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# Valuing Internal vs. External Knowledge: Explaining the Preference for Outsiders

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**T**his paper compares how managers *value* knowledge from internal and external sources. Although many theories account for favoritism toward insiders, we find that preferences for knowledge obtained from outsiders are also prevalent. Two complementary case studies and survey data from managers demonstrate the phenomenon of valuing external knowledge more highly than internal knowledge and reveal some mechanisms through which this process occurs. We found evidence that the preference for outsider knowledge is the result of managerial responses to (1) the contrasting status implications of learning from internal versus external competitors, and (2) the availability or scarcity of knowledge—internal knowledge is more readily available and hence subject to greater scrutiny, while external knowledge is more scarce, which makes it appear more special and unique. We conclude by considering some consequences of the external knowledge preference for organizational functioning.

*(In-Group Favoritism; Learning; Internal Competition; Knowledge Management)*

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## 1. Introduction

How do managers value knowledge possessed by members of their own organization and how do they value the knowledge possessed by outsiders? The “not-invented-here” (NIH) syndrome represents one answer to this question (Katz and Allen 1982), arguing that there is a bias against ideas from the outside. Managers within an organization often cohere in closely knit in-groups and come to see the knowledge that insiders possess as superior to knowledge that lies outside the walls of their institution. This was the mindset at Apple Computer in the early 1990s, where managers recoiled from good external ideas and lived in what was widely known as their own “reality distortion field” (Burrows 2000, p. 102).

Although the NIH syndrome is consistent with theories of in-group favoritism and out-group derogation (e.g., Brewer 1979), organizational reality frequently contradicts it. Consider how U.S. corporations and writers venerated Japanese management practices in

the 1980s (e.g., Athos and Pascale 1981). Interestingly, W. Edwards Deming (1986) of the United States developed some of the most popular ideas associated with Japanese management, such as total quality management. American managers ignored many of these practices until Japanese companies embraced them. Similarly, managers often value the analysis of consultants, whose claims of expertise and objectivity can dominate the recommendations of internal prophets, even when they both wind up saying the same thing. Many studies of interorganizational diffusion also find that firms frequently copy and transfer knowledge, strategy structures, and management practices from outsiders (e.g., Burt 1992, Davis 1991, Haunschild 1993, Haveman 1993, Mizruchi 1992) even to the point of pursuing managerial fads and fashions (Abrahamson 1996).

Even while managers chase after fads, copy what other companies do, engage in competitive benchmarking, and seek the help of outside consultants,

they often ignore or resist good internal ideas. For example, when a junior officer in the U.S. Navy pioneered an innovation that dramatically increased the accuracy of firing guns from ships, senior naval officers rejected this technology, and finally implemented it only after President Theodore Roosevelt intervened (Morison 1966). General Motors had difficulty in learning from highly successful internal ventures such as NUMMI (a joint venture with Toyota) and Saturn (a division characterized by teamwork and a collaborative relationship with the union) (Pascale 1990). Perhaps the most striking instance of ignoring internal knowledge occurred at Xerox in the 1970s. While Xerox managers carefully benchmarked the activities of external competitors (Jacobson and Hillkirk 1986), they ignored and failed to introduce product innovations developed at Xerox's Palo Alto Research Center (PARC), such as the personal computer, the Ethernet, the mouse, and word-processing software, all of which other companies later commercialized profitably (Smith and Alexander 1988). These examples have inspired researchers to investigate the reasons why there is so much "stickiness" and resistance to using knowledge from inside the firm (Goodman and Darr 1996, Szulanski 1996, von Hippel 1994).

Despite evidence that managers sometimes place a premium on external knowledge and face difficulties in transferring internal knowledge, *we cannot yet conclude that external knowledge is valued more than internal knowledge*. This is because very little research has directly compared knowledge valuation from either source. For instance, one of the few studies that compared internal and external knowledge *transfer* in multiunit firms found that organizational units benefited more from the knowledge of units in the same franchise than from the knowledge of units in different franchises (Darr et al. 1995). However, *transferring* knowledge is not the same as *valuing* it, and it is possible that the two are not perfectly correlated. Internal knowledge may indeed be transferred more often than external knowledge because availability increases the ease of communication between insiders, such as the frequency of phone calls and meetings (Darr et al. 1995), while outsiders face social, physical, and legal obstacles that inhibit knowledge transfer. Yet, even more internal knowledge that could

be transferred may fail to be transferred because it is relatively undervalued as compared to external knowledge.

In this paper, we use a pair of case studies and some surveys to document managerial preferences for external knowledge and to identify some mechanisms that help explain this preference:

(1) *Incentives in internal versus external competition*. Although organizational boundaries promote identification, they also demarcate an arena within which competition for promotions, status, and salaries occurs. As a result, when people value an insider's knowledge, they often gain little in the way of personal self-enhancement, and instead face the prospect of legitimating a direct competitor for organizational rewards. External competition involves contrasting incentives: Managers are motivated to learn from competitors because they fear being outcompeted in the marketplace, and they can learn and borrow without facing the status costs of validating a direct competitor—in fact, managers are often rewarded for learning from outsiders.

(2) *Knowledge availability and scarcity*. Although the relative availability of internal knowledge makes it easy to access and use (Cyert and March 1963), availability can simultaneously reduce its valuation through a series of perceptual processes. Specifically, the flaws of internal knowledge appear more visible simply because both insiders and their ideas can be examined more closely. In contrast, managers cannot scrutinize the ideas of outsiders as closely, so the flaws of external ideas are less visible until such ideas are brought inside and actually implemented. Moreover, the difficulty of accessing external knowledge makes it scarce and unique, which heightens its perceived value (Cialdini 2001).

In addition to identifying some explanations for the preference for outsider knowledge, we conclude by describing some of its possible consequences for organizational functioning.

## 2. Theoretical Perspectives

Although much theorizing explains insider preferences, few theories illuminate the causes of the reverse preference for outsiders. We will first describe

the major mechanisms that account for insider preferences and then situate them within organizational contexts to yield propositions that help account for preferences for outsiders and their knowledge.

