COUNTRY RESOURCE ENVIRONMENTS, CORPORATE DIVERSIFICATION STRATEGIES, AND FIRM PERFORMANCE

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Corporate diversification research has made significant advances in the past decades (Hoskisson & Hitt, 1990). To date, the dominant approaches to diversification have largely been premised on the United States and United Kingdom contexts. However, the coexistence of different types of diversification strategies in the world would appear to provide *prima facie* evidence that there is no single "best" diversification strategy. For example, business conglomerates have dominated many economies throughout the world (Khanna & Palepu, 1997). This fact appears to contradict extant research that high levels of product diversification are detrimental to firm performance. More recently, the topic of international diversification has also captured the attention of researchers (e.g., Hitt, Hoskisson, & Kim, 1997; Tallman & Li, 1996). Despite its significant contribution, this line of research has largely focused on firms located in the most affluent countries such as the United States or Japan but rarely examined firms located in other countries.

This study brings country environmental context to the foreground and contends that different country environments embody diverse levels of resource endowments. By employing a multidisciplinary, comparative approach, we examine the performance implications of various corporate diversification strategies associated with dissimilar country resource environments. By juxtaposing product and international diversification strategies in an integrative conceptual framework premised on a common set of rationales, the paper seeks to provide an explanation for the apparent "paradoxical" relationship between diversification strategies and firm performance across different country resource environments.

COUNTRY RESOURCE ENVIRONMENTS

Drawing upon arguments developed in institutional economics (e.g., North, 1990), political science (e.g., Putnam, 1993), and strategy (e.g., Rumelt, 1974), we contend that country resource environment is a context that provides firms with a multitude of resources. Country resource environments provide two main kinds of resources: factor resources for transformational activities and institutional resources for transactional activities. We maintain that different country resource environments embody diverse sets of opportunities and constraints for firms. We reconceptualize various diversification strategies as strategic actions to facilitate the acquisition or utilization of environmental resources for building competitive advantages.

Accordingly, we suggest that certain diversification strategies are more likely to be associated with superior performance in certain environmental contexts.

COUNTRY RESOURCE ENVIRONMENTS AND CORPORATE DIVERSIFICATION

Firms compete for resources to attain competitive advantages. Country resource environments constitute the context within which firms devise appropriate actions to maximize competitiveness. Because country resource environments possess diverse levels of resources, the resources that firms need or can obtain, and capabilities subsequently developed, are likely to differ across such environments. As a departure from the extant literature, we contend that it is at this point where various diversification strategies come into play in different country resource environments. When resources differ among environments, strategic success is unlikely to hinge on the same set of factors. As such, different diversification strategies can be understood as different actions to acquire or utilize specific environmental resources for competition. We examine below how country resource environments may influence the performance implications of various diversification strategies (product, outbound international, and inbound international).

Product Diversification

In environments with higher levels of (both institutional and factor) resources, firms enjoy easier access to an abundant supply of public environmental resources. A healthy supply of institutional resources enables firms to enjoy specialization benefits facilitated by the availability of market transaction mechanisms. Abundant factor resources imply that competitive advantages would be mostly based on transformational efficiency. Firms would find it beneficial to pursue lower levels of product diversification, which places great emphasis on developing unique capabilities.

> *Hypothesis 1a: In country environments with higher levels of resources, product diversification is negatively related to firm performance.*

In environments with lower levels of (both institutional and factor) resources, higher levels of product diversification may allow firms to create private resources. Diversified firms can overcome external capital market failures by reaping the benefits of internal financial economies (Hill & Hoskisson, 1987). Moreover, fostering ties with government bureaucrats would allow firms to enjoy state favors. These diversified firms can erect institutional entry barriers by monopolizing scarce factor resources or even lock competitors out of the product market by changing “the rules of the game” (e.g., lobbying). By pursuing higher levels of product diversification, these firms can maximize returns on capabilities that are not tightly restricted to any specific product market.

> *Hypothesis 1b: In country environments with lower levels of resources, product diversification is positively related to firm performance.*

Outbound International Diversification

Firms in environments with higher levels of resources may rely on the abundant factor resources to develop global competitive advantages. Besides, their competitive edge is sharpened by

intense rivalry as well as sophisticated customer demand in the domestic market (Porter, 1990). High levels of institutional resources provide an adequate "appropriability regime" to encourage firms' innovation incentives (Teece, 1986). The level of market competition is also enhanced due to active enforcement of anti-trust regulations, resulting in "the survival of the strongest." Building on a solid home base, firms in these environments would be potent global competitors.

