

Objective-Driven Negotiations

LES Add-On Session

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Classical Definition of Negotiation

“A discussion intended to produce an agreement.”

-- Webster's Dictionary

“... Tactics teaches the use of armed forces in the engagement; strategy, the use of engagements for the object of war.”

-- Carl von Clausewitz, On War

“... Now the general who wins a battle makes many calculations in his temple ere the battle is fought. The general who loses a battle makes but few calculations beforehand. Thus do many calculations lead to victory, and few calculations to defeat: how much more no calculation at all! It is by attention to this point that I can foresee who is likely to win or lose.”

-- Tsun Tzu



Object-Driven Negotiations

The successful execution of a planned strategy, clear tactics and good teamwork to obtain a stated objective from another party.

Arguably the most important skill needed in life, it is rarely taught, seldom inherited and mastered too late in life.

Examples of Object-Driven Negotiations:

- Obtaining candy & toys
- Staying up late / out late
- Receiving an Allowance, Permission to Use Car
- Dating (No imagination required...)
- Grades & Homework – Flexibility, Extensions
- Purchases: House, Car & Big Ticket Items
- Employment:
 - Employee (Benefits, Deliverables, Position, ...)
 - Employer (Employees, Contractors, Leading Horses to Water...)
- Marriage & Relationships (No Explanation Required...)
- Children (Now the Skills Get Honed...)



Dimensions of Strategy

	Win-Lose	Win-Win
Objective	Anything good for me	A good deal for both
Attitude	We don't care	It's Important
Time Frame	Short-Term	Long-Term
Other Party	The Adversary	Our Partner
Empathy	Your problem, not mine	Let's work this out
Flexibility	My way or the highway	Flexible with options
Information	Info is power. Keep it.	Common sense. TRADE
Trust	Low or non-existent	High, increasing
Process	Competitive, conflict	Collaborative, creative



Some Examples of Communication Styles

<i>Behavior</i>	<i>Japanese</i>	<i>American</i>	<i>Brazilian</i>
Verbal Interruptions / 10m	12.6	10.3	28.6
Silent periods > 10s / 30m	5.5	3.5	0
Eye Contact / 10m	1.3	3.3	5.3
Touches / 30m	0	0	4.7



Our Cultural Strengths & Weaknesses

American Strengths:

- (1) Friendliness
- (2) Fairness / Honesty
- (3) Flexibility
- (4) Innovativeness
- (5) Pragmatism
- (6) Cooperativeness

American Weaknesses:

- (1) Impatience
- (2) Arrogance
- (3) Poor Listening Skills
- (4) Myopia
- (5) Legalism
- (6) Naïveté



Cultural Specific Styles

Negotiators from different countries are EQUALLY effective when they negotiate with parties from their own country (intra-cultural)

- The ways the negotiators negotiated were different
- For instance:
 - In American negotiations, more profitable outcomes are achieved by making opponents feel *uncomfortable*
 - In Japanese negotiations, more profitable outcomes are associated with making opponents feel comfortable



Get Ready... Get Set...

- Gather information – who, how, what, where, when, why
- Unstructured planning – brain dump
- Structured planning – organize information
- Plan – down to the detail, team composition
- Check – teammates, roles, information
- Take-Along – cheat-sheets, materials
- Negotiate
- Review – do a post-mortum



The Objective – Begins with Needs & Issues

Own Party
Needs

Other Party
Needs

Negotiation Zone

AGREEMENT

Own Party
Issues

Other Party
Issues



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Unstructured Brain Dump

Begin by summarizing:

- Who are the parties,
- What are the issues at hand,
- Where and when will the negotiation be held,
- What are the needs of both parties,
- What do you hope to achieve,
- What are the expected claims and counter claims
- Are there any clear walk-away positions?

<i>Issue</i>	<i>Action</i>	<i>Reaction</i>	<i>Counter- Reaction</i>
Issue 1	We request X	They counter with Y	We explain why this is difficult
Issue 2	We request A	They counter with B	We offer to trade C in exchange for B



Structured Preparation

- **Why:**
 - Needs: What are the needs of both parties?
 - Other Options: Are there other options?
 - Characters: Fred, Joe, Alice, Bob – why are these characters involved and what motivates them?
 - Strengths and Weaknesses:
 - Own Party Strength, Own Party Weakness
 - Other Party Strength, Other Party Weakness:
 - Alternatives: Are there alternatives to doing a deal?
- **Who:**
 - Parties: Company X and Company Y.
 - Go-Forward Style: Competitive / friendly / hostile?
 - Historical Relationship: What has been the historical relationship?
 - Third Parties / Competitors: Who else is involved?
 - Authority: do all parties have the authority to do a deal?
 - Personal: how have the parties been on a personal level?
 - Recording: Who's going to record the negotiation?



