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Corporate Strategy in a Small Open Economy: Reducing Product Diversification While Increasing International Diversification

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This study has investigated the changes in corporate strategy and performance in 20 large Swedish MNC's between 1985, 1994 and 1998. It has found a strong pattern of product focusing, increased internationalisation, and a strong increase in accounting-based performance. This development seems to be contrary to former empirical evidence, that international diversification pays off better for more product diversified firms than for less product diversified. This might be due to a country effect; Swedish MNC's having substantial international experience might have created unique internationalising capabilities compared to many other countries' large firms. © 2000 Elsevier Science Ltd. All rights reserved

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The topic of diversification represents a dominant stream of research in the strategic management literature. In the area of product diversification significant research has been done since Rumelt's seminal work (Rumelt, 1974). Expansion into new product areas has been a popular corporate strategy among companies all over the industrialised world (e.g. Bengtsson, 1999; Chang and Choi, 1988; Dyas and Thanheiser, 1976). International diversification has spurred less research, but several empirical studies have researched the relationship between performance and international diversification. Researchers have shown that international diversification decreases the variability of a firm's revenues (Kim *et al*., 1993) and that geographic scope is positively related to firm performance (Tallman and Li, 1996; Hitt *et al*., 1997).

A few studies have tried to combine product and international diversification and relate the combined effects of these corporate strategies to performance. Even though findings vary somewhat, these seem to suggest that the combined effects of international diversification and product diversification on performance are positive (Sambharya, 1995). Delios and Beamish (1999) found in their study of Japanese manufacturing firms a positive effect of wide geographic scope on corporate performance for all product diversified firms, but an especially strong effect for the highly diversified firms. However, Hitt *et al*. (1997) found that these effects are different for companies with different levels of product diversification and international diversification. They found that single-business companies seem to have largely a negative relationship between international diversification and performance, while high-product diversifying companies have largely a positive effect of increasing international diversification. Moderate diversifiers enjoy, at first, a positive effect of increased international diversification but at some point this effect turns negative. On the other hand increased international diversification was generally associated with a higher degree of innovation, while product diversification generally was associated with a negative relationship towards innovation. Thus, we might conclude that the trade-offs between product and international diversification and long-term performance are complex and that further research is needed.

Most of the research referred to above have been done using American data. Large American firms are generally more product diversified and less internationally diversified than big companies originating from smaller open economies like Sweden. The reasons for this might be due to smaller average size of the big companies from the smaller countries (increased product diversification is positively related to size) but also larger incentives for the smaller-country companies to internationalise to compensate for their smaller domestic markets. Swedish MNCs are typically very internationalised with foreign sales often accounting for more than 50 per cent of total sales, in some cases more than 95 per cent. These companies are typically active in many countries, usually more than 50 countries, and to have subsidiaries in many of these. In the study reported here the average number of subsidiaries were 38 in 1998. Thus, the level of international diversification is often very high. In a study of French MNCs, Riahi-Belkaoui (1996) defined high internationalisation as foreign sales exceeding 44 per cent of total sales. Seen from a Swedish perspective this is a low level of foreign sales. The Swedish sample in this study had an average of 89 per cent of foreign sales in 1998 and no company would be below the level defined in Riahi-Belkaoui's study. Thus, there might be a country effect in earlier studies, having studied MNCs with a relative low level of internationalisation compared to MNCs from small open economies like Sweden.

However, the level of product diversification in Swedish firms is generally more modest and most of them could be classified as dominant or related diversifiers. Following the logic of the research made by Hitt *et al*. (1997), one could expect that Swedish MNCs would increase their level of product diversification and perhaps decrease their level of international diversification in order to raise performance. This course of action makes even more sense when considering the development of the corporate world in the 1990s which could be described in terms of increasing levels of competition and demands for higher levels of performance from investors during the 1990s. Pushing the degree of internationalisation even further would risk these firms encountering decreasing returns, if we are to believe the research made by Hitt *et al*. (1997) and others.

These studies on product diversification and internationalisation have generally also been cross-sectional not considering that diversification levels might change over time due to external developments, differing competitive pressures, differing investor pressures, waves of mergers and acquisitions and so forth. Empirical strategy research is generally too preoccupied with cross-sectional research and places too little emphasis on process dimensions of internationalisation strategy (Melin, 1992).

Thus, a study based on longitudinal data and data from MNCs based in a small open economy might provide an interesting and complementary perspective on former diversification research mostly based on cross-sectional data and on American firms. Also the research presented here is based on recent information. A corporate world becoming more competitive, more global and more dependent on financial markets might have changed the preconditions for large firms and their corporate strategy.

The aim of this paper is to answer the following questions:

1. To what extent have Swedish MNCs product and international diversification strategies changed from 1985 to 1998?
2. How have the firms' performance developed during this time period?
3. Can the pattern in the corporate strategy changes be explained by the theories mentioned above or do we have to resort to new explanations?

Method

From an earlier study of product diversification in the 50 largest Swedish manufacturing firms (Bengtsson, 1999) we had observed the tendency for a majority of these firms to reduce their product scope between 1985 and 1994. At the same time they seemed to have increased their international operations, though we did not collect any systematic data on their international operations. In order to do so we complemented our earlier data with data on international diversification and also collected data for the most recent year that annual reports had been published, i.e. 1998. Out of the 50 largest manufacturing firms we identified 22 firms that had been in the sample all three years (1985, 1994, and 1998). Two of the firms could not be classified as MNCs as they had international operations in fewer than six countries. The final sample consisted of 20 Swedish MNCs. As several of these firms had merged with foreign firms during this time period ABB (Swedish Asea and Swiss Brown Boveri) Avesta Sheffield (Swedish Avesta and British Sheffield), Scancem (Swedish Euroc and Norwegian Aker), Pharmacia & Upjohn (Swedish Pharmacia and American Upjohn), and StoraEnso (Swedish Stora and Finnish Enso) the charac-