

Feature Articles

This month's focus: **Internal Capital and Labor Markets in Diversified Firms**

Why Do Diversified Firms Exist ? The Role of Internal Markets

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The businesses of a diversified firm are separated from external markets because they are part of a larger organization. Consequently, diversified firms play the role of “markets” for their businesses. This function, known as the internal market, can rationalize the existence of diversified firms. However, it can also cause conglomerate discounts. This article considers the pros and cons of this important organizational mechanism, focusing on internal capital and labor markets, which allocate scarce funds and human capital, respectively, across businesses.

Productivity Dispersion Across Business Segments and Internal Capital Allocation: Diversification as Exploration and Corporate Governance

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This paper uses business-segment data for Japanese diversified firms from 2004 to 2021 to examine how productivity dispersion across segments affects firms' internal capital allocation—that is, the share of capital expenditures directed to high-productivity segments—and subsequent performance. The results show that greater productivity dispersion is associated with more concentrated investment, and that institutional investors further intensify investment concentration among firms whose core businesses have a clearly stable competitive advantage. Investment concentration is positively related to next-period ROA, and its reflection in firm value is also confirmed for the group of firms with a clear competitive advantage in their core businesses.

The Relationship Between Diversification, Cash Holdings, and Payout Policies in Japan

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This study examines the impact of business diversification on the cash holdings and payouts of Japanese firms. The results show that diversified firms hold significantly lower cash reserves than firms with a more focused business model. This effect is more pronounced among firms facing financial constraints or those with effective governance. Regarding the relationship between diversification and payout amounts, this study suggests that diversified firms without financial constraints and those with effective governance exhibit significantly higher payout levels. These findings indicate that the effects of diversification, such as the coinsurance effect and the disciplinary effect of governance are evident in diversified Japanese firms.

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Corporate Diversification and Labor Investment Inefficiency: Evidence from Japanese Listed Firms

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This study investigates whether corporate diversification enhances or impairs labor investment efficiency in Japan. Using a panel of listed firms from 2010 to 2023, we analyze the relationship between diversification and labor investment efficiency, which we measure as the absolute value of the residual from a benchmark model of employment growth based on economic fundamentals. Our findings indicate that more diversified firms tend to display greater labor investment inefficiency, supporting the perspective that diversification increases information asymmetry and weakens external monitoring. Although inefficiency rises with initial diversification, the marginal negative effect diminishes as diversification becomes more extensive.

Articles

Are Fund Ratings Useful? An Empirical Analysis of Investor Behavior and Performance Predictability

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This paper examines whether fund ratings provide useful information for investors in their fund selection process. The empirical analysis reveals that investors place significant weight on ratings, with a distinct concentration of fund flows into the highest-rated funds (Rating 5).

The findings indicate that Rating 5 Japanese equity funds exhibit significantly higher future alpha, suggesting the existence of performance persistence. In contrast, this trend is not observed in global equity funds; instead, a mean-reversion phenomenon in performance has been confirmed, particularly in recent years. Although the results vary across asset classes, the study concludes that for Japanese equity funds, investing in high-rated funds leads to superior future performance. Consequently, fund ratings serve as a valuable information source and play a crucial role in investors' decision-making processes.
