

O n Bargaining Power

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Editors' Note: Strip away concepts of power based in your opponent's relative wealth compared to yours, or based on other popular myths, says Korobkin here. What are you going to do if there is no agreement? What is the other party likely to do? Answer those questions, and you will know who really has how much power in this situation. (For counterpoint, read Bernard's Powerlessness.)

In an ideal world, all negotiators would have what are sometimes called "common interests."¹ The old chandelier that to me is clutter in the basement would be an antique to you, and your pleasure in receiving it would be outweighed only by my joy in getting rid of it. In most bargaining situations, however, negotiators' interests are in conflict. You might like the chandelier more than I do, which makes a mutually advantageous bargain possible, but it is currently lighting my dining room and I would prefer to keep it rather than give it away. You are interested in buying the chandelier from me, but you want to pay a low price. I will consider selling it to you, but I want a high price. In this zero-sum contest, the outcome will most likely depend on the distribution of bargaining power, defined as the ability to convince the other negotiator to give us what we want even when the other would prefer not to do so.

The source of bargaining power is misunderstood by many negotiators, who wrongly assume that the indicia of success in other realms of life are directly related to power at the negotiating table. Wealth, brains, beauty, political connections, prestige, and social influence are nice to have, but none of these items guarantee you the ability to exercise power in any particular negotiation. Bargaining power is situational, not personal. In some labor disputes, unions have more power than management; in others, management has more power than unions. In some merger negotiations, the target company enjoys more power than the suitor; in others, the dynamic is reversed. In some litigation settlement negotiations, the plaintiff has more power than the defendant; in others, the defendant enjoys the advantage. An employee seeking a raise from his boss might enjoy a relative power advantage, or he might not.

In each of these situations, relative bargaining power stems entirely from the negotiator's ability to, explicitly or implicitly, make a single threat credibly: "I will walk away from

the negotiating table without agreeing to a deal if you do not give me what I demand." The source of the ability to make such a threat, and therefore the source of bargaining power, is the ability to project that he has a desirable alternative to reaching an agreement, often referred to as a "BATNA."² This chapter elaborates on this claim.³

BATNA Strength

What you and what your bargaining counterpart will do in case of impasse determines your relative power in the negotiation. In market situations with fungible buyers and sellers, your BATNA is to enter into a similar transaction with someone other than your negotiating counterpart and, thus, your power depends implicitly on the forces of supply and demand. Imagine that you arrive at an automobile dealership hoping to pay "dealer invoice" for the new car of your choice and begin to negotiate with a dealer who hopes to charge the "sticker price." Your BATNA is to buy an identical car from another dealer, and you have no reason to prefer this dealer over his competitors. The dealer's BATNA is to wait for the next customer to enter the showroom and attempt to sell the car to that customer. Just as you don't care from whom you buy the car, the dealer doesn't care about the identity of the purchaser so long as he pays cash or has good credit.

If the model you have selected is in short supply and all of the other dealers in town have a waiting list of purchasers, your BATNA is relatively weak (you will have to wait for a car and probably pay a premium) and the dealer's BATNA is relatively strong (he is confident that another customer will be willing to pay the sticker price). In this situation, the dealer enjoys more bargaining power because he can threaten impasse if you do not agree to pay the sticker price. That threat would be credible because, if you refuse to pay that amount, impasse would be in his best interest. In contrast, if all dealers are overstocked and the new year's models are soon to arrive, you will enjoy a relative power advantage. You can credibly threaten to walk away if the dealer will not agree to a handsome discount, because the chances are good that another dealer, anxious to reduce inventory, would likely agree to a discount. In turn, this means that impasse with this particular dealer would be in your best interest if you do not receive the price that you demand.

