

CULTURAL DIVERSITY AS A MECHANISM FOR INNOVATION: WORKPLACE DIVERSITY AND THE ABSORPTIVE CAPACITY FRAMEWORK

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ABSTRACT

Although prior research demonstrates a relationship between organizational diversity and firm performance, there lacks detailed explanation describing how and why organizational diversity impacts firm performance. This limited understanding of the diversity “black box” may explain why prior research has produced mixed results concerning the relationship between diversity and either group or firm outcomes. Culturally diverse firms experience improved performance when an innovation strategy is in place, and group diversity has been linked to creativity in prior research. This may mean that diversity-creativity linkages are variables responsible for firm performance outcomes. However, there is scant attention paid to how individual- and group- levels of creativity and innovation within the firm result in firm-level innovation. The author of this article explores how firms that value diversity become innovative through their ability to harness creativity and transform it into useful ideas, products, and services. Multi-level creativity is described by the author, and using the diversity perspectives and absorptive capacity framework, the paper discusses how diversity and the manner in which it is managed creates an environment ripe for firm-level innovation to flourish.

INTRODUCTION

Innovation cannot exist in the absence of creativity (Basset-Jones, 2005). Furthermore, creative behavior may be considered a subset of innovative behavior (Yuan & Woodman, 2010), as innovation involves both generating and implementing new ideas (Woodman, Sawyer, & Griffin, 1993). Although there is theoretical support (Cox & Blake, 1991; Jackson, 1992) and empirical evidence demonstrating that cultural diversity impacts organizational creativity (McLeod, Lobel, & Cox, 1996) and performance (Dezso & Ross, 2012; Richard, 2000; Richard, McMillan, Chadwick, & Dwyer, 2003), there are inconclusive results linking diversity with firm innovation (Horwitz & Horwitz, 2007). Knowing from prior research that diversity relates to creativity (McLeod et al., 1996; Watson, Kumar, & Michaelsen, 1993), a subset of innovation, it should logically follow that diversity plays a role in how firms become innovative. However, there is a dearth of empirical evidence and theoretical grounding to support this claim.

Although prior research demonstrates a relationship between organizational diversity and firm performance (Richard, 2000; Richard et al., 2003), there lacks a comprehensive framework that describes *how* and *why* organizational diversity impacts firm performance. In fact, the few empirical results investigating the relationship between diversity and organizational outcomes have only been significant when the firm engages in a growth (Richard, 2000) or innovation strategy (Richard et al., 2003). Additionally, other variables have been identified in past research that offer further explanation as to why many of the relationships between diversity and other outcomes exist (Lawrence, 1997). This limited understanding of the diversity “black box”

(Lawrence, 1997) may explain why prior research has produced mixed results concerning the relationship between diversity and either group (Horwitz & Horwitz, 2007; Knippenberg & Schippers, 2007) or firm outcomes.

A firm's perspective towards diversity can govern the ability of its employees to communicate effectively and reap sustained benefits from diversity. Ely and Thomas (2001) identified three perspectives under which cultural diversity could either improve or harm work group functioning. The fairness-and-discrimination perspective explains how organizations comply with the law, but do not necessarily benefit from diversity at work. The access-and-legitimacy perspective explains how racial minorities may benefit with access to the workforce, but the organization itself does not derive much benefit from its diversity practices. The integration-and-learning perspective suggests that organizations and its employees can benefit from a diverse workforce when it is managed properly. The authors suggest that these perspectives may influence the climate or culture of an organization. However, the relationship between these perspectives, diversity and innovation has not been examined.

