

WORKSHOP 2

HOW OVERCONFIDENCE INFLUENCES ENTREPRENEURSHIP

Ioannis Salamouris
Hellenic American University
isalamouris@hauniv.us

ABSTRACT

The only thing certain in economic life is that most of it is conducted into an uncertain environment; that raises a question though: what makes individuals to pursue entrepreneurship which engages too much risk for an unsure, or too little, return? Entrepreneurs appear to be individuals that would try to make profit even if the odds of achieving their goal are really slim; apparently statistics do not seem to affect their decision. Research has shown that people tend to be optimistic when a decision is made under uncertainty (Taylor and Brown, 1988) and exhibit overconfidence in judgment (DeBondt and Thaler, 1995). Overconfident individuals tend to overestimate their relative ability (Svenson, 1981); therefore, their perception about their actions, probabilistically, appears to them to be safer than others that exhibit no overconfidence. The fact that entrepreneurs use all their effort and resources in the pursuit of their business endeavors may be intuitively inferred as overconfidence. A sample of 2,994 entrepreneurs provides us with interesting research findings (Cooper, Woo, and Dunkelberg, 1988): 81% considers their chances of success to be at least 70% and 33% believe their chances of success to reach a probability of 100%. In reality, about 75% of new businesses no longer exist after five years. What does this really say to us? Is it that entrepreneurs are incapable of seeing the risk or/and measure it, or is it that they consciously perceive a different dimension of risk involved in their actions? A more recent study (Wu and Knott 2006) showed as a general observation that entrepreneurs are more cautious than most of us would think or believe and the belief that entrepreneurs have bigger tolerance for risk is rather unsupported according to the empirical findings. Although there are some cases where entrepreneurs appear to be more risk averse than average, still it does not prevent them to bear risk. Such finding sounds controversial but in reality it is not. Entrepreneurs seem to set different dimensions for uncertainty, thus the oxymoron suggested above actually justifies their actions. Entrepreneurs, believe that uncertainty has two dimensions, one, is the well-known, market uncertainty, and two, the uncertainty regarding ability. Similar to the majority of people, entrepreneurs detest the market risk but on the other hand they much appreciate their own abilities. The element of overconfidence in their ability is the factor that compensates for their dislike of risk. Practically any entrepreneurial action is dictated by the level of overconfidence in comparison to the level of risk involved. Theoretically as long as overconfidence prevails over market risk, entrepreneurs will have a high probability to undertake the projects. The purpose of this paper is to highlight the impact of overconfidence in entrepreneurial behavior.

Keywords: Entrepreneurship Overconfidence, Uncertainty, Behavior.