Influence of Geographical Diversification Strategy on Performance of Non-Financial Firms Listed at the Nairobi Securities Exchange in Kenya

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ABSTRACT

Threats to firms' performance from business environment uncertainties have forced firms to rethink their strategies in order to remain relevant to their stakeholders. The study was an investigation on the influence of geographical diversification strategy on performance of listed non-financial firms. Descriptive correlational survey design was employed. A census survey was adopted. Both primary and secondary data was collected. Secondary data was obtained from the audited annual reports of these companies for a period of five years. Semi-structured questionnaires were administered to 135 departmental managers. Data was analysed in form of descriptive and inferential statistics. The study established a significant positive relationship between geographical diversification and performance. Conclusions were that this strategy was essential for firms to use in widening their markets because R^2 = 0.217 which implied that 21.7% of changes in firm performance were attributed to use of this strategy. The study recommended that firms should diversify in regions where competition is not intense and capitalize on the freedom to determine prices that are optimal to ensure profitability.

Keywords*: Geographical Diversification, Firm Performance, Non-Financial Firms*

1.0 INTRODUCTION

Firms have in the recent years been forced to rationalize their operations and review their corporate strategy in response to stiff competition resulting from changes in business environment and introduction of competitive policies. Development arising from these forces and the need for organizations to survive in today's fiercely competitive market are causing many organizations to rethink the way of doing business in order to remain relevant to their stakeholders. Diversification is one of the strategies that have been used by several organizations across the globe in order to enhance their business objectives.

Marinelli (2011) asserts that most organizations around the world consider diversification as one of the ways of value creation. Diversification strategies allow firms to venture in business lines different from the current activities and also operate in several economic markets. It is a form of growth strategy that involves significant increase in the performance objectives surpassing past performance records. It has an impact on the firm performance especially on its finance. To boost a

firm's performance, diversification as a growth strategy is adopted by many business organizations, some of which have succeeded while others have failed. Diversification would make sense only to the extent that it adds more to shareholder's value than what a shareholder could accomplish acting individually and also reduce systematic risk in the shareholder's portfolio (Erdorf, Hartman-Wendels , Heinrichs, & Matz, 2011).

Due to globalization of world markets and production many firms are experiencing a lot of environmental changes and challenges. To gain competitive advantage the firms are expanding their operations to different regions. Internationalization or multinational is beneficial for businesses because of cost-reduction, innovation, and knowledge sharing and acquisition (Geringer, *et al.*, 1989). Internationalisation is defined as 'firm' expansion across global regions and countries borders to different geographical locations or markets. The firms do this in order to enjoy the numerous advantages which enable them to enhance their competitive advantage.

Where an organization diversifies into national markets or markets in different countries, this diversification offers firms opportunities to acquire additional businesses and extend operations into new markets in new countries. The scope of operations ranges from one country to several countries and eventually globalization. International diversification has some economic benefits such as enabling a firm to reap economies of scale by having large markets for its products.

According to Johnson *et al.*, (2008) international diversification enables a firm to stabilize its earnings across markets whereby a drop in one region is offset by increased earnings in another region. Capar and Kotabe (2003) allude that international diversification is closely related to geographical diversification which entails cross-border expansion of firms outlets through either branches or subsidiaries.

Firm performance is the extent to which an investment is profitable (Murimiri, 2009). In the corporate world performance is the criterion by which a firm measures its capability to prevail. The balance score card as introduced by Kaplan and Norton (2001) is a realistic measure of firm performance. It defines a strategy cause and effect relationship and provides a framework to organizing strategic objectives into the financial perspective in line with the vision and mission of the firm. In this study the following accounting measures were used to measure the study's dependent variable; Return on total asset (ROTA), Return on capital employed (ROCE) and profit margin (PM). The assumption is that the economic conditions of Kenya during 2011 through to 2015 were stable.

