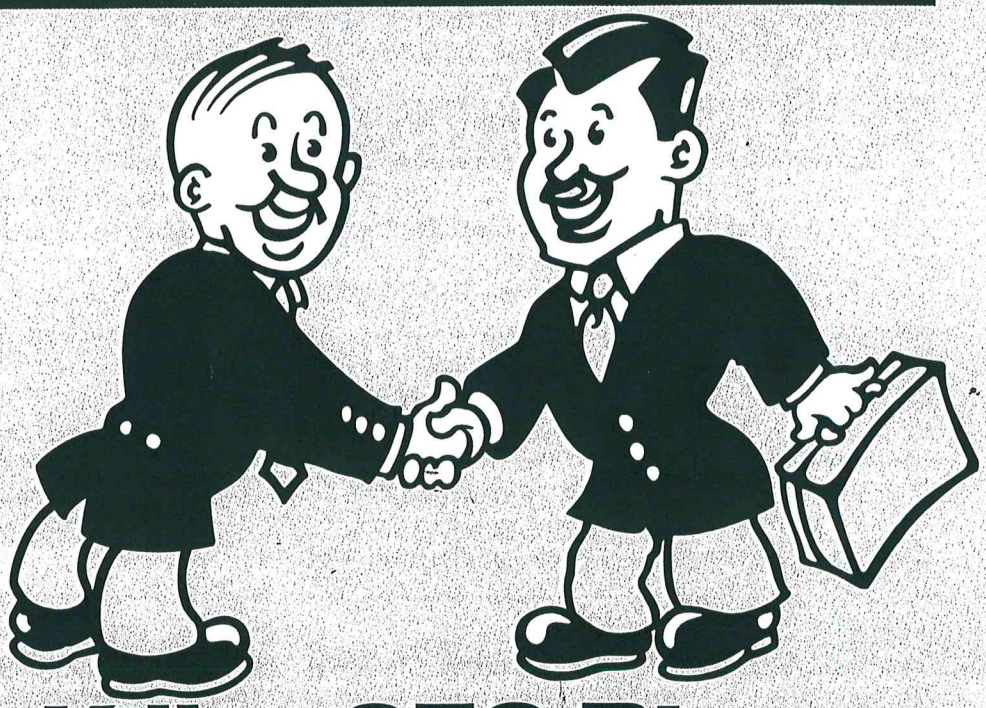


Three Killer CEO Biases to Avoid in M&A

In the world of deal-making, blind spots can be brutal. J.D. Ford's Joseph Durnford outlines three biases that can derail mergers and how to guard against them derailing your deal.

By **Joseph M. Durnford and Jeffrey A. Sasakura**

When it's done well, a merger offers a bounty of benefits. The right deal can round out an acquiring company's product and service portfolio, boost market share for the new entity, lower costs via operational synergies and increase value for shareholders of both buyer and seller.

But success remains elusive in M&A. Countless studies have put the failure rate of mergers and acquisitions somewhere between 50 percent and 90 percent. Most of these doomed marriages fall apart in the post-deal integration, when the companies fail to realize the synergies promised, the performance of the combined organization stalls, turnover spikes as disillusioned employees jump ship and the CEO is left wondering what on earth went so wrong.

Some of these deals were wrong to begin with, but the CEOs involved were too blinded by their own biases to see it. When CEOs let emotions lead, they can make decisions that are fatal to the success of an acquisition and devastating to the company's shareholders.

On the other hand, those who can be honest with themselves and remain aware of their own biases can mitigate problems and objectively evaluate and successfully execute M&A opportunities.

Whether the biases are your own, your internal teams or those of your professional advisors and consultants, self-awareness will go a long way toward your future success as a dealmaker. The following are three key biases most common among CEOs—and what you can do to avoid them.

Bias #1: The Overconfidence Trap

As a CEO, your positive outlook and confidence enable you to tackle risks from which others shy away. Your entrepreneurial spirit gives you the strength to lead your company into uncharted territory and gives your employees faith in the future. But that same confidence, unchecked, can lead you to miss opportunities.

That was the case for one of our former clients, the CEO of a leading direct-selling company. Advances in technology had created market opportunities in new industries, and our client capitalized on this opportunity by launching a direct-selling business to enable customers to better utilize computer-based tools. The business model he created was highly successful for many years, with revenues and earnings growing steadily each year.

That success led our client to develop an overconfidence bias, in which he assumed his company's growth trajectory would continue indefinitely. This bias skewed both his expectations of value as well as his perception of risk. Year after year, potential purchasers came to the table offering increasingly attractive valuations for the company; but year after year, he turned down these proposals with the expectation that if he were to wait and sell later, the business would be worth even more. The highest and final offer he received was for nearly $100 million.

Meanwhile the competitive landscape in this industry was changing and his target market was rapidly evolving. As the business matured, the CEO failed to recognize changing fundamentals that would soon make many of the company's products obsolete.

The business eventually lost its footing as the market evolved; and after many attempts to revive and reposition the company, the CEO finally closed shop, having lost the bulk of his net worth by passing up many opportunities to monetize what was once a highly innovative idea.

