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Book Review

Strategie in volatilen Märkten
Wettbewerbsvorteile durch Unternehmungsdiversifikation

by James D. Madden
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reviewed by Grigoris Zarotiadis*

Competition is the Holy Grail of the orthodox school; not any kind of competition, but the perfect one among competitors who seek to optimise their very personal welfare. Yet, neither competition is perfect, nor is it merely to maximise the individual benefits of competitors.

James D. Madden contributes to this everlasting discussion, with his PhD dissertation "*Strategie in volatilen Märkten*" (Strategy in volatile Markets); he provides a comprehensive theoretical study (with empirical backing) on diversification, one of the major aspects of socioeconomic reality that removes perfectness from actual competition.

The author does not hide his preference for the (neo-) classical school – Friedrich A. von Hayek is his main inspiration and the source for the introducing citations chosen in the main chapters of his thesis. Nevertheless, Madden is a business economist; therefore, he succeeds in anticipating that beyond the necessary micro-foundation of theoretical macroeconomic neoclassical equilibria there lies the reality of the daily struggle to sustain a business in the framework of aggressive, often destructive, imperfect competition. This becomes obvious from the very beginning of the book, when the author sets the basic hypothesis of his analysis: "*on the one hand, businesses depend on new knowledge in order to adjust successfully to changing general conditions; yet, on the other hand, they do not have the time they would probably need to develop this new knowledge… business diversification is a way to efficiently solve this problem*" (page 7 of the book).

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The organisation of the book is quite straightforward. In his introductory chapter, the author determines his main question(s) and provides a logical diagram (page 25) that clearly describes the methodological structure of the ensuing pages.

Madden starts from the main linkage in relevant literature: from the point of view of each specific entrepreneur the decision to diversify results from uncertainty. It is the lack of perfect information that motivates producers to differentiate the commodities supplied, either in the procedure of producing them, or in their very specific characteristics themselves.

Here, it is necessary to clarify two issues with respect to this starting hypothesis set by the author: first, it is a microeconomic argument that searches for individual incentives, although, macro-economically speaking, diversification refers to the fact that today's societal needs expand not only quantitatively but also qualitatively. Second, it is a clearly neoclassical way of anticipating the motives for diversification, as they result from denying one of the most crucial 'orthodox' assumptions, namely, perfectness of information.

Heterodox analysts see in the decision to diversify one of the thinkable choices for the energetic, aggressive (in that sense) competitors to maintain and expand their spectrum of monopolistic power. It becomes obvious that the uncertainty argument (the starting point of Madden in his PhD thesis) refers, on the contrary, to passive competitors, who simply try to optimise their position in the framework of an overlying, untouchable competitive environment.

Next, in the contents of the book, the author proceeds with the second chapter presenting a thorough review of standard relevant literature regarding the decision to diversify. Beyond presenting theoretical justifications in a comprehensive way, he also includes in his examination an empirical meta-analysis to reach combinatory conclusions on the assessment of existing theoretical arguments. Overall, Madden concludes that existing empirical contributions provide, at best, a weak association between diversification and business success, whereas the causality of this relationship is even more dubious. For him this is an indication for the need of further, more sophisticated theoretical contributions. Thereby, he justifies the introduction of new arguments resulting from the non-standard assumptions of limited rationality, opportunistic behaviour and uncertainty, which is actually the theoretical path he chooses to follow.

In the following two chapters (C and D in the book) Madden goes deeper into a detailed analysis of the two main ways of modelling the decision to diversify, as well as the direction of diversification: first the theory that starts from transaction costs and, second, the one that focuses on the most efficient use of resources.

According to the author, neither transaction costs nor the resources based considerations are capable of providing convincing justification for our main question. Madden sees the reason for this weakness in the simplistic, I would also say obsessive, use of neoclassical and standard industrial economics hypotheses.

Based upon this recognition, the author proceeds to combine the tradition of transaction costs and resources modelling in a model where dynamic know-how and technology are included. In chapters E and F of the book, he presents his approach in detail, starting from the basic conceptions and moving on to the final presentation of the comprehensive model. The proposed framework goes beyond the standard assumption of homogenous technologies shared by all competitors and, consequently, provides alternative solutions for explaining the phenomenon of diversification in an environment of uncertainty. Madden summarises his contribution in 6 theoretical hypotheses that describe the way in which process and/or behavioural uncertainty induce businesses to develop-market, cooperative or hierarchical forms of diversification.

Concluding, the monograph reviewed constitutes a useful tool for any scholar who wants to deal with competition theory, especially concerning diversification issues. This happens because, first, the author provides a constructive review of relevant literature along with a practical categorisation of alternative arguments, and, secondly, because Madden presents an innovative, combinatory model that can form the basis for future theoretical advancements, as well as for relevant empirical research.