

SPLIT

THE

**DIE
PIE**

A Radical New
Way to Negotiate

BARRY NALEBUFF

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SPLIT THE PIE

A Radical New Way to Negotiate

BARRY NALEBUFF



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To Herb Cohen and David Stern (1942–2020),
two negotiation giants from whom I've had the privilege to learn.

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INTRODUCTION

Negotiation is stressful. That's even true for me. A great deal is at stake: money (sometimes life-changing money), opportunity, time, relationships, and reputations. Negotiation can bring out the worst in people as they try to take advantage of the other side or just naïvely imitate the tough negotiations they hear about.

Wouldn't it be better if there were a principled way to negotiate? Wouldn't it be even better if there were a way to treat people fairly and get treated fairly in a negotiation? *Split the Pie* does both via a radical new approach to negotiation, one I have been teaching to MBA students and executives at Yale School of Management for the last fifteen years and to over 350,000 online learners at Coursera. It's the approach I used in selling my company to Coca-Cola. It's a simple, practical approach based on ideas from game theory. Like all good new ideas, it is also old. The fundamental insight can be traced back to the two-thousand-year-old Babylonian Talmud. (We explore this connection in Chapter 9.)

I start by helping you identify what's really at stake in a negotiation—what I call “the pie.” The pie is the *additional* value created through an agreement to work together. Once you see the pie, you will change how you think about fairness and power in negotiation. The notion of “dividing the pie” is commonplace in

negotiations. But most people are splitting the wrong pie; they focus on the total amount, not the gain created by an agreement. As a result, they argue over the wrong numbers and issues, and take positions they perceive as reasonable but are, in fact, self-interested. The hard part of negotiation is to measure the pie correctly. When the stakes are correctly understood, it is far easier to reach an agreement.

In a nutshell, negotiation is about creating and capturing value. When it comes to creating value, Roger Fisher and William Ury's *Getting to Yes* taught the world how to succeed by focusing on interests, not positions. Left unresolved is the messy problem of how to divide the gains created, whether they be synergies in a merger or cost savings from sharing an Uber. The resulting tension is why many people so dislike negotiating.

To resolve the tension, some negotiators appeal to fairness: "I've given you a fair offer. You should take it." But what looks fair to one side may not look so fair to the other. One side could offer less than half and still call this fair if the other side cares more about the deal. In other circumstances, one side might argue it's fair to split everything down the middle, even if the starting points are different. I think such divisions don't reflect the true nature of fairness in a negotiation.

Other negotiators appeal to arguments based on power. One side will argue it is "entitled" to a larger share because it is bigger, because it brings more to the table, because it can walk away more easily, because it has more options, and so on. Such appeals to power often prevail. The typical result is to divide things up proportionately, where the proportionality may be in terms of size (units, revenue, profit, dollars invested), or some other supposed metric of power. I think such divisions are flawed and don't reflect the true nature of power in a negotiation.

This book introduces a new approach, one that reveals the true power of the players and is fair in representing their contributions. The radical part is the conclusion that the pie should be divided evenly. That doesn't mean both sides end up with the same amount.

What is evenly divided is not the total but only the additional value created by the agreement, namely the negotiation pie. Because this even split fundamentally changes how people look at power, there will be resistance—especially from people who benefit from the illusion of power under the status quo. However, that resistance can be overcome, and I'll explain how.

What you will get from *Split the Pie* is a practical and theory-based approach to negotiation. When I say the approach is practical, I mean it has been field-tested. You'll read how it helped reframe what was for me a high-stakes negotiation when Coca-Cola purchased Honest Tea, a company I cofounded with my former student Seth Goldman. (We are the "Seth & Barry" on the back label.) That negotiation in 2008 was when the theory first moved beyond the classroom. Until then, it had been an idea germinating in my Yale negotiation course. The pie approach was developed out of necessity to help overcome Coke's reasonable objection that they didn't want to pay for value they helped create. Early on, we agreed to split the pie, whatever it turned out to be, and that gave both sides an incentive to make the pie as big as possible, which is just what we did.

The pie framework isn't just for high-stakes corporate negotiations. You'll learn how the pie will help guide negotiations should you ever need to break a lease with a landlord or buy a domain name from a squatter. You'll learn a better way to split costs between partners when the benefits are unequal. You'll learn how smart real estate lawyers in New York City employ the pie to rebalance an unfavorable default split of tax savings and thereby gain several thousand dollars for their clients—and you'll learn how to do it, too.

The pie framework will change the way you approach negotiations in business and in your personal life. It will allow you to see the negotiation more clearly and more logically. It will lead you to an agreement where the principle applied doesn't depend on the specifics of your situation. It will help you make arguments that persuade others by identifying inconsistencies in their approach.

Splitting the pie works when there is an opportunity to cooperate with the other side to maximize the value you can create together.

