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Horizontal Diversification Strategy Adoption and the Performance of State Owned Sugar Firms in Western Kenya

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Abstract: **The main objective of this study was to examine the effect of diversification strategies on the performance of state owned sugar firms in Kenya. The specific objective was, to establish the effect of horizontal diversification on firm performance of sugar firms in Kenya. The study employed descriptive survey study research design. The target population of the study comprised of all sugar firms in western Kenya; Nzoia, Sony, Chemelil, Muhoroni and Miwani that were purposively selected. From the accessible population, a sample of 50 strategic and top managers were selected to provide data. Ten managers were selected from each firm using census sampling technique. Primary data was collected using questionnaires which were administered to the respondents. The data collected was coded and analyzed using descriptive statistics in form of percentages, mean and Standard deviation and inferential statistics applied Pearson's coefficient of correlation and multiple regressions done to ascertain the relationship between organizational performance and horizontal diversification strategy. The Hypothesis postulated that there is no significant relationship between adoption of horizontal diversification strategy and performance of sugar firms. The null hypothesis was accepted and therefore concluded that there is no relationship between adoption of horizontal diversification strategy and sugar firms' performance. The study recommends 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.**

Keywords: **Diversification, horizontal diversification, Performance, state owned sugar firms, strategies.**

I. INTRODUCTION

Several scholars view diversification as the strategy of adding related or similar product/service lines to existing core business, either through acquisition of competitors or through internal development of new products/services, which implies increase in available managerial competence within the firm. In this sense, diversification is a matter of degree of relatedness among the activities carried out by a firm. Product relatedness is defined as the extent to which a firm's different lines of business are linked by a common skill, market, purpose, or resource (Luo, 2002). Recent studies have attempted to examine diversification patterns from underlying resource requirements: the degree to which two industries use the same types and proportions of human expertise or rely on the same inflows of technology. However, these studies characterize resources only at the industry level, which limits the ability to address issues relating to heterogeneity in firms' resource bases. Thus, in practice, diversification is normally measured as the number of activities a firm undertakes in different sectors. Saunders (2002) distinguishes motivations for diversification by firms as: the search for market power; managerial motive, value maximization motive, the solution to agency problems; capital strength, risk diversification motive and the application of bundles of resources to attain a competitive advantage (resource-based view). Focusing on the determinants of the distribution of the firm's activities over industries beside its primary focus on vertical integration, transaction cost economics suggests that diversification is an alternative contractual method by which a firm can exploit its surplus resources. According to Sindhu, Ehtasham, Sajid, & Muhammad, (2014) and Grossmann, (2007) diversification may be a means to extend the boundaries of a firm in the presence of internal coordination problems, which naturally arise in large firms. Multiproduct firms can increase their market power by cross subsidization activities, i.e. market strength in one particular industry may be used to sustain low price strategies in other markets. Sugar manufacturing firms operate in an environment that is very turbulent and the changes that take place in an environment greatly influence the business activities. The fundamental challenge facing corporate diversification is the conflicting forces stemming from synergy and responsiveness, or in other words, "managing the conflict between the new and old (business activities) and overcoming the inevitable tensions that such conflict produces for management". Questions are raised on how managers could redesign diversified organization in order to easily exploit potential synergy and other benefits and avoid managerial conflict, (Isoe, *et.al.,* 2013). Empirical studies of synergy and responsiveness only enable us to state whether diversification has a positive (due to synergy) or a negative (due to responsiveness) effect on firm performance, or which type of diversification, related or unrelated, is more beneficial. With respect to the curvilinear relationship between diversification and firm performance, we cannot explain to what extent the positive effect from synergy fades away and will be replaced by the negative effect of responsiveness, or why moderate levels of diversification yield higher levels of performance than either limited or extensive diversification (Tran & Santarelli, 2012). Mwau (2005) states that when an organization diversifies, it moves out of its current products and markets into new areas, which in this case will involve a step into the unknown and will carry a higher degree of business risk. However, Onsomu (2013) argued that the organization may minimize this risk if it moves into related markets. (Related here means a market that has some existing connection with its existing value chain). Companies might wish to create and exploit economies of scope, in which the company tries to utilize its existing resources and capabilities in other markets. This can often time be the case if companies have under-utilized resources or capabilities that cannot be easily disclosed or closed. Using a diversification strategy, Onsomu (2013) concluded that organizations will therefore be able to utilize all its capabilities (in this case resources), and able to attract new business from market segments not catered to earlier before diversification.

