

Chapter 13

How interests and creativity overcome a negotiation gap

Based on an Interview with Mark Young

In some negotiations the gap between the needs of the respective negotiators is simply too large to overcome, both financially and with other issues. When this realization sets in on the parties it is common for all involved to determine nothing more can be done, and they decide they have no choice but go their separate ways. This is particularly the case when there is a lack of cross over within the Zone of Possible Agreement (ZOPA).

Such was the scenario in this case, until the parties involved altered their way of thinking by removing themselves directly from the negotiation process and designating an informal working group to take over and to determine what they could create that might satisfy the different needs the parties had. Ultimately when the parties involved set up such a group they came to realize that other factors they had not previously considered were driving the deal. With that insight they were able to overcome the perceived gaps and find a creative solution that worked for the parties.

Background and the Negotiation Challenge

In 1993, as part of the reunification of East and West Germany and the subsequent privatization of many industries, the Agency in Trust (AT) decided to sell the famous Deutsche Film-Aktiengesellschaft (DEFA) Studio. DEFA was the birthplace of the German film industry and where Fritz Lang and Marlene Dietrich, among many others, began their careers and became stars. The studio sat on a 40 hectare plot of land¹ with a very large portion of the area still undeveloped. The other party to the negotiation was the French company Compagnie Générale des Eaux (CGE), which today is known as Vivendi.

Dr. Gert Schmidt was department head for AT. He was given the mandate of selling all of the companies and closing down the entire studio portfolio within

a six week timeframe. If he were able to accomplish that feat within the time frame he would be given a substantial bonus. Interestingly, he did not initially need payment for the deal within those six weeks, but he did have to reach a general agreement for the income to count towards his bonus. Dr. Schmidt was also one of the few former East German officials in management at the company. This background would become important in the negotiation for a number of reasons that will be discussed later.

Ivan Laurier was the Vice President of International Acquisitions at CGE. At the time of this negotiation, Mr. Laurier had 10 years of experience in making international acquisitions in a variety of industries. Mr. Laurier came to Berlin in order to conduct the negotiations to buy the company that owned DEFA studios. Laurier was unclear on where the process would lead and how good a deal this was for the company, but he was interested in exploring the possibilities.

Preparing to Negotiate

For both of the parties to the negotiation there was a lot of uncertainty involved. As CGE and Laurier analyzed the situation they wanted to take things slowly to make certain the deal was right for them. In particular, they were uncertain how they would use the vast plot of land, but they were clear about one thing. The studio would help their profile across Europe as they continued developing their foothold in the filmmaking industry. Mr. Laurier also knew that property in East Germany after the reunification was selling fast and this particular venue held sentimental value for many Germans. Finally, after receiving DEFA's initial offer, Laurier was very skeptical a deal could be reached since there was a significant gap in the ZOPA.

Laurier began his preparation with some unease, given he was handed a situation where his colleagues seemed overly eager for a deal. Laurier's boss had signed a letter of intent with CGE to buy DEFA and Laurier was forced to attend a joint press conference when he arrived before he could do his own due diligence (much more research was needed from his point of view). In addition, CGE was already overextended in their acquisitions and intercompany borrowing at CGE was very expensive.

Laurier's staff conducted an initial earnings-based cash flow valuation of the companies and recommended that CGE not pay more than 35 million Euros for DEFA. They also recommended this be paid out over a few years. Laurier's boss has explained to him that he could pay up to 50 million Euros, but that seemed very unrealistic to Laurier based on his own information. There was one critical place where Laurier was fully onboard however -- he saw the strategic value of DEFA for CGE's overall business plan and future focus.

There was one other key issue Laurier needed to be aware of during this negotiation that he contemplated as he prepared to engage. While Laurier did not want to rush, there was indeed time pressure on him as well. CGE had recently signed a contract for a 100 million Euro European film project, subsidized by the European Union (EU), to commence by the end of the year. Purchasing DEFA would help greatly with this endeavor – particularly given its strong brand. The only other way to realize their strategic goals related to filmmaking would be to create a new studio on a previously unused site. This BATNA, while possible, would prove to be time-consuming, expensive and less desirable than reaching a deal with DEFA.

On the other side of the table was Mr. Schmidt. Schmidt had the unenviable task of selling a cultural icon and important entity to the German state in a time of great turmoil. If he sold it to the wrong entity, or for a deal he could not justify, he knew this would be a public relations nightmare.

As is common in many negotiations, Schmidt had his company's interests to consider as well as his own personal interests. When Schmidt was given his mandate, he was told that if he were to be able to sell the company within six weeks he would get a significant bonus. He was also given other parameters listed below that might have felt as if they ran counter to a quick sell.

The first parameter was the sale price. Schmidt was given an internal asset-based valuation that showed the company to be worth at least 60 million Euros. Liquidation, with the sale of all assets, would net about 30 million Euros for AT.

The second parameter Schmidt had to meet was that all AT sales contracts had to include guarantees by the investor to maintain a certain percentage of jobs and to make suitable capital investments. Of the 1100 employees working at DEFA at the time, Schmidt was told to preserve as many jobs as possible. Schmidt determined that his goal would be to retain at least 800 people for a minimum of 5 years.

The final parameter Schmidt was working under was to make absolutely certain that CGE continue to develop DEFA as a film business. Schmidt knew that the large plot of land on which DEFA stood was very valuable and several developers had made substantial offers to buy it and turn it into apartments and office space. This would be a political disaster for AT and would confirm everyone's worst fears that most investors were only interested in property speculation. Schmidt was very skeptical of CGE in this regard given they were primarily a diversified water utility company, and not, a film studio.

