

NEGOTIATION BRIEFINGS



In negotiation, is “benevolent deception” acceptable?

Contrary to popular belief, certain types of lies can actually strengthen bonds between parties, new research finds. But deceptive attempts to help others are not risk free.

Do you behave as honestly as possible in your negotiations? Do you view honesty as a critical attribute in your negotiation counterparts?

You probably answered these questions in the affirmative: Like many of us, you view deliberate deception to be both unethical and risky.

Now read the following negotiation scenarios. In each of them, a negotiator lies (or hides the truth) in a way that benefits another person. Are these lies unethical? Do they make you view the negotiator as untrustworthy?

- Sylvie, a graphic designer, hears through the grapevine that Bob, one of her favorite clients, is facing financial difficulties due to his wife being laid off from her job. Making Bob a low offer for a new project they’ve been negotiating, Sylvie lies about how much time she expects it to take her.
- Manny, a colleague Rex is mentoring, represents their negotiating team in his first major presentation. To Rex’s disappointment, Manny seems very nervous and fumbles through his talk. Believing that an honest assessment would set Manny back further, Rex tells him that he did a good job and schedules some time to discuss relaxation techniques.
- A married couple, Pam and Leroy, are deciding where to go on vacation this year. Because of their very different

tastes, such discussions normally trigger lengthy debates. But this year, when Pam suggests that they take a cruise, Leroy readily agrees, lying that he’s always wanted to go on one. Pam has been feeling low lately, and he hopes that a cruise will lift her spirits.

Past negotiation research has found unequivocally that deception is toxic to negotiation. When detected, lies and other forms of deception trigger negative emotions, prompt retaliation, and irrevocably damage trust between negotiators. But most research on deception has studied lies that have selfish motives, such as a negotiator lying to get a better deal at a counterpart’s expense, write Emma E. Levine and Maurice E. Schweitzer of the University of Pennsylvania’s Wharton School in a new study published in the journal *Organizational Behavior and Human Decision Processes*.

Yet as the three anecdotes above suggest, not all forms of deception are selfish. As children, we are taught to be polite: to say we like the food that’s put in front of us, to pretend we’re happy to receive socks for our birthday, and to suppress our potentially hurtful observations about strangers. In other words, we are taught to lie or hide the truth in the service of others’ feelings and desires.

Given this socialization, you might not be surprised to learn that adults lie in roughly 20% of their everyday social interactions,

IN THIS ISSUE

- 4 “No one’s really in charge”
The risk of no-negotiation policies
- 6 Exploring new opportunities to negotiate
When negotiation isn’t the norm, tread carefully
- 7 Negotiation research you can use
Men, women, and violations of trust
- 8 Dear Negotiation Coach
Earning out and earning up

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Editorial Correspondence

E-mail negotiation@law.harvard.edu, or write to: *Negotiation Briefings*, Program on Negotiation, Harvard Law School, 1563 Massachusetts Avenue, 513 Pound Hall, Cambridge, MA 02138-2903.

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continued from page 1

according to research by Bella M. DePaulo of the University of Virginia and her colleagues, and that most of these lies are *prosocial*—that is, they are intended to benefit the person being lied to.

Do we view prosocial lies as immoral or acceptable? How might such lies, if detected, affect trust between people? Levine and Schweitzer examined these questions in a series of experiments.

Lies, lies, and more lies

We tell prosocial lies for various reasons: for example, to protect another person's feelings and beliefs, avoid conflict, help us out of uncomfortable or embarrassing situations, or help someone reach his goals.

There are two main types of prosocial lies, according to Levine and Schweitzer:

1. **Altruistic lies** are the false, misleading statements we make to help someone at a cost to ourselves. Sylvie, for example, wanted to make a financial sacrifice to help Bob through a tough time.
2. **Mutually beneficial lies** are false, misleading statements that are intended to benefit both the person we're lying to and ourselves. For example, Rex told Manny that he did a good job with the hope of improving Manny's future performance, a result that would benefit both of them and their company.

