5-2017

Building negotiation capital

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Citation

BENOLIEL, Michael. Building negotiation capital. (2017). *Asian Management Insights (Singapore Management University)*. 4, (1), 54-60.

Available at: https://ink.library.smu.edu.sg/ami/67

Building Negotiation Capital

Today, unlike the marketing or supply chain tasks, the negotiation task remains unstructured, sporadic, often improvised, and rarely analysed critically in the post-deal stage.

By Michael Benoliel

In 1716, Francois de Callieres, a French diplomat wrote: "The art of negotiation with princes is so important that the fate of the greatest states often depends upon the good or bad conduct of negotiations and upon the degree of capacity the negotiators employed." This sound advice is yet to be appreciated in the business environment and the work of negotiation in modern organisations is valued much less than it should be.

To appreciate the important role of negotiation, one has to look no further than at the disappointing record of several large conglomerates. In the megamerger between America Online (AOL) and Time Warner, for example, about US$200 billion in shareholder value vanished.[1] In another mega deal, Robert Campeau, a Canadian businessman, overpaid to acquire Federated Department Stores and he declared bankruptcy two years later. In the US$5.8 billion acquisition of Rubbermaid by Newell, the former CEO of Newell admitted that his company had overpaid for this acquisition.[2] In another case, the US$39 billion acquisition agreement between AT&T and T-Mobile included a reverse termination fee clause. This meant that if AT&T failed to close the deal, it would pay T-Mobile US$4 billion in compensation, which was 10.25 percent of the total value of the deal, while the industry standard was only four to five percent. Because AT&T failed to anticipate the formidable resistance to the proposed acquisition, it had to pull out of the agreement and pay the hefty termination fee.

Likewise in small-scale deals, negotiators sometimes fail to pay attention to important details. For example, Brian Overstreet, the agent of Tarrel Brown, the football player with the San Francisco 49ers, negotiated successfully Brown's US$2.93 million salary for the 2013 football season. In July 2013, Brown failed to show up for after-season fitness training, and as a result, received a penalty of US$2 million. Brown, unaware of the penalty clause in his contract, was surprised. Needless to say, he fired his agent. One has to wonder why Overstreet agreed to such a huge penalty clause–68.3 percent of Brown's salary–in the first place?

Certainly, not all deal-makers perform poorly. Successful ones in companies like Cinven, a leading European private equity firm; Nestlé, a Swiss conglomerate and textbook acquirer; and Bain Capital, a top-tier private equity company, create great value because they have invested in building negotiation capabilities. Given the countless transactions that are carried out each year by organisations globally and the billions of dollars that these transactions are worth, one can easily see that even a fraction of a single percentage point improvement in a negotiator's deal-making capabilities can result in substantial value creation.

I suggest that building *negotiation capital* should be viewed both from the perspective of the individual (negotiator) and the organisation.

Negotiator's capital

Negotiators should have cognitive, emotional, social and cultural capabilities in order to create value in negotiation. I elaborate on these below.

COGNITIVE CAPITAL

Cognitive capital refers to the negotiator's ability to understand, analyse and synthesise the substance or the issues of the negotiation. Cognitive capital is particularly necessary in complex negotiations that require managing a vast amount of information, designing a negotiation strategy, formulating bundled trade-offs, creating multiple proposals, and making rational decisions. It is also important in ambiguous situations that present either risks or opportunities. Imagine an ongoing and unhappy business partnership among four partners who have different levels of power and priorities. The strongest partner is pressing hard to buy out the other three partners. As the weakest partner among the four, you are not sure whether to negotiate with the most powerful partner first, second or last. What should the negotiation sequence strategy be?

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EMOTIONAL CAPITAL

The modern rational approach to negotiation overemphasises the value of logic and rational decisions. Much less attention, until recently, was given to understanding the role of emotions in negotiation. Emotional capital refers to the value inherent in the negotiator's ability to perceive, comprehend, analyse and regulate emotions in the face of emotional challenges in negotiation. These challenges, such as anxiety, stress and frustration, are triggered by the inherent uncertainty and risk in any negotiation situation. A source of uncertainty, for example, is the unknown or unpredictable behaviour of the counterparty, who may use threats, deceptions or delay tactics.

