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IMPRESSION MANAGEMENT AND REPUTATION DEFENSE IN

19TH CENTURY CREDIT RATING

Kelly Lee Patterson, Ph.D.

Cornell University 2013

I focus empirically on credit rating decisions by local offices within a prominent 19th Century credit rating agency, as the organization, as a whole, responded to external threats. Findings from this study show that the heightened accountability of reported performance feedback is an important factor shaping the nature of lower-level organizational response to evident failures in decision-making processes. Public failure, which engenders threat to the organization, heightens the need to justify decision-making processes at the local level. Though, these legitimacy-driven responses led to poorer quality decisions and less functional information.

Category: Sociology: Organization Theory: Small Business Rating

Keywords: Credit Rating, Entrepreneurship, Impression Management

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Executive Summary

Research on markets and organizations reveals that the attempt to evade an audience and cloud its perceptions is not an uncommon phenomenon. There certainly has been no dearth of research exploring the ways and conditions under which organizations manipulate audience cognition by distorting information. On the edge of organizational theory, studies ranging from literature in marketing on persuasion and customer attraction (e.g., Gardner 1975) to more critical studies of fraud and deception (e.g., Baker and Faulkner 1993; Galbraith 2004) examine the active management of constituent attitudes and sensitivities through information content and access. More centrally, institutional theory studies of decoupling and symbolic management (Pfeffer 1981; Perrow 1985; Westphal and Zajac1994 2001), as well as impression management studies of spokesperson intervention and "sense-giving" maneuvers (Sutton and Callahan 1987, Elsbach et al. 1998), tie firms' choices of structures, strategies, and tactics to the need to "mask or distract attention from controversial activities" (Elsbach and Sutton 1992:700; see also Meyer and Rowan 1977).

I examine information distortion as it relates to socially-constructed reputations in markets (Merton 1968; Rao 1994) – reputations that depend on performance as well as attention to building and maintenance, which builds on previous work that examines legitimacy and its relationship to performance and conformity behavior (Aldrich and Fiol 1994; Phillips and Zuckerman 2001). What sets this study apart, however, is its emphasis on the recognition of poor performance versus success. I show how a firm will engage in conformity and legitimacy-seeking behavior to mask poor performance, softening its impact on a firm's reputation – even when this legitimacy-seeking behavior erodes performance even further.

In this study, I examine mid-19th century small firm credit reporting – during a time when reporting professionals at a major reporting agency were addressing the inevitability of their own poor performance. I provide evidence to show how these ratings experts, concerned with averting scrutiny of an emerging reporting format, intentionally distorted published evaluations through shifts in evaluation criteria, manipulation of evaluation outcomes, and changes to the information collection and recording process. I submit that these distortions were designed to fend off criticism of newly (and reluctantly)-introduced credit ratings, minimizing reputational damage during periods when the visibility of these evaluations is particularly high.

In my setting, I observe that a credit reporting firm used distortion to avert controversy at two key moments: (a) at the time of the release of this new, inferior credit reporting format and (b) at the time of extreme public censure following the release. For this firm, building and maintaining its reputation during the earliest, formative years of the credit reporting industry required managing the reporting process to help distance itself from anticipated audience challenges (e.g., media scrutiny, litigation) that threatened to erode market share and legal protection.

Research Setting

The emergence of credit-rating agencies in the 19th century represents one of the earliest attempts to solve a growing information asymmetry problem in the market for commercial credit. With the improvement of transportation and communications technology during this period, the ability to conduct trade beyond local networks grew. Local exchange partners could get by with easily-gathered local information and informal credit assessments. However, as chains of commercial credit expanded, business owners needed credit reporting intermediaries with agents in the field to inspect and appraise smaller merchants in distant areas (Norris 1978). Located in offices all across the country, these credit-rating agencies supplied much-needed summary surveillance information to eager merchants for purposes of trade finance and investment. That is, these agents provided information to merchants concerned with the likelihood that a trading partner will default (fail to meet a debt obligation). These experts played an especially important

role in emerging U.S. geographic markets. Powerful merchants in Northeastern cities were rapidly expanding their trade networks in the Western United States and in the South. Here, information asymmetry was especially acute, due to geographic distance, cultural differences, and scarcity of personal ties (Carruthers and Cohen 2006; Oligario 2006).

