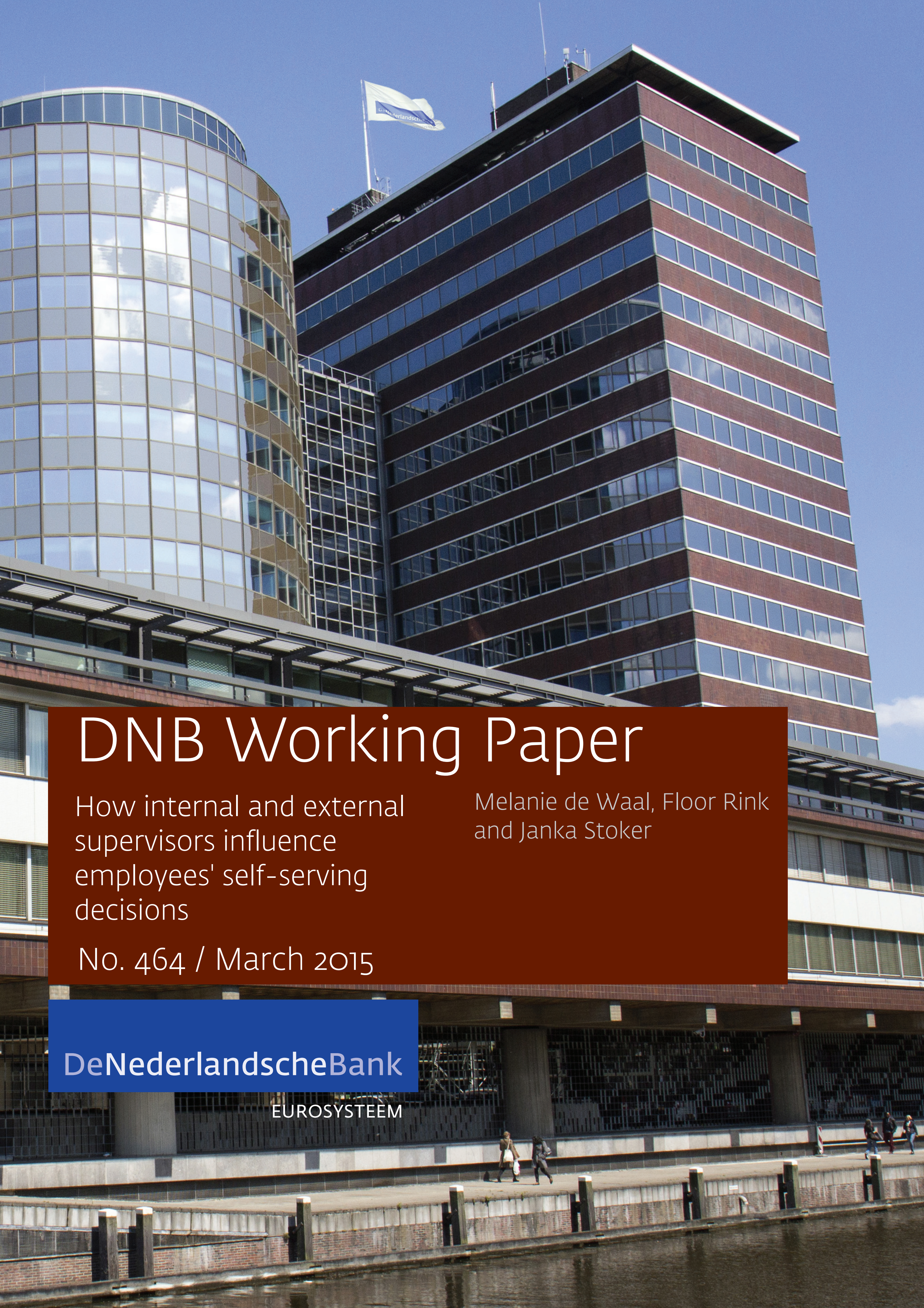

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* Views expressed are those of the authors and do not necessarily reflect official positions of De Nederlandsche Bank.

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How internal and external supervisors influence employees' self-serving decisions *

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Abstract

The current investigation examined the effects of internal and external supervisors (i.e., formally installed institutions that hold employees accountable for their actions) on employees' self-serving decisions. In two studies, it was found that internal supervisors reduced self-serving decisions more strongly than external supervisors did because they hold more position power over employees. The findings further suggest that the presence of both supervisors did not provide additive advantages, as employees primarily responded to internal supervisors. We discuss the theoretical and practical implications of these findings.

Keywords: self-serving decisions, internal supervision; external supervision, power bases.
JEL classifications: G30, D23, C93.

* Views expressed are those of the authors and do not necessarily reflect official positions of De Nederlandsche Bank.
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INTRODUCTION

A number of scandals have shown that employees can make self-serving decisions that are not in the interests of their organization's goals or in the interests of society with disastrous consequences (De Cremer & Van Knippenberg, 2004; Howell & Shamir, 2005). The Libor case in 2012, for example, revealed that in as many as twenty banks, employees had manipulated the most commonly used interest rate used for financial products to receive a large bonus on the profits (i.e., the Libor rate; Financial Times, 2013). As this interest rate is used to calculate prices that customers pay for loans and influence the credits customers receive for their savings, this case raised a fierce public debate on how these banks could restore trust in those who work for them.

In order to prevent employees from making self-serving decisions, many organizations appoint internal supervisors that lay down rules for proper practices (i.e., codes of conduct) and control employees' work actions (Treviño, Den Nieuwenboer, Kreiner, & Bishop, 2014). Yet after the financial crisis the political response was to further strengthen the power of external, independent supervisors who can monitor the risks that organizations pose on their customers and the stability of the financial system (Wouters & Van Kerckhoven, 2011). Advocates of this call assume that employees will be consciously aware that their organization has to justify her outcomes to these external supervisors, and will adapt their behavior accordingly. It remains to be investigated, however, whether internal and external supervisors are both equally effective in reducing employees' self-serving decisions on a day-to-day basis. The current research therefore sets out to answer this question.

