CHAPTER- 7
CONCLUSIONS, IMPLICATIONS, AND SUGGESTIONS

The chapter summarizes and concludes the research findings arrived pertaining to the study objectives. Subsequently, the notable contributions of the research to the corporate diversification literature have been outlined. The theoretical as well as practical implications of the research findings for the corporate managers, investors, and public policy have been highlighted, followed by valuable suggestions. Finally, the scope and directions for further research have been emphasized.

7.1 INTRODUCTION

Corporate diversification has been defined as the “entry of a firm into new lines of business activity (whether related or unrelated), either by acquisition or by internal business development” (Ramanujam & Varadarajan, 1989, p. 525). The resultant organization can be structured either as a business group or a multi-segment firm. Theoretical arguments suggest that diversification has both value-enhancing and value-reducing effects. Matsusaka and Nanda (2002) held that diversification is good for some firms and bad for others, whereas Montgomery and Wernerfelt (1988) regarded diversification as an appropriate way to realize ‘Ricardian rents.’

100 Differences in institutional framework of economies explain why some firms profit from diversification activity while many others do not. Hence, the theoretical underpinnings are important for understanding the appropriateness of corporate diversification as an organizational growth strategy. This evidently brings out the importance and need of assessing the costs (or risks) and benefits (or returns) of corporate diversification strategy.

Although corporate diversification studies have long been a centerpiece of strategic management research, a synthesis of the streams of strategic management and financial economics fosters a multi-disciplinary analysis of diversification (Ramanujam & Varadarajan, 1989). It is beyond doubt that business houses play a dominant role in the Indian economy. Despite this, the economic analysis with regards to their costs and benefits has not reached a definitive consensus. However, the

100 Ricardian or economic rents are perceived as ‘arising to the owners of unique factors.’
related empirical studies (both foreign and Indian) have majorly focused on the diversification’s impact on value, the present study complements the existing literature by bringing together both the cost (cost of capital) and benefit (corporate value) aspects, and systematically studying the association of diversification activity with the company’s cost of capital and corporate value in the Indian scenario. The research attempts to render material input for the strategic managers in deciding the appropriate corporate strategy for growth, while keeping the country’s institutional setting and company’s capabilities in mind.

Considering the scant evidence on the association between diversification and cost of capital, and diverse results on the diversification’s impact on corporate value across emerging economies, the present research was initiated in the Indian context. For the purpose of the study, all companies listed on the Bombay Stock Exchange were considered in order to construct the final sample. Based on a pre-specified sample selection procedure, a final sample of 16,058 company-year observations was derived for Objective 1, viz., examination of the relationship between diversification and company’s cost of capital, and 22,782 company-year observations for Objectives 2 and 3, viz., examination of the relationship between diversification (and its strategy) and corporate value. The final sample of companies was further classified into unaffiliated standalone companies and diversified business groups (related and unrelated diversified business groups). An indepth analysis of the association of diversification with the cost of capital and corporate value was carried out for a period of sixteen years, i.e., from the FY 1998-99 to FY 2013-14. In addition to examining the impact of diversification (and its strategy) on the company’s cost of capital and corporate value, the study also explored the possible sources of value gains from diversification. Therefore, with the major objective of comprehensively evaluating the merits of corporate diversification, the present study has been organized into seven chapters.

Presenting an overview of the practical relevance of the research problem and the underlying rationale of the issue, Chapter 1 discusses the general background of research study. Following the thorough examination of the motivations behind the study, the research objectives have been enumerated. In addition, the limitations of the study have been specified to enable a fair interpretation of research findings.
Chapter 2 provides an extensive discussion on the theoretical framework governing the diversification, cost of capital, and corporate value. The instrumental role of the underlying theories in examining the relationships hypothesized in the study has further been discussed. Besides detailed conceptualization, the Chapter provides useful insights into the techniques for the estimation of study variables.

