

## ≈ SUMMARY ≈

**RISK PERCEPTION BY ENTREPRENEURS: ‘ROSE-COLOURED GLASSES’  
AND OTHER SYNDROMES***Evan J. Douglas**Brisbane Graduate School of Business, Queensland University of Technology***Principal Topic**

Entrepreneurship is characterised by individuals starting new ventures that involve both foreseen and unforeseen risks, and then attempting to cope with the risks that arise. Research into entrepreneurial risk taking has largely focused on the individual’s attitude toward risk, with the presumption that entrepreneurs are more risk tolerant than others, but there is also evidence that entrepreneurs are relatively risk averse (Mullins & Forlani, 2005) or even risk preferring (Brockhaus, 1980). But the attitude toward risk is neither a necessary or sufficient condition for entrepreneurship (Douglas & Shepherd, 2000), so such diversity of empirical evidence might be expected. The relationship between risk attitude and entrepreneurship is potentially moderated by risk perception, however.

There is an abundant literature on risk perception which examines the potentially different perceptions of risk by different individuals (see Ricciardi, 2004). Entrepreneurs may look at the world through ‘rose-colored glasses’ (Palich & Bagby, 1995; Cooper, Woo & Dunkelberg, 1988). Entrepreneurs were found to be more overconfident than managers of other firms by Busenitz & Barney (1995). We also expect variation among entrepreneurs (Gartner, 1985). Some will have greater self-efficacy, and although they perceive specific risks they minimize the importance of those risks, believing that they have the ability to overcome those risks.

This eye-wear analogy bears extension to characterise some other cognitive biases that might help or hinder the entrepreneur to ‘see’ risk. The risk perceived will depend upon the human capital of the entrepreneur – different individuals will have different knowledge and prior experience in the industry and/or the market, and thus perceive less risk than another person with little prior relevant knowledge or experience. (Heath & Tversky, 1991). This clarity of perception may be called the ‘clear lens’ effect, and is akin to looking at the risk through one’s own prescription lens rather than through another’s (blurry) lenses.

‘Blue-blockers’ are eyeglasses that filter out the ‘blue’ end of the visible light spectrum and thus allow better visibility in poor light conditions, as experienced when driving at night, for example. They block out what the individual does not want to see. Similarly, entrepreneurs with high involvement in their new ventures may be so emotionally involved that they see only what they want to see, and may effectively wear such glasses to help them deny the existence of risk in their new venture. They may feel that if they actually see the risk they may have to abandon the new venture, and they would rather maximize their utility by proceeding ahead with a false sense of clarity. This is the ‘blue lens’ effect.

Finally, ski goggles utilise yellow lenses to achieve greater clarity of vision in high-glare, low-contrast situations such as are found on ski runs. For the entrepreneur these glasses represent market research, prototype testing, formal management education, and other information-

seeking activities designed to accumulate more knowledge about the technology, market and management issues involved in the new venture. Perhaps most entrepreneurs are reluctant to put on these glasses, since that would delay the exploitation of the new venture opportunity, and would thereby increase the risk associated with the new venture, since being first to market (with the answer to perceived customer needs) is expected to confer important first-mover advantages. This is the 'yellow lens' effect.

In this paper we investigate the perceptions of risk through the clear, rose, blue and yellow lenses that may be utilized by entrepreneurs. We argue that the entrepreneur will wear (or not wear) these lenses according to their differences in human capital, self-efficacy, involvement, and the urgency of their situation. We argue further that these differences among entrepreneurs will influence their willingness to engage in risk-reducing information search activity and will affect their intention to behave entrepreneurially.

### **Methodology/Key Propositions**

This is a conceptual paper that analyses risk perceptions using the economist's toolkit and the psychologist's cognitive and affective differences between individuals. The entrepreneur is assumed to be utility-maximizing, and will gain utility from income, independence, ownership and other perquisites, and disutility from risk and work effort (Douglas & Shepherd, 2000). Accordingly, the entrepreneur chooses to exploit the new venture opportunity that promises maximal utility, and this might have high or low risk associated with it (depending on the values of the variables in the decision function and on the individual's attitudes to those variables). We note that risk derives from ignorance and that ignorance is offset by information search activity (Shepherd, Douglas & Shanley, 2000). But this incurs search costs, which reduce the entrepreneur's total utility. Thus search activity will only be taken to the point where the marginal conditions for utility maximization are satisfied.

### **Results and Implications**

Risk preferring and risk neutral individuals will undertake no risk-reducing search behaviours, since the associated costs will reduce their total utility. For the risk averse, the extent of information search undertaken will depend not only on the degree of risk aversion, but also on their degree of preference for income (i.e. the material goods that can be bought using income). It will also depend on the extent of risk that is perceived, according to the rose, clear, blue and yellow lens effects. Accordingly, an entrepreneur will undertake less risk-reducing information search if he/she is more materialistic, more self-efficacious, more involved, and more impatient to gain first-mover advantages. Further, the 'lens effects' will moderate the impact of entrepreneurial attitudes on the intention to become an entrepreneur.

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