DISTINGUISHING BETWEEN RELATED AND UNRELATED INTERNATIONAL GEOGRAPHIC DIVERSIFICATION: A COMPREHENSIVE MEASURE OF GLOBAL DIVERSIFICATION

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Abstract. This paper argues that it is important to distinguish between related and unrelated international geographic diversification when measuring impact of diversification on performance. It then extends the Jacquemin-Berry entropy measure to propose a comprehensive measure of global diversification that comprises related and unrelated product diversification, and related and unrelated international geographic diversification. It suggests a classification of firms based on diversification strategies and proposes hypotheses for future research.

In order to understand the impact of a multinational’s global diversification on profit performance and stability it is important to study the effect of both product diversification and international geographic diversification (or, internationalization). Research on product diversification has moved from focusing exclusively on unrelated product diversification (e.g., Gort [1962]; Arnould [1969]) to drawing a distinction between related and unrelated product diversification (e.g., Wrigley [1970]; Rumelt [1974]). Unrelated product diversification measures the extent to which a firm’s activities are dispersed across different industries (i.e., different at the two-digit SIC level). Related product diversification measures dispersion of activities across business segments (at the four-digit SIC level) within industries. Research on international geographic diversification (or, internationalization) has generally not studied the effect of what might be referred to as “related international geographic diversification.” This is the dispersion of

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a multinational’s activities across countries within a relatively homogeneous cluster of countries, and is analogous to the concept of related product diversification. Some studies have measured what might be referred to as “unrelated international geographic diversification” (e.g., Hirsch and Lev [1971]; Miller and Pras [1980]), though the studies do not use that description. Unrelated international geographic diversification is the dispersion of the multinational’s activities across heterogeneous geographic regions and is analogous to the concept of unrelated product diversification.

The following example helps illustrate the distinction between related and unrelated international geographic diversification. Let us assume that the Pacific Rim countries can be regarded as a relatively homogeneous cluster. A Korean firm that sells in four foreign countries, all of which are in the Pacific Rim, would be regarded as having relatively high related international geographic diversification but low unrelated international geographic diversification. On the other hand, a Korean firm that sells in four countries with one each in Africa, Latin America, Europe and North America would be regarded as having relatively low related international geographic diversification but high unrelated international geographic diversification.

A number of studies on international geographic diversification have focused on aggregate measures, such as the percentage of a firm’s sales accounted for by foreign sales (e.g., Wolf [1975]; Geringer et al. [1989]). These measures do not distinguish between related and unrelated international geographic diversification. This paper argues that it is important to distinguish between related and unrelated international geographic diversification when measuring impact on a multinational’s profit level and stability. It then proposes a comprehensive measure of global diversification that comprises related and unrelated product diversification, and related and unrelated international geographic diversification.

LITERATURE REVIEW

Product Diversification

Research on product diversification is extensive and encompasses the firm’s decision to diversify (e.g., Reed and Lufman [1986]; McDougall and Round [1984]), the nature and mode of diversification (e.g., MacDonald [1985]; Lamont and Anderson [1985]), and the management of diversification (e.g., Leontaides and Tezel [1981]; Pitts [1977]). Probably the most extensively researched stream is the relationship between product diversification and performance (e.g., Rumelt [1974]; Bettis [1981]; Lecraw [1984]; Michel and Shaked [1984]; Montgomery and Singh [1984]). Ramanujam and Varadarajan [1989] observe that the theoretical basis offered for that relationship in empirical studies depends on the discipline: economic studies emphasize market power effects; finance studies focus on market efficiency; and, strategy studies emphasize synergy.