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The Borrower's Curse: Optimism, Finance and Entrepreneurship

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Abstract

This paper argues that most of the facts characterising small-scale businesses, including high failure rates, reliance on bank credit rather than equity finance, relatively low interest rate margins, and credit rationing, can be explained by a tendency for those who are excessively optimistic to dominate new entrants. Drawing on findings in psychology, we model entrants as relatively naive optimisers. Banks on the other hand are viewed as well informed and efficient processors of information.

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