

IMPACT OF BEHAVIORAL FINANCE ON ENTREPRENEURIAL DECISION MAKING

Author Name: ANUSHREE SRIVASTAVA

Affiliation: ASSISTANT PROFESSOR, BABU BANARASI DAS UNIVERSITY, LUCKNOW, UP, INDIA

E-Mail: anushreesri88@gmail.com

Abstract

Decision making is one of the critical and most responsible areas of effective entrepreneurship. It is in entrepreneurship only where key decisions can have wide impact on the overall functioning of a business enterprise. There are three central decisions in entrepreneurship which are funding, investment, growth. Behavioral finance holds an important impact because it is the only theory applicable to issues in entrepreneurial finance and trends of investors towards investment and funding in these ventures. Although individual decision-making varies from person to person but in general, behavioral finance gives guidelines and expected tendencies of investment and the general mood of entrepreneurs. Risk taking behaviour is considered to be the key dimension of entrepreneurship as the theory of return is measured only with the amount of risk taken. But research provide mixed findings it's not just entrepreneurs are risk raven from birth only, their judgements are affected by emotions, perceptions etc. to some extent. High risk propensity is due to fact that entrepreneurs perceive risky situations more optimistically than non-entrepreneurs.

Keywords : Finance, Decision making, Risk, Perception

INTRODUCTION

The emergence of new sources of financing in the aftermath of financial crisis has substantially increased the funding options available to new entrepreneurial ventures for e.g. Technology parks, Start-up incubator, Business angels, Venture capital funds and institutional investors have significantly increased the alternatives of funding channels. It has crucial implications for both investors and entrepreneurs, creating new policy challenges at the national and global levels. Entrepreneurial finance is a field of finance study that has strongly developed in the last two to three decades. It throws light on the financing methods and tendencies of investors and their general behavioral aspects towards funding and investment. It is quite obvious that not only access to finance explains the survival of new companies. Behavioral Finance therefore introduces the possibility that in practical world entrepreneur's irrational behavior, biases, and perceptions, somehow affect their financing decisions. Entrepreneurs can have a better understanding of this and how has this impacted on the financial well-being of their businesses. Behavioral finance sheds light on the true behavior of entrepreneurs, how behavioral bias impacted financial decisions. It is the study of the influence of the psychology on the behavior of

Investors

and financial

analysts. It focuses on the fact that investors are not always rational but are sometimes influenced by their biases. These biases further influence the investors in their investing criterion and decisions. If behavioral finance could be understood then it would help one in avoiding emotion driven speculation leading to losses and failure. When it can have an impact on investment in money market instruments then behavior can lead to impact on capital market investment, venture funds, loans etc. Therefore, entrepreneurial finance and behavior finance are related to each other in the way that differences in opinion and biases can lead to subsequent losses.

LITERATURE REVIEW

Through past studies it has been found out that impact of behavioral finance on the investing behavior of financial analysts and investors have been found. Behavioral finance theories have been the cornerstone of modern asset pricing for the past many years. There have been many theories explaining the behavioral finance theory but there have been many contradictions also regarding every theory. Behavioral finance theory is said to be a useful benchmark for regulators and central banks. Although the behavioral finance theory has difficulties in testing and analyzing yet it explains a number of anomalies in the financial world. In real world both the theories that is *efficient market hypothesis* and Behavioral finance theory are required to explain asset pricing. Since investors are rational they consider all available information to them in the investment decision making process. Behavioral finance considers how various psychological traits affect the way investors make their investment decisions. In this paper various theories have been reviewed and analyzed to have a clear understanding of the subject and how much it is significant in financial decision making. From the literature review it is deduced that behavioral finance tries to fill the gap between actual behavior and expected behavior.

