Corporate Diversification and Firm Performance: Theoretical Boundaries and Proposed Research Agenda.

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Abstract

By applying a meta-narrative review approach and thematic analysis, 202 articles over the period 2000-2020 were evaluated to identify and collate the literature on corporate diversification and firm performance into six theoretical perspectives: industrial economics, resource-based view, agency theory, financial perspective, organizational learning and institutional perspective. A novel research agenda is proposed that suggests two alternative explanations: the geopolitical and historical perspectives. It is concluded that these should be part to the study of corporate diversification and firm performance.

Keywords

Corporate Diversification; Review; Historical; Geopolitical

Introduction

The theoretical perspectives that explain the relationship between corporate diversification and firm performance are extensive and diverse. Industrial economic theory asserts that as firms diversify firm performance becomes positive due to a higher market power, economies of scale and scope and factors related to industry profitability until a certain point where the performance becomes negative as firms becomes more diverse, theorizing a U-inverted relationship (Palich, Cardinal & Miller, 2000). The financial approach states that diversified firms operate with a diversification discount or at least a constant relationship with performance; diversification leads to financial synergies, risk reduction and more debt capacity that are surmounted by the higher costs of managing a more diverse firm (Nippa, Pidun & Rubner, 2011). The agency theory declares that diversification has a negative relationship with firm performance because managers of the firms diversify to obtain private benefits and entrench themselves in the firm at the expense of overall performance (Aggarwal & Samwick, 2003). The organizational learning approach suggests that diversified firms acquired knowledge through past diversification experiences, therefore, firms that diversify multiple times show higher performance due to the learning process, thus, a positive relationship is expected (Andreou, Louca & Petrou, 2016). Institutional perspective claims that diversified firms exhibit a positive performance in emerging economies by compensating for the inefficiencies of capital, labor and product markets of the country; however, this relationship becomes negative when diversified firms operate in developed economies as advantages of diversification tend to disappear due to institutionally stronger country environments (Benito-Osorio, Guerras- Martin, Zuñiga-Vicente, 2012). The resource-based view states that a diversified firm possesses a wider range of intangible and valuable resources and capabilities that share among business developing synergies and a positive influence in the relationship with firm performance (Hauschild & Knyphausen-Aufseß, 2013). These perspectives could help researchers to understand the heterogeneity of empirical results found in different studies; positive, negative, non-linear or constant relationships. Yet, these traditional approaches may not be enough to explain the nature of this relationship. Therefore, it is discussed that alternative perspectives might help to explain the heterogeneity of this linkage: the historical and geopolitical perspectives.

The purpose of this study is to identify and collate the traditional theoretical perspectives that help to explain the relationship between corporate diversification and firm performance to propose a research agenda that includes two alternative perspectives. Thus, the next question is presented:

What are the theoretical perspectives that help to explain the relationship between corporate diversification and firm performance?

This paper contributes to diversification research in at least three important ways. First, it reviews and collates the perspectives that help to explain the relationship between diversification and firm performance. Second, it identifies the theoretical rationale, main subtopics and assumptions of each approach. Third, it proposes a research agenda that offers two alternative explanations to the study of corporate diversification and firm performance.

Review Methodology

The review methodology follows the four phases and guidelines of Snyder (2019).

Phase 1: In the first phase, the literature review is designed. In designing the review, the plan is to detect the theoretical approaches that explain the diversification-performance linkage. Thus, an initial scanning of other literature reviews is performed. As the review evolved, it revealed a large body of research studied from distinct theoretical approaches with many subtopics and conducted by different groups of researchers. Therefore, a semi-systematic or meta-narrative review approach is applied. Two distinct searching strategies to select studies were employed. The first, used the following key terms: 'Corporate Diversification and performance', 'Multi-business and performance', 'Scope of the firm', 'Conglomerates and performance', 'Diversification literature review' and 'Diversification Meta-Analysis' within 9 databases, Ebsco Business, Elsevier, Web of Knowledge, Springer, IEEE, Emerald, JSTOR, ABI/Inform and Pro-quest to identify all articles that report these words either in the title, abstract or keywords. The second strategy consists of using forward and backward citation tracking to find seminal articles iteratively. In specific, literature review articles were citation-tracked to identify theoretical approaches and empirical findings. The synthesis includes articles from the last 20 years from 2000 to 2020, also, literature reviews, theoretical and empirical findings are included in the examination. In addition, articles have to be written in English and be peer-reviewed.

