

DOING THE RIGHT ENTREPRENEURIAL THING: ETHICAL DECISION MAKING UNDER UNCERTAINTY

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ABSTRACT

Are entrepreneurs more or less ethical than other business agents? This study finds that complex and novel decision settings yield biases that render entrepreneurs to have lower ethical judgment than that of managers. Such a finding raises important questions about the moral expectations that society places on entrepreneurs.

INTRODUCTION

Business persons of all types have a moral obligation to account for the interests of their stakeholders and to act in ways that maximize the benefits or minimize harms to all involved (e.g. Clarkson 1995; Donaldson and Dunfee, 1994; Donaldson and Preston, 1995; Quinn and Jones, 1995). Although there remains considerable ambiguity in the precise nature of such moral obligations (see e.g. Lewis, 1985; Mitchell et al., 1997), the avoidance of harm is widely regarded as a universal norm that applies to all human activities (Linklater, 2006). Studies on entrepreneurial ethics, however, challenge such a moral principle. A large body of entrepreneurial cognitive research finds that entrepreneurs operate in highly uncertain decision settings. These settings introduce egocentric biases that preclude the entrepreneur from fully identifying and comprehending the harms or risks done to its various stakeholders (e.g. Dew and Sarasvathy, 2007; Lepoutre and Heene, 2006).

The objective of this study is to theoretically and empirically examine the moral applicability of stakeholder approaches to entrepreneurial ethics through two basic research questions. First, under what decision settings of uncertainty do entrepreneurs face biases in their ability to identify with their stakeholders? Second and subsequently, how do biases resulting from uncertainty impact an entrepreneur's ability to satisfy its moral obligations to societal stakeholders, especially from that of other business persons, such as managers?

CONCEPTUAL DEVELOPMENT

A Cognitive Approach to a Stakeholder view of Ethical Judgment

To develop a cognitive approach to a stakeholder view of entrepreneurial ethics, entrepreneurial cognition research argues and finds that an entrepreneur's judgment relies on decision biases when dealing with uncertain settings characterized by complexity and novelty (e.g. Baron, 1998; Busenitz and Barney, 1997; Hayward et al., 2006; Simon and Houghton, 2003).

Complexity. Complexity is rooted in the limited resources of the entrepreneur (Busenitz and Barney, 1997). An entrepreneur's limited resources require that its business existence rests on the support of a complex array of direct and indirect stakeholder partnerships (Fassin, 2000). For instance, direct stakeholders provide resources in marketing and manufacturing that overcome the specific operational challenges that impact the survival of the entrepreneurial firm. Venture capitalists, angels, and other funders provide advice and monitoring. Although indirect stakeholders, such as government and local community groups, do not have a direct stake in an entrepreneur's business, they nevertheless provide resources of a more general nature that support the existence of businesses with similar challenges.

Although this complexity is consistent with the utilitarian premise of stakeholder approaches, such complexity, however, yields an uncertainty in an entrepreneur's ability to satisfy his moral obligations to its varied stakeholders. With complexity, there is an uncertainty between the resources provided by the various stakeholders and its relationships to the survival of an entrepreneur's business (see also Foss et al., 2008; Sarasvathy, 2001). With such complexity, the entrepreneur cannot uniquely identify the resource contributions of each stakeholder because in an interdependent system the contributions of each stakeholder cannot be examined independently of that of another (see also Dew and Sarasvathy, 2007). Hence, as the entrepreneur cannot fully identify all those that have "stake" in the survival of their business, complexity yields an uncertainty in which the entrepreneur cannot fully identify all stakeholders that can be harmed by his risk taking actions.

