

# Business strategy and strategic deviation in accounting, finance, and corporate governance: A review of the empirical literature

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## Abstract

We review the empirical archival literature on the consequences of business strategy and strategic deviation on accounting, finance, and corporate governance outcomes. We use Miles and Snow's (*Organizational strategy, structure, and process*. McGraw-Hill, 1978; *Organizational strategy, structure and process*. Stanford University Press, 2003) strategy typology that has been quantified using financial statement data by Bentley et al. (*Contemporary Accounting Research*, 2013, 30, 780). Research has used this strategy score to investigate the consequences of firms following two distinct strategies namely, prospectors versus defenders, on various organisational outcomes. Our survey provides mixed evidence on the relationship between business strategy, financial reporting quality, finance outcomes, and corporate governance including corporate social responsibility (CSR) activities. We offer some suggestions for future research.

## KEYWORDS

Business strategy, Financial reporting quality, Strategic deviation

## JEL CLASSIFICATION

M10, M40, M41

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# 1 | INTRODUCTION

This systematic literature review synthesises the empirical archival research on the consequences of business strategy and strategic deviation in the accounting, finance, and corporate governance literature. Business strategy can be defined as the mechanism or pattern of resource allocation (Mintzberg, 1978), which is mainly focused on how distinct competencies can be converted into competitive advantage (Andrews, 1980). While management literature focuses on strategy formulation, implementation and operationalisation aspects, accounting and finance research have generally focused on how different strategies affect firm-level outcomes.<sup>1</sup> Since business strategy affects both the agency problem and firm-level uncertainty, as well as the overall firm behaviour (Habib & Hasan, 2021), we would expect that business strategy has a significant impact on various accounting, finance and governance outcomes. Agency theory and uncertainty hypothesis have been the dominant theoretical focus for most accounting and finance research. Given that strategy choice and implementation is likely to be affected by agency problems, this has major implications for accounting disclosures, capital market consequences and governance outcomes. Therefore, focusing on business strategy in the domain of accounting, finance, and corporate governance is important.

The management literature provides several typologies of business strategy that describe how companies compete in their respective market environments. Some of the more well-known typologies, include: Porter (1980), who describes business strategies in terms of cost leadership and product differentiation; March (1991), who describes business strategies in terms of exploration and exploitation; and Treacy and Wiersema (1995), who describe business strategies in terms of operational excellence, product leadership, and customer intimacy. Miles and Snow (1978, 2003) operationalise strategy in terms of organisation's rate of change regarding its products and markets. Although the labels for business strategies differ across the typologies mentioned above, one common feature is that they most clearly identify companies that operate at one end or the other of a strategy continuum.

Miles and Snow's (1978, 2003) strategy typology, for example, identifies three main types of organisations. First, the defender-type strategy focuses on maintaining the existing products and markets while achieving efficiency. Second, the prospector-type strategy continuously engages in pursuing new products and markets and undertake high risks in doing so. Finally, analyser-type strategy encompasses characteristics from both ends (see detailed explanation in subsection 2.1). Strategy deviation, on the other hand, can be defined as deviation in resource-allocation pattern relative to industry peers (Finkelstein & Hambrick, 1990). Managerial choice of a particular business strategy plays an influential role in determining the business risk which in turn determines variation in firm-level outcomes (Miles & Snow, 2003). Our paper summarises and critiques the empirical archival research that examines the consequences of strategy typology as operationalised by Bentley et al. (2013) and strategic deviation on financial reporting outcomes, corporate governance, and financial policies.

In explaining the role of strategy on these outcomes, the extant research has mainly used multiple theoretical perspectives. Drawing insights from organisation theory, it can be argued that intrinsic characteristics of each strategy type create different levels of business risks (Miles & Snow, 2003). Accounting and finance literature, stemming from the positivist research paradigm, uses information asymmetry arguments to explain the impact of strategy on the chosen firm-level outcome. Innovation-oriented prospector-type strategy escalates information asymmetry because of heightened uncertainty, high risk, unstable conditions due to continuous changes in the operations for seeking new products and markets. In contrast, firms following defender-type strategy operate within a narrowly defined

<sup>1</sup>It is to be noted, however, though that the primary purpose of strategic management accounting is to provide relevant information for assisting top management in formulating and monitoring business strategy (Simmonds, 1981).

product market and invest in a single-core technology and, thus, have relatively lower risks and hence, suffer from less information asymmetry. Our review also includes a critical discussion on the strategy measurements used by the studies due to its arbitrary allocation of firms into different types of strategies that are placed at the two extreme ends on the strategy continuum.

In selecting papers for review, we confined our choice to papers that quantified strategy and strategic deviation following Miles and Snow strategy typology using data from financial statements (Bentley et al., 2013; Tang et al., 2011): a significant departure from prior research in management and accounting disciplines that primarily relied on interviews, surveys, experiments and conceptual analysis (Desarbo et al., 2005; Hambrick, 2003; Kabanoff & Brown, 2008; Simons, 1987). Since the publication of Bentley et al. (2013), we have seen a growing interest from accounting and finance researchers to examine the consequences of the Miles and Snow (1978, 2003) strategy typology as quantified by Bentley et al. (2013) on various firm and market outcomes. The advantages of using a quantified measure of strategy are as follows. First, a comprehensive quantified measure for organisational business strategy type is generalisable across various industries and across different financial reporting regimes. Second, a quantified measure of strategy typology is relatively easily replicable. Finally, robust econometric testing can be implemented by using a quantified measure, which generates reliable and valid conclusions.

We conduct a systematic literature review by identifying, reviewing, and classifying relevant published research work (Brauer, 2006), by first defining a literature review period from 2011 to the first quarter of 2023. Our review period begins from 2011 as the first paper on 'strategic deviance' by Tang et al. was published in 2011. Second, we identified three disciplines on which to focus our search: accounting, finance, and corporate governance. Third, we conducted a two-step keyword search process, first step included the following keywords, 'business strategy', 'strategy typology', 'strategy deviation', 'strategic deviation'. We used these search terms to retrieve articles from the major business databases, including EBSCOhost, Emerald Insight, Scopus, Web of Science, and Google Scholar. As the second step of the search, we included the following keywords within the generated results from step one. They are, 'financial reporting', 'financial reporting quality', 'reporting irregularities', 'audit', 'taxation', 'internal controls', 'dividend', 'investments', 'stock price', 'CSR', 'ESG reporting', 'sustainability reporting', 'carbon disclosures', 'performance'. Fourth, we skimmed through each of the articles initially derived, to identify whether the research question tested the consequences of strategy empirically using Bentley et al. (2013) measurements. We include articles published in journals listed on the 2019 Australian Business Deans Council (ABDC) rankings ranked B and above to maintain a certain quality threshold. In total, our review includes 45 published papers. We have excluded studies that examine the determinants of strategy, strategic uniqueness, and strategic changes (Bednar et al., 2013; Haynes & Hillman, 2010; Oehmichen et al., 2021; Zhu & Chen, 2015) because they are mainly conducted in the Management discipline. Other papers also used quantified measure of firm's strategic orientation using alternative strategy typology (Jia, 2018; Noh & Park, 2023), we exclude those papers from our review as well. Finally, we exclude papers that used strategy as a moderating variable.<sup>2</sup>

Our review is expected to contribute to the extant literature in two important ways. First, since business strategy determines many of the operational decisions made by the executives, an understanding of the consequences of strategic choices will assist academic researchers who intend to investigate the implications of business strategy to examine

<sup>2</sup>Limited research focused on the moderating effects of strategy and strategy deviation on the strength or nature of the relationship between two other variables (Hsu et al., 2018). Inclusion of such papers would have increased the number of papers for review but would fail to highlight the direct effect of strategy and/or strategic deviation on the outcome variable: the main purpose of our review.

hitherto unexplored consequences of strategic choices using the business strategy score both in the US as well as in an international setting. Second, the mixed findings in the empirical literature on the consequences of strategy and strategic deviation suggests that future research needs to reassess the strategy score developed by Bentley et al. (2013). Our review opens a debate around the validity and reliability of the extant measures of strategy typology and invites future researchers to develop more refined and reliable measures. We, therefore, call accounting and finance researchers to engage in more research on the consequences of strategy and strategy deviation in explaining accounting, finance and governance outcomes such as capital structure, tax planning, labour investment efficiency, stock price crash, dividend policy, financial reporting, corporate governance, climate risk, and carbon reporting and assurance.

The remainder of the paper proceeds as follows. In the next section, we provide an overview and definitions of business strategy and strategy deviation, followed by a brief theoretical overview of business strategy. Section 3 elaborates on the strategy measurements along with a critical discussion of measurement issues. In Section 4, we review the literature on the consequences of strategy and strategic deviation. Section 5 discusses the opportunities for future research. Section 6 concludes the paper.

## 2 | STRATEGY TYPOLOGY AND THE THEORETICAL FRAMEWORK

As explained above, the studies that we reviewed used Miles and Snow's (1978, 2003) strategy typology. We, therefore, first briefly explain the typology. Further, these studies have employed different theoretical lenses to explain why strategy has an impact on various firm-level outcomes. The second part of this section elaborates the theoretical framework(s) that have been used in accounting and finance literature.