Of course, there can be gray areas between altruistic and mutually beneficial lies. For example, Sylvie may view her financial sacrifice as insignificant compared with the personal satisfaction she gains from helping out Bob and his family.

Prosocial lies shouldn't be confused with so-called white lies, write Levine and Schweitzer. White lies tend to be inconsequential and undetectable—such as lying to a counterpart that you like his new glasses—whereas prosocial lies can have higher stakes.

When altruism trumps honesty

To find out how prosocial lies affect trust, Levine and Schweitzer first looked at how people react to altruistic lies. They had participants engage in economic games

and varied the incentives associated with lying and truth telling.

In one experiment conducted online, participants were paired with counterparts who had the opportunity to lie to them about the outcome of a coin flip. If a counterpart lied to the participant (for example, said the coin landed on heads when it really landed on tails), the participant would earn \$1, and the counterpart would earn \$1.75. If a counterpart told the truth about the outcome of the coin flip, the participant would earn nothing, and the counterpart would earn \$2. That is, the counterpart could help the participant by telling an altruistic lie that was somewhat costly to the counterpart.

In the experiment, participants were more trusting of counterparts who lied to help them than they were of those who personally benefited from telling the truth. In another economic game called the "Trust Game," participants were given \$1 and told they could either keep it or pass it to their counterpart from the coin-flip game. If they passed the dollar, its value tripled to \$3, and the counterpart could choose to either keep the \$3 or return half of it to the participant. Thus, passing the initial dollar is an act of trust; it reflects the belief that the counterpart can be relied on to return half the money in the future.

In this game, participants were more willing to trust counterparts who had lied to them about the coin toss than counterparts who had been selfish but honest. Participants also rated the liars as more benevolent and trustworthy than the truth tellers, even though they recognized the liars were more deceptive.

In another experiment, participants also trusted individuals who lied to help *other* people more than they trusted individuals who told the truth to benefit themselves. In other words, participants did not need to personally benefit from the lie to judge the liar favorably. Overall, these results suggest that prosocial lies increase rather than decrease trust that is rooted in perceptions of benevolence. So when we're deciding whether to loan money

to others, seek emotional support from them, or share sensitive information with them, the results suggest that we'll first examine their intentions—and if they seem benevolent, we won't be bothered by evidence of deception. For many trusting decisions, we care about protection, benevolence, and kindness more than honesty.

Altruistic and mutually beneficial deception can be less benign than they initially appear.

However, Levine and Schweitzer clarify that not all types of trust are benefited by prosocial deception. Some trust decisions, like the willingness to rely on someone's claims, are deeply rooted in perceptions of honesty and integrity. In Levine and Schweitzer's final experiment, for example, participants had to make a trust decision rooted in perceptions of integrity—specifically, participants had to decide if they should trust a partner's advice about whether a jar contained an odd or even number of coins. This time, participants looked more closely at how honestly the partner had behaved in previous interactions than at how benevolent those actions were. Participants did not trust the claims of individuals who had told prosocial lies in the past. Thus, we may view honesty to be more important than benevolence when we need to personally rely on someone's words.

Are prosocial lies truly benign?

Contrary to the widespread belief that deception, when detected, always damages trust in negotiation and other exchanges, Levine and Schweitzer's

study suggests that lying can actually increase trust when lies clearly have benevolent intentions. In fact, our attitudes toward deception may be hypocritical: We denounce lying yet also tell prosocial lies and benefit from the prosocial lies of others.

"Managers should . . . consider if honesty is always the best policy," write Levine and Schweitzer. But openly advocating prosocial lying within organizations could be a risky move, for several reasons.

