

# NegotiAuctions

By

Stephen McHenry

# Topics

- Negotiations
- Auctions
- NegotiAuctions

# Cable & Wireless America

- Stalking Horse bid - \$125M

- Jan 21<sup>st</sup> 2004, 10AM

- 7 bidders

- Jan 22<sup>nd</sup>

- “early hours” - \$64.7M

- 7:15AM - \$66.2M

- What Now?

# Cable & Wireless America

- Survivor Rounds
  - Low bid is eliminated
  - \$70M...
  - \$80M
  - \$100M
  - \$120M
  - At \$143M – two bidders left
    - Savvis Communications
    - Gores Technology

# Cable & Wireless America

- And, the winner is...
  - Savvis - \$164.8M
- Are you – Unhappy? Satisfied? Happy?

# Cable & Wireless America

- Savvis
  - Sold 5 CWA Data Centers to DuPont Fabros
    - Savvis received \$52M & took a 15 year leaseback
  - Stock went up 33% on announcement (\$85M)
  - Estimated value to Savvis - \$250M

# Cable & Wireless America

- Savvis
  - Previously, 2 customers – 73% of revenues
    - Reuters & Moneyline Telerate
    - Unable to get financing for expansion
  - After deal – 450 customers
    - Reuters/Telerate was 15% of revenues
  - 3 years later – Phil Koen (CEO)
    - Recreating CWA assets would have cost “multi-billion” dollars

# Staples

- First round – VC financing
- Beat early sales targets by 50%
- New competitors – needed expansion capital
- VCs closed ranks – poor valuation, more equity

*What now?*

- Goldman Sachs – investment bank
  - Same story



# Staples (cont'd)

- Sought advice
  - Go directly to pension funds and insurance companies (the limited partners at VC firms)
    - They get 20% higher return (no VC mgmt fees)
- High-net-worth Individuals
- Worsened VC no-deal options
  - Returned to the table – on his terms

# PMA vs. ILWU

- 1999
  - PMA wanted technological improvements
  - ILWU struck - \$6B/wk stopped
  - PMA gave in
- 2002
  - Replaced weak members with strong ones
  - Lobbied Commerce, Treasury, Transportation, DHS
  - Message to media and public
  - Union slowdown → Port Lockout
  - Bush invokes Taft-Hartley → orders ILWU back to work
  - Tom Ridge (DHS) called them “Economic Terrorists”