In two studies, a field survey and a scenario experiment, we find that external supervisors are able to exert some effect on employees' self-serving decisions, but this effect is weaker than the effect of internal supervisors. Internal supervisors influence the extent to which employees make self-serving decisions more strongly because employees believe that internal supervisors can instantly reward or punish them for their behavior (i.e., hold position power over them, French & Raven, 2001). Employees thus feel that their position is more dependent on the evaluations of internal supervisors than on the evaluations of external supervisors.

The research presented in this paper contributes to existing literature in two important ways. First, external supervisors have a significant role in monitoring and controlling organizational actions and in this capacity influence organizational outcomes or CEO behavior (e.g.,Barth, Caprio & Levine, 2004; Walsh & Seward, 1990; Westphal, 1998). However, literature in the area of corporate governance has not yet directly examined whether external supervisors also have a direct impact on the daily work decisions of employees operating at lower levels within the organization (Laeven & Levine, 2009; Hambrick & Mason, 1984). By contrast, research in organizational behavior did examine how organizations can prevent such individual employees from making self-serving decisions (Barreto & Ellemers, 2000; Smith & Louis, 2009). Yet this stream of literature advocates that *internal* supervisors, who can directly and constantly monitor the everyday activities of employees, should be particularly effective in reducing their self-serving decisions (e.g., Brass, Butterfield & Skaggs, 1998). Although these different theoretical developments reflect the topic's relevance across multiple disciplines, they also indicate that research to date has examined the effectiveness of each supervisory body at different levels of analyses (i.e., organizational and CEO level vs. individual employee level). By conjointly examining the influence of internal and external supervisors on employees' self-serving decisions, the present research aims to integrate the two streams of literature to offer a broader, more conclusive viewpoint on this matter.

Second, this research also examines *why* employees are affected differently by internal and external supervisors. We propose that employees' beliefs that they are dependent on a supervisor (in terms of receiving resources or getting punished) drive their motivation to reduce self-serving decisions (Emerson, 1962). Knowledge on this underlying process is critical as it will provide valuable insights into the psychological foundations of employee behavior and informs society why certain forms of control, or power bases, influence employees more effectively than others.

THEORETICAL FRAMEWORK

Why Supervision is Needed

Employees' work decisions often reflect judgments that are influenced by self-interest and that seem indefensible to others. Such self-serving decisions tend to be caused by general psychological pressures, such as people's tendency to process information in manners that support their pre-existing views (e.g., the self-serving bias, Haidt, 2001). However, also organizational pressures, like certain incentives or work structures, can persuade employees to engage in actions that maximize their own utility (Dowd, 2009).

Given that employees' self-serving decisions tend to be detrimental to the collective (Pitesa & Thau, 2013), there is general agreement among practitioners, policy makers and scientists that their actions should be monitored closely. Supervisors execute this monitoring process; they are formally installed to hold employees accountable for their decisions (Bovens, 2005; Frink & Klimoski, 1998). Supervisors thus require employees to explain their activities in a transparent manner and to justify their conduct (Lerner & Tetlock, 1999**).**

There is abundant empirical evidence that employees indeed make less self-serving decisions when they are held accountable for their behavior (De Cremer & Bakker, 2003; De Cremer, Snyder & DeWitte, 2001; Kerr, 1999; Lerner & Tetlock, 1999). Given that people have a basic human need to get approval from others (Baumeister & Leary, 1995), they tend to experience self-presentational concerns to perform well when their behavior is being monitored (Baumeister & Hutton, 1987). Nonetheless, having supervision in place does not always establish desirable effects. For example, some studies show that employees who have to justify their decisions to supervisors can also behave relatively strategic; they merely depict a more positive image of their accomplishments but do not change their behavior substantially (Frink & Ferris, 1998; Lerner & Tetlock, 1999). Accordingly, more research is needed to understand what type of supervision will reduce the likelihood that employees make self-serving decisions.

Some scholars have argued that effective supervision is contingent on the *kind* of behaviors that employees are held accountable for (Pitesa & Thau, 2013; Lerner & Tetlock, 1999). Indeed, there are studies demonstrating that employees make significantly fewer self-serving decisions when they have to justify the process through which they reached their work decisions (i.e. procedural accountability), than when they only have to account for the quality of those outcomes (i.e., outcome accountability; Siegel-Jacobs & Yates, 1996). So when employees are also held accountable for how they arrive at their actions, they make a more even-handed evaluation of alternatives (Pitesa & Thau, 2013). Scholars have started to use these findings as a point of departure to propose that effective supervision may also depend on *who* is monitoring employees (Frink & Klimoski, 2004; Pennington & Schlenker, 1999). Indeed, employees often have to justify their actions to supervisors outside their organization (e.g., to government agencies, external regulators and/or governing committees; Abelman, Elmore, Even, Kenyon & Marshall, 1999) and/or to supervisors inside their organization (e.g., to internal audit committees, compliance departments and/or supervisory boards; Frink & Klimoski, 2004). The main goal of the present research is to compare the influence of these external and internal supervisors on employees' self-serving decisions.

The Power of Internal and External Supervisors

External and internal supervisors both control important resources upon which organizations and employees depend (Brass et al., 1998; Frink & Klimoski, 1998; Milgram, 1963).

External supervisors have legitimate authority to sanction organizational operations (Adams & Ferreira, 2012) and to change organizational and incentive structures and replace top managers (Barth et al., 2004). Moreover, external supervisors are often commissioned by important organizational stakeholders, such as governments (Lerner & Tetlock, 1999; Tetlock, 1992). Studies on corporate governance demonstrate that external supervisors therefore tend to reduce negative organizational outcomes, such as organizational risk-taking (e.g. Leaven & Levine, 2009), and enhance a collective focus among the organization's board of directors (Hambrick & Mason, 1984). As said, because of these positive effects at the organizational and top management level, corporate governance research seems to assume that external supervisors also will influence employees daily work decisions. It is important to note, however, that this link is not made explicit in corporate governance research and this assumption has never been tested empirically.

