Mission of JEE

The mission of the JEE is to publish (double-blind, peer reviewed) interdisciplinary scholarly research (conceptual, theoretical, empirical) or teaching cases that connect entrepreneurship and ethics and appeal to both the academic and the practitioner.

The views expressed in the Journal of Ethics and Entrepreneurship are the personal views of the author(s) of the individual articles and are not intended to reflect the views of the Editors, members of the Editorial Review Board, the Godbold School of Business or Gardner-Webb University.
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# Journal of Ethics and Entrepreneurship

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FROM THE PRESIDENT OF GARDNER-WEBB UNIVERSITY

With social, economic and political issues growing more and more challenging, it is difficult to imagine how there could be a greater need for character-based leadership. That need is revealed almost daily in the news. We must have leaders with principle, integrity and courage.

This is why Gardner-Webb University seeks to prepare and to inspire such leaders. As we seek to carry out our mission of service “For God and Humanity,” our focus is on Faith, Service, and Leadership. The life of faith brings with it a commitment to serve—to serve the greater good, to make other people’s lives better, as well as our own. Strong, faith-based leadership makes such service successful. Often, such leadership is expressed in entrepreneurship, in business as well as in social entrepreneurship.

As exemplified through the Center for Ethics and Entrepreneurship, the Godbold School of Business demonstrates, in a very effective manner, the University’s focus on Faith, Service, and Leadership. That focus can be found in the Journal of Ethics & Entrepreneurship.

As President of Gardner-Webb University, I am extremely pleased that our mission and our principles are advanced so effectively by the Godbold School of Business and by this journal.

-Frank Bonner

FROM THE DEAN OF THE GODBOLD SCHOOL OF BUSINESS

This issue of the Journal of Ethics & Entrepreneurship (JEE) published by the Center for Ethics and Entrepreneurship in the Godbold School of Business at Gardner-Webb University is dedicated to the memory of our beloved Associate Provost – Dr. Gayle Bolt Price. Dr. Price was instrumental and worked fervently to see the fruition of the establishment of the Center for Ethics and Entrepreneurship and consequently the introduction of the Journal.

The Journal is now in its third edition and has become a well-respected journal among its peers and a regular feature at several national conferences. We commend the Editor and the Associate Editor – Dr. Don Caudill and Dr. Jim Littlefield – for their dedication and hard work. We also extend gratitude to the authors in this issue and the distinguished Editorial Review Board. We especially thank Mr. John and Mrs. Lind Godbold for their vision and for establishing and endowment that made JEE a reality. Further, we thank the President of GWU, Dr. Frank A. Bonner and the Senior Leadership for their support if the Center and JEE. Finally, we thank Katherine F. Lovelace, Associate Director for Creative Services at GWU and Kathy Martin, Assistant Director of Graphic Design at GWU, for their exceptional layout and design work.

~Anthony Negbenebor
Guest Editorial

International Entrepreneurship: The Essence of Globalization from the Bottom-up

A. Coskun Samli

ABSTRACT

Globalization in its current form is from top-down and as such it is not reaching out to the forgotten majority of the world. In fact, it is creating a significant gap between the economic well-being of haves and have-nots. It is necessary to counteract the current globalization by a second globalization wave starting from the bottom. This bottom-up globalization is totally dependent upon entrepreneurial ventures. For these ventures to become a reality, entrepreneurial cultures must be generated that would cultivate entrepreneurial activity. This article explores how these entrepreneurial cultures develop entrepreneurial ventures and how these ventures internationalize.

KEY WORDS: International entrepreneurship, globalization, entrepreneurial culture

INTRODUCTION

Although unstoppable, globalization in its current form is not working for many of the world’s poor. Similarly, it is not working for the environment nor is it creating a type of stability that is so necessary for the global economic progress (Stiglitz 2002). Today, of the 100 largest economies in the world, 51 are corporate entities and only 49 are different nation states. In other words, corporate entities have much more economic power than many countries.

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The sales of some major auto companies are greater than the GDP of total sub-Saharan states in Africa. Wal-Mart has total sales greater than the revenues of most of the states of Eastern Europe. Additionally about 1.6 billion of the world’s population live on one dollar a day, another almost 1.0 billion live on 3 dollars or less a day. These numbers are growing faster than the rest of the world economies (Samli 2008). Thus globalization from the top-down, despite its tremendous impact and its unstoppable start, is making a select few very rich and is ignoring what Samli called (2004) the forgotten majority. Hence the gap between the rich and poor is widening (Isaak 2005). A global poll by the BBC, for instance, reports that in many countries the benefits and burdens of economic development have not been fairly distributed. Respondents polled also felt that economic conditions vary widely in their countries and this situation is worsening. In most cases the respondents blamed globalization for being discriminating (BBC World Service Poll 2008). Almost all of the global giants that are most instrumental in spreading globalization go after the best markets around the world and they ignore the possibility of spreading out to poorer world markets. Thus, this top-down globalization exacerbates the economic gap between rich and poor (Samli 2009). In addition to these problems created by top-down globalization, global giants are becoming too big and rather dysfunctional. According to some authors, all major companies have been entrepreneurially oriented at the beginning, but in time they become very large, and their administrative practices suffocate their entrepreneurial orientation (Sciacia et. al. 2007). Thus maintaining their entrepreneurial touch may mean establishing some limitations to growth. Current economic conditions and behaviors of certain global giants can reiterate this point. Very selectively:

- General Motors needed billions of dollars from the American government to survive
- AIG needed billions of dollars from the American government to survive
- Toyota re-called 8 million cars to be repaired
- BP created perhaps the most horrendous environmental problem in history.

The important point is that as companies become very large and comfortable they lose their entrepreneurial zeal. They become too attached to prevailing technologies and resultant incremental innovations which are against radical innovations that generate growth at the small entrepreneurial level (Christensen 2003; Christensen and Clayton 2003). As such, they continue extending globalization from the top down.

Globalization from the top-down is not likely to be stopped. Indeed, it must go on. However, its powers must be balanced by, what this author calls, bottom-up globalization. The proposed bottom-up globalization is not going to stop the current globalization activity, but it will give an opportunity to reach out to the poor of the world through bottom-up globalization and stop the widening gap between have and have-nots of the world (Samli 2008).

This article makes an effort to establish the need for bottom-up globalization. It maintains that this can be achieved only by supporting international entrepreneurship. The article presents a model by which international entrepreneurship can be cultivated and expanded throughout the world.
The Magic of Entrepreneurship

Ever since Schumpeter (1934) brought serious attention to entrepreneurship as a key factor of economic development, there has been much emphasis on this topic. However, much of this emphasis has been just talk. Globalization from the top-down has been almost totally overshadowing entrepreneurship both in study and in action.

But on the other hand, as Sundnes (2003) has stated, entrepreneurial activity has been paying an increasingly important attention to economic development. In fact entrepreneurs managing small businesses are, or should be, more important for the economy than global giants. In the late 1980s, for instance, the Fortune 500 companies eliminated more than 3.5 million jobs as their entrepreneurial counterparts created 87% of the new jobs in the United States (Sundnes 2003). This is because entrepreneurs are more innovative and closer to markets. They are more flexible and more efficient than industrial giants. Perhaps above all they are much more sensitive to consumer needs than their gigantic counterparts. At the writing of this article the world is suffering from a deep recession and almost all governments are supporting global giants rather than supporting entrepreneurs who create jobs. So, top-down globalization lives on. In other words what Friedman coined “Darwinism on Steroids” (Friedman 2000), or globalization, continues expanding and widening the gap between the world’s poor and the rich (Samli 2009, Isaak 2005). Friedman (2010) has reported that between 1980 and 2005 about 40 million jobs were created in the U.S. Virtually all new jobs were created by entrepreneurial companies which were start-ups and were fewer than five years old.

To reiterate, small and medium-size entrepreneurships are very critical for the future of the world. They could cater effectively to the world’s forgotten majority (Samli 2008), and they could create what this author coined a second wave of globalization without which the present third world does not have a future. The size and the characteristics of markets in most third world countries give a special impetus to entrepreneurial involvement. They are almost a natural breeding ground for successful entrepreneurial activity. It has been estimated that, even though they are scattered, small and idiosyncratic, the third world markets combined have significant buying power and expansion potential. As Prahalad (2005) coined it, there is a fortune at the bottom of the pyramid. It is almost a given that entrepreneurial companies do well in the lower end of the world markets as opposed to their gigantic global counterparts (Samli 2004, Prahalad 2005, Isaak 2005). However, most of the economically advanced countries are more suited to do well in terms of generating entrepreneurships than those who particularly need them (Reynolds, Bygrave, Autio 2002). If globalization from the bottom-up were to materialize, the poorer countries of the world must focus more readily on generating powerful entrepreneurial cultures. This is perhaps the most important challenge for the third world countries. The examples of Singapore and China, which are briefly discussed in this paper, indicate that it can be done.

Developing a Culture of International Entrepreneurship

After having taken a position that entrepreneurship is an absolute necessity to create economic growth and counteract globalization from the top-down, it is critical that development of entrepreneurship is explored.

In order for entrepreneurship to flourish there must be respect, support and special emphasis on small business. Entrepreneurship is primarily cultivated in an enterprise culture that is particularly paying special attention to dynamic small businesses as is done
in Singapore and China (Tang et al. 2007, Bhasin 2007). In both of these countries a deliberate and very special effort is being put into developing entrepreneurial talents and entrepreneurial activity.

Such entrepreneurial development cultures have two key dimensions that are considered in this article: macro and micro. This author believes that without the proper macro-dimension, micro-dimension cannot possibly come into being and become successful. The two dimensions must be cultivated fully if a dynamic entrepreneurial sector is expected to emerge. These dimensions are displayed in Figure 1.

Figure 1. Dimensions of Entrepreneurship

SOURCE: Adapted and revised from Samli and Howard (2009).

Macro Dimensions

If there is not a culture in existence that is conducive to entrepreneurial development it will be a near impossibility for individual talent to surface and function. As seen in Exhibit 1 there are at least four key macro dimensions for an entrepreneurial culture. These dimensions are applicable to any society, however, with varying degrees of importance.
Cultural Characteristics:

Cultural characteristics of a society can be such that individuals develop an affinity for managing risk. According to Hofstede (1980) risk evasiveness is one of the cultural traits that societies can be evaluated on. If the society recognizes, faces risk and manages it successfully, it is quite likely that such a society can produce much entrepreneurial talent. For example, it has been maintained that Chinese, in general, are willing to take risks and are considered more entrepreneurial (Azar 1999; Reynolds, Bygrave and Autio 2003; Tang et al. 2007). Similarly special attempts have been made in Singapore to develop a more risk-taking culture (Bhasin 2007). Having national programs to facilitate the emergence of entrepreneurial cultures appears to be a necessity.

It is also important to observe that some of the poorest countries such as Mozambique, Chad, Nigeria or Sudan do not show much entrepreneurial spirit and perhaps this is one of the most critical reasons why these countries are not moving fast in their economic development (Ekanem 2004). They may not have dynamic entrepreneurial activity because of lack of education, lack of confidence, and lack of funds (Enslin 2003). Once again, they need special emphasis on entrepreneurship in their efforts to develop their economies.

Attitude toward Small Business:

In the current top down globalization movement, international corporate giants are being paid much more attention to than entrepreneurial activities (Samli 2009). This is because they have a powerful orientation towards foreign direct investments (FDIs). These investments yield very short run positive results and therefore are strongly favored by governments of emerging countries. Furthermore the global giants have tremendous political powers which typically create economic favors by the host countries. Thus the economic resources do not support entrepreneurial activities. But such favoritism does not help an entrepreneurial culture to emerge (Samli 2009).

Government Support:

Somewhat connected to the previous section, many governments in the industrialized world as well as in emerging countries clearly favor supporting big industrial giants. Particularly in more collectivistic countries where not the individual but the group is the focus of economic activity, it is difficult for entrepreneurial ventures to emerge because individual entrepreneurial activities are less common and the government support for small businesses is not readily available. Such cultures are not prone to be entrepreneurial by their nature. Thus, governments in these cultures have a major challenge to start entrepreneurial activity. Perhaps the Singaporean and Chinese models can be used for that purpose.

Availability of Information:

Even if the attitude towards small business is positive and government support for entrepreneurial activity is present, unless there is availability of critical and supportive information, entrepreneurial attempts are not likely to be successful. Without certain supportive and guiding information, prospective entrepreneurs will not be successfully steered to critical business involvement. Research, ideas will come to the prospective entrepreneurs who are better-than-average educated, intelligent, and full of energy and aspiration. Even with those positive individual features, entrepreneurs-to-be still need critical information to determine the most plausible market opportunities which they may emphasize and succeed.

It must be reiterated that these four macro-dimensions are all necessary. Without their presence entrepreneurial hopes will be seriously diminished. As indicated in Exhibit 1, in
addition to the macro-dimensions there must be micro-dimensions also presents as well. That is if an entrepreneurial culture is deemed to be present and successful.

**Micro Dimensions**

Everyone cannot be an entrepreneur. All entrepreneurial talent must have at least five major features for success (Exhibit 1).

**Vision:**

Entrepreneurial talent, whichever country it may belong to and whichever culture it may be brought up in must have a vision. This vision must be holistic enough to see how the project fits into existing external conditions. This vision would enable the entrepreneur to know where to go, what to get and with whom to work among other contingencies (Samli 2009).

It is such a vision that inspired a British innovator to develop a crank-radio for African markets where electricity and batteries were scarce and information to protect oneself against the AIDS epidemic is desperately needed. Hence, the entrepreneurial vision that would fill these gaps is critical and quite beneficial to the economy.

**Proactivity:**

Somewhat closely related to vision, the entrepreneurial talent must move on quickly to realize the perceived undertaking. The entrepreneur has to have the ability to look at a new undertaking and see what specific detailed activity it would take to accomplish the full undertaking and how it can make a mark quickly in the market. Such a proactive orientation would imply that the entrepreneurial talent is at the cutting edge of the opportunity related to market conditions (Samli 2009).

**Interpersonal Skills:**

The entrepreneur cannot accomplish everything all by himself or herself. Therefore, it is critical for the entrepreneur to hire the right kind of personnel and motivate them in such a way that the productivity of the undertaking and of the individual workers is optimized. This would call for certain leadership skills on the part of the entrepreneur which most often means giving enough credit to co-workers. Needless to say, the entrepreneurs in these cases need to have a desire to succeed and must have overall strong personalities to bring the project to a successful level by connecting with people who have the necessary skills (Samli 2009).

**Friendliness:**

Over and above the interpersonal skills, the entrepreneur must be friendly in order to establish and continue with a strong relationship marketing stance. This would mean that the entrepreneur would establish long-lasting and fruitful relationships with customers as well as with suppliers. Furthermore, in the international arena, the entrepreneurs will be able to make major economic contributions by being friendly enough to establish partnerships in various countries. These partnerships will have to be based on selfless ambition that is prompted from friendliness.

**Personality Characteristics:**

Although the above micro dimensions indicate most of the personality characteristics, there are still other personality features that need to be considered. Among these additional features the entrepreneur must be well-educated, practically trained, capable of problem solving, and possessive of a drive which goes in the direction of responsibility, vigor and initiative (Liraa 2003). Since these features are rather obvious, although extremely important, they are not discussed here in detail.
Synergistic Impact of Entrepreneurship

Although every country, rich or poor, industrialized or emerging, must have a clear-cut policy to support and promote entrepreneurship, if the globalization is going to flourish from the bottom-up, this is not quite the general experience of the world at the present time. There is not enough emphasis, particularly in poorer countries, to cultivate entrepreneurial activities. This is at least partly due to lack of knowledge and a powerful theory of international entrepreneurship.

As discussed earlier, the macro and micro dimensions are necessary but they are not going to materialize without an overall entrepreneurial culture. It is such a culture that would create and support these macro and micro dimensions. As a Samli (2009) states, if a society is trying to generate an entrepreneurial culture, it must learn to identify young people with specific innate features and teach them other learned traits. Among these learned traits are understanding economic opportunities, being able to analyze them, identify one and focus on it, start small but think big, and never ignore the possibility of being a market leader (Nicholson 1998). In 70 years of experience Eastern Communistic systems could not put together the will to stimulate entrepreneurial activity at the individual level. However, the lessons learned from that era are being put to use in China and Singapore (Bhasin 2007, Tang et al. 2007). Entrepreneurship is clearly more emphasized in these countries and is flourishing. Communism in the USSR might have failed, at least partially, because it did not generate entrepreneurs and use them effectively. But the lessons learned from these experiences can easily be used particularly by all developing countries. Again, in order to counteract the current globalization movement which is coined “Darwinism on steroids,” every effort must be put forth to generate entrepreneurship cultures particularly in the third world countries. Here it is not quite adequate to have a unique and different entrepreneurial culture in each third world country. Those entrepreneurial cultures must overlap so that globalization from the bottom-up becomes a reality. This situation calls for the emergence of entrepreneurial partnerships. Although this is a very involved and detailed process, a brief description of international entrepreneurship development is presented in Exhibit 2. This exhibit provides much opportunity for future research in this very critical area.

International Synergy

If bottom-up globalization were to become a reality, national small entrepreneurs will reach out to other entrepreneurs in other countries. Such entrepreneurial partnering would lead in the direction of international entrepreneurial networks and international trading blocks. These developments are intimately related to the synergism that would be generated by international entrepreneurial partnering which is the major starting point of the globalization activity from the bottom-up (Samli 2002, Alon 2004, Samli 2009). This synergism has two separate dimensions, relational and performance.

Figure 2. distinguishes relational synergy from performance synergy for international entrepreneurial partners.
Figure 2. Synergistic Possibilities of International Entrepreneurial Partnering

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<tr>
<th>RELATIONAL SYNERGY</th>
<th>POSSIBLE OUTCOMES</th>
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<tr>
<td>✷ Information sharing</td>
<td>All parties are informed</td>
</tr>
<tr>
<td>✷ Communication</td>
<td>Information flows in proper directions</td>
</tr>
<tr>
<td>✷ Security</td>
<td>All parties are trustworthy</td>
</tr>
<tr>
<td>✷ Control</td>
<td>All parties have much to say on processes and strategies</td>
</tr>
<tr>
<td>✷ Planning</td>
<td>Parties jointly plan on activities and expansion</td>
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<tr>
<th>PERFORMANCE SYNERGY</th>
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<tr>
<td>✷ Flexibility</td>
<td>The overall processes become more adjustable</td>
</tr>
<tr>
<td>✷ Productivity</td>
<td>Shared knowledge improves productivity</td>
</tr>
<tr>
<td>✷ Promotion</td>
<td>Partnerships are better promoted</td>
</tr>
<tr>
<td>✷ Distribution</td>
<td>Jointly parties can put together an effective logistical effort</td>
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SOURCE: Adapted and revised from Samli (2009).

If partners are related to each other, then they can function comfortably and be synergistic. This is coined the relational synergy. This particular aspect of international partnering implies that partners are sharing information and they are not taking advantage of each other. This means proper communication among partners. Similarly, trustworthiness is taking place among them. All parties have much to say on all of the functions of the partnership, controlled by a generally accepted control process. Finally, planning is done jointly in terms of partnership activities for success and expansion.

Relational synergy leads in the direction of performance related activities of the partnership as indicated in Figure 2. Although there may be many others, aspects of this synergy, the exhibit emphasizes four key areas. Perhaps above everything else, performance synergy implies that the overall processes of the partnership can be changed, adjusted and improved easily.

It must be emphasized that without the relational synergy there will be no performance synergy. Certainly, an improved process enhances productivity, at least partially, because parties are sharing knowledge. Needless to say, joint international partners would have
more potential power to establish their market power. Finally, it becomes easier for the partnerships to develop a powerful logistics function for their multinational distribution activities.

The key point in our discussion here is that if these synergistic conditions, and perhaps others, are met, the much needed bottom-up globalization would materialize and function in the directions of what the current top-down globalization is not achieving. Improving the economic conditions of the world’s poor and improving the quality of life of the scattered, small and idiosyncratic world markets composed of the world’s forgotten majority are clearly not the goals or functions of global giants.

Conclusions and Suggested Research

Despite its tremendous power and influence, today’s top-down globalization is not reaching out to the world’s poor and forgotten majority. Thus, a globalization from the bottom-up is needed to balance this equation. Globalization from the bottom-up cannot materialize without creating entrepreneurial cultures over much of the world.

The discussion in this piece has maintained that entrepreneurial activity is a prime mover in economic development to cultivate globalization from the bottom up; hence there should be more emphasis on its development. It is maintained here that in order to develop entrepreneurship, certain macro conditions must be present. Those macro conditions would facilitate utilization of micro conditions. Successful entrepreneurial cultures would generate successful entrepreneurs. These would eventually partner with other entrepreneurs. They will develop international networks and construct international trading blocks. These entities would thrive on the synergy they would generate. Future research must emphasize how the poorer countries can develop entrepreneurial cultures. Further, research must emphasize the synergistic needs of international entrepreneurial partnerships. Generating synergy is not automatic and must be better understood.

Thus there is much needed international entrepreneurial research. Creating entrepreneurial cultures is much easier to talk about than actually creating them; much research must be undertaken as to how such cultures can be developed. Finally, entrepreneurial functions and identified entrepreneurial talents must be identified and cultivated individually. The future of the world depends on these explorations.

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Strategic Accountability in Young Firms

Brian L. Connelly, K. Ashley Gangloff, Angela M. Balog, and William I. Sauser, Jr

ABSTRACT

A key aspect of preventing new venture fraud is implementation of an apparatus that creates transparency and facilitates feedback regarding the young firm’s strategic decision making. We call this “strategic accountability.” Entrepreneurs would be unlikely to adopt measures of strategic accountability unless they are keenly aware of its potential costs and benefits. Therefore, after defining the construct, we explore how a system of strategic accountability would be likely to affect key firm level outcomes and describe how these might work together in new ventures that explicitly contract strategic accountability with organizational stakeholders. Recommendations for leaders of young firms are provided based on this analysis.

