Four Key Concepts: Your Starting Points

Excerpted from

Negotiation

Harvard Business School Press
Boston, Massachusetts

ISBN-10: 1-4221-0567-9
ISBN-13: 978-1-4221-0567-2
5672BC

This chapter was originally published as chapter 2 of *Negotiation,*
copyright 2003 Harvard Business School Publishing Corporation.

You can purchase Harvard Business School Press books at booksellers worldwide.
You can order Harvard Business School Press books and book chapters online at www.HBSPress.org, or by calling 888-500-1016 or, outside the U.S. and Canada, 617-783-7410.

2

Four Key Concepts

Your Starting Points

Key Topics Covered in This Chapter

- *BATNA (best alternative to a negotiated agreement)*
- *Reservation price*
- *ZOPA (zone of possible agreement)*
- *Value creation through trades*

When people don't have the power to force a desired outcome, they generally negotiate—but only when they believe it is to their advantage to do so. A negotiated solution is advantageous only under certain conditions, that is, when a better option is not available. Consider this example: One of your best employees, Charles, is being courted by another company. Replacing him will be costly, but perhaps not as costly as negotiating some combination of financial inducements and work changes that will persuade him to stay and keep on contributing. Your mental calculator tells you that the cost of these inducements is less painful than your only other option—losing a star employee.

Any successful negotiation must have a fundamental framework based on knowing the following:

- The alternative to negotiation
- The minimum threshold for a negotiated deal
- How flexible a party is willing to be, and what trade-offs it is willing to make

Three concepts are especially important for establishing this framework: BATNA (best alternative to a negotiated agreement), reservation price, and ZOPA (zone of possible agreement). This chapter develops these three concepts using distributed negotiations as examples. It then expands the framework to include a fourth concept: value creation through trade, switching to integrative negotiations for an example. This switch simultaneously illustrates how the concepts of reservation price and ZOPA shift when you move from distributive to integrative negotiations.

Know Your BATNA

BATNA, a concept developed by Roger Fisher and William Ury, is the acronym for best alternative to a negotiated agreement. It is one's preferred course of action in the absence of a deal. Knowing your BATNA means knowing what you will do or what will happen if you fail to reach agreement in the negotiation at hand. Consider this example:

> *A consultant is negotiating with a potential client about a month-long assignment. It's not clear what fee arrangement she'll be able to negotiate, or even if she'll reach an agreement. So before she meets with this potential client, she considers her best alternative to an acceptable agreement. In this case, the best alternative to a negotiated agreement—the consultant's BATNA—is spending that month developing marketing studies for other clients—work that she calculates can be billed out at $15,000.*

Always know your BATNA before entering into any negotiation. Otherwise, you won't know whether a deal makes sense or when to walk away. People who enter negotiations without this knowledge put themselves in a bad position. Being unclear about their BATNAs, some will reject a good offer that is much better than their alternatives because they are overly optimistic. For example, Fred has brought a damage suit against a former employer. That employer has offered to settle out of court for $80,000. But Fred wants more. "I know that I'm in the right and can get what I want if I don't settle, but go to court," he tells himself. Going to court is his best alternative to the $80,000 settlement offer. But how good is that alternative? Fred hasn't really done a thorough job of estimating the probability of winning in court, nor the size of a potential award. In other words, he has no real idea of the alternative to the employer's settlement offer.

A King Who Knew His BATNA

Long before the acronym BATNA was invented, savvy operators kept their best alternatives in mind as they dealt with opponents. Consider France's Louis XI, one of the most crafty monarchs in fifteenth-century Europe. When England's Edward IV brought his army across the Channel to grab territory from his weaker rival, the French king decided to negotiate. Knowing that his BATNA was to fight a long and costly war, Louis calculated that it was safer and cheaper to strike a deal with Edward. So he signed a peace treaty with the English in 1475, paying 50,000 crowns up front and an annuity of 50,000 crowns for the rest of Edward's life (which proved to be short). To seal the deal, Louis treated his royal counterpart and the English army to forty-eight hours of eating, drinking, and merrymaking. As an added token, he assigned the Cardinal of Bourbon to be Edward's "jolly companion" and to forgive his sins as he committed them.

