Harvard Business Review OnPoint COLLECTION

www.hbr.org

Masterful Negotiating, 2nd Edition

Your deal looks brilliant on paper. But will it work *in practice?*

Included with this collection:

Product 8320

Harvard Business Review OnPoint

Collection Overview

You know negotiating is tricky business. Despite your savviest efforts at the bargaining table, you may end up holding the short end of the stick. And even if you seal a deal that looks brilliant on paper, the whole thing can fall apart when you start implementing your agreement.

How to strike deals that create real value for your company? This *Harvard Business Review* OnPoint collection offers four strategies:

- Before you even sit down at the bargaining table, actively **shape the set-up** of the deal. Work behind the scenes to ensure that the right parties are approached in the right order and about the right issues.
- Once you're at the table, let the other guy have *your* way. **Understand your counterpart's priorities**, then shape his decisions so he chooses what *you* want because it's in *his* interest, too.
- **Cultivate an implementation mindset.** While bargaining, focus less on closing deals and more on establishing successful long-term relationships. With the other party, brainstorm the practical implications of your agreement—and devise strategies for successful implementation.
- **Attend to the spirit of the deal**—tacit assumptions about the "what" and "how" of your agreement. Is this a one-time transaction or long-term partnership? How will you and your counterpart work together, communicate, and handle surprises *after* the ink on the contract has dried?

Apply these strategies, and you'll leave the bargaining table with deals that look great on paper *and* work out brilliantly in practice.

The Articles

Harvard Business Review OnPoint

1st article from the collection:
Masterful Negotiating, 2nd Edition

3-D Negotiation

Playing the Whole Game

by David A. Lax and James K. Sebenius

Included with this full-text *Harvard Business Review* article:

Product 5372

3-D Negotiation

Playing the Whole Game

The Idea in Brief

Why didn't those last deals work out the way you expected? You brilliantly followed all the rules in negotiation manuals: You built enormous goodwill. You demonstrated astute cultural sensitivity. And you unlocked hidden value for all parties. But you were still left empty-handed.

Like most of us, you may have waited too long to *start* negotiating. We're trained to think that negotiation happens at the bargaining table—in the first dimension of interpersonal and process tactics—or at the drawing board—the second dimension, where the substance of the deal is hashed out. But by the time parties are sitting down to hammer out an agreement, most of the game has already been played.

That's why savvy 3-D negotiators work behind the scenes, away from the table, both before and during negotiations to set (and reset) the bargaining table. They make sure that all the right parties are approached in the right order to deal with the right issues at the right time.

3-D moves help you engineer deals that would otherwise be out of tactical reach. Rather than playing the hand you're dealt, you reshape the scope and sequence of the entire negotiation to your best advantage.

The Idea in Practice

In addition to skillfully handling tactical and substantive challenges, consider these guidelines to 3-D negotiation:

SCAN WIDELY

Search beyond the existing deal on the table to find complementary capabilities and value that other players might add. Ask such questions as: Who, outside the existing deal, might most value aspects of it? Who might supply a piece missing from the current process? Who might minimize the costs of production or distribution?

This process will identify all the actual and potential parties and crucial relationships among them, such as who influences whom, who defers to whom, who owes what to whom.

▶ Example:
When WebTV Networks was launching, founder Steve Perlman obtained seed funding, developed the technology, created a prototype, and hired his core team. But in order to turn the start-up into a self-sustaining company, he needed more capital and broader capabilities. So he identified potential partners in many fields: Internet service providers, content providers, consumer-electronics businesses, manufacturers, distributors.

MAP BACKWARD AND SEQUENCE

The logic of backward mapping is similar to project management: You begin with the end point and work back to the present to develop a critical path. In negotiation, the completed "project" is a set of agreements among a coalition of parties.

To start, identify what you'd ideally like to happen. Then, determine who must sign on to make your vision a reality. Often, approaching the most difficult—and most critical—partners *first* offers slim chances for a deal. Instead, figure out which partners you need to have on board *before* you initiate negotiations with your most crucial partners.

▶ Example:
Even though WebTV badly needed capital, Perlman didn't approach obvious investors immediately. He knew that VCs were skeptical of consumer electronics deals, so he mapped backward from his VC target. Since VCs would be more apt to fund his company if a prominent consumer electronics company were already on board, he first forged a deal with Phillips and then used that deal to sign up Sony, as well. When he finally approached VCs, he was able to negotiate new venture money at a higher valuation.

MANAGE INFORMATION FLOW

How you tailor your message to each potential partner can dramatically alter the outcome of your negotiation. Timing is vital: Decide which stages of the negotiation process should be public, which private, and how much information from one stage you should convey at other stages.

Savvy negotiators not only play their cards well, they design the game in their favor even before they get to the table.

3-D Negotiation

Playing the Whole Game

by David A. Lax and James K. Sebenius

What stands between you and the yes you want? In our analysis of hundreds of negotiations, we've uncovered barriers in three complementary dimensions: The first is tactics; the second is deal design; and the third is setup. Each dimension is crucial, but many negotiators and much of the negotiation literature fixate on only the first two.

For instance, most negotiation books focus on how executives can master tactics—interactions at the bargaining table. The common barriers to yes in this dimension include a lack of trust between parties, poor communication, and negotiators' "hardball" attitudes. So the books offer useful tips on reading body language, adapting your style to the bargaining situation, listening actively, framing your case persuasively, deciding on offers and counteroffers, managing deadlines, countering dirty tricks, avoiding cross-cultural gaffes, and so on.

The second dimension, that of deal design—or negotiators' ability to draw up a deal at the table that creates lasting value—also receives attention. When a deal does not offer enough value to all sides, or when its structure won't allow for success, effective 2-D negotiators work to diagnose underlying sources of economic and noneconomic value and then craft agreements that can unlock that value for the parties. Does some sort of trade between sides make sense and, if so, on what terms? Should it be a staged agreement, perhaps with contingencies and risk-sharing provisions? A deal with a more creative concept and structure? One that meets ego needs as well as economic ones?

Beyond the interpersonal and deal design challenges executives face in 1-D and 2-D negotiations lie the 3-D obstacles—flaws in the negotiating setup itself. Common problems in this often-neglected third dimension include negotiating with the wrong parties or about the wrong set of issues, involving parties in the wrong sequence or at the wrong time, as well as incompatible or unattractive no-deal options. 3-D negotiators, however, reshape the scope and sequence of the game itself to achieve the desired outcome. Acting entrepre-

David A. Lax (lax@negotiate.com) is a principal of Lax Sebenius, a negotiation-strategy consulting firm in Concord, Massachusetts. **James K. Sebenius** (jsebenius@hbs.edu) is the Gordon Donaldson Professor of Business Administration at Harvard Business School in Boston and a principal of Lax Sebenius. They are both members of the Negotiation Roundtable forum at Harvard Business School and the authors of *3-D Negotiation: Creating and Claiming Value for the Long Term,* forthcoming from Harvard Business School Press.

neurially, away from the table, they ensure that the right parties are approached in the right order to deal with the right issues, by the right means, at the right time, under the right set of expectations, and facing the right no-deal options.

Former U.S. trade representative Charlene Barshefsky, who has negotiated with hundreds of companies, governments, and nongovernmental organizations to spearhead deals on goods, services, and intellectual property, characterizes successful 3-D negotiations this way: "Tactics at the table are only the cleanup work. Many people mistake tactics for the underlying substance and the relentless efforts away from the table that are needed to set up the most promising possible situation once you face your counterpart. When you know what you need and you have put a broader strategy in place, then negotiating tactics will flow."[1]

3-D Negotiation in Practice

Even managers who possess superior interpersonal skills in negotiations can fail when the barriers to agreement fall in the 3-D realm. During the 1960s, Kennecott Copper's long-term, low-royalty contract governing its huge El Teniente mine in Chile was at high risk of renegotiation; the political situation in Chile had changed drastically since the contract was originally drawn up, rendering the terms of the deal unstable. Chile had what appeared to be a very attractive walk-away option—or in negotiation lingo, a BATNA (best alternative to negotiated agreement). By unilateral action, the Chilean government could radically change the financial terms of the deal or even expropriate the mine. Kennecott's BATNA appeared poor: Submit to new terms or be expropriated.

Imagine that Kennecott had adopted a 1-D strategy focusing primarily on interpersonal actions at the bargaining table. Using that approach, Kennecott's management team would assess the personalities of the ministers with whom it would be negotiating. It would try to be culturally sensitive, and it might choose elegant restaurants in which to meet. Indeed, Kennecott's team did take such sensible actions. But that approach wasn't promising enough given the threatening realities of the situation. Chile's officials seemed to hold all the cards: They didn't need Kennecott to run the mine; the country had its own experienced managers and engineers. And Kennecott's hands seemed tied: It couldn't move the copper mine, nor did it have a lock on downstream processing or marketing of the valuable metal, nor any realistic prospect, as in a previous era, of calling in the U.S. fleet.

Fortunately for Kennecott, its negotiators adopted a 3-D strategy and set up the impending talks most favorably. The team took six steps and changed the playing field altogether. First, somewhat to the government's surprise, Kennecott offered to sell a majority equity interest in the mine to Chile. Second, to sweeten that offer, the company proposed using the proceeds from the sale of equity, along with money from an Export-Import Bank loan, to finance a large expansion of the mine. Third, it induced the Chilean government to guarantee this loan and make the guarantee subject to New York state law. Fourth, Kennecott insured as much as possible of its assets under a U.S. guarantee against expropriation. Fifth, it arranged for the expanded mine's output to be sold under long-term contracts with North American and European customers. And sixth, the collection rights to these contracts were sold to a consortium of European, U.S., and Japanese financial institutions.

These actions fundamentally changed the negotiations. A larger mine, with Chile as the majority owner, meant a larger and more valuable pie for the host country: The proposal would result in more revenue for Chile and would address the country's interest in maintaining at least nominal sovereignty over its own natural resources.

Moreover, a broad array of customers, governments, and creditors now shared Kennecott's concerns about future political changes in Chile and were highly skeptical of Chile's capacity to run the mine efficiently over time. Instead of facing the original negotiation with Kennecott alone, Chile now effectively faced a multiparty negotiation with players who would have future dealings with that country—not only in the mining sector but also in the financial, industrial, legal, and public sectors. Chile's original BATNA—to unceremoniously eject Kennecott—was now far less attractive than it had been at the outset, since hurting Kennecott put a wider set of Chile's present and future interests at risk.

And finally, the guarantees, insurance, and other contracts improved Kennecott's BATNA.

If an agreement were not reached and Chile acted to expropriate the operation, Kennecott would have a host of parties on its side. Though the mine was ultimately nationalized some years later, Chile's worsened alternatives gave Kennecott a better operating position and additional years of cash flow compared with similar companies that did not take such actions.

This case underscores our central message: Don't just skillfully play the negotiating game you are handed; change its underlying design for the better. It is unlikely that 1-D tactical or interpersonal brilliance at the table—whether in the form of steely gazes, culturally sensitive remarks, or careful and considered listening to all parties—could have saved Kennecott from its fundamentally adverse bargaining position. Yet the 3-D moves the company made away from the table changed the negotiation's setup (the parties involved, the interests they saw at stake, their BATNAs) and ultimately created more value for all involved—much of which Kennecott claimed for itself.

How 3-D Moves Work

Successful 3-D negotiators induce target players to say yes by improving the proposed deal, enhancing their own BATNAs, and worsening those of the other parties. 3-D players intend such moves mainly to *claim* value for themselves but also to *create* value for all sides.

Claiming Value. 3-D negotiators rely on several common practices in order to claim value, including soliciting outside offers or bringing new players into the game, sometimes to create a formal or informal auction. After negotiating a string of alliances and acquisitions that vaulted Millennium Pharmaceuticals from a small start-up in 1993 to a multibillion-dollar company less than a decade later, then–chief business officer Steve Holtzman explained the rationale for adding parties to the negotiations: "Whenever we feel there's a possibility of a deal with someone, we immediately call six other people. It drives you nuts, trying to juggle them all. But number one, it will change the perception on the other side of the table. And 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. It will come across with a whole other level of conviction." (For more on Millennium, see "Strategic Deal-making at Millennium Pharmaceuticals," HBS case no. 9-800-032.)

While negotiators should generally try to improve their BATNAs, they should also be aware that some of the moves they make might inadvertently worsen their walkaway options. For instance, several years ago, we

The Three Dimensions of Negotiation

Our research shows that negotiations succeed or fail based on the attention executives pay to three common dimensions of deal making.

	Focus	Common Barriers	Approach
1-D	Tactics (people and processes)	Interpersonal issues, poor communication, "hardball" attitudes	Act "at the table" to improve interpersonal processes and tactics
2-D	Deal design (value and substance)	Lack of feasible or desirable agreements	Go "back to the drawing board" to design deals that unlock value that lasts
3-D	Setup (scope and sequence)	Parties, issues, BATNAs, and other elements don't support a viable process or valuable agreement	Make moves "away from the table" to create a more favorable scope and sequence

worked with a U.S. manufacturing firm on its joint-venture negotiations in Mexico. The company had already researched possible cultural barriers and ranked its three potential partners according to the competencies it found most desirable in those companies. After approaching the negotiations in a culturally sensitive spirit, and in what had seemed a very logical sequence, the U.S. team had nevertheless come to an impasse with the most attractive partner. The team abandoned those talks and was now deep into the process with the second most desirable candidate—and again, things were going badly. Imagine subsequent negotiations with the third, barely acceptable, partner if the second set of talks had also foundered—in an industry where all would quickly know the results of earlier negotiations.

As each set of negotiations failed, the U.S. firm's BATNA—a deal with another Mexican company or no joint venture at all—became progressively worse. Fortunately, the U.S. company opened exploratory discussions with the third firm in parallel with the second. This helped the U.S. company to discover which potential partner actually made the most business sense, to avoid closing options prematurely, and to take advantage of the competition between the Mexican companies. The U.S. business should have arranged the process so that the prospect of a deal with the most desirable Mexican partner would function as its BATNA in talks with the second most desirable partner, and so on. In short, doing so would have created the equivalent of a simultaneous four-party negotiation (structured as one U.S. firm negotiating in parallel with each of the three Mexican firms) rather than three sequential two-party negotiations. This more promising 3-D setup would have greatly enhanced whatever 1-D cultural insight and tactical ingenuity the U.S. firm could muster.

In addition to strengthening their own position, 3-D negotiators who add parties and issues to a deal can weaken the other side's BATNA. For instance, when Edgar Bronfman, former CEO of Seagram's and head of the World Jewish Congress, first approached Swiss banks asking them to compensate Holocaust survivors whose families' assets had been unjustly held since World War II, he felt stonewalled. Swiss banking executives saw no reason to be forthcoming with Bronfman; they believed they were on strong legal ground because the restitution issue had been settled years ago. But after eight months of lobbying by Bronfman, the World Jewish Congress, and others, the negotiations were dramatically expanded—to the detriment of the Swiss. The bankers faced a de facto coalition of interests that credibly threatened the lucrative Swiss share of the public finance business in states such as California and New York. They faced the divestiture by huge U.S. pension funds of stock in Swiss banks as well as in all Swiss-based companies; a delay in the merger between Swiss Bank and UBS over the "character fitness" license vital to doing business in New York; expensive and intrusive lawsuits brought by some of the most formidable U.S. class-action attorneys; and the wider displeasure of the U.S. government, which had become active in brokering a settlement.

Given the bleak BATNA the Swiss bankers faced, it's hardly surprising that the parties reached an agreement, including a commitment from the Swiss bankers to pay $1.25 billion to survivors. It was, however, an almost unimaginable outcome at the beginning of the small, initially private game in which the Swiss seemed to hold all the cards.

Another way for negotiators to claim value is to shift the issues under discussion and the interests at stake. Consider how Microsoft won the browser war negotiations. In 1996, AOL was in dire need of a cutting-edge Internet browser, and both Netscape and Microsoft were competing for the deal. The technically superior, market-dominant Netscape Navigator vied with the buggier Internet Explorer, which was then struggling for a market foothold but was considered by Bill Gates to be a strategic priority. A confident, even arrogant, Netscape pushed for a technically based "browser-for-dollars" deal. In the book *aol.com,* Jean Villanueva, a senior AOL executive, observed, "The deal was Netscape's to lose. They were dominant. We needed to get what the market wanted. Most important, we saw ourselves as smaller companies fighting the same foe—Microsoft."

But when all was said and done, it was Microsoft that had etched a deal with AOL. The software giant would provide Explorer to AOL for free and had promised a series of technical adaptations in the future. Microsoft had also agreed that AOL client software would be bun-

Microsoft shifted the negotiations from Netscape's technical browser-for-dollars deal toward wider business issues on which it held a decisive edge.

dled with the new Windows operating system.

Microsoft—a direct competitor to AOL—would place the AOL icon on the Windows desktop right next to the icon for its own online service, the Microsoft Network (MSN). AOL's position on "the most valuable desktop real estate in the world" would permit it to reach an additional 50 million people per year at effectively no cost, compared with its $40 to $80 per-customer acquisition cost incurred by "carpet bombing" the country with AOL disks. In effect, Bill Gates sacrificed the medium-term position of MSN to his larger goal of winning the browser war.

How did 3-D moves swing the negotiations in Microsoft's favor? Microsoft's Web browser was technically inferior to Netscape's, so the chances of Microsoft winning on those grounds were poor, regardless of its negotiating skills and tactics at the table. Instead, Microsoft shifted the negotiations from Netscape's technical browser-for-dollars deal toward wider business issues on which it held a decisive edge. Rather than focus on selling to the technologists, Microsoft concentrated on selling to AOL's businesspeople. As AOL's lead negotiator and head of business development, David Colburn, stated in his deposition to the Supreme Court in 1998, "The willingness of Microsoft to bundle AOL in some form with the Windows operating system was a critically important competitive factor that was impossible for Netscape to match." Instead of trying to skillfully play a poor hand when dealing with party X on issues A and B, Microsoft changed the game toward a more compatible counterpart Y, emphasizing issues C, D, and E, on which it was strong.

These examples of 3-D value-claiming moves conflict with the standard 1-D interpersonal approach to negotiation. Actions taken away from the table—sharply altering parties and issues, restructuring and resequencing the process, changing BATNAs—are not primarily about 1-D interpersonal skills but rather about enhancing the underlying setup of the negotiation itself.

