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THE IMPACT OF DIVERSIFICATION ON FIRMS PERFORMANCE IN SAUDI ARABIA

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ABSTRACT

Diversification is a strategic option that many managers use to improve their firms' performance. This research examines the impact of diversification strategy on diversified firms performance in Saudi Arabia. The relationship of the performance and the factors that effect on the firm such as firm size, risk, and return are the key decision making used by Saudi investors. As it explains the main reasons that let the investors apply this strategy in their businesses that include increases in profitability, reduction in risk, higher growth, and extension of the business life cycle. The data were collected from the annual reports of each firm in the Saudi Stock Exchange "Tadawul" and Bloomberg. The sample was taken from 8 diversified firms in Saudi Arabia listed in Saudi Stock Exchange "Tadawul'' from the period of 2010 to 2015. The results of diversified firms in descriptive statistics and correlations showed that there is a relationship between performance with firm size and risk, as the relationship between risk and return. All firms showed that size has a positive impact on performance while the risk has negatively affected on performance. In addition, this research paper found through the use of diversification strategy in the firms, the performance will be better while the return will increase and the risk decreases. So the diversification strategy affects on the performance in a positive way. As indicated, that the highly diversified firms may perform better than less diversified firms.

CCS CONCEPTS • Insert your first CCS term here • Insert your second CCS term here • Insert your third CCS term here

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INTRODUCTION

Diversification is viewed as the most vital system in the business field, particularly for the organizations. It is a system that plans to diminish hazard and expand return through putting resources into different regions of its center business into other item showcases that make the business not the same as the others contenders [1]. It will shape the business itself to achieving long-go money related objectives. This methodology utilized dependent on numerous reasons and these reasons will fabricate a future for the firm. These reasons incorporate expanded gainfulness, decrease in hazard, expanded piece of the pie, higher development, an diversification of the business life cycle [2]. Gomes and Livdan [3] found that the enhancement prompts the company's development and enables the firm to investigate the business sectors. At the point when the organizations need more benefits with high development in the market, they tend to utilize this alluring methodology which is differentiating the business itself and the movement of the firm. According to Barnes and Brown [4], the hazard, estimate and other related components impact the broadening with the execution of the firm.

There are three kinds of diversification methodology incorporate the concentric broadening, combination enhancement, and level diversification [5]. As indicated by Ramanujam and Varadarajan, [6], found the connection among diversification and execution is dubious. I found that there is a solid connection between broadening technique and firm execution. Numerous investigations concur with this relationship which is high diversification prompts better execution. Gomes and Livdan [3] found that the broadening prompts the association's development and enables the firm to investigate the business sectors. The elements that influence the execution of the firm will be firm size, hazard, and return. According to Barnes and Brown [4], the hazard, estimate, and other related elements impact the broadening with the execution of the firm according to examined the UK base organizations. These elements may impact on firms execution as it will enable the directors to choose whether to utilize enhancement procedure in their organizations or not.

There is a connection among size and execution. As per Mayer and Whittington [7] expressed that firm size is contrarily identified with the execution. In any case, Gassenheimer and Keep [8] found that the firm size is emphatically identified with the execution as the firm gets economies of scale all the more quickly and having ROA effectively in a sensible position to use. Different elements that may impact the firm execution is a hazard and return. Enhancement assumes a huge job in limiting the firm hazard with the end goal to increment expected return. Doukas and Kan [9] clarified that all inclusive expanded firms are liable to generally safe because of portfolio administration.