1.1 STATEMENT OF THE PROBLEM

In the last three decades firms have faced a lot of challenges in the course of running their businesses. There has been market deregulation, intense competition, technological progression and reduction in trade barriers across national borders which have necessitated adoption of diversification strategies among firms around the world. As a result, the non-financial firms listed at NSE in Kenya and the rest of the world are steadily moving away from the traditional sources of revenue. From literature review there is no agreement on whether diversification improves performance of non-financial firms or not, which creates the need for further research. The profit levels of some of the non-financial firms such as Uchumi Supermarket, Transcentury, Kenya Airways and Rea Vipingo has been on the decline in the past few years for instance Uchumi Supermarket posted a loss of Kshs. 690 million in June 2004 which was after two years of poor performance and was put under receivership (RoK, 2007). Therefore the non-financial firms have been diversifying using different strategies. However it is not clear which diversification strategy would aid the non-financial firms improve on their performance. It is against this background that

the study aims to investigate the influence of geographical diversification strategy on performance of non-financial firms listed at NSE.

1.2 Objectives of the Study

The study was carried out to examine the influence of geographical diversification strategy on the performance of the non-financial firms listed at NSE in Kenya.

1.3 Hypothesis of the study

H_0: There is no significant influence of geographical diversification strategy on the performance of the non-financial firms listed at the NSE in Kenya.

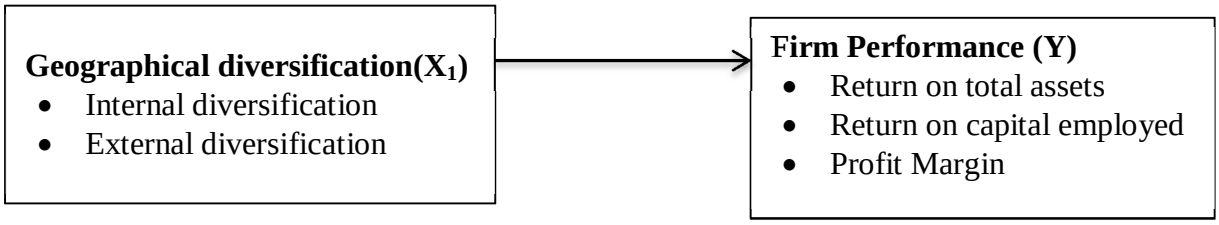

Figure 1: Conceptual Framework

2.0 LITERATURE REVIEW

2.1 Transaction cost approach

Arguments by Coase (1937) are that there exist conditions in which it is more efficient for a company to create a market internally rather than venture into foreign ones. Transaction are free of cost in a perfect market because; information is freely available, decisions are made rationally, there are always different options of suppliers and buyers and the specific transactions do not have carry-over effects between two parties from one period to another. However, in reality these conditions do not exist. Due to non-existence of these conditions transaction costs are incurred.

This approach makes an assumption that a firm has developed firm specific advantages in its home market. The advantages are usually in the form of development of intangible assets internally, some form of know-how which give the firm superiority in terms of production, product, marketing and /or management knowledge. Due to the imperfections characterised by the market for know-how complications in terms of pricing and transfer arise which in turn increase associated cost of transacting with a partner. According to Madhok (1997) a preference for internalizing the transaction results when there is a high level of transaction cost in the external imperfect market. However, firms will prefer to produce abroad when they perceive that the costs of organising transactions internally is greater than the costs of external imperfect market.

Johanson and Mattson (1987) allude that this approach predicts that international market starts with the markets nearby, this is because the internalization is associated with administrative and risk-taking cost. These costs may be lower in cases where the foreign market is less different from the home market. This approach also argues that firms choose the form of organisation and location for which the overall transactions costs are minimized (Coviello & Martin, 1999). Transaction characteristics are analysed and their efficient management is viewed as a firm's force of competitiveness (Madhok, 1997).

The theory informs geographical diversification strategy in the sense that adoption of geographical diversification may lead to a firm incurring heavy costs such as market entry costs, costs of

coordinating business units in different countries and regions as well as information-processing costs. The management of the firm therefore need to be keen about this strategy as under certain conditions as was noted by Sambharya (1995) the costs may surpass the benefits. As firms venture outside their home markets there is need to analyse the transaction characteristics and firms' management must ensure that these transactions are efficiently managed as this can be viewed as a firm's force of competitiveness.

