

## Are Entrepreneurs Risk Lovers? Risk Characteristics and Risk Preferences of Herbal SMEs

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**ABSTRACT:** Small-scale enterprises are considered the drivers of economic growth in all countries. The ability of entrepreneurs to make decisions is the main thing to support business growth, especially related to risk. This study focuses on the risk preferences of small and micro businesses in herbal drinks. This study conducted a survey of small and micro businesses in Indonesia, namely in the city of Surabaya, East Java province. This survey was followed by 271 participants. Data were collected through a combination of survey questionnaires. Data analysis used descriptive statistics Cronbach alpha to analyze the data. The results show that small and micro-scale herbal producers have a risk averse character.

**Keywords:** Small and medium-sized enterprises (SMEs), Risk Preference, Herbal Producers.



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## INTRODUCTION

Small and Medium Enterprises play a role as a catalyst for the growth of large companies (McPherson, 1996). Countries around the world recognize that SMEs improve productivity and the investment climate (Surya et al. 2021; Qurratu'Aini & Hapsari, 2019; Myslimi & Kaçani, 2016; Fiseha & Oyelana, 2015). SMEs have a role in creating employment and income for people in the lower sector (Myslimi & Kaçani, 2016; Sujarwo & Hanani, 2016). Not only that, SMEs also have to bear the risk of various alternative decisions taken. The entrepreneurial point of view states that risk may occur in various forms, for example: abstract constructions, such as trust (Brunetto and Farr-Wharton, 2007), or the "real" threat of business opportunities (Oswald et al., 2011). SMEs as decision makers must be able to manage risk in their business, be able to exercise control over thoughts, feelings, and actions, which greatly affect individual views (Bandura, 1997). An entrepreneur assesses risk preference which is defined as an individual's general tendency to take or avoid risk in a particular decision context (Mullins & Forlani, 2005; Sujarwo & Pratiwi, 2011) can affect the success of an organization. The SME's preferences or willingness to take risks have been analyzed and optimal decisions are made to reduce the risk of the choice, kAsset ownership

and socioeconomic variables affect risk preferences (Eggert & Lokina, 2007). Research related to risk preferences to determine alternative tendencies towards risk has been widely studied. These studies mainly deal with consumers, farmers and producers (Chiappori et al., 2019; Vieder et al., 2019; Ai & Bansal, 2018; Jianjun et al., 2015; Georgousopoulou et al. 2014; Liu & Huang, 2013; Eggert & Lokina, 2007; Binswanger, 1982; Young, 1979).

Previous research has shown that small business owners are more focused on handling losses and the magnitude of risk rather than potential returns on investment (Behr and Guttler, 2007; Sauner-Leroy, 2004). Most SMEs are family-oriented businesses (Brouthers and Nakos, 2005). This fact, combined with a low risk approval culture and means that SME owners are highly risk averse (Petrakis, 2005). According to Bannock Consulting (2001), less than 1 percent of SME owners are willing to seek external capital to finance their business.

This situation has also ensured that risk remains one of the dominant themes in entrepreneurship research. From this study, we can find out whether Herbal SMEs are like other SMEs, which have a low preference for risk and whether herbal products can be placed into risk preference groups based on their characteristics.

The impact of cultural differences is what we want to use as a basis for learning. Based on the literature review above, this study aims to:

- 1) Identifying the risk characteristics of herbal SMEs
- 2) Analyzing the risk preferences of herbal SMEs to financial risk

## **METHOD**

The method should be well elaborated enhancing the model, the analysis approach and the steps taken. Equations should be numbered as we illustrate.

### **1. Sample**

This research was conducted on herbal drink manufacturers in the city of Surabaya. The reason for determining the research area is that this area has a group of herbal drink producers under the guidance of the city government. The herbal drink was chosen because it is a local icon, namely herbal medicine. Participants were collected by accidental technique, after obtaining permission from the Surabaya city government authority. A total of 271 participants (44.94%) MSEs and (55.06%) did not complete the survey.

