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### Deals Without Delusions

Key ideas from the [Harvard Business Review](#) article By Dan Lovallo, Patrick Viguerie, Robert Uhlener, John Horn

#### The Idea in Brief

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Half of all acquiring companies pay more for target firms than they're worth. Often it's because of executives' mental biases: Their interest in a deal keeps them from being objective about its value. Thus, during *preliminary due diligence*, many aspiring acquirers overestimate revenue and cost synergies. While *bidding*, they get sucked into price wars. And in the *final phase*--additional due diligence with access to the target's books--they ignore signals suggesting danger ahead.

To avoid overpaying for M&As, say Lovallo and his coauthors, systematically attack mental bias. For instance, during due diligence, seek out evidence that challenges your assumptions about revenue and cost synergies. Don't bid until you've set a maximum price. And solicit independent analysts' perspectives during the final phase.

By anticipating and countering common mental biases, you make sounder judgments at each stage of the M&A process. You forge the right M&A deals--and steer clear of the wrong ones.

#### The Idea in Practice

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The authors suggest strategies for countering mental biases at each stage of the M&A process:

##### Preliminary Due Diligence

**Confirmation bias**--seeking out information that validates your initial interest in the target company.

**Antidote:** Seek evidence disconfirming your estimates of the deal's potential value.

A company looking to acquire a firm with a complementary technology takes into account the target's slowing growth rates--which signal deteriorating attractiveness of the target's markets.

**Overconfidence**--relying solely on your own estimates of synergies between your firm and the target.

**Antidote:** Examine numerous similar deals your firm and others have done. If your expected synergies are skewed toward the high end of, or beyond, what comparable deals have yielded, watch out.

**Underestimating cultural differences**--ignoring conflicts between merging firms' cultural conventions that can damage post-M&A performance.

**Antidote:** Identify potential problems, such as differences between compensation systems, and develop plans for addressing them.

**Underestimating time, money, and other resources needed for integration.**

**Antidote:** Identify best practices for improving integration efforts.

GE Capital applies Six Sigma principles to drive continuous improvement in its integration practices and sponsors conferences to foster idea sharing on M&As.

## Bidding

**Bidding above the target's true value when multiple players enter the game.**

**Antidotes:** Set a maximum price for each deal. Then walk away if competitors initiate a bidding war.

## Final Due Diligence

**Anchoring**--refusing to adjust an initial valuation even if new information about the target firm suggests that the initial number is meaningless.

**Sunk costs fallacy**--refusing to walk away from the deal, even if the costs are unrecoverable, because you've invested so much time, money, effort, and reputation into making the deal happen.

**Antidotes:** Hire fresh, dispassionate experts to examine relevant aspects of the deal--but don't tell them your initial estimate of the deal's value. Always entertain multiple M&A possibilities; you won't get so emotionally attached to one deal.

- [Purchase the full-length Harvard Business Review article here.](#)
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## Further Reading

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### Articles

**[Delusions of Success: How Optimism Undermines Executives' Decisions](#)**

*Harvard Business Review*

July 2003

by Dan Lovallo and Daniel Kahneman

To counter the unwarranted optimism that can distort decisions of all types--including acquisitions--Lovallo and Kahneman recommend using reference forecasting. This technique

produces more accurate predictions and augments your intuitive "inside view" of a potential acquisition with a more objective "outside view." To use reference forecasting for acquisition decisions, apply these steps: 1) Select past acquisitions (by your company or others) to serve as your "reference class." 2) Identify the averages and extremes in the reference-class acquisitions' outcomes. 3) Predict where your potential acquisition would fall along the reference class's distribution. 4) Assess your prediction's reliability by evaluating how well your past predictions matched actual outcomes. 5) Correct your intuitive estimate based on your predictability analysis.

### **What You Don't Know About Making Decisions**

*Harvard Business Review*

November 2003

By David A. Garvin and Michael A. Roberto

The authors explain how to counter another common problem in acquisitions: managers' tendency to take a stand early and advocate for that position without weighing opposing--and valuable--views. The article presents three strategies for balancing advocacy with inquiry to arrive at smarter acquisition decisions: 1) Promote constructive conflict; for example, by requiring vigorous debate while prohibiting language that triggers defensiveness. 2) Ensure that everyone involved in the decision perceives the process as fair by conveying openness to new ideas and willingness to accept different views. 3) Bring the decision process to closure at the appropriate time by discouraging too-early closure and endless loops in which warring factions repeatedly restate their positions.

## About the Authors

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