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The Influence of Horizontal Integration on Business Performance



Author

M.J. Millenaar

910815572030

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AUTHOR

M.J. Millenaar

910815572030

SCIENTIFIC SUPERVISOR

Dr. E.F.M. Wubben

SCIENTIFIC CO-SUPERVISOR

Dhr. S. Pascucci PhD

EXECUTIVE SUMMARY

This executive summary provides an insight in the literature review: *The Influence of Horizontal Integration on Business Performance* and contains a summary of the problem analysis, a summary of the literature review and a summary of the recommendations.

PROBLEM ANALYSIS

Van der Valk Hotel Tiel aims to expand the range of services with the introduction of health care & sport facilities. Aiming at an improvement of the value proposition of the company. The expansion in services includes the realisation of a so called health care hotel. Van der Valk Hotel Tiel is moving to a new product-market combination with the implementation of this health care & sport facilities project. This new project can be appointed as a form of horizontal integration or as a diversification strategy in particular.

In order to make the right strategic choices with respect to horizontal integration, knowledge about the new market and specific knowledge about legal forms is required. Most important question in this study is whether horizontal integration is preferable or not with respect to the original brand? What are the effects of horizontal integration and complementary activities on the core business of a company? Is it therefore advisable to execute the horizontal integration when those activities are intended to complement the core business?

The expansion of activities within a company has several effects on both the organisation and on the existing core activities. In addition, uncertainty within the company increases when the company is unfamiliar with these new activities. Hence, the objective of this research is to get further insights in the existing knowledge about horizontal integration in general and brand extensions in particular. The general research question in this study is: What is the relationship between horizontal integration on the one hand and the existing activities of a company on the other hand?

LITERATURE REVIEW

Horizontal integration follows out of four potential value-creating drivers: *economies of scope*, *stretching corporate management competences*, *exploiting superior internal processes* and *increasing market power*. Seeking for synergies by means of horizontal integration produces various risks as well, because horizontal integration could also follow out of three potential value-destructing drivers: *responding to market decline*, *spreading risk* and *managerial ambition*. It can be concluded that horizontal integration does not automatically adds value to the existing business.

Companies can choose between three types of diversification strategies, based on growth stages: *disruptive strategy*, *buy & build strategy* and *pioneering strategy*. The motivation behind the choice to diversify can be found in responding to external changes, which can be seen as threats for the company and therefore the strategies are defensive in character. Companies with a diversification strategy that is restricted to a limited range of activities have shown significant better performance than other types of companies within the study. Furthermore, a negative significant impact of diversification on the business performance is found, due to the suggestion that highly diversified companies might fail partially in transferring their competences to other segments.

The strength of a particular brand can be indicated in terms of brand associations, distinguished by three aspects *favourability*, *abstractness* and *confidence*. A fit between the original brand and the brand extension is of major importance, since the transfer of the perceived quality from the core brand to the extension will be enhanced when the type of products contain similarities in some way. When the introduction of a brand extension is considered as an incidental stimulus to sales of the original brand, one could expect a positive effect. In addition, significant and consistent spillover effects of brand alliances on the original brand are identified.

RECOMMENDATIONS

This study comes to a close with four recommendations to Van der Valk: first, it is important to oversee the actual motivation for the strategic choice to diversify. Subsequently, it must be examined

whether this motivation is a potential value-creating driver or a potential value-destructing driver. Second, it is recommended to adopt a buy & build strategy, in order to achieve effective growth in competences. Third, it is recommended to limit the range of new activities, since companies with a restricted degree of diversification show significant better performance than companies with a high degree of diversification. Finally, it is advisable to implement horizontal integration in the form of a brand extension.

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1 RESEARCH DESIGN

In this first section the relevance and the research problem of this study are explained. This results in the formulation of the research objectives and research questions. Next, the general research question provides guidance through the research and is accomplished by approach of different specific research questions. Furthermore, an overview of the technical design is provided. Finally, an explanation of the research strategy is given and the chapter closes with an overview of the research material.

1.1 RELEVANCE OF STUDY

Van der Valk Hotel and Restaurants is a Dutch company in the hospitality industry, founded in 1939 by Martien van der Valk. Nowadays Van der Valk is a family business with 98 separate hotels and motels. All of these establishments are fully owned and in charge of Van der Valk-descendants. The legal status of the Van de Valk-chain have been changed to a franchise organisation after an expansion and accompanying reorganisation in the beginning of this millennium. The Van der Valk-formula is the largest catering company in the Netherlands and is well known by their hospitality and entrepreneurial spirit.

Van der Valk Hotel Tiel aims to expand the range of services with the introduction of health care & sport facilities. Aiming at an improvement of the value proposition of the company. The expansion in services includes the realisation of a so called health care hotel, with activities such as fitness centres, a swimming pool and physiotherapy. In order to realise this strategic ambition Van der Valk has to attract external expertise and resources, since they have little to no experience in the field of health care & sport. It is therefore necessary to collaborate with external parties to obtain the expertise and resources in the field of health care & sport.

1.2 RESEARCH PROBLEM

Van der Valk Hotel Tiel is moving to a new product-market combination with the implementation of a health care & sport facilities project. This new project can be appointed as a form of horizontal integration or as a diversification strategy in particular. The new activities occur on the one hand outside the market segment of the current activities, but on the other hand in the extension of the current activities (Hassanien, 2005). In order to make the right strategic choices with respect to horizontal integration, knowledge about the new market and specific knowledge about legal forms is required. Hence, a key aspect of the successful implementation of a diversification strategy is the exploitation, exploration and management of knowledge (Burgers et al., 2008).

Most important question in this study is whether horizontal integration is preferable or not with respect to the original brand? What are the effects of horizontal integration and complementary activities on the core business of a company? Is it therefore advisable to execute the horizontal integration when those activities are intended to complement the core business? The literature review in this study will focus on horizontal integration in general and complementary activities in particular.

In this literature review the study of *brand extensions* will be approached. Implementing a brand extension is a form of horizontal integration. A brand extension can be defined as a practice of introducing a new brand, by making use of an established brand name as leverage (Jiang et al., 2002). In view of this definition, the study of brand extensions is suitable to abstract effects of horizontal integration to the core business. This in case of using the same brand name in both the core business as the new activities. Hence, the question arises what the effects of the brand name and the company's reputation are on the new activities? Besides, to what extent do spillover effects occur and affect the performance of the core business? These combined questions will help to identify the effects of horizontal integration on business performance.

