Strategic Management Journal
Strat. Mgmt. J., **20**: 147–166 (1999)

TO BE DIFFERENT, OR TO BE THE SAME? IT'S A QUESTION (AND THEORY) OF STRATEGIC BALANCE

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This paper addresses the performance consequences of firm-level strategic similarity. Past research observed that firms face pressures to be different and to be the same. By differentiating, firms reduce competition. By conforming, firms demonstrate their legitimacy. Both reduced competition and legitimacy improve performance. This paper begins building a theory of strategic balance by synthesizing the differentiation and conformity perspectives. The theory directs attention to intermediate levels of strategic similarity where firms balance the pressures of competition and legitimation. Empirical support for the theory is found in a longitudinal study of commercial banks. Several suggestions for developing a theory of strategic balance conclude the paper. The theory's major implication is that firms should be as different as legitimately possible.

Similarity among firms has received a great deal of attention in strategic management and organizational theories. Similarity (or differences) is the subject of several agenda-setting works (e.g., DiMaggio and Powell, 1983; Hannan and Freeman, 1977; Rumelt, Schendel, and Teece, 1994). For the most part, individual researchers have focused on one side of the similarity question, that is, what is the value of being different, or what is the value of being the same. By being different, a firm benefits because it faces less competition, *ceteris paribus* (Barney, 1991; Baum and Mezias, 1992; Hannan, Ranger-Moore, and Banaszak-Holl, 1990; Hawley, 1968; Henderson, 1981; Porter, 1991). By being the same, a firm benefits because it is recognized as legitimate, *ceteris paribus* (DiMaggio and Powell, 1983; Hybels, 1995; Meyer and Rowan, 1977; Pfeffer and Salancik, 1978; Suchman, 1995).

Some recent research recognized the tension between the need for a firm to be different and the need for a firm to be the same. For instance, Porac, Thomas, and Baden-Fuller (1989: 414) suggested that strategists needed to balance on a 'competitive cusp' between simultaneous pressures to conform and to differentiate. Abrahamson and Hegeman (1994) observed that strategic conformity reduces both competitive risk and opportunities for competitive advantage. Reflecting on the contradictory prescriptions of strategic management and institutional theories, Chen and Hambrick (1995: 475) said 'emphatically that theory and research on competitive conformity—its causes and effects—should be a high priority for the field of strategy.'

This paper addresses this tension by developing an integrative theory of strategic balance. The paper first deduces from existing research conflicting differentiation and conformity propositions. These are used as the basis for theory building (Poole and Van de Ven, 1989; Sutton

Key words: differentiation; conformity; competition; legitimation; banking
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CCC 0143–2095/99/020147–20 $17.50

Received 30 September 1996
Final revision received 6 April 1998

and Staw, 1995). The two are synthesized into the strategic balance proposition, which states that moderately differentiated firms have higher performance than either highly conforming or highly differentiated firms. The empirical section demonstrates the usefulness of this perspective by examining the strategies of competing commercial banks. The integrated hypothesis of a curvilinear relationship receives stronger empirical support than either the differentiation or conformity hypotheses. The last section suggests several avenues for future development of a more comprehensive theory of strategic balance.

This paper provides theoretical and statistical support to the idea of a 'competitive cusp' identified in Porac *et al.*'s (1989) cognitive research. It also contributes to a growing stream of research addressing the interaction between competitive and institutional forces (Baum and Oliver, 1991, 1992; Carroll and Hannan, 1989; Chen and Hambrick, 1995; Dacin, 1997; Oliver, 1997; Roberts and Greenwood, 1997; Singh, Tucker, and House, 1986). Strategic balance theory directs our attention to intermediate levels of differentiation where firms balance the benefits of reduced competition against the costs of reduced legitimacy. The theory's main recommendation is that firms seeking competitive advantage should be as different as legitimately possible.

BUILDING THE STRATEGIC BALANCE PROPOSITION

The theory of strategic balance addresses relations among strategic similarity, competition, legitimacy, and performance. The unit of theorizing is the individual firm. The theory building proceeds as follows. The first section presents definitions and assumptions. It also introduces commercial banking, the empirical context used to illustrate and test the theory. The second and third sections derive the differentiation and conformity propositions, respectively, from strategic management and organizational theories. The fourth section integrates the two propositions.

Definitions, assumptions, and context

One important step in building new theory from two or more existing theories is defining concepts that are analogous to those of the original theories (Kaplan, 1964; cf. Tsoukas, 1991; Van de Ven and Poole, 1995). A related step is to make explicit assumptions that simplify theory building, including the boundary conditions specifying the context.

Although many firm attributes could be, and have been, the subject of research on similarity, this paper focuses on strategy. Strategy is conceptualized as a firm's realized position in its competitive market (Mintzberg, 1987; Porter, 1980). Each firm's strategic position is supported by its resources and capabilities, reflecting the idea that resources and positions are two sides of the same coin (Wernerfelt, 1984). From the perspective of organization theory, a firm's realized strategic position is analogous to an organization's actual domain, that is, the markets an organization serves and the technologies (i.e., resources) it uses to serve them (Haveman, 1993; Levine and White, 1961; Thompson, 1967).

Several theories imply that a firm's strategic position relative to the strategic positions of competing firms should influence a performance construct, although the terms differ. For instance, strategic management discusses how firm differences affect competitive advantage (Barney, 1991; Porter, 1980); organizational ecology discusses how similar firms have higher competitive intensity that affects survival rates (Hannan *et al.*, 1990); and institutional theory discusses how isomorphism affects social and economic fitness (DiMaggio and Powell, 1983). This paper defines *strategic similarity* as a firm-level construct representing the extent to which a firm's strategic position resembles the strategic positions of other firms competing in its market at a particular point in time. Strategic similarity is a covering term representing firm differences, isomorphism, etc. Firms can have the same level of similarity but not have the same strategy. This paper defines *performance* as the net flow of resources through a firm. Performance is a covering term representing competitive advantage, survival, social and economic fitness, etc.. To simplify theory building, this paper assumes these performance constructs are equivalent. In general, firms with persistent net resource outflows will eventually fail.

A firm interacts not only with competitors but also with other actors in the external environment, which is divided into the organizational field and the general environment. The organizational field

consists of a network of competitors, suppliers, customers, regulators, trade associations etc. (DiMaggio and Powell, 1983: 148; cf. industry environment (Porter, 1980) or task environment (Dill, 1958; Thompson, 1967)). In an organizational field, institutional models develop and diffuse through cohesive and structurally equivalent network ties (Davis, 1991; DiMaggio and Powell, 1983; Galaskiewicz and Burt, 1991; Galaskiewicz and Wasserman, 1989). The general environment consists of other organizations outside the organizational field and sociocultural, technological, economic, and other trends (Porter, 1980).

