Generic Strategies and Performance: An Empirical Analysis for German Listed Companies and Possible Effects for Co-Determination

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Agenda.

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1 **Introduction.**

2 **Empirical Results and Limitations in the Literature.**

3 **Methodology to Answer our Research Question.**

4 **Variables, Regression Models and Multivariate Analysis.**

5 **Summary and Implications.**

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1 Introduction.

There Exist Many Different Approaches, Tools and Objectives in the Strategy Literature.

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Different Strategic Approaches.

- Strategy means different things to different people (Bracker, 1980).

The focus of our study is the effect of strategic decisions in order to generate a competitive advantage and the possible impact on co-determination/employees.

This Research Project was Designed to Test the Effects of Generic Strategies on Company Performance.

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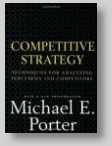
Strategy Definition According to Porter and Objective of our Study.

01 Competition



Strategy definition according to Porter (1980):
"... positioning a business to maximise the value of the capabilities that distinguish it from its competitors.".

- The specific strategy definition depends on the respective area of research.
- One of the most common classification of strategies are according to Porter's generic strategies (differentiation vs. cost leadership), whereby these strategies are the focus of our study.[1]
- One of the main challenges for every company is to achieve a sustainable, strategic competitive advantage.
- A competitive advantage is basically the attribute that allows a company to outperform its competitors, as a result of a better customer value proposition through a much lower price or better products and services.
- Other strategy options to achieve long-term competitive advantage are internationalization and diversification.

To What Extent do Generic Strategies have an Influence on the Performance of German Listed Companies?

1: We selected this focus for the reason that e.g. Porter's niche strategy is mainly used by small companies.

In our Analysis we Tested the Four Strategy Options: Differentiation, Cost Leadership, Internationalization and Diversification.

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The Focus of our Study Represents the Main Strategic Orientations Based on the Ongoing Scientific Debate and Business Practice.

Strategies to achieve a competitive advantage

Differentiation

01

„Creating something that is perceived industrywide as being unique“ (Porter, 1980), such as new technologies, product design, brand, customer service, brand loyalty, or lower sensitivity to price.

Cost Leadership

02

The main focus of this strategy is to achieve overall cost leadership in an industry. This strategy is driven by efficiency, size, scale, scope, experience, and it requires tight cost and overhead control as well as cost minimization in areas such as R&D or advertising.

Internationalization

03

Access to new markets, new tangible and intangible resource potentials, opportunities for growth in foreign economic regions, increased earnings potentials and risk mitigation.

Diversification

04

A positive change of the risk-return profile of the company, thus increasing the chances and reducing risks. This represents a source of synergies that can only be achieved through diversification.

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2 Empirical Results and Limitations in the Literature.

A Few Important Research Gaps Can be Identified in the Relevant Literature.

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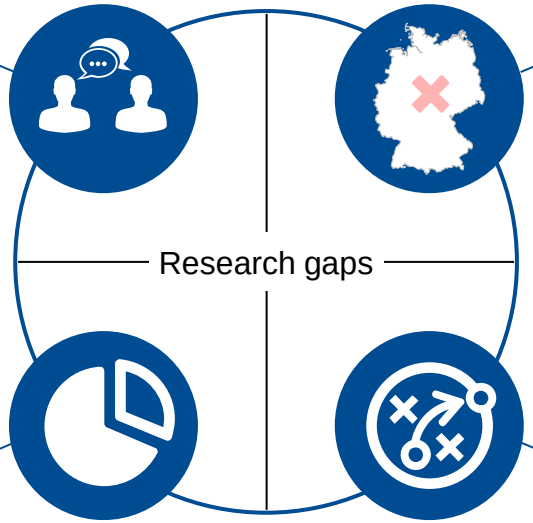
The Current State of Research.

- The investigation of strategies from an economic context have been carried out for over 70 years.
- Porter has developed the generic strategies (differentiation and cost leadership) in the 1980s and since then many different empirical studies have addressed this strategic approach.
- “The simplicity of Porter‘s model captures much of the complexity inherent in strategic gestalts.” (Miller, 1993).
- However, a few important research gaps can be identified in the relevant literature, which builds the basis for our study. With a focus on German listed companies we aim to closing these research gaps.

Many studies in the empirical strategy literature are qualitative in nature.

To the best of our knowledge there are no existing studies in the literature with a focus on Germany.



Frequent application of cross-sectional data, whereby one-time effects cannot be excluded.

