



Industry
Canada

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Key Investor Readiness Skills

MODULE 3: Improve Your Negotiation Skills



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3.1 Improve Your Negotiation Skills: Introduction

Do you have what it takes to be a successful negotiator? During negotiations the investor will be looking for certain rates of return, exit strategies and other conditions based on how he or she values the potential of your opportunity. At the same time, you'll be looking for certain terms and conditions that you need to maintain control of your business.

Because you and the investor will have different points of view, skirmishes are likely to occur during negotiations. But if you deal effectively with these differences you can influence the results of the negotiation to get what you want and reach an agreement that's mutually beneficial to you and the investor.

There are a number of outcomes that could occur as a result of negotiations. Depending on how you address the negotiations, you will reach one of the following outcomes.

Win-Win. Both parties achieve their goals and are satisfied with the outcome. For example, both you and the investor are happy with the terms of the negotiation contract.

Win-Lose. One party achieves the goal at the expense of the other party. For example, the investor is happy with the terms of the contract, but you believe the investor will have too much control of your business.

Lose-Lose. Both parties are dissatisfied with the terms of the negotiated contract. For example, you feel that the investor is demanding too high a return, and the investor feels that your valuation of your goodwill is exaggerated. The two of you cannot agree on these points, but they are the only items that are preventing you from signing the deal, so you leave them in and close the deal.

As you want to build a long, prosperous relationship with the investor, you should aim for a win-win agreement so that both parties feel that their needs have been met.

In This Module

You will focus on tips that will refine your negotiation skills and learn to address conflict in a constructive way.

- Become a Better Negotiator
- Use Conflict to Your Advantage
- Understand Conflict Resolution Styles
- Use a Structured Approach
- Capabilities Check

The New Tech Story

Follow the fictional company New Tech Distributors Corp. (New Tech) as it pursues venture financing. This case example gives you a feeling for the "real" data and strategic decisions you'll be facing.

3.2 Become a Better Negotiator

The essence of negotiation is dealing with differences between two or more parties. The final result of any negotiation must be an agreement. This can be a mutually beneficial solution, an agreement to disagree or something in between. Both parties must deal with the differences at hand; these differences must be communicated with understanding of the other's points of view and with a logical, open-minded approach to conflict resolution.

Typically a successful negotiator is a strong communicator. It's someone who's willing to do whatever it takes to build a positive business relationship. It's someone who's prepared to make compromises to achieve a larger, more creative and mutually agreeable goal.

- Focus on Building a Healthy Business Relationship
- Communicate Effectively
- Handle Conflict Effectively
- Be Flexible and Creative
- Understand Power and Use It Effectively
- Disclose Information Effectively
- Approach Negotiations Logically

Focus on Building a Healthy Business Relationship

Focusing on a positive healthy business relationship helps you work toward a win-win agreement. By knowing that you're in it for the long haul, you may want to be more flexible, open and understanding. You should listen more effectively, seek to understand the investor's viewpoints and adopt approaches that are conducive to a win-win agreement.

Consider adopting some of the following approaches.

- Use positive negotiation tactics.
- Clarify expectations.
- Separate people from the issues.
- Focus on interests.
- Create solutions that are beneficial to both.
- Use common ways to calculate financial and market projections.

Communicate Effectively

Communication is probably one of the most important elements of the negotiation process. It helps you build trust, ease tension and understand the investor.

Here are some useful tips that will help you communicate better.

- Encourage dialogue.
- Use your voice effectively.
- Deal with non-verbals.
- Listen effectively.
- Get your point across in writing.

Sometimes you need to put yourself in the other person's shoes. By trying to see things from the other's perspective, you'll gain an awareness of what issues are important to the other person and why.

Handle Conflict Effectively

Conflict will inevitably be part of the negotiation process as you and the investor have different points of view, goals and interests. To reach a win-win agreement, you need to address conflict in a constructive way.

Being patient, handling stress and controlling your emotions are essential to successful negotiations. You should have a high tolerance for frustration and take whatever time is necessary to reach an agreement. Long negotiations, tedious processes, conflict and unexpected events will increase your stress level. Keep your emotions under control. It's healthy to express how you feel, but don't let your emotions cloud your judgment or negatively affect your business relationship with the investor.

