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A REVIEW ON BUSINESS GROUP AFFILIATION, DIVERSIFICATION STRATEGIES AND FIRM PERFORMANCE

İşletme Grubuna Bağlılık, Çeşitlendirme Stratejileri ve Firma Performansı Üzerine Bir Değerlendirme

Özlem ÖZEN[1]

ABSTRACT

Product diversification and international diversification are the strategies that are implemented by firms in emerging and developed economies. These strategies have favorable or negative impacts on firm performance and firms' context may affect this relationship. Business group is one of the contexts that may affect the relations between product diversification strategy, international diversification strategy and firm performance. Business groups can provide member firms with valuable resources and knowledge for pursuing these strategies. Existing studies have examined the diversification strategies and performance relations in various economies and several moderating factors in this relationship; however, the role of business group affiliation has been addressed to a lesser extent. Therefore, this study discusses the relations between product diversification, international diversification strategies and firm performance considering the business group affiliation. Following the relevant literature, this study also presents propositions which can be examined further. The propositions suggest that emerging economy firms can perform better by implementing product diversification and international diversification; however, these two strategies may also harm firm performance. Moreover, group affiliation may have favorable or negative moderating impact in these relations when firms pursue product or international diversification. This study aims to provide foundations for future studies on diversification strategies, firm performance and business group affiliation relationships.

Keywords: *Business group affiliation, Product diversification, International diversification, Firm performance*

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ÖZET

Ürün çeşitlendirme ve uluslararası çeşitlendirme gelişmekte olan ve gelişmiş ekonomilerdeki firmalar tarafından uygulanan stratejilerdendir. Bu stratejiler firma performansı üzerinde olumlu veya olumsuz etkiler yapmakta ve bu etki firmaların içinde bulundukları bağlama göre değişebilmektedir. Ürün çeşitlendirme, uluslararası çeşitlendirme ve firma performansı arasındaki ilişkileri etkileyen faktörlerden birisi işletme gruplarıdır. İşletme grupları kendilerine bağlı firmalara bu stratejileri sürdürmede kaynak ve bilgi sağlamaktadır. Yazındaki çalışmalar, farklı ekonomilerde çeşitlendirme stratejileri ve firma performansı arasındaki ilişkileri ve bu ilişkideki aracı faktörleri incelemişlerdir; ancak, işletme grubuna bağlılığın rolüne daha az değinilmiştir. Bu nedenle bu çalışma, ürün çeşitlendirme, uluslararası çeşitlendirme ve firma performansı arasındaki ilişkileri işletme grubuna bağlılığı dikkate alarak tartışmaktadır. Bu çalışma ayrıca ilgili yazın çerçevesinde araştırma gerektiren önermeler sunmaktadır. Önermeler, firmaların ürün ve uluslararası çeşitlendirmeden faydalanabileceğini; ancak, bu stratejilerin diğer yandan firma performansına zarar verebileceğini ileri sürmektedir. Ayrıca, işletme grubuna bağlılık bu ilişkilerde olumlu veya olumsuz aracı etki yapabilmektedir. Bu çalışmada, çeşitlendirme stratejileri, firma performansı ve işletme grubuna bağlılık arasındaki ilişkiler üzerine ileride yapılabilecek araştırmalar için temel oluşturulması amaçlanmaktadır.

Anahtar Kelimeler: *İşletme grubuna bağlılık, Ürün çeşitlendirme, Uluslararası çeşitlendirme, Firma performansı*

INTRODUCTION

A business group is a type of organization existing in emerging economies (Bucheli, Salvaj & Kim, 2019; Carney, van Essen, Estrin & Shapiro, 2018; Colli & Colpan, 2016; Ghemawat & Khanna, 1998; Khanna & Rivkin, 2001). Groups are called Jituanqiye in Taiwan, Keiretsu in Japan, Grupos Economicos in Latin America, Cheabol in South Korea, and Holding in Turkey. They have common characteristics such as having affiliated companies within a group and high diversification strategies to overcome imperfections in emerging economies (Khanna & Palepu, 1997). Granovetter (1995) defines business groups as a set of firms that are linked with each other through formal or informal connections. In similar terms, Khanna and Rivkin (2001) describe business groups as a collection of legally independent firms connected with each other by various formal and informal ties.

