BORN DIVERSIFIED: THE PERFORMANCE TRAJECTORY IMPLICATIONS OF PRODUCT DIVERSIFICATION AT THE TIME OF FIRM FOUNDING (INTERACTIVE PAPER)

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Principal Topic

The purpose of this paper is to explicate a novel demarcation among new ventures – their level of product market diversification at the time of firm founding. We draw upon the rich diversification and organizational imprinting literatures to hypothesize and test several relationships between the level of diversification at the time of a firm’s founding and its performance trajectory.

We argue that diversification at the founding of a firm – what we term being “Born Diversified” (BD) – imprints a broad entrepreneurial mindset in the managers of a new venture, which in turn is positively related to performance trajectories. This imprinted mindset increases the likelihood that managers will recognize cross-domain synergies and provides them with the confidence and knowledge to exploit such opportunities, long after the firm’s founding. Thus, while initial performance may be higher for ventures that do not disperse resources over several markets, increases in subsequent performance may be better gleaned from multi-market activity.

Method

Our sample is comprised of newly-founded firms in the Japanese computer services industry in the 1990s and early 2000s. Firm performance was represented by sales, while the diversification level was measured by the entropy of sales based on product markets. We track the trajectory of firm performance from the firm foundings. Our analysis follows random coefficient growth modeling.

Results and Implications

Our analysis indicates that a firm’s diversification level at the founding is positively related with the slope of firm performance. Specifically, we find that the performance trajectories of firms with low levels of initial diversification are flat, while those of firms with high levels of initial diversification are significantly positive and linear.

Our findings have important implications for theory and practice. As to theory, the study expands the boundaries of extant literature on organizational imprinting. Given BD’s qualitatively unique nature and its link to performance, the imprinting effect of initial diversification holds significant promise for future research. As to practice, entrepreneurs often struggle with the question of when to diversify; they often make such decisions simply based on the presence of opportunities. This study elucidates the consequences of diversification decisions and provides guidance as to the conditions under which initial diversification is most appropriate.

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