

# SPOTLIGHT

**ARTWORK** Jack Sutherland, *Ancient Sun*

Acrylic and oil on linen, courtesy of saatchiart.com





**Deepak Malhotra** is the Eli Goldston Professor of Business Administration at Harvard Business School and the author of *Negotiating the Impossible* (Berrett-Koehler, forthcoming in 2016), from which portions of this article are drawn.

# Control the Negotiation Before It Begins

***Focus on four preliminary factors that can shape the outcome.***

*by Deepak Malhotra*

**C**ountless books and articles offer advice that can help deal makers avoid missteps at the bargaining table. But some of the costliest mistakes take place before negotiators even sit down to discuss the substance of the deal. That's because people fall prey to a seemingly reasonable—but ultimately faulty—assumption about deal making. Negotiators often take it for granted that if they bring a lot of value to the table and have sufficient leverage, they'll be able to strike a great deal. While those things are certainly important, many other factors influence where each party ends up.



In this article I draw on my experience advising scores of companies on deals worth millions or billions of dollars to present four factors that can have a tremendous impact on negotiation outcomes. In each case, I provide guidance on what negotiators should do before either side starts making offers or counteroffers.

## **1 Negotiate Process Before Substance**

A couple of years ago, two cofounders of a tech venture walked into a meeting with the CEO of a *Fortune* 100 company who had agreed to invest \$10 million with them. A week earlier, the parties had hammered out the investment amount and valuation, so the meeting was supposed to be celebratory more than anything else. When the cofounders entered the room, they were surprised to see a team of lawyers and bankers. The CEO was also there, but it soon became clear that he was not going to actively participate.

As soon as the cofounders sat down, the bankers on the other side started to renegotiate the deal. The \$10 million investment was still on the table, but now they demanded a much lower valuation; in other words, the cofounders would have to give up significantly more equity. Their attempts to explain that an agreement had already been reached were to no avail.

What was going on? Had the cofounders misunderstood the level of commitment in the previous meeting? Had they overlooked steps involved in finalizing the deal? Had the CEO intended to renege all along—or had his team convinced him that the deal could be sweetened?

Upset and confused, the cofounders quickly assessed their options. Accepting the new deal would hurt financially (and psychologically), but they'd get the \$10 million in needed funds. On the other hand, doing so would significantly undervalue what they brought to the table. They decided to walk out without a deal. Before they left, they emphasized their strong desire to do a deal on the initial terms and

explained that this was a matter of principle as well as economics. Within hours, they were on a plane, not knowing what would happen. A few days later, the CEO called and accepted the original deal.

The gutsy move worked out for the cofounders, but it would have been better not to let things go wrong in the first place. Their mistake was a common one: focusing too much on the substance of the deal and not enough on the process. Substance is the terms that make up the final agreement. Process is how you will get from where you are today to that agreement. My advice to deal makers: Negotiate process before substance.

Consider another scenario. You've been negotiating with someone for months. You have a few final concessions that you've been holding back—they're costly but worth making if it will close the deal. With the finish line in sight, you make the concessions, and the other side responds: "This is great. I appreciate your flexibility on these issues. Let me share this with my boss to see what she thinks." Unfortunately for you, you had no idea your counterpart even had a boss—you thought he was the final decision maker. The negotiations are clearly not over, and you have nothing left to give.

The more clarity and commitment you have regarding the process, the less likely you are to make mistakes on substance. Negotiating process entails discussing and influencing a range of factors that will affect the outcome of the deal. Ask the other party: How much time does your company need to close the deal? Who must be on board? What factors might slow down or speed up the process? Are there key milestones or dates we should be aware of? Remember to find out simple things such as, Who will be in the meeting tomorrow? What will the agenda be? Since we are not going to discuss the issues of importance to us in the next meeting, when will we address them?

