

THE MODERATING ROLE OF MANAGERIAL OVERCONFIDENCE IN THE NEXUS OF MANAGERIAL ABILITY AND FIRMS LEVERAGE

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Abstract: *This study aimed to investigate the impact of managerial ability on corporate financial leverage and examine the moderating role of managerial overconfidence in Indonesian publicly listed firms. The analysis was based on 1,440 firm-year observations from 2017 to 2020 and used fixed-effects regression models with firm-clustered standard errors. The results showed that higher managerial ability was positively associated with greater financial leverage. Furthermore, it was found that managerial overconfidence increased this effect, suggesting that highly capable yet overconfident managers were more inclined to increase debt levels, potentially due to greater risk tolerance. This study contributed to the corporate finance literature by showing how cognitive biases interacted with managerial competence to influence leverage decisions, an interaction largely overlooked in traditional capital structure theories. These results offered practical implications for corporate governance, emphasizing the importance of complementing evaluations of managerial ability with behavioral assessments to minimize excessive risk-taking. In the context of emerging markets, this study emphasized the need for institutional reforms that consider both managerial skills and psychological traits in executive decision-making.*

Keywords: Accounting Behavior, Firms Leverage, Managerial Ability, Overconfidence

INTRODUCTION

Financial leverage, the use of debt to finance corporate activities, remains an important topic in the discourse of corporate finance due to its dual role in enhancing operational capabilities and posing financial risks. Debt financing allows firms to capitalize on fixed interest costs, tax shields, and greater financial flexibility (Hanlon and Heitzman 2022), but it exposes firms to increased vulnerability, particularly under conditions of poor cash flow management or economic downturns (Zheng et al. 2023). According to the pecking order theory

(Myers and Majluf 1984; Yıldırım and Celik 2021), firms tend to prioritize internal financing first, followed by debt, and finally equity, in order to avoid information asymmetry and the dilution of ownership. Within this framework, the role of managerial discretion becomes crucial, as managers are the primary agents responsible for selecting the optimal capital structure that correlates with firms strategic direction.

Contemporary corporate finance literature increasingly emphasizes the heterogeneity of managerial quality as a critical determinant of financial decision-making.

Seminal works have documented that managerial ability, which is a multidimensional construct reflecting managers efficiency in using firms resources, has profound implications for outcomes, including investment policies, financial reporting, tax strategies, and overall performance (Demerjian et al. 2013; Baik et al. 2018; Hasan 2020). For example, firms with highly capable managers often show greater transparency, better financial forecast accuracy, and stronger market reactions to managerial disclosures (Baik et al. 2020). Meanwhile, Lastiati et al. (2024) investigated managerial ability in Indonesia State Owned Enterprises (SOEs) on investment efficiency. Himawan and Wibowo (2016) included human capital to examine financial leverage, as their intelligence, skill, and knowledge are crucial factors for firms. Furthermore, capable managers are known to promote informational efficiency, reduce agency costs, and maintain favorable credit ratings, all of which contribute to lower borrowing costs and enhanced access to capital markets (Bui et al. 2018; Bonsall et al. 2017; Cornaggia et al. 2017).

Despite these advances, the relationship between managerial ability and capital structure remains theoretically and empirically contentious. Some studies suggested that capable managers, due to their superior information and risk assessment, may be more inclined toward higher leverage ratios, leveraging their reputational capital and superior foresight to negotiate favorable terms (Zahid et al. 2024; Khoo and Cheung 2022). Others stated the opposite that high-ability managers may strategically avoid excessive debt to reduce default risk and maintain operational flexibility, particularly under conditions of asymmetric information (Choo et al. 2021; Alam et al. 2024). This inconsistency points to the presence of unaccounted contextual or behavioral contingencies that moderate the relationship between managerial ability and leverage.

A potential resolution to this empirical ambiguity lies in the consideration of managerial behavioral traits, particularly overconfidence as

a moderating factor. Overconfidence, a well-documented psychological bias, refers to the tendency of individuals to overestimate their knowledge, skills, and predictions (Hackbarth 2008). When exhibited by corporate executives, this cognitive bias can skew financial decisions by causing managers to underestimate risks, overvalue future returns, or prefer debt over equity financing due to optimistic outlooks on firms performance (Malmendier et al. 2011). Studies have shown that CEO overconfidence can explain divergences in capital structure choices (Gurdgiev and Ni 2023; Carvalho et al. 2024). Therefore, the interaction between managerial ability and overconfidence may help explain why some capable managers choose aggressive debt financing, while others remain conservative.

