



The Tension between Creating and Distributing Value

Jim West needs to find an apartment. After visiting several places and finding nothing he likes, he stumbles across an ad in his local paper that looks enticing. One walk-through with the listing agent convinces him: this is the place. Although the \$1,200 rent is more than he had hoped to pay, the apartment's high ceilings and cozy fireplace make him believe he could feel at home here. Jim arranges to meet with the owner of the condominium, Sara Grier. Jim learns that Sara is moving to France for a year to teach at a French business school. As they discuss various details in the lease, Jim wonders whether Sara intends to leave any of her furniture. He has some furniture of his own, but he doesn't have a bedroom set, a desk, or lamps and rugs. Politely, Jim inquires whether Sara plans to store her beautiful antique bed and dresser or whether she will be taking the furniture with her.

SARA: I'm not sure. But my agent told me I could rent the apartment fully furnished for about \$1,700 a month.

JIM: Whew. That would be way more than I could afford. \$1,200 is already a stretch. But it sure would be great not to have to scrounge for a bed somewhere. And your fireplace andirons are really nice; I'd rather not have to buy stuff like that. So if you're just going to end up paying to store those things . . .

SARA: I suppose I could leave *some* of the furniture. For a price.

THE GOAL: CREATING VALUE THROUGH PROBLEM-SOLVING NEGOTIATION

What's going on in this negotiation between Jim and Sara? What's at stake, and how can we better understand the dynamics at work?

Jim and Sara are engaging in the central activity in problem-solving negotiation: the search for value-creating trades that can make one or both parties better off. Jim needs an apartment. Sara has one to rent. Jim has a couch and a dining room table but no bed. Sara has a bed and nowhere to store it. Through negotiation they may be able to capitalize on their different interests, resources, and capabilities and discover agreements that expand the pie. If they can reach a deal in which Jim uses some of Sara's furniture in return for a slightly higher rent, their lease will be more economically efficient than if they ignore the possibility of this trade and Jim simply leases the place unfurnished.

What do we mean by creating value? By definition, whenever there's a negotiated agreement, *both* parties must believe that the negotiated outcome leaves them at least as well off as they would have been if there were no agreement. In this narrow sense, any negotiated outcome, if better than your best alternative away from the table, could be said to create value. In this book, however, when we talk about creating value, we typically mean reaching a deal that, when compared to other possible negotiated outcomes, either makes both parties better off or makes one party better off without making the other party worse off.¹ Assume that Jim would prefer to rent Sara's apartment unfurnished for \$1,200 rather than to pursue other alternatives. If they were to agree to this simple transaction, Jim knows he would have to spend at least \$2,000 purchasing the furniture he needs, and Sara knows that she will have to spend \$100 a month to store the items she doesn't plan to take with her. If Sara and Jim strike a deal in which Sara leaves some of her furni-

ture and Jim pays her something extra per month to use it, each side is better off.

Jim and Sara are both able negotiators, and they expect that their negotiation might present value-creating opportunities. So they search for these opportunities during their discussion:

JIM: OK, it makes sense that if you leave your furniture, I'll compensate you somehow. But before we get to that, let's talk seriously about what would work for each of us here. I'll be up front—I could really use all the furniture in your bedroom, and it would be nice to have the desk as well. What are your thoughts on leaving the furniture or taking it?

SARA: I haven't figured all that out yet. I'm really pretty flexible. I was going to store some of it and give some to friends. But I'd rather not have to go through the hassle of moving it and storing it.

JIM: Yeah, that's what I figured. I don't need your couch or dining room table, or most of the other furniture in the living room. I've got one sofa I'll be bringing with me, and a lot of other furniture in storage that I inherited recently, including a living room set that I'd like to use. So I'm pretty set there.

SARA: Where's your storage facility?

JIM: Right downtown. I moved all of my grandmother's furniture here from Albany when she moved into a retirement home.

SARA: So when you move the living room set out, you'll have some extra space in that storage unit, won't you?

JIM: Actually, I already have some extra space. Are you thinking we could share the storage unit?

SARA: That might work really well. I wouldn't have to rent a whole unit by myself. Most of the units I've seen are just too big for my needs anyway.

JIM: Great. And maybe we could use the same mover and save some money there, too.

Sources of Value

To understand how to uncover value-creating trades, it helps to have a basic sense of their economic underpinnings. Here we first explore three sources of value in negotiation. Later we add a fourth.

- Differences between the parties
- Noncompetitive similarities
- Economies of scale and scope

DIFFERENCES BETWEEN THE PARTIES

The notion that differences can create value is counter-intuitive to many negotiators, who believe that they can reach agreement only by finding common ground. But the truth is that differences are often more useful than similarities in helping parties reach a deal.² Differences set the stage for possible gains from trade, and it is through trades that value is most commonly created. Consider the following five types of differences:

Different Resources: In the simplest example, two parties may simply trade resources. A vegetarian with a chicken and a carnivore with a large vegetable garden may find it useful to swap what they have. Likewise, Jim might trade some of his storage space for Sara's bedroom furniture.

Different Relative Valuations: Even if both parties have chickens and vegetables, and both prefer chicken to some extent, they can still make useful trades. To put it in economic terms, if the two parties attach different *relative* valuations to the goods in question, trades should occur that make both better off. The party who more strongly prefers chicken to vegetables should be willing to pay a high enough price—in terms of vegetables—to induce the other party to give up at least some of her chickens.

Different Forecasts: Parties may have different beliefs about what the future will hold. In the entertainment industry, for example, performers, agents, and concert halls often have different predictions about the likelihood of various attendance levels. Performers are often convinced of their ability to draw huge crowds, while concert halls may be much less sanguine. By trading on these different forecasts—perhaps through contingent fee arrangements—the parties can resolve these differences to mutual advantage. A singer who expects to draw a standing-room-only crowd might agree to a guaranteed fee based on 80 percent attendance, plus a percentage of any profits earned from higher attendance. Such arrangements allow the parties to place bets on their different beliefs about the future.

Different Risk Preferences: Even if the parties have identical forecasts about a particular event, they might not be equally risk-tolerant with regard to that event. My life insurance company and I might have similar

expectations about what the odds are that someone my age will die within the next year. But we will probably have very different risk preferences regarding that possibility. I will be risk-averse, knowing that my family will face financial hardship if I die. Therefore, I might pay the insurance company to absorb that risk. The insurance company, by pooling my risk with the risk of others, can offer me insurance based on costs averaged over the entire pool. In effect, I have shifted the risk of my early demise to the more efficient risk carrier—the insurance company. Negotiators often create value in this way. A car buyer might purchase an extended warranty, or a start-up company might sell shares to a wealthy investor in exchange for needed capital. In each case, by allocating risk to the more risk-tolerant party for an acceptable price, the parties create a more beneficial agreement.

Different Time Preferences: Negotiators often value issues of timing differently—when an event will occur or a payment will be made. For example, a law school graduate and his wife fell in love with a condominium in Washington, D.C. Because he was going to be clerking for a federal judge for two years, his salary during that time was not sufficient to cover the mortgage payments. After the clerkship, however, he knew that he would be joining a large D.C. law firm, at more than twice his clerkship salary. He could then easily afford the house. The solution lay in structuring a mortgage schedule so that there were small payments for the first two years—less than even the interest costs—and larger payments thereafter. Although he had to pay a premium for agreeing to this tiered payment schedule, in the meantime he was able to “afford” his dream home.

Similarly, Jim and Sara might have different preferences about when Jim moves into the apartment. Although a standard lease would begin on the first of the month, Jim may need to move in earlier. If it is worth more to Jim to move in early than it costs Sara to move *out* early, they may agree to accommodate Jim’s schedule in exchange for compensation to Sara.

These five types of differences—in resources, relative valuations, forecasts, risk preferences, and time preferences—are all potential sources of value creation. They all support the same basic principle: trades can create value.

NONCOMPETITIVE SIMILARITIES

In some instances, parties have similar interests that truly do not compete, in that one person's gain does not mean the other's loss. For example, negotiators often have a shared interest in a productive, cordial working relationship. To the extent that they can improve their relationship, both gain. Likewise, parents generally share an interest in the well-being of their children. If a child flourishes, both parents derive satisfaction. Thus, even for divorcing parents, arrangements that benefit a child create joint gains for both adults.

Jim and Sara may share several interests that do not compete. For example, they may both hope that Jim gets along with the downstairs neighbors. Sara may value them as friends and neighboring property owners; Jim may simply believe that getting along well with them will make his year in Sara's apartment more enjoyable. If Jim and Sara identify this shared interest, they might arrange for Sara to introduce Jim to the neighbors before she moves.

ECONOMIES OF SCALE AND SCOPE

Economies of *scale*—in either production or consumption—can also create value. For example, two firms that each have a small plant may be able to reduce the unit cost of production by having a joint venture that builds one large production facility. Or a group of friends who share the same commute can organize a car pool to save money on gas and tolls. Families are perhaps the most natural beneficiaries of economies of scale; they share food, shelter, a car, and a television set, which lowers the cost per member of such basic living expenses. Jim and Sara have also identified a potential economy of scale: sharing Jim's storage unit, which will reduce storage costs for each of them by exploiting Jim's excess capacity. Creating or preserving such scale economies is a rich source of value creation.

Economies of *scope* can also create value. These arise when more than one good or service can be produced using the same basic resources, thus reducing the cost of each. A restaurant supplier who is selling and delivering fresh vegetables may be able to offer fresh fruits at very little additional cost. A law firm that's handling a client's corporate work may

be able to more effectively offer legal advice concerning employment law because the firm may already know a great deal about the client's business and its practices.

THE PROBLEM: DISTRIBUTIVE ISSUES AND STRATEGIC OPPORTUNISM

Why don't negotiators just share all their information, search for value-creating trades, and both walk away happy? The answer is that as negotiators share information in order to attempt to create value, they increase the risk of being exploited. A negotiator who freely discloses information about her interests and preferences may not be met with equal candor from the other side. Herein lies the core of our first tension: without sharing information it is difficult to create value, but when disclosure is one-sided, the disclosing party risks being taken advantage of.

Two classic stories from the negotiation literature capture this dilemma. The first story concerns two siblings who had what they perceived as a purely distributive dispute over how to divide an orange.³ Each claimed the right to the entire orange, and after much haggling they decided to compromise and cut the orange in two. Each went her separate way with half an orange. One ate the fruit of her half and threw the peel in the trash. The other went home to the kitchen, peeled her half of the orange, used the peel to flavor a cake, and tossed the juicy pulp in the garbage. The point of this story is that when negotiators focus myopically on distributive issues and don't share *any* information, they may squander a lot of value.

The second story involves Nancy and Bob.⁴ Nancy has ten oranges and no apples. Bob has ten apples and no oranges. Apples and oranges are otherwise unavailable to either. Bob loves oranges and doesn't much like apples. Nancy likes them both equally well. Bob suggests to Nancy that they both might gain from trading. Before the bargaining begins, neither knows the preferences of the other. If Bob discloses to Nancy that he loves oranges and hates apples, Nancy might exploit him. She might say that she has the same preferences as Bob, which would be a lie. Or she might simply propose that Bob give her nine of his apples in exchange for one of her oranges. In either case, she knows that Bob would

probably prefer having just one orange to ten apples. This story illustrates that the disclosure of preferences—particularly if unreciprocated—can invite exploitation with respect to the distributive aspects of bargaining.

Lurking distributive issues may inhibit the disclosure needed to find value-creating trades. For example, Sara might initially have been reluctant to volunteer that she was going to have to spend \$1,200 to store her furniture for the year she was going to be in Paris, because Jim might exploit her need by pretending that he didn't really want her furniture around but would tolerate it if she insisted on leaving it behind. Conversely, when Jim disclosed that he needed her furniture, Sara might have tried to extract a more substantial premium for a partially furnished apartment. Jim might rent the apartment unfurnished because they never discover the option that could make them both better off. More fundamentally, as we will see, concern about distributive issues may lead to no deal whatsoever.

Distributing Value

For many, distributing value—as opposed to creating it—is the essence of negotiating. Consider the negotiation between Sara and Jim. Rent is a key term in their agreement. Every extra dollar of rent represents a dollar more for Sara and a dollar less for Jim. If the monthly rent were the only term under discussion, their negotiation would be almost purely distributive. But because they are willing to explore a deal involving other elements as well, their negotiation has value-creating potential. Sara is willing to lend Jim some furniture, for a price. Jim might be willing to share his storage space, if he gets some credit for it. Of course, no matter how much value is created, at some point they will still have to divide the larger pie and price the deal by setting the rent.

To explore the distributive aspects of bargaining, consider a more straightforward negotiation where the key element is simply the price of a single item. Imagine that Sara says: "By the way, you don't need a car, do you? I'm selling my 1992 Honda Accord." As it happens, Jim recently changed jobs and does need a car. Their negotiation turns from the apartment to the Honda. What will this negotiation be about?

Begin by considering Sara's situation. She received the car as a gradu-

Alternatives: The range of possible things you can do away from the table without the other negotiator's agreement.

BATNA: Best Alternative to a Negotiated Agreement—of all your possible alternatives, this is the one that best serves your interests—that you will most likely take if no deal is reached.

Reservation value: Translation of the BATNA into a value at the table—the amount at which you are indifferent between reaching a deal and walking away to your BATNA.

ZOPA: Zone of Possible Agreement—the bargaining range created by the two reservation values. The ZOPA defines a “surplus” that must be divided between the parties.

Box 1

ation gift from her parents. The eight-year-old car now has 58,000 miles on it. Sara has taken the car to three used car dealers to see what she can get. The local Honda dealer offered her the best price: \$6,900. But Sara is starting to get nervous. She is leaving for France in six days. One way or another, she has to do *something* with the car before she leaves. She knows that the Honda dealer would sell the car for about \$9,800, and she has advertised the car in the local newspaper for \$9,495. She tells Jim that this is her asking price.

Jim needs a car to get to work. He once owned a Honda Accord, so he likes them and is confident of their reliability. He takes Sara's car for a test drive and does a little research. Based on the age and condition of Sara's car, he estimates that a dealer would charge about \$10,000 for it. He has already visited several dealers and has found only two other used Hondas for sale: a 1994 with lower mileage than Sara's, for which the dealer's firm price is \$11,500, and a 1990 with much higher mileage, which Jim could buy for \$6,500. Faced with these alternatives, Jim would much prefer to buy Sara's car than the 1990, even if it costs him more.

Should we expect Sara and Jim to make a deal? To explore this question and unpack the distributive issues involved, let's consider the alternatives available to each party. Alternatives are those things that Sara or Jim might do if they don't reach agreement. Sara has a number of alternatives: she can sell the car to a dealer; wait and see if another buyer

comes along; lend the car to a friend; donate it to a charity; or take it with her to France. She can do all of these things without Jim's agreement. Jim, too, has alternatives: he can buy either of the used cars at the dealership, or he can investigate the ads in the local paper.

Our colleagues Roger Fisher, Bill Ury, and Bruce Patton have coined a phrase to denote a negotiator's best course of action away from the table: the Best Alternative to a Negotiated Agreement, or BATNA.⁵ Which alternative would Sara choose if she makes no deal with Jim? Sara decides that her best alternative to a negotiated agreement with Jim is to continue trying to sell the car to another private party for a few more days, and, failing that, to sell it to the dealer for \$6,900.

Knowing her BATNA is not enough, however. Sara needs to translate it into a *reservation value*, which is the minimum amount she would accept from Jim rather than pursue her BATNA. Suppose Sara is mildly optimistic that in the next six days she will find another buyer who would pay more than the \$6,900 offered by the dealer. In this case, she might set a reservation value of \$7,000. This is the lowest price she would accept from Jim rather than take another course of action. (Sara's reservation value could also be *lower* than the cash value of her BATNA. If she doesn't want to go to the trouble of seeking out other buyers or taking the car to the dealer, she might decide that her reservation value with Jim is \$6,800.)

What is Jim's best alternative if he doesn't buy Sara's car? He will buy the 1994 Honda for around \$11,500. Does this mean that he is willing to pay \$11,500 for Sara's 1992 Honda? No; it is an older model with more mileage. To determine Jim's reservation value, we need to know the highest amount he would pay Sara and still prefer buying Sara's car to pursuing his BATNA. Suppose this amount is \$9,000. If Jim can get Sara's car for \$9,000 or less, he'd rather buy it than the 1994 model. Otherwise, he'd prefer the newer car.

Given these assumptions, Sara and Jim could make a deal somewhere between \$7,000 and \$9,000, and both parties would be better off than with no deal at all. This is the Zone of Possible Agreement, or ZOPA (Figure 2), and in this simple transaction we might expect the parties to settle somewhere in this range.