Structured Preparation (2)

- Start with the difference in issues, then plan for the dynamics

<i>Issue</i>	<i>Own Party</i>	<i>Other Party</i>	<i>Difference</i>
Issue 1	Position 1	Position 2	The difference explained in plain English
Issue 2	Position 1	Position 2	The difference explained in plain English

<i>Issue</i>	<i>Start</i>	<i>Norm</i>	<i>Instability</i>	<i>Pass</i>
Issue 1	Will open with this position 1.	We expect to get this for position 1.	We get cool on this position 1.	We pass on this position 1.
Issue 2	Will open with this position 2.	We expect to get this for position 2.	We get cool on this position 2.	We will pass on this position 2.
Issue 3	Will open with this position 3.	We expect to get this for position 3.	We get cool on this position 3.	We pass on this position 3.



Framing of a Deal Before Negotiating

Own Needs

1. Long-term relationship
2. Economic motivation

Other Party Needs

1. Long-term commitment
2. Economic motivation

Agreement

1. Appointment of project manager
2. Seed investment, long-term debt, sliding-scale conversion
3. Focus on first product

Own Issues

1. People
2. Access to know-how
3. Getting to market

Other Issues

1. Commitment
2. Desire more "R" than "D"
3. Performance criteria



Negotiation Dynamics – Do

- Listen (70% of the time) and Take Notes (continually)
- Test assumptions & summarize positions
- Ask clarifying questions
- Express feelings & Flinch at every number
- Focus on agreement
- Summarize and present final objectives
- Stick to plan (or Revisit the Plan)
- Take breaks
- Offer insight / be resolute
- Offer silence when necessary
- It's a matter of grey: Positive to Negative
- Be polite and respectful – it takes as much time to be nice as to be bad



Negotiation Dynamics – Don't

- Press irritation buttons
- Lose face
- Follow the other party
- Be impatient
- Immediately offer counter-proposals
- Be pulled into debates or arguments
- Lie
- Bully
- Insult
- Send out obvious body language signals



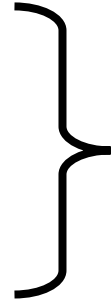
Expecting the Tricks & Tactics

- Excessive Demands
- Return / Revisit Closed Issues
- Bluff
- Manipulating the Agenda
- Non-Existent Dangers & Blow It Out Of Proportion
- Concealing the Facts
- Tough Guy, Silence
- The Salami-Tactic
- No Authority
- Deadlines, Emotional Outbursts



Preparing for an Equity Negotiation

- Valuation
- Liquidation Preference
- Anti-Dilution



Worth the Fight

- Protective Provisions
- Preemptive Rights
- Board Composition
- Covenants +/-



Provides Leverage



Negotiating Value

Valuation is the key determinant of the extent of dilution suffered by the founders in a financing. *The Price of Money*

Source of tension: The investor wants to get **more** for **less** vs. the founder who wants to give up **less** for **more**.

- Lower Valuation = Greater Dilution
- Higher Capitalization = Greater Dilution
- If there is a large pool of outstanding warrants or debt, it's a telltale sign that there have been differences in opinion around valuation.



Negotiating Preferences

- Exits usually involve an M&A event, rather than an IPO
- Liquidation preference determines the size of the slice that investors get versus founders / employees
- “Plain Vanilla:” Founder Favorable
 - 1X Preference, then Common
- Investor Favorable
 - Full Participating Preferred feature. 1x to Preferred, remainder shared pro rata between Preferred and Common
- Voluntary Conversion



Negotiating Anti-Dilution

- Anti-Dilution determines the extent of additional shares are issued to former investors who purchased at a higher price than is now on offer.
- Results in additional dilution to founders/employees.
- Broad-based “weighted average”: adjustments based upon the price and shares issued of new securities relative to total capitalization and previous share price.
- “Full-ratchet”: Regardless of the number of new shares issued, previously higher priced shares are fully adjusted to the new price.





Structuring Your Negotiation

<i>Issue</i>	<i>Low Uncertainty – Attributes “Norm”</i>	<i>High Uncertainty – Attributes “Instability”</i>
Value	Solid, low debt (or well-defined conversion terms), low number of warrants	Low value, no issuance of preferred stock, lots of outstanding warrants, debt with no “floor” on conversion
Liquidation Preference	1x – 1.5x (Also a function of available capital)	2x – 3x (Also a function of available capital)
Antidilution	Weighted average	Full Ratchet
Protective Provisions	Adversely affect Preferred Stock rights, Amending the articles or bylaws, merger or acquisition	Entering into transactions with \$, approval required for day-to-day operational matters
Board Composition	Investor with 1 board seat, plain voting rights agreement	Investor with right to appoint > 1 board seat, special voting rights or veto rights



In Closing

- Prepare for engagement
- Plan with the team – plan, plan, plan, plan
- Tsun Tzu: “...many calculations before battle”
- Be aware of cultural differences in international deals
- Execute the plan & stick to it
- Monitor the engagement & TAKE BREAKS
- Review the outcome
 - What went well
 - What could be improved
- Handouts and Take-Aways



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