Phase 2: Conducting the review. The review process is tested on a smaller sample by reading the abstracts to make the appropriate selection and then the full analysis of the articles later, before the final selection. In addition, references in the selected articles are mapped to identify possible relevant studies. Selected articles are classified into two groups from the years 2000 to 2010 and from 2011 to 2020 to organize more clearly the data and also to identify possible trends.

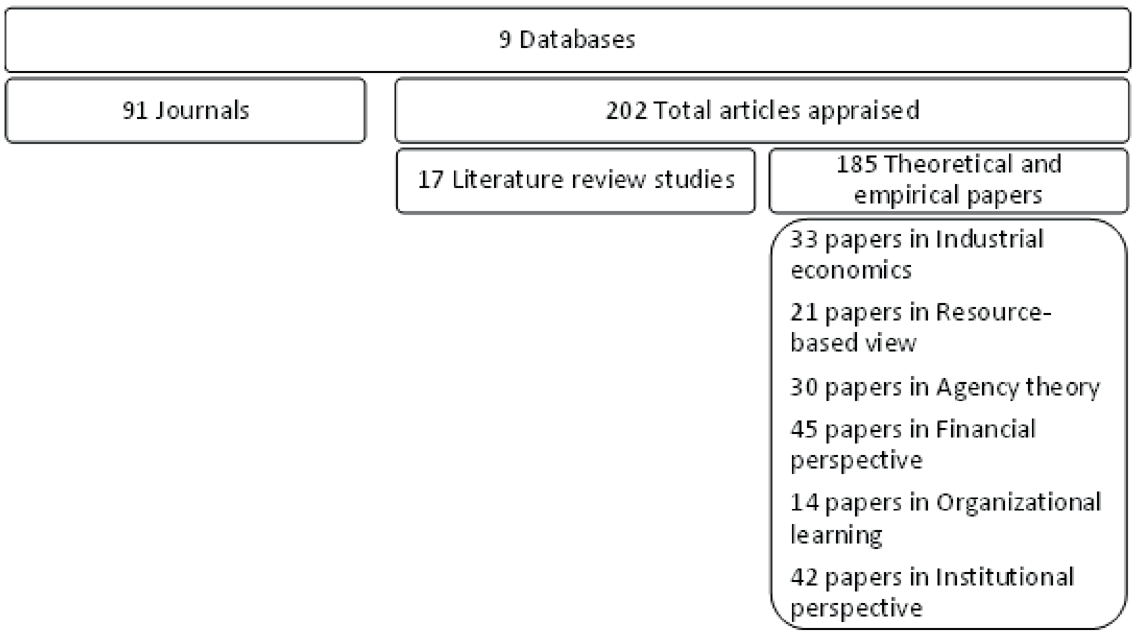
Phase 3: Analysis. Given that various groups of researchers within different disciplines have used different theoretical approaches and subtopics, as well as, different methods and used distinct criteria to analyze diversification-performance linkage, a thematic analysis is applied rather than statistical techniques. This qualitative technique is applied to identify and categorize the articles into each traditional theoretical approach along with their underlying subtopics. The review is conducted by reading the abstract, theoretical basis and conclusions of each article in the final sample. The theoretical rationale and main subtopics of each traditional approach are identified by coding and contrasting common features in the articles (Wong, et al., 2013).

Phase 4: Writing the review. The review is written to provide a clear summary of the theoretical perspectives, their rationale and main subtopics within each approach. The numbers of articles reviewed, number of journals and classification of the manuscripts are provided. The classification is summarized in one table including their logic and assumptions and, the second table, summarizes the main subtopics and the collection of authors in the period selected.

Results

The final sample resulted in 202 articles matching the criteria; 17 were literature review papers and 185 were theoretical and empirical studies within 91 journals. To summarize the number of documents and source of origin, the following figure is provided.

Figure 2.1
Scheme of research



The thematic analysis involved, first, familiarizing with diversification research data and noting initial ideas, then, the coding process is created where common features across the articles are collected to group them into potential theoretical themes. An iterative analysis to re-define, name and synthesize properly the themes resulted in six traditional perspectives, their core logic and main assumptions are summarized in the next table.

Table 2.1
Summary of traditional perspectives and their core logic and assumptions.

