

Effects of Diversification on Financial Performance of Small and Medium Enterprise in Somalia (A Case Study of Bakara Market)

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ABSTRACT

The general objective of this study was to investigate the effect of diversification of the financial performance in Somalia with specific focus of the industrial small businesses in bakara market. This study investigated to ascertain how liquidity, risk diversification and mergers and acquisition affects financial performance of an organization in small businesses bakara market in Mogadishu. The study employed a survey research design in data collection. This research employed quantitative data collection method whereby data was gathered by the use of closed ended questionnaires which were self-administered. Factor analysis was used to assess the validity and Cronbach alpha to assess reliability of the questionnaire. Multiple regression analysis (standard and step wise) were conducted to determine the effects between the effect of diversification determinants and financial performance. Results confirm the varying importance of diversification determinants in the small businesses processing in Bakara market Mogadishu-Somalia. In general, the results reveal that risk diversification and mergers acquisition have significant and positive effects on financial performance, liquidity and risk diversification have insignificant effects on financial performance in the small businesses in bakara market Mogadishu-Somalia. The study recommends that to improve financial performance in the small businesses in bakara market Mogadishu-Somalia, managers of the small businesses in bakara market Mogadishu-somalia should nurture and develop market Competition and financial performance. Based on the findings of the study, it is essential to give recommendations in order to gather more gains from diversification. It is recommended that; 4 Management should in still discipline upon itself by ensuring good financial performance, promote technological progress and increase its paid up capital regardless of the statutory requirements so that the continued existence of the firm is not jeopardized after undergoing diversification. Management should not only undertake diversification in order to improve operation and sustain failing businesses but also improve their competitiveness and financial performance. Management should come up with a sound strategy towards liquidity and risk diversification management so as to avert the problem of mismatching investments and also the quality of liquidity should be enhanced. Management should put into consideration the degree of transferability and marketability of liquidity invested in so that these assets can provide liquidity to the firm with ease.

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1. Introduction

The relationship between diversification and financial performance has been the subject of abundant research in several fields, including Strategic Management, Industrial Organization and Corporate Finance (Berger and Ofek, 1995; Palich, Cardinal, and Miller, 2000). The main focus in this literature has been the relative performance of diversifiers versus specialized firms (i.e. non diversifiers that operate only in one industry), typically analyzing empirically large samples that include a broad number of industries. However, despite the research accumulated in the last three decades, there is no widely accepted causal relationship between diversification and performance. Though most scholars would probably agree on a somewhat negative relationship between diversification and performance based on the empirical evidence of a diversification.

In this paper, we will review some of the most recent developments, especially those investigating the self-selection

problem and the data limitations studied in the finance literature in the last few years (Villalonga, 2004b), which once again question whether there is a diversification or indeed a premium. Anticipating our main argument, we will explain conceptually and provide empirical evidence that no relationship (either positive, negative, or even quadratic) should be expected between diversification and performance across all organizations, as it has been typically tested. We will show that the actual relationship depends on the underlying nature of the organizations in the sample, even after taking into consideration the self-selection problem present in most of the accumulated research. Thus, to understand whether diversification leads to improved or worse performance for organization, we should probe deeper into the characteristics of the specific organization in which the organization is involved and, more specifically, the extent to which specialized organization or diversifiers have a competitive advantage when competing in a given industry or

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set of organization. We will argue that some organization characteristics may be more favorable for the relative performance of diversifiers than specialized organization, or vice versa. The previous

Literature has overlooked this possibility and it has focused in estimating an average effect of diversification on performance homogeneous across all organization, usually controlling for some measure of relatedness among the business units at the organization level.

In this study, we investigate how the effect of diversification on performance indeed varies depending on the organization that we include in the sample and how this fact affects the interpretation of earlier literature on this topic. We will show that there is a diversification discount when the sample is comprised only by diversifiers competing against a relatively large number of specialized companies. In contrast, we find a diversification premium when the same estimation is done only in organization in which just a few specialized firms compete. Thus, no diversification premium or discount should be expected across the board. This argument will lead us to question the inverted-U relationship proposed by some researchers in strategy (Grant, Jammine, and Thomas, 1988; Palich, Cardinal, and Miller, 2000). We will argue that the effect diversification on performance depends on the relative strength of diversifiers versus specialists in the set of industries under consideration. The paper is structured as follows: First, we will review briefly the empirical research on the diversification-performance relationship in strategy and the diversification in finance. Then, we will use a simple statistical model to explain why we should not expect to find a constant relationship between diversification and performance across all industries. These ideas will be tested empirically through the analysis described in the following section. The fifth section shows the results of the analysis in which we replicated the methodologies traditionally used in each of the two fields, finance and strategy. In the last section, we present the conclusions from this study and suggest new ways to uncover the effect of diversification on firm performance. 2. Empirical research on the effect of diversification on performance

Since the early work of Palich (1996, 2003), most strategy scholars believe diversification eventually begins having a negative impact on firm performance, based on the notion of relatedness among the businesses in which a corporation competes. A recent meta-analysis of the literature finds evidence of this idea, supporting an inverted- relationship between diversification and performance, though several other functional relationships have been found in the literature (Palich, Cardinal, and Miller, 2000).

