Attitude towards Risk and Entrepreneurship Development in Emerging Economies: The Case of Bangladesh

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ABSTRACT

Bangladesh is a large and densely populated country which is striving to advance its economic growth. Stimulating entrepreneurship activities could be an effective vehicle for achieving progress. Risk is an integral part of any business and it can act as an important deterrent or motivation for entrepreneurship development. There are two sides to risk: the potential for loss (downside) and the opportunity for higher profit and growth (upside). Both the downside and the upside of risk are relevant when considering or evaluating business ventures. In this study we discuss the implied impact of investors' risk attitude on entrepreneurship motivations. We surveyed a large sample of Bangladesh investors and potential investors with varying degrees of different characteristics to learn about their attitude towards risk. We found that the following variables affect the motivations for entrepreneurship development in Bangladesh: (1) the degree to which the compensation of the decision-maker is tied to the success of the decision; (2) the investment time-horizon; (3) the experience; and finally, (4) the degree to which the decision-maker shares the decision with others or whether the responsibility is born solely by the decision-maker. We have two main recommendations: First, that compensation schemes of decision-makers should be tied, to the extent possible, to the success of the investments. Second, that the performance evaluation should be made with a long-term view rather be based on short-term accomplishments. We believe that by appropriately modifying decision-makers' behavior by offering adequate sets of incentives, Bangladesh can materialize its great potential. By stimulating its entrepreneurship development, Bangladesh can take advantage of its population and geography to experience great economic growth.

Keywords: Risk, Entrepreneurship Development, Bangladesh, Survey Study

INTRODUCTION

The economic development in Bangladesh is of great importance for the world economy. Bangladesh is a large and densely populated country which is striving to advance its economic growth. Stimulating entrepreneurship activities could be an effective vehicle for achieving progress. Exploring some of the potential obstacles and motivations for entrepreneurship may help in this direction and risk is one such an important determinant. Risk is an integral part of any business and it can act as an important deterrent or motivation for entrepreneurship development. The risk concept and its implications, however, have been poorly understood by many decision-makers. Traditionally risk has been viewed as being negative or harmful with expected adverse effects. But, there are two sides to risk: the potential for loss (downside) and the opportunity for higher profit and growth (upside). Both aspects of risk are relevant when we consider evaluating business ventures.

In this study we discuss the implied impact of investors' risk attitude on entrepreneurship motivations and conclude with a few recommendations. We surveyed a large sample of Bangladesh investors and potential investors with varying degrees of different characteristics to learn about their attitude towards risk. In the next section, we shall start by briefly discussing the concept of risk. Then we link the risk perception to the entrepreneurship development in Bangladesh. We proceed in the following section by presenting the empirical results and analysis. We end the paper by a brief summary and recommendations.

RISK

Traditionally, risk has been viewed as being negative or harmful with expected adverse effects. Various definitions have been used to represent this notion. Typically, it has been assessed by the volatility of an entity's return. However, there are two sides to risk: the potential for loss (downside) and the opportunity for higher profit and growth (upside). Both the downside and the upside of risk are relevant when we consider or evaluate business ventures (Hagigi & Sivakumar, 2009). Sometimes, an investor's risk inclination might prevent him or her from taking a beneficial investment action. For example, the decision-maker might stay away from initiating a new business, or wrongly select a sub-optimal investment strategy. Knowledge of the various decision-makers risk perceptions might enable

firms and regulators to correct such sub-optimal behavior by designing and tailoring accommodating incentive schemes.

Traditionally, researchers have viewed and measured risk in terms of return variability. The use of standard deviation or variance, which has been very common, is very convenient for statistical purposes. In many cases, however, managers may not view risk as a return variability. It has been documented that, while managers prefer more profits to less, they are mainly concerned about avoiding the downside outcomes rather than the variability of the potential outcome (Telser, 1955-56; Roy, 1952; Baumol, 1963). Each decision-maker may have in mind a certain rate of return as the minimally accepted one. This approach depicts the Safety-First notion.

It is conventionally assumed that people are risk-averse; however, effective risk management does not necessarily imply a need to reduce risk. In general, for a given expected return, risky ventures are less desirable and as a result their prices are lower compared to ventures that are less risky. Hence, the expected profitability of riskier ventures is higher, as is its risk. It has been widely documented that there is an inverse relationship between risk and return. Therefore, effective risk management does not necessarily mean risk avoidance but rather suitably tailoring the risk strategy to the firm's goals and risk preference. An investor may opt to select a risky project knowing that the compensation will more than make up for that. This upside potential might lead to break-through results such as important innovations and developments. Such an attitude towards risk might encourage investing in seemingly risky business ventures and stimulate entrepreneurship development.

