

Related Corporate Diversification Strategy, Managerial Ability, and Firm Performance: A Conceptual Framework for Manufacturing SMEs in Malaysia

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Abstract

Manufacturing small and medium-sized enterprises (SMEs) operate in an environment characterized by expanding growth opportunities, supply-chain disruptions, technological advances, intensifying competition, and limited managerial resources. Although diversification offers opportunities for growth, it does not necessarily create value. This conceptual paper examines the conditions under which related corporate diversification strategy (RCDS) enhances the performance of manufacturing SMEs in Malaysia. Drawing on prior literature, RCDS is reconceptualized as a higher-order formative construct comprising horizontal, vertical, and concentration strategies. The formative specification reflects the distinct strategic options represented by these dimensions, including expanding product offerings, extending involvement in upstream or downstream supply chains, and pursuing related technologies and markets. These strategies offer opportunities to generate technological and resource synergies, while potentially increasing coordination demands, information-processing requirements, and organizational complexity. The paper positions managerial ability as a boundary condition that determines whether potential diversification synergies translate into performance improvements. Recent scholarship identifies dynamic managerial capabilities, strategic flexibility, and organizational agility as important mechanisms through which SMEs convert resources into performance under uncertainty. Accordingly, two propositions are advanced: RCDS positively influences SME performance, and managerial ability strengthens this relationship. The paper contributes to strategic management literature by shifting attention from whether diversification benefits firms to how related diversification creates value and under which managerial conditions it becomes productive for manufacturing SMEs. By integrating distinct diversification strategies within a

formative framework and specifying the moderating role of managerial ability, it provides a foundation for more precise theoretical development and empirical investigation. Implications are discussed for SME owners and managers, alongside directions for future research using partial least squares structural equation modelling (PLS-SEM).

Keywords: Related Corporate Diversification Strategy, Horizontal Diversification, Vertical Diversification, Concentric Diversification, Managerial Ability, Firm Performance, Manufacturing Smes, Malaysia, Dynamic Capabilities

Introduction

While continuing to increase production of products that a company already successfully markets can be an important element of growth for manufacturing SMEs, in today's fast-changing environment of customer expectations, shortening product life cycles due to the speed of technology, fragile supply chains and increasing competition from beyond industry borders, many companies are considering strategic expansion into related products, into key inputs or technologies. Furthermore, such expansion can create completely new income streams and increase the efficiency of utilization of existing assets and competences. However, such expansion also needs to be carefully considered in terms of the strategic fit and the ability of a company's people, management and financial resources to handle additional challenges.

Furthermore, a key observation that underscores this additional complexity, however, is that the typical manufacturing SME is characterized by a relatively constrained resource base, and accordingly, its owner-manager/senior management team frequently is required to manage multiple functions including operations, finance, customers, employees, suppliers, technology and strategy. This in turn means that diversification is not merely a portfolio option but also a management implementation challenge. Research emanating from emerging markets containing large populations of SMEs, for example, reveals the critical importance of a variety of dynamic managerial capabilities and strategic flexibility in affecting enterprise performance given the necessity to monitor and respond to a constantly changing environment, to facilitate and coordinate numerous activities and to reallocate resources as required (Almohtaseb & Aldehayyat, 2026; Bajwa et al., 2021). More recently, a study of Malaysian manufacturing SMEs identified the transformation of employee competencies into effective firm performance through organizational agility as particularly significant (Zongyuan et al., 2025).

More recent research on diversification has highlighted the need to recognize that diversification is not a uniform strategy. While technologically related diversification may create value by means of technological synergies, the implications of such a diversification strategy are complex, and it is often difficult to gauge its value for external observers (Morandi & Santaló 2025). In addition, the process of resource redeployment within multi-business firms is far from trivial and requires elaborate organizational arrangements (Sakhartov & Helfat 2026). For SMEs, the value of relatedness depends not only on whether two firms are related, but also on whether they can be made to share, redeploy, and coordinate resources within them. This argument could be further developed within the specific context of Malaysia. Manufacturing SMEs in Malaysia are at present going through several phases of development, increasing productivity, gearing up to face new technologies, and widened markets. Recent studies on Malaysian SMEs noted that dynamic capabilities, organizational

agility, strategic orientation, and a firm's ability to adapt during a crisis are important in explaining the performance of SMEs under uncertainty (Hamzah, 2025; Zongyuan et al., 2025). Thus, instead of analyzing whether SMEs with sufficient managerial ability that engage in strategically related diversification would be able to gain performance advantages, a more appropriate research question would be to analyze whether such diversification in fact produces performance advantages.

