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# Organizational learning and corporate diversification performance☆

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ABSTRACT

This study investigates the role of organizational learning on the valuation effects of corporate diversification. The empirical findings suggest that corporate diversification reduces shareholders' wealth. However, consistent with the absorptive capacity viewpoint of organizational learning, diversification performance depends on repetitive and accumulative experiences that relate to a firm's prior diversification activity and/or a firm's experience in operating in multiple-business segments. Specifically, single-business firms that diversify once demonstrate significant value reduction. In contrast, multi-business firms that diversify once do not demonstrate value reduction, while single/multi-business firms that diversify multiple times demonstrate value creation. Findings also reveal that performance is conditional on the mode of diversification since internal growth diversification shows higher valuation effects than diversifications through acquisitions. These findings contribute to the literature by affirming the importance of organizational learning, a cognitive and behavioral perspective, in explaining the valuation effect of corporate diversification.



## 1. Introduction

A considerable body of academic literature that examines the performance of corporate diversification finds that, on average, diversification destroys shareholder value, a finding known as the diversification discount (Berger & Ofek, 1995; Lang & Stulz, 1994). However, scholars pay much less attention to the cross sectional variance of corporate diversification performance. Identifying factors that make diversification successful for some firms but not for other is of great importance for managers, because, this insight provides clues on how to best implement a diversification program to enhance performance. This study proposes that one such factor is organizational learning. The motivation comes from prior evidence that establishes a positive relation between organizational learning and operating performance pertaining to strategic decisions, such as mergers, acquisitions, alliances, sell-offs, and spin-offs (Amburgey & Miner, 1992; Barkema & Vermeulen, 1998; Bergh & Lim, 2008).

This study develops and tests a theoretical model that draws on the absorptive capacity viewpoint to relate organizational learning to the valuation effects of corporate diversification. Specifically, an organization's ability to learn from strategic decisions arises from the existence of absorptive capacity, which develops when a firm repeats a specific corporate action and/or accumulates experience by operating in a certain environment (Bergh & Lim, 2008; Zahra & George, 2002). Past relevant experience enables the firm to recognize and explicitly codify valuable new knowledge into systems, routines, and procedures that guide future actions (Lane & Lubatkin, 1998; Mayer, Stadler, & Hautz, 2014). The absorptive capacity viewpoint also assumes that learning performance is greatest when the object of learning relates to past knowledge (Bergh & Lim, 2008; Cohen & Levinthal, 1990; Zahra & George, 2002), which indicates the relevance of resource relatedness. Overall, organizational learning improves subsequent strategic, financial and operational decision making (Haleblian, Kim, & Rajagopalan, 2006; Mayer et al., 2014; Shaver, Mitchell, & Yeung, 1997), resulting in competitive advantage and higher firm performance (Hitt, Dacin, Levitas, Arregle, & Borza, 2000). Fig. 1 shows the abovementioned theoretical perspective and the testable relations.

To empirically investigate the relation between organizational learning and valuation effects of corporate diversification, however, one needs to recognize that firms often engage in a program of actions as a means of implementing their corporate strategy (Schipper & Thompson, 1983). Scholars suggest that corporate actions in a program influence each other, and therefore individual diversification events may not explain adequately the performance of corporate programs (Laamanen & Keil, 2008; Barkema & Schijven, 2008b; Shi & Prescott, 2011). In this respect, the experience from individual diversifications,

