Are overconfident CEOs born or made? asks Management Insights study

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A study of CEO's finds that many overestimate their own negotiating skills and overlook the element of luck in successful mergers, acquisitions, and other deals, according to the Management Insights feature in the current issue of Management Science, the flagship journal of the Institute for Operations Research and the Management Sciences (INFORMS).

Management Insights, a regular feature of the journal, is a digest of important research in business, management, operations research, and management science. It appears in every issue of the monthly journal.

"Are Overconfident CEOs Born or Made? Evidence of Self-Attribution Bias from Frequent Acquirers" is by Matthew T. Billett and Yiming Qian of the University of Iowa.

Whether to engage in mergers and acquisitions is one of the most important decisions top managers make, the authors write. While many of the factors influencing these decisions may be based on objective financial metrics, there is increasing evidence that behavioral biases play an important role in managerial decision making. The authors explore one such bias--managerial overconfidence-- and find evidence suggesting CEOs develop overconfidence through 'self-attribution bias' when making merger and acquisition decisions. Individuals subject to self-attribution bias overcredit their role in bringing about good outcomes and underestimate the role of luck.

Consistent with this, they find that CEOs appear to overly attribute their role in successful deals, leading to more deals even though these subsequent deals are value destructive.

They also find evidence that CEOs alter their stock holdings prior to deals in a pattern consistent with overconfidence in the outcome of these subsequent deals.

The authors advise that CEOs be particularly cautious and disciplined when engaging in acquisitions following prior success. Boards and other stakeholders should also ensure that any proposed deal is judged on its own merits and is not justified on the basis of prior CEO success in mergers and acquisitions, they say.

Professors Billett and Zian based their results on a sample of public acquisitions between 1985 and 2002. Over this period, U.S. public companies acquired $3.7 trillion worth of other U.S. public companies.

The current issue of Management Insights is available at mansci.journal.informs.org/cgi/reprint/54/6/iv .

Source: Institute for Operations Research and the Management Sciences