

Escalation of Investment Decision Commitment on Micro, Small, and Medium Enterprises (MSMEs) Bandeng Presto in Semarang

Nurchayati^{1*}, Parju¹

¹Business and Economics Faculty, Universitas 17 Agustus 1945 Semarang, Indonesia

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*Corresponding author: Nurchayati

Business and Economics Faculty, Universitas 17 Agustus 1945 Semarang, Indonesia

Abstract

MSME entrepreneurs in running a business are likely to face risks, so that the expected results are not appropriate and the business suffers big losses and even goes bankrupt. MSME entrepreneurs who choose to stick to this commitment are the beginning, which is called the phenomenon of commitment escalation. The method used in this research is qualitative method. The qualitative method was chosen because the research will explore human behavior (that is, why MSME entrepreneurs maintain the experience of experiencing losses), and find motives that are committed to conducting in-depth interviews. The results showed that the increase in MSME commitment was due to several factors such as personal responsibility in the initial business, excessive trust supported by extensive experience, self-esteem (avoiding being considered incompetent) and to protect reputation.

Keywords: MSMEs, investment decisions and commitment escalation.

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INTRODUCTION

The Micro, Small and Medium Enterprises (MSME) sector is one of the business sectors chosen by individuals to earn income. MSME entrepreneurs in running a business are faced with opportunities or the need to invest for business development and new product development. Investment decision making means the entrepreneur allocates a large amount of funds with high risk i.e. spending now (definitely) but uncertain future cash flows (future risk). Making wrong investment decisions affects business continuity both in the short and long term. This happens when the business suffers a huge loss and can even go bankrupt.

Entrepreneurs who have made a sizable initial investment and there is information that the investment is likely to fail then the entrepreneur faces a decision to continue the commitment or terminate it. This decision making seems simple and often occurs in the decision to increase rather than stop commitment, this is a phenomenon that occurs in decision making [1-3]. Entrepreneurs who choose to continue investing there are two possibilities, namely, first, succeeding in overcoming the loss and second, failing to overcome the loss, the risk of loss will be greater and the debt will

accumulate. Entrepreneurs who choose to persist in continuing to invest despite negative information are known as the commitment escalation phenomenon [4].

Escalation of commitment is a decision to hold on or continue a failed investment and even increase its commitment to recover the initial investment [5-9]. Escalation of commitment is influenced by the field of social psychology [10]. Commitment escalation occurs when individuals continue to invest resources, into investments that will fail, if they give up on investments that fail, they will lose the money and time invested. Therefore the individual is committed to the initial commitment, in an effort to change these unfavorable conditions for the better.

Various empirical evidence shows that individuals who start a business and then the business is not profitable tend to continue the business [4, 11]. Reputation protection causes managers to experience commitment escalation [12-15]. Individuals tend to increase their commitment to failing actions because they are personally responsible [10, 16-18]. Tsai & Young [19], found that anger toward fear lead to a lower perception of risk so that it has a tendency to increase commitment.

Research on commitment escalation has been carried out by many previous researchers [4, 12-15, 20-25], but his research focuses on large companies and the financial sector, not many have researched on the MSME sector even though the phenomenon of commitment escalation can also occur in MSMEs.

Most of the presto milkfish craftsmen in Semarang are individual businesses and generally the practice of running their business activities does not maintain financial records and tends to rely on memory. MSMEs can run normally without the support of adequate financial information and business decision making tends to be influenced by the behavior of the entrepreneur himself, for example based solely on intuition and habits derived from previous experience. This intuition-based decision-making sometimes causes MSMEs to experience the risk of loss because financial management is not based on financial records, so what is planned sometimes does not match the reality it faces or negative deviations occur (lower sales or higher costs). If this happens, MSMEs will experience losses and if these losses occur continuously it can result in their business gradually becoming bankrupt. MSME entrepreneurs tend to stick to initial investments with the hope that in the future managed investments can get good results, so that with the profits they can of course cover losses in the past.

