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**COMMERCIAL NEGOTIATION LESSONS,  
STRATEGIES AND TECHNIQUES (Part II)**

POZZUOLO RODDEN POZZUOLO, P.C.

COUNSELORS AT LAW

2033 WALNUT STREET, PHILADELPHIA, PA 19103

215-977-8200/FAX 215-977-9663

[www.pozzuolo.com](http://www.pozzuolo.com)



**COMMERCIAL NEGOTIATION LESSONS,  
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(Part II DUE DILIGENCE)**

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This newsletter is the second part of a multi-part series to help you understand the factors, skills and strategies involved in business negotiations. The first part was provided in last month's newsletter and discussed the main factors and techniques that greatly affect the outcome of commercial negotiations. This second part introduces the various stages that any negotiation follows and more specifically discusses the pre-contact and post-contact due

diligence stages. The later stage will be discussed in a future newsletter in the interest of length. Then, a final newsletter will give examples of how the framework and techniques of the various stages of negotiations play itself out in the following two examples of common, day to day business negotiations: 1) the negotiation of a commercial/real estate business loan; and 2) the negotiation of the purchase or sale of a business.

## **RECAP OF NEGOTIATION FACTORS**

The outcome of any negotiation is generally determined by whom has the informational advantage, who has relative bargaining power, the creativity of the parties, the communication skills of the parties, and the parties' abilities to follow through. A party with superior information, high relative bargaining power, greater creativity, greater effective communication skills (including the ability to listen), and the greater ability to follow through (and ability to demonstrate that) will generally dominate the negotiations. Additionally, in the short run, a party is able to improve their informational advantage, creativity, and superior communication skills by performing better due diligence and/or hiring a skilled representative, whereas bargaining power and the ability to follow through are items that may take longer to improve. Understanding what makes a negotiation tick helps identify what is necessary to improve your position for the next and future deals.

## **NEGOTIATION STAGES**

Almost all negotiations generally follow the following five stages where some of the stages are longer and some are shorter than others:

1. Pre-contact due diligence stage;
2. Post-contact due diligence stage;
3. Negotiation stage;
4. Confirming the agreement; and,
5. Following through.

Knowing the general stages, what should be done in each stage, the order of stages and when the transaction is ripe to move to the next stage are important to help you move forward, avoid missteps and hopefully close the transaction according to your business plan and goals. For instance, if you start making offers or accept a deal without due diligence, you may make a suboptimal offer and have a tough time working back from there. You may offer to buy a product for \$100/unit that the seller would have been glad to sell for \$80/unit. Again, in the interest of time and length, this newsletter will discuss the pre-contact due diligence stage and the remaining stages will be discussed in a future newsletter.

1. Pre-Contact Due Diligence Stage – The pre-contact due diligence stage is the first stage of any negotiation and is about doing your homework before the commencement of negotiations so you can create an informational advantage (or minimize an informational disadvantage), and know what you are getting into. This is about finding information out prior to any direct or indirect interaction or contact with the counter-party as even a simple request for information starts the more formal negotiations. This homework is by far the most important stage to any negotiation, but is many times overlooked in favor of diving into the negotiation stage. The following are areas that should be evaluated:

*The Parties* – You need to know the parties and who you are really dealing with. You need to know if this is the type of party you are looking to work, negotiate or bargain with. For example, in its most simplistic form, if you want to buy a new 2025 BMW automobile you do not go to a used car dealer but to a new BMW authorized dealer. If you are looking for good cup of coffee, while a coffee vending machine may provide a cheap quick cup of coffee, a corner coffee shop is far better. The same works for negotiations. Make sure you are going to the right party that offers what you are looking for. You do not want to waste your time, energy and money negotiating for something the other party does not have, does not want to offer, or does not have the power or authority to offer. A clear example is negotiating with a bank's branch manager for a \$10,000,000 commercial loan when he/she only has the authority to approve a maximum \$500,000 residential mortgage loan.

Once you know you are dealing with the right party, you will want to know specifics about the party itself. For instance, if you know the counter-party is insolvent and needs cash, you now know you may be able to purchase assets at a substantial discount without the possibility of any after purchase service. If the counter-party is a traveling lecturer with limited time, he/she may simply take substandard terms in the interest of time and simplicity or he/she may avoid transactions that are or may become too complex and/or time consuming. Additionally, you need to know who is influencing the deal and calling the shots. In other words, who has the authority to close or finalize the transaction? There may be someone behind that is calling all of the shots. You need to be cognizant of that party's needs too. For instance, if closing of a transaction requires governmental or third party (such as the party's bank) approval, you will need to know what the governmental authority or bank wants. You can create the best deal in the world with the immediate counter-party, but if the governmental authority or third party is not happy, the deal may be never close or be scrapped. Lastly, you may be immediately negotiating with the minority owner of a business without approval power, when you need to cater to the majority owner.

