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Diversification Strategy and Firm Profitability: Evidence from Selected Fast-Moving Consumer Goods Firms in Lagos State, Nigeria

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ABSTRACT

The environmental turbulence has affected many fastmoving consumer goods manufacturing firms owing to the keen competition of the players in the industry. To cope with the dynamics of the business environment, several organisations in the industry resorted to diverse strategies one of which is the diversification strategy. The paper thus established the effect of diversification strategy on profitability of fast-moving consumer goods manufacturing firms in Lagos State, Nigeria. Survey research design was adopted for the study. Data were collected with the use of a validated research instrument whose Cronbach's alpha reliability coefficients ranged from 0.731 to 0.956. The population comprised 1,337 top and middle level management staff of four notable players in the FMCG industry in the State (Honeywell flower mills plc, Dangote flower mills, Unilever Nigeria Plc, and Cadbury Nigeria Plc. Through proportionate stratified random sampling technique, 400 out of the 1,337 were sampled for the study. The research instrument was administered to the sampled population with 84.25% response rate. The data were analysed by descriptive as well as inferential techniques. The results indicated that diversification strategy had a significant effect on profitability of the fast-moving consumer goods manufacturing firms in Lagos State Nigeria (0.726, $\beta = 0.842$, $t = 29.782$, $P \leq 0.05$). The study recommend that policy provisions should be made by fast moving consumer goods in Lagos State, Nigeria to promote and support diversification strategies in the interest of firms profitability.

Keywords: Diversification, FMCG, Lagos State, Performance, Profitability,

JEL Classification: D 92, L 25, M 10

1.0 INTRODUCTION

There is no gainsaying the fact that the fast-moving consumer goods (FMCGs) sector is unarguably one of the biggest manufacturing firms in the world and comprised varieties of product offerings such as foods, drinks, personal care products, electronics, household goods and many more (IBAN, 2016). The aforementioned products are basically cheap products but are usually having high turnover in terms of units sold to the consumers of such products. This is because FMCGs are usually household products and are used quite frequently (Pradhan & Misra, 2014, KPMG, 2016). While the volume of sales is usually high for FMCGs, the profit margin is however low per unit of the product sold hence, the FMCGs sector usually operates on low profit margin (Bijuna and Sequeira, 2012).

Another notable characteristic of the FMCGs is that the products are usually easily substituted either by competitors' activities or otherwise. A major portion of the monthly budget of each household is however spent on FMCGs (Anupam & Sharma, 2012; KPMG, 2016). In view of the intricacies associated with the operations of the FMCGs considering the turnover and the substitutability of the products, the performance of the firms in the industry is usually based on the volume of sales.

It is worthy of note that the bulk of the income of the FMCGs firms is normally realized from the people at the base of the pyramid which by IBAN (2016) was put at 4.5 billion. The estimated volume of purchases from this class of people was put at about $5 trillion out of which expenditure on FMCGs products stood at 50% ($2.3 trillion). The implication of this figure is that the people in the low-income bracket are critical to the survival and sustainability of the FMCGs firms the world over (Singh, 2014). Since this study is focused on Nigeria, it is pertinent to assess the income of the FMCGs firms in the country. In a study, L. B. S. (2016) noted that 71 % of the FMCG firms' income come from customers at the low end of the socio-economic status.

Considering that the sector of the customers that account for the bulk of the profit of the FMCGs firms are at the low rung of the socio-economic status, this category of people are characterized by high price sensitivity which explains why they can easily switch to substitutable products at the slightest opportunity thus FMCGs firms need to find ways of minimizing cost of production such as to remain competitive both in the business as well as in the industry.

This goal of achieving sustainability and competitiveness according to empirical evidence can be achieved through adoption of diversification strategy (Burak, 2018; Kannan & Saravanan, 2012; Business Development Bank of Canada {BDC}, 2015); Suhag, Solangi, Larik, Lakho, & Tagar, 2017). However, documented evidence revealed that the level of diversification in the FMCG firms in Nigeria is rather low (Lekhanya, Olajumoke, & Nirmala, 2017; Muthoni, 2017).

The FMCGs are facing diverse economic challenges that imposes on them the necessity to be competitive in other to remain in business. Such challenges confronting the industry include depreciating value of the naira, delayed salaries paid to workers by many government and public employers (L. B. S., 2016). In view of these and several other challenges, FMCGs firms are constrained to adopt competitive strategies for their operations in other to keep their businesses (Buul & Omundi, 2017; Suh, & Lee, 2018).