Despite growing research on diversification and SME performance, three specific gaps remain insufficiently addressed in the context of Malaysian manufacturing SMEs. First, existing studies often examine diversification through individual dimensions, such as product, horizontal, or vertical diversification, without integrating horizontal, vertical, and concentric diversification into a unified framework that captures the different ways manufacturing SMEs extend their existing businesses. Consequently, it remains unclear how these distinct but related strategic choices collectively explain performance differences among Malaysian manufacturing SMEs. Second, although previous research has examined the relationship between diversification and firm performance, it provides limited explanation of why firms pursuing related diversification may achieve different performance outcomes despite having access to similar opportunities for resource sharing, technological synergies, and market expansion. This issue is particularly important for Malaysian manufacturing SMEs, which operate with relatively constrained financial, technological, and managerial resources and may therefore experience substantial coordination costs when expanding into related activities. Third, although recent research emphasizes managerial capabilities and organizational agility in explaining SME performance, the role of managerial ability as a specific boundary condition in the relationship between related corporate diversification strategy and firm performance remains insufficiently integrated into a single conceptual framework for Malaysian manufacturing SMEs. To address these gaps, this study conceptualizes related corporate diversification strategy as a higher-order formative construct comprising horizontal, vertical, and concentric diversification and proposes that managerial ability moderates its relationship with firm performance. The study's novelty therefore lies not simply in examining diversification in Malaysia, but in integrating the distinct dimensions of related diversification with managerial ability to explain when and why related diversification is more likely to translate into improved performance among Malaysian manufacturing SMEs.

This paper introduces four conceptual issues related to related corporate diversification strategies. First, a definition for related corporate diversification strategies is provided. Second, in contrast to most prior papers on this subject, a few different related strategies (horizontal, vertical, and concentrated strategies) are contrasted and discussed at some length. Third, the nature of RCDS as a higher-order formative construct is detailed at some length. Fourth, the construct of managerial ability is defined and used as a moderating variable to explain strategic incongruity found in some SMEs with seemingly equivalent related diversification strategies. This paper does not argue that all types of diversification are good for companies. Instead, it provides a contingent explanation for the potential created through related diversification, i.e., the potential for resource sharing, knowledge spillovers, market entries, and value chain coordination. The crucial point is the identification, organization, and implementation of this potential. Managerial ability represents the human

and organizational factor that makes a difference with respect to the translation of potential synergies into real performance.

Research Problem

The central problem is one of conceptual fragmentation. Discussions of diversification are frequently shifted between product, vertical, geographical, technology and portfolio diversification without due recognition of the different strategic mechanisms represented by each of these. However, a major problem for researchers using surveys is that of constructing appropriate measures to include in surveys of managers, and between studies with apparently similar objectives much variation is reported which is not easily explained. Often the two companies described as 'diversified' will have quite different performance records.

The second limitation is related to the treatment of different diversification dimensions, such as horizontal, vertical and concentric diversification. These are not necessarily correlated. For instance, a manufacturing SME may enter adjacent products while keeping suppliers and distribution channels unchanged, whereas another firm may integrate suppliers or distributors without entering new products.

A third firm may enter a technologically related venture targeting somewhat different markets. In sum, these are not alternative reflective states, but rather different strategic choices that can be combined in various ways. This is the main reason for modeling RCDS as formative.

There are also problems that are related to the effective implementation of strategy by SMEs. Recent research indicates that an SME's strategic flexibility and its manager's dynamic capabilities are critical determinants of its ability to handle uncertainty and achieve better performance (Almohtaseb & Aldehayyat, 2026). In terms of the evidentiary research on SMEs' diversification strategies, while relatedness can create value through synergies, these must be matched with suitable mechanisms of coordination and information processing (Morandi & Santaló, 2025; Sakhartov & Helfat, 2026).

As a result, instead of accepting the conventional causal link between an SME's strategy of diversification and its low performance, there is increasing support in the literature for the adoption of a conditional model which specifies how an SME's manager can exploit the strategic relatedness created by the firm's diversification strategy.

Research Objective

This is a conceptual paper that seeks to develop a framework that examines the relationship between a related corporate diversification strategy (RCDS) and the performance of manufacturing SMEs in Malaysia. The objectives of this paper are: (1) to conceptualize RCDS as a higher-order formative construct; (2) to differentiate among horizontal, vertical and concentric types of diversification; (3) to conceptualize and explain the relationship between RCDS and performance and to explore the mediating effects of resource leverage and capability deployment; (4) to use managerial ability as a boundary condition; and (5) to develop and present a testable conceptual model that can be analyzed using PLS-SEM in subsequent empirical studies.

