How to Handle "Extreme" Negotiations with Suppliers

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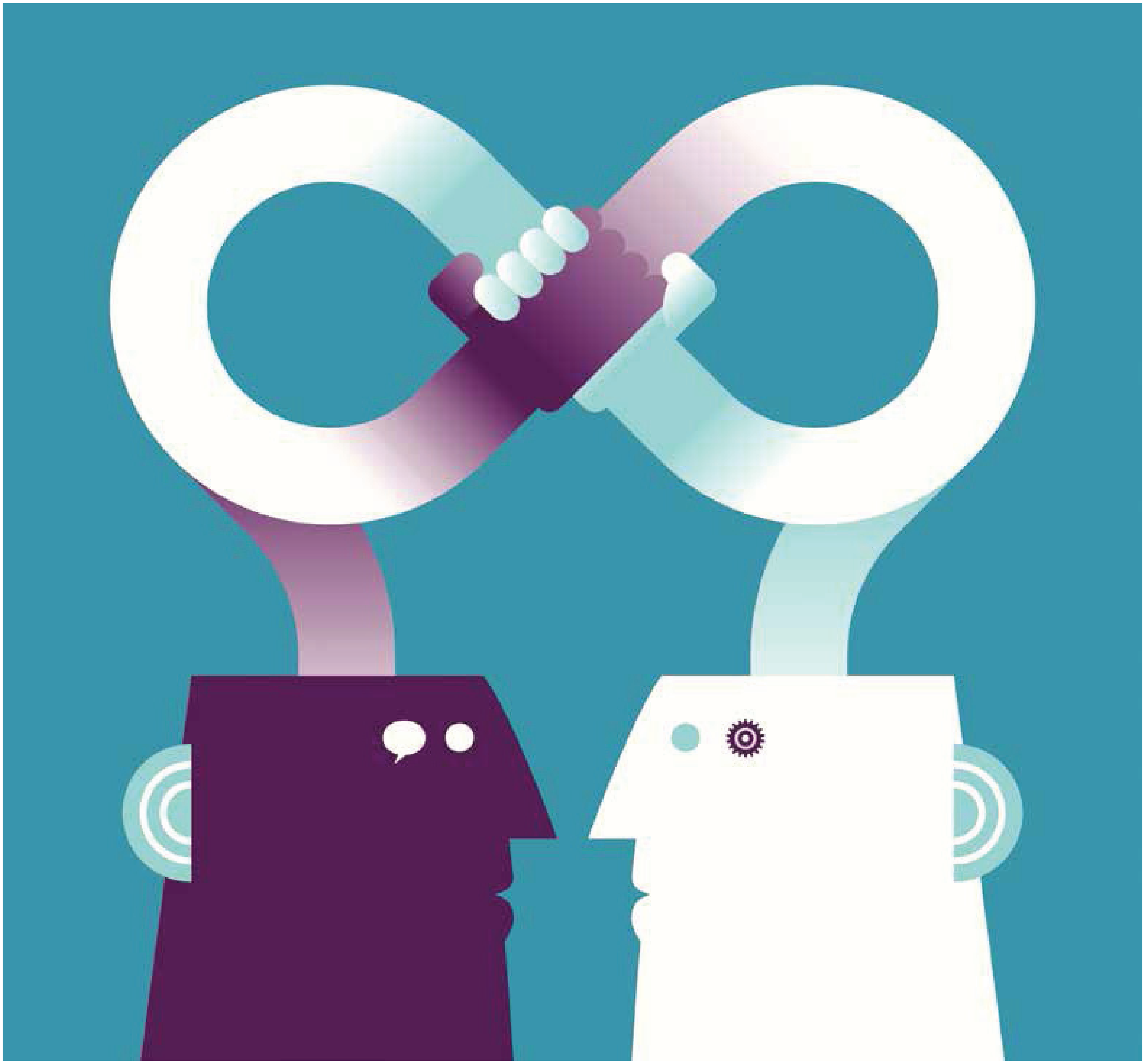
When negotiating in high-stakes, high-risk ("extreme") situations with suppliers, the tendency is to act quickly and forcefully. Yet acting in haste to take charge and look in control often leads to disappointing, even dangerous, results. A better approach: slow down the pace of the negotiation, understand the other side's position, and work toward a more collaborative negotiation process.

