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Abstract

Diversification is an intensively discussed topic in the specialized literature. There are still many contradictions and inconsistencies related to it and, so far, no consensus has been reached regarding its various aspects.

When a certain topic arrives at maturity in terms of research, three criterias are fulfilled: first, a considerable amount of studies regarding that particular subject has been conducted; second, the findings of the research are consistent, valid and interpretable; and third, the research on that specific topic led to a general agreement (Palich et al., 2000, p. 155). The topic of diversification fulfills only the first condition of being considered a mature subject: there is a rich body of literature on this subject, which has been partially reviewed in the following chapters of this thesis. However, there are still inconsistencies, contradictions and unresolved matters and no consensus has been reached regarding this particular strategy, so that the second and third criteria are not met.

The motivation of this thesis is to derive conclusions about international and product diversification strategies based on a literature review; the main objective is trying to formulate at least a partial consensus regarding diversification, based on the majority of authors' views, while the subordinate purpose is to identify issues that lead to these contradictions and inconsistencies.

Introduction

Diversification refers to a company's entry into new activity lines (Ramanujam, Varadarajan, 1989, p. 525) and is a broadly researched topic, but there are still inconsistencies and no unanimity reached regarding multiple angles of the product – international diversification strategy. Therefore, the aim of this review is to try and derive a partial consensus and draw certain conclusions based on the majority of authors' approaches, regarding the following research questions:

- Which of the international or product diversification can lead to better performance outcomes of firms, i.e. is there a preference towards one type of strategy over the other?
- What is the interrelation between international and product diversification?
- What is the impact of diversification on performance?
- Can companies reach an optimal level regarding performance by using diversification, and to which extent?

The first chapter of the paper considers the factors that impact the decision of firms to initiate diversification or to change an already existing diversification level. In other words, it compiles the elements prior to diversification that are considered the main influencing factors in incentivizing firms with respect to this strategy. The categorization of these incentives has been made from a broad perspective, namely from the point of view of the general market setting - perfect and imperfect markets, industry; disruptive changes of the general business environment – economic downturns, convergent and reorientative changes; to more specific factors, such as region, country, firm characteristics, internal and external incentives, internal capital market, size; and managerial viewpoint. From the macro to the micro level, each of these elements have a distinct and relevant impact in stimulating companies with regard to diversification strategies and have been therefore taken into account for shaping the path to diversification. Prior to diversification, it is relevant to note that the exogenous (general, industrial, regional, domestic), as well as the endogenous (firm characteristics, management) conditions can give directions regarding which diversification strategy would be more suitable to pursue and in which context.

The second chapter deals with the benefits and costs of international and product diversification, the nature of their interrelation – substitutable or complementary, and the moderating effects that one strategy has on the performance relation to the other. The first two chapters are able to therefore address the first two research questions, namely which of the international or product diversification can lead to better performance outcomes, when taking into account the aforementioned circumstances; and what kind of relation there is between the two diversification dimensions, in order to determine whether a trade – off would be necessary.

In the third chapter, the outcomes that are subsequent to diversification are reviewed, namely the impact on performance, from various angles: the separate and joint effect of product and geographic diversity on performance (general performance, in terms of profitability, but also R & D, since research and development is significantly researched in this context, and, to a lesser extent, diversifying acquisitions and the risk – return profile); and the graphic relation between diversification and performance, following the three main directions that have been discussed throughout literature : linear, curvilinear, and sigmoid. The third part can answer the last two research questions, namely what the impact of diversification on performance is; and whether and how an optimal diversification level in terms of performance can be reached by firms.

The fourth and last chapter outlines the issues that lead to contradictions and inconsistencies related to this topic: diversification and performance measurement, sampling and control variables.

Even though some of the diversification contradictions can be overcome based on the majority of the specialized literature views, there is still yet much to analyze and consider when testing for diversification before reaching a generally accepted consensus. More harmonized measures should also be used when testing for diversification. Nevertheless, the findings of this paper can be of use for managers or firms that are considering diversification as a next strategic step to be taken home and abroad, or if they consider changing an already existing diversification degree: even though markets are imperfect, diversification is a proper tool for dealing with these imperfections and face competitions; even when business is disrupted by downturns, financial crisis or other types of shocks, diversification can act as a buffer against losses and help firms adjust to such changes; when it comes to industry, mainly differentiated among manufacturing and service firms, it is easier most of all for manufacturers, and then for knowledge – based service providers to increase their diversification levels; intra – region diversification, namely

within the neighbouring countries, can lead to better performance than diversifying in regions that are economically, institutionally, and culturally further; the existence of a supportive institutional framework of a country through capital markets and skilled labor force is one of the most powerful incentives to diversify; legally, firms from civil law countries are incentivized to diversify to make use of the internal capital market benefits; a saturated domestic market also stimulates firms to diversify and seek growth elsewhere, while a too large and competitive home market discourages firms from diversifying; if a firm disposes of the necessary resources, especially financial ones; if it has less than desirable performance outcomes and cash flow forecasts; if the market orientation permits establishing institutional and social networks; and regardless of size, firms have motives to diversify; also, if a firm has a capable management, this encourages diversification, but not if diversification is pursued by managers out of personal reasons that can lead to agency costs – however, even in this case, diversification is useful, because it can be applied as a governance tool.

There is no clear preference regarding which type of diversification to choose, but the majority of the authors are in favor of a joint product and international diversification; when analyzed separately, international diversification is favored; between product related and unrelated diversification, the related one registers higher performance. The relation between the two is substitutable and interdependent – they go hand in hand, with no trade – off needed.

But perhaps the most researched topic is the impact of diversification on performance. This impact is mainly a positive one, especially when there is a combination of international and product diversification; the risk – return profile can be improved through a related product diversification; regarding R&D, which is one of the most important contributors to the achievement and maintaining of a long – term competitive advantage and performance of a firm, companies should not over – diversify and should opt for an international, rather than a product diversification approach. Otherwise, R&D and innovation are hindered, especially if the firm is active in an industry that required high levels of innovation. Nevertheless, there is a certain threshold regarding the advantages of diversification when it comes to performance: if firms diversify up to an intensity that is too high, benefits are surpassed by costs. Therefore, most authors find an optimal diversification level at medium stages, but the exact level of the threshold and whether it can be increased is yet to be tested for.

Chapter I: Prior to Diversification – Factors that Influence the Decision to Diversify

In order to answer the research questions, i.e. identify the elements that influence the choice of diversification strategy and which factors drive companies to diversify, the relationship between international and product variety, the impact on performance and whether an optimal level in terms of profitability can be reached, specialized literature has been reviewed and synthesized. Diversification has been analyzed and tested in various contexts: from the macro level/general environment – business setting, industry, continents, regions, countries; to the micro one – firm characteristics. All of these contexts have been outlined in the following sections, embedding the incentives to diversify for both firms that are already diversified, but perhaps desire to modify the level of diversification, as well as for firms that have not pursued this plan of action yet, in order to be able to find out which strategy is more suitable, and in which background.

1. General Environment

Diversification incentives can be firstly regarded from the general market framework perspective. Namely, diversification can either be impacted by relative market perfection expectations and homogeneity, or by market imperfections (Hoskisson and Hitt, 1990, p. 462).

1.1. Perfect Markets

Diversification cannot happen in markets with relative perfect competition, within which there are similar products and focus on a single product line or market. Shareholders can diversify on their own by reducing risk within their investment portfolio; hence diversification under perfect markets cannot be rationalized. Moreover, a perfect market assumes no informational asymmetries, while, in fact, these asymmetries exist and this is another reason for which diversification cannot function in a perfectly competitive market. Perfect market conditions are distorted by policies, taxes and transaction costs, such that diversification can be induced by external motives, while unsatisfactory performance levels, risk and cash flow

forecasts represent some of the internal incentives of firms to diversify. There are also managerial motives to diversify, but the agency costs between managers and shareholders can be mitigated through governance.

In a perfect market, managerial influence is not particularly high. Markets determine firms to adopt homogenous strategies that limit or do not use diversification at all. As companies are not compelled by any major external motives to diversify, industry is the main driver when firms are in the decision making process (Hoskisson and Hitt, 1990, p. 466). The most suitable resources in such a market framework are the intangible ones, as they are the hardest to reproduce by competitors. In this context, industry is the main performance driver (Christensen, Montgomery, 1981, p. 338; Hoskisson, Hitt, 1990, p. 469) and not outcomes that are due to diversification.

As a result, under relatively perfect market conditions, there are little incentives to diversify.

1.2. Imperfect Markets

On the other hand, when imperfections appear, strategic choices based on external motives are crucial. Market imperfections that are the basis factors for wanting to pursue diversification are the heterogenous resources that permit exploiting market differences, leading to internal and external motives to diversify (Hoskisson, Hitt, 1990, p. 472). The external motives to diversify include relaxation of anti – trust laws¹ and shareholders preference to reinvest in other industries, as capital gains are not as heavily taxed as dividends. After dividends and capital gains began to be taxed the same, this incentive disappeared. However, debt funding increased the preference over retained earnings and business opportunities over dividends. Corporate taxes also make acquisitions more attractive, as a blending of acquirer – target through diversification means lower taxes. Based on the transaction cost theory, there are high transaction costs (that can arise for e.g. due to high specificity) that could lead to diversifying instead of selling excess capacities. When firms internalize, and transaction costs are higher than costs of organization (coordination, control), diversification is more viable.

¹ Anti-trust laws refer to market constraints that prevent predatory competition among firms (and especially among the large ones, which can have better bargaining power and a larger market share, compared to the small ones that are less powerful).

2. Industry

When it comes to controlling for industry in an analysis, authors usually evaluate diversification for service and manufacturing firms, with the aim of contrasting them.

In case of service companies compared to manufacturers, service firms need to make more adjustments to match customer preferences abroad. Their focus is on customer contact, therefore it is more likely that cultural and language differences are larger when wanting to advertise and sell a service, rather than a manufactured product; there is also a need for higher control and monitoring due to the intangible character of services (Capar, Kotabe, 2003, p. 348). Service firms focus on risk reducing at the customer end, while manufacturers are more likely to seek cost reducing at product end (Oh et al, 2014, p. 4).

The most desirable outcomes of service firms are for an intermediate degree of diversification (Contractor et al., 2003, p. 15). First internationalization steps imply costs due to differences based on distance, diseconomies of scale and no bargaining power. Service firms are also bound to location, since there is a simultaneous production and consumption, therefore subsidiaries must be established abroad and considerable initial investments are needed. While manufacturers can export relatively easy, retailers, for instance, have to first establish a store network, by investing in subsidies, supplies, labor, logistics (Oh et al, 2014, p.5). Therefore, at the initial stages, costs are extremely high, creating diseconomies of scale and hindering profitability at first. Along the following internationalization stages, after initial stages, when there is an increased learning and experience, there are also lower costs, better capabilities and hence positive effects for service firms. Performance increases, mostly due to economies of scope. These effects decrease again, when complexities, control and coordination costs increase and exceed opportunities, i.e., when diversification is at a large level. Firms register a lower performance for higher levels of international diversification, therefore service firms can do better if they diversify but, at the same time, focus on fewer customer segments. This has been confirmed by other studies which find higher performance level for service firms dealing with business that is related (Nayyar, 1992, p. 219).

Differentiating between knowledge – intensive and capital intensive service providers shows how there are different growth opportunities and performance outcomes, depending on each type. Knowledge-based firms that are active in, for instance, advertising, market research, publishing,

and financial services, have a philosophy of pursuing the clients. In contrast to capital – intensive service firms (e.g. air transportation, construction, hotels, restaurants, wholesale and retail trade, shipping), knowledge-based service do not seek to significantly invest in tangibles required for building subsidiaries abroad. They already have a formed client base, and, due to higher standardization, they can operate with fewer costs. It is therefore more likely that knowledge – intensive service firms are going to benefit from better outcomes in terms of performance compared to the capital – intensive ones, because the latter involve more costs and require a higher scale of operations before realizing benefits (Contractor et al., 2003, p. 16). This has also been confirmed by other studies, according to which performance and diversification are positively associated for knowledge – intensive firms, but only when diversification is related to the service industry (Castaldi, Giarratana, 2014, p. 4).

Large multinational service firms tend to be more domestic than manufacturers, due to the complexity of independently adjusting upstream and downstream activities when there is a high distance between the home and the host country (Rugman, Verbeke, 2008, p. 397). There is less globalization in this case also due to higher human capital asset specificities, supply-demand synchronization difficulties, as they are location-bound. Manufacturers can better focus on the homogeneity of products and it is easier for them to separate upstream - downstream activities. Services cannot be stored, they encounter stronger governmental restrictions and the main driver for service firms is the market; also there is inseparability between production and delivery/consumption (Rugman, Verbeke, 2004, p. 10). For these reasons, it is easier for manufacturers to operate on a more global scale than service companies, which are focused more on the home region or market. Service firms diversify more intra- than inter-regionally (Rugman, Oh, 2009, p. 482). A study on the largest 500 multinationals from Fortune Global has found that 100 of them are service companies, out of which 45 are retailers, that due to capital-intensiveness and location-boundness, there is a preference to concentrate activities and diversify within the home region. It is more suitable for service firms to develop firm-specific capabilities in the home region, before pursuing a global diversification strategy (Oh et al, 2014, p. 17).

Industry also has an effect on the risk – return profile, namely, choosing to diversify in related industries has a positive effect on the risk – return performance (Kim et al., 1993, p. 143).

The positive or negative effect of diversification on performance also depends on industry characteristics. In very specialized industries, with up to three major players, diversification has a

positive effect on performance (Santalo, Becerra, 2008, p. 28). Such industries are not characterized by a very intense competition; therefore firms do not need to be extremely specialized and can use higher diversification levels. On the other hand, in industries where competition is intense, companies can differentiate themselves and face this competition by specializing on their core abilities, production and scope, therefore such companies can keep diversification only at lower levels or, in some cases, exclude it completely as a strategy, because diversifying in an industry where focus on specialization is required hinders performance (Santalo, Becerra, 2008, p. 16; Berger, Ofek, 1995, p. 59).

3. Disruptive Changes

The global business is a constantly developing, complex climate, whose dynamic nature is due to the changes that can intervene within the general environment. This dimension is thus also relevant when reviewing specialized literature, in pursuance of how decisions related to diversification or its outcomes might be impacted when the general environment undergoes certain changes. Systemic risk² has been taken into consideration in literature when analyzing diversification, due to its inherent nature.

3.1. Economic Downturns

During recessions, valuation indicates considerable a rise in relative value of companies that use global diversification and for firms that use both industrial and global diversification, not due to making use of the access to broader capital markets, but to a more efficient internal allocation of capital as a result of financial constraints. However, results indicate that this value increase is limited and vanishes within a one year period from recession.

For globally diversified firms, a domestic recession implies more difficulties in obtaining credit at home; for operational reasons, they could finance their segments by accessing capital from markets that are not experiencing a downturn. Companies that are active outside their domestic market could efficiently allocate subsidies to segments that are not in areas/countries affected by recession. However, diversified firms have lower leverage than firms with only one segment, although their access to broader capital markets is facilitated (Volkov, Smith, 2014, p.

² Risk of a financial failure in the market.

161). At the outbreak of a crisis, internal financial markets are more efficient, therefore the increase in relative firm value of diversified companies is at least partly due to this (Hovakimian, 2011, as cited by Volkov and Smith, 2014, p. 161). In the four quarters after recession, the value level goes back to pre-recession. Improved internal distribution of capital is actually a trigger of diversification discount decrease while experiencing a downturn.

Research shows doubt between diversification and premium, instead, it finds discounts³ of diversified companies in comparison to single segment, domestic firms (Lang and Stulz, 1994, p. 1278; Denis et al., 2002, p. 1975), but the views are contradictory. Diversified firms should be valued at premium compared to single segment companies, due to cross-subsidizing their lines (lower cost of capital due to easier access to capital markets – Hann et al, 2013, as cited by Volkov and Smith, 2014, p. 161), economies of scale, intangible assets, shifting profits to countries where taxes are lower. However, when core business becomes mature/unproductive/stagnant, firms begin to diversify, hence leading to a discount (Gomes, Livdan, 2004, as cited by Volkov, Smith, 2014, p. 161). According to the agency view, diversification is pursued because managers want growth for the sake of growth and their own power, leading to a discount. On the other hand, the internal capital markets theory explains that diversified firms subsidize lines with internal capital, achieving a competitive advantage over companies in need of external funds and therefore leading to a premium. Other authors find that this discount that is associated with a decreased firm value is actually due to firm characteristics, and not to diversification (Campa, Kedia, 2000, p. 2), such that, even though a discount may occur in the context of diversification, this strategy does not have a negative impact on firm value (Villalonga, 2004, p. 24).

