



How to Size Up a Negotiation

Posted by *Anthony K. Tjan* on February 18, 2010 11:14 AM

In one of my posts last year, I shared a [framework for more effective negotiations](#). The first step of the framework described the need for pre-negotiation homework with an emphasis on understanding the specific interests and positions of the opposing side. Making a list of these points is the right starting place as it helps show where the biggest gaps might be.

The next step is to quantify the value of each negotiation point and of the negotiation in its entirety. While this seems obvious, it is not done as often as it should be. In most negotiations, people enter with pre-determined positions and then in the process allow emotion to override logic. Having the discipline to assess and quantify the facts beforehand helps one to maintain rationality and perspective.

Here is a quick look at how best to quantify a negotiation:

1. Understand the big picture price / value you are trying to achieve
2. Determine which of the negotiation points are quantifiable
3. Bound the low and high values of each point
4. Create scenarios for both "edge cases" which might be of concern and for "likely scenarios"
5. Re-prioritize negotiation points
6. Aggregate quantifiable points to see how they compare to the big picture you are trying to achieve

The big picture of the negotiation is critical to quantify. I'll talk more about the relative importance of this from the buy and sell side in a separate post, but for now it is sufficient to say that the most important number to remember is the total number you are trying to achieve. In the course of a negotiation many people end up negotiating on a point-by-point basis and without remembering the real value of any given point in the context of the broader ultimate goal. Making efforts to quantify the spread in a deal makes the negotiation much easier and can even eliminate points of negotiation. Let me illustrate with an example:

I will always remember an intense negotiation between two sets of lawyers about the best tax treatment for a business that I was selling. After some three hours on the phone with legal counsel, I asked if anyone had quantified the differences between each proposed tax treatment. Everyone understood there were different ways to treat the situation, but no one had quantified the difference. It turned out that the likely savings resulting from choosing one tax treatment over the other would be a nominal compared with the price of the legal and tax work required to maximize the benefit, and it was negligible to the total deal. Any one of the tax proposals would have been fine. As I pointed out bluntly to the folks on the phone, the cost of them bringing up this point and then working on it was greater than anything I might have saved — it was a waste of time. .

With the big picture understood, set low and high values for each negotiation point and develop some scenarios. You then need to try and understand these points in their full context and be careful in how you trade them off against the overall goal. Another mundane example helps illustrate: Let's say you were looking at a vacation package and the car transfer price range you researched in the market was a low of \$50 and a high of \$200. Let's assume that your total goal of all the vacation components was \$1500. If you subsequently learned that the car transfers as part of your package were an outrageous \$200 per transfer (and you could have had equivalent transport for say \$50 per transfer), should you really care if the total trip was a good deal? Scenarios help put a reality check on the negotiation. In our venture capital business, a lot of the negotiation does not really matter unless there is something really bad that happens or something

really good. Often while you are doing a deal it feels like you are negotiating both a pre-nup and a pre-agreement to how you'll share winnings if you hit the jackpot. It helps to outline scenarios to see how meaningful certain deal points really are. For example, in early stage ventures, founders and investors often spend a lot of time and discussion on the pre-money valuation. You can learn a lot about what someone is really thinking by quantifying a few scenarios and with that proposing the appropriate one to the opposing side. For example, an entrepreneur who argues hard against giving an investor the "first money out" suggests that he is not as confident as he should be about the eventual liquidity event (because it should theoretically be much higher than the money invested). Similar to bounding individual negotiation terms with low and high ranges, it makes a lot of sense to try and roll the movie forward to see how low, medium, or high cases might play out.

For our own deals, we estimate what the company really needs in terms of capital and what we need to subsequently believe for our investment to achieve say 2x, 3x, 5x, and 10x our money. I am continually reminded in doing this exercise that even critical terms such as valuation often matter less than one believes they do in several scenarios. By now the common theme should be obvious: quantify, analyze, and prioritize key points, but always focus more on winning in aggregate. Sizing up your negotiation before it starts and periodically during the negotiation will help you understand what it really means to win.