Malaysian Manufacturing SMEs and the Strategic Need for Relatedness

Malaysian manufacturing SMEs play important roles within production networks, as suppliers, exporters and in terms of technology upgrades. While the entrepreneurial characteristics of SMEs provide potential for diverse opportunities, these same characteristics render them susceptible to constraints that affect their ability to pursue multiple unrelated ventures. Key constraints include lack of financial resources, dependence on key customers, dearth of specialized employees, and a centrally preoccupied owner/manager. More recent Malaysian research has once again identified the importance of organizational agility for manufacturing SMEs. Employee competencies and SME performance were found to be positively related in 313 Malaysian manufacturing SMEs in a recent study by Zongyuan et al. (2025). The implication for business diversification is that while financial means are required for establishing a new business, it also requires the right people who can learn, coordinate, adapt, and implement. Thus, diversification is a growth strategy that requires specific capabilities.

Studies on the broader SME literature also found that crisis adaptiveness was relevant to the relationship between strategic orientations and performance of SMEs. For example, Hamzah (2025) analyzed data from 656 SMEs located in Greater Kuala Lumpur and surrounding areas. He found that the performance of SMEs was influenced by crisis adaptiveness. Arifa and Herawan (2026) stressed the interactions between leadership, entrepreneurial ecosystems, and dynamic capability and identified their impact on the performance of SMEs in emerging economies. The studies indicated that performance of SMEs was influenced not only by resources that SMEs possessed but also by how SMEs could mobilize the resources in changed circumstances. In the context of manufacturing SMEs, related diversification is particularly relevant. A manufacturing SME typically cannot replicate the resource base of a large conglomerate but can often extend its existing production technology into adjacent product spaces, bring critical supplier activities in-house, create adjacent services, and enter new customer spaces that are adjacent on the factor market. Related diversification thus allows for growth while keeping most of the strategy intact. However, it is equally important to note that having related ventures does not guarantee success. Han and Celly (2025) found that while product diversification by internationalizing SMEs can yield positive results at lower to moderate levels of relatedness, excessive relatedness can lead to capability strain. In their study of service-oriented diversification in manufacturing by established firms, Adem et al. (2026), treated diversification as a strategic choice whose performance outcomes depend on the conditions under which a new business model can be translated into value for the firm. These studies support the central assertion of this paper, namely that related diversification should be studied as a managed capability configuration rather than simply as an increase in the number of ventures.

Literature Review*Related Corporate Diversification Strategy*

Related means new products, activities, technologies, markets, and parts of the value-chain of corporations which can be developed strategically in the context of their current business and where, within the scope of the new venture, there are relationships to customers, production processes, technologies, suppliers, distribution, knowledge and organization already existing in the company (Wang et al., 2024). Related corporate diversification thus focuses on strategic relatedness rather than diversification width. New evidence on related

diversification has appeared recently. In the paper titled “Financial value and informational complexity in technologically related diversification: evidence and a synthetic framework”, Morandi and Santaló (2025) analyze the financially additive value of related diversification and the informational complexity involved in it. Their research suggests that related diversification may create opportunities for synergies and thus financial value, while at the same time the value may not be easily seized due to information problems. In other words, relatedness creates opportunities for synergy, but realizing them is not necessarily easy.

Another perspective on the performance effect of diversification is provided by Sakhartov and Helfat (2026). The authors examine the process of resource redeployment in multi-business firms and discover the significant problems this type of organization faces. In addition, because of limited resources, the misallocation of resources in an SME can have a greater impact on the total resources of the organization than in a larger organization. Thus, the effect of diversification on the performance of a firm depends in part on the firm’s ability to identify where resources are most valuable and move them to where they can add the most value.

In this paper, RCDS is viewed as a strategic architecture consisting of three dimensions of diversification: horizontal, vertical, and concentrated. The dimensions are related because all of them consist of an extension of the current activities and a connection to already established businesses (de la Fuente et al., 2025). However, the linkage mechanism differs from one dimension to the other.