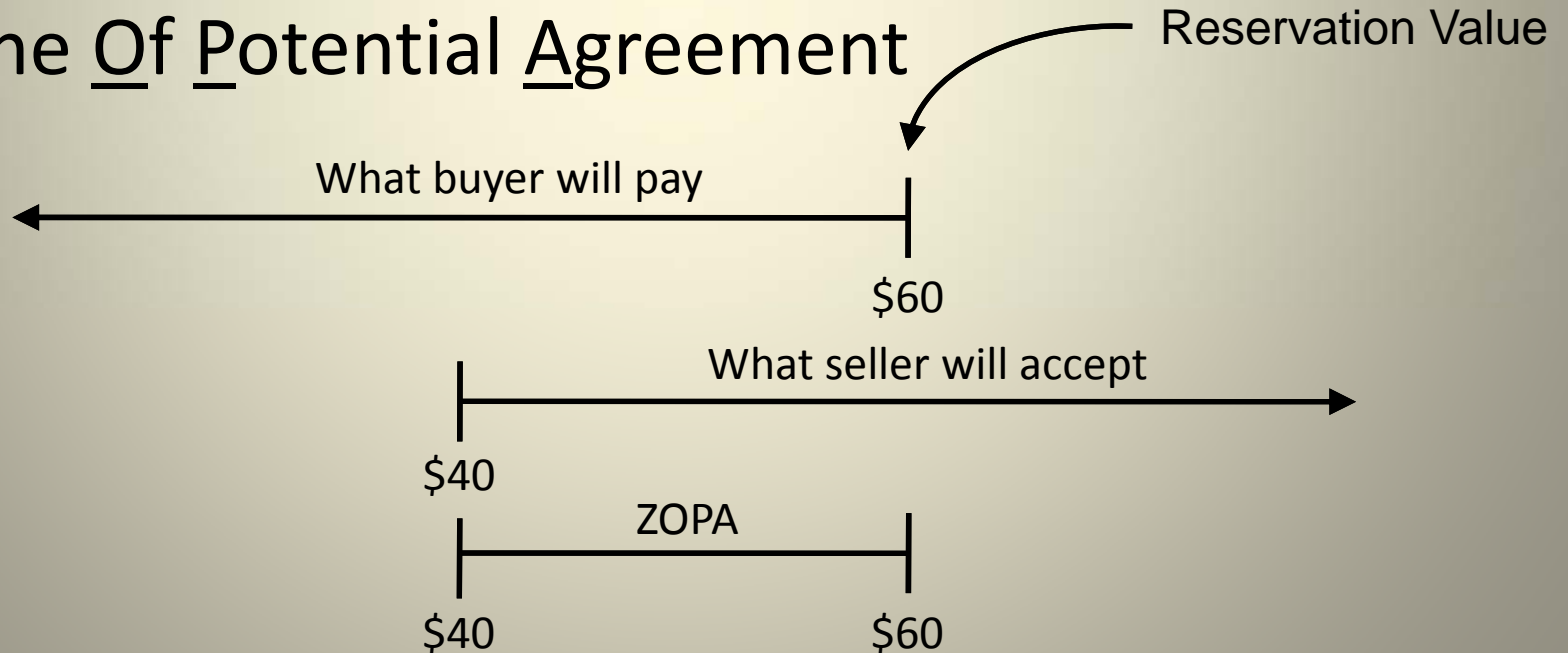
# Two Important Definitions

BATNA

Best Alternative To a Negotiated Agreement

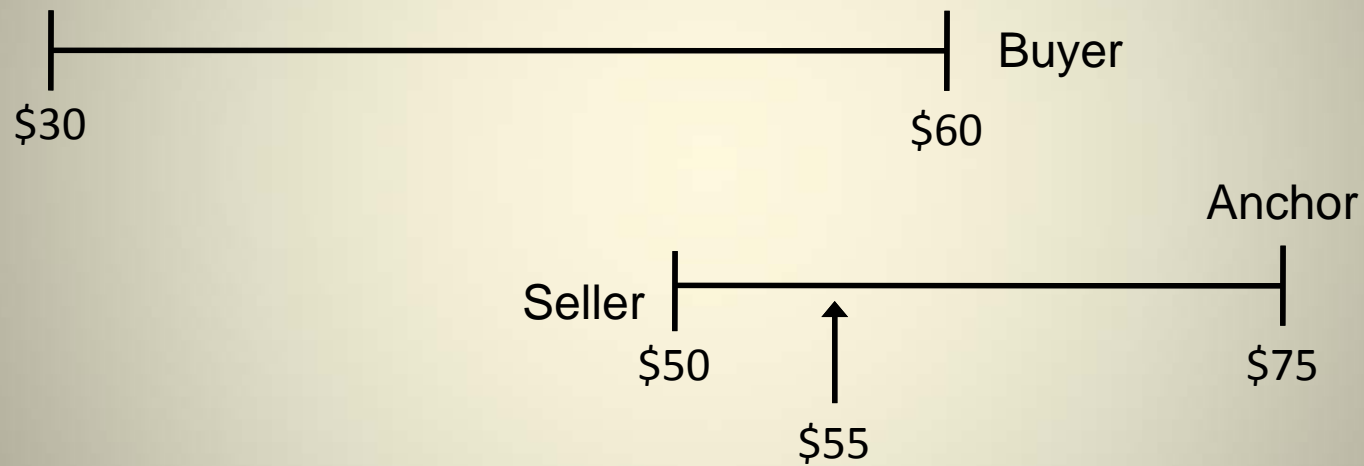
ZOPA

Zone Of Potential Agreement

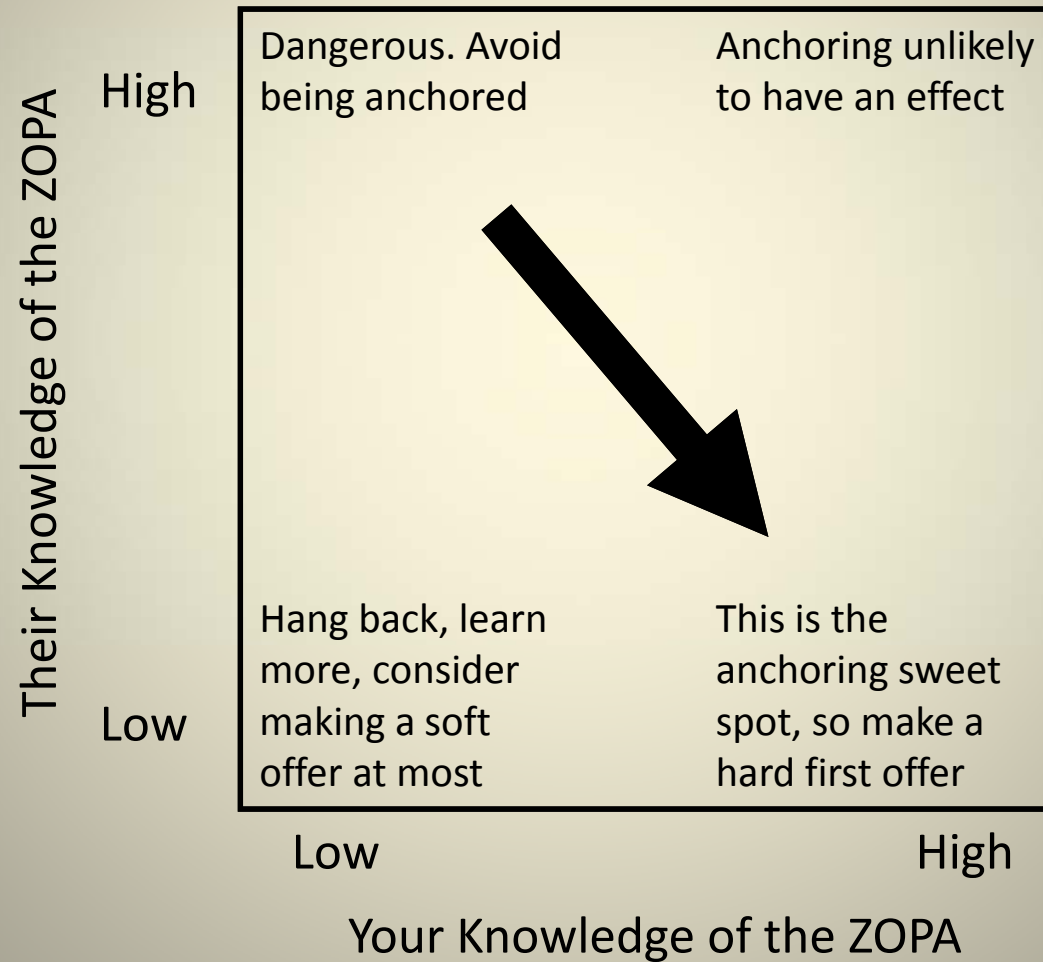


# Anchoring

Making an initial offer



