

The Mediating Role of Operating Cash Flow in the Relationship Between Managerial Overconfidence, Firm Value, and Tax Avoidance

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EXTENDED ABSTRACT

Introduction

this study investigates the impact of managerial overconfidence on firm value and tax avoidance by considering the mediating role of operating cash flow. In today's dynamic and complex business environment, managerial behavioural traits such as overconfidence play a crucial role in shaping financial strategies and company performance. Overconfident managers tend to overestimate their knowledge and ability, which can lead to higher risk-taking behaviour. This may result in both value creation through innovation and investment or, conversely, value destruction due to overinvestment in negative NPV projects. Additionally, tax avoidance strategies—although often employed to preserve liquidity—may carry legal and reputational risks. The role of operating cash flow as a financial performance indicator and a potential mediator in this context is of particular interest.

Hypotheses

based on theoretical background and empirical literature, the following hypotheses were developed:

H1. Managerial overconfidence is hypothesized to have a significant impact on firm value.

H2. Managerial overconfidence is expected to influence the extent of corporate tax avoidance.

H3. Operating cash flows are proposed to mediate the relationship between managerial overconfidence and firm value.

H4. Operating cash flows are hypothesized to mediate the relationship between managerial overconfidence and corporate tax avoidance.

Method

This is an applied and descriptive-correlational study using panel data. The statistical population includes all non-financial firms listed on the Tehran Stock Exchange from 2017 to 2023. A total of 105 firms were selected through a screening process. To test the hypotheses, five regression models and two mediation models (using the Sobel test) were estimated. The main variables included Tobin's Q (firm value), effective tax rate (tax avoidance), operating cash flow (mediator), and managerial overconfidence measured by excess investment proxy. Control variables such as asset turnover, financial leverage, board independence, and firm size were included.

Results

The empirical findings reveal that managerial overconfidence exerts a positive and statistically significant influence on firm value, whereas its effect on tax avoidance is negative and statistically insignificant. Furthermore, operating cash flows are found to significantly mediate the relationship between managerial overconfidence and firm value; however, their mediating role in the relationship between managerial overconfidence and tax avoidance is not supported. Overall, the results underscore the importance of managerial behavioural traits in shaping firm outcomes and highlight the critical role of cash flow management in enhancing corporate value.

Discussion and Conclusion

The findings of this study indicate that managerial overconfidence has a positive and significant effect on firm value, suggesting that confident managers can enhance corporate performance and market perception. However, its effect on tax avoidance is negative and insignificant, implying that overconfident managers may not necessarily engage in aggressive tax strategies.

In addition, operating cash flows play a significant mediating role in the relationship between managerial overconfidence and firm value, emphasizing the importance of effective cash flow management in translating managerial behaviour into higher firm value. Conversely, the mediating role of operating cash flows between managerial overconfidence and tax avoidance is not confirmed, indicating that liquidity alone does not explain managers' tax-related decisions.

Overall, these results highlight the influence of managerial behavioural characteristics on firm performance and underline the importance of financial discipline and governance mechanisms in improving organizational value.

Keywords: Managerial Overconfidence, Firm Value, Tax Avoidance, Operating Cash Flow.