



**OYO STATE COLLEGE OF AGRICULTURE AND
TECHNOLOGY, IGBOORA (OYSCATECH)**



in Collaboration with

OYSCATECH GLOBAL CONSULT

PRESENTS

2ND BIENNIAL CONFERENCE

TAGGED:

OYSCATECH

2021

E-Proceeding

Theme:

**A SYNERGY BETWEEN AGRICULTURAL PRODUCTION,
TECHNOLOGICAL INNOVATION & MANAGEMENT EFFICIENCY:
A PANACEA TO ECONOMIC STABILITY
DURING PANDEMIC**

Date: Mon. 12th - Thur. 15th July, 2021

Venue: 800-Seater, Lecture Hall, OYSCATECH, Igboora

Editors:

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FACTORS AFFECTING DIVERSIFICATION STRATEGY EFFECTIVENESS IN NIGERIAN FIRMS: A STUDY OF SELECTED FIRMS IN THE BEVERAGE INDUSTRY IN LAGOS STATE.

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Abstract

Diversification strategy has been a contentious issue in strategic management literature in the last decade. Several researches have been conducted and results suggest that diversification may be incentive, substitute, risk reduction technique or for profit maximization. Despite the efforts put into diversification strategy research, few studies have been identified on the factors affecting diversification strategy effectiveness in three beverage firms in Lagos. Survey method was considered appropriate and the respondents were purposively selected with the use of questionnaire. The data generated were analysed using correlation and regression analysis techniques. The findings show that management style, organizational structure and poor personnel impeded diversification strategy effectiveness. The study suggests that better management style, good organizational and flexible structure be introduced and well experienced and knowledgeable personnel should be involved if organisations are to achieved diversification strategy effectiveness. This study suggests that further future researches could be carried out on the other factors identified in the body of the work to ascertain whether they constitute factors affecting diversification strategy effectiveness or otherwise.

Keywords: Diversification Strategy, Management Style, Organisation Structure

Introduction

The twenty-first century has been a period of heightened volatility for firms within and outside the home markets because of the competition created by globalization of markets and products that affect the organizational intent towards better performance and organizational effectiveness.

The role of diversification strategy as a catalyst for competitive strategies and long-term profitability is well established in the literature (Oladele, 2012). The importance of diversification becomes more open in terms of the gains of diversification and the roles it plays in enhancing the firm's profitability and organizational effectiveness. These benefits and advantages include substantial increase in market power, creation of energy in market operations, risk reduction and increase in the probability (Amit and Livnat, 1988; Ramirez and Espitia, 2002; Kotler, 2003).

There are two seemingly irreconcilable reasons and facts that motivate this study. First, that diversification strategies have become important for firms that tend to expand their corporate portfolios for future growth. Second, managers and stockholders/business owners are worried about sustainability of diversification strategy and what could constitute constraints to diversification strategy effectiveness.

Diversification has been classified as a means by which firms expand from their core business into other product markets (Aaker, 1980; Kasmi, 2008) Recent researches have shown that corporate managers are more engaged in diversification, (agency theorists) Firms are considered diversified if they are concurrently active in more than one business. Diversification strategies are used to expand firm's operations by adding markets, products, services, or stages of production to the existing business. The purpose of diversification is to allow the company to enter lines of business that are different from or related to the current operations. When the new venture is strategically related to the existing lines of business i.e. the new and old businesses are unrelated, which is a strategy to increase the variety of businesses, services, or product types in an organisation's array of businesses or portfolio (Kasmi, 2008).

It is because of the complexity in the business environment, organisations intend to look for ways of responding to emergencies before they occur. This explains one of the reasons for organisations at times, to the growth strategy as an option to exploit the advantage of new market opportunities, aiming at profit making or reducing risk by spreading interests over different areas or both. This can be achieved through acquisition or through internal research and development.

The extent to which firms in developing countries used the diversification option, the nature of the diversification strategy they are pursuing and the extent to which such diversification moves can be effective require an extensive research. With particular reference to countries like Nigeria, many firms operate in different sectors of the country's economy and have sought to diversify their product-market portfolios in an effort to spread the risks of their businesses, improve their profitability and cope with the hardship and challenges of competing in an economy that is deregulated and highly volatile in some sectors like the beverage.

Despite the assumed benefits of diversification such as spreading of risks and cost, the advantage of the synergy arising from the economics of scope, the pooling and/leveraging of resources among other reasons.

