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The Effect of Cognition, Institutions, and Long Term Orientation on Entrepreneurial Ethical Behavior: China vs. U.S.

Abstract This paper presents a theoretical framework to examine if entrepreneurs think and behave differently at various phases of a venture, namely opportunity exploration and exploitation stages. It is also proposed that there is a difference between entrepreneurs in China and in U.S. due to institutional voids. Furthermore, we argue that the difference increases across the two stages of the entrepreneurial process. Specifically, at the exploration stage, entrepreneurs in China and U.S. behave similarly when ethics is concerned. However, entrepreneurial unethical behavior seems to be more rampant in China compared with that in U.S. Lastly, we provide future research directions to build a stream of research.

Keywords entrepreneurs, opportunity exploration, opportunity exploitation, unethical behavior

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1 Introduction

Entrepreneurs are notorious for being opportunistic. There is a Chinese saying that all merchants are dishonest. Shylock, the merchant of Venice, depicts a western example of an unethical business owner. Research suggests that entrepreneurs tend to act unethically when there is financial gain involved (e.g., Longenecker, McKinney & Moore, 1988; Wong, 2008). Although more scholars have started to examine the relationship between entrepreneurship and business ethics, many questions remain unanswered (Harris, Sapieza, & Bowie, 2009). Among them are the following: (i) Are there significant differences in ethical decisions in the Western vs. Eastern cultures? (ii) Do entrepreneurs make different ethical decisions at different stages of the entrepreneurial process? We investigate the above questions in this paper.

We were motivated to conduct this study to address two primary gaps in the literature. First, while Shane and Venkataraman (2000) define entrepreneurship as a process where entrepreneurs as individuals discover, evaluate, and exploit business opportunities, scholars of business ethics have studied entrepreneurial endeavor as a single step process. Brenkert (2009) observes that scholars tend to view “the ethical questions entrepreneurs encounter as occurring in a static context” (p.453). We explain the difference in these two views by suggesting that entrepreneurs make decisions differently across their

entrepreneurial endeavors. They may think non-linearly at the exploration stage, and hence may break more rules while they explore with opportunities (Brenkert, 2009; Paik, Groves, Vance & Li, 2011). Second, previous research has investigated entrepreneurial ethics. However, the context has mainly been in Western countries (e.g., Harris, et al., 2009; Payne & Joyner, 2006). On the other hand, business ethics studies in China primarily focus on the comparison between Chinese and American managers (e.g., Hoivik, 2007; Paik, et al., 2011). While managers have been found to think differently from entrepreneurs (Groves, Vance, & Choi, 2011), a methodical comparison between American and Chinese entrepreneurs is needed. Institutional voids perspective argues that emerging markets and developed countries differ on five contextual subjects-political, openness, capital, labor and consumptions (Khanna, Palepu, & Sinha, 2005). Those environmental factors are crucial to entrepreneurs. Moreover, Hofstede (2001) noted that there were significant differences in the national cultures of the two countries along cultural dimensions of individualism/collectivism, power distance, uncertainty avoidance, masculinity/femininity and long-term/short-term orientations. Drawing upon these perspectives, it can be argued that there are significant differences in entrepreneurial values and beliefs of countries like U.S. and China. Hence, our paper uses these two perspectives to identify the key differences of ethical behavior between entrepreneurs in China and U.S.

Our paper has two main objectives. First, we attempt to fill a gap in the literature by examining if entrepreneurs think and behave differently across the various stages of entrepreneurial process. In doing so, we contribute to entrepreneurial ethics research. Second, we compare ethical decision-making by Chinese and American entrepreneurs. Our research lends support to institutional voids perspective.

The rest of the paper is structured as follows. First, we explain why business ethics is relevant to entrepreneurs. Next, we attempt to link thinking style with ethical behavior at the exploration and exploitation stages. Then, we compare the environmental characteristics that face entrepreneurs in China with those in the U.S. Finally, we conclude with a discussion of the research implications and direction for future research studies.

2 Business ethics and entrepreneurs

Ethics is about right or wrong and it helps guide human beings to do the right things (e.g., Harris, et al., 2009). However, the issue of whether a behavior is right or not is a subjective matter. Two philosophies, deontological and teleological, are often employed to determine the morality of an action.

Teleological ethicists hold the belief that “the ultimate determinant of what is morally right is the non-moral value the action results in” (Alder, 1998, p730). Accordingly, it is a right thing to do when the good outcome of an action far outweighs the evil that it produces. Hence, this philosophy puts its trust on external outcomes. Deontological believers argue that a right action does not exclusively depend on external outcomes. Rather, a moral decision is dependent upon inherent values, such as respect for human rights, fidelity, and integrity (DeConinck & Lewis, 1997). According to this philosophy, individual internal values determine if an action is acceptable morally.

