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Prospect theory and the risk-return association: An empirical examination in 85 industries ☆

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Abstract

A new sample of 85 industries (about 3,300 firms) defined in terms of homogenous products provides strong evidence that prospect theory can explain the tradeoff between two of the most researched parameters in evaluating organizations, namely, risk and return. In particular, organizations below their target level are found to be risk-takers (H1) while organizations above their target level are risk-averters (H2); moreover, the below target tradeoff was generally steeper than the above target with a median below to above slope ratio of about 3:1 (H3).

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> …We likewise test the positive interaction effects of a contingency variable (i.e., investing in a less-developed country) on the positive relationship between industry followers' domestic market position and foreign subsidiary exit time. We build on and combine the postulates from the strategic competitive dynamics literature (Ito & Pucik, 1993; Lee et al., 2009, 2017; Smith, 2014) and prospect theory (Fiegenbaum, 1990; Fiegenbaum & Thomas, 1988; Jiménez & Delgado, 2012; Kahneman & Tversky, 1979) to propose that the internationalization of firms from emerging economies might be significantly determined by their domestic market position in such a way that dominated firms are more likely to succeed when investing in less-developed markets, thus extending their foreign subsidiary exit time. The reason is that although firms from this type of economy may find their experience in their home countries useful to adapt to similar markets with underdeveloped institutions compared to competitors from developed countries (Cuervo-Cazurra et al., 2007; Cuervo-Cazurra & Genc, 2008; Khanna & Palepu, 1997), the ability to effectively adjust as required by the host market is shaped by the firm's competitive dynamics in its home country.…

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