The broadening system has as of late spread. Most speculators in Saudi Arabia pursued this technique for some reasons. As per Afza, Slahudin and Nazir [10], discovered enhancement may not be considered as only a pattern; rather it depends on coherent reasons. These reasons may incorporate expanded productivity, decrease in hazard, higher development, and augmentation of the business life cycle. Every one of these reasons are identified with one another with the utilization of enhancement procedure. In any case, Baringger [11] added more to the significance and reasoned that when an organization works out of gainful and development related open doors then the broadening is an appealing procedure. The enhancement of firms isn't a simple procedure, ought to apply it as indicated by exact investigation of firm structure on the off chance that it is permitted to utilize this technique or not. The utilization of broadening system in the organizations is one of the components that adds to the achievement of the business, however whenever utilized in an effectively way that is the reason it needs precise investigation before utilize it. Now and then may prompt disappointment of the business. In light of the significance of this technique the outcomes that will get from the utilized of diversification may have decidedly or contrarily effect of the organizations.

There is a relationship between diversification and firm performance, the more diversifying firms lead to the better and high performance. There is no research has been done in Saudi Arabia in this area. This research attempts to find whether diversification strategy is a good choice of the firms in Saudi Arabia or not on the basis of size, risk and return. This study aims to analyze the diversification strategy and its effects on the firm’s performance through the factors such as firm size, risk, and return.

METHODOLOGY

Research Design

The study follows a quantitative approach based on the secondary data. All data used in this research were collected from the Saudi Exchange Stock "Tadawul", "Financial reports" of each company and "Bloomberg" on the Six-years from the period of 2010- 2015. The data collected to analyze the hypothesis and the objectives of the research. this study tried to choose the most popular and well-known companies and analyzed during the period from 2010- 2015. A sampling of this study is made up of 8 public and private diversified companies in Saudi Arabia listed in Saudi Stock Exchange "Tadawul". Those companies are which are, Savola Group, Almarai Co, The National Agricultural Development Company (NADEC), Saudi Arabia mining Co (Ma’aden), Tassnee Co, Abdullah A.M Alkhodari sons, Arab Supply Trading Co. (ASTRA), and Saudi Basic Industries Corporation (SABIC). All these companies are private and public companies listed in Tadawul, as it's followed different types of the diversification strategy.

Quantitative Method

The quantitative method used in order to test the relationship between factors that are mentioned in the literature review, which includes several statistical techniques such: Descriptive statistics and correlation technique are used to find the relationship between diversification and performance as it explains which factors have an impact on firm performance in Saudi Arabia. In addition, return on assets to measure the performance, standard deviation to measure the risk and market value to measure the firm size. The data collected were analyzed using both descriptive and correlation statistics. The first descriptive method described information such as return on assets, risk and firm size. The analysis showed in excel and SPSS software used in information of mean, standard deviation and variance. The second correlation method used to describe and measure the relationship between two variables which are the risk and firm size, it Indicated as a Pearson Correlation. So the correlation it should be a linear relationship "Bloomberg.

Hypothesis of the Research

The hypothesis that formulated for this research are, H1: In highly diversified firms their performance should be higher than less diversified firm. H2: There is a positive relationship with diversification strategy and firm performance. H3: There is a relationship between size and performance of the firm. H4: Risk and return have a relationship with diversification and risk is negatively related to the performance.

Model Used

There are several techniques used to test the hypothesis and the objectives and to find the relationship between diversification strategy, risk and firm size with the performance of the firm. As it explains which of the factors in the literature review have an impact on firm performance in Saudi Arabia.

General form of the model used for the diversified firms is: Yit = α + β1 Sizeit + β2 Riskit + eit.

The performance measurement which is depended using in this study is based on Return on Assets (ROA) to find the real relationship between diversification and performance. Return on Assets (ROA) = Income after taxes/Total Assets.

The second measurement of the variable is Firm size also it has a relative relationship with performance, to find firm size first we need to find the market value: Market Value (MV) = Share price × Number of shares outstanding Firm Size = Ln (MV) The third measurement variable has been used to measure the risk, also to measure the relationship of diversification strategy with risk and how the effect on firm performance: Risk = SROA.