Despite the reliance on external outcomes versus internal values, the two perspectives are not necessarily mutually exclusive. Baron (2008) proposes that entrepreneurial behavior is dependent on the external environment and internal cognition. Fraedrich and Iyer (2007) argue that both external and individual internal factors influence the ethical nature of an individual's action, even though external opportunity and pressure are more salient in a business setting. The findings are not surprising in that businesses, entrepreneurs in particular, are driven by profits and opportunities (Shane, 2003). In this paper, we assume that entrepreneurial behavior is guided by both external (institutional) and internal forces (cognition) because "the environment in which entrepreneurs function are often highly unpredictable and filled with rapid change" (Baron, 2008, p329), and because such an environment can exert strong influence on entrepreneurs' "cognition and behavior" (Baron, 2008, p329).

It has been suggested that entrepreneurs are significantly different from non-entrepreneurs (e.g., Baron, 2008; Buchholz & Rosenthal, 2005; De George, 1993). They develop a different view about business ethics from others, a proposition that has received strong support in recent years (Harris, et al., 2009). For instance, Buchholz and Rosenthal (2005) argue that successful entrepreneurs need to be creative so as to find novel ideas and further develop the ideas into viable businesses. Since creativity and novelty tend to be closely related to rule-breaking (Brenkert, 2009), ethics is more crucial to entrepreneurs than to other managers (Buchholz & Rosenthal, 2005). While many factors determine how entrepreneurs behave, we specifically examine how thinking styles, institutional contexts, and long-term cultural orientation determine entrepreneurial ethical behavior.

3 Theoretical Development

Human behavior, including ethical conduct, is dependent on their cognitive processes, such as perception, judgments and heuristic thoughts (e.g., Baron, 2008; Groves, et al., 2011). People make judgments about their situations and take actions based on those perceptions. Of the numerous factors leading to unethical behavior, McKendall, Sanchez, and Sicilian (1999) list three as key determinants-potential benefits of the behavior, the opportunity to act unethically, and the probability of being caught if performing a misconduct when presented with the opportunity to do so. Although the research by McKendall and associate (1999) focuses on corporate governance, we argue it is also applicable to entrepreneurial behavior.

Over the past few decades, scholars have gradually converged on the central aspect of entrepreneurship as opportunity (e.g., Busenitz, et al, 2003; Shane and Venkataraman, 2000; Short, Ketchen, Shook, & Ireland, 2010). In addition, researchers have generally agreed that entrepreneurship is a process where entrepreneurs explore, evaluate, and exploit opportunities (Choi & Shepherd, 2004; Eckhardt & Shane, 2003). Furthermore, studies have found that entrepreneurs may engage in different activities in different stages of the entrepreneurial process. For example, Greve and Salaff (2003) noted that entrepreneurs spend more time on the planning stage than established and motivation stages. However, previous research examining ethical entrepreneurial behavior has either ignored opportunity or mostly treated opportunity as a static phenomenon (Dean & McMullen, 2002; Paik, et al., 2011). In this paper, we propose entrepreneurial ethical

behavior is a dynamic phenomenon that changes across the different stages of the entrepreneurial process.

4 Ethical Behaviors and Thinking Style

A learning organization succeeds by balancing between exploration and exploitation (March, 1991). While exploration refers to search for and discovery of new ideas, exploitation addresses issues such as selection, implementation and execution of the ideas. As March (1991) states, too much of exploration may lead to negative performance because companies may run out of resources by exploring too many undeveloped ideas. Moreover, excessive exploitation may negatively impact businesses since outdated ideas will be rejected by customers. However, entrepreneurial endeavor is different from the organizational learning process because organization needs to consider both exploration and exploitation at the same time whereas entrepreneurs often first explore with ideas and then select the attractive options to exploit. Isaack (1978) proposes that individuals need to discover or conceive an idea first, and after that intellect can take over. Bhide (1994) advocates that entrepreneurs should play with and explore ideas, letting their strategies evolve through a process of guesswork (thinking), analysis and action. He encourages entrepreneurs to take a mid-way ground by placing a good balance between action and thinking so as to avoid both paralysis by analysis or extinct by instinct (Harari, 1993; Langley, 1995).

