DIVERSIFICATION STRATEGIES AFFECTING THE BUSINESS PERFORMANCE OF SMEs IN KENYA

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Abstract: **The main purpose of the study was to investigate diversification strategies affecting the business performance of small and medium enterprises in Kenya. Small and medium enterprises particularly in developing countries tend to pursue product diversification strategies as a growth strategy in today's dynamic environment. In Kenya, an average number of SMEs employ diversification strategies haphazardly without any strategic analysis which in turn negatively affect their business performance. Most SMEs practice "trial and error method" when implementing diversification as a growth strategy. This provides the need for SMEs to have the know-how in choosing the right diversification strategy to lower their risks and uncertainty and improve business performance. The challenge most SMEs in emerging countries face is deciding the most appropriate type of diversification strategy for their business once product diversification has been chosen as a growth path. The study sought to find out which is the efficient product diversification strategy for SMEs particularly in developing countries. The findings indicated that there is an inverted U shaped relationship between diversification strategies and SME performance. The study concluded that concentric diversification strategy is an attractive strategy for SMEs but not the best as it limits SMEs to certain sector, product or service; conglomerate diversification strategy is the efficient strategy for small and business enterprises because of their flexibility characteristic; interrelated diversification strategy least increases SMEs performance.**

Keywords: **Related diversification strategy, unrelated diversification strategy, interrelated diversification strategy, small and medium enterprises, product diversification strategy, developing countries, Kenya.**

I. INTRODUCTION

1.1 Background of the Study:

Small- and medium-sized enterprises (SMEs) are considered the engines of growth in developing countries. In developed countries, SMEs have historically played a vital role in creating jobs, spurring innovations, and creating new products, and thus contributed to economic vitality and growth (Kedogo, 2013). Fernando and Maria (2011) also contends that a healthy SME sector is vital to the growth and sustainability of an economy, especially in developing countries since their economy is mostly dominated by the SME segment. However, SMEs face a variety of challenges in this globalization economy. Singh et al (2009) observes that major constraints were lack of financing, limited managerial resources, reduced intellectual capital, excess costs of research and development projects, and in-effective incentive policies.

From a global perspective, diversification strategy has been advocated by Canadian SMEs according to the BDC Report after facing a myriad of challenges. Canadian SMEs who diversified into different products and services or geographically outperformed SMEs that were undiversified .German SMEs, UK SMEs, China SMEs and Indian SMEs have also used diversification as a strategic tool to improve their business performance (Singh et al, 2010; Park, 2010).

In Africa, diversification strategies are mostly sought after as competitiveness increases in the world (Ortiz, 2011). South Africa is the leading country that has plunged into geographical and internalization diversification strategies.

Globalization has opened large opportunities to Africa SMEs. However, their lack of resources and capabilities has limited them to export and product diversification as compared to their large counterparts (Kedogo, 2013). This has enhanced SMEs to compete within the dynamic environment that keeps changing everyday (Ortiz, 2011).

In Kenya, the business performance of SMEs has continued to decline over the years (Githaiga & Kabiru, 2015). SMEs 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 SMEs have to not only keep abreast of these emerging local and global issues, but more importantly how to adapt to achieve growth. They are increasingly aware that they have to be competitive because of the local competition and even international competition in their home market. The Kenyan market is however, becoming more open to global competition, hence competitiveness for the SMEs is the key to survival. Some of these competitive factors can be under the direct control of the firm; some can be managed by strategic planning, while others are outside the firm's control.

SMEs result to diversification as a growth strategy in order to competitive in this turbulent environment. Product diversification is a growth strategy that enables a company to add businesses that are either related or unrelated to its core products and markets (Kotler & Armstrong, 2008). According to Rushin (2006) diversification is a key strategic decision of an organization's corporate strategy to pursue different markets in expectation of creating enhanced returns and eventually greater profits. In addition, expanding operations in other businesses brings a financing advantage to firms (Jang, 2012). Therefore, corporate diversification is regarded as a strategic tool for organizations to sustain growth and profitability.

1.1.1 Small and Medium Sized Enterprises in Kenya:

There is no generally accepted definition of small and medium enterprises worldwide. Different countries in the world define SMEs differently. This is due to largely differences in the interpretation of word "small and medium" and also in the evaluation of the characteristics of SMEs (CMA Report, 2010). For example the European Union, defines SMEs as a business or company that has fewer than 250 employees, has annual turnover not exceeding 50million euros and whose voting rights of 20% is not owned by one enterprise (FSD, 2015). The GOK defines small enterprises are those businesses that have 10-50 employees whereas medium enterprises are those businesses that employ 51-99 employees (Muriungi, 2012).

It is a known fact that SMEs around the world have been critical to the development of the economy. In developed countries, SMEs have contributed immensely to the growth of their economy (Clemens, 2008) and the same also applies to developing countries. In Kenya, the SMEs sector has continued to play an important role in the economy of Kenya. The sector's contribution to the GDP has increased from 13.8 per cent in 1993 to about 40 per cent in 2008 (CMA Report, 2010). According to the Economic Survey (2009), the SMEs sector has provided approximately 80% of total employment and contributed over 92% of the new jobs created in 2008. Generally, the SMEs sector in the country comprises of manufacturing and trade (wholesale and retail) sub-sectors, with substantial engagement in agro-based activities, which, directly affects a larger population in the society. The SMEs subsector are businesses in both formal and informal sectors accounting to more than 74% of the total persons engaged in employment per year and contributing more than 18.4% of the country's GDP (FSD, 2015).

SMEs compared to large companies are quite different. They possess limited international exposure, managerial competencies and fewer resources compared to their large counterparts (Hilmersson, 2013). The typical characteristics of SMEs are; flexibility (by responding to customer needs quickly), focus on incremental innovation than radical innovation, execute decisions quickly to capture opportunities and reduce threats, have less bureaucracy but no planning since they focus more on operations, personality of the owner which affects the growth and success of the business, and lastly loose and informal work relationship (Wu, 2009).

1.2 Statement of the Problem:

The study of product diversification has for a long time being researched by strategic management scholars. Despite several attempts however, strategic management research has failed to establish a consistent and clear relationship between patterns of diversification strategies and business performance and most of such attempts are inconclusive (Scholes & Johnson, 2007) with conflicting results reported from some of the investigations. For instance, while Lei and Schmit (2009) have found that more diversified firms have better business performance, Hakrabarti (2007), concluded that diversification is associated with poorer performance for both diversified firms and independent firms.

Prior empirical studies on the effects of diversification on business performance are inconclusive because of the conflicting evidence. Most of the investigations focused on large companies in developed countries as opposed to small and medium enterprises. Empirical research on diversification revealed that researchers hardly paid attention to SMEs. Few past studies noted that impact of diversification strategy on SMEs is quite different from large companies (Bood, 2001). Therefore, the study aims to bridge the gap by examining the influence of diversification strategies on business performance in developing countries with particular reference to SMEs in Kenya.

Secondly, SMEs are considered as the cornerstone for economic development in any country (Asman, 2013). However, there has since been a decline with their growth rate. In Kenya, statistics indicate that the number of closed SMEs in the year 2016 was 46.3% in the first year of business operation as compared to other consequent years. The percentage rate implies many SMEs do not reach maturity growth stage and if they do, very few survive as a result of challenges (Kivungi, 2013). These challenges, for instance, access to resources, capital and procedural barriers limit SMEs potential to invest and improve profitability and sustainability (Maina, Butoyi & Nkatha, 2009). To improve their performance, SMEs need to employ growth strategies which are viewed as a primary building block of competitive distinctiveness and advantage essential for superior firm performance (Casadesus & Ricart, 2011; Lechner & Gudmundsson, 2012).

Numerous SMEs use different growth strategies. However, according to a survey report by BDC Consultants, diversification strategy is considered a key growth strategy for SMEs success in today's dynamic and competitive environment if adopted early. In Kenya, an average number of SMEs employ diversification strategies haphazardly without any strategic analysis which in turn negatively affect their business performance. Most SMEs practice "trial and error method" when implementing diversification as a growth strategy. This provides the need for SMEs to have the know-how in choosing the right diversification strategy to lower their risks and uncertainty and improve business performance (Mackey, Barney & Dotson, 2016). The challenge most SMEs in emerging countries face is deciding the most appropriate type of diversification strategy for their business once product diversification has been chosen as a growth path. Therefore, the study aimed to examine the efficient diversification strategies affecting the business performance of small and medium enterprises. It investigated whether SMEs that pursue concentric diversification strategy or conglomerate diversification strategy outperform or underperform those that pursue interrelated diversification strategies.