Where ROA: Return on Asset, LN(MV): Log of year-end market value of equity, SROA: Standard deviation of Return on Assets, Yit: Is the measure of dependent variable of firm I and time t, α: Is a constant, β: vector of coefficients,, i: Represents the number of the firms i.e i= 1,2,3…..N, t: Represents time period i.e t= 1,2,3……T

Variables

In this study, the performance of the firms showed as a dependent variable. The idea of measuring the performance is to evaluate the managerial performance of the firms and shows if the firm achieves high profits based on their assets and returns. The Performance measurement is critical for effective management of any firm.. The study used the accounting measures to measure the performance which is: ROA which is the dependent variable. The independent variable for this work is risk and firm size. The first independent variable is risk depends on the firm itself as it has a relationship with performance level and the return of the firm. However, this study uses the risk as a factor of the diversification strategy to find the risk ratio of the firm and how will be affected on the performance. The second independent variable is size, it's one of the factors that has a bigger control of the firm based on the future goals of the firm. Moreover, this factor has a direct and positive relationship with performance, where the large size of the firms has better performance. As it shows a positive relationship with performance.

Result And Discussion

The statistics that have taken through the whole sample of diversified firms in Saudi Arabia. These samples show the impact of diversification strategy on firm performance through some factors Using excel and SPSS software to find these data which are ROA, RISK, and LFS and analyzed through these techniques, descriptive statistics, and correlation.

Descriptive Statistics

The variables analyzed using the descriptive statistical technique. The purpose of descriptive statistics is to summarize, describe and give overall a view frequency and distribution the values depending on variables which are Risk and Firm size. In the (Table 1) I will analyze the most important data which are Mean, Standard deviation and variance. The mean shows the average and is computed as the sum of all the observed outcomes of (ROA, LFS, SROA) from the companies divided by the total number of Diversified companies. The results in (Table 1) shows that the mean of the Return on assets (ROA) based on all samples of diversified companies are 4.60, firm size (LFS) is 9.47 and risk (SROA) is 1.83. The Standard deviation it is a standard way that shows what is extra large or extra small between ROA, LFS, and risk. ROA shows the highest standard deviation which is 2.41, then LFS equal 1.76 and the last one is risk equal 1.02.

The variance is used to test the probability theory through the small 8 samples of Saudi diversified companies. So the variance finds more generalized outcomes because it gives an information about the distribution of data around the mean. The variance showed in the following table of ROA is 5.85, for LFS is 3.12 and for Risk is 1.04. So, the results that from this analysis confirm that through diversification strategy, companies will take the lowest proportion of the risk.

Table 1: Descriptive Statistics of Mean, Standard Deviation, and Variance

Variable	ROA	LFS	RISK
Mean	4.60606275	9.471421786	1.83508337
Standard Error	0.855282088	0.624906362	0.362173638
Median	4.361024146	9.895280635	1.270755784
Standard Deviation	2.419103056	1.767502105	1.024381741
Sample Variance	5.852059595	3.124063693	1.049357952
Kurtosis	-1.819402162	-0.376972574	-1.409091818
Skewness	-0.016311066	0.346220298	0.821317011
Range	6.499168357	5.15464555	2.453373676
Minimum	1.210023617	7.383674605	0.97077571
Maximum	7.709191974	12.53832015	3.424149386
Sum	36.848502	75.77137429	14.68066696
Count	8	8	8

Correlation

Showing as the Pearson Product Moment Correlation or PPMC.It is a measurement using a set of variables to see how well they are related. This research used Correlation to analyze and investigate the relationship between variables which is a performance with the firm size and risk. The results in (Table 2) shows the Pearson Correlation method that the risk is negatively affected on performance, which means when ROA increase the risk will decrease. However, the correlation is not significant to have an impact. The risk is a negative low correlated relationship with the performance at -0.106. Therefore, the results as we thought in the hypothesis for this research that risk and return have a relationship with diversification and is negatively related to the performance.

