OVERCONFIDENCE AND COGNITIVE ENTRENCHMENT IN ENTREPRENEUR DECISION-MAKING (SUMMARY)

David M. Townsend  
The University of Oklahoma, dtown@ou.edu

Mark Simon  
Oakland University

John Kim  
Oakland University

Susan Houghton  
NC A&T University

Recommended Citation
Townsend, David M.; Simon, Mark; Kim, John; and Houghton, Susan (2012) "OVERCONFIDENCE AND COGNITIVE ENTRENCHMENT IN ENTREPRENEUR DECISION-MAKING (SUMMARY)," Frontiers of Entrepreneurship Research: Vol. 32: Iss. 6, Article 18.  
Available at: http://digitalknowledge.babson.edu/fer/vol32/iss6/18

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OVERCONFIDENCE AND COGNITIVE ENTRENCHMENT IN ENTREPRENEUR DECISION-MAKING

David Townsend, The University of Oklahoma, USA
Mark Simon, Oakland University, USA
John Kim, Oakland University, USA
Susan Houghton, NC A&T University, USA

Principal Topic

Knowledge overconfidence (KO), one of the most common cognitive biases, occurs when the certainty that one knows specific facts exceeds the accuracy of that knowledge (Busenitz & Barney, 1997; Forbes, 2005). Entrepreneurs have been found to be especially vulnerable to KO (e.g., Forbes, 2005; Malmendier & Tate, 2005; Busenitz & Barney, 1997). However, the performance implications of KO for entrepreneurs are unclear. On one hand, some scholars argue that the performance ramifications of overconfidence may be positive in certain settings since KO can improve decision-making efficiency in rapidly shifting environments (e.g., Busenitz & Barney, 1997). Others argue that KO will lead entrepreneurs to act on faulty information (e.g., Sykes & Dunham, 1995), thereby allocating resources to high-risk projects (Hayward, Shepherd, & Griffin, 2007) because they failed to conduct important upfront research (Mahajan, 1992). In either case, entrepreneurship scholars generally agree that success depends upon the ability of the entrepreneur to be open to ongoing feedback. What is less clear, however, is whether the cognitive effort associated with an intensive search process that may lead to overconfident entrepreneurs decreases cognitive flexibility producing cognitive entrenchment (Dane, 2010; Chi, 2006; Lewandowsky & Kirsner, 2000; Lewandowsky, Little, & Kalish, 2007).

Method

To explore these arguments, we conduct a multi-stage experiment to explore whether KO that was a function of recent effort versus KO that did not arise from recent effort influenced cognitive entrenchment in entrepreneurial decision-making among a sample of 163 MBA and Executive MBA students.

Results

Overall, our study suggests that there are two classes of knowledge overconfident entrepreneurs: those whose initially high overconfidence was from easily retrieving pre-existing knowledge, and those whose initial overconfidence was greatly enhanced as a result of recent effort. While both classes were highly overconfident when presented with “expert” feedback indicating they were wrong, those who did not invest cognitive effort were much more likely to change their answer (i.e., demonstrate flexibility) than the second group. These findings suggest that entrepreneurs who become overconfident by investing in upfront information searches may be inadvertently entrenching their thinking, limiting their ability to respond to future feedback.

CONTACT: David M. Townsend; dtown@ou.edu; (T) 405-325-3137; The University of Oklahoma, Norman, OK 73019.