In 2010, Jeff Weiss and Jonathan Hughes, together with Major Aram Donigian, published an article in the *Harvard Business Review* entitled "Extreme Negotiations." That article explored lessons from the U.S. military about negotiating in high-stakes, high-pressure situations—lessons with potential relevance to complex negotiations in the business world. A key insight underlying the ideas from the article is that negotiation behaviors tend to be deeply ingrained



and are often reactive rather than deliberate, especially under conditions of significant stress. By carefully analyzing how military officers in theater were often able to defuse dangerous situations, five replicable strategies emerged. Although these strategies differ from most people's default reactions to stressful negotiating situations, the ability to implement them can indeed be learned.

This article is a companion to the *Harvard Business Review* piece, and addresses how the same approaches can be employed in especially challenging negotiations with suppliers. Over the past several years, we have helped sourcing and supply chain executives and professionals employ these strategies when traditional forms of leverage seemed unavailable (for example, with single and sole source suppliers), and/or when business-critical suppliers seemed to be engaging in opportunistic or even adversarial negotiation tactics. These strategies are not only useful at the bargaining table, but can (and should) also serve to reshape planning and positioning far in advance of formal negotiations.

Strategy 1: Broaden your field of vision, question assumptions, and re-think objectives.

Start by identifying key assumptions and subject them to scrutiny; use negotiation planning and execution to continually gather new information and revise strategies accordingly.

To do this . . .	
Avoid	Instead, try
Assuming you have all the facts: "Look, it is obvious that…"	Being curious: "Help me understand how you see the situation."
Assuming that the supplier is biased (but you're not).	Being humble: "What do I have wrong?"
Assuming the supplier's motivations and intentions are obvious (and likely nefarious).	Being inquisitive: "Is there another way to explain this?"

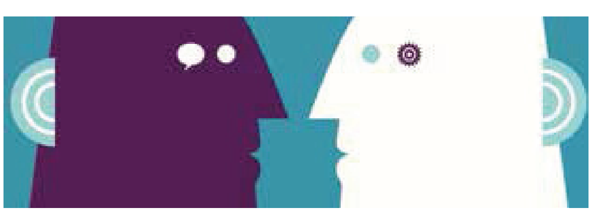
One hallmark of "extreme" negotiations is a feeling of danger that creates pressure to act fast, and thus reduce the level of perceived threat. In the face of this pressure, negotiators often begin acting before they fully assess the situation. They react, quickly, based on a gut feel and initial perceptions. Given the added pressure to look strong and gain (or remain in) control, they tend not to test or revisit their initial assumptions even as the negotiation progresses. As a result, they often negotiate based on incomplete or incorrect information. This often leads to conflict, impasse, or, at best, a resolution that addresses only a part of the problem or opportunity at hand.

A senior sourcing executive for the research division of a major pharmaceutical company approached us a few years ago for assistance with a complicated, high-stakes negotiation. The company had a contract with a single-source supplier that comprised hundreds of millions of dollars in spend. The supplier appeared to have most (if not all) the leverage—and the sourcing team felt that leverage was increasing with every day that brought expiration of the current agreement closer. The supplier was the largest in its industry, and seemed clearly to be the only company with the scale and capabilities necessary to meet the pharmaceutical company's needs. Additionally, through various strategic projects and supply chain initiatives, the supplier had become deeply embedded in the customer's organization, such that switching costs, even if there were an alternate supplier, were deemed to be unacceptably high.

Despite substantial pressure to move quickly and decisively, the sourcing team decided to conduct a series of focus groups with internal stakeholders to identify and prioritize what they would like to see improved under a new contract. To their surprise, the team discovered high levels of dissatisfaction with the incumbent and unexpected openness to considering alternative solutions (both for day-to-day equipment and services, as well as for support on strategic supply chain initiatives underway with the current supplier)—even if that meant a difficult transition period. Moreover, further evaluation of marketplace options indicated that there was another supplier that might be able to provide the full breadth and global scope of services that the company required.

In a significant deviation from their original plan, the sourcing team decided to conduct a non-traditional RFP process—one consisting of a series of workshops with both the incumbent and the potential alternate supplier. During these sessions, they shared information about the company's R&D strategy and key long-term objectives for the category. They also explored the two suppliers' unique capabilities and alternate approaches to meeting the company's needs.