KEY WORDS: Accountability, Entrepreneurship, decision making, fraud

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INTRODUCTION

Entrepreneurs value independent decision-making (Busenitz & Barney, 1997). In fact, many individuals start businesses expressly because they desire the freedom and flexibility they associate with “being their own boss” (Shaver & Scott, 1991). The power to make firm-level decisions in new ventures often resides with a single individual or small founding team (Cooper & Daily, 1997). This allows the firm to decide quickly and respond nimbly to environmental changes (Baum & Wally, 2003). Thus, the autonomy that entrepreneurs enjoy can serve as a mechanism for strategic competitive advantage insofar as it facilitates fast, flexible decision-making. For this reason, there could be costs associated with implementing accountability mechanisms that interfere with speed and flexibility. Faced with making a “rational” decision about whether or not to implement accountability structures, entrepreneurs could discount the value of these structures with a view toward maintaining an efficiency-maximizing approach of firm decision making. What may be less obvious, however, is there could be a dark side to strategic autonomy. For example, such autonomy could make the young firm more susceptible to wrongdoing.

New venture fraud appears to be on the rise or, at a minimum, is becoming more public, and scholars have devoted increased attention to understanding this trend (Bucar, Glas, & Hisrich, 2003; Fadahunsi & Rosa, 2002; Morck & Yeung, 2003). Some have advanced models to predict the likelihood of fraud, described the consequences of fraud, and prescribed remedies for recovering firms (Lamsdorff, 2002; Pfarrer, Decelles, Smith, & Taylor, 2008). Fraud prevention from a young firm age, on the other hand, has received less scholarly attention, though scholars acknowledge its importance (Ferrell & Ferrell, 2010; Jia, Ding, Li, & Wu, 2009). This is somewhat surprising, given that the costs and public burden of new venture fraud is well documented (Fieldstad & Tungodden, 2003; Siebert, 2002). While there are benefits to understanding the mechanisms of new venture fraud and being able to predict its occurrence, the academic community should also address the ounce of prevention that could help young firms avoid the pound of cure (Murphy & Dacin, 2003). Strategic management scholars may be in a unique position to contribute to such a discussion because we are concerned with the direction of new ventures and the macro decisions executives make which determine that direction (Hitt & Tyler, 1991; Schwenk, 1995). In this paper we consider actions a young firm may take to ensure that its strategic decision-making does not move it in the direction of fraudulent activity, a construct we call “strategic accountability.”

Traditionally, researchers have described accountability in terms of corporate finances (Everrett, Neu, & Rahaman, 2007; Stewart, 1986). The emphasis in financial accountability is on ensuring that resources are allocated appropriately, which can help prevent cronyism, corruption, and misappropriation of rents early in the firm’s lifecycle (Andre, 2010). More recently, some have begun to put forward more behavioral perspectives of accountability (Huse, 2005). The terminology and focus of these models are different, with greater emphasis on trusting relationships and transparency of process rather than transparency of outcomes (Painter-Morland, 2006). However, this latter research has been advanced largely by human resource management scholars focused mainly on employee-level accountability with a view toward prevention of cheating and stealing (Beu & Buckley, 2004; Frink & Klimoski, 2004). We suggest these behavioral models of accountability are also apropos to a new venture’s strategic decision making process (Schwenk, 1995). As young firms engage
one another in the competitive marketplace, they are forced to make fast, highly
consequential decisions that determine the venture’s direction and, ultimately, its fate
(Eisenhardt, 1989b). Accountability at this level remains relatively unexplored in the
literature.

Although most would agree that strategic accountability structures are likely to be useful
toward preventing new venture fraud, entrepreneurs are unlikely to surrender any amount
of control or autonomy for strategic decisions unless the advantages of doing so are clear.
Therefore, we ask in this paper: what are the key economic costs and benefits of
implementing such structures? We put forward a model that contrasts the positive and
negative effects that strategic accountability is likely to have on new venture performance.
Because the literature addresses accountability for strategic decision making only
tangentially, we start by defining the construct. We also synthesize what we believe will be
the collective effect of the independent costs and benefits and describe how practicing
entrepreneurs might implement and benefit from strategic accountability.

CONCEPTUAL DEVELOPMENT

Research Context

New ventures are particularly vulnerable to fraud. Consider this in terms of the fraud
triangle, which describes how fraud is most likely to occur in the presence of opportunity,
incentive, and attitude (PCAOB, 2005). Managers of young firms (a term we use
interchangeably with “entrepreneurs,” although the terms are not strictly synonymous) may
have opportunities to engage in fraud that are not found in more established organizations.
This is due, in part, to their structures not having fully evolved and because external
constituents have not yet imposed mandated forms of accountability, such as board
oversight and Securities and Exchange Commission (SEC) regulations (Fiegner, 2005).
These managers could also find themselves facing incentives to engage in fraud that
managers of more established firms do not. For instance, young firms are often found in a
position where they need a cash infusion to grow their business, giving entrepreneurs a
powerful incentive to exaggerate or, worse, lie about their firm’s prospects in order to gain
the trust of potential investors (Teoh, Welch, & Wong, 1998). Lastly, entrepreneurs
provide a unique context attitudinally because normalization and socially acceptable
behavior is less well defined for their organizations, which could facilitate the process of

Accountability structures are not likely to be a high priority for entrepreneurs, and could
even be considered a liability. Entrepreneurs are often biased to believe that their own
strategic decisions are better than those of others (Cooper, Woo, & Dunkelberg, 1988), so
they may not see a dark side of autonomy, or they may not feel that they themselves are
vulnerable to it (Pronin, Lin, & Ross, 2002). However, autonomy can result in poor
decision making, commitment to a failing course of action, or in-group bias, all of which
contribute to the likelihood of fraudulent activity and wrongdoing (Staw & Ross, 1978;
Turner & Pratkanis, 1998). In addition, potential investors that are not closely connected
to the entrepreneur might harbor some level of suspicion about strategic decision making
autonomy, which could hinder the young firm’s ability to compete for scarce resources in
capital markets. Accountability structures counter these effects. For example, human
resource management researchers have found that accountability can result in better quality decisions and may foster trust between partners (Frink & Klimoski, 2004). Therefore, implementing strategic accountability could afford young firms with a competitive advantage as they vie for attention in capital markets. Thus, our focus in this study is on the unique context of young firms.

Accountability Theory

Over the past several years there has been steadily increasing interest in the subject of accountability (Ferrell & Ferrell, 2010; Frink & Klimoski, 2004; Luo, 2005). Accountability theory is rooted in social psychology (Adelberg & Batson, 1978), and within the context of organizations owes much of its development to the work of human resource management researchers (Ammeter, Douglas, Ferris, & Goka, 2004). Historically, scholars have examined accountability mainly as an individual-level construct. The focus has been on individual behavior and the broad framework that has shaped accountability research is the theory of individual roles and relationships (Frink & Klimoski, 1998). This has been a fruitful stream of research that has produced helpful managerial prescriptions about such behavioral issues as performance evaluation (Frink & Ferris, 1998), trust (Ammeter et al., 2004), and leadership (Hall, Blass, Ferris, & Massengale, 2004). Additionally, Mitchell et al. (1998) found a negative association between accountability mechanisms and illegal behavior. However, few researchers have considered the strategic effects of accountability as a macro level phenomenon (Cropanzano, Chrobot-Mason, Rupp, & Prehar, 2004).

At the organizational level, research on accountability has been limited to the arenas of financial accountability (Banks, 2004), governance (Aguilera, 2005), and stakeholder management (Hillman & Keim, 2001). Financial accountability is addressed mainly in the accounting literature. It is an important dimension of organizational accountability that has garnered significant attention in the wake of several financial scandals, such as those at Lehman Brothers, AIG, and Satyam Computer Services. Governance accountability, which is focused on the monitoring role of boards of directors, has also received attention in light of recent best practice governance guidelines and regulations such as the United Kingdom Higgs Review and the United States Sarbanes-Oxley Act (Dalton, Daily, Ellstrand, & Johnson, 1998). Board member accountability research typically examines the presence or absence of independent and outside directors but, somewhat surprisingly, rarely delves into accountability with respect to a firm’s strategic decisions (Aguilera, 2005). Lastly stakeholders, defined as those with an interest or concern in the firm, typically hold the organization accountable for socially responsible actions. This research generally explores concepts of social reporting, environmental care, and community involvement (Aupperle, Caroll, & Hatfield, 1985). What is under-researched at the organizational level is consideration of accountability with respect to matters of firm strategy (Dubnick, 2005).

The Strategic Accountability Construct

An important first step in exploring this issue is to define what we mean by strategic accountability. We do so by considering accountability and strategic decision making in turn. Organizational scholars have advanced numerous definitions of accountability. The most commonly accepted definitions denote a social relationship involving observation and evaluation as well as some potential for reward or punishment. For example, according to
Hall et al. (2004), accountability is “a real or perceived likelihood that actions, decisions, or behaviors of an individual, group, or organization will be evaluated by some salient audience, and that there exists the potential for the individual, group, or organization to receive either rewards or sanctions based on this expected evaluation” (p. 33). According to Mero, Guidice, and Brownlee (2007), accountability links the individual with the social system to which he or she belongs and the decisions he or she makes. Thus, accountability suggests some set of standards or expectations against which a firm’s behavior is compared, and the associated belief of some likelihood that the firm may need to defend or justify its decisions and behaviors (Frink & Klimoski, 2004).

The construct of accountability has been dichotomized in several ways. One is a comparison between explicit and implicit accountability (Ferris et al., 1995). Explicit accountability refers to objective measures, such as organizational practices and policies. Implicit accountability suggests a form of accountability that resides in organizational culture and values (Sauser, 2008; Sims, 2005). A second dichotomy exists between process and outcome measures (Siegel-Jacobs & Yates, 1996). Under outcome accountability individuals are held responsible for the results of their decisions, regardless of the means used to arrive at those results. Conversely, process accountability is concerned with the means to an end rather than the end itself. Additionally, we propose a third dichotomy: mandated versus contracted accountability. Mandated accountability may be understood to be those forms of accountability that originate from and are imposed by an external actor. Contracted accountability is voluntary, originating from the individual or firm being held accountable. As we will demonstrate, the mandated/contracted distinction will be useful for explicating the costs and benefits of accountability as it applies to a firm’s strategic decisions.

Mintzberg, Raisinghani and Theoret (1976, p.246) define a strategic decision as one which is “important, in terms of the actions taken, the resources committed, or the precedents set.” These decisions can determine the overall direction of the firm (Quinn, 1980). Research on strategic decision making ranges widely from the battery of decisions facing a single individual to decision formulation and implementation processes in complex organizations (Rajagopalan, Rasheed, & Datta, 1993). We consider the strategic decision making process specifically in young firms. Strategic decision-making is perhaps the most critical task that entrepreneurs undertake (Eisenhardt & Zbaracki, 1992). The focus of strategic decisions in an entrepreneurial context is focused on such issues as opportunity exploration and exploitation, resource allocation, and competitive dynamics (Mador, 2000; Short, Ketchen, Shook, & Ireland, 2010). Unlike attributes of the entrepreneur, these processes are malleable phenomena subject to constructive intervention.

Merging these two constructs, strategic accountability refers to the observation and evaluation of the strategic decision making process with some potential for reward or punishment and an associated belief that the firm will need to justify or defend its strategic decisions. Because most strategic decisions for new ventures reside in the upper echelons of the firm (Hambrick & Mason, 1984), the entrepreneur and founding team are the most logical targets of strategic accountability. The most commonly considered external actors holding them accountable would be either the board of directors or their principal investors, which could be private investors, angel investors, or venture capitalists, among others (Denis, 2004). We summarize these foundational ideas in Table 1.
Our understanding of strategic accountability is informed, in part, by extant literature on agency theory and auditing. Agency theory (Jensen & Meckling, 1976) identifies the degree to which there is a conflict of interest between two parties—the owner or ‘principal’ and his/her representative or ‘agent’; this is termed ‘the agency problem.’ The extent to which an agency problem exists is determined by the amount of information asymmetry and threat of opportunism in the relationship (Eisenhardt, 1989a). Agency theoretic prescriptions seek to alleviate the agency problem by aligning the interests of the parties. When interests are aligned, there is little need for monitoring. Strategic accountability, then, can be understood as one possible solution to the agency problem. Strategic accountability does not seek to align the interests of the parties, but instead leverages feedback and control mechanisms to ensure that the agent is held responsible for acting in accordance with the principal’s interests. Whereas agency theory broadly examines asymmetric relationships with a view toward determining the optimum contract, strategic accountability is one type of contract that could potentially be used to alleviate agency concerns.

Audited accounting measures are also pertinent to strategic accountability, but the construct of strategic accountability is more complex. Whereas audited accounting is mainly concerned with proper financial reporting, strategic accountability addresses transparency with respect to the firm’s strategic direction. Admittedly, many major strategic decisions will be reflected in financial reports. Proper accounting asks whether these figures are reported correctly. Strategic accountability, on the other hand, considers the underlying decisions which brought about those financial transactions and resource allocations and evaluates them in view of the principal’s concerns. The notion of strategic accountability runs deep, considering the degree to which strategic activity is shared and individuals are held responsible for their strategic decisions. Further, strategic accountability is broader than the field of audited accounting because it may be applied to multiple constituents, such as accountability to potential investors or other stakeholders.

### Table 1. Elements of Strategic Accountability

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<td>Observation</td>
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Strategic Accountability in the Young Firm

Strategic accountability takes on particular importance and unique characteristics during the initial years of a firm’s existence. For example, new ventures typically find it necessary to share information with outsiders in order to raise capital. At the same time, these firms must also guard proprietary information because it may be their most important source of competitive advantage (Covin, Slevin, & Heeley, 2000). These competing demands force entrepreneurs to make important decisions about the amount of information that will be shared with the investing community, and such decisions may imprint the company with enduring characteristics (Bamford, Dean, & McDougall, 2000). Strategic accountability is concerned with issues of transparency and information sharing, and therefore takes on distinct properties when considered in light of the pressures being placed on young firms.

In addition, strategic accountability takes on particular significance in young firms when we consider the issue from a resource perspective. Firms in the early stages of the organizational life cycle are typically resource constrained (Eisenhardt & Schoonhoven, 1990), which could limit their ability to engage accountability measures. Strategic accountability is not without cost; it requires the allocation of a variety of resources, including financial capital and managerial attention. This investment could represent a greater portion of the total resource allocation of new ventures, as compared to more established firms, suggesting that the benefits of strategic accountability for young firms must be sizeable and quantifiable in order to justify the relative costs.

Further, new ventures can sometimes struggle with legitimacy (Florin, Lubatkin, & Schulze, 2003). They do not enjoy the benefits of a history of exchange with trading partners nor do they have name or product recognition. These problems form one aspect of the ‘liabilities of newness,’ which suggests that young firms are more susceptible to failure than established firms (Freeman, Carroll, & Hannan, 1983). Strategic accountability can be an important tool to overcome such liabilities and reduce the likelihood of early failure.

Lastly, there is likely to be considerable variance in the way young firms implement strategic accountability. Because they are subject to fewer institutional standards (e.g., SEC regulations or institutional requirements) than publically-held firms, young firms may choose to be more closed with respect to their strategic decisions. Others, however, may voluntarily contract accountability relationships in an attempt to benefit from them. We suggest that, despite the challenges of implementing strategic accountability, there are several mechanisms by which it could provide competitive advantage for young firms. We show these in Figure 1 and describe them in the following sections.

**PROPOSITIONS**

**Decision-making**

Scholars have shown that the speed with which managers make strategic decisions is positively associated with performance (Bourgeois & Eisenhardt, 1988). Judge and Miller (1991) found this relationship to hold primarily in high-velocity environments, but the relationship can be negative in low-velocity environments such as hospitals or textiles. Entrepreneurial endeavors are more likely to be found in high-velocity environments because the changing environment affords greater opportunity (Dean & Meyer, 1996). Therefore, it is reasonable to expect that for most entrepreneurial firms strategic decision speed will be central to performance (Certo, Connelly, & Tihanyi, 2008).

We expect that strategic accountability will have a deleterious effect on decision making
The process of communicating strategic decisions to external constituents will likely contribute to the amount of time it will take the firm to enact its plans. By providing outsiders a depth of insight on their internal processes, firms make their decisions vulnerable to observation and evaluation, as we have defined strategic accountability. This makes their decision-making speed a function of the efficiency with which these functions are performed. Further, once observation and evaluation take place, more people (e.g., private investors) become armed with information and gain influence over the decision-making process. Baum and Wally (2003) found that increasingly widespread power with respect to strategic decision making reduces the speed with which those decisions are made. Strategic accountability, therefore, introduces accountability relationships that could constrain judgment processes such that we may expect a more prudent and controlled pace of decision making (Ammeter et al., 2004).

Proposition 1: Strategic accountability in young firms is negatively associated with the speed of managerial decisions.

At the same time, we expect that a system of strategic accountability could foster better quality decisions for several reasons. Research has demonstrated that decision quality improves when decisions subsequently need to be justified (Simonson & Nowlis, 2000). Managers in accountability relationships are forced to collect and organize information in such a way that strategic decisions can be clearly communicated to individuals with less insider knowledge than themselves. Thus, they consistently prepare a better array of information from which their decisions may be made and the information they have is better organized because it needs to be communicated to external constituents (Reynolds, Schultz, & Hekman, 2006). Additionally, these firms enjoy the benefit of process feedback.
from heterogeneous stakeholders, thus ensuring that a wide range of decision alternatives are considered before coming to a conclusion.

Further, strategic accountability is likely to improve decision quality because of its emphasis on process over outcome. Entrepreneurs who have less exposure to a system of strategic accountability will be responsible for outcomes related to performance and survival, while processes are disclosed only at the entrepreneur’s discretion. An emphasis on outcomes, such as financial controls, over processes, such as strategic controls, heightens the risk of fraudulent activity (Bungay & Goold, 1991; Johnson, Ryan, & Tian, 2009). Organizations that emphasize the bottom line without regard for ethical decision making create pressure for misconduct or even illegal behaviors (Hall et al., 2007). For example, one accounting executive recently involved in a corporate scandal described how a focus on performance outcomes rather than process outcomes caused “smart people to stop asking questions,” (Beenen & Pinto, 2009; p. 278). On the other hand, entrepreneurs working under a more stringent system of strategic accountability enjoy the benefit of process feedback from outsiders. This is likely to make it more difficult to hide nefarious activity and affords the benefit of providing alternative perspectives and more varied opinions regarding the firm’s direction (Sonpar, Pazzaglia, & Kornijenko, 2010). Therefore, we expect that a system of strategic accountability will improve the decision quality of young firms over time.

Proposition 2: Strategic accountability in young firms is positively associated with the quality of managerial decisions.

Trust
Trust is “a willingness to be vulnerable to another party” (Schoorman, Mayer, & Davis, 2007, p.347) and has a long history in strategic management research (Dirks & Ferrin, 2001). The development of trust between a firm and its suppliers and resource-controllers has been associated with performance benefits, which is often ascribed to the ability to use less formal controls and provide access to resources (Gullett et al., 2009; Ring & Van de Ven, 1992). However, developing the trust of certain stakeholders can be difficult for young firms. In young firms, trust between managers and their capital stakeholders and other resource-controllers is particularly important. This is essentially an agency relationship, and scholars have described at least two key factors to developing trust in such relationships: information asymmetry and the threat of opportunism (Cohen & Dean, 2005; Singh & Sirdeshmukh, 2000). Both of these hold the potential of hindering trust (Alvarez & Barney, 2003).

Information asymmetries occur when different people know different things (Stiglitz, 2002). In young firms, this is frequently brought on by the phenomenon of the “prospector’s paradox.” The prospector who discovers a gold mine needs help in extracting its value but, as soon as he informs others of the mine, they could begin prospecting themselves and thereby reduce the value of the mine. Because entrepreneurial activities are associated with innovation and unique knowledge (Miller & Friesen, 1982), entrepreneurs often find themselves facing such a paradox and thus become protective of their primary source of competitive advantage. Although their actions are understandable and justifiable, the resultant information asymmetries nonetheless foster a lack of trust on the part of resource-controllers such as investors and corporate allies (Connelly, Hoskisson, Tihanyi, & Certo, 2010).
Strategic accountability can help entrepreneurs overcome problems of information asymmetry, thereby facilitating the development of trust with resource-controllers. At its core, strategic accountability mandates some level of transparency. As stakeholders gain additional ability to observe and evaluate strategic decisions of the firm, information asymmetries will be reduced. Whitener, Brodt, Korsgaard, & Werner (1998) suggest that accurate information, explanations for decisions, and openness are all factors that contribute to perceived trustworthiness. Willingness of the firm to reduce the difference in information available to stakeholders signals underlying firm quality and ethical decision making, making the firm more trustworthy (Connelly, Certo, Ireland, & Reutzel, 2011). Thus, strategic accountability has the capacity to facilitate trust-building by reducing information asymmetries.

Proposition 3: Strategic accountability is negatively associated with the level of information asymmetry between a young firm and those that control needed resources.

Strategic accountability also has implications for reducing the threat of opportunism. Opportunism describes the exploitation of circumstances in self-interest and is especially relevant in young firms owing to their typically high levels of managerial discretion. In addition, ownership structures in young firms differ from their post-IPO counterparts in that owners provide capital infusions in large chunks with little recourse to withdraw. That is, owners cannot sell their stake in the firm as easily as investors that own shares of stock. Venkataraman (1997, p. 126) describes how “once specialized investments have been committed, the entrepreneur can hold the other party hostage.”

Firm owners, however, will be more likely to trust if they know they have a channel by which to reward behavior they desire and discipline that which they wish to avoid (Dalton, Hitt, Certo, & Dalton, 2008). Hirschman (1970) describes how, when one partner experiences disillusionment with an exchange relationship, he/she has the options of exit, voice, or loyalty. With young firms, owners often forfeit their ability to exit because their capital investments are not fluid. So, if owners have concerns or problems with the strategic direction of the firm, they do not have exit as a recourse. Strategic accountability, thus, becomes imperative because it provides these owners with voice, so that they are not left in a situation where their only choice is loyalty.

