

Corporate Portfolio Analysis Tools Revisited: Assessing Causes that may Explain Their Scholarly Disdain

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While prominent corporate portfolio analysis tools such as the BCG Growth–Share Matrix took centre stage in the field of strategic management from the 1960s to the mid-1980s, this review of the literature shows that they have since then largely disappeared from the academic agenda, despite their practical relevance and widespread application. There may be two independent reasons for this apparent scholarly disdain: corporate portfolio analysis tools (a) may have been recognized as unsuitable owing to inherent flaws or superior alternative concepts or (b) may have become obsolete because of proof that corporate diversification is inferior to market diversification. Thus, this assessment is based on an extensive review of the most relevant academic literature on corporate portfolio analysis tools and on the constitutive diversification–performance link published in leading management journals over the past five decades. The review reveals that research to date has not produced advanced tools based on an objective criticism of the original matrices, nor has corporate diversification – as a precondition for corporate portfolio analysis – proved to be inferior to market-based co-ordination mechanisms. Thus, this literature review constitutes a call for further academic research in the field of corporate portfolio analysis tools as well as corporate diversification.

Introduction

Triggered by significant changes in the economic environment of the 1960s, management scholars and practitioners put greater emphasis on marketing, market segmentation and organizational divisionalization (van der Velten and Ansoff 1998). As excess cash and the saturation of traditional markets fostered diversification into new businesses, top management of diversified corporations faced the increasing problem of managing a set of more or less related businesses. Transferring the concept of portfolio analysis from finance theory (e.g. Sharpe 1963) to the real economy, management consultancies such as The Boston Consulting Group (1970), A.D. Little (Wright 1978) and McKinsey (Wind 1974) developed and

propagated different product portfolio approaches (Bettis and Hall 1981; Cummings and Daellenbach 2009). They predominantly proposed making use of a graphical representation of the competitive positioning of a corporation's businesses, supporting decision-making with regard to resource allocation, formulating strategies, setting individual performance targets and valuating the portfolio balance (e.g. Grant 2008, p. 420f.). Such portfolio matrices became very popular and were implemented by many large companies, especially in the 1970s (Bettis and Hall 1981; Haspeslagh 1982; Wind and Mahajan 1981). However, they were also criticized from the beginning.

Original corporate portfolio analysis (CPA) tools such as BCG's Growth–Share Matrix and

McKinsey's Industry Attractiveness–Business Strength Matrix have been subject to harsh criticism in the academic literature (e.g. Bettis and Hall 1983; Day 1977; Derkinderen and Crum 1984). Criticism ranges from fundamental arguments denying the validity of these concepts in general (e.g. Armstrong and Brodie 1994; Day 1977; Slater and Zwirlein 1994) to questioning the underlying assumptions and incorporated components (Hax and Majluf 1983; Wensley 1982), through to criticizing the inappropriate practical application of CPA instruments by corporate executives (Day 1977; Seeger 1984). This criticism may be an important reason for the fact that hardly any scholarly publications since the mid-1980s have dealt with CPA instruments. However, neither has there been any comprehensive review and critical assessment regarding the validity and relevance of this criticism to date.

Another possible reason for the apparent scholarly disdain of CPA tools is based on the argument that they are obsolete or at least negligible because diversified multi-business firms are outdated models owing to economic disadvantages compared with market-based co-ordination mechanisms (e.g. Denis *et al.* 2002; Markides 1995; Villalonga 2004). However, at least two facts cast doubt on the reliability of this paradigm dismissing diversification. On the one hand, despite at least two decades of writing off conglomerates, i.e. firms with a set of mainly unrelated businesses and diversified corporations at large, they still exist (Montgomery 1994) and – even more importantly – many of them are exceedingly successful (e.g. General Electric or 3M; Kaye and Yuwono 2002). On the other hand, there are increasing doubts regarding the validity and reliability of empirical studies that analysed diversification–performance links, corporate effects and/or conglomerate discounts (e.g. Lang and Stulz 1994; Sull and Houlder 2006). However, despite existing reviews of the diversification–performance literature (Palich *et al.* 2000), it is necessary to assiduously reappraise the prevailing research in this field.

Hence, possible research inconsistencies as well as current economic developments that contradict the general belief and confidence that financial markets are of superior rationality and efficiency suggest that research regarding appropriate CPA tools is still of high relevance. The objective of this paper is therefore to prove the need for new research initiatives and to propose future research initiatives with regard to CPA instruments – especially matrices – based on a comprehensive review and assessment of the

academic debate, including relevant theories, concepts and empirical findings.

The paper offers a qualitative review of the main publications in the fields of CPA and corporate diversification. We conduct a broad literature review of peer-reviewed journals, focusing mainly on the following top-ranked journals: *Harvard Business Review*, *Journal of Finance*, *Journal of Marketing*, *Long Range Planning* and *Strategic Management Journal*. The reviewed papers cover theory-focused and conceptual research as well as empirical studies. Our review of these journals spans over 50 years (1957–2010) and covers research on CPA tools and corporate diversification. Both the focus on peer-reviewed, high-quality research and the extensive time span ensure a comprehensive reflection of the current status of this field of research.

The remainder of the paper is structured as follows. The research question of the degree to which scholarly criticism of CPA tools is valid is at the centre of a comprehensive review of the academic coverage of respective instruments. Because corporate diversification and multi-business corporations are fundamental preconditions for the application of CPA tools, we continue by reviewing the most relevant studies on diversification and assess in particular the empirical findings regarding the diversification–performance link. As part of the conclusion, we focus on highlighting promising future research streams.

Reviewing the scholarly assessment of CPA tools

In response to diversification strategies triggered by growth aspirations and the resulting decision problems of multi-business firms (e.g. resource allocation, acquisition, divestiture), portfolio analysis concepts elaborated in the field of finance theory in order to optimize investment alternatives (e.g. Sharpe 1963) were adapted to evaluate a set of products and businesses managed by a corporation. In the late 1960s, management consultancies such as The Boston Consulting Group (1970), A.D. Little (Wright 1978) and McKinsey (Wind 1974), as well as corporate practitioners (e.g. General Electric) developed frameworks to support executives of diversified corporations (e.g. Goold and Luchs 1993; Grant 2008; Hax and Majluf 1983). All prominent product or corporate portfolio concepts evaluate and rank strategic business units (SBUs) with regard to (a)

1 their market attractiveness along one axis and (b)
2 their competitive position along the second axis, thus
3 constituting different kinds of matrices (Bettis and
4 Hall 1981; Prahalad and Bettis 1986). While the
5 original BCG Growth–Share Matrix measures and
6 quantifies these two dimensions based on single
7 proxies (market growth versus relative market share),
8 frameworks such as the GE/McKinsey Industry
9 Attractiveness–Business Strength Matrix aggregate
10 multiple parameters (e.g. Bettis and Hall 1981; Grant
11 2008; Wind and Mahajan 1981). Other corporate
12 portfolio instruments consider different dimensions,
13 but fundamentally resemble the traditional versions
14 or merely apply modifications (Hambrick and Mac-
15 Millan 1982). An empirical study by Haspeslagh
16 (1982) showed that CPA matrices were applied in
17 their original form or adapted to the specific needs of
18 the respective firms by a large share of diversified
19 firms in the 1960s and 1970s. Accordingly, the under-
20 lying concepts found their way into almost every
21 contemporary strategic management textbook and
22 the vast majority of curricula of strategic manage-
23 ment courses (e.g. Grant 2008; Johnson *et al.* 2008).