The strategic balance proposition developed here applies to for-profit firms in an established market within a structurated organizational field, such as financial service or health care firms. This context is a refinement of Scott and Meyer's (1991) ideal sector in strong technical and institutional environments. Firms in an established market compete with each other for both customers and suppliers (Brooks, 1995; Chen, 1996). At this point, the paper assumes there are no strategic groups in this market and that firms do not collude (Kwoka and Ravenscraft, 1986; Gimeno and Woo, 1996). Firms in a structurated organizational field face institutional pressures from government regulators, professional associations, and social networks (DiMaggio and Powell, 1983). In this context, theoretical statements involving competitive and institutional forces should hold. These assumptions will be revisited in the last section of the paper.

The assumption that strategy is related to the competitive environment is a fundamental one in strategic management (Porter, 1980; Rumelt, Schendel, and Teece, 1994). The assumption that strategy is related to the institutional environment requires elaboration, because initial work in the new institutional theory focused on structures and practices in governmental and educational organizations (Meyer and Rowan, 1977; Meyer and Scott, 1983; Tolbert and Zucker, 1983). Several researchers have extended institutional theory to the strategies of for-profit businesses, the importance of which was noted by Powell (1991) and Scott (1994: xx, 1995: 140), among others. Fligstein (1991) described how different diversification strategies became legitimated among the largest U.S. corporations over the period 1919–79. Davis (1991) and Haunschild (1993) showed that the poison pill and acquisition strategies, respectively, diffused through director networks. Haveman (1993) presented evidence for mimetic isomorphic pressures in the selection of asset strategies by California savings and loans. Deephouse (1996) found that isomorphism in strategies was associated with legitimacy conferred by regulators and the media. Dacin (1997) showed how norms for Finnish nationalism emanating from the general environment legitimated the founding of newspapers in Finnish rather than Swedish. Strategy researchers using a cognitive perspective suggested that managers in an industry develop a cognitive consensus about what strategies are proper and reasonable, in other words, legitimate (Huff, 1982; Porac *et al*., 1989; Reger and Huff, 1993; Spender, 1989; Suchman, 1995). This consensus develops from interactions with the task environment, a subset of the organizational field used by institutional theorists. Thus, this theory assumes that strategies can be legitimated by institutional forces in both the organizational field and the general environment.

To focus on the relationship between strategic similarity and performance through the mechanisms of competition and legitimation, this presentation makes a few additional assumptions. The first assumption is that managers are organizationally rational, in that they select and implement strategies that they think will lead to higher performance (Simon, 1976). This assumption does not exclude institutional forces, however. Institutional pressures such as regulatory suasion, professional orientation, or imitation of competitors may lead managers to believe that certain strategies will lead to higher performance (DiMaggio and Powell, 1983; Fligstein, 1991; Powell, 1991; Roberts and Greenwood, 1997). This rationality assumption minimizes the important complexities of managerial cognition and decision-making in determining strategic similarity (Farjoun and Lai, 1997; Porac *et al*., 1989; Reger and Huff, 1993). The second assumption is that firms are not powerless in the face of institutional forces. Instead, firms can resist or attempt to influence them (Kraatz and Zajac, 1996; Oliver, 1991; Pfeffer and Salancik, 1978; Powell, 1991; Scott, 1995; Selznick, 1957). The third assumption is that other determinants of competition, legitimacy, and performance are assumed constant in order to focus on the role of strategic simi-

larity. The research design controls for many of these determinants.

The specific context used to illustrate and test the theory is a sample of competing commercial banks.[1] Commercial banks are chartered by government regulators. Commercial banks serve as financial intermediaries, channeling money from investors to borrowers. They also play central roles in the payment system and in the implementation of monetary policy. A commercial bank differs from a bank holding company which can own multiple commercial banks, savings banks, and banking-related subsidiaries like a credit card unit.

Fundamental strategic decisions of a commercial bank are the selection of assets and liabilities (Santomero, 1984). Bank assets are investments in various sectors of the economy, such as real estate loans and government securities. Bank liabilities are borrowings of various types, such as checking deposits and money market borrowing. Associated with each asset and liability is an interest rate reflecting the asset's price and the liability's cost.

In this study, commercial banks are assumed to be price-takers on cost side. None of the banks are major players in the money markets, so they have minimal impact on borrowing costs. Banks are also assumed to be price takers for other costs of doing business, such as rent and wages, because they compete in a market with firms of all types for office space and employees.

The strategic decisions examined in this study are asset allocation decisions (Santomero, 1984). These decisions in banking are analogous to the allocation of resources to certain product markets described by Chandler (1962). Strategic management researchers studying banks have used asset allocation models (e.g., Haveman, 1993; Mehra, 1996; Reger, Duhaime, and Stimpert, 1992). Banks have to decide how much to invest in each asset category, such as real estate lending. A bank that decides to expand its real estate lending may have to lower its interest rate, relative to competitors. The bank will also have to fund this expansion with borrowings, the cost of which is assumed to be set in the money market.

Competitive banking markets were defined by bank regulators as metropolitan areas or rural counties during the period under study (Barnett, Greve, and Park, 1994; Hannan, 1991; Smirlock, 1985). Banks in a single market offer similar products to similar customers, and they compete for similar factors of production (Chen, 1996; Hannan *et al.*, 1990). For example, a bank competes with other banks to lend money to a real estate developer; it competes for the loan officer who makes the loan; and it competes for deposits to fund the loan. Thus, banks in a single area face strong competitive forces.

Banks are also in a structurated organizational field and thus face strong institutional forces from many sources (DiMaggio and Powell, 1983; Scott and Meyer, 1991). Because of their crucial roles in the economy, banks are highly regulated (Spong, 1990). This regulation consists of not only unambiguous rules like Regulation O limiting loans to insiders but also more ambiguous and idiosyncratic supervision of each bank. In the supervisory process, regulators examine bank strategies, practices, and financial reports and discuss their findings with bank managers. Banks also belong to trade associations, like the American Bankers Association. The Bank Administration Institute offers professional training. Banks follow business developments in the media, such as the local business press and *American Banker*, the daily newspaper of the U.S. banking industry. They also use forecasts from business economists in strategic planning.

To recap, strategic similarity is a firm-level construct representing the difference between a firm's realized strategy and those of its competitors. Strategic similarity is subject to competitive and institutional forces. These forces are present in banking. The next two sections propose that a firm should be different and a firm should be the same, respectively. The theory building concludes by synthesizing these two propositions.

A firm should be different

The basic argument is that a firm with a different strategy benefits because it faces less competition for resources, *ceteris paribus*. The market is assumed to have a finite level of resources at a specific point in time. The resources are divided

[1] Useful references on commercial banking include government and central bank publications, textbooks, and academic journals in banking and finance. This overview relied primarily on Gilbert (1984), Mishkin (1992), Santomero (1984), and Spong (1990).

among competing firms to the extent their realized strategic positions tap the same resource niches (Baum and Mezias, 1992; Baum and Singh, 1994; Carroll, 1985; Hotelling, 1929).

A firm that conforms to the strategies of others has many similar competitors that limit the performance of the firm and increase failure rates (Baum and Singh, 1994; Hannan *et al*., 1990; Henderson, 1981). The firm targets similar market resources using similar competencies. This situation approaches perfect economic competition where economic rents equal zero.