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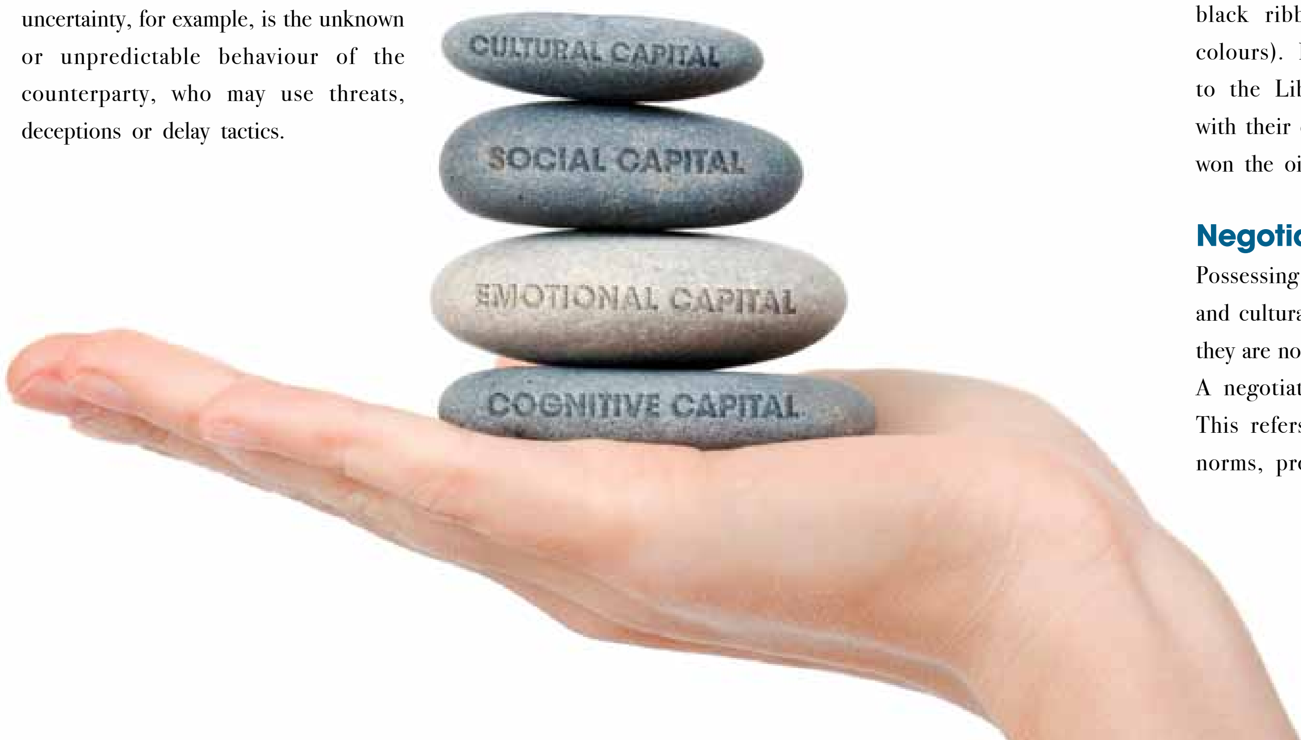
SOCIAL CAPITAL

Negotiation, at its core, is relational. Effective negotiators recognise that they are people first and negotiators second. Social capital refers to the inherent value in the negotiator's ability to develop relationships, nurture trust, show respect, be flexible, play fair, and build a positive reputation over time. Some of the benefits arising from having social capital include better access to information, greater ability to influence others, and increased solidarity that creates mutual obligations and reciprocal behaviour of give and take.



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CULTURAL CAPITAL

Increasingly, companies operate in complex multi-cultural environments. Cultural capital refers to the inherent value in the negotiator's ability to understand the nuances of the stated and unstated values and norms of different cultures, and negotiate effectively in complex cultural contexts. It is, for example, the ability to understand subtle cues of verbal and nonverbal communications; to understand the different approaches to expressing emotions; and to appreciate how different cultural patterns of relationships and trust building affect the negotiation process and outcomes.

For example, when Armand Hammer, the culturally sensitive CEO of Occidental Petroleum, presented his bid to get a Libyan oil concession, it was written on a sheepskin parchment, rolled up, and tied with green and black ribbons (the Libyan national colours). Hammer had demonstrated to the Libyans that he was familiar with their culture and respected it. He won the oil concession.[3]

Negotiation ecosystem

Possessing cognitive, emotional, social and cultural capitals are necessary, but they are not sufficient to ensure success. A negotiation ecosystem is required. This refers to a set of organisational norms, processes and structures that are designed to support negotiators in the negotiation task. Below is a brief description of the elements of an effective ecosystem.