Be Flexible and Creative

You should seek creative alternatives that benefit both the investor and you. If you reach a roadblock, think "what else?" and you may be able to unleash previously unexplored possibilities. Be flexible; don't reject the investor's alternatives too quickly. Avoid the desire to get everything and never give in. Admit that you don't know something or that you were wrong. More specifically, the investor's response to your investment proposal and your response to the term sheet are the first negotiation step. Use the term sheet as a guide, not a step-by-step list over which to haggle.

Understand Power and Use It Effectively

Even though you might perceive investors as powerful because they control the financing, you also have power. Power can come from a variety of sources, such as:

- having a second-best option if you can't reach a deal with the investor;
- seeking to establish a two-way communication;
- respecting the investor;
- probing for the reasons behind the investor's position;
- looking for alternatives that benefit you both; and
- using an agreed upon method for assessing the value of the investment proposal's elements.

Don't place too much emphasis on only one or two of those sources of power. You should strive to have a good balance of each.

Disclose Information Effectively

When and how information is disclosed can make a difference in the results of a negotiation. Essentially there are two main approaches to disclosing information.

Blurring It All out Reduces Your Credibility

The first approach consists of telling everything without any interaction or pauses. The fact that you're providing so much information when the investor spent little effort asking for it might seem suspicious and reduce the credibility of your information.

Disclosing Bit by Bit Increases Your Credibility

The second approach involves more interaction with the investor. In fact, you disclose information a few bits at a time. Because investors sense that they control the flow of the information, they may be more confident about the reliability of the information.

Disclosure should be a two-way, not a one-way, process.

Be open to pauses in the conversation or silences.

Approach Negotiations Logically

Every issue needs to be discussed. There are two basic approaches you may choose to take.

The first approach consists of addressing the easy points first to build momentum. It's usually easier to start the negotiations by reaching an agreement on minor issues.

The second approach consists of going over issues that are more important to both parties and then using minor issues to sweeten the deal. If you decide to use this approach, be aware of the way you present the issues on which you strongly disagree. In this case it may be appropriate to start by going over past meetings, conversations, resolutions and submitted documents. This would serve to bring the proceedings up to the present. It would also enable you and the investor to explain the situation with your respective perspectives and express how you feel about them.

For more information, see the *Do's and Don'ts of Negotiation* in the Appendix.

3.3 Use Conflict to Your Advantage

Conflict that isn't handled effectively is one of the biggest deal breakers within the investment process. During negotiations, parties have different facts (e.g. one party is holding back information from the other), different goals (e.g. both parties seek competing outcomes for exit strategies) or even different values (the investor wants more control of the business than the entrepreneur is willing to give up). This combination often results in conflict.

Conflict is an essential, healthy part of the investment process. You can prepare for it and use it to your advantage to prove your ability as a competent businessperson and to ensure that the investor is someone you want as a partner.

Resolving Conflict Can Make You Look Good

Some conflict will be dealt with quickly and easily. By solving problems during negotiations, you'll have proved your creativity and communication skills, as well as your ability to develop mutually agreeable business relationships. The investor should be impressed with the application of your management capabilities.

Inability to Resolve Conflict Can Be a Valuable Lesson

Some conflict will result in irreconcilable differences between you and the investor. It may not be obvious, but this scenario is critical to your getting the best deal possible. Let's say you hit a brick wall with your investor during negotiations. You both strongly disagree with each other and, based on what you've just experienced with this particular investor, you decide that you can never form a positive working relationship. In this case, the presence of conflict has highlighted your mutual incompatibility before you are business partners. It might be time to walk away from the table. It's better to find out these facts before you both sign a legally binding agreement.

Other Positive Outcomes

The word conflict stirs up images of people embroiled in an argument with tensions running high. Conflict makes us uncomfortable, and often we shy away from a conflict to avoid exposure to certain negative behaviours like anger and stress. By dealing effectively with conflict, some positive results can occur.

- Different points of view are expressed, increasing the likelihood of reaching a high-quality decision. This is important because weaker alternatives will be discussed and rejected for valid reasons.
- Problem-solving skills can be enhanced. The participants are encouraged to explore various alternatives.
- Critical issues are discussed that might not have been. If everyone agrees all the time, then group members start to believe that they can't fail. They don't take the time to evaluate strategies and may make unnecessarily risky decisions.

3.4 Understand Conflict Resolution Styles

Understanding how people deal with conflict may help you see it coming and handle it more effectively. There are several typical styles, but most people rely on one particular style out of habit. Often, too, we may unconsciously react very negatively to another style just because it isn't our own preferred approach.