Rational differentiation reduces competition and increases performance. A firm selects a distinct position in what it *ex ante* perceives to be an unexploited or underexploited niche. Porter (1991: 102) postulated that 'the firm must stake out a distinct position from its rivals. Imitation almost ensures a lack of competitive advantage and hence mediocre performance.' A distinct position enables a firm to earn higher rents because the firm faces less competition and perhaps even a local monopoly (Baum and Mezias, 1992; Baum and Singh, 1994; Hannan *et al*., 1990; Porter, 1980, 1991). Underlying the distinct position of a successful firm are firm resources which are rare, valuable, nonsubstitutable, and inimitable (Barney, 1991). A firm that attempts to establish a position in a niche that is *ex post* unviable will either fail or change to a viable niche. Over time most firms that establish different positions will be those with superior performance.

Profits from a distinct position will persist depending on the ability of competitors to imitate the position. Consider first the case in which imitation is difficult. The successful firm identifies and exploits market opportunities and then takes advantage of its first mover status to build barriers to imitation (Lieberman and Montgomery, 1988; Reed and DeFillippi, 1990; Rumelt, 1987). Such barriers include brand loyalty, switching costs, causal ambiguity, scale economies, and preemption of strategic assets. A key resource of the successful firm is finding unexploited niches and then erecting defensible barriers. Consider also the case where imitation is easy. In this case, the successful firm must reestablish distinct positions that exploit new niches to stay ahead of the competition (D'Aveni, 1994). A key resource of the successful firm is locating profitable new strategic opportunities for its core competencies (Prahalad and Hamel, 1990).

In commercial banking, both processes may occur. For instance, a successful bank that perceived unexploited opportunities in real estate lending would be able to lock-in the best quality loans. Moreover, the interest rates on the loans are likely to be more favorable to the bank because of limited competition for these loans. This bank would establish a distinct position *vis-à-vis* its rivals. As competitors recognized opportunities in real estate lending, they would compete more vigorously in it, driving down lending rates and profit margins. Competitors may induce the best-quality borrowers to switch banks. Meanwhile, the successful bank would rely on its skills in identifying and capitalizing on the next underexploited sector, such as commercial lending, before its competitors. In the process, it would reestablish its distinct position.

The precise relationships among strategic differentiation, competition, and resulting performance have not been conclusively demonstrated. A general linear relationship between strategic similarity and performance is attractive theoretically and may hold statistically for more complex relationships. Thus:

> *Differentiation proposition: Less strategic similarity increases performance.*

Empirical research using related variables has been supportive of this relationship. Gimeno and Woo (1996) found that similarity in airline strategies was related to higher rivalry, measured as declines in revenue per passenger mile. Higher rivalry usually leads to lower performance, because firms must expend resources to compete more intensely, as in an airline price war. Ecological research has identified at least two factors analogous to strategic similarity that increase failure rates. The first is competitive intensity, the nearness of a firm to other firms on strategic dimensions (Baum and Mezias, 1992; Hannan *et al*., 1990). The second is niche overlap density, the number of firms competing for the same resources (Baum and Singh, 1994).

A firm should be the same

A second perspective on strategic similarity is that a firm should be same as others in order to achieve superior performance. This is called the conformity proposition, and it is derived primarily

from resource dependence and new institutional theories.[2] The basic argument is that a firm which is similar to other firms avoids legitimacy challenges that hinder resource acquisition, *ceteris paribus*.

The organizational field institutionalizes and legitimates a range of normal strategies through an iterative isomorphic process (Scott, 1995). This process resembles the ones that occurred in U.S. education and in U.S. Equal Employment Opportunity law (Dobbin *et al.*, 1993; Edelman, 1992; Meyer *et al.*, 1988). Strategy selection is inherently uncertain because it requires a commitment to certain ways of doing business in the future (Cyert and March, 1963; Ghemawat, 1991). Under conditions of uncertainty, mimetic behavior is likely (Cyert and March, 1963; DiMaggio and Powell, 1983). Firms select strategies to achieve future success, and successful strategies are imitated (Haveman, 1993). Managers develop a cognitive consensus about the strategies that will lead to success (Huff, 1982; Porac *et al.*, 1989; Reger and Huff, 1993; Spender, 1989). Called 'industry recipes' by strategists (Spender, 1989), these strategic norms resemble the governance structures, institutional logics, and institutional templates of institutional theory (DiMaggio and Powell, 1991; Greenwood and Hinings, 1996; Scott, 1995). Strategic norms can develop about different scope and resource commitments, such as diversification and innovation. The cognitive consensus develops through cohesive and structurally equivalent relationships among members of the organizational field (Davis, 1991; Galaskiewicz and Burt, 1991; Haunschild, 1993).

During this isomorphic process, a range of normal strategies becomes legitimated. A firm's strategy is legitimate if it is acceptable to its organizational field (Aldrich and Fiol, 1994; DiMaggio and Powell, 1983; Scott, 1995; Suchman, 1995). A firm's strategy is cognitively legitimated if it is aligned with the cognitive consensus or industry recipe (Porac *et al.*, 1989; Spender, 1989). A firm's strategy is normatively, sociopolitically, or regulatively legitimated if members of the organizational field endorse it. The state, as ultimate authority, and the professions play a role by endorsing or rejecting certain strategies (DiMaggio and Powell, 1983; Dobbin *et al.*, 1993; Edelman, 1992; Meyer and Scott, 1983). For example, U.S. antitrust policies influenced corporate diversification strategies (Fligstein, 1991). The selection and implementation of strategies by competing firms lead to some variation in realized strategic positions. Reger and Huff (1993) proposed that there are 'core' firms that follow strategic recipes closely and 'secondary' firms that follow recipes less closely. Because members of the organizational field do not perceive or are indifferent to certain amounts of differentiation, firms can be different to some degree from their competitors and maintain their legitimacy. This recognizes the empirical fact that firms aren't exactly alike. The range of strategic similarity in which firms maintain their legitimacy is called range of acceptability.

A firm which selects strategies outside of the range of acceptability does so at its own peril. It is subject to questions and actions challenging its legitimacy, reliability, and rationality (Ashforth and Gibbs, 1990; DiMaggio and Powell, 1983; Hambrick and D'Aveni, 1992; Hirsch and Andrews, 1984; Meyer and Rowan, 1977; Suchman, 1995). These questions and actions are called legitimacy challenges here, following Hirsch and Andrews (1984). Legitimacy challenges occur because the firm's strategies reject the conventional wisdom that is incorporated in the industry consensus (Miller and Chen, 1995; Porac *et al.*, 1989). 'Misfits' and 'idiosyncratic firms' were two labels given by Reger and Huff (1993) for these firms. Legitimacy challenges subsequently diffuse through the organizational field.

Legitimacy challenges diminish the ability of a firm to acquire resources from potential exchange partners in the organizational field, such as customers, suppliers, and regulators (DiMaggio and Powell, 1983). A legitimate firm obtains resources of higher quality and at more favorable terms than does a firm whose legitimacy is challenged. There are at least three related reasons for this.

