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The moderating role of brand diversification on the relationship between geographic diversification and firm performance in the US lodging industry

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ABSTRACT

In spite of the prevalence and strategic importance of diversification for US lodging firms, research on the effects of diversification has been insufficient in the hospitality literature. Especially, an examination of the moderating effect of brand diversification on the relationship between geographic diversification and performance of US lodging firms has been lacking in the literature in various disciplines, including hospitality field thus far. This study aims to first investigate the individual effect from each of brand and geographic diversification strategy on firm performance in the US lodging industry. Further, to investigate effects of diversification comprehensively, this study examines the moderating effect of brand diversification on the relationship between geographic diversification and performance of US lodging firms. The study's results indicate a positive and significant effect of geographic diversification on firm performance, an insignificant effect of brand diversification, and a positive and significant moderating effect of brand diversification in the US lodging industry.

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1. Introduction

Firms have prevalently adopted diversification, simultaneous business operations in multiple markets, as a main corporate strategy to gain competitive advantages (Barney and Hesterly, 2008; Chang and Wang, 2007; Hitt et al., 1997). For example, large publicly traded US and EU firms operated their businesses, on average, in more than three distinctive geographic markets already in 1980s (Bodnar et al., 1999; Pavelin and Barry, 2005). And, large publicly traded German, UK, and US manufacturing firms operated their businesses in more than two different product markets in 1990s (Fauver et al., 2004). Moreover, in general, firms in various industries have simultaneously adopted different dimensions of diversification strategies (Denis et al., 2002; Tallman and Li, 1996). That is, firms penetrate into new geographic markets with new acquired products or brands, pursuing high speed, or with already existing diversified product or brand portfolios, majorly considering greater control (Barwise and Robertson, 1992).

US lodging firms conduct mainly two dimensions of diversification as their key corporate strategies. While US lodging firms employ geographic diversification as a core strategy, at the same time, they also actively adopt brand diversification, operation of multiple brands, as another major strategy. For example, Marriott International currently expands into 49 states in the U.S. lodging market with 19 different brands. Similarly, Starwood Hotels & Resorts simultaneously operates 9 brands across 10 different states in the US.

In accordance with the proliferation of diversification strategies in various industries, diversification has become a key research subject in strategic management, finance, and economics (Amit and Livnat, 1988; Chang and Wang, 2007; Denis et al., 2002; Hitt et al., 1997; Tallman and Li, 1996). One focused research subject regarding diversification is the effect of diversification on firm performance. However, theoretical viewpoints and empirical results regarding the effect of an individual diversification strategy have been mixed and inconclusive.

One avenue of research found the positive impact from the degree of geographic diversification (Bodnar et al., 1999; Deng and Elyasiani, 2008; Han et al., 1998), based on the internalization theory (Buckley and Casson, 1976) and the resource-based view (Barney, 1991). On the other hand, a group of scholars found the negative effect from the degree of geographic diversification (Denis et al., 2002; Fauver et al., 2004; Kang et al., 2012), supporting the internal transaction cost arguments (Egelhoff, 1982; Hitt et al., 1994; Jones and Hill, 1988) of the transaction cost theory (Williamson, 1975) and the agency theory (Jensen, 1986; Jensen and Meckling, 1976). By reconciling costs and benefits from diversification, some others proposed an inverted U-shaped relationship (Kotabe et al., 2002; Tallman and Li, 1996; Hitt et al., 1997) or a

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U-shaped relationship (Capar and Kotabe, 2003; Ruigrok and Wagner, 2003) between geographic diversification and firm performance.

For brand diversification strategy, empirical examinations and theoretical foundations for the effect of brand diversification on firm performance have been relatively scarce among diverse research fields. One rare study with a sample mostly composed of large manufacturing firms, conducted by Morgan and Rego (2009), found the degree of brand diversification associates with a higher Tobin's q and lower cash flow variability. In contrast, in the restaurant industry context, Choi et al. (2011) found the negative effect of brand diversification on Tobin's q.

Such seemingly contradictory findings for the unidimensional effect of one diversification strategy on firm performance may be caused by industry specific idiosyncrasies or methodological differences among various studies (Capar and Kotabe, 2003; Fauver et al., 2004; Hoskisson and Hitt, 1990; Ruigrok and Wagner, 2003; Tallman and Li, 1996). However, more importantly, the failure to incorporate interaction effects with other dimensions of diversification may be a critical reason of inconsistencies in findings of the effect of an individual diversification strategy (Bodnar et al., 1999; Gleason et al., 2003; Sambharya, 1995). That is, a unidimensional approach that does not consider other diversifications as potential sources of value may lead to a biased estimation. For example, Sambharya (1995) found that while both geographic and product diversifications separately have no significant effect on firm performance, the positive effect of geographic diversification increases as the level of product diversification increases. Although some studies examined such moderating effect of product diversification on the geographic diversification–firm performance relationship (Chang and Wang, 2007; Hitt et al., 1997; Tallman and Li, 1996), a study that attempts to investigate the moderating role of brand diversification has not appeared in the literature of various disciplines.

