THE IMPACT OF SECTOR ROLE (SUMMARY)

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SUMMARY

THE IMPACT OF SECTOR ROLE

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Principal Topic

Modularity theory (Baldwin & Clark, 2000) identifies two archetypal sector roles – systems integrator and component supplier – and ascribes superior strategic opportunities to systems integrators. Our theory is that the benefits and risks associated with a firm’s sector role are contingent on environmental conditions. Where environmental conditions are favorable, the best opportunities are available to firms that operate closest to the favorable impact. Where environmental conditions are unfavorable, firms that operate furthest from the unfavorable impact are subject to the least risk. Because systems integrators produce final products that are used by individuals and organizations, they can be said to operate closer to the market than component suppliers. As a consequence, we expect systems integrators to benefit more than component suppliers from favorable market-based exogenous shocks, and to be a greater risk than component suppliers from unfavorable market-based exogenous shocks.

Method

We compare the founding and financing rates of systems integrators and component suppliers in the communications equipment industry. The internet bubble of the late 1990s, and the dotcom bust of 2000, serve as positive and negative market-based exogenous shocks, respectively. Our sample is the entire population of communications equipment firms founded in Ottawa, Canada prior to 2005 (117 firms).

Results and Implications

Our results show that the changes in demand in the late 1990s and early 2000s had a stronger impact on the founding and financing rates of systems integrators, than on the founding and financing rates of component suppliers. These findings imply that sector role is an important attribute of firms that explains why firms in the same sector may experience the same environmental conditions differently. The fact that systems integrators were more strongly affected by the market-based exogenous shocks than component suppliers suggests that modularity theory is useful for understanding of the structure of sectors and how the effects of exogenous shocks travel across sectors. For entrepreneurs, our findings suggest that where firms are sensitive to changes in environmental conditions, they will be just as strongly affected by falling tides as they are by rising tides. As one of the systems integrators in our sample put it: “within a week, we will either be the next big thing or toast”.

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