In order to reduce risks in their home environments business groups pursue high level of product diversification strategy. Groups' resources and capabilities allow them to have diversified structures (Hobday & Colpan, 2010). However, after 1980s, since many of the world's economies are affected by the liberalization policies, international expansion became a strategic decision for firms as well (Toulan, 2002). Therefore, international diversification became a major strategy of the firms along with product diversification to compete with their counterparts in developed and emerging economies (Capar & Kotabe, 2003) and diversification strategies have association with firm performance and growth (Berry, 1971; Rumelt, 1982). Moreover, it is acknowledged that affiliation with a group is beneficial for firms as groups allow firms access to internal resources within the group which is considered as a performance increasing factor (Chang, Chung & Mahmood, 2006; Chang & Hong, 2002; Hsieh, Yeh & Chen, 2010; Manikandan & Ramachandran, 2015; Mukherjee, Makarius & Stevens, 2018). In this sense, since product and international diversification are the main strategic decisions in business groups and for firms in emerging economies, this study reviews the relations between firms' strategies regarding diversification and performance considering the business group affiliation. The present paper aims to enhance the understanding by providing a review on product, international diversification, business groups and suggesting propositions which can be examined in the future studies.

This paper is set out as follows. Firstly, the theoretical foundation of business groups is explained. Then, considering group affiliation, the relations between product diversification decision, international diversification strategy, and firm performance are discussed. Propositions are presented based on these relations in the relevant sections. Finally, the paper concludes with some suggestions for future research.

1.THEORETICAL FRAMEWORK FOR THE EXISTENCE OF BUSINESS GROUPS IN EMERGING ECONOMIES

1.1. Institutional Theory

In emerging economies, the institutional approach is prevalent in explaining firm behavior (Hoskisson, Eden, Lau & Wright, 2000). According to institutional theory institutional environment determines the firm behavior. The coercive, normative and mimetic pressures (DiMaggio & Powell, 1983) cause homogeneity among firms which is reflected by conforming cognitive, normative and regulative structures (Scott, 1995). The formal and informal institutions in the environment constraint firm behavior through rules, regulations, laws, and norms (North, 1990). In emerging economies, where the institutions are not well developed, firms need to take these formal and informal constraints of their home environments into account in their strategic decisions (Peng, 2002; Peng, Sun, Pinkham & Chen, 2009). In order to gain legitimacy, firms follow the procedures which are established in their environments (Meyer & Rowan, 1977).

The diversified business groups in emerging economies have emerged as a result of state regulations, orientation of the state toward economic development and social relationships (Granovetter, 1995). Governments with their institutional support and incentives encourage the development of business groups (Yiu, Lu, Bruton & Hoskisson, 2007). Home country environment, which includes political, legal and societal institutions, influences business activities of firms (Wan & Hoskisson, 2003) such as product and international diversification (Gaur & Kumar, 2009; Thomas, 2006; Wan, 2005). Diversified business groups conform to the institutional context in emerging economies (Ghosh, 2010). In a study on Chinese business groups, Chen (2010) states that state intervention and the institutional environment have different impacts on performance of business group. However, depending on the development of institutions the resources on which the business groups rely may change. In a study of business groups in China, Yiu, Bruton and Lu (2005) reveal that groups that have market-based resources are more successful than the groups with government resources.

According to the institutional approach, affiliation with a business group is beneficial for operation of firms. In addition to access to resources, group allows firms to decrease the constraints of the institutional environment in the allocation of capital and managerial resources (Leff, 1978). The various ties among affiliates enable them to behave in a coordinated manner (Khanna & Rivkin, 2001). Garg and Delios (2007) state that in Indian business groups, affiliation and development in the host country influence the survival of foreign subsidiaries. Groups have a good reputation and can have benefits through links with the governments, which may not be available to independent firms. Groups diversify unrelatedly and control their members through a family or state ownership structure owing to such benefits (Singh & Gaur, 2009).