Be careful about trying to pigeonhole the other person into one style during a negotiation. The way an individual addresses conflict may change based on the situation at hand. And your reactions and behaviour may also influence the other person to adopt a different style.

Examine Your Style and Reactions

Look over the following styles of handling conflict. Can you identify your own preferred approach? Of the approaches you don't usually take, which ones make you uncomfortable? If an investor adopts one of those styles, how will you handle your negative reactions? What will you do to exert a positive influence on the situation?

Conflict Styles	Your Style?	Your Reaction?
Avoid (Run away.) You completely withdraw from the conflict, as if it doesn't exist.		
Accommodate (I give up, let's do it your way.) You put aside your goals and basically give in, although inside you are frustrated and angry.		
Force (My way or the highway.) You force your point until the other party eventually gives up.		
Compromise (Meet you in the middle.) You give up something and so does the investor, but neither of you is totally satisfied.		
Collaborate (Let's do it together.) You and the investor work together to find a solution that satisfies both of you.		

Collaboration Often Recommended

While each style has its own advantages and disadvantages, the collaboration style is often recommended as it allows both parties to gain maximum benefits from the interaction. The style that you use will be influenced by your present motivation and emotional state, the circumstances that led up to the conflict, your personality, the investor's willingness to participate and many other issues.

While the collaboration method is preferred, it isn't always possible to achieve. A good understanding of the different styles and their uses will help you devise your strategy for resolving conflict. A description of the advantages and disadvantages of each style is contained in the *Conflict Resolution Styles Tool*, found in the Appendix.

3.5 Use a Structured Approach

A structured approach to conflict resolution can help you reach a win-win agreement in your negotiations. The following approach is simple, easy to follow and logical. You should apply it during negotiations when the situation arises. It will instill confidence in the investor that you are a businessperson committed to building collaborative solutions.

Like any approach, the following one is designed to be a guideline. Adapt it as you see fit. Apply it not only during negotiations but also in your daily operations.

The diagram below shows this five-stage approach:



Open Discussion of Problems

During this stage, both parties should feel free to express any concerns that they have, without fear of being ridiculed or judged. You can't expect to deal with your concerns if you don't discuss them, regardless of relative importance. Communicate fully. This approach can be a long process.

Remember that you're setting the tone for any future meetings or transactions, so you want to establish an environment of openness and honesty. This will also facilitate trust building with the investor.

Identify Differences

Imagine if a deal fell through because you and the investor thought you had incompatible goals but, in reality, you didn't. That's why it's so important to separate real from perceived differences in opinion. Be prepared to explain the rationale behind your demands so that you and the investor can determine if you have different interests (a true conflict) or just different ways of getting to the same result (perceived conflict).

Conflict arises from a difference in opinion or values. The cornerstone of dealing with conflict is understanding the gaps between your desires and those of the investor. You need to do this before you can bridge these gaps.

Build Understanding for Point of View

You need to gain an understanding of the investor's needs and ensure the investor understands your point of view. Conflict resolution techniques that focus on positive outcomes of conflict may help you approach the issue from a more workable angle. Here are some intervention techniques that you can use.

- **Try to understand the other person's point of view.** Listen to the investor without trying to think of what you'll say next. Focus on the investor, giving your full attention.
- **Acknowledge that the investor has a point of view.** Do this even if you disagree with it.
- **Use open body language.** (Maintain eye contact, nod in agreement.) Physically show your willingness to be reasonable and open to discussion. Whether you're listening or speaking, you're still communicating silently with the investor through your body language. Your audience responds more to what your body is

doing than to what you are *saying* so try to synchronize your actions with your words. Together they can transmit your message much more clearly than each one can individually.

- **Initially focus on points where you and the investor agree.** That way you won't waste time discussing those points. Tell the investor which points you agree with and why. Ask the investor to repeat the process for you.

Reduce Defensiveness

When someone triggers one of our emotional "hot buttons," our instinctive response is to defend ourselves by counterattacking. When we're defensive, it's difficult to see the situation objectively — our logic is clouded by our emotions. This can create a vicious cycle of increasingly hostile exchanges with one party trying to outdo the other.

Defensiveness can be detrimental to the relationship because the focus switches from common goals to individual interests. There are several ways you can break the cycle of defensiveness.

Disengage. Back off for a bit.

Empathize. Express an understanding for the other side's view.

Inquire. Ask questions focussing on the situation, not on the people involved.