As Edward and his army staggered back to their boats, ending the Hundred Years War, Louis remarked: "I have chased the English out of France more easily than my father ever did; he drove them out by force of arms while I have driven them out by force of meat pies and good wine." Such is the power of negotiating when you know your BATNA.

SOURCE: Richard Luecke, *Scuttle Your Ships Before Advancing* (New York: Oxford University Press, 1993), 49.

Others run the risk of accepting a weak offer, one that is less favorable than what they could have obtained elsewhere if there were no agreement ("I probably have some other options, but this seems like a good deal").

Strong and Weak BATNAs

Your best alternative to a negotiated agreement determines the point at which you can say no to an unfavorable proposal. If that BATNA is strong, you can negotiate for more favorable terms, knowing that you have something better to fall back on if a deal cannot be arranged. A weak BATNA, on the other hand, puts you in a weak bargaining position. Consider the position of the consultant in our earlier example if she had no other work lined up. In that case her alternative to a deal might be sitting around waiting for the phone to ring—a terrible position to be in during negotiations.

Whenever a negotiator has a weak BATNA (or hasn't taken the time to determine what that BATNA is), it is difficult to walk away from a proposal—no matter how paltry it might be. And if the other side knows that its opponent has a weak BATNA, the weak party has very little power to negotiate. Not that this stops some people from trying to drive a hard bargain. For example, in late 2001, an organized group of the unemployed in France threatened to strike if the government failed to meet their demand for higher unemployment benefits! Needless to say, this group had little negotiating power.

Take a minute to think about your own best alternative to whatever deal you are presently negotiating. Do you have one? Is it strong or weak? Can you quantify it?

Improving Your Position

A weak BATNA is not the end of the world. Whatever hand you've been dealt, here are three potential approaches to strengthening your position:

1. Improve your BATNA.
2. Identify the other side's BATNA.
3. Weaken the other party's BATNA.

Each of these options is discussed in the following sections.

IMPROVE YOUR BATNA BATNA seems a given. Our consultant has $15,000 of other work she can turn to if negotiations with the new client fail. But she might be able to expand that other work, thereby improving her BATNA and giving her a strong hand in negotiations. For instance, she might call her current client and say, "You know those marketing studies you asked me to develop. For a slightly higher fee—say, $5,000 more—I could expand the scope of those studies to include sales estimates of your two leading competitors' products. Would you like me to do that?" If she got the go-ahead to expand the project, her new BATNA would be higher—$20,000.

Anything that can be done to improve your BATNA will strengthen your negotiating position. Take a minute to think of ways you could do that, given current circumstances.

If you have a strong BATNA—and if you are certain that it's much stronger than anything the other side can muster—don't be shy about it. Discreetly let the other side know that you're negotiating from a strong position.

IDENTIFY THE OTHER SIDE'S BATNA Knowledge of the other side's BATNA is another source of negotiation strength. Is its alternative to a deal strong or weak relative to yours? A good estimation of the other side's BATNA can be a big help to you. For instance, in the example given earlier, our consultant would have a stronger bargaining hand if she knew that her potential client would have to pay $25,000 to another firm for the same work. Twenty-five thousand dollars would be the client's BATNA; knowing that would help our consultant be more effective at the negotiating table. Better still, a little sleuthing might reveal that the competing consulting firms were booked solid for the next four months. If the work had to be done soon, the potential client would have a very weak BATNA, and our consultant could pursue negotiations with much greater confidence. "My price is $30,000, and I can begin the work later this month."

