

# **BIAS AND PRECONCEPTIONS: THE BIGGEST BARRIER TO VALUATION**

Session 2

# BIAS: THE SOURCES

- **The power of the subconscious:** We are human, after all, and as a consequence are susceptible to
  - Herd behavior: For instance, there is the “market price” magnet in valuation, where estimates of intrinsic value move towards the market price with each iteration.
  - Hindsight bias: If you know the outcome of a sequence of events, it will affect your valuation. (That is why teaching valuation with cases is an exercise in futility)
- **The power of suggestion:** Hearing what others think a company is worth will color your thinking, and if you view those others as more informed/smarter than you are, you will be influenced even more.
- **The power of money:** If you have an economic stake in the outcome of a valuation, bias will almost always follow.
  - Corollary 1: Your bias in a valuation will be directly proportional to who pays you to do the valuation and how much you get paid.
  - Corollary 2: You will be more biased when valuing a company where you already have a position (long or short) in the company.

# VALUING YOUR OWN BUSINESS

- You are valuing your own business for sale to a third person.
  - a. High
  - b. Low
  - c. Unclear
  
- You are a venture capitalist valuing this business for an investment.
  - a. High
  - b. Low
  - c. Unclear

# IT'S PERSONAL

- You are valuing your own business for divorce court; half of your estimated value will go to your spouse (soon to be ex-spouse)
  - a. High
  - b. Low
  - c. Unclear
  
- You are an appraiser for the owner, valuing a business for tax purposes.
  - a. High
  - b. Low
  - c. Unclear
  
- You are an appraiser for the IRS, valuing the business for tax purposes.
  - a. High
  - b. Low
  - c. Unclear

# EQUITY RESEARCH AND M&A

- You are a sell side equity research analyst, valuing a company with the intent of putting a buy or sell recommendation on it.
  - a. High
  - b. Low
  - c. Unclear
  
- You are buy-side analyst, valuing a company for your portfolio manager, who already happens to own a million shares of its stock.
  - a. High
  - b. Low
  - c. Unclear
  
- You are buy-side analyst, valuing a company for your portfolio manager, who already happens to have shorted a million shares of its stock.
  - a. High
  - b. Low
  - c. Unclear

# A FRIENDLY TAKEOVER

- You are an M&A analyst, working for the banker for the acquirer in a friendly takeover, valuing the target company.
  - a. High
  - b. Low
  - c. Unclear
  
- You are an M&A analyst, working for the banker for the target in a friendly takeover, valuing the target company.
  - a. High
  - b. Low
  - c. Unclear

# A HOSTILE TAKEOVER

- You are an M&A analyst, working for the banker for the acquirer in a hostile takeover, valuing the target company.
  - a. High
  - b. Low
  - c. Unclear
  
- You are an M&A analyst, working for the banker for the target in a hostile takeover, valuing the target company.
  - a. High
  - b. Low
  - c. Unclear