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### **BEHAVIORAL FINANCE: EFFECTS ON FINANCIAL DECISION MAKINGS OF ENTREPRENEUR IN KAZAKHSTAN**

**Abstract.** The purpose of this study was to further explore differences between entrepreneurs decision-makings. However, rather than focusing on previously examined individual differences, this study examined differences in the decision-making processes used by entrepreneurs. Building on nonrational decision-making models from behavioral decision theory, we asserted that entrepreneurs are more susceptible to the use decision-making biases and heuristics than are managers in large organizations. The use of biases and heuristics may also offer some help in explaining why entrepreneurs sometimes make bad managers. Whereas the use of cognitive biases may be beneficial in some circumstances, it can lead to major errors in others. Although research has yet to establish performance implications, it is possible that the more extensive use of heuristics in strategic decision-making may be a great advantage during the start-up years. However, it may also lead to the demise of a business as a firm matures.

**Key words:** behavioral finance, decision making, culture effect.

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**Аңдатпа.** Осы зерттеудің мақсаты одан әрі іскерлік белсенділіктің шеңберінде қабылданатын шешімдердің арасындағы айырмашылықтарды зерттеу болып табылады. Алайда, оның орнына бұрын талқыланған жеке айырмашылықтарға назар аудара отырып, осы зерттеу кәсіпкерлер шешім қабылдау барысында айырмашылықтарды зерттейді. Шешім қабылдау теориясы, мінез-құлық теориясы үлгілерінде негізделген. Сол себептен кәсіпкерлер ірі ұйымдардың басшыларына қарағанда шешім қабылдау барысында сезімтал екенін байқалады. Осындай ауытқулардың зерттеуі арқылы кәсіпкерлер кейде нашар менеджерлер болатынын тусінікті болады. Когнитивті пікірлерді қолдану

кейбір жағдайларда пайдалы болуы мүмкін, алайда бұл басқарып отырған мекемеге қатерінтігізуі мүмкін. Зерттеулер әлі күнге дейін осы саланы толықзерттемегенімен, стратегиялық шешімдерді қабылдау осындай әдістерін кеңінен қолдану алғашқы жылдары үлкен артықшылығы болуы мүмкін.

**Кілт сөздер:** мінез құлықтық қаржы, шешім қабылдау, мәдениет әсері.

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**Аннотация.** Цель данного исследования заключается в дальнейшем изучении различий между решениями, принятыми в рамках предпринимательской деятельности. Однако, вместо того, чтобы сосредоточиться на ранее рассмотренных индивидуальных различиях, в этом исследовании изучаются различия в процессах принятия решений, используемых предпринимателями. Основываясь на моделях принятия решений, не относящихся к теории принятия решений, из теории поведенческих решений, данное исследование утверждает, что предприниматели более восприимчивы к личным пристрастиям во время принятия решений, в отличие от менеджеров крупных организаций. Использование отклонений в сторону пристрастий может также помочь в объяснении, почему из предпринимателей иногда выходят плохие менеджера. В то время как использование когнитивных предубеждений может быть полезным в некоторых обстоятельствах, это может привести к серьезным ошибкам других. Несмотря на то, что исследования еще не привели к последствиям таких работ, возможно, что более широкое использование методов стратегического принятия решений может быть большим преимуществом в течение первых лет.

**Ключевые слова:** поведенческие финансы, принятие решений, эффект культуры.

Biases, Heuristics, and Entrepreneurial Decision-Making. Since Simon's early work, organizational scholars have recognized that managerial decision-making often falls short of the purely rational model. Several factors that prevent purely rational decision-making have been cited, including: (1) the high costs of such decision-making efforts, (2) information-processing limits of decision-makers [1], (3) differences in decision-making procedures adopted by managers, and (4) differences in the values of decision-makers.