Falsification bias. Due to basic limits in cognition, entrepreneurial cognition research shows that entrepreneurs respond to such complex decision settings by using a falsification bias (e.g. Palich and Bagby, 1995). A falsification or confirmation bias refers to an individual's inability to consider or seek information that contradicts or falsifies their personal beliefs or interests (Einhorn and Hogarth, 1978; Nickerson, 1998; Schwenk, 1986). Complex decision settings favor the use of such a bias because it simplifies an entrepreneur's attention to selective aspects of their information environment and thus relinquishing the need to comprehend the full complexity of their decisions (e.g. Palich and Bagby, 1995). As a consequence of complexity, this falsification bias can lead to a selective interpretation of an entrepreneur's stakeholder environment in which such a bias focuses on those stakeholders that directly serve an entrepreneur's personal interests. Namely, although the entrepreneur has a personal stake in the survival of his business, such an objective is also affected by the resource commitments of his direct stakeholders because these stakeholders directly contribute to an entrepreneur's immediate survival (e.g. Lepoutre and Heene, 2006). Hence, as complexity renders that an entrepreneur is vulnerable to a falsification bias, he is subject to a falsification bias in which he seeks to preserve his self-interests by avoiding harm to this direct stakeholder group at the expense of incurring harm to the broader interests of society (Lepoutre and Heene, 2006). This is consistent with ethical blindness research that finds entrepreneur's can fail to do the right thing because their actions to satisfy the moral concerns of one group blinds them from fulfilling their moral

obligations to a broader social group (e.g. Chugh and Bazerman, 2007; Lepoutre and Heene, 2006; Palazzo et al., 2011). However, as managers have been reported to face fewer challenges with complexity (Busenitz and Barney, 1997), the following is thus hypothesized:

Hypothesis 1. Conditional on highly complex decision settings, entrepreneurs exhibit different and lower ethical judgments than managers.

Novelty. Besides complexity, entrepreneurs also operate in uncertain settings characterized by novelty (Busenitz and Barney, 1997; Hayward et al., 2006; McMullen and Shepherd, 2006; Simon and Houghton, 2003). Novel decision settings involve a co-creative process in which entrepreneurs and their stakeholders collectively contribute resources to creating innovations (Dew and Sarasvathy, 2007; Fassin, 2000; Sarasvathy, 2001), typically through a Schumpeterian (1934) process of recombining the complementary resources of external stakeholders (e.g. Dew and Sarasvathy, 2007; Sarasvathy, 2001). Yet, because novelty lacks a historical precedence, stakeholders' commitment of resources to an entrepreneur's innovation process are subject to "unknowable risks" or harms that cannot be known ex ante (Dew and Sarasvathy, 2007; Read et al., 2009).

Inside Bias. To overcome such "unknowable" risks, novel decision settings have been closely associated with an "inside view" bias (Kahneman and Lovallo, 1993; Kahtri and Ng, 2000). An insider view involves a distinct mode of causal inference in which an uncertain future is not inferred from an extension of a similar and repeatable past (see also Langlois and Cosgel, 1993). Rather, an inside view "divines" a future by drawing on the unique and holistic details of a given situation to overcome obstacles in realizing a constructed future (Kahneman and Lovallo, 1993; see also Read et al., 2009; Sarasvathy, 2001). Entrepreneurs are vulnerable to such an insider view because entrepreneurs typically have a personal stake in their innovations (Miles et al., 2004) and thus intimately understand the challenges and obstacles facing their venture's innovation processes. Furthermore, entrepreneurs are often pre-occupied with "firefighting" day to day production, marketing, finance, and human resource problems (Lepoutre and Heene, 2006) and thus yielding a holistic understanding of the various aspects and challenges confronting their venture's innovation process.

As innovation rests on a direct commitment of resources (Read et al., 2009), novelty renders entrepreneurs vulnerable to this inside bias because it serves to overcome the "unknowable" risks or harms faced by their direct stakeholders. Namely, direct stakeholders constitute core components to an entrepreneur's innovation process because employees, investors, suppliers, alliances partners, consumers, offer skills, expertise and resources that complement an entrepreneur's skills and talents. These direct stakeholders also bear the greatest unknown risks or harms from an entrepreneur's innovation process (Harris et al., 2009; Sarasvathy, 2001). Yet, since an inside bias yields a detailed and holistic understanding of the innovation process, this inside bias reduces the unknowable risks faced by its direct stakeholders. A consequence of novelty is that even though an entrepreneur's inside bias overcomes the unknown risks or harms to its direct stakeholder, such moral obligations are made at the expense of broader or indirect stakeholders. In that, since an entrepreneur's inside bias focuses his attention to seeking those resource combinations that overcome the unknown risks or harms to its direct stakeholders, such an insider view limits his ability to identify and overcome the "uncertain" risks or harms faced by his indirect stakeholder groups. This is consistent with Kahneman and Lovallo's (1993) who argue an inside bias' focus on the holistic details of current

situation is often made at the expense of rejecting a broader “outside view”. As managers have been found to face fewer challenges with novel decision settings (Busenitz and Barney, 1997), the following is thus hypothesized:

Hypothesis 2: Conditional on highly novel decision settings, entrepreneurs exhibit different and lower ethical judgments than managers.

METHODS AND PROCEDURES

Description of World Values Survey Data and Variables

To empirically examine these hypotheses, we draw on data from the fifth (2005-2006) wave of the World Values Survey (WVS, 2009) to explore differences in ethical judgments between entrepreneurs – as defined by small business managers (e.g. Lepoutre and Heene, 2006; Longenecker et al., 1989; Longenecker et al, 2005)- and managers – defined by large business managers- under settings of complexity and novelty. To construct a proxy for ethical judgments from the WVS, respondents were asked if the following behaviors that involves harmful actions to the greater society (i.e. indirect stakeholders): (1) “Claiming government benefits to which you are not entitled”; (2) Avoiding a fare on public transport”; (3) “Cheating on taxes if you have a chance”; and (4) “Someone accepting a bribe in the course of their duties.” Higher scores on these indicators represent higher ethical judgments and we used the average of these four measures to construct an average ethical judgment variable.

As complexity yields a falsification bias that insulates an entrepreneur’s ethical judgments to their indirect stakeholders, complexity engenders a greater sense of entrepreneurial independence or egocentrism (see Longenecker et al., 1988). To capture this independence, we use a WVS variable that measures the degree –from 1 to 10- to which an individual’s job tasks are independent whereby highly independent decision settings are equated with higher response values. Furthermore, as complexity yields a falsification bias that requires a greater cognitive processing of tasks, this falsification bias is proxied by a “cognitive” variable in the WVS survey that is also scaled from 1 to 10, such that highly cognitive tasks have larger values (i.e. 10). Both of these aspects are then combined to create a dichotomous complexity variable equal to 1 if the respondent indicated a 6 or higher (on a 10 point scale) for both the independence and cognitive task variables. Low complexity takes on a value of 0 for values less than 6. Novelty is captured by a “creative task” variable in the WVS survey measuring the degree of routineness and creativeness of work activities. To maintain consistency with the complexity variable, novelty is constructed as a dichotomous variable equal to 1 if the respondent indicated a value of 6 or higher, suggesting tasks that are relatively creative. In contrast, values less than 6 involve mostly routine tasks and thus taking on a value of 0.

To control for other factors expected to affect the respondent’s ethical judgments, we controlled for the respondent’s degree of religiosity (Singhapakdi et al., 2000) as well as their age and gender (e.g. Lewis, 1985). Moreover, because ethical judgments are likely affected by cultural influences (see Clark and Aram, 1997; O’Fallon and Butterfield, 2005), we include country dummies (e.g., Bucar et al. 2003).

To determine whether entrepreneur have systematically different judgments from that of managers, we used a MANOVA analysis to examine differences in ethical judgments between these two groups. Furthermore to see how entrepreneurship affects ethical judgments while controlling for individual characteristics such as age, gender, and religious belief as well as

individual country effects, we employ a series of OLS regressions using the average ethical judgment as the dependent variable. For each set of regressions (corresponding to our two entrepreneurship categories), we run the full sample as well as subsamples split by complexity and novelty, each time controlling for country effects.

RESULTS

 INSERT TABLES 1 AND 2 ABOUT HERE

The MANOVA results from Table 1 show that based on all four categories of ethical judgments, managers of small business exhibit lower ethical judgments than managers of larger businesses in settings of high complexity ($F = 4.64, p = 0.001$) and high novelty ($F = 2.01, p = 0.092$). The results shown in Table 2 also provide strong evidence that entrepreneurs in highly complex and novel decision settings tend have lower ethical judgments. Under the full sample estimate, the signs on the entrepreneur coefficients – regardless of classification- are negative and significant at the 1% level, even while controlling for age, gender, church attendance, and country. In examining the split-sample estimates, complexity and novelty affect an entrepreneur’s ethical judgments in ways that are generally consistent with Hypotheses 1 and 2.