2. *Negotiation Parameters* – It is important to know what the parameters of a transaction are and if there is any flexibility in those parameters. Some negotiations are simple where price is the only parameter. Some are more complex where you may be negotiating price, quantity, timing of delivery, who pays for delivery, risk of the product in transit, certain costs and expenses, etc. You may obtain a good price, but at the cost of poor additional terms and variables.

Also, it is important to know how these various parameters interact and which may be sticking points. Some parameters are flexible, some flexible within a smaller range, and some are inflexible. Try to understand which parameters will be important and how flexible each parameter is to each party. For instance, if a bank is insisting on two points above the prime rate of interest for a ten million dollar commercial loan, the two above prime may be a sticking point to the bank, but flexible to the borrower. Instead of insisting on lowering the two points to one, the transaction may work best for both if, for instance, the bank still charges two above prime rate of interest for the loan while adding additional bells and whistles for the borrower such as capping the attorney documentation fee, capping the loan origination fee and increasing the percentage to borrow off current receivables or the definition of borrower receivables. When parties value the parameters of a transaction differently, it has the potential to be a win-win situation because both parties can give up something unimportant to them, but very important to the other party.

3. *Relationship* – You need to understand the prospective relationship. First, you need to know the intended length of the relationship. Parties will be much more reasonable to one another if they are expected to have a long term relationship and much less reasonable if the negotiations are merely one quick deal. Second, you need to evaluate yourself and the counter-party with relation to the negotiation factors themselves as previously explained. If the other party has greater knowledge or skill, you will want to be cautious especially if the other party appears to be offering you a deal that seem too good to be true to make sure you are not missing something they know. Additionally, if you lack bargaining power, then you will look foolish making baseless demands and threats to the party who controls the deal. It may be better to coax the party through sympathy. If you hold the cards then know you can use these if and when necessary. These factors help you know how to approach the deal.

*Thinking creatively* – Due diligence is not only about gaining information, but about planning. Think of different angles to approach the deal. See if you can turn it into a win-win situation instead of a zero sum game of win-lose. As stated, use differences in importance in negotiating parameters to find a win-win where both parties are giving up on something unimportant relative to each party, but where it is a major gain for the other party. If you are concerned with price and the other party with shipping terms, you may be able to achieve favorable price terms by giving them more favorable shipping terms. In essence, both sides are happy receiving what they wanted and from their own side feel like they did not give up much. Come up with your desirable variables and approach beforehand so you can guide the deal into terms you desire instead of what the counter-party wants. Having a game plan is one of the most important aspects of the pre-contact due diligence.

4. *Note Missing Information* – You will not know everything during this stage as some information you can only obtain from the counter-party. During this stage it is more important to know what you do not know than what you do. It is important to create a list of what information you are missing and what questions you need to ask. This will save you time and allow you to pinpoint exactly what you need so you can fully evaluate the transaction. If not, you may end up with a deal you thought was good and then find issues

and problems after the fact.

5. Post-Contact Due Diligence Stage – The next stage is due diligence after making contact with the counter-party. Many parties make a mistake by jumping into making offers without knowing all of the information and variables once they get in contact. They should hold off until after they learn the missing pieces from the counter-party itself. There are three important goals in this stage: 1) to break the ice/test the other party; 2) to fill in the gaps from your own due diligence to date ; and, 3) then to use that new information to alter your approach. Your goal in this stage should be to extract as much information from the other party as possible without giving away more information than necessary and then use this information to your advantage. The general rule is that the more information they give you, the better your position becomes, but the more information you give them, the better their position becomes. For example, not knowing the other party's pricing, you may offer to purchase a widget at \$100/unit once you sit at the bargaining table knowing you will make a good profit on the product. That sounds good! However, what if you come to know at a later stage that the counter-party usually sold that widget for \$80/unit and you just offered a 25% premium on their usual price? You left \$20/unit on the table. Clearly, sitting back, asking questions and allowing them to provide you their information would help tremendously.