As discussed above, entrepreneurial opportunity exploration and exploitation engage in different activities. Active searching and finding new ideas are the process of exploration. Searching and contemplating on ideas are very important to entrepreneurs in a complex environment (Cooper, et al., 1995; March, 1991). Thus, between exploration and exploitation, thinking becomes very crucial at the stage of exploration. In this paper, we only investigate the effect of thinking style. Following Paik and associates (2011), we define thinking style as “one’s preferred approach to utilizing mental abilities in daily activities, including understanding and solving problems and challenges” (p2). Thinking style can be classified into two categories: linear versus non-linear. While linear thinkers pay attention to logic and external hard facts, non-linear people may be more likely subject to their internal feelings, intuition, and heuristics (Busenitz & Barney, 1997). Opportunity exploration has been regarded as “cognitive events or processes occurring within the minds of specific individuals” (Baron, 2008, p332). Because entrepreneurs need to find something new to pursue, such as new materials, new markets, or new processes (Schumpeter, 1934), individual entrepreneurs need to be creative so that they can locate new ideas. Since creativity requires non-linear thinking, we propose the following:

Proposition 1a: Entrepreneurs tend to think non-linearly at the opportunity exploration stage.

Selecting ideas and acting on the chosen ideas involve the process of exploitation. Entrepreneurial exploitation is often reflected in actions, and hence, commitment. While some activities indicate loose commitment, others require definite decisions. For example, one can easily state that he/she is saving money for the business, but it is not a firm commitment (Bird, 1988) because the money can be used for other purposes as well. Instead, discriminating activities, such as buying of facilities or equipment, and

developing models/prototypes, are strong commitment indicators because investments on these activities are often hard to retrieve (Carter, et al., 1996). These types of activities are highly correlated whether nascent entrepreneurs actually start their own businesses. Due to the commitment at the exploitation stage, entrepreneurs often balance linear thinking and non-linear thinking (Groves, et al., 2011). Hence, the next proposition can be stated as:

Proposition 1b: Entrepreneurs tend to think both non-linearly and linearly at the opportunity exploitation stage.

Unethical behavior is often the result of irrational thinking (McKendall, et al., 1999; Paik, et al., 2011). Cognition theory argues that when people employ intuition for sense-making, they tend to commit unethical behavior (Sonenshein, 2007) while a balance of thinking styles—linear and non-linear, is theorized to lower unethical behavior. Empirical research also lends support to such a claim (Paik, et al., 2011). In addition, institutional voids perspective contends that when lacking predictable business contexts, deviant behavior tends to go rampant. Hence, due to the lack of formal structure in the exploration stage, entrepreneurs often strongly impose their wills on their organizations. This leads to a display of lower level of caring for others, observing rules, or following rule and laws (Neubaum, Mitchell, & Schminke, 2004). Therefore, we propose:

Proposition 1c: Entrepreneurs commit more unethical behaviors at the opportunity exploration stage than at the exploitation stage.

4.1 Entrepreneurs in China and U.S.

Business environment, such as technological changes and political stability, has been studied for a better understanding of company and executive behaviors (e.g., Daboub, Rasheed, Priem, & Gray, 1995). Environment is also crucial to ethical decision-making. For example, Staw and Szwaijkowski (1975) showed that when firms operate in a less munificent environment, they are more likely to conduct illegal activities. Entrepreneurs are no exceptions. For instance, Brenkert (2009) proposes that competitive context may change entrepreneurs' view about what is right and wrong. He states that "something that is morally wrong, and yet from a broader, ethical perspective their actions may be viewed as acceptable or even, in some cases, admirable" (Brenkert, 2009, p453).

China presents business environment very differently from that in U.S. because China is an emerging economy that lacks the required institutional context to start and run a business (Azmat & Samaragunge, 2009; Khanna, Palepu, & Sinha, 2005). The institutional voids theory predicts that entrepreneurs in such a market resort to informal mechanisms, such as *guanxi*, for successful venturing (Xin & Pearce, 1996). Entrepreneurs in such countries need to combat severe business environment such as corruption and lack of clear rules and laws because business owners tend to behave unethically when corruption and poor rules are prevalent (Azmat & Samaragunge, 2009). Compared to the U.S., China lacks clear rules and regulations as well as the mechanisms that implement the existing rules (Chen, Yasar, & Rejuses, 2008). Hence, we propose:

Proposition 2: Entrepreneurs in China tend to behave more unethically in their entrepreneurial process than those in the U.S.