Sugar industry in Kenya:

Sugar firms in Kenya are going through challenging times and are experiencing fundamental changes and other environmental dynamics which are having huge impacts on how they are managed and governed. These firms are now having to not only keep abreast of these emerging local and global issues, but more importantly how to adapt to achieve growth. The sugar industry faces collapse due to lack of accountability. Meanwhile, it must be noted the sugar sub-sector is heavily taxed in terms of Value Added Tax (VAT), Sugar Development Levy with the result that gains accruing to farmers and Millers are heavily eroded. According to CGD Bills Digest (2005) report the sugar subsector is identified with low level of technology, high cost of production, operational, low market price, and competition from cheap legally imported sugar under Common Market for Eastern and South African States (COMESA) protocol and political interference as part of problems bedeviling the industry.

Statement of Research Problem:

The Kenyan sugar industry has been undergoing changes in an effort to diversify their product line and strengthen their revenue base in this current turbulent business environment. Multi-lateral and regional trade treaties, like COMESA, EAC and WTO, have facilitated the importation of sugar into Kenya at minimal or Zero tariffs from producer member states and has had an adverse impact on the marketability of locally produced sugar, which because of its high production cost, attributed with high taxation like VAT, CESS and SDL as indicated by Wanyande, (2001) relative to imported sugar, cannot compete head to head with foreign sugar in the domestic and foreign markets. Whether the corporations achieve their goal through diversification strategy begs for an answer. Stiroh (2009) states that when an organization diversifies, it moves out of its current products and markets into new areas. This will involve a step into the unknown and will carry a higher degree of business risk as it entails changes in its administrative structure, systems and other management procedures. However, pursuing product diversification activities may enable a firm to exploit market opportunities and enjoy the benefits of economies of scale or scope. Product diversification may also achieve competitive advantage for companies through economies of scale and other synergies from using the company's resources and capabilities across different product lines. Such synergies from product diversification are more likely to be realized when firms expand into

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related lines of new products and markets (Luo, 2002). Therefore, Tran & Santarelli, (2012) reported that product diversification is positively related to a firm's profitability and growth. Using a diversification strategy, companies may therefore be able to utilize all its capabilities or resources, and able to attract new business from market segments not catered to earlier. However, research by Asman (2013) found that profitability of diversified firms is similar to profitability of undiversified firms. Because of this contradictory results, the relationship between diversification and performance is controversial and has been the subject of abundant research in several fields. Thus, the question of whether diversification if adopted, improves or worsens firm performance is still worthy of further research such as the one being undertaken in this study. This study therefore aims at examining the effect of horizontal diversification strategy adoption on the performance of state-owned Sugar firms in Western Region in Kenya.

Specific Objective:

To find out the effect of horizontal diversification on firm performance of state owned sugar firms in Kenya.

Research Hypothesis:

There is no significant relationship between adoption of horizontal diversification strategy and sugar firms performance in Kenya.

Conceptual frame work:

The independent variable is Diversification, the dependent variable is the Sugar firms' performance and the intervening variable is the organizational factor.