RISK AND ENTREPRENEURSHIP DEVELOPMENT IN BANGLADESH

Meredith, et al., (1982); Siropolis (1997); Hisrich and Peters (1998); Khanka (1999); and Hossain (2006), among others, have mentioned the importance of the risk-taking characteristic for an entrepreneur. Rahman (1989), on the other hand, characterized the Bangladesh entrepreneur as moderate in terms of risk-taking investment behavior. An interviewee mentioned to the authors recently that Bangladesh investors are leaning towards low risk taking ventures. This view is echoed also by Sadeq (1989) who claimed that "in Bangladesh, risks and uncertainty discourage potential entrepreneurs from undertaking highly profitable

and socially desirable new ventures." He also comments that there is a shortage of experienced entrepreneurs in the country, which is unfavorable for entrepreneurship development (Hossain 2006). The importance of experience for promoting entrepreneurship development was mentioned also by other researchers such as, for example, Rahman (1989).

Another related issue, mentioned in an interview to the authors, is related to the time-horizon of the Bangladesh entrepreneurs. It was claimed that they are favoring short-term profits and leaning towards avoiding long-term investments.

Many researchers mentioned the lack of adequate financial support as a substantial obstacle for promoting entrepreneurship in Bangladesh. Sadeq (1989) contends that the lack of sufficient capital pushes entrepreneurs towards non-institutional lenders who are overcharging interest payments.

These above mentioned contentions are among the variables studied in our empirical part in the following section.

THE EMPIRICAL STUDY

The object of this survey is twofold: First, we examine whether the degree of "safety-first" approach is the same or different between lenders and investors. If, for example, lenders are more safety-first oriented then they are less inclined to finance risky ventures, and this might be a substantial obstacle for entrepreneurship development. Second, we explore the impact of five different variables on the decision-makers risk behavior: (1) lender versus investor viewpoint; (2) the degree to which the compensation of the decision-maker is tied to the success of the decision; (3) the time-horizon; (4) the experience; and finally, (5) the degree to which the decision-maker shares the decision with others or whether the responsibility is born solely by the decision-maker.

We surveyed 152 investors and potential investors from the following five sectors (30 or 31 from each sector): loan-officers; university economic educators; university accounting educators; university finance educators; and, finally, from other different investors. Each participant was asked to indicate a preference for method A or B for the first project, to reveal tendency to safety-first approach, and between method C or D for the second project, to discern an inclination towards the upside potential.

Project 1 (Testing for Safety-First Behavior)

A specific rate of return is expected to be achieved by using a traditional investment (Method A), or by investing in an innovative alternative method (Method B). Both methods are expected to result in about the same overall rate of return. However, in almost all scenarios, Method B is expected to result in a higher rate of return, while there is a small (and significant) probability of an exceptionally large loss.

Project 2 (Testing for Seeking Upside Potential)

A specific rate of return is expected to be achieved by using a traditional investment (Method C), or by investing in an innovative alternative method (Method D). Both methods are expected to result in about the same overall rate of return. However, in most scenarios, Method D is expected to result in a lower rate of return, while there is a small (and significant) probability of an exceptionally high rate of return.

RESULTS AND ANALYSIS

As seen in Table I, Panel A, the majority of the interviewees opted for method A, which reflects preference for Safety-First (SF). It is important to note that this preference was substantially stronger for those having a lender perspective compared to those with an investor perspective. As Table I, Panel B clearly demonstrates, the difference between these two groups is statistically significant, at the level of 5% (P-value = 0.011).

Table I, Panel A: Preference between Methods A and B

Percentage Distributions (Out of 152 interviews)

Perspective\Project	Project B	Project A	Total
From a Lender's Perspective	10.0%	90.0%	19.7%
From an Investor's Perspective	38.5%	61.5%	80.3%
			100.0%

Table I, Panel B: Results of a Logistic Regression

		Number of obs	=	152		
		LR chi2(5)	=	12.86		
		Prob > chi2	=	0.0247		
Log likelihood = -89.850039		Pseudo R2	=	0.0668		
	Coef.	Std. Err.	z	P>|z|	[95% Conf.	Interval]
Lender's versus Investor's Perspective	0.82497	0.32484	-2.54	0.011	-1.461646	-0.1883

This interesting phenomenon explains the difficulty that investors, and in particular entrepreneurs, face in getting loans to finance their ventures in Bangladesh.

Table II deals with the upside potential case. It relates to the choice between methods C and D. Method C portrays a "regular" pattern of expected return variability. In most foreseeable scenarios, method D is expected to result in a lower rate of return than C, but it has a small (and significant) probability of having an exceptionally high rate of return. Table II, Panel A, presents the percentage distributions of those who prefer C and D, by different explanatory variables.

