Preface

This study investigates diversification behavior of firms post economic liberalization in India in 1991. The study examines the impact of three aspects – environmental uncertainty, shareholder identity, and industrial context – on firms' diversification strategies. These are investigated in three separate essays.

The first essay examines how firms responded to punctuated change in external environment as a result of economic liberalization in India in 1991. Liberalization threatened sharp increase in competitive intensity. The initial years post liberalization were, however, characterized by considerable fears of reversal of economic policy reforms. Such uncertainties hamper adaptations by firms. We posit that firms' diversification behavior during these initial years would differ from that during later years when uncertainties dwindle. Empirical analysis on a longitudinal dataset, covering 1992-2007 period, indicates that emphasis of firms during this period was on retaining flexibility to allow switching from one strategy to other depending upon how the external environment shapes up in future. Firms hedged their options, diversifying into new unrelated markets as well as making efforts to strengthen competitive position in current markets. But, as uncertainty regarding permanence of policy reforms began to recede, their efforts tilted towards strengthening of operations in select few markets. The results of this essay contribute to literature on environmental discontinuities and firm adaptation. Although received literature in this domain acknowledges uncertainties as inalienable part of environmental discontinuities, it doesn't yet differentiate various kinds of uncertainties. This study engages with this aspect highlighting the complexities in firms' adaptations due to state uncertainty or inability to predict the state of environment in future.

The second essay examines the role of different categories of shareholders or ownership structure in firm diversification behavior. The received literature in this domain has examined shareholders' role primarily from agency perspective. The usual assumption is that diversification is value destructive and shareholders' key role is monitoring and control of managers to curb these activities. We argue that these views reflect a partial or unidimensional conceptualization of shareholders' dominant sphere of influence and are possibly more appropriate for well-developed institutional environment. In an underdeveloped institutional environment such as India, diversification both into unrelated and related markets may add value to firm. Also, shareholders contributions become much more diverse. This study elucidates these varied contributions of shareholders using resource-based, institutional, and agency lenses. India offers an ideal laboratory to test these arguments because of the emerging nature of her economy and underdeveloped institutions. The essay indicates that family and corporate shareholders support firms' diversification into unrelated and related markets. In contrast, financial institutions do not encourage both unrelated and related diversification. Their investment behavior, however, differs for group and non-group firms. They tend to support formers' diversification efforts into related markets but not that of latter. The results of the study thus strongly bring out the importance of shareholder identity in influencing diversification decisions and the need to disentangle their impact by related and unrelated diversification.

The third essay investigates how performance impacts diversification strategies of firms. Prior studies in this domain indicate that firms diversify into unrelated markets only if they are not performing well. Otherwise they diversify into related markets. We assert that the relationship between performance and diversification strategy is moderated by risk propensity of firms. From this perspective, the industrial context in terms of product markets competitiveness also becomes important. With increase in a country's product markets competitiveness, risks to current market operations and that associated with entry to new markets would change thereby impacting firm diversification behavior. India offers an appropriate laboratory to test our arguments due to evolving nature of her economy from underdeveloped towards advanced state of industrialization. The study indicates quadratic relationship between performance and firm diversification. Both related and unrelated diversification vary in inverted-U shaped manner with performance. However, as product markets advance, this relationship strengthens in case of related diversification whereas weakens in case of unrelated diversification.