

Title: **Business Exit and Strategic Change: Sticking to the Knitting or Striking a New Path?**

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Business Exit and Strategic Change: Sticking to the Knitting or Striking a New Path?

Abstract

The purpose of this study is to examine the potential of business exit for initiating strategic change in divesting parent firms. In contrast to prior literature that mainly investigates the impact of different antecedents on the likelihood of business exit in general, this study additionally tests the influence of these antecedents on the choice between two exit types with a cross-industry sample of divesting firms listed in the German CDAX over the time period 1999-2004. A divestiture involving strategic change is a strategic business exit; otherwise it is denoted as status quo-preserving. The findings reveal that a relatively highly dissipated focus does not automatically enhance the likelihood of business exit in general and status quo-preserving business exit in particular. CEO turnover and pressures exerted by institutional investors predict neither strategic nor status quo-preserving business exit. Low firm performance does not nurture the likelihood of business exit *per se* but especially promotes status quo-preserving business exit.

Keywords: business exit, strategic change, divestiture, corporate restructuring

Introduction

Business exit that implies that a firm divests business units in terms of, e.g., sell-off, buy-out, spin-off, or dissolution (e.g., Bergh, Johnson, and Dewitt, 2008; Burgelman, 1996; Chang and Singh, 1999; Duhaime and Grant, 1984; Mitchell, 1994; Moliterno and Wiersema, 2007) is frequently seen as an equivalent to failure or decline (Whetten, 1980). Since firms often engage in transformation in terms of the internal recombination of units such that activities are regrouped and retained within firms before divesting an entity (Karim, 2006; Karim and Mitchell, 2000), the more positively connoted transformation and the extinction of businesses need not exclude each other. Burgelman's (1994, 1996) findings, for instance, documenting Intel's exit from the dynamic random access memory (DRAM) business in the mid-1980s and its simultaneous transformation into a microcomputer company, and recent evidence by Brauer (2009) suggest that business exit bears the potential for strategic change. Although prior interest in business exit has revealed a significant number of antecedents, the broad literature neither pays much attention to potential types of business exit nor to the antecedents that may trigger each of them. While different theories, such as agency theory (e.g., Bethel and Liebeskind, 1993; Gibbs, 1993; Lang, Poulsen and Stulz, 1995; Seward and Walsh, 1996; Steiner, 1997; Wright and Ferris, 1997), transaction cost theory (e.g., Bergh and Lawless, 1998; Hoskisson and Turk, 1990; Makhija, 2004), the resource-based view (e.g., Bergh, 1995, 1998; Chang and Singh, 1999; Morrow, Sirmon, Hitt and Holcomb, 2007; Villalonga and McGahan, 2005), population ecology (e.g., Chang, 1996; Delios and Beamish, 2001; Kalnins, Swaminathan and Mitchell, 2006), or the upper echelons perspective (e.g., Bigley and Wiersema, 2002; Wiersema, 1992, 1995) have been used to explain why multibusiness firms divest, their impact as drivers of different types of business exit has not been studied, yet. This gap is astounding, since the antecedents show that they signal a mismatch between the firm's actual behaviour and its constituencies' expectations on the firm

(Higgins and Gulati, 2006). Therefore, first, this study examines the impact of common antecedents on the likelihood that a business unit is divested; second, these antecedents are interpreted as signals of the need for special exit types. Although we do not investigate processes of strategic change in detail, we argue and demonstrate that business exits can be used to nurture strategic change in terms of the consequences for the parent company and the remaining businesses in the corporate portfolio after a divestiture. Thereby, some antecedents are more likely to promote “striking a new path” than others that rather tend to nurture “sticking to the knitting”. The abandonment of a business unit that involves strategic change is being denoted as a *strategic business exit*, while the withdrawal from a business without changing the parent’s strategic direction is being considered as *status quo-preserving*.

This study hence contributes to management research by augmenting our wisdom on business exit with, first, a differentiation between business exit in general and the identification of exit types, second, the specification of antecedents that trigger the divestiture of a business unit and their interpretation as signals of the need for strategic change that motivate different exit types, and, third, an empirical test of this idea with panel data from a cross-industry sample of 91 firms listed in the German CDAX that provide observations from the time period 1999-2004.

The remainder of this paper is organized as follows. In the next section a framework is developed that applies the findings of prior studies and extends them by emphasizing the value of the identified antecedents as drivers of special exit types. Methods and findings of the study are outlined in subsequent sections. The results of this study as well as its implications for future research and management are discussed at the end of the paper.