### 2.1 | Strategy typology

Business strategy typologies describe how firms compete in their respective market environments. The management literature contains many strategy typologies. For example, Porter (1980) describes strategies as cost leadership, competing in terms of price, vs product differentiation, competing based on the innovative product development. Similarly, Treacy and Wiersema (1995) distinguish between product leadership, operational excellence, and customer intimacy while March (1991) develops a typology that identifies business strategies as either explorative or exploitative. Drawing insights from organisational theory, Miles and Snow (1978, 2003) develop a strategy typology based on a firm's innovation orientation. This is the most widely used strategy typology in the accounting and finance literature.<sup>3</sup>

Miles and Snow (1978, 2003) propose *three distinct business strategies* that may be present within industries – Prospectors, Defenders, and Analysers. These strategies can be positioned along a continuum depending on the firm's orientation towards pursuing new products, markets, and their R&D intensity. In other words, the key aspect of the Miles and Snow strategy typology is the firm's rate of change regarding its products and markets (Hambrick, 1983). Firms pursuing Prospector-type strategies (PROSPECTOR) rapidly change their product and market mix to be innovative market leaders. On the other hand,

<sup>3</sup>In addition to the Miles and Snow (1978, 2003) strategy typology, there are other strategy typologies presented by management scholars. We do not review papers that used other typologies as we focus on the accounting and finance literature which has exclusively used Miles and Snow's typology.

firms adopting defender-type strategies (DEFENDER) continue to appear in narrow and stable markets focusing on a narrow product range, thus competing on the basis of price, service and quality (Miles & Snow, 1978, 2003). According to Bentley et al. (2013, p. 809), PROSPECTOR firms ‘continually seeks new and innovative products and operates on the basis of a diversified decision maker model’, while DEFENDER firms ‘typically vertically integrated, has a narrow set of decision makers, specializes in a very narrow product line and focuses heavily on cost reduction’. Further, PROSPECTOR firms invest extensively in R&D, achieve growth through product-market development with a strong focus on marketing while the DEFENDERS’ main focus is to achieve efficiency in terms of distribution systems and production. In order to cater to these distinct features, PROSPECTOR usually have decentralised organisational structure in contrast to the DEFENDERS’ strict centralised controls. Accordingly, PROSPECTOR and DEFENDER can be placed at the two extremes of a strategy typology continuum. Meanwhile, the ANALYSER-type strategy adopters fall in between PROSPECTOR and DEFENDER (Miles & Snow, 1978, 2003). The mainstream accounting and finance literature focused only on two distinct strategies at the ends of the continuum. See Bentley et al. (2013) Appendix 1 for a detailed description of characteristics of PROSPECTOR and DEFENDER-type strategic orientations.

## 2.2 | Theoretical framework

Research that investigates the consequences of business strategy have mainly based their theoretical stance on the organisational theory. Drawing insights from organisational theory Miles and Snow (1978, 2003) argue that firms following different business strategies exhibit differences in firm-level outcomes. As discussed above, characteristics of PROSPECTOR firms include heightened uncertainty, high risk, unstable conditions due to continuous changes in the operations for seeking new products and markets. These characteristics presumably pose challenges on managers, auditors, investors to gauge accurate firm-level outcomes such as information disclosures, internal controls and consequently have distinct capital market consequences. DEFENDERS, on the other hand, do not have such challenging implications for its stakeholders. Following the organisational theory, research in the accounting and finance mainly examine whether pursuing different business strategies have implications for various firm-level financial reporting and capital market outcomes.

The studies in the accounting and finance domain have mainly relied on agency theory, information asymmetry theory, proprietary cost perspective, and resource-based view to explain how business strategy of the firms can cause variations in financial disclosures, auditing and other capital market outcomes. According to Healy and Palepu (2001, p. 406), ‘demand for financial reporting and disclosure arises from information asymmetry and agency conflicts between managers and outside investors’. Characteristics of each of the strategy typology explain the motivation for the managers to pursue various disclosure strategies that impact information environment. Thus, if the managers have the incentives to reduce information asymmetry that arise due to the strategy that they pursue, they are likely to disclose more information.

Innovation intensive PROSPECTOR firms have higher agency costs because their managers seek to invest in innovative and risky projects (Rajagopalan, 1997; Rajagopalan & Finkelstein, 1992). To reduce this agency cost PROSPECTOR firms produce more voluntary disclosures to the market (Nagar et al., 2003). In addition, PROSPECTOR firms rely significantly on external financing for their new product and market development activities. Furthermore, their internally generated funds are relatively lower due to volatile profitability and uncertainty. As a result, PROSPECTORS provide more financial information to capital providers (Bentley et al., 2013; Miles & Snow, 1978, 2003). PROSPECTOR firms have to adopt aggressive marketing strategies to boost brand awareness (McDaniel &

Kolari, 1987) which further increases external sources of information for PROSPECTORS. Making more information available to stakeholders also helps to achieve competitive advantages. Ho et al. (2022) and Yuan et al. (2020) suggest that PROSPECTOR firms are better corporate social responsibility (CSR) activities performers than DEFENDERS as it benefits them in achieving competitive advantages. When PROSPECTORS engage in more socially responsible activities, it reduces information asymmetry, fosters stakeholder trust, and increases public visibility, leading to competitive advantages (Hart, 1995; Russo & Fouts, 1997). Therefore, characteristics of PROSPECTOR firms may provide incentives for their managers to disclose more information to reduce information asymmetry and access low-cost finance and increase other capital market benefits. However, firms that are likely to be innovative may be reluctant to disclose more information due to their reluctance in revealing sensitive information. Verrecchia (1983) suggests that firms that have higher proprietary costs are less likely to disclose information that may reveal sensitive trade information to the market. Thus, proprietary cost perspective can be used to explain managers' incentives to engage in different financial reporting behaviour depending on the business strategy they adopt. PROSPECTORS are selective in disclosing information on their R&D activities while DEFENDERS prefer to protect the information regarding their operational activities (Porter, 1980).

In conclusion, requirement to access external finance, lack of internal financing and exhaustive marketing strategies of PROSPECTORS lead to produce more information compared to the DEFENDERS. Intuitively, we would expect that PROSPECTOR firms to have lower information asymmetry than DEFENDER firms. However, PROSPECTORS can exhibit higher levels of information asymmetry compared with DEFENDERS due to proprietary cost concerns. In addition, high R&D intensive PROSPECTOR firms are mostly unable to obtain asset pricing information pertaining to intangible assets (Aboody & Lev, 2000; Barth et al., 2001) and as a result may face greater information asymmetry. Further, PROSPECTORS' outcome uncertainty and high-risk projects pave ways for them to engage in low disclosures. Therefore, research that we review have used organisational theory, agency theory, proprietary cost and information asymmetry, in particular, to support their findings.

### 3 | MEASUREMENTS

#### 3.1 | Business strategy

A majority of the studies that we reviewed used the composite business strategy measure, following the seminal work by Bentley et al. (2013) and Higgins et al. (2015). These archival measures were developed based on the Miles and Snow (1978, 2003) and Ittner et al. (1997) strategy typology measures positioned in the strategic management literature. To assign firms to different strategic types, Bentley et al. (2013) compute a discrete STRATEGY composite measure using COMPUSTAT data.

The following six measures are intended to capture different elements of a firm's business strategy and as such used to construct STRATEGY:

- (i) the ratio of research and development to sales,
- (ii) the ratio of employees to sales,
- (iii) a historical growth measure (1-year percentage change in total sales),
- (iv) the ratio of marketing (SG&A) to sales,
- (v) employee fluctuations (standard deviation of total employees), and
- (vi) capital intensity (net PPE scaled by total assets).

Each of the above six variables are calculated using a rolling average values over the previous 5-year period. Then the six variables are ranked by forming quintiles within each two-digit SIC industry-year. Within each firm-year, those observations with variables in the highest quintile are given a score of five, in the second highest quintile, a score of four is awarded, etc. The observations with variables in the lowest quintile are given a score of one. However, the capital intensity is reverse-scored so that observations in the lowest (highest) quintile are given a score of 5 (1). Then for each firm-year, the scores across the six variables are totalled. Accordingly, a company could receive a maximum score of thirty and a minimum score of six. A firm-year which receives a score of 30 (6) would be categorised as a PROSPCETOR (DEFENDER) firm. Researchers also follow Bentley et al. (2013, p. 802) and develop alternative strategy measures by creating dummy variables denoted as PROSPECT (if strategy score  $\geq 24$ ), DEFEND (if strategy score  $\leq 12$ ), and ANALYSE (the remaining observations).

### 3.2 | Strategy deviation

Strategy deviation measures the extent to which a firm's strategy aligns with the strategy of industry peers (Finkelstein & Hambrick, 1990). In measuring strategy deviation, first, the strategy dimension is calculated using the same approach as explained in subsection 3.1 above. Second, the strategy deviation is assessed by standardising each strategic indicator by industry-year (mean = 0 and standard deviation = 1) based on two digits SIC codes. Then, the absolute differences between each firm's score and industry averages for each indicator are calculated. Finally, the six standardised scores are averaged to create a composite measure for strategic deviation (Finkelstein & Hambrick, 1990; Geletkanycz & Hambrick, 1997). The higher value of the composite index implies a greater deviation of a firm's strategy from its industry norms.

