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JUDUL: **COGNITIVE BIASES OF INDEPENDENT ENTREPRENEUR
IN DETERMINING ENTREPRENEUR'S VENTURE
SUCCESS.**

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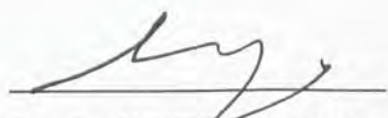
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**COGNITIVE BIASES OF INDEPENDENT
ENTREPRENEUR IN DETERMINING THE
ENTREPRENEUR'S VENTURE SUCCESS**

MOHD NASRUDDIN BIN MOHD YAAKUB

**DISSERTATION SUBMITTED IN
FULFILLMENT FOR THE MASTER OF
BUSINESS ADMINISTRATION**

**SCHOOL OF BUSINESS AND ECONOMICS
UNIVERSITI MALAYSIA SABAH
2012**



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DECLARATION

I hereby declare that the material in this thesis is my own except for quotations, excerpts, equations, summaries and references, which have been duly acknowledged. I also declare that all of the materials in this thesis has not been submitted to any or other university.



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ABSTRACT

COGNITIVE BIASES OF INDEPENDENT ENTREPRENEUR IN DETERMINING ENTREPRENEURIAL VENTURE SUCCESS

This study aims to investigate the relationship between dimension of cognitive biases and entrepreneur venture success among business communities at Kota Kinabalu, Sabah. A cross-sectional study was conducted among randomly selected independent entrepreneur at Kota Kinabalu, Sabah. Self-administered questionnaires were used to collect data. Data analysis included descriptive statistics, factor analysis, reliability test, multiple regression analysis and hierarchical regression analysis. Out of 200 sets of questionnaire, only 165 sets of completed questionnaire were used for data analysis. Most of the respondents (6.8%) were at the age 33 years. Regression analysis found that there was a significant relationship among dimension of cognitive biases and entrepreneur venture success ($p \leq 0.001$). However, in the case of Kota Kinabalu independent entrepreneur found that only one dimension has significant positive relationship with entrepreneur venture success. This study concluded that cognitive biases has partially supported or has a relationship with entrepreneur venture success among Kota Kinabalu entrepreneur. This study able to understand where illusion of control most likely to influence entrepreneur venture success.

ABSTRAK

Kajian ini bertujuan untuk mengkaji hubungan antara dimensi kognitif berat sebelah dan usaha kejayaan usahawan di kalangan komuniti perniagaan di Kota Kinabalu, Sabah. Satu kajian keratan rentas telah dijalankan di kalangan usahawan bebas yang dipilih secara rawak di Kota Kinabalu, Sabah. Pendekatan kawal selia telah digunakan untuk mengumpul data. Analisis data termasuk statistik deskriptif, analisis faktor, ujian kebolehppercayaan, analisis regresi berganda dan analisis regresi hierarki. Daripada 200 jumlah keseluruhan borang soal selidik, Sebanyak 165 set soal selidik telah digunakan untuk analisis data. Kebanyakan responden (6.8%) adalah pada berumur 33 tahun. Analisis regresi mendapati bahawa terdapat hubungan yang signifikan antara dimensi kognitif berat sebelah dan usaha kejayaan usahawan ($p \leq 0.001$). Walau bagaimanapun, dalam kajian ini, hanya satu dimensi mempunyai hubungan yang signifikan positif dengan kejayaan usaha usahawan. Kajian ini menyimpulkan bahawa kognitif berat sebelah telah sebahagiannya disokong atau mempunyai hubungan dengan kejayaan usaha usahawan di kalangan Kota Kinabalu usahawan. Kajian ini dapat memahami di mana ilusi kawalan yang paling mungkin untuk mempengaruhi usahawan kejayaan perniagaan.

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CHAPTER 1

INTRODUCTION

1.1 Introduction

This chapter will explain the research questions where the idea of the research background will be introduced for the understanding of the proposed research. Apart from that, in this part, the importance of this research to the practitioners will be highlighted and discussed.

1.2 Background of Entrepreneurship

There is a growing acceptance towards entrepreneurship field which demanding for the establishment of the theoretical framework. This is because, according to Bulut, (2008), there are the needs to develop more theoretical tools in the field of entrepreneurship and the limitation of the data still exists. However, According to Baran and Velickait (2008), research in entrepreneurship field has been looked seriously in the past.