Chapter 3 conducts an extensive review of the most relevant literature in four parts, that is, diversification and company’s cost of capital, diversification and corporate value, diversification strategy and corporate value, and sources of value gains or losses from diversification, with each pertaining to a particular research objective. The literature review concerning the research objectives has been discussed in various rounds, each reflecting different strands of opinion. Following the review, the testable hypotheses have been formulated on the basis of the findings of majority of studies. Fundamental methodological observations have been drawn from the review, which serve as a useful guide to present empirical research.

Chapter 4 explains the methodology adopted for conducting the present empirical analysis. For analyzing the secondary data collected for the purposes of research objectives, the study period, population and sample selection, operationalization of independent, dependent, and control variables, data sources, and the framework for conducting data analysis have been detailed in the chapter. Under framework for analysis, an outline of the descriptive analysis, univariate analysis, and multivariate regression analysis, along with the procedures for testing the assumptions of multiple regression model have been given. For the purpose of determining the impact of diversification on company’s cost of capital, descriptive statistics, Mann-Whitney U test, Median test for 
k samples, ANOVA, pooled regression analysis, and panel data regression models were employed. In order to empirically address the association between diversification (and its strategy) and corporate value, descriptive statistics, Mann-Whitney U test, Median test for 
k samples, and panel data regression models were used. The regression diagnosis was performed by retrieving histograms, P-P plots, skewness, kurtosis, Kolmogorov-Smirnov, and Shapiro-Wilk statistics for normality, Levene’s test for homoscedasticity, correlation matrices and variance inflation factor statistics for multicollinearity, and Durbin-Watson statistic for autocorrelation.
Chapter 5 provides an analysis of the relationship between diversification and company’s cost of capital. For this purpose, the chapter puts to empirical examination the association between Herfindahl Index based on assets and excess cost of capital, while controlling for firm-specific characteristics, namely, size, leverage, and book-to-market. As a preliminary check, the chapter assesses the systematic risk differences amongst diversified groups and standalone companies. The results obtained by employing the descriptive analysis and panel regression model contributes to scant literature available on the relationship between diversification and cost of capital in the emerging markets context. The chapter thereafter reported a series of robustness checks in order to strengthen the results obtained.

The evaluation of corporate diversification from the return perspective has further been made in the Chapter 6. The chapter conducts empirical examination of the relationship between diversification (and its strategy) and corporate value. The analysis employed the Berger and Ofek’s (1995) ‘Industry Multiplier Approach’, descriptive statistics, and panel regression models linking the excess values to diversification, number of group companies, and relatedness, with firm-specific controls. The chapter results seek to cross-validate the prior evidence on the relationship in the emerging economies. Recognizing the higher corporate value of diversified groups over unaffiliated standalone companies and superiority of unrelated diversifiers over related diversifiers, being statistically confirmed, the chapter also explores the sources of value gains from diversification by highlighting the role of the country’s institutional frameworks in driving the corporate strategy for diversification.

The present chapter culminates the discussion on diversification, cost of capital, and corporate value in five sections. Section 7.2 provides a brief summary of the research findings pertaining to the study objectives. An amalgam of these findings leads towards Section 7.3, which identifies the contributions of the research to the corporate diversification literature with respect to emerging economies. Section 7.4 highlights the theoretical as well as the practical implications of the research findings. Furthermore, the suggestions with regards to the appropriateness of the diversification strategies to reduce cost of capital and enhance value have been incorporated in Section 7.5 and lastly, Section 7.6 puts forward directions to future researchers in the domain of evaluation of corporate diversification.
7.2 RESEARCH FINDINGS AND CONCLUSIONS

The findings of the research have been summarized in four sections, categorized on the basis of study objectives. The results of the diversification's impact on cost of capital have been briefed in Sub-section 7.2.1. Sub-section 7.2.2 discusses the results of the impact of diversification on the corporate value. Lastly, Sub-section 7.2.3 highlights the research findings regarding the effect of diversification strategy on corporate value.