Though the first step of calculating the strategy dimension of strategy deviation studies is similar to strategy-based research, we observe slight differences in proxies used to measure them. For example, strategy-based studies use ratios-employees to sales, the 1-year percentage change in total sales, employee fluctuations (standard deviation of total employees), and net PPE scaled by total assets, which are absent in deviant studies. Strategy deviant studies used advertising expenses to sales, net property, plant & equipment to gross property, plant & equipment, inventories to sales, and total debt to equity instead (Dong et al., 2020; Provaty et al., 2022; Ye et al., 2021). Further, similar to strategy-based research, Tang et al. (2011) use capital intensity but measure it using the ratio of fixed assets to the number of employees. Using different proxies in strategy composite measures emphasises the lack of reliability in strategy deviant measurements.

### 3.3 | Measurement issues

We present a discussion on the measurement issues. This is important, because the inferences gained from the reported results must be evaluated in light of the validity and reliability of the strategy measurements. First, Bentley et al.'s (2013) strategy measurement involves arbitrarily assigning firms into different strategy types, which may not necessarily reflect an accurate picture of the firms' strategy choice. For example, firms that receive a score of 23, that is, an ANALYSER, maybe following similar innovation orientation just like a PROSPECTOR but the measurement has categorised the firm as an ANALYSER. Further, Bentley et al.'s (2013) categorisation generates about 80% firms as ANALYSERS. What is the meaning and strategy orientation of these firms, which have been ignored by the mainstream accounting and finance research? Second, when calculating the measures, missing values for advertising and R&D

are replaced with zeros. This might be an incorrect assumption because firms choose not to disclose R&D information and ‘a blank R&D field could represent a firm’s conscious decision not to separate R&D expenses from other reported expenses, such as expense shifting’ (Koh & Reeb, 2015, p. 73). Koh and Reeb (2015) find that 10.5% of missing R&D firms file and receive patents, which is 14 times greater than zero R&D firms. Third, Bentley et al. (2013) did not check the validity and reliability of their strategy score. It is necessary to identify the characteristics of firms with different strategic orientation, such as firm size, age, board characteristics and geographical characteristics that load onto the different strategy typologies. Finally, mixed methodologies can confirm the findings of archival categorisation of strategy. One can conduct interviews and surveys to ascertain their strategy orientation and match these findings with the archival categorisation.

## 4 | SURVEY OF THE LITERATURE

### 4.1 | Business strategy, financial reporting and auditing outcomes

#### 4.1.1 | Business strategy and financial reporting outcomes

As explained in Section 3, competing theoretical arguments exist to explain financial reporting behaviour for firms pursuing different strategic orientation. Organisation theory and information asymmetry theory can be used to explain managerial incentives for voluntary information disclosures depending on their positioning along the strategy continuum (Bentley-Goode et al., 2019). Uncertainty-driven PROSPECTOR firms may try to reduce information asymmetry by improving the quality of information environment by providing more voluntary disclosures. Bentley-Goode et al. (2019) examine whether a firm’s business strategy affects its information environment. The authors find that PROSPECTOR firms issue more frequent management earnings guidance, engage more in press releases and are followed by more financial analysts compared to their DEFENDER firm counterparts: findings supporting the organisational theory perspective. Using the number of risk-related sentences in the annual reports as the measure of risk disclosures, Weber and Müßig (2022) find that PROSPECTOR firms are more likely to disclose risk information than DEFENDER firms in the European setting. This supports PROSPECTOR firm’s reporting strategy to reduce agency conflicts by minimising information asymmetry. This view is also supported by other studies conducted in developing countries (Chin, 2023, for example).

The competing view suggests that PROSPECTOR firms are reluctant to disclose more information to avoid proprietary costs associated with voluntary disclosures. As explained above, PROSPECTOR firms can suffer from proprietary costs of private information from increased disclosures. In line with the information asymmetry argument, Bentley et al. (2013) document that PROSPECTOR firms are likely to have financial reporting irregularities because PROSPECTOR firm managers have incentives to be less forthcoming with the timely disclosure of bad news. Supporting the proprietary cost perspective, some studies (Habib & Hasan, 2020; Lim et al., 2018) find that PROSPECTOR firms produce annual reports that are more difficult to understand compared to annual reports of DEFENDER firms: a finding that supports the obfuscation hypothesis (Li, 2008). Habib and Hasan (2020) also document that firm performance mediates the association between strategy type and readability. Lim et al. (2018) find that PROSPECTOR firms display more negative and uncertainty tones while DEFENDER firms exhibit more litigious tone in their 10-Ks. Studies conducted outside the US also support the proprietary cost assertion. For example, Chen et al. (2022), using evidence from China, find that PROSPECTOR firms are associated with more financial reporting violations than their DEFENDER counterparts. Using evidence from Europe, Weber and

Müßig (2022) suggest that PROSPECTOR firms use more complex language when explaining their risk-related information than DEFENDERS.

In addition to the quantity and quality of disclosures proxied by readability of disclosures, researchers also studied the relation between business strategy and reporting conservatism. Accounting conservatism is viewed as an essential qualitative characteristic of financial reporting framework (Statement of Financial Accounting Concepts [SFAS] No. 2: FASB, 2008), which can be defined as the timely recognition of bad news or the so-called conditional conservatism (Basu, 1997). Hsieh et al. (2019) examine whether business strategy has an impact on conditional conservatism and finds that the intense uncertainty of PROSPECTOR firms leads to ambiguity and as a result increases conditional conservatism. These studies mainly support the view that PROSPECTOR firms' reporting strategies attempt to reduce agency problems by minimising information asymmetry.

#### 4.1.2 | Business strategy and audit outcomes

Uncertainty driven PROSPECTOR firms have higher business risks than more stable DEFENDER firms which is reflected in higher audit fees charged by auditors for PROSPECTOR firms (Bentley et al., 2013). As the authors note 'If auditors consider their clients' business strategy as an underlying component of client business risk ... prospectors [will] require greater audit effort because of their risk-oriented focus, tendencies toward lower profitability, and other risk characteristics' (Bentley et al., 2013, p. 786). Chen et al. (2022), using evidence from China support the above finding. Habib and Hasan (2020) find that auditors respond to narratives that do not correspond to the particular strategy characteristics of the client firms by charging higher audit fees.<sup>4</sup>

An entity's internal control systems is an important mechanism that ensures the quality of financial reporting environment. Therefore, financial market regulators have regulations and guidance around implementation and reporting of internal controls. For example, the Sarbanes–Oxley Act of 2002 requires the management of US-listed companies to review and report on the effectiveness of a company's internal control over financial reporting (ICOFR). At the same time, the auditors are required to provide assurance on their clients' internal controls. Auditors are also required to provide an assessment of the entity's ability to continue as a going concern entity. Thus, it is important to understand whether business strategies affect ICOFR. Bentley-Goode et al. (2017) and Chen et al. (2017) are two such relevant studies. PROSPECTOR firms are constantly changing their control systems due to their uncertain and continuous change of markets, products and systems while relatively stable DEFENDERS do not have to modify their internal controls as often as their PROSPECTOR counterparts. Bentley-Goode et al. (2017) find that PROSPECTOR firms exhibit higher number of material weaknesses pertinent to ICOFR. Additionally, auditors' find it more challenging to assess internal controls of PROSPECTOR clients than DEFENDER clients because PROSPECTOR strategies are more complex to understand. Chen et al. (2017) find that PROSPECTOR firms are more likely to have entity-level material weaknesses, but not account-level weaknesses, compared to DEFENDER firms. In addition, Chen et al. (2017) find that the likelihood of PROSPECTOR firms receiving a going concern opinion is higher than DEFENDER firms.

<sup>4</sup>They find that this effect is mainly driven by DEFENDER firms that produce narratives akin to those of PROSPECTOR firms. Auditors do not appear to penalise PROSPECTOR firms who produce narratives that reflect the feature of DEFENDER firms (subsection 5.3.2).

### 4.1.3 | Business strategy and tax planning

Difference in the strategy orientation including the risk tolerance and organisational structure influence the costs and benefits of tax planning and tax avoidance. The innate risk-seeking PROSPECTOR firms are better equipped to deal with the uncertainty resulting from aggressive tax planning. In contrast, DEFENDER firms are faced with high competition and have close substitutes, which put them in a difficult position to avoid tax due to reputation concerns. Therefore, PROSPECTOR firms are more likely to be tax aggressive than DEFENDER firms. Using evidence from the US, Higgins et al. (2015) find evidence to support the above assertion. The authors further document that PROSPECTOR firms also locate their operations in tax haven countries. Using evidence from China, Fan and Chen (2023) also support the assertion that innovation-oriented firms are more likely to engage in aggressive tax avoidance. They also find evidence to suggest that innovative firms with political connections are less tax aggressive compared to those without political connections due to the potential benefits received by the politically connected firms such as special resources and ability to access low-cost-capital. Using evidence from South Korea, Suh and Park (2022) find that PROSPECTOR firms are more likely to be trusted taxpayers<sup>5</sup> than DEFENDER firms.