Put Your P&L to the Test

Posted by *Anthony K. Tjan* on December 16th, 2009 10:34 AM

My job is to fund companies with high growth prospects. When we evaluate prospective investments, one of the things we hear from time to time is, "My company could be profitable if we wanted it to be, but we're just investing for growth." Really?

To test this assertion, do this simple litmus test. Take out all the expense assumptions that are directly related to "investing for growth" and have a look at the reset profit line to see what it would look like if you applied an efficient level of resources to run the company and let it grow at an organic pace. "Normalizing" your P&L in this way is a useful exercise as we come to the close of 2009 and managers begin to develop 2010 budgets. You should repeat the exercise periodically to ensure that you have a profitable business model or at least are marching towards one.

Cash flow is still king, and I like business models that can grow both their top-line and bottom-line. Given the choice, though, I'll take a bottom-line that expands and grows faster than the top-line. Software and "software as a service" (SaaS) business models exhibit such potential with recurring revenues and fixed cost leverage. Many times they reach an inflection point where the cash flow and margins can grow faster than the top line. Yet, too many early stage companies get overly focused on their revenue growth and believe they are making progress as long as they see it growing year over year. To be absolutely clear, growth at the expense of earnings is okay, but the critical question is to understand what would happen if you stopped funding that growth. As many saw in this recent downturn, the option value of creating profit is a good one.

Understanding whether or not you have profitable growth by quickly normalizing the income statement is a good proxy to see if you are creating a positive impact on your invested capital — effectively your ROIC (return on invested capital). You absolutely need to spend money to make money, but you have to remember that spending money does not necessarily make you money.

Every CEO Should Write an Annual Memo to the Board

Posted by *Anthony K. Tjan* on November 12, 2009 11:02 AM

It is hard to believe but yes, 2009 is winding down. Thanksgiving is around the corner, the holiday rush is almost palpable, and before you know it we'll be watching our TV screens for the ball to drop in Times Square. It is about this time of year that many businesses begin to feel the pressure of making Q4 work, budget planning for 2010 gets underway, and if there is any time left, to reflect on what this past year has meant.

Each November or December, we sit down with each of our portfolio company CEOs and ask that they put down their top priorities for the upcoming year and lessons learned for the past year. We do this exercise in the form of a CEO Memo to the Board. It's not complicated and certainly not overly detailed, but it sets the big picture and creates an incredibly powerful mechanism for alignment between boards and CEOs.

The bottom line is that writing stuff down clarifies thoughts and regularly revisiting and circulating those thoughts drives alignment. If you are on a board, ask yourself if you can honestly state the top company priorities for the next 12 months. What about the most critical lessons for the company? An annual one-page memo from the CEO to the Board that clearly articulates the most important lessons from the prior 12 months and the most critical priorities for the next 12 months is an indispensable tool to focus leadership on the things that really matter. Here is our five-point plan on how we develop and use a CEO Memo to the Board in our companies:

1. CEOs begin preparing an annual memo at the end of each year that summarizes their most important lessons over the past 12 months and their top four to five priorities for the coming 12 months. There are **never more than five priorities for a 12 month period**. An important rule for us: **a new priority cannot be added until one is completed**.
2. The first of these priorities is almost always: **"Achieve the financial plan."** The memo should refer to the top line and bottom line target or to the date when these targets will be agreed upon between management and board.
3. Other priorities reflect the **top strategic initiatives for the year**, which may include such things as new product launches, customer service enhancements, or new market locations.
4. This memo is then used as a **recurring framework for update discussions and board meetings**. For example, the first page of each board meeting presentation throughout the year is often an update on the major priorities as stated in the annual memo. The priority agenda in the memo also offers an opportunity to drill deeper into one of the specific priorities for the key purpose of a board or update meeting.
5. Regarding the lessons learned: we can accept failure, but we cannot accept not learning from past mistakes. Once a year, a CEO should share with the Board and with employees, **what the most important lessons were and what it means for the organization going forward**.