Theoretical perspective	**Core logic and assumptions**
Industrial economics	Industrial economics evaluates diversification in terms of its influence on competition, industry and technical productivity. Diversified firms may use cash generated through one business to cross-subsidize another increasing market power and generating economies of scale and scope. The benefits of diversification can be exploited to only a certain degree of diversification, stating a U-inverted relationship with performance.
Resource-based view	Resource-based view assess diversification with relation to the bundle of resources and capabilities that can be shared among business. Diversified firms develop synergies and a positive moderating impact on performance by sharing and exploiting related resources. The benefits of diversification may increase with related resources and decrease with unrelated resources, asserting a U-inverted relationship.
Agency Theory	Agency theory considers diversification in terms of the conflicts of interest that may arise between managers and stakeholders. Firm managers diversify to obtain power and compensations, reduce individual employment risk and entrench themselves in the firm at the expense of overall performance. Diversification reduces firm performance due to agency problems.
Financial Perspective	Financial perspective views diversification regarding its impact on financial performance, debt capacity and risk reduction. Diversified firms operate with a discount in value due to the high costs to run a diversified firm potentially overcoming financial synergies. Diversification reduces value or at least produces a constant relationship.
Organizational Learning	Organizational learning evaluates diversification in terms of the learning process from past experiences and organizational knowledge transfer. Firms that diversify multiple times have greater performance than single firms due to the learning process and prior diversification experiences. Diversification increases performance as the firm acquires experience and learns from prior diversifications.

Institutional perspective	Institutional perspective studies diversification emphasizing the influence of institutional environment, country development and public policy. Diversified firms exhibit a positive performance in emerging economies by compensating for the inefficiencies of capital, labor and product markets of the country but a negative performance in developed economies due to the potentially stronger institutions. Diversification increases performance in emerging economies and reduces it in developed economies.

The analysis of others literature review studies helped to identify relevant diversification trends, main subtopics and seminal papers that were citation-tracked forward and backwards (Guerras-Martin et al., 2020; Schommer et al., 2019; Lüthge, 2018; Ahuja & Novelli, 2017; Mehmood & Hillman, 2017; Picone & Dagnino, 2016; Dhir & Dhir, 2015; Erdorf et al., 2013; Weiss, 2013; Hauschild & Knyphausen-Aufseß, 2013; Purkayastha et al., 2012; Benito-Osorio et al., 2012; Wan et al., 2011; Nippa et al., 2011; Bausch & Pils, 2009; Martin & Sayrak, 2003; Palich et al., 2000).

Table 2.2

Theoretical perspectives and subtopics on the diversification-performance linkage.

Theoretical Perspectives	**Main Subtopics**	**Authors**	
		2000-2010	**2011-2020**
Industrial Economics	1. Market power 2. Industry analysis 3. Internal capital markets 4. Economies of scope and scale 5. Conglomerates and group affiliation 6. Technology & productivity	Liebeskind (2000);Narasimhan & Kim (2002); Maksimovic & Phillips (2002); Park (2003); Li & Greenwood (2004); Helfat & Eisenhardt (2004); Stern &Henderson (2004); Jandik & Makhija (2005); Varanasi (2005); Wiersema & Bowen (2005, 2008); Fukui & Ushijima (2006); Yan (2006); Leten et al. (2007); Tan et al. (2007); Lafontaine & Slade (2007); Doukas & Kan (2008); Tanriverdi & Lee (2008); Schmid & Walter (2009); He (2009); Ganco & Agarwal (2009); Çolak, G. (2010); Rawley (2010)	Banker, Wattal & Plehn-Dujowich (2011); Purkayastha (2013); Zahavi & Lavie (2013); Seru (2014); Matvos & Seru (2014); Su & Tsang (2015); Hashai (2015); Sun & Govind (2017); La Rocca et al. (2018); Westerman et al. (2020)
Resource based view	1. Resources and Capabilities 2. Competitive advantage 3. Dynamic capabilities 4. Synergies and knowledge 5. Heterogeneity of the firm	Geringer et al. (2000); Matsusaka (2001); Galunic & Eisenhardt (2001); Valvano & Vannoni (2003); Piscitello (2004);Gary (2005); Kor & Leblebici (2005) ; Wang & Barney (2006);Pehrsson (2006); Ng (2007); Fang et al. (2007); Chari et al. (2008);Døving & Gooderham (2008);Ravichandran et al. (2009);Eisenhardt & Martin (2010); Nath et al. (2010) Lichtenthaler (2010)	Liu & Hsu (2011); Villasalero (2013, 2015, 2017)