2.2 Empirical Literature Review

2.2.1 Geographical Diversification Strategy

Geographical diversification is the proliferation of branches and service outlets across a geographical boundary, often a country. Uchenna *et al.*, (2012) also defines it is as the opening of branches by a firm outside the head office location and according to Goetz *et al.*, (2013) as the spread of a firm's assets across different geographical points. In the context of this study it will mean the organizational spread of a firm beyond its local borders or company head office to another region either internally (within the country) or externally (beyond the country's borders) (Ibrahim *et al.*, 2009; Oyewobi *et al.*, 2013).

Numerous researches have been undertaken to show the relationship between geographical diversification strategy and firm performance. Some scholars posit that the relationship between the geographic diversification and firm performance was positive due to the uncovered opportunities in other geographical regions (Delios and Beamish, 1999; Qian and Li, 2002), and the increase of market power (Kim *et al.*, 1993; Kogut, 1985). While others found a negative or non-existent relationship between variables and argued that global diversification represented a cost related to the agency relationship between managers and investors, widely known as "diversification discount" (Denis and Yost, 2002).

Findings of a study by Goetz, *et al.*, (2013) among the U.S. bank holding companies revealed that geographical diversification intensified agency problems, and thus hurt performance. This therefore implied a negative relationship between geographical diversification and firm performance. Results of a study done by Wan (1998) on Hong Kong Multinational Corporations (MNCs) show that, the MNCs were more internationally diversified, but did not perform better, than domestic firms. Also, among them, international diversification had a positive impact on profit stability and sales growth.

In their study Lu and Beamish (2004) based on 1489 Japanese firms for the periods between 1986 to 1997 revealed a consistent non-linear curve which at first showed a decrease in performance with increase in internationalisation, followed by a positive relationship between an increase in geographical diversification and performance which then declined at higher levels of multinationality. This relationship was moderated by intangible assets merits that were derived with the geographic scope expansion of the firm. In the early stages, internationalization increased a firm's costs because of newly generated complexity for governance. Nevertheless, performance started to increase after firms got acquainted with the environment and acquired new knowledge and capabilities. In their research Contractor *et al.*, (2003) found a sigmoid-shaped relationship in knowledge-based service firms.

Wu, Wu, and Zhou (2012) investigated the relationship between expansion internationally and firm performance of 318 listed Chinese manufacturing firms for the period between 1999 to 2008. The study explored the relationship between the variables and then investigated the role of diversification and established the moderating effect of diversification between internationalisation and firm perfromance. The firms were grouped into three according to the levels of diversification; high, medium and low levels. Data was analysed through statistical technique of fixed effects panel data model. The findings revealed that internationalisation at high and low levels was negatively

associated with firm performance but at medium level there was a positive association. Bany-Ariffin *et al.,* (2016) study which aimed at evaluating the impact of internationalization and firm performance of 100 Malaysian MNCs which had investment abroad, employed panel generalized method of moment estimation technique for data analysis. The findings revealed that the move for investment abroad had a positive impact on these firms' performance.

Arasa (2014) carried out a study on the KCB Group. Using trend data and content analysis to establish the effect of diversification on performance, the findings revealed that KCB group adopted geographical diversification strategy which had a positive effect on performance. A study by Kwena (2015) on commercial banks in Kenya revealed that there was a negative relationship between income and geographical diversification when return on assets was used as a measure of performance. However, a positive relationship existed between the two variables when return on equity was used as a measure of performance. These studies were carried out in the banking sector and based on the findings the results are contradictory. This indeed has made it difficult for generalisations and conclusions to be drawn on the relationship between geographical diversification strategy and firm performance.

The study done by Njuguna (2013) on the effect of diversification on growth of companies listed at NSE. Findings from the regression analysis revealed a positive relationship between growth in income of the listed firms and firm sizes though the relationship was not very strong. A negative relationship was revealed between growth and branch expansion. This was mainly attributed to the fact that regional expansion may have to take sometime to break even and therefore net income of the firms would present a negative relationship.

