

**DIVERSIFICATION STRATEGY AND PERFORMANCE
OF KENYAN COMMERCIAL STATE-OWNED
CORPORATIONS**

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DECLARATION

This research project is my original work and has not been presented for examination in any other institution.

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The research project has been submitted for the examination with my approval as University supervisor.

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DEDICATION

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ABSTRACT

The study focuses on the effects of diversification strategy on the performance of Kenyan Commercial state-owned corporations. It critically looks at whether or not these corporations use diversification strategy and then goes ahead to examine the relationship between diversification strategy and performance of the same corporations. The main areas explored include theories of diversification, types of diversification and organizational performance. To achieve this objective a cross-sectional survey study was conducted on 14 Kenyan commercial state-owned corporations including Kenya Meat Commission, Kenya Power and Lighting Company, Postal Corporation of Kenya, National Bank of Kenya and Kenya Reinsurance Corporation among others. Structured questionnaires were administered in the 14 selected Kenyan Commercial state-owned corporations. A sample of five employees from each selected state-owned corporation was interviewed resulting to total of 70 respondents. However, only 44 respondents filled and returned their questionnaires. Data was collected and the responses coded into labeled categories and thoroughly analyzed. Since this was a descriptive study, the data obtained was analyzed using statistical tools. Frequency distribution tables, mean scores and standard deviation were used to determine the relationship between diversification strategy and organizational performance in the Kenyan commercial state-owned corporations. The information was presented by use of tables and charts. According to the study, most of the organizations had been operating for more than ten years while most of the employees had worked for the same organization for more than six years. This means that the data collected was factual and credible for the study. This study revealed that diversification strategy has a positive relationship with performance in the Kenyan commercial state-owned corporations.

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CHAPTER ONE

INTRODUCTION

1.1 Background of the study

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. Organizations spend their resources to diversify with the main aim of improving their organizational performance. Organizational performance is defined as the actual output or results of an organization as measured against its intended outputs or goals and objectives. According to Richard et al. (2009) organizational performance encompasses three specific areas: (a) financial performance (b) product market performance and (c) shareholder return.

The fundamental theories of diversification include: Game theory, Resource based view and the dynamic capabilities theory. In the game theory two or more players (firms) have a range of actions or similar freedom to a set of choices, and also have certain information. Each player has a set of preferences for the diverse possible outcomes, and the results of the interaction depend on all the players' decisions. The dynamic capabilities theory posits that firms integrate, build, and reconfigure their internal and external firm-specific competencies into new competencies that match their turbulent environment.

The resource-based view argues that a company's growth is limited by opportunities that exist as a function of a set of the company's earning power. The theory's basic reasoning is that the type, amount and nature of an organization's resources should be considered first in selecting and establishing strategies that can lead to sustainable competitive advantage.

Kenyan state-owned commercial corporations 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 corporations are now having to not only keep abreast of these emerging local and global issues, but more importantly how to adapt to achieve growth.

In line with this situation, the corporations 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. This research will aim to take a critical look at the effects of diversification strategy on the performance of the Kenyan commercial state-owned corporations.

1.1.1 Concept of Diversification strategy

Traditionally, diversification refers to the involvement of a firm in markets (or industries) beyond the market (or industry) boundaries in which it originally belongs (Berry, 1975; Gort, 1962). However, Ramanujam and Varadarajan (1989, p. 525) in a review of the literature, concluded that diversification is 'the entry of a firm or a business unit into new

lines of activity, either by processes of internal business development or acquisition, which entail changes in its administrative structure, systems, and other management processes'. Diversification can also be seen as a business development strategy allowing a company to enter additional lines of business that are different from the current products, services and markets.

Diversification is one of the most dominant concepts in the economics, finance, strategic management and marketing disciplines. Diversification has been used to explain firms' economic performance, financial efficiency, market dominance and risk reduction. Although most of the available research focuses on large industrial firms, diversification seems to be important for other types of firms as well. For example, Nayyar (1990) demonstrated that diversification is equally important for service firms.

Diversification of business activities brings competitive advantages allowing companies to reduce or spread business risks. That is why it is a great tool for business development. However, its successful implementation requires profound knowledge and thorough preliminary assessment of the organization and its environment. Although sometimes diversification is difficult for some companies, it can prove to be inevitable when their original markets become unviable.

One of the main arguments of the diversification literature (Hoskinsson and Hitt, 1990; Ramanujam and Varadarajan, 1989) is that specialization (i.e. non-diversification or focus on the products of a single industry) or dependence on one industry (i.e. product

category) may mean reliance on the industry's cycle and volatility as well. Operating in several industries at the same time will reduce such effects and create stability in state corporations' performance. The possibility of two or three unrelated industries or products to concurrently follow the same seasonal, cyclical or irregular movement patterns is limited.

According to Porter (1980) an industry with a small number of suppliers (or buyers) or powerful suppliers (or buyers) will be less attractive and display lower levels of profitability than other industries. Firms within such industries, generally, have lower bargaining power towards suppliers or buyers and are more prone to make concessions towards them (such as price discounts or provision of extra cost-adding services) which subsequently reduce their profitability. However, a firm operating in multiple industries is less prone to give in to the demands of its suppliers or buyers.

Accordingly, a firm's viability does not rely entirely on a single industry, the firm will find it easier to resist demands from its suppliers or buyers and as a consequence the firm will attain higher levels of profitability. Based on the above arguments, Cho (1987) claimed that product-diversified enterprises are less vulnerable to the power of suppliers or buyers than product specialized ones and as a result enjoy higher levels of profitability. This argument has been favoured equally by Porter (1980).

1.1.2 Organizational Performance

Organizational performance is the actual output or results of an organization as measured against its intended outputs (or goals and objectives). According to Richard et al. (2009) organizational performance encompasses three specific areas of firm outcomes: (a) financial performance (profits, return on assets, return on investment), (b) product market performance (sales, market share, and (c) shareholder return. Specialists in many fields are concerned with organizational performance including strategic planners, operations, finance, legal, and organizational development.

