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When a Contract Isn't Enough: How to Be Sure Your Agent Gets You the Best Deal

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BY JAMES K. SEBENIUS

When a Contract Isn't Enough: How to Be Sure Your Agent Gets You the Best Deal

Negotiation is often handled by an agent or representative. Here's some advice on managing this potentially double-edged relationship.

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WHEN SELLING YOUR HOUSE OR COMPANY, working out terms with your publisher, or handling a lawsuit, you often engage an agent. Lawyers, investment bankers, literary agents, and others who negotiate on your behalf may help you in many ways: they may have greater specialized expertise than you do, they may be better bargainers, they may have superior access to the other side, they may serve as a useful buffer, and they may save your time. (In "When You Shouldn't Go It Alone," an article in the March issue of *Negotiation*, my colleague Lawrence Susskind delves into some of the advantages of relying on agents and offers good advice on how to use them effectively.)

With the benefits of employing an agent, however, come certain risks. A faulty contract, for instance, can set the stage for disaster by failing to properly align her incentives and provide for appropriate monitoring of her work. (See the sidebar "The Pitfalls of Faulty Contracts" on page 5.) Even experienced negotiators who take great care in constructing agent contracts may unexpectedly find themselves facing agent incentive and monitoring problems. These issues, which often arise from factors that fall heavily *outside* the structure of the contract, can lead to three kinds of problem agents.

In this article, I describe the telltale signs of *faulty agents*, *free agents*, and *double agents*. If you fail to look out for these problem agents, your interests may suffer in negotiation.

1. Faulty agents

A *Wall Street Journal* article tells the story of top executive-pay attorney Joseph Bachelder, who was representing a client who'd just been chosen as a company's next CEO. After a first session with the board's representative to hammer out a compensation package, Bachelder took his client aside and informed him that he would get everything he wanted from the negotiation.

Why was Bachelder so confident of total victory? Because, he explained, the board had put the firm's well-regarded general counsel in charge of the negotiations. Why was this a mistake? "When this is over, you're going to be that guy's boss," Bachelder happily informed his client. "He knows that. He can't fight you too hard on anything."

The board picked a *faulty agent* for this negotiation—one whose underlying incentives conflicted with the board's best interests. The general counsel's dominant interest was to lay the groundwork for a good relationship with the future CEO. As its representative in these critical talks, the board should have instead hired an outside specialist with properly aligned interests.

The faulty agent problem often shows up in Pentagon contracting. Procurement officers are charged with representing the public interest when negotiating with defense contractors. Yet some of these officers quietly make plans to leave the civil service and join one of these defense con-

tractors—at a far higher salary. While still representing the Pentagon, such agents are likely to go much easier on the other side than they should.

While an overriding self-interest in a future relationship with a negotiation counterpart may create a faulty agent, so may the *lack* of any meaningful future concern. Consider a company that is negotiating an alliance or acquisition through a heavily price-driven process with a strong legalistic component. In such instances, it's common for one internal team, such as the business development unit, to act as the company's agent. When the team's job is done—often after a nasty, adversarial process—the company's operational management unit inherits the unenviable job of making the arrangement work.

Jerry Kaplan, founder of GO Corporation, an early pen computing firm, criticized the process by which IBM invested in his firm. In his book *Startup* (reprint ed., Penguin, 1996), Kaplan writes, "Rather than empowering the responsible party to make the deal, IBM assigns a professional negotiator, who usually knows or cares little for the substance of the agreement but has absolute authority.... The negotiator begins by assembling a list of interested internal constituents, all of whom are free to add new requirements...or block some minor concession."

When a faulty agent leads a negotiation, it's unlikely the right minds will converge on a productive arrangement. Similarly, while the top management of two companies in a supply chain may speak glowingly of the strength and quality of their partnership, the buyer's procurement agent may be motivated by monthly targets and penny-pinching while overlooking broader concerns. A fanatical focus on getting the best price may be due in part to how the agent is evaluated by her superior, but also may derive from the organization's culture.

When suppliers seek advice on dealing with faulty agents, they might be told to listen actively, to improve their body language, and to decide who should make the first offer. Another strategy is to nurture an internal champion on the other side who truly benefits from your added quality and service—and who will pressure the agent on your behalf.

2. Free agents

Supposedly a negotiator who works faithfully on behalf of his principal's real interests, a free agent has incentives and control over the process that effectively lead him to act independently. Investment bankers or other dealmakers with a powerful interest in closing a deal can function as free agents. For example, when Matsushita Electric Industrial Co. paid \$6.59 billion in 1990 for MCA, the owner of Universal Pictures and several record companies and

THE PITFALLS OF FAULTY CONTRACTS

Some of the trickier aspects of designing the right contract with your agent include properly aligning her incentives and monitoring her work. Supervising your agent can be especially hard when she knows more than you do about the area of work. For example, hiring an agent who's a lawyer and paying her on an hourly basis may induce her to spend more time than you think necessary—at your expense. She might become a literary perfectionist, spending hours crafting and polishing an offer letter to the other side when, as far as you're concerned, the second draft would have done just fine. To prevent her from running up needless hours, you might opt instead for a fixed-fee engagement. Then, however, she may cut corners, doing just enough to reach her fee.

