

Journal of Economics and Business

Yousfani, Kinza, Shah, Nida, and Kazi, Hameedullah. (2019), Entrepreneurial Investor: Decision Making and Profitability. In: *Journal of Economics and Business*, Vol.2, No.1, 32-37.

ISSN 2615-3726

DOI: 10.31014/aior.1992.02.01.64

The online version of this article can be found at:
<https://www.asianinstituteofresearch.org/>

Published by:
The Asian Institute of Research

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Entrepreneurial Investor: Decision Making and Profitability

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Abstract

An entrepreneur influences the parameters of the strategic decision process by the approach he is going to adopt (rational, emotional or intuitive). The decision process, on the other hand, affects the entrepreneurial profitability, knowledge, and experience. Successful decision making requires an accurate understanding of the environment in which the decision will be played out. The logic behind entrepreneurial decision making is a complex issue, not clearly explained by the traditional economic theory. Therefore, finding this relationship is important for determining the factors which influence entrepreneurial investors' decisions and consequently affects their profitability. For this purpose, data were collected from a sample of 150 entrepreneurial investors of Hyderabad and Karachi through a structured questionnaire. The study concludes that no significant relationship exists between age, qualification and decision making. However, a significant relationship is found between income and decision making. In addition, combination entrepreneurial investors earn more income than the irrational and rational entrepreneurial investor. This study will be of profound interest for individual and institution entrepreneurial investor market regulatory and academician.

Keywords: Entrepreneurial Investor, Rational, Irrational, Combination Investor, Decision Making and Profitability

Introduction

All risk that is acted upon must be perceived risk because perception is based upon sensory data, we can only sense the 'real world' because we have no other way of being informed (Robert Olsen 2010). Different researchers characterize entrepreneurs differently, it is well known that Knight (1921) emphasizes risk bearing as the main function of entrepreneurs while Schumpeter (1947) views entrepreneurs as persons who do new things. However, these are not the only functions of entrepreneurs as Casson (2005) reviews the literature and argues that judgmental decision making is a common feature of entrepreneurship. In general, there are three types of problems that require decision making on the part of the entrepreneurs and investors:

1. Entry/Seed Funding Decisions
2. Financing/Investment Decisions, and
3. Growth/Exit Decisions

The logic behind entrepreneurial decision making is a complex issue, not clearly explained by the traditional economic theory according to which the market dictates the firms' performance. One of the first thinkers to discuss

the entrepreneurial role in the economic theory was Schumpeter, 1912, in the theory of economic development. The Schumpeterian entrepreneur is not a common businessman, but an innovator motivated by the opportunity of profit, here entrepreneur plays a key role in creating new businesses through a process of creative destruction. Fundamentally, an entrepreneur undertakes tasks that are not performed in the ordinary course of the business routine. The entrepreneur is, therefore, the first mover that can be present both in a small activity and in large corporations, either as a single physical person or a group. When entrepreneurs start their ventures, their concepts are unproven, the outcomes uncertain. Subsequently, as their ventures unfold, feedback is received from the marketplace. The new information can then be used as they make decisions about whether to increase financial investment, to continue the business as it is, to scale back investment, or to discontinue the business. These decisions would be based upon the feedback being received, with the entrepreneur being more likely to increase investment when ventures are showing success and being more likely to scale back when results are disappointing. However, ongoing research in the field of decision making suggests that psychological processes possibly play a role in these important decisions. Thus, under certain conditions, entrepreneurs may be more likely to increase investment, regardless of feedback. This phenomenon is termed as "escalation of commitment" by the researchers in decision making, may lead to irrational decisions. They may be irrational in the sense that psychological processes (which may not even be recognized by the entrepreneurs) play an important role in shaping investment decisions.

