#85 “Entrepreneurs’ Perceived Chances For Success” (Cooper, Woo and Dunkelberg, 1988):

A Critical Appraisal.

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Starting a business is a risky venture. Previous studies suggest poor long-term survival prospects for most new businesses\textsuperscript{1,2}. Cooper, Woo and Dunkelberg’s study investigated entrepreneurs’ perceived chances of business success and if they were evaluated against relevant factors. I present a summary of the paper with a critique and directions for future research.

\textit{Paper summary}

The study tested three hypotheses. The first was that entrepreneurs’ perceived odds of success will be less than or equal to 0.5. This was based on the summarised finding that at best, less than 50\% of businesses survive for over five years with a given owner. The second hypotheses was that perceived odds of own success will not significantly differ from the odds assigned to similar businesses. The third hypothesis was that perceived odds of success would be positively related to factors previously shown to be objective predictors of success. These included; college education, business experience and prior ownership. 2994 entrepreneurs in the US were surveyed. Each rated the odds of success for their own business, and similar businesses, on a scale ranging from 0 chances in 10 to 10 chances in 10. Success predictors were assessed.

The entrepreneurs displayed optimism. They had higher odds for success than would seem justified by historic evidence of new businesses. 85\% perceived odds of success of 6/10 or more, with 33\% of 10/10. The mean was 8.1. They perceived odds for own success better than similar businesses, with a mean of 5.9, significantly less than 8.1. 68\% saw their chances of success as better than others, whereas only 27\% perceived their odds as the same as others. Perceived prospects for own success were not systematically related to objective factors which previous research has associated with success (explained very little of the variance). Being poorly or well prepared didn’t seem to influence optimism. All three of the hypotheses were rejected.

The authors concluded that entrepreneurs’ assessment of their own chance of success is dramatically detached from rational, objective evaluation of relevant factors. They offer some explanations for the bias towards optimism. They describe post-decisional bolstering\textsuperscript{3}, claiming the optimism may be defensive attitudes and rationalizations about their decision to start a
They relate optimism to the psychological make-up of entrepreneurs. They explain risk-taking propensity. Entrepreneurs are only moderate risk takers and have a preference for tasks in which their efforts or skills can make a difference. They also state that entrepreneurs have high internal locus-of-control beliefs. They have a high belief in their ability to influence business achievement, therefore perceiving failure possibility as low.

**Critique**

These findings inform and raise awareness of optimism for entrepreneurs. The authors state that an external individual should be used to provide objective and detached advice. This means the study has real-world implications and is helpful to entrepreneurs.

The authors assumed the perceptions of odds to succeed would be objectively evaluated related to previous findings of business survival, however the entrepreneurs may have lacked or had false knowledge of business statistics. Why would their odds be 0.5 if they were unaware that 50% of businesses fail? Therefore they may not be optimistic if they had no value to base their prediction around. Recallability could have distorted the entrepreneurs’ judgements depending on their awareness of recent businesses’ successes or failures. Giving statistical data of business failures could have avoided this.

It was a representative sample, being the largest and most diverse sample of small business owners to their knowledge. It accounted for findings in literature such as high-technology firms have a higher likelihood of success. However, all the businesses were within the United States, and there is evidence of cultural differences in optimism.

The entrepreneurs had high level commitments of money and especially time. This means there were incentives for the entrepreneurs to assess their chances for success with care, and motivation to be realistic. However, interestingly there has been evidence to show that overconfidence actually increases with incentives to perform well.

The authors identified the potentially confounding variable of time in business which could affect optimism. They found there was no significant effect; optimism was independent of
months in business. However age does not seem to have been reported and is a different variable to months in their current business. Older people tend to take less financial risks than younger people\textsuperscript{12,13}. Gender was not accounted for. Men have been shown to be more optimistic than women regarding a wide range of issues, including economy and financial markets\textsuperscript{14}. Another confounding variable could have been current business performance or sales, affecting optimism if their business was currently succeeding or not. Mood at the time of rating could have been assessed. A positive mood can increase optimism\textsuperscript{15,16}.

The authors make suggestions for their findings as discussed, but they fail to recognise other psychological biases. The social desirability bias\textsuperscript{17} may have influenced the findings. Entrepreneurs may have wanted to look successful and been reluctant to admit their own business may fail. This could have led to higher ratings of odds for success, rather than optimism. “Success” was also not defined and framing effects\textsuperscript{18} could affect optimism. If the questions were worded with “odds of failure” they may have obtained different results.

There are similar findings which support the present paper. Business owners forecast negative returns for an average market participant, but themselves as an exception\textsuperscript{19,20}. However, the present authors claim the entrepreneurs showed “extreme” optimism. This may not be justified. The “above-average-effect”\textsuperscript{21} has been demonstrated in non-entrepreneurs. Students rated their chances to be above average for positive events and below average for negative events\textsuperscript{22}. About 80% of people believe they are above the median on their abilities, such as driving\textsuperscript{23}. Also, people tend to be optimistic when a decision is made under uncertainty\textsuperscript{24}. The business environment is plagued with uncertainty. The authors neglected to identify belief perseverance\textsuperscript{25,26}. Entrepreneurs must have had the initial belief that their business would be successful, in order to commit to it. They may cling to this belief and this could account for the optimism. Loss aversion is the tendency to strongly prefer avoiding losses to acquiring gains\textsuperscript{27}. Why would entrepreneurs highly commit to a business if they didn’t think it had high chances of success? Thus, it seems logical that they would rate high odds of success and not so “extreme”.
Future Research

Similar hypotheses could be tested within the student population to investigate if optimism exists in perceived expected salary after graduation and perceived time to pay off student debt. Students could be given statistical data of average salaries of their career choice and calculations of time until debt would be paid off. They would state their expected salary in comparison to the average, and an estimation of time it will take them to clear their student debt. Optimism of greater expectations of salary and less time to pay off debt would be assessed. Predicting factors of higher salaries (within the same career choice) could be assessed and related to their expectations and potential optimism.

The authors state that it is hard to judge whether optimism leads to inadequate preparations or overlooking potential problems. There may be benefits associated with optimism; avoiding discouragement, overcoming problems and big time commitments could increase chances of success. Future research could examine how optimism affects business performance. This could be implemented by identification of inadequate preparations or problems overlooked, by an external observer, or be assessed retrospectively when a business fails. Alternatively, sales and business growth could be assessed and related to optimism rating. This could provide further help for entrepreneurs regarding the consequences of optimism, positive or negative.

Another extension could be a follow up study to investigate potential hindsight bias\textsuperscript{28-30} in the businesses that fail. An interview could be conducted to assess if some entrepreneurs claim they “knew it all along”, but rated their odds for success as high in the present study. They could be asked to rate the odds that their business was bound to fail, and this could be compared to their initial ratings of odds for success.

Conclusion

The paper raises awareness of optimism in entrepreneurs and provides advice to reduce the negative consequences. There are limitations including; lack of statistics presented, effects of culture, age, gender, social desirability bias, above-average-effect, belief perseverance and loss
aversion. I have made links to financial decision-making and given directions for future research.
Bibliography