1.3 RESEARCH OBJECTIVE

The expansion of activities within a company has several effects on both the organisation and on the existing core activities. In addition, uncertainty within the company increases when the company is unfamiliar with these new activities. A good example of this phenomenon is the business case of Van

der Valk Hotel Tiel as described above. Van der Valk Hotel Tiel aims to broaden their activities by means of horizontal integration. The company, however, is unfamiliar with the effects of these new activities on their business performance. Hence, the objective of this research is to get further insights in the existing knowledge about horizontal integration in general and brand extensions in particular.

The general research question (GRQ) in this study is: What is the relationship between horizontal integration on the one hand and the existing activities of a company on the other hand? This general research question is subordinated into several specific research questions (SRQ):

1. What are the key drivers of horizontal integration? (Chapter 2)
2. What is the motivation behind the choice for diversification strategies? (Chapter 3)
3. Which effects occur because of diversification? (Chapter 3)
4. To what extent does the brand affect performance in implementing new activities? (Chapter 4)
5. Which spillover effects can be identified between new activities and the core business? (Chapter 4)

1.4 RESEARCH FRAMEWORK



Figure 1: Research framework

1.5 RESEARCH STRATEGY

This study can be described as a desk research as it focuses on the use of existing material and resources of other researchers. Furthermore, this desk research can be specified as a literature review. This specific review focuses entirely on the study of the existing literature within a determined field of knowledge. This study concentrates on existing literature, concerning the subject.

For seeking appropriate research material the following keywords are used: new business development; horizontal integration; brand diversification; new business development success factors;

firm performance; reputation and integration; brand extension. To get a clear overview about the relevant literature, most recent articles as well as dated high quality articles in the field of horizontal integration, diversification and brand extensions are included. This study will focus solely on the *status questiones*: what has already been written about these specific questions by other researchers published in journals?

2 DRIVERS OF HORIZONTAL INTEGRATION

This second chapter provides an insight in the drivers of horizontal integration. It is composed of an enumeration of both the positive as the negative potential drivers. Horizontal integration, i.e. diversification or parallelisation, is a corporate strategy whereby a company expands its activities to another related business chain (figure 1). The company operates with for the company new products or services in a new market. The existing business chain of a particular industry becomes smaller, because two or more chains are being merged: e.g., when a restaurant starts offering overnight stays, two industries are being linked. The two different industries are now combined into one business chain, which makes the range of the business chain smaller than when the two chains are separated (Van de Voorde & Vanelslander, 2009). This is in contrast with vertical integration (figure 1), where the company absorbs new activities which are in the same business chain: e.g., when a butcher intends to slaughter their own meat, two chains in the same business chain are being merged.

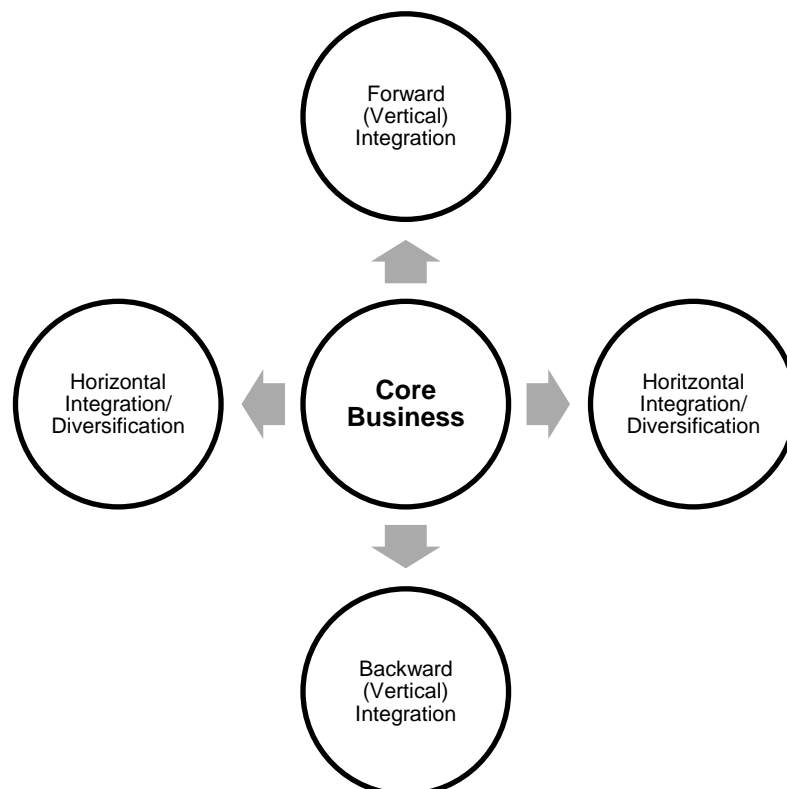


Figure 2: Horizontal- and vertical integration (based on: Van de Voorde & Vanelslander, 2009)

2.1 POTENTIAL DRIVERS FOR HORIZONTAL INTEGRATION

Horizontal integration follows out of four potential value-creating drivers: *exploiting economies of scope*, *stretching corporate management competences*, *exploiting superior internal processes* or *increasing market power* (Lichtenthaler, 2005; Van de Voorde & Vanelslander, 2009; Johnson, et al. 2015). To start with the first potential driver: *economies of scope* refers to the increase of efficiency, by applying existing capabilities and resources to new markets. This driver occurs mainly in organisations with under-utilised resources. The competencies and capabilities are not fully utilised for an considerable part. This allows the organisation to exploit the potential of those competencies and capabilities to other activities (Rumelt, 1982): e.g., a hotel that only allows their guests to make use of their integrated fitness centre, does not utilise the full potential of that facility. A facility as a fitness centre possesses more potential capabilities than only being an added value to the hotel stay: i.e., in potential more is possible than only being complementary to the core business.

The next driver, *stretching corporate management competences*, is very similar to the first driver, economies of scope. Stretching corporate management competences concerns the utilisation

of potential skills of talented employees (Lichtenthaler, 2005). The skills of talented management can be used to implement new activities. The logic behind is that the management competences are spread among the portfolio of activities and thereby will be fully utilised. The third driver, *exploiting superior internal processes*, is based on the assumption that internal processes within a company are in potential more efficient than widely used external processes in an open market. This implies that when for example the labour or capital markets in a developing market are not mature enough to meet the demand, conglomerates or diversified companies are able to cope with this shortfall in external resources by utilising their own internal processes. This phenomenon even makes sense when the different business units of a conglomerate do not have operating relationships with each other at all. Well-organised conglomerates possess the ability to mobilise assets, retrain employees and shift managers (Lichtenthaler, 2005) The last driver, *increasing market power*, refers to an entirely different perspective: competitive advantage. Being operational in diverse markets may result in increasing market power with respect to the competition (Van de Voorde & Vanelander, 2009). Conglomeration provides the possibility to strengthen 'business A' with recourses from 'business B'. This allows the conglomerate or diversified company to achieve acquired market power: e.g., prices within 'product market A' can be kept low artificially by subsidising 'business A' with, on the short term redundant, assets of 'business B'. In this way the diversified company is able to balance between the various businesses by making strategic choices.