Independent variable | **Dependent variables**

Diversification strategy | Organizational Performance

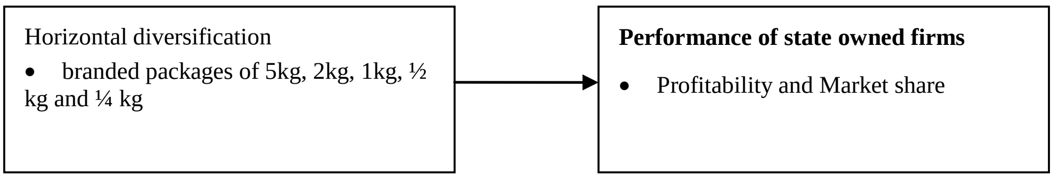

Figure 1.1: Systematic presentation of conceptual framework

Source: Researcher's own conceptualization 2015

As per the above figure, 1.1, the researcher intends to find out what motivates state owned sugar firms to embrace diversification strategies and then examine the effect that adoption of horizontal strategy (independent variable) would have on the performance of state owned sugar firms (dependent variable). The study will establish the effect of horizontal diversification to packaging sugar in branded packages of 5kg, 2kg, 1kg, ½ kg and ¼ kg in contrast to the current packaging in bags of different sizes. The organizational performance of the sugar firms will be determined by looking at the effect of the above on market share, profitability and the productivity of the sugar firms as a result of their adoption.

II. LITERATURE REVIEW

Synergetic Motive:

Synergy occurs when the sum of all businesses together equals more than the sum separately (Hitt *et al*., 2001). Hoechle *et al*. (2009) argue that diversification into related businesses may augment the market power of the diversified company which in turn may help the company enhance its long-term strategic position. Synergies are of great importance when firms diversify. The likely success of the diversification strategy will be the fit between the different business units and their working relationships. The impetus is on the managers of the different units to understand their inter-relationships so the probability of synergy can be increased (Wefwafwa, 2009). Other researchers have argued that while investors should diversify, firms should not unless synergies can be exploited. Thus, it appears that diversification may be a bad strategy in the long run unless the various businesses in the corporate portfolio can obtain certain synergies and gain competitive advantage (Collins & Montgomery, 2008).

Diversification Strategy and Organizational Performance:

Several empirical studies have been conducted to explain the relationship between diversification and performance. For example, Onsomu (2013) attempted to connect diversification with organizational performance. He argued that there are performance differences at different levels of diversification and stressed that companies have limitation in developing enterprise wide capacity due to the lack of managerial skills and resources. He further argued that the relationship between diversification and performance can form both linear and non-linear curves, meaning the impact of diversification strategy on organizational performance can either be positive or negative. Wefwafwa, (2009) posited that diversification allows an organization to grow and diversification strategically takes the organization away from its current markets and products with the overall intention to increase the diversity that must be overseen by the organization. These sentiments were also echoed by Lole, (2009) who cited that diversity in all its implications became the central driver for organization onwards. Muchiri, (2009) asserted that diversification includes both reviewing the inputs and the outputs and it helps in creation of synergy, by moving into new areas, opportunities emerge to develop new inter-relationships through the actual process of working on new services and markets. This synergy according to Richard, *et al*. (2009) makes it possible to produce a combined return on resources that is greater than the sum of the parts. Richard, *et al.* (2009) stressed that diversification strategy is a business development strategy allowing a company to enter additional lines of business that are different from the current products, services and markets. In spite of the vast amount of research done on the diversification-performance relationship, in an extensive review of research in this area, concluded that the findings of studies attempting to demonstrate the effects of diversification on performance remain inconclusive. For example, Michael (2008) concluded that diversified firms in general, and related diversifiers in particular, outperformed others. In contrast, longitudinal study of the US pharmaceutical industry found that diversification resulted in lower performance due to diversification activities shifting resources away from managerial activities, including R&D and advertising, and thus affecting innovation and brand loyalty; and increases in bureaucratic costs were not offset by increased operational efficiencies. On the other hand, studies by Michael (2008) concluded that firms diversifying into unrelated areas have been able to generate superior performance over those with predominantly related businesses. Different researchers have either found support for different forms of the diversification-performance relationship, or have concluded that diversification has a negative or no impact on performance. One of the main reasons for these mixed results has been on account of samples chosen for research. Michael (2008) has warned against studying a mixed group of companies or using “pooled data” unless tests of sample homogeneity yield positive results. According to Michael (2008), if the possibility can be admitted that the relationship between diversity and performance can be industry- or environment-specific, then pooling of data is a critical issue that needs to be addressed. Michael (2008) has also concluded that industry level models and indiscriminate pooling of data can produce results that are misleading if used at the firm level. Ghazanfar *et al*. (1985) argue that careful industry studies are necessary prerequisites for making sense of complex industries, understanding the relationship between diversification and performance**.**