Taken together prior research on the relationship between business strategy and financial reporting quality do not provide conclusive evidence. While some studies support the proprietary cost of information revelation and increased information asymmetry (Bentley et al., 2013; Habib & Hasan, 2020) others find evidence to support that innovation-oriented PROSPECTOR firms are likely to produce voluntary disclosure to reduce information asymmetry (Bentley-Goode et al., 2019). We also can conclude that PROSPECTOR firms' heightened uncertainty, high risk and complexity of operations make it harder for the auditors to make an accurate judgement on firm's going concern status and internal control environment. Strategic orientation also affects firm's tax planning strategies.

## 4.2 | Business strategy and finance outcomes

### 4.2.1 | Business strategy, dividend policy and cash holdings

Combining the information asymmetry and rent extraction perspective, Akindayomi and Amin (2022) argue that firms' strategy orientation affects firm's dividend policy. As discussed above, PROSPECTORS suffer from information asymmetry which allow managers of PROSPECTOR firms to extract rent at the expense of minority shareholders as manifested in lower dividend payouts. The authors further document that increased cash flow volatility and low-quality accounting information of PROSPECTOR firms are the channels through which the negative association between business strategy and dividend payout manifests itself. Based on the risk and uncertainty aspects of PROSPECTORS, Cao, Chen, Harakeh, and Lee (2022) and Houqe et al. (2023) also provide evidence to support lack of dividend payments by PROSPECTORS. The authors also argue that PROSPECTOR firms require more cash for their innovation and new market developments, which they try to secure by reducing dividend payments. In addition, Cao, Chen, Harakeh, and Lee (2022) and Cao, Chen, and Lee (2022) find that investment opportunities and firm performance moderate the impact of strategy on

<sup>5</sup>Trusted taxpayer system is specific to South Korea where the requirements and characteristics of the trusted taxpayer system vary depending on the geographical area in South Korea. The Korean Customs Service and the Ministry of Strategy and Finance in South Korea deliberates the selection of trusted taxpayers based on the results of tax investigations conducted by the National Tax Service or recommendations from the National Tax Service or others (Suh & Park, 2022).

dividend payment.<sup>6</sup> Drawing insights from organisational theory and information asymmetry, Magerakis and Tzelepis (2020) argue and find evidence to support that PROSPECTOR firms hold more cash than their DEFENDER counterparts. The above study also examines the implications of cash holdings and find that DEFENDER firms' cash holding have a higher firm value than PROSPECTORS. It can be argued that the investors perceive that PROSPECTOR firm managers hold cash for opportunistic purposes. Houqe et al. (2023) also examine the impact of business strategy on cash holding and substantiate Magerakis and Tzelepis (2020) findings.

#### 4.2.2 | Business strategy and investment efficiency

Navissi et al. (2017) find evidence to suggest that PROSPECTOR firms over-invest while efficiency-oriented DEFENDER firms under-invest because managers of DEFENDER firms encounter less managerial discretion (Thomas & Ramaswamy, 1996) and more stringent monitoring (Bentley et al., 2013). Navissi et al. (2017) further find that PROSPECTOR firms' stock-based options exacerbate sub-optimal investments because PROSPECTOR firm managers have incentives to maximise stock return volatility (Rajagopalan, 1997). Navissi et al. (2017) focus on capital investment efficiency whereas labour investment efficiency is also critically important since labour is an important factor of production which is essential for economic growth (Pinnuck & Lillis, 2007). Habib and Hasan (2021) examine whether business strategy is associated with labour investment efficiency. Using a large sample from the US, they find that PROSPECTOR firms pursue inefficient labour investments as such firms are subject to more business uncertainties stemming from greater difficulties in accurately predicting labour demand by prospector-type firms. Drawing insights from wage efficiency hypothesis, Sheng et al. (2019) argue that productivity-focused DEFENDER firms pay higher wages to their employees to increase efficiency. Using evidence from China, the authors find that DEFENDER firms pay higher wages than their PROSPECTOR counterparts. State owned enterprises (SOEs) in China receive funds from the state to boost investments and the executives of the SOEs are rewarded for higher investments (Lin et al., 1998). Sheng et al. (2019) find that PROSPECTOR firms' low wages are more pronounced for SOEs. Miles and Snow (1978) suggest that business strategy determine firm level capital investment decisions. Innovation-oriented PROSPECTOR firms are more likely to invest in high growth and high-risk projects (Rajagopalan, 1997).

#### 4.2.3 | Business strategy and financing decisions

Prior research investigates whether business strategy affects the provision of trade credit (the supply side argument for trade credit). Cao, Chen, and Lee (2022) find that PROSPECTOR firms provide more credit to their customers compared to their DEFENDER counterparts. This is consistent with trade credit being 'used by prospectors as a marketing tool to stimulate demand and serve as an implicit guarantee of product quality given their differentiated products that do not have readily available substitutes and are less known by customers firms...' (Cao, Chen, & Lee, 2022, p. 503). The authors further examine whether an exogenous shock to talent supply affect the association between business strategy and the provision of

<sup>6</sup>When several innovative investment opportunities are available, PROSPECTOR firms are expected to pursue new investments while DEFENDER firms are less likely to pursue them due to high risk. Similarly, when firms perform well and generate significant profits, PROSPECTORS use this surplus cash to exploit new investment opportunities while DEFENDERS may use these excess cash to pay dividends.

trade credit. By exploiting the staggered adoption of the Inevitable Disclosure Doctrine (IDD)<sup>7</sup> by the US state courts as an exogenous shock, the authors document that PROSPECTOR firms headquartered in states that adopted the IDD reduce the provision of trade credit. Furthermore, using variation in credit supply at the state level due to branch deregulations across US states as another exogenous shock, this study finds that DEFENDER firms those who follow efficiency-oriented strategy offer more trade credit when bank credit is cheaper and more accessible.

#### 4.2.4 | Business strategy and the stock price informativeness

A substantial body of empirical literature has investigated the determinants of stock price synchronicity, predominantly from an ‘information transparency’ perspective (Morck et al., 2013). However, the role of business strategy in determining price informativeness has remained unexplored. Zhang (2021) argues that innovation-oriented PROSPECTOR firms have low stock price informativeness (i.e., high synchronicity) due to their bad news hoarding (Habib & Hasan, 2017) and financial reporting irregularities (Bentley et al., 2013), which allows less firm-specific information transmission to the market. Consequently, there is more market and industry specific information incorporated into stock prices of PROSPECTOR firms than DEFENDER firms resulting in higher synchronicity for PROSPECTOR firms than DEFENDER firms.

The association between business strategy and stock price crash risk (SPCR) also received research attention which is not surprising given the voluminous research on the determinants of SPCR (Habib et al., 2018). The impact of business strategy on SPCR can be explained using information asymmetry and bad news hoarding arguments. The SPCR literature suggests that price crash occurs when managers engage in bad news hoarding behaviour (Jin & Myers, 2006). PROSPECTOR firms suffer from information asymmetry which enable managers to hoard bad news, resulting in higher SPCR than their DEFENDER firm counterparts. Habib and Hasan (2017) find support for this assertion for a sample of US firms and also find that overvalued equity mediates the positive association between business strategy and the SPCR. The positive association between business strategy and the SPCR is further confirmed by Xu et al. (2023) for an international sample: the association that is more pronounced when information opacity and CEO overconfidence is high. In addition, Xu et al. (2023) find evidence to suggest that cultural dimensions such as power distance and individualism have a significant impact on the association between strategy and the SPCR.

Prior research also investigates the association between business strategy and insider trading profitability. Corporate insiders use inside information to gain personal benefits (Aboody & Lev, 2000). Insider managers of PROSPECTOR firms, which are plagued with information asymmetry, are more likely to earn profits from insider trading than DEFENDER firm managers. Using evidence from Chinese A-share listed firms, Chen and Keung (2019) find evidence to support this assertion. The authors further document that this main effect is driven by insider sales and male insider trades. Further analysis of the study find that higher trading profits are stronger in non-special treatment firms and family-controlled firms.

Research on the consequences of business strategy using Bentley et al. (2013) measure on various finance outcomes provides some interesting insights. General findings suggest that firms following prospector strategies pay less dividends, hold more cash, make less efficient

<sup>7</sup>IDD is a state level regulation which enables employers to enter into contracts with their employees forbidding them from working in competitor firms for a certain period of time (Al-Hadi & Habib, 2023).

investments, are more prone to future stock price crash risk, conduct more profitable insider trading activities, and receive less trade credit.

### 4.3 | Business strategy and corporate governance outcomes

#### 4.3.1 | Business strategy and executive compensation

Strategic orientation is one factor that determines the executive compensation (Chen & Jermias, 2014). PROSPECTORS attempt to survive in an environment where there is uncertainty; thus, their top managers may tend to undertake risky innovation in an attempt to enter new markets (Miles & Snow, 1978, 2003). Given that top managers have more bargaining power to determine the compensation structure (Bebchuk & Fried, 2003; Faleye et al., 2013), PROSPECTOR top managers are able to negotiate for better pay based on risks associated with innovative activities. In this context, PROSPECTORS are more likely to have a higher pay gap. This could result in an agency problem, where the interest of the managers and shareholders are misaligned (Jensen & Meckling, 1976).