Table 2: Correlation between Performance and Risk

		Average ROA	Risk
Pearson Correlation	Average ROA	1.000	-.106
	Risk	-.106	1.000
Sig. (1-tailed)	Average ROA	.	.402
	Risk	.402	.
N	Average ROA	8	8
	Risk	8	8

In addition, in (Table 3) the results of the Pearson Correlation show that there is a relationship between performance and size and this relationship is a positively effect on the performance. It means when the firm size increases the performance will be high. So, the correlation is not significant have an impact. The size is a positive low correlated relationship with performance at 0.312.

Table 3: Correlation between Performance and Size

		Average ROA	Average Size
Pearson Correlation	Average ROA	1.000	-.312
	Average Size	-.312	1.000
Sig. (1-tailed)	Average ROA	.	.226
	Average Size	.226	.
N	Average ROA	8	8
	Average Size	8	8

Based on the main objective of this study is to analyze the diversification strategy and its effects on the firm's performance through of some factors such as firm size, risk, and return.

Determine the relationship of performance with these factors. The results above analyzed the diversification strategy through some tests such as descriptive statistics and correlation. As shown that there is a statistical relationship between the performance of diversified companies with these factors which are Firm size, as well as a relationship between performance and risk. According to the model that I used before. Moreover, these figures below shows this relationship.

In (figure1) shows the relationship between performance and firm size. According to hypothesis 1 & 3 in this research, H1: indicate that in highly diversified firms their performance should be higher than less diversified firm. Hypothesis 2 indicates that there is a relationship between size and performance of the firm. Both of them are accepted in this study through the analysis of results. So the most diversified companies their performance are better and higher than less diversified companies. The results in this figure show that there is a relationship between size and performance of the firm, according to the diversification strategy that investors followed. In the figure below SABIC is the highest diversified company and shows the highest size, which is 12.54 with good performance, which is 7.12. As well as Ma'aden company is a less diversified company than SABIC and the performance shows less which is 1.21. We can associate the second hypothesis with the results of hypothesis 1& 3, which means the relationship of diversification strategy of these firms is positively affected by the performance.

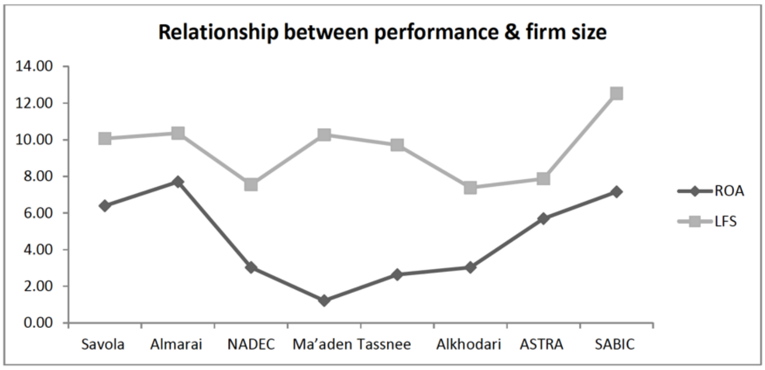

Figure 1: Relationship between performance and firm size

In the next following figure shows how diversification strategy has an impact on firm performance through these factors which are the risk and return. In (Figure 2) indicates to the relationship between risk and return through the sample of Saudi diversified companies. The first point is Savola group the risk is 0.97 and the return is 6.39, the second point of Almarai company the risk is 1.25 and return is 7.71, the third point for NADEC company the risk is 1.30 and the return is 3.03, fourth point for Ma'aden company the risk is 1.09 and return is 1.21, the fifth point for Tassnee company the risk is 3.16 and return is 2.63, the sixth point for Alkhodari company the risk is 2.49 and return is 3.02, the seventh point the risk is 3.42 and return 5.70, the last point for SABIC industries the risk is 1.01 and return is 7.16.