### **2.1. Status Implications of Knowledge Use: In-Group Identification vs. Competition**

Much literature argues and shows that people affirm in-groups and bask in their reflected glory to maintain a positive social identity and engage in self-enhancement (Abrams and Hogg 1990, Tajfel and Turner 1986). At first glance, such motives fail to account for the in-group denigration and out-group favoritism that people occasionally display. However, more nuanced extensions accommodate such phenomena by suggesting that group members enforce conformity to group norms by derogating insiders who fail to comply with the standards of behavior and thought ascribed to the group. Thus, group members display "horizontal hostility" towards in-group members who threaten the category's distinctiveness from out-groups (White and Langer 1999). They dislike deviant in-group members more than certain out-group members (Marques et al. 1998), and they reject insiders who advocate diverse ideas more than outsiders who advocate them (Phillips 2000).

Although such arguments admit the possibility of in-group derogation, they focus on very specific types of in-group members: those who violate norms and threaten group status or distinctiveness. Further, the arguments do not account for favoritism to outsiders, because they assume that insiders actually lose status when they deviate from the in-group and borrow from the out-group.

Theories of in-group favoritism and, for that matter, predictions that similarity enhances interpersonal attraction (e.g., Berscheid and Walster 1969) often proceed from the argument that favoring similar others and those within one's own group is self-reinforcing and self-enhancing. However, one can accept the validity of the self-enhancement motive without necessarily concluding that its operation leads to in-group favoritism in an *organizational* setting. In-group favoritism is a problematic route to self-enhancement because organizations are often fraught with internal competition for rewards, status, and promotions.

In competitive organizations, knowledge users concede deference to internal knowledge sources (Blau 1955, Lee 1997) and transfer power to them when they acknowledge their ability to cope with critical problems (Salancik and Pfeffer 1982). Therefore, competent insiders are more threatening than competent outsiders (Tesser et al. 1988), and people will sometimes ignore knowledgeable insiders to avoid the painful implications of social comparisons with them (Taylor 1983), or denigrate them to outshine them in competition for organizational rewards.

These status threats, and the tactics they evoke, are not present when acquiring knowledge from more distant, external competitors. Rather, external competition motivates insiders to monitor outsiders (Ruscher and Fiske 1990), and managers actually gain status by using external contacts and knowledge (Burt 1992, Tushman and Scanlan 1981). Therefore:

PROPOSITION 1. *Internal competition raises the status costs of valuing internal knowledge.*

PROPOSITION 2. *External competition increases motivations to value external knowledge.*

### **2.2. Knowledge Availability: Lower Financial Costs of Acquisition vs. Lower Perceived Value**

Internal and external knowledge also differ in how easy they are to obtain. Insiders are physically proximate and more likely to communicate, so their knowledge is cheap and readily accessible, while legal and technological (security) barriers shroud competitor knowledge and prevent easy access to it. Consequently, managers ought to prefer internal knowledge because they tend to overweight readily available knowledge (Neale 1984, O'Reilly 1982, Tversky and Kahneman 1973). These preferences are efficient as well, as managers can limit their search to locally available options (Cyert and March 1963).

Although this logic illustrates how availability increases the ease of *transferring* knowledge, there are no direct implications for how availability affects the *valuation* of knowledge. In fact, availability could decrease knowledge valuation because available sources of knowledge are subject to greater scrutiny than are inaccessible sources. Subordinates

in close proximity to a manager's office will receive a more critical performance evaluation at year-end than will remote employees, because the proximate subordinates' errors are more visible and closer surveillance can result in less trust (Strickland 1958). Additionally, like many scarce goods, external knowledge might be subject to overvaluation, in part because it requires greater expenditures of time, effort, and financial resources to obtain. A manager who has paid those higher costs to obtain external knowledge becomes more committed to affirming its value (Cialdini 2001) to justify the expenditure. Thus:

**PROPOSITION 3.** *Although availability lowers the financial costs of obtaining and using internal knowledge, it also subjects it to greater scrutiny and criticism. While internal knowledge comes to be seen as familiar and flawed, scarce and difficult-to-obtain external knowledge retains its uniqueness and value.*

The rest of this paper develops these arguments further, using pertinent evidence from case studies and surveys.

### 3. Case Study and Survey Methods

We describe two case studies that follow contrasting sequences of events. The first case documents how a salad buffet chain called Fresh Choice valued the knowledge of another salad buffet chain called Zoopa—first, when the restaurants were competitors, and then after a merger. The second case illustrates how Xerox valued an Internet-based document technology—first when insiders at PARC developed it and subsequently once outsiders at an external firm called Impresse developed the technology independently. While the first case study illustrates how knowledge valuation *decreased* as the outsider became an insider, the second case shows how knowledge valuation *increased* once outsiders independently developed what was originally an internal technology.

The contrasting cases also enable us to draw other inferences with greater precision. It is possible that Fresh Choice stopped valuing Zoopa's knowledge over time, not because it valued external knowledge more, but because it had already learned all it

could from Zoopa. The Xerox case, in contrast, suggests the opposite: Xerox was reluctant to accept new, innovative knowledge initially, but actually valued it more highly over time after an outside competitor embraced it. Second, the merger of Fresh Choice and Zoopa naturally elicited organizational change and possible resistance that could have affected Fresh Choice's orientation to Zoopa after the purchase. The Xerox case enables us to examine the phenomenon without the complications of a merger. Furthermore, the Fresh Choice case addresses a limitation of the Xerox case by standardizing the target of perception, examining how managers perceive the same organization (rather than two targets differing along various dimensions) over time. Finally, the juxtaposed cases enrich our analyses by documenting favoritism to outgroup knowledge in diverse organizational settings.

#### 3.1. The Settings

Fresh Choice, a salad buffet chain that operated 51 units in California, Texas, and Washington, was founded in 1986 and went public in 1992. After seeing its stock price rise to the low 30s by the fourth quarter of 1994, the company suffered substantial financial losses in 1995 and 1996, and had just returned to marginal profitability in the late 1990s with roughly \$75 million in annual sales following a turnaround effort. Zoopa was a four-unit chain founded in the early 1990s in Seattle, where there were also three Fresh Choice restaurants. We did not select this case to demonstrate our prior beliefs about knowledge valuation across, versus within, organizational boundaries. We began the study in 1997 to look at knowledge transfer more generally, three months before the merger occurred. As we studied how this merger affected Fresh Choice's relationship with Zoopa, we noticed a striking, and unpredicted, contrast whereby Fresh Choice, which had so highly prized Zoopa's knowledge when the firms were competitors, markedly reduced its valuation of Zoopa's ideas after the merger.