Horizontal Diversification

Horizontal diversification refers to new products and services that are introduced at about the same stage as the value chain as existing products and services. They can be offered to the same customer base by using the same production facilities, by marketing through the same channels, or by making use of the existing brand name and distribution network. A manufacturing SME might introduce a complementary component, a related finished product or even use the same product and technology to serve another customer in a different application. The principal performance logic in this case is that of resource sharing. Existing knowledge, supplier relationships, plant, distribution channels, and customer knowledge can be redeployed to support the new product or service. Recent work on technologically related diversification has identified the existence of synergy when there are technological linkages between businesses and knowledge and capabilities can be transferred (Morandi & Santaló, 2025). While diversification into horizontally related markets can have a positive performance effect for SMEs, it also increases product complexity. As a result, the performance effect will depend on whether the firm’s current skills can be used in new areas and whether management has the capacity to organize new activities (Lee, 2025). Thus, the impact of RCDS on performance is likely to be enhanced by the skills of management.

Vertical Diversification

Vertical diversification occurs when a company goes upstream (towards suppliers) or downstream (towards distribution and customers) from its current position. For manufacturing SMEs, vertical diversification can mean bringing in-house production inputs or activities that are currently processed outside by other companies. It can also mean downstream expansion, i.e. into distribution, into services, into retailing and even into face-to-face contact with customers. If the SMEs can add value to activities further up or down the

supply chain, then it may be possible to improve control over key inputs and to influence factors such as quality and lead time. In addition, vertical expansion can reduce dependence on suppliers or other partners, where there are high transaction costs or poor quality of coordination. However, there will be increased fixed costs and complexity to manage. Moreover, a recent study of resource redeployment in multi-business organizations highlighted the importance of internal organizational arrangements (Sakhartov & Helfat, 2026). The transition to vertical diversification affects the resource allocation problem. Not only must a new activity be operated, but it also must be coordinated with the already existing organizational system. Thus, vertical diversification is above all a matter of capability, and not merely a make-versus-buy decision.

Concentric Diversification

Concentric diversification refers to new businesses in new markets which are significantly different from the firm's current activities, but where there are substantial linkages in technology, manufacturing, marketing and customers. Therefore, it represents a form of extension on the fringe of the current business and can be said to involve the transfer and application of knowledge and capabilities to new areas. The value proposition for a concentratively diversifying firm is based on knowledge and capability transfer. Thus, a manufacturing company might use the engineering expertise it has developed in a product to enter new technologies, leverage customer relationships to develop related services, or utilize production competences in new markets that are technologically compatible with and related to previous ones. Recent evidence on technologically related diversification highlights the value for the firm moving across related businesses and how technological synergies can create value (Morandi & Santaló, 2025; XU et al., 2022). Perceived relatedness could be greater than actual relatedness. Likewise, a company could be considered technologically adjacent but then need very different regulatory knowledge, sales capabilities, production and even human capital. Furthermore, the performance implications of diversification can be influenced by the alignment between a company's diversification strategy and the human capital of its CEO (Yücel et al. 2026). Thus, in addition to product/technology strategic fit, also managerial and human-capital fit is required.

Theoretical Foundations

Resource-Based Explanation

Based on the resource-based perspective, the present framework simply states the obvious: Diversification can create value if a company's resources and abilities can be efficiently used in related fields. In order to achieve this, however, the issue of resource relatedness must first be resolved. If a company, for example, possesses expertise in manufacturing, has already established relations with customers, has a stock of technologies, distribution channels, and suppliers at its disposal, then an extension of its business activities can generate economies of scope and help to avoid a costly reproduction of resources and abilities which already exist elsewhere in the company (Lindlbauer et al., 2025). Recent research has continued to provide support for this logic in recent years. Studies such as Adem et al. (2026) utilized a resource-based perspective to clarify differences in performance among manufacturing firms undertaking service diversification. The fit between executive human capital and the firm's diversification strategy was found to affect performance in the study by Yücel et al. (2026). Thus, resources, whether physical/technological or managerial/human, are key and may influence performance to an equal degree. The resource-based view is especially relevant for

SMEs with limited resources. Even though related diversification can offer the possibility of extending the range of businesses for a firm with existing knowledge and skills, for a small manufacturer the costs of errors are high. From a resource-based viewpoint, RCDS can improve performance, but it does not explain why firms following the same strategy obtain different results.

