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The Relationship Between Diversification Strategy And Organizational Performance: A Research Intended For Comparing Belgium And Turkey

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Abstract

The aim of this study is to determine whether there is a significant difference between types of diversification and performance values comparing Turkey and Belgium. Diversification strategy and organizational performance relationship seems to differ across developed and developing countries. The data from 2007-2011 of 114 business groups in Belgium and 118 business groups in Turkey were analyzed. ROA and ROS for organizational performance and Rumelt's measure for diversification were used. According to the results, when organizational performance values are high for single businesses, dominant businesses and unrelated diversification in Belgium, organizational performance is high for dominant businesses in Turkey.

Keywords: Diversification Strategy, Organizational Performance, Developing Country, Developed Country

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1. Introduction

While several studies have examined the relationship between diversification strategy and organizational performance (Chakrabarti, Singh, Mahmood, 2007, Markides, 1996; Stimpert 1997; George, 2007; Compillo and Gago, 2008, Geringer, Talman, Olsen, 2000; Guo and Cao, 2012), the question how and when diversification can be used to build long-run competitive advantage and better performance are not straightforward. It seems there are different views depending on empirical evidences on this topic.

Some researchers derived their samples diversification strategy has a lot market efficiencies and performance advantage that are unavailable to a single business firm (Palic et al. 2000, Stern and Henderson, 2004). Diversification strategy alone will not produce superior performance. There are other factors that will be shape the relationship between diversification and performance. Superior performance of diversification depends on both diversification style and institutional development. Extant research indicates that for diversification the level of a country's institutional development is a determinant for the relative size of such costs and benefits. Besides this several studies propose that diversification is more likely to be profitable in institutionally developing economies (Chang and Hong, 2002; Kock and Guillen, 2001). Institutional environments between developed and developing countries and markets are a critical factor in shaping economic activity and firm performance. For example in a country political and legal weaknesses can lead to market failure, as characterized by information problems and poor judicial systems. Kock and Guillen (2001) propose that contacts and connections are more important than competencies and technological abilities for determining the incentives and outcomes of diversification in developing economies. The underlying argument is that key aspects of institutional environments in developing economies are the lack of well-established product markets, financial markets and labour markets, coupled with the lack of necessary laws, regulations and inconsistent enforcement of contracts.

Rumelt's (1974) proposition that related diversification produces greater profits than unrelated diversification has generally been accepted. Since Rumelt, many empirical studies have claimed that related diversification enhances profits more than unrelated diversification (Montgomery, 1979; Markides and Williamson 1996; Markides and Williamson 1994). Moreover, Geringer, Talman and Olsen (2000) suggested that diversification strategies and their effects on performance vary across time periods according to their study on Japanese firms. All of these inconclusive empirical research evidences have led to a need for researchers examining how diversification strategy affects firm performance in different institutional environments and market conditions.

It is aimed to compare the relationship between diversification strategy and organizational performance in Belgium, a developed country and in Turkey, a developing country. The study will provide the managers wishing to grow their firms by diversifying scientific findings. In this context, the study begins with a literature review of diversification, diversification and organizational performance and development of hypotheses. Research goal, sample, data collection and measurement methods of the research variables and analyses results take place at the third section. The results of the analyses will be discussed and recommendation will be provided for academicians at the last section.

2. Literature Review and Hypotheses

2.1. *Diversification*

Diversification strategy can be defined as "Expanding or entering in new markets which are different from the firm's existing product lines or markets" (Johanson and Scholes, 2002; Rumelt, 1982). Diversification can be driven by a range of perceived benefits associated with greater market power, more efficient allocation of resources through internal capital markets, utilization of existing resources in new settings, or reduced performance variability by virtue of a portfolio of imperfectly correlated set of business (Chakrabarti et al. 2007). This means that using corporate resources in two business units can exploit any synergies between the two (for example, in manufacturing or distribution) to achieve cost or differentiation advantages over undiversified firms. Same advantages stem from tax and other financial advantages associated with diversification (Knoll, 2008). But these benefits depend on institutional development. If institutional development is high, diversification strategy is less beneficial in more developed institutional economies (Kock and Gulline, 2001).

Diversification strategy has disadvantages and risks, too. According to Porter's study on diversification records of 33 large, prestigious U.S. companies over the 1950-1986 period, it is concluded that though most of them were expected to have a positive value, diversification created negative aspects, too (Porter, 2001). The corporate diversification strategies could have some risks because of bureaucratic costs that can reason from business number, coordination among business units (Hill and Jones, 1998), agency problems that managers will act largely out of self-interest unless they are closely monitored by large block stakeholders (Lane and others, 1998) and wrong decisions about diversification (Hill and Jones, 1998).