We began the second case in the fall of 1999, when we approached the chief scientist at Xerox PARC with the specific intent of studying the valuation of internal and external knowledge. He suggested that we examine those dynamics within PARC's Docu-

ments.com project. Documents.com was a Web-based technology that enabled users to click on and perform a series of advanced document services, including printing, summarization, and translation. When the Documents.com project began in early 1995, Xerox had just completed a period of enormous growth. Between 1986 and 1993, the company's sales doubled, its assets grew threefold, and the company's Fortune 500 ranking jumped from 42 in 1982 to 21 in 1993 (Shukla 1997). However, between May and December in 1999, Xerox's stock price fell 65%, which management attributed to competition, Y2K worries, and a salesforce reorganization. Whereas prior research about Xerox's failures to commercialize brilliant PARC technologies concluded that the problems derived from the general inertia of a large, successful bureaucracy (Smith and Alexander 1988), our case finds something different. Xerox was largely unresponsive to internal knowledge, but was actually quite receptive to ideas and technologies originating outside the company.

For both cases, we conducted extensive semistructured interviews as a primary data source, and supplemented these interviews with internal documents, relevant newspaper articles, and observations about the companies recorded during visits. We conducted a total of 26 taped and transcribed interviews at Fresh Choice that lasted between one and two hours. The interviews were usually conducted face-to-face at various Fresh Choice locations, but we relied on phone interviews for out-of-state informants. We interviewed the entire Fresh Choice top management team, employees at several levels (regional management, restaurant general management, and restaurant employees), and general managers and employees at the acquired firm, Zoopa.

At Xerox, we conducted 13 semistructured interviews that lasted between one and two hours. The interviews targeted three groups of people: researchers at PARC (the key directors of PARC and the members of Documents.com team); Xerox corporate management in Palo Alto, who had evaluated both the PARC project and the offering of the external firm, Impressee; and Xerox executives in Rochester, New York, who had made funding decisions involving Documents.com. All interviews were on-site at

the various Xerox locations, except for a single phone interview. Additionally, we were invited to sit in on a PARC research presentation to a government agency.

To lend quantitative support to the observations that emerged from the interviews, we conducted several surveys. At Fresh Choice, we surveyed employees and executives about human resources practices, including those around knowledge management. As a final step in our data collection, we collected a pair of short surveys using samples of working adults to generalize some of our findings beyond the specific cases and to explore the mechanisms favoring external knowledge in more detail.

We analyzed the case data following grounded theory-building techniques (Glaser and Strauss 1967, Miles and Huberman 1984) to inductively derive the mechanisms that evoked the differences in knowledge valuation within and between organizations. After writing separate case studies, we conducted a cross-case analysis to locate common themes and compare the differences that emerged across these cases (Eisenhardt 1989). Our interview transcripts grounded our observations in the empirical data, and refined our inferences about the underlying dynamics of knowledge valuation.

## 4. Fresh Choice and Zoopa

### 4.1. Valuing Knowledge as Competitors

As summarized in Table 1, there is considerable evidence that Fresh Choice valued Zoopa's knowledge more when they were competitors than after they became one organization. The people who founded Zoopa were actually inspired to start the chain when they literally were sitting in a Fresh Choice restaurant. Also, when Fresh Choice later confronted business difficulties, its management also looked to Zoopa's ideas. Zoopa had developed a more varied menu than traditional salad buffets, and had supplemented soups, salads, and pastas with daily specials such as roasted chicken and pizza. As part of their turnaround effort, Fresh Choice also experimented by offering roasted chicken and pizza.

Fresh Choice management particularly admired the look and feel of Zoopa's restaurants, with their color-

**Table 1** Fresh Choice's Valuation of Zoopa's Knowledge as an Insider vs. an Outsider

	Examples of knowledge valuation	Examples of inhibited knowledge valuation
As external competitors (1990–May 1997)	<p><i>Motivation to value and use competitor knowledge</i></p> <p>Restaurants Unlimited, inspired by Fresh Choice, founds Zoopa.</p> <p>Fresh Choice begins its Employee Profile program, largely drawing from Zoopa training programs and materials.</p> <p>Fresh Choice adopts Zoopa's design elements and opens its Roseville location.</p>	<p><i>Limited access to knowledge, but motivation to value and use it</i></p> <p>Although Fresh Choice is motivated to learn from aspects of the Zoopa concept, organizational boundaries limit the amount of knowledge that is available and legal restrictions prevent Fresh Choice from copying and diffusing the form in its entirety.</p>
As insiders within a single organization (May 1997–present)	<p><i>Diffusion of a previously adopted innovation</i></p> <p>Fresh Choice makes plans to move the Zoopa brand to the Texas region, but according to a Zoopa manager, "it is the name, not the concept that is moving."</p>	<p><i>Access to knowledge, but limited motivation to value and use it</i></p> <p>Fresh Choice resists Zoopa's ideas to improve its food preparation consistency.</p> <p>Fresh Choice gives Zoopa many more recipes that it adopts from Zoopa.</p> <p>hangindent 8pt Fresh Choice persists in top-down management style rather than learning from Zoopa's participatory style.</p> <p>Fresh Choice changes purveyors rather than learning from Zoopa's use of relationships over contracts.</p> <p>Fresh Choice emphasizes cost cutting at Zoopa rather than learning from it.</p> <p>With the resignation of the entire Zoopa management team, Fresh Choice loses all Zoopa intellectual capital.</p>

ful, lively signs, and separate food stations, which, in contrast to a buffet line, involved different "vendors" energetically engaging customers:

Zoopa not only would be considered a competitor of ours in the Seattle region. The Zoopa design and environment is really something that we were looking to do and started to do with our Roseville [California] location. We opened our Roseville location in May of '96 and then at that point it was designed with much warmer colors, open ceilings, and an open kitchen where you could actually see people preparing the food and cooking, which you can see at Zoopa as well.

