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Negotiating a Deal in Korea: Reflections of a Battle-Scarred Veteran

Michael E. Zacharia‡

I. INTRODUCTION

In 1996, for an international widget company[1] focused on selling to the Japanese tourist and looking to expand its business, Korea was the Promised Land. Korea had a widget business well in excess of (U.S.) $500 million, and was the second most popular Japanese tourist destination. No foreign companies were in the market, and my client BWC (a world-renowned widget company), sought to change that. They did, for a while. This paper analyzes select aspects of the twelve months of Round One negotiations that led to the triumphant signing of a Joint Venture Agreement with SY, a leading Korean widget retailer. Space constraints permit only the briefest recap of Round Two of the negotiations, which was the not-so-triumphant dissolving of that joint venture ("JV") eighteen months later—a victim of the intervening Asian financial crisis. We found that in *this* Promised Land the milk was not so fresh and the honey not so sweet. We also found that a carefully crafted agreement that plans for the worst-case scenario is essential to surviving the expected and unexpected risks of doing business in the often-volatile international business arena.

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1. This paper reflects an actual Korean negotiation; however, in order to protect the privacy of the parties to this negotiation, the names and certain identifying information and relationships have been changed.

II. THE PREPARATION

"Negotiation is a process of communicating back and forth for the purpose of reaching a joint decision."[2] Painstaking preparation is critical to success at the bargaining table.[3] That process has been described helpfully with the acronym, CAP (Collect information, Analyze information, Plan a strategy based on the information).[4] This negotiation, to be done right, was going to require a great deal of preparation, and clearly understanding my client's interests was the first step.[5] "'Interests' are the 'abstract needs' that must be satisfied to complete a negotiation."[6] Interests motivate people and organizations, and are the "silent movers behind the hubbub of positions."[7] Only by first identifying my client's interests could I determine and evaluate our various alternatives for entering the Korean market. This process of identifying "interests" is called "going below the line."[8]

The key interests of BWC in Korea were:

1. A desire to enter into one of the largest and fastest growing downtown widget markets, and position us for entry into the soon-to-be opened new Icheon International Airport in Seoul;

2. A need to team up with a Korean partner since foreign companies were not permitted to obtain a business license to sell widgets in Korea;

3. The Korean partner would need to have the following qualities: a large market share; be of high repute because a foundational underpinning of the BWC reputation and

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2. ROGER FISHER, WILLIAM URY & BRUCE PATTON, GETTING TO YES: NEGOTIATING AGREEMENT WITHOUT GIVING IN 32 (Bruce Patton ed., 2d ed. 1991).

3. STRAUS INSTITUTE FOR DISPUTE RESOLUTION, PEPPERDINE UNIVERSITY SCHOOL OF LAW, NEGOTIATION AND SETTLEMENT ADVOCACY NOTEBOOK, 3:14 (1993).

4. Richard Coleman, Negotiation Theory and Practice lecture notes (Fall 2007) (on file with the author).

5. Understanding the interests of the party with whom one wants to negotiate is equally important, but that cannot take place until after your own interests and alternatives are analyzed and understood.

6. STRAUS INSTITUTE FOR DISPUTE RESOLUTION, *supra* note 3, at 3:4 (emphasis omitted).

7. FISHER ET AL., *supra* note 2, at 41. "'Positions' are the parties' 'definable perspectives' on the issues of the negotiation." STRAUS INSTITUTE FOR DISPUTE RESOLUTION, *supra* note 3, at 3:4 (emphasis omitted). "'Issues' are the 'identifiable and concrete' concerns that must be addressed to conclude a negotiation successfully." *Id.* (emphasis omitted).

8. STRAUS INSTITUTE FOR DISPUTE RESOLUTION, *supra* note 3, at 3:2.

success was high integrity; be well connected politically and with the labor and travel agent community to protect and advance the business; have a good downtown location with aspirations to be in the new airport;

4. A need to be the exclusive supplier of goods and have primary management responsibility and control;

5. Have a profitable business model that ultimately would lead to majority ownership;

6. Have a deal structure that would align the BWC and partner incentives;

7. Have a deal that would protect BWC's investment.

8. In addition to the interests of my client, I needed to recognize my own interests as the lead negotiator: this was my first deal for the client, and I did not want to screw it up.