Related diversification strategies (vertical and horizontal) give rise to a number of competitive advantages. This is because related diversification presumably allows the corporate centre to exploit the interrelationships that exist among its different businesses and so achieve cost and differentiation competitive advantages over its rivals (Markides and Williamson, 1994, p.149). These advantages are resulted from core competence that has valuable assets transferred from business units and economies of scope. Unrelated diversification strategies provide few operational synergies and therefore must rely on financial synergies for increasing value. Unrelated diversification helps businesses to achieve economies of scope but frustrates businesses due to the difficulty of applying existing experience to unfamiliar market conditions (Zhao and Luo 2002).

2.2. Diversification Strategy and Organizational Performance

There are a lot of evidences about that diversification should have a positive influence on performance due to economies of scope, and scale, market power effects, risk reduction effects and learning effects. Additionally, most empirical studies on the relationship between diversification and organizational performance are shaped into four types. The first type is inverted U shape. Thus; there is a nonlinear relationship between diversification and organizational performance. As the diversification degree increases to some average level, the performance will also increase, however after an average level the company performance will decrease (Palich and others, 2000). This curvilinear relationship between diversification and organizational performance is based on the level of diversification (Varadarajan and Ramanujam, 1987; Palich et al. 2000, Kakani, 2000). Second type is based on the findings showing a positive relationship between diversification and organizational performance (Pandaya and Rao, 1998; Singh et al. 2001; Piscitello, 2004), a negative relationship (Markides 1995; Lins and Servaes 2002, Gary, 2005), or lack of a relationship (Grant et al., 1988; Montgomery 1985). The third type is based on the style of diversification especially categorised as related and unrelated diversification. Some studies found that related diversified firms perform better than those that are unrelated (Montgomery, 1979; Varadarajan and Ramanujam, 1987; Markides and Williamson 1996; Markides and Williamson 1994). The fourth type is based on the differences of countries. Several studies depicts that diversification is more likely to be profitable in developing countries (Gullien, 2000; Khanna and Palepu, 1997).

In general, the potential returns from diversification decrease with market and institutional development, so that diversification would not improve firm performance in perfect markets. So it is expected that firms in less institutionally developed economies will benefit more substantially from diversification than firms in more institutionally developed economies (Chakrabarti et al. 2007). Thus, new studies between developed and developing economies or countries in business groups should be carried out to examine the diversification strategy and organizational performance relationship.

2.3. Development of Hypotheses

Diversification strategy can be driven by a range of perceived benefits associated with greater market power, more efficient allocation of resources (Chakabarti, Singh, and Mahmood, 2007). However It is emerged that the relationship between diversification strategy and organizational performance shows differences in developed countries and developing countries (Lins and Servaes, 2002). Harvey, lins, Roper (2001) suggested agency costs across countries are not the same and higher in developed markets than developing markets. In the emerging markets much higher cost are faced than developed countries (Khanna and Palepu, 1997). Unlike the developed countries, the corporate environment factors such as the limits of the market of developing countries, the relations of the government and businesses, product market and labour market can be effective for diversified businesses. From this perspective, different institutional environments for diversification and performance link may not be same. Developing economy or market suffer from economy-wide shocks much more than developed economy. These difficulties reduce the related diversification benefits such as risk

spreading and resource sharing across businesses in developing economy (Hannan, Polos and Carrol , 2003). Relying on existing arguments, we argue that diversification strategy has effects on organizational performance in different institutional environments (developed and developing countries) and propose the hypotheses following:

H₁: Single businesses' organizational performance is higher in Belgium and than in Turkey

H₂: Dominant businesses' organizational performance is higher in Belgium than in Turkey.

H₃: Related diversification's organizational performance is higher in Belgium than in Turkey

H₄: Unrelated diversification's organizational performance is higher in Turkey than in Belgium

3. Methodology

3.1. Research Goal

The aim of this research is to determine whether there is a significant difference between types of diversification and performance values comparing Turkey and Belgium.

3.2. Sample, Data Collection and Measurement Methods of the Research Variables

The survey of this study is conducted with the data of the businesses operating in Turkey obtained from www.imkb.gov.tr and www.kap.gov.tr and the data of businesses operating in Belgium obtained from Bloomberg data base. The data of 114 business groups in Belgium and 118 business groups in Turkey were analyzed. The 2007-2011 data of organizational performance were used in the research. The independent variable of the research is measure of diversification and the dependent variable is organizational performance.

