



IBUS3107: BUSINESS NEGOTIATIONS

CONSOLIDATED READINGS & COURSE NOTES SUMMARY

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Reading 1 – Negotiation Dynamics

Overview:

- BATNA, RP, TP and ZOPA
- Distributive, Integrative and Compatible Issues
- What information should be disclosed in a negotiation?
- Psychology: the anchoring and adjustment heuristic and the reasons effect
- Notions of fairness: equity, equality and need

- In a negotiation, need to know 3 numbers: (1) BATNA; (2) Reserve Price; (3) Target Price

BATNA

- Essentially your **opportunity cost** – Taking option X makes you forego opportunity of taking your next best option
 - E.g. Can either watch movie or got to dinner, if you choose movie lost opportunity is dinner
- If your current option (X) value exceeds value of next best option (Y), pick X (economic profit)
 - Generally should not settle for a price lower than BATNA
- Strong BATNA (Y) allows you to push harder in negotiations of X, given alternative is desirable
 - Actively try to increase BATNA to give you this option
- Never change BATNA based on what opponent says, update BATNA when it itself changes i.e. in case you lose part of value of your next best opportunity
- Never reveal your BATNA, it would allow them to anchor on your (generally) lowest acceptable price
 - E.g. If a real estate agent knows your BATNA is \$1m they are unlikely to try to get you more for property you are selling if they know you will settle for this

Reserve Price (RP)

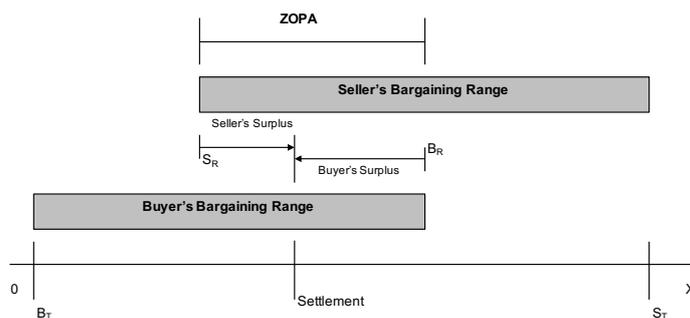
- **Seller:** Minimum you are willing to receive
- **Buyer:** Maximum you are willing to pay
- May set RP lower than your BATNA → relying on **social proof** to drive price up.

Target Price (TP)

- **TP:** Best price you can reasonably hope to receive – **aspiration point**
- E.g. A vending machine will have its TP and RP at parity as it can only charge one price for coke
- TP should never equal your first offer unless only once chance to make offer (as in case of vending machine) – Most do not agree with first proposition put to them
- Following should hold true:
 1. $TP \geq \text{Reserve Price}$
 2. $TP \geq \text{BATNA}$
 3. $RP \geq \text{BATNA}$ (**situationally dependent**)
- Exceptions to the above:
 - BATNA \geq RP
 - e.g. buyer offers you \$400 (BATNA) of computer, you feel you can get \$600 or best case \$800 (TP) on eBay. Yet you may choose a \$100 reserve to stoke a bidding flurry
 - BATNA = RP = TP (**Fixed Price scenario**)
 - e.g. train ticket has a fixed price and will cost the same from every vendor whether it is a machine or natural person, hence BATNA is identical across all vendors.
- **Strategy:** Always think about BATNA, RP and TP of your opponent to make outcome of your negotiation more successful (**Galinsky & Mussweiler, 2001**)

Zone of Possible Agreement (ZOPA)

- E.g. Y offers to buy your TV for \$400, you need \$300 minimum from it to pay for a hard drive. You will only sell TV if you get \$300 (RP). If negotiating with Z and your best true offer is Y's, then BATNA is \$400 (will likely raise RP in negotiation with Z to \geq \$400)
 - If agreement with Z is not $>$ \$400 you will sell to Y for \$400.
 - Technically you're indifferent between offer of \$400 from Y or Z.
 - Hence, you might set new reserve (in negotiation with Z) at **point of indifference** i.e. \$400, as opposed to say \$401 or more. (In latter, you make positive economic profit)
 - Your target price is \$600. Z has a budget of \$405, set as RP. Your ZOPA is $\$405 - \$401 = \$4$ or if you set your reserve at point of indifference (BATNA) $\$405 - \$400 = \$5$. It is only in this zone that you can/should agree.
- **Positive:**
 - If $s < b$ (i.e. buyer is willing to pay more than least seller will accept), then a zone of possible agreement exists; the zone of agreement is from s to b .
 - E.g. Buyer willing to pay up to \$400K for house that Seller willing to sell for min of \$350K
- **Negative:**
 - If $b < s$ (i.e. the seller demands more than most buyer will pay), then there is no possible zone of agreement.
 - E.g. Buyer willing to pay up \$365K of house that Seller is willing to sell for min of \$385K