2.2.2 Firm Performance

Firm performance stimulation is a priority in both public and private sectors since it is associated directly with an entity's value creation. Firms are constantly striving for better results, competitive advantage and influence. However, most are struggling to enhance their performance. According to Richard (2009) there are models, frameworks or methods for conducting entities valuations, these create unnecessary stress for management to select the paths that would be congruent with the organizations beliefs and cultural philosophy.

Ibrahim, Ibrahim, and Kabir (2009) maintain that there are various measures of firm performance which produce different results. Firm performance was conceptualized from the accounting point of view. The study used variables from the accounting domain that depict the firm performance to test the viability of the diversification strategy - firm performance relationship. Earlier studies used different accounting measures; Capon, Farley, and Hoenig (1990) assert that accounting measures of performance would include return on equity, return on assets, return on sales, and return on invested capital.

3.0 RESEARCH METHODOLOGY

The study employed the descriptive correlational survey design. It was deemed appropriate since it gave a description of a group of people, phenomena or an event based on the influence on another variable (Salkind, 2010) and also because of its observational nature of data from the audited financial reports of the non-financial firms listed in NSE. The design was also aimed at examining the relationship between variables (correlational), where these variables have some kind of the correlation it could either be positive, negative or none at all (Walliman, 2011).

Population is a well-defined collection of individuals or objects with similar characteristics (Kothari, 2004) for which a researcher wishes to make some inferences (Cooper & Schindler, 2008). The researcher's target population consisted of all the 45 non-financial firms listed at the

Nairobi Securities Exchange (NSE) in Kenya. Census survey was used in this study as recommended by Mugenda and Mugenda (2003) that when a population is small census approach is recommended. The unit of analysis was the non-financial firm and the unit of observation were three departmental managers per firm. In this case the resulting sampling size was 135 which were considered representative.

Both primary and secondary data were collected. The primary data was collected using a semi-structured questionnaire with both open ended and closed ended questions. These questionnaires were administered to 135 departmental managers. The closed-ended items of the questionnaire were constructed on a 5 point Likert scale, this enabled them provide responses which facilitated quantitative analysis, testing hypothesis and drawing of conclusions. The open ended questions provided additional information that may have been omitted by the closed-ended questions. Audited annual financial reports were used to collect the secondary data for the period between 2011 and 2015.

Pilot testing in this study was done by collecting data from managers of the listed firms not participating in the main study. The study took 10% of the main sample size and therefore four firms were picked through convenience sampling, this was based on the recommendation by Cooper and Schindler (2008). A total of three managers from each firm were used in the testing of the reliability and validity of the questionnaire. To test the data reliability the study employed Cronbach's alpha coefficient, this indicates the extent to which a set of test items can be treated as measuring a single latent variable (Cronbach, 1951). The value of greater than 0.7 was adopted for this study as recommended by Field *et al*., (2012). The findings showed that the scales were reliable as they surpassed the minimum Cronbach's alpha value threshold of 0.7 and hence none of the items in the questionnaire were deleted after the pilot study. The questionnaire was adequate to be used in the final survey. The construct and content validity of the questionnaire items were verified through literature review and expert suggestions as recommended by Mugenda and Mugenda (2003).

4.0 RESULTS AND DISCUSSION

The response rate of questionnaires was 116 out of the desired 135, this was 85.9%. According to Babbie (2004) and Mugenda and Mugenda (2003), this response rate of 85.9% was high enough to analyse and make conclusions.

4.1 DESCRIPTIVE STATISTICS

The results presented in Table 1 indicated that 74.1% of the respondents revealed that their firms ventured into new markets for the last five (5) years. This is an attribute of geographical diversification. The results further showed that majority of the respondents agreed that they had branches both locally, regionally and globally. Some companies indicated to have as many as over 10 branches regionally and globally while others had between 1 and 3 branches in the regions and around the world. These results clearly indicated that majority of the listed non-financial firms had diversified geographically locally and to both regional markets and global markets.

