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Research Article

The Level of Expected Returns, the Level of Risk and the Relationship between Return and Risk in MSME Investment Decisions

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Abstract

There is a vast amount of business and economic literature that provide empirical findings suggesting that business units will naturally grow from small businesses to large businesses. In the context of Micro, Small and Medium Enterprise (MSMEs), the idea of growth is translated as the idea of increasing the business class from a small business to a medium business, up until becoming a large business. Furthermore, the concept of 'graduating' is not easily applied to MSMEs in Indonesia. The classic problem of MSMEs in developing their business is related to funding and marketing issues. It is emphasised the ability of MSMEs still depends on adequate funding. The Indonesian government has provided solutions to this problem by providing commitment through Bank Indonesia (BI). Bank Indonesia has instructed banks to increase the portion of MSME loans to a minimum of 20% of total loans. Although this supports government policy, SMEs as the main actors are not yet progressively participating in the competition. The growth ability of MSMEs is highly dependent on the potential to invest, innovate, and qualify. In order to carry out the 'grade-up' strategy in line with the idea conveyed, namely 'enterprise upgrading'. Companies that can grow must prioritise the role of internal characteristics (entrepreneurs and companies), these characteristics are referred to as, 'demographic characteristics'.

Keywords: SME, MSME, investment decision, return and risk, enterprise

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1. Introduction

Enterprise upgrading strategy related to investment decisions by SMEs as investors is closely related to sustainable business development. Sustainable business is in line with the theory of Resource-based View (RBV), which explains that above average financial performance as the long-term goal of the company is through profitability (financial performance) [1]. To achieve financial performance goals, companies use various inputs, such as financial resources (capital), human resources (labour), technology, network, etc [2]. The performance obtained is based on three main bases in investment decisions, which are related to the expected return, the level of investment risk, and the relationship between yield and risk [3]. Decisions taken by investors are closely related to investor behavior towards risk. Investor behaviour obtains different business returns. The risk process no longer requires a risk avoidance strategy, but has to concentrate more on an accurate diagnosis and personnel management [4]. The link between investment is illustrated in Figure 1.

Figure 1. Investment Relations, Return, Risk and Demographic Characteristics

Investment selected by investors are strongly influenced by investor behaviour, which is defined to be investor attitudes towards the risks to be faced, whether investors like risk (risk seekers), avoiding risk (risk averter), or ignoring risk (risk in difference) [5]. Additionally, investor demographic factors are also suspected to affect investors in investing. The basis of investment decisions consists of the level of expected returns, the level of risk, and the relationship between return and risk [6]. The assumption model regarding investor preferences is only based on the expected return and risk of the portfolio that considers investors to have the same utility function. Consideration of the Markowitz model is the value of the portfolio with the smallest risk for a certain expected return [7]. Returns that are based on demographic characteristics are explained from Upper Echelon Theory. This theory suggest that organisations as a reflection of top management strategy highly depend on managerial background characteristics. Managerial background is defined to be the demographic characteristics possessed by the leader, which are related to age, experience, education, social background, and economic conditions [8]. Despite that group/environment wheres/he belongs and has a huge influence on the way entrepreneurs digest, analyse, and solve problems. A study provides evidence that demographic characteristics affect company performance by influencing the decision-making process [9].

2. Enterprise Upgrading Strategy and Demographic Characteristics

Enterprise lays out the important role about the internal characteristics of entrepreneurs and companies. In turn, the characteristics of entrepreneurs influence the tendency of companies to expand their business scale and scope. The characteristics of entrepreneurs include the age of the entrepreneur, gender, education and work experience, motivation, and ability to take risks. In terms of company characteristics, there is the age of the company, location, line of business [10], formality, financial access as well as the company's ability to identify, evaluate and utilise external knowledge for commercial purposes.

A definition of demographics as the study of everything encompassing human conditions and attitudes that can be measured, which includes changes in general, physical civilisation, intellect, and moral conditions. Investment is related to demographic factors like age, education, employment, income. Demographic characteristics in these regards is akin to its usage in social science studies [11]. Related with the population of an area, whether a village, sub-district, district, province, or country. The demographic characteristics are the special characteristics of a population that is able to distinguish these populations with other residents in different regions.

The Theory of Reasoned Action explains the behavior of individuals is influenced by external variables that integrate with environmental factors that determine behaviour (demographics, personal characteristics, beliefs about objects, attitudes towards objects, task and situational characteristics).