1.2. Transaction Cost Economics

According to the transaction cost economics, business groups are formed to respond to underdeveloped markets and institutions (Ghosh, 2010). In contrast to developed economies, in emerging economies, there are various failures in markets, and intermediaries such as venture capitalists, financial analysts, investment bankers, mutual funds, are inefficient (Khanna & Palepu, 2000b). Therefore, in emerging economies, lack of well functioning markets and institutional mechanisms create institutional voids. Thus, large, diversified business groups have emerged to fill these institutional voids through substituting resources, capital, and labor for their affiliates (Khanna & Palepu, 1997, 2000a). In similar terms, business groups provide these markets internally through which affiliated firms can get benefit to mitigate market failures (Khanna & Palepu, 2000b). Chang and Choi (1988) argue that the diversification of Korean business groups is affected by market imperfections which increase transaction costs.

1.3. Resource Based View

The resource-based view (RBV) acknowledges organizations as dependent entities to their environments to survive. According to this view, a firm's main aim is to get access to rare and valuable resources to pursue its activities. According to Pfeffer (1982), firms are dependent to their environments due to the resource requirement. Wernerfelt (1984) focuses on the importance of the firms' resources. The RBV emphasizes the role of unique tangible and intangible resources firms have (Wernerfelt, 1984), and presumes that firms' competitive advantages derive from unique resources which are difficult to imitate by competitors (Barney, 1991). The RBV, which emphasizes the internal resources in explaining diversification, suggests that those firms with related diversification have superior performance through sharing resources among business units (Wan, Hoskisson, Short & Yiu, 2011). Groups in emerging economies are formed if political and economic conditions allow them to get resources to take part in new industries through combining foreign and domestic resources (Guillen, 2000). Also, RBV can be extended to include external advantages that business group affiliation provides, such as reputation and social capital that enable access to resources (Becker-Ritterspach & Bruche, 2012).

2. PRODUCT DIVERSIFICATION AND FIRM PERFORMANCE

Khanna and Palepu (1997) identify various characteristics of institutional environments in emerging economies which are important aspects to explain diversification strategy. The absence of well-functioning financial, product and labor markets, laws and regulations and inconsistent contract enforcement cause difficulties in pursuing strategies and outcomes in such economies. In order to cope with an institutional environment and compete with other firms where capital market, product market and labor market are not developed, and where laws, regulations and contract enforcement are insufficient, firms may wish to pursue unrelated diversification strategy to gain institutional support. In environments, where factors and institutions lack, product diversification is the ideal strategy for firms to create resources and to build networks (Wan, 2005; Wan & Hoskisson, 2003).

Emerging economy firms diversify unrelatedly to overcome the problems of their countries, such as uncertainty, institutional pressures and lack of support (Li & Wong, 2003). Therefore, in emerging economies, unrelated diversification may enable a firm to perform better through conforming institutional norms (DiMaggio & Powell, 1983; Li & Wong, 2003; Scott, 1995). Peng, Lee and Wang (2005) attribute the positive link between conglomeration and performance in emerging economies to the relationship of firms with institutions which is referred as "institutional relatedness" and state that firms in uncertain environments utilize social, political and reputational capital to perform well. The absence of markets for risk and uncertainty, lack of advantages to have the benefits of focused strategy also explain groups' entry in diversified product lines (Leff, 1978; Nachum, 2004). Gathering under a parent company is an opportunity to share suppliers and consumers as well (Ghemawat & Khanna, 1998).

As a result, firms operating in such environments may have higher performance through diversifying into irrelevant businesses and imitating the institutions which are insufficient to allow firms to get access to resources. Conditions of institutional environments and implementation of unrelated diversification in such environments may be relevant in explaining the diversification strategy and performance relations (Li & Wong, 2003). In a study of Chilean firms, Khanna and Palepu (2000a) indicate that the relation between firm performance and unrelated group diversification is curvilinear. In addition, member firms outperformed focused independent firms.