Dynamic Capability Explanation

The dynamic capability perspective, on the other hand, stresses the firm's ability to sense opportunities and exploit them through the due reconfiguration of resources as circumstances change. Management ability is the ability of managers to identify a suitable potential opportunity for diversification and subsequently match it with the existing stock of resources. It is also the ability to direct attention and financial resources, to coordinate activities and to change a firm's strategy should initial assumptions prove incorrect. The recent body of research focused on SMEs offers relevant empirical support for the above capability-based interpretation of performance. Almohtaseb and Aldehayyat (2026) found that dynamic managerial capabilities that enhance strategic flexibility can improve the performance of SMEs, and that market turbulence positively affects flexibility. Zongyuan et al. (2025) demonstrated that organizational agility enhances the performance of manufacturing SMEs by converting their employees' competencies into effective actions. Supramono et al. (2025) found that dynamic capabilities are relevant to MSME recovery and sustainability. Therefore, as opposed to focusing only on the resources a firm owns, performance is generated by a firm's ability to 'mobilize' and 'reconfigure' resources (Febriani et al., 2025). The framework presented here combines two different logics. RCDS first creates potential through the relatedness of resources. Then, management ability is used to turn this potential into effective action. In contrast to a model treating diversification as automatically creating performance, this framework first creates potential and then translates it into reality.

Conceptualization of RCDS as a Higher-Order Formative Construct

The RCDS construct is modeled as higher-order and formative. Importantly, horizontal, vertical, and concentric diversification are not just three alternative ways to express a related dimension of strategic behavior. Instead, there are three distinct strategic activities, which in aggregate describe the breadth of a firm's related diversification strategy. A reflective construct is one where the latent variable causes the indicators, and hence they will all correlate well with each other. However, for RCDS, a firm could have lots of horizontal diversification but little vertical, or lots of vertical diversification but no concentric channels. Thus, removing one dimension fundamentally changes the meaning and scope of the overall construct, which is to be expected with a formative construct. Further, by specifying diversification in a formative manner, the practical validity of the model is increased. That is, the model can capture the strategic behavior of SMEs rather than forcing all firms into a single diversification strategy. Future research can also investigate whether different dimensions have different effects. For example, horizontal diversification may be more relevant when customer relationships and production technologies are transferable, whereas vertical diversification is more relevant when supply-chain control is strategically important.

Table 1.0

Related Corporate Diversification Strategy Concept

Dimension	Core linkage	Typical SME action	Primary value logic
Horizontal diversification	Product/customer linkage	Introducing adjacent products for existing or closely related markets	Economies of scope, customer leverage, asset utilization
Vertical diversification	Value-chain linkage	Internalize selected upstream or downstream activities	Supply control, quality, coordination, transaction-cost reduction
Concentric diversification	Technology/capability/customer linkage	Enter an adjacent business using existing know-how or market capabilities	Knowledge transfer, technological synergy, capability reuse

Moreover, a distinction between the three dimensions is necessary since different types of management decisions may be required. Horizontal expansion might need product development and customer knowledge, whereas vertical expansion requires process integration and supply-chain governance. Concentric expansion is dependent on technology learning as well as market adaptation. Therefore, even between the three dimensions, management ability is of relevance but with different tasks.

Hypotheses Development*Related Corporate Diversification Strategy (RCDS) and Firm Performance*

Three (3) theoretical arguments explain the relationship between RCDS and firm performance. First, by using existing resources, such as production facilities, technologies, and knowledge, as well as customer and distribution relations, related diversification enables firms to share resources between different activities. Second, in related diversification, knowledge can be transferred between units by using familiar routines in new contexts. Third, by reducing excessive dependence on a single product and customer group, related diversification creates revenue and resilience opportunities for firms. There is substantial empirical support for relatedness to create value; however, benefiting from it is subject to conditions. In their more recent work, Morandi and Santaló (2025) focused on the technological synergies generated in related diversification. In addition to increasing returns on investment, diversification can also increase labor productivity through internal reallocation of resources. Importantly, the gains in investment efficiency and labor productivity that the firm can reap from its diversification into services within the manufacturing sector are dependent upon whether the firm in the corresponding business model question can implement. Note that at the SME level, the relationship between product and international diversification and RCDS is not necessarily linear. Han and Celly (2025) found that while learning and capability development can increase with higher levels of product and international diversification, this will not always be the case and that in fact, excessive diversification could be counterproductive. Buzhymyska et al. (2024) argued that horizontal diversification enables firms to expand product lines using existing resources and knowledge,

facilitating faster market entry and strengthening competitiveness. In addition, vertical diversification enables firms to control supply chains and distribution channels, reducing dependence on external partners and improving operational efficiency, which can strengthen competitiveness and business performance. Rehman (2026) found that horizontal diversification strategy and vertical diversification strategy have a positive impact on firm performance among Malaysian firms. Past studies found that there is a positive and significant relationship between concentric diversification strategy and performance (Mwariri et al., 2024). Therefore, while the relationship is expected to be positive at a conceptual level, future research should examine whether the relationship decreases at higher levels of diversification (Jiang et al., 2025; Rehman, 2026). RCDS is defined as related expansion, and strategic linkage is the basis for the resource leverage promised by RCDS. Based on the discussion, the following hypothesis is proposed:

