Contraction for the sake of expansion – An oxymoron?

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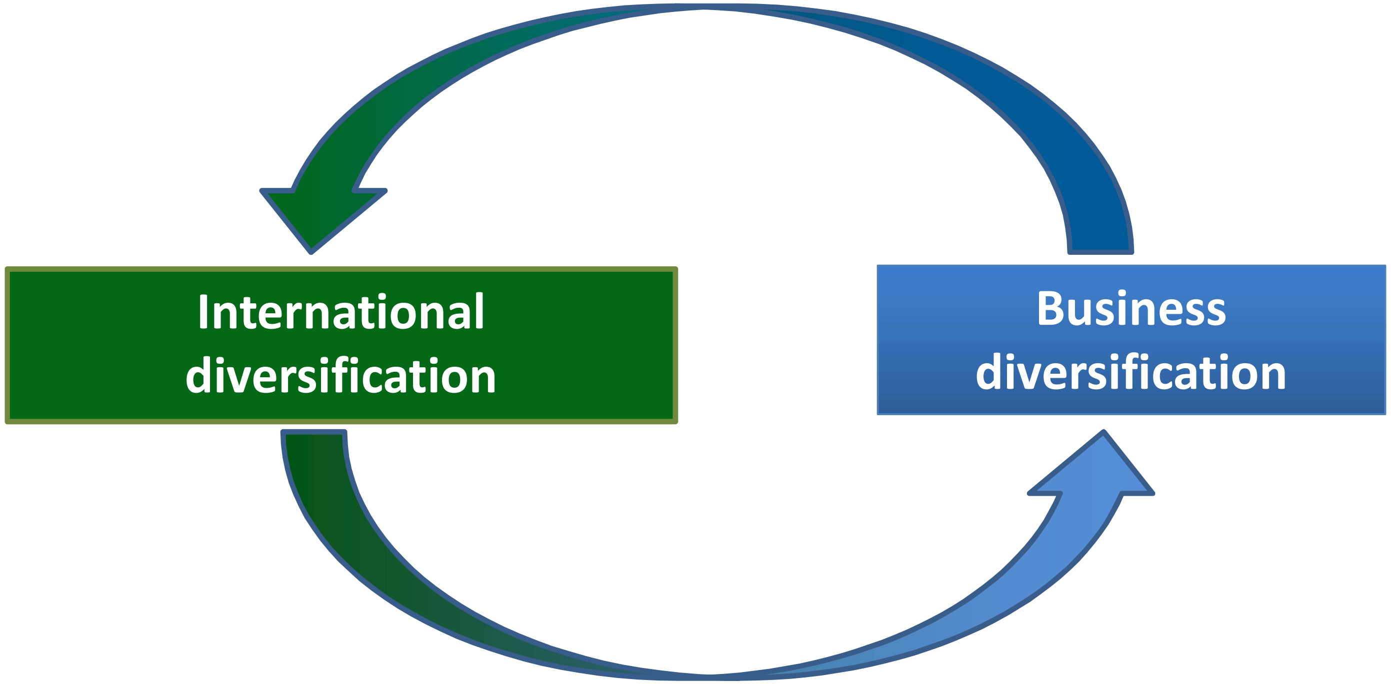
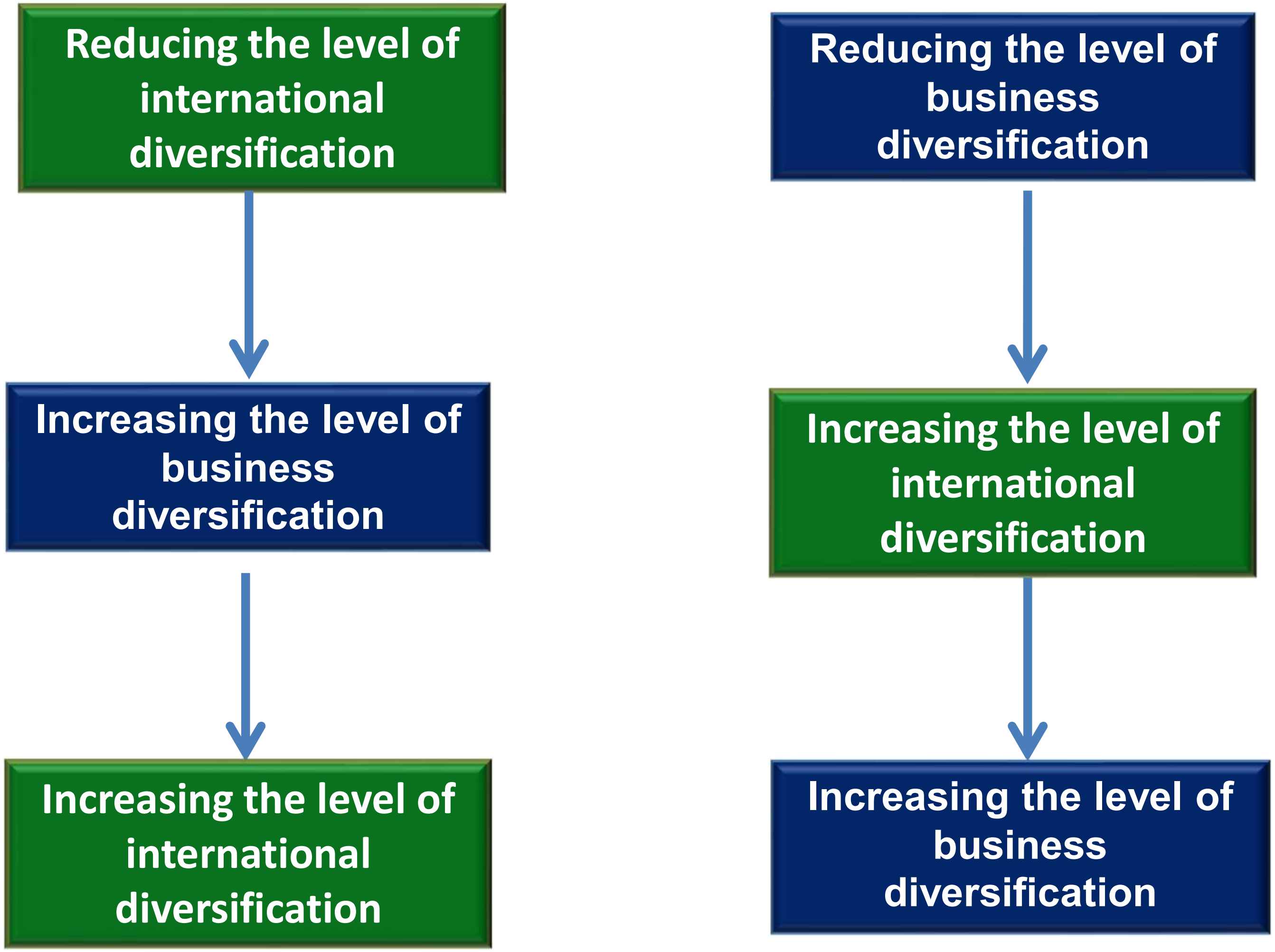
How to reach an optimal level of different growth strategies?