In contrast to institutional economics perspective, the resource-based view supports diversification into related areas. Through related diversification, firms build resources, capabilities and share these among their businesses. This allows collaboration among units within a firm (Li & Wong, 2003). Regarding to creation and development of business groups, Kock and Guillen (2001) propose that groups' unrelated diversification should be understood as an extension of capabilities that are different from ones in developed countries and group structure is a response to the strategic contingencies in an environment. Guillen (2000) suggests that in emerging economies, firms can build up inimitable capabilities to enter industries by combining domestic and foreign resources.

In a study of Chinese firms, Li and Wong (2003) explore the impact of related and unrelated diversification decisions on firm performance combining resource based and institutional perspectives. Their results reveal that resource building, related diversification strategy and institutional environment management following unrelated diversification are essential for performing well in emerging economy firms. It is suggested that affiliates benefit from sharing intangible and financial resources within the Korean business groups (Chang & Hong, 2000). In a case study of Taiwanese busines groups, Chung (2006) reveals that group diversification is a process driven by resources and market opportunities. The Guanxi networks are influential when markets are controlled, and the competitive advantage stems from the ability to build networks which link a group to domestic and international resources.

However, some studies depict negative effect of diversification on performance. Bae, Kwon and Lee (2011) state that diversification into unrelated areas in Korean firms decreases firm value; however, related diversification strategy does not diminish firm value. Moreover, being affiliated with a large business group increases the valuation impact of firm diversification. Choi and Cowing (2002) state that diversification in Korean chaebols does not affect profits. In a study on U.S. firms, Palepu (1985) finds that related diversified firms perform better than firms with unrelated diversification. Unrelated product diversification, despite the different results in the literature, can be beneficial for firms in emerging economies. It can also have a negative impact. Moreover, group firms may benefit from diversification when compared to independent peers; therefore, it can be proposed that:

Proposition 1a: Product diversification strategy has a positive effect on firm performance.

Proposition 1b: Product diversification strategy has a negative effect on firm performance.

Proposition 2: Business group affiliation positively moderates the relation between product diversification strategy and firm performance.

3. INTERNATIONAL DIVERSIFICATION AND FIRM PERFORMANCE

Hitt, Hoskisson & Kim (1997) define internationalization as having foreign operations within a firm. There are several theories that explain the internationalization strategy of the multinational enterprises (MNEs) from developed economies such as the Uppsala model and OLI (ownership-location-internalization) paradigm. According to the Uppsala model, firms internationalize in small steps through exporting, establishing a subsidiary and beginning production in foreign countries (Johanson & Wahlne, 1977). The OLI theory assumes that firms with ownership, location and internalization advantages can operate in foreign countries to compete with the domestic firms (Dunning, 1988).

The benefits of diversification can be enhanced by international diversification strategy in business groups. The higher level of country risk in emerging markets makes international diversification more attractive. Internationalization can allow emerging economy firms to deal with the problems in their countries (Nachum, 2004). International diversification can enable firms from emerging economies to decrease the unfavorable effects of market failures in obtaining resources from their country (Gaur & Kumar, 2009). Nachum (2004), examining developing country firms, finds a positive relationship between industrial diversification, geographic diversification strategy and performance; moreover, geographic diversification has stronger impact on performance than industrial diversification.

The internationalization of the business groups is affected by the institutional factors (Yang, Jiang, Kang & Ke, 2009). According to Peng, Wang and Jiang (2008) societal, legal and political changes in India influence the inward and outward strategies of Indian firms. Carney and Dieleman (2011) attribute the lower level of internationalization of Indonesian business groups to the institutional and firm level factors. In a study of Turkish multinationals, Erdilek (2008) states that the liberalization in the home environment, foreign environment, technologies, access to markets, fiscal motives, natural resources, brands play important roles as foreign direct investment drivers.

