

Contracts and Negotiating

The Seven Deadly Negotiating Sins

An outsourcing negotiation is a complex endeavor, with interwoven financial, technical, performance, people, and legal issues. However, after boiling it all down, there are seven very common mistakes both vendors and customers make in negotiating outsourcing contracts. This article will help you spot those mistakes. Then you can correct them in your own negotiating team and exploit them in the other side's negotiation.

Those seven deadly sins are:

1. Assuming the Worst

Some negotiators assume the worst of the other side. They assume that everything that the other side wants is bad for them. They see negotiation as a zero-sum game, where one side can win only if the other side loses.

This assumption hurts because it ignores opportunities for "expanding the pie" by devising creative solutions or accepting the other side's "win-win" proposals.

Outsourcing transactions are so complex that creative negotiators can generally negotiate solutions that work for both parties, even on the toughest issues. Excessive distrust destroys that opportunity. Some negotiators even lose valuable deals.

2. Assuming the Best

An equally serious mistake is assuming that the other side will always act in your best interest. Wrong. They'll act in their own best interests. At times, their best interests are the same as yours. At other times, they are exactly opposite.

A good outsourcing contract aligns interests. For example, provisions, which share the benefits of projects that the vendor implements for the customer, give both the vendor and the customer incentives to make the project successful. Assuming the best in negotiations leads you away from demanding contract provisions that align the other side's incentives with your own.

Assuming the best in negotiations also leads to bad negotiating. In good negotiating, you focus on both expanding the pie and dividing the pie. When you are expanding the pie, the vendor's interests are similar to the customer's interests. When you are dividing the pie,

the vendor's interests are close to being the opposite of the customer's interests. Assuming the best keeps you from fighting hard enough for your fair share of the pie.

3. Anchoring

When you are dividing up the pie, you need a reference point to decide whether you've gotten enough of the pie. In negotiating research, this point is called your "anchor." Quite often, a negotiator's anchor point is the other side's initial position. That's an error. The other side may have picked its initial position out of thin air, or chosen it only in the hope that you will accept it as your reference point.

Imagine that you're shopping for a used car. At the first dealer, you find a car you like with a sticker price of \$20,000. You bargain the price down to \$16,000, and you buy the car. Think about how you feel. Was that a success? Did you save \$4,000? If your anchor was \$20,000, you're feeling good.

Now imagine that you then drive past another used car dealer and see the same car. Out of curiosity, you stop and check the sticker price. It's \$14,000. Now how do you feel? Not so good anymore. It turns out that making a decision based on your anchor point -- the first dealer's initial position -- wasn't a very good idea after all.

The right anchor point is your best alternative to the deal. For a customer, that might be the deal that a competing vendor would offer or the value of an insourced solution. For a vendor, it might be a minimum pro forma margin that makes it worthwhile to sign the deal. On specific legal terms, the anchor might be the level of risk that you simply will not accept. With those as anchors, you'll never "feel good" about a deal you shouldn't sign.

4. Flying Blind

Of course, to compare a deal to your best alternative, you need to know what you want and what alternatives are available. If you don't know that, you're flying blind. Too often, customers fly blind when they're contemplating outsourcing. They haven't done enough homework to know what they want and they haven't done a competitive selection or other market test to find out what alternatives are available. As a result of a "sole source, let's not waste time" strategy, they end up, in essence, paying \$16,000 for that \$14,000 car.

It's also common to see a vendor sales team with its eye on signing a contract (and spending a bonus) get a vendor into an ill-fitting and ultimately unprofitable deal. Steps like due diligence, negotiating an acceptable contract and doing a pro forma profitability analysis may seem like time consuming drudgery, but without them the vendor is flying blind.

5. Irrational Escalation of Commitment

Another way to end up paying \$16,000 for a \$14,000 car is to get drawn into the sales process. This cycle is an irrational escalation of commitment. The negotiator becomes more determined to make a deal, even if the deal itself keeps getting worse.

One reason why outsourcing negotiators irrationally escalate their commitment to a deal is what economists call the sunk cost fallacy. The long hours spent negotiating seem like an investment in the deal. It seems like all is "lost" if the deal dies. In fact, the time spent on the deal is a sunk cost. It's gone and it will never come back.

The internal dynamic of an outsourcing negotiation also makes negotiators irrationally escalate their commitment. If you're a negotiator who's reported good progress to your management, are getting close to a drop-dead date, or watched your organization make heavy investments in the deal, it gets harder and harder for you, personally, to stick your neck out by recommending against the deal. If you're an executive, who's staked a reputation for good judgment on a deal, it's almost impossible to back out if the negotiations go badly. Thus, companies escalate their commitments to deals when they should be walking away.

6. Overconfidence

Researchers have confirmed time and time again that we have too much confidence in our judgments. We think that we know more than we actually know in most of what we do. However, the high stakes and emotion of an outsourcing negotiation magnify our emotional need to feel in control, and thus make us more likely to be overconfident.

Overconfidence blinds negotiators. It keeps you from hearing, much less asking, the right questions to find evidence that goes against your view of the negotiation. It makes you do what worked before, instead of what will work this time.

Every negotiation is unique. You've got to seek out the

facts of each new deal, and develop a strategy for each negotiation based on its own facts.

7. Ignoring Leverage

Perhaps the most important fact in an outsourcing negotiation is leverage. A skilled negotiator can win many points with persuasive arguments, force of personality and being a bit smarter. However, leverage, or negotiating power, wins critical points in most outsourcing negotiations.

Too many negotiators waste their leverage. For example, some customers waste their leverage by choosing a single vendor, signing a binding letter of intent and announcing the deal to the affected employees, all before contract negotiations begin. Those customers have given up most of their ability to walk away. The end result, of course, is that the contract will be at a high price with limited performance commitments.

Other negotiators fail to build leverage into the contract. For example, customers gain (and vendors lose) leverage when the contract includes rights to use third parties or insource existing and new services, terminate for convenience (with reasonable termination charges), partially terminate, obtain termination assistance services, control architecture and standards, require the vendor to use designated subcontractors, approve or remove key vendor employees, and audit and dispute charges. That leverage will translate, over the long term, into dozens if not hundreds of small victories for the party that worked to gain leverage in contract negotiations. Thus, by making the mistake of ignoring leverage in the contract negotiation, a negotiator can lock his or her company into a long-term losing relationship.

Lessons from the Outsourcing Primer:

- You lose value in the negotiation if you assume the best or the worst of the other side. Either you miss opportunities to create mutual gain or you don't get your fair share of the value you create.
- Evaluate success or failure against your best alternative, not an anchor point suggested by the other side.
- Learn the facts unique to every negotiation.
- Be mindful of commitments both obvious and subtle, and whether the benefits you gain for making a commitment are worth more than the options and leverage you sacrifice.