One of the most important classes of models that explain deviations from rational decision-making focuses on biases and heuristics. Biases and heuristics are decision rules, cognitive mechanisms, and subjective opinions people use to assist in making decisions. Frequently, the use of biases and heuristics yields acceptable solutions to problems for individuals in an effective and efficient manner. In this study, the term «biases and heuristics» is used to

refer to these simplifying strategies that individuals use to make decisions, especially in uncertain and complex conditions.

Although most previous research has been conducted in laboratory conditions, a broad range of empirical findings suggests that most decision-makers apply biases and heuristics to simplify their decision-making most of the time and that inquiry into such behavior is critical for understanding strategic decision-making. This research is also consistent with this observation. However, we acknowledge the possibility that all decision-makers may not be subject to these biases and heuristics in their decision-making to the same degree. In support of this research direction, decision-makers have recently been found to have different cognitive trails. Furthermore, Bazerman and Neale noted in their review that although individuals are generally affected by systematic deviations from rationality, some individuals appear to be more accurate in their interpersonal judgments or less influenced by the frame of the situation. The possibility that there may be differences in the extent to which decision-makers are subject to biases and heuristics suggests an interesting possibility for research on differences between entrepreneurs and managers in large organizations. Biases and heuristics may be particularly critical for explaining variations in strategic decisions. Perhaps a critical difference between these two sets of individuals is the extent to which they manifest biases and heuristics in their decision-making.

**Differences in the Use of Bias and Heuristics.** To understand why entrepreneurs and managers in large organizations may vary in the extent to which they manifest biases and heuristics in their decision-making, it is important to understand the utility of non-rational decision-making. Under conditions of environmental uncertainty and complexity, biases and heuristics can be an effective and efficient guide to decision-making. In such settings, more comprehensive and cautious decision-making is not possible, and biases and heuristics may provide an effective way to approximate the appropriate decisions. Also, entrepreneurship has been characterized as an "enactment" process where acting precedes thinking. In this sense, entrepreneurship is more a function of actions taken than some objective set of conditions.

**Decision Uncertainty.** On average, the level of uncertainty facing entrepreneurs in making decisions is greater than the level of uncertainty facing managers in large organizations in making decisions. At the very least, managers in large organizations usually have access to historical trends, past performance, and other information that can help reduce the level of uncertainty they face in making decisions. Moreover, this information can reduce the level of uncertainty facing decision-makers in large firms at relatively low costs. In this sense, managers in large organizations can more closely approximate the rational ideal in their decision-making.

Entrepreneurs, on the other hand, often have to make decisions where there are no historical trends, no previous levels of performance, and little if

any specific market information [2]. Just the decision to start a venture based on a new product or service involves making numerous decisions for which there is little or no hard information. Furthermore, the market's acceptance of the new product or service almost always contains a great deal of uncertainty. However, efforts by entrepreneurs to reduce their uncertainty in decision-making are likely to be very costly and usually not terribly effective. And yet, decisions still need to be made if the venture is going to be launched or to quickly move forward once the venture has started. A greater use of biases and heuristics facilitates a perceived sense of overall understanding and a sense that the «rules of the game» are now understood. Thus, we argue that those who are more susceptible to the use of biases and heuristics in decision-making are the very ones who are most likely to become entrepreneurs. The more cautious decision-makers will tend to be attracted to larger organizations where more methodical information tends to be more readily available. Entrepreneurial activities simply become too overwhelming to those who are less willing to generalize through the use of bias and heuristics.

**Decision Complexity.** Not only are the decisions made by entrepreneurs, on average, made in a more uncertain environment than decisions made by managers in large organizations, the decision-making context facing entrepreneurs also tends to be more complex than that facing managers in large organizations. Whereas they may have some potential pitfalls, biases and heuristics are likely to have more utility in these highly complex decision settings, compared with less complex decision settings [3].

Large organizations develop elaborate policies and procedures to aid managers in their decision-making. Nelson and Winter call these decision-making practices "routines" and emphasize the ability of routines to simplify the decision-making complexity facing managers. In addition to these routines, large organizations adopt elaborate organizational charts that define areas of decision-making responsibility. These limits have the effect of reducing the complexity of the decision-making context facing a firm, thus enabling managers in large organizations not to rely on biases and heuristics as much.

