

# The Effect of Banking Diversification Strategy on the Performance of Bank Papua

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## Abstract

This study aims to describe the performance of Bank Papua after diversification and to analyze the effect of diversification strategies on the performance of Bank Papua. This research is a quantitative study with a population of 37 Bank Papua branch offices throughout Indonesia. The data source used is secondary data in the form of financial reports for 2016-2018. Data analysis using descriptive analysis and linear regression. The results showed that the diversification strategy carried out by Bank Papua had a significant and negative effect on the performance of Bank Papua as indicated by a significance value of 0.038 ( $p < 0.05$ ) and a value of  $t = -2.086$ . The significant and negative effects of the diversification strategy also apply to each bank performance variable based on LDR (influence magnitude of 5.9% and significance of 0.010), ROA (influence size of 3.6% and significance of 0.047), NPL (magnitude of influence of 3.6% and a significance of 0.046), and CAR (magnitude of influence 3.9% and significance 0.038). It can be concluded that the higher the diversification, the lower the bank's performance.

## Keywords

Diversification; Bank Papua; Bank Performance; ROA; LDR

## INTRODUCTION

Banks have a very important role in the economy and national development. Bank Papua began to undertake a diversification strategy in the form of business diversification as a step intended to obtain maximum profit by combining several investment portfolios whether by producing various goods, establishing a number of business units, or establishing new subsidiaries or even buying companies that are already established (Hariadi, 2005: 37).

Bank Papua's business diversification is the development of a single business by adding more business units to the Bank. This strategy is an attempt by Bank Papua to expand by opening branch offices outside Papua. This diversification strategy is expected to enable Bank Papua to earn more revenue as more branch offices are opened. This effort is also a step to improve bank performance.

### **Diversification Strategy**

In the economy, diversification includes business and products diversification in products, stated by Kotler and Armstrong (2008: 71) which explains that diversification is

a strategy in growing a company by starting a new business or buying other companies outside the company's products and markets that are already owned when this. Hariadi (2005: 37) defines business diversification as a step that is intended to obtain maximum profit by combining several investment portfolios whether by producing various goods, establishing business units, or establishing new subsidiaries or even buying existing companies. The definition is also put forward by Coulter in Rahayuningsih (2015: 443-445) defines business / business diversification as a company growth strategy where the company expands its operations by entering different industries

Rahayuningsih (2015: 443-444) suggests that diversification is carried out to increase total company value. Value is created when a particular strategy enables business units to increase revenue or reduce costs while implementing its business-level strategy. Another reason is to get more market power than its competitors. In addition, a diversification strategy is implemented to neutralize the market power of competitors and to expand the company's portfolio in order to reduce managerial employment risk, for

example, if one business fails, top-level executives can still work in the diversified company.

Rumelt (1974) in Sabihaini (2012) classifies diversification strategies into 5 business categories according to their level of diversification. In addition to the single business categories and the dominant business, increasingly related firms are classified into related and unrelated categories. A company is concerned through its diversification when there are relationships among its business units, for example units with various products or services, technology, or distribution networks. The tighter the ties between the business units, the more "limited" their diversification links will be. Disconnection refers to the absence of a direct relationship between businesses. The levels and types of diversification are described in the following table,

Table 1. Diversification Level

<b>Diversification Level: Low</b>	
1. Single Business	More than 95% of revenue comes from a single business
2. Dominant business	Between 70% and 95% of revenue comes from a single business
<b>Diversification Level: Moderate-High</b>	
3. Related constrained	Less than 70% of revenue comes from the dominant business, and all businesses share products, technology and distribution networks
4. Related linked	Less than 70% of revenue comes from the dominant business, and there are limited relationships between these businesses
<b>Diversification Level: Very High</b>	
5. Unrelated	Less than 70% of revenue comes from the dominant business, and there is no relationship between these businesses

Source: Rumelt (1974) in Sabihaini (2012)  
The basis used by Rumelt (1974, 1982) to determine the level of diversification uses a

specialization rate (SR) or concentric rate (CR) which is the ratio between core business income and total income. The formula is as follows:

$$SR = \frac{\sum Ru}{\sum Rt}$$

Information:

Ru = main business income

Rt = total income

SR = specialization rate

The level of diversification based on the SR can be explained as follows:

1. If the SR number is higher (95% > SR > 70%), the lower the level of diversification, meaning that the company's business activities are concentrated (concentrated) on the main business activities.
2. If the SR number is getting smaller (below 70%), the higher the level of diversification, it means that business activities are moving away from the main business or the company tends to business activities that generate fee based income (supporting activities).

