Attitudes to Economic Risk-Taking

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Abstract: The words ‘averse’, ‘seeking’, ‘tolerant’ or ‘neutral’ represent a chosen response to uncertainty that matters, driven by perception. This phrase forms a working definition of risk attitude, which is a choice made by a given individual or group in the face of a particular risky situation, and which is affected by a range of perceptual factors.

Key words: risk, attitude, business.

The concept of risk is essentially a modern one. In ancient and mediaeval societies the idea of risk management would never have arisen and fortune was attributed to luck, fate or 'acts of God'. Giddens\(^1\) has demonstrated that the concept of risk is now central to our society and he defines risk as being different to danger or hazard in that it is related to our impact on our environment and stems directly from the consequences of our actions on the world. The term risk was introduced by Portuguese explorers who identified uncharted areas of sea as “risky”. The term has thus gone from having a spatial meaning to its current temporal meaning whereby risk relates to future events. Such a concept could only have arisen in a society bent on controlling the future. Giddens also stresses that the notion of risk is positive as well as negative and cites the example that the whole rationale behind western capitalism is based on the calculation of future risk.

Today, the word “risk” is a common and widely-used part of our vocabulary, relating to personal circumstances (health, pensions, insurance, investments etc), society (terrorism, economic performance, food safety etc), and business (corporate governance, strategy, business continuity etc.

Risk has two characteristics: it is related to uncertainty, and it has consequences.

Risk however is not the same as uncertainty, whether aleatoric variability or epistemic ambiguity. The key distinction between uncertainty and risk arises from consideration of the consequences. Perhaps the simplest definition of risk is “uncertainty that matters”, since uncertainty without consequence poses no risk. A more complete definition therefore might be “an uncertainty that could have a positive or negative effect on one or more objectives”.

Defining the link between risk and objectives is essential to the process of risk management, since it is a prerequisite for identifying risks, assessing their significance, and determining appropriate responses. It is also however a crucial factor in understanding risk attitudes, since these are driven by the objectives of the individual, group or organisation concerned, and the extent to which the risk “matters”.

\(^1\) Anthony Giddens, Baron Giddens (born 8 January 1938) is a British sociologist who is known for his theory of structuration and his holistic view of modern societies.
Attitude is another word used commonly but loosely. Dictionaries offer two differing definitions. The first relates to the inner working of the human mind, where “attitude” is “state of mind, mental view or disposition with regard to a fact or state”. A second equally valid definition describes the positioning of an object in space, such as an aircraft, spaceship, or missile, where “attitude” is said to mean “orientation of axes in relation to some reference plane, usually the horizontal”.

It is interesting to note that both definitions insist that attitude can only exist in relation to a datum point – either a fact towards which one holds a mental disposition, or a reference plane such as the horizon against which orientation is measured. In this respect “attitude” is similar to “risk”, which is defined in terms of objectives.

This attribute of attitudes to be capable of modification is essential to the case for understanding and managing risk attitudes. If attitudes were fixed inherent attributes of individuals, inborn and unchangeable, then while it might be possible to understand them it would never be possible to manage them. The attitudes of individuals or groups would then not be comparable to an aircraft flying freely through the air, but would instead be like a cruise missile pre-programmed to strike a fixed target.

What is risk attitude?
If “risk” is defined as “an uncertainty that could have a positive or negative effect on one or more objectives”, and “attitude” is defined as “chosen state of mind, mental view or disposition with regard to a fact or state”, then combining the two gives a working definition of “risk attitude” as “chosen state of mind with regard to those uncertainties that could have a positive or negative effect on objectives”, or more simply “chosen response to perception of significant uncertainty”.

A range of possible attitudes can be adopted towards the same situation, and these result in differing behaviours, which lead to consequences, both intended and unintended. Indeed behaviour is the only reliable diagnostic indicator of inner attitude, and considerable attention has therefore been paid to behavioural psychology and management by those seeking to understand and manage the effects of human factors in business. Another approach however, which might prove more fruitful, is to seek to understand and address the underlying attitudes, rather than concentrating on the presenting behavioural symptoms.