Although it might appear that Fresh Choice managers were simply interested in Zoopa's superficial exterior attributes, their valuation of Zoopa's look and feel represented an appreciation of far

more fundamental and tacit knowledge. Fresh Choice executives hoped that such attributes would help transform Fresh Choice's "sterile and boring atmosphere" into "Zoopa's exciting and fun atmosphere." These exterior attributes stimulated different behaviors whereby employees were more likely to interact with customers. Thus, about a year before the acquisition, Zoopa's "guest first" philosophy became Fresh Choice's primary model for service improvements. Zoopa was the source of both ideas and materials for Fresh Choice's "Employee Profile" initiative, a concerted attempt to develop employees that fit a more service-oriented profile. According to a Fresh Choice regional manager, "The Employee Profile...is definitely something that they've [Zoopa] done an excellent job with—hiring to a certain standard. So I would

say that that would be another a reason why we were looking to them [Zoopa]. It related really to service—they really think in terms of full service.”

Zoopa was born when its founders imitated the Fresh Choice concept with a different twist. When Fresh Choice faced business difficulties, it turned to Zoopa for potential solutions, copying food offerings, elements of the restaurant design, the Employee Profile, and behaviors such as service initiatives. All of this occurred while the restaurants were competitors. Thus, when Fresh Choice’s director of strategic planning described the rationale for the merger, he saw the acquisition of intellectual capital—and not simply physical capital—as one of the goals:

When I pitched it [the acquisition] to the board of directors...I also talked about what I feel is a real opportunity for Fresh Choice, and that is to start looking at how some really bright, creative people would take our concept and change it if it were theirs. And in this case, that’s exactly what happened. ...I think they made some great decisions...I did believe that a lot of what we were getting was intellectual capital.

#### **4.2. Reduced Knowledge Valuation After the Purchase**

After the purchase, although the legal and physical barriers to acquiring Zoopa’s knowledge were removed, Fresh Choice executives reduced their valuation of Zoopa’s knowledge and, consequently, their attempts to acquire and use that knowledge. When Zoopa was a competitor, its personnel received a great deal of respect. Terms such as “bright,” “creative,” and “energetic” dot the interviews with Fresh Choice people, as does the idea that Zoopa had intellectual capital to contribute. After the acquisition, however, Fresh Choice executives consistently discounted Zoopa managers’ performance—their financial and operational control of the stores—and particularly their quality and skill. One manager, for example, is referred to as being “burnt out.” The Fresh Choice regional manager who oversaw the new stores stated, “I’ve got to tell you, in some of these cases as well the quality of operations in their building was not great by any means.”

Fresh Choice also displayed less interest in Zoopa’s previously admired service behaviors and culture.

Although Fresh Choice had borrowed Zoopa’s idea of the Employee Profile, was interested in improving customer service, and, prior to the acquisition, had tried to instill Zoopa’s “guest first” customer-driven philosophy, once the acquisition was completed, there was little attention devoted to improving service quality or learning how to do so. Instead, the focus was on reducing Zoopa’s costs. A Zoopa manager recounted the following conversation with the Fresh Choice regional manager:

I mentioned to our regional manager that there’s no vision, there’s no direction that we are working towards...What I was trying to explain to our regional manager was that our focus has been directed really toward [short-term] profitability... That’s not how you get to this service thing...What physically have the people in the restaurant seen? They have seen that our janitorial company has been changed. They have seen that our pest control company has been changed. They have seen that our music company has been changed.

In addition to eschewing the emphasis on service in favor of short-term cost cutting, Fresh Choice also did not capitalize on Zoopa’s recipes or more tacit knowledge about its food preparation process. Within three months of the acquisition’s closing, Fresh Choice had lost all three of the Zoopa general managers who had come to the company after the acquisition, and, in the process, many future opportunities to acquire Zoopa’s knowledge.

Another potential explanation for our findings is that knowledge valuation declined, not because of the shift in Zoopa’s identity from outsider to insider, but as a result of the poor management practices endemic to the merger integration (Haspeslagh and Jemison 1991, Ravenscraft and Scherer 1987). In this case, however, it was unlikely that knowledge valuation declined because of mismanagement alone. Not only did Fresh Choice follow much of the advice about how to implement a merger—i.e., “show that you are personally involved” and “make clear that integration is a top priority” (Hirsch 1988, p. 15)—interestingly, Zoopa management was overwhelmingly positive about how Fresh Choice executives welcomed Zoopa employees and indicated that they had good career opportunities at Fresh Choice. In our interviews with the Zoopa managers, all informants emphasized that



initial contacts between the two organizations made them feel appreciated and respected, and created a positive feeling among Zoopa employees:

People [at Zoopa] were really excited—jazzed. Fresh Choice was going to grow it, which meant opportunity. They [Fresh Choice] did the right thing in terms of making people feel important and special... They came in and did the dog-and-pony show. I was really impressed with the president and the head of human resources. I thought they did a great job... People were excited.

Given the substantial evidence of a reasonably well-handled merger, we suggest that it was the change in boundaries, transforming an external source of knowledge into an internal source, that contributed to the altered patterns of knowledge valuation. An assumption underlying this explanation is that Fresh Choice executives actually valued internal and external knowledge differently. To show some preliminary quantitative evidence that this is so, and to support the qualitative evidence for our claims, we present data from a card-sort survey administered before the purchase took place, in which a small number of executives and employees participated. Seventeen employees and each of the five members of Fresh Choice's executive team rated the extent to which their firm used 70 randomly ordered human resources practices, and the executives also rated the extent to which these activities were important for organizational performance. They did this by sorting the practices (listed on cards) into category ratings placed before them. Our survey considered two internal learning items (employees in different departments learning from one another, and employees in geographically dispersed departments learning from one another) and three external learning items (learning from firms within the industry, firms from other industries, and learning from customers). When we created a composite of these variables, the external learning composite was rated more highly than the composite of internal learning items when employees ( $t(16) = -2.8, p < 0.01$ ) and executives ( $t(4) = -4.5, p < 0.01$ ) rated which practices the firm actually *used*, and when executives rated which practices were more important for organizational performance ( $t(4) = -2.0, p < 0.12$ ). This is tentative evidence that learning from outsiders was both more

common and more valued as an organizational practice in this organization.