Entrepreneurs, on the other hand, usually have not developed the elaborate decision-making policies and procedures characteristic of large firms. In this context, simplifying biases and heuristics may have a great deal of utility in enabling entrepreneurs to make decisions that exploit brief windows of opportunity. Furthermore, entrepreneurs are often opportunists, acting on an idea with limited information. In doing so, they must convince numerous stakeholders of the credibility of the venture. Using base rate probabilities to justify their entrepreneurial ventures is usually meaningless.

It is important to recognize that we are not arguing that the decisions facing managers in large organizations are not uncertain or complex. Clearly, they often are. Rather, all we are arguing is that, on average, decisions made by

entrepreneurs tend to be more uncertain and more complex than the decisions made by managers in large organizations. Also, without some unsubstantiated enthusiasm, many ventures would never be started or would quickly die following their start-up. This logic that biases and heuristics may have more utility for entrepreneurs is consistent with findings suggesting that entrepreneurial posture and proactiveness are positively related to performance [4]. Thus, those who make greater use of biases and heuristics in their decision-making are more likely to find themselves in an entrepreneurial context. By doing so, they should be able to filter through more information and more effectively communicate to various stakeholders the legitimacy of the venture.

**Specific Decision-Making Differences.** As previously suggested, a large number of biases and heuristics have been studied in the nonrational decision-making literature [5]. From among all these biases and heuristics, we chose to examine differences between these sets of individuals with reference to two biases and heuristics: overconfidence and representativeness. Overconfidence was chosen because it is considered somewhat characteristic of a number of other biases and heuristics identified in the literature. Representativeness is one of more widely used heuristics Barnes and is a good indicator of how quickly one is likely to generalize from a single or limited number of experiences [6].

**Overconfidence.** First described by Oskamp, overconfidence has been shown to exist in a wide variety of settings. Overconfidence exists when decision-makers are overly optimistic in their initial assessment of a situation, and then are slow to incorporate additional information about a situation into their assessment because of their initial overconfidence. For example, Fischhoff et al. found that subjects who assigned odds of 1000:1 of being correct were correct only 81% of the time. Most decision-makers are overconfident in their estimation abilities and do not acknowledge the actual uncertainty that exists. Furthermore, decision-makers are generally slow to incorporate additional information because of their confidence in their existing assumptions and opinions [7].

And managers in large organizations are, somehow, different from each other. It has been somewhat disconcerting that most academic efforts at discovering the sources of these experienced differences have met with limited success. This study presents empirical evidence suggesting that entrepreneurs do behave differently than managers in large organizations and that these differences are substantial. By applying the theory of biases and heuristics, this study has shown that entrepreneurs and managers in large organizations think differently.

This field study has important implications for future work on biases and heuristics. In particular, most previous work has focused on understanding whether specific biases and heuristics exist and the conditions that affect their

usage. This research accepts this general premise and moves to another question: Do individuals vary in the extent to which biases and heuristics operate in their decision-making? The results of this study suggest that the extent to which decision-makers deviate from the strict econometric approach may not be a constant and that different individuals may utilize biases and heuristics to different degrees.

Of course, this research only examines two biases and heuristics: overconfidence and representativeness. Other biases and heuristics already identified in the literature may also differentiate between entrepreneurs and managers in large organizations. Future research will need to examine other biases and heuristics to more completely explain the differences between entrepreneurs and managers in large organizations. Also, future research will need to refine current measures of biases and heuristics, to examine not only if these phenomena exist, but also the extent to which they vary among individuals and organizations. Finally, additional samples of entrepreneurs and managers in large organizations should be examined to ensure the generalizability of the findings reported here.