1.3 General Objectives:

The general objective of the study was to investigate the product diversification strategies affecting the business performance of SMEs in Mombasa County.

1.4 Specific Objectives:

This study was guided by the following specific objectives;

- To assess the effects of concentric diversification strategy on the business performance of SMEs in Mombasa County.

- To examine the effects of conglomerate diversification strategy on the business performance of SMEs in Mombasa County.

- To evaluate the effects of interrelated diversification strategy on the business performance of SMEs in Mombasa County

1.5 Hypotheses:

This study was guided by the following hypotheses:

- H_{01} - Concentric diversification strategy does not affect the business performance of SMEs.

- H_{02} - Conglomerate diversification strategy does not affect the business performance of SMEs.

- H_{03} - Interrelated diversification strategy does not affect the business performance of SMEs.

1.6 Significance of the Study:

Small and medium sized enterprises business operations significantly influence the development and growth of any economy, both in developing economies and emerging economies. They are often viewed as the building blocks of an economy (FSD Report, 2015). It is this aspect of small and medium sized enterprises that provides a compelling rationale for studying diversification strategies that enable them to survive and increase their business performance in today's dynamic competitive environment.

The study will therefore assist small and medium-sized enterprises in choosing diversification strategies that are best for long term growth of their firm. This will make it easier for managers to understand which strategy best fits the firm. Therefore, SMEs will be able to position themselves competitively within their industries and increase their business performance. The study will also help policy makers such as the government to formulate and implement regulatory policies that increase the growth and development of the SMEs sector in Kenya. For example, policies that can create an enabling business environment that is beneficial to the SMEs and government sponsored programs to improve SMEs information to market and industrial trends.

The study will be of great benefit to scholars and researchers who are interested in increasing their knowledge on product diversification so as to teach or develop a body of strategic management theory.

1.7 Scope of the Study:

This study focused on diversification strategies affecting the business performance of SMEs in Mombasa County. The county has 3500 licensed small and medium enterprise. However, 361 licensed SMEs were used for this study categorized in 7 groups namely general trade, wholesale, retail, stores, shops, personal services; transport, storage and communications; agriculture, forestry and natural resources extraction; accommodation and catering; professional and technical services; private education, health and entertainment services; industrial plants, factories, workshops, contractors. The study population was business owners, top managers and middle managers of SMEs.

1.8 Limitation of the Study:

First and foremost was accessibility of financial data. Most respondents were reluctant to give copies of their financial statements. This led to the change of the questionnaire from use of parametric data to use of non- parametric data when measuring the SMEs business performance.

Secondly, the usage of strategic management terms such as concentric and conglomerate was difficult for some of the respondents to comprehend. This was addressed by having an introduction of the terms at the beginning of the questionnaire using layman's language that respondents understood and using the same consequently throughout the questionnaire.

II.   LITERATURE REVIEW

2.1 Introduction:

This section explores the review of relevant literature with regard to the theoretical and conceptual framework of the independent and dependent variables, summary, empirical review and research gap.

2.2 Theoretical Framework:

Generally, four main theories have been identified by several scholars in their empirical research to explain why firms choose to diversify their businesses either in the short run or the long run. However, the study focuses on only three theories: resource based view theory, transaction cost theory and agency theory. In a nutshell, resource based theory state that businesses diversify into related businesses because of the excess resources and capabilities and also the existence of a strategic best fit. Transaction cost economics theory state that businesses tend to check the cost of production and the outsourcing cost and decides on the one is lower. Therefore, if business will chose to diversify into unrelated businesses if the production cost is high. The agency theory states that there exists an agency problem between owners of the businesses and managers. Both diversify into businesses for their selfish interests. These theories show how the SMEs may be influenced in deciding which business to diversify.

2.2.1 Resource Based View Theory:

Osorio, Corino and Vicente (2015) noted that the product diversification and firm performance relationship has been influenced by the resource based view theory for the last 20 years. This theory suggests that the specific type of diversification strategy depends on the resources and capabilities of a company. The resource based view (RBV) provides an internal perspective that explains the influence firms use their resources and capabilities for diversifying into related businesses (Wan et al, 2011).

Generally, the resource based theory observes a company's strategy intent from the resources point of view, rather than of market or even product premises. Xiaorong (2007) acknowledges the resource based theory is a strategic theory about how a firm can exploit the resources to achieve its economic goals or a sustainable advantage over its rivals. He asserts that based on Penrose's theory of the growth of the firm, several companies diversified due to excess capacity in resources or capabilities.

The resource based theory provides a rationale for concentric diversification. Kivungi (2013) points out that the type of diversification strategy strongly depends on the specific resources of the company. He asserts that several resources are a must if a company decides to diversify into unrelated businesses. In the resource based approach, resources and capabilities for example human capital, technological knowledge or managerial expertise when maximized fully have the possibility of creating value when shared (Miller, 2006).

The resource-based view (RBV) theory emphasizes the firm's primary resources as the focal point of competitive edge and business performance. It also assumes firms within the same industry may be different with respect to the type of resources that they have. In addition, resource heterogeneity may continue over time because the resources differ across firms. Thus the type of diversification strategy is defined by the firm's unique resources and capabilities (Chatterjee & Wernerfelt, 2005; Miller, 2006; Kivungi, 2013).

In order to diversify, a company needs to possess the required resources, such that corporate diversification is economically feasible. Chatterjee & Wernerfelt (2005) examined the influence of the degree of flexibility of a resource on the diversification strategy. They considered three classes of resources in their study: physical resources, intangible assets and, financial resources. The first two of these resources types are inflexible, since they are relatively end-product specific. As a result, unadoptable resources favor related market diversification. For instance, physical resources, such as plant and equipment, are highly unadoptable, because they can only be used in a few similar industries. Therefore, if a firm has a high degree of surplus of physical capacity, it is easy for the firm to employ related diversification (Chatterjee & Wernerfelt, 2005). Financial resources have the topmost degree of elasticity, and appropriate for related and unrelated diversification. Nonetheless, there is a difference between the effects of the availability of internal assets and equity capital. In general, managers use internal assets for unrelated diversification. However, dependent on the type of risk and the economic environment a company is facing, internal funds may be used for related diversification as well.

According to Karaevli (2013), RBV theory suggests that the economic- political circumstances and uncertainty do not encourage entrepreneurs to develop technological and market based capabilities that are prerequisites to get economics of scope in related diversification. However, the same circumstances permit entrepreneurs to create and maintain generic resources such as brand name and capabilities such as leveraging local and foreign contacts, and establishing close relationship with the government (Miller, 2006). However, resources and capabilities of unrelated diversification must have the VRIO criteria. They must be valuable, rare, and inimitable and organization of the resources and capabilities (Guillen, 2000; Karaevli, 2013; Miller, 2006).

2.2.2 Transaction Cost Economics Theory:

The transaction cost economics theory introduced by Coase states that there are costs for a firm to provide an activity internally, which is termed the production cost while the cost of purchasing an activity is termed a transaction cost (Lei & Schmit, 2009; Lincoln, Silvio & Scavarda, 2014). Hence, transaction costs skills include the direct and indirect costs of negotiating, monitoring and evaluating contracts between companies and suppliers. TCE asserts that companies normally do a cost benefit analysis between transaction and production costs before making a decision on whether to in source or outsource a function (Guillen, 2000; Karaevli, 2013; Miller, 2006). Effectively, TCE theory explains why some firms choose to make products while others purchase the said products. Firms provide a service function internally when it is economically more cost effective than purchasing the same service function on the open market. Therefore, the higher the transaction cost, the more likely that the function is provided within the firm rather than purchasing (Chatterjee & Wernerfelt, 2005; Lieu & Klein, 2009; Lincoln et al, 2014).