Table 1: Frequency for Geographical Diversification Sub-variables

		Frequency	Percent (%)
Has the company ventured into any new markets for the last five (5) years?	No	30	25.9
	Yes	86	74.1
	Total	**116**	**100**
Local branches in Kenya (Domestic Market)	None	25	21.6
	1-3 branches	18	15.5
	4-6 branches	21	18.1
	7-9 branches	28	24.1
	Over 10	24	20.7
	Total	**116**	**100**
Branches in the East Africa region (Regional Market)	None	26	22.4
	1-3 branches	20	17.2
	4-6 branches	23	19.8
	7-9 branches	23	19.8
	Over 10	24	20.7
	Total	**116**	**100**
Branches or affiliates in the world (Global Market)	None	23	19.8
	1-3 branches	27	23.3
	4-6 branches	29	25
	7-9 branches	19	16.4
	Over 10	18	15.5
	Total	**116**	**100**

Source: Field Data (2018)

Table 2 contains the findings based on the statements on Likert scale. The respondents were expected to indicate their opinion on a scale of 5-strongly agree to 1-strongly disagree in regard to the attributes of geographical diversification strategy. The responses were analyzed through the mean and standard deviation. The respondents agreed that their firms frequently ventured into marketing of their products in new geographical areas; the firms had expanded operations to different regions through branches or subsidiaries which were found within and outside the country's borders; firms had established related firms in other regions within Kenya and unrelated firms across the country and that it was important for the firms to establish branches or subsidiaries in different regions. Each of the factors had a mean score of 3.41, 3.66, 3.11, 3.56, 3.61, 3.48 and 3.55.

The aggregate mean score for the attributes was 3.55 which tends to 4 (agree) on the 5 point Likert scale used in the study. The variability of responses from the aggregate mean score as shown by the aggregate standard deviation of 1.29 was low. This aggregate mean score revealed that the attributes related to the use of geographical diversification strategy in the non-financial firms was high. Additionally the low aggregate standard deviation showed that the responses concentrated around

the mean and hence a stable and reliable estimator of the true mean. The narrow variation from the overall mean response confirmed that the respondents agreed that geographical diversification strategy played a major role in performance of their firms.

Table 2: Attributes of Geographical Diversification

Statements	SA	A	N	D	SD	Mean	Std Dev
The firm frequently ventures into marketing of its products in new geographical areas	20.7%	30.2%	28.4%	11.2%	9.5%	3.61	1.21
The firm has expanded its operations to different regions through branches or subsidiaries	36.2%	24.1%	20.7%	7.8%	11.2%	3.66	1.34
The branches or subsidiaries are found within the country's borders	27.6%	8.6%	20.7%	30.2%	12.9%	3.41	1.33
The branches or service outlets are found outside the country's borders	27.6%	32.8%	19.8%	7.8%	12.1%	3.56	1.30
To what extent would you agree that your firm has established related firms in other regions within Kenya	25.0%	30.2%	23.3%	11.2%	10.3%	3.48	1.27
To what extent would you agree that your firm has established unrelated firms across the country	31.9%	26.7%	22.4%	8.6%	10.3%	3.61	1.30
To what extent would you agree that it is important for your firm to establish branches or subsidiaries in different regions	29.3%	27.6%	23.3%	8.6%	11.2%	3.55	1.30
Average						**3.55**	**1.29**

Source: Field Data (2018)

4.2 INFERENTIAL STATISTICS

In this study 95% level of confidence was adopted as a statistical basis for drawing conclusions. The correlation analysis was conducted to test the strength of the association between geographical diversification strategy and firm performance. The results of this analysis as shown on Table 3 indicated that geographical diversification had a positive and significant correlation ($r = 0.466$, $p = 0.000$) with performance of listed non-financial firms in Kenya. This association was moderately strong. The findings implied that positive increase in geographical diversification would result in corresponding positive change in firm performance.

Table 3: Correlation Results Geographical Diversification Strategy and Firm Performance

		Geographical diversification	Firm Performance
Geographical Diversification	Pearson correlation	1	0.466**
	Sig. (2-tailed)	0.000	0.000
	N	116	116
Firm Performance	Pearson correlation	0.466**	1
	Sig. (2-tailed)	0.000	0.000
	N	116	116

** Correlation is significant at the 0.05 level (2-tailed)
Source: Field Data (2018)

The model summary results (Table 4) R-squared of 0.217 which implied that geographical diversification strategy accounted for 21.7% of the variation in performance of listed non-financial firms can be explained by geographical diversification strategy while the remaining percentage of 78.3% is explained by other variables not in the model.