This study takes research variables from Demographic Characteristics: Business Type, Gender, Age of Owner, Length of Business, Education, and Experience.

3. Risk Tolerance and Financial Performance

The basis of investment decisions depends on the level of expected returns, the level of risk and the relationship between return and risk. The investment decision process is an onward continuous decision process. This consists of five decision stages that continue until the best investment decision is reached. The five decision stages include: (1) Determination of investment objectives (2) Determination of investment policies (3) Selection of investment strategies and (4) Selection of assets. The selected investment and the amount of funds to invest is also greatly influenced by investor tolerance for risk, also called risk tolerance, which is the behaviour of the risks to be faced. Risk tolerance is measured by whether the investor likes risk (risk seeker), avoids risk (risk averter),or ignores risk (risk neutral). Risk tolerance is a very strong predictor in investment decision making [12]. The three types of investors will be very different in decision making and depends on the allocation of funds for investment. Risk perception is the result of many factors, which form the basis of differences in decision making towards possible losses.

The central concept of entrepreneurship and the strategy management literature are ideas for constructing multidimensional performance. Especially for the dimensions of financial performance (financial performance) using the construct of profitability, growth, efficiency, financial structure, survivability, cash flow and resource accumulation. In general, the measurement of SME business success is based on an assessment of financial performance. The indicator of of financial performance used in this study is: ‘Finance profitability’.

4. Relationship between Demographic Characteristics and Risk Tolerance

Demographic characteristics have a high influence to risk tolerance because Upper Echelon Theory suggests organisations are a reflection of top management. The choice of organisational strategy is predicted by the characteristics of the managerial background. Leaders play an important role in strategic decision making [13]. The strategies chosen by leaders are a reflection of their values and cognitive ability. Their strategy relates to investor behavior in dealing with risk (risk tolerance). Some of these relationships have been tested, including the relationship of business types to risk. In regards to employment (type of business), Certain occupational groups, e.g. corporate executives, avoid risk (risk averter) in investing. The relationship between age and risk include the following demographic factors: age, which explains that usually younger investors will be riskier to take risks in investments than the unproductive or elderly, who do not dare to take risks in investing. Upper Echelon Theory suggests that age logically shows an accumulation of experience. However, age correlates with the willingness and ability of leaders to face risk. Organisations with younger leaders tend to take risky strategy choices. Older leaders, in addition to being burdened by their past experience that is not impossible to have been exposed to failure also have physical and psychological limitations and thus tend to avoid risk. Moreover, education is a significant factor. In the study, ‘Hunger for Risk: Education’, Risk tolerance to also have a relationship with one’s level of education. People who dare to take risks (risk aggressive) can be said to be highly educated because they have extensive knowledge and are able to calculate the risks faced.

Previous research provides an illustration that demographic characteristics have a relationship with investors' attitudes in choosing risks.

Hypothesis 1 (H1): There is a significant relationship between Demographic characteristics and Risk Tolerance.

5. Relationship between Demographic Characteristics and Financial Performance

The relationship between demographic characteristics and financial performance. Resource-based View (RBV) theory explains that excellent performance in terms of output or profitability is one of the main goals of every company. In order to achieve these objectives, companies use various inputs, such as financial resources (capital), human resources (labour), technology, among others [14]. Superior company performance depends on available resources, both tangible and intangible. RBV strongly highlights company resources that are unique, rare, and valuable, which lead to the company's competitive advantage. The relationship between demographic characteristics and financial performance can also be seen from gender relations to performance. A study conducted gender diversity does not have an impact on company performance. In a research, it was found that women are more committed to their organisation compared to men.

Relationship of Age to Performance. A study shows that age is one of the factors that gives a good influence on the performance and organisational commitment towards employees in the organisation. The relationship of company age to performance study found there was a significant influence on the company's higher profits than the newly established company. Relationship of Education to Performance illustrates that the better knowledge and intellectual experience found by an employee or human will make the task to be more easily done and be able to produce the best output [15]. Relationship of Experience to Performance explains that companies have a tendency to increase profits and have a tendency to do income smoothing due to the experience in managing their business. Furthermore, the intellectual experience found by an employee or person willing to make the task can be easily done and able to produce the best output.

Several studies also found that there is a relationship between demographic characteristics and financial performance [16].

Hypothesis 2 (H2): There is a relationship between demographic characteristics and financial performance.

