Stakeholders, Entrepreneurial Rent and Bounded Self-Interest

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STAKEHOLDERS, ENTREPRENEURIAL RENT,
AND BOUNDED SELF-INTEREST

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ABSTRACT

This paper examines how the change from an assumption of pure self-interest to an assumption of bounded self-interest alters basic propositions regarding the way entrepreneurs select, negotiate with and manage relationships with their initial set of stakeholders. Although a purely economic approach would focus on material cost as the sole consideration when conducting these activities, we argue that nonmaterial factors such as reciprocity and fairness are potent forces during the initial resource acquisition process. We explain that non-material considerations are accounted for in negotiations with stakeholders and positive reciprocity is encouraged through openly sharing information with stakeholders about the value of their contributions to the venture. Furthermore, we expect that entrepreneurs do and should seek stakeholders with expectations about future outcomes that are complementary to their own. This analysis provides a new perspective on the creation of entrepreneurial rent that promises to provide an enhanced understanding of the resource acquisition process as well as guidance to practitioners and researchers.

INTRODUCTION

Entrepreneurship may be envisioned as a process through which an actor (the entrepreneur) attempts to create rent by attracting and combining resources to satisfy a market need (e.g., Alvarez and Barney, 2007; Schumpeter, 1934; Shane and Venkataraman, 2000). Throughout this process entrepreneurs must engage stakeholders to provide resources – such as prospective partners, employees, customers, suppliers, and financiers – who are often uncertain about the entrepreneur’s probability of success, and give them sufficient motivation to provide their resources to the venture (Freeman, 1984). This can be a challenge because in order to create and appropriate rent the entrepreneur must offer the stakeholders, as a group, less than the value of their combined resources, while at the same time trying to persuade them to engage in the venture (Coff, 2010; Rumelt, 1987).

A purely economic perspective to this entrepreneurial problem would suggest that the entrepreneur should seek out those initial stakeholders who are expected to provide their resources at the lowest cost, bargain to extract the lowest cost, and then withhold any information from them that might cause them to want a better deal in the future. The reasoning
here is simple to understand if we assume that the entrepreneur is purely self-interested. Based on this assumption, the rational decision is to maximize each transaction without consideration of the interests of the stakeholders. We question whether this assumption provides an appropriate foundation upon which to understand the entrepreneur’s resource acquisition problem and whether it is likely to lead to optimal decisions on the part of the entrepreneur. The efficacy of the pure self-interest assumption will be examined, followed by a discussion of how changing it alters our perspective of the behavior of entrepreneurs as they establish and manage relationships with resource-providing stakeholders. Related to Freeman’s (1999) separation thesis, the logic we build based on the assumption of bounded self interest explicitly recognizes the inseparability of ethical and economic behavior.

**QUESTIONABLE ASSUMPTION**

Entrepreneurs require the cooperation of a variety of resource providers in order to create entrepreneurial rent. These resource providers (stakeholders) typically include customers, materials suppliers, financiers, employees, managers, and owners. Explaining the interactions among actors requires an assumption about what drives their behavior. Self-interest is the cardinal human motive that drives behavior in most economics-based theorizing (Miller, 1999; Schwartz, 1986). This way of thinking has a long tradition building at least from Bentham’s (1780) philosophy of utilitarianism. Utilitarianism is based on the principle that humans are motivated exclusively by the pursuit of pleasure and the avoidance of pain. Jevons (1866), one of the co-founders of neoclassical economics, further specified that for economists self-interest refers only to the pursuit of satisfaction arising from the consumption of material goods (commodities).

“Economy investigates the relations of ordinary pleasures and pains thus arising, and it has a wide enough field of inquiry. But economy does not treat all human motives. There
are motives nearly always present with us, arising from conscience, compassion, or from some moral or religious source, which economy cannot and does not pretend to treat. These will remain to us as outstanding and disturbing forces; they must be treated, if at all, by other appropriate branches of knowledge” (Jevons, 1866: 282).

The now-familiar assumption of self-interest is that people attempt to realize the greatest personal pleasure by picking the best combination of commodities they can afford given their income (Varian, 1999). A useful way to examine this phenomenon is in terms of the utility each possible combination might bring to the individual. Each combination of commodities, like a shopping cart, yields a certain number of underlying units of pleasure, which might be called ‘utils’. An actor’s utility function represents the tradeoff calculations he/she makes when evaluating alternative courses of action. A utility function is applied to a set of expected material outcomes that might be consumed given each alternative course of action and a relative preference assigned by the actor to each outcome. The very concept of rent under this assumption, then, refers to the material value of commodities.