Table 4: Model Summary for Geographical Diversification

Model	R	R-Squared	Adjusted R-Squared	Std. Error of the Estimate
1	0.466	0.217	0.210	0.58784

a. Predictors: (Constant), Geographical Diversification
Source: Field Data (2018)

As shown on the Table 5, F-test was carried out to test the null hypothesis that there is no significant influence of geographical diversification strategy on the performance of the non-financial companies listed at NSE in Kenya. The results of ANOVA showed that F value 31.658 with p-value = 0.000 which is less than 0.05 meaning that the null hypothesis was rejected and conclusion made that there is significant influence of geographical diversification on performance of listed non-financial firms in Kenya.

Table 5: ANOVA for Geographical Diversification

Model		Sum of Squares	Df	Mean Square	F	P-value
	Regression	10.940	1	10.940	31.658	0.000[b]
	Residual	39.394	114	0.346		
	Total	50.333	115			

a. Dependent Variable: Firm Performance
b. Predictors: (Constant), Geographical Diversification
Source: Field Data (2018)

To test the significance of the effect of geographical diversification strategy on firm performance, the regression coefficients (β), the intercept (α), and the significance of all coefficients in the model were subjected to the t-test to test the null hypothesis that the coefficient is zero. The null hypothesis state that, β (beta) = 0, which meant there is no significant effect of geographical diversification strategy on firm performance as the slope β (beta) = 0.

The model $\mathbf{Y= \beta_0+ \beta_1X_1+\varepsilon}$ therefore became **Firm Performance = 1.484 + 0.381 (Geographical Diversification Strategy) +ε.** The beta coefficient results of the resulting model showed that the constant $\alpha = 1.484$ was significantly different from 0, since the p- value = 0.000 is less than 0.05. The coefficient $\beta = 0.381$ similarly was significantly different from 0 with a p-value = 0.000 which was less than 0.05.

These results revealed that there was a positive and significant relationship between geographical diversification strategy and firm performance. The results implied that a unit change in geographical diversification strategy would result in 0.381 units change in performance of the non-financial companies listed at NSE in Kenya. This confirms that there is a significant positive effect of geographical diversification strategy on firm performance of listed non-financial firms in Kenya.

Table 6: Regression Coefficients for Geographical Diversification

	β	Std. Error	Beta	t	P-value
(Constant)	1.484	0.246		6.033	0.000
Geographical Diversification	0.381	0.068	0.466	5.627	0.000

a. Dependent Variable: Firm Performance Mean
Source: Field Data (2018)

5.0 CONCLUSION AND RECOMMENDATIONS

Firm performance is paramount to management within organizations. This study was carried out to establish the relationship between geographical diversification strategy and performance of listed non-financial firms in Kenya. The results of decriptive analysis clearly indicated that majority of the listed non-financial firms had diversified geographically to regional market and global markets. Geographical divesification was made easy through globalisation and advancement in business technology.

The correlation results indicated that geographical diversification had a positive and significant association with performance of listed non-financial firms in Kenya. The findings implied that positive increase in geographical diversification would result to a corresponding positive change in firm performance. To test the null hypothesis that there is no significant influence of geographical diversification strategy on performance of the listed non-financial firms in NSE, F test was carried out. From the test results the null hypothesis was rejected and conclusions made that there was indeed a significant influence of geographical diversification strategy on performance of the non-financial firms listed at the NSE. Regression analysis results confirmed that there existed a significant influence of geographical diversification strategy on performance of the non-financial companies listed at the NSE.

The study recommended that firms should diversify in regions where competition is not stiff and intense and also capitalize on the freedom to determine prices that are optimal enough to ensure profitability. Therefore firms should always engage in research to identify new strategic regions to introduce their products. The study further recommended that management of the listed firms should come up with sound policies to guide them when diversifying. Since the findings and conclusions were limited to non-financial firms in Kenya, future research should focus on validating the findings and conclusions of the study by carrying out replicative researches in other organisations and sectors in Kenya.

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