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Diversification And Performance Relationship in Turkey: A Study of Companies Listed on Istanbul Stock Exchange

Türkiye'de Çeşitlendirme ve Performans İlişkisi: İstanbul Menkul Kıymetler Borsası'nda Kayıtlı Olan İşletmeler Üzerine Bir Araştırma

Abstract

Diversification strategy is a critical decision for companies aiming to grow, reduce risk, and enhance competitive advantage. The purpose of this research is to explore the relationship between diversification strategies and organizational performance in Turkey as an emerging country. Annual data of 318 companies listed on Istanbul Stock Exchange Market spanning eight years from 2016-2023 are analyzed. This research examines empirical data through statistical analysis. The results reveal that 83% of companies prefer a single business strategy, indicating a tendency towards specialization rather than diversification. Also, unrelated diversification leads to the highest performance, followed by single business strategies. In contrast, dominant strategies generally yield the lowest performance.

Keywords: Diversification Strategy, Organizational Performance, Emerging country

JEL Codes: L25, O1

Özet

Çeşitlendirme stratejisi, büyümek, riskleri azaltmak ve rekabet avantajını artırmak isteyen firmalar için temel bir karardır. Araştırmanın amacı, Türkiye'de, gelişmekte olan bir ülke olarak çeşitlendirme stratejileri ile örgütsel performansı arasındaki ilişkiyi incelemektir. İstanbul Menkul Kıymetler Borsası'nda işlem gören 318 firmaların 2016-2023 yıllarını kapsayan sekiz yıllık verileri analiz edilmektedir. Bu araştırma istatistiksel analiz yoluyla ampirik verileri incelemektedir. Sonuçlar, firmaların %83'ünün yoğunlaşmış stratejisini tercih ettiğini ve bu durumun, çeşitlendirme'ye kıyasla uzmanlaşmaya olan tercihi yansıttığını ortaya koymaktadır. Ayrıca, ilişkisiz çeşitlendirme en yüksek performansı sağlamaktadır, sonra yoğunlaşmış stratejisi yer almaktadır, ancak esas iş temelli stratejilerin genellikle en düşük performansı göstermektedir.

Anahtar Kelimeler: Çeşitlendirme Stratejisi, Örgütsel Performansı, Gelişmekte Olan Ülke

JEL Kodları: L25, O1

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INTRODUCTION

Researchers have long debated whether diversification strategy enhance organizational performance or whether it instead reduce performance results. Diversification strategy involves spreading company resources and investments across a variety of sectors or markets to reduce risk and increase organizational performance. This strategy is akin to the well-known adage of "not putting all your eggs in one basket." The relationship between diversification and performance has been a subject of significant academic debate, offering different conclusions on how diversification impacts organizational performance.

The concept of diversification originally introduced by scholars such as (Ansoff, 1957, p. 113; Chandler, 1962, p. 78; Markowitz, 1952, p. 78; Gort, 1962, p. 8). It is a strategy that a company pursues when operating in different product or service markets (Ansoff, 1957). Performance is the degree to generate higher financial returns in diversified company than those of a comparable portfolio of single companies (Rumelt, 1974). According to (Markowitz, 1952) in Modern Portfolio Theory, diversification strategy lead to stable returns, reduced risk and high level of performance. Moreover, diversification creates synergy, enhance competitiveness (Oladele, 2012) market share, debt capacity, growth opportunity (Afza, Slahudin, & Nazir, 2008) and the cross-utilization and exploitation of resources (Chatterjee & Wernerfelt, 1991).

According to (Knecht, 2014), corporate diversification has three general forms: (i) related and unrelated diversification; (ii) horizontal, vertical, and conglomerate diversification; and (iii) domestic and international diversification. Horizontal and vertical can be subsumed under the term related diversification, conglomerate strategy can be subsumed under the term unrelated diversification. Domestic diversification refers to diversification within the boundaries of a company's home country, while international diversification means reaching into markets outside the company's home country.

While related diversification provides synergy, unrelated diversification reduces risk. (Rumelt, 1974) findings indicates that related diversification increases organizational performance. Conversely, (Michel & Shaked, 1984) findings indicates that unrelated diversification increases organizational performance and (Li, 2002) findings indicates that unrelated diversification reduces performance. In the other side (Yin, 1999) concluded that single, dominant and related diversification outperform unrelated diversification.