Creating Value. By adding complementary parties or issues to the negotiating process, 3-D negotiators can not only claim value for themselves but also create more value for all parties involved. In *Co-opetition,* their influential book on business strategy, Adam Brandenburger and Barry Nalebuff explored the concept of the *value net,* or the collection of players whose potential combination and agreement can create value. 3-D negotiators often facilitate in the development of such value nets. They scan beyond their specific transactions for compatible players with complementary capabilities or valuations, and they craft agreements that profitably incorporate these players.

The world of foreign affairs offers many examples in which potentially valuable bilateral deals can be impossible unless a third party with complementary interests is included. In a 1985 issue of *Negotiation Journal,* University of Toronto professor and international negotiation specialist Janice G. Stein wrote the following about the importance of Henry Kissinger's 3-D role in a crucial Middle East negotiation: "The circular structure of payment was essential to promoting agreement among the parties. Egypt improved the image of the United States in the Arab world, especially among the oil-producing states; the United States gave Israel large amounts of military and financial aid; and Israel supplied Egypt with territory. Indeed, a bilateral exchange between Egypt and Israel would not have succeeded since each did not want what the other could supply."

In an example from the business world, the owners of a niche packaging company with an innovative technology and a novel product were deep in price negotiations to sell the company to one of three potential buyers, all of them larger packaging operations. Instead of mainly working with its bankers to make the case for a higher valuation and to refine its at-the-table tactics with each packaging industry player, the niche player took a 3-D approach. Its broader analysis suggested that one of its major customers, a large consumer goods firm, might particularly value having exclusive access to the niche player's technologies and packaging products, so it brought the consumer goods firm into the deal. The move uncovered a completely new source of potential value—and a much higher potential selling price. It also increased the pressure on the larger packaging companies: They would face more competition and might not be able offer the same kind of exclusive, customized packaging service to their customers.

The potential elements of a value net are not always obvious at the start of a negotia-

Mapping Backward to Yes

What does a sophisticated 3-D strategy look like? Consider the experience of Henry Iverson and his partners, who acquired Concord Pulp and Paper (CPP) for $8.5 million in a highly leveraged transaction. (All company names and details have been disguised.) After the basic deal was done, they needed additional financing to make profitable improvements at CPP. Federal Street Bank (FSB) turned them down flat, even after they had used such 1-D tactics as persuasive appeals and elegant lunches. It was time to move into the 3-D realm.

But first, some background. To acquire CPP from its creditors, Iverson and his partners had put up $700,000 in equity and obtained $7.8 million in financing from FSB, consisting of a $1.3 million short-term loan against receivables and a $6.5 million loan against assets. Soon after, the opportunity arose for CPP to add a recovery boiler, which would increase plant capacity by 100 tons a day, improve overall quality and margins, and boost yearly net cash flow by $4.1 million. The boiler would cut CPP's emissions in its host town of Concord by 95%. Over a two-year construction period, the boiler project would cost $9 million, $6 million of which would go to Bathurst and Felson Engineering (BFE) and the rest to smaller contractors.

The FSB loan officer who delivered the bad news cited the bank's policies: "We will loan against 50% of unencumbered inventory and 80% of receivables. CPP has neither, and its capital structure is already 93% leveraged." When Iverson pressed, he was told that if he had more equity, FSB might consider a short-term construction loan—but only if a credible third party would provide guaranteed takeout financing after two years. So Iverson used 3-D negotiating tactics to scan widely and map backward from his current predicament to establish the prior agreements (with as-yet uninvolved parties) that would maximize the chances of an ultimate yes from the bank.

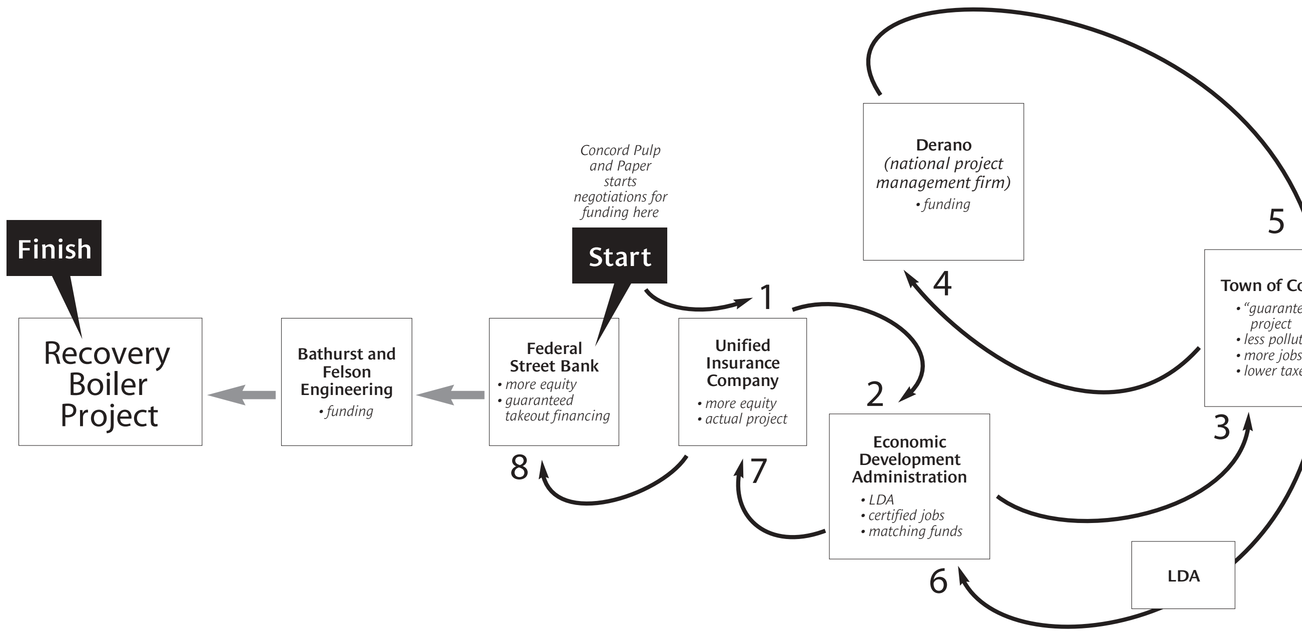
1. Involve UIC. Iverson approached two insurance companies for takeout financing. Unified Insurance Company (UIC) had the most attractive fee structure; Worldwide Insurance had higher fees and was uninterested. Both flatly stated, "CPP is too leveraged." Moreover, UIC would only lend against the cash flow of fully completed projects. Iverson coaxed a deal letter from UIC: For a commitment fee plus a share of increased profits from the boiler, Unified agreed to lend, conditional on the successful completion of the project—and more equity in CPP's capital structure.

2. Involve the EDA. Iverson's attempts to raise more equity from investors failed, so he dug further and learned that the U.S. Economic Development Administration (EDA) could make junior (subordinated) loans to firms for certified job-creating projects; the overall loan limit was equal to the number of jobs times $50,000. Since the recovery boiler project would generate at least 30 new full-time jobs, this implied a junior loan of up to $1.5 million. However, the EDA loan had to be 50% matched by a Local Development Administration (LDA), which did not exist in Concord.

At this point, Iverson took stock of the barriers: the engineer wouldn't proceed without money and, in any case, wouldn't guarantee more than the boiler itself—the only thing BFE would build. The rest of the required system would be complex. Local and regional contractors were in no position to guarantee the overall project. FSB wouldn't do a construction loan without guaranteed takeout financing and more equity. UIC wouldn't do permanent takeout financing without a successful project and more equity. The EDA wouldn't lend without matching funds from the LDA and a guarantee of a successful, certified, job-creating project. And there was no LDA to certify the jobs or provide matching funds.

3. Involve the Town of Concord. Undaunted, Iverson approached the Concord Town Council and proposed that it form an LDA, which could raise matching funds, to facilitate the recovery boiler project. He argued that construction and operation of the project would create new jobs and dramatically cut CPP's odors and pollution levels. And it would add at least $180,000 a year in property taxes if the new boiler were built. The council received these arguments favorably but, before committing, wanted assurances that the project would actually work.

4. Involve Derano. In great need of some plausible guarantee of project success, Iverson approached Derano, a large, national (bondable) engineering, design, and project management firm. Derano expressed serious doubts about managing an already-designed project with BFE and local contractors in place. But by offering to pay above the normal fee, Iverson got Derano to manage the overall project and to give a nonrecourse performance "guarantee"—all conditional on CPP's raising project financing.



5. Go back to Concord with Derano deal. Carrying Derano's letter that gave the provisional guarantee, Iverson revisited Concord's Town Council, which agreed to create an LDA. The LDA would be instructed to issue bonds for $500,000, backed by tax revenue increases and presold to wealthy citizens, local and regional contractors, and other area businesses. As a government entity, the LDA would also formally certify the expected successful job-creation impact of the recovery-boiler project.

6. Go back to the EDA with the Derano letter and the LDA commitments. Iverson approached the EDA, arm-in-arm with the Concord LDA, which brought matching fund commitments and its formal job certification (along with Derano's guarantee) of the boiler project. With this backing, EDA committed to a $1 million junior (subordinated) loan (plus the $500,000 matching loan from Concord's LDA)—all conditional on Iverson's obtaining construction and long-term financing.

7. Go back to UIC to modify its "more equity" provision. Iverson successfully negotiated with Unified Insurance to modify the "more equity" term of its commitment letter to include junior debt, since the EDA–LDA subordinated debt met UIC's real interest in a greater financial cushion for the UIC loan.

8. Go back to FSB with Derano, LDA and EDA commitments, and UIC modification. Returning to the bank, Iverson argued that EDA–LDA loans would provide the functional equivalent of FSB's requirement for more equity. In making the case to the risk-averse loan officer, he tactfully noted that UIC, a "notoriously demanding creditor," was willing to treat it as such to financially cushion UIC's permanent financing. Surely that would be adequate to protect FSB's brief two-year exposure. With this condition met—and given Derano's performance "guarantee" and the LDA's certification—the bank agreed that UIC's commitment letter met its interest in guaranteed takeout financing. FSB's new construction-loan commitment unlocked the EDA–LDA money, which started funds flowing to Derano and BFE. And the project was launched.

tion. For example, a U.S.–European conservation group wished to preserve the maximum amount of rain-forest habitat in a South American country. From membership contributions and foundation support, the conservation group had U.S. dollars it could use (after converting the dollars to local currency at the official exchange rate) to buy development rights. The owner of the land and the conservation group negotiated hard and tentatively agreed on an amount of rain forest to be protected and a price per hectare based on local currency. But 3-D thinking ultimately improved the deal for all sides.

The host country was indebted in dollar-denominated bonds, which were trading at a 45% discount to their face value (given their perceived default risk). The country had to use scarce dollar-export earnings, needed for many pressing domestic purposes, to keep its debt-service obligations current; of course, interest payments were determined by the face value of the debt, not the bond discount. These facts suggested that more value could have been created by adding two other sets of players to the initial negotiation between the landowner and the conservation group.

In this green variant of a debt-for-equity swap, the conservation group bought country debt from foreign holders at the prevailing 45% discount. It then brought this debt to the country's Central Bank and negotiated its redemption for local currency at a premium between the discounted value of the debt and its full-dollar face value (up to an 82% premium over the discounted value). The conservation group then used this greater quantity of local currency from the Central Bank to buy more development rights from the landowner at a somewhat higher unit price.

This expanded four-party negotiation—sequentially involving the conservation group, international bondholders, the Central Bank, and the landowner—benefited everyone more than the best result possible in the initial negotiation between just the landowner and the conservation group. The bank was able to retire debt and cancel dollar-interest obligations, which were very costly to the country, using cheaper (to it) local currency without exporting more or diverting scarce export earnings. The conservation group was able to save more rain forest at the same dollar cost, and the landowner got a higher price in a currency it was better positioned to use.

To find complementary parties and issues, as the conservation group did, you should ask questions that focus on relative valuation. What uninvolved parties might highly value elements of the present negotiation? What outside issues might be highly valued if they were incorporated into the process? Are there any parties outside the immediate negotiations that can bear part of the risk of the deal more cheaply than the current players?

On the other hand, it is sometimes necessary to shrink—or at least stage—the set of involved issues, interests, and parties in order to create value. For example, rather than enter into a full multiparty process at the outset, an industry association that wants to negotiate a certain set of standards may benefit from first seeking agreement between a few dominant players, which would then serve as the basis for a later deal among the wider group. Or, negotiations to forge a multi-issue strategic alliance between two firms may be dramatically simplified by one side which instead proposes an outright acquisition.

Certainly, the form chosen for a transaction can dramatically affect the complexity of negotiations and the value to be had. The planned merger of equals by Bell Atlantic and Nynex would have required separate negotiations with regulatory authorities in each of the 13 states served by the companies. To avoid having to undergo politically charged negotiations at 13 different tables, the parties changed the game by creating a functionally equivalent structure in which Bell Atlantic was the nominal acquirer.

Indeed, it can be necessary to change the process, rather than the substance, of a negotiation. For example, two partners seeking to terminate their relationship may have difficulty determining exactly who gets what. But they may instead be able to agree to a special mechanism like the "Texas shoot-out," in which one side names a price at which it would be either a buyer (of the other's shares) or a seller (of its own shares) and the other side must respond. Often, changing the form of a negotiation by bringing in a skilled third-party mediator creates value. For example, two intensive mediation efforts by outside parties helped to finally thaw the frozen negotiations between Microsoft and the Justice Department. Many fundamentally different variants

While 3-D negotiators should play the existing game well, as tacticians and deal designers, they should also act as entrepreneurs.

of mediation, arbitration, and other special mechanisms exist, but all are options to change the game itself rather than efforts to negotiate more effectively by purely interpersonal means.

Implementing a 3-D Negotiation Strategy

Sophisticated negotiators act in all three dimensions to create and claim value. While 3-D negotiators should play the existing game well, as tacticians and deal designers, they should also act as entrepreneurs, seeking to create a more favorable target game. They can do so by scanning widely to identify possible elements of a more favorable setup; "mapping backward" from the most promising structure for the deal to the current setup; and managing and framing the flow of information to improve their odds of getting to yes.

Scan widely. To act outside the box, one must first look outside the box. By searching beyond the immediate deal on the table for elements of a potential value net, 3-D negotiators can retrain their focus on complementary capabilities and valuations that other players might add. Useful game-changing questions include: Who outside the existing deal might most value an aspect of it? Who might minimize the costs of production, distribution, risk bearing, and so on? Who might supply a piece missing from the current process? Which issues promise mutual advantage? What devices might bring such potential value-creating parties and issues into the deal? And at what point does complexity or conflict of interest between parties call for shrinking the scope of the negotiation? Scanning beyond the current game to claim value normally focuses on a parallel set of questions: Are there additional bidders or parties who could favorably alter BATNAs in other ways? Can certain issues be linked for leverage?

Such scanning should result in a map of all the actual and potential parties (including other interested groups within an organization, if necessary). You need to assess their actual and potential interests and BATNAs, as well as the difficulty and cost of gaining agreement with each party and the value of having its support. Your map should also identify the crucial relationships among the parties: who influences whom, who tends to defer to whom, who owes what to whom, who would find it costly to oppose an emerging agreement with key parties on board, and so on.

The founders of new ventures almost always need to scan widely in order to construct the most promising sequence of deals that lead to a self-sustaining company. Consider the situation WebTV Networks founder Steve Perlman faced in the early and mid-1990s. He had obtained seed funding, developed the technology to bring the Web to ordinary television sets, created a prototype, and hired his core team. Running desperately low on cash, Perlman scanned widely and discovered an array of potential negotiating partners—ISPs, VCs, angel investors, industrial partners, consumer-electronics businesses, content providers, manufacturers, wholesale and retail distribution channels, foreign partners, and the like. He needed to engage in 3-D analysis to determine the right subset of potential partners to create the most promising deals to build his company.

Map backward and sequence. It is helpful to think of the logic of backward mapping as being similar to the logic of project management. In deciding how to undertake a complex project, you start with the end point and work back to the present to develop a time line and critical path. In negotiation, however, the completed "project" should be a set of value-creating, sustainable agreements among a supportive coalition of parties.

For instance, when Perlman's WebTV was almost out of money, it might have seemed obvious that he should approach venture capital firms first. However, because VCs were deeply skeptical of consumer-electronics deals at that time, Perlman mapped backward from his VC target. He reasoned that a VC would find WebTV more appealing if a prominent consumer-electronics company were already on board, so Perlman embarked on a sequential strategy. After his first choice, Sony, turned him down, Perlman kept reasoning backward from his target. Finally, he was able to get Phillips on board. He then used Phillips to reopen and forge a complementary deal with Sony. Next he negotiated new venture money—at a far higher valuation—since both Sony and Phillips had signed on. With new money in the tank, it was fairly straightforward to thread a path of supporting agreements through manufacturers, wholesale and retail distribution channels, content providers, ISPs, and alliance

A 3-D player's ability to determine whether a related negotiation happens before or after his own—as well as whether the results become public—can greatly influence the outcome.

partners abroad.

As the WebTV case suggests, a common problem for a would-be coalition builder is that approaching the most difficult—and perhaps most critical—party offers slim chances for a deal, either at all or on desirable terms. To improve the odds of getting to yes, figure out which partners you would ideally like to have on board when you initiate negotiations with the target party. As the answer to this question becomes clear, you have identified the penultimate stage. Continue mapping backward until you have found the most promising sequence of discussions.

Consider the successful sequencing tactics of Bill Daley, President Clinton's strategist for securing congressional approval of the North American Free Trade Agreement, as reported in a 1993 *New Yorker* article: "News might arrive that a representative who had been leaning toward yes had come out as a no. 'Weenie,' [Daley would] say. When he heard the bad news, he did not take it personally....He'd take more calls. 'Can we find the guy who can deliver the guy? We have to call the guy who calls the guy who calls the guy.'"

Beyond pure sequencing, the 3-D negotiator can use the scope of the negotiation—how elements are added, subtracted, combined, or separated—to influence the chances of bringing each party on board. Issues can be added to make a deal more attractive (as Microsoft did with AOL) or a BATNA less attractive (as happened to the Swiss banks). And by not bringing on board a party to whom others have antipathy, negotiators can increase the probability of their success. That's what James Baker did when building the first Gulf War coalition; by omitting Israel from explicit membership in the group, he was able to attract moderate Arab states.