[2] Strategic group and oligopoly theories also suggest that having similar strategies increases performance. They are excluded in the interest of parsimony. In these theories, performance increases because similar firms recognize their interdependence and collude (Caves and Porter, 1977). Whether collusion actually occurs in an industry is subject to many conditions (Cool and Dierickx, 1993; Hatten and Hatten, 1987), and empirical support is mixed (Berger, 1995; Gimeno and Woo, 1996; Kwoka and Ravenscraft, 1986; Peteraf, 1993). If collusion were occurring among the banks in the sample, it would benefit the larger banks (Berger, 1995; Smirlock, 1985). Size is included as a control variable to account for this.

First, a potential exchange partner that does not comprehend a firm's strategies or accept them as rational will not provide any resources to the firm, restricting resource supply. Second, an exchange partner may accept less favorable contract terms from a legitimate firm. This occurs because the legitimacy of the exchange partner is enhanced by contracting with a legitimate firm (Galaskiewicz, 1985; Pfeffer and Salancik, 1978: 145; Wood, 1991). In contrast, an exchange partner may require greater inducements to contract with a firm whose legitimacy is challenged. Third, less legitimate firms are more likely to fail (Baum and Oliver, 1991; DiMaggio and Powell, 1983; Singh *et al*., 1986). This induces exchange partners to demand higher risk premiums in contracts (Cornell and Shapiro, 1987; Miller and Bromiley, 1990). Moreover, firms with a greater risk of failure have difficulty maintaining quality managers and outside directors, reducing the effectiveness of firm decision-making and subsequent performance (Hambrick and D'Aveni, 1992). In sum, dissimilar firms face legitimacy challenges that hinder resource acquisition and reduce performance.

Strategic norms develop in commercial banking through an iterative isomorphic process. Asset selection at commercial banks is inherently uncertain because banks do not know which assets in which economic sector will fail to make future payments. Spong (1990: 11) pointed out that bank regulation does not substitute regulatory strategic decision-making for bank strategic decision-making. In other words, regulators do not specify exact institutional templates for bank strategies in a top-down manner (DiMaggio and Powell, 1991; Greenwood and Hinings, 1996; Scott, 1995). Instead, strategic norms develop through multiple institutional processes, including: regular interactions among banks, regulators, borrowers and depositors; reports of successes or failures presented by the media; and the activities of banking associations and bank training programs. Publicly available quarterly financial reports (Call Reports) inform members of the organizational field about bank strategy selections. Moreover, regulators provide each bank with Uniform Bank Performance Reports that compare the bank's asset strategies and performance with its peer group. And although regulators do not make strategic decisions for banks, Spong (1990: 58) did point out that regulators do have a 'subtle influence' on the level of bank exposure to fluctuations in different economic sectors.

Historically, many banks that took actions outside of standard industry practices faced legitimacy challenges. If a bank planned to grow faster than a specified rate, the bank was required to notify regulators. In the 1980s, banks that pushed aggressively into agricultural and real estate loans faced increased oversight and even closure by regulators. Banks that didn't conform to standard industry strategies also were subject to legitimacy challenges in the media (e.g., Loomis, 1992).

The precise relationships among strategic conformity, legitimacy, and resulting performance have not been conclusively demonstrated. A general linear relationship between strategic similarity and performance is attractive theoretically and may hold statistically for more complex relationships such as the one described above. Thus:

> *Conformity proposition: Greater strategic similarity increases performance.*

Empirical research has been indirectly supportive of the proposition that strategic conformity leads to higher performance because of increased legitimacy. Positive correlations between strategic conformity and performance were reported by Abrahamson and Hegeman (1994) and Chen and colleagues (Chen and Hambrick, 1995; Miller and Chen, 1995). Positive relationships between strategic conformity and endorsements were reported by Deephouse (1996), and positive relationships between endorsements and survival rates were reported by Baum and Oliver (1991, 1992) and Singh *et al*., (1986).

A firm should be balanced between differentiation and conformity

In markets with strong competitive and institutional forces, both the differentiation and conformity propositions should be important. Thus, a firm faces a trade-off between conforming and differentiating. The ultimate relationship between strategic similarity and performance then depends on the relative strength of the differentiation and conformity propositions over the range of strategic similarity. This section synthesizes the differentiation and conformity propositions to derive the strategic balance proposition. Except as noted

in this section, the assumptions and arguments of the preceding sections apply. Two thought experiments are used in this synthesis (Hempel, 1965; Weick, 1989). The first applies the differentiation and conformity propositions to three types of firms in three mutually exclusive ranges of strategic similarity: high, moderate, and low. The second applies the two propositions to a firm as its strategic similarity decreases from being exactly like all its competitors. Both experiments suggest that firms with moderate levels of strategic similarity will have higher performance than those with high or low levels.

The first thought experiment applies the differentiation and conformity propositions to three types of firms classified by three mutually exclusive ranges of strategic similarity: high, moderate, and low. Firms in the high-similarity condition face strong competition and avoid legitimacy challenges. Firms in the low-similarity condition face reduced competition and face legitimacy challenges. Firms in the moderate similarity condition face reduced competition and avoid legitimacy challenges.[3]

The first type of firm has a high level of strategic similarity. The firm competes with many other firms in a similar way for similar resources. This situation resembles perfect competition in microeconomics where rents equal zero. The conformity proposition implies that members of the organizational field recognize these firms as legitimate. Differences are not significant enough to generate legitimacy challenges, so the firm does not benefit in its contracting on the basis of legitimacy. Thus, firms with high levels of strategic similarity are expected to have relatively low performance because the costs of strong competition outweigh the benefits from being legitimate.

A second type of firm has a low level of strategic similarity. The differentiation proposition implies the firm faces few competitors for its targeted resources and thus can price more monopolistically. The conformity proposition implies that resources become more scarce because many potential exchange partners do not understand or approve of the firm's strategy and therefore do not consider doing business with the firm. Furthermore, the resources the firm can obtain will be of lower quality and priced at less favorable terms. Thus, firms with low levels of strategic similarity are expected to have low performance because the costs of legitimacy challenges outweigh the benefits of reduced competition.

The third type of firm has a moderate level of strategic similarity. This type of firm faces reduced competition for resources, so its performance is higher than firms of the highly similar type. The firm is not so different that members of the organizational field challenge its legitimacy, so its performance is higher than firms that have low similarity. Thus, firms with moderate levels of strategic similarity are expected to have high performance because they benefit from reduced competition while maintaining legitimacy. This range of strategic similarity is where firms balance differentiation and conformity pressures.

