Interests, value and the art of the best deal

Managers should negotiate to create value as well as to claim it. James Sebenius and David Lax offer a strategy for making deals that can lead the other party to choose what you want.

Behind the headlines that trumpet the mega-deals, internal and external negotiation has become a way of life for managers. Whenever interests or perceptions differ and parties depend on one another for results, the need for negotiation arises. Yet what is its essence? Hagglng? Building relationships? Carving up an economic pie? Expanding it? There is truth in each of these, but, in essence, I am an effective negotiator if I can persuade you to say yes, and mean it, to a proposal that also meets all my real interests. And why should you say yes? Because the deal meets your real interests better than your best no-deal option. So my problem is to shape your perceived choice, of deal versus no-deal, so that what you choose in your own interest is also what I want. Paraphrasing Italian diplomat Dante Vare, negotiation is "the art of letting them have their way (for their reasons)". This principle can be read as a recipe for manipulation. Understood more deeply, it offers the key to jointly creating and claiming value in a sustainable way. To do this most effectively, you should: map the full set of involved parties; assess the full set of your and your real interests; appraise each side’s no-deal options; and, finally, solve the joint problem of crafting a deal for all which is better than any of the no-deal options.

Step one: draw a deal diagram

This may seem obvious: in the simplest negotiation, two principals negotiate. Yet your deal diagram should include potentially complicating parties such as lawyers, bankers and other agents. While there may be a single negotiator for the other side, you should be alert for internal factions with different interests; they may be deal-blockers or internal champions of your proposal. Anglo-Saxon companies attempting acquisitions in Germany, for example, have often been stymied by the unexpected importance of the management board (Vorstand) as well as the supervisory board (Aufsichtsrat) and unions under the potent policy of "co-determination". The crucial first step is to map all parties in the context of their decision process - and don't forget to include influential players in your own internal negotiations.

When pharmaceutical giants Glaxo and SmithKline Beecham announced a merger in 1998, investors increased the combined firm's market capitalisation by $3bn. Yet despite early agreement on executive positions in the combined company, internal disagreement about management control and position sank the deal and the $3bn evaporated. (Logic ultimately drove the two back together, but only after nearly two years.) This episode confirms two related lessons. First, while the overall economics of a deal are generally necessary, they are often not sufficient. Second, map potentially influential internal players; don't lose sight of their interests or capacity to affect the deal. What is "rational" for the whole may not be so for the parts.

Step two: assess interests

Your interests in a negotiation are whatever you care about that is at stake in the process. The best negotiators are clear on their ultimate interests and those of the other side. They also know their trade-offs among lesser interests and are remarkably flexible and creative on the means.

Assess the full set of interests at stake - yours and theirs - including relationships, the process itself and the "social contract". Negotiations generally address tangible factors such as price, timing and specifications. Yet as Felix Rohatyn, former managing partner of Lazard Freres, and a veteran of making deals, observed: "Most deals are 50 per cent emotion and 50 per cent economics." Crucial interests are often intangible and subjective: the character of the negotiating process, the effect on trust and your reputation, and so on.

When working out longer-term arrangements, relationships, rather than transactions, can be the predominant negotiating interests in much of Latin America, southern Europe and southern Asia. Deal-oriented North Americans, northern Europeans, and Australians often come to grief by underestimating the strength of this relational interest in such cross-border encounters. Similarly, in setting up a new venture, for example, negotiators tend to focus on the economic contract: equity splits, governance and so on. Yet, often implicitly and often poorly, the parties also negotiate a "social contract", or the "spirit of a deal". Beyond trust and a good working relationship, the social contract includes expectations about the nature, extent and duration of the venture, about process, about the way unforeseen events will be handled, and so on. Some negotiators fail to develop positive social contracts that reinforce valuable economic contracts; as with other interests, the...
"hard" can drive out the "soft". Scurrying to check the founding documents when candidates signal a badly negotiated social contract.