It is still unclear, if generic strategies in its pure form lead to an improved performance compared to hybrid strategies.

The Research of the Relationship Between Strategy and Performance is Bringing out Controversial Results.

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Extract of Different Results in the Empirical Literature.

Publication: 2007; Sample: 1999-2000

Strategic Management Journal
Strat. Mgmt. J., **28**: 553–561 (2007)
Published online 21 February 2007 in Wiley InterScience (www.interscience.wiley.com) DOI: 10.1002/smj.606
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RESEARCH NOTES AND COMMENTARIES

STRATEGIC PURITY: A MULTI-INDUSTRY EVALUATION OF PURE VS. HYBRID BUSINESS STRATEGIES

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Twenty-five years of empirical research has failed to resolve a basic strategy question. Does strategic purity pay? Most theorists believe strategic purity—the extent to which a business pursues one type of generic strategy over another—contributes to better performance. By defining the strategy space consistent with the theory, and employing improved design and methods, our study of 2,351 businesses finds a significant relationship between strategic purity and performance. Purity does appear to pay. Some variations in strategic purity and performance relationship were observed across four major industry sectors: manufacturing, construction, retail, and business services. But in all instances pure strategies never did less well, and often did better than hybrid strategies. Copyright © 2007 John Wiley & Sons, Ltd.

INTRODUCTION

Does pursuit of a pure business strategy lead to superior performance relative to a mixed or hybrid strategy? Porter (1980, 1985, 1996) suggests combining generic strategies causes most businesses to get 'stuck in the middle' and experience poorer performance. There has been much empirical research since Porter first made this assertion 25 years ago, but these studies are equivocal and no consensus has emerged. Campbell-Hunt (2000: 149) identified this question as 'the central hypothesis of the dominant paradigm of competitive strategy' and his meta-analysis of the generic competitive strategy research found that 'there is no clear evidence here that no-distinctive-emphasis designs are any more or less capable of above-average performance than other archetypes'. Some studies find for purity, others for a hybrid strategy. The absence of a broad empirical consensus on this fundamental strategy question is so disturbing that Campbell-Hunt (2000: 149)

The pursuit of a pure generic strategy (differentiation or cost leadership) does appear to pay. Pure strategies never did less well, and often did better than hybrid strategies.

Publication: 2014; Sample: 1989-2003

The current issue and full text archive of this journal is available at
www.emeraldinsight.com/0025-1747.htm

Does a differentiation strategy lead to more sustainable financial performance than a cost leadership strategy?

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Abstract
Purpose – The purpose of this paper is to investigate the relationship between the strategic positioning of firms and the sustainability of firm performance. The paper argues that pursuing a differentiation strategy leads to more sustainable financial performance compared to following a cost leadership strategy. However, a differentiation strategy may also be associated with greater risk.
Design/methodology/approach – To investigate the research questions, the authors utilize publicly available archival data consisting of 12,849 firm-year observations for the period 1989-2003. In the first stage of the analysis, factor analysis is used to determine firms' strategic positioning. The resulting factor scores are subsequently used in regression analysis to investigate the sustainability of performance based on the strategic positioning of firms.
Findings – The results indicate that both cost leadership and differentiation strategies have a positive impact on contemporaneous performance. However, the differentiation strategy allows a firm to sustain its current performance in the future to a greater extent than a cost leadership strategy. The differentiation strategy, though, is also associated with greater systematic risk and more unstable performance.
Originality/value – Sustainability of performance refers to how much a firm's current profitability can be sustained in future periods. The main contribution of this study is the comparison of generic strategies based on the sustainability of firm performance. This aspect of the strategy-performance link has not been considered in prior work. Another contribution of the study is that it considers multiple dimensions of firm performance in order to evaluate the trade-offs involved with pursuing different strategies. In particular, the authors contribute to the literature by documenting that while differentiation leads to more sustainable earnings, it also leads to riskier and more unstable earnings.

Keywords Sustainability, Differentiation, Firm performance, Strategic positioning, Cost leadership
Paper type Research paper

I. Introduction
Recent work in strategic management examines the characteristics of resources

Differentiation as well as cost leadership strategies have a positive impact on company performance. The differentiation strategy allows a firm to sustain its current performance in the future, but is also associated with greater systematic risk and unstable performance.