The four potential value-creating drivers have all one element in common. They occur due to the synergetic effect of horizontal integration. This implies that competencies, capabilities or assets of the activities complement each other, with a combined surplus of benefits as a result. The synergy is caused by the phenomenon that the effect of the combined activities is greater than the effect of the sum of the two activities individually (Scott Morton, 2002).

2.2 NEGATIVE POTENTIAL DRIVERS FOR HORIZONTAL INTEGRATION

Seeking for synergies by means of horizontal integration produces various risks. A number of potential drivers entail negative synergies, with value destruction as a consequence. Horizontal integration could follow out of three potential value-destructing drivers: *responding to market decline*, *spreading risk* or *managerial ambition* (Sappington, 2003; Scott Morton, 2002; Johnson, et al. 2015). The first potential driver, *responding to market decline*, refers to the deflection to other sources in response to market decline of the main activity. Companies in declining markets are trying to compensate for decreasing earnings. This particular driver is common practice when it comes to horizontal integration. However, it is not the most appropriate motivation for value-creation. It has potential risks of achieving a negative synergic effect (Johnson, et al. 2015).

The next potential value-destructing driver, *spreading risk*, involves the security which managers like to earn by targeting more than one market. Managers assume to be at a lower risk of failure with this mindset. Setbacks within the one market could be compensated with success from the other markets. Nevertheless, this diversification strategy leads to value-destruction rather than value-creation, since there is no trust of creating any synergetic effect (Sappington, 2003). The third potential driver, *managerial ambition*, reaches far behind any diversification strategy. This driver follows out of personal motives of managers, rather than out of economic reasons. Managers with this mindset are eager on excessive growth in short term. They aim for personal financial benefits or prestige. It is self-evident that the company obtains the benefits as well. However, the peak is reached at the short term, because of a lack of long term strategy. The misguided horizontal integration is condemned to lead to value-destruction, due to a lack of expertise and guidance (Scott Morton, 2002).

It can be concluded that horizontal integration does not automatically adds value to the existing business. Besides, the chance of being value-destructive is plausible when improper motives are dominating. For this reason the strategic choice of implementing horizontal integration in the company can have a negative effect on overall business performance. When there is no added value, the company should reconsider persisting the process of horizontal integration. A milder solution can for example be found in the option to divest the new activity from the existing business.

2.3 SUMMARY

This chapter provides an insight in the following specific research question: *what are the key drivers of horizontal integration?* (SRQ 1). Horizontal integration is a corporate strategy whereby a company expands its activities to another related business chain. Horizontal integration follows out of four potential value-creating drivers: *economies of scope*, *stretching corporate management competences*, *exploiting superior internal processes* and *increasing market power*. Seeking for synergies by means of horizontal integration produces various risks as well, because horizontal integration could also follow out of three potential value-destructing drivers: *responding to market decline*, *spreading risk* and *managerial ambition*. It can be concluded that horizontal integration does not automatically adds value to the existing business.

3 EFFECTS OF DIVERSIFICATION

The motivation behind the choice for a diversification strategy and the effects of diversification are being discussed in this third chapter. First, literature concerning multiple diversification strategies are approached, followed by a description of the diversification motives. In the next paragraph the effects of diversification on business performance have been researched. Finally, this chapter closes with an overview of literature concerning diversification in hospitality industry.

A vast majority of businesses is engaged in some kind of diversification strategies. Especially when the market or the business itself is caught in satiety, with declining growth rates as a result (Lichtenthaler, 2005). In one of the most prominent publications about strategies for diversification, Ansoff (1957) associates diversification with changes in the characteristics of the company's product line or in the market where the company is operating. Whereby the outcome is in contrast to market penetration, product development and market development, the other by Ansoff (1957) typified growth strategies (figure 2). This results in other types of changes in product characteristics of market structure (Ansoff, 1957). More practically, diversification can be defined as the increase in both products and markets of a company. These new activities can be related or unrelated to the current portfolio of the company (Lichtenthaler, 2005).

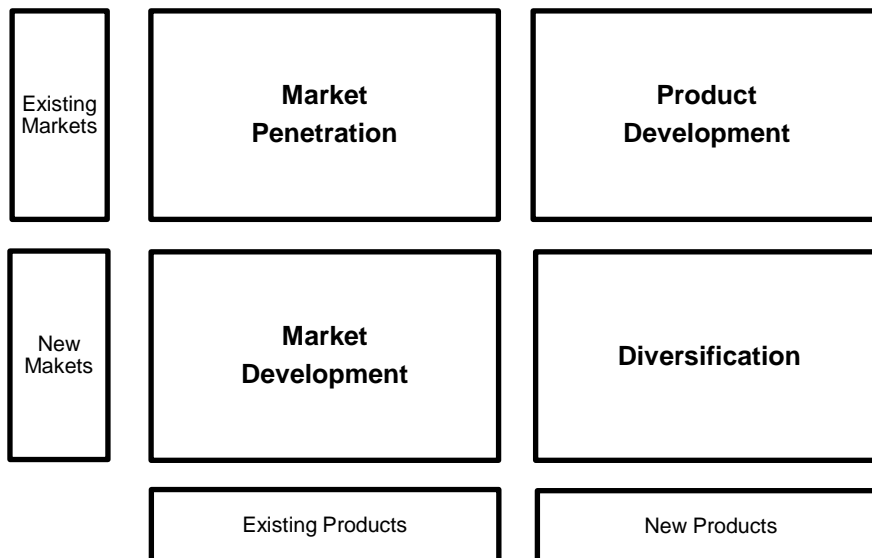


Figure 3: Growth strategies (Ansoff, 1957)

3.1 DIVERSIFICATION STRATEGIES

A company can diversify in multiple ways, with as starting point its own current market and competences. According to Lichtenthaler (2005) companies can choose between three types of diversification strategies, based on growth stages: *disruptive-*, *pioneering-* and *buy & build strategy* (figure 3). When a company is intended to enter an existing market, it implements a *disruptive strategy* (Lichtenthaler, 2005). Entering an existing market is possible in the situations of possessing the required competences or not possessing the required competences. In both situations will be switched to a disruptive diversification strategy. However, this is in essence only possible when the company can gather a competitive advantage, which is exploited in a disruptive manner. The bigger the competitive advantage, the easier the entry to the market (Adner & Levinthal, 2002). Hence, the competitive advantage has to be sufficiently large to be from disruptive nature.