Of course, you can't always get clear answers to every question at the outset—and sometimes it is

*Tell your counterparts what to expect in the negotiation process. This allows you to shape how they'll interpret a negative event should one occur and to ensure that they don't overweight its significance.*

## Idea in Brief

### THE PROBLEM

Some of the costliest mistakes in negotiations take place *before* anyone sits down at the bargaining table. That's because deal makers tend to focus too much on substance—offers, counteroffers, concessions—and not enough on process.

### THE SOLUTION

Four strategies can help set the stage for a successful negotiation.

- Negotiators need to address matters of process at the outset.
- They must set realistic expectations.
- They need to clearly identify all players that will influence or be influenced by the deal.
- And they must set the psychological frame through which the deal will be viewed.

premature to ask certain questions. But you should seek to clarify and reach agreement on as many process elements as possible—and as early as is appropriate—to avoid stumbling on substance later.

## 2 Normalize the Process

A businessman who owns multiple manufacturing facilities in Asia once told me that he no longer does business with companies from the West unless their top managers are willing to first fly into his city to meet with him. My initial thoughts were: Is this about ego? Is it about building relationships? Is it a cultural norm or ritual of some sort? Actually, none of those had anything to do with his precondition to signing a contract.

Here's how he explained it to me: "Until they have flown into my city and then driven to our manufacturing plants—which are located 20 kilometers from the airport but take almost three hours to reach—until they have experienced that, they simply don't understand how things work around here. And if they don't understand, we run into serious problems. Because the first time there is a delay or disruption, or if we need to renegotiate something, they will immediately assume we are either incompetent or stealing from them. Once they've seen how things actually work, we can have a more productive relationship."

Unless business partners understand what is "normal" in a given context or culture, they are likely to misunderstand or overreact to adverse events. The same is true in negotiations of all kinds: It is important to normalize the process. If you've ever been involved in an ugly conflict that went into mediation, you may have seen this in action. When a good mediator sits down with parties who are in a bitter dispute, she might say something like, "You think you hate each other today? I can assure you, about three days

into this process, you're going to hate each other even more. And when that happens, I want you to remember something: That's normal."

If the mediator does not give this warning, the parties are much more likely to abandon the process when emotions heighten and things seem to be falling apart. But if she explains at the outset that it's normal for things to get worse before they get better, the parties are more likely to keep at it. By normalizing the process, she effectively manages their expectations.

The same principle applies to any negotiation where there's a risk that things will not go perfectly smoothly. If you anticipate delays or disruptions on your side, tell your counterparts. This allows you to shape how they will interpret a negative event should one occur and to ensure that they do not overweight its significance. You'll have a much harder time trying to influence their perceptions or win back their trust after something goes wrong that they did not expect.

Normalizing the process entails discussing, in advance, any factors that might cause the other side to question your intentions or ability or to doubt the likelihood of a successful outcome. You might explain typical barriers that need to be overcome, moments during the process when it's common for parties to feel anxious or pessimistic, events that might delay progress, and the difference between disruptions that are commonplace and easy to resolve and ones that are more serious.

Encourage the other side to do the same for you. People often hesitate to discuss "what might go wrong," because they're focused on presenting themselves and the merits of the deal in the best possible light. This is especially true in certain cultures and in contexts where competition is fierce. Your counterpart might be thinking, "Why should I talk

about problems if my rivals are pretending things will be great?”

That’s understandable. If other parties think that mentioning a potential disruption could cost them the business, or that you’ll use it as a lever to extract greater concessions, they’re unlikely to be truthful. To encourage people to be open about problems, make it safe for them. Explain that you are experienced enough to know that every deal and relationship is likely to encounter difficulties and disruptions, and that you want to learn more about the specific risk factors that might play a role in this case. And if you can signal (or commit to) having no intention of holding those factors against them, you have a better chance of reaching an understanding that works for both sides.