The TCE theory argues that the level of diversification is linearly and positive related to performance. These benefits includes creating and exploiting advantages arising from market power, obtaining financial advantages dissociated from the use of an internal capital market and resources, risk reduction, the "co-insurance effect" that enables firms to increase their debt capacity and a lower tax burden due to more efficient intra-company transactions (Lei & Schmit, 2009; Lieu & Klein, 2009; Lincoln et al, 2014).

The transaction cost economics theory (TCE) approach focuses primarily on the question of vertical integration or the make or buy decision and it plays an important role in determining the distribution of the firm's activities over industries. It also focuses on the firm's choice to diversify into a new industry rather than contract out any assets that are valuable in that industry. TCE does not predict much about the specific industries into which a firm will diversify. However it can be combined with other approaches, such as resource based, which describe which assets are useful where. Firms that have economies of scale resources would most likely pursue unrelated diversification strategy and enter into new industries (Lieu & Klein, 2009; Lincoln et al, 2014)

The transaction cost theory investigates if a transaction can be undertaken at a lower cost via the market or within the hierarchy of the firm. It consist of the negotiating, monitoring, and enforcements cost which arise when a transaction between two or more parties takes place. The presence of transaction costs causes external motivations for companies to diversify. Six main factors that cause transaction difficulties are: bounded rationality, opportunism, uncertainty, small numbers, information impact, and asset specificity (Jones & Hill, 2008; Lincoln et al, 2014). Studies point out that transaction costs theory fails to explain the diversity strategy because it is an explanation of a mode rather than a strategy. And although transaction costs are easy to argue theoretically, it is extremely difficult to evaluate and test them empirically. (Xiaorong, 2007)

2.2.3 Agency Theory:

Agency theory is a dominant paradigm that explains the firm's efficiency problem. The agency problem normally arises when one party performs some service on behalf of the other party. It proposes that both parties are only interested after their own selfish interests. Xiaorong (2007), notes that, principals can limit the divergence between principal and agent by using the appropriate monitor and incentive arrangement such as managerial shareholding, institution shareholding etc. However, consideration should also be made to the costs of monitoring and incentives. In addition, the information is imperfect and asymmetrically distributed among the principal and agent; this means the governance efficiency will be lacking (Pandey, 2010). Therefore, it is believed that the agent will not always act in the best interests of the principal.

In a nutshell, the agency theory assumes that the agents and principals are opportunistic and systematically pursue their own personal interests (Purkayastha, Manolova & Edelman, 2012). This therefore sheds some light on the reason why managers prefer diversification strategy as opposed to shareholders who detest the strategy. Studies show that shareholders are averse to unrelated diversification for two main reasons (Neffke & Henning, 2013). The first reason according to the theory of the Capital Asset Pricing Model is that, shareholders are only sensitive to specific risk and are indifferent to the unsystematic risk of a given investment as they can reduce it to zero via the diversification of their investment portfolio (Denis et al, 2010). That is to say, they consider decisions that only reduce unsystematic risk such as unrelated diversification which in fact reduce the value of their investment. The second reason is basically linked to the reduction in firm value as a result of this strategy. And it mostly affects conglomerate diversification.

Managers on the other hand, favor diversification because of three main reasons. First and foremost, numerous studies agree diversification lowers company risk because of the combination of industry cash flows that are not perfectly correlated and also reduction of employment risk (Denis et al, 2010). Secondly, diversification strategy gives managers power and prestige (Singh et al, 2004). And lastly due to the linkage of the size of the firm and executive compensation, most managers pursue diversification strategies.

To that end, managers prefer unrelated diversification as it enables the reduction of unsystematic risk and provides managers with more projects to manage thereby making them indispensable. Therefore, an agency problem exists if managers favor diversification while shareholders are averse to it. However, the owners in SMEs are in fact the managers and thus use personal reasons to expand into conglomerate businesses that are different from their core business (Bood, 2001).

2.3 Conceptual Framework:

The conceptual framework consists of independent variables and dependent variables. The independent variables are concentric diversification strategy, conglomerate diversification strategy and interrelated diversification strategy. The constructs for the independent variable are degree of diversification, benefits and costs of diversification strategies. The dependent variable is business performance of SME's and has three constructs namely profitability, product or service quality and customer satisfaction as shown in Figure 1 below.
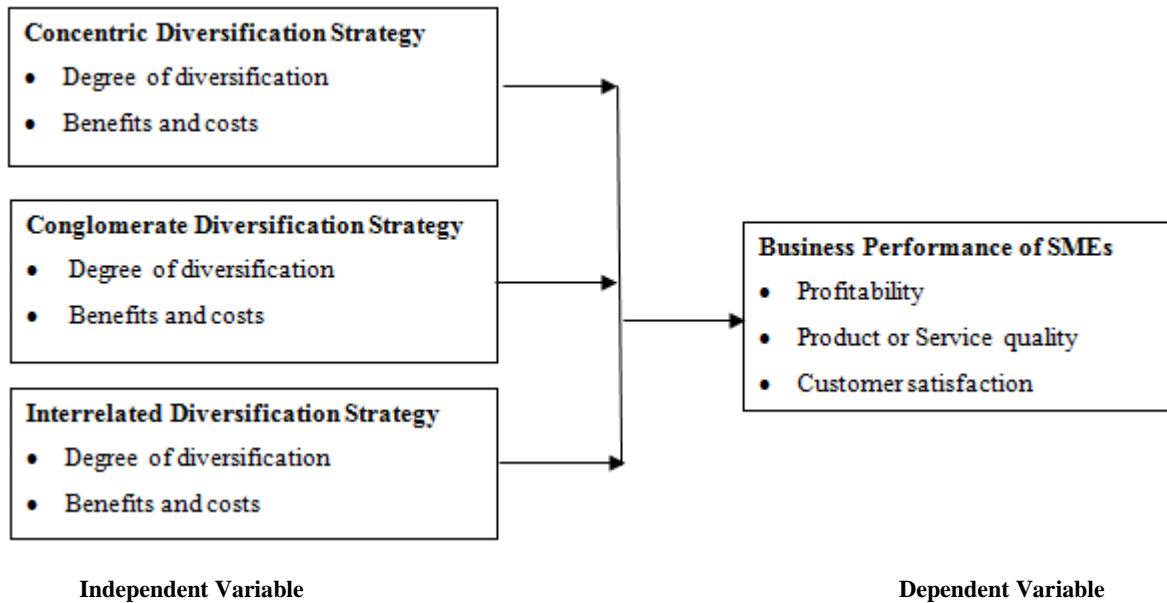
Independent Variable   Dependent Variable

Figure 2.1: Conceptual Framework

2.4 Review of variables:

2.4.1 Concentric Diversification Strategy and Business Performance:

Concentric diversification strategy is a growth strategy that involves expansion into related products or services that are clearly differentiated or distinct from the firm's current business (Barnat, 2014). Firms diversify into related businesses when there is some kind of strategic fit between the two businesses. Strategic fit exists when businesses have sufficiently related activities in the value chain that offer competitive advantage of lower costs, economies of scale (combining activities into a larger scale operation), economies of scope (ability to eliminate costs by doing things together rather than independently) and transfer of managerial skills and expertise. This competitive advantage increases a business performance (Bae, Kwon, & Lee, 2008).

The goal of related diversification is to achieve strategic fit. Strategic fit allows an organization to achieve synergy. According to Barnat (2014), synergy is the ability of two or more resources or capabilities of an organization to maximize its overall business performance. Most companies achieve this by combining with other firms that have complementary resources and capabilities.

In contrast, financial synergy may be realized by two companies; one with strong financial resources but limited growth opportunities whereas the other company with great market potential but weak financially. Moreover, strategic fit in operations normally result in synergy when a company combines two or more resources and capabilities to improve overall business efficiency. This leads to elimination of duplicate departments or functions within a company(Zahavi & Lavie, 2013). Thomas (2010) also contends that quantity discounts offered through combined orders or yet by utilizing resources from existing operations within a business entity.

Management synergy can be achieved when managerial expertise and knowledge are applied to different circumstances within a firm. This requires managers to have a vast wealth of experience to achieve the firm's vision and mission. However; caution is necessary when assuming that management experience is universally transferable (Santarelli & Tran, 2015). Situations that appear similar may require significantly different management strategies. Personality clashes and other situational differences may make management synergy difficult to achieve (Yang et al, 2013). Although managerial skills and experience can be transferred, individual managers may not be able to make the transfer effectively (Thomas, 2010).