In a second situation, an existing market can also be targeted without having the necessary competences available, but where possessing this competences on the other hand is a requirement. In this kind of situation a *buy & build strategy* is recommended (figure 3). This strategy implies that external capabilities are being attracted to achieve effective growth in competences: e.g., when the market is partitioned or when companies in that market are about to be restructured, the appropriate strategy is to incorporate these companies partially or to cooperate with them. These companies will

be used as a growth platform, in order to enter the market and capture market share. The last option, *pioneering strategy*, is used when a company is about to enter a new market (figure 3). Entering new markets occurs mainly when these markets are in an early stage. The diversifying company generally possesses the required competences. However, entering a new market without the necessary competences belongs to the possibilities as well (Lichtenthaler, 2005).

The three diversification strategies all relate to the current state of the business life cycle of the company. This implies that the used strategy is connected with the internal growth of the company. A pioneering strategy is often used in the early stages of the company's business life cycle: i.e., the emergence and growth stages. The buy & build strategy and the disruptive strategy mainly concern respectively the middle and later stages of the business life cycle.

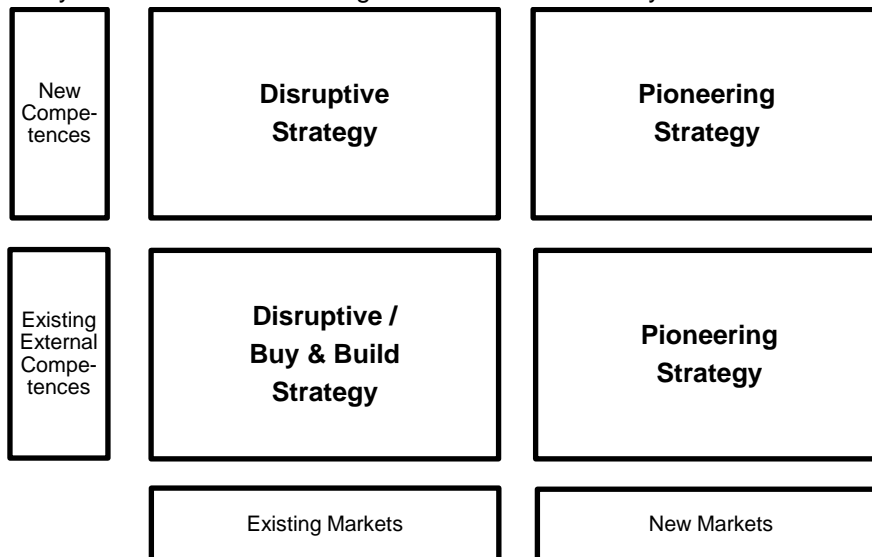


Figure 4: Diversification strategies (based on: Lichtenthaler, 2005)

3.2 DIVERSIFICATION MOTIVES

The company's desire to diversify is mostly multi causal. The motivation behind the choice to diversify can be found in responding to external changes, in addition to causes which result from internal occasions. These external changes can have major effects on sales and business performance. Hence, in this case without occurrence of internal alterations, which could explain that same effects (Adner & Levinthal, 2002). However, the outcome of such environmental changes is reasonably unpredictable. Determining an appropriate strategy to overcome side-effects, whose outcome remains unknown, is difficult. Common external changes are for example: an economic recession or an economic depression, as well as a pioneering research or technological breakthrough (Ansoff, 1957). These external changes can be seen as threats for the company and therefore the strategies are defensive in character. When it comes to external trends in the industry, the opposite occurs. Trends are being considered as opportunities, where the company must benefit from: e.g., opportunities in manufacturing costs, trends in the industry or general economic developments (Adner & Levinthal, 2002).

3.3 DIVERSIFICATION EFFECTS

The question in business literature whether diversification is of economic value or not, is regularly an issue. The effects of diversification are reasonably identifiable. On the other hand the true economic performance is arguable. This results from difficulties in measurement methods of the various studies. Diversification (figure 3) can be implemented on large scale: e.g., a conglomerate business. On the other hand, diversification can also be implemented in a subtle way: e.g., simple parallelisation within a company. This makes diversification to an important component of strategic management (Rumelt, 1974).

Several papers about economic performance of diversification arrive at different outcomes, due to the variety in measurement methods. Where strategic management literature is mostly based

on the classification scheme of Rumelt (1974), literature concerning business organisation does not go beyond simple measurement of product diversity of a company's operations (Choi et al. 2011). Fundamental difference between both types of methodology is the distinction between related and unrelated diversification. The classification scheme of Rumelt takes the relative value of diversification into account, with respect to the core business: i.e., what is the correlation between the performance and the degree of diversification? By contrast, this phenomenon has not taken into consideration by researchers in literature concerning business organisation (Montgomery, 1982).

In order to develop his classification scheme, Rumelt (1974) identified the shortcomings of the previous diversification performance measurements and devised a method to counteract this phenomenon. He designed a categorical measurement which merges three critical elements: (1) the company's commitment with respect to diversity, (2) the company's competences that enable the diversification and (3) the degree of relatedness between the new and the old activities. Subsequently, he subdivided the diversified companies into nine different categories by using a range of quantitative criteria. With this categorisation it became possible to analyse a sample of diversified companies on economic performance. Concluding that companies with a diversification strategy that is restricted to a limited range of activities have shown significant higher performance than other types of companies within the study. Adding that the range of activities of these diversified companies all fall within the competence of the company: i.e., related diversified companies show better profitability compared to unrelated diversified companies (Rumelt, 1974; Palepu, 1985; Choi et al. 2011).

In practice switching to a diversification strategy is not easy. Companies struggle with finding new opportunities and preparing the internal organisation for this change in business strategy. First, the decrease of research & development (R&D) intensity, due to the reduction of budgets, is an important struggle which results in declining diversification intentions. On the other hand, increasing R&D budgets can lead to saturation of available technologies. This makes developing new innovations and thus entering into new business opportunities, to an increasingly scarcity. Furthermore, companies have trouble recognising potential future growth markets. Intentions may be clear, but the knowledge how to start and how to proceed in generating new business opportunities is lacking. Next to these internal struggles, additional difficulties are identifiable in the external environment: e.g., the barriers of entry have increased due to growth markets that become global in no time. This makes it more difficult to enter the market for companies that aim to diversify (Lichtenthaler, 2005).