7.2.1 Relationship between Diversification and Company’s Cost of Capital

In order to study the association between diversification and company’s cost of capital, the present study adopted descriptive, univariate, as well as multivariate techniques. The descriptive statistics (mean, median, standard deviation, minimum, maximum, and quartile values) were determined for all the variables with respect to total sample of companies as well as for the subsamples of unaffiliated standalone companies (SC) and diversified groups (DG). The descriptive information highlighted the larger size (with approximately three affiliates and 40% higher assets, on an average) and higher leverage levels (higher by roughly 15%, on an average) of diversified groups relative to standalone companies. In addition, the unrelated diversified groups were found slightly bigger (by about 3%, on an average) in terms of assets vis-à-vis related diversified groups. The book-to-market was found considerably higher (i.e., about 31%, on an average) for standalone companies over diversified groups, possibly due to high stock market prices of diversified group companies in emerging economies. Moderate level of diversification (0.601) was exhibited by the diversification measure, which is, asset-based Herfindahl Index \( \{HI(\text{Assets})\} \). Since the value of Herfindahl Index falls as the degree of diversification increases, thus lower mean value of \( HI(\text{Assets}) \) was observed for unrelated diversified groups over related diversified groups. Furthermore, the descriptive statistics revealed higher excess cost of capital (ECOC) for diversified groups over standalone companies.

The beta differences between diversifiers and non-diversifiers were tested as a prelude to the main analysis. For this purpose, the descriptive statistics, ANOVA, and pooled regression were employed. The descriptive statistics reported higher beta (by about 40%) for diversified groups over standalone companies. The results of ANOVA
revealed significantly different betas across unaffiliated standalone companies, related diversifiers, and unrelated diversifiers, whereas the pooled regression of beta on diversification (measured as categorical variable with three categories) resulted in the significantly higher betas of diversified groups (both related and unrelated) over standalone companies. Such findings, however, challenging the cross-validation of modern portfolio theory in the domain of corporate diversification, were in conjunction with the results of Montgomery and Singh (1984), Barton (1988), Lubatkin and Chatterjee (1994), and Olibe et al. (2008).

For a comprehensive analysis of diversification’s impact on company’s cost of capital, the panel regressions of \( ECOC \) on \( HI(Assets) \) were estimated, while controlling for the set of firm characteristics, namely, size, leverage, and book-to-market. It was observed that the significantly negative coefficient (at 1%) on \( HI(Assets) \) resulted into a negative relationship between \( ECOC \) and \( HI(Assets) \). Contrary to the findings of Hann et al. (2013), the results revealed a significantly higher cost of capital for diversified groups over unaffiliated standalone companies. It was further observed from the panel regressions of \( ECOC \) on diversification strategy (measured using dummy variable) that the unrelated diversifiers possessed highest \( ECOC \), followed by related diversifiers and standalone companies. In addition, the statistical accuracy of these results was established by invoking regressions using alternative measures of diversification, namely, diversification dummy, number of affiliates, and number of industries. The results confirmed a higher cost of capital for the diversified Indian business groups. Such findings, although failed to extend support to the hypothesis formulated, were possibly due to the high leverage levels and consequently high betas observed for diversified Indian business groups in relation to standalone companies, as posited by numerous researchers (e.g., Melicher & Rush, 1973; Hill & Stone, 1980; Montgomery & Singh, 1984; Barton, 1988; Lubatkin & Chatterjee, 1994; Mansi & Reeb, 2002).

