THE EFFECT OF CORPORATE DIVERSIFICATION ON COMPANY PERFORMANCE USING MANAGERIAL OWNERSHIP AS A MODERATING VARIABLE

(Undergraduate Thesis)

By

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ECONOMICS AND BUSINESS FACULTY
UNIVERSITY OF LAMPUNG
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ABSTRACT

THE EFFECT OF CORPORATE DIVERSIFICATION ON COMPANY PERFORMANCE USING MANAGERIAL OWNERSHIP AS A MODERATING VARIABLE

By

Nova Berliana

The purposes of this study are to analyze the effect of corporate diversification on company performance and the moderating effect of managerial ownership on the relationship between corporate diversification and company performance. Using manufacturing company that listed on Indonesia Stock Exchange for the period 2016-2019, the empirical results indicate that product diversification and geographic diversification show insignificant and positive effect on company performance. Furthermore, managerial ownership as a moderating variable between product diversification and company performance shows significantly negative. However, managerial ownership as a moderating variable between geographic diversification and company performance shows significantly positive.

Keywords: Product Diversification, Geographic Diversification, Corporate Diversification, Company Performance, Managerial Ownership

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With this, I declare that my thesis with entitled **"THE EFFECT OF CORPORATE DIVERSIFICATION ON COMPANY PERFORMANCE USING MANAGERIAL OWNERSHIP AS A MODERATING VARIABLE"** is true of my own work. In this thesis there is no whole or partial of the writings of others by copying or forging in the form of a series of sentences or symbols that show ideas or arguments or thoughts of other authors, which I acknowledge as my own writing, other than that or I took it from someone else's writing without giving the original author's acknowledgment. If later it is proved that my statement is not true, then I am ready to accept sanction in accordance with applicable regulations.

Bandar Lampung, April 11th, 2022

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BIOGRAPHY

The author was born in Bandar Lampung on November 04th, 1999 with full name Nova Berliana as the older child of 2 siblings. Her father's name is Mr. Suwandi and her mother's name is Mrs. Sri Wahyuni. The younger brother's name is Juliar Dwi Riski Andi.

The author completed her kindergarten education at Taman Kanak-Kanak (TK) Tunas Harapan in 2005, continued her elementary school and graduated from SD Negeri 3 Gunung Terang in 2011. The author completed the junior high school education and graduated from SMP Negeri 8 Bandar Lampung in 2014. The author completed the senior high school education and graduated from SMA Negeri 7 Bandar Lampung in 2017.

After graduated from senior high school, the author continued her study in University of Lampung with major of accounting. In second semester the author was selected as a part of International Class Program, and got the scholarships by government that is Bidikmisi. While being International class student, the author was obligated to have international experience. Then in 2019 the author took Short Course Program that was carried out by the School of International Politics, Economics and Communication at Aoyama Gakuin University in Japan.

As a student, the author was active in several activities. The author was a part of the Young Brigadier of BEM University of Lampung in period 2017-2018. After the author graduated from BEM University of Lampung, the author has another activities in outside of campus such as the author became private tutor for junior high school for three years, the author became supervisor from Bawaslu in the Pemilu for the year 2019 and 2020, the author was a part of BKKBN from 2019 and ever became supervisor in Pendataan Keluarga for the year 2021 (PK 21), and the author was a part of Coaching Clinic 12 in Rumah Inggris.

DEDICATION

Alhamdulillahirobbil'alamin

Praise be to Allah SWT for all the grace, blessing and grace so great to the author, thus this undergraduate thesis can be completed.

I dedicate this undergraduate thesis to the most important people in my life:

My beloved parents, Mr. Suwandi and Mrs. Sri Wahyuni,

My little brother Juliar Dwi Riski Andi

Truly grateful to be surrounded and guided by an incredibly supportive family. Thank you for always let me to be my own self, trust and let me choose all the things without interfering with my choice, thanks for let me be the best version of myself. I would not be who I am today without their guidance, love, advice, prayers, and unconditional supports for my success.

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MOTTO

"Allah tidak membebani seseorang melebihi kemampuannya"

(Q.S Al-Baqarah:286)

"Sesungguhnya sesudah kesulitan itu ada kemudahan"

(Q.S. Al-Insyirah:5)

"Cukuplah Allah sebagai penolong kami dan Allah adalah sebaik-baik pelindung"

(Q.S. Ali Imran:173)

"Maka nikmat Tuhanmu yang manakah yang kamu dustakan?"

(Q.S. Ar-Rahman)

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Nova Berliana

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CHAPTER I

INTRODUCTION

1.1 Background

A company is established for a variety of purposes. The objective of the company is to increase company performance by maximizing the profit and minimizing the risk. However, to achieve this goal, there must be the right strategies. The company can use many kinds of management strategies. One of these strategies is corporate diversification. This strategy can be used to increase company performance by making different segments to expand the market scope.

There are various types of corporate diversification which are generally divided into two types; first, it is based on the scope such as product (the differences of product), geographic (regional and international), service, and major customers; and second, it is based on the form such as concentric, relational, and conglomerate.

The corporate diversification regulation stated in Indonesian Financial Accounting Standard (*PSAK)* No. 5 about "*Segmen Operasi"* and IFRS No. 8 about Operating Segments. IFRS No. 8 about Operating Segments explains how an entity should report information about their operating segments in the annual financial statements and the interim financial reports. The company with the diversification must already set out the requirements for segment disclosures about products, services, geographical areas, or major customers in their financial report related to the aspect that they diversify. That can be some types of diversification, such as product, service, geographic, and customer. Based on this situation, the number of segments reported in the financial statements of the company can reflect corporate diversification.