# Anchoring

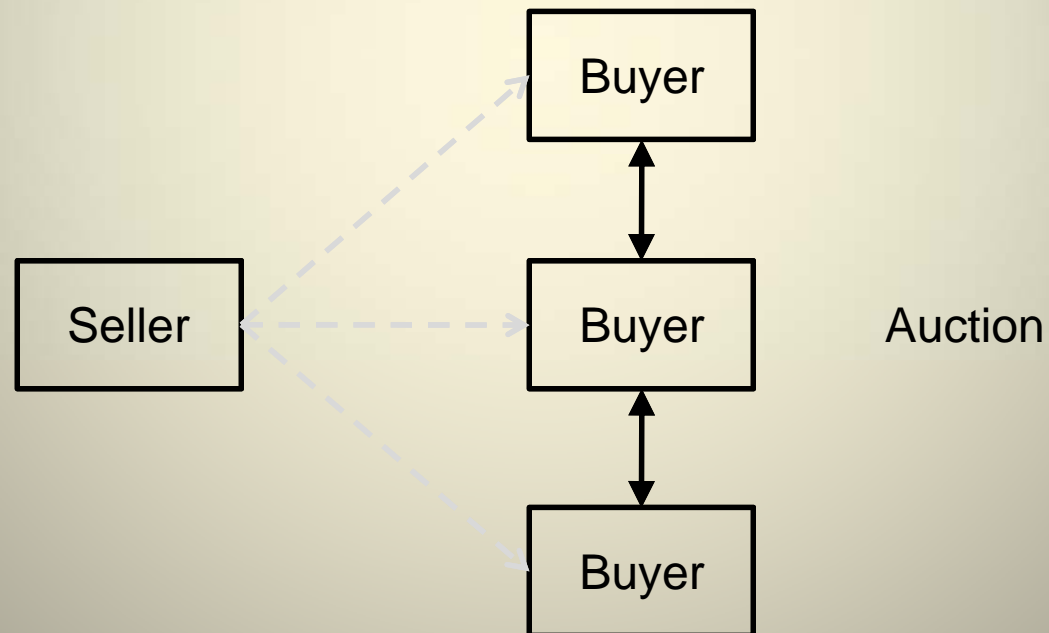
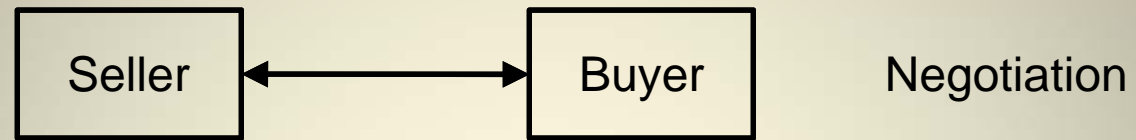


# Definitions

An ***auction*** is a mechanism in which the seller is a passive participant after the process has been set, and the primary source of competitive pressure arises from the competition among buyers.