First, viewing prosocial lies as acceptable and encouraging other negotiators to do the same could lead us to engage in or tolerate less benign forms of deception. Unfortunately, unethical behavior often occurs on a slippery slope, write Harvard Business School professor Max H. Bazerman and Notre Dame University professor Ann E. Tenbrunsel in their book *Blind Spots: Why We Fail to Do What's Right and What to Do about It* (Princeton University Press, 2011). That is, we justify a tiny ethical infraction and then allow ourselves to commit increasingly more serious infractions as time passes. We also are less likely to notice the unethical behavior of others when it occurs gradually rather than all at once.

Second, both altruistic and mutually beneficial deception can be less benign than they may appear. Suppose, for example, that a bank officer grants a loan to an underqualified friend. To protect her pride, the banker doesn't tell her that she was the beneficiary of an exception. This decision would not only be a bad bet for the bank but also set the applicant up for failure and discriminate against applicants who lack such connections.

Third, we may find ourselves telling seemingly prosocial lies for reasons that are actually selfish. In the real world, an individual's true motivations may be much murkier than they were in Levine and Schweitzer's experiments. For example, Leroy may think he's lying for Pam's benefit about wanting to go on a cruise. But if, deep down, he just doesn't want to argue about where to go, he may be setting them both up for an unhappy vacation. Similarly, in our business negotiations, we may be tempted to avoid conflict by justifying a lie or an omission as prosocial.

Given these risks, negotiators would be wise to think twice before telling a seemingly prosocial lie (or omitting an important truth), as there may be a more satisfying way to meet their goals. For example, rather than secretly giving Bob a discount on her services, Sylvie could reveal to him that she heard about his wife's layoff and then ask whether he would consider accepting a onetime discount or payment in installments. As compared with a lie, this direct approach arguably demonstrates greater respect for Bob and creates an opportunity for a more honest working relationship.

In your organization, rather than uniformly outlawing or, conversely, condoning prosocial deception, you might instead open up a dialogue about its prevalence in society and encourage individual negotiators to search their consciences to determine where their ethical boundaries lie.

Our decisions and behavior in negotiation often diverge from our ethical standards. By examining our tendencies, we can start to live up to the high standards we set for ourselves and others. ■



3 truths about deception

1. Prosocial lies are common, despite widespread condemnation of deception in our society.
2. We are likely to tolerate deception if it is intended to help us.
3. Negotiators can avoid the potential risks of prosocial lying by identifying more honest means of communicating their goals.



James Foley



Luke Somers

NEGOTIATION IN THE NEWS

“No one’s really in charge”

Hostage taking and the risks of no-negotiation policies.

In the business world, we sometimes are tempted to avoid negotiating with unsavory counterparts—people or groups we view to be immoral, untrustworthy, or simply unlikable—even if they appear to offer the straightest path to our goals. Imagine a counterpart who works in a business that you believe to be immoral, someone who has a reputation for gossiping, or a longtime client who routinely falls back on hardball tactics despite your repeated efforts to encourage collaboration.

The decision not to negotiate with a particular party can be a perfectly legitimate one, provided we think it through carefully. But when walking away from a problem would simply leave it in someone else’s hands, we could end up creating problems for them and even for ourselves. In such instances, we may need to take a closer look at the impact of the decision not to negotiate.

Two recent tragedies involving hostages taken by terrorists in the Middle East illustrate the potential repercussions of no-negotiation policies. Although the cases are extreme, they do have an important message for those of us in less dangerous realms.

For families, no guidance

In November 2012, U.S. journalist James Foley was taken hostage in Syria by the Islamic State in Iraq and Syria (ISIS), a terrorist group. About a year later, ISIS e-mailed Foley’s brother, Michael, demanding approximately \$130 million and the release of Muslim prisoners being held in the United States.

Because the U.S. government, like some other nations, has a policy against negotiating with or paying ransoms to terrorists, the FBI told the Foley family that it couldn’t bargain on the family’s behalf. In fact, one staffer from the National Security Council (NSC) reportedly even warned the Foleys and the family of another U.S. journalist being held with Foley, Steven J. Sotloff, that they could face criminal charges if they made ransom payments on their own, according to *Foreign Policy* magazine.