To see whether these patterns of valuation of external versus internal knowledge generalized to a larger, more diverse sample of managers, 42 experienced managers in Stanford's Sloan M.S. program for mid-career executives rated the same items. To preserve confidentiality, we omitted demographic items. However, because 42 out of 48 members of the class participated, we present the general statistics Stanford publishes about these students: 77% were male; there was considerable national diversity (52% U.S. citizens, 23% Asian, 15% European, and 10% non-U.S. managers from the Americas); a variety of functional backgrounds (21% general management, 21% technical management, 15% marketing, 15% production/operations, 19% finance, and the rest administration), and the respondents had, on average, 11 years of work experience. Using a five-point scale, participants rated whether they disagreed (1) or agreed (5) with statements that the same five organizational practices described above were important for their organization's success. Participants rated the items from the external composite ( $\alpha = 0.70, M = 4.3$ ) more highly than they rated items from the internal composite ( $\alpha = 0.89, M = 3.9$ ),  $t(41) = -3.10, p < 0.05$ , suggesting that the phenomenon we observed at Fresh Choice generalizes to at least one other managerial population.

## 5. Preferences for Outsider Knowledge at Xerox

The Xerox case provides a second setting where we can study preferences for external knowledge. In the Zoopa-Fresh Choice case, once knowledge was internalized, it was seen as less valuable. Xerox permits us to examine the opposite phenomenon—an internal idea that was undervalued when it was *inside* Xerox was seen as exciting and desirable when an external firm developed it.

When PARC scientists began the Documents.com project in 1994, Xerox was shifting its identity and business strategy from "the copier company" to "the document company." The project should have fit well within the Xerox culture, as it recreated the historic

business model that relied on the click (Xerox had traditionally sold copies, registered by the click, rather than copy machines). Documents.com regenerated a digital version of the "click" by creating a "bus" of document services including printing, summarization, and translation, to be placed on the Internet. When the user clicked on these services, the services would be performed and the user would be charged. The Documents.com team had a three-year head start before the time that competitors would begin to work on similar initiatives.

However, despite this head start and apparent compatibility with both the traditional business model and Xerox's evolving strategy, the project faced a somewhat troubled and convoluted "path to the sea" as it became embroiled in funding struggles with skeptical top management at Xerox over the next several years. Xerox was reluctant to make the service available to existing customers because, according to a Xerox executive, the project was an "ugly baby," a reference to its imperfections and uncertainties. "If I'm going to sell this," he argued, "then I need to have this thing all wrapped up with a bow on it." And according to East Coast managers, it is impossible to fund every initiative that that comes out of PARC, so "some puppies must be drowned." Another setback occurred in 1998 when it appeared that Xerox would provide the service with an external partner, but the partnership fell through. By 1999, funding had been cut off for the project, and the few Xerox executives who were still interested in pursuing Documents.com had their connections to the team severed when they were shuffled in reorganizations and told to finish up their old projects. Recently the team has attempted to seek out specific customers who needed the software for customized solutions—a somewhat unusual marketing effort for what is supposed to be primarily a research group.

Xerox's objections to Documents.com cannot simply be explained as a general resistance to the Internet economy, as a resistance to change more generally, or even as resistance to providing document services on line. We say this because Xerox was quite responsive and interested when external companies emerged with similar and overlapping offerings to those provided by Documents.com. Three years after

the initiation of the Documents.com project, external companies began to emerge with similar offerings. So, at the same time that PARC scientists were working on their now unfunded project and searching for external customers, Xerox sent two managers to Impresse, one of the emerging competitors, on a special assignment. According to one of them, "We were there just to get the regular corporate spiel, see a demo, that kind of thing, but we had ulterior motives... We were told to investigate them from the perspective of possibly Xerox partnering or even maybe buying them." They described Impresse as focused, sophisticated, elegant, and as located in a crucial market space for Xerox. According to PARC's chief scientist, this interest in the market space once competitors already occupied it came too late, and with a large financial cost to the company:

We were three years ahead and we could have owned all that. But once Impresse started to get this huge market cap, and get all this visibility, then people felt much less risky about this one. If you put five full-time people on Documents.com, it would be history now. It would have made history. It turns out it was the right idea. But I tell you three years ago it was not clear if it was the right idea.

## 6. Why Did Managers Prefer External Knowledge to Insider Knowledge?

Drawing inferences about potential causes of a phenomenon is always complicated and the cases, grounded in their specific social contexts, naturally elicit many questions. Although we encountered a host of explanations for our phenomenon, we focus here on two mechanisms most strongly supported across the two cases and the surveys.

### 6.1. The Motivation to Learn from Competitors in External vs. Internal Competition

One contrast that emerged was the different implications of external and internal competition on a manager's motivation to learn: Market competition makes knowledge from external competitors seem more valuable, while organizational competition makes knowledge from internal competitors seem less valuable. In part, this is because managers assume that

they must resolve market competition objectively. Fresh Choice's CEO noted that the company that offers customers the best value proposition usually wins, so firms must learn what rivals are doing to avoid being outcompeted:

Anybody in the price category is a competitor. We have an average check of \$6.73 or something like that. So anywhere you can go for \$6.73 is a competitor, in a sense... So you study that market segment and look at what they're doing that's different and we're doing things differently as a result of that... A question I always ask [is] tell me who your competitors are, what do you know about your competition. Well,... I don't want to know their names, I want to know what they're doing that's different that we can learn from.

Learning is a valuable tool for coping with external competition because it can improve performance. Fresh Choice's CEO noted that firms use whatever tools are at hand—strategic decisions, benchmarking, and changing product offerings—in a series of warlike moves and countermoves to learn from and respond to external competition:

Right now, we're tracking [competitors]... I want to know strategically what you think they're going to do, where are they going to move, and what we have to do to counter it. You know, it's like a war, going back and forth. So we're doing more of that now, which we could be better at it, but we're doing more of it.

Likewise, a PARC scientist noted that Impresse immediately caught Xerox's attention:

Xerox was not an early adopter for Documents.com four years ago and could have been setting precedent by being able to offer the services. Now that we have (market) competition it's suddenly perceived to be of genuine value as opposed to potentially emergent value four years ago. So, it's interesting that the barriers are for internal adoption by Xerox. Yet, when there is a clear market indicator that it is of value and that people do find it to be a significant business offering that's validated... they are now motivated to go and play catch up.