Hypothesis 2a: In country environments with higher levels of resources, outbound international diversification is positively related to firm performance.

Redeployment flexibility of a firm's capabilities (Anand & Singh, 1997) determines if a firm may transfer its capabilities across countries. Most firms in environments with lower levels of resources lack globally redeployable capabilities to compete in foreign markets. Dominant firms are likely to compete largely based on institutional advantages (e.g., government ties). Nonetheless, these institutionally based competitive advantages are localized in nature and likely to dissipate in foreign countries. Outbound international diversification is unlikely to lead to higher levels of performance in these environments and may even have detrimental effects on performance as these firms are likely to be outcompeted in the global market.

Hypothesis 2b: In country environments with lower levels of resources, outbound international diversification is negatively related to firm performance.

Inbound International Diversification

Despite the benefits of cooperation with foreign partners, or outbound international diversification, research has noted the associated hazards (e.g., Inkpen and Beamish, 1997; Porter, 1990). In environments with higher levels of resources, inbound international diversification is less likely to yield significant benefits because many firms have the resources to develop superior capabilities. The resources that can be contributed by most foreign firms would generally be less valuable. To the extent that managing international alliances and dealing with foreign partners impose burden on the management or divert their attention away from domestic competition, inbound international diversification would even hurt firm performance.

Hypothesis 3a: In country environments with higher levels of resources, inbound international diversification is negatively related to firm performance.

Firms in environments with lower levels of resources would find inbound international diversification strategy beneficial. Despite their potential advantages, foreign firms may still be hindered by a host of local factors. This creates opportunities for local firms to collaborate with foreign partners. Although firms in these environments often lack the capabilities to pursue outbound international diversification, inbound international diversification represents a "virtual" exit to acquire foreign resources. In addition, firms pursuing this strategy may neutralize the threats from foreign entrants by turning some of them into partners and become better equipped to counter other foreign entrants. Although the difficulty of managing international alliances still exists, the benefits are likely to outweigh the costs in these environments.

Hypothesis 3b: In country environments with lower levels of resources, inbound international diversification is positively related to firm performance.

Interaction Effects

To compete globally, firms need to have superior competitive advantages that allow them to compensate for operating in unfamiliar countries (Hymer, 1960). In environments with higher levels of resources, competition is intense because abundant supplies of environmental resources allow a larger number of firms to compete in the market. To develop competitive advantages in these competitive environments, firms have to focus on developing expertise in a certain product market. Higher levels of product diversification would significantly compromise firms' abilities to develop global advantages. Although outbound international diversification is likely to increase firm performance in these resource environments in general, such a relationship would be negatively moderated by the level of product diversification.

Hypothesis 4a: In country environments with higher levels of resources, the interaction between product diversification and outbound international diversification is negatively related to firm performance.

Inbound international diversification would benefit firms in environments with lower levels of resources because firms can draw on foreign partners' resources. Firms that are more diversified in these environments may also achieve higher levels of performance as they have the abilities to create private resources to facilitate their business operations. Foreign firms would prefer to cooperate with these diversified firms because of their social connection and influence. When diversified firms cooperate with foreign partners, their ability to dominate the market would become even stronger. As such, pursuing higher levels of inbound international diversification and product diversification is likely to be particularly beneficial in these resource environments.

Hypothesis 4b: In country environments with lower levels of resources, the interaction between product diversification and inbound international diversification is positively related to firm performance.

METHODS

The country sample was drawn from Western European countries. A larger number of variables were used for the three components of factor resources (endowed factors, advanced factors, and human factors) and institutional resources (political institutions, legal institutions, and societal institutions. To classify 16 Western European countries into country environments with higher and lower levels of resources, we used split half (and median split), mean spilt, and cluster analysis. We then narrowed the sample size to six countries. The first group (country environments with higher levels of resources) contains Sweden, France, and U.K. and the second group Ireland, Italy, and Portugal (country environments with lower levels of resources).

For firm-level data, we used a three-year average for the independent and control variables (95 to 97) and the dependent variables (96 to 98). The sample, which was constructed from *Worldscope*, has 722 firms (first group: 499; second group: 223). Returns on assets (ROA) and

earnings before interest and taxes divided by assets (EBIT) were used as performance indicators. We used imputed weighted diversification (Caves, Porter, & Spence, 1980) to calculate product diversification. The number of countries where the firm had subsidiaries or alliances was used to capture outbound international diversification. The number of countries, as represented by the foreign partners of the firm's alliances, was used to capture inbound international diversification. We controlled for leverage, sales growth, ownership, firm size, industry, and country.

