regression Model

Multiple regression analysis was conducted to test the influence among predictor variable on organizational performance of manufacturing companies in Uasin Gishu County. The test results are shown in Table 4.

Table 4 ANOVA Results

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	46.302	4	11.576	321.519	.000[b]
1	Residual	3.600	100	.036		
	Total	49.902	104			

a. Dependent Variable Organizational Performance

c. Predictors: (Constant), horizontal diversification.

The findings showed that there was a statistically significant relationship between the independent variable and the dependent variable (F= 321.52; p<0.05). This therefore indicates that the multiple regression model was a good fit for the data. It also indicates that horizontal diversification influence organizational performance of manufacturing companies in Uasin Gishu County.

Individual Regression Coefficients

The study employed multiple regression analysis to test the hypotheses. Multiple regression analysis was conducted to test the effect of the study variable horizontal diversification on organizational performance of manufacturing companies in Uasin Gishu County. This was done with a significance level of 0.05, such that when the significance value is less than the 0.05 the null hypothesis is rejected and when it is above 0.05 it is accepted. These results were presented in Table 5.

Table 5 Individual Regression Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.224	.119		1.875	.064
Horizontal diversification	.263	.051	.314	5.130	.000

a. Dependent Variable: Organizational Performance

Thus, the regression equation becomes;

$Y= 0.224+ 0.263 X_1$ .... Equation 4.1

From the study, Hypothesis one stated that;

H_{01}: Horizontal diversification has no significant effect on organizational performance of manufacturing companies in Uasin Gishu County.

The study findings indicated that horizontal diversification was positive and significant effect on organizational performance of manufacturing companies in Uasin Gishu County with ($\beta = 0.263$; $p < 0.05$). Therefore, the null hypothesis was rejected. This implies that horizontal diversification enhances organizational performance of manufacturing companies in Uasin Gishu County. In addition, it is confirmed that for each unit increase in horizontal diversification there is 0.263 unit increases in organizational performance of manufacturing companies in Uasin Gishu County. This study concurs with the study by Eukeria and Sebele (2014) who established that through horizontal diversification organizations created value and justified their existence as they were able to build and leverage the unique resources to gain competitive advantage, increase profitability, market value of the companies ultimately improving shareholder value. Maina (2016) concluded that horizontal diversification positively affects firm performance although not statistically significant.

CONCLUSIONS

From the findings, it was concluded that horizontal diversification affects organizational performance of manufacturing companies. Therefore, horizontal diversifications positively and significantly affect organizational performance of manufacturing companies.

Recommendation for Policy and Practice

It is recommended that manufacturing companies that wish to achieve economies of scale and redeem their financial position in the face of downturn or decline in the product life cycle should diversify its product lines to better meet customers' demands, as well as to achieve profitability and expansion as well as increase performance, since diversified organizations were found to perform better than the undiversified entities.

Manufacturing companies' managers and other high-level stakeholders could also apply the range of diversification strategies highlighted in expanding the scope of markets and operations of their entities in a bid to ensure sustainable competitive advantage

Furthermore, organizations should identify their rare and inimitable capabilities in order to achieve economies of scale and outsmart competitors.

Finally, manufacturing companies should be developed to achieve the most cost-effective channeling of resources, the identification of opportunities as they arise in the business environment, as well as to select other strategic options in the most effective way.

Scope for Further Research

The study was limited to the case of manufacturing companies in Uasin Gishu which means that the findings may not be readily generalizable to manufacturing companies in other geographical areas. As such, the study needs to be replicated in different geographical areas to validate the findings. Additionally, a study with a larger sample than the one used in the current study should be conducted to offer a better platform for validating these findings.

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