A SURVEY OF PRODUCT DIVERSIFICATION STRATEGIES ADOPTED BY NZOIA SUGAR COMPANY LTD.

BY

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Declaration

I declare that this is my original work and it has not been presented to any university for examination purposes.

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This Research project Report has been submitted for an examination with my approval as the student supervisor.

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Dedication

This work is dedicated to my family and friends who supported me during the entire period of study.

To my Family: My wife Sophie and daughters: Christine Lato, Marianne Navututu and Sisina Munyereti-I thank you for your unbelievable support, patience, and as source of inspiration throughout my time away to pursue my professional and Educational pursuits. I did all this for you.

To my Parents: My father Eliud and my mother Margaret for parental guidance throughout my life today and tireless efforts to have made me who I am today.

To all my friends: They were source of inspiration and gave me challenge that I did not lose my Focus.
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ABSTRACT

Pursuing product diversification activities may enable a firm to exploit market opportunities and enjoy the benefits of economies of scale or scope. Product diversification may also achieve competitive advantage for companies through economies of scale and other synergies from using the company’s resources and capabilities across different product lines (Geringer et al., 2000). Such synergies from product diversification are more likely to be realized when firms expand into related lines of new products and markets (Qian, 1997; Luo, 2002). Therefore, Qian (2002) reported that product diversification is positively related to a firm's profitability. This study sought to determine product diversification strategies adopted by Nzoia Sugar Company and also to establish what managers of the company consider to be the relationship between product diversification and performance. This study used a case study analysis since the unit of analysis was one organization. Primary data was collected from the company management staff by use of interview guides. Interview guides were designed and administered through interview and discussions with key informants who include senior managers and departmental heads. The completed interview guides were edited for completeness and consistency before processing the responses. Being a case study, content analysis was most useful. From the findings, the study found that the product diversifications strategies adopted by Nzoia Sugar Company were moving from 50 kilogram unbranded sugar into packaged branded sugar in 5 kilogram 1 kilogram packet, 2 kilogram packet, ½ kilogram packet and 10 kilogram packet. The company by-product (molasses) is sold to other users for making industrial products like Spirits and other commercial alcoholic products and also develops cane seedlings that are sold to farmers. Product diversification increased the company’s sales, creates competitive advantage, it grows the business portfolio and profitability of the company and also improved company turnover. The study therefore recommends that Nzoia Sugar Company should fully embrace product diversification in order to improve the performance of the firm by increasing sales, creating a competitive advantage over the competitors and also to enhance customer loyalty to the products.
CHAPTER ONE: INTRODUCTION

1.1 Background of the study

In today’s business environment organizations are faced with various challenges that impact on their survival and growth objectives. Various business models must be adopted to mitigate the challenges and diversification strategy is one of them a company may adopt to create Value. However as analyzed in the text below there is no perfect strategic decision but one has to balance conflicting objectives and priorities to make meaningful choices about its portfolio. The sugar industry is a key player in the Kenyan economy and challenges posed by entry of Comesa players and the desire to improve their bottom line they have to re-look at the way they do business as a way of remaining competitive. In this regard Nzoia Sugar Company has been chosen among the local sugar firms in this study to examine their diversification strategies. This chapter summarizes the introduction to the subject of product diversification strategies available for Nzoia Sugar Company. The concept of diversification strategies and its implications is expounded followed by an overview of the Nzoia Sugar Company and justification of the study. The Importance of the study and finally the objectives of the study have also been analyzed.

1.1.1 Diversification strategies

The environmental changes of business will become more fast-paced and business environment will become more complex as well. As a result, any corporation must go through certain evolution to confront this circumstance and must be continually developing new strategies with the goal of re-inventing themselves into agile organizations (Narasimhan and Kim, 2002). A major problem that has to be confronted as part of the strategy development is how to pursue diversification-based strategy. A firm can be diversified by diversifying its products, entering either related or unrelated businesses, and/or pursuing international markets. Once a firm has been diversified, it cannot concern itself only with its business unit strategy, i.e. how to create a sustainable competitive advantage within its chosen marketplace (Jones and Swanson, 1995), but must pursue diversification-related activities when it confronts greater competitive pressures
Hitt et al. (1997) assert that, for successful diversification, firms should have coordination capability for managing internal diversity and complexity that diversification creates. The coordination requires significant internal interactions among organizational units that might be geographically dispersed and external transactions with suppliers and customer.

However, some strategic researchers argue that the choice of strategy may be severely constrained by some environments and that the nature and dictates of those environments must be correctly perceived (Pelham, 1999; Pelham and Lieb, 2004; Tan and Tan, 2005). And in their researches, they have documented the central role of environmental scanning and perceptions of the environment in strategy planning. For example, Pelham and Lieb (2004) argue it would be expected that these differences in perceptions would impact negatively on strategy formulation and execution resulting in unsatisfactory firm performance. Some strategy's theorists contend that successful implementation of strategy is contingent on competitive environment characteristics. Sustaining business growth is one of the key challenges to the business leader. Product diversification is one of a few answers to this problem. Researchers, however, claim that most companies struggle to diversify profitably (Bishop, 1995; Porter, 1996; Zook, 2001a). Zook (2001a) points out that 90 percent of companies’ efforts to diversify outside of their core business have failed over the past decade. His research shows that diversification around the core business (concentric diversification) has a higher success rate than other approaches to diversification.