Agency Theory	1. Conflicts of interest 2. Individual employment risk 3. Compensations and perquisites 4. Entrenchment incentive	Boot & Schmeits (2000); Shaffer & Hillman (2000); Ueng & Wells(2001);Cronqvist et al. (2001);Hyland & Diltz (2002);Thomas (2002); De Motta (2003);Aggarwal & Samwick (2003);Jensen & Zajac (2004); Best et al. (2004);Gong et al. (2007); Xiaorong & Rwegasira (2008);Lim et al. (2008) ;Jiraporn et al. (2008); Lim et al. (2009)	El Mehdi & Seboui (2011); Tong(2011); Dhir & Mital (2012) Hoechle et al.(2012); La Rocca & Stagliano (2012); Goetz et al. (2013); Castañer & Kavadis (2013); Farooqi et al. (2014); Choe et al. (2014) Ataullah et al. (2014); Stagliano et al. (2014); Arikan & Stulz (2016); Oxley &Pandher (2016); Alhadab & Nguyen(2018); Mili et al. (2019)
Financial Perspective	1. Risk reduction 2. Mergers and Acquisitions 3. Financial synergies 4. Corporate investments 5. Financial costs 6. Stock markets 7. Debt capacity and tax shields	Chevalier (2000); Rajan et al. (2000); Lamont & Polk (2001);Hadlock et al. (2001); Whited (2001); Mansi & Reeb (2002); Campello (2002) Graham et al. (2002);Denis et al (2002) ;Campa & Kedia (2002); Ferris et al. (2003) Burch & Nanda (2003); Gomes & Livdan (2004) ;Carrieri et al. (2004) ; Villalonga (2004a, 2004b) ; Stowe & Xing (2006); Laeven & Levine (2007); Hayden et al. (2007); Rhodes-Kropf & Robinson (2008) ; Massa & Rehman (2008); Lelyveld & Knot (2009); Akbulut & Matsusaka (2010); Mitton & Vorkink (2010);Klein & Saidenberg (2010) ;Hoberg & Phillips (2010);Hund et al. (2010) ; Yan et al. (2010) ; Berger et al. (2010);Glase et al. (2010); Grass (2010);Elsas et al. (2010)	Anderson et al. (2011); Gatzert & Schmeiser (2011) ;Marinelli (2011); Ammann et al. (2012); Rudolph & Schwetzler (2014) ; Manrai et al. (2014); Custodio (2014); Volkov & Smith (2015); Liang et al. (2016) Kuppuswamy & Villalonga (2016) ; Anjos & Fracassi (2018) ;Bielstein et al. (2018) ; Cheng & Wu (2018)

Institutional Perspective	1. nstitutional environment 2. Public policies 3. Country/region development 4. Institutional voids 5. Cross-country analysis 6. Legal systems	Claessens et al. (2000); Shaffer and Hillman (2000) Khanna & Rivkin (2001); Khanna & Palepu (2000); Kock & Guillen (2001); Ramirez & Espitia (2002); Lins & Servaes (2002); Kogut et al. (2002); Mayer & Whittington (2003); Wan & Hoskisson (2003); Laurila & Ropponen (2003); Li & Wong (2003); Szelesset al. (2003); Ramaswamy et al. (2004); Fauver et al. (2004); Hoskisson et al. (2005); Peng et al. (2005) Wan (2005); Chang et al. (2006); Peng & Delios (2006); Shackman (2007); Chakrabarti et al. (2007); Santalo & Becerra (2008); Delios et al. (2008); Lee, et al. (2008); Dos Santos et al. (2008); Singh et al. (2010); David et al. (2010)	Diestre & Rajagopalan (2011) ;Braakmann et al. (2011); Chen & Chu (2012) ;Nankervis & Singh (2012); Oyewobi et al. (2013) ; Kang (2013); Nachum (2014); Jara- Bertin et al. (2015); Akben(2015); Seifzadeh (2017); Bhatia & Thakur (2018); Brahmana et al. (2019); Zuñiga-Vicente et al. (2019); Setianto (2020)
Organizational Learning	1. Diversification experiences 2. Learning and knowledge transfer 3. Organizational issues	Tanriverdi & Venkatraman (2005) ; Bergh & Lim (2008) Hutzschenreuter & Guenther (2008) Cao & Liu (2010)	Bardolet et al. (2011); Kim et al. (2011); Chen et al. (2013); Theodorakopoulos et al. (2014) ; Mayer et al. (2014) ;Villasalero (2014) Sohl & Vroom (2014) ; Sakhartov & Folta (2014); Andreou et al.(2016); Ryu et al. (2020)

Proposed Research Agenda

This study was conducted to provide an exhaustive review of theoretical and empirical articles that explain the relationship between diversification and firm performance to identify theoretical gaps that have been overlooked. In fact, the meta-narrative review approach and thematic analysis have revealed two important perspectives: the historical and geopolitical perspectives.

