

Corporate diversification has been the subject of ongoing debate among investors and academics. To estimate idiosyncratic and systematic risks of the sample firms, we employ a modified version of the Fama–French three–factor model instead of the one–factor market model and incorporate world returns (from the MSCI World Excluding U.S. index) as a fourth factor to circumvent the issue of incomplete modeling. While some studies document that corporate diversification reduces systematic risk (Fatemi, 1984; Hann et al., 2013; Lubatkin & Chatterjee, 1994; Shaked, 1986; Stulz, 1999), other studies show that diversified firms have a higher systematic risk (Krapl, 2015; Olibe et al., 2008; Reeb et al., 1998), a higher idiosyncratic risk, and a higher volatility of cash flows and earnings (Krapl, 2015).³ In this paper, we investigate the impact of corporate diversification on firms' risk exposure from 1998 to 2016. Rugman (1976), Brewer (1981), Fatemi (1984), Thompson (1984), Shaked (1986), Lubatkin and Chatterjee (1994), Goldberg and Helfin (1995), Reeb et al. (1998), Stulz (1999), Olibe et al. (2008), and Hann et al. (2013) measure the variance of stock returns and systematic risk (U.S. beta). Barriers to investment, including imperfectly integrated capital markets, transaction costs, and limited access to information, can impose impediments on homemade diversification, making it more efficient for investors to invest directly in diversified firms (Mathur & Hanagan, 1983). Studies suggest that corporate diversification should lower investment risk at a fraction of the cost incurred by individual investors (Agmon & Lessard, 1977; Doukas & Travlos, 1988; Harris & Ravenscraft, 1991; Sanders & Carpenter, 1998). We conclude the paper in

Section 6