MANAGEMENT SUPPORT

Excellence in negotiation has yet to gain enough momentum to appear on the managerial radar screen. The full benefits of negotiation capabilities will materialise only when senior executives recognise, independently or through imitation, the criticality of the negotiation task. Only then will they make it a strategic thrust and allocate substantial resources to its development at the individual and organisational levels.

CULTURE OF EXCELLENCE

A culture of excellence in negotiation, championed by senior executives, is propagated by shared values, ideas, success stories and celebratory rituals. Recently, and in contrast, I witnessed how the shared stories among a group of managers were about the failed acquisitions by the organisation. It was a source of cynicism and laughter. The message was clear: we don't know how to negotiate value creating deals.

The founders of Google, Larry Page and Sergey Brin, have been promoting a culture of innovation by encouraging risk-taking and legitimising failure as an integral part of the innovation process. Unique to the company, Googlers (Google's employees) can use 20 percent of their working time engaging in tasks that are not necessarily directly related to their daily activities. This example illustrates that senior executives' support and a supportive culture go alongside each other.

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REWARD SYSTEM

There is a difference between doing deals and doing the right deals. Robert Kohlhepp, the vice chairman and former CEO of Cintas, a supplier of uniforms, observed that negotiators in mergers and acquisitions, for example, are evaluated on how many deals they seal. Senior executives are also motivated by deal completion because they are paid bonuses for closing deals. A case in point are the Boston Scientific executives, who received a special bonus of US$1.98 million in cash plus options and deferred stocks, following the acquisition of Guidant by Boston Scientific in 2006. These bonuses were not contingent on the future value that this acquisition might create.

Some experts suggest that rewarding deal-makers for merely closing deals offers a perverse incentive to undertake deals that may even destroy future value. Self-interested external agents, such as investment bankers or real estate brokers, who are compensated only for closing deals, also may not create the right deal. For example, Prudential-Bache, an investment firm, recommended that Rawson Food Services, a major supermarket chain in Florida, the United States, acquire 43 supermarkets from Pantry Pride Enterprise Incorporated. Rawson accepted the recommendation and paid Prudential-Bache millions of dollars in agency fees, but, unfortunately, had to file for bankruptcy shortly afterwards. It seems that it was a deal that should not have been made. Rawson sued Prudential-Bache and was awarded about US$26 million by a Florida jury.[4] Therefore, organisations should develop a well-designed system that rewards negotiators or agents for closing the *right* deals that will create both short- and long-term value.