Problemeigning positions to understand deeper interests. Issues are on the table that are in conflict. Agreement. Positions are your stands on the issues. Interests are underlying concerns that would be affected by resolution. Positions are in the public, but your interests, but need not be identical. For example, an issue in taking a job may be salary, while a political position may be a demand for $20,000. Yet while your interests reflected in that salary demand include purchasing power, they may also involve status, or needs that could be met in ways other than money.

Positional bargaining envisions a dance of positions, which ideally converges to agreement. Interest-driven bargaining sees the process primarily as a reconciliation of underlying interests: you have one set of interests, I have another, and through joint problem-solving we should be able to agree. For example, environmentalists and farmers endlessly battled a US power company over whether to build a dam (that should be a dam). Their positions: "absolutely yes" and "no way". Yet incompatible positions masked common interests. The farmers were worried about reduced water flow below the dam, the environmentalists were focused on the downstream habitat of the endangered whooping crane, and the power company needed results and a greener image. They devised a better agreement than continuing court warfare: a smaller dam built on a fast track, stream flow guarantees, downstream habitat protection and a trust fund to enhance whooping crane habitats elsewhere.

Too much emphasis on positions - What's your position? Here's mine! - often drives negotiation toward a risky, ritual dance that does not meet the parties' fundamental interests. Learning about and reconciling the full set of interests requires patience, researching the other side, many questions, and real listening.

Step three: assess your BATNAS

Our Harvard colleagues Roger Fisher and Bill Ury coined the acronym BATNA, or "best alternative to negotia-
ted agreement." To describe the course of action you would take if the proposed deal was not possible. BATNA may involve anything from walking away, to approaching another source, to building a better proposal. The value of your BATNA to you sets the threshold of the full set of your interests that any acceptable agreement must exceed. This is also true for the other side. As such, BATNA implies the existence of a zone of possible agreement, and determine its location.

Not only should you assess your own BATNA, you should carefully analyze the other side's BATNA. In one instance, a British company hoped to sell a poorly performing division for a bit more than its depreciated asset value of $7m to one of two potential buyers known to be fierce rivals. Each might be induced to see its BATNA as obtaining a relatively unprofitable business, but as a hated rival snatching a prize away. So they agreed to design a contract that would ensure that each suitor knew the other was looking, and never to let either buyer say they were not interested. Following this, the division was sold for $45m.

"Consider improving your BATNA: be careful not to worsen it. Not only do BATNAs define the minimum conditions for a deal but also enhance the ability to "walk away," a factor often associated with negotiating influence. Your better BATNA appears both to you and to the other party, the more credible your threat to walk away. Instead of further refining your tactics at the table, you should sometimes act away from the table to improve your BATNA."

Steve Holtzman, chief business officer for Millennium Pharmaceuticals, did a string of deals from company's founding in 1986 to a value of $1.4bn. He said: "Whenever we feel there's a possibility of a deal with someone, we immediately call all other people. It drives you nuts, trying to juggle them all, but it will change the perception on the other side of the table, number one. Number two, it will change your self-perception. If you believe that there are other people who are interested, your bluff is no longer a bluff, it's real."

Step four: solve the joint problem

Here is your basic negotiation problem: by the choice of agreement or no agreement, how can you best advance the full set of your interests? The other party's problem is a mirror image of yours: by the choice of agreement or no agreement, how can they best advance the full set of their interests? Since they will say yes for their reasons, your needs, agreement means joint problem-solving: addressing their interests and your own. In this sense, effective negotiators are "selfish altruists". An associate of Rupert Murdoch remarked that, as a buyer, Murdoch "understands the seller - and, whatever the guy's trying to do, he crafts his offer that way. He is able to see what the person most wants out of the deal."

"Understand and shape how they see their basic negotiation problem. To change the other side's mind, you need to know their mind; "putting yourself in the other party's shoes" is venerable but good advice. Then, with them, you can try to build what Bill Ury calls a "golden bridge" from where they now are to where you want them to go. This is generally more promising than showing them towards your solution."