Manage the information flow. Some negotiations are best approached by gathering all affected parties together, fully sharing information, and brainstorming a solution to the shared problem. Frequently, however, vital 3-D questions involve deciding which stages of the process should be public or private as well as how information from one stage should spill over to or be framed at other stages.

A wry story illustrates the potential of such choices to set up a linked series of negotiations. A prominent diplomat once decided to help a charming and capable young man of very modest background from Eastern Europe. Approaching the chairman of the state bank, the statesman indicated that "a gifted and ambitious young man, soon to be the son-in-law of Baron Rothschild," was seeking a fast-track position in banking. Shortly thereafter, in a separate conversation with the baron, whom he knew to be searching for a suitable match for his daughter, the statesman enthusiastically described a "handsome, very capable young man who was making a stellar ascent at the state bank." When later introduced to the young swain, the dutiful daughter found him charming, with enviable talents and prospects, and acceptable to her father. When she said yes, the three-way deal allegedly went through—to everyone's ultimate satisfaction.

Setting aside the dubious factual base and ethics of this negotiation, notice how the diplomat's 3-D actions set up the most promising game for his purposes. By separating and sequencing the stages of the process, as well as opportunistically framing his message at each juncture, the statesman created a situation that fostered an otherwise most unlikely outcome. Of course, had the banker, the baron, the daughter, and the young man been initially thrown together in a face-to-face meeting, it is doubtful that even the statesman's suave 1-D approach could have closed the deal.

Analogously, potential investors should be wary of the common tactic of separating deals to close both: for instance, getting investor A to commit funds based on the commitment of "savvy investor" B, when B has indeed committed, but only on the informal (and wrong) understanding that "reputable investor" A has unconditionally agreed to do so.

Negotiations to assemble land for a real estate project offer another good example of the importance of staging the release of information. Early knowledge of a developer's plans can be quite valuable to landowners in the target area. Since landowners may use this knowledge to extract maximum price concessions in later stages of assembly, the need for secrecy and separation of the individual negotiations is usually obvious. Indeed, the choice of which parcel to buy first, second, and so on, may depend on the relative odds that a given purchase will leak the developer's intentions as well as whether the parcels already obtained would permit some version of the project to go ahead, or whether they would be useless without a later acquisition.

Indeed, a 3-D player's ability to determine whether a related negotiation happens before or after his own—as well as whether the results become public—can greatly influence the outcome. For example, according to a 1985 article in *International Studies Quarterly,* while the United States was in separate talks with Japan, Hong Kong, and Korea over textile trade agreements, a Korean negotiator told the U.S. representatives, "We'll ask Hong Kong to go first, then see what they get." The Koreans apparently regarded Hong Kong officials as highly skilled negotiators, with better language skills for dealing with the Americans. An observer reports that, "After waiting for Hong Kong and Japan to go first, Seoul asked for the features they had secured and then also held out for a bit more." In essence, the order chosen by the Americans (as encouraged by the Koreans) revealed information about the U.S. approach that was of great value to the Koreans. One wonders whether the Americans should have rethought the sequence and started with Seoul.

• • •

That negotiators should be good listeners, persuaders, and tacticians is a given. But beyond perfecting these 1-D skills, negotiators should also be innovative 2-D deal designers who have mastered the principles for crafting value-creating agreements. And the third, often-missing dimension—actions taken to change the scope and sequence of the game itself—can be crucial to a negotiation that would otherwise be completely out of tactical reach.

Negotiators must take care to keep sophisticated 3-D moves from blurring into the unethical and manipulative. Yet without 3-D actions, coalitions vital to many worthy initiatives could never have been built.

To create and claim value for the long term, great negotiators should be at home in all three dimensions. To do anything less is to risk playing a one- or two-dimensional strategy in a three-dimensional world.

1. A complete set of sources for this article can be found at www.people.hbs.edu/jsebenius/hbr/3-DNegotiation.pdf.

Reprint R0311D; *Harvard Business Review*
OnPoint 5372
To order, see the next page
or call 800-988-0886 or 617-783-7500
or go to www.hbr.org

3-D Negotiation

Playing the Whole Game

Further Reading

ARTICLES

Turning Negotiation into a Corporate Capability
by Danny Ertel
Harvard Business Review
May–June 1999
Product no. 5394

If one 3-D negotiator can achieve results that would have been impossible through "ordinary" negotiating tactics, imagine what a whole company of 3-D negotiators could do. Few companies think systematically about their negotiating activities as a whole. As a result, individuals within a company treat each deal as a one-off, and often inadvertently undermine each other's efforts. A creative response to one customer's needs, for example, may unravel a broader product strategy. Ertel suggests a **coordinated negotiation system:** 1) Give bargainers more information about past negotiations and corporate priorities. 2) Define success in nonfinancial terms, such as better communication with suppliers. 3) Distinguish between deals and long-term relationships. 4) Walk away from a deal if a better alternative exists. With these principles, you'll ensure each deal supports the *company's* goals.

Breakthrough Bargaining
by Deborah M. Kolb and Judith Williams
Harvard Business Review
February 2001
Product no. 6080

When you're setting the scope and sequence of your next negotiation, pay attention to the dynamics of the **shadow negotiation**—unspoken assumptions that determine how bargainers deal with one another, whose opinions get heard, and whose interests hold sway. Shadow negotiations loom largest when bargainers hold unequal power—subordinate/boss, new/veteran, male/female. If ignored, the shadow negotiation can stall deals. But the authors describe three types of moves that can get negotiations back on track. *Power* moves coax reluctant bargainers to the table by offering explicit incentives for participating, putting a price on inaction, and enlisting support from higher-ups. *Process* moves help you shape negotiation agendas by seeding ideas early and building consensus. And *appreciative* moves foster trust and candor by highlighting common interests, helping others save face, and soliciting new perspectives.

Hidden Challenge of Cross-Border Negotiations
by James K. Sebenius
Harvard Business Review
March 2002
Product no. R0203F

In this article, Sebenius focuses on the culture-clash risk factor of international negotiation. Beyond surface behaviors such as table manners, and deeper characteristics such as attitudes toward deadlines, people from different cultures can vary widely in how they handle the negotiation process itself.

How to prepare for such differences? Sebenius explains how to map out your decision-making process—including who's involved, what formal and informal roles people play, and how a resolution is achieved. Then you can design a 3-D strategy that anticipates obstacles before they arise—boosting your chances of achieving your desired outcome.

To Order

For reprints, *Harvard Business Review* OnPoint orders, and subscriptions to *Harvard Business Review:*
Call 800-988-0886 or 617-783-7500.
Go to www.hbr.org

For customized and quantity orders of reprints and *Harvard Business Review* OnPoint products:
Call Frank Tamoshunas at 617-783-7626,
or e-mail him at
ftamoshunas@hbsp.harvard.edu

Harvard Business Review OnPoint

2nd article from the collection:
Masterful Negotiating, 2nd Edition

Six Habits of Merely Effective Negotiators

by James K. Sebenius

Included with this full-text *Harvard Business Review* article:

Product 9411

Six Habits of Merely Effective Negotiators

The Idea in Brief

High stakes. Intense pressure. Careless mistakes. These can turn your key negotiations into disasters. Even seasoned negotiators bungle deals, leaving money on the table and damaging working relationships.

Why? During negotiations, six common mistakes can distract you from your *real* purpose: getting the other guy to choose what you want—for *his* own reasons.

Avoid negotiation pitfalls by mastering the art of letting the other guy have your way—*everyone* will win.

The Idea in Practice

NEGOTIATION MISTAKES

Neglecting the other side's problem
If you don't understand the deal from the other side's perspective, you can't solve his problem *or* yours.

▶ Example:
A technology company that created a cheap, accurate way of detecting gas-tank leaks couldn't sell its product. Why? EPA regulations permitted leaks of up to 1,500 gallons, while this new technology detected *8-ounce* leaks. Fearing the device would spawn regulatory trouble, potential customers said, "No deal!"

Letting price bulldoze other interests
Most deals involve interests *besides* price:

- a positive working relationship, crucial in longer-term deals
- the social contract, or "spirit of the deal," including goodwill and shared expectations
- the deal-making process—personal, respectful, and fair to both sides

Price-centric tactics leave these potential *joint* gains unrealized.

Letting positions drive out interests
Incompatible *positions* may mask compatible *interests*. Your gain isn't necessarily your "opponent's" loss.

▶ Example:
Environmentalists and farmers opposed a power company's proposed dam. Yet compatible *interests* underlay these seemingly irreconcilable positions: Farmers wanted water flow; environmentalists, wildlife protection; the power company, a greener image. By agreeing to a smaller dam, water-flow guarantees, and habitat conservation, everyone won.

Searching too hard for common ground
While common ground helps negotiations, *different* interests can give each party what it values most, at minimum cost to the other.

▶ Example:
An acquirer and entrepreneur disagree on the entrepreneurial company's likely future. To satisfy their differing interests, the buyer agrees to pay a fixed amount now and contingent amount later, based on future performance. Both find the deal more attractive than walking away.

Neglecting BATNA
BATNAs ("best alternative to a negotiated agreement") represent your actions if the proposed deal weren't possible; e.g., walk away, approach another buyer. Assessing your own *and* your partner's BATNA reveals surprising possibilities.

▶ Example:
A company hoping to sell a struggling division for somewhat more than its $7 million value had two fiercely competitive bidders. Speculating each might pay an inflated price to trump the other, the seller ensured each knew its rival was looking. The division's selling price? *$45 million.*

Failing to correct for skewed vision
Two forms of bias can prompt errors:

- *Role bias*—overcommitting to your own point of view and interpreting information in self-serving ways. A plaintiff believes he has a 70% chance of winning his case, while the defense puts the odds at 50%. Result? Unlikelihood of out-of-court settlement.
- *Partisan perceptions*—painting your side with positive qualities, while vilifying your "opponent." Self-fulfilling prophecies may result.

Counteract these biases with role-plays of the opposition's interests.

Like many executives, you know a lot about negotiating. But still you fall prey to a set of common errors. The best defense is staying focused on the right problem to solve.

Six Habits of Merely Effective Negotiators

by James K. Sebenius

Global deal makers did a staggering $3.3 trillion worth of M&A transactions in 1999—and that's only a fraction of the capital that passed through negotiators' hands that year. Behind the deal-driven headlines, executives endlessly negotiate with customers and suppliers, with large shareholders and creditors, with prospective joint venture and alliance partners, with people inside their companies and across national borders. Indeed, wherever parties with different interests and perceptions depend on each other for results, negotiation matters. Little wonder that Bob Davis, vice chairman of Terra Lycos, has said that companies "have to make deal making a core competency."

Luckily, whether from schoolbooks or the school of hard knocks, most executives know the basics of negotiation; some are spectacularly adept. Yet high stakes and intense pressure can result in costly mistakes. Bad habits creep in, and experience can further ingrain those habits. Indeed, when I reflect on the thousands of negotiations I have participated in and studied over the years, I'm struck by how frequently even experienced negotiators leave money on the table, deadlock, damage relationships, or allow conflict to spiral. (For more on the rich theoretical understanding of negotiations developed by researchers over the past fifty years, see the sidebar "Academics Take a Seat at the Negotiating Table.")

There are as many specific reasons for bad outcomes in negotiations as there are individuals and deals. Yet broad classes of errors recur. In this article, I'll explore those mistakes, comparing good negotiating practice with bad. But first, let's take a closer look at the right negotiation problem that your approach must solve.

Solving the Right Negotiation Problem

In any negotiation, each side ultimately must choose between two options: accepting a deal or taking its best no-deal option—that is, the course of action it would take if the deal were not possible. As a negotiator, you seek to advance the full set of your interests by persuading the other side to say yes—and mean it—to a proposal that meets your interests better than your best no-deal option does. And why should the other side say yes? Because the deal meets its own interests better than its best no-deal option. So, while protecting your own choice, your negotiation problem is to understand and shape your counterpart's perceived decision—deal versus no deal—so that the other side chooses *in its own interest* what you want. As Italian diplomat Daniele Vare said long ago about diplomacy, negotiation is "the art of letting them have your way."

This approach may seem on the surface like a recipe for manipulation. But in fact, understanding your counterpart's interests and shaping the decision so the other side agrees for its own reasons is the key to jointly creating and claiming sustainable value from a negotiation. Yet even experienced negotiators make six common mistakes that keep them from solving the right problem.

Mistake 1
Neglecting the Other Side's Problem

You can't negotiate effectively unless you understand your own interests and your own no-deal options. So far, so good—but there's much more to it than that. Since the other side will say yes for its reasons, not yours, agreement requires understanding and addressing your counterpart's problem as a means to solving your own.

At a minimum, you need to understand the problem from the other side's perspective. Consider a technology company, whose board of directors pressed hard to develop a hot new product shortly after it went public. The company had developed a technology for detecting leaks in underground gas tanks that was both cheaper and about 100 times more accurate than existing technologies—at a time when the Environmental Protection Agency was persuading Congress to mandate that these tanks be continuously tested. Not surprisingly, the directors thought their timing was perfect and pushed employees to commercialize and market the technology in time to meet the demand. To their dismay, the company's first sale turned out to be its only one. Quite a mystery, since the technology worked, the product was less expensive, and the regulations did come through. Imagine the sales engineers confidently negotiating with a customer for a new order: "This technology costs less and is more accurate than the competition's." Think for a moment, though, about how intended buyers might mull over their interests, especially given that EPA regulations permitted leaks of up to 1,500 gallons while the new technology could pick up an 8-ounce leak. Potential buyer: "What a technological tour de force! This handy new device will almost certainly get me into needless, expensive regulatory trouble. And create P.R. problems too. I think I'll pass, but my competition should definitely have it." From the technology company's perspective, "faster, better, cheaper" added up to a sure deal; to the other side, it looked like a headache. No deal.

Social psychologists have documented the difficulty most people have understanding the other side's perspective. From the trenches, successful negotiators concur that overcoming this self-centered tendency is critical. As Millennium Pharmaceuticals' Steve Holtzman put it after a string of deals vaulted his company from a start-up in 1993 to a major player with a $10.6 billion market cap today, "We spend a lot of time thinking about how the poor guy or woman on the other side of the table is going to have to go sell this deal to his or her boss. We spend a lot of time trying to understand how they are modeling it." And Wayne Huizenga, veteran of more than a thousand deals building Waste Management, AutoNation, and Blockbuster, distilled his extensive experience into basic advice that is often heard but even more often forgotten. "In all my years of doing deals, a few rules and lessons have emerged. Most important, always try to put yourself in the other person's shoes. It's vital to try to understand in depth what the other side really wants out of the deal."

Tough negotiators sometimes see the other side's concerns but dismiss them: "That's their problem and their issue. Let them handle it. We'll look after our own problems." This attitude can undercut your ability to profitably influence how your counterpart sees its problem. Early in his deal-making career at Cisco Systems, Mike Volpi, now chief strategy officer, had trouble completing proposed deals, his "outward confidence" often mistaken for arrogance. Many acquisitions later, a colleague observed that "the most important part of [Volpi's] development is that he learned power

James K. Sebenius is the Gordon Donaldson Professor of Business Administration at Harvard Business School in Boston, where he led the creation of the negotiation unit. He helped found and worked at the Blackstone Group, a New York investment banking and private equity firm. He is coauthor with David Lax of the forthcoming book *3-D Negotiation: Creating and Claiming Value for the Long Term*.

doesn't come 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."

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." If you want to change someone's mind, you should first learn where that person's mind is. Then, together, you can try to build what my colleague Bill Ury calls a "golden bridge," spanning the gulf between where your counterpart is now and your desired end point. This is much more effective than trying to shove the other side from its position to yours. As an eighteenth-century pope once noted about Cardinal de Polignac's remarkable diplomatic skills, "This young man always seems to be of my opinion [at the start of a negotiation], and at the end of the conversation I find that I am of his." In short, the first mistake is to focus on your own problem, exclusively. Solve the other side's as the means to solving your own.

Mistake 2
Letting Price Bulldoze Other Interests

Negotiators who pay attention exclusively to price turn potentially cooperative deals into adversarial ones. These "reverse Midas" negotiators, as I like to call them, use hard-bargaining tactics that often leave potential joint gains unrealized. That's because, while price is an important factor in most deals, it's rarely the only one. As Felix Rohatyn, former managing partner of the investment bank, Lazard Frères, observed, "Most deals are 50% emotion and 50% economics."

There's a large body of research to support Rohatyn's view. Consider, for example, a simplified negotiation, extensively studied in academic labs, involving real money. One party is given, say, $100 to divide with another party as she likes; the second party can agree or disagree to the arrangement. If he agrees, the $100 is divided in line with the first side's proposal; if not, neither party gets anything. A pure price logic would suggest proposing something like $99 for me, $1 for you. Although this is an extreme allocation, it still represents a position in which your counterpart gets something rather than nothing. Pure price negotiators confidently predict the other side will agree to the split; after all, they've been offered free money—it's like finding a dollar on the street and putting it in your pocket. Who wouldn't pick it up?

In reality, however, most players turn down proposals that don't let them share in at least 35% to 40% of the bounty—even when much larger stakes are involved and the amount they forfeit is significant. While these rejections are "irrational" on a pure price basis and virtually incomprehensible to reverse Midas types, studies show that when a split feels too unequal to

Academics Take a Seat at the Negotiating Table

Paralleling the growth in real-world negotiation, several generations of researchers have deepened our understanding of the process. In the 1950s and 1960s, elements of hard (win-lose) bargaining were isolated and refined: how to set aggressive targets, start high, concede slowly, and employ threats, bluffs, and commitments to positions without triggering an impasse or escalation. By the early 1980s, with the win-win revolution popularized by the book *Getting to Yes* (by Roger Fisher, William Ury, and Bruce Patton), the focus shifted from battling over the division of the pie to the means of expanding it by uncovering and reconciling underlying interests. More sophisticated analysis in Howard Raiffa's *Art and Science of Negotiation* soon transcended this simplistic "win-win versus win-lose" debate; the pie obviously had to be both expanded and divided. In *The Manager as Negotiator* (by David Lax and James Sebenius), new guidance emerged on productively managing the tension between the cooperative moves necessary to create value and the competitive moves involved in claiming it. As the 1990s progressed with work such as *Negotiating Rationally* (by Max Bazerman and Margaret Neale), the behavioral study of negotiation—describing how people actually negotiate—began to merge with the game theoretic approach, which prescribed how fully rational people should negotiate. This new synthesis—developing the best possible advice without assuming strictly rational behavior—is producing rich insights in negotiations ranging from simple two-party, one-shot, single-issue situations through complex coalitional dealings over multiple issues over time, where internal negotiations must be synchronized with external ones. Negotiation courses that explore these ideas have always been popular options at business schools, but reflecting the growing recognition of their importance, these courses are beginning to be required as part of MBA core programs at schools such as Harvard. Rather than a special skill for making major deals or resolving disputes, negotiation has become a way of life for effective executives.

