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The role of institutional arbitrage in the search for product innovation: Firm level evidence from Norway

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ABSTRACT

Evolutionary theorizing conceptualizes the discovery of new products as a successful outcome from searching for innovation in which firms combine new and old knowledge and resources. Prior research has shown that the propensity for discovering new products is greatest when firms cross a technological and/or organizational boundary in the search for new knowledge. In this paper, we add a new dimension to this literature: we examine whether, and to what extent, crossing a national boundary, as when firms use knowledge from network partners in foreign countries, influences the likelihood that firms will introduce new products into the market. Drawing on theorizing on institutional arbitrage in the literature on national innovation systems (NIS) and varieties of capitalism (VOC), we propose that companies that cross a national boundary in searching for innovation are significantly more likely to introduce new products. Detailed survey data on firms; data on their network partners, including their location; and regression analysis show that the use of knowledge from actors in foreign NIS has a positive influence on product innovation.

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1. Introduction

Knowledge and competence are becoming increasingly important for firms (Håkansson, Havila, & Pedersen, 1999) and represent a key source of competitive advantage. One important way firms can exploit superior knowledge and competence is by introducing new products into the market. Product innovation, defined as the market introduction of a new product (goods/services) (Laursen & Salter, 2006; OECD/Eurostat, 2005), has therefore received widespread attention among both scholars and practitioners. The reason is that the introduction of new products is a key mechanism through which firms can secure new turnover, appropriate business from competitors, and gain new market shares (Nelson & Winter, 1982; O'Cass, & Ngo, 2011; Pianta, 2005; Teece, 2007). Firms' ability to introduce new products is therefore a real concern for managers, and most managers agree that product innovation is important for their business (Salaman & Storey, 2002). Indeed, top managers point to innovation as the key factor driving their firm's performance (Carden, Mendonca, & Shavers, 2005).

Evolutionary theorizing purports that firm's ability to introduce new products into the market is, at least partially, determined by their ability to learn and to recombine sources of knowledge in new ways (Nelson & Winter, 1982; Teece, Pisano, & Shuen, 1997). However, research has shown that many companies struggle in the attempt to develop and introduce new products (Salaman & Storey, 2002; Story, O'Malley, & Hart, 2011), supporting the view that how firms learn to develop their

knowledge and competence is a crucial issue for managers and their firms (Håkansson & Waluszewski, 2007; Håkansson et al., 1999).

Recent studies and literature reviews therefore argue that we need more research on the factors that enable firms and their managers to successfully introduce new products into the market and especially more research "about which organizational mechanisms and practices the managers need to utilize to make innovation search more effective" (Laursen, 2012, p. 1210). In this paper, we focus on firms' search for two types of product innovation: (1) the development of a product that is new to the firm (but not new to the firm's market) and (2) the development of a product that is new to the firm's market (and thereby also new to the firm). These two types of product innovation differ in the sense that the first type represents the adoption and modification of an existing product, often developed by others, while the second type represents the generation of an entirely new product (Damanpour & Wischnevsky, 2006; Pérez-Luño, Wiklund, & Cabrera, 2011).

Further, the distinction between the generation and adoption of new products is similar to the distinction between exploration and exploitation in the organization learning literature, where it is argued that firms need to achieve a balance between exploration and exploitation to maximize their short-term and long-term performance (March, 1991; Pérez-Luño et al., 2011). Thus, this paper focuses on firms' search for product innovations that are "new to the firm" and "new to the market", through exploitative and exploratory learning, respectively, in order to succeed. Given the importance of these two types of product innovation and the learning processes associated with them, research and theorizing have focused on how companies can succeed in developing new products and introducing them into the market.

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Generally speaking, firms learn in basically two ways: Internal learning and learning from others (Håkansson et al., 1999). Prior research argues, within the context of innovation, that a predominant focus on internal learning is – at least in the longer run – a less effective approach to product innovation. The reason is that firms will find it increasingly difficult to connect their knowledge elements in new ways, reducing the likelihood of introducing new products into the market (Stuart & Podolny, 1996; see Laursen, 2012). Learning from others involves, on the other hand, transfer of knowledge. Such learning can be embedded in products or processes or take a more pure form where companies learn directly from external actors, such as through active cooperation with others (Håkansson et al., 1999; Powell & Grodal, 2005; Katila, 2002; Katila & Ahuja, 2002).

Transfer of knowledge and experiences from others to the focal firm can open up possibilities to find new connections between unconnected knowledge elements and increase the probability of finding a new product. It is thus argued that firms' ability to introduce new products often depends on the type and quality of a firm's interactions with other actors in its environment (Powell & Grodal, 2005; Wilkinson & Young, 2002), such as clients, suppliers, universities, and competitors (Chesbrough, Vanhaverbeke, & West, 2006; Lundvall, 1992; Nelson, 1993; Von Hippel, 1988).