Internal supervisors also operate under order of important stakeholders and can control organizational operations, incentive policies and managerial positions (Finkelstein, 1992; John & Senbet, 1998). In addition, internal supervisors can engage in frequent contact with employees, and can thus build personal relationships with them. We propose that this possibility gives internal supervisors more power than external supervisors who can only monitor employees indirectly and infrequently (see Brass et al., 1998; Foucault, 1982; Haslam, 2004; Stigler & Friedland, 1962). This proposition resonates with social psychological research demonstrating that most employees are influenced more strongly by the opinions of fellow organizational members than by opinions of outsiders (Brass et al., 1998; Gino, Ayal & Ariely, 2009) because they feel committed to their organization and its representatives (Ellemers, De Gilder, & Haslam, 2004).

Importantly however, our premise is also supported by literature suggesting that internal supervisors, because of their unique position within an organization, have more specific options to sanction or reward employees' daily work activities than external supervisors (Brass et al., 1998;

French & Raven, 2001). Some social psychological studies have indeed also found that employees feel highly dependent on internal supervisors for gaining certain organizational resources, such as promotions or incentives (Hillman & Dalziel, 2003). We therefore present the following hypotheses:

Hypothesis 1. Internal supervisors reduce employees' self-serving decisions more strongly than external supervisors.

Hypothesis 2. Internal supervisors hold more power over employees than external supervisors.

Hypothesis 3. Internal supervisors' power level mediates the relationship between presence of internal supervisors and employees' self-serving decisions, such that internal supervisors' higher power explains their stronger influence on reducing employees' self-serving decisions.

Note that we do not hypothesize that external supervisors exert no effects on employees at all. External supervisors do have legitimate authority to sanction employees' self-serving decisions, so they should influence employees' work actions, at least to some extent. We solely expect that employees perceive internal supervisors to be more powerful, and hence reduce their self-serving decisions more strongly, than external supervisors.

Finally, as organizations and policy makers can of course also (and often do) present employees with both internal and external supervisors (Walsh & Seward, 1990), we will also examine their joint effects on employees' self-serving decisions. We do this for explorative reasons as to date, little is known about the effects of their combination (Green, Visser, & Tetlock, 2000). On the one hand, corporate governance scholars argue that a combination of both supervisors should have an additive effect and be most effective in reducing employees' self-serving decisions because they can then compensate for each other's weaknesses (Adams & Ferreira, 2012; Walsh &

Seward, 1990). On the other hand however, social psychological literature suggests that internal supervisors, with their relatively high level of power, may already offer such strong guidelines to employees on how to behave that adding external supervisors may have little surplus value (Ellemers, van Rijswijk, Bruins & De Gilder, 1998). Indeed, although there is research demonstrating that external supervisors can change top management strategies and organizational outcomes (Barth et al., 2004, Beck, Demirguc-Kunt, & Levine, 2006; Booth, Cornet & Tehranian, 2002), evidence of their effects on individual employee behavior is relatively limited (Louis, Taylor, & Douglas, 2005).

Overview of Studies

We executed two studies to test our predictions. The first, cross-sectional study was conducted among a large working population to get initial insights in the extent to which lower-level employees recognize that they have to justify their work actions to internal and external supervisors. This study further assessed whether employees perceive both supervisors to hold power over them, and demonstrate a tendency to adapt their self-serving decisions accordingly. Study 1 thus allowed us to observe whether there is a natural relationship between employee decisions and the presence of internal and external supervisors, without interference of specific organizational or task conditions. Study 2 was conducted among financial managers and used a scenario methodology to confirm the causal direction of our predicted effects. Moreover, by using an experimental design, we could also make a more systematic comparison of the power bases of the two supervisors. The financial managers were asked to solve an investment dilemma in which they had to choose between their personal and the organization's interests (Komorita & Parks, 1994). They were informed that they would be held accountable for their decision by either an internal supervisor, an external supervisor, or by both supervisors.

STUDY 1: METHOD

Procedure and Sample

The study was part of a large-scale research questionnaire presented to readers of *Intermediair*, a Dutch national magazine aimed at professionals. In total, 473 respondents received the questionnaire online in return for participating in a book-token raffle. However, 55 respondents were excluded a priori from this sample due to incomplete responses. This yielded a final sample of 418 respondents (247 men, 171 women, $M_{ag\ e=}$ 43.4 years). In terms of education, 43% had a Bachelor, 41 % a Master, and 9 % a Post doctorate or comparable. Of the participants 28 % worked in industry, 34 % worked in trade and commercial services, 30 % worked in non-commercial services, and 15 % worked in other sectors. About half of the respondents held a management position (50 %). Of this group, 24 % operated at lower management level, 20 % at mid-management level and 6 % at top management level.

Measures

Presence of supervisors. Employees' awareness of the presence of internal supervisors and external supervisors was measured with two single items (see Frink & Ferris, 1998): "I am held accountable for my work by the top management *within* my organization" and "I am held accountable for my work by a party *outside* of the organization". Both items were assessed on a 7-point Likert scale ranging from 1 ("*totally disagree")* to 7 ("*totally agree"*).

Self-serving decision. Employees' tendency to make self-serving decisions was measured with one dichotomous item; "When I experience conflict between my personal interests and the organization's interests at work, I tend to choose; (0) the organization's interests or (1) my personal interests". Accordingly, a higher score on this measure refers to more self-serving decisions.

Perceived power. The extent to which employees' perceived each supervisor to hold power over them was measured with scales consisting of two items each (see Lammers, Stoker & Stapel, 2009). For internal supervision, the items were: "To what degree do you think that top management has power in your organization" and "To what degree do you think that top management has influence in your organization". Together, these items represented a reliable scale (*r*= .82, p < .001). For external supervision, the items were: "To what degree do you think that external parties, such as external supervisors, have power in your organization?" and "To what degree do you think that external parties, such as external supervisors, have influence in your organization?". These items also represented a reliable scale (*r*= .83, p < .001). All questions were assessed on a 7-point Likert scale ranging from 1 ("*totally disagree")* to 7 ("*totally agree*").