Table II, Panel A: Preference between Methods C and D

Percentage Distributions (Out of 152 interviews)

Characteristic \ Project		**Project C**	**Project D**	**Total**
From a Lender's Perspective	1	56.7%	43.3%	19.7%
From an Investor's Perspective	3	67.2%	32.8%	80.3%
				100.0%
Compensation not tied to performance	1	36.2%	11.8%	48.0%
Compensation partially tied to performance	2	24.3%	15.8%	40.1%
Compensation tied to performance	3	4.6%	7.2%	11.8%
				100.0%
Short Time-Horizon	1	11.2%	0.7%	11.8%
Medium Time-Horizon?	2	40.1%	23.7%	63.8%
Long Time-Horizon	3	13.8%	10.5%	24.3%
				100.0%
Not much Experience	1	17.8%	4.6%	22.4%
Medium Experience	2	44.1%	26.3%	70.4%
A Lot of Experience	3	3.3%	3.9%	7.2%
				100.0%
Sharing Responsibility on Decisions	1	9.9%	6.6%	16.4%
Sharing Partly Responsibility on Decisions	2	30.9%	20.4%	51.3%
Having Full Responsibility on Decisions	3	24.3%	7.9%	32.2%
				100.0%

Table II, Panel B: Results of a Logistic Regression

			Number of obs	=		152
			LR chi2(5)	=		25.25
			Prob > chi2	=		0.0001
Log likelihood = -85.662356			Pseudo R2	=		0.1285
upside_D	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
LENDER_INVESTOR	0.033247	0.23528	0.14	0.888	-0.4278936	0.494387
COMPENSATION	0.862361	0.280475	3.07	0.002	0.3126399	1.412082
TIME_HORIZON	0.791615	0.345234	2.29	0.022	0.1149695	1.468261
EXPERIENCE	0.841833	0.381426	2.21	0.027	0.094252	1.589415
RESPONSIBILITY	-0.66302	0.29809	-2.22	0.026	-1.247262	-0.07877
Constant	-4.04929	1.345629	-3.01	0.003	-6.68667	-1.4119

While in most of the cases the decision-makers preferred the safer method C and moved away from the upside potential, there were interesting differences in the degrees of preferences stemming from the examined explanatory variables.

The first variable, lender versus investor's viewpoint, did not explain the above mentioned preference. Indeed, as Panel B reveals, the logistic regression coefficient is not statistically significant (p-value = 0.888). However, all the other four explanatory variables are statistically significant. The coefficient on the second variable, COMPENSATION, is significantly positive (p-value = 0.002), which reveals that as the degree to which the compensation of the decision-maker is tied to the success of the decision, the preference switches from method C to D to benefit from the upside potential. This result might have an implication for stimulating entrepreneurship development in Bangladesh: Such development can be enhanced by designing compensation schemes, for all the involved parties (loan-officers; employees etc.), to be tied, somehow, to the success of the business ventures. Once the decision-maker can benefit from the exceptional expected return – he or she will be motivated to take the extra risk to achieve it. A similar pattern is revealed by the significantly positive coefficient (p-value = 0.022) on the third variable, TIME-HORIZON: as the decision-maker's time-horizon is longer – the preference switches from method C to the method with the upside potential, method D. The conclusion from this is that promotions and compensations should

be based more on long-term performance rather than on the short-run. The significantly positive coefficient (p-value = 0.027) on the fourth variable, EXPERIENCE, indicate that the longer the experience of the decision-maker – the more he or she will tend to select the project with the upside potential. This result is consistent with the academic literature that was previously mentioned, such as Rahman (1989), among others. The significantly negative coefficient (p-value= 0.026) on RESPONSIBILITY indicates that the more a decision-maker shares the decisions and the responsibility with others – the more he or she will tend to switch away from selecting method D, the method with the upside potential.

SUMMARY AND CONCLUSIONS

There are two sides to risk: the potential for loss (downside) and the opportunity for higher profit and growth (upside). Both the downside and the upside of risk are relevant when considering or evaluating business ventures.

The majority of the decision-makers who participated in our study opted for the method which reflects preference for Safety-First (SF). This tendency was substantially prevalent for those having a lender's perspective compared to those with an investor's perspective. This phenomenon echoes the difficulty that investors, and in particular entrepreneurs, face in getting loans to finance their ventures in Bangladesh.

The other results of this study support the claims that the following variables affect the motivations for entrepreneurship development in Bangladesh:

(1) the degree to which the compensation of the decision-maker is tied to the success of the decision; (2) the investment time-horizon; (3) the experience; and finally, (4) the degree to which the decision-maker shares the decision with others or whether the responsibility is born solely by the decision-maker.

The implications of these results point to some steps which might enhance the development of entrepreneurship in Bangladesh. For example, we have two recommendations for incentives that might be created to stimulate the entrepreneurship spirit in the country. First, we suggest that compensation schemes of decision-makers should be tied, to the extent possible, to the success of the investments. Second, we recommend that the performance evaluation should be made with a long-term view rather than be based on short-term accomplishments. We believe that by appropriately modifying decision-makers' behavior by offering

adequate sets of incentives, Bangladesh will be able to materialize its great potential. By stimulating its entrepreneurship development, Bangladesh can take advantage of its huge population and land to experience great economic growth.

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