2.4.2 Conglomerate Diversification Strategy and Business Performance:

According to Barnat (2014), conglomerate diversification is a growth strategy that makes it possible for companies to enter into new and unrelated products and services that are predominantly different from the organization's core products and services. The main reason for conglomerate diversification is that expansion into unrelated industries is quite

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attractive particularly to SMEs in developing countries. However, conglomerate diversification strategy impacts the business performance of a business both positively and negatively. In developing countries, SMEs as entrepreneurs mostly execute this strategy unknowingly by becoming involved in multiple unrelated businesses because of the many benefits associated with it. Examples of the benefits include; spread of business risk over different industries, new market opportunities, stability of profits (i.e. when one industry is experiencing hard times, financial stability can be offset by another industry experiencing good times) and increase in shareholder value (Yamaoh & Kanyandekwe, 2014).

In conglomerate diversification strategy, companies may have synergy through the application of managerial expertise or financial resources. However, little concern is given to achieving marketing or production synergy with conglomerate diversification. Most SMEs particularly pursue conglomerate diversification strategy because opportunities in their core businesses are limited. Therefore, most SMEs may decide to consider other alternatives businesses other than their core businesses when there is a crisis in their core industry. This indicates that companies that pursue conglomerate diversification strategy have a competitive advantage (Thomas, 2010).

As discussed earlier, SMEs with a higher growth in sales are more likely to attract investors and even potential customers to their businesses. This higher growth in sales normally results in increase of power and reputation of the firm's business and employees. Conglomerate growth may be effective if the new products and services have a greater growth opportunity compared to the ones in the core business. However, the biggest demerit of a conglomerate diversification strategy is the increase in administrative challenges linked with having unrelated businesses. For example, managers from both unrelated businesses and core business may have different backgrounds because of the different organization culture that are affiliated with the different businesses. Moreover, competition between different strategic business units for resources and capabilities causes tug of war of the ownership of resources. This creates rivalry and administrative challenges between unrelated businesses and core businesses (Xiaorong, 2007; Karaevli, 2013; Miller, 2006).

According to Wu (2009), SMEs who lack managerial expertise in the unrelated businesses must do their due diligence before deciding to pursue attractive opportunities, failure to which the company may be unable to ascertain the viability of new businesses for lack of proper knowledge. Moreover, problems would still occur in the future despite the new business being profitability. Such unrelated diversified SMEs may require managerial expertise for the new businesses to perform effectively and efficiently. It is therefore imperative for unrelated diversified companies to have a strategic fit so as to maximize business performance in all the business units. Failure to which, such companies may not survive in its initial business stage. In fact, performance of the new business and may deteriorate because of business process controls placed on the new business by the parent conglomerate company. In addition, another demerit of conglomerate diversification strategy is the fact that decision-making may become slower due to longer evaluation sessions and complicated reporting systems (Lei & Schmit, 2009).

2.4.3 Interrelated Diversification Strategy and Business Performance:

An interrelated diversification strategy is a mix of concentric and conglomerate strategies. A company that pursues interrelated diversification strategies diversify their business into related products but distinct to their core business as well as unrelated products. Oyedijo (2012) noted that there is a positive relationship between interrelated diversification strategies and business performance of firms. The basic premise of interrelated diversification strategies is that a business does not put his/her eggs in one basket but spreads them. Therefore, there is spread of risk when financial crisis hits the business and the business is cushioned from total losses (Yamaoh & Kanyandeke, 2014).

SMEs that use interrelated diversification strategies have to use criteria's in determining the type of services and products to venture into. Examples of the criteria used are profitability, return on investment, liquid assets, growth opportunities in the industry and threats affecting the business as a whole (Scholes & Johnson, 2007). Interrelated diversified firms that qualify enjoy some kind of "strategic fit" thereby achieving a consolidated performance. These strategic fits are normally categorized as market- related fits where a variety of cost-saving opportunities (or economies of scope) can arise from market-related strategic fit: using a single sales force for all related products rather than separate sales forces for each business, advertising related products rather than separate sales forces for each business (Kotler & Armstrong, 2008).

Secondly, operating fits where it presents cost-saving opportunities; some derive from the economies of combining activities into a larger-scale operation (economies of scale) and some derive from the ability to eliminate costs by doing things together rather than independently (economies of scope). For example, sharing procuring materials, conducting R&D and performing administrative support functions (Singh et al, 2004). In addition, companies that endeavor to achieve management fit must have managerial skills and abilities that can be transfer from one business unit to another to solve problems facing that unit. These strategic fits in both related and unrelated businesses offer a unique competitive advantage.

2.4.4 Measurement of business performance:

According to Ebenezer & Collins (2015), SMEs business performances have been measured using various performance indicators. Most scholars however, recommend hybrid performance measures (financial measures and non-financial measures). Financial measures include return on investment, turnover, profitability, and sales volume while non-financial measures include market share, customer satisfaction, product or service quality, employees turnover and delivery time. In this study, SME's business performance will be measured on both financial and non-financial measures. These will consist of profitability, product or service quality and customer satisfaction.

However, prior empirical studies noted that these measures tend to be susceptible, problematic and not credible as most companies are unwilling to report the correct value of their financial statements while others manipulate their financial figures to reflect an attractive financial position. Moreover, other companies are unable to keep accurate records of their business transactions because of lack of managerial expertise which eventually translates to incorrect business performance measures. In addition, Chong (2008) argued that it was possible for companies to measure their overall business performance using hybrid approach by combining both financial and non-financial measures. Examples of non-financial measures are quality of the product or service, aftersales service, delivery time, customer satisfaction and employees turnover). Forsman (2008) also suggested the use of financial and non –financial measures so as to measure the whole facets of business performance. For example; return on investment, reduction of costs, profit ratio, quality, and market share.

Measurements of product diversification strategies have resulted to contradictory findings for over a century with scholars opting to use Rumelts measures, SIC measures or categorized measures. From his study, Park (2010) suggested that the non-linear hypothesis based on benefits and costs of diversification under the separation of the level of diversification is the most optimal measure of product diversification strategy.

2.5 Empirical Review:

Diversification strategies have largely been conducted on large multinational companies. Recent studies have focused on international and geographical diversification of SMEs. For example, Cieslik, Kaciak, & Welsh (2012) studied "the impact of geographic diversification on export performance of small and medium-sized enterprises". Only a few studies have investigated diversification strategy among SMEs (Singh, 2010; Qian, 2002). Moreover, these studies indicate that diversification by SMEs differ from their large counterparts (Park, 2010).

Based on these studies, it is not clear how the SMEs investigated were diversified. The degree of diversification seems to vary greatly. This is because the studies employ different definitions of SMEs and diversification measures. From Bood's (2001) research of diversification of SMEs, his analysis of three studies (the Stratos project of 1990, Robinson et al study of 1991 and Gankema et al of 1994) indicated that different SMEs employ different degree of diversification. Park (2010) in his study of the restaurant industry found that high related firms outperformed low related firms, whereas low unrelated firms outperformed high unrelated firms.

Bood (2001) suggests that small business owners preferred entering into new businesses themselves than acquiring businesses from other people. From his view, most of these new products or services of the diversified SMEs were unrelated. This is partly due to the characteristic nature of SMEs of being flexible and responsive to their customer's needs. As such most SMEs hardly shared majority of their resources and capabilities such as marketing, technology and machinery. However, general resources like accounting and human resource were the only resources shared by majority of the diversified SMEs firms. As a result, most diversified SMEs are geared towards conglomerate and combined diversification strategy as opposed to concentric diversification strategy. BDC Report (2015) further notes that diversification correlates strongly and positively with business performance regardless of being measured in terms of products and services, number of customers or geography.

Empirical studies by Bood (2001) indicate that SMEs that diversify into a variety of distinct businesses run into problems as a result of lack of skills and resources. Previous studies on US SMEs by Fombrun and Wally concluded that fast growing SMEs hired external managers at the expense of internal promotions as their product diversity increased. In addition, these firms became more bureaucratic and formal as their product diversity increased (Bood, 2001). Bullon and Bueno (2011) also noted that diversification as a growth strategy was difficult to implement in the long term because of the predominant characteristics that exists in Spanish SMEs. For example, limited resources, lack of prior experience in the addition of new products and accessing new markets.