Control variables. Past research has emphasized the critical role of an employees' gender, age and management level within the organization in how they respond to supervisors (e.g., Mulgan, 2000; Rus, Van Knippenberg, & Wisse, 2011). We therefore considered these employee characteristics as potential control variables in our analyses. Employees' age and gender were measured with the following two questions; "How old are you?" and "Your gender is; (1) Male, (2) Female". Employees' management level was assessed with four categories (1= non-management, 2= lower management, 3= middle management, 4= higher management).

STUDY 1: RESULTS

Descriptive Statistics

Table 1 presents means, standard deviations, and Pearson zero-order correlations for all study measures and control variables. This table shows that management position and age were positively correlated with employees' self-serving decisions. Age and gender were both associated with the perceived power of both supervisors. Interestingly, employees' awareness of the presence of internal supervisors was unrelated to their awareness of the presence of external supervisors, suggesting that the two supervisors are indeed believed to be distinct from each other. Table 1 further shows that the presence of internal supervisors was negatively correlated with employees' self-serving decisions, whereas the presence of external supervisors was not.

Hypotheses Testing

To test hypothesis 1, we conducted a logistic regression analysis. After entering the control variables, we entered the presence of internal supervisors and the presence of external supervisors as our main independent predictors, as well as their interaction term. There was no significant interaction between the two supervisors on employees' self-serving decisions (B = .02 , p = .61; R^2 = .11), but the results demonstrate that the presence of internal supervisors had a marginal significant negative effect (B = -.25, p = .09; R^2 = .11), whereas the presence of external supervisors did not affect their self-serving decisions significantly (B = .04, p = .83; R^2 = .11). Together, these findings suggest that internal supervisors may indeed reduce employees' self-serving decisions more strongly than external supervisors.

Insert Table 1 about here

To test hypothesis 2, we standardized all independent variables according to Aiken and West (1991) and conducted two moderated ordinary least square (OLS) regressions (one to predict the perceived power of internal supervisors and one to predict the perceived power of external supervisors). In both analyses, we first entered the control variables before including the presence of internal supervisors, the presence of external supervisors as well as their interaction term as our main independent predictors. The results of the first regression revealed that the perceived power of internal supervisors was only predicted by employees' awareness that these supervisors were present (B = .33, p < .05, R^2 = .07). There was no main effect of the presence of external supervisors (B = -.06, p = .39, R^2 = .07), nor an interaction effect of both supervisors (B = .-.06, p= .37, R^2 = .07). The results of the second regression showed a similar pattern for the perceived power of external supervisors. Their power level was mainly predicted by employees' awareness of their presence of external supervisors (B = .45, p < .05, R^2 = .12), and not by the presence of internal supervisors (B = .08, p = .30; R^2 = .12). There was, however, also an interaction effect of both supervisors (B = .18, p < .05, R^2 = .12), demonstrating that external supervisors were perceived to be most powerful when both external and internal supervisors were present.

Nonetheless, an additional multivariate repeated measure analysis on the perceived power of both supervisors with the presence of both types of supervision as within-subject factors demonstrated that participants' perceived the internal supervisors that were present to be significantly more powerful than the external supervisors that were present (F [1, 417] = 147.94, p < .001, η = .269). Hence, we found support for hypothesis 2.

To test our third mediation hypothesis, we first conducted another OLS regression to examine the extent to which the perceived power levels of both supervisors predicted employees' self-serving decisions. Only the perceived power of internal supervisors had a significant effect (B = -.39, p < .05, R^2 = .10; perceived power of external supervisors; B = .23, p = .12, R^2 = .10). A subsequent SPSS process macro that provides the bias-corrected and accelerated bootstrap confidence intervals for mediation effects (Hayes, 2012) confirmed that the direct effect of the presence of internal supervisors on employees' decisions became insignificant (B = -.19, p = .15) while the indirect effect of the perceived power of these supervisors became significant (B = -.08, SE = .04, p < .05, R^2 = .101; CI 95%= -.1783, -.0171, 5000 re-samples).

To further test the robustness of our effects, we also re-ran all analyses reported above without the control variables included. As expected, the exclusion of these variables did not change the results significantly

STUDY 1: DISCUSSION

The findings from Study 1 provide initial evidence for our hypotheses. The presence of internal supervisors was negatively, and more strongly related to employees' self-serving decisions than the presence of external supervisors because employees believed that internal supervisors hold more power over them than external supervisors. So, even though employees granted power to both supervisors when they were aware of their presence, employees particularly believe to be dependent on internal supervisors and this dependence drives their motivation to reduce self-serving decisions. Interestingly, this study provides a first indication that the presence of both internal and external supervisors does not affect the day-to-day decisions of employees. This tentatively suggests that there was no surplus value in combining both types of supervision.

An important strength of this first study is that we collected data among a large working population from real-life organizations operating in diverse business sectors. We therefore feel confident that our findings reflect natural relationships that extend to a broad range of employees working across different contexts. However, as Study 1 was cross-sectional in nature, we could not make causal inferences based on these results, or use different measurement methods to assess our constructs (Podsakoff, MacKenzie, Lee, & Podsakoff, 2003). To address these limitations, we conducted a second experimental study among financial managers in which we manipulated the presence of internal and external supervisors independently from each other and subsequently asked them to make a hypothetical investment decision.

STUDY 2

In addition to testing the causal direction of the proposed relationships, there were a few other reasons why we designed Study 2. First, the results from Study 1 suggest that external supervisors are less influential compared to internal supervisors; external supervisors did not exert an effect on employee decisions and were believed to hold less power than internal supervisors. Even though these findings were in line with our predictions, we consider it unlikely that external supervisors are completely incapable of motivating employee behaviour. After all, external supervisors represent quasi-legal institutions that can use rewards and punishments to control organizational activities. As such, external supervisors do hold legitimate or position power over organizations and their employees (French & Raven, 2001; Raven, Schwarzwald, & Koslowsky, 1998). So perhaps external supervisors did not have any influence on employees' self-serving decisions in Study 1 because we did not sufficiently capture this particular power base. In Study 2, we thus examined whether employees recognize what exact forms of control, or power bases, internal and external supervisors hold over them. Power literature focuses on two bases of power which can be based on either a formal division of roles (i.e., position power), or, on the basis of personal characteristics of the power holder (i.e., personal power; Yukl & Falbe, 1991). In other words, one can derive power from formal, authoritative functions or positions that are associated with the control and distribution of rewards and punishments (see also Kelman, 1974; French & Raven, 1959), or, from personal characteristics that enable a power holder to build personal relationships with employees (French & Raven, 1959; Ellemers e.a., 1998). We propose that internal supervisors can exert both position power over employees because they reward and punish them directly on the basis of their position *and* also have personal power to create shared commitment towards collective goals (Brass et al., 1998; Cole, Schaninger, & Harris, 2002), whereas external supervisors can only exert position power over employees through indirect rewards and punishments.