From a theoretical perspective, the Upper Echelons Theory (Hambrick and Mason 1984) provides a foundational framework to understand this interaction. The theory suggests that organizational outcomes are partially influenced by the cognitive and psychological characteristics of top executives. Accordingly, the financial leverage decision, while informed by managers technical ability, may also be significantly influenced by their cognitive biases. Overconfident managers are more likely to perceive risks as manageable or negligible and to interpret market signals more favorably than warranted (Ho et al. 2016). This behavioral disposition may exacerbate or mitigate the effects of managerial ability on financial leverage, depending on the relationship between perceived and actual risks.

Empirical evidence on the interplay between managerial ability and overconfidence remains limited. Even though previous studies have investigated the influence of managerial ability (Alam et al. 2024; Choo et al. 2021) and overconfidence (EL-Ansary and Ahmed 2023; Gurdgiev and Ni 2023) on corporate financing decisions independently, few have examined their combined effects (Koester et al. 2017; Curi and Lozano-Vivas 2020). For instance,

[Demerjian et al. \(2013\)](#) found that firms led by more capable managers were less likely to engage in opportunistic financial reporting. [Baik et al. \(2020\)](#) showed that capable managers are more prone to use income smoothing to enhance the informativeness of earnings. Concurrently, the literature on managerial overconfidence ([Liu and Tan 2021](#); [Li et al. 2025](#)) showed that overconfident individuals systematically overestimate the accuracy of their predictions, leading to suboptimal risk-taking and financial planning. Therefore, integrating both constructs offers a new perspective for understanding capital structure decisions under conditions of cognitive and informational asymmetries.

Studies grounded in the information asymmetry perspective emphasized that debt markets rely on managers' informational credibility. Firms operating in poor information environments tend to depend heavily on bank financing to alleviate adverse selection costs ([Dhaliwal et al. 2011](#)). In contrast, firms led by highly capable managers, who enhance informational transparency, may find it easier to access diverse financing. Furthermore, [Baik et al. \(2018, 2020\)](#) and [Hasan \(2020\)](#) showed that managerial ability improved earnings quality and enhanced the firms reputation in capital markets, thereby influencing the availability and cost of leverage.

Despite the number of literature addressing either managerial ability or overconfidence, there is a gap concerning their intersection in shaping capital structure. This study aimed to fill the gap by exploring whether overconfidence moderates the effect of managerial ability on financial leverage decisions. Specifically, it was hypothesized that while managerial ability has a positive influence on leverage decisions, this effect is intensified in the presence of managerial overconfidence. Moreover, overconfident managers may amplify the use of leverage based on their optimistic assessments of firms outcomes, even when tempered by high technical competence.

This study had two primary objectives, first it aimed to address the inconsistencies in the existing literature on the relationship between managerial ability and financial leverage by introducing managerial overconfidence as a moderating variable. Second, it offered new empirical evidence from Indonesia, an emerging market with distinctive institutional and financial characteristics that provide a valuable setting for testing behavioral finance theories. This study used managerial ability framework developed by [Demerjian et al. \(2012\)](#) and adopted established empirical methodologies to isolate the impact of managerial characteristics on capital structure decisions. By elucidating the interplay between cognitive traits and managerial competence, the analysis contributed to the corporate finance and behavioral accounting literature, offering nuanced insights into the strategic determinants of leverage. Therefore, this work advanced the understanding of how individual-level attributes influenced firms financing policies within complex organizational contexts.

The agency theory provides a foundational perspective in understanding corporate financial decisions, particularly regarding leverage. According to [Myers and Majluf \(1984\)](#), agency problems arise when there is a disagreement between managers' and shareholders' interests, often leading to inefficient investment decisions such as overinvestment in empire-building activities. Within this theoretical context, financial leverage can serve as a mechanism to correlate managerial incentives with shareholder value, reducing the opportunity for managerial opportunism by imposing external monitoring through creditors.

Managerial ability is defined as the efficiency with which managers use corporate resources, as well as impact strategic decisions such as debt financing ([Hasan 2020](#)). It plays a significant role in shaping firms' financial structures. High-ability managers are expected to assess risks accurately and foster greater

trust among creditors, which in turn facilitates strategic use of debt. Previous studies supported the positive association between managerial ability and debt usage. For instance, [Shang \(2021\)](#) found that managerial ability was positively associated with the use of short-term debt, suggesting that competent managers were better at managing the risks associated with short-term obligations. Moreover, [Kabir et al. \(2024\)](#) showed that firms with more capable managers preferred higher levels of public debt over bank debt, further emphasizing the role of managerial ability in accessing and structuring external financing.