Hypotheses

Business Exit

Prior studies on business exit predominantly investigate its financial outcomes which are mainly positive (e.g., Chang, 1996; John and Ofek, 1995; Mulherin and Boone, 2000; Steiner, 1997). A much smaller amount of prior findings imply that a business exit can be a vehicle for the elimination of a misconceived strategy that challenges a firm's acceptability in the market (e.g., Burgelman, 1994, 1996; Kaiser and Stouraitis, 2001; Markides, 1995). Thereby, any business exit has implications at different levels:

At the *corporate level*, the divesting company raises funds that it can use for other purposes, e.g., in order to invest in the remaining businesses' actions, reduce its debt burden, or use the business exit as a vehicle for strategic change. Although any divestiture has an impact on corporate strategy, in many cases, exit goes beyond the reduction of a performance gap at the firm level (e.g., Chang, 1996) or a decrease of a firm's degree of diversification (e.g., Markides, 1995). For example, Intel exited from the dynamic random access memory (DRAM) business in 1984-1985, stopped capacity expansion for erasable programmable read only memory (EPROM) manufacturing in 1991, and transformed itself from a memory company into a specialist for microcomputers (Burgelman, 1994). Accordingly, a *strategic business exit* denotes the divestiture of a business unit which involves strategic change. In that context, Byerly, Lamont and Keasler (2003) differentiate between refocusing and repositioning. Refocusing means that a firm eliminates mainly peripheral activities. A firm's current core business is to be strengthened. Sears Roebuck, e.g., refocused to its retailing business by divesting financial services and insurance businesses. By repositioning a firm aims at striking a new strategic path as it establishes a new core business (Byerly et al., 2003). For example, as a result of a steadily decreasing per capita consumption of spirits in Germany and legislative pressures, the German manufacturer of spirits and juices Eckes sold

its traditional domestic hard liquor business to Rotkäppchen-Mumm and transformed itself into a company being famous for high-quality juices (Brück, 2006). Some business exits involve both core change and the simultaneous reduction of the number of businesses. Altana, e.g., selling its pharmaceutical business to the Danish company Nycomed, turned to its much smaller chemistry business and changed it into its new core business (Handelsblatt, 2007). Put differently, a business exit will be strategic, if it has an impact on the fate of the remaining business units and their differential importance within a parent firm's portfolio of business units. Nonetheless, many if not most business exits are not used as a vehicle for strategic change at the corporate level but serve the purpose of reducing firm assets in order to mitigate the risk of firm turnover due to performance problems, e.g., in terms of asset retrenchment (Morrow, Johnson, and Busenitz, 2004). Such an exit is *status quo-preserving*, because it hardly affects the remaining businesses with regard to the divesting firm's efforts to enhance its fit with relevant stakeholders' expectations.

Outcomes at the *business level* consist of increases in financial performance (e.g., Dranikoff, Koller, and Schneider, 2002; Woo, Willard, and Daellenbach, 1992) or managerial improvements, e.g., changes in internal control practices (e.g., Seward and Walsh, 1996). For example, by abandoning the DRAM business and transforming itself in a microcomputer company, Intel learned that resource shifting and technological uncoupling at the business level were value-added activities, because they released scarce resources from businesses in which the firm's strategic position was weak (Burgelman, 1994). The Intel example also shows that a business exit affects the divesting firm at the level of *strategic competences*. The parent company and the remaining business units lose their access to a divested entity's competences. In turn, under the condition that the divested unit is not shut down but, e.g., sold to a new owner or spun off, it needs to organize and monitor its own portfolio of competences itself, irrespective of the former parent's governance structures, capabilities and

resources. The divested business unit's performance can improve after exit, if a business is held by a parent firm whose skills and resources do not match the unit's special requirements and is hence unable to add value to that business and reap benefits for the whole company. Therefore, on the one hand, the abandonment of competences may be economically sound. The specialty-packaging company Pactiv, e.g., sold its high-performing polyethylene-packaging business, because the parent firm considered its own competences, in particular regarding the uncertain polyethylene industry, as insufficient for adequately managing this business in the long run (Dranikoff, Koller, and Schneider, 2002). On the other hand, the abandonment of strategic competences can constrain a firm's strategic path at the corporate level in the long run. Consider, e.g., the German business group Arcandor that filed for bankruptcy in 2009. If Arcandor had actually sold its premium department stores in Berlin, Hamburg and Munich, as it had planned, it would have constrained its opportunities for retailing in the luxury segment in the long run and made a shift back into this segment impossible for years to come. Due to high switching costs, Arcandor would have been locked in retailing in a medium price range for the next years (Sydow, Schreyögg, and Koch, 2009).