Second, although we propose that high levels of position and personal power represent the key mechanism explaining the effects we obtained for internal supervisors, some scholars suggest that internal supervisors may also be so impactful because they are simply more proximal to employees (Frink & Klimoski, 1998). So the influence of internal supervisors could ostensibly be caused by the mere fact that these supervisors are so close by, and engage in continuous surveillance, rather than that these supervisors hold a great degree of power over employees. To test this alternative explanation, we added a proximity measure to Study 2.

Finally, as we cannot draw firm conclusions about the effects of the presence of both supervisors on the basis of the results obtained in Study 1, we will examine their combination again in Study 2. The use of an experimental design in Study 2 allowed us to make a more systematic comparison between the independent and joint effects of the two supervisors.

STUDY 2: METHOD

Design and sample

This study used one factorial (supervisor: internal supervisor present/external supervisor present/both supervisors present) between-subjects design[1]. We recruited managers with work experience in the financial sector through snowball sampling, aiming for a minimum of 80 managers, but ended up with 63 managers from different organizations across Europe who filled in the questionnaire correctly. Of the managers, 29% was female (M_{age} = 38.79, *SD* = 13.02; $M_{\text{years of}}$

[1] We originally also designed a condition where both supervisors were *absent*. However, most of the managers who were assigned to this condition failed the checks because they were reluctant to believe that they did not have to justify their actions to some supervisory body. This condition was therefore removed from the study design. Previous research has reported similar difficulties in manipulating situations where people believe that they are not held accountable for their behavior (see Skitka, Mosier, Burdick, 2000).

$_{\text{work experience in financial sector}}$ = 12.42, *SD* = 11.42) and 94% held a college degree or higher. Significant proportions of the managers worked at the intermediate management level or higher (48%) and/or occupied a leadership position with formal supervision responsibility over 1 or more subordinates (56%). All managers participated voluntarily in the study, were randomly assigned to one of the three conditions and received all study materials online.

Scenario. The participating managers were presented with a hypothetical decision dilemma adapted from Pitesa and Thau (2013) where they had to decide how much money the organization should invest in a new business project. The project could be highly profitable due to its size and prospects, but also carried significant risks because its feasibility was difficult to estimate. The managers learned that they would get a sizeable bonus if the project would be successful. In case of failure, there would be no major personal consequences for the managers (e.g., job loss); only the organization's performance and market position would be at stake. As such, the investment decision implied a moral hazard in that the managers could maximize their own utility to the detriment of others (Kotowitz, 2008).

Supervision manipulation. After the manager read about the business project, we introduced a supervisor to whom they had to justify their decision (based on Frink & Ferris, 1998). In the internal supervisor condition, the managers learned that they had to justify their decision to supervisors *within* the organization who control whether they act in line with formal internal policy rules (e.g., the organizational management board or an internal audit committee). In the external supervisor condition, the managers learned that they had to justify their decision to supervisors from *outside* the organization who control whether they act in line with formal external legal rules (e.g., external regulators, tax supervisors or external accountants). In the condition where both supervisors were present, the managers received information about the internal and external supervisors (with the internal supervisors always presented first).

To test the effectiveness of this manipulation, managers had to answer three checks at the end of the questionnaire that contained our dependent measures (see Frink & Ferris, 1998; Siegel-Jacobs & Yates, 1996); (1)"I had to justify my investment decision" ; "I was held accountable for my decision by an internal supervisor"; (3) I was held accountable for my decision by an external supervisor". All questions had to be answered on a 7-point scale ranging from 1 ("*strongly disagree")* to 7 ("*strongly agree"*). The results of a series of one-way ANOVAs with condition as independent factor confirmed that across all three conditions, managers felt that they had to justify their decision, F (2, 59) = .980, p = .38, η^2= .03. Moreover, as intended, the managers in the internal supervisor condition (M= 5.90, SD= .85) and the managers in the condition where both supervisors were present (M = 6.14, SD = .48, p = .83) believed more strongly that they were held accountable by an internal supervisor than the managers in the external supervisor condition (M = 4.76, SD = 2.07), F (2, 59) = 6.44, p < .005, η^2= .179. By contrast, the managers in the external supervisor condition (M = 5.00, SD = 1.55) and the managers in the condition where both supervisors were present (M = 5.38, SD = 1.53) believed more strongly that they were held accountable by an external supervisor than the managers in the internal supervisor condition (M = 3.80, SD = 1.93), F (2.59) = 4.92, p < .05, η^2= .14. These results demonstrate that our manipulation was successful.

Measures

Self-serving decision. Managers' tendency to make self-serving decisions was measured with one continuous item; "How much money would you invest in the new business project?" The answering scale ranged from 0 Euros to 1.000.000 Euros. A higher score on this measure refers to more self-serving decisions since the investment of a large amount of money carried risks for the organization only, not for the managers. The managers could in fact benefit from this investment personally (in terms of a larger bonus) when the project turned out to be successful.

Perceived power bases. The extent to which managers' perceived each supervisor to hold *position power* over them was measured with the following four items developed by French and Raven (1959); "These supervisors can (1) influence my personal pay level; (2) influence whether or not I get a pay raise; (3) influence whether or not I get a promotion and (4) provide me with special benefits". Together these items formed a reliable scale ($\alpha = .94$). The extent to which managers' perceived each supervisor to hold *personal power* over them was also measured with four items from French and Raven (1959); "These supervisors can (1) make me feel valued; (2) make me feel like they approve of me; (3) make me feel accepted and (4) make me feel important as a person". These items also formed a reliable scale ($\alpha = .92$). All questions had to be answered on a 7-point scale ranging from 1 ("*strongly disagree")* to 7 ("*strongly agree*").