Absorptive capacity (ACAP) of a firm is related to the effectiveness of its deployed innovation strategies. ACAP is defined as the ability of an organization to acquire, assimilate, and exploit information to commercial ends (Cohen & Levinthal, 1990). The innovative capability of an organization is a result of its level of absorptive capacity (ACAP) which has been linked to firm performance. There is limited research concerning how firm capabilities for innovation are derived from organizational learning and employees' knowledge. Prior research suggests that environmental conditions must be met in order for knowledge creation or transfer to occur (Cohen & Levinthal, 1990; Grant, 1996; Szulanski, 1996). The characteristics of the environment, as described among researchers (Cohen & Levinthal, 1990; Grant, 1996; Spender, 1996; Szulanski, 1996) both differ and overlap ranging from the responsibility of the firm to remove barriers to knowledge transfer (Szulanski, 1996) to the amount of exposure, practice, and frequency that firms allow its employees to have with new information and knowledge (Cohen & Levinthal, 1990; Lindsay & Norman, 1977). However, there is no explicit mention of how cultural diversity ties into a framework for explaining how firms become innovative. Although the structure and policies of the firm play a role in producing innovation, it is important to recognize that firms can be conceptualized as being comprised of social actors, each with potentially strategic added value to the firm (Branco & Rodrigues, 2006). Organizational actors may include top management teams, the CEO, or even employees at the lower levels of the firm governed by control mechanisms which may include policies, procedures, and differing organizational climates. Individuals play a prominent role in knowledge creation (Grant, 1996; Nonaka, 1994) that affects firm innovation.

The primary purpose of this paper is to extend previous research on the impact of organizational diversity on firm outcomes by (1) conceptualizing how the diversity – creativity relationship can be used by firms to harness innovation, (2) examining the role that best management practices play regarding the diversity-creativity relationship to affect innovation, and (3) developing a comprehensive theoretical framework for future research that describes the relationship between diversity management practices and firm-level innovation. I propose that the implementation of programs and policy structures that support organizational diversity and organizational actors enhance the ACAP of firms allowing them to perform innovatively. Using a multi-level perspective, I propose a framework that integrates workplace diversity research from the individual-, group-, and firm- level regarding the relationship between diversity and creativity with the process of absorptive capacity and innovation. Using the three-perspective

diversity framework (Ely & Thomas, 2001), I propose that the governance and management of diversity policies and practices creates an environment where absorptive capacity may flourish to impact the effect of diversity-creativity linkages on firm innovation. Throughout the paper diversity is defined as being cultural, racial, or sex-based and distinctions between the different types are made for clarity when necessary.

THE CASE FOR THE DIVERSITY - CREATIVITY - INNOVATION RELATIONSHIP

Scholars have found that heterogeneity of teams leads to more effective outcomes given the broader knowledge scope (e.g., Cox & Blake, 1991; Eisenhardt & Schoonhoven, 1990; Keck, 1997). However, greater levels of skills and cognitive diversity do not always yield a positive influence on outcomes. For example, when examined at the team level Horwitz and Horwitz (2007) found no relationship between bio-demographic diversity and the quality of team performance. Others have found negative relationships between diversity and problem-solving processes (e.g., Tsui & O'Reilly, 1989). One explanation for the variation in results may be lack of consideration for the time a team of individuals spends together. Watson and colleagues (1993) found that over time, heterogeneous groups outperformed homogeneous groups while working on tasks. Time that employees spend with one another also allows for them to share more information, whereby their deep-level traits such as work attitudes become more important in their relationships than surface-level traits (Harrison, Price, & Bell, 1998). It is not uncommon for teams of employees in organizations to spend lots of time with one another on a task. Without considering the team or organizational influences, studies are limited in the ability to capture the motivations guiding the collaboration process. Organizations may be influenced by not only policies but also structure. Thus, diversity practices, policies, and the level within the organization where employee interactions occur, has a substantial relationship on firm outcomes such as innovation, yet has not been fully examined in extant literature.

THE INFLUENCE OF POLICY ON DIVERSITY OUTCOMES

Signaling theory (Spence, 1973) posits that when presented with incomplete information, individuals interpret the limited information that is known to them using it as a substitute and as a way to reduce uncertainty. They may rely on this limited information for making decisions for job related outcomes (Rynes, 1991). Similarly, policies or norms of an organization signal to employees how much they are valued by the company or how fair they perceive they will be treated irrespective of their race or gender, impacting the perceived climate of the organization.