Prior studies on the antecedents of business exit primarily focus on the question of whether and why a business unit needs to be divested. The specified antecedents mainly refer to financial performance, corporate diversification, executive turnover and institutional pressures (Brauer, 2006). Both underperformance at the firm and the business level are important antecedents (Singh, 1993), but a divestiture will be especially likely, if an underperforming business can no longer be hidden among its peer units and the whole corporation's performance suffers from the unit's decline (e.g., Chang, 1996; Cho and Cohen, 1997; Montgomery and Thomas, 1988). Corporate managers will be particularly willing to abandon a business, if the whole firm's financial performance decreases. In addition, the lower the fit of a business unit with its peer businesses, the higher is the likelihood of

divestiture: in the absence of internal complementarities the marginal return of an activity does not increase with the augmenting level of another activity in the same corporation (Hanson and Song, 2003; Stieglitz and Heine, 2007). That is, the strategic competences that are unified in a single corporation can be too diverse and dissipated (e.g., Byerly et al., 2003; Johnson, 1996; Markides, 1992a, 1992b; Steiner, 1997). Dissipation entails that relevant stakeholders do not perceive a firm's strategic path as evident as that of more focused companies whose product offerings rely on a comparatively limited set of competences. Corporate parents can be forced to restructure their firms in order to avoid conglomerate discounts. The latter occur because highly diverse firms render valuation through securities analysts difficult. The valuation of firms draws on product categories which conglomerates do not match. Thus, highly diversified firms cannot easily be compared with one another (Zuckerman, 2000). Furthermore, executive turnover frequently coincides with corporate restructuring (e.g., Matthyssens and Pauwels, 2000; Ravenscraft and Scherer, 1991). The arrival of a new CEO increases the likelihood of business exit, especially when his power, cognitive orientations, professional background, and ability to resist inertial forces favour such a step (Bigley and Wiersema, 2002; Brauer, 2009; Gordon, Stewart, Sweo and Luker, 2000; Hayward and Shimizu, 2006; Shimizu and Hitt, 2005; Wiersema, 1992, 1995). Finally, firms must prove their investment legitimacy to powerful institutional investors. Their pursuit of a better control in order to avoid strategies such as unrelated diversification that may have a negative impact on firm performance in the long run, are at least partly responsible for business exit (Bethel and Liebeskind, 1993).

The antecedents of business exit as signals of the need for strategic change

Organizational behaviour involves signals that communicate information about a firm's current situation and enable its constituencies to assess its potential to be beneficial for them (Basdeo, Smith, Grimm, Rindova and Derfus, 2006). These signals act as contingencies that

promote the choice of a strategic option such as strategic business exit over another such as status quo-preserving business exit. Thus, we suggest that the pre-defined antecedents either nurture strategic or status quo-preserving business exit.

Firm performance. Dissatisfactory performance at the firm level is a signal to the marketplace that some aspects of a firm's operations are flawed and put its existence at risk. Although studies illustrate that firms tend to divest businesses due to a performance decline (e.g., Chang, 1996; Duhaime and Grant, 1984; Hamilton and Chow, 1993; Hanson and Song, 2003; Lang et al., 1995; Steiner, 1997) especially at the firm level (Cho and Cohen, 1997), they do not investigate what type of exit is likely. At least Montgomery and Thomas (1988) differentiate between types of divesting firms because companies react to a performance decline in different ways: while 'tactical' divestors use business exits to raise funds in order to improve short-term performance, 'strategic' divestors are likely to re-evaluate and eventually change their strategy with a business exit. The latter is more offensive and risky than a divestiture without the simultaneous pursuit of strategic change, especially in terms of repositioning (Byerly et al., 2003). Risk-taking is less likely in the face of performance problems, because managers tend to adopt defensive strategic choices, when survival is perceived to be at risk (Laughunn, Payne and Crum, 1980; Shimizu, 2007). Shrinking size without striking a new path is viewed as less risky than an exit that involves strategic change.

Hypothesis 1. The weaker a firm's financial performance, the higher is the likelihood of the choice of status quo-preserving over strategic business exit.

Corporate diversification. At the corporate level, the simultaneous investment in too many and too diverse technological fields or the performance of redundant activities often leads to a perceived lack of strategic focus (Markides, 1995). The latter jeopardizes a firm's credibility in the market. Especially external stakeholders tend to separate themselves from organizations that suffer from a lack of focus (Arthaud-Day, Certo, Dalton and Dalton, 2006; Zuckerman, 2000). At the business level, some corporations are likely to use the gains from

their core businesses or other profitable units to provide financial resources to businesses that are to be strengthened. Those resource commitments can harm the whole corporation, since promising businesses may suffer from a lack of funds in the long run (Kaiser and Stouraitis, 2001). However, a firm's strategic focus is mainly an outcome of its strategic competences. Firms that are characterized by a highly dissipated focus tend to be engaged in many different fields that need not complement each other. A large heterogeneity of competences under a single corporate umbrella is the main characteristic of those conglomerates (Hanson and Song, 2003; Stieglitz and Heine, 2007). Therefore, in the presence of a high degree of diversification, a business exit hardly affects the competences in the remaining business units. Consequently, we argue that a status quo-preserving business exit is more likely than a strategic business exit, since the need for strategic change is rather low.

Hypothesis 2. The more dissipated a firm's strategic focus, the higher is the likelihood of the choice of status quo-preserving over strategic business exit.