In recent years, many organizations have attempted to manage organizational performance using the balanced scorecard methodology where performance is tracked and measured in multiple dimensions such as financial performance (shareholder return), customer service, social responsibility (corporate citizenship, community outreach) and employee stewardship.

1.1.3 Diversification Strategy and Organizational Performance

Several empirical studies have been conducted to explain the relationship between diversification and performance. For example, Rumelt (1982) was the first author that attempted to connect diversification with economic 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 the lack of managerial skills and resources. Pandya & Rao (1998) also concurred adding that, managerial and resource constraints is one of the causes of diseconomies of scope at higher diversification levels.

It is also emphasized by some researchers such as Datta et al. (1991), Murkherjee (1998), that past diversification strategy literature has failed to find a consensus on the relationship between diversification and organizational performance. The above argument is also supported by Palich et al. (2000), who 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.

1.1.4 Kenyan state-owned corporations

A state owned corporation or a state corporation is a legal entity established by the government to carry out activities on behalf of that government in line with the government's expectations and aspirations. In Kenya, each state corporation is responsible to a parent Ministry within the government, with the corporation being answerable to the Parent Ministry. The government, however, may issue guidelines from time to time defining further the role of a given state-owned corporation.

A Kenyan state-owned corporation is established by an act of parliament. Advice on the appointment, removal or transfer of officers and staff of State Corporations, the secondment of public officers to the state corporations and the terms and conditions of any appointment, removal, transfer or secondment is done by the State corporations Advisory Board. The State Corporations Advisory Board also carries out other oversight duties in relation to the State-owned corporations (State Corporations Act revised 2012)

1.1.5 Kenyan state-owned commercial corporations

A state-owned commercial corporation is a legal entity created by a government to undertake commercial activities on behalf of that government. Their legal status varies from being a part of government to stock companies with a state as a regular stockholder. The defining characteristic is that they have a distinct legal form and they are established to operate in commercial affairs. While they may also have public policy objectives, state-owned commercial corporations are different from other forms of government agencies or state entities established to pursue purely non-financial objectives.

Given that they engage in various commercial activities in different industries, it is difficult to generalize the state-owned corporations and their commercial projects or activities. Most of these corporations are in the industries that deal with essential commodities and services such as energy, telecommunication, health and transport among others. Apart from ensuring the provision of the said services, the state-owned corporations also make commercial gain and contribute to the funding of the exchequer.

1.2 Research Problem

Diversification strategy has been adopted by many state-owned corporations all over the world. Improvement in the organizational performance is the main objective of that strategic direction. Whether the corporations achieve their goal through diversification strategy begs an answer. A corporation having focused business strategy does not have any product diversification at all. Using diversification strategy implies having product portfolios containing different products within different industries.

Kenyan commercial state-owned corporations are composed of a board of directors empowered to carry out functions relating to the overall direction and management of the state corporation and a chief executive officer appointed and employed to exercise the executive powers of the state corporation. In addition, state corporations report to their line ministries through the permanent secretary of that ministry. This means that as much as the corporations are given the free will to engage in commercial activities, they are still bound by the bureaucracy of the government.

The rapid and often discontinuous change that is taking place in the business environment has a direct impact on the manner in which businesses are managed and even their performance. Managers are finding that old proven recipes for success and specialized routines are no longer effective and are of necessity adopting new approaches to managing their companies. These changes, both in the environment and in the organization also have an impact on the strategies the organizations adopt.

According to Montgomery (1994) a diversification explained by the resource view implies that the company has excess resources that can be profitably employed in other businesses, while the market power view implies that diversification strategies gain better market power compared to competitors. By gaining market power a state corporation having a large market share may be able to charge premium prices. Another approach to create value by gaining market power is the strategy of vertical integration. For these corporations it is possible to integrate the stages in the vertical supply chain, which includes production, packaging and distribution (Doyle, 2002).

Early studies (Levy & Sarnat, 1970) showed that, under acceptable assumptions about financial markets, there are no economic motives for diversification. Later studies however (Galai & Masulis, 1976), have shown that if one introduces some frictions into the financial markets such as bankruptcy costs and taxes, there may be financial motives. There exist many contradictory findings on diversification-performance relationship, mostly so due to different time frame, different measurements on diversification and performance (Sambharya, 1995).

Perhaps, unrelated diversification like Postal Corporation of Kenya's new innovation dubbed Posta Pesa may not increase their profitability but on the other hand increase their market power and dominance in Kenya. Among the state corporations, unrelated diversification or focused business strategies seem to provide the firms with a larger portion of revenues, more than for a related business diversification. However, an unrelated business strategy or focused strategy seem to decrease variables measuring management effectiveness or profitability while related diversification strategies pay off better on financial efficiency according to Jung (2003).

However, former research by Markham (1973) found that profitability of diversified firms is similar to profitability of undiversified firms. This contradiction from different researchers makes it interesting to test the impact of diversification strategy on the performance of Kenyan commercial state-owned corporations. Another reason to use diversification strategy has its base in portfolio theory.

Through diversification of products, it has been observed that portfolio risk will be reduced as fronted by the argument that one should not “put all eggs in one basket” (Evans & Archer, 1968). In cases where the future and attractiveness of the current industry is not certain, firms diversify to escape from undesirable or unattractive industry environments.

Several hypotheses in earlier research have predicted a positive association between diversification and firm profits. These have two implications (i) those predicting greater market power for diversified firms, and (ii) those hypothesising greater efficiency. Market power advantages might arise through the exploitation of an advantage of one market in some other market. Efficiency advantages can be claimed for diversified firms because they are able to avoid some of the imperfections of the capital market. Promising investment opportunities in one market can be funded by drawing capital away from other markets, without jeopardising the profitability of the investment by having to reveal its characteristics to raise capital. The study by Mueller (1986) has found a positive association between diversification and profits.

At the same time 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 (gospel truth) about the relationship between diversification and organizational performance. This research will therefore aim to answer the following two questions: 1) Do Kenyan commercial state-owned corporations use diversification strategy in their organizational management? 2) What is the impact of diversification strategy on the performance of the Kenyan commercial state-owned corporations?

1.3 Research Objective

The objective of this study was to examine how diversification strategy affects the performance of Kenyan commercial state-owned corporations.

