

How Not to Lose Your Head in a Bidding War

Heading into a competitive auction, you should take steps to anticipate how potential escalations could change your frame of mind. Research by Sebastian Hafenbrädl uncovers two things that improve outcomes in these adrenaline-filled circumstances.



December 1, 2018

Remember the tale of Ulysses and the sirens? Heeding sage advice from the goddess Circe, Ulysses had his crew plug their ears with beeswax and tie him tight to their ship's mast in order to resist the enticing call of the sirens as they sailed by. Although Ulysses had been warned that the alluring sirens were really monsters ready to kill, he was wise to listen to Circe when she said that he might not be able to resist their call in the moment he heard it.

She was right, of course, and the preventative measures saved Ulysses and his crew. Executives facing the dangers of competitive escalations might want to heed similar advice (fit for the business context, of course). That is to say, savvy executives should not only prepare for a competition -- e.g., set their own price limits for an auction -- but also acknowledge how escalating pressure could change their frame of mind as the bidding unfolds.

This is according to research by IESE's [Sebastian Hafenbrädl](#) with co-author Jan K. Woike from the Center for Adaptive Rationality. Via a series of experiments involving competitive escalations, the co-authors conclude that an understanding of what *really* happens in these escalations -- when there's adrenaline running -- can help save managers from costly mistakes. The experiments also show that either direct experience or vicarious learning from those who have faced similar situations can help managers get better outcomes in bidding wars or other corporate "arms races."

What You Think You'll Do vs. What You Do

Here's an interesting question: How much would you bid for a \$20 bill -- if you faced competition in the auction and both the winning and the losing bids had to be paid out in full? Yes, this variant of a traditional auction simulation requires not only the winning *but also* the losing bids to pay their respective highest bid. Losing hurts here.

Note that this auction game was invented by an economist to help illustrate the paradox of competitive escalations. In this game, when players have a hard time quitting -- feeling trapped by sunk costs and egged on by competition -- end payments of \$40 to \$50 are not uncommon (In a very extreme case, the bidding in an executive class even reached \$2,000). In other words, all too often, everyone loses.

So, how might managers prepare themselves to win, even amid competitive escalation, in this \$20 auction simulation game? Hafenbrädl and Woike find that simply pre-setting bidding limits before the competition starts is not enough. Instead, more effective interventions acknowledge that most managers don't truly anticipate a competitive-escalation experience before they enter it. And what they don't know *can* hurt them. To avoid pitfalls, managers without previous direct experience should seek out the advice of those who have experienced competitive escalations before.

Here's a quick run-down of the auction simulation game results, in four circumstances:

- (+) With **direct experience in a similar situation** with competitive escalation, participants fared better in the dollar auction game.
- (-) But if **participants' direct experiences lacked escalation**, there was no improvement in their results.

- (-) **Setting oneself a goal or limit** re: where to exit the competition was not enough when faced with escalation.
- (+) **Learning from others with experience** handling a competitive escalation did improve results.

So, why is past experience and vicarious learning from others so important here? The authors turn to prior research that says there's a "cold-hot empathy gap" that prevents people from anticipating how they will experience a "hot" situation before entering it. When you're level-headed, rational and cool, you may fail to understand what will happen when, say, hunger strikes or adrenaline is pumping.

Which is why the tale of Ulysses is cited here. If he didn't have Circe's advice, Ulysses and crew might have listened to the lovely song of the sirens without preventative measures in place, thinking they'd be strong enough to sail on. They would have been wrong.

Methodology, Very Briefly

The dollar auction game is used as a proxy for other competitive escalation situations in business, such as patent races or bidding wars for corporate mergers. The authors combined lab and online auction experiments -- with a combined 1,229 participants (including experienced executives) -- to test how direct and indirect interventions affected players' outcomes (i.e., winning or losing money).

www.iese.edu/insight