CEO turnover. CEO turnover can help eliminate a misalignment between a manager's actions and the firm (Furtado and Karan, 1990). A prior CEO's enduring commitment to a strategic path can be an outcome of cognitive inertia, e.g., as a result of long tenure. The appointment of a new CEO fosters the likelihood of both divestiture and strategic change (e.g., Gilmour, 1973). CEO turnover may hence be an appropriate mechanism to trigger strategic business exit (Hayward and Shimizu, 2006). It proves the well-functioning of internal and external control mechanisms and the firm's openness for a new beginning (Barker and Duhaime, 1997; Hambrick, Geletkanyez and Fredrickson, 1993; Hannan and Freeman, 1984; Hayward and Shimizu, 2006). New CEOs must prove their distinctiveness from their predecessors to relevant audiences, e.g., the board of directors, shareholders, or analysts. A new CEO's background, skills, and experiences that are different from his predecessor might enable a new understanding of a firm's problems and facilitate strategic change (Kraatz and Moore, 2002). Openness to change will be most likely, if the incumbent

CEO is replaced by a manager who comes from outside. Outsiders are less inclined to adhere to the status quo but are more likely to act as change agents (Wiersema, 1992). They are not trapped in a prevailing cognitive framework, feel personally less affected and are more likely to de-commit from a losing strategic action (Lant, Milliken and Batra, 1992), i.e., their openness to change tends to be higher.

Hypothesis 3. The higher a CEO's openness to change, the higher is the likelihood of the choice of strategic over status quo-preserving business exit.

Institutional investors. A group of owners who is dominant due to its relative size and power is able to strongly determine a firm's strategic direction (Gillan and Starks, 2003; Thomsen and Pedersen, 2000). Against conventional wisdom that institutional investors have a short-term planning horizon and thus tend to urge managers to act myopically, empirical evidence from the U.S. reveals that this owner type is likely to support managers who want to invest in projects that will be profitable only in the long run (Wahal and McConnell, 2000) and foster "striking a new path". Financial investors as owners have a relatively long planning horizon. They engage in portfolio investments and arm's length relationships to their investment firms. Their success is assessed with the financial performance of the firms in their portfolio. Therefore, their main objectives are the creation of shareholder value and high liquidity of their firms (Gillan, Kensinger and Martin, 2000). A strategic business exit requires a long-term planning horizon, as its profits might be visible only in the long run. Hence, influential financial investors as dominant owners can urge corporate managers to undertake strategic business exit, if it appears justified to them (Bethel and Liebeskind, 1993). Similarly to financial analysts, they use an industry-based system in order to classify firms and compare them with their peers. Highly diversified firms render this classification difficult and confuse outside parties, since their corporate identities contradict to commonly accepted rules for evaluating companies. To prevent a diversification discount, many multibusiness firms are willing to refocus (Zuckerman, 2000). Repositioning is also likely:

the German conglomerate Linde, e.g., was urged by its financial investors to alter its strategic focus and transformed itself into the market leader in industrial gases by reconfiguring the whole corporation (Wildhagen and Esterhazy, 2006).

Hypothesis 4. The higher the pressures for investment legitimacy, the higher is the likelihood of the choice of strategic over status quo-preserving business exit.

Methods

Sample and Data Sources

The initial sample consisted of all firms that are listed at the German stock exchange in the CDAX. The CDAX is a composite index which includes the shares of all domestic companies that are listed at *Frankfurt Stock Exchange*. All in all, 678 firms were identified. The *Mergers & Acquisitions Database* being published by the University of St. Gallen (Switzerland) and providing data on selling and buying firms, the sold units, and their industries, helped identify all exits between 1999 and 2004. 521 transactions which had been undertaken by 160 firms listed in the German CDAX were identified. The number of divesting firms was less than the number of business divestitures because of multiple exits by the same parent firm. *Compustat Global*, *Datastream*, *Worldscope* and the *Hoppenstedt Database* provided the required data. The German *Federal Statistical Office* provided information on the gross national product. Most studies eliminate restructuring transactions in the financial services industry, as acquisitions and divestitures are part of those firms' business models and hence accompanied by different motives (e.g., Villalonga, 2004). Those firms were excluded. Therefore, the final sample consists of 546 observations from 91 firms over the 1999-2004 time period.

Variables and Measures

This study includes two dependent variables. The first dependent variable is *exits*. Based on the data contained in the *M&A database*, we count a firm's number of divestitures

in a given year. This variable is used in order to test the baseline assumption that dissatisfactory firm performance, a dissipated focus, CEO turnover and institutional pressures enhance the likelihood of business exit. The second dependent variable refers to the *exit type*. Strategic change can be measured as the absolute change in the corporate diversification level of a diversified firm. The numbers and types of segments in different NACE codes reported by a focal firm are analyzed over the time period in order to measure reductions or changes in corporate diversification which indicate refocusing and/or repositioning (Villalonga and McGahan, 2005). Based upon the NACE classification, the absolute difference in diversification level between the years t (= year of exit) and $t+1$ (= one year after exit) is calculated and represents the kind of change in corporate strategy. Refocusing means a reduction in the number of businesses that a firm reports, repositioning involves a change in a firm's main classification code. If both a reduction in the number of businesses and a change in firm's core business are observable, both refocusing and repositioning are pursued. If a divestiture does not involve strategic change, there will be no visible change in a firm's NACE. Consequently, for our second dependent variable that is included in the hypotheses, we use a limited range dependent variable that is coded with 0 "no exit in a given year", 1 "divestiture in a given does not involve strategic change" (status quo-preserving business exit) and 2 "divestiture in a given year involves strategic change" (strategic business exit). The option "no exit" is used as a reference group against which the other categories are compared in the multinomial logistic panel models.