Publication: 1993; Sample: PIMS database

Journal of Management Studies 30:4 1993
0022–2380

ASSESSING PORTER'S (1980) MODEL IN TERMS OF ITS GENERALIZABILITY, ACCURACY AND SIMPLICITY

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ABSTRACT

The Porter (1980) model of generic strategies is evaluated in terms of simplicity, accuracy (*i.e.*, predictive and explanatory power), and generalizability, through an empirical analysis of PIMS data. Results lead to the following conclusions: (1) the simplicity of Porter's model captures much of the complexity inherent in strategic gestalts; (2) Porter's framework could be improved by viewing it as providing three important dimensions of strategic positioning rather than three (or four) distinct strategies; (3) performance norms vary significantly across strategic types, though Porter's predictions of performance are not entirely accurate; (4) strategies such as those described by Porter are possibly more contingent than generic, thus limiting the generalizability of some prescriptions implicit in the model.

INTRODUCTION

Although Porter's (1980) framework continues to provide the basis for numerous follow-up studies and extensions, little empirical research has been directed toward assessing its suitability for this role. Without such an assessment, we are unsure of the generalizability of the many propositions and hypotheses in Porter's work. The most widely-accepted criteria for evaluating a model are: (1) its ability to simplify the complex, thereby making it more manageable for researchers; (2) its ability to maintain accuracy in predicting and exploring relationships in spite of its simplicity; (3) its generalizability to a variety of settings, and (4) its fruitfulness in generating interest for follow-up research. (Refer to Anderson, 1983, Blalock, 1982, and Weick, 1979, for details on these criteria.)

Porter's model fares well in terms of the fourth criterion. To gain some

Combinations of generic strategies (differentiation and cost leadership) are not only possible in the form of a hybrid strategy but also profitable. Even though it is not the manner in which it is originally portrayed by Porter.

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3 Methodology to Answer our Research Question.

„To What Extent do Generic Strategies have an Influence on the Performance of German Listed Companies?“

We analyzed 403 German Listed Companies (CDAX) in the Period Between 2009 and 2016.

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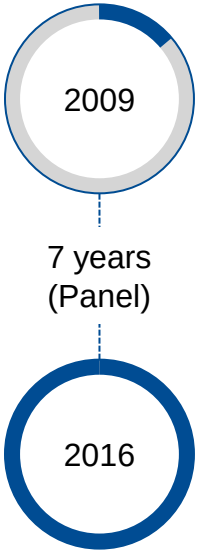
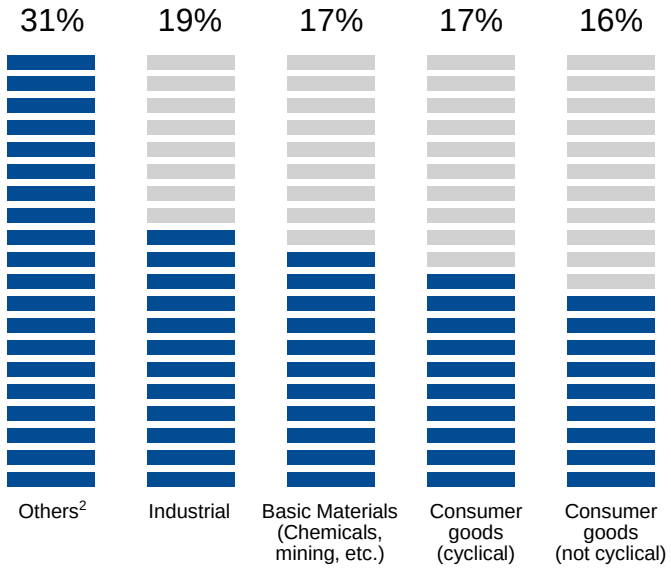
Project methodology.

Sample

Time period



Industry Classification (Thomson Reuters)



Research approach

01 Literature Review to identify relevant variables.

02 Data collection via Thomson Reuters Eikon.

03 Correction and completion of the data.

04 Data analysis and development of our regression models.

05 Interpretation, Summary and completion of the study.

1: CDAX-Companies with the excklusion of companies of the financial and insurance industry.
2: Healthcare, Technology, Telecommunication, Utility.

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4 Variables, Regression Models and Multivariate Analysis.

We Used Different Measures to Operationalize the Different Strategic Options.

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The Selection of our Variables.