Xerox executives carefully studied their external competitor, directly approached it, and considered it to be a potential partner, seeking knowledge so that they could make objective improvements in their offerings to meet the competitive challenge—all while

ignoring relevant insiders who had similar knowledge years earlier.

While market-based external competition motivated the *valuation* of external knowledge, internal competition motivated the derogation of insiders and *devaluation* of their knowledge. Companies have an incentive to benchmark, seize knowledge and advantage from a competitor, and make improvements so that the final products pass the test of consumer choice. In contrast, hierarchical superiors, who make *subjective* evaluations of competence, often mediate internal competition. As a result, when an insider values a direct competitor's knowledge, they risk legitimating them. We will illustrate two political strategies used at Fresh Choice and Xerox—deprecating and also ignoring insider knowledge—both of which coped with internal competition but, in the process, devalued internal knowledge.

Both Fresh Choice and Xerox were internally competitive environments. Internal competition occurred at Fresh Choice because of its internal labor market and promotion-from-within policies. Also, Fresh Choice's financial stress, frequent succession at the top, and attempts to upgrade the caliber of its store-level management through initiatives such as the Employee Profile also exacerbated competition. After the merger between Fresh Choice and Zoopa, the relationship between the firms' managers changed as they became direct competitors for organizational positions and rewards and naturally began to make comparisons with one another. Under pressure to enhance themselves and derogate their internal competitors, management at Fresh Choice, which had admired Zoopa managers prior to the merger, subsequently maintained that they weren't so special after all. Given an insecure environment, the last thing a Fresh Choice manager would be motivated to do was to confirm Zoopa's supposed superiority.

Xerox also was internally very competitive. There had been a number of senior management successions and, as the 1990s progressed, layoffs as Xerox struggled to meet increasing competitive challenges. People were concerned for both their well-being and the well-being of the company, and the history of Xerox's failure to commercialize technologies from PARC loomed over the company. In this context,

the very existence of Documents.com increased status competition among several internal divisions and provoked political struggles at Xerox. Documents.com was embroiled in a longstanding internal conflict between hardware divisions, which provide the bulk of Xerox's revenue stream, and software initiatives such as Documents.com, which can potentially run on competitors' hardware and undermine the profits of internal hardware divisions. Documents.com also provoked a struggle with Xerox's sales divisions by creating a channel conflict with one of Xerox's largest customers, who had ambitions to create a similar offering. Finally, a somewhat more surprising internal competitor was Xerox's newly formed Internet division on the East Coast. In name, this division could have been an ally for Documents.com, but in reality its incentive was to fight for control of turf, according to a Documents.com scientist:

There were other groups that had "Internet" in their name... You'd think that they would be a natural recipient to this technology that the research center could work effectively with to implement this. I think there were a number of things that came in the way... to them it probably looked as if we were competition. And, therefore, it was much safer to say, "We're going to do this, this is a good idea, we'll do it. We're onto it..." But it never happened.

Having stimulated competition from at least three parts of the company, Documents.com was caught in a web of political obstacles that tainted its legitimacy. As a result, according to a PARC scientist, Xerox managers preferred to protect current businesses by stopping the threats that Internet projects such as Documents.com posed:

We were told, "That [Internet projects] would destroy the Xerox business. Don't ever talk about it." And there is the sense that the Internet and the web are very, very threatening and not real. I mean everybody wants to believe it's going to pass by.

Xerox managers could explain away the importance of internal ideas by considering them to be another group's attempts to control turf, and coped with such threats in their historic, gentlemanly Xerox style—by quietly ignoring them. According to a business director at Xerox, "It's the stuff no one talks about. It's the stuff that you know you realize. Oh, they

didn't answer the e-mail. They didn't send anyone to the meeting." Interestingly, Impresse provoked many of the same threats to Xerox's divisions that Documents.com posed. What is critical, however, is the fact that although political maneuvering could eliminate the internal threat, it could not eliminate a threat in the marketplace. Market competitors could not be eliminated by ignoring them; managers were forced to use the opposite tactic of learning from them to "outcompete" them.

Even when direct competition between divisions was not an issue, internal technologies were orphaned—left without internal supporters—because insiders lacked personal incentives to take responsibility for them. According to a PARC scientist, even if people were not actively opposed to a technology, their personal interests lie elsewhere and they were not committed to advancing the development of a peer's technology:

They [other groups] all have their own mission and they're trying to make the numbers and they're trying to develop their software and do their thing and be king of the hill and be promoted or save their jobs... I don't know what motivates them all; that's what they're about. Taking this stuff [new technologies] and doing something with it is not what they're about. They'll take it and do something with it and if it helps them get done what they need to get done without distracting them too much.

While external ideas provoked knowledge valuation and hence learning, internal ideas languished because they were, at worst, threats for managers embroiled in political contests, and at best, potential opportunities that did not command much attention.

Using the case study evidence, we have argued that people seem to receive differential credit depending on whether they are using ideas from inside or outside of the company. To see if these ideas about credit from borrowing knowledge from inside or outside the company generalized beyond the two organizations we studied, we also surveyed 110 students from the University of Chicago's evening and campus MBA programs. The students answered a short survey in exchange for pizza, and each of the students who was present in class that day agreed to participate. The participants were 29 years old on average, with just over 6 years of work experience. seventy five percent

were Americans, and 62% of them were male. Eleven percent had worked in marketing, 27% in finance, 16% in general management, 6% in accounting, 6% were engineers, and the rest listed other functions.