By identifying these interests, I was able to make an initial assessment of our Best Alternatives To a Negotiated Agreement ("BATNA")[9] with each of our possible entry alternatives to Korea, prior to beginning negotiations with anyone. Only after this analysis does one have a sense of both the strengths and weaknesses of the various alternatives to a negotiated agreement with any particular party. The BATNA is the standard against which any proposed agreement must be measured.[10] After going through this analysis by looking at the potential partners in Korea, it became clear that SY, the third largest widget retailer in Korea, was our best (and only realistic) potential partner. If we were not able to negotiate an agreement with them, our alternative was to not be in Korea.

Trying to understand the other side's BATNA is also very important to conduct effective negotiations.[11] I wanted to know as much as possible about SY's BATNA before even initiating contact with them so we would

9. FISHER ET AL., *supra* note 2, at 100.
10. FISHER ET AL., *supra* note 2, at 100.
11. FISHER ET AL., *supra* note 2, at 105.

best know how to pitch our case to them right from the start. By talking with our many industry sources, we were able to determine that SY, even though the third largest player in the market, was having severe financial problems, significant problems with key suppliers, and was very poorly managed by the original founding husband and wife team. If they were not able to fix these problems, we learned, they would likely go out of business. We also learned that they were people of good reputation and very well connected politically and with the travel agent community. Their shortcomings were our strengths and our shortcomings were their strengths. When I overlaid their needs and strengths against ours, there seemed to be a very good match on paper.

Because this was to be a cross-cultural negotiation, a whole range of specialized considerations came into play when preparing.[12] Understanding the meaning and importance of "face" is perhaps the most critical factor in negotiating with the Koreans.[13] The concept of "face" in Korea, like many other collectivist societies, is of fundamental importance.[14]

> 'Face' in [Korean society] is a psychological-affective construct that is tied closely with other concepts such as "honor" "shame" and "obligation." In [the US], "face" exists only in the immediate time-space that involves the two conflict parties, while "face" in [Korea] involves the multiple faces of relatives, friends, and family members that are closely linked to the interactants. "Face" is a relatively "free" concept in [the US] but "face" is an obligatory concept in [Korea] that reflects one's status hierarchy, role position, and power resource.[15]

From the very start, this concept of face would play a critical role throughout our discussions.

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12. *See* DAVID AUGSBURGER, CONFLICT MEDIATION ACROSS CULTURES (1992); TERRI MORRISON & WAYNE CONAWAY, KISS, BOW, OR SHAKE HANDS (2d ed. 2006).

13. AUGSBURGER, *supra* note 12.

14. AUGSBURGER, *supra* note 12. Certain cultures, such as the United States, are viewed as "individualistic" because of the great societal emphasis that is placed on the individual and his or her accomplishments. This contrasts with "collectivistic" cultures, such as the Koreans, who place great emphasis on the "group" rather than the individual. The group can be family, work, community, or otherwise. In a collectivistic culture, what is right for the group is far more important than the consequences to the individual, and conforming to group ideals and standards is strongly encouraged. *See* G. HOFSTEDE, CULTURAL CONSEQUENCES: COMPARING VALUES, BEHAVIORS, INSTITUTIONS, AND ORGANIZATIONS ACROSS NATIONS 209 (2d. ed. 2001); Nina Meierding, Cross Cultural Negotiation and Dispute Resolution Manual (unpublished) (on file with author). *But see* MORRISON & CONAWAY, *supra* note 12, at 458 (Koreans are more independent and individualistic than their Asian neighbors).

