# Are takeover battles waged RATIONALLY?

The field of behavioral economics finds evidence to the contrary, says Brunswick's **STUART HUDSON**

Nobel Prize winner Daniel Kahneman has long argued that people make poor financial decisions. They rely on "heuristics," making most decisions using mental shortcuts or rules of thumb that often turn out to be wrong. They are "loss averse," putting a higher price tag on a thing they already hold, versus a thing they do not. And they are susceptible to "framing," or being influenced by the way an idea is presented.

Sophisticated investors are not immune from this behavior. Harvard's Andrei Shleifer talks of "systematic" deviations from rationality. Repeated studies have found a short-term momentum effect in stock prices, suggesting a psychological feedback mechanism influencing investment decisions.

And it isn't just investors. Georgetown's Donald C. Langevoort has found that CEOs in takeover situations – particularly acquirers – are more likely to display overconfident and risk-taking behavior. And corporate board members and their advisers can be affected too. When they are surrounded by a deal team consisting largely of senior males who feel experienced in their field, watch out. Competitive behavior can then create a desire to win at almost any cost – including to shareholders. And the desire for cohesion can suppress dissenting opinions.

All of this suggests that future takeover battles may be won by those who effectively incorporate the insights of behavioral economics and psychology.

### Here are THREE LESSONS to start with.

**FIRST,** don't just recite numbers; tell a story that builds trust. It is crucial to develop a narrative that explains that you "get" your shareholders. Show how your track record demonstrates that shareholders can trust you, and clarify how and why your team is best suited to manage the embattled company.

That means telling the story of your management team's journey, the progress you have made and the opportunity that a takeover could jeopardize. The bidder must counter that narrative with a story of their own, one that undermines the credibility of the target's track record and that explains why they deserve the confidence of shareholders.

**SECOND,** when rebutting claims from the other side, don't just rely on facts. People are susceptible to confirmation bias, only accepting evidence that fits their existing views, so telling them they are wrong and arguing the facts might only make things worse. There can even be a backfire effect, in which correcting people actually increases their misperceptions. The science behind vaccines, after all, is solid. Yet a classic Harvard study showed how attempts to debunk myths about vaccines failed to convince dubious parents.

Instead, before trying to convince skeptics of an alternative narrative to the one they believe, first look for a way to reassure them and build some common ground.

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**THIRD,** recognize that you and your team are likely susceptible to your own biases and to groupthink.

When you express a point of view on an important question, ask yourself "What would cause me to change my mind?" In *Superforecasting*, Philip Tetlock and Dan Gardner suggest that in any decision-making process you should list all the signs and factors that would cause you to come to a different answer. If you have identified these factors at the start, you may be more open-minded when your colleagues or advisers suggest that the time has come to change course.

In the months and years ahead, it is likely that the study of behavioral economics and finance will yield more insights for those working in M&A. If you are going to win a business-critical takeover battle, you cannot afford to be left behind.

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