The second thought experiment applies the differentiation and conformity propositions to a firm as it becomes increasingly less similar to other firms. When the firm is exactly like its competitors, it benefits from being legitimate but faces intense (i.e., economically perfect) competition. It does not gain any positional advantage from having a larger realized niche, nor does it gain advantage by being more legitimate than other firms. As the firm differentiates, competition is reduced, its realized niche increases, and performance increases. When the firm becomes different enough so that members of the organizational field challenge its legitimacy, this will have a detrimental effect on performance. As long as the gains from reduced competition outweigh the costs of legitimacy challenges, the firm's performance will continue to increase. The firm will achieve maximum performance at the level of strategic similarity where the gains from reduced competition are equal to the costs of legitimacy challenges. This level is the balance point or 'competitive cusp' between differentiation and conformity pressures (Porac *et al.*, 1989: 414). At greater levels of dissimilarity the costs of legitimacy challenges exceed the benefits of reduced competition, leading to lower net performance. The general implication is that the firm has highest performance at intermediate levels of

[3] An alternative interpretation of moderate levels of strategic similarity is that firms face strong competition and legitimacy challenges. This paper assumes firms persisting in this state fail because they have neither the profitability nor the legitimacy necessary to survive (DiMaggio and Powell, 1983).

strategic similarity. Both thought experiments imply:

> *Strategic balance proposition: Moderate amounts of strategic similarity increase performance.*

RESEARCH DESIGN

Sample and data

The propositions were statistically examined in a population of commercial banks competing in a single market from 1985 to 1992. The population was located in the Minneapolis–St. Paul, Minnesota, United States, metropolitan area (Twin Cities), a competitive market according to bank regulators (Barnett *et al.*, 1994; Hannan, 1991; Smirlock, 1985). Using one industry in one market controls for differences across industries and local business conditions.

The variables were collected from the Call Reports data base maintained by U.S. government regulators. The unit of analysis is the bank-year. 1985 was the first year because regulators instituted a major revision in the Call Reports in 1984. There were 159 independent banks in the Twin Cities because Minnesota historically limited bank branches. During the period, the state ended branching limitations in the Twin Cities. Many acquisitions subsequently occurred, the effects of which are incorporated in the measurement of strategic position. After accounting for foundings, mergers, failures, the use of lagged dependent variables, and the deletion of one outlying value, there were 960 observations in the period 1985–92.

Dependent variable

The measure of performance was based on return on average assets (ROA), the ratio of net income to average assets. Average assets was used in the denominator, consistent with bank regulatory practice, because banks undertake 'window dressing' of their balance sheets at year-end and assets change over time. ROA is a common measure of bank performance (Barnett *et al.*, 1994; Gilbert, 1984; Mehra, 1996; Reger *et al.*, 1992).

Relative ROA was the performance measure used in the statistical tests. Relative ROA is the difference between the bank's ROA and the average ROA of all Twin Cities' banks in a given year. The measure thus indicates how well a bank is doing relative to its competitors. This procedure also controls indirectly for several market and macroeconomic factors, such as concentration, density, interest rates, and economic cycles.

Independent variable

Strategic similarity is the focal construct of this research. As noted earlier, the specific strategies used are bank asset strategies, the allocation of resources to a certain bank product market (Haveman, 1993; Mehra, 1996; Reger *et al.*, 1992; Santomero, 1984; cf. Chandler, 1962). This research examined 11 strategy variables: commercial loans, real estate loans, loans to individuals, agriculture loans, other loans and leases, cash, overnight money, securities, trading accounts, fixed assets, and other assets. Each asset strategy was measured as a proportion of total assets. For example, the real estate lending strategy was measured as the proportion of assets that a bank committed to real estate loans.

For a given set of strategies, there may be several ways to compute strategic similarity. This paper used standard deviation units because DiMaggio and Powell (1983: 156) and Scott (1995: 76) suggested these indicate conformity to institutional norms. Suchman (1994) measured the idiosyncrasy of individual venture capital contracts using standardization procedures on 16 contract dimensions. Kraatz and Zajac (1996) measured homogeneity in liberal arts colleges (i.e., isomorphism) using the mean absolute deviation of one dimension, the number of professional programs. Standard deviation units also were used in strategy research (Abrahamson and Hambrick, 1995; Abrahamson and Hegeman, 1994; Finkelstein and Hambrick, 1990).

The measure of strategic similarity is called *strategic deviation*, and its calculation was similar to that used by Finkelstein and Hambrick (1990) to measure strategic conformity. In a given year, each asset strategy for each bank was compared to the industry mean for that strategy and expressed as a standard deviation. The absolute values of the standard deviations of all 11 strategy variables were totaled for each bank because strategy is holistic concept involving interrelated components and aggregation increases model parsimony (Finkelstein and Hambrick, 1990; Mintz-

berg, 1978). The following equation illustrates the calculation of the strategic deviation of bank i in year t, where P_{ait} is the proportion of the assets in strategy a for bank i in year t, ABS is the absolute value function, $M(P_{at})$ is the mean of asset strategy a in year t for Twin Cities' banks, and $SD(P_{at})$ is its standard deviation.

$$\text{Strategic Deviation}_{it} = \sum_{a=1}^{11} \text{ABS}\left[(P_{ait} - M(P_{at}))/\text{SD}(P_{at})\right]$$

The range of strategic deviation includes all numbers greater than or equal to zero. Strategic deviation equals zero if and only if all firms have the same strategy.

Hypotheses

Given these measures of strategic similarity and performance, the following hypotheses will be used to test the differentiation, conformity, and strategic balance propositions.

Hypothesis 1 (Differentiation): There is a positive relationship between strategic deviation and relative ROA.

Hypothesis 2 (Conformity): There is a negative relationship between strategic deviation and relative ROA.

The strategic balance proposition states that moderate levels of strategic similarity have higher performance than those with high or low levels. This is tested with a curvilinear relationship.

Hypothesis 3 (Strategic balance): There is a curvilinear, concave down relationship between strategic deviation and relative ROA.

Control variables

Market share of deposits

Research on banks in industrial organization economics suggests that market share increases performance. Larger banks may dominate the market and price aggressively (Gale, 1972); they may also be more efficient (Demsetz, 1973). If collusion were occurring, it would benefit the larger banks (Berger, 1995; Smirlock, 1985). Moreover, size may delineate strategic groups that differ in profitability (Porter, 1979). There were a few large banks in the Twin Cities which could have exerted market power, exercised price leadership, or comprised a strategic group. Market share based on deposits is used here, consistent with prior bank studies (e.g., Berger, 1995; Smirlock, 1985). This variable, labeled *market share*, is expected to have a positive coefficient.

Total expense ratio

The asset strategies that are the focus of this paper primarily address the revenue side of banking, not the cost side. Although Twin Cities banks are assumed to be price-takers, some may be more cost efficient than others, leading to higher performance. The extent of cost reduction was measured by the ratio of total interest and non-interest expense to total average assets (Dos Santos and Peffers, 1995). This variable, labeled the *total expense ratio*, is expected to have a negative coefficient.

Market growth of deposits

Changes in the resource environment over time may affect competition and performance (Porter, 1980). Firms in expanding industries face less competition than firms in contracting industries. Following Berger (1995), the annual percent change in real total market deposits was included as a control variable. This variable, labeled *real market growth*, is expected to have a positive coefficient.

Lagged dependent variable

The lagged dependent variable also is included as a control. It reflects the possibility that the effects of changes in the independent variables are distributed over multiple time periods (Fomby, Hill, and Johnson, 1984). Moreover, it controls for omitted variables (Kennedy, 1992). This variable is expected to have a positive coefficient.