According to Singh et al (2010), German SMEs showed an inverted U shaped relationship between diversification strategies and SME performance. In other words, performance improved in an increase of diversification strategies until a certain point, after which any further increase in diversification strategies lead to a decrease in performance. Liu and Hsu (2011) from their study of hardware manufacturing companies in Taiwan indicated that a curvilinear relationship exists between corporate diversification and firm performance.

In addition, Singh et al (2010) pointed out that the key difference between large firms and SMEs in the context of diversification strategy is that "Large firms exploit their capabilities through corporate diversification while SMEs exploit the diversification strategy to benefit from it". Bood (2001), notes that the analogy of "do not put all your eggs in one basket" is only applicable after a solid base has been established in the primary business in which the firm operates.

Moreover, when SMEs diversify too widely, the costs of diversification exceeds its advantages. For example, conglomerate SMEs experienced a much higher overall volatility in performance and showed a higher bankruptcy rate than concentric SMEs. In addition, there is a relationship between profitability and age of diversification i.e. the profitability of older diversification is significantly higher than those of younger businesses (Bood, 2001).

2.6 Critique of the Literature Review:

Diversification strategies do affect the business performance of SMEs. Concentric diversification is an attractive strategy for SMEs beyond a certain firm size as it improves its profitability. However, a solid base is required before diversification improves the business performance of SMEs since majority of the SMEs in developing countries lack strategic resources and capabilities which are critical for the formation of sustainable competitive advantages. Prior empirical studies note SMEs that pursue conglomerate diversification run the risk of bankruptcy as they lack resources and skills to manage a large variety of distinct businesses. The conglomerate diversification strategy leads SMEs to incur higher transaction costs in the long run as a result of hiring external managerial expertise. And this affects the SMEs financial performance negatively. The effect of interrelated diversification strategies has not been researched extensively. However, few studies indicate that there is poor financial performance compared to related and unrelated diversified firms. There are a lot of risks involved when SMEs expand into both concentric and conglomerate businesses. This is heightened by under developed resources and capabilities that SMEs have.

In my opinion, SMEs should first overcome their shortcomings before adopting diversification in order to improve the profitability associated with these strategies. SMEs should acquire resources and capabilities prior to undertaking diversification strategies. These resources and capabilities should be valuable, rare, difficult to imitate and non-substitutable so as to best position the SME for long term success.

In the event of higher transaction costs arising from conglomerate diversification, SMEs should hire the managerial expertise so as to build up its strategic resources and capabilities thereby increasing its financial performance in the long run. SMEs should also avoid expanding into both concentric and conglomerate businesses as it decreases the business performance of a business.

2.7 Research Gaps:

There have been extensive studies on the effects of product diversification on firm performance on large companies (Xiaorong, 2007; Karaevli, 2013; Miller, 2006; Ravichandran et al, 2009). Despite the growing volume on this topic, there are two under researched areas. First, most of the existing studies focused on large firms and ignored small and medium-sized firms (Bood, 2001; Singh, et al, 2010; Qian, 2002).

Secondly, majority of empirical studies focused on developed economies and comprehensively investigated the impact of concentric and conglomerate diversification strategies on the firm performance as a whole. However, product diversification in the developing countries especially the Africa continent has not been investigated to find out what particular diversification strategy leads to increased business performance of SMEs (Bullon & Bueno, 2011). Developed countries have different organization resources and capabilities which cannot be generalized on developing countries.

Thirdly, according to (Palich, Cardinal and Miller, 2000; Singh et al, 2010), the relationship between diversification strategies (both related and unrelated) and business performance has not reached the status of maturity. Therefore, the study examines diversification strategies affecting the business performance of SMEs in Mombasa County, Kenya to contribute to the literature.

2.8 Summary:

The RBV theory states that "the accumulation of strategic resources and capabilities provides a business with a niche opportunity to create competitive advantages over its rivals." These competitive advantages in companies assist businesses to enjoy great profits. As a result, RBV theory favors concentric diversification because of the economies of scale and scope created between the related businesses. On the other hand, TCE theory states that the higher the transaction costs, the more likely the business will choose to make rather buy. This theory encourages SMEs to expand internally than acquire new businesses.

The Agency theory suggests that the separation of ownership in firms creates conflict of interest between the firm's shareholder and managers. This is mainly because managers have the opportunity to use the resources of the firm in ways that benefit themselves personally to the detriment of shareholders' wealth maximization. Interestingly, in the context of SMEs, the owners are in fact the managers of the businesses. This explains why owner-managers of SMEs use personal reasons to expand into conglomerate businesses.

The empirical studies, on the other hand, indicate a curvilinear relationship between diversification strategies and business performance of SMEs. This means diversification only pays off beyond a certain organizational size but profits disappear when an SME diversifies too widely into a conglomerate business.

III. RESEARCH METHODOLOGY

3.1 Introduction:

This chapter examines in detail the aspects of methodology that the study adopted. These aspects are; research design, target population, sample size and technique, data collection instruments, pilot study, data analysis and presentation.

3.2 Research Design:

The study adopted a descriptive research design. According to Mugenda & Mugenda (2008), a descriptive research design determines what exists and assists to record, analyze and interpret the current status of the variables and also collect information about people's attitudes, opinions, habits and issues. Furthermore, descriptive research design is considered conclusive in nature due to its quantitative nature (Kothari, 2014; Creswell, 2014). This design was appropriate as it enabled an in depth study of the diversification strategies affecting the business performance of SMEs in Kenya. The descriptive design also assisted the researcher to draw comparisons between business performances of concentric diversified firms, conglomerate diversified firms and combined diversified firms. A cross sectional survey was used to collect data from the target population.

3.3 Target Population:

According to recent studies by the Kenya National Bureau of Statistics (2016), there are 3500 licensed and 163,900 unlicensed SMEs in Mombasa County. The target population consisted of 3500 licensed SMEs in Mombasa County. The County Government of Mombasa has further grouped the licensed SMEs into 7 categories as shown in the table below:

Table 3.1 Target population

Category	Population	Percentage (%)
General Trade, Wholesale, Retail, Stores, Shops, Personal Services	1296	37
Transport, Storage and Communications	405	12
Agriculture, Forestry and Natural Resources Extraction	250	7
Accommodation and Catering	355	10
Professional and Technical Services	380	10
Private Education, Health and Entertainment Services	514	15
Industrial Plants, Factories, Workshops, Contractors	300	9
Total	**3500**	**100**

3.4 Sample Frame:

According to Cooper and Schindler (2008), a sampling frame describes the list of all population units from which the sample was selected. The sample frame for this study consisted of a list of licensed small and medium enterprises from the Kenya National Bureau of Statistics and the County Government of Mombasa according to the different categories as indicated in table 3.1 above.

3.5 Sample Size and Sampling Technique:

A sample size of 361 (which is 10.3% of the target population) was acquired from the target population using stratified random probability technique. This was in line with Kothari (2014), who noted that a sample size of 10% of the target population is large enough for reliable data analysis and testing. In addition, Sekaran (2010) pointed out that a stratified random probability technique can only be used if the sample to be obtained does not constitute a homogenous group. This study constituted a heterogeneous group of seven categories. The study used Yamane's formula to calculate the sample size with precision level of 0.05 as shown below:

$$n = \frac{N}{1 + N(e)2}$$

Where   n= desired sample size

N= estimate of the population size

e = level of precision

Therefore;

$$n = \frac{3500}{(1 + 3500(.05)2}$$

n= 361

A sample size of 361 respondents was examined as shown in the table below:

Table 3.2 Sample Size

Category	Population	Sample Proportion	Sample Size per Stratum
General Trade, Wholesale, Retail, Stores, Shops, Personal Services	1296	10.3%	133
Transport, Storage and Communications	405	10.3%	42
Agriculture, Forestry and Natural Resources Extraction	250	10.3%	26
Accommodation and Catering	355	10.3%	37
Professional and Technical Services	380	10.3%	39
Private Education, Health and Entertainment Services	514	10.3%	53
Industrial Plants, Factories, Workshops, Contractors	300	10.3%	31
Total			**361**

3.6 Data Collection Instruments:

The researcher used both primary and secondary data to collect the required data. According to Cooper and Schindler (2008), effective questionnaires should have both open and close ended questions. The primary data for this study was collected using a semi structured questionnaire comprising of both open and closed ended questions. Furthermore, the questionnaire was based on the 5 point Likert scale. The 5 point Likert scale was employed to ensure respondents refrain from making neutral responses (Sekaran, 2010). The secondary data was obtained through scholarly journals, global reports, business articles, academic business books and internet search.

