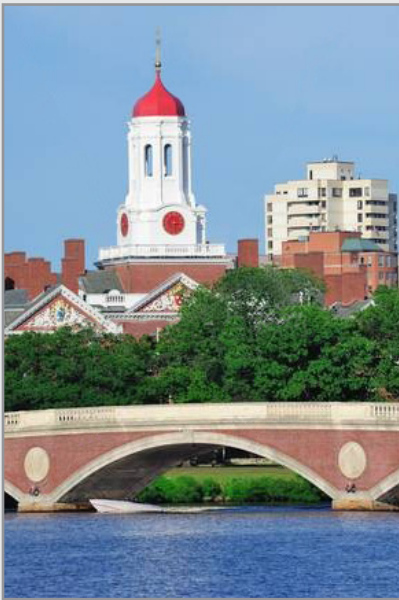


MANAGEMENT REPORT

BATNA Basics: Boost Your Power at the Bargaining Table



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Negotiation Management Report #10

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1. Assess your BATNA using a four-step process.

Adapted from “Accept or Reject? Sometimes the Hardest Part of Negotiation Is Knowing When to Walk Away,” by Deepak Malhotra (professor, Harvard Business School), first published in the *Negotiation* newsletter, August 2004.

It was a classic case of a business partnership gone awry. After building a profitable construction company together over several decades, Larry Stevenson and Jim Shapiro recognized that their differences had become irreconcilable. Stevenson wanted to buy out Shapiro, who was willing to sell for the right price. After months of haggling and legal maneuvering, Stevenson made his final offer: \$8.5 million for Shapiro’s shares in the company.

The company is worth about \$20 million, Shapiro thought to himself. I own 49% of the shares. Heck, I helped build this company. I’m not going to accept anything less than my fair share—\$10 million. I’d rather fight in court than accept \$8.5 million. Shapiro rejected the offer, and each party prepared for a trial.

Shapiro’s rationale for rejecting Stevenson’s offer seemed reasonable enough. Furthermore, Shapiro’s lawyers assured him, a court ruling very likely would be in his favor.

Yet Shapiro made the wrong choice. He could have figured this out if he had assessed his BATNA—his *best alternative to a negotiated agreement*. A negotiator’s BATNA is the course of action he will pursue if the current negotiation results in an impasse. An evaluation of your best alternative to a deal is critical if you are to establish the threshold at which you will reject an offer.

Effective negotiators determine their BATNAs before talks begin. When you fail to do so, you’re liable to make a costly mistake—rejecting a deal you should

have accepted or accepting one you'd have been wise to reject. In negotiation, it's important to have high aspirations and to fight hard for a good outcome. But it's just as critical to establish a walkaway point that is firmly grounded in reality.

Assessing your BATNA. To determine your BATNA in a given negotiation, follow these four steps:

List your alternatives. Think about all the alternatives available to you if the current negotiation ends in an impasse. What are your no-deal options?

Evaluate your alternatives. Examine each option and calculate the value of pursuing each one.

Establish your BATNA. Choose a course of action that would have the highest expected value for you. This is your BATNA—the course you should pursue if the current negotiation fails.

Calculate your reservation value. Now that you know your BATNA, calculate your *reservation value*—the lowest-valued deal you are willing to accept. If the value of the deal proposed to you is lower than your reservation value, you'll be better off rejecting the offer and pursuing your BATNA. If the final offer is higher than your reservation value, you should accept it.

To assess his BATNA, Shapiro first should have obtained the following information from his lawyers: estimated litigation costs, \$500,000; his likelihood of winning in court, approximately 70%; and the fact that if he won, he would receive \$10 million for his shares, whereas if he lost, he likely would receive only \$3 million.

Next, Shapiro should have used this formula to determine the actual value of his BATNA:

$$\begin{array}{r}
 (0.7 \times \$10\text{MM}) \text{ Value if he wins in court} \\
 + (0.3 \times \$3\text{MM}) \text{ Value if he loses in court} \\
 - \$500,000 \text{ Cost of litigation} \\
 \hline
 \$7.4\text{MM}
 \end{array}$$

Shapiro should then have determined his reservation value for the negotiation with Stevenson: What is the least he would accept? It's worth noting that, after the trial was well under way, Shapiro came to believe that he should not

have rejected Stevenson's offer. "I still think the offer should have been higher," he said, "but if I could go back, I'd accept it. Righteous indignation is worth something, but it's not worth \$1.1 million."

2. Take your BATNA to the next level.

Adapted from "Taking BATNA to the Next Level" by Guhan Subramanian (professor, Harvard Business School and Harvard Law School), first published in the *Negotiation* newsletter, January 2007.

If your current negotiation reaches an impasse, what's your best outside option? Most seasoned negotiators understand the value of evaluating their BATNA, or *best alternative to a negotiated agreement*, a concept that Roger Fisher, William Ury, and Bruce Patton introduced in their seminal book, *Getting to Yes: Negotiating Agreement Without Giving In* (Penguin, 1991, second edition). Even those who don't know the term probably think through their BATNA instinctively as they prepare for a negotiation. An awareness of your BATNA—particularly if it's a strong one—can give you the confidence you need to walk away from a subpar agreement.