### 3 Map Out the Negotiation Space

Some years ago, a client of mine was preparing to sell his stake in a company that was jointly owned by four entities. The owners had been squabbling for many years; it was clear that the asset would need to be consolidated under one party (or perhaps two who could get along). It was also clear that no one wanted to sell. However, there was little choice in the matter, because one of the owners—Company X—was a much larger company with the power and the clout to push people out. It announced that it would buy out the other three.

My client wanted to wait until Company X had bought out the other two owners before negotiating the sale of his shares. He figured that by being “the last piece of the puzzle,” he would be able to hold out for more money.

When we met to discuss his strategy, I asked him to step back and “map out the negotiation space.” This consists of every party that can affect the negotiation, along with any party that will be affected by the negotiation. In my experience, a strategy that makes perfect sense when you’re thinking

bilaterally—that is, about the relationship between any two parties in the negotiation—can suddenly become ineffective or even disastrous when you take a multilateral perspective. I encouraged my client to evaluate the interests, constraints, alternatives, and perspective of all the relevant parties. One of the things we looked at was how much equity each party had and how much of the board each one controlled:

#### THE NEGOTIATION SPACE

COMPANY X		
1/3 of shares 2 board seats		
↕		
COMPANY A	CLIENT	COMPANY B
1/3 of shares 2 board seats	1/6 of shares 1 board seats	1/6 of shares 0 board seats

We then focused on the interests of each company: What exactly are their interests in this deal? How would you rank their priorities? The four parties had known one another a long time, and my client did not have any trouble identifying what mattered most to each. Company X, for example, was concerned about three things, and its priorities were as follows: (1) Reputation: It did not want ties with any organization that could hurt its reputation. (2) Control: It wanted ownership only in businesses where it had a majority of board seats, and (3) Money: It would want to pay as little as possible, but this was not as big a concern as reputation and control.

After delving into the perspectives of all parties, we unearthed one more important bit of information: Company A was the least interested in selling and was already putting up a fight that could drag things out.

*You put yourself at a disadvantage when you focus narrowly on the party on the other side of the table. You have to assess the perspective of all the parties that can influence or are influenced by the deal.*

When we put all these details together, it became clear that the “last piece of the puzzle” strategy would be unwise. Why?

For Company X, control was a higher priority than money. To get control, it needed to buy either my client or Company A—as soon as it made either purchase, it would control more than 50% of the board seats and hence the company (for most decisions). Therefore, if my client were the last to sell, he would be negotiating with Company X after it had control. At that time, my client would be able to get paid only for his 1/6 share of the firm’s equity. But if he were to sell first, at a time when Company A was refusing to sell and was making things difficult for Company X, he could monetize two assets: his shares and his board seat. In other words, the last party to negotiate would have the least leverage and limited opportunities to monetize its assets.

In the real world, you’ll never have as complete a picture as you’d like, but you put yourself at further disadvantage if you focus too narrowly on the party on the other side of the table. You have to assess the perspective of all the parties that can influence or be influenced by the deal: Who has the ability to influence the person on the other side of the table? How might the strategy or actions of other parties change your alternatives, for better or worse? How does the deal affect the interests of those who are *not* at the table? How will this negotiation affect your leverage with future negotiation partners? If multiple parties are involved in the deal, does it make sense to negotiate with them simultaneously or in sequence, together or separately?

Your analysis might suggest a change of strategy—that you should negotiate with a different party first, delay the deal or speed it up, bring others into the room, expand or contract the scope of the deal, and so on.

## 4 Control the Frame

The outcome of a negotiation depends a great deal on each side’s leverage—the better your outside options are and the more ways you have to reward or coerce the other side, the more likely you are to achieve your objectives. But the psychology of the deal can be just as important.

In my experience, the frame, or psychological lens, through which the parties view the negotiation has a significant effect on where they end up. Are the parties treating the interaction as a problem-solving

## *The psychological lens through which parties view a negotiation has a significant effect on where they end up.*

exercise or as a battle to be won? Are they looking at it as a meeting of equals, or do they perceive a difference in status? Are they focused on the long term or the short term? Are concessions expected, or are they seen as signs of weakness?