A ***negotiation*** is a mechanism in which the primary source of competitive pressure arises in across-the-table dynamics between buyer and seller.

# Dynamics



# Auction or Negotiate

- Profile of potential bidders
  - Number of bidders



- Certainty about who the bidders are
- Bidders' incentive to participate
- Distribution of valuations



# Auction or Negotiate

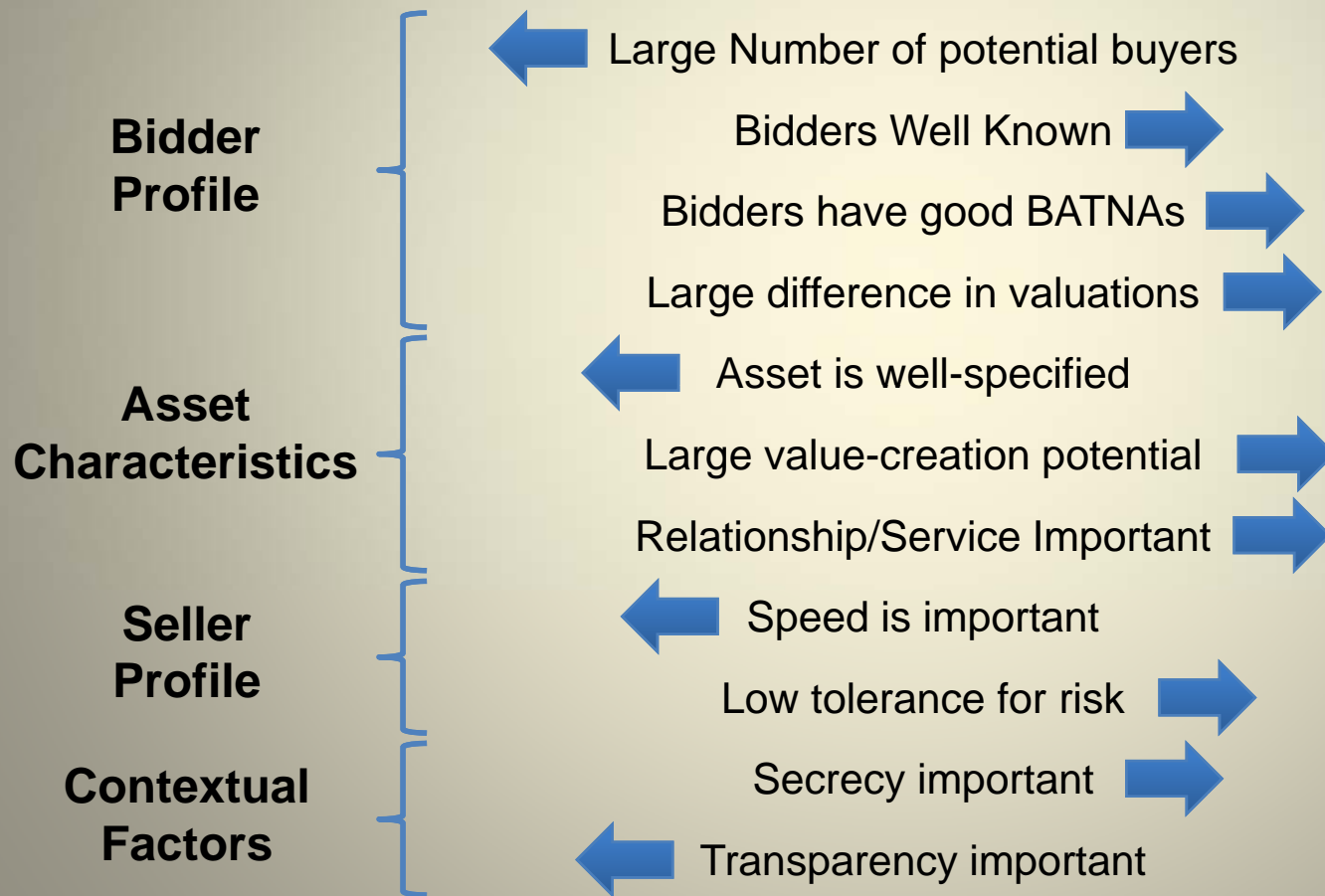
- Asset Characteristics
  - Ability to specify the asset
  - Potential for value creation
  - Importance of relationship
- Seller Profile
  - Importance of Speed
  - Tolerance for Risk

# Auction or Negotiate

- Contextual Factors
  - Need for secrecy
  - Importance of transparency

# BASC Framework

Auction ←————→ Negotiate



# **NEGOTIATIONS**

# Negotiations

- Setup the Right Negotiation
- Design Value Creating Deals
- At The Table

**SET UP THE RIGHT NEGOTIATION**

# Get The Parties Right

- Highest value players
- Potentially influential players
- Those involved in internal decision-making / governance
- Agents / representative with wrong incentives
- Those who must approve the deal
- Those who must implement the deal
- Are there too many parties?

