CHAPTER I

INTRODUCTION

1.1 Background

In an increasingly competitive business environment, companies continuously seek strategies to enhance performance and maintain their presence in the market. In Indonesia, business competition has intensified alongside economic growth, the influx of foreign investments, and technological advancements that have introduced new players across various industries. This is reflected in Indonesia's significant improvement in global competitiveness. According to the World Competitiveness Ranking (WCR) 2024 report released by the International Institute for Management Development (IMD), Indonesia ranks 27th out of 67 countries, climbing seven spots from 34th in the previous year with a score of 71.52. One strategic move often employed to navigate these pressures is mergers and acquisitions.

Theoretically, mergers and acquisitions are distinct. The merger involves the unification of numerous businesses to one company, where one company continues to exist while the others are absorbed into it. Meanwhile, an acquisition represents an act towards gaining control over the assets of a business or shares by another business., with the acquired entity either continuing to operate as a separate legal entity or being integrated into the acquiring company (Gaughan, 2017). The primary objective behind engaging in mergers and acquisitions is to collaborate with other companies in ways that are more advantageous than competing alone in the market. Mergers and acquisitions provide opportunities for companies to expand market reach, strengthen industry positions, and enhance firm value (Malik et al., 2014).

Over the past decade, the annual number of merger and acquisition activities has been relatively fluctuating. Furthermore, the diversification of merger and acquisition activities across sectors has become increasingly varied. For instance, the merger between Gojek, a company in the transportation industry, and Tokopedia, an e-commerce technology company, exemplifies this trend. In addition, globalization has led to merger and acquisition activities not only within Indonesia but also across borders, as seen in PT Indofood CBP Sukses Makmur Tbk acquisition of Pinehill Company Limited, a producer of instant noodles in Saudi Arabia.

In accordance with Law No. 40 of 2007 concerning Limited Liability Companies, the merger and acquisition decision-making procedure requires managers to submit a merger and acquisition plan to the board of commissioners for input and approval. The approval from the board of commissioners will then be discussed in the general meeting of shareholders for a final decision. According to Article 89 of the Limited Liability Company Law, If a decision receives the support of at least three-quarters of the votes cast, it is deemed valid. A comprehensive assessment of possible advantages, risks, and synergies is conducted throughout the process, from proposal to decision-making, to guarantee that the merger and acquisition choice is rational. However, merger and acquisition decisions are not always based on objective analysis and rational considerations. One psychological factor that may influence these decisions is the managerial overconfidence characteristic (Mundi & Kaur, 2019).

According to Presson & Benassi (1996) managerial overconfidence is associated with the illusion of control, which is defined as a propensity for managers to exaggerate their impact on results or achievement. Overconfident managers frequently think they have more influence over a problem than they actually have. This mindset frequently leads to unrealistic decisions and results that fall short of expectations. When making decisions, overconfident managers tend to engage in excessive investments and take on high-risk projects without adequately considering the potential negative impacts on the company (Chen et al., 2022).

One factor that can amplify managerial overconfidence is managerial ownership, including among members of the managers. Managers who own significant shares in a company often feel a stronger sense of control over its direction, which in turn increases their confidence in making strategic decisions (Quang & Xin, 2014). By bringing managers interests in line with those of shareholders, this share ownership usually encourages a stronger dedication to the company's a profitable outcome. However, this condition can also trigger an exaggerated illusion of control, where managers believe their decisions are not only correct but also consistently supported by shareholders (El-Ansary & Ahmed, 2023). Such excessive confidence may drive managers to take higher risks in strategic decisions, potentially affecting the overall performance of the company (Kasiani et al., 2015).

A study conducted by Bernardo and Welch (2001) on Los Angeles entrepreneurs discovered out overconfidence has a detrimental impact on CEOs' long-term viability and does not result in better performance. Furthermore, a study by Goel and Thakor (2008) on non-financial companies listed in the Fortune Global 500 from 2000 to 2006 found that CEOs with excessive overconfidence tend to overinvest and fail to enhance firm value. Another study conducted by Malmendier & Tate (2008) using data from 394 large companies in the United States. They found that negative of managerial overconfidence on making crucial decisions, particularly in mergers and acquisitions, leading to financial losses and reduced shareholder value. Similarly, research by Liu & Taffler (2009) involving 2,300 firms in United States revealed that managerial overconfidence has a detrimental impact on corporate performance. The latest research by Gu (2023) found that managerial overconfidence negatively impacts corporate performance by reducing innovation investments and amplifying risks in merger and acquisition decisions using Chinese A-share listed companies as a sample from 2007 to 2018 with 700 merger and acquisition transaction.