Diversity Perspectives Effect on Innovation

Ely & Thomas (2001) proposed three perspectives that firms adopt when managing organizational diversity, the fairness-and-discrimination, access-and-legitimacy, and integration-and-learning perspective. A diversity perspective can either be explicit such as through the use of formal policies and guidelines, or implicit such as through leadership behaviors (Ely & Thomas, 2001). In their qualitative study, the three perspectives were identified among three professional service firms and related to their effect on group processes and outcomes. The integration-and-learning perspective was found to have the most positive impact on work outcomes. Firms that held this perspective incorporated policies and practices that directly tied

cultural diversity to work processes, thereby creating a high value for cultural identity as a resource for learning. As a result, a greater number of women and minorities were empowered to influence work outcomes. One of the main indicators for progress was the increase in leadership among minority employees and the result of both process and product innovation.

The access-and-legitimacy perspective resulted in an increase of minority employees too. However, policies were not promoted to be effective at empowering minority employees or supporting them in leadership roles of influence. The access-and-legitimacy climate embraced the perspectives of its minority employees, but only as a means to expand the firm's market share among previously untargeted racial and ethnic groups of consumers. The input from minority employees in the company was limited with no viable leadership opportunities aside from those that directly enabled to company to benefit from access to minority consumers.

The fairness-and-discrimination perspective is characterized as having a low value for cultural identity where the rationale for diversifying was to be in compliance with the law and reduce liability against employment discrimination. This perspective views one dominant culture as effective with the expectation for all employees to assimilate into it.

Each perspective stems from the extent to which policies or practices are used to embrace employee diversity. In the study, firms that possessed a fairness-and-discrimination perspective resulted in having increased representation of women and minorities, but did not fully benefit due to norms that limited connections between employee diversity and work functioning. The integration-and-learning climate, the most attractive one by employees, was found to be the most effective at influencing work group functioning. Companies with an integration-and-learning perspective were high-functioning compared to the other perspectives.

LEVELS OF THE FIRM AND ITS RELATIONSHIP TO DIVERSITY AND INNOVATION

Individual- Level Relationship to Innovation

Innovation cannot occur within the organization without employees. Yuan and Woodman (2010) identified both individual and organizational factors that serve as antecedents to innovative behavior in the workplace. A primary individual factor was the creativity of individuals. But that is not enough. Although the antecedent to innovation stems from creativity within individuals or in teams (Basset-Jones, 2005), individual innovation is influenced by organizational culture and climate (Scott & Bruce, 1994), supervisor relationship quality and personal social image (Yuan & Woodman, 2010). People are motivated by expected consequences (Vroom, 1964; Yuan & Woodman, 2010). If individuals fear reprisal for taking risks, then they will not innovate (Yuan & Woodman, 2010). Similarly, a climate that is not supportive of diversity may create a culture perceived by employees to lack organizational support, cohesion, and identity resulting in interpersonal communication breakdowns which can hinder the elements needed for innovation to exist. Additionally, relationships between employees and supervisors may suffer (Ely & Thomas, 2001). On the other hand, an organization that celebrates diversity using the integration-and-learning perspective will provide a climate containing contextual factors that nurture innovative behavior. Employees often participate in the decisions made by the organization (Richard et al., 2003). When employees feel included they will be more apt to share their ideas and express their creativity. As a result, more innovative behavior among employees will lead to increased opportunities for innovation for the firm.