Types of Issues

- **Distributive issue (D):** **Zero-Sum game** where there is a **fixed pie** distributed among **finite** parties.
 - E.g. Within \$4 range, every \$1 gained by Z is \$1 lost by you and vice versa
 - Can generally reveal D issues to opponent
- **Integrative issue (I):** **Expands pie** that you negotiate over
 - E.g. if I want to buy 1 scarf and most I am willing to pay (RP) is \$6 and lady selling has a minimum selling price (RP) of \$2, then ZOPA is \$4 ($\$6 - \2). At the moment, negotiation is purely distributive and zero-sum.
 - if I buy 2 scarfs, willingness to pay for 2nd decreases from \$6 to \$5 (RP has remained same for 1st, but for 2nd has changed), and her minimum price remains same
 - Leads to new ZOPA of \$7 [$(6-2) + (5-2) = 7$]. Now there is \$3 more value = pie has expanded
 - N.b. Issue is only integrative before you have fully expanded pie after which issue becomes fully distributive
- **Compatible issue (C):** **No zero-sum negotiations**
 - Gain of mine is a gain of yours, though not necessarily a gain of same kind/amount.
- **Strategies:**
 - Know, prioritise & have a list of all your D, I and C issues
 - Start negotiation by putting all Integrative issues on table and try to figure out true value of pie before dividing it (brainstorm integrative issues)

Norms of Distributive Bargaining

- **Monotonicity:** (1-direction) Each successive offer should move in the direction of giving the other side more of what they want
- **Reciprocity:** Each concession should be matched with a concession from the other side

Prioritisation

1. Which issues are worth most
2. Trade off worthless ones for worthy ones
3. When planning your negotiation, clearly define issues and know how to prioritise

What You Should Keep to Yourself & Winners Curse

- Do not accept first offer even if it exceeds your reserve
 - This often creates **winner's curse** in opponent
 - Putting up a fight can make your opponent happier
 - Opponent likely to feel regret (i.e. should've offered a lower price) if initial offer is accepted

Basic Tactics

Anchoring & Adjustment Heuristic

- Under **situation of uncertainty**, people, upon hearing/seeing a number will anchor on that, without regard for its relevance
- They will then adjust their own estimate of worth of consideration, relative to anchor
- Anchoring leads people to settle on a figure closer to one they were presented with initially
- **Strategies:**
 - Try to slip anchors into sentences "do you think commission higher or lower than x% is fair"
 - By stating an outrageous anchor, you circumvent the nature of the heuristic
 - If opponent tries to anchor you, immediately re-anchor:
 - "it costs x, really I was going to bid Y, but let's stop this and start the real bidding."
 - "It costs X, thank you for the offer but my understanding is Y because..." (using reasons)

Getting to Yes

- Fisher & Ury's 4 objective criteria:
 1. Frame each issue as a **joint search** for **objective criteria**. Once objective criteria is found, it should form basis of your discussion of value of issue under negotiation
 2. Justify and be open to other's justifications as to what are most appropriate criteria and how they should be applied
 3. Never yield to pressure, only principle
 4. Agree on principles before negotiating over the sums
- **Strategies:**
 - Get other party to suggest criteria, pick one of those criteria that suits your case – They will not likely be able to go back on this (**commitment & consistency effect**)
 - Manipulate what is a fair and objective criteria to meet your needs

Reasons Effect

- People are more accepting of doing things for others if they have a reason to do so, just like anchoring, reason **need not be logical or relevant**
- **Strategy:** Use word because more "May I use XYZ, because I need to do X" – **triggers compliance**

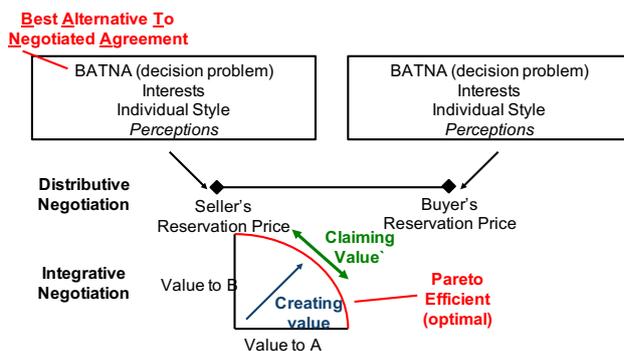
Notions of fairness

1. **Equality rule:** Value under consideration is **split evenly** among those who wish to claim it
 - E.g. 'lets split the bill' – Great for person who ordered chicken waffles, but not so good for the person who only bought fries