The psychological trait of overconfidence has been extensively examined in the corporate finance literature. Overconfidence describes the propensity of individuals to overestimate their abilities and the probability of favorable outcomes ([Kaplan et al. 2022](#)). Overconfident CEOs, in particular, tend to believe they possess superior knowledge about future events and are more likely to achieve positive results than is objectively warranted ([Ho et al. 2016](#)). This cognitive bias can have profound implications on corporate financing decisions, particularly by altering risk perceptions and decision-making under uncertainty.

[Hackbarth \(2008\)](#) stated that overconfidence biases managers' risk perceptions, leading them to underestimate financial risks and adopt more aggressive debt policies. Overconfident managers who believe in their superior abilities and optimistic forecasts may perceive borrowing as less risky, thereby increasing leverage levels. Accordingly, [EL-Ansary and Ahmed \(2023\)](#) found that CEO overconfidence amplified the relationship between long-term debt maturity and firms growth potential, particularly among firms facing internal financing constraints. By integrating these theoretical insights, this study investigated both the direct impact of managerial ability on financial leverage and the moderating role of overconfidence in shaping this relationship. The

combination of high managerial ability and high overconfidence may lead to an amplified usage of debt, as competent yet overly optimistic managers are more likely to aggressively exploit leverage under the belief that their superior skills will ensure favorable outcomes.

Managerial Ability and Financial Leverage

Building upon the theoretical framework, the first hypothesis relates to the direct effect of managerial ability on leverage. Managers with high abilities are better equipped to manage resources efficiently, identify profitable investment opportunities, and establish strong relationships with creditors. Therefore, they are more confident and strategic in their use of debt financing. [Hasan \(2020\)](#) stated that such managers are adept at assessing risks, enabling them to leverage debt to optimize firms capital structure. Supporting evidence from [Shang \(2021\)](#) and [Kabir et al. \(2024\)](#) strengthened this view and showed that capable managers favor higher levels of debt, particularly public debt. Therefore, this study hypothesized that managerial ability is positively associated with financial leverage, proposed as follows:

H₁: Managerial ability positively affects financial leverage.

Moderating Role of Overconfidence

Even though managerial ability influences leverage decisions, psychological traits such as overconfidence may further shape these decisions. Overconfident managers, as discussed by [Ho et al. \(2016\)](#), are prone to overestimating their knowledge and capabilities, leading them to underestimate risks associated with debt financing. [Hackbarth \(2008\)](#) suggested that when overconfidence interacts with managerial ability, the risk assessment distortions become even more pronounced, potentially leading to higher levels of leverage.

Empirical results by [EL-Ansary and Ahmed \(2023\)](#) showed that CEO overconfidence intensified the relationship between debt

maturity and firms growth potential, showing a more aggressive use of leverage under conditions of perceived future success. Managers with excessive confidence often downplay potential risks while exaggerating the anticipated advantages of a project (Sangiorgi and Schopohl 2021). Also, overconfident managers often overlook the limitations of available resources in their environment and overrate their own performance capabilities (Zhang et al. 2024). Therefore, when highly capable managers are overconfident, the combination may lead to a more aggressive leverage strategy compared to those with high ability but low overconfidence. The competence of managers provides the technical foundation for debt utilization, while overconfidence fuels greater risk-taking and optimistic projections, encouraging higher leverage levels. Therefore, the second hypothesis was proposed as follows:

H₂: Overconfidence strengthens the positive relationship between managerial ability and leverage.

The conceptual framework guiding this study is visually summarized in Figure 1.

METHOD

Data and Sample

The dataset for this study comprised publicly listed firms over a multi-year period between 2017-2020. Firm-level financial and accounting data were sourced from

standardized commercial databases, ensuring consistency and comparability across firms and time. To maintain data integrity and ensure meaningful analysis, financial institutions and utilities were excluded due to their distinct capital structure regulations. In this study, firms with incomplete information on key financial variables or those with missing managerial ability scores were excluded. This selection procedure was consistent with previous empirical work in capital structure studies that isolated the firm-level characteristics influencing debt usage while avoiding sectoral distortions (Myers, 1977; Li & Singal, 2019). The sample in this study consisted of 1,440 observations from 445 firms.