The threat of opportunist behavior can be even more acute when there is a lack of exchange history between executives in the young firm and those providing capital to the firm (Tsai & Ghoshal, 1998). In this situation owners are relying on voice, rather than exit or loyalty, to ensure the young firm is headed in the proper direction, but the mechanisms for communicative exchange between the owner and the firm’s executives are less well developed. Formal accountability structures can help alleviate this problem. For example, Ammeter and colleagues (2004) describe how accountability structures can facilitate communication and minimize the threat of opportunism between partners. These authors found that when two parties have less experience interacting with each other, a self-imposed system of accountability facilitates exchange. We expect, therefore, that mechanisms, rules, and structures that the young firm imposes as a means of strategic accountability can facilitate communication between owners and managers and thus could be central to reducing the threat of managerial opportunism.
Proposition 4: Strategic accountability is negatively associated with the threat of opportunistic behavior by managers in a young firm.

Legitimacy
Organizational legitimacy is “a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions” (Suchman, 1995, p. 574). The need for legitimacy is driven by a combination of firm characteristics and its context and is especially important to new firms (Dacin, Oliver, & Roy, 2007). Audiences are more likely to supply resources to firms that appear legitimate (Lounsbury & Glynn, 2001). Research has shown that firms lacking legitimacy are more likely to fail while those that garner legitimacy with customers, suppliers, governing authorities and the community at large will see associated performance gains (Reuf & Scott, 1998). This is especially important for young firms that lack experience and reputation and are trying to overcome their liability of newness (Dacin, 1997). Young firms frequently find themselves pioneering the creation of new ideas, products, and services, which can compound the difficulty of establishing legitimacy.

Aldrich and Martinez (2001) explain that entrepreneurial firms lack legitimacy along three primary dimensions: cognitive, moral, and regulatory. Cognitive legitimacy is acceptance that an organization or its products are necessary. This is sometimes difficult for young firms to establish, given that their products or services have likely not been available for long, so they have not yet been accepted as taken-for-granted features of the environment (Zucker, 1983). Moral legitimacy reflects a generally positive normative evaluation of the firm (Aldrich & Fiol, 1994). This type of legitimacy points to conformity with cultural norms and values. It takes time to establish, and therefore could be lacking early in the life of a young firm. Regulatory legitimacy describes conformity to government and authoritative bodies, which may also be difficult for young firms to establish because public policy often favors actors with the greatest bargaining power.

Aldrich (1999, p. 49) puts forward that “more research is needed on the strategies innovative new ventures might follow to overcome the lack of ... legitimacy.” We suggest that a system of contracted strategic accountability could be particularly useful in overcoming legitimacy barriers for entrepreneurial firms. By contracted, we mean voluntarily self-imposed. This signals underlying quality to stakeholders because managers have voluntarily invited accountability measures upon their own strategic decision making processes. While there are costs (e.g., decision speed and flexibility) associated with implementing mechanisms of strategic accountability, it is precisely those costs that signal value to firm owners (Connelly et al., 2011). The signal would not be useful as an indicator of quality if there were no costs associated with it. Mandated accountability structures may not carry the same signaling value because they do not indicate willingness on the part of the signaler (Certo, 2003).

We expect that strategic accountability could help young firms overcome problems of cognitive legitimacy. New products, technologies, and activities involve high levels of uncertainty, so that young firms may need to convince preexisting legitimate entities to lend support (Suchman, 1995). Although little can be done to force a new product or service into the mental schema of outsiders, it may be possible to lessen the impact of low cognitive legitimacy. Managers who voluntarily impose strategic accountability communicate that they are “willing to go down with the ship.” In doing so, their actions
could bring owners to stop questioning the product or service and begin to look more closely at the executive(s) who have staked their reputation on the success of those products or services. The cognitive emphasis thus shifts to the managers themselves.

By way of analogy, if a stranger asks us to try some food we would be hesitant to oblige. If that same person offers to eat the food at the same time, they presumably take the same risks upon themselves that we would take by eating it. Thus, we begin to think less about the food and more about the stranger as we evaluate our decision. While the product or service offered by an entrepreneurial firm may not enjoy cognitive legitimacy, new ventures or new products could stand on the strong reputation of key personnel (Suchman, 1995). Thus, strategic accountability may serve to overcome a lack of cognitive legitimacy by shifting the principal’s evaluative energy from the firm and its product or service to the entrepreneur. Therefore, we posit the following:

Proposition 5: Strategic accountability in young firms is positively associated with their cognitive legitimacy.

By the same reasoning, strategic accountability may have a positive impact on moral legitimacy. Normally, it takes time for an entrepreneurial firm to comply with cultural norms and values to the point where suppliers and customers might inductively conclude that the firm will abide by the rules of the game and thus ascribe moral legitimacy to the firm. However, by leveraging strategic accountability, a young firm communicates to stakeholders that managers are willing to take on responsibility for complying with norms and values. A record of technical success, the best hope to establish new grounds for moral legitimacy, is not usually available for young firms (Ashforth & Gibbs, 1990). However, success is socially constructed and strategic accountability could aid in this construction (Powell, 1991). Specifically, strategic accountability generally involves releasing information regarding a firm’s inputs, processes, outputs, and performance in such a way that it builds a coalition of believers in the firm (Elsbach & Sutton, 1992). Whether real or symbolic, this transparency and the resulting coalition that builds is likely to contribute to the nascent firm’s moral legitimacy. This suggests the following proposition:

Proposition 6: Strategic accountability in young firms is positively associated with their moral legitimacy.

We expect that regulatory legitimacy would likely be least affected by strategic accountability. Most prescriptions for earning regulatory legitimacy center on the establishment of standard-setting bodies and collective action, thus it is difficult to posit a direct relationship between strategic accountability and regulatory legitimacy. We could imagine strategic accountability having benefits for a firm’s regulatory legitimacy if those accountability structures were tightly linked to institutional frameworks and regulatory pressures, but we do not put forward a proposition about these main effects because the boundary conditions are too uncertain.

Organizational Change

Entrepreneurial firms often rely on organizational flexibility and the capacity to innovate for strategic competitive advantage in their industry (Connelly et al., 2007; Lipparini & Sobrero, 1994). These advantages may be due in large part to matters of size, structure, and
Innovation and flexibility are important sources of growth for young firms. The former allows firms to generate new ideas, products, and services, and the latter allows them to perform the necessary work to connect those ideas with business opportunities (Bartel & Garud, 2009). Because innovation and flexibility are both exceedingly difficult to maintain over time within more established organizational configurations, young firms stand to gain if they can leverage these characteristics to their advantage.

Scholars have considered both micro-level factors that affect innovation in entrepreneurial firms, such as creativity and decision-making style, and macro-level factors, such as environmental complexity and control (Damanpour, 1991). At the micro-level, strategic accountability is likely to have a negative effect on innovation. The creativity and freedom of range that drive innovation at the individual level are not well served by additional layers of monitoring and control. Greater amounts of accountability are associated with decreased individual risk-taking and cognitive complexity, which can impede innovative activity (Lerner & Tetlock, 1999). Furthermore, strategic accountability establishes relationships wherein managerial decision making will be shaped by the concerns and restrictions of others, who may be less willing or able to adopt innovative approaches (Jensen & Roy, 2008). Similarly, at the macro-level, strategic accountability imposes an additional degree of complexity and control, suggesting that it too will have a negative relationship with organizational innovation. For example, accountability systems can foster firm-level standardization and a culture of conformity that stifle innovation (Hall et al., 2007). Therefore, we suggest the following:

**Proposition 7: Strategic accountability is negatively associated with the amount of innovation in a young firm.**

Flexibility refers to an organization’s capability to identify major changes in the external environment and quickly commit resources to new courses of action in response to those changes (Shimizu & Hitt, 2004). The first step in this process is to scan and accurately assess the external environment (Stewart, May, & Kalia, 2008). Entrepreneurs receive more information about their own industry and their firm’s ability to compete in that industry, with greater speed and reliability, than those outside the firm (Certo, Daily, & Dalton, 2001). As such, they may be expected to assess the changing nature of the environment better than those who have less firsthand information. Implementing a system of strategic accountability could remove some of the freedom that managers have to adapt quickly to changing environmental demands. An emphasis on standardization and control that often accompanies accountability structures can inhibit flexibility (Picken & Dess, 1997). The monitoring function of strategic accountability necessarily incorporates a temporal element that could reduce the ability of a young firm to act quickly in response to competitors and the environment (Baum & Wally, 2003). As such, we expect strategic accountability to be negatively associated with organizational flexibility in new ventures.

**Proposition 8: Strategic accountability is negatively associated with a young firm’s ability to adapt to a changing competitive environment.**
DISCUSSION

Synthesis
Implementing measures of strategic accountability is an important way of reducing the likelihood of fraud, but firms are unlikely to be willing to accommodate those measures without having a full grasp of the costs and benefits. Lerner and Tetlock (1999, p. 270), for example, note that “accountability is a logically complex construct that interacts with characteristics of the decision maker and properties of the task environment to produce an array of effects - only some of which are beneficial.” A collective view of these primary costs and benefits suggests that strategic accountability could have a multidimensional impact on firm performance. New ventures that implement a system of strategic accountability are likely to experience both positive and negative influences on performance as compared to those that do not. As we describe in the propositions above, we expect the main negative effects to operate through the influences of strategic accountability on decision speed, information asymmetry, threat of opportunism, innovation, and flexibility. These are immediate and intuitively causal relationships that we expect would be likely to take hold rather quickly. For example, as soon as a strategic accountability system is in place, we would likely see an immediate negative impact on the speed with which decisions are made. The negative effects of strategic accountability are born primarily out of the added structural complexity required to allow monitoring and feedback. The negative impact, then, comes upon new firms as quickly as the added complexity itself.

The positive effects of strategic accountability occur more slowly. Positive influences operate through the more socially complex mechanisms of increased trust and legitimacy, as well as improved decision-making capability. These effects build over time. For example, trust does not come about overnight but instead requires some amount of lag to take hold in the minds of the trusting parties (Gulati, 1995). While competence-based reliability may be demonstrated in a relatively short amount of time, integrity-based trust requires more time to develop (Connelly et al., in press). Therefore, the positive influence of strategic accountability is likely to lag behind the negative influence.

At the same time, although the positive effects may come to occur more slowly they could also have a more lasting influence on performance. Decision speed, innovation, and flexibility will all suffer an incremental loss due to some degree of added structural complexity associated with strategic accountability. The upside potential of the positive effects, on the other hand, could be much greater. Increased legitimacy and trust provide access to resources with potential to connect the firm to entirely different social circles and move the firm in whole new directions. The benefits of trust and legitimacy, though difficult to obtain and maintain, are far-reaching and long lasting (Seal & Vincent-Jones, 1997). Therefore, in the long term, the economic benefits of a system of strategic accountability are likely to outweigh the costs, yielding a probable U-shaped relationship between time and the value of strategic accountability to the firm.

Mechanisms of Strategic Accountability
We conclude our study by considering strategic accountability from a managerial perspective to explain the phenomenon in practical terms. There are myriad ways in which young firms might go about the business of implementing strategic accountability. In fact, we expect new ventures to be entrepreneurial about their methods. For example, Michel-Edouard Leclerc, CEO of French retailer E. Lerclerc, uses a blog as an extension of his
personal diary as a means of strategic accountability. He advises CEOs, “don’t be afraid of it. It’s a way to concentrate your thoughts, test your ideas, and accept criticism” (Matlack & d’Arcier, 2005, p. 48). LeClerc appears to be leveraging technological access to a broad constituency to provide a tremendous degree of transparency with respect to the strategic decisions of his firm.

We may also conceive of strategic accountability mechanisms aimed at transparency with the board of directors. Many young firms are providing increased access to deeper levels of firm operations for directors. This allows the board to become more in tune with the strategic decision environment, rather than receiving information filtered through a single individual. As the CEO of one firm aptly stated, “the fact that I give them unfettered access makes them feel I’m more secure in the job. If I were trying to stage manage everything they receive, they’d wonder what I was trying to hide” (Weber, Crockett, & Arndt, 2005, p. 40). This is an example of how fostering strategic accountability with the board of directors can confer trust and improve the long-term viability of the firm. Thus, by providing “unfettered access” the organization will reduce the likelihood of fraud in part by improving relationships with stakeholders.

The effective use of strategic alliances could also be a means to establish strategic accountability for young firms. A new venture may partner with an established firm in a variety of different ways. As a potential exchange partner, it is unlikely that external constituents would confer legitimacy on a new venture without a history of exchange, where the firm’s reputation is somewhat of a blank sheet. However, if the alliance incorporates some level of oversight and control, then outsiders may indeed transfer the legitimacy of a partner firm to the new venture (Dacin et al., 2007). Thus, implementing a system of strategic accountability by contracting with a partner firm could have particular benefits for a firm’s legitimacy, but it also makes the firm’s decision-making vulnerable to another organization. This can be dangerous if the partner firm chooses at a later time to be a competitor or even to acquire the young firm in a hostile action.

Managers of young firms might also attempt to signal the presence of strategic accountability, regardless of the extent to which it actually exists. This could be accomplished through symbolic language, standardized codes of ethics and practice, or membership in standard-bearing societies. Symbolic language, for example via press releases or in official corporate documentation, may be used to reflect an internal locus of control that communicates to outsiders a willingness to justify decisions and be held responsible for actions. However, this is simply a signaling, not an implementation, of strategic accountability, and would therefore have little ability of actually reducing the likelihood of fraud (Adams, Tashchian, & Shore, 2001). Because there is no real monitoring and control, the negative effects associated with added structural complexity do not apply. Similarly, standardized codes of ethics signal the presence of strategic accountability, but with no formal mechanism to impose that accountability. In the same way, membership in professional societies that maintain such codes is usually voluntary and thus has the effect of communicating strategic accountability without the teeth to impose sanctions in the event of non-compliance. Thus, while managers have at their disposal the option of trying to signal strategic accountability without actually implementing it, this is not a preventative mechanism and is unlikely to result in the same kind of long-term benefits with respect to legitimacy, trust, or decision quality.

Family firms provide another setting that could provide a unique context for examining
the challenges of implementing strategic accountability in young firms. Founders of family firms seek to build businesses with objectives that are oriented not only around generating economic value, but also providing financial sustainability for family members and creating an enduring business legacy that can be transferred to younger generations (Chrisman, Chua, & Steier, 2003). Family firms are often concerned with wealth preservation and are not structurally equipped to operate in high-velocity environments (Carney, 1998; Chandler, 1990). Some have suggested the problems that are characteristic of family firms may not easily be resolved within the context of governance, which would complicate efforts to implement strategic accountability (Schulze, Lubatkin, Dino, & Buchholtz, 2001). We suggest, however, that there may be important benefits to strategic accountability in family firms. Contracting strategic accountability in the form of non-family managers whose unique skills set and experiences add value to the business may assist in providing a basis for a differentiated view and more comprehensive decision making (Poza, 2010).

Recommendations for Leaders of Young Firms

Figure 2 illustrates our recommendations—based on this analysis—to leaders of young firms with respect to implementing strategic accountability measures. When the need for speed and flexibility (to stay nimble in a high-velocity market) exceeds the need for external legitimacy, leaders of the young firm would be wise not to incur the additional cost and complexity of voluntarily implementing strategic accountability measures. Conversely, if the need for external legitimacy (to raise capital, expand markets, and/or create a sustainable legacy) exceeds the need for nimbleness, then the firm should take intentional (contracted) measures—such as those described above—to signal legitimacy through external accountability. As the firm ages, it may encounter a critical point in time at which the need for a strategic shift in external legitimacy may occur; recognizing this trigger point and acting on it is an aspect of the art of management. In the other two cells of the matrix, where needs for speed/flexibility and external legitimacy are relatively equal, a balanced use of strategic accountability measures is recommended.

Figure 2. Decision Matrix for Leaders of Young Firms
CONCLUSION

Few would argue that implementing greater transparency with respect to strategic decision making would be likely to reduce the capacity for fraud early in a firm’s life cycle. The question then becomes, how painful would it be to implement this kind of strategic accountability? Entrepreneurs value their independence, and they are unlikely to sacrifice any aspect of that independence without a clear accounting of the costs and benefits of doing so. In this study, we develop arguments that suggest there are circumstances under which complete freedom of strategic decision making, in the absence of accountability, could actually be detrimental to the entrepreneur and the firm. Although most entrepreneurs admit to the importance of financial accountability in their new venture, strategic accountability has received less attention. We put forward a model that suggests there is a delicate balance between needs for (a) strategic speed and flexibility and (b) external legitimacy, and that both factors must be weighed carefully by leaders of young firms when they are considering the implementing strategic accountability measures. Entrepreneurs that implement measures of strategic accountability may initially encounter the negative effects of added structural complexity, but are likely ultimately to enjoy significant positive effects such as increased legitimacy, trust, and access to new resource pools. Thus, strategic accountability structures may not only reduce the risk of ownership for current and potential firm investors, but could also have positive long-term economic benefits.

REFERENCES


Empirical Evidence of Abusive Supervision in Entrepreneurial and Small Firms

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ABSTRACT

While scholarly interest in the phenomenon of abusive supervision has grown in recent years, the entrepreneurial small business milieu is an under-studied environment in the prevailing literature. The present study explored abusive supervision based on firm size and tested the potency of several structural and personal factors in predicting its occurrence. We found that employees in small, entrepreneurial firms experienced more abusive supervision and that supervisors who receive performance feedback, have higher levels of formal education, and have effective means of social support are less likely to abuse their employees.

KEY WORDS: Abusive supervision, small business, entrepreneurs, firm size

INTRODUCTION

Abusive supervision is particularly destructive workplace behavior whereby those with power use it in an unethical manner to subjugate their underlings. While studies have shown that it is a low base-rate phenomenon (Tepper, 2007), structural factors related to the work environment and personal factors related to the supervisor may produce conditions more favorable to such behavior. Checks and balances within large organizations may reduce the frequency of abusive supervision. By contrast, fewer oversight and control mechanisms in small firms would be expected to result in higher levels of abusive supervision in such firms. The primary focus of previous research in this stream has been limited to the study of large organizations. There is a dearth of research on abusive supervision in the small business environment. In this paper, we address this gap in...
the literature and investigate the frequency with which abusive supervision occurs along with particular structural and personal factors that may result in higher levels of abusive behavior in small business firms.

Abusive Supervision

We adopt the definition presented in extant literature that abusive supervision is “subordinates’ perceptions of the extent to which their supervisors engage in sustained displays of hostile verbal and non-verbal behaviors excluding physical contact” (Tepper, 2000). Abusive supervision is not necessarily intentionally designed to harm and some perpetrators are not even aware of how their behavior is interpreted by the targets of their abuse (Glasø, Nielsen, & Einarsen, 2009). Examples of abusive supervision include intimidation, threats of job loss, aggressive eye contact and humiliating or ridiculing someone in front of others (Tepper, 2000).

Negative outcomes to targets of abusive supervisors include both personal (health, emotional) and professional consequences. Employees have reported lower job and life satisfaction, psychological distress, low self-esteem, decreased morale, and lowered citizenship behavior (Burton & Hoobler, 2006; Tepper, 2000; Tepper, Henle, Lambert, Giacalone, & Duffy, 2008; Zellars, Tepper, & Duffy, 2002). Determining the financial costs of this behavior is difficult. However, targets’ reduced morale and commitment likely translate to reduced productivity and increased levels of absenteeism, turnover and workplace deviance (Detert, Trevino, Burris, & Andiappan, 2007; Tepper, 2000). Direct targets are not the only organization members harmed. Bystanders who observe this negative behavior often report similar deleterious outcomes (Hoel, Glasø, Hetland, Cooper, & Einarsen, 2010). Thus, the cost to the organization spreads beyond the immediate parties involved and can poison the workplace leading to increased employee turnover (Tepper et al., 2009). The resulting loss of employees can translate to reduced customer loyalty and ultimately lower revenues and profits. Thus, when employees are abused by their supervisors the firm can experience inferior bottom line results.

Researchers have found that a combination of internal environmental factors along with individual forces best explains the variance in counterproductive workplace behavior in organizations (Einarsen, Hoel, Zapf, & Cooper, 2003; Sperry, 2009). A work environment that is unfriendly to employees combined with poorly trained supervisors sets the stage for abuse, harassment, incivility, and other destructive interactions. This interplay between environment and person suggests that researchers consider both aspects when studying organization behavior. We propose that the internal small business environment is more likely to foster dysfunctional supervisory behavior due to environmental and personal dimensions unique to this milieu. We identify a number of factors from the abusive supervision literature that may lead to a higher incidence of abusive supervision in small owner-operated firms.

The present study tests the predictive power of six proposed antecedents of abusive supervision in small firms. Internal structural factors included in this study are an advisory board, a human resource professional, and employee advocacy mechanisms (e.g., labor unions). Personal attributes included in this study are supervisory accountability, supervisor access to social support, and supervisor’s level of formal education. We acknowledge that characteristics of the target and external environmental factors may impact exposure to and perceptions of supervisory abuse. However, these are beyond the scope of our study.
Further, the external environment will equally impact employees in both small and large firms and our purpose is to compare the occurrence of abusive supervision experienced in both small and large firms. Therefore, we limit our investigation to internal factors only as there are expected to be significant differences between the two work environments.

**Unique Attributes of Small Firms**

The U.S. Small Business Administration (SBA) defines a small business based on either number of employees or annual revenues. This categorization scheme produces ranges from 100 to 1500 employees encompassed in the “small business” definition (SBA, 2012). An alternate definition provided by the Internal Revenue Service (IRS) states that to qualify for the Small Business Health Care Tax Credit, a company must employ fewer than 25 full-time employees (IRS, 2012). Small businesses may be subject to fewer workplace regulations (i.e., Family Medical Leave Act applies to employers of 50 or more employees) and less oversight by stakeholders as ownership may be limited to a select few rather than thousands of shareholders as in a large publicly-held corporation. This freedom to operate unencumbered can be attractive to individuals that might have difficulty working within a bureaucratic, rule-bound organization structure. Typical checks and balances might be absent in favor of a more relaxed atmosphere. Because of the structural changes that require more administrative practices and changes in legal obligations that occur when firms reach a certain size, in the present study we adopted a cutoff of 50 employees to classify a business as “small” or “large.”

