Strategic Negotiation

GAVIN KENNEDY

GOWER
Introduction

The concepts and applications in this chapter are necessary background for the commercial and operational imperatives derived from the business plan because you would make little progress in the Strategic Negotiating Process Model without familiarity with them. It is inevitable that the chapter strays over the strict boundaries of what you require to know but this is a useful convenience in the presentation of the large amount of content within the subject headings.

The organization has at least four potential growth strategies:

- organic from within its own resources
- joint ventures and partnerships
- mergers and acquisitions
- licensing, franchises, master franchises and agency distributors.

All of them involve negotiation within and without the organization, including with other organizations and government agencies in the home country and sometimes in foreign countries.

The laws governing a contract may be singular or multi-jurisdictional. The parties can number from two upwards; the negotiations may be simple or complex, and the outcomes may have varying degrees of complexity. Growth can be a normal evolution from a small, local organization progressively towards a global presence in all markets, or a prelude to the organization’s demise. The people who start the organization on a growth path may not be with it as it takes off, or for long afterwards; they may drop off as the organization takes a decisive turn to follow a different growth strategy – the organization as predator comes to the attention of another, smarter or bolder predator, better suited to making a success of the strategy than its originators.
Growth strategies can be a fusion of two organizations at the same, or at different stages in their growth cycles – one organisation’s distribution negotiation is seen as a prelude to a joint venture and is perceived by the other party as a prelude to an eventual acquisition; and one organisation’s merger negotiation is seen by the other organisation as a face-saving step to an outright acquisition; one organization’s disposal strategy of non-core businesses is another’s integration strategy of compatible businesses; and one organization’s negotiated M & A deals for another organization are negotiations about its global growth. From the perspective of those within the organization, the organization grows; to the market, the organization is being absorbed, like the genes of parents dispersing through successive generations. The parents of a global growth strategy may begin their journey in a single department of an organization far from its centre of power, with no vision of what is about to happen to them and the organization. Their vision may be far-reaching; their operational horizons need not.

Alex Scott, an authority on strategic planning explains the dilemma of accounting for rational choice after perhaps a long sequence of unstructured earlier events:

*The objective of an analysis of choice is to investigate the structures within which choices are made among competing alternatives. Inspection of real-life cases reveals that in many instances no choice was actually made, and that the company was simply carried along by the force of events, perhaps ending up with a dominant market position as a result of good fortune, which it then capitalized on. In other instances choices were made, but on such a non-structured basis that no general lessons can be drawn from the experience. The problem of drawing lessons from the experience of companies is compounded by the fact that different perspectives on the same choice can come to the conclusion either that the outcome was fortuitous or that it was a result of a structured choice approach. This is partly due to the difficulty of determining after the event what actually happened during the choice-making process; managers are as prone as anyone else to justifying their actions. There is a tendency to superimpose a structure on a series of events which, at the time they took place, were unstructured. Probably emergent strategies are the norm, but do not tend to be recognized as such.*

(Scott 2005, Strategic Planning, Edinburgh Business School, p. 7/2)

Strategic negotiation is about the implementation of the strategic choices (usually) already made by the organization, by different people; hence I do not
cover the concepts and models, or their evaluation from a strategic planner’s perspective. The Process Model takes the business plan’s objectives as given and explores and delivers the negotiating imperatives that follow from it. It is an operational activity which implements the necessary decisions that are made as a result of the plans aiming to take it to the organization’s planning horizon.

Strategic negotiators, who implement the organization’s business plan, in effect, say to the planners: ‘OK. If that is what you intend us to achieve then these are the ways we could do it from our negotiations.’ In practice, the line between planners and implementers is not always clear-cut and clean. But for our purposes it is better to focus on the merits of the strategically driven negotiating tasks and not on constantly second-guessing the merits of the plan, except where it contains glaring errors or inconsistencies.

A well-known phenomenon associated with ‘analysis-paralysis’ causes indecision among would-be negotiators preventing them from actually doing anything. As Americans say: ‘Are we here to fish or cut bait?’ But it is always possible that the items chosen for the Negotiation Agenda cannot help the organization to reach the plan’s objectives. It is also likely that any dissonance between method and objectives will be exposed when trying to derive the Negotiation Agenda from the business plan.

For example, the preparatory work, including the due diligence reports, for a negotiation to acquire a business unrelated to the future prospects of the organization – for example, the acquired business is an intercontinental air transport service but the main organization ships its output abroad via container shipping – should highlight for the negotiators that the acquisition is of insufficient positive value to the acquiring organization.

**Organic growth**

Many organizations do not grow in terms of their sales or net profits; they only age. Their turnover is static. Mom-and-pop stores, small, local wholesale and retail businesses, bars, restaurants, hotels and taxis are among the no- or slow-growth businesses bounded by local market conditions, perhaps seasonal, with little capacity or trading opportunities for growth. Their owners make a living by dint of hard work and long hours; there is an upper limit to the amount of groceries a small corner shop can sell in a district, given all the competing shops accessible to its customers. Reality erodes ambition. Growing from a one-man-and-a-dog business to anything bigger (owning three or four corner
**CASE STUDY**

*Roads To Riches Or Ruin?*

On a long taxi journey from Sydney airport to a business meeting in Canberra, Australia (aircraft cabin crews were on strike), I conversed for some hours with the driver as he drove through the night. He told me he had just paid off the loan on his taxi and now owned it, though he still picked up fares for the same taxi company, which had sold him the taxi on their lease-purchase scheme. Not all of their drivers, he told me, were prepared to reduce their net earnings to buy a cab, preferring a higher wage to the responsibilities and burdens of ownership. I was familiar with a similar lease-purchase scheme for wet-cement truck drivers in the UK and we discussed the finances of such schemes.