There it is. Nothing magical, but an annual priority agenda is one of those seemingly obvious things that is rarely done. I have no stats, but my conservative guess is that less than 10 percent of companies undergo such an exercise. I am sure that people feel that they do some version of this, but the litmus test is individually asking leadership members of a company what the top three priorities are for their company and seeing if their answers diverge. We've just found it easiest to put it down on paper and to use it as a "ground hog day" agenda guide throughout the year to see if we are making progress against the big picture.

Four Rules for Effective Negotiations

Posted by Anthony K. Tjan on Tuesday July 28th, 2009 at 3:30 PM

I've been involved in many negotiations in my career. They've all been different in some ways, and alike in others. But through them all, I've identified four "golden rules" to be the most helpful towards productive negotiation outcomes. The rules parallel different stages of a negotiation:

1. The background homework: Before any negotiation begins, understand the interests and positions of the other side relative to your own interests and positions. Put these points down and spend time in advance seeing things from the other side.

2. During the process: Don't negotiate against yourself. This is especially true if you don't fully know the position of the other side. Much is learned about what the other side really wants during the actual negotiation process. Stay firm on your initial set of positions and explain your rationale but don't give in too early on the points. Wait to better understand which points are more important to the other side.

3. The stalemate: There will often come a point in a negotiation where it feels like there is zero room for either side to budge. Two sides are stuck on their positions and may have lost sight of the overall goals of the negotiation. Emotion may have overtaken logic at this point. If you recognize that you've reached this point, see if you can give in to the other side on their issue in exchange for an unrelated point that is relatively more important to you. An example helps clarify: during a friend's recent car purchase he negotiated the price to a level that the dealer did not want to move any more. My friend was going to leave when he asked if they would do the deal if he took the car price the dealer wanted, but give him a substantial discount on a brake job he needed on his second car. They said yes - likely since the discount on the brake job was an easier give (less profit on a job, but on a job they would not have gotten). Yet there was higher relative value of that discount for my friend who would have had to pay higher on the brake repair elsewhere. Bottom line - there is usually negotiation currency outside of the last area you are focused on negotiating. Use different "currencies" and you might get there.

4. To close or not to close: My partner John Hamel always reminds me that the uber golden rule of negotiation is to always let someone else walk away. Whether you drive too hard a bargain, cannot reconcile on key terms, or feel that the deal is just too rich for your blood, make the offer you want and let the other side walk if they don't want it. This is not to say to be offensive or to low ball, but rather to be honest, straightforward on what you are willing to do and explain that you understand if it does not work for them and that it is the best you can do. A great example to end on is how John Hamel recently purchased his new home. He had found a unit in a townhouse complex that he liked and was ready to close on it at price x per square foot. That said, he thought he'd take a shot on a larger and more recently renovated unit by advising that owner (who he knew was interested in selling) that he was going to be accepting a price on the other unit in 24 hours, but would take their unit at an even more aggressive price per square foot if they were interested with an immediate close. Remarkable thing, he ended up with the larger unit and one of the best units in the complex.

Four Simple Ways to Make your Employees Happier

Posted by Anthony K. Tjan on Tuesday July 21st, 2009 at 11:23 AM

There is a very simple secret to long-term employee loyalty and retention and it is not money, perks, or stock options. It's giving them meaningful roles.

This is not an idealistic motherhood-and-apple pie dream, but rather a basic condition of human behavior and psychology that many businesses and leaders often forget: **people are driven as much or more by intrinsic meaning as they are by extrinsic rewards.**

Look around your social circle and you'll quickly remember that some of your brightest friends are working at places that pay jack-all relative to what they could be earning in a different job. They are in those jobs because they provide fulfillment and a sense of purpose beyond the job. Another easy example? Go to an Apple Store and talk to an employee there. Now compare that to the average employee at 95 percent of other retail establishments. Enough said.