A final set of control variables comprising the 11 asset strategies was considered. These represent the bank's strategic position. Estimates using them are not reported here (but are available from the author) because they suffered from

serious collinearity problems. Condition numbers exceeded 234, well above the 30 suggested by Judge *et al.* (1988) as being cause for concern. Results for strategic deviation using these strategy variables were consistent with the results reported.

Analysis

The data were analyzed using hierarchical regression. Model 1 tested the control variables. Model 2 added the first-order strategic deviation term, testing Hypothesis 1 vs. Hypothesis 2. Model 3 added the second-order strategic deviation term. Hypothesis 3 would have greater credence over Hypotheses 1 and 2 if the coefficient of this term is negative and significant and its inclusion improves the fit of the model. The following equation presents Model 3:

$$\begin{aligned}\text{Relative ROA}_{it} = {} & b_0 + b_1 * \text{Strategic Deviation}_{it}^2 \\ & + b_2 * \text{Strategic Deviation}_{it} \\ & + b_3 * \text{Market Share}_{it} + b_4 * \text{Total Expense Ratio}_{it} + b_5 * \text{Real Market Growth}_{it} \\ & + b_6 * \text{Relative ROA}_{i,t-1} + e_{it}\end{aligned}$$

Three violations of ordinary least squares (OLS) required investigation in the process of choosing an estimation procedure. First, the presence of the lagged dependent variable on the right-hand side violated the OLS assumption of nonstochastic regressors. Moreover, because the data form a pooled cross-sectional time series, two other possible OLS violations were heteroscedasticity across banks and autocorrelation over time. Autocorrelation and the lagged dependent variable were addressed first. The correlation between the error terms was assumed to take the form called first-order autocorrelation, consistent with most econometric work using annual data (Greene, 1993: 417; Kennedy, 1992: 120). Missing values were inserted between each bank to prevent autocorrelation from being defined across banks (Bromiley, 1991). Durbin's *h*-statistics, which are distributed asymptotically standard normal, were used to test for autocorrelation in the presence of lagged dependent variables (Greene, 1993: 428; Kennedy, 1985: 125). For all models, Durbin's *h*-statistics were less than 1.28 (N.S.), implying that autocorrelation was not a problem in this model and that OLS estimators were consistent (Greene, 1993; Kennedy, 1992). Kennedy (1992: 140–141) noted that OLS estimators are usually the most appropriate estimator in this case.

The third possible violation of OLS assumptions was heteroscedasticity. This was investigated by examining plots of residuals from ordinary least-squares regression against the predicted values, the year, and the independent variables. The 'megaphone opening left' shape of the residual plot vs. market share suggested that the error variance was inversely proportional to market share. Weighted least-squares estimation, a special case of generalized least squares, was used to produce unbiased, minimum variance estimates of the hypothesized parameters in the case of heteroscedasticity (Greene, 1993; Kennedy, 1992). These are reported in the results. The GLS transformation negates the interpretability of *R*-squared goodness of fit measures. Because of this, Models 1, 2, and 3 were compared using *F*-tests computed with sums of squared errors (Greene, 1993: 363; Griffiths, Hill, and Judge, 1993; Kennedy, 1992).

One outlying observation stood out following the estimation of each model: Norwest Bank Minneapolis, N.A., in 1987. This outlier was identified by examining studentized deleted residuals from the weighted least-squares estimates (Judge *et al.*, 1988). It had the highest studentized deleted residual in all three models. Its minimum value was 21.8 in Model 2, which was about 50 percent higher than the second highest studentized deleted residual. This outlier may have occurred because Norwest was in the process of consolidating its Twin Cities affiliates in 1987. For these reasons, this observation was deleted. The principal effect on the parameter estimates from deleting this observation was to improve the significance of the control variables.

RESULTS

Table 1 presents the means, standard deviations, and correlations among the variables. The large correlation (0.95) between strategic deviation and its squared value suggested that collinearity needs to be considered in Model 3.

Table 2 presents the weighted least-squares estimates. To simplify presentation of the results, relative ROA and its lagged value were multiplied by 100 prior to estimation. Model 1 presents the baseline model of control variables. The coef-

Table 1. Means, standard deviations, and correlations

Variables	Means	S.D.	1	2	3	4	5	6
1. Relative ROA	0.000	0.007						
2. Relative ROA$_{t-1}$	0.000	0.007	0.62***					
3. Strategic Deviation^2	66.956	66.548	–0.12***	–0.14***				
4. Strategic Deviation	7.640	2.932	–0.14***	–0.17***	0.95***			
5. Market Share	0.008	0.037	–0.04	–0.08**	0.49***	0.41***		
6. Total Expense Ratio	0.085	0.012	–0.45***	–0.40***	0.09**	0.13***	–0.03	
7. Real Market Growth (%)	–1.094	5.492	0.01	–0.01	0.00	0.00	–0.02	0.08*

$n = 960$
* $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$

Table 2. Results of weighted least-squares regressions[a]

Independent variables	Model 1	Model 2	Model 3
Intercept	0.929***	1.164***	0.511**
	(0.169)	(0.172)	(0.171)
Strategic Deviation^2			–0.006***
			(0.001)
Strategic Deviation		–0.020***	0.170***
		(0.004)	(0.017)
Market Share	–0.576***	–0.093	–0.457**
	(0.138)	(0.161)	(0.155)
Total Expense Ratio	–9.948***	–10.601***	–15.387***
	(2.001)	(1.974)	(1.895)
Real Market Growth	0.014***	0.016***	0.018***
	(0.004)	(0.004)	(0.003)
Relative ROA$_{t-1}$	0.369***	0.361***	0.403***
	(0.028)	(0.027)	(0.026)
Sum of squared errors	2.978	2.886	2.530
Δ Sum of squared errors over Model 1		0.092***	0.448***
Δ Sum of squared errors over Model 2			0.356***

[a] Standard errors are in parentheses. $n = 960$
* $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$

ficient for market share was significant, but its sign was opposite of what was expected. The coefficient for the total expense ratio was negative and significant at the $p < 0.001$ level, as expected. The coefficients for real market growth and the lagged dependent variable were positive and significant, also consistent with expectations.

Model 2 added the strategic deviation term in order to perform a strong test between the differentiation and conformity hypotheses. The coefficient on strategic deviation was negative and strongly significant ($p < 0.001$). This result supported Hypothesis 2 over Hypothesis 1, suggesting that conformity was more profitable than differentiation. Hypothesis 2 gains further credence because the inclusion of strategic deviation improved the fit of the model over the baseline model. The change in the sum of squared errors was 0.092 ($F = 30.4$, d.f. = 1,954) which was significant at the $p < 0.001$ level. Market share did not have a significant impact on relative ROA in this model. The total expense ratio, market growth, and the lagged dependent variable were significant at the $p < 0.001$ level in the expected directions.