Thus, knowledge of the other side's BATNA is extremely helpful when you can obtain it. But how can you obtain that knowledge? The opposing negotiator won't tell you unless his BATNA is very strong. He may even bluff about it. Sometimes, however, the other party's circumstances can be discovered. Asking questions during the negotiation can help you learn about the other side's BATNA, but you can also learn in advance by doing the following:

- Contacting sources within the industry
- Checking potentially relevant business publications

A Caution on BATNA Values

Although it's absolutely essential that you know your own BATNA and try to estimate that of the other side, be aware that most people don't do a good job of estimating BATNA values. For example, Lax and Sebenius describe an experiment involving the value of a company up for sale. "Even given identical business information, balance sheets, income statements, and the like," they write, "those assigned to buy the company typically rate its true value as low, while those assigned to sell it give much higher best estimates. Neutral observers tend to rank the potential someplace in between."[1]

The lesson here is that BATNA values can be influenced by your personal perspective. So be as objective as possible. Check your thinking with a neutral third party.

- Reviewing annual reports (or public filings)
- Asking questions informally of the negotiator or others within the company
- Imagining what your interests, preferences, and needs would be if you were in their position

Knowing the other side's BATNA lets you know how far you can go. But other knowledge is equally important. For instance, the more you know about the other side's broader concerns, industry, corporate structure, and other deals and goals, the better able you will be to find creative ways of meeting their interests (preferably at low cost to you).

WEAKEN THE OTHER PARTY'S BATNA Anything that weakens the other side's alternative to a deal will improve your relative position. In some cases, weakening the other side's BATNA may be done directly.

Final Haven, Inc., a Texas-based chain of funeral homes, had been acquiring independently operated rivals in the northeastern United States and was in preliminary negotiations with Jim and Barbara Stanley for the purchase of their establishment in central Connecticut. When those negotiations began, the Stanleys were confident that they could get a high price since another funeral home operator in the area, Bob's Discount Funerals, had been saying for years that he'd like to buy them out. "That's a fine funeral business you have there," he had told them repeatedly. "If you ever want to sell it, talk to me." Bob had even hinted at $800,000.

The Stanleys thought of $800,000 as their best alternative to cutting a deal with Final Haven. "If we can play Bob off Final Haven," Jim Stanley told Barbara, "we should be able to get a still better price—maybe $1 million." Needless to say, the Stanleys were crestfallen when the local newspaper announced "Bob's Discount Funerals to Be Acquired by Texas-Based Chain." Their alternative had just evaporated, leaving them in a weak position relative to the deal makers from Final Haven.

In this example, Final Haven neutralized Jim and Barbara's alternative deal. Their $800,000 BATNA had been taken off the table, leaving continued operation of the business as their only alternative to an offer by Final Haven. Thus, Final Haven strengthened its position relative to the other side by weakening the Stanleys' BATNA. Of course, the Stanleys' position may not be entirely untenable. They might take steps to strengthen their BATNA. For example, they might entice another potential bidder into the game—perhaps a rival chain of funeral homes.

When You Have No Alternatives

No negotiator is in a weaker position than one with no alternative to a deal. In this case, the other side can dictate the terms. The BATNA-less party is a deal *taker,* not a deal *maker*. If you find yourself in this dangerous situation, you must create an alternative. Writing in the *Harvard Business Review,* Danny Ertel described how Colbún, Chile's third-largest electric power producer, managed to do this:

> *Colbún has often found itself at a substantial disadvantage in terms of scale and negotiating leverage. It had to bargain for transmission capacity, for example, with the transmission arm of the largest power company. If it had gone into those negotiations without an alternative, it would have been at the mercy of the other side, and it would have ended up paying dearly for the capacity. But Colbún had an express corporate policy requiring the establishment of a BATNA in any negotiation. Because there were no other existing options for purchasing transmission capacity, Colbún had to create one—developing its own transmission line, conducting feasibility studies, and even putting construction contracts out to bid.*[2]

As described by Ertel, this approach worked. The other side steadily reduced its price quote as development of Colbún's BATNA progressed.

Are you without an alternative in any of your current negotiations—with your boss, with a customer, or with someone else? If you are, stop to think about how you could create one. Think, too, about which type of alternative would most strengthen your hand.