The FBI stayed in touch with the Foleys but kept most of the intelligence it gathered about James’s imprisonment secret from them because of security concerns. Contradicting the NSC staffer, the FBI let the Foleys know that they were unlikely to face charges for paying a ransom. Aided by their son’s employer, the Foleys began raising money for a ransom.

They held conference calls with three other families of hostages to discuss strategy and the possibility of private rescue efforts, but the terrorists’ demands were daunting. As private citizens, the Foleys obviously could not deliver on the demand for a prisoner exchange, for example.

Complicating matters was a lack of coordination between the relevant U.S. agencies. Speaking of the U.S. government’s role in managing foreign hostage crises, one source told *Foreign Policy*, “No one’s really in charge.” Meanwhile, several European countries whose citizens were being held with Foley set up crisis centers and negotiated directly with ISIS through family members’ e-mail accounts. These negotiations have led to numerous ransom payments and the release of about 15 European hostages.

Mixed messages

On May 31, 2014, the Obama administration secured the release of Sergeant Bowe Bergdahl, the sole American prisoner of war (POW) in the Afghan conflict, in exchange for five Taliban detainees. The administration justified the apparent break from policy on the grounds that (1) Bergdahl was a POW rather than a civilian and (2) the

Taliban, though a U.S. enemy, is not a designated terrorist group. Many found the reasoning difficult to understand, as we reported in our September 2014 issue.

On August 19, a week after sending the Foleys a final e-mail complaining about their government's refusal to negotiate, ISIS executed Foley. Sotloff was killed on September 2, and a British aid worker soon after.

On December 7, another horrific story unfolded after Al Qaeda warned the United States that it had three days to meet ransom demands for Luke Somers, an American photojournalist being held in Yemen. President Obama authorized a military operation aimed at rescuing Somers before the deadline. But the raid failed, and Somers was killed by his guards, along with eight other civilians. In a dreadful twist of fate, Pierre Korkie, a South African civilian being held with Somers, was also killed in the raid—just hours before he was due to be released by Al Qaeda. Although South Africa also has a policy against negotiating with terrorists, Korkie's wife, Yolande, and a South African charity had negotiated an initial \$3 million ransom demand down to \$200,000, paid the funds, and made an intricate plan for Korkie's departure from the desert.

A more reasoned approach

In his book *Bargaining with the Devil: When to Negotiate, When to Fight* (Simon & Schuster, 2010), Program on Negotiation chair Robert Mnookin notes that the decision not to negotiate with a particular

group should be made with care, as closing off the possibility of negotiation can leave us stranded with few options for resolving a conflict.

Indeed, Al Qaeda expert Gregory D. Johnsen told the *New York Times* following the failed raid to save Somers, "When the U.S. unilaterally takes all the other options off the table and leaves itself with only the military option, then if that goes wrong, the results can be tragic." Similarly, in the business realm, when we refuse to negotiate, a costly litigation process may become our only option for resolving a conflict.

For these reasons, Mnookin advises us to think through three key challenges before deciding not to negotiate with an enemy:

1. Identify and avoid emotional traps.

Irrational perceptions, such as the tendency to view those outside our group with suspicion, can lead us to demonize other parties in a way that thwarts the potential for negotiation. We need to face these tendencies and try to look beyond them.

2. Analyze the costs and benefits of negotiating.

Before writing someone off, carefully consider your interests in the negotiation, your and the other party's alternatives to negotiation, the likely costs of negotiating, and obstacles to implementation of a deal. This analysis should help clarify whether negotiation is your best option.

3. Address ethical and moral issues.

The desire not to taint our sense of honor or integrity can lead us

to avoid negotiations with certain unsavory-seeming parties. But if not negotiating could harm those we represent, such as our family or fellow citizens, we may have a greater moral duty to negotiate.