Unlike the new car example, many transactions involve goods or services that are somewhat unique, such that they create a degree of bilateral monopoly: that is, identical transactions are unavailable to one or both parties. In this case, each negotiator's BATNA will usually be a substitute transaction that is different in character from the subject of the present negotiation. For example, assume that you are negotiating with a potential employer. You want a high salary; the employer wants to hire you for a low salary and save resources. If impasse results, both parties will enter into similar but not identical transactions. The employer will hire a different person for the job, with similar but somewhat different skills, experiences, and qualifications from yours. You will accept employment with another firm doing somewhat different work.

In this case, the distribution of bargaining power depends on whose alternative is more desirable to him. If you have job offers in hand from many desirable firms offering high salaries, while the employer's second-choice job candidate has substantially worse qualifications than yours, you will have a power advantage and are likely to receive a very attractive offer of compensation. On the other hand, if the economy is sputtering and your only alternative offer is for a substantially less interesting job at a low salary, while the firm has a stack of job applications from other impressive graduates, the firm has relative power and is likely to obtain your services for a relatively low price.

Still other bargaining situations can be characterized as pure bilateral monopolies: that is, no substitute transactions are available to either party. In this case, the consequence of impasse will be that neither party enters into any transaction. Both parties therefore have a BATNA of not transacting at all, and relative bargaining power depends upon which party finds the status quo more acceptable. Litigation bargaining is an example of a pure bilateral monopoly situation. A plaintiff and defendant who fail to reach agreement do not have the option of entering into settlement agreements with other negotiators. Instead, an impasse will mean that litigation continues and the dispute will ultimately be submitted to adjudication.⁴

Bargaining power in this situation depends on whether this course of events is more desirable for the plaintiff or the defendant. If the plaintiff's case is strong on the legal merits and provable damages are high, the plaintiff will enjoy bargaining power because she can credibly threaten to end negotiations and proceed to adjudication if she does not receive the high settlement price that she demands. The defendant, of course, can make the same threat if the plaintiff will not accept a low settlement offer, but the threat would not be credible because it would not be in the defendant's best interest to take a weak case to court and face the likelihood of a large verdict rather than agree to pay a higher settlement price (but one that is still lower than the expected verdict). Similarly, holding constant the quality of the parties' legal cases, a disputant who employs a less expensive or a contingent fee lawyer, or one who has relatively more resources at his disposal, has bargaining power because the expected cost of continued litigation is less painful, making the threat to break off negotiations if his settlement demands are not met more credible.

Perception is Reality

Strictly speaking, it is not the actual, objective quality of the negotiator's BATNA that determines his degree of bargaining power, but what the counterpart believes that the negotiator believes about the quality of his BATNA. For example, if an employee receives a job offer from a competing firm and asks his boss for a raise, the employee's power depends on whether the boss believes that the employee will accept the competing offer if the demand for a raise is not met. The credibility of the employee's threat to walk away from the negotiation is unaffected by the fact that neither the boss nor any of the employees' colleagues would prefer the competing offer to the employee's current job at his current salary. Where power is concerned, the beauty of a BATNA is in the eye of the beholder, and eccentricity is not penalized as long as it is perceived to be genuine.⁵ The employee's threat of impasse will be credible to the boss, thus giving the employee power, even if the employee himself actually would not prefer the competing offer, so long as the boss thinks that the employee would prefer that offer.

An objectively strong BATNA is helpful, of course, because a BATNA that *appears* strong renders the negotiator's claim that he believes his BATNA *is* strong more credible. The employee's threat of impasse will more likely translate into bargaining power if his competing job offer is a \$300,000 per year CEO position than if it is a \$15,000 per year mailroom attendant position. But either a phantom BATNA (i.e., a nonexistent alternative) or a real BATNA with phantom value (i.e., an existent but undesirable alternative) can be a source of power in the hands of a persuasive negotiator.