Although this hedonistic, individualistic assumption about human behavior has helped to explain many features of the collective economic behavior of society, the appropriate focus for explaining how entrepreneurs work with stakeholders to create entrepreneurial rent is on the level of individual actors (Freeman, 1984). Beyond the purely self-interested pursuit of commodities, what motivates the entrepreneur and the prospective stakeholder to engage with each other?

Scholars in a range of fields have found that the self-interest assumption is a poor description of human motivation because it abstracts from some of the subtler aspects of humanity and society that affect competitive market behaviors (Jevons, 1866; Keen, 2002). Extensive research in fields such as economics (Fehr and Gächter, 2000), philosophy (Rawls, 1999; Becker, 1986), sociology (Cropanzano and Mitchell, 2005), psychology (Rabin, 1998),
and social psychology (Cialdini, 1984) shows humans are only *boundedly* self-interested. Bounded self-interest means actors’ self-regarding behavior is bounded by the norm of fairness. When they experience something better (worse) than they expected they positively (negatively) reciprocate toward other actors in many competitive market situations (Fehr and Gächter, 2000). That is, economic actors regularly sacrifice self-interest to reinforce behavior they perceive as fair and to punish behavior they perceive as unfair (Thaler, 1991).

Self-interest is bounded because while people are motivated by the pursuit of personal pleasure and the avoidance of personal pain, this motivation reaches its boundary when it begins to violate their perceptions of what is fair. Concern for fairness means we are self- and other-regarding, not just self-regarding. Bosse, Phillips and Harrison (2009) provide a review of bounded self-interest that focuses on the work developed by labor economists, behavioral economists, and organizational justice scholars. This work shows employees reciprocate positively to their employers when they perceive that they (and others) have been treated fairly. Positive reciprocity is demonstrated when employees provide more effort or more resources than originally expected. Employees also reciprocate negatively – by decreasing their effort or providing fewer resources than originally expected – when they perceive their employer has treated them (or others) unfairly. The difference between actual effort/resources provided and the expected effort/resources in an exchange can occur because employment contracts are incomplete. Bosse et al. (2009) extend the application of bounded self-interest from the employee-firm context to all stakeholder-firm contexts.

The organizational justice literature contributes to the assumption of bounded self-interest by demonstrating that stakeholders’ reciprocal behaviors are likely to be influenced by their perceptions of at least three types of fairness: distributive, procedural, and interactional (e.g.,
Bosse et al., 2009; Colquitt et al., 2001). In our context, distributive fairness refers to whether a stakeholder believes the distribution of material outcomes to the entrepreneur and the network of stakeholders is justified (Adams, 1965; Nelson, 2001; Rabin, 1993). Procedural fairness refers to whether a stakeholder believes the decision-making process is fair (Lind and Tyler, 1988; Phillips, Freeman and Wicks, 2003). This assessment can include aspects of the decision making process such as the amounts of influence stakeholders have in decision-making and the transparency of the decision criteria. Finally, interactional fairness refers to whether the entrepreneur treats stakeholders with respect and dignity or rudely and dismissively (Cropanzano, Bowen and Gulliland, 2007). Research demonstrates that people collectively consider all three of these types of fairness – and they consider tradeoffs among them – when enforcing the norm of fairness (i.e., Ambrose, Seabright and Schminke, 2002; Blanchflower et al., 1996; Brockner, 2006; Greenberg, 1988, 1993).

How does the bounded self-interest assumption change what is captured by the concept of rent? A venture has created rent when it compensates the actors, including the entrepreneur and all stakeholders, enough to keep them engaged in the venture, with at least one actor receiving compensation above that which is required to keep them engaged (adapted from Coff, 1999; Rumelt, 1987). Therefore, if concerns for distributive, procedural and interactional fairness affect the competitive behavior of entrepreneurs and stakeholders, rent must refer to compensation that is both material and nonmaterial. Part of an actor's compensation comes from the way they are treated by exchange partners. It even comes from the way their exchange partners treat third parties because fairness is not only enforced through reciprocity in dyadic exchanges, but also among third party actors in a network of exchanges (Ekeh, 1974). Nonmaterial compensation could come in many forms, such as better information, more voice in
decision-making, or better treatment during exchanges. These nonmaterial factors have value, too, because they motivate boundedly self-interested actors.

We now examine how shifting from the self-interest assumption to the bounded self-interest assumption changes three basic propositions for how entrepreneurs interact with their initial stakeholders to create entrepreneurial rent.