Diversification Measure: In this research Rumelt's classification is used for measuring diversification. According to Rumelt's measure of diversification; *Specialization Ratio-SR*: The ratio of the strategic business unit or group with the highest revenue to total revenues of the corporation, *Relationship Ratio (Related Ratio-RR)*: denotes, analyzing the amount of revenues, the status of interrelatedness of the areas of the strategic business units that make up this amount; Rumelt's Measure of Diversification; Single Company ($SR \geq 0.95$), Dominant Company ($0.95 > SR \geq 0.70$), Related Company ($SR < 0.70$ and $RR > 0.70$), Unrelated Company ($SR < 0.70$ and $RR < 0.70$). The distinction between the designated categories of related and unrelated strategic business units is made within the framework 4-digit and 2-digit SIC code. According to this distinction, the companies which are associated with a 4-digit were considered as related and 2-digit ones were considered as unrelated. As stated earlier, in majority of prior studies (Rumelt, 1982; Palepu, 1985; Markides and Williamson, 1994; Markides, 1995; Busija and Zeithaml, 1997; Chakrabartive al, 2007) SIC code within Rumelt's classification is used for the related-unrelated discrimination.

Organizational Performance: Analysis to measure organizational performance, financial measures utilized and reasons for using these measures are summarized below.

Researches in which Performance is measured by ROA (Return on Assets): ROA is accepted as an important indicator to measure the effectiveness of management by the researchers that measure organizational performance by ROA value only. In addition, external shareholders and business managers who need the performance of the business organization express that ROA is a sufficient criterion to evaluate the performance of organization (Tihanyi, 2003; Dubofsky, 1987; Kim and others, 2004; Ravichandran, 2009). On the other hand, according to Rumelt (1977), Christensen and Montgomery (1981) ROA is a standardized measure of performance (Dubofsky and Varadarajan, 1987). This rate shows to what extent the assets are used effectively, in other words how much revenue can a company make over its assets.

Researches in which Performance is measured by ROS (Return on Sales): the reason that researchers use the ROS value only or with other financial measures for organizational performance is that the ROS ratio is calculated after deducting taxes and other expenses. The ROS value is accepted as an important factor in measuring the efficiency of operational activities (Palepu, 1985; Markides, 1995; Markides, 1996).

3.3 Analyses and Results

3.3.1. Frequencies for Diversification in period of 2007-2011, ROA and ROS Values

At Table 1, the frequencies according to the extent of diversification, operating frequency and indicators of the average performance in each measure of diversification of the enterprises within the research, are presented. The reason for this is that one person or investment group has shares in different firms. Thus, the number of firms, corporations and businesses differ in Belgium. The same situation was observed rarely in Turkey. According to table 1 illustrating the corporate level, 96 corporations of the total 118 in Turkey are single businesses, 5 of the corporations are related diversified. Based on the data, single businesses have the highest ratio of 81.35% among the groups. According to table 1, 91 corporations of the total 114 in Belgium are single businesses, 8 of the companies are relatedly diversified. Based on the data, single businesses have the highest ratio of 79.82% among the groups.

Table 1. Frequencies for Diversification in 2007-2011 Period, ROA, ROS Values

Diversification Measure	Corporate Level				Performance Indicators			
	Frequency		Percentage		ROA		ROS	
	TR	BL	TR	BL	TR	BL	TR	BL
Single	96	91	81,35	79,82	0,0464	0,0543	0,0513	0,1455
Dominant	7	8	5,93	7,01	0,2602	0,0185	0,067	0,0481
Related	5	8	4,23	7,01	-0,0229	0,0715	-0,0116	0,4849
Unrelated	10	7	8,47	6,14	0,0164	0,0643	0,0231	0,1114
Total	118	114	100	100	0,0536	0,0267	0,0472	0,0341

Additionally, normal distribution analysis (one sample KS; and histograms) was applied before testing hypotheses. As the results were not normal, nonparametric analysis was chosen. Accordingly, Mann-Whitney U test was applied to measure the difference between two variables.

3.3.2. Diversification Strategy (Single Businesses) and Organizational Performance

The results of Mann-Whitney U test which is one of the Rumelt’s diversification measures and was made for single businesses will be presented under this title. The tables are for comparing Turkey and Belgium.