The organizational structure, management style, poor personnel and other challenges of achieving diversification strategy effectiveness appear enormous for companies in a third world nation such as Nigeria to bear. Companies in the third world nations can ill afford the experiences of corporate product-market diversification failure. This necessitates the need for this empirical study in order to close the gap which can only be through an empirical evidence of this nature.

The objective of this study is to examine diversification strategy effectiveness and value factors like the organizational structure, the management style, the quality of personnel, reward-performance management, the organizational culture and climate and poor internal information system, as some factors that may impede diversification strategy effectiveness. It is also to study whether diversification is an incentive, substitute and ways of reducing risks on return in the beverage industry, or not.

Research hypotheses

1. Ho: that organizational structure does not affect diversification strategy effectiveness
2. Ho: that diversification strategy effectiveness is not determined and influenced by management style
3. Ho: that the quality of personnel does not affect diversification strategy effectiveness

Literature review

Several research questions have been raised over three decades on diversification strategies across industries. However, the viability and reliability of diversification strategy effectiveness is an investigative research question that requires more attention in strategies management research. Generally, there are no agreements on the economic situation demanding firms' decisions to operate in more than a business (Ng, 2007).

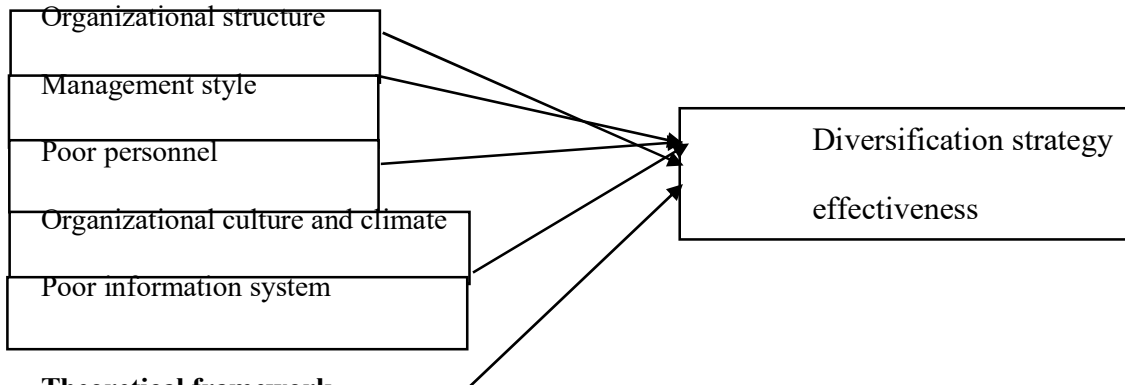
Diversification strategy is an established topic in management and finance research, and the identification of antecedents, decisional processes, implementation and outcomes of diversification have been of particular importance to the research area in the last three decades.

The importance of this review on diversification is to have a broad view based on the extant research.

There are different meanings to the word 'diversification' as explained by Reed and Luffman (1986). Diversification is usually driven by the desire (industry volatility or financial ability) to expand beyond the apparent limit of existing market and or by the desire to reduce business risk by developing new "leg" (Kock, 2001). De Wit and Meyer (2004), posit that diversification occurs when a corporation enters a business by starting up new activities (internal growth) or by buying it leading to an expansion of the business and thereby ensuring synergy and increase in profitability of the organization. This also helps organisations to spread their risks. Firms are considered diversified if they are concurrently active in more than one business.

Diversification strategy can be described by the extent of participating in different businesses and the underlying patterns of relationships among the various businesses of firms (Nayyar, 1992). Ansoff (1965) defines diversification as a branching out both into new products and new markets. Generally diversification occurs when a company adds to its business either in terms of consumer function, consumer group or alternative technology (Oyedijo, 2004; Kasmi 2008).

Conceptual Model



Theoretical framework

Over the years, empirical results presented have been conflicting while the stockholders and managers have been at cross roads on the gains of diversification strategy and its sustainability (Rumelt, 1974; Hoskisson and Hitt, 1990; Datta Rajagopalan and Rasheed, 1991; Berger and Ofek, 1995; Lins and Servaes, 1999; hadlock, Ryngaert and Thomas, 1999; Rajan, Servaes and Zingales, 2000; Lamont and Polk, 2002; Villalonga, 2004a, 2004b)

Consequently, the study will consider theoretical arguments for better understanding of diversification concepts. The following theories will be considered; synergistic theory, agency theory, theory of internal capital markets, debt co-insurance effect, value-maximizing and dynamic models and the corporate refocusing theory.