### Bank Performance

According to Syaifuddin (2009: 25), bank performance is basically the work that can be used to evaluate the ability of banking management to manage its business to achieve bank goals, namely with certain risks for high profitability.

Bank health assessment refers to Bank Indonesia Regulation (PBI) number 13/1 / PBI / 2011 concerning Assessment of Commercial Bank Soundness Level. Assessment of bank soundness as stipulated in Article 2, namely by using a risk approach (Risk Based Bank Rating) either individually or on a consolidated basis. This method replaces the previous valuation method, namely a method based on Capital, Asset, Management, Earning, Liquidity and Sensitivity to market risk or what is called CAMELS. In Article 6 of PBI number 13/1 / PBI / 2011, the RBBR method uses an assessment of four factors, namely the Risk Profile, Good Corporate Governance, Earning and Capital (RGEC).

#### 1. Risk Profile

The risk profile can be measured by credit risk and liquidity risk. Credit risk can be measured using the Non Performing Loan (NPL) ratio, with the formula:

$$NPL = \frac{\text{Problem credit}}{\text{Total Credit}} \times 100\%$$

- a. Non-performing loans are loans to non-bank third parties that are classified as substandard, doubtful, and bad.
- b. Total credit is credit to non-bank third parties.

Table 2. NPL Determination Criteria

Rating	Keterangan	Kriteria
1	Very Healthy	NPL < 2%
2	Healthy	2% ≤ NPL < 5%
3	Fairly Healthy	5% ≤ NPL < 8%
4	Unwell	8% ≤ NPL 12%
5	Not Healthy	NPL ≥ 12%

Source: Bank Indonesia Circular No. 6/23/DPNP of 2004

Measuring liquidity risk can be done with the Loan to Deposit Ratio (LDR), with the formula:

$$LDR = \frac{\text{The Amount of Credit Granted}}{\text{Third - party funds}} \times 100\%$$

Table 3. LDR Determination Criteria

Rating	Keterangan	Kriteria
1	Very Healthy	LDR ≤ 75%
2	Healthy	75% < LDR ≤ 85%
3	Fairly Healthy	85% < LDR ≤ 100%
4	Unwell	100% < LDR ≤ 120%
5	Not Healthy	LDR > 120%

Source: Bank Indonesia Circular No. 6/23/DPNP of 2004

## 2. Good Corporate Governance (GCG)

In Attachment 1 of Bank Indonesia Circular Letter No. 13/24 / DPNP, parameter / assessment of the GCG factor which is an assessment of the Bank's management on the implementation of GCG principles referring to the Bank Indonesia provisions concerning GCG for Commercial Banks with due regard to the characteristics and complexity of the bank's business. The principles of GCG include transparency, accountability, responsibility, independence, and fairness.

## 3. Rentability

Based on Appendix I of Bank Indonesia Circular Letter number 13/24 /

DPNP, profitability is indicated by the level of ROA. ROA is the ratio between net income and total bank assets, using the following formula:

$$ROA = \frac{\text{Profit Before Tax}}{\text{Average Total Asset}} \times 100\%$$

Table 4. ROA Determination Criteria

Rating	Keterangan	Kriteria
1	Very Healthy	ROA > 1,5%
2	Healthy	1.25% < ROA ≤ 1,5%
3	Fairly Healthy	0,5% < ROA ≤ 1,25%
4	Unwell	0% < ROA ≤ 0,5%
5	Not Healthy	ROA ≤ 0%