A broader moral duty

The United States and other governments have compelling justifications for their blanket refusal to negotiate with terrorists. Most notably, ISIS and other terrorist groups have turned hostage taking into a lucrative form of fund-raising. The payment of ransoms seems likely to motivate further kidnappings of foreigners abroad.

But the Foleys and other families have accused the U.S. government of giving them contradictory messages and leaving them to flounder through negotiations with terrorists—negotiations that ordinary citizens are unqualified to pursue and that take an enormous emotional and financial toll. In response, Obama has ordered a review of U.S. policy on American hostages taken abroad.

Deciding not to negotiate with terrorists doesn't absolve governments of their duty to their citizens, including the families of those being held hostage. More generally, if we decide not to negotiate with a particular individual or organization we find distasteful, we may still have a moral responsibility to guide and assist—to the extent that we can—those who will be left to pick up the pieces. ■

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Exploring new opportunities to negotiate

When negotiation isn't the norm, tread carefully.

Many U.S. law schools are in crisis, to hear some tell it. During the recent recession, many law firms instituted mass layoffs and pay cuts, and few have fully recovered. As a result, college graduates are thinking twice about becoming lawyers, and many law schools have fewer high-quality applicants to choose from. In the past three years, the number of first-year U.S. law school students fell by 24%, according to the American Bar Association.

That state of affairs has created fierce competition among law schools for the best applicants—and led them to offer new enticements, such as tuition freezes and reductions and increased financial aid, even as they try to trim spending, writes Elizabeth Olson in a *New York Times* article on the trend.

The situation has also led to a growing realization among law school applicants that they are in a prime position to negotiate the terms of their admission. “Students are voting with their feet, and demanding a better deal,” Daniel B. Rodriguez, dean of the Northwestern University School of Law, told the *Times*. “It’s insane. We’re in hand-to-hand combat with other schools.”

Emily Trieber, a first-year student at the Roger Williams University School of Law in Bristol, Rhode Island, told the *Times* that after the school offered her a scholarship, she successfully negotiated to lower her tuition further, as many of her classmates have. “It doesn’t hurt to ask,” she explained.

The story makes a bigger point: When the deal you’re being offered isn’t as appealing as it used to be, the time is ripe to ask for a better one. But what’s the best way to open up a negotiation when negotiation isn’t the norm? The following three guidelines should help:

1. Focus on BATNAs.

As in any business negotiation, your primary source of power will be your

best alternative to a negotiated agreement, or BATNA—your ability to walk away from a deal that doesn’t meet your needs in favor of one that does. For law school applicants, that might mean applying to several schools and, if all goes well, negotiating issues such as tuition and financial aid with each one of them.

When negotiation is not the norm, it becomes particularly important to assess not only your own BATNA but also your target’s. For example, a law school applicant should easily be able to find statistics on enrollment, tuition trends, and LSAT data for the schools he’s considering. Such research would help him identify whether a school is, indeed, struggling to maintain its prestige, in which case it may be open to negotiation, or whether it is holding strong, in which case it may not.

In business negotiations, you should be able to get a clearer sense of your negotiating leverage with a particular party by researching relevant economic indicators, checking media reports, and asking around your network.

2. Set the stage for success.

Rather than opening with strong demands, begin by presenting your well-researched case that a better deal is warranted, whether due to changing economic conditions, increased competition, or whatever the reason may be. In addition, lay out any evidence you have that negotiation is becoming increasingly common in this realm.

You might also increase the other party’s willingness to negotiate by asking questions. For example, you could ask him to confirm whether your research is accurate: “My understanding is that the availability of cheaper parts is driving down costs in your industry; is that correct?” Because your counterpart may be unprepared to negotiate, express your



willingness to discuss details after giving him time to get ready.

3. Identify what’s in it for them.

If a counterpart is eager to do business with you and conscious of changing marketplace conditions, it might not be difficult to convince her to negotiate. But what if she resists cutting you a better deal?