As you'll soon see, it also works when going up against someone who doesn't care about fairness or the pie perspective. Because it is principled and because it leads to fair results, this approach offers the potential for negotiation without all the posturing. Achieving a fair division allows both sides to focus their energy on making the biggest possible pie. The pie framework goes a long way toward resolving the tension between creating and capturing value.

It will soon be apparent that this book has more numbers than your typical negotiation guide. The numbers serve a purpose. They help build your understanding of the pie logic across different applications. The details allow you to fully engage with the examples. You are given enough information so that you can push back rather than take the answers on faith. I hope you will get some of the exciting experience of being in an MBA case discussion. At the same time, I do my best to keep the numbers simple: no Excel is required.

You may wonder if this is asking you to be too logical and too analytical. What about emotions and empathy? Of course, emotions matter. Yes, empathy is critical. Indeed, it is fully rational to be empathetic. But logic in negotiation is fundamental and is far less understood. Having a logical argument—a principle to refer to—can help bring down the emotions. The pie logic is what allows you to find truly fair solutions. The logic is what allows you to make a principled stand.

Don't worry, this book is not *The Vulcan Guide to Negotiation*. While the first half of the book focuses on the logic, the second half focuses on empathy. The tools and cases there are designed to help you be less egocentric and more allocentric—more centered on others. Empathy, not sympathy or charity, will help you better understand the other party's objectives and thereby expand the pie. Logic will ensure you get your fair share. If you can combine logic and empathy, you'll have the best of Mr. Spock and Captain Kirk.

With that, we boldly go where no negotiation book has gone before.

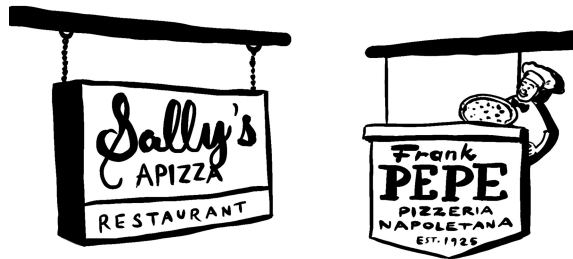
PART I

THE PIE

Chapter 1

A PIZZA

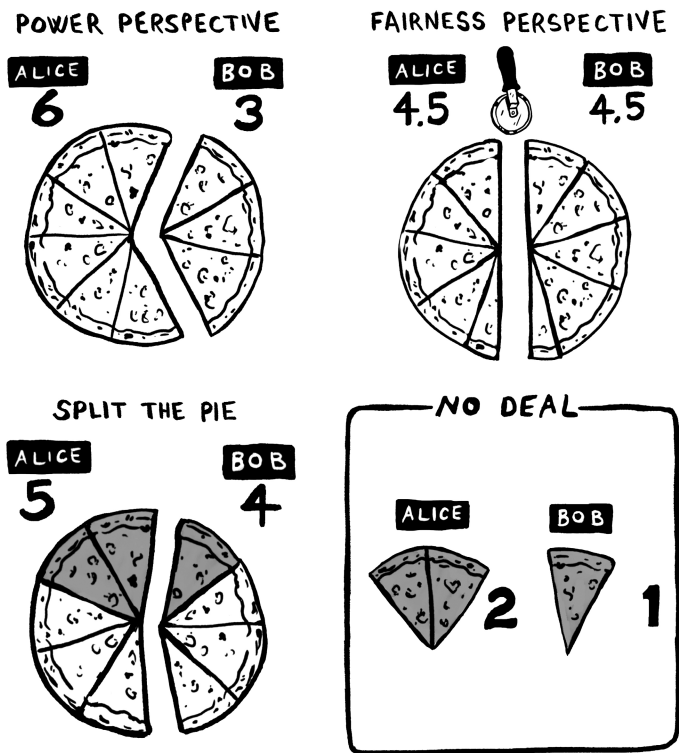
I live and work in New Haven, Connecticut. Alongside Yale University, New Haven is famous for its pizza. Some are fiercely loyal to Sally's and others to Pepe's. Based on their long lines, you might think they are harder to get into than Yale. That's because their clam pizzas are in a league of their own. At the risk of choosing sides, I look at a negotiation over a pie from Pepe's.



Pepe's will give Alice and Bob one of their 12-slice clam pizzas if the two can agree on how to divide it up. If they can't agree, Pepe's

will still give them some pizza, but only half a pie, and with some favoritism: 4 slices will go to Alice and 2 to Bob.

There's plenty of incentive to reach a deal. The challenge is there are many deals that work for both sides, some more favorable to Alice and others to Bob. But they need to pick one. Most people employ one of two perspectives for how Alice and Bob might negotiate an agreement.



The first is the power perspective. Alice starts with more power—her fallback of 4 slices is twice as good as Bob's—so she should get twice as much: 8 slices for Alice and 4 for Bob.

The second is the fairness perspective. The two sides focus on what each ends up with. In this scenario, they divide the pizza in half: Alice gets 6 slices and Bob gets 6 slices.