According to earlier research described above that managerial overconfidence negatively impacts firm value, several other studies have found contrasting results, indicating that managerial overconfidence can increase the worth of the company. For instance, Slothouber (2010) revealed that CEO overconfidence positively correlates possessing solid worth, as determined by Tobin's Q. Overconfident CEOs are subjected to stricter oversight regarding leverage and investment decisions, which leads to more optimal controls. Additionally, Banerjee et al. (2015) investigated businesses listed on the NASDAQ and New York Stock Exchange and discovered that following the enactment of the Sarbanes–Oxley Act (SOX), companies led by overconfident CEOs showed an increase in dividend payments, post-acquisition performance, and market value, while reducing risk exposure. Similarly, Mundi and Kaur (2019) examined enterprises registered on the Indian Stock Exchange from 2000 to 2015 and concluded that overconfident CEOs had a favorable influence on firm performance, as they tend to make optimal investment decisions, thereby enhancing corporate performance. Additionally, Tang et al. (2020) found that CEO overconfidence increases business value following mergers and acquisitions after analyzing 193 listed companies from the China Accounting and Stock Market Research Database. They found that CEOs who are overconfident can influence merger and acquisition choices.

Over the past eleven years, Indonesia has experienced significant growth in merger and acquisition activity and has also faced various challenges. This makes understanding the role of manager overconfidence in shaping these decisions very important. Indonesia presents a unique market environment compared to countries where similar studies have been conducted, due to factors such as concentrated ownership structures and high prevalence of family owned businesses. These characteristics can amplify the effects of managerial overconfidence, making its impact on firm value even more critical to investigate. Additionally, previous studies in various countries have reported mixed findings on this relationship, highlighting the need for further investigation in different market contexts. However, to date, no research in Indonesia has specifically examined the influence of managerial overconfidence on firms engaging in merger and acquisition activities. Therefore, this study seeks to fill this gap by analyzing companies listed on the Indonesia Stock Exchange from 2013 to 2023.

1.2 Problem Statement

Based on the facts mentioned, the problem statement for this research is: Does manager overconfidence involved in mergers and acquisitions have an adverse relationship with firm value as measured by Tobin’s Q?

1.3 Research Purposes

The research purposes of this study are as follows:

1. To present quantitative data on how managerial overconfidence affects business value as determined by Tobin's Q, in companies engaged in merger and acquisition activities in Indonesia during the period 2013–2023.
2. To give empirical data on the role of managers ownership over three years (before and after) of merger and acquisition activities in reflecting managerial overconfidence.

1.4 Research Benefit

The literature on managerial overconfidence and business value is theoretically enhanced by this study, especially when considering Indonesian companies engaged in mergers and acquisitions. It addresses gaps in prior research by resolving inconsistencies in findings regarding the effect of managerial overconfidence on firm value. Additionally, this research serves as an empirical study evaluating this relationship during the 2013–2023 period in Indonesia, contributing to the advancement of management and finance knowledge. Empirically, this study offers more proof of how managerial overconfidence affects company value, especially by looking at the connection between managerial confidence and their effects on firm value in merger and acquisition decisions. Furthermore, it explores how specific factors, such as firm size, leverage, return on assets, and cash flow, impact the connection between business value and executive overconfidence in the context of mergers and acquisitions. Last but not least, this study sheds light on the long-term connection between managerial overconfidence and firm value and how it affects the viability of business plans in firms that are engaging in mergers and acquisitions.

1.5 Systematic Structure

This research consists of five parts of the discussion of the research conducted. The following is the systematics carried out in this research:

CHAPTER I	: INTRODUCTION This chapter outlines the background, problem statements, research objectives, research benefits, and the systematic structure of the writing related to the research title.
CHAPTER II	: LITERATURE REVIEW This chapter presents the theoretical framework used as a relevant reference for this research, along with empirical findings from previous studies. It also outlines the development of the hypotheses to be tested.
CHAPTER III	: RESEARCH METHODOLOGY

The type of research, demographic and sample selection, data types and sources, research variables, and data analysis techniques are all covered in this chapter.

CHAPTER IV : RESULTS AND DISCUSSION

This chapter presents the research findings related to data description, statistical data overview, data analysis, and discussions for each variable.

CHAPTER V : CONCLUSION

The research findings, limitations, and conclusions are presented in this chapter along with suggestions based on the research.