To diversify is one of the key strategic decisions taken by the CEO, board or the executive team of small and medium enterprises in somalia The effectiveness of diversification as a strategic tool has been mixed and questioned by many practitioners as well as by academics. It is unclear if diversification adds value to an organization and if it leads to superior financial performance than organizations that follow a more focused strategy.

Several international studies have been conducted to determine if diversification leads to superior financial and economic performance, or if it leads to value destruction. The evidence in different markets, countries and functions are contradictory, Panday and Rao (2004) suggests that there is a difference in opinion between functional disciplines within organization, with management and marketing favoring

related diversification on the one hand. While Fukui (2004) attempted to measure economic performance of diversified companies in Japan as they wanted to understand why firms refocused in the 1990's and to establish what went wrong for Japanese companies, Ramanujam and Varadarajan (2003) in their attempt to conduct a synthesis concluded that the literature on diversification covers a great degree of breadth and scope, but that no comprehensive review of the literature exists.

The research study will attempt to measure the financial performance of group of diversified and focused organization of a sample of companies we investigate how the effect of diversification on performance indeed varies depending on the organization that we include in the sample and how this fact affects the interpretation of earlier literature on this topic. We will show that there is a diversification discount when the sample is comprised only by diversifiers competing against a relatively large number of specialized companies. In contrast, we find a diversification premium when the same estimation is done only in organization in which just a few specialized firms compete. Thus, no diversification premium or discount should be expected across the board. In this study, we investigate how the effect of diversification on performance indeed varies depending on the organization that we include in the sample and how this fact affects the interpretation of earlier literature on this topic.

Study Objectives

The general objective of the study is to investigate the effect of diversification of the financial performance of small and medium enterprises in Somalia

1. To ascertain how liquidity affects financial performance of small and medium enterprises in Somalia
2. To determine whether risk diversification affects financial performance of small and medium enterprises in Somalia
3. To assess how mergers and acquisitions affect financial performance of small and medium enterprises in Somalia

2. Related Literature

a) Transaction Cost Theory

Transaction cost theory tries to explain why companies exist, and why companies expand or source out activities to the external environment. The transaction cost theory supposes that companies try to minimize the costs of exchanging resources with the environment, and that companies try to minimize the bureaucratic costs of exchanges within the company. Companies are therefore weighing the costs of exchanging resources with the environment, against the bureaucratic costs of performing activities in-house.

The theory sees institutions and market as different possible forms of organizing and coordinating economic transactions. When external transaction costs are higher than the company's internal bureaucratic costs, the company will grow, because the company is able to perform its activities more cheaply, than if the activities were performed in the market. However, if the bureaucratic costs for coordinating the activity are higher than the external transaction costs, the company will be downsized. According to Ronald Coase (2000), every company will expand as long as the company's activities can be performed cheaper within the company, than by e.g. outsourcing the activities to external providers in the market.

According to Williamson (1999), a transaction cost occurs "when a good or a service is transferred across a technologically separable interface". Therefore, transaction costs arise every time a product or service is being transferred from one stage to another, where new sets of technological

capabilities are needed to make the product or service. the transaction costs related to the exchange of resources with the external environment could be reflected by the following factors. Environmental uncertainty, opportunism, risks, bounded rationality, core company assets. The factors above will all potentially increase the external transaction costs, where it may become rather expensive for a company to control these factors. Therefore, it may very well be more economical to maintain the activity in-house, so that the company will not use resources on e.g. contracts with suppliers, meetings, supervision etc.

b) Liquidity Preference Theory

Liquidity preference, in economics, the premium that wealth holders demand for exchanging ready money or bank deposits for safe, non-liquid assets such as government bonds. As originally employed by John Maynard Keynes, liquidity preference referred to the relationship between the quantity of money the public wishes to hold and the interest rate. According to Keynes, the public holds money for three purposes: to have on hand for ordinary transactions, to keep as a precaution against extraordinary expenses, and to use for speculative purposes. He hypothesized that the amount held for the last purpose would vary inversely with the rate of interest.

The most significant point about Keynes's theory is that, at some very low interest rate, increases in the money supply will not encourage additional investment but instead will be absorbed by increases in people's speculative balances. This will occur because the interest rate is too low to induce wealth holders to exchange their money for less liquid forms of wealth and because they expect interest rates to rise in the future. The concept of liquidity preference was used by Keynes to explain the prolonged depression of the 1930s. Post-Keynesian analysis, in which the classification of liquid assets has been broadened, has tended to relate the demand for money to a wider array of variables; these include wealth and the various forms in which it is held, the yields of these different forms, and the level of income, as well as the interest rate.

c) Efficient market hypothesis

The efficient market hypothesis is a model for how markets perform. A market is said to be efficient if prices in that market reflect all available information. an investment theory that states it is impossible to "beat the market" because stock market efficiency causes existing share prices to always incorporate and reflect all relevant information. According to the EMH, stocks always trade at their fair value on stock exchanges, making it impossible for investors to either purchase undervalued stocks or sell stocks for inflated prices. As such, it should be impossible to outperform the overall market through expert stock selection or market timing, and that the only way an investor can possibly obtain higher returns is by purchasing riskier investments.