**SELF-INTEREST AND STAKEHOLDER ENGAGEMENT**

To obtain resources for their ventures, entrepreneurs must (1) search for parties to serve as stakeholders, (2) negotiate terms of exchange, and (3) manage exchanges after initiation (Coff, 2010; Gulati, 1998; Kale and Singh, 2009; Larson, 1992). Assuming economic actors are exclusively self-interested, we can deduce entrepreneurial behaviors in each of these stages that would seem to result in a greater amount of rent for the entrepreneur. For instance, we can predict based on this assumption that entrepreneurs will select stakeholders who are likely to charge the lowest cost, negotiate the lowest possible price required to engage those stakeholders and, after the initial exchange, withhold any information that could be used by stakeholders to opportunistically renegotiate for a larger portion of the rent that has been created.

**Pure Self-interest and Engaging with Stakeholders**

With regard to search, a prospective stakeholder who believes that the material outcomes from an entrepreneurial venture will be great will attempt to secure as many of those material benefits, ex ante, as possible. The lowest price, then, will tend to be charged by the stakeholder who has the lowest expectation of ex post material outcomes for the venture. The entrepreneur will select this stakeholder because it represents the lowest cost. Using this logic, we arrive at the following proposition:
Proposition 1: Entrepreneurs generate more entrepreneurial rent by engaging stakeholders who possess the lowest expectations of ex post material outcomes from the venture.

After selecting an ideal prospective stakeholder, the entrepreneur must make an offer that entices them to engage in the new venture.\footnote{We control for differences in prospective stakeholders’ resource quality in a given category (i.e., raw materials suppliers, employees, etc.) in this discussion to highlight the relevant differences arising from the assumptions of pure self-interest vs. bounded self-interest.} When evaluating an offer to enter a transaction, actors compare the offer to their opportunity cost – which is based on their expectation of the material outcomes they will receive from the best alternative use for the resources they control. Our proposition regarding an entrepreneur’s offer to a prospective stakeholder under the self-interest assumption is simply derived from Rumelt’s (1987) definition of entrepreneurial rent. The self-interested entrepreneur offers the lowest material compensation required to engage the stakeholder.

Proposition 2: Entrepreneurs generate more entrepreneurial rent by offering stakeholders the minimum material value required to engage them.

After selecting and negotiating terms of exchange with stakeholders, entrepreneurs must carefully manage each stakeholder relationship. It is reasonable to expect that the existence of entrepreneurial rent relies on uncertainty regarding the outcomes of the venture (Alvarez and Barney, 2005; Kor, Mahoney and Michael, 2007), which drives entrepreneurs and prospective stakeholders to have different expectations of the value that will be created. Otherwise resource providers would be more likely to appropriate much or all of the surplus value created by the venture, thus leaving little or no rent for the entrepreneur (Coff, 2010). Uncertainty exists largely due to a lack of reliable and verifiable information (Alvarez and Barney, 2005; Kor et al., 2007). As the entrepreneur successively forms exchanges with various stakeholders in pursuit of his/her opportunity, he/she begins to collect reliable and verifiable information about the expected value
of the venture. If the entrepreneur is at the nexus of the stakeholder network, he/she may be the only actor with access to this information. What the entrepreneur does with this information can influence the entrepreneurial rent that is both created and retained.

Purely self-interested stakeholders seek the largest possible share of the rent. So if a stakeholder finds out their resource contributed material value that exceeds the cost they charged the entrepreneur, they will opportunistically renegotiate for a larger share of the rent (Coff, 2010). Purely self-interested entrepreneurs actively seek to appropriate a strictly larger share, too, so they will understate or withhold information about the actual underlying distribution of outcomes as it becomes available. This strategy of concealing information about the ex post value is executed until the entrepreneur can acquire isolating mechanisms (Knott, 2003; Mahoney and Pandian, 1992; Peteraf, 1993; Rumelt, 1984, 1987), which are factors that protect the value-producing aspects of the entrepreneur’s venture from competitive imitation (e.g., property rights, learning, buyer switching costs, reputation, organizational routines).

**Proposition 3**: Entrepreneurs generate more entrepreneurial rent by withholding as much positive performance information as possible from stakeholders.

While these three propositions are logical extrapolations based on the assumption of pure self-interest, they change when the assumption of bounded self-interest is introduced. The next three sections will examine these changes and provide alternative propositions.