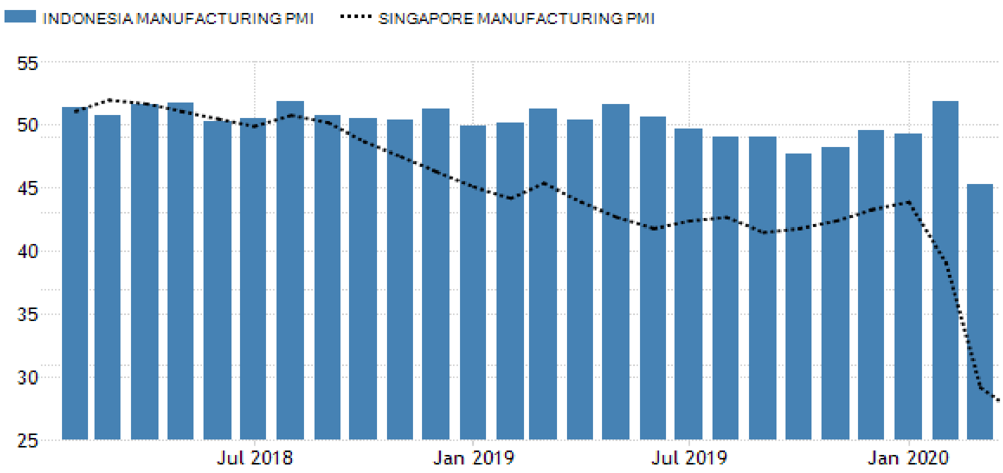
According to an article by Damayanti,Aulia. "*Belasan Ritel Bangkrut Dan Tutup Toko, Ini Daftarnya.*" by *finance.detik.com*, on July 2020, many diversified companies with their business have faced bankruptcy. Some of the multinational corporations closed their business because of corporate diversification such as NPC international inc., Lucky Brand inc., Brooks Brothers Inc., Sur La Table, and PVH Corporation. Meanwhile, there are also successful companies in their business by using corporate diversification strategies such as Starbucks and McDonald's. These companies are successfully survived with diversification strategy. Both of these companies that bankrupt or successful are the manufacturing companies.

The manufacturing companies are product manufacturers for consumers that are trying to survive and expand the business with high competition and diversification levels. The manufacturing companies also have a special index namely PMI. The PMI (Purchasing Managers Index) is an economic indicator that reflects the confidence of business managers in the manufacturing sector. Therefore, it also gives an impact on the stock market.

The Purchasing Managers Index or PMI is an economic indicator created by surveying several Purchasing Managers in various business sectors. Besides, the high PMI index value shows the optimism of the business sector regarding the prospects of the economic future. The most index that investors and analysts pay attention to the manufacturing sector is called the Manufacturing PMI.

The increase of Manufacturing PMI value shows performance in the manufacturing business. Thus, it affects the investors to enter and invest in this sector. On the stock market, especially for the shares price from manufacturing industry sector will tend to rise. Meanwhile, the exchange rate of the currency in the market has a positive impact on short-term economic growth. If the percentage of the Manufacturing PMI index is >50%, it indicates that the manufacturing sector in the country has grown and vice versa.

Figure 1.1 Comparison of Indonesia Manufacturing PMI and Singapore Manufacturing PMI

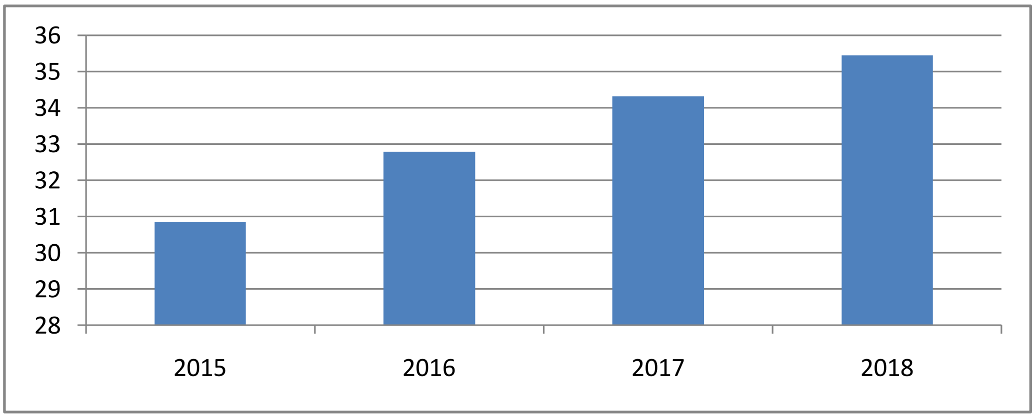


Source: *www.tradingeconomics.com*, 2021

Singapore is one of the developed countries in Asia. From chart in the figure 1.1, Indonesia Manufacturing PMI is higher than Singapore Manufacturing PMI from July 2018 until March 2020, which means that the Indonesian manufacturing company performance is better than the Singapore. The manufacturing company usually diversifies their products included Indonesia manufacturing company so it means the diversification affects the company performance. Because of that, the subject in this study is a manufacturing company in Indonesia.

In this case, the manufacturing company sector in Indonesia is divided into three sub-sectors of industry, which are: the consumer goods; the basic and chemical; and the miscellaneous industries. The consumer goods industry sector is the one sub-sector of manufacturing company that contributes a good percentage for national growth. It has a consistently positive performance (*kemenperin.go.id*), which has a high level of diversification with the percentage of companies 86.96% (Geraldo, 2019). Besides, there has been no previous research that takes specifically about the consumer goods industry companies. So, this research subject is using the Consumer Goods Industry listed in Indonesia Stock Exchange.

Figure 1.2 The Economic Growth in the sub-sector Consumer Goods Industry (%)



Source: *www.kemenperin.go.id*, 2019

Some studies show the inconsistencies in the corporate diversification effects on the company performance. Hsu and Liu (2008) stated that the product diversification and customer diversification are positive significant effects on the company performance. Geogre and Rezaul (2012) and Krivokapic et al. (2017) stated that the corporate diversification improves the company performance. Therefore, the corporate diversification has a positive significant effect on the company performance.

According to Lang and Rene (1994), the corporate diversification strategy is not positively significant effect on the company performance. Meanwhile, Geraldo (2019) stated that the corporate diversification has a significantly negative effect on the company performance. Iqbal et al. (2012) also stated that the corporate diversification strategy gives no significant effect on the company performance. On the other hand, Mehmood et al. (2019) and Cristian et al. (2020) stated that the corporate diversification strategy has a significant effect on the company performance.

Based on the inconsistencies in the results of previous researches about the corporate diversification effect on the company performance, then it can be concluded that other factors influence both variables. In this case managerial ownership can be a moderating variable between corporate diversification and company performance. Managerial ownership is the ownership of the shares owned by the manager in the company which is measured by the percentage of the number shares owned by the manager. A higher level of managerial ownership can motivate managers to generate maximum profits for the company. The existence of managerial ownership can be strengthened or weaken the effect of corporate diversification on company performance.