RESULTS AND DISCUSSION

Each model was tested using OLS regression. In general, the results show that the performance implications of diversification strategies differ between environments with higher and lower levels of resources. The results held for a number of robust checks and alternative specifications.

Product Diversification

Product diversification was found to have a negative relationship with performance in more munificent environments (Hypothesis 1a). Also as predicted, product diversification was found to positively influence firm performance in less munificent environments (Hypothesis 1b). The results suggest that product diversification is not always detrimental. The negative effects appear to be largely conditioned by the environmental context. To examine the robustness of the findings, we used the number of 2-digit SIC codes (Lins & Servases, 1999) and the results were consistent. We used product diversification squared to test for a curvilinear relationship in more munificent resource environments (Palich, Cardinal, & Miller, 2000) but the results are not statistically significant. Despite the theoretical appeal of the benefits of moderate levels of diversification, firms may not easily realize such benefits (Hill & Hoskisson, 1987; Jones & Hill, 1988). As for less munificent environments, we also did not find any curvilinear relationship.

Outbound International Diversification

When firms diversify internationally, our results suggest that their performance increased (Hypothesis 2a). However, such a positive relationship was non-existent for firms located in environments with lower levels of resources (Hypothesis 2b). Together, these results indicate that the benefits of outbound international diversification may be more fully acquired by firms located in more munificent country resource environments. We also used the number of regions as a proxy. There is a significant, positive relationship between number of regions and EBIT (not for ROA) for more munificent environments. No relationship was detected for less munificent environments. By and large, the results are consistent. We used outbound international diversification squared to test the relationship for more munificent environments and the results indicate that an inverted U-shaped relationship may exist (Hitt et al., 1997).

Inbound International Diversification

For more munificent environments, the results do not support a negative relationship between inbound international diversification and performance (Hypothesis 3a). For less munificent environments, we hypothesized but did not find a positive relationship between inbound international diversification and firm performance (Hypothesis 3b). This may suggest that the

benefits are difficult to realize than is commonly assumed. Firms in these environments may be overly dependent on external resources, and thus most benefits are expropriated by their foreign partners (Inkpen & Beamish, 1997). Furthermore, these firms may lack absorptive capacity (Cohen & Levinthal, 1990) to learn from their foreign partners. We also tested the relationship using inbound international diversification squared and the results were likewise non-significant.

Interaction Effects

As noted above, although firms in less munificent environments were hypothesized to benefit from inbound international diversification (Hypothesis 3b), this effect was not found. However, we hypothesized and found that product diversified firms in these environments benefit more from inbound international diversification (Hypothesis 4b). Taken together, these results imply that the benefits of inbound international diversification are limited to diversified firms. Because these firms are dominant in their environments, they can negotiate for better terms. These firms also can leverage the factor resources obtained from their foreign partners across more businesses. In more munificent environments, the hypothesis that there is the interaction between product diversification and outbound international diversification is negative and statistically significant is also supported (Hypothesis 4a). Firms with high levels of product diversification perform worse when they diversify internationally. Our findings suggest that focused firms enjoy the benefits of outbound international diversification whereas product diversified firms suffer from such a strategy. We tested the interaction between product diversification squared and outbound international diversification but no statistical significant effect was detected. We also tested if high levels of product diversification would reduce the negative effects of high levels of outbound international diversification on performance (Hitt et al., 1997) but did not find such a moderating effect.

CONCLUSION AND IMPLICATIONS

We adopt a comparative approach examining strategic outcome heterogeneity between dissimilar country resource environments. Such an approach provides a valuable starting point for international research on corporate diversification. Future research might profitably focus on areas where we have not. For example, the approach developed in this study may be linked to international corporate governance by providing an integrated perspective for explaining the co-existence of market-based and non-market based governance structures across countries. Furthermore, our approach may help foster improved understanding regarding international entry as firms may consider matching environmental resources in making entry decisions. Our approach may additionally have implications for public policy makers who face many critical issues (e.g., privatization) that are taking place in many emerging and transition economies (Hoskisson, Eden, Lau, & Wright, 2000). Given the potential importance of the conceptual approach developed in this study, further research using this approach is likely to be fruitful.

REFERENCES AVAILABLE FROM THE AUTHOR