In support of this claim, Abernethy et al. (2022) find that firms with PROSPECTOR strategies have a larger CEO–Vice President (VP) pay gap in equity compensation. The authors argue that it is important for PROSPECTOR firms to make timely decisions with a long-term focus. Thus, the PROSPECTOR firm assigns greater authority to the CEO in strategic matters. The authority structure and the CEO's ability give rise to a pay differential between the CEO and the VP. Sun et al. (2021) also provide evidence from China that business strategy is related to firm-level tournament incentives: the latter is measured via the pay gap between the CEO and other executives. The authors find that firms pursuing the PROSPECTOR strategy have larger tournament sizes than defender-type firms. In PROSPECTOR firms, where highly talented executives outperform their peers in the industry, tournament incentives promote competition among executives. The winner is awarded a high remuneration and a position on the corporate ladder based on relative rank. Kong et al. (2022), too, find that PROSPECTORS have a higher within-firm pay gap; but the CSR-related regulations improve PROSPECTORS' employee relations and thus significantly reduce the pay gap.

Abernethy et al. (2019) examine the role of strategy on the selection of CEOs and whether these appointments add value to the firms. This study argues that PROSPECTOR firms seek new products and markets. Therefore, they are more likely to choose CEOs with high social capital<sup>8</sup> because these CEOs can use their existing network to access resources and to mitigate uncertainty. The study also finds that those PROSPECTOR firms which hire CEOs with social capital demonstrate better firm performance and this effect is stronger for the firms with good corporate governance.

#### 4.3.2 | Business strategy and CSR

We also consider firm's action towards environmental sustainability as falling within corporate governance landscape. Stakeholders expect firms to take responsibility to show their commitment to a sustainable approach, but investments in sustainability do not always lead to financial success (Figge et al., 2002). This uncertainty makes it difficult for firms to decide

<sup>8</sup>Social capital in other words, relational capita can be defined as the network of relationships accumulated by a CEO's connections through past and present employment, memberships in social clubs, and their alumni memberships (Engelberg et al., 2012).

whether to invest in sustainability initiatives. Ultimately, the decision is influenced by the firm's strategic orientation. Reflecting the relationship between a firm's strategic orientation and sustainability, Hart (1997, p. 76) states, 'companies will be challenged to develop clean technologies and to implement strategies that drastically reduce the environmental burden in the developing world while simultaneously increasing its wealth and standard of living'. The literature shows two avenues of research on the relationship between strategic choice and firms' engagement in CSR initiatives. One stream of research suggests that PROSPECTOR firms, which have more tolerance for risk and uncertainty, may see the investment in CSR as an opportunity to reduce the information asymmetry because informed investors react positively to such initiatives.

Providing evidence from China, Kong et al. (2020) find that PROSPECTOR firms take more pro-environment activities than DEFENDER firms. This is more pronounced when PROSPECTOR firms are faced with more severe financial constraints because such investments help gain recognition, bank loans, and tax incentives, which can alleviate financial difficulties. Combining a resource-based view and organisational theory, Yuan et al. (2020) document that PROSPECTOR firms are better CSR performers than DEFENDERS because the innovative PROSPECTOR firms, with a long-term horizon and more tolerance for uncertainty and risk can use CSR as a strategic resource to achieve competitive advantages. Drawing from a resource-based view and information asymmetry, Ho et al. (2022) find that when PROSPECTOR firms engage particularly in external stakeholder-related CSR initiatives, it increases their competitive advantage and financial performance. Magerakis and Habib (2021) provide evidence that PROSPECTOR firms are environmentally more efficient than DEFENDERS. As the authors argue, PROSPECTOR firms shift their policies towards green practices while engaging in technological advancements and new product development. The embracing of green practices leads PROSPECTOR firms to release fewer toxic chemicals into the environment than DEFENDERS.

Contrasting evidence suggesting that PROSPECTORS engage less in CSR activities also exists. Maniora (2018) finds that PROSPECTOR firms are more likely to mismanage sustainability issues than DEFENDER firms. As the author argues, sustainability management is not the main concern of PROSPECTOR firms, given their focus on rapid growth. Also, PROSPECTOR firms experience extreme performance and financing issues and thus may not spend extensively on sustainability issues. Such behaviour of PROSPECTORS may lead to intentional and unintentional mismanagement of sustainability. Similar to Maniora (2018), Liu and Kong (2021) argue that PROSPECTORS have opportunities to take less sustainable development initiatives, for example, green innovations, given their tolerance to risk and uncertainty and find supportive evidence. Especially when there is a political connection, PROSPECTORS may continue unethical business behaviours, such as greenwashing, which ultimately undermine the credibility of green initiatives and harm the environment. PROSPECTORS enjoy better profitability due to fewer green innovations. However, as the authors find, PROSPECTORS unwillingly engage in some green innovations due to pressure from environmental regulations. Thus, PROSPECTORS seem environmentally friendly but less likely to protect the environment.

In brief, previous studies on the relationship between firm strategy and their environmental/social initiatives do not provide conclusive evidence. Some research shows that PROSPECTOR firms tend to be more socially and environmentally responsible than DEFENDERS (Ho et al., 2022; Kong et al., 2020; Magerakis & Habib, 2021; Yuan et al., 2020). Still, some evidence exists that the benefits of such environmental/social initiatives may not always be realised (Liu & Kong, 2021).

## 4.4 | Consequences of strategic deviation

Strategic deviation refers to the degree to which a firm strategy differs from its industry norms (Barney, 1991; Finkelstein & Hambrick, 1990). The business strategy encompasses the resource allocation pattern at the firm level, whereas strategic deviation depicts the resource allocation pattern compared to the industry peers (Finkelstein & Hambrick, 1990). Thus, compared to business strategy, strategy deviation provides valuable insight into a firm's competitiveness and allows it to benchmark against its industry peers.

Previous studies discuss strategic deviation using two theoretical perspectives: agency theory and information asymmetry theory. Managers in deviant firms have a greater level of discretion, which leads managers to act opportunistically to maximise their private interests (Easterbrook, 1984; Jensen & Meckling, 1976). Thus, when a firm decides to strategically deviate from industry norms, it makes it more difficult for stakeholders to uncover managers' opportunistic behaviour (Carpenter, 2000; Rajagopalan, 1997), which results in an increase in information cost, including information asymmetry and an opaque information environment. In support with these theoretical perspectives, Dong et al. (2020) find that firms with deviant strategies hold more cash and market discounts cash holdings of deviant firms. The authors also find that such a relationship between strategy deviation and cash holding is more pronounced in firms with high agency-cost.

Provaty et al. (2022) document a positive association between strategic deviation and short-term debt. As the authors argue, strategically deviant firms are characterised by information asymmetry and agency problems, which limit access to long-term debt. Based on the neo-institutional perspective, Tang et al. (2011) find that dominant CEOs tend to deviate from industry norms and thus earn extreme performances, either a big win or big losses. However, powerful boards can help mitigate the negative effects of dominant CEOs by tempering their tendency towards extreme performance. The findings suggest that the concept of power balance should be considered in a broader context in the case of deviant firms. Ranasinghe and Habib (2023) find that deviant firms are characterised with sub-optimal investments. This finding is stronger for firms with weaker monitoring, for firms operating in high product market competition, and having a low-quality information environment.

Damle and Sinha (2022) find that deviant firms neither receive trade credit from suppliers nor provide trade credit to customers. As the authors argue, deviant firms are less likely to receive trade credit because it is difficult for suppliers to forecast deviant firms' extreme performance (Tang et al., 2011), given the absence of private information advantage and lower accounting quality. Also, deviant firms are less likely to provide trade credit to customers as they receive lower trade credit from their suppliers. Whether deviant firms, then rely on bank loans for financing their positive NPV projects remain unclear because banks, too, will consider deviant firms risky and will only grant loans at a high cost and with stringent loan conditions. Hasan and Chen (2023) find that deviant firms experience higher idiosyncratic return volatility (IRV). As the authors argue, deviant firms experience greater uncertainty in future performance and cash flows due to information asymmetry and extreme performance. Such uncertainties of deviant firms increase IRV. The authors further find that the relationship between strategy deviation and IRV is weaker for firms with better corporate governance and a transparent information environment.

In contrast, some studies we reviewed provide evidence opposing agency conflict and information asymmetry caused by strategic deviation. Dong et al. (2021) find that strategically deviant firms hire high-quality auditors because such auditors reduce aggregated information asymmetry and agency conflicts. Ye et al. (2021) find a negative relationship between strategic deviation and stock return synchronicity. On the one hand, deviant firm managers increase voluntary disclosures such as regular managerial forecasts. On the other hand, they are characterised by information asymmetry, making it more profitable for sophisticated investors to

gather information about them. Thus, sophisticated investors and disclosures help impound more firm-specific information into prices, which reduces stock price return synchronicity. Interestingly, using evidence from an exogenous shock, COVID-19, Kong et al. (2021) find that deviant firms are more resilient to external shocks. More specifically, the authors find a positive association between strategic deviation and cumulative abnormal returns (i.e., 5 days before and after the outbreak of the pandemic) as a proxy for enterprise resilience. This finding suggests that being different from the industry norms provides protection from external shocks, which is reflected in the stock prices.