Geopolitical perspective

The concept of Geopolitics was coined by Rudolf Kjellén in 1914 and then developed by German General Prof. Karl Haushofer during World War. Classical geopolitical thought is based on the political power to control and compete for geographical space (Engelbrekt, 2018). In this context policy makers sometimes encourage firms to diversify into new sectors via suggestions or global regulatory policies. Thus, diversified firms and states are constantly interrelated and influencing each other to bargain strategic positions (Abdelal, 2015; Schneider, 2009).

The geopolitical perspective may evaluate diversification in terms of global externalities, geopolitical regulatory policies and strategic geography. In this perspective, natural resources, territory and intergovernmental communities may rise as a global externalities influencing diversification and firm performance. It is also argued that the impact of global regulatory policies on diversification results, as international government authorities may impose constraints to certain industries, in case of global crisis, conflict or sanitary issues. Properties of topography, allocation and transportation of products, logistic access to ports, sea lanes and cargo airports may influence the relationship between corporate diversification and firm performance. Also, the interactions between human society and ecological environment may shape the decisions to diversify. These arguments suggest factors that have been neglected according to this literature review, thus, the following research questions are raised:

Does the geopolitical perspective help to explain the diversification-performance linkage?

Do the global externalities, geopolitical policies and strategic geography influence the diversification-performance linkage?

Historical perspective

The history of business view involves complex interactions between industries, entrepreneurs, socio-political environment and firms in their historical context. In this perspective, the evolution of firms and historical relations contribute to have a deeper understanding of business phenomena including strategies and performance (Jong, Higgins & van Driel, 2015).

The historical perspective may view corporate diversification with regard to historical events, temporal dynamics and historical cultural traditions. A proper study of the historical context can clarify corporate diversification research in given historical events by finding key advice documents from the past that offers alternative explanations (Rutterford & Sotiropoulos, 2016). This perspective includes the study of temporal dynamics prompted by innovations and technical revolutions and how they may shape the different strategies and performance (Perez, 2010). In this scenario, strategies and firm outcomes may be explained by periodical industrial-technical revolutions over time. Hence, the relationship between diversification and performance may be mediated by historical trends and patterns. In this perspective, diversification may also be related to cultural and historical traditions (i.e., shared education, symbolic structures and language) as these may guide firm behavior and results. It is stated that the relationship between corporate diversification and performance draws upon a set of commonly shared meanings, discourses and symbolic structures of culture that are embedded in human physical and mental daily activities. Therefore, according to these factors, historical understanding of the context might help to explain diversification and performance, thus, the next questions are presented:

Does the historical perspective help to explain the diversification-performance linkage?

Do the historical events, temporal dynamics and cultural-historical traditions influence the diversification-performance linkage?

Summary of perspectives

Based on the narrative literature review approach and thematic analysis of 202 articles, two alternative perspectives to explain corporate diversification and performance are proposed, as summarized in the following table.

Table 2.3

roposed theoretical perspectives and subtopics on the diversification research.

Proposed theoretical perspectives	Subtopics
Geopolitical perspective	Global externalities Geopolitical policies Strategic Geography
Historical perspective	Historical events Temporal dynamic Cultural-historical traditions

Discussion

This paper reveals six theoretical perspectives, and proposes two alternative approaches to the study of the relationship between corporate diversification and firm performance. Although, the review and research method allow to develop and tailor the survey process to ensure the appropriate literature is covered, it may not be sufficient to properly classify the themes. The large body of research, overlap between the themes and theoretical contradictions may hinder such endeavor. However, this article highlights the lack of consideration for geopolitical and historical perspectives from previous literature review studies, theoretical and empirical papers.

This study has different implications for research and practice. In research, scholars interested in this relationship may use this review to identify the theoretical boundaries that have been discussed over the last 20 years. Also, it assistances to develop an integrated framework and promote further investigations on the subject. In practice, this study may assist corporate managers to make better diversification decisions for corporate planning and particularly resource allocation among business by considering the theoretical perspectives here presented. It may also help them to identify guidelines on important contingencies that may affect diversified firms.

Conclusion

The relationship between corporate diversification and firm performance cover a multidisciplinary and broad literature. Overall, research on corporate diversification offers a traditional set of perspectives to explain the nature of this relationship. The evidence suggests six theoretical perspectives to explain diversification and performance: industrial economics, resource-based view, organizational learning, institutional perspective, agency theory and financial perspective. This study suggests an historical and a geopolitical approach and their main subtopics as alternative explanations. It is concluded that these perspectives should be part to the study of corporate diversification and firm performance.

Note

The theoretical and empirical studies analyzed in this review can be provided upon request.

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