A panel data framework was adopted to observe firms across time and exploit both cross-sectional and temporal variation. Year fixed effects were included in all regressions to control unobserved heterogeneity that varied over time but common across firms. This adjustment helped isolate the effects of firm-specific managerial traits from macroeconomic shocks, regulatory changes, or evolving market trends that could systematically affect all firms in a given year (Breuer and DeHaan (2024)). Standard errors were clustered at the firms level to account for serial correlation and heteroscedasticity within firms over time, providing robust inference in the presence of time-varying firm-level shocks.

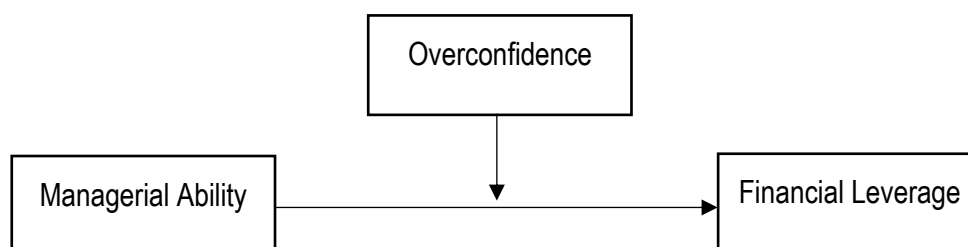


Figure 1. Conceptual Model

Key Variables

The dependent variable in this study was financial leverage, defined as the capitalization ratio of total debt to total assets (Arhinful and Radmehr 2023). This measure, widely recognized as a proxy for capital structure, captured the degree to which firms depend on debt financing (Myers 1977). Meanwhile, the primary independent variable was managerial ability, assessed using the methodology developed by Demerjian et al. (2012). This two-stage approach first used Data Envelopment Analysis (DEA) to evaluate firms efficiency in converting inputs into revenues. The efficiency scores were subsequently regressed on firm-specific factors unrelated to managerial skill, with the residuals isolating managers unique contribution to firms performance.

Managerial overconfidence is incorporated as a moderating variable, operationalized in line with behavioral finance literature. Overconfident managers are characterized by their tendency to overestimate future returns and underestimate risks, which shapes their distinctive investment and financing decisions (Hackbarth 2008; Malmendier et al. 2011). Moreover, overconfidence is proxied using the regression of sales growth on total asset growth, then adjusted by subtracting the industry median residual (Schrand and Zechman 2012). The inclusion of an interaction term between managerial ability and overconfidence allowed the exploration of whether cognitive bias conditions the effect of managerial skill on leverage decisions.

In addition to these core variables, several firm-level controls known to affect capital structure were included. The first control variable in this study was tangibility (Tang), based on the study by Camisón et al. (2022), calculated as the value of tangible fixed assets divided by firms total assets. Meanwhile, the control variable financial slack (FIN_SLACK) was adopted from the study by Hou et al. (2016), measured as the amount of cash and short-term investments relative to the average total assets. Variable

control firms size (SIZE) was also included in this study model to emphasize its greater effectiveness in acquiring external financial resources (Himawan and Wibowo 2016). SIZE is defined as a natural log total asset. Asset tangibility is particularly salient, as firms with more tangible assets are better positioned to secure debt financing by pledging physical assets as collateral (Y. Li and Singal 2019). The trade-off theory states that high tangibility lowers the cost of debt, thereby encouraging higher leverage (Myers 1977).

Regression Model

To investigate the relationship between managerial ability and leverage, a linear regression model was estimated with leverage as the dependent variable. The model included managerial ability, overconfidence, interaction term, and the previously described control variables. Year fixed effects are incorporated to capture unobserved time-specific influences common to all firms, thereby enhancing the robustness of the estimates. To estimate the proposed model, we utilize a moderating regression analysis (MRA) approach with panel data. We analyze the data through a sequence of three models to build a comprehensive understanding. First, Model 1 establishes a baseline with firm-level control variables. Next, Model 2 incorporates the moderating variables independently. The full analysis is presented in Model 3, which includes the critical interaction terms to evaluate the moderating relationships. The estimated model takes the following form:

$$LEV_{it} = \beta_0 + \beta_1 CONTROL_{it} + \gamma FE_t + \epsilon_{it} \dots (1)$$