The results of this study are expected to explain behavioral factors (commitment escalation) in investment decisions in MSMEs and can be used by stakeholders related to MSMEs in providing policies on empowering MSMEs.

LITERATURE REVIEW

Condition of SMEs in Financing Decisions

In general, the practice of SME activities runs without relying on financial information that is arranged in an orderly and orderly manner. Many SMEs can run normally without the support of adequate financial information. They can succeed without financial statements on which to base decisions. Decision making is based solely on intuition and habits derived from previous experience. As a result, MSME actors do not know exactly how much income should be received, how much operating costs should be incurred and how much should still be left. Even if there is an activity plan, it is usually not arranged in an orderly manner so that it is difficult to allocate the existing funds.

Most MSMEs do not keep proper financial records and accounts and this often creates problems when trying to apply for a loan from a financial lending institution such as a bank where financial statements are required. Most financial lending institutions require financial reports to evaluate the creditworthiness of the applicant [26]. According to Maility & Mwewa [27] that one of the reasons MSMEs do not keep proper financial records is that transparent reporting will

expose them to excessive taxes and hence their reluctance to keep records. Failure to keep records can be attributed to a lack of knowledge or a lack of appreciation of the usefulness of keeping records for control and decision-making purposes.

Various sources of funding throughout the MSME business stages, from the start of the company the funds are mainly provided by the founders, family and friends referred to as '3Fs' [28, 29]. At the start, the commonly held view was that the company had difficulty accessing external finance [30]. The most important and commonly used at this stage are the personal savings of the owner of the company, and the finances of friends and family members [31]. While a company can raise sufficient capital to do business, lack of planning can lead to undercapitalization problems at an early stage, in extreme cases the company may not be able to continue the business.

Prospect Theory

Prospect theory suggests that individuals exhibit risk-seeking or risk-averse behavior depending on the particular situation or problem. Prospect theory was developed by [27] as a guide for individual decision making in conditions of risk and uncertainty. Risk-averse behavior is proposed when information is framed positively, and risk-seeking behavior is proposed when information is framed negatively.

In the prospect theory that risk aversion is related to individual behavior that develops as a survival mechanism, survival is maximized by employing a precautionary approach. Besides emphasizing the importance of risk aversion, prospect theory introduces other concepts that help explain decision making, firstly, individuals compare each gain and loss outcome separately rather than considering absolute final outcomes; and second, decision burden refers to a human bias that distorts decision making based on individual probabilities tending to increase the likelihood of success being low. MSME actors in maintaining businesses that are about to fail, are more willing to take big risks because if the business really fails, then they only take into account losses only to the extent of additional investment in the business. However, if the business is successful then the additional utility (marginal utility) decreases.

Escalation of Commitment to MSMEs

Escalation of commitment is defined as a phenomenon that explains that a person decides to increase or increase his investment in the form of money, time, effort or energy, even though new evidence explains that the decision that has been made is wrong. Escalation of commitment explains that individuals who start a business and then the business is not profitable tend to continue the business [4]. Escalation of commitment indicates the tendency of decision makers to persist in a series of actions that fail

[23]. Commitment escalation occurs when a job that is perceived as problematic is continued, rather than terminated [32] states that commitment escalation can occur when the initial investment decision loses but the decision maker still allocates resources to achieve goals [20].

MSME entrepreneurs carry out commitment escalation due to the consideration of the existence of framing of information that becomes a benchmark for making decisions on a business condition. Decisions made by individuals are based on how the information is presented. When negative information is framed positively, MSME entrepreneurs tend to avoid risk and when negative information is framed negatively, MSME entrepreneurs tend to look for risk, resulting in an escalation of commitment. This is in accordance with [33] who conducted experiments with US and Canadian managers, proving that negative framing can increase the likelihood of commitment escalation.