24 Although predominantly perceived as helpful,
25 innovative and easy-to-handle toolkits for the
26 management of large, diversified corporations by
27 practitioners and academics alike (e.g. Hax and
28 Majluf 1983; Hedley 1977; Morrison and Wensley
29 1991; Seeger 1984), CPA tools – mainly developed
30 by management consultancies – have been criticized
31 in the academic literature from the beginning.

32 Peaking in the early 1980s – partly in reaction
33 to a shift in strategic thinking from corporate diver-
34 sification towards refocusing on core competencies
35 (Prahalad and Hamel 1990) – a wide range of criti-
36 cism have been expressed in the academic literature.
37 In this paper, criticism of CPA tools is subsumed
38 under three major categories: (a) denying the validity
39 of portfolio concepts at large; (b) questioning under-
40 lying assumptions and basic components of portfolio
41 instruments; and (c) criticizing the inadequate appli-
42 cation of these instruments.

44 *Criticism regarding the validity of* 45 *portfolio concepts*

46 A common concern addresses the danger of over-
47 simplification of complex and interdependent strate-
48 gic decisions of multi-business firms (e.g. Ansoff
49 *et al.* 1982; Grant 2008). Corporate portfolio analysis
50 instruments are criticized for their dogmatic nature –
51 deriving norm strategies for SBUs that have been

52 identified as, for example, dogs, cash cows, stars or
53 question marks, does not account for all competitive
54 environments and situations (Christensen *et al.* 1981;
55 Seeger 1984). Similarly, oversimplification of tradi-
56 tional CPA tools is criticized by Ansoff *et al.* (1982),
57 who state that – especially in turbulent environments
58 – ‘single point positioning’ of business units into the
59 grid systems should be replaced with ‘dispersed
60 positioning’, i.e. plotting areas rather than points into
61 the matrices according to the estimated probability of
62 occurrence of the respective parameters. Another
63 stream of fundamental criticism asserts that there
64 is empirical evidence of inferior performance of
65 companies following the prescriptions of CPA tools
66 (Armstrong and Brodie 1994; Slater and Zwirlein
67 1994), although the underlying experiments, analyses
68 and conclusions have been questioned (Wensley
69 1994). Furthermore, it is argued that the traditional
70 portfolio models bear the risk of producing incon-
71 sistent results as a result of inherent problems and
72 incompatibilities associated with the application of
73 financial portfolio concepts in the business world
74 (Devinney and Stewart 1988). Thus, the authors
75 suggest a more rigorous model tied much more
76 closely to risk–return criteria.

78 *Criticism regarding underlying assumptions and* 79 *basic components*

80 Underlying assumptions of the portfolio concepts
81 and on basic components of CPA tools are frequently
82 criticized. In particular, criticism addresses the ambi-
83 guity of definitions of determinants such as SBUs,
84 relevant markets, the matrix scales and dividing lines
85 (e.g. Bettis and Hall 1983; Christensen *et al.* 1981;
86 Day 1977; Morrison and Wensley 1991; Wind *et al.*
87 1983). According to Day (1977), the definition of
88 market growth and relative market share is highly
89 dependent on the definition of the relevant market and
90 is thus often vague. Morrison and Wensley (1991,
91 p. 126) criticize ‘the arbitrary nature of the scales, the
92 criteria and the variability of the resulting classifica-
93 tions’. Wind *et al.* (1983) illustrate the consequences
94 of ambiguous or weak definitions of matrix dimen-
95 sions and dividing lines in a case study of a Fortune
96 500 company with 15 SBUs. They compare the posi-
97 tioning of these SBUs within the BCG Growth–Share
98 Matrix based on four different definitions of market
99 growth and market share and show that only four out
100 of the 15 SBUs were consistently classified, i.e. posi-
101 tioned in the same quadrant. Bettis and Hall (1983)
102 criticize the SBU definition underlying the business

1 portfolio approach for being too ambiguous and
2 suggest a 'less dogmatic approach relying on a situational
3 matching of implementation to the circumstances of the particular firm' (p. 98).

4 Other critics are concerned with the lacking
5 comprehensiveness of existing instruments (e.g.
6 Derkinderen and Crum 1984; Haspeslagh 1982;
7 Morrison and Wensley 1991; Wensley 1982). Risk
8 assessment is one of the factors claimed to be
9 missing in the existing portfolio instruments
10 (Derkinderen and Crum 1984; Devinney and Stewart
11 1988; Wensley 1982). In addition, capabilities and
12 endurance, defined as 'the capability of a company to
13 marshal resources to ensure survival in the event of
14 adverse developments', are mentioned with regard
15 to inadequate consideration by original CPA tools
16 (Derkinderen and Crum 1984, p. 131). Other authors
17 miss a sound evaluation of competitive expectations
18 (Wensley 1982) and a more stringent method regard-
19 ing the identification and assessment of new busi-
20 nesses (Haspeslagh 1982). Furthermore, the BCG
21 Growth–Share Matrix in particular is criticized for
22 its too narrow focus on two measures (Morrison and
23 Wensley 1991). However, the authors fail to specify
24 which factors should be included in more compre-
25 hensive CPA models.