The following are the main assumptions for a market to be efficient: a large number of investors analyze and value securities for profit, new information comes to the market independent from other news and in a random fashion, stock prices adjust quickly to new information, stock prices should reflect all available information

A market theory that evolved from a 1960's Ph.D. dissertation by Eugene Fama, the efficient market hypothesis states that at any given time and in a liquid market, security prices fully reflect all available information. The EMH exists in various degrees: weak, semi-strong and strong, which

addresses the inclusion of non-public information in market prices. This theory contends that since markets are efficient and current prices reflect all information, attempts to outperform the market are essentially a game of chance rather than one of skill.

The weak form of EMH assumes that current stock prices fully reflect all currently available security market information. It contends that past price and volume data have no relationship with the future direction of security prices. It concludes that excess returns cannot be achieved using technical analysis. the semi-strong form of EMH assumes that current stock prices adjust rapidly to the release of all new public information. It contends that security prices have factored in available market and non-market public information. It concludes that excess returns cannot be achieved using fundamental analysis.

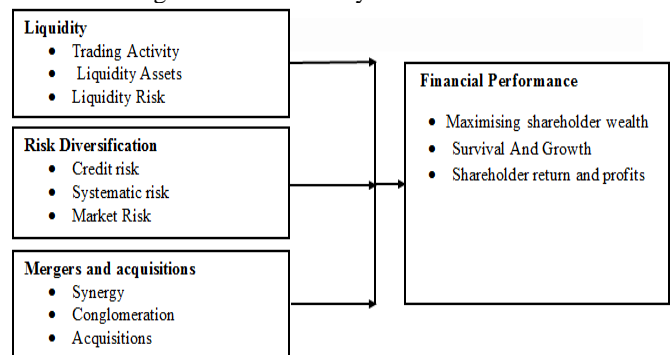


Figure 2.1. Conceptual Framework.

2.1.1 Liquidity

Liquidity is a financial institution's capacity to meet its cash and collateral obligations without incurring unacceptable losses. Adequate liquidity is dependent upon the institution's ability to efficiently meet both expected and unexpected cash flows and collateral needs without adversely affecting either daily operations or the financial condition of the institution. Liquidity risk is the risk to an institution's financial condition or safety and soundness arising from its inability (whether real or perceived) to meet its contractual obligations. The primary role of liquidity-risk management is to (1) prospectively assess the need for funds to meet obligations and (2) ensure the availability of cash or collateral to fulfill those needs at the appropriate time by coordinating the various sources of funds available to the institution under normal and stressed conditions. The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid assets.

During times of market stress, liquidity gives investors the comfort of knowing that they are well placed to ride out a difficult period. "If you have the cash to deal with immediate liquidity demands, then you have the luxury of being able to wait until markets start behaving normally again," says Mr Tollette. "If you're not liquid, patience is a luxury you probably can't afford." This flexibility ultimately needs to come from having a diversified portfolio rather than from hoarding cash. However, this is where liquidity and diversification prove to be unhappy bedfellows.

While investors look to diversify their portfolios into new asset classes to boost returns and reduce risk, the asset classes they are turning to are often illiquid. "We're all exploring new areas of asset management and some of those areas are by their very nature illiquid," says Robert Higginbotham, chief executive officer of Fidelity International's European

business. "There is a tension between the need for diversification and liquidity, and the responsibility can only sit with the asset manager to make sure that it is not providing apparent liquidity to an asset class that is fundamentally illiquid. (Pralhalad and Bettis 2003.)

2.1.2 Risk Diversification

Risks can come from different ways e.g. uncertainty in financial markets, threats from project failures (at any phase in design, development, production, or sustainment life-cycles), legal liabilities, credit risk, accidents, natural causes and disasters as well as deliberate attack from an adversary, or events of uncertain or unpredictable root-cause. There are two types of events i.e. negative events can be classified as risks while positive events are classified as opportunities. Several risk management standards have been developed including the Project Management Institute, the National Institute of Standards and Technology, actuarial societies, and ISO standards. Methods, definitions and goals vary widely according to whether the risk management method is in the context of project management, security, engineering, industrial processes, financial portfolios, actuarial assessments, or public health and safety.

Risk sources are more often identified and located not only in infrastructural or technological assets and tangible variables, but in Human Factor variables, Mental States and Decision Making. The interaction between Human Factors and tangible aspects of risk, highlights the need to focus closely into Human Factor as one of the main drivers for Risk Management, it is an extremely hard task to be able to apply an objective and systematic self-observation, and to make a clear and decisive step from the level of the mere "sensation" that something is going wrong, to the clear understanding of how, when and where to act. The truth of a problem or risk is often obfuscated by wrong or incomplete analyses, fake targets, perceptual illusions, unclear focusing, altered mental states, and lack of good communication and confrontation of risk management solutions with reliable partners.

The strategies to manage threats (uncertainties with negative consequences) typically include transferring the threat to another party, avoiding the threat, reducing the negative effect or probability of the threat, or even accepting some or all of the potential or actual consequences of a particular threat, and the opposites for opportunities (Kerin, Mahajan and Varadarajan 1997)

2.1.3 Mergers and acquisitions

One plus one makes three: this equation is the special alchemy of a merger or an acquisition. The key principle behind buying a company is to create shareholder value over and above that of the sum of the two companies. Two companies together are more valuable than two separate companies - at least, that's the reasoning behind M&A. This rationale is particularly alluring to companies when times are tough. Strong companies will act to buy other companies to create a more competitive, cost-efficient company. The companies will come together hoping to gain a greater market share or to achieve greater efficiency. Because of these potential benefits, target companies will often agree to be purchased when they know they cannot survive alone.

