Executive Overconfidence and Securities Class Actions
Outline

- Introduction to Securities Class Actions
- Executive Overconfidence
- Main Hypothesis
- Potential Explanations
- Conclusions
- Applications
- Questions
Securities Class Actions

- Class Action Lawsuit
- Person/Entity who purchased a co.’s securities (stock)
- Economic Injury
- Disclosure of information in violation of securities laws
  - Falsely positive statement
  - Omission of negative info
Executive Overconfidence

- Overly positive view of their ability and co.’s prospects
  - Excessively optimistic, ignore negative information
- Measured by stock options (HOLDER67)
  - 67% in-the-money
- Undiversified wealth
Main Hypothesis

- Overconfident executives more likely to:
  - Make falsely positive statements
  - Omit negative information
  - Be sued in a SCA

- Results:
  - 4.5% vs 5.5%
  - 65% of all lawsuits
Potential Explanations

- Event – Seasoned Equity Offering
- Weak corporate governance
  - Sarbanes-Oxley
- Managerial entrenchment
- Option-based compensation
  - SFAS 123
Conclusions

- Sarbanes-Oxley decreased likelihood of SCA
- Managerial entrenchment increases the likelihood
  - If overconfident CEO
- SFAS 123 decreased likelihood
- SEO did not have an effect
Applications

- Fraud Triangle
  - Pressure, Opportunity, Rationalization
- Internal Controls
- Professional skepticism
Questions?