26 In addition, underlying assumptions are claimed
27 to be void. This criticism addresses primarily three
28 premises of the original CPA matrices: (a) the
29 necessity to maintain a balanced portfolio in terms
30 of internal cash flows; (b) the positive correlation
31 between market share and profitability; and (c) invest-
32 ment in market growth (e.g. Armstrong and Green
33 2007; Day 1977; Hax and Majluf 1983; Wensley
34 1981). First, the basic assumption of the Growth–
35 Share Matrix, i.e. that an ideal corporate portfolio has
36 to feature a net cash flow balance, is questioned by
37 stressing the fact that 'the capital market as a source of
38 funds seems to be almost ignored in some approaches'
39 (Wensley 1981, p. 176; similarly, Hax and Majluf
40 1983). Secondly, another specific assumption of the
41 BCG matrix, i.e. the use of relative market share
42 as a proxy for the advantage or disadvantage of the
43 respective competitive position and profitability, is
44 challenged. While Day (1977), for example, does not
45 question the general logic of the experience-curve
46 concept underlying the market share–profitability
47 link, he argues that this correlation becomes tenuous
48 under certain circumstances and provides empirical
49 evidence that the value of market share differs signifi-
50 cantly from industry to industry. Similarly, Hax and
51 Majluf (1983) question whether market share is really

52 the major driver of profitability. Based on evidence
53 from 12 studies, Armstrong and Green (2007) show
54 that pure competitor-oriented objectives such as
55 increasing market share tend to reduce rather than
56 increase profitability. Hambrick and MacMillan
57 (1982) also question the unequivocal relationship
58 between relative market share and profitability as well
59 as the blurred line distinguishing high- from low-
60 share businesses. They provide empirical evidence
61 based on PIMS data that not all dog businesses are
62 poor performers and that they consequently need not
63 necessarily be divested. Instead, it should rather be
64 carefully analysed whether and how these businesses
65 can 'achieve their potential as long-term, reliable cash
66 generators' (Hambrick and MacMillan 1982, p. 94).
67 Finally, the second dimension of the original Growth–
68 Share Matrix, i.e. market growth, is similarly criti-
69 cized within the academic literature. Critics cast
70 particular doubts on the assumption that industry
71 growth is the only dominant variable that fully
72 explains growth opportunities (Hax and Majluf 1983)
73 and that, as a consequence, free cash flow should
74 always be directed from lower-growth markets
75 towards high-growth markets (Wensley 1981).

76 Another frequent – albeit minor – point of criti-
77 cism regarding the elements of CPA tools is the alleg-
78 edly destructive labelling of matrix positions. It is
79 argued that labels such as 'dogs' or 'question marks'
80 might be too derogatory (e.g. Hax and Majluf 1983).

81 *Criticism regarding misapplication* 82

83 Inadequate or inappropriate application of CPA tools
84 by executive managers of corporations is another
85 major concern addressed within the academic
86 literature. As one of the earliest critics, Day (1977)
87 objected that – facilitated by the somewhat arbitrary
88 nature of CPA tools – managers might be tempted to
89 manipulate the product–market boundaries and the
90 input parameters in order to give their businesses
91 the appearance of a more favourable positioning in
92 the grid system, thus increasing the likelihood of
93 receiving funds, managerial attention and respect.
94 Beyond defective actions by different interest
95 groups, unintended misinterpretations and too rigid
96 adherence to norm strategies also increases the
97 risk of misapplication (Seeger 1984). In addition,
98 the latter author refers to the fact that, owing to
99 their standardized methodology and procedures,
100 CPA matrices may lead to sub-optimal decisions, as
101 managers may stick to prescribed strategies rather
102 than seeking and using additional information that is
103

1 often necessary. Referring to the terminology of the
2 Growth–Share Matrix, he argues that ‘not all stars
3 turn out to be winners’, cash cows could ‘give more
4 than milk’, and ‘every dog has its day’ (pp. 94, 96).
5 Similarly, Christensen *et al.* (1981) question the
6 appropriateness and feasibility of norm strategies,
7 especially concerning ‘dog’ businesses. They argue,
8 for instance, that divestments of ‘dog businesses’ are
9 in some cases not reasonable and are in many cases
10 difficult to implement owing to potential inter-
11 dependencies among business units, legal or political
12 barriers to exit, and ethical or societal expectations.

14 Evaluating the validity of the criticism

16 The objective of the following section is to show that
17 criticism targeting CPA tools is not generally valid
18 and not limited to these corporate decision-making
19 instruments. There is ample evidence that CPA
20 tools should not be removed from the academic or
21 management agenda. Rather, critical suggestions
22 should be understood as a call for research efforts
23 to advance them.

24 Strategic decisions, by definition, bear significant
25 consequences for the success and survival of the
26 respective organization. They can be characterized by
27 long-term effects and a high degree of uncertainty,
28 complexity and interdependence. In order to support
29 strategic decision-making effectively, instruments
30 have to make use of simplification, similar to theo-
31 ries. Simplification is therefore a major reason for and
32 an important benefit of such instruments. The down-
33 side of simplification is – although difficult to deter-
34 mine – oversimplification. This is, however, more a
35 problem of managers applying strategic planning
36 tools, as they have to assess the need to take into
37 account additional decision factors (e.g. Day 1977).
38 However, theories and strategic planning tools
39 alike are subject to verification of their reliability and
40 accuracy through empirical studies. While some
41 researchers claim to have empirically proved a sys-
42 tematic underperformance of firms using CPA tools,
43 these studies have in part also been challenged by
44 other researchers (e.g. Wensley 1994). It is apparent
45 that further empirical research testing the CPA
46 application–firm performance link is needed.

47 Criticism challenging the underlying assumptions
48 of CPA tools and complaining about neglected but
49 important elements and variables (e.g. risk, inter-
50 dependence) does not mean that they should be
51 scrapped rather than advanced. In particular, the

ambiguity and arbitrariness, e.g. of market defini-
tions, scales and mapping, should be addressed. Surprisingly, to the best of our knowledge, there are no academic attempts to advance or substitute traditional CPA tools.

Inappropriate application of CPA tools by senior executives is definitely a serious risk – as it is for any strategic planning tool. With the exception of the methodological limitations already mentioned, however, this is not a flaw of the instrument itself. In addition, misuse of portfolio concepts largely depends on whether the concept is regarded as a prescriptive guide rather than a diagnostic aid (Morrison and Wensley 1991). Although one would assume that the practical application of CPA tools and processes has been frequently studied in order to confirm certain deficiencies and problems, research to that effect is meagre and probably outdated. Empirical research investigating the practice of CPA and addressing, for instance, the number and distribution of users and perceived benefits and drawbacks, as well as the corresponding need for improvement, dates back to the late 1970s and early 1980s (e.g. Bettis and Hall 1981; Haspeslagh 1982). Haspeslagh (1982) conducted a series of interviews and a survey among Fortune 1000 companies as well as some selected European corporations regarding the application and limitations of CPA. According to his study, as of 1979, 36% of Fortune 1000 and 45% of Fortune 500 companies had used portfolio planning approaches – at least to a certain extent. An earlier clinical study of 12 large, diversified US firms by Bettis and Hall (1981) found that, in 1977, at least 200 of the Fortune 500 companies were using some kind of portfolio planning concept. Based on their expert knowledge, the authors assume similar application rates in Europe. Our review reveals that no further empirical studies regarding the actual application of CPA tools have been published in leading management journals since then. Intensifying research in that field may help to identify the key competencies and skills needed to successfully implement CPA methods and thereby provide necessary input for improving management education in that respect (Morrison and Wensley 1991).

Reviewing the academic enhancement of CPA tools

Despite extensive academic criticism of CPA concepts and instruments, the advancement of traditional CPA matrices has been neglected by academia, with rare exceptions.