3.7 Data Collection Procedures:

According to Mugenda and Mugenda (2008), it is important for a researcher to identify themselves to respondents prior to data collection so as to enhance quality of the information. The researcher obtained an introductory letter from the Department of Commerce and Economics in the School of Human Resource Development and administered the open and close ended questionnaires through hand delivery to the relevant respondents in an effort to achieve the necessary information.

3.8 Pilot Study:

Cooper and Schindler (2008), suggest that pilot testing should be conducted to detect weaknesses and reliability of data instruments. The researcher conducted pilot testing to pre-test the questionnaire before data collection. Pilot testing is an important exercise that enables a researcher to ascertain the reliability and validity of the data collection instrument

(Mugenda & Mugenda, 2008). The researcher used a sample of 14 respondents in the pilot study as it reflected the entire different stratum in the target population.

3.8.1 Reliability of the Instrument

According to Creswell (2014), researchers should test data instruments to ensure its reliability and validity. The study used internal consistency to test the reliability of the instrument. Cronbach's alpha formula was used to measure the internal consistency. The test result was 0.802 which was deemed reliable since it exceeded the prescribed threshold of 0.7.

3.8.2 Validity of the Instrument:

According to Sekaran (2010), factor analysis is considered adequate in checking the validity of data instruments. Factor analysis was used to check validity of the constructs. Kaiser-Mayor-Oklin measures of sampling adequacy (KMO) & Bartlett's Test of Sphericity is a measure of sampling adequacy that is recommended to check the case to variable ratio for the analysis being conducted. In most academic and business studies, KMO & Bartlett's test play an important role for accepting the sample adequacy.

3.9 Data Processing and Analysis:

Data was analyzed using descriptive statistics, regression analysis and SPSS version 24. This was deemed appropriate according to (Creswell, 2014; Kothari, 2014; Sekaran, 2010) who observed that Statistical Package for Social Sciences (SPSS) is suitable in the analysis of huge data. The findings were then presented using descriptive statistics such as percentages, mean standard deviation and frequencies. Multivariate regression analysis was used to determine the relationship between the independent and dependent variables by use of the regression formula;

$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon$

Where;

Y = (Dependent Variable); X1 – X3 = (Independent Variables)

Y= Business Performance of SMEs

X1 = Concentric Diversification Strategy

X2 = Conglomerate Diversification Strategy

X3 = Interrelated Diversification Strategy (Concentric and Conglomerate)

β_0 = Co-efficient of the model

$\beta_1 - \beta_5$ = Beta Co-efficient of Determination

ϵ = Stochastic Error Term

3.9.1 Hypothesis Testing:

The hypotheses were tested using the critical value approach. In the critical value approach, the likely or unlikely of a hypothesis is determined by observing whether the test statistic is more extreme than would be the critical value. If the test statistic is greater than the critical value, then the null hypothesis is rejected and if the test statistic is less than the critical value, then the null hypothesis is accepted.

IV.   DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction:

This chapter presents analysis, findings and results of the data on the diversification strategies affecting the business performance of SMEs in Mombasa County, Kenya. The data is mainly presented in frequency tables, means and standard deviation.

4.2 Response Rate:

The study targeted 361 SMEs in Mombasa County, Kenya. From the study, 255 out of the 361 sample respondents filled-in and returned the questionnaires making a response rate of 72.5% as per Table 4.1 below.

Table 4.1 Questionnaire Return Rate

	Frequency	Percentage
Respondent	255	70.63
Non-respondent	106	29.4
Total	**361**	**100**

According to (Mugenda & Mugenda, 2008) a response rate of 50% is adequate for analysis and reporting; a rate of 60% is good and a response rate of 70% and over is excellent; therefore, this response rate was adequate for analysis and reporting.

4.2.1 Validity:

Factor analysis was used to check validity of the constructs. Kaiser-Mayor-Oklin measures of sampling adequacy (KMO) & Bartlett's Test of Sphericity is a measure of sampling adequacy that is recommended to check the case to variable ratio for the analysis being conducted. In most academic and business studies, KMO & Bartlett's test play an important role for accepting the sample adequacy. While the KMO ranges from 0 to 1, the world-over accepted index is over 0.5. Also, the Bartlett's Test of Sphericity relates to the significance of the study and thereby shows the validity and suitability of the responses collected to the problem being addressed through the study. For Factor Analysis to be recommended suitable, the Bartlett's Test of Sphericity must be less than 0.05.

The study applied the KMO measures of sampling adequacy and Bartlett's test of sphericity to test whether the relationship among the variables has been significant or not as shown in below in table 4.2. Factor 1 was based on six items that represented concentric diversification strategy; Factor 2 was based on five items that represented conglomerate diversification strategy, Factor 3 was based on six items that represented combined diversification strategy, Factor 4 was based on three items that represented business performance. The Kaiser-Mayor-Oklin measures of sampling adequacy shows the value of test statistic as 0.789, which is greater than 0.5 hence an acceptable index. While Bartlett's test of sphere shows the value of test statistic as 0.000 which is less than 0.05 acceptable indexes. This result indicates a highly significant relationship among variables.

Table 4.2 KMO Bartlett's Test

KMO and Bartlett's Test		
Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.789
Bartlett's Test of Sphericity	Approx. Chi-Square	427.762
	Df	6
	Sig.	.000

4.2.2 Reliability Analysis:

Prior to the actual study, a pilot study was carried out to pre-test the validity and reliability of data collected using the questionnaire. The pilot study allowed for pre-testing of the research instrument. The results on reliability of the research instruments are presented in Table 4.3

Table 4.3 Reliability Analysis

Scale	Cronbach's Alpha	Number of Items	Remarks
Concentric Diversification Strategy	0.779	6	Accepted
Conglomerate Diversification Strategy	0.812	5	Accepted
Interrelated Diversification Strategy	0.700	6	Accepted
Business Performance	0.711	3	Accepted

The overall Cronbach's alpha for the four categories was 0.802. The findings of the pilot study showed that all the four scales were reliable as their reliability values exceeded the prescribed threshold of 0.7 (Creswell, 2014).

4.3 Analysis of Objectives:

In the study analysis, a tool rating scale of 5 to 1 was used; where 5 were the highest and 1 the lowest. Opinions given by the respondents were rated as follows, 5= Strongly Agree, 4= Agree, 3= Neutral, 2= Disagree and 1= Strongly Disagree. The analysis for mean and standard deviation were based on this rating scale.

4.3.1 Concentric Diversification Strategy:

Table 4.4 Concentric Diversification Strategy

Descriptive Statistics			
Concentric diversification strategy	N	Mean	Std. Deviation
New products or markets have improved our profitability	255	3.84	1.398
Related new business has reduced costs due to transfer of managerial and expertise skills	255	3.84	1.814
Adding businesses related to our core business was easy because resources were shared e.g. employees, offices,	255	3.74	1.484
No additional managerial skills were needed	255	3.51	1.345
More knowledge of the new business was not required	255	3.72	1.345
There is more risk as compared to dealing with our core business only	255	2.60	1.152
Valid N (listwise)	255		

The first objective of the study was to establish the effects of concentric diversification strategy on business performance of SMEs in Mombasa. Respondents were required to respond to set questions related to concentric diversification strategy and give their opinions. The statement that new products or markets have improved our profitability had a mean score of 3.84 and a standard deviation of 1.398. The statement that related business has reduced costs due to transfer of managerial skills and expertise skills had a mean score of 3.84 and a standard deviation of 1.814. The statement that adding a business related to our core business was easy because resources were shared e.g. employees and offices had a mean score of 3.74 and a standard deviation of 1.484. The statement that no additional employees were needed had a mean score of 3.51 and a standard deviation of 1.345. The statement that more knowledge of the new business was not required had a mean score of 3.72 and a standard deviation of 1.345. The statement that there is more risk as compared to dealing with our core business only had a mean score of 2.60 and a standard deviation of 1.152. The findings agreed with Bood (2001) who notes that due to their independence, SMEs tend to face constraints with managerial resources and skills. In concentric diversified SMEs, most owner-managers would diversify into related business activities to retain their independence.

