

The Hidden Challenge of Cross-Border Negotiations

by James K. Sebenius



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International deal makers have
long bowed to local traditions and etiquette.
But new research suggests they also need
to understand something deeper – the subtle yet potent ways
that national culture shapes the governance
and decision-making process.

The Hidden Challenge of
**CROSS-BORDER
NEGOTIATIONS**

by James K. Sebenius

CULTURAL DIFFERENCES can influence business negotiations in significant and unexpected ways, as many a hapless deal maker has learned. In some cases, it's a matter of ignorance or blatant disrespect, as with the American salesman who presented a potential Saudi Arabian client with a multimillion-dollar proposal in a pigskin binder, considered vile in many Muslim cultures. He was unceremoniously tossed out and his company blacklisted from working with Saudi businesses. But the differences can be much more subtle, arising from deep-seated cultural tendencies that influence how people interact – everything from how people view the role of the individual versus the group

to their attitudes, say, about the importance of time or relationships. In response to these challenges, a great body of literature has emerged to help executives navigate differences not only in protocol and deportment but in deeper cultural tendencies as well.

But my research shows that there's another, equally treacherous, aspect to cross-border negotiation that's been largely overlooked in the literature: the ways that people from different regions come to agreement, or the processes involved in negotiations. Decision-making and governance processes, which determine either a "yes" or a "no," can differ widely from culture to culture, not just in terms of legal technicalities but also in terms of behaviors and core beliefs. In my experience observing and participating in scores of international negotiations, I've seen numerous promising deals fail because people ignored or underestimated the powerful differences in processes across cultures. In these pages, I will examine how systematic differences in governance and decision making can disrupt cross-border negotiations, and I will offer advice on how to anticipate and overcome possible barriers on the road to yes.

Map the Players and the Process

In any negotiation, you are always interacting with individuals, but your real purpose is to influence a larger organization—representing a diverse set of interests—to produce a meaningful yes. In an international deal, just as at home, you need to know exactly who's involved in that larger decision process and what roles they play. But in unfamiliar territory, the answers might surprise you. Indeed, applying "home" views of corporate governance and decision making to international deals may seriously hinder the negotiation process. I find it's useful to break down the decision-making process into several constituent parts: Who are the players? Who decides what? What are the informal influences that can make or break a deal? Let's look at each of these factors, which can vary dramatically when you cross national borders.

Who are the players? If you're accustomed to deal making in the United States, you know that extra players beyond those representing the two companies may influence the deal: the SEC, the Federal Trade Commission, and the Justice Department, among others. In his book *Masters of the Universe*, Daniel J. Kadlec writes that when Travelers and Citicorp were contemplating a merger, the heads of both companies together visited Federal Reserve Chairman Alan Greenspan to get a reading on the Fed's likely attitude.

Abroad, you'll of course find extra players as well, but they will be different and often less obvious. For those executives experienced in North American shareholder-based corporate governance, it may come as a surprise to

discover that in Germany, labor has virtually equal representation on many supervisory boards of directors. It will probably be less surprising, though no less discomfiting, to discover that local party officials play an integral part in Chinese negotiating teams in the People's Republic, even when the Chinese company is nominally "private." In the European Union, various Brussels commissions may get involved in business negotiations. If an acquisition target has foreign subsidiaries, the skein of negotiating partners may grow even more tangled. All these constituencies bring their own interests to the table, as well as varying abilities to block or foster negotiations. Even GE, one of the most experienced acquirers, suffered a humiliating defeat in its attempted merger with Honeywell, in part because GE's management underestimated the nature and seriousness of European concerns about competitiveness and the potential for these concerns—and GE's European competitors—to obstruct the deal.

Another example is drawn from the research of my colleagues William A. Sahlman and Burton C. Hurlock: Near the time of the collapse of the Soviet Union, California-based venture capital firm Sierra Ventures was negotiating with the director of the Institute for Protein Research in Russia, hoping to get the rights to an apparently revolutionary biotechnology process. Marathon negotiations with the institute's management team—heroically bridging huge gaps between East and West, business and science, bureaucracy and venture capital—seemed as if they would finally culminate in an acceptable deal for both sides. Although the deal ultimately succeeded, nearing the finish line it suddenly became clear that several Moscow ministries, each with its own point of view and agenda, also had to approve the agreement. This posed a potentially fatal set of obstacles that could have been anticipated had the Sierra team made more than a perfunctory effort early on to learn about the real decision process.

