

UNDERSTANDING ENTREPRENEURSHIP: IMPACT OF OVERCONFIDENCE ON ENTREPRENEURSHIP

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Abstract: Economic life is full of uncertainties and only thing that is certain here is that most of it is conducted into the dynamic environment; this brings a question in point though: Why individuals opt for entrepreneurship that involves a good amount of risk, and where there are little or no returns? There are ample research data available to show people are more optimistic when decision is taken under uncertainty and even show overconfidence in the judgement.

The relative ability is often overestimated by the overconfident individuals and so probabilistically, their perceptions for their actions seem to be safer to them in comparison to those who show no overconfidence. Interesting findings are shown in the sample of 2,944 entrepreneurs there are as many as 81% people who feel their chances of obtaining success are at least 70%, there are 33% other people with a belief that the probability of 100% exists in terms of their chances of success.

The truth is that, as many as 75% new businesses fail to exist after 5 years. Here arises a question that, are the entrepreneurs not in a position to see the risk, or do they carry a different perception of the risk involved in their acts? Going through a recent study, it is clear that the entrepreneurs are very much cautious (even more than what we think) and the opinion that entrepreneurs have more tolerance for risk is considered wrong in the findings.

There are few cases though, where entrepreneurs seem to bear less risk than normal, still it does not stop them to take risk.

Some people find these findings controversial, but the truth is that, it is not the case. Different dimensions are set by entrepreneurs for uncertainty; therefore, the oxymoron as discussed above in reality justifies their actions.

As per the belief of entrepreneurs, there are two dimensions of uncertainty: Uncertainty related to the ability and the uncertainty of the market. Just like most of the people, entrepreneurs too hate the market risk, however they do appreciate their own abilities that results in compensating for their hatred for risk. The main objective of this paper is to showcase the impact of overconfidence in the behavior of entrepreneur.

I. Review

It has been analyzed by Psychologists as well, many a time people are highly confident on the kind of abilities that they pursue.

Over confidence establishes a mental state wherein the people undervalue the directions of the possible outcomes. The reason behind the same is not that they are unable to assess them; however they tend to ignore them without taking their importance. The reason behind the same is merely the ability to tackle them as they arise. It is essential to note that the tendency of overconfidence is quite common in many cases and forms.

In most of the situations, overconfidence takes place from the calibration studies. Here the subjects are offered a set of G.K. questions like what is your opinion for the size

of river, Nile or Amazon- which is bigger, who is going to win the elections and so on. Additionally, the individuals are being asked to judge their answers' probability to be right.

In most of the studies, individuals find the probability of their answers to be right, though the result of their answers was not as per the probability that was stated earlier. This clearly shows that people tend to feel that their knowledge is more accurate than it is in real and therefore they access their ability even more than the average.

As a result, the overconfidence plays a very important role in the process of decision making. Same results took place when individuals were required to stake money on their answers, not showing any change in their answers. In most of the cases, individuals state that they are confident as far as the accuracy of their answer is concerned; in fact only 80% were correct. The phenomenon of overconfidence continued again. Even when the correct answers are being shown to the individuals, still their level of overconfidence remained the same. Now the question that arises is that, do people don't learn from their mistakes or they tend to justify their overconfidence?

Specifically, people learn from experiences and in a number of situations they get converted into less confident than from being overconfident.

Generally, people are more biased towards overconfidence. May be because of the reason that a good part of overconfidence is not considering the unfavourable results that are underestimating or the contrary evidences, taking them as extreme cases or unique.

The main objective of this paper is to showcase the importance of overconfidence in the behavior of human being and to stress more on the way overconfidence is affecting the behavior of entrepreneur in particular.

Thaler and DeBondt emphasized that the strongest finding in the judgement psychology is that most of the people are overconfident. It is basically the driving force that motivates individuals to go for the ventures that other individuals might not dare to take.

There are some people of the opinion that these kinds of decisions include some irrationality levels, however as per the recent studies there are enough evidences available to show why such kind of irrational behavior may and in most of the circumstances do, exist.