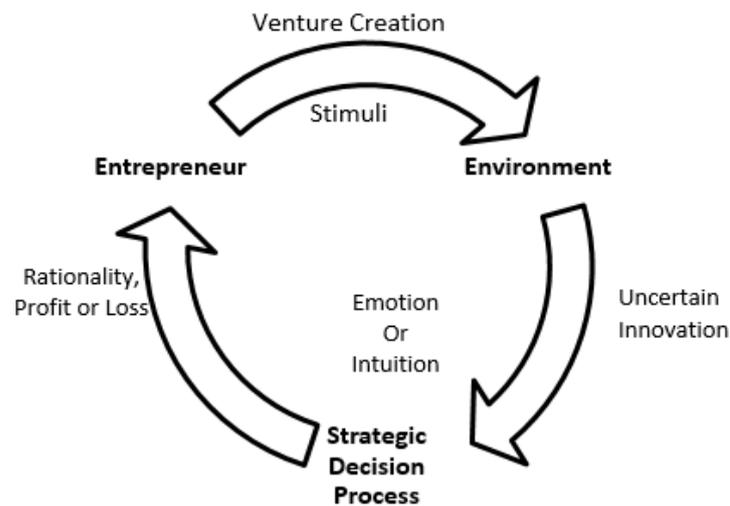


Figure 1: Levels of Analysis in the Decision-Making Process

Decision making is the choice of the best alternative to reach for the set goals, based on the correct understanding, estimation, analysis, and prognosis of the internal and external environment of the enterprise (Moore, 2009).

Entrepreneur influence the parameters of the strategic decision process by the approach he is going to adopt (rational, emotional or intuitive). The decision process, on the other hand, being strategic and affect the entrepreneur bringing profit or loss to the business and will thus possibly reshape the entrepreneurial knowledge and experience. Successful decision making requires an accurate understanding of the environment in which the decision will be played out. Without that understanding, it is impossible to assess the probable consequences and choose thoughtfully among them (Elissaveta Ivanova, 2003). Decision making lies at the very heart of the entrepreneurial process. Entrepreneurs have to make an excess of different decisions on a daily basis, like concerning refinements of the business idea, creating or identifying a market niche, solving technical problems, acquiring resources, recruiting key personnel, etc. (Davidsson and Klofsten, 2003). Studying entrepreneurial decision making, therefore, is important for a better understanding of the process whereby individuals create and exploit new venture opportunities.

Rational decision making demands technical knowledge and practical experience. Rational investors form a rational expectation about asset return, motivated by the maximizing principal. They collect available and relevant

information for making decisions (Bhat et al., 2012). Behaviorists argue that investors often behave irrationally when making investment decisions thereby incorrectly pricing securities. They relate investors' decision-making behavior to gamblers' fallacy, anchoring, mental accounting, overconfidence, overreaction (i.e., emotion/intuition) and herding behavior (Banerjee, 1992). While decision making can be seen as a function of entrepreneurs' prior to the experience, we may also have to consider that their intentions, in terms of what they aim for and where they want to go in the future can influence their decision making as well (Krueger, 2003).

According to (Curseu et al., 2010) and (Curseu, 2006), entrepreneurs are responsible for making strategic decisions in entrepreneurial enterprises and are typically the only decision makers in the organizations, their personal attributes such as attitudinal factors; including risk propensity and tolerance for ambiguity, and motivational factors; including self-efficacy and need for cognition, have been introduced as important characteristics that affect the way entrepreneurs make decision. Moreover, demographic factors; including entrepreneurial experiences, age and education are among elements which have been examined by (Curseu and Louwers, 2010) in term of their effects on the quality of strategic decisions made by entrepreneurs.

This paper examines the financial investment decisions of entrepreneurs, specifically considering the following questions: Do entrepreneurs behave according to a rational model of decision making? How can we classify them on a three-scale continuum of rationality: rational combination and irrational. Are the decisions for investment influenced by qualification and age? The study investigates entrepreneurs' investment decisions and its impact on the profitability of individual entrepreneur investors. More recently, (Casson, 2005) reviews the literature and argues that judgmental decision making is a common feature of entrepreneurship.

