

## Idea Expropriation, Incentives, and Governance within Organizations

**Authors :** Gulseren Mutlu, Gurupdes Pandher

**Abstract :** This paper studies the strategic interplay between innovation, incentives, expropriation threat and disputes arising from expropriation from an intra-organization perspective. We present a simple principal-agent model with hidden actions and hidden information in which two employees can choose how much (innovative) effort to exert, whether to expropriate the innovation of the other employee and whether to dispute if innovation is expropriated. The organization maximizes its expected payoff by choosing the optimal reward scheme for both employees as well as whether to encourage or discourage disputes. We analyze two mechanisms under which innovative ideas are not expropriated. First, we show that under a non-contestable mechanism (in which the organization discourages disputes among employees), the organization has to offer a “rent” to the potential expropriator. However, under a contestable mechanism (in which the organization encourages disputes), there is no need for such rent. If the cost of resolving the dispute is negligible, the organization’s expected payoff is higher under a contestable mechanism. Second, we develop a comparable team mechanism in which innovation takes place as a result of the joint efforts of employees and innovation payments are made based on the team outcome. We show that if the innovation value is low and employees have similar productivity, then the organization is better off under a contestable mechanism. On the other hand, if the innovation value is high, the organization is better off under a team mechanism. Our results have important practical implications for the design of innovation reward system for employees, hiring policy and governance for different companies.

**Keywords :** innovation, incentives, expropriation threat, dispute resolution

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