A firm's *earnings per share* ratio (net earnings divided by outstanding shares) is incorporated as a measure of firm performance in the year prior to exit. This ratio is an important indicator for a share's price. It is essential for financial investors. The higher its value, the better a company is performing and the lower is its need for striking a new path in investors' eyes (Brealey, Myers and Allen, 2008). A firm's diversification is measured with

the number of businesses that a divesting parent firm was engaged in the year prior to the exit. It is operationalized as the number of industries with distinct NACE codes at the two-digit level (*divers*) (Chi, Nystrom and Kircher, 2004; John and Ofek, 1995; Steiner, 1997). The higher the number of businesses, the more dissipated is a firm's strategic focus. CEOs have power to initiate strategic change (Isabella, 1990; Wiersema, 1995). Based on the information provided by the *Hoppenstedt Database*, a variable that indicates the likelihood and type of *CEO* turnover is included (with 0 = no turnover, 1 = insider, and 2 = outsider) in the year prior to exit (Barkema and Schijven, 2008; Gordon et al., 2000). A new CEO is an outsider, if s/he has not been member of the top management team of the firm before (Shimizu and Hitt, 2005). The owners of the sample firms are also listed in the *Hoppenstedt Database* and can be classified into six ownership categories, namely banks, institutional (financial) investors, (other non-financial) firms, personal/family ownership, government, and free float (Pedersen and Thomsen, 2003; Thomsen and Pedersen, 2000). The categorization into one of the six classes indicates which group owns the largest percentage of shares in the year prior to business exit. Since financial investors are assumed to exert a critical influence on the strategic decisions of the sample firms, this type of owners is measured with a dichotomous variable. Thereby, 1 denotes that financial investors are the main owners of a divesting firm and hold at least 5 percent of common shares outstanding; 0 if otherwise.

This study controls for a number of additional factors. *Firm size* is measured in terms of the logarithm of a firm's total assets (Morrow et al., 2007). *Firm age* is operationalized as the logarithm of the number of years at the time of the divestiture (Dawley, Hoffman and Lamont, 2002). *Year dummies* are included to control for potential trends, e.g., the maturing of the sample firms or exit waves (Barkema and Schijven, 2008). The growth of the gross national product (GNP, in percent) over the defined period of measurement is used to assess the *market* growth in Germany in the defined time period (Dawley et al., 2002; Dobrev, Kim

and Carroll, 2003; Dobrev, Kim and Hannan, 2001; Ravenscraft and Scherer, 1991). Strategic change frequently requires additional resources. In particular, excess financial resources, i.e., unabsorbed slack, increase the likelihood of strategic change under conditions of organizational decline. They provide flexibility and facilitate risk-taking and experimentation (Barker and Duhaime, 1997; Sommers, Nemec and Harris, 1987). *Slack* is measured as a firm's current ratio, i.e., current assets divided by current liabilities. The higher the ratio in the year prior to exit, the more liquid is a sample firm (Bergh, 1997; Cheng and Kesner, 1997; Morrow et al., 2004).

Data Analysis

Our data consist of repeated observations of the same firms over time in the form of time-series of cross-sections. First, we examine the impact of the pre-specified antecedents on the likelihood of business exit in a given year. Second, we investigate a limited-range dependent variable with three pre-specified exit options, whereby we use “no exit” as our reference group against which status quo-preserving and strategic business exit, respectively, are compared in the multinomial logistic regression models. For our analyses, we use fixed-effects panel regressions (Wooldridge, 2006). A fixed-effects model corresponds to the addition of dummy variables for each firm and considers features that are stable over time, e.g., a firm's industry. In order to test our baseline proposition on the likelihood of exit, we use the number of business exits in a given year as a dependent variable and calculate a series of OLS fixed-effects panel regressions (Wooldridge, 2006). The hypotheses are tested with multinomial logistic regressions which reveal the effects of the independent variables on status quo-preserving and strategic business exit versus no exit (the omitted category) (Eisenmann, 2002). The models are one-year-lag models because the antecedents are highly visible signals that require fast subsequent actions to quickly reverse a company's situation.

