

# Project Procurement Management: Negotiations



Different Projects have different constraints depending on their size, nature and the environment in which they are conducted; however, there are five or six major constraints that are always present in each and every project and these are the Time, Scope, Cost, Quality, Human Resources and Risk. All the above mentioned constraints are somehow related with the procurement processes within a project, therefore procurement is considered to be an important knowledge area in the project management discipline. For example, the reliability and efficiency of a supplier can have a significant impact on the projects schedule, the knowledge and skills of a subcontractor can influence the quality and hence affect the life cycle costing of the project's deliverables. In other cases the different types of contracts used in a project

determine the level of risk an organisation assumes during the project's life cycle. Organisations' have varying roles depending on the project they are executing and they might act as a buyer or a supplier or in some cases as both. A Firm Fixed Price contract for example encompasses higher risks for the supplier while in the case of Cost Reimbursable Contract the risk is higher for the buyer.

The various Project Management Standards offer a structured way of approaching procurement management within projects. During the planning stage of project a Procurement Management Plan is developed and the strategy for managing the procurement needs of the projects is outlined. During the execution stage the procurement strategy is put into action via advertising, bidder's conferences, proposal evaluations, negotiations and so on. Procurement activities might start as early in the project lifecycle and should be monitored and controlled throughout using inspections, audits and work performance information while at the end of a contracts lifecycle proper closure should take place in order to capture lessons learned and provide the necessary documentation for future reference.

A complete procurement system can offer significant benefits to an organisation as it provides a single point of reference for all procurement activities and it can achieve significant economies for the organisation. Beyond the cost related economies a complete procurement system provides time savings thus allowing the project team to focus its attention on the negotiation processes rather than on the procurement administration processes.

Negotiations are an integral part of every procurement process and they actually determine the additional business value that can be achieved by each project the organisation undertakes. Project team members participating in negotiations must understand the negotiation process and have the essential skills in order to achieve the best results during the negotiations. The legal constraints and the environment in which a negotiation takes place greatly influence the individual's or team's approach in negotiations and this becomes more evident in cross-cultural environments. Organisations should be fully aware of the legal framework and whether the agreements and contracts signed can be enacted within the country of application.

Once the decision has been made to negotiate with another party the very first analysis to follow is whether the negotiation will rely on the “*Position*” of each party or whether it will be “*Interest*” based. Position based negotiations are competitive and in many cases adversarial as each party assumes a position and attempts to achieve the most out of the process without taking into consideration the other party’s interests. Occasionally negotiations might become disputes and in such cases *Alternative Dispute Resolution* processes involving third parties might be used. Such processes are the *Mediation, Arbitration* and *Litigation*. Position based negotiations usually result in win-lose situations. In interest based negotiations the focus is to understand each party’s interests and try to find convergence points from where both parties can benefit. The resulting outcome is usually a win/win situation. There are even examples of organisations that by looking for convergence points in dispute resolutions managed to turn them into interest based negotiations that resulted in prosperous joint ventures and helped them strengthen their market positions. Eventually, the best way to benefit from the negotiation process is to actively listen and record the other party’s interests trying to mesh them with own interests. Once the converging points have been identified, these should be promoted and emphasised during the negotiation process in order to achieve a negotiated agreement.

It is important however, that the overall goal of the negotiation is not compromised therefore the key issues should be identified and the various options should be analysed prior negotiation commencement. The process of identification and analysis of the key issues and options will provide negotiators with the *Best Alternative to a Negotiated Agreement* (BATNA). BATNA represents the major tool by which negotiators will formulate their negotiation strategy. It should not be treated as a safety net but as a tool to improve the negotiating position of a party. Therefore, in order to come up with the BATNA a thorough analysis, qualification and quantification of the various options should take place. Overestimating or underestimating the BATNA can weaken the negotiating position of a party and lead to undesirable results. While in general it is recommended not to reveal the BATNA during the negotiation process, this really depends on how strong the BATNA of a party is. The stronger the BATNA the safer or wiser it is to reveal it, while a weak BATNA should be kept secret.

There are several tools and techniques used to analyse BATNA. One of the most frequently used tools is the Decision Tree Analysis. Following a qualitative analysis of the alternatives, probabilities and impact are associated with each of the options in order to rank them and be able to quantify them. For example, an organisation has to choose between two subcontractors to assign the development of a deliverable of a project. Subcontractor’s A offer is £100000 UK pounds. Based on market and historical information analysis the particular subcontractor always provides the lowest prices, however he lacks in terms of reliability and there is a 30% probability that the delivery will delay by three months. Sub-contractor B has already worked with the organisation before and has a very good track record. He offers to do the same work for £150000 UK pounds with only a 10% probability of delaying the delivery by one month. The project is critical and the organisation will be penalised with 30000 UK pounds for each month the project delays. Using the “normative” (prescriptive) approach an analysis is conducted in order to the *Expected Monetary Value of each option* (EVM). EVM represents the total of the weighted outcomes associated with a decision, the weights reflecting the probabilities of the alternative events that produce the possible payoff. It is expressed mathematically as the product of an event's probability of occurrence and the gain or loss that will result (*businessdictionary.com*). Based on the analysis of the Expected Monetary Value (EVM) presented in a Decision Tree (Figure 1) an organisation should choose the investment with the highest

EMV or the EMV with the lowest cost impact on the organisation. The example below is simplified, however Decision Trees can be used to analyse several options and assist with complex decision making when trying to understand and quantify the BATNA, various investment options and risks within a project.