MSME entrepreneurs as business owners have full personal information about their business, so they tend to escalate commitments because other people cannot control their decision-making actions. Kanodia, Bushman, & Dickhaut [27] found the results that the manager's decision to continue or stop the project depends on the personal information obtained, when the manager stops the project which is indicated to have failed, it will affect his reputation and career.

Thinking Framework

MSME entrepreneurs in maintaining businesses that will fail tend to add resources for the continuation of their business, this is because they have great confidence in their actions that the business can run well or have good prospects. In general, milkfish SME craftsmen in Semarang are facing difficult times or lack of capital, they dare to do business loans and they feel able to pay off according to the agreement and they hope that the business they are doing with credit loans will get good results.

RESEARCH METHOD

Research Design

The method used in this research is qualitative method. The qualitative method was chosen, because the study will explore human behavior (that is, why MSME entrepreneurs maintain a business where the business will fail), and find the underlying motives for escalating commitment by conducting in-depth interviews. With a qualitative approach it is possible to develop insights, which may be difficult to obtain from survey research designs or public documentation [35].

Data Collection Method

The method of collecting data is triangulation, namely collecting data while simultaneously testing the credibility of the data, namely checking the credibility of the data with various data collections and various

data sources [36]. Triangulation is used to obtain data from different sources with the same technique, namely passive observation, in-depth interviews, and documentation for the same data source simultaneously.

Researchers made passive observations, namely by observing in depth the activities of milkfish SME entrepreneurs in the city of Semarang. Researchers first met the cluster head (P) in the Krobokan area of West Semarang as a data source. This initial informant was chosen because this informant is considered as an "opener of doors" to recognize the broad terrain. Next, the cluster leader advised the researcher to contact the first resource person (H) and the second resource person (T). To test the validity of the data, this study uses data triangulation to avoid biased interviews with dishonest answers so that a more in-depth approach is taken to each source.

Data Analysis

The data analysis selected depends on the research input (data) and research output. In this study, the research input is empirical data, while the output is a descriptive model description of commitment escalation. This research is exploratory and does not yet have a hypothesis, so it cannot be analyzed by inference. Therefore, the appropriate analytical method is to describe the phenomenon and find an explanation why the phenomenon occurs [36].

Data Presentation

Presentation of data is a collection of structured information that gives the possibility of drawing conclusions and taking action. The presentation of the data made then draw conclusions by doing abstractions and generalizations so that generally accepted conclusions are found.

RESEARCH RESULTS

Overview of MSMEs for milkfish craftsmen in Semarang City

Milkfish presto is one of the typical products of the city of Semarang with a wide marketing area, and has even been exported abroad. Besides being processed into presto milkfish, it is also processed into milkfish brains and presto milkfish pepes. These products are not only marketed in traditional markets, but are also available in shops or shopping centers for souvenirs typical of Semarang. Processed milkfish products are produced by MSMEs of presto milkfish craftsmen in the city of Semarang, which amount to around 117 MSME units. The average daily production is 50-200 kg of fresh milkfish supplied from pond farmers in the city of Semarang and Pati Regency. The average price of presto milkfish per kg is Rp110,000 – Rp160,000, while for milkfish otak-otak it is Rp195,000.

Social Background of the Resource Persons

The first resource person (F), the head of the presto milkfish cluster in Semarang, was initially engaged in the business of marine fish, such as dried fish, fresh fish and other marine products. In 1997, he started to produce presto milkfish, which initially only produced 5 kg per day, now he is able to produce about 200 kg per day. The second resource person (H) is a housewife who is concerned about seeing the fishermen's wives just sitting around waiting for their husbands' fish to catch them, so they invite the women to produce presto milkfish. The pressurized milkfish business that has been managed has started producing pressure-pressed milkfish since 1980, producing only 3 kg per day and is now able to process 400 kg of fresh milkfish per day. The third resource person (T) has opened a pressurized milkfish business since 2000 with a production of 4-5 kg per day, now he is able to produce about 50 kg of fresh milkfish per day.