1.4 Value of the Study

This study contributed to three main theories of Diversification strategy. These theories include the Game theory, Dynamic capabilities theory and the Resource based view. Generally, the research gave a complete in-depth analysis on diversification strategy and performance and supported hypotheses fronted by the above mentioned theories. The study contributed to strategic management as a body of knowledge by showing how various theories of diversification strategy come into play in organizational management.

The research study was very useful in analyzing the need to diversify. Practitioners and managers of corporations will be able to put into practice the findings of the study to make future decisions and to learn the areas that they have not dealt with properly in the past. Many organizations have faced serious challenges emanating from attempts to

invest in strategies without research inputs. This study will help organizations in their strategic planning in regards to Diversification strategy and organizational performance. It is indispensable to depend on researched works to guide the principles of the organization's investment.

Policy makers both from the Public and Private sector will be able to make use of the findings of this study. Research-based policy making is increasingly becoming popular and research findings are an important input for policy makers. Governments are particularly interested in research studies that relate to governmental activities. Well informed policies in terms of research data are more likely to achieve the desired goals than policies that lack any research backing. This study is a blue print reference material for policy-making purposes.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter aims to evaluate the critical points of current knowledge including substantive findings, as well as theoretical and methodological contributions in relation to Diversification strategy and organizational performance.

2.2 Theoretical Foundation

Diversification strategy represents one of the most important lines of research in the field of strategic management (Hoskisson & Hitt, 1990; Wan, Hoskisson, Short, & Yiu, 2010). Following Rumelt (1974)'s seminal work, several strategic management scholars were attracted to the study of corporate diversification strategy as a gateway to understanding variance in firm growth and performance, spawning a large array of subsequent studies (Miller, 2006; Palich, Cardinal, & Miller, 2000; Piscitello, 2004).

A great majority focused on investigating the differential effects of related and unrelated diversification on firm performance (Hoskisson & Hitt, 1990; Markides, 1995; Miller, 2006; Palepu, 1985; Robins & Wiersema, 1995). Diversification strategy's proponents argue that it should reduce the total risk of earnings variability, yield increasing growth and profit, accelerate adaptation to environmental change, and allow for economies of scale in general management expertise and R&D to materialize. By extension, diversification in all its forms should induce higher financial performance compared to the conservative single-business.

Another key argument in support of the multi-business firm is that it can realize positive synergies (between businesses) that can produce super-additive value and sub-additive costs that jointly induce improved financial performance (Tanriverdi&Venkatraman, 2005). An important source of such a synergy is the resource relatedness – the existence of similar activities, knowledge, and shared resources – across constituent businesses (Farjoun, 1998; Markides& Williamson, 1994; Robins &Wiersema, 1995). Use of these resources within the same industry entails minimal costs and likely substantial benefits, thus casting support on strategies of diversification than single-business firms.

From the very early studies on the matter, performance differences among different companies were associated more closely with the way new businesses were related to existing ones than the overall diversity of the corporation. For instance, Rumelt (1974) found that Related-Constraint and Dominant-Constraint firms were the best performers. Both types reflected the pursuance of business activities that related to and could derive strength from products, skills, or market characteristics that were common to all businesses within the firm (Rumelt, 1974).

Moreover, the complementary nature of independent but mutually supportive related resources further advocates the super-additive value synergies that can be captured through resource combinations (Tanriverdi&Venkatraman, 2005). The use of related resources in discrete or complementary combinations has been posited as a prime

inducement for growth (Penrose, 1959) and has largely rendered related diversification the dominant mode of organizational expansion (Wan *et al.*, 2010).

In agreement with the early studies on diversification, recent studies find related diversification to achieve superior performance than unrelated diversification (Palepu, 1985; Palich *et al.*, 2000; Rumelt, 1974; Tanriverdi & Venkatraman, 2005).

Nevertheless, empirical evidence unveils that organizations diversify more broadly than envisaged by the relatedness arguments (Argyres, 1996; Mayer & Whittington, 2003) and often achieve premium performance (Campa & Kedia, 2002; Chatterjee & Wernerfelt, 1991; Khanna & Palepu, 2000; Villalonga, 2004). For example, between 1949-1969, Rumelt (1974)'s study period, the prevalence of major US industrial companies with a previously narrow product-market scope gradually moved into more unrelated businesses.

The overarching logics behind diversification are grounded in that in conditions of market failure the firm has increasing incentives to expand into unrelated businesses with the expectation that the deliberate formation of an "internal capital market" will constitute a more efficient environment for resource and knowledge allocation than the external capital market (Chatterjee & Wernerfelt, 1991; Hill, Hitt, & Hoskisson, 1992). Hence, the Resource Based Theory (RBT)'s rationale of relatedness-induced synergies and path dependence (Barney, 1991; Wernerfelt, 1984) is too narrowly defined to account for such behaviors and loses its explanatory power in circumstances of market failure (Eisenhardt & Martin, 2000; Ng, 2007).

Proponents of Diversification strategy draw their arguments from a number of theories:

Game theory can be defined as part of a large body of theories providing a formal language to describe conscious, goal-oriented, decision making processes involving one or more players. The solution concepts derived from game-theory may be thought of as normative or descriptive views of multi-person decision-making (Shubik 1972). Game theory may also be described as the analysis of rational behavior in situations involving interdependence of outcomes (Camerer 1991).

The essence of game theory models are two or more players (firms) who have a range of actions or similar freedom to a set of choices, and also have certain information. Each player has a set of preferences for the diverse possible outcomes, and the results of the interaction depend on all the players' decisions. Put another way, game theory models have six common features: conflicting parties, choices, information, desired outcomes, results of choices and outcomes dependent on choices of all participants (Martin 1978). Game theory provides a set of tools and components that may be used to develop logically consistent models of rational human behavior. These models allow researchers to discount explanations of behavior where people act against their own objectives, neglect opportunities, or ignore strategic behavior of other parties (Postrel 1991).