The Mercantile Agency was one of the early credit reporting pioneers. Founded by Lewis Tappan in 1841 and then later managed by Robert Graham Dun in the mid-1850's, the RG Dun Mercantile Agency ("Dun") sent out its cadre of local agents to provide appraisals of the creditworthiness of would-be borrowers. Through direct experience, word of mouth, and letters of recommendation, all methods used previously by merchants in local transactions, this vast network of reporters allowed trading partners to assess large numbers of entrepreneurs in distant markets. As noted by the agency some time later, "the local agent . . . having his eye upon every trader of importance in his county, and noting it down as it occurs, every circumstance affecting his credit, favorably or unfavorably, becomes better acquainted with his actual condition than any stranger can be" (Norris 1978).

Censure of 19th Century Reporting Agencies

Though credit reporting firms such as R.G. Dun and Co. were important in solving problems of information asymmetry caused by nationwide shifts in the nature of trade during the 19th Century, the credit reporting process was not safe from criticism. Narratives found in reports were, at times, blurry and ambiguous -- especially in cases where information was hard to come by. At times, Dun and Co. had to face accusations (mostly from subjects of appraisals) that its reports were flawed and even slanderous. To be fair, entrepreneurial activity during this time – particularly in the decades following the Civil War – was fraught with uncertainty and risk, and even firms with the greatest potential failed. Local knowledge was difficult to convey under these circumstances, and crafting the most careful, deliberate, and unbiased report was undoubtedly a challenge. Nonetheless, the public continued to criticize the reporting, assigning, and updating of ratings by

local staff. Even ratings scores themselves were thought to be crude and flat, with an arbitrary feel to them in their lack of texture, if not non-contextualized manifestations of differentially biased ledger reports (Norris 1978).

Public Censure as Catalyst for Response

Research shows that actors can enhance the way the public perceives them through strong endorsements and public recognition by highly-regarded others, such as the press, credentialing organizations, trade associations, and regulatory institutions (Ruef and Scott, 1998; Jensen and Roy 2008). These well-publicized boosts in credibility act as a form of validation (Rao, 1994), even in cases where they do not necessarily provide new information about the firm (Rindova et al, 2005). As news of public endorsement circulates, it strengthens the generalized belief of an expert's quality (Barney, 1991; Hall, 1992; Deephouse and Suchman 2008), stakeholders feel more secure in building relationships, and customers feel more comfortable paying a premium for services rendered (Bromley, 1993; Fombrun, 1996). News of public censure, on the other hand, has the opposite effect of damaging credibility, and if negative publicity is left to circulate, perceptions of quality will likely fade (King and Pearce, 2010). Being singled out for poor performance, however, can be an effective mechanism for triggering a problemistic search – a search for strategies to restore public comfort and confidence. As Zajac and Westphal (1994) suggest, negative signals of quality from external audiences can grab a scrutinized firm's attention, prompting immediate corrective action.

Limits to Response

While motivated to take action, a firm that faces public censure quickly finds itself in a unique situation that limits the range of corrective action it can take. First, it is limited in its ability to demonstrate performance improvement. With time it has the opportunity to provide admissible

evidence of reliability and competence, reestablishing or reasserting professional standing; however, it bears the immediate burden of signaling to its stakeholders that its poor performance will not continue. This elevated sense of urgency to "fill the void", so to speak, reduces the firm's ability to properly search for a performance improvement solution to effectively assuage its critics (Suchman, 1995). Consequently, its immediate focus shifts from improving technical processes to managing the perception that processes are sound (Perrow, 1984; Ashforth and Gibbs, 1990). As Suchman (1995) suggests, the firm must build an immediate "firewall" between past censure and ongoing credibility-building. These symbolic gestures serve to validate its processes more expeditiously than building a reputation for quality, even when such action has no real impact on performance (Boeker, 1992; Phillips and Zuckerman, 2001; Uzzi and Lancaster, 2004).