Arising from the foregoing, the objective of the paper is to establish the effect of diversification strategies on profitability of FMCG firms in Lagos State, Nigeria. To achieve this objective, the paper addressed the research question-" what is the effect of diversification strategies on profitability of FMCGs firms in Lagos State, Nigeria?" The paper is organized as follows: the first section of the paper dealt with the background issues that led to the topic while section two focused on the review of related literature in line with the concepts, theory, and empirics relating to the study variables.

Section three was devoted to methodology adopted for the study with specific emphasis on the population and sample size determination together with data collection. In the fourth section, the data collected were presented, summarized, analysed and corresponding findings were discussed while the fifth and the last section covered the conclusion and recommendations flowing from the findings of the study.

2.0 LITERATURE REVIEW

The aim of every profit or not-for-profit organisations alike is to remain a going concern in spite of prevailing challenges that could hinder their operations. Hence, there is a dire need to adopt relevant measures to ensure sustainability of their performance over time. In the interest of their competitiveness, organisations embark on diverse strategies to attain and maintain a status that confer on each of them an advantageous competitive position in the industry (Buul & Omundi, 2017).

Firms compete for several targets in their respective industries. The objects of competition amongst firms include revenue customers, and market share, in their respective dynamic business environments. Considering the improved access to information coupled with the rapid change in the tastes and preferences of these customers, the customers keep demanding for improved quality of goods and services offered to them possibly at lower prices even (Bhattacharjee & Wertenbroch, 2014; Brumfield, Adelaja, & Lininger, 1993; Dirisu, Iyiola & Ibidunni, 2013; Suh & Lee 2018). It is noteworthy that the accelerated rate of global competition has imposed a responsibility on firms to map out strategies to achieve a status of competitive advantage over their competitors in their business industry (Buul & Omundi, 2017; Suh & Lee 2018; Yasar, 2010).

There are various strategies an organization can adopt to acquire competitiveness in an industry. Competitive strategy can be defined in various ways by various authors over time. In the words of Bhuyan and Tripathy (2015) competitive strategy is a long-term plan that enables a firm to perform better than its competitors. To Porter (2007), competitive strategy is seen as actions of an organisation that help an organization to compete better than others in the industry. In the same vein, Cook, Boekholt and Todtling (2007) posited that a competitive strategy refers to approaches of an organization to attract customers better than other organisations in the same industry.

Amongst several strategies that an organization can adopt to attain a state of competitiveness in an industry is the diversification strategy (Kannan & Saravanan, 2012). According to the authors, diversification strategy enables a business to increase share in the current market, enter new market thereby enhance their competitiveness in their respective industry.

Laforet (2008) observed that firms of various sizes in developing and developed countries are operating under rapidly changing market situations. Consequently, Kamau and McCormick (2016) argued that diversification strategies such as product and market diversifications are tools that can be used to gain competitiveness in different ways such as increasing market base by adding new markets to an existing market of an organization or increase market share thereby enhance the profitability and performance of firms. In view of the foregoing, diversification strategy is a useful tool for promoting organisational profitability and sustainable competitiveness.

However, much as diversification is critical to organisational sustainability and profitability, several organisations have experienced failure with the adoption of the strategy. Such organisations as noted by Ballard (2018) include the Coca-Cola that diversified into wine business in 1977, another is the Kodak's venture into pharmaceutical business that also failed. Hence diversification as a strategy has not benn well understood by many firms as to when and how to go about it.

The other variable of concern to this study is the performance of an organization such as the FMCG. The performance index is a success factor that reveal the health of an organisation and as such it is vital to every organisation (Urbancova, 2013). Organisational performance can be defined in several ways by diverse authors. Syombua sees it as the ability of an organisation to achieve its vision and mission through strong governance, sound management, and a persistently dedicated workforce. Several metrics can be used to measure the performance index of an organisation. Prominent among such measures are non-financial and financial indicators (Ittner & Larcker, 2003).

Armstrong (2006) argued that organisational performance can be measured in several ways depending on the industry of interest. Performance measures may include, employees retention, profits, branding, increased market share, recognition of company, and physical expansion. It is the accomplishment of laid down objectives.

According to Odongo and Owuor (2015), firm growth can be used to evaluate the level of effectiveness of an organisation. A number of factors have been identified by several authors as determinants of firm growth. Epstein (2003) identified organisational learning as one of the pre-conditions for organisational security, existence, and profitability. Also, Maurer and Weiss (2010) opined that continuous learning process is another necessary condition for firm growth. In yet another study undertaken from financial perspective, Miller, Boehlje, and Doddin (2010) argue that earnings generation and retention are notable determinants of firm profitability. The authors in their study maintained that factors such as return on asset (ROA), capital growth (CG), profit growth (PG), and sales growth (SG) are other financial indicators of firm growth apart from generated and retained earnings.