Pursuing this approach initially felt risky to some members of the team. They feared it would signal weakness to both suppliers (particularly the incumbent), by implying too much reliance on external ideas and expertise. They also expressed concern that by sharing more information about the underlying business drivers for the category, and by failing to define highly specified requirements for supplier solutions, they would lose what little leverage they might have. Nonetheless, careful assessment of the strategy's risks and benefits eventually persuaded everyone



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that this was the best course of action.

During this process, the company discovered that not only could the non-incumbent supplier effectively step in and continue supporting several ongoing strategic projects, they had also invested in new technology and capabilities that would enable them to deliver substantial savings and improved service levels as well. After careful "apples-to-oranges" analysis of two very different proposals from the suppliers, and extensive consultations with internal stakeholders and end-users, the company moved the business to the new supplier.

As a result of slowing down, re-evaluating the marketplace, consulting extensively with internal stakeholders, and engaging in collaborative "what if" discussions with both the incumbent and the alternate supplier, the company realized millions of dollars in immediate savings, identified a number of major opportunities to implement innovative solutions, and captured savings over the life of the contract of over 10 percent of total projected spend (compared to a continued relationship with the incumbent).

Strategy 2: Uncover underlying motivations and invite collaboration.

Uncover (often hidden) motivations and concerns; take responsibility for proposing possible solutions; invite the other side to critique or improve on those ideas.

To do this . . .	
Avoid	Instead, try
Asking: "What do you want?" Making unilateral offers: "I'd be willing to…" Simply agreeing to, or refusing, the supplier's demands	Asking questions: "Why is that important to you?" Proposing possible solutions for critique: "Here's a possibility; what might be wrong with this?

Danger (a high level of proximate risk) not only creates a desire to act fast, but also produces a perceived need to look strong and take control. This, in turn, often leads negotiators to quickly put a stake in the ground, and to negotiate primarily by making demands. Unfortunately, this position almost always triggers or exacerbates resistance from the other side. As a result, such an approach tends to produce contentious and inefficient negotiations, running the risk that no agreement will be reached—even when one was possible.

A couple years ago, the CFO and chief procurement officer of a large technology company confronted a difficult negotiation with a sole-source supplier of critical

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components upon which their business was highly dependent. The supplier was demanding a significant price increase—one which the company could ill afford to pay. However, any disruption in supply of these components would have jeopardized production of a flagship product, with potentially devastating revenue implications.

Feeling considerable pressure, the executives decided they could not let the supplier (which had long been seen as arrogant and aggressive in their negotiations) push them around and attempted to take control by making a counter-demand for a price reduction. The supplier refused to even meet to discuss this. The CPO then dashed off an email offering a small price increase and declared the concession to now be a "take it or leave it" offer. As the risk of losing the supplier increased, the posturing became worse. Ultimately, a deal was struck at a number somewhat lower than the supplier had initially demanded, which was considered to be a victory under the circumstances. Unfortunately, the negotiation had never turned to any discussion of why the supplier demanded the price increase in the first place.

Within six months, shipments from the supplier were late and quality issues began to emerge. The executive team assumed, not without reason, that the supplier was not making full, good-faith efforts to deliver on their contractual obligations because they were unhappy with the outcome of the recent negotiation. Almost immediately, the customer began to consider legal recourse. At this juncture, they also contacted us to ask for advice. We suggested that before taking any further action, they simply ask the supplier to explain why these problems were occurring, and offer to jointly explore how to resolve them. To the company's surprise, the supplier responded by being very forthcoming about the fact that they had been experiencing major problems with their suppliers. The supplier also pointed to costly quality control and yield management issues due to certain recent changes in the customer's specifications. While it took several months to fix the quality and delivery problems, they were indeed solved. And in the process, the company's relationship with the supplier significantly improved.

Some of the individuals involved at the company remained bothered by the fact that the supplier had not been more forthcoming from the beginning. Others acknowledged a history at their company of quickly terminating contracts when suppliers encountered difficulties, and pointed out the disincentive this created for suppliers to be open and transparent. A few individuals felt that it was inherently unfair that they had to take the lead in collaborating with a supplier perceived to have a long history of arrogant and even opportunistic behavior. (Not surprisingly, it later turned out the supplier felt the customer was arrogant and aggressive, and saw their own actions primarily as a defensive reaction.) Ultimately though, the business benefits of pursuing a strategy of enlightened self-interest—versus responding in kind to the supplier's (perceived) bad behavior—yielded results that were undeniably far superior to what could have been achieved through any other course of action.