Group- Level Relationship to Innovation

Research investigating groups and teams has produced mixed results pertaining to the group performance of heterogeneous groups (Horwitz & Horwitz, 2007; Knippenberg & Schippers, 2007). This suggests that the mere presence of diversity is not sufficient to introduce creativity or innovation. There are two primary competing viewpoints on the relationship that diversity has on performance outcomes (Horwitz & Horwitz, 2007). The first is grounded in theories guided by cognitive diversity hypotheses that contend that heterogeneous environments produce creativity, innovation and better problem-solving (Horwitz & Horwitz, 2007; Cox & Blake, 1991). The information/ decision-making model stems from this viewpoint suggesting that diverse groups and organizations possess a wide range of perspectives and abilities from its members that can benefit organizations (Cox & Blake, 1991; Richard & Shelor, 2002). On the other hand, the similarity- attraction viewpoint contends that heterogeneity has an adverse impact on the performance of teams (Byrne, 1971; Horwitz & Horwitz, 2007; Tajfel & Turner, 1986). The similarity- attraction paradigm and social categorization theory stem from this viewpoint explaining how diversity negatively impacts organizations as members categorize themselves into social groups and may create conflict and prefer not to work with dissimilar others (Byrne, 1971; Ely & Thomas, 2001; Jackson, 1992; Tajfel & Turner, 1986). There is empirical evidence supporting both claims, demonstrating that diverse groups have both positive (Watson et al., 1993) and negative (Tsui, Egan, & O'Reilly, 1992) outcomes relative to homogenous groups. However, the differences in values and attitudes towards dissimilar others within a work group fuel conflict and discussion which can also spark further innovative thinking among group members. In fact, some studies demonstrate that over time, diverse work groups are more creative than homogeneous groups, generate more solutions and perspectives when addressing problems (Watson et al., 1993), and introduce innovation in team settings (Albrecht & Hall, 1991). The results from those studies reveal the impact that diversity has on groups and teams.

Drawing from the diversity perspectives towards diversity practices management, the integration-and-learning perspective was the most successful for the performance of groups with culturally diverse settings (Ely & Thomas, 2001). As individual groups and teams within an organization function successfully, a strong system of group performance emerges. A system of diverse groups has the potential to spawn creative ideas and solutions. Although a creative process can be produced by groups independently, organizations that apply the integration-and-learning perspective may motivate group members to intra-communicate thereby developing a collective of creativity. In other words, group creativity has the potential to aggregate to firm level creativity in preparation for innovation to flourish.

Firm- Level Relationship to Innovation

Based on anecdotal evidence, many business leaders will attest that diversity is linked to innovation and improved firm performance (Diversity Inc., 2011). However, inconclusive findings regarding the relationships with diversity outcomes could suggest that investigating main effects for diversity on firm outcomes is futile (Horwitz & Horwitz, 2007). Researchers have found mixed results demonstrating that diversity can be either beneficial (Cox & Blake,

1991; Hambrick, Cho, & Chen, 1996; Richard & Shelor, 2002) or detrimental (Jackson, 1992; Tajfel & Turner, 1986) to group and organizational outcomes. Other studies have concluded that there is no main effect of diversity on firm outcomes (Horowitz & Horowitz; 2007; Richard, 2000; Richard et al., 2003). An explanation for this may be that other variables are not accounted for in prior research that impact the effect that diversity has on organizational outcomes (Lawrence, 1997). A focus on investigating variables that influence diversity may shed light on future research of diversity and firm outcomes (Lawrence, 1997; Richard et al., 2003).

Richard (2000) demonstrated that culturally diverse organizations possess rare, valuable, and inimitable resources (Barney, 1991) that positively impact market performance, return on equity, and productivity. Diversity of top management teams is also linked to firm performance as female representation brings informational and social diversity benefits (Dezso & Ross, 2012). Such representation may signal a climate of inclusiveness and value for employees. As a result, managers are more motivated which impacts managerial task performance and thus better firm performance. The resource-based view (RBV) of the firm suggests that a firm may achieve a competitive advantage when its resources are rare, valuable, inimitable, and non-substitutable (Barney, 1991), and employees are resources that can serve as a competitive advantage (Wright & McMahan, 1992) for an organization when managed properly. Using RBV and a contingency approach, Richard (2000) suggested that a growth strategy impacts the effect of diversity on performance because the characteristics of having a diverse firm benefit the firm by attracting a greater number of qualified employees. However, a growth strategy only addresses the firm's impact on the quantity of diverse employees but not necessarily the quality of its diversity climate. In fact, another study by Richard and colleagues (2003) demonstrated that diversity positively relates to firm performance when an innovation strategy is used by the firm.

