10.1 Summary

In the past several years, researchers have sought to assess the relative importance of industry, business, and corporate factors in determining profitability differences across firms. To answer this question, researchers focused on empirical studies that use variance decomposition techniques. These studies incorporate the relative role of entire classes of effects in explaining differences in profitability. The current debate about the importance of industry, business, and corporate effects began with a study by Schmalensee (1985), followed by studies by Wernerfelt and Montgomery (1988), Rumelt (1991), McGahan and Porter (1997, 1998), Chang and Singh (1997) and Fox, Srinivasan and Vaaler (1997). These studies decompose the variance of business group or firm performance into components associated with corporate (strategy), industry and business effects, and some studies include year effects and interaction effects as well. Their findings having its origin in I/O Economics concluded that industry effects dominated profitability, followed by business effects, and corporate effects are insignificant. However, off late, a revisionist view is going around that corporate effects does matter; has gained considerable influence in recent years (Bowman and Helfat, 2001).

Our thesis reaffirms faith in strategy literature that factors at the corporate level of business groups significantly contribute to differences in profitability, but evidences also suggest that factors specifically associated with diversification strategy significantly contribute to corporate effects. Corporate strategy in fact does matter. In order to evaluate such inferences, we first ask: what in theory are the corporate level factors that influence firm or business profitability, and to what extent these factors reflect corporate strategy. Corporate influence on profitability results from factors associated with membership of multiple firms or businesses within individual groups. Of the many corporate level factors that influence performance, much research has focused on the scope of the firm, including selection of industries in which they operate. Building on the work of Rumelt (1974), research has analysed the link between relatedness in diversification and firm performance. A large amount of research also has investigated the consequences of vertical integration of firms, which pointed out to the advantages of vertical integration when transaction costs are high.
(Williamson, 1975, 1985). Prahalad and Hamel (1990) point to the importance for corporate success of core competencies that span businesses within a corporation, as another well-known example of corporate level factors thought to affect profitability.

With regard to conglomerates in the developed markets, Chandler (1962, 1977) emphasised the advantage of multi-divisional form of organization structure over the functional organisation of multiple-business form (M-form). Research related to firm organisation has shown that organisational structure also affects corporate profitability (Hansen and Wernerfelt, 1989). Other research has dealt with the systems of planning and control, including the use of strategic versus financial control (Goold and Campbell, 1987). Additionally, profitability may be influenced by top management skills, which includes managerial ability, and manifests itself concretely in managerial plans, decisions, directives, advice, and goal setting for the group as a whole and for individual businesses within the group (Andrews, 1987; Hambrick and Mason, 1984). Further, researchers have also used similar techniques to estimate top management effects (in terms of leadership) on profitability. It captures one type of transient corporate effect for both single-business and multi-business firms (Lieberson and O’Connor, 1972; Weiner and Mahoney, 1981).

A fundamental part of any group’s strategy is its choice of business portfolio to compete in. According to strategy literature, this decision by and large reflects the superiority of related over unrelated and single business firms (Ansoff, 1965; Rumelt, 1974; Bettis, 1981; Lecraw, 1984; Palepu, 1985); though some authors point towards unrelated diversification by business groups in emerging markets as a more effective strategy (Khanna and Palepu, 1997; Khanna and Palepu, 2000; Khanna and Rivkin, 2001). However, despite over four decades of extensive research, there is still considerable disagreement about precisely how and when diversification can be used to build long term competitive advantage (Markides and Williamson, 1994). The proposition of related diversifications seems robust and comprehensive, because, it presumably allows the corporate epicenter to exploit the inter-relationship that exists among its various businesses to achieve competitive advantage through cost and/or product differentiation. We argue traditional measures of relatedness provide an incomplete and potentially exaggerated picture of the scope for a corporation to exploit the interrelationships between its different businesses. This is because traditional measures look at relatedness only at the product, market or industry level. In this controversy
we try to build upon a more dynamic concept of strategic relatedness, which is superior to other traditional measures of relatedness (Markides and Williamson, 1994).

We further argue that traditional ways of measuring relatedness are incomplete because they ignore the strategic importance and similarity of the underlying assets residing in these businesses, and primarily because it tends to equate the benefits of relatedness with static exploitation of economies of scope. In order to predict how much a strategy of related diversification will contribute to superior long-term returns, it is necessary to adopt a more holistic view of strategy and need to incorporate the entire gamut of corporate level factors to understand the influence of strategy on performance, and not merely concentrate on diversity. Theoretically, this thesis attempts to overcome this major weakness in explaining how relatedness can yield synergy across a diversified set of businesses.