Strategy 3: Focus on fairness to persuade and build buy-in.

Use facts and the principles of fairness (not brute force) to persuade others; arm them with ways to defend their decisions to their constituents; focus on creating useful precedents for future negotiations.

To do this . . .	
Avoid	**Instead, try**
Threats: "You better agree, or else!"	Appeals to fairness: "What ought we to do?"
Arbitrary demands: "I want it because I want it"	Appeals to logic and legitimacy: "I think this makes sense, because…"
Being close-minded: "Under no circumstances will I agree to, or even consider, that proposal"	Considering constituent perspectives: "How could we each explain this agreement to our colleagues?"

Stressful circumstances often produce a temptation to use coercion or threats to achieve objectives—even when reasoned analysis shows that such efforts are unlikely to succeed and may well backfire. Even if such approaches succeed in the short run, they almost always breed resentment and sow the seeds for future conflict. Moreover, even in the short term, a reliance on pressure tactics often triggers a response in kind from counterparts, thus catalyzing a destructive cycle of threat/counter-threat.

We recently advised a major utility on negotiations with a single-source supplier for a large capital construction project. (The supplier was the only one with the capabilities and available resources to deliver the project in the required timeframe.) The supplier demanded a huge upfront payment, before completion of any key milestones. Paying it would have jeopardized the economics of the entire project, but the utility felt like they had no viable alternatives, hence no leverage, and thus no choice but to pay it.

We recommended a very simple strategy. Rather than agreeing to what the supplier was demanding, or refusing the demands, or trying to haggle over the specific number, do the following: simply ask the supplier why they were asking for such a large up-front payment. The sourcing team did so, and was told the payment was needed so that the supplier could place orders with its own suppliers for expensive, long lead-time items. This was a valid explanation in theory, but in practice, the math did not seem to add up. We then conducted our own quick and dirty analysis, and came up with a rough estimate of about 20 percent of what the supplier was demanding.

So the sourcing team went back to the supplier with this analysis and said: "We fully agree in principle that we should cover your costs to purchase equipment you need to deliver this project. That said, here's our estimate of what those costs should be. What are we missing?" The team was careful not to imply in any way that they thought the supplier was being dishonest or unreasonable; part of our strategy was to make it easy for the supplier to back down, without losing face. The supplier asked for a few days to review the numbers. When they came back, they said that the sourcing team's estimate was in fact somewhat low, but that they (the supplier) had based their initial estimate on some past projects that were in fact quite different. So now that they had an opportunity to conduct more detailed analysis, they would be willing to accept the figure the sourcing team had come up with.

Afterwards, the sourcing team expressed surprise that when asked what was behind the demand for upfront payment, the supplier actually gave a reason, rather than simply saying: "That's what we require if you want to engage us for this project." The team was even more astonished that the supplier then agreed to the figure we had come up with. Of course, things might have turned out differently. Sometimes suppliers do act to capitalize on the leverage they may possess to the fullest extent possible (and when they do, there are no silver bullet solutions). In our experience, however, this is quite rare.

Fairness—not only the desire to feel fairly treated, but the desire to be seen as reasonable and fair-dealing by others—is a fundamental human motivation. It is quite difficult, psychologically speaking, for individuals to simply assert a demand and fail to offer a justification for it—especially when asked in a non-threatening way. Even the most aggressive negotiators, if you listen carefully, typically proffer some sort of justification for their demands. When suppliers seem to have all the power, and seem to be taking unreasonable advantage of it, leveraging the potential of fairness to persuade is one of the few strategies available—and it is often surprisingly effective.

Perhaps the most fundamental lesson is that in the very contexts where we feel the most pressure to act quickly and forcefully, it is best to do neither.

Strategy 4: Actively build relationships based on mutual trust and respect.

Deal with relationship issues head-on; make incremental commitments to build trust and encourage cooperation.

To do this . . .	
Avoid	**Instead, try**
Trying to "buy" a good relationship with a supplier by making offers or concessions that are not justified on the merits. Demanding concessions from suppliers to repair breaches of trust (actual or perceived).	Exploring where and why a breakdown in trust may have occurred, and how to remedy it. Requesting (or making) concessions only if they are a legitimate way to compensate for losses incurred due to non-performance or broken commitments. Always treating suppliers with respect, and always acting in a manner that will command theirs.