In this case, stress the assets you bring to the table, and don’t be afraid to refer to your BATNA. A top-notch law school candidate, for example, could remind her contact in the admissions office of her qualifications and mention the other schools she’s considering. If she has a good offer in hand, she might ask the school if it could improve on the offer or, at the very least, match it. The message: She has options and is not afraid to exercise them.

In addition, look for carrots you might dangle to lessen your counterpart’s resistance to negotiation. Think in particular about perks that would be easy for you to give and that the other party might value, such as introductions to influential members of your network.

If the other party still refuses to negotiate, you may need to choose between taking what’s being offered and turning to your BATNA. Don’t be surprised, however, if the counterpart calls you back to the table after the reality of losing you has hit home. ■

When negotiation isn't worth your time

Popular books such as Herb Cohen's *You Can Negotiate Anything: The World's Best Negotiator Tells You How to Get What You Want* (Bantam, 1982) suggest that virtually everything is negotiable, from utility bills to airfare. But just as spotting new negotiating opportunities is a key skill, so is the ability to recognize when it's smart to pass on a negotiation.

In their book *Negotiation Genius: How to Overcome Obstacles and Achieve Brilliant Results at the Bargaining Table and Beyond* (Harvard Business School, 2007), Harvard Business School professors Deepak Malhotra and Max H. Bazerman present several situations in which you might sensibly choose not to negotiate. Here are four of them:

- 1. When time is money.** We sometimes become so fixated on "getting a great deal" or "winning" that we overlook the value of the time we're devoting to that goal. Prioritize your negotiations so that you have enough time and other resources for more important negotiations and activities that you value.
- 2. When you have no good alternatives.** If you have a weak BATNA—a lack of alternatives—it may make sense to accept the deal being offered rather than risking it by trying to haggle. Then, after you have the deal in hand, you might ask for better terms by appealing to your counterpart's sense of fairness or altruism.
- 3. When negotiation sends the wrong signal.** In certain situations, such as being offered a plum assignment at work, initiating a negotiation may signal that you don't trust the other party or that you're ungrateful. In such instances, you might choose not to negotiate, or you might ask for more information as a way of inviting the other party to initiate talks.
- 4. When negotiation is culturally inappropriate.** In our own culture, we tend to know when it's appropriate to negotiate a better deal (at a car dealership, at an antiques market) and when it's not (at the grocery store, at a coffee shop). When we visit those in other cultures, we often violate their norms for negotiation. Before negotiating with someone from another culture, research the relevant norms so you won't cause offense.

Negotiation research you can use

Men, women, and violations of trust

In negotiation, there is almost nothing more upsetting than finding out that a counterpart betrayed your trust. In a new experiment, Michael P. Haselhuhn of the University of California, Riverside and his colleagues looked at whether there is a gender difference in people's willingness to trust others following a violation of their trust.

Across their three experiments, women and men were similarly trusting of counterparts who had not given them reason to be distrustful. After a counterpart violated participants' trust, both men and women were much less likely to trust that person going forward. However, more women than men were willing to trust the counterpart, especially following a promise to behave more honestly going forward.

In one of the experiments, for example, participants were asked to imagine that they were buying refurbished, "as is"—condition computers for their

company. The supplier claimed that the machines were in good working order and sent them in two batches. Some of the participants were told that the computers in the first shipment seemed to be in good condition when they were received but quickly began to fail. A local repair shop reported that the computers had recently been serviced for the same issue. The supplier apologized, and there was no problem with the second batch of computers.

Men and women were similarly trusting of the company before they became aware of the problems with the first batch of computers, but men were significantly less trusting of the company after the problems became known. The researchers found that female participants' greater investment in relationships as compared with male participants explained their greater trust.

Is women's greater trust following a violation a pro or a con? That

may depend on the context. When negotiators are simply competing for the best deal, women may be at more risk for exploitation than men. But in complex, multi-issue negotiations, women's trust may be an asset. "Women's relatively persistent trust may enable them to overlook minor misunderstandings or initial competitive posturing and collaborate with the other party to reach a creative solution," write Haselhuhn and his colleagues, "whereas men may lose trust quickly and be less willing to collaborate with a counterpart after a minor violation."