Source: Bank Indonesia Circular No. 6/23/DPNP of 2004

## 4. Capital (Capital)

The assessment of capital factors is measured using the Capital Adequacy Ratio (CAR). CAR is calculated by the following formula:

$$CAR = \frac{\text{Bank Capital}}{\text{Risk Weighted Assets}} \times 100\%$$

Table 5. CAR Determination Criteria

Rating	Keterangan	Kriteria
1	Very Healthy	CAR > 12%
2	Healthy	9% ≤ CAR < 12%
3	Fairly Healthy	8% ≤ CAR < 9%
4	Unwell	6% < CAR < 8%
5	Not Healthy	CAR ≤ 6%

Source: Bank Indonesia Circular No. 6/23/DPNP of 2004

## RESEARCH METHODS

The population in this study were all branch offices of Bank Papua throughout Indonesia after diversification, namely 37 branch offices. The research sample was all Bank Papua branch offices in the last 3 years, namely during the 2016-2018 period. The sampling technique in this study used a census, in which all members of the population were sampled.

The type of data used includes secondary data. Secondary data sources were obtained from data from all Bank Papua branches

regarding the level of diversification including main business income and total income, and the performance of Papuan banks including CAR, ROA, LDR, and NPL.

The data analysis used descriptive analysis, which is the statistic used to analyze the data by describing the data with the diversification level, ROA value, CAR value, LDR value, and NPL value. Hypothesis testing in this study uses linear regression test.

Hypothesis:

The high level of diversification strategy affects the low performance of Bank Papua, and vice versa.

### RESULTS AND DISCUSSION

Bank Papua's diversification strategy was implemented by opening 37 branch offices throughout Indonesia (5 branches in Papua and 32 branches in Papua). Branch Offices (BO) in the Papua region include BO Kaimana, BO Teminabuan, BO Jayapura, BO Waisai, BO Wamena, BO Wasior, BO Agats, BO Merauke, BO Oksibil, BO Aimas, BO Tanah Merah, BO Nabire, BO Waren, BO Sentani, BO Dekai, BO Mulia, BO Abepura, BO Sorong, BO Arso, BO Sarmi, BO Fakfak, BO Bintuni, BO Karubaga, BO Kasonaweja, BO Timika, BO Biak, BO Enarotali, BO Keppi, BO Serui, BO Manokwari, BO Waghete, and BO Ilaga. Meanwhile, branch offices outside Papua include BO Jakarta, BO Yogyakarta, BO Makassar, BO Surabaya, and BO Manado.

#### 1. Bank Papua Diversification Strategy

From the annual report for 2016-2018, the data is presented in the following table:

Table 6. Bank Papua Revenue Data 2016-2018

Year	Main income year (Rp), in million	Supporting income (Rp), in million	Total Revenue (IDR), in million
2016	2.088.661	322.333	2.410.994
2017	2.114.796	381.485	2.496.281
2018	1.892.775	588.420	2.481.195

Diversification strategies that are increasingly being carried out are measured using a specialization rate or SR, in this study using the basis used by Rumelt (1974, 1982) which is the ratio between core business income and total income as follows:

$$SR = \frac{\sum Ru_{main\ business\ income}}{\sum Rt_{total\ income}}$$

Based on the formula above, the level of diversification of Bank Papua from 2016-2018 can be obtained as follows:

$$SR_{2016} = \frac{2.088.661.000.000}{2.410.994.000.000} = 0,866 \text{ or } 86,6\%$$

$$SR_{2017} = \frac{2.114.796.000.000}{2.496.281.000.000} = 0,847 \text{ or } 84,7\%$$

$$SR_{2018} = \frac{1.892.775.000.000}{2.481.195.000.000} = 0,763 \text{ or } 76,3\%$$

Based on the results of the above calculations, it can be seen that from 2016 to 2018 the SR number is getting lower (although still > 70%) which indicates that the level of diversification is getting higher, meaning that business activities move away from the main business or companies tend to business activities that generate fee based income (supporting activities). This means that activities are no longer focused on main activities that generate principal benefits in the form of interest income, but are also expanded through other supporting activities. Therefore, the decreasing SR figure shows that income is not only based on main income, but also supporting income. This is what causes the SR number to decrease, indicating that the main income has also decreased due to switching to income from supporting activities. It can be concluded that the lower the SR number, the wider the diversification will be.