In sum, some studies find evidence that strategic deviation exacerbates agency conflict and information asymmetry and, hence, is detrimental for shareholder wealth (Dong et al., 2020; Tang et al., 2011). However, other studies provide evidence that deviant firms hire high-quality auditors, and reduce stock price synchronicity (Dong et al., 2021; Ye et al., 2021). Inconclusive evidence about strategic deviation and firm and capital market outcomes, therefore, opens up important issue for future research.

Table 1 includes the surveyed papers in this section, summarising the key findings and the economic significance of the reported results where relevant.

## 5 | FUTURE RESEARCH OPPORTUNITIES

Based on this survey on the consequences of strategy typology and strategic deviation we offer some suggestions for future research below. It is evident that previous studies mainly examined the CEO/executive pay gap in relation to business strategy (refer to subsection 4.4). Limited research has focused on the relationship between strategic orientation and other corporate governance mechanisms. For example, a new line of research on corporate governance in accounting and finance looks at board faultlines<sup>9</sup> and its consequences. Future research could look into whether strategic orientation is related to the formation of different board faultlines and whether this brings positive or negative consequences for firms.

Future research could use Bentley et al.'s (2013) proxy for business strategy typology to examine the relationship between strategic orientation and management controls of firms. Langfield-Smith (2007) reviews and critiques quantitative research focusing on the relation between management control systems (MCS) and strategy. This stream of research relies mainly on survey methodology, and to some extent, interviews and archival data. This strand of research mainly focuses on the fit between the design of MCS including cost controls, budgetary controls, performance evaluation, reward systems and strategy (Chenhall, 1997; Govindarajan & Gupta, 1985; Ittner et al., 1997). With the advent of new strategic management control techniques like activity-based costing/management, life cycle costing, balanced scorecard, and customer profitability analysis, among other techniques, future research can use Bentley et al.'s (2013) strategy measure to examine whether firms' strategic orientation or strategic deviation is related to the adoption of these management control techniques and whether such adoption has value implications for firms.

This review identifies that there is a significant gap in the research that investigate the interplay between financial intermediaries such as analysts, institutional owners and short sellers and business strategies. The importance of private information acquisition relating to analyst forecasts and stock recommendations is well addressed in the literature (Barker, 1998; Chen et al., 2018; Jiang et al., 2019). Jiang et al. (2019), for example, report that analysts' private information acquisition is negatively associated with stock price synchronicity in China. The extent to which such private information acquisition is motivated by the business strategies pursued

<sup>9</sup>Board faultline can be defined as a hypothetical dividing line, or faultline, or crack, which is formed based on multiple director diversity attributes and results in splitting the board into subgroups (Van Peteghem et al., 2018).

**TABLE 1** Consequences of business strategy and strategic deviation for organisational outcomes.

Authors	Research question	Sample	Key results	Theme
Tang et al. (2011)	Strategy deviation and firm performance	US: 51 firms between 1997 and 2003	Firms with dominant CEOs tend to deviate from the industry norms and, thus, earns extreme performance – either big wins or big losses. However, powerful boards improve the likelihood of dominant CEOs extremeness	Strategy deviation
Bentley et al. (2013)	Business strategy, financial reporting irregularities, and audit effort	US: 14,409 firm year observations from 1998 to 2009	PROSPECTOR firms are more likely to have accounting irregularities than DEFENDER firms. The odds of experiencing an AAER, lawsuit, or restatement are 2.32, 1.10, and 0.47 times higher, respectively, for firms with a STRATEGY score at the cutoff for PROSPECTORS relative to firms with a STRATEGY score at the cutoff for DEFENDERS. Audit efforts (reflected in audit fees) is higher for the PROSPECTOR firms than that for DEFENDER firms. Firms at the cutoff for PROSPECTORS will pay audit fees approximately 22% higher than firms at the cutoff for DEFENDERS	Strategy, financial reporting, and auditing outcomes
Higgins et al. (2015)	Business strategy and tax planning strategies	US: 29,324 firm-years between 1993 and 2010	PROSPECTORS engage in more tax avoidance in a more risky, uncertain ways. DEFENDERS engage in less tax avoidance, due to the costs and risk involved	Strategy and finance outcomes
Bentley-Goode et al. (2017)	Business strategy, internal control over financial reporting, and audit quality	US: 19,350 firm-year observations from 2004 to 2014	PROSPECTOR firms are associated with higher likelihoods of reporting material weakness and lower likelihoods of remediation. Auditors have greater difficulty in identifying and reporting material weaknesses for PROSPECTOR firms Internal control strength partially mediates the positive association between strategy and restatements	Strategy, financial reporting, and auditing outcomes
Chen et al. (2017)	Business strategy and auditor reporting	US: 4322 firm-year observations from 2000 to 2013	PROSPECTOR firm is more likely to receive a going concern opinion than a DEFENDER firm. Auditors are more prone to Type II errors (false positive) when auditing PROSPECTOR clients. Business strategy does not significantly affect auditors' Type I error (false positive) rates	Strategy and audit outcomes

(Continues)

TABLE 1 (Continued)

Authors	Research question	Sample	Key results	Theme
Habib and Hasan (2017)	The effect of firm-level business strategy on future stock price crash risk	US: 80,090 firm-year observations from 1974 to 2012	PROSPECTOR firms are more likely to encounter future stock price crash risk than DEFENDER firms. A one-standard deviation increase in strategy score leads to 1.74% and 2.50% increase in crash risk for the two crash risk proxies used in the study. Overvalued equity of the PROSPECTOR firms mediates the association between business strategy and stock price crash risk	Strategy and finance outcomes
Navissi et al. (2017)	Business strategy, investment efficiency and executive compensation	US: 36,007 firm-years from 2000 to 2009	PROSPECTOR firms over invest and DEFENDER firms under invest. These investment inefficiencies are associated with lower future performance. In the PROSPECTOR firms, the over investment is exacerbated in the presence of more stock-based compensation. In the DEFENDER firm context, the under investment is exacerbated in the presence of cash-based compensation incentives	Strategy and finance outcomes
Lim et al. (2018)	Business strategy and annual report readability	US: 24,817 firm-years from 1989 to 2011	Firms pursuing an innovation-oriented PROSPECTOR strategy have less readable 10-Ks relative to firms pursuing an efficiency-oriented DEFENDER strategy. PROSPECTORS display more negative and uncertainty tones while DEFENDERS exhibit more litigious tone in their 10-Ks	Strategy and financial reporting outcomes
Maniara (2018)	Business strategy and mismanagement of sustainability	US: 4596 firm year observations between 1991 and 2014	PROSPECTOR firms are more likely to mismanage sustainability issues compared to DEFENDER firms	Strategy and sustainability
Abernethy et al. (2019)	Business strategy, CEO selection and firm performance	US: 1150 observations from 2000 to 2013	Prospector-type firms have greater incentives to appoint a CEO with high social capital. One-standard deviation increase in PROSPECTOR is associated with approximately equivalent to 11.8% of the standard deviation in CEOTIES. Firms that are pursuing a prospector-type strategy and appoint CEOs with high social capital perform better than those that do not match the choice of CEO with the strategy	Strategy and governance

TABLE 1 (Continued)

Authors	Research question	Sample	Key results	Theme
Bentley-Goodle et al. (2019)	Business strategy and firm's information environment	US: 15,005 firm year observations from 1997 to 2009	PROSPECTORS issue more management earnings forecasts and press releases than DEFENDERS. The rate of issuing management guidance increases by a factor of 12.38 at the cutoff for PROSPECTORS and DEFENDERS. PROSPECTORS receive greater analyst (but not press) coverage than DEFENDERS. PROSPECTORS exhibit smaller bid-ask spreads, lower analyst forecast dispersion, and higher analyst forecast accuracy than DEFENDERS. PROSPECTORS have an average daily bid-ask spread that is about 10.8% lower than DEFENDERS	Strategy, financial reporting and information environment
Chen and Keung (2019)	Business strategy and insider trading profitability	China: 4369 A-shares listed on the Shanghai and Shenzhen Stock Exchanges during the period 2012–2015	Insiders at PROSPECTOR firms earn higher trading profits than insiders at DEFENDER firms. Higher trading profits are stronger in non-special treatment firms and family-controlled firms. Finally, higher insider trading profitability is mainly driven by insider sales and male insider trades	Strategy and finance outcomes
Hsieh et al. (2019)	Business strategy and conservatism	US: 62,194 firm-years from 1988 to 2012	PROSPECTOR firms, which have more ambiguity, results in more conservatism when compared to DEFENDER firms	Strategy and financial reporting outcomes
Sheng et al. (2019)	Business strategy on employee wage premium	China: 13,888 firm-years from 2007 to 2017	PROSPECTORS exhibit lower wages than DEFENDERS. The negative relation between business strategy and wage premium are more pronounced in state-owned firms. Government intervention attenuates the negative association between strategy and wage premium	Strategy and finance outcomes
Dong et al. (2020)	Strategic deviance and corporate cash holdings	US: 25, 894 firm-year observations between 1992 and 2016	Strategically deviant firms hold more cash via paying lower dividends and tax avoidance. The market value of the cash decreases with strategy deviance. A one-standard-deviation increase in strategic deviance increases the ratio of cash holdings over total assets by 0.7%, approximately 5% of the sample's average cash holdings)	Strategy deviation