Negotiators under extreme pressure are often tempted (consciously, or sub-consciously) to leverage a counterpart's desire for a good relationship to extract concessions. However, holding a relationship hostage to extract a better deal usually carries a high long-term price. Such tactics breed resentment and often leave deeper issues unaddressed, which contributes to future problems that could otherwise have been avoided.

Alternatively, high-stakes, high-risk contexts frequently produce a temptation to try to "buy" cooperation. In order to build a relationship, or rebuild trust, many negotiators choose the quick and easy path of attempting to trade resources or make concessions in order to mollify the other side and reach agreement. After all, that's typically what their counterparts are demanding. Unfortunately, making substantive concessions in an effort to buy a good relationship almost never works. Doing so almost always creates a perverse set of expectations and incentives; it invites future extortion, and breeds disrespect or even outright contempt.

Recently, a large multi-national company was renegotiating a half billion-dollar contract with their main IT outsourcing provider. The negotiation was extremely high-profile within the company. The negotiation team was under great pressure to (1) improve service levels and reliability (from unhappy constituents who had recently experienced major outages, and who had come to suspect that the supplier had deliberately made promises they knew they couldn't keep) and (2) cut the overall IT outsourcing budget by at least 15 percent (from executive leaders who were taking heat from Wall Street to improve the bottom line).

Reacting to this pressure, the team informed the supplier that trust had been broken by the recent outages, and that if the supplier wanted to rebuild trust and prove its desire to be a good partner, they needed to grant a 20 percent price concession. Not surprisingly, the supplier pushed back. Yet confronted with an unhappy customer and an important contract renewal, the supplier eventually granted a price decrease very close to the 20 percent demand. At first glance, the negotiation seemed successful from the customer's perspective.

Within a year, however, both the customer and supplier were in trouble. When new quality and performance problems arose—which were quite clearly caused in large part by the customer—there was no foundation for jointly engaging in effective root cause diagnosis and problem-solving. Mistrust and resentment were rampant on both sides. Consequently, neither customer nor supplier was willing or able to listen objectively to the other's concerns or suggestions, no matter how reasonable. Furthermore, the supplier's margins on this account (one of their largest) had been reduced to the point where many of their top people had been re-deployed to other, more profitable accounts. Also, the supplier had put off investing in certain key technology upgrades that would likely have improved performance.

As problems continued to get worse, conflict escalated, and ultimately the customer triggered a clause that led to termination of the agreement—forcing them to go through the pain of finding and negotiating with a new IT outsourcing provider, and managing a costly transition process.

During our facilitation of after-action reviews of this outcome, a consensus emerged among procurement and end-users that the situation might have turned out differently had they invested time and effort in exploring how to work more closely with the supplier—rather than only pushing for an immediate cost-reduction. As a result of lessons learned from this experience, the company fundamentally changed their model for governance of major outsourcing relationships, which until than had been focused largely on the escalation and resolution of problems. The new governance has a dual equal focus: (1) cultivating and maintaining a transparent, collaborative relationship with key service providers and (2) ensuring that a focus on holding suppliers accountable for performance is coupled with openness to looking at the company's own contributions to supplier performance and delivery problems.

Strategy 5: Focus on shaping the negotiation process, not just trying to control the outcome.

To do this . . .	
Avoid	**Instead, try**
Reacting, without deliberate consideration of how any action might advance, or impede, progress toward your objectives. Acting without considering how the supplier is likely to perceive your actions, and how they are likely to respond. Ignoring the future consequences of a given action (later in this negotiation, as well as other subsequent negotiations).	Talking not just about the issues, but about the process: "We seem to be at an impasse; perhaps we should spend some more time exploring our respective objectives and constraints." Slowing down the pace of negotiations: "I'm not ready to agree, and I'd prefer not to walk away either. I think the issues warrant further exploration." Issuing warning, without making threats: "Unless you are willing to work with me to search out a mutually acceptable outcome, I cannot afford to spend more time negotiating."

Consciously change the game by not reacting to the other side; deliberately take steps to shape the negotiation process as well as the outcome.