Respondents read a scenario in which they assumed that they managed a large hotel chain and had to conduct performance evaluations of two managers in that chain. Those managers had attained similar levels of performance, but differed in that one had implemented services that another member of the chain had offered to customers, whereas the other had implemented services a chief competitor had offered. The survey was thus a within-subjects design in which participants evaluated two managers and allocated bonuses to them. We counterbalanced whether the participant rated the internal learner or the external learner first, but found no order effect. When we performed a paired samples *t*-test, we found that participants rated the external learner as expending more effort ( $t(107) = 6.5, p < 0.001$ ) and as more creative ( $t(107) = 4.8, p < 0.001$ ), and competent ( $t(107) = 6.3, p < 0.001$ ) than the internal learner (Table 2). As a result, they believed that the external learner gained more status than the internal learner ( $t(106) = -5.3, p < 0.001$ ), and were more likely to promote him ( $t(107) = -5.8, p < 0.001$ ), and give him a higher bonus ( $t(105) = 6.6, p < 0.001$ ). If, as these results indicate, managers receive more status, a higher bonus, and are given more credit for effort and creativity when they learn from outsiders rather than from insiders, even when they learn the same thing and get the same business results, the tendency to direct attention externally that we observed in the cases is perfectly rational from the standpoint of advancing one's own career.

Both the survey and the qualitative evidence illustrate that there are significant differences in the incentives that managers have to acquire internal and external knowledge. While the financial costs of using internal knowledge might be lower, its social costs are clearly higher—particularly in internally competitive environments.

## 6.2. Knowledge Availability vs. Scarcity

If internal competition provides a motivation to downgrade the value of internal knowledge, the fact

**Table 2 Mean Attributions About Internal and External Learners**

	Manager learns internally	Manager learns from external competitor
<i>N</i> = 110		
Effort	4.6 (1.0)**	5.4 (1.0)
Creativity	3.8 (1.3)**	4.6 (1.4)
Competence	4.3 (1.0)**	5.1 (1.1)
The amount of status the manager gained by learning	4.7 (1.2)**	5.4 (1.1)
Likelihood to promote the manager	4.4 (1.1)**	5.1 (1.1)
Bonus awarded to the manager	\$42.31 (19.42)**	\$57.10 (20.48)

Notes. \*\* $p < 0.001$ .

Effort, creativity, competence: 1=Unsatisfactory, 4 = Average, 7 = Outstanding.

How each manager's action affects their status: 1 = Hurts them, 4 = Neither, 7 = Helps them.

Likelihood to promote each manager: 1 = Unlikely, 7 = Likely.

Bonus: 0 = minimum, 100 = maximum.

that internal knowledge is closer at hand and consequently subject to more scrutiny provides a basis from which to do so. In contrast to findings that available knowledge is preferred and that proximity and mere exposure increase positive affect (e.g., Festinger et al. 1950), we describe how proximity and the resulting scrutiny can reduce the perceived value of internal knowledge.

First, the proximity of internal knowledge decreased its valuation by making its flaws more visible. Before the acquisition, Fresh Choice could only monitor Zoopa's results in terms of sales, service, and atmosphere, but after the acquisition, Fresh Choice managers were privy to previously invisible flaws, such as details about wastage and food preparation, that organizational boundaries had once concealed. Similarly, as with most new technical ideas, Documents.com was replete with minor imperfections. Xerox evaluators described the Documents.com project as an "ugly baby." It was not developed in industry-standard code, it lacked adequate administrative functions (log-in names, passwords), it had a poor user interface, and further, it tried to offer too many services.

Second, proximity permitted inside observers to see the imperfect processes that lay behind the creation of even unblemished final products. When Fresh Choice could see only Zoopa's atmosphere, food, and service,

the company admired the results. After the merger, when Fresh Choice saw the processes by which those outcomes emerged, the evaluation was much less favorable. As enumerated by Fresh Choice's president: "Their [Zoopas'] food cost is very high... They also were very wasteful in the restaurants. A lot of wastage, overproduction, and that. They didn't have a good system to follow-on production and predict customer counts." Just as the sausage tastes better when one hasn't witnessed its production, external knowledge, typically seen in the form of a completed final product, looks better to observers.

A third consequence of proximity, and one that does not even require the presence of negative information, was that it stripped insiders of the benefits of scarcity, rendering them more familiar, more ordinary, and less unique and special. In the words of a Xerox executive, lower levels of knowledge about Impresse contributed to its heroic stature:

At a personal level you have worked year after year after year with Dr. M and Dr. N [two PARC scientists] but someone from Impresse that has the backing of all these stellar venture capitalists looks better because you don't have the same level of information about them as people, as an organization. So you're willing to trust, and take that external paper validation because you do know Dr. M and Dr. N and you see them dream wild things, etc. They have the burden of the PARC cachet. So that's why you choose the people you know less about. It's a paradox.

Scarcity also heightens the uniqueness and value of external knowledge by escalating commitment to it (Staw 1976). Given that external knowledge is frequently more costly and difficult to obtain than proximate internal information, managers become particularly committed to affirming the value of external knowledge to justify the efforts they expended to obtain it.

## 7. Some Consequences of the Preference for Outsiders

We have provided a descriptive account and some theoretical explanations for why managers often prefer external to internal knowledge, but a question that naturally arises is whether these preferences are consequential for managerial decision making and

organizational functioning. After all, much research has noted the rationality of preferences for external knowledge, providing evidence that the performance of research groups declines over time as they insulate themselves from external communications and become nonresponsive to the environment (Katz and Allen 1982, Jaworski and Kohli 1993, Narver and Slater 1990). Further, managers must monitor sectors that control and affect important organizational goals (Pfeffer and Salancik 1978) and that are sources of strategic uncertainty (Daft et al. 1988). Finally, despite the costs and lower detail of external knowledge, it has certain benefits that internal knowledge does not, given that it is more varied and less tied to the path-dependent experience of a single organization (Ingram and Baum 1997, Halebian and Finkelstein 1999). However, the results from the two cases—both of which suggest missed opportunities and wasted knowledge—seem to imply that the patterns that emerged were indeed harmful, and that personal career incentives, rather than organizational benefits determined the processes we observed. Specifically, overvaluing external knowledge can negatively affect an organization's ability to innovate, implement knowledge, and maintain employee morale.

With respect to innovation, both Fresh Choice and Xerox took reactive rather than innovative stances to the marketplace. Both companies were in effect outsourcing knowledge and idea production to outsiders while stifling, or at least not encouraging, internal innovation. On one hand, a PARC executive noted that this valuation of external knowledge reduced risk, "The risk is now reduced on exactly what the offering [Documents.com] is because it's been developed and adopted by others like HP which is a major competitor for Xerox. So now Xerox is showing some interest in it." As a consequence of this stance, however, the executive noted that the company also lost the rewards that come from innovation and risk taking:

By choosing not to adopt the technology four years ago you have created the opportunity for somebody else to do it. That's what's been given away. You have not exercised the option of being able to take this technology and be able to test it and get it to a state probably in two years rather than the four years it's taken

for Impresse to become visible and a viable business offering.

