International diversification of business: The literature review

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Abstract: In the context of international diversification in times of crisis, this article reviews the literature that describes the geographical diversification of the companies' assets and activities and the impact of such diversification on their economic performance. There is a lot of research aimed at studying the links and dependencies between the level of diversification of various aspects of companies' activities and their financial and other indicators. Most studies show the effectiveness of diversification strategies without considering the impact of crisis conditions. In this context, crisis, as an external factor, can be not only a risk factor for a company but also an incentive for a successful diversification project. For this article, studies that show different spectra of the impact of international diversification were chosen in order to identify the most significant areas for future research, which may also include mentioned crisis factors.

Keywords: international diversification, crisis, globalization, literature review

JEL Classification codes: F23

INTRODUCTION

Under the conditions of globalization of the world economy, acceleration of the pace of scientific and technological progress, and aggressive competitive environment as well, companies from various sectors are diversifying their economic and financial activities. Nowadays, one of the successful business strategies in dynamic and highly competitive markets is for companies to focus on multiple products, services, industries, or markets (Dhir et al., 2015).

This study aims to review the literature on international and geographical diversification of firms and the impact of crisis factors on diversification performance. Geographic diversification is a potentially successful strategy for firms seeking to expand their area of operations and reduce their dependence on a single market or region. By expanding into new markets, firms can gain access to new customers, increase their revenues, and reduce the risks associated with operating in one market. In addition, this strategy allows the firm to realize economies of scale and scope (Lu & Beamish, 2004; Contractor, 2007). Barney (1991) also explains that one of the reasons for diversification is the opportunity to maintain the company's long-term competitive advantage through a strategic pool of heterogeneous resources. Factors that influence diversification decisions include not only the mentioned competition (Fiss and Hirsch, 2005; Meyer, 2006; Vidal and Goetschalckx, 2001) and the economic environment (Sundaram & Black, 1992) but also risk management attitudes (Wang & Barney, 2006), technological discontinuity (Miller & Douglas, 2006) and the motives of company managers (Tihanyi et al., 2000).

Researchers from all over the world conduct research and study the effectiveness of international diversification not only as a stand-alone company strategy but also evaluate the impact of various internal and external factors on the performance of this strategy. This paper describes studies that focus both on the impact of international diversification itself on companies and studies that show how the financial crisis has affected the performance of diversified companies (Lu and Beamish, 2004; Delios & Beamish, 1999;). This paper provides an overview of such studies, their results, and a selection of literature describing different approaches to the study of this issue. After presenting the literature, I analyze the results of the works described and identify a relevant topic for further research in the field of international and geographical business diversification.

1 LITERATURE REVIEW

In recent years, there has been a growing body of research on the impact of geographic diversification on firm performance, risk, and value (Hilmersson, 2014; Lu and Beamish, 2001; Zahra et al., 2000). One of the main findings in the literature is that geographic diversification can have a positive impact on firm performance. For example, in a study published in 2010 by Nick and Zhao, the authors investigated the relationship between geographic diversification and the performance of European firms and found that diversification into new markets was positively associated with improved firm performance. In addition, various older studies also show that a higher level of geographic diversification can have a positive effect on firm performance (Delios & Beamish, 1999; Errunza & Senbet, 1984) and create the opportunity for companies to grow (Contractor, 2007; Ruigrok and Wagner, 2003). Similarly, Li and Chen (2013) found that geographic diversification has a positive effect on firm value in emerging markets, and according to Chakrabarti et al. (2007), international companies can get primary benefits from imperfections of these markets.

Lu and Beamish (2004) in their study investigated the relationship between international diversification and firm performance on a sample of 1489 firms from Japan over the period of 12 years. The authors tested the "S-curve hypothesis" and found a relationship between international diversification and firm performance, with firms experiencing a decline in performance initially and then a gradual improvement as they gained more experience in the international market. Furthermore, the authors also found that the relationship between international diversification and performance was stronger for firms in industries with a high level of experience and knowledge. In an earlier study by Lu & Beamish (2001), the results showed a U-shaped relationship in medium and small firms that had little experience with internationalization early in the process. Some studies in previous decades showed an inverted U-shaped relationship between firm internationalization and productivity using a sample consisting of large firms with high levels of internationalization, where the rising costs of coordinating their activities were taken into account (Geringer et al., 1989; Hitt et al., 1997).