Research conducted by Geraldo (2019) stated that managerial ownership, as a moderating variable, was able to moderate the relationship between corporate diversification and company performance, and the effect is significantly positive. According to Rasyid et al. (2020), as a moderating variable, managerial ownership was not able to moderate the relationship between corporate diversification and company performance.

Based on the description above, the title of this research is "**The Effect of Corporate Diversification on Company Performance Using Managerial Ownership as a Moderating Variable**".

1.2 Research Problem

Based on the background that has been described above, the problems can be identified as follows:

1. Does the corporate diversification by product diversification affect the company performance?
2. Does the corporate diversification by geographic diversification affect the company performance?
3. Does managerial ownership affect the relationship between corporate diversification and company performance?

1.3 Research Objectives

In line with the research problems above, the objectives of this research are:

1. To test and analyze the effect of corporate diversification by product diversification on the company performance.
2. To test and analyze the effect of corporate diversification by geographic diversification on the company performance.
3. To recognize the effect of managerial ownership in the relationships between corporate diversification and company performance.

1.4 Research Benefits

This research is expected to provide the following benefits as follows:

1. For the stakeholders and the managers

This research can provide the input to consider in making decisions for the company. It is used to expand the market by product and geographic diversification. So, the decisions can give some benefits.

2. For manufacturing company

It can give a contribution by providing information about corporate diversification strategy, whether it can be one of the strategies that guarantee the company to increase the company performance.

3. For further researchers

This research is expected to increase the knowledge for readers through the reference material. Besides, it can be developed for further researches by using other management strategies as a substitute variable.

4. For Academics

This research is expected to contribute developing science, especially in economics field.

CHAPTER II

LITERATURE REVIEW

2.1 Theoretical Basis

2.1.1 Agency Theory

According to Godfrey (2010), agency theory is a theory that explains and predicts the action of agents (managers) and the action of principals (shareholders or owners). The theory assumes that both the agent and the principal have the utility to maximize their inconsistent interest. Besides, there is no reason to believe that the agent will always act in the principal's best interest. Because the principal goal (owner) is entrusted by an agent (manager), the theory concentrates on the relationship between agent and principal. Atkinson and Feltham in Godfrey (2010) stated that agency theory considers the management demand on information and decision making.

A business contract relationship creates a separation of interests between ownership and manager. For example, the principal wants the maximum profit (higher dividend distributed over the business), and the manager, as an agent, wants high wages for his services. Frequently, the agency problems that arise from the asymmetry information provided by the agent and the principal are caused by their different objectives (Godfrey, 2010).

If there is an asymmetry information between the principal and the manager in determining the company strategies, it often gives a bad effect on the company. In this corporate diversification strategy, if the principals, as the funds' providers, not know about the purpose of their funds, it will have a material impact on the company. For example, in the case of investors, they will withdraw their funds due to management decisions that are not consistent with their goals. Therefore, the final result to the company is going to bankrupt.

2.1.2 Entrenchment Managerial Theory

The entrenchment theory explains if the managers have a higher proportion of the shares, they will prioritize their interest rather than the shareholder's interest. Because the managers have a significant portion of the capital in the company, they have higher controls of the company and their actions will contrary to the company goals (Baratiyan, 2013). The managerial entrenchment gives an impact on the company because the risk and greater cost occur from the manager activity. The basic goal of the company is to increase wealth of shareholders. However, it is not true in real world; it seems like the managers prefer to increase their benefits first such as increasing their wages, bonus, power, position, and so on (Baratiyan, 2013).

For example of the managers actions exist in the investment activity, the managers will focus on the projects investments which have short-term benefits (benefits and rewards associated with earnings) and do not pay attention to long-term projects (benefits for shareholders). The managers also try to make themselves valuable to shareholders by using several contract investments (implicit and explicit) with the result that only can be evaluated by investor through financial report. For the explicit contract investment such as diversification investment, the managers do that activity with the purpose, first based on their interest. Because that is big investment, the managers can increase their power and negotiate their wages. This activity investment may be decreased the company performance because the investors only can be evaluated the results from financial report and also this activity based on the managers purpose.

2.2 Corporate Diversification

According to Ansoff (1957), the term "diversification" is usually associated with the changes in the characteristics of the company's product or market. This means that the company diversification can be shown by the type of company's products and the company's market based on the geographic area or the major consumer.

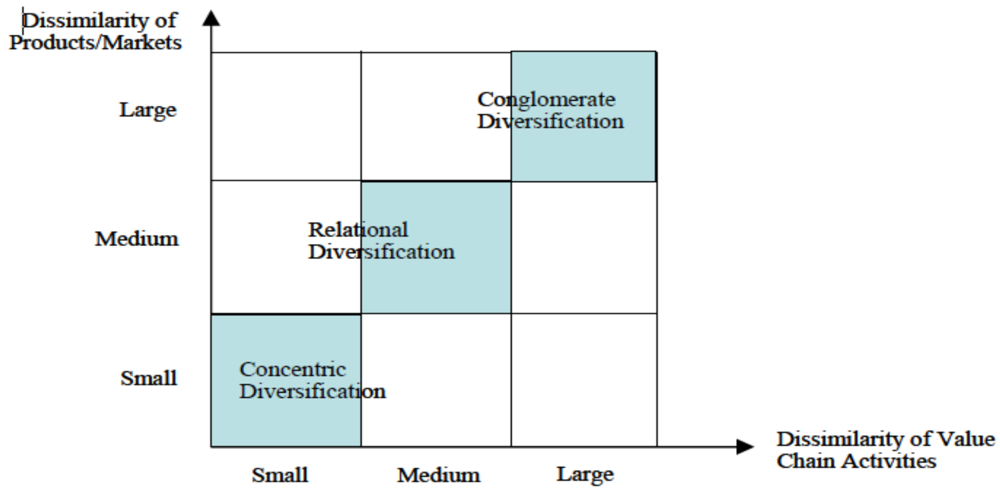
Kotler and Gary (2017) describe diversification as a strategy for developing a company by starting or making a new business that is different from the previous company’s products or markets. The diversification strategy can be implemented in a business that indicates the differences of the company activities. Therefore, diversification can be seen as the differences of segment activity.