He was quite clear that he wanted to lease-purchase another, newer, taxi and hire a driver and put him to work. He was looking forward to owning six taxis within two years and then starting his own radio taxi company. He was ambitious, indeed, for his world.

He also intended to negotiate a better lease-purchase deal from the company. We discussed other options for financing a second taxi. He could purchase it in one transaction, paying the finance company off out of the earnings from his two taxis at lower interest rates than the taxi company charged under their scheme.

We discussed why taxi companies (and wet-cement suppliers) encouraged drivers to buy their vehicles. We agreed that because it made them self-employed and no longer employees, it saved the company employee payroll expenses and relieved it from being saddled with social responsibilities, such as expensive contributory pension schemes, holiday pay, plus the infamous Australian scourge of ‘sickos’ (feigned illness with pay), and, crucially, vehicle insurance for ‘smash repairs’. He did not think much of taxi drivers who knew nothing about Sydney’s geography, or the behaviours of lazy drivers, his tone suggesting that he did not regard himself as one of them.

Lease-purchase schemes were a reasonably safe growth strategy for the taxi company because it retained a steady pool of good drivers (bad drivers wrecked their cars and went off the road) while they bought their cabs, and meant the taxi company could run more cabs for a self-financing outlay, and more cabs meant higher gross revenues in a shorter time span than otherwise would be financially prudent.

I asked him: would he employ drivers or hire self-employed owners? And how would he motivate them to remain keen, energetic and honest? This meant:

- remuneration negotiations with people who may not share his interests;
- more than two cabs parked outside his suburban house would run up against city zoning or planning regulations and he would need to rent premises and negotiate with landlords and planning officials;
- he would need to negotiate legal, accounting and tax advice to form and run his taxi company;
- he would need to negotiate the purchase/hire of equipment for his radio/telephones;
- he would also need to negotiate paid office help and the purchase/hire of office furniture in his rented office;
- plus, he would need to negotiate the design of his cab livery,
advertising and marketing ('Yellow Pages' adverts?) expenses.

The list of his pending negotiations climbed as fast as he sped his cab and me towards Canberra.

It soon became clear he had some tactical issues to sort out before he did anything else. How was he going to grow from one to six cabs, plus drivers, on the road without his current cab company noticing a potential rival growing up amidst its own operations and privy to its own customer base? They would surely recognize the signs of his growing independence or potential for a breakaway. They might take preemptive action to prevent his growing any bigger by his free riding on their customer base. He had to find a market niche to grow from or remain vulnerable to being sacked before he had paid off his debts on his cabs. But what niche could he search for in a highly regulated market like cab services in Sydney?

I began to feel that his chances of success were diminishing as each layer of difficulty was uncovered. Even if everything to be done was confined only to the six negotiation decisions listed above, he would still have problems of coordinating them in such a way that he was not carrying indeterminate costs for long periods without earning compensating revenues, and given that he did not appear to have much capital, it did not look a rosy enough scenario for me to be other than sceptical that he would make it. This left two questions for which I did not have an answer.

- Were his growth plans bankable?
- Would he realize his ambition or realize its impracticality?

The wrecked ambitions of those running small enterprises who test the big challenges of growth deter the risk averse because most fail. A comforting mantra like 'it won't happen to me' is flimsy protection. But for a small minority, success is its own reward. Whether those whose capital the cab driver needed to borrow for his growth plans would share his self-belief in his fate is another (unsentimental) matter.

Contract negotiation for non-growth small businesses poses few strategic problems. They tend to be repeat negotiations of standard contracts from suppliers (payment terms, exclusivity, promotion deals, returns policy), including landlords (lease renewal terms, relocation, change of use).

Negotiations for organic growth businesses may have some strategic implications if that growth implies changes of some kind in the product mix or location. A decision to add to the product range requires answers to strategic questions such as, for example, how to extend a common product range or diversify into new products, or how to add enhanced services to existing products, with associated contracts for new employment implications, new leases, and supply and sales.

grocery shops?) is a big challenge, and the big challenges of growth are never easy, no matter how big the business becomes. Truly, growth is risky and can kill a business.
Emblem, a leading business hotel chain, chose to diversify by setting up a subsidiary of smaller, 30-bedroom, no-frills budget hotels for business customers. A few pilot schemes located near main roads and large cities proved that the concept worked. Though room rates were a quarter of those in their city hotels, they appealed to budget-conscious businesses, and their room-only, no-restaurant overheads, showed they could achieve almost 98 per cent occupancy rates on weekdays, which was much better than under 55 per cent occupancy rates, plus heavy staffing costs, mainly in the mostly half-empty restaurant and bar facilities, normal for their city locations.

Because the budget business market was likely to be highly competitive, there was going to be a dash to market once word got around about what Emblem was planning. The strategic objective was to acquire suitable locations quickly before rivals appeared. A special ‘national site acquisition unit’ was set up to begin the programme, located anonymously in a rundown warehouse complex. Later, regional, not national, estate agencies were contracted to locate and acquire sites in their areas to expedite the expansion.

The land negotiators were recruited from experienced property professionals. They sought likely sites, with high volumes of passing traffic (main crossroads and motorway exits) and landowners, usually farmers, who were prepared to sell an acre or two (average value as agricultural land was well under that of a development site), and particularly where local planning authorities were flexible. From the hotel chain’s perspective, paying a commercial price per acre, with a small non-returnable deposit for the irrevocable option on the land while planning permission was sought, was sound business. With planning permission for a budget hotel, a roadside diner and a petrol station, site values could treble. Once built, the complex was a viable and profitable business.