15. WILLIAM GUDYKUNST & STELLA TING-TOOMEY, CULTURE AND INTERPERSONAL COMMUNICATION 159 (1988).

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III. BEGINNING OUR NEGOTIATIONS

How to make the initial introduction is one practical outgrowth of this concept of "face." "Koreans tend to be suspicious of people they do not know, or people with whom they do not have a mutual contact . . ."; therefore, an introduction by a trusted third party is very beneficial. While I knew that our reputation as the world's largest widget retailer would be well known to the SY owners, we set up the first meeting with them in January 1997 through a third party intermediary who we knew was trusted and respected by them. Hierarchy, rank, and age are also very important aspects of "face" in all interactions with Koreans. We made sure that in our meetings we matched the Chairman of their company (the founding husband) with the Chairman and CEO of BWC. The President of their company (the Chairman's wife) was matched with the President of BWC's Asia Group and me, as BWC's counsel and lead negotiator. The SY founders brought in a close family friend, who had studied in the United States and was fluent in English, to act as interpreter for our discussions. I established an excellent rapport with this man and I made a judgment call to agree to use him and not add another interpreter at this early stage of the negotiations. By doing that, I gave "face" to the SY founders (and the interpreter) at very little, if any, risk to us at this early stage.

Establishing trust and a personal relationship is vitally important in negotiations in Asia[16] and one must expect for Asian negotiations to take much longer than in the West.[17] We spent the first two months simply getting to know each other and our respective businesses better through a series of dinner and lunch meetings. These discussions revealed a large number of shared interests upon which both sides thought a JV relationship might be built. It also revealed some competing interests, like their need to get out from under an exorbitantly large debt load (which they no doubt would want my client to finance).

I did not discuss any specific terms at this stage because I wanted us to continue to focus on interests and options and building a relationship. I also wanted to gather more information, and I did not want to begin to take positions or propose structures until I had as much information as possible. The more information about the other side you are able to learn, the more effective you will be in negotiations with them. In a corporate deal context,

16. *Id.* at 462-63.

17. *Id.*

information gathering occurs by conducting a due diligence investigation of the party's business operations and records. This is often a very touchy subject because a company, particularly a privately-held family-owned Korean company like this one, is reluctant to open up its books and records unless they feel there is a high likelihood of a successful deal. After a great deal of discussion, I was able to persuade President Eun Jung that it would be in her interest (as well as ours) to allow us at this stage to conduct a limited due diligence review in order to determine in what areas and in what amounts we believed we could add value to their business if we were to form a JV. In March, we negotiated a letter agreement outlining the timing and structure of a limited two-phase due diligence review. We also agreed on a June target date by which BWC would submit its initial offer.

At this point I assembled both our due diligence and negotiating teams. I learned valuable lessons from sometimes painful experiences in my younger days in the State Department as head of the U.S. delegation negotiating international trade controls. Among these lessons, I learned that the authority of the lead negotiator, the make up of your team, and how you manage their interactions with the other side are critical factors for success in complex negotiations.[18]

My client's CEO made it crystal clear to the organization that I was in charge of these negotiations, so that was never an issue. I knew that for these negotiations and this deal to be successful, I needed to have buy-in among the many key internal BWC stakeholders. Those included, first and foremost, the Chairman and CEO, who ultimately would be responsible and would have to get the Board of Directors' approval before any deal could be finalized. In order to get the CEO's support for any deal we negotiated, I needed to have the key internal stakeholders feel that they had been a part of the process and that their interests had been taken into account in the ultimate deal that was struck. Those individuals included: the Asia Region President, who would be responsible for operating the JV and producing a profitable P&L; the CFO; the General Counsel; and the Chief Merchant. I had a representative from each of these groups as part of my due diligence team so that they could feel like a part of the process from the start and, importantly, provide their great expertise in analyzing the business and assisting me with how best to come up with creative deal options. A much smaller subset of this due diligence group ultimately became my negotiating team.

I chose as outside Korean counsel a very experienced, older, native Korean who was senior partner in a very prestigious Seoul law firm. This turned out to be an inspired choice, as D.H. Kim became one of my most

18. *See* STRAUS INSTITUTE FOR DISPUTE RESOLUTION, *supra* note 3, at 3:24.

trusted advisors on both the law and on Korean protocol and "thinking." He served as my interpreter of both language and culture. Because of his age, stature in the community, and calm demeanor, the SY owners quickly grew to respect him greatly. On a number of very tense occasions, he was able to play an invaluable "go-between" role, even though he was our counsel.