2.2.1 Types of Diversification

A. Types of Diversification Based on Forms

Hutzschenreuter and Sonntag (1998) in Hutzschenreuter and Fabian (2006) define three diversification types (concentric, relational, and conglomerate diversification) according to two dimensions "dissimilarity of products/markets" and "dissimilarity of value chain activities".

Figure 2.1 Types of Diversification



1) Concentric Diversification:

   Concentric diversification is the company diversification that has several same business products and markets. Additionally, the business has the same customers and competitors which are almost identical in value chain activities. Concentric diversification is similar to related company diversification (horizontal diversification). It is the strategy that makes another business, but still has a correlation with the previous business.

2) Relational Diversification:

Relational diversification is the diversification of products, markets, and internal activities are different. But, it still has similar competitors, customers, and competencies for managing value chain activities.

3) Conglomerate Diversification:

Conglomerate diversification is the diversification when the products, markets, and internal activities are totally different. This type is similar to unrelated diversification (vertical diversification). Unrelated diversification is the strategy that makes other businesses totally different from previous business (selling new product or buying company that has no relation with the previous company).

B. Types of Diversification Based on Scope

According to IFRS No.8 about Operating Segments, Diversification is divided into four types, which are:

1) Product Diversification

Product diversification is a strategy taken by the company to make a new product or different products line.

2) Services Diversification

Services diversification is a strategy taken by the company to make a new services or different services lines.

3) Geographic Diversification

Geographic diversification can be done by making a new branch, acquisition, merger, or buying other companies in different area.

4) Customer Diversification

Customer diversification shows the types of customer levels in the company.

2.2.2 Advantage and Disadvantage of a Corporate Diversification Strategy

According to Yessika (2010), there are three main advantages of the company which diversifying their business:

(1) minimizing the risk of loss by increasing the company's growth,

(2) reducing the operating costs, and

(3) having a competitive advantage.

However, this strategy also has some disadvantages which are:

(1) Wrong funding mechanism when allocation the capital to division,

(2) Fraud by the manager (agent), and

(3) Asymmetry information or higher cost to delivering information.

Corporate diversification can be a strategy that creates a competitive advantage for the company compared to the company without diversification. Moreover, product diversification or geographic diversification makes the consumers prefer to buy it. Companies that diversify their business have a good ability in managing their companies.

2.3 Managerial Ownership

Managerial ownership is an entity of good corporate governance mechanism due to the existence of managerial ownership in a company. It can minimize agency problems between the agent (manager) and the principal (shareholder). According to Ruan et al. (2011), managerial ownership is the ratio of shares owned by all board members (managers) that are divided by total outstanding shares of the company. So, those managers can have an equal position with the shareholders. By this action, the managers will improve their performance and be careful to improve the gain and to reduce loss. So, it gives benefits to shareholders and their own interests. Therefore, managerial ownership becomes a unifying tool for the managers and the shareholders.

In managerial ownership, the managers will be careful to make the right decision for the managers and the shareholders. Then, when the company wants to diversify its business, this strategy gives benefits for the managers and also to the shareholders. If the managers or shareholders want to diversify the company, so there is no manager’s interest as a shareholder (not have managerial ownership). This will affect the shareholders’ or investors’ decisions because they are not included in the company decisions. Therefore, it makes principals (shareholders) distrust the company and withdraw their funds. In brief, the final result of the company is deficiency of capital for their operation and bankrupt.

2.4 Company Performance

The establishment purpose of the company is to increase the profit, the sustainability, and the company's value. In order to achieve the company's success, it must be supported by the company's competitive advantages and minimize the company's weakness. It can be seen in the company's performance measured through financial reports.

As stated by Tangen, Stefan (2004) company performance is the ability of the company especially in efficiency, effectiveness, and adaptability in their activities which can be measured by two dimensions which are financial (e.g. cash flow, profitability) and non-financial (e.g. consumer satisfaction, productivity). According to Tandelilin (2010), Return on Equity is the one formula to know about profitability (Financial dimension) in the company which explains about how much the company gains for the shareholders. The higher ROE explains the higher performance in the company consistent with the higher gains for the shareholders.

The higher return on equity indicates the higher income from capital in the company. In this case, corporate diversification strategies need a lot of funds to make a new product or a new company. Therefore, the higher capital needs to make this corporate diversification strategy. If the corporate diversification makes higher income, the company will get a higher return for what they are invested.

2.5 Company Leverage

Almost all of the company’s funds are based on their own funds, investor and sometimes from creditors. The company which has creditors’ debt usually uses the funds to increase their business. One way to increase the business is corporate diversification strategy such as product diversification or geographic diversification. For the funds which used to make corporate diversification should be paid back by the company. To measure the company‘s ability to payment their creditor debt is using financial leverage.

The previous research by Christian et al. (2020) stated that company leverage is measured by total debt divided by total assets. Hsu and Liu (2008) stated that company leverage is measured by total debt divided by total equity, this leverage is a good proxy for knowing the firm’s financial structure. Based on that situation, firm leverage is an essential aspect to know the company performance.

The companies that have a higher level of financial leverage indicate the higher size of the company's debt in their capital structure. Besides, the higher the corporate financial leverage level, the higher the corporate risk level will be rise. If the leverage percentage of the company is over 100%, it means the company has bad performance because the company debt is higher than the company equity. Thus, the lower leverage indicates the good company performance.

2.6 Company Size

According to Setiyadi (2007), there are several indicators to determine the company size, which are:

a. Number of workers, it indicates how many permanent and non-permanent workers who are working within a certain period;

b. Sales Level, the rates of company sales in a certain period;

c. Total debt, the sum of company debt in a certain period;

d. Total assets, the total amount of assets owned by the company in a certain period.

There are several proxies that can be used to measure the company size, namely Ln (total assets), Ln (sales), and total market capitalization. In a previous study by Hsu and Liu (2008), the company size can be measured as the natural logarithm of the total sales revenue of the sample firm. Meanwhile, in another previous research by Christian et al. (2020), the company size can be measured as the natural logarithm of the total assets. Then, the company size in this study is measured by Ln (total assets) because the asset value is more stable than the sales value or market capitalization. The reason for using natural logarithmic for total assets is because it aims to make the data without extreme fluctuations. Natural logarithms only reduce the data scale without changing the actual proportion of the data.