1 First, there are a few academic contributions sug- 52
2 gesting more sophisticated approaches with regard 53
3 to alternative corporate investment decisions, for 54
4 instance theoretical models for the portfolio prob- 55
5 lem based on risk and profitability reasoning (e.g. 56
6 Devinney and Stewart 1988). However, there are no 57
7 attempts to translate these theoretical approaches into 58
8 pragmatic, easy-to-handle and nevertheless sophisti- 59
9 cated instruments that can be applied by corporate 60
10 planners to improve resource allocation decisions. 61
11 Early approaches to applying risk–return portfolio 62
12 analyses – as originally developed in finance – to 63
13 product-line decisions (Cardozo and Smith 1983; 64
14 Cardozo and Wind 1985) have also been criticized for 65
15 the critical underlying assumptions (Devinney *et al.* 66
16 1985).

17 Secondly, there are a few alternative matrix-based 68
18 approaches that focus on different, yet often highly 69
19 specific, corporate management issues. One alterna- 70
20 tive published in leading management journals is the 71
21 Parenting Matrix, or Ashridge Portfolio Display, pro- 72
22 posed by researchers from the Ashridge Strategic 73
23 Management Centre (Campbell *et al.* 1995; Goold 74
24 *et al.* 1998; Johnson *et al.* 2008). Unlike traditional 75
25 CPA matrices, the Parenting Matrix does not evaluate 76
26 and compare the attractiveness of individual SBUs, 77
27 but rather assesses the strategic fit between the parent 78
28 company and its portfolio of SBUs. The authors 79
29 argue that such a fit is necessary in order to add 80
30 superior value to the business and thereby justify 81
31 corporate ownership. SBUs that do not yield such a 82
32 fit should be sold to an alternative owner to increase 83
33 shareholder value (Campbell *et al.* 1995). Another 84
34 less prominent alternative approach is the ‘CV/M 85
35 Matrix’ (Gomes and Knowles 1997). Building on a 86
36 strong marketing focus, this customer-oriented port- 87
37 folio matrix assesses SBUs based on the two dimen- 88
38 sions ‘perceived customer value’ and ‘fit to mission.’ 89
39 However, from our perspective, these alternative 90
40 approaches are more supplements than substitutes 91
41 and do not offer a comprehensive solution to the 92
42 shortcomings of traditional CPA matrices.

43 44 *Conclusion 1: Need for advanced CPA tools* 45 *and applications*

46 Although parts of the criticism of CPA tools, 93
47 particularly traditional CPA matrices, are valid, the 94
48 academic conclusion to abandon them appears to be 95
49 wrong and ignorant. Wrong because there is no 96
50 adequate substitute regarding the strategic manage- 97
51 ment of multi-business firms, and ignorant because 98
99
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102

there have been only a few research attempts to 52
further confirm and understand problems with 53
regard to CPA applications and/or to advance the 54
relevant instruments and applications. The majority 55
of companies probably do not apply traditional CPA 56
matrices dating back 50 years, but rather adjust 57
them to their specific needs based on their competi- 58
tive environment. In addition, it is reasonable to 59
assume that top management consultancies such as 60
BCG or McKinsey have developed more sophisti- 61
cated CPA methods in the meantime. Academic 62
research that builds on these resources and informa- 63
tion may advance knowledge within this important 64
field of strategic management. As a result, the 65
benefits as well as the limitations and pitfalls of 66
CPA tools may become more apparent. 67

68 Nonetheless, some researchers, mainly econo- 69
70 mists, argue that evaluating and advancing CPA and 70
71 CPA tools at large is a hopeless endeavour in itself, 71
72 as corporate diversification has been proved – at 72
73 least theoretically – to be inferior to market-based 73
74 diversification. In other words: corporate diversifi- 74
75 cation has to be considered as a precondition for the 75
76 development of management concepts and tools that 76
77 support the efficient management of multi-business 77
78 firms, i.e. corporate portfolios. Thus, if – for what- 78
79 ever reason – corporate diversification vanishes 79
80 altogether, the development and application of CPA 80
81 tools will also become dispensable. To be compre- 81
82 hensive, a review and evaluation of the causes of a 82
83 scholarly disdain of CPA tools must therefore 83
84 answer the fundamental question of whether cor- 84
85 porate diversification has actually been proved to be 85
86 economically inferior. This implies a review of the 86
87 research in the field of diversification and especially 87
88 of empirical studies that address the diversification– 88
89 performance link.

90 **Reviewing the diversification–** 91 **performance literature**

92 Since the beginning of the diversification era in 93
94 the 1950s and, in particular, since the emergence of 94
95 conglomerates, i.e. corporations with many – mostly 95
96 unrelated – businesses, diversification and diversifi- 96
97 cation strategies have been elaborated in the aca- 97
98 demic literature. Besides strategic intentions and 98
99 motives for diversification, the fundamental question 99
100 of whether and how diversification leads to superior 100
101 performance dominated the research and respective 101
102 publications. The academic attention to the topic of 102

1 diversification has not abated to this day (Jackson
2 2009). While the common impression prevails that
3 research regarding diversification, and particularly
4 the diversification–performance link, has produced
5 relatively clear results, namely the superiority of
6 external markets over internal co-ordination as well
7 as overwhelming proof for conglomerate discounts,
8 past reviews already cast doubts (e.g. Grant 2008,
9 p. 406; Palich *et al.* 2000; Robins and Wiersema
10 2003) on such predictions.

11 While the diversification–performance link is of
12 main interest for an assessment of the need for CPA
13 and CPA tools, ambiguities and inconsistencies
14 regarding the definition of diversification as well as
15 the underlying motives for diversification seem to be
16 one reason why insights derived from diversification
17 research are still relatively blurred. As the review of
18 the relevant academic literature will prove, First,
19 there is no unequivocal definition of the term ‘diversification’
20 in the academic literature. Secondly, the reasons for
21 diversification are manifold and cannot
22 be reduced to one general motive. Inconsistent
23 results brought forward by numerous empirical
24 studies analysing the impact of diversification on
25 firm performance may be the direct consequence.

27 *The impact of different forms of diversification*

28 Despite ongoing research activities, a broadly
29 accepted definition of the term ‘diversification’ is
30 still lacking (Ramanujam and Varadarajan 1989).
31 More importantly, many empirical studies of the
32 diversification–performance link do not define the
33 term at all, making it hard to compare results (e.g.
34 Berger and Ofek 1995; Servaes 1996; Villalonga
35 2004).