According to Porter (1996), companies erode their competitive advantage through poor product diversification strategies. Thus, diversification often results in the decay of the very competitive advantage that made the business successful in the first place. It would seem reasonable to expect that, if a firm was able to maintain or manage its competitive advantage while diversifying, it would result in successful product diversification. Recent studies have shown that diversification effects on performance remain inconclusive (Mukherji, 1998). The strategy of internal diversification of a company may be explained in terms of branching-out from its existing dominant areas of knowledge and key competences, and the application of these to the marketing of new and improved products and services (Meyer and Utterback, 1993; Kim and Kogut, 1996).
Developing and investing in knowledge and related capabilities enables companies to undertake processes of expansion and product diversification, and to take advantage of the evolution of markets and future opportunities in industries of rapid growth (Kim and Kogut, 1996). Kim and Kogut (1996) stated that, in evolving environments, the capability of a company to improve and renew its products and services, and to diversify within related segments, is based on the construction and accumulation of knowledge derived from past experience. Therefore, the capability to evolve and diversify product is an on-going process of construction and accumulation of new knowledge extending beyond that which already exists within the company. As a result, the knowledge held by the company must be transferred to fields of application and action that are different from the current ones, through processes by which this new knowledge takes the material form of new products or of complete new businesses (Jaskolski, 1996; Riggs et al., 1996; Helfat and Raubitschek, 2000). Within this approach, the arguments presented will have their foundations essentially in the theory postulated by Hedlund (1993) and Nonaka and Takeuchi (1995), which focus on the analysis of the processes by which knowledge is generated and of the particular factors of organizational design that are necessary for this generation to be undertaken successfully.

1.1.2 Nzoia Sugar Company

Nzoia Sugar Company Limited is located in Bungoma District, Western province and is within Kenya’s sugar belt. It was formed under Companies Act Cap 486 Laws of Kenya with Memorandum of Articles of Association and issued a certificate of incorporation. Out grower companies supply 80% of the cane it crushes while it harvests 10% from its nucleus estate. Initial objectives for the inception of sugar were to: - increase the country’s GDP through exports; open rural industrialization development; curb rural-urban migration and create employment; create social-economic enhancement; improve rural infrastructure and communication systems; and attain self-sufficiency in sugar production. These objectives had a more social –Politico than economic orientation and with global trends the latter had to be given prominence.

The company’s shareholding structure is as follows: - government of Kenya (97.93%), Fives Coil Babcock (FCB) – 1.13% and Industrial Development Bank (0.93%). The company occupies
a total surface area of 4600 ha situated in Western Province of Kenya, 20km from Bungoma Town, and five kilometers off the Bungoma / Webuye highway. The factory serves over 30,000 farmers within Bungoma, Kakamega and Lugari. The Nucleus Estate whose total area is 4,629 Ha, supplies 20% of sugarcane requirement. Currently, the area under cane is 3,500 ha with an average plant crop yield of 124 TCH (Tonnes of Cane per Hectare) and Ratoon crop yield of 93 TCH.

Nzoia Sugar Company (NSC) is undertaking efforts aimed at increasing its competitiveness before the implementation of the new agreement between the Common Market for East and Southern Africa (COMESA) and Preferential Trade Area Agreement come March 2008. In order to avoid being traded out of the sugar business, the sugar company is exploring ways to improve efficiency and reduce costs in order to remain competitive in the changing business environment. Towards this end, feasibility studies for the factory expansion to 7000 TCD are being undertaken and expansion will commence once all preparations are done. This will include installation of cane preparation equipment, automation and the installation of a standby power generating station. In addition, a diversification programme which will include co-generation, paper manufacturing, animal feeds, spirits and sugar refining is being put in place to ensure proper utilization of by-products and improvement of the company revenue base.

According to the 2005-2010 Company Strategic Plan, the factory Planned to expand its sugar production capacity from 67,000 to 180,000 tonnes of sugar by the year 2011 to secure a competitive edge and remain profitable. In agriculture, plans are underway to increase cane yields by developing seeds with a shorter maturity period. Currently, the company’s Nucleus Estate totals 4629 Ha. The company is now competing favourably by giving farmers good service; prompt payment and the best cane prices. Training seminars for stakeholders in the sugar industry are being held to educate farmers in the area. The company is also investing heavily in computerization as several departments are still operating manually.

Development of the company information communication and telecommunication system has been boosted with the installation of VSAT (Very Small Aperture Terminal) in October 2005. this will go a long way towards enabling Nzoia Sugar advertise its products in the world market
and communicate efficiently with its stakeholders worldwide.

Nzoia Sugar Company is bracing itself for privatization in order to avoid the risk of becoming obsolete in today’s market driven economy. With privatization, the company will be able to reduce Government participation and allow it operate freely like any other private enterprise under reduced bureaucracies. Other areas include reduction of costs, through staff rationalization, factory Modernization and phasing out of non-core business practices. The planned feasibility study by consultants would explore areas of diversification like power generation to improve on the mill's profitability and determine how much the planned expansion would cost, taking into account the increased area under cane.

1.2 Statement of the Problem

During the past three decades, a number of studies (Hitt et al., 1997; Lu and Beamish, 2001) have examined issues related to product diversification strategies at the corporate level, and have argued that firms can engage in such activities because they possess a particular set of advantages (Delios and Beamish, 1999). Large subsidiaries are better able to engage in geographic and product diversification activities than small ones; more autonomous subsidiaries, reflecting their strategic importance to parent firms or their ability to influence parent firms' decisions (Forsgren et al., 1992), tend to diversify more actively. Pursuing product diversification activities may enable a firm to exploit market opportunities and enjoy the benefits of economies of scale or scope. Product diversification may also achieve competitive advantage for companies through economics of scale and other synergies from using the company’s resources and capabilities across different product lines (Geringer et al., 2000). Such synergies from product diversification are more likely to be realized when firms expand into related lines of new products and markets (Qian, 1997; Luo, 2002). Therefore, Qian (2002) reported that product diversification is positively related to a firm's profitability. Paynor (2002) even argues that product diversification strategies by a company create a real option that provides additional synergy from diversification which individual investors cannot create through their personal portfolio diversification. Such a real option creates strategic hedge that reduces risk and turns to be in the money in case of future integration.
Locally, Mohamed (1995) did a study on portfolio diversification: an empirical investigation of commercial banks in Kenya; Mwindi (2003) carried out an analysis of the application of unrelated diversification strategy by the major oil companies in Kenya; Njoroge Thuo (2003) carried out a study on diversification strategy. A case of nation media group while Munene Caroline Wanjiru (2008) studied diversification strategies of Christian community services of Mount Kenya east region. To the best of the researcher’s knowledge, no known study has been done on product diversification strategies in Nzoia Sugar Company. Moreover, existing research on management typically focuses on the product diversification strategies of companies in developed countries (Bartlett and Ghoshal, 1986; Taggart, 1997); few studies have examined the product diversification strategy behaviors of companies in developing countries. This study, therefore, sought to fill the knowledge gap by examining the product diversification strategies adopted by Nzoia Sugar Company. The study seeks to answer the following questions:

Has Nzoia Sugar Company adopted Product Diversification strategies?

What relationship do the diversification strategies have on company performance?

1.3 Objectives of the study

The study was guided by the following objectives

i. To determine the product diversification strategies adopted by Nzoia Sugar Company.

ii. To establish the relationship between product diversification and company performance

1.4 Importance of the study

The study is invaluable to the Nzoia Sugar Company management in that it will provide an insight into the various approaches towards product diversification strategies and how product diversification could be used to enhance performance; the government in policymaking regarding taxation and other regulatory requirements of the Nzoia Sugar Company and to the academicians, the study has provided a useful basis upon which further studies on product diversification strategies could be conducted.
CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter summarizes the information from other researchers who have carried out their research in the same field of study. The specific areas covered here are management theories and diversification, diversification motivations, significance of diversification, challenges of diversification, the diversification-performance relationship and product diversification strategies.
2.2 Management theories and diversification

Work done by Ansoff (1988) provides an appropriate introduction when considering the management theories around diversification. He produced a product/matrix that identified directions for strategic development. The matrix promotes four different strategies informed by whether the strategy direction is in new/existing markets with new/existing products. Diversification is established as one of four broad strategic opens in the model. Apart from diversification, the others are: Market penetration: growth occurs through the increased share of existing markets. For a public service, the focus will be to extend the user group within an existing market. This is the least risky strategy for expansion. Market development: opportunities are in markets other than those currently being targeted but with the same product. The overarching aim is to increase profit by selling more existing products in new markets. Product development: adopted when the organization has a less than comprehensive products/services in market. There will be an awareness of customer requirements and therefore knowledge of gaps in product/service range. Costs will be attached to developing new services and their resulting promotion. The remaining strategic option is diversification that is represented in the lower right hand quadrant (new products in new markets). Diversification and the Ansoff model have been touched on in some library management books (Roberts and Rowley, 2004).

The main purpose of diversification is to allow an organization to grow (Grant, 2005; Thomas and Mason, 2006). Diversification strategically takes the organization away from its current markets and products with the overall intention to increase the diversity that must be overseen by the organization. IBM provides a good example of an organization that has pursued diversification in a purposeful and vigorous manner (Strategic Direction, 2005). Up until the 1980s, IBM enjoyed a virtual monopoly in hardware but this changed very rapidly with increased competition. Diversity in all its implications became the central driver for IBM from 1995 onwards. Diversification included both reviewing the inputs (with the diversification of the workforce) and the outputs (with the move away from products towards services and solutions).

One of the main advantages of diversification identified in the management literature is the synergy that it creates (Ansoff, 1988; Ensign, 1998). By moving into new areas, opportunities
emerge to develop new inter-relationships through the actual process of working on new services and markets. This synergy makes it is possible to produce a combined return on resources that is greater than the sum of the parts (Ansoff, 1988). The likely success of the diversification strategy will be the fit between the different business units and their working relationships. The impetus is on the managers of the different units to understand their inter-relationships so the probability of synergy can be increased. Diversification does pose various challenges at the strategic level. By moving out of current products and current markets, it represents a step into the unknown. This very uncertainty carries a higher degree of business risk (Lynch, 2006). With diversification there is a limited knowledge of the new services and markets that make the accurate predictions of success levels very difficult. Resources also need to be invested into both product and market development. van Oijen and Douma (2000) have highlighted that the main reason for having a diversification strategy occurs when there is a fundamental change in the industry (such as when an existing technology is replaced by a new one). The emergence of the internet is provided as an example which forces new strategic direction to meet the changing industry condition. In a curious observation, Grant (2005) likens diversification to sex: “its attractions are obvious, often irresistible but yet often experience is disappointing”. Despite this misgiving, Grant acknowledges that if organizations are to survive and prosper over the long term they must change. Inevitably this change involves redefining the business in which the organization operates.

2.2.1 Approaches to diversification

The management literature highlights two major different approaches to diversification: related and unrelated. When diversification occurs through acquiring similar business options it is termed related (or concentric) diversification. This contrasts with unrelated (or conglomerated) diversification, which is the development of products or services beyond the organizations' current capabilities. Johnson et al. (2005) have provided a succinct overview of the options available from both related and unrelated diversification. Related diversification occurs when there is a high degree of compatibility and complementation between the existing products/services and those being moved to. The major advantage of related diversification is that is allows economies of scale to develop. The major disadvantages revolve around the
management time and cost in making it happen and also the difficulties around sharing resources. Within the broad theory of related diversification it is possible to have both vertical integration (both backward and forward) and horizontal integration:

Backward vertical integration. This focuses on developments into activities concerned with the inputs to the organizations current system. It could for example involve extending backwards to acquire the raw material that go into an activity. Forward vertical integration. In contrast the focus here is to develop into activities that are concerned with a company's outputs. Control is sought over the distribution channels and outlets. In Horizontal integration Diversification occurs here into activities that are complementary to present products/services. There is a realisation that there are opportunities in other markets that build on the organization’s strategic capabilities. Related diversification is seen as being superior to unrelated diversification. In unrelated diversification the underlying strategy has nothing to do with securing access to compatible technologies, products or markets. The main objective is to acquire valuable assets that will increase profitability.

