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How Does CEO Overconfidence Change with Macroeconomic Condition?

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Abstract

Overconfidence (hubris or overestimation of one's ability to perform) has been viewed in the finance literature as a character trait that is stable over time, e.g., assuming that if a manager is overconfident, he/she is overconfident all the time. In this paper, we aim to show that managerial overconfidence can be state-contingent, i.e., the level of managerial overconfidence could be influenced by an external economic shock such as a financial crisis. A novelty of this paper is to provide the evidence and application of the concept of state-based managerial overconfidence, which is new in the finance literature. We found that managerial overconfidence could vary according to changes in the state of the macroeconomy. Our findings have important practical implications for the credit market. According to the state-contingent overconfidence hypothesis, creditors might reduce the loan amount or the loan duration (or other loan contract terms) too excessively by more than the efficient level during a financial crisis if the offsetting or attenuating effect of state-contingent overconfidence is ignored.

Keywords: Overconfidence, State-Contigent; Credit Market