6. Relationship between Risk Tolerance and Financial Performance

The assumption model regarding investor preferences, based on the expected return and risk of the portfolio chosen by the investor (small risk for certain expected returns). If investment is wanted, the person is referred to as an investor or a person who invests. Basically, there are three types of investors that when linked to the level of risk they can accept, (1) Risk averter, (2) Risk Neutral and (3) Risk Seeker.

Furthermore, investor attitudes can also influence financial risk and company performance.

Hypothesis 3 (H3): There is a significant relationship between Risk Tolerance and Financial Performance

Demographic Characteristics, which consists of Business Type, Gender, Age of Owner, Business Age, Education, and Experience variables will have an influence on the risk tollerance and financial performance. The type of risk tolerance adopted by entrepreneurs will ultimately influence their company financial performance and vice versa.

Entrepreneurial university, entrepreneurial intention, theory of planned behavior entrepreneur insight and financial literacy is one of the main impacts of economic growth in which it reduces poverty, creates wealth, innovation and technology deployment stated. The development of the entrepreneurship activity has been getting important in Malaysia because it brought to better economic efficiencies, increase employment rate, creates jobs opportunity, and brought creative and innovation to market and contribution to the Malaysia domestic product. The importance of entrepreneurship to the growth of Malaysia's economy was supported by a variety of supporting mechanisms and government policies that existed for entrepreneurs in Malaysia, which were including financial, physical infrastructure and business consultant services.

Due to the rapid change on entrepreneurship, many countries had proposed the entrepreneurial university to reduce the numbers of unemployed graduates. Hence, research stream on the entrepreneurial university and education views entrepreneurial activity as a step in the natural evolution of a university system that emphasizes economic development in addition to the more traditional mandates of education and research. The university can be more entrepreneurial, by offering greater incentives for faculty’s involvement in entrepreneurial activities. There has been a significant global growth in entrepreneurship education within the university sector in the last two decades owing to its potential social, economic and educational benefits. Previously, there were a few researchers study about the entrepreneurial intention among students. However, the research topic has less to the extent of the entrepreneurial intention among the employees. There remains debate within the university sector regarding the effectiveness of entrepreneurial university is to confirm the entrepreneurial intention from the context of provider, specifically the employees who serve student with entrepreneurial environment and knowledge [17]. A person without an entrepreneurial intention might not have the thought to consider entrepreneurship as their employment choice or maybe they would end up with unemployed or being employed. Understanding a person’s intention could help with predicting on what kind of behavior would be performed or otherwise.

Based on discussion above, Indonesia universities especially universities at East Java have the rapid change on development of entrepreneurship. Indonesia is one of the countries proposed the entrepreneurial university to reduce the numbers of unemployed graduates.

Therefore, universities in Indonesia consider the importance of entrepreneurship education as an increase in the ability of students to open their own businesses. Entrepreneurial ability is the main asset for someone to be successful in their business. It is necessary to cultivate entrepreneurial intentions of the university. The purpose of this study is to analysis whether the attitude, subjective norms, and perceived behavior control have influences to entrepreneurial intention among employees.

7. Entrepreneurial Intention

Entrepreneurial intention referred to someone who had interest in entrepreneurship activities that involve any attributes that related to the consciousness of entrepreneurial decisions. Entrepreneurship education, social support and achievement motivation on entrepreneurial competence play important role in the industrial era 4.0. The entrepreneurial intentions had been seen from the view of psychological and economic that inspired entrepreneurs to go toward undertaking business as their second and third career. This was because the entrepreneurial performance was important while involve in this field where it can lead the entrepreneur to be prepared from the well strategic planning. The entrepreneurship intentions could be identified when employee or staff in organization could see the opportunities as to be an entrepreneur based on several factors that could influence them aware about this career. Most of the employees from the public sectors had chosen to became an entrepreneur as their alternative choice of career. It might be driven by numerous impacts that related through economic, social, politic and environment a state that always changing from year to year. The impact of planned behavior had driven the entrepreneur to implications of culture, human capital and other demographic. This was because it would show the pros and cons of attitudes, supported from the society and the way entrepreneur facing with the risk taking. Therefore, the entrepreneurial intention was important toward employee by concerning about university surroundings and the nature of business that they wanted to get involved.