In times of constraint, funds are distributed to projects with a higher worth that can increase firm value, therefore there is a more efficient internal distribution in times of recession (Rajan, Zingales, 2000, p. 26). When financing domestically becomes more stringent during downturns, diversified firms have the advantage of easier access to capital markets and do not give up

³ Shares of diversified companies are discounted. The market undervalues shares of conglomerate businesses (diversify risk by being active in multiple markets); discount is due to “sum-of-parts valuation”, i.e. segment worth if lines were separated.

investments, not even research and development. This has also been confirmed by other studies, which find that diversifying or diversified firms make investments

In economic downturns, the relative value of globally and industrially-diversified companies increases; this higher relative valuation is due to the facilitated ability of diversified firms to use broader capital markets for financing. The higher value during times of financial constraint can also be explained by the fact that as diversified firms choose which projects are more valuable to fund, they allocate capital internally in a more efficient way (Volkov, Smith, 2014, p. 173).

Between a more efficient fund distribution due to constraints and an easier access to broader markets for financing, the main trigger of the improved relative valuation of diversified firms is the more efficient internal capital allocation, especially at the time of recession commencement. Because financial constraints bring vulnerability, a recession can act as a governance tool as well, seeing that managers put their best efforts into productively allocating funds internally. A premium would be justifiable in this case, as diversification can act as a buffer in times of downturns.

3.2. Convergent and Reorientative Changes

Besides systemic risk, which is the risk of a financial failure in the market, such changes include, but are not limited to, two types of major directions that can significantly deviate the regular course of business and that have been classified as:

- 1) Convergent changes, i.e. “long periods of incremental change which elaborate a particular strategic orientation” or
- 2) Reorientative changes, i.e. a fundamental rearrangement of consistency systems “towards a new basis of alignment” (Tushman, Romanelli, 1985, p. 174).

That is, convergence refers to when the general environment undergoes a series of added modifications that are consistent with the business system, but alter prior practices up to a certain extent without completely distorting them; reorientation has a stronger effect than convergence when it comes to the magnitude of change, because it alters business with more force and has the consequence of more substantial modifications that need to be implemented.

3.2.1. Convergent Changes

Literature has analyzed diversification and its effect on performance in both situations. First, a convergent conversion has been, among many other examples, the occurring of internet and its repercussions. Transaction costs are a substantial element of diversification; however, the adoption of the cyberspace has made diversification more attractive to firms, as the internet facilitates access to new markets by reducing costs. Due to e-commerce, initial investments in setting up the necessary physical infrastructure such as building subsidiaries or outlets are no longer required. Moreover, coordination, control and managing of large and diverse quantities and packages of products and services are easier to implement and enforce online. Technology and diversification are tools that should be considered by firms that want to expand abroad, but which either do not have the necessary international experience or resources for foreign direct investment or exporting, or do not wish to invest in them and instead choose e-sales as a response to increased competition. For instance, a study on companies using data from national statistic offices from 14 European countries indicates that firms which pursue e-commerce benefit from labor productivity and a slow, but stable sales growth, especially in the case of services. Even though smaller firms enjoy a larger increase in e-sales compared to the levels when e-commerce is first implemented (this does not mean, however, that the amount of sales coming from the online environment is more pronounced than the one of the large firms, only that it grows at a faster pace considering the very low e-commerce degree small firms have in the beginning), it is the “large firms, high productivity firms and firms with international experience” that use e-sales with a higher frequency (Falk, Hagsten, 2015, p. 15) and hence reap its benefits more. This has also been confirmed by Totonchi and Manshady (2012, p. 83), who review in their study various sources of specialized literature and reveal that the higher the level of globalization of a firm, the higher the e-commerce employed and its effects on performance. Manufacturing global firms usually focus on B2B and do business with other manufacturers, while service firms have a higher probability to use B2C, on a domestic plan (Totonchi and Manshady, 2012, p. 85). Therefore, between domestic and global firms, it is the global ones that are more diversified, however, service firms can also benefit from diversifying via online sales locally. A diversification strategy paired with technology has a positive effect on performance in both cases.

The emergence of e-commerce can also be considered for the case of European emerging countries, such as Romania (Cristache et al, 2015, p.351), a country that is in the process of economic development and convergence to the Union European in terms of sale amounts. Electronic commerce is also developing fast across the nation, not only through online sales, but also through mobile phone transactions, as more households are equipped with computers and more consumers using mobile internet. Online purchases are significant for services such as entertainment activities, restaurants and travel, while there is a lower percentage for products (IT, books and cosmetics). As mentioned in the previous study, it has also been found that in Romania service firms tend to diversify locally through e-commerce more than manufacturers (Cristache et al., 2015, p. 358). The case of Romania is relevant because it can also be applied to other emerging European countries, for example, Bulgaria, Ukraine, Serbia Moldova and because it is also a part of a worldwide phenomena: technology permits a fast dispersion and it is a tool that can simplify diversification and strengthen a company's competitive advantage. For these reasons, in the context of a positive convergent market change such as the internet emergence, product and international diversification strategies are advantageous, because they permit a firm to gradually adjust to the changed general business environment and enjoy its benefits.

Another example of a significant convergent modification is the implementation of free trade within the European Union. The EU as a consolidated structure of countries is a large-sized economy, with very big import and export volumes, and justifying for more than 25% of the global worth measured in terms of GDP⁴. A free trade policy is useful in creating and supporting a unified market under the responsibility of the Union, and not the national governments, a market which permits the free circulation of products, services, labor and capital. Because the EU is much stronger in trade than negotiations than any of its members taken separately, free trade opens the markets and spurs economic growth. Forecasts⁵ computed in 2014 show an estimated GDP growth of approximately 2% as a result of the free trade policy completion and a possible creation of two million jobs. Firms can benefit from offering a greater variety of products and services at reduced prices, because not only are all barriers within the EU foregone, but costs are also reduced. For instance, manufacturers have the advantage of being able to

⁴ The European Union Explained: Trade, 2014, p.3 http://europa.eu/pol/pdf/flipbook/en/trade_en.pdf

⁵ The European Union Explained: Trade, 2014, p.5 http://europa.eu/pol/pdf/flipbook/en/trade_en.pdf

produce outputs cheaper, as imports and components for manufacturing cost less and there is access to cheaper labor sources. Service firms can also benefit from the reduced labor expenses and a facilitated ability to disperse across the EU and improve performance outcomes. On the legal side, competition is prohibited from becoming unfair under strict regulation, not only among the large firms, but also for smaller, local firms, in order to permit them to continue their activities without having to withdraw from the market due to, for instance, large corporations that have a wide European and/or international presence. Investors are also encouraged by the increased shareholder protection and investment opportunities. Altogether, the EU and its support for trade as a convergent market change are positive stimuli for companies that diversify or plan on becoming diversified, because this setting offers them ease of entry in another markets, reduced transaction costs and legal protection against unfair practices. Moreover, even though the countries that form the European Union all have well-defined cultures and styles, they are characterized more by homogeneity than heterogeneity, i.e. there is no large political, geographical, or cultural distance. A convergent market change such as the formation and free trade within a union of countries positively incentivizes diversification to be adopted as a strategy by the companies, or, if companies are already diversified, free trade allows firms to improve their performance.

3.2.2. Reorientative Changes

Besides convergence, the general business environment can also be subjected to reorientation, which is triggered by an exogenous shock that can impose major changes to the economy, such as the terror attacks that happened on September 11, 2001 (Li, Talmann, 2011, p.1). The influence on international diversification on multinational companies' performance has been analyzed, as the effects were not only experienced in the U.S., but internationally. The September 11 attacks had a reorientation repercussion on the global economy, as they implied turmoil for the business world and forced firms to adjust their approach. However, such shocks can also have certain opportunities embedded. Initially, diversification is negatively correlated with performance measured by the cumulative abnormal returns⁶, because immediately after events, firms incurred losses. In the long run, however, diversification has proven to be useful for

⁶ Cumulative abnormal returns are the difference between the actual and the expected return of a security.

the performance outcomes. Especially firms that were already diversified and had a few years of experience with this strategy managed to bounce back and improve their profitability.

In the subsequent timeframe to the terror attacks, performance of MNCs was deteriorated, but in the long-run, prior international diversification had a positive effect on performance (Li, Tallman, 2011, p. 3 - 4). International diversification refers to the range to which a firm is active in the international business, therefore the more it is expanded, the higher the risk of being affected when disruptive changes happen globally, due to occurred losses and adjustment difficulties. Diversification is complex and it becomes even more complex when disruptive exogenous events require strategy adaptations. Nevertheless, even if in the short-term, performance is negatively affected compared levels before the economic shock, because the burden of the attack was reflected in the return component that disrupted expectations prior to the event, international diversification is of great help in the long run. Due to worldwide activities, it enhances a company's abilities to adapt and manage complexities at lower cost (i.e. through the ability to achieve and maintain a competitive advantage). In other words, prior international diversification experience could represent a "how-to" manual in case business is obstructed, by helping a company rebound thereafter. Results show no difference between U.S. and non – U.S. firms immediately after the attacks, proving how interconnected today's economy is; in the long run, the positive diversification effect on performance has been stronger for the U.S. multinationals (Li, Tallman, 2011, p. 5).

Especially when the firm has several years of international diversification prior to such an event, performance is positively impacted, as an internationally diversified company has the necessary tools for recovering: experience in coordinating and managing complexities of structures of foreign subsidiaries and flexibility get accustomed to market conditions. Right after a shock, investors attached importance to risk aversion by diversifying less. In the long run, internationally diversified firms adjust and manage even such sudden changes, register positive performance.

Another reorientation of the general environment happened due to the financial crisis that occurred in 2007 – 2008. A study by daCosta Neto and Romeu states that diversification through exporting diminished the effects of the crisis for a sample composed by firms from South American countries, confirming the benefits of export diversification on growth (Cabellero, Cowan, 2006, as cited by daCosta Neto, Romeu, 2011, p. 3). However, it is product

diversification that mitigates the crisis effects, as the geographical one did not have a strong impact on the outcomes in their analysis (daCosta Neto, Romeu, 2011, p. 4).

After the outburst of the financial crisis in 2007, exports dropped in Europe, China, North and South America by approximately 20% (Federal Reserve Bank of Dallas, Globalization and Monetary Policy Institute, 2009, as cited by daCosta Neto and Romeu, 2011, p.3), however the drop was not exclusively due to systemic risk, but also due to specific elements, such as export diversification, that can have a considerable effect on firm output growth, i.e. trade aggregation can mitigate or magnify the crisis effect on exports. Product diversification can mitigate the crisis repercussions, while geographical diversification has a higher probability to have a less softening effect of the crisis, because being present in numerous countries simultaneously requires too many resources and makes things even more complicated, thus financial crisis distortions are amplified. In case of product diversification, as firms were more product - diversified, they suffered more export loses after the crisis, especially when diversification was done using single products. However, product diversification in terms of commodities detained companies from being severely affected by the trade collapse after the financial crisis more than in the case of manufacturing. Diversifying across commodities helped companies after the crisis, because commodity trading is not as cyclical as manufacturing (da Costa Neto and Romeu, 2011, p. 13).

4. Region

One of the most used classifications of regional divisions in literature is the “Triad” : U.S, Europe, and Japan (Ohmae 1985, Rugman Verbeke, 2004, 2004, 2008; Rugman, Oh 2009, 2012, 2013; Oh et al., 2014). The mentioned authors who are using this classification method when testing for diversification also state that focusing on the home region when diversifying brings companies more benefits than trying to expand globally (also confirmed by Dunning, 1998, p. 60; Hennart, 2007, p. 445), and that there are very few large multinationals that diversify across all three regions. Some studies find that the 500 largest MNEs from the Fortune Global 500 do not actually operate globally, although it is widely considered that MNEs are the main creators and triggers of globalization. These MNEs are mostly active in their home region, with a lesser

focus on a second region from the Triad and, in few cases, present in all three regions of the Triad (Rugman, Verbeke, 2004, p. 36; Rugman, Oh, 2010, p. 486; Oh et al., 2014, p.4).

Another classification of regions that has often been used in the literature is inter – vs intra – regions (Rugman, Verbeke, 2008; Rugman, Oh, 2009; Oh, Contractor, 2014; Qian et al, 2008, 2012; Volkov, Smith, 2014). The intra – regional scope is composed by a firm's home region and refers to markets that are close to that firm's domestic country. When diversifying within the home region, all distance dimensions are reduced: there are common business practices between countries; similar institutional and legal frameworks, which enables a less challenging market entry and transfer of skills and knowledge; low cultural distance; and a low physical distance, which reduces costs of logistics (transport, processes etc.). As a consequence, companies are incentivized to have their main focus on the home region and, even if they also want to expand beyond the home region, to begin expansion by firstly diversifying intra – regionally. Intra-regional diversification involves an easy learning process and existing operations of a company can be used in their exact form in other countries of the home region in their exact same form, or with minor adjustments (Oh et al., 2014, p. 5). Performance of multinational companies is mostly increased when a firm is active within the home region, because it can reach economies of scale and scope faster than outside the home region. The speed of achieving these economies is also increased or decreased by the amount of adjustments required to fit the distance (economic, political, geographic, institutional), i.e. a company diversifying in the home region can reap the benefits of economies of scale and scope faster, as the amount of adjustments needed is lower (Hennart, 2007, p. 431).

The inter – regional diversification implies an expansion that goes beyond the home region, facing a higher cultural and institutional distance, with significant resources that are required to be invested, adaptation to more stringent government regulation and higher costs of coordination and control (Oh et al., 2014, p.1). Environmental complexity is lower for intra - than inter - regional expansion, due to adaptation costs; operating in similar and proximate countries of the home region is less resourceful and less costly (Verbeke et al., 2009, p. 149). Therefore, there is a stronger incentive to focus on and start through diversification within the home markets, because, along with complexity and cost reduction, there is also a higher possible performance. When choosing between intra – and inter – regional diversification, companies should consider the fact that evidence shows that the performance measured as company market value relative to

its replacement costs is enhanced when internationalization focus is on the intra - region, rather than on the global one (Rugman, Oh, 2010, p. 485), because of familiarity, common set of practices, similar cultures and lower costs. However, if a firm is powerful in terms of performance, resources, management etc., the most benefits it can achieve is by diversifying globally⁷, in both inter – and intra – regional markets and also the third region of the Triad, although such companies are not extremely numerous (e.g. Walmart, Royal Dutch Shell etc.)

Also in the context of regional and global diversification, the upstream (production) – downstream (sales) diversification approaches have been discussed based on firm specific characteristics. It has been stated that the upstream approach in terms of firm specific advantages refers to the capability of selecting locations where these advantages can be easily used with the location specific advantages of the host region and where no significant adjustments need to be made (Rugman, Verbeke, 2008, p. 311). Downstream requires more adjustments, but, even though this kind of adaptation is often viewed as a remedy in overcoming the challenged posed by entering international markets, multinational firms prefer to focus on market similarities, especially when it comes to the home region. However, when wanting to exploit regions across the home market, this value adding through exploitation of market similarities is not effortless; but it is this type of challenge that represents the main source of adding value, namely dealing with and profiting from such regional dissimilarities, and a successful integration requires the process of combining upstream firm specific abilities developed at home with the advantages that the host market is offering (Rugman, Verbeke, 2004, p. 17). Therefore a combination of the two approaches, up – and downstream, can bring improved outcomes. Diversification in the home region is facilitated by market resemblances, and can help a firm increase its strength and develop specific abilities that differentiates it from the competition, but, with the suitable adjustments and the right strategy to tackle upon dissimilarities, the firm can add significant extra value.

Diversification has been considered not only in developed, but also in emerging markets. For instance, studies on companies from emerging countries find that diversification in this case is most of all stimulated by managerial experience (Sahaym, Nam, 2012, p. 421).

⁷ Source: Fortune Global 500

5. Country

The country effect also plays a role and is being controlled for when testing diversification. One of the incentives for a firm to diversify is the home market becoming saturated (Geringer et al., 1989, p. 8; Kogut et al., 2002, p. 163). Size is also relevant: when the home country has a small size, it is more likely that opportunities for firms are going to deplete faster, hence firms are stimulated to go abroad and diversify internationally in order to benefit from more growth; if the domestic market is large, there is a great advantage of reaching considerable economies of scale and scope through diversification, but this requires significant investments and costs, therefore a large home country market is not easily manageable, also because it is more likely that competition in such a market is intense. However, it is also possible for local firms to have advantages compared to new market entrants in some cases, because incumbent companies are “at home”, they possess better market knowledge and can easily overcome all culture and language barriers, therefore home market diversification is stimulated. Nevertheless, this does not mean that product or international diversification of companies in foreign countries is discouraged, as firms that possess the necessary resources and capabilities can successfully diversify both domestically and abroad.

As country distance and differences can impact the incentive to change the diversification level and its effect on performance. There are views claiming that country specificities are the main triggers of diversification strategy (Li, Yue, 2008, p. 667). Firms take abroad what they develop home, but their competence is actually a reflection of resources and support from institutions in their domestic markets, or in the countries they want to entry. Based on the RBV, company resources and abilities are not only an internal, but also an external reflection, namely of the home and host country environment, in terms of institutional and legal framework (Kogut et al., 2002, p. 163).