Despite research showing the positive impact of diversification, one of the key challenges associated with geographical diversification is the need to manage the various cultural (Mihov & Naranjo, 2019; Grinblatt & Keloharju, 2001), legal (Mihov & Naranjo, 2019; Sundaram & Black, 1992) and economic (Hitt et al., 1994) differences between markets. For example, a company that plans to enter a new market may need to adapt its products and marketing strategies to meet the unique and different needs and preferences of customers in that market (Mihov & Naranjo, 2019). Because of various factors that can have a significant impact on the results, different studies can have opposite results (Contractor et al., 2003; Glaum and Oesterle, 2007; Annavarjula & Beldona, 2000; Lu and Beamish, 2004). Some studies have shown a negative relationship between the level of geographical diversification and firm performance (Tallman & Olsen, 2000; Denis & Yost, 2002). Li and Chen (2015) found that geographic diversification is positively related to increased firm risk, suggesting that firms that diversify into new markets may expose themselves to more risk than when operating only in a local market.

The next important factor in the literature review in this area is the impact of crisis factors on the performance of internationally diversified enterprises (Purdy & Wei, 2014). External crises can have a negative impact on the company and reduce the effectiveness of the diversification strategy in all or part of the markets in which the company operates. In this context, research will focus on the financial crisis of 2008 as it is the closest historically global crisis that has impacted businesses around the world but is distant enough to be able to assess its impact and conduct some research on this topic. The impact of the financial crisis on companies has been complex and varied, with some companies suffering significant losses (Blankenburg & Palma, 2009; Arner, 2009; Kotz, 2011), while others managed to survive the events relatively well and without major losses.

2 METHODOLOGY

The purpose of this paper is to explore the literature in the field of international geographical diversification of companies, as well as studies aimed at the impact of the crisis on the performance of diversified enterprises. In order to achieve this objective, it was necessary to conduct a thorough analysis of works and studies specializing in the impact of diversification strategies on companies' success, profits, and overall financial performance. The studies should also present the main metrics and indicators by which scholars have identified the level of international diversification of companies, as well as criteria for comparing their results.

Online resources such as JSTOR and ProQuest were used in the literature selection. In addition to these portals, the online Google Scholar database and a general search were also used to cover as many resources as possible that were potentially useful for the research question posed. The main focus was on research carried out since the mid-1990s, but given the long-term relevance of the topic, theoretical background from earlier significant research on international diversification was also included in order to provide a broader view of the issue.

In the course of this study, it was important to identify the main lines of inquiry into the topic in question and to find key findings and approaches in dealing with diversification. It is important to understand that the term diversification itself can be used in different contexts, and therefore the criteria to be met by the selected works were defined at the beginning of the study. The main inclusion criteria for selecting the study were the focus on international business diversification, including a sample of companies operating in several countries. Excluding criteria were a narrow or very specific field of business, as well as companies operating in specific markets. The next exclusion criteria were the study of business diversification in specific and non-standard conditions beyond the crisis, which may have different purpose of the study. The last exclusion criteria were geographical diversification within a single country, divided only by regions, areas, or cities in that country.

Using the criteria described above, articles were selected to further examine them, compare the results and identify areas with potential for new research in the future. The results of the relevant literature review are presented in the next chapter of this paper.

3 RESULTS AND DISCUSSION

After reviewing the selected literature, the main areas in which the authors consider the impact of international diversification on companies were identified. The papers compare not only a company's revenue and profitability but also many studies focus on a company's risk share, value, and measures such as return on assets (ROA) (Qian et al. 2010), return on equity (ROE) (Mihov & Naranjo, 2019), return on capital (ROC) (Purdy & Wei, 2014), or gross profit margin (GPM) (Purdy & Wei, 2014). Some papers also present measures of corporate social responsibility (CSR) (Attig et al., 2016) and the impact of a company's international diversification on it. Most studies use large samples of publicly traded companies and publicly available financial data about these companies for analysis.

In the following, we present a selection of relevant papers that meet the criteria set out and from which it is possible to identify key areas for further research. This description provides information on the authors' working methods and main conclusions.