Theorizing on the search for innovation therefore suggests that the propensity for discovering new products is greatest when firms cross a technological and/or an organizational boundary when searching for new knowledge (Rosenkopf & Nerkar, 2001; see Laursen, 2012 for a review). Consistent with this hypothesis, empirical research finds that technological and organizational boundary spanning search is associated with superior innovation performance (see Laursen, 2012). This is consistent with the network literature where it is argued that: "what creates value is the very manner in which the resources are combined over organizational and technological borders" (Waluszewski & Håkansson, 2007, p. 16)

While considerable research has focused on the importance of crossing organizational or technological boundaries in the search for new products (Laursen, 2012), the influence of crossing a country boundary when searching for new knowledge has received scarcer attention in the literature. Crossing a country boundary can have an important influence on firms' ability to discover new products, as knowledge from another country may differ, sometimes radically, from the knowledge that the firm has access to in its home country. Further, the focal firm may be exposed to qualitatively different type of learning experiences when interacting with others in foreign countries.

The potential influence of crossing a country boundary on product innovation is supported by the related literature on national innovation systems (NIS) and varieties of capitalism (VOC). These streams of literature argue that countries have different institutional frameworks that govern the creation and diffusion of knowledge within a NIS (Nelson, 1993; Lundvall, 1992; Hall & Soskice, 2001; see Edquist, 2005 for a review). Owing to institutional differences, economic actors within a NIS, as well as their knowledge, resources, and practices, will be more similar than those between different NIS (Amable, 2003; Hall & Soskice, 2001), all other factors being equal. Firms in search of new knowledge can exploit these differences. The exploitation of differences between different institutional arrangements among countries is referred to as institutional arbitrage in the VOC/NIS literature (Boisot & Meyer, 2008; Jackson & Deeg, 2008).

The purpose of this paper is to examine the role of institutional arbitrage in the search for innovation. We focus on domestic firms in a home NIS that acquire knowledge from actors in foreign NIS and ask the following research question: To what extent does the use of knowledge from network partners located in foreign NIS influence product innovation at the firm level?

The paper contributes to the literature in two important ways. First, research on the search for innovation has focused on the effect of crossing organizational and/or technological boundaries. In this paper, we

add a new dimension to this literature: we examine whether the use of knowledge and technology from network partners located in foreign countries and NIS influences product innovation. Thus, we focus on whether crossing a national boundary influences firms' propensity to introduce new products.

A related second contribution is that we merge theorizing on the search for innovation with theorizing on institutional arbitrage found in the NIS and VOC literature. Thus, we develop a theoretical framework that provides the basis for forming testable hypotheses concerning a potentially positive relationship between the use knowledge from network partners in foreign NIS and product innovation within the focal firm. Moreover, a central argument in the NIS/VOC literature is that national boundaries continue to be important, and increasingly so, in our globalized world. However, research on NIS/VOC tends to be conceptual, macro-oriented, and sometimes rather descriptive (Edquist, 2005). In this paper, we extend this literature and test whether knowledge used in the innovation process from network partners in different NIS influences firms' ability to innovate. Testing the theoretical relevance of NIS research with large scale micro-databases has been called for in the literature (Edquist, 2005) but has been seldom been done.

This paper is organized as follows. In the next section, we discuss the theoretical framework of our study, which merges macro-oriented theories on institutional differences between countries and how such differences can lead to specialization and comparative advantages in knowledge generation and diffusion among countries. Section 3 discusses the data and the method that was used to examine the research question. Section 4 presents and discusses the empirical results. The last section concludes.

2. The search for innovation and knowledge from domestic and foreign NIS

Evolutionary organizational theory, such as the evolutionary economics perspective initiated by Nelson and Winter (1982), argues that firms that desire to introduce new products into the market are left with the problem of how to successfully innovate. According to this theory, the introduction of new products – either new to the firm or new to the firm's market – is a journey into the unknown. While the end goal is clear (i.e., successful market introduction of new products), the means of reaching that goal are unclear for most firms.

Although evolutionary organizational theory argues that firms can – and should – use their existing knowledge and resources to solve the problem of how to discover new products (Nelson & Winter, 1982), firms' existing knowledge may not be sufficient. Firms need to search for new knowledge and integrate that new knowledge with existing knowledge and resources to be able to introduce new products (Laursen, 2012). In general, evolutionary theory argues that the propensity for finding new products increases when firms search for different types of knowledge, both familiar and new, and attempt to combine these knowledge sources (Katila, 2002; Katila & Ahuja, 2002; Nelson & Winter, 1982).

Research suggests that firms can search for innovation both internally and externally (Lichtenthaler & Lichtenthaler, 2009; Winter, 1984). Most firms use internal and familiar knowledge in the search process (Helfat, 1994; Stuart & Podolny, 1996). Although the use of familiar knowledge has the benefit that it will increase the reliability of the search process, and is less costly (Laursen, 2012), it can also lead to local search. Local search is the tendency for organizations to conduct an innovative activity that is strongly related to a previous innovative activity (Stuart & Podolny, 1996). Prior studies have demonstrated that local search often predominantly focuses on the use of knowledge which is in the neighborhood of the firm's current knowledge (Helfat, 1994; Stuart & Podolny, 1996). Local search may have negative effects on firms' ability to develop new products, as the propensity for discovering new products is, at least in part, a function of new knowledge

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