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Falling Prey to Bias? The Influence of Advisors on the Manifestation of Cognitive Biases in the Pre-M&A Phase of Organizations

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Abstract
Our study demonstrates that the pre-M&A phase provides breeding ground for irrational behavior in the form of cognitive biases. These biases not only arise within acquiring and acquired firms, but M&A advisors themselves are also prone to effort-saving techniques and subconscious biases, which may be reflected in the client's M&A decision-making process. Cognitive biases stem from the contractual client–advisor relationship that elicits time pressure, standardization, and emotionality—that is, circumstances that favor the employment of effort-saving techniques. These biases lead to complex decisions based on the selective collection, framing and evaluation of data, the overestimation of one's rationality, ability and deal likelihood, the illusion of control, and one-sided views. Such a biased evaluation of information is likely to induce the selection of a non-optimal target or acquirer or simply forcing a deal that should not be made in the first place. Hence, these cognitive biases can be seen as a source for consequent M&A failure. With the identification of cognitive biases and bias-fostering circumstances, our study allows for awareness and consequent mitigation of such blind spots, thereby improving

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decision-making processes in the pre-M&A phase via the introduction of "debiasing" strategies and the creation of favorable conditions for rational reasoning.

Keywords
pre-M&A deal phase, cognitive bias, advisors, M&A failure

Introduction

Mergers and acquisitions (M&As) represent "important means for corporate change and growth" (Welch, Pavićević, Keil, & Laamanen, 2020, p. 844) and thus constitute key strategic decisions that firms make. However, most studies indicate that the majority of M&As do not meet expectations (Dao & Bauer, 2021), and some scholars even suggest that up to 90% of M&As fail at fulfilling their main purpose, namely, creating value (Christensen, Alton, Rising, & Waldeck, 2011). In attempting to shed more light on the reasons behind this phenomenon, the M&A literature has increasingly focused on "the human aspect," particularly during the post-M&A integration phase (Sarala, Vaara, & Junni, 2019). Issues related to human integration (e.g., stress, low cooperation or commitment, and negative attitudes) (Kroon & Noorderhaven, 2018; Weber & Drori, 2011), a loss of identity (Appelbaum, Gandell, Yortis, Proper, & Jobin, 2000; Joshi, Sanchez, & Mudde, 2020), employee uncertainty (Marks & Mirvis, 2011), and cultural misfit (Tarba, Ahammad, Junni, Stikes, & Morag, 2019) have all been attributed to the cause of M&A failure.

At the same time, M&A failure rates continue to be high (Dao & Bauer, 2021). This could be due to the existing M&A literature suffering from a streetlight effect (i.e., only looking at what can easily be observed), which is further complicated by the difficulty of collecting empirical data on the M&A decision-making process due to legal and competitive reasons (Kroon & Reif, 2021; Marks & Mirvis, 2001). As a result, there is an evident lack of attention to the pre-M&A deal phase in M&A studies (Welch et al., 2020). The pre-M&A phase, however, arises as a prospectively crucial phase in determining the potential success or failure of an M&A (Steinbach, Gamache, & Johnson, 2020). Moreover, many challenges emerging in the post-M&A integration phase can, in fact, be traced back to decisions being made in the pre-M&A phase (Haspeslagh & Jemison, 1991; Kroon, Cornelissen, & Vaara, 2015; Vaara & Monin, 2010).

Although the rationality perspective is still dominant in M&A research (Polowczyk & Zaks, 2018), the pre-M&A phase is characterized by risk,

uncertainty, and a limited time frame (Asaoka, 2019), which implies that both buying and selling firms can find themselves in unfavorable circumstances affecting management's decision-making capabilities. In the absence of complete information and unlimited time or resources, managers frequently resort to effort-saving techniques such as heuristics—that is, mental shortcuts for information processing purposes—which can then result in cognitive biases and thus a clouded judgment of the issue at hand (Meissner & Wulf, 2013). M&A decisions, particularly in the pre-M&A phase, involve a high degree of discretion and judgment and thus can be seen as "myriad complex decisions" (Kauser, Gordon, Papamichail, & Reddy, 2015, p. 10), which implies they are highly exposed to cognitive pitfalls. These cognitive biases could be among the fundamental causes of M&A failure (Polowczyk & Zaks, 2018).

In order to improve decision-making processes in the pre-M&A phase, firms often resort to the aid of advisors who provide an external point of view that is assumed to be conducive to mitigate biases, and, as such, to arrive at "better decisions." Advisors, however, do not only arise as under-researched agents in the M&A process (Welch et al., 2020), the effect of their involvement on M&A outcomes is also equivocal. Moreover, the dynamic, time- and resource-constrained as well as stance-taking nature of the job is likely to make M&A advisors vulnerable to effort-saving techniques such as heuristics, and hence their own subconscious biases, which may be reflected in the client's M&A decision. Gordon, Molina-Sieiro, Ellis, and Lamont (2019, p. 29) therefore conclude that "the literature lacks inquiry into the role that advisors play in the pre-acquisition […] period."

We aim to fill this research gap by combining a clear focus on a specific part of the M&A process—the pre-M&A phase—with a focus on advisors throughout this stage. In our two-wave empirical study, we first conducted interviews with managers from both acquiring and acquired firms, which allows us to provide insight into the decision-making process leading to a merger or acquisition and the role of cognitive biases among decision-taking managers. During the second wave, we conducted interviews with advisors as research subjects to more closely examine their influence on (the effect of) cognitive biases of these decision-taking managers, specifically during the pre-M&A phase.

Our study's contribution lies not only in the mere exploration of specific cognitive biases for both managers and advisors but also in explaining how their occurrence arises and affects decision making in the pre-M&A deal phase. Although it has become increasingly common to employ advisors in firms (Gordon et al., 2019), their effect on the (pre-)M&A process has not been examined in depth. In this study, we elucidate how the contractual

advisor–client relationship gives rise to bias-fostering circumstances (i.e., time pressure, standardization, and emotionality), which provide a favorable environment for cognitive biases to appear. We further lay bare the imminent risk raised by cognitive pitfalls in strategic decision-making processes such as M&As. Finally, the findings of our study hold an awareness-raising function and we advocate for the incorporation of active debiasing strategies in favor of improved decision-making conditions.

In the remainder of our paper, we lay out the theoretical and methodological foundations for our study, detail our emergent findings, and examine how those findings relate to our understanding of the role of advisors in the manifestation of cognitive biases during the pre-M&A phase of organizations. We end with discussing the practical implications of our study and providing directions for future research.

Theoretical Background

M&As are considered key strategic decisions that firms make, which legitimizes the extensive research that has been devoted to the field. Answering the question of why firms seek to pursue M&A deals is considered key for understanding M&A success or failure (Calipha, Tarba, & Brock, 2010), and a variety of motives have been identified over time. Haleblian, Devers, McNamara, Carpenter, and Davison (2009) suggest a classification of motives into four broad categories: value creation (e.g., gaining market power and resource redeployment), managerial self-interest (e.g., prestige, increased remuneration, and defense tactics), environmental factors (e.g., imitation and resource dependence), and firm characteristics (e.g., firm strategy and positioning), thus offering a more distinguished explanation that goes beyond synergy and growth.

Notwithstanding the fact that these motives could explain the increasing volume of M&A transactions taking place across the globe, numerous scholars have alluded to the paradoxical observation that most M&As are far from successful (Appelbaum et al., 2000; Dao & Bauer, 2021; Haleblian et al., 2009). At the same time, Meglio and Risberg (2011) conclude that M&A performance is a multi-faceted construct which can be operationalized in various ways. In the long history of M&A deals, an abundance of studies have been conducted on shareholder wealth effects of acquiring and target firms. Although the findings of studies differ individually, we can generally conclude that acquiring firms often experience a decrease in firm performance, while targets see positive returns after an M&A announcement (King, Dalton, Daily, & Covin, 2004). In an emerging market context, results remain more

inconclusive, ranging from a positive effect for emerging market acquirers (Li, Li, & Wang, 2016) to value destruction (Aybar & Ficici, 2009).

Recent M&A studies have shifted their focus away from a sole shareholder lens and evaluate other stakeholders in an M&A context, such as customers (Dong, Li, & Li, 2021) or employees (Joshi et al., 2020). Relatedly, M&A success has been measured in different ways, for example, strategic goal accomplishment (Ariño, 2003), deal completion (Ermolaeva, 2019), or employee (dis)satisfaction (Kroon & Noorderhaven, 2018). Findings of these studies suggest that M&A failure rates continue to be high. This has prompted scholars to conduct various studies attempting to shed light onto this phenomenon, trying to not only grasp the key drivers but also inhibitors of a deal. Scholars have, for example, proposed various factors that influence the M&A-performance relationship. Such moderators range from deal type, ownership, firm size, acquirer experience, to regulations (Agrawal, Jaffe, & Mandelker, 1992; Haleblian et al., 2009). But as King et al. (2004) concluded that financial and strategic perspectives face difficulties in explaining M&A failure, a growing body of research has shifted to "human" explanations for these disappointing outcomes (Sarala et al., 2019; Stahl et al., 2013). One of these human factors is the existence of cognitive biases.