Because the parties' *perceptions* of their and their counterparts' alternative courses of action are ultimately what determines the allocation of bargaining power, information is critical. A car buyer who knows both the dealer invoice price of the model in which he is

interested and that dealers usually sell it for \$500 over invoice will enjoy more bargaining power than the buyer who wanders into the dealership without doing research, for two related reasons. First, the informed buyer will know that the dealer's threat to create an impasse if the buyer will not pay the full sticker price is not credible, and thus the buyer will not be tempted to acquiesce to the dealer's demand. Second, if the buyer demonstrates to the dealer that he is so informed, the dealer will be more likely to perceive as credible *his* threat to walk away from the negotiation if the dealer will not agree to sell for \$500 over invoice. More generally, when B knows that A knows the precise value of A's BATNA (i.e., buying from another dealer for \$500 over invoice), A can credibly threaten not to settle for any deal that is not at least as valuable as his BATNA.

Patience and Power

In many bargaining contexts, especially those involving some degree of bilateral monopoly, the BATNA of both parties, at least in the short term, will be to continue to negotiate, not to pursue a substitute transaction. In this situation, a negotiator's threat not to agree unless her demands are met is in essence a threat of temporary rather than permanent impasse. When both parties have a BATNA of temporary impasse, the negotiator for whom temporary impasse is less costly has the strongest BATNA and thus a relative bargaining power advantage. In this situation, then, the less problematic or costly temporary impasse is for a negotiator, the more power she will enjoy. If we define "patience" in negotiation as the ability to withstand the costs of temporary impasse, it follows that patience translates into bargaining power.

When a union and management meet to attempt to negotiate a settlement of a strike, union members rarely threaten to find substitute employment, and management is precluded by law from firing the striking workers.⁶ The union's threat is that if management does not meet its demands, it will continue to strike, extending the impasse. Management's threat is that, if the union does not accede to its terms, it will continue to permit the strike to go on. If the union has a large strike fund and if management cannot fill its orders with the labor of replacement workers, the union can be more patient in reaching an agreement and will consequently enjoy superior bargaining power. In contrast, if the union's strike fund is empty and its members cannot pay their rents while management has a large quantity of inventory in storage, temporary impasse will be relatively more costly to the union, giving management power.

A similar analysis is often useful in the litigation bargaining setting. If the plaintiff and defendant do not reach a settlement, their dispute will ultimately go to court for adjudication. But if the trial date is not imminent, the BATNA of both parties in the short term is to hold out for a better offer from the other side. In this situation, power resides with the party that can be more patient. If the plaintiff needs money to meet his living expenses or has a strong psychological need for closure of the litigation, she might be less patient, giving the defendant a power advantage. On the other hand, if the plaintiff has retained counsel on a contingent fee basis whereas the defendant is paying his lawyer \$300 per hour to conduct discovery in preparation for a possible trial and to continue negotiations with the plaintiff's lawyer, the plaintiff might be extremely patient and the defendant less so, giving the plaintiff relative power in the settlement negotiations.

The Risks of Power

In a world in which opposing negotiators had perfect information about the other's alternatives and preferences and both made all negotiating decisions with cold rationality, attempts to exercise bargaining power would never cause impasse. In any situation in which a mutually beneficial agreement were possible, the party with relatively less power would yield to the party with relatively more.⁷

Few negotiations, however, are characterized by perfect information and lack of emotion, and both of these facts mean that attempts to exercise power can easily lead to impasse. If both negotiators believe that they have a strong BATNA but that their counterpart does not, each might try to exercise power while neither yields. Thus, lawsuits go to trial, labor strikes drag on, and ethnic warfare continues,⁸ even when agreements that would make both sides better off are feasible, because each party believes his adversary is on the verge of surrender. Alternatively, or in addition, the less powerful party might resent the sense of coercion or inequity inherent in the more powerful negotiator's demands and refuse to yield, even knowing that this course of action will result in a worse outcome for himself, at least objectively speaking, as well as for his bargaining counterpart.⁹

Because negotiators who yield to superior power often feel that they have been ill-treated by their counterpart, a successful exercise of power can have negative relational and reputational consequences. Thus, an employer who succeeds in convincing an employee with a poor BATNA to agree to work for a relatively low salary might find that the short-term savings comes with the baggage of a disaffected worker and difficulty in recruiting employees in the future. A corporate lawyer who uses his client's excellent BATNA as leverage to squeeze every possible concession out of his counterpart in contract negotiations might find that, in the future, other companies call his client to do deals only as a last resort.