Perceived proximity. The extent to which managers' perceived each supervisor to be relatively close to them was measured with three self-developed items; (1) "I expect to meet these supervisors on a regular basis"; (2) "I expect to have personal contact with these supervisors.", and (3) "I expect to give personal updates to these supervisors". These three items also had to be answered on a 7-point scale ranging from 1 ("*strongly disagree")* to 7 ("*strongly agree*") and formed a reliable scale ($\alpha = .93$).

STUDY 2: RESULTS

Hypotheses Testing

The results on our dependent measures were obtained by performing a series of one-way ANOVAs with condition as the independent factor and managers' age, gender and management level as control variables. None of the control variables influenced the effects of the supervision manipulation on our measures, nor did the results change when these variables were excluded from the analyses. Their outcomes are therefore not included in the results reported below. See Table 2 for means and standard deviations of the dependent variables.

Insert Table 2 about here

Self-serving decision. The results of the ANOVA on managers' self-serving decision revealed an effect of the supervision manipulation (F [2, 59] = 3.87, $p < .05$, $\eta^2 = .12$). The managers were significantly less inclined to invest money in the business project (i.e. to make a decision that was less self-serving) in the condition with internal supervisors only (M = 402.500 Euros, SD = 355.215 Euros) than in the conditions with external supervisors only (M = 669.048 Euros, SD = 298.947 Euros) or with both supervisors present (M = 605.238 Euros; SD = 302.285 Euros; Tukey post hoc, $p < .05$ for the internal supervisors-only versus external supervisors-only contrast, $p > 1$ for the external supervisors-only versus both supervisors contrast). So, internal supervisors reduce managers' self-serving decisions more strongly than external supervisors (see Hypothesis 1). The presence of both supervisors did not yield a similar effect, a finding we will address in the discussion section below.

Perceived power bases. The results of the ANOVA on perceived position power of the supervisors revealed an effect of the supervision manipulation (F [2,59] = 5.40, $p < .01$, $\eta^2 = .16$). In the condition with external supervisors only, the managers believed that the supervisors had significantly less position power (M = 2.95, SD =1.55) than in the conditions with internal supervisors only (M =4.27, SD = 1.76) or with both supervisors (M = 4.63, SD =1.89; Tukey post hoc, $p < .05$ for the external supervisors-only versus internal supervisors-only contrast, $p > 1$ for the internal supervisors-only versus both supervisors contrast).

For personal power, the results of the ANOVA revealed a similar pattern (F [2,59] = 6.31, p < .01, η^2 = .18). In the condition with external supervisors only, the managers believed that these supervisors had significantly less personal power (M = 3.84, SD =1.60) than in the conditions with internal supervisors only (M = 5.17, SD = 1.38) or with both supervisors (M = 5.19, SD = 1.19; Tukey post hoc, p < .05 for the external supervisors-only versus internal supervisors-only contrast, p > 1 for the internal supervisors-only versus both supervisors contrast). Together, these results support hypothesis 2; internal supervisors are believed to hold more position *and* personal power than external supervisors. Interestingly, however, a combination of the two supervisors was also perceived to be relatively powerful.

Proximity. The results of the ANOVA on perceived proximity of the supervisors revealed an effect of the supervision manipulation (F [2, 59] = 7.25, p < .05, η^2 = .20). The managers believed that the supervisors were significantly less proximal to them in the condition where only external supervisors were present (M = 4.08, SD = 1.91) than in the conditions where only internal supervisors were present (M =5.18, SD = 1.29) or where both supervisors were present (M = 5.75, SD = .94; Tukey post hoc, p < .05 for the external supervisors-only versus internal supervisors-only contrast, p > 1 for the internal supervisors-only versus both supervisors contrast). These results demonstrate that internal supervisors are indeed perceived to be more proximal than external supervisors. It is worth nothing, however, that a combination of the two supervisors was also believed to be highly proximal.

Mediation. To test our mediation hypothesis that the higher power level (or multiple power bases) of internal supervisors explains why these supervisors reduce employees' self-serving decisions more effectively than external supervisors, we contrasted the conditions in which these supervisors were only present against the conditions in which they were absent (see Field, 2005).

An ‘internal supervision’ dummy was created by labelling the internal supervisors-only condition as “1” and the external supervisors-only condition as “0”. An ‘external supervision’ dummy was created by labelling the external supervisors-only condition as “1” and the internal supervisors-only condition as “0”. We subsequently used a bootstrapping technique developed by Hayes (2012) to test for multiple mediation patterns (see Model 4 of his process macro, Preacher & Hayes, 2008). With this technique, we could compare the explanatory value of the internal supervisors’ position power versus their personal power on employees’ self-serving decisions. The results revealed a significant indirect effect for position power (B = -103.122, SE = 72.666, $p < .05$; CI 95%= -312,909, -12.043, n = 41; 5000 re-samples), and not for personal power; (B = 13.108, SE = 58099, *ns*.; CI 95%= -89.568, 148.155). These findings suggest that the relationship between the presence of internal supervisors and managers’ self-serving decisions was primarily explained by the *position* power of these supervisors.

To test the alternative explanation, that proximity explains why internal supervisors are more effective in reducing managers’ self-serving decisions than external supervisors, we conducted a second multiple mediation analysis where proximity was added as a third possible mediator. However, we did not establish a significant indirect effect of proximity (Internal supervision dummy; B= -5.347, SE =47.459, *ns*.; CI 95%= -117.563, 80.562). Inclusion of this additional mediator variable also did not change the indirect effects of position and personal power significantly. Accordingly, the effectiveness of internal supervisors was not due to their degree of closeness to the managers.