Cognitive Biases in M&As

The complexity of the M&A process—characterized by uncertainty, ambiguity, information asymmetry, time pressure, and speed—fosters potential problems and (cognitive) pitfalls (Graebner, Heimeriks, Huy, & Vaara, 2017; Nelson, 2018). Moreover, the interdependencies of the different M&A phases imply re-iterations and constant adjustments of assumptions, which further complicate the process. Potential errors in the pre-M&A phase, for example, relate to rushed, inadequate, or misleading due diligence, improperly allocated risks during negotiation, or simply forcing a deal that should not be done. Complications can also be attributed to the highly varying activities, that is, the transition from initial, broad information gathering to more intense due diligence, which implies changing cognitive demands on the agents conducting the activities of the pre-M&A deal phase, giving rise to cognitive biases (Steinbach et al., 2020).

Prior research already indicates that in activities like M&A decision-making, where humans are assumed to exhibit rational behavior, people do not behave as rationally as expected (Fanto, 2001). In fact, the failure to explain M&A's empirical (predominantly negative) outcomes and the inaccurate assumption that M&A decisions are (only) based on rationality

(Polowczyk & Zaks, 2018) has necessitated a new stream of research that can account for the motives and implications of human behavior and the related processes during the M&A trajectory.

Bounded rationality, introduced by Simon (1955), takes into account the cognitive limitations of the decision-maker. It thus contradicts the notion of rationality and efficiency as implied by the traditionally perpetuated concept of homo economicus, that is, a human who has knowledge that is "if not absolutely complete, […] at least impressively clear and voluminous" (Simon, 1955, p. 99). Simon's (1955) seminal work on bounded rationality was further refined by Tversky and Kahneman (1974), and it has today resulted in a research stream which examines cognitive biases in a variety of decision-making contexts (Kannadhasan, Aramvalarthan & Pavan Kumar, 2014).

Decisions related to mergers and acquisitions, like other major strategic decisions, involve "complexity, ambiguity, and a lack of structure" (Duhaime & Schwenk, 1985, p. 287). As bounded rationality suggests, decision makers are unable to simultaneously consider or evaluate all the variables involved in a complex decision, which means they have to resort to simplifying and accelerating techniques like heuristics (ibid.). Heuristics are "simple and efficient rules for judgements under uncertainty" (Kauser et al., 2015, p. 5) and are predominantly adopted as an effort-saving technique (i.e., the cost of effort is higher than the gain in accuracy), considering that people face limited resources in terms of time, information, and cognitive capacity (Gigerenzer & Gaissmaier, 2011).

Although heuristics are highly economical and held to be generally useful (Gigerenzer, 2008), they may not always produce the optimal outcome. Instead, they can result in cognitive biases, that is, "severe and systematic errors" of judgment (Tversky & Kahneman, 1974, p. 1124). Tversky and Kahneman's (1974) work on cognitive biases is still highly influential, and meanwhile more than 100 cognitive biases have been documented in the literature (Ehrlinger, Readinger, & Kim, 2016), among which the framing effect (i.e., depending on how positive or negative an option is presented, it is chosen or not), the endowment effect (i.e., people value objects in their possession more highly than when they are not in their possession), overconfidence (i.e., people are more confident in their judgments than justified), and the confirmation bias (i.e., the tendency to favor or recall information that confirms one's beliefs) appear to be most pervasive.

Although heuristics and cognitive biases have been pointed out as relevant factors impacting decision-making processes (Garbuio, Lovallo, & Horn, 2010), research up to date has mostly focused on decision-making contexts

outside the arguably more complex and risky M&A sphere (e.g., Gigerenzer & Gaissmaier, 2011; Kannadhasan et al., 2014; Meissner & Wulf, 2013). Recognized, but not necessarily (empirically) examined, biases in an M&A context include the anchoring bias (Baker, Pan, & Wurgler, 2012; Malhotra, Zhu, & Reus, 2015), the hubris or overconfidence bias (Malmendier & Tate, 2005; Roll, 1986), the status quo bias or endowment effect (Garbuio et al., 2010), escalation of commitment (Duhaime & Schwenk, 1985; Puranam, Powell, & Singh, 2006), the retrospective bias (Lander & Kooning, 2013), the temporal bias (Thelisson & Meier, 2022), and confirmation bias (Bogan & Just, 2009).

These human cognitive biases affect managers' approaches to M&As and can be regarded as one of the fundamental causes of M&A failure (Polowczyk & Zaks, 2018). For example, these biases have been shown to result in overvaluation, excessive risk taking, irrational preferences, and overoptimistic predictions (Asaoka, 2019). Studies have also focused on effects as lost opportunities and exposure to vulnerabilities (Evaristo & Zaheer, 2012), both in developed and emerging markets (Skvortsova & Vershinina, 2021).

The Pre-M&A Phase: Activities and Characteristics

Weber and Tarba (2012) note that all phases of an M&A process are premise to success (or failure). Yet, compared to the well-established literature on the post-M&A integration phase, research on the pre-M&A phase is still in infancy (Welch et al., 2020). One possible reason for this is the difficulty of collecting empirical data on the M&A decision-making process in this phase due to sensitivity, legal, and competitive reasons (Marks & Mirvis, 2001). At the same time, the pre-M&A phase is crucial, and decisions made in this phase impact not only the performance of a certain deal but also long-term value creation. Steigenberger (2017) further notes that decisions taken in the pre-M&A phase influence post-M&A outcomes. For example, the introduction of a common business language (e.g., English) in international M&As may have important implications for perceptions of power and relative standing and the willingness of employees to identify with the newly merged organization in the post-M&A stage (Kroon et al., 2015). In this section, we provide a more detailed account of the pre-M&A phase, including its process and activities, ranging from initiation to closure.

The pre-M&A deal phase begins with *initiation*, that is, the decision to engage in a merger or acquisition, and can be initiated not only by the target or acquiring firm but also by external parties such as investors (Welch et al., 2020). Initiation is then followed by *target selection*, where targets are identified and pre-screened. This stage entails market screening and the

creation of adjustable lists of potential targets. Networks or external advisors may be included in this stage, and the primary aim is to collect a broad range of possible targets so as to maximize opportunities. Having identified potential targets, the compilation of information takes place in order to assess organizational fit and quality of the targets, followed by a narrowing down of the target list to efficiently gather information and conduct a more thorough due diligence on the targets that meet strategic fit (Cullinan & Holland, 2002). Target selection is, however, complicated by the existence of information asymmetry, that is, acquirers' limited information about potential targets, which can be alleviated by involving former alliance partners, geographical proximates, or connections made through client or manager networks (Rogan & Sorenson, 2014; Rousseau & Stroup, 2015).

Once the target is selected, the pre-M&A deal phase continues with *bidding and negotiations* (Welch et al., 2020). An initial, non-indicative offer may be provided by the acquirer, which is a starting point for negotiations as well as discussions concerning deal terms and alternatives. In case of consensus, a formal agreement with key terms and conditions is drawn up. Frequently, however, deals are abandoned at this stage (Cullinan, Le Roux, & Weddigen, 2004). Factors like competition among bidders, the commitment of involved parties, negotiation techniques, and hostility or trust have been mentioned as impacting the bidding and negotiation process. While competition impacts speed and commitment of negotiations, commitment can also be fueled by parties' overconfidence, managerial interest, or risk propensity despite unfavorable information at hand (Duhaime & Schwenk, 1985; Jemison & Sitkin, 1986).

As part of the *valuation and financial terms* process within the pre-M&A deal phase, valuation activities start before the negotiation process but continue during due diligence and negotiation efforts to improve the accuracy of valuation (Welch et al., 2020). Key financial decisions in this process concern the M&A premium, acquired stake, method of payment, and deal financing. With the *announcement* of the deal, the private deal period is transformed into a public one. Negative public perception, which is tried to be countered with impression management tactics, as well as information leakage, can affect—or even jeopardize—this stage of the deal (Welch et al., 2020).

The pre-M&A deal phase ends with *closure*, that is, the period between announcement and completion of the deal when parties have agreed on deal terms, arranged the necessary consents, and signed the purchase agreement. The likelihood and timing of deal closure can be influenced not only by internal stakeholders such as CEOs and board of directors but also by external stakeholders such as financial and legal advisors as well as the media. This

implies that the deal could still be abandoned or blocked (e.g., by antitrust authorities), although the pressure to close is usually high (Becher, Cohn, & Juergens, 2015).

While many scholars focus solely on the acquirer and target, Oberg (2012) shifts her focus toward a network perspective, stating that neglecting other stakeholders can drive M&A failure. Typical stakeholder groups in an M&A context consist of managers, shareholders, banks, employees, customers, and regulatory authorities (Boone & Mulherin, 2007; DePamphilis, 2008). The interconnectivity among all these parties involved can be critical in determining M&A success or failure. In the pre-M&A phase, scholars have more specifically focused on lawyers, who act as principal negotiators for legal terms, provide legal due diligence, and draft contracts (Westbrock, Muehlfeld, & Weitzel, 2019). Liou, Brown, and Hasija (2021), in a cross-border context, indicate that firms can also hire lobbyists who might influence lawmaking but also convey relevant legal and regulatory information back to the firm. Importantly for our purposes, firms increasingly rely on M&A advisors to support their (pre-)M&A activities (Gordon et al., 2019; Schmitz & Sievers, 2021).