$$LEV_{it} = \beta_0 + \beta_1 ABLT_{it} + \beta_2 OC_{it} + \beta_3 CONTROL_{it} + \gamma FE_t + \epsilon_{it} \dots (2)$$

$$LEV_{it} = \beta_0 + \beta_1 ABLT_{it} + \beta_2 OC_{it} + \beta_3 (ABLT_{it} \times OC_{it}) + \beta_4 CONTROL_{it} + \gamma FE_t + \epsilon_{it} \dots (3)$$

where LEV_{it} denotes leverage of firms i in year t , $ABLT_{it}$ is managerial ability score, OC_{it} is an indicator for overconfidence, and $ABLT \times OC_{it}$ is the interaction effect. $CONTROL_{it}$ is the vector of control variables, γFE_t is year fixed effects, and ϵ_{it} is the error term clustered at the firms level.

This specification allowed assessment of the direct influence of managerial ability on leverage and to test whether this effect is moderated by the presence of overconfidence. By adopting a flexible model that controls time trends, this study aimed to isolate the specific role that managerial traits play in shaping capital structure outcomes.

RESULTS

Managerial Ability and Leverage

The regression results used in the analysis are presented in Table 1. The primary variable of interest, managerial ability (ABLT), showed a consistently positive and statistically significant association with leverage across all model specifications. In Model (1), which controls for firms characteristics and managerial ability, the coefficient on ABLT was 0.241 ($p < 0.01$), showing that a one-unit increase in managerial ability corresponded to a 24-

percentage point rise in leverage, holding other factors constant. This relationship remained robust in Models (2) and (3), where the coefficient declined marginally but retained significance at the 1% level. These results were consistent with previous studies that firms led by more capable managers have stronger financial performance and tend to pursue more aggressive financing strategies (Hasan 2020; Baik et al. 2018). Moreover, this supported the notion advanced by Demerjian et al. (2013), who stated that high managerial ability enhanced firms' information environments, thereby facilitating access to external financing and increasing leverage. This correlated with the information asymmetry literature, which suggested that greater managerial competence mitigated adverse selection costs and improved market perceptions, ultimately easing constraints on external financing.

Table 1. Regression Results of Managerial Ability and Overconfidence on Leverage

| VARIABLES | (1) LEV | (2) LEV | (3) LEV |
|----------------|----------------------|----------------------|----------------------|
| ABLT | 0.241*** (0.0517) | 0.240*** (0.0517) | 0.218*** (0.0529) |
| OC | | 0.0252 (0.0193) | 0.0123 (0.0205) |
| ABLT*OC | | | 0.169* (0.0910) |
| Tang | 0.110* (0.0571) | 0.108* (0.0571) | 0.0991* (0.0573) |
| FIN_SLACK | -0.116* (0.0663) | -0.132* (0.0675) | -0.131* (0.0674) |
| SIZE | -0.00797 (0.0173) | -0.0133 (0.0178) | -0.0101 (0.0178) |
| Constant | 0.652 (0.497) | 0.805 (0.511) | 0.717 (0.513) |
| Year effect | Yes | Yes | Yes |
| Observations | 1,440 | 1,440 | 1,440 |
| R-squared | 0.030 | 0.031 | 0.035 |
| Number of firm | 445 | 445 | 445 |

Standard errors in parentheses *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Overconfidence and Its Interaction with Managerial Ability

Model (2) incorporated managerial overconfidence (OC), which produced a positive but statistically insignificant coefficient (0.0252, $p > 0.10$). This showed that overconfidence, in isolation, does not significantly influence firms' leverage decisions. Even though this result did not correlate with previous psychological evidence suggesting that overconfident executives tend to overestimate future returns and underestimate risks ([Malmendier et al. 2011](#); [Hackbarth 2008](#)), it emphasized the necessity of accounting for contextual factors such as managerial ability when assessing behavioral impacts on capital structure choices.

To further examine this interplay, Model (3) introduced an interaction term between managerial ability and overconfidence. The interaction (ABLT*OC) was positive and statistically significant at the 10% level, with a coefficient of 0.169. This result suggested that overconfidence strengthened the positive effect of managerial ability on leverage. This is consistent with the notion that confidence can increase the assertiveness of capable managers in pursuing debt financing. In accordance with ([Chung et al. 2024](#)), who characterized overconfidence as a self-serving bias, this result showed that when overconfidence is coupled with high ability, managers may be more inclined and better positioned to undertake complex financing strategies, thereby increasing firms leverage.

