How do incentives motivate absorptive capacity development? The mediating role of employee learning and relational contingencies

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A R T I C L E   I N F O

Keywords:
Absorptive capacity
Innovation incentives
Employee learning
Relational context
Expectancy theory
Equity theory

A B S T R A C T

This study explores the antecedents of a firm’s absorptive capacity by examining the role of innovation incentives. Building on expectancy theory and equity theory, we argue that innovation incentives enhance absorptive capacity through promoting employees learning; and the effectiveness of incentives is positively moderated by teamwork (i.e., horizontal relation) but negatively moderated by transformational leadership (i.e., vertical relation). To test our hypotheses, we employ a multi-respondent research design based on a sample of 102 Chinese automotive companies. The results show strong support for the hypotheses and demonstrate the positive impact of innovation incentives on a firm’s absorptive capacity through the mediating role of employee learning, as well as the moderating effect of the relational context in shaping the influences of innovation incentives.

1. Introduction

Absorptive capacity (AC) is defined as “a firm’s ability to recognize the value of new information, assimilate it, and apply it to commercial ends” (Cohen & Levinthal, 1990, p. 128). AC can be viewed as one of a firm’s fundamental learning capabilities, which is closely related to successful product innovation and superior performance (Lane, Koka, & Pathak, 2006; Lewin, Massini, & Peeters, 2011; Zahra & George, 2002). Given its significant implications, researchers are interested in understanding the causal factors of AC and propose various antecedents, including prior related knowledge (Cohen & Levinthal, 1990), R&D investment (Huang, Lin, Wu, & Yu, 2015), organizational capabilities and mechanisms (Jansen, Van Den Bosch, & Volberda, 2005), and knowledge management processes (Lewin et al., 2011).

Despite these rich insights, prior studies on the drivers of AC tend to overlook the influence of employee participation and motivating factors provided by the organization, which are key elements in the “micro-foundation” of organizational capability (Chen & Huang, 2009; Foss, 2011). While motivation and capability are distinct constructs, employees’ motivation and participation are indispensable to the development of firm capabilities, given that a firm’s knowledge and capability ultimately resides within and among individual employees (Ebers & Maurer, 2014; Minbaeva, Pedersen, Björkman, Fey, & Park, 2003; Volberda, Foss, & Lyles, 2010). Based on expectancy theory (Vroom, 1964), incentives link desirable future gains for employees to their achievement of organizational goals, making them motivated to exert effort to meet organizational expectations (Cadsby, Song, & Tapon, 2007; Trevor, Reilly, & Gerhart, 2012). Innovation incentives, defined as the firm’s use of strategic compensation tactics that reflect employees’ learning and innovative efforts (Wei & Atuahene-Gima, 2009; Yanadori & Marler, 2006), relate positively to the exchange, acquisition and creation of new knowledge, such that they are highly relevant for enhancing employees’ motivation and ability to learn new knowledge, which subsequently lead to the development of AC.

Moreover, how the relational context in the workplace shall shape the effectiveness of innovation incentives is understudied. According to equity theory, incentives are inevitably socially and relationally constructed, because social comparison processes are likely to occur when incentives are given to employees in a differentiated manner (Greenberg, Ashton-James, & Ashkanasy, 2007). This suggests that individual employees do not respond to their own incentives in isolation, but instead are influenced by their relative standing among their peers (Shaw, Gupta, & Delery, 2002; Trevor et al., 2012). Inadequately allocated incentives could evoke feelings of injustice and dysfunctional competition that in turn undermine social behaviors and performance (Pfeffer & Langton, 1993; Siegel & Hambrick, 2005; Yanadori & Cui, 2003).
Overall, equity theory explains the conditions under which innovation incentives would be effective in developing AC, what remains understudied is how the perception is formed and affected by the relational context in the workplace.

To bridge these gaps, we consider the role of innovation incentives in developing firms’ AC through promoting employee learning, a critical micro-level process underpinning organizational capability. Furthermore, we study how workplace relationships moderate the effectiveness of innovation incentives on AC. In particular, we emphasize two distinct dimensions of social relations in the workplace: teamwork, which consists of the horizontal relationships among coworkers, and transformational leadership, a vertical relationship between a leader and subordinates. Building on expectancy and equity theory, we argue that innovation incentives foster AC through employee learning, and the positive effect of incentives on AC is enhanced by teamwork but attenuated by transformational leadership.

The results from a multi-informant survey of Chinese automotive companies provide support for our hypotheses, leading to several theoretical contributions. First, this study establishes the organizational incentives-capability link by emphasizing the micro-foundation of organizational capability, namely, the indispensable role of employee learning, which is demonstrated to mediate the effect of incentives on AC. Second, we incorporate equity theory to highlight the importance of the two relational factors as moderators of the effectiveness of innovation incentives. Our findings reveal contrasting moderating effects of teamwork and transformational leadership. Third, we introduce social comparison and justice assessment processes to transformational leadership research. By revealing the negative interaction between transformational leadership and innovation incentives, our findings provide a more nuanced and balanced understanding of transformational leadership.

