

The Opportunity Recognition Process and New Venture Start-Up Motivators: The Real Options Approach

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Principal Topic

This study utilizes the Panel Study of Entrepreneurial Dynamics (PSED) to examine the decision making process of nascent entrepreneurs (NEs) in the United States. Drawing on the real options theory, I check whether the motivators that drive the start-up of the new business venture (NBV) differ between the proactive NEs (i.e., those individuals who proactively look for business opportunities with the goal of becoming an entrepreneur) and the reactive NEs (i.e., those individuals who reactively decide to become an entrepreneur only after a business opportunity presents itself). OpR is one of the central areas of entrepreneurial research. Stevenson and Jarrilo (1990) proposed a definition of entrepreneurship that emphasized opportunity: "the essence of entrepreneurship is the willingness to pursue opportunity, regardless of the resources under control." Venkataraman (1997) concluded that entrepreneurship requires both enterprising individuals and lucrative opportunities (i.e., entrepreneurship cannot exist without OpR).

It has been argued that entrepreneurs are stimulated by different motivators depending on their gender, ethnicity, desire for independence and other factors and circumstances. However, I believe that many of the previously researched factors (e.g., gender and ethnicity) are, in fact, secondary to the fundamental distinction between entrepreneurs in regards of their OpR: reactive vs. proactive. Reactive NEs can be hypothesized to start their NBVs for different reasons than proactive NEs.

According to McMullen and Shepherd (2002), little attention has been given to the research on motivation, and "this neglect is disconcerting." Whereas overall research on motivation is lacking, research on reactive vs. proactive OpR and motivations appears to be non-existent.

Real options theory leads us to believe that NEs are making discrete choices under uncertainty in a way that maximizes their learning and contains downside risk while allowing them to capitalize on upside opportunities. Real option theory is particularly suitable for assessing uncertain projects in the rapidly changing competitive environment and has recently become a focus of managerial research (e.g., McGrath 1999; 2003).

Methodology/Key Propositions

In all analyses, the underlying assumption was that NEs base their decisions on real option reasoning (i.e., are rational decision makers) and choose the option with the highest expected utility.

It was hypothesized that, initially, reactive NEs enjoy better existing outside options (e.g., employment and higher household net worth, etc.) than do proactive NEs. Because of their less favorable existing outside options, proactive NEs are more inclined to actively search for opportunities and might potentially settle for less valuable opportunities. Reactive NEs, on the other hand, are satisfied with their existing options and do not feel the urge to actively search for NBV opportunities. However, once they come across a valuable opportunity, reactive NEs make a rational choice to pursue it. It is, therefore, hypothesized that opportunities pursued by reactive NEs might, on average, be more valuable than opportunities pursued by proactive NEs. Multinomial logistic regressions and chi-square tests were performed on the American PSED database to test the hypotheses.

PSED is a longitudinal study which eventually involved more than 100 entrepreneurship scholars who came together as part of the Entrepreneurial Research Consortium (ERC). The primary objective of the PSED was to describe how new venture come into existence. Data was collected from a representative sample of the United States population using random digit dialing (RDD) telephone survey interviews, followed by a mail questionnaire. The study methodology allowed researchers to identify NEs - those individuals in the process

of starting up a new venture - and to longitudinally follow their progression through data collection periods over time.

Results and Implications

It was found that reactive NEs enjoyed a much higher household net worth than did the proactive NEs ($p=0.000$), which clearly supports the real options reasoning. Moreover, proactive NEs were more likely to expect the NBV both to provide their families with financial security and to be the main source of their family income.

It was also found that reactive NEs were less likely than proactive NEs to see starting the NBV as a more desirable option than both other available career opportunities and other potential career opportunities. Further, proactive NEs were shown to be significantly more likely to be willing to try more other ideas if their current NBV idea proved to be unsuccessful. This is a clear indication that, compared to the reactive NEs, proactive NEs, on average, consider starting an NBV to be a more attractive option than their other options. Contrary to the prediction, it was found that reactive NEs were not significantly likely to be more satisfied with their last job, to be more likely working for others for pay, or to have more managerial experience than the proactive NEs. Similarly, opportunities pursued by reactive NEs were not found to be more valuable than the opportunities pursued by the proactive NEs (as measured by the expected NBV income in the 5th year of operation).

Despite the somewhat mixed results, one can conclude that, on average, proactive NEs are more likely than the reactive NEs to start an NBV because of their somewhat inferior present options. Further, reactive and proactive OpR is not likely to be a psychological trait since the attractiveness of other options appears to influence the OpR type.

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