- We based the selection of our variables on previous empirical studies about the relationship between strategy and performance.
- The selection of our dependent variables are representing financial accounting (EBIT) and capital market (MARKETCAP) perspective in order to account for effects in both areas.
- The MARKETCAP can be seen as the aggregated assessment of investors, thus it is reflecting current and future developments.
- The individual variables are representing indicators, „to measure“ the adopted strategy. The number of different variables depend on the possibility to measure the strategy through one specific variable (e.g. the differentiation strategy includes more than just the measure of R&D expenses).
- We additionally examined the robustness of our results by including different variables such as Return on Assets, but the result has not significantly changed.

Our Used Variables from the Thomson Reuters Eikon Database.

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Variable Description.

Variables	Unit	Performance/Strategic Orientation
EBIT	MEUR	Performance (Dependent Variables)
MARKETCAP	MEUR	
SALES	MEUR	Differentiation
RD	MEUR	
SGA	MEUR	
COGS	MEUR	
MARKETVALTOBOOKVAL	%	
SALES	MEUR	Cost Leadership
CAPEX	MEUR	
BOOKVAL	MEUR	
EMPL	#	
TOTASSETS	MEUR	
INTSALES	MEUR	Internationalization
SEGMENTS	#	Diversification

We Analyzed our Data Through Linear Panel Data Models.

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Regression Analysis.

- Application of linear panel data models, since the individual companies (i) have been observed over several time periods (t) (2009-2016).
- We have used a two-stage procedure, in which we have initially estimated the regression models for the individual strategies and then estimated a complete model including all strategies.

Regression model (theoretical)

$$y_{it} = \beta_0 + \beta_1 x_{it1} + \beta_2 x_{it2} + \ldots + \beta_k x_{itk} + a_i + u_{it,} \quad t = 1, 2, \ldots, T.$$

Regression model (operationalization)

$$\ln_EBIT_{it}\ bzw.\ \ln_MARKETCAP_{it}$$
$$= \beta_0 + \beta_1 RD_SALES_{it1} + \beta_2 SGA_SALES_{it2} + \beta_3 SALES_COGS_{it3} + \beta_4 MARKETVALTOBOOKVAL_{it4}$$
$$+ \beta_5 SALES_CAPEX_{it5} + \beta_6 SALES_BOOKVAL_{it6} + \beta_7 EMPL_TOTASSETS_{it7} + \beta_8 ln_INTSALES_{it8}$$
$$+ \beta_9 SEGMENTS_{it9} + a_i + u_{it,} \quad t = 1, 2, \ldots, T.$$

Complete Model (EBIT).

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Results.

Variables ln_EBIT	Expected Sign	Model 1	Model 2	Model 3	Model 4	Model 5
RD_SALES	-	-2.452648^{+}				-4.242093**
SGA_SALES	-	-.6606836^{+}				-1.199187**
SALES_COGS	+	.0809753*				.2102638***
MARKETVALTO BOOKVAL	+	.059718***				.1030259***
SALES_CAPEX	+		-.0002233***			-.0011559*
SALES_BOOK VAL	+		.0018976			-.0075176***
EMPL_TOT ASSETS	- / +		-.0405345***			-.0369459
ln_INTSALES	+			.398426***		.6310913***
SEGMENTS	+				.0474398*	.0135024
Observations		1.048	2.086	1.611	2.100	913
Adjusted R^2		0.9357	0.9226	0.9410	0.9247	0.9471

Significance level: $^{+}$ p<.10; * p<.05; ** p<.01; *** p<.001.

Complete Model (MARKETCAP).

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Results.

Variables ln_MARKETCAP	Expected Sign	Model 1	Model 2	Model 3	Model 4	Model 5
RD_SALES	+	.0075059				.8149116**
SGA_SALES	-	-.0047834				-.5306458***
SALES_COGS	+	-.0000334				.1009934***
MARKETVALTO BOOKVAL	+	.0000529				.0256736***
SALES_CAPEX	+		-.0001924***			-.0020869***
SALES_BOOK VAL	+		.0000069			-.0016537^{+}
EMPL_TOT ASSETS	- / +		-.0751124***			-.0664585***
ln_INTSALES	+			.3165441***		.4679211***
SEGMENTS	+				.0729872***	.0505692**
Observations		1.285	2.463	1.861	2.513	1.083
Adjusted R^2		0.9531	0.9490	0.9585	0.9507	0.9680

Significance level: $^{+}$ p<.10; * p<.05; ** p<.01; *** p<.001.

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5 Summary and Implications.

Based on our Study We Find Evidence for Different Effects on Company Performance.

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Summary.

- Based on our analysis we find evidence that the specific, generic strategies have an effect on company performance. However, it has to be noted that financial statements and capital markets do not always react in the same direction and effects vary depending on the measure of company performance.