**Bounded Self-interest and the Search for Stakeholders**

The first proposition that entrepreneurs should seek resources from stakeholders with pessimistic predictions regarding the economic success of the venture follows directly from the Rumelt (1987) definition of entrepreneurial rent and the assumption of self-interested actors. However, common observation suggests entrepreneurs often choose to engage stakeholders with
high expectations for the new venture. We suggest that an assumption of bounded self-interest supports a more accurate depiction of entrepreneurial decision making in this regard.

Under the assumption of bounded self-interest, actors reciprocate positively or negatively based on perceptions of distributive, procedural, and interactional fairness. This means some of the material outcome will be associated with the effort and level of resources provided by the stakeholders – and these things are determined in part by stakeholders in response to the entrepreneur’s actions. Therefore, the material outcomes of a venture are partially endogenously determined by the interactions among the entrepreneur and his/her stakeholders. The entrepreneur in this model is unlikely to generate the most rent by selecting stakeholders with the lowest absolute expectations for the venture.

Reciprocal behavior is ultimately driven by mismatches between what an entrepreneur thinks is fair compensation for a given stakeholder and what that stakeholder thinks is fair. These expectations of fairness are not conceived exogenously in absolute terms. Evidence from the ultimatum game suggests expectations of fairness are relative (Fehr and Gächter, 2000). The ultimatum game is a popular experiment used by behavioral economists in which player A is given the right to propose a scheme for dividing a fixed sum of money with player B. This proposal is the “ultimatum.” Player B has the authority to accept or reject the ultimatum. The result of a rejected offer is that both parties walk away with nothing; accepted offers are implemented. Findings across a wide range of subject populations show proposals that allocate less than 30 percent of the available money to player B are rejected (Fehr and Gächter, 2000). A ten dollar pot split $2/$8 is rejected as is a hundred dollar pot split $20/$80. Player B incurs a cost of twenty dollars, in this latter example, just to punish Player A for proposing an unfair split. A plausible interpretation is that people adjust their expectations of what is fair based on the
relative allocation of compensation rather than on the absolute level of compensation they will receive.

Applying this logic to our context, we expect entrepreneurs generate more rent when they engage stakeholders who possess complementary ideas about what is fair compensation for both parties. Because the level of compensation perceived to be fair is influenced by what the other party gets, searching for the stakeholder with the lowest absolute expectation (ex ante) for the venture can easily result in mismatched perceptions of fairness. Bounded self-interest characterizes entrepreneurs as well as prospective stakeholders, so the motivation of the entrepreneur (stakeholder) to engage with particular stakeholders (entrepreneurs) is influenced by his/her perceptions of fair and unfair treatment exhibited by those stakeholders (entrepreneurs). Thus, mismatching expectations for fairness likely leads to allocations of compensation that stimulate negative reciprocity from one of the parties. Negative reciprocity, in turn, is associated with less rent creation (Bosse et al., 2009).

The revised proposition is that entrepreneurs create more rent when they select stakeholders who share complementary (i.e., matching rather than mismatching) expectations for fair compensation. This proposition, based on the bounded self-interest assumption, reflects a win-win scenario. The ideal strategy changes from ‘get the largest slice of a fixed pie’ to ‘grow the size of the whole pie.’ This approach is also appropriately seen as the ‘names and faces’ mental model of the startup venture (Werhane, 2011, this volume). This is because the entrepreneur believes stakeholders who hold complementary expectations of fairness will foster positive reciprocity, thus creating greater total value. A network of such stakeholders with complementary expectations of fairness will also help allocate the (now larger) material and nonmaterial value fairly. ‘Complementary’ here means the best stakeholder is the one most likely
to reciprocate positively to the entrepreneur, given the entrepreneur’s own expectations for
distributive, procedural, and interactional fairness. The revised proposition under the bounded self-interest assumption is:

Revised Proposition 1: Entrepreneurs generate more entrepreneurial rent by engaging stakeholders who possess expectations of distributive, procedural, and interactional fairness that are complementary to the entrepreneur’s expectations.

One of the upsides of the logic associated with bounded self-interest is that it recognizes entrepreneurs’ personal influence on the value created through new resource combinations. Entrepreneurs can influence expectations of fairness through the way they engage with stakeholders. For example, they can exhibit a high level of respect and courtesy for potential stakeholders during their contacts with them (interactional fairness). They can consider the needs and concerns of stakeholders as they develop plans for the venture, and can regularly communicate those plans and the way that stakeholder needs and concerns are accounted for (procedural fairness). They can also manifest a willingness to share the material outcomes from the venture fairly (distributive fairness), and to communicate regularly and openly with stakeholders concerning the particulars of the venture that are most important to them (interactional and procedural fairness). Indeed, we suggest that successful entrepreneurs do these things and that they help to keep the front-end costs as low as possible.