Dynamic capabilities theory examines how firms integrate, build, and reconfigure their internal and external firm-specific competencies into new competencies that match their turbulent environment (Teece, Pisano, & Shuen, 1997). The theory assumes that firms with greater dynamic capabilities will outperform firms with smaller dynamic

capabilities. The aim of the theory is to understand how firms use dynamic capabilities to create and sustain a competitive advantage over other firms by responding to and creating environmental changes (Teece, 2007). Winners in the global marketplace have been firms demonstrating timely responsiveness, flexibility and rapid product innovation, along with the management capability to effectively coordinate and redeploy internal and external competences.

Dynamic capabilities are called “first-order” capabilities because they refer to intentionally changing the product, the production process, the scale, or the markets served by a firm (Winter, 2003). An organization has dynamic capabilities when it can integrate, build, and reconfigure its internal and external firm-specific capabilities in response to its changing environment. For example, whereas organizational capabilities have to do with efficient exploitation of existing resources, dynamic capabilities refer to efficient exploration and implementation of new opportunities (March, 1991).

A firm has a capability if it has some minimal ability to perform a task, regardless of whether or not that task is performed well or poorly (Helfat et al., 2007). A firm does not actually have to use a capability in order for it to have that capability. However, on average, firms have to use their capabilities in order to sustain their ability to use them. In other words, there is a “use it or lose it” assumption about a firm’s capabilities over time (Helfat & Peteraf, 2009).

According to Helfat et al. (2007), a dynamic capability is “the capacity of an organization to purposefully create, extend, and modify its resource base” (p. 4). The resource base of an organization includes its physical, human, and organizational assets (Eisenhardt &

Martin, 2000). Dynamic capabilities are learned and stable patterns of behavior through which a firm systematically generates and modifies its way of doing things, so that it can become more effective (Macher & Mowery, 2009; Zollo & Winter, 2002). For example, operating routines develop from the accumulation of experience through the repeated execution of similar tasks over time (Argote, 1999).

Diversification strategy would make firms integrate, build, and reconfigure their internal and external firm-specific competencies into new competencies that match their turbulent environment (Penrose, 1959). Resource-based theory or resource-based view of firms is based on the concept of economic rent and the view of the company as a collection of capabilities. The resource-based perspective highlights the need for a fit between the external market context in which a company operates and its internal capabilities.

This theory is grounded in the perspective that a firm's internal environment, in terms of its resources and capabilities, is more critical to the determination of strategic action than is the external environment. When a firm has underused resources that can be profitably employed, it also has an incentive to expand (Penrose, 1959). Instead of focusing on the accumulation of resources necessary to implement the strategy dictated by conditions and constraints in the external environment, the resource-based view suggests that a firm's unique resources and capabilities provide the basis for a strategy.

2.3 Types of diversification strategies

Diversification is a strategic approach adopting different forms. Depending on the applied criteria, there are different classifications. Depending on the direction of company diversification, the different types are: Horizontal Diversification is acquiring or

developing new products or offering new services that could appeal to the company's current customer groups (Lynch, 2003; Macmillan et al, 2000). 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.

Vertical diversification occurs when the company goes back to previous stages of its production cycle or moves forward to subsequent stages of the same cycle - production of raw materials or distribution of the final product (Ansoff, 1957). For example, if you have a company that does reconstruction of houses and offices and you start selling paints and other construction materials for use in this business. This kind of diversification may also guarantee a regular supply of materials with better quality and lower prices.

Concentric Diversification is enlarging the production portfolio by adding new products to fully utilize the potential of the existing technologies and marketing system (Ansoff, 1957). The concentric diversification can be a lot more financially efficient as a strategy, since the business may benefit from some synergies in this diversification model. It may enforce some investments related to modernizing or upgrading the existing processes or systems. This type of diversification is often used by small producers of consumer goods, for example a bakery producing pastries or dough products.

Heterogeneous (conglomerate) diversification is moving to new products or services that have no technological or commercial relation with current products, equipment, distribution channels, but which may appeal to new groups of customers. (Ansoff, 1957)

The major motive behind this kind of diversification is the high return on investments in the new industry. Furthermore, the decision to go for this kind of diversification can lead to additional opportunities indirectly related to further developing the main company business - access to new technologies, opportunities for strategic partnerships.

2.4 Organizational Performance measurement

Organizational performance is the actual output or results of an organization measured against its intended outputs. Organizational performance has been one of the most extensively researched issues since the early development of organizational theory (Rojas 2000). 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.

Since the corporations in the sample belong to different industries, which have different depreciation and tax schedules, the gross measure of profitability is taken. These measures are scaled by the total assets to give the profitability measure of return on total assets. The value is then adjusted for the benchmark value of industry profitability. The benchmark value of return computes the returns over the assets had the corporation operated in the respective industries as single segment firms. Thus, this measure represents the excess returns over total assets available with the corporation. The difference in the level of excess profitability between different corporations can be attributed to the type of industries in which the corporation is operating.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The research methodology requires gathering relevant materials from the specified sources and compiling them in order to analyze the data obtained. The purpose is to arrive at a complete understanding of the relationship between diversification strategy and organizational performance by taking a critical look at the Kenyan state-owned commercial corporations.

3.2 Research design

A cross-sectional survey of fourteen Kenyan state-owned corporations was used to establish the relationship between diversification strategy and organizational performance in the corporations. Research design is considered as a "blueprint" for research, dealing with at least four problems: which questions to study, which data are relevant, what data to collect, and how to analyze the results.

Research design can be divided into fixed and flexible research designs (Robson, 1993). The research design was a cross-sectional survey study. The objective of this study was to establish effects of diversification strategy on performance of Kenyan state-owned corporations. Cross-sectional survey research involves the use of structured questionnaires and/or statistical surveys to gather data about people and their thoughts and behavior (Cooper, 2001).

3.3 Population of the study

The population of the study included all Kenyan commercial state-owned corporations. At this stage, the entire lot of Kenyan state-owned corporations, whether commercial or non-commercial were included. This population also cut across all corporations regardless of the industries within which they operate. In this regard, 146 Kenyan state-owned corporations formed the population of the study for this research.

A research population is generally a large collection of individuals or objects that is the main focus of a scientific query. It is for the benefit of the population that researches are done. However, due to the large sizes of populations, researchers often cannot test every individual in the population because it is too expensive and time-consuming.

