



Macro-Competitive Context and Diversification: The Impact of Macroeconomic Growth and Foreign Competition



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This longitudinal study of large European firms (1993–2007) offers a conceptual model that explains how two key aspects of the macro-competitive environment, macroeconomic growth and foreign competition, shape product and international diversification. The results indicate that greater foreign competition reduces product diversification but fosters international diversification, while macroeconomic growth has a positive impact on product diversification and a negative one on international diversification. These findings suggest that managers have to set economy-wide, macro-competitive conditions alongside firm and industry-level considerations when making diversification strategy choices.

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Introduction

“Siemens is strongly affected by changes in general economic and business conditions.” Peter Loescher, CEO of Siemens, 2012¹

In a recent presentation of quarterly results, Siemens's CEO has stressed the importance of aligning the firm's portfolio with wider economic trends. Such anecdotal evidence indicates that senior managers consider developments in the macro-competitive environment as important to the choice of corporate strategies. Although the strategic management literature has long suggested that the macro-competitive environment affects the performance of diversification strategy (Geringer et al., 2000; Hill, 1983; Li and Tallman, 2011), its impact on the choice of product and international diversification strategies has not been theorized or examined empirically in a systematic manner. Typically, the impact of the economic environment on diversification choice has been captured through industry-level effects (Delios and Beamish, 1999; Hutzschenreuter and Groene, 2009b; Rumelt, 1974; Santaló and Becerra, 2006; Wiersema and Bowen, 2007). An implicit assumption of such a focus is that economic developments impact on firm strategy through industry-level mechanisms exclusively. This assumption is challenged by empirical and theoretical developments in both the economics and management literatures. Recent work has demonstrated that key strategic variables such as R&D (Barlevy, 2007), advertising (Hall, 2012) and firm growth (Beck et al., 2004) are impacted significantly by wider economic conditions distinctly and separately from industry-level conditions. Studies have highlighted the importance of macro-competitive conditions for fundamental aspects of strategic development by demonstrating their impact on firm survival and entry (Ouyang, 2009) and examining the robustness of strategies over the business cycle (Alessandri and Bettis, 2003). Of particular interest in relation to our present focus on diversification strategy is work that has considered the role that the correlation of business cycles across business units plays in affecting organizational risk (Donaldson et al., 2012). Research has, moreover, suggested a relationship between the wider economic context and diversification at national and regional levels (Frenken et al., 2007; Gutierrez De Pineros and Ferratino, 1997; Imbs, 2004) raising some tantalizing questions about the possible impact on the firm level.

The wider literature thus strongly reinforces calls for a more systematic examination of the impact of national economic activity on strategy (Chakrabarti et al., 2007; Geringer et al., 2000). This paper contributes to this agenda by offering a first theorization of how the macro-competitive context shapes both product and international diversification, distinctly and separately from firm and industry-level factors. More specifically, this study offers a conceptual model that explains how two

¹ <http://www.siemens.com/press/en/pressrelease/?press=/en/pressrelease/2012/corporate/2012-q1/axx20120113.htm>.

key aspects of the macro-competitive environment — macroeconomic growth and foreign competition — shape product and international diversification. Empirically, we estimate the impact of the macro-competitive context on diversification in an integrative simultaneous equation model that captures the joint and simultaneous nature of product and international diversification, and accounts for both endogeneity and interdependence (Bowen and Wiersema, 2009; Kumar, 2009).

The empirical focus is thereby on large diversified European firms. The data spans the timeframe from 1993 until 2007, covering the era beginning with the formation of the European Single Market and ending with the onset of the recent global economic crisis. Over this time period, the sample firms were confronted with profound changes in the economic landscape which are expected to influence firm strategy (Dierx et al., 2002). The widespread reduction of barriers to trade and significant increases in foreign competition make this empirical setting highly suitable for examining the impact of such wider economic conditions on diversification strategy.

The paper proceeds as follows. In the next section we develop the theoretical background and formulate our hypotheses. The third section describes the sample, variables and method. In the fourth section we present our results, which we discuss in the final section where we consider the implications of this and offer suggestions for future research.