People care about much more than the absolute level of their own economic outcome; competing interests include relative results, perceived fairness, self-image, reputation, and so on.

people, they reject the spoils as unfair, are offended by the process, and perhaps try to teach the "greedy" person a lesson.

An important real-world message is embedded in these lab results: people care about much more than the absolute level of their own economic outcome; competing interests include relative results, perceived fairness, self-image, reputation, and so on. Successful negotiators, acknowledging that economics aren't everything, focus on four important nonprice factors.

The Relationship. Less experienced negotiators often undervalue the importance of developing working relationships with the other parties, putting the relationships at risk by overly tough tactics or simple neglect. This is especially true in cross-border deals. In much of Latin America, southern Europe, and Southeast Asia, for example, relationships—rather than transactions—can be the predominant negotiating interest when working out longer term deals. Results-oriented North Americans, Northern Europeans, and Australians often come to grief by underestimating the strength of this interest and insisting prematurely that the negotiators "get down to business."

The Social Contract. Similarly, negotiators tend to focus on the economic contract—equity splits, cost sharing, governance, and so on—at the expense of the social contract, or the "spirit of a deal." Going well beyond a good working relationship, the social contract governs people's expectations about the nature, extent, and duration of the venture, about process, and about the way unforeseen events will be handled. Especially in new ventures and strategic alliances, where goodwill and strong shared expectations are extremely important, negotiating a positive social contract is an important way to reinforce economic contracts. Scurrying to check founding documents when conflicts occur, which they inevitably do, can signal a badly negotiated social contract.

The Process. Negotiators often forget that the deal-making process can be as important as its content. The story is told of the young Tip O'Neill, who later became Speaker of the House, meeting an elderly constituent on the streets of his North Cambridge, Massachusetts, district. Surprised to learn that she was not planning to vote for him, O'Neill probed, "Haven't you known me and my family all my life?" "Yes." "Haven't I cut your grass in summer and shoveled your walk in winter?" "Yes." "Don't you agree with all my policies and positions?" "Yes." "Then why aren't you going to vote for me?" "Because you didn't ask me to." Considerable academic research confirms what O'Neill learned from this conversation: process counts. What's more, sustainable results are more often reached when all parties perceive the process as personal, respectful, straightforward, and fair.[1]

The Interests of the Full Set of Players. Less experienced negotiators sometimes become mesmerized by the aggregate economics of a deal and forget about the interests of players who are in a position to torpedo it. When the boards of pharmaceutical giants Glaxo and SmithKline Beecham publicly announced their merger in 1998, investors were thrilled, rapidly *increasing* the combined company's market capitalization by a stunning $20 billion. Yet despite prior agreement on who would occupy which top executive positions in the newly combined company, internal disagreement about management control and position resurfaced and sank the announced deal, and the $20 billion evaporated. (Overwhelming strategic logic ultimately drove the companies back together, but only after nearly two years had passed.) This episode confirms two related lessons. First, while favorable overall economics are generally necessary, they are often not sufficient. Second, keep all potentially influential internal players on your radar screen; don't lose sight of their interests or their capacity to affect the deal. What is "rational" for the whole may not be so for the parts.

It can be devilishly difficult to cure the reverse Midas touch. If you treat a potentially cooperative negotiation like a pure price deal, it will likely become one. Imagine a negotiator who expects a hardball, price-driven process. She initiates the bid by taking a tough preemptive position; the other side is likely to reciprocate. "Aha!" says the negotiator, her suspicions confirmed. "I *knew* this was just going to be a tough price deal."

A negotiator can often influence whether price will dominate or be kept in perspective. Consider negotiations between two companies trying to establish an equity joint venture. Among other issues, they are trying to place a value on each side's contribution to determine ownership shares. A negotiator might drive this process down two very different paths. A price-focused approach quickly isolates the valuation issue and then bangs out a resolution. Alternatively, the two sides could first flesh out a more specific shared vision for the joint venture (together envisioning the "pot of gold" they could create), probe to understand the most critical concerns of each side—including price—and craft trade-offs among the full set of issues to meet these interests. In the latter approach, price becomes a component or even an implication of a larger, longer term package, rather than the primary focus.

Some negotiations are indeed pure price deals and only about aggregate economics, but there is often much more to work with. Wise negotiators put the vital issue of price in perspective and don't straitjacket their view of the richer interests at stake. They work with the subjective as well as the objective, with the process and the relationship, with the "social contract" or spirit of a deal as well as its letter, and with the interests of the parts as well as the whole.

Mistake 3
Letting Positions Drive Out Interests

Three elements are at play in a negotiation. *Issues* are on the table for explicit agreement. *Positions* are one party's stands on the issues. *Interests* are underlying concerns that would be affected by the resolution. Of course, positions on issues reflect underlying interests, but they need not be identical. Suppose you're considering a job offer. The base salary will probably be an issue. Perhaps your position on that issue is that you need to earn $100,000. The interests underlying that position include your need for a good income but may also include status, security, new opportunities, and needs that can be met in ways other than salary. Yet even very experienced deal makers may see the essence of negotiation as a dance of positions. If incompatible positions finally converge, a deal is struck; if not, the negotiation ends in an impasse. By contrast, interest-driven bargainers see 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 better able to meet both sets of interests and thus create new value.

Consider a dispute over a dam project. Environmentalists and farmers opposed a U.S. power company's plans to build a dam. The two sides had irreconcilable positions: "absolutely yes" and "no way." Yet these incompatible positions masked compatible 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 new capacity and a greener image. After a costly legal stalemate, the three groups devised an interest-driven agreement that all of them considered preferable to continued court warfare. The agreement included a smaller dam built on a fast track, water flow guarantees, downstream habitat protection, and a trust fund to enhance whooping crane habitats elsewhere.

Despite the clear advantages of reconciling deeper interests, people have a built-in bias toward focusing on their own positions instead. This hardwired assumption that our interests are incompatible implies a zero-sum pie in which my gain is your loss. Research in psychology supports the mythical fixed-pie view as the norm. In a survey of 5,000 subjects in 32 negotiating studies, mostly carried out with monetary stakes, participants failed to realize compatible issues fully half of the time.[2] In real-world terms, this means that enormous value is unknowingly left uncreated as both sides walk away from money on the table.

Reverse Midas negotiators, for example, almost automatically fixate on price and bargaining positions to claim value. After the usual preliminaries, countless negotiations get serious when one side asks, "so, what's your position," or says, "here's my position." This positional approach often drives the process toward a ritual value-claiming dance. Great negotiators understand that the dance of bargaining positions is only the surface game; the real action takes place when they've probed behind positions for the full set of interests at stake. Reconciling interests to create value requires patience and a willingness to research the other side, ask many questions, and listen. It would be silly to write off either price or bargaining position; both are extremely important. And there is, of course, a limit to joint value creation. The trick is to recognize and productively manage the tension between cooperative actions needed to create value and competitive ones needed to claim it. The pie must be both expanded and divided.

Mistake 4
Searching Too Hard for Common Ground

Conventional wisdom says we negotiate to overcome the differences that divide us. So, typically, we're advised to find win-win agreements by searching for common ground. Common ground is generally a good thing. Yet many of the most frequently overlooked sources of value in negotiation arise from differences among the parties.

Recall the battle over the dam. The solution—a smaller dam, water flow guarantees, habitat conservation—did not result from common interests but because farmers, environmentalists, and the utility had different priorities. Similarly, when Egypt and Israel were negotiating over the Sinai, their positions on where to draw the boundary were incompatible. When negotiators went beyond the opposing positions, however, they uncovered a vital difference of underlying interest and priority: the Israelis cared more about security, while the Egyptians cared more about sovereignty. The solution was a demilitarized zone under the Egyptian flag. Differences of interest or priority can open the door to unbundling different elements and giving each party what it values the most—at the least cost to the other.

Even when an issue seems purely economic, finding differences can break open deadlocked deals. Consider a small technology company

Solving Teddy Roosevelt's Negotiation Problem

Theodore Roosevelt, nearing the end of a hard-fought presidential election campaign in 1912, scheduled a final whistle-stop journey. At each stop, Roosevelt planned to clinch the crowd's votes by distributing an elegant pamphlet with a stern presidential portrait on the cover and a stirring speech, "Confession of Faith," inside. Some three million copies had been printed when a campaign worker noticed a small line under the photograph on each brochure that read, "Moffett Studios, Chicago." Since Moffett held the copyright, the unauthorized use of the photo could cost the campaign one dollar per reproduction. With no time to reprint the brochure, what was the campaign to do?

Not using the pamphlets at all would damage Roosevelt's election prospects. Yet, if they went ahead, a scandal could easily erupt very close to the election, and the campaign could be liable for an unaffordable sum. Campaign workers quickly realized they would have to negotiate with Moffett. But research by their Chicago operatives turned up bad news: although early in his career as a photographer, Moffett had been taken with the potential of this new artistic medium, he had received little recognition. Now, Moffett was financially hard up and bitterly approaching retirement with a single-minded focus on money.

Dispirited, the campaign workers approached campaign manager George Perkins, a former partner of J.P. Morgan. Perkins lost no time summoning his stenographer to dispatch the following cable to Moffett Studios: "We are planning to distribute millions of pamphlets with Roosevelt's picture on the cover. It will be great publicity for the studio whose photograph we use. How much will you pay us to use yours? Respond immediately." Shortly, Moffett replied: "We've never done this before, but under the circumstances we'd be pleased to offer you $250." Reportedly, Perkins accepted—without dickering for more.

Perkins's misleading approach raises ethical yellow flags and is anything but a model negotiation on how to enhance working relationships. Yet this case raises a very interesting question: why did the campaign workers find the prospect of this negotiation so difficult? Their inability to see what Perkins immediately perceived flowed from their anxious obsession with their own side's problem: their blunders so far, the high risk of losing the election, a potential $3 million exposure, an urgent deadline, and no cash to meet Moffett's likely demands for something the campaign vitally needed. Had they avoided mistake 1 by pausing for a moment and thinking about how Moffett saw his problem, they would have realized that Moffett didn't even know he had a problem. Perkins's tactical genius was to recognize the essence of the negotiator's central task: shape how your counterpart sees its problem such that it chooses what you want.

The campaign workers were paralyzed in the face of what they saw as sharply conflicting monetary interests and their pathetic BATNA. From their perspective, Moffett's only choice was how to exploit their desperation at the prospect of losing the presidency. By contrast, dodging mistake 5, Perkins immediately grasped the importance of favorably shaping Moffett's BATNA perceptions, both of the campaign's (awful) no-deal options and Moffett's (powerful) one. Perkins looked beyond price, positions, and common ground (mistakes 2, 3, and 4) and used Moffett's different interests to frame the photographer's choice as "the value of publicity and recognition." Had he assumed this would be a standard, hardball price deal by offering a small amount to start, not only would this assumption have been dead wrong but, worse, it would have been self-fulfilling.

Risky and ethically problematic? Yes…but Perkins saw his options as certain disaster versus some chance of avoiding it. And was Moffett really entitled to a $3 million windfall, avoidable had the campaign caught its oversight a week beforehand? Hard to say, but this historical footnote, which I've greatly embellished, illuminates the intersection of negotiating mistakes, tactics, and ethics.

Many people associate the ability to inflict or withstand damage with bargaining power, but your willingness to walk away to an apparently good BATNA is often more important.

and its investors, stuck in a tough negotiation with a large strategic acquirer adamant about paying much less than the asking price. On investigation, it turned out that the acquirer was actually willing to pay the higher price but was concerned about raising price expectations in a fast-moving sector in which it planned to make more acquisitions. The solution was for the two sides to agree on a modest, well-publicized initial cash purchase price; the deal included complex-sounding contingencies that virtually guaranteed a much higher price later.

Differences in forecasts can also fuel joint gains. Suppose an entrepreneur who is genuinely optimistic about the prospects of her fast-growing company faces a potential buyer who likes the company but is much more skeptical about the company's future cash flow. They have negotiated in good faith, but, at the end of the day, the two sides sharply disagree on the likely future of the company and so cannot find an acceptable sale price. Instead of seeing these different forecasts as a barrier, a savvy negotiator could use them to bridge the value gap by proposing a deal in which the buyer pays a fixed amount now and a contingent amount later on the basis of the company's future performance. Properly structured with adequate incentives and monitoring mechanisms, such a contingent payment, or "earn-out," can appear quite valuable to the optimistic seller—who expects to get her higher valuation—but not very costly to the less optimistic buyer. And willingness to accept such a contingent deal may signal that the seller's confidence in the business is genuine. Both may find the deal much more attractive than walking away.

A host of other differences make up the raw material for joint gains. A less risk-averse party can "insure" a more risk-averse one. An impatient party can get most of the early money, while his more patient counterpart can get considerably more over a longer period of time. Differences in cost or revenue structure, tax status, or regulatory arrangements between two parties can be converted into gains for both. Indeed, conducting a disciplined "differences inventory" is at least as important a task as is identifying areas of common ground. After all, if we were all clones of one another, with the same interests, beliefs, attitudes toward risk and time, assets, and so on, there would be little to negotiate. While common ground helps, differences drive deals. But negotiators who don't actively search for differences rarely find them.

Mistake 5
Neglecting BATNAs

BATNAs—the acronym for "best alternative to a negotiated agreement" coined years ago by Roger Fisher, Bill Ury, and Bruce Patton in their book *Getting to Yes*—reflect the course of action a party would take if the proposed deal were not possible. A BATNA may involve walking away, prolonging a stalemate, approaching another potential buyer, making something in-house rather than procuring it externally, going to court rather than settling, forming a different alliance, or going on strike. BATNAs set the threshold—in terms of the full set of interests—that any acceptable agreement must exceed. Both parties doing better than their BATNAs is a necessary condition for an agreement. Thus BATNAs define a zone of possible agreement and determine its location.

A strong BATNA is an important negotiation tool. Many people associate the ability to inflict or withstand damage with bargaining power, but your willingness to walk away to an apparently good BATNA is often more important. The better your BATNA appears both to you and to the other party, the more credible your threat to walk away becomes, and the more it can serve as leverage to improve the deal. Roger Fisher has dramatized this point by asking which you would prefer to have in your back pocket during a compensation negotiation with your boss: a gun or a terrific job offer from a desirable employer who is also a serious competitor of your company?

Not only should you assess your own BATNA, you should also think carefully about the other side's. Doing so can alert you to surprising possibilities. In one instance, a British company hoped to sell a poorly performing division for a bit more than its depreciated asset value of $7 million to one of two potential buyers. Realizing that these buyers were fierce rivals in other markets, the seller speculated that each party might be willing to pay an inflated price to keep the other from getting the division. So they made sure that each suitor knew the other was looking and skillfully cultivated the interest of both companies. The division sold for $45 million.

Negotiators must also be careful not to inadvertently damage their BATNAs. I saw that happen at a Canadian chemical manufacturing company that had decided to sell a large but nonstrategic division to raise urgently needed cash. The CEO charged his second-in-command with negotiating the sale of the division at the highest possible price.

The target buyer was an Australian company, whose chief executive was an old school friend of the Canadian CEO. The Australian chief executive let it be known that his company was interested in the deal but that his senior management was consumed, at the moment, with other priorities. If the Australian company could have a nine-month negotiating exclusive to "confirm their seriousness about the sale," the Australian chief executive would dedicate the top personnel to make the deal happen. A chief-to-chief agreement to that effect was struck. Pity the second-in-command, charged with urgently maximizing cash from this sale, as he jetted off to Sydney with no meaningful alternative for nine endless months to whatever price the Australians offered.

Negotiators often become preoccupied with tactics, trying to improve the potential deal while neglecting their own BATNA and that of the other side. Yet the real negotiation problem is "deal versus BATNA," not one or the other in isolation. Your potential deal and your BATNA should work together as the two blades of the scissors do to cut a piece of paper.

Mistake 6
Failing to Correct for Skewed Vision

You may be crystal clear on the right negotiation problem—but you can't solve it correctly without a firm understanding of both sides' interests, BATNAs, valuations, likely actions, and so on. Yet, just as a pilot's sense of the horizon at night or in a storm can be wildly inaccurate, the psychology of perception systematically leads negotiators to major errors.[3]

Self-Serving Role Bias. People tend unconsciously to interpret information pertaining to their own side in a strongly self-serving way. The following experiment shows the process at work. Harvard researchers gave a large group of executives financial and industry information about one company negotiating to acquire another. The executive subjects were randomly assigned to the negotiating roles of buyer or seller; the information provided to each side was identical. After plenty of time for analysis, all subjects were asked for their private assessment of the target company's fair value—as distinct from how they might portray that value in the bargaining process. Those assigned the role of seller gave median valuations more than twice those given by the executives assigned to the buyer's role. These valuation gulfs had no basis in fact; they were driven entirely by random role assignments.

Even comparatively modest role biases can blow up potential deals. Suppose a plaintiff believes he has a 70% chance of winning a million-dollar judgment, while the defense thinks the plaintiff has only a 50% chance of winning. This means that, in settlement talks, the plaintiff's expected BATNA for a court battle (to get $700,000 minus legal fees) will exceed the defendant's assessment of his exposure (to pay $500,000 plus fees). Without significant risk aversion, the divergent assessments would block any out-of-court settlement. This cognitive role bias helps explain why Microsoft took such a confrontational approach in its recent struggle with the U.S. Department of Justice. The company certainly appeared overoptimistic about its chances in court. Similarly, Arthur Andersen likely exhibited overconfidence in its arbitration prospects over the terms of separation from Andersen Consulting (now Accenture). Getting too committed to your point of view—"believing your own line"—is an extremely common mistake.