2.2.2 Concentric diversification – leveraging competitive advantage

Owing to the risky nature of diversification, as a result of reduced fit with inconsistencies between and loss of focus in the existing and acquired business, diversification strategies that reduce this risk and result in highly compatible acquisitions will be desirable (Davis and Devinney, 1996; Porter, 1996; Markides, 1997; Zook, 2001b). A number of characteristics of successful concentric diversification efforts include the following themes: existence of a strong core business; diversification into adjacencies that are close to the core business; and leveraging of skills from the core business.

Concentric diversification results in a highly compatible acquisition of a new business that is related to the acquiring firm in terms of its key assets – technology, markets, distribution channels, resources or products. Growth undertaken is based on existing strengths and weaknesses and the diversified firm profits from an improvement in strengths and reduced weaknesses – resulting in synergies (Pearce and Robinson, 2000). Based on a ten-year study of more than 2,000 technology, service and product companies in a variety of industries, Zook and
Allen (2001) argue that most diversification strategies fail to deliver value and that most successful companies achieve their growth by expanding into logical adjacencies that have shared economies, and not from unrelated diversifications or moves into “hot” markets.

According to Zook (2001a), most businesses fail to achieve sustained profitable growth because they wrongly diversify from their core business. In order to succeed, firms must first know their “key assets” – consistent with concentric diversification. For example, they must identify their customers, capabilities, products, distribution channels, and other strategic assets, such as patents, brands, and position. They must reach their full potential in their core business and then expand into logically adjacent businesses surrounding the core (Zook, 2001a, b).

According to Markides (1997), when embarking on diversification strategies, managers must consider not only what their company does but also what it does better than its competitors, in other words what is their competitive advantage? In order to achieve effective concentric diversification, these firms must first concentrate on understanding their true strengths and unique assets, deepening their strategic positions and reaching the full potential of the core business (Davis and Devinney, 1996; Porter, 1996; Markides, 1997; Zook, 2001b; Zook and Allen, 2001). According to Porter (1996), this will ensure that they do not “undermine [their existing] competitive advantage”. Collis and Montgomery (1995) suggest that companies must leverage their existing resources into all the markets in which those resources may contribute to competitive advantage. Therefore, in diversifying concentrically, firms must not lose sight of their existing competitive advantage and leveraging it in their expansion programmes.

2.3 Diversification motivations

Ever since Chandler's (1962) seminal work on the strategy and structure of expanding US corporations, diversification – the entry of a firm into new lines of activity – has been a central topic in the strategy literature (Szeless et al., 2003; Li and Greenwood, 2004; Bowen and Wiersema, 2005; Lichtenthaler, 2005). Diversification strategy is a distinct aspect of corporate management when developing a business's competitive advantage. Strategy researchers and academicians have shown the impact of diversification strategy on firm performance with respect to both market and product diversification (Tallman and Li, 1996; Hitt et al., 1997; Aulakh et al.,
From a conceptual perspective, it has been generally recognized that increasing levels of diversification should have a positive influence on performance due to economies of scope and scale, market power effects, risk reduction effects, and learning effects. The concept of diversification is yet to be clearly defined and there is no consensus on its definition among researchers. Definitions of diversification are many. What is needed, therefore, is a comprehensive definition which is both theoretically valid and managerially meaningful. Booz, Allen and Hamilton (1985) have defined diversification as “a means of spreading the base of a business”. Ramanujam and Varadarajan (1989) define diversity as “the extent to which firms are simultaneously active in many different businesses”. These two definitions are consistent and reflect the views of theoreticians and practitioners. To elaborate, a firm can spread its base in two ways: it can increase the number of segments in which to operate; or it can redistribute its businesses among the existing number of segments to become more diversified, the “extent” which Ramanujam and Varadarajan alluded to. In fact this is what managers do after deciding on the type of diversification; they determine the number of segments and the distribution among those segments.

2.4 Significance of diversification

Diversification may yield financial synergies and increased debt capacity (Singh et al., 2001; Doukas and Lang, 2003) and can be either related PD or unrelated PD. It is argued in the article (Geringer et al., 2000) that related PD provides more performance benefit than unrelated PD, because the different product areas can leverage the learning from other areas. In other words, a related product diversifier can utilize particular techniques and learning effects from one business to resolve problems and exploit opportunities in other businesses (Qian, 1997). Subsequent studies using Rumelt's method (Geringer and Beamish, 1989; Dubofsky and Vandarajan, 1987) have generally concluded that related diversifiers achieved higher performance levels than unrelated diversifiers. Further, the studies of Geringer et al. (2000) using the resource-based view of the firm found that an intermediate level of product diversifier such as related product or dominant-constrained diversifier should experience performance benefits exceeding that of lower or higher diversifier suggesting a nonlinear relationship between diversification and performance.
It has also been noted that diversification and internationalization have been some of the new corporate strategies pursued by an increasing number of Chinese firms (Benson and Zhu, 1999; Zhang et al., 2006). Influential authors (Ansoff, 1965; Chandler, 1962; Hoskisson and Hitt, 1990) have argued that firms adopting a diversification strategy in related businesses are able to achieve better economic performance through the synergy of sharing resources and skills across multiple businesses, although evidence from research studies remain inconclusive (Zhao and Luo, 2002; Li and Wong, 2003). It has also been argued that a diversification strategy may be a useful business strategy for firms operating in emerging economies in order to overcome deficiencies in the institutional environment (Li and Wong, 2003). There are several reasons why firms choose to diversify “in order to provide channels for growth, profits and employment” (Nolan, 2004, p. 207). These include: the need for financial resources (Li and Wong, 2003), limited capability to compete in export markets, high-transactional cost due to the underdevelopment of infrastructure, and most importantly, the Chinese “government's support for the idea of a ‘business group’ with a core firm at its centre” (Nolan, 2004, p. 207). Private businesses in China generally do not enjoy the sort of privilege and favorable treatment (e.g. bank loans and other resources) from the central and local governments like their state-owned or state-affiliated counterparts (Lau et al., 1999). Private businesses have to develop their own social network to obtain necessary resource for them to survive and compete in the market. An important way to develop this network is to diversify into un-related businesses in order to gain access to resources necessary for the firm to perform which are otherwise difficult to obtain due to the deficiency of the market system and the insufficient government support (Zhao and Luo, 2002; Li and Wong, 2003).