In the study "International Diversification and Firm Performance: The S-Curve Hypothesis" (Lu & Beamish, 2004), the authors investigated the nature of the relationship between regional diversification and firm performance in firms with different assets and at different stages of internationalization. They found that geographic diversification has a non-linear relationship with firm performance. The degree of geographic diversification had an inverse correlation with firm success at high and low levels of internationalization but was positively correlated with a performance at moderate levels of internationalization. In addition, firms that had made large investments in intangible assets such as technology and advertising saw an increase in profits as a result of increased foreign direct investment. The study analyzed company data over 12 years on a sample of 1,489 Japanese companies. The authors used return on assets (ROA) and Tobin's Q to measure financial performance. To calculate internationalization, the authors used the number of foreign subsidiaries as well as the number of countries in which the company has subsidiaries. The main limitation of this study was that it was conducted on a sample of companies from one country, while not taking into account other factors, such as organizational design in the company and the effectiveness of employees in implementing a diversification strategy. Future research could be carried out in different countries, taking into account local characteristics, as well as using more variables that affect the success of such a strategy.

The next example of research in this area is "Corporate internationalization, subsidiary locations, and the cost of equity capital." by Mihov, A., & Naranjo, A. (2019). This study looks in detail at the relationship between the level of internationalization of companies and the cost of equity and the indicators in which this relationship manifests itself. The research used comprehensive data from Exhibit 21 in companies' 10-K reports, which covered the foreign countries where U.S. multinational companies had material operations during the period from 1996 to 2012. The study showed that market conditions and the financial strength of the company have a significant impact on the cost of equity capital and can increase or decrease the cost of equity capital, depending on the country in which they operate, as well as the impact of the crisis. Furthermore, directing this diversification into countries with similar cultures, strong governments, and stable financial markets is likely to further reduce the cost of equity capital. According to the study, the benefits of diversification played a particularly large positive role in the 2008 crisis.

The performance implications of intra- and inter-regional geographic diversification. Qian et al. (2010) analyzed the performance implications of intra- and inter-regional geographic diversification in a sample of 127 US-based multinational enterprises. The study used inter-regional sales figures as well as the presence of foreign subsidiaries. ROA was used as a comparative variable. The study found that geographic diversification does have a positive effect on a company's financial performance, but depending on the type of this diversification, this indicator may change for the better or for the worse over time. Intra-regional diversification allows firms to improve their performance in a linear fashion while facing limited market opportunities. Inter-regional diversification yields a U-shaped curve, meaning that this strategy can have a growing positive effect, but only in the limited level of its application and worsens the financial performance of the firm over time. Authors note that future studies may aim to cover the limitations of this research, which is the analysis the relationship between financial performance and time-series, that can show how companies have reacted to past experience and how this has influenced their diversification decisions. In addition, future research may use other ways to define regions, such as cultural regions. In this study, only the division into geographic regions was used. Another potential direction for future research would be to analyze companies based in other countries and with more markets involved.

The following study aims to investigate the impact of foreign ownership on various measures of international firm performance under the impact of the 2007-2008 crisis factors. This study is included in this article because it shows how the impact of the crisis on local companies differs from the impact on companies that are part of internationally diversified structures. In this study named "Surviving the Global Financial Crisis: Foreign Ownership and Establishment Performance" (Alfaro & Chen, 2012), the authors made a comparison using company data from 2005-2007 as a benchmark of company performance before the crisis and data from 2007-2008 to compare the change in company performance under the impact of the global financial crisis. One of the most important aspects of this comparison was the separation of the performance of globally diversified subsidiaries, which may have affected their economic performance and stability from the changes directly caused by the crisis. This was done by comparing local companies with subsidiaries of international companies with as similar economic characteristics as possible and operating in the same industry and country. In this way, the researchers were able to separate the effect of other factors on company performance during the crisis from the effect of foreign capital, which made it possible to study this effect based on the differences in the performance of subsidiaries and their local counterparts. The results of this study confirm some of the already mentioned hypotheses about the positive impact of international diversification while adding a crisis factor to the initial situation. In this paper, the researchers pointed out that, on average foreign-owned subsidiaries were more resilient during the crisis than their local counterparts. When comparing the advantage of foreign ownership over local ownership, it was found that under normal conditions it was not as pronounced as under economic crisis conditions. Vertical and horizontal production and financial relationships between subsidiaries and parent companies were also factors with a significant impact on the financial performance of the studied companies. Based on the study, vertical financial and production linkages between these companies could mitigate the effects of the economic crisis. In future research, the authors may explore how, in times of crisis, international linkages can serve as international transmission mechanisms (Alfaro & Chen, 2012).