Horizontal Diversification:

Horizontal Diversification is acquiring or developing new products or offering new services that could appeal to the company’s current customer groups (Klein and Lien, 2009). In this case the company relies on sales and technological relations to the existing product lines. For example a dairy, producing cheese adds a new type of cheese to its products. Horizontal diversification consists, instead, of corporate expansion into more than one industry across businesses not necessarily related to each other. With respect to vertical integration, the theoretical grounding behind horizontal diversification is less clear-cut. In particular, two partially competing explanations are at work. On the one hand, industrial organization suggests that, because of commonalities in technology or economies of scale, firms may profit from synergies through the allocation of internally generated cash flows across different businesses (Mohamed, 2005). By diversifying internally, firms can, in fact, expand without bearing the risk of paying the transaction costs linked to the exploitation of synergies in a contractual fashion. As a result, diversification usually occurs throughout related industries, although conglomerates at times claim that expansion across unrelated businesses may equally provide substantial synergies from non-industry-specific economies of scale and scope (Mashiri & Favourate, 2014).

Organizational Performance:

Performance in an organization context refers to the quality of process or end product with both quantity or quality considerations, (Isoe, *et.al*, 2013), while Richard, *et al.* (2009) defined organizational performance as the actual output or results of an organization as measured against its intended outputs or goals and objectives. Organizational performance has been one of the most extensively researched issues since the early development of organizational theory. Under the profit maximization hypothesis, it can be assumed that a corporation undertakes diversification strategy with the expectation that it will lead to improved performance. The performance of the corporation is measured in terms of profits taken gross of interest, depreciation and taxes. According to Clawson, (2012) diversifying in to new products and service lines can provide an effective path to fast growth, as firms sell more products to existing customers or establish new markets. Wakwoma, (2007) indicated that organizations spend their resources to diversify with the main aim of improving their organizational performance. According to Richard et al. (2009) organizational performance encompasses three specific areas: (a) financial performance (b) product market performance and (c) shareholder return. In line with this situation, organizations have been grappling with ideas and efforts on how to remain relevant and competitive in this turbulent environment. A number of them have ventured into diversification as a strategy for survival in the name of meeting the above mentioned performance indicators, (Maithulia, 2005).

Profitability:

Diversification is one significant method firms use to maintain their competitiveness and enhance their profitability. This they do in order to achieve value creation through economic of scope, financial economies, or market power, (Chen & Yu, 2012). Empirically, the impact of diversification on firm profitability is mixed (Mwau, 2005). Some studies claim diversifying into related product markets produces higher returns than into unrelated markets, others propose that less diversified firms perform better than highly diversified firms (Michael, 2006),. Some claim that the economies in integrating operations and core skills obtained in related diversification outweigh the costs of internal capital markets and smaller variances in sales generated by unrelated diversification While Michael (2006), claim that it is not product-market diversity but the strategic logic applied by managers that determines the effect of diversification on profitability, Montgomery (1985) argues that it is not management conduct, but industry structure that governs firm profitability.

Market share:

Market share can be defined as the percentage of a market accounted for by a specific entity and it is an advantageous way of measuring business competitiveness since it is less dependent upon macro environmental variables such as the state of the economy or changes in tax policy, (Marangu, *et.al* ,2014). According to Marangu, *et.al*, (2014), firms with higher market share are stronger than those with lower market share. Firms diversify as long as they see the opportunity to consolidate their market power, which predicts a linearly positive relationship between diversification and profitability. Diversification strategies undertaken by growth-oriented managers may both well exploit scope economies and at the same time increase firms' market power. An efficient way to increase firms' market power is the multimarket contact hypothesis (Michael, 2006), following which firms meeting in several markets have a greater incentive to network with each other in order to sustain collective power. By diversifying in a similar way (in order to exploit cost synergies), a group of firms might create and consolidate a situation of multimarket contacts where collusive practices are more likely to emerge. With respect to the effects, good performance outcomes for diversified firms are consistent with both market power, i.e. firms meeting in several markets co-ordinate to increase their bargaining power on setting higher prices, and efficiency reasons, i.e. firms diversify to exploit positive cost externalities