3.4 DIVERSIFICATION IN HOSPITALITY INDUSTRY

In recent years many restaurants and hotels choose to diversify (Choi et al. 2011; Lichtenthaler, 2005). Unfortunately, in business literature not much have been published about the impact of diversification strategies on companies in hospitality industry. Most researchers do not go into great detail and have a more general approach towards the subject. Nevertheless, possible effects cannot simply be generalised due to fluctuation among the different industries. Therefore, some recent studies focused particularly on the hospitality industry. Choi et al. (2011) for example examined the impact of diversification among a sample of publicly traded restaurants in the United States.

First, differences between diversification strategies occur due to the degree of diversification. Choi et al. (2011) argue that the depth of diversification will affect the outcome in terms of the degree of effect on business performance. Many restaurants are implementing diverse strategies, often based on the brand portfolio: e.g., some restaurants develop a multiple brand strategy by devising new brand concepts or acquiring complete brands (Choi et al. 2011). Other restaurants implement a more focused brand strategy by minimising their brand scope. The difference between the examples is that the depth of diversification respectively increases and decreases. Second, brands in general have an important impact on the business performance as an intangible asset. Especially in the hospitality industry brands are of major importance, even as a core asset. Primary reason is the effect of the brand on the perception of consumers (Jiang et al. 2002).

When it comes to impact of diversification on business performance in the hospitality industry, Choi and his colleagues (2011) analysed the *Tobin's q* from a sample of publicly traded restaurants in the United States. *Tobin's q ratio* can be defined as the total market value of the company divided by

the total asset value: i.e., the market value divided by the replacement value of the company's assets (Lang & Stulz, 1993). Choi et al. (2011) found a negative significant impact of diversification on the business performance of the measured sample. In addition, they argue that the additional costs of diversification may outweigh the overall benefits. They found that the *Tobin's q* of companies decreased as the degree of diversification increased. In order to achieve a possible explanation for this phenomenon, there is suggested that highly diversified companies might fail partially in transferring their competences to other segments (Choi et al. 2011). These findings are endorsed in an earlier study of Wernerfelt and Montgomery (1988), who found a retrograde effect due to diversification. In addition, Choi et al. (2011) speculate that the negative impact could be caused by insufficient utilisation of synergetic advantage between the core business of the company and the new activities. This statement is implied by Carter (1977) as well in an earlier study aimed at business performance and synergy (Choi et al. 2011; Carter, 1977).

Furthermore, another reason for the negative impact is the possible similarity between the core business and the new activity, which leads to reciprocal competition. Choi and his team (2011) found a correlation between the degree of competition and the *Tobin's q* of the company, i.e., companies with a low degree of reciprocal competition show a higher *Tobin's q* ratio (Choi et al. 2011). This assertion is contradicted by both Rumelt (1974) and Lichtenthaler (2005), who stated that the impact of related diversification on business performance is higher than the impact of unrelated diversification on business performance (Rumelt, 1974; Lichtenthaler, 2005). It is plausible that the related activities within the studies of Rumelt (1974) and Lichtenthaler (2005) contain a low rate of reciprocal competition towards the core activity and therefore the possible rebuttal can be rejected.

Finally, Wernerfelt & Montgomery (1988) argue that differences in performance of diversified companies can be explained by changes in efficiency, caused by transferring their competences to the potential new markets. Moreover, their study led to a positive focus effect in business performance of diversified companies, which contradicts the findings of Choi et al. (2011). However, Wernerfelt & Montgomery (1988) argue that the positive effect increases as the degree of focus of diversification increases. Choi et al. (2011) does not take this degree of focus into account and thus further research with the addition of degree of focus of diversification in the hospitality industry is recommended.

3.5 SUMMARY

This chapter provides an insight in the following specific research questions: *what is the motivation behind the choice for diversification strategies?* (SRQ 2) and *which effects occur because of diversification?* (SRQ 3). Companies can choose between three types of diversification strategies, based on growth stages: *disruptive strategy*, *buy & build strategy* and *pioneering strategy*. The motivation behind the choice to diversify can be found in responding to external changes, which can be seen as threats for the company and therefore the strategies are defensive in character. Companies with a diversification strategy that is restricted to a limited range of activities have shown significant higher performance than other types of companies within the study. Furthermore, a negative significant impact of diversification on the business performance is found, due to the suggestion that highly diversified companies might fail partially in transferring their competences to other segments.

4 BRAND EXTENSIONS AND SPILLOVER EFFECTS

The subjects brand extensions and spillover effects are being covered in this fourth chapter. First, the term *brand extensions* will be defined, followed by relevant literature concerning *brand associations*, which indicates the strength of a particular brand. Finally, the spillover effects of respectively brand extensions and brand alliances are being discussed.

A brand extension is a common marketing tool in hospitality industry. Since the late seventies of the past century many hotels and restaurants choose to lever their brand name, in order to launch new products or services (Jiang et al., 2002). Utilising the power of a well-established brand name provides advantages, but can also be harmful. Therefore, it is important to understand the reasoning of consumers when it comes to brand evaluation as well as to understand how a brand extension can possibly affect the core brand (Mahasuweerachai & Qu, 2015).

4.1 BRAND EXTENSIONS

The term *brand extension* can be defined as the practise of launching a new brand in another market segment, by utilising a well-established brand as leverage (Jiang et al., 2002). These extensions are most attractive to companies with a high risk of new business failure, since the brand extension provides the advantage of brand recognition. In that way the brand extension takes a lead relative to unknown new brands, when entering new markets. Utilising a well known brand reduces the risk of introducing new products or services in both new and existing markets, since the consumers already are familiar with the established core brand (Aaker & Keller, 1990). However, exploiting the most valuable asset of a company: their brand reputation, is risky, since the probability is also present that an extension will decrease the value of that asset. Furthermore, introducing a brand extension is found to be an appropriate strategy of influencing the customers' brand choices. It allows a company to break the entry barriers between product or service categories, by leverage of the brand reputation (Jiang et al., 2002).