8. Attitude and Subjective norms

Attitude could bring impact for an entrepreneur on the job performance, relationship as well as successful in business. Attitude played a significant role in motivating a person’s career choice behavior in entrepreneurship. Attitude could be stated that as an individual who had the perceptions of the personal desirability of performing entrepreneurial behavior. An employee who preferred the high income as a symbol of achievement or success and to obtain autonomy, power and freedom was a favorable attitude toward money stated by. Such situations were often tended happen on successful entrepreneurs [18]. Hence, the person who had the positive attitude towards income they were likely to have high intention to be an entrepreneur. There was a positive relationship between attitude and entrepreneurial intention among the employees in Surabaya, Indonesia.

Subjective norms referred to the extent to which friends, family, peers and society at high expectation or stressing the individual to perform a specific behavior. Subjective norms as a form of impact from the social surrounding that affected the individuals so that they had the intention to do something or act in a particular way. Parents, peers and other important relatives of an individual would influence his or her intention to become an entrepreneur. Nevertheless, entrepreneurial intentions could be raised by enterprise education and simultaneously motivate skill accumulation and epistemology, which could be leveraged to issue various subjective norms and resource obstacles to firm. In the context of career, subjective norms represented normative conviction about entrepreneurship as a career option was probably a motivation to comply with these normative convictions. Furthermore, those pressures could play a role as an outset to the development of entrepreneurial career and it relied on the social environment. This was discovered by those who made a positive indication about family business, project perceived desirability and the perceived feasibility of commence self-employed business. Past childhood experience faced severe or difficult circumstances predicted a positive influence on the independence of individuals and manner toward self-employed. The first experience of a new business venture would affect the manners and sentience towards entrepreneurship and career.

No significant relationship between subjective norms and entrepreneurial intention. There were controversies regarding subjective norms in measuring entrepreneurial intentions due to the place of study and the dimension of national culture. In conclusion, it appeared that there were many factors that would affect how subjective norm to related or not with entrepreneurial intentions. Future analysis was required to resolve this divergence of subjective norms and entrepreneurial intention.

9. Perceived Behavior Control

Perceived behavior control referred to a perception regarding the ability to perform a given. There were many types of behavior that could be analyzed such as their attitude and other characters that could be defined as the behavior or indication of certain people. Past research showed that there was positive and significant relationship with the entrepreneurial inclination of the individuals. An entrepreneurial intention was based on a person commitment to start his/her own business. This commitment could be achieved when a person was capable to control over the situation or behavior.

Moreover, perceived behavior control was based on a person who was willing and capable to control their behavior, so the person behavioral tendency could be observed whether it gave ease or difficulty. If a person who had high perceived behavior control, they would get a better opportunity, they would be more optimistic, more prepared, and able to handle the process of developing and starting the entrepreneurship and vice versa. Apart from that, according to the research result, there was positive relationship between perceived behavioral control and the entrepreneurial intention among employees in Surabaya, Indonesia. In a conclusion, under perceived behavioral control, the results of the past researcher showed that there was significant relationship between the entrepreneurial intention and the perceived behavior control.

10. Conclusion

The main reason for investing is to make a profit (return). Investment returns consist of expected returns as well as realised returns (actual returns). The difference between the two returns is based on the amount of risk that must be considered in the investment process. Other factors considered in the investment process are related to the demographic characteristics of investors. Furthermore, highlight that the most important problem in SMEs is no longer how to get credit, but how to develop financial solidity evaluation instruments in SME entrepreneurs and how to avoid bankruptcy problems. Therefore, it is important to develop instruments that can identify and evaluate risk.

Based on observations that have been made both empirically and theoretically, it was revealed that Indonesia experiences a growing number of SMEs from year to year, but not on the growth of their businesses. The problem of MSMEs is not only in financing, but also on their sustainability. Previous research suggests a diagnosis related to key people who become human capital, namely demographic characteristics that can determine attitudes towards risk and achieve company goals (financial performance) in the long run. This is according to the theory of enterprise upgrading as a company's strategy to grow or ‘grade up’. Therefore, our research objective is to explore the differences in MSME financial performance based on differences in demographic characteristics and differences in risk tolerance. The results of this study are expected to enrich knowledge on the growth strategy for MSMEs in Indonesia. We hope this research could help the government in developing a MSME growth program to reduce poverty levels and improve the Indonesian economy. This research is consistent with the literature on financial management and strategy management. Financial management focuses on investment and financial behavior whereas strategy management is related to the company's growth strategy (product life cycle).

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