

It pays to be pessimistic, shows new research into entrepreneurs

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Optimistic thinking is leading people to set up businesses that have no realistic prospect of financial success, shows new research which may help explain why only fifty per cent of businesses in the UK survive their

first five years.

Tracking individuals as they move from paid employment to setting up their own [business venture](#), the study found that [business owners](#) with above average optimism earned some 30 per cent less than those with below average optimism. Many of the optimists would have been well advised to remain an employee.

The research from the University of Bath, the London School of Economics and Political Science, and Cardiff University, published in *European Economic Review*, explores the financial consequences of becoming an entrepreneur for optimists—people with a tendency to overestimate their chances of doing well and underestimate their probability of failure.

Despite entrepreneurs earning on average less, working longer hours and bearing more risk than their counterparts in paid employment, optimists are more likely than most to mistakenly think they have found a good [business](#) opportunity and that they have what it takes to exploit it successfully.

Realists and pessimists are less likely to proceed with unpromising entrepreneurial ventures.

Studies consistently report that about 80 per cent of the population have an overly optimistic outlook. This can increase ambition and persistence, encourage others to cooperate, and generally enhance performance. Ominously though, basing choices on faulty assessments also leads to participation in activities doomed to fail.

In 2016, according to the Office of National Statistics, 414,000 businesses were set up in the UK, against 328,000 business failures in the same year.

Dr. Chris Dawson, Associate Professor in Business Economics at the University of Bath's School of Management, said: "Our results suggest that too many people are starting business ventures, at least as far as personal returns are concerned. As a society we celebrate optimism and entrepreneurial thinking but when the two combine it pays to take a reality check. Every episode of the BBC's Dragon's Den provides examples of such wishful thinking. Pessimism may not generally be seen as a desirable trait but it does protect people from taking on poor entrepreneurial projects."

Professor David de Meza, in the LSE Department of Management, added: "Governments frequently talk about the role of entrepreneurs in creating economic growth, but there is a downside. The personal and societal fall-out of failed businesses shouldn't be underestimated, which is exactly what optimists do. Policy makers should not encourage the wrong sort of start-up."

The study analysed 18 years of data from the British Household Panel Survey—a major longitudinal study—recording optimism as a bias in forecasting personal financial outcomes when subjects are still in paid employment, and its subsequent effects on entrepreneurial returns.

More information: Christopher Dawson et al, Curb Your Enthusiasm: Optimistic Entrepreneurs Earn Less, *European Economic Review* (2018). DOI: [10.1016/j.euroecorev.2018.08.007](https://doi.org/10.1016/j.euroecorev.2018.08.007)

Provided by University of Bath

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