Consequent upon these expositions, the focus of every management of diverse organisation is on ways and means of boosting the performance of their organisations which can be measured in diverse ways such as financial performance (profits, return on assets, returns on investment, return on equity, return on capital employed), product market performance (sales return, market

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share), and shareholders return (total shareholders return, economic value added) (Richard, Devinney, Yip & Johnson, 2009).

Empirical works have shown diverse ways of improving the performance of an organisation. Sindhu, Haq, and Ali (2014) in their study on diversification and firms' performance noted that diversification strategies enhance performance of Pakistani firms. Other studies also share this view (Boz, Yigit, & Anil, 2013; Nwaeke, & Wodu, 2012; Santarelli, 2013; Asman, 2013; Mwangi, 2016). Others like Onyali & Okerekeoti (2018) looking at the issue of performance from another perspective. In their study the authors argued that board heterogeneity positively affects corporate performance of firms in Nigeria.

From theory, it could be also be argued that diversification can also drive performance of an organization and by extension it's growth. The resource-based view theory of the firm as propounded by Wernerfelt (1984) posited that an organization with resources having the following qualities: valuable, rare, costly to imitate, and organized to capture value, such resources are capable of conferring on such organization(s) competitive advantage which can be leveraged upon for sustainable growth. Arising from this theory, the theoretical framework in figure 2.1 applies to this study.

Diversification Strategies (DIS) --→ Firm Profitability (FPR)

Figure 2.1 Simplified theoretical framework

Source: Adapted from resource based-view of Wernerfelt (1984).

The above model viewed diversification strategies in its various forms such as product and market diversification.

The above framework can be reduced into the model below:

$$FPR = \beta_0 + \beta_1 DIS + \varepsilon \quad \text{(i)}$$

From equation (i), FPR is firm profitability, DIS is diversification strategies, and ε is the exogenous variable which captures all other variables that could explain firm profitability outside the model. Equation (i) is the working equation estimated by the study in section 4.0

Furthermore, other studies have also approached the issue of performance enhancement from yet another perspective. Uremadu (2018) argued that capital structure positively affected corporate performance in Nigeria. Oyedijo (2012) in another study posited that product-market diversification strategy positively affects corporate financial performance and growth of some companies in Nigeria.

3.0 METHODOLOGY

The study adopted a survey research design. The sample size of 400 was estimated from a population of 1,337 top and middle level managers of the FMCGs firms selected for the study using the Yamane (1967) formula. Data were collected with a validated structured adapted instrument with Cronbach's alpha values ranging from 0.731 to 0.956. A response rate of 84.25% was obtained from the questionnaire administration.

4.0 DATA ANALYSES

Analyses of the data collected commenced with the verification, cleaning, and treatment of the data to ensure that the data generated were clean, correct, and useful. Thereafter, descriptive and inferential analyses were carried out in line with the main objective of the study which is to determine the effect of diversification strategy on the profitability of FMCGs firms in Lagos State, Nigeria. The results of the descriptive analyses were as contained in the tables 4.1 and 4.2.

Table 4.1: Descriptive Statistics of Respondents Responses on Diversification Strategy

Statements	Strongly Agree	Agree	Partially Agree	Partially Disagree	Disagree	Strongly Disagree	Mean	Standard Deviation
In the past five years our organization has ventured into new business area(s) related to our existing business	51 15.1%	124 36.8%	105 31.2%	15 4.5%	31 9.2%	11 3.3%	4.34	1.251
Our organization has crated products for new markets	18 5.3%	141 41.8%	99 29.4%	36 10.7%	28 8.3%	15 4.5%	4.12	1.209
In my opinion I think investing in new business areas whether related or unrelated is a wise corporate strategy to adopt	68 20.2%	126 37.4%	65 19.3%	44 13.1%	26 7.7%	8 2.4%	4.42	1.289
In the past three years our organization has ventured into a new business area(s) unrelated to our existing business	86 25.5%	85 25.2%	49 14.5%	71 21.1%	35 10.4%	11 3.3%	4.25	1.462
Grand Mean							4.28	1.303

Source: Computed from field reports (2018)

The responses in the above table 4.1 revealed that the mean responses to question items on diversification strategies of the selected FMCG firms ranged from 4.12 to 4.42 with 4.28 as the grand mean response. On a six-point Likert-type scale, since this grand mean fall between 4.0 and 4.49 it is interpreted that the overall respondents partially agree that the firms adopt diversification strategy. The implication of this is that the level of diversification strategy in the selected FMCG firms were considered mild by the respondents.