Synergistic theory

The first and obvious argument on diversification is that it could result into synergy for firms that combine activities that are related to the current activities of the firm. Synergy occurs when the sum of all businesses together equals more than sum separately (Hitt et Al, 2001) Amit and Livnat (1988), content that diversification strategy into related activities may influence the market strength of the firms that diversified and eventually become productive over time. Furthermore, synergy may also be introduced if the activities of a business segment complement the other segment. Synergic operation over a long time may erect barriers for potential firms from entering the market or industry.

Agency theory

Suggests that, irrespective of the mode of investments and positive results attained and recognized by the stockholders, diversification will typically be in the interests of management. Interestingly, managers have incentives to diversify their products or businesses so as to (a) build an empire in order to justify and sustain their position (b) increase their position, affluence, power and compensation (Jensen, 1986; Jensen and Murphy, 1990; Stulz, 1990), (c) it is an employment risk reduction strategy on the part of individual manager (Amihud and Lev, 1981), and (d) to create management entrenchment makes their skills and abilities to be been demanded for (Shleifer and Vishny, 1989). That is, they wish to increase the value differential between themselves and the potential replacement managers. Therefore, managers generally have a tendency to overinvest and grow their firms beyond the optimal size. Continuous investment into several projects could undermine the level of organizational effectiveness in terms of coordination and weaken the financial base of the existing business and also reduce the returns of the shareholders.

Internal capital markets theory

The motive of internal capital theory is to generate financial resources from a segment of an existing business using it as collateral for obtaining funding for other segments and the cash flows generated by one segment may be used to subsidize investments in the other divisions of the firm. Theoretical models imply on one hand, that this cross-subsidization can be efficient, if the firm eliminates some of the costs of the financial constraints. On the other hand, it may be inefficient, if the firm underinvests in divisions with better growth opportunities and overinvests in those with worse prospects. Specifically, Stein (1997), contends that, in contrast to outside investors (external capital), the CEO has insider information about the various segments' investment prospects and may thus be able to engage in winner-picking. He achieves a more efficient allocation of a given amount of funding

across division through internal capital markets. Gertner et al. (1994), conclude that the difference in ownership structure between internally and externally funded projects results in the comparative advantage of internal capital markets, although the total effect on firm effectiveness depends on whether the benefits (higher monitoring incentives, improved asset redeployability) or costs (decreased entrepreneurial incentives) of internal capital dominate. Hence, internal capital markets are not necessarily beneficial. Rajan et al. (2000), show that a greater diversity of investment opportunities across segments leads to a greater misallocation of internal capital by diversified firms, due to power struggles between divisions. Meyer et al. (1992), show that inefficiency through lobbying costs occurs, if managers of a division with poor growth prospects attempt to lobby the firm's top management to increase the investment flows available to their division, but it does not lead to misallocated resources per se.

Moreover, Wulf (2009) links the efficiency problems of internal capital markets with agency problems in a moral hazard model, whereby investment inefficiency depends on (a) division manager ability to skew information, (b) division manager compensation incentives, and (c) the public image of the investment opportunity.

Debt co-insurance effect/financial theory

The notion of this theory suggests that firms should avoid putting all their eggs in a basket. Lewellen (1971), explains that there is also a purely financial rationale for diversification. A combination of different businesses, with imperfectly correlated flows, reduces overall firm risks and thereby decreases the probability of insufficient debt service. This so-called debt coinsurance leads to a higher (potential) debt capacity and, in turn, to gains in firm value, through an increase tax shield, due to substitution of equity with debt capital. Amit and Livnat (1981), contend that when the financial flows of segments are not perfectly correlated, the entire risks, as evaluated by variability of consolidated cash flows are reduced by diversification.