Differentiation:
Higher R&D expenses have a negative effect on the EBIT, but due to the future potential it has a positive effect on MARKETCAP. A higher ratio of SALES_COGS as well as MARKETVALTOBOOKVAL have a positive effect on company performance, as a result of the possibility to charge higher prices and increased growth- and investment opportunities.

Cost Leadership:
With regard to the cost leadership strategy we found not the expected positive effect on company performance. Although we find statistically significant negative effects on company performance, its economic impact was really small.

Internationalization:
We find evidence that an increasing internationalization has positive effects on EBIT and MARKETCAP. This is due to the access to new markets, resource potentials and opportunities of growth in foreign economic regions.

Diversification:
The diversification of companies through different SEGMENTS has a significant positive effect on MARKETCAP, which can be attributed to the risk aversion of capital market investors.

Scientific and Practical Interpretation of our Results.

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Summary.

- The empirical evidence shows that strategy do have an effect on the performance of German listed Companies. The choice of a specific, generic strategy can lead to an increased performance.
- Our results are constant over time and consider not only one specific year but the time period between 2009 and 2016.
- We find evidence that effects vary depending on the measure of company performance, thus the assessment have to be based on either a financial statement or capital markets perspective.
- Moreover, we find evidence that differentiation strategies are outperforming cost leadership strategies.
- In practice, these results may help to forecast the effects of different strategies on company performance. It should allow practitioners to asses the main drivers for long-term growth or long-term decline of performance, due to the pursuit of different strategies.

Importance of our Results for Co-Determination.

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Summary.

- In the practice of co-determination strategic decisions frequently are driven by the executive board and shareholders, therefore the financial performance is often the focus point. However, whether and to which extent strategic decisions have an influence on company performance is unknown.
- These facts are commonly determined by anecdotal evidence and non-transparent benchmarks. On this basis it is difficult for the co-determined supervisory board to argument in favor of a specific strategic decision.

Our results suggest for Germany.

- Differentiation strategies have a positive effect on EBIT and MARKETCAP.
- Cost Leadership strategies do not have a positive effect.
- Increased international revenues and diversification lead to an increased performance.

Employee- and union representatives can use our empirical results as a basis to question the sense of specific strategies with regard to company performance.

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Appendix: Variable Description (1/2).

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Our Used Variables from the Thomson Reuters Eikon Database.

Variables	Unit	Description
Performance (Dependent Variables)		
EBIT	MEUR	Earnings of a company before interest expense and income taxes.
MARKETCAP	MEUR	Total market value of a company's shares.
Differentiation (Independent Variables)		
SALES	MEUR	Sales and other operating revenues.
RD	MEUR	Direct and indirect costs related to the creation and development of new processes, techniques, applications and product.
SGA	MEUR	Expenses not directly attributable to the production process but relating to selling, general and administrative functions.
COGS	MEUR	Specific or direct manufacturing cost of material and labor entering in the production of finished goods.
MARKETVALTOBOOKVAL	%	Ratio of ordinary (common) equity divided by the balance sheet value.

Appendix: Variable Description (2/2).

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Our Used Variables from the Thomson Reuters Eikon Database.

Variables	Unit	Description
Cost Leadership (Independent Variables)		
SALES	MEUR	Sales and other operating revenues.
CAPEX	MEUR	Funds used to acquire fixed assets other than those associated with acquisitions.
BOOKVAL	MEUR	Common shareholders' investment in a company.
EMPL	#	Full time employees of the company.
TOTASSETS	MEUR	Sum of total current assets, long term receivables, investment in unconsolidated subsidiaries, other investments, net property plant and equipment and other assets.
Internationalization (Independent Variables)		
INTSALES	MEUR	Sales generated from operations in foreign countries.
Diversification (Independent Variables)		
SEGMENTS	#	Number of segments.

Appendix: Descriptive Statistics.

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All Variables.

Variables	Unit	Observations	Mean	Standard deviation
EBIT	MEUR	2,758	418.16	1,588.10
MARKETCAP	MEUR	2,699	3,636.16	11,292.79
SALES	MEUR	2,788	5,357.75	18,018.24
RD	MEUR	1,399	221.41	772.89
SGA	MEUR	2,614	1,017.85	3,275.84
COGS	MEUR	2,669	3,263.99	12,643.02
MARKETVALTOBOOKVAL	%	2,920	1.66	55.79
CAPEX	MEUR	2,720	268.11	1,041.50
BOOKVAL	MEUR	2,786	2,270.25	7,626.35
EMPL	#	2,651	16,617.78	55,896.49
TOTASSETS	MEUR	2,786	17,221.32	111,172.20
INTSALES	MEUR	2,333	3,964.80	13,689.00
SEGMENTS	#	2,610	3.80	1.84

Appendix: Differentiation Strategy (1/2).

