The Confirmation Bias Lurking in Plain Sight

A private equity firm decided to grow a retail company by buying another in the same business. The promise was: dramatic increase in revenue and cost savings via synergies. The amount and depth of financial analysis done for this deal was stunning. Only cursory attention was paid to the management talent, supply chain and organizational culture. The methods, skill and vigor used to look at them were vastly inferior to those brought to bear on the financial analysis. Three years later the company was broke, jobs were lost and reputations tarnished.

Quentin Tarantino talks about how often movies are directed by someone who is not in the same room where the acting is occurring. His advice is "don't go to video-land." My advice is don't buy a business you have examined in only one-way.

This deal happened without a sincere look at the target. At a high level, it looked good and strategically it made all the sense in the world. It was at this point the investors became committed to the deal. Not financially committed, emotionally committed. This has a powerful impact on perception and decision-making even though it is usually unconscious and almost universally denied.

By the time the potential buyers looked more deeply, they were psychologically invested, making it nearly impossible to see the many risks. It was easier to ignore them.

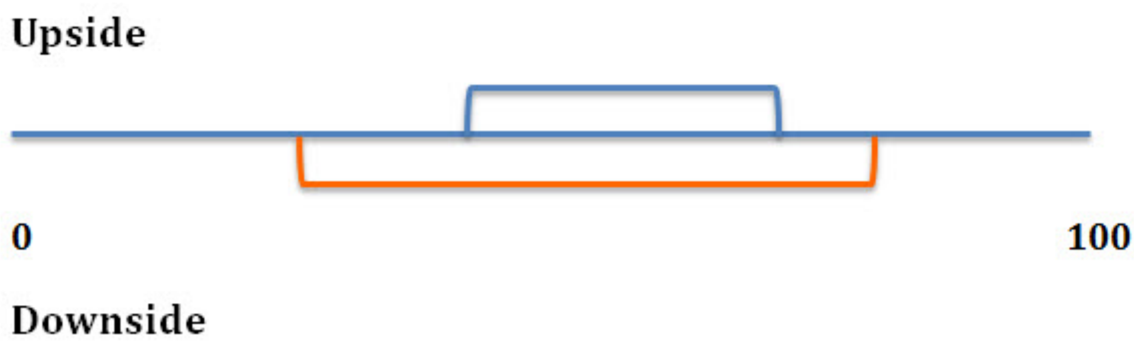
Why? Human beings have a strong tendency towards the confirmation bias. This bias leads people to view information that supports our beliefs or decisions as more valid, more significant or more voluminous than data that challenges our position.

How could the investors in this case have made a mistake of such proportion? How could their analysis have led them astray? Their analysis didn't, they went to video-land, or in this case, spreadsheet-land. The projections of future profits were blindingly bright, and they were blinded.

What can you do to make sure you aren't similarly blinded?

1. Make major decisions in the right sequence. Write down the decision you need or want to make. Then ask yourself, "do I already know what I will do?"
    - If yes, and the decision is a major one, slow down!
    - If no, proceed.
2. Ask others (not just your buddies) what information you should consider in your decision.
3. Think about the relative importance of the information you are gathering and its source. Not all data is equal.
4. Get out of video-land! If you are buying a retail business, shop there a few times. Priceless information emerges when you gather observational data.
5. Estimate the range of upside, not just a number, a range. Humans are terrible predictors no matter how educated, why swim against a strong current? If you use ranges instead of discrete numbers, you'll do better.
6. Estimate the range of downside. Same reason as number 4.

Look at the magnitude of the upside and downside *and* the range.



This should prompt valuable conversation. It does with our clients.

To get more insight about your approach to the non-technical side of deals, our **new self-evaluation**. Twenty-five short questions to help you be sure you are looking through a clear lens.