Literature Review

Maria Sylvia (Macchione Saes et al., 2013) conducted research on Entrepreneurial Decision Making using the Knightian Uncertainty Approach. This article discusses the entrepreneurial decision-making behavior aimed at investigating the entrepreneurial decision rationale. The behavioral model of decision making under uncertainty was used to test the hypothesis of overconfidence, model based on Bayesian inference. The finding suggests that, under the hypothesis of overconfidence, entrepreneurs decide to invest, despite the fact that the expected utility model indicates the contrary. This theoretical finding could explain why there are many business failures in the first years of commotion. Pēteris Dimants (2014) examine on entrepreneurs' decision-making skills development role of the small and the medium-sized enterprises promote development. The study aims to analyze the successful and less successful entrepreneurs' decision-making process, revealing young people's decision-making skills in business development need to increase the long-term small and medium efficiency. The research methodology is based upon the literature on business decision making analysis, the author established the model of decision making, interviewing successful entrepreneurs and young people in decision making promotional business experience gained in promoting "green" business farm "Dangas" and conducting activities "in the green business incubator" analysis. The results obtained reveal the need for business decision making and entrepreneurial skills to organize targets at school and university is designed for decision making in business development activities in formal and non-formal education. Rosa Mehrabi and Amir Mohammad Kolabi (2012) conducted research to investigate the effects of entrepreneurs Personal Attributes and Cognitive Heuristics on the Quality of Entrepreneurial Strategic Decision Making. The aim of the study is to examine the effects of an entrepreneur's motivational and attitudinal characteristics, cognitive biases, heuristic and demographic factors on the quality of entrepreneurial strategic decision making. The samples were 110 prominent Iranian entrepreneurs during the period 2010 – Ministry of Labor and Social Affairs database. The main data collection instrument was a questionnaire. Structural equation modeling and confirmatory factor analysis methods were used to analyze the model, and it is estimated that entrepreneurs' attitudinal characteristics have negative effects on quality of entrepreneurial strategic decision making, while the effects of entrepreneurs' motivational characteristics on quality of entrepreneurial strategic decision making are positive. Furthermore, it is estimated that the effects of demographic factors and overconfidence bias on quality of entrepreneurial strategic decision making are positive however representation bias has a negative effect on it.

Diamanto Politis and Jonas Gabriellsson (2006) conducted research on Entrepreneurial Decision Making: Examining Preferences for Causal and Effectual Reasoning in the New Venture Creation Process. Aim of the study is to examine entrepreneurs' preferences for causal and effectual reasoning in the new venture creation process and the dominating view is that entrepreneurial decision making to a large degree varies in response to the unique situational context whereas the researcher also worked on the individual career experiences and career motives entrepreneurs make in favor of one decision making logic over another. Statistical analysis on a sample of 291 Swedish entrepreneurs was conducted for the argument that entrepreneurs' career experience and career motives have a significant influence on entrepreneurial decision making. The findings suggest that the entrepreneurs also seem to have some stable preferences that make them in favor of one decision making logic over another. Therefore, even if it may be more effective to rely on causal or effectual reasoning depending on the specific circumstance entrepreneurs are facing they may be based on their routines and intended directions and have a preference for causal or effectual reasoning. Ehsan-ul-Hassan et al. (2013) focused on individual investors all over Pakistan who are currently trading on the Pakistani Stock Market. The data was collected through a questionnaire from 270 investors from the Islamabad Stock Market. This study is based on exploring the real impact of behavioral heuristics, fears, and anger on individual investor's judgments and decision making in the context of Pakistan. Confirmatory Factor Analysis is used to measure the validity of three determinants of individual investor's decision making. They concluded that the involvement of behavioral biases and psychological impacts on investor's judgments and decision making leads them towards irrational decision making.

Josiah A. et al. (2012) conducted research on behavioral and financial performance of individual investors in trading shares of companies listed in Nairobi Stock Exchange in Kenya, purpose of this research was to categorize the behavior of individual investor while making the investment decisions, The study adopts the probability sampling technique and systematic sampling technique to collect the data; from each 10 brokerage firms 5 respondents were selected. The questionnaire was designed to investigate behavioral issues that influence the investment decision making of the individual investor. Therefore it is concluded that the diverse behavior of individual investors was found, few investors go for the companies with dominant and good financial performance in the stock market which exhibit rational behavior, some investors showed negative results due to irrationality and herding behavior, most investors had enough experience in trading in stock and the majority of the investor did not have knowledge in making best investment decisions.