The bigger company's size indicates a competitive advantage in survival compared to the small company. The bigger company size which is calculated by their total asset usually has company diversification at least product diversification. The greater company size, the bigger company tendency to diversify its business segment.

2.7 Previous Research

Author	Title	Variable	Research Result
Iqbal et al. (2012)	Impact of Diversification on Firms' Performance	Independent Variable : Corporate Diversification Dependent Variable : Company Performance	The study found there has no positively affect between diversification and firm performance. All firms are performing equally whether they are highly diversified firms, moderately diversified firms or less diversified firms with respect to their return and risk dimensions.
George and Rezaul (2012)	Heterogeneity in business groups and the corporate diversification –firm performance relationship	Independent Variable: group size, group diversity, and share ownership Dependent Variable :Company Performance	Using a sample firms from India, the study found some evidence that for firms affiliated to larger business groups, corporate diversification positive effect to firm performance. The impact of diversification on firm performance differs substantially owing to the heterogeneity in share ownership.
Krivokapic et al. (2017)	Effects of corporate diversification on firm performance: evidence from the Serbian insurance industry,	Independent Variable : product diversification, non-life insurance, firm size, capitalization, industry concentration, type of insurance,	The research results show that the relation between return on assets and return on equity and line-of-business diversification and performance measured by entropy is significant and positive, which means

		affiliation, and ownership Dependent Variable : Company Performance	that diversified insurers outperform undiversified insurers.
Hsu and Liu (2008)	Corporate diversification and firm performance: The moderating role of contractual manufacturing model.	Independent Variable : product diversification, customer Diversification, geographic diversification. Dependent Variable : Company Performance	The empirical investigation finds that product diversity and customer diversity are positively associated with firm performance, but geographic diversity negatively associated with firm performance. However, contractual manufacturing model is not only positively associated with firm performance, but also acts as a moderator between product diversity and firm performance.
Geraldo, Youri (2019)	Pengaruh diversifikasi segmen terhadap kinerja perusahaan dengan kepemilikan manajerial sebagai variabel moderasi.	Independent Variable : Diversification Dependent Variable : Company Performance Moderating Variable : Managerial ownership	The result from this study is diversification measured by HHI has a significant negative on company performance proxy by NPM. Managerial ownership has a positive significant impact on moderating the segment diversification to company performance proxy by NPM.
Chen and Ho (2000)	Corporate diversification , ownership structure, and firm value The Singapore evidence	Dependent variable : business segments. Independent variables : insider ownership, outside block ownership, Size, Age, R&D	The diversification has positive effect to firm size but negative effect to equity ownership.

		intensity	
Christian et al. (2020)	International diversification, ownership structure and performance in an emerging market: evidence from Chile	Independent Variable : Diversification Dependent Variable : Company Performance Moderating Variable : ownership structure	International diversification and company performance are related. The ownership structure moderates the relationship between international diversification and performance, ownership positively impacts the performance of companies initiating international diversification.
Mehmood et al. (2019)	The Impact of Corporate Diversification and Financial Structure on Firm Performance: Evidence from South Asian Countries	Independent Variable : Diversification Dependent Variable : Company Performance Moderating Variable : Financial structure	Product diversification and geographic diversification significantly affected the firms' financial performance. The dividend policy and capital structure have a significant impact on the firm's financial performance.
Stadler et al. (2018)	International And Product Diversification Which Strategy Suits Family Managers**?**	Independent Variable : Managerial Ownership Dependent Variable : Company Performance Moderating Variable : International And Product Diversification	Managerial Ownership has a positive significant on company performance. International diversification as moderate variable has negative impact between managerial ownership and company performance. But product diversification has positive impact between managerial ownership and company performance.
Rasyid et al. (2020)	The Moderating Effect of Managerial	Independent Variable : industrial diversification and	The industrial diversification has a positively affect to company performance but

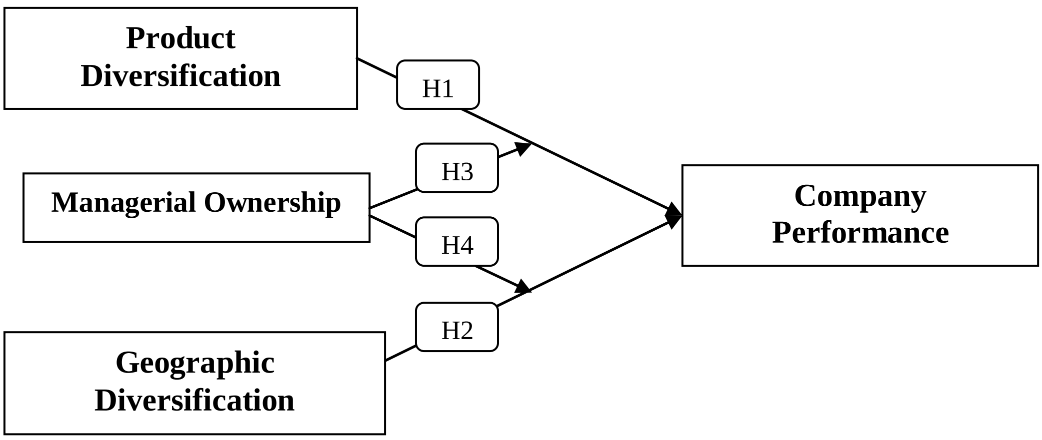
	Ownership on Diversified Conglomerates and the Performance of Family Companies on the Indonesian Capital Market	international conglomerates Moderating Variable : managerial ownership Dependent Variable : company performance	international conglomerates has a negatively affect to company performance. The managerial ownership could not moderate the relationship between conglomerate diversification and company performance.

Table 2.1 Previous Research

2.8 Research Framework

In this study, the company performance is used as dependent variable and the corporate diversification is used as independent variables. Then, the company size and the company leverage become control variables. The managerial ownership as moderating variable is described in agency theory. According to the agency theory, managerial ownership as one form of good corporate governance can be used to reduce the asymmetry information by the agent (managers) and principal (stakeholders).

Figure 2.2 Research Framework



2.9 Hypothesis

1. *Product Diversification on Company Performance*

According to IFRS No. 8, product diversification is a company strategy to create a new product or a different product line. The size of product diversification can be seen from the product sales that sold by the company in the financial report. In the previous study by Geraldo (2019), company diversification used the HHI formula, meanwhile based on Hsu and Liu (2008) product diversification used the Pd formula and some previous research used the total number of product segment.