**Table 1. Participant Response**

Description	Number of Participants	Percentage (%)
Total Participants	603	100
Did not complete the Questionnaire	332	55.06
Complete the Questionnaire	271	44.94

Source: Survey Questionnaire (2021)

**Table 2. Distribution of Participants**

Location	Frequency (n)	Percentage (%)
East Surabaya	28	10.33
West Surabaya	98	36.16
Central Surabaya	39	14.39
North Surabaya	44	16.23
South Surabaya	62	22.87

Source: Survey Questionnaire (2021)

**Table 3. Participant Profile**

description	Number of Participants (n)	Percentage (%)
Licensing		
Have Licensing Legality	97	35.79
Non Legality of Licensing	174	64.21
Length of business		
Less than 1 Year	115	42.43
1-3 Years	73	26.94
4-5 Years	37	13.65
6-10 Years	26	9.59
More than 10 Years	20	7.38
Number of employees		
Less than 5 people	236	87.08
6-10 people	30	11.07
10-30 people	1	0.37
More than 30 people	4	1.48

Source: Survey questionnaire (2021)

Participants who completed the questionnaire (44.94%) were relatively lower than the participants who did not complete the questionnaire (55.06%). However, the number of participants in this study was higher than previous studies. These include Picazo-Tadeo & Wall (2011) reported 130 participants in his study, Georgousopoulou et al., (2014) 150 participants and Kimutai et.al. (2014) 267 participants who took part in the questionnaire survey. Descriptive statistics are reported in Table 3. Research participants were dominated by producers with a duration of business less than 1 year (42.43%) and has less than 5 employees (87.08%). Next, participants without the legality of licensing (64.21%) is greater than those who already have the legality of the license (35.79%).

## 2. Survey Design

The survey questionnaire consists of three parts. The first section includes questions about the manufacturer's profile. The next section includes questions regarding the characteristics of producers to risk, the third part is the risk preferences of producers. In this survey, participants receive a monetary incentive (Rp. 10,000) with the aim of increasing the response rate. The survey was conducted on producers found in the field and willing to participate in the survey. The survey was conducted on September 1, 2021 – October 31, 2021.

## Data Analysis

**Table 4. Producer Characteristics Against Risk**

Category	Frequency	Percent (%)
An extreme risk-averse	36	13.2
Alert	77	28.3
Willing to take risks after adequate research	102	37.5
Don't really care about risk	14	5.1
Enjoy taking risks in my business	33	12.1
True luck tryer	9	3.3
Total	271	99.6

Source: Survey Questionnaire (2021)

Survey shows producer characteristics willing to take risks after adequate research (37.5%) and wary of risks (28.3%). Then producers who avoid extreme risk by 13.2%. The rest enjoy taking risks (12.1%) and don't care about risk (5.1%). The results show that small and micro-scale herbal producers participating in this study dominated by producers with a risk averse character. Risk averse is a characteristic that tends to avoid risk, and prefers a smaller risk.

**Table 5. Purchase Insurance and Apply for Credit**

Category	Option	Frequency	Percent (%)
Buying insurance for business	Yes	89	32.7
	Not	182	66.9
	Total	271	99.6
Open a line of credit for business capital	0%	147	54.0
	1%-10%	64	23.5
	11%-25%	34	12.5
	26%-50%	19	7.0
	51%-75%	6	2.2
	More than 80%	1	.4
	Total	271	99.6

Source: Survey Questionnaire (2021)

Participants in this study stated that they did not buy insurance for their business (66.9%) and the majority did not open a line of credit as their business capital (54%).

**Table 6. Risk Preference**

Category	Importance levels (5 = most important)				
	1	2	3	4	5
I have enough cash or assets that can be easily converted into cash to pay all my bills	3.7	9.2	15.4	41.2	30.1
I rely heavily on market information (eg government reports, private market news services, extensions) in making my marketing decisions	1.5	13.7	11.1	39.9	33.9
I have adequate life insurance	9.9	14.0	12.5	34.9	28.3
I registered my business insurance	8.5	21.7	10.3	31.3	27.9
Income outside of business is important for my family's survival	0.7	3.7	8.9	42.8	43.9
Investing outside of business is an important source of income for my family	0.4	7.7	8.5	39.9	43.5
In case of emergency, I have adequate backup and manpower management	1.8	10.3	11.4	41.7	34.7
Most of my production machines are new and/or in good condition	1.8	6.6	8.9	36.5	46.1
I consider myself a low-cost producer	1.5	15.5	11.4	35.4	36.2
I use financial information in making decisions about my business	0.7	7.0	7.4	46.1	38.7
Passing my business on to my children is important to me	2.6	2.6	7.0	36.9	50.9