Work conducted in the field of finance and economics in the last decade suggested that a kind of behavior is triggered by overconfidence that is irrational in theory but highly applicable in practical.

A good number of examples are available in the form of analysts in the stock market and in the investors' behavior, where people show irrational behavior only because of the

fact that they tend to overestimate their ability or observe that the chances of being wrong are very rare.

It is even emphasized by Griffin and Tversky that in the cases where limited amount of predictability exist, as in the case of stock markets, the experts are seen to be more prone to overconfidence as compared to the new comers.

In simple words, uncertainty that exists in the stock market may be waged by the higher level of overconfidence in such a manner that decision can be made.

Theoretically, decisions can be made when the sufficient amount of information is present. Practically, when decisions are required to be taken in the absence of sufficient information, overconfidence gets converted into rational decision.

II. Entrepreneurs and overconfidence

In the work of a number of researchers, the overconfidence among entrepreneurs has been documented. In a sample of as many as 2,900 entrepreneurs, 80% of them, on an average 2400, are of the opinion that their chances of success are approximately 70%. Out of the sample, 32% are of the belief that the chances of success are 100% and as many as 75% new businesses are there that fail to work well and get closed within next 5 years of their operation.

It was revealed in another research by Busenitz and Barney that when entrepreneurs were asked if the main cause of death in USA is heart disease or cancer, against other individuals, the entrepreneurs stated a level of confidence in their reply which was quite higher than others whereas the quantity of right answers were equally diffused. It is frequently exhibited by the tendency of entrepreneurs that they underestimate the chances of occurrence of the unfavourable results. The chances of a new venture to earn profit or to fail, also the impact of competition, have been underestimated since the entrepreneurs depict overconfidence in their ability to deal with the contingencies or unfavourable things to take place.

Busenitz and Barney and Palichand Bagby pointed out that although the large number of managers are overconfident, the entrepreneurs show more overconfidence as compared to the managers. By this finding, it can be concluded that the start of a number of new ventures were basically the result of the overconfidence that entrepreneur depict.

Equally and similarly, overconfidence can be seen as the degree responsible for the chances of failures of the new ventures, on the condition that entrepreneurs who are overconfident underestimate their ability to take right decisions in launching and flourishing their new ventures.

By this it can be evaluated that if entrepreneurs show overconfidence, the young entrepreneurs normally show overconfidence when they shape their intention to start their own ventures.

A number of studies also showed that the main objective to become self-employed has greater level of dependency on the feelings of the individuals to independence, risk, and ownership. In simple words, due to their perceptions, the individuals are encouraged to go on with a new venture. Therefore, now the question comes in mind that whether the intensions of the individuals are affected independently by the habit of overconfidence or if overconfidence comes as a moderator of the intensions of entrepreneur.

It can be stated that both instances work complementarily. Basically, the sense of ownership, independence and risk will be facilitated by a person becoming self employed. Although, the attempt may fail due to not showing the confidence on your own ability to get access, the effort may fail to get results.

The confidence level that is depicted by the individuals will perform until it gets converted into conscious belief. As per Forbes, a demarcation is made between self efficacy and over confidence. Forbes more specifically makes it clear that overconfidence is a measure of accuracy of the ability of an individual, whereas the entrepreneurial self efficacy results in measuring the perception of the abilities of the individual.

This kind of distinction states that overconfidence gets converted into a subconscious phenomenon, although self efficacy of entrepreneur gets evolved into the belief that is consciously held.

Not just that, it was also claimed by Forbes that the entrepreneurial self efficacy of the individual varies to various levels of over-inflated opinions for their abilities. Under these circumstances, the higher the over inflated opinion, more will be the probability for the individuals to show overconfidence in their abilities.

Depending on that, a number of entrepreneurs, with the past business successes subsequently get converted into overconfidence because the level of their self efficacy is quite high. Therefore, overconfidence appears to work as an independent variable that result in holding the relationship between entrepreneurial intensions and self efficacy of the entrepreneurs.