Consequently, our revised proposition suggests the lowest costs are not necessarily offered by stakeholders with the lowest expectations for ex post material outcomes from the venture. Rather, stakeholders with complementary fairness considerations may be willing to charge the entrepreneur comparatively low prices because they believe fairness considerations have value with regard to the size of the outcomes and the way they will be distributed.

Bounded Self-interest and Negotiating with Stakeholders
The components of cost and value under the bounded self-interest assumption include both material and non-material components. Furthermore, the material components do not just refer to distributions of value that can be monetized, but also the fairness of their distribution. So while actors hold different expectations of ex post material outcomes due to uncertainty (Kor et al. 2007), they can develop shared expectations (through reputation and discussion) of fair material and non-material outcomes. Astute entrepreneurs check references of potential stakeholders such as employees, financiers, and suppliers. A strong reputation for fairness enhances the desirability of the stakeholder. The parties can also discuss, for example, what role the stakeholder will play in decision making (a form of procedural compensation) or the way the entrepreneur will treat the stakeholder (interactional compensation). The upshot is that ex ante costs and ex post value are interdependent under the bounded self-interest assumption. Ex post value is positively related with ex ante cost because stakeholders reciprocate based on what they receive.

Entrepreneurs in a world of boundedly self-interested actors seek to manage the expectations for fairness among prospective stakeholders by demonstrating what levels of nonmaterial value they can expect in a proposed exchange. By explaining their relevant decision making processes and treating prospective stakeholders with dignity and respect during the offer negotiation process, entrepreneurs influence the basis for stakeholders’ expectations for nonmaterial compensation.

These efforts put forth by the entrepreneur serve to mitigate some of the material outcome uncertainty that characterizes the entrepreneurial process (Kor et al., 2007). As stakeholders get better information about the nonmaterial compensation they can expect, even at the first point of contact, their uncertainty about the proposed exchange is reduced. As stated
previously, people acknowledge tradeoffs in the three types of fairness. A distribution of procedural fairness that exceeds the norm, for example, can compensate for a potential distribution of material value that is below a stakeholder’s (material) opportunity cost (Colquitt et al., 2001). Thus, a stakeholder who has reason to believe they will be treated fairly may be willing to reduce the price they charge the entrepreneur for access to their resource.

The revised proposition regarding an entrepreneur’s offer to a prospective stakeholder under the bounded self-interest assumption builds on the endogeneity of ex post outcomes and ex ante costs. The entrepreneur crafts an offer to stakeholders such that the total material and nonmaterial value will be maximized. Because some of the value is endogenous to the fairness the entrepreneur distributes to stakeholders, the entrepreneur will seek to remove any nonmaterial uncertainty by promising (and demonstrating) a pattern of fairness toward stakeholders.

Revised Proposition 2: Entrepreneurs generate more entrepreneurial rent by offering stakeholders a total compensation including procedural, interactional, and material fairness that initiates a cycle of positive reciprocity.

Bounded Self-interest and Sharing Information with Stakeholders

As Proposition 3 suggested, the pure self-interest assumption leads to the idea that entrepreneurs should withhold positive information about the success of a venture so that stakeholders do not attempt to appropriate more of the value created. However, shifting to the bounded self-interest assumption, actors (both entrepreneurs and stakeholders) are expected to be more open with information about performance outcomes to the extent that they believe they can seek to make adjustments to their contracts where necessary.

If a stakeholder finds out the true value attributable to their contribution (material and non material) is greater or less than their perception of the fairness they have received, they will
seek to remedy this unfairness. Stakeholders enforce fairness by either renegotiating for a more fair compensation or by adjusting the effort or value of resources they provide the entrepreneur. The nature of the bounded self-interest assumption incorporates reciprocal rewards and penalties that occur after the initial agreement. Third-parties that become stakeholders also reciprocate positively and negatively based on their perceptions of the entrepreneur’s behavior even if the second party stakeholder they observe only engages in one transaction with the entrepreneur. The upshot is that norms of fairness are enforced over the course of multiple transactions between the entrepreneur and stakeholders. So even if the entrepreneur overpays a stakeholder at the initiation of their exchange, when that becomes apparent given the information that becomes available later, that stakeholder will either provide more value to justify the extra compensation they have received or give back some of the extra compensation. This is an example of boundedly self-interested actors willingly incurring cost to enforce their principles.