At stake in this negotiation is a surplus of \$2,000, which must somehow be divided. If Jim pays \$8,900, Sara captures most of the surplus. If

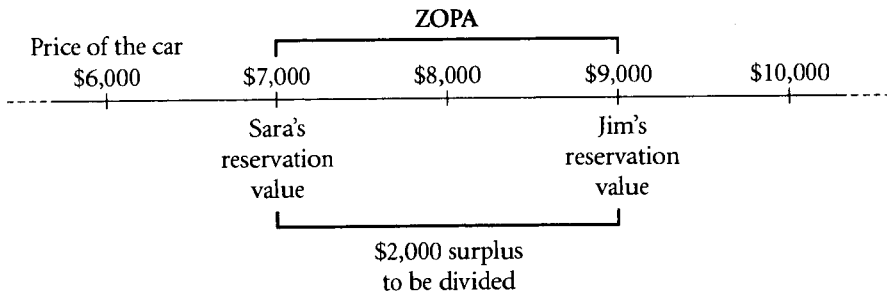


Figure 2

Jim pays \$7,100, Jim gets most of the surplus. If they decided to split the difference between what a dealer would pay Sarah (\$6,900) and what Jim would have to pay a dealer (\$9,800), the price would be \$8,350. Or, if they truthfully disclosed their reservation values and split that difference, the price would be \$8,000.

Because of the distributive issue, however, Jim and Sara might not reach a deal at all. Neither of them knows that a ZOPA even exists. Sara's asking price of \$9,495 is higher than Jim's reservation value of \$9,000. Although it would be *efficient* for Sara and Jim to reach an agreement at any price between \$7,000 and \$9,000, they might fail to do so. Two factors help explain this conundrum: information asymmetries and strategic behavior.

Information Asymmetries

In most negotiations, each party has at least some material information that the other party doesn't have. Such information asymmetries exist here. Sara knows nothing about Jim's job or the fact that he is under time pressure to buy a car. Nor does she suspect that Jim has a fondness for Hondas. Nor does she know that Jim, having now set his heart on a Honda, has little choice but to spend \$11,500 for a newer model than hers.

Jim does not know that Sara must sell the car in the next six days. Nor does he know that if necessary Sara is prepared to sell the car to the dealer for \$6,900.

The condition or quality of the goods to be traded raises another

potential information asymmetry. A seller typically knows far more about the quality of what is being sold than the buyer. This is true whether it is a car or a corporation being sold. Sara is in a better position than Jim to know the condition of her car. Some defects may be obvious, such as a dented fender, but other latent problems are not readily apparent. A mechanic may have told Sara to expect the transmission to need replacement within the next few months, for example. Jim knows that sellers often exaggerate the quality of what is being sold and fail to disclose latent defects. Even if Sara states truthfully that to the best of her knowledge the car is in great shape (and refuses to drop her price), Jim might be quite suspicious if he can't verify her claim. A skeptical buyer has little way of knowing whether a stranger is an honest seller. Ironically, the more successful a buyer is at negotiating a bargain price, the more suspicious he should be that he's being sold a lemon.

Strategic Opportunism

The desire for distributive gain may not simply inhibit value creation—it can also lead to other sorts of negotiation failures. Parties may not reach an agreement at all even though both might benefit. And even if agreement is reached, they may unnecessarily waste a lot of time and resources playing hardball. The strategic problem is that neither negotiator knows how far it might be possible to push the other side.

Negotiators rarely honestly reveal their reservation value, and are often reluctant to talk about their BATNAs. Thus, Jim is unlikely to know that Sara will accept anything above \$7,000, and Sara is unlikely to learn that Jim will pay up to \$9,000. Moreover, it may be difficult for either of them to obtain and confirm such information independently. If Jim were well prepared, he might have consulted the "Blue Book," which lists approximate retail and wholesale prices for used cars, but this would have given him only an estimate of what a dealer would pay for Sara's car. He still wouldn't know how long Sara was prepared to search for a buyer who would pay substantially more.

Consider the strategic difficulties that Sara and Jim face. With respect to the distributive dimension of bargaining, each negotiator is trying to

assess two things. First, what's the best agreement that I can reasonably hope to get? Second, can we make a deal here at all? (In other words, is the other side willing to accept an agreement that is at least minimally acceptable to me?) If Jim only cared about finding the answer to the second question, he might simply offer Sara \$9,000—saying that this is the most he's willing to pay. Sara, for her part, can't be sure that Jim might not be willing to pay more. Should she hold firm at her initial asking price of \$9,495—which is still less than what a dealer would charge Jim? Sara might not believe him and might counter for \$9,200 or more. In all events, by making this his initial offer Jim has given up any opportunity to explore whether he might make a deal that's better than minimally acceptable. On the other hand, if Jim pushes too hard for distributive gain by firmly making a lowball initial offer, Sara may conclude that it's not worth her time to negotiate further. The parties may never make a deal, even if there is a zone of possible agreement.

The essence of a lot of distributive bargaining is the attempt on the part of negotiators to shape each other's perceptions of what is possible. When deciding what action to take, each player must consider the other's possible reaction, and vice versa. This is strategic interdependence. Each negotiator is constantly assessing what the other side might eventually be willing to do—how far they may go. For example, Jim wants to assess how little Sara might accept. At the same time, Sara is trying to influence Jim's perception of what that amount is. Conversely, Sara is trying to determine how much Jim might be willing to pay, knowing that he will want to influence that perception in a way favorable to himself. And so on.

Negotiators employ a variety of tactics to influence the other side's perceptions—some misleading, some outright dishonest. Sara might mislead Jim if he asks about her best alternative. She might claim—untruthfully—that she has another offer for \$9,195 and imply that she won't accept less than that amount. Jim might pretend that he is willing to invest hundreds of hours in searching for a real bargain, seeking to influence Sara's perception of his willingness to hold out for a very favorable price. Jim may misstate his preferences, indicating that he really prefers a Toyota but is reluctantly willing to consider a Honda if necessary. Such moves are common bargaining tactics.

TEN COMMON HARD-BARGAINING TACTICS

We generally do not recommend hard-bargaining tactics as an approach to negotiation. The costs are often high and the risks substantial. But it is important for negotiators to understand such maneuvers and not be caught unprepared. To that end, we often ask lawyers and businesspeople to describe the most common difficult tactics they have encountered in negotiation. The following is the Top 10 list we have compiled from these responses and our own experience:

- (1) **Extreme claims followed by small, slow concessions:** Aiming high (or low) and conceding slowly. This may be the most common of all hard-bargaining tactics, and it has undeniable advantages. Chiefly, it protects the user from giving away too much surplus at the start. Experimental research also suggests that an ambitious initial demand tends to anchor the other negotiator's perceptions of the bargaining range—even though the other side knows full well that the opening demand is probably a self-serving gambit that conceals the offerer's true reservation value.⁶ But this tactic has two disadvantages: it lessens the chances that any deal may be made and it invites protracted haggling.
- (2) **Commitment tactics:** Committing to a course of action that ties one's hands, thus forcing the other side to accommodate; limiting one's freedom of action in order to influence the other side's view of what agreements are possible. To be effective, a commitment must seem "binding, credible, visible, and irreversible."⁷
- (3) **Take-it-or-leave-it offers:** Stating that one's offer is non-negotiable—that the negotiation will end if it is not accepted. Like commitment strategies, the risk is that no deal will be made if both parties play chicken. Moreover, take-it-or-leave-it offers can often be countered simply by making some other offer.
- (4) **Inviting unreciprocated offers:** Asking the offerer to bid against himself. Instead of meeting an offer with a counter offer, the hard bargainer indicates that the first offer is insufficient and requests a better offer.
- (5) **Flinch:** Piling one demand on top of another until the other side makes a visible sign that the demands have reached her breaking point.
- (6) **Personal insults and feather ruffling:** Using personal attacks to play

on the other side's insecurities, fluster him, throw him off balance, and otherwise gain psychological advantage.

- (7) **Bluffing, puffing, and lying:** Trying to influence the other side's perception of what would be acceptable by exaggerating or misrepresenting facts.
- (8) **Threats and warnings:** Promising drastic consequences if one's demands are not met.
- (9) **Belittling the other party's alternatives:** Trying to influence the other side's reservation value by bashing their BATNA.
- (10) **Good cop, bad cop:** Designating one person in a two-negotiator team as the reasonable person who is supposedly trying to help the other side out, while the other negotiator adopts a tough, abrasive manner and pushes for concessions.

A FOURTH SOURCE OF VALUE: REDUCING TRANSACTION COSTS AND DAMPENING STRATEGIC OPPORTUNISM

Hard-bargaining tactics, strategic opportunism, and the problems of information asymmetry all suggest a fourth source of value. Negotiators can create value by reducing the transaction costs of reaching an agreement and by dampening strategic opportunism. This can occur in several ways: by making the process of a negotiation less time-consuming and costly, by reducing the risk that the parties will deceive each other, and by better aligning future incentives.

By reducing transaction costs—in time and money—both negotiators can be better off. This may require neutralizing the other side's hard bargaining or changing the game to problem-solving (see Chapter 8). Although the transaction costs for Jim and Sara are likely to be fairly low—a matter of a few hours in all events—in more complex deals or legal disputes vast amounts of time and money can be wasted. As we suggest in later chapters, lawyers can create value by resolving legal disputes without protracted and expensive litigation (see Chapter 4).

Negotiators can also create value by reducing the risk of deception and overcoming information asymmetries. For example, recall the lemons problem arising from the fact that Sara probably knows more about the quality of her car than Jim, and that Jim may be skeptical about her claims that the Honda is in great shape.⁸ If as part of their deal they can

“Lemons” problem: The problem created when the seller knows the quality of an item being sold but the buyer does not. The buyer must worry that he will get an adverse selection out of the population of goods on the market.

Moral hazard: The problem created when a contract shifts risk from one party to another party and information asymmetries permit the non-riskbearer to behave adversely under the contract without detection or consequence.

Box 2

figure out an efficient way for Jim to verify or Sara to warrant the quality of the car, they will both be better off.

The lemons problem explains why sellers often volunteer their reason for selling. To the extent that Sara has a legitimate motivation for selling now—unrelated to the quality of the car—Jim may be reassured. To the extent Jim remains uncertain about the car’s quality, he would presumably reduce the amount he might otherwise be willing to pay. Paradoxically, Sara would probably *improve* her chances of selling the car at a favorable price if she reveals that she’s leaving for France and can’t take the car with her. On the other hand, if she discloses the imminence of her departure, Jim might try to exploit her need to sell quickly.

Jim and Sara might try other means of overcoming these quality-related information asymmetries. If Jim could verify Sara’s reputation for honesty and trustworthiness, he might be reassured. Reputation can go a long way to overcome strategic dilemmas. If Sara could give Jim references to six others to whom she’d previously sold automobiles, this would help. But of course Sara is not in the business of selling cars, and there may be no easy way for Jim to check Sara’s general reputation for veracity or fair dealing.

Sara could also signal her confidence in the car’s condition by offering a written ninety-day warranty under which she would reimburse Jim for any necessary repairs during that period. For a single transaction between two private parties this may be impractical. How does Jim

know that he'll be able to find Sara to enforce the warranty, at least at a cost that would be sensible, given the amount at stake? Moreover, for Sara such a guarantee may pose what is called a *moral hazard problem*. Shifting who bears future risks can create incentives that may affect future behavior adversely. The classic example relates to insurance. If I know that my insurance company will pay the full cost of any damage to my car, I may be more willing to take chances behind the wheel. Likewise, if Sara gives Jim too broad a warranty that covers all costs for an extended period of time, he may have less incentive to take good care of the car himself.

If Jim can't rely on Sara's claims about quality, the parties might search for other ways for him to verify the car's condition. Sara might offer a written representation that she has had the car regularly serviced. Sara might have a complete set of service records and give Jim her mechanic's telephone number. Alternatively, Sara might invite Jim to take the car to an independent repair shop of his choosing for an inspection, although presumably this form of verification would impose some costs.

The essential point here is broader than this example. As we'll see in future chapters, in both deals and disputes, negotiators can often create value by devising cost-effective means of dampening strategic opportunism by reducing the risks of deception and better aligning incentives.

THE APPROACH: MANAGING THE TENSION

We have now arrived at the core of the problem. How can you create value while minimizing the risks of exploitation in the distributive aspects of a negotiation?⁹

The challenge of problem-solving negotiation is to acknowledge and manage this tension. Keep in mind that this tension *cannot be resolved*. It can only be managed. The goal is to design processes for negotiation that allow value creation to occur, when possible, while minimizing the risks of exploitation. In this chapter and in Chapters 2 and 3, we offer some general guidelines for an approach that facilitates problem-solving. Our advice concerning the best ways of defending against the risks of exploitation, even in the face of hard-bargaining tactics, is reserved for Chapter 8.

To Prepare

We cannot overstate the importance of preparation—the cornerstone of successful negotiation. Good preparation begins with the following steps, which we will look at in turn:

- Identify the issues and think about interests—yours and theirs
- Contemplate value-creating opportunities
- Know your BATNA and improve it if possible
- Establish an ambitious but realistic aspiration level

IDENTIFY THE ISSUES AND THINK ABOUT INTERESTS— YOURS AND THEIRS

In preparing for a negotiation, an obvious place to start is by thinking about the various issues that might usefully be discussed at the table. Some issues are conspicuous, particularly “the price” or a salient money issue. Jim and Sara know that they’ll need to talk about the price of the car or the rent for the apartment. Other issues may be less obvious. When Jim asks Sara about using her furniture, he broadened the scope of the negotiations by bringing up an additional issue. This is often a useful way to find trades.

Too often, people focus their preparation too narrowly. Imagine, for example, that Stephanie McGrath has been looking for a new job and is about to negotiate for a position she has been offered servicing accounts for the Bradford Advertising Agency. She will obviously want to prepare to talk about salary. Bradford has indicated that it will pay her \$95,000 a year, which is a substantial increase over her present earnings of \$80,000. But as she prepares, Stephanie realizes that there are a number of other issues involved as well. For example, what will her title be? How will her job be defined? How much vacation will she receive? How much will she be expected to travel? Will the company pay for her moving expenses if she takes the job?

Stephanie should think deeply about her interests vis-à-vis her new job. Interests reflect the concerns and needs underlying bargaining positions. Some are fairly obvious. Stephanie has certain financial interests. Like most people, other things being equal, she would prefer to be paid more rather than less. But when it comes to employment, people have

very different interests and priorities. Someone with substantial family responsibilities may have a strong interest in finding employment that offers financial security and predictable hours without much travel. Because Stephanie is only thirty years old, what she cares about most is building her career in advertising over the long term. She has an interest in improving her skills and learning to be an effective manager and leader. Job security is relatively unimportant, but prospects for growth are critical. She also is concerned that her salary fairly reflect current market conditions and signal that she has significant responsibilities at Bradford. She doesn't mind working long hours, but having at least three weeks of vacation is important to her because she spends time with her family at Christmas and a week in the summer at a family reunion, and she tries to take one week a year to travel to a foreign destination that she's never visited before. Travel is one of her real passions.

Stephanie also needs to consider what Bradford's interests might be. In preparation, there is an important difference between thinking about your interests and thinking about the other side's interests. With thorough preparation you can *know* your own interests, subject to some change if you learn new information during the course of the negotiation. With respect to the other side's interests, however, thorough preparation can provide you with no more than a tentative list. A key activity at the table will be to learn from the other side more about their interests to deepen your understanding. Indeed, a critical part of preparation is to think through what questions you will ask to learn the other side's concerns.

Stephanie can make some informed guesses about Bradford's likely concerns. The agency may be concerned about setting a bad precedent or making a deal with her that would create problems with other employees. There is probably company policy about benefits, vacation, and moving expenses. Bradford also obviously has financial interests. Other things being equal, they'd probably rather pay Stephanie less than more. On the other hand, she knows the agency has a strong interest in growing the business, securing new clients, and being seen as a "hot" agency, where talented young people want to work. Bradford certainly wants to be perceived in the market as a fair employer.

Certain intangible interests may be important to some degree in almost every negotiation. The parties may have interests in feeling under-

Issues	Stephanie's Interests	Bradford's Possible Interests
<ul style="list-style-type: none"> • What will her salary be? 	<ul style="list-style-type: none"> • To get more rather than less • To be treated fairly • To be compensated for the clients she'll bring with her • To be recognized by clients as part of management 	<ul style="list-style-type: none"> • To pay less rather than more • To be seen as fair by potential employees • To create appropriate employee incentives • To fit new position into firm's organizational structure and to avoid an awkward precedent • To avoid creating resentment among other employees
<ul style="list-style-type: none"> • Will the company pay her moving expenses? • Amount of vacation per year? 	<ul style="list-style-type: none"> • To alleviate her short-term cash-flow problem • To stay in touch with family and have a week for travel with friends 	<ul style="list-style-type: none"> • To maintain consistent policy? • To maintain consistent policy?