Table 4.2: Descriptive Statistics of Respondents Responses on Profitability

Statements	Strongly Agree	Agree	Partially Agree	Partially Disagree	Disagree	Strongly Disagree	Mean	Standard Deviation
We exploit our profit potentials each year	61 18.1%	124 36.8%	82 24.3%	27 8.0%	35 10.4%	8 2.4%	4.37	1.292

Our organization's annual profits exceed those of our competitors	27 8.0%	153 45.4%	86 25.5%	29 8.6%	28 8.3%	14 4.2%	4.24	1.231
Our organization is able to meet its profit target each year	92 27.3%	112 33.2%	63 18.7%	36 10.7%	28 8.3%	6 1.8%	4.55	1.313
We sustain substantial increases in our annual profits year after year	70 20.8%	111 32.9%	66 19.6%	61 18.1%	25 7.4%	4 1.2%	4.38	1.267
Grand Mean							4.39	1.276

Source: Computed from field reports (2018)

From table 4.2, the mean responses of the respondents to the various questions on firm profitability ranged from 4.24 to 4.55 with 4.39 as the grand mean. The implication of this is that the respondents' position is that firm's productivity is moderately high on a six-point Likert-like scale.

Combining the descriptive statistics of the tables 4.1 and 4.2, the responses indicate that diversification strategies could influence the profitability of FMCG firms in Lagos State.

The inferential analysis employed in the study is the ordinary least square linear regression to determine the effect of diversification strategies on profitability of FMCG firms in Lagos State. The results were as displayed in tables 4.3, hereunder.

Table 4.3: Summary of Regression Analysis of Diversification Strategy and Firms Profitability

Model	**Unstandardized Coefficients**		**Standardized Coefficients**	**T**	**Sig.**
	B	**Std. Error**	**Beta**		
(Constant)	3.121	.498		6.271	.000
Diversification Strategy	.842	.028	.852	29.782	.001
$R = 0.852$; $R^2 = 0.726$					

Source: Computed from survey data (2018)

From table 4.3, the estimated model of the study is as stated hereunder.

FPR = 3.121 + 0.842DIS (where FPR = Firm Profitability, DIS = Diversification Strategies)

The above model showed that diversification strategies had a significant effect on profitability of FMCGs firms in Lagos State, Nigeria. The results further revealed that diversification strategies explain 72.6% of variations in observable Profitability of FMCG firms in Lagos State, Nigeria while the remaining 27.4% is explained by variables that are exogenous to the model. The model further revealed that a unit increase in diversification strategies produces 0.842 unit increase in firm Profitability. The t-statistics also revealed that there is a significant difference between the two means. This also is evidence in the results.

5.0 DISCUSSION

The effect of diversification strategies on profitability of FMCGs firms in Lagos State, Nigeria has been empirically determined in this study. The analyses results (descriptive and inferential) were presented in tables 4.1 – 4.3. The inferential results revealed that diversification strategies have a significant effect on profitability of FMCGs firms in Lagos State, Nigeria. By implication. It means that for FMCGs firms in Lagos State to progress and succeed they must adopt diversification strategies. This finding of this study is consistent with that of McCormick (2016) who in his study found that diversification strategy had a significant effect on profitability of firms.

Similarly, the finding of this study is also in consonance with that of Sindhu, Haq, and Ali (2014) who in another study investigated the effect of diversification strategy on firm profitability discovered that diversification strategy had a significant effect on firm financial performance.

On a theoretical note, the result of this study aligned with the resource-based view propounded by Penrose (1959). Diversification strategy according to the theory, diversification strategy of an organisation is expected to enhance the profitability of such firms. Hence, the finding of this study that showed that diversification strategies have significant effect on firm profitability is a contribution to theory as it supports the argument of the resource-based view.

CONCLUSION AND RECOMMENDATIONS

The study concluded that diversification strategies positively affect profitability of FMCG firms. The implication of the finding of this study is that diversification strategies can help organisations to improve on its performance status. In view of the outcome of this study, it is recommended that management of FMCGs in Lagos State Nigeria should initiate policies that will support adoption of diversification strategies to enhance market size and market share and by extension the profitability of the firms in the FMCGs industry.

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