A developing country like Malaysia improve the economic development and social well-being using a mechanism of entrepreneurial activities which has been seen as a way to enhance the distribution of income, fostering growth, and enhancing the economic framework which is highly associate with big company. Therefore, there are various government initiatives to prompt and to foster the economic development using several agencies to help the business community. Based on the Ninth Malaysia Plan (2006-2010), they are the Ministry of Entrepreneur and Cooperative Development (MECD), its agency Perbadanan Nasional Berhad (PNS) and the SME (Small and Medium Enterprises) Bank (Yusof, 2011).



1.3 Research Problem

Entrepreneurship has been well-known for its ability to curb economic downturn since it able to breaking the ice by using the innovative approach thus, pushing new market offering (Maier & Zenovia, 2011). Apart from that, it is able to act as a catalyst towards enhancing and creating competencies then, accessing into new boundaries of a market via innovation (Maier & Zenovia, 2011). This is important to bring a company or firms into the new level of development and survival, because yesterday's value doesn't ensuring values for today. As a result, a sustainable company who will be able to stay in the market due to the creativity approach in creating value for tomorrow (Maier & Zenovia, 2011). Another study done by Bulut (2008) about managing unexpected changes, mentioned that the information is the crucial parts in sustaining the dynamism of entrepreneurship because this is the source to foster the economy, therefore, considerable amount of attention must be look forward.

Apart from that, in order to come across towards the key problem, all of researchers realized that not every person has the same quality of entrepreneurship to another due to the human factors and some firms may succeed in their undertaking and some may not or by just replicating what others being done due to the fact that differences in entrepreneurship quality (Bulut, 2008). De Carolis and Saporito (2006) said that in understanding entrepreneurial behavior, it is best to look at individual cognition and social capital, this is because entrepreneurship consist of two domains which is enterprising individual and combining the presence opportunities. Thus, it's also suggest that entrepreneurial behavior is due to manipulating of inter environment within their existing social capital and cognitive biases. Apart from that, De Carolis and Saporito (2006) also confident that there is a possibility the entrepreneurial cognition can lead to successful exploitation of opportunities.

1.4 Research Questions

The research questions in this study have the following corresponding questions with the research objectives as follow:

- a. Does confidence (cognitive biases) have a positive relationship with Entrepreneur's Venture Success?
- b. Does illusion of control (cognitive biases) have a positive relationship with Entrepreneur's Venture Success?
- c. Does representativeness (cognitive biases) have a positive relationship with Entrepreneur's Venture Success?
- d. Does Status Quo (cognitive biases) have a positive relationship with Entrepreneur's Venture Success?

1.5 Research Objectives

The specific objectives of this study are as listed below:

- To examine the relationship between cognitive biases on Entrepreneur's Venture Success.

1.6 Problem Statement

Recently, entrepreneurship has become the main subject. This is because the world has changing rapidly due to the technological advancement. Firms need to compete globally and survive under current economic conditions. Therefore, entrepreneurs must come out with creative idea, products and market offering to the society in order to maintain its survivability. Under the competitive environment, entrepreneurs make a decision to make their major undertaking on new business, or ensuring successful business venture creation. This has reflected the entrepreneurial behavior in entrepreneur's decision making. Hence, innovation and value creation takes place to tag the opportunities by combining their own resources. Apart from that, managing unexpected changes had become one of the issues among independent entrepreneurs in Kota Kinabalu, Sabah. There is limited study has been carried out in East Malaysia likes Kota Kinabalu, Sabah. Therefore, it requires more studies to be conducted in

order to provide in-depth information on the understanding the antecedents of entrepreneurial behavior.

Figure 1.1: Theoretical model of De Carolis and Saporito

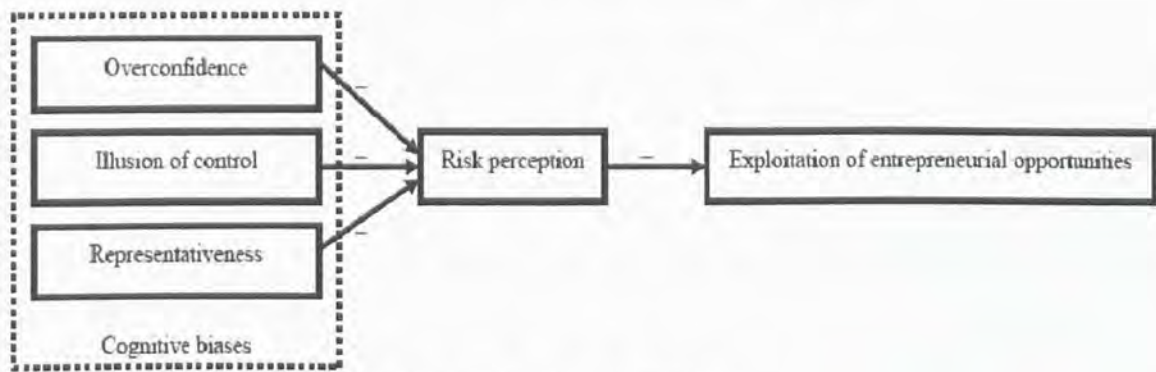


Figure 1 – Adjusted conceptual model of De Carolis and Saporito (2006).