Although they are often uttered in the same breath and used as though they were synonymous, the terms merger and acquisition mean slightly different things. When one company takes over another and clearly established itself as the new owner, the purchase is called an acquisition. From a legal point of view, the target company ceases to exist, the buyer

swallows the business and the buyer's stock continues to be traded. In the pure sense of the term, a merger happens when two firms, often of about the same size, agree to go forward as a single new company rather than remain separately owned and operated. This kind of action is more precisely referred to as a merger of equals. "Both companies' stocks are surrendered and new company stock is issued in its place. Very merger has its own unique reasons why the combining of two companies is a good business decision. The underlying principle behind mergers and acquisitions (M & A) is simple: $2 + 2 = 5$. The value of Company A is \$ 2 billion and the value of Company B is \$ 2 billion, but when we merge the two companies together, we have a total value of \$ 5 billion. The joining or merging of the two companies creates additional value which we call synergy value. (Welman and Kruger 2001).

2.1.4 Financial performance

Although "performance" may appear to be an easy concept, a unique definition in the literature does not exist. Moreover, academics often use special definitions tailored to fit the individual research purposes (Langfield-Smith, 1997). The financial performance is often measured using traditional accounting Key Performance Indicators such as Return On Assets, Operating Profit margin, Earnings Before Interest and Tax, Economic Value Added or Sales growth (Ittner & Larcker, 1997; Fraquelli & Vannoni, 2000; Crabtree & DeBusk, 2008). The advantage of these measurements is their general availability, since every profit oriented organization produces these figures for the yearly financial reporting (Chenhall & LangfieldSmith, 2007). However, balance sheet manipulations and choices of accounting methods may also lead to values that allow only limited comparability of the financial strength of companies. Ratios are best used when compared or benchmarked against another reference, such as an industry standard or "best in class" within the industry. This type of comparison helps to establish financial goals and identify problem areas. Vertical and horizontal analysis can also be used for easy identification of changes within financial balances.

2.1.4 Measurement of financial performance

Financial performance measurement is a fundamental building block of TQM and a total quality organization. Historically, organizations have always measured performance in some way through the financial performance, be this success by profit or failure through liquidation. However, traditional performance measures, based on cost accounting information, provide little to support organizations on their quality journey, because they do not map process performance and improvements seen by the customer. In a successful total quality organization, performance will be measured by the improvements seen by the customer as well as by the results delivered to other stakeholders, such as the shareholders according to Garrison et, al(2012)

This section covers why measuring performance is important. This is followed by a description of cost of quality measurement, which has been used for many years to drive improvement activities and raise awareness of the effect of quality problems in an organization. A simple performance measurement framework is outlined, which includes more than just measuring, but also defining and understanding metrics, collecting and analyzing data, then prioritizing and taking improvement actions. A description of the balanced scorecard approach is also covered.

Cost of quality measurement The cost of doing a quality job, conducting quality improvements and achieving goals

must be carefully managed, so that the long-term effect of quality on the organization is a desirable one. These costs must be a true measure of the quality effort, and are best determined from an analysis of the costs of quality. Such an analysis provides:

- A method of assessing the effectiveness of the management of quality
- A means of determining problem areas, opportunities, savings and action priorities

Cost of quality is also an important communication tool. Crosby demonstrated what a powerful tool it could be to raise awareness of the importance of quality. He referred to the measure as the "Price of Nonconformance", and argued that organizations chose to pay for poor quality according to Garrison et, al (2012)..

Quality-related activities that will incur costs may be split into prevention costs, appraisal costs and failure costs. Prevention costs are associated with the design, implementation and maintenance of the TQM system. They are planned and incurred before actual operation, and could include:

- Product or service requirements – setting specifications for incoming materials, processes, finished products/services
- Quality planning – creation of plans for quality, reliability, operational, production, inspection
- Quality assurance – creation and maintenance of the quality system
- Training – development, preparation and maintenance of programmers

Appraisal costs are associated with the suppliers' and customers' evaluation of purchased materials, processes, products and services to ensure they conform to specifications. They could include:

- Verification – checking of incoming material, process set-up, products against agreed specifications
- Quality audits – check that the quality system is functioning correctly
- Vendor rating – assessment and approval of suppliers, for products and services

Failure costs can be split into those resulting from internal and external failure. Internal failure costs occur when the results of work fail to reach designed quality standards and are detected before they are transferred to the customer. They could include:

- Waste – doing unnecessary work or holding stocks as a result of errors, poor organization or communication
- Scrap – defective product or material that cannot be repaired, used or sold
- Rework or rectification – the correction of defective material or errors
- Failure analysis – activity required to establish the causes of internal product or service failure

External failure costs occur when the products or services fail to reach design quality standards, but are not detected until after transfer to the customer. They could include:

- Repairs and servicing – of returned products or those in the field
- Warranty claims – failed product that are replaced or services re-performed under a guarantee according to Garrison et, al(2012).