Effective negotiators will seek to control or adjust the frame early in the process—ideally, before the substance of the deal is even discussed. Here are three elements of framing that negotiators would be wise to consider.

**Value versus price.** I’ve worked with many technology companies whose innovative products provide tremendous value for customers but are priced significantly higher than what their competitors are charging—or what customers are paying for their legacy systems. While the high price is justified by the value proposition, salespeople often face immediate resistance when a potential customer learns that the cost will be five or 10 times the amount he is currently paying. Too often, the salesperson will hear something like: “You are charging five times what others charge. No one pays that much for this kind of thing!”

One of the most common mistakes salespeople make in those situations—without even realizing it—is to apologize for having a high price. They do this when they say “I understand it’s pricey, but...” or when they hastily signal a willingness to adjust the price. My advice: Always justify your offer, but never apologize for it. When you apologize, you signal that even you don’t think the price is appropriate, and you give the other side license to haggle. The entire frame of the negotiation becomes about price, when what you really want to discuss is value.

A better response would be, “What you seem to be asking is, How is it that despite a higher price, we still have a long and growing list of customers? We both know that no one will pay more for something than it’s worth, so let’s discuss the value we bring so that you can decide what’s best for you.”

In negotiations of all kinds, the sooner you can shift the discussion away from the cost to your counterpart and focus on the value you bring to the table, the more likely it is that you will be able to monetize that value.

**Your alternatives versus theirs.** Research and experience suggest that people who walk into a negotiation consumed by the question “what will happen to me if there is no deal?” get worse outcomes than those who focus on what would happen to the other side if there’s no deal. When you are overly concerned with your own alternatives, and especially when your outside options are weak, you think in terms of “what will it take (at a minimum) to get them to say yes?” When you make the negotiation about what happens to them if there is no deal, you shift the frame to the unique value you offer, and it becomes easier to justify why you deserve a good deal.

**Equality versus dominance.** Not so long ago I was consulting on a strategic deal in which our side

was a small, early-stage company and the other was a large multinational. One of the most important things we did throughout the process—and especially at the outset—was make sure the difference in company size did not frame the negotiation. I told our team, “These folks negotiate with two kinds of companies—those they consider their equals and those they think should feel lucky just to be at the table with them. And they treat the two kinds very differently, regardless of what they bring to the table.” Over the years, I’ve seen many large organizations impose demands on their perceived inferiors that they’d never require from those they considered equals. In this negotiation, I wanted to make sure our counterpart treated us like equals.

To keep the dominance frame from taking hold, we started shaping expectations and perceptions at the very beginning, before we even considered the economics of the deal. For example, any time our counterpart made a procedural demand—however small—that we felt they would not have made of an equal, we respectfully pushed back on it. Any time they included a provision in the term sheet that seemed one-sided, even if it would not have been a costly concession, we redrafted it to be symmetrical. And throughout the negotiation, we made sure they understood that although our firm was much smaller, we were equals in this negotiation because of the tremendous value we offered. While I am not an advocate of nitpicking on minor issues, in this case we did so intentionally to help set the right frame.

Negotiators can shape the frame in countless other ways and on many other dimensions. At the very least, you want to ensure that the psychological lens that takes hold respects the value you bring to the table.

**IN THE ART OF WAR**, Sun Tzu posits that every war is won or lost before it even begins. There is truth to this sentiment in most strategic interactions. While it would be unwise for negotiators to minimize the importance of carefully managing the substance of a deal, they should make every effort to avoid the mistakes that can occur before anyone has even formulated an offer. By paying attention to the four factors discussed here, you increase your chances of creating more-productive interactions and achieving more-profitable outcomes. ▀



“Sorry—what we really want is a beginner with *experience*.”

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