(Continues)

TABLE 1 (Continued)

Authors	Research question	Sample	Key results	Theme
Habib and Hasan (2020)	Business strategy and annual report readability	US: 38,014 firm-year observations from 1994 to 2013	Firms with prospector-type business strategies produce less readable narratives in the annual reports, while those with defender-type business strategies produce more readable narratives. The BOG Index is 4.3% higher for companies at the PROSPECTOR cut-off than for companies at the DEFENDER cut-off, <i>ceteris paribus</i>	Strategy and financial reporting outcomes
Kong et al. (2020)	Business strategy and environmental protection	China: 4753 firm-year observations between 2007 and 2017	Firms that follow PROSPECTOR strategies make more environmental protection efforts. PROSPECTORS exhibit more environmental protection behaviours than DEFENDERS when the degree of financial constraints or earnings management is high and operates in SOEs and heavy-polluting industries. Further, PROSPECTORS are more environmentally friendly when firms are located in regions with strict environmental regulations	Strategy and sustainability
Magerakis and Tzelepis (2020)	The impact of business strategy on cash holding	US: 254,011 firm-year observations between 1970 and 2016	PROSPECTORS are more likely to hold higher cash levels than DEFENDERS. The market value of cash increases significantly only for the firms that pursue a DEFENDER strategy	Strategy and finance outcomes
Yuan et al. (2020)	Business strategy and CSR performance	US: 13,999 firm-year observations between 2004 and 2012	PROSPECTORS are associated with better CSR performance than DEFENDERS. When business strategy changes from a DEFENDER to a PROSPECTOR, CSR performance increases by 1.47 times compared to the mean CSR score	Strategy and sustainability
Dalwai and Salehi (2021)	Impact of business strategy on firm performance and Bankruptcy	Oman: 380 firm-year observations for 2015–2019	DEFENDER type have a better return on equity (ROE). PROSPECTOR firms are more likely to go bankrupt than the DEFENDERS	Strategy and firm performance
Dong et al. (2021)	Strategic deviation and high-quality external auditors	China: 27,123 firm-year observations between 2003 and 2018	Strategically deviant firms hire high-quality auditors due to agency conflicts	Strategy deviation

TABLE 1 (Continued)

Authors	Research question	Sample	Key results	Theme
Habib and Hasan (2021)	Business strategy and labour investment efficiency	US: 92,148 firm-year observations from 1980 to 2015	Firms undertaking a prospector-type business strategy are associated with inefficient labour investment, due to uncertainty of these firms. The authors further document that inefficient labour investment by PROSPECTORS leads to relatively low profitability in subsequent periods. One standard deviation increase in strategy score is associated with a 0.75% increase in abnormal net hiring	Strategy and finance outcomes
Kong et al. (2021)	Strategy deviation and enterprise resilience	China: 3490 firms from March 13, 2019 to February 12, 2020	Firms that deviate from industry norms are more likely to have higher resilience, measured as cumulative abnormal returns (CAR 5 days before and after the pandemic) from external shocks, such as COVID-19. However, the positive impact of strategy deviation on CAR is less pronounced when the diversification is higher due to resource allocation issues	Strategy deviation
Liu and Kong (2021)	Business strategy and green innovations	China: 13, 811 firm-year observations between 2007 and 2016	PROSPECTORS engage in less green innovation than DEFENDERS Political connection promotes, but environmental regulation weakens the negative relationship between business strategy and green innovation. The low (high) green innovation of PROSPECTORS (DEFENDERS) enhances (damage) profitability	Strategy and sustainability
Magerakis and Habib (2021)	Business strategy and environmental inefficiency	US: 10, 923 firm-year observations between 1990 and 2014	Prospector-type firms reduce the toxic chemicals released to the environment compared to defender-type strategy firms. A one-standard deviation increases in business strategy decreases environment inefficiency by 3.63% relatively to its mean value	Strategy and sustainability
Sun et al. (2021)	Business strategy and firm-level tournament incentives	China: 5705 firm-year observations between 2011 and 2017	Firms pursuing PROSPECTOR strategy have larger tournament sizes compared with defender-type firms. State ownership and foreign institutional investors moderate the association between business strategy and tournament incentives. A one-standard deviation increase in strategy increases tournament incentives by 11.37%	Strategy and pay gap.

(Continues)

TABLE 1 (Continued)

Authors	Research question	Sample	Key results	Theme
Ye et al. (2021)	Strategic deviation and stock return synchronicity	US: 56,390 firm-year observations between 1982 and 2014	The strategic deviation is negatively associated with stock return synchronicity. Deviant firms issue more frequent managerial forecasts and have a higher level of block ownership which partly mediate the association between strategic deviation and stock return synchronicity	Strategy deviation
Zhang (2021)	The effect of strategy on stock price informativeness and analyst coverage efficiency	US: 60,211 firm-year observation between 1981 and 2016	Stock prices of PROSPECTORS are less informative than those of DEFENDERS. Higher analyst coverage efficiency of PROSPECTORS than DEFENDERS	Strategy and finance outcomes
Abernethy et al. (2022)	Business strategy and pay differentials between the chief executive (CEO) officer and vice president (VP)	US: 11,725 firm-year observations between 1998 and 2016	CEOs' relative authority and ability in strategic decision-making led PROSPECTORS to have a larger CEO–VP difference in equity compensation	Strategy and pay gap.
Akindayomi and Amin (2022)	Business strategies and pay-out decisions	US: 43,022 firm-year observations between 1992 and 2018	Firms following PROSPECTOR strategies are less likely to pay dividends than the firms following DEFENDER strategies. A one-point increase in the composite business strategy variable reduces a firm's propensity to pay dividends by about 10%	Strategy and finance outcomes
Cao, Chen, Harakeh, and Lee (2022)	Business strategy and dividends	US: 90,241 firm-year observations between 1962 and 2019	Firms following a PROSPECTOR (DEFENDER) business strategy pay lower (higher) dividends. Influence of business strategy on dividend pay-out policy is heterogeneous depending on investment opportunities and performance	Strategy and finance outcomes
Cao, Chen, and Lee (2022)	Business strategy and trade credit	US: 134,094 firm-year observations from 1962 to 2019	PROSPECTORS offer significantly more trade credit than DEFENDERS. PROSPECTORS reduce the provision of trade credit following the exogenous reduction of talent supply. DEFENDERS increase trade credit following the increase in bank credit supply. PROSPECTORS increasing trade credit provisions enjoy better performance. PROSPECTORS also receive significantly more trade credit from their suppliers	Strategy and finance outcomes

TABLE 1 (Continued)

Authors	Research question	Sample	Key results	Theme
Chen et al. (2022)	Business strategy, financial reporting violations, and audit pricing	China: 11,642 firm-year observations from 2013 to 2018	PROSPECTORS are associated with more financial reporting violations and higher audit fees than DEFENDERS. The odds of experiencing a financial reporting violation are 0.26 times higher for PROSPECTORS than DEFENDERS. PROSPECTORS pay approximately 8.1% higher audit fees than DEFENDERS	Strategy, financial reporting and auditing outcomes
Damle and Sinha (2022)	Strategic deviation and trade credit	Global sample: firm year observation between 1996 and 2020	Strategic deviance reduces demand and supply of trade credit. A one standard-deviation increase in strategic deviance results a 1.34% decrease in the demand for trade credit. Further, a one-standard deviation increase in strategic deviance leads to a 2.26% reduction in the supply of trade credit	Strategy deviation
Ho et al. (2022)	Business strategy, CSR and company performance	US: 10,466 firm-year observations between 2003 and 2016	A positive relationship between external (internal) CSR and financial performance for PROSPECTOR (DEFENDER) companies. A one standard deviation increases in PROSPECTORS' (DEFENDERS) external (internal) CSR from its mean value increases return on assets by 0.256%	Strategy and sustainability
Kong et al. (2022)	Business strategy and the intra-firm pay gap between top managers and low-level employees	China: 14,246 firm-year observations between 2004 and 2017	PROSPECTORS exhibit a higher pay gap than DEFENDERS. CSR significantly lower the effect of business strategy on the within-firm pay gap in PROSPECTORS	Strategy and sustainability
Provaty et al. (2022)	Strategic deviation and debt maturity structure	US: 90,805 firm-year observations between 1981 and 2020	The strategic deviation is positively associated with short-term debt. A one-standard deviation increase in strategic deviation increases 2.88% (3.12%) short-term debt relative to mean (median level)	Strategy deviation
Weber and Müßig (2022)	Business strategy and risk disclosures	30 countries in the European Economic Area (EEA): 2344 from 2005 to 2017	DEFENDERS (PROSPECTORS) are less (more) likely to reveal risk information in their annual reports. PROSPECTORS are not more likely than DEFENDERS to cover the main risk topics extensively	Strategy and financial reporting outcomes

(Continues)

TABLE 1 (Continued)