In life, people make the "love or money" trade-off all the time. What can businesses do to minimize this trade-off? It comes down to balancing the intrinsic with the extrinsic rewards. The former is the heart and soul of an organization and a person's reason for working there. The latter is the practical mind and wallet. Here are four design points towards unlocking the secret of long-term employee loyalty:

1. **Help her create a meaningful role.** Ask in an interview what she would be doing if she had all the money she needed; explain and remind the employee why her role is critical and how it fits into the bigger picture. This is the foundation and most critical component of long-term retention.
2. **Give feedback.** Do so regularly, with both honesty and thoughtfulness.
3. **Offer professional development.** Keep her larger career path in mind; ask what she wants most to learn. People want to know where they are heading and that you care in helping them get there.
4. **Say thank you.** This means both intrinsic and extrinsic recognition — that is, reaffirm your appreciation for their role (a simple hand-written note or verbal thanks from time to time goes a long way) and pay them fairly.

Making people happy at their jobs is not as hard as it seems.

The Key to Shorter, Better Meetings

Posted by Anthony K. Tjan on Tuesday June 23rd, 2009 at 1:04 PM

Here is a simple managerial tip for meeting effectiveness that I learned some years ago.

Outside of general relationship building, consider that **there are only three functional purposes for having a business meeting:**

1. To inform and bring people up to speed.
2. To seek input from people.
3. To ask for approval.

Use this as a filter to determine why you are having a meeting and explain that purpose to your audience. Your meetings may often cut across multiple objectives but forcing yourself to clarify the agenda into these three purposes can result in more effective meetings.

Consider a meeting that sets its agenda goals along the lines of: "I want to bring you up to speed on these two things; I need input on this item; and finally I would like to seek your approval on these outstanding issues." That's it — a simple 3 purpose meeting rule that frames the goals of the meeting from the perspective of the meeting participant.

If you haven't figured it out, the purpose of this blog was twofold: to inform you on this framework and seek your input on it. What do you think?

The Fallacy of Financial Metrics

Posted by Anthony K. Tjan on Monday June 8th, 2009 at 5:45 PM

In both entrepreneurial and larger companies, **we too often spend time focusing on the desired financial performance target, rather than the inputs that drive those numbers.** Because boards, investors and management demand an objective way to measure performance, we often go right to the result without focusing on what caused those results.

Financial performance is a result, a by-product, a consequence of something else. The financial "numbers" ultimately represent the scorecard we care about, but they do not help us understand how to score. When we ask management teams what are the most important drivers (or what we call operating metrics) of their financial results, I usually see one of two reactions: a) a dog in front of the television blank stare or b) a further breakdown of financial results: "sales on the West Coast drove the results." When pressed further, we may get even further sales breakdowns which tell us little. As my partner, Dick Harrington, says, "We end up slicing baloney with a scalpel" and are talking too much about the "what" without getting the "why."

Operating metrics are the inputs that correlate or drive the desired results of a business. If you focus on the inputs, you need to worry less about the financial outputs. Examples of inputs include customer convenience, product quality, customer retention, or customer referral rate.

Let me provide a couple of concrete examples. In many of our retail or restaurant investments, we espouse a value proposition of convenience. The more convenient we can make the experience, the happier the customer will be, and the more likely we will have customer repeat and referral, **meaning not just higher revenues but higher quality of revenues.** How does convenience translate into a measurable operating metric? As a proxy for convenience we measure metrics such as turn-away rates and wait times for service. That is, when a prospective patron walks in or makes a call for a reservation how often do we turn them away because we are full or short-staffed? We want that turn-away number as low as possible to reinforce convenience. If we detect a repeat issue we can see how to solve it, perhaps through improved reservations systems or increased staffing. Other metrics we might measure include weekly cleanliness scores, customer loyalty, and periodic customer satisfaction reviews. Of course we will look at these operating metrics alongside the financial and more quantitative results, but again--the point is to uncover the correlation between operating drivers and financial outcomes.

Businesses need to focus on the 3-5 metrics that represent the most important drivers of value creation. It helps align an organization towards doing the right thing in a repeatable and scalable manner. When you just ask a team to chase results on a plan, you may never be sure what drove that result even if you are successful. There is a difference between having a good year of numbers and a sustainable business model that allows for more predictable year-over-year results. From a managerial tool perspective, a weekly or monthly dashboard that highlights not just the financial results, but also the operating metrics is smarter and more actionable. A dashboard with operating metrics serves effectively as an exception-based report where you look for deviations from the norm of operating metric levels and then consider whether the issue is systemic or one-off.

