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Does CEO Bias Escalate Repurchase Activity?*

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Abstract

We propose and test the hypothesis that overconfident-CEOs, with upwardly-biased estimates of own firm-value, are more predisposed to repurchasing stock. An implication is that the stock-market, recognizing overconfident-CEO behavior, will react less positively to repurchase announcements. The hypothesis is strongly supported: Overconfident managers repurchase stock at lower levels of cash holdings, and respond more to stock-price declines. Entrenchment exacerbates this behavior. Interestingly, institutional investors appear to encourage repurchases, perhaps to curb excessive investment. Overconfident-CEOs are also more likely to substitute repurchases for dividends or capital expenditure. Consistent with our hypothesis, the stock-market reaction to these share repurchase announcements is less positive.

Keywords: Overconfidence, Repurchases, Dividend-repurchase substitution, Investment-repurchase substitution, Corporate Governance

JEL Classifications: G32, G35

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