2. Theoretical background and hypothesis development

Since Cohen and Levinthal’s (1990) seminal work, the concept of absorptive capacity has evolved and expanded from a static view, which focuses on prior knowledge, to a more dynamic, process-based perspective, which emphasizes collective capability (Lane et al., 2006; Zahra & George, 2002). In this paper, we define absorptive capacity as a set of organizational routines and processes by which firms identify and understand information from external sources, share and transfer the knowledge among different parts of the organization, and harvest and employ the knowledge to create new knowledge and commercial outputs (Lane et al., 2006; Lewin et al., 2011; Zahra & George, 2002). As one crucial organizational capability, the performance implications of AC are well-recognized, such as exploiting strategic opportunities, facilitating intra- and inter-organizational learning, accelerating innovation process, and contributing to financial performance (Foss, Lyngsø, & Zahra, 2013; Huang et al., 2015; Kostopoulos, Papalexandris, Papachroni, & Ioannou, 2011). Prior studies also examine various drivers of AC. For example, Jansen et al. (2005) argue that firms need combinative capabilities to be able to synthesize and apply new knowledge; therefore, organizational mechanisms associated with those combinative capabilities enhance AC. In a multinational corporation setting, Schleimer and Pedersen (2013a) focus on organizational mechanisms such as decentralization, normative integration, and innovative culture as determinants of AC. To summarize, most prior studies consider macro-level, knowledge-based, or structure-related drivers of AC.

However, a firm’s knowledge and capability ultimately reside within and among individual employees (Yanadori & Cui, 2013). Employees’ motivation, capability, and effort to acquire, assimilate, and apply new knowledge is critical to the development of AC (Chang, Gong, Way, & Jin, 2013; Minbaeva et al., 2003). Yet employees’ self-interests do not necessarily align with those of the firm, so incentives are required to motivate employees to exert their efforts to achieve organizational goals (Cadsby et al., 2007). According to expectancy theory (Vroom, 1964), individual motivation and efforts to perform depend strongly on the instrumentality or rewards of that activity. In the workplace, employees receive cues about incentives and attempt to infer the likelihood that a given level of performance will result in certain outcomes, and then act accordingly (Belogolovsky & Bamberger, 2014). Guided by expectancy theory, many empirical studies find a positive link between incentives and employee motivation and performance (e.g., Cadsby et al., 2007; Shaw et al., 2002). In this study, we examine how innovation incentives facilitate AC via employee learning.

Whereas expectancy theory focuses on the absolute value of incentives, equity theory highlights their relative value (Adams, 1965). The main argument underlying equity theory is that people naturally acquire and use social comparisons to develop their equity assessments, which forms and shapes employees’ perception of the fairness of the organization. As such, it is not just the absolute value but also the relative value of incentives that drive a person’s emotion and motivation. Perceived inequitable treatment of oneself threatens economic self-interest, causes distress, and encourages actions to restore justice; perceived inequitable treatment of others may violate moral standards, as everyone deserves to be treated in a fair and just manner (Bernerth & Walker, 2012). Therefore, equity theory explains the conditions under which innovation incentives would be effective in developing AC, namely incentives will only take effect when allocated in a fair manner as perceived by employees. In support, empirical research demonstrates that pay dispersion yields motivating benefits only when it occurs for legitimate reasons or with perceived justice (Aime, Meyer, & Humphrey, 2010; Shaw et al., 2002); and the negative effect of pay dispersion is most salient when the reward allocation cannot be justified (Pfeffer & Langton, 1993).

However, equity theory implicitly grounds justice on an equity-based reward allocation rule such that those who contribute most should receive the greatest share of the outcomes. Yet other types of reward allocation rules exist, such as need-based (i.e., outcomes are distributed based on individual needs) and equality-based (i.e., outcomes are distributed equally) (Morand & Merriman, 2012). Moreover, an individual’s judgment of justice or equity may not be based on objective “facts”, but rather be distorted by subjective interpretations (Ryan, 2016). Specifically, workplace relational contexts may moderate the incentive-AC relation. As social relations in the workplace influence how employees receive and process information they use in their social comparisons to form justice perceptions, they should critically shape employees’ attitudinal and behavioral reactions to differential incentives (Duffy, Scott, Shaw, Tepper, & Aquino, 2012).

Along this line of inquiry, we examine how two distinct dimensions of social relations in the workplace—horizontal relationships among coworkers, and vertical relationships between leaders and subordinates—influence the efficacy of innovation incentives for the development of AC. In particular, we address the horizontal relationship using the concept of teamwork, defined as the quality of the interactions and collaborations among organizational members (Hoegl & Gemuend, 2001; Hoegl, Weinkauf, & Gemuenden, 2004). For the vertical relationship, we consider transformational leadership, which occurs when leaders emphasize employee development by acknowledging individual differences, elevating employees’ interests, generating awareness and acceptance of the purpose of work, and providing employees with confidence to perform beyond expectations (Birn斯坦, 2014; Dvir, Eden, Avolio, & Shamir, 2002; Kang, Solomon, & Choi, 2015).3

3 Transactional leadership instead focuses on supervision and mandates compliance through rewards and punishments. We consider transformational leadership because it is widely recognized as more effective for promoting innovative behavior than is transactional leadership (e.g., Birn斯坦, 2014). Moreover, transactional leadership might overlap conceptually with innovation incentives, which also contain an element of contingent rewards (Walumbwa, Wu, & Orwa, 2008).
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