2.2 Empirical Literature Review

The effects of diversification on firm performance are mixed. Three recent reviewers (Datta, Rajagopalan and Rasheed 2000, Hoskisson and Hitt 2003, Kerin, Mahajan and Varadarajan 2000), broadly conclude: the empirical evidence is inconclusive; models, perspectives and results differ based on the disciplinary perspective chosen by the researcher; and the relationship between diversification and performance is complex and is affected by intervening and contingent variables such as related versus unrelated diversification, type of relatedness, the capability of top managers, industry structure, and the mode of diversification. Some studies claim diversifying into related product-markets produces higher returns than diversifying into unrelated product-markets and less diversified firms perform better than highly diversified

firms (Christensen and Montgomery 2004, Keats 2004, Michel and Shaked 2003, Rumelt 2001, 2002, 1986). Some claim that the economies in integrating operations and core skills obtained in related diversification outweigh the costs of internal capital markets and the smaller variances in sales revenues generated by unrelated diversification (see Datta, Rajagopalan & Rasheed 1998).

While agreeing that related strategy is better than unrelated, Prahalad and Bettis (2000), clarify that it is the insight and the vision of the top managers in choosing the right strategy (how much and what kind of relatedness), rather than diversification per se, which is the key to successful diversification. Accordingly, it is not product-market diversity but the strategic logic that managers use that links firm diversification to performance; which implies that diversified firms without such logic may not perform as well. Markides and Williamson (2000) show that strategic relatedness is superior to market relatedness in predicting when related diversifiers outperform unrelated ones. Others however argue, it is not management conduct so much, but industry structure that governs firm performance (Christensen and Montgomery 2003, Montgomery 2000).

Besides diversification types and industry structure, researchers have also looked at the ways firms diversify. Simmonds (1990) examined the combined effects of breadth (related vs. unrelated) and mode (internal R & D versus Mergers & Acquisitions) and found that relatedly diversified firms are better performers than unrelatedly diversified firms, and R & D based product development is better than mergers and acquisition- led diversification (Simmonds 1990, Lamont and Anderson 1985). Among studies of acquisitions the results are mixed. Some report that related acquisitions are better performers than unrelated ones (Kusewitt 1985), or there is no real difference among them

(Montgomery and Singh 2005 some studies on breadth and performance find relatedly diversified firms perform better than firms that are un relatedly diversified (Pelich 2000, 2003, 1986). Others show confounding effects in firm performance because of diversification and Firm Performance: An Empirical Evaluation 69 diversification category and industry (Christiansen and Montgomery 1981, Montgomery 2004).

Recent studies suggest service firms should not diversify (Normann 2004), whereas, Nayyar (1993), shows that in the service industry diversification based on information asymmetry is positively associated with performance, whereas diversification based on economies of scope is negatively associated with performance. A contradiction of Johnson and Thomas' (2000) confirmation of Rumelt's finding that the appropriateness of product diversity is judged by a balance between economies of scope and diseconomies of scale. It also appears there is a limit on how much a firm can diversify; if a firm goes beyond this point its market value suffers and reduction in diversification by refocusing is associated with value creation (Markides 2006). apart from the empirical evidence, the efficient market hypothesis (EMH) holds that competition among investors for information ensures that current prices of widely traded securities are the unbiased predictors of their future value, and that current prices represent the net present value of its future cash flow. Evidence supports the existence of weak, semi- and near-strong forms of market efficiency (Fama 1970).

If this view of the market is true, then investors have the information necessary to construct portfolios of stocks to maximize their risk/return strategies for a given amount of

resource. Consequently, a firm's management cannot do better for the investor by diversifying into different product markets and create a portfolio that will improve returns or better manage risk than investor's stock portfolio. Stockholders also do not pay a premium for diversified firms (Brealey and Myers 1996); the market does not value risk/return trade-off positively for unrelated diversification (Lubatkin and O'Neil 2000), and acquiring firms only earn normal returns (Lehn and Mitchell 1993), and not economic rents. Finally, corporate takeovers discipline managers who waste shareholder resources and bust-ups promote economic efficiency by reallocating assets to higher valued uses or more efficient uses (Jensen and Ruback 1994, Lehn and Mitchell 1993).

The review of empirical literature from Management/Marketing disciplines and the theoretical and empirical literature from Finance show that the relationship between diversification and performance is complex and is affected by intervening and contingent variables. Taken together, the evidence and arguments presented above seems to suggest that diversified firms (i.e. highly unrelated diversified firms) as a class, should perform less well than an optimal securities portfolio, and thus for our study we propose the following null hypothesis.

Our null hypothesis (H0) is that: Highly diversified firms should perform less well than moderately diversified and single product firms.

There are numerous arguments and findings against the null hypothesis proposed above. In certain markets, an investor may face assets constraint in constructing a portfolio, restricting diversification opportunities (Levy 1998). Farrelly, and Reichenstein (2006) show that total risk rather than systematic risk alone, better explains the expertly assessed risk of stocks. Jahera, Lloyd and Page (2000), find well-diversified firms have higher returns regardless of size. DeBondt and Thaler (1999, 2000), argue that the market as a whole overreacts to major events. Prices shoot up on good economic news and decline sharply on bad news. According to Brown and Harlow (1988, 1993), investors hedge their bets and over react or under react to important news by pricing securities below their expected values. As uncertainties decrease, stock prices adjust upwards, regardless of the direction of the impact of the initial event.