There is a different—and more logical—way to divide the pizza. It's more logical because it focuses on what the negotiation is really about: the extra 6 slices created by an agreement. If Alice and Bob don't reach a deal, they will have a total of $4 + 2 = 6$ slices. If they reach a deal, they will have a total of 12 slices. The value of reaching a deal is to go from 6 to 12 slices. That increase of 6 slices is what's at stake or what I call the negotiation pie. To get those 6 slices, Alice and Bob are equally needed. Because they have equal power, the 6 slices should be split equally. In addition, each side gets their fallback. This leads to an overall division of $4 + 3 = 7$ slices to Alice and $2 + 3 = 5$ slices to Bob.

While it seems odd to say this, most people end up being confused over what their negotiation is really about. They argue over the 12 slices, rather than the 6 slices. They focus on the whole pizza pie, not the relevant negotiation pie. The negotiation pie feels like an obvious idea hiding in plain sight. Once you frame the negotiation in terms of the relevant pie, the logical conclusion is that the relevant part of the pie should be divided evenly. That's what I need to convince you of. And then I'm going to give you the tools to convince others.

As a first step, I want to explain what's wrong with the status quo. In my view, the power perspective confuses power *outside* the negotiation with power *inside* the negotiation. Why should the total amount be divided up in proportion to the fallback options? The slices are not negotiating with each other—Alice and Bob are. While 8:4 seems like a reasonable outcome because it mimics the ratio of their respective fallbacks, there is no inherent reason why the outcome should be based on that ratio.

One way to see the weakness of the ratio argument is to consider a different scenario, one where Bob would get no slices, just a few crumbs, if there's no deal. Trying to mimic the ratio of fallbacks in that instance would lead to absurdly high ratios of slices (approaching infinity), suggesting nearly all 12 slices go to Alice.

Some might argue that Bob is in a weaker bargaining position since he will get just 2 slices if there's no deal, while Alice will get 4 slices. That argument misses the point of the negotiation. If they don't reach a deal, Alice will get nothing more than her 4 slices just as Bob will get nothing more than his 2. Effective negotiation is about beating your fallback. For Alice and Bob to beat their fallback, they are equally needed and hence equally powerful.

The second approach, an equal split of the total, is an oversimplified view of fairness. When it comes to dividing the 12 slices, Alice and Bob are not in equal positions. Alice has a better fallback. If 6:6 is really a viable view of fairness, it should work for any set of fallbacks. It doesn't. Look what happens if Alice's fallback option rises to 7 slices, while Bob's remains at 2 slices. If fairness means a 6:6 split, Alice would reject it. She'd rather keep her fallback of 7 slices than accept 6. While this flaw in an even split may not be apparent when the fallbacks are 4 and 2 slices, we see that as a rule for fairness, splitting the total in two is fundamentally flawed.

Splitting the total is a common mistake. Let's say we assign the fallbacks for Alice and Bob at random and then have them negotiate. What do you predict? Just such an experiment was done by Nejat Anbarci and Nick Feltovich.¹ Provided both fallbacks were less than half the total, the two sides split the total equally 42 percent of the time. It sounds fair and neither side does better by walking away. But as soon as one of the fallbacks exceeded half, equal division was chosen less than 8 percent of the time.

What is going on is the two parties were grasping for a solution that looks fair. The problem is they haven't learned to see the relevant pie as $12 - (4 + 2) = 6$ slices and so they end up splitting the wrong total. They split the 12 slices, not the 6 slices. It is fine to care about fairness, but fairness has to be applied to the relevant negotiation pie, not to the total. When it comes to the 6 slices of the negotiation pie, Alice and Bob are perfectly symmetric, equally positioned, and equally necessary. Dividing the negotiation pie equally is what's fair.

Under the pie perspective, the negotiation pie of 6 is split 3 and 3.

Each side gets their fallback plus half the pie. Alice ends up with $4 + 3 = 7$ slices, and Bob gets $2 + 3 = 5$ slices.

Splitting the negotiation pie is not just about fairness. Alice and Bob have equal power. If Alice doesn't agree to the split, the negotiation pie is lost. The same is equally true for Bob. Neither party can be said to contribute more than the other to creating the negotiation pie of 6. Inside the negotiation, where the object is to create incremental value beyond where the parties are starting, the two parties are entirely symmetric. The two do have differential power outside the negotiation as reflected in their unequal fallbacks. But that has no bearing on how to divide up the negotiation pie.

Now you've seen the secret sauce. It may look deceptively simple in the pizza case, at least in hindsight. When we apply this approach to more complicated real-world problems, the pizza example underlies everything we do.

Henceforth when I use the term "pie" I will always mean the relevant negotiation pie. That's the pie that matters. As I said up front, the hard part of negotiation is to measure the pie correctly. It isn't always as straightforward as in the pizza example. You may have to work with the other side to discover the pie. Recognizing the pie is the key to getting half. And once you resolve the problem of dividing the pie, you can focus your attention on working together to grow the pie.

Let's get started.