Who decides what? Even if you know who's playing, a failure to understand each player's role—and who owns which decisions—can be very costly. For example, when Italian tire maker Pirelli sought to acquire its German rival, Continental Gummiwerke, Pirelli claimed control of a majority of Continental's shares and received tacit backing from Deutsche Bank and support from Gerhard Schröder, then Prime Minister of Lower Saxony, where Continental is based. In a U.S. transaction, merely owning enough equity often allows the acquirer to control the target. But not in this setting.

Unfortunately for Pirelli, German corporate governance provides a structure in which other key players can block the will of even a majority of shareholders. While the management board in most large German companies has day-to-day management responsibilities, it is only one of four sets of players—along with shareholders, a supervisory board, and labor—that can play a significant role in

any major decision. What's more, under union codetermination, labor elects fully half of the members of the supervisory board, which in turn elects the management board. And the management board can prevent any single shareholder, no matter how large his or her holdings, from voting more than 5% of the total company shares. Thus, having failed to gain real buy-in from all the players, especially labor and key managers, Pirelli couldn't complete the transaction, even though it claimed effective control over Continental's shares and had powerful allies—a humiliating defeat that cost the Italian company nearly half a billion dollars.¹

There are some impressive stories of executives deftly navigating these potential barriers—U.K.-based Vodafone's successful acquisition of Germany's Mannesmann is a notable recent example—and such cases might seem to herald major changes in German law and governance. But the circumstances and tactics in Vodafone's case were highly specific to the deal, and the general implications

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for Euro-governance seem limited. Deeply entrenched structures continue to blindside many a corporate suitor—and not just in Germany. In fact, versions of this cautionary tale could be repeated in locales as distinct as Switzerland and Japan, where boards of directors representing constituencies other than shareholders may exert powers unfamiliar to those accustomed to Anglo Saxon-style governance, including voting caps and the power to block share registration or voting of outside equity holders.

Cultural assumptions can sometimes make it very difficult to recognize or acknowledge who has formal decision rights. For example, when Honda invested heavily in an extensive relationship with British automaker Rover, workers and managers at the two companies developed very positive working relationships for more than a decade. The partnership intensified after the government sold Rover to British Aerospace (BAe), but as Rover continued to lose money, BAe decided to discard the relationship, abruptly selling Rover to BMW through a secretive deal that caught Honda completely unawares. The Japanese automaker considered its connection with Rover a long-term one, much like a marriage, and it had shared advanced product and process technology with Rover well beyond its effective contractual ability to protect these assets. Honda's leaders were dumbfounded and outraged that BAe could sell—and to a competitor, no less.

Yet while Honda's prized relationship was at the level of the *operating* company (Rover), the Japanese company had not taken seriously enough the fact that the decision rights over a Rover sale are vested at the *parent* (BAe) level. From a financial standpoint, the move made sense for BAe, and it was perfectly legal. Yet Honda's cultural blinders made the sale seem inconceivable, and its disproportionate investments in Rover in effect created a major economic opportunity for BAe. The bottom line: Understanding both formal decision rights and cultural assumptions in less familiar settings can be vital. (For more on how cultural assumptions can influence negotiating behavior, see the sidebar "Cross-Cultural Etiquette and Behavior: The Basics.")

A final note on identifying decision rights: Even the experts may stumble over their assumptions. U.S. attorneys apparently told Bernard Arnault's French luxury conglomerate LVMH that companies traded on the New York Stock Exchange could not increase their share base by a significant amount without shareholder approval. With this understanding, LVMH acquired almost 35% of Gucci in a takeover bid.² However, it turns out that different stock rules apply to companies based outside the United States—Gucci, for instance, traded in New York but was chartered in the Netherlands and is headquartered in Florence. Gucci's defense team discovered this loophole and used it

to shut down the deal. The company first issued 20% new shares to its employees in an ESOP-like transaction and then offered 42% additional new shares to a group controlled by François Pinault, Arnault's French rival. LVMH's massively diluted position in effect handed ultimate control to Pinault, leaving LVMH-trapped as a relatively powerless minority shareholder in Gucci.

What are the informal influences that can make or break a deal? It's important to understand which people must sign the contract to finalize a deal, but that's often not enough. Many countries have webs of influence that are more powerful than the actual parties making the deal, even though those webs don't have the formal standing of, say, government agencies. In Japan, it may be the *keiretsu*—industrial groups that are linked by a web of business ties, lending, and cross-shareholdings. In Germany's financial sector, it might be the insurance giant Allianz. In Italy, it may be a set of powerful families. In Russia, it can be the Russian mafia and other protection rackets. Outsiders need to understand these webs and

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factor them into their negotiating approach. It's a lesson many companies have learned the hard way.