Results

Out of the 546 observations from 91 firms, 103 cases in the sample are status quo-preserving business exits, 31 cases are strategic business exits; the other observations refer to the “no exit”-category. Table 1 presents means, standard deviations, and correlations among the study variables. The correlation coefficients as well as the variance inflation factors (VIF) and tolerance measures do not indicate any serious problems of multicollinearity among the study variables. The tolerance measures are all above 0.20 and the VIF values are all below 5 (Hutcheson and Sofroniou, 1999).

Insert Table 1 about here

Performance problems, high diversification, CEO turnover and institutional pressures are expected to foster the occurrence of business exit. We calculate six OLS fixed-effects panel regressions. Table 2 includes the results of the regression models for the baseline assumptions. Model 1 only includes the control variables. The explanatory variables are subsequently incorporated in the four following models. Model 6 contains all variables.

Insert Table 2 about here

Model 1 shows that a firm’s age and size positively and significantly affect the likelihood of business exit, indicating that the older and larger a firm, the higher is its propensity to divest a business unit. Moreover, the coefficient for *market* is negative at a significant level. Thus, the lower the market growth, the higher is the likelihood of exit. These findings are mainly corroborated by the other models in Table 2. Model 2 shows that, against our expectations, a decline in performance does not promote the likelihood of business exit. The coefficient for *earnings per share* is negative but at an insignificant level. Model 3 reveals that diversification (*divers*) does not enhance the likelihood that a business

unit is extinguished. Conversely, *CEO* turnover fosters the occurrence of business exit, as Model 4 illustrates. In addition, in the presence of institutional (financial) investors (*owner*) as the dominant owners of a firm, the likelihood of business exit does not increase, as Model 5 reveals. The full model (Model 6) corroborates these findings.

Insert Table 3 about here

Table 3 reports the results of the polytomous panel regression models for testing the hypotheses that go beyond the baseline assumptions based on prior literature. Model 7 and 8 estimate the effects of the control variables on the likelihood of either status quo-preserving or strategic business exit. The coefficients show that a firm's age and size as well as low market growth enhance the likelihood of status quo-preserving business exit. As Model 9 and 10 reveal, in accordance with Hypothesis 1, low performance (*EPS*) promotes status quo-preserving business exit but does not nurture strategic business exit. Hypothesis 2 assumes that the choice of status quo-preserving business exit is more likely than the choice of strategic business exit in the presence of high diversification (*divers*). Rejecting Hypothesis 2, Model 11 and 12 illustrate that the occurrence of status quo-preserving business exit is not enhanced. However, the more dissipated a firm's focus, the lower is the likelihood of strategic business exit. *CEO* turnover is expected to enhance the likelihood of strategic business exit, especially if a new top executive is an outsider. Hypothesis 3 is rejected because in Model 13 the positive and significant coefficient implies that *CEO* turnover fosters status quo-preserving business exit. The same holds true for Hypothesis 4: the presence of financial owners (*owner*) does not exert any influence on the choice of strategic over status quo-preserving business exit, as Model 15 and 16 reveal. The full models 17 and 18 show that the effect of *earnings per share* on the likelihood of status quo-preserving

business exit vanishes. The negative effect of diversification (*divers*) on strategic business exit remains stable.

Discussion

The starting point of this study based on German data was the observation that the likelihood of business exit is predominantly studied without a distinction of different exit types. Though we have been collecting much knowledge on the antecedents and the performance implications of divestiture for more than thirty years, the strategic implications of a diversified firm's extinction of a business unit have hardly been studied. In other words, there are many studies on the various modes of business exit, e.g., spin-off, sell-off, dissolution (e.g., Chang, 1996; Mitchell, 1994), but exit types referring to the subsequent strategic implications of the abandonment of a business unit for the divesting parent firm have seldom been considered. Business exit can be a new beginning, since it can involve strategic change. The latter can largely contribute to a firm's subsequent approval and acceptance in the market. Therefore, this study suggests that a distinction of exit types is necessary: if business exit results in strategic change at the corporate level of the divesting parent firm, it will be strategic (Burgelman, 1996). Conversely, a status quo-preserving business exit is a retrenchment that serves the purpose of shrinking firm size, complexity, and/or costs without abandoning the prior pattern of strategic actions (Morrow et al., 2004).

This study contributes to management research in some ways: First, although it is well understood that business exit mainly serves the purpose of performance enhancement, strategic change as an implication of business exit has hardly been investigated by prior research. Accordingly, a perspective emphasizing the rather negative connotation of business exit as a failure predominates the literature. The optimistic viewpoint of this study entails that business exit can successfully contribute to organizational viability in the long run by

changing a firm's current and eventually obsolete strategic path. Consequently, in contrast to prior research, this study differentiates between two business exit types. Second, this empirical study proceeds in two steps. In a first step, it uses a panel dataset from the German context in order to test whether a range of well-known antecedents increase the likelihood of divestiture. It replicates the conventional procedure as it can be observed in numerous prior studies. The second part is more innovative. The dataset is used to investigate whether the same antecedents promote a certain exit type.

