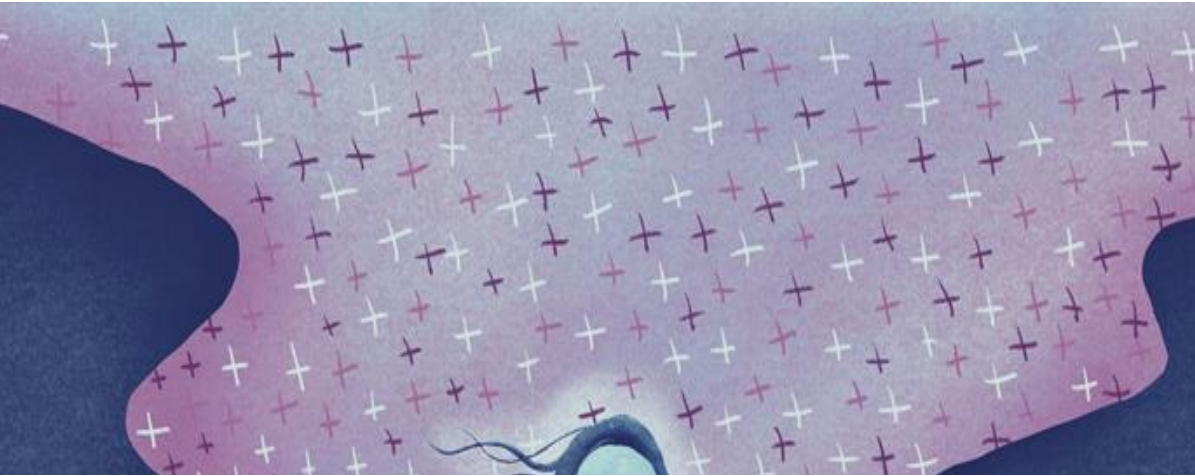


Too much optimism can hurt you as an entrepreneur

Over-optimistic entrepreneurs frequently ignore their market competitors, argues Rainer Zitelmann in his book *The Wealth Elite*.

by Rainer Zitelmann





OPINION

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One of the most successful entrepreneurs I've ever met says of himself, "As far as I'm concerned, the glass is always half empty." Not half full. Half empty. That makes him an exception among entrepreneurs, but his rather pessimistic attitude is probably one of the reasons his company has been so successful for half a century in an extremely risky industry – real estate development. It's an industry in which few companies survive anywhere near so long.

Optimism is a great quality. For entrepreneurs, it's downright essential, because hardly anyone would start a business if they weren't an optimist. But especially in difficult situations, too much optimism can also be really damaging.

Against the odds

Over-optimism can be defined as a tendency of individuals to think of themselves as above average in terms of certain traits or abilities, even if they are not.

As early as the end of the 1980s, the scientists Arnold C. Cooper, Carolyn Y. Woo and William C. Dunkelberg showed how widespread over-optimism is by drawing on a survey of 2,994 entrepreneurs who had just

started their own businesses. Although about two thirds of businesses founded at this time in the United States failed within four years, 81 percent of the respondents put their personal odds for success at 70 percent or more, and 33 percent said their chance of failing was zero.

The entrepreneurs were also asked to estimate the odds for success for other comparable companies. Here, too, their estimations were too optimistic, although not as optimistic as for their own companies.

The researchers also examined whether the degree of optimism stood in direct proportion to any specific characteristics or abilities exhibited by the respective business founder that would actually influence their prospects of success. No such connection was identified. The entrepreneurs were all equally optimistic, irrespective of whether this optimism was justified in their case or not.

Blind belief

When presented with negative news and forecasts, specifically relating to their own companies, entrepreneurs are in no way disconcerted. In one experiment, inventors were given the results of an objective and expert analysis of the commercial odds of success of their ideas.

Even those who were given the lowest chances of success were not dissuaded in half of the cases. Later, only five of these 411 projects were actually successful. Some 47 percent of the inventors who were advised that their projects were unfeasible continued their efforts unchanged and doubled their losses, rather than throwing in the towel.

Ignoring market competitors

Such over-optimistic entrepreneurs frequently ignore their market competitors. Another team of scientists interviewed 34 founders of high-tech companies, along with 20 employees who had seriously considered founding a company.

In their over-optimism, the founders ignored all external factors (as did, interestingly, the non-founders), in particular whether there were serious competitors in their chosen markets. They were concerned exclusively with their own abilities and the factors that had a direct bearing on their own projects. This study showed that external factors played an incredibly small role in the decision to start a company or not.

Without a great sense of optimism, most entrepreneurs would most likely never have become self-employed. Founders' over-optimism is, many

scientists believe, key explanation for why people launch companies even though the probability of failure is so high. At the same time, excessive optimism is often damaging, especially in difficult situations – such as when an entrepreneur or investor continues to inject their own money into their company when an objective observer would long have recognised the hopelessness of the situation.

In 2009, Keith M. Hmieleski and Robert A. Baron published a study based on interviews with 207 founders. The first important result of the study was that the entrepreneurs were, as a group, extremely optimistic. Their optimism was much more pronounced than in the average population. While optimism appears to be a fundamental prerequisite for entrepreneurship, Hmieleski and Baron’s survey also shows a negative correlation between levels of optimism and the success of an entrepreneur.

The authors measured the level of an entrepreneur’s optimism on the one hand and indicators of the company’s success (profit growth and growth of the number of employees) on the other hand. Since the degree of optimism for all interviewed entrepreneurs was very high in comparison with the average population, the authors assumed a non-linear relationship between optimism and company success. “The relationship between optimism and new venture performance may be positive up to moderate levels of optimism, but beyond this point, may become negative.”

Overconfidence, says Hanno Beck, another expert in the field, should not always be viewed negatively. After all, he points out, it promotes entrepreneurship and enables motivated entrepreneurs to convince others (e.g. finance providers and potential investors) of their ideas. “It may be possible that it is exactly this overconfidence and over-optimism that moves people to great deeds – but it is the same phenomenon that makes them fail. When only five of 100 over-optimistic people succeed in breaking through, then this strategy has advanced humanity in an evolutionary sense – to the detriment of the other 95 over-optimists who failed.”

Guarding against over-optimism

Even if this is beneficial for society as a whole, on an individual level it still raises the question of how a person can protect themselves, at least to a certain degree, from damaging over-optimism. Is there a prescription against over-optimism?

One recommendation is to conduct the following exercise before starting any project: a group of people, all of whom are very familiar with a plan, should come together in a meeting where they are given the following

should come together in a meeting, where they are given the following brief: “Imagine that we are a year into the future. We implemented the plan as it now exists. The outcome was a disaster. Please take five to 10 minutes to write a brief history of that disaster.”

The key benefit of this “premortem method” is that it both allows doubt and encourages the advocates of the decision to explore possible dangers that have not already been considered.

This is an abridged version of a chapter in Rainer Zitelmann’s book *The Wealth Elite: A Groundbreaking Study of the Psychology of the Super-Rich*

Picture by Getty Images / Juanma Hache