2.5 Challenges of diversification

Although the widespread interest in diversification is understandable given the massive changes occurring in the defense market, much of the academic literature concerned with corporate strategy is skeptical of the merits of diversification. Indeed, as Campbell has recently noted: “Every textbook, article and researcher concludes that diversification is to be treated with caution” [2]. In reviewing the evidence on diversification, Howe has concluded that as a strategy it “has not lived up to expectations” (DTI, 1993). One recent study of strategic response to
recession by Whittington, for example, concluded that diversification had little positive impact on performance (Campbell 1992). The difficulties involved with diversification have been well aired in the literature (Kastens, M.L. 1973). Diversification is often viewed as a panic measure which suffers from a lack of strategic planning. Moreover, management skills may not be easily transferable to a new area of business. It is generally agreed that to attempt simultaneously to enter new markets and develop new products is a risky strategy which should be avoided if at all possible. The degree of relatedness of the new area of business with a company’s existing business has also been thought to be of some importance to the likely success of diversification. A recent study by Very, for example, argues that the key to successful diversification is building on the core competences of a business and that superior performance through diversification is primarily based on relatedness (Ansoff, H. 1988).

Warnings concerning the potential pitfalls of diversification have been echoed by some studies of the defense industry. The Mckinsey report by the electronics sector group of the NEDC has argued that there is overwhelming evidence that British defense companies are poorly prepared to enter civilian markets. The problems which were identified included a lack of ability to create new products, control costs or market civilian activities adequately (Syedain, H., Beresford, A. 1990).

2.6 The diversification-performance relationship

In spite of the vast amount of research done on the diversification-performance relationship, Ramanujam and Varadarajan (1989), in an extensive review of research in this area, concluded that the findings of studies attempting to demonstrate the effects of diversification on performance remain inconclusive. Rumelt (1974), for example, concluded that diversified firms in general, and related diversifiers in particular, outperformed others. In contrast, Hill and Hansen’s (1991) longitudinal study of the US pharmaceutical industry found that diversification resulted in lower performance due to diversification activities shifting resources away from managerial activities, including R&D and advertising, and thus affecting innovation and brand loyalty; and increases in bureaucratic costs were not offset by increased operational efficiencies. On the other hand, studies by Michel and Shaked (1984), and Montgomery and Wilson (1986)
concluded that firms diversifying into unrelated areas have been able to generate superior performance over those with predominantly related businesses. Different researchers have either found support for different forms of the diversification-performance relationship, or have concluded that diversification has a negative or no impact on performance.

One of the main reasons for these mixed results has been on account of samples chosen for research. Bass et al. (1978) have warned against studying a mixed group of companies or using “pooled data” unless tests of sample homogeneity yield positive results. According to Ramanujam and Varadarajan (1989), if the possibility can be admitted that the relationship between diversity and performance can be industry- or environment-specific, then pooling of data is a critical issue that needs to be addressed. Hatten et al. (1978) have also concluded that industry level models and indiscriminate pooling of data can produce results that are misleading if used at the firm level. Ghazanfar et al. (1985) argue that careful industry studies are necessary prerequisites for making sense of complex industries, understanding the relationship between diversification and performance.

As stated, despite a rich body of researched topics in the strategy literature is the relationship between firm performance and diversification (Kim et al., 2004; Miller, 2004; Stern and Henderson, 2004; Kor and Leblebici, 2005; Miller, 2006), there continues remaining some argument about the diversification and performance relationship (Dess et al., 1995). However, some researchers believe that the relationship between and diversification and performance is moderated by the type of diversification being pursued (Dess et al., 1995). In particular, related and unrelated diversification both have an impact on firm performance, although in opposite directions. The commonly accepted rule of thumb is that related diversification is associated with higher levels of performance, while unrelated diversification tends to result in lower performance (Rumelt, 1982).

In this study, two kinds of the performance measures are employed. One is financial performance, and the other is non-financial performance. Financial performance includes return on assets (ROA), return on equity (ROE), and sales growth (SG). ROA, ROE, and SG, accounting-based measures of performance, are the most extensively used measures of
performance in business research and have been found to be related to other indicators of financial performance for a wide range of firms (Keats and Hitt, 1998; Brown et al., 1995; Qian, 2002; Lee et al., 2003). Non-financial performance comprises market share, acquisition of resources, capacity utilization productivity and efficiency, availability of information, introduction period of new product and cohesive work force.