Four viewpoints on the connection between organizational performance and diversification have been distinguished by academics. First, companies with greater degrees of diversification perform better. Second, greater diversity impedes the advancement of performance. Third, the performance of a company is not much affected by diversification. Fourth, there is a non-linear "U"-shaped link between corporate performance and diversification (Le, 2019).

1. Literature Review and Hypotheses

Diversification is a growth strategy used both for companies in developed (Datta, Nandini, & Abdul, 1991) and emerging countries (Kakani, 2000). Diversification's effect on performance varies over time (normal or crisis period) and across different market conditions (Emergent or developed market) (Agarwal & Gort, 1996). The relationship between diversification and performance has been extensively studied in developed economies and briefly examined in emerging economies.

In developed economies, (Belkaoui, 1996, s. 367; Chatterjee S., 1986, s. 119; Kim, Hoskisson, & Lee, 2014, s. 518; Montgomery, 1994, s. 163; Park & Jang, 2013a, s. 51) found that related diversification tends to lead to better performance in developed countries because of the ability to leverage existing resources and competencies.

Contrary, (Bettis & Hall, 1982, p. 254; Joudaa, Bouzgarroua, & Hellara, 2016, p. 1; Lang & Stulz, 1994, p. 1248) found that unrelated diversification, tends to have a negative impact on performance and company value and (Rumelt, 1974) found that the relationship between diversification and performance is not linear. Instead, he proposed a curvilinear (inverted U-shaped) relationship. Which means, firstly, as a company diversifies (either related or unrelated diversification), performance improves. This is due to spreading risk, exploiting economies of scale, and achieving synergies between related businesses. secondly, as a company continues to diversify beyond a certain point, particularly into unrelated areas, performance starts to decline. This is because of increasing complexity, loss of focus, and difficulties in managing unrelated businesses.

In emerging economies, (Hoskisson, Eden, Lau, & Wright, 2000, p. 249; Kakani, 2000, p. 19), found that unrelated diversification tends to lead to better performance in emerging countries because of government interventions and economic and institutional voids. Contrary (Ajao, 2021, p. 91; Chu, 2004, p. 391; Phung & Mishra, 2017, p. 386) found that unrelated diversification generally does not improve performance and often leads to negative results due to market challenges and related diversification did not yield significant positive performance improvements either. (Khanna & Palepu, 2000a) found that the effect of corporate diversification on performance is not linear. Instead, it follows an inverted U-shaped (curvilinear) relationship.

Developed economies are characterized by strong and developed institutions with efficient product, labor and capital markets. Unrelated diversification is value-destroying in developed economies (Palich, Cardinal, & Miller, 2000), and value-creating in emerging economies (Khanna & Palepu, 2000a, p. 268; Kock & Guillen, 2001, p. 77). Diversification can increase performance in emerging economies because of insufficient market and institutional development (Khanna & Palepu, 2000a). Therefore, in emerging economies unrelated diversification may be chosen due to the lack of well-established product markets, financial markets and labor markets, gaps in laws, corruption, regulations and inconsistent enforcement of contracts (Anıl & Yiğit, 2011, s. 1494; Palepu, 1985, s. 239; Yiğit & Behram, 2013, s. 121; Yiğit, Behram, & Işçi, 2013, s. 76). While unrelated diversification improve performance in emerging economies, related diversification improve performance in developed economies (Khanna & Palepu, 2000a). Factors like privatization policies, working condition, product life cycle and competition, influence of government and business relation, market production, labor factors, and political and economic issues impacts the relationship between diversification and performance (Hoskisson, Eden, Lau, & Wright, 2000, p. 249; Khanna & Palepu, 2000a, p. 268; Sajid, Shujahat, & Tahir, 2016, p. 381). Still previous empirical studies have led to different findings, thus making a generalization remain impossible (Palich, Cardinal, & Miller, 2000)

Turkey is an emerging market with a unique position bridging Europe and Asia, it's a unique blend of characteristics of both emerging and developed economies, which provides its companies with both challenges and opportunities for growth and expansion. In Turkey, companies predominantly adopt concentrated strategies, the relationship between diversification and performance is impacted by several factors like:

The limited representation of companies on the Istanbul Stock Exchange and the underdeveloped sectors. Also, Government policies and interventions especially privatization have created opportunities for businesses to invest in new areas, particularly in profitable public enterprises being privatized. (Boz, Yiğit, & Anıl, 2013, p. 797; Yiğit, Behram, & Işçi, 2013, p. 76; Yiğit & Behram, 2013, p. 121) Government-business relations play a crucial role in navigating bureaucratic challenges in emerging markets, with large conglomerates sometimes influencing economic programs or prioritizing resource allocation (Khanna & Palepu, 1997). Economic factors, such as inflation and interest rates, alongside market conditions, also affect diversification strategies. The lack of perfect

competition encourages companies to pursue unrelated diversification in order to capitalize on market gaps (Khanna & Palepu, 1997). Labor market conditions further influence diversification, with challenges in finding skilled labor, alongside an abundance of unskilled labor, affecting cost structures. In Turkey, the relatively young population helps reduce labor costs, incentivizing businesses to invest in areas that do not require a highly skilled workforce, even if they are unrelated to their core business. These unique conditions create a distinct dynamic for diversification strategies in Turkey, differing from those in developed countries.

In general, Turkey's diversification has historically been impacted by privatization policies (Yiğit, Behram, & Işçi, 2013, p. 76; Yiğit & Behram, 2013, p. 121). Essentially, a profitable public enterprise can be sold regardless of being related or unrelated to a company's current industry (Karaevli, 2008). The implementation of liberalization and internationalization program in January 1980 impacted significantly the Turkish economy (Önis, 1992). State intervention played a key role in the growth of business groups, but the liberalization and privatization processes of the 1980s presented new challenges. Businesses that successfully adapted to the market economy and global competition generally performed better and those who failed to adjust to the new economic realities of globalization faced stagnation or decline (Bugra, 1994). The country's state policies and the variety of these policies are the reasons for the high level of corporate diversity (Üsdiken & Göksen, 2001). According to Istanbul Stock Exchange, Turkish economy is characterized by 95% of medium and small sized enterprises family-owned companies, which are over-leveraged. Turkey is also characterized by institutional voids and operational deficiencies, large gaps in skills and earning capacity of individuals, persistent unemployment, low level of fiscal transparency, a high cost of loans and equity in private markets, significant economic volatility, inflation and currency devaluation.

Based on a combination of theoretical insights from the diversification literature and empirical evidence from Turkish studies on corporate performance. And due to Turkey's environmental opportunities, institutional gaps and lack of perfect competition conditions, it is expected that the performance of single and unrelated diversified companies will be higher. We intend to test the following hypothesis:

H1: There is a significant difference between types of diversification and organizational performance in Turkey.

2. Methodology

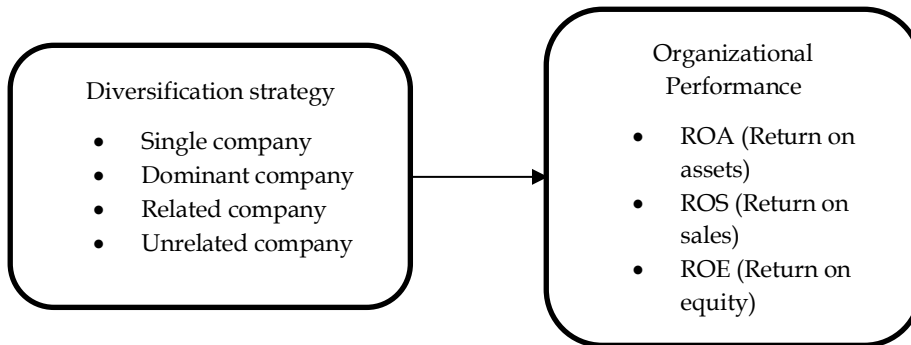
2.1 Research Goal

This research aims to determine whether there is a significant difference between types of diversification and organizational performance in Turkey.

2.2 Research model

The research model employed in this research examines the relationship between diversification and organizational performance in Turkey, specifically focusing on companies listed on the Istanbul Stock Exchange. Diversification is measured using Rumelt's classification, which categorizes companies based on their strategic scope ranging from single companies to dominant, related or unrelated diversified companies. Performance is evaluated using three key financial metrics: Return on Assets (ROA), Return on Equity (ROE), and Return on Sales (ROS), which provide a comprehensive view of a company's efficiency and profitability. By analyzing these variables, the research explores how different types of diversification impact the organizational performance within the Turkish market. Consequently, the research model is structured as follows.