Based on the SR data in the table above, it can be seen the trend of increase or decrease in the SR number for each Bank Papua branch office.

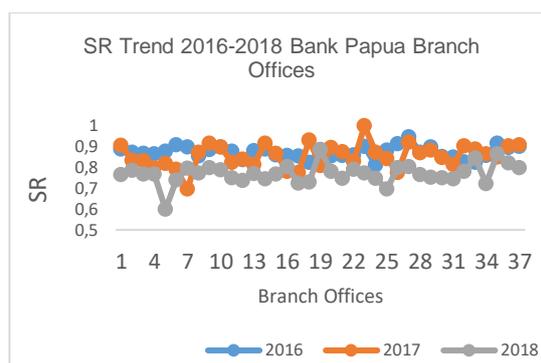


Figure 1 Trend of SR for Bank Papua branch offices in 2016-2018

In the above, it can be seen that from 2016-2018 in most branch offices there was a decrease in the SR number, although some branch offices fluctuated but at the end of the

research year (2018) almost all branch offices were at the lowest SR number.

Based on the description of the SR figures in the 2016-2018 period, the average SR value of the branch offices shows a decreasing value. This indicates that the branch office is adjusting its diversification strategy according to the direction of the head office.

## **2. The performance of Bank Papua**

### **a. Loan to Deposit Ratio (LDR)**

Loan to Deposit Ratio (LDR) is measured to determine the bank's ability to repay its obligations to customers who have invested in the bank, namely in the form of credit. LDR is measured by comparing the amount of credit extended to third party funds.

The LDR percentage shows the soundness level of the bank, the higher the percentage, the more unhealthy the bank is. Based on the LDR criteria, several Bank Papua branch offices were categorized as unhealthy, even unhealthy. Bank Papua branch offices that are not healthy based on LDR are Makassar, Sentani, Eranotali, and Manado with  $LDR > 120\%$ , while unhealthy branch offices with  $100\% < LDR \leq 120\%$  are Yogyakarta, Waisai, Wasior, Waren, Sorong, Biak, and Serui. Several branch offices also experienced changes, from a healthy condition to a less / unhealthy condition, namely BO Kaimana, BO Teminabuan, and BO Jakarta.

### **b. Return of Assets (ROA)**

Return of Assets (ROA) is a ratio to measure a bank's ability to generate income from managing its assets. This relates to the profit or loss experienced by a bank. ROA ratio is obtained by comparing profit or loss before tax with average total assets. The ROA percentage shows the soundness of the bank, the smaller the percentage, the less healthy the bank.

The LDR percentage shows the soundness level of the bank, the higher the percentage, the more unhealthy the bank is. Based on the ROA criteria, several Bank Papua branch offices were categorized as unhealthy, even unhealthy. Bank Papua branch offices that are not healthy based on ROA are BO Kaimana, Teminabuan BO, Jakarta BO, Yogyakarta BO, Sentani BO, Eranotali BO, and Manado BO with  $ROA < 0\%$  (minus). The seven branch

offices were consistently in unsanitary conditions during 2016-2018.

### **c. Non Performing Loan (NPL)**

Non Performing Loan (NPL) is the ratio of the level of non-performing loans. Credit risk is the risk related to the possibility of a debtor's failure to pay off his debt, both principal and interest, at a predetermined time. This ratio is calculated by comparing non-performing loans with total loans. The NPL used in this study is Gross NPL with the consideration that non-performing loans are not only bad loans, but also all credit problems.

A high NPL percentage value indicates problems in bank lending, the greater the NPL percentage, the more unhealthy the bank is. Based on the NPL criteria, some Bank Papua branch offices are categorized as unhealthy, even unhealthy. Several branch offices that were categorized as unhealthy were BO Teminabuan, BO Jakarta, BO Yogyakarta, BO Wamena, BO Eranotali, and BO Manado. All of these branches consistently had NPL rates of  $> 12\%$  during 2016-2018.

### **d. Capital Adequacy Ratio (CAR)**

Capital Adequacy Ratio (CAR) is the size of the minimum capital requirement. The CAR percentage value is a benchmark for bank health, the greater the CAR percentage, the healthier the bank.