Value-maximizing and dynamic models

Recently, academics have developed models of diversification as an ex ante rational and value maximizing strategy, although it might turn out to be inefficient ex post. Matsuka (2001), describes diversification as a dynamic matching process for a firm's organizational capabilities. Hence, the process of searching for businesses with successful matching, is characterized by uncertainties, which can often only be resolved by experimenting, that is, by diversifying. The model yields some important implications. Firstly, a large number of divestitures may not be evidence of corporate failure, but rather a result of a failed matching experiment. Secondly, the model can explain the existence of a possible diversification discount, despite diversification being an ex ante value-maximizing strategy. With a profit-maximizing neoclassical model of optimal firm size and growth, Maksimovic and Phillips (2002) show how diversified firms allocate resources across divisions and how they adjust their resource allocation compared to single-segment firms in response to industry shocks. The model indicates that the diversification decision depends on the division's productivity and on industry demand shocks. Using plant-level data and taking productivity and optimal firm size into account, they find that their source of allocation of most diversified firms is consistent with value maximizing. Gomes and Livdan (2004) develop a dynamic model of optimal corporate behavior, in which diversification is a value-maximizing response to increasing firm age and growth. In their model, firms diversify for two reasons: Firstly, after a certain time span, investment in a firm's current business is no longer profitable, so that diversification becomes a rational strategy for firms that experience insufficient profitability in their core business. Secondly, diversified firms can use economies of scope, due to declining fixed cost of production and eliminating redundancies across different activities. Gomes and Livdan (2004) argue that the endogenous selection mechanism – that firms diversify when they become relatively unproductive in their current businesses – accounts for the diversification account as an implication of their real options framework. They predict that firms follow a certain life cycle, from being specialized to discovering broader investment opportunities, and finally ending up either focused or diversified, after having learned about their resources throughout this process. Given that young firms have more to learn about their resources their volatility of resource uncertainty is higher, and this leads to a higher value in this real options approach. This approach is related to resources based theory.

Methodology

The study was carried out in Lagos, using survey research design. The target population was 1500 employees of three selected beverage firms in Lagos. A sample size of 450 comprising managers and operating staff formed the respondents for the study. Purposive sampling technique was used to select the respondents. Copies of questionnaires were used to collect data which were validated through a pilot study. The questions were closed-ended on a five point Likert scale. Descriptive Statistics was used to analyse data with the help of Statistical Package for Social Science (SPSS).

Data Analysis and Presentation

Data analysis was undertaken based on the responses gathered from the questionnaire. Out of the 450 copies of questionnaires administered to respondents, 420 copies of questionnaires were returned and found useful for the analysis. The data were exported into a SPSS software version 17.0. the formulated hypotheses were subjected to inferential test using correlation and regression.

Data presentation

The study examined some factors affecting diversification strategy effectiveness in Nigerian firms; a study of selected firms in beverage industry. The research questions are measured using homogenous scale (1=strongly disagree to 5=strongly agree). Data are presented in the table below

Descriptive Statistics

	Mean	Std. Deviation	N
Diversification Strategy	4.7952	.40401	420
Organisation Structure	4.5976	.49096	420
Management Style	4.3905	.74083	420
Quality of Personnel	4.7452	.43625	420

The descriptive statistics table confirmed that 420 responses were found fit for the analysis, the mean and standard deviations of each of the variables are indicated.

Correlation

	Diversification Strategy	Organisation structure	management style	Quality of personnel
Pearson Correlation Diversification strategy effectiveness	1.000	.366	.786	.868
Organisation structure	.366	1.000	.184	.245
Management style	.786	.184	1.000	.789
Quality of personnel	.868	.245	.789	1.000
Sig. (1-tailed) Diversification strategy effectiveness		.000	.000	.000
Organisation structure	.000		.000	.000
Management style	.000	.000		.000
Quality of personnel	.000	.000	.000	
N Diversification strategy effectiveness	420	420	420	420
Organisation structure	420	420	420	420
Management style	420	420	420	420
Quality of personnel	420	420	420	420

The Correlation analysis showed the strength and direction of the linear relationship between diversification strategy effectiveness and each of the independent variables (Organisation structure, Management style, Quality of personnel).

From the table above, the Pearson correlation coefficient between diversification strategy and organization structure is 0.366, indicating a Positive and medium correlation between Diversification strategy effectiveness and organization structure. Thus, flexible organization structure positively enhances diversification strategy effectiveness.

Also, from the table above, the Pearson coefficient between Diversification strategy effectiveness and management style is 0.786, indicating a Positive and strong correlation between diversification strategy effectiveness and management style. Thus good management style positively and strongly enhances diversification strategy effectiveness.

Finally, from the above, the Pearson correlation coefficient between Diversification strategy effectiveness and quality of personnel is 0.868, indicating a Positive and large correlation between diversification strategy effectiveness and quality of personnel. Thus, quality personnel positively and strongly enhances diversification strategy effectiveness.