I strictly controlled the nature and content of the interactions of my due diligence team (and later my negotiating team) with the SY representatives. This was necessary to ensure that one unified message was being communicated and to prevent SY from prematurely learning about our internal assessment of the deal possibilities through conversations with any of my team members. I encouraged vigorous debate on all issues among my team when we were behind closed doors, but once a position was agreed upon, I tolerated no debate of it in front of the other side. I was the sole BWC spokesman at the negotiating table unless I expressly authorized one of my team members to speak — which I frequently did. This sounds authoritarian (and it is), but it is essential to a successful negotiation.[19] I encouraged any team member who thought I was off base during any of the negotiations to alert me discretely and I would privately consult with them at an appropriate break time.

Through our due diligence review, which also involved numerous discussions with the owners, we learned information about the condition of the company that greatly aided our position in the negotiations. It became clear to me that their alternatives to a negotiated agreement with us (their BATNA) were very bleak. Moreover, BWC, with its particular strengths, was uniquely positioned to provide relief to many of their problems. Armed with a great deal of information about their interests and BATNA, it was now time to make our offer.

Who should make the initial offer in a negotiation is an important strategic decision.[20] In this case I wanted to make the initial offer for a number of reasons. I wanted to "anchor" the discussion early around an approach and standard that was favorable to us.[21] I wanted this negotiation to proceed more as an "integrative" bargaining process as opposed to a primarily "distributive" (or "competitive") bargaining process. "Distributive" bargaining is a process by which the parties distribute, between themselves, the substance over which they are bargaining.[22] This

19. *See* STRAUS INSTITUTE FOR DISPUTE RESOLUTION, *supra* note 3, at 3:24.

20. FISHER ET AL., *supra* note 2, at 169.

21. *Id.*

22. STRAUS INSTITUTE FOR DISPUTE RESOLUTION, *supra* note 3, at 2:2.

type of bargaining assumes a fixed pie and is essentially a zero-sum exchange where whatever one side gains the other side must lose.[23] This type of bargaining proceeds from one position to another by means of a series of concessions.[24] It can be very hard on relationships[25] and must be used judiciously in negotiations for a JV, which by its very nature contemplates an important ongoing relationship between the parties. In "integrative" bargaining, the parties work cooperatively to "expand the pie" and create value by generating new options that focus on underlying interests rather than positions.[26] All negotiations are a mixed-motive exchange involving competition and cooperation,[27] and I wanted to structure the opening offer to maximize the integrative bargaining aspects and minimize and postpone some of the necessary competitive aspects (like "price") until we could all get excited about the larger and tastier pie we could bake and divide.

Our opening offer in June was in the form of a non-binding Letter of Intent ("LOI") that set out all the important areas upon which we needed to agree in broad strokes and principled approaches rather than specific details and numbers. In this way, we could use this document as a framework agreement and we could move toward commitment gradually and comprehensively.[28] I also wanted to establish the importance and "linkage" of each of these issues to the ultimate deal we might strike. Linkage is a key negotiating concept, particularly in this negotiation, because of the importance BWC placed on satisfactory agreement on a number of issues as a condition to the price.[29] On the important question of "price," I adopted a principled but flexible position.[30] Importantly, we inserted the right to protect our investment by requiring his repayment of our investment if we "put" our shares to him in the event of his material breach or a material adverse change of conditions.

It took us many meetings between June and August to finalize agreement on the LOI. Even in the context of just trying to hammer out the general terms for this non-binding LOI, it became clear (surprise, surprise)

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23. *Id.*

24. *Id.* at 4:2.

25. *Id.* at 2:5.

26. *Id.* at 3:2; *see also* FISHER ET AL., *supra* note 2, at 40-55.