7.2.2 Relationship between Diversification and Corporate Value

Though the relationship between diversification and corporate value has long been studied, there are disparities in results across and within countries. Therefore, with a major focus on examining the effect of diversification on corporate value in the Indian setting, the present study assessed the excess value differences between diversified groups and standalone companies. The same has been accomplished by employing the
'Industry Multiplier Approach' of calculating excess values using three multiples (sales, assets, and EBIT), following the pioneering work of Berger and Ofek (1995). This approach provides a direct estimate of the excess value associated with diversification by calculating it as the natural logarithm of the ratio of a company’s actual value to its imputed value. The imputed value of the diversified business group is an estimate of the value of the group if all of its affiliates are operated as stand-alone businesses, rather than being a part of the group. The association between diversification and corporate value has been studied by employing descriptive, univariate, and multivariate analysis. The descriptive information highlighted larger sizes, lower growth opportunities, and higher profitability for diversified groups over standalone companies. For instance, in line with a number of related studies, the diversified groups had approximately 1.4 times the assets (\(\text{LnTA}\)) of unaffiliated standalone companies. The growth opportunities (\(\text{CAPEX\_SALES}\)) were, on an average, approximately 30 percent higher for standalone companies over diversified groups. In addition, the higher profitability (\(\text{EBIT\_SALES}\)) of diversified groups (by about 33%) relative to standalone companies projected higher corporate values for diversified groups in India. Besides this, considerably higher mean and median excess values of diversified groups over standalone companies, along with the significantly positive differences (at 1%) in mean and median excess values between diversified groups and standalone companies across all the three multipliers portrayed value gain from diversification.

In order to conduct an in depth analysis of the diversification-value relationship, the excess value (\(\text{EV}\)) based on sales, assets, and EBIT was regressed on the diversification dummy (\(\text{DIV}\)), while controlling for the size, profitability, and growth opportunities. The results from the panel data regressions underlined significantly positive (at 1%) coefficient estimates for \(\text{DIV}\), and thereby affirmed a value gain from diversification ranging from 14 to 18 percent across the three multipliers. Rendering support to the hypothesis formulated, the findings were found to be in line with the evidence from the previous literature with regards to the emerging economies in general (e.g., Khanna & Rivkin, 2001; Beckmann et al., 2012; Lee et al., 2012; Belfiore, 2015; Borda et al., 2017; Gyan et al., 2017) and Indian market in particular (e.g., Pandya & Rao, 1998; Khanna & Palepu, 2000; Mishra & Akbar, 2007; George & Kabir, 2012; Berg, 2016; Ramaswamy et al., 2017). Subsequent to the above mentioned empirical analysis, the reasons behind higher
valuations attributed to diversified groups were explored. The market imperfections ingrained in the framework of emerging economies, ineffective regulation, privileged access to foreign investment, inexpensive access to factor markets, political connections, and high market power were identified as the most important sources of value gains arising from diversification.

### 7.2.3 Relationship between Diversification Strategy and Corporate Value

In order to investigate the value differences between related and unrelated diversifiers, an extensive analysis of the impact of diversification strategy on corporate value was conducted. An initial observation of the descriptive statistics brought forth higher excess values of unrelated diversified groups (by approximately 23-30%) relative to related diversified groups across all the three multipliers, i.e., sales, assets, and EBIT. Additionally, by virtue of the fact that the unrelated diversified groups are comparatively of the larger size than related diversified groups, the unrelated diversifiers possessed a maximum of twenty-six affiliates (N) against seven owned by related diversifiers. Moreover, the high mean value of related segments (RS) variable for the related diversified groups reflected high interconnection among the affiliates of such groups. Such interconnection among the affiliates of related diversified business groups stems from the similarities in their nature of economic activities. Not much difference was discovered between related and unrelated groups with regards to the size, profitability, and growth opportunities. These statistics highlighted the superiority of unrelated diversification strategy in the Indian context.

The conclusive evidence on the impact of diversification strategy on corporate value was arrived at by computing panel data regression of excess value on RS and N, with firm-specific controls. The results, although insignificant, reported negative coefficient estimates for RS and consequently, higher corporate values for unrelated diversified groups. The re-estimated regressions by taking an alternative measure of diversification strategy, i.e., dummy for diversification strategy (DDS) in place of RS established that the unrelated diversified groups have significantly higher corporate value relative to related diversified groups. Such findings can be attributed to the high market power and profitability enjoyed by unrelated diversifiers. In consonance with the evidence available from numerous emerging market studies (e.g., Khanna & Rivkin, 2001; Marinelli, 2011; Purkayastha *et al*., 2012; Purkayastha, 2013), the findings extend support to the hypothesis formulated. A crux of the overall results has been presented in Table 7.1.
Table 7.1: Results at a Glance