Box 3

stood or fairly treated. In business deals, the principals may have interests in not losing face and in strengthening their reputation. A client may be concerned about preserving his relationship with the other side, despite their current dispute. Only by thinking about both tangible and intangible interests can you create a complete picture of what is motivating you and the other side.

CONTEMPLATE VALUE-CREATING OPPORTUNITIES

Having identified your interests and the likely interests of the other side, you can start thinking about the sorts of value-creating options that you may want to suggest to the other side. For example, because Stephanie is more concerned about career advancement than job security, she may want to propose quarterly performance reviews and a commitment that

she would be in her initial job for no more than one year—that it would be up or out.

In her preparation Stephanie might also think about some possible options to resolve the salary difference between Bradford's initial offer and her aspiration. She wants a higher salary in part because she is confident that she will be able to attract new clients for Bradford, including some accounts she already has in her present job. She may suspect that Bradford is most concerned about setting a bad salary precedent for other new employees, some of whom may not have any clients at all. One solution might be to propose a base salary plus a bonus giving Stephanie an agreed-upon percentage of billings for any new clients she brings in. This salary arrangement takes advantage of two sorts of differences between the parties: differences in predictions (about the certainty that Stephanie will be able to deliver new clients) and differences in resources (her existing relationships with certain clients that Bradford would like to attract).

Both in preparation and at the table, consider the basic sources of value when searching for possible trades:

- **Resources:** Do you and the other side have different assets that you could trade?
- **Relative valuations:** Are there things that are valuable to you but less valuable to the other side, and vice versa?
- **Forecasts:** Do you have different predictions about some future event that you could bet on?
- **Risk preferences:** Do you have different abilities to absorb risk? Is one person more risk-preferring than the other?
- **Time preferences:** Do you have different needs concerning *when* things happen or don't happen? Are there differences in short-term versus long-term interests?

If the company doesn't pay moving expenses, Stephanie may want to suggest a one-time signing bonus, or perhaps an interest-free loan, to help cover her expenses. These options might better meet Bradford's concerns. Of course, in preparation you can't know for sure what the other side's interests, resources, and capabilities may be, so you won't be able to identify all the value-creating opportunities that may exist. That

must wait until you meet with the other side. Your goal in preparation is to begin to think about what *some* value-creating opportunities might be. If you have some ideas that sound plausible and attractive to the other side, it will be easier to invite them to problem-solve with you. In addition, by thinking about value creation in advance, you may remind yourself not to focus solely on distribution in your upcoming negotiation.

KNOW YOUR BATNA AND IMPROVE IT IF POSSIBLE

To prepare for managing the tension between creating and distributing value, you must determine the point at which you will walk away from accepting *any* deal with the other side. How will you know whether to tell the other side, "Sorry, that's just not good enough. I'm going to have to go elsewhere"? You need to identify your best alternative to a negotiated agreement and how that translates into a reservation value at the table.

In her preparation for negotiations with Bradford, Stephanie thinks about her possible alternatives. She has basically decided that if she doesn't move to the Bradford Agency, she will stay in her current position with the Ames Agency. The Bradford offer is better than her present position—it pays her more and she would be working under a manager from whom she thinks she could learn a great deal. But negotiation is not a static game. Stephanie may be able to improve her BATNA because of the Bradford offer. Ames may offer her a big promotion to keep her. And this in turn may improve her negotiation with Bradford. This raises an interesting issue of timing. She might want to explore the possibilities of a new position with Ames before trying to close a deal with Bradford. In essence she may create something akin to an auction for her services.

Stephanie also thinks about her prospective boss's possible alternatives. What will he do if the two of them don't reach agreement? Although she may not know what Bradford will do if the agency doesn't hire her, she tries to identify the likely alternatives. Identifying the other side's possible alternatives may help Stephanie think through what the upcoming negotiation looks like from Bradford's point of view. If the company's BATNA would be to find another candidate outside the firm, how long would the search take? Is there likely to be a candidate as good

Stephanie's Alternatives

If I don't take this job I will:

- Stay at Ames Agency for \$100,000 per year
- Keep looking for a better offer elsewhere

Stephanie's Assessment of Bradford's Alternatives

If Bradford doesn't hire me it will:

- Look for another candidate outside the firm
- Look for a candidate to promote from inside the firm

Box 4

as Stephanie? What would hiring someone else cost the firm? What would the search itself cost in personnel time and interview expenses? How tight is the labor market?

When you have identified your BATNA and thought about the other side's likely alternatives, you want to *begin* thinking about how to translate your BATNA into a reservation value at the table. In our car example, which is a very simple case, this is relatively easy. Jim knew that if he didn't buy Sara's car he would buy the 1994 Honda, and he knew he preferred that alternative unless he could get Sara's car for less than \$9,000.

Stephanie's situation is more complex. Assume Ames has offered her a promotion with a salary of \$100,000. Stephanie might well prefer the Bradford offer at a lower salary if she were persuaded that there would be long-term benefits to her career. How much she would be prepared to sacrifice might very well turn on things she does not yet know. She may want to find out more about her prospects for promotion at Bradford; what opportunities she might have for foreign travel that she would find exciting; and whom she would be reporting to.

In other words, even when she has a firm sense of her BATNA, translating that into a single reservation value or bottom line does not make sense in a negotiation like this. Stephanie must compare the two possible jobs along a number of dimensions. At the bargaining table, she will still

be learning more about the package of terms that Bradford is willing to offer and various advantages and disadvantages of working at Bradford. Because the minimum salary she might accept could be influenced by what she learns about these other elements, picking a single salary figure that represents her walk-away point would be unwise. Instead, because her negotiation involves multiple issues, Stephanie must think about the trade-offs between those issues so that ultimately she can compare her BATNA to what she and Bradford agree to.

Nevertheless, as part of her preparation it is indispensable that she begin thinking about not only her BATNA but how to translate that into a reservation value that she can work with at the table. Ultimately, she will have to decide which position better meets her interests.

ESTABLISH AN AMBITIOUS BUT REALISTIC ASPIRATION LEVEL

It's not enough simply to think about your reservation value—the least you would accept. In your preparation, it is critical that you aspire to an outcome that serves your interests much better than your best alternative. You generally won't get what you don't ask for. Much research has shown that those negotiators with high aspirations on average do better.

We are *not* saying that you should make outrageous demands that cannot be justified. Instead, as part of your preparation you should marshal in advance the arguments that might in good faith support your aspirations. What salary would Stephanie like to ask for initially? In negotiating with Bradford, for example, she may be able to argue that in light of her talents and current market conditions a base salary of \$120,000 with a bonus for strong performance would be reasonable. This does not mean that she should start with an opening demand of \$180,000. But Stephanie should think about what salary she will ask for and what arguments she can make about why her initial demand is reasonable.

At the Table

When you are ready to negotiate, how do you proceed? A problem-solving negotiator will try to negotiate a process that allows the negotiators to:

- Identify each other's interests, resources, and capabilities
- Generate value-creating options
- Treat distributive issues as a shared problem

IDENTIFY INTERESTS, RESOURCES, AND CAPABILITIES

At the table, the joint task for Stephanie and Bradford is to identify each other's interests, resources, and capabilities—the prerequisite for value-creating trades. How is this done? By asking questions designed to elicit the other side's interests. The best of these questions are:¹⁰

- What is important to you?
- Why?
- Why not?
- What else?
- What would be wrong with . . . ?

If Stephanie has prepared well, she will enter her negotiation with a tentative list of the other side's interests. At the table, she can check her hypotheses to determine which are accurate and which need revision. There are many ways to accomplish this. The simplest way is to ask directly: "Are you concerned about setting a precedent for other employees if you give me three weeks' vacation?" Stephanie can also put herself in the firm's shoes and hypothesize about how management might be thinking about the situation: "If I were you, I might be worried about other employees asking you to expand their benefits if you've done it for me. Is that right?" Regardless of the way she frames her questions, the purpose is to keep learning what the other side cares about.

Consider the following dialogue between Stephanie and her prospective boss about the amount of vacation she will receive. She has asked for three weeks and has been turned down. She wants to know *why* the boss will only grant two weeks.

BRADFORD: I'm sorry—I can only offer you two weeks of vacation a year for your first three years.

STEPHANIE: Why is that?

BRADFORD: Well, that's our standard amount for a position at this level. I

have to be sure that your benefits package lines up with others in the company.

STEPHANIE: Having a consistent vacation policy is important to you.

BRADFORD: Exactly.

STEPHANIE: Are there any other reasons that granting more vacation might be a problem?

BRADFORD: Yeah—I'd be concerned about having you gone for two weeks or more at a time.

STEPHANIE: What would be wrong with that, from your perspective?

BRADFORD: Well, given the importance of your new position during this time, I think that might be very disruptive.

STEPHANIE: I see. So if I had three weeks, you'd worry that I'd take one long vacation and my absence would be disruptive.

BRADFORD: Yes.

Stephanie is probing to find out Bradford's concerns on this issue. She should also share some of her own interests. For example, she might explain that for the last four years she's had three weeks vacation at Ames and that this is important to her because she likes taking one week off three times a year, to visit her family and to travel. Unfortunately, all too often interests don't get discussed in negotiations. Consider the following example:

BRADFORD: I'm sorry—I can only offer you two weeks of vacation a year.

STEPHANIE: Why is that?

BRADFORD: Well, that's our standard amount for a position at this level. I have to be sure that your benefits package lines up with others in the company.

STEPHANIE: But as I understand it, three weeks is standard in the industry for a mid-level manager. Two weeks won't do it, given my family obligations.

BRADFORD: Well, that's the best I can do.

What happened? Stephanie started off well by asking why Bradford only wanted to offer two weeks a year. But rather than show understanding of the response and ask more questions to uncover the agency's interests more fully, she succumbed to the temptation to argue. The implicit message is, "OK, that's your interest or concern, but it's wrong." Or, "I've got a competing interest that should be given priority." If Stephanie takes that approach, she isn't likely to learn much more about Bradford's

concerns. Instead, they'll just fight about whose interests are more important.

It takes discipline to stick to your task. At this stage, Stephanie wants to uncover as much information as she can about what drives the other side. What concerns underlie his stated demands? What needs is he not expressing but worrying about? These underlying interests are the stuff of which value-creating trades are made.

It may help Stephanie to know that she'll have an opportunity to assert her own perspective and interests—later. She should clarify up front that her desire to understand Bradford's interests should not be taken as agreement with or acceptance of those interests. And she should ensure that he recognizes her reciprocal right to have an opportunity to explain her point of view.

GENERATE VALUE-CREATING OPTIONS

Now Stephanie is ready to look for value-creating trades. But this is not as easy as it might appear. Many negotiators jump into a negotiation process that inhibits value creation. One side suggests a solution and the other negotiator shoots it down. The second negotiator proposes an option, only to be told by the first why it can't work. After a few minutes of this, neither side is willing to propose anything but the most conventional solutions. This method mistakenly conflates two processes that should be engaged in separately: generating options and evaluating them.

It often helps to engage in some sort of brainstorming. The most effective brainstorming requires real freedom—however momentary—from practical constraints. In Stephanie's negotiation with her prospective boss, she may want to set aside some time simply to generate solutions, not critique them. She might say something like, "Well, I think I have a good sense of your interests, and you seem to understand mine. Now I'm wondering how we can meet those interests. I'd like to take the job if we can work out these remaining issues, and I've got some ideas. My suggestion is that we take ten minutes and just try to brainstorm as many possible solutions to this problem as we can think of—even crazy solutions. Then we can decide if any of them make sense."

In this way, Stephanie is enlisting Bradford's cooperation in the first ground rule of brainstorming: *no evaluation*. Premature evaluation in-

Ground Rules for Brainstorming

- No evaluation
- No ownership

Box 5

hibits creativity. We are all self-critical enough, and adding to our natural inhibitions only makes matters worse. When brainstorming, avoid the temptation to critique ideas as they are being generated. This includes avoiding even congratulatory comments about how great someone else's idea is, murmurs of approval, and backslapping. When you signal such approval, you send the implicit message that you're still judging each idea as it is generated—you're just keeping the *negative* comments to yourself. That does not encourage inventiveness. The goal is to liberate those at the table to suggest ideas. One person's idea may seem crazy, but it may prompt another person to suggest a solution that might otherwise have been overlooked. There will be time enough for evaluation. The idea behind brainstorming is that evaluation should be a separate activity, not mixed with the process of generating ideas.

The second ground rule of brainstorming is: *no ownership of ideas*. Those at the table should feel free to suggest anything they can think of, without fear that their ideas will be attributed to them or used against them. Avoid comments such as: "John, I'm surprised to hear you suggest that; I didn't think you believed that idea made much sense." John should be able to suggest an idea *without believing in it*. Indeed, those at the table should feel free to suggest ideas that are *not* in their best interests, purely to stimulate discussion, without fear that others at the table will later take those ideas as offers.

In preparing for negotiations, brainstorming is often employed behind the table with colleagues in order to generate ideas. For many negotiators, however, it may feel very dangerous to engage in this activity with someone on the other side. Our own experience suggests, nevertheless, that by negotiating process clearly, brainstorming can also be productive across the table.

How do you convey these ground rules to the other side? You can get the point across without sounding dictatorial or rule-obsessed. Just explain what you're trying to achieve and then lead by example. Returning to Stephanie's negotiation with Bradford, she might say, "I understand that the company's policy is to give new employees two weeks of vacation a year. I'd like to see if we could come up with some creative options to apply to my case that would still serve the company's interests. In my experience, it often helps to spend a few minutes just listing all of the ideas we can think of—without saying whether we think they're good or bad or even acceptable."

Stephanie is inviting Bradford to discuss options with her, and she's signaling her commitment to the no-evaluation, no-ownership-of-ideas ground rules. Together they may generate a list of possibilities: Stephanie is permitted a third week without pay (perhaps compensated for by an increase in her salary); Bradford gives Stephanie credit for her time working at Ames and brings her in as if she's been working at the Bradford Agency for three years; or Bradford agrees to modify the policy slightly and extend Stephanie's vacation from two weeks to three weeks after only one year with the firm.

Similarly, Stephanie and Bradford might come up with a variety of options for resolving their disagreement about who should pay Stephanie's moving expenses. They could share the cost of the move; the agency could extend Stephanie an interest-free short-term loan to cover her expenses; or Bradford could increase her starting bonus to reflect the moving costs. Generating these possible options may broaden the parties' thinking about the terms of their negotiated agreement.

Many of these options demonstrate that a negotiator's interests can often be met in a variety of ways. And often the simplest solution is to compensate one side by adjusting the price term—in Stephanie's case, her salary—to accommodate the parties' needs and concerns. Rather than change the company's vacation policy, for example, Bradford might prefer the option of paying Stephanie a little more and then allowing her to take one week of unpaid leave a year, because that does not set as bad a precedent for other employees. In many deal-making situations, such "side payments" can be an effective way to adjust the distributive consequences of value-creating moves (see Chapter 5).

TREAT DISTRIBUTIVE ISSUES AS A SHARED PROBLEM

Now Stephanie is fairly far along in her negotiation. As she looks at the list of possible options that she and Bradford have created, one thing will stand out: some of the options are better for her than others. And Bradford will be thinking the same thing. No matter how good you are at brainstorming and no matter how carefully you search out value-creating trades, at some point the pie has to be sliced.

What happens to interest-based, collaborative problem-solving when you turn to distributive issues? Some negotiators act as if problem-solving has to be tossed overboard when the going gets tough. We could not disagree more. In our experience, it's when distributive issues are at the forefront that problem-solving skills are most desperately needed.

Stephanie's goal at this point is to treat distributive issues as a shared problem. Both sides know that distributive issues exist. She knows that, other things being equal, she'd like to earn more and Bradford would like to pay less. There's no getting around it. At the same time, however, she doesn't want to behave in a way that would damage her relationship with Bradford.

Suppose Stephanie knows that she would want to accept Bradford's offer so long as Bradford pays her what Ames is offering and that she would accept even if Bradford does nothing more with respect to moving expenses or a third week of vacation. In other words, a \$100,000 salary is her reservation value. What might Stephanie do to move to closure?

She might say something like the following: "I would very much like to come to work for you, and while salary is not my primary consideration, I obviously care about being compensated fairly. What appeals to me most about Bradford is my long-term opportunity to build my career. Here's a package I'd be pleased with. I'd like you to consider it." Stephanie then lays out a package with the following elements: a base salary of \$100,000; a bonus of up to \$20,000 depending on her ability to deliver new clients; an option to take a third unpaid week off each year until her fourth year, subject of course to work schedule; and a one-year interest-free loan of \$10,000 to cover moving expenses. "I think this respects your firm's present policies," Stephanie says, "and I think it's

fair in light of what you've paid others with my experience and what I know about compensation packages for account executives at comparable firms."