Investment Decisions and Commitment Escalation in MSMEs

The results of the interview with the first resource person (P), namely the head of the Presto Milkfish cluster in West Semarang City, showed that the business was started in 1996 using relatively small personal funds of around Rp. 3,000,000 and could only produce 5 kg of fresh milkfish every day. At the beginning of his business, the resulting product did not provide profitable results, but the business continued. His tenacity in his efforts yielded satisfactory results, namely he succeeded in producing 50 kg of fresh milkfish per day. Production from year to year has increased and the marketing area has reached Malaysia. In 2010 the production of presto milkfish reached 150 kg per day, therefore to meet the increasing market demand, in 2010, it was decided to replace the traditional pressure cooker equipment with new pressure cooker equipment, namely the Low Temperature High Coller (LYHPC) with a capacity of 50 kg once cooked. The investment required is 3 pressure cookers with an investment value of IDR 500,000,000. Funds for the investment come from bank loans with a tenor of 10 years. After the investment has been running for five years, information is obtained that the investment made has the potential to suffer a loss of Rp. 400,000,000, this is due to the presence of competitors who produce presto milkfish with more sophisticated presto tools and superior product quality compared to their production. The results of the interview showed that P experienced an escalation in commitment even though the information obtained about the investment was negative, i.e., it had the potential to suffer losses. Negative information by P is framed negatively, namely that the information is likely to lose, therefore P is willing to take risks to continue his initial investment.

The results of the interview with the second informant (H) showed that Hartini started making

pressure milkfish on December 25, 1980. At the beginning of the business, the subject asked a group of women to jointly make milkfish presto, which was named the Women Farmers and Fishermen Group. Starting a business for 41 years is not a short time because when you first opened a presto milkfish business, you were only able to produce 3 kg of milkfish and had experienced losses and capital difficulties. In the 1990s, the subject made an investment in buying pressure cooker equipment with modern technology with bank debt funding sources, but even though it was difficult, he never gave up. The results can be seen now, now UD Mina Makmur is able to produce up to 400 kilograms of pressure milkfish and all of them are sold out every day. The marketing area is not only in Semarang and Indonesia, but the production of presto milkfish has been enjoyed by consumers abroad such as Malaysia to Korea. From the beginning with a small amount of capital, now UD Mina Makmur has generated a turnover of up to hundreds of millions.

The results of the interview with the third informant (T) show that the business started in 2000 and has experienced ups and downs in running its business. The initial capital to run the business is around IDR 5,000,000 with a daily production of 4-5 kg. His business continued to increase until 2007 when a new product was introduced in the form of milkfish brains. This new product was developed because there is information that demand from potential consumers to produce this new product. To develop its business, the investment decision is taken by applying for a bank loan of Rp. 100,000,000 with a period of 5 years. In 2010, it suffered a huge loss due to an error in estimating sales turnover, for example per day it was estimated that 20 kg of new product could be sold per day, but in fact it only sold 5 kg per day. This means new product sales are below initial expectations. This condition did not force T to stop his investment and decided to continue producing the new product even though he still had to repay the bank loan. Consideration T to continue investing because to avoid embarrassment if the business is closed and by continuing to invest hoping that in the future the product offers promising sales prospects. Finally, T's business has been successful until now with a daily production of 50 kg and in order to preserve its business, an innovation of milkfish recipe was made to produce a better taste than other business products. This finding is consistent with [37].

Interview results show that individuals continue their business, even though it is no longer profitable. Our two interviews also demonstrated this behavior. They still continue their business even though the business conditions are not supportive and even go bankrupt. They struggle to continue their business by allocating more funds to their start-up business because they expect future profits to compensate for their initial

losses. This finding supports Ghosh [11] and Suwarni *et al.*, [38].