Large organizations are more likely to implement formal control mechanisms such as policy statements, governance boards or councils, human resource staff, and employee advocacy programs (Churchill & Lewis, 1983) that can reduce the occurrence of abusive supervision. In firms with 50 or fewer employees the owner-founder decides whether to adopt these practices. Many choose to bypass these mechanisms, which may lead to a work environment with fewer controls and guidelines for behavior (Singh, 2006; Wiklund, Patzelt, & Shepherd, 2009).

Proper training in effective management techniques is less common in small firms which may result in poorly-prepared individuals managing by gut instinct or mimicking inappropriate role models (Miner, 2000). Working conditions in small firms can be quite stressful due to intense customer demands and a frequent lack of resources. Managing under such conditions without proper training and appropriate social support can lead to a high level of unmitigated stress and a tendency to take it out on less powerful members of the organization (Viswesvaran, Sanchez, & Fisher, 1999). The lack of formal control mechanisms along with poorly-prepared supervisors in small firms leads to our first hypothesis.

**H1. Abusive supervision is more likely to occur in small firms rather than large firms.**

**INTERNAL STRUCTURAL FACTORS**

Differences in organization structure and formality of systems are frequently related to firm size. The owner-founder of a small firm establishes and maintains the culture, policies, and practices of the firm (von Gelderen, Frese, & Thuriik, 2000). The “dark side” of entrepreneurship may result in a work environment focused on protecting the idiosyncrasies of the founder and offering little support for employees (Kets de Vries, 1985;
Strenger & Burak, 2005). Structural factors that should mitigate the occurrence of abusive supervision include (but are not limited to) governance, human resource oversight, and employee support and advocacy. Figure 1 presents a model of our hypotheses.

**Figure 1. Relationship of Size to Mediators and Mediators to Supervisory Abuse**

Advisory board

In large organizations the board of directors provides guidance, direction, and feedback to the executive management team. However, the board may be more concerned with strategy than operations, and with the actions of top executives rather than front-line supervisors (Pugliese et al., 2009). In a small firm, the board's role might involve bringing improved discipline to the firm, providing leadership, and helping to overcome potential moral hazard problems. However, small firms are less likely to have a formal board of directors or advisors who bring discipline and leadership to the firm (Deakins, O’Neill, & Mileham, 2000; Fiegener, 2005). Rather than adopting a formal advisory board, the owner of a small firm might seek advice on a less formal and regular basis from trusted advisors such as an attorney, accountant, or other business owners on an ad hoc basis. Thus, critical observations regarding a manager’s behavior or operating style might be missing and the owner would be oblivious to his or her effectiveness as a manager. This leads to our second set of hypotheses.

**H2a.** Small firms are less likely to utilize a formal advisory board.

**H2b.** Abusive supervision is more likely to occur when there is no formal advisory board to oversee supervisory behavior.
H2c. The effect of firm size on abusive supervision will be mediated by the use of a formal advisory board.

Human resource staff

A common heuristic is that a firm with 100 or more employees should have a designated human resource professional on staff (Mathis & Jackson, 2011, p. 24). When an organization reaches that critical size, employing an HR professional is frequently necessary to ensure compliance with legal requirements and to implement effective selection and talent management practices (DOL, 2011; EEOC, 2010). The human resource professional’s role includes implementing workplace policies, providing employees an outlet to report concerns, and overseeing employee relations activities. Selection practices are likely to be more sophisticated such that applicant qualifications are more carefully vetted and a better person-job fit can be determined. Small firms are more likely to assign the human resource function to accounting or administrative staff because a primary human resource task is processing payroll and the firm lacks the financial capacity and economies of scale to efficiently administer a human resource system (Vickerstaff, 1992). Without appropriate policies and procedures to establish proper workplace behavior, employees and supervisors may enjoy a higher level of autonomy, which can lead to misbehavior (Storey, Sarisakis, Sen-Gupta, Edwards, & Blackburn, 2010). This leads to our third set of hypotheses.

H3a. Small firms are less likely to utilize a human resource professional.

H3b. Abusive supervision is more likely to occur when there is no human resource professional in the organization.

H3c. The effect of firm size on abusive supervision will be mediated by the presence of a human resource professional

Employee advocacy

Employees have traditionally held less power than the organizations that employ them and therefore they look to systems or people to advocate for them if they encounter work-related problems. In large organizations the human resource staff typically protects employee interests (Mathis & Jackson, 2011, p. 27). Human resource professionals are charged with balancing the organization’s interests with those of employees so that both stakeholders benefit from the relationship. As stated previously, in small firms there is less likely to be a human resource professional to ensure fairness and ethical treatment of employees. Because the abusive owner may be responsible for employment matters, the employee may not have a designated representative working on his or her behalf to prevent mistreatment.

In small firms, there is a lower probability of employees collectively banding together to form a labor union (Pearce, 1990). Unions traditionally generate revenue from member dues and greater numbers of members results in higher dues revenue. Small firms with fewer employees would be less attractive to a labor union. There can be significant costs involved in establishing a labor union at a work site and it may not be cost-effective to organize firms with few employees. Thus, employees in small firms are less likely to have labor union representatives working on their behalf to prevent mistreatment and abuse.
Employee Assistance Program (EAP) counselors can offer safe haven and emotional support to employees targeted by an abusive supervisor. EAP services are provided to employees and their families to assist with emotional and mental health concerns as well as to resolve work-related problems. The counseling provided by an EAP can help to mitigate some of the negative outcomes of abuse in the workplace and foster a healthy return to work for the employee. While 65 percent of U.S. employees are offered an EAP provided by their employers, 35 percent are not (Institute, 2008). Large organizations are more likely to sponsor an EAP program and all Fortune 1,000 companies offer these services. Owners of small businesses are less likely to offer an EAP; frequently because they are not aware of the benefits of providing a plan (London, 2010). Employees working for small firms are less likely to have access to these services.

Lastly, federal anti-discrimination laws may protect employees against harassment on the basis of their status in a protected class (i.e., race, sex, age, religion). Abusive supervision often occurs as an “equal employment opportunity” phenomenon and harassment is not directed at employees because of their protected status. Furthermore, there are employment thresholds that must be met before an employer is legally required to comply. Most anti-discrimination laws apply to employers with 15 or more employees and age discrimination law applies to employers with 20 or more employees (EEOC, 2010). It follows then that employees of relatively small firms may not be afforded the protection of federal employment laws. This leads to our fourth set of hypotheses.

H4a. Small firms are less likely to provide employee advocacy mechanisms.

H4b. Abusive supervision is more likely to occur when there are no employee advocacy mechanisms in the organization.

H4c. The effect of firm size on abusive supervision will be mediated by the use of employee advocacy mechanisms.

The internal structural factors described in the previous section represent the internal environmental dimensions that might lead to abusive supervision in small firms. We now turn our focus to the explication of personal factors relative to supervisors working in small firms that we propose also influence the occurrence of subordinate abuse.

PERSONAL ATTRIBUTES

Personal factors relative to supervisors in small firms may predispose these individuals to employ an abusive management style. We consider supervisory accountability (via performance evaluation), supervisor access to social support, and supervisor’s level of formal education as primary personal attributes of supervisors that might explain the propensity to mistreat subordinates. While not exhaustive, these reflect supervisors’ relationship to the organization (accountability), to others (social support), and their investment in themselves (education) that are expected to distinguish owner-founders and supervisors from corporate managers.
Supervisor accountability

One mechanism for establishing supervisor accountability is the performance evaluation process. Employees (including managers) vary in their response to performance feedback; some reflect and adjust future behavior while others ignore or deny any negative or critical observations (Lam, Yik, & Schaubroeck, 2002). Owner-founders of small firms receive limited performance feedback and consequently report greater feelings of isolation (Hannafey, 2003). A lack of performance feedback and self-reflection can lead to abuse as the supervisor is kept in the dark about his or her behavior (Glaso, et al., 2009).

Despite the fact that small firms that adopt performance appraisal practices experience higher growth than those that do not (Fabi, Raymond, & Lacoursière, 2007), small firms are less likely to adopt such HRM practices (Cassell, Nadin, Gray, & Clegg, 2002). As firms grow they are more likely to adopt a formal performance appraisal system for their employees (Kotey & Slade, 2005) This leads to our fifth set of hypotheses.

H5a. Supervisors in small firms are less likely to be held accountable for receiving and responding to performance feedback.

H5b. Abusive supervision is more likely to occur when supervisors are not held accountable for receiving and responding to performance feedback.

H5c. The effect of firm size on abusive supervision will be mediated by the use of accountability for receiving and responding to performance feedback.

Supervisor access to social support

Supervisors working in small firms may face a number of stressful conditions such as severe resource constraints, being micro-managed by an owner-founder, and limited opportunities for peer interaction and networking. Research has shown that abuse is more likely to occur when stressful working conditions and destructive leadership styles co-occur (Hauge, Skogstad, & Einarsen, 2007). Social support can mitigate some of these stressors and relieve the pressure on the supervisor. Social support is typically manifested as emotional support (i.e., a sympathetic ear, demonstrating caring and understanding) or tangible/instrumental support (i.e., pitching in to relieve work load, providing resource) (Viswesvaran, et al., 1999). Access to peers, superiors, and human resource staff in a large organization can offer both emotional and tangible support to supervisors experiencing work-related stress. However, supervisors in small firms may have few avenues of social support and not be equipped to cope with the stressful working conditions that prevail. Supervisors in small firms, who are often owner-founders, are noted to be “lonely souls” (Kets de Vries, 1977) or mavericks who are set apart from others.

This leads to our sixth set of hypotheses.

H6a. Supervisors in small firms are less likely to have access to a strong social support system.

H6b. Abusive supervision is more likely to occur when supervisors have limited access to a strong social support system.

H6c. The effect of firm size on abusive supervision will be mediated by the supervisor’s level of social support.
Supervisor’s level of education

Formal education is easily measured by the attainment of an academic credential. Academic credentials may serve as a proxy for manager capability such that those with more education are assumed to be better prepared for the role of manager. In large firms, formal education often serves as a credential that is used as a filter or “must-have” for advancement to a management position. In small firms, there may be less emphasis placed on formal education particularly when the supervisor is a personal acquaintance of the owner-founder or the owner-founder themself. Small firms are more likely to rely on word of mouth when recruiting prospective employees as owners prefer to hire managers who are known to them on a personal level and not strangers attracted by more formal recruitment strategies (Kotey & Slade, 2005). Owner-founders may emphasize personal knowledge of supervisor applicants along with performance track record instead of formal training and education.

Studies have shown that knowledge gained from education (Bates, 1990) affects firm survival and success. Because there are no professional entry requirements to start a firm, many small firms may be managed by those with insufficient training, making it difficult to hire and oversee effective supervisory staff. We suggest that the likelihood of abusive supervision in small businesses may be influenced by the supervisors’ professional preparation. Supervisors who lack appropriate management skills may have a greater tendency to exhibit abusive supervisory behaviors than those who have gained more managerial experience in the context of a highly administrative structure (O’Gorman, Bourke, & Murray, 2005).

\[ H7a. \] Supervisors in small firms are less likely to have an appropriate level of education to fulfill their job duties.

\[ H7b. \] Abusive supervision is more likely to occur when supervisors do not have an appropriate level of education to fulfill their job duties.

\[ H7c. \] The effect of firm size on abusive supervision will be mediated by the supervisor’s level of education.

METHOD

A convenience sample was collected by 35 undergraduate students in an online management course at a large Midwestern university using a form of a respondent-driven sampling. Students served as enumerators who were assigned to survey ten individuals who each worked for a different organization. To ensure the quality of the surveys, the enumerators were required to submit a list of participants along with email or phone number contact information. Ten percent of respondents were contacted and confirmed their participation.

Although students were used as enumerators to collect data from ten acquaintances, there are several key differences between this approach and that in typical respondent-driven sampling. Respondent-driven sampling, also known as snowball sampling, was designed to identify hidden or difficult to reach populations, such as the homeless or intravenous drug users (Salganik & Heckathorn, 2004). Accordingly, great care must be used in drawing inferences from such a sample. Our sample differs from a typical snowball sample in three ways. First, the sample did not “snowball” more than one level; enumerators collected their surveys directly from ten acquaintances. Secondly, the
population sampled did not have an identifiable characteristic (such as drug use) other than having been employed in the last year, allowing for a diverse sample of the overall population. Enumerators did not select respondents known to have abusive supervisors and so the greatest threat to validity in snowball samples (sampling on the dependent variable) was minimized. Third, enumerators were instructed not to sample more than one person from any given employer, thus increasing the diversity of individuals and industries included in the sample. Additionally, numerous controls, such as industry and respondent age were included in the model to address biases that may occur during sample selection.

Surveys were submitted by 346 respondents. Due to missing data, 17 were dropped from the pool, leaving a sample of 329 usable responses. One hundred thirty one respondents worked for small organizations and 198 worked for large organizations.

Measures

Abusive supervision. Abusive supervision was measured using Tepper’s (2000) 15-item scale for supervisor abuse. This scale had satisfactory reliability (α = .926).

Structural factors. Three structural factors: advisory board, human resource professional, and employee advocacy were measured using one item for each factor. Respondents were asked if each of the three structural factors was present in the employing organization (e.g., Does the organization have an advisory board to oversee the owner of the business?) Responses were recorded as a dichotomous variable; “No” was coded as 0 and “Yes was coded as 1.

Supervisor accountability. Supervisor accountability was measured with one item (“This person received and responded to performance evaluation and feedback”) on a 5 point Likert-type scale (1 = Strongly disagree; 5 = Strongly agree).

Supervisor access to social support. The level of perceived social support available to the supervisor was measured with one item (“The person has a strong social support system”) on a 5 point Likert-type scale (1 = Strongly disagree; 5 = Strongly agree).

Supervisor’s level of formal education. Supervisor’s level of formal education was measured with one item (“How much education has this person had?). Respondents were offered five levels (High school, some college, college, masters degree, PhD) and selected the appropriate response.

Firm size. Firm size was measured by two open-ended items. One item asked for the number of employees working at the specific location where the respondent was employed. The second item asked for the total number of employees if the respondent’s employer was a multi-site organization. Respondents were categorized as working for small firms (50 and fewer total employees) or large firms (more than 50 total employees) based upon the total number of employees working at that location.

Control variables. Two organization characteristics, industry and corporate structure, were included to address concerns that we might oversample respondents from retail/restaurant establishments, common places of employment for undergraduate students. Participants stated the type of business for which they worked, and then two raters dummy coded industry - 0 for retail, bar and restaurants, 1 for all other (service/manufacturing, professional and non-profit/government). Reliability for the two raters was .94. Responses on which the coders disagreed were discussed until the coders reached agreement. Corporate structure was measured with a forced choice question offering the following alternatives: independent (one location), independent (multi-site),
corporate owned, or franchise. Responses were recoded into a dummy variable where 0 = independent and multi-site, and 1 = all other corporate forms.

We controlled for differences in ownership based on firm size by including the level of the supervisor’s financial investment in the organization. Financial investment was measured with one item (“This person had a substantial personal or family financial investment in the firm”) on a 5 point Likert-type scale (1 = Strongly disagree; 5 = Strongly agree). Respondent age was measured with a forced choice question offering the following alternatives: (1) 18-25, (2) 26-35, (3) 36-45, (4) 46-55, and (5) 56 or higher; to check whether student participants recruited only respondents in their own age cohort, thus limiting the variance in respondent age. Table 1 shows the frequencies for all control variables.

### Table 1. Frequencies for Control Variables and Firm Size

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<td>232</td>
<td>97</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Independent</td>
<td>155</td>
<td>174</td>
<td></td>
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</tr>
<tr>
<td>Financial Stake</td>
<td>78</td>
<td>51</td>
<td>73</td>
<td>53</td>
<td>74</td>
<td></td>
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<tr>
<td>Age*</td>
<td>144</td>
<td>84</td>
<td>45</td>
<td>40</td>
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<td>Firm size</td>
<td>131</td>
<td>198</td>
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<td></td>
</tr>
</tbody>
</table>

*Respondent age brackets: (1) 18-25, (2) 26-35, (3) 36-45, (4) 46-55, and (5) 56 or higher

### Analysis and Results

Table 2 shows means and standard deviations for the study variables and control variables for the full sample and each sub-sample (small and large organizations). Table 3 shows the correlations among all study variables. Results of t-tests used to compare small and large companies are included in Table 2. Three of the four control variables were significantly different between small and large companies. Small companies were more likely to be independent, supervisors were more likely to have a significant financial stake in the company, and the age of those being supervised tended to be younger. Industry sector was not significantly different.

The aggregate mean for abusive supervision was 1.536 (sd = .651) consistent with results from recent studies that have reported levels from 1.26 (Tepper, Duffy, Hoobler, & Ensley, 2004) to 1.7 (Zellars, et al., 2002). As predicted, abusive supervision was higher in small firms (µ = 1.623) than in large firms (µ = 1.478) (p <.05, two tailed), supporting Hypothesis 1. T-test results showed that small firms were less likely to utilize advisory boards, human resource professionals, and employee advocacy, supporting Hypotheses 2a, 3a, and 4a. T-test results also showed that small organizations were less likely to hold supervisors accountable via performance evaluation and supervisors in small organizations
Eesley and Meglich had lower levels of formal education, supporting Hypotheses 5a and 7a. However, supervisor access to social support was not significantly different between small and large organizations, thus Hypothesis 6a was not supported.

Hypotheses 2a through 7b propose a mediation model, in which the small organizational size reduces the level of the mediators, the mediators reduce the level of abusive supervision, and when both size and a mediator are included, only the mediator is significant in predicting abusive supervision. Because structural equation modeling does not allow the use of dichotomous mediators (Preacher & Hayes, 2008), we used Baron & Kenny’s (1986) recommended procedures for assessing mediation. For the three dichotomous mediators, advisory board, human resource professional and employee advocacy, logit regression was used to predict the relationship between firm size and the mediator. These relationships are reflected in Figure 2 Panels H2 to H7, and an example of the regression of abusive supervision on firm size and the controls is shown in Table 4; Model 1.

### Table 2. Descriptive Statistics and t-Tests to Compare Small and Large Firms

<table>
<thead>
<tr>
<th></th>
<th>All Employees</th>
<th>Employees &lt;= 50</th>
<th>Employees &gt; 50</th>
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<tbody>
<tr>
<td></td>
<td>N</td>
<td>Min.</td>
<td>Max.</td>
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<tr>
<td>Abuse</td>
<td>329</td>
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<td>Rest_Retail</td>
<td>329</td>
<td>0.000</td>
<td>1.000</td>
</tr>
<tr>
<td>Indep</td>
<td>329</td>
<td>1.000</td>
<td>5.000</td>
</tr>
<tr>
<td>Fin. Stake</td>
<td>329</td>
<td>0.000</td>
<td>1.000</td>
</tr>
<tr>
<td>Age</td>
<td>329</td>
<td>1.000</td>
<td>5.000</td>
</tr>
<tr>
<td>Adv. Board</td>
<td>329</td>
<td>0.000</td>
<td>1.000</td>
</tr>
<tr>
<td>HR Pro</td>
<td>329</td>
<td>0.000</td>
<td>1.000</td>
</tr>
<tr>
<td>Advocacy</td>
<td>329</td>
<td>0.000</td>
<td>1.000</td>
</tr>
<tr>
<td>Education</td>
<td>329</td>
<td>1.000</td>
<td>5.000</td>
</tr>
<tr>
<td>Social</td>
<td>329</td>
<td>1.000</td>
<td>5.000</td>
</tr>
<tr>
<td>Perf. Eval</td>
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<td>1.000</td>
<td>5.000</td>
</tr>
<tr>
<td>Size</td>
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a Two-Tail Test of Significance

<table>
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<tbody>
<tr>
<td>Abuse</td>
<td>1.000***</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Size</td>
<td>-0.109*</td>
<td>1.000***</td>
<td></td>
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<td></td>
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<tr>
<td>Indep</td>
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<td>-0.100</td>
<td>1.000***</td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>Age</td>
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<tr>
<td>Adv. Board</td>
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<td>-0.015</td>
<td>0.365***</td>
<td>1.000***</td>
<td></td>
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</tr>
<tr>
<td>HR Pro</td>
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<td>-0.227***</td>
<td>-0.022</td>
<td>-0.033</td>
<td>1.000***</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Advocacy</td>
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<td>0.448***</td>
<td>-0.009</td>
<td>-0.564***</td>
<td>-0.344***</td>
<td>0.155</td>
<td>1.000***</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Education</td>
<td>-0.160*</td>
<td>0.358***</td>
<td>-0.096</td>
<td>-0.330***</td>
<td>-0.267***</td>
<td>0.215</td>
<td>0.530***</td>
<td>1.000***</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Social</td>
<td>-0.227***</td>
<td>0.458***</td>
<td>-0.134</td>
<td>-0.295***</td>
<td>-0.252***</td>
<td>0.182</td>
<td>0.490***</td>
<td>0.556***</td>
<td>1.000***</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Perf. Eval</td>
<td>-0.254***</td>
<td>0.137*</td>
<td>-0.255***</td>
<td>0.024</td>
<td>0.015</td>
<td>0.066</td>
<td>0.045</td>
<td>0.028</td>
<td>0.168**</td>
<td>1.000***</td>
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<td></td>
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<tr>
<td></td>
<td>-0.352***</td>
<td>0.040</td>
<td>0.016</td>
<td>0.109*</td>
<td>0.175**</td>
<td>0.059</td>
<td>-0.075</td>
<td>-0.006</td>
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<td>0.052</td>
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<tr>
<td></td>
<td>-0.460***</td>
<td>0.186***</td>
<td>-0.102</td>
<td>-0.098</td>
<td>0.008</td>
<td>0.042</td>
<td>0.167**</td>
<td>0.217***</td>
<td>0.263***</td>
<td>0.187***</td>
<td>0.334***</td>
<td>1.000</td>
</tr>
</tbody>
</table>

had lower levels of formal education, supporting Hypotheses 5a and 7a. However, supervisor access to social support was not significantly different between small and large organizations, thus Hypothesis 6a was not supported.
Firm size was negatively related to supervisory abuse ($\beta = -0.18$, $p < 0.05$). Thus Hypothesis 1, that abusive supervision is more likely to occur in small firms rather than large firms, is supported. Firm size was positively related to the likelihood of having an advisory board ($\beta = -0.22$, $p < 0.001$) supporting H2a, but advisory board was not significantly related to abusive supervision, failing to support H2b. Thus advisory board does not moderate the effect of firm size on abusive supervision (H2c). Firm size significantly increased the likelihood of having a human resource professional, employee advocacy mechanisms, supervisor accountability via performance evaluations and higher formal education. Each of these moderators significantly decreased abusive supervision. Additionally, in each of these cases, when abusive supervision was regressed on both firm size and one of these moderator variables, firm size was insignificant, indicating that the effect of size was mediated. These results support Hypotheses 3abc, 4ab and 5abc & 7abc. Finally, H6a was not supported because firm size was not significantly related to social support, although social support did significantly decrease abusive supervision ($\beta = -0.23$, $p < 0.001$), supporting H6b. The effect of firm size on abusive supervision therefore was not mediated by social support, and so H6c was not supported.