Mehmood et al. (2008) who researched in South Asian Countries found that corporate diversification has a significant effect on company performance with the condition it is proper diversification strategies by efficiently utilize the firms' resources because the excessive diversification can decrease company performance. In addition, effective management of corporate diversification with good corporate governance and proper implication of financial structure can improve the financial performance of manufacturing companies.

According to Hsu and Liu (2008), product and customer diversification can improve company performance. In other words, the higher exploitation in the company will increase the higher competency. So, the higher customers and the types of the products sold by the company can increase the company sales which directly affect the company performance.

Krivokapic et al. (2017) who researched the Serbian insurance industry shows that services diversification can improve company performance. The higher types of services are provided to the customers, those give customers the option to adjust the insurance type based on their needs and abilities. Based on the logical thinking and the previous research, the higher level of the product diversification, the higher level of the company performance

H1: *Product diversification has a positive effect on company performance*.

2. Geographic Diversification on Company Performance

According to IFRS No. 8, geographic diversification is an action to diversify the company by make another company location to sell the products or services. This diversification can be done by buying, establishing, joining mergers, or acquiring other companies.

Geographic diversification provides an advantage for the company because the higher level of company location, the higher level of company facility to get a large market. According to George and Rezaul (2012), the company with high level of diversification will have a business group-affiliated and that can increase the market and company profit.

If all the company products can access all of the markets, the consumer can easy to find the product and get the cheap price by reducing transportation costs (production costs) in the area where the company is built or sold. The company sales can increase because the sale of cheap and good quality products make customers prefer to buy more than the company without diversification. In addition, this diversification also makes companies are easy to acquire limited and rare resources.

Christian et al. (2020) who researched in Chile found that geographic diversification has a significant effect on company performance. The company with geographic diversification has increased sales by buying and selling activities in the large market both regional and international. Geographic diversification can make the company reach a large market than the stagnant local market and improve the company internal conditions by increasing the human resources from the various regions.

According to Chena and Wai (2000), Geogre and Rezaul (2012), corporate diversification especially in geographic diversification has a significant positive effect on company performance. The company has more than one area for selling the products. So, it can be the company's ability in facilitating the consumer to easily get their products and also the company to easily get their limited and rare resources. Furthermore, geographic diversification has an advantage for the company and can increase the company performance. Based on the logical thinking, the higher level of the geographic diversification, the higher level of the company performance

H2: *Geographic diversification has a positive effect on company performance.*

3. The Effect of Managerial Ownership between Corporate Diversification and Company Performance

Investors and shareholders invest their capital in the company because they believe the managers can manage the company well and give benefits to the investors with high dividends. However, the problems arise because the manager only acts for their interest which is inconsistent with the owner, so that's why the manager's decisions cannot give benefit to the owner (Godfrey, 2010).

The different information between the managers and owners (asymmetry information) provides an advantage for the managers because the managers know more detail about the company's activities. The problem appears if the company has inconsistent goals or interests between managers and shareholders. Moreover, without good supervision can make managers take free action without accountability.

This case can be minimized by increasing managerial ownership. Managerial ownership can harmonize the interest between managers and shareholders. According to Ruan et al. (2011), managerial ownership is the ratio of shares which owned by all board members (managers) and divided by total outstanding shares by the company. So, it can make managers have an equal position with the shareholders. By this action, the managers will improve their performance and be careful to improve the gain and to reduce loss. So, it gives benefits to shareholders and their own interests. Therefore, managerial ownership becomes a unifying tool for the managers and the shareholders.

It also makes the managers take action based on the shareholders. Managerial ownership is an excellent corporate governance mechanism to reduce the agency problem that occurs because of the inconsistency interest between ownership and manager of the company (Rasyid et al., 2020).

If the company takes a big decision such as corporate diversification strategies, the existence of managerial ownership can support this corporate diversification to be the proper decision because it has been considered from the perspective of the managers and shareholders. So, it not only gives benefits for the managers but also for the shareholders and the company and increasing the company performance.

According to Geraldo (2019), managerial ownership has a positive significant effect to moderate the relationship between corporate diversification and company performance. Based on the logical thinking and previous research, managerial ownership can moderate the relationship between corporate diversification and company performance.

H3: *Managerial ownership positively moderates the relationship between product diversification and company performance.*

H4: *Managerial ownership positively moderates the relationship between geographic diversification and company performance.*

CHAPTER III

RESEARCH METHODS

3.1 Data Collection Methods

3.1.1 Types and Sources of Data

The type of data used in this study is secondary data. According to Sekaran and Roger (2016), secondary data are the data that already exist and effortless to be collected by the researcher. Secondary data have some sources such as statistical bulletin, government publication, published information, data available from the previous research, case studies and library record, online data, website, and the internet. The collected data in this study are the annual financial statements of manufacturing companies which taken from the official website of the Indonesia Stock Exchange and company website for the years from 2016 until 2019.

3.1.2 Population and Sample

The population in this study is 193 manufacturing companies in Indonesia (invesnesia.com). The purposive sampling method is used to analyze the sample for this study. According to Sekaran and Roger (2016), the purposive sampling method is a method for determining specific research samples using certain criteria by the researcher in order that the obtained data can represent the population. The sampling criteria in this study are as follows:

a. Manufacturing industry companies listed in the Indonesian stock exchange;
b. Manufacturing industry companies in sub-sectors consumer goods industry;

c. Manufacturing industry companies that always publish their financial reports related to the research period; and

d. The annual financial statements of the company with complete data related to the variables in this study.

Table 3.1 Research Samples

No.	Criteria	Total
1.	Manufacturing industry companies in Indonesia on October 25, 2020	193
2.	The company sub-sectors basic industry and chemicals industry	(78)
3.	The company sub-sectors in various industries	(50)
4.	The company that has incomplete annual financial reports during the period 2016 until 2019	(13)
5.	The company that bankrupt during the study period	(11)
6.	The company that has incomplete variable	(8)
7.	The sample companies	33
8.	**Total Samples**	**132**

Source: Data Processed 2021

The total sample is 33 companies. It is because 8 companies do not provide necessary information about the independent variables both of product and geographic diversification. Besides, 11 companies have been deactivated or liquidated during this study period.