**Table 7. Reliability Statistics**

Cronbach's Alpha	N of Items
.834	11

The variable items used to measure the entrepreneur's risk preferences were assessed using a Likert scale. Participants responded that they believed in each statement by responding on a 5-point scale, 1 (strongly disagree) to 5 (strongly agree). Cronbach's alpha scale is 0.834, indicating that the producers predominately agree with the statement.

## **RESULT AND DISCUSSION**

Characteristics of small-scale herbal producers to risk, from data analysis it was found that 37.5% of participants were willing to take risks after adequate research. This is not a new finding because previous research revealed that small-scale producers tend to avoid risk (Kirsten & Sartorius, 2007).2002; Georgousopoulou et al.2014; Ruiz Meza,2015). Small-scale producers have limited funding sources, this is one of the considerations for producers to be more careful in making decisions that will have an impact on business risk (Taylor & Kane, 2003).2005; Hernandez-Jover et al.2012; Pomeroy et al.2020). Small-scale producers generally have low technology adoption and a narrow marketing reach (Georgousopoulou et al.2014). Galloway et al., (2004) found that SMEs in urban areas tend to adopt technology compared to rural areas.

The preference of herbal producers for financial risk control shows that small-scale herbal producers do not show a negative preference for efforts to control business risk. The proportion of participants did not show a negative risk preference for each variable. The results of the analysis show that herbal producers have careful planning for controlling the company's financial risks. Manufacturers agree to have enough cash or assets that can be easily converted into cash to pay all their bills (41.2%) and strongly agree (30.1%), producers also agree that they have adequate life insurance (34. 9%), and using financial information in making business decisions (46.1%), producers agree in an emergency to have adequate reserve management and workforce (41, 7%) and strongly agree (34.7%). Producers strongly agree that non-business income is important for family survival (43.9%), producers strongly agree that non-business investment is an important source of income for families (43.5%).

The results of this study confirm the findings regarding the decisions of SME owners in preventing financial-related business risks. Manufacturers prepare carefully regarding the company's financial risks. This result is very interesting because the traditional view of small-scale producers is that they have poor financial management (Mohammed et al.2020; Ghaffar et al.2019; Dzomonda & Fatoki,2018; Taylor & Kane,2005). This can be caused by producers trying to fight threats that cannot be predicted during making decisions, especially in terms of capital.

## **CONCLUSION**

This research is motivated by the desire to better understand the risk preferences of SMEs. This study focuses on the herbal SMEs sector because herbal SMEs are icons of local products that are expected to increase local value. Previous research has shown that SMEs are generally risk averse (Georgousopoulou et al., 2014). Our study in particular contributes to the development of knowledge namely the risk preferences of SMEs with respect to the prevention or minimization of capital risk.

We also find that most of the variables influencing SMEs' responses to various risk preference measures (eg perceptions of financial losses due to operational disruptions and human error, perceptions of the importance of demand and expected profits, and insurance to cover business losses) are intrinsic to SMEs; that is, they are not directly caused by external factors. Many studies note that SMEs are important to the economy.

Based on our findings, further studies should be directed towards exploring the most effective ways to ensure that SMEs respond positively to risk preference measures, both internally and externally. This study highlights that SMEs are unlikely to change their character to risk without strong support from local authorities. This can be achieved through proactive government action in the form of access to cheaper capital, reduced bureaucracy, business insurance and government-facilitated marketing assistance for small-scale producers. Our study also contributes to knowledge by showing the risk characteristics of SMEs so that local authorities in managing the development of SMEs based on their characteristics.

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