Although BATNA is a commonsense concept in the negotiation world, achieving "best practice" in this arena is not easy. Here are three strategies to help you take the BATNA concept to the next level and gain a critical advantage in upcoming deals.

1. Translate your BATNA to the current deal. Here's a classic illustration of the BATNA concept: while haggling over a rug in a bazaar, you're aware that you can purchase an identical rug at a nearby stall for \$100. Assuming that you want only one rug, you won't pay more than \$100 in the negotiation at hand. Such clear-cut BATNAs tend to exist more in theory than in reality. In truth, your best alternative to agreement is rarely, if ever, apples-to-apples comparable with the deal at hand.

The implication? When negotiating, take time out for an explicit translation process to ensure that you aren't giving up a good deal in hand for a BATNA in the bush. Recently, for example, as the renewal deadline for his homeowner's insurance policy approached, Larry decided to do a "market check" to compare

prices. His existing insurer—let’s call it Acme—had been raising its rates by 7% to 10% annually for the past three years, and Larry wasn’t sure he was getting the best deal. He then found a carrier that offered a policy for 30% less than Acme’s renewal rate.

Delighted, Larry came very close to switching to the new insurer. But after doing some digging (and receiving some self-interested guidance from Acme), Larry identified important coverages and term definitions buried deep in the legalese of the two policies. After going through a translation process to make the prices comparable, Larry realized that Acme, his current insurer, was offering him a better deal. The lesson: Rather than assuming that the deal on the table matches your BATNA point by point, translate your BATNA to fully understand what it means for the current negotiation.

2. Assess their BATNA with care. It may seem an obvious step, but even the most sophisticated negotiators often fail to think through the other party’s BATNA as carefully and objectively as they think through their own. Although you can’t assess someone else’s BATNA as precisely as you can your own, asking “What will he do without a deal?” provides valuable insight.

Consider the case of a Mississippi farmer in the early 1990s. The state legislature had just legalized riverboat gambling, and the farmer owned land along the Mississippi River that was very attractive for the development of hotels, restaurants, and other businesses. Sure enough, an entrepreneur approached the farmer about buying his land. Before meeting to negotiate a purchase price, the farmer hired a professor of agriculture to estimate the land’s value. After conducting soil tests and estimating cash flows, the professor concluded that the land was worth approximately \$3 million.

As the negotiation began, the farmer kept quiet and let the entrepreneur frame the discussion. His opening offer: \$7 million. Though ecstatic, the farmer kept his composure and made a counteroffer of \$9.5 million. Eventually they reached a deal of \$8.5 million.

You might view this tale as a success story for the farmer; after all, he got \$8.5 million when he was only expecting \$3 million. But what if the farmer had considered the entrepreneur’s perspective, perhaps retaining an expert in the gaming industry to assess the land? He might have learned just how profitable casinos

can be and that the benefit to the entrepreneur of securing the optimal location rather than a second-best BATNA was worth much more than \$8.5 million.

3. Think through two-level BATNAs. In most business negotiations, you face two counterparts: the individual across the table and the organization he represents. This means you're facing two BATNAs as well. Sophisticated deal makers think through *both* BATNAs—the organization's and the individual's.

In one real-world case, a vacation resort was seeking to have certain equipment installed on its property. The equipment manufacturer sent Frank, the CEO's newly hired lieutenant, to negotiate this major contract. The resulting deal was extremely successful for both sides.

A few years later, the manufacturer held its annual meeting of top managers at the resort to show off its installations and celebrate the deal. The two organizations held a panel discussion to reflect on the dynamics of their negotiation. At one point, the moderator asked Frank to reveal his BATNA. He responded with a textbook analysis: "Our BATNA was to look around for some other major contract in which to powerfully demonstrate our capability." When pressed, he continued, "Well, *my* BATNA, as a new hire, was probably to look around for another job if I didn't get the deal."

Most meaningful negotiations occur between organizations, not individuals—yet individuals, not organizations, negotiate deals. Thus, it's crucial to consider the incentives of the individual across the table: How is she compensated? How long has she worked for the company? What are her long-term aspirations? Only by examining both pieces of the BATNA will you gain a complete picture of the other side's walk-away alternatives.

3. Track BATNAs in multiparty negotiations.

Adapted from "How to Cope When the Table Gets Crowded," first published in the *Negotiation* newsletter, August 2011.

Negotiations between just two sides can be tough enough to manage. Add more parties to the mix, and things get a lot more complicated. Yet multiparty talks are common: think of department heads dividing up scarce resources,

family members debating the future of a business, or a group of consumers launching a class-action lawsuit.

One of the issues that makes multiparty negotiations more complex than two-party talks, according to Massachusetts Institute of Technology professor Lawrence Susskind and Harvard Law School professor Robert Mnookin, is the fluctuating nature of each party's *best alternative to a negotiated agreement* (BATNA). By preparing for this complication, you will be well positioned to thrive in your next round of multiparty negotiations.

