Knowledge & Motivation: How Negative Feedback in Old vs. New Domains Translates into Firm Action & Performance

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Abstract:
When does failure and negative performance feedback provide the foundation for future success? Some research suggests that performance below aspiration levels spurs the firm to action and provides knowledge that informs future success, but other research suggests that negative feedback discourages firm actions and may not produce usable learning. We seek to reconcile these two perspectives by arguing that possession of prior knowledge – whether the feedback comes from an experienced area or a new area to the firm – affects the way in which negative feedback is translated into action and subsequent firm performance. We argue that negative feedback in a domain where the firm has prior knowledge effectively combines motivation to alter behavior with knowledge to correct the problem, while negative feedback in a new domain may provide motivation but the firm lacks key knowledge to effect productive change. Using data on all U.S. mutual fund companies during the period of 1962-2002, we find that negative feedback in an experienced domain leads to better future performance than positive feedback, while the opposite relationship exists in new domains for the firm. Our fund level examination provides detailed insights into the processes behind these results.