POSTER 6

Which Drives More in Business Performance: Differentiating the Effects of Risk-Aversion and Overconfidence about Risk on Business Performance among Agricultural Enterprises

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Producers are consistently facing risks and uncertainties when making business decisions. Yet, behavioral economics shows that some producers are often irrational due to misperception of risks. In particular, when people take less notice of the risks they face or tend to believe certain outcomes to be more favorable on average than the true outcomes, they are overconfident. In the market context, studies have shown that in theory, overconfident yet risk-averse producers would produce more aggressively and get closer to the production level of their risk-neutral counterparts. When it comes to market outcomes, overconfident producers may even have better chances to succeed at the extreme cases, driving rational yet risk-averse producers out of the market.

This study proposes a feasible way to empirically disentangle the effects of overconfidence and risk aversion on business performance. This study utilizes a theoretical characterization of production behaviors and the Ontario Farm Income Database to discern the effects of risk aversion and overconfidence on market outcome and business performance. Preliminary results show that even though risk aversion may decrease the expected payoff on average, moderate level of overconfidence would overweigh the conservativeness due to risk aversion, leaving the producers with competitive advantages surviving the market. The results will shed light on the distribution of these behavioral traits within the producer population and their effects on sector competitiveness, which would not be observed otherwise. Market welfare analysis and the marginal effects of participating government sponsored programs, such as Business Risk Management programs will also be discussed.