Basic risk attitudes
- Risk averse – uncomfortable with uncertainty, desire to avoid or reduce threats and exploit opportunities to remove uncertainty. Would be unhappy with an uncertain outcome.
- Risk seeking – comfortable with uncertainty, no desire to avoid or reduce threats or to exploit opportunities to remove uncertainty. Would be happy with an uncertain outcome.
- Risk tolerant – tolerant of uncertainty, no strong desire to respond to threats or opportunities in any way. Could tolerate an uncertain outcome if necessary.
- Risk neutral – uncomfortable with uncertainty in the long term so prepared to take whatever short-term actions are necessary to deliver a certain long-term outcome.

Risk attitude, appetite and tolerance
The terms attitude, appetite and tolerance are often used similarly to describe an organization's or individual's attitude towards risk taking. Risk averse, risk neutral and risk
seeking are examples of the terms that may be used to describe a risk attitude. Risk tolerance looks at acceptable/unacceptable deviations from what is expected. Risk appetite looks at how much risk one is willing to accept. There can still be deviations that are within a risk appetite.

**Gambling** is a risk-increasing investment, wherein money on hand is risked for a possible large return, but with the possibility of losing it all. Purchasing a lottery ticket is a very risky investment with a high chance of no return and a small chance of a very high return. In contrast, putting money in a bank at a defined rate of interest is a risk-averse action that gives a guaranteed return of a small gain and precludes other investments with possibly higher gain.

In the following table there are some of the management attitudes that run counter to effective risk management and indeed themselves introduce risk to a project.

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<th>Attitude</th>
<th>Impact</th>
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<tr>
<td>Extreme Risk Aversion</td>
<td>Procrastination in decision-making. This often means that some possible options/opportunities are no longer feasible. Setting risk threshold of acceptable activities so low that the institution is incapable of change.</td>
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<tr>
<td>Pass the buck</td>
<td>Related to the above. Inability to reach closure on difficult decisions. Issues discussed regularly by a range of committees without progress. Decisions not documented and followed through.</td>
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<td>No news is good news</td>
<td>The belief that a project manager causes a risk or an issue simply by reporting it. Encourages people to report only good news. Often risks/issues aren't noted until it is too late to deal with them effectively.</td>
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<td>Knee-jerk reaction</td>
<td>Tendency to deal with symptoms rather than causes and to deal with the immediate and specific rather than the systemic.*</td>
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<td>My mind is made up</td>
<td>Inability to review or reverse past decisions in the light of changing circumstances.</td>
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<tr>
<td>Shoot the messenger</td>
<td>The 'Don't bring me problems' approach. Inability to cope with the identification of risks that don't have an obvious solution.</td>
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<tr>
<td>Make it so</td>
<td>'Don't be so negative'. The belief that a poorly conceived or inadequately resourced project can be made to succeed by sheer force of will.</td>
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Table 1. Management attitudes

It not possible to simply blame “bad luck” when things happen unexpectedly, at the worst possible moment and cost money we don't have. Risk management is about identifying what could occur and developing a planned response that is factored into the project plan and budget.

**Conclusions**

When decisions have to be made under conditions of uncertainty, each of these influences is important, because they drive the perception of risk. Risk attitude is the chosen response of an individual or group to uncertainty that matters, driven by perception.
As a result, the ability to understand risk attitude offers a key to unlock the mysteries of effective decision-making where risk is involved. Understanding risk attitude is a critical success factor which promotes effective decision-making in risky situations.

In order to make a ‘good’ decision, sometimes risk attitude needs to be intentionally managed to override habitual/normalized patterns of behaviour or to change perspectives that have been biased by erroneous conscious or subconscious influences.

References
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