We then conducted Sobel tests (Sobel, 1982) of the indirect effect of firm size on abusive supervision for each variable. Evaluation of the indirect effect of firm size on abusive supervision is complicated by the presence of dichotomous mediators. This is because the coefficient from IV to mediator is a logit log-likelihood, and all other coefficients are OLS coefficients. According to the procedures outlined by MacKinnon & Dwyer, (1993), the regression coefficients must be made comparable across equations. This is accomplished by multiplying each coefficient by the standard deviation (SD) of the predictor variable in the equation and then dividing by the SD of the outcome variable (Herr, 2012). As seen in Table 5, indirect effects were significant for human resource professional, employee advocacy, education, and performance evaluation. Firm size did not have a significant indirect effect on abusive supervision through advisory board or social support, failing to support H2c & H6c.

Finally, a regression of supervisory abuse was run on firm size with all of the mediators and controls entered together to determine if the mediators affected abusive supervision independently. (See Table 4; Model 2). In this model, all three structural mediators were insignificant – advisory board ($p = 0.55$), human resource professional ($p = 0.34$) and
employee advocacy \((p = .06)\), but each of the personal attributes of the supervisor - performance evaluation, social support and education - were significant \((p < .001)\).

Ad hoc analysis was performed to investigate if the structural variables’ effect on abuse were mediated by the personal attributes of the supervisor. We regressed each of the personal attributes on the controls, firm size, and all three structural factors. Employee
advocacy was significantly related to performance evaluation \( (p < .01) \), and education \( (p < .01) \), and human resource professional was also related to education \( (p < .05) \). These findings indicate that in our sample, the path from employee advocacy to abuse is mediated by the use of performance evaluations and education, and the effect of human resource professional on abusive supervision is mediated by education. A summary of findings can be found in Table 6.

**DISCUSSION**

The finding of this study, that supervisory abuse is more prevalent in organizations of 50 or fewer employees suggests that employees of these companies bear some of the negative consequences of “dark side” of entrepreneurship (Kets de Vries, 1985; Strenger & Burak, 2005). For small firms, more abusive supervision occurs in part because there are fewer formalized structures such as human resource professionals or employee advocacy.

### Table 4. Regression Models for Abusive Supervision

<table>
<thead>
<tr>
<th></th>
<th>Model 1</th>
<th>Model 2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Predictors</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Constant)</td>
<td>1.80 ***</td>
<td>3.15 ***</td>
</tr>
<tr>
<td>Rest_Retail</td>
<td>0.15</td>
<td>0.06</td>
</tr>
<tr>
<td>Fin. Stake</td>
<td>-0.06 *</td>
<td>-0.03</td>
</tr>
<tr>
<td>Indep</td>
<td>0.03</td>
<td>0.02</td>
</tr>
<tr>
<td>Age</td>
<td>-0.02</td>
<td>0.00</td>
</tr>
<tr>
<td>Size</td>
<td>-0.18 *</td>
<td>0.02</td>
</tr>
<tr>
<td>Adv. Board</td>
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<td>0.05</td>
</tr>
<tr>
<td>HR. Pro</td>
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<td>-0.08</td>
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<tr>
<td>Advocacy</td>
<td></td>
<td>-0.15</td>
</tr>
<tr>
<td>Education</td>
<td></td>
<td>-0.10 ***</td>
</tr>
<tr>
<td>Social</td>
<td></td>
<td>-0.15 ***</td>
</tr>
<tr>
<td>Perf. Eval</td>
<td></td>
<td>-0.19 ***</td>
</tr>
<tr>
<td>( R^2_{adj} )</td>
<td>0.026</td>
<td>0.28</td>
</tr>
<tr>
<td>( F )</td>
<td>2.754 *</td>
<td>12.70 ***</td>
</tr>
</tbody>
</table>

* \( p < .05 \), ** \( p < .01 \), *** \( p < .001 \)

*Standardized Coefficients*
mechanisms to protect employees from mistreatment. Additionally, small firms employ supervisors with less formal education and do not hold supervisors as accountable to performance feedback, two factors which can lead to a greater propensity to exhibit abusive supervision.

The evidence suggests that the presence of an advisory board was not related to abusive supervision for either large or small firms. For large firms, one explanation may be that having multiple levels of management makes compliance with CEO directives at the front-line supervisor level more challenging (Westhead & Storey, 1996). The effect may be weak because advisors to top management of large firms are concerned more with the strategy than with operations, and with the support of top corporate officers rather than lower level supervisors (Pugliese, et al., 2009). Additionally, the hierarchy separates employees who are low on a large firm’s organizational chart from top management and ownership, making them less likely to be concerned with or aware of the organization’s corporate governance structure. Survey respondents may therefore have been less accurate with their responses regarding the use of boards of advisors.

In small firms, the owner or supervisor has greater control over all aspects of the organization due to less distance between the owner and the employees (Jenkins, 2004; Wiklund, et al., 2009). The close proximity between owner and employees reduces the need for formality, and is characterized by undocumented human resource practices and procedures (Kotey & Slade, 2005). If the advisory board consists of close friends of the owner, or if the human resource professional is the owner’s child, the presence of such formal administrative structures may not be effective in reducing abusive supervision. In this context, formal practices might be viewed as unwanted or unnecessary (Storey, et al., 2010).

### Table 5. Sobel Test of Significance of Indirect Effect of Size on Abusive Supervision

<table>
<thead>
<tr>
<th>Variable</th>
<th>Sobel</th>
<th>Std. Error</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advisory Board</td>
<td>-0.518</td>
<td>0.010</td>
<td>0.605</td>
</tr>
<tr>
<td>Human Resource Professional</td>
<td>-2.142</td>
<td>0.013</td>
<td>0.032</td>
</tr>
<tr>
<td>Advocacy</td>
<td>-3.334</td>
<td>0.012</td>
<td>0.001</td>
</tr>
<tr>
<td>Education</td>
<td>-2.189</td>
<td>0.020</td>
<td>0.029</td>
</tr>
<tr>
<td>Social</td>
<td>0.724</td>
<td>0.026</td>
<td>0.469</td>
</tr>
<tr>
<td>Performance Evaluations</td>
<td>-3.212</td>
<td>0.035</td>
<td>0.001</td>
</tr>
</tbody>
</table>

### Table 6. Summary of Hypotheses Support

<table>
<thead>
<tr>
<th>H1</th>
<th>H2</th>
<th>H3</th>
<th>H4</th>
<th>H5</th>
<th>H6</th>
<th>H7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abuse</td>
<td>Advisory Board</td>
<td>HR Professional</td>
<td>Employee Advocacy</td>
<td>Performance Evaluations</td>
<td>Social Support</td>
<td>Education</td>
</tr>
<tr>
<td>(a) Related to Size</td>
<td>Supported</td>
<td>Supported</td>
<td>Supported</td>
<td>Supported</td>
<td>Not Supported</td>
<td>Supported</td>
</tr>
<tr>
<td>(b) Related to Abuse</td>
<td>Not Supported</td>
<td>*Supported</td>
<td>*Supported</td>
<td>Supported</td>
<td>Supported</td>
<td>Supported</td>
</tr>
<tr>
<td>(c) Mediates Size</td>
<td>Not Supported</td>
<td>*Supported</td>
<td>*Supported</td>
<td>Supported</td>
<td>Not Supported</td>
<td>Supported</td>
</tr>
</tbody>
</table>

*Supported using Baron & Kenny mediation test and Sobel test, not supported in full regression in Model 2.
Unlike an advisory board, the human resource professional more directly engages with employees and so we would expect a significant negative relationship to supervisory abuse (presence of human resource professional should reduce abuse). This is the case when it is entered with the controls, ($β=-.20, p =< .05$) (see Figure 2 Panel H3), but not when added to Model 2 in Table 4. Our ad hoc analysis indicated that the effect a human resource professional has on abusive supervision is mediated by education. That suggests that it is not simply the presence of a human resource professional that lowers abusive supervision, but rather it is a human resource professional who assists in hiring supervisors with greater education or who promotes their continued educational advancement during their tenure with the firm.

Employees in large firms were much more likely to have avenues of employee advocacy (labor unions and employee assistance programs). Abusive supervision was lower in organizations with these mechanisms, but not when personal attributes of the supervisor were included in the model. Our ad hoc analysis indicated that the effect of employee advocacy mechanisms was mediated through higher levels of education and the use of performance evaluation. The interesting finding here is that it is not enough to have a mechanism such as a union to give voice to employee concerns, but these mechanisms are effective when they are associated with the selection of better educated and accountable supervisors.

Formal education strongly reduced abusive supervision. Supervisors with lower levels of education may have inadequate management skills for the job, leading to lower performance (Orser, Hogarth-Scott, & Riding, 2000). Poorly trained supervisors can lead to a stressful and dissatisfying work environment that heightens the likelihood of abusive supervisory behavior (Spector, 1997). Accordingly, lower levels of frustration and dissatisfaction should reduce unethical and abusive behavior by the supervisor (DeClercq & Dakhli, 2009).

Supervisors in small firms were less likely to be held accountable to receive and respond to performance evaluations. Our findings show that this factor is the strongest preventive measure to prevent abuse ($β=-.19, p =< .001$). The present study echoes the findings of Glaso, et al. (2009) and emphasizes the importance of providing information to supervisors about their behavior and enhancing their accountability for their actions. While performance evaluations are often viewed as a tool for promotion and incentives, they serve an important role in informing supervisors of their behavior and its effects on employees. Because small business are much less likely to adopt this important feedback system (Cassell, et al., 2002; Kotey & Slade, 2005) we found that it contributed to greater levels of abusive supervision in small firms.

Contrary to our prediction, supervisors at both large and small organizations had access to the same level of support. We found that when participants perceived that their supervisors had access to a strong social support system, abusive behaviors were diminished. This was the second strongest factor in reducing abusive supervision ($β=-.15, p = .001$). In large organizations, social support is a powerful defense against the frequent challenges an impersonal and bureaucratic organization may present. In small firms, while many authors have discussed the small businessman as a nonconforming and lonely soul (Kets de Vries, 1977), that does not appear to be the case in our sample. For these small business supervisors, social support is a critical element enabling them to function in what is often a challenging environment with few formal structures to offer assistance.
Implications for Theory

Our study extends theory in the areas of entrepreneurship, small business, and abusive supervision. The study of the “dark side” of entrepreneurship has received very little focused attention since the concept was introduced by Kets de Vries (1985). Since then, Shepherd & Haynie's (2009) application of optimal distinctiveness theory is perhaps one of the only attempts to apply a theoretical approach to the psychological well-being of entrepreneurs. The present study contributes by applying the theoretical tenets of the abusive supervision literature to the realm of small business owners and supervisors, and then testing it empirically in the field. In doing so we provide new insight and support to the observation that small businesses are in fact different from large businesses (Storey, 1994). Consistent with other empirical findings on the different adoption rate and impact of formal systems such as human resource staff (Kotey & Slade, 2005; D. J. Storey, et al., 2010) our study suggests that abusive behavior is reduced by adopting some of the administrative controls common in large organizations, and that these controls operate by increasing the level of personal attributes that reduce abusive supervision. Additionally, our findings highlight that small firms more strongly reflect the nature and character of their owners and leaders. Small businesses experience higher levels of abusive supervision, in part related to personal factors such as lack of accountability and lower levels of formal education that are more common in these firms.

Second, we extend the consideration of the “dark side” of self-employment beyond that of the owner-founder to the work conditions of the employee. This is helpful because it broadens consideration of the impact of inappropriate behaviors to a key group of stakeholders for whom the consequences of abusive supervision are well known. Although it has been understood that negative mental states affect not only the individual, but also the health of the firm (Kets de Vries & Miller, 1984) this study explicates one mechanism, abusive supervision, by which this damage occurs.

Third, by exploring one aspect of the ‘dark side’ of entrepreneurship, we answer the call to provide measures of entrepreneurial outcomes other than firm performance that reflect the unique characteristics of small and entrepreneurial firms (Shane & Venkataraman, 2000). We found that in comparison to large firms, abusive supervision occurs more frequently in small firms, a previously untested research question. Our effort to understand one of the costs of being a small and entrepreneurial firm complements the work of scholars who are attempting to value the off-balance sheet benefits realized by entrepreneurs (Carter, 2011).

Practical Implications

Because the consequences of abusive supervision such as turnover, workplace aggression, and poor performance are costly, stakeholders of small businesses such as investors, business partners, or potential employees can benefit by understanding the conditions under which it most likely to occur. Small firms are less likely to have structural factors such as a human resource professional or a union; it follows that stakeholders in small businesses may want to look to other means of increasing the training and accountability of the organization’s supervisors. For example, stakeholders could use informal mechanisms such as morning huddles or quarterly gatherings where they can discuss organizational practices.

Additionally, unlike traits such as narcissism or authoritarianism that are difficult to measure and can only be done so with the consent of the subject, abusive supervision is
reported by employees using a highly reliable scale. This provides a much more accessible method for stakeholders to evaluate the extent of the ‘dark side’ of a small organization. If access to employees is limited, stakeholders can begin to assess the health of the company’s culture by simply assessing the avenues of employee advocacy and the levels of supervisory accountability, formal education, and access to social support. When stakeholders then identify patterns of abusive supervision, corrective action can begin first with informal mechanisms such as diagnosing the supervisor’s level of training or accountability rather than seeking to impose a more formal set of controls or adding additional staff.

LIMITATIONS & FUTURE RESEARCH

The form of respondent-driven snow ball sampling used does not allow us to readily generalize these findings to a larger population. Additionally, all data were single-source, self-reported, leading to the possibility of common method variance. However, the level of abuse we found was well within the range of prior studies, giving us confidence that our findings are not significantly biased. Moreover, we included numerous other controls to address possible biases introduced through sample selection. The second limitation is the accuracy of responses to some measures. For example, many employees, particularly of large companies, may not have been aware of whether the organization had an advisory board. This study may have assessed the participants’ awareness of these factors rather than the existence of them. Third, some of our measures were single items, and more insight could be gained from using more complex measures that more richly investigate the relationship with abusive supervision.

A promising area for future research may be to investigate how the various motivations for working at a small business affect perceptions of and consequences of abusive supervision in small firms. For example, if the informal practices of small businesses allow individuals in these organizations to feel greater levels of key job characteristics such as autonomy or task variety, do they perceive abuse in the same way as their colleagues in larger organizations? More importantly, when they perceive abuse, do they respond to it in a similar manner? A second area of investigation would be to assess whether some of these factors affect abusive supervision differently in large or small organizations. For example, does education, which is a proxy for managerial competence, have a greater or lesser effect on abusive supervision than in small firms where such credentials are valued differently?

CONCLUSION

We studied the prevalence of abusive supervision and found higher levels of this behavior in firms of 50 employees or fewer compared to larger organizations. Moreover, we tested differences in structural and personal supervisory characteristics and found evidence that these differences often had a significant impact on the level of abusive supervision. These findings provide important insight into the nature of entrepreneurial and small business management and highlight actionable steps that can be taken to encourage ethical and moral supervisory behavior.

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Truth as an Ethical Trust System

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ABSTRACT

In Thomasma’s 1994 article, “Telling the Truth to Patients: A Clinical Ethics Exploration,” he outlines that truth telling is done primarily for three reasons. First, it is a right to be told the truth. Second, it is useful and beneficial to tell the truth. Lastly, it is a kindness to be told the truth (p. 149).

While Thomasma’s article is directed to patient policy in health care, one could easily take the same reasons for truth telling to patients and apply them directly to telling the truth to customers and consumers. In fact, one way of viewing truth telling in health care could be stated as follows: truth earns trust which allows for treatment. In sales, especially from a relationship building model, character instills confidence which allows for cooperation.

This approach, plus suggestions from the works of Immanuel Kant, will provide some guidelines for decision making in sales settings and managing those who make ethical decisions about things such as lying on a routine basis.

KEY WORDS: Ethical decision making, ethical dilemmas

INTRODUCTION

In relationship building models, cooperation between the buyer and sales person to arrive at the correct or appropriate product or service is not much different from a physician’s goal of shared decision making with patients. The doctor shares with the patient all of the pertinent information about treatments, options, alternatives, risks, etc. No course of treatment is perfect or always one hundred percent effective but a best option can be determined and presented to the patient for his or her informed consent to the procedure.
A sales transaction can look similar as far as a sales person sharing all the important information to the potential buyer, including options, alternatives, etc. If there is genuine trust and confidence in the sales person, the buyer should feel free to make a decision that is informed and not view the sales person as an adversary but someone with whom to cooperate. While this appears to be easy to do, in reality it is extremely difficult to accomplish. In this paper, challenges and difficulties in truth telling will be surfaced following the kindness, utility, and right model first mentioned by Thoma’sma.

**Truth is a kindness**

In the world of Kantian deontological ethics, it is a universal rule never to lie. In fact, it is only rational to tell the truth (Kant, 1964, p. 92). This strikes many as counter intuitive as many people lie and for seemingly good reason. As such, lying looks rational, logical, and anything other than universally forbidden. This is a short sighted understanding of what it means to tell the truth and, more importantly, if one truly understands truth telling, in a non-moral sense, then lying and truth telling do appear as if they can be governed by the strict rules which Kant employs.

There is a species of lying which can be called unintentional lying. Unintentional lying clearly occurs when someone shares false information unknowingly. There is no malice intended and, in fact, the liar is not even aware he or she is sharing false information. An overt expression of this kind of lie is when someone explicitly tells something to another person that is false.

Consider a simple example of either asking directions or being asked for directions. What are the simplest or most basic answers given? Simply the correct directions as understood by the speaker. In fact, the question is what would it take for the responder to lie? The easiest answer is some form of self-interested motivation. Without self-interested motivation there is no reason to lie and, moreover, it is actually more rational to tell the truth. The vast majority of mundane everyday communication is fraught with honesty and truth telling simply because without honesty there could never be any genuine communication. People would know where to go or what time it really was if everyone lied continually. It is only rational to tell the truth.

This first type of lying, unintentional lying will be a good place to highlight the two different expressions of lying. Unintentional lying clearly occurs when someone shares false information unknowingly. There is no malice intended and, in fact, the liar is not even aware he or she is sharing false information. An overt expression of this kind of lie is when someone explicitly tells something to another person that is false. A covert expression of this kind of lie is simply when a bit of information is not shared as the person either was not aware of it or was not aware that he or she was to explicitly share the information.

At the front end of a sales transaction, the sales person must consider whether she or he is possibly going to create harm to the customer or consumer. If so, then the transaction must cease. If not, then everything transacted at this stage simply serves to demonstrate the character of the sales person, which is critical as consumers consider choosing to buy a particular product or service. In higher education, recruiters must build relationships and ‘sell’ the university to prospective students who are really buying an intangible product. Practical honesty as unintentional speaks volumes for the character of the sales person or recruiter. Character is even more honored when potential students recognize it as genuine and that they will not be humiliated or harmed by possible approaches or responses in the
recruitment process. In short, these simple considerations in communication help establish trust.

Unintentional communication is how people typically engage one another. In fact, these unintentional engagements highlight the truth telling side of human behavior. In situations where no self-interested benefit can be found, the rational behavior is to tell the truth when asked various kinds of questions. This is the only way to effectively communicate with someone. Thus, it is rational, in normal events, to tell the truth so that communication is achieved.

Unfortunately, though, in sales settings, people also unknowingly lie. In these same mundane scenarios, sales people or sales managers share false information fully believing in its veracity. Clearly, this may cause harm and miscommunication but this is not a moral shortcoming since there was no intention to cause harm. In fact, most people believe themselves to be helpful when imparting information.

Perhaps, in the future, sales persons and sales managers should get their facts straight but that is about all one can say that is actionable in this scenario as this kind of "lie" is bound to happen from time to time, unintentionally. The emphasis on avoiding unintentional lying in a proactive sense is in order to create a culture where truth telling is a habit. Lying is practice that is learned and adopted early in life. In some sense, there already exists a well-practiced bad habit of lying. So, in order to overcome that development, truth telling must be emphasized inside organizations. Moreover, cases of mundane, rational truth telling must be highlighted as the examples of accepted behavior.

This may certainly sound like nitpicking when it comes to truth and communication but this is a simple form to use to explain the difference between overt lying and covert lying, or lying by omission. Moreover, while not a morally blameworthy act, it does point out that, typically, if this kind of action is caught, one will go to great lengths to make sure that people know pertinent information and that the 'liars' are coached to share openly.

A covert expression of this kind of lie is simply when a bit of information is not shared as the person either was not aware of it or was not aware that he or she was to explicitly share the information. This may certainly sound like nitpicking when it comes to truth and communication but this is a simple form to use to explain the difference between overt lying and covert lying, or lying by omission. Moreover, while not a morally blameworthy act, it does point out that, typically, if this kind of action is caught, we go to great lengths to make sure that people know pertinent information and that the 'liars' are coached to share openly.