III. RESEARCH METHODOLOGY

Descriptive survey was used. The population of the study included all Kenyan state-owned sugar firms which in this case are commercial and then the employees of these sugar firms specifically the strategic and top level managers. The sugar firms are, Nzoia, Muhoroni, Chemelil, Sony and Miwani. The researcher used census sampling technique to collect data from the strategic managers working on the state owned sugar firms by sampling 10 managers in every sugar firm. This would yield a total of 50 respondents. The questionnaire provided a major source of primary data that was used in the study. Pilot study was carried out to enhance validity and reliability of the research instrument. Reliability estimate of the instrument was measured using Cronbach alpha of internal consistency. The coefficient of consistency was put at a scale of 0.70, this value or above is considered reasonably high for research purpose (Kothari 2005). Twenty one questionnaires were sent and twenty were returned. The data was then analyzed and the results were correlated to determine their reliability coefficients. All variables combined had a reliability coefficient of 0.833.The data collected in the questionnaire was coded then descriptive and inferential statistics used to describe and summarize the data. Percentages, frequency distribution tables, pie charts and graphic representations were used to meaningfully describe the distribution scores and perception of issues raised in the research. Multiple regression was then used to estimate the effects of independent variables on the dependent variable.

IV. RESEARCH FINDINGS AND DISCUSSION

Response rate:

At the time of sending out questionnaires, Miwani sugar factory was not in operation and hence no response was realized. A total of 40 structured questionnaires were distributed to the four sugar factories. The study collected data from 33 respondents which constituted a response rate of 82.5%. This response rate was excellent and representative and conforms to Mugenda and Mugenda (1999) stipulation that a response rate of 50% is adequate for analysis and reporting; a rate of 60% is good and a response rate of 70% and over is excellent. In this regard, a response rate of 82.5% was adequate for the purpose of this study.

Findings of Diversification and Firm performance:

From the finding as shown by table 4.1, the respondents highly agreed that diversification had helped the firm maximize profits (mean 4.39). They also agreed that because of diversification market share held by the firm was significant (mean 4.27). Further the respondents indicated that diversification improved firm productivity (mean 4.09). They further confirmed that diversification was a wise strategy adopted by the firm (mean 4.45). Finally, respondents highly recommend other firms to adopt diversification strategy in order to improve their performance (4.52). The results concur with Clawson (2012) that diversifying in to new products and service lines can provide an effective path to fast growth, as firms sell more products to existing customers or establish new markets. Strategic alliance is important sources for companies to achieve sustainable competitive advantages (Sambasivan et al. 2013). Previous studies tested the effect of strategic alliance and found that it has positive implications on the organizational performance of involved parties (Das et al., 1998; Schreiner et al., 2009). Jiang and Li (2008) commented that having strategic alliance can improve the organzational learning and performance. Similarly, Khalid and Larimo (2012) found a significant effect of alliance entrepreneurship on the performance.

Table 4.1: Diversification and Firm performance

Diversification and Firm performance	N	Mean	Std. Deviation
Diversification maximizes profitability of a firm	33	4.39	0.788
Diversification increases market share of a firm	33	4.27	0.839
Diversification improves productivity of a firm	33	4.09	0.980
Diversification is a wise strategy to adopt	33	4.45	0.905
I advise other firms to adopt diversification	33	4.52	0.870

Findings of Horizontal diversification strategy:

From the findings shown by table 4.2, respondents greatly agreed that by selling sugar in packages of 5, 2, 1, 1/2 and ¼ kgs had a positive effect on the profitability of the firm (4.27). They further highly agreed that by selling sugar in packages of 5, 2, 1,1/2 and ¼ kgs had a positive effect on the market share of the firm (4.24). They however indicated that by selling sugar in packages of 5, 2, 1, 1/2 and ¼ kgs had slightly effect on productivity (3.79). East African Breweries Limited made various changes in its principal brewing and bottling technologies by investing in new equipment so as to make competitive products. It also changed the basic products by adding new features (Njau, 2000). The University of Nairobi responded to environmental changes by introducing new programs based on the needs of the stakeholders, ensuring staff had performance skills and conducting review exercises. Diversification involves developing new products for new markets. Diversification makes sense when good opportunities can be found outside the present business circuit. Kotler (2000) states that a good opportunity is one in which the industry is highly attractive and the firm has the mix of business strengths to succeed. Diversification involves developing new products for new markets. Diversification makes sense when good opportunities can be found outside the present business circuit. Kotler (2000) states that a good opportunity is one in which the industry is highly attractive and the firm has the mix of business strengths to succeed.