Threatening circumstances produce a strong desire to avoid harm. This, in turn, short-circuits strategic thinking, and often leads negotiators to give in on critical issues to avoid or minimize immediate threats. The result, unfortunately, is often an agreement that creates substantial future risk exposure.

Several years ago, the president of a leading technology company's largest division committed to enter into a new market. His sourcing team led a market scan and evaluation process that identified a supplier with unique, cutting-edge technology to work with on new product offerings. Unfortunately, the potential alliance with this supplier was announced before the agreement was fully negotiated, and expectations within the company and among the analyst community quickly grew. As the negotiation entered into its final phases, the prospective supplier demanded a substantial increase in NRE (non-recurring engineering) payments, revenue-sharing from new, jointly developed products, and a minority investment in their company.

The senior executive and the sourcing team supporting him were caught by surprise, but time was now of the essence. They had not expected to be confronted with such demands, and thus were unprepared to respond. Rather than seeking to slow down the pace of the negotiation, the sourcing team responded by quickly telling the supplier that their demands were unreasonable and would never be accepted. The prospective supplier then threatened to walk away from the deal. Fearful that the potential relationship (and his new growth strategy) were in jeopardy, the executive stepped in and accepted the proposed terms "as is."

Two years later, tens of millions of dollars had been paid to the supplier, new product development was way behind schedule, and the company found itself with little recourse. In retrospect, it may seem obvious that the consequences of a bad deal were more costly than the risk of delay in getting the original agreement signed. But the risk of the supplier walking away (and of needing to start the process over) was also very significant.

A better planned negotiation process, designed to minimize the time pressures that the division president and the sourcing team found themselves under, would have helped (and was eventually adopted). Similarly, more robust preparation would have reduced the risk of not anticipating supplier demands that came late in the negotiation process. Finally, a less reactive and aggressive response to the supplier's demands would have uncovered that the supplier was motivated not primarily by opportunism (as we later learned). Instead, the supplier's engineering department had completed a last-minute risk assessment. Their negotiation team, not being highly experienced or skillful, thought they had the leverage to simply demand greater protection, rather than jointly and collaboratively negotiate with the customer over how to structure an optimal agreement in light of new concerns.

EXHIBIT 1

Two Perspectives on Negotiations with Suppliers

A Tactical View of Negotiations	A Strategic View of Negotiations
• Negotiation is an event	• Negotiation is a process
• Negotiated results are determined primarily by market dynamics and skillful bargaining "at the negotiation table"	• Negotiated results can be significantly affected by strategic positioning and robust preparation
• Negotiation requires making a choice (or striking a balance) between, a "hard" or a "soft" approach	• It is possible to negotiate assertively without being adversarial, and to be collaborative without being naïve
• The goal of negotiations is to get the deal signed and secure the most favorable contract terms	• The goal of negotiation is to enable maximum value to be realized from interactions with suppliers over time
• Negotiations end once a supplier contract is signed	• Formal contract negotiations are the first of many "negotiations" with a supplier
• Contract negotiations have little impact on the ongoing relationship with a supplier	• Contract negotiations lay the foundation (for better or for worse) for interactions that follow

Source: Vantage Partners LLC

Slow Down, Collaborate

At core, perhaps the most fundamental lessons when negotiating in high-stakes, high-risk ("extreme") situations is that in the very contexts where we feel the most pressure to act quickly and forcefully, it is best to do neither. In the absence of traditional forms of leverage that many procurement professionals are accustomed to relying on, extreme negotiations are best approached by slowing down the pace of the negotiation, diligently seeking an unbiased understanding of one's counterparts (even at the risk you might begin to empathize or even partially agree with their positions!), and actively trying to lead them into a more collaborative negotiation process.

Often, this approach is dismissed as a "soft" or even naïve way to negotiate with suppliers. But successful negotiators know that it is quite possible to be assertive, without being adversarial, and to be collaborative without being taken advantage of. The strategies in this article are about being strategic rather than reactive; thinking several moves ahead about how your actions in a negotiation are likely to be perceived by the other side; and making deliberate choices that elicit constructive responses and help move the negotiation toward achievement of your ultimate objectives. (*Exhibit 1 sums up the perspective needed for this approach, contrasting it with the conventional, more tactical view.*) It is up to sourcing and supply chain executives to create an organizational climate in which their negotiation teams are encouraged and equipped to engage successfully in such inherently challenging negotiations.