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The art of negotiation

Singapore Management University

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Be clear about your objectives before sitting down to make a deal

In 1999, when household goods company Newell approached Rubbermaid to discuss the possibility of a merger, it seemed like a good idea. Rubbermaid's product lines appear to complement Newell's, and the projected synergy looked to be a foregone conclusion. The deal went ahead in a multi-billion dollar deal worth US$5.8 billion, but it has since gone down in mergers and acquisitions (M&A) history as one of the biggest busts, with former Newell CEO Daniel Ferguson admitting that they had grossly overpaid for Rubbermaid.

“A party may fall in love with the target before doing due diligence by believing the target would create synergy,” explains Michael Benoliel, Associate Professor of Organisational Behaviour & Human Resource at Singapore Management University (SMU). This might explain how, despite being given just three weeks to perform due diligence, Newell committed and acquired Rubbermaid. It also demonstrated the dangers of poor negotiation skills.

Preparation is everything

“It’s important for negotiators when they go to the table to be mindful of the ‘no deal’ option,” says Benoliel, who teaches negotiation at SMU. “Negotiators don’t always think about: What if there is no deal? What are my options? They have to condition themselves to walk away from the table if there is no deal.”

Such situations arise when the must-have objectives cannot be met. Negotiators hammer away and sometimes settle for a less than optimal deal because “nobody wants to lose the sunk costs that have already gone into the negotiations”. “When there is no deal,” Benoliel says of negotiators striking a deal when they should not, “there is a sense of failure.”

> ***"Negotiators have to condition themselves to walk away from the table if there is no deal."***

Benoliel emphasises the importance for negotiators to know their must-haves (critical) and like-to-haves (desired). That way, not only can negotiators identify when there is no deal, it also makes negotiations much more fruitful when both sides know what they are talking about.

“The ideal negotiation will be when both negotiators are highly skilled and highly prepared,” Benoliel explains. “However, it’s naïve to think that both sides in a negotiation are equally prepared. There is always some information asymmetry and preparation asymmetry. The question is: how much? If the discrepancy is too high, it's not constructive for negotiations."

When one side is clearly much better prepared than the other, it might be tempting to take full advantage, but Benoliel believes that might be not the wisest thing to do.

"A well prepared negotiator, negotiator A, can take full advantage of the poorly prepared negotiator B, and claim plenty of value. That would work if negotiator A is thinking of the negotiation as a tactical one, and not a strategic one. As a negotiator, you don't want to claim too much value because in the long run, it may not be the best strategy."

He adds: "One of the things a highly skilled negotiator can do is not take advantage of the less well prepared negotiator and give the other side time to prepare, or slow down the negotiation process instead of overwhelming him."

Giving due respect to due diligence

In negotiating M&A deals, effective due diligence is of crucial importance. Besides being in love with the deal before the numbers are crunched – Benoliel describes it "confirmatory bias" – senior executives can suffer from hubris or overconfidence. This is when executives believe "they hold more information than they actually have, or consider their own information more valuable than external information", resulting in a subjective and errant decision.

Ex-Newell CEO Ferguson was particularly guilty of falling in love with the Rubbermaid deal before due diligence was done, but Rubbermaid played a part in the debacle as well by what Benoliel describes as "perfuming the pig": stuffing the channels of its retailers and distributors with inventory to create the impression of higher sales. Rubbermaid then imposed a three-week limit to do due diligence or risk having the deal called off – classic time pressure tactics.

The combination of Ferguson being in love with the deal and Rubbermaid's time pressure tactics led to the inevitable merger, which produced Newell Rubbermaid. Newell and Rubbermaid shareholders suffered significant decline in share value, eventually leading to US$514.9 million being written off in goodwill in 2002. To avoid such financial pain in future, Benoliel suggests changing the way due diligence is done.

“The scope of due diligence is too limited. Traditionally in the U.S., it centres around financial and legal issues, and the financial engineering around the deal. Not enough attention is paid to things such as the managerial competency of the target company. You can hire an expert in a specific field to measure the capabilities of the managers at your target company.”

“Also, not enough focus is put on whether the buying and target company have a cultural fit. The scope of due diligence needs to be much wider than it is currently.”

Michael Benoliel is the instructor of SMU’s Executive Development course, “Advanced Negotiation Strategies”, which took place on June 26-27, 2014.