Sometimes, however, people will give incorrect directions or lie about the time or weather for no more reason than the enjoyment of teasing another person by providing false information. Consider a friend asking a cohort if it is raining outside. The cohort considers the 'fun' that could be had by saying no and allowing his friend to leave work without an umbrella. In reality, many people perform various levels of teasing for 'fun,' 'self-interested' reasons.

In Kant’s educational ‘system,’ for lack of a better word, the first stage is a setting of nurture (Frankena, p. 83). The main objective in this first stage is simply to prevent bad habits from forming, such as lying knowingly or otherwise. What should be nurtured is the rational behavior of truth telling. In non-motivated scenarios, or what are generally situations where communication is just carried out with little intention other than simply
conveying of information, telling the truth is just the rational thing to do. During the majority of most days, we tell the truth without even thinking about it simply because we want the information conveyed. It is just how unintentional communication takes place, which is also why it is easy to fall in to a lie by sharing something false or by omitting something that was necessary. Nonetheless, all normal communication is done rationally by truth telling. This is what is to be nurtured.

To take these examples a step farther, consider the fact that ‘nice’ people who are helpful are quick to give correction directions, tell the accurate time, and the like. Simply as a matter of kindness, people tell the truth. It would take some form of malicious self-interest to tell a lie. To perform this kind of lying puts an individual into the category of overt lying out of self-interest and there can be various reasons for this.

Out of this first realm of unintentional lying and intentional lying for jocularity, the actions can be evaluated with respect to kindness. Out of kindness, the truth is almost always told in mundane settings with the simple exception of perhaps not really knowing the correct, true answer. Out of kindness, people are not to be teased because it is harmful. If there could be any universality, not just rationality about truth telling, it could simply be expressed as a universal rule not to harm people. A leader or manager of a work force must be able to nurture the honesty of mundane truth telling and discipline those who are apt to tease and possibly humiliate others for enjoyment’s sake. This kind of coaching and management helps to instill character into a workforce and sales force. It is the honest behaviors that consumers are looking for and they can recognize when sale persons are not kind.

Kant does mention that metaphors and jokes are forms of lying and it is difficult to grasp as a problem, especially in team environments where jocularity is not just accepted but perhaps encouraged as being part of the group (Kant, 1964, p. 93). Kant, however, makes an important point, especially in light of the current state of our society. Jokes, which are made at the expense of another person, are the same as lying for self-gain. You have made someone else feel as though she were not deserving of respect in exchange for the smiles and laughter and spotlight that get in return. In our culture, we see this taken to an extreme where these jokes are turned into bullying situations. The gain is not just accolades for a well turned phrase. Rather, the gain is power and submission of the other person.

The overt form of this lie is obvious. It is possible that the covert form is akin to those who standby and laugh at or enjoys the humiliation of others. Regardless, like the straightforward lying for financial gain, this type of lie is dangerous because of the harm it creates for others. In the case of bullying, discipline is not only required but also the emphasis of creating a new culture where these kinds of lies are not practiced nor encouraged.

Kant’s point with these kinds of intentional lies is that we are to treat other people, including ourselves, with dignity and respect (Kant, 1964, p. 92). People are not things to be used but valuable in and of themselves (Kant, 1959, p. 48). As such, all persons are to be treated with truth, honesty, and merit. This should be the culture inside any organization. As a leader or manager of people, particularly a sales force, one must consider what kind of climate this creates in the sales force. In more current vernacular, at its worst, this can be considered a form of bullying, which can be harmful. Kant, in his philosophy of teaching, gave specific steps in teaching and educating people, not just children. These same steps can be applied to leading and managing people.
Truth as a Utility

The second category of lies is essentially based on the principle of doing no harm to other people. While harm was not desired in the previous section it was more out of poor sense of humor, bad judgment, and perhaps bad manners. In this scenario the concern is the creation of rules to prevent harm to others that would or could extend beyond their feelings.

There are two main types of lying performed in this category: lying out of self-preservation and lying for self-gain. The harm to others is generated by a general lack of respect for the other person. Lying to someone in order to gain, financially or otherwise, is tantamount to using them. Worse yet, this behavior often gets repeated and re-enforced for a variety of reasons to the point where the behavior could become accepted practice (Mazar, Amir, & Ariely p. 32). The only course of action in these cases is discipline (Frankena, p 83). This is habit that must be broken because it is morally repugnant and blameworthy. A supervisor should never allow this type of false communication to occur. The punishment can range, depending upon severity of the abuse of the wronged individual, from withholding favors and respect to more drastic measures such as termination. Again, these lies can be either overt or covert. That is, a person may go out of his or her way to tell a falsehood or that person may allow another to hold a mistaken belief because of the gain that would fall to them from believing the mistake.

In the category of lying for self-preservation is a form that is probably performed every day and they may not necessarily harm people in such a morally blameworthy way. These are learned early at childhood and practiced well into adulthood as they are performed routinely and examples are set everywhere at work and in the media. The first example of such a lie is the white lie. This form is well known but what is not often discussed in terms of its ‘wrongness’ is the fact that such lies are not very prudent. That is, the truth will always come out in the long term. The supposed value or benefit of such lies is really quite fleeting and really more detrimental in the long run as it can completely destroy trust. Lying out of self-preservation is a natural off shoot from white lies. White lies are said to be told to ‘protect others’ feelings’ but the genuine motive is to avoid a conflict, an argument, or an uncomfortable situation. While these may be laudable goals, if the real intention is something other than the respect of others, then one is lying for oneself. In fact, this is learned at an early age.

Consider lying to parents. Why do people lie to parents? Most people lie to their parents because they stayed out past curfew, went out with friends they were not to associate with, etc. Clearly, the lie is just an extension of the committing of a prior violation. The dynamic that takes place, though, is that one punishes the lie and often bypasses the actual problem. So, what gets reinforced is that person can continue to break rules and attempt to cover up the behavior. In the end, nothing is fixed.

In the white lie scenarios listed above, avoiding the conflict does not mean the conflict will never occur. Punishing someone for lying also does not resolve the problem that was meant to be covered up by the lie. Moreover, organizations often foster the ‘avoid conflict’ atmosphere in order to do just that. In essence, lying is actually being instilled in the company. Moreover, discipline and punishment are likely not to be handled appropriately in cases of lying. If a team’s only experience with truth telling is negative, that is, the only result or is firm punishment when somebody is caught lying, then people will actually risk
the lie over the other firm handed punishment for a possible mistake. That is, if lying appears to protect them from being punished, then it seems to be perfectly rational to lie. Appropriate sense of discipline suggests that praise and reward are shown towards favored behaviors such as truth telling. Moreover, these rewards of character can be withheld from those who lie. The net result is that only more grievous acts should be punished harshly. Still, many managers, like parents, always only punish the lie, and nothing was learned about the negative behavior. Now, that is not to say that team members should be able to break the rules as long as they tell the truth. Notice, instead, that the real problem comes from the negative behavior prior to the lie.

As for lying for self-gain, there is a motive such as seeking a gain or reward for our own benefit. Perhaps someone is looking for an escape from something he should not have done to begin with, which is really problematic. Again, lying harms people. A liar may have either broken someone’s confidence already and she is trying to cover our tracks or using them to get to some reward she really wants. Being self-interested, in-and-of itself, is not morally corrupt or necessarily damaging. Someone can do plenty in her own interest but what she should not do is seek her own interest to the extent of breaking a rule, or a law and, more importantly, at the expense of another person. This form is well known but what is not often discussed in terms of its ‘wrongness’ is the fact that such lies are not very prudent. That is, the truth will always come out in the long term. The supposed value or benefit of such lies is really quite fleeting and really more detrimental in the long run as it can completely destroy trust.

A Kantian-styled solution to the problem would be to work on cultivating the proper behavior that is desired (Frankena, p. 83). Leaders and managers must find ways to help employees acquire the dispositions that are favorable to success. Creating a culture of truth telling is paramount.

Take Enron as an example of culture and self-gain problems. Enron lied to its employees, officials, the public, and shareholders in order to make money. The financial system nearly collapsed in recent years. Some believe the problem stemmed from over aggressive sales of questionable home loans. And, the motive for such behavior was nothing more than money and profit. Nearly everyone will easily acknowledge that pursuit of profit in this fashion is, at least, morally questionable and, at worst, morally reprehensible. In fact, some will go to great lengths to chastise people who lie and deceive in order to further themselves regardless of what the gain is. Still, while stones are cast with one hand, the other hand is dealing cards.

Poker playing is a great context for evaluating the benefit of lying (Carr, p. 138). Bluffing in poker is clearly a lie in one’s own favor. By bluffing, one is trying to win the pot of money for herself. As such, this is an example of lying for one’s self benefit. And, more importantly, people expect it and want to do it. The significant difference between lying at a poker table and lying for shareholders can be difficult to discern. In either case, the lie is for self-benefit. In either case, someone is going to lose and be harmed. So, bluffing in poker and lying to shareholders look very similar, yet, most people will say they are as different as night and day. Moreover, these same individuals will argue that bluffing is actually part of the ‘game.’ Lying is part of the rules of poker. But, apparently, lying is never considered to be part of the rules when in the context of business.

Many popular book titles in management suggest that business is a game or, better yet, business is war. Consider the war analogy first. In chapter six of Sun Tzu’s classic book on
military strategy and warfare, The Art of War, he argues that the chief strategy that is to be employed is providing misinformation or practicing deception. The military objective is to feed the opposition false information, while, at the same time, attempting to discover the truth of their strategy. How does this lesson get applied to business? It appears that the goal of business strategy is to deceive the competition and conduct espionage to find out the opponent’s strategy.

Context appears to be the deciding factor in distinguishing bluffing from lying. That is, there appears to be a suspension of ‘moral’ rules for ‘game’ rules when individuals decide to play a game. This may be noteworthy. When people voluntarily enter into a situation where it is clearly understood that ‘moral’ rules will be suspended in favor of alternative ‘game’ rules, then can it really be said that they were harmed by being lied to? True, they may lose money but a fool and his winnings will soon be parted.

If the above statements are consistent and true, then there needs to be an evaluation as to whether or not business is war or simply a game since, in groups, unethical behavior such as lying can be influenced by other ‘unethical’ people (Gino, Ayal, & Ariely, p. 22). In either instance, there seems to be a suggestion that suspension of moral rules is acceptable for more pragmatic ones that support the purpose of the game or war and that is winning. Recognize that winning is the only consequence that is important. Further recognize that winning at all costs, as a consequence, creates a set of behaviors that can be lethal.

A great deal is written on marketing and advertising strategies which exercise almost behavioristic control over people to drive buying, or even overcome objections to buying (Arrington, p. 282). While short term gains of sales numbers being reached are undoubtedly achieved and successful, the long term risks are great. A significant challenge in the long term is that some customers feel mislead or lied to and they often carry remorse for their purchase (Holley, p. 290). Additionally, consider simple management and team engagements. Is a project bid or sale important enough to win at all costs? If it is, then understand this. If that is the most important thing on the ‘to do’ list, then everyone else involved as a team member or colleague takes a back seat. In fact, often find these persons may be viewed as expendable or useful as tools or pawns in the game.

Did the executives at Enron really plan to do intentional harm to everyone involved? Perhaps, not necessarily. Further, many of those executives did not necessarily recognize they were doing anything wrong, as odd as that may sound. Some people rein in certain behavior if it is believe to be harmful to others. From a Kantian perspective, though, lying in this manner is not prudent as, in the long run, no real good was gained for everyone and, more importantly, people were harmed.

Consequences drive a tremendous amount of behavior. They are even enlisted in cost-benefit analyses. There is nothing necessarily wrong with consequentialist thinking and decision making in normal processes. But, when working with a customer or sales team, thinking in terms of consequences can be fatal. Consequences are how tangible benefits are identified for a course of action. This can easily construct a situation where the tangible benefits are in the ‘lying’ column. And, as a result, so too does harming others fit the benefit column. So, how can one find tangible benefits in the ‘truth telling’ column?

When Kant formulates his moral theory, the linchpin is that you do not use people. That principle alone dictates that people are to be treated with dignity and respect. As a result, they are deserving of the truth and we disrespect our fellow teammates, employees and colleagues when we hide the truth from them. What this means on a daily basis is that
communication, as a life blood for teams, demands us to be honest and make an honest connection to others by showing them how much respect is shown to them and, as a result, how much trust is earned. Like the child example, we know he is lying and who cares at this point. The question should be ‘why did he break the rule?’ That is the behavior that is really upsetting. The same is true for working with others. A certain kind of behavior from teammates and employees is desired and expected. If one finds out that someone else is lying that should really not be surprising. And, if the lie is out of self-preservation, then one would want to find out what the person did that motivated her to lie. Once that problem is solved, then one can move forward in a positive manner in praising honesty and fostering a strong relationship with good communication. As a matter of utility and what is useful, good communication is always of greater benefit for more people than self-gain. And, as people recognize that then ought to alter their own behavior. In fact, this is a matter of prudence, according to Kant, and being taught the ‘right thing to do’ (Frankena, p. 110).

Truth as a Right

In some circles of philosophy regarding decision making, there is a position that holds that people either use or are to use an internal principle or something akin to practical reason. The benefit of such a position is that it is deliberate, intentional, or proactive. That is, these are chosen principles on which to act and demonstrate a kind of rationality, if the right principles are chosen. This benefit stems from the fact that the rational agent has become aware of her previous position of preconception or, in cognitive science, of confirmation bias. Now that she has become aware of her biases and foibles, she can rationally determine what is true, what works. Unfortunately, with no working benchmark or yardstick here, how is real rationality determined? Kant had a very particular version of rationality that is difficult to argue with if you agree with his initial assumptions.

The ideal rational agent is a species of rationality that is difficult to explain but, perhaps, easy to point to. Kantian styled ethics is grounded in ideal rational agents where not only does information yield behavior change, but the information itself is extremely particular. Specifically, rational agents adhere to the moral law which itself is unchanging. Moreover, the adherence to the moral law is what in fact grants a person her autonomy (Kant, 1959, p. 59).

In this category, there is more gray area and more certainty at the same time. In terms of certainty, Kant is clear that it is a perfect duty to tell the truth and to never lie (Kant, 1964, p. 92). In terms of gray area, Kant acknowledges that autonomy is to be secured. That too, however, will eventually prove to be a certainty.

With respect to perfect duties, if an action is truly universal and applicable to all and it falls in line with the laws of nature then it is a perfect duty to which there are no exceptions. Only if the action is attempted to be applied universally but cannot always be done due to the laws of nature, then it is an imperfect duty requiring a policy of a sort. A policy implies exceptions and a ‘hypothetical’ approach that admits of exceptions, imperfections, and impossibility to establish a general rule applicable to all. Rather, the result is an approach akin to managing by exception, all exceptions.

All employees, managers, leaders, sales people must be aware of, at this point, that this perfection is what Kant calls morality. It requires the alignment of autonomous decision making with the moral law. In fact, such an alignment is only what might properly be called autonomy. Any other alignment of decision making and choice is really letting some another thing or person make the decision or control the situation. Only a person acting
by the moral law can be truly said to act and decide by her own rational mind. This is a principle which demands to be taught by leaders and managers to all members of the organization.

One of the intriguing aspects to truth telling is that, despite some research to the contrary, everyone actually probably tells the truth the majority of the time, in the most mundane of settings. For example, when someone asks how to get to the grocery store, the responder probably does not typically go out of her way to lie to the ‘asker.’ In fact, it is quite natural just to rattle off the correct directions with little thought of risk, reward, benefit, or anything. This is a very telling behavior that any normal communication is dependent upon honesty. People, in control of their emotions and decisions, typically opt for truth in conversation. For Kant, this demonstrates the universality and rationality of following the moral law. Perhaps the same claim cannot necessarily be endorsed here but, at least, it does seem to be anecdotally evidentiary that autonomous behavior does often yield truth telling. Ultimately, within organizations, truth telling and the moral development of individuals are based on relationships and responsibility. This notion of responsibility truly demonstrates how truth completes a functioning system of trust.

The final form to be discussed here is lying under duress and it is indicative of what may occur in whistle blowing cases. This form is similar to the self-preservation lie. This is common because it is completely rational for anyone to want to avoid punishment or harm to themselves. For Kant, however, it is a moral point and must be addressed as a matter of autonomy.

People can and will determine their own course of behavior. Managers, supervisors, and leaders, must point out the moral misgivings of such behavior and, yet, still expect people to lie as it is their choice until they really learn why such communication is not rational. Duress lying occurs when the truth is ‘challenged’ out of someone. Whether the truth is told or not, only something negative will be the result due to the requester. If the truth is told something bad will happen. If the truth is withheld then something bad will happen. If a lie is told, it is a lie but why should anyone be made to participate or be coerced in an immoral action of any kind. A lie here is not necessarily a lie, according to Kant, but, rather it is a weapon against the one causing the duress (Kant, 1930, p. 112).

As a matter of creating a truth telling culture, the better option is to praise honesty and to actively seek it out, even, or especially, when the information being conveyed is bad news. This is old news but the strength of this approach is missed. People mistakenly believe they are just establishing relationships and communication. While they are establishing relationships and communications, they are also creating an environment and context in which behaviors can be isolated, addressed, and corrected. Still, leaders must adhere to this practice of praising behaviors which are deserving of approbation consistently, if they are to create a culture of honesty (Hoogervorst, De Cremer, & van Dijke, p. 36).

There is no real magic formula for establishing trust or even communicating with others. The simple truth, no pun intended, is to have honest, intentional conversations with people and to demonstrate to them that they are deserving of dignity and respect. The only other guideline is to always consider that dignity and respect when put into a position where lying is an option. Sure, someone may not get caught. Maybe, it’s a small lie. But, is the lie worth the loss of trust, credibility, integrity and relationships? There are not many lies which are worth that price. People often rationalize that the circumstances warrant or dictate lying but, if it puts working relationships and networks in precarious positions, then there is hardly a true benefit.
The lesson here is that no one should ever be placed in such a scenario. The last approach in terms of education and development is that people need additional guidance and mentoring. If duress lying is occurring then it is probably a safe bet that the cultural environment inside the organization is seriously lacking proper moral guidance and accountability.

The most dysfunctional organizations with the worst organizational health can probably point at issues with trust and security as the culprits. Trust and security are lost in environments where self-preservation lying is practiced. While it makes sense, it highlights that greater things are in trouble than just the communication or feelings in the organization. This is why employees must be made to understand the morality involved in their communication.

CONCLUSION

Incomplete knowledge can show a lack of concern to be diligent or credible, so, to be intentional, as a sales force shares what it knows it should make certain that it is sharing the correct information. This approach will help stop bad habits in order to foster better ones. To further be intentional about communication, one ought not to go out of his way to intentionally harm someone. If communication is harmful it hurts others, it hurts customers, and it hurts the team, and hurts the overall productivity of the team. This type of communication requires discipline and the cultivation of better behaviors. Lastly, everyone must be cognizant as to whether he or she is only being self-serving in communication. That is, she should take care that she is not communicating only for self-preservation. In order to avoid these kinds of communication break downs, according to Kant, prudence, morality, and guidance is needed (Frankena, p. 133). If communication is the life blood of teamwork, then it should be honest communication and, if certainty of this honesty is desired, then follow the preceding three points with a fourth one. Leaders should seek honest feedback about their communication and honesty. Honesty in communication will serve them well too.

In sum, leaders should practice intentional communication which takes three things into account. First, leaders should ask, “Is my communication filled with incomplete knowledge or is it forced?” Next, “Am I attempting to harm my fellow workers, employees, or costumers?” Finally, “Is my communication aimed at a particular agreed upon team end or objective?” Or, more simply, “Is my communication self-serving?” By calibrating one’s own behavior, a leader can better equip her team with autonomy and truly serve as a guide and mentor to others.

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New Venture Legitimacy Lies and Ethics: An Application of Social Contract Theory

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ABSTRACT

Entrepreneurs of new ventures face unique concerns with regard to ethics, yet remarkably little research addresses these concerns. As such, the purpose of this work is to apply social contract theory to the new venture context. The foundation of this work is that, because of a liability of newness, new venture entrepreneurs face unique ethical considerations in their quest for legitimacy; and these considerations can be captured by the notion of “legitimacy lies”. Our assertion is that commonly applied ethical paradigms, such as Kantianism or utilitarianism, do a less than ideal job of addressing the nuanced ethical nature of new venture legitimacy lies. We argue that social contract theory, specifically that version developed by Donaldson and Dunfee for application to the area of business ethics, is a paradigm that can more fully consider the ethical contours of the subject and more importantly, offer guidance to entrepreneurs attempting to navigate this precarious stage of existence.

KEY WORDS: new venture entrepreneurs, legitimacy, ethics, social contract theory
INTRODUCTION

There has been a bevy of theory development (Anderson & Smith, 2007; Dunham, 2010; Harmeling, Sarasvathy, & Freeman, 2009) and empirical research (Morris, Schindutte, Walton, & Allen, 2002; Clarke & Holt, 2010) directed at understanding the ethical and moral issues affecting entrepreneurs. Much of this work holds that these individuals are morally aware and often act in more ethical ways than non-entrepreneurs (e.g. Teal & Carroll, 1999), while other research takes a more macro view and addresses firm level ethics (Longnecker, McKinney, & Moore, 1998) or the ethical/moral impact of entrepreneurship on society (Brenkert, 2002). This work is certainly enlightening and constitutes an important body of research. We argue here, though, that the vast majority of it leaves out a critical subpopulation—the new venture entrepreneur. This subpopulation is unique because entrepreneurs at this stage of existence face dramatically different conditions than entrepreneurs at any other stage of existence, and these conditions present special challenges with regard to ethicality. For example, because of liabilities of newness and smallness, startup entrepreneurs often are tempted to misrepresent or omit important information in their efforts to gain initial legitimacy for their firm (Neubaum, Mitchell, & Schminke, 2004; Useem, 1999). These issues are simply not well understood (McVea, 2009).