Hypotheses

- H1: Decision-making process influences the profitability of entrepreneurial investor.
- H2: Qualification influences Decision making of the entrepreneurial investor.
- H3: Age influences the Decision making of the entrepreneurial investor.

Techniques & Tools

For this research standard instrument is used for measuring the variable as this is a descriptive research, questionnaire is used to measure the variables. The aspects measured are rational and irrational investment behaviors of entrepreneurial investors' profitability. To measure the entrepreneurs' rational investment behavior, 5 items are adopted from Cazilia Loibl (2006), and Entrepreneurs irrational investment behavior is measured by 6 items adopted from a book "The Behavioral Finance and Wealth Management" written by Michael M. Pompian. The scores of entrepreneurial investors on rational and irrational decision making will be used to classify them on a tracheotomy of decision making: Rational decision makers and irrational decision makers and a combination of the two. The relationship between age and decision making is measured using the Kruskal-Wallis test, and the age is ordinal variable and decision making is categorical. The relationship between profitability and decision making is measured using the Mann-Whitney test, and here profitability is an ordinal variable and decision making is categorical variable. The relationship of qualification (Undergraduate, graduate, masters, M.Phil. and PhD.) with decision making is measured using Chi-square phi and Cramer's V, and dummy was created for each level of qualification to measure the decision making in each level of education.

Data Analysis

First, we tested the normality of all the variables using the Shapiro-Wilk test of normality using SPSS 17.0, and all the variable were not found normally distributed. This is the reason for applying a non-parametric test.

Table I: explains the results of the relationship between age, income and decision making. The mean rank rational investor (67.88) is lower than combination (74.56), and irrational investor (84.75) however difference is not significant (Chi-square = 3.747, P value 0.154).

In income, the mean rank of the combination decision maker (83.76) is higher than irrational (74.73) and rational investors (63.77). The results were found statistically significant Chi-square = 6.113, P value 0.047).

<i>Variables</i>	<i>Decision Making (Mean Rank)</i>			<i>Chi Sq.</i>	<i>P-value</i>
	<i>Rational</i>	<i>Irrational</i>	<i>Combination</i>		
Age	67.88	84.75	74.56	3.747	0.154
Income	63.77	74.73	83.76	6.113	0.047

Table II: illustrates the results of the relationship between Qualification and decision making. Most of the undergraduate entrepreneurial investors are rational decision makers (mean rank = 4) However most of the graduate (25), Masters (31) and M.Phil. (6) are combination decision makers, But the result are statistically insignificant.

<i>Variables</i>	<i>Decision Making (Mean Rank)</i>			<i>Chi Sq.</i>	<i>Phi and Cramer's</i>	<i>P-value</i>
	<i>Rational</i>	<i>Irrational</i>	<i>Combination</i>			
Undergraduate	4	2	3	1.167	0.088	0.558
Graduate	13	11	25	1.909	0.113	0.385
Masters	25	25	31	1.854	0.111	0.396
M.Phil.	1	3	6	2.004	0.116	0.367
PhD	0	1	0	2.589	0.131	0.274

Conclusions & Comments

Decision making is the choice of the best alternative to reach for the set goals, based on the correct understanding, estimation, analysis, and prognosis of the internal and external environment of the enterprise. Entrepreneurs are responsible for making strategic decisions in new ventures and are typically the only decision makers in the organizations, their personal attributes such as attitudinal factors; including risk propensity and tolerance for ambiguity, and motivational factors; including self-efficacy and need for cognition have been introduced as important characteristics that affect the way entrepreneurs make decisions. The data were collected from a sample of 150 entrepreneurial investors of Hyderabad and Karachi through a structured questionnaire. Finding this relationship is important as it determines the factors considered by the entrepreneurial investors in making decisions and consequently affects their profitability. The study concludes that no significant relationship exists between age, qualification and decision making. As far as income, a combination entrepreneurial investors earn more income than an irrational and rational entrepreneurial investor. This study will be of profound interest for individual and institution entrepreneurial investor market regulatory and academician.

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