First Offer

By Barry Goldman

For many years, the accepted wisdom among negotiation mavens was that you didn't want to make the first offer. It was believed to be advantageous to have the other party do it. The reason for this advice was something called the "winner's curse."

Suppose you are walking down the street and encounter a man who has a potrzebie for sale with a sign that reads, "Make an Offer." You have always wanted a potrzebie, so you ask, "How about $100?" The guy breaks into a large grin, sticks out his hand, and says, "Sold."

In this scenario, you saw something you wanted and made what you thought was a reasonable offer. In fact, if you are any kind of negotiator, you made what you thought was a low offer. You would have been willing to pay more if the seller had countered. Now the potrzebie belongs to you at the price you offered to pay, and you're not happy. That is the winner's curse. You got what you wanted at a price you were willing to pay, but the transaction left you dissatisfied.

The way to escape the winner's curse, the reasoning went, was to avoid making the first offer. Let the other party make the first offer and get the winner's curse.

The exception to that rule was that it was okay to make the first offer if you were confident in your superior market knowledge. If you are certain your first offer is so good you won't regret if it is immediately accepted—if you are sure you are immune to the winner's curse—then go ahead and make it. Otherwise, let the other party do it.

So far, so good. We had a clear theory, a story everyone could understand, and a simple prescription: only make the first offer if you are confident in your superior market knowledge.

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Then someone conducted an experiment, and it turned out that reality did not agree with theory. In study after study, in the lab and in the field, negotiation outcomes favored the party that made the first offer. The party that made the first offer shifted less from the initial offer than the party who responded to it. This became known—not very creatively—as the "first-offer advantage." The explanation for it had to do with the concept of "anchoring."

One of the best demonstrations of the power of anchoring is an experiment done by Dan Ariely at Duke University. Ariely asked people to write the last two digits of their cell phone number at the top of a piece of paper. Then he asked them to write the two-digit number again with a dollar sign in front of it. He then presented a number of objects including a bottle of fancy wine, a bottle of cheap wine, a computer mouse, and a box of chocolates and asked participants to bid on them. For each object, he asked the subjects two questions: (1) Would you pay the price determined by the last two digits of your cell phone number? and (2) What is the maximum amount you would pay to purchase this object?

The results were remarkable. People were sensitive to relative price; that is, everyone bid less for the cheap wine than for the expensive wine. However, those with high cell phone numbers consistently bid more on average for every object than those with low numbers. In fact, participants with cell phone numbers ending between 90 and 99 bid more on average than those with cell phone numbers ending in the 80s who, in turn, bid more than people with numbers ending in the 70s, and so on for every decile.

Why should this be? Most of us do not carry a book of prices in our heads. When we're asked to come up

Fast Facts

- Conventional wisdom held that it is a mistake to make the first offer in a negotiation. It was later understood to be a mistake *not* to make the first offer. The most recent research suggests neither prescription is right for all circumstances.

with a price, we look for an anchor and adjust from that. The anchor establishes a neighborhood. It's like looking at the menu in a new restaurant. If you see that the entrées cluster around $8.95, you know you're in one kind of restaurant. If they cluster around $40, you know you're in another kind. What counts as expensive or inexpensive depends on the neighborhood you're in.

The cell phone numbers in the Ariely experiment act in a similar way. Subjects looking for a pricing neighborhood for a bottle of wine or a computer mouse consulted their memories. The last numbers entered into their memories were the last two digits of their cell phone numbers, so they adjusted from that starting point. What they didn't do—and what many of us don't do either—is adjust sufficiently. So, in one experiment after another, people were unduly influenced by their anchors.

That's why there is an advantage to making the first offer in a negotiation. The first offer sets the anchor and establishes the negotiating neighborhood. No other number has the psychological power of the first offer. No other psychological principle has the same punch as the anchoring effect.

So the field of negotiation theory adjusted to the new information. The winner's curse was de-emphasized and the first-offer advantage took over. The new prescription was to take advantage of the anchoring effect, enjoy the first-offer advantage, and make the first offer whenever you could.

But now there is even newer information. We are going to need a revised theory and a reformulated prescription.

According to the most recent research,[1] the first-offer advantage works fine as long as the interests of the parties are directly opposed—such as in a simple purchase-and-sale transaction in which the seller wants the price to be as high as possible and the buyer wants the price to be as low as possible. In that case, the party who puts the first number on the table establishes the anchor and is likely to move a smaller distance from his or her initial offer than the other party will move from his. But something remarkable happens when the interests of the parties are not directly opposed.

Suppose you're selling a house. If you ask $200,000 and the seller accepts, everything is fine. But because you know about the first-offer advantage, let's imagine that at the same time you set the asking price you also say, "And I want the buyer to take immediate possession."

