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Application of signaling theory in management research: Addressing major gaps in theory

Saud A. Taj

Glasgow Caledonian University, GCU London, 40-48 Fashion Street, Spitalfields, London, E1 6PX, United Kingdom

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ABSTRACT

Dealing with information asymmetry is essential for developing a strong signaling environment with signals flowing efficiently and effectively between the firm and its stakeholders. This study applies signaling theory to examine the flow of signals between corporate headquarters (HQ) and the local subsidiary of a multinational and explore the implementation and outcomes of employer branding change programs, with the aim of achieving authenticity in employee voice by reducing information asymmetry. Findings suggest that developing a strong signaling environment requires understanding how best to deal with negative signals; the significance of signal precedence; and the role of counter-signals (feedback) in the signaling process. These questions inform major gaps in signaling theory research to which this paper contributes. The study also has far reaching implications for subsidiary managers and extends their knowledge on reducing information asymmetry between HQ (signal designers) and local employees (signal receivers) through efficient and effective signaling, so that employer branding programs can be implemented successfully.

1. Introduction

The emergence of signaling theory resulted from the study of information economics under conditions in which buyers and sellers dealt with asymmetric information while interacting in the market (Spence, 1974). The theory has been extensively used to study information asymmetry between two parties, occurring as a result of knowledge disparity, in a variety of organizational and business contexts (Connelly, Certo, Ireland, & Ruetzel, 2011; Spence, 2002; Stiglitz, 2002). According to Connelly et al. (2011), getting accurate information is crucial as it affects the decision-making processes used by individuals, businesses, and governments. Therefore, it is one of the key functions of signaling theory to reduce such asymmetries in information (Spence, 2002), which is particularly relevant to the current study that examines the signaling between corporate HQ of a European multinational and its local subsidiary in a developing country during the implementation of employer branding change programs. Hence, the main contribution of this study is to help us understand the complexities involved in signaling effective employer brands across the two divergent environments.

The concept of employer branding was coined by Ambler and Barrow (1996) who defined it as *'the package of functional, economic, and psychological benefits provided by employment, and identified with the employing company'* (p. 187) and was initially discussed in this journal by Martin, Beaumont, Doig, and Pate (2005) who provided the evidence for the then emerging branding-HR relationship while supporting the contention through a model based on the review of literature from a variety of fields including marketing, communications, organizational studies, and HRM. One of the main purposes of an employer brand is to create an image of the organization as a good working place hence it has emerged as a concept for differentiating employers from competitors by providing distinct employment experiences. To do this, employers must clarify the unique aspects of their offerings by sending signals to their stakeholders in order to appear *different* than competitors and yet remain *socially legitimate* in the eyes of their stakeholders. This is particularly important for designing *authentic* employer brands that reflect on the voice of local stakeholders (Harquail, 2009) and respond to the local needs. This is also important for multinationals to address a wide range of strategic issues including the integration-responsiveness problem (Martin, Gollan, & Grigg, 2011; Rosenzweig, 2006). This brings in sight the possibility of exploring the concept through the lens of signaling theory as it underpins employer branding research and plays an

E-mail address: SaudAl.Taj@gcu.ac.uk.

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important role in the branding process by explaining the honesty of signals and the costs associated with sending dishonest signals (Martin & Groen-in't Woud, 2011) thereby helping firms develop authentic employer brands. Nevertheless, authentic employer brands require a strong signaling environment based on efficient and effective signaling between organization and its employees at all levels who are able to send and receive honest and credible signals thereby reducing information asymmetry. However, establishing a strong signaling environment requires us to understand how the presence of negative signals disturb the signaling process; how signal precedence affects receiver's interpretation of signals; and how feedback-seeking behavior improves the overall signaling process. These questions that inform significant gaps within signaling theory research are addressed in this study.

The paper begins with a critical review of literature around the application of signaling theory in management research to identify potential gaps. This is followed by a discussion of the study's methodological approach. Findings are then presented which are discussed in the light of extant theory. Finally, the implications of the study for theory and practice are discussed and its limitations and future research areas are highlighted.