Notice what Stephanie has done. She asked for more than the minimum she would accept. But she made no threats, and her proposal was not in the form of a take-it-or-leave-it offer. Her proposal respected Bradford's concerns about the agency's policies. She had a reason to justify both the salary and her bonus, and she explained why her proposal was consistent with current market conditions.

In some situations it's easy to find a salient market norm around which to structure an agreement. Stephanie, for example, may be able to do only a few minutes of research on the Internet and find what comparable salaries would be at other agencies for someone in her position. And her competing offer from the Ames Agency provides one easy standard against which to measure Bradford's proposal. As Stephanie and Bradford work to reach agreement, she may bring up these norms rather than just arbitrarily demanding something over Bradford's offer of \$95,000.

As it turned out, Bradford accepted Stephanie's offer, and during her first year she in fact earned the full \$20,000 bonus. Is it possible that Stephanie could have demanded and received an even sweeter package than the one that she proposed? She'll never know. But what she does know is that the deal she struck serves her interests very well while respecting those of her employer. And the agreement with Bradford is better than her BATNA.

What if Bradford had merely matched the Ames base salary but done nothing more, or, worse still, had simply held firm at \$95,000? In either case, Stephanie could ask Bradford to explain the reasoning underlying the offer. How does the agency justify its number? On what norms is it based? Why should it persuade her? And in both cases, Stephanie would have to decide whether to stay at Ames or to move. Based on the facts, this would be a very close question. It's possible that she would turn down \$95,000 because she concluded that her interests would be better served by staying at Ames. At the same time, Stephanie could have accepted the offer without losing face and without having damaged her relationship with Bradford.

Sometimes, of course, you won't be able to find a solution that satisfies both sides. No matter how hard you try, you will continue to disagree about salary, the amount to be paid in a bonus, or some aspect of a dispute settlement. Norms may have helped move you closer together, but there's still a big gap between the two sides. What should you do?

Think about process. How can you design a process that would fairly resolve this impasse? In a dispute settlement, you might be able to hire a mediator to address the distributive issues that are still open. Is there anyone both sides trust enough to decide the issue? Could you put five possible agreements into a hat and pick one at random?

Procedural solutions can often rescue a distributive negotiation that has reached an impasse. They need not involve complicated alternative dispute resolution procedures that cost money and time. Instead, you can often come up with simple process solutions that will resolve a distributive deadlock and allow you to move forward.

CHANGING THE GAME

Not everyone approaches negotiation from a problem-solving perspective. The basic approach described in this chapter—with its emphasis on the sources of value creation and the importance of a problem-solving process—obviously departs from the norm of adversarial haggling. To be a problem-solver, a negotiator must often lead the way and change the game. We explore this theme in Part III, where we not only describe how to defend against hardball distributive tactics but introduce other game-changing possibilities, including adding or subtracting issues, changing the parties, creating effective relationships, and otherwise altering the system of a legal negotiation. Here we merely note that a problem-solver does not assume that the issues, process, or structure of a negotiation are fixed. Instead, one is always alert to game-changing possibilities.

CONCLUSION

The tension between value creation and value distribution exists in almost all negotiations. But as our teaching and consulting have shown us, many people tend to see negotiation as purely one or the other. Some people see the world in zero-sum terms—as solely distributive. We work

hard to demonstrate to people that there are nearly always opportunities to create value. Others believe that, with cooperation, the pie can be made so large that distributive questions will disappear. For these negotiators, we emphasize that there are always distributive issues to address.

Of course, some negotiations present many value-creating opportunities, while others are very distributive. Very distributive negotiations typically involve a one-shot dispute or single issue (such as price); fixed transaction costs; and parties with no continuing relationship. An example would be an accident victim's damage claim against an unknown or arm's-length insured driver. If both parties have fixed legal costs, the negotiation is essentially about how much one party will pay the other. A dollar more for the plaintiff means a dollar less for the defendant.

Other negotiations have many value-creating possibilities. If the parties value an ongoing relationship, they can both gain by pursuing this shared interest. If transaction costs are high relative to the amounts at stake, both parties may gain by designing an efficient negotiation process. If many issues or variables are involved, the parties may have different relative valuations and may thus be able to make trades.

The problem-solving approach we have suggested here will not make distributive issues go away or this first tension of negotiation disappear. But it does outline an approach that will help you find value-creating opportunities when they exist and resolve distributive issues efficiently and as a shared problem. We now turn to the interpersonal dynamics at work in negotiation—and our second tension.

2

The Tension between Empathy and Assertiveness

Four years ago, Susan Reese and Martin DiPasquale opened a restaurant and take-out catering business on Main Street in Winchester amid much fanfare and high hopes. Unfortunately, things have not gone as planned. Although the business has done well and continues to turn a profit, the relationship between the two partners has soured. Martin finds Susan unbearably pessimistic and difficult to work with—the restaurant just isn't fun anymore. Susan thinks Martin has no business sense and won't take their finances seriously—he's constantly giving away meals and drinks to friends and neighbors, wants to spend extravagantly on fancy ingredients and overpriced advertising, and occasionally treats customers in a flamboyant way. Because of their seemingly insurmountable differences, Susan and Martin have decided to end their partnership. They face the difficult question: How? Should they sell their business to a third party and split the proceeds? Should Susan buy out Martin's 50 percent share, or vice versa? If so, how should the price be set? What would best meet their interests?

The partners are having their first conversation about what to do. They've already been talking for about ten minutes when Susan says:

SUSAN: I think that it makes the most sense for you to sell your 50 percent to me. You never wanted to be in the restaurant business anyway. You just don't have the business sense to run this place alone, and you wouldn't enjoy it. Too much administrative hassle—paying the staff, dealing with the suppliers, all of it.

MARTIN: Hmph. I don't really see it that way, but I'm curious about why you do. Why do you think that I never wanted to be in the restaurant business and wouldn't like running it by myself?

SUSAN: It's not your style, Martin. You've just never shown much interest in the business side of the business—you'd be terrible on your own.

MARTIN: So you think that I don't like the business side of running the restaurant, and that I wouldn't do well here without you?

SUSAN: Exactly.

MARTIN: And you got that impression because I don't work on the books or fire people, that sort of thing?

SUSAN: Right. That kind of stuff always fell on me to do.

MARTIN: Well, I guess I always thought you really liked the bookkeeping side of the restaurant, so I left those jobs to you. I focused my energy on connecting with our customers and getting the restaurant noticed. I never thought you were much of a people person, quite frankly. And obviously you never thought I was much of a business person. But I'm sure I could do those things—or hire someone to help manage the place if it got out of hand.

SUSAN: Well, we obviously disagree. Anyway, I think you should sell me your 50 percent.

MARTIN: We'll see—I'm not so sure about that yet. But you don't have any doubts that you'd like to buy me out and stay here, right?

SUSAN: That's right. I don't feel ready to quit.

MARTIN: What do you mean?

SUSAN: I just think that we've spent all this time and energy building the business, especially the catering side. You've never shown any interest in the catering business—and I really enjoy it. And I think that the customer base is growing and that the catering side could really take off.

MARTIN: OK. So for you, selling out now would be bad timing; we wouldn't get paid back for all the money and effort we've put in?

SUSAN: Right.

THE GOAL: COMBINING EMPATHY AND ASSERTIVENESS IN NEGOTIATION

How are Martin and Susan doing as they try to have this difficult conversation? How is their negotiation going? Are they likely to be able to solve their problem by finding ways to make them both better off? Or is a potential deal going to dissolve into a bitter dispute that destroys the business in the process?

Martin is doing two things well in his discussion with Susan. First, he is demonstrating his understanding of Susan's perspective. He notes that Susan thinks Martin should sell his share to her, that he has never shown much interest in the business side of the restaurant, and that it would not be a good time to sell the catering business. Martin is asking Susan questions about her views and opinions and is demonstrating his understanding of her answers by paraphrasing them back to her.

Showing Susan that he understands her perspective can't be easy for Martin in this conversation. The substance under discussion is difficult; neither Susan nor Martin is willing to sell half of the business at this point, and it's an emotionally charged issue for both of them. In addition, Susan is saying things in an aggressive and confrontational way—making a lot of assumptions about who Martin is and what he wants (such as, “You just don't have the business sense to run this place alone, and you wouldn't enjoy it”)—with which Martin disagrees. Despite this, Martin works hard to listen, and to show Susan that he's listening.

At the same time, Martin is asserting *his* perspective and interests in the conversation. He has explained why he focused more energy on customers and less on managing the restaurant's books. He says that he's sure he could handle the accounting side of the business, or that he'd know how to find help if he needed it. And he consistently notes that even when he's showing Susan he understands her views, he has views of his own that differ from hers.

In our experience, the most effective negotiators try, like Martin, to both empathize and assert in their interactions with others. For purposes of negotiation, we define *empathy* as the process of demonstrating an accurate, nonjudgmental understanding of the other side's needs, interests, and perspective.¹ There are two components to this definition.

Empathy: Demonstrating an understanding of the other side's needs, interests, and perspective, without necessarily agreeing.

Assertiveness: Advocacy of one's own needs, interests, and perspective.

Box 6

The first involves a skill which psychologists call *perspective-taking*—trying to see the world through the other negotiator's eyes. The second is the nonjudgmental *expression* of the other person's viewpoint in a way that is open to correction.²

Defined in this way, empathy requires neither sympathy nor agreement. Sympathy is feeling for someone—it is an emotional response to the other person's predicament. Empathy does not require people to have sympathy for another's plight—to “feel their pain.” Nor is empathy about being nice. Instead, we see empathy as a “value-neutral mode of observation,” a journey in which you explore and describe another's perceptual world without commitment.³ Empathizing with someone, therefore, does not mean agreeing with or even necessarily liking the other side. Although it may entail being civil, it is not primarily about civility. Instead, it simply requires the expression of how the world looks to the other person.

By *assertiveness*, we mean the ability to express and advocate one's own needs, interests, and perspective.⁴ Assertiveness is distinct from both *belligerent* behavior that transgresses the rights of others and *submissive* behavior that demonstrates a lack of self-respect. An assertive negotiator begins with the assumption that his interests are valid and that having them satisfied is legitimate.⁵ (That's why assertiveness training involves developing self-confidence as well as rhetorical skills.)⁶ Assertiveness, however, does not necessarily mean dominating the conversation or the other negotiator. Instead, it means identifying one's own interests, explaining them clearly to the other side, making arguments if necessary, and having the confidence to probe subjects that the other side may prefer to leave untouched.

Three main points about empathy and assertiveness are central:

- Problem-solving negotiations go better for everyone when each side has well-honed empathy and assertiveness skills
- Problem-solving negotiations go better for an individual negotiator if she both empathizes and asserts, even if the other side does not follow her lead
- Empathy and assertiveness make problem-solving easier in both the value-creation and the value-distribution aspects of negotiation

The first point needs little elaboration. Empathy and assertiveness are aspects of good communication. When people communicate well with each other, problem-solving is easier. But as we've seen, sometimes the other side doesn't want to reciprocate and is reluctant to listen. Susan seems to be all assertiveness and no empathy. What should Martin do? In our view, Martin is better off combining assertiveness with empathy, even if he has to empathize alone, for a number of reasons.

First, regardless of how Susan is behaving, Martin really *does* need to understand her point of view. She may be annoying, but she has interests and viewpoints—and he'd better know what they are. This will help him both when he's trying to create value from the deal and when he faces any dispute over how that value should be distributed. Although Susan has no problem being highly assertive, her opening statements don't give Martin much to work with. By inviting her to say more, Martin learns that Susan thinks it's premature to sell to a third party and that she'd like to expand the catering business. To the extent that Martin can clarify *for himself* what Susan's motives and goals are, he will be better equipped to find value-creating trades. Indeed, research confirms that negotiators with higher perspective-taking ability negotiate agreements of higher value than those with lower perspective-taking ability.⁷

Such perspective-taking on Martin's part may also facilitate distributive moves. Perhaps Martin will end up running the restaurant, Susan will expand the catering operation, and they will divide these into two separate businesses. The better Martin understands Susan's thinking, the better he will be able to anticipate the strategic problems and opportunities that may crop up in the negotiation—and to prepare for them.

A second benefit of empathy is that it allows Martin to correct any

misperceptions *he* may have about Susan's thinking. It would be easy, in this emotionally charged situation, for Martin to start making unfounded assumptions about Susan's agenda. He needs to keep checking in with her, to make sure that he's not getting off on the wrong track. Indeed, regardless of the emotional content of a negotiation, research has shown that negotiators routinely jump to mistaken conclusions about their counterparts' motivations, usually because their information is limited.⁸ Such mistakes are a major reason why negotiations and relationships break down. For example, negotiators often make *attributional* errors—they attribute to their counterparts incorrect or exaggerated intentions or characteristics. If a counterpart is late to a meeting, we might assume either that he intended to make us wait or that he is chronically tardy, even though we may be meeting him for the first time. In either case, we have formed a judgment that may prove counterproductive—particularly if we decide to keep *him* waiting the next time or seek other ways to even the score.

A third benefit of combining assertion with empathy is that Martin may be able to loosen Susan up—and gain her trust. Negotiation is a dynamic process. Most people have a need to tell their story and to feel that it has been understood. Meeting this need can dramatically shift the tone of a relationship. The literature on interpersonal communication constantly emphasizes this point.⁹ Even if you are not interested in sharing a deeply soulful moment with your counterpart, remember that empathizing has highly practical benefits. It conveys concern and respect, which tend to defuse anger and mistrust, especially where these emotions stem from feeling unappreciated or exploited.

Finally, your empathy may inspire openness in others and may make you more persuasive. Two-sided messages, in which the speaker describes the other person's viewpoint before stating her own, are more persuasive than one-sided messages.¹⁰

It is not surprising to most people that assertiveness can confer benefits in the distributive phase of a negotiation. Assertive negotiators tend to get more of what they want, and negotiators with high aspirations do better than those with low aspirations. But assertiveness can also contribute to value creation; only when each party takes the opportunity to directly express his own interests can joint gains be discovered.

There are other benefits to being assertive, however, that have nothing

to do with value creation and distribution. Assertiveness may facilitate successful working relationships. The assertive negotiator confronts interpersonal difficulties as they occur, rather than permitting them to fester, and thus makes long-term cooperation possible. Assertive behavior may also promote self-respect, as the assertiveness-training literature emphasizes. Finally, to the extent that an assertive negotiator feels satisfied not just with the substance of an agreement but with the way she negotiated it, the agreement itself is likely to prove more durable.

Viewing Martin and Susan's negotiation through this lens, we see that Martin in some ways is fortunate to have a partner who is so "up-front" about her views and desires. By demonstrating his understanding of Susan's perspective, but also asserting his own, Martin can lead the way toward a solution that leaves both parties better off.

As we saw in Chapter 1, differences are most often the source of value-creating trades. Martin has just discovered that Susan is concerned about timing—and that she has certain forecasts about the future success of the business. Any deal they reach should incorporate this information. Perhaps Martin's forecast is different: maybe he doesn't expect much change in the business in the next few years. Whether he buys out Susan's share or vice versa, they can incorporate their different views into the structure of their transaction. But Martin discovered this difference only by listening carefully to Susan's assertions.

THE PROBLEM: UNPRODUCTIVE TENDENCIES

In our experience few people actually employ both empathy and assertiveness well in their negotiations. When faced with conflict, we tend to either advocate forcefully—often too forcefully—our own view *or* focus on the other side's view, rather than moving nimbly from one skill to the other. We each assert our own story and listen to the other side only for the purpose of constructing a "Yes, but" response. We cycle through argument and counter-argument, never demonstrating understanding or really communicating very effectively.

Most people experience empathy and assertiveness as being in tension with one another. Either I can listen and try to understand your point of view, or I can assert my own. If I empathize, it will be harder for me to assert later. Once I understand your view—and show you I under-

stand—holding on to my own perspective will become too difficult. After all, if I agreed with *your* view I wouldn't have *mine!* Conversely, if I try to assert myself in this negotiation, it's going to be tough to demonstrate an understanding of how you see things. Our views are just fundamentally different. If I advocate for mine, I can't also advocate for yours. It's one or the other, not both.

Three Common Negotiation Modes

Instead of both empathizing and asserting, people often deal with conflict in one of three suboptimal ways—they *compete*, *accommodate*, or *avoid*.¹¹ Consider this example: A student comes into a professor's office asking for an extension on a lengthy written assignment. The professor knows that granting the extension will create all sorts of administrative hassles for himself. He plans to grade the papers during a short window of free time that he's set aside immediately after the due date. He knows that if he starts granting extensions now—even for students with good reasons—he will be inundated with extension requests. So he would rather not grant the extension.

A stereotypical response in each of the three modes might be:

COMPETITOR: No, I'm sorry, you can't have an extension. I've said no extensions, and I meant it. It's really not open to discussion.