Likewise, Fresh Choice, in failing to learn from Zoopa, was forced to react to external innovations in its industry rather than being more in control of its own destiny.

With respect to implementation, these organizations wasted tacit, detailed, and available internal knowledge and systematically pursued less-rich external knowledge. Because there are often weaker (or non-existent) social ties to outsiders as compared to insiders, such knowledge can be more difficult to implement (Hansen 1999). Although initially Fresh Choice only had access to sparse knowledge that could be gathered through observation, an innately more superficial method of data collection than two-way communication, it engaged in a careful, thorough, and sometimes complex analysis of Zoopa's operations. Once Zoopa was a part of Fresh Choice, Fresh Choice gained access to the more tacit details of its knowledge and how to use it. However, as reported in Table 1, after the acquisition Fresh Choice imitated and geographically diffused the physical elements of the Zoopa design in a mechanical way, rather than identifying and using the tacit knowledge now available. According to a Zoopa manager:

Zoopla [was] a way to sort of spark Fresh Choice into action. They're taking the name to Texas. I always think of companies that have no problem giving away their intellectual property or the recipes or something like that. I always [used to] think, "Gosh, why are they giving it away?" I notice as I get older [that] having a great building, that's the easy part. Having great recipes, that's the easy part. It's how you bring it life and the culture and the environment in which that takes place.

Likewise, Xerox, which had appeared to be uninterested in Documents.com for the past four years, despite its access to both the details of the technology and communication with its originators, eagerly sent observers to competitor firms such as Impresse. This suggests a paradox whereby less-accessible, sparser external knowledge became relatively overvalued and overused compared to accessible, rich, internal knowledge, from which value could have been more easily captured.

Finally, and perhaps most importantly, organizational preferences for external knowledge depressed the morale of the internal knowledge producers. PARC scientists described how it was "obviously a source of great frustration to [scientists] that now that the market has validated that this is of value and that there are going concerns out there on the Internet; suddenly Xerox takes it as a point of recognition that they now have to adopt this." Most dramatically, Zoopa managers expressed their frustration—due in large part to Fresh Choice's limited interest in using their knowledge—by leaving the firm.

## 8. Discussion

We have seen that several fundamental features of organizational life reverse the robust psychological findings of in-group favoritism and out-group derogation. Internal and external competition both act to raise the valuation of external knowledge relative to internal knowledge. Also, frequent oversight and evaluation in organizations renders the flaws of internal knowledge readily visible, while the scarcity of external knowledge enhances its value as does the effort required to obtain it. These processes are likely to dominate the not-invented-here syndrome, particularly in internally competitive organizations, and can produce detrimental consequences for innovation, implementation, and internal morale.

Our research, based on two case studies and some selected managerial surveys, is exploratory and preliminary, and obviously needs to be extended to explore a broader sample of organizations as well as to encompass more elaboration and exploration of the causal mechanisms we have described and other mechanisms that also help account for more valuation of external knowledge (see Menon and Blount 2002 for a review). Despite their apparent generality and consistency with established social psychological theories, our explanations are derived from the particulars of cases within two organizations, and further research should examine these processes in multi-organization, multi-industry samples. At the same time, a more fine-grained examination of the underlying causal mechanisms would be useful,

specifying for instance the nature of the threats people experience when facing internal and external rivalry (Menon et al. 2003) or the degree to which the phenomenon of valuing external knowledge reflects outsider favoritism, insider derogation, or both of these processes (Brewer and Brown 1998).

And while we have focused on some psychological determinants of the phenomenon, future research should consider the contributions of determinants at other levels. Likely candidates include the characteristics of individual decision makers, such as their own backgrounds (that might lead them to favor insiders or outsiders), the culture and values of the organizations in which they work, and market conditions, particularly the degree of competition in the marketplace that might make external sources of knowledge particularly salient and attractive.

Additionally, because we have studied managerial choices between internal and external knowledge, we have implicitly assumed a negative relation between the valuation of knowledge from the two sources. This assumption should also be tested, because it gives rise to empirical questions about how internal and external search vary with one another (Ancona and Caldwell 1992), and when the use of one source of knowledge enhances, rather than inhibits, the valuation and use of the other because of increases in absorptive capacity (Cohen and Levinthal 1990).

Despite the limitations that arise from the exploratory nature of our studies, our research directly compares processes within and between organizations, and therefore hints at the differences between competition, legitimation, and imitability across interorganizational and intraorganizational contexts. Managers appear to hold contrasting assumptions about inter- and intraorganizational competition, and hence cope with each by using contrasting strategies. When competition takes place between organizations, managers value incorporating a competitor's knowledge. Yet, when competition occurs within organizations, managers often have incentives to reject, devalue, or ignore the knowledge of opponents. We argue that this difference results, in part, because the symbolic and social costs of knowledge use differ within and between firms. The outcomes of imitation are significantly more negative when it occurs within the orga-

nizational boundary, where it harms personal status rather than increasing legitimacy.

Consequently, the predicted relationship between legitimation and imitation that institutional theory relies upon may be restricted to processes between, rather than within, firms. This observation has implications for the resource-based view of corporate strategy (Barney 1991, Wernerfelt 1984) and its focus on the challenges of attaining sustainable competitive advantage by generating firm-based resources that cannot be imitated by competitors. The dilemma of acquiring sustainable competitive advantage is particularly challenging, if, as implied by this research, managers systematically value external knowledge more than internal knowledge. In such a world, firms would be highly motivated to copy away the competitive advantage of others, while being less motivated to generate competitive advantage internally. However, copying others must, invariably, produce results that are about the same as those others. It is only by doing something unique, valuable, and difficult to imitate that companies can achieve advantage in the marketplace. Our research, however, also suggests a possible solution to this dilemma: Organizational practices that enable managers to share credit for internal knowledge transfers and to acknowledge the biases arising from close oversight may be less likely to promote dysfunctional search, and more likely to foster the development of internally generated competitive advantage.

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