3.4 Sampling design

Sampling is a method of selecting experimental units from a population so that we can make decision about the population. In Kenya we have about 146 state-owned corporations that have been listed. These corporations are mixed; some of them are commercial while others are not. For the purpose of this research, out of the 146 state corporations purposive sampling method was used to select 14 Kenyan state-owned corporations that were considered commercial in their operations. This method ensured ensure that we get the relevant sample that gave data that was relevant to this study.

This sampling method was based on the fact that not all Kenyan state-owned corporations are commercial. Five senior employees were interviewed from each chosen Kenyan

commercial state-owned corporation. This gave a number of 70 respondents. This sample size was considered to be large enough, reflective and representative of the whole population while at the same time being time and cost effective. Larger samples are normally more preferred but they pose other challenges when carrying out the research.

3.5 Data collection

Data collection is the process of gathering information about a phenomenon using data collection instruments (Saharan, 2000). Both primary and secondary sources of data were used to obtain information about the study. Secondary data was obtained from the organizations' strategic plans, policies, business development plans, firms' websites, press releases, magazines and brochures. Primary data was collected using semi-structured questionnaires. The questionnaires were divided into three parts.

Part one of the questionnaires dealt with background information of the respondent, part two dealt with diversification strategies and part three dealt with the impact of diversification strategy on performance of Kenyan commercial state-owned corporations. The questionnaires were administered by trained research assistants to 70 respondents who were drawn from top and middle managers including the Chief Executive Officers, Deputy Chief Executive officers, Human Resource Managers, Finance Managers, Marketing Managers and other heads of departments because they form the team of decision makers in the organization.

3.6 Data Analysis

Descriptive statistics was used and measures of central tendency such as mean, median and mode were also employed. Measures of variability including the standard deviation or variance, the minimum and maximum values of the variables, kurtosis and skewness were used to analyse the data. Descriptive statistics was preferred in this research because it provided simple summaries about the sample and about the observations that were made. The results were then presented in form of charts, graphs and tables.

Analysis of data is a process of inspecting, cleaning, transforming, and modelling data with the goal of discovering useful information, suggesting conclusions, and supporting decision making. Summarizing data is often critical to supporting arguments made with that data. At the same time presenting the data in a clear and understandable way is most important for the whole research to have useful meaning. For that matter, the data was thoroughly checked for completeness and consistency.

CHAPTER FOUR

DATA ANALYSIS, INTERPRETATION AND DISCUSSION

4.1 Introduction

This section presents the research findings and discussions. The findings in this chapter were analyzed in accordance with the objective of the study which is to examine how diversification strategy affects the performance of Kenyan commercial state owned corporations. A total of 70 questionnaires were issued to the respondents however only 44 were fully completed and returned for analysis. The response rate for this study was 63%.

4.2 Organization Profile

The company profile detailed the nature of the company under study and the number of years the company has been in operation. This helped the researcher to understand the effects of diversification strategy on the performance of the Kenyan state owned corporations.

Table 1: Years in Operation

Years in operation			
Years	Frequency	Percentage (%)	Cumulative %
1 to 3	0	0.00%	0
3 to 6	2	14.29%	14.29%
6 to 12	2	14.29%	28.57%
> 12 Years	10	71.43%	100.00%
Total	14	100.00%	

Years in operations shows the duration the company has been carrying out its business activities. Most companies gain business experience depending on the number of years they have operated in the market. This is the experience that will enable them to employ the diversification strategy in the best way to improve their performance.

As indicated in the table 1 above, 71.43% of companies are more than 12 years and this indicates that the industry is composed of companies which have gone through several business cycles of operation and management styles. 14.29% of companies are less than six years in operation in this industry. This shows that the level of new entrants as state corporations is low.

4.3 Diversification Strategy

Table 2: Product or Service range per organization

Organization deal with more than one product or service			
	Frequency	Percentage	Cumulative %
Totally Agree	35	79.5%	79.5%
Somewhat agree	6	13.6%	93.2%
Somewhat Disagree	1	2.3%	95.5%
Totally Disagree	2	4.5%	100.0%
Total	44	100.0%	

The respondents were asked to indicate if their organization deals with more than one product or service. This is a form of vertical diversification. As indicated in table 2 above, 79.5 % of organizations deals with more than one products or service .Only 4.5% of the organizations don't deal with more than one product or service. This means that more of the state owned commercial corporations have embraced diversification strategy.

Table 3: New products or Services for existing customer groups

Organization have developed new products or service			
	Frequency	Percentage	Cumulative %
Totally Agree	31	70.5%	70.5%
Somewhat agree	11	25.0%	95.5%
Somewhat Disagree	0	0.0%	95.5%
Totally Disagree	2	4.5%	100.0%
Total	44	100.0%	

The respondents were asked to indicate if their organization had developed new products or services that appealed to the existing customer groups. As shown on the table above, 70.5 % of the respondents confirmed that their organizations had indeed developed new products or services that appealed to their existing customers. The findings here therefore show that Horizontal Diversification is being used as a strategy by the organizations sampled.

Horizontal Diversification is whereby an organization acquires or develops new products or offers new services that could appeal to the company's current customer groups (Lynch, 2003; Macmillan et al, 2000). In this case the company relies on sales and technological relations to the existing product lines and takes advantage of the already available customers.

Table 4: Production of New products to fully utilize the potential of existing technology

New products fully utilize the existing technological potential			
	Frequency	Percentage	Cumulative %
Totally Agree	22	50.0%	50.0%
Somewhat agree	14	31.8%	81.8%
Somewhat Disagree	7	15.9%	97.7%
Totally Disagree	1	2.3%	100.0%
Total	44	100.0%	

The respondents were asked to indicate whether the organizations they are working with produces new products to fully utilize the potential of existing technology. As indicated in table 4 above, 50.0 % of the respondents agree to the utilizations of new technologies through production of new products. This kind of diversification is called Concentric and it means enlarging the production portfolio by adding new products to fully utilize the potential of the existing technologies and marketing system (Ansoff, 1957).