The post-event adjustment in prices tends to be greater in the case of bad news than in the case of good news. Haugen (2000) also casts doubts on the validity of the EMH. Finally, Fama and French (2007), changing their earlier stance, argue that the capital asset pricing model (CAPM) is incapable of describing the last fifty years of stock returns, and the beta is not an appropriate measure of risk. This implies that a stockholder may not be better positioned to diversify his portfolio of stocks as compared to a corporate manager as implied by the null hypothesis.

On the basis of this discussion, we could argue that market inefficiency may not allow investors to optimally allocate their resources. It can put managers, especially good ones, in a more advantageous position to diversify their product market portfolios and thereby improve firm performance.

Thus, our alternate hypothesis (H1) is: that diversified firms perform better in terms of return and risk measures compared to less diversified firms. Thus, on average, diversified firms as a class, should perform better than moderately diversified or single-product firms

3. Methodology

The research was descriptive in nature. A clear definition of the details of the descriptive makes the desired statistical analyses possible, and almost always improves the usefulness of the results. The desired result is to produce a layout of the design along with an explanation of its structure and the necessary statistical analyses. The researcher targeted a population of 300 SMEs in Bakara Market. A sample size of 75 SMEs was selected for the study (Burns & Grove 1997)

4. Research Findings

4.1 Study Variables Findings

The following presents the findings on the various study variables. The effects of diversification on firm performance are mixed. Three recent reviewers (Datta, Rajagopalan and Rasheed 2000, Hoskisson and Hitt 2003, Kerin, Mahajan and Varadarajan 2000), broadly conclude: the empirical evidence is inconclusive; models, perspectives and results differ based on the disciplinary perspective chosen by the researcher; and the relationship between diversification and performance is complex and is affected by intervening and contingent variables such as related versus unrelated diversification, type of relatedness, the capability of top managers, industry structure, and the mode of diversification. Some studies claim diversifying into related product-markets produces higher returns than diversifying into unrelated product-markets and less diversified firms perform better than highly diversified firms (Christensen and Montgomery 2004, Keats 2004, Michel and Shaked 2003, Rumelt 2001, 2002, 1986).

4.1.1 Liquidity of Financial performance

The study sought to investigate the effects of Liquidity on financial performance of SME's. Table 4.1 summarizes respondents' level of agreement on liquidity affects financial performance. The respondents agreed that We Have more branches in our business as shown by a mean of 2.15. The respondents agreed our firm lengthens credit period for the customers reported a mean of 1.88. The respondents also agreed to the fact that we make discount of every customer. Were similar, reporting a mean of 2.01. Our organization avoids cash shortages regularly reported a mean of 1.99. According to Begg, Fisher and Rudiger (1991) liquidity refers to the speed and certainty with which an asset can be converted back into money (cash, income) whenever the asset holder desires. Cash is the most liquid asset of all. In terms of accounting, liquidity can be defined as the ability of current assets to meet current liabilities (working capital). In terms of investment, it is the ability to quickly convert an investment portfolio to cash with little or no loss in value.

Table 4.1 liquidity

Statement	N	Mean	Std. Deviation
Our firm lengthens credit period for the customers	75	1.88	.734
Our organization avoids cash shortages regularly	75	1.99	.797
We make discount of every customer.	75	2.01	.744
We Have more branches in our business	75	2.15	.800
Valid N (listwise)	75		

4.1.2 Risks diversification on financial performance

The study sought to establish the effects of risk diversification on financial performance of SME's. Respondents agreed that We secure and stable our current financial situation, including our ability to pay living expenses for our self and dependents, and the amount of savings available for emergencies depicted by a mean of 1.91, the

respondents agreed that the investment portfolio that has been structured to meet your long-term objectives and a few months later, there is a significant decline in the value of your total portfolio that is caused by a small number of your investment holdings. Due by a mean of 1.80 and a mean of 1.79 was obtained We are comfortable with investments that may frequently experience large declines in value if there is a potential for high returns. Same as mean of 1.79 the respondent agreed if the financial markets were experiencing a period of decline, would you sell off parts of your riskier holdings and put the money into safer assets. (Montgomery and Singh 2000). Same studies on breadth and performance find relatedly diversified firms perform better than firms that are unrelated diversified (Pelich 2000, 2003).

Table 4.2. Risk diversification.

Statement	N	Mean	Std. Deviation
If the financial markets were experiencing a period of decline, would you sell off parts of your riskier holdings and put the money into safer assets	75	1.79	.722
We are comfortable with investments that may frequently experience large declines in value if there is a potential for high returns.	75	1.79	.759
Investment portfolio that has been structured to meet your long-term objectives and a few months later, there is a significant decline in the value of your total portfolio that is caused by a small number of your investment holdings.	75	1.80	.771
We secure and stable our current financial situation, including our ability to pay living expenses for our self and dependents, and the amount of savings available for emergencies?	75	1.91	.756
Valid N (listwise)	75		