Insert Figure 1 about here

STUDY 2: DISCUSSION

The results of Study 2 largely confirm our hypotheses; Internal supervisors reduced employees' self-serving decisions more effectively than external supervisors did because the employees believed that internal supervisors held more power over them. Interestingly, we proposed that internal supervisors hold two power bases over employees (i.e. both position and personal power) whereas external supervisors can only exert position power indirectly over employees. The results of Study 2 indeed support this proposition. In fact, employees believed that the presence of internal supervisors alone captured both power bases to the same extent as a combination of the two supervisors. However, the results also showed that only the ability of internal supervisors to reward and punish employees directly (i.e., their position power) explained their effectiveness. Moreover, it turned out that the combination of supervisors was less effective than the presence of internal supervisors alone, despite their equally high levels of power. We will elaborate on these issues in the general discussion below.

GENERAL DISCUSSION

In response to public calls to examine how employees can be prevented from making decisions that may harm their organization and customers, this research drew on corporate governance research and research in the areas of organizational behavior and social psychology to articulate a contingency theory of the relationships between the presence of internal and/or external supervisors and their degree of power on the one hand, and employees' self-serving decisions on the other hand. Across a large field survey and an experimental study we found that simply combining both supervisors does not provide a cumulative benefit. Instead, it was found that internal supervisors hold more power over employees than external supervisors and, by themselves, are more effective in reducing employees' self-serving decisions than external supervisors are or a combination of both supervisors. Study 2 demonstrated that the effectiveness of internal supervisors was *not* explained by their high level of personal power over employees or by their high degree proximity to employees. Instead, internal supervisors primarily decreased employees' self-serving decisions because they hold more *position* power over employees (at least more so than external supervisors). Indeed, whereas external supervisors can only reward and punish employees indirectly through organizational channels, internal supervisors have a direct impact on their rewards (e.g., promotions or incentives) and can punish self-serving behavior immediately.

Theoretical Implications

The findings presented in this paper have several important implications for existing theory. The findings imply, for example, that effective supervision is indeed not only contingent on the kind of behaviors that employees are held accountable for (Pitesa & Thau, 2013). Rather, effective supervision may also depend on *who* is monitoring employees (Pennington & Schlenker, 1999). Second, although scholars have related the power of internal and external supervisors to their ability to reduce employees' self-serving decisions theoretically (Rus et al., 2011), our research demonstrates this link empirically and shows that position power is more important than personal power in terms of influencing employees. So by explaining *why* employees are affected differently by internal and external supervisors, the findings have implications for the ways organizations may choose to control their employees.

Third, corporate governance literature seems to assume that external supervisors, through their influence at the organizational level, will also affect the day-to-day decisions of individual employees as well (Barth et al., 2004; Beck et al., 2006). Our findings imply, however, that their influence on employees is far more limited than the influence of internal supervisors, and as such, support research on organizational behavior and social psychology research suggesting that internal supervisors have more immediate control over the everyday activities of employees (Platow & Van Knippenberg, 2001).

Finally, our findings tentatively suggest that the combined influence of internal and external supervisors may not have any surplus value in influencing employees' self-serving decisions. In the sense that our results indicate that internal supervisors are more effective in reducing self-serving decisions than the combination of both supervisors. This stands in contrast to certain traditional viewpoints in the corporate governance literature, such as the idea that external supervisors will automatically make up for the pitfalls of internal supervisors and that their combination should therefore have a stronger effect (Becher & Frye, 2011). Based on our preliminary findings it seems that internal supervision is still the strongest force at play even when it is combined with external supervision.

Strengths, Limitations and Future Research

The current research has several strengths. First, we used different populations across our two studies; Study 1 used employees from a wide range of organizations, whereas Study 2 used financial managers. Second, we measured employees' self-serving decisions in broad terms (Study 1) *and* in relatively specific terms (i.e., investing in a risky business project which may harm the organization but not the self, Study 2). Third, we captured the naturally occurring relationships between internal and external supervisors, their power levels, and employees' decisions in Study 1 and established the causal direction of these relationships in Study 2. Finally, our findings largely replicated across the two studies, leading to greater confidence in the ability to generalize our findings.

Nonetheless, our research suffers from some limitations as well. For example, we did not go beyond observing employees' intentions to engage in self-serving decisions. So we recognize that future research could employ more objective data from employee behavior in order to further establish the validity of our findings.

Another limitation of our work is that we defined the presence of internal and external supervisors in relatively broad terms. In this way, we could ensure that all respondents, who worked in a wide range of different organizational contexts, were sufficiently familiar with the examples we provided. In doing so, however, we left out certain forms of internal and external supervision that apply to specific sectors. In the financial sector, for example, external supervision is organized by well-known national and international governmental, legal institutions, such as the Federal Reserve in the United States, that may be seen as more powerful than the external supervisors we exemplified in our research (e.g., tax supervisors and external accountants). It is therefore important that future research creates more certainty on when external supervisors impact on employees' decisions in these specific sectors and when they do not.

Moreover, given their joint occurrence in real life, we also examined the combined influence of internal and external supervisors on employees' decisions. We took an exploratory approach to this question as literature suggests that there are both benefits and downsides to their combination. But both studies showed that the combination of supervisors did not have surplus value, suggesting that organizations should primarily increase awareness among employees about the presence of internal supervisors who control them. We feel, however, that this result should be interpreted with care. After all, employees did believe that the two supervisors together held high degrees of position and personal power. One possible reason why employees did not reduce their self-serving decisions in this situation could be that the added presence of an external supervisor triggers employees to believe that the *organization* has to justify her actions to these supervisors, rather than they personally (Sinclair, 1995). Or, the combination of the two supervisors may confuse employees as to whom they have to justify their actions; to both supervisors simultaneously or to just one of them. Especially, when these supervisors have different norms and expectations this will make employees evade decision making altogether (Green et al., 2000). Accordingly, we acknowledge that more research into the combined effects of both supervisors is needed.