4.3.2 Conglomerate Diversification Strategy:

Table 4.5 Conglomerate Diversification Strategy

Descriptive Statistics			
Conglomerate diversification strategy	N	Mean	Std. Deviation
Having unrelated businesses has reduced our business performance	255	3.16	1.524
The performance of our core business was better as compared to having unrelated businesses	255	3.39	1.507
Having unrelated businesses required good management skills and business expertise	255	3.74	1.762
Having unrelated businesses has increased our business performance	255	2.61	1.373
There is more risk when dealing with unrelated businesses as compared to dealing with our core business only	255	4.14	.828
Valid N (listwise)	255		

The second objective of the study was to establish the effects of conglomerate diversification strategy on business performance of SMEs in Mombasa. Respondents were required to respond to set questions related to conglomerate diversification strategy and give their opinions. The statement that having unrelated businesses has reduced our business performance had a mean score of 3.16 and a standard deviation of 1.524.

The statement that the performance of our core business was better as compared to having unrelated businesses had a mean score of 3.39 and a standard deviation of 1.507. The statement that having unrelated businesses required good management skills and business expertise had a mean score of 3.74 and a standard deviation of 1.762. The statement that having unrelated businesses has increased our business performance had a mean score of 2.61 and a standard deviation of 1.373. The statement that there is more risk when dealing with unrelated businesses as compared to dealing with our core business only had a mean score of 4.14 and a standard deviation of 0.828. This is in agreement with Singh et al (2010) due to their unique charateristics, SMEs find it easier to engage in unrelated businesses. And also the nature of their core businesses have very few related businesses which require additional manpower and resources.

4.3.3 Interrelated Diversification Strategy:

Table 4.6 Interrelated Diversification Strategy

Descriptive Statistics			
Interrelated diversification strategy	N	Mean	Std. Deviation
Business profitability has improved significantly after adding new products that were both related and unrelated to our core business	255	3.52	1.042
Costs have increased due to operating both related and unrelated businesses	255	3.46	1.463
There is more risk as compared to dealing with our core business only	255	3.66	.958
It was difficult to add both related and unrelated products or services to our core business	255	3.58	1.557
More knowledge and capabilities of the new businesses was required	255	3.60	.920
It is easy to operate both related and unrelated products at the same time with our core business	255	2.95	1.327
Valid N (listwise)	255		

The third objective of the study was to establish the effects of interrelated diversification strategy on business performance of SMEs in Mombasa. Respondents were required to respond to set questions related to combined diversification strategy and give their opinions. The statement that business profitability has improved significantly after adding new products that were both related and unrelated to our core business had a mean score of 3.52 and a standard deviation of 1.042. The statement that costs have increased due to operating both related and unrelated had a mean score of 3.46 and a standard deviation of 1.463. The statement that there is more risk as compared to dealing with our core business only had a mean score of 3.66 and a standard deviation of 0.958. The statement that it was difficult to add both related and unrelated products and services to our core business had a mean score of 3.58 and a standard deviation of 1.557. The statement that more knowledge and capabilities of the new businesses was required had a mean score of 3.60 and a standard deviation of 0.920. The statement that it is easy to operate both related and unrelated products at the same time with our core business had a mean score of 2.95 and a standard deviation of 1.327. The results agree with Park (2010) who noted that a large number of SMEs may actually result to a mix of related and unrelated businesses before settling to a single type of diversification strategy.

4.3.4 Business Performance:

Table 4.7 Business Performance

Descriptive Statistics			
Business performance	N	Mean	Std. Deviation
In terms of yearly turnover, our business may be described as profitable	255	3.63	1.476
In terms of the quality of product or service, our business may be described as excellent	255	3.60	1.086
In terms of customer satisfaction, our business may be described as outstanding	255	4.74	.673
Valid N (listwise)	255		

The statement in agreement that in terms of yearly turnover, our business may be described as profitable had a mean score of 3.63 and a standard deviation of 1.476. The statement that in terms of the quality of product or service, our business may be described as excellent had a mean score of 3.60 and a standard deviation of 1.086. The statement that in terms of customer satisfaction, our business may be described as outstanding had a mean score of 4.74 and a standard deviation of 0.673.

4.4 Correlation Analysis:

To establish the relationship between the independent variables and the dependent variable the study conducted correlation analysis which involved coefficient of correlation and coefficient of determination.

4.4.1 Coefficient of Correlation:

Pearson Bivariate correlation coefficient was used to compute the correlation between the dependent variable (Business Performance) and the independent variables (concentric diversification strategy, conglomerate diversification strategy and

interrelated diversification strategy). According to Sekaran (2010), this relationship is assumed to be linear and the correlation coefficient ranges from -1.0 (perfect negative correlation) to +1.0 (perfect positive relationship). The correlation coefficient was calculated to determine the strength of the relationship between dependent and independent variables (Kothari, 2014).

Table 4.8 Pearson Correlation

Correlations		Business Performance	Concentric Diversification Strategy	Conglomerate Diversification Strategy	Interrelated Diversification Strategy
Business Performance		1			
		255			
Concentric Diversification Strategy		$.212^{**}$	1		
		.001			
		255	255		
Conglomerate Diversification Strategy		$.703^{**}$	$.580^{**}$	1	
		.000	.000		
		255	255	255	
Interrelated Diversification Strategy		$.490^{**}$	$.223^{**}$	.982	1
		.000	.000	.000	
		255	255	255	255
**. Correlation is significant at the 0.01 level (2-tailed).					

In trying to show the relationship between the study variables and their findings, the study used the Karl Pearson's coefficient of correlation (r). This is as shown in Table 4.8 below. According to the findings, it was clear that there was a positive correlation between the independent variables, concentric diversification strategy, conglomerate diversification strategy and interrelated diversification strategy and the dependent variable business performance. The analysis indicates the coefficient of correlation, r equal to 0.212, 0.703 and 0.490 for concentric diversification strategy, conglomerate diversification strategy and interrelated diversification strategy respectively. This indicates positive relationship between all the independent variable namely concentric diversification strategy, conglomerate diversification strategy and interrelated diversification strategy and the dependent variable business performance. However, conglomerate diversification strategy is efficient in enhancing business performance in SMEs. This is in agreement with Bood (2001) who noted that SMEs especially in emerging countries will have a tendency of having many businesses unrelated to one another because of limited resources and managerial capabilities.

4.4.2 Coefficient of Determination (R2):

To assess the research model, a confirmatory factors analysis was conducted. The three factors were subjected to linear regression analysis in order to measure the success of the model and predict causal relationship between independent variables concentric diversification strategy, (conglomerate diversification strategy and interrelated diversification strategy), and the dependent variable (Business Performance).

Table 4.9 Coefficient of Determination

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	$.827^{a}$	.684	.680	1.16972
a. Predictors: (Constant), Interrelated Diversification Strategy, Conglomerate Diversification Strategy, Concentric Diversification Strategy				

The model explains 68.4% of the variance (Adjusted R Square = 0.680) on business performance. Clearly, there are factors other than the four proposed in this model which can be used to predict financial performance. However, this is still a good model as Cooper and Schinder, (2008) pointed out that as much as lower value R square 0.10-0.20 is acceptable in social science research. This means that 68.4% of the relationship is explained by the identified three factors namely concentric diversification strategy, conglomerate diversification strategy and interrelated diversification strategy. The rest 31.6% is explained by other factors in the business performance not studied in this research. In summary the four factors studied, determines 68.4% of the relationship while the rest 31.6% is explained or determined by other factors.

4.5 Regression Analysis:

4.5.1 Analysis of Variance (ANOVA):

The study used ANOVA to establish the significance of the regression model. In testing the significance level, the statistical significance was considered significant if the p-value was less or equal to 0.05. The significance of the regression model is as per Table 4.10 below with P-value of 0.00 which is less than 0.05. This indicates that the regression model is statistically significant in predicting diversification strategies affecting the business performance of SMEs in Mombasa County. Basing the confidence level at 95% the analysis indicates high reliability of the results obtained. The overall Anova results indicated that the model was significant at F = 181.073, p = 0.000. This is in agreement with Bood (2001) who noted that SMEs will diversify their products and services either to related or unrelated products and services as compared to using other growth strategies.

