

Entrepreneurial Risk and Market Entry

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By Xun (Brian) Wu and Anne Marie Knott, January 2005. [28] pages

Note

This paper was the recipient of the 2005 Office of Advocacy Best Doctoral Paper Award at the United States Association for Small Business and Entrepreneurship (USASBE) annual meetings. Xun (Brian) Wu is a doctoral student at the Wharton School at the University of Pennsylvania. Anne Marie Knott is a visiting assistant professor at the Robert H. Smith School of Business at the University of Maryland at College Park.

Purpose

Entrepreneurs, by their nature, are risk takers. The authors of this study suggest that there are two forms of uncertainty in entrepreneurial ventures: (1) uncertainty regarding market demand, and (2) uncertainty regarding one's own entrepreneurial ability. They further propose that entrepreneurs display risk aversion with respect to demand uncertainty, but exhibit overconfidence or "risk seeking" with respect to ability uncertainty. To examine this view, the authors model the entrepreneur's entry decision.

Overall Findings

The research shows that entrepreneurs, while risk-averse in their role as risk-bearers, are willing to bear economic risk when overconfidence compensates for their aversion

Highlights

Using data from the banking industry, the authors confirm their hypothesis. Entrepreneurs are risk-averse

towards market demand but are overconfident with respect to their own abilities. These results reconcile entrepreneurial risk aversion with their role as economic risk bearers. Entrepreneurs are willing to bear economic risk when the degree of ability uncertainty is comparable to the degree of demand uncertainty.

Scope and Methodology

To test the entry decision, the authors have chosen the post-deregulation commercial banking industry. This industry is ideal because it is fragmented with localized competition, is marked by significant *de novo* entry, and because the Federal Deposit Insurance Corporation (FDIC) collects complete cost data on all firms.

The data for this study come from the FDIC Research Database, which contains quarterly financial data for all commercial banks filing the "Report of Condition and Income" (Call Report). Each of the 50 states and the District of Columbia is examined for the period 1984 to 1997.

There are two stages to the analysis. In the first stage, the authors model an industry cost frontier to collect measures of cost efficiency for each banking firm in each year. In the second stage, entry is modeled as a function of the two sources of uncertainty: demand and ability.

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