Most companies choose to diversify, at least at first, in the neighbouring countries. However, in such cases, not all diversification theories hold. The transaction cost theory⁸ does not apply, for example, when a firm desires to diversify in a similar country. For instance, in Europe, markets are similar, there is a narrow geographical and cultural distance, therefore the height of the cost level in case a company pursues a highly geographically-diversified strategy is not as

⁸ Transaction cost theory: “make versus buy”, i.e. weighing the costs of performing activities in – house versus outsourcing to external market providers

pronounced as in the case of, for instance, U.S. (Capar, Kotabe, 2003, p. 353). Nevertheless, U.S. firms can benefit more from international diversification than non - U.S. firms due to the fact that in the U.S., service firms, for example, began to internationally diversify faster and hence already reached a more advanced state (Contractor et al., 2003, p. 16).

Among the specific country factors that can influence diversification, the strongest effect is the one of the institutional framework. Institutional support of a country, not only the internal, but also the external, is relevant for a firm's performance. Market liberalization, and skilled human capital leads to positive stimulation of international diversification. The institutional framework has a very strong influence; when a country's conditions are not optimal in terms of regulation, financial institutions, skilled workforce etc, there is a negative effect on incentivizing enterprises to internationally diversify (Sahaym, Nam, 2012, p. 424). Institutional structure of a company's country of origin (capital markets, financial intermediaries, skilled labour) has a considerable effect on the internal and external competitive advantage of a firm (Bobillo et al., 2010, p. 607). In other words, when a country is offering institutional support in terms of advantageous access to capital markets and is providing attractive conditions for skilled labor, it stimulates companies into diversifying by better exploiting their competitive advantages. When it comes to differentiating among countries after their reliance on competitive advantages, evidence shows that Spain is among the countries that rely more on the external capabilities (orientation towards market, networks), France emphasizes internal capabilities (managerial competence, intangibles, company culture), while Germany, UK and Denmark commit to both types of competitive advantages.

The legal frameworks of countries are typically divided into common and civil law⁹. Civil law countries (most of the continental Europe, Asia, South America etc.) are organized according to codes and laws and have a government dominance; it is more costly to obtain external capital in such countries, but this can be overcome through diversification by internal capital markets of companies. On the other hand, common law nations (US, UK, Canada, Australia etc.) involve more private contracts, more support regarding the financial framework and a stronger protection of stockholders and creditors.

⁹ Source: International Network to Promote the Rule of Law, Common Law and Civil Law Traditions, 2012: <http://www2.fjc.gov/sites/default/files/2015/Common%20and%20Civil%20Law%20Traditions.pdf>

Diversification in common law countries lacks the benefits of the internal capital markets. Companies from common law countries do not benefit from the internal capital market, which is set by firms from civil law nations, but, on the other hand, in civil countries, due to internal capital markets, firms are more incentivized to diversify, in order to surmount the obstacles of less investor protection and a more difficult access to capital market. Firms from civil law countries companies are more likely to opt for diversification (Li, Yue, 2008, p. 681), because in common law countries, everything is “at home” already. All the resources can be exploited domestically and firm do not need to expand abroad to benefit from a better legal framework or more investor rights.

7. Firm Characteristics

7.1. Resources

Firms need resources to diversify. Financial resources (e.g. FCFs) are the most suitable for diversification; tangible assets can be used most properly deployed for related product diversification, but intangible resources (core capabilities) stimulate diversification even more. Of these categories, financial resources enjoy the highest liquidity and ease of deployment (Hoskisson and Hitt, 1990, p. 464). The more resources available, the higher the willingness to diversify, but the strongest impact of the three types of resources is the one of the financial ones, as they are the most flexible.

7.2. Internal and External Incentives

One of the classifications of firm characteristics includes its internal and external abilities. Based on the resource – based view, namely on the internal capabilities that can create a competitive advantage through, for instance, investments in intangible assets, the internal competence of a company evolves around its innovation capacity, skilled staff, corporate culture and working style. Other internal motives to diversify appear after a company registers low performance (Burgers et al., 2009, p. 370); also, if a firm is facing future cash-flow uncertainty, this can also stimulate a company to diversify. Regarding demand and supply fluctuation risks, hedging through diversification can also provide the necessary incentives to engage in an

unrelated product diversification, but this argument is contradicted in the literature. Diversification with the aim of pure risk reduction is not efficient on its own, without strategic controls. During downturns, unrelated firms are more challenging than related or single businesses, because unrelated diversification increases systematic risk (Lubatkin, Rogers, 1989).

On the other hand, there are also external incentives to diversify. When companies opt for diversification is likely a reaction to exogenous changes in the firm (Campa, Kedia, 2000, p. 18). Other firm – related incentives to diversify, such as external competitive advantages, are due to the effectiveness of the cost structure and on the market orientation. It is crucial for a company to be able to obtain information from social networking and from establishing corporate partnerships (Bobillo et al., 2010, p. 608).

These characteristics, regardless of being endogenous (internal capabilities) or exogenous (external competitive advantage), are influenced by the institutional framework. A firm's success is not exclusively determined by its resources and capabilities, but also by the external environment and the institutional support it can receive. International diversification is incentivized, among others, by the institutional framework of a country, for the reason that institutional factors can improve the balance between internal and external competitive advantages and aid a company in improving performance, as achievement is strongly linked to making use of firm specificities. The institutional framework of a country (legal, political, economic, and social rules) influences the market and can support it by creating a setting such that transactions are not very costly or risky. By formulating and implementing the laws in a way that is favorable for country and its market players, institutional elements help the economy and also the firms in their attempts to gain competitive advantages both domestically and in foreign countries.

Supportive institutional factors can provide skilled human capital which is essential for a firm, as deployment of resources and strategies depends on the experience and capabilities of the personnel. A well-trained, competitive workforce complements a globally and technologically experienced management are the ingredients for a firm's well-functioning and potential performance. Hence, diversification is attractive for multinationals when they are "equipped" this way and it is incentivized when the institutional framework is providing valuable human capital that strengthens internal capabilities (Sahaym, Nam, 2012, p. 426).

The degree of internationalization (DOI) is derived from relying both on internal and external capabilities, in order to achieve a competitive position that can be supported by institutional factors: skilled human capital - for strengthening the internal competence) and a suitable financial framework - capital markets, relation to banks etc, for improving the external abilities (Bobillo et al., 2010, p. 610). The international diversification strategy must take into account the institutional framework of the host country, in order to be able to fully benefit from the external and internal comp.adv. Also, policy makers should provide support by applying appropriate reforms after an in-depth understanding of the country institutional structure, so that firms can make better use of their characteristics and core capabilities and strengthen their competitive advantage.

Other views suggest that endogenous characteristics of the firm, such as intangible assets, lead to companies choosing a related diversification, while a higher liquidity (internal funds, unused debt) is more likely to be associated with an unrelated diversification (Chatterjee, Wernerfelt, 1991, p. 35).

7.3. Internal Capital Market

Another firm characteristic which has an internal nature and is related to the institutional framework is the internal allocation of capital and the broader access to capital markets due to diversification (Volkov, Smith, 2014, p. 162). Undiversified firms have access only to external funding, which cost more than internal funds. On the other hand, diversified companies can have access to both external and internal funding, i.e. attracting debt from the outside, but also allocating capital internally, by shifting funds across their business scope. This permits a more efficient and less costly capital distribution (Palich et al., 2000, p. 157). This advantage of diversification permits a company to make use of capital even when the domestic market is constrained or does not have such a favorable institutional framework, by using access to capital in other markets in which it is active.

Even in times of economic downturns, the value of a diversified firm is higher, due to its facilitated ability to use broader capital markets for financing and because it is more likely that it will choose which projects are more valuable to fund and allocate capital internally in a more efficient way (Volkov, Smith, 2014, p. 173). Internal capital market is an incentive that can help firms from civil law countries overcome the difficulties of obtaining funding from external

capital markets. Companies from common law countries do not enjoy this advantage when it comes to diversification, therefore due to the advantage of creating an internal capital market; firms from civil law nations tend to have a higher degree of international diversification (Li, Yue, 2008, p. 673).

7.4. Size

Size, although not heavily researched as one of the main characteristics of a firm when diversifying, also plays a role. There is a tendency towards the belief that smaller companies that engage in diversification can perform well mostly in the stages of early internationalization, while the large multinationals that are diversifying increase their performance levels at more advanced stages, because they pursue a more challenging and a more complex diversification that is very costly and resourceful in the beginning. Large firms dispose of more profits and resources and they also allocate larger amounts of internal capital, but small firms have the advantage of growth opportunities. (Villas – Boas, Suarez – Gonzales, 2007, p. 17 – 18).

8. Management

A successful strategy is created and pursued by both material resources and experienced personnel that can manage the decision making process, but, of these two, management team and capabilities are worth more, cannot be easily imitated and have a crucial influence on the optimal diversification strategy in terms of performance (Geringer et al., 1989, Koskisson, Hitt, 1990, Hitt et al., 1997, Sahaym, Nam, 2012). Global experience of managers is a valuable capability that influences the decision of firms from emerging countries to internationally diversify if this is also supported by institutional elements. This prior international experience of managers, combined with well trained teams, are necessary conditions for being able to create and implement learning and knowledge from being exposed to new countries, information assimilation and access to new resources. When managers are experienced, they can successfully work with new technologies, experiment and recombine resources in more advanced international contexts.

Over time, managers learn more and assimilate both tacit and explicit knowledge related to diversification. This enables them to rearrange information and strategies with existing

businesses and target everything to other markets through diversification. Top management teams can successfully deal with heterogeneous markets, with cultural, institutional and economic differences to their home market, through the inherited knowledge and capabilities developed through experience due to diversification. Knowledge and learning are used by managers and their teams to tackle with complex problems such as leveraging resources abroad, implement control and growth strategies etc. and turn such challenges into opportunities. This experience also increases networking, due to access to social capital acquired through top management team staff and contacts from abroad. A well-experienced manager, with a valuable team, can overcome the complexities that arise through international diversification, its uncertainties and difficulties (Sahaym, Nam, 2012, p. 424).

International experience of managers also gives them the opportunity to access the latest and most advanced technologies by licensing from firms in developed countries, enhancing their experience with such technologies. Only experienced managers have such access and the opportunity not only to gain from innovation and progress, but also from spillover effects that can happen between the units. This is another motivation for enterprises to expand abroad, as international and technological experience of management form a double incentive to internationally diversify (Sahaym, Nam, 2012, p. 425). Experience with advanced technologies involve opportunities to increase learning, knowledge, while managerial capabilities allows reconfiguration and adjustments of these technologies for the firm, in order to be competitive and successfully expand abroad in order to gain more.

Another context in which executive control plays a compelling role in choosing and coordinating the diversification strategy is in times of disruptive shifts to the market. Valuable managerial skills are necessary in adapting a company's strategy in both convergent contexts, when the adjustments to be made are cumulative and continuous, as well as in reorientative settings, when the necessary adjustments that a firm should make are more sudden and more substantial (Tushman, Romanelli, 1985, p. 215). Therefore diversification can be regarded two-fold from a managerial perspective when the market conditions change due to either incremental alteration or shocks: on one hand, when the firm already is diversified and has a certain degree of experience, diversification is a tool which, with the appropriate adjustments, can benefit the firm in the long-run; on the other hand, if the firm is not yet diversified, diversification can be an initiation by executives as reaction to disruptive changes. The aim is improving performance if

the business environment requires such a reorientation or if the company has suffered losses due to market disruptions.

In imperfect markets, managerial motives to diversify play one of the most significant roles (Hoskisson, Hitt, 1990, p. 484). When managers have more room to expand strategies and can exercise a greater influence on decisions (compared to a perfect market setting), strategies become more heterogeneous and diversification gains in importance. Performance varies more than under relative market conditions, depending on the chosen strategy, therefore managers are stimulated to diversify. In such a market, the managerial decision power is one of the key factors that can explain performance (Hoskisson, Hitt, 1990, p. 471).

8.1. Managerial incentives to diversify and governance

Risk reduction regarding keeping manager's position (as firms become more and more diversified, so does the level of complexity; therefore a manager that pursued this strategy in the first place is not so easily replaced by another manager that can continue dealing with such complexities) and higher compensation levels due to higher size ("empire building") are the main motives that drive managers to opt for or modify the diversification degree of a company. It is highly likely that diversification is mostly a result of managerial motives (Grant, Thomas, 1988; Hoskisson, Hitt, 1990; Best et al., 2004; Duchin, Sosyura 2013). However, governance that can arise through diversification can keep managerial incentives to excessively diversify under control. In the context of diversification and agency costs, other views state that when firms choose to remain diversified although an increase in focus on specific segments would bring more value; this is due to agency problems. Diversification per se does not reduce firm value due to agency problems, but rather does not bring the same value as it did in the beginning (Denis et al., 1997, p. 25).

In case of imperfect markets, there are agency costs between the principal (owner) and agent (manager), due to the possibility of self-interest of the managers, which is not aligned with the interest of the shareholders. According to the agency view, diversification is due to managers following their own self interests, wanting growth for the sake of growth and their own power. As governance mechanisms are also imperfect, this creates personal incentives for managers to diversify, with the aim of decreasing the risk of losing their position and for increasing compensation. Another issue that arises in the context of agency costs is the informational

asymmetry, i.e. one party holding or having access to more information as the other party or parties involved. Higher levels of information asymmetry lead to a reduced value of diversified firms (Best et al., 2004, p. 235). In an imperfect market, this can be overcome through a proper degree of fitness between executive characteristics and strategy. Managerial decisions and alignment of interests between the principal and the agent can be at least partially solved by diversification acting as a governance tool (Hoskisson and Hitt, 1990, p. 485).

Regarding board composition, it is likely that managers get to control the board, through personal ties; hence directorship should only or mostly be meant for entities coming from outside the firm. Otherwise, connections fueled by favoritism are negatively connected to investment efficiency and firm value (Duchin, Sosyura, 2013, p. 23). However, this involves a risk aversion trade-off, as directors from the outside focus on financial outcomes, rather than strategic controls. On the other hand, diversification involves strategic controls as opposed to financial controls. When financial controls are emphasized, this can lead to reduced shareholder value over the long term, because the firm is not concentrating on expanding and gaining more, but rather on short – term earnings.

Moreover, if shareholder concentration is low, with many shareholders owning small amounts, monitoring is not efficient, hence managers could be prone to overdiversify, and overdiversification hinders performance. A high shareholder concentration means a better alignment of interests. Unrelated product diversification usually involves more firm directors coming from outside and a more dispersed ownership than related businesses, and hence higher agency costs.

Other authors consider ownership also from a managerial point of view. Diversification and equity ownership of managers are negatively related, i.e. a high degree of diversification means that the manager is not involved in the ownership of a company, while focusing on specific segments in the detriment of diversification is rather a result of a high managerial equity ownership (Denis et al., 1997, p. 27).

As for the executive compensation, the alignment of interests between the manager and the owners can also be done by directly involving managers into ownership. This way, the gap between managers – shareholders becomes narrower, because managers do not have a self-interest anymore as they are also among the shareholders. However, there is also the risk of focusing more on short-term objectives than long-run performance, as this would mean larger

bonuses, but if managerial compensation is directly related to the outcome of the firm, this can best motivate managers to perform efficiently (e.g. a share-based compensation is an incentive to find and implement best strategic decisions in order to increase share value and involves a long-term commitment of management). Long-term focus has a downside as well, namely long-term risk exposure, making managers more risk averse, pursuing less strategies and expansions. When performance is not at desired levels, this could involve a takeover threat, a golden parachute, a voluntary restructuring etc. This increases replacement risk for managers if they overdiversify or diversify inefficiently and the firm underperforms. Therefore, external governance acts as a disincentive to diversify purely out of reasons such as empire-building that can increase compensation based on size and investment activities, rather than performance outcomes.

Managers have own reasons to diversify, but corporate controls can attenuate this. Internal and market governance can reduce opportunism, nevertheless, they can also increase risk aversion of management by shifting the focus on financial controls, leading to strategic controls, innovation and growth opportunities being hindered (Hoskisson and Hitt, 1990, p. 491). A high level of governance decreases diversification, as any assumptions or expectations of either financial distress or changes in the managerial positions determines managers to act with much more precaution, avoiding diversification (Denis et al., 1997, p. 23), which involves a higher degree of risk. This risk aversion increases even when a firm performs well. As firms are performing better, managers are less willing to take risks and thus are also less willing to engage the company in investments based on strategic controls, which also imply a certain degree of risk (Hitt et al., 1991, p. 703). Therefore, diversification as a governance tool should not be used excessively.