Finally, our research also raises the question of whether internal supervisors will have a lasting impact on employees' self-serving decisions if they primarily rely on their positon power. Although there is meta-analytical proof that the ability to reward and punish others directly indeed enhances cooperation (Balliet, Mulder & Van Lange, 2011), there is also research demonstrating that such surveillance has a negative side, particularly when used by agents within an organization (Subašić, Reynolds, Turner, Veenstra, & Haslam, 2011). More specifically, it has been found that power holders' use of position power tends to reduce followers' sense of autonomy (Pierro, Cicero, & Raven, 2008), which may hinder the internalization of, or the intrinsic motivation to demonstrate the desired behavior (Deci, Koestner & Ryan, 1999; Gagné,2003; Joussemet, Koestner, Lekes, & Houlfort, 2004). Hence, internal supervisors who predominantly use their positon power may yield mere compliance in the short term, but are unable to maintain control over employees in the long-run. It would therefore be worthwhile to re-examine the effects of internal and external supervisors on employee decisions with a longitudinal research design.

Conclusion and Practical Implications

In conclusion, the financial crisis and recent scandals, such as the Libor case, have emphasized the importance of effective supervision systems to control employee behavior. While there is general agreement among scholars in the field of corporate governance that independent, external supervisors will achieve this goal, the current research shows that internal supervisors, through their higher levels of position power, reduce employees' self-serving decisions more effectively. To effectively stimulate employees to act in the interest of the organization, rather than their own, it is particularly important that organizations pay attention to the governance and quality of internal supervision. We thus advise organizations to make more use of their internal supervisors and provide them with effective position power instruments to reach their full influence potential.

In most situations, however, both external and internal supervisors are present. In these cases, we advise external supervisors to collaborate closely with, and exert their influence through, internal supervisors and influence employees' day-to-day decision making indirectly. In this way external supervision can make more effective use of their capacity than by working independently from internal supervision. To do so, external supervisors can use their formal position to facilitate, strengthen and control the governance and quality of internal supervision in the organizations they supervise. For instance, external supervisors can assess the suitability of those individuals occupying these important internal supervisor seats.

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TABLE 1

Descriptive Statistics and Correlations among Variables and Control Variables in Study 1

Variables	Mean	S.D.	1	2	3	4	5	6	7
1. Age	43.43	9.62							
2. Gender	1.40	0.49	.28**						
3. Management level	1.83	0.96	-.19**	.30**					
4. Employees' self-serving decisions	0.16	.16	.10*	-.03	.18**				
5. Presence internal supervisors	4.81	1.59	-.03	.04	.02	.10*			
6. Presence external supervisors	2.90	1.86	.00	-.03	-.01	-.08	.08		
7. Power internal supervisors	5.31	1.33	-.12*	.05	-.04	.12*	.25**	-.03	
8. Power external supervisors	4.17	1.65	-.11*	.15*	-.10*	-.08	.07	.29**	.14*

n= 418 (listwise)

* $p < .05$

** $p < .01$ (two-tailed)

TABLE 2

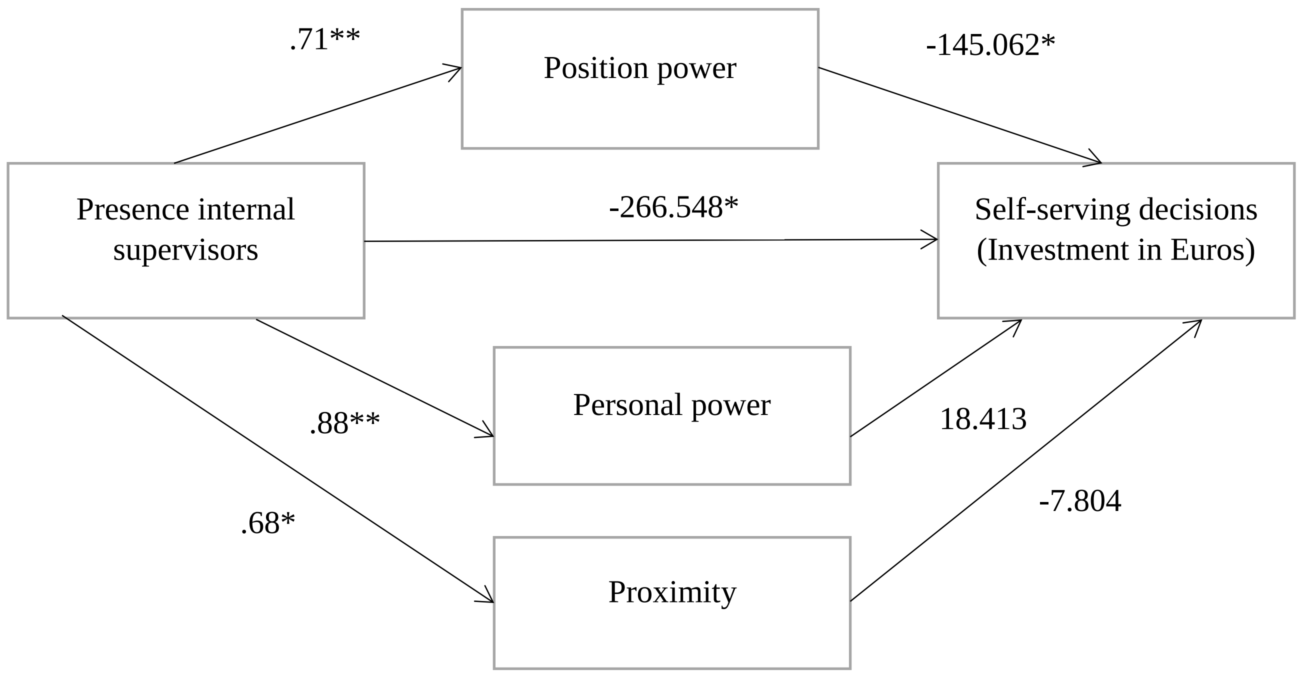
Descriptive Statistics and Correlations among Variables in Study 2

Variables	Mean	S.D.	1	2	3	4
1. Self-serving decisions	56.1451.63	33.3903.13				
2. Position power	3.95	1.85	-.36**			
3. Personal power	4.72	1.50	-.16	.51**		
4. Proximity	5.00	1.58	-.14	.35**	.43**	

n= 62
* *p* < .05, **
p < .01 (two-tailed)

FIGURE 1

Path Model for Mediation of Two Power Bases and Proximity in the Relationship between the Presence of Internal Supervisors and Managers' Self-serving Decisions.



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