Limitations and Implications for Future Research

This study has some limitations: First, the emphasis on the strategic implications of business exit brings out a rather "bright" side of an action that is typically associated with organizational decline and failure. Consequently, the necessity to abandon a business should not necessarily be interpreted as a sign of defeat but rather considered as a "near-failure" (Kalnins et al., 2006; Kim and Miner, 2007), since it bears the potential for learning, change and organizational survival in the long run. However, the theoretical framework implicitly assumes that, in general, strategic change is a desirable implication of business exit. Such a viewpoint tends to ignore prior empirical evidence from organization ecology research which illustrates that those actions are surrounded by high ambiguity. They strongly increase the uncertainty that a firm faces and thus enhance the hazard of organizational failure (Barnett and Freeman, 2001). The Arcandor example outlined above illustrates that point: the change that a business exit can involve may constrain a firm's strategic path for years to come.

Second, institutional investors as the dominant owners of a firm do not enhance the likelihood of strategic business exit. Thus, in contrast to prior empirical evidence (e.g., Wahal and McConnell, 2000) that mainly originates from the U.S., the results do not indicate that this owner type supports corporate managers to use an incident such as business exit as an opportunity to change their firm's strategic direction. This may be owing to the different

institutional context. Institutional owners may be less relevant to corporate managers' strategic choices in Germany than in the U.S. A fruitful avenue for future research may be a comparative investigation of the impact of institutional owners on the number of business exits in general and the likelihood of certain exit types in different institutional contexts. Another implication for research especially in continental Europe may be to examine the influence of family ownership on the volume and the type of business exit in a given year, since family-owned companies are more common there than, e.g., in the U.S. or in U.K. (Pedersen and Thomsen, 2003).

Managerial Implications

For both corporate managers and management consultants, an understanding of the opportunities that a business exit can provide is of high relevance. The question of why multibusiness firms divest is actually not new. In awareness that a business exit is often seen as a kind of failure that corporate managers tend to avoid (Wiersema, 1995), this study shows the chances that it can bear, if we differentiate between exit types and consider different levels of decision-making in divesting firms. It can provide some insights into how managers can use exits for ensuring their firms' viability in the long run.

First, the choice between different business exit types has been outlined as an important step that can have implications at three levels of strategic decision-making and depends on decision-makers' propensity to take risks and act offensively. At the corporate level, a business exit mainly aims at enhancing a firm's fit with internal and external stakeholders' expectations; at the business level, it contributes to the differential importance of various business units in a corporate portfolio; at the level of strategic competences, it enables or constrains the firm's strategic actions in the long run. Exit type choice, however, has not been found to be as important to decision-makers as expected. Moreover, strategic business exit seems to be less likely to be chosen than status quo-preserving business exit.

Second, the findings of our study demonstrate that a relatively highly dissipated focus does not enhance the likelihood of business exit in general and a special business exit type in particular. This finding may at least partly support the idea that, at the corporate level, focused firms do not necessarily find more approval in the marketplace than more diversified ones (Harper and Viguerie, 2002). That viewpoint can be seen as a kind of countermovement to the excessive diversification moves in the 1980s and the refocusing era in the 1990s. In addition, it may imply that, at the level of strategic competences, corporate decision-makers prefer “sticking to the knitting” to “striking a new path” either as a result of a lock-in in a particular pattern of actions owing to cognitive, normative, or resource-based constraints, or in order to avoid inflexibility from the outset to pursue a certain strategic path in the long run, as the Arcandor example illustrates (Sydow et al., 2009).

Third, our findings imply that decision-makers that are commonly viewed as important change agents (Isabella, 1990) do not exert such a strong influence than expected. Although CEO turnover tends to enhance the general likelihood of business exit in a given year, it does not necessarily mean an increase in openness to strategic change. In contrast, the strategic status quo is likely to be preserved. In addition, although researchers and practicing managers alike claim the growing impact of institutional investors on the strategic direction of the firms in their portfolios (e.g., Thomsen and Pedersen, 2000; Wahal and McConnell, 2000), they do not increase the likelihood of business exit in general or of a special exit type in our study. Other factors seem to be more influential. Our study demonstrates that, although low firm performance does not enhance the number of business exits in a given year *per se*, it nurtures status quo-preserving business exit. Evidently, the potential of business exit for striking a new path has rarely been considered up to now. “Sticking to the knitting” still seems to be more promising, since it appears less risky and offensive than “striking a new path”.

Table 1.

Means, Standard Deviations, and Correlations

Variables	Mean	SD	1	2	3	4	5	6	7	8	9
1 exits	0.39	0.89	1.00								
2 age	1.38	0.64	0.11*	1.00							
3 size	5.91	1.04	0.31**	0.22**	1.00						
4 market	1.32	1.15	-0.26**	-0.07	-0.05	1.00					
5 slack	2.11	2.87	-0.07	-0.06	-0.14**	-0.05	1.00				
6 EPS	0.24	5.38	-0.02	0.18**	0.24**	0.03	0.02	1.00			
7 divers	1.89	1.23	0.18	0.12	0.17**	-0.09	-0.02	0.05	1.00		
8 CEO	0.10	0.39	0.14**	-0.01	0.09	-0.07	-0.00	-0.04	0.11*	1.00	
9 owner	0.22	0.42	0.05	0.08	0.55	-0.00	0.03	0.04	-0.04	0.03	1.00

Significance levels: ** $p < 0.01$; * $p < 0.05$.