# Get All The Interests Right

- Make mapping interests a central priority, early and often
  - Your interests
  - Their interests
- Two mistakes to avoid
  - Letting price bulldoze a potentially richer set of interests
  - Mistaking bargaining positions for a fuller set of richer interests



# Get All The Interests Right

- Mistake - Focusing on price instead of:
  - Relationships
  - The Social Contract
  - The Negotiation Process Itself
  - Ethics

# Get All The Interests Right

- Mistaking bargaining positions for a fuller set of richer interests
  - Ask, listen, probe
  - Use public sources to map interests
  - Tap internal sources
  - Tap knowledgeable advisors
- Psychological traps to avoid
  - Mythical “fixed-pie”
  - Self-serving role bias
  - Partisan perceptions

# Get the No-Deal Options Right

- A Tale of Two Car Buyers
- Examine best no-deal options of all parties
- Make sure other side sees you as willing to walk away
- Protect (and don't weaken) your no-deal options
- Consider worsening your no-deal options very carefully
- Assessment of no-deal options in determining whether there is a role for negotiations

# Get the Sequence/Process Choices Right

- Get the Sequence right
  - Scan widely to map the range of potential parties as well as relationships among them
  - Map backward from target (more promising) game to the current (less promising) situation
  - *Who is most difficult to get on board?*
  - *What prior agreement among which other players would maximize chances of getting target to **yes**?*
  - *Repeat for next hardest, etc.*

# Get the Sequence/Process Choices Right

- Basic Process Choices

- Decide, Announce, Defend
- Full Consensus

- Other Choices

- Auspices
- Mandate
- Participation
- Decision Rules and Procedures
- Agenda
- Staging of Process
- External Communication
- Process Support
- Postdeal Arrangements

**DESIGN VALUE CREATING DEALS**

# Deal Design Principles

- Dovetail differences to create value
- Maximize the total net pie

# Negotiator's Dilemma

		Bob's Choice			
		Create	Claim		
John's Choice	Create	Good	Great	Bob's Payoff	John's Payoff
	Claim	Terrible	Mediocre		



# Deal Probability

Bob's Choice

Create

Claim

		Bob's Choice	
		Create	Claim
John's Choice	Create	<div>Good</div> <div>[likely]</div> <div>Good</div>	<div>Great</div> <div>[unlikely]</div> <div>Terrible</div>
	Claim	<div>Terrible</div> <div>[unlikely]</div> <div>Great</div>	<div>Mediocre</div> <div>[possible]</div> <div>Mediocre</div>

Bob's Payoff	
John's Payoff	

# Dovetailing Differences

- Forecasts (or beliefs about the future)
  - Contingent agreements w/ incentives
- Risk
  - Reflect risk in price
  - Allocate risk (and higher return) to one party
- Time
  - Vary percentage over time
  - Lump sum payment vs. spread out over time
- Other Areas
  - Tax Status
  - Expertise

# Making Lasting Deals

- Anticipate
  - Buyouts or exits
  - Shifts in attitudes
  - External shocks and their effects on attitudes
- Multiplex agreements to protect against likely vulnerabilities
- Make insecure contracts secure
  - Recognize structural characteristics that tend to make them insecure
  - Make anticipatory moves to set up more favorable situation

# Negotiate the Spirit of the Deal

- Social Contract – expectations held by two or more negotiating parties about their agreement
  - Underlying social contract (what)
    - Discrete transactions or real partnership
    - Acquisition or merger of equals
    - Culture: Operational, Marketing, Engineering, Research
  - Ongoing social contract (how)
    - Decisions
    - Unforeseen events
    - Communication
    - Dispute resolution

# Audit the Social Contract

- Consultation
  - How fully, about what, with whom, how formally, how frequently
- Decision Making
  - Consensus/Majority, Informally/Formally, what parties at what levels
- Dispute Resolution (beyond contract)
  - Informal discussion, Mediation, Binding Arbitration, Court
- Reevaluation and Renegotiation
  - Triggers
  - Expectations

# Social Contract – Misperceptions

- Primarily about the working relationship
- Implies a relationship that is cooperative, democratic and/or participatory
- Implies a shared view
- Can be spelled out in an agreement

**AT THE TABLE**

# Shaping Perceptions

- Preparing for a Price Deal
  - Is it really a price deal?
  - Address Twin Tasks
    - Learn about the true ZOPA
    - Shape your counterpart's ZOPA perceptions to your advantage



# Price

- Set an ambitious target price
- Should you make first offer?
- The Anchoring Effect
  - Justify your proposal
  - Use flexible but extreme offers and “non-offers” to anchor
  - Recognize and use the norm of reciprocity
  - Couple anchoring and use of contrast principle