Resource: "Gender Differences in Trust Dynamics: Women Trust More Than Men Following a Trust Violation," by Michael P. Haselhuhn, Jessica A. Kennedy, Laura J. Kray, Alex B. Van Zant, and Maurice E. Schweitzer. Journal of Experimental Social Psychology, Vol. 56, 2015.

Q: I am trying to buy a smaller company in my industry, but the negotiations have stalled over price. It probably won't surprise you to hear the seller thinks his company is worth a lot more than I think it is. So far we have been talking about doing a straight cash deal, but now I'm contemplating an earn-out to try to bridge the valuation gap. Is this a good idea?

A: For those who aren't familiar with the term, earn-outs are a form of "contingent contract" that experts often recommend as a way of unlocking value in negotiations. A typical structure for an earn-out is to stipulate that the buyer make one or more future payments contingent on the company's performance during a set period of time after the sale—say, its ability to hit certain profitability or revenue targets. Earn-outs are popular because (typically optimistic) sellers attach a high likelihood of achieving these future payouts, while (typically pessimistic) buyers will attach a low likelihood of having to pay. An earn-out is a bargain for the buyer, who has to pay only if the performance targets are met. Finally, an earn-out forces a seller to "put his money where his mouth is"—thereby testing the validity of his claims.

However, earn-outs should be used with care because they work only under certain conditions. First, performance metrics need to be clearly defined. This may sound simple, but in the complex world of accounting, revenues or the number of new stores is generally a better performance metric than more malleable measures such as profitability.

Second, the performance metric should not distort behavior. For example, although cash flow may seem like a reasonable performance measure for an earn-out, it can cause the seller (to the extent that he or she has operational control) to under-invest during the earn-out period, for fear of reducing today's

cash flows with investments that will pay off only after the seller is gone.

The conventional wisdom in transactional practice is that earn-outs are either fully paid out or litigated. Unfortunately, this is only a slight exaggeration, and the two main reasons that earn-outs trigger lawsuits are unclear performance metrics and claims of distorted behavior.

Earn-outs have business implications as well. For example, typically a seller will insist that the earn-out be tied to the performance of its business, not the overall business into which it is selling. This means that books and records must be kept separately for the duration of the earn-out period. In many cases, the seller will want to maintain operational control over its business during the earn-out period so that it can work to ensure that the earn-out is achieved.

To see an example of a successful earn-out, consider the example of Sukhpal Singh Ahluwalia, a self-made British entrepreneur. In 2011, he was in negotiations to sell the company he had built, Euro Car Parts (ECP), to LKQ Corporation, a larger U.S. company in the same industry. (I later joined the board of LKQ, but only after this negotiation had been completed.) Like many entrepreneurs, Ahluwalia was convinced that his company was worth more than LKQ was offering. The solution was a sale price of £225 million, payable at closing, plus a potentially large earn-out: a further £55 million if ECP hit certain growth targets for 2012 and 2013.

Both sides wanted Ahluwalia to maintain operational control of ECP so that LKQ could make use of his expertise during the earn-out period. The result: ECP performed terrifically, Ahluwalia met his growth targets, and the earn-out was paid in full in 2014. LKQ was delighted to pay the full £55 million because Ahluwalia had created far more value than that for LKQ shareholders.

In this case, an earn-out helped bridge a valuation gap and create a classic win-win outcome. It worked because the metrics were clear (growth targets), ECP remained a separate business from LKQ during the earn-out period, and Ahluwalia maintained operational control during the earn-out period. As this anecdote illustrates, an earn-out can work to bridge a valuation gap, but only when the circumstances are right.



Guhan Subramanian
Academic Editor, Negotiation Briefings
Joseph Flom Professor of Law and Business,
Harvard Law School
Douglas Weaver Professor of Business Law,
Harvard Business School

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