Chapter II: Product and International Diversification

1.1. Product and International Diversification

Diversification can bring many opportunities: access to new information and resources (location – specific advantages, e.g. cheap labor costs, facility of access to capital markets and lower costs of capital); economies of scale (reduced unit production costs by spreading expenses across a larger output); economies of scope (using same inputs, costs of extending production to more segments is more favorable than concentrating on only one product/market); learning opportunities that develop the firm's abilities and managerial skills and help firms in dealing with higher complexities and periods of economic downturns or market shocks; higher market share and bargaining power; transfer of knowledge between units; shifting of assets in countries where taxation is lower; reduced risk; balancing out supply and demand fluctuations; using revenues from other units or scopes as buffers for losses; overcoming domestic saturation and lack of growth opportunities; (Hitt et al., 1991, 1994, 1997; Kim et al., 1989, 1993; Grant, Thomas, 1988; Tallman, Li, 1996, 2011; Vilas – Boas, Suarez – Gonzalez, 2007; Bowen et al., 2014; Chang, Wang, 2006; Boehe, Jimenez, 2016; Geringer et al., 1989; Li, Yue, 2008; Hennart, 2007; Capar, Kotabe, 2003; Kogut et al., 2002; Hann et al., 2012; Berger, Ofek, 1995; Bobillo et al., 2010; Volkov, Smith, 2014; Oh et al., 2014).

On the other hand, diversification also comes with costs, namely adjustments costs, coordination, control, monitoring, complexity, costs of overcoming dissimilarities between markets and countries, distance (economic, political, cultural, physical), complying with foreign institutional factors, physical infrastructure costs (setting up subsidiaries, logistics, infrastructure, etc.), agency costs, informational asymmetries (Geringer et al., 1989; Kim et al., 1993; Hoskisson, Hitt, 1990; Grant, Thomas, 1988; Tallman, Li, 1996; Vilas – Boas, Suarez – Gonzalez, 2007; Chang, Wang, 2006; Volkov, Smith, 2014; Rugman, Verbeke, 2009; Bobillo et al., 2010; Bowen et al., 2014; Kumar, 2009; Capar, Kotabe, 2003; Boehe, Jimenez, 2016; Lu, Beamish, 2004; Contractor et al., 2003; Duchin, Sosyura 2013; Best et al., 2004, Oh et al., 2014).

In order to be able to answer the question whether and why companies lean more towards a certain type and level of diversification when selecting a new strategy or modifying a current

one, various angles are to be considered: product, international, or a combination of the two¹⁰. The proposals towards one diversification strategy or the other, or a mix of product and geographic diversification, is in this case derived from the impact that diversification has on performance or on other elements that build a company's competitive advantage and have a contribution to performance (for example, R&D and innovation or the risk – return profile).

Some authors are in favor of product diversification (Geringer et al., 1989; Rumelt 1974; Keats, Hitt 1988; Page et al. 1988; Robins, Wiersema 1995; Wan 1998; Campa, Kedia 2002; Morck and Yeung 2003; Villalonga 2004; Miller 2006); while others find mixed results, namely that product diversification is beneficial for small to moderate levels (Hoskisson, Hitt, 1990, 1991; Hitt et al., 1997; Christensen, Montgomery, 1981; Robins, Wiersema 2003; daCosta, Romeu, 2011; Palich et al., 2000): when differentiating between the related and unrelated product diversification, most studies are in favor of a related product diversification leading to better performances (Rumelt 1974, 1982,; Palepu 1985; Ramanujam, Varadarajan 1989; Wernerfelt, Montgomery 1986; Hoskisson, 1987; Geringer et al. 1989; Berger, Ofek 1995; Chang 1996; Tallman, Li 1996; Miller 2006; daCosta, Romeu, 2011; Delios, Beamish 1999; Palich et al., 2000); but there are also authors according to whom unrelated diversification can bring more benefits (Hitt, Ireland 1986; Hitt et al., 1997; Lubatkin, 1987); the majority of the authors are in favor of international diversification up to a certain threshold, claiming that product diversification brings less benefits to performance (Kim, et al., 1989, 1993; Grant, Thomas, 1988; Bartlett Goshal 1989; Delios, Beamish 1999; Zahra, Hitt, 2000; Tongli et al., 2005; Berger, Ofek, 1995; Lang, Stulz, 1994; Wernerfelt, Montgomery, 1988; Hoskisson et al. 1994; Hitt et al. 1997; Denis et al. 1997; Rajan et al., 2000; Lu, Beamish, 2004; Vilas-Boas, Suarez – Gonzales, 2007; Tongli et al., 2005; Geringer et al., 1989; Hitt et al., 1997; Tallman, Li, 2011; Capar Kotabe, 2003; Contractor et al., 2003; Contractor, Kundu, 2003; Volkov, Smith, 2014; Rugman, Verbeke 2004; Rugman, Oh 2009; Lu, Beamish 2004; Li, 2005; Boehe, Jimenez 2016; Alexander, Myers 2000; Dawson 2001, Palich et al., 2000).

A combination of both international and geographic diversification has also been asserted (Hitt et al., 1997; Vilas – Boas, Suarez – Gonzalez, 2007; Oh et al., 2014; Lu, Beamish, 2004; Bobillo et al., 2010; Li, Yue, 2008; Bowen, Wiersema, 2007; Kumar, 2009; Meyer, 2006; Thomas, 2004; Bowen, Wiersema 2007; Davies et al., 2001; Denis et al., 2002; Hitt et al., 1997;

¹⁰ See Appendix I

Kim, et al., 1989; Barkema, Vermeulen, 2001; Mayer et al., 2014; Zahra et al., 2000; Delios, Beamish, 1999). It is usually believed that there is a positive interaction between international, product diversification and performance (Tallman, Li, 1996; Hitt et al., 1994; Chang, Wang, 2006). In other words, when firms use both diversification types, it can reap even more benefits. However, it can be that one of the strategies receives more focus than the other, depending on certain factor and incentives that have been outlined in the first section. The second section gives more insight into the relation between the two strategies, whether there should be a trade – off between them, their moderating effects and relation to performance. Product diversification involves the shift from a single unit to a multidivisional, decentralized structure. In earlier stages of product diversification, there is emphasis on relatedness, with the aim of capturing synergies. According to the RBV, resources and practices employed in product diversification can also be replicated and adjusted for international diversification, as an integration of both diversifying strategies can better exploit business interconnections of a firm. Related product diversification is one of the contributors to better profits and potential growth opportunities; unrelated product diversification can also be useful for decreasing risk, by using some markets as “buffers” for the businesses or segments which are not producing desired outcomes or are facing difficulties. Moreover, transferring and allocating different resources enable hard-to-imitate complementarities and hence higher returns.

The arguments for choosing both an international and a product diversification are concerning the synergies created and the learning effect that helps one dimension deal with the costs on the other (Bowen et al., 2014, p. 10). International diversification paired with related or unrelated product diversification has different effects on performance. Product in combination with international diversification enables inter-division knowledge learning: related product diversification is more efficient, as it involves shared understanding among divisions, therefore learning across business permits replicating capabilities when going abroad. However, unrelated markets also have embedded the opportunity to tackle with new knowledge, improving learning, but when differences are too large, this is not the case (technological and organizational dissimilarities distort performance). Product diversified firms that want to internationally diversify deal with increased knowledge transfer difficulties; therefore related diversification has the advantage of being able to better leverage firm capabilities for foreign expansion compared to unrelated diversification.

There are greater synergies that can be achieved by using geographic diversification and both types product diversification (related and unrelated), as joint output is greater than one single product diversification strategy. Related diversification has the advantage of scale and scope economies: shared inputs, higher and more diverse outputs, lower costs; in combination with international diversification, related products generate synergies through shared fixed assets. International and unrelated product diversification can lead to economies of scope through shared marketing and IT knowledge. Unrelated markets also mean an increased customer base. Both related and unrelated product diversification strategies can create synergies and positively moderate the international diversification – performance relation.

International and product diversification combined can involve a higher complexity and hence the need for more stringent internal control mechanisms, in order to be able to handle transactions and business between the headquarters and each unit or subsidiary. Unrelated product diversification poses more difficulty related to strategic controls, due to higher diversity than related businesses. There is more emphasis on short term earnings due to financial control, at the cost of long term investments in R&D. Financial control has a negative effect on R&D expenditures, which can contribute to a long – term competitive advantage and performance in the long – run. Related product diversifiers register lower asymmetries, less costs and more focus on strategic control and long-run investments. Unrelated product diversification is less permissive for internationally diversified firms than related product diversification.

There is also the need for higher adjustments of the internal setting with the external environment. International expansion involves a great deal of complexity, therefore internal and external frameworks must be matched, in order not to hinder performance. Related product diversification deals with similarities in supplies, customers, competition, so this high symmetry makes it easy to adjust among business lines/divisions. Unrelated product diversification, on the other hand, involves diversity, different customer preferences, so that the degree of fitness between the internal and the external environment is lower and costlier. Costs of adjustments are higher for unrelated than for related product diversification.

A joint diversification strategy also leads to higher governance costs. Unrelated diversification implies more transaction costs, especially when paired with international diversification. Sometimes, these governance costs can be so high, that they exceed benefits. However, others argue that unrelated product diversification implies lower governance costs,

because monitoring and control is rather concentrated on the related businesses. This is contradicted by the fact that related businesses are not challenging in terms of coordination and governance. However, there are some governance costs for related product diversification as well.

Even though a combination between international and product diversification also involves costs, it is a firm to differentiate itself from the competition not only by improved and more diverse products, but also through lower costs (Hitt et al., 1997; Tallman, Li, 1996; Hitt et al., 1994; Chang, Wang, 2006; Davies et al., 2001; Denis et al., 2002; Hitt et al., 1997; Kim, et al., 1989; Mayer et al., 2014; Zahra et al., 2000, Stephan, 2002; Bowen et al., 2014).

1.2. Substitutes or Complements?

Product and international diversification are interdependent strategies, both implying investment commitment, leverage, resources employed into new geographic and product scopes and both adding to the complexity that a firm has to manage (Bowen, Wiersema, 2007; Kumar, 2009; Meyer, 2006; Penrose, 1959 as cited by Pitelis, 2009; Teece, 1982; Thomas, Eden, 2004).

When testing for the relationship between product and international diversification as having a substitute or complementary nature, results are mixed.

The substitute relation view states that product and international diversification decisions are taken simultaneously and as a result of changing conditions within the business environment. Authors who claim that product and international diversification are substitutes, because the firm needs to do a trade – off (Kumar, 2009, p.108; Bowen, Wiersema 2007, p.26) between the two approaches base their argument on the transaction cost theory: a higher expansion and a broader scope involves more control and coordination costs, hence the firm cannot increase a certain diversification dimension without reducing the other dimension (Bowen et al., 2014, p. 33). A joint product and international diversification that leads to these costs affects performance, in the sense that product diversification limits geographic diversification and vice – versa. Although expanding along both magnitudes of international and product diversification brings benefits, short-run difficulties that arise create a necessary trade-off and a negative link between the two strategies. The decision to diversify should be based on available resources (endogenously) and interdependently instead of independently. There is negative growth associated with the two simultaneous strategies: growth along product diversification is negatively associated to growth

along international diversification, because economies of scope are offset by constraints (tacit knowledge transfer) (Kumar, 2009, p. 113).

The complementarity view (Davies et al., 2001, Denis et al., 2002; Hitt et al., 1997, Kim, et al., 1989) is derived from the resource-based theory. By not making use of all unique resources that create competitive advantages, managers have incentives to leverage excess resources into new markets and hence diversify. Firms operation in more geographic and product markets increase knowledge and gain greater capabilities (Hitt et al. 1997, Barkema, Vermeulen, 2001, Mayer et al., 2014, Zahra et al., 2000), hence, when a firm is considering pursuing an increased product diversification range, it is more likely that it is also going to increase the degree of its geographical diversification (Bowen et al., 2014, p. 33).

Other findings suggest that the relation is of substitution for low diversification levels, namely when firms begin diversifying and do not yet have the necessary experience to manage this strategy in more depth; as firms advance in their diversification intensity, increase learning and have more experience, the relation becomes complementary (Mayer et al., 2014, p 14).

Product and international diversification are interdependent decisions and rather complementary strategies: expansion within one scope is not limited by the other scope (Bowen et al., 2014, p. 34), because the experience accumulated while diversifying in both directions brings more benefits than a trade – off between the two. The two approaches are complementarity strategies in achieving growth and development and resources employed can be shared, i.e. capabilities and investments used in pursuing or increasing product diversification can also be used for a geographic expansion and vice versa. Based on the RBV, a combined, complementary diversification strategy permit firms to make use of interconnections between businesses and achieve economies of scope (Stephan, 2002, p. 11). Higher product or international diversification involves higher costs of coordination and control, but experience on one dimension help with the costs for the other dimension. Both product and geographic diversification are positively related to performance (Bowen et al., 2014, p. 36).

1.3. Moderating Effects

Product diversification acts as a moderator on the international diversification – performance connection, because product - diversified firms that also decide to internationally diversify can achieve better performances than international diversification firms that do not have a product variety strategy (Hitt et al., 1997, p. 775). A combination of both diversification types involves a better structure, coordination, and opportunities to achieve more managerial capabilities due to experiential learning. The moderating effect of product diversification is, in this context, a positive one. For different levels of diversification, having product diversification as a moderator, the relation between international diversification and performance is negative for firms that do not diversify, positive for firms that have a high diversification level, and curvilinear for moderate product diversification degrees (Hitt et al., 1997, p. 768). Product diversification as a moderator involves increased market share, reduced risk, and economies of scale, lower costs, and therefore a stronger competitive advantage (Vilas-Boas, Suarez – Gonzales, 2007, p. 19).

A related product diversification has an even stronger positive moderating effect than an unrelated one, the latter negatively moderating the relation between international diversification and performance (Chang, Wang, 2006, p. 61). For MNCs, related and unrelated product diversification strategies both create synergies through economies of scale and scope and both generate governance costs. However, the related product diversification involves more market similarities, knowledge, information, and an easier learning.

Product diversification can have, however, a negative moderating effect on the international diversification – innovation relation when innovation is taken into account (Hitt et al., 1997, p. 770). Internationally diversified firms employ resources for R&D and innovation in order to achieve a good competitive advantage, and also to be able to have access to new information from abroad. Hence, there is a positive relation to innovation, upon which product diversification acts as a moderator. According to the RBV, learning due to product diversification creates knowledge of management and the necessary capabilities to deal with international diversification. Based on the organizational learning theory, experience gained with product diversification gives the firm the ability to tackle the complex challenges of international diversification. Product diversification is a negative moderator of the international diversification

– performance link, because product diversification creates unfavorable conditions that prevent firms from benefiting from the resources brought by international diversification for innovation (RBV). Strategic controls (coordination and understanding between corporate and business-level managers) are replaced by financial controls, whereby business level managers do not focus on innovation, but financial results. When understanding fails, learning opportunities of int diversification are missed.

Product diversification and innovation are positive related (although some authors contradict this: there is a negative relation between product diversification and innovation - Hoskisson Hitt 1989), because as firms increase their product ranges, they also gain more knowledge and there is also a possible spillover effect among the units. However, other views claim that irregardless of the product diversification intensity, even for low levels, the effect on willingness to invest in R&D is negative. This is because product diversification shifts managerial focus from strategic controls (emphasis on R&D and investments in innovation) to financial results, due to asymmetries and failure to understand the activities of all units in different product markets. International diversification motivates firms regarding innovation, but product diversification disincentivizes them. Increased product diversification involves a higher amount of info that needs to be understood and assimilated, higher coordination, and more transactions, which reduce willingness to invest in R&D. As enhanced product diversification levels also involve more risk, reducing R&D expenditure can lower this risk. Therefore, product diversification is a negative moderator on the link between geographic diversification and innovation.

Product diversification can also have mixed effects as a moderator when taking into account the region (Oh et al., 2014, p.5). The effect is positive when the regional diversification is intra – regional, as firms can significantly improve their performance when focusing on the home region (Oh, Contractor, 2014, p. S42), due to an easier market entry and diversification process and negative for inter – regional. The inter - regional diversification can bring better outcomes when the focus of the firm is on a geographic expansion, rather than a product one, because of the involved complexity level.

International diversification can also be a moderator for product diversification, in the sense that, for product diversified firms, an international expansion can increase their benefits and performance outcomes up to a certain point (Tallman, Li, 1996, p. 191). Thus, international

diversification can act as a positive moderator on the relation between product diversification – performance (Hitt et al., 1994, p.297).

International firms can also be diversified in terms of products, such as product diversification can act as a moderator on the international diversification – performance relation. Having product diversification as a moderator, the relation between international diversification and performance is negative for firms that do not diversify, positive for firms that have a high product diversification, and curvilinear for moderate levels of product diversification¹¹. Early diversification leads to positive performance outcomes, due to economies of scale, scope, learning and knowledge effects, better performance, and the ability to maintain a stable competitive advantage. Effects become negative as international diversification intensity increases, because it becomes too difficult to handle and is also costly in terms of coordination, distribution, distance, and factors which are necessary in achieving independence of local subsidiaries abroad – investments, complying with laws and the institutional framework etc.