Figure 1: **Research model on the relationship between diversification strategy and organizational performance**



2.3 Sample, Data Collection and Measurement Methods of the Research Variables

This research adopts a quantitative research design to explore the relationship between diversification and organizational performance in Turkey. The research universe is the 446 companies listed on Istanbul Stock Exchange Market-Borsa İstanbul (BIST) , annual data of 318 companies spanning eight years from 2016-2023 are analyzed. Data are retrieved from www.kap.org.tr and www.borsaistanbul.com and www.zonebourse.com.

The independent variable of this research is diversification and the dependent variable is organizational performance. Diversification is measured using Rumelt classification and organizational performance is measured using (ROA) (ROS) and (ROE).

Historically the most and commonly used methods to measure diversification are the Berry-Herfindahl index, the Jacquemin's and Berry's entropy index and Rumelt's classification. Still, the Rumelt classification rule is more scientific and provides a specific numerical scale reference (Le, 2019).

For diversification, various classification methods have been proposed by researchers worldwide, including the (Ansoff, 1957, p. 113; Rumelt, 1974, p. 80; Wrigley, 1970, p. 174) methods. Among the most widely used measures are Rumelt's diversification classification, it provides a structured way to analyze how companies diversify and the implications of each strategy on performance. According to Rumelt, diversification can be categorized into four types based on the specialization ratio (SR) and the relatedness ratio (RR).

- The **specialization ratio** measures the degree to which a company's revenue or assets are concentrated in its core business.
- The **relatedness ratio** is used to measure the degree of relatedness between the industries or businesses within a company's portfolio.

The four types of diversification are as follows:

1. **Single Business:** Companies focus on a single product or market. They rely entirely on their core business, which constitutes at least 95% of their total revenue.
2. **Dominant Business:** Companies operate in one primary industry but generate between 70% and 95% of their revenue from that industry.
3. **Related Diversification:** Companies expand into businesses that are related to their core operations, either through horizontal or vertical integration. These businesses share the same technologies, resources, or market channels, leading to the creation of economies of scope.

4. **Unrelated Diversification:** Companies enter industries or markets that are not related to their current industry.

Table 1: **Rumelt's classification**

<i>Categories</i>	<i>Ratios</i>
<i>Single Company</i>	(SR \geq 0.95)
<i>Dominant Company</i>	(0.95 > SR \geq 0.70)
<i>Related Company</i>	(SR < 0.70 and RR > 0.70)
<i>Unrelated Company</i>	(SR < 0.70 and RR < 0.70)

Source: Table compiled by author

According to this method, industries are categorized using either the NAICS (North American Industry Classification System) or ISIC (International Standard Industrial Classification).

(Lamont & Anderson, 1985) emphasize the importance of using multiple performance measures in Diversification-Performance research, as it provides valuable insights into how funds are allocated for strategic decision-making. Previous researches generally used Return on Sales (ROS), Return on Assets (ROA) and Return on Equity (ROE) ratios in order to measure financial efficiency (Tallman & Li, 1996). (Bettis & Hall, 1982) argue that ROA is the most appropriate measure in Diversification Performance research, as it represents a return that management can directly control. Three of the most widely used accounting-based measures of performance are used in this research, as follows:

- **Return on Asset**, is defined as current year net income divided by total assets.
- **Return on Sales**, is defined as current year net income divided by total sales.
- **Return on Equity**, is defined as current year net income divided by total equity.

2.4 Analyses and Results

To assess the relationship between diversification and performance of companies listed on Istanbul Stock Exchange. Series of statistical tests are conducted, starting with an analysis of normal distribution. However, the data exhibited a non-normal distribution, prompting the adoption of a non-parametric approach for analysis. First of all, the frequency values are calculated, then the Kruskal-Wallis test is employed to evaluate Hypothesis 1, which claims that there is a significant difference between types of diversification and organizational performance in Turkey. Finally, the Mann-Whitney U test is applied to determine whether significant differences exist between organizational performance and each of Rumelt's diversification categories. The results of these analyses are presented below:

2.4.1 Frequencies for Diversification in period of 2016-2023, ROA, ROS and ROE Values

Table 2 presents the distribution of companies based on the extent of diversification, including their frequency within each diversification category and the corresponding average performance indicators. During the period from 2016 to 2023, a significant majority of companies listed on the Istanbul Stock Exchange are single companies. Out of 200 companies, 167 companies (83%) pursue a single business strategy, while 15 companies (7.5%) pursue a dominant business strategy. Additionally, 7 companies (3.5%) are engaged in related diversification, and 11 companies (5.5%) pursue unrelated diversification strategy. There is a net preference for specialization over diversification, as 83% of the companies maintain a focused business strategy rather than expanding into multiple industries. Unrelated diversified companies tend to outperform single companies, followed by related diversified companies, with dominant companies generally yielding the lowest performance.