ACCOMMODATOR: Well, let's see what we can do. I suppose if it's no more than a week late, I can get the grades in on time.

AVOIDER: I'm really busy right now—you'll have to come back another time.

What's going on in each of these responses?

COMPETING

Competing is a label for doing lots of asserting but very little empathizing. A competitor wants to experience winning and enjoys feeling purposeful and in control. Competitive negotiators exude eagerness, enthusiasm, and impatience. They enjoy being partisans. Competitive negotiators typically seek to control the agenda and frame the issues. They stake out an ambitious position and stick to it, and they fight back in the face of bullying or intimidation in order to get the biggest slice of any pie.

This style may have advantages vis-à-vis the distributive aspects of bargaining, but it also risks escalation or stalemate. A conspicuous disadvantage is that competitors tend to be hard on themselves, and they feel responsible when negotiations turn out poorly. Their competitive buttons often get pushed, and they may later regret or feel embarrassed by their loss of self-control. Although it may not be their intention, competitors may damage relationships if people on the other side resent their conduct.

ACCOMMODATING

Accommodating consists of substantial empathy but little assertion. An accommodator prizes good relationships and wants to feel liked. Accommodators exude concern, compassion, and understanding. Worried that conflict will disrupt relationships, they negotiate in smoothing ways to resolve differences quickly. Accommodators typically listen well and may be too quick to give up on their own interests when they fear the relationship may be disrupted.

This style has straightforward advantages. On balance, accommodators probably do have better relationships, or at least fewer relationships marked by open conflict. Because they listen well, others may see them as trustworthy. Similarly, they are adept at creating a less stressful atmosphere for negotiation.

One disadvantage is that this tendency can be exploited. Hard bargainers may extract concessions by implicitly or explicitly threatening to disrupt or terminate the relationship—in other words, by holding the relationship hostage. Another disadvantage: accommodators who are unduly concerned with maintaining a relationship may not spend enough energy grappling with the actual *problem*. They may pay insufficient attention to both distributive issues and value-creating opportunities. As a result, accommodators may feel frustrated in dealing with both substantive and interpersonal issues.

AVOIDING

Avoiding means displaying little empathy or assertiveness. Avoiders believe that conflict is unproductive, and they feel uncomfortable with explicit, especially emotional, disagreement. When faced with conflict, avoiders don't compete or accommodate: they disengage. They tend not

to seek control of the agenda or to frame the issues. Rather, they deflect efforts to focus on solutions, appearing detached, unenthusiastic, or uninterested.

At times, avoidance can have substantial advantages. Some disputes are successfully avoided; if ignored, they eventually just go away. In other cases, avoiders may create a chasing dynamic in which the other side does all the work (arranging the negotiation, establishing the agenda, making proposals). Because they appear aloof, avoiders can have more persuasive impact when they do finally speak up. In addition, their reserve and cool-headedness makes it difficult for others to know their true interests and intentions, and this can have strategic advantages.

The greatest disadvantage of avoidance is that opportunities to use conflict to solve problems are missed. Avoiders often disengage without knowing whether obscured interests might make joint gains possible. They rarely have the experience of walking away from an apparent conflict feeling better off. Even when they do negotiate, they may arrive at suboptimal solutions because they refrain from asserting their own interests or flushing out the other side's.

Like competitors, avoiders may have a difficult time sustaining strong working relationships. Others see them as apathetic or indifferent or even passive-aggressive. Avoiders may well have a rich internal life, but because they do not express and share their feelings, they can feel misunderstood or overlooked. Some avoiders feel stress from internalizing conflict and concealing their emotions.

Interactions among Negotiating Styles

In our experience, these styles interact with one another in fairly predictable patterns.

Competitor-Competitor: Two competitors will produce an energetic negotiation—making offers and counteroffers, arguments and counterarguments, relishing the strategic dance of bargaining for the sheer fun of it. However, because both are primarily focused on winning, they are likely to reach a stalemate—or an outright blow-up—because neither negotiator is listening to the other. The challenge for the two competitors, therefore, is to find ways of trading control and framing compromises in terms digestible to the other side.

Competitor–Avoider: When a competitor meets an avoider, a different problem arises. Avoiders have a knack for driving competitors crazy. By refusing to engage, they exploit the competitor's need to control. Frustrated competitors may offer concessions to induce avoiders to come to the table. Alternatively, competitors might alienate avoiders by coming on too strong. Thus, the challenge for competitors is to manage their need for control and their taste for open conflict in a way that makes it safe for avoiders to engage. The challenge for avoiders is to improve their assertiveness skills and learn to engage with competitors without feeling bullied or intimidated.

Competitor–Accommodator: For the accommodator, negotiating with a competitor can be a nightmare. Savvy competitors can exploit the accommodator's desire to preserve the relationship and to minimize disagreements. Because accommodators often make substantive concessions to resolve conflicts quickly, they can improve their performance in such situations by developing assertiveness skills to match their refined sense of empathy.

Accommodator–Accommodator: When two accommodators negotiate, they will be exquisitely attuned to each other's relationship needs. But they may fail to assert their interests adequately. They may avoid distributive issues and overlook value-creating opportunities. The challenge for accommodators is to learn to tolerate more open conflict in relationships and not to reach agreement too quickly in the interest of keeping the peace.

Accommodator–Avoider: When an accommodator meets an avoider, the negotiation often goes nowhere fast. If the accommodator accommodates the avoider, *both* will end up avoiding the problem. The negotiation may flourish, however, if the accommodator can keep the emotional temperature of the interaction low enough to coax the avoider out of his shell.

Avoider–Avoider: Two avoiders never face up to the conflict in the first place!

By recognizing these patterns, a savvy problem-solver can use this framework during a negotiation to diagnose what's going wrong and often to figure out what to do about it.

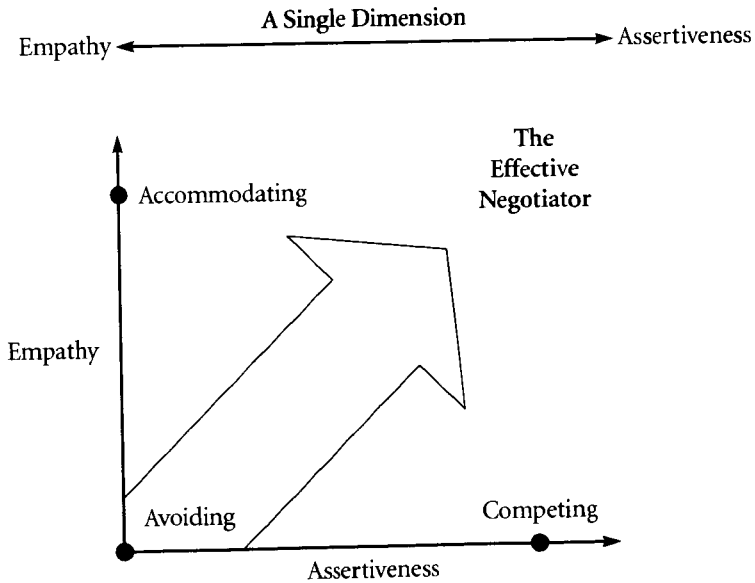


Figure 3

THE APPROACH: MANAGING THE TENSION

Many negotiators feel stuck because they assume that they must choose a single point on an empathy-assertiveness spectrum (Figure 3, top). This often leads to confusion and frustration as people try to decide what relative priority to attach to these two desirable sets of skills. We suggest that empathy and assertiveness are not opposites but are instead two independent dimensions of negotiation behavior (Figure 3, bottom). A negotiator need not make trade-offs between them but can exhibit high levels of both.

The challenge is to build your repertoire so that in conflict situations such flexibility becomes possible. The goal is to pay attention to three things:

- Understanding *your own* conflict tendencies and hot buttons—the way you are likely to react in different sorts of conflict situations—and learning to expand your repertoire of skills
- Being able to diagnose *others'* conflict tendencies and inviting them to empathize or assert as needed

- Being able to understand the *interactions* you're having with the other person and how your interactions may be unproductive

Moreover, you must learn to monitor these dynamics *while a negotiation is in progress*, which can help you recognize when to change the game if you get stuck.

But changing ingrained habits can be difficult, particularly if you fear jeopardizing the benefits of your particular negotiating style. You may also exaggerate the risks of exercising new skills. For example, a competitive negotiator may worry that any display of empathy will be perceived as weakness. He may also fear that if he really understands the other side he might no longer be able to assert his own interests forcefully. An accommodating negotiator may worry that if he acts more assertively, he may damage a valued relationship—particularly if he associates assertiveness with rude and distastefully aggressive behavior.

What specific steps can you take in your negotiations to increase the likelihood that at least you—and preferably the other party as well—will both empathize and assert? To introduce the fundamentals of a problem-solving approach to empathy and assertiveness, we again divide our advice into two parts: those things you can do in preparation for a negotiation, and those things you can do at the table.

To Prepare

Once again, good preparation is key. It requires introspection, curiosity, and a willingness to share your own perspective.

KNOW THYSELF

What are your conflict tendencies and hot buttons?¹² How might they be triggered in this negotiation? If you enter a negotiation without understanding how your defenses tend to get triggered, you will be easily pushed off balance by the other side.

Are you a conflict-avoider? Do you walk the long way around the hallways just to avoid the office of someone you've recently had an upsetting conversation with at the fax machine? Do you screen calls on your answering machine so that you won't have to talk to your mother about the fight you had last weekend? At different times and in different contexts, all of us avoid conflict. There's nothing wrong with that. In

preparing for a negotiation, however, you should consider whether the upcoming interaction is likely to activate your “avoid” reaction. Who will you be negotiating with? What will you be talking about? What implications—for your career, your life, your self-image—does the negotiation have? Are any of these factors likely to make you want to leave the table entirely?

Are you an accommodator? Do you tend to seek out the person in the office that you recently had a disagreement with, for the purpose of apologizing and repairing the relationship? Do you stay up nights crafting the perfect thing to say that will help them understand and make everything better? When your mother calls, do you do everything in your power to keep her from being upset? Again, these tendencies are natural—we all experience them. Sometimes it is wise and fair to put another person’s interests first—to accommodate their needs instead of our own. If accommodating is a conscious choice and not a habitual reaction to being confronted with another’s distress, it can be an important part of building and maintaining relationships. But in preparing for a negotiation, you want to consider whether your accommodating tendencies are likely to be triggered and whether they’ll serve you well. Who are you about to negotiate with? What does this relationship mean to you? Will you find it difficult to assert your own interests and perspective with this person? Will certain topics be off limits?

Or are you a competitor? Are negotiations like a game in which you try to win as much as you can, regardless of how you affect others? Do you enjoy conflict situations because of the adrenaline rush you experience when you come out ahead? Are you likely to seek out an office-mate so that you can continue your argument and convince him that you were right all along? There’s nothing wrong with wanting to win, and there’s nothing wrong with wanting to do as well as you can for yourself. Asserting your own needs and interests is fundamental to negotiating effectively. At the same time, in preparing for a negotiation you should consider to what extent a competitive style may backfire. Is this a situation in which acknowledging the other person’s perspective, interests, and needs is particularly important? If your competitive and assertive tendencies get triggered here, how are you likely to behave and what effect will that have on the other side—and your relationship?

Most people are complicated amalgams of these three styles. They

shift from one to the other depending on the situation and whom they're negotiating with. Sometimes they compete. Sometimes they avoid. Sometimes they'll do anything to preserve a relationship. As we have said, each style has advantages and disadvantages. As part of your preparation, you should think about what your tendencies are likely to be in this particular context.

BE CURIOUS ABOUT THE OTHER SIDE

In thinking through the first tension—between creating and distributing value—you will have already begun the process of putting yourself in the other negotiator's shoes. You will have drafted a list of your counterpart's interests and alternatives. This list will make empathy at the table easier by preparing you to be open to his story about the negotiation.

Now ask yourself: What is the other side's story, anyway? What is he telling his colleagues or friends about you and your situation? We all tell ourselves stories all the time, and the other side will undoubtedly have one about your negotiation. As you prepare, if you can't imagine how the situation makes sense from his point of view, that means you still need to acquire more information from him. Consider the best way to elicit this information. What questions can you ask? How can you frame these questions so that you sound genuinely interested and not accusatory?

Don't assume you know the other side's story. If you think you do, you're probably wrong. Even if you turn out to be substantially right, you will still be more effective if you begin with an attitude of curiosity about how the other side sees the world.

In thinking about the upcoming negotiation, recognize that it can be challenging to demonstrate understanding of things you don't want to hear. Maybe you have a pretty good idea of what the other side will say, and just *thinking* about hearing him say it makes your blood boil. Maybe you have negotiated with this person before. Maybe he made you so angry that you lost control, and you worry about that happening again. Maybe you fear that the other side could say things that would be so hurtful to you that it's not even worth *having* the negotiation. Whatever you imagine, now is the time to draw off some of the poison—while you're still in the preparation phase. Suppose you expect the other side to attack, as Susan attacked Martin in our example. How can you pre-

pare to demonstrate understanding of what, to you, is outrageous nonsense and unjustified criticism?

Your preparation consists in large part of *not* doing what you might normally do, namely, building an arsenal of counter-punches. That will only make you tense and angry before you even get to the table. With that kind of build-up, you'll explode before the other side ever gets a word out. Remember that the other side might not say or do any of the horrible things you are expecting.

Next, ask yourself: What is the worst thing the other side could say about you? What's going to be the hardest thing for you to hear? Make a list, either mental or written, of these trigger points. If the negotiation centers on a deep-seated or long-standing conflict, you may need to enlist a close friend to act as a coach and sounding-board. In our experience, it can be enormously helpful to hear the imagined criticisms—the ones that are *really* going to send you over the top—spoken out loud in a neutral setting. It's good to hear them coming out of your own mouth, as you explain them to your coach, and it's even better to hear them spoken by your coach as he talks out the problem with you. These attacking comments will begin to lose their sting as you become increasingly used to hearing them.

Then ask your coach to play the role of the other side, and practice responding to each attack by simply paraphrasing it. Recall how Martin responded to Susan's belittling comments:

SUSAN: You've just never shown much interest in the business side of the business—you'd be terrible on your own.

MARTIN: So you think that I don't like the business side of running the restaurant, and that I wouldn't do well here without you?

Resist the temptation to argue, even with your coach. You don't need to argue. Indeed, you may find that you are much calmer when you don't even try. Instead, just practice acknowledging that the speaker has expressed a certain view of your behavior, which you don't necessarily share.

PREPARE TO SHARE YOUR PERSPECTIVE

For many, empathy is the hard part; assertion is easy. But this isn't always the case. Sometimes it's hard to assert your own perspective, especially

when the other person doesn't want to hear what you have to say or thinks something very different. And it can be hard to do confidently, particularly when you don't feel confident.

We all have a right to express our views. Even if your perspective or story turns out to be incomplete or inaccurate, you should be confident in your right to articulate how you see the situation. Just as you don't need to agree with the other side when you demonstrate understanding of his views, he doesn't need to agree with you when you explain yours. But he should listen, and if he doesn't, you should insist.

In preparing for this assertive component of your negotiation, first ask yourself whether you really feel entitled to have your say. If you have any hesitation in this regard, it can help if you resolve to try to empathize with *the other side's* views; this may make you feel more confident about asserting your own. "At least I won't be acting like a jerk," you can tell yourself. "I'll demonstrate understanding of what the other person is saying, and then I'll try to explain how I see it differently. That's balanced. That's fair." Part of your preparation is to think about how to negotiate a process that ensures that both sides have an opportunity to assert their own perspective and demonstrate an understanding of the other's perspective.

Next, practice telling your story. Don't just imagine it in your head—say it out loud. You'll be surprised how much revision and refinement you'll want to make when you hear the story in your own words, with your own ears. Does your story tend to meander and get side-tracked in irrelevant details? What are the key points that you want to make? Are there elements of your story that you're unsure about? Do you need more information to make your case clearly and persuasively? How can you get that information? Figure all of this out ahead of time. Such preparation can help you identify confusion in your own thinking and can even lead you to reevaluate your story. Maybe it's stronger than you thought. Or not as strong. Either way, your story will be more forceful if you get your ducks in a row ahead of time. Once you've refined the narrative, make a list of your key points. At the table, you don't want to waste mental energy worrying that you might forget something important.

Finally, consider how to frame your story so that the other side can take it in and it is most persuasive. Rehearse a story that doesn't blame

the other side and doesn't characterize her motivations or intentions. For example, if your negotiation will inevitably involve a discussion of past conflicts with the other side, try to present your account in as neutral a way as possible. "When you [did X], this is how it affected me. I'm not suggesting that was your intention. I don't know what your intention was, and you may have intended something quite different. But the impact on me was . . ." In this way, you will give the other side some breathing room to absorb what you are saying.