2.7 Product diversification strategies

Product diversification as strategy has been widely discussed in the strategy field, where the majority of studies have examined the performance consequences of diversification – even though the nature of this relationship still remains largely unresolved (Park, 2002). Early studies have argued that product diversification was valuable: from a conceptual perspective, increasing levels of product diversification should have a positive influence on performance due to economies of scope and scale, market power effects, risk reduction effects, and learning effects (Christensen and Montgomery, 1981). In contrast, more recent research has found that conglomerate firms have significantly lower profitability (Varadarajan and Ramanujam, 1987; Davis et al. 1992). The wide belief that product diversification is inefficient is also partly attributed to its contradiction to one of the oldest economic theorems that argues that specialization is productive (Matsusaka, 2001). It has also been shown that highly diversified firms have less market power in their respective markets than more focused firms (Montgomery, 1985). Product diversification has been found to be negatively related to firm value (Lang and Stulz, 1994; Servaes, 1996) and to occur in firms with less managerial and shareholder equity ownership (Denis et al., 1997). As far as unrelated product diversification is concerned, previous research found a correlation between failures of diversification and failure to establish relatedness among various business lines at the corporate level (Narasimhan and Kim, 2002). In contrast to Rumelt's work, Michel and Shaked (1984) found that unrelated product diversifiers outperform related product diversifiers. Reconciling the two views, other research suggests that each form of corporate strategy is associated with a different set of economic benefits (Teece, 1982). In the case of unrelated product diversification, the main benefits are economies of
internal capital markets in that unrelated business units can be monitored more effectively by constraining them to a single internal capital market – rather than by the external capital market en masse (Williamson, 1999). In the case of related product diversification, the main economic benefits are economies of integration and economies of scope. Economies of integration provide the firm with lower costs of production (Klein et al., 1978).

CHAPTER THREE: RESEARCH & METHODOLOGY

3.1 Introduction

This chapter discusses the methodology that was used in gathering the data, analyzing the data and reporting the results. Here the researcher aimed at explaining the methods and tools used to collect and analyze data to get proper and maximum information related to the subject under study.

3.2 Research Design

This was a case study since the unit of analysis is one organization. This was a case study aimed at getting detailed information regarding the product diversification strategies adopted by Nzoia Sugar Company and also their impact on performance. According to Yin (1989) a case study allows an investigation to retain the holistic and meaningful characteristics of real life events. Kothari (2004) noted that a case study involves a careful and complete observation of social units. It is a method of in depth study rather than breadth and places more emphasis on the full analysis of a limited number of events or conditions and other interrelations. Primarily data collected from such a study was more reliable and up to date.

3.3 Data Collection Methods

Primary data was collected from the company management staff by use of interview guides (Appendix 1) in order to establish the product diversification strategies adopted by Nzoia Sugar Company and also their impact on performance. Interview guides were designed and administered through interview and discussions with key informants who include senior
managers and departmental heads as follows; The Marketing Manager, Production / Factory Manager, Human Resources Manager, The Finance Manager, IT Manager, Agriculture Manager, Strategy and planning Manager and the Managing Director. The interview guide comprised open ended questions. Mugenda and Mugenda (1999) notes that such questions allow for a greater depth of response. Secondary data sources will also be used to provide additional information.

3.4 Data Analysis

The completed interview guides were edited for completeness and consistency before processing the responses. Being a case study, content analysis was most useful. Nachamias and Nachamias (1996) describe it as any technique used to make inferences by systematically and objectively identifying specific characteristics and messages. This was the best method of analyzing the qualitative data that was collected from the interviews and discussions.
CHAPTER FOUR: DATA ANALYSIS AND INTERPRETATIONS

4.1 Introduction

This chapter presents the data analysis from the field. Data for this study was from the interviews from senior managers and departmental heads on product diversification strategies adopted by Nzoia Sugar Company.

4.2 Background Information

The respondents were in departments such as marketing, finance, factory, human resource and I.T department. The respondents were in designations which included marketing managers, production/factory manager, assistant finance manager, IT managers, human resources managers and also strategy and planning managers. The majority of these respondents had a working experience of over 5 years and therefore they were well versed with the product diversification strategies adopted by Nzoia Sugar Company.

The study found that marketing department was the one mostly involved in the product diversification at Nzoia Sugar Company. The marketing department gets feedback from the customers after market research is done every quarterly to accommodate market needs and also establish what other markets (competitors) are doing. Others who were involved in the product diversification process were the board of directors and top management as they were the ones to change the idea into action and approve it, the factory departments which were involved in sourcing and installation and finally production of the finished products i.e. they are the main engineers and technicians, finance department for cost benefit analysis and availing resources for diversification and also HR managers for establishing human resource requirements.

4.3 Product Diversification Strategies

On the product diversification strategies employed by the company, the study found that the company has moved from 50 kilogram unbranded sugar into packaged branded sugar that is now available in 5 kilogram 1 kilogram packet, 2 kilogram packet, $\frac{1}{2}$ kilogram packet and 10
kilogram packet. The company also gets about 3% of its revenue from molasses which are a by-product of finished sugar that is mainly used by farmers to enrich cow feeds. Molasses is also used in making industrial products like spirits and other commercial alcoholic products. Major companies that buy molars from Nzoia include Agrochemical Company in Kisumu and East African Specter. The company also develops cane seedlings that are sold to farmers. This has been enabled by the research department that develops varieties of cane for extension into sugar belt. The company also has plans to into production of white sugar as the company predominated in brown sugar. Studies and consultations have been carried out to venture into commercial power generation and bottling of water which are yet to take off due to lack of finance.

From the study, the company diversified into branded sugar denominators to expand its sales penetration into supermarket chains that do not take or stock 50 kilogram bags and also to avail branded sugar directly to consumers who shop in supermarkets and retail outlets. Diversification into branded sugar was also a vehicle to achieve brand identity and brand loyalty. The study also found that increasing levels of product diversification increased competitive advantage of the company and financial independence from increasing product base. There is also increased consumer choice of products and the company is able to tap in more consumer segments that improve sales and growth.

On the role of product diversification in sustaining business growth, the study found that it main role is to increase resource base and competitive and competitiveness and also it is critical for Corporate growth.

The study also sought to establish the benefits realized through diversification around the core business (concentric diversification) in the company. From the findings, the study found that since the products are related, the company is able to use the same human resources and other synergies i.e. maximization of resources. There is also less diversification of focus thus the probability of failure or risk is minimized. Raw materials are readily available and in the case of Nzoia Company, there is enough cane, water and packaging materials.