36 Diversification may be defined according to three
37 aspects: (a) range of products; (b) markets in which
38 the firm is active; and (c) tangible and intangible
39 resources constituting the full value chain. Whereas
40 most researchers only take one or two of these
41 aspects into consideration, others account for all
42 three dimensions. Chandler (1962), for example,
43 already considers the development of new products
44 as diversification. Berry (1975, p. 37), too, applies
45 only one dimension – in this case markets – and
46 defines diversification as ‘an increase in the number
47 of industries in which firms are active’. Most of the
48 current definitions of diversification refer to Ansoff’s
49 product–market approach. His narrower definition –
50 accounting for two of the three aspects mentioned
51 above – limits diversification to cases where new

markets are served with new products (Ansoff 1965).
Ansoff’s multi-dimensional approach is further
specified by Ramanujam and Varadarajan (1989,
p. 525), who put special emphasis on the administrative
linkages and processes and therefore argue that ‘simple
product line extensions that are not accompanied by
changes in administrative linkage mechanisms do not fall
under the conceptualization of diversification’.
Furthermore, they distinguish between the process and
the status of diversification and introduce the term
‘diversity’ for the status of being diversified (*ibid.*).
Applying a resource-based view, Rumelt (1974, p. 10)
suggests that ‘a diversification move is taken to be
any entry into a new product–market activity that
requires or implies an appreciable increase in the
available managerial competence within the firm [. . .]
using as a point of departure the range of skills
possessed corporately by the firm’.

Inconsistent definitions and the fact that many
researchers do not define the term underlying their
empirical studies at all have a substantial influence
on the generalizability of results and must be
considered as some of the reasons for the ambiguity
of empirical research results regarding economic
implications of corporate diversification. Thus,
future studies in the field of diversification – whether
conceptual or empirical – should provide clear
definitions in order to prevent misleading conclusions
and ensure comparability of results.

The impact of different diversification motives

Contributions identifying and evaluating motives¹
for corporate diversification are of special interest,
as knowledge about the underlying objective for
diversification activities may help to answer the
question of whether diversification strategies offer
economic advantages over market-based co-ordination
forms and, if so, under what circumstances.

Reviewing the relevant literature on diversification
motives (see Table 1) reveals four dominant categories,
namely (a) growth aspirations, (b) profitability
increases, (c) risk reduction and (d) self-interest
of corporate managers.

A common motive for deliberate corporate
diversification activities is the aspiration for growth
opportunities – especially when the opportunity to

¹The term ‘motive’ in this paper also subsumes aspects
mentioned as advantages or reasons for diversification
in the academic literature.

Table 1. Overview of motives for corporate diversification

	Author	Year	Journal	Nature of study	Specific motives for corporate diversification	Category
1	Ansoff	1958	<i>Harvard Business Review</i>	Conceptual/qualitative	Improved growth patterns and sales stability	Growth aspiration
2	Williamson	1979	<i>Journal of Law & Economics</i>	Conceptual/qualitative	Lower transaction costs	Profitability
3	Goold/Luchs	1993	<i>Academy of Mgmt Executive</i>	Qualitative/lit. review	Value added through general management skills of top executives	Profitability
4	Montgomery	1994	<i>Journal of Economic Perspectives</i>	Qualitative/lit. review	Aspiration to create market power	Profitability
5	Campbell/Goold/Alexander	1995	<i>Harvard Business Review</i>	Conceptual/qualitative	Parenting advantage	Profitability
6	Servaes	1996	<i>Journal of Finance</i>	Empirical/quantitative	1. Increase of shareholder wealth ^a 2. Private benefits of managers (agency problem)	Profitability and personal benefits
7	Stein	1997	<i>Journal of Finance</i>	Conceptual/qualitative	Lower cost of capital through internal capital markets with lower information asymmetry	Profitability
8	Palich/Cardinal/Miller	2000	<i>Strategic Management Review</i>	Empirical/quantitative	Aspiration to create market power	Profitability
9	Hadlock/Ryngaert/Thomas	2001	<i>Journal of Business</i>	Empirical/quantitative	Financing/equity issuing benefits	Profitability
10	Denis/Denis/Yost	2002	<i>Journal of Finance</i>	Empirical/quantitative	Private benefits of managers ^b (agency problem)	Personal benefits
11	Chiu	2007	<i>Journal of Fin. Mgmt & Analysis</i>	Empirical/quantitative	Corporate risk reduction ^c	Risk reduction

^aThrough (a) overcoming imperfections of external capital markets, (b) tax shield advantages of debt financing and (c) economies of scope.

^bE.g. increased power and prestige, compensation arrangements and personal risk reduction.

^cBy means of hedging cash flow uncertainty.

1 increase a firm's market share in its primary domain
2 is limited or exhausted. Accordingly, Ansoff (1958)
3 describes diversification based on a product-market
4 matrix as one of four commonly recognized growth
5 alternatives that a corporation can pursue, the others
6 being market penetration, market development and
7 product development.

8 In addition to growth aspirations, improvement of
9 profitability by exploiting cost advantages, synergies,
10 general management skills and parenting advantage,
11 on the one hand, and market power-related mecha-
12 nisms (Montgomery 1994; Palich *et al.* 2000), on the
13 other, is frequently mentioned within the academic
14 literature as another motive for diversification.
15 Servaes (1996), Stein (1997), as well as Hadlock
16 *et al.* (2001), for instance, highlight the lower cost of
17 capital of diversified firms as a reason for diversifi-
18 cation. Whereas Hadlock *et al.* (2001) provide
19 empirical evidence that equity issues (in the external
20 market) are evaluated more positively by the capital
21 market for diversified firms than for focused firms,
22 Stein (1997) and Servaes (1996) argue for higher
23 efficiency of internal capital markets of diversified
24 firms as compared with external capital markets
25 (similarly, Williamson 1979). Goold and Luchs
26 (1993) propose that the major justification – and thus
27 the primary motive – for the emergence of diversified
28 firms in the late 1950s was the hypothesis that
29 general management skills of executives translate
30 into an added value of diversified firms. Similarly,
31 Goold *et al.* (1998) – advocating their concept of
32 parenting advantage – argue that the corporate centre
33 of diversified corporations could add value to the
34 firm as a whole. The parenting advantage concept
35 can therefore also be included under the diversifica-
36 tion objective of profitability enhancement.

37 Yet another motive for diversification is the mini-
38 mization of corporate risk. Chiu (2007), for example,
39 refers to the hedging of cash-flow uncertainty as a
40 major motive for diversification. Ansoff (1958)
41 already mentioned the improved stability of sales as
42 a major reason for diversification decisions.

43 Finally, self-interest of corporate managers is
44 frequently mentioned – especially by advocates
45 of agency theory – as another important motive
46 for corporate diversification. Without repeating the
47 broad, mainly conceptual, literature here, it is argued
48 that corporate managers maximize their own inter-
49 ests at the expense of the shareholders, based on
50 an existing information asymmetry (Jensen 1986;
51 Jensen and Meckling 1976; Shleifer and Vishny
52 1997). Triggered partly by executive compensation

that is related to company size, a reduction of the
managerial risk due to diversified investments and
increased power and prestige through 'empire-
building', some corporate managers are assumed to
diversify to serve their own interests (Denis *et al.*
2002; Servaes 1996).