As a result, findings of business ethics studies—even small business ethics studies—may not be applicable or helpful to entrepreneurs in new ventures or to those who study them. We submit here that this is a substantial gap in the literature. The main purpose of this paper is to partially address this gap by applying social contract theory to explore the ethical dimensions of one important aspect of the business life of new venture entrepreneurs, namely the use of legitimacy lies. Legitimacy lies (Rutherford, Buller, & Stebbins, 2009) are intentional misrepresentations told by entrepreneurs with the goal of being granted initial legitimacy by stakeholders. We choose to focus on the matter of legitimacy lies because we believe that it fairly represents the plight of startup entrepreneurs in pursuing performance and survival in an ethical manner. From a temporal standpoint, the point could be made that startup is the most critical stage of existence for the simple reason that if firms do not survive this stage, addressing other stages becomes moot. As a result, this work will focus squarely on the new venture entrepreneur and that entrepreneur’s special challenges with regard to ethicality in pursuit of profitable survival. In particular we focus on one such challenge, the struggle for legitimacy, and one specific response to that challenge, the issuance of legitimacy lies. Notably we will discuss both the new venture and the entrepreneur. In so doing we recognize that we change levels of analysis, but we also recognize that these entities are inextricably intertwined and a discussion of one without the other would be incomplete. Our argument will be that the social contract approach to ethics, exemplified in the applied field of business ethics by the work of Donaldson and Dunfee, provides an especially applicable perspective from which to discuss the ethicality of legitimacy lies as a general phenomenon and from which to generate a decision-making “checklist” for new venture entrepreneurs to use in deciding whether particular instances of legitimacy lies are ethical.

The Quest for Initial Legitimacy

There is an important element regarding growth and survival in the new firm that is seldom made explicit. For many new ventures, legitimacy—not resource attainment (i.e.
revenue, financing)—is the key outcome (Delmar & Shane, 2004). This is the case because, at this stage, the latent notion of legitimacy is a precursor to tangible resources. As a result, an entrepreneur should focus effort on establishing a legitimacy base, as opposed to single-mindedly pursuing more tangible resources.

Scholarly study on new venture legitimacy has become increasingly popular (Zimmerman & Zeitz, 2002; Choi & Shepherd, 2005; Tornikoski & Newbert, 2007), and the area has become a collection of writing and research that deals with a fundamental and overarching problem that afflicts most entrepreneurs—attaining an initial base of legitimacy. Broadly defined, legitimacy is “...a social judgment of acceptance, appropriateness, and desirability, [that] enables organizations to access other resources needed to survive and grow” (Zimmerman & Zeitz, 2002). It is this “social judgment” aspect of firm legitimacy which we believe makes a social contract approach to the matter of legitimacy lies especially relevant. As explained below, social contract theory captures the “audience” in the entrepreneurial performance and incorporates their perspective into ethical considerations of the acceptability of new venture legitimacy lies. While the above definition clearly takes the new firm into account, much of the work on legitimacy has been done in the institutional theory realm and has therefore taken place in the mature firm context (e.g., Deephouse, 1999; Suchman, 1995), and the origins of legitimacy in institutional theory can be traced back to Weber (Weber, 1947). In this context, legitimacy is discussed as an outcome of cultural support that can protect a firm from the external environment (Meyer & Rowan, 1977). As a result, in much of this writing legitimacy is viewed as a way to overcome crises and negative press that may impact the organization (Child, 1972; Pfeffer & Salancik, 1978), rather than as an ongoing process of gaining social standing and acceptance. Like most constructs, though, legitimacy in the context of the new firm has a different connotation than it does in the established organization (Rutherford, et al, 2009; Choi & Shepherd, 2005; Williamson, 2000) because of the importance of legitimacy in obtaining initial resources. If seen only as isolated reactions to events which threaten the firm’s continued existence, though, legitimacy lies are apt to be treated only as acts that new ventures engage in when faced with somewhat exceptional circumstances. Ethical evaluation of such lies, then, would itself be based on the “exceptional” nature of the circumstances under which they occur, a consideration which often leads to ethical judgments which are restricted to only those exceptional cases. If, on the other hand, legitimacy is seen as not just a concern when the firm is “threatened,” as it were, but as a part of the daily lives of new ventures until they exceed the legitimacy threshold, then the occurrence of legitimacy lies should be treated as a persistent temptation for, and even tendency of, new ventures. Viewed this way, ethical assessment of legitimacy lies becomes more a matter of judging the general practice of legitimacy lies as it functions as part of the overall life of a new venture. This is likely a truer view of the issue because unlike older and larger firms, most new firms possess little or no legitimacy. For an established organization, increasing incremental levels of legitimacy is far less difficult than attaining the initial base at the beginning of an organization’s life cycle (Rutherford & Buller, 2007).

A key tenet of legitimacy is that it is, by definition, a stakeholder driven process. Thus, a new venture cannot manufacture legitimacy. The new venture must instead be granted legitimacy by influential stakeholders (e.g., financiers, employees, suppliers, consumers, local communities). This is particularly challenging for the new venture entrepreneur.
exactly because these stakeholders will not grant legitimacy until a base is achieved (or at least perceived), and without that legitimacy being granted no base can be formed—a catch 22. This quandary has also been termed the “credibility merry-go-round” (Birley & Norburn, 1985). Regardless of terminology, this problem is among the most difficult aspects of establishing a new business (Rutherford, et al. 2009).

Legitimacy Lies

While there are ethical boundaries, legitimacy lies can serve as an effective, and sometimes necessary, device for building this initial base of social acceptance. For this work, we adopt the Rutherford, et al (2009) definition of the legitimacy lie: “An entrepreneur’s intentional misrepresentation of the facts in an effort to encourage various stakeholders to deem them a legitimate entity” (p. 950). There are two basic premises underlying the legitimacy lie: 1) new venture entrepreneurs (as a group) are uniquely encouraged to lie, and 2) they are more likely to gain from that lie. The first issue is most clearly explained by examining the entrepreneur-funder dyad. A new venture entrepreneur seeking funding will face many unique hurdles stemming from the fact that, because of the firm’s newness, financiers are unable to adequately discern the quality of that firm. This inability to properly observe the activities of the entrepreneur and his constituents, adds risk to a funder’s investment. This describes an agency problem termed moral hazard—the concern that an agent (entrepreneur) may not act in the best interest of the principal (funder) after the relationship is created, but will instead act in his own best interest. In attempts to counteract moral hazard possibilities, the funder will engage in extensive contracting and monitoring; but will also add “points” to debt or equity investments in the new, opaque venture—effectively increasing the new firm’s cost of capital. Since the entrepreneur is being “punished” for lying de novo, there may be a temptation to actually engage in the act.

To the second point, startup entrepreneurs may be less concerned about long term trust consequences that often accompany lies. While both mature and new firms will likely face repercussions stemming from lies long term, startup entrepreneurs understand that, without lying, the firm may not survive long term. This is less likely the case in the mature firm, as they have, by definition, established some degree of legitimacy and face much lower hazard rates on average (Singh, et al, 1986). So if the lie results in the achievement of a legitimacy base, this is no small accomplishment in the entrepreneur’s quest for survival. It should also be noted that most, if not all, stakeholder groups desire for new ventures to reach the legitimacy threshold and grow because they stand to benefit economically and in other ways from a growing body of mature firms. If the legitimacy threshold represent a point in the life of a new venture past which the chances of it maturing into a stable business operation increase noticeably, then it is reasonable to believe that stakeholder groups will in general benefit from new ventures clearing that hurdle (e.g. more stable employment, more reliable tax bases for local communities, increased consumer confidence, etc.). As we will show, this important fact about the relationship between stakeholder groups and new ventures figures prominently in a social contract approach whereas it is less likely to play the role that it should in ethical assessments of legitimacy lies through deontological or utilitarian perspectives.

The majority of ethically questionable behaviors in the new venture context fall under the rubric of isomorphism. Isomorphism explains the legitimating practice of conforming
to accepted practices, structures, and paradigms. In this way an organization has a greater chance of appearing legitimate to stakeholders and ultimately increases its chances of survival (Bruton, Ahlstrom, & Li, 2010). Firms at all stages engage in the practice (often subconsciously), but it is especially relevant to new firms, “...where constituents are unfamiliar with the organization or its performance, or expectations are not clear or easily assessed” (Ashforth & Gibbs, 1990, p. 178). Clearly it is advisable that the new firm engage in isomorphism. Interestingly, though, a new organization likely lacks the means to engage in true isomorphism (DiMaggio and Powell, 1983), and must engage in symbolic isomorphism (Ashforth & Gibbs, 1990). Meyer and Rowan (1977, 1978) refer to this as “ceremonial conformity”, whereby the organization engages in minimal but highly visible conforming acts, while leaving the core of business unchanged. Entrepreneurs must symbolize legitimacy because they do not possess it; however, through symbolizing they can affect stakeholder perceptions such that they are endorsed and trusted— also known as “fake it ‘till you make it”. “...symbols can become substance if myth-makers and constituents alike believe the message and respond accordingly” (Ashforth & Gibbs, 1990). It is precisely this symbolism that leads to our ethical slippery slope, because while isomorphism is valuable and legitimates (Deephouse, 1996), it is technically impossible for resource constrained startups to mimic older and larger firms without some form of misrepresentation.

This leads us back to a discussion of the legitimacy threshold. The legitimacy threshold describes the condition, alluded to above, that accumulating a base level of legitimacy is more difficult than incrementally increasing legitimacy. Moreover, it is far more likely that symbolic mechanisms will be needed to gain the base. Once some level of legitimacy has been achieved through symbolic means—allowing the firm to achieve some resources, and age and size—the firm may then switch to more substantive management of legitimacy (Ashforth & Gibbs, 1990). It is when this base is formed that most new firms will encounter a threshold of legitimacy.

**Legitimacy Lies through the Lens of Social Contract Theory**

Scholars who study entrepreneurial ethics are still searching for a dominant theory base on which to base predictions and prescriptions. A scan of the literature will reveal several bases originating from philosophy (e.g. utilitarianism; Mill, 2001 ), economics (e.g. Knightian uncertainty; Knight, 1921), and the organization sciences (e.g. stakeholder theory; Freeman, 1984). This assortment of theoretical bases reflects a field in development and is likely appropriate. As such, it is not the goal of this work to comment on the merits of each. Instead, we would like to introduce social contract theory as an underpinning for illuminating the ethical plight of the startup entrepreneur, especially as it involves the issuance of legitimacy lies.

In previous work, Rutherford, et al, 2009 explored the ethical issues of the legitimacy lie by applying general frameworks of deontology and utilitarianism. Though helpful in working through the ethical implications and acceptability of legitimacy lies, these two traditional approaches have theoretical and practical limitations which, we argue, make them less suitable and less pragmatically informative in addressing the matter of legitimacy lies than the social contract approach. To no surprise, they concluded that legitimacy lies, no matter how small they may appear to be, are generally not permissible from a strictly deontological point of view. At issue for the deontological assessment of legitimacy lies is the fact that they are lies; the fact that they are legitimacy lies matters not at all. This
“bracketing out” of the context in which startup entrepreneurs are inclined to engage in legitimacy lies is a drawback to the deontological approach, as it is for the deontological approach to lying in general (recall the Kantian dilemma in resolving the case of lying to a would-be murderer). This is especially troublesome if it is the case that in many, if not most, scenarios involving new ventures and legitimacy lies, the participants involved operate with a tacit understanding of the role of such lies and a tacit acceptance of their presence which lessens the deceptive character of the “lies” in questions. The deontological approach highlights the value consideration which is at the heart of the default position that lying is inherently wrong (i.e. that lying fails to respect the autonomy of others), something which, as we will see, is also of importance for the social contract approach. However, the absolute nature of its prohibition on lying in practice fails to cohere with our moral intuition that there are times where lying may not only be permissible but may also be required (see the aforementioned case of lying to a would-be murderer). Further, it was argued, while legitimacy lies might be acceptable from a utilitarian point of view, the long-term consequences of legitimacy lies on the character of the entrepreneur and on trust in the relationships with stakeholders, make such lies problematic. As with utilitarian evaluations in general, utilitarian evaluations of legitimacy lies suffer from their appearance as post hoc rationalizations. When employed as a decision-making methodology by startup entrepreneurs, utilitarianism requires them to make predictions about the potential effects of particular lies on the overall happiness of all stakeholders potentially affected, calculations which are notoriously difficult to make. Further, simple utilitarian judgments about legitimacy lies, especially predictive ones, tend to overlook or at least de-emphasize the inherent value of autonomy preservation by casting it as just one of a range of effects that may positively or negatively affect individual and collective happiness.

Our dissatisfaction with deontology and utilitarian theories to address the question of legitimacy lies leads us to consider social contract theory as an alternative. As explained below, we believe that social contract theory provides a more case sensitive and useful way of approaching the topic of legitimacy lies. Social contract theory provides a pragmatic, process-oriented approach to exploring the ethical boundaries of the legitimacy lie while avoiding the pure case-relative position that utilitarianism quite often finds itself in. As argued by Buchholz and Rosenthal (2005), such an approach is more in the “spirit of entrepreneurship” than other, principle-based, traditional approaches like Kantianism and utilitarianism. We believe that the social contract lens leads to an ethical approach that entrepreneurs can in fact use.

So, in what way is a social contract approach to the issue of legitimacy lies a more “natural” fit than utilitarian, deontological, or virtue-based approaches? At its heart, the social contract approach to ethics and philosophy, in general, is an attempt to develop an account of the source of ethical and political norms without grounding such an account in a priori normative commitments, or at least keeping to an absolute minimum the range of assumptions that must be treated as given in order to generate a practical moral philosophy. As noted above, traditional moral philosophies like classical utilitarianism and Kantian deontology require that adherents accept the truth of certain normative claims as givens. For utilitarians, it is the claim that pleasure or happiness is the only thing intrinsically desired by persons. For Kantians, it is the claim that ethical norms must be the product of rational consistency applied to possible intentions for actions. The many varieties of virtue-based approaches require that there be a preferred mode of existence for humans toward
which the possession of a virtuous character tends us. For each of these philosophical approaches, one can always question the assumptive claims made and in doing so also call into question the stand alone veracity of the moral philosophy which follows. If Utilitarians and Kantians are mistaken in their foundational claims about human nature, then we have much less reason to accept as adequate their moral philosophies. On the other hand, the social contract approach, at least as it has developed since Rawls’ resuscitation of the tradition in the 1960’s and 1970’s, requires a bare minimum of assumptions about human nature as a foundation for developing a moral and political philosophy. For Rawls, we need only assume that the hypothetical contractors are rationally self-interested, and conceive of society and its many particular institutions and practices as obligated to treat them as free and equal citizens. Richer accounts of human nature and the source of ethical norms are not required, since the consent of hypothetical contractors so conceived is all that is needed to account for the source of binding principles of morality and justice. Occam’s razor, then, would seem to recommend a social contract approach.

Even more importantly, the social contract approach is “built” to purportedly address the very kind of question that is raised by the concern with legitimacy lies. In a strong sense, entrepreneurial efforts to pass the legitimacy threshold are efforts to build a certain kind of relationship between new ventures and various stakeholder groups, some such relationships more critical than others. New firms are seeking acceptance. At the same time, stakeholder groups want to accept new ventures. They want such ventures to be successful. In general, all are better off with successful new ventures than with high rates of failure. Given that attaining social acceptance is at the heart of the struggle for legitimacy and the failure to gain legitimacy can mean the demise of the venture, there is a mutual need for the social acceptance of new ventures to happen. In seeking that acceptance, the question is how far entrepreneurs may go in terms of self-representation before an ethical boundary is crossed? Put in language common to social contract thinking, entrepreneurs are in search of ongoing consent on the part of stakeholder groups to engage in a mutually beneficial, collective, cooperative practice. The social contract approach is intended to answer, in a formal way, that very question. For classical contractarians like Hobbes, Locke, and Rousseau, the question was why individuals would move from a pre-social independent existence, what they labeled the “state of nature,” into constrained social living. Their particular analyses of the reasons for agreeing to abide by a social contract also served to provide broad content to the contract (e.g. for Hobbes the reason to consent is to obtain a degree of personal security so the social contract itself will contain restrictions of personal liberty sufficient to create the desired level of individual security). For Rawls, the social contract thought experiment, though never actually instantiated as an historical document, allows us to conceive of those basic rules of justice which ought to govern our future, real socio-political arrangements, if we were in a position to actually consent or not consent to them. More recently, Donaldson and Dunfee (1999) have developed an application of social contract thinking, what they call Integrative Social Contracts Theory (ISCT), to the problem of fixing the content of an economic ethic which is to provide reasonably specific norms for the moral governance of actual business enterprises and practices. In all its manifestations, the social contract framework is intended to provide the means by which to determine the unanimously consented to boundaries for social, political, or economic
activities while allowing for the freedom of individuals and groups to craft particular norms for specific activities that they may freely choose to enter into, what Donaldson and Dunfee dubbed “moral free space” (Donaldson & Dunfee, 1999).

Deciding which ethical framework provides the most insight and most philosophically satisfying answer to the legitimacy lies question as well as providing the most help in guiding the actual decision-making and behavior of novice entrepreneurs requires that attention be paid to the context in which the problem arises and to the desired outcome of putting in place ethical rules to direct entrepreneurs in their efforts at clearing the legitimacy threshold. As Buchholz and Rosenthal (2005) have argued, a pragmatic, process-oriented approach to ethical decision-making not only best represents the manner in which we actually proceed, but also best fits what they have termed the “spirit of entrepreneurship.” That spirit is characterized by the possession of personal qualities like imagination, novelty, creativity, and sensitivity (Buchholz & Rosenthal, p. 307). Because entrepreneurs operate in an environment of newness, change, and risk, they are less able to rely on established ethical traditions and patterns of behavior. Instead, as they seek out new solutions to problems or new business opportunities, they must also be innovative in their ethical thinking which requires that they adopt an “experimental method” which begins by focusing on the “concrete situational interactions” which constitute the decision settings they find themselves in and moves through progressive attempts to develop and “test” meaningful solutions to the ethical problems encountered. Absolute, stand-alone ethical principles may help in this process by “shedding light on moral situations and providing additional guidelines for evaluating the moral aspects of different courses of action,” (Buchholz & Rosenthal, p. 310) but they are neither the proper starting point for ethical decision-making nor sufficient to produce a contextually sensitive solution. What startup entrepreneurs require is adequate “moral free space” in which to experimentally determine, in “consultation” with stakeholder groups, which responses to novel, concrete, legitimacy hurdles are to be judged acceptable or not.

If the issue of legitimacy lies is treated from this pragmatic perspective, then there are good reasons to believe that a social contract approach would provide more help to novice entrepreneurs than either the utilitarian or Kantian approach, especially due to the pragmatic requirement that ethical decision-making begin with an assessment and understanding of those “concrete situational interactions” which fill out the various environments novice entrepreneurs find themselves in. As has been argued (Rutherford, et al, 2009), though entrepreneurial lying may be justified by an appeal to the principle of utility in the short term (e.g. the lie allows the firm to receive financing which itself helps the firm to survive and provide employment), there is the risk that such lies will damage the reputation of the firm involved which itself can result in damage to its standing with stakeholders critical to its long-term survival. Further, the entrepreneur’s own character may suffer as the willingness to lie or misrepresent snowballs into a pattern of behavior rather than an isolated incident, especially if initial legitimacy lies prove successful. The risk here is that a utilitarian analysis and subsequent judgment would function mostly as a rationalization for a decision that novice entrepreneurs would seek to make for egoistic business reasons. If a “just so story” can be developed which indicates that the potential for serving the greater overall good is high, then novice entrepreneurs may treat that as sufficient justification to proceed with deceptive misrepresentations that would otherwise not pass ethical muster. Though, as Buchholz and Rosenthal (2005) recommend, context
matters tremendously in deciding how to proceed ethically, context alone cannot fully
determine our moral judgments inasmuch as the particular datum of a situation does not
determine which facts are morally relevant. Some moral “theory” must be involved. A
Kantian approach, given how much it has to say about the morality of lying, would seem
to fit the bill for organizing the facts surrounding instances of potential legitimacy lies so
as to allow for a context sensitive analysis. However, its absolute prohibition on lying
based on the inherent rational inconsistency of the intention behind lying makes context
considerations irrelevant. If a sound analysis of the morality of legitimacy lies should take
into account the particular business environment in which the temptation to engage in
them arises, then an orthodox Kantian approach will be of little pragmatic help. On the
other hand, if we grant that the “world” within which we are to consider the rationality of
lying is already a world in which there are no expectations on the part of stakeholders that
pre-legitimate entrepreneurial ventures will in practice always tell the truth, then the
Kantian approach to lying will still be of very little pragmatic help. In contexts where
there is no presumption of truth-telling, e.g. poker, there can be no intentional lying since,
in principle, no one can be deceived. Consequently, attempts at legitimacy lies will not by
definition be lies and so will not be of moral concern. As argued in our previous
discussion of the legitimacy threshold, the absence of a universal expectation of truth-
telling is one of the conditions that describe the world of the pre-legitimate firm, at least
as regards its relationship with potential financiers. So, though both can provide reasoned
treatments of the morality of legitimacy lies, neither utilitarianism nor Kantian
deontology adequately meet the demands of a pragmatically-driven ethical analysis. We
now turn to show why a social contract approach like that present in Donaldson and
Dunfee’s (1999) ISCT is better suited to such an analysis.

**Integrative Social Contract Theory (ISCT)**

While a full description of ISCT is beyond the scope of this paper, we will provide a
general account of its form and purpose with attention paid to those elements of ISCT
which make it uniquely suited to a pragmatically-driven, ethical analysis of legitimacy lies.
ISCT is intended to provide the framework in which to integrate two ways of thinking
about contracts which are often held to be distinct:

1. Hypothetical or “macro” contracts that reflect hypothetical agreement among
   idealized, rational members of society
2. Extant or “micro” contracts that reflect some actual agreements among real
   (non-idealized) members of a community

It does so by making use of the former to set the general ethical boundaries for the
latter. In either case, whether we are talking about macro or micro contracts, hypothetical
or real, one element remains the same: the legitimacy of the contracts in question is
grounded in the rational, informed, voluntary consent of all parties to the contract. In the
case of extant contracts, individuals are making a decision about the impact being party to
some specific contract will have on their own individual happiness, especially their future
happiness, as well as its impact on their ethical integrity and life. This judgment is based
on the knowledge they do have about their current station in life, including those ethical
commitments they hold, and on predictions they make about how participation in
various contracts will impact their experience of happiness in the future. In the case of the macro social contract, the decision to opt in or opt out is based on a formally identical decision-making procedure, only in this case the predictions are based on an abstracted view of the human condition not on any of the particulars of one's own, “real life” condition. Following in the Rawlsian tradition, the question to ask regarding the macro contract is not, “Will I be better off by entering into this contract?” but rather “Would any rationally self-interested person be better off by entering into this contract?”