For the hospitality literature, in spite of the proliferation and strategic importance of diversification for hospitality firms (Basham and Kwon, 2009; Kang et al., 2011), research on diversification has been insufficient. Especially, despite a critical role of brands as core assets in the lodging industry (Jiang et al., 2002; Kim and Kim, 2005), research that investigates the moderating effect of brand diversification on geographic diversification–firm performance relationship also has not existed in the hospitality literature. Since examining the moderating effect of another diversification strategy can provide unbiased estimation for the effect of geographic diversification on firm performance (Bodnar et al., 1999; Gleason et al., 2003; Sambharya, 1995), investigating the moderating role of brand diversification strategy employed by hospitality firms is a necessary avenue for enriching diversification research in the hospitality industry.

Thus, motivated by the strategic importance of each dimension of diversification in the hospitality industry, mixed viewpoints and findings in the literature, and insufficient empirical examinations of diversification strategies in the hospitality field, first this study attempts to examine the effect of each diversification strategy on firm performance for the US lodging industry. Further, to investigate effects of diversification more comprehensively by incorporating interactions between different diversification strategies, this study seeks to examine the moderating effect of brand diversification on the relationship between geographic diversification and the performance of US lodging firms. This study expects to contribute not only to the hospitality literature and industry by providing comprehensive evidences for the effects of diversification strategies in the hospitality industry, but also contribute to the whole body of diversification literature and theory by adding a unique dimension, considering research on the moderating effect of brand diversification on the geographic diversification–firm performance relationship has not existed. The study next reviews relevant literature, and explains methodology in the subsequent section. Results and discussion are provided, and limitations and suggestions for future research finalize the study.

2. Literature review

2.1. Geographic diversification and firm performance

Geographic diversification can be defined as operations of a firm in multiple geographic markets simultaneously (Barney and Hesterly, 2008). Empirical findings of the positive impact from geographic diversification on firm performance (e.g., Grant, 1987; Han et al., 1998; Chang and Wang, 2007) are largely based on the internalization theory and the resource-based view (Buckley and Strange, 2011; Capar and Kotabe, 2003; Chang and Wang, 2007; Hitt et al., 1997; Tallman and Li, 1996). According to Buckley and Casson (1976), who proposed the internalization theory, diversified firms can enjoy benefits from diversification by organizing bundles of activities internally to develop and exploit firm-specific advantages in knowledge and products. More specifically, given the market failure, by internalizing the market a diversified firm can enjoy efficiencies in resource allocation in the internal capital market (Khanna and Palepu, 1999) and the internal labor market (Nickerson and Zenger, 2008), which enables the firm to reap above market returns on its specific assets.

Similarly, according to the resource-based view (Barney, 1991; Wernerfelt, 1984), firms may employ diversification as a strategy for establishing resources and capabilities to achieve competitive advantages through interactions among diverse business operations (Barringer and Harrison, 2000; Eng, 2005). Moreover, a firm's skills and knowledge deeply imbedded in the firm are difficult to sell in the market (Nelson and Winter, 1982). Selling those intangible assets involves many contracting problems (Wernerfelt, 1988; Caves, 1982). Therefore, a firm is more likely to utilize those excess resources within the organization thorough diversification rather than sell in the market.

Based on the internalization theory and the resource-based view, performing activities internally, using accumulated resources and capabilities, enables a diversified firm to gain economies of scale, economies of scope, and learning by exploiting the interrelationships and differences among business segments and geographic areas (Hamel, 1991; Kogut, 1985; Porter, 1990).

Additionally, for benefits from geographic diversification, managerial economists proposed the market power view, which asserts that with conglomerate power achieved from diversifying across markets, a firm can reduce competition, establish a dominant position, and gain greater bargaining power (Montgomery, 1994; Sundaram and Black, 1992). And, especially for the benefit of risk reduction through diversification, the modern portfolio theory (Lintner, 1965; Markowitz, 1952; Sharpe, 1964) may hold. That is, with diversification, a firm can reduce risk and bankruptcy costs because a firm's overall return stabilizes due to uncorrelated goods and factor markets (Kim et al., 1989), economic conditions (Rugman, 1976), and regulations (Caves, 1982) across various markets in which the firm operates businesses.

On the other hand, costs from diversification mainly arise from the internal transaction costs argument of the transaction cost theory. According to Egelhoff (1982), Hitt et al. (1994), and Jones and Hill (1988), diversified firms are more complex and have exposure to more complicated factors, such as different regulations in various markets, cultural diversity in organizations and customer segments, and diverse natural environments. Dealing with such factors may substantially increase the internal transaction costs,

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