Had the CEO been aware of how his emotions were playing into his decision-making, he could have avoided that fate. He might have recognized that hubris was playing a key role in his refusal to let go of the company or to make the necessary changes to the business model to keep up with changing times. In the end, his blindness proved fatal for his company.

Bias #2: Hopping on the Bandwagon

This Achilles' heel causes CEOs either to miss out on incredible opportunities to buy assets when prices are low or to make poor acquisitions simply because they see others doing deals.

We saw much of the first example after the subprime mortgage debacle and ensuing decline in the economy in 2008, when investors fled the markets and companies hunkered down to weather the storm. Rather than seeking growth, most CEOs focused on cost cutting and survival. Risk aversion skyrocketed and the M&A market dried up. Even CEOs running the healthiest companies, who had plenty of cash to make acquisitions, were deterred by the uncertain future of the economy.

Eventually, the federal government began taking steps to re-inject confidence into the market and bolster the economy. Despite the stimulatory actions of the Fed, most companies remained on the sidelines, paralyzed by the prevailing negativity about the economy. No one wanted to make the first move despite the fact that many potentially lucrative M&A opportunities existed at attractive and unprecedented valuations.

The leading UK firm Barclays was one company that benefited from bucking the negativity trend. Barclays did not fall victim to the bias that saturated the market. Instead, after Lehman Brothers filed for bankruptcy in 2008, Barclays saw an opportunity to capitalize by purchasing the assets of Lehman at the bargain price of $250 million cash. Barclays then-CEO Bob Diamond recognized the deal as an opportunity to become a top-10 player in the global investment banking community. "You cannot have a global cash equities business without a big U.S. presence. That is not something you can build organically," he said at the time. The acquisition of Lehman gave the firm the opportunity to purchase a long-established business that would allow it to quickly penetrate the U.S. market. That acquisition paid off greatly. Not only did Barclays enter the global top 10, it was the only European bank to be in the top five U.S. investment banks as of September 30, 2013, according to the *Wall Street Journal* and Dealogic.

Bias #3: Missing the Forest for the Trees

The sale process can be daunting and mired with obstacles. Finding the right buyer who satisfies all the objectives of the shareholders can feel like finding a needle in a haystack. During a complex sale process, it can be all too easy to get caught up in the nuances of the due diligence process or minute details of negotiations and ultimately lose sight of one or more of your initial objectives. You wind up focusing on aspects of the deal that, while seemingly important at the time, are not germane to the overall outcome or the achievement of the goals and objectives originally established by the CEO and/or shareholders.

For example, recently, we had a client who was the owner of a 100-unit retail jewelry business and was looking to retire. Before they even began shopping for a potential buyer, our client and the company's shareholders established several key objectives, which included maximizing value at the top of the priority list and finding an acquirer that would be a good steward of the brand, would retain most of the employees and would value the unique real estate assets controlled by the business.

The sale process garnered multiple offers from highly qualified buyers, but the negotiations ultimately came down to two finalists. One was an international strategic buyer from India, relatively unknown in the U.S.; the other was a Berkshire Hathaway company—a.k.a. Warren Buffett. The international buyer was offering roughly double the price, stated that it would retain nearly all of the employees and would use the company as a platform for U.S. expansion. To us, the decision to accept twice the price seemed obvious and we were confident that the international buyer had the capacity and commitment to close.

But for our CEO client, the decision was not as clear. He became enamored with the idea of being acquired by this prestigious investor and began focusing on aspects of the deal that were not part of the original objectives. Specifically, he began overweighting new aspects of the deal—certainty of closing, employee integration and how the company might change if it were sold to a foreign buyer—while underweighting a key objective: value to shareholders.



Ultimately, the CEO recognized and evaluated his bias, refocused on the initial transaction objectives and made the decision to sell the company to the international buyer, which turned out to be an excellent transaction for both the selling shareholders and the new owners.

Beware of Outsider Bias

In addition to being aware of one's own biases, a CEO must also manage those of the many other players—advisors, consultants, executive teams, board members—involved in deal making. Advisors and consultants play a pivotal role in the evaluation of M&A opportunities and the execution thereof, and many CEOs have profited or perished by relying on their advice.

On the buy-side, for example, outside accountants, lawyers and consultants are charged with many elements of due diligence and they are, therefore, an indispensable part of your team. However, they also tend to be biased toward conservative decisions and focus on details, which may lead them to advise against a closing. As CEO, it is essential for you to assess your advisors' biases and leverage their expertise to find ways to avoid risk while still taking advantage of the broader opportunities you see.

On the sell-side, your investment banker is a key asset, and in many instances is the deal's chief advocate and lead negotiator. While professional investment bankers make every effort to be objective and to work as trusted advisors, they are biased toward action and a willingness to accept risk. They are also compensated at closing.

The bottom line? Consider advice, but scrutinize all input carefully. The deal may seem ideal to your investment banker, overly complex to your lawyer or too risky to your accountant, but the final call is yours and yours alone. The better you understand all the players' biases and what drives each one, the easier it will be to make the best decision for the most important parties: you, your employees and your shareholders. Ultimately, the ability to evaluate a transaction objectively, while staying true to your goals, can mean the difference between passing on an excellent M&A opportunity, pursuing a disastrous M&A initiative—or successfully executing the deal of a lifetime.

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