If the buyer needs to delay taking possession while he sells his house, your interests are directly opposed,

we're on familiar ground, and the negotiation proceeds along customary lines. He says 90 days, you say 10 days, etc. You make a deal.

But suppose you want the buyer to take immediate possession because you don't want to pay two mortgages, and he wants immediate possession because he doesn't have anywhere to live. If you make your immediate possession proposal at the same time you set the asking price, the negotiation may not proceed in the familiar way. By putting immediate possession into your first offer, you introduce an information asymmetry. The buyer knows you need to get out, and you don't know he needs to get in.

It's possible the buyer will say, "Isn't that fortuitous. We both want immediate possession. How nice." But there is also another possibility. Where there are information asymmetries, there are opportunities for exploitation.

Even though a moment ago the buyer would have been pleased to gain immediate possession, it's now quite possible he will be reluctant to accommodate your preference, saying, "It's gonna cost you."

This means we need a change in our prescription. Making the first offer confers an advantage, but only when the interests of the parties are directly opposed. Making the first offer regarding issues for which the interests of the parties are not opposed produces an information asymmetry that can be exploited to the detriment of the first offeror. So the new prescription is to avoid making the first offer if you are not sure whether the parties' interests are opposed.

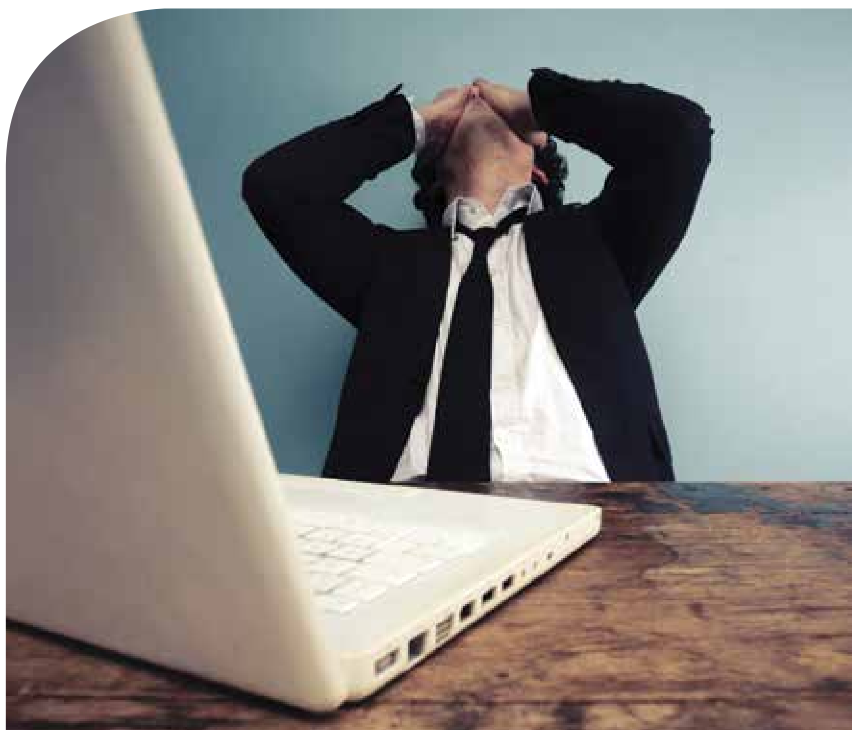
The problem is that this advice is in tension with another prescription in the literature, which says it is easier to negotiate if there is more than one issue on the table. For example, if you want to sell high and I want to buy low, we may have a difficult time of it. But if in addition to a high price you want an all-cash deal, and in addition to a low price I want immediate possession, we can horsetrade. Each of us can give up some of what we value less in exchange for some of what we value more. Additional issues enhance possibilities for trade-off.

So where does that leave us? One piece of advice says add issues and make the first offer. The other says adding issues to the first offer can lead to information asymmetry that leaves the offeror open to exploitation.

The answer is not neat and simple. Here are five suggestions:

(1) Do your homework. Find out as much as you can before you meet with your negotiation opponent. The more you know in advance about his or her likely preferences, the better.

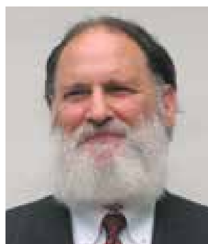
(2) Make use of the first-offer advantage, but only concerning issues on which you know the parties' interests are directly opposed.



(3) If you are unsure whether the parties' interests are in opposition, ask. Say, for example, "My price is $200,000. What is your preference regarding possession?"

(4) Proceed carefully. Volunteer information only when your opponent reciprocates. Take one issue at a time. Gather information by offering your opponent alternative choices.

(5) Pay attention to what your opponent says in response. ■



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ENDNOTE

1. See Loschelder, Swaab, Trötschel & Galinsky, *The First-Mover Disadvantage: The Folly of Revealing Compatible Preferences*, 25 Psychological Science 954–962 (2014).