The Role of Advisors in the Pre-M&A Phase

Information gathering, interpretation, and analysis are among the key tasks conducted in the pre-M&A deal phase, and this "is often portrayed as a rational and systematic process" (Welch et al., 2020, p. 851). However, the review above already hints at the presence of nutrient soil for the emergence of heuristics and cognitive biases. As a result, different strategies to mitigate the negative implications of cognitive biases in M&As have been introduced. Evaristo and Zaheer (2012), for example, propose the use of strategic capability mapping to assess the capabilities across merging firms and quickly identify complementarities. Skvortsova and Vershinina (2021) further found that various corporate governance mechanisms can reduce the effect of CEO overconfidence on value destruction. Perhaps most importantly, acquiring and target firms employ advisors, that is, hired agents to assist acquiring or selling firms in their M&A decision process, who provide an external point of view that is assumed to be conducive to mitigate biases, and, as such, to arrive at better and more rational decisions (Welch et al., 2020).

The total value of global M&A advisory fees earned by investment banks reached 25.5 billion USD in 2017 (Gordon et al., 2019), but the effect of their involvement on M&A outcomes appears to be rather ambiguous. Schmitz and Sievers (2021) found that, if employed regularly, M&A advisors can increase

M&A success by 0.4–3.7%. At the same time, M&A advisors have to be regularly employed to assure knowledge transfer to the advised firm (Hinds, Patterson, & Pfeffer, 2001). Moreover, M&A advisors are likely to have a negative impact on M&A success in more complex M&As (Schmitz & Sievers, 2021; Servaes & Zenner, 1996).

These inconclusive results could be explained by the two-sided nature of the relationship between advisors and acquiring (or target) firm. On the one hand, advisors can provide expertise in the M&A process, resulting in higher returns (Wang, Xie, & Zhang, 2022). Benefits relate, for example, to reduced process costs, improved target identification, and enhanced negotiation skills (Bowers & Miller, 1990; Golubov, Petmezas, & Travlos, 2012). On the other hand, from an agency theory perspective (Jensen & Meckling, 1976), there can be misaligned interests between the firm and the advisor. As we have seen above, there are different M&A motives for a firm, such as value creation, managerial self-interest, environmental characteristics, and firm characteristics (Haleblian et al., 2009). However, the advisor's goal is to complete the M&A, regardless of the firm's motive to engage in an M&A. Indeed, Rau (2000) finds that acquiring firms advised by top-tier investment banks earn lower announcement returns but are more likely to complete the M&A transaction. As a result, firms and advisors have different preferences about different parts of the M&A transaction, such as partner selection (Arikan & Capron, 2010), purchase price (Kesner, Shapiro, & Sharma, 1994), and method of payment (Hayward, 2003). Advisors may also act on their own interest. For example, information about the M&A may leak to industry competitors (Chang, Shekhar, Tam, & Yao, 2016).

Based on our review of the literature, we conclude that we need a better understanding of the decision-making biases in the pre-M&A phase of organizations. Moreover, there is currently insufficient understanding of the multiple actors involved in the M&A pre-deal phase and their interactions (Welch et al., 2020). Advisors appear particularly relevant to examine, as they constitute significant intermediaries conducting information gathering, due diligence and valuation, and thus inform the final decision-making managers regarding a merger or acquisition. Therefore, our study is guided by the following research question: *How do M&A advisors affect the manifestation of cognitive biases in the pre-M&A deal phase of organizations?*

Methodology

Due to the explorative nature of the research question posed in this study, that aims at gaining a deeper understanding of the role of M&A advisors in the

decision-making processes in the pre-M&A phase, and due to the nascent state of theory development, a qualitative research approach is considered most suitable (Edmondson & McManus, 2007).

Research Design

This study follows an exploratory approach and is guided by grounded theory as a qualitative research design. With exploratory approaches yearning to gain an in-depth understanding of an under-researched topic, grounded theory is a suitable design to develop theory from qualitative data (Creswell, 2007; Strauss & Corbin, 1998). In line with this, we employ a social constructivist, or interpretivist research philosophy which suggests that reality is socially constructed as individuals "seek understanding of the world [and] develop subjective meanings of their experiences" (Creswell, 2007, p. 20). This research philosophy fits our research design as the aim is to inductively rely on participants' perspectives and meanings in order to develop new theory. As further outlined by Patton (2015), qualitative data aim to illuminate how individuals create meaning, which again corresponds to our interpretivistic perspective.

The interpretation of qualitative, open-ended data promises to reveal new concepts or patterns, closing the identified literature gap (Edmondson & McManus, 2007). Hence, by adopting an interpretive approach (Flick, 2007), our qualitative study focuses on processes, meanings, and understanding. Accordingly, our theory is developed inductively, supporting a better understanding of how M&A advisors affect the manifestation of cognitive biases in the pre-M&A deal phase of organizations (Gioia, Corley, & Hamilton, 2013).

Research Context

To examine decision-making processes and potential cognitive biases influencing these processes in the pre-M&A phase, we first interviewed a sample of 8 M&A experts. These M&A experts are professionally active in different industries and have been dealing with pre-M&A-related activities, such as target selection, due diligence, and negotiations. Our first sample consists of acquiring- and acquired-firm managers, investment bankers, lawyers, private equity investors, and M&A consultants.

To delve deeper into the role that M&A advisors play in the pre-M&A phase, we conducted follow-up interviews with 14 M&A advisors working at departments in consultancy firms dealing with M&A-related activities. More specifically, these M&A departments consist of advisors that, upon

commissioning, assist clients with their major strategic decision of completing a transaction by offering both guidance and their expertise with regard to, for example, target identification and selection, due diligence, synergy analysis, and valuation, thus facilitating the pre-M&A process. These advisors are particularly relevant informants in that they constitute expert intermediaries that can be seen as having a direct influence on the buyer and seller decisions regarding, for example, target choice, valuation, and acquisition price.

Data Collection

Data collection in this study primarily involves semi-structured one-on-one interviews with 22 informants. The interviewees were selected based on previous experience as firm managers having dealt with M&A-related activities or as advisors in M&A-related departments of consultancy firms, who have assumed an essential part in the pre-M&A deal phase and whose efforts have led to both completed and/or abandoned deals. Although the focus lies on classical M&A transactions, distressed M&A processes are also taken into account allowing for conclusions to be made such as whether decision-making processes related to distressed targets deviate from regular targets that are not affected by imminent bankruptcy.

Although the study requires a relatively homogenous sample in terms of pre-M&A deal related assignments, variation is achieved by interviewing informants across various firms, industries, and in different roles, to allow for a range of different M&A transaction processes and thus a potentially wider range of cognitive biases. In the end, our purposive sampling technique attempts to select particularly informative cases with respect to the research question and is considered useful for grounded theory strategy (Saunders, Lewis, & Thornhill, 2015).

The 22 interviews were conducted over a period of 5 years. The interviews in 2016 started face-to-face but throughout 2020/2021, due to the circumstances of the COVID-19 pandemic, the final interviews were held via a video conferencing application. All interviews were recorded and transcribed verbatim, and they lasted between 35 and 164 minutes. The interviews were held in Dutch and German, depending on the mother tongue of our informants, making it easier to express themselves. Furthermore, this lowers the opportunity for potential miscommunication and biased interpretation. The list of interviewees with relevant details like position, industry, and country can be found in Table 1. The majority of our respondents were male, and their age ranges between 30 and 54 years.

In the semi-structured interviews, we followed a story-telling approach (Czarniawska, 2004): respondents were able to tell their own narratives and

Table 1. Overview of Respondents.

Interviewee	Function	Industry	Country	M&A Experience
1	Manager	Corporate finance	Netherlands	High
2	Manager	Corporate finance	Netherlands	Medium
3	Manager	Investment banking	Netherlands	Medium
4	Entrepreneur	Construction	Netherlands	Low
5	Entrepreneur	IT services	Netherlands	Medium
6	Investment manager	Private equity	Netherlands	High
7	Investment manager	Private equity	Netherlands	High
8	Entrepreneur	Hospitality	Netherlands	Low
9	Manager	Consultancy	Netherlands	High
10	Manager	Consultancy	Netherlands	Low
11	Senior manager	Consultancy	Germany	High
12	Manager	Consultancy	Germany	Medium
13	Manager	Consultancy	Germany	High
14	Manager	Consultancy	Germany	High
15	Manager	Consultancy	Germany	Medium
16	Consultant	Consultancy	Switzerland	Low
17	CEO	Boutique Consultancy	Germany	Medium
18	Senior manager	Boutique Consultancy	Germany	Medium
19	Senior manager	Consultancy	Germany	High
20	Manager	Consultancy	Germany	Medium
21	Senior manager	Consultancy	Germany	Medium
22	Manager	Boutique Consultancy	Germany	Medium

their interpretations of key issues and activities. By so doing, we avoided putting words into their mouths. However, the semi-structured interviews also entailed questions related to the pre-M&A decision-making context. In order to allow participants to construct meaning of a situation, broad and open-ended interview questions were asked, such as "*Could you describe your M&A negotiation experience?*" and "*What is the advisor's role in the pre-M&A phase?*". We also asked questions dealing specifically with cognitive biases, such as "*How are you influenced during M&A negotiations?*" and "*Do you think you have acted purely rational?*".