BATNA Is Not Always Simple

BATNA is a straightforward concept. But applying it is not as simple as we've made it appear. Most business negotiations involve many variables, some of which cannot be quantified or compared. This makes for a fuzzy BATNA. For example, let's suppose that you are contemplating the purchase of a used 2001 Volvo sedan with an automatic transmission and 28,000 miles on the odometer. The dealer has it listed for $26,000 and offers a ninety-day warranty. Your neighbor, however, owns a 2001 Volvo station wagon with a standard transmission (which you prefer) and 53,000 miles on the odometer. He says that it has no known mechanical problems, and will part with it for $18,000—with no warranty. As you negotiate with the car dealer, your neighbor's vehicle would seem to be your BATNA. But is it a useful benchmark of what you could achieve in the absence of an agreement?

If price were the only issue, the neighbor's Volvo would be your BATNA, but there are substantial quantitative and qualitative differences between the two vehicles. The neighbor's car has a lower price and a standard transmission—which you like—but it has higher mileage and no warranty—which you don't like. Most negotiations involve similar complexities.

In a transaction that involves price and various other features, such as the car example, you can make the BATNA less fuzzy by assigning a monetary value to the various features and adjusting the BATNA value by that amount. For example, you could assign a price penalty of $4,000 to your neighbor's Volvo to adjust for its higher mileage, and another $1,000 for the fact that it comes with no warranty. At the same time, you could add a price premium of $500 to that same car for the fact that it has the standard transmission, which you prefer. Netting these adjustments, you have $4,500 (or $4,000 + $1,000 – $500). Add these to the neighbor's offer of $18,000 and you have $22,500—your new, less fuzzy BATNA. If the auto dealer would reduce his asking price to $22,500, you'd be indifferent as to which car you'd buy—at least theoretically.

Not all situations are amenable to price adjustments, for the simple reason that price is not always the fulcrum of negotiated deals. Qualitative issues also matter. For example, a person who is negotiating the purchase of a small business may be concerned with *when* the transaction will take place and with the *level* of the current owner's involvement as a consultant. In these cases, the negotiator must be able to make trade-offs in both sizing up the deal and developing his or her BATNA.

Reservation Price

The *reservation price* (also referred to as the *walk-away*) is the least favorable point at which one will accept a deal. Your reservation price should be derived from your BATNA, but it is not usually the same thing. If the deal is only about money, however, and a credible dollar offer is your BATNA, then your reservation price would be approximately equal to your BATNA.

Consider the following example:

> *You are currently paying $20 per square foot for suburban office space. The location is satisfactory and you believe that the price is fair, but you wouldn't mind paying more to be closer to your downtown customers. While preparing to negotiate with a commercial landlord for an office lease in a downtown high-rise, you decided that you would not pay more than $30 per square foot. That's your reservation price. If the landlord insists on more, you can walk away and attempt to lease space in a different building. Or you can stay where you are at $20 per square foot (your BATNA).*
>
> *At the end of a lengthy negotiation session, the landlord declares that he will not accept less than $35 per square foot—and he won't budge. You graciously terminate the negotiation and walk away from the deal.*

In this example your reservation price is different from your BATNA. BATNA in this case is the current rent at the current location: $20 per square foot. But the new location has different characteristics

Setting Your Reservation Price

Do you know your reservation price in your current negotiations? What variables affect your price? What value have you traded off in figuring your walk-away? The appendix contains a handy worksheet that can help you set an objective reservation price. The worksheet and other tools can also be found online at the Harvard Business Essentials Web site: www.elearning.hbsp.org/businesstools. The site offers free interactive versions of the worksheets, checklists, and other tools introduced in this series.

that enter into the equation. It's closer to customers, and it may be a more attractive space with greater workplace utility. You'd be willing to assume the added expense and the hassle of moving, even if it meant paying $30 per square foot. Anything more than that, however, would be unacceptable. Thus, there's a subtle difference between your BATNA and your reservation price.