The next factor that can be influenced by a company's international diversification is access to sources of foreign financing in the form of corporate bonds and bank loans (Jang, 2017). This is the area Yeejin Jang explored in his 2017 study "International Corporate Diversification and Financial Flexibility", in which he described opportunities to access foreign capital using a sample of U.S.-based corporations for the period 2000-2010. The sample includes 3,850 domestic companies and 2,353 multinational companies. The hypothesis in this study was that corporations with subsidiaries in other countries outside the U.S. are more flexible in terms of external financing than their counterparts operating only in the local market. In addition, this work also examined the impact of the crisis factors on the capital market between 2007 and 2009. The crisis was seen as a shock that adversely affected the supply of capital within the U.S. and hampered access to capital by local and international companies. The study found that, under such circumstances, internationally diversified companies had more opportunities to borrow from foreign banking institutions. Moreover, investments by U.S. companies with subsidiaries abroad were less affected during the crisis than those of purely local companies, partly because of the greater use by international corporations of the foreign bond markets to which they had access. This study only uses a sample of U.S. companies, which is a major limitation that could be expanded in future studies. When examining a sample from other countries, the results may also be affected by the conditions for issuing bonds in other states, as well as the specifics of the legislation in these countries.

Purdy & Wei's (2014) "Another Look at the Case for International Diversification" is another significant study of the impact of international diversification on firm performance. This paper fits very well with the criteria defined for reviewing the literature in this area, as the authors use a large sample of the world's top 500 companies from the 2011 Fortune Global 500, including companies from different business sectors. Furthermore, the analysis is carried out on 5,000 companies over a 15-year period from 1996 to 2010. The advantage of working with data from this period is also that it includes not only economic growth, which could have a positive impact on business, but also the period of the economic crisis in 2008. Two indicators were used to determine the level of diversification of companies: the share of the company's assets allocated overseas and the share of revenue that companies generate overseas. For the purposes of this study, overseas was defined as a region outside the company's home region. In this case, such regions were not defined by the borders of a specific state but rather by the economic dimensions of certain parts of the world. That is, Canada and the U.S. were considered North America, but Mexico was not included, while the European region included the European Union. Return on capital (ROC), gross profit margin (GPM) as well as total company revenues were used to assess the performance of the companies. The study also takes into account factors that influence a company's financial performance beyond diversification. These factors include the market capitalization of companies, the size of the home market as well as the volatility of companies' stocks. The overall results of the study show that international diversification has a positive effect on the financial performance of the studied companies, but this effect may not be noticeable immediately after the implementation of this strategy. The results show that both diversification of a company's revenue sources and its assets may not cause an increase in profits. When comparing the two strategies, it was found that diversification of revenue sources abroad can produce quick results while having a negative impact on the profit margin in the long run. International asset diversification, although not significant in terms of its impact on revenue and may be overhead in the short term, can improve both the company's profit margin and competitiveness in the long term. According to the authors of the study, the results will be more relevant for large international companies, since the study used a sample of large diversified companies from the Fortune Global 500 list. These companies are generally successful in their industry and many other factors influence their results, in addition to international diversification. This limitation could be covered by a similar study but for smaller businesses.

The following study, which I review in this paper, aims to examine the impact of international diversification on firm performance risk, including the impact of firm resources. Capar et al. (2015) conducted this study titled "Effects of International Diversification and Firm Resources on Firm Performance Risk" using a sample of 258 U.S. manufacturing companies in different industries, operating internationally, existing at least for six years and having minimum average annual sales of $100 million. The authors studied data for the period from 2009 to 2013. An important feature of this study, which distinguishes it from many others, is that it includes an examination of the impact of companies’ resources, which can play a key role in the effectiveness of international diversification (Elango & Pattnaik, 2007; Kotabe et al., 2002). In doing so, the paper has limitations that relate primarily to the type of activity of the companies, although the selected manufacturing companies operate in 13 different industries. The ratio of foreign sales to total sales (FSTS) was chosen as the criteria for determining the international diversification of a company. To measure performance risk, the authors used return on assets (ROA) ratio. The authors chose innovation assets (R&D intensity), marketing assets (advertising intensity), and various control variables (financial leverage, industry effects, and size of the company) as indicators of company resources. The study found that when company resource variables were added, international diversification had no significant effect on firm performance risk, and no linear or non-linear relationship between firm performance and international diversification was found. However, the following limitation in the study is observed here, namely measuring international diversification by only one indicator FSTS.