Authors	Research question	Sample	Key results	Theme
Chin (2023)	Business strategy and financial opacity	Taiwan: 4685 observations from 2013 to 2018	DEFENDERS are likely to mitigate financial opacity through loss avoidance and exacerbate financial opacity through earnings aggressiveness, especially when they are faced with financial constraints and decreased production demand	Strategy and financial reporting
Fan and Chen (2023)	Business strategy and their tax aggressiveness in China	China: 10,830 firm-year observations for the period between 2011 and 2017	Firms adopting innovative business strategy are more tax aggressive overall. However, innovative firms with political connections are less tax aggressive compared to those without political connections	Strategy and finance outcomes
Hasan and Chen (2023)	Strategic deviation and idiosyncratic return Volatility (IRV)	US: 87,709 firm-year observations between 1992 and 2020	Strategically deviant firms are related to higher IRV. The relationship between strategy deviation and IRV is weaker for firms with transparent information environments and better corporate governance. An increase of one-standard deviation in a firm's strategic deviation results in a 5.74% increase in its IRV	Strategy deviation
Houque et al. (2023)	Business strategy, cash holding and dividend pay-out	US: 60,246 firm-years for the dividend model and 71,192 firm-years for the cash holding model from 1992 to 2017	PROSPECTORS (DEFENDERS) are likely to hold more (less) cash and pay less (more) dividends than other firms. PROSPECTORS pay dividends less frequently than do DEFENDERS. One standard deviation change in PROSPECTOR (DEFENDER) is related to 63.8% increase (15.9% decrease) of cash holding. One standard deviation increase in the strategy score of a PROSPECTOR is related to a 2.86% reduction in dividend payment	Strategy and finance outcomes
Ranasinghe and Habib (2023)	Strategic deviation and investment inefficiency	US: 56,133 firm year observation between 1987 and 2020	Deviant firms have sub-optimal investments. A one-standard-deviation increase in strategic deviation increases investments by 3.23% relative to mean investments. The relationship between strategic deviation and investment inefficiency is moderated by weaker monitoring, high product market competition and a low-quality information environment	Strategy deviation

TABLE 1 (Continued)

Authors	Research question	Sample	Key results	Theme
Suh and Park (2022)	Trusted taxpayers and business strategy	South Korea: 564 firm-year observations from 2009 to 2019	PROSPECTOR strategy firms are more likely to be selected as trusted taxpayers than DEFENDER strategy firms. The probability of selection as a trusted taxpayer increases by approximately 6.4% when the business strategy index increases by 1 unit	Strategy and tax planning
Xu et al. (2023)	Business strategy and future stock price crash risk	International: 65,774 firm-year observations from 1985 to 2017	Information asymmetry plagued PROSPECTOR firms are more likely to have stock price crash risk in the future than DEFENDERS. Information environment, CEO overconfidence and cultural aspects moderate the impact of strategy on stock price crash risk	Strategy and finance outcomes

Note: Papers are reported in reverse chronological order.

by firms, however, remains unexplored. Also, future research in the finance domain could explore whether and how the firm-level business strategy motivates short sellers to take short positions. Short sellers<sup>10</sup> perform two roles in the financial markets: financial intermediary and information spill over. There is lack of research that examines whether business strategy and strategic deviation determine short selling positions.

Strategy deviation offers a perspective on how a firm could allocate resources compared to industry peers (Finkelstein & Hambrick, 1990). Thus, strategy deviation provides insight into a firm's competitiveness compared to business strategy. However, strategy deviation is a fairly new research agenda in the accounting field. Over the period from 2013 to 2022, only a few studies were published examining how firms' decision to deviate from industry norms impacts accounting-related issues (see subsection 4.4 above). Thus, we propose the following research avenues to enrich our understanding of the relationship between strategy deviation and accounting-related issues.

First, previous strategy-deviation research has investigated areas such as debt financing, audit quality, stock return synchronicity, corporate cash holding, and performance. This leaves a vast array of areas unexplored in the lens of strategy deviation, including but not limited to capital structure, tax planning, labour investment efficiency, stock price crash, dividend policy, financial reporting, and corporate governance. Climate risk, carbon reporting and assurance is another important area that needs attention from future research. Researchers can examine whether strategy deviation has an impact on the climate reporting and assurance initiatives. Second, the studies we reviewed mainly examined the context of China and the US. Expanding the research on strategy deviation to context outside China and the US, for example, the Gulf Cooperation Council (GCC) would enable us to understand how strategy deviation works globally. Third, subsection 4.4 above highlights the dual role of agency motive in the strategy deviation. As found by some studies, deviant firms aggregate agency conflicts (Dong et al., 2020; Provaty et al., 2022) while others alleviate them (Dong et al., 2021; Ye et al., 2021). In this context, it is not clear whether the strategy deviance firms would have a severe agency conflict. Thus, based on agency and information asymmetry perspectives, more research on the consequences of strategy deviation in the accounting field is required. As this stream of research mainly infers the findings using agency theoretical framework, they assume that opportunistic managers are likely to move away from the industry norms. However, managers may have other incentives to deviate from industry practices. It may be worthwhile to engage in some qualitative inquiries to understand the underpinning motivation of managers to deviate from industry norms. Findings from these qualitative inquiries may provide insights on which avenue of research is more useful for regulators and practitioners.

A stream of research, mainly in the Management discipline, examine the determinants of business strategy choice using interviews and surveys (see Bednar et al., 2013; Haynes & Hillman, 2010, for example). We call for research to examine the determinants of managerial choice of business strategy using archival data in the accounting, finance and corporate governance. Furthermore, it is important to identify whether it is the strategy typology or the strategy deviation that provide more insightful implications. While the strategy typology provides the impact of strategy choice, strategy deviation provides the impact of being different from the industry. In moving forward in this stream of research, it is important to identify whether researchers need to engage in more strategy deviation or strategy typology research.

Accounting and finance research in the strategy domain can be further advanced by using alternative theoretical models to explain the implications of strategy. Future research may take a critical aspect of 'normative strategy' model into consideration. The strategy articles that we reviewed are grounded on the positivist research paradigm, in which researchers reach

<sup>10</sup>Short sellers make profits by borrowing stocks from brokers at a low cost and then sell high. When share prices drop later on, they buy back the securities and return them to the broker (Jiang et al., 2022).

conclusions based on scientific methods and emphasise rationality. Langfield-Smith (2007) argues that research that is informed by the positivist research paradigm assumes that strategy is an outcome of a rational choice. However, strategy is subject to interpretation and the espoused strategy that is formally presented may not be the true strategy that is implemented. As an extreme alternative to this rational model of strategy research, a normative model can be used to explain how cognitive processes limit rational procedures of strategy implementation (Langfield-Smith, 2007). The research that is grounded on the interpretivist research paradigm, case study research for example, has followed other alternative theoretical frameworks such as structuration theory, institutional theory and actor network theory. (This literature review does not focus on these studies). Other theoretical lens such as institutional theory, institutional logics and accountability models can be used to explain managerial role in implementing strategies with the intention of manipulating firm-level financial reporting, auditing and capital market outcomes.

## 6 | CONCLUSION

The main objective of this literature review is to summarise and highlight the advances in the research areas pertinent to business strategy. Although there is a plethora of research that examine business strategy and its implications using interviews and surveys in the management discipline, there is lack of research that explores the implications of business strategy and strategic deviation using a *quantified and replicable* measure of these constructs in accounting, finance and corporate governance discipline. We mainly focus on studies that used the Bentley et al. (2013) measure of strategy, which was developed based on Miles and Snow (1978, 2003) strategy typology. We follow this theme to select papers for the survey and highlight areas requiring additional research to further our understanding of the implications of the business strategy and strategic deviation.

The first part of the review recognises different strategy typologies that exist in the management domain. Then we discuss different theoretical stances that the existing research has used to explain the impact of strategy on accounting and finance outcomes. Section 3 summarises measurement used to proxy the Miles and Snow (1978) strategy typology and we alert the researchers on the validity and reliability of this measure. Section 4 analyses and points out the evolving nature of the business strategy literature, demonstrating a focus on the financial reporting, auditing, finance and corporate governance consequences as a response to business strategy.

Our critical review of the extant literature highlights a few limitations of the current research. First, there is lack of reliable and reflective measures to proxy business strategy. Our comprehensive search did not reveal any studies that investigate the determinants of business strategy using archival measures of strategy in the accounting and finance research. There are insufficient insights into the role of short sellers, analysts and institutional owners. Similarly, more empirical investigation is necessary to fully understand the role of board of directors in monitoring managerial behaviour conditional on business strategy. There is a wide scope in the CSR and carbon reporting and assurance domain that still need to be explored in the business strategy context. We also call for research in an international setting, because it potentially offers richer insights into the interplay between institutional factors and business strategy.

## ACKNOWLEDGEMENTS

We thank an anonymous reviewer for helpful comments. Open access publishing facilitated by Massey University, as part of the Wiley - Massey University agreement via the Council of Australian University Librarians.

## DATA AVAILABILITY STATEMENT

Data sharing not applicable – no new data generated.

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**How to cite this article:** Habib, A., Ranasinghe, D. & Perera, A. (2024) Business strategy and strategic deviation in accounting, finance, and corporate governance: A review of the empirical literature. *Accounting & Finance*, 64, 129–159. Available from: <https://doi.org/10.1111/acfi.13131>