THE PERFORMANCE EFFECT OF CEO OVERCONFIDENCE ON CORPORATE LONG-TERM VALUATION: THE CASE OF INTERNATIONAL MERGERS AND ACQUISITIONS

JUNG-HO LAI, NATIONAL TAIPEI UNIVERSITY OF BUSINESS

INTRODUCTION

The leadership research has paid increasing attention to the implications of managers' irrational behaviors, particularly that of managers who possess a sense of superiority. This study extends this line of research by proposing a contingency construct highlighting the imperative of simultaneous consideration of the related concerns to have a more complete assessment of the influence of managerial overconfidence on firm strategic outcomes.

INFLUENCE OF CULTURE DISPARITY

Different national cultural backgrounds can introduce misunderstanding in perceptions and value systems, which obstructs communications and the building of a consensus in M&A negotiations. The greater the cultural gap, therefore, the harder it is to form a consensus, which leads to difficulties in communication and integration and creates significant challenges for management. Managerial overconfidence leads to an underestimation of the challenges and the degree of difficulty in implementing an IMA.

Hypothesis 1: There exists a negative interaction effect between CEO overconfidence and culture distance between the acquiring and target companies such that a larger culture distance leads to a worse performance of IMA.

INFLUENCE OF THE DEGREE OF INDUSTRIAL INTERRELATION

The risk of information asymmetry is greater when the acquiring company and target company come from different industries. Hence, when the acquiring and acquired companies come from different industries, there are even more significant differences in each company' s background and knowledge of the other , elevating the difficulties for the acquiring company to properly value the target company. This suggests that performance of unrelated industry IMA undertaken by overconfident managers will be less successful than that by rational managers. That is, the lower the industrial correlation between the acquiring company and the target company, the more severe is the dual information asymmetry faced by trans-national IMA strategies.

Hypothesis 2: There exists a significant negative interaction between CEO overconfidence and the degree of industrial interrelation such that a lower degree of industrial interrelation between the acquiring and target company leads to a worse performance of IMA.

INFLUENCE OF THE DEGREE OF INTERNATIONAL DIVERSIFICATION

The information asymmetries that characterize overseas M&As require foreign acquirers to put forth substantial efforts to learn and adjust to local circumstances, which pose greater challenges in achieving strategic objectives. Overconfident CEOs, faced with these disadvantages, due to their high belief in own abilities to produce excellent results from uncertain conditions, can underestimate challenges of cross-border M&As while overestimating the accuracy of the information they possess and their abilities to overcome obstacles in the internationalization process.

Hypothesis 3: There exists a negative interaction effect between CEO overconfidence and the degree of international diversification, such that a higher degree of international diversification leads to a worse performance of IMA.

EMPIRICAL RESULTS

Table 1-Cross-Sectional Regression Analyses of Interaction Effect of CEO overconfidence

Variables	Model 1	Model 2
	1.458	1.001
Intercept	(2.23)**	(1.70)*
	1.001	0.981
CEO overconfidence	(0.98)	(0.25)
	-1.956	-1.256
culture Distance	(-2.76)***	(-2.41)***
	1.481	1.027
Business Relatedness	(1.72)*	(1.41)
	-1.057	-0.981
International Diversification	(-1.98)*	(-1. 68)*
CEO overconfidence *		-0.856
Culture Distance		(-1.95)**
CEO overconfidence *		-1.556
Business Relatedness		(-2.35)***
CEO overconfidence *		-0.943
International Diversification		(-1.76)**
	-1.314	-1.037
Firm Size	(-2.33)***	(-1.93)**
	-0.689	-0.423
Debt Ratio	(-1.57)	(-0.74)
Deal characteristics Controls		
	0.897	0.591
Cash Payment	(1.67)**	(1.56)*
	0.239	0.147
Deal Size	(0.23)	(0.14)
Industry Controls	Yes	Yes
Adjusted R^2	0.045	0.067
n	903	903

Numbers in parentheses are t-statistics. ***, **, * denote significance at the 1, 5 and 10 %levels.

CONCLUSION

Our research findings carry important implications to the scholarship regarding CEO overconfidence. It is worth noting that when companies face a scenario of uncertainty where a high cultural gap and high industrial gap exist, the higher negative impact overconfidence carries.