The variety of reasons and motives for corporate
diversification discussed in the academic literature
indicates that the evaluation and measurement of the
benefit and value of diversification are more complex
than they might seem at first glance. Depending on
the respective motives behind the diversification
decisions, diversification may be beneficial for some
corporations while reducing competitiveness for
others. Furthermore, there are additional concerns
regarding the usefulness of the academic debate
on diversification motives. While one may argue
that different motives may be used and tested as
contingency factors regarding the diversification-
performance link, our review does not confirm such
a use. In addition, some of the diversification motives
suggested in the scientific literature (e.g. 'empire-
building' by risk-averse, opportunistic managers)
lack empirical examination.

While strategic motives for corporate diversifica-
tion are, as a rule – with the exception of managerial
self-interest – related to aspects that lead to competi-
tive advantage, diversification also has to bear costs.
Most prominent co-ordination and monitoring costs
mount, while synergies and parent advantages
dwindle away as more and more unrelated businesses
have to be co-ordinated by corporate managers (e.g.
Lamont and Polk 2002; Palich *et al.* 2000). Thus,
the relationship between corporate diversification
and corporate performance is determined by a set of
relatively complex cost and benefit effects.

Assessing the unambiguousness and validity of diversification-performance studies

Research on the diversification-performance link is a
domain within the field of strategic management
theory which has attracted broad attention over the
years (Chatterjee and Wernerfelt 1991; Ramanujam
and Varadarajan 1989). Various authors from differ-
ent disciplines, mainly financial economics and
management, have analysed the diversification-
performance link at large. A closer look reveals both
similarities and important differences between these
studies. With regard to CPA, the important question
arises as to whether these empirical studies
unambiguously prove an economic disadvantage of

1 corporate diversification, as in that case CPA would
2 become obsolete – at least from a theoretical
3 perspective. We therefore briefly review relevant
4 empirical studies. We do not intend to provide a
5 comprehensive review of the topic,² but to elaborate
6 the need for further research owing to striking incon-
7 sistencies between the various results. As we argue
8 that these inconsistencies may be the result of diverg-
9 ing operationalization of key variables, we analyse
10 studies relevant in this respect first.

11 *The impact of different diversification measures.*

12 Generally, there are two different approaches to
13 operationalizing corporate diversification: categori-
14 cal and continuous measures. While categorical
15 measures classify firms into one of several types of
16 diversification, continuous measures position a firm
17 on a continuous scale indicating its relative degree of
18 diversification (Robins and Wiersema 1995). A major
19 deficiency of the first measure is the lack of objectivity
20 due to the low level of standardization of the under-
21 lying information, leading to a subjective analysis
22 and classification process (Rumelt 1974). Continuous
23 measures offer two important advantages that make
24 them very attractive for quantitative research: they
25 provide variables at a higher level of measurement,
26 and they use (secondary) data classified according to
27 standardized categories (Robins and Wiersema 1995),
28 e.g. ‘standard industrial classification’ (SIC) codes.
29 The manifold continuous measures proposed in the
30 academic literature range from simple summations
31 of the number of products or segments to measures
32 assigning weightings to the relative importance of
33 each of the corporation’s products or segments
34 (Jacquemin and Berry 1979). The major criticism of
35 such measures (e.g. SIC based) is the fact that these
36 codes offer only limited information regarding strate-
37 gic interdependencies (e.g. synergies) that are impor-
38 tant for the efficiency of a multi-business firm (Robins
39 and Wiersema 2003). In its simplest form, the con-
40 tinuous measure merely counts the number of SIC
41 codes, thus neglecting any information on the relative
42 importance, e.g. revenue or staff distribution, of indi-
43 vidual business units. This may result in an exaggera-
44 tion of the degree of overall diversification in the case
45 of numerous, relatively small business units (Vara-
46 darajan 1986). In order to eliminate this deficiency,

47
48
49 ²Comprehensive reviews of the diversification–performance
50 link have been provided, for example, by Goold and Luchs
51 (1993), Martin and Sayrak (2003), Palich *et al.* (2000) and
52 Ramanujam and Varadarajan (1989).

53 Varadarajan (1986) and others propose to apply more
54 sophisticated indices which use weighted average
55 measures and take into account the relative impor-
56 tance of each SIC segment to the particular company.
57 The three most common diversification indices –
58 the Herfindahl index, the entropy measure and the
59 concentric index – differ in the way they weight
60 the individual business units. The Herfindahl index
61 employs the respective size of each business unit (or
62 SIC segment) as a weighting factor. As a conse-
63 quence, large business units have a strong influence
64 on the degree of diversification. Jacquemin and Berry
65 (1979) suggest applying the entropy measure, a loga-
66 rithmic weighting factor, in order to eliminate the bias
67 of the Herfindahl index towards large business units.
68 Finally, the concentric index proposed by Caves *et al.*
69 (1980) applies the relatedness of SIC codes among the
70 industries in which the firm is active as a weighting
71 factor (Wernerfelt and Montgomery 1988).

72 Beyond the mere difficulty of comparing empiri-
73 cal studies testing the diversification–performance
74 link due to different methods of measuring diversi-
75 fication, Robins and Wiersema (2003) demonstrate
76 that different modes of operationalization may even
77 lead to opposing results.

78 *Application of different performance measures.*

79 Diverging operationalization of the diversification–
80 performance link does not stop at the independent
81 variable: The dependent variable, i.e. performance,
82 is also measured in different ways. Measures may
83 include profitability indicators such as return on
84 capital, return on equity and return on assets (Chat-
85 terjee and Wernerfelt 1991; Itami *et al.* 1982;
86 Markides 1995; Rumelt 1974, 1982), growth meas-
87 ures such as the growth rates of sales or earnings
88 (Itami *et al.* 1982; Kim *et al.* 1989), and risk param-
89 eters (Itami *et al.* 1982). In addition to these
90 accounting-based indicators, performance is fre-
91 quently measured in terms of market value of the
92 corporation (e.g. Fauver *et al.* 1999; Lamont and Polk
93 2002; Villalonga 2004; Wernerfelt and Montgomery
94 1988).³

95
96
97
98 ³We are grateful for the comment of a reviewer, who empha-
99 sifies the fact that, besides studies that investigate the direct
100 link between product diversification and financial perform-
101 ance, other researchers and studies have checked for indirect
102 performance effects by examining the relationship between
103 diversification and investments in R&D, i.e. product innova-
104 tion (e.g. Baysinger and Hoskisson 1989; McEachern and
105 Romeo 1978).