4.1.3 Mergers and acquisition on financial performance

The study sought to establish the effects mergers and acquisition on financial performance of small and medium enterprises in Somalia From the findings indicated in table 4.2 the respondents agreed will the merged entity require new capital contributions one firm that is highly with a mean of 1.95 being obtained. These results are consistent with the findings obtained on the name of the new firm is the leading deal breaker in merger negotiations, so have you to address it from the start of discussions. a mean of 1.79. The respondent also agreed the firm's primary reason for a merger Acquiring talent, increasing profits, obtained a mean of 1.83. Who is current bonding company and how your bonds are serviced obtaining a mean of 1.81. Mergers and Acquisitions refer to the change in ownership, business mix, assets mix and alliance with the view to maximize shareholders' value and improve firm performance. One of the main elements of improving company performance is the boom in mergers and acquisitions (Pazarkis et al, 2006). Additionally, (Gaughan ,2002) defines a merger as the process in which two firms combine and only one endures and the merged entity cease to exist.(Nakamura, 2005).

4.1.4 Financial performance

A number of questions were asked to determine how SME's performance in bakara market. Respondents agreed

that they have been able to generate profits for the last two years obtaining a mean of 1.88.

Table 4.3. Mergers and acquisition.

Statement	N	Mean	Std. Deviation
The name of the new firm is the leading deal breaker in merger negotiations, so have you to address it from the start of discussions.	75	1.79	.810
Who is current bonding company and how are your bonds serviced?	75	1.81	.766
It is the firm's primary reason for a merger Acquiring talent, increasing profits,	75	1.83	.724
Will the merged entity require new capital contributions One firm that is highly	75	1.95	.868
Valid N (listwise)	75		

The respondent agreed they are strong position in the market compared to competitors obtaining a mean of 1.87. And similarly a mean of 1.83 terms of firm how uses its profits as internal sources of financing were respondent agreed. Although "performance" may appear to be an easy concept, a unique definition in the literature does not exist. Moreover, academics often use special definitions tailored to fit the individual research purposes (Langfield-Smith, 1997). The financial performance is often measured using traditional accounting Key Performance Indicators such as Return On Assets, Operating Profit margin, Earnings Before Interest and Tax, Economic Value Added or Sales growth (Ittner & Larcker, 1997; Fraquelli & Vannoni, 2000; Crabtree & DeBusk, 2008).

Table 4.4. financial performance

Statement	N	Mean	Std. Deviation
Our firm uses its profits as internal sources of financing	75	1.83	.828
We are at strong position in the market compared to competitors	75	1.87	.920
We have been able to generate profits for the last two years	75	1.88	.821
Valid N (listwise)	75		

4.2 Multiple Regression Analysis

Multiple regressions is an extension of simple linear regression. It is used when we want to predict the value of a variable based on the value of two or more other variables. The variable we want to predict is called the dependent variable (or sometimes, the outcome, target or criterion variable). The variables we are using to predict the value of the dependent variable are called the independent variables (or sometimes, the predictor, explanatory or regress or variables). For example, you could use multiple regressions to understand whether exam performance can be predicted based on revision time, test anxiety, lecture attendance and gender. Alternately, you could use multiple regressions to understand whether daily cigarette consumption can be predicted based on smoking duration, age when smoking, smoker type, income and gender started. Multiple regressions also allow you to determine the overall fit (variance explained) of the model and the relative contribution of each of the predictors to the total variance explained. For example, you might want to know how much of the variation in exam performance can be explained by revision time, test anxiety, lecture attendance and gender "as a whole", but also the "relative contribution" of each independent variable in explaining the variance.

This "quick start" guide shows you how to carry out multiple regressions using SPSS Statistics, as well as interpret and report the results from this test. However, before we introduce you to this procedure, you need to understand the different assumptions that your data must meet in order for multiple regression to give you a valid result.

4.2.1 Model Summary

Model summary is a summary that describes how far the independent variables explain the dependent variables that mean the greater R value has the greater number the greater independent variables explain with dependent variable. In order to test the research hypotheses, a standard multiple regression analysis was conducted using financial performance the dependent variable, and the three investigations determine effect of diversification of the financial performance: liquidity, risk diversification, and merger acquisition as the predicting variables. Tables 4.5 and 4.6 present the regression results. From the model summary in table 4.5, it is clear that the adjusted R2 was 0.245 indicating that a combination of liquidity, risks diversification, and mergers acquisitions explained 27.6% of the variation in the financial performance of SME's in bakara market Mogadishu Somalia.

Table 4.5. Model Summary

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.525 ^a	.276	.245	.66012

4.6.3 Analysis of Variance

Analysis of Variance (ANOVA), as the name implies, is a statistical technique that is intended to analyze variability in data in order to infer the inequality among population means. This may sound illogical, but there is more to this idea than just what the name implies. The ANOVA technique extends what an independent-samples t test can do to multiple means. The null hypothesis examined by the independent samples t test is that two population means are equal. If more than two means are compared, repeated use of the independent-samples t test will lead to a higher Type I error rate (the experiment-wise α level) than the α level set for each t test.

Table 4.6 Analysis of Variance

ANOVA ^b						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	11.766	3	3.922	9.001	.000 ^a
	Residual	30.939	71	.436		
	Total	42.705	74			

From the ANOVA table 4.6, it is clear that the overall standard multiple regression model (the model involving constant, liquidity, risk diversification and merger acquisition) is significant in predicting how liquidity, risk diversification, and merger acquisition determine financial performance of the

SME's in bakara market Mogadishu Somalia. The regression model achieves a degree of fit as reflected by an R2 of 0.276 (F = 9.00; P = 0.000 < 0.05).