4.2 Long-Term Orientation and Entrepreneurial Ethical Behavior

Hofstede (1980) defines national culture as ‘collective programming’ of the mind that gives distinction among nations. His research supports the assumption that most of the people from a particular national culture share certain characteristics (Hofstede, 1980). For example, Chinese tend to be more group-oriented (collective) than Americans. Based on his study of more than 110,000 employees of IBM in 66 countries, Hofstede (1980; 2001) described national culture in terms of the following dimensions-power distance, uncertainty avoidance, individualism/collectivism, masculinity/femininity, and long-term/short-term orientation. Some of the dimensions have been proposed to be related to entrepreneurial activities in prior research. For example, individualism is found to have a negative impact on total entrepreneurial activities (Wu, 2007). While U.S. and China differ significantly on many of these dimensions, long-term/short-term orientation is of particular interest when comparing these two cultures since it was not even reflected in the original study where the instrument was developed by Western social scientists (Franke, Hofstede & Bond, 1991). It suggests the non-existence of the relevant values in the Western cultures. It was only when a subsequent study was conducted using Chinese values that the fifth dimension was revealed. This dimension distinguishes the difference in thinking between the East and West.

Long-term and short-term orientations differ on several significant aspects. First, people with long term orientation focus more on the future, while short term has an orientation towards the past and present. Second, long-term orientation has a focus on virtues while short-term is identified more with truth. Third, a short-term view concerns with the results and the ends while long-term orientation places emphasis on the process and the means. Long-term orientation, influenced by Confucius beliefs, has been China’s dominant philosophy for thousands of years while the behavior of managers and entrepreneurs in U.S. tend to change based on the current situations and external environments (Franke, Hofstede & Bond, 1991).

With regards to ethical behavior, short-term orientation is in line with teleological ethicists that emphasize the importance of external outcome while people in culture of long-term orientation support the deontological beliefs of moral sustenance, independent of the external environment. This indicates that China, a culture with long term-orientation, may be committed to behaving in a certain pattern without much change, irrespective of the circumstance. For example, Paik and associates (2011) propose Chinese managers are *unlikely* to change their perceptions of ethical behavior even though utilization may have experienced an alteration. Hoivik (2007) also observes that “Chinese do not need recommendations as how to sustain integrity; it is already a part of who they are as human beings. It is important to make sure that ethical rules and values come from the heart, something one truly believes in and is totally committed to” (p465). Therefore, a pattern of persistence, commitment, and long term thinking can be commonly expected among Chinese entrepreneurs (Li, 2008). Hence, Chinese entrepreneurs do not seem to change their ethical behavior significantly at the various stages of the entrepreneurial process even though their American counterparts may do so.

As argued in propositions 1 and 2, entrepreneurs at the exploration stage are inclined to commit more unethical behavior, and Chinese entrepreneurs may be prone to behave more unethically than their American counterparts. However, the long-term orientation of Chinese culture suggests that Chinese entrepreneurs are less likely to change their behaviors, unlike the American entrepreneurs whose behavior is dependent upon the

external environment. Hence, we argue that across exploration and exploitation stages, entrepreneurs in China do not change their behavior significantly while American business owners alter their behavior to a large extent because of the strict regulations in U.S. which reduce their unethical behavior. Based on the argument, we propose the following:

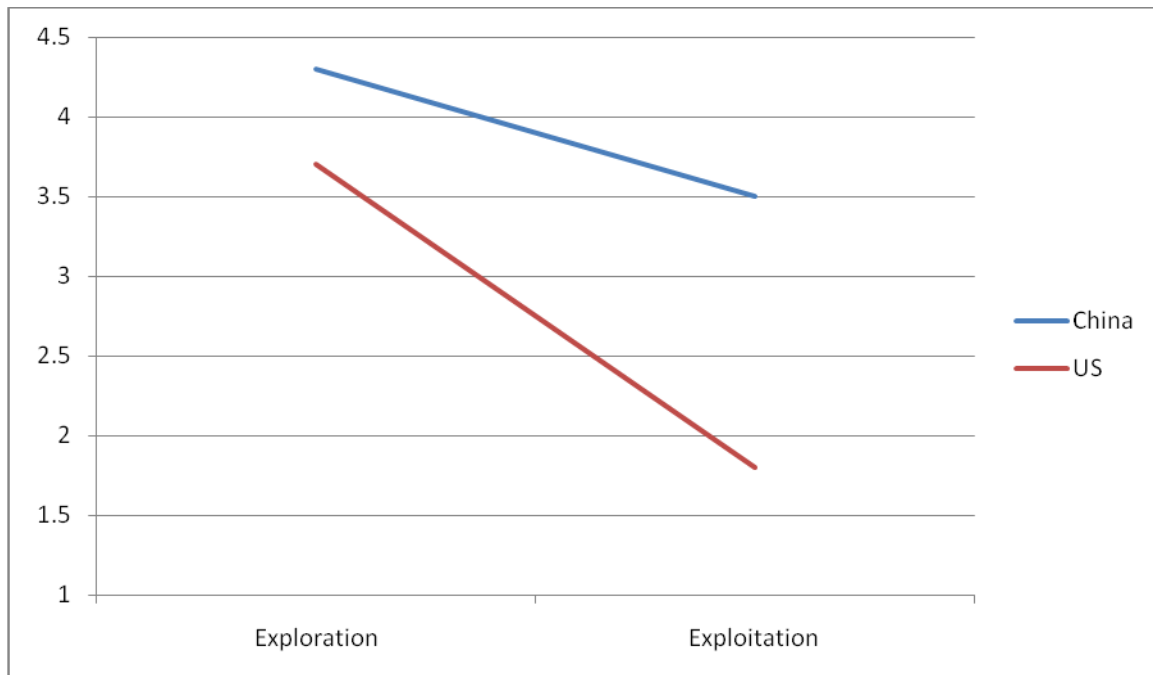
Proposition 3: The difference of unethical behavior between entrepreneurs in China and U.S. is larger at the exploitation stage than at the exploration stage.