Diversification Strategy (Single Businesses) and Return on Sales (ROS): There is a significant difference in performance (ROS) between Turkey and Belgium (Table 2). It is seen that the performance values of single businesses in Belgium are higher than in Turkey.

Table 2. 2007-2011 Period Diversification Strategy (Single Businesses) and Return on Sales (ROS)

Country	Corporate Level	Median	Mean	Std. Deviation	Mann-Whitney U	3360,000
Turkey	96	0,340	0.0513	0,12045	Wilcoxon W	8016,000
Belgium	91	,0633	0.1455	0,28936	Z	-2,725
Total (N)	187		-	-	Sig. (2-tailed)	,006

H₁ was accepted for ROS.

Diversification Strategy (Single Businesses) and Return on Assets (ROA): There isn't a significant difference in performance (ROA) between Turkey and Belgium. Also, it is seen that the performance values in Belgium are higher than in Turkey when the average and median values are examined (Table 3).

Table 3. 2007-2011 Period Diversification Strategy (Single Businesses) and Return on Assets (ROA)

Country	Corporate Level	Median	Mean	Std. Deviation	Mann-Whitney U	3778,000
Turkey	96	0,364	,0464	,11487	Wilcoxon W	8434,000
Belgium	91	,0525	0,0543	,10864	Z	-1,595
Total	187	-	-	-	Sig. (2-tailed)	,111

H₁ was rejected for ROA.

3.3.3. Diversification Strategy (Dominant Businesses) and Organizational Performance

The results of Mann-Whitney U test, one of Rumelt's diversification measures, made for dominant businesses will be presented. ROA and ROS values are shown in the tables separately and they are for comparing Turkey and Belgium.

Diversification Strategy (Dominant Businesses) and Return on Sales (ROS): There is not a significant difference in performance (ROS) between Turkey and Belgium (Table 4), but when median values are examined, it is understood that the performance values of dominant businesses in Belgium are higher than in Turkey.

Table 4. 2007-2011 Period Diversification Strategy (Dominant Businesses) and Return on Sales (ROS)

Country	Corporate Level	Median	Mean	Std. Deviation	Mann-Whitney U	63,000
Turkey	7	,0130	,0670	0,15634	Wilcoxon W	118,000
Belgium	7	,0448	,0481	,39150	Z	-,124
Total(N)	14	-	-	-	Sig. (2-tailed)	,901

H₂ was refused for ROS.

Diversification Strategy (Dominant Businesses) and Return on Assets (ROA) : There is not a significant difference in performance (ROA) between Turkey and Belgium, but when the average and median values are examined, it is understood that the performance values of dominant businesses in Turkey are higher than in Belgium (Table 5).

Table 5. 2007-2011 Period Diversification Strategy (Dominant Businesses) and Return on Assets (ROA)

Country	Corporate Level	Median	Mean	Std. Deviation	Mann-Whitney U	14,000
Turkey	7	0,923	,2602	0,31762	Wilcoxon W	50,000
Belgium	8	,0153	,0185	,09116	Z	-1,620
Total(N)	15	-	-	-	Sig. (2-tailed)	,105

H₂ was refused for ROA.

3.3.4. *Diversification Strategy (Related Diversification) and Organizational Performance*

The results of Mann-Whitney U test, one of Rumelt’s diversification measures, made for related diversification will be presented. ROA and ROS values are shown in the tables separately and they are for comparing Turkey and Belgium.

Diversification Strategy (Related Diversification) and Return on Sales (ROS) : There is a significant difference in performance (ROS) between Turkey and Belgium, when the average and median values are examined, it is understood that the performance values of related businesses in Belgium are higher than in Turkey (Table 6). According to this result, even the hypotheses are refused; the average and median based findings show that internal factors in Belgium such as sources and skills can increase performance.

Table 6. 2007-2011 Period Diversification Strategy (Related Diversification) and Return on Sales (ROS)

Country	Corporate Level	Median	Mean	Std. Deviation	Mann-Whitney U	9,000
Turkey	5	-,0004	-,0116	0,4890	Wilcoxon W	20,000
Belgium	8	,5973	0,4849	,55536	Z	-2,202
Total(N)	13	-	-	-	Sig. (2-tailed)	,028

H₃ was accepted for ROS.

Diversification Strategy (Related Diversification) and Return on Assets (ROA) : There is not a significant difference in performance (ROA) between Turkey and Belgium (Table 7). However, it is understood that the performance values of related businesses in Belgium are higher than in Turkey when the average and median values are examined.