Table 4.10 ANOVA

ANOVA[a]						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	743.255	3	247.752	181.073	.000[b]
	Residual	343.428	251	1.368		
	Total	1086.682	254			
a. Dependent Variable: Business Performance						
b. Predictors: (Constant), Interrelated Diversification Strategy, Conglomerate Diversification Strategy, Concentric Diversification Strategy						

4.5.2 Multiple Regression:

The researcher conducted a multiple regression analysis as shown in Table 4.11 so as to determine the relationship between business performance and the three variables investigated in this study.

Table 4.11 Multiple Regression

Coefficients[a]						
		Unstandardized Coefficients		Standardized Coefficients		
Model		B	Std. Error	Beta	t	Sig.
1	(Constant)	13.547	.725		18.692	.000
	Concentric Diversification Strategy	.078	.028	.132	2.844	.005
	Conglomerate Diversification Strategy	.392	.024	.742	16.317	.000
	Interrelated Diversification Strategy	.317	.031	.388	10.209	.000
a. Dependent Variable: Business Performance						

The regression equation was:

$Y = 13.547 + 0.078X_1 + 0.392X_2 + 0.317X_3$

Where;

Y = Business Performance

X_1 = Concentric Diversification Strategy

X_2 = Conglomerate Diversification Strategy

X_3 = Interrelated Diversification Strategy

The regression equation above has established that taking all factors into account (Business performance as a result of concentric diversification strategy, conglomerate diversification strategy and interrelated diversification strategy) constant at zero, business performance will be 13.547. The findings presented also shows that taking all other independent variables at zero, a unit increase in concentric diversification strategy will lead to a 0.078 increase in the scores of business performance upto a certain point; a unit increase in conglomerate diversification strategy will lead to a 0.392 increase in business performance up to a certain point; a unit increase in interrelated diversification strategy will lead to a

0.317 increase in the scores of business performance up to a certain point, after which the performance starts decreasing. This therefore implies that all the three variables have a positive relationship with conglomerate diversification strategy contributing most to the dependent variable.

From the table we can see that the predictor variables of concentric diversification strategy, conglomerate diversification strategy and combined diversification strategy got variable coefficients statistically significant since their p-values are less than the common alpha level of 0.05. This is in agreement with, Singh et al, 2010; Park, 2010; Liu & Hsu, 2011) that performance improved in an increase of diversification strategies until a certain point, after which any further increase in diversification strategies lead to a decrease in performance.

4.6 Hypothesis Analysis:

4.6.1 Hypothesis 1

H_0: There is no effect of concentric diversification strategy on business performance of SMEs in Mombasa County.

$$\beta_1 = 0,$$

H_1: There is an effect of concentric diversification strategy on business performance of SMEs in Mombasa County.

$$\beta_1 \neq 0,$$

In relation to the variable concentric diversification strategy, the results in Table 4.11 above indicate that concentric diversification strategy on business performance. This is supported by regression analysis t-value of 2.844 which is greater than the critical value 2.0 and a p-value of 0.00 at 95% level of significance which is less than 0.05

After testing the hypothesis by comparing the scores of calculated t-value and critical t calculated t-values was 2.844 for concentric diversification strategy, which is greater than the critical t_{36} (0.05)= 2.0, the study rejected the null hypothesis and accepted the alternative hypothesis that there is an effect of concentric diversification strategy on business performance of SMEs in Mombasa County.

4.6.2 Hypothesis 2

H_0: There is no effect of conglomerate diversification strategy on business performance of SMEs in Mombasa County.

$$\beta_1 = 0,$$

H_1: There is an effect of conglomerate diversification strategy on business performance of SMEs in Mombasa County.

$$\beta_1 \neq 0,$$

In relation to the variable conglomerate diversification, the result in Table 4.11 above indicates that conglomerate diversification strategy has a significant influence on business performance. This is supported by regression analysis t-value of 16.317 which is greater than the critical value 2.0 and a p-value of 0.00 at 95% level of significance which is less than 0.05. After testing the hypothesis by comparing the scores of calculated t-value and critical t; Calculated t-values was, 16.317 for, which is greater than the critical t_{36-1} (0.05) = 2.0, The study rejected the null hypothesis and accepted the alternative hypothesis that there is an effect of conglomerate diversification strategy on business performance of SMEs in Mombasa County.

4.6.3 Hypothesis 3

H_0: There is no significant effect of interrelated diversification strategy on business performance of SMEs in Mombasa County.

$$\beta_1 = 0,$$

H_1: There is a significant effect of interrelated diversification strategy on business performance of SMEs in Mombasa County.

$$\beta_1 \neq 0,$$

In relation to the interrelated diversification strategy, the results in table 4.11 above indicate that interrelated diversification strategy has a significant influence on business performance of SMEs in Mombasa County.This is supported by regression analysis t-value of 10.209 which is greater than the critical value 2.0 and a p-value of 0.00 at 95%

level of significance which is less than 0.05. After testing the hypothesis by comparing the scores of calculated t-value and critical t; Calculated t-values was, 10.209 for interrelated diversification strategy, which is greater than the critical t_{36-1} (0.05) = 2.0, The study rejected the null hypothesis and accepted the alternative hypothesis that there is an effect of interrelated diversification strategy on business performance of SMEs in Mombasa County.

V. CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion:

Concentric diversification strategy is an attractive strategy for SMEs but not the best as it limits SMEs to certain sector, product or service. Concentric diversified SMEs must rely on their core business resources and capabilities in order to diversify up to a certain point. In addition, managerial weaknesses lead to the underperformance of concentric diversification strategy in the long run.

Conglomerate diversification strategy is the efficient strategy for small and business enterprises. SMEs are normally flexible and responsive to customers' needs. These characteristics enable them to diversify into a variety of diversified categories. Conglomerate diversified SMEs are able to spread their risk as result of pursuing unrelated businesses. However, conglomerate diversified SMEs cannot compete with large companies in the long run due to their lack of business know- how.

Interrelated diversification strategy outperforms concentric diversification strategy. Its benefits and costs outweigh that of concentric diversified SMEs. However, interrelated diversified SMEs require quick and reliable information in order to make real time decisions to enhance their productivity due to their complex business activities. Most SMEs have partially utilized the digital technology in enhancing their performance but more needs to be done for the interrelated diversification strategy to be highly successful in the long run.

5.2 Recommendations:

The study recommended the following:

Concentric diversification strategy is good but not the best in emerging countries. However, SMEs who choose this diversification strategy need to focus on management training to increase their intellectual capital so as to improve their business performance. Business owners, top managers and middle managers should upgrade their management skills for them to stay relevant in the business world. The Government of Kenya should also implement programs to enhance SME management training. Such programs should be tailor-made to cater all the different SMEs in the Country regardless of their degree of diversification.

Conglomerate diversification strategy is the efficient diversification strategy for SMEs in emerging countries because of their flexibility characteristic. However, SMEs should upgrade their capacity to gather information. In this information age, business competitiveness is heightened by accessibility to data and information. For SMEs to participate in the dynamic environment effectively and efficiently, they must form partnerships with the government, parastatal bodies and private firms. The government should also improve SMEs access to information infrastructure and international markets through their digital software, seminars and business forums.

Interrelated diversification strategy is a very complex strategy. SMEs who aspire to undertake this strategy need to address their weaknesses such as upgrade of their technology base and managerial capabilities before embarking on this diversification strategy. In the current dynamic environment, most SMEs should invest in ICT based applications that apply to their businesses processes. Most business software is easily affordable and SMEs owners should not shy away from utilizing them to improve their business performance. This software provides real time information and greatly enhance decision making.

5.3 Suggestion for Further Studies:

This study focused on the diversification strategies affecting business performance of SMEs in Mombasa County. However, 68.4% of results were explained by the independent variables. Therefore, further studies should be carried out on other factors such as owner's leadership style and innovation as moderating factors on diversification strategy and SMEs business performance.

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