<table>
<thead>
<tr>
<th>Hypotheses No.</th>
<th>Hypotheses</th>
<th>Statistical Techniques</th>
<th>Results</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objective 1:</td>
<td>To examine the relationship between diversification and company’s cost of capital.</td>
<td>Descriptive Statistics, ANOVA using the general linear model, Pooled regression, Panel data regression</td>
<td>Rejected</td>
</tr>
<tr>
<td>$H_1$</td>
<td>Cost of capital of diversified business groups is lower than the cost of capital of unaffiliated standalone companies.</td>
<td>Descriptive Statistics, ANOVA using the general linear model, Pooled regression, Panel data regression</td>
<td>Rejected</td>
</tr>
<tr>
<td>Objective 2:</td>
<td>To examine the relationship between diversification and corporate value.</td>
<td>Descriptive statistics, Panel data regression</td>
<td>Accepted</td>
</tr>
<tr>
<td>$H_2$</td>
<td>Diversified business groups have significantly higher corporate value than unaffiliated standalone companies.</td>
<td>Descriptive statistics, Panel data regression</td>
<td>Accepted</td>
</tr>
<tr>
<td>Objective 3:</td>
<td>To examine the relationship between diversification strategy (related or unrelated) and corporate value.</td>
<td>Descriptive statistics, Panel data regression</td>
<td>Accepted</td>
</tr>
<tr>
<td>$H_3$</td>
<td>There is a significant difference in the corporate values of related and unrelated diversified business groups.</td>
<td>Descriptive statistics, Panel data regression</td>
<td>Accepted</td>
</tr>
</tbody>
</table>

Source: Researcher’s own compilation

7.3 CONTRIBUTIONS OF RESEARCH

The present research renders robust empirical evidence with regards to the evaluation of corporate diversification from risk (cost of capital) and return (corporate value) perspectives by employing advanced statistical techniques. In accomplishing these objectives, the research brings about the following contributions:

- First, the previous work in the domain of corporate diversification has examined the association of diversification (and its strategy) with company’s cost of capital and value separately. The present study evaluates diversification from both cost and benefit perspective and is instrumental in unravelling the nature of diversified business groups in an emerging market context, i.e., India.

- The cross-validation of established evidence is essential to reinforce the generalization of research findings. Besides proving the effectiveness of corporate diversification as an appropriate growth strategy in the Indian context, the findings of the present study ratify prior evidence on higher values
of diversified groups in India. Also, it significantly contributes to the nearly absent empirical evidence in India on the impact of diversification on cost of capital.

- Third, in the field of strategic management, the research contributes in determining the types of diversification strategies that can result in superior performance or value for the diversifying firms. Also, the present research ventures to synthesize the strategy and finance disciplines by assessing the financial implications of diversification strategies.

- Fourth, the results of the present study indicate a positive relationship between corporate diversity and beta (or systematic risk). Thus, the research contributes in proving the inapplicability of modern portfolio theory in the field of corporate diversification. The modern portfolio theory, conceived by Harry Markowitz in 1952, holds relevance in the domain of stock diversification and securities management, but is inappropriate in explaining the risk consequences of corporate diversification. The supremacy of the portfolio theory rests upon the principle (though arguable) assumptions of (a) absence of taxes and transaction costs, and (b) existence of rational and risk-averse stockholders holding fully diversified portfolios (Lubatkin and Chatterjee, 1994). It is an ultimate guide to a securities manager or shareholder in optimizing stock portfolios in such a way so as to maximize expected return and minimize risk. The theory fundamentally held that a stockholder, by diversifying his portfolio of stocks, can completely eliminate the firm’s unsystematic (or firm-specific) risk, but such diversification fails to affect (or reduce) the systematic (or market) risk. Supporting arguments have been put forth by Lubatkin and Chatterjee (1994), who originally contended that the modern portfolio theory was conceived for securities, and not for businesses.