For any of these instances, the correlation coefficient is statistically significant, that is $p < 0.001$

Variables Entered/Removed

Model	Variables Entered	Variables Removed	Method
1	Quality of personnel Organisation structure Management style		Enter

a. All requested variables entered

Model Summary^b

Model	R	R Square	Adjusted Square	R of the Estimate	Std. Error				
1	.898	.806	.805	.17838	.806	577.740	3	416	.000

a. Predictors: (Constant), Quality of personnel, Organisation structure, Management style

b. Dependent Variable: Diversification Strategy effectiveness

From the Model Summary table above the, value of R Square (0.806) reveals that the models (Organisation structure, Management style, Quality of personnel), explains 80.6% of the variance in diversification strategy effectiveness. This is quite a respectable value.

ANOVA^b

	Sum of Squares	Df	Mean Square	F	Sig
1 Regression	55.153	3	18.384	577.740	.000 ^a
Residual	13.238	416	.032		
Total	68.390	419			

a. Predictors: (Constant), Quality of personnel, Organisation structure, Management style

ANOVA^b

	Sum Squares	of Df	Mean Square	F	Sig
1 Regression	55.153	3	18.384	577.740	.000 ^a
Residual	13.238	416	.032		
Total	68.390	419			

a. Predictors: (Constant), Quality of personnel, Organisation structure, Management style

b. Dependent Variable: Diversification Strategy effectiveness

To assess the statistical significance of the results of the R square explained in the table above, it is necessary to look in the table labeled ANOVA above. This tests the null hypothesis that multiple Regressions in the population equal 0. The model reaches statistical significance (Sig. = .000; this really means $p < .0001$). Therefore the null hypothesis is rejected.

Coefficients^a

Model	Unstandardised Coefficients		Standardised Coefficients		Sig	Correlation		
	B	Std. Error	Beta	t		Zero- order	Partial	Part
1 (Constant)	.824	.118		6.958	.000			
Organisation structure	.137	.018	.166	7.458	.000	.366	.343	.1
Management style	.149	.019	.273	7.782	.000	.786	.356	.1
Quality of personnel	.567	.033	.612	17.210	.000	.868	.645	.1

a. Dependent Variable: Diversification Strategy effectiveness

Another thing worth examination is the individual contribution of the variables included in the model, as shown in the table above. Looking down the Beta column, it was revealed that “quality of personnel” has the largest beta value (0.612). This means that this variable makes the strongest unique contribution to explaining the dependent variables in the model is controlled for. The beta value for organization structure is the smallest, indicating that it made less of a unique contribution. Also, the column titled “Sig. value” shows that the contribution of each of the variables is statistically significant. That is, ‘p value’ is less than 0.001.

Empirical Findings

Linear multiple regression was used to assess the ability of Organization structure, Management style, Quality of personnel to predict diversification strategy effectiveness. Preliminary analyses were conducted to ensure no violation of the assumptions of normality, linearity, multicollinearity and homoscedasticity. (Organisation structure, Management style, Quality of personnel were inserted into model using “enter method”

The model explains 80% of the variance in diversification strategy effectiveness, R square change = .806, F change (4,416) = 577.74, $p < .0001$.

Finally, all the independent variables contributed statistically significant, to diversification strategy effectiveness, the quality of personnel recorded a higher beta value (beta = 0.612, $p < .0001$) followed by Management style (beta = 0.0273, $p < .0001$) and lastly Organisation structure (beta = 0.166, $p < .0001$).

Conclusion and Recommendations

The empirically generated findings showed the proportionate level at which the independent variables affect diversification strategy effectiveness. Though, all the variables tested significantly influenced diversification

strategy effectiveness, however, the quality of the personnel was found to be the strong determinant of diversification strategy effectiveness followed by management style and organization structure.

In the light of the results generated, the following suggestions were made; firstly, the quality of personnel is a prerequisite and strongest determinant to the effectiveness of diversification strategy in organisations and should be made the most priority in order to achieve and sustain diversification strategy effectiveness.

Secondly, firms should consider management style and approach to be used so as not to impede diversification strategy effectiveness. Thirdly, Organizations should ensure it has a well-arranged structure, and flexible enough to accommodate unforeseen situations so as to make diversification strategy effective.

Finally, diversification strategy effectiveness requires a combination of some factors for consideration. Diversification strategy can also serve as an incentive, substitute, and risk reduction among others. Furthermore, several factors that affect diversification strategy effectiveness were identified, diversification theories were examined based on extant literature and this empirically conducted research has become an eye opener and has enlightened firms, owners and managers alike on some factors that can affect diversification strategy effectiveness. In the light of this, Nigerian managers should be wary of these factors while trying to expand their businesses in order to achieve the purpose and benefit of diversification designed.

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