Once Emblem reached over a hundred sites, rivals began to take notice and the race for market dominance began in earnest. Naturally, this raised site-acquisition costs (land agents tend to be savvy about the value of land) making piecemeal growth a slow route to market. Seville, a rival hotel chain, was able to jump into the market quickly by acquiring an existing chain of 350 branded roadside diners (Little Eaters). None of them had hotels near them, but quite a few had petrol stations, and most had spare land attached. Seville expanded most of the several hundred sites it acquired from Little Eaters to produce the proven profitable combination of diner, budget hotel and petrol station. It overtook Emblem, the early mover, within a year to become the largest budget hotel chain in the country.

Thus, Emblem, which had at first grown organically, negotiation by negotiation, with small independent farmers an acre at a time, watched Seville, as it scaled up dramatically by negotiating the acquisition of Little Eaters, a large, rather sleepy, but profitable, roadside diner business aimed at motoring families.

Let us explore how the Strategic Negotiation Process Model might have taken Emblem, which initiated the move into budget hotels, straight to the successful growth strategy demonstrated later by Seville, instead of undertaking the stealth-like and ultimately unworkable Emblem strategy.

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**CASE STUDY**

**Best Laid Schemes Succumb To Better**

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customers. Discounting was a growing problem on profitability (special offers, weekend 2-for-1 offers, corporate discount rates, lower rates after 11 pm, and so on). The outcome included slowly declining occupancy rates and flattening profitability. Regular sales of marginal hotels reduced some costs, and purchases of small chains improved coverage but none of this altered the obvious fact of a mature business-hotel market in slow decline.

Once the concept of the budget hotel chain, with its stripped down, no-restaurant, no-frills ambience, but comfortable rooms with en suite facilities, pay phones and pay TV was accepted as a winner, the strategic question was surely how fast could they move before the competing hotel chains imitated the concept?

The choice of the organic growth strategy, and its ten or twelve sites a month, built from scratch, may have been necessitated by budgetary restraints and the need to prove the timid strategy before board-level approval for a major change to a bolder strategy. The necessary discussions in the Strategic Negotiation Process Model for the plan would raise the question of the timing of the slower strategy at the start.

The forming of the special acquisition unit to conduct the budget hotel programme and its analysis and diagnosis should have shown that a schedule of targets (10–12 a month) was not going to produce secure, uncontested (and incontestable) first-mover dominance early enough in this market niche because the business plan’s horizon of 3 to 5 years allowed imitators to gain a foothold and expand it into a serious challenge.

There was plenty of development expertise available to Emblem for the collective wisdom of this expert group to have noted that once underway, the completion times for each project from greenfield site to a developed operation open for business, depended on the time it took to achieve planning permission, including the provision of architects’ drawings, completing the tendering with builders, time to prepare the site and build on it, recruit staff and to open the sites. This annual total of likely completions for the budget chain opening within the business plan horizon was woefully deficient to deter early and rapid competition from imitators.

Budgeting the necessary finance for the building programme, and for the projections of cash flow of the venture, provides another source that should have warned Emblem of the flaws and the glaring weakness running through the spine of the site-at-a-time strategy. The exposure of major structural weakness should have prompted the senior planners to look for alternatives.

The negotiation load alone would have been formidable, and on the initial site-by-site acquisition approach there was not much scope for scalability. If not anticipated, it must have been apparent in the preparation phases that a slow organic programme would be difficult to keep invisible from potential competitors because recruiting that many developers would soon become news in the trade (people know others and speak about their jobs and who is recruiting).

Public bodies linked to local elected authorities manage planning permission in the UK. The elected authority considering applications for planning permission publishes each application (which any person can read on payment of a small printing fee) and it also writes to those owners with property near a proposed application to notify them of the application and how it might affect them. They have a right to make a written objection to the proposal, which the authority must take into account, though it must accept or reject the objection only on planning grounds. In these conditions, it would not be long before rival hotel chains and land speculators noticed local media reports on current applications. Once they noted
Changing scale changes perspectives, complicated by timing. Rapid expansion of sites in retailing and warehousing invites new questions, not least that of the viability of replicating previous success formulae when stretching control and the quality of your people resources. Too slow an expansion invites early imitation by bolder and better-financed rivals.

Expansion driven by opportunities and not by prudent financing has a knife-edge quality, courting disaster and success in equal measure. The Strategic Negotiation Process Model highlights the strengths or weaknesses of a poorly-timed growth plan by identifying the resources required to deliver the Commercial Imperatives, thrown sharply into relief against projected performance in a 5-year horizon of the business plan. Imprudent decisions to add to capacity beyond an organization’s cash flow projections (how far should capacity race ahead of the organic expansion of cash flow?) require policy decisions under the operational imperatives for finance, such as: if not organic growth, then how?
In general, organic growth is usually contained within the contractual negotiation experience of the organization if it sticks to its familiar business, because it requires more of the same negotiated factor inputs from markets it understands. When the organization undertakes completely different products in completely different markets, or markets not very closely related to its core business, it risks unfamiliar turbulence.

Newspapers and greetings cards are different products but the customers likely to buy one are also likely to buy the other and they can be sold from the same premises by the same staff. Adding Internet cafes to a newsagent chain adds a different product with not enough overlap either in customers or trained staff to be managed easily.

