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Robert Faff

How ‘overconfident’ CEOs borrow short

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Overconfident public company CEOs are more likely to destroy shareholder activity through M&A activity, as has been well documented, but recent Australian research shows they are also likely to favour a higher proportion of short-term debt, which can exacerbate the problem.

In a short presentation at the Investment Management Research (IMR) Conference at the University of Technology, Sydney last week, Professor Robert Faff of the University of Queensland, said that overconfident CEOs favour short-term debt – with maturity of one, two or three years – because they think they can refinance when the market becomes aware of the “good news” for their company’s activities.

They are also likely to:

- have a higher-than-average proportion of very short-term debt – less than 12 months
- be undeterred by creating higher liquidity risks, and
- have lower syndicated loan costs.

The research defined ‘overconfidence’ based on executive option behaviour – betting above the market on a company’s future share price. It involved a study of 931 firms between 2006-2010.

Faff’s work on the subject, involving a series of papers, has been in conjunction with Ronghong Huang and Kelvin Jui Keng Tan.

The IMR conference, which is a collaboration between UTS and the Portfolio Construction Forum, was held at the UTS Sydney campus on September 28-29. More than 100 academics and practitioners attended.

(See other reports this issue.)

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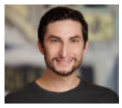
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