RESEARCH METHODOLOGY

The research methodology used in the preparation of this paper is divided into two parts; one is Literature Review and the other is empirical study. For Literature Review, papers published on entrepreneurship, behavioral finance, and the tendencies of investors have been taken into consideration. Studies have shown that their customary beliefs, perceptions, market fear takes front seat while investing in ventures that demands some experiments or their past endeavors have not been so successful. It is where small enterprises, household industries remain far behind due to this behavioral assumptions. For empirical study, a study has been made on start-ups, SMEs, small household enterprises. This paper provides a deeper understanding and

insights into entrepreneurial finance by interlinking theoretical models and empirical findings. Questionnaires has been provided keeping in view the problems of funding they face, the challenges and the orthodox perception of fundraisers, the scope of behavioral finance in the well-being of the enterprises.

FINDINGS

In this paper we have found that it is not just the financial matters/ operating areas alone which alone stands for the failure of the business enterprise but the impact of behavior is also responsible for the future of a venture. Till date studies have been done on SME, Start-ups, IPO based companies, but in this paper it has been found that the problem is the same with all types of companies. The approach to handle them and the solutions available to them is different in case of different options. Dealing with biases, perceptions, and beliefs is the biggest challenge which an entrepreneur has to face, that is basically his internal conflicts. The societal attitude towards a new entrepreneur or a successful business which has now lost its space in the market has also been discussed in this paper. This paper quotes examples of how some businesses have lost their market value due to some faulty decisions and how some businesses grew million steps ahead instead of observing failures at the very first step.

ENTREPRENEURSHIP & BEHAVIORAL FINANCE

Entrepreneurship is the process of designing, launching and running a new business, which is generally a small business at the initial level. Behavioral Finance is the science that studies the influence of psychology on the behavior of investors or financial analysts. It studies about the behavior of investors and focuses on the fact that investors are not always rational, have limits to their self- control and are influenced by their own biases. Understanding it helps us in overcoming emotion driven speculation leading to losses and thereafter devise an appropriate wealth management strategy. Due to higher risks involved in the process of entrepreneurship a significant proportion of start-up businesses have to be closed due to lack of funding, bad business decisions, irrationality, or combination of all of these. There are many entrepreneurs who failed miserably before making it big in the business world like Evan Williams (Twitter), Marcus and Blank (The Home Depot), Jeff Bezos (Amazon) to name a few. If we take a recent example we can take an example of *Snapdeal* which was once the 1st choice among the online customers, unable to adapt it to changing environment needs could not sustain. Its messed up strategies, inability to control over quality of products, high-margin, fast growing fashion segment led to its merger with Flipkart.

EMERGING ENTREPRENEURSHIP

Entrepreneurship in today's time is not just limited to profit making or as a full-fledged profession but also to other aspects which are like part time entrepreneurs, agricultural entrepreneurs, societal entrepreneurs etc. One of the emerging trends in entrepreneurship these days is **social entrepreneurship** which focuses not just on profit making but also meeting the societal needs and maintaining ethics and standards. Social entrepreneurship or altruistic entrepreneurship is doing business for a social cause. Many innovative entrepreneurial ideas are there in the minds of today's youths which are unable to get processed due to faulty guidelines, Government setbacks, and mishandling, financing issues. Women entrepreneurs are also rising in today's economic world, in last few years the number of successful women entrepreneurs is significant. Women make up for 1/3rd of female entrepreneur globally although the route to envisaging and establishing business comes with unknown hurdles. Behavioral finance influences these emerging entrepreneurs too. Investors biases, irrational thinking, age old beliefs, illogical decision-making, inability to come out of safe zone are the major reasons behind their unsuccessful ventures.

IMPACT OF BEHAVIOURAL FINANCE

It is the study of the influence of psychology on the behavior of investors or financial analysts. It is based on the fact that investors are not always rational, and are influenced by their own biases. Understanding Behavioral Finance devises an appropriate wealth management strategy and avoids emotion driven speculation. It is about trying to understand biases in human behavior when it comes to money. This paper throws light on how behavioral implications put an impact on the financial decisions of entrepreneurs and how that effects the growth and future of the firm in the long run.

(1) Behavioral Finance helps us in understanding about the reasons that pulls back an investor to invest in an experimental entrepreneurial venture.

