



Headquarters involvement and efficiency of innovation development and transfer in multinationals: A matter of sheer ignorance?

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ABSTRACT

We compare two theoretical perspectives on the knowledge situation of headquarters (HQ) in multinational corporations: the bounded rationality perspective and the sheer ignorance perspective. We claim that these perspectives lead to different expectations when it comes to HQ's role and the effects of HQ involvement in innovation processes at the subsidiary level. More specifically, we examine the impact of HQ involvement on the efficiency of 71 subsidiary innovation projects. The findings show that HQ involvement in innovation development and transfer has a negative rather than a positive impact on efficiency in both processes. We contribute by showing and suggesting that the sheer ignorance perspective might provide a more accurate portrayal of the HQ knowledge situation than the bounded rationality perspective does. This study furthers understanding of the role of HQ in the contemporary, knowledge-creating multinational.

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1. Introduction

Innovation processes, i.e., the development and transfer of innovations within the organization, are considered crucial activities for the contemporary multinational corporation (MNC). Thus, the corporate capabilities required for the efficient development and internal transfer of innovations leading to new products, production and marketing processes constitute the basis of competitive strength for the MNC (Cantwell, 1989; Forsgren, Holm, & Johanson, 2005; Ghoshal & Bartlett, 1988; Holm & Pedersen, 2000; Zander, 1991; Zander & Kogut, 1995) and thus a major concern for managers and researchers. It has also been pointed out, however, that, due to the specific characteristics of the MNC as a geographically and functionally dispersed organization (Andersson, Forsgren, & Holm, 2002; Birkinshaw & Hood, 2001; Cantwell, 1989; Mudambi & Navarra, 2004; Rugman & Verbeke, 2001), innovation processes are largely carried out at subsidiary rather than HQ level. Much of the relevant expertise needed for innovating is therefore assumed to be more rooted in the subsidiaries' local knowledge than in HQ's knowledge. At the same time, corporate HQ plays an important role as a resource contributor (e.g., Ambos & Schlegelmilch, 2007; Chandler, 1991; Ghoshal & Bartlett, 1988; Poppo, 2003), coordinator, and decision maker (Foss, 1997; Ghoshal & Bartlett, 1988).

A closer look at the literature on the MNC as a knowledge-creating entity reveals divergent views on the role of HQ in MNC innovation processes. One dominant perspective, here called 'bounded rationality', views corporate HQ as having a

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reasonable possibility of monitoring the innovation process at the subsidiary level, albeit from a distance (e.g., Buckley & Hashai, 2009; Doz & Prahalad, 1981; Egelhoff, 1988; Ghoshal & Bartlett, 1988; Ghoshal & Nohria, 1997; Hennart, 1993). Through its direct involvement in the process and through different control mechanisms, HQ has a decisive influence in shaping innovation processes. The fact that HQ may lack crucial knowledge of innovation processes at the local level and may therefore have limited possibility to contribute to the processes – let alone control them – is basically treated as a problem that can be solved through appropriate organization. Therefore, this view assumes that HQ can efficiently design and (at least indirectly) control innovation processes.

Another perspective, which we call ‘sheer ignorance’, is less optimistic about the possibilities open to HQ. Scholars have pointed out that the ability of HQ to control processes at the subsidiary level and/or contribute to them with its own expertise is far from clear (Andersson, Forsgren, & Holm, 2007; Barner-Rasmussen, Piekkari, Scott-Kennel, & Welch, 2010; Birkinshaw, Holm, Thilenius, & Arvidsson, 2000; Goodall & Roberts, 2003). They stress that serious problems relating to HQ’s knowledge and power limit, and sometimes totally inhibit, its possibility to influence innovation processes at the subsidiary level.

Basically, the discrepancy between the two perspectives mirrors different views on what can be called the HQ *knowledge situation*. The ability of HQ to play a positive role and contribute to the efficiency of innovation processes at the subsidiary level is highly dependent on its level of access to relevant knowledge. If we assume that HQ either (i) actually possesses knowledge of crucial importance for a particular innovation process, or (ii) does not possess such knowledge but has a fair understanding of what kind of knowledge the process requires but HQ lacks, or (iii), even worse, not only lacks the knowledge but also any inkling of what knowledge it lacks, it has a profound impact on HQ’s potential role. The issue obviously calls for further inquiry.

The purpose of this paper is to confront the predictions of the *bounded rationality* perspective with those of the *sheer ignorance* perspective. In line with Scott, we define *perspective* as a conceptual umbrella “with a number of varying approaches that bear a strong family resemblance” (Scott, 1981, p. 55). In this sense, bounded rationality and sheer ignorance are perspectives “with respect to a limited, approximate, simplified model of the real situation” (March & Simon, 1958, p. 153). These perspectives are therefore difficult to measure and compare directly. However, we can compare whether or not the two ‘simplified models’ of the HQ knowledge situation lead to different predictions for a specific empirical phenomenon.

The empirical phenomenon is the relationship between HQ involvement in innovation processes and the performance of these processes. More specifically, we examine the impact of HQ involvement in subsidiary-level innovation development and transfer processes on the efficiency⁴ of these processes. We define efficiency in terms of time and cost, i.e., as the amount of resources required to develop and/or transfer a certain innovation (Szulanski, 1996; Verona, 1999) and argue that each perspective leads to different expectations regarding the effects of this involvement on the efficiency both in the development of an innovation at a specific subsidiary and in the transfer of this innovation to other subsidiaries. By confronting these expectations with empirical data, we assess the relative merits of the two perspectives for increasing our understanding of the potential role of HQ in innovation processes undertaken within MNCs with highly distributed knowledge-creating processes.⁵

In the next section, we construct two contrasting models and formulate three pairs of competing hypotheses concerning the impact of HQ involvement on subsidiary innovation efficiency. These hypotheses are then tested on a dataset of subsidiary innovations, and the results are presented and discussed. The final section of the paper outlines the implications of the study, advances future research issues and identifies its limitations.

2. Theory, models, and hypotheses

2.1. Innovation and HQ involvement in subsidiary innovation processes

We begin by defining innovation and HQ as two central constructs related to MNCs and used in this study. The first, *innovation*, can be defined following the OECD’s Oslo Manual (2005, p. 47) as “the implementation of a new or significantly improved product (good or service), or process, a new marketing method, or a new organizational method in business practices, workplace organization or external relations”. We use this definition of innovation because it stresses newness and significant improvement. Further, the innovative process is seen as path dependent and involving the putting into practice of product designs and manufacturing processes that are new to the firm (Nelson, 1993). With respect to the second, *headquarters*, we follow Collis, Young, and Goold (2007), and define it as including the staff functions and executive management with responsibility for, or providing service to, the whole of (or most of) the company, excluding staff employed in divisional headquarters.⁶

⁴ We limit our study to the efficiency aspect of the innovation process, ignoring other typical dimension of performance, i.e., effectiveness. Although no study has researched performance under the two knowledge perspectives we have discussed, previous research in this field has dealt mainly with efficiency (e.g., Brown & Eisenhardt, 1995; Eisenhardt & Tabrizi, 1995; Teece, 1977; Zander & Kogut, 1995). However, some studies addressing both dimensions show that they respond in a similar way to the influence of examined factors (e.g., Pérez-Nordtvedt et al., 2008; Verona, 1999).

⁵ It should be pointed out that bounded rationality and sheer ignorance are not looked upon as two different managerial tools, but rather as theoretical lenses through which to examine the actual possibilities and limitations of HQ to play a role in innovation processes.

⁶ That is, corporate and divisional executives plus (only) corporate staff.

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