And influence on negotiations need not be driven by an informal, underlying power structure, as U.S. Stone Container Corporation learned. While negotiating the terms of a major forest project in Honduras, Stone Container's executives assumed that the Honduran president and his relevant ministries had the power to decide whether to allow the project and therefore dealt primarily with the president. But while the president did have the legal authority to make the deal and ultimately approved it, the company's proposal and negotiating strategy seemed to signal a possibly corrupt deal among elites. This inadvertently triggered the involvement of the Honduran Congress, labor unions, political parties, potential business competitors, indigenous people in the affected region, and domestic and international environmental groups. Had Stone taken into account the history of strained relationships between Honduras and the U.S. government and multinationals, as well as the fragile status of the presidency in this fledgling democracy, it could have developed a strategy that accommodated this informal web of potential influences. Instead, Stone's lack of foresight caused it to become enmeshed in an adversarial, multi-party process that ultimately failed. When interviewed for a Harvard Business School case, Stone executive Jerry Freeman likened the experience to being "caught in a drive-by shooting with no place to hide."

U.S. companies like Stone—and others from cultures with strong legal systems—frequently underestimate the power of informal influences because they assume that foreign legal systems will enforce formal contracts just as they are expected to at home. What they may ultimately learn is that dispute resolution can look very different in different cultures. In Japan, which has a relatively small legal system and few lawyers, companies rely on relationships and negotiation to sort through most commercial disputes. Present-day Russia has practically no functioning judiciary. Many countries' legal systems are corrupt or controlled by local political powers.

The fact is, there can be a great gulf between the laws on the books and how things really work, as one U.S. electrical goods manufacturer learned after it entered a joint venture with a Chinese company and hired a local manager to run the Chinese operation. As described in Charles Olivier's 1996 *WorldLink* article, "Investing in China: 12 Hard Lessons," the company tried to expand its product line, but the Chinese manager balked, insisting there was no demand for the additional products. The U.S. management team tried to resolve the dispute through negotiations, and when the Chinese manager wouldn't budge, the team fired him—but he wouldn't leave. The local labor bureau refused to back the U.S. team, and when the U.S. executives tried to dissolve the venture, they discovered they couldn't recover their capi-

tal because Chinese law dictates that both sides need to approve a dissolution. A foreign law firm, hired at great expense, made no headway. It took some behind-the-scenes negotiation on the part of a local law firm to finally overcome the need for dual approval—an outcome that demanded local counsel well versed in the intricacies of Chinese culture.

In short, successful cross-border negotiators begin by discarding home-market presumptions and developing a clear map of the players who are likely to influence the formal and informal decision process. Only when you know exactly who these players are can you develop a strategy that targets their interests.

Adapt Your Approach

Unfortunately, however, knowing who's involved in the process is only half the battle. While you negotiate with people, you are typically seeking to influence the outcome of an organizational *process*. That process can look different in different cultures, and different processes may call for radically different negotiation strategies and tactics. Even seasoned executives often fail to adapt their approaches to those different processes, with costly consequences. While it's difficult to generalize, such processes tend to take one of several forms: top down, consensus, and multistage coalition building.

Top Down. In some cases, you will deal with a "real boss," a top-down authority who won't delegate in any meaningful way and will ultimately make the decision unilaterally. When there is the local equivalent of a very much in charge Admiral Rickover, Harold Geneen, or Robert Moses, revealing key information or making premature concessions to those not genuinely in the decision loop can work to your disadvantage. The most effective negotiators avoid making deals with relatively powerless agents who function as important messengers or emissaries but not as powers in their own right. Instead, these negotiators find ways to interact directly with the boss—or, if that's not possible, to connect with people outside the process who have close ties to or influence over the boss.

In some cultures, even if the boss delegates authority, going directly to the top can sometimes be more effective. For example, when one Italian industrial products firm wished to acquire a large division of a French conglomerate, it first made friendly overtures to the target unit. But as it became clear that unit management wouldn't even consider discussions about a possible sale, the Italian chief went quietly to the top. He eventually closed the deal with the boss, who—consistent with that company's top-down culture and, in fact, much of French corporate governance—simply "crammed it down" on the division, softening the blow somewhat by offering any reluctant managers a chance to be absorbed into the

