Project title: Value, Survival, and the Evolution of Firm Organizational Structure
Investigators: Richard Borghesi Joel Houston and Andy Naranjo
Department: Finance and Economics

Project summary:
We examine corporate product diversification as a dynamic process. Consistent with prior research, we find that the average diversification discount is about 8% when using the standard value-multiple approach. However, we find that a significant portion of the observed diversification discount arises from benchmark comparisons of value ratios of mature firms (which are more likely to have low value multiples and to be diversified) with those of very young firms (which are more likely to have extremely high value multiples and to be focused). The magnitude of the diversification discount falls significantly when we control for firm age. We also show that diversification reduces the mortality rate of firms, and we provide evidence that mature firms pursue diversification strategies in part as a means to exit stagnant business segments in favor of industries that are more highly valued. Our results suggest that diversification can be an optimal firm evolutionary response to external pressures.