The product diversification level acts as a positive moderator between the international diversification - performance relation. Non-diversified firms (single business) do not profit from the benefits of international diversification, so the relation with performance is negative. Single businesses do not possess the managerial knowledge and organizational frameworks to manage complexities and information of diversification. Moderate product diversification implies related product markets, economies of scale and scope, exploited interdependencies, synergies, but the depicted relation to performance is an inverted U: continuing to internationally diversify until high levels are reached hinders performance due to complexities that cannot create the necessary opportunities in order to cover all costs (Hitt et al., 1997, p. 787).

There other elements that can have a moderating effect on the diversification – performance relationship: firm characteristics (Oh et al., 2014, p. 15-16; Lu, Beamish, 2004, p. 601), external and internal competitive advantages and institutional elements (Bobillo et al., 2010, p. 608), legal institutions (Li, Yue, 2008, p. 670).

¹¹ See Appendix 2.

Chapter III: Subsequent to Diversification – Impact and Relation to Performance

1. Impact on Performance

Regarding the general environment, in perfect markets, there are no internal, nor external motives to diversify, and industry is the main performance driver, hence there is a negative relation between diversification and performance in such a setting. In imperfect markets, however, managerial decisions has the strongest explanatory power when it comes to performance: the stronger the managerial incentives to diversify without surpassing the benefits due to incurred costs, the more a company is going to benefit in terms of performance (Hoskisson, Hitt, 1990, p. 484).

When it comes to product and international diversification and their impact on performance, there are several theories that can be related: transaction cost theory, resource – based view and organizational learning (Hitt et al., 1997, p. 768). International diversification involves making use of specific, internal capabilities, in order to be able to exploit global imperfections (according to RBV), but there are high T-costs as the diversification level increases. There is a necessary coordination for achieving economies of scope, but as complexity grows, coordination costs are too high, and costs surpass benefits. Diversification is optimal up to a certain threshold: it efficiently dealt with only as long as complexity does not become too high (Grant, Thomas, 1988, p. 9). When complexities reach significant levels, profitability registers negative impacts upon it. Firms that use both diversification strategies have a tendency to reduce their diversification degree. Although some of the most successful companies are highly diversified, there is a limit.

A profitable company has the necessary resources to dispose of for a new diversification strategy, while unrelated product diversification could be a reaction to low profits, rather than a cause (Grant, Thomas, 1988, p. 2). Thus, the relation between diversification and performance of a firm has also been regarded from the point of view of being causal: diversification can lead to improved profitability, but the link can also be inverse, namely that profitability levels can determine the direction of a company to diversify, either by incentivizing a company to opt for a

new diversification strategy, or change an already existing one. Cash - flows drive diversification, hence diversification is “supply-led” (Grant, Thomas, 1988, p. 19), as firms want to invest their earnings and seek diversification opportunities. Initial profitability can affect diversification strategies of a company, namely, when profitability is low, this positively stimulates diversification, while when there is a high profitability level, firms opt reducing diversification by focusing on specialization (Burgers et al., 2009, p. 376).

The relation between diversification and profitability is influenced by a firm’s competitive advantage, by the degree of complexity that increases proportionally with the extent of diversification, and by the causal relationship profit – diversification (Grant, Thomas, 1988, p. 4).

A company’s competitive advantage is created by diversification strategies through economies of scope or skill transferring between business areas. International diversification leads to higher profitability levels than product strategies. This can be explained by facilitation of transferring capabilities and resources between countries, rather than industries. Diversifying into related businesses has a better impact on profitability compared to unrelated businesses.

High complexity leads to high costs due to coordination, management difficulties and control, and, as a result, diversification is manageable only up to a certain point.

Another influencing and influenced element in the context of diversification is profitability. Literature generally analyzes the impact of diversification on profitability, i.e. diversification resulting in more profits, but profitability can also impact diversification in the sense diversification is created depending on the amount of earnings a firm has and invests in this strategy. Which drives what first? Product diversification changes do not significantly impact ROI variations, however, cash flow does have a positive (although not very strong) relation to diversification, therefore deployed earnings increase the diversification level.

Diversification is not a strong factor for explaining performance measured as ROI differences between firms; industry is a more powerful explanatory variable (Christensen, Montgomery, 1981, as cited by Grant, Thomas, 1988), but it has also been found that diversification is correlated to profitability. There is no considerable explanatory power regarding differences in profitability among firms and no significant differences in performance between related and unrelated diversification (Rumelt, 1976, as cited by Grant, Thomas, 1988, p.4).

Although literature has mixed views regarding which of the related or the unrelated strategies leads to better outcomes, the general belief states that related diversification is better, as firms with a higher level of interrelatedness between businesses perform better (Robins, Wiersema, 1995, p. 292), although there are also authors according to whom unrelated diversification can bring better results. Even though related diversification involves the benefits of economies of scale and skill transferring, the costs incurred in achieving these benefits might have a stronger impact than benefits. Operational relatedness, which involves economies of scope and leads to cost reduction, is offset by the coordination costs that arise at higher levels of diversification. (Grant, Thomas, 1988, p. 17).

Performance and product diversification are linked through a quadratic relation: as complexity increases, costs are greater than benefits. When international diversification, industry, size and leverage are taken into account, ROI increases as product diversification is higher, but only up to a point. As diversification increases, the strongest influence is the one of costs due to complexity and high diversity. However, there is a positive relation between diversification and profitability until a certain threshold, which is the result of economies of scope, skill transferring, or profitability that leads to investments into diversification.

The relation between international diversification and performance is not a quadratic one, but rather linear (Grant, Thomas, 1988, p. 9). International diversification has an overall positive effect on profitability compared to product diversification.

Product diversification does not lead to an increased profitability and this could question the reasons for which firms diversify. One argument could be reducing risk instead of increasing returns, but, corporate companies do not experience lower unsystematic, nor systematic risk. There are no benefits associated to diversification that cannot be increased by stockholders through diversifying their own portfolios.

Some of the reviewed literature sources claim that international diversification leads to a better profitability than product diversification. Domestic market profitability stimulates foreign expansion abroad; multinational diversification has better results in terms of profitability than product diversification. In terms of profitability, international diversification leads to better results than product diversification, because after a certain intensity is reached, product variety begins to negatively affect firm outcomes. Diversification's success is also contingent upon relatedness: it is easier to use corporate-level instead of operational relatedness, as related

diversification can lead to a better performance due to derived synergies (Singh, Montgomery, 1987,p. 384), but the view on the outcomes of related vs. unrelated diversification has not reached a generally accepted belief in the literature.

MNEs have different levels of performance, depending on strategy, namely depending on their diversification level - spectrum and product relatedness and DOI - focus on domestic market and/or abroad. What really allows firms to achieve better performance is their inimitable competitive advantage, created through managerial decisions regarding which resources to be deployed and what investments to be made. An efficient resource deployment that can lead to higher performance compared to competitors follows both types of strategy, namely product diversification and how related products are and DOI: international diversification, i.e. the active presence of companies on foreign markets in relation to the home market.

According to Wrigley (1970) and developed by Rumelt (1974) (as cited by Geringer et al. 1989, p. 110), product diversification can have four extents: single, dominant, related and unrelated¹². Using this classification, it has been stated that the dominant- and related-constrained diversification strategies can lead to highest performance of MNEs, while unrelated-passive and dominant-vertical strategies can lead to the lowest performance levels (Geringer et al, 1989, p. 111).

Instead of a product diversification, a firm can also pursue a geographic diversification strategy. The coordination of operations within different markets abroad can benefit the company through economies of scale, scope and experiential learning. As countries become more similar in terms of infrastructure, distribution, technology, going abroad is not so costly anymore and permits differentiation across a wide activity spectrum. However, a broad operation range does involve costs, especially when transferring competitive advantages and having to deal with another country's cultural, economic and legal differences; as a result, achieving a competitive advantage while at the same time facing the obstacles of not being able to completely differentiate from the competition, along with costs of coordination, is a real challenge that can negatively impact the potential benefits that can be derived from an enhanced scope that is due to diversification. Hence, the performance of MNEs is positively related to the MNE's DOI (extent of sales coming from abroad) and therefore its geographic diversification level; the degree of

¹² See Appendix 5

internationalization can, however, significantly explain the relative performance of MNEs only up to a certain level.

Therefore, diversification is a significant factor in explaining relative performance, with related diversification leading to better results of MNEs. As DOI increases, so does performance, however, only until an “internationalization threshold” (Geringer et al., 1989, p. 117). Beyond this peak, performance is negatively impacted by high DOI, due to high costs that result from adjustment, coordination, and complexities that arise once geographic diffusion is large costs that surpass benefits.

Expanding abroad implies an “internationalization threshold” (Geringer et al., 1989, as cited by Hitt et al., 1997, p. 772): as the degree of international diversification increases, so does performance, but, even though international diversification can positively impact performance, after a certain level, however, performance starts to decrease and eventually becomes negative. International diversification is crucial in achieving a competitive advantage, but it is also very challenging due to arisen complexities.

Worldwide diversity can lead to growth opportunities, internalization benefits (high levels of internal activities, efficient allocation of internal resources), economies of scale that amortize R&D expenses and achieve greater bargaining power, economies of scope, improved learning, sharing, and exploiting market imperfections and differences in terms of resources. Therefore, the benefits of internationalization are mostly derived from the RBV.

When a firm is successful domestically, it is stimulated to use its core capabilities to transcend national borders and apply its model abroad, gaining synergies from sharing resources among international activities. It can do so foremost by diversifying up to a moderate level, where multiple benefits are created for a firm and the costs and challenges can be overcome (coordination, distribution, management, different laws, exchange rate fluctuations, trade quotas, cultural and economic differences). This complex structure demands not only resources, but also processing of information by the management in order to efficiently allocate capital and resources, decide which strategy to pursue, to what level, or which strategy to modify etc. Such experiential/informational demands are more stringent when it comes to diversifying into foreign markets rather than across the product range. Due to transaction costs and higher necessary managerial commitment in terms of information assimilation and implementation, international diversification costs surpass benefits after a certain level. This precise peak of the “threshold”

mentioned by Geringer et al. (1989) is dependent on the managerial capabilities of a firm (Hitt et al, 1997, p. 773).

When integrating product and international diversification, the differences in performance of firms, are influenced related and unrelated product diversification and depend on the international diversification intensity. Corporate diversification has distinct strategic dimensions, namely product and foreign markets, being separate, but having combined effects on performance. Diversification strategies have a separate, yet joint impact on corporate performance (Kim et al., 1989, p. 45).

The effect of diversification on profit performance has been researched by either focusing on the product dimension of diversification (Rumelt 1974, Christensen Montgomery 1981, Palepu 1985, cited by Kim et al., 1989, p. 45) or on the international market dimension (Rugman 1979, as cited by Kim et al., 1989, p. 45). These two directions are not consistent from the point of view of treating them individually, because the two strategic dimensions are not to be considered separately, but analyzed together regarding their effect on performance of the profit with regard to the profitability level and the profit stability.

Profit stability can be achieved through integrated related product and international diversification, since their integration can stabilize returns. An integrated unrelated product and international diversification paves the way of a company to profit growth, because unrelatedness can be taken into consideration as a hedging measure, spreading risk across a broader portfolio of products in different markets. Most likely, this strategy can lead to favorable returns and less losses.

In a related diversification, the core skills can be easily transferred and allocated across businesses; there is a stronger competitive advantage, economies of scope, and a higher cost reduction. International diversification usually has a favorable consequence on performance, but, when size, country of origin, industry attributes are introduced, the positive effect does not have the same strength anymore (Tallman, Li, 1996, p. 191).

When the regional aspect of diversification is taken into account, the most proper way a firm can increase profitability is by the three stage internationalization process: domestic practices are taken into primary markets that are very similar, at first; then in secondary target markets; and finally in tertiary regions, having a higher economic, cultural, geographical distance. The most desirable outcomes in terms of performance is diversification in the intra – regional market,

namely in countries and markets whose dissimilarities are not very large (Oh et al., 2014, Rugman, Verbeke, 2004, 2009).

Based on their past experience, firms can apply experiential learning to diversification to make market entry in foreign country easier and less costly. There are also more synergies and potential benefits when product diversification is applied to regional markets: stronger economies of scale and scope, more efficiency when allocating resources, enhanced bargaining power and competitive advantages. However, there are also disadvantages: both types of diversification combined involve a greater amount of information that needs to be integrated, asymmetries, high costs, innovation and R&D (that are essential) are “sacrificed” out of financial considerations. Also, it is difficult to fit everything in new markets when diversifying (government regulation, infrastructure etc.) As the foreign transaction level is enhanced, so are coordination and governance costs. When there is also product diversification, everything becomes even more complex, so managerial capabilities could be surpassed

Diversification and performance is strongly impacted by the country framework, which plays a very important role. Performance depends on variations regarding the domestic market environment. The “munificent” domestic market are characterized by factors such as focus on tangibles (infrastructure, natural resources, human capital – labor) and institutions (less tangible: political – bureaucracy, legal – rules, societal – norms), therefore a country’s opportunities are composed of factors and institutions, which are sought by the firms. In countries that have a lower (Ireland, Italy, Portugal) / higher (France, Sweden, UK) munificence level, performance and product diversification levels are positively/negatively linked (Wan, Hoskisson, 2003, p. 40). In less munificent countries, product diversification strategy can create substitutes for factors and institutions that are missing (internal financial economy can at least partially cover the external capital market, through a more efficient allocation of internal funds; build facilities, subsidies, logistics – costs are spread among units).

The goal of international diversification is of strengthening the competitive position domestically and has a positive link to performance in domestic markets that are less munificent (less liberal).

1.1. Innovation and R & D

According to RBV and the organizational learning, international diversification has a positive effect on innovation (Hitt et al., 1997, p. 774), as increased global competition requires more attention given to R&D and innovations in order to be competitive. Product developments are required by customers in order to achieve satisfaction and loyalty, but there are high necessary investments in achieving this. Worldwide diversification allows access to more resources, information, ideas and hence easier achievement of innovation due to increased learning (organizational knowledge theory). Investments in R&D and innovation create valuable resources and capabilities for the firm, and strengthen the competitive position and performance in the long term. International diversity incentivizes investment in R&D and innovation, in order to achieve higher returns and resist competition; therefore it has a positive effect on the innovation grade.

International diversification is therefore strongly and positively related to R&D as source of intangible value (Morck, Yeung, 1999, p. 21), since geographically diversified companies are also more innovative; however, product diversification effects are negative, namely that when an international diversified firm is also deploying product diversification, this is going to negatively affect the R&D levels. Therefore a trade-off between the two dimensions of product and international diversification is necessary (Kumar, 2009, p.102), otherwise innovation, R&D and the long-term competitive position are affected. As international competition grows, firms have to come up with new and more creative strategies in order to maintain their competitive advantage: innovation and R&D are essential, shifting focus on product and process development. R&D is important for companies in helping them achieve and maintain a competitive position, therefore product diversification can negatively moderate performance on the long run if the company is not investing or is investing less in innovation, especially for industries that require high degrees of innovation (Hitt et al, 1997, p. 791).

Other studies find that international diversification has a positive effect on firm performance also when IT investments are considered. Diversified firms that place a great value on IT investments significantly outperform diversified firms that invest in IT only moderately or at low levels (Chari et al., 2007, p. 194).

Product diversification, on the other hand, is a negative moderator of the international diversification – performance link, because product diversification creates conditions that prevent firms from benefiting from the resources brought by international diversification in terms of innovation (Hitt et al., 1997, p. 770). Strategic controls (innovation, coordination, and understanding between corporate and business-level managers) are replaced by financial controls, whereby business level managers do not focus on innovation and outcomes on the long run, but on financial results and short – term earnings. When the desire to innovate and the deep understanding and inter – relatedness between business units fail, learning opportunities and R&D benefits of international diversification are distorted. Therefore, product diversification can have a negative impact on performance, especially for firms that need a long – term competitive advantage sustained by R&D, in innovation – intensive industries.

A geographic variety motivates firms regarding innovation, but product diversification disincentivizes them. Increased product diversification involves a higher amount of information that needs to be understood and assimilated, higher coordination, and more transactions, which reduce willingness to invest in R&D. As enhanced product diversification also involves more risk, reducing R&D expenditures can lower risk. Highly product - diversified firms provide enough experience of managers who can deal with complexities, but, when international diversification is too high, returns begin to decrease and performance is affected.

For firms that do not use product diversification, the effect of international diversification on R&D intensity is the most beneficial one, while for moderate product diversification levels: this effect is slightly positive, however, for highly product – diversified companies, R&D is distorted. Firms that are not product - diversified employ more resources for R&D and innovation than the highly product - diversified ones, therefore product diversification has a negative moderating effect on international diversification – R&D (Hitt et al., 1997, p. 788).

