THE ROLE OF FIRM AND MANAGERIAL CHARACTERISTICS IN REDUCING THE SEVERITY OF ADVERSE EVENTS IN YOUNG FIRMS (SUMMARY)

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Recommended Citation
Available at: http://digitalknowledge.babson.edu/fer/vol27/iss10/7

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THE ROLE OF FIRM AND MANAGERIAL CHARACTERISTICS IN REDUCING
THE SEVERITY OF ADVERSE EVENTS IN YOUNG FIRMS

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Principal Topic

Studies in strategic management, focused on environmental volatility, have largely concentrated on the
influence of resource endowments (Kraatz & Zajac, 2001) and post-event actions (Tripsas & Gavetti,
2000) that create adaptation to change. This stream of research has largely been informed by the
investigation of established companies reacting to environmental changes. A gap in this research is its
applicability to young ventures and its concentration on organizational ex-post responses. There is little
that discusses the ex-ante characteristics of organizations that might affect event severity.

This paper contributes to this stream of literature by proposing and testing a model of organizational
characteristics that may moderate the value destroying effects of an adverse event in young ventures. In
particular, we propose that the composition of the top management team is critical to shareholder
interpretation of event severity. In so doing, we rely on insights from Signaling Theory (Spence, 1973) to
examine the linkage between Top Management Team (TMT) characteristics and shareholder
interpretation of event severity.

Method

The biotechnology industry presents a unique environment to examine the interaction of firm
characteristics, the occurrence of a firm level adverse event and shareholder interpretation of event
severity. Compustat, the Recombinant Capital Database and Lexus Nexus news reports were used to
collect data on all publicly traded biotechnology firms where the failure of a biotechnology drug in FDA
trial could be identified by date. The final dataset is made up of 84 clinical trial terminations. An event
study methodology was applied.

Results and Implications

Our research shows that the severity of shareholder interpretation of a firm level adverse event is
affected by the characteristics of both the firm and the TMT. Shareholders react more negatively to events
that occur to younger and smaller firms, with firm size demonstrating a greater affect than firm age on
negative shareholder interpretation. The average age of the TMT as a proxy for experience decreases
stakeholder interpretation of event severity. However, no interaction was identified between firm size and
age and TMT characteristics. Thus, given the occurrence of a firm level adverse event, the experience of
management is no more important to the small or young venture than it is to a larger older venture.

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