The context in the escalation of commitment that occurred in the subjects studied showed a different context for making investment decisions, namely raw material investment (for Pak Petrus) and new product investment decisions (for Ibu Tri). In the first case, Mr. Petrus decided to buy raw materials (fresh milkfish) which exceeded its productive capacity without adequate raw material storage facilities which in the end caused a lot of raw materials to rot. This decision caused him to suffer heavy losses and be in debt. He then tried his best to pay off his debts, such as selling his personal assets and even borrowing money from his relatives and neighbors. With his tenacity and enthusiasm, he managed to maintain his business. In the second case, the new product decision is not based on a market survey of consumer responses to the new product. As a result, the new product attracts relatively few consumers, and the additional revenue cannot cover costs. Losing big, he still had to repay the bank loan he relied on to develop new products. Since his debt service obligations did not depend on the profitability of his business, he decided to continue selling new products by modifying his recipe. The decision improved the taste of his products and allowed him to expand his market to traditional markets and villages. Thanks to his tenacity and hard work, consumers are increasingly aware of his new products, and he has succeeded in continuing his business. Both interviews showed that the persistence of SME owners and increased commitment showed a positive relationship. Furthermore, there is a direct relationship between sunk costs and subsequent investment of resources.

The first resource person showed a high entrepreneurial spirit in facilitating his business so that it showed promising prospects. In 2007-2008, he received assistance from various universities and regional offices, such as the Department of Cooperatives, Marine Affairs, and Industry and Trade of Semarang City. He made many innovations, such as buying a Low-Temperature Pressure Cooker (LTPHC) which outperformed manual tools that were less efficient, fuel efficient, and eroded a lot of fish protein due to long cooking times.

The results of the interview show that using the LTPHC pressure cooker in the production process is more efficient because previously the production process used a pressure cooker which took eight hours, while with LTPHC it only took two hours with a relatively low temperature pressure of around 110 degrees Celsius so that it can preserve products with fish protein content of 24.98 percent and product damage only 0.5 percent during the production process. The LTPHC pressure cooker has many excellent features, including: very fuel efficient, efficient, better at processing products so as to produce pressure

milkfish with higher protein content and better quality for the production process.

The results show that MSMEs are able to survive in the worst situations or conditions because their owners show persistence and a strong spirit and continue to innovate in various aspects, such as controlling product quality, improving production facilities (for example, replacing traditional pressure cookers with more sophisticated ones), and following workshops and training held by various local government agencies in the city of Semarang. As entrepreneurs, our resource persons are motivated to persevere, don't give up easily, and continue to innovate to keep their business afloat because their business is their only source of daily income.

Psychological Factors, Increased Commitment, and Sustainability

When their business starts to decline, they make external funding decisions. They are optimistic and confident that they can maintain their business and pay off their debts. In other words, they show overconfidence in their ability to solve problems based on their previous experience in dealing with difficult situations. Optimism and individual belief have the potential to control the positive outcome expected by self-justifying the initial commitment. Individuals add resources to compensate for negative outcomes. This finding confirms McCarthy *et al.*, [39] who showed that when entrepreneurs' trust exceeds their belief in their business, they are more likely to increase their commitment to their project.

The interview results explained that if they stop their business, their self-esteem will be eroded and they are ashamed of their neighbors and relatives because they think their neighbors and relatives consider them incompetent, thus damaging their reputation. Increased commitment develops in part from a desire to protect and maintain the individual's self-esteem by rejecting initial wrongdoing. This finding follows the well-documented relationship between overconfidence and self-esteem preservation [37].

CONCLUSION

Despite experiencing unfavorable conditions and even going bankrupt, SME owners decided to continue their business activities. The findings imply that our SMEs show increased commitment. Escalation of commitment theory suggests that individuals will continue to invest resources; including time and money, in failed projects. They often assume that stopping a failed project means losing all the money and time invested. Thus, these individuals continue their commitment in making the initial decision to improve these unfavorable conditions.

The results showed that SMEs showed increased commitment due to several factors, such as

personal responsibility in the initial business, excessive trust supported by extensive experience, self-esteem (avoiding being considered incompetent), and the desire to protect reputation.

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