

RESPONSIVENESS TO MARKET OPPORTUNITIES AND PERFORMANCE: AN INTERNAL CAPITAL ALLOCATION PERSPECTIVE

ABSTRACT

This paper assesses the responsiveness of firms' internal capital allocations to market opportunities and the implications of such responsiveness for firm performance in markets. Evidence from the generation segment of the U.S. electric power industry (1998-2010) suggests that geographically-diversified firms' internal capital allocations are responsive to market opportunities. Restrictions to the flow of financial resources within those firms – stemming from regulation – reduce this basic effect. Interestingly, we find that increased investment responsiveness to market opportunities is associated with weaker firm performance, measured as lower capacity utilization in a market than otherwise expected. Our evidence suggests that this result stems from the fact that investment responsiveness is associated with increased firm exposure to market-level investment bandwagons and resulting detrimental market overcapacity situations.

KEYWORDS: *Capital allocation; Capacity investments; Competitive Strategy; Bandwagons; Performance*