Abstract

This study analyses the overall effect of CEO overconfidence on firm value and documents how it impacts different corporate policies. The different effects of CEO overconfidence on corporate governance and firm performance with other control variables like firm size, market to book value, capital expenditure, and market capitalization are assessed and incorporated into one framework to determine the overall effect on firm value. The focus of this study is on U.S. firms in the period from 2015 to 2020. The methodology of Malmendier and Tate (2005) is adopted to construct overconfidence measures based on option exercise behavior Holder67 and holder above threshold. For the estimates of firm value, we use Tobin's Q, and for firm performance, we use return on investment. We also check the effect of corporate governance on bias behavior of managers; for this, we construct a composite index name (G- index). The results indicate that moderate and high overconfidence levels positively affect firm value.

Furthermore, low overconfidence harms firm value. The interaction of CEO overconfidence with corporate governance has a positive and significant association. Overconfident managers positively but insignificant impact firm value by moving investment levels closer to optimal. This study implies that firms should focus on hiring overconfident managers. Furthermore, alternative mechanisms or more monitoring towards corporate policies could help reach more optimal firm value.