The study also found that there were some benefits accrued by the company through marketing of improved products. These benefits were such as high product acceptability in the market.
place, brand loyalty and also increased competitive advantage and the company is able to charge
premium price thus improved profitability. The study also revealed that development and
investing in knowledge and related capabilities has enabled the company to undertake strategies
of product diversification as less energy and funds is spent in training stated in related
diversification and there are also other synergic benefits.

From the study, the researcher found that there were some effects of accumulation of knowledge
derived from past experience in enhancing capability of the company to improve and renew its
products. These effects were such as Nzoia Sugar Company has realized considerable
improvements in terms of improved factory performance and reduced cost of production which
has in turn led to increased profit by 19% in 2007/2008 hitting K shs.42 billion shilling turnover
the highest ever. Key areas being addressed include cane preparation index, boiler automation,
process automation and milling automation. These improvements are ongoing and completion is
expected within the financial year 2011/. In agriculture, the most significant achievement has
been attainment of the target to pay farmers within 30 days upon delivery within the financial
year 2005/2006. The current target is to pay farmers within three weeks upon sugarcane delivery
in this financial year. Staff mobility has also been improved which in turn has upgraded the
Extension Education Services and technologies. If an organization has a high capability of
knowledge accumulation, regardless of the changes in external environment people have to face,
then they can take better advantage of the knowledge they already possess in response to any
changes in the external environment, and they will demonstrate a better performance in both
administrative innovation and technical innovation.

The study also found that there were benefits realized by the company when it expands into
related lines of new products. These benefits were such as the new products will be produced at
lower costs, the new products will be easily accepted by the customers, marketing of the product
is very easy and also the company creates a competitive edge, the firm can achieve
administrative innovation and technical innovation. It was also established that the Governmental
regulatory policies at the local, state, and national level can also have an impact on the
diversification decisions. This is because Government can limit or even foreclose entry into the
industry with such controls as licensing requirements and limits on access to raw materials.
Regulatory controls on air and water pollution standards and product safety and efficacy can increase the capital needed for product diversification and the required technological sophistication and even the optimal scale of facilities. Safeguard its citizens from unrelated product diversification which negatively moderates the international diversification–performance relationship and also because of the high risks explained, many attempts of the company to diversify at a failure hence the government can regulate the firm’s diversification strategies to safeguard them from falling.

The study also found that the effects of product diversifications on innovation and brand loyalty were that it increases customer perception; it encourages customers to have a wide range of products to choose from hence maintaining and improving the brand image n loyalty. Some of the product diversification motivations of the company were competition, new technologies, improvement in sugarcane yields, improvements in terms of improved factory performance and performance contracts.

### 4.4 The Diversification-Performance Relationship

From the study, the diversification that results in higher levels of performance were all the related diversifications such as concentric diversification and product diversification. From the study, the main purpose of product diversification was to create competitive advantage, in order to grow the business portfolio and profitability and also to maximize the resources. Product diversification also affects the performance of the company as there is improved turnover and growth, improved sales, improved customer loyalty and also the company has a competitive edge over the other related companies. The study also revealed that product diversification has helped the company to take advantage of the evolution of market and future opportunities in industries of rapid growth by increasing products and brands for competitive advantage.
CHAPTER FIVE: DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of the findings (discussions), makes conclusions and gives recommendations to the study. The objectives of this study were to determine product diversification strategies adopted by Nzoia Sugar Company and also to establish what managers of the company consider to be the relationship between product diversification and performance.

5.2 Discussions

From the findings, the study found that Nzoia Sugar Company had employed some product diversification strategies. These diversification strategies were that company has moved from 50 kilogram unbranded sugar into packaged branded sugar that is now available in 5 kilogram 1 kilogram packet, 2 kilogram packet, ½ kilogram packet and 10 kilogram packet. The company sell molasses to industrial customers that is used in making industrial products like spirits and other commercial alcoholic products. The company also develops cane seedlings that are sold to farmers. The market power of increasing levels of product diversification were to increase its sales, its a vehicle to achieve brand identity and brand loyalty, diversification increased competitive advantage of the company and financial independence from increasing product base, increased consumer choice of products and the company is able to tap in more consumer segments that improve sales and growth.

The study also found that the role of product diversification in sustaining business growth, the study found that its main role is to increase resource base and competitiveness and also it is critical for growth. The benefits realized through diversification around the core business (concentric diversification) in the company were that since the products are related, the company is able to use the same human resources and other synergies i.e. maximization of resources, there is also less diversification of focus thus the probability of failure or risk is minimized, raw materials are readily available and in the case of Nzoia Company, there is enough cane, water and packaging materials. The benefits accrued by the company through marketing of improved products were high product acceptability in the market place, brand loyalty and also increased
competitive advantage and the company is able to charge premium price thus improved profitability. The study also revealed that development and investing in knowledge and related capabilities has enabled the company to undertake strategies of product diversification as less energy and funds is spent in training for related diversification and there are also other synergistic benefits. From the study, effects of accumulation of knowledge derived from past experience in enhancing capability of the company to improve and renew its products were that Nzoia Sugar Company has realized considerable improvements in terms of improved factory performance and reduced cost of production which has in turn led to increased profit, staff mobility has also been improved which in turn has upgraded the Extension Education Services and technologies, if an organization has a high capability of knowledge accumulation, regardless of the changes in external environment people have to face, then they can take better advantage of the knowledge they already possess in response to any changes in the external environment, and they will demonstrate a better performance in both administrative innovation and technical innovation.