Partisan Perceptions. While we systematically err in processing information critical to our own side, we are even worse at assessing the other side—especially in an adversarial situation. Extensive research has documented an unconscious mechanism that enhances one's own side, "portraying it as more talented, honest, and morally upright," while simultaneously vilifying the opposition. This often leads to exaggerated perceptions of the other side's position and overestimates of the actual substantive conflict. To an outsider, those caught up in disintegrating partnerships or marriages often appear to hold exaggerated views of each other. Such partisan perceptions can become even more virulent among people on each side of divides, such as Israelis and Palestinians, Bosnian Muslims and the Serbs, or Catholics and Protestants in Northern Ireland.

Partisan perceptions can easily become self-fulfilling prophecies. Experiments testing the effects of teachers' expectations of students, psychiatrists' diagnoses of mental patients, and platoon leaders' expectations of their trainees confirm the notion that partisan perceptions often shape behavior. At the negotiating table, clinging firmly to the idea that one's counterpart is stubborn or extreme, for example, is likely to trigger just that behavior, sharply reducing the possibility of reaching a constructive agreement.

As disagreement and conflict intensify, sophisticated negotiators should expect biased perceptions, both on their own side and the other side. Less seasoned players tend to be shocked and outraged by perceived extremism and are wholly unaware that their own views are likely colored by their roles. How to counteract these powerful biases? Just knowing that they exist helps. Seeking the views of outside, uninvolved parties is useful, too. And having people on your side prepare the strongest possible case for the other side can serve as the basis for preparatory role-playing that can generate valuable insights. A few years ago, helping a client get ready for a tough deal, I suggested that the client create a detailed "brief" for each side and have the team's best people negotiate for the other side in a reverse role-play. The brief for my client's side was lengthy, eloquent, and persuasive. Tellingly, the brief describing the other side's situation was only two pages long and consisted mainly of reasons for conceding quickly to my client's superior arguments. Not only were my client's executives fixated on their own problem (mistake 1), their perceptions of each side were also hopelessly biased (mistake 6). To prepare effectively, they needed to undertake significant competitive research and reality-test their views with uninvolved outsiders.

From Merely Effective to Superior Negotiation

So you have navigated the shoals of merely effective deal making to face what is truly the right problem. You have focused on the full set of interests of all parties, rather than fixating on price and positions. You have looked beyond common ground to unearth value-creating differences. You have assessed and shaped BATNAs. You have taken steps to avoid role biases and partisan perceptions. In short, you have grasped your own problem clearly and have sought to understand and influence the other side's such that what it chooses is what you want.

Plenty of errors still lie in wait: cultural gaffes, an irritating style, inadvertent signals of disrespect or untrustworthiness, miscommunication, bad timing, revealing too much or too little, a poorly designed agenda, sequencing mistakes, negotiating with the wrong person on the other side, personalizing issues, and so on. Even if you manage to avoid these mistakes as well, you may still run into difficulties by approaching the negotiation far too narrowly, taking too many of the elements of the "problem" as fixed.

The very best negotiators take a broader approach to setting up and solving the right problem. With a keen sense of the potential value to be created as their guiding beacon, these negotiators are game-changing entrepreneurs. They envision the most promising architecture and take action to bring it into being. These virtuoso negotiators not only play the game as given at the table, they are masters at setting it up and changing it away from the table to maximize the chances for better results.

To advance the full set of their interests, they understand and shape the other side's choice—deal versus no deal—such that the other chooses what they want. As François de Callières, an eighteenth-century commentator, once put it, negotiation masters possess "the supreme art of making every man offer him as a gift that which it was his chief design to secure."

1. W. Chan Kim and Renée Mauborgne, "Fair Process: Managing in the Knowledge Economy," HBR July–August 1997.

2. This and other studies illustrating this point can be found in Leigh Thompson's *The Mind and Heart of the Negotiator* (Prentice Hall, 1998).

3. See Robert J. Robinson, "Errors in Social Judgment: Implications for Negotiation and Conflict Resolution, Part I: Biased Assimilation of Information," Harvard Business School, 1997 and Robert J. Robinson, "Errors in Social Judgment: Implications for Negotiation and Conflict Resolution, Part II: Partisan Perceptions," Harvard Business School, 1997.

Reprint R0104E; *Harvard Business Review*
OnPoint 9411
To order, see the next page
or call 800-988-0886 or 617-783-7500
or go to www.hbr.org

Six Habits of Merely Effective Negotiators

Further Reading

ARTICLES

Change the Way You Persuade
by Gary A. Williams and Robert B. Miller
Harvard Business Review
May 2002
Product no. 9969

Williams and Miller introduce another obstacle to effective negotiating: not understanding how the other party makes decisions. Executives typically fall into one of five decision-making styles: **Charismatics** are intrigued by new ideas, but base final decisions on balanced information and impact on the bottom line. **Thinkers** are risk-averse and need lots of information before making a decision. **Skeptics** are suspicious of data that don't fit their worldview and, therefore, follow their guts. **Followers** make decisions based on how trusted colleagues have acted in the past. And **controllers** focus on facts and analyses because of their own fears and uncertainties.

If you know your negotiating partner's preferences for hearing or seeing certain types of information, you can frame your argument in the most appropriate way and improve your odds of getting the outcome you desire.

Fair Process: Managing in the Knowledge Economy
by W. Chan Kim and Renée Mauborgne
Harvard Business Review
July–August 1997
Product no. 407X

This article focuses on **fair communication process**—one of the four nonfinancial interests Sebenius cites. A fair process builds trust between negotiators, encouraging people to share knowledge and make decisions based on proposed plans' merits. Three qualities define a fair process: 1) **engagement**—participants give their opinions and test each other's assumptions, 2) **explanation**—participants understand the reasons for the final decision, and 3) **expectation clarity**—participants grasp the final decision's implications. Negotiations marked by trust create sustainable value for both parties.

3rd article from the collection:
Masterful Negotiating, 2nd Edition

Getting Past Yes

Negotiating as if Implementation Mattered

by Danny Ertel

Included with this full-text *Harvard Business Review* article:

Product 8339

Harvard Business Review OnPoint

Getting Past Yes

Negotiating as if Implementation Mattered

The Idea in Brief

Why do so many deals that looked great on paper end up in tatters? Negotiators on both sides probably focused too much on closing the deals and squeezing the best terms out of one another—and not enough on implementation. Bargainers with this **deal-maker mind-set** never ask how—or whether—their agreement will work *in practice*. Once implementation begins, surprises and disappointments crop up—often torpedoing the deal.

How to avoid this scenario? Bargain using an **implementation mind-set**. Define negotiation not as closing the deal but as setting the stage for a successful long-term relationship. Brainstorm and discuss problems you might encounter 12 months down the road. Help the other party think through the agreement's practical implications, so your counterparts won't promise something they can't deliver. Ensure that both sides' stakeholders support the deal. And communicate a consistent message about the deal's terms and spirit to both parties' implementation teams.

Deals negotiated from an implementation mind-set don't "sizzle" like those struck by bargainers practicing brinksmanship. But as companies like HP Services and Procter & Gamble have discovered, a deal's real value comes not from a signature on a document but from the real work performed long after the ink has dried.

The Idea in Practice

To adopt an implementation mind-set, apply these practices *before* inking a deal:

START WITH THE END IN MIND

Imagine that it's a year into implementation of your deal. Ask:

- **Is the deal working?** What metrics are you using to measure its success?
- **What has gone wrong so far?** What have you done to put things back on course? What signals suggest trouble ahead?
- **What capabilities are needed to accomplish the deal's objectives?** What skills do your implementation teams need? Who has tried to block implementation, and how have you responded?

By answering these questions now, you avoid being blindsided by surprises during implementation.

HELP THE OTHER PARTY PREPARE

Coming to the table prepared to negotiate a workable deal isn't enough—your *counterpart* must also prepare. Before negotiations begin, encourage the other party to consult with their internal stakeholders throughout the bargaining process. Explain who you think the key players are, who should be involved early on, and what key questions about implementation you're asking yourself.

TREAT ALIGNMENT AS A SHARED RESPONSIBILITY

Jointly address how you'll build broad support for the deal's implementation. Identify both parties' stakeholders—those who will make decisions, affect the deal's success through action or inaction, hold critical budgets, or possess crucial information. Map how and when different stakeholders' input will be solicited. Ask who needs to know what in order to support the deal and carry out their part of its implementation.

SEND ONE MESSAGE

Ensure that each team responsible for implementing the deal understands what the agreement is meant to accomplish. Communicate *one* message to them about the terms of the deal, the spirit in which it was negotiated, and the trade-offs that were made to craft the final contract.

▶ Example:
During IBM Global Services' "joint handoff meetings," the company's negotiators *and* their counterparts brief implementation teams on what's in the contract, what's different or nonstandard, and what the deal's ultimate intent is.

MANAGE NEGOTIATION LIKE A BUSINESS PROCESS

Establish a disciplined process for negotiation preparation in your company. Provide training in collaborative negotiation tools and techniques for negotiators *and* implementers. Use post-negotiation reviews to capture learning. And reward individuals for the delivered success of the deals they negotiated—not for how those deals look on paper.

Techniques that can help you seal a deal may end up torpedoing the relationship when it's time to put the deal into operation.

Getting Past Yes

Negotiating as if Implementation Mattered

by Danny Ertel

In July 1998, AT&T and BT announced a new 50/50 joint venture that promised to bring global interconnectivity to multinational customers. Concert, as the venture was called, was launched with great fanfare and even greater expectations: The $10 billion start-up would pool assets, talent, and relationships and was expected to log $1 billion in profits from day one. Just three years later, Concert was out of business. It had laid off 2,300 employees, announced $7 billion in charges, and returned its infrastructure assets to the parent companies. To be sure, the weak market played a role in Concert's demise, but the way the deal was put together certainly hammered a few nails into the coffin.

For example, AT&T's deal makers scored what they probably considered a valuable win when they negotiated a way for AT&T Solutions to retain key multinational customers for itself. As a result, AT&T and BT ended up in direct competition for business—exactly what the Concert venture was supposed to help prevent. For its part, BT seemingly outnegotiated AT&T by refusing to contribute to AT&T's purchase of the IBM Global Network. That move saved BT money, but it muddied Concert's strategy, leaving the start-up to contend with overlapping products. In 2000, Concert announced a complex new arrangement that was supposed to clarify its strategy, but many questions about account ownership, revenue recognition, and competing offerings went unanswered. Ultimately, the two parent companies pulled the plug on the venture.[1]

Concert is hardly the only alliance that began with a signed contract and a champagne toast but ended in bitter disappointment. Examples abound of deals that look terrific on paper but never materialize into effective, value-creating endeavors. And it's not just alliances that can go bad during implementation. Misfortune can befall a whole range of agreements that involve two or more parties—mergers, acquisitions, outsourcing contracts, even internal projects that require the cooperation of more than one department. Although the problem often masquerades as one of execution, its roots are anchored in the deal's inception, when negotiators act as if their main objective were to sign the deal. To be successful, negotiators must recognize that signing a contract is just the beginning of the process of creating value.

During the past 20 years, I've analyzed or assisted in hundreds of complex negotiations, both through my research at the Harvard Negotiation Project and through my consulting practice. And I've seen countless deals that were signed with optimism fall apart during implementation, despite the care and creativity with which their terms were crafted. The crux of the problem is that the very person everyone thinks is central to the deal—the negotiator—is often the one who undermines the partnership's ability to succeed. The real challenge lies not in hammering out little victories on the way to signing on the dotted line but in designing a deal that works in practice.

The Danger of Deal Makers

It's easy to see where the deal maker mind-set comes from. The media glorifies big-name deal makers like Donald Trump, Michael Ovitz, and Bruce Wasserstein. Books like *You Can Negotiate Anything, Trump: The Art of the Deal*, and even my own partners' *Getting to Yes* all position the end of the negotiation as the destination. And most companies evaluate and compensate negotiators based on the size of the deals they're signing.

But what kind of behavior does this approach create? People who view the contract as the conclusion and see themselves as solely responsible for getting there behave very differently from those who see the agreement as just the beginning and believe their role is to ensure that the parties involved actually realize the value they are trying to create. These two camps have conflicting opinions about the use of surprise and the sharing of information. They also differ in how much attention they pay to whether the parties' commitments are realistic, whether their stakeholders are sufficiently aligned, and whether those who must implement the deal can establish a suitable working relationship with one another. (For a comparison of how different mind-sets affect negotiation behaviors, see the exhibit "Deal-Minded Negotiators Versus Implementation-Minded Negotiators.")

This isn't to say deal makers are sleazy, dishonest, or unethical. Being a deal maker means being a good closer. The deal maker mind-set is the ideal approach in certain circumstances. For example, when negotiating the sale of an asset in which title will simply be transferred and the parties will have little or no need to work together, getting the signatures on the page really does define success.

But frequently a signed contract represents a commitment to work together to create value. When that's the case, the manner in which the parties "get to yes" matters a great deal. Unfortunately, many organizations structure their negotiation teams and manage the flow of information in ways that actually hurt a deal's chances of being implemented well.

An organization that embraces the deal maker approach, for instance, tends to structure its business development teams in a way that drives an ever growing stream of new deals. These dedicated teams, responsible for keeping negotiations on track and getting deals done, build tactical expertise, acquire knowledge of useful contract terms, and go on to sign more deals. But they also become detached from implementation and are likely to focus more on the agreement than on its business impact. Just think about the language deal-making teams use ("closing" a deal, putting a deal "to bed") and how their performance is measured and rewarded (in terms of the number and size of deals closed and the time required to close them). These teams want to sign a piece of paper and book the expected value; they couldn't care less about launching a relationship.

The much talked about Business Affairs engine at AOL under David Colburn is one extreme example. The group became so focused on doing deals—the larger and more lopsided the better—that it lost sight of the need to have its business partners actually remain in business or to have its deals produce more than paper value. In 2002, following internal investigations and probes by the SEC and the Department of Justice, AOL Time Warner concluded it needed to restate financial results to account for the real value (or lack thereof) created by some of those deals.[2]

The deal maker mentality also fosters the take-no-prisoners attitude common in procurement organizations. The aim: Squeeze your counterpart for the best possible deal you can get. Instead of focusing on deal volume, as

Danny Ertel (dertel@vantagepartners.com) is a founder and director of Vantage Partners, a consulting firm in Boston, and CEO and chairman of Vantage Technologies, which develops software to enable negotiation and relationship management processes.

Deal-Minded Negotiators Versus Implementation-Minded Negotiators

Deal-Minded Assumption	Deal-Minded Behaviors	Negotiation Tactics	Implementation-Minded Assumption	Implementation-Minded Behaviors
Assumption "Surprising them helps me. They may commit to something they might not have otherwise, and we'll get a better deal."	**Behaviors** Introduce new actors or information at strategic points in negotiation. Raise new issues at the end.	*Surprise*	**Assumption** "Surprising them puts us at risk. They may commit to something they cannot deliver or will regret."	**Behaviors** Propose agendas in advance so both parties can prepare. Suggest questions to be discussed, and provide relevant data. Raise issues early.
Assumption "It's not my role to equip them with relevant information or to correct their misperceptions."	**Behaviors** Withhold information. Fail to correct mistaken impressions.	*Information sharing*	**Assumption** "I don't want them entering this deal feeling duped. I want their goodwill during implementation, not their grudging compliance."	**Behaviors** Create a joint fact-gathering group. Commission third-party research and analysis. Question everyone's assumptions openly.
Assumption "My job is to get the deal closed. It's worth putting a little pressure on them now and coping with their unhappiness later."	**Behaviors** Create artificial deadlines. Threaten escalation. Make "this day only" offers.	*Closing techniques*	**Assumption** "My job is to create value by crafting a workable agreement. Investing a little extra time in making sure both sides are aligned is worth the effort."	**Behaviors** Define interests that need to be considered for the deal to be successful. Define joint communication strategy.
Assumptions "As long as they commit, that's all that matters. Afterward, it's their problem if they don't deliver."	**Behaviors** Focus on documenting commitments rather than on testing the practicality of those commitments. Rely on penalty clauses for protection.	*Realistic commitments*	**Assumption** "If they fail to deliver, we don't get the value we expect. "	**Behaviors** Ask tough questions about both parties' ability to deliver. Make implementability a shared concern. Establish early warning systems and contingency plans.
Assumption "The fewer people involved in making this decision, the better and faster this will go."	**Behaviors** Limit participation in discussions to decision makers. Keep outsiders in the dark until it is too late for them to derail things.	*Decision making and stakeholders*	**Assumption** "If we both fail to involve key stakeholders sufficiently and early enough, whatever time we save now will be lost during implementation."	**Behaviors** Repeatedly ask about stakeholders: Whose approval is needed? Whose cooperation is required? Who might interfere with implementation?

business development engines do, these groups concentrate on how many concessions they can get. The desire to win outweighs the costs of signing a deal that cannot work in practice because the supplier will never be able to make enough money.

Think about how companies handle negotiations with outsourcing providers. Few organizations contract out enough of their work to have as much expertise as the providers themselves in negotiating deal structures, terms and conditions, metrics, pricing, and the like, so they frequently engage a third-party adviser to help level the playing field as they select an outsourcer and hammer out a contract. Some advisers actually trumpet their role in commoditizing the providers' solutions so they can create "apples to apples" comparison charts, engender competitive bidding, and drive down prices. To maximize competitive tension, they exert tight control, blocking virtually all communications between would-be customers and service providers. That means the outsourcers have almost no opportunity to design solutions tailored to the customer's unique business drivers.

The results are fairly predictable. The deal structure that both customer and provider teams are left to implement is the one that was easiest to compare with other bids, not the one that would have created the most value. Worse yet, when the negotiators on each side exit the process, the people responsible for making the deal work are virtual strangers and lack a nuanced understanding of why issues were handled the way they were. Furthermore, neither side has earned the trust of its partner during negotiations. The hard feelings created by the hired guns can linger for years.

The fact is, organizations that depend on negotiations for growth can't afford to abdicate management responsibility for the process. It would be foolhardy to leave negotiations entirely up to the individual wits and skills of those sitting at the table on any given day. That's why some corporations have taken steps to make negotiation an organizational competence. They have made the process more structured by, for instance, applying Six Sigma discipline or community of practice principles to improve outcomes and learn from past experiences.

Sarbanes-Oxley and an emphasis on greater management accountability will only reinforce this trend. As more companies (and their auditors) recognize the need to move to a controls-based approach for their deal-making processes—be they in sales, sourcing, or business development—they will need to implement metrics, tools, and process disciplines that preserve creativity and let managers truly manage negotiators. How they do so, and how they define the role of the negotiator, will determine whether deals end up creating or destroying value.