Business groups in emerging economies intend to operate in developed economies when their main aim is to explore new resources and capabilities; whereas, they are more likely to have relations in other emerging economies when the aim is to exploit resources of their groups (Hoskisson, Kim, White & Tihanyi, 2004). Firms in such economies pursue international activities to overcome the disadvantages of their institutional home country environments; whereas, firms in developed economies expand internationally to exploit the capabilities they build in their home countries (Gaur & Kumar, 2009). However, Wan (2005) states that domestic firms develop strong capabilities to a lesser extent to internationalize, and although firms in emerging economies intend to pursue international diversification, most of them do not have the ability to compete in foreign environments. Wan (1998) reveals that among Hon Kong multinational companies, international diversification strategy has no positive effect on profitability; moreover, industrial diversification reduces the profitability.

The studies, which investigate the relationships between international diversification, product diversification and performance depict different results. While product diversification generally has negative effect or no effect on performance, international diversification increases the performance of the firms. In their study, Wan and Hoskisson (2003) reveal that product diversification decision is negatively associated with firm performance in more generous environments; however, positively linked to firm performance in less munificent ones. Additionally, outward international diversification increases performance of the firms in more munificent environments; whereas, in less munificent environments it is not beneficial. On the other hand, inward international diversification is not beneficial in less munificent environments. Tongli, Ping and Chiu (2005) examine the product diversification strategy, international diversification strategy and performance relationships in Singapore firms. While product diversification strategy is negatively associated with performance, international diversification has a positive effect. Geringer, Tallman and Olsen (2000) examine the product diversification, international diversification and performance relationships among Japanese multinationals. Their results depict that product diversification strategy has a weak impact on firm performance; whereas, international diversification has a negative effect on profitability with positive sales growth in certain periods. Moreover, their results show that while diversification strategies differ between member and independent firms, performance does not differ much. Delios and Beamish (1999), considering the effect of proprietary assets on firm performance, find that geographic expansion is positively related to firm profitability in Japanese firms; whereas, product diversification is not associated with firm performance.

In a study of Japanese firms, Lu and Beamish (2004) find a S shaped relation between internationalization and firm performance. Hitt et al. (1997) show an inverted U shaped relation between diversification into international activities and firm performance. Moreover, in non-diversified firms, international diversification strategy is negatively related to firm performance; whereas, in highly product diversified firms the relationship is positive. International diversification has also positive impact on R&D; however, the interaction impacts with product diversification is negative. Geringer, Beamish and DaCosta (1989) examine the relationships between product, international diversification decisions and firm performance on US and European MNEs. Their results depict that related diversification strategies cause higher performance. However, the relation between internationalization strategy and performance is inverted U shaped. Lu and Beamish (2001) find a U shaped relation between internationalization strategy and performance in Japanese SMEs where the liability of foreignness decreases the profitability of firms. Contractor, Kundu and Hsu (2003) find an S shaped relation between diversifying in international environment and performance in knowledge based service firms in the U.S. Thomas and Eden (2004) show an S shaped relation between diversification into international markets and performance among U.S. manufacturing firms.

Studies from developed economies reveal that while related product diversification may have favorable impact on performance to a certain point, international diversification can moderate the relation between product diversification strategy and firm performance. Tallman and Li (1996) investigate the relationships among international diversity, product diversity and performance in American MNEs. Their results reveal that product diversification and performance are related up to a certain point; however, the increase in product diversity causes low performance. The international diversification has weak effect on performance and similarly has weak effect on the relation between product diversification choice and performance. In a study of the US firms, Kim, Hwang and Burgers (1989) indicate that unrelated diversified firms with high global diversification have higher profit than unrelated diversified firms with low global diversification. However, related diversified firms' profit growth is not affected by global market diversification. Firms in emerging economies may benefit from international diversification or may have negative performance impacts of international diversification due to the liability of foreignness; therefore, it can be proposed in line with the literature that:

Proposition 3a: International diversification strategy has a positive effect on firm performance.