We summarize our propositions in Table 1. We also show the expected empirical results of proposition 3 in Figure 1.

Table 1 Summary of Propositions 1a, 1b, 1c and 2.

	Exploration	Exploitation
Thinking style	Linear (P1a)	Linear + Non-linear (P1b)
Unethical behavior	Exploration > Exploitation (P1c)	
USA vs. China	Unethical (China) > Unethical (USA) (P2)	

Fig.1 Visual Demonstration of Proposition 3



5 Discussion

Previous research has made many inquiries into entrepreneurial ethical behavior. However, scholars have assumed that entrepreneurs follow a steady ethical pattern across

the entrepreneurial process of opportunity exploration and exploitation. We relax the assumption and argue that entrepreneurs act differently across different stages of their endeavor. Specifically, we contend that because there is a great deal of uncertainty at the exploration stage that impact their thinking style, entrepreneurs may commit more unethical behavior at this stage. We also propose that institutional voids may push Chinese entrepreneurs to engage in more opportunistic conducts. Lastly, based on cultural perspective, we argue that entrepreneurs in China may be more committed to their behavior and be more persistent in what they do while entrepreneurs in U.S. are more likely subject to changes under external conditions. Hence, the difference between Chinese and U.S. entrepreneurs may grow over the progress of entrepreneurial process. Our argument lends support to institutional theories, and builds on entrepreneurial ethical behavior studies.

This paper is important because it contributes to the research on ethical decision-making by entrepreneurs in significant ways. It adopts a unique perspective by examining how factors external to entrepreneurs impact the ethical nature of their decision-making. First is the stage of entrepreneurial endeavor since we argue that the ethical nature of entrepreneurial decisions may change at different stages of the endeavor. Second is the environment in which the entrepreneur operates. Some business environment is less susceptible to unethical decision-making than others. Third is the national culture of entrepreneurs. We propose that entrepreneurs will be guided in their decision-making by the values imbibed in them by their culture.

6 Directions for Future Research

While the framework presented here has the potential to contribute to the existing stream of research, it is a theoretical paper and hence, future studies need to test the ideas presented here empirically. Several concerns related to designing and empirical testing of such a study need to be considered. First, testing the two stages of entrepreneurial process, exploration and exploitation, would benefit from longitudinal design. However, it would be a challenge to get longitudinal data of this kind. An alternate approach could use Greve and Salaff's (2003) classification of entrepreneurs into two categories and therefore, two stages based on their activities. This technique can be more easily implemented. Second, unethical behavior is a sensitive issue. Thus, entrepreneurs may hesitate to respond to personal survey. Even if they respond, the responses may be biased. Future research can use policy-capturing technique whereby entrepreneurs are given scenarios that they can respond to (e.g., Busenitz & Barney, 1997; Joardar, Kostova & Ravlin, 2007). This approach enhances participation and controls confounding effects. This also reduces social desirability in responses. However, this approach may require experimental design.

As noted earlier, in this paper, we draw from institutional voids theory and focus on Chinese and U.S. entrepreneurs because of the significant differences between the two based. While the theory examines emerging markets vs. developed world, we examine two specific countries here. Hence, the arguments made here may not be extended without any modification to other countries. We call for future studies to expand our framework to other cultures in order to understand the broader implications of the phenomenon examined here. It is also possible that the nature of industry has an impact

on entrepreneur decision-making. For instance, will decision-making be less ethical in a highly competitive industry compared to others? Future research should investigate this to build on our stream of research.

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