Disclose. Use "I" statements to tell the other party how you interpret things.

Depersonalize. Separate your identity from your tasks/work; you're not the company, you're an officer of the company.

When challenged during negotiations, you'll probably feel personally attacked. Many of the issues causing a difference of opinion were based on your earlier business decisions, the same ones that you thought were brilliant at the time. Don't take things personally. Minimize your defensiveness. Ensure that you don't lose your cool, and keep focussed on your goal: successfully negotiating an investment deal.

Begin Mutual Problem Solving

The binding thread for all the conflict management techniques is trust. If you have a good relationship with the investor, both of you will want to work toward a mutually beneficial agreement. You'll likely feel more comfortable using some of the strategies mentioned in this Step, like effective listening and open body language, in order to achieve total understanding. Most of this adaptation will be done subconsciously as your relationship with the investor improves and your communication and business development skills are enhanced.

3.6 Capabilities Check

The negotiation stage is key to the future well-being of your business and to your ongoing relationship with the investor. Make sure your skills are top-notch in this area, and if you feel uncertain about some of your capabilities, consider retaining an expert to guide and support you during the give and take of negotiations.

Negotiating Capabilities Check

A = Highly Capable B = Need Some Assistance C = Need Expert Help

Can You...	Rate Yourself
• Communicate effectively?	
• Remain flexible and creative in pressure situations?	
• Recognize where your power lies and use it effectively?	
• Disclose information selectively to make the most of it?	
• Remain logical even though emotions may be running high?	
• Handle conflict effectively?	
• Use a structured approach to prepare for and manage the negotiation process?	
• Use your understanding of conflict styles positively?	

Appendix

Do's and Don'ts of Negotiation (see section 3.2)

The Wrong Approach to Negotiations

Picture this. An investor is interested in an entrepreneur's proposal. The two parties meet to discuss some of the specifics of the proposal. The investor is very interested and submits a term sheet to the entrepreneur.

During the negotiations, the entrepreneur:

- is unwilling to adjust the rate of return from 20% to 30% and doesn't care why the investor wants to adjust it;
- fails to understand the concerns of the investor regarding the suggested exit strategy;
- approaches the negotiations using a hard-line approach trying to intimidate the investor;
- becomes insulted when challenged on management skills, especially communication skills; and
- wants to win each negotiated item of the deal.

With these actions, negotiations between the investor and the entrepreneur will be unsuccessful. Neither party will come to an agreement, nor will an investment deal be reached.

What Went Wrong

The reasons for failure in this particular example are due to the entrepreneur's lack of understanding of the benefits of reaching a win-win agreement. For example, the entrepreneur:

- wasn't willing to explore alternatives, which shows a lack of flexibility;
- wasn't willing to listen to the investor's reasons behind any requested changes;
- didn't look at things from the investor's perspective or listen to the investor's needs; and
- wanted to win each issue (even if it meant the investor lost), wanted nothing less than complete victory and refused to make any concessions.

Based on this short example, it's clear that there's a right way and a wrong way to approach negotiations. If you make do with poor negotiation skills, you could end up with a mediocre agreement that doesn't meet many of the needs of either party. If you develop strong negotiation skills, you'll likely land up with a satisfying agreement and your investor will probably feel the same way.

The Right Approach to Negotiations

The right approach to negotiations is discussed elsewhere in this self-study guide. Here we will just touch on the main points that can result in a win-win agreement.

1. Discuss the term sheet.
2. Focus on interest.
3. Find common ways to calculate financial elements.
4. Create alternatives to benefit both parties.
5. Discuss each alternative.
6. Select a solution.
7. Close the deal.
8. Stay calm.

Conflict Resolution Styles (see section 3.4)

There are five conflict resolution styles: avoid, accommodate, force, compromise and collaborate. This tool presents the advantages and disadvantages of each style as well as when and when not to use each style.

Avoid

One party uses non-assertive, passive behaviour and withdraws from the conflict. Neither party is able to pursue goals. For example, your business partner makes a mistake during the presentation, but you don't want to embarrass him so you stay quiet and let the investor hear wrong information.

Advantages

- Keeps you out of situations where your involvement will only result in negative outcomes for you;
- May keep you from harmful influence of others;
- Buys some time (may give you the opportunity to collect information to use when you later address the conflict);
- Attention can be paid to other more important issues; and
- Keeps you distant from issues others can manage without your involvement.