The fact that the prospective landlord would not take less than $35 per square foot suggests that $35 is his reservation price.

ZOPA

The *ZOPA,* or zone of possible agreement, is a third key concept to remember. ZOPA is the area or range in which a deal that satisfies both parties can take place. Put another way, it is the set of agreements that potentially satisfy both parties.

Each party's reservation price determines one end of the ZOPA. The ZOPA itself exists (if at all) in the overlap between these high and low limits, that is, between the parties' reservation prices. Consider this example:

> *A buyer has set a reservation price of $275,000 for the purchase of a commercial warehouse. "That's as high as I'm willing to go," she tells herself. Naturally, she would prefer paying less. Unbeknownst to her, the seller has set a reservation price of $250,000. That is the least he'll take for the property. The ZOPA, therefore, is the range between $250,000 and $275,000, as shown in figure 2-1. The two parties might haggle a bit in reaching agreement, but an agreement in this range would satisfy each.*

FIGURE 2-1

Zone of Possible Agreement

BUYER: "What would you say to an offer of $255,000? I could agree to that."

SELLER: "Thanks, but I believe that the building is worth more—and I can get more if I leave the building on the market for another month or so."

BUYER: "Maybe, but maybe not. I'd be willing to pay $260,000 now if we could reach an agreement."

SELLER: "$265,000 and it's yours."

BUYER: "Then $265,000 it is."

In this commonplace example, each party had a reservation price, and they bargained within the ZOPA. In doing so, each got a better price than his or her walk-away. We can assume here that neither knew the reservation price of his or her counterpart. As you can imagine, that knowledge would have been extremely valuable. For example, with foreknowledge of the other side's reservation price, the buyer might have driven a tougher bargain, holding out for something closer to $250,000. Estimating the other side's reservation price is sometimes possible. If, for example, equivalent properties in the area were listed for $260,000, the buyer could assume with some confidence that the seller's reservation price would be close to that figure. Likewise, if investigation revealed that the seller was highly motivated to sell, the buyer would offer less.

Now consider what would happen if the numbers were reversed—that is, if the buyer had set a reservation price of $250,000 and the seller had set a reservation price of $275,000. That is, the buyer won't pay more than $250,000, and the seller wouldn't take anything less than $275,000. There would be no overlap in the ranges in which the two parties could reach agreement—no ZOPA. No agreement would be possible, no matter how skilled the negotiators, unless there were other elements of value to be considered or if one or both sides' reservation prices changed. For example, if the warehouse seller determined that the potential buyer needed parking space for ten delivery trucks, and if he happened to have that many unused spaces available at an adjacent location, he might offer them to the seller as part of the package. That "sweetener" might break the impasse. This would be an example of the way value is created in integrative negotiations, as described in chapter 1. Information sharing makes it possible.

Value Creation Through Trades

Another fundamental concept of negotiation is value creation through trades. This concept tells us that negotiating parties can improve their positions by trading the values at their disposal. Value creation through trades occurs in the context of integrated negotiations. It usually takes the form of each party getting something it wants in return for something it values much less. Consider the following example:

> *Helen and John are collectors of rare books and view their holdings as sources of artistic satisfaction and investment gain. "With rare books I can achieve a higher financial return than I can in the stock market," says Helen confidently, "and I experience the exquisite pleasure of having these wonderful first editions in my home." Helen's pride and joy is her set of Hemingway novels. She has every one in a first printing, with the exception of* For Whom the Bell Tolls. *She is negotiating with John, who has a copy for sale.*
>
> *John is pleased to have his original Hemingway, but as negotiations over the phone reveal, his primary interest is in building a collection of the works of the nineteenth-century American historian William Prescott. He currently has first printings of Prescott's multivolume* History of the Reign of Ferdinand and Isabella *and is aggressively looking for Volume 2 of that same author's* The Conquest of Mexico. *As luck would have it, Helen has a first printing of Volume 2, and is agreeable to parting with it since it is not part of any collection she is building. It is merely something she had purchased at an estate sale.*
>
> *In the end, John sells Helen the Hemingway book, completing her set, for $100 plus her copy of Prescott's Volume 2, which completes his set.*
>
> *Both are extremely happy with the deal.*

This is a case in which two individuals were able to create value, not simply claim it. Both emerged with substantial satisfaction from the deal. This was possible because the goods exchanged had only modest value to their original holders, but exceptional value to their new owners.