Model 3 added the squared strategic deviation

term in order to test the strategic balance hypothesis. The coefficient of the squared strategic deviation term was negative and significant at the $p < 0.001$ level. Analysis of the estimated function indicated the relationship between strategic deviation and performance has an inverted U-shape in the range of strategic deviation for banks in this sample. Thus, there is support for Hypothesis 3. Hypothesis 3 gains greater credence because the inclusion of the squared strategic deviation term improved the fit of the model over both Models 1 and 2. Compared to the baseline model, the change in the sum of squared errors was 0.448, significant at the $p < 0.001$ level ($F = 84.4$, d.f. = 2,953). Compared to Model 2, the change in the sum of squared errors was 0.356, also significant at the $p < 0.001$ level ($F = 134.1$, d.f. = 1,953). Overall, these results support the strategic balance hypothesis over the baseline model and the conformity and differentiation hypotheses.

Turning to the remaining variables, market share had a significantly negative impact on relative ROA, in contrast to expectations. This may reflect firms trying to invest in market share or the higher expenses from the processes of acquisition and consolidation. The coefficient for the total expense ratio was negative and significant, as expected. The coefficients for market growth and the lagged dependent variable were positive and significant, as expected.

Collinearity may have affected the results in Model 3 because of the high correlation between the second-order and first-order strategic deviation terms. Several steps were taken to investigate collinearity's impact (Greene, 1993; Judge *et al.*, 1988; Kennedy, 1992). First, the parameter estimates did not have high standard errors, suggesting that the cross-product matrix of the independent variables was not close to being singular. Moreover, the parameter estimates themselves were not large in magnitude. Second, Model 3 was estimated without the first-order term. The estimated coefficient for the squared term remained negative and significant ($\beta = -0.001$, S.E.(β) = 0.0001). Moreover, the fit of the model, as indicated by the sum of squared errors (S.S.E. = 2.803), was better than Model 2 but worse than Model 3. Finally, condition numbers were examined (Belsley, Kuh, and Welsch, 1980). The largest condition number (35.0) was slightly greater than the 30 suggested by Judge *et al.* (1988) and Kennedy (1992) as being cause for concern. These investigations suggested that collinearity was not serious.

TOWARDS A COMPREHENSIVE THEORY OF STRATEGIC BALANCE

Several researchers observed that firms in established industries face conflicting pressures to conform and to differentiate (e.g., Abrahamson and Hegeman, 1994; Chen and Hambrick, 1995). From a study of managerial cognitions, Porac *et al.* (1989: 414) proposed that managers balance these pressures at a point they called the 'competitive cusp.' This paper begins building a theory for this inference using concepts and relationships from strategic management and organization theories. A hypothesis derived from the strategic balance proposition received better empirical support in a large sample study than differentiation or conformity hypotheses did.

Further development of a theory of strategic balance can help researchers better understand the trade-offs between differentiation and conformity. It can also help future managers identify the strategic balance point where the benefits of reduced competition are offset by the costs of legitimacy challenges. The term strategic balance point is used instead of Porac *et al.*'s (1989) competitive cusp because firms in this paper balance competitive and institutional forces. Precise identification of the strategic balance point requires a better understanding of the underlying relationships among similarity, competition, legitimation, and performance. As is common in the early stages of theory building, this paper used a typology and simple relationships. The first part of this section suggests alternative relationships for future testing.

First, consider the relationship that strategic differentiation reduces competition which increases performance. This paper tested a linear relationship, but these relationships could be nonlinear, with very similar firms facing very strong competition. Future research should consider an alternative model suggested by the economic property of diminishing returns: differentiation reduces competition at a declining rate, thus increasing performance at a declining rate.

Second, consider the relationship that strategic conformity increases legitimacy which increases

performance. This paper tested a linear relationship, but these relationships could be nonlinear. Firms within the range of acceptability are similar enough to be judged legitimate by the organizational field. Thus, strategic similarity does not influence legitimacy in this range, nor does strategic similarity affect performance through this mechanism. Beyond this point, there is a negative effect on performance. One question for future research is evaluating how much similarity is needed to avoid legitimacy challenges. A second question is how rapidly performance declines when firms move beyond this point.

Third, consider the relative strengths of competitive forces in the market and legitimating forces in the institutional environment. Firms with high strategic similarity were assumed to face competition that was more costly than the benefits of legitimacy. Firms with low similarity were assumed to face legitimacy challenges that were more costly than the benefits of reduced competition. Future research should develop ways to compare these forces.

An enhanced theory of strategic balance should examine how the strategic balance point changes over time. One applicable model for this purpose is the punctuated equilibrium model (Gersick, 1991; Tushman and Romanelli, 1985). As applied to strategic balance theory, it suggests the strategic balance point goes through relatively long periods of convergence toward greater similarity punctuated by brief periods of divergence toward less similarity. Convergence occurs as institutional forces lessen the variation in strategies, similar to the increasing conformity in hospital TQM practices over time found by Westphal *et al.* (1997). Divergence is likely to occur following periods of poor performance, an antecedent of deinstitutionalization (Oliver, 1992). This weakens the cognitive consensus about the appropriate strategies that lead to success. Davis, Diekmann, and Tinsley (1994) described how poor performance was a contributor to the deinstitutionalization of the unrelated diversification strategy.

Several assumptions used to build the strategic balance proposition warrant examination. First, the paper assumed that performance constructs from strategic management and organizational theories were theoretically equivalent. For instance, propositions from institutional theory and organizational ecology that pertained to survival were also assumed to apply to performance. Future research should test whether strategic balance affects survival rates and other measures of firm performance.

The development of the strategic balance proposition assumed there were no strategic groups, and the research design controlled for strategic groups using size (Porter, 1979). Future research should consider relaxing this assumption. There are at least three opportunities for future research applying strategic balance theory at the strategic group level. The first is to see if strategic balance theory applies at the strategic group level. A firm within a strategic group should distinguish itself from the rest of the group to reduce competitive intensity. Nevertheless, the firm needs to maintain its legitimacy, so it should not go beyond the group's range of acceptable strategies. The second is to examine whether conformity to strategic group norms or industry norms is more important for avoiding legitimacy challenges.

A third opportunity is to examine how a firm interacts with different strategic group norms. Moreover, Reger and Huff (1993) observed that strategic groups may overlap. A firm in two strategic groups may benefit from the legitimacy of both groups. This firm should be a high performer because it is recognized as members of two groups but faces less competition from group members. Reger and Huff also described 'misfits' and 'idiosyncratic firms' that don't fit in any strategic group. These do not gain legitimacy benefits from being in a strategic group. Even if they move towards another strategic group, they do not gain the benefits of legitimacy until they become similar enough to be recognized as part of that group.

The theory also assumed that firms did not collude. Industrial organization economics has suggested that firms which are similar to each other have greater opportunities to collude and thus increase performance (e.g., Stigler, 1964; Caves and Porter, 1977). The presence of collusion should move the strategic balance point towards being more similar. Future research should test this proposition in an industry where tacit collusion is present.