Disadvantages

- Allows conflict to grow (snowball effect);
- Sets the stage for a bigger explosion later;
- Keeps any solution from being found;
- Causes others to perceive that you do not care;
- Leaves the impression that you cannot change; and
- Reinforces the notion that conflict is bad and should be avoided.

When to Use

- The issue is not important to you;
- The issue will not affect whether the deal goes through; and
- The issue is too emotionally charged and could damage the relationship.

When Not to Use

- Safety or ethical issues are involved that might harm you or your workers; and
- The relationship is not at risk or in any jeopardy.

Accommodate

One party puts aside his/her goals in order to satisfy the other party's goals. For example, you, the entrepreneur, feel intimidated by the investor's negative position on granting you additional office space, so you agree to exclude it from the terms of the agreement.

Advantages

- When you are wrong it shows you can be reasonable;
- When you are outnumbered it shows you can be flexible;
- If the issue is important to the other party but not to you, giving a little can gain a lot;
- Minimizes your losses if you are going to lose anyway;
- Advances harmony; and
- Displays trust of the other party's judgment.

Disadvantages

- Reduces creativity;
- May explode later;
- The solution may cause more trouble than the original problem;
- The person who accommodated a solution may change his/her mind later;
- May demonstrate lack of commitment;
- Lessens the power of the party giving in; and
- May foster a tone of competitiveness by being overly nice.

When to Use

- The issue is not important to you; and
- You are interested in preserving the relationship.

When Not to Use

- The issue concerns ethics, legality, safety; and
- You don't want to set a precedent.

Force

One party achieves his/her own goals at the expense of the other party. For example, during negotiations, you and the investor disagree on the amount of office space that should be allotted to senior executives. This is the only issue that you cannot agree on. The investor refuses to sign the agreement unless you concede on this point. Even though you feel strongly about it, you know that the deal is otherwise sound, so you give in.

Advantages

- Decisions can be made quickly;
- Focuses on the goal and not on the other party (good only if the relationship with the other party does not matter);
- Demonstrates commitment; and
- Demonstrates importance of the issue.

Disadvantages

- Reduces the conflict to limited options;
- Reduces creativity;
- May harm the relationship between the parties involved;
- May explode later;
- May encourage covert behaviour; and
- Defines a winner and a loser.

When to Use

- Quick action is needed;
- Issues of legality and ethics are at hand; and
- There is only one prize. (Note: there is almost always the chance for both parties to win.)

When Not to Use

- You want to build a working, fairly long-term relationship; and
- You have limited knowledge about the subject.

Compromise

Both parties give up something to get partial goal attainment. For example, the investor wants to tie cash payments to 20% growth every month, and you are aiming for an overall 20% growth for the year. You settle on quarterly growth of 20%.

Advantages

- Quick resolution is possible;
- Can be seen as a win for both parties;
- Demonstrates equal power balance;
- Can be creative;
- Appears reasonable to outside parties; and
- Can be used as a last resort when other methods fail.

Disadvantages

- Solution may not fit the demands of the situation;
- Can be seen as a loss for both parties rather than a win for either;
- Restricts creativity more often than it promotes it; and
- May be another form of avoidance so neither party has to make a decision (example: flipping a coin).

When to Use

- Your goals are truly mutually exclusive (somebody has to lose);
- You have tried another strategy and didn't get the results you wanted; and
- You can give up issues that aren't important to you.

When Not to Use

- Ethical or legal issues are involved; and
- Your goals are compatible.

Collaborate

Both parties actively try to find solutions that will satisfy them both. For example, you want to launch a new product in the next quarter and will need a significant amount of

capital. However, as soon as your cash holdings fall below \$100,000, the investor withdraws funding. You agree that if you can land a contract by the end of month that will make up the difference, there will be no penalty.

Advantages

- Satisfies both parties;
- Promotes creativity;
- Demonstrates importance of both parties' goals;
- Demonstrates importance of the relationship;
- Demonstrates respect for the other party;
- Builds trust in the relationship;
- Demonstrates commitment to finding a good solution;
- Gains commitment to solution from both parties; and
- Promotes the idea that conflict can be productive.

Disadvantages

- Time consuming; and
- Energy consuming.

When to Use

- Issue is important and requires long-term buy-in;
- You want the most input into the solution; and
- You want to build a relationship.

When Not to Use

- You don't have time; and
- You have little flexibility due to outside contract agreements, ethical or legal issues.