The revised proposition regarding entrepreneurs’ information sharing with stakeholders builds on the assumption that fairness is enforced by stakeholders through both positive and negative reciprocity. The information-sharing strategy for an entrepreneur when actors are boundedly self-interested is to be transparent with stakeholders. They will openly share stakeholders’ contributions to the rent that is created because openly sharing information with stakeholders stimulates positive reciprocity. For example, stakeholders may also be more disclosing with information that could be useful to the entrepreneur in creating even more value. Harrison et al. (2010) argue that stakeholders are more likely to share nuanced information with firms that exhibit characteristics associated with what is considered fair and that this information can be used to increase the efficiency with which resources are allocated, spur innovation, and better manage environmental uncertainty. These factors can also contribute to the success of an
entrepreneurial venture. Even if a given stakeholder is purely self-interested, openly sharing this information with other stakeholders enables them to serve as fairness enforcers (positively and negatively) for the whole network of stakeholders (including the entrepreneur).

Revised Proposition 3: Entrepreneurs generate more entrepreneurial rent by openly sharing performance information with stakeholders.

Taken together, the three revised propositions suggest that entrepreneurs will be more successful in generating rents from their ventures if they seek out stakeholders as resource providers who have similar values to their own with regard to fairness considerations (procedural, interactional, distributional), emphasize fairness characteristics as a component of the bargaining process, and openly share performance information with them after the deal is struck. These propositions envision a scenario in which stakeholders and the entrepreneur are willing to strike a deal in which the costs of the resources may not be optimal in purely financial terms and from their own perspectives. In other words, the entrepreneur may not be getting the lowest possible price for a resource, in financial terms, but instead trades off this position for a situation in which he/she believes that the resource provider will exhibit fairness and that the terms of the agreement can be renegotiated ex post based on actual outcomes. “I may not be getting the lowest price right now, but this stakeholder will be fair with me as our exchange (relationship) proceeds.”

Nevertheless, we do not expect that the entrepreneur will have to pay the highest prices for resources either. If the entrepreneur exhibits fairness characteristics during the bargaining process and promises disclosure of relevant information down stream, the stakeholder providing the resources is also expected to consider these nonmaterial forms of compensation as a part of the deal. “We may not be getting the highest price possible, but this entrepreneur is going to be fair and open with us.”
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Fairness considerations mean that the initial cost of resources provided by stakeholders may not be as important as they are considered to be under the assumption of pure self-interest. After all, fairness would suggest that initial contracts can be adjusted ex post. However, of equal importance to this discussion is the idea that fairness also influences the behavior of the actors through reciprocity (Bosse et al., 2009). Stakeholders reciprocate positively when they perceive that they (and others) have been treated fairly. Positive reciprocity is demonstrated through means such as providing additional effort or resources than originally expected. Stakeholders can also reciprocate negatively – by decreasing their effort or providing fewer resources than originally expected – when they perceive the entrepreneur has treated them (or others) unfairly. In our context, reciprocation means that fairness, as defined herein, will lead to a higher level of rent creation because of the motivation levels and actions of the actors in the venture.

If an entrepreneur is poorly matched with a stakeholder in terms of fairness considerations the optimal situation described above erodes, leading to less rent creation. Note that Revised Proposition 1 talks in terms of complementary expectations of distributive, procedural, and interactional fairness between the entrepreneur and stakeholders. If the entrepreneur exhibits a high level of fairness and a stakeholder does not, then the stakeholder is likely to try to take advantage of the entrepreneur. Furthermore, procedural, interactional and distributive fairness come with costs, and those costs will not be compensated for unless they are associated with similar behaviors on the part of the stakeholder. From the opposite perspective, if the stakeholder exhibits a high level of fairness but does not perceive that the entrepreneur is of like mind, then the highest possible price will be charged for resources provided, recognizing that nonmaterial compensation factors are not likely to be realized ex post. Furthermore,
additional effort and resources will not be provided. Either one of these scenarios will reduce the amount of total rent created by the venture.

The notion of matching entrepreneurs with stakeholders is similar to the concept of “optimal trust” espoused by Wicks, Berman and Jones (1999). Indeed, trust is essential to the expectations of fairness we have been discussing. Wicks et al. argue that it is possible to overinvest or underinvest in trust. For instance, companies can invest too many resources in establishing trust, thus eroding profitability, and too much trust can also lead to opportunistic behavior. Similarly, companies may not expend sufficient resources to establish the trust that is needed for productive relationships with their stakeholders. In our situation, an entrepreneur who exhibits more fairness than the stakeholder is using the additional resources needed to create that level of fairness unproductively, at least in that particular stakeholder relationship. Also, an entrepreneur who does not exhibit fairness to the stakeholder will have to pay what is essentially a premium for resources provided in order to compensate for the lack of nonmaterial consideration. As explained by Hartman (2011, this volume), entrepreneurs and stakeholders can efficiently come to agreement about what is fair through conversation (rather than bargaining).