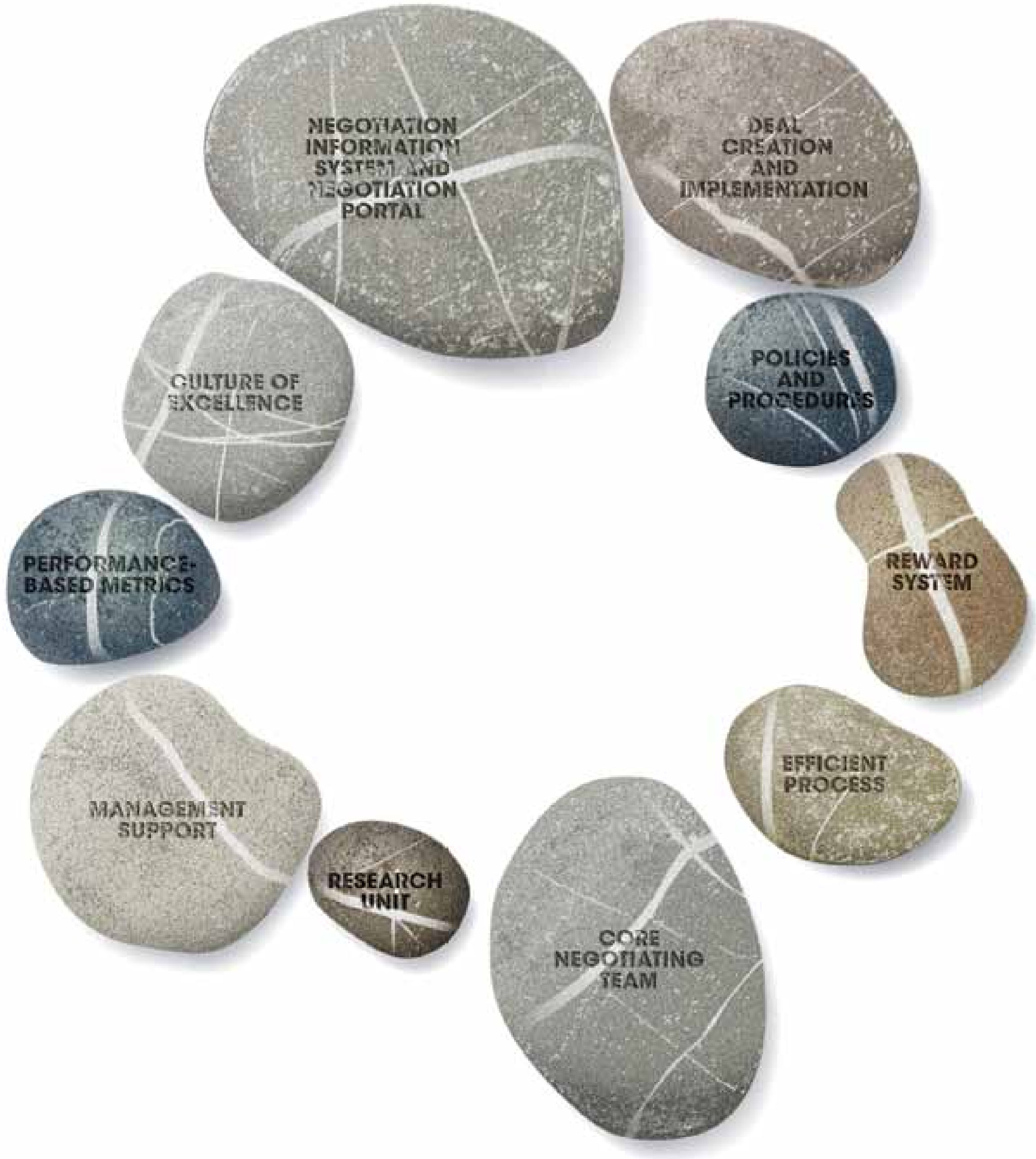
PERFORMANCE-BASED METRICS

What is negotiation success? What should be the specific success criteria? Each organisation has to define for itself what it considers a success. And a negotiator's performance and rewards should accordingly be based on clear success criteria that are well-defined and 'translated' into specific metrics that capture the true nature of negotiation events.

In general, the metrics should first encapsulate measures related to the negotiator's behaviour before and during the negotiation, such as those related to planning and preparation. More specifically, it should identify interests; state clearly the 'must have' and the 'like to have' objectives; develop scenarios and multiple alternatives (including the no-deal ones); as well as articulate several deal design options. Second, the measures should be related to the negotiation process itself. This could include the duration of the negotiation cycle from beginning to end of different types of deals, and the average cost of each type of deal (including personnel, travel and accommodation costs) associated with negotiating the contracts. Costs should be measured both in total and as a percentage of the deal amount. And third are measures related to the negotiation outcome. For example, the ratio of the target value to the actually achieved value of each deal; the average price of the deal over a given period; the conversion ratio of deal leads; the net value of the deal and type of deals; and outcome-based ranking between negotiators.

EFFICIENT PROCESS

The outcome of a deal depends on many factors including the efficiency of the negotiation process. For instance, Hewlett-Packard's contract negotiation process was previously long and troublesome, involving two stages of negotiation. It was only after procurement officers completed the first stage of negotiation, which focused mainly on price, that the senior legal staff could begin the second stage, which focused on legal issues such as intellectual property and privacy matters. Motivated to create a more efficient negotiation process, Hewlett-Packard created a Global Contracts team in which legal experts worked together with procurement officers in a single-step negotiation process.[5]



As compared to the routine and structured process of say, production or supply chains, the negotiation process is 'tailored' to a specific context. It cannot be completely uniform or formalised across all negotiation events. Therefore, the negotiation process should be a blend of structure, when possible, and flexibility, when necessary. At Nestlé, for example, the acquisition deal-making process is structured with a standard template to ensure that key aspects of a deal are covered. However, the standard template serves as a stimulant rather than an impediment to making a deal. The process is flexible and adaptable to the uniqueness of a given deal. Organisations should hence periodically review their negotiation processes and examine the degree to which they are efficient.