Table 2: Frequencies for Diversification in 2016-2023 Period, ROA, ROS, ROE Values

Diversification measure	Frequency	Percentage	Performance Indicator		
			ROA	ROS	ROE
Single	167	83,1	0,052	0,135	0,142
Dominant	15	7,5	0,051	0,124	0,007
Related	7	3,5	0,056	0,145	0,005
Unrelated	11	5,5	0,052	0,141	0,015
Total	200	100	0,211	0,545	0,169

2.4.2 Diversification Strategy and Return on Assets (ROA)

According to the results of Kruskal Wallis analysis applied to test Hypothesis1, the 5% error margin return on asset diversification strategy showed no significant difference in ROA across diversification levels (Chi-Square = 2,012, $p = 0.570$). This means diversification does not appear to have a strong impact on Performance.

Table 3: 2016-2023 Period Diversification Strategy Return on sales (ROA)

Diversification Measure	Frequency	Percentage	Mean Rank	ROA	Kruskall Wallis	
Single	167	83,1	102,47	0,052	Test Statistics a,b	
Dominant	15	7,5	80,11	0,051	Chi-Square	2,012
Related	7	3,5	93,60	0,056	Df	3
Unrelated	11	5,5	99,14	0,052	Asymp. Sig	,570
Total	200	100		0,211	a. Kruskal Wallis Test b. Grouping Variable: ROA	

2.4.3 Diversification Strategy and Return on Equity (ROE)

According to the results of Kruskal Wallis analysis applied to test Hypothesis1, the 5% error margin return on equity diversification strategy showed near significant difference in ROE across diversification levels. (Chi-Square = 6,509, $p = 0.089$). This means ROE might be influenced by diversification, A 10% ROE is considered valid for reliability and this result is statistically significant. According to Mann-Whitney U test, ROE has a borderline significance, suggesting some potential effects between dominant companies and unrelated diversified companies and between dominant companies and single companies. Unrelated diversified companies and single companies outperform dominant companies.

Table 4: 2016-2023 Period Diversification Strategy Return on sales (ROE)

<i>Diversification Measure</i>	<i>Frequency</i>	<i>Percentage</i>	<i>Mean Rank</i>	<i>ROE</i>	<i>Kruskall Wallis</i>	
<i>Single</i>	167	83,1	104,10	0,142	Test Statistics a,b	
<i>Dominant</i>	15	7,5	65,29	0,007	Chi-Square	6,509
<i>Related</i>	7	3,5	79,40	0,005	Df	3
<i>Unrelated</i>	11	5,5	99,27	0,015	Asymp. Sig	,089
<i>Total</i>	200	100		0,169	a. Kruskal Wallis Test b.Grouping Variable:ROE	

2.4.4 Diversification Strategy and Return on Sales (ROS)

According to the results of Kruskal Wallis analysis applied to test Hypothesis1, the 5% error margin return on sales diversification strategy showed no significant difference in ROS across diversification levels. (Chi-Square = 5,118, $p = 0.163$). A 20% ROS is considered valid for reliability. According to Mann-Whitney U test, ROS has a borderline significance, suggesting some potential effects between unrelated diversified companies and single companies. Unrelated diversified companies outperform single companies.