A large number of studies has revealed a plethora of relationships between the International and business diversification moves of firms

We highlight a novel relationship: contraction for the sake of expansion



Key theoretical mechanisms:

- **Substitution between non-scale free resources**

(Levinthal & Wu, 2010; Wu, 2013)

  - E.g., the attention and cognitive load of internally trained managers (Hitt, Hoskisson & Kim, 1997; Joseph & Ocasio, 2012; Penrose, 1959)

- **Creating new scale free resources**

  - **new brands and product technologies** /**intimate familiarity with foreign consumer preferences and access to foreign technologies**

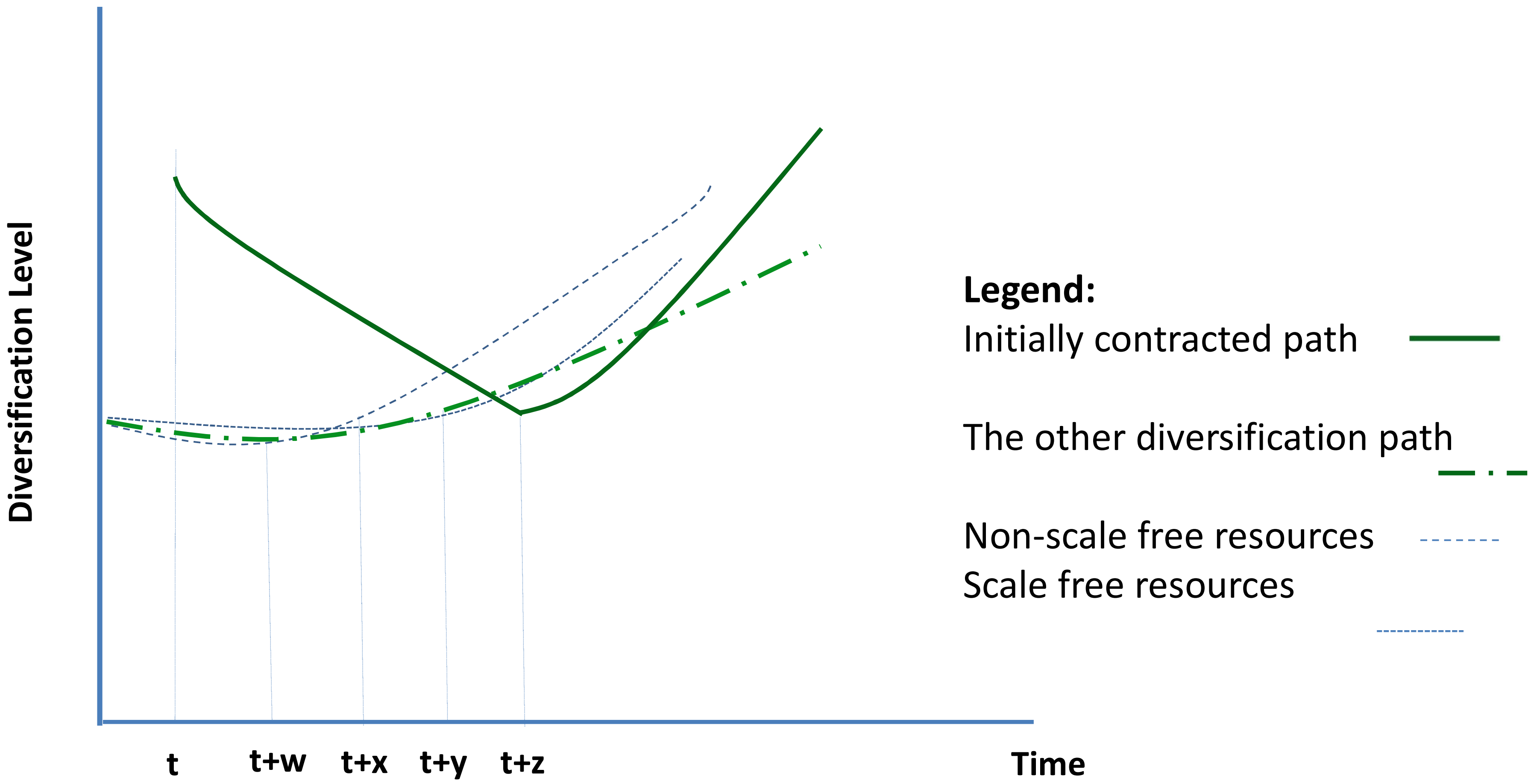
- **Adjustment costs and resulting time lags**

(Dierickx & Cool, 1989; Knott, Bryce & Posen, 2003)

Intuition

- Firms narrow down the variety of businesses where they operate →
- Use freed managerial time and attention to gradually penetrate more foreign countries →
- Become exposed to new technologies and sources of knowledge/diverse consumer preferences →
- Identify new opportunities in product markets where they do not operate →
- Expansion into new business segments

The consequences of contracting a given diversification path



Hypotheses

Hypothesis 1 – Contraction of a given diversification path is positively associated with a lagged expansion of the other diversification path.