*Initial Ice Breaking and Testing* – The initial ice breaking stage is about loosening the parties up, poking and prodding the counter-party's temperament, intelligence, and skill, finding out whom you are negotiating with and what his/her power, discretion and authority is. First, it is good to start with something light and airy to get to know each other and find some common ground. For example, talk about children, sports, celebrity gossip, your backgrounds, cars, what you are doing for upcoming holiday, family, the weather, etc. Maybe find his/her Facebook or LinkedIn page to find topics, subjects or universities the other party may be interested in or may tell more about them. The idea is to find common ground and create a relationship, even if minor, where he/she feels you have common interests, are reasonable and he/she can trust you.

Second, with this initial ice breaker, you want to use it to read your counter-party's temperament, intelligence and skill. You want to watch how they react, what they talk about, and how they speak. While this seems petty, it is important to know whom you are negotiating with. Many negotiations drag on too long or breakdown because the counter-party has a short, fast or irritable temperament or lacks the intelligence to understand what you are offering. Understanding this allows you to know what you are getting into, especially for a long term relationship, and how to change your own temperament and approach to counter his/her personality or intelligence/skill level. For instance, you may take extra time to explain your points and/or ask him/her to recite them back which you may not have to do with a more intelligent counter-party. There may even be times when you may need to bring in another party of your negotiating team to counter your counter-party's temperament. Once again, this is when due diligence is mandatory and egos must be left at the curb.

Last, it is important to find out whom you are negotiating with and what authority and

power he/she has. You need to be negotiating with the person making the decision or at a minimum, have him/her on call: 1) to not waste your time, energy and money; and, 2) to show that you are being taken seriously. For instance, as previously explained, different lending officers have authority to negotiate different types of loans up to certain dollar amounts. If you need a \$10 million commercial real estate loan for your business, you want to make sure the lending officer has the authority to make or at least recommend that type of loan and in an amount up to or greater than \$10 million. There is no point spending a half of a day traveling to and from and a meeting with a residential mortgage lender who can only lend up to \$500,000. Also, sometimes a counter-party will send someone with no authority to further its own due-diligence on you. This may be fine in an early stage of negotiations if you are allowing such a meeting to gather information to complete your own due diligence, but it is a slap in the face if it is later in negotiations. Make sure you are not wasting your time with someone who does not take you seriously or have the power to follow through and make decisions.

6. *Fill the Gaps from Due Diligence* – After finishing the ice breaking and sizing up the other party, you should be moving into filling in your information gaps with information that you need directly from the counter-party. Your purpose here is to receive enough information where you would be willing to move forward. If a party seems evasive or you still have further questions do not move forward until you feel satisfied. If afforded the luxury of time, it may be worth a couple sessions so you have time to process new information and come up with new questions, creativity and variables. Sometimes you may be forced to move forward before being satisfied, but at least know you are making a conscious decision to take a risk.

Additionally, at this stage, it is always better to focus on inquiring about information instead of providing information. As stated before, the more information you divulge, the better position you place your counter-party in whereas the more information you receive the better position you are in. Divulge only enough information as necessary but do not come off as evasive. You do not have to answer every question, especially if your counter-party is evasive. Only give enough of an answer as necessary, and if they ask something, make sure you receive something back by turning your answer into your next question. Last, never make comments such as: “my breaking point is...” or “my client cannot go higher than...” If that is really the breaking point you just set your price or terms at that breaking point. If it is not your limit and you go beyond it, your counter-party will not trust you or respect your boundaries in the future knowing it is a false boundary. Lastly, it is a basic, fundamental principle of negotiation to not give or say too much to always leave your options open.

*Using the New Information* – Again, information gathering and due diligence are not only about information, but are also about planning. Take the new information you gained from the counter-party and figure out whether you can now improve your approach with the new information. For example, if you find a party is willing to sell a product at \$80/unit when you would have paid \$100/unit, this changes the price range of your first offer from \$100 to at or below \$80/unit. Another example is if you learn that the counter-party has unreasonable expectations, you may realize it is better to walk away and potentially they

will come back a couple months later after they learned their expectations were too high instead of ruining the relationship arguing with them. Negotiation is about constantly taking in new information and learning how to use to your advantage.

In summary, the due diligence and information gathering stages are the most important stages of a negotiation. Without them, you are negotiating in the dark. They set the stage for where to start the actual offers, how to approach the counter-party, and even finding the appropriate counter-party. It takes a little extra time to brainstorm and plan, but the extra time can go a long way by avoiding wasted time, energy and money and obtaining much greater terms.

If you need help or assistance in any of your business negotiations, one of our **Philadelphia Business Attorneys** is here to take assist you. Contact **Pozzuolo Rodden Pozzuolo** today!

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