(2) It also makes us understand how a very promising start-up could not grow well due to the risk pervasive attitude of an investor. Since, capital is the fuel of any venture, lack of it creates a major setback. Sometimes, it is also seen that in the midst of the maturity of the firm, the capital infused is taken back due to orthodox perceptions. And this perception is not just limited to emerging entrepreneurial ventures, but gender disparities, lack of reliable brand, economic fluctuations, Government policies etc.

(3) Innovation and entrepreneurship are key drivers of economic growth and opportunity.

Entrepreneurship is not just limited to traditional business setup. This is a visionary step in terms of development of a country as well as welfare of the masses.

(4) Business brings innovation, technology, revenue along with it. But now ideas, ventures require a lot of capital, efforts and patience. It is true that it is dicey to start a new venture, business. Focus should be on supporting early stage entrepreneurs in developing their own roadmap. While there are more and more resources and opportunities for early stage innovators, too many still lack access to them.

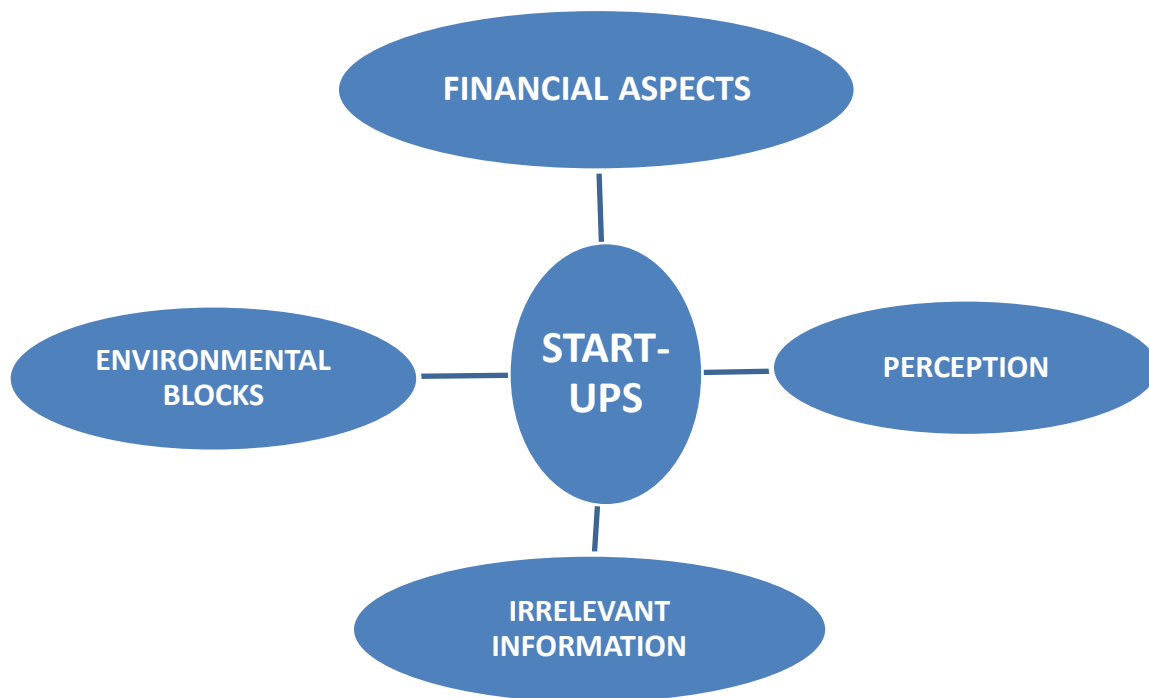
It is said that, "Nine out of ten start-ups will fail. "An entrepreneur needs a dose of reality now and then to maintain optimism in his life. If optimism is the first reason, running out of cash is the second reason behind the failure of start-up. The most common example is failure of Fintech Start-up, many Fintech start-ups fail because they are unable to understand the behavioral science of money, credit, savings, payments etc. Secondly, they were being trapped by 'Financial Institutions' as their competitors.