As earlier noted, when conflict stemming from diversity is not managed properly it can negatively impact organizational outcomes. Negative outcomes can occur due to differences in conflicting attitudes, values, and beliefs of individuals (Byrne, 1971; Jackson, 1992; McGrath, Berdahl, & Arrow, 1995) or based on self-categorization between group members based on demographic characteristics (Tajfel & Turner, 1986). Human resource management strategies may aid in managing conflict (Basset-Jones, 2005). An effective human resources strategy also aids in employing an innovative competitive strategy (Richard et al., 2003). An integration – and – learning perspective towards organizational diversity may play a role in motivating employees to be more productive (Basset-Jones, 2005; McMahan, Bell & Virick, 1998), creative (Cox & Blake, 1991; McLeod et al., 1996) and allow the firm access to diverse markets (Cox & Blake, 1991). As a result, the control mechanisms in place that effectively manage a diverse firm may offer some additional explanation as to how organizational diversity impacts innovation at the firm level.

THE FIT OF DIVERSITY IN THE STUDY OF INNOVATION

Although the link between diversity and creativity may occur at the individual - and group- level, it does not insure that firm innovation will occur. Multi-level creativity occurs when creative ideas exist at different levels within the firm. It is formulated knowledge that can serve as a prerequisite for firm innovation. However, in this state, the creativity residing in each level of the firm is at risk of existing in a silo, with each level functioning autonomously only benefitting itself without any means to share information. Multi-level creativity must undergo a transformation to become innovation at the firm level. Applying the integration-and-learning

perspective of managing diversity using policies and properly managed diversity practices may transform multi-level creativity into firm-level innovation.

Cox and Blake (1991) suggested that firms that value diversity will reap benefits of doing so by experiencing greater access to resources, lower costs of doing business, creativity, increased marketing opportunities, and system flexibility. McMahan and colleagues (1998) using the resource-based view of the firm (Barney, 1991) suggested that firms that were culturally diverse could gain a competitive advantage. Furthermore, Richard and colleagues (2003) demonstrated that firms can leverage cultural diversity to perform well using an innovative strategy. I posit that diversity management best practices reflecting the components of the integration- and- learning perspective (Ely & Thomas, 2001) serve as a medium through which an innovative strategy is made possible. This is because useful creativity, or knowledge, is more readily accessible as (1) individuals of the firm feel more open to express themselves, and (2) groups or departments within the firm are more willing to interact allowing multi-level creativity to aggregate to firm-level creativity, ready to be absorbed and transformed into innovative ideas, products, and services.

The Transformation of Multi-Level Creativity to Firm-Level Innovation

Absorptive capacity (ACAP) is linked to firm performance given that it supports the acquisition and integration of new knowledge (Zahra & George, 2002). ACAP includes two components: “potential” absorptive capacity (PACAP) and “realized” absorptive capacity (RACAP). PACAP is the process that makes the firm receptive to acquiring and assimilating new knowledge, and RACAP is a function of the knowledge exploitation process (Zahra & George, 2002). ACAP of firms is dependent upon four distinct dimensions or capabilities: acquisition, assimilation, transformation, and exploitation. Acquisition and assimilation are dimensions associated with PACAP while transformation and exploitation are dimensions of RACAP. Together they form ACAP into a dynamic capability to foster change (Zahra & George, 2002). In order for innovation to occur, a firm must possess external knowledge sources, knowledge complementarity, and experience (Zahra & George, 2002). As discussed earlier, there is evidence to suggest that diversity can enhance creativity among groups and teams, and affect firm performance. Combining the ACAP model with research from workplace diversity literature may explain how diversity-creativity linkages serve as a precursor to innovation.