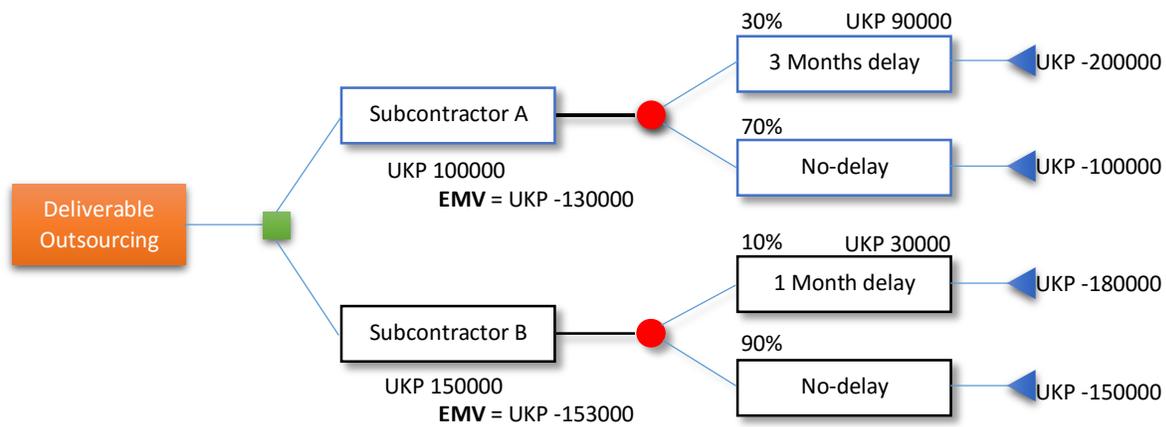


Figure 1 Decision Tree Analysis

Actively listening to the other party's interests, collecting as much information as possible and having a BATNA can be revealing in the sense that a "bargaining range" or a *Zone of Potential Agreement (ZOPA)* can be established. The existence and extend of the Zone of Potential Agreement prevails the success of a negotiation process.

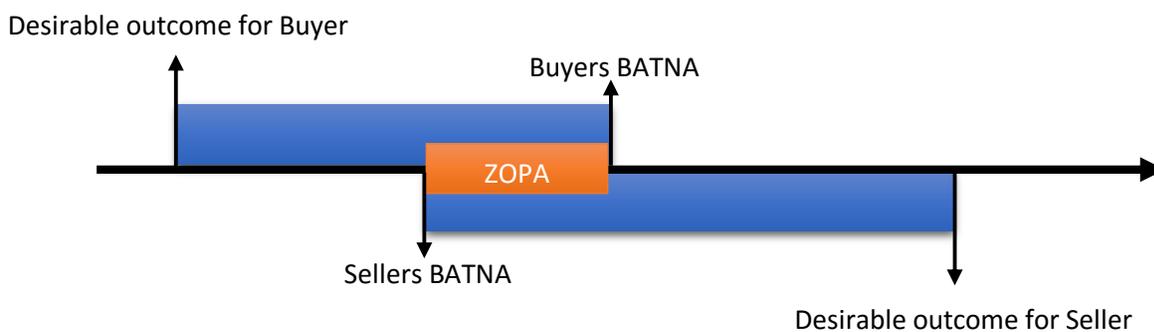


Figure 2 Zone of Potential Agreement

A prescriptive or normative approach as it is described above is not always the case because negotiations are conducted by human beings and in several cases feelings, personal attitudes and behaviour in general dictate a negotiation process and the decision process. Therefore, it is essential to know how humans

behave in a negotiation context in order to gain an advantage or avoid pitfalls. The *Descriptive* (behavioural) approach provides insights into human's behaviour in relation to negotiations and decision making contrary to the prescriptive approach that completely eliminates feelings, behaviours and attitudes from the negotiation equation.

In many cases peers in a negotiation approach each other thinking that the other party is a competitor and in every attempt they try to devalue the other side's proposals. This "Reactive Devaluation" has a negative effect on the negotiation progress and can have undesirable outcomes. As already mentioned it is better to actively listen to the other party's interest and try to identify if convergence of interests exist.

Another characteristic of the human behaviour is the tendency to remain within a close range from an initial proposition. For example, one of the party's reveals early in the negotiation process its desirable number or position. In such a case the natural reaction of the other party will be to remain in a close range from the initial proposition in order to keep the negotiation alive or to avoid being accused as irrational. This "Anchoring" behaviour raises the question whether it is better to be the first to place a proposition on the negotiation table or await for the other side to do it. Conventional thinking dictates that such information should not be revealed. According to "Anchoring" though it would be more wise to reveal a position or price especially if these are well defined during the alternatives analysis process. Research proves that humans are optimistic creatures by nature. This characteristic however, can lead negotiators in wrong directions as in most of the cases they will look for confirming evidence in a negotiation process rather than disconfirming evidence.

In conclusion there are three major elements beyond the cultural, legal and environmental factors that should be taken into consideration before and during the negotiation process in order to achieve a successful result. The first element is the thorough analysis of the various options and the identification of the *Best Alternative to a Negotiated Agreement*. The second element is the collection of as much information as possible on the other party's interests so as to understand if there is a *Zone of Potential Agreement* and the third element is being aware of how humans act under certain circumstances relating to negotiations. In terms of tactics there are several of them and will be discussed in a future article.



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Written by: Andreas Solomou PMP®

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