# Responding to Their Offer

- The Midpoint Rule
- Responding to an extreme offer
  - Rule them out firmly and clearly
  - Shift to something else
    - Earnings multiple → Discounted Cash Flow

# Moving Towards Closure

- One side is convinced that the other side is not going to move further
- One side or the other is not comfortable using tactics that would induce further concessions
- Both sides agree – implies an outcome in the ZOPA

# Convergence

- Use converging concessions creatively
- Use the reciprocity principle in the concession process
- Avoid unsupported commitments – consider making supported commitments
  - Reference other contracts, MFN status
- Responding to commitments
  - Contract is \$600K; Buyer can't go above \$500K
  - Break into two \$300K deals
  - Clarify nature of the problem
  - Treat as aspiration, refusing to “hear” it as commitment

# Constructive Negotiation

- Reconciling the parties' real interests rather than battling over positions
- The future and mutual possibilities, rather than the past and who was right/wrong/to blame for it
- Factual discussions, rather than broad generalizations
- Joint problem solving, rather than adversarial positioning

# Tactical Advice

- Ask, Listen and Learn
  - Try active listening
  - Avoid questions that have a yes or no answer
  - Ask open-ended questions
  - Bring a designated listener
- Divulge Information Strategically
  - Begin with the end
  - Use norm of reciprocity to build trust and share/gain information
  - Present multiple equivalent offers
  - Sequence issues carefully and negotiate packages

# Tactical Advice (cont'd)

- Foster an Appealing and Productive Negotiation Process
  - Positional → Interest-based
  - Blaming & past actions → Problem solving & future
  - High-level assertions → Fact-based statements
  - Price haggling → Joint problem-solving

# Tactical Advice (cont'd)

- Adopt a Persuasive Style
  - Understand their story
  - Be open to persuasion
  - Be both empathetic and assertive
  - Frame proposals in terms of what they care about
  - Seek arguments that feel fair to both sides
  - Persuade with stories, as well as analysis
  - Inoculate against potentially disadvantageous arguments



# Tactical Advice (cont'd)

- Adopt a Persuasive Style (cont'd)
  - Build both substantive and relationship credibility
  - Match you appeal to where the other side is
  - Respond to the emotion when your counterpart displays emotion
  - Deal with your feelings too
  - Make your appeal work through their cultural filters

# **AUCTIONS**

# Choosing the Auction Type

- Open Outcry or Sealed Bid
  - Number of Potential Bidders
  - Affiliation of Bidder Signals
  - Bidder Risk Aversion
  - Bidder Collusion

# Sealed Bid vs. Open Outcry

Sealed Bid ←————→ Open Outcry

← Small Number of Potential Bidders

Affiliated Signals →

← Bidders are Risk Averse

← Bidders Might Collude

# Auction – Design Choices

- Open Outcry
  - English / Reverse English / Dutch / Japanese
  - Minimum Bid / Increment
  - Changing Minimum Bid Increment
- Sealed Bid
  - First Price / Second Price
  - Number of Rounds
  - Indicative Round followed by Binding Round

# Process Taker Role

- Before you enter:
  - Consider all costs and benefits in setting your reservation value
- Losing the auction could leave loser worse than status quo
- Known as “All Pay” Auctions

# All Pay

- Example
  - Auction of supplier to its two customers
    - Winner is stronger competitor
    - Loser suffers full market share loss
  - What about 10 bidders instead of two?

# Competitive Arousal

- Irrational unwillingness to lose to a competitor causing temptation to bid more
- Example:
  - VP who continued bidding well below previously calculated reservation value.
  - Lost the auction
  - Said he would have bid even lower, if he'd known other bidder was biggest competitor



# Winner's Curse

- Feeling that you overpaid
  - More typical in sealed bid
- Counterexample
  - Having “edge” based on expertise
    - Right to drill – estimate \$3M of reserves
      - Exxon-Mobil bids \$2.0M
      - Bob's Oil & Gas bids \$1.5M
  - Private value
    - Exxon-Mobil owns adjacent lands

# Open Outcry

- Should update reservation value
- Less knowledgeable bidders get free ride
- Beware: Competitive Arousal
  - Intense rivalry among bidders
  - Time pressure
  - Presence of an audience
- Write down your reservation value