Table7. 2007-2011 Period Diversification Strategy (Related Diversification) and Return on Assets (ROA)

Country	Corporate Level	Median	Mean	Std. Deviation	Mann-Whitney U	9,000
Turkey	5	-,0007	-0.0229	0,10401	Wilcoxon W	24,000
Belgium	8	,0572	0.0715	,06501	Z	-1,615
Total(N)	13	-	-	-	Sig. (2-tailed)	,106

H₃ was refused for ROA.

3.3.5. *Diversification Strategy (Unrelated Diversification) and Organizational Performance*

The results of Mann-Whitney U test, one of Rumelt’s diversification measures, made for unrelated diversification will be presented. ROA and ROS values are shown in the tables separately and they are for comparing Turkey and Belgium.

Diversification Strategy (Unrelated Diversification) and Return on Sales (ROS) : There is not a significant difference in performance (ROS) between Turkey and Belgium, but when the average and median values are examined, it is understood that the performance values of unrelated businesses in Belgium are higher than in Turkey (Table 8). It can be thought that factors within organization and environmental factors have similar effects in Turkey and Belgium according to this result for ROS.

Table 8. 2007-2011 Period Diversification Strategy (Unrelated Diversification) and Return on Sales (ROS)

Country	Corporate Level	Median	Mean	Std. Deviation	Mann-Whitney U	20,000
Turkey	10	,0061	,0231	,20810	Wilcoxon W	75,000
Belgium	7	,1035	,1114	,12496	Z	-1,464
Total	17	-	-	-	Sig. (2-tailed)	,143

H₄ was refused for ROS.

Diversification Strategy (Unrelated Diversification) and Return on Sales (ROA): There is not a significant difference in performance (ROA) between Turkey and Belgium (Table 9). However, it is understood that the performance values of unrelated businesses in Belgium are higher than in Turkey when the average and median values are examined. The reason of high unrelated diversification performance values can be the effectiveness of such factors like high environmental opportunities and absence of perfect competition conditions in all sectors.

Table 9. 2007-2011 Period Diversification Strategy (Unrelated Diversification) and Return on Assets (ROA)

Country	Corporate Level	Median	Mean	Std. Deviation	Mann-Whitney U	27,000
Turkey	10	-,0839	,0164	,54249	Wilcoxon W	82,000
Belgium	7	,0528	,0643	,07601	Z	-,781
Total(N)	17	-	-	-	Sig. (2-tailed)	,435

H₄ was refused for ROA.

4. Conclusion

When the results are considered in terms of Hypothesis 1, the average of performance indicators in Belgium is higher than in Turkey for single business. However, Hypothesis 1 was accepted for ROS but refused for ROA. When the results are considered in terms of Hypothesis 2, the average of performance in Turkey is higher than in Belgium for dominant businesses. Also, the performance values of unrelated businesses in Belgium are higher than in Turkey when the average and median values are examined (Hypothesis 3). These analyses of the research reveal that the performance averages only by the developing countries seem to have similar characteristics. As emphasized by the researches mentioned above concerning the developing countries, the reason for such insignificance appears to stem from conditions that are thought to be differentiated in Turkey. The relationship between diversification and performance is thought to be affected by factors such as some of the privatization policies in Turkey, working conditions, crises conditions that coincide with the period of research, absence of perfect competition conditions markets in Turkey, some sectors in developing countries being at the end of product life cycle curve while being at point of entry in Turkey.

To see if related diversification-organizational performance relationship is different in Turkey and Belgium, Hypothesis 3 was suggested. According to results of Hypothesis 3 There is significant relationship between Turkey and Belgium. It means, the average organizational performance in Belgium is higher than in Turkey. It is considered that the business groups of Belgium prefer diversification focusing on the internal resources rather than environmental opportunities because of high averages and results similar to developed countries in the literature.

Within the framework of the results emerging from this study, the following recommendations are proposed to researchers and executives: Results of this research can stimulate new researches into;

- The same study can be carried out including more developed and developing countries. Also, some variables such as crisis conditions, agency problems, business growth, national income and trend rate of gross national product growth.
- The same studies can be carried out using only Entropy Index or both Rumelt's diversification measure and Entropy Index.

In order to separate related and unrelated diversification 2-digit SIC was used in this study. Another study where 3-digit is used for this separation can be carried out. Even there is a separation based on developing and developed countries in literature, it can be thought that this relationship can differ from country to country regarding changing environmental conditions.

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