Hypothesis 2 – Firms that expand their other diversification path, after contracting a given diversification path, increase their probability of expanding both diversification paths after an additional time lag.

Sample and measures

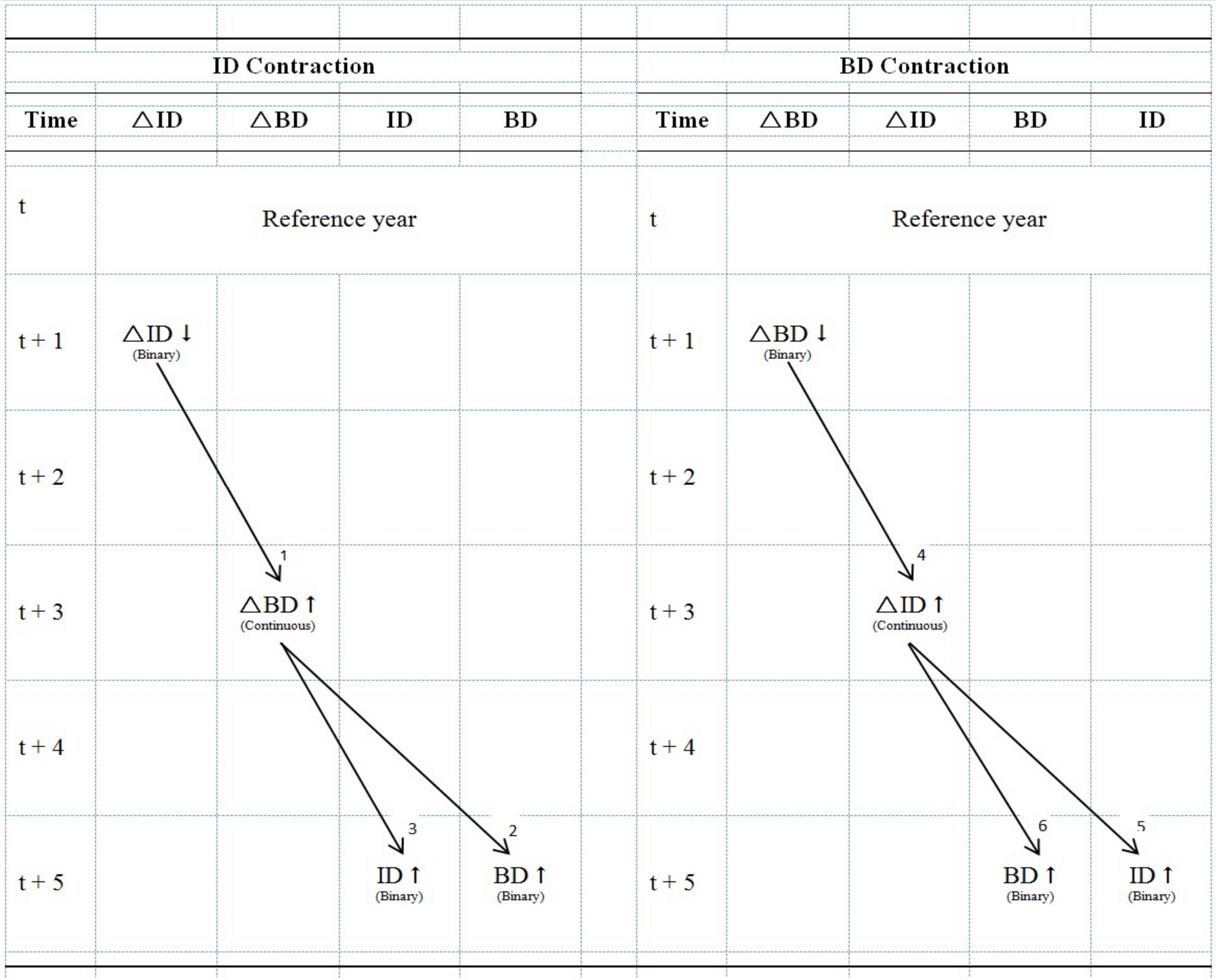
Panel data for 1673 US public firms for the period 1997-2011 (Compustat), 6973 firm-year observations