The semi-structured nature of the interview allows the researcher to be flexible in terms of order, style, and number of questions asked to the interviewee, that is, depending on the flow of conversation additional questions may be asked for clarification and specification, thus enabling a natural, non-scripted conversation that benefits the exploration of the research question (Saunders et al., 2015). For example, when one of the M&A advisors talked about a presentation to the client, we critically asked him whether he was presenting a purely objective account of the target to the client or whether the advisory nature of his job inclined him to present a certain perspective. The advantage thus lies in allowing interviewees to speak as freely as possible and necessary, while keeping a guiding frame that ensures a focus on the research question. To further capture cognitive biases during the interviews, we showed our respondents a visualized list with 20 random cognitive biases (e.g., stereotyping, the anchoring bias, and overconfidence) which often stimulated the conversation.

Data Analysis

Our study attempts to conceptualize advisors' influence on pre-M&A decision-making processes and to develop an empirically derived theoretical model of cognitive biases in this phase, which promote further inquiry into this relevant topic. The interviews focus on individuals' experiences and strategies within the pre-M&A process with the aim to discover (the antecedents of) cognitive biases, which requires a coding of these "multiple realities" (Creswell, 2007, p. 65).

As Gioia's methodology (Gioia et al., 2013) has proven successful in qualitative data analysis through its systematic categorization and grounded theory articulation process, we decided to employ this approach. Like other inductive research trying to provide more insights into a phenomenon where some theory already exists, it is recommended to use what is already known as a starting point for the examination (Charmaz, 2006). In the context of our study, we acknowledge earlier work on cognitive biases and the role of advisors in the pre-M&A phase. However, our analysis pushes beyond this existing work and explores novel concepts and relationships that can provide an advancement of theory.

The analysis proceeds in stages, from first-order analysis of the data to second-order analysis to the distillation into aggregate dimensions (Gioia et al., 2013). Stage one entails open coding, that is, the procedure of finding patterns and segmenting the data into categories of information that form the so-called first-order codes, or concepts, retaining participants' terminology where possible ("in vivo coding"). For example, a statement as "*the bride is*

made pretty" is captured under the first order-concept "beautifying the truth." While this approach is certainly interpretivistic, we made sure to avoid taking statements out of context. Moreover, this first stage of the coding process was supported by color coding (according to similar wording or meaning in context), which facilitated the initial detection of first-order concepts by simple means of visualization.

As the analysis progressed, similarities and differences between emerging first-order codes were sought, thereby reducing the number of categories and deriving more abstract second-order themes therefrom. This clustering of codes also allows for pattern recognition and hence the identification of common and thus significant "incidences," that is, commonly, although rather subconsciously, exerted biases, from which meaning and relationships to other concepts can be derived. As an example, the first-order concepts "beautifying the truth," "omitting information," and "putting everything in a positive or negative light" are captured under the second-order theme "use of framing." The second-order analysis involves the identification of concepts that assist in answering our research question, which are then, in a third step, distilled into aggregate dimensions (Gioia et al., 2013).

The third stage of our analysis led to the identification of three relevant aggregate dimensions. First, the *cognitive biases* that reflect acquiring- and acquired-firm manager's and advisor's decision-making processes with regard to the pre-M&A phase (e.g., we identified the "overconfidence bias" based on respondent statements indicating that they were essential for deal closure). Second, the *cognitive bias-fostering circumstances* that lead to the occurrence of these cognitive biases (e.g., we identified "time pressure" based on respondent statements indicating that they sometimes had to make decisions quickly), and third, the *interplay between client and advisor*, which is a particular relationship that can be seen as triggering the presence of cognitive bias-fostering circumstances (e.g., we identified "out of scope elements" based on respondent statements that there was a clear demarcation of tasks between advisor and client) (see Figure 1 for our final data structure).

Following this first phase of data analysis, grounded theory is generated by identifying and demonstrating the dynamic relationships among the recognized concepts, a process yielding a "systematically derived […] theoretical model that describes or explains the processes and phenomena under investigation" (Gehman, Glaser, Eisenhardt, Gioia, Langley, & Corley, 2018, p. 286). To summarize, the logic of the data structure (Figure 1 in our case) arises from the connection between raw/coded data and higher order theoretical notions (thus the many-to-one relationship between first order concepts and second order themes, and between second order themes and aggregate dimensions), whereas the logical representations *between* themes (and thus

between aggregate dimensions) arise in the theoretical model, where relationships between the major constructs are illustrated (Gioia et al., 2013).

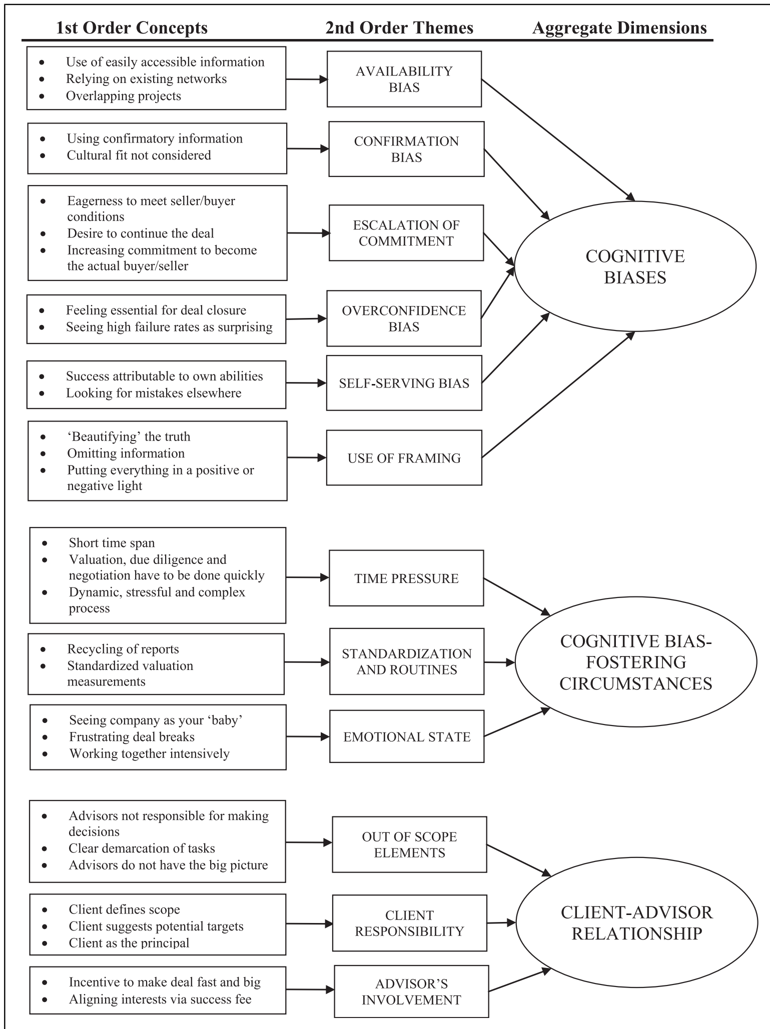

Figure 1. Data structure.

Trustworthiness

As researchers we are provided with multiple realities via the interviews concerning the pre-M&A decision-making process (Creswell, 2007). Similarly, we as researchers are shaped by our background and experiences, which affects the interpretation of the qualitative study. Therefore, we made sure to enhance the trustworthiness of this study with regard to credibility, dependability, transferability, and confirmability (Lincoln & Guba, 1985). Although the research context is relatively specific in that it concerns a certain group of actors, a certain context, and a certain process, which could imply idiosyncrasy and limited transferability, the goal of qualitative research, or grounded theory in particular, can be seen in generating concepts or theory with relevance to not only the M&A domain but also other contexts that are likely to be affected by cognitive biases at any time (Gioia et al., 2013).

Hence, while the pre-M&A context arises as particularly suitable due to its uncertainty, risk, and dynamics, fostering cognitive biases, the theory derived from this research is transferable to similarly conditioned contexts. Objectivity, or confirmability, is improved with regard to interpretation by in vivo coding rather than over-relying on researcher's meaning-making, thus counteracting the emergence of confirmability biases. The heightened awareness of the researcher to biases due to the research topic at hand can also be seen as improving scholarly rigor and the credibility of this study (Gioia et al., 2013; Lincoln & Guba, 1985). Finally, by presenting this study's entire research process as clearly and transparently, dependability and confirmability are likely to be enhanced. We also increased dependability by having both authors code the data independently. This yielded a very high reliability, and any confusing or conflicting cases were discussed to reach an agreement.

Findings

The following section lays out the collected insights according to the aggregate dimensions in our data structure. Afterward, we discuss our inductively derived theoretical model which we also ground into the existing literature.

Cognitive Biases

Our respondents in wave 1 indicate that the pre-M&A phase ideally is a rational process in which buyer(s) and seller not only negotiate the best possible outcome but also acknowledge that in practice M&A negotiations are far from rational. Respondent 6 mentions: "*There's an awful lot of ratio in the process,*

but eventually, the human factor will interfere, and that is decisive. I think that 9 out of 10 times the human factor eliminates the ratio." In fact, we identified a range of cognitive biases in the pre-M&A phase based on the interviews with managers from both acquiring and acquired firms as well as M&A advisors.

