



# Risk-taking in entrepreneurs, compared to criminals and students: The role of uncertainty and stakes<sup>☆</sup>

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## ABSTRACT

Entrepreneurs', college students' and criminals' risk-taking were compared in hypothetical bet situations. The level of uncertainty and the amount staked were varied in gain and loss situations. Potential profit motivates entrepreneurs to choose higher stakes, expected loss will prompt the avoidance of risk. In profit-making situations, college students' strategies are different: Students' decisions are more influenced by probability factors than by the amount staked. Risk-taking tendency of criminals is higher than that of the other two groups, without applying a consistent strategy in taking risk.

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Our stereotyped image of various groups is typically linked to their inclination to take risks. We expect increased risk-taking in certain age groups (adolescents), discover it in people's favorite activities (e.g. hang gliding), in lifestyles (alcohol and drug use), in occupations (entrepreneurs, car racers), and in defiance to social norms (convicts). Risk-taking has positive and negative meaning as well. Entrepreneurs' behavior when taking risk is considered adaptive, thus has positive meaning, while committing criminal act is considered as a maladaptive behavior, thus negative. In the present study we try to distinguish adaptive and non-adaptive risk-taking by concentrating not only on the amount of risk taken by different groups of people, but on the strategy of the risk-taking behavior. With this aim in mind we focus the attention on the risk-taking of two groups, namely, that of entrepreneurs and convicts, and compare them to a control group, students.

Risk-taking was studied from a normative point of view in the decision-making framework. It is a well-documented knowledge that people are not consistent in their risky choices. The inconsistency toward risk was demonstrated by [Tversky and Kahneman \(1981\)](#); [Tversky et al. \(1990\)](#). In the same situation formulated in a different way, people preferred different alternatives because of different framing, and proved to be risk avoidant in gain, and risk seekers in loss situations. People often choose certain alternatives even if their expected usefulness is smaller than that of the risky alternative. Taking the example of lottery: It is definitely not worth playing in the lottery, since the probability of the return of the invested money is negligible, but the hope for a big prize and the small amount of the investment clouds rationality. Yet people playing on the

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lottery are not risk takers, and many of them strive for high levels of certainty in other areas of life. The example of the lottery also proves that decision makers in everyday life do not think along the lines of normatives. Sometimes the expected amount of profit attracts them, disregarding probabilities, while at other times the desire for certainty is their decisive motive, and they do not plunge into situations of great opportunities.

The decision maker may choose along a criterion, which is in harmony with his/her personal strivings. Game theory has identified several such strategies: e.g. persons following the *maximax* strategy optimistically chooses the alternative in which the chances of winning are the highest, regardless of losses and probabilities; *maximin* is a pessimistic choice, where the person examines how s/he can get the most out of the bad outcomes; while *minimax* starts from the regret s/he would feel if s/he missed a profit by not choosing the alternative. This analysis assumes consistency of choice on the part of the decision maker, and the strategies may be translated into the terms of risk-taking (*maximax*) and risk avoidance (*maximin*).

Risk-taking is always in the fore when characterizing entrepreneurs. This is not surprising, since due to the incalculable behavior of consumers and competitors, entrepreneurs unavoidably face risks when making decisions (e.g. about entering a new market, or manufacturing a new product). Although different aspects of the behavior of entrepreneurs are emphasized by various authors (e.g. readiness for innovation by Schumpeter, 1934; recognition of opportunities by Kirzner, 1973; self-confident and independent decision-making in uncertain situations by Knight, 1921), all of the views include the opinion that entrepreneurs do not shrink from risky solutions if they hope for great profit or success. Stewart et al. (1998) propose that individual personality features, like risk-taking propensity, innovativeness and achievement motivation are the most important characteristics of entrepreneurship. According to Sitkin and Pablo (1992) risk propensity is the determinant of risk behavior in organizations.

Instead of personality characteristics, a number of researches have focused on the process of risky decision-making of entrepreneurs.

The studies conducted by Palich and Bagby (1995) set out from the observation that entrepreneurs may behave in various ways: Some grab opportunities, others get frightened at risks; some carry flourishing businesses, others become bankrupt. The authors recommend taking a cognitive approach instead of the supposedly futile search for personality characteristics. In their studies, entrepreneurs and non-entrepreneurs had to form opinions about various business scenarios. The authors found a difference between the groups in the categorization of the situations: The entrepreneurs found the situations more positive, noticed the strengths more than the weaknesses, saw more opportunities than threats, and discovered more progress than failure in these situations. However, no difference between the tendencies of risk-taking was found between the groups.

Forlani and Mullins (2000) complain that despite the importance of risk-taking, there are relatively few studies regarding how behavior is influenced by the various components of risky behavior, i.e., by risk perception (how dangerous the subject perceives the situation to be), by expected outcome (extent of profit and loss), by probability (the chances of an event taking place), and by willingness of taking risks. In their study, entrepreneurs evaluated hypothetical businesses. It was found that the respondents were willing to take greater risks if the situation promised great enough profit (they could choose from four possible investments: Business risking a smaller or greater amount of money, associated with a smaller or greater probability of success). Great risk-taking, however, was present only in cases of large amounts of money. The respondents avoided highly uncertain situations. It was not only risk itself, but also its different perception and the individuals' risk-taking tendency also influenced the respondents' behavior. Risk-taking tendency had no effect on perception, but did on choice. In a field experiment where the impact of the available resources, the aspiration level, and the risk-taking propensity of the individual was studied Faragó (2005) found that students took much smaller risk in real situations where they had to face real consequences, compared to a control laboratory group. Risk-taking tendency diminished in the loss, compared to gain condition.

Shapira (1995) investigated manager's risk-taking and found that managers focuses their attention on the amount of gain or losses and tend to disregard probability.

Much research and several related theories have identified risk-taking as an important component of criminal behavior. Gottfredson and Hirschi (1990) demonstrated the connection between criminal behavior and poor self-control in their theory, considering risk-taking an important component of self-control. Grasmick et al. (1993) and Romero et al. (2003) considered self-control as a multidimensional construct whose leading factor was impulsive risk-taking. One of the key momentums of Farrington's (1995) theory based on a 24-year longitudinal study is decision-making prior to the criminal act, which is based on the cost-benefit analysis well known from economics, i.e., if the expected benefit is greater than the cost (being caught), the criminal act will be very likely to take place. Naturally, the evaluation of both cost and that of benefit are highly subjective, they greatly depend on the personality, values, attitude and previous experiences of the person and on the given situation. Thus, the criminal perpetrator always takes a great risk when making a positive decision.

Violent criminals are doubly risk takers: On the one hand, the criminal act itself involves a risk (counter-attack by the attacked person or attack by the arriving authorities), and on the other hand, the person risks imprisonment if got caught. In his phenomenological approach, Lyng (1993) proposes that there are important instances of similarity between risk-taking and criminal behavior with respect to the experience. In his view, the experience of the extension of control and the bombardment of boundaries add important plus to the actor, thus, risk-taking is a strong reinforcer of self-image. The experience and the motivation are similar, but the difference is that well-socialized persons direct their risk-taking behavior to socially accepted areas, while poorly socialized persons act on their similar tendencies in socially unaccepted fields.

Studying the relationship between personality and criminal behavior, and based on the personality test (MPQ) of 800 young people, Krueger et al. (1994) found no difference between criminals and non-criminals along the dimension of risk-

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