Suppose Martin realizes that it is important to him that Susan understand why he has always been so gregarious with customers and eager to spend money on promotions and marketing. He might say something like this:

MARTIN: I know I've mentioned this a million times, but I always dreamed of owning a restaurant. I was raised in a big Italian family where food was the center of the universe. Every Sunday our house was the place where everybody dropped in for dinner. We had a tiny house, so the dining room was crammed with people. Sometimes it felt like the whole neighborhood was in there. People would sit for hours, telling stories. Both of my parents were great cooks, so that pretty much defined my idea of what food was all about. I've always wanted to create that same feeling in our restaurant. In college, my business training largely focused on marketing. My course in hotel management was obsessed with word-of-mouth. They actually taught us that in restaurants you *should* give food away, if it builds customer loyalty. So when you and I started our restaurant, I had all these ideas in my head—about my family and about good business practice and so on. You may have thought I was cavalier and wasteful or just didn't care about money, but I was making conscious decisions. You might not have agreed with them, but they were decisions. The problem is, we never talked about it. So I'm not blaming anyone. We just had different perspectives. You were worried that the restaurant would fail because of costs being too high, and I was worried that it would fail because of our customer base being too small.

At the Table

Your first goal at the bargaining table is to lay a foundation for problem-solving. To do this, you need to establish a process that will allow both parties to empathize and assert. These basic tasks are critical to ensuring

that, as the negotiation goes along, it doesn't derail because of misunderstandings or unnecessary escalation of conflict.

NEGOTIATE A RECIPROCAL PROCESS

In our experience, it often helps to discuss process explicitly at the start of a negotiation, by saying something like this: "I have a suggestion. I'd like to be sure we both have an opportunity to explain how we see things. I suspect your perspective about these issues is very different from mine. But I'd like to understand your perspective, and I'd like you to understand mine, even if we don't agree. You can go first, and I'll listen. After you're satisfied that I understand your point of view, then I'd like to take a few minutes to tell you about mine. How does this sound to you?" But beware of trying to impose a process. The negotiator on the other side may have her own views of what the agenda should be. And she may not immediately see the utility of trying to explore each other's views and interests.

It often helps to let the other side talk first. People like to talk, and they like to assert their own views. Competitors, of course, will jump at this invitation. Even accommodators and avoiders may find it hard to resist sharing their point of view, especially if they haven't been put on the defensive by hearing your perspective first. This approach can be particularly productive if there are strong emotions attached to the negotiation. Many people *cannot listen at all* until they've blown off steam. Let them say their piece. Give them plenty of time. Let them run out of gas. Be prepared to show them you understand. And make it clear from the outset that understanding doesn't mean agreeing. This simple process will give you a much better chance of getting the other person's attention when it's your turn to talk. And it will give you a chance to demonstrate what empathy looks like in a negotiation.

MARTIN: You obviously feel strongly about buying me out, and I have some ideas of my own. So why don't you go first? Tell me your ideas about the future of the restaurant. I'd really like to understand them, even though I don't know yet whether I agree with them. Then I'll take a few minutes and explain how I see things. Maybe you won't agree with *my* ideas, but I'd like to know that you at least understand what I'm thinking. How does that sound?

But what if the person on the other side won't stop talking? You will need to remind him of the understanding that you would both have some air time. You might want to say something like this: "You've been explaining how you see the situation for a while now, and I think I've shown you that I understand your point of view. Because we see things differently, I'd like a chance to explain my perspective and make sure that you understand it. Would that be OK with you—if I take a few minutes to tell you my view of the situation?" Every negotiation follows some process—you can't get around it. If you don't take the time to negotiate a *reciprocal* process, you may end up in a cycle of argument and counter-argument in which neither side listens to the other. In that case, the process that you will have established by default is "Whoever talks loudest and longest wins."

USE THE EMPATHY LOOP

Assuming that the other side sees the need for some reciprocal understanding, and that she has accepted your invitation to talk first, how do you go about demonstrating that you are trying to understand? Use a technique we call the *empathy loop* (Figure 4).¹³ The empathy loop has three steps:

- (1) You inquire about a subject or issue
- (2) The other side responds
- (3) You demonstrate your understanding of the response and test or check that understanding with the other person

In other words, you loop your understanding of the other side's perspective back to them. If they respond to your looping by saying that you've gotten it wrong, you treat this as a return to step two and again loop what they have said. The empathy loop is the basic tool to fall back on when you are trying to demonstrate understanding.

To switch examples for a moment, let's go back to Stephanie's negotiation with her prospective boss about whether the Bradford Advertising Agency would pay her moving expenses (see Chapter 1). As she probes his interests, she might say something like this:

STEPHANIE: So it sounds like you aren't interested in paying for my moving expenses. Why not?

BRADFORD: Well, it's pretty simple—as a company policy we just don't cover moving expenses. I can't bend the rules in every case.

STEPHANIE: I see. So the company has a policy about this, and you're concerned about the consequences if you made an exception in my case.

BRADFORD: Right. You know, your expenses probably won't be that high, but some people move half way around the world and have a ton of stuff, and then the company gets socked for a huge moving bill. So our rule is no moving expenses.

STEPHANIE: OK. So you think my expenses would be pretty low, but you're still concerned that if the company picked them up it could get stuck later with someone else's really high bill. Is that basically it—or is there something I'm missing?

BRADFORD: No, that's it in a nutshell. I wish I could help you out.

At this point, Stephanie has tracked Bradford's concerns and interests carefully, looped those back to him, and inquired toward the end about whether her understanding is complete or still seems—to Bradford—to be missing something.

There is no single formula for demonstrating understanding. But we *can* suggest some helpful questions for eliciting the other person's story and showing them that you're trying to understand. These include:¹⁴

- “Is this the problem as you see it?”
- “Will you clarify what you mean by . . . My understanding is . . . Is that right?”
- “What I understand you to say is . . . Is that right?”
- “As I understand it, the problem is . . . Am I hearing you correctly?”
- “To summarize, the main points as I heard them are . . . Have I understood you right?”
- “What am I missing?”
- “Is there anything about how you see this that we haven't talked about yet?”

The precise formulation is less important than trying to check the accuracy of what you have understood. Demonstrating understanding requires paraphrasing, checking your understanding, and giving the other person a chance to respond. Empathy, as we see it, requires genuine curiosity.¹⁵ It cannot be easily faked with the insincere use of catch-phrases, including those suggested above. Most people are pretty good at detect-

The Empathy Loop

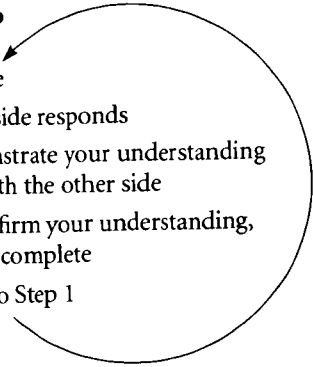
- 
- Step 1 You inquire
 - Step 2 The other side responds
 - Step 3 You demonstrate your understanding and test with the other side
 - Step 4 If they confirm your understanding, the loop is complete
If not, go to Step 1

Figure 4

ing a phony who is simply going through the motions. “What I hear you saying is” can make matters worse if the other person thinks you really don’t care about learning their perspective or are being manipulative. Having the right mindset is critical.

DON’T AGREE IF YOU DISAGREE

As you listen and demonstrate understanding, the other person may say something like, “Don’t you think that’s right?” or “Do you see what I’m saying?” Generally these questions are merely attempts to get you to continue to demonstrate understanding, but they invite confusion about whether you actually agree on the substance. Be clear that you do not, or that you are not yet sure about what you think. Say, “I’m just trying to understand—I have a perspective of my own, but let’s wait on that.” Or, “I’m not sure yet whether I agree or disagree, but for now I just want to understand how you see the situation.” Keep clarifying the point that empathy doesn’t mean agreement.

No matter how much *both sides* listen and empathize, they may still disagree. And then there may be sparks—not out of anger or aggression but merely because of genuine difference. Be prepared for such conflict, particularly if you tend to be an avoider. Expect it. Imagine how it will feel to sit in the face of the disagreement and hold on to your view in a respectful and productive way. Prepare yourself for conflict so that you’ll be able to manage it skillfully.

CHECK IN ONE LAST TIME

At some point you will likely feel that you have heard the other side out and have shown her that you understand her view. It may take longer than you expected. But eventually you'll loop enough times that she should feel that you've heard her.

To make the transition to asserting your own perspective, you want to check in with the other side one more time to be sure that she agrees that you have heard her point of view. "So—it seems that you think X, Y, and Z. I also heard you say A, B, and C. Is that right? Is there anything I'm missing in your story, or more you want me to hear? No? OK, well, I guess I'd like to tell you how I see things."

EXPLAIN YOUR STORY

After you have demonstrated to the other side's satisfaction that you understand her perspective, you should be in a better position to assert some of your own interests and concerns. For example, Stephanie might say:

STEPHANIE: Well, I appreciate that you'd like to help out with the move. Let me explain my concerns about moving expenses and why I hope we can find a creative solution. Is that OK?

BRADFORD: Sure.

STEPHANIE: If I accept this job, I'm going to have some start-up expenses. I'll have to sell my house and buy a house here. I'm concerned about a cash-flow problem. The moving expenses alone will be about \$10,000. Frankly, I don't have that much in savings. The move will take a couple of weeks, and I probably won't get a paycheck until I've been at work at least a month. I'm worried about how I'm going to make it through this period.

BRADFORD: Oh, I see. That's a tough situation.

STEPHANIE: Yeah, frankly it creates a real problem.

Stephanie doesn't attack or belittle the company's policy. She simply explains her own point of view and why the cost of moving concerns her. Because she's prepared (she knows there will be two different stories), she is less tempted to say, "Your policy is stupid; my story is the right one." Instead, her task—which she negotiated explicitly up front—

is just to lay out her own story, even if it differs from her prospective employer's.

CHECK THE OTHER SIDE'S UNDERSTANDING OF YOUR STORY

As a last step in laying the foundation for problem-solving, you want to be sure that the other side has heard *you*. Don't assume that his nodding head or "Yes, yes" indicates true understanding. Ask him to demonstrate understanding more completely by sharing his version of your story. There are many ways to do this, including:

- "I'm worried that I'm not getting my message across. Could you help me out: what did you hear me say?"
- "Just to be sure I'm not confusing you, what do you think my point was there?"
- "I've tried to show you that I understand the situation from your point of view—I wonder if you could do the same. What do you hear me saying?"

By asking the other side to demonstrate their understanding of your perspective, you can reinforce that *your* empathy with him didn't mean agreement. Once he has to show *you* understanding, he is far less likely to say, "But you agreed with me before." Moreover, you will most likely identify points that he *didn't* hear completely or has translated in a way that doesn't make sense to you.

IF NECESSARY, CHANGE THE GAME

No matter how carefully you try to establish a productive process at the start, you may find that eventually you get stuck. Perhaps neither you nor the other side is listening after all. Perhaps you are feeling defensive. Perhaps the other side seems to be tuning out.

Recall our discussion of the three negotiating tendencies and how they typically interact. Try to diagnose what is happening. Have you been acting like a competitor? Have you taken up too much air time and tried to control the agenda? Do you need to back off and listen for a while? Think about the other side's behavior. What negotiating style has he been using? What does that tell you about why the two of you have gotten stuck? Look for a pattern. Then see if you can change the dy-

namic by adding more empathy or assertiveness, as needed. If you think you've gotten caught up in a competitive mode, you might say: "You know, I realize I've been doing all the talking and I'm not sure I've fully understood what you're trying to say. Would you take a few minutes and help me understand why . . . ?"

CONCLUSION

Like the tension between creating and distributing value, our second tension between empathy and assertiveness must be managed. The most skilled negotiators have a broad repertoire of interpersonal skills. They can both listen well and speak persuasively. These basic communication skills lay the best foundation for problem-solving.

3

The Tension between Principals and Agents

Sam Walsh is about to sell his house and move to Arizona to retire. He bought the house eight years ago when the real estate market was in a slump. The market is booming now, and some of his friends have recommended that he sell his home without a real estate agent. Sam has seen books that describe how to advertise a house, how to conduct a successful open house, and how to negotiate with a potential buyer through the process of offer and acceptance, purchase and sale, and closing. And of course the Internet now offers new possibilities for listing one's home. Given all these resources and a booming market, Sam thinks perhaps he could sell his house fairly quickly and for a good price by himself, without paying an agent's 6 percent commission.

But Sam isn't so sure that the savings are worth all that effort and anxiety. Granted, real estate agents are expensive, but what if selling independently doesn't go well? And it seems like an awful hassle. Wouldn't it be easier to let an agent handle all the details? And more comfortable not to have to do all that negotiating with the buyer?

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Sam calls a family friend who recently bought property in the neigh-

borhood and asks her whether she liked her real estate agent. "Sure," the friend says. "She's a great agent—her name is Betty Ortiz. Give her a call. She'll help you out."

THE GOAL: REAPING THE FULL BENEFITS OF HIRING AN AGENT

Sam wonders whether hiring a real estate agent will provide a net benefit in the sale of his home. On the one hand, maybe an agent will sell his home more quickly and for more money than he could otherwise get. If he doesn't use an agent, maybe his home will sit unsold for months. But on the other hand, maybe the agent won't earn her commission and will end up *costing* Sam money. How should Sam decide what to do? How will his decision about hiring an agent affect the sale of his home? Moreover, if he hires an agent, how should he negotiate the terms of that relationship?

Agency relationships are everywhere. We constantly delegate authority to others so that they may act in our place. We ask lawyers to represent us; we give money managers authority to make our investments; we ask doctors to take responsibility for our medical care; we depend on employees to do the work we assign; and we elect public officials to legislate on our behalf. Indeed, it is hard to imagine how society could function at all without agents acting on behalf of principals—diplomats on behalf of nations; labor leaders on behalf of unions; sports agents on behalf of players; literary agents on behalf of authors.

When a principal hires an agent to act on his behalf in negotiations across the table with another party, he may expect—naively—that the agent will be motivated solely to serve the principal's interests. This is how principal-agent relations would work ideally. But in the real world, agents always have interests of their own. As a result, the principal-agent relationship is rife with potential conflicts that demand skillful management behind the table.

For example, a client and his lawyer may need to negotiate how the lawyer will be paid; how the other side will be approached; what information will be sought from or disclosed to the other side; at what point to accept the other side's offer, and so on. If these issues are left unacknowledged and unaddressed, they can adversely affect the negotiation

across the table. For all of these reasons, effective negotiation requires a good understanding of the benefits and risks of the agency relationship and how it can best be managed.

Agency Benefits

Why are agency relationships so pervasive in negotiation? Because an agent can provide significant benefits to her principal. These benefits derive from four sources:

- **Knowledge:** An agent may have specialized knowledge—that the principal lacks—about market conditions, formal or informal norms, or relevant risks and opportunities. An investment banker will know potential buyers for her client's company, for example, and may be better able to price the deal.
- **Resources:** An agent, by reason of his reputation and relationships, may be able to provide access and opportunities that would otherwise be unavailable. For example, a well-known literary agent can get a publisher to read a new author's manuscript, and later negotiate favorable deal terms, because of the agent's reputation for having good judgment.
- **Skills:** An agent may be a better negotiator than the principal, whether owing to experience, training, or natural ability. A client may hire an attorney to negotiate a settlement or a deal, for example, because the client believes that the lawyer will be more effective.
- **Strategic advantages:** An agent may be able to use negotiation tactics on behalf of the principal in a way that insulates the principal from their full impact. The principal can remain the "good cop" while the agent plays the bad cop. For example, a sports agent can engage in hard-bargaining tactics with the team's general manager while the player remains on good terms with the team. Conversely, a collaborative agent may be able to settle a dispute with an agent on the other side even if the principals are in conflict.

In many cases, the agent will be able to do things the principal could never do on his own, and the possibility for both the principal and agent to benefit from trade between them is clear. The agent may have an absolute advantage over the principal with respect to those activities. In Sam and Betty's case, Betty may have skills, knowledge, and resources that Sam lacks. But economic theory suggests that even if Sam knows

as much—or more—about selling residential real estate as Betty, that doesn't necessarily mean that he should sell his house himself. The economic principle of *comparative advantage* dictates that there can be gains from trade when each party (whether a person, firm, or country) specializes in the production of goods and services for which that party's opportunity cost is lower. If Sam's opportunity costs are high, it may be more efficient for Sam to hire Betty as his agent and spend his time doing what he does best.

Imagine that Sam has decided to talk to Betty about whether to hire her. They meet at his home on a Saturday afternoon. Betty walks through the house, noting approvingly many of the details and features that might raise the selling price. As Sam gives Betty a tour, she asks him all sorts of questions—about the square footage of the house, when he purchased it and what he paid for it, the age of the appliances and heating system, the condition of the roof, any electrical work or other upgrading he might have done. By the time they sit down to talk, Betty has a fair picture of the investment that Sam has made.