From a sellers' perspective, firms tend to influence potential buyers by selectively sharing and withholding relevant information. This information is often formulated more positively than reality as costs are normalized, business results are optimized, and forecasts are projected overly positive. Respondent 1 explains: "*Of course it is not always said that you mention everything. You highlight the positives and you do not go into the negatives*. [...] *We give trading updates during the M&A process. So every single time we say: 'Look how good things are going! Beautiful, look how beautiful!'. And the potential buyer reacts: 'Wow, indeed, it is an incredibly beautiful company!' And we do not give a trading update if the results are negative.*" Hence, these selling firms make use of framing, that is, the presentation of a situation with a positive or negative connotation. Respondent 6 continues: "*The Information Memorandum always shows a projection that the results went up, like a hockey stick. I've never seen a sales booklet summarizing that the results went down. What do you do as a seller: 't is always made better than it really is and the risks are downplayed.'"* The use of framing is not a bias per se, but it can result in one, when the decision made is based on the framed situation.

A distinctive line is drawn between the "critical" buy side and the "beautifying" sell side, as pointed out in the interviews: *"Yes, of course, the sell side does some kind of beauty contest. Of course, they try to present everything as beautifully as possible, and the buy side naturally tries to focus on the risks"* (Respondent 20). Advisors in the M&A business, however, appear to be highly aware of the use of framing, not least because they employ the method themselves. Especially, sell-side advisors appear to make use of positive frames when presenting their target to potential buyers, as respondent 19 indicates: *"This is really a sales brochure. It's like vacuum cleaner dealers. A story is told and of course the 'bride is also made pretty'. Yes, everything is positive, everything is awesome."* The positive framing can even go as far as omitting certain aspects that might be relevant for the buyer or overloading them with information that makes it difficult to process: *"Sure, if you are selling, of course you try to highlight the positive aspects of the company. And you mustn't give wrong answers, but your answers to risk fields can simply be shorter or if you won't answer briefly, then you simply provide so much information that it can't be processed due to the time, and the probability is low that one will draw a conclusion from it"* (Respondent 11).

Another profound cognitive bias which showed up in our study was the escalation of commitment (on both buyer and seller sides). Bazerman and

Moore (2012) describe this as the degree to which an individual escalates commitment to a previously selected course of action to a point beyond that which a rational model of decision making would prescribe. Respondent 6 stated that once you get further in the negotiation process as a buyer, your commitment to become the actual buyer increases rapidly: "*Basically you get so far in the buying process that you are already so far in the funnel that you can't go back.*" The escalation of commitment of the buyer and seller is enhanced if they have agreed to be negotiating exclusively. As respondent 7 indicates: "*You are able to stretch the process, for a month or something.* [...] *So basically you can build more comfort regarding the deal. Because you know that the other party is committed to finalize the deal with you.*" On the other hand, this same respondent notes that "*the negative side of exclusivity is that at the moment you arrive at the binding offer, or the final negotiation, you know: 'Okay, now we need to negotiate on the content of the deal without having another party that might outbid this party or act as surrogate'. You know you are depending on one another.*"

To mitigate cognitive biases, acquiring and acquired firms heavily rely on M&A advisors. As respondent 6 notes: "*Normally we hire an M&A adviser. To create distance between the buyer and seller.*" But interestingly, based on our available data, we observed that these advisors are also prone to cognitive biases themselves. For example, the availability bias—a mental shortcut that relies on the ease of recall of information for evaluation and thus attributes greater importance to information that comes readily to mind or is readily available (Tversky & Kahneman, 1974)—manifested itself based on two elements. On the one hand, the relevance of the advisor's network was pointed out. On the other hand, the use of easily accessible information was emphasized. In this regard, overlapping projects influencing each other were often mentioned. When asked how the long and short lists for target selection were derived, one M&A advisor answered: "*Normally it is like this ... which company do we have good connections to? As a consultancy firm, we are pretty well connected*" (Respondent 20).

The preferred fall back on the network was further emphasized in the interviews, as it facilitates the contacting of potential targets for the buyer (i.e., client): "*On the basis of this available information you also talk to the client and ask, what is your priority A, B, C? And then you consider, you check which contacts you have to that company or to the owners and try and get in touch for priority A*" (Respondent 21). In addition to the network, "hunches" were considered as readily available information which also influenced the prioritization of target lists. Respondent 17 noted: "*Information from the network that is considered valid certainly influences prioritization.* […] *It is certainly influenced by the experience and the feeling 'Who can I trust?'*" The

importance of gut feeling in selecting targets was emphasized more than once: "*Sometimes it's just facts, sometimes it's more good feel*" (Respondent 9).

The confirmation bias—the search for and interpretation of information or evidence that confirms one's previous beliefs (Bazerman & Moore, 2012) — could also be identified. In this case, M&A advisors use sources that confirm their ideas, assessments, or gut feelings: "*But certainly, if I'm thesis driven, and I have to be in a process like this, if I have multiple sources that confirm the thesis, I'm probably not going to keep looking for seven days*" (Respondent 17). In particular, sell-side advisors were demonstrating this behavior, where the nature of their job inclined them to find confirmatory information rather than disconfirmatory evidence: "*The M&A advisor on the sell side is more of a seller, looking for info that confirms. The plan will always be a bit more positive than on the other side*" (Respondent 19).

Cultural fit is often mentioned as a relevant success factor in M&A deals, but M&A advisors interpret the absence of consideration of such cultural fit in the pre-M&A phase as justified (i.e., some respondents readily substantiate their initial belief of its impracticality): "*And how are you going to check that when you have three interested parties and three should actually come into the company during daily business and check whether it's a fit?*" (Respondent 16). Such an open disregard of the cultural element is fully accepted, despite the general awareness of the importance of cultural fit in M&A deals, as exemplified by respondent 21: "*Now a cultural assessment* [...] *because that's where acquisitions often fail, as it turns out in retrospect* [...] *But I don't know. I wouldn't say that this is a topic for us as M&A consultants.*"

These confirmation biases also contribute to overconfidence, another important cognitive bias identified in the interviews with M&A advisors. The overconfidence bias relates to people's subjective confidence in their ability in comparison to their lower objective performance (Pallier et al., 2002) and manifests itself at various points throughout the M&A deal trajectory. During this process, the client is challenged by advisors and advisors often give their opinions on a topic: "*I think it's very important at this moment to confront the client directly and openly, and I even go one step further, in that I usually try to get the client breaking away from his previous products and his previous positioning*" (Respondent 12). These conversations do not always run smoothly, but M&A advisors see a purpose in clearly expressing their views and proposals and confronting the client therewith: "*But of course, you discuss with the client, you also discuss hard with the customer and you say that makes sense, or makes no sense*" (Respondent 20).

Most pronounced is overconfidence in relation to deal closure, where advisors consider themselves as absolutely essential to successful deal closure. As respondent 13 indicates: "*So far I have not come across a deal where I*

had the feeling that it could have been done the same way without us." Such deal closure is also considered a personal success that is celebrated accordingly: "*Yeah, you're, of course, you're very happy. And you see this as your personal success. And you celebrate that*" (Respondent 10). This success is also seen as attributable to advisor's perceived high level of rationality: "*I always firmly believe that in most cases I have massively... significantly helped to secure a transaction. Why? Because I approach the matter objectively, I am not emotionally attached and above all I have learned that nothing is as hot as it is cooked*" (Respondent 12).

Another related cognitive bias found in the data is the self-serving bias, where people attribute success to their own abilities or efforts but failure to unrelated factors (Campbell & Sedikides, 1999). The attribution of successful deal closure to advisors' efforts has already been laid out above, but at the same time, the reasons for a lack of deal closure (i.e., failure) were attributed to "external" factors. As respondent 16 mentioned to a client: "*Hey, it's really not our problem that we can't sell your business, that you are structurally not so attractive for the investor.*" Failure is thus not related to advisors (as opposed to successful deals) but instead linked to other parties, either on the sell side or the buy side, client themselves, or rather, their unwillingness to pay enough money, the unattractiveness of the business, or the lack of chemistry between the parties. As respondent 20 notes: "*I would say in all honesty, the M&A advisor is usually not the bottleneck. The bottleneck is almost always the selling side.*" Respondent 22 further explains: "*And in the end, it also fails somewhere because of the client himself. He then says 'the CEO you brought me ... I had no cultural fit or the chemistry just wasn't right or something'. Yes, there's little I can do about it, or if he doesn't want to put enough money on the table, there's also little I can do about it.*"

Cognitive Bias Fostering Circumstances

While the identification and description of cognitive biases are relevant for answering our research question, we were also interested in the causes of managers' and advisors' cognitive biases. When asked for descriptive adjectives for the pre-M&A phase, the following words and phrases were mentioned: *intense, high pressure, exciting, interesting, complex, emotional, stressful, tough timeline, quick, expensive, dynamic, hectic,* and *demanding.* This environment, in which time pressure appears to be most salient, may provide breeding ground for cognitive biases: "*So you have to prioritize, especially when it's a stressful phase where you have limited time, you can't take everything into account and one or the other will fall behind. The question is: do you have to consider everything?*" (Respondent 15).