As in a two-party negotiation, you should enter multiparty talks with a solid idea of your BATNA—that is, what you will do if a deal fails to materialize. Knowledge of your BATNA can help you stand firm in the face of offers that fall short of your goals.

Suppose that Mark, an unemployed marketing professional, is preparing to meet with his three siblings to discuss the future of their marginally profitable family business. Mark's preference is to dissolve the business and use his share of the assets to start a consulting firm. However, he knows that one or two of his siblings would prefer to keep the business running as is or sell it. If the negotiation doesn't work out as he would like, Mark decides that his BATNA is to move to a city across the country where a colleague has offered him a job.

You should also attempt to analyze the BATNAs of the other parties at the table. Roughly calculating the minimum you can offer someone to secure a commitment will help you immensely. Mark, for instance, expects that his sister Leah, who has been involved in the business, will demand a large share of the pie in exchange for agreeing to dissolve it. He estimates that she will ask for 50% of the assets but be willing to settle for about 40% and accept a position with a client.

In negotiations among a large number of parties, determining each party's BATNA can be a daunting, even impossible, undertaking. At the very least, try to foresee how parties may align and estimate the BATNA of each possible coalition.

Once discussions begin, parties' BATNAs will begin to fluctuate, according to Susskind and Mnookin. For instance, imagine that Mark persuades his sister Jaclyn and brother Tom that the business should be dissolved. At this point, because

Leah is outnumbered, her BATNA becomes a virtual nonissue. Yet to preserve their relationship with her and each other, her siblings become focused on dividing up the assets in a way that satisfies them all. A payoff matrix—a spreadsheet that lists the names of the parties in rows, the issues to be discussed in columns, and the parties’ priorities on those issues in the boxes that are formed—will help you keep track of shifting BATNAs in addition to parties’ preferences.

4. Anticipate hidden hazards of BATNA research.

Adapted from “Dear Negotiation Coach: Hidden Hazards of BATNA Development,” by Francesca Gino (professor, Harvard Business School), first published in the *Negotiation* newsletter, May 2012.

Question: I was recently put in charge of negotiations with a supplier involved in one of our company’s products. Given what I’ve learned in school and in negotiation books, I did my homework: I started exploring options with other suppliers to gain power and reduce risk in case the current negotiations with my preferred vendor go sour. I invested quite a bit of time (and money!) creating those options, but in the end I was not interested in pursuing them, and I let them go. Now I can’t help but wonder: Was it a mistake to do so much research?

PROFESSOR FRANCESCA GINO: Negotiators often spend time and energy pursuing alternatives to the current deal to gain more power at the bargaining table. In classic negotiation texts and research, you’ll find the same advice: bargainers would be wise to invest resources in strengthening their *best alternative to a negotiated agreement* (BATNA), or their fallback alternative, in the event that the parties fail to reach an agreement.

Investing in outside alternatives enhances power by giving you other opportunities if the current negotiation cannot or will not provide the outcome you desire. Thus, outside alternatives often entail sunk costs, or irrevocable investments that keep open the possibility of pursuing other specific courses of action in the future. In a situation such as yours, investments in outside alternatives may enhance your leverage in the negotiation.

So far, so good, right? Well, there’s more to the story. In addition to helping

you enhance your power, these investments in strengthening your BATNA can have other, potentially unintended consequences. Your realization that investments you made and discarded represent irrecoverable costs may affect your behavior in the current negotiation in ways you don't expect.

Specifically, research I conducted with my Harvard Business School colleague Deepak Malhotra shows that the extent to which decision makers invest directly in outside options influences how entitled they feel in the current negotiation. When you decided to forgo options that you invested time and money in creating, you may feel as though you wasted resources. This perceived loss creates a desire for a counterbalancing gain. Thus, it is likely to trigger a sense of entitlement: the feeling that you deserve a favorable outcome in the current negotiation. Our research shows that the costlier a negotiator's investment in developing a strong BATNA is, the stronger those feelings of entitlement will be.

We found that this sense of entitlement causes the negotiator to have high aspirations in the current relationship, and these aspirations fuel opportunistic behavior.

Your sunk costs—and not simply the leverage provided by the outside options you created—may lead you to exploit your counterpart in ways that could damage your relationship going forward. So, for instance, you may find yourself lying or misrepresenting information to your counterpart in an attempt to improve your outcomes. You may feel entitled to use aggressive strategies to reach a better deal for yourself. Without your realizing it, the foregone alternatives are influencing your behavior.

Since you likely are interested in maintaining a good relationship with the supplier in your current negotiation, you should consider the effect that the foregone options in which you invested might have on your expectations and behaviors as you negotiate. Namely, your prior investments may compromise your ethical standards. By remaining vigilant about negotiating in good faith and reciprocating goodwill, you should be able to emerge from the shadow cast by sunk costs. ♥



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