Second, the firm facing public scrutiny may have more success with some gestures than with others. Any strong, self-promotion tactics following negative publicity may be hazardous, since they would likely be viewed as forced, superficial, or manipulative (Ashforth and Gibbs, 1990). Institutional theory suggests that, rather than actively broadcasting a counter-message from a tainted source, a publically-failing organization would probably have more success shaping public opinion by minimizing the extant negative message – what Suchman (1995) labels a "normalizing" strategy. Rather than fighting fire with fire with a broken match, so to speak, a firm battling negative publicity might be better served removing the coals fueling the other flame.

Minimizing Salience

Managers of scrutinized firms can engage in anticipatory tactics as one way to protect themselves from possible future, negative reactions to criticism. Rather than flooding potential critics with relevant information, reducing an audience's ability to process these cues, they likely work to minimize their salience in the eyes of their critical audience. That is, rather than overloading processing, they likely avoid stimulating this processing in the first place. As research

shows, the salience of actors in social contexts affects how they are perceived by others (McArthur, 1981). Not only are more prominent actors perceived as being more influential, they are subject to more extreme evaluations than their less salient counterparts (Taylor and Fisk, 1978). Research on reputation formation shows that more salient actors attract more attention; therefore, audiences learn more about them and are more likely to form opinions that are consistent with behavior (Anderson and Shirako, 2008). Moreover, behavior by more salient actors is more likely to "stick" – persisting beyond the point of interaction (e.g., Merton, 1968). This can be beneficial, as it can provide the more prominent actor a broader base of support (Burt, 2001). On the other hand, this can be a handicap, as those under the microscope are more likely to build an unfavorable reputation when engaging in controversial behavior (Taylor and Fiske, 1978; Anderson and Shirako, 2008).

While limited in scope, research does suggest that actors manipulate their salience to avoid scrutiny (e.g., Van Maanen, 1975). The current study builds on this idea, suggesting that credit rating agents do so when subject to negative publicity. Specifically, they manipulate the salience of their ratings as way to preemptively manage impressions, lowering the risk of heightened criticism. This involves two steps: 1) minimizing the number of changes to ratings themselves, as well as 2) shifting the weight of certain ratings criteria toward those that are more legitimate as a way to legitimize the ratings process.

Discussion of Results

Analyses included in my study provide evidence to suggest that, when facing heightened accountability, decision-makers may adopt both signaling and filtering strategies to avoid unwanted attention. Regression results show how ratings professionals preemptively demonstrated legitimacy through the use of external decision-making criteria to assign potentially controversial ratings. A second set of results show how these professionals manipulate outcomes as well as the means under these conditions, minimizing the number of changes to reduce their

signature. Together, these results support the claim that organizations may “use preemptive impression management to affect specific audience behaviors associated with routine organizational events that are ambiguously negative” (Elsbach et al. 1998:69).

What makes this evidence of anticipatory signaling and filtering particularly meaningful is that Dun professionals are taking steps here to avoid confrontation – steps that do not necessarily serve to better predict underlying fitness. As a third set of results begin to show, as Dun professionals reacted to heightened accountability, the quality of their ratings eroded.

In this study, I examine mid-19th century credit reporting and how credit reporting professionals addressed their own poor performance. Through an inspection of reporting formats, I provide evidence to suggest that these experts do try to blend in by distorting their reports and manipulating their data collection and reporting procedures. Furthermore, this evidence suggests that these reputation-preservation tactics do appear at moments when they were at risk of being singled out. That is, when accountability pressure – the pressure to justify decisions and outcomes – was heightened, they tried to mask their poor performance by minimizing their own informational signal. When they needed to disappear most, impression management tactics appeared.

By blending in, they tried to avoid anticipated audience challenges (e.g., media scrutiny, litigation) that threatened to erode market share and legal protection. In doing so, however, they sacrificed the quality of their reporting formats. This environmental change and the immediate reaction to it by agents at Dun represents a unique opportunity to study how sharp changes in the environment can affect the behavior and performance of expert organizations – institutional actors that provide a central role in the healthy functioning of mediated markets.

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