In addition, standardization and routines can be seen as paving the way for mental shortcuts to reach an outcome most efficiently but likely not most diligently. Although a certain scorn toward the re-use of previously created reports for M&A targets is noticeable in the data (Respondent 9: "*You cannot just reuse other reports and adapt them*"*),* templates for highly standardized products such as due diligence documents exist and are sometimes only filled with new content (Respondent 14: "*Let's say that the chapters are the same, so e.g., products, services, market, competition, finance, schedule, fees, that is always the same. But how you fill it with content is always specific.*"). Some M&A advisors also admit to the recycling of content, if fit is given: "*Yeah, we do that. We love to do that. Because that saves time*" (Respondent 10). Respondent 19 adds: "*The same industry, the same areas or something like that. Then you can also repeat the content.*" The perceived benefits related to efficiency and simplicity may however lead to less in-depth engagement with the actual target and thus allow for errors. Routines, for example, with regard to the valuation of targets, are also observable in our data. Such routines are used in the same initiation procedure, for example, the client may already propose certain targets he is interested in buying but also in standardized valuation measurements, for example, multiples, which involve a price identification based on a comparable business.

Finally, the emotional involvement of both client and advisor may foster heuristics. On the sell side, the client's company can be considered their "baby," resulting in emotional decisions that surpass purely rational decisions, for example, by asking an unjustified sales price. As respondent 5 emphasizes: "*How do you of form a price? 90% emotionality.*" This may still result in a deal, however, if the other party is desperate to buy the target and willing to pay a higher price: "*In other transactions, I also know that more was paid than was calculated in the company valuation, because the company was desperately wanted and was in a kind of bidding war at the end*" (Respondent 15). As Respondent 13 notes, such emotional states can get reinforced by advisors: "*The two acting parties, buyer and seller, usually get very emotional at least three to 18 times at some stage in the process. If the consultant then also throws emotions around, the whole thing becomes very uncoordinated.*"

Although M&A deals are M&A advisors' daily jobs, their emotions are seen as tied to clients' emotions, especially after weeks and months of working together: "*If you have worked on a buy side for many months, invested a lot of time, held talks* [...] *There is always the risk that someone else makes the race and that you were only second. Especially if it is an auction process. That is personally frustrating of course. I mean, you also connect, you identify with your project or with the client and you also grow together with the client as a team*" (Respondent 21). The frustration attached to such a deal break may

even result in a "revival" phase, where one tries to still sell the target—with low chances of success: "*And in the end they both jump off. And that's just seven months and eight months gone, a lot for nothing. Yes, then you start another revival like that and these revivals are really... they really have a small probability that something will come out of it*" (Respondent 22).

To summarize, an environment characterized by time pressure, standardization processes for efficiency, and emotions on both advisors' and clients' (i.e., buy and sell side) sides can be seen as providing a favorable environment for cognitive biases to appear. The next section will elaborate on the special relationship between client and advisor, which also has an important effect on the manifestation of cognitive biases. More specifically, the relationship between advisor and client is seen as creating the very circumstances that elicit time pressure, emotionality, and standardization, which in turn lead to cognitive biases.

Client–Advisor Relationship

The client–advisor relationship is first and foremost characterized by a clear definition of scope, that is, what exactly the advisor's work entails. What stood out in the interviews was the clear demarcation, visible in the emphasis of out-of-scope elements. What was repeated continuously was the fact that M&A advisors do not make decisions, only suggestions. Respondent 13 explains: "*What is really important is that the consultant – and this is really a very, very central distinction – doesn't make the decisions. And that's where the whole story stands and falls and hangs.* […] *That's a basic differentiation between client and consultant. And that's why* [Company X], *for example, will never go and make any decisions on behalf of the customer. That will not happen.*"

The scope of work with regard to content is also decided beforehand with the client, meaning that the individual evaluations of a target are made by different teams, departments, or even firms. This implies that as an advisor you do not necessarily have the big picture but might only be involved in one part of the pre-M&A process: "*You work very focused on a certain frequent subarea of this transaction. This means that if you only do the financial due diligence, then you have no contact with the commercial due diligence and others that also influence the figures. This is also not the scope of work. You are also not paid for that" (Respondent 11). Respondent 1 further notes: "I just do the deal and then I am gone."* At the same time, this implies a certain attitude of indifference with regard to the post-signing phase. Once the pre-M&A deal phase is over, advisors see their task as completed and do not worry about the actual integration phase that follows.

Out of scope is also the advice with regard to the initial decision to acquire or merge a company. Strategy advisors are seen as responsible for this step, and M&A deal advisors are only involved once the decision to buy or sell has already been made: *"As an M&A consultant, we are not the strategy consultant who maybe starts at an earlier stage and says 'What are your markets? Have you considered going into China at all or have you considered adding new technologies to your technology portfolio?' That's not the consultant's job"* (Respondent 21).

Another important theme within the interplay between client and advisor is the client's area of responsibility. One important point has already been touched upon previously, namely, the decision-making power, which falls to the client, not the hired advisor: *"And then we say the client is king, if you want that, then we do that. If you, for example, like that business instead of that one while the other one is clearly more profitable, and more interesting, but you still like that one, because you like the product, for example, then yeah, it's your money"* (Respondent 10).

What becomes obvious is that the power of the client as the principal (i.e., the one that pays for the service) clearly exceeds that of the advisor as the agent (i.e., the one hired by the client and acting in their interest). This dynamic is interesting in light of cognitive biases, as advisors can be seen as supporting clients' actions, even if they recognize them to be irrational (to a certain extent). With the client on the top of the project and advisors' narrowly formulated scopes according to their specialization, the responsibility to make sense of the reports from different departments or companies (e.g., commercial due diligence by company X, financial due diligence by company Y, and legal due diligence by a law firm) inconveniently falls to the client too. As respondent 11 emphasizes: *"This specialization in financial DD, tax DD, CDD and so on…this is such a fragmentation of the project that I don't think it leads to a combination of the essential aspects in a meaningful way – or at least not very often. […] This doesn't help in decision-making to the extent that it should."*

Lastly, the advisor's involvement also forms part of the client–advisor relationship. According to the data, clients usually hire advisors primarily not only due to their network but also due to their knowledge of the investor market, expertise with previous M&A deals and specialized areas (e.g., tax, finance, and law) as well as available resources that the client himself may lack. The engagement itself is usually defined via a contract that includes a success fee, that is, a percentage of the final sales price (sell side), and a retainer fee, that is, a regular payment for the services required from the advisors (buy side). While the retainer fee is more time-based, the success fee is deal-based and is portrayed as a common tool to align interests of both agent

and principal by incentivizing advisors to find a buyer willing to pay a high price for the target: *"Then the client knows that we do as much as possible to receive a higher price and we are incentivised to do that"* (Respondent 10). On the other hand, the success fee tempts advisors to close a deal under any circumstances and to make it as big as possible (even if a smaller one could have been a better fit), implying a questionable compatibility of the merging firms. As respondent 12 notes: "The M&A consultant who sits in the classic investment bank has a bonus component that usually corresponds to his annual salary. This is also true for most boutiques. He needs a deal, because only with a deal he gets a success fee and accordingly he will do everything to close a deal."

The success fee also incentivizes advisors to close a deal more quickly, which adds to the time pressure triggering cognitive biases: "*Yes, well, because we are also, I would say, very strongly triggered by the success fee, we naturally want the mandate to go through as quickly as possible"* (Respondent 20). A final complexity is the conscious or subconscious indirect effect the success fee has on the valuation of the company. If strong growth can be shown for the coming years, an investor will be willing to pay a higher price, which might lead to the manipulation—or framing—of such business plans: *"We always make a business plan for the next three, four, five years, whatever. And of course we would like to show quite strong growth, because that will then be included in the valuation and of course reflected in the transaction price for us and thus in our success fee"* (Respondent 16).

Cognitive Biases in the Pre-M&A Phase: An Advisor's Perspective

In this section, we bring our findings together in an empirically driven conceptual model. We also ground our findings into the existing literature by discussing the pre-M&A deal phase with a focus on cognitive biases along the decision-making process leading to a potentially value-destroying deal. As can be seen from Figure 2, the cognitive biases are embedded in the bias-fostering circumstances, which themselves are triggered by the specificities of the client–advisor relationship. As an example, the time pressure noted in *Cognitive Bias-Fostering Circumstances* can be seen as arising from the scope and timeline defined between advisor and client (*Client–Advisor Interplay*), which may, in turn, lead to the collection of easily accessible information, likely resulting in the availability bias (*Cognitive Biases*).

In this first stage of the pre-M&A phase, M&A advisors are predominantly seen as executors who are not asked to question the deal but whose task

consists of selecting and evaluating a suitable target (or finding a suitable buyer) and assist in closing the deal. This finding concurs with Garbuio et al. (2010), who point out that advisors are "role-conferred" and are not expected to question their mandate, fittingly illustrated by Warren Buffet's quote from a 2009 shareholder letter: *"Don't ask the barber whether you need a haircut"* (in Garbuio et al., 2010, p. 91). As a result of this pre-defined scope in the client–advisor relationship, the (potentially erroneous) strategic decision to engage in a deal could already pose a threat to the desired value creation effect. The failure to question such deal appropriateness—albeit conditioned by the defined scope and the advisor engagement created by the client's choice to make a deal—marks a first example of neglecting all possible decisions (e.g., also to not engage in a deal). The very engagement between client and advisor, which can be seen as made at a point of no (or unlikely) return thus complicates, if not prevents, a re-evaluation of the fundamental decision to engage in a deal. This finding relates to the client's decision-making power, from which M&A advisors in our study clearly distance themselves. Hence, the client makes the final decision to engage in a deal, which moves the accountability for any kind of irrational decision away from the advisor.