Based on LDR criteria, several Bank Papua branch offices were categorized as unhealthy ( $6\% < CAR < 8\%$ ), namely BO Teminabuan, BO Jakarta, and BO Oksibil. The three branches have a figure of  $6\% < CAR < 8\%$  respectively during 2016-2018. The branch offices that are not healthy ( $CAR \leq 6\%$ ) are BO Yogyakarta and BO Eranotali. The two branch offices respectively have a CAR value of  $\leq 6\%$  during 2016-2018.

Based on the indicators of LDR, ROA, NPL, and CAR, branch offices that are always in an unhealthy condition are BO Yogyakarta, BO Eranotali, and BO Manado. Apart from that, BO Jakarta and BO Teminabuan also need attention because based on ROA, NPL, and CAR, the two branch offices are always in an unhealthy condition. Based on the LDR and ROA indicators, BO Sentani is always in an unhealthy condition, and based on the NPL and CAR indicators, BO Wamena is also always in an unhealthy condition.

## **3. Effect of Diversification on the performance of Bank Papua**

The calculation of the test for the effect of diversification on the performance of Bank Papua is carried out by means of regression analysis which includes regression analysis of diversification strategies on LDR, diversification strategies towards ROA, diversification strategies towards NPL, diversification strategies for CAR, and diversification strategies for overall financial performance. Diversification strategy is measured by the specialization rate or SR, the lower the SR, the higher the diversification and vice versa.

Table 6 Hypothesis Test Calculation Results

Independent variable	Dependent variable	Sig.	Information	Magnitude of influence
Diversification Strategy	Overall Performance	0,039	Negative and significant impact	3,8 %
	LDR	0,010	Negative and significant impact	5,9 %
	ROA	0,047	Negative and significant impact	3,6 %
	NPL	0,046	Negative and significant impact	3,6 %
	CAR	0,038	Negative and significant impact	3,9 %

Based on the table above, it can be concluded that the diversification strategy has a significant effect on the performance of Bank Papua.

Table 7 Test Results of the Effect of Diversification Strategy on the Performance of Bank Papua

Model	t	Sig.
1 (Constant)	2.568	.012
SR	-2.086	.039

a. Dependent Variable: Performance

Based on the table above, it can be seen that the significance value shows the number 0.039 or  $p < 0.05$  with a t value of -2.086, so it can be concluded that there is a negative and significant influence of diversification strategies on the performance of Bank Papua. This shows that the diversification strategy has a negative effect on the performance of Bank Papua, where the higher the diversification, the lower the bank's performance. Based on these results, the hypothesis is accepted.

The regression equation can be arranged based on the coefficient value which can be seen in column B (Unstandardized Coefficients) to form a linear regression equation as follows:

$$Y = a + \beta X$$

$$Y = 650,898 - 634,262 X$$

From the above equation, it can be concluded that the influence of the independent variables, namely the diversification strategy on the performance of Bank Papua, is:

- 1) Constant of 650,898; it means that if the SR is constant, the performance value is 650,898.
- 2) The regression coefficient for the diversification variable is - 634,262; this means that if the diversification strategy has increased by 1%, then the performance of Bank Papua has decreased by 634,262. The coefficient is negative, meaning that there is a negative relationship between the diversification strategy and the bank's performance, the wider the diversification is, the lower the bank's performance.

To determine the magnitude of the influence of the independent variables on the dependent variable, the coefficient of determination is used.

Table 8 Coefficient of Diversification Strategy Determination on the Performance of Bank Papua

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.196 <sup>a</sup>	.038	.030	204.753814

a. Predictors: (Constant), SR

If R2 is greater, then the percentage change in the dependent variable caused by the independent variable is higher and vice versa. From the calculation results obtained R2 of 0.038 or 3.8%. This shows that the diversification strategy affects the performance of 3.8% and the remaining 96.2% is influenced by other variables that are not examined. Bank diversification is an expansion of the bank's business, meaning that activities are expanded to generate income other than the main income, namely bank interest. With the expansion of bank activities through diversification, it is very possible that the income will no longer rely on the main income supporting income and also

contribute to the profits obtained by the bank.