These possibilities make the exercise of bargaining power as potentially risky as it is potentially rewarding. Before attempting to employ bargaining power, the negotiator must carefully compare the gains that might be achieved to the increased risk of impasse today and the costs of angering, alienating, or reducing trust among potential future trading partners. A negotiator with good judgment not only knows how to identify and exploit sources of power but also when not to do so.

Endnotes

¹ See, e.g., DAVID A. LAX & JAMES K. SEBENIUS, *THE MANAGER AS NEGOTIATOR* (1986).

² See ROGER FISHER, ET AL., *GETTING TO YES* 100 (2d ed. 1991) (coining the well-known acronym, short for "Best Alternative to a Negotiated Agreement").

³ For a more elaborate treatment of this subject, see RUSSELL KOROBKIN, *NEGOTIATION THEORY AND STRATEGY* 149-82 (2002).

⁴ In the case of a low value claim, the plaintiff's BATNA might be to dismiss the suit. But assuming adjudication dominates dismissal for the plaintiff, adjudication will be the plaintiff's BATNA. Usually, negotiating parties have different BATNAs, but notice that in the litigation context they have the same BATNA, because a plaintiff who opts for adjudication has the legal right to force the defendant to submit to adjudication also. Of course, the fact that the two parties have the same BATNA (submitting to adjudication) does not suggest that this BATNA has the same value to each of them or that they will have the same reservation price. For a more complete discussion, see Russell Korobkin, *A Positive Theory of Legal Negotiation*, 88 *GEORGETOWN LAW JOURNAL* 1789, 1794-

97 (2000).

⁵ As Thomas Schelling wrote, the person who stands on a stranger's porch and threatens to kill himself if the stranger does not give him \$10 is more likely to be paid "if his eyes are bloodshot." THOMAS SCHELLING, *THE STRATEGY OF CONFLICT* 22 (1960).

⁶ See National Labor Relations Act, 29 U.S.C. § 158(a)(1), (3) (2000). Although not important for the analysis here, the law is actually somewhat more complicated than this statement suggests. Management may legally hire "permanent" replacement workers and consequently refuse to give striking workers their jobs back when the strike ends until there are vacancies.

⁷ Game theorists have demonstrated that, under these assumptions, negotiators would divide the cooperative surplus to be gained from reaching agreement in proportion to their relative costs of impasse. See, e.g., DOUGLAS G. BAIRD, ET AL., *GAME THEORY AND THE LAW* 222 (1994).

⁸ Cf. Russell Korobkin & Jonathan Zasloff, *A Negotiation Theory Perspective on the Israeli-Palestinian Conflict After Yasser Arafat*, 30 *YALE JOURNAL OF INTERNATIONAL LAW* 1, 38-39 (2005) (arguing that one explanation for the ongoing Middle East conflict is that both sides believe that they can outlast the other).

⁹ An excellent example is the "ultimatum game," in which Player A proposes a division of a stake—say \$10—and Player B either accepts the proposal, in which case both players receive the allocation proposed by A, or rejects the proposal, in which case both players receive \$0. Although Player B maximizes his income by accepting any nonzero offer, research repeatedly demonstrates that experimental subjects in the role of B often reject low (but nonzero) offers, thus making both players worse off. See, e.g., Ernst Fehr & Simon Gächter, *Fairness and Retaliation: The Economics of Reciprocity*, 14 *JOURNAL OF ECONOMIC PERSPECTIVE* 159 (2000); Werner Guth & Reinhard Tietz, *Ultimatum Bargaining Behavior: A Survey and Comparison of Experimental Results*, 11 *JOURNAL OF ECONOMIC PSYCHOLOGY* 417 (1990).