Source: De Carolis & Saporito (2006)

Referring to De Carolis and Saporito (2006) theoretical model, the three antecedents of cognitive biases reduce the level of perceive risk, which trigger risky actions. First of all, a study done by Burmeister & Schade (2007) on the decisions of entrepreneurs, they argued and confirmed most of the decisions made by entrepreneurs suffer from the *status quo bias*. Status quo has been defined by the author as '*the behavioral tendency to decide for a status quo option disproportionately often*'. Burmeister & Schade (2007) argue that people choose what they have chosen before. Therefore, this bias could lower the risk perception among entrepreneurs.

Another study done by Simon et al. (2002) who test the model among student as a control group where this study should be put more focus on real entrepreneur and corporate entrepreneur who is capable in describing entrepreneurial behavior. Davidsson (2005) further argue from the methodology of the study, prediction towards entrepreneurial behavior can be predicted well by using real entrepreneur instead of control group such as student (Davidsson, 2005).

Another view from Bulut, (2008), the theoretical model of De Carolis and Saporito (2006) seems to general. It seems to be fit with everyone who engages with entrepreneurship that explains entrepreneurial behavior. But, it does not focus on other aspects such as the distinction of independent entrepreneur and corporate entrepreneur.

In general, opportunities exploitation can be seized by independent entrepreneurs and corporate entrepreneurs. According to, Busenitz and Barney (1997), entrepreneurs are more overconfident and are displaying representativeness extensively than managers. Managers which are labeled as corporate entrepreneurs, work for the sake of organizational gain, and will show less cognitive biases than independent entrepreneurs. On the on the other hand, independent entrepreneurs work for self gain. As a result, independent entrepreneurs are more prone to cognitive biases than corporate entrepreneurs.

1.7 Scope of the Study

This is a cross-sectional study that used quantitative survey approach to investigate the relationship between the antecedents of cognitive biases and entrepreneur's venture success among independent entrepreneurs in business community at Kota Kinabalu, Sabah. sample random sample sampling technique has been used for selecting some of the independent entrepreneurs in Kota Kinabalu, Sabah from the company list obtained from SEDIA. Self-administered questionnaires have been used to collect data. In this study, entrepreneur's venture success is the dependent variable whereas there are four dimensions of cognitive biases of independent variables which include confidence, illusion of control, representativeness and status quo. The primary aim of this research is to see the cognitive biases leads to ***Entrepreneur's Venture Success***. The subject group is *Independent Entrepreneur (IE)*. For the purpose of collecting data, several organizations had been engaged from Dewan Perniagaan Melayu Malaysia (SABAH). At first, a courtesy call to DPMM(S) office at Sembulan, Kota Kinabalu, Sabah and discuss the intention. Second, a visit to Sabah Investment

Agency (SEDIA) for the list of Companies in Kota Kinabalu, Sabah for data mining for this study.

1.8 Significance of the study

The growing acceptance towards entrepreneurship field which demanding for the establishment of more theoretical framework. This is because, according to Bulut, (2008), there are needs to develop more theoretical tools in the field of entrepreneurship and the limitation of the data still exists. Thus, the grey area surrounding entrepreneurship field can be use to explore and fill the gap in the field of entrepreneurship and also will help policy makers and academicians to design policy and expand to another level of research (Bulut, 2008).

This study aims to investigate the entrepreneur's cognitive biases which are, confidence, illusion of control, representativeness and status-quo giving an impacts towards entrepreneur's venture success. Most of the study done by another researcher only covers the potential entrepreneurs. In this study, real independent entrepreneurs had been use to complete this study. From this study, it is also can look from the aspects of entrepreneurial behaviour which can leads to innovative entrepreneur (Bulut, 2008).

As part to answer the call for government Economic Transformation Programme (ETP), an innovative entrepreneur must be there to ensure the efficiency and success of the programme due to the global climate change and economic uncertainty. Independent entrepreneur need to be more flexible in order to survive and sustain under Economic Transformation Programme (ETP) due to the competitive business environment. Apart from that, entrepreneurs need to sustain and manage unexpected changes. Therefore, a past experienced, past judgements and managing risky decision as seems crucial in entrepreneurial behaviour where entrepreneur engaging in decision making process which is influenced by past experienced. Thus, it reflects the role of risk perception against entrepreneur's venture success.