Variations in the operationalization of the independent as well as the dependent variable of different diversification–performance studies may play an important role in explaining inconsistent and partly contradictory results that make generalizations difficult and obstruct comparability (Martin and Sayrak 2003).

Implication 1: Inconsistent findings regarding the performance impact of diversification. A review of academic contributions that empirically study the link between corporate diversification and firm performance shows that there is strong ambiguity not only in the measurements of the underlying dependent and independent variables, but also in the results of the correlation itself (see Table 2). While a few studies have proved a positive correlation between diversification and performance (e.g. Rumelt 1974, 1982), other studies yield results showing an inverse relation between these two factors (e.g. Markides 1995). A third group of studies concludes that diversification may have positive and negative performance impacts. According to the findings of Kim *et al.* (1989), for instance, the impact of diversification on corporate profit varies, depending on the extent of a firm’s international market diversification. Earlier studies of Itami *et al.* (1982), as well as a more recent meta-analysis of 55 previously published studies by Palich *et al.* (2000), suggest that there is a curvilinear, ‘inverted U-shaped’ relation between the degree of diversification and profitability. It must therefore be acknowledged that, despite more than forty years of empirical research, the relationship between diversification and firm performance is still relatively vague (Grant 2008; Markides and Williamson 1994).

Implication 2: Inconsistent findings regarding the market value impact of diversification. Similar to the diversification–performance studies described above, empirical studies analysing the impact of diversification on market value also yield ambiguous results (see Table 3). The hypothesis that diversification negatively impacts the market value of corporations (i.e. ‘conglomerate discount’) has found broad acceptance in the academic literature. Several empirical studies provided support for this hypothesis (e.g. Berger and Ofek 1995; Best *et al.* 2004; Billet and Mauer 2003; Denis *et al.* 1997, 2002; Lamont and Polk 2002; Lang and Stulz 1994; Lins and Servaes 1999; Servaes 1996; Wernerfelt and

Montgomery 1988). However, there is also empirical evidence for the opposite hypothesis, i.e. the existence of conglomerate premiums depending on various contingency factors and time periods researched (e.g. Fauver *et al.* 1999; Klein 2001; Villalonga 2004). Furthermore, other researchers even doubt the existence of any causality between diversification and market value (Campa and Kedia 2002; Mansi and Reeb 2002). While the latter show that lower values were attached to diversified firms than to focused firms, they could not find evidence that this discount was caused by a diversification strategy. Hence, there is no unequivocal evidence that the stock market ‘punishes’ all conglomerates with a valuation discount. Furthermore, as market value is influenced by the expectations of the market participants, i.e. shareholders and analysts, the existence of self-fulfilling prophecies cannot be ruled out.

On the impact of relatedness as key moderating factor. A few studies take into account that different degrees of relatedness between the business units held by a corporation may impact the economic consequences of diversification. While there are many diversification–performance studies which support Rumelt’s (1974) original finding that related diversified firms perform better than unrelated ones, i.e. conglomerates (Chiu 2007; Itami *et al.* 1982; Palich *et al.* 2000; Rumelt 1982), there is also evidence in support of the opposite result (Chatterjee and Wernerfelt 1991; Michel and Shaked 1984).

While most diversification–performance studies consider the moderating impact of relatedness, only a limited number of conglomerate discount/premium studies do so (see Table 3). For instance, Wernerfelt and Montgomery (1988) and Berger and Ofek (1995) find significantly lower valuation discounts for related diversifiers than for unrelated diversifiers. Similarly, Villalonga (2004) proved a positive impact of relatedness on market value, showing that related diversification yields valuation premiums, whereas unrelated diversification results in conglomerate discounts.

For the purpose of proving the causes of an apparent scholarly disdain of CPA tools, one can refrain from further reviewing the relatedness literature (e.g. types and relevance of relatedness, operationalization and measures), as the fundamental challenge of CPA tools, i.e. the disappearance of multi-business firms, can be refuted owing to a lack of empirical evidence.

Table 2. Overview of diversification–performance research

	Author	Year	Time period under review	Diversification/performance correlation	Performance measure	Distinction between degree of relatedness	Results of relatedness examination
1	Rumelt	1974		Positively correlated	ROC	Yes	Positive correlation between relatedness and profitability
2	Itami <i>et al.</i>	1982	1963–1973	Dependent on degree of diversification/relatedness ^a	ROC, ROE, growth of sales, growth of earnings, risk	Yes	Positive correlation between relatedness and profitability
3	Rumelt	1982	1976	Positively correlated	ROCI	Yes	Positive correlation between relatedness and profitability
4	Michel/Shaked	1984	1975–1981	Dependent on degree of diversification/relatedness	Sharpe, Treynor and Jensen measure	Yes	Negative correlation between relatedness and profitability
5	Kim/Hwang/Burgers	1989	1982–1985	Varying contingent upon international diversification	Profit growth and stability	No	Related diversifiers only outperform unrelated ones in case of low global market diversification
6	Chatterjee/Wernerfelt	1991	1981–1985	Positively & negatively correlated	ROA	Yes	Under specific circumstances unrelated diversification can also create value
7	Markides	1995	1981–1987	Negatively correlated	ROS, ROE, ROA	Yes	Unrelated-business firms with lower profitability than single-business firms
8	Palich <i>et al.</i>	2000	n/a	Dependent on degree of diversification/relatedness ^a	Several accounting- and market-based measures ^b	Yes	Positive correlation between relatedness and profitability

^aCurvilinear, inverted U-shaped correlation.

^bMeta-analysis of 55 previously published studies.

Table 3. Overview of diversification–market value research

	Author	Year	Time period under review	Discount/premium	Distinction between degree of relatedness	Results of relatedness examination
1	Wernerfelt/Montgomery	1988	1976	Discount	Yes	Related diversifiers outperform unrelated diversifiers
2	Lang/Stulz	1994	1978–1988	Discount	No	–
3	Berger/Ofek	1995	1986–1991	Discount	Yes	Lower discount for related diversifiers
4	Servaes	1996	1961–1976	Discount	No	–
5	Denis/Denis/Sarin	1997	1984–1986 and 1992	Discount	No	–
6	Fauver/Houston/Naranjo	1999	1991–1995	Discount/premium ^a	No	–
7	Lins/Servaes	1999	1992/93 and 1994/95	Discount	No ^b	–
8	Klein	2001	1966–1974	Discount/premium ^c	No	–
9	Campa/Kedia	2002	1978–1996	No causality ^d	No	–
10	Denis/Denis/Yost	2002	1984–1997	Discount	No	–
11	Lamont/Polk	2002	1979–1997	Discount	Yes	Negative correlation between unrelatedness ^e and excess value
12	Mansi/Reeb	2002	1988–1999	Insignificant relation ^d	No	–
13	Billet/Mauer	2003	1990–1998	Discount	No	–
14	Best/Hodges/Lin	2004	1987–1998	Discount	No	–
15	Villalonga	2004	1989–1996	Discount/premium ^f	Yes	Related diversification yielding premiums, unrelated diversification yielding discounts

^aDiscount in high-income countries; no discount or premium in lower income countries.