A conscious and deliberate decision to grow a business should be taken by the owners, in the case of a small business, or the most senior managers in the case of a large business. It is not possible to hide the consequences of growth from the controllers of an organization. Growth makes new demands upon all the organization’s resources, if only because growth will deplete the availability of some resources and the managers or users of the depleted resources will react to the changes they experience in the normal supply of what they need. Growth creates its own demands for access to resources – more people, more inputs, more facilities, more time – and when resource demands run up against availability, the strains become apparent in the functions trying to use those resources.

To increase from a one-person to a two-person business doubles the organization’s employment. This highlights the risks of growth; everything is dependent on the quality of the additional person. To open new depots in other places, even nearby, dilutes direct managerial attention and weakens its controls, which are appropriate to dealing with a single depot but which are unproven in managing multiple sites.

Growth decisions must be more than good ideas (especially when brought to your attention by sellers or brokers with an interest in selling you the idea); they have to be well thought out and prepared, and the act of preparing should raise challenging questions about capabilities. Growth strategies are as much managerial as financing decisions and they should be made with the most careful attention.
Joint ventures

There was a time when business formation was relatively simple but now the law and related regulations, including taxation liabilities, intrude to the point that without legal expertise it is unlikely that the essentially simple decision of two parties agreeing to cooperate for some purpose would be achievable without high-level legal, taxation and accounting advice and guidance (it certainly would be extremely inadvisable for you to attempt it on your own).

The business plan could envisage that a product is to be taken to a wider market beyond the initial jurisdiction within three years. That strategic decision creates an agenda for future negotiations. New opportunities bring their rewards, but also their burdens. What appears to be a logical development from a strong domestic market for an organization’s products, in turn produces a host of questions that complicate what starts out as a straightforward decision. Among these questions is that of how the organization is going to give effect to the decision to market beyond current boundaries. One answer could be to form a joint venture (JV) with another company already located in the target market. This is where strategic negotiators ought to have some exposure to what is involved in a JV and what to look out for.

WHY A JOINT VENTURE?

To take a simple point: any decision to form a JV between two separate companies is bound to raise high-level policy concerns among regulators about the reduction in competition implied in this decision:

- Why don’t the two entities remain separate and compete?
- Are the gains to the public good from their JV such that they should override considerations of a reduction in competition?

No firm answers can be given without detailed consideration of the circumstances.

One such consideration operating in favour of a JV might be one between two separate companies domiciled in separate markets which combine to pursue a worthwhile or necessary project that neither could do on its own.

Joint ventures in R & D also are looked on favourably, except, perhaps, in drug medication where the major drug companies are strong enough to conduct independent projects without recourse to partners from among their rivals. Many smaller companies specializing in fine chemicals are sub-contracted by
the main drug research firms to mass-produce their products, but these are covered by normal commercial contracts and not JV agreements.

Full-scale JVs face regulatory interventions or at least close scrutiny by the competition authorities. This led to experiments with various forms of alliances among passenger airline firms around the world. These are subject to approval by national authorities, and some notable attempts to form code-sharing alliances were frustrated by being linked to separate issues, such as the degree of freedom accorded to non-US airlines for open-sky routing across the USA, or to the vexed and continuing problem of the redistribution of landing slots at Heathrow, London. The takeover of KLM, the Dutch national carrier, by Air France was dressed up as an alliance to deter intervention by the European competition authorities, though the takeover was backed by each country’s government.

Joint ventures are useful vehicles for separate businesses to cooperate in the supply of products or services to markets. Cooperation between organizations within the same country, and sometimes among organizations formed under different laws in different countries, is not unusual, despite the difficulties in forming them and their less-than-startling performance. The successful creation and operation of a joint venture poses unique strategic problems, not the least being: Why a JV and not a wholly owned subsidiary?

The nature of a JV varies from arms-length licences through franchises to a formal legal entity (‘NewCo’), jointly owned and operated by the partners. The range of intermediate structures for marketing products and services is extensive and necessarily I have reduced them to a few.

You could consider almost any relationship between two organizations that cooperates in an arrangement as intermediate suppliers as a kind of JV – the outputs of one company are inputs into another company’s outputs. In the normal course of business our suppliers are in a kind of JV with us to deliver added value to final customers. However, the JVs we are concerned with are of the kind where there is a relationship with independent organizations (an existing entity, or a NewCo, jointly owned or not) that delivers added value product to final customers.

FORMS OF JOINT VENTURE

The form a JV takes will be influenced by the reason for agreeing to form one. That decision is where we should start from: what problems could be addressed by the formation of a JV that cannot be addressed any other way at least as
well? As usual, such a question can only be seriously answered by beginning with the organization’s business plan and deriving from this its commercial imperatives. The JV should be justified by its being essential and efficacious for the objectives it is designed to accomplish. But a JV also brings with it burdens that the partners may not wish to carry.

One partner may be expected to provide almost all of the local inputs – people, locations and product – while the other provides a proportion of the capital and makes a contribution to costs. Seems straightforward enough, until the details are negotiated and each realizes that it is unfairly exposed in different ways:

• If party A is providing the local infrastructure of the JV, how is it to be recompensed?
• If party B is contributing to the running costs, how sure is it that these are not open to padding by its partner?
• How are the profits to be divided?

In these circumstances party A might press for Newco to be wholly owned by itself, or for party B to contribute a much larger initial investment. This does not alter the difficulties of party B monitoring its interests in the distantly located JV, closely managed by party A and effectively closed to daily scrutiny by party B.

Early in the negotiations to form the JV, the parties might conclude that a JV is not the best vehicle for what they propose to do together in the distant territory and they could agree to revert to party A setting up a wholly owned Newco, and that party B will enter into normal commercial arrangements to exploit each other’s interests in the collaboration.