We built on the concept of dominant logic to develop a platform, which enabled us to take an birds eye view of factors that influences strategy and performance. In other words, dominant logic can be seen associated deeply with the genetic factors embedded in the roots of an organisation. Its influence is pervasive. It permeates the organisation, yet it is invisible. It predisposes the firm to certain kinds of strategic problems and often interacts with organisational systems and structures in a complex way in causing these problems. The major theoretical advance of this study is the contention that, as long as a diversification strategy (i.e. choice of business) is strategically related with the dominant logic of the group, performance will be enhanced and vice-versa. Unlike previous studies, this centrality will not only enable us to identify factors that relate to strategic successes, but strategic failures as well. This concept not only enables us throw more light on the nature of relationship between diversity and group performance, but also on the nature of impact of group affiliation on firm performance.

However, dominant logic is not a static tool, especially when emerging markets use economic liberalisation as tool to further economic growth. The factors that shape dominant logic is then of considerable importance, in analysing these institutional changes. Prior, to economic liberalisation most emerging markets were characterised by institutional voids and gaps. During such periods market imperfection was pre-dominant in explaining strategic choice of business portfolios. However, as markets become more and more efficient and emerging markets integrated with the global markets, group resources and more particularly,
distinctive capabilities became more and more pre-dominant in explaining such strategic choices. In such situations, business groups need to dynamically respond and adapt to such changes in the business environment, by changing its dominant logic. And more importantly restore strategic fit, when the equilibrium between dominant logic(s) and business portfolio becomes deviating. Perhaps, one of the safest ways to take exposure in industries where the fit is deviating is to radically change the composition of the top management or hand over control of the business to a strategic partner. Or else wait for the industry to take its own course of action till it fits the dominant logic of the business group. Not only business groups should be able to see change in the environment but also transform themselves in the light of the changing economic environment. Business groups, which responded appropriately to such changes, succeeded; in contrast business groups which fail to respond to the changing faces of the economic environment, inevitably perished. This phenomenon has not only been observed in emerging markets, but in the case of developed markets as well. Strategic restructuring of business portfolio is the key to superior performance, especially when the institutional context changes. This is perhaps an indication that the growth trajectory followed by a business group is not primarily the outcome of its socio-economic, political and cultural forces surrounding it. Diversification strategies facing business a group is also an outcome of its own volition.

10.2 Implications, Contribution, and Limitations

Why is synergy elusive to diversification? The answer to this question has tremendous implications for top management decision-making. Whenever, diversifications strategies fail or businesses experience low profits, the top management usually resort to stopgap approaches. We have observed that the top management usually seeks short-term remedies. However, when the origin of a problem lie deeply embedded in genetic factors of an organisation, a more pragmatic approach is essential. The top management should consider an approach that involves an altogether different paradigm. Any attempt to tamper with surface level factors will only add complexity to the problem and make the entire restructuring process futile. In such situations, a change in the organisational systems and structure will not suffice nor by simply diversifying to break out of the independence of this industry. Introspection into the dominant logic(s) of an organisation is likely to provide long-term solutions. Therefore, when strategic bottlenecks are evident, ensuring strategic fit is the
key to diversification successes. There are evidently two strategic measures to ensure adequacy of this fit. One way is to totally recast the composition of the top management or hand over control to an outside strategic partner. Second, wait for the industry to adjust its forces till it fits the dominant logic.

From the point of view of contribution to theory, the study is an attempt to dig out a concept (i.e. dominant logic) that is lying dormant for more than two decades, despite being considered a milestone in strategic management research. It enabled us to study the applicability of this concept in the emerging market context. The concept has been ignored in most of subsequent research, because of the mystifying way in which the concept of dominant logic has been proposed. Criticality, of the concept is undoubtedly acknowledged. However, its implementation remained a major bottleneck, as the authors did not provide any clues on measurement of the construct. As assessed by the original authors, it is not only sufficient to develop methods of directly assessing dominant logic. It is more important to establish techniques to assess the degree of strategic fit between the dominant logic and businesses characteristics.

The study also tries to integrate some useful concepts from multiple theoretical lenses to propose a unified theoretical framework on diversification. Most of earlier studies have looked at the diversity–performance relationship from the point of view of a single theoretical lens. This is perhaps an attempt to marry theories combining multiple theoretical lenses. Managerial explanations have been merged with explanations grounded in economic theory to enable a holistic view of the research problem. Though the need of the same has been felt much earlier, but most authors failed to move beyond the conceptualisation phase. And in some cases even the conceptualisation was incomplete, leaving little or no scope for further improvement. An important offshoot of the study is the capturing of the dimension of environmental efficiency on a longitudinal scale, which has seldom been attempted before. We have also made an attempt to develop reliable proxies for certain critical industry and organisational variables. These proxies can be replicated in other economic contexts to test their cross-context robustness and to further improve upon them.