Even when combined with international diversification, product diversification still has a negative impact on R&D, due to the focus on financial rather than strategic controls. Because R&D expenses decrease returns in the short run, management has incentive to cut such expenditures, most likely when their compensation is tied to profitability on a yearly basis. However, geographic diversification still has a positive relation to innovation and R&D, even when the firm is highly product - diversified. Overall, product diversification effects are mixed. On one hand, it benefits performance when paired with international diversification, but it

negatively moderates the impact of international diversification on innovation. This could lead to the situation where product diversification benefits may be offset by potential losses due to reduced innovation and foregone R&D investments that are important for the competitive advantage of a company. Therefore, product diversification is of high relevance for firms active in foreign markets, but where innovation is not among the most important key factors to success. Moreover, the negative effects of product diversification on innovation can be surpassed by a higher level of international diversification, again, only up to a certain point, beyond which returns decrease and performance is affected (Hitt et al., 1997, p. 791).

R&D and advertising intensities are negatively related to diversification, because complex intangible resources are difficult to transfer and replicate, creating more costs than advantages. Although innovation creates opportunities, it also poses various challenges to the firm, challenges that can negatively affect growth (Kumar, 2009, p. 113).

1.1.1. Diversifying acquisitions and R&D

Diversification through acquisitions is mainly pursued to reduce firm risk and strengthen managerial positions. Even though it is one of the most widely used diversification approaches, it does not always have positive outcomes in terms of performance, because it distorts R&D and innovation investments that contribute to a firm's competitive advantage. Acquisition is mainly a benefit for the shareholders of the target firm (Jensen, 1988, p. 22); and can also be favorable for the owners of the acquirer in case of related acquisitions, when the profile of the target and of the buyer are similar (Jensen 1988; Hopkins, 1987 as cited by Hitt et al., 1991, p. 693), i.e. a related diversifying acquisition can bring more benefits. Other authors adopt the view of an alternation between international diversification and acquisition, as opposed to a trade-off between the two (Vermeulen, Barkema, 2001, p. 471).

The impact of acquisitions as a way of diversification on performance are not so beneficial due to three main reasons (Hitt et al., 1991, p. 694): first, due to the possibility that the acquirer overvalues the target and pays more than what it is actually worth, without benefiting from the synergies because these do not surpass the premium paid and consequently, the shareholders of the buyer do not enjoy any value gain in this context; second, in order for an acquisition to be made, there are significant resources at stake, that are also invested by partly foregoing investments in advertising, innovation, quality control etc., which have a proven track record of

ensuring performance on the long run; thirdly, acquisitions interfere with the R&D process of seeking and analyzing new ideas in order to implement them, thereby reducing R&D expenditures and outputs (measured in patents). Firms exchange innovation for acquisitions that grant them a fast market entry, broader market scope and access to the acquired firm's capabilities, distribution channels, customer base etc, without having to do any R&D to improve/create new products and then seek new markets, channels, attract customers etc.

For this reason, the R&D degree of a firm is negatively affected by diversification through acquisitions. Creation and deployment of patents is also affected, because acquisitions commit managers less or do not commit them at all to innovation, patents as outcomes of R&D are thereby reduced (Hitt et al, 1991, p. 695). Cuts in R&D expenditures after acquisition are justified by managers through the economies of scale and scope synergies that arise from the integration of R&D units of the target and the acquirer. The reduction in number of patents after the acquisition process is due to the fact that the buyer might not fully exploit the acquired technology of the target or the combined technology of target and buyer, or perhaps the acquired technology is not new.

Since firms achieve from integration, this should not have a negative impact on R&D. However, there are no synergies registered from economies of scale or scope in R&D after an acquisition; in fact, the innovation activity is decreased, while before undergoing the purchase, patent activity had positive movements. Regardless of acquisition or diversification taken separately, as acquisitions are investments that require significantly resources and are mostly financed through debt, thus increasing leverage and the diversification degree of a firm, it is most likely that the impact on R&D investment and outcomes (patents) is a negative one (Hitt et al., 1991, p. 702).

Acquisitions also have advantages: acquired firm's shareholders gain; an acquisition can be used as takeover tactic to replace inefficient management, adding value. However, buyer's shareholders face trade-offs, one of them being trading R&D investments at the expense of deploying resources for realizing acquisitions (Hitt et al, 1991, p. 702). Such tradeoffs are of great importance and should be taken into serious consideration especially for firms within industries that require significant innovation. Acquisitions as a way of diversification can bring positive results, on one hand; on the other hand, they might decrease management's risk appetite, which, over time, affects strategies pursued in order to improve/strengthen the competitive

advantage of a firm (Hoskisson, Hitt 1991, as cited by Hitt et al., 1991, p. 703). The risk aversion increases, even when a firm performs well. As firms are performing better, managers are less willing to take risks and thus are also less willing to engage the company in innovation investments that also imply a certain degree of risk.

Other authors adopt the view of an alternation between international diversification and acquisition, as opposed to a trade-off between the two (Vermeulen, Barkema, 2001, p. 471).

1.2. The Risk – Return Profile

According to the Bowman paradox, it is possible that for high returns, risk is actually low. This particular risk-return profile can be partially explained by diversification strategies (Kim et al., 1993, p. 129) that facilitate the access to more opportunities for firms expanding abroad than what the domestic setting offers, but there is no clear evidence that related or unrelated product diversification can lead to high returns without having to also face high risks. The answer lies within the mix between geographic and product diversification, controlling for the industry effects, because if industry is not taken into consideration, there is no risk-return correlation. This combination can provide economies of scale and scope, learning by being exposed to more information and innovation opportunities, as well as to complexities which require developing existing and new capabilities, and cost reduction by allocating each unit in the least costly location for the purposes of that unit.

A favorable return at low risk levels can be explained by the fact that diversification positively impacts performance through higher returns, while at the same time decreasing risk, by permitting, through a broader scope, to balance the losses or difficulties from some markets with the positive effects of others. Therefore, when firms diversify, they can smooth supply/demand risk from any country they are active in. Moreover, production and resources can be shifted in order to be able to deal with competition and fluctuations in interest rates, exchange rates, prices etc.

Product diversification effects on the risk-return profile depend on strategy: it is generally believed that related diversification is associated with higher returns, while an unrelated product strategy leads to lower returns (Kim et al., 1989, p. 45). However, these results (Amit, Livnat, 1988, as cited by Kim et al., 1993) do not control for industry affiliation and can be therefore inconsistent. In addition, the impact on the degree of risk and return is not complete when

analyzing only product diversification, as international diversification should also be simultaneously considered.

When analyzing companies with different risk – return profiles, namely low risk - high return, high risk - medium return, medium risk - medium return and low risk - low return (Kim et al., 1993, p. 139), it has been stated that a global market diversification has a favorable impact on the risk - return profile, namely enabling a high return at low risk, due to the opportunities that an international expansions offers in contrast to domestic markets.

There is a risk - return trade-off with both related and unrelated product diversification strategies (Kim et al., 1993, p. 142). Product diversification alone, regardless of being related or unrelated, cannot lead to a desired high return at low risk. A related product diversification can lead to advantageous returns at the expense of higher levels of risk, while an unrelated diversification is less risky at the expense of higher returns. However, between the two, the related product diversification is more beneficial. A company can achieve an inverse risk – return relation, namely high returns at low risks, when strategy is driven by product diversification and low levels of return, but also at lower risks, when it is pursuing a global market diversification (Kim et al., 1993, p. 143).

2. Relation to Performance

There are three main directions and sources of contradictions when it comes to depicting the graph of diversification in relation to performance:

- I. The relation between diversification and performance is linear.
- II. The relation between diversification and performance is curvilinear.
- III. The relation between diversification and performance is sigmoid.

2.1. Linear

A linear relation implies that performance outcomes increase with the diversification level. The higher the diversification degree, the more benefits a company can reap in terms of profitability.

According to some authors, international diversification is linearly linked to performance¹³ and has a better effect than product diversification (Grant, 1988, p. 9), especially in the case of companies that are highly diversified¹⁴ (Hitt et al., 1997, p. 785). This is contradicted in the literature by studies that find no evidence for the linear relation between international diversification and performance (Tallman, Li, 1996, p. 191). One of the arguments for the diversification – performance being linear is an aggressive pricing strategy. By implementing such a plan, companies can effectively surpass their competitors and benefit from future higher prices that can offset losses in the short-run. Therefore, by implementing such a pricing strategy, a company does not face significant constraints in increasing its diversification level, because even for higher diversification degrees, it will still enjoy performance benefits. However, other studies show that such pricing strategies are rarely employed (Palich et al., 2000, p. 157).

2.2. Curvilinear

2.2.1. U - shaped

A U – shaped graph has usually been found between international diversification and performance (Grant, Thomas, 1988; Hitt et al., 1994; Lu, Beamish, 2001; Ruigrok, Wagner, 2003).

U-shaped means that excessive diversification is not optimal. Costs grow faster than benefits. In the initial and medium phases of internationalization, a company has already expanded in the desired markets (similar and less similar, but of great interest), therefore there are only “peripheral countries with a lower profit potential” (Contractor et al., 2003, p. 8). Coordination costs, complexity, governance, managerial constraints involve too many resources and efforts of the firm to consider intensive internationalization a viable option. Hence this stage does not usually have a long duration. There are not a lot of companies that enter this stage.

This implies that at early stages of internationalization, because it is most likely that a company is going to expand first in similar countries or in its home region, the necessary costs for doing so are not considerable. There are no significant adjustments necessary, and also, there are no major dissimilarities between markets, therefore early internationalization stages are favorable for performance. However, as firms increase their diversification, there are difficulties

¹³ See Appendix 1

¹⁴ See Appendix 2

and costs (coordination, control, and dealing with economic, cultural, and institutional differences) that decrease performance. Nevertheless, as firms become more and more experienced, they gain the necessary knowledge to be able to deal with high levels of diversification, therefore for advanced diversifiers, performance is again positively impacted.

Industry is a relevant factor; service firms are the ones that are most likely to have an U – shaped relation to performance. In contrast to manufacturers: service firms need to make more adjustments to match customer preferences abroad (focus on customer contact involves more costs in overcoming cultural and language differences); there is also a need for higher control and monitoring due to the intangible character of services. Nevertheless, even if performance decreases after initial stages, it increases for larger diversification levels (Capar, Kotabe, 2003, p. 353).

Some authors also find a U – shaped graph in case of product diversification (Palich et al., 2000, p.169) or international diversification (Ruigrok, Wagner, 2003, p. 74), while others test for the interaction between product and international diversification and find the same U graph in the case of non-diversifiers¹⁵.

2.2.2. Inverted U

There are also proposed version of an inverted U depiction, meaning that performance is negatively impacted initially and at high diversification stages and positive for moderate levels. As the degree of internationalization increases, performance is also increased, but only up to an “internationalization threshold”¹⁶ (Geringer et al., 1989; Hitt et al., 1994, 1997; Lu, Beamish, 2011). Beyond this peak, performance is negatively impacted by high diversification, due to high costs that result from adjustment, coordination, and complexities that arise once geographic diffusion is larger. These costs surpass benefits.

By taking into account the differentiation between product diversification types, it has been found that as firms switch from single – business to related product diversification, performance starts to increase up to a certain threshold, due to economies of scope achieved through shared resources and making use of unemployed assets. This point marks the adoption of unrelated diversification, which does not have a positive effect on performance, because of the costs and

¹⁵ See Appendix 2

¹⁶ See Appendix 3

the limitation it imposes on management. Hence the graph of the diversification – performance relation is an inverted U (Palich et al., 2000, p.167).

In more detail, firms willing to pursue higher degrees of sales abroad are also willing to invest more abroad. This leads to accelerated market learning, enabling the ability to be competitive and to achieve potential high sales from exports relative to total sales, overcoming initial costs. In the first stage, adjustment costs are foreseen for large volumes, therefore the per unit amount is low. When a firm exports a lot, it can gain synergies from shared inputs and can begin to more efficiently enter new territories due to learning, at low costs. Even at the latter stages, the benefits outweigh the costs, as there is significant learning, risk hedging and financial economies, because revenues from across borders could balance out a stringent domestic situation. When the firm reaches more advanced exporting stages, however, the complexity becomes too high: the increased diversity cannot be tackled upon with the same shared inputs and applied knowledge, there are extra adjustments needed, higher costs, and hence a negative effect on performance (Boehe, Jimenez, 2016, p.4)

An inverted U can also be the case for product diversification¹⁷ (Grant, Thomas; 1988, p. 7; Tallman, Li, 1996, p.183). Beyond a certain threshold, transaction costs become too large, therefore product diversification is positively related to performance only up to a certain point. According to the RBV, competitive advantage is improved by differences across internal firm capabilities. Spreading core resources across related businesses creates economies of scope that increase returns as long as the firm stays within its domain. Unrelated diversification, which transcends core capabilities or the firm's "natural habitat", does not generate extra payments. Beyond a certain threshold, transaction costs are too large.

The combination of RBV and T – cost theory shows that a related product diversification has better effects on performance and therefore the threshold up to which benefits are larger than costs is greater than for an unrelated product diversification.

The combination of international and product diversification also has an inverted U shape, namely for moderate diversifiers¹⁸.

¹⁷ See Appendix 1

¹⁸ See Appendix 2

2.3. Sigmoid

2.3.1. S - shaped

Based on the majority studies that have been reviewed, the relation between diversification and performance is S – shaped¹⁹, namely categorized in three stages: first stage involving initial learning costs, insufficient economies of scale, foreignness, with a negative relation to performance; second stage – economies of scale and scope, experiential learning, access to resources, positively related to performance; third stage: complexity, high coordination and control costs, negative relation to performance.

First internationalization steps are costly due to distance and differences between markets, diseconomies of scale, no bargaining power. However, in the following internationalization stages, companies can enjoy increased learning and experience, lower costs, better capabilities and therefore positive effects on profitability. Performance decreases again, when complexities control and coordination costs increase and exceed opportunities. Thus, the international diversification – performance connection is S-shaped: negative at first, positive at medium levels, negative again when geographical diversification intensity is high (Contractor et al., 2003, p. 16). In the beginning, there is no positive influence on performance, but, as the firm progresses, performance is favorably impacted by internationalization. However, at significantly high diversification levels, performance decreases (Rugman, Verbeke, 2004; Rugman, Oh, 2009; Oh et al., 2014; Lu, Beamish, 2004).

When firms diversify through exports, they must take into account that exports are costly and require prior market research, adjustments, obtaining of permits etc. This cost structure compels companies to be more innovative prior to market entry, therefore learning and innovation from the basis for going abroad and also the level of resources that are to be committed to foreign markets.

As companies that choose low export levels still incur significant costs, but not so many benefits as firms that export more, this can negatively affect performance. Even when export volumes are considerable, if they account only for a small portion of a firm's operations, diseconomies of scale, costs and lack of numerous benefits for low degree exporting makes home markets more attractive. However, as the degree increases, and the movement on the line

¹⁹ See Appendix 4

of the S-shaped graph, learning increases, there are diversification effects also regarding risk (economic, operational etc.), and hence the overall impact on performance is a positive one. Furthermore, in latter stages, even low exporting can involve expansion opportunities and more potential profits.

If the export degree becomes too high, on the other hand, learning and income benefits are hindered, because high exporting also means increased distance and complexity due to cultural and economic differences. This demands investments in R&D, production and logistics, but, given the fact that not so many resources are willing to be committed by the firm, performance is put under pressure and starts decreasing. As a result, there is an S-shaped relation of low degree exports-firm performance (Boehe, Jimenez, 2016, p.3).

Since firms are aware that the third stages brings more costs than benefits, it is interesting to notice why some companies still choose to enter this third step (Contractor et al., 2003, p.16). The reason is due to difficulty of precisely determining when a firm is overdiversifying. Many firms cannot exactly pin down their apex. On the other hand, some firms intentionally pursue a high diversification level, motivating their choice through long-term goals of enhanced market share. Most firms are in the first two stages (lower and moderate diversification degrees).

When it comes to industry and to differentiating between service companies, the knowledge-based ones (follow the client: advertising, market research, publishing, financial services) have less difficulties in early internationalization stages, therefore they reach the second stage easier. On the other hand, capital-intensive service firms (air transportation, construction, hotel, restaurant, fast food chains, wholesale and retail trade, shipping) face more costs. Knowledge-based service firms have the following advantages in obtaining international diversification benefits: no significant investments in tangibles required in the initial stages and hence less costs; an already formed client base; higher standardization.

The S-shape relation is also the case when taking into account the region (Oh et al., 2014, p.17). For an inter - regional diversification, the first stage involves higher cultural distance countries, competition, significant resources required more than in the home region, government regulation, domestic experiential learning that is not so easily applied and transferred, costs (new business and knowledge, coordination, monitoring, administrative costs). As a result, there are negative effects of going abroad on performance. During the second stage, firms can use experiential learning from the first stage, reduce transportation costs and time, especially when

the strategy foresees entering new countries/markets that are not so far from the stage one operations. There are positive performance outcomes. In the third stage: high distance countries from existing business, high costs (network, distribution, administration), performance is negatively affected.