BETTY: Well, it's a beautiful property. You obviously care a great deal about your home. The kitchen is lovely—you made a wise choice to remodel there. I think you should do very well, given the way houses are selling this season. The first thing we would need to do is agree on a listing price and a date to put the house on the market. I'd suggest sooner rather than later. As for a price, I've brought some information we can look at.

SAM: That's great. But before we get into the numbers, I wondered if we could talk about your services. To be honest, I'm still trying to decide whether to retain an agent at all, rather than sell the house myself.

BETTY: Oh, sure. No problem. I would definitely go with an agent, but then I'm biased. But let me tell you the sorts of advantages having an agent brings.

In describing the role she will play for Sam in the transaction, Betty emphasizes the sorts of benefits described above. First, Betty says she can help Sam get the best possible price for his house. "Setting the right asking price is critical," Betty says. "I know the market." She's brought lots of information showing recent sales in his neighborhood and town, recent trends in the market, and detailed comparables that she would use

to justify whatever price they arrive at. "It's not easy setting just the right price," Betty says. "Too low and it's easy to sell but you don't get full value. Too high and you can scare off potential buyers. Or if you do find one, the bank won't finance their mortgage."

Betty then describes her approach to marketing and shows Sam a few sample brochures of other houses she has sold recently. She also emphasizes how her relationships might benefit Sam. "I have some clients of my own who might be interested, and I know every important broker in town," she explains. She tells Sam that after putting his house on the market she would first bring a caravan of other real estate brokers through in order to expose the house to those working in the area. Then she would invite brokers to bring their own clients for a few days before hosting the first open house on a Sunday afternoon. "That's a big draw," Betty says. Brokers who have seen the house already will try to get their clients back before the open house. And then the open house should attract lots of casual lookers and those clients who weren't able to make it during the week. After the initial open house, Betty explains, she would hold open houses for two more weekends. "I can also save you from what would otherwise be a real nuisance. I'll be responsible for showing your house, and I'll be sure that we set these open houses and other visits at times that are convenient for you."

SAM: That would be great. The less hassle, the better.

BETTY: Last but not least, I've had lots of experience at negotiating home sales. Not only can I help you get the best price, I can help you figure out which offers to take seriously, how best to make counteroffers, and what secondary terms are reasonable. In my experience it's best if the seller doesn't have to deal directly with the buyer or the buyer's agent. You'll find it a lot more comfortable to hold out for the good price if you don't have to deal directly with the other side.

SAM: What about after I've accepted an offer?

BETTY: Well, I'll take care of moving toward a formal purchase and sale agreement. I'll make sure any necessary inspections get done, and sometimes I even help the buyers get their mortgage.

Betty and Sam keep talking, and Sam sees the advantages that Betty will confer in terms of skills, resources, and knowledge. She has access to clients and other brokers, she knows the market, and she has lots of time

to invest in selling his house. He decides that he'll use an agent, and he feels comfortable with using Betty. She seems open and easy to talk to, and not too pushy.

SAM: OK, but what about fees? What would your commission be on a sale?

BETTY: My commission is the standard 6 percent of the sale price. You pay nothing unless we sell the house. Actually, the fee is normally split with the buyer's agent, assuming there is one. But whether or not the buyer has an agent, the fee is 6 points.

SAM: Hmm. What happens if you sell the house very quickly? Is the fee still 6 percent?

BETTY: Yep, if we sell it quickly, isn't that a good thing? That's what we want, right?

SAM: Sure, I guess. But the quicker the sale, the less work you have to do, right? And what if there *isn't* a buyer's agent? What if a random buyer just walks in to the first open house and plunks down my asking price? Is the fee still 6 percent?

BETTY: Yes, it is.

THE PROBLEM: AGENCY COSTS

Sam sees the advantages of hiring Betty. But there's a nagging question in his mind: Are these fees really worth it? What if she sells the house without much effort? Or what if she doesn't work hard enough? How will Sam know? Despite Betty's upbeat attitude and optimism about working together to sell his house, Sam fears there may be problems down the road. At this point, however, he's not sure exactly what those might be.

Hiring an agent is not a simple matter. Bringing an agent into a negotiation introduces a third tension: between the principal and the agent. Because agents often have expert knowledge, substantial experience, and special resources that the principal lacks, the relationship can create value. At the same time, however, because the agent's interests may not align with those of the principal, a number of unique and intensely stubborn problems can arise. The literature on this subject is vast, largely because these problems are so pervasive and cut across so many activities.¹ Here, we introduce some of the central issues.

The Sources of the Tension

Agency costs are not limited to the amount of money that a principal pays an agent as compensation for doing the job. They also include the money and time the principal spends trying to ensure that the agent does not exploit him but instead serves his interests well. To understand why agency costs exist, consider that principals and agents may differ in three general ways:²

- Preferences
- Incentives
- Information

DIFFERENT PREFERENCES

First, the preferences, or interests, of an agent are rarely identical to those of the principal. Consider their economic interests. Betty's primary economic interest is in her own earnings as a real estate agent. In this transaction, Sam's primary economic interest is in the net sale price for his house. Betty may have other interests as well. She has a strong interest in her reputation and in securing future clients. She has an interest in maintaining good relationships with other agents, banks, home inspectors, and insurance agencies. Betty is a repeat player in this game, while Sam, particularly if he intends to leave the community, is a one-shot player who might be more than willing to sacrifice Betty's reputation in order to get a better deal for himself. Conversely, Betty may be reluctant to bargain hard for certain advantages for Sam because of her desire to maintain a congenial relationship with the buyer's agent, who may be a source of future client referrals.

DIFFERENT INCENTIVES

Agency problems may also arise because the *incentives* of the principal and the agent are imperfectly aligned. The culprit is typically the agent's fee structure, which may create perverse incentives for the agent to act contrary to the principal's interests. This discrepancy is sometimes called an incentive gap.

For example, Sam wants an arrangement that maximizes his expected net sale proceeds after her fee. Betty, on the other hand, wants a fee

structure that yields her the highest expected return *for her time spent*. If they agree to a percentage fee, Betty may prefer a quick and easy sale at a lower price to a difficult sale at a higher price because with the former she will get more return for hours spent working. Indeed, a recent study suggests that when realtors put their *own* homes on the market, they tend to get higher-than-average prices, because they get the entire benefit of their additional hours of work, not just 6 percent of it.³

DIFFERENT INFORMATION

The information available to the principal and the agent may differ. We are speaking here of kinds of information that either side may have an incentive to keep to itself. Betty may know that market conditions are improving, for example, but she may be reluctant to share this with Sam for fear of inflating his expectations. Similarly, it may be difficult to know how much effort an agent is actually putting in on the principal's behalf. Because the principal cannot readily discover this information, the agent might shirk her responsibilities and earn pay without expending effort.

Management Mechanisms and Their Limitations

These potential conflicts can be controlled somewhat, through three basic management mechanisms:

- Incentive contracts
- Monitoring systems
- Bonding

INCENTIVE CONTRACTS

Incentives can be built into contracts between principals and agents to better align their interests. For example, instead of paying employees an hourly wage, a manufacturing firm might choose to pay its workers by the piece, thereby tying compensation of these agents directly to volume. Or a distributor might pay its salespeople on a commission basis, compensating them only to the extent that their sales efforts boost the bottom line. Similarly, farm workers are often paid by the amount of produce harvested instead of by the hour, to minimize slacking, and waiters are paid through tips, to encourage more attentive service.

Many different incentive structures exist, including:

- Percentage compensation
- Hourly fees
- Fixed fees
- Bonuses or penalties

These methods can minimize the principal-agent tension, but no incentive structure can ever completely resolve it. To see why, consider our real estate example. Real estate agents are commonly paid a commission only if a sale is completed. This is an incentive contract: the agent's reward depends on successful performance. Such contracts have both benefits and drawbacks. On the one hand, Betty profits—and Sam incurs agency-related costs—only if Betty manages to sell his house. On the other hand, as we have seen, this incentive may induce Betty to pressure Sam to accept a deal that is not optimal for Sam but which guarantees Betty a quick profit in comparison to her efforts. To be *perfectly* aligned, Betty's incentives vis-à-vis the sale would have to be identical to Sam's. But for this to occur, Betty would have to buy the house herself and resell it; only then would she have a 100 percent stake in the sale, as Sam does. This, of course, would transform her into the principal stakeholder and eliminate the agency relationship altogether.

Because Betty does not have as great a stake in the sale as Sam does, Betty and Sam may face conflicting incentives at various points in the transaction. Suppose that with very little effort, maybe 25 hours of work, Betty could sell Sam's house for \$250,000. With a 6 percent commission, this would generate a \$15,000 fee—\$600 an hour. Assume that with a great deal of effort, perhaps 100 hours of work, the house could be sold for \$275,000. Sam would pay Betty an additional fee of \$1,500 on the extra \$25,000. From Betty's perspective, the marginal effort may not be worthwhile. She works 75 extra hours for only \$1,500—which works out to \$20 an hour. Even if Betty could sell the house for \$300,000 with only 50 extra hours of work, she might still decide that it was not worth the extra \$3,000 fee at \$60 per hour. She might feel that her 50 hours would be better spent selling someone else's house at a much higher hourly rate—even though Sam would almost *surely* feel that an extra \$47,000 in *his* pocket justified the additional time on Betty's part.

Uncertainty about the housing market will further complicate Sam and Betty's task. Neither of them knows what will happen if Sam turns down an offer of \$250,000 and Betty puts in additional effort in the hope of receiving \$275,000 or \$300,000. Most likely, however, Betty will have more information on this point than Sam. Can he trust her to reveal this information candidly, when it might be in her interest for him to accept the lower offer?

Consider the homeowner's dilemma at an even earlier stage of the transaction, before the house goes on the market. After thinking about these problems, Sam might realize that Betty has an incentive to set a low selling price for his home so that it could be sold quickly and with little effort. Reaching for the stars isn't in Betty's interest. It might not be in Sam's interest either, but he wants to be sure that Betty is giving him information candidly. He might thus decide to ask a number of agents for competing estimate recommendations. Although this could provide him with some reassurance, competition of this sort is not a complete solution. Instead, such competition may encourage agents to make unrealistically high estimates in the hopes of securing an exclusive listing. After the listing is secured, an agent might put the house on the market for the high price but then expend little effort trying to market the house. After some period of time, the agent might then approach the owner and indicate the necessity of lowering the price to increase the chances of a sale. In the end, the homeowner may end up *worse* off for having initially set an unrealistically high price, particularly if a record of large unilateral price concessions is taken by prospective buyers to indicate that the house is of questionable value. Again, information disparities make it difficult for the principal to align the agent's incentives with his own. The homeowner may be unable to monitor the agent's efforts or the accuracy of a single agent's estimates.

Why doesn't Sam just pay Betty by the hour? Many professionals—including lawyers and accountants—have traditionally been compensated in this way. At first glance, this may seem a straightforward way to guarantee that the agent expends the needed effort to get a good price. In reality, however, compensation by the hour creates an incentive for an agent to put in *more* time than may be necessary to get a good price. To earn a large commission on the sale of Sam's house, Betty will necessarily have to invest a great deal of time. A quick sale with little effort

will be less profitable for her than a sale that takes longer. Other things being equal, of course, Sam would prefer a sale sooner rather than later. Betty's incentive to put in extra time doesn't necessarily meet Sam's needs.

An hourly fee also creates monitoring problems. How does Sam know the number of hours Betty is actually putting in? And how does he know whether those hours are being spent efficiently, in a way that most benefits Sam? Is she diligently pursuing buyers, contacting other agents, and creating attractive brochures and ads to market the property? Or is she just holding open houses over and over again so that she can bill Sam for the set-up and break-down time? Sam might have reason to fear that Betty will not use her time most productively under an hourly fee arrangement.

Sam could also offer to pay Betty a fixed fee for her work. Assume that Sam expects to list the house for \$250,000. He and Betty know that if the house sells for this amount she'll earn a commission of \$15,000. But neither knows what the actual sale price will be. The market is hot. Maybe Sam will receive offers above his asking price—it's been known to happen in his neighborhood. Or maybe no buyer will come along and he'll have to drop the price to \$230,000, or even lower. If Sam believes that the hot market will work to his advantage, he might offer to pay Betty \$15,000, regardless of the sale price. He would thus insure against the possibility of a greater fee, at the risk that he would overcompensate Betty in the event the market failed him and the price had to be lowered.

Fixed fees have certain advantages. They encourage the agent to get the job done within the cost parameters set by the fixed fee. However, fixed fees can create perverse incentives of their own. If Betty will receive \$15,000 regardless of her effort or the sale price, why should she put in the time required to sell the house at \$250,000, as long as she sells it at *some price*?

What about a percentage fee with a clause to reduce the percentage if the house sells very quickly? Sam has already expressed concern that the house might sell in just a few days with minimal effort on Betty's part. If that's the case, why should Betty get her full 6 percent commission? Sam might propose that if the house sells within seven days of listing, Betty's commission will be reduced to 4 percent. Even if Betty agrees to this fee structure, however, it creates a new set of incentive problems. Now Betty

has an incentive to delay. Why sell the house on day five if on day eight she'll make an additional 2 percent?

What about some hybrid of a percentage fee and an hourly fee? After all, Sam's real concern is that Betty will slack off if the house *doesn't* sell quickly. It's on day fifty that he needs Betty to work at selling the house, not on days one and two. Thus, Sam might suggest a lower percentage fee—perhaps 5 percent—plus an hourly bonus for work performed after day fourteen. In this way, he might hope to inspire Betty to put effort in when he needs it most. But from Betty's perspective, this arrangement forces her to put effort into trying to sell a house that's not priced right for the market. Why should she bear the burden in such a situation? Why shouldn't Sam lower the price and thus generate more sales interest? And why should she work toward an early sale—which Sam, too, would prefer—if it just means that she'll get a lower percentage fee?

MONITORING SYSTEMS

If incentive contracts don't completely solve the problem, why can't a principal just watch over his agent and ensure that the agent performs satisfactorily? This is the second management mechanism: monitoring. If Sam knows which marketing activities are most likely to result in the sale of his house, he can simply follow Betty around and see whether she engages in those activities. This mechanism is often used by employers, who monitor their employees and compensate them based, in part, on how well they perform.

The problem with monitoring, however, is that it is expensive and it doesn't always tell the principal what he needs to know. In order to determine whether an agent has performed appropriately, the principal must be able both to observe the agent's behavior, which is often impossible, and to distinguish desirable from undesirable behavior, which is often beyond the principal's expertise. Sam, for example, can't watch Betty's every move. To do so would waste the time he is saving by hiring her in the first place. In addition, even if he did watch her closely, he might not be able to distinguish between high-quality and low-quality work. If only three people attend his first open house, should he blame Betty? Were her marketing efforts substandard compared to what other agents would have done? Sam is unlikely to know.

Perhaps Sam could employ another specialist or expert to monitor

Betty. This approach is not uncommon. For example, a corporation's in-house lawyers often monitor the efforts of the corporation's outside lawyers, who work for private firms. Similarly, outside corporate directors often monitor the efforts of management. It should be obvious, however, that this is hardly an ideal solution. Hiring yet another professional to provide services is expensive—and the compensation arrangement for this other professional may *in itself* create distorting incentives. Moreover, a conspiracy of sorts may develop between the agents. In the corporate world, management is often responsible for selecting their monitors—the outside or “independent” directors. This inevitably raises concerns about informal collusion. In a general sense, such collusion results from the fact that similarly situated agents have more frequent contact with each other than principals and agents do. To the extent that agents expect to have repeat dealings with one another, this may well affect their behavior—sometimes in ways that may benefit the principal, but other times in ways that do not.

BONDING

Principal-agent differences can also be dampened by requiring the agent to post a bond, usually in the form of money, at the start of the agency relationship, which he must forfeit if he acts in a way that conflicts with the principal's interests. In the construction industry, a contractor may post a bond underwritten by an insurance company that can be used to complete the job for the owner if the contractor goes broke during the project. Pensions are sometimes considered such a bond: throughout their careers employees are induced to act in their employers' best interests for fear of losing their pension's large financial rewards. Similarly, compensation that is above market rates can be considered a form of principal-agent bond: if an employee is found acting contrary to the employer's interests and is fired, he forfeits the market surplus that he has enjoyed up to that point.

An agent's concern for her reputation can also serve as a bond to protect her principal.⁴ Even if Betty has an economic incentive not to spend extra time working for a sale price above \$250,000, and even if she knows that Sam cannot effectively monitor her shirking, Betty might still work diligently in order to keep her professional reputation intact. Real estate agents often acquire clients through word of mouth. Without

recommendations from previous clients like Sam, Betty is unlikely to succeed in her business.