- 2. **Equity rule:** Inputs that parties put in are in same proportions as what parties get out
 - E.g. John puts in \$10, Sarah \$5 and Bob \$5 to buy \$20 lottery ticket. If they win \$1m, would split with \$500k going to John + \$250k going to other
- 3. **Needs based rule:** Party that needs most gets most
 - E.g. hospital emergency rooms where person in more need is given more resources
- **Tactic:** Manipulate above to pick whatever notion suits your case, guilt/shame others to 'do what's fair'

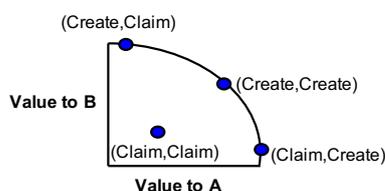
Contingency Agreements (Value Creation Strategy)

- Often businesspeople focus on future to solve current differences. Problem arises when parties have **different predictions** of what will happen in future & when it will happen.
- Contingency agreements solve these dilemmas:
 1. Identifying range of future happenings/outcomes that could take place in a **mutually exclusive, collectively exhaustive** fashion; and
 2. Pre-specifying obligations each party will take upon each of those happenings/outcomes
- Advantages of contingent contracts:
 - Allow you to build on differences, rather than arguing about them
 - Allow you to manage decision making biases of opponet
 - Allow you to solve problems of trust
 - Enable trust to be built without confrontation
 - Useful lie-detection device
 - Allows parties' incentives to be mutually aligned
- Used to create incentives & focus on differential predictions of future
- **Certainty Effect:** People prefer more certain outcomes.
- E.g. "if X, then Y; if no X, then Z" ... "if RBAs rates go up by 25 basis points, then bank will raise home loan interest rate by same amount"



Negotiator's Dilemma

	Create	Claim
Create	(Good, Good)	(Terrible, Great)
Claim	(Great, Terrible)	(Mediocre, Mediocre)



- Creating value (increasing size of pie)
 - Joint gains are created by exploiting differences in relative valuation of issues
 - Many issues typically mean win-win opportunities exist
 - Agreements “should” be Pareto efficient
- Tactics for creating value leave you vulnerable to tactics for claiming
 - Revealing information
 - Clear communication of interests
 - Flexibility (willingness to make constructive concessions)

2 Negotiation styles

1. Rational
 - Direct, mindful, information-based, logical
 - Uses analysis, proofs, algorithms
2. Psychological
 - Based on liking, social capital, social networks, obligation, loyalty, subtle threats, who-was there-first, un-enforceable contracts etc.

Reading 2 – Preparation for Negotiation

Overview:

- Self-assessment
- Assessment of the other party(s)
- Situational Assessment
- Generalised Strat: Scope, Sequence, Packaging, Framing and Formula
- Post-settlement settlement

- Steps:
 1. Assessment of yourself
 2. Assessment of other party(s)
 3. Define scope of your negotiation i.e. issues will you negotiate over, timeframe etc.
 4. Understand sequence that you will present those issues in, and/or if you will present issues in bundles (i.e. packages).
 5. Consider general principles, strategies, tactics and tricks that you will use to negotiate

Step 1: Self-Assessment

1. Identify all issues
2. Identify what type of issue each issue you identified is: D, C or I.
3. identify your BATNA on those issues, update your BATNA as new info comes available
4. Prioritise issues and rank in order of importance – allows you to determine which issues you need to fight hardest over (develop a scoring system)
5. Set TP
6. Set RP
7. Assess your risk propensity
8. Package issues together into bundles of equivalent value for yourself.
 - ≤ 3 bundles, or opponent will become overwhelmed - Presenting less may make you seem less flexible leading to **positional bargaining**
 - In making bundles take into account priorities/worth of each issue, make each package of equal value to you. What package opponent most like/dislike will be a clue to their priorities
9. Put on a game face, opponents that sense fear will walk over you

Advanced Tactics

Focal Points (& sunk costs)

- Before entering negotiation strip your mind of any focal points – Irrelevant but salient figures in your mind e.g. price opponent bought land for 10 years ago
 - Buyers who know that sellers had higher sunk costs pay more for a property
- **Strategy:** Try to make obvious your sunk costs to other party to trigger focal point effects in them -> Skews your opponents estimates of value

Endowment effect

- **Form of loss aversion**, tends people toward valuing what they have over what they could have
- Coffee cup study:
 - 1st group given coffee cup, 2nd group told they could buy that cup
 - 1st cup wanted buyers to pay 2x as much to buy cup as buyers were willing to pay
- **Strategy:** Using endowment effect to your benefit
 - E.g. Negotiator says, 'you want to sell your coy's manufacturing division?', you say 'yes', they say 'what are you going to spend on?', they say 'a consulting business', you say 'great, tell me about your new consulting business', they say 'We will do ...'. Now what the seller is