3.2 Operational Variables

3.2.1 Dependent Variable

According to Sekaran and Roger (2016), the dependent variable is the primary or the main variable in the study. The dependent variable in this study is company performance using the proxy return on equity.

1. Company Performance

A company is established with the purposes such as increasing the company's profit, sustainability, and value. The company achievement can be seen in the company performance through financial reports. According to Tangen (2004), Company performance can be measured through financial reports that are divided into 2 types namely, financial performance and non-financial performance. In this study, the proxy return on equity is used to measure the financial company performance. Return on equity is a formula to know how the efficiency of the company used their equity into a profit (Tandelilin, 2010). Return on Equity (ROE) is calculated by using the formula:

$$\boldsymbol{ROE = \frac{Net\,Profit}{Total\,Equity}\ \mathrm{X}\ 100\%}$$

3.2.2 Independent Variable

According to Sekaran and Roger (2016), independent variables are the variables that influence the dependent variable in either a positive or negative direction. The independent variables used in this study are corporate diversification by using proxy product diversification and geographic diversification

1. Product Diversification

In this research, product diversification is measured by taking 1 minus the sum i in year t (Hsu and Liu, 2008). A high product diversity level reflects a high level product diversification in the company.

The formula for Product diversification (Pd) is:

$$\textbf{Sp} = \frac{\textbf{\textit{Sales per segment product}}}{\textbf{\textit{total sales}}}$$

$$\textbf{Pd} = \textbf{1} - \sum_{t=1}^{n} \left(\textbf{Sp}_{i}^{2}\right)$$

2. Geographic Diversification

According to Hsu and Liu (2008), geographic diversification is calculated by taking 1 minus the sum square of sales percentage per each external sales region or country and included into equation, in order to evaluate the manufacturer's geographic diversification. The higher level of geographic diversity reflects the higher level of geographic diversification in the market.

The formula for Geographic diversification (Gd) is:

$$\textbf{Sg} = \frac{\textbf{\textit{Sales per geographic segment}}}{\textbf{\textit{total sales}}}$$

$$\textbf{Gd} = \textbf{1} - \sum_{t=1}^{n} \left(\textbf{Sg}_{i}^{2}\right)$$

3.2.3 Moderating Variable

According to Sekaran and Roger (2016), the moderating variable is one of the strong contingent effects in the relationship between the independent and dependent variable. The presence of the third variable (moderating variable) modifies the original relationship between independent and dependent variable.

The moderating variable in this study is:

1. Managerial Ownership

Managerial ownership is the entity of a good corporate governance mechanism because the existence of managerial ownership in a company can minimize agency problems between the agent (manager) and the principal (shareholder). According to Ruan et al. (2011), managerial ownership is the ratio of shares which owned by all board members (managers) and divided by total outstanding shares by the company.

The managerial ownership formula is:

$$\boldsymbol{MO = \frac{Total\ shares\ owned\ by\ managers}{Total\ Outstanding\ Shares}}$$

3.2.4 Control Variables

According to Sugiyono (2010) control variable is the variable which is constantly made to control independent and dependent variable so that not affect by other variables which are not involved in this study. There are two control variables in this study; company leverage and company size. Company leverage indicates financial structure in the company that explains company debt whereas company size indicates the ability of the company to survive in the large business.

As the variable controls, company leverage and company size are caused by company diversification as independent variable in this study. Company leverage is used because of the capital needs to make or provide the facilities of company diversification. Company size is used because of the impact of company diversification. When the company has diversification, it needs another aspect to support this diversification, for example, the company needs new employees or new assets that used to implement this company diversification.

1. Company Leverage

According to Hsu and Liu (2008), company leverage is a formulation of the total debt divided by total equity, that leverage is a good proxy for knowing the firm's financial structure. Based on that situation, company leverage is an essential aspect to know how the financial performance of the company. The higher company leverage indicates the higher debt of company that must be paid.

The company leverage formula is:

$$\boldsymbol{LEV = \frac{\textbf{Total Debt}}{Total\ Equity}}$$

2. Company Size

The company size can be measured by total employees, total assets, total sales, or ranking index. According to Hsu and Liu (2008), company size can be measured as the natural logarithm of the total sales from sample companies. Christian et. al (2020) stated that company size can be measured as the natural logarithm of the total assets. The firm size in this study measures by Ln (total assets) because the asset value is more stable than the sales value or market capitalization, Ln in equation is used to control the data scale without changes the value. The bigger company size indicates the competitive advantage in survive than small company.

The company size formula is:

$$\boldsymbol{SIZE = Ln\ (total\ asset)}$$

3.3 Data Analysis Methods

3.3.1 Descriptive Statistic Method

The descriptive statistic method is a method that describes the research object based on the collected data (Sugiyono, 2010). In the descriptive statistic method, the data conditions are presented in the form of table, diagram, graph, and so on. The descriptive statistic method is used to make the collected data are easy to read (communicate).

3.3.2 Classic Assumption Test

The classic assumption test is an analysis method to test the existence of linear regression model whether it has classic assumption problem or not. The classic assumption test is used to determine the data fulfills the requirements for the regression model.

1. Normality Test

The normality test is used to determine whether the data population is normally distributed or not (Gujarati and Porter, 2013). This test is important because it is related to the data used in the statistic selection. Kolmogorov Smirnov test is used for the normality test. The requirements for the normality data are using the following conditions:

a. If the results are significant > 0.05, the data is normally distributed,

b. If the results are significant < 0.05, the data is not normally distributed.

2. Multicollinearity Test

The multicollinearity test is used to test whether the regression model correlates with dependent or independent variables. A good regression model should not correlate with dependent variable and independent variables. To find out whether the regression model has multicollinearity or not is using Variance Inflation

Factor (VIF) and Tolerance. Decisions according to multicollinearity test from VIF values and Tolerance value are as follows:

a) If the tolerance value is ≥ 0.10 or the VIF value ≤ 10, it means there is no multicollinearity.

b) If the tolerance value is ≤ 0.10 or the VIF value ≥ 10, it means there is multicollinearity.