When the JV is in the territory where both parties have a substantial presence, a Newco could be formed, with each providing it with personnel, locations, technology, IPR and marketing facilities, and it could be run on normal commercial lines of a registered independent company, wholly owned by both parties, and open to close monitoring by the parent partners. JVs of this type can accommodate several partners; for example, Britvic, the fruit juice producer and bottler for several competing breweries and owners of public houses worked well as a JV for many years and as the JV’s internal affairs were transparent to the partners, there was little friction between them.
There are certain essential features for negotiating JV Newcos that are worth reviewing. All UK companies (and similar arrangements are found in most countries) are formally registered with the State authorities. This facilitates taxation and compliance with company laws and helps to protect the rights of shareholders who do not participate in the daily management of the company. In the UK two formal documents, the Memorandum of Association and the Articles of Association, are required. The former identifies the name of the company (‘Newco’ is a working title only until an official name is agreed and registered), outlines what business will be conducted (written as widely as possible), and sets its share capital and its private limited or public limited status. The Articles are about how the internal affairs of the company will be managed, often written as a mixture of boilerplate and bespoke clauses. In the USA, in place of the Memorandum and Articles, a Limited Liability Company (LLC) uses an Operating Agreement, which serves much the same purpose.

SHAREHOLDERS’ AGREEMENTS

For a JV, a Shareholders’ Agreement is normally negotiated (remember that the shareholders of the JV are limited to the parties that have set it up, though the JV itself should be made a party to the Shareholders’ Agreement too). Unlike the Memorandum and Articles, which are registered and in the public domain, a Shareholders’ Agreement usually remains (but need not be) confidential to the parties, and its contents may extend to cover a wide range of matters not dealt with in the Memorandum and Articles. Whereas the Memorandum and Articles bind any new shareholders, in the case of the Shareholders’ Agreement a new shareholder (for example, party C joins the JV) is not bound by the previous Shareholders’ Agreement and a new agreement has to be negotiated or agreed. (A LLC Operating Agreement can bind new shareholders without requiring to be renegotiated.)

Boring as the Memorandum and Articles may be for those impatient with detail, a careful consideration of them is essential to prevent mishaps, such as directors from party A being able to pass board resolutions in the absence of directors from party B or share transfers occurring that (intentionally?) alter the ownership of the JV. A Shareholders’ Agreement can be a comfort if it sets out strict rules for such meetings and transfers, but unless these are aligned with the provisions of the Memorandum and Articles, and the parties are aware of their importance, a serious controversy lies dormant until events bring it to the fore, usually at an inconvenient time.

An area of concern in any JV is on the transfer of shares both within the JV company and between a shareholder and third parties outside the JV. For
example, where the parties to the JV are individuals and companies, on the death of an individual, the shares of the deceased become part of the estate and third-party beneficiaries would inherit the shares. This may be unacceptable to the JV partners because the beneficiary may sell on the shares to, say, a competitor of the JV, or because the parties to the JV formed the company so that each of them contributed something important to its operations and success, whereas the new outsider is regarded as having nothing to contribute to the JV, except to draw dividends.

By negotiating a pre-emption clause for the Articles and a Shareholder’s Agreement, the parties can ensure that the shares of the deceased must be offered to the remaining shareholders (to prevent erosion of the original membership base) and that the beneficiary of the deceased’s estate receives the money value of the shares and not the shares themselves (also prevents erosion and so on).

Similarly, if a party to the JV wishes to withdraw from the JV and realize their investment, the Articles and the Shareholder’s Agreement could specify that the shares must be offered first to the other parties in the JV and only on a refusal to buy could the shares be transferred to an outsider. If the existing shareholders wish to block the entry of new shareholders, they can club together to buy out the leaver and pre-empt dilution.

Such measures prevent the dilution of the original parties’ ownership. But all such measures require to be negotiated when the JV is set up and not afterwards at a distant date in the future when reliance on everybody’s goodwill and their continuing commitment to the JV may be tenuous. Member organizations of a JV change personnel over time and new views as to the value of a JV, or pressing financial circumstances, may arise, that make a disposal attractive to one of them.

Of similar importance is the non-competition clause that prevents a party to the JV from competing with the JV. The interests of the JV parties are clear: there is less incentive to invest in a JV company if one or more of the member parties continues competing with it, and, anyway, as the member parties will know about the costs, pricing and plans of the JV, it could give them an unfair competitive advantage if they were to compete with it. However, such a clause could be of concern to the competition authorities if it reduces competition in the territory where the JV operates.

In summary the main points to look for in a JV are:
• In place of a JV NewCo should we form a wholly-owned subsidiary?
• If a JV is chosen what is each member bringing to the party?
• How are the members assured of each other’s contributions?
• What should be included in the content of the public Memorandum and Articles of Association (and what excluded)?
• What protections are essential for inclusion in a private Shareholders’ Agreement?
• What protection do we need to prevent members from competing with the JV?
• How might we cope with the scrutiny of the JV’s intentions and practice by the competition authorities?
• How do we distribute the profits between the members and fund the necessary growth of the JV?

A most useful contribution to the analysis and diagnosis stage in the Process Model can be made by those at least aware of some of the common pitfalls of JV propositions that otherwise look most tempting. Looking for the consequences of an action down track is a fundamental obligation of those who would seek to implement decisions from the business plan three or more years after they were first made or mooted.

Mergers and acquisitions

A merger by any other name should be called an acquisition, for that is the reality, sooner or later, no matter how it is presented before, during or shortly afterwards. When two equal partners merge, the leading personnel of one of them emerge eventually as the leading players of the merged entity; in short they physically take over the merged organization. In few mergers does the equality of the leading players remain tangible for long and, as happens, rarely do people from the two previously independent organizations lose their previous identities and merge into one new one – only post-merger recruits tend to do so.

