



Local creative culture and corporate innovation

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ABSTRACT

The purpose of this study is to investigate the impact of local creative culture on corporate innovation. This paper uses a novel measure of creative culture, namely, proportion of local creative class, and empirically examines the role of local creative culture in corporate innovation for a large sample of US firms in a regression analysis setting. The empirical findings show that firms located in areas with strong local creative culture have more innovation outputs, as measured by the number of patents and patent citations. The findings remain robust after controlling endogeneity via the instrumental variable approach and other econometric techniques. This paper introduces the role of local creative culture in generating innovation for firms. The empirical results are also stronger for local firms, and this finding highlights the local component of corporate innovation as an important determinant of corporate innovation.

1. Introduction

Innovation is an important corporate decision, and firms invest large amounts of resources to be successful in innovation. The corporate innovation literature investigates the factors that make firms more innovative and the common characteristics of innovative corporate environments. Creativity plays a key role in generating innovation (e.g., Florida, 2002a; Florida, 2002b; Florida, 2005; McGranahan & Wojan, 2007). Human capital is a key determinant of innovation, and consistent with prior literature, one expects that innovative people and creative environments lead to stronger innovation outputs. Moreover, creative people are risk-takers (e.g., Amabile, 1983; Dewett, 2006; Heilman, 2016), and local creative culture and innovative environments can support risky investments such as innovation. To my knowledge, the role of this key component—local creative culture—in corporate innovation has received little or no attention in the literature. Therefore, this paper examines the extent to which creative culture affects corporate innovation. I investigate this effect by focusing on the link between creative culture and corporate innovation. In particular, I empirically examine the impact of local creative culture, as measured by the proportion of local creative class, on corporate innovation output for a large sample of US firms.

Innovation is a process of generating new products or new ideas (Van de Ven, 1986). While inventing new ideas can arise at the individual level, innovation is considered to be a collective accomplishment (Van de Ven, 1986). Therefore, cultural or local factors affecting groups of individuals or communities in an area can influence the creativity and innovative behavior in the area. Communities with a

significant number of creative people are expected to host creative cultures. Similarly, creative cultures are expected to emerge in areas with a significant number of people from the creative class—people employed in occupations that require creative thinking and innovative skills. Creativity is a major determinant of innovation, and it is important to unearth the connection between creativity and corporate innovation. In this paper, I study this connection by examining the effect of local creative culture on corporate innovation. My empirical findings demonstrate that firms located in areas with strong creative culture, as measured by the proportion of the creative class, have a higher number of patents and patent citations. A one-standard deviation increase in the proportion of the creative class in a county is associated with an increase in the number of patents (patent citations), which is almost 12% (13.5%) of the average patent (patent citation) variable in the sample. My empirical findings provide an answer to the question on the impact of local creative culture on corporate innovation and indicate a strong local creative culture effect.

The creative class argument was introduced by Florida (e.g., Florida, 2002a; Florida, 2002b; Florida, 2005). He suggests that the creative class is a crucial economic force in urban economic development. The creative class consists of people in occupations that create new knowledge and ideas and people with high levels of creativity (e.g., Florida, 2002a; McGranahan, Wojan, & Lambert, 2011). Prior literature suggests that the creative class provides an atmosphere supporting creativity and innovative activity, as well as growth, in local environments (e.g., Florida, 2002a; Florida, 2002b; Florida, 2005; McGranahan & Wojan, 2007). I use the proportion of local creative class to measure local creative culture in my empirical analysis. Leuenberger and Kluver

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(2005) suggest that the creative class is a key component in shaping creative culture and creative culture communities can produce solutions that include creativity. Pitta, Wood, and Franzak (2008) state that cities or areas with a significant number of creative individuals can be defined as creative communities. Therefore, the proportion of the local creative class can be considered as a good proxy for local creative culture.

Corporate innovation has received growing attention in the recent literature. For example, Kogan, Papanikolaou, Seru, and Stoffman (2017) examine the relationship between technological innovation and growth. Galasso and Simcoe (2011) investigate the link between managerial characteristics and innovation. Tian and Wang (2014) report a positive relationship between tolerance for failure and innovation. Previous studies (e.g., Johnsen, Phillips, Caldwell, & Lewis, 2006; Krolkowski & Yuan, 2017) also examine the impact of customer-supplier relationship on corporate innovation. Lin, Zeng, Liu, and Li (2016) investigate the role of intermediaries in innovation. My paper focuses on a key component of innovation—creativity or creative culture—and introduces local creative culture as a new determinant of corporate innovation in this literature.

Studies in the innovation, entrepreneurship, and economy areas of the literature highlight the importance of local and cultural factors in innovation. For example, national cultural factors have an impact on innovation in cross-country studies (e.g., Kostis, Kafka, & Petrakis, 2018; Rossberger, 2014; Shane, 1993; Steensma, Marino, Weaver, & Dickson, 2000; Sun, 2009; Taylor & Wilson, 2012). Rosenbusch, Brinckmann, and Bausch (2011) argue that culture has an impact on the innovation-growth relationship. Roig-Tierno, Ribeiro-Soriano, and Mas-Verdú (2017) report that individual firms' innovation strategies echo some characteristics of their local areas (Herstad, 2018). My paper examines the variation of a cultural factor within a nation and underlines the role of local cultural factors in corporate innovation.

