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The Winners Curse

Over the last few weeks there has been a lot of press in the Australian media regarding Lend Lease Corporation having won a bunch of development & construction projects. Then across the shores in the US, General Growth Properties is about to be bought out of bankruptcy by nemesis Simon Property Group or maybe another party as Simons first offer was rejected and the rumour is that a number of players are about to enter the bidding.

All this bidding and potential M&A got me thinking as to whether winning the auction process is in fact a good thing or in fact the opposite a "curse". In 1971 a group of engineers Capen, Clapp and Campbell published a seminal paper which may help us understand some of the pitfalls in the auction or bidding process.

Lets first start with an experiment conducted by Max Bazerman and William Samuelson (1983). Suppose you filled a glass jar with A\$1 coins and you went into your local pub and auctioned the jar to the highest bidder. Empirical evidence suggests that the average bid will strangely be below the actual number of coins in the jar, this is best explained by humans natural *risk aversion* bias, this bias merits further discussion in future letters; where things get interesting in our analysis is the anomaly relating to the winning bid. Out of 48 studies the winning bidder was on average 20% higher than the actual number in the jar. Quite a neat party trick if you are looking to make a quick buck!

The engineers Capen, Clapp and Campbell made their discovery whilst advising on the bidding for an oil field. When you bid on an oil field you employ experts to give you an estimate as to how much oil is believed to be beneath the surface. What these guys discovered is that as more bidders entered the bidding process, the natural human inclination was to increase the bid.

From these 2 different examples a very simple and logical explanation relates to the winning of an auction or bidding process. The winner is almost always the one who has the most optimistic views on the purchase under consideration, and for this reason the winner may in time be "cursed".

Coming back to Lend Lease Corporation and Simon Property Group; I have no idea who was involved in the tenders that Lend Lease bid on and also have no idea if Lend Lease were the highest bidders in each instance what I will say is that the very fact that they have been the winners of so many recent projects makes them likely to be employing a very optimistic outlook on the future. In the case of Simons bid for General Growth Properties I would say that the fact that their first offer was rejected and that more bidders are likely to come into play lowers the chances of Simon purchasing the portfolio at a relatively cheap price. I am not saying Simon won't make money if it lands up winning the portfolio at a higher price, what I am suggesting is that by more participants entering the bidding process the chances of paying a lower price are slim. It is important to keep this in mind when investing in a company that is either winning a lot or a very large auction, and always ask yourself, "is this company suffering from the Winners Curse?"

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