Negotiating for Implementation

Making the leap to an implementation mind-set requires five shifts.

1. Start with the end in mind. For the involved parties to reap the benefits outlined in the agreement, goodwill and collaboration are needed during implementation. That's why negotiation teams should carry out a simple "benefit of hindsight" exercise as part of their preparation.

Imagine that it is 12 months into the deal, and ask yourself:

Is the deal working? What metrics are we using? If quantitative metrics are too hard to define, what other indications of success can we use?

What has gone wrong so far? What have we done to put things back on course? What were some early warning signals that the deal may not meet its objectives?

What capabilities are necessary to accomplish our objectives? What processes and tools must be in place? What skills must the implementa-

A New Mind-Set

Five approaches can help your negotiating team transition from a deal maker mentality to an implementation mind-set.

1. Start with the end in mind. Imagine the deal 12 months out: What has gone wrong? How do you know if it's a success? Who should have been involved earlier?

2. Help them prepare, too. Surprising the other side doesn't make sense, because if they promise things they can't deliver, you both lose.

3. Treat alignment as a shared responsibility. If your counterpart's interests aren't aligned, it's your problem, too.

4. Send one message. Brief implementation teams on both sides of the deal together so everyone has the same information.

5. Manage negotiation like a business process. Combine a disciplined preparation process with postnegotiation reviews.

"Leaving some money on the table is OK if you realize that the most expensive deal is one that fails."

tion teams have? What attitudes or assumptions are required of those who must implement the deal? Who has tried to block implementation, and how have we responded?

If negotiators are required to answer those kinds of questions before the deal is finalized, they cannot help but behave differently. For example, if the negotiators of the Concert joint venture had followed that line of questioning before closing the deal, they might have asked themselves, "What good is winning the right to keep customers out of the deal if doing so leads to competition between the alliance's parents? And if we have to take that risk, can we put in mechanisms now to help mitigate it?" Raising those tough questions probably wouldn't have made a negotiator popular, but it might have led to different terms in the deal and certainly to different processes and metrics in the implementation plan.

Most organizations with experience in negotiating complex deals know that some terms have a tendency to come back and bite them during implementation. For example, in 50/50 ventures, the partner with greater leverage often secures the right to break ties if the new venture's steering committee should ever come to an impasse on an issue. In practice, though, that means executives from the dominant party who go into negotiations to resolve such impasses don't really have to engage with the other side. At the end of the day, they know they can simply impose their decision. But when that happens, the relationship is frequently broken beyond repair.

Tom Finn, vice president of strategic planning and alliances at Procter & Gamble Pharmaceuticals, has made it his mission to incorporate tough lessons like that into the negotiation process itself. Although Finn's alliance management responsibilities technically don't start until after a deal has been negotiated by the P&G Pharmaceuticals business development organization, Finn jumps into the negotiation process to ensure negotiators do not bargain for terms that will cause trouble down the road. "It's not just a matter of a win-win philosophy," he says. "It's about incorporating our alliance managers' hard-won experience with terms that cause implementation problems and not letting those terms into our deals."

Finn and his team avoid things like step-down royalties and unequal profit splits with 50/50 expense sharing, to name just a few. "It's important that the partners be provided [with] incentives to do the right thing," Finn says. "When those incentives shift, you tend to end up [with] difficulties." Step-down royalties, for instance, are a common structure in the industry. They're predicated on the assumption that a brand is made or lost in the first three years, so that thereafter, payments to the originator should go down. But P&G Pharmaceuticals believes it is important to provide incentives to the partner to continue to work hard over time. As for concerns about overpaying for the licensed compound in the latter years of the contract, Finn asserts that "leaving some money on the table is OK if you realize that the most expensive deal is one that fails."

2. Help them prepare, too. If implementation is the name of the game, then coming to the table well prepared is necessary—but not sufficient. Your counterpart must also be prepared to negotiate a workable deal. Some negotiators believe they can gain advantage by surprising the other side. But surprise confers advantage only because the counterpart has failed to think through all the implications of a proposal and might mistakenly commit to something it wouldn't have if it had been better prepared. While that kind of an advantage might pay off in a simple buy-sell transaction, it fails miserably—for both sides—in any situation that requires a long-term working relationship.

That's why it's in your best interest to engage with your counterpart before negotiations start. Encourage the other party to do its homework and consult with its internal stakeholders before and throughout the negotiation process. Let the team know who you think the key players are, who should be involved early on, how you hope to build implementation planning into the negotiation process, and what key questions you are asking yourself.

Take the example of Equitas, a major reinsurer in the London market. When preparing for commutations negotiations—whereby two reinsurers settle their mutual book of business—the company sends its counterpart a thorough kickoff package, which is used as the agenda for the negotiation launch meeting. This "commutations action pack" describes how the reinsurer's own commutations department is organized, what its preferred approach to a commutations negotiation is, and what stages it follows. It also includes a suggested approach to policy reconciliation and due diligence and explains what data the reinsurer has available—even acknowledging its imperfections and gaps. The package describes critical issues for the reinsurer and provides sample agreements and memorandums for various stages of the process.

The kickoff meeting thus offers a structured environment in which the parties can educate each other on their decision-making processes and their expectations for the deal. The language of the commutations action pack and the collaborative spirit of the kickoff meeting are designed to help the parties get to know each other and settle on a way of working together before they start making the difficult trade-offs that will be required of them. By establishing an agreed-upon process for how and when to communicate with brokers about the deal, the two sides are better able to manage the tension between the need to include stakeholders who are critical to implementation and the need to maintain confidentiality before the deal is signed.

Aventis Pharma is another example of how measured disclosure of background and other information can pave the way to smoother negotiations and stronger implementation. Like many of its peers, the British pharmaceutical giant wants potential biotech partners to see it as a partner of choice and value a relationship with the company for more than the size of the royalty check involved. To that end, Aventis has developed and piloted a "negotiation launch" process, which it describes as a meeting during which parties about to enter into formal negotiations plan together for those negotiations. Such collaboration allows both sides to identify potential issues and set up an agreed upon process and time line. The company asserts that while "formally launching negotiations with a counterpart may seem unorthodox to some," the entire negotiation process runs more efficiently and effectively when partners "take the time to discuss how they will negotiate before beginning."

3. Treat alignment as a shared responsibility. If their interests are not aligned, and they cannot deliver fully, that's not just their problem—it's your problem, too.

Unfortunately, deal makers often rely on secrecy to achieve their goals (after all, a stakeholder who doesn't know about a deal can't object). But leaving internal stakeholders in the dark about a potential deal can have negative consequences. Individuals and departments that will be directly affected don't have a chance to weigh in with suggestions to mitigate risks or improve the outcome. And people with relevant information about the deal don't share it, because they have no idea it's needed. Instead, the typical reaction managers have when confronted late in the game with news of a deal that will affect their department is "Not with my FTEs, you don't."

Turning a blind eye to likely alignment problems on the other side of the table is one of the leading reasons alliances break down and one of the major sources of conflict in outsourcing deals. Many companies, for instance, have outsourced some of their human resource or finance and accounting processes. Service providers, for their part, often move labor-intensive processes to Web-based self-service systems to gain process efficiencies. If users find the new self-service system frustrating or intimidating, though, they make repeated (and expensive) calls to service centers or fax in handwritten forms. As a result, processing costs jump from pennies per transaction to tens of dollars per transaction.

But during the initial negotiation, buyers routinely fail to disclose just how undisciplined their processes are and how resistant to change their cultures might be. After all, they think, those problems will be the provider's headache once the deal is signed. Meanwhile, to make requested price concessions, providers often drop line items from their proposals intended to educate employees and support the new process. In exchange for such concessions, with a wink and a nod, negotiators assure the provider that the buyers will dedicate internal resources to change-management and communication efforts. No one asks whether business unit managers support the deal or whether function leaders are prepared to make the transition from managing the actual work to managing the relationship with an external provider. Everyone simply agrees, the deal is signed, and the frustration begins.

As managers and employees work around the new self-service system, the provider's costs increase, the service levels fall (because the provider was not staffed for the high level of calls and faxes), and customer satisfaction plummets. Finger-pointing ensues, which must then be addressed through expensive additions to the contract, costly modifications to processes and technology, and additional burdens on a communication and change effort already laden with baggage from the initial failure.

Building alignment is among negotiators' least favorite activities. The deal makers often feel as if they are wasting precious time "negotiating internally" instead of working their magic on the other side. But without acceptance of the deal by those who are essential to its implementation (or who can place obstacles in the way), proceeding with the deal is even more wasteful. Alignment is a classic "pay me now or pay me later" problem. To understand whether the deal will work in practice, the negotiation process must encompass not only subject matter experts or those with bargaining authority but also those who will actually have to take critical actions or refrain from pursuing conflicting avenues later.

Because significant deals often require both parties to preserve some degree of confidentiality, the matter of involving the right stakeholders at the right time is more effectively addressed jointly than unilaterally. With an understanding of who the different stakeholders are—including those who have necessary information, those who hold critical budgets, those who manage important third-party relationships, and so on—a joint communications subteam can then map how, when, and with whom different inputs will be solicited and different categories of information might be shared. For example, some stakeholders may need to know that the negotiations are taking place but not the identity of the counterpart. Others may need only to be aware that the organization is seeking to form a partnership so they can prepare for the potential effects of an eventual deal. And while some must remain in the dark, suitable proxies should be identified to ensure that their perspectives (and the roles they will play during implementation) are considered at the table.

4. Send one message. Complex deals require the participation of many people during implementation, so once the agreement is in place, it's essential that the team that created it get everyone up to speed on the terms of the deal, on the mind-set under which it was negotiated, and on the trade-offs that were made in crafting the final contract. When each implementation team is given the contract in a vacuum and then is left to interpret it separately, each develops a different picture of what the deal is meant to accomplish, of the negotiators' intentions, and of what wasn't actually written in the document but each had imagined would be true in practice.

"If your objective is to have a deal you can implement, then you want the actual people who will be there, after the negotiators move on, up front and listening to the dialogue and the give-and-take during the negotiation so they understand how you got to the agreed solution," says Steve Fenn, vice president for retail industry and former VP for global business development at IBM Global Services. "But we can't always have the delivery executive at the table, and our customer doesn't always know who from their side is going to be around to lead the relationship." To address this challenge, Fenn uses joint hand-off meetings, at which he and his counterpart brief both sides of the delivery equation. "We tell them what's in the contract, what is different or nonstandard, what the schedules cover. But more important, we clarify the intent of the deal: Here's what we had difficulty with, and here's what we ended up with and why. We don't try to reinterpret the language of the contract but [we do try] to discuss openly the spirit of the contract." These meetings are usually attended by the individual who developed the statement of work, the person who priced the deal, the contracts and negotiation lead, and occasionally legal counsel. This team briefs the project executive in charge of the implementation effort and the executive's direct reports. Participation on the customer side varies, because the early days in an outsourcing relationship are often hectic and full of turnover. But Fenn works with the project executive and the sales team to identify the key customer representatives who should be invited to the hand-off briefing.

Negotiators who know they have to brief the implementation team with their counterparts after the deal is signed will approach the entire negotiation differently. They'll start asking the sort of tough questions at the negotiating table that they imagine they'll have to field during the postdeal briefings. And as they think about how they will explain the deal to the delivery team, they will begin to marshal defensible precedents, norms, industry practices, and objective criteria. Such standards of legitimacy strengthen the relationship because they emphasize persuasion rather than coercion. Ultimately, this practice makes a deal more viable because attention shifts from the individual negotiators and their personalities toward the merits of the arrangement.

5. Manage negotiation like a business process. Negotiating as if implementation mattered isn't a simple task. You must worry about the costs and challenges of execution rather than just getting the other side to say yes. You must carry out all the internal consultations necessary to build alignment. And you must make sure your counterparts are as prepared as you are. Each of these actions can feel like a big time sink. Deal makers don't want to spend time negotiating with their own people to build alignment or risk having their counterparts pull out once they know all the details. If a company wants its negotiators to sign deals that create real value, though, it has to weed out that deal maker mentality from its ranks. Fortunately, it can be done with simple processes and controls. (For an example of how HP Services structures its negotiation process, see the sidebar "Negotiating Credibility.")

More and more outsourcing and procurement firms are adopting a disciplined negotiation preparation process. Some even require a manager to review the output of that process before authorizing the negotiator to proceed with the deal. KLA-Tencor, a semiconductor production equipment maker, uses the electronic tools available through its supplier-management Web site for this purpose, for example. Its managers can capture valuable information about negotiators' practices, including the issues they are coming up against, the options they are proposing, the standards of legitimacy they are relying on, and the walkaway alternatives they are considering. Coupled with simple postnegotiation reviews, this information can yield powerful organizational insights.

Preparing for successful implementation is hard work, and it has a lot less sizzle than the brinksmanship characteristic of the negotiation process itself. To overcome the natural tendency to ignore feasibility questions, it's im-

Negotiating Credibility

HP Services is growing in a highly competitive market, and its success is partly due to its approach to negotiating large outsourcing transactions. In a maturing market, where top tier providers can demonstrate comparable capabilities and where price variations inevitably diminish after companies bid against one another time and time again, a provider's ability to manage a relationship and build trust are key differentiators. The negotiation and the set of interactions leading up to it give the customer a first taste of what it will be like to solve problems with the provider during the life of the contract. "Decisions made by clients regarding selection have as much to do with the company they want to do business with as with price, capability, and reliability," acknowledges Steve Huhn, HP Services' vice president of strategic outsourcing. "Negotiating these kinds of deals requires being honest, open, and credible. Integrity is critical to our credibility."

Huhn's team of negotiators uses a well-structured process designed to make sure that the philosophy of integrity is pervasive throughout the negotiation and not just a function of who happens to be at the table on any given day. It begins with the formation of a negotiation team. Because transition in complex outsourcing transactions represents a period of high vulnerability, it is important to involve implementation staff early on; that way, any commitments made can be validated by those who will be responsible for keeping them. A typical negotiation team consists of a business leader, or pursuit lead, who is usually responsible for developing the business and structuring the transaction; a contract specialist, who brings experience with outsourcing contract terms and conditions; and the proposed client manager, who will be responsible for delivery.

Negotiation leads work with a high degree of autonomy. Huhn believes that a negotiator without authority is little more than a messenger, and messengers are unlikely to earn trust or build working relationships with counterparts. At HP, negotiators earn that autonomy by preparing extensively with templates and by reviewing key deal parameters with management. A negotiator's mandate does not just cover price: It also encompasses margins, cash flow, and ROI at different times in the life of the contract; the treatment of transferred employees; the ways various kinds of risk will be allocated; and how the relationship will be governed. All these interests must be addressed—both in preparation and at the negotiation table.

HP's outsourcing negotiators are subject to informal reviews with full-time deal coaches as well as formal milestone reviews. The reviews, which are designed to get key stakeholders committed to implementation, happen before the formal proposal is delivered and before the deal is signed.

The pursuit team leaders aren't finished once the agreement is signed. In fact, they retain responsibility during the transition phase and are considered "liable" for the deal's performance during the next 18 to 24 months. That means negotiators can't simply jump to the next alluring deal. On the contrary, they have a vested interest in making sure the closed deal actually meets its targets.

portant for management to send a clear message about the value of postdeal implementation. It must reward individuals, at least in part, based on the delivered success of the deals they negotiate, not on how those deals look on paper. This practice is fairly standard among outsourcing service providers; it's one that should be adopted more broadly.

Improving the implementability of deals is not just about layering controls or capturing data. After all, a manager's strength has much to do with the skills she chooses to build and reward and the example she sets with her own questions and actions. In the health care arena, where payer-provider contentions are legion, forward-thinking payers and innovative providers are among those trying to change the dynamics of deals and develop agreements that work better. Blue Cross and Blue Shield of Florida, for example, has been working to institutionalize an approach to payer-provider negotiations that strengthens the working relationship and supports implementation. Training in collaborative negotiation tools and techniques has been rolled down from the senior executives to the negotiators to the support and analysis teams. Even more important, those who manage relationships with providers and are responsible for implementing the agreements are given the same training and tools. In other words, the entire process of putting the deal together, making it work, and feeding the lessons learned through implementation back into the negotiation process has been tightly integrated.

• • •

Most competitive runners will tell you that if you train to get to the finish line, you will lose the race. To win, you have to envision your goal as just beyond the finish line so you will blow right past it at full speed. The same is true for a negotiator: If signing the document is your ultimate goal, you will fall short of a winning deal.

The product of a negotiation isn't a document; it's the value produced once the parties have done what they agreed to do. Negotiators who understand that prepare differently than deal makers do. They don't ask, "What might they be willing to accept?" but rather, "How do we create value together?" They also negotiate differently, recognizing that value comes not from a signature but from real work performed long after the ink has dried.

1. For more perspectives on Concert's demise, see Margie Semilof's 2001 article "Concert Plays Its Last Note" on InternetWeek.com; Brian Washburn's 2000 article "Disconcerted" on Tele.com; and Charles Hodson's 2001 article "Concert: What Went Wrong?" on CNN.com.

2. See Alec Klein, "Lord of the Flies," the *Washington Post*, June 15, 2003, and Gary Rivlin, "AOL's Rough Riders," *Industry Standard*, October 30, 2000, for more information on the AOL Business Affairs department's practices.

Reprint R0411C
Harvard Business Review OnPoint 8339
To order, see the next page
or call 800-988-0886 or 617-783-7500
or go to www.hbr.org

Getting Past Yes

Negotiating as if Implementation Mattered

Further Reading

ARTICLES

When to Walk Away from a Deal
by Geoffrey Cullinan, Jean-Marc Le Roux, and Rolf-Magnus Weddigen
Harvard Business Review
April 2004
Product no. R0404F

This article emphasizes the importance of an implementation mind-set during mergers and acquisitions. In the realm of M&A, deal making is glamorous. Crafting agreements with implementation in mind is not. For that reason, too many negotiators get "deal fever." Rather than using due diligence to analyze the deal's strategic logic and the acquirer's ability to realize value from the agreement, they use it to justify the financial viability of their prospective acquisition.