Measures

International diversification(**ID**), Business diversification (**BD**) – entropy measures of sales distribution across geographic/business segments

Controls: firms age, firm size, R&D intensity, ROA, firm risk, firm leverage, firm asset intensity + industry value added, industry productivity + year and industry dummies

Empirical strategy



AB- GMM regression results (controls not shown)

Variables	Model 1 DV= $\Delta BD_{(t\ to\ t+3)}$	Model 2 DV= $\Delta BD_{(t\ to\ t+5)}>0$	Model 3 DV= $\Delta ID_{(t\ to\ t+5)}>0$
<u>Independent Variable</u>			
$\Delta ID_{(t\ to\ t+1)}<0$	**0.034*** **(0.016)**		
$\Delta BD_{(t\ to\ t+3)}$		**0.638***** **(0.128)**	
$\Delta BD_{(t\ to\ t+3)}$			**0.410*** **(0.175)**
Observations	6,389	834	841
Number of Firms	1,584	425	429
Chi-squared	96.53***	132.09***	1214.60***
AR(1)	2.79**	-2.48*	-2.97**
AR(2)	1.48	-1.17	-0.22
Hansen Test	194.43	352.89	237.99

Robust standard errors in parentheses; P values in square brackets.

AB- GMM regression results (cont.)

Variables	Model 4 DV= $\Delta ID_{(t\ to\ t+3)}$	Model 5 DV= $\Delta ID_{(t\ to\ t+5)}>0$	Model 6 DV= $\Delta BD_{(t\ to\ t+5)}>0$
<u>Independent Variable</u>			
$\Delta BD_{(t\ to\ t+1)}<0$	**0.070*** **(0.032)**		
$\Delta ID_{(t\ to\ t+3)}$		**0.853***** **(0.192)**	
$\Delta ID_{(t\ to\ t+3)}$			**0.277*** **(0.133)**
Observations	6,679	902	907
Number of Firms	1,570	416	424
Chi-squared	1571.23***	166.99***	181.07***
AR(1)	9.26***	-1.99*	-5.17***
AR(2)	-1.52	-1.53	-1.64
Hansen Test	360.65	304.56	328.30

Robust standard errors in parentheses; P values in square brackets.

Contribution

Highlighting a novel combination of diversification moves

- the contraction of a given diversification path in the short term for the sake of expanding both diversification paths in the long term

- transfer non-scale free resources from the contracted path to the other path in the short term (Berry, 2010; Kaul, 2012; Vidal & Mitchell, 2015; Wu, 2013)
- generation of new scale free resources that can support renewed diversification in the initially contracted diversification path

Contribution (cont.)

Broader understanding of strategic trajectories' 'coevolution' - technological knowledge and product scope (Helfat & Raubitschek, 2000; Kaul, 2012); technological knowledge and internationalization (Golovko & Valentini, 2011) or exploitation and exploration (Levinthal & March, 1993)

Managerial 'orchestration' of resources (Teece, 2007) when shifting between international and business diversification, due to their **mutual interdependence**

Thank you!

Comments are welcome at: nhashai@idc.a.il