# Multiproduct Firms, Export Product Scope, and Trade Liberalization: The Role of Managerial Efficiency

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## Summary

Many firms produce multiple products (called firm product scope) and export multiple products (called export product scope). They allocate resources among all products they produce in the most efficient way. Trade liberalization changes the cost and benefit of each product and in response, firms adjust their total product scope, its export product scope and the resources allocated among the new sets of products. Such an adjustment affects the efficiency within firms.

Existing theoretical studies have shown that firms with different productivity respond to trade liberalization differently. In particular, high-productivity firms expand their product scope while low-productivity firms reduce their product scope. Existing empirical studies provide mixed results, however. Our paper provides a theoretical and empirical analysis of the effects of unilateral tariff cuts on firms' export product scope. The most distinguishing feature of our analysis is to introduce a different aspect of firm heterogeneity, namely heterogeneity in managerial efficiency. In particular, our theoretical model explicitly incorporates cost of management (to capture managerial efficiency) in addition to the commonly used production cost (which captures production productivity). To sharpen our focus, we assume that firms are heterogeneous in terms of managerial efficiency but homogenous in terms of production productivity. The analysis predicts that the home country's tariff cut reduces all home firms' export product scope, whereas in response to the foreign country's tariff cut, a home firm's export product scope expands (shrinks) if the firm's management cost is low (high). These predictions are supported by our empirical analysis based on data on Chinese firms from 2000 to 2006. In our empirical study, we use a firm’s overhead expenses as a proxy of the firm’s management cost. Our empirical findings are robust to various specifications of the measurements.