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Overconfidence Bias in Working Capital Management and Performance of Small and Medium Enterprises: The Perspectives of Ghanaian SME Managers

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Abstract

Although managerial overconfidence is receiving substantial attention in economic analysis, explanations so far mostly focused on corporate executives and corporate investment and financing decisions. This study investigates SME managers (owners) overconfidence behavioral bias in working capital management and performance. A qualitative case study was employed to explore the perspectives of 35 SMEs managers from trading and manufacturing firms. Data were obtained through Semi- structured interviews. Based on the thematic analysis, the study found superior financial ability, perfect industry knowledge and optimism in business success to be SMEs overconfidence behaviors and their influence on working capital management and performance resulted in aggressive working capital investment and financing and expected higher performance. Specifically, overconfident SME managers is more likely to overinvest in working capital inventory for expected higher profits if they have access to sufficient internal capital. However, they are less likely to invest more in firms with substantial working capital investment in inventories if expected sales revenue are below expectation. We argued that, overconfident matters so it is not enough to study working capital management and performance of SMEs without considering manager's biases.

Keywords: Overconfidence bias, SMEs Managers, Working Capital Management, Performance, Ghanaian SMEs, Manufacturing and Trading, Qualitative Study.

Introduction

Working capital management has attracted scholars' attention concerning how SME make working capital investment decisions to maximize profit. Although it is believed that when firms apply modern finance practices, they can optimize their investments, but smaller businesses are yet to fully embrace these practices in working capital management. Instead, most SMEs adopt subjective approach (Khoury et al., 1999; Howorth & Westhead, 2003) and do not apply working capital models (Filbeck, & Lee, 2000). But rather managers rely on their experiences in managing working capital (Pham, 2013, p.88; Bandara & Rathnasiri, 2016). Yet, researchers have still not look into SMEs managers' perspectives on working capital management. Thus, given the fact that subjective decision is a typical case of behavioral bias, and noting that SMEs managers (owners) are the top executives, they are more likely exhibiting overconfident behavioral biases in working capital management and performance.

Overconfidence research spans many disciplines and is one of the main managerial biases influencing corporate decision outcomes. Overconfident people unrealistically believe in their abilities, precision of knowledge and personal information to be better. This belief induces managers to overestimate firm value and underrate their failure. Although managerial overconfidence influence outcome of corporate policies (Ben-David, et al., 2010), how it influences short term financial management is unknown. Till date literature on overconfidence in working capital management is lagged behind. What we know is overconfident CEO and CFO and long-term decisions (Malmendier & Tate, 2015; Panpan, & Xindong, 2017). However, what is unclear yet is how overconfident SME managers influence working capital management and performance, despite that the fact overconfident people exist in every professional.

In Ghana, SME's working capital management practices are less formalized. Managers (owners) rely on their experience and interest to make working capital decision due to their weakness in formal financial practices. That means those with exceptional personal traits, emotional and cognitive abilities can influence working capital management. And managers with such abilities and experiences to identify new business opportunities tend to be more optimistic about their future growth than their peers. So, they tend to commit more financial resources into working capital and new business projects in order to maximize higher sales revenue and returns, making them believe that they control the expected cash flows or their performance and thus be committed to their decisions. Therefore, the aims of this research are follows:

- To explore overconfident behaviors of SMEs managers (owners).
- To investigate influence of overconfident SME managers working capital management and performance.

Numerous studies found overconfident people's subjective decision result in systematic biases. Managerial overconfidence means overestimation of future performance. Malmendier and Tate,