**DISCUSSION**

This paper examines three propositions regarding the creation of entrepreneurial rent under the common assumption that actors are driven by a cardinal human motive of pure self-interest. For each proposition we also derive a revised proposition by assuming actors are boundedly self-interested. While the assumption of bounded self-interest is believed by many scholars to be a more accurate depiction of human behavior (Becker, 1986; Cialdini, 1984; Cropanzano and Mitchell, 2005; Fehr and Gächter, 2000; Rabin, 1998; Rawls, 1999), our objective is not to prove the accuracy of this assumption. Instead, we have sought to draw
attention to the face validity of these contrasting propositions about how entrepreneurs behave when creating entrepreneurial rent. The result is a set of explanations that extend important concepts of stakeholder theory to the initial resource acquisition behaviors of entrepreneurs.

The first proposition explains selection criteria entrepreneurs use when identifying prospective stakeholders. Under the purely self-interested assumption the ideal stakeholder, ceteris paribus, is the one that expects to receive the lowest payment for the use of his/her resources. Because stakeholders have divergent expectations regarding the value a venture will create, entrepreneurs search for the lowest price resource provider (stakeholder) based on who has the lowest expectations of future material outcomes.

In contrast, we explain that under the assumption of bounded self-interest the entrepreneur and the prospective stakeholders will use more than material costs and benefits in their evaluation of who to engage in transactions. We argue that entrepreneurs and stakeholders will choose to engage with actors who possess expectations of distributive, procedural, and interactional fairness that are complementary with their own expectations. When two parties in an exchange have complementary expectations of fairness, neither party is motivated to negatively reciprocate toward the other. So the best strategy for an entrepreneur is not to pick the stakeholder who has the most divergent future expectation to his/her own, but to pick the stakeholder who has the most convergent expectation of fairness.

Many new entrepreneurs select family and friends as their stakeholders. We see this as an example of Revised Proposition 1. Friends and family, by definition, have preexisting relationships with the entrepreneur so they have knowledge of his/her pattern of fairness, exhibited in terms of distributive (e.g., generosity), procedural (e.g., patterns of decision making), and interactional fairness (e.g., respect). Likewise, knowledge of how potential friends
and family stakeholders behave enables the entrepreneur to judge which ones are ideal prospective stakeholders for the new venture. This compensates for a portion of the exogenous uncertainty about material outcomes for both parties. The entrepreneur is highly motivated to behave in a manner that will be perceived as fair to the stakeholders, and they are highly motivated to do what they can to make the venture a success. In a sense, family and friends offer an extreme case of complementarity, although we expect the phenomenon to be evident to a lesser degree in most entrepreneurial decisions regarding selection of stakeholders.

The second foundational proposition is about what entrepreneurs offer prospective stakeholders in order to generate more rent. Pure self-interest suggests that entrepreneurs provide only material value to stakeholders and that they should therefore offer the minimum material value required to engage them. However, under the assumption of bounded self-interest this would not generate the most rent possible. Instead, offering the least possible material value while ignoring procedural and interactional value considerations could initiate negative reciprocity from a stakeholder that would be costly. In a world of boundedly self-interested actors, entrepreneurs can reduce the uncertainty of “returns” to a stakeholder by promising procedural and interactional fairness that he/she can determine, and he/she offers a fair distribution of whatever material value they ultimately create together. Stakeholders who are uncertain about the material outcome, but comfortable that they will receive procedural and interactional fairness, are likely to accept a lower price for their resources, all else equal. This revised proposition provides a plausible explanation for why so many entrepreneurs with limited resources are, in fact, able to access the resources necessary to pursue an opportunity and generate rent.
This line of reasoning also implies that the ex post distribution of value is not entirely established ex ante in a bounded self-interest world. The material value that is created by the entrepreneur depends in part on the way stakeholders are treated. Stakeholders give more effort and resources when they are treated fairly, and less effort and resources when treated unfairly. As a result, entrepreneurial rent is larger when the entrepreneur can get stakeholders to positively reciprocate. This logic emphasizes the collective nature of entrepreneurial opportunity creation, suggesting that the entrepreneur and his/her earliest stakeholders have highly interdependent roles in creating and exploiting an opportunity together (Harper, 2008).