This interaction effect provided empirical nuance to the literature on behavioral finance and corporate decision-making. Even though overconfidence alone may not significantly influence leverage, its presence becomes consequential when paired with high managerial competence. The moderation effect was particularly insightful, as previous results by ([Moore and Bazerman 2022](#)) showed that skilled individuals were more likely to conflate confidence with ability, potentially leading to bolder yet informed strategic choices.

Control Variables

Asset tangibility (Tang) showed a positive and statistically significant relationship with leverage across all model specifications, consistent with the predictions of the Trade-Off Theory ([Myers 1977](#)). The coefficient estimates range from 0.0991 to 0.110, all significant at the 10% level, reinforcing previous evidence that firms with higher tangible assets have greater borrowing capacity due to the collateral value of fixed assets ([Y. Li and Singal 2019](#)). Meanwhile, financial slack (FIN_SLACK) is negatively associated with leverage, with coefficients ranging from -0.116 to -0.132, all significant at the 10% level. Another control variable, SIZE had a negative but statistically insignificant relationship with leverage, with coefficients ranging from -0.0133 to -0.007. This result showed that firms with greater internal liquidity were less reliant on external debt financing. This correlated with previous empirical work in Indonesian telecommunication firms by ([Himawan and Wibowo 2016](#)). In addition, it was consistent with the pecking order theory that firms prioritized internal financing to minimize information asymmetry and transaction costs.

Discussion

Managerial Ability and Leverage: Strategic Decision-Making through Competence

The results showed a robust and statistically significant positive relationship between managerial ability and leverage, reinforcing the growing body of literature that emphasized the strategic role of managerial quality in corporate financing decisions. Specifically, higher managerial ability, as captured by the efficiency-based metric of ([Demerjian et al. 2012](#)), enabled firms to sustain greater levels of debt. This suggested that capable managers were better equipped to navigate debt markets, due to their superior skills in forecasting returns, managing risks, and articulating value propositions to creditors. The results correlated with the foundational trade-off theory of capital structure, which states that firms

balance the tax advantages of debt against the costs of financial distress ([Myers 1977](#)). However, it refined this theory by introducing heterogeneity in managerial capability as a determinant of how these trade-offs are evaluated and operationalized. From this perspective, high-ability managers are not merely agents executing firms policy, but are active strategists capable of leveraging their competence to expand financial options, reduce financing frictions, and implement more aggressive debt policies ([Demerjian et al. 2013](#)).

Importantly, these results correlated with previous studies on managerial quality and market perception. [Hasan et al. \(2020\)](#) stated that capital markets responded more favorably to high-ability managers due to the perceived reduction in information asymmetry and moral hazard. In this context, the positive association between managerial ability and leverage may be facilitated by more favorable credit terms, stronger relationships with lenders, and more accurate assessments of firms risk profiles.

Overconfidence as a Conditional Amplifier of Managerial Ability

Even though managerial overconfidence does not significantly predict leverage, the results showed that it significantly moderated the relationship between managerial ability and leverage. This nuanced interaction suggested that overconfidence alone may not lead to aggressive financial strategies, but when combined with managerial ability, it amplified the willingness to pursue higher leverage levels. This result offers empirical support to the dual-role theory of overconfidence in financial decision-making. [Malmendier and Tate \(2005\)](#) proposed that overconfidence can lead managers to overestimate firms future cash flows, leading to overinvestment and excessive debt. However, the evidence presented in this study suggested that such outcomes were contingent upon managers underlying competence. While overconfidence may increase risk tolerance or assertiveness, it is the

presence of high managerial ability that determines whether this disposition translates into strategically advantageous decisions.

In this regard, the interaction effect corroborates previous studies suggesting that behavioral biases do not operate in isolation but are influenced by contextual and individual-level variables ([Gurdgiev and Ni 2023](#); [Carvalho et al. 2024](#)). From a cognitive perspective, [Moore and Bazerman \(2022\)](#) stated that overconfidence among competent individuals may reflect greater epistemic certainty and goal-directed behavior, as opposed to hubris or miscalculation. The results of this study reflected this distinction that when ability is high, overconfidence functions as a catalyst for assertive leverage strategies, whereas its independent effect is muted.

This interaction introduces important considerations for corporate governance and managerial selection. Even though overconfidence is often portrayed as detrimental, its impact is moderated by underlying competence. Firms may benefit from appointing overconfident leaders when such confidence is underpinned by substantive skill and strategic acumen. In contrast, overconfidence separated from ability poses a significant risk of value-destroying decisions.

