

Make, Buy, or Innovate: Sequential Innovation and the Theory of the Firm

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In recent years, scholars have been turning their attention to the relationship between innovation and the theory of the firm. Curiously, this literature has mostly ignored the most important aspect of innovation – innovation itself. So far, the models for integrating innovation with the theory of the firm treat innovation as having happened, and then attempt to understand how the firm's decisions regarding development and exploitation will proceed. In this paper, we reframe the model. We treat innovation not as already having occurred. Instead, we consider what an innovator's options are when it wishes to participate in a certain product or service market, and must decide whether to borrow from existing ideas, some of which may be subject to property claims, or innovate around those ideas. We consider four major sorts of factors that influence this decision: (a) legal (i.e., what is the scope of the existing property rights and how enforceable are they); (b) technological and artistic (the maturity of the technology or art involved; the role of tacit knowledge; coordination costs); (c) market conditions (agency costs; competitive interests; network effects; availability of intermediaries; economies of scale), and (d) behavioral traits (risk preferences; taste for novelty; biases in creators' perceptions of available innovation space; creativity effects).