Donaldson and Dunfee (1999) set the following four conditions for the hypothetical, macro-contractors:

1. Though basically self-interested, there is a pluralism of motivational interests which the contractors bring with them (somewhere between egoism and pure altruism).
2. The contractors are rational, they are not afflicted by inconsistency or logical confusion, and they are knowledgeable of the range of facts accepted as true.
3. Contra Rawls, the contractors are not ignorant of all personal facts about themselves. They are aware of their economic and political preferences. They are, however, ignorant of the economic communities of which they are members and of their actual economic standing relative to others.
4. The contractors bring with them a set of “hypernorms” which form the ethical baseline for their deliberations and choices regarding the economic ethic they will eventually consent to (Donaldson & Dunfee, 1999, pp. 26-27).

Additionally, the contractors are subject to the deliberative constraints imposed by the condition of bounded moral rationality they operate under. There are two parts to this bounded moral rationality. First, the original contractors face the full range of practical limitations of instrumental rationality which plague all of us as we struggle to make decisions intended to optimize our future happiness. As Donaldson and Dunfee note, “Human beings have finite intellectual resources and will inevitably be forced to ‘satisfice’ in both economic and moral decision making.” (Donaldson & Dunfee, 1999, p. 30) It is important to note that these limitations of instrumental rationality are inherent to human psychology, not avoidable by simply adding more information to the calculations. Second, they recognize the limited ability of ethical theory to capture commonsense moral convictions and preferences which will likely inform the hypernorms they bring to the table. Despite the difficulties this bounded rationality poses for choices about economic ethics, the original contractors are still able to, or we can imagine them as able to, at least seek to “satisfice” their future happiness through the construction of an economic ethic which affords them ample liberties and opportunities to satisfy the economic preferences which form the core of their individual conceptions of happiness while at the same time protecting those ethical hypernorms which they hold as equally basic.

The logical priority goes to the formation of the macro social contract. Once its basic parameters are set, one has in place a set of ethical constraints for the subsequent formation of the many particular political, social, and economic contracts which will fill out the day-
to-day lives of the individual parties to the macro contract. The macro-contract functions as an overarching economic ethic which constrains the “moral free space” in which actual micro contracts are to be forged. No actual micro contracts, implied or explicit, will be morally legitimate if they violate the basic “hypernorms” which set the ethical foundation for the macro contract, the economic ethic which the hypothetical contractors are consenting to abide by. The role of ethical hypernorms in ISCT has been a matter of critical debate over the past decade. In a 2006 review of the recurring concerns hypernorms, Dunfee has this to say about those concerns.

Hypernorms have been a lightning rod for criticism of ISCT. The recurring themes concern whether hypernorms (1) can be identified for actual decision-making; (2) are sufficiently justified in the ISCT macrosocial contract; (3) should be redefined in some significant way; and (4) are even necessary to the overall framework of ISCT. Implicit in some of these critiques is a fifth issue: whether hypernorms change or evolve over time and whether in a given context conflicting hypernorms might be identified, necessitating priority rules for hypernorms (Dunfee, 2006, p. 305).

Setting aside these larger issues for the present work and accepting as is the role that Donaldson and Dunfee assign to hypernorms in their social contract theory of business ethics, we can see how this approach has distinct advantages when applied to the issue of new venture legitimacy lies. Whatever micro-contracts members of society might seek to form, and these micro-contracts could range in scope and size from unique one-to-one contracts to consensus-based agreements on broad socio-economic practices such as corporate governance (Stout, 2002) or the social function of professions (Donaldson, 2000), they must be both “legitimate” and “authentic.” They are legitimate if they do not stand in violation of relevant hypernorms, and they are authentic if they represent a consensus on the part of the parties involved. In this way, the social contract approach avoids the problem of relative situationality that would result from basing ethical legitimacy simply on the fact that the parties involved did actually agree to participate. It possesses the means by which to judge some voluntary agreements as ethically illegitimate. At the same time, it avoids across the board absolutism by allowing for contextually unique and variable agreements generated by a consensus of those involved to be ethically acceptable. Given the uniqueness of the issues facing new venture entrepreneurs, this flexible yet bounded approach to thinking about the contours of a possible micro-contract regarding the telling of legitimacy lies seems to offer the most promise. It brings into play theory in the form of hypernorms while allowing that the concrete moral commitments of individuals and groups will be worked out in context.

ISCT and Legitimacy Lies

For the current concern, the first question to ask is whether there are any presumptive hypernorms relevant to the moral issues raised by the practice of legitimacy lies. As Donaldson and Dunfee describe (Donaldson and Dunfee, 1999, chapter 3), there are philosophical reasons for believing that there would be a “no lying” hypernorm. Both Kantian moral philosophy and the work of Ross provide a basis for positing the existence of a hypernorm which requires truth-telling. There is, however, a critical difference between the two. As noted earlier, the Kantian prohibition on lying is grounded in the rational inconsistency of the very act of lying. Employing Kant’s categorical imperative as the test, the intention of lying cannot be universalized because the moment one “wills” it to
be so one cannot actually act on that intention due to the fact that the precondition for lying, namely that others will believe what one says, is removed. This yields an absolute prohibition against lying. On the other hand, Ross, in an attempt to overcome the oversimplification of our moral life which he found in both Kantianism and utilitarianism, treated duties such as the duty to tell the truth as prima facie duties, duties which we are indeed obligated to perform because they identify a feature of our moral life which common sense calls each of us to pursue, but which are not absolutely binding. In any given situation, there may be a range of duties present from which we must form our intention to act. Here too, Ross believed that our common sense understanding of morality can lead us to determine which duty, in the current situation, we should follow. As a philosophical basis for a presumptive hypernorm regarding fidelity, then, the Rossian version would be more like a default norm of truth-telling. Additionally, Donaldson and Dunfee propose that some version of the Golden Rule would appear as a presumptive hypernorm, drawing upon philosophical and religious foundations. Given that we generally desire to be told the truth, for a number of reasons, this presumptive hypernorm would come into play when thinking about legitimacy lies. Finally, citing Rawls, Donaldson and Dunfee propose a presumptive hypernorm which requires that institutions and practices operate in such a way as to maximize the extent of liberty that individuals have comparable with a similar degree of liberty for all. Lying of any form bears the potential to impinge upon the liberty of others, so this hypernorm is relevant to considering the moral legitimacy of the practice of legitimacy lies. The key question here is what justifications for an exemption from this general duty to not lie would it be rational for hypothetical contractors to consent to while maintaining the principled commitment they have regarding the morality of lying? In other words, how much moral free space would, for example, we give to startup entrepreneurs to lie in order to secure some benefit (i.e. a base of legitimacy)?

In our previous paper (Rutherford, et al, 2009) we highlighted three concrete features of the environment in which new firms operate relative to financiers and customers. The first, adverse selection, describes markets where judgments about the quality of products offered cannot be accurately made by buyers (p. 952). In such markets, financiers are hesitant to provide capital to high quality, but new firms due to the lack of proven desirability among buyers. The second, moral hazard, describes the realization on the part of financiers that novice entrepreneurs can engage in immoral activity without the financier knowing, thereby presenting yet another hurdle to legitimacy. (p. 953). The third, opaqueness, captures the fact that external stakeholders are unlikely to have access to that information about a new firm and its product which would be sufficient to ground an acceptance of the firm as legitimate. (p. 953). All three conditions are related, and collectively they paint a picture of “concrete situations” in which information asymmetry and weak control of risk dominate. The result is an environment in which trust is lacking, yet within which trust is sought via legitimacy. It is in such an environment that legitimacy lies emerge as a well-documented practice. Is such a practice an authentic norm as Donaldson and Dunfee define it? To be authentic, the practice must have the support of a clear majority of the members of that community generating the practice. Caution must be exercised regarding the term “support.” Weakly, “support” could simply mean that a majority of individuals or institutions participating in a practice accept the existence of some norm of behavior for that practice and engage in it themselves, but without believing that said norm have such a presence in the first place. Some portion of that majority could behave in ways consistent
with the norm in question because to fail to do so puts them at a competitive disadvantage and because they are powerless to change the “governing” status of the norm. The existence of this type of “support” would be insufficient to establish it as an authentic norm. What is needed is evidence that a majority of a community endorse the presence of the norm, for economic reasons or otherwise. Can it be said that legitimacy lies are authentic in this way? We cannot offer a definitive answer to that question in this work, though the literature cited earlier in the paper as part of the characterization of the environment in which new venture entrepreneurs operate provide substantial reason to think that there is at least a rudimentary authentic norm regarding legitimacy lies.

If we allow that an authentic norm exists in the new venture entrepreneurial community, which includes all non-entrepreneurial stakeholders involved with them, recognizing certain types of legitimacy lies, we can then ask whether such a norm passes the test of ethical legitimacy. Do the hypernorms referred to previously allow for sufficient moral free space to accommodate the practice of certain types of legitimacy lies? As mentioned earlier, it is quite likely that a “no lie” rule would be the default position of hypothetical contractors, but not an absolute prohibition. A commitment to the value of truth-telling and personal autonomy ground this hypernorm. Additionally, a concern for the protection of individual liberty expressed in one or more hypernorms would likely proscribe a range of behavior involving lying and misrepresentation even though the hypernorms themselves may not directly address lying. How would the range of authentic legitimacy lies that new venture entrepreneurs engage in, or are inclined to engage in, fare when judged against these hypernorms? In keeping with the pragmatism advocated by Buchholz and Rosenthal described earlier (Buchholz and Rosenthal, 2005), that question is answered by considering concrete situations. Consider this example of a common type of legitimacy lie included in our previous paper:

When a leasing agent told an entrepreneur that to be considered for a space in the mall the company needed to be “established.” The entrepreneur took that to mean that he needed to have been in business for at least two years. “So we manipulated our financials and we lied our way through that and said yes we have, even though we had actually been in business for six months. (Seglin, 1998).

Here we have intentional misrepresentation of facts for firm-specific business reasons. Though “established” is a vague requirement, given her own interpretation of the requirement the entrepreneur deliberately presents false information to the leasing agent for personal gain. This rather straightforwardly violates even a prima facie duty of truth-telling since there is no other similarly pressing duty in play. Given the specificity of the lie (i.e. claiming to have been in business for two years), there is no way to treat the information forwarded by the entrepreneur as just an interpretation of the requirement, which might have been the case if the entrepreneur had simply claimed that her business was “established” in some way other than the time it has been in existence. The liberty of the leasing agent is quite directly impacted by the lie in that acting on the misinformation may lead the agent to make an ill-informed decision regarding the best choice for renting the space.

The implication in this first example is that the leasing agent is not aware of the misrepresentation and, therefore, cannot act so as to mitigate the negative impact of the lie.
on his liberty. This latter consideration is important as can be seen by examining another common example of a new venture legitimacy lie.

Thousands of entrepreneurs knowingly inflate their forecasts expecting that investors will "haircut" these forecasts by at least half, certain that they will be penalized if they don't "play the game." As one pioneering and successful (another NASDAQ IPO) entrepreneur told me, whose actual sales were off his initial forecast by a factor of about 50, "We had no idea: this was an entirely new market, so we just put down numbers that the investors wanted to see." (Isenberg, 2010)

In this case, we have not only the expectation that entrepreneurs will overstate financial forecasts, but also a practice on the part of investors to mitigate the potential harm that misrepresentation could cause them. In effect, they accept the misrepresentation and willingly adjust their response accordingly. Further, in this case the information being misrepresented is information for which there is no accurate measure. All parties involved know that they are dealing with guesses or approximations. In this type of case, though the financial numbers presented by the entrepreneur are "made up," it can be reasonably argued that they do not constitute a lie. Given the conditions which describe the operating environment of the new venture entrepreneur presented previously, especially the fact that investors cannot make qualitative judgments about new ventures with the confidence they can of mature firms, it can be anticipated by investors that such entrepreneurs will experience "entrepreneurial euphoria" (Dees & Starr, 1992) and be optimistic and even overconfident about future earnings. At the same time, entrepreneurs can anticipate that investors will protect themselves against the potential ill effects of taking financial forecasts at face value. Because of this, and unlike the first example, it can be argued that investor liberty is not impinged upon in a morally alarming way.

Financial "puffery" is not the only kind of self misrepresentation that new venture entrepreneurs might be inclined to engage in. For example:

One way to . . . coax that early customer, supplier, or investor into taking a flier--is simply to create the impression that you're bigger and more established than you are. This might involve playing office background noise in your home office when someone calls or adding "Suite 3B" to your address at Mailboxes Etc.--tricks that don't really rise to the level of outright mendacity. They're a bit like "framing" in baseball, whereby the catcher subtly pulls the ball into the strike zone with his mitt; not cheating, just exploiting the umpire's visual biases. (Useem, 1999)

Apart from the puffery involved, the "early customer, supplier, or investor" would have other reasons for being interested in doing business with the new venture (e.g. the promise of a net beneficial purchase, an increase in revenue, or a solid return on investment). A modicum of due diligence on the part of these potential stakeholders would minimize the influence of the puffery involved on their final decision to do business with the new venture. Here, as with the previous case, the parties involved are easily able to mitigate the possible harms to their own interests that a fuller reliance on the information conveyed via the acts of puffery would result in. Unlike cases of outright lying, where one cannot in principle consent to its
occurrence, puffery can still occur in a setting where all involved acknowledge its presence though its effectiveness is noticeably diminished. So, in cases like these two, the concerns for truth-telling, respect for autonomy, and the protection of liberty, which serve as the ground for a general, though not absolute, hypernorm regarding lying would not seem to be directly threatened.

One final example to consider.

Had Kathy Taggares told the truth, the whole truth, and nothing but the truth, she probably wouldn’t have a $32 million business today. Twelve years ago Taggares was itching to ditch her employer, frozen-food maker Chef Ready Foods, to start her own business. So she covertly approached Marriott International about buying one of its salad dressing factories. To her utter surprise, her overtures got a warm reception. “As a young single woman, I’d had so many doors slammed in my face,” she remembers, “and here’s Marriott, and they’re taking me seriously.” Marriott was even offering to help her finance the $5 million purchase over several years. It seemed almost too good to be true. And wouldn’t you know it, it was. The Marriott people, it slowly dawned on Taggares, erroneously believed she was representing her employer, Chef Ready—not herself as a solo entrepreneur. That’s why they were taking her seriously.

To own up to the truth would almost certainly have meant another door slammed in her face. So what did Taggares do? “They never directly asked me,” she says, so “I let them believe what they wanted to believe.” Namely, that she was negotiating on behalf of Chef Ready. “They finally found out,” she recounts, “and they were quite angry at the very end.” But by then the deal had all but gone through. (Unseem, 1999)

This example represents a boundary case in the area of legitimacy lies. Technically, Taggares has told no untruths per se nor has she intentionally misrepresented any materially relevant information. In these respects, we do not have a direct violation of the truth-telling hypernorm. Nonetheless, we do have a case where one party is aware of the fact that another party is operating under a materially relevant misconception about a critical business fact. Would the truth-telling hypernorm invalidate an authentic, “If they don’t ask don’t tell” norm? Likely not in all cases, since if it were to that would impose upon every party to a business contract or relationship the duty to reveal from the beginning every fact that might possibly be seen as relevant. That duty would be overly demanding and unnecessary in most cases. That said, a duty to correct materially relevant misconceptions, especially in situations where the party acting on the wrong information will be, as a result of the misconception on their part, in a position where they cannot exit, without serious penalty, a contract resulting from the misconception, is not one which is overly demanding and is essential to good faith dealing. Arguably, a concern for respecting personal autonomy, a concern which is at the heart of the truth-telling hypernorm as well as the liberty protection hypernorm, is meaningful if it includes not only a duty to inform truthfully but also the duty to correct misconceptions when one can easily do so and the failure to do so significantly lessens the future autonomy of the other party, as is the case in this example.

We may, then, offer a set of minimal conditions for the “legitimate” and “authentic” existence of micro-contracts between startup entrepreneurs and stakeholder groups which involve the telling of legitimacy lies.
1. All parties mutually benefit from the presence of the practice that involves the legitimacy lies, or at least can be reasonably expected to do so.

2. All parties are aware of the tendency to misrepresentation involved.

3. All parties can in practice freely enter and exit the practices involving the legitimacy lies; they are not, in any concrete way, required to participate in them.

4. No party intends to harm another via the issuance of a legitimacy lie.

5. Parties to which the misrepresentation is directed are able to mitigate the potential harm that may result.

The conditions are only minimal ones intended to capture the social contract conditions that contracts must be the result of rational, informed consent.

**SUMMARY AND CONCLUSIONS**

In this paper we have focused on ethical considerations of the general tendency of new venture entrepreneurs to engage in legitimacy lies, intentional misrepresentations of the facts. This tendency is due to the critical need for new ventures to overcome liabilities of newness and smallness in order to survive. Unless a new venture can gain initial legitimacy from key stakeholders such as financiers and customers, it will likely fail. The question remains: what are the ethical considerations of the legitimacy lie? We have previously examined this question using the ethical lenses of deontology and utilitarianism. However, we have argued here that these frameworks are of limited help because they are too rigid, abstract, and therefore difficult to apply in concrete situations. Instead, we propose that social contract theory is a more useful lens from which to examine the ethics of the legitimacy lie because attaining social acceptance is at the heart of the struggle for legitimacy. New venture entrepreneurs are essentially in search of consent on the part of various stakeholders to engage in mutually beneficial outcomes.

Specifically, we argue that a social contract approach like that developed by Donaldson and Dunfee (1999) provides a basis for defining “macro” norms for the moral governance of actual business practices, while at the same time allowing freedom for individuals to establish particular “micro” norms for specific practices that they freely choose to enter into. As noted, new ventures are unique in that they confront issues of adverse selection, moral hazard, and opaqueness. These conditions create information asymmetry and an environment in which trust is lacking. Social contracts as defined here provide a basis for all parties to establish rules that minimize the chances that the entrepreneur will be advantaged at the expense of other stakeholders by a legitimacy lie. In other words, an approach like ISCT provides a basis for understanding when a climate of working trust can be established where there is no history of trust and when the means by which that climate of trust is initially created involves behavior which at first glance seem antithetical to the creation of trust. We have applied social contract thinking to several case examples to demonstrate how this framework can provide a set of minimal conditions for the acceptability of cases of legitimacy lies. Though only a set of minimal conditions, it can form the basis for decision-making on the part of startup entrepreneurs when faced with the temptation to engage in some type of legitimacy lie.
IMPLICATIONS FOR THEORY AND RESEARCH

While we have shown that a social contract approach to the ethical concern that attends the practice of legitimacy lies is more informative and helpful than other approaches such as utilitarianism and Kantian deontology, and that there is a natural fit between a social contract approach and the quest for new venture legitimacy, a quest which itself is a struggle for social acceptance, much more work is needed to fully develop an account of the conditions which must be met before judging particular instances of legitimacy lies to be ethically acceptable. That fuller account would also need to be operationalized in ways which translate readily into decision-making methodologies employable by startup entrepreneurs on the ground. Further, to the extent that there are debilitating theoretical problems with the role Donaldson and Dunfee (1999) assign hypernoms in their normative theory, applications of that theory such as ours will also suffer. For example, startup entrepreneurs could find themselves in situations where adhering to the ethical demands of the legitimacy lies micro-contract would entail acting contrary to demands placed upon them by other micro-contracts. Some type of priority rules would need to be developed to aid entrepreneurs facing such ethical dilemmas. There is also the need for further empirical research regarding the ways in which new venture entrepreneurs make decisions when faced with the temptation to engage in legitimacy lies. Do they think in terms reflective of social contract theory (i.e. do they think in terms of macro-norms and micro-contracts)? What are the effects on initial legitimacy and future performance when entrepreneurs violate ethical norms when telling legitimacy lies? In particular, what happens when an entrepreneur gains initial legitimacy through a legitimacy lie and is later “found out” by a key stakeholder to have intentionally violated ethical norms? Of course, there are challenges in studying these and other kinds of questions since entrepreneurs may not admit to engaging in deceptive practices to gain legitimacy.

It is also necessary to translate the tenets of the social contract framework in a way that is practical for new venture entrepreneurs. For example: How can “macro” and “micro” norms regarding legitimacy lies be readily identified and understood? How can entrepreneurs become more sensitive to creating mutual happiness for themselves and their stakeholders? How can entrepreneurs better consider both short-term and long-term ramifications of their actions? Are there some guiding questions that new venture entrepreneurs can use to think through ethical issues using ISCT?

In applying ISCT, it would be critical for new venture entrepreneurs to first understand and accept a “lying hypernorm” that reflects a default position that lying is ethically wrong and that she or he has a duty, though not an absolute one, to avoid lying. Then, the challenge for entrepreneurs would be to discern the specific “micro” conditions under which an exemption to this general norm would be permitted. Based on our previous discussion, the following questions might provide a useful guide as entrepreneurs consider engaging with various stakeholders in a particular situation:

- What are my motivations in this transaction? What do I hope to achieve by engaging this (these) stakeholder(s)?

- What are the relevant facts in this transaction, as best as I can ascertain them?

- Who are the relevant stakeholders in this transaction? What does each hope to gain/lose in completing this transaction?
Do I intend to harm any stakeholder in this transaction?

What are the likely short-term and long-term outcomes of completing this transaction for me and the various stakeholders involved?

Will I and all relevant stakeholders mutually benefit from this transaction?

Are all parties aware of the possible misrepresentations involved in this transaction?

Are all parties free to enter and exit the practices involved in this transaction?

Do the stakeholders involved in this transaction have the ability to mitigate against any potential risk that may result?

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