The analysis of control variables produced additional insights into firm-level determinants of leverage, particularly asset tangibility and financial slack. Consistent with the Trade-Off Theory, asset tangibility had a positive association with leverage, reinforcing the notion that tangible assets provide collateral that mitigates lender risk ([Myers, 1977](#); [Li & Singal, 2019](#)). In contrast, financial slack consistently showed a negative relationship with leverage across all model specifications, suggesting that firms with greater internal liquidity were less reliant on external debt. This result correlated with the Pecking Order Theory, that firms prioritize internal financing to minimize information asymmetry and transaction costs. This preference for internal funds is particularly

relevant in contexts where debt may include covenants, monitoring, or dilution of managerial discretion. High-ability managers may strategically retain internal funds to preserve autonomy and buffer against future uncertainty, reflecting a more nuanced approach to capital structure optimization.

CONCLUSION

In conclusion, this study contributed to literature in several important respects. First, by integrating behavioral finance and managerial ability into a unified framework, it offered a more comprehensive explanation of capital structure decisions. Even though previous studies including [Alam et al. \(2024\)](#), [Choo et al. \(2021\)](#), [EL-Ansary and Ahmed \(2023\)](#), and [Gurdgiev and Ni \(2023\)](#) typically examined managerial ability and overconfidence in isolation, the current analysis showed that their interaction is important for understanding firms leverage. This synthesis advanced the understanding of how cognitive biases and managerial competence jointly influence financing outcomes. Second, this study offered empirical validation for the contingent effects of psychological traits on corporate policy. Overconfidence is not universally detrimental or beneficial, its consequences depend on managers ability to process information, assess risk, and execute strategy. This contingency correlated with recent behavioral theories emphasizing the importance of boundary conditions and dual-process cognition in financial decision-making ([Chung et al. 2024](#); [Liu and Tan 2021](#)).

From a practical perspective, the results have implications for executive recruitment, investor analysis, and corporate governance. Boards of directors and investors should not evaluate managerial traits in isolation. A nuanced assessment that considers both behavioral dispositions and ability metrics can offer more accurate predictions of corporate policy and performance. Furthermore, lenders may consider managerial profiles as part of credit risk assessments, due to the influence of

ability-overconfidence interactions on leverage decisions.

This study offered empirical evidence on the relationship between managerial ability, overconfidence, and corporate leverage, showing critical insights into how individual-level characteristics shape firms financial decisions. The results showed a strong and positive association between managerial ability and leverage, suggesting that capable managers are better equipped to assess risk, secure financing, and implement complex debt strategies. Furthermore, this study emphasized the significant moderating role of overconfidence. Even though overconfidence alone did not influence leverage, it intensified the positive effect of managerial ability when both traits co-occur. These results showed that overconfidence was strategically advantageous when accompanied by competence.

By incorporating behavioral and cognitive dimensions into capital structure analysis, this study contributed to the growing literature that recognized the heterogeneity among decision-makers as a determinant of financial policy. The nuanced interaction between ability and overconfidence offered a more holistic explanation of leverage variation across firms, bridging gaps between traditional finance theories and behavioral insights. This study enriched the theoretical understanding of capital structure determinants and offered practical implications for executive hiring, governance, and credit evaluation. Future investigations can expand on these results ngs by exploring other psychological traits, examining different institutional settings, or using alternative measurement techniques for overconfidence. Overall, this study affirmed the critical role of managerial characteristics in corporate financial behavior and opens promising pathways for further investigation into behavioral corporate finance.

Despite its contributions, this study is subject to several limitations. First, the measurement of overconfidence relied on proxy

variables that may not fully capture the psychological complexity of the construct. Future studies may benefit from integrating experimental or survey-based approaches to accurately distinguish overconfidence from related traits such as optimism or risk tolerance. Second, although the dataset offered broad firms coverage and an extensive temporal range, it remained confined to a specific institutional context. Cross-country replications or applications in varied economic environments

would strengthen the external validity and generalizability of the results.

Future investigations should explore how other behavioral traits, including narcissism, loss aversion, or emotional intelligence, interact with managerial ability in shaping capital structure. Similarly, longitudinal studies could investigate how managerial traits evolve over time and how the evolution affects financial decisions, particularly during periods of crisis or transformation.

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