To do full justice to addressing this kind of exploratory research, the research design would have been ideal to use a combination of complementary research designs, viz., a few in-depth studies followed by large sample survey. Case studies are an ideal platform for an in-depth
understanding of strategy crises. However, a full scale empirical research to confirm the robustness of the proposed framework could not be carried out because one doctoral thesis alone is not enough for carrying out a research of such magnitude as time, as resources poses a major constraint. Currently, as our research stands, much room remains for further development. A distinct step towards ensuring higher significance for our study is to bypass longitudinal clinical investigation to assess dominant logics. A more direct approach through top management interaction would be much more meaningful and incisive. Perhaps, the first step towards assessment of the robustness of the framework is to confine the model to a large scale empirical testing comprising not less than fifty business groups, coupled with sophisticated modeling techniques, including neural networks. At successive steps of analysis, as we move from univariate to bivariate to simple multivariate analyses some of the relationships between variables become insignificant. This is a pointer that simple linear regression models may not adequately represent the complex reality surrounding diversification strategies facing business groups. Finally, efforts should be made to explore the application of this model over a wide range of strategic choices, and not focusing on choice of diversification alone.

10.3 Conclusion

The study is a small beginning towards a step in developing a unified theoretical framework on the nature and extent of diversification, its antecedents and impact on performance. It has adopted a holistic view combining multiple theoretical lenses to identify external and internal variables that has a bearing on the nature of relationship between diversity and performance. Select case studies were drawn across three largest business groups in India to analyse the nature of inter and cross-relationships among these variables. Special attention was focused on nature, and impact of the variables and its change from the point of view of economic liberalisation in India. More specifically, we tried to determine how business groups restructured their business portfolio in response to the same and its resulting effect on diversity and performance. Our observations led us to conclude that diversity in isolation has very insignificant bearing on performance. The composition of the business portfolio of a group is a far more superior indicator than diversity. We subsequently propose an integrated model of diversification strategies pursued by business groups in emerging markets. Our contention is that performance effects of high levels of diversifications may not be declining
provided business groups makes a conscious effort to restructure their portfolio of dominant logics, and diversify in businesses which are consistent to the same.

In this study we have taken a birds-eye view by including a large number of critical variables. Though breadth is definitely missing from our study, one would appreciate that especially when new horizons are being explored, depth is more important than breadth. As a result we have been able to significantly increase the explanatory power of the diversity – performance relationship, which was not achieved earlier. Economic liberalisation has formed the primary background for our study. The model has been framed by and large by incorporating the impacts of first and second phase of economic liberalisation in India on choice of diversification strategies facing business groups. But as we enter the third and the most important phase of economic liberalisation, which many other emerging markets have gone through, the validity of the model may pose questions. During this phase we expect to witness some critical ratification’s (i.e. capital account convertibility, free foreign entry and exit, etc), which may pose a different set of diversification strategies not experienced earlier. This may enhance performance of business groups, or may put the entire institution of business groups at stake. These factors may be required to be controlled for. Though we have tried to generalise the model as far as practicable, further research studies on this platform may be launched in other emerging markets to study the efficacy of this model, as different countries have used different models of economic liberalisation. Hence the crises faced by business groups in such markets and their subsequent strategies of business portfolio restructuring may be unique and different from the Indian context. We sincerely hope that this study will generate sufficient interest, which is likely to spark off new direction for future research on this framework.

10.4 Directions for Future Research

The validity of our integrated diversification model has been found to hold well across our sample survey. However, the robustness of the model may be put to question, given the limitations of sample size. Therefore, at this stage it would be wise to broaden the size of the sample by including business groups of varying profiles and cross-sections. This would better our understanding of business groups regarding the centrality of diversification choices. In order to position our model as a true unified theory, it also needs to be tested across a wide section of emerging markets. As the origin of business groups in different
markets can be traced to different sources of market failure. Our intuitive feelings also suggests that perhaps our proposed model would also hold good over an array of strategic choices, viz. choice of mode of strategy implementation, selection of strategy partner, etc. An extension along those lines would truly make the theory more generalisable in nature. Finally, assuming that behavioral patterns of business groups represent complex systems, use of statistical tools like neural networks for testing the model and its validation would be more incisive.