2.3.2. Inverted S

The inverted S – shaped curved can also be observed for intra – regional diversification of retailers. For instance, when accounting for regional effects, an intra – regional diversification allows an easy learning process regarding the local practices, because existing operations can be used in their exact form or with minor adjustments. A first mover advantage can also be enjoyed. As a result, positively performance is positively impacted during the first steps of diversification within the intra – region. In the second stage (medium levels), operations are expanded in key countries, again, using the experiential learning gained home and in the close countries. There are extra costs of coordination, building supply chain, and therefore, a negative impact on performance. The third intra - regional diversification stage is characterized by the experiential learning of the first two steps that is being used for managing complexities. There is a positive relation to performance and hence an overall inverted S shape (Oh et al, 2014, p.15).

Other views also contradict the S – shaped curved, proposing that both highly diversified firms (both internationally and from the product point of view), as well as firms that have low levels of international and product diversification outperform companies that are moderate diversifiers (Karthik et al., 2015, p. 8). In other words, high diversifiers and focused firms are better off than firms that are diversified at a medium level. Reason behind is the contingency of firm performance upon product diversification: a firm can mostly benefit from diversification either at high levels, whereby an international firm that is also highly diversified in terms of products can better capture economies of scope and can better transfer and exploit resources and capabilities, through synergies; on the other hand, at low diversification levels, costs of internalizing an expansion abroad exceed benefits and therefore it is better for firms to stay focused on a more limited range of markets and products and commit less resources (Karthik et al., 2015, p. 5).

Chapter IV: Issues that Lead to Contradictions

Contradictions in literature regarding diversification, namely which of the international, related or unrelated diversification has more beneficial effects on performance, whether the strategies are substitutes or complements, the nature of relation to performance and whether an optimal level of diversification can be achieved, are the consequence of the lack of harmonization regarding measurement, sampling and control variables.

The product diversification degree has either been measured through the classification proposed by Rumelt²⁰ (Rumelt, 1974; Grant, Thomas; 1988; Geringer et al., 1989), the 4 SIC code to attest that a firm is pertaining to a certain industry (Kim et al., 1993; Bowen, Wiersema, 2005; Bowen et al., 2014; Vilas – Boas, Suarez – Gonzalez, 2007; Kogut et al., 2002,), in relation to indexes such as Herfindahl (Tallman, Li, 1996; Vilas – Boas, Suarez – Gonzalez, 2007; Kogut et al., 2002), weight indexes that measure the weight of each segment as proportion of total sales (Hitt et al., 1991, 1997) or the entropy measure (Palepu, 1985; Kim et al., 1989, 1993). While the SIC code does capture the industry within which firms are present, it does not identify business interrelationship and the degree of relatedness. The Herfindahl index can provide information about the size, but not the relatedness (Bowen, Wiersema, 2005, as cited by Sambasivan et al., 2016, p.57), while the entropy measured shows high sensitivities to number of businesses/units and size of the core industry or business. These types of product diversification measures (Herfindahl, entropy, weight indexes) are mostly based on the SIC hierarchy and could also encounter issues of subjectivity and biases.

International diversification is usually measured through the entropy method (Kim et al., 1989; Volkov, Smith, 2014; Tallman, Li, 2011; Vilas – Boas, Suarez – Gonzalez, 2007) and sometimes through the Herfindahl index (Hitt et al., 1997), DOI – degree of internationalization (Contractor et al., 2003; Geringer et al., 1989), weights as proportions of foreign to total sales or assets (Rugman, Oh, 2009; Li, Tallman, 2011; Capar, Kotabe, 2003; Denis et al., 2002) or depending on the number of countries and subsidiaries abroad (Delios, Beamish, 1999; Lu, Beamish, 2004; Zahra et al., 2000). Kim's entropy measure does not differentiate among related and unrelated international diversification, while DOI cannot capture the various dimensions of the geographic diversification, only its degree and relatedness among businesses (Sambasivan,

²⁰ See Appendix 5

2016, p. 58). It has been found that good information regarding how well a company performs across borders, separate from the domestic activity, can be provided by using ratios of sales coming from abroad as proportion to total sales. By contrast, measuring international diversification by weighting the number of foreign countries a firm is active in or the number of subsidiaries against the number of total countries and subsidiaries that a firm operates can lead to inaccurate results and does not reflect a firm's international performance, only the degree to which a firm has expanded (Rugman, Oh, 2011, p. 205).

Performance has also been measured in various ways, but lacking a harmonized method to be used across literature. Two main categories of measuring performance have been used, namely accounting – based: ROA, ROS (Contractor et al., 2003; Hitt et al., 1997; Grant, Thomas, 1988; Delios, Beamish, 1999; Lu, Beamish, 2004; Bobillo et al., 2010, Capar, Kotabe, 2003, Geringer et al., 1989, Hitt et al., 1994, Contractor et al., 2003, Pandya, Rao, 1998; Kim et al., 1993; Tallman, Li, 1996; Vilas – Boas, Suarez – Gonzalez, 2007; Geringer et al., 2000), sometimes ROE, although ROE is sensitive to a firm's capital structure (Hitt et al., 1997, p.778); and market – based : Tobin's q (Montgomery, Wernerfelt, 1988; Li, Tallman, 2011, Vilas – Boas, Suarez – Gonzalez, 2007, Chang, Wang, 2006; Rugman, Oh, 2009). These two methods are very different in nature and can lead to negative correlations. Performance based on accounting relies on past financial reports of companies, while Tobin's q reflects the market value of the company relative to its replacement costs based on forecasts and expectations. Moreover, accounting – based measures can be manipulated and are subject to differences among firms. In this sense, research should use both or even multiples measures of performance, in order to capture the various aspects of performance (market performance, accounting performance, growth, historical versus expectations, short – and long – run etc.) and be able to assess certain results and conclusions when testing for diversification.

Control variables also play a significant role in proving consistency of results and are hence often used in literature (Contractor et al., 2003; Vilas – Boas, Suarez – Gonzales, 2007; Tallman, Li, 1996, 2011; Kim et al., 1993; Hitt et al., 1991; Kumar, 2009; Capar, Kotabe, 2003; Lu, Beamish, 2004; Kogut et al., 2002). Usually, the variables being controlled for are industry, firm size, country effect, leverage and, seldom, R&D intensity and growth. Controlling for certain factors can reduce significance and strength of diversification effects, for example the industry effect can reduce the significance of international diversification (Tallman, Li, 1996, p.191), but,

if results are consistent and valid, they are not sensitive to the industry effect (Vilas – Boas, Suarez – Gonzalez, 2007, p.17; Kim et al., 1993) ; the country effect can benefit some nations more in terms of diversification of service firms than others, i.e. U.S. firms began diversifying earlier and have more experience, hence this decreases the diversification impact for European companies (Contractor et al., 2003, p. 7). Accounting for leverage shows a propensity of levered firms to diversify less (Hitt et al., 1991, p. 698), but it has a negative impact on performance (Vilas – Boas, Suarez – Gonzalez, 2007, p. 18), while growth is usually positively impacting when controlled for. When controlling for size and growth, results show a larger growth U – graph between diversification and performance for large firms and an inverted U for large firms. While industry and leverage are generally considered to have among the strongest effects as control variables, this has been contradicted by some authors, according to whom firm size has a much stronger explanatory significance than leverage and industry. Not all authors consider control variables, however, therefore, in order to verify the consistency of results and sensitivity to certain effects, a complete testing for diversification should also take into account multiple control variables.

Sampling is mainly focused on developed economies: U.S. (Bowen et al., 2014; Wiersema, Bowen, 2008; Contractor et al., 2003; Qian et al., 2012, Volkov, Smith, 2014; Chang, Wang, 2006, Geringer et al., 1989; Kim et al., 1993, Li, Tallman, 2011), Europe (Geringer et al., 1989; Vilas – Boas, Suarez – Gonzalez, 2007; Oh et al., 2014; Capar, Kotabe, 2003; Kogut et al., 2002) or the Triad region – U.S., Europe, Japan (Ohmae 1985; Rugman, Verbeke, 2004, 2008; Rugman, Oh 2009, 2012, 2013; Oh et al., 2014). Fewer authors focus on emergent countries (Sahaym, Nam, 2012; Cristache et al., 2015; daCosta Neto, Romeu, 2011; Kumar et al., 2012), therefore diversification should also be tested more extensively in such states, or even in within frontier ones.

In order to overcome these differences in measurement, control variables and sampling and increase the validity of results in order to reach a consensus, a more harmonized approach should be implemented, namely through standardization (Klein, Lien, 2009, p. 21), new diversification measures that not only capture its degree and business relatedness, but also the various diversification dimensions (Sambasivan et al., 2016, p. 58). Moreover, databases that would permit a better access to data availability would be essential in obtaining more valid and generally applicable results, as authors often need to reduce their samples due to unavailable

information. Even though there are studies that also consider emergent countries, the majority of the literature is focused on the developed countries, due to lack of facilitated access to information, Therefore the possibility to test diversification in more depth in emerging and frontier countries is another argument for setting up available data.

Conclusion

Diversification is a rich topic in specialized literature sources; however, its dimensions that are related to which factors have an effect on the decision to diversify; whether product, diversification strategy, or a combination of the two, can lead to better outcomes; how these two approaches are interrelated; and whether an optimal diversification level can be reached and managed, are still debated.

Concerning the incentives that can influence companies' decision to modify their level of diversification (from the macro to the micro level), market imperfections - which reflect reality closer than perfect markets - incentivize diversification. In an imperfect market, where competition arises, diversification can be useful in helping companies create competitive advantages to differentiate themselves. Being present in various segments and markets at the same time helps firms overcome a saturated domestic market, balance out fluctuations of supply and demand and seek new growth opportunities. Even when the market experiences disruptive changes (economic downturns, convergent and reorientative changes), diversification strategy is a tool with which firms can rebound themselves financially, by using the experiential learning and adaptability gained through diversification. When taking into account the regional factor, the majority of the studies show that diversifying in the home region can bring the most benefits for a firm's performance, due to familiarity, set of common practices, culture and distance. Diversifying at home and in the home region, in most cases, and, in more rare situations, in another major region that is beyond the home one, can bring the most benefits also due to avoiding the costs of foreignness, adaptability, control and coordination.

The country factor plays a crucial role as well. A supportive institutional framework in terms of financial institutions and skilled labor are the two strongest incentives for firms to diversify. An optimal diversification strategy is one that enters a market that provides facilitated relations to financial institutions and the proper conditions for valuable human capital. Legally, companies from civil law are incentivized to diversify more; in order to benefit from the internal capital market that diversification offers as a method of overcoming a more difficult access to capital markets than in common law countries. There are countries that rely more on their external capabilities (e.g. Spain), internal (e.g. France), or both (UK, Denmark, Germany), but, regardless of their orientation, the optimal diversification level is always at a medium degree. For emergent

countries, diversification is better pursued when there are strong managerial capabilities. Optimal diversification is more likely to be reached when there is more liberalization, relaxation of anti-trust laws and when corporate taxes are high - which makes diversifying acquisitions more attractive.

When it comes to industry, studies show that the majority of the largest multinational companies are diversified focusing on the home region, with some also in several regions and few global; and that there is a tendency for manufacturers to be more internationally diversified than services. Service companies focus more domestically or in the immediate region, however, it is easier for knowledge- than for capital – based firms to diversify.

Firm characteristics also influence the diversification decision. A diversification strategy is always an optimal choice when there is low performance and when future cash-flows are uncertain. Related product diversification can help stabilize profit and returns at lower risks. Early and medium diversification is optimal as a governance tool, as in the case of management.

Managerial capabilities are, according to some authors, the most important incentive for firms to modify their diversification level. A well – skilled management can deal with complexity and the large amount of new information that needs to be assimilated; however, diversification is not efficient if complexity becomes too high and surpasses managerial capabilities. Diversification can also be pursued due to personal interests of the manager, that are not aligned with the interests of the owners and lead to agency costs; managers can opt for diversification to reduce their employment risk, because once a firm becomes diversified, it is hard to replace management and deal with the arisen complexities, and also to increase compensation. Excessive diversification can be kept under control at medium level with diversification itself, as a governance tool: higher shareholder concentration for a better alignment of incentives, compensation tied to firm performance (e.g. share-based), and control to reduce opportunism. However, companies should pay attention not to implement a too stringent control that would shift focus from strategic controls, which deal with innovation creating a long term competitive advantage etc., to financial controls, that deal with short – term earnings, because this can hinder performance in the long run.

There is no generally available opinion in literature regarding which of the product or international diversification should be preferred in terms of performance outcomes. Views are very different. There are authors who are in favor of product diversification, while others state

that the geographic one is more suitable, or that a joint effect can lead to better profitability, for example:

- on the product diversification – performance relation:

positive: Geringer et al. 1989, Hoskisson Hitt 1990, Da Costa et al 2011

negative: Berger Ofek, 1995; Lang, Stulz, 1994

mixed: Grant, Thomas, 1988; Jensen, 1988; Hoskisson, Hitt, 1990, 1991; Hitt et al., 1997; Christensen, Montgomery, 1981; Tallman, Li 1996; Palich et al, 2000;

- on the international diversification – performance relation:

positive: Kim, Hwang, Burgers, 1989, 1993; Grant, Thomas, 1988; Bartlett, Goshal 1989; Tallman, Li 2011;

negative: Denis et al., 2002; Hitt et al, 1997;

mixed: Geringer et. al, 1989; Hitt et al., 1997; Tallman, Li 1996, 2011;

- on the product and international diversification – performance relation:

Product diversification has a positive moderating effect on the international diversification-performance relation: Hitt et al. 1997; Vilas-Boas, Suarez-Gonzales, 2007; Chang, Wang, 2007.

Product diversification has a negative moderating effect on the inter-regional diversification – relation performance, hindering R &D and innovation and hence performance in the long – run : Oh, Contractor, 2014; contradicted by Oh et al., 2014.

International diversification acts as a positive moderator on the product diversification – performance relation: Hitt et al., 1994.

There is no significant effect of the joint product – international diversification on performance: Vilas-Boas, Suarez-Gonzalez, 2007.

There are mixed effects of product and internationally diversified firms on performance during economic downturns: Volkov, Smith, 2014; Hoon Oh et al., 2014.

(Un)related product diversification is a (negative) positive moderator on the international diversification-performance relation: Chang, Wang, 2006.

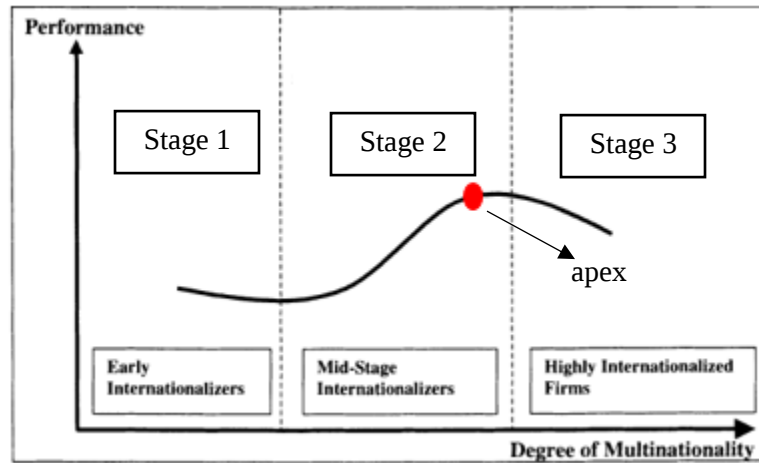
It has also been discussed whether a firm should trade – off in terms of diversification when it comes to the two directions, product and geographic. The majority of the authors claim that no

trade – off is needed, as product and international diversification are interdependent, complementary decisions, and can work well together. Experience gained with one dimension can help deal with complexities and reduce costs in the other. In achieving better performance outcomes, product diversification is not limited by international diversification, or vice versa.

In order to answer the question regarding the optimal diversification level, all of the above mentioned factors should be taken into account as incentives that lead to the decision to modify the diversification degree of a firm – either by initiating diversification, or by changing an already existing diversification degree. The optimal diversification level is more likely to be achieved when exploiting market imperfections; when firms have the ability to adapt to disruptive market changes due to previous experience gained through diversification; when they are active in manufacturing, optimal diversification has higher levels than for service firms, that are less global; when the services are knowledge – based, an optimal level is easier reached and with fewer costs; when diversifying within the home region; when countries have favorable institutional factors in terms of capital markets, skilled labor market; a civil law code, that permits benefiting from an internal capital market; when the home market is saturated and growth opportunities are sought beyond borders; when firms have the necessary resources, want to benefit from an internal capital market and overcome less satisfactory performance levels and cash – flow uncertainties; when they can establish institutional and social networks; when managerial capabilities are strong; when managerial motives that lead to agency costs are reduced through governance due to diversification; and, all in all – when companies diversify up to moderate levels.