^bNo consideration of relatedness because of evidence that there is no effect (referring to Berger/Ofek).

^cDiscount shown in the 1970s; no discount shown in the 1960s.

^dDiscount is proved, but no causality between diversification and discount is doubted.

^eProxied in terms of diversity in industry investment.

^fDiscount for unrelated diversification and a premium to related diversification.

1 *Conclusion 2: Corporate diversification matters –*
2 *so do CPA tools*

3 Inconsistencies between empirical results regarding
4 the economic impact of diversification are caused by
5 different factors: First, by the variety of assumptions,
6 operationalization and measurement problems (e.g.
7 Robins and Wiersema 2003) and, secondly, by the
8 conclusion that several other internal and external
9 factors besides the pure degree of diversification
10 have a substantial influence on the economic per-
11 formance of a multi-business firm, as well as its
12 valuation by different investors. Furthermore, it is
13 proposed that inconsistent findings can be explained
14 by the sensitivity of the results to (a) the measures
15 used to perform the comparisons, (b) the way these
16 measures are normalized in order to facilitate com-
17 parison across researched companies, and (c) the
18 starting dates of these comparisons (Lang and Stulz
19 1994). Finally, the existing literature on the
20 diversification–performance link is criticized for its
21 neglect or insufficient consideration of relatedness of
22 the businesses in diversified firms’ portfolios
23 (Markides and Williamson 1994). According to the
24 latter authors, there are two reasons why ‘there is still
25 considerable disagreement about precisely how and
26 when diversification can be used to build long-run
27 competitive advantage’ (p. 149). First, relatedness is
28 not measured appropriately, because the strategic
29 importance and the similarity of the underlying
30 assets are neglected. Secondly, truncated and mis-
31 leading assumptions of traditional researchers are
32 criticized. Limiting the economic benefits of related-
33 ness to the exploitation of economies of scope
34 ignores the potential for related diversifiers to expand
35 their stock of strategic assets or to build up new ones
36 more quickly and at lower cost than competitors
37 (Markides and Williamson 1994).

38 As a result of this review, one must conclude that
39 the ongoing interest in and great number of empirical
40 studies analysing the impact of diversification
41 on performance and market value is a sign of open
42 questions rather than of a clear answer or even con-
43 vergence. So far, there is no evident proof of a
44 general economic inferiority of diversification (inter-
45 nal co-ordination) compared with purely focused
46 companies (external co-ordination). Although relat-
47 edness has been identified as a major moderator and
48 curvilinear relationships have been favoured lately
49 (e.g. Palich *et al.* 2000), other studies show the need
50 to examine its general applicability and, moreover, to
51 define and operationalize relatedness more precisely

(e.g. Markides and Williamson 1994). Given the
52 economic relevance of corporate diversification,
53 one must conclude that the management of multi-
54 business firms, corporate strategy at large and
55 corporate portfolio management are still impor-
56 tant and relevant concepts in the domain of strategic
57 management. Consequently, it is worthwhile to
58 advance existing CPA tools further based on legiti-
59 mate criticism. 60

61 **Conclusion** 62

63 Evidence from corporate headquarters and multi-
64 business firms at large indicates that there is still a
65 need for strategic planning instruments that support
66 strategic decision-making with regard to the alloca-
67 tion of scarce resources to SBUs, the acquisition of
68 new businesses and divestment of others, and the
69 exploitation of synergies and parenting advantage.
70 Predominantly developed by top management con-
71 sultancies, CPA matrices have been widely applied
72 and have become an essential element in most
73 management education curricula. As this review
74 reveals, the academic debate of CPA and CPA tools
75 was largely limited to criticism based on logical or
76 theoretical reasoning and, to a lesser degree, on
77 empirical verification. After peaking in the early
78 1980s, relevant publications in leading management
79 journals disappeared, with rare exceptions. Address-
80 ing this apparent discrepancy, this contribution seeks
81 to reveal and critically assess underlying causes in
82 order to prove the need for new research initiatives
83 and propose future research initiatives. 84

85 One frequently mentioned major reason for the
86 diminishing academic interest in CPA tools is the
87 economic inferiority of internal capital markets of
88 diversified, multi-business firms compared with co-
89 ordination by external capital markets. Contra-
90 dicting conventional wisdom, this literature review
91 reveals that there is clear evidence neither of a
92 systematically negative diversification–performance
93 link nor of a curvilinear relationship. Consequently,
94 strategic decision-making regarding the management
95 of a parent firm’s portfolio of businesses will remain
96 a relevant strategic management topic as long as
97 multi-business firms persist. 98

99 Unsuitability and deficiencies of CPA tools,
100 particularly CPA matrices, may be another major
101 reason for the observed academic disdain. The first
102 part of our comprehensive review of the respective
103 criticism published in leading management journals

shows that most of it applies to other strategic planning tools, as well, or needs further elaboration. More importantly, the review reveals a striking reluctance of strategic management thinkers and researchers to advance and enhance existing CPA processes and instruments or to propose superior approaches. Finally, there has been almost no empirical research on CPA practices for more than two decades.

We therefore propose to intensify the research in the field of corporate portfolio management and corresponding CPA instruments in the future in order to fill these gaps and provide practitioners with advanced methods to support and improve future strategic decision-making at the corporate level. In addition, the inconsistency of existing research results on the diversification–performance link calls for further conceptual and empirical research. There is probably no one best way, i.e. an unequivocal answer to the general question of whether diversification creates or destroys value. It therefore seems necessary to intensify the research into the still relatively vague concept of ‘relatedness’, as different aspects of relatedness may impact firm performance differently. Additionally, research regarding important contingencies beyond relatedness that builds on previous works investigating, for instance, the impact of the organizational context (Stern and Henderson 2004) or the specificity of resources (Chatterjee and Wernerfelt 1991)⁴ seems to provide fruitful avenues to advance knowledge about corporate diversification.

Concerning the actual CPA research, we suggest starting by understanding the current practices and needs of corporate practitioners. Questions regarding the current use of CPA tools, the embedding of the CPA process into other strategic processes, the relevant criteria for evaluating business units and their interaction, and the benefits, shortcomings and areas for improvement of existing CPA concepts and instruments should be in the focus of these initial research initiatives. A sound understanding of the actual requirements of practitioners provides a valid starting point for the necessary academic analysis of established CPA concepts and their advancements, and the results should be compared with existing or emerging organizational and strategic theories in order to draw relevant conclusions.

⁴We wish thank one of the reviewers for this important reference.

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