Proposition 3b: International diversification strategy has a negative effect on firm performance.

When product diversification is considered in internationally diversified firms, it may have favorable or negative moderating impact on international expansion and firm performance relationship. Therefore, it can be proposed that:

Proposition 4a: Product diversification positively moderates the relationship between international diversification and firm performance.

Proposition 4b: Product diversification negatively moderates the relationship between international diversification and firm performance.

3.1. Business Group Affiliation and International Diversification

Buckley, Cross, Tan, Xin and Voss (2008) state that ownership advantages that emerging economy firms accumulate from their experience in turbulent home country conditions can be helpful in operating abroad. Business groups have both domestic and foreign resources. Thus, group affiliation can provide a firm competitive advantage in foreign expansion through its access to groups' capital, resources and labor (Yaprak & Karademir, 2010). Although independent firms also have similar resources, group firms can share resources and build capabilities among themselves to compete with independent peers (Gaur, Kumar & Singh, 2014; Hobdari, Gammeltoft, Li & Meyer, 2017; Sing & Gaur, 2013). Firms learn from other affiliates' international experiences (Borda, Geleilate, Newburry & Kundu, 2017; Lee, Yang & Park, 2020). Moreover, the national governments in emerging economies may increase the foreign direct investment through their support on business groups (Buckley et al., 2008). Kim, Hoskisson and Wan (2004) find that keiretsu affiliation has dissimilar implications for keiretsu member firms with strong power and for those with weak power. Keiretsu member firms with strong power show significantly more positive relationships between product diversification, international diversification and sales growth, compared to those of independent firms.

However, business groups, which diversify into many unrelated businesses, may become counterproductive when they expand abroad. Therefore, highly geographically diversified member firms may have lower performance when competing abroad (Gaur & Kumar, 2009). Business groups generally rely on product diversification to gain competitive advantage; therefore, product diversification may moderate the relationship between international diversification strategy and firm performance (Hoskisson et al., 2004) In a study of Indian firms, Gaur and Kumar (2009) reveal that while internationalization has a favorable influence on firm performance, business group affiliation conditions the relation between internationalization strategy and performance negatively.

Group membership benefits may change when the institutional environments develop or when firms expand abroad (Gaur & Kumar, 2009). Adopting a longitudinal study, Kim, Kim and Hoskisson (2010) investigate the influence of market based institutional change on international diversification in business group member and independent firms in Korea. The results depict a negative relation between diversifying internationally and firm performance. Moreover, while during institutional frictions, the moderating influence of business group membership on the relation between international diversity and firm performance is negative, it becomes positive during the convergence term. Following the arguments, it can be proposed that:

Proposition 5a: Business group affiliation positively moderates the relation between international diversification and firm performance.

Proposition 5b: Business group affiliation negatively moderates the relation between international diversification and firm performance.

CONCLUSION

This paper reviews the relationships between firms' product diversification, international diversification strategies and performance along with the business group affiliation. Business groups exist in emerging economies and provide their affiliated firms with resources which allow to pursue diversification strategies to compete with independent peers. However, many firms in such economies follow product and international diversification to perform better than competitors. In this sense, the examination of relations between these strategies and performance becomes essential. Thus, the purpose of the present paper is to discuss whether product and international diversification strategies are beneficial or harmful for firms in emerging economies and how being affiliated with a business group moderates this relation. The studies in the literature reveal different results regarding the relationships between product, international diversification, performance and group affiliation. Therefore, future research can explore the impact of product and international diversification strategies on firm performance in emerging economies (Wan et al., 2011). Also, the moderating impact of factors, such as product diversification strategy, institutional advancement, corporate governance on the relation between international diversity and firm performance needs further investigation in such economies. Moreover, whether being affiliated with a group contributes to firm performance when firms pursue product and international diversification needs further examination (Carney et al., 2018; Gaur, Pattnaik, Singh & Lee, 2019; Holmes, Hoskisson, Kim, Wan & Holcomb, 2018).

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