DEAL CREATION AND IMPLEMENTATION

A negotiated deal is no more than an exchange of promises between parties that is codified in a legal agreement. Once a deal is signed, the negotiators who have their own goals to achieve move on to the next deal or tender, leaving the implementation to others who also have their compelling goals to achieve. It is in this space between deal creation and deal implementation that challenges and conflicts arise.

At Nestlé, the operations people are involved early on in the acquisition process; they participate in the evaluation phase of a potential target for acquisition. Closing a deal by the deal formulators is only half of the story. To avoid the typical disconnect between deal negotiators and deal implementers, the full set of interests (e.g., budget, quality standards, deliverables and schedules) must be fully represented and secured in the deal-making phase.

POLICIES AND PROCEDURES

Concerned with control, organisations tend to centralise and standardise their activities by developing uniform policies and procedures across divisions, product lines and geographical locations. Sometimes, however, they ignore the specific needs and demands of customers or suppliers in certain segments of the market or geographic areas. For example, a multibillion dollar company issued a new global pricing policy of its commodities, which was transparent, indexed (subject to fluctuations), and not discounted. However, commodity buyers from Asia disliked it and continued to insist on negotiating a fixed and discounted price.

To be more responsive, organisations should periodically conduct a fitness test to examine the extent to which their policies and procedures fit the challenges of the negotiation task in different contexts. The question to ask is: Do our negotiation-related policies and procedures fit the needs and demands of our stakeholders in different markets?

CORE NEGOTIATING TEAM

Recognising the value of having a strong in-house negotiation capability, Nestlé established a core team of experienced deal-makers to be involved in every large-scale deal. Standing in contrast to Nestlé are the many organisations that have not created national or global teams of negotiators.

For example, a global consumer product company with more than 3,500 retail outlets around the world delegates the task of negotiating many millions of dollars worth of commercial real estate leases for its retail stores to country managers, some of whom may not be fully skilled in such negotiations. Given the financial scope of these negotiations, this organisation and others could benefit from establishing a core unit of first-class negotiators who will work closely with the country managers, procurement personnel, salespeople and the business development experts to create more favourable outcomes.

The expertise of the core negotiating team should not be limited to negotiations only. When appropriate, it should also include expertise in auctions, negotiauctions (a combination of negotiations and auctions), tenders and negotitenders (a combination of tenders and negotiations).

RESEARCH UNIT

In a recent survey, 250 global executives involved in mergers and acquisitions admitted that there were breakdowns in their due diligence processes such that important deal-related issues were undetected.[6] In contrast to this case, the findings of a study of 1,700 mergers show that the executives in the highest performing mergers conducted more effective due diligence research, including superior investigations and analyses.[7]

The value of sound research is self-evident to all, including negotiators. Unfortunately, many negotiators fail in this task for three reasons. Firstly, busy negotiators do not always have the time to do the necessary research in order to prepare and plan well. Secondly, many negotiators are not familiar with sophisticated and systematic preparation and planning frameworks. Thirdly, many organisations do not provide their negotiators with easy-to-use templates–structured documents on how to research, prepare or plan.

NEGOTIATION INFORMATION SYSTEM AND NEGOTIATION PORTAL

The purpose of establishing a negotiation information system is to facilitate the recording, storage and analysis of all the negotiation events and experiences of the negotiators. The database can include all information that is impactful, and directly or indirectly related to the negotiation process and outcomes. It should include, for example, the profiles of all the negotiators, issues of concern in the negotiation, objectives, interests, options, designed processes, various deal designs, outcomes, lessons learned, and implications for future negotiations.

A virtual and closed negotiation portal can provide a secure platform for negotiators in the same organisation to network. The portal would effectively facilitate an ongoing internal learning community of deal-makers. Hewlett-Packard, for example, created the 'Negotiator's Garage', an online negotiation resource library that includes training resources, templates for planning and preparation, stories of negotiation histories, and much more. Other organisations could similarly benefit from a negotiation portal uniquely designed for their needs that would include training content, industry-specific articles related to deal-making, tailor-made templates, chat rooms for consultation, and discussion boards.

Recognising the value of negotiation

In many organisations, the negotiation task has yet to be recognised as an important value creating task. It still remains a discrete, unstructured and improvised event. I believe organisations can become more competitive by rethinking the value of negotiation and investing in building negotiation capabilities at the individual and the organisational levels.

The combination of negotiators' capitals and organisational ecosystems, which together constitute negotiation capabilities, can help build strong organisations that can overcome the challenges of the negotiation task in an increasingly complex and interconnected global environment.

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