Contingent contracts that grant higher agent fees as your outcome improves may superficially align both your interests. Yet here, too, conflicts may lurk. For example, as a negotiation unfolds, if your agent believes that the odds that the deal will close are falling, he may reduce his effort, and the no-deal outcome may become self-fulfilling. By contrast, once a profitable agreement seems very likely, your agent, unbeknownst to you, may take excessive negotiating risks on your behalf, hoping for a much better outcome or even a "trophy deal" to burnish his reputation. In short, even when both you and your agent have incentives to reach a strong deal, your appetites for risk may radically differ.

These pitfalls suggest the need for awareness and clarity when drawing up a contract with an agent. Specifically, you should work to design the financial arrangement most suited to your situation, align incentives and monitor the agent's work as well as possible, and engage either someone you've worked with successfully or someone who has a solid reputation for efficiency, effectiveness, and faithful representation.

For more on this topic, see *Beyond Winning: Negotiating to Create Value in Deals and Disputes*, by Robert H. Mnookin et al. (Harvard University Press, 2000), and *Negotiating on Behalf of Others*, ed. by Robert H. Mnookin and Lawrence E. Susskind (Sage, 1999).

theme parks, its rationale was to ensure a steady flow of "creative software" for its global hardware businesses. Senior MCA management agreed to the acquisition largely with the expectation that its new, cash-rich Japanese parent could provide capital for entertainment businesses

Be Sure Your Agent Gets You the Best Deal *(continued)*

needed to make MCA competitive with rivals such as Disney and Cap Cities/ABC.

Matsushita chose Mike Ovitz, a former Hollywood talent agent with a burning ambition to become a corporate matchmaker, to represent it at the bargaining table. Ovitz masterminded an intricate set of maneuvers that kept the two parties mostly *apart* during the process, managing the information flow and both sides' expectations until the deal was virtually closed.

Both Matsushita and MCA developed a distorted perception of the other's real intentions, leading to postdeal friction and the sale of MCA five years later to Seagram, at a substantial loss to Matsushita both in terms of face and money—¥165 billion, or about \$1.6 billion. In part due to the cultural chasms dividing old-line industrial Japan, creative Hollywood, and the New York financial community, neither side truly probed the other's underlying expectations until it was too late. But even more than culture, a free agent with a dominant interest in forging a deal—almost any deal—was a key factor, as was the substantial freedom he was given to act on that interest.

3. Double agents

When their incentives are wrong enough and their control over the negotiation process is high, merely faulty agents can morph into *double agents*. Many buyers of real estate and of companies can wryly testify how standard financial arrangements can unwittingly produce this result. Consider the common practice of compensating the real estate agents or investment bankers on both sides with a percentage of the sale price. What tacit alignments do such arrangements create? Just like the seller and his agent, the buyer's agent now benefits from a high-priced deal. Pity the hapless buyer, the sole player looking for a bargain.

Beyond faulty contracts, other factors can produce double agents. After a small business suffered a fire, for example, its owner hired an experienced consultant to negotiate damage claims with his insurance company. The consultant was promised a fixed fee for success, plus a sliding bonus based on the settlement amount. The consultant very quickly negotiated an adequate settlement, but the owner soon became disenchanted with the outcome. Why? Because he learned that his agent, after dealing for years with the same small set of insurance companies, had fallen into a pattern of rapid but relatively modest claims settlements. If he had bargained harder for his client, the consultant might have gained an incremental incentive fee but would have risked retaliation from the insurance company. In effect, the business owner was a one-time bit player in a long-term game that

powerfully aligned the interests of the insurance company with those of the consultant.

Here's a more unusual instance of a double agent. *New York Times* columnist Nicholas Kristof was reporting from Iraq when he was summoned to a government ministry to account for an "outrageous" article he'd written detailing Saddam Hussein regime's brutal torture of a Muslim leader. Included in the meeting was Kristof's official Iraqi government minder. In a 2003 column, Kristof describes the experience of being "menacingly denounced by two of Saddam's henchmen":

Neither man could speak English and they hadn't actually read the offending column...my government minder took my column and translated it for them. I saw my life flash before my eyes. But my minder's job was to spy on me, and he worried that my tough column would reflect badly on his spying. Plus, he was charging me \$100 a day, and he would lose a fortune if I was expelled, or worse. So he translated my column very selectively. There was no mention of burning beards or nails in heads. He left out whole paragraphs. When he finished, the two senior officials shrugged and let me off scot-free.

Kristof was fortunate indeed that the incentives of this Iraqi government representative—just like those of double agents in more benign settings—were dramatically misaligned from those of his superiors. Contrary interests plus the capacity to control and shape the information that he passes along is a common trait of a double agent.

How can you avoid becoming the next victim of a faulty agent (wrong interests), a free agent (wrong interests plus control of the process and information), or a double agent (an extreme version of faulty and free)? When evaluating and engaging a potential agent, you need to focus on more than just designing a contract that aligns your financial incentives. To keep a problem agent at bay, fix a penetrating eye on her present and future relationships, her full set of interests, and the extent to which she will be able to filter information and control the negotiating process. ♦

James K. Sebenius is the Gordon Donaldson Professor of Business Administration at Harvard Business School, director of the Negotiation Roundtable, and a member of the Executive Committee of the Program on Negotiation at Harvard Law School. He is the coauthor, with David Lax, of *3-D Negotiation: Creating and Claiming Value for the Long Term*, forthcoming from Harvard Business School Press.

He can be reached at negotiation@hbsp.harvard.edu.

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