H₁: Related corporate diversification strategy is positively associated with firm performance among manufacturing SMEs in Malaysia

Management Ability Moderates the Relationship between RCDS and Firm Performance

The present research investigates the boundary condition of the relationship between quality of management and firm performance. As mentioned above, the capacity of managers to identify opportunities, to make timely strategic decisions, to allocate resources, to coordinate activities to be developed, and to successfully implement the decisions made are all part of the management ability studied here and go far beyond the technical skills of management that are usually measured. Mirković and Mirković (2024) argued that related diversification (which includes many forms of horizontal diversification) generally improves firm performance, especially in the short term. Past studies found mixed results on the related diversification strategy and firm performance. The authors also noted that the diversification-performance relationship often follows an inverted U-shape, meaning moderate diversification is beneficial while excessive diversification can also be harmful. Past studies found an insignificant impact of diversification (and its types) on all firm performance measures (Nigam & Gupta, 2020). Another study on the effect of diversification strategy found that related diversification strategy negatively impacts accounting performance (Brandon et al., 2017). Past studies also found a positive relationship between related diversification and firm performance (Palich et al., 2000). Past research has reported mixed findings regarding the relationship between related diversification strategy and firm performance, because a diversification strategy produces not only synergies but also anti-synergies (Mirković & Mirković, 2024). Hayes and Preacher (2014) suggested that when there is a mixed result, there is a possibility of the existence of a moderator. As noted above, the existence of strategic relatedness between two businesses does not automatically create synergy. Two (2) businesses sharing major technologies can fail to transfer knowledge between them. A production facility that can support many products can have its capacity misallocated between them. An activity that a firm previously had conducted to contract with a supplier now becomes a costly bureaucracy instead of increased efficiency. These are all managerial execution failures. Research on small and medium-sized enterprises (SMEs) has also been adding value to the existing argument. For example, Almohtaseb and Aldehayyat (2026) highlighted the positive impact of dynamic managerial capabilities on SMEs' performance via strategic flexibility. In addition, the relationship between CEOs' human capital and the firm's diversification strategy and its performance is positive (Yücel et al., 2026). Ho and Yang (2026) examined how managerial ability could impact top-management-

team human capital and firm performance. The aggregate implication is that higher managerial quality should translate into better outcomes for firms with given strategic configurations. The extent to which high management ability in Malaysian manufacturing SMEs can help to identify genuine synergy and choose between different paths of diversification, as well as to sequence investment, communicate strategic objectives, and reallocate resources as new ventures develop in ways that were not anticipated, will be contrasted with the circumstances in which lower management ability enables the costs of coordination and complexity to swallow any potential benefits from relatedness. Hsu (2023) suggested that no studies have examined whether managerial ability moderates the relationship between corporate diversification performance and firm performance. Based on the discussion, the following hypothesis is proposed:

H₂: Management ability moderates the relationship between related corporate diversification strategy and firm performance

Conceptual Model

The proposed model is parsimonious. The higher-order formative construct RCDS is modeled by means of the dimensions horizontal, vertical, and concentric diversification. The endogenous outcome variable is firm performance. Management ability is the moderator that affects the extent to which the performance potential of related diversification is realized. Figure 1 shows the proposed conceptual framework. This model needs to be empirically tested by specifying a higher-order formative measurement model for RCDS and by including an interaction term between RCDS and management ability. The above model does not claim that all the specified relations have already been studied for the Malaysian manufacturing SMEs. Rather, it is a model that needs to be tested empirically.