On the M&A advisor side, the questionability of the success fee as a tool for deal closure should be addressed: not only do advisors have an incentive to

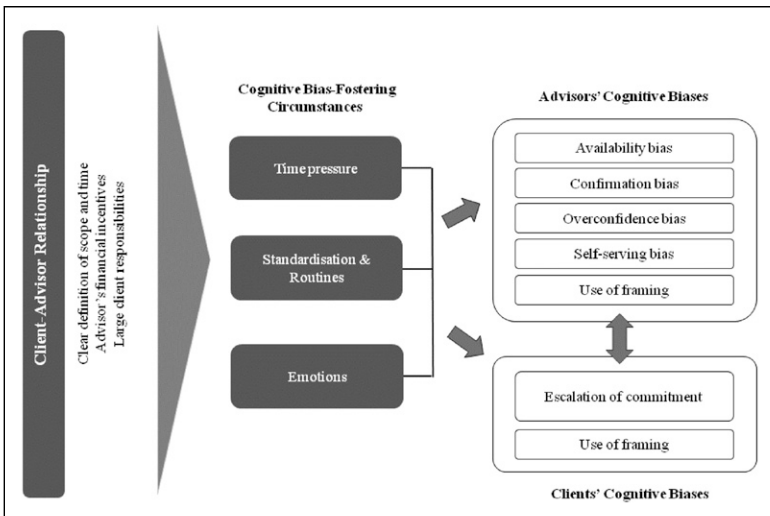

Figure 2. A conceptual model of advisors' influence on the manifestation of cognitive biases during the pre-M&A phase of organizations.

enforce deal closure under all circumstances, but they also have an incentive to make the deal as big as possible and to close the deal as fast as possible. While all these points may, at first sight, be in the interest of the client too, this incentivizing tool of a success fee gives rise to the bias-fostering circumstances—especially time pressure and efficiency-increasing standardization measures—which in turn may give rise to a faulty and hasty decision-making process encompassing a variety of cognitive biases, and, consequently, have negative effects on realized synergy and value creation.

The client's high degree of responsibility runs through other stages of the pre-M&A phase as well. As our findings illustrate, the client is in the lead throughout the complete process, that is, also in the stage of target selection, where they not only define their needs to M&A advisors but also actively offer potential targets for advisors to consider. While this may already influence M&A advisors in their objective evaluation of targets due to their "client is king" stance, advisors also rely on availability for the selection of their long and short lists—namely, via their network, which reflects a certain "ease of recall" by which the availability bias is characterized. Hence, the cognitive biases of M&A advisors themselves may further trigger irrational decision making at the client's side. Paradoxically, the network is one of the main reasons for clients to employ advisors, stemming from their previous or current projects that offer valuable connections from which the client benefits, as information asymmetries between target and acquirer—a complicating factor during target selection (Rogan & Sorenson, 2014) —can already be significantly reduced. This availability bias, likely further enabled by the client–advisor interplay that puts the client's wishes first, as well as time pressure to find a target to close a deal, has already been hinted at in previous literature (Garbuio et al., 2010).

Apart from the availability bias, Garbuio et al. (2010) highlight two further biases occurring in the pre-M&A phase that could also be identified in our data, but particularly for M&A advisors: overconfidence and the confirmation bias. Overconfidence forms part of positive illusion research, where Taylor (1989) argues that the majority of people view themselves in a "considerably more positive light than is objectively accurate" (Bazerman & Moore, 2012, p. 90). While confidence helps individuals to master tasks, it is also identified as a barrier to effective professional decision making, as individuals become resistant to different perspectives or new options. Overconfidence manifests itself in overestimation (of performances or chances of success) and overplacement (i.e., ranking oneself as better at a certain task) (Bazerman & Moore, 2012). The overconfidence bias was observed in several stages of the pre-M&A phase, but with regard to target selection it is visible as overplacement of advisors and their superior knowledge compared to the client, as

well as an overestimation of their rationality. M&A advisors consider their involvement as essential to successful deal closure. Such overconfidence may limit advisors' supposedly objective evaluations, making them less cautious and conveying an illusion of control or knowledge that may not be legitimate.

The confirmation bias, on the other hand, leads people to evaluate evidence selectively and uncritically so as to support their initial beliefs. In our study data, information gathering for the evaluation of a target consisted of some advisors taking a largely thesis-confirming path, a bias that can be expected to be particularly pronounced at the sell side. On this sell side, where advisors admitted to actively engage in positive framing, this bias involves an overly favorable business planning for the years to come that, for example, portrays the product or service market in question as flourishing or manifests itself in a high valuation of the client's company. Such framing necessarily draws on confirmatory evidence, as the forecasts, theses, or valuations—however overly optimistic they may be—need to be somehow substantiated to look credible. Again, the bias-fostering circumstances created by the advisor–client interplay, where advisors emerge as knowledgeable experts and need to conform to this role as well, are found to play an important role in the occurrence of both overconfidence and the related confirmation bias. Apart from their effect on (irrational) decision-making processes, these biases also assist in authenticating advisors' roles as experts via the confirmatory and thus confident behavior elicited.

Another positive illusion, where people view themselves positively rather than accurately (Taylor, 1989), relates to the self-serving bias, where people attribute success to their own abilities or efforts but failure to unrelated factors (Campbell & Sedikides, 1999). The placement of fault on external factors in case of unsaleability, or the blaming of the opposing side in case of lengthy pre-deal processes, indicates a refusal of acceptance of responsibility and a required affirmation of worth, resulting from overconfidence. Scholars note that the maintenance of unrealistically optimistic beliefs about oneself is determined by their credibility or ability to disconfirm them (Allison, Messick, & Goethals, 1989; Kunda, 1990). As the reasons for an unsuccessful or aborted deal are, in theory, infinite and as advisors strongly rely on their perception as knowledgeable experts, the maintenance of such positive illusions, as in overconfidence or self-serving biases, is indeed practicable.

The last stage of the pre-M&A deal phase is where the client–advisor interplay comes to an end. The clients align their interests with those of the advisors by financially motivating them to find a suitable target or acquirer. Thus, deal closure must be seen as desirable, not to be questioned, and is ambitiously pursued. As already mentioned before, the success fee on the sell side does not only incentivize advisors to maximize the transaction price but

also to find an acquirer and enforce a transaction under all circumstances—as fast as possible—thus eliciting time pressure and emotions. Under such restraining circumstances, further amplified by uncertainty, limited resources, and dynamics of M&A processes, mental shortcuts or cognitive biases, to save effort and time but, at the same time, clouding the judgment of advisors or clients, are bred (Meissner & Wulf, 2013).

Emotionality has been mentioned as a characteristic describing the pre-M&A deal phase too and can be seen, for example, when the client's "baby" is sold. The resulting irrationality in the form of not accepting offers that are subjectively perceived as too low, manifests itself in the endowment effect, where clients value what they possess as more highly than what they would be willing to pay for it (Thaler, 1990), or loss aversion**,** that is, the perception of losses (in this case a no deal) as more extreme than gains (a deal) (Kahneman & Tversky, 1979).

Finally, the pre-M&A phase is often presented as a somewhat standardized process that is checked off step after step and, to a certain extent, relies on previous reports or templates and follows a pre-defined client–advisor interplay (based on routines). This stands in contrast to the dynamic—and thus adaptability-requiring—character of most M&A deals. With pre-defined steps and roles, the temptation to repeat previous actions without critically questioning them is heightened. Defined as automated strategies that lose their conscious decision-making character by becoming habitual through replication, routines can be compared to decision-making heuristics in that they serve a decision-facilitating purpose and are thus considered predominantly positive and desirable. Such behavioral automation, however, requires stable context conditions to work (Harms, 2003), a precondition that the context of the pre-deal M&A phase, described as dynamic and complex by the respondents, lacks. Routines can thus be seen as jeopardizing the perception and conscious evaluation of alternative options by M&A advisors and fostering the occurrence of cognitive biases.

The model in Figure 2 captures the essence of the findings in this study. Cognitive biases occur at various stages during the pre-M&A phase and have profound implications for the decision-making processes within this phase. The pre-M&A deal client–advisor relationship, initiated by the mandate of the client to execute a deal (sell or buy), enables bias-fostering circumstances, characterized by time pressure, standardization/routines, and emotions. The bias-fostering circumstances provide breeding ground for cognitive biases on both M&A advisors' and clients' (i.e., acquiring- and acquired firms managers) sides, which further reinforce each other.

Discussion

In this study, we have explored cognitive biases in decision-making processes in the pre-M&A phase of organizations. The uniqueness of this study lies in the combination of an under-researched yet relevant M&A phase (i.e., pre-M&A phase) and under-researched actors in the M&A process (i.e., advisors). Although stages in the pre-M&A deal phase such as target selection are often presented as rational and systematic (Welch et al., 2020), we have illustrated that this phase provides breeding ground for irrational behavior in the form of cognitive biases.