While in some circumstances the principal may be able to affect the agent's reputation, this is generally an imperfect solution to agency problems.⁵ It may be difficult to observe or verify that a particular outcome—success or failure—is attributable to the agent's actions.

In addition, principals can exploit agents as well as the other way around. For example, a homeowner might use an agent to acquire valuable information about the home's expected value, and even to begin testing the house on the market, but then exclude some friend or acquaintance from the agency contract and subsequently sell the house directly to this third party. By doing so, the buyer and seller could share in the savings of the agent's fee, while the agent would be left uncompensated for her efforts.

For our purposes, one major lesson emerges: although these management mechanisms can reduce principal-agent differences, none of them eliminates the tension completely, alone or in combination. Our third tension is inescapable: there are always agency costs. In a particular context, some mechanisms will obviously be better than others. But reputational markets are never perfect. Monitoring is always costly. And any compensation scheme creates incentives that can be perverse in some circumstances. In a relatively simple transaction such as a real estate sale, the parties may not find it worthwhile to expend resources writing elaborate agency contracts. To do so would just further shrink the pie. In addition, trying to exert control over an agent can have paradoxically *negative* consequences on the agency relationship: in part, agents are value-creating for their principals *because* they are independent decision-makers, not puppets.

Principal-Agent Problems in the Legal Context

The principal-agent relationship of most interest to us here is the relationship between a lawyer and a client who are involved in a legal negotiation. Like all other agency relationships, this one poses problems for both parties, owing to differences in preferences, information, and incentives. Here, we briefly outline some management mechanisms that

can dampen the principal-agent tension when it arises in the context of a legal negotiation.

INCENTIVES

To tackle incentive problems, lawyers and clients have developed an array of fee structures—all inevitably flawed. The most common of these are:

- Contingency fee
- Hourly fee
- Fixed fee
- Mixed fee
- Salary

Contingency Fee: In this arrangement, the lawyer earns a percentage of the recovery, if any, that he wins for the client. This structure is most often used by plaintiffs' attorneys in tort litigation, and it has the same advantages and disadvantages as the percentage fee in our real estate example. Its chief advantage is that the plaintiff pays nothing unless there is a recovery. A contingent fee also enables a plaintiff to engage in a lawsuit that she otherwise might not be able to afford. In essence, the client is selling the lawyer a third of her lawsuit in exchange for the lawyer's services. It is a reasonably effective way of aligning the parties' interests, in that the lawyer has an incentive to win a large recovery for the client. The incentives are not perfectly aligned, however, because the lawyer is putting in all the effort and only receiving a fraction of the benefit. The contingent-fee lawyer may be better off with a quick settlement that takes little effort rather than a higher recovery that requires substantially more work. A contingency fee can also allow a client to exploit her attorney. Plaintiffs' lawyers typically screen their cases carefully because they are bearing part of the risk of failure.⁶

Hourly Fee: Under this arrangement, the lawyer is paid by the hour. This fee structure is most often used by defense counsel in litigation and by deal-making attorneys. Its advantage is that it motivates the lawyer to devote the time needed to achieve the best result for the client—particularly when it is not clear from the outset how much time the matter will

consume. The disadvantage for the client is that it removes any necessary link between the benefit the lawyer's work confers on the client and the amount the client pays. The lawyer may be tempted to do more work in order to earn more, even if the work is unnecessary. On the other hand, hourly billing may disadvantage the lawyer in some circumstances. For example, lawyers may be reluctant to charge on the basis of normal hourly fees when the lawyer's special expertise and experience can produce very substantial economic benefits for a client in a short period of time.

Fixed Fee: Here, the lawyer earns a specified amount for handling a particular legal matter. This arrangement gives the lawyer an incentive to get the work done in as short a time as possible, and it caps costs for the client. On the other hand, the client may have an incentive to try to expand the scope of the work covered by the fixed fee.

Mixed Fee: Hybrid fee arrangements are becoming increasingly common. For example, a client may pay her lawyer a diminished hourly rate plus a bonus if the lawyer achieves good results. Although a hybrid of this sort may align incentives reasonably well, it is often difficult to implement. A precise formula for computing the bonus may be hard to establish in advance, especially where there is no single, easily measurable benchmark for a good outcome. The parties may simply agree to negotiate the amount of the bonus after the fact, but at that point lawyer and client may have different notions of what more, if any, the lawyer deserves.

Salary: A salaried lawyer works for a single client, whether a government agency or a private corporation. Bringing counsel in-house does not eliminate the principal-agent tension, however. The lawyer still has interests of her own. The incentive effects will depend on the details of the salary arrangement and career paths within the organization. Compensation may share the characteristics of either a fixed fee arrangement or even hourly fees, depending on how the lawyer's pay is computed. In-house counsel are sometimes thought to be more risk-adverse and less willing to provide independent legal advice that the client may not want to hear, because their career depends on keeping the favor of a single client.

MONITORING SYSTEMS

The principal-agent tension may be dampened by monitoring the agent's activities. This is difficult and expensive in the legal context, with respect to both inputs and outputs. To know whether a lawyer is acting solely in his client's interest, the client must possess enough knowledge to evaluate the lawyer's decisions and must be able to observe the lawyer's behavior. There may be no easy way for a client to verify information about a lawyer's true work habits, diligence, or timekeeping practices. Similarly, it may be quite expensive for a client to monitor the quality of her lawyer's work, unless the client is herself an attorney. Often in-house corporate counsel can monitor the activities of outside counsel, but this is hardly a cost-free solution.

REPUTATIONAL BONDING

To the extent that potential clients have access to accurate information about an attorney's reputation, the attorney will have more incentive to build and maintain a reputation for trustworthiness and hard work. If an unsatisfied client can go elsewhere in the market for legal services, a lawyer is more likely to act loyally and diligently to keep that client.

But this constraint is an imperfect one. Once a lawyer-client relationship has been established, it is often very costly for the client to leave one lawyer and start a new relationship with another. In the middle of a lawsuit or a complicated transaction, for example, a new lawyer would have to invest a great deal of time to learn what the old lawyer already knows about the matter. Because the client will typically have to pay to educate his new lawyer, these extra costs of switching lawyers midstream mean the market cannot completely constrain opportunism. For this market constraint to operate most effectively, moreover, clients must be able to evaluate the performance of their lawyers, which, as noted above, is no simple matter.

To the extent that a lawyer and client expect their relationship to extend over time, each is less likely to act opportunistically in the present. If the shadow of the future is long, the risk of losing future business may deter present disloyalty. In the corporate world today, however, steady long-term relationships with outside counsel are becoming the exception, not the rule. Rather than long-term retainers, clients increasingly

hire lawyers for a single transaction or for a particular lawsuit.⁷ In such short-term one-shot relationships, each side may be more tempted to try to exploit the other.

PROFESSIONAL NORMS

Law is a regulated profession. Explicit and formal professional norms—some aspirational and some that carry the force of law—influence lawyers' actions, as do more informal and implicit norms of behavior that exist within communities of attorneys. Lawyers swear oaths upon admittance to the bar, and they are bound by their state's rules of professional conduct. We believe that most lawyers take their ethical obligations seriously and want to see themselves as loyal agents. This constraint, however, is obviously less than perfect. The profession's norms afford great leeway for lawyers who wish to abuse the rules.

Tort law provides an additional constraint on lawyers' behavior. In general, an attorney is liable for negligence in the handling of a client's negotiations if she fails to exercise the ordinary skill and knowledge expected of attorneys who work in her field.⁸ This requires communicating offers and counteroffers to one's client, advising one's client on well-established legal principles that may affect the client's decision to settle, and explaining to one's client how a settlement might affect future rights and obligations.⁹ Although there are relatively few reported negotiation-related malpractice cases, in some but not all jurisdictions a lawyer may be liable if he *mistakenly* recommends settlement on the basis of an erroneous assessment of the settlement's value,¹⁰ or if the lawyer showed poor professional judgment by engaging in questionable negotiation tactics that ultimately led to a less-than-favorable result for his client.¹¹ All of these constraints can help dampen principal-agent tensions in the legal context. None is perfect, however. Ultimately, as we discuss in Part III, a lawyer and client must negotiate with each other to ensure that both parties are well-served by their relationship. For now, we merely point out that our third tension is highly relevant to the legal context.

THE APPROACH: MANAGING THE TENSION

The central challenge in agency relationships is to capture the benefits while minimizing agency costs. Our approach requires that the tension

be acknowledged and managed explicitly; that principals and agents use the concept of comparative advantage to structure their roles and responsibilities; and that they aim to form a partnership based on reciprocal candor and respect. In Chapter 7 we discuss in some detail how this can best be done in the lawyer-client context. Here, we outline our general advice.

CREATE A COLLABORATIVE RELATIONSHIP THAT MINIMIZES AGENCY COSTS

The principal-agent tension should be acknowledged, not avoided, and treated as a shared problem. Fees and monitoring should be addressed explicitly, not left lurking under the table. Discuss these issues. Rather than have the principal worry silently about the agent's choices and behavior, principals and agents should search together for ways to reassure the principal without overly burdening the agent. In our experience, openness and candor build trust.

The goal should be to find fee arrangements and monitoring mechanisms that are thoughtfully tailored to a given context. One size does not fit all. If a principal wants an agent exhaustively to research an issue where a lot is at stake, compensation by the hour may create a better incentive than a fixed fee. On the other hand, if a principal is worried about controlling costs and thinks she is in a position to monitor quality effectively, a fixed fee may be better. Consider the incentive effects of different fee arrangements and the feasibility of monitoring either the agent's inputs (such as time) or the volume and quality of outputs. Similarly, to what extent can reputation constrain opportunism? Perfection may not be possible, but some agency relationships are better than others.

CONSIDER COMPARATIVE ADVANTAGE AND STRATEGY IN ALLOCATING ROLES

A principal and agent may allocate negotiation roles in a variety of ways. At one extreme, the principal may do all the negotiating herself, using the agent as a coach and consultant behind the scenes. At the other extreme, the agent alone may be at the bargaining table and may not even disclose the principal's identity to the other side. There are many options in between. In some negotiations, the principals and agents are all at the

table together. In others, the principals may negotiate broad deal points, leaving the agents to negotiate the detailed documents that implement the deal.

Sometimes conventions influence who is at the table and how roles are allocated. In residential real estate transactions, offers are generally presented to the seller's agent, who then transmits them to the seller. Buyer and seller may have very little direct contact until the closing. Similarly, sports agents often deal with team representatives without their clients at the table. In litigation, clients typically act through their lawyers, and professional standards prohibit a lawyer from contacting an adverse party, for example, unless counsel is also present.

Principals and agents obviously should take such conventions into account, but they also must consider comparative advantage and may even want to challenge assumptions about who should be at the table. Once again, one size hardly fits all. The preferences, skills, knowledge, and resources of the principal and agent must be considered. What is the agent particularly good at? What about the principal? Who has more information that will be relevant to the upcoming negotiation? Who is more skilled at negotiating? Who has more time or desire to engage in the various tasks needed to prepare for the negotiation? By thinking carefully about their relationship and about what each can bring to the table, a principal and agent can structure their roles so that each does those things for which he is particularly suited.

Strategic implications must also be taken into account. Who your side sends to the table can depend on, and influence, who the other side sends. If your side brings a lawyer, the other side is more likely to bring one, too. Indeed, hiring an agent can often be a strategic signal. If an agent has a reputation for being a warrior, the message is very different than if an agent is known to be a collaborative deal-maker.¹² Your side may wish to discuss with the other side who should be at the table and how the negotiation will be structured. Will principals attend the first meeting? Without such explicit discussion, an agent may show up alone when the other side expected principals to attend and participate. Or one side may bring a whole team of agents and advisors and unintentionally overwhelm the other side.

If an agent plays a role at the bargaining table, what is the scope of the agent's authority or mandate, and what information is the agent autho-

rized to share with the other side? If a principal is fearful that his agent will disclose too much, this worry can inhibit the principal from sharing necessary information with his agent. On the other hand, by sending only the agent to the bargaining table, a principal may be able to avoid having to answer awkward questions that might be posed by the other side.

The most salient question is whether the agent has the authority within a particular range to settle a dispute or make a deal. This is an important issue for principals and agents to discuss in allocating roles. Too often, however, an agent will simply ask the principal for her bottom line or reservation value to make clear just how far the agent can go. This can be a mistake for several reasons.

First, as Roger Fisher and Wayne Davis have pointed out, whenever there are multiple issues in a negotiation, "there is no one 'bottom line.' The minimum figure acceptable on one issue, such as price, will depend on what is proposed on other issues, such as credit, interest rate, closing dates, warranties, and restrictions."¹³ By oversimplifying the principal's interests, an agent may leave himself with much less room to search for trades that create value, and he may reinforce the notion that negotiation is purely distributive.

Second, if an agent merely asks for his principal's bottom line, the principal has an incentive to manipulate the agent by exaggerating the reservation value in order to encourage the agent to work harder. The principal may fear disclosing her true reservation value, expecting that the agent may treat as a goal what the principal sees as a minimally sufficient point of indifference. Or, the principal may simply exaggerate to set high aspirations for the agent.

Finally, in some circumstances, the principal cannot—if unassisted—evaluate her best alternative. In a legal dispute, for example, the best alternative to a negotiated settlement will typically be to pursue litigation. But without a lawyer's help, most clients cannot make reasonably informed judgments as to whether a proposed settlement is reasonable in light of the opportunities and risks of litigation.

Rather than ask for the principal's bottom line, the more appropriate, and subtle, question is how the agent's authority should be adjusted during the course of a negotiation. Paradoxically, limiting the authority of agents may facilitate brainstorming and the development of creative

solutions because neither agent has power to bind. At the outset of a negotiation, it may be best for the agent to have no authority to make a binding commitment on substantive issues but instead to have a broad mandate to design a negotiation process, discuss interests, and generate options.¹⁴

CONSIDER THE INCENTIVES CREATED BY AGENCY RELATIONSHIPS ON THE OTHER SIDE

In addition to thinking through principal-agent issues on your side, you should consider the relationships on the other side as well. Do not naively assume that the other side is a “unified actor” with a single set of interests. What are the agent’s incentives? A broker or a sales agent may get paid only if the deal goes through. A contingent-fee lawyer who is very pressed for time because of other commitments may be eager to settle. An executive on the other side may either support or oppose a merger, depending on how his career will be affected. In crafting proposals, it is not enough to consider only the interests of the principal on the other side. The agent’s incentives and interests should be taken into account as well.

BEWARE OF THE TACTICAL USE OF AGENTS

The agency relationship can be used to implement a variety of hard-bargaining tactics. An agent can play the bad cop to his client’s good cop, or vice versa. Ambiguities about authority can be exploited to take two bites at the apple: an agent at the table might extract a final concession from you in order to strike a deal, only to report subsequently that his principal demands more—he really had no authority to commit. A problem-solving negotiator must be able to recognize these tactics and deploy effective countermeasures. Naming their game and being explicit about process and authority can help, as we suggest in Chapter 8.

CONCLUSION

Agents are used pervasively in negotiations, and the principal-agent tension—like the other two—must be managed. Use of agents complicates bargaining by creating a web of relationships in which a variety of actors interact, each with his own interests, incentives, and information. The

introduction of agents—and the system of relationships it generates—may be either a blessing or a burden with respect to the management of the first two tensions.

Consider the tension between empathy and assertiveness. An agent may compensate for his principal's more limited repertoire of communication and interpersonal skills. For example, an agent may help his principal better understand the perspective, interests, and needs of the other side. At the table, an agent may be better able than his principal to demonstrate understanding of the other side and to assert effectively. In circumstances where the principals have difficulty communicating with one another, a pair of agents can construct a bridge between them.

But none of this automatically follows from the introduction of agents. Communications between the two sides may become more twisted, not less, as additional players enter a negotiation. If the principals receive all of their information about what's going on across the table through their agents, a manipulative agent can seriously distort his principal's perceptions and decision-making. Rather than helping his principal demonstrate understanding of the other side, an agent can inflame conflict and demonize. Rather than serve as a bridge, a damaged relationship between the two agents can itself become a barrier.

The same is true of the tension between creating and distributing value. As a counselor, an agent can help a principal better understand and prioritize his interests. An agent's knowledge, skill, and contacts may help the principal in assessing and improving his BATNA. And an agent may be able to broaden the set of options under consideration. At the table, the agent may be more able constructively to lead the way. Agents help create a negotiation process that manages the distributive aspects of negotiation without inhibiting value creation. Even in the face of hard-bargaining tactics, a skilled agent may be able to change the game to problem-solving.

But bargaining through agents can destroy value if their involvement leads to escalating transaction costs and distributive stalemate. An agent may be a specialist in hard-bargaining tactics—a mercenary for hire. A real danger is that agents will merely increase costs, delay negotiations, and exacerbate tensions.