Think for a moment about your own negotiations—with customers, suppliers, and fellow employees. Are you pulling and tugging with each other in a win-lose framework? Now think of ways that you might be able to satisfy the other side with something that would cost you very little.

- For a supplier, that greater value might take the form of an extended delivery period. For the customer, having deliveries spread out during the month might be of no great consequence, but for a supplier with strained production facilities, it may be very important.
- For a customer, greater value at low cost might take the form of three months of free repair services if needed. For a vendor who has great confidence that its products will need no repairs during that period, free service is nothing of consequence. In providing it to the customer the vendor incurs little cost, even though the customer values the repair service highly.
- For another department in your company, greater value might be found in your offer of two high-powered workstations that your people rarely if ever use. That department may be able to offer something in exchange that you value more than it does.
- For an employee, the opportunity to work from a home office two days each week may produce great satisfaction while costing the employer nothing.

Few of the things that others value highly will have little value to you, and vice versa. But they are sometimes there, and a little thinking and probing can identify them. That's value creation. Just be sure that if you give something of value, then you ask for something in trade.

Summing Up

This chapter has explained the fundamental concepts used by skilled negotiators.

- BATNA is the best alternative to a negotiated agreement. It is one's preferred course of action in the absence of a deal. Knowing your BATNA means knowing what you will do or what will happen if you fail to reach agreement. Don't enter a negotiation without knowing your BATNA.
- If your BATNA is weak, do what you can to improve it. Anything that strengthens your BATNA improves your negotiating position.
- Identify the other side's BATNA. If it is strong, think of what you can do to weaken it.
- Reservation price is the price at which the rational negotiator will walk away. Don't enter a negotiation without a clear reservation price.
- ZOPA is the zone of possible agreement. It is the area in which a deal will satisfy all parties. This area exists when the parties have different reservation prices, as when a home buyer is willing to pay up to $275,000 and the home seller is willing to take an offer that is at least $250,000.
- Value creation through trades is possible when a party has something he or she values less than does the other party—and vice versa. By trading these values, the parties lose little but gain greatly.

Notes

Chapter 2

1. David A. Lax and James K. Sebenius, *The Manager as Negotiator* (New York: Free Press, 1986), 57–58.

2. Danny Ertel, "Turning Negotiation into a Corporate Capability," *Harvard Business Review,* May–June 1999, 55.

Harvard Business Essentials

The New Manager's Guide and Mentor

The Harvard Business Essentials series is designed to provide comprehensive advice, personal coaching, background information, and guidance on the most relevant topics in business. Drawing on rich content from Harvard Business School Publishing and other sources, these concise guides are carefully crafted to provide a highly practical resource for readers with all levels of experience, and will prove especially valuable for the new manager. To assure quality and accuracy, each volume is closely reviewed by a specialized content adviser from a world-class business school. Whether you are a new manager seeking to expand your skills or a seasoned professional looking to broaden your knowledge base, these solution-oriented books put reliable answers at your fingertips.

Books in the Series:

Business Communication
Coaching and Mentoring
Creating Teams with an Edge
Crisis Management
Decision Making
Entrepreneur's Toolkit
Finance for Managers
Hiring and Keeping the Best People
Manager's Toolkit
Managing Change and Transition
Managing Creativity and Innovation
Managing Employee Performance
Managing Projects Large and Small
Marketer's Toolkit
Negotiation
Power, Influence, and Persuasion
Strategy
Time Management