
Risk taking in entrepreneurial decision-making

Objective

- Understand entrepreneurs' tendencies to take risks
 - Examine why entrepreneurs engage in risk
 - Discuss keys for entrepreneurs to more accurately assess risk and improve decision-making
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Do entrepreneurs show higher natural tendencies to take risks?

- No, not consistently
 - Growing consensus among researchers that managers and entrepreneurs do not show differences in natural tendencies to take risks (Busenitz, 1999)
 - Perceptions of risk may differ
 - Other factors are motivating entrepreneurs to start firms besides risk propensity
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VENTURE CAPITAL

Elon Musk, of PayPal and Tesla Fame, Is Broke

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The funny thing about Elon Musk is that he does sort of remind you of Tony Stark. Minus the Iron Man suit.

Like the fictional Mr. Stark, Mr. Musk seems like the kind of guy every Silicon Valley hopeful wants to be. For starters, he's a rocket scientist. No, really: he helped design the Falcon 9 booster used by [NASA](#). He also helped create Solar City, a leader in solar power. And he helped dream up the Tesla, the electric car that made electric cars sexy. No wonder the film director Jon Favreau modeled his über-capitalist superhero on Mr. Musk.

There is just one small problem: Mr. Musk says he is broke.

Come again? Mr. Musk is a member of the PayPal Mafia — those serial entrepreneurs who, for a time, looked like the Brat Pack of the Valley. He made a fortune as a co-founder of PayPal, the e-commerce payments system. Not so long ago, he had more than \$200 million in cash. Not bad for 38.

Now Mr. Musk, who is in the middle of a divorce, says his account is empty. Actually, less than empty. He says he invested his last cent in his businesses and is living off loans from his wealthy friends. He subsists, according to court filings, on \$200,000 a month and still flies his private jet.



Cognitive complexity contributes to a better understanding of ESDM

- Explores an individual's information processing capabilities
 - Addresses the structural configuration of a decision-maker's mental representation of a decision situation
 - How does the *cognitive complexity* of individual entrepreneurs relate to their *risk propensity*?
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Strategic entrepreneurial decisions are inherently risky

- Rarely know all possible outcomes
 - Difficult to apply probabilities to outcomes
 - If information about the consequences of a decision and the probabilities of these consequences is incomplete, uncertainty involves risk.
 - Risk is conceptualized based on the individual entrepreneur's assessment of risk and uncertainty in a decision.
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Why do entrepreneurs engage in risk?

- Lack necessary information in a decision situation (Gibcus et al., 2008)
 - Develop an inside view of the decisions they face (Kahneman & Lovallo, 1993)
 - Ignore elements of past situations
 - Favor positive possible outcomes
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Key influencing factors of entrepreneurs accepting risk in their decision

- How high are the risks?
 - What are the rewards?
 - What are the consequences?
 - Were all of the complex elements of the decision considered?
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Industry dynamism influences entrepreneurial decision-making

- Relationship between *cognitive complexity* and *risk-taking* behavior is negatively moderated by the dynamism of the industry in which the decision takes place
 - Entrepreneurs operating in highly dynamic (changing) industries see the necessity of taking risk
 - Also more easily recognize when there is no need to take large strategic risks
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Keys for entrepreneurs to assess real risk and improve decision-making

- Apply multiple perspectives to a decision situation
 - Integrate these perspectives into the decision
 - Use a complex cognitive framework regarding a decision situation
 - Broader and deeper view of the decision at hand may result in a more accurate assessment of risk
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Summary

- Entrepreneurs' tendencies to take risks are influenced by perception and relative risk and reward.
 - Entrepreneurs engage in risk for a unique variety of reasons that are personally important to them.
 - It's important for entrepreneurs (and aspiring entrepreneurs) to more accurately assess risk and thereby improve their decision-making.
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