Concentric diversification can be a lot more financially efficient as a strategy, since the business may benefit from some synergies in this diversification model. It may enforce some investments related to modernizing or upgrading the existing processes or systems. 2.3 % of the respondents totally disagree on the utilization of the new technologies to coming up with new products. This means that some organization have not adopted the new technology to improve on new product developments.

Table 5: Expansion to other geographical markets by organizations

Organization has expanded the market to other regions			
	Frequency	Percentage	Cumulative %
Totally Agree	17	38.6%	38.6%
Somewhat agree	19	43.2%	81.8%
Somewhat Disagree	7	15.9%	97.7%
Totally Disagree	1	2.3%	100.0%
Total	44	100.0%	

The respondents were asked to whether the organizations they are working with have expanded their geographical markets to other regions or countries other than their original ones. 38.6% of the respondents totally agreed with that as indicated in the figure 4 above.

Table 6: Dealing with unrelated but profitable products or services by Organizations

organization deals with unrelated products or services which are profitable			
	Frequency	Percentage	Cumulative %
Totally Agree	15	34.1%	34.1%
Somewhat agree	13	29.5%	63.6%
Somewhat Disagree	15	34.1%	97.7%
Totally Disagree	1	2.3%	100.0%
Total	44	100.0%	

The respondents were asked to whether the organizations they are working with have expanded its geographical market to other regions or countries other than its original market. 50% of the respondents totally agree with that.

4.4 Diversification strategy and performance

Table 7: The effect of diversification strategy on performance

	New products have improved profitability		New products fully utilize the technological potential		New markets have increased revenue		New products have reduced losses		New products have improved return on assets	
	Freq	% freq	Freq	%freq	Freq	% freq	Freq	%freq	Freq	%freq
Very large extent	23	52.27%	8	18.18%	14	31.82%	9	20.45%	13	29.55%
large extent	10	22.73%	21	47.73%	17	38.64%	16	36.36%	18	40.91%
moderate extent	8	18.18%	10	22.73%	5	11.36%	12	27.27%	9	20.45%
little extent	3	6.82%	5	11.36%	4	9.09%	4	9.09%	3	6.82%
Not at all	0	0.00%	0	0.00%	4	9.09%	3	6.82%	1	2.27%
Total	44	100.0%	44	100.0%	44	100.00%	44	100.0%	44	100.0%

The respondents were asked to indicate to what extent the new products have improved the profitability of their organizations. 52.27% of the respondents indicated that new

products improves profitability to very large extent and 22.73% indicated that the new products improves profitability to large extent as shown on the table above. This is a clear indication that the new products have a great improvement on profitability which is a measure of performance in an organization.

Organizational performance has been one of the most extensively researched issues since the early development of organizational theory (Rojas 2000). 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. From this research the new products development which is a diversification strategy improves the performance of an organization.

The new products utilize the technological potential to a large extent of 47.73% as per the indication on table 7 above. The new products have led to reduction of losses by 20.45% .This means the performance of the organizations has improved through the reduction of the losses. The new products have improved return on assets. As indicated in the table 7 above, the new products have improved the return on assets to a very large extent of 29.55% and to a large extent of 40.91%. In any organization, the benchmark value of return computes the returns over the assets.

4.5 Discussion

From this study, virtually all the Kenyan Commercial State-owned corporations engage in some form of diversification strategy. It is also evident from the findings that diversification strategy has improved the performance of the corporations. These results are in agreement with some of the earlier studies which indicate that diversification strategy has several benefits to the firm.

Lewellen (1971) suggests that in the presence of capital market imperfections, diversified firms have a lower probability of bankruptcy than focused firms due to imperfectly correlated cash flows between their divisions. Mansi and Reeb (2002) also show that corporate diversification has a risk reducing effect. Managers may attempt to diversify the firm in order to increase a firm's debt capacity by exploiting the coinsurance effect.

This observation is also consistent with the findings of Ibrahim and Kaka (2007) that the majority of firms in the United Kingdom favoured diversification. However, Teo and Runeson (2001) found that substantial proportions of firms in the United States of America are not prepared to diversify; rather, they elect to operate in one market only, despite the advantages of diversification. This phenomenon could be attributed to the fact that some of the diversified firms adopted the strategy as a short term survival plan during periods of low demand rather than as a long-term growth strategy.

Finally, Fluck and Lynch (1999) found that diversified firms may be able to finance positive net present value projects that cannot be financed on stand-alone basis in a period of distress. Therefore, it is likely that diversified firms may be more likely to undertake positive net present value projects, thereby creating more growth. Khanna and Tice (2001) further found that internal capital markets function well for diversified firms as they transfer resources away from troubled divisions. The effect of all these benefits should all be reflected in the operating performance of the organizations.

The results from the study above have clearly revealed that the Kenyan commercial state-owned corporations indeed use diversification strategy as a tool of survival in the turbulent and unpredictable business environment. It is also clear that there is a positive relationship between diversification strategy and performance in these corporations. This observation is consistent with strategic management theories of economies of scale and synergies resulting from diversification. Essentially, the theories posit that a firm may achieve benefit from diversification through the sharing of activities or leveraging of competencies among its business units (Christensen and Montgomery, 1981; Palepu, 1985; Hamilton and Shergill, 1993; Palich et al., 2000).

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the study findings where the main objective was to examine how diversification strategy affects the performance of Kenyan commercial state-owned corporations. Conclusion and recommendations are also discussed in this chapter plus the limitation of the study and the suggestions for further study.

5.2 Summary

From the data analysis, it is clear that majority of Kenyan state owned corporations have been in operation for more than 12 years. These companies have a wide experience in this sector. It is only 14.29 % of state owned corporations that have operated in less than 6 years.

From the results of this study it is evident that diversification strategy has improved performance in Kenyan state owned commercial corporations. There is a major boost in the revenues to these corporations from the introduction of new unrelated products by utilization of the existing technological capacity. The expansion of geographical markets to other regions and countries has also had its own impact on the performance of the featured corporations.