4.2.2 Regression Coefficients

Table 4.7 presents the regression results on how liquidity, risk diversification and merger acquisition determine financial performance of the SME's in bakara market Mogadishu Somalia. The multiple regression equation was that: $Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \epsilon$ and the multiple regression equation became: $Y = -0.11 - 0.176X_1 + 0.552X_2 + 0.661X_3$. As depicted in table 4.9, there was positive and significant effects of diversification on financial performance ($\beta = 0.342$; $t = 2.904$; $p < 0.05$).

There was positive and significant effects of merger acquisition on performance ($\beta = 0.269$; $t = 2.304$; $p < 0.05$). However, there was negative but insignificant effects of risk on performance ($\beta = -0.019$; $t = -0.896$; $p > 0.05$).

Table 4.7. Regression Coefficients.

Coefficients ^a						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.011	.553		-.019	.985
	Liquidity	.661	.228	.342	2.904	.005
	Risk Diversification	-.176	.197	-.092	-0.896	.373
	Mergers and Acquisitions	.552	.239	.269	2.309	.024

a. Dependent Variable: Financial Performance

4.2.3 Correlation Analysis

Pearson Bivariate correlation coefficient was used to compute the correlation between the dependent variable effect of diversification and the independent variables financial performance. According to Sekaran (2008), this relationship is assumed to be linear and the correlation coefficient ranges from -1.0 (perfect negative correlation) to +1.0 (perfect positive relationship). The correlation coefficient was calculated to determine the strength of the relationship between dependent and independent variables (Kothari, 2013). From table 4.5, the results generally indicate that except for liquidity, other independent variables (risk diversification and mergers and acquisitions) were found to have positive significant correlations on financial performance at 5% level of significance. There was a weak positive but insignificant Performance correlation Merger Acquisitions ($r = 0.433$, $P < 0.05$). There was a weak positive and significant correlation between liquidity ($r = 0.46$, $P < 0.05$). There was a strong negative and highly significant correlation between risk diversification and financial performance ($r = -0.019$, $P < 0.01$).

Table 4.8. Correlation.

Correlation					
		Performance	Liquidity	Risk Diversification	Mergers And Acquisitions
Financial Performance	Pearson Correlation	1	.460**	-.019	.433**
	Sig. (2-tailed)		.000	.870	.000
	N	75	75	75	75
Liquidity	Pearson Correlation	.460**	1	.170	.495**
	Sig. (2-tailed)	.000		.144	.000
	N	75	75	75	75
Risk Diversification	Pearson Correlation	-.019	.170	1	.053
	Sig. (2-tailed)	.870	.144		.649
	N	75	75	75	75
Mergers and acquisitions	Pearson Correlation	.433**	.495**	.053	1
	Sig. (2-tailed)	.000	.000	.649	
	N	75	75	75	75

** . Correlation is significant at the 0.01 level (2-tailed).

There was a moderately positive and highly significant correlation between effects of diversification and financial performance ($r = 0.469$, $P < 0.01$). The results imply that liquidity, mergers acquisitions and diversification significantly influenced financial performance of the SME's in bakara market Mogadishu Somalia.

5. Conclusions

Based on the findings of this study, the following conclusions were drawn. The results reveal that liquidity, merger acquisition and profitability have significant and positive effects on organizational performance, while risk have insignificant effects on profitability in the SME's in bakara market mogadishu somalia in Mogadishu. Stepwise regressions revealed that liquidity determinants of profitability including risk and merger acquisition explained statistically significant portion of the variance associated with the extent of profitability of the small and medium enterprise in bakar market Mogadishu Somalia. The study recommends that to improve profitability in the small and medium enterprise in bakara market, managers of the SME's in bakara market Mogadishu Somalia in Mogadishu should nurture and develop liquidity and merger acquisition.

6. Recommendations

Based on the findings of the study, it is essential to give recommendations in order to gather more gains from diversification. It is recommended that;

1. Management should in still discipline upon itself by ensuring good financial performance, promote technological progress and increase it's paid up capital regardless of the statutory requirements so that the continued existence of the firm is not jeopardized after undergoing diversification.
2. Management should not only undertake diversification in order to improve operation and sustain failing businesses but also improve their competitiveness and financial performance.
3. Management should come up with a sound strategy towards liquidity and risk diversification management so as to avert the problem of mismatching investments and also the quality of liquidity should be enhanced.
4. Management should put into consideration the degree of transferability and marketability of liquidity invested in so that these assets can provide liquidity to the firm with ease.

7. Areas For Further Research

Further research in other sectors that have engaged in diversification should be getting on on so as to obtain further insights. This is because the type of industry may make a difference to the pre-diversification and post-diversification financial performance of firms. Extensive research has been already been carried out on effect of diversification on the financial performance of the SME's companies and thus it is important to look into other sectors such as; insurance companies, manufacturing companies, IT and communications firms to enable to determine whether diversification do have a significant impact on the financial performance of firms. In addition, it is important to study the effect of diversification on shareholder value of the stated firms.

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