So, all these points in (figure 2) shows the relationship between risk and return. The diversification strategy has a rule of increasing the return and reducing the risk. As the selected of samples of Saudi companies indicated to this relation through analysis companies that diversifying in their industrie. So, according to hypothesis 4 which indicates that the risk and return have a relationship with diversification and risk is negatively related to the performance. accepted this strategy because when the risk goes down the return increases that means there is a negative relationship between risk and return as well with the performance. So when investors using the diversification strategy the risk will be divided between their businesses not concentrated on one aspect that why the risk will go down, thus the return will rise. However, Almarai through its diversification strategy has the highest return which is 7.71 and the risk is low 1.25 over the 6 years.

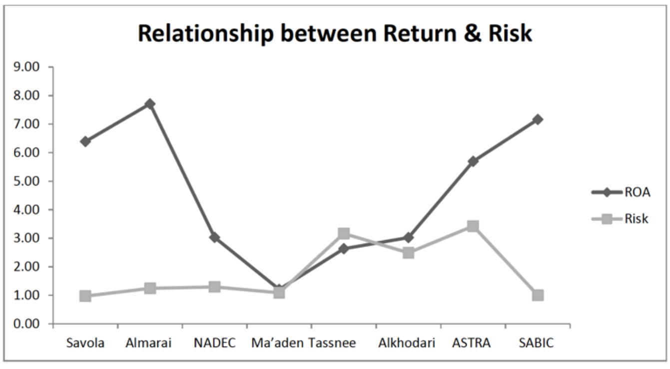

Figure 2: Relationship between return and risk

When comparing the results of diversifying firms from the evidence of Pakistan study with these results. According to [12] it was found that the size is significant to explain the performance, and the size has a positive effect on firms' performance whereby large firms have an ability to effectively use their resources to increase performance. As for risk effect on performance, which means the risk and performance are negatively correlated. So this study showed the same results of firm size and risk with performance. This means that the size has a positive impact on performance. As well as the risk is a negatively has an effect on performance.

Suppose the results of the study helps identifying the reasons for using a diversification strategy between the firms. The reasons for using this strategy have been determined in the literature review and answered on one of the research questions which is, why investors need to diversify their activities or businesses. The results were many of investors needs to use the diversification strategy for many reasons may include increased profitability, reduction in risk, higher growth, and extension of the business life cycle. As through this strategy, the firm may explore new markets that lead to growth the business and entering into a competitive environment.

CONCLUSION

Diversification strategy has been defined as a technique that aims to reduce risk and maximize return through investing in various areas of its core business into other product markets that make the business different from the others competitors. It will shape the business itself to reaching long-range financial goals. While conducting this research the main objective was to draw the impact of diversification strategy on firms performance in Saudi Arabia for the period of 2010 to 2015. Also, focused on the answer to the main question of the study, which is how the diversification strategy having an impact on the firm's performance In Saudi Arabia. So yearly data were collected and has been analyzed through descriptive statistics and correlation models. The finding section answered to these questions and tested the hypothesis. Through some factors such as firm size, risk, and return that have an effect on the firm performance.

According to the relationship of these factors with performance.This research emphasizes that there is a positive relationship between diversification strategy and firm performance. Which means highly diversified firms their performance is better than less diversified. As well as the relationship between firm size and performance, when the size of the firm increases their performance becomes good. Moreover, the risk is a negatively affected in the performance, because performance is associated with the return on assets, that is why when firms are diversified in their industries and activities, the increases otherwise the risk decreases. Finally, through an understanding of the goal of diversification strategy and the reasons that discussed in the literature review. The samples that have taken from Saudi diversified firms showed that diversification will be the right option under a competitive environment such as Saudi Arabia and the results from these samples described the main reasons of using this strategy, which is the increase in profitability of the firm while reducing the risk. So it is a useful strategy to be adopted by companies for the long term. In addition, this research indicated that the highly diversified firms may perform better than less diversified firms.

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