

Lessons from Microsoft Vs. Yahoo Negotiation 2008

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1. Prologue



Steve Ballmer of Microsoft [Left] & Jerry Yang of Yahoo [Right]
(Source: Business Week, May 19, 2008)

In April 2008, Microsoft's top U.S. salesperson for online advertising, Keith Loritio, visited a client in New York City. In a midtown office tower, he sat down with Nicholas Utton, the chief marketing officer at online broker Etrade. Utton was much impressed with Microsoft's technology, and he was a big advertiser on the company's MSN Money site. When it came to Internet search, however, the biggest and most lucrative advertising market online, Utton made it clear that Microsoft was, as he saw it, way behind front-runner Google at that time. To him Microsoft were not getting many of their search dollars. Lorotio's pitch just got even tougher. On May 3, 2008, Microsoft CEO Steven A. Ballmer withdrew his offer for Web giant Yahoo, the number two power in online ads, after the two sides failed to agree on a price — which startled business leaders all over the world

to a considerable degree. Ballmer had mentioned that the proposed acquisition, which valued Yahoo at \$47.5 billion, was the best way for Microsoft to gain the scale necessary to compete against Google for online advertising dollars.

After three months of negotiation, it looked as if Microsoft and Yahoo would be left trying to catch Google on their own. Furthermore, their prospects were grim. But for Ballmer, the game was far from over. Even before yanking the Yahoo offer, he had begun laying the groundwork for a strategy to compete with Google