1.9 Definitions of Key Terms in Study

The definitions of key terms are explained as follow for the ease of understanding the related terms used in this precise study.

1.9.1 Entrepreneurial Success

Entrepreneurial success happens due to the creative activity in the company. Most research defined creativity as the production of novel and useful ideas in any domain (Soon & Zainol, 2011). Soon and Zainol (2011) said in their study, that creativity processes are potentially important to Malaysian SMEs. Their research study has found that the organizational creativity is positively related to organizational performance. Organizational performance according to Soon and Zainol (2011) can be evaluated through the "overall success, market share, growth rate, profitability, and innovativeness". In the case of Malaysian SMEs, there is some existence of evidence of change and improvement in the last decade. It is evident from this study that SMEs capacity to play an important part in the economic activity depends on their commitment to knowledge management (Soon & Zainol, 2011).

1.9.2 Independent Entrepreneur

An entrepreneur, in this thesis, is an independent entrepreneur owning a firm with at least ten employees and operating more than three years (Bulut, 2008).

1.9.3 Entrepreneurial behaviour

The meaning of entrepreneurial behaviour in this study is engaging with entrepreneurial thinking, whether the entrepreneur dare to take risky action and decision in order to pursue to the next level of venture success (Bulut, 2008). According to Bulut (2008), Entrepreneurial behaviour means most likely implementing entrepreneurial thinking, in which an individual takes risky actions, involving in innovative actions and being proactive (Bulut, 2008). The occurrence of entrepreneurial behaviour can be explain in several fields where focus can be given on cognitive biases which at the end influencing entrepreneurial behaviour. For instance,

entrepreneur emotion can influence a variety of entrepreneurial cognitions (Mitchell et al., 2007).

1.9.4 The Entrepreneur

The term "entrepreneur" has its origins in 17th century, where an entrepreneur is a person who dedicated to undertake a particular commercial project. An entrepreneur therefore is commonly understood to be someone who undertakes certain projects, and recognized them, by at least, by what they actually do (Dellabarca, 2002). Hisrich, Robert D., Michael P. Peters, Dean A & Shepherd (2005), an entrepreneur is a person who connecting all resources and make value out of it. For another businessman, they views others entrepreneur as a threat, supplier, resources and sometimes an ally in creating opportunities and wealth. Since entrepreneurship engaging with dynamic process of wealth creation, it involves some of the risky actions and decision (Hisrich, Robert D., Michael P. Peters, Dean A & Shepherd, 2005).

There have been many studies trying to determine a psychological model of the entrepreneur. However, research by Dellabarca (2002) only focus on the influenced from education, family, genes and career experience. Apart from that, there is no acceptable model has been highlight to elaborate why successful entrepreneurs regardless of colour and description, sex and shape (Dellabarca, 2002).

1.9.5 Cognitive biases

In a study done by Bulut (2008), cognitive biases define as mental shortcuts for the purpose of making judgments. Biases always exist in making judgement and decisions, subjective opinions and cognitive mechanisms, which are useful in determining ways of making decisions on an effective and efficient manner (Busenitz & Barney, 1997). Therefore, by having cognitive biases in mind, it is useful to make quick decision by relying on existing experience as a guidance known as mental rules (Bulut, 2008). By having cognitive biases in mind, it seems to decrease the

uncertainty and enhance decision making process which leads to generate context-specific misjudgements that could lead to risky actions (Simon and Houghton 2002). Despite the fact, it may move to important misperceptions, it is also able to trigger the entrepreneurs' willingness to choose risky actions (Busenitz and Barney 1997). Even though it helps entrepreneur to engage with their cognitive limitations, they may result in less rational, less comprehensive decision-making (Mark Simon, Susan M. Houghton 2002).

The four cognitive Biases which are the focus of this study:

According to Russo & Schoemaker (1992), **overconfidence** known as a shortcut of mental failure, where the person doesn't realized the limitations of his or her knowledge.

According to Simon et al (2000) in his journal entitle "Cognitive biases, risk perception and venture formation: How individuals decide to start companies", "**illusion of control** is an expectancy of a personal success probability inappropriately higher than the objective probability, would warrant". Illusion of control is a common cognitive bias demonstrated by entrepreneurs (Simon, Houghton et al. 2000). It will empower independent entrepreneurs to look for information that aligned with their hypothesis and ignore weaken evidence (Simon, Houghton et al. 2000).