4.2 BRAND ASSOCIATIONS

The strength of a particular brand can be indicated in terms of brand associations (figure 4). The term *Brand association* has been defined as the sum of the aspects: quality perception, sentiment of value, behaviour and all other thoughts and feelings in relation to the brand (Dacin & Smith, 1994). The importance of brand associations is mainly evident when it comes to the study of brand extensions: i.e., the focus is mostly restricted to understanding factors that reveal the correlation between consumer's brand affection on the one hand and the leverage towards the brand extension on the other hand.

Dacin & Smith (1994) assume that the behaviour towards a brand is to a great extent the outcome of the beliefs consumers have about that particular brand. In addition, academic literature distinguishes three aspects which enable one to indicate brand strength: *favourability of*-, *abstractness of*- and *confidence in* brand associations. First, the *favourability* towards a brand is the most common brand association and is the core of brand strength (Aaker & Keller, 1990). Consumers create an image of a brand by evaluating the quality which they associate with that particular brand. In addition, consumers rely mainly on brand names when they make conclusions about the quality of the products, without observance of the physical characteristics of the products (Montgomery & Wernerfelt, 1992). This enables the favourability of a brand to contribute to the decision making process.

Second, the *abstractness* of brand associations involves the extent to which consumers make an association between a brand and an overall product category. The extent to which this second aspect enhances brand strength has been contradicted by Tauber (1981), who stated that it is unclear whether abstractness of brand associations weakens or strengthen a brand name (Tauber, 1981). Consumers have a tendency to relate the brand extension to other products and product categories which are closely affiliated to the core brand. They base these relationships on a variety of factors, such as product features and –characteristics (Aaker & Keller, 1990). In that way the brand is known by the various product categories it embraces and vice versa. Nevertheless, this influenced mindset can affect brand strength both positive and negative: e.g., Apple is associated with laptops, tablets,

smart phones and watches. For consumers it would be very difficult to use Apple as a basis for identifying a new brand extension, such as when Apple aims to sell shoes. In this example the abstractness of the brand association will rather weaken than strengthen the original brand or the brand extension. Third and last factor is the consumers' *confidence* in their brand associations. This factor involves the extent to which the consumer has confidence in using their brand associations to make a deliberate purchase decision. Confidence follows out of a brand's attempt to improve the decision making process efficiency of a consumer: i.e., any form of information provision leads to a reduction of perceived risk (Montgomery & Wernerfelt, 1992).

A variety of above described brand associations can potentially be transferred to the brand extension. Associations between the original brand and the brand extension have been created in the mind of many consumers. Nevertheless, associations can also being made with for example a place, a situation or a type of user: e.g., respectively Ikea is associated with Sweden, Red Bull with extreme sports and Ralph Lauren with the golf playing wealthy (Aaker, 1982). These strong associations of the original brand can possibly be attached to the newly formed brand extension. This existing associations of the original brand can be valuable and helpful for a new brand extension. When a particular brand is associated with high quality, the brand extension is considered to benefit from it. On the other hand, the impact of the brand associations can be harmful as well and could affect the brand extension negatively: e.g., when a relatively cheap supermarket launches a fashionable clothing line, the brand associations related to the supermarket will in all likelihood harm the new brand extension (Aaker & Keller, 1990). In this example the brand associations that are highly valued in the product class of the original brand may be negative in context of the brand extension. When a brand is associated with inferior quality, it will probably harm the brand extension.

In summary, a fit between the original brand and the brand extension is of major importance, since the transfer of the perceived quality of the core brand to the extension will be enhanced when the type of products contain similarities in some way. In addition, the strength of a particular brand, i.e., brand loyalty in terms of consumer behaviour, is identifiable by three aspects. The brand strength is an expression of the favourability of associations which consumers have towards a particular brand. Followed by the confidence consumers have to utilise these associations, in order to complement the decision making process. Finally, the abstractness of associations makes the image a consumer has towards a brand to a whole, taking into account that this aspect is not a determined and thus appropriate way of identifying brand strength.

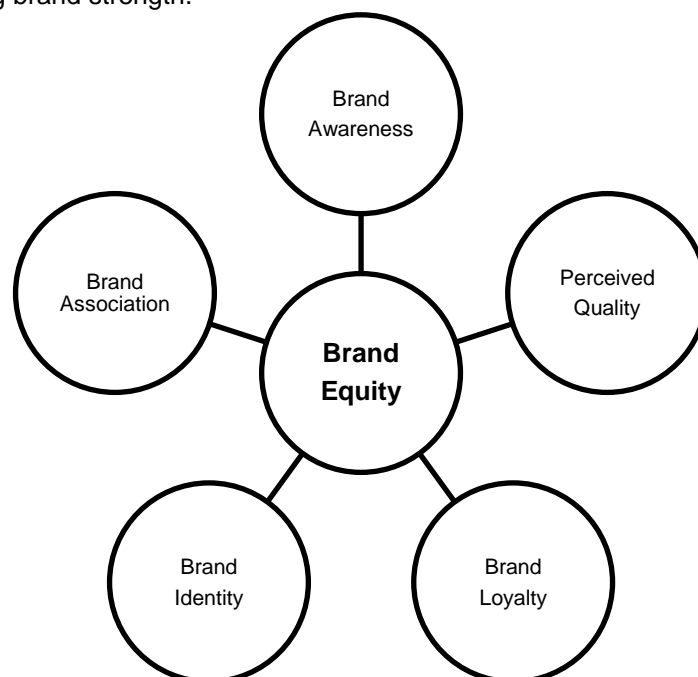


Figure 5: Brand equity (based on: Milewicz & Herbig, 1994)

4.3 SPILLOVER EFFECTS OF BRAND EXTENSIONS

In brand marketing the impact of spillover effects between brand extensions has been identified repeatedly. When introduction of a brand extension generates additional benefits towards the original brand in general, one can expect that the brand extension's advertisement activities has a positive influence on the original brand's sales as well (Balachander & Ghose, 2003). However, in academics not a lot of literature covers the study of the existence- and impact of advertising spillover effects between a brand extension and the original brand. Spillover effects can be defined as economic events that occur as a result of a primary event, which are seemingly unrelated to each other (Simonin & Julie, 1998).