Table 4.2: Horizontal diversification strategy

Horizontal	N	Mean	Std. Deviation
Selling sugar in packages of 5,2,1,1/2 and ¼ kgs has a positive effect on the profitability of the firm	33	4.27	0.674
Selling sugar in packages of 5,2,1,1/2 and ¼ kgs has a positive effect on the market share of the firm	33	4.24	0.792
Selling sugar in packages of 5,2,1,1/2 and ¼ kgs has a positive effect on the productivity of the firm	33	3.79	0.992

Correlation Analysis Horizontal diversification strategy and performance of state owned sugar firms:

The Pearson correlation analysis was used investigate the relationship between horizontal diversification strategy and the performance of state owned sugar firms. The objective tested the second hypothesis of the study which is There is no significant relationship between adoption of horizontal diversification strategy and sugar firms' performance in Kenya. The results in Table 4.3 indicated there is no specific motive for the adoption of diversification strategy by the state owned sugar firms in Western Region in Kenya, positive and statistically not significant (R =.-027, p>.880) with 99.0% confidence level. The study accepts the second null hypotheses since the significance level is more than 0.05 and confirm there is no significant relationship between adoption of horizontal diversification strategy and sugar firms' performance in Kenya.

Table 4.3: Horizontal Diversification correlations

		Y	X2
Y	Pearson Correlation	1	-.027
	Sig. (2-tailed)		.880
	N	33	33
X2	Pearson Correlation	-.027	1
	Sig. (2-tailed)	.880	
	N	33	33

Hypothesis testing:

The rule is; accept the null hypothesis if the calculated p-value is greater than the table F-value otherwise reject the null hypothesis.

Table 4.4: Horizontal Diversification correlations

	Hypothesis	F-value	Calculated p-values	Accept/ Reject null hypothesis
H0	There is no significant relationship between adoption of horizontal diversification strategy and sugar firms performance in Kenya.	p<0.05	p= 0.880	Accept (p>0.05)

Relationship between Variables:

For meaningful analysis inferential statistics was carried out using regression model to establish the effect of independent research variables on the dependent variable. Regression model established how and to which extent each of the independent variable explained the dependent variable. From the findings as shown by table 4.5 below, the diversification motives explained negative 18.9% of the performance of sugar firms, horizontal diversification strategy explained negative 16.5% of the performance of sugar firms, concentric diversification strategy explained 54.0% of the performance of sugar firms and conglomerate diversification strategy explained negative 2.4% of the performance of sugar firms.

Table 4.5: Coefficients

		Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
		B	Std. Error	Beta	t	Sig.	Tolerance	VIF
1	(Constant)	4.075	1.434		2.842	.008		
Model	X2	-.186	.205	-.165	-.905	.373	.869	1.150

a. Dependent Variable: Y

V. CONCLUSION AND RECOMMENDATION

Conclusion:

The study sought out to examine the effect of diversification strategies on the performance of state owned sugar firms in Kenya. The specific objective being, to establish the effect of horizontal diversification on firm performance of sugar firms in Kenya. The finding was as follows,

The Hypothesis postulated that ***Ho***: There is no significant relationship between adoption of horizontal diversification strategy and performance of sugar firms in Kenya. The null hypothesis is accepted and therefore concluded that there is no relationship between adoption of horizontal diversification strategy and sugar firms performance in Kenya.

Recommendation:

In the current competitive business situation, firms have to strive to open other revenue streams to keep afloat. However, the sugar firms must analyse the effect of horizontal diversification on firm performance before implementation.

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