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# Rijas-Vericampos Negotiation

## Confidential Information for RIJAS

In this negotiation you will be playing the role of Rijas, a company offering environmental cleanup services.

Vericampos is a major manufacturer of paper and paper products, located in Quito, Ecuador. Vericampos requires significant water for its production, which results in large amounts of hazardous waste water at the end of the process. Due to new environmental regulations, Vericampos is hoping to hire a third party service to handle the removal, recycling, and cleanup of the waste water, and is currently in talks with Rijas Environmental Services to do so. Rijas is a regional company that provides environmental services and cleanup.

The appropriate technology to handle the waste water has been jointly specified by a team of engineers from both companies, and thus is not open to negotiation. There are, however, a number of important unresolved issues including price, level of service, payment terms, and installation schedule. In the prior negotiation, a proposal was on the table, which while marginally acceptable to both sides, was not formally accepted by either side.

In fact, both sides believe there is room – and potentially a significant amount of it – to improve the deal. The teams that negotiated the first deal will not be present for this phase of the negotiation; instead, you and your counterpart will have full authority to reach agreement – or to end the negotiation without a deal.

There are four main issues on the table, which you and your counterpart will need to negotiate. The first is nominal price, which is the price that Vericampos will pay to Rijas for its services. The nominal price will vary based on the level of service, payment schedule, and delivery terms.

The second issue is the service provision. The operation and maintenance of Rijas's equipment requires constant service by highly trained technicians. The proposal on the table is for the lowest package of service, known as standard service. Rijas could provide higher levels of service over the five-year life of the contract, but only if Vericampos is willing to cover the additional costs involved. Standard service includes only warranty work, with Vericampos assuming certain basic repair costs. There are 3 additional levels of service – levels two, three and four. At level four, Rijas would take full financial and administrative responsibility for operating the equipment. Under packages two and three, Rijas would share this responsibility with Vericampos. Vericampos would certainly benefit from higher service packages, though if Rijas

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demands too high a price, it may be able to cover the work more efficiently using its own technicians or hiring third party consultants.

The third issue is payment schedule. It is common for manufacturers like Rijas to sell its equipment and services on an installment basis, which is paid off over the course of the contract. Naturally, Rijas would prefer to be paid sooner, while Vericampos would prefer to postpone the payments for later. There are three different payment options: “level” (in which regular installments are made over the life of contract), “front-loaded” (in which Vericampos pays more at the beginning of the contract than the end), and “back-loaded” (in which Vericampos pays less at the beginning than at the end). The current agreement is for back-loaded installment payments, although Rijas might be willing to accept a lower price if Vericampos were willing to accelerate its payments. There might be additional factors to consider here as well, depending on unique financial considerations.

The fourth issue is delivery date. The delivery date is when Rijas will install the equipment for Vericampos. Under the current proposal, Rijas will deliver the equipment six months from the date of contract signing.

In addition, while both sides are confident in Rijas’s technology, the engineers have expressed disagreement about the exact percent of waste water that Rijas will be able to recycle. Rijas insists that its technology will enable Vericampos to successfully recycle 95 percent of its waste water, while Vericampos’s engineers contend that the clean yield will be closer to 80 percent. By those calculations, Vericampos would have to pay more than $100,000 annually to clean the additional waste water to meet new environmental standards set forth by the Ecuadoran government. By contrast, if Rijas’ figures are correct, Vericampos’s ongoing disposal costs would be substantially lower than they predict. The previous team was unable to reach consensus on these numbers. Perhaps you and your counterpart will be more effective in this regard.

For this negotiation, please do not construct any other issues beyond those noted above – there are enough items to resolve as is! Strive to reach an agreement that creates as much net value for your company as possible. As previously noted, prior negotiations with Vericampos have been handled by one of your colleagues, who is now out of the country. You now have full authority to reach agreement – or to end the negotiation with Vericampos without a deal, if its representative insists on terms that are unattractive to your company.

In the prior negotiation, the following proposal was on the table (though it was not formally accepted by either side):

- Nominal price: $5,000,000
- Service provision: Standard
- Payment schedule: Back-loaded installments
- Delivery: Six months from date of contract signing.

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If Vericampos insisted, you would reluctantly agree to these terms, but they are only marginally acceptable. You hope to do substantially better. Here is how you should evaluate alternative packages.

**Nominal price.** This really depends on how much service you are obligated to provide, and when you will be paid. Nominal price thus does not tell you much about the net value of the deal.

**Payment schedule.** For planning and budgeting purposes, your company uses a 10 percent annual discount rate. Your company thus applies the following factors when calculating the present value of different price and payment packages:

- Back-loaded: 68 percent of nominal price
- Equal payments: 76 percent of nominal price
- Front-loaded: 83 percent of nominal price

In short, you would be willing to reduce the nominal price somewhat if Vericampos would agree to accelerate its payments, though you would not want to give too deep a cut.

**Service provision.** Operation and maintenance of your equipment requires constant service by highly trained technicians. The proposal currently under consideration contemplates the lowest package of service (standard). You can provide higher levels of service over the five-year life of the contract, but only if Vericampos is willing to cover the additional costs involved. Here, in present value terms, are your full marginal costs for the various levels of service you can provide.

- Service package two costs: $700,000 more than standard
- Service package three costs: $1,000,000 more than standard
- Service package four costs: $1,500,000 more than standard

In short, you would be require at least $700,000 more to upgrade to level two service (and at least $1,000,000 more than standard for level three, and $1,500,000 more for level four). Your goal of course, is to choose whichever service level is the most cost effective, that is, whichever one proves to be the best bargain.

**Delivery date.** When your company originally spoke with Vericampos, the earliest it could accept installation of the equipment would be six months from now. Privately, however, you have just learned that an important job with another customer has been postponed. To avoid under-utilizing staff, you would be willing to give Vericampos as much as a $100,000 discount (in present value terms) if it would be willing to commence installation immediately. You would prefer to get them to do so without lowering your price.

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**Other issues.** You expect that you will successfully recycle 95% of the waste water, not the 80% Vericampos' engineers have predicted. If your figures are correct, Vericampos' on-going disposal costs will be substantially lower than their prediction of $100,000 annually. Your predecessors tried to use this argument to justify a higher price, but to no avail.

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