Does Diversification Create Value in the Presence of External Financing Constraints? Evidence from the 2007–2009 Financial Crisis

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Abstract

We show that the value of corporate diversification increased during the 2007–2009 financial crisis. Diversification gave firms both financing and investment advantages. First, conglomerates became significantly more leveraged relative to comparable focused firms. Second, conglomerates' access to internal capital markets became more valuable not just because external capital markets became more costly, but also because the efficiency of internal capital allocation increased significantly during the crisis. Our analysis provides new evidence on how the diversification discount and its drivers vary with financial constraints and economic conditions, and suggests that corporate diversification can serve an important insurance function for investors.

Keywords: Crisis, Diversification, Discount, Conglomerates, Internal capital markets

JEL Classification: G31, G32, G34

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4. Gross book (market) leverage is the ratio of total debt to total book assets (market value of assets) at the end of each quarter. Net book (market) leverage is the ratio of total debt minus cash and marketable securities to total book assets (market value of assets). The cash ratio is the ratio of cash and marketable securities to total book assets. The industry matching is carried out using the narrowest SIC grouping that includes at least five single-segment firms. The