Sullivan (1990) found an increased demand of Jaguar cars in general, after the introduction of a new Jaguar product. In this study the correlations between effects on sales of the original product and sales of a newly introduced product are investigated. In general a positive spillover effect is identified. In addition, Sullivan (1990) found that due to advertisement activities, concerning the introduction of a new model of Jaguar cars, the demand of used Jaguar cars has decreased. This reduction indicates a negative spillover effect on the sales of the original brand. Moreover, when the introduction of a brand extension is considered as an incidental stimulus to sales of the original brand, one could expect a similar positive effect. The same applies to the situation when consistent advertisement activities ensure ongoing stimuli. However, Sullivan (1990) does not find such equal results (Sullivan, 1990). Balachander and Ghose (2003) argue that this outcome is not evident, due to the absence of separation of two phenomena: i.e., the positive spillover effects in the study are not separated from the decreasing sales of excising products or other negative substitution effects of the brand extension (Balachander & Ghose, 2003). One can conclude that although positive spillover effects from ongoing advertisement activities are present, they are not always strong enough to overcome the negative substitution effects.

4.4 SPILLOVER EFFECTS OF BRAND ALLIANCES

Brand alliances involve the physical or symbolic combination of two or more brands or products (Simonin & Julie, 1998). Although brand alliances and brand extensions seem to be similar, they differ in at least one key item: where brand extensions consist of a single brand, brand alliances are composed of two or more different brands (Aaker & Keller, 1990). Simonin & Julie (1998) found significant and consistent spillover effects of brand alliances towards the original brand. Even after omitting prior brand attitudes, significant effects were observed. Main observance in spillover effects was the modification of subsequent attitudes towards the original brand: i.e., additional brand associations strengthened the original brand. In addition, the least familiar brands in the brand alliance show the highest spillover effects.

Moreover, the results show a positive relationship between attitudes towards the brand alliance on the one hand and product fit, brand fit and attitudes of the prior original brand on the other hand (Simonin & Julie, 1998). With observance of this knowledge, it is arguable that it is not necessary to collaborate with a brand with high consumer favourability, since a potential partner is able to deliver high value of subsequent attitudes due to product or brand fit: i.e., successful collaboration with a company with low favourable brand attitudes is possible when favourable product or brand fit is high (Broniarczyk & Joseph, 1994). However, the reverse does not apply. Both brand fit and product fit do not have direct spillover effects on the core brand attitudes.

4.5 SUMMARY

This chapter provides an insight in the following specific research questions: *to what extent does the brand affect performance in implementing new activities?* (SRQ 3) and *which spillover effects can be identified between new activities and the core business?* (SRQ 4). Brand extension can be defined as the practise of launching a new brand in another market segment, by utilising a well-established brand as leverage. The strength of a particular brand can be indicated in terms of brand associations, distinguished by three aspects *favourability*, *abstractness* and *confidence*. A fit between the original brand and the brand extension is of major importance, since the transfer of the perceived quality from the

core brand to the extension will be enhanced when the type of products contain similarities in some way. When the introduction of a brand extension is considered as an incidental stimulus to sales of the original brand, one could expect a positive effect. Furthermore, significant and consistent spillover effects of brand alliances on the original brand are identified.

5 CONCLUSION

In this last chapter conclusions are derived out of the three previous chapters. Furthermore these conclusions are followed by recommendations towards the business case. This chapter ends with a discussion with limitations and recommendations about this study.

The expansion of activities within a company has several effects on both the organisation and on the existing core activities. In addition, uncertainty within the company increases when the company is unfamiliar with these new activities. Van der Valk Hotel Tiel aims to broaden their activities by means of horizontal integration. The company, however, is unfamiliar with the effects of these new activities on their business performance. Hence, the objective of this research was to get further insights in the existing knowledge about horizontal integration in general and brand extensions in particular, by means of answering the following general research question: *what is the relationship between horizontal integration on the one hand and the existing activities of a company on the other hand?*

5.1 CONCLUSION

In chapter two the potential positive value-creating drivers and negative value-destructing drivers are described. Horizontal integration is a corporate strategy whereby a company expands its activities to another related business chain. The existing business chain of a particular industry becomes smaller, because two or more chains are being merged. Horizontal integration follows out of four potential value-creating drivers. The first potential driver: *economies of scope* refers to the increase of efficiency, by applying existing capabilities and resources to new markets. The next driver, *stretching corporate management competences*, is very similar to the first driver and concerns the utilisation of potential skills of talented employees. The third driver, *exploiting superior internal processes*, is based on the assumption that internal processes within a company are in potential more efficient than widely used external processes in an open market. Finally, *increasing market power*, refers to competitive advantage, whereby being operational in diverse markets may result in increasing market power. The four potential value-creating drivers have all one element in common. They occur due to the synergistic effect of horizontal integration. Seeking for synergies by means of horizontal integration produces various risks as well, because horizontal integration could also follow out of three potential value-destructing drivers. The first potential driver, *responding to market decline*, refers to the deflection to other sources in response to market decline of the main activity. The next potential value-destructing driver, *spreading risk*, involves the security which managers like to earn by targeting more than one market. Finally, The third potential driver, *managerial ambition*, follows out of personal motives of managers, rather than out of economic reasons. It can be concluded that horizontal integration does not automatically adds value to the existing business. For this reason the strategic choice of implementing horizontal integration in the company can have a positive as well as a negative effect on overall business performance, depending on the potential drivers.

Chapter three provided an insight in the literature concerning diversification. The chapter opened with a definition, followed by the diversification strategies and motives and the chapter closed with the effects of diversification. A vast majority of businesses is engaged in some kind of diversification strategies. Diversification can be defined as the increase in both products and markets of a company. These new activities can be related or unrelated to the current portfolio of the company. Companies can choose between three types of diversification strategies, based on growth stages. When a company is intended to enter an existing market, it implements a *disruptive strategy*. This is in essence only possible when the company can gather a competitive advantage, which is exploited in a disruptive manner. An existing market can also be targeted without having the necessary competences available, by means of a *buy & build strategy*. This strategy implies that external capabilities are being attracted to achieve effective growth in competences. A *pioneering strategy*, is used when a company is about to enter a new market, which occurs mainly when these markets are in an early stage. The motivation behind the choice to diversify can be found in responding to external changes, which can be seen as threats for the company and therefore the strategies are defensive in character.

The effects of diversification are reasonably identifiable. Rumelt (1974) identified a categorical measurement in order to analyse a sample of diversified companies on economic performance. There can be concluded that companies with a diversification strategy that is restricted to a limited range of activities have shown significant higher performance than other types of companies within the study. In practice switching to a diversification strategy is not easy. Companies struggle with finding new opportunities and preparing the internal organisation for this change in business strategy, due to: the decrease of R&D intensity which can result in declining diversification intentions, increasing R&D budgets which can lead to saturation of available technologies, companies which have trouble with recognising potential future growth markets and additional difficulties in the external environment which makes it more difficult to enter the market for companies that aim to diversify. Differences between diversification strategies occur due to the degree of diversification, since it will affect the outcome in terms of the degree of effect on business performance. Besides, brands in general have an important impact on the business performance as an intangible asset. Choi et al. (2011) found a negative significant impact of diversification on the business performance of the measured sample within their study. There is suggested that highly diversified companies might fail partially in transferring their competences to other segments or possible similarity is identifiable between the core business and the new activity, which leads to reciprocal competition.

