TÉKHNE - Review of Applied Management Studies (2013) **11**, 76–82

Tékhne

www.elsevier.pt/tekhne

ARTICLE

An assessment of the diversification–performance linkage: An empirical comparison between Turkish and Italian firms

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Received 12 February 2013; accepted 3 October 2013
Available online 8 November 2013

KEYWORDS
Diversification strategy;
Rumelt's diversification measure;
Organizational performance;
Emerging market;
Emerged market

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 Italy. Diversification strategy and organizational performance relationship seem to differ across the developed and developing countries under stable conditions. The research aimed to identify the effect of institutional diversification on organizational performance was carried out on the businesses in Turkey and Italy. The data of 418 business groups in Italy and 128 business groups in Turkey were analyzed. The data of 2007–2011 were used in the research. According to the results of the study, when organizational performance values are high for single businesses and unrelated diversification in Turkey, organizational performance is high for dominant businesses and related diversification in Italy. Accordingly, organizational performance is increased by environmental factors in Turkey and by internal factors in Italy.

1. Introduction

Corporate diversification has remained an important strategy for many firms worldwide for the last half century. It may not be considered as just a trend; rather it is based on logical reasons. These reasons include increased profitability, reduction in risk, increased market share, increased debt capacity, higher growth, extension of business life cycle, and efficient utilization of human and financial resources. Many writers proved diversification to be a successful strategy in their studies but still a number of researches are having different views (Afza, Slahudin, & Nazir, 2008). Palich, Cardinal, and Miller (2000) suggested that there has been inconsistency in the findings of the diversification–performance research for more than 30 years and there is a lack of consensus. Some of empirical findings were either a positive relationship with economic performance (Pandaya & Rao, 1998; Piscitello, 2004; Singh, Mathur, Gleason, & Etebari, 2001), a negative relationship with economic performance (Gary, 2005; Lins & Servaes, 2002; Markides, 1995), a curvilinear relationship depending on the level of diversification (Kakani, 2000; Palich et al., 2000; Varadarajan & Ramanujam, 1987) or lack of a relationship (Grant, Jammine, & Thomas, 1988; Montgomery, 1985).

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http://dx.doi.org/10.1016/j.tekhne.2013.10.001

All of these mixed and 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. In accordance with this need, the primary motivation of this study is to examine the relationship between diversification strategy and organizational performance in developed and emerging economy contexts. Thus we analyze and compare how diversification affects organizational performance in Turkey as an emerging economy and in Italy a developed economy.

2. Conceptual framework

Investigations into the relationship between diversification strategy and organizational performance represent one of the most actively investigated areas in the fields of strategy and finance (Chakrabarti, Singh, & Mahmood, 2007; Hoskisson & Hitt, 1990; Kakani, 2000; Khanna & Palepu, 2000; Miller, 2004; Montgomery, 1994; Rumelt, 1974). However, despite the enormous interest in the field, the debate on whether corporate diversification creates or destroys value remains inconclusive with several studies offering differing results on the phenomena among different institutional context (Rejie, 2007) and market conditions.

The outcomes of firm diversification will vary across countries, because of the influence of the institutional environment within which diversification takes place. Khanna and Palepu (1997) suggested that the degree of market and institutional development is an important determinant of the efficacy of diversification. 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).

2.1. Diversification–performance relationship in emerging economy context

Several studies propose that diversification strategy is more likely to be profitable in emerging economies (Guillen, 2000; Khanna & Palepu, 1997; Kock & Guillen, 2001). The underlying argument is that key aspects of institutional environments in emerging economies are the lack of well-established product markets, financial markets and labor markets, privatization policies, coupled with the lack of necessary laws and regulations and inconsistent enforcement of contracts (Anil, Yigit, & Canel, 2013; Yigit & Behram, 2013). More specifically, to cope effectively with this institutional environment companies may wish to pursue unrelated diversification strategy as an effective means of gaining self-generated institutional support. Consequently, the nature of the institutional environment and the resultant need for firms to employ an unrelated diversification strategy element in a poorly structured institutional environment constitute the institutional environment management explanation of the diversification and performance relationship (Li & Wong, 2003). In Turkey, recent privatization policies are an example of the situation. Acceleration on the privatization policies in Turkey creates an opportunity for businesses which want to invest in new areas. After all, a profitable public enterprise can be sold regardless of being related or unrelated to a company's current industry (Colpan & Hikino, 2008; Karaevli, 2008).

Khanna and Palepu (1997, 2000) argue that greater diversification may not harm performance in emerging economies because of insufficient market and institutional development. By diversifying, firms create internal markets that may be more effective than inefficient external markets. These firms enjoy scope and scale advantages from internalizing functions provided by external intermediaries or institutions in advanced economies. As intermediaries are often absent or inefficient in developing economies, internalization may be viable and profitable (Chakrabarti et al., 2007). Lins and Servaes (2002) also argued that in institutionally developing economies, the absence or inefficiency of external intermediate institutions results in firms developing these institutions internally, which helps firms to lower their costs. Thus, internalization in less developed institutional environments would bring about greater net marginal benefits (Purkayastha, Manolova, & Edelman, 2012).

2.2. Diversification–performance relationship in developed economy context

Recent evidence indicates that corporate diversification has not enhanced the value of firms in the US, the UK, Germany and Japan (Berger & Ofek, 1995; Lang & Stulz, 1994; Lins & Servaes, 1999; Servaes, 1996). The evidence in these papers suggests that, for the average firm operating in developed capital markets, the costs of diversification outweigh the benefits (Lins & Servaes, 2002).

Efficient markets in developed economies detect and penalize diversification costs more than the less efficient markets of institutionally developing economies. This may be because the internal intermediate institutions of diversified firms in developed economies cannot match the efficiency levels of open market institutions. Diversified firms thus have higher costs, which results in lowering their performance (Purkayastha et al., 2012; Leaven & Levine, 2007; Villalonga, 2004).

According to the transaction cost theory based explanation, most developed economies have strong and well developed institutions with efficient product, labor and capital markets. Hence, the market structure would be a much more efficient mechanism for transactions. In this light, there are higher costs associated with diversified firm structure and therefore it is predicted that conglomerates would be poor performers in strong and mature market (Mishra & Akbar, 2007). Diversification has some limits for businesses. Collections of different businesses should restructure their organizations because management costs can be inadequate (Froelich & McLagan, 2008). Yet, transaction cost predicts that diversified group structure is a beneficial organization form in emerging economies (Mishra & Akbar, 2007).

Resource-based-view theorists argue that diversification in developed economies would be efficient if it were based on specific resources, rather than generic resources, so that synergistic benefits from economies of scope can be exploited (Purkayastha et al., 2012). Therefore, related