(5) Behavioral Finance explains how investors can be unconsciously drawn to risk aversion in their funding decision making. Entrepreneurial behavior is based on the actions taken by the entrepreneur to reach desired goals.

(6) Entrepreneurial performance is affected by individuals and environment and how this puts an overall effect on business performance. Not just investors, entrepreneurs themselves get demotivated by losses, initial failures, and environmental pressures and lose hope in carrying on with their ventures.

(7) Behavioral Finance is connected both to investors (who are financing it) and entrepreneurs (who are running it) and lack from any the side will ultimately effect the financial performance of business.

Entrepreneurial failure can have a major impact on the discovery of opportunities and innovation. It is a general opinion that entrepreneurs benefit from their previous failures. As a catalyst for future growth, failure provides learning opportunities. But sometimes continuous failure can lead to permanent closure of an enterprise. Failure is connected to the manager's decision and behavior and because of them how he conducts his enterprise. Overconfidence and excessive risk taking tendency can be seen as the principal causes of business failures. Studies have revealed how behavioral biases and individual perception leads to setbacks in business enterprise.

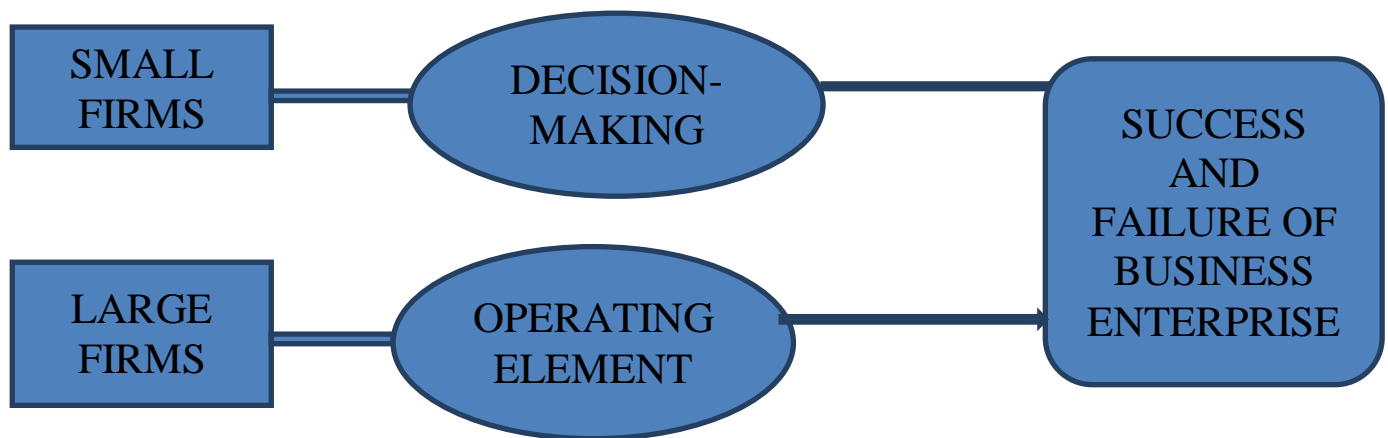


ROADBLOCKS TO START-UPS SUCCESS

SMALL FIRMS vs. LARGE FIRMS

In this paper we have found that not just the operational issues are responsible for firm failure but the human/ managerial/ decision-making is also responsible for smooth running or failure of a business enterprise. This paper discusses how psychological phenomenon and principles can be utilized in making models that can lead to probable failure and success of an enterprise. Decision-making is the common thing which is common both to large firm as well as small firm and it holds a key element in the success of the firm. Researchers cannot ignore the human/managerial/decision-making (cause-based) side of the equation for any company large or small. It is common for start-ups, early stage ventures as well as I.P.O. based companies. It gives us the potential of gaining better insights regarding problem areas that may lead to financial distress and later failures. Psychological phenomenon is the possible predictors of business success or failure. For example-: *The importance of Human Decisions, The Ability of Risk Taking, The On-going Traditional Financial Concepts* all prove to be true in this area. Starting, Financing, Managing, Growing any new venture is a complicated task and it requires efforts from all areas of society whether economic, political, or on the individual basis. It's easy to be an entrepreneur but to sustain as an entrepreneur is really difficult.