5.3 Conclusion

The finding of this study has shed light on the main effect of diversification strategy on performance of Kenyan commercial state-owned corporations. It has established that there is a positive relationship between diversification strategy and performance of the Kenyan commercial state-owned corporations. Organizations should therefore employ the diversification strategies so that they can improve their performance. The objective of this study was achieved as shown from the findings.

The effect of diversification strategy on the performance Kenyan commercial state-owned corporations has been determined. The study has also established that several types of diversification have positive relationship with performance. However the relationships vary from one type of diversification to another. The theories that say that diversification strategy improves performance of organizations have been supported by the findings of this study.

5.4 Limitation of the Study

Limitation of this study was the unwillingness of some respondents to fill the questionnaires in full. They felt that some of the questions in the questionnaire demanded confidential information of the company which they were not ready to reveal. A number of respondents also declined to answer questions that were likely to reveal their identities such as name of the organization and designation. Other respondents delayed in completing the questionnaires while others did not return their questionnaires.

5.5 Recommendations

This study found out that diversification strategy has a positive effect on the performance of Kenyan commercial state-owned corporations. It is therefore recommended that authorities in the corporations that wish to go commercial should embrace diversification strategy to enhance their performance. Similarly, the government should create an enabling environment for the state corporations to diversify. This should be done through favourable legislation such as removal of barriers to entry into other industries by the state-owned corporations.

Due to the stiff competition between the commercial state-owned corporations and those in the private sector, it is recommended that even those corporations in the private sector should use diversification strategy so that the competition remains healthy and the entire industry grows. Organizations should invest in new product development and also in market research so that they can improve their revenue base.

5.6 Area for Further Study

This study concentrated on the effect of diversification strategy on Kenyan commercial state-owned corporations. Since diversification is a strategy that is also practiced by other organizations in the private sector, another study should be carried out to determine the effect of diversification strategy on small and medium enterprises in Kenya. For example, Nayyar (1990) demonstrated that diversification is equally important for service firms.

5.7 Implication on Policy, Theory and Practice

Government and organizational policies can have a huge impact on whether or not the state-owned corporations will succeed under diversification strategy. A company engaged in introducing a new product into the market should first ensure they have adequate access to distribution channels within the targeted market. Such channels can sometimes be hampered by government policies. Michael Porter (1980) argued that the more limited the wholesale or retail channels for a product are, obviously the tougher entry into the industry will be.

Government can limit or even foreclose entry into industries with such controls as licensing requirements and limits on access to raw materials," confirmed Porter (1980), who added that regulatory controls on air and water pollution standards and product safety and efficacy should also be weighed. Government controls, policies and bureaucracies can give competitors advantage over the government owned corporations. For example, long and winded procedures can give notice to the private corporations to prepare retaliatory actions by the time a state-owned corporation diversifies.

The modern business environment is rapidly changing and businesses are finding it increasingly difficult to retain or expand their market share and maintain their competitive advantage. The competition is becoming very steep, as a result of this; Kenyan commercial state-owned corporations are using diversification strategy to remain competitive.

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APPENDICES

Appendix I: Questionnaire

Please give answers in the spaces provided and tick in the broken circles () that match your response to the questions where applicable.

Section A: Person and organization profile

1. Name.....Designation
2. Name of the organization
3. Organization sector.....Organization address
4. Number of years the organization has been in existence?
1 – 3 years() 3 – 6 years() 6 – 12 years() More than 12 years()

5. For how long have you been employed in this organization?

0-2 years() 2-4 years() 4 – 6 years() 6 – 10 years() More than 10 years()

Section B: Diversification Strategy

6. The organization deals in more than one product or service.

Totally agree ()

Somewhat agree ()

Somewhat disagree ()

Totally disagree ()

7. The organization has developed new products or services that appeal to its existing customer groups

Totally agree ()

Somewhat agree ()

Somewhat disagree ()

Totally disagree ()

8. The organization is producing new products to fully utilize the potential of the existing tecl capacity

Totally agree ()

Somewhat agree ()

Somewhat disagree ()

Totally disagree ()

9. The organization has expanded its geographical market to other regions or countries oth original market.

Totally agree ()

Somewhat agree ()

Somewhat disagree ()

Totally disagree ()

10. The organization deals in unrelated but profitable products or services

Totally agree ()

Somewhat agree ()

Somewhat disagree ()

Totally disagree ()

Section C: Diversification Strategy and performance

11. To what extent do the following statements apply to your organization? Please tick.

Statements relating to the organization	Very large extent	Large extent	Moderate extent	Little extent	Not at all
New products have improved profitability					
New products fully utilize the technological potential					
New markets have increased revenue					
New products have reduced losses					
New products have improved Return on assets					

Appendix II: Introductory Letter

Rakki Manasseh Asman
School of Business,
University of Nairobi,
P.O Box 30197,
NAIROBI.

October, 2013.

Dear Respondent,

RE: PARTICIPATION IN ACADEMIC RESEARCH.

I am a postgraduate student at the University of Nairobi, School of Business pursuing a master's degree in Business Administration. I am undertaking a research project on Diversification strategy and performance of Kenyan Commercial State Corporations. You have been selected to form part of this research. This letter is to request you to participate in this study by responding to all the items on the attached questionnaire to reflect your opinion and experience.

Kindly note that you will remain anonymous throughout the research process and the information and data you provide will be used for academic purposes only. Your participation is critical for the success of this project and your cooperation will be highly appreciated.