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Variable Description – Model 1.

Variables	Expected Sign	Description
RD_SALES	- / +	Companies that pursue a differentiation strategy have comparable higher R&D expenditures in relation to their sales, thus a negative effect is expected on EBIT. However, since the capital market is expecting a positive return from investments in R&D in the future we expect a positive effect on MARKETCAP.
SGA_SALES	-	To differentiate from its competitors companies are heavily investing in sales and promotional activities to strengthen their brand image and customer loyalty, thus we expect a negative effect on company performance.
SALES_COGS	+	A successful adaption of a differentiation strategy enables a company to charge higher prices, thus we predict a positive effect on company performance.
MARKETVALTO BOOKVAL	+	The ratio between market- and book value reflects potential growth and investment opportunities, which are expected comparably higher for companies that pursue a differentiation strategy, thus we expect a positive effect on company performance.

Appendix: Differentiation Strategy (2/2).

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Results – Model 1.

Variables	Expected Sign	EBIT	Market-capitalization
RD_SALES	- / +	-2.452648^{+}	.0075059
SGA_SALES	-	-.6606836^{+}	-.0047834
SALES_COGS	+	.0809753*	-.0000334
MARKETVALTO BOOKVAL	+	.059718***	.0000529
Observations		1.048	1.285
Adjusted R^2		0.9357	0.9531

Significance level: $^{+}$ p<.10; * p<.05; ** p<.01; *** p<.001.

Appendix: Cost Leadership Strategy (1/2).

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Variable Description – Model 2.

Variables	Expected Sign	Description
SALES_CAPEX	+	A higher ratio of SALES_CAPEX indicates a more efficient use of assets, thus we expect a positive effect on company performance.
SALES_BOOK VAL	+	A higher ratio of SALES_CAPEX indicates a more efficient use of assets, thus we expect a positive effect on company performance.
EMPL_TOT ASSETS	- / +	A higher ratio of EMPL_TOTASSETS indicates a more efficient use of labor, thus we expect a positive effect on company performance.

Appendix: Cost Leadership Strategy (2/2).

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Results – Model 2.

Variables	Expected Sign	EBIT	Market-capitalization
SALES_CAPEX	+	-.0002233***	-.0001924***
SALES_BOOK VAL	+	.0018976	.0000069
EMPL_TOT ASSETS	- / +	-.0405345***	-.0751124***
Observations		2.086	2.463
Adjusted R^2		0.9226	0.9490

Significance level: $^{+}$ p<.10; * p<.05; ** p<.01; *** p<.001.

Appendix: Internationalization Strategy (1/2).

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Variable Description – Model 3.

Variables	Expected Sign	Description
ln_INTSALES	+	An internationalization strategy enables companies to access new markets, to access new tangible and intangible resource potentials, opportunities of growth in foreign economic regions, to increased earnings potentials and risk mitigation, thus we expect a positive effect on company performance.

Appendix: Internationalization Strategy (2/2).

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Results – Model 3.

Variables	Expected Sign	EBIT	Market-capitalization
ln_INTSALES	+	.398426***	.3165441***
Observations		1.611	1.861
Adjusted R^2		0.9410	0.9585

Significance level: $^{+}$ p<.10; * p<.05; ** p<.01; *** p<.001.

Appendix: Diversification Strategy (1/2).

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Variable Description – Model 4.

Variables	Expected Sign	Description
SEGMENTS	+	The diversification through different segments leads to a positive change of the risk-return profile of the company, thus increasing the chances and reducing risks. This represents a source of synergies that can only be achieved through diversification. Moreover, different segments mutual assure each segment and therefore a better diversification of risk is possible, thus we expect a positive effect on company performance.

Appendix: Diversification Strategy (2/2).

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Results – Model 4.

Variables	Expected Sign	EBIT	Market-capitalization
SEGMENTS	+	.0474398*	.0729872***
Observations		2.100	2.513
Adjusted R^2		0.9247	0.9507

Significance level: $^{+}$ p<.10; * p<.05; ** p<.01; *** p<.001.