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Can Being Overconfident Make You a Better Leader?

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When Apple CEO Steve Jobs approached AT&T about partnering on a new kind of mobile phone — a touchscreen computer that would fit in your pocket — Apple had no expertise in the mobile market. Yet AT&T executives quickly came to believe so strongly in Job's vision that they skipped internal process protocols to land the deal. Randall Stephenson, then CEO of AT&T, famously said, "I told people you weren't betting on a device. You were betting on Steve Jobs." Apple went on to secure massive commitments from AT&T's suppliers, who spent hundreds of millions to build factories for iPhone-specific parts.

Most of us think of overconfidence as a bad thing. Daniel Kahneman, the 2002 Nobel prize laureate and psychologist, has said that if he had a magic wand, he'd eliminate it. And for good reason — research has shown that when overconfidence permeates the upper levels of management, companies may fail to choose the best investment policies or engage in reckless and damaging acquisitions.

Yet stories like the one above about Steve Jobs made us wonder: might there be some hidden benefits to overconfidence in the context of corporate leadership? To study it more closely, we examined 1,921 U.S. companies over the period from 1993 to 2011, asking the following question: Is there systematic evidence that overconfident CEOs are indeed better leaders?

All CEOs are surely exceptionally confident individuals. To make it to the top of an organization requires not only talent, but also extreme self-belief and confidence. Our first challenge was to answer the question: How do we separate the merely confident managers from the overconfident variety?

We quantify overconfidence by tracking the CEO's vested-in-the-money stock options. This is a common approach in academic literature. In theory, a CEO should exercise these options for the purpose of wealth diversification. CEOs who don't are likely to be excessively optimistic about their company's future. By hanging on to these vested stock options, these CEOs are personally under-diversified and face the risk of great financial losses if their stock price were to fall. Only the most overconfident CEOs would have such strong belief in their abilities that they are willing to excessively risk their personal wealth.

We also had to figure out how to measure leadership, a trickier question. Leadership has many dimensions, but as financial economists, we define leadership as *the ability of a leader to motivate greater effort from key stakeholders*. In the modern corporate world, leadership is distinct from the formal authority of instructing subordinates to perform certain actions. Instead, great corporate leaders are able to motivate and inspire their employees to go the extra mile. Such CEOs may even be able to reach beyond the boundaries of their firm and engage external suppliers to make major investments to support their vision. For example, for a company with almost no manufacturing capacity of its own, the iPhone could not exist without heavy commitments from key suppliers. There was also no way that Apple could have met its tight product timelines, or kept its products shrouded in secrecy until launch, without fierce commitments from its employees.

We predicted that managerial overconfidence might help leaders gain greater effort from stakeholders like employees and suppliers. An overconfident CEO may have more skin in the game — by putting his personal wealth at stake, he demonstrates his strong belief in the firm's future prospects (think of Elon Musk's all-or-nothing compensation plan). In turn, he might be committed to work harder (Steve Jobs was known for his maniacal attention to detail, down to the shade of color on an app) or be more likely to lead from the front (his famous product unveilings). These kinds of behaviors may, in turn, inspire greater commitment from others. To test this, we took a closer look at employee and supplier behavior in firms that were run by overconfident CEOs.

To measure employee commitment, we looked at two factors. First, we measured employee tenure, on the theory that employees that are committed to their companies are more likely to stay longer. Second, we looked at how much company stock employees held in their retirement plans, since employees who believe in their companies and the vision of their leaders may be more likely to hold more company stock.

Our findings supported our hypotheses. We found that firms led by overconfident CEOs are associated with significantly lower employee turnover, and that employees at firms led by overconfident CEOs allocated a greater fraction of assets in their retirement benefit plans to company stock. Both findings suggest that employees not only commit their human capital longer, but also put their personal wealth at stake to follow their employers' leadership.

Our analysis also showed that overconfident CEOs are more likely to develop relationships with key suppliers, and that these relationships with suppliers tend to last longer than average. Moreover, CEOs are better able to secure supplier commitments when such inputs are particularly valuable to the firm. Overconfident CEOs are better able to induce the development of specialty inputs requiring R&D that are specific to their company's needs. As such, our findings are consistent with research showing that overconfident CEOs are better innovators.

Steve Jobs was known for having a "reality distortion field" — such confidence in his ideas and unrealistic timelines that he was able to sell them to employees, suppliers, and investors. Our research suggests that the reality distortion field is real. At least in the corporate world, there may be a bright side to overconfidence: it can increase the commitment of other people to your venture.

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