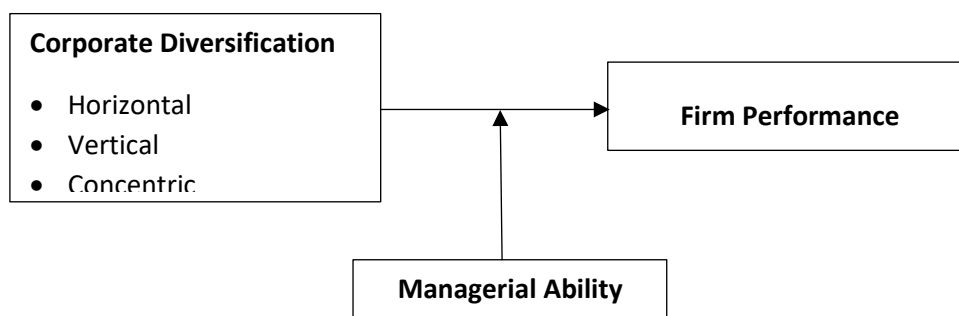


Figure 1.1 Conceptual Model

Methodological Implications for Future Empirical Testing

As a conceptual paper, no empirical results are presented. However, the proposed framework is a testable model. Future studies can test the model using a cross-sectional survey on Malaysian manufacturing SMEs and apply PLS-SEM for analysis, as the research objective is to predict outcomes and a higher-order formative construct is at the core of the proposed model. It is important to note that the analysis of data for such a model would differ between measuring the model and testing the structural relationships. Future research could expand the model by including other independent, mediating, and moderating variables and further strengthen the empirical findings.

Population and Respondents

The target population consists of Malaysian manufacturing SMEs that are currently active and have clear strategic decision-makers. Owners, CEOs, Managing Directors, General Managers, as well as Senior Managers with in-depth knowledge of the diversification strategy and the performance of the company under investigation are considered suitable. Screening of respondents is required as questions on diversification are of an organizational nature.

Measurement Model

RCDS is a higher-order formative construct of three dimensions of RCDS: horizontal, vertical, and concentric diversification. Each of the three dimensions can be operationalized by several lower-order items, such as provided in the conceptual definitions. Management ability can be operationalized by several opportunity recognition, decision timing, resource allocation, coordination, and implementation effectiveness items. Firm performance can be measured by several perceptual indicators for sales growth, profit, market share, productivity, and overall performance over a given time span. For the higher-order formative factor, we should go beyond examining the internal consistency of the indicators, i.e. also examining their relevance and possible collinearity. Convergent validity can be checked by means of redundancy analysis. The structural effects can be tested by means of bootstrapping. The interaction of RCDS and management ability should be tested after appropriate centering or standardization of the factors. The simple-slope plot then can be used to explain the significant interaction effect.

Common Method and Endogeneity Considerations

Single respondent studies that largely rely on perceptual data should address common method bias by providing a set of procedural and statistical remedies. By separating the measures that are predictors and those that are outcome variables and clearly stating confidentiality in the administration of the measures, researchers can provide instructions to respondents on how to best complete the survey. Additionally, checking for collinearity as well as the use of a marker variable or a latent-method-factor are also appropriate. The study also has the problem of endogeneity in that firms with higher levels of current performance may have greater resources to engage in diversification, thus reversing the causality in the model. Hence, future studies would benefit from the use of longitudinal data, from lagging the measure of diversification, from the use of instrumental variables where appropriate, and from additional controls to ensure that the model is not being misinterpreted.

Theoretical Contributions*Clarifying the Meaning of Related Diversification*

Diversification as defined by broad terms like horizontal, vertical, and concentrated related Diversification (RCDS) needs to be more refined. We argue that different types of related diversification, i.e., product/customer expansion, value-chain extension, and capability/technology extension, can have different degrees of success in terms of performance effects.

Advancing a Formative View of RCDS

The second contribution refers to the measurement aspect of the old model. In contrast to viewing horizontal, vertical, and concentric diversification as alternative forms of related diversification, in a formative perspective these different strategic decisions are independent

from each other. In contrast to the model under review, this view does not fail to acknowledge that not all companies are pursuing the same strategy of diversification. For future comparative studies in different industries and countries, the view **is also** much more suitable.

Bringing Managerial Execution into the Diversification Argument

The third contribution resides in the management ability boundary condition. While the last few years of research emphasize the importance of managerial capabilities, strategic flexibility, and human capital in influencing performance (Almohtaseb & Aldehayyat, 2026; Yücel et al., 2026), the proposed framework develops these insights by relating them to the concept of related diversification and by asserting that the ability to manage potential synergies and coordination is managed by the management.

Extending the SME Context

A fourth contribution is of a contextual nature. Most studies on diversification are conducted on large corporations that are rich in financial, technological, and management resources. Manufacturing SMEs function differently, and the value of relatedness is heightened as they attempt to reuse the few resources at their disposal. Also, the costs of managerial failures are pronounced as well. Thus, a study that examines the interaction between strategic relatedness and management capability in the Malaysian manufacturing SME sector is particularly relevant.