Table 2.

OLS Fixed-Effects Panel Regressions for the Impact of Pre-Specified Antecedents on the Likelihood of Business Exit

Variable	exits _t					
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
intercept	-2.24** (1.08)	-2.00* (1.18)	-3.95** (1.47)	-1.91 (1.71)	-2.76 (1.68)	-2.62 (2.15)
firm age	0.85** (0.40)	0.56 (0.43)	1.15* (0.61)	0.54 (0.73)	0.39 (0.76)	0.83 (0.91)
firm size	0.30* (0.17)	0.33* (0.18)	0.51** (0.21)	0.32 (0.24)	0.50** (0.22)	0.36 (0.29)
slack	-0.01 (0.02)	-0.02 (0.03)	-0.00 (0.02)	0.00 (0.03)	-0.01 (0.02)	0.01 (0.04)
market	-0.24*** (0.06)	-0.25*** (0.06)	-0.23** (0.07)	-0.21** (0.10)	-0.22** (0.09)	-0.23* (0.12)
EPS		-0.01 (0.01)				0.01 (0.01)
divers			0.00 (0.05)			0.00 (0.07)
CEO				0.30** (0.11)		0.31** (0.13)
owner					0.16 (0.18)	0.29 (0.19)
R square	0.17	0.17	0.16	0.18	0.12	0.19
Model F	10.05***	8.46***	7.25***	5.91***	4.32***	4.07***
n	479	458	432	329	373	285

^a Standard errors are in parentheses. Year dummies are not reported owing to space constraints.

- † p < .10
- * p < .05
- ** p < .01
- *** p < 0.001

Table 3.

Results of the Multinomial Panel Regressions for Hypothesis 1 to 4

Variable	Hypothesis	status		strategic		status		strategic		status		strategic	
		Model 7	Model 8	Model 9	Model 10	Model 11	Model 12						
firm age		10.66** (4.41)	13.47 (9.10)	10.87** (5.15)	13.69 (9.05)	10.47** (4.44)	18.75* (10.04)						
firm size		4.06*** (1.14)	1.08 (1.79)	3.78** (1.22)	2.29 (2.24)	4.01** (1.16)	1.99 (1.91)						
slack		-0.03 (0.07)	0.90 (0.74)	-0.15 (0.14)	0.98 (0.78)	-0.03 (0.07)	0.78 (0.79)						
market		-0.79** (0.29)	-0.79** (0.40)	-0.82** (0.30)	-0.86** (0.41)	-0.77** (0.30)	-0.68 [†] (0.39)						
EPS	1			-0.09 [†] (0.05)	0.08 (0.09)								
divers	2					-0.08 (0.27)	-0.68 [†] (0.41)						
CEO	3												
owner	4												
Wald χ^2		80.16***	26.27***	78.17***	27.11**	67.01***	24.98**						

^a Standard errors are in parentheses. Year dummies are not reported owing to space constraints.

[†] p < .10

* p < .05

** p < .01

*** p < 0.001

Table 3 (continued)

Variable	Hypothesis	status	strategic	status	strategic	status	strategic
		Model 13	Model 14	Model 15	Model 16	Model 17	Model 18
firm age		11.39 [†] (5.84)	31.17 (33.22)	8.48 [†] (4.78)	12.99 (9.44)	10.93 (6.80)	24.51 [†] (14.88)
firm size		2.90** (1.32)	-27.97 [†] (16.64)	3.42** (1.13)	0.43 (1.82)	2.51 [†] (1.41)	-2.70 (4.12)
slack		0.03 (0.11)	17.55 [†] (9.62)	-0.04 (0.07)	0.85 (1.01)	-0.08 (0.28)	6.13 (4.00)
market		-0.69 [†] (0.41)	-13.25 (3.58)	-0.56 [†] (0.32)	-0.54 (0.41)	-0.43 (0.46)	-2.33** (1.18)
EPS	1					-0.00 (0.10)	0.11 (0.17)
divers	2					0.34 (0.45)	-1.11 [†] (0.60)
CEO	3	0.67 [†] (0.41)	4.57 (10.69)			0.73 (0.47)	0.28 (3.82)
owner	4			0.09 (0.57)	1.31 (1.14)	0.33 (0.70)	2.08 (3.07)
Wald χ^2		59.30***	38.05***	45.33***	16.69 [†]	50.81***	28.26***

^a Standard errors are in parentheses. Year dummies are not reported owing to space constraints.

[†] p < .10

* p < .05

** p < .01

*** p < 0.001

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