By overestimating the ability, overconfidence replaces the lack of information. It was observed by Langer that if the task would be more difficult, then the chance of overconfidence to appear will also increase.

Above all, individuals that complete their tasks successfully in the past tend to appear more confidence regardless of the fact that their level of confidence is justified or not.

After a certain point, the individuals start to disregard the risks associated or the information attached to the task and mainly on their ability which is over inflated, built up on the past incidents which may not have been very progressive.

In situation, the entrepreneurs are overconfident; they show the tendency to go through their own information, ignore the fact that they lack information on any subject or tend to down weigh the information that is publicly available.

Remaining individuals that carry such kind of behavior hold the belief that the entrepreneurs are not afraid of risks or they have more tolerance against risks. This kind of perception can be found to exist for a number of years and was considered to be one of the most important entrepreneurs' characteristics.

To that belief, contrary information was provided by the study conducted by Wu and Knott. They felt that as against our belief, entrepreneurs are more cautious. In a number of cases, they tend to be more risk averse than the usual, that too without being discouraged in taking up the new businesses and the risk. This kind of finding although appears to be contradicting, but in reality it is not. You can get the explanation of the same on the basis of the perception that the entrepreneurs carry to risk.

impact of overconfidence that helps in characterizing the human behavior.

Topic that can be taken for further research would be when or under which kinds of circumstances the entrepreneurial ability may not be considered sufficient to set aside the risk in any new business.

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Most of the individuals take risk as the uncertainty level of something that may happen or not. Thus, if the amount of uncertainty is more, greater would be the risk involved. There are different dimensions for uncertainty as set by entrepreneurs, which results in allowing them to carry on with the tasks, which for a number of individuals may appear to be uncertain.

As per the belief of the entrepreneurs, there are two dimensions of uncertainty, one is systematic risk or the market uncertainty and the second one is related to the ability uncertainty. Although like most of the people, the entrepreneurs don't like risk, but do believe more on their ability.

It is basically the appreciation of the ability of the entrepreneurs that comes in and results in compensating for the market risk; for this reason, any new business gets less risky and appears to be more appealing.

From these findings, it is implied that if the ability of the entrepreneurs gets appreciation, no business may appear to be risky enough to dishearten them. Opposite to that, if there is a high degree of uncertainty related to the ability, then most of the entrepreneurs would avoid getting into new ventures as they won't be able to get rid of the systematic risk.

It seems that the information volume that may reveal the uncertainty level in a venture may get insignificant. Those who are not entrepreneur try to be rational by casting their votes not only on private rather public information too. The same is done by the entrepreneurs but they give weight age to their own information which is basically the result of their ability and they tend to reduce the public information's value.

III. CONCLUSIONS

It is argued in this paper that overconfidence is something that helps in characterizing the human behavior in most of the cases. It is seen that people appreciate their knowledge to a very great extent, even in the circumstances where their prior experience is just contrary to that. Inference that can be taken out from this paper is that overconfidence is something that can be expected and in cases where very less information is available, but the overconfidence impact on the behavior of people may vary based on their insight on uncertainty.

Usually those who are non-entrepreneurs show overconfidence up to the limit where the information seems to be not sufficient; hence the work becomes uncertain.

On the other hand, entrepreneurs show similar overconfidence besides the fact if information is available or not. It is basically the self-assessment of the skills of entrepreneurs as well as their ability that can be seen as the driving force which seems not related to the level of information.

To compensate any missing information, their ability is considered sufficient. When entrepreneurs are of the opinion that their ability will be sufficient to overcome the difficulties of objective or when they over-assess their ability, then increase can be seen in the probability of failures.

They are not discouraged by the prior failures as a part of overconfidence is separating the unfavourable results, taking them as out of the rules.

Rational behavior can be found in the entrepreneurs, contrary to what is the belief of individuals, under the