- Fifth, the research extends valuable contributions to the institutional theory by depicting a positive relationship between diversity and value. According to the tenets of institutional theory, the corporate diversification activity is a function of the country’s institutional development. The economic rationale behind existence of diversified business groups in India is the non-existence as well as poor performance and governance of external markets for products, labour,
and capital. Therefore, in the economies characterized by inadequate institutional development, corporate diversification (either internal or external) is considered as an appropriate organizational solution to obtain value and performance benefits (Kim et al., 2004).

- Sixth, the research efforts attempt to test the application of the Capital Asset Pricing Model (CAPM) to the actual corporate data in the current Indian setting. CAPM, being widely used in the securities market for pricing of risky securities, has been employed in order to calculate the cost of equity capital. Additionally, to compute the beta values (as an input into CAPM), an analogue of CAPM, i.e., the market model has been applied.

7.4 IMPLICATIONS

Whilst the diversification-value relationship has been studied in the developed countries since the 1960s merger wave and has established concrete evidence, the research on the topic has not reached that level of development in the emerging economies like India. This, however, signifies the need for research into the same. Also, the evaluation of corporate diversification from the cost of capital perspective is largely an unexplored theme. Influencing the strategy and finance disciplines, the research findings, thus, have long-term implications for the conceptual knowledge base and practical relevance for the corporate managers, general investors, and public policy, discussed in Sub-sections 7.4.1 and 7.4.2, respectively.

7.4.1 Implications for Theory

The findings of the study will be helpful for theorists and academicians in corroborating the well-established theories and conceptual models with the help of robust empirical analysis. Following are the theoretical implications of the overall research findings:

- As a long established theoretical premise, the traditional view that the diversification does not affect a corporation’s cost of capital on account of its inability to alter systematic risk (or beta) is largely promulgated through standard finance literature. The present research findings put forth robust empirical evidence that is contrary to this traditional theoretical perspective. The negative impact of corporate diversification on the company’s cost of
capital will hopefully provide theorists with valuable insights on corporate diversification from a different theoretical lens, i.e., ‘coinsurance effect’, rather than relying on the propositions of portfolio theory.

- There is a considerable difference in the organization of a multi-segment firm and a diversified business group. The diversified groups are a collection of legally independent companies having separate set of shareholders. The proposition of internal capital markets created by diversification does not apply well to the setting of diversified business groups. This, however, can be one of the possible reasons for difference in the prospects of corporate diversification across economies. Henceforth, in the wake of increasing number and importance of diversified business groups in emerging economies, a more refined theoretical knowledge base with respect to corporate diversification at the ‘group-level’ is necessitated in order to improve the understanding of the organizational dynamics with respect to the institutional setting. By establishing the nature of relationship of diversification with cost of capital and corporate value, the findings yield added insights towards building a comprehensive theory of business groups.

- The study results also have pedagogical implications. Much of the existing knowledge about corporate diversification has been abstracted from the modern portfolio theory. The same is being taught in the business schools and practiced in the corporate arena. However, the present research findings regarding the impact of diversification on cost of capital disapprove the use of diversification for solely hedging purposes since it actually resulted in increasing the corporate risk and cost of capital for diversified Indian business groups. Complementing this, Lubatkin and Chatterjee (1994) suggested an optimal level of diversification (referred to as constrained diversification) in order to minimize the risk and maximize performance.

### 7.4.2 Implications for Corporate Managers, Investors, and Public Policy

The research holds major relevance for the strategic and finance managers in evaluating and altering their strategies for growth. With the multidisciplinary impact, the findings have following implications for the set of corporate managers, investors, and public policy makers:
• The research findings have implications for the corporate managers in selecting an appropriate corporate strategy for growth (diversification or specialization) that can be profitably practiced in the prevailing institutional setting. The results clearly established the superiority of diversification over specialization and unrelated diversification strategy over related diversification strategy in the backdrop of an emerging market, i.e., India. Hence, in the light of current findings, the corporate or strategic managers at the helm of business groups would prefer growth by widening the scope as against the scale of operations.

• The evidence that diversification alters systematic risk and cost of capital renders novel implications for the financial managers in taking capital budgeting and valuation decisions while undertaking corporate diversification activity (either through internal business development or via mergers and acquisitions).