Tough negotiators sometimes dismiss the other side's concerns: "That's their problem. Let them handle it." This can make you your capacity to influence their problem, as they see it, in your interest. Early in a career of making deals at Cisco Systems, Mike Volpi's "outward confidence" was mistaken for arrogance and he had trouble completing proposed deals. Many acquisition, a relative newcomer, a deals came from telling people you are powerful. He went from being a guy driving the deal from his side of the table to the guy who understood the deal from the other side.

Easy in tough dealings, this perspective is very useful. A major technology company was engaged in a contentious, highly publicized negotiation with a shareholder and joint venture partner. Despite a reputation of near invincibility, research revealed he had not in fact "won" all such battles but had an acute interest in maintaining that perception. The multinational firm therefore offered a deal that kept the essential substance for itself but gave the shareholder the appearance of victory (while making sure the shareholder saw his Batna as a viable public loss).

Solve the joint problem by "creating value". The important issue here is to create value in a sustainable way as well as merely "claiming value". To do this, search beyond common ground for differences among the parties as the ingredients for value creation. By "claiming value", we mean the process of dividing the pie. By "creating value", we mean the vital process for simultaneously increasing the worth of the agreement to each side. The trick is to recognize and manage the tension between co-operative actions needed to create value and competitive ones to claim it.

Barriers to value creation seem to be hard-wired: many people equate negotiation with value claiming. They simply assume their interests to be the opposite of yours - rather than different and potentially compatible. If the pie is fixed, of course, the enterprise truly is one of claiming value (zero-sum or win-lose), in which my gain is your loss. Psychologists have discovered this "fixed pie" bias to be pervasive. For example, in one survey conducted by 32 negotiating studies, participants failed to see compatible issues fully half of the time. In real world terms, this means unknowingly leaving value uncreated, or both sides walking away from money on the table.

When Egypt and Israel were negotiating over the Sinai, their positions were incompatible. Deeply probing the bargaining, both parties realized that negotiators exploited a vital difference of underlying interests: the Israelis cared more about security, while the Egyptians cared more about territory. The solution was to establish a demilitarized zone under the Egyptian flag.

Even when the issue is economic, finding differences can break a deadlock. A small technology company and its investors, demonstrating high price, were stuck in negotiation with a large strategic acquirer that was adamant about paying much less. The acquirer was willing to pay the asking price, but was very concerned about sharply raising price expectations in a fast-moving industry, so they planned to make more acquisitions. The solution was for the two sides to agree on a modest cash purchase price initially, which was widely published, with complex contingencies that virtually guaranteed a higher price later.

"The joint problem approach, through a "3D" approach, including actions "away from the table". "One-dimensional" negotiation is the most familiar image: an interpersonal process involving persuasion, cultural sensitivity, crafting offers and so on. Two-dimensional negotiation moves from interpersonal process to the substance of value creation: "deal crafting" or the logic of devising and structuring agreements that create sustainable value. Yet these two dimensions are limited: when the parties engage in a face-to-face process of creating and claiming value over a given agenda, much of the die is cast.

The best negotiators participate in a 3D game. With the potential value to be created as their guiding beacon, they act as entrepreneurs. They envision the most promising architecture and act, often away from the table, to effect it. They get the right parties to the table, in the right order, to deal with the right issues at the right time, by the right process, and facing the right BATNA. 3D negotiators not only play the game as given, they are masters at setting it up and changing it to maximise the results.

In summary, seeing negotiation as 3D problem is a reminder that solving the other party's problem is very much part of solving your own. Having done a deal diagram and having analyzed the situation, and both BATNAs, your strategy is to shape how they see their basic problem such that, for their reasons, they choose what you want. The goal is to create and claim sustainable value. Superb deal makers instinctively understand how to do this, and an outside commentator, when he described a negotiation master as possessing "the art of creating every man's personal win" towards that which it his chief design to secure".

Further reading

- An extended version of this article with sources can be found at: Sebastijan, J. (2000), Dealmaking Essentials, item 2-800-483, http://w3.hbs.harvard.edu/