When considered separately, the majority of the literature favors international diversification; while when testing for the joint effect with product diversification, authors find that firms can reap more benefits if they use both diversification dimensions. A particular factor that contributes to performance is R&D, which can be distorted by high product diversification levels. Firms, especially the ones that are active in highly innovative industries, should not alter their innovative capacity and should have a higher international diversification level. Also, if a firm wants to achieve higher returns at relatively low risks, a related product diversification is more suitable.

Most authors agree on the fact that the graph relation between diversification has an S – shape²¹ (see graph below, after Contractor et al., 2003, p.7).



In the first stage, there are costs of early internationalization, namely learning costs that are due to not being familiar enough with the new market; even though it might be that, at first, firms choose to expand in similar countries (culturally, economically, and geographically close), there are overhead costs even in such cases. The link between diversification and performance is negative; however, performance is not severely affected, as the stage does not have a considerable duration.

In the second stage, a company can mostly gain from diversification. Costs, R&D expenditures etc. can be spread across more countries or units, and the benefits are growing faster than the costs. There is access to country-specific resources (cheaper inputs and labor, lower costs of capital), a better ability to transfer knowledge and an increased market power.

In the third stage, the achievement of diversification benefits does not continue in an unlimited manner, therefore the costs of complexity and high coordination surpass benefits. Few firms enter this stage, as it is the one that distorts performance the most.

Therefore, the majority of the authors agree that there is an optimal diversification level, namely mid – stage, but its exact level is not easy to pin down.

Issues regarding measurement, variables and samples prevent reaching a general consensus regarding diversification. Specialized literature views on whether firms should prefer one

²¹ See Appendix 4

diversification strategy over the other, the relation between these two dimensions and whether an optimal level does indeed exist and how it should be reached are still inconclusive and not yet resolved (Hennart, 2007, p. 444; Palich et al., 2000, p. 169; Wiersema, Bowen, 2011, p. 153). It is challenging to exactly determine the apex of diversification and whether a firm is under – or overdiversified. Since firms are aware that the third stages brings more costs than benefits, it is interesting to notice why some companies still choose to enter this third step. Some firms intentionally pursue high diversification levels, motivating their choice through long-term goals of enhanced market share (Contractor et al., 2003, p. 9). Diversification still remains a complex and not yet mature subject, with further research needed in terms of additional reviews and the use of more harmonized, standard measures in the literature.

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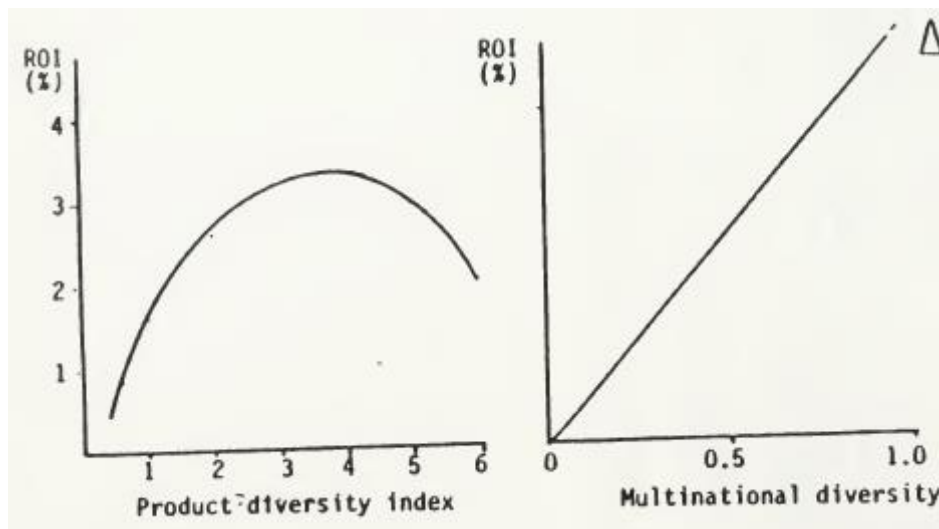
Appendix I : Diversification and Performance – A Summary of Literature Views

International diversification impact on performance	
Positive	Grant, Thomas 1988; Bartlett, Goshal 1989; Kim, Hwang, Burgers, 1989; 1993; Delios, Beamish 1999; Zahra et al., 2000; Tongli et al., 2005
Negative	Denis et al., 2002
Mixed	Grant, Thomas, 1988; Wernerfelt, Montgomery 1988; Bartlett, Goshal, 1989; Haar 1989; Kim et al., 1989, 1993; Geringer et al.; 1989; Lang, Stulz, 1994; Hoskisson et al., 1994; Berger, Ofek, 1995; Hitt et al., 1997; Hitt et al., 1997; Denis et al., 1997; Delios, Beamish, 1999; Alexander, Myers 2000; Palich et al., 2000; Rajan et al., 2000; Zahra, Hitt, 2000; Dawson, 2001; Capar Kotabe, 2003; Contractor et al., 2003; Thomas, Eden, 2003; Ruigrok, Wagner, 2003; Contractor et al., 2003; Contractor, Kundu, 2003; Lu, Beamish 2004; Rugman, Verbeke 2004; Li, 2005; Tongli et al., 2005; Chari, 2007; Vilas – Boas, Suarez – Gonzales, 2007; Oh 2009; Tallman, Li, 2011; Volkov, Smith, 2014; Boehe, Jimenez, 2016

Product diversification impact on performance	
Positive	Rumelt 1974; Keats, Hitt, 1988; Page et al., 1988; Geringer et al., 1989; Robins, Wiersema 1995; Wan 1998; Campa, Kedia 2000; Morck, Yeung 2003; Villalonga 2004;
Negative	Grant, Thomas, 1988; Wernerfelt, Montgomery, 1988; Hoskisson et al. 1993; Lang, Stulz, 1994; Berger, Ofek, 1995; Denis et al. 1997; Rajan et al. 2000; Lu, Beamish 2004; Tongli et al., 2005; Vilas-Boas, Suarez - Gonzales 2007; Bausch, Pils 2009
Mixed	Johansson, Valne, 1977; Christensen, Montgomery, 1981; Jensen 1988; Hoskisson, Hitt, 1990, 1991; Hitt et al., 1997; Palich et al., 2000; Robins, Wiersema, 2003; daCosta, Romeu, 2011; Kahloul, Hallara, 2010
Relatedness having a better impact	Rumelt, 1974, 1982; Hill 1983, 1989; Singh, Montgomery, 1984; Palepu, 1985; Wernerfelt, Montgomery, 1986; Hoskisson 1987; Frank, 1989; Geringer et al., 1989; Hill et al., 1992; Robin, Wiersema, 1995; Berger, Ofek 1995; Tallman, Li, 1996; Delios, Beamish 1999; Palich et al., 2000; Mayer, Whittington 2003; Park 2003; Miller 2006; daCosta, Romeu, 2011; Oyedijo 2012;
Unrelatedness having a better impact	Hitt, Ireland 1986; Dubofsky, Varadarajan 1987; Lubatkin 1987

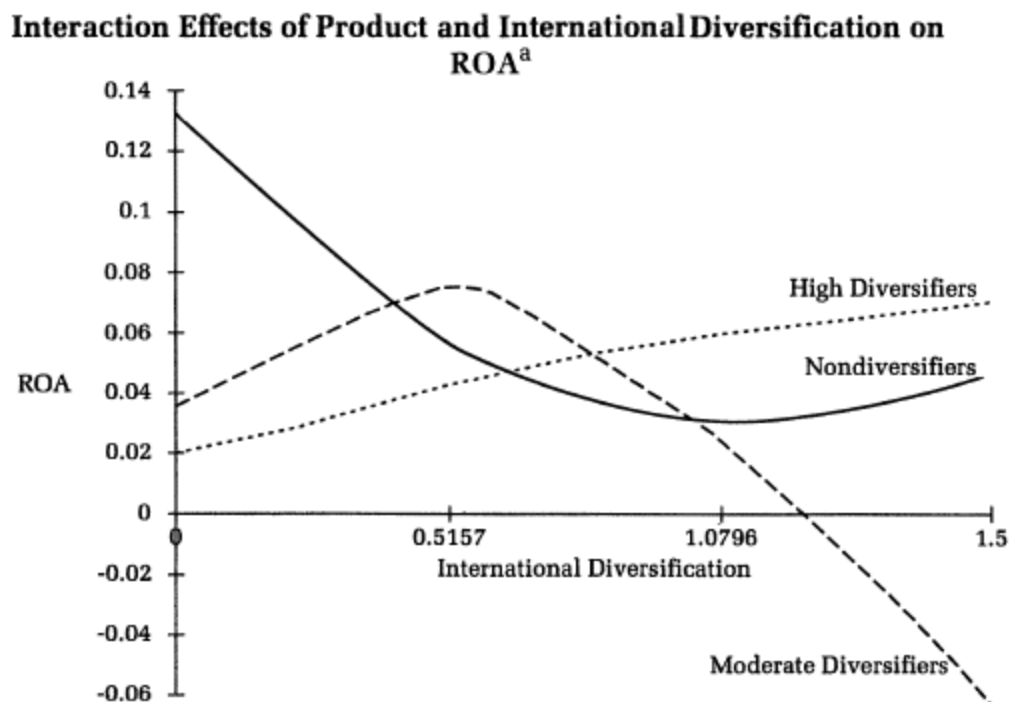
Joint effect of product and international diversification	Teece, 1982; Pandya, Rao, 1998; Kim, et al., 1989; Hitt et al., 1997; Delios, Beamish, 1999; Zahra et al., 2000; Davies et al., 2001; Vermeulen, Barkema, 2001; Bowen, Wiersema, 2007; Denis et al., 2002; Thomas, 2004; Lu, Beamish, 2004; Meyer, 2006; Vilas – Boas, Suarez – Gonzalez, 2007; Li, Yue, 2008; Kumar, 2009; Kumar, 2009; Bobillo et al., 2010, Oh et al., 2014; Mayer et al., 2014; Khartik et al., 2015.
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Appendix 1: Relationship between Product and International Diversification to Performance



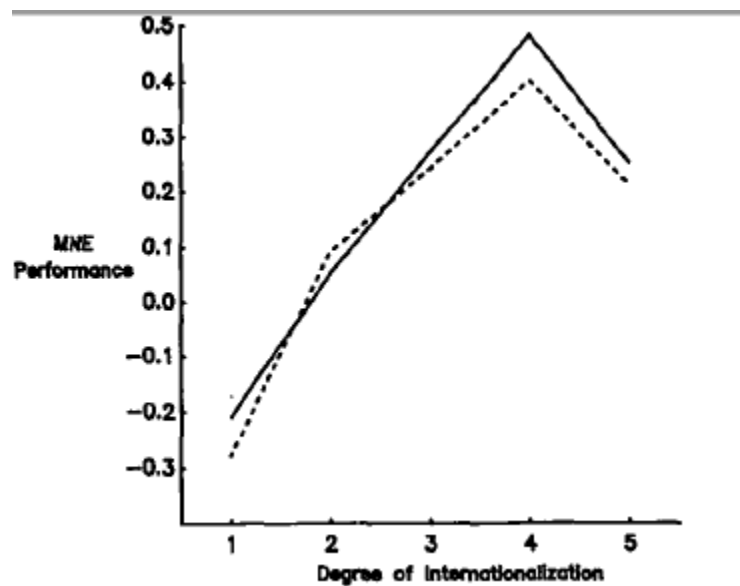
Source: Grant, Thomas, 1988, p. 30

Appendix 2: Interaction Effects of Product and International Diversification on ROA



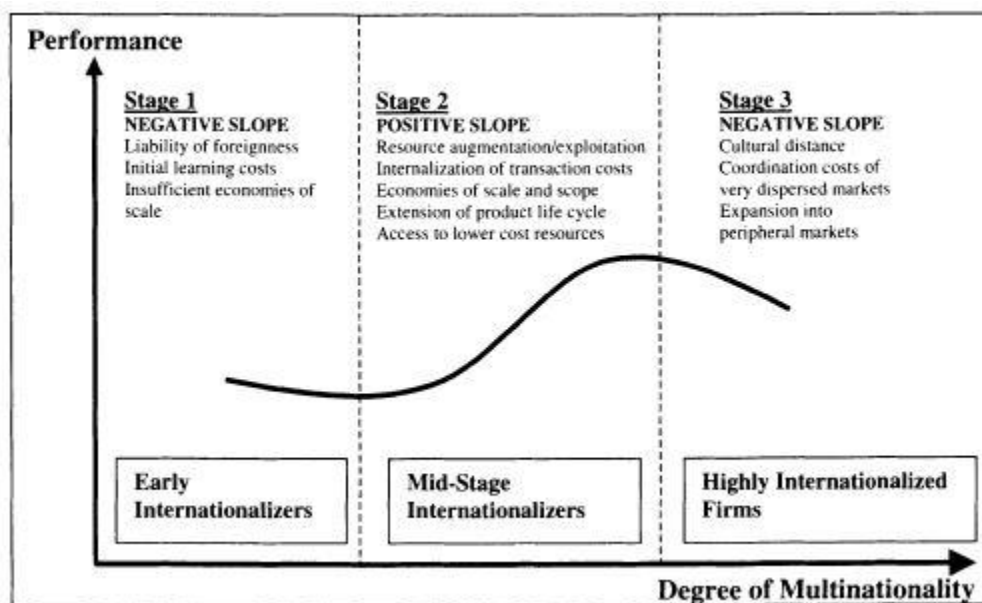
Source: Hitt et al., 1997, p. 787

Appendix 3: International Diversification and Performance



Source: Geringer et al., 1989, p.9

Appendix 4: The Stages of International Diversification in Relation to Performance



Source: Contractor et al., 2003, p.7

Appendix 5: Product Diversification Classification by Rumelt

1. *Single business* (SB): firms that are basically committed to a single business in a single industry ($R_s > 0.95$).
2. *Dominant business*: firms that have diversified to some extent, but still obtain the preponderance of their revenues from a single business in a single industry ($0.95 > R_s > 0.70$)
 - (a) *Dominant-vertical* (DV): vertically integrated dominant firms.
 - (b) *Dominant-constrained* (DC): non-vertical dominant firms that have diversified by building on some particular strength; their activities are strongly related.
 - (c) *Dominant-linked* (DL): non-vertical dominant firms that have diversified by building on several different strengths; activities are not closely related, but are still linked to their dominant business.
 - (d) *Dominant-unrelated* (DU): non-vertical dominant firms whose diversified activities are not linked to their dominant business.
3. *Related business*: non-vertically integrated diversified firms operating in several industries but whose activities are linked ($R_s < 0.70$ and $R_r > 0.70$).
 - (a) *Related-constrained* (RC): related firms, all of whose activities are related to a central strength.
 - (b) *Related-linked* (RL): related firms that have diversified using several different strengths and hence are active in widely disparate businesses.
4. *Unrelated business*: non-vertical firms that have diversified without regard to the relationships between new business and current activities ($R_r < 0.70$ and $R_s < 0.70$).
 - (a) *Active conglomerates* (AC): firms that have made at least five acquisitions in the past 5 years, of which at least three were unrelated to past activities.
 - (b) *Unrelated passive* (UP): unrelated business firms that do not qualify as active conglomerates.

-
1. R_s = specialization ratio: the proportion of a firm's revenues attributable to its largest single business in a given year.
 2. R_r = related ratio: the proportion of a firm's revenues attributable to its largest group of related business.

Source: Geringer et al., 1989, p. 11

Anhang: Zusammenfassung

Diversifikation ist ein intensiv diskutiertes Thema in der Fachliteratur. Es gibt noch viele Widersprüche und Ungereimtheiten in Bezug auf diesen Bereich und bisher war zwischen Autoren kein Konsens über ihre verschiedenen Aspekte erzielt.

Wenn ein Thema zum reifen wissenschaftlichen Zustand gelangt, sind drei Kriterien erfüllt: zuerst, eine beträchtliche Forschung zu diesem Thema ist geführt worden; zweitens, die Ergebnisse der Studien sind konsistent, gültig und interpretierbar; und drittens, die Forschung hat zu einer Grundsatzvereinbarung geführt (Palich et al., 2000, p. 155). Das Thema der Diversifikation erfüllt nur die erste Voraussetzung, nämlich gibt es eine reiche Literatur darüber, welche in den Kapiteln dieser Masterarbeit teilweise untersucht ist. Allerdings gibt es noch Inkonsistenzen, ungelöste Fragen und keinen Konsens über diese Thematik, sodass die zweite und dritte Voraussetzung nicht erfüllt sind.

Die Motivation dieser Masterarbeit ist es, Schlussfolgerungen über die International- und Produktdiversifikation basierend auf Literaturstudien zu ziehen. Hauptziel ist eine Formulierung eines teilweisen Konsensus über Diversifikation auf Basis der Mehrheit der Meinungen; der untergeordnete Zweck ist die Identifikation möglicher Probleme, die zu den Widersprüchen der Autoren führen.