• In the light of high corporate values of diversified groups being empirically established in the present study, the investors of stock and businesses can base their investment decisions in such a way that can maximize their returns at minimum risk. The findings report high market values of affiliates of diversified groups over standalone companies, hence reinforcing the proposition that stock investors are more likely to invest in group companies.

• Corporate diversification has been statistically identified as a favourable corporate growth strategy that prospers under the constraints of underdeveloped market institutions. The present study findings shed light on the utility of diversified business groups in one of the fastest growing emerging economies of the world, and thus hold significant importance to the practitioners and policy makers as they can work towards devising radical policies that bestow group affiliates with competitive edge over their privately held business counterparts (e.g., tax benefits). This will determine the future of diversified business groups in India.

• Although institutional reforms take a long time to get established, several studies doubt the persistence of diversified organizations once the pro-market reforms get underway and the institutional environment is fully evolved.
Hence, the foremost practical implication that can be drawn for the public policymakers is to develop intermediary institutions and adequate infrastructure for regulation and contract enforcement that can help in strengthening the factor markets.

7.5 SUGGESTIONS

Subsequent to performing a comprehensive empirical analysis of the impact of diversification on cost of capital and corporate value, it becomes indispensable to provide suggestions to the corporate management, investors, academicians, and financial analysts.

- The differences in the corporate values and cost of capital between diversified groups and standalone companies find roots in the varied institutional settings across countries. Hence, the conclusions derived for one country during a particular period may not apply to another country or period. Moreover, it is axiomatic that the diversification activity provides different benefits in different emerging economies, depending upon the institutional void they cater to. According to Peng and Heath (1996, p. 519-520), “As the institutions and organizations in the various countries co-evolve, more diversity in the results might be created among the countries because of the dynamic interaction between institutions and organizations.” Therefore, the results of the present study may not hold for the corporate landscape in other countries.

- The diversification discount evidenced in the developed economies research may be on account of various other factors, such as improper measurement techniques or the database biases, rather than the diversification per se. Hence, the results must be interpreted with extreme caution. Rather than concluding from the face of results, there is a need to explore the reasons behind such value gains or losses from diversification. For instance, the studies conducted by Lang and Stulz (1994), Campa and Kedia (2002), Graham et al. (2002), and Lamont and Polk (2002) among others, asserted that the reduced values of diversifying firms are attributable to the endogeneity of the diversification decision, inefficient acquisitions (i.e., the acquired firms were already trading at discount), and cross-subsidization, which must be controlled to avoid
incorrect inferences. The above mentioned studies evidenced that the diversifying firms were poor performers even prior to diversification activity.

- The corporate management should be wary of the financial consequences of their diversification moves as they continuously modify the scale and scope of their business operations. Additionally, the practicing strategic managers must learn to reorient their growth strategies with changing institutional arrangements. The performance outcomes associated with alternative diversification strategies adopted by diversified business groups change as the institutions develop and markets mature. There are possibilities that the developments in the market structures may render diversification (or any specific diversification strategy) an unprofitable growth strategy. However, it will take decades to fill the institutional voids for the reason that the market institutions are relatively resistant to change and hence, evolve gradually (Scott, 2013).

- The contrasting findings between advanced and emerging economies suggest that for the internationally-cum-industrially diversified business groups, the strategies for the affiliates in one country may not be appropriate for the affiliates in other countries. Hence, the corporate diversification strategies must be chosen separately for the economies differing in their market structures.

- The findings with respect to the impact of diversification on cost of capital and corporate value can also be influenced by alternate research designs (i.e., cross-sectional or longitudinal) though conducted with similar objectives and measurements. Thus, an interpretation of the results from such studies by the corporate managers requires forethought.