Contrary to previous research which sees advisors as agents who provide an external point of view that is assumed to be conducive to mitigate biases (Welch et al., 2000), we found that M&A advisors are vulnerable to effort-saving techniques themselves, and hence their own subconscious biases and heuristics, which may be reflected in the client's M&A decision. For example, we observed a self-serving bias, where advisors attribute successful deal closure to their own efforts but failure to close to exogenous factors. This serves as a certain confirmation of advisors' competency—especially against the backdrop of their strong reliance on their perception as infallible experts by clients and third parties.

Other cognitive biases identified in our study partially overlap with existing findings but also add to the M&A literature. For example, while the over-confidence bias (Malmendier & Tate, 2005; Roll, 1986), confirmation bias (Bogan & Just, 2009), escalation of commitment (Duhaime & Schwenk, 1985; Puranam et al., 2006), and availability bias (Garbuio et al., 2010) were already observed in previous studies, we further highlighted the use of framing. This framing is not a bias per se, but it can result in one, when the decision made is based on the framed situation.

Framing predominantly comes to play on the sell side, where advisors present their target from the best side with a neglect of risks and downsides. Although M&A advisors claim to be aware of such framing on the buy side, that is, they realize certain issues may be covered up or certain risks may be downplayed while opportunities are praised, the influence of framing must not be underestimated, as data presented in a certain way may still function as a hook in the form of "anchoring". This means that once the sell side's information is presented to the buy side in an optimistic way, the information might not be sufficiently adjusted downward due to the (subconscious) anchoring function of an, for example, "hockey stick effect," where the target's revenues are presented as going through the roof in the business planning. It appears, thus, that the subconscious anchor could nevertheless outplay the conscious awareness of the framing employed.

A valuable addition to the M&A literature is the advisor–client relationship and its consequences for decision-making processes. The advisor–client relationship itself, a special agreement in which an agent is hired to assist the acquiring or acquired firm in closing a deal, enables the circumstances leading to cognitive pitfalls along the decision-making processes within the pre-M&A phase. The contractual agreement based on financial incentives to find an acquirer or target, the clear definition of scope and deadlines, the large decision-making and sense-making responsibilities that still fall to the client, as well as advisors' desire to accommodate the client in every way, are surmised to evoke time pressure, standardization, and emotions, which are seen as antecedents fostering the identified cognitive biases. While time pressure and emotions are complexity-increasing factors, standardization is an effort-saving technique reducing such complexity and can thus be subsumed under the term heuristics. Thus, we presume that both complicating factors as well as effort-saving techniques lead to cognitive biases.

We concur with Bauer, King, and Schriber (2018, p. 3) who argue that "M&A research remains confined within established boundaries and leaves new, potentially important insights understudied." For example, the rationality perspective is still dominant in M&A research (Polowczyk & Zaks, 2018), and there is a scarcity of M&A literature regarding emotionality, although it emerges as a salient topic that affects decision making to a significant extent. Not only do emotions arise during the actual integration phase (e.g., Graebner et al., 2017; Kroon & Reif, 2021), they also seem to play a vital role in the pre-M&A phase in affecting management and advisor's decision-making capabilities.

The inability to simultaneously consider or evaluate all the variables involved in a complex decision, such as engaging in a merger or acquisition, results in the selective collection of data, the neglect of potentially relevant data, overestimation of one's rationality, abilities, deal likelihood, synergies or growth expectations as well as the illusion of control and one-sided views. These immediate consequences provide a starting point for Welch et al.'s (2020) call for an approach as to how cognitive biases affect a certain process but certainly need to be studied in more depth.

Implications for Practice

Apart from these contributions to the sparse body of the literature regarding the effect of advisors on cognitive biases in strategic decision-making processes such as M&As, the practical relevance of this research consists in its awareness-raising function and a reduction of M&A failure rates due to an identification of their potential sources. By providing insights into which

biases arise in the pre-M&A phase as well as elucidating what circumstances foster them, this study allows managers to take steps to reduce the likelihood of cognitive biases, and hence, suboptimal decisions based on systematic thinking errors. Thus, if the factors leading to such blind spots are recognized, their adverse effects can be mitigated or even avoided altogether by following strategies to reduce cognitive biases.

Debiasing strategies related to the processes itself, such as eliciting external feedback via a four-eye principle to allow for additional logical checks, scenario-planning to reduce the framing bias via listing multiple alternatives (Meissner & Wulf, 2013), a listing of other options to correct an overemphasis on targets in the network, a reduction of time pressure, or a confrontation of emotionality with objectivity can improve decision quality within substages of the pre-M&A phase.

To not only engage in palliative but rather curative "bias-care," changes related to the client–advisor relationship are also necessary. Considering that the financial incentives for advisors to find and close a deal are not contingent on the subsequent success or actual organizational or cultural fit of the merging parties, those factors can, in theory, easily be neglected by advisors. Moreover, with M&A advisors continuously pointing out that it is the client, not the advisor, making the final decision, advisors maintain a safe distance from the responsibility or liability associated with a potentially inadequate deal or unsatisfactory consequent integration process. The only incentivizing factor would be the advisors' reputation, on which they rely for future mandates. As however the self-serving bias illustrates, the positive advisor's image can be relatively easily maintained. Hence, we propose the creation of favorable conditions for rational reasoning, for example, via an increase of advisors' accountability for decisions proposed to the client as well as for outcomes in the post-deal phase but also a broadening of advisors' scope by including them in the strategic decision of engaging in a deal in the first place, or at least an abolition of deal-enforcing incentives.

While some of these strategies are already common practice at consultancies, we urge them to institutionalize such mental habits and ways of working by reinforcing the relevant processes. This goes hand in hand with the acknowledgment and acceptance of one's general susceptibility to bias, as opposed to its denial and clinging on to one's image of a completely rational being. As the ability to effectively work through the tasks and activities of the pre-M&A phase determines whether the target is suitable and can fulfil the acquirer's expectations, the earlier in the process cognitive biases are recognized and ideally eliminated, the higher the chance for satisfactory deal closure and desired M&A performance.

Limitations and Future Research Opportunities

As all research is inherently flawed, the limitations of this research—which predominantly relate to our sample, research context, and the mono-method approach—can and must be addressed. The selection of 22 interviews can be justified by their in-depth nature and the goal of our exploratory study, which is "to indicate rather than conclude" (Crouch & McKenzie, 2006, p. 492). Nevertheless, it constitutes a relatively small sample whose representativeness must be questioned, and the purposive selection of our interviewees may give rise to a lack of generalizability. Furthermore, the interviews have to be seen as realities constructed between interviewee and interviewer that are informed by subjective backgrounds, experiences, and, potentially, biases (Creswell, 2007). Although we are aware of interview biases, given the very nature of this study's topic, a total prevention of research bias cannot be guaranteed.

Another important point to consider is that inductive approaches as the one employed in this study aim at the "discovery of an order that fits the surprising facts" (Reichertz, 2004, p. 163), thus not reflecting reality, but rather producing "mental constructs with which one can live comfortably or less comfortably" (ibid.) This invites the current mono-methodological approach to be extended, or complemented, by quantitative, and thus more generalizable research, which would benefit the rigor of this research. For example, Westbrock et al. (2019) measured the "advisor–client relationship" through prior interactions between them and divided this by the total number of firms with which an acquirer had previously worked with to examine tie strength. Ultimately, it has to be kept in mind, though, that qualitative research aims at "specificity and not necessarily at generalizability" (Saunders et al., 2015, p. 140). That is why we choose to interview a relatively small sample of respondents who were particularly informative and could help us in providing an answer to our research question.

Future research opportunities entail a more in-depth exploration of cognitive biases in other M&A stages. For example, further research is clearly needed to more fully explore the variety of cognitive biases among actors at various stages of the M&A process. Furthermore, the cultural dimension was disregarded despite the different origins and backgrounds of our interviewees (e.g., Switzerland, Germany, and the Netherlands). Such a cultural variation among advisors could offer interesting insights with regard to the cognitive bias-enabling circumstances constructed between advisor and client in different countries and cultures. But although we have focused on a Western research context, we can assume that managers in emerging markets are influenced by the same biases as managers in developed markets (Skvortsova & Vershinina, 2021). Moreover, it would be interesting to examine different

types of M&A advisors. For example, Gordon et al. (2019) distinguish between financial M&A advisors, legal M&A advisors, audit M&A advisors, and management M&A advisors.

This study focused on the recognition, antecedents, and consequences of cognitive biases in pre-M&A deal decision-making processes, not on debiasing techniques, which means that the potential debiasing strategies mentioned before are not to be regarded as exhaustive but merely indicative. Future research is encouraged to develop debiasing techniques that build on the findings of this study so as to actively reduce thinking errors and increase decision quality in M&A processes, leading to value-creating M&A deals (e.g., corporate governance mechanisms, see Chen, Chen & Wei, 2009). It is key that also advisors, despite their propagated image as experts and their vehemently rejection of irrationality in their actions, become aware that they are subject to bounded rationality and thinking errors, too—especially due to the bias-fostering circumstances created by the relationship between advisor and client.

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