The study also found that the benefits realized by the company when it expands into related lines of new products were that new products will be produced at lower costs, the new products will be easily accepted by the customers, marketing of the product is very easy and also the company creates a competitive edge, the firm can achieve administrative innovation and technical innovation. Government regulations also had an effect on product diversification strategies. These were such as governmental regulatory policies at the local, state, and national level can also have an impact on the diversification decisions, as the government can limit or even foreclose entry into the industry with such controls as licensing requirements and limits on access to raw materials. Regulatory controls on air and water pollution standards and product safety and efficacy can increase the capital needed for product diversification and the required technological sophistication and even the optimal scale of facilities. Safeguard its citizens from unrelated product diversification which negatively moderates the international diversification–performance relationship and also because of the high risks explained, many attempts of the company to diversify at a failure hence the government can regulate the firm’s diversification strategies to safeguard them from falling. The effects of product diversifications on innovation
and brand loyalty were that it increases customer perception; it encourages customers to have a wide range of products to choose from hence maintaining and improving the brand image and loyalty. Some of the product diversification motivations of the company were competition, new technologies, improvement in sugarcane yields, improvements in terms of improved factory performance and performance contracts.

On diversification-performance relationship, the study found that the types of diversification that results in higher levels of performance were all the related diversifications such as concentric diversification and product diversification. The main purpose of product diversification was to create competitive advantage, in order to grow the business portfolio and profitability and also to maximize the resources. Product diversification also affects the performance of the company as there is improved turnover and growth, improved sales, improved customer loyalty and also the company has a competitive edge over the other related companies. Product diversification has also helped the company to take advantage of the evolution of market and future opportunities in industries of rapid growth by increasing products and brands for competitive advantage and also it has enabled adoption of new and advanced technologies for effective participation in the evolving markets.

5.3 Conclusions

From the findings and the discussions in this chapter, the study concludes that the product diversifications strategies adopted by Nzoia Sugar Company were moving from 50 kilogram unbranded sugar into packaged branded sugar that is now available in 5 kilogram 1 kilogram packet, 2 kilogram packet, ½ kilogram packet and 10 kilogram packet. The company uses by-product (molasses) in making industrial products like spirits and other commercial alcoholic products and also develops cane seedlings that are sold to farmers. The study also concludes that product diversification enhances performance of the company. This is because from the study, product diversification increases the company’s sales, creates competitive advantage, it grows the business portfolio and profitability of the company and also improved company turnover.
5.4 Recommendations

The study therefore recommends that Nzoia Sugar Company should fully embrace product diversification in order to improve the performance of the firm by increasing sales, creating a competitive advantage over the competitors and also to enhance customer loyalty to the products.

The study also recommends that for the company to succeed in product diversification, intensive research should be undertaken to determine the customers’ needs and in order to identify the niche market to be served. The company should therefore ensure that the products offered are of high quality.

5.5 Recommendations for Further Research

The study recommends that further studies should be conducted in other types of companies to establish the product diversification strategies adopted and impact on performance.

5.6 Implication on Policy and Practice:

For the government and other regulatory Authorities, the study gives an overview how the concept of product Diversification may be used by state corporations to turn around organizations that are not doing well and give them a competitive edge to come up. This study will enrich policy formulation to that end.
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Appendix 1: Interview guide

A survey of product diversification strategies adopted by Nzoia Sugar Company

Kindly answer the following questions

Part A: Background Information

1. Name of department: ...........................................................................................................

2. What is your designation? ........................................................................................................

3. What is your total work experience in years? ....................................................................

4. Who is involved in the product diversification process at your company? (titles) …...

SECTION B: Product diversification strategies

5. What are some of the product diversification strategies employed by your company?

6. What approach of product diversification does your company take?

7. What is the market power affects of increasing levels of product diversification

8. What is the role of Product diversification in sustaining business growth?

9. Which are some of the benefits realised through diversification around the core business (concentric diversification) in your company?

10. What are the benefits accrued by your company through marketing of improved products?

11. In what ways has development and investing in knowledge and related capabilities enabled your company to undertake strategies of product diversification?
12. Of what effect is accumulation of knowledge derived from past experience in enhancing capability of your company to improve and renew its products?

13. What benefits are realized when your company expands into related lines of new products?

14. What is the effect of government regulation on product diversification strategies?

15. What are the effects of product diversification on innovation and brand loyalty?

16. What are some of product Diversification motivations of your company?

SECTION C: The diversification-performance relationship

17. In your opinion what type of diversification result in higher levels of performance?

18. In your opinion what is the main purpose of product diversification?

19. In what way does product diversification affect performance of your company?

20. How has product diversification helped your company to take advantage of the evolution of markets and future opportunities in industries of rapid growth?

21. In what ways has employing product diversification strategies helped your company yield financial success?

Thank you!

Appendix 11-Introduction letter

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DATE: 8/10/2009

TO WHOM IT MAY CONCERN

The bearer of this letter, Clifford Wikeili Lengefero,
Registration No. LB1/8628/2004,

is a Master of Business Administration (MBA) student of the University of Nairobi.

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate if you assist him/her by allowing him/her to collect data in your organization for the research.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.

UNIVERSITY OF NAIROBI
SCHOOL OF BUSINESS
MBA OFFICE
P.O. Box 30197
NAIROBI

DR. W.N. IRAKI
CO-ORDINATOR, MBA PROGRAM

appendix 111: Approval letter to collect data
NSC/HRD/PF/5044/2009
15th October 2009

University of Nairobi
School of Business
Lower Kabete Campus
P.O. Box 30197
NAIROBI

Att: Coordinator, MBA Program

Dear Sir,

RE: DATA COLLECTION ON DIVERSIFICATION STRATEGY AT Nzoia Sugar Company Limited

We are in receipt of your request as above on data collection by Mr. Clifford Mabale Wefwafwa.

He is hereby given permission to collect data from our Managers as requested for use for academic reasons only.

Yours faithfully,

P.W. MURAMBI
Human Res. Manager