The diversification strategy undertaken by Bank Papua includes diversification of business / business and product diversification. Diversification of business / business, namely the addition of business units with expansion of 32 branch offices in the Papua region, starting to build 5 branch offices outside Papua covering Jakarta, Makassar, Surabaya, Manado and Yogyakarta, bringing the total branch offices to 37. The product diversification is carried out by developing various products and services such as EDC and CDM facilities, credit payment systems, samsat payments (online samsat), tax payments (PPH and PPhn), electricity payments, motor vehicle installment payments, electronic card services for civil servants, Save Deposit Box (SDB) facilities, payment for airplane tickets, and so on.

The consequence of this diversification is that operating costs have increased so that the profits obtained are not as high as when focusing on the main business. However, if diversification can be maximized, profits can be multiplied, both from the core business (main business) and the supporting business.

The results of this study are supported by several previous studies, namely Sabihaini (2012), which shows that the diversification carried out by banks is increasingly moving away from (leaving) the main function of the bank or bank business activities tend to be business activities that generate fee-based income. Sianipar's (2015) research also found that income diversification had no effect on firm value, but had a positive effect on profitability. In large banks, it is found that the effect of income diversification is negative on stock beta when compared to small banks.

This is in line with Amyulianthy and Sari's (2013) research which shows that the company diversification strategy carried out by the majority of companies has not yet provided optimal results on company performance. In fact, their performance is below companies that carry out a focused strategy (specialized firms or single-segment firms). The results showed a negative effect of diversification on company performance, meaning that diversification was not profitable for the company.

The reason for the decline in performance is due to diversification, which Amyulianthy and Sari (2013) also put forward, namely, if viewed from an agency theory perspective, diversification will cause managers to take excessive overinvestment due to distortions of internal capital allocations so that they become inefficient and result in projects. being funded carries a high risk. In addition, diversification makes the company unfocused because it has many business segments. Controlling and monitoring measures are often inefficient and difficult to implement perfectly because they cost a lot of money so that the goal congruence set by the head office is often ineffective because the division manager prioritizes his own division.

## CONCLUSION

Based on the results of research and discussion, the conclusion drawn is that the diversification strategy carried out by Bank Papua has a significant and negative effect on the performance of Bank Papua which is indicated by a significance value of 0.038 ( $p < 0.05$ ) and a  $t$  value of -2.086. More details regarding the effect of the diversification strategy on each performance indicator, namely LDR, ROA, NPL, and CAR can be seen as follows:

1. The effect of diversification on bank performance based on LDR is 5.9%. The test results show that diversification has a negative and significant effect on LDR performance with a significance of 0.010 ( $p < 0.05$ ) and a value of  $t = -2.612$ . It is concluded that the higher the diversification, the lower the bank's performance.
2. The effect of diversification on bank performance based on ROA is 3.6%. The test results showed that diversification had a negative and significant effect on ROA performance with a significance of 0.047 ( $p < 0.05$ ) and a value of  $t = -2.011$ . It is concluded that the higher the diversification, the lower the bank's performance.
3. The effect of diversification on bank performance based on NPL is 3.6%. The test results show that diversification has a negative and significant effect on NPL performance with a significance of 0.046 ( $p < 0.05$ ) and a value of  $t = -2.018$ . It is concluded that the higher the

diversification, the lower the bank's performance.

4. The effect of diversification on bank performance based on CAR is 3.9%. The test results show that diversification has a negative and significant effect on CAR performance with a significance of 0.038 ( $p < 0.05$ ) and a value of  $t = -2.612$ , so it can be concluded that the higher the diversification is, the lower the bank's performance.

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## List of Tables

### Table 1. Hypotheses Test

Coefficients<sup>a</sup>

Model	Unstandardized Coefficients		Standardized	t	Sig.	
	B	Std. Error	Coefficients Beta			
1	(Constant)	650.898	253.463		2.568	.012
	Diversification Strategy	-634.262	304.109	-.196	-2.086	.039

a. Dependent Variable: Performance

**List of Figures**

**Figure 1. Model Test**