Table 5: 2016-2023 Period Diversification Strategy Return on sales (ROS)

<i>Diversification Measure</i>	<i>Frequency</i>	<i>Percentage</i>	<i>Mean Rank</i>	<i>ROS</i>	<i>Kruskall Wallis</i>	
<i>Single</i>	167	83,1	98,49	0,135	Test Statistics a,b	
<i>Dominant</i>	15	7,5	105,00	0,124	Chi-Square	5,118
<i>Related</i>	7	3,5	78,40	0,145	Df	3
<i>Unrelated</i>	11	5,5	135,82	0,141	Asymp. Sig	,163
<i>Total</i>	200	100		0,545	a. Kruskal Wallis Test b. Grouping Variable: ROS	

The Mann-Whitney U test is conducted to compare **organizational performance** (ROA), (ROE) and (ROS) between two diversification sub-variables at a time. It helps to identify statistically significant differences. The results indicate no significant differences in organizational performance between companies engaged in:

- Related and unrelated diversification
- Dominant and related diversification
- Single and related diversification

A statistically significant difference is observed in ROS between unrelated diversified companies and single companies, with unrelated diversification demonstrating higher ROS ($p = 0.031$). And no significant differences are found in ROA and ROE across these groups. Unrelated diversification outperforms single companies.

Table 6: Mann-Whitney Test for Single and Unrelated diversified companies

<i>Mann-Whitney U</i>	<i>ROA</i>	<i>ROS</i>	<i>ROE</i>
<i>p (2-tailed)</i>	,838	,031	,753

A statistically significant difference is observed in ROE between dominant companies and unrelated diversified companies ($p = 0.080$), which means that unrelated diversified companies experience a higher performance compared to dominant companies.

Table 7: **Mann-Whitney Test for Dominant and Unrelated diversified companies**

<i>Mann-Whitney U</i>	<i>ROA</i>	<i>ROS</i>	<i>ROE</i>
<i>p (2-tailed)</i>	,298	,476	,080

A statistically significant difference is observed in ROE between dominant companies and single companies ($p = 0.018$), ROE is significantly lower for dominant companies compared to single companies, which is a disadvantage in equity returns for companies operating under a dominant business strategy. Single companies outperform dominant companies.

Table 8: **Mann-Whitney Test for Single and Dominant companies**

<i>Mann-Whitney U</i>	<i>ROA</i>	<i>ROS</i>	<i>ROE</i>
<i>p (2-tailed)</i>	,172	,713	,018

CONCLUSION

The relationship between diversification and organizational performance in Turkey, presents challenges and opportunities. It has been moderately explored, with findings indicating varying outcomes. (Yiğit & Behram, 2013) found that single business and unrelated diversification strategies tend to achieve higher organizational performance. In contrast, (Boz, Yiğit, & Anıl, 2013) found that dominant business strategies are also associated with strong organizational performance. This research explores how diversification strategies (single, dominant, related and unrelated) impact organizational performance and overall corporate success within the Turkish business landscape. Focusing on companies listed on Istanbul Stock Exchange between 2016 and 2023. The findings reveal that the majority of companies (83%) are single companies, indicating a preference for specialization over diversification.

The results of the Kruskal-Wallis and Mann-Whitney U tests show no significant differences in ROA across all diversification categories. ROE is significantly lower for dominant companies compared to single companies and to unrelated diversified companies. Additionally, Unrelated diversification shows an advantage in ROS. ROS is significantly higher for unrelated diversified companies compared to single companies, which means that the expansion into unrelated industries may enhance sales performance.

Hypothesis 1 is supported when the findings of this research are evaluated in terms of ROS and ROE. In Turkey unrelated diversified companies tends to deliver the highest performance, followed by single companies and related diversified companies with dominant companies generally yielding the lowest performance. The relationship between diversification and performance among Turkish companies cannot be analyzed in isolation from the broader institutional context. The reasons behind our findings may be the unique economic and regulatory environment of Turkey. Factors such as privatization policies, working conditions, crises conditions that coincide with the period of research and the absence of perfect competition conditions markets play a crucial role in these results.

Finally, the performance of single and unrelated diversified companies is higher in Turkey. Future research could further make comparative research between Turkish companies and those in other emerging or developed economies to provide deeper insights into how diversification strategies impact performance across different economic contexts.

AUTHOR NOTES

This article has not been published elsewhere. The findings of this study have not been presented at any conference or journal.

AUTHOR CONTRIBUTIONS

Design: Author 1; Data Collection: Author 1; Data Processing: Author 1; Author 2; Analysis and/or Interpretation: Author 1; Literature Review: Author 1, Author 2; Manuscript Writing: Author 1, Author 2; Critical Review: Author 2

CONFLICT OF INTEREST

There is no conflict of interest regarding this study.

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ETHICAL STATEMENT

The author(s) declare that all processes of the study comply with research and publication ethics, adhering to ethical standards and principles of scientific citation.

The study does not require ethical permission.

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