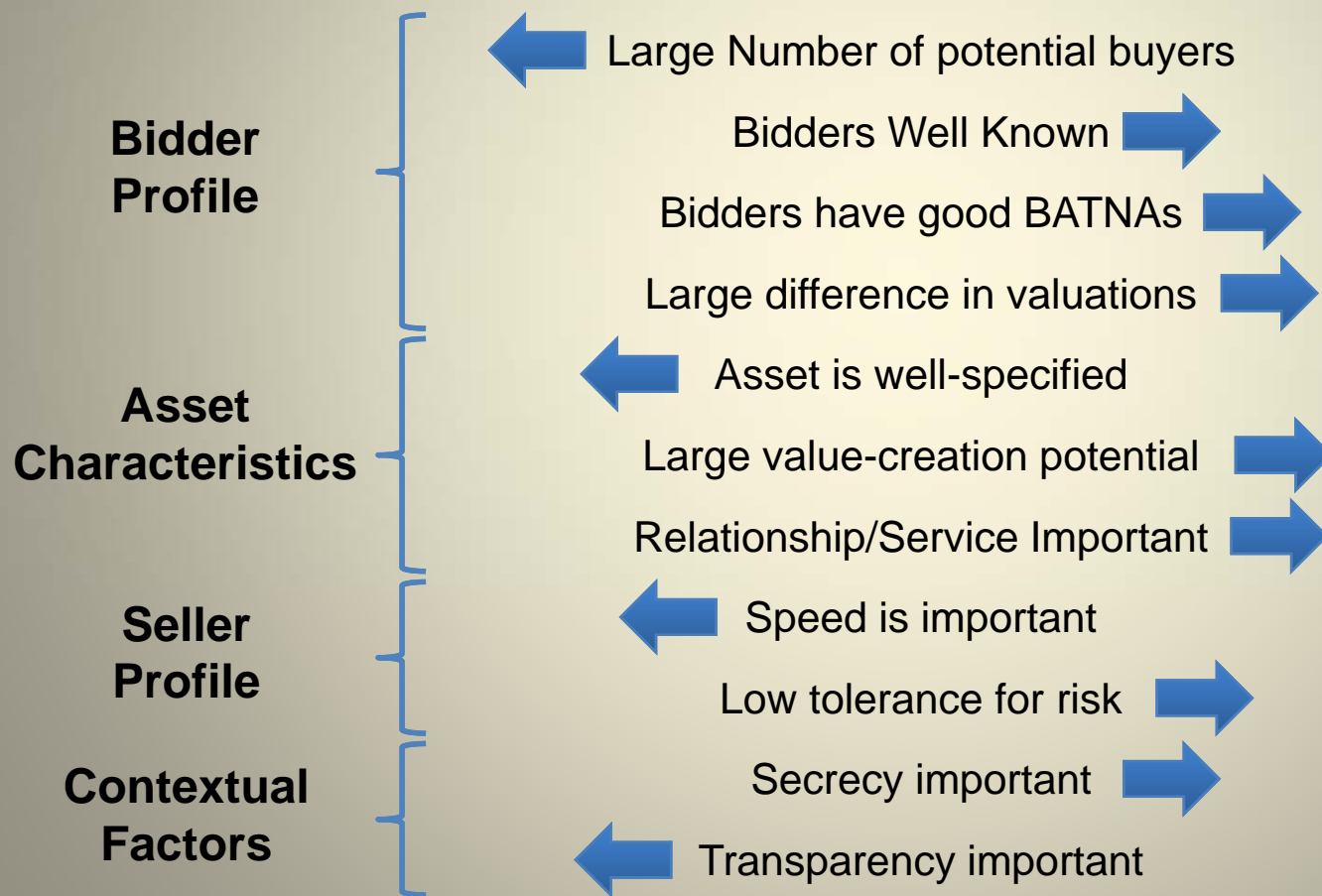
# **NEGOTIAUCTIONS**

# What is Negotiauction?

- Several potential buyers (3-10)
- Asymmetric information
- Ambiguity around traditional process-setter / process-taker roles
- One-on-one meetings that resemble standard negotiations
- One or more rounds of bidding and other forms of direct competition among buyers that resemble auctions

# Process Setter (BASC Framework)

Auction ←————→ Negotiate



# Process Taker

- Changing The Game
  - Setup Moves
  - Rearranging Moves
  - Shut-down Moves

# **SETUP MOVES**

# Setup Moves

- House on Martha's Vineyard
  - List \$1.395M; Offer \$1.28M
  - Another Buyer – full price

*What now?*

- They bid full price - \$1.395M
- Agreed to participate in bidding



# Setup Moves

- House on Martha's Vineyard
  - Their bid - \$1.484M – sealed envelope
  - Conditions to *their* broker
    - May submit to other broker if:
      - Other buyer has in fact submitted a new offer with a precise dollar figure
      - Other broker assures that this is the final round and seller will accept best offer by 3PM

*What happened?*

# Setup Moves

- Agree to play only if this is best and final round
- Tried to get identity of other buyer (no luck)
- Only delivered if other buyer bid again
- Precise dollar figure
- Only allow opening of bid if setup conditions were satisfied