One of the leading team usually gives up, burns out or steps back to spend more time with their family, encouraged by a golden parachute (a large dollop of cash for their retirement). The only question is how long this takes – a few months or a couple of years (seldom longer). In other cases, the accidents of life
re-organize the main players’ prospects (age, illness of self or family), as do the manipulations of the more energetic players, less inhibited by considerations of inter-personal ethics than their elders. Previous ethically doubtful behaviour can also trip up strong candidates if discovered and used in time to spoil their party.

Acquisition remains the major strategic route to growth for most companies. Acquisition involves intense negotiation, including pre-negotiation preparation. It is time-consuming and hard work. It takes strong commitment to the strategic goals of the organization to maintain the necessary focus. And in many cases it fails in its objectives, when, sooner or later, the organization tries an acquisition too far (the predator is out-predated by a smarter predator).

But whatever the track record of acquisitions, it remains the most common form of growth. The strategic choice having been made, strategic negotiators are left to get on with it.

The Strategic Negotiation Process Model provides guidelines for ensuring that the negotiation part of the acquisition process does not contribute unintentionally to the failure of the acquisition. Some of the avoidable early fault lines in an acquisition destined to go sour are inherited from errors made during the negotiations; the rest are divided between the mistaken strategic choices which initiated the acquisition before the negotiations began and from faults in the implementation of the plans to add value to the acquirer’s business from the acquisition after the negotiations are concluded.

Once the strategic decision is taken to pursue an acquisition, suitable targets can be put into play by the potential acquirer’s team. The identified targets can
come from a search for a suitable target (sometimes these are obvious), or can emerge from prompting by a merchant bank, accountancy firm or professional go-betweens, searching for a potential buyer for a business on their books. The names of suitable candidates are in constant circulation among businesses, complete with prospectuses, but beware of going after something merely because a competitor is reported to be interested in it.

The question in all discussions about suitable targets becomes: how might this target deliver the Commercial Imperatives that will achieve the objectives in the business plan? In short, does this target fit our plan (and not, you should note: does our plan fit this target?)?

Basic questions include:

- If the business plan is looking to increase output, could the target do so within the cost parameters that make it profitable to add its capacity to our current capacity?
- If the business plan requires penetration of new regions, what would the target contribute to this goal?
- If the business plan sets goals for purchasing downstream/upstream capability in our business sector, how might the target contribute to that end?
- What aspects of the target’s operations, including surplus assets, could we dispose of to raise capital for our other operations?
- What technology (broadly defined, and including IPR, patents and copyrights) does the target own that would add value to our operations?

Acquisitions are associated with intensive, even exhaustive, diagnosis in a process known as ‘due diligence’, usually conducted by professional third-party accountants, lawyers and risk analysts. Due diligence has to have a forensic quality about it because it is about proving positively that the acquisition is what it purports to be and what the acquirer believes it to be, that is, for example:

- Its accounts have no black holes in them, they are a true and fair view of the business, and its claimed turnover and transactions are confirmed by its bankers in writing.
• It has no undisclosed (backed by tight warranties) liabilities to actual or potential litigants, the tax authorities, customers, suppliers, employees, third parties and so on.

• Its assets are owned with clear and proven titles and their valuation is confirmed professionally.

• Its principals’ CVs are as represented (checked by employee search and investigation agencies).

• Its board has the power and authority to sell the business.

• What the seller is selling is identical to what the buyer believes it is buying (an all too common negotiating error!).

Due diligence is the ‘caveat’ part of ‘caveat emptor’. It is not a substitute for identifying the imperatives; it moves the decision to proceed with the acquisition to the starting blocks. And the allusion to the start of a race is often a good description of what follows once contact with a potential seller is made. While the initial approaches may seem leisurely in comparison, everything speeds up from the moment that a seller’s decision to sell in principle is aligned with a buyer’s decision to buy, again in principle, and as always, subject to contract.

The pressure is on psychologically, as the aspirations of each side firm up (the seller contemplating the post-sale enjoyment of the riches to come, and the peace of mind from shedding all responsibilities for the business; the buyer contemplating excitedly the post-purchase environment and how it might affect its existing business), and their aspirations crystallize around how much the seller will get and how much the buyer must pay.

The pressure intensifies if the seller has put the business on the market and invites bids from several buyers. The seller will provide much of the data needed for prospective purchasers to contemplate a bid, but it still has to be checked carefully by the professional advisors of the buyers and detailed searches have to be performed if key information is unclear or missing.

Inevitably some buyers drop out (the target did not fit their plans, or they discover aspects of the target causing them to raise their risk assessments). Those left in the race might be expected to make indicative bids to permit the seller to identify a preferred bidder, or a serious bidder might insist on a period of exclusivity (or lockout) as the only bidder while conducting its negotiations.
The seller will also conduct a form of due diligence into the bona fides of the potential buyers and the focus will be a mixture of factual (the evidence is either factual or not), or negotiable. For example:

- Who they are (are they legit)? (Factual)
- Where are they domiciled (can we litigate if they are from another jurisdiction with some hope of recovering losses)? (Factual)
- What is it they think they are buying? (Negotiable)
- What is their financial status and the security of their covenants (do they have the money)? (Factual)
- What indicative price might they pay? (Negotiable)
- Are there any barriers to their completing the purchase (do they have power and authority to make the deal or are there any complicated consents required from their shareholders, bankers and creditors, or the local version of the Monopolies Commission)? (Factual)
- What warranties and indemnities do we require from them? (Negotiable)

The acquisition will be negotiated between the principals, supported by their professional advisors.