The Effect of Diversity on External Knowledge Sources and Complimentarity

External knowledge sources are antecedents to PACAP. It can vary in form including sources such as inter-organizational relationships, acquisitions, alliances, and joint ventures. The diversity of sources of knowledge to which a firm is exposed can affect the firm’s acquisition and assimilation capabilities. Noting that an organization cannot exist without its “actors” (Branco & Rodrigues, 2006), the knowledge that an organization possesses is a direct result from what is known by its employees. The knowledge derived from external sources is transferred via individuals and groups as an organization’s ACAP depends on the ACAP of its individual members (Cohen & Levinthal, 1990). From a cultural diversity perspective, a firm that values diversity will attract and retain a variety of employees who can offer knowledge regarding consumer behavior of different cultural groups (Cox & Blake, 1991). A homogeneous firm may lack the insightful knowledge regarding the world view of a given cultural group. As a result,

firms lacking in diversity may limit their external knowledge regarding this source of information which is valuable for marketing products and services (Cox & Blake, 1991). Considering that individual members of a firm possess innovative capital (Yuan & Woodman, 2010), the likelihood for innovative knowledge to transfer to the firm increases when members of the firm are diverse.

A firm's knowledge complementarity, the extent to which external knowledge is both similar and different from the knowledge they already can access, is equally important. When managed properly, a diverse organization may garner multiple perspectives from one idea, product, or service due to the varied perspectives that stem from a diverse workplace setting (Cox & Blake, 1991) and diverse teams working together (Albrecht & Hall, 1991; Watson et al., 1993).

The Link between Diversity and Experience

Prior knowledge, memory, and problem solving abilities are experiences needed on both the individual (Cohen & Levinthal, 1990) and organizational level (Zahra & George, 2002) in order for ACAP to occur. Diversity practices managed well enact employee diversity as a resource and allow the firm to have access to a broader array of knowledge stemming from the multiple experiences of its employees (Cox & Blake, 1991). When the firm demonstrates that it is supportive of diverse perspectives and opinions, employees will share ideas, and the foundation of innovation is established. Firms with exposure to diverse and complementary forms of knowledge are proposed to have enhanced levels of absorptive capacity (Zahra & George, 2002), which supports firm innovation. With a broader scope of knowledge, firms are better able to acquire and exploit new forms of knowledge, which supports innovation activities in the firm. Furthermore, the innovation capabilities of the firm are not specific to one, single individual (except in cases of a one-person firm), but rather the innovation resides in a network of individuals across the firm. Culturally diverse organizations experience increased system flexibility (Cox & Blake, 1991), whereby they are able to communicate, adapt to change, and confront challenges more readily.

A broad range of skills among employees creates an enhanced capacity for the exchange of knowledge, which supports problem solving and innovation. It is the dissimilarity in expertise and education that fosters a broader range of cognitive skills (Cohen & Levinthal, 1990). By initiating policies and activities that promote diversity, the firm is able to enhance innovation activity; therefore, I suggest that properly governed diversity practices are related to innovation activity in the firm. Organizations that value diversity also attract a wider variety of talent than other firms because they draw from a larger labor pool. This may create a competitive advantage in finding individuals with varied cognitive skills which supports problem-solving and innovation.

CONCLUSION

The current paper proposes that the implementation of programs and policy structures that support organizational diversity and organizational actors enhance the ACAP of firms allowing them to perform better. This is due in part because (1) the diversity-creativity linkage at each level of the organization contributes to its multi-level creativity, (2) the successful management of diversity-creativity linkages at each organizational level allows for more creative opportunities to be recognized by the firm, and (3) the successful management of diversity

within organizations utilizing the proper perspective allows for multi-level creativity to be transformed to firm-level innovation due to employees feeling less alienated in an inclusive work environment, and greater accessibility to useful knowledge resulting from diversity-linkages. In other words, to further the prior research investigating the effect of diversity on firm performance, the effective management of a diverse workforce is equally, if not more, important than the mere presence of diversity for innovation to flourish, because it creates an organic environment conducive for organizational learning and improved performance through which creativity and innovation can thrive. Managers can benefit from this understanding of how diversity affects firm-level innovation when attempting to adopt a strategy for creating new ideas, products, and services.

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