# Other Setup Moves

- Exclusivity
- Acceptance within timeframe
- Acceptance by others
- Reimbursement of expenses
- Additional reimbursement if offer is not accepted

# Setup Moves

- Generally require acceptance by process setter
  - Must (generally) be better than setter's perceived BATNA
  - If not, will protect against entanglement in situation where winning is impossible (e.g., pay to play)

# **REARRANGING MOVES**

# ABN AMRO Deal

- ABN AMRO announced exclusive merger discussions with Barclay's
- Two other banks interested
  - RBS – wanted American operations
  - Banco Santander would take the rest
- Problem – Dutch Authorities
  - Enter third bank – Fortis (Dutch)

# ABN AMRO – The Plan

- Create RBS Holdings
  - 38.3% RBS, 33.8% Fortis, 27.9% Santander
  - Make tender offer
- ABN AMRO
  - carved out US subsidiary – LaSalle Bank & sold to BofA (\$21B)
  - Announced Barclay's deal at \$91B

# ABN AMRO – The Result

- RBS Holdings Offer
  - 38.40/share 90% in cash
- Barclay's response
  - 35.73 – 1/3 cash, remainder in Barclay's stock
- Result
  - Sent to shareholders
  - 86% accepted RBS bid



# Book Publishng

- Feb 1993
  - James Carville (Clinton) & Mary Matalin (Bush)
  - Joint memoirs – “Hepburn & Tracy” of DC Politics
- Robert Barnett – auctioner
- Chance encounter
  - Richard Snyder (Simon & Schuster)
  - Harold Evans (Random House)
- “Like Hatfields & McCoys publishing Montagues and Capulets”

# Toys R Us

- March 2005 – Retrained Credit Suisse to sell Co.
- Notable – Toys owned the real estate of stores
- 29 buyers contacted → 9 preliminary bids
- Narrowed to 4 Private Equity firms
  - Cerberus; Apollo; Kohlberg, Kravis & Roberts (KKR); Bain Capital/Vornado

# Toys R Us

- Entering Best-and-Final, KKR would only bid if they could partner w/ Bain/Vornado
  - Vornado – real estate expertise
  - KKR & Bain – operational skill & financing ability
- Apollo - \$24-26/share
- Cerberus - \$25.25/share
- Bain/Vornado/KKR - \$26.75/share

# Neiman Marcus

- Retained Goldman Sachs to sell company
- 32 bidders contacted → 8 preliminary bids
- Before final few rounds, bankers grouped bidders into teams of two
  - KKR & Thomas H Lee
  - Warburg Pincus & Texas Pacific Group
  - Blackstone Group & Bain Capital
- Warburg Pincus/TPG paid \$100/share (\$5.1B)

# Information Flow

- Process setter wants to control rearranging moves to maximize value of deal
- Goal – create equally matched teams
- If strong bidders are known
  - Control information flow that might allow collusion
- If not
  - Allow communication and let bidders discover moves

# **SHUT-DOWN MOVES**

# Car Purchase

- Auction (Busted)
- Negotiation
- Final price
- Shut-down move

*Shut-down move* cuts off same side of the table competition

# Sale of Two Companies

- New Yorker Sale
  - Wasserstein
    - “Flew under radar” for entire process
    - Last minute “pop-up” bid
    - Contingent on acceptance – no more bids
- RJR Nabisco
  - CEO-led group appeared to be in control
  - Suddenly, a bid from nowhere – shuts down negotiations

(Stealth bidder? Henry Kravis (KKR) & Wasserstein)



# Keys to Success

- Must be better than process-setter's BATNA
  - CWA
    - \$80M at start of auction
    - \$80M at 6AM following morning
- Must not be “just another bid”
  - Needs a “threat”
  - Else, will be used to extract more from other bidders

# HUB International

- Apax refused to participate in the auction process
- At end of meeting, announced they would present offer in 10 days – subject to:
  - Due diligence
  - No additional solicitations

# Degrees of Shutdown

- Complete shutdown
- Dampen same-side-of-table competition
  - Toys R Us
    - KKR/B/V – deal protection of \$247.5M (4% of value)
    - Plus 3 day waiting period where Toys board had to “negotiate in good faith with [KKR Club] to make adjustments ... such that [outside] acquisition proposal would no longer constitute a superior proposal”
    - Full breakup fee if more than half of assets sold to another buyer (Babies R Us)

# Residential Real Estate (Opening Up Moves)

- Buyers give up exclusivity (in contract) in exchange for \$50K breakup fee
- Not common
  - Tradition – Legal Contracts
  - Agent incentive – higher price
- In UK – sellers continue to take offers from other buyers - called *Gazumping*
- Also *Gazundering* – buyers seeking last minute reductions in price, just before closing

# Questions