The last assumption examined is the theory's boundary condition of an established market in strong competitive and institutional environments. If future research is able to measure the strength of these environments, the theory may be appli-

cable in other settings, such as new industries. The relationships between similarity and competition and between similarity and legitimation could be moderated by the strengths of the competitive and institutional environments, respectively, and shift the strategic balance point outward or inward. Such measures may also help explain the nature and pace of strategic convergence and divergence in new industries. New industries are typically in undeveloped institutional environments (Aldrich and Fiol, 1994; Van de Ven and Garud, 1989). In this setting, conformity pressures from institutional actors would be relatively weak. Over time, the pace of strategic convergence may be directly related to the pace of structuration in the institutional environment. Alternatively, new industries face considerable uncertainty that may promote strategic conformity (DiMaggio and Powell, 1983; Geletkanycz and Hambrick, 1997; Henderson, 1996).

There were other limitations in the empirical study that present opportunities for future research. One was that the sample was limited to a single banking market. Future research should examine if strategic balance theory applies in other markets facing strong competitive and institutional pressures, such as hospitals or drug manufacturers. The specific strategic resource commitments in these markets may vary (Chandler, 1962; Schendel and Patton, 1978). For instance, R&D expenses and advertising expenses may be important in the pharmaceutical industry (Cool and Schendel, 1987), whereas technical sophistication in non-routine treatments may be important in hospitals (Ketchen, Thomas, and Snow, 1993; Westphal, Gulati, and Shortell, 1997). Within these industries, strategic norms would develop around different resource commitments, such as innovation or product promotion. A firm which was significantly different from others on these commitments would face legitimacy challenges.

Second, the theory examined only one type of firm difference, that of strategy. Strategy was used because it sets the overall direction of the firm (Simon, 1976). Nevertheless, other firm characteristics may be important, such as technology, structure, or marketing. Conformity in one characteristic may offset differentiation in another. By incorporating these other characteristics, the theory of strategic balance may evolve to a more general theory of firm balance. Third, the theory also assumed that successful differentiators were able to build isolating mechanisms to prevent imitation or were astute at identifying the next market opportunities in cases where imitation was easy. Future research should examine the nature of the imitative processes and measure barriers to imitation.

Measurement of strategic similarity is a fourth important issue. The measure used here leaned towards indicating institutional isomorphism over competitive intensity. This paper used the averages of firm strategies as reference points. Some research on competition used pairwise comparisons, which compute distances between the focal firm and every other firm on several dimensions before aggregating to a summary measure (Baum and Mezias, 1992; Gimeno and Woo, 1996; Hannan *et al.*, 1990). This paper also used standard deviations to measure distance. Linear and Euclidean (i.e., squared) distances have been used in other studies (Baum and Mezias, 1992; Cool and Dierickx, 1993; Hannan *et al.*, 1990; Kraatz and Zajac, 1996).

Nevertheless, the results indicate the strategic deviation measure had predictive validity for testing a theory that incorporated *both* competitive and institutional forces. Many strategy researchers stated the industry or strategic group average is useful for assessing strategic positions (Cool and Dierickx, 1993; Cyert and March, 1963; Fiegenbaum and Thomas, 1988, 1995; Huff, 1982; Mintzberg and Waters, 1985). Standard deviation units have been used in institutional and strategy research (Abrahamson and Hambrick, 1995; Abrahamson and Hegeman, 1994; DiMaggio and Powell, 1983; Finkelstein and Hambrick, 1990; Scott, 1995; Suchman, 1994). Future research should compare different measures of strategic similarity. Pairwise methods might better reflect competition between individual firms, whereas standard deviation methods might better reflect the legitimation of a firm within the industry.

From a theory building perspective, this paper illustrated the value of integrating existing theories to develop and test new theory (Poole and Van de Ven, 1989; Sutton and Staw, 1995). Following the lead of Baum and Oliver (1991, 1992), Carroll and Hannan (1989), Oliver (1997), Roberts and Greenwood (1997), etc., this paper began building a theory integrating competitive and institutional perspectives. Empirical testing suggested the theory of strategic balance is a

better model of the complex, multifaceted reality of organizations (Blalock, 1984).

This paper thus informs theories that advocate firms differentiate to reduce competition, such as strategic management. Although moderate amounts of strategic similarity increased performance, larger amounts reduced it. The theory of strategic balance suggests this occurred because firms lose legitimacy. Potential exchange partners have difficulty comprehending the firm's strategy and therefore don't accept or approve of the firm (Meyer and Rowan, 1977; Suchman, 1995). They are less likely to exchange resources with the firm, or they will require significant inducements to do so. Most notably, if customers don't understand or accept the firm's way of doing business, the firm's strategic niche will be devoid of customers. The theory of strategic balance thus gives meaning to the idea of an attractive niche (Porter, 1991). An attractive niche is one that is different from other firms' niches (Hawley, 1968; Henderson, 1981) yet similar enough to be rational and understandable (Meyer and Rowan, 1977; Suchman, 1995). In sum, the need for legitimacy limits the firm's ability to differentiate into specialized niches.

This paper also informs theories that advocate firms conform to maintain legitimacy, such as institutional theory (DiMaggio and Powell, 1983; Meyer and Rowan, 1977; Scott, 1987, 1995). Reviews of institutional theory recommended that researchers extend institutional theory to the strategies of for-profit firms and incorporate competitive forces (DiMaggio and Powell, 1991; Powell, 1991; Scott, 1994, 1995). Most empirical research on this sector has shown how institutional forces have been important in the adoption of certain strategies (Dacin, 1997; Davis, 1991; Fligstein, 1991; Haunschild, 1993; Haveman, 1993). The performance consequences of adoption have been less well studied. The theory of strategic balance suggests that the legitimating benefits of conforming to strategic norms are offset by increased competition. For institutional theory to play a greater role in understanding for-profit businesses, it needs to recognize the effects of conformity on competition and performance. This paper also proposed that the institutionalization and legitimation of strategy occurs through an iterative process, rather than the top-down process most commonly seen in new institutional research (Scott, 1995).

CONCLUSION

This paper addressed the question of whether a firm should be different from or the same as its competitors. It began developing a theory of strategic balance by integrating strategic management and organizational theories. Strategic management and organizational ecology contribute the idea that competition reduces the benefits of institutional isomorphism. Institutional and resource dependence theories contribute the idea that legitimacy activates the flow of resources that energizes a firm. The theory of strategic balance directs our attention to intermediate levels of differentiation where a firm benefits from reduced competition while maintaining its legitimacy. The discussion section suggested several ways for investigating the balance point where a firm is as differentiated as legitimately possible.

ACKNOWLEDGEMENTS

I would like to thank Arthur Bedeian, Manuel Becerra, Philip Bromiley, Timothy Chandler, Javier Gimeno, Carter Hill, David Ketchen, Matthew Kraatz, Charles McDowell, Grant Miles, Kevin Mossholder, and Timothy Palmer for their assistance and helpful comments on earlier drafts of this paper. The final version benefitted greatly from the suggestions of Edward Zajac and the anonymous reviewers of this journal. I am also indebted to Graeme Edge, Justin Hayward, and William Shakespeare for their contributions to the title of the paper.

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