- Increased efforts towards developing a new generation of managers through training and education are warranted. It will enable them to rethink the concepts of strategy and structure along with their relationship and effectiveness in particular institutional framework. Besides this, such training and education is critical for them to function efficiently towards reducing the higher cost of capital evidenced in the present research.
7.6 **DIRECTIONS FOR FUTURE RESEARCH**

The examination of diversification’s impact on company’s cost of capital and corporate value, along with the exploration of potential reasons for the success of diversification as a corporate growth strategy in emerging economies like India paves the way for further investigation into a number of other related aspects. The following are the promising directions for future research in the field of corporate diversification that will complement the present analyses and extend the understanding of the very nature of the Indian diversified business groups:

- It is pertinent to mention that while the present study results provide fine-grained insights about the nature of relationship of diversification with cost of capital and corporate value in the current Indian institutional context, these are nevertheless limited to the country that formed the focus of the study. Moreover, a number of sample selection conditions and data requirements have kept certain companies out of the purview of examination. Hence, in order to establish the generalizability of findings, the research needs to be conducted in other emerging economies. Such research efforts can serve as a step towards a more robust understanding of the efficacy of the group-level corporate diversification.

- It is also interesting to statistically explore and spot the institutional differences between developed and emerging economies that influence the appropriateness of diversification as a growth strategy for firms and contributes to varying financial consequences of diversification activity across countries.

- There arises an intriguing need to explore how the stock investors perceive corporate diversification strategy. The capital market performance (e.g., movement of stock prices, trading volume) of the affiliates of diversified business groups can be compared *vis-à-vis* the focused companies. Besides, an assessment of the market’s reaction to changes in the corporate diversification strategy would provide constructive insights into the desirability of specialization (or refocusing) versus diversification and related diversification strategy versus unrelated diversification strategy.
As the present study posit higher cost of capital for diversified groups over standalone companies, the researchers can also empirically explore the other costs associated with the group affiliation. Khanna and Palepu (2000) highlighted various potential costs of group affiliation (e.g., agency costs of diversification resulting from the conflict of interests between minority and controlling shareholders, cross-subsidization of failing affiliates by the profitable ones, suboptimal investment decisions) that can undermine the performance and value of diversified groups relative to specialized companies. This can be an interesting avenue for the researchers to statistically examine.

Future research would be constructive to strengthen the results obtained by altering the measurements of diversification, cost of capital, and corporate value. An enquiry into the appropriate measure of value, performance, or cost of capital is also worthy of research. Further, to enrich the present analysis, a study can be undertaken using different time periods and sample of companies.

While calculating imputed values and the relatedness among the group’s affiliates, two-digit NIC code has been taken as a basis for identifying the industries. Future researchers can increase the degree of refinement by moving to three-digit or four-digit NIC codes.

The following are the related and promising research issues that have not been addressed in the literature and can be the prospects for future research:

- An understanding of the meaning and nature of business group is in itself an under-studied research avenue.
- A case analysis of successful diversified business groups to identify their critical success factors that provide them an edge over focused companies.
- An industry-wise analysis of the relationship between diversification and value or cost of capital can be conducted to assess any intra-industry and inter-industry variations in the impact which are not considered when studies are conducted at an aggregate level. One such attempt has been made by Purkayastha (2013) by selecting three distinct industries.

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The success of diversification activity is not only governed by the institutional framework but also the organizational mechanisms. Future research can be conducted to explore such mechanisms necessary to make diversification a profitable corporate strategy. In addition, the identification of the organizational structures (co-operative or competitive) suitable for the success of a particular diversification strategy (related or unrelated) is largely an unexplored issue in case of emerging markets.

The relationships hypothesized in the study can be examined under dynamic and volatile conditions (such as global or domestic financial crisis) as a testament to the prevailing evidence.

An exploration into the motives or the reasons which govern the firm’s decision of diversifying into related or unrelated avenues as a reinforcement to the resource-based view of firm.

India is an emerging country undergoing institutional transition to remedy the numerous sources of market failures that plagued the Indian economy prior to 1991 (Zattoni et al., 2009; Ramaswamy et al., 2017). Owing to the ongoing progressive changes in the market institutions and business organizations, the examination of the appropriateness of diversification as a growth strategy of firms and its resultant effects on the corporate accounting and market financials will remain an open empirical research issue.
REFERENCES