27. STRAUS INSTITUTE FOR DISPUTE RESOLUTION, *supra* note 3, at 3:1.

28. FISHER ET AL., *supra* note 2, at 171-72.

29. STRAUS INSTITUTE FOR DISPUTE RESOLUTION, *supra* note 3, at 2:15; Coleman, *supra* note 4.

30. I proposed this wording: "For purposes of discussion, we ask that you tell us what you believe should be the appropriate percentage of SY share capital that BWC should receive in exchange for an investment of $25 million, together with the reasons for your views."

that the price and value of the company was going to be a key battleground. I did not want to engage fully in that battle yet because I wanted us to make progress on the myriad of other issues critical to BWC before we tackled agreement on price. SY also insisted on us investing more than the $25 million. To get past the price issue at this stage, we agreed on principled, yet non-committal wording.[31] On August 7, we signed a revised version of my June draft LOI and set October as the deadline for finalization of a binding agreement between us. Step by excruciating step, we were moving forward.

The period of August to October was one of intense negotiations and further due diligence. The price issue quickly became the most difficult in a range of difficult issues. Chairman Jin Ho locked in on an absurdly high valuation of his company. I was able to persuade him to allow us to appeal to "objective criteria" as a principled way to arrive at a mutually acceptable valuation number.[32] We agreed to have two different investment banks value the company. While this was a good idea in theory, in practice, the result was that the investment bank he chose came in with a very high valuation, and the one we chose came in with a dramatically lower valuation. Chairman Jin became extremely emotional when we discussed this issue, and it became clear to me that the valuation of his company was very much a question of "face" for him. No reasoning could budge him from his position. It appeared that our negotiations were at an insurmountable impasse. I spent a great deal of time with my team brainstorming how to overcome this hurdle. By stepping back from the positions being advocated and focusing carefully on our respective interests, I saw that we really had differing interests that could be creatively "dovetailed."[33] BWC was only willing to put at risk $30 million of investment and wanted management control, exclusive supply rights, a good return and protection of its investment. Chairman Jin wanted our money and he wanted the "face" of having created a $200 million company.

This is how we "dovetailed" and "linked" these interests. I made a big point of the fact to Chairman Jin that we would concede and agree to his

31. "[SY] will submit to [BWC] an itemized justification for its valuation of the company's shares and [BWC] shall be entitled to conduct all necessary due diligence concerning the valuation. Thereafter, [SY] and [BWC] will agree on a valuation of [SY] and, based on the agreed upon valuation, [BWC] will acquire no more than 49% of [SY]." BWC & SY Letter of Intent (1997) (on file with author).

32. *See generally* FISHER ET AL., *supra* note 2, at 85 (discussion of developing objective criteria).

33. *Id.* at 73 (discussion of dovetailing practice).

$200 million valuation, which meant our $30 million would buy us only fifteen percent of the company. In exchange, he would have to agree to give us management control (with a management fee), exclusive supply rights (with a supply fee), a schedule (at our option) of how to purchase additional chunks of the company in the future, and "super majority" rights which would require our approval on any important decision affecting the company. He was ecstatic. This gave him what he wanted, and it gave us what we wanted. The combination of fee income more than made up for the projected dividend returns we would have gotten on the higher percentage of equity ownership at our lower valuation of the company and the "super-majority" rights gave us the same level of control we would have had at a much higher percentage ownership of the company. This perceived "major concession" by us also allowed me to persuade him to provide us not only mortgages on all of his properties to secure his repurchase obligation in the event we "put" our shares, but also that he would obtain a bank guarantee securing this obligation.

The negotiations during this critical period had another notable aspect: the use of "tricky bargaining" by Chairman Jin and President Eun.[34] "Tricky bargaining" is the use of tactics and tricks to take advantage of another negotiator,[35] ranging from illegal, unethical or simply unpleasant.[36] There were a number of tactics they used, but only one upon which I will comment because it was a doozey. Every time I arrived in my hotel room in Seoul there would be a beautiful bouquet of flowers waiting for me, sent as a gift from President Eun. I appreciated the gesture, but because I was traveling to Seoul dozens of times and each time there would be a bouquet, I early on began to get a little suspicious. I knew from my days as a State Department negotiator about wire intercepts during international negotiations, and I wondered whether that advantage was now being used against me here in Korea. I consulted with a security firm and acquired a very sophisticated electronic "bug detector" which I brought with me on one of my early trips to Seoul. Sure enough, when I scanned the beautiful bouquet in my Seoul hotel room, the detector lit up like a Christmas tree. I also found that my phone had been bugged and, for good measure, there was another bug in one of the light fixtures.

