Economica: How corporate overconfidence impacts important policies

By ET Bureau | 15 Nov, 2013, 12.00PM IST

READ MORE ON Ohio State University | John Graham | Fuqua School of Business | Fisher College of Business | Duke University | Campbell Harvey

Ads by Google

1 Tip to Lose Belly Fat

promopureage.com - Cut pounds of stomach fat every week by using this 1 weird old tip.

Most of us know it is tough to forecast the stock market and would offer a wide range of possible outcomes if pressed for a prediction. Not true for Chief financial officers asked to explain movements in their company's stock prices — overconfident in their ability to forecast correct.

According to a new research study by Itzhak Ben-David of Ohio State University's Fisher College of Business and John Graham and Campbell Harvey of Duke University's Fuqua School of Business, the range of outcomes that CFOs provide for one-year stock market forecasts are unrealistically narrow. "These executives are too sure of their ability to predict the future. This overconfidence is linked to decision-making at their firms, so there is a real-world impact," says Ben-David.

The study, published in the November issue of the Quarterly Journal of Economics, asked CFOs to predict a range of outcomes that would lead them to be 80% right. However, the ranges they gave were so narrow that they barely got 1 in 3 correct. "For example, they might say next year's return should fall in the range of -20 to +20%. If the market return is 10%, they are correct. But that is not what we found. They would give really tight ranges, like 11 to 18 percent. If the market return is 10%, they are wrong. This is a classic trait of severe overconfidence," said Harvey.

The magnitude of the miscalibration led the researchers to investigate whether this overconfidence impacted the way they ran their businesses. Graham said executives were also asked to predict the range of possible outcomes for their own investment projects, "and again they proved to be extremely overconfident. It is well known that..."
companies' investment outcomes are volatile but CFOs seem oblivious to this risk."

<table>
<thead>
<tr>
<th>More from The Economic Times</th>
<th>More from the web</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Infosys should offer to fix Healthcare.gov for free 07 Nov 2013</td>
<td>- Make the Right Choice: Three Steps to Effective Decision Making The Financialist</td>
</tr>
<tr>
<td>- Asian shares creep ahead, count on Fed being benign 30 Oct 2013</td>
<td>- The Most Dangerous Dogs Puppy Toob</td>
</tr>
<tr>
<td>- Brent slips to 4-month low below $105 ahead of ECB, data 07 Nov 2013</td>
<td>- James Bond Actor Paul Bhattacharjee Committed Suicide After Declaring… E! Online</td>
</tr>
</tbody>
</table>

2014 Ford Fiesta

News in Pics
Friends, family and celebrities witness Sachin play

Travel Video
Katrina Kaif avoids media at the airport

Infocus on ET Today
Top Stories
Sachin to get Bharat Ratna; first sportsperson to bag it
Difficult to imagine cricket without Sachin: Omar

There are no comments on this article yet. Be first to post one!
Comments are moderated and will be allowed if they are about the topic and not abusive.
Sachin! Sachin! will reverberate in my ears forever

Tendulkar, in an emotional speech said that the twenty-four years of cricketing journey have been very special for him. "My life between 22 yards for 24 yrs."