Regarding the impact of resources on productivity risk, the authors found that a statistically significant negative impact on this indicator is a company's marketing assets, and a statistically significant positive impact is R&D intensity. In addition to using a single indicator to measure the level of diversification, this study has the limitation of using a sample of only U.S. manufacturing companies.

The studies described above have, in one way or another, examined the impact of diversification on indicators related to the financial and economic performance of firms. The next study, titled "Firm Internationalization and Corporate Social Responsibility" (Attig et al., 2016), examines the impact of a company's level of international diversification on its corporate social responsibility (CSR) rate. This study is different from all of those described above, but it is also an important indicator that international business diversification can matter not only in the context of the impact on financial performance, but also other aspects of companies, including social. In this paper, the authors conducted a study using two samples from U.S.-based international companies as well as companies from around the world. The first sample consisted of 3,040 U.S. companies and 16,606 firm-year observations over a 19-year period from 1991 to 2010. The second sample comprised companies from 44 countries with 11,077 observations over the period 2002-2010. To measure the level of internationalization, the authors used the following indicators: ratio of foreign sales to total company sales (FS/S), ratio of foreign assets to total assets (FA/A), entropy index (Hitt et al., 1997), and sales Herfindahl index (Black et al., 2014), profitability (EBITDA to ROA), ratio of total debt to total assets (leverage - LEV), market-to-book ratio (MTB) and long-term institutional ownership (LTIO). The results showed that the internationalization of firms has a statistically significant positive effect on the level of CSR in diversified firms. The authors also found that because of internationalization, only large multinational companies increase their investment in CSR. A further finding was that companies with subsidiaries in countries with a strong legal and regulatory system have a higher CSR rating.

Thus, based on the above studies, it can be concluded that international diversification affects very different areas of a company, affecting not only its financial performance but can also influence the social aspects of a company and help the business to be more resilient under the influence of crisis factors.

CONCLUSION

This article researched papers on the topic of international business diversification, as well as the effectiveness of such diversification in the crisis, using the example of the 2008 financial crisis. The purpose of the paper was to investigate articles over the past 25 years that focus on the effectiveness of international diversification and its impact on the financial performance and other indicators of companies. The reviewed literature includes studies focused solely on international business and does not investigate geographic diversification within a specific country. Internet sources such as JSTOR, ProQuest, and Google Scholar were used to analyze the required literature.

As a result of the literature review on this topic, the main areas of research in the field of international business diversification were identified, the specific methodologies and data used in the research were identified, and the key findings of these studies were described. The main area of research can be defined as the study of the impact of international diversification on several key metrics in business, such as gross profit margin (GPM), return on capital (ROC), total revenue, and return on assets (ROA), which is, based on this analysis, the most used metric to assess the impact of diversification on company performance. To determine the level of company diversification, most of the authors in the described studies used the FSTS ratio as well as the presence of subsidiaries in other countries or economic areas.

The main conclusions that have been drawn from the studies described are the overall positive impact on the financial performance of companies. Those studies that have examined other areas, such as the advantage of access to foreign capital markets or CSR, have also shown a positive effect of internationalization on business. Those studies that have also described negative effects are generally limited to the time frame of this negative effect or attribute these results to the influence of additional factors such as company resources.

At this stage of the literature review, we can conclude that in the field of international diversification, there are many directions and additions that can affect the results of research on the effect of this strategy. One of these directions can be the study of the effectiveness of the redistribution of company resources between subsidiaries during the crisis and its effectiveness as a stabilizer of the financial performance of the company. In addition, a possible direction of research is to add variables related to the costs of physical business security in riskier regions, as well as take into account the measurement of risk in international diversification. Studies of diversified companies during a crisis can include separating the specific effects of the economic crisis on the activities of multinational companies and comparing them with similar effects on local businesses, which will identify the most significant tools that can be used by those or other companies in the event of a crisis. The results of such studies can be effectively applied in practice by managers of multinational corporations as part of anti-crisis planning.

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