Our theory underscores the importance of the reputation of the entrepreneur, even in the early stages of a first venture (Fischer and Reuber, 2007). A reputation for fairness can facilitate acquisition of resources and reduce their material costs (Barney and Hansen, 1994). Alternatively, a tarnished reputation can make resources very expensive or even make impossible the acquisition of sufficient resources to initiate the venture (Zahra, Yavuz and Ucbasaran, 2006). The ideas in this paper suggest that an entrepreneur should be very careful about projecting the right image with regard to fairness considerations. This argument may partially explain the existence of serial entrepreneurship. An entrepreneur who exhibits fairness towards stakeholders in a first venture will be in a much stronger position to obtain resources for the next venture. Furthermore, those resources may cost less because of his/her earned reputation for fairness.

After the entrepreneur has begun collecting market feedback about the actual material value of the venture, the third proposition formed under an assumption of pure self-interest is that being opaque with stakeholders about this information results in more rent creation for the entrepreneur. Under bounded self-interest, however, entrepreneurs do not withhold information
about the true value of their stakeholders’ contributions because this is an unfairness that providers will penalize upon discovery. Instead, entrepreneurs openly share information about the true value of their stakeholders’ contributions and information about the venture as a whole. This reduces uncertainty and can motivate stakeholders to share nuanced information with the entrepreneur that can lead to still higher levels of rent creation.

The revised propositions included in this paper are consistent with a statement from Baker and Pollock who, during a review of the literature at the intersection of the entrepreneurship and strategic management fields, suggest “research in entrepreneurship has consistently provided empirical support for the continued importance of values and goals besides maximizing short-term profitability in shaping entrepreneurial activity (2007: 300).” In this paper we have deliberately avoided a normative perspective; however, we openly acknowledge that the values associated with fairness have a strong moral foundation. We suggest that this paper provides a foundation for future research on how nonmaterial considerations affect entrepreneurial rent creation.

On a broader scale, we question whether a comparison of ex ante costs and ex post material outcomes really captures the success of an entrepreneurial venture. In a world of bounded self-interest, two major things can happen to distort this measurement. First, according to distributive fairness, an entrepreneur may distribute more of the material outcomes to stakeholders who have contributed the most to the success of the venture if the ex post material outcomes are great. In essence, rent appears smaller than would otherwise be the case because it is widely distributed (Coff, 1999). Second, actors accept nonmaterial outcomes associated with procedural and interactional fairness as a part of their compensation. Rent itself would tend to have a nonmaterial dimension as the entrepreneur gains satisfaction from reciprocating with
certain stakeholders. The entrepreneur may also justify such behavior as building relationships to facilitate acquisition of resources for future ventures.

Another potentially fruitful area for future examination is the application of the bounded self interest assumption to the question of managerial discretion and nexus rents presented by Phillips et al. (2011, *this volume*). If the entrepreneur chooses to interact with potential stakeholders in the ways described above under the pure self interest assumption, our analyses and theories likely underestimate how much stakeholders can constrain those entrepreneurs. The bounded self interest assumption, because it draws attention to the initiation of reciprocal behavior among stakeholders, helps to highlight stakeholders’ influence on the entrepreneur’s discretion (or the constraints on his behavior).

Moving forward, in-depth study of entrepreneurial resource acquisition can help shed light on these issues. Case studies and surveys that include an examination of fairness issues would be useful in ascertaining the decision-making processes of entrepreneurs and their stakeholders during and after venture formation (also suggested by Jones, 2011, *this volume*). Which nonmaterial factors do entrepreneurs and stakeholders consider as they decide who they will engage? How do entrepreneurs and stakeholders trade off material and nonmaterial costs and expected outcomes? How and to what extent does full performance information disclosure influence the behavior of stakeholders ex post? These questions provide fruitful areas for future empirical research.

In conclusion, this paper questions some of the fundamental propositions that can be derived from the assumption of pure self-interest on the part of entrepreneurs and stakeholders as a venture is formed to pursue an opportunity. The underlying premise is that nonmaterial considerations are a potent force in the resource acquisition process and in the management of
performance information after the venture is initiated. We suggest that reciprocity and fairness considerations are important to the decisions that entrepreneurs make regarding their stakeholders as well as the material and nonmaterial outcomes of the venture. Consequently, entrepreneurs should be very careful about the stakeholders they choose, their first interactions with those potential stakeholders, and how they manage performance information after the venture is started. Entrepreneurial rent may increase as a function of the fairness exhibited by both entrepreneurs and their stakeholders although such increases may be hard to detect because fairness also means that more value is likely to be allocated back to stakeholders.
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