The fourth chapter contained a review of the literature concerning brand extensions and spillover effects. The chapter started with a definition, continued with brand associations and ended with the spillover effects of brand extensions and brand alliances. The term brand extension can be defined as the practise of launching a new brand in another market segment, by utilising a well-established brand as leverage. Introducing a brand extension is found to be an appropriate strategy of influencing the customers' brand choices. Utilising the power of a well-established brand name provides advantages, but can also be harmful. Utilising a well known brand reduces the risk of introducing new products or services in both new and existing markets, since the consumers already are familiar with the established core brand. The strength of a particular brand can be indicated in terms of brand associations, distinguished by three aspects. First, the *favourability* towards a brand is the consumers' creation of an image of a brand by evaluating the quality which they associate with that particular brand. Second, the *abstractness* of brand associations involves the extent to which consumers make an association between a brand and an overall product category. Last factor is the consumers' *confidence* in their brand associations, in order to make a deliberate purchase decision. A fit between the original brand and the brand extension is of major importance, since the transfer of the perceived quality of the core brand to the extension will be enhanced when the type of products contain similarities in some way. When introduction of a brand extension generates additional benefits towards the original brand in general, one can expect that the brand extension's advertisement activities has a positive influence on the original brand's sales as well. When the introduction of a brand extension is considered as an incidental stimulus to sales of the original brand, one could expect a similar positive effect. The same applies to the situation when consistent advertisement activities ensure ongoing stimuli. Nevertheless, they are not always strong enough to overcome the negative substitution effects. Furthermore, Simonin & Julie (1998) found significant and consistent spillover effects of brand alliances towards the original brand. Even after omitting prior brand attitudes, significant effects were observed. It is not necessary to collaborate with a brand with high consumer favourability, since a potential partner is able to deliver high value of subsequent attitudes due to product or brand fit.

To close this section, the pros and cons which result from this literature review are enumerated in the following tables:

Pros
Economies of scope as potential driver of horizontal integration.
Stretching corporate management competences as potential driver of horizontal integration.
Exploiting superior internal processes as potential driver of horizontal integration.
Increasing market power as potential driver of horizontal integration.
Implementing a disruptive strategy when the company can gather a competitive advantage.
Implementing a buy & build strategy when the company does not have the necessary competences available.

Implementing a diversification strategy that is restricted to a limited range of activities.
Introducing a brand extension is found to be an appropriate strategy of influencing the customers' brand choices.
Utilising a well known brand reduces the risk of introducing new products or services, since the consumers already are familiar with the established core brand.
The strength of a brand depends on the favourability of the brand, the abstractness of the brand associations and the confidence in the brand associations.

Cons
Responding to market decline as potential driver of horizontal integration.
Spreading risk as potential driver of horizontal integration.
Managerial ambition as potential driver of horizontal integration.
Implementation of a too broad range of new activities when diversifying.
The decrease of R&D intensity, which can result in declining diversification intentions, makes it more difficult to enter the market for companies that aim to diversify.
Increasing R&D budgets, which can lead to saturation of available technologies, makes it more difficult to enter the market for companies that aim to diversify.
Difficulty with recognising potential future growth markets makes it more difficult to enter the market for companies that aim to diversify.
Highly diversified companies might fail partially in transferring their competences to other segments.
Possible similarity is identifiable between the core business and the new activity of highly diversified companies, which leads to reciprocal competition.
Spillover effects of brand extensions are not always strong enough to overcome the negative substitution effects.

5.2 RECOMMENDATION

Following this literature study one can conclude that implementing horizontal integration can both enhance as harm the original brand of Van der Valk and thus have positive or negative effects on business performance. First, it is recommended to oversee the actual motivation for the strategic choice to diversify. Subsequently, it must be examined whether this motivation is a potential positive value-creating driver or a potential negative value-destructing driver. A value-destructing driver has most likely negative effects on overall business performance on the short- or long term. Second, it is recommended to adopt a buy & build strategy, in order to achieve effective growth in competences. Van der Valk does not possess the required competences to implement the new activity fully independently, with as a result that attracting external capabilities is advisable. Besides, the effect on business performance of related diversification is higher than the effect of unrelated diversification, since required competences are already partially present when implementing related diversification. Third, it is recommended to limit the range of new activities, since companies with a restricted degree of diversification show significant higher performance than companies with a high degree of diversification. In addition, Van der Valk might fail partially in transferring their competences to the new segments in case of the implementation of a too broad range of new activities. Besides, possible similarity might be identifiable between the activities, which leads to reciprocal competition. Fourth and final, it is advisable to implement horizontal integration in the form of a brand extension. Utilising a well known brand as Van der Valk reduces the risk of introducing new products or services, since the consumers already are familiar with the established original brand Van der Valk. Additionally, the perceived quality of the core brand will enhance the extension. When introduction of the new brand extension generates additional benefits towards the original brand of Van der Valk in general, one can expect that the brand extension's advertisement activities has a positive influence on the original brand's sales as well. The recommendations towards Van der Valk are enumerated in the following table, in order to close this section:

Recommendations towards Van der Valk
It is recommended to oversee the actual motivation for the strategic choice to diversify.
It is recommended to adopt a buy & build strategy, in order to achieve effective growth in competences.

It is recommended to limit the range of new activities, since companies with a restricted degree of diversification show significant higher performance than companies with a high degree of diversification.

It is advisable to implement horizontal integration in the form of a brand extension.

5.3 DISCUSSION

This study is focused on three main terms: horizontal integration, diversification and brand extension. These topics include the most suitable literature to comply to the objective. Nevertheless, these three terms do not include the complete spectrum of information about the subject. In addition, this literature review is limited to articles which derive from the predetermined keywords. These keywords are determined on the basis of relevance as a result of the specific research questions. Further research by means of broader issues and additional recent articles is recommended, in order to get a full view about the subject. Furthermore, in order to limit the scope of this literature review the amount of specific research questions is restricted and consequently, this study does not include a full answer to the objective. Further research by means of literature study is recommended. Finally, a clear insight in the business case of Van der Valk is lacking. Therefore empirical research concerning the subject is recommended.

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