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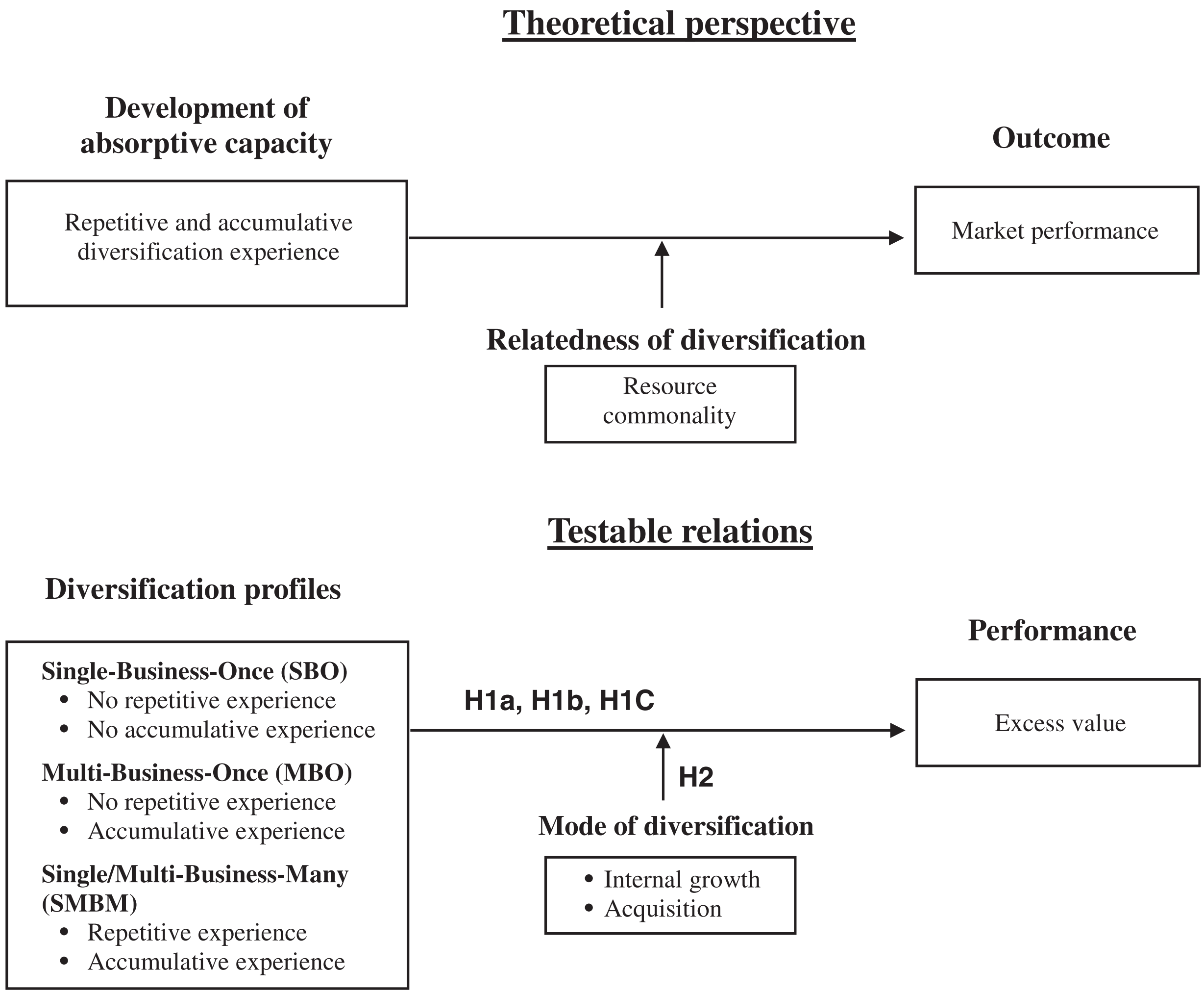


**Fig. 1.** The theoretical and empirical setting of the study.

including failed ones, create valuable learning for firms which can enhance the overall performance of a diversification program (Haleblian & Finkelstein, 1999; Muehlfeld, Sahib, & Witteloostuijn, 2012). To address this issue, this study uses business segment-level data, to develop corporate diversification profiles that capture different capacities of repetitive and accumulative organizational experiences as an indication of absorptive capacity. This study uses information throughout the entire period of investigation rather than information from each individual diversification activity separately, and avoids mixing together the impact of organizational learning capacity during the periods before and after a decision to diversify. Specifically, the study defines diversification profiles by classifying diversified firms into three categories, depending on both a firm's prior diversification activity and the firm's experience in operating in a multiple-business structure: (i) single-business firms that diversify once (Single-Business-Once), (ii) multi-business firms that diversify once (Multi-Business-Once), and (iii) single/multi-business firms that diversify multiple times (Single/Multi-Business-Many). Single-Business-Once firms should bear no repetitive and accumulative experience resulting to the lowest organizational learning with respect to corporate diversification relative to both Multi-Business-Once and Single/Multi-Business-Many firms, and thus should demonstrate the lowest diversification performance. Single/Multi-Business-Many firms should display both repetitive and accumulative experience, resulting to the highest organizational learning, and thus, should demonstrate the highest diversification performance relative to the other two diversification profiles. Multi-Business-Once firms should demonstrate only accumulative experience resulting to in-between organizational learning relative to the other two profiles, and thus, should demonstrate higher corporate diversification performance in comparison to Single-Business-Once firms and lower corporate diversification performance in comparison to Single/Multi-Business-Many. Further the study assesses learning performance using the mode of diversification as an indicator of resource relatedness; internal growth versus acquisition. Firms that rely on internal growth to diversify utilize their own organizational resources, and therefore, are likely to benefit more from learning since they employ more similar processes, systems and organizational culture (Chatterjee, 1990) relative to acquisitions that don't share such organizational resource commonalities (Tanriverdi & Venkatraman, 2005; Xie & O'Neill, 2014). As a result, diversifications should demonstrate higher performance when firms diversify through internal growth than acquisitions.

This study contributes to the literature by affirming the importance of organizational learning, a cognitive and behavioral perspective, in explaining the valuation effect of corporate diversification. Early studies provide evidence that corporate diversification, on average, destroys value (Berger & Ofek, 1995; Lang & Stulz, 1994; Hitt, Tihanyi, Miller, & Connelly, 2006; Martin & Sayrak, 2003). Instead, this study focuses on the cross-sectional variance of diversification performance and provides evidence that a firm's diversification profile, which captures different degrees of repetitive and accumulative experience, affects value. These findings are important since they contribute to the literature that

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