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Abstract

"Corporate strategies and their effectiveness constitute a crucial research problem in both finance and strategic management. Product diversification is a common corporate strategy by which an organization moves into a wider range of products. A growing interest in comparing the relative success of product diversification vis-à-vis focussed strategies has spawned a rapidly expanding literature. Nevertheless, in India, there exists a gap in empirical research on the impact of corporate diversification strategy on financial performance.

India's industrial sector continues to be dominated by business houses. These business groups often diversify across different product lines. However, little empirical work has been done on the relationship between Indian business groups' financial performance and product diversification strategies. So, it will be interesting to examine the relationship between diversification strategy and financial performance of Indian business groups.

Using aggregated financial statement data and capital market data of 240 large Indian business houses, we studied the performance of Indian business houses' vis-à-vis their diversification strategy. To make the study robust, we made use of multiple measures for performance and product diversification. We also made use of a large set of control variables and a longer time span of 12 years (1987-99) divided into three sub-periods (viz., 1987-91, 1991-95 and 1995-99) having different economic conditions.

We found that product diversification strategy was negatively related to business groups shareholder value (Tobin's Q Ratio) for all the three periods of the study. Shareholder value maximization depends on a group's growth, profitability, risk and the general capital market conditions. So, the study extended itself to investigate the precise performance components that drove the above result during the three different periods.

We found that during periods of low competition in the Indian economy (1987-91), profitability and net profit margins were negatively related to degree of product diversification. During 1991-95, a period of high growth rates for business groups post-

liberalization, it was found that profitability, net profit margins and sales turnover were negatively related to a group's product scope. In 1995-99, a period of high competition from industrial deregulation, we found that growth and sales turnover of business groups were negatively related to their diversification levels. The results in the later periods also seem to be influenced by the capital market's preference for focussed business groups. So, the differences among the performance indicators across sub-periods apparently exhibit the influence of diverse competitive factors and economic characteristics prevailing during the three sub-periods.

It was found that, apart from a business group's product diversification strategy, its size, solvency position and international exposure levels were important factors affecting their market-based and non-market based performance measures during all the sub-periods of study.