3. Autocorrelation Test

The autocorrelation test is used to test the existence of the linear regression model about the correlation between the errors in period (t) and the interfering errors in the period before (t-1). The decision regarding the autocorrelation test is:

• If the value of Asymp. Sig. (2-tailed) < 0.05, it means there is have autocorrelation.

• If the value of Asymp. Sig. (2-tailed) > 0.05, it means there is no have autocorrelation.

4. Heteroscedasticity Test

The heteroscedasticity test is used to the existence of the regression model about the inequality of the variance from residual to other observations. A good regression model does not have homoscedasticity or heteroscedasticity problem.

3.3.3 Multiple Regression Test

The researcher used multiple regression method because this study has more than one independent variable with one dependent variable. Multiple regression models are used to determine the most significant independent variable and test the significant effect of the independent variables on the dependent variable.

The formula for this analysis model is:

$$\mathbf{ROE = \alpha + \beta1Pd + \beta2Gd + \beta3MO + \beta4LEV + \beta5SIZE + \beta6\ PdMO + \beta7\ GdMO + \varepsilon}$$

Information:

- α = constant
- β1 – β7 = coefficient regression
- ROE = company performance (Return on Equity)
- Pd = product diversification
- Gd = geographic diversification
- MO = managerial ownership
- LEV = the level of corporate debt/ company leverage
- SIZE = company size
- PdMO = product diversification and managerial ownership
- GdMO = geographic diversification and managerial ownership
- ε = error

1. The Coefficient of Determination

The Coefficient of Determination (R2) is essentially used to measure how far the model ability explains the variations in the independent variables. The coefficient of determination value is between zero and one. The small value of R2 means that the ability of the independent variable to explain variations is very limited. If the R2 value is closer to one, it means the independent variable provides almost all the information needed to predict variations in the independent variable.

2. Model Significance Test

The model significance test which is usually called the F statistic test shows whether all the independent or free variables included in the model regression affect on the dependent variable. The following criteria are used to test the hypothesis:

1) If F-count > F-table and significance level (α) < 0.05, it means rejecting H_0 which states that all independent variables have no effect on the dependent variable. Based on that, it can be concluded all independent variables have a significant effect on dependent variable.

b. If F-count < F-table and significant level (α) > 0.05, it means accepting H_0 which states that all independent variables have no effect on the dependent variable. Based on that it can be concluded all independent variables have no significant effect on the dependent variable.

3. Individual Significance Test

The T-test or the individual significance test is used to know the truth of the hypothesis from the data (Sugiyono, 2010). The T-test basically shows how far the influence of one independent variable to explain the variation of the dependent variable.

The following criteria are used to test the hypothesis:

1) If the sig. value is <0.05 or 5% or t-count>t-table, then rejecting H_0, it means the independent variable affects the dependent variable

1) If the sig. value is >0.05 or 5% or t-count<t-table, then accepting H_0, it means the independent variable not affects the dependent variable

CHAPTER V

CONCLUSION AND SUGGESTION

5.1 Conclusion

This study was conducted to recognize the effect of product diversification, geographic diversification, company leverage, company size, the effect of managerial ownership in moderating the relationship between product diversification and geographic diversification on company performance in manufacturing companies in Indonesia for the period 2016 until 2019. The conclusions from the results can be seen as follows:

1. Product diversification, as the independent variable, has insignificant positive effect on company performance. The insignificant effect may be caused by company performance in this research is proxy by Return on Equity. The companies need a lot of capital to their investment activity especially increasing their equity. Because to see the increasing of ROE it's depends on the period and this research used 4 years as researched time. It's not long enough to see an increase in Return on Equity. The companies with corporate diversification have more a competitive advantage rather than the companies without diversification and also for the companies that diversify their products would have the variety of the products preferred by the consumers to choose based on their needs and abilities rather than companies without product diversification.

2. Geographic diversification, as the independent variable, has an insignificant positive effect on the company performance. This diversification provides an advantage for the company because increasing the company number will increase the company facility to get a large market. The consumers will be easy to find the product and get the cheaper price by reducing transportation costs (production cost) in the area where the company is built or sold the product. Because of the cheap products, it makes the customers buy more products rather than the other companies. Then, it can increase the company's sales. Geographic diversification easily makes company to acquire limited and rare resources. It also makes company can reduce tax by transfer capital from one company to other companies.

3. Managerial ownership, as a moderating variable, has a negative effect in moderating the relationship between product diversification and return on equity. Managerial ownership with product diversification has negative effect because the managers as the agents and the owners will free act to maximizing their profits that is used for their personal interests such as additional income and extra power. So, it can be concluded that managerial ownership which has only product diversification gives negative effect to the company performance.

4. Managerial ownership, as a moderating variable, has a positive effect in moderating the relationship between geographic diversification and return on equity. Managerial ownership in the large companies indicates internal market efficiency. It aims to manage the complex mechanism in the company without make agency problem. The reason is because in the large companies, they have consolidated financial report to control their financial and investment activities.

Then, managerial ownership with geographic diversification gives positive effect to company performance.

5. Company Size and Company Leverage as the control variables have a positive significant effect to the company performance. Therefore, the higher size and leverage make the higher company performance.

5.2 Limitations of Research

The limitations in this study are as follows:

1. The adjusted R2 value is 0.220, which means that the independent variables have an effect of 22% on the dependent variable. Then, the independent variables in this research have small effect to the dependent variable.

2. This study is using the manufacturing industry companies. The total sample which fulfills the criteria is only 32 companies particularly in the consumer goods sector. Meanwhile, the total number of manufacturing companies in Indonesia is 193 (October 25, 2020).

3. Lack of information and other supporting data in hypothesis development because from four hypotheses only one hypothesis is accepted.

5.3 Suggestions

Based on the research results, some suggestions for the further researches are as follows:

1. Replace the dependent variable such as operating profit or share prices to get better results in this study because of only one of four hypotheses accepted.

2. Replace the population such as service companies or information technology companies.

3. Change or expand the time period for the next study. It is used to know about the effect of variables in the long term or different period.

5.4 Research Contribution

This research was conducted to increase the accounting science development that related to product diversification, geographic diversification, company leverage, company size, managerial ownership, and company performance. The purposes are to recognize the effect of corporate diversification to return on equity and the effect of managerial ownership in moderating the relationship between corporate diversification and company performance. The information in this study can be used as an additional knowledge for the companies for running their business if they want to carry out the diversification strategy.

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