Representativeness has been described by Bulut (2008) which carry the meaning on one generalizes a situation from a sample to true facts and limited number of information gathered. According to Tversky & Kahneman (1971), representativeness exist when a person allow only small numbers of information to make a judgment and decision. Individuals tend to make random samples to make judgment about the population and statistics in which decision makers bond to the numbers of information they can gather (March & Simon, 1958).

Status quo bias has been defined as doing nothing in solving problematic decision or maintains the current state of decision by a person (Bulut, 2008).

1.10 Summary and Organization of remaining chapter

This Master thesis is constructed in a five chapter format. Chapter 1 in this study presents the background of the study, problem statements, the research objectives, and the significance of the study, the contributions and scope of the study and definitions of key terms. Chapter 2 includes a thorough literature review on cognitive biases element and entrepreneurial venture success. Chapter 3 of this study provides an obvious research methodology consist of the theoretical framework, research design, population and sampling plan, and data analysis procedures and chapter 4 is finding for the analysis then comes chapter 5 which include discussion, implication and conclusion for this study.

CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

For this specific chapter, it discusses some of the key areas of previous studies concerning to entrepreneur behaviour and personal factors among independent entrepreneur.

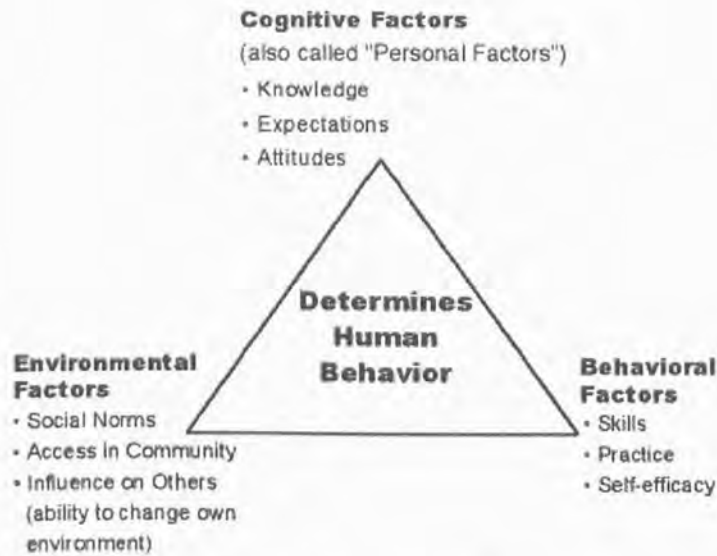
2.2 Entrepreneurial Cognition Theory

In the social cognitive theory, entrepreneurial behavior exists due to the interactions of environments and certain cognitive biases of entrepreneurs (Augoustinos & Walker, 1995), and also in line with Fiske & Taylor (1984), Bandura (1986) and Wood & Bandura, (1989) where all of the authors propose the same suggest and come out with a new model towards cognitive biases. They also suggest that in understanding entrepreneurial behavior, individual cognition and social capital both play crucial role.

In the entrepreneurship, literature in cognition is one of the new things in entrepreneurship field (Baron, 2004). According to Baron & Ward (2004), in the cognition literature, it fails to solve or addressed one issue which is "do entrepreneurs make decision or judgment differently compared to others. For instance, entrepreneurs are different from others when they cope in a setting that allowed cognitive errors. According to Baron & Ward (2004), they argued that This condition most likely will influence the success and failure of entrepreneur because they tends to rely on decisions reached by them or around them within their knowledge. Apart from that, Forbes (1999) argued entrepreneurial cognition associates with cognitive processes.



Figure 2.1: The Structure of Social Cognitive Theory



Source: Bandura (1989)

Figure 2.1 exhibit the structure of Social Cognitive Theory. The social cognitive theory describe as learning theory which explained how it relates to behavior being learned (Bandura, 1989). It represents dynamic approaches in which behavior, personal and environmental build the Social Cognitive Theory that strongly relates to each other. Apart from that, it is also display the personal and environment influenced behavior.

2.3 Opportunity Recognition

Opportunity recognition play a crucial role in starting up a venture because it is part of entrepreneurial process where it does provide the impetus for the next undertaking in term of venture or business creation (Dellabarca, 2002). This is important process because it's symbolized entrepreneurial success. For instance, Richard Branson from Virgin Group, who is opportunity oriented in any business venture (Dellabarca, 2002).

The venture creation started when an entrepreneur decide to start a venture after going through the process of exploitation of entrepreneurial opportunity. In the

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