Theory and hypotheses

Theoretical and empirical insights into the impact of the macro-competitive context on diversification strategy are limited. While some studies have controlled for factors such as macroeconomic growth when investigating the impact of industry-level antecedents (e.g., Hutzschenreuter and Groene, 2009a,b), no clear theoretical expectations about its impact on diversification have been formulated. In addition, systematic empirical analysis of the direct links between these macro-level factors and diversification strategies has yet to be conducted. What is required, then, is a model that not only captures the key dimensions of the macro-competitive context in an integrative manner, but also examines their effect on firm-level strategic choice while controlling for relevant firm and industry-level economic antecedents.

In order to theorize the distinct effect of the macro-competitive environment on diversification it is instructive to consider briefly the logic and limitation of capturing the impact of external economic developments purely at the industry level. The starting point for such approaches lies in Rumelt's "escape hypothesis" (Rumelt, 1974; Stimpert and Duhaime, 1997), which establishes diversification as a way of escaping from unattractive or deteriorating competitive conditions in a firm's existing industry base (Delios and Beamish, 1999; Rumelt, 1974; Santaló and Becerra, 2006). In other words, diversification is an attempt to move away from "low-opportunity markets" (Christensen and Montgomery, 1981: 338). The implicit assumption is that the firm can identify markets offering more attractive opportunities elsewhere. This, however, does not account for environmental contingencies that affect the existence of such markets.

Consider the following thought experiment: Assume Firm A, with a given set of firm specific assets and capabilities, is facing declining prospects in its established markets. If this occurs during a recession, then its ability to identify and enter more attractive markets will be more limited than in the context of macroeconomic growth. Without accounting for how such differences in the wider external environment shape the diversification opportunities available, an industry-level explanation of diversification strategy remains incomplete. In short, firm diversification decisions will be shaped not only by their existing resources and capabilities and competitive factors affecting their existing portfolio of activities, but also by the opportunities in the wider economic context (Helfat and Eisenhardt, 2004).

As highlighted recently (Augier and Teece, 2009), the development and recognition of opportunities is integral to core theories of strategy in general, and diversification research in particular. In one of the foundational texts of the field, Edith Penrose, for example, argued that the "theory of growth of firms is essentially an examination of the changing productive opportunities of firms" (Penrose, 1959: 31–32). For diversification strategy specifically, this means that patterns of diversification are shaped by the "opportunities which lie ahead" (Teece et al., 1994: 28), which are influenced substantially by the development of the wider economic and competitive context. Diversification allows firms to respond and adapt to changing environmental conditions (Davis et al., 1994) by enabling search processes which can lead to new uses and better matches for organizational capabilities and resources (Matsusaka, 2001). Helfat and Eisenhardt (2004) observe that Penrose (1959) notes "that as markets mature, they may become relatively less profitable compared with new investment opportunities that firms could undertake using their resources." The macro-competitive context is central to the development of such opportunities (Augier and Teece, 2009; North, 1990; Pattanaik and Xu, 2000; Teece, 2007; Teece et al., 1994; Wan and Hoskisson, 2003).

Economic expansion, for example, reflects an overall easing of the intensity of competition across industrial sectors (Helg et al., 1995). At the same time, sector level growth rates, although typically associated positively with overall macroeconomic change, differ from one another (Helg et al., 1995; Steenkamp and Fang, 2011). Changes in the wider economic context thus signal both absolute and relative changes in the diversification opportunities available to firms. In the following we consider the impact of two aspects of the macro-competitive environment that jointly influence the overall pattern of diversification opportunities, macroeconomic growth and foreign competition. The specific hypotheses we develop are grounded in the assumption that firms respond to such external opportunities.

Macroeconomic growth

Macroeconomic growth and contraction is one of the most fundamental parameters of business activity. Recent studies suggest that the benefits from diversification will be affected by macroeconomic conditions (Chakrabarti et al., 2007).

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