Lastly, Schmidt was dealing with this all of this against a backdrop of internal turmoil at AT. There had been numerous layoffs and other scandals bubbling up that engulfed AT in chaos. While Schmidt did have another offer

from a filmmaking company in Germany, it was a rather dubious one and not a very good BATNA should things fall apart with CGE.

The Negotiation

As the negotiations commenced in Berlin a number of issues rose to the surface immediately. The first issue that had to be addressed was AT's concern about CGE's intentions and their plans for DEFA. Since CGE was primarily a diversified water utility company, AT wanted to know why they were so interested in purchasing the studio and the land. As was previously mentioned, it was critical to AT that the studio be preserved and used into the future for film development. Early on in the process Mr. Laurier was able to assure Mr. Schmidt about CGE's intentions – including a discussion of their new film business and sharing the fact that they had signed a contract with the EU. Further, Mr. Laurier was able to convince Mr. Schmidt about CGE's objectives when he explained that they were really not that interested in the developable land connected to the studio. Of course, they would agree to take it on as part of the deal, but it was clear that it was more of a potential challenge than benefit.

The second issue that took center stage in the negotiation was the timing of the sale. Mr. Schmidt emphasized, on numerous occasions, the importance of signing the contract within six weeks. Initially, it was unclear to Mr. Laurier why this was so critical to Mr. Schmidt and he did not feel that it was appropriate to ask directly. Eventually, through back channel investigations, Mr. Laurier came to understand that there was a bonus in it for Mr. Schmidt if the deal was signed in that time frame. Fortunately, all of the details on the final agreement did not need to be solidified within this six week time period. This nuance gave the parties the ability to agree in principle, but then slow the process down so that Mr. Laurier could do his due diligence in a comfortable manner.

The final, and perhaps most important, element of the negotiation was the price gap between the parties. This financial chasm was unlikely to be bridged without really understanding the interests of all involved and coming up with a creative option that met everyone's needs. Initially the gap between what AT was seeking and what CGE was willing to pay was significant. CGE was willing to spend up to 30 million, while the target for AT was of 60 million. After considerable back and forth with little progress, Schmidt and Laurier decided to create a collaborative working group that unearthed quite a bit of common ground -- helping to enlarge the pie.

A key sticking point that kept arising was the land, which was very valuable, oversized and totally unnecessary for making movies. The parties eventually reached an arrangement to allow CGE the ability to sell the

undeveloped land off piece by piece, with a so-called “claw back” provision. The claw back provision provided for 50% of the proceeds of each parcel of land sold going to AT. This creative solution effectively monetized the deal breaker and created enough resources for both parties to gain and claim victory to their respective constituents.

Lessons Learned

When there is an iconic entity involved in a negotiation the outcome takes on tremendous importance because of the symbolism involved. This was certainly the situation in this example and, when coupled with the tense cultural backdrop of the companies involved, the odds of reaching an agreement seemed almost insurmountable. That is, until the parties used the tactics below and cleverly worked their way through the negotiation problem.

Lesson 1: Separating the relationship/cultural issues from the problem

Difficult relationship issues underpinned the negotiations from the beginning, mostly of a cultural nature between CGE (French) and AT (East German). These two countries had a history of tense relations with each possessing very different cultural norms when it comes to negotiation. The French tend to be more nuanced, circuitous, and diplomatic in their approach, while the East Germans are more direct and logical. Eventually, these were successfully put aside by Laurier and Schmidt to focus on the content of crafting the deal. The key to separating the cultural constraints from the negotiation was to create a working group -- away from the two principals -- which improved the climate considerably and helped the parties stay focused on the content of the process.

Lesson 2: Not getting fixated on price helped generate creativity

A central lesson to this case was not getting fixated on the overall price, but understanding the deal from a bigger picture point of view. When the parties shifted away from the price they were able to get into some creative thinking processes that helped them enlarge the pie.

To accomplish the aforementioned task, the parties began to conceptualize the deal and structure in three nested circles. The studio was the first circle, it was at the center, and needed to be preserved. Both sides concurred about that. The second circle was the ring around the studio that would be comprised of buildings and offices that would support the movie making endeavors of CGE. The third and final external circle was the developable land that lay on the outskirts of the property. By working out an arrangement that allowed CGE to sell off the

properties in that circle piece by piece, with a claw back provision of 50% of the proceeds for AT, the parties were able to monetize what might have become a deal breaker. This also helped CGE convince AT of their seriousness related to the movie making industry. This also unlocked the ability of CGE to apply for government subsidies and investment credits to aid in their movie making.

Lesson 3: Grasping the varied interests involved

There were many varied interests involved in this negotiation and they were fundamental to bridging the gaps in this negotiation. When those interests were put on the table and discussed in depth, the parties were able to overcome numerous roadblocks. From a personal interest in getting a deal done within a certain timeframe, to a critical need to preserve DEFA, to the ability to use valuable but non-essential property to bridge the financial gaps, interests paved the way for a deal when there was significant skepticism as to whether it would happen at all.

Lesson 4: Guarding against taboos and helping the other save face

One of the important lessons from this case was to guard against certain taboos and to enable AT to save face as part of the agreement. A deal breaker for AT was a developer coming in and not preserving the iconic DEFA studio. AT was a steward of a critical part of German history and needed to be able to show how they protected it in any deal. Without a recognition by CGE of how important this was for AT they would not have been able to save face with the public.