DISCUSSIONS AND CONCLUSIONS

This study introduces a cognitive approach to stakeholder ethics that differs from ethics literature. Normative approaches to stakeholder ethics are based on an underlying metaphysical assumption that the avoidance of harm is the right or moral thing to do (see also Donaldson and Dunfee, 1994; Donaldson and Preston, 1995; Mitchell et al., 1997; Quinn and Jones, 1995). Yet, such moral obligations often fail to consider the descriptive or empirical realities faced by entrepreneurs (see e.g. Parmar et al. 2010; Weaver and Trevino, 1994). Although avoiding harm is a generally accepted universal principle (Linklater, 2006), knowing whose interest to take into account, and how various parties might be harmed, is particularly challenging for entrepreneurs operating under conditions of complexity and novelty. Note that our goal is not to reject the normative foundations of stakeholder approaches, but to emphasize that ethics operates in a particular decision context (e.g. Weaver and Trevino, 1994) that can prevent an individual from doing the right thing. Hence by drawing on a cognitive approach, we introduce a descriptive account of account of moral agency into normative treatment of stakeholder ethics (see also Mitchell et al., 1997). This underscores that an entrepreneur’s ethical judgment may not be driven by an individual’s sense of right and wrong, but may also be determined by the decision settings that surround them.

REFERENCES AVAILABLE FROM THE AUTHORS

Table 1. MANOVA analysis of differences in mean ethical judgment variables for different definitions of entrepreneur (managers of smaller businesses), conditional on highly complex and Novel decision settings (complexity=1, Novelty=1), controlling for individual countries.

Ethics Variable	Group	Mean (Complexity)	F Test Complexity	Mean (Novelty)	F-Test (Novelty)
Claiming benefits	Mgrs of small bus.	8.93	14.02***	9.02	4.99**
	Mgrs of larger bus.	9.40		9.31	
Avoiding fare	Mgrs of small bus.	8.53	10.77***	8.56	4.53**
	Mgrs of larger bus.	9.01		8.88	
Cheating on taxes	Mgrs of small bus.	8.44	30.02***	8.59	19.45***
	Mgrs of larger bus.	9.27		9.22	
Accepting a bribe	Mgrs of small bus.	9.25	12.16***	9.29	4.67**
	Mgrs of larger bus.	9.63		9.52	

*** significant at 1%, ** significant at 5%

Table 2. Regression model for entrepreneur as **manager of smaller businesses**, where dependent variable is *Average Ethics*, comparing high and low complexity and novelty conditions with full sample.

Variable	Full Sample	Low Complexity	High Complexity	Low Novelty	High Novelty
Intercept	8.108* (0.195)	8.020*** (0.285)	8.252*** (0.255)	8.186*** (0.286)	8.023*** (0.261)
Mgrs of small bus.	-0.170*** (0.097)	-0.072 (0.149)	-0.217* (0.119)	-0.121 (0.159)	-0.186* (0.113)
Attends church	0.054 (0.114)	-0.013 (0.154)	0.201 (0.169)	-0.048 (0.160)	0.240 (0.160)
Age	0.020*** (0.002)	0.022*** (0.004)	0.015*** (0.003)	0.019*** (0.004)	0.019*** (0.003)
Male	-0.037 (0.084)	-0.068 (0.126)	-0.006 (0.106)	-0.001 (0.131)	-0.067 (0.105)
Country dummies	Yes	Yes	Yes	Yes	Yes
R-squared	0.178	0.162	0.205	0.194	0.133
N	1472	832	640	776	696

Note: Standard errors in parentheses. High complexity refers to cases in which complexity=1, and high novelty refers to cases in which novelty=1. *** significant at 1%; ** significant at 5%; * significant at 10%.