I thought about how best to respond to this tactic. I could, of course, confront them with the evidence. This approach, however, would cause a significant loss of face and likely jeopardize the continuation of our negotiations. Instead, I opted for a different approach. First, whenever I

34. FISHER ET AL., *supra* note 2, at 134.

35. *Id.* at 134.

36. *Id.* at 134.

needed to have a conversation with any of my team and we did not want to be seen (or heard) elsewhere in the hotel, as strange as it sounds, we would meet in my bathroom (unbugged). Secondly, I decided I could use this dirty tactic to our great advantage. In October, we were at a critical point in the negotiations on a number of points, and my client's Chairman and CEO was in Seoul to participate with me to get the deal over the line. During one particularly important negotiating session, Chairman Jin and his wife took extremely aggressive and unyielding positions on some key issues. It was now time to spring the trap by using their own "tricky bargaining" tactic against them. That evening, I wrote out a script for my client's CEO to speak into his hotel room phone (which we knew was bugged) after placing the flowers (which we also knew were bugged) close by. The script he read was a voice mail message he left for his San Francisco assistant to supposedly transcribe and supposedly send to the members of the BWC's Board. In the message, he stated that he had reached the end of his rope with the negotiations and that because of Chairman Jin's and President Eun's stubbornness and unreasonableness, he intended to tell them the next day that we were done. Lo and behold, the next day Chairman Jin and President Eun could not have been more accommodating, and we were able to reach an agreement on all of the key points still at issue. We never let on that we knew about the bugging. It became the subject of negotiating lore within BWC.

On October 25, 1997, my client's Chairman and Chairman Jin signed a binding Memorandum of Agreement for the JV. We still needed until February to negotiate the exact wording of the many necessary separate definitive agreements that made up our deal, to negotiate with the Korean bank the wording of the all important bank guarantee of Chairman Jin's repurchase obligation, and to obtain the necessary Korean government approvals for our investment. Finally, on February 11, 1998 we popped the champagne as we signed the one-inch stack of agreements and gave life to our new JV.

IV. CONCLUSION

I wish I could tell you that the story had a happy ending. It did not. In the late fall of 1997 and early 1998, the widespread Asian financial crisis crippled the Korean economy and currency. Throughout 1998, Chairman Jin struggled mightily, yet unsuccessfully, to reduce the debt of the company to agreed-upon levels. Moreover, President Eun, in violation of our agreement, refused to step back from the day-to-day management of the business, which

led to significant conflict on a daily basis with our BWC appointed managing director. On top of all that, the economic crisis hit the intra-Asia tourism business hard and threw our financial projections in the trash bin. By the latter part of 1998, we reluctantly came to the conclusion that this JV was not going to work, and we would need to exercise our contractual "put" rights and get back our $30 million. That is when the carefully crafted "belt and suspenders" protections we had built into our agreement to protect repayment under our "put" rights all came into play. Unbeknownst to us, Chairman Jin had encumbered all the securing assets, so we had to call on the backup bank guarantee. Incredibly, the bank itself fell victim to the Asian crisis and went bankrupt. We had to mount a full-scale lobbying effort on the U.S. government to pressure the Korean government to honor this obligation to us. Ultimately, on October 19, 1999, after over one year of intense negotiations, we signed a settlement agreement sanctioned by the Korean government, which dissolved the JV and provided for repayment to us of our $30 million.

This negotiation taught me many lessons, including the importance of preparation, perseverance, and careful drafting. It also taught me that there are many unpredictable factors, both economic and human, in any international business deal. I learned that humility and a good sense of humor are essential companions to an international deal negotiator. A good bug detector occasionally helps as well . . . .