PICTORIAL REPRESENTATION



SUGGESTIONS

Investor Decision-making is affected by two main criterion; financial as well as non-financial aspects of the venture. The investment in a start-up is not just about funding a team with financial resources but maintaining cooperation between the investor and the start-up team. The non-financial cooperation usually plays a big role in start-ups growth. Maintaining connection with those investors who can connect with key people in the industry, with whom the start-ups can partner with are the major concerns of any new venture. There are certain biases that can affect investor behavior that distort make certain decision less rational. It studies how basic human emotions like fear, greed, overconfidence or risk aversion can influence the behavior of players. It should comply with both validity and reliability requirements while also providing information to answer the questions. So basically while financing a new firm criterion should be made on-:

- (1) How a firm is viable in the coming years?
- (2) How a product would be useful to the society?
- (3) Will this product help in sustainable development?
- (4) Will this initiative lead to financial inclusion?
- (5) Will it help in promoting Emerging Entrepreneurship?
- (6) Will it help in overall growth and development of the country?

If decisions would be made keeping in mind these criterions it would certainly help the emerging entrepreneurs to take effective decisions in right direction and it would also help them in becoming successful entrepreneurs.

CONCLUSION

Behavioral Finance is a branch that deals with psychology & science and entrepreneurship is setting and managing business. But the impact of behavioral finance is crucial in entrepreneurship. Research throws light on the fact that entrepreneurs use shortcuts when decisions are complex. It may simplify decision making process but also introduces biases that can lead to errors in judgment. Such Research methodologies should be employed which helps to build empirical methodologies while being governed by behavioral finance. Behavioral Finance not only affects entrepreneurship decisions but also investment decisions in the Venture Capital sector. Problem lies in the fact that firstly entrepreneurs try to be overconfident; secondly choice would be influenced in the manner how problem is framed; thirdly entrepreneurs make decisions on what information is available to them; fourthly entrepreneurs tend to form judgment on stereotypes. It is up to entrepreneurs that how they would avoid their biases and behavioral judgments to make their functioning proper and in an effective way.

REFERENCES

- (a) www.sciencedirect.com
- (b) Baron, R.A. (1998) Cognitive Mechanisms in Entrepreneurship: Why and when entrepreneurs think differently than other people, *Journal of Business Venturing*, 13: 275–294.
- (c) www.businessjargons.com
- (d) Cahandler & Hanks, (1998). “An examination of the substitutability of founders human and financial capital in emerging business ventures”, *Journal of Business Venturing*, 13 (5): 353–369.
- (e) Casson, M. (1982). *The entrepreneur*, Totowa, NJ: Barnes and Noble Books.
- (f) www.researchgate.net
- (g) www.emeraldinsight.com
- (h) Choi, Y. R. & Shepherd, D. A. (2004). Entrepreneurs' decisions to exploit opportunities, *Journal of Management*, 30 (3): 377–395.
- (i) CHARUPAT, N. & DEAVES, R. 2003. How behavioral finance can assist financial planners. Michael DE Groote School of Business Germany, 1-13.
- (j) Yazdipour, R. 2011. *A Behavioral Finance Approach to Decision Making in Entrepreneurial Finance*. Springer Science+Business Media. Los Angeles Platt, H.D. and M.B. Platt (2002), “Predicting Corporate Financial Distress: reflections on choice-based sample bias,” *Journal of Economics and Finance* 26, pp. 184-199.



- (k) Platt, H.D. and M.B. Platt (2002), “Predicting Corporate Financial Distress: reflections on choice-based sample bias,” *Journal of Economics and Finance* 26, pp. 184-199.
- (l) Ramaswami, M. (1987), “Stock Market Perception of Industrial Firm Bankruptcy,” *The Financial Review* 22:2, pp. 267-279.
- (m) www.investopedia.com