My findings can also be interpreted based on risk-taking behavior. Previous studies highlight the link between creativity and risk-taking (e.g., Belbaly & Somsing, 2014; Dewett, 2004; Dewett, 2006; Marade, Gibbons, & Brinthaup, 2007). Creative behavior requires a willingness to take risks for employees in organizations (Dewett, 2006), and creative environments emerge when employees take risks (Tesluk, Farr, & Klein, 1997). Creative people are considered as risk-takers (e.g., Amabile, 1983; Dewett, 2006; Gardner, 1993; Heilman, 2016). Consistent with the prior literature, one expects to see a strong risk-taking tendency associated with areas with a higher proportion of the creative class. Corporate innovation is a risky investment. Therefore, I hypothesize that firms located in areas with a strong local creative culture generate more innovation output. My findings provide evidence supporting this conjecture.

One might argue that the choice of firm location in an area with a higher proportion of the creative class might be endogenous. My findings remain robust after controlling for endogeneity by using an instrumental approach. In addition, the empirical results remain strong after addressing endogeneity by using other techniques. My results also hold after running a series of robustness tests. The empirical findings remain robust after controlling for firm and location fixed effects, as well as local economic, demographic, and cultural factors. These additional tests present more supporting evidence and indicate a substantial impact of local creative culture on corporate innovation. I also find a more pronounced creative culture effect for local firms compared to geographically dispersed firms. Therefore, this paper highlights the local component of corporate innovation and demonstrates creative culture as an important local determinant of corporate innovation.

This paper contributes to the literature in the following ways. First, to my knowledge, this is the first paper that investigates the link between the creative class and corporate innovation in the intersection of the innovation and finance areas of the literature. This paper also contributes to the literature on the relationship between culture and economic or financial outcomes by shedding additional light on the role

of a new cultural factor, creative culture, in corporate innovation. Second, this paper unearths a missing determinant of the role of geography in corporate innovation by demonstrating geographically varying corporate innovation outcomes in line with the variations in local creative culture. My paper also shows that a creative culture has a stronger effect on innovation for local firms compared to other firms. This finding suggests that the creative effect emerges through the local channel via the interactions between corporate and local cultures. Therefore, this paper underlines the local component of corporate innovation. This paper also highlights the link between risk-taking and corporate innovation outcomes by suggesting the role of risk-taking tendency induced by creative culture can play an important role in corporate innovation.

2. Related literature

Corporate innovation is a risky investment decision, and there is a growing body of literature examining this corporate decision (e.g., Adhikari & Agrawal, 2016; He & Tian, 2013; Krolkowski & Yuan, 2017). Recent studies (e.g., Almazan, De Motta, Titman, & Uysal, 2010; Dougal, Parsons, & Titman, 2015) highlight the connection between geography and financial decisions and suggest that there is a need for further research to shed additional light on the role of geography in corporate decisions. Recent literature has shown that local characteristics can lead to geographically varying corporate policies. For example, local characteristics have an important part in shaping corporate dividend policies. Becker, Ivkovich, and Weisbenner (2011) show that firms headquartered in locations with a higher proportion of senior citizens are more likely to be dividend payers. Similarly, Ucar (2016) finds a geographically varying dividend clientele effect in line with the variations in risk aversion among different local religion. Hilary and Hui (2009) examine how local religion affects financial outcomes and show the impact of local religion on risk exposure, ROA, investment and R&D activity. Hilary and Hui (2009) suggest that local religion has an important role in corporate risk-taking. Ucar (2017) examines the risk-taking tendency associated with creative culture and shows the role of local creative culture for corporate risk-taking for some corporate policies. My paper focuses on corporate innovation and asks the question of what the role of local creative culture plays for corporate innovation. The empirical findings suggest that local creative culture can help us better understand the importance of local dynamics for corporate innovation.

Richard Florida's creative class argument suggests that the creative class plays a major role in economic growth than raw materials or inputs (e.g., Florida, 2002a; Florida, 2002b; Florida, 2005; McGranahan & Wojan, 2007). Other studies in the literature update Florida's creative class measure and re-examine the role of creative class in urban economic development (e.g., McGranahan & Wojan, 2007; McGranahan, Wojan, & Lambert, 2011). Previous studies define the creative class as the proportion of a population that includes people from the knowledge-intensive workforce, artists, and intellectuals (e.g., Florida, 2002a; Florida, 2002b; Florida, 2005; McGranahan & Wojan, 2007). The creative class provides creative and innovative environments and plays a crucial role in generating innovative output (e.g., Florida, 2002a; Florida, 2002b; Florida, 2005; McGranahan & Wojan, 2007). My results can be interpreted as consistent with the creative class argument. The empirical findings suggest that locations with a higher proportion of the creative class population provide more innovative corporate environments than other areas.

Florida (2002a) suggests that an important concentration of bohemians and creative people in a location indicates the innovation and creativity in an area. This point underlines the link between the creative class and local creative culture. Florida (2002a) reports that other studies also define bohemian and creative individuals as “subcultural capital” in cities where they are located. The communities with more creative individuals are the environments where the production of new

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