Due diligence specialists search the data and the business environment for threats because surprises usually are bad news. Threats sometimes appear during a negotiation and are expressed explicitly or implicitly during debate, or become obvious in slips of the tongue during debate.

Dominance ploys, such as imposing pre-conditions, rigged agendas and non-negotiable issues, imply that a failure to concede to them threatens termination of the negotiation (though they may be bluffing). Sometimes they appear as shaping ploys, when a negotiator tries to force a decision on something over which the negotiations have stalled. Closing ploys (take it or leave it; or else; now or never; yes, but; quivering quill and the imposition of a time deadline) also imply a threat to conclude negotiations without an agreement.

Are the threats real or bluffs? Hard to tell. Deterrence theory operates on the basis that there is a threat if a party’s capability (can they damage us?) is matched by its commitment (are they likely to do so?). On the basis of the assessment of threat perceptions, a party should prepare its defences.
If any party has the capability and is committed to using it, then the threat has to be deterred by demonstrating capability to resist it, and by regular reinforcement of the commitment to use that capability, should the party initiate its threats.

Do these same considerations of deterrence in business apply to threats during negotiations? In part, yes, but (thankfully) the purpose of deterrence is to inhibit a party’s willingness to initiate its potential threat and not to provoke a party to implement its threats. Though a business can lose a contract, it is seldom except in the most pressing of circumstances that it will go out of business as a result of the loss of a single contract, and if this is a threat of a real consequence it suggests that the firm is at risk of going out of business anyway.

Most books on due diligence are technical in scope, looking at the data and for evidence of black holes in the accounts or the contracts. What a strategic negotiator needs is due diligence based on good commercial sense, and I recommend that you look through Peter Howson’s *Commercial Due Diligence: the key to understanding value in an acquisition* (Gower, 2007). Its scope and hands-on feel for commercial strategy is just what the strategic negotiator needs to evaluate more confidently due diligence reports and to question those who present them, often under time pressure to support or not a proposed acquisition or joint venture partner. It will also help you in briefing the professionals about to undertake due diligence assignments (even to evaluate their suitability) in the areas you consider are critical for a go/no-go decision. Leaving it to the experts is as risky a strategy as doing it yourself to save expense; you will also learn a great deal about what is important in analysing the commercial and operational imperatives of your own business.

Threats often feature in negotiation, originating from implicit or explicit messages sent from one party to the other, and from analysis of vulnerabilities that could be or might be initiated by the other party. Not all parties warn those they deal with that retribution inevitably follows some action on their part. Sometimes a party is warned that action will follow without further warning. For instance a party is told: ‘Unless it ceases “passing off” its products as if they are produced by the Acme Corporation, then Acme will initiate legal proceedings without warning.’

Threats that are specified have both strengths and weaknesses. Once they are given with a date, time and place, the clock ticks. The recipient can judge the seriousness of the threat beforehand – can they damage us and will they
An example of a severe consequence of ignoring a strategic threat can be seen in the case of a regional tyre distributor (Ajax), which was approached by another distributor (Phoenix) from an adjacent region with a view to it purchasing the Ajax business as a going concern.

Ajax rejected the approach almost out of hand, though it was already ailing from poor commercial performance, and it ignored the nascent threat from Phoenix that it intended to expand into the region. Its purchase of Ajax would give it the opportunity to do so within months rather than two or three years. Ajax’s main assets were in the tyre depots it owned, most of which were sited in good locations, close to heavily populated centres across its main operating region (the Home Counties around but not in London). Phoenix withdrew its opening offer (which it considered a basis for negotiation, not an ultimatum) and Ajax unwisely considered the matter to be closed. It did not undertake a threat assessment of Phoenix’s intentions or its capabilities (power) to achieve its ends by other means.

Phoenix, however, had done its research and noted the financial performance of Ajax, the locations of its tyre depots, the ill-prepared basic business skills of the Ajax owners and their outdated marketing image. Ajax’s owners failed to consider their vulnerabilities fully, nor did they make any efforts to modernize their image. Most depots needed refurbishment, a few needed to be relocated, and its marketing image looked dated and in some cases tatty. In short, Ajax did not take the Phoenix threat seriously.

The situation began to change three months later when, adjacent to one of the Ajax sites, an empty warehouse re-opened as a Phoenix Top Tyres depot in a blaze of local publicity and a wave of special offers (for example, buy-one-get-one-free-type promotions). This was followed quickly by three other Top Tyres depots all opening within a few yards of other Ajax depots and all flying ‘nobody beats our prices’ banners on their buildings, a theme repeated in the local press and on local radio. Sales at Ajax plummeted whenever Phoenix opened near them and there was no sign of the Phoenix depot opening campaign slackening.

By the time that Ajax realized what was happening, it was too late. Within six months it called in the administrators, who sold Ajax at a debt-clearing price (no premium) to Phoenix, which sold on the sites it did not want to single buyers, as long was they were not in the tyre business. Phoenix took its vulnerabilities seriously.
To avoid such a dénouement, if making a threat for some (good) reason, leave the threat unspecific, because vagueness lowers the seriousness of the threat. A threat that there may be serious consequences from taking certain actions carries less weight than specifying that serious consequences will follow and when. But vagueness leaves it to the recipient to imagine the nature of the threatened consequences and their timing. However, if the capability of the threatening party is less specific, it dilutes the threat’s impact, added to its dilution of the commitment of the party to an unspecified course of action. True, imagination may produce in the mind an even more serious impact of a threat than a specified but limited threat, and where there are doubts about the form that the threat might take, there is likely to be a lower estimate of the probability of its occurrence.