Practical Implications

For the SME owner-manager, the new framework suggests that diversification decisions should be based on a resource-and-capability audit, not market attractiveness. The basic questions to ask about a new activity before entering it are: What resources can be reused from existing activities? Which customers, technologies, suppliers, and processes are already used in other activities? What new resources are required? How much management time and attention will the new activity demand? These questions make relatedness operational not rhetorical. Growing revenue does not necessarily mean increasing profitability. Managers should therefore make a distinction between growth and complexity. A diversification decision should be evaluated in terms of the additional contribution that it makes, as opposed to additional sales. Resource redeployment should be deliberate, especially when the same employees, production facilities, or the manager's time are required to run other activities (Sakhartov & Helfat, 2026). Additionally, the manager's capabilities must also be developed. In their studies of SMEs, researchers have highlighted the importance of the companies' agility, strategic flexibility, and their dynamic capabilities in times of uncertainty (Zongyuan et al., 2025; Almohtaseb & Aldehayyat, 2026). For a manufacturing SME, this means stronger cross-functional coordination, more systematic market monitoring, faster decision-making, and clear assignment of tasks for the integration of diversification. Secondly, managers should be skeptical of the assumption that relatedness is sufficient. Just because a venture is technologically related does not mean that it is also commercially sound, and just because it is commercially sound does not mean that it is also operationally sound. The issue is whether the venture can become a functioning part of the firm's capability system.

Limitations and Future Research

There are limitations to the current conceptual work. Firstly, the proposed relationships have not yet been tested empirically in Malaysian manufacturing SMEs. The theoretical hypotheses

developed in this paper are proposals which have not yet been empirically verified. Also, the framework was developed to conceptualize three types of related diversification and hence does not model geographical diversification, international diversification, and unrelated diversification. These could be important boundaries for future research. A third area of value is that of the management ability construct. This can be explored in greater depth by decomposing opportunity recognition, strategic decision making, resource allocation, coordination and implementation. Research may also explore whether different aspects of managerial human capital (i.e. experience, functional affiliation, technology expertise and industry expertise) affect different strategies (e.g. Yücel et al., 2026). Performance of human-capital alignment in terms of diversification strategy is explored. This model has several limitations. In particular, it does not consider environmental turbulence, firm size, firm age, innovation intensity, financial flexibility, and internationalization. These variables could either moderate or mediate the effects depicted in this model. For example, financial flexibility could amplify the performance effects of diversification as found by Chen and Nguyen (2025). Future studies on Malaysian firms need to test whether managerial ability is still a boundary condition after incorporating financial and environmental contingencies. Although our framework is primarily linear, we do not rule out the possibility of nonlinear relationships in future studies. Although initially diversified in a positive way, excessive diversification can indeed create negative effects. Recently, SME diversification was studied in greater detail, which may lead to new insights (Han & Celly, 2025). A quadratic or even a configurational approach could possibly be more appropriate to explain the strategic breadth and focus of manufacturing SMEs.

Conclusion

The starting point of the paper is the problem of many manufacturing SMEs growing and having to extend their activities, yet limited resources for such extensions are available. Diversification is not to be seen as good or bad, but a more precise description of its conceptual underpinning is provided in this paper. Related corporate diversification strategy is viewed as a higher-order formative construct consisting of the dimensions of horizontal, vertical, and concentric diversification. These different ways of extending the activities of a company while at the same time keeping a link to the core business all have their specific values, such as sharing of resources, knowledge transfer, customer leverage, supply-chain control, and reuse of existing capabilities. Possible synergy between different ventures does not necessarily translate into effective performance. Identifying strategic fit, allocating scarce resources, and coordinating activities, as well as changing and implementing new strategies, become more critical as SMEs venture into diversification. Research on dynamic managerial capabilities, strategic flexibility, alignment of human capital, and redeployment of resources (Almohtaseb & Aldehayyat, 2026; Sakhartov & Helfat, 2026; Yücel et al., 2026) provides solid contemporary underpinnings to viewing the ability of managers as a boundary condition rather than as something ancillary. Thus, the newly created framework changes the direction of the research question from 'Does diversification improve performance?' to 'When does related diversification create performance?' For Malaysian manufacturing SMEs, the opportunity of a related business is of strategic value only if it can be successfully integrated into the respective system of resources, people, processes and decisions of the company. Strategic expansion and adequate management capacity are two notions which cannot be separated. Future research could empirically test the relationships studied here among Malaysian manufacturing SMEs, using a higher-order formative measurement model and an

interaction-based moderation analysis. It would be interesting to establish whether conceptual logic can be transferred to other industries and to test the value of different types of related diversification under different managerial and environmental circumstances. Note: Attached in Appendix A: please find RCDS survey questionnaires. Appendix B shares suggestions for the control variable.

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