It is true that people behave based on what they are measured by. Here are some guidelines on setting a culture driven by operating metrics and measuring your team on the right stuff:

1. Ensure management understands the difference between operating metrics and financial metrics - operating inputs versus financial ratios. The latter is for number-crunching analysts to focus on, the former is for managers and it is what will make the latter automatic.

2. Clearly communicate across the organization a small number of the most important operating metrics. It takes some thought to filter through the many possible inputs / operating metrics, but pick only the 3-5 that have the highest correlation to the desired financial goals.

3. Regularly review an operating metric dashboard, but focus on exceptions. You'll be able to scan the health of your business very quickly. In an earlier blog, I interviewed superstar Oprah doctor and cardiac surgeon Mehmet Oz, and discussed the vitals for good personal health. Indeed, an excellent analogy is that operating metrics should represent the blood pressure and cholesterol levels of a company. Focus on the right ones, regularly measure them, and if they are out of whack, do something before your company has a heart attack.

Five Questions Every Mentor Must Ask

Posted by [Anthony K. Tjan](#) on Wednesday March 25, 2009 11:25 AM

One of my partners, [Mats Lederhausen](#), recently shared with me a mentorship framework, first inspired by wellness guru, Deepak Chopra, that he's evolved and used over the years. The framework is an amazingly simple-yet-powerful set of five critical questions. [As venture capitalists and advisors](#), we spend significant time partnering with portfolio companies and very often find ourselves in a mentoring role. These five questions, when asked in the order presented, form an effective diagnostic tool that can provide better guidance to mentees, employees, or generally anyone with whom you are playing the role of a counselor. Additionally, they can serve as a self-diagnosis of one's own capabilities and opportunities.

Here are the questions:

1. What is it that you really want to be and do?
2. What are you doing really well that is helping you get there?
3. What are you not doing well that is preventing you from getting there?
4. What will you do differently tomorrow to meet those challenges?
5. How can I help / where do you need the most help?

Let's briefly look at each question:

1. What is it that you really want to be and do? This question is about aspiration and purpose. The reason why someone is doing what they are doing should come out here. The question is also meant to get at the business goals and broader aspirations of an individual - someone wishing to be successful in business so that they can do more to help others, for example. The answer to question one should surface the driving passion of individuals - what is it they do or wish they could be great at doing?

2. What are you doing really well that is helping you get there? This question helps spotlight a core strength and the person's ability to execute towards his/her goal. What is someone naturally good at doing? Detailed and standardized operations? Leading and motivating staff? Numbers? What is it that someone does better than the average person that can help her achieve her aspiration?

3. What are you not doing well that is preventing you from getting there? This is about facilitating an honest and critical assessment of the roadblocks, challenges or weaknesses in a person or company that is slowing their ability to win the game; to meet the goal from question one.

4. What will you do different tomorrow to meet those challenges? Questions two and three help determine whether people are spending the right time on the right things. Progress cannot be measured just by hard work. Someone may have a great work ethic, but if he is not focused on the right priorities, then "you're making good time, but you're lost," as another one of my partners likes to say. People also have a tendency to practice and repeat what they are already good at doing. It is human nature to show off your best side and hide weaknesses. As a kid playing racquet sports, I remember being asked once why I kept practicing my forehand when my backhand sucked. Use this question to probe whether the person has the aptitude to change behavior. Will the person practice start practicing his backhand?

5. How can I help / where do you need the most help? The answers to the first four questions matched against areas where you as a mentor have particular strengths, relationships, or learning resources - should help determine how you can best help someone achieve the goal.

These questions will help you assess where you can really help an individual or a company. Try these five critical questions the next time you are interviewing a mentee candidate, the next time you have a mentoring session, or answer them yourself as a self-diagnostic. The answers can help you or your mentees put together a sensible game plan for forward progress.