Yours faithfully,

Rakki Manasseh Asman

Appendix III: List of State-owned corporations in Kenya

Categories

- (I) Banks
- (II) Financial and Insurance
- (III) Development Authorities and Corporations
- (IV) Processing and Training
- (V) Research and Educational
- (VI) Regulatory/Advisory Organizations
- (VII) Miscellaneous/Consultative Professional/Advisory
- (VIII) Countrywide Co-operatives and Companies where there is interaction between co-operatives, Government and State-owned corporations

Categories of State-owned corporations in Kenya

Category I: BANKS

1. Central Bank
2. Consolidated bank of Kenya
3. National Bank of Kenya
4. Cooperative Bank of Kenya
5. Kenya Post Office Savings Bank

Category II: FINANCIAL AND INSURANCE

6. Industrial Development Bank

7. Agricultural Finance Corporation
8. Kenya National Assurance Company
9. Kenya Re-insurance Corporation

Category III: DEVELOPMENT AUTHORITIES AND CORPORATIONS

10. Industrial and Commercial Development Corp.
11. National Housing Corporation
12. National Construction Corporation
13. Tana River Development Authority
14. Kerio Valley Development Authority
15. Lake Basin Development Authority
16. Agricultural Development Corporation
17. Kenya Railways Corporation
18. Kenya Ports Authority
19. Kenya Posts and Telecommunications Corp.
20. Kenya Airways Ltd.
21. National Irrigation Board
22. Kenya Tourist Development Corp.
23. Kenya Pipeline Co.
24. Kenya Industrial Estates
25. Pyrethrum Board of Kenya
26. Kenya Tea Development Authority
27. Mombasa Pipeline Board

Category IV: PROCESSING AND TRAINING ORGANIZATIONS

28. Kenya Meat Commission
29. Cotton Lint and Seed Marketing Board
30. National Cereals and Produce Board
31. Kenya National Trading Corporation
32. Kenatco
33. Coffee Board of Kenya
34. Kenya Cargo Handling Services
35. Kenya Film Corporation Ltd.
36. National Agricultural Chemicals and Fertilizers Ltd.

Category V: RESEARCH AND EDUCATIONAL ORGANIZATIONS

37. National Council for Science and Technology
38. Kenya Agricultural Research Institute
39. Kenya Industrial Research and Development Institute
40. Kenya Marine and Fisheries Research Institute
41. Kenya Medical Research Institute
42. Kenya Trypanosomiasis Research Institute
43. Egerton College Board of Governors
44. Catering Levy Trustees (Kenya Utalii College)
45. Coffee Research Foundation
46. Tea Research Foundation
47. Council of Legal Education

- 48. Council of the University of Nairobi
- 49. Kenya National Library Services

Category VI: REGULATORY/ADVISORY ORGANIZATIONS

- 50. Kenya Bureau of Standards
- 51. Kenya Dairy Board
- 52. Pig Industry Board
- 53. Water Apportionment Board
- 54. Transport Licensing Board
- 55. Betting Control and Licensing Board
- 56. Horticultural Crops Development Authority
- 57. Canning Crops Board
- 58. Civil Aviation Board
- 59. Sisal Board of Kenya
- 60. Tea Board of Kenya
- 61. Kenya Sugar Authority

Category VII:

**MISCELLANEOUS/CONSULTATIVE/PROFESSIONAL/ADVISORY
ORGANIZATIONS**

- 62. Central Agricultural Board
- 63. Tana Catchment Board
- 64. Rift Valley Catchment Board

65. Athi Catchment Board
66. Northern Ewaso Nyiro Catchment Board
67. Lake Victoria (North) Catchment Board
68. Lake Victoria (South) Catchment Board
69. Divisional Land Control Boards
70. Provincial Land Control Appeals Board
71. Central Land Control Appeals Board
72. Military Council
73. Defence Council
74. College of Arms
75. Wakf Commissioners
76. Settlement Fund Trustees
77. Board of Trustees of the National Museum
78. Kenya Board of Censors
79. Disciplinary Committee (Advocates)
80. Board of Estate Duty Commissioners
81. Bankrupt Contingency Fund Board
82. The Board of Review
83. The Insurance Advisory Board
84. Kenya National Council of Social Service
85. Adult Education Board
86. External Trade Authority
87. Gold Mines Development Loans Board

88. Board of Trustees of Kenya National Parks
89. Wildlife Fund Trustees
90. Wildlife Conservation and Management Service Appeal Tribunal
91. Fish Industry Advisory Councils
92. Kenya Accountants and Secretaries National Examination Board
93. Institute of Certified Accountants
94. Registration of Accountants Board
95. Kenya Polytechnic Board
96. Mombasa Technical Institute Board
97. The Higher Education Management Board
98. Schools Boards of Governors
99. Teachers Service Commission
100. Teachers Service Commission Appeal Tribunal
101. Teachers Service Commission Remuneration Committee
102. Asiatic Widows and Orphans Pension Board
103. Asiatic Officers Family Pension Board
104. Labor Advisory Board
105. The Industrial Court
106. National Industrial Training Council
107. National Society Security Council
108. Wages Advisory Board
109. Central Board of Health
110. Radiation Board of Kenya

111. Pharmacy and Poisons Board
112. Council of Kenya Society for the Blind
113. Medical Practitioners and Dentists Board
114. Public Health Standards Board
115. Council of the Kenya Red Cross Society
116. National Hospital Insurance Advisory Council
117. Nurses, Midwives, and Health Visitors Council
118. Veterinary Surgeons Board
119. District Road Board
120. The Road Authority
121. Central Road Authority
122. Hotels and Restaurants Authority
113. Catering Levy Trustees
124. Board of Registration of Architects and Quantity Surveyors
125. Engineers Registration Board
126. Weights and Measures Board
127. Provincial Agricultural Boards
128. District Agricultural Committees
129. Landlord and Tenant (shops, hotels, and catering establishments) Tribunal
130. Trade Development Joint Loans Board
131. Electricity Licensing Board
132. The Power Board
133. Water Resource Authority

134. MacMillan Library -Board of Trustees
135. The Kenya Cultural Centre Council
136. The Kenya Scouts Council
137. Kenya Girl Guides Association
138. Local Government Loans Authority
139. Local Government Officers Superannuation Fund
140. Local Government Service Commission
141. Local Authorities Provident Fund Board

**Category VIII: COUNTRY-WIDE CO-OPERATIVES AND COMPANIES
WHERE THERE IS INTERACTION BETWEEN THE CO-OPERATIVES, THE
GOVERNMENT, AND STATE-OWNED CORPORATIONS**

142. Kenya Farmers Association
143. Kenya Planters Cooperative Union
144. Uplands Bazon Factory
145. Horticultural Cooperative Union
146. New Kenya Cooperative Creameries Ltd.

Source:

Office of public communication 2010

<http://www.publicservicecommission.go.ke>

Performance Evaluation Report for Year 2010/2011