In addition to extending this research to examine other kinds of biases and heuristics, future work will need to examine whether the use of biases and heuristics in strategic decision-making remains stable over time. Some have argued that biases and heuristics are often applied in an unconscious manner and thus are relatively immune from change or modification. Alternatively, others have reasoned that decision biases can be corrected through training. If the use of biases and heuristics are stable over time, then it would follow that those who are uncomfortable with heuristic-based decision-making, on average, will be attracted and selected into larger firms where this type of decision-making is less frequently required. On the other hand, those who are comfortable with creating and relying on these decision-making short cuts are likely to be attracted to entrepreneurial settings where these decision skills are best utilized. An assumption future research could address is whether individuals with different decision preferences will naturally and efficiently select into organizational contexts where those preferences are valued and accepted, i.e., into entrepreneurial firms or larger organizations. Future research should also explore if the use of biases and heuristics effectively helps with career placement decisions.

This research on biases and heuristics also potentially helps resolve some counter-intuitive conclusions from previous work on risk. Few themes are as synonymous with entrepreneurship as risk, and yet, remain so clouded. Entrepreneurs clearly accept higher levels of risk in their careers and business decisions than managers in large organizations, yet empirical evidence surrounding this phenomenon is diverse and often weak. For example, many psychological-based studies have shown that the risk-taking propensity of entrepreneurs is *not* greater than that of managers in large organizations. Thus,

most academicians hold that entrepreneurs do not differ substantially in their risk-taking propensity. This conclusion is widely held even though it is clear that entrepreneurs are generally involved in starting ventures that are more likely to fail than succeed. This contradiction is frequently resolved by characterizing entrepreneurs as risk accepters (versus risk seekers or risk averse). Thus, the focus has shifted toward understanding how to manage the risk inherent in an entrepreneurial opportunity [8].

For understanding entrepreneurial behavior, the issue may not be one of risk propensity or the sensitivity to probability estimates of possible outcomes, but rather how entrepreneurs think about the decisions they make surrounding the business opportunities they undertake [9]. It may be that entrepreneurs are more susceptible to the use of biases and heuristics and are likely to perceive less risk in a given decision situation than are managers in large organizations in the same situation. By being more willing to generalize from limited experience (representativeness) and by feeling overconfident that they will be able to master the major obstacles, entrepreneurs may conclude that a situation is simply less risky than would managers in large organizations. Thus, it may not be the differences in risk propensity that distinguish entrepreneurs from managers in large organizations, but the ways they perceive and think about risk.

Finally, these observations have a potentially important impact in analyzing the relationship between decision-making and performance. Kahneman noted that the use of heuristics may actually improve decisions by noting that they are «quite useful»; that they are «valuable estimation procedure[s]» and that they «are highly economical and usually effective». Nonetheless, such claims are typically followed by warnings that heuristics may also «lead to severe and systematic errors». Rarely if ever do Tversky and Kahneman give examples of heuristics working well. However, if different individuals and organizations are cognitively biased in different ways, then they may make strategic choices in fundamentally different ways. If these cognitive biases are difficult to change, they may represent sources of sustained differences among individuals and firms. Such differences, in the field of strategic management, have been shown to be sources of sustained competitive advantage and sustained competitive disadvantage. By recognizing that strategic decisions can be nonrational in different ways, this research points to a possible connection between cognitive theories of decision-making, strategic management, and firm performance. Of course, additional research will need to be conducted to examine these potential linkages.

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## **HUMAN RESOURCE MANAGEMENT USING THE THE EXAMPLE OF KASPI BANK**

**Abstract.** This paper utilizes a unique dataset collected through site visits to extend the analysis of the relationship between the human resource management environment and establishment performance to the service sector, specifically the branch operations of a large bank. Case studies of several branches were used to understand how and why the human resource management environment is likely to affect branch level performance. The branch interviews were instrumental in properly specifying a branch-level performance equation. The econometric analysis showed that, controlling for the characteristics of the market in which the branch is located and the characteristics of the branch employees, as well as unobserved branch-specific and unobserved manager-specific branch characteristics, the human resource