This also points to the important consideration: for the party making a threat it is not your own estimate of your capability and commitment that counts in deterrence, but the perceptions of the other party as to your capabilities and commitment. One factor that weighs on the other party’s mind is your history of making threats. Some negotiators invest considerable resources in raising their credibility as a threat maker. That is why firms pursue small breaches of their copyright and trade names that cost much more than the actual damage to demonstrate their seriousness in suing for more major breaches that others might be tempted to risk. (‘Look, if they’ll spend £20 000 suing for a breach worth £750, they’ll sure as heck sue us for a breach worth £120 000.’)

Three growth options

I shall illustrate some aspects of the Strategic Negotiation Process Model for three options that the organization might consider when deciding on a growth path:

- growth by expansion of the organization’s activities (organic) from its home base;
- growth by expansion of the organization’s activities by locating wholly-owned branch capacity in another region or country;
- growth by acquisition of an existing independent organization in another region or country

The three options are considered together because they are related in scope. Merely shipping product into another region or country is a normal initial expansionary route for an organically growing company. On a small scale it may
not even be noticed, except in rising sales figures, and may not need additional resources – the data are inputs into the business plan and not a consequence of it, up to some level of additional sales. However, as distant sales increase in volume and value, the logistics of servicing them will begin to press on existing resources. The need to respond to the opportunity is illustrated in Figure 6.1.

The planners could respond to the reported opportunities for distant sales with acknowledgement in the business plan of the detailed need to manage and fund this additional work.

If we stick purely to the physical requirement for despatch and delivery capacity, and ignore the changes that may be required in the output capacity of the organization to produce whatever is being sold at a distance. In Figure 6.1, the business plan target is summarized as a 30 per cent increase in distant

Figure 6.1  Increasing distant sales
sales within the planning period. This produces the commercial imperative to assemble the capacity to meet that target, plus others. To achieve the commercial imperative, operational imperatives are required, from which list, Figure 6.1 refers to people, facilities and technology (there could be many others depending on the nature of the product, the distance despatched and the circumstances).

The Negotiation Agenda comprises all the arrangements that must be negotiated to acquire the resources to deliver the commercial imperative(s) that deliver(s) the business plan. Once again the seamless link is emphasized between what the negotiators undertake to agree to with many third parties (and internal members of the organization) and the business plan. Figure 6.1 shows three headings for the Negotiation Agenda (rewards, contracts and purchases), and each set of negotiations is undertaken with different negotiation partners, but in this approach they are all linked strategically.

If we now go to the next stage of growth policy, we assume that the organization has found that the policy of distributing its products to distant markets from its home base exposes inefficiencies and risks which compromise continuing success in its markets unless significant changes are made. It could also be the case that the organization took the decision to set up distant production and distribution branches from near the beginning of the emergence of distant sales. In either case, the same process of aligning its negotiations with its Business Plan is followed, as shown in Figure 6.2.

Although there are obvious differences between expanding home facilities and locating expansion capacity at a distance, there are many similarities in both options. The major difference is that the distant location option is liable to be more expensive than local expansion and the decision is certain to be made at board level because of the risks and investment required.

Leasing rather than purchasing is not necessarily cheaper because there is still a financial commitment for the duration of the lease, requiring top-level approval, and while a purchase option may be expensive in the initial outlay, it may be easier to sell a property if the growth option fails to meet expectations than it would be to break a lease before its review date. There is also the usual problem of the multiplicity of locations that could meet the objective in the Business Plan, at least in the minds of those favouring the different options, and this adds to the time needed to come to a single decision.
This choice is bound to raise the question of making an acquisition, either searched for or brought to the attention of the organization by an adviser. Acquisitions in the home territory are less complex than acquisitions in a foreign territory but there may not be much choice if they are not perfectly substitutable and the market opportunity requires it.

Acquisition is complex and time consuming whichever route is followed, whether you are buying or selling. Figure 6.3 illustrates a brief summary, greatly simplified, of how a Negotiation Agenda is derived to deliver one objective out of many in the business plan. Instead of five items on the Negotiation Agenda there can be many more – thirty or more main headings are not uncommon – and the documentation alone accounting for several volumes of documents, all of which must be mastered by the negotiators and their professional advisers.

Figure 6.2  Locating wholly owned distant facilities to increase distant sales
When the negotiations conclude with an agreement the paperwork is completed and the transfer of ownership from the original to the new owners, the crucial stage of implementation, commences. Acquisitions can go sour from poor agreements, but poor implementation is also a major cause of failure. If selling at a distance has its problems, managing at a distance adds more problems such as adequately staffing distant negotiations.
Activities for Chapter 6

Activity 6.1

What do you know of the history of your organization, where and when it started, how it developed, what it is doing now that it was not doing earlier in its history (and what it is not doing now that it originally set out to do)?

Comments on this activity

You can find out by asking around and looking up the files, or old brochures and catalogues, checking old addresses and reading press clippings – try a Web search to get background on your organization.

Activity 6.2

If your organization has a business plan you should apply to read it at your earliest opportunity – even an old one – to familiarize yourself with its construction and contents.

Comments on this activity

There is nothing like reading an old business plan to reveal just how fragile the assumptions of many of them prove to be when what they achieved is measured against what they intended. However, how they were constructed is revealing and this should caution you against the adoption of the weak assumptions that feature in some plans.

Most banks, and the accountancy bodies, offer booklets on the writing of business plans. It is not a difficult activity to undertake. Venture capitalists report that they can often tell the quality of a business plan in the first few paragraphs.