2. Signaling theory in management research

It is interesting to notice the attention signaling theory has received in the last couple of decades by viewing the number of its citations in management literature (see for example, [Strategy] Carter, 2006; Chung & Kalnins, 2001; Coff, 2002; Deephouse, 2000; Kang, 2008; Karamanos, 2003; Lampel & Shamsie, 2000; Lee, 2001; McGrath & Nerkar, 2004; Miller & Triana, 2009; Perkins & Hendry, 2005; [Entrepreneurship studies] Arthurs, Busenitz, Hoskisson, & Johnson, 2008; Bell, Moore, & Al-Shammari, 2008; Certo, Daily, & Dalton, 2001; Certo, 2003; Daily, Certo, & Dalton, 2005; Filatotchev and Bishop, 2002; Higgins & Gulati, 2006; Michael, 2009; Zimmerman, 2008; [HRM and OB] Ehrhart & Ziegert, 2005; Hochwater, Ferris, Zinko, Arnell, & James, 2007; Highhouse, Thornbury, & Little, 2007; Ryan, Sacco, McFarland, & Kriska, 2000; Srivastava, 2001), which increased from 16 to 144 between 1989 and 2009; a rise of 128 citations (Connelly et al., 2011). Furthermore, numerous studies have integrated signaling concepts with other related theories of management (e.g. Deephouse, 2000; Ryan et al., 2000; Sanders & Boivie, 2004) to understand information asymmetry. In the field of management, it has been applied to help explain the influence of asymmetric information in a wide range of research contexts e.g. a corporate governance study showed how CEOs signaled their firms' unobservable quality to potential investors through the observable quality of their financial statements (Zhang & Wiersema, 2009). It has also been used by a range of researchers to explain how firms make use of diverse boards to communicate adherence to social values to a variety of organizational stakeholders (Miller & Triana, 2009). It has been frequently applied in the entrepreneurship literature to examine the signaling value of board characteristics (Certo, 2003), characteristics of top management teams (Lester, Certo, Dalton, Dalton, & Cannella, 2006), founder involvement (Busenitz, Fiet, & Moesel, 2005), and angel investor presence and venture capitalist (Elitzur & Gavius, 2003). While majority of the HRM and OB studies have examined the signaling in talent attraction and recruitment processes (Celani & Singh, 2011; Suazo, Martinez, & Sandoval, 2009) recent studies have also applied signaling theory to employer branding and corporate reputation management research (such as Bergh, Ketchen, Boyd, & Bergh, 2010; Celani & Singh, 2011; Martin & Groen-in't Woud, 2011).

Therefore, in an attempt to contribute to the growing body of literature, I apply signaling theory in the context of employer branding research to examine the signaling mechanism prevalent within an MNE to understand the implementation and outcomes of employer branding programs, which need a strong signaling environment for signals to flow efficiently and effectively between signal designer (employer) and receivers (employees) in pursuit of minimizing information asymmetry. In so doing, the paper will address the signaling theory gaps as highlighted in the previous section.

3. Key elements of signaling theory: identifying major gaps

The key elements of signaling theory comprise of *signaler*, *signal*, and the *receiver*. *Signalers* are insiders, such as the management or executives, who obtain information about an individual (Spence, 1973), organization (Ross, 1977), or product (Kirmani & Rao, 2000), which outsiders are unaware of. Normally, insiders obtain information, positive and negative, that is useful for the outsiders and includes a number of details such as specifics about the products and services, news regarding preliminary sales results report, or information about organization's other aspects such as union negotiations and pending lawsuits (Connelly et al., 2011). In simple terms, this private information helps insiders develop their perceptions regarding the underlying quality of some aspect of the individual, product, or organization (Connelly et al., 2011). In terms of management research, signaler is generally a person, product, or organization. HRM and OB studies focus on signals eliciting from individuals, such as recruiters (Ehrhart & Ziegert, 2005; Ma & Allen, 2009; Rynes, Bretz, & Gerhart, 1991), managers (Ramaswami, Dreher, Bretz, & Wiethoff, 2010), or employees (Hochwater et al., 2007). This study will focus on the organization at the HQ and local subsidiary levels as employer brand signalers.

Signals are informational cues sent out by one party to another in order to influence desired outcomes. After obtaining private information (positive or negative), insiders decide whether to communicate it to the outsiders or not. Usually, the prime aim of insiders is to send out positive signals to outsiders and avoid sending negative information deliberately in order to reduce information asymmetry, which helps firms reach their ultimate goal of positively influencing desired outcomes e.g. leaders of a young firm in an initial public offering (IPO) appoint diverse group of prestigious directors to send a message to potential investors about the firm's legitimacy (Certo, 2003; Filatotchev & Bishop, 2002). In this context, the main focus of signaling theory remains on purposely communicating positive information for conveying positive attributes of the organization to outsiders (Connelly et al., 2011). However, in the process, negative signals may be sent out unintentionally e.g. the issuance of new shares sends negative signals to outsiders because equity is issued by executives when they think that the stock price of the company is over-valued (Myers & Majluf, 1984). Therefore, it is important to understand how these unintended (often negative) signals that complement the intended (often positive) signals disturb the signaling process and confuse the receivers. As this paper focuses on sending positive employer brand signals, it is essential to understand how negative (unintended) signals confuse the receivers (employees in this case). Therefore, the first gap question I address is: *how do negative signals disturb the signaling process?*

Nevertheless, signaling process cannot complete without the *receiver* of the signal. Generally, OB or HR studies are concerned with the elements within the labor market and mostly have employees as the receivers of signals (Davila, Foster, & Gupta, 2003; Ehrhart & Ziegert, 2005; Martin & Groen-in't Woud, 2011). These receivers are generally outsiders who possess limited information regarding the organization and are willing to receive it (Connelly et al., 2011). Both, signalers and receivers have conflicting interests in a way such that the signaler is benefitted from a