The authors suggest ways in which companies can improve their due diligence capabilities. In particular, effective due diligence requires answering four basic questions: 1) What are we really buying? 2) What is the target's stand-alone value? 3) Where are the synergies—and the potential pitfalls? 4) What's our walk-away price? Answering these questions will affirm—or quash—the strategic rationale for a prospective acquisition.

Turning Negotiation into a Corporate Capability
by Danny Ertel
Harvard Business Review
November 2000
Product no. 5394

Ertel sheds additional light on the concept of managing negotiation like a business process. Four practices can help ensure that deals conducted by your company collectively make—not break—your firm's bottom line:

1) *Create a negotiation infrastructure.* Provide all negotiators with information on past and current deals, and clarify each agreement's connection to corporate priorities. 2) *Broaden your measures of success.* Evaluate deals not just by their financial merits but also by how well they improve communication with suppliers, stimulate fresher solutions, and generate more workable commitments. Link those measures to negotiators' incentives. 3) *Distinguish between the deal and the relationship.* Agree not to resolve deal-related issues, such as conflicts over pricing, by exacting concessions that would erode trust and mutual respect. 4) *Learn to walk away from a deal.* Define your BATNA—your best alternatives to a negotiated agreement—before the bargaining begins. Then evaluate proposed agreements against your BATNA. If your BATNA is better than any offering put on the table, walk away.

To Order

For reprints, *Harvard Business Review* OnPoint orders, and subscriptions to *Harvard Business Review:*
Call 800-988-0886 or 617-783-7500.
Go to www.hbr.org

For customized and quantity orders of reprints and *Harvard Business Review* OnPoint products:
Call Frank Tamoshunas at 617-783-7626,
or e-mail him at ftamoshunas@hbsp.harvard.edu

Harvard Business Review OnPoint

4th article from the collection:
Masterful Negotiating, 2nd Edition

Negotiating the Spirit of the Deal

by Ron S. Fortgang, David A. Lax, and James K. Sebenius

Included with this full-text *Harvard Business Review* article:

Product 3051

Negotiating the Spirit of the Deal

The Idea in Brief

The deal looked so promising: a merger of Deutsche Bank and Dresdner, which would have produced the world's third largest bank. But the agreement unraveled within hours of its announcement.

What happened? While the parties had agreed to the *letter* of the deal—the economic contract—they neglected its *spirit*—the **social contract**—which included assumptions that the new entity wouldn't sell a Dresdner division.

Though parties may agree to identical terms on paper, they may have contrasting expectations about how their agreement will work *in practice*. Unless they concur on the social contract—that is, by explicitly discussing assumptions *before* cementing a deal—the agreement may sour.

The Idea in Practice

THE SOCIAL CONTRACT

The social contract has two levels:

- **The underlying social contract** answers, *What* is our agreement's nature and purpose? Is this a short- or long-term deal? A discrete transaction or partnership? How much autonomy will each party have? What decisions will each participate in? Parties differing in basic ways—small versus large, entrepreneurial versus bureaucratic, and so on—often hold divergent views of the underlying social contract.
- **The ongoing social contract** answers, *How* will we work together? How will we communicate? Consult with each other? Resolve disputes? Handle surprises?

RISK FACTORS

Lack of awareness causes most social-contract misunderstandings. Parties form expectations about how the deal will be implemented but don't necessarily discuss them. Certain conditions are especially ripe for misunderstandings:

- **Cultures clash.** When a U.S. plant manager instigated downsizing at NCR Japan, differing cultural expectations about lifetime employment sparked organization of a union and a supplier boycott at NCR Japan.
- **Third parties drive the deal.** When investment bankers or other professional negotiators drive deals, conflicting social-contract assumptions can be overlooked. Involve those who must make the deal work in the negotiating process—where they can begin forging a positive social contract.

▶ Example:
When Matsushita Electric considered acquiring MCA (owner of movie studios and record companies), former talent agent Michael Ovitz brokered the deal. To build momentum, Ovitz *separated* the parties during negotiation—unwittingly causing each side to form distorted views of the other's intentions. Result? Post-deal friction and Matsushita's sale of MCA to Seagram several years later—at a $1.64 billion loss.

- **Too few parties are involved in the deal.** Even tightly aligned social and economic contracts can fragment if only a few individuals share the agreement's expectations. Widen the web of dependencies throughout your company to cultivate more sustainable relationships—and greater commitment to implementing agreements.

DOVETAILING THE CONTRACTS

To boost your deal's chances of success, make economic and social contracts mutually reinforcing.

▶ Example:
To save its business in the late 1980s, Chrysler defined a new *social* contract emphasizing cooperation and long-term partnerships with suppliers, expecting them to improve their own performance *and* enhance Chrysler's overall operations. It also revised its *economic* contracts. Rather than selecting lowest bidders, it prequalified suppliers based on their engineering and manufacturing capabilities and past performance, then lengthened contract life from two to four years. The payoff? A 32% reduction in vehicle-development time and rise in per-vehicle profit from $250 to $2,110.

You know how to hammer out the terms of an economic contract—but what about the social contract?

Negotiating the Spirit of the Deal

by Ron S. Fortgang, David A. Lax, and James K. Sebenius

Experienced negotiators are generally comfortable working out the terms of an economic contract: They bargain for the best price, haggle over equity splits, and iron out detailed exit clauses. But these same seasoned professionals often spend so much time hammering out the letter of the deal that they pay little attention to the social contract, or the spirit of the deal. So while the parties agree to the same terms on paper, they may actually have very different expectations about how the agreement will work in practice. Without their arriving at a true meeting of the minds, the deal they've signed may sour.

Consider the fate of a joint venture launched by two chains: a national hospital organization and a regional health care provider. Executives at these organizations realized that two of their hospitals, located near each other, were competing for doctors' practices and building redundant facilities. In response, they enthusiastically negotiated a joint venture that would manage the two hospitals and buy or build needed facilities within their shared area.

The two partners created a governance system and appointed managers to whom they offered incentives to maximize the venture's profits. Yet despite compelling economics, the arrangement didn't last—largely because the partners held clashing but unspoken assumptions about the joint venture's purpose. Moreover, the contract they actually negotiated didn't fit either organization's real objective.

Because the national chain had only one hospital in the region, it resisted economically sensible steps, like eliminating redundant departments, which were consistent with the joint venture's formal contract and management incentives. The national chain was understandably concerned that the joint venture might one day fail and its hospital—now offering reduced services—would no longer be competitive. Executives at the regional chain, by contrast, saw the joint venture as a way to extend and rationalize their regional network. They persisted in trying to make the regional operation more efficient, but the formal contract and management incentives—to maximize only the joint venture's profits—conflicted with that mission, too. Had the parties better understood each other's views of the underlying purpose of the venture in the first place, they might have forged a more limited, but more effective, agreement. Such a deal would have ignored possible operating efficiencies and focused on gains from jointly buying practices and building shared feeder facilities. As it happened, each organization's underlying expectations clashed both with the other's and with the actual contract, transforming enthusiasm and potential profits into a swamp of recriminations.

Based on our participation in hundreds of negotiations and a growing body of academic work on implicit and "relational" contracts, we have come to believe that cultivating a shared understanding of the spirit of the deal can be every bit as important as agreeing on the letter of the deal.[1] This article explains what the social contract is, shows how the parties' views of the social contract can sharply diverge, explores problems that arise when the social and economic contracts are at odds, and suggests ways to negotiate both so that they are independently strong as well as mutually reinforcing.

The Underlying Social Contract

The term "social contract" carries political connotations, bringing to mind the writings of Locke and Rousseau, but we use the concept on a radically smaller scale. In a negotiation context, we define the social contract in terms of the parties' expectations. This contract has two levels: The *underlying social contract* answers the question, What? (For instance, are we working out a series of discrete transactions or a real partnership? *What* is the real nature, extent, and duration of our agreement?) The *ongoing social contract* answers the question, How? (In practice, *how* will we make decisions, handle unforeseen events, communicate, and resolve disputes?)

We'll look at the underlying social contract first. Too many negotiators leave the underlying social contract implicit, which can cause misunderstandings and ultimately poison a relationship. Rather than discuss their expectations during negotiations, the parties project their own reasonable, but sometimes incompatible, assumptions about the fundamental nature of the deal. Some people, for instance, view a contract as a starting point for a problem-solving relationship. Dan Orum, the president of Online Operations at Oxygen Media, is in that camp. He says, "The five words I most hate to hear in my business dealings [are], 'It's not in the contract.'" If the person he is negotiating with takes a more legalistic approach and sees the contract as an exhaustive description of mutual obligations, issues are bound to arise. That's why parties should strive for a real meeting of the minds on whether they are entering a problem-solving partnership or simply making a series of discrete transactions. Each approach is valid; the important thing is to recognize the potential for differing views and to try to align them.

Like clashing views of partnership versus transaction, divergent assumptions about autonomy versus conformity may create problems when the difference is identified late in the game. Consider what happened to an entrepreneur who failed to get clarity on this issue before she sold her boutique enterprise to a very eager corporate buyer. She decided to sell and agreed to stay on for five years because the purchaser assured her that she was "the essential player to lead the business to the next level" and because she envisioned her still-autonomous unit turbocharged by the acquirer's size, reach, and resources. The responsible corporate executive passionately shared her goal of taking the boutique concept global, but he simply assumed that only by following highly disciplined corporate procedures would the global rollout be possible.

Soon after the celebratory dinner, the unhappy reality began to dawn on the seller in the form of a legion of junior staff from HR delivering policy manuals and patronizing lectures on who bought whom. Even though the provisions of the economic contract—the letter of the deal on financial terms, governance, and the like—were acceptable to her, there had clearly been no meeting of the minds on the underlying social contract. Chances are, this will be one more failed acquisition despite its strategic logic, the skills and good intentions of both sides, and an acceptable economic contract.

Failure to make the underlying social contract explicit is by no means limited to small companies like the boutique enterprise. Take, for example, the proposed megamerger be-

Ron S. Fortgang (fortgang@negotiate.com), **David A. Lax** (lax@negotiate.com), and **James K. Sebenius** (jsebenius@hbs.edu) are principals of Lax Sebenius, a negotiation-strategy consulting firm in Concord, Massachusetts. They are members of the Negotiation Roundtable forum at Harvard Business School in Boston, where Sebenius is the Gordon Donaldson Professor of Business Administration. Lax and Sebenius are coauthors of *The Manager as Negotiator: Bargaining for Cooperation and Competitive Gain* (Free Press, 1986), and they are working on another book, tentatively titled *3-D Negotiation: Creating and Claiming Value for the Long Term*.

The most common causes of social contract problems are lack of awareness and benign neglect.

tween Deutsche Bank and Dresdner, which would have produced the third-largest bank in the world (with $1.25 trillion in assets), leading many people to view the planned deal as a landmark in the transformation of Europe's financial services industry. The banks planned to merge their retail operations, enabling them to close about 700 branches and concentrate on their more profitable corporate businesses.

Throughout the negotiations, Deutsche chairman Rolf Breuer implied that this was to be a "merger of equals." Although the new bank was to bear Deutsche Bank's name, the corporate color was to be Dresdner's green. Bernhard Walter, Dresdner's chairman, was particularly concerned that Deutsche would sell off Dresdner Kleinwort Benson (DrKB), which had contributed more than half of Dresdner's 1999 pretax profits. Aware of Dresdner's sensitivities, Breuer uttered words that would soon haunt him: "[DrKB] is a jewel, and we want to keep that jewel. It will be neither closed nor sold, and any reports to the contrary are 'barer Unsinn' [pure nonsense]." Satisfied, Walter declared, "A merger means you combine both parts into a new whole. I never had the slightest feeling that things would go differently."

Yet within hours of the joint announcement of the merger, Deutsche apparently decided to sell DrKB, believing that its own investment-banking arm had further global reach. And by selling the unit, Breuer wouldn't have to go through the long and expensive process of integrating DrKB's 7,500 employees. When DrKB staff members learned of this decision (from a *Financial Times* article by a source who came to be called the "torchman"), they moved to a state of alert.[2] The report mobilized powerful internal opponents to block the deal. In light of this clash—together with growing investor doubts about the deal's business rationale and actual terms—the merger was called off, after a month of furious negotiations, protestations of misunderstanding, and efforts at compromise. During that time, Deutsche's share price plunged 19%, and Dresdner's fell almost as much. Whether by accident or design, Deutsche's vision of the underlying social contract was at odds with Dresdner's, and those opposing assumptions helped to doom the deal.

Parties that differ in basic ways are especially likely to hold divergent views of the underlying social contract. Such differences could involve the companies' size, organizational approach, and business focus: small versus large, entrepreneurial versus bureaucratic, centrally managed versus decentralized, and finance driven versus operations centered. For example, serious postalliance ownership conflict between Northwest Airlines and KLM Royal Dutch Airlines was less due to a cultural clash than it was exacerbated by a disagreement over management focus and risk tolerance. Pieter Bouw, KLM's Dutch president, stressed airline operations and conservative financial management. Gary Wilson and Al Checchi were high-profile, risk-taking financiers who had acquired Northwest in a highly leveraged buyout. Even agreement on the terms of an economic contract could not resolve those fundamentally different approaches to running an airline.

The examples given thus far illustrate some of the issues that need to be aired about whether minds have truly met on the underlying social contract. Other questions include, Is this a short- or long-term deal? Is it openended or task specific? Will it be learning or production oriented? Do we believe in lifetime or at-will employment? In countless deals, the tangible terms may seem fine, but the two sides realize only when it's too late that the reality doesn't match their expectations.

Although agreeing on the underlying social contract is important, a degree of what diplomats call "constructive ambiguity" is sometimes appropriate. Imagine, for example, two companies that both want control in a proposed equity joint venture. If pressed to fully resolve the issue at the outset, they would probably walk away from the deal. Yet if they could agree to launch a pilot venture with shared control, even if each side still believes that it must have total control in the ultimate venture, the deal might build their confidence in their ability to work together—even without such control. Success in the pilot could change the way they approach the social contract in the larger deal. As the French saying goes, "There could be no treaties without conflicting mental reservations." The trick, of course, is to distinguish true confidence-building steps from the papering over of fatal differences.

The Ongoing Social Contract

Just as important as the underlying social contract is the ongoing social contract. It answers the question, How will we work together? Properly negotiated, it outlines the broad process expectations for how the parties will interact: norms for communication, consultation, and decision making; how unforeseen events will be handled; dispute resolution; conditions and means for renegotiation; and the like.

A positive ongoing social contract can foster efficient sharing of information; lower the costs of complex adaptation; permit rapid exploitation of unexpected opportunities without the parties having to write, monitor, and enforce complete contracts; and reduce transaction costs and even fears of exploitation. In fact, in a 1997 study of North American and Asian automakers and suppliers, then Wharton professor Jeffrey Dyer found that "General Motors procurement (transaction) costs were more than twice those of Chrysler's and six times higher than Toyota's. GM's transaction costs are persistently higher…because suppliers view GM as a much less trustworthy organization."

Clearly, a well-functioning ongoing social contract is beneficial, but too often, partners hold conflicting expectations. Imagine, for example, that a global manufacturer has a joint venture with a major local distributor. The relationship runs smoothly until the manufacturer approaches another distributor about selling a different product line. Since the economic contract governing their joint venture said nothing about the new line, the manufacturer may think it perfectly reasonable to use another distributor. But the first distributor may have expected to have been given the opportunity and may think that the manufacturer has acted in bad faith. Because their assumptions were never made clear, their relationship suffers, even though no actual breach of contract has occurred.

Because conscious efforts to shape the social contract can help stave off problems like this, we suggest that both sides conduct an audit of sorts. They should formally ask such straightforward questions as, How will we handle proprietary information? About what actions—inside and outside the bounds of the deal—will we inform each other? How do we properly launch a partnership? (For more on questions to ask in an audit, see the sidebar "Conducting an Audit: Sample Questions.")

A final note on forging a productive ongoing social contract: It is often beneficial for senior executives to be involved in every stage of the deal. Ford and Mazda did an excellent job at this. In 1969, the automakers began a remarkable strategic partnership, initially driven by Ford's search for a low-cost production source and Mazda's desire to break into the U.S. market. Serious disputes erupted because of U.S.—Japanese political tensions, efforts to protect proprietary technology, cultural differences, product design, and material selection. To deal with these problems, senior executives (three top managers from Ford and Mazda and six other operating heads) held a three-day summit every eight months. The first two days of these summits were devoted to strategy and operations, but the third typically functioned to repair or realign the social contract as needed.

Risk Factors

The most common causes of social contract problems are lack of awareness and benign neglect. The parties involved inevitably form expectations about how the deal will be carried out, whether they discuss them or not. Even if initially compatible, those expectations can silently shift in response to actions taken, even though no overt negotiation takes place. Of course, if costly misunderstandings are to be avoided, it's normally in the parties' best interests to make their expectations explicit and negotiable. And red flags should go up when especially challenging conditions, such as the following, are present:

When Cultures Clash. Negotiators from diverse organizational, professional, or national cultures often bring clashing assumptions to the table. As Ming-Jer Chen, the former director of Wharton's Global Chinese Business Initiative, explains in *Inside Chinese Business*, "The Chinese perceive contracts as too rigid to take new circumstances into account. Hence, there is no stigma to changing the terms of an agreement after it has been signed." That approach often frustrates businesspeople who assume a signed contract is a done deal and a complete, fixed description of each side's obligations.

Consider how cultural expectations damaged relationships at NCR Japan. While the company was U.S. owned, it had a history of stable lifetime employment and a union that enjoyed close relations with management. However, when the plant's first U.S. manager instigated downsizing to enhance returns—even though the plant was profitable—employees resisted this perceived violation of the underlying social contract. A second union was quickly organized, and it took a far more adversarial approach, demanding higher wages and insisting on job guarantees. Local suppliers saw the company as untrustworthy and refused to do business with it. A full decade after the plant manager was ousted, the second union remained in power, and the supplier boycott continued.

This example underscores not only the risk of underestimating differences between cultures but also the strength of the backlash to perceived breaches of a social contract. It's important to note here that not all breaches need be fatal; how they are handled can strengthen or rupture the social contract. If a breach is inadvertent, for example, managers normally should acknowledge it and reassure the other side that the "violation" was unintentional, not exploitative. Indeed, sincere efforts to rebuild confidence can often buttress the existing social contract.

When the Wrong Minds Meet. Sometimes problems arise not because of cultural differences but instead because the right people are not involved in negotiations. For example, when two CEOs negotiate a strategic partnership—say between a retailer and a supplier—they may stress the importance of many dimensions of cooperation, the mutual need for service and quality, and the long-term time horizon of the joint effort. Yet the retail buyer, for instance—mainly compensated on the basis of quarterly numbers—refers to "our strategic partnership" primarily to beat price

Conducting an Audit

Sample Questions

Discussing expectations *before* you sign a deal can greatly increase the odds of its success. To help you get that conversation started, here are some sample questions about the letter and spirit of your deal.

Underlying Social Contract

Real nature and purpose of the agreement

Do you envision a discrete transaction or a partnership? A merger of equals or something quite different? Are you building an institution for the long term or making a financial investment with a nearer horizon? What is the driving culture (operational, for example, or research oriented)?

Scope and duration

Is your agreement focused on a discrete, short-term task, or is it open-ended? Is it a likely prelude to a larger or different arrangement? What kinds of actions, even outside the bounds of the deal, do you expect to be told about? And about which do you expect some say?

Ongoing Social Contract

Consultation

How fully, formally, and frequently do you expect to consult with the other side? How extensively will you and your partner share or protect information?

Decision making

Beyond the formal governance mechanisms, by what process do you want to discuss and make decisions: by consensus or majority? Informally or formally? Who will be involved?

Dispute resolution

In the case of conflict, what approach do you expect to use: informal discussion, mediation, binding arbitration, court? What if disagreement persists?

Reevaluation and renegotiation

How will you handle unexpected challenges (such as changing economics or competitive dynamics)? What should trigger reevaluation or renegotiation, and what should you and your partner expect from each other in such a case?

Meeting of the Minds and Fit

Alignment

Do the economic and social contracts reinforce each other? If they don't, what should you and your partner do to align them?

Shared perceptions

All things considered, what's your view of the social and economic contracts? What do others in your organization think? What is the other side's view, and does it mesh with yours? How do you know? How can you and your partner ensure that you have a real meeting of the minds on your perceptions? If you discover divergent perceptions, how should you resolve them?

Different parties can hold wildly divergent expectations about the deal, even when they've signed the same piece of paper.

reductions out of the supplier. This problem will persist unless senior retail executives work to reset employees' expectations and incentives at the working level when they forge what *they* see as a strategic alliance.

There are other, less obvious, ways that key parties are inadvertently omitted from social contract negotiations. For example, in 1988, Komatsu, Japan's leader in earth-moving construction equipment, and U.S. conglomerate Dresser Industries combined their North American engineering, manufacturing, and marketing efforts to attain what they called a "mountain of treasure." Dresser sought Komatsu's design technology and a cash infusion for plant modernization and capital expenditures. Komatsu hoped to become a successful global player, so it wanted better North American market penetration. While preserving parallel brands and distributorships, Komatsu and Dresser created a 50-50 joint venture (Komatsu Dresser Corporation, or KDC), merging manufacturing, engineering, and finance operations. The joint venture maintained equal management representation on the six-person oversight committee and agreed to a $200 million investment. Beyond the economic terms of the companies' arrangement, they aimed to foster a strong social contract between their management teams.

Yet the implementation of their arrangement strained the emerging deal, and the separate distributors, who never subscribed to the new expectations, began competing for sales. Tensions escalated: Komatsu saw Dresser as backward and unresponsive; Dresser complained of learning about key Komatsu decisions after the fact. As the situation worsened, executives from both companies clamped down on communications, which prevented dealers from getting vital information about their counterpart's inventory levels and warranty coverage, further exacerbating the conflict.

Despite the efforts of industrial consultants and a last-minute plan to swap employees between the two companies, the dealer conflicts intensified, KDC market share declined sharply, losses mounted, 2,000 jobs were cut, and ultimately, the venture was dissolved. Subject to more than the usual cross-cultural hazards, KDC suffered: It failed to ensure that potentially influential parties bought into the new social contract.

When Third Parties Drive the Deal. Failure also happens when one team, such as the business development unit, uses a heavily price-driven process to negotiate an alliance or acquisition. Once the parties agree to the terms, the team "throws it over the fence" to operational management, which is stuck with the unenviable job of forging a strong, positive social contract after the fact. Jerry Kaplan, Go Technologies' founder, was especially critical of the negotiation process IBM used when it invested in Go. As Kaplan explains in *Startup*, "Rather than empowering the responsible party to make the deal, IBM assigns a professional negotiator, who knows or cares little for the substance of the agreement but has absolute authority." With a process like that, the right minds have little chance of truly meeting on the underlying social contract. It's almost always best to get the managers who must make the deal work involved in the negotiating process, where they can begin to forge a positive social contract.

In some cases, investment bankers or other deal makers with a powerful interest in making a transaction happen—for better or worse—can divert the principals' attention from possibly fatal differences in their views of the underlying social contract. For example, Matsushita Electric's primary rationale for paying $6.59 billion for MCA—owner of movie studios, record companies, and theme parks—was to ensure a steady flow of creative software for its global hardware businesses. Senior MCA management agreed to the acquisition, expecting the new, cash-rich Japanese parent to provide capital for acquiring more record companies, a television network, and so on, all of which were vital to helping the combined companies compete with rivals such as Disney and Cap Cities/ABC.

To get the deal done, however, Michael Ovitz, talent agent turned unorthodox corporate matchmaker, kept the parties mostly *apart* during the process, managing expectations separately on each side and building momentum until the deal was virtually closed. Neither side did its due diligence on their mutual perceptions of the real underlying social contract—partly because of the cultural chasms dividing old-line industrial Japan, creative Hollywood, and the New York financial community, but largely due to the deal-driving third party (Ovitz). As a result, each side had an optimistic but badly distorted view of the other's real intentions, leading to postdeal friction and the sale of MCA a few years later to Seagram, at a substantial loss to Matsushita both in financial terms (roughly $1.64 billion) and in prestige.

When Too Few Parties Are Involved in the Deal. Even a tightly aligned social and economic contract can be vulnerable if the expectations and agreements that underlie it are shared by only a select few. Senior partners in consulting firms, for instance, often depend primarily on their relationships with CEOs in their client companies. But if the CEO leaves, the consulting firm may lose the account. Consciously creating a wider web of involvements and dependencies throughout the firm would result in a more sustainable relationship—and greater commitment to implementation of agreed-upon recommendations—even when fewer participants could complete the consulting projects more efficiently.

Dovetailing the Contracts

It can be tempting to regard the social contract as unwritten and psychological and the economic contract as written and tangible. Yet the two can be productively dovetailed, with elements of the economic contract directly tied to the social one. Sometimes, the way to arrange such a fit seems obvious: A discrete, project-oriented agreement, for instance, should have clean, workable exit and termination provisions linked to both sides' understanding of when their shared objective is accomplished (or has become impossible). By contrast, if a deal's central aim is ongoing knowledge transfer, negotiators might set terms in the economic contract that would further that goal. For instance, when Wal-Mart and Procter & Gamble formed an alliance, interface team members signed confidentiality agreements, binding them from releasing information from team discussions even to their own parent companies. This cemented the group's commitment to total discretion and unleashed greater creativity, since members could try things out without fear that proprietary data would be shared outside the alliance team. Whatever the goal of the deal, it will generally be much easier to reach if the economic and social contracts are mutually reinforcing.

Some companies have mastered this skill. Italian apparel-maker Benetton, for example, has enjoyed many successes in new markets by following a tried-and-true formula. First, it establishes a local agent to develop licensees for products from Italy; then it develops local production capability, partnering with an area business for further market development. If that is successful, it buys out its partner, which typically retains a significant role, and integrates the foreign subsidiary into Benetton's global network. This staged approach has worked repeatedly because Benetton's contracts with its local partners explicitly detail the expected trajectory of the partnership and include formal mechanisms to accomplish its stated goal.

Many companies bungle the kind of smooth transitions Benetton often achieves because they fail to fully vet expectations about how their partnerships will run. If negotiations are handled poorly, high-status local partners can end up feeling betrayed and devalued by unexpected buyout initiatives. In addition, badly handled negotiations can result in unworkable valuation formulas that lead to disagreements, impasses, and the like. No successful private equity or venture capital firm would invest without establishing clear exit expectations for when milestones have been met or when circumstances have changed. Despite the potential awkwardness of negotiating a prenuptial agreement while heading into marriage, most companies should spell out similar provisions in their contracts.

To highlight how critical it is to dovetail the letter and spirit of a deal, we like to contrast two cases, negotiated by different experienced investors during the same year, in which subsequent attitudes toward the deal played key roles. The first involved prominent pediatricians who were looking for assistance to make a series of interactive CDs on parenting issues. A venture investor provided capital in return for a half-interest in the new company that would own all the doctors' products in this business area. The investor helped the doctors create a demo CD, wrote a business plan and marketing materials, and showed the entire package to key people at major software publishing houses. When a publisher expressed enthusiasm, the doctors surprised the investor by arguing that "he owned too much of the company," that "their ideas and reputation *were* the company," and that he should willingly reduce his stake. Needless to say, after all the time and effort he had invested in developing the company, he felt stung. When efforts at resolution reached an impasse, the new company languished, and the agreement blocked the doctors from developing their ideas elsewhere. Clearly, both sides neglected to work through different scenarios to test the perceived fairness and psychological sustainability of the deal, firm up their social contract, and alter the economics if necessary. As a result, great value was left unrealized.

By contrast, consider the contract a different investor designed when he was approached by a commercial banker who financed independent filmmakers. Although filmmaking is a risky business, the banker had not lost money on any of his 41 loans—in part because he had nurtured worldwide contacts and then presold foreign rights. Unhappy with his compensation as a bank employee, he was planning to leave and start a film-finance company. To get the fledgling business off the ground, he was seeking an $18 million investment to complement the $2 million he would contribute, and he offered the investor 90% of the new company.

Even though the investor's analysis projected a 100% annual rate of return on this investment, he turned down the offer and counterproposed a deal that was, in fact, more lucrative for the banker and less so for himself. The investor reasoned that in two or three years he would have simply taken the place of the bank, providing little but commodity capital, and the banker-entrepreneur would end up seeking a better deal from new capital sources. Therefore, his counteroffer contained a series of results-linked options: The banker would be able to buy back some of the investor's equity at a relatively low price after the investor had received his first $5 million, then buy back more equity after the investor had received the next $5 million, and so on. At each point under this deal structure, it would be in the banker's interest to stay in the relationship rather than to start out on his own again. The investor's projected rate of return on this offer was closer to 30%. But he preferred to sign a contract stipulating a 30% return that he believed he would actually receive rather than one with a 100% return on paper that would very likely spur the banker to abrogate at some point.

This investor understood that the spirit and letter of the deal needed to complement each other, whereas the investor who financed the doctors' CD development company struck an economically sensible but perhaps psychologically naive deal. The investor involved in the film-finance company structured his proposal to match predictable changes in circumstances and attitudes, and he found the right fit between the economic and social contracts.

Not only should the social contract complement the economic one, but the economic contract itself can also actually embody much of the social one. In the late 1980s, for example, Chrysler deliberately restructured both the letter and spirit of its contracts with suppliers to save its business. In 1989, the company faced a projected $1 billion overrun on a new program, a $4.5 billion unfunded pension liability, and a record loss of $664 million in the fourth quarter. To stop the hemorrhage, Chrysler decided to revolutionize its supplier relationships (along with other strategic measures). The automotive giant had traditionally given its business to the qualified bidder offering the lowest price, relying on supplier competition to drive down costs. Now it looked to form long-term partnerships with a subset of its traditional suppliers. In this new model, the partner was expected not only to improve its own performance but also to enhance Chrysler's operations beyond the supply relationship.

To support this new social contract, Chrysler substantially revised its economic contract. Rather than choosing the lowest price from qualified bidders, Chrysler prequalified a group of suppliers (1,140 out of its original 2,500) based on their advanced engineering and manufacturing capabilities and on their past performance in terms of on-time delivery and the like. Within this smaller set of players, Chrysler shifted from a system in which multiple suppliers competed over separate design, prototype, and production contracts to one in which a single supplier held primary responsibility for the combined design, prototype, and production of a component or system.

Under the old system, the average supplier contract lasted 2.1 years. The new approach saw the life of an average contract grow to 4.4 years, and Chrysler gave oral guarantees to more than 90% of its suppliers that the current business would remain with them for at least the life of the relevant model if performance targets were met. Because this new social contract stressed cooperation, Chrysler sought to ensure a fair profit for all parties. Instead of relying on commodity pricing to squeeze its suppliers, the automaker adopted a target-costing approach that worked backward from total cost to end user in order to calculate allowable costs for systems, subsystems, and components. Further, in keeping with the spirit of cooperation, Chrysler required suppliers to look beyond their own operations and find cost-saving possibilities within Chrysler itself equal to at least 5% of contract value—and suppliers would get half of the savings.

In essence, the written terms of the new economic contract—on selection, scope, duration, renewal, pricing, and performance requirements—consciously underpinned the new social contract emphasizing longer-term, integrated partnerships. The results were impressive: Chrysler was able to cut the time needed to develop a vehicle from an average of 234 weeks during the 1980s to 160 weeks in 1997—a 32% reduction. The cost of developing a vehicle plunged between 20% and 40% during the 1990s, and profit per vehicle jumped from an average of $250 during the late 1980s to a record of $2,110 in 1994. A new social contract deeply intertwined with the new economic one was largely responsible for these results.

Clearly, Chrysler saw dramatic improvements, but this particular social-economic contract combination isn't right for every company. Forging tight partnerships with a much smaller supplier base has some drawbacks. These include the difficulty of further shrinking the supplier base as relationships deepen as well as the risk of being "held up" by a critical supplier that has no real competition, especially in a tough economy. The crucial point, however, is that the underlying and ongoing social contracts consist of more than purely "psychological" expectations; they can and should be embedded in and complemented by the formal economic contract.

Common Misperceptions

We have witnessed dozens of deals unravel or fall well short of their potential because the participants failed to achieve a meeting of the minds on the spirit of the deal. To avoid that fate, make sure you don't fall prey to the following misperceptions:

Many people believe that the social contract is primarily about the working relationship. But as we've shown, the social contract defines not just how the relationship will proceed but also exactly what the real nature of the relationship is. So while the ongoing social contract covers the working relationship—including expectations about communication, consultation, decision making, dispute resolution, and opportunities for renegotiation—the underlying social contract outlines expectations about the fundamental purpose, extent, and duration of the deal.

Another popular misconception is that the term "social contract" means a cooperative, democratic, and participatory relationship. The social contract can embody those ideals, but it need not. Indeed, a productive social contract could detail an autocratic relationship or an "eat what you kill" culture. What's key is that both parties move toward shared expectations about the deal.

Many people think that a social contract implies that the parties involved have a shared view. As we've shown, different parties can hold wildly divergent expectations about the deal, even when they've signed the same piece of paper. Reaching a shared understanding is crucial, but getting to that point takes focus and energy. A healthy social contract, mutually understood, is a goal, not a given.

Too many people set themselves up for failure because they think negotiation stops when the ink dries. However, even after the economic contract has been signed and minds have met on the underlying social contract, the parties should consider adapting the agreement to changed circumstances. And, by continuing to invest in the ongoing social contract, the people involved can help avoid costly misinterpretations and can greatly enhance the value of the economic contract, especially when they want to explore new opportunities or must tackle unexpected challenges.

A final misperception, and one that bears repeating, is that the social contract must be primarily psychological, or "soft"—not something that can be spelled out in a written agreement. But as we've shown, key provisions of the social contract—such as expectations about the nature and duration of the relationship—can often be made explicit in the economic contract. Negotiating complementary economic and social contracts greatly improves the odds that the deal will deliver the benefits it promises on paper.

The authors wish to thank Ashish Nanda, who provided invaluable insights and examples, as well as John Hammond, Rosabeth Moss Kanter, Deborah Kolb, Richard Meyer, Ken Mildwaters, Howard Raiffa, Jeff Weiss, Michael Yoshino, and members of the Harvard Negotiation Roundtable.

1. Sources for such studies, along with a more complete set of sources for this article, can be downloaded from http://www.people.hbs.edu/jsebenius/hbr/negotiating_the_spirit_of_the_deal_v3-41b.pdf.

2. "Torch That Sent a Deal Down in Flames," *Financial Times*, April 12, 2000.

Reprint R0302E; *Harvard Business Review* OnPoint 3051
To order, see the next page
or call 800-988-0886 or 617-783-7500
or go to www.hbr.org

Negotiating the Spirit of the Deal

Further Reading

ARTICLES

Harnessing the Science of Persuasion
by Robert B. Cialdini
Harvard Business Review
October 2001
Product no. 7915

It's never going to be easy to hammer out economic and social contracts, but behavioral psychologists have found that the art of persuasion isn't all that mysterious. In fact, persuasion is governed by several principles that can be taught and applied: 1) People are more likely to follow someone who is similar to them. 2) People are more willing to cooperate with those who are not only similar to them, but like them, as well. 3) Experiments confirm that people treat you the way you treat them. 4) Individuals are more likely to keep promises they make voluntarily, publicly, and in writing. 5) People defer to experts.

Cialdini explores the implications of these principles have, and shows how mastering them will help you sway the undecided and convert the opposition.

Betting on the Future: The Virtues of Contingent Contracts
by Max H. Bazerman and James J. Gillespie
Harvard Business Review
September–October 1999
Product no. 99501

The ongoing social contract can also include differing expectations about the future—which can create an impasse. For example, the negotiators may be so confident in their predictions—or so suspicious of one another's motives—that they refuse to compromise.

A **contingent contract** can help break the impasse. The agreement's terms aren't finalized until the uncertain event in question—the contingency—takes place. Contingent contracts offer numerous benefits. For example, they enable a difference of opinion to become the basis of agreement, not an obstacle to it, and they reduce risk by sharing it among the parties.

Negotiating Without a Net: A Conversation with the NYPD's Dominick J. Misino
Harvard Business Review
October 2002
Product no. R0210C

A seasoned crisis negotiator, Misino has defused numerous potentially fatal hostage situations. How? He views each negotiation as a series of small agreements and orchestrates those agreements so his adversary learns to trust him and see his viewpoint.

For example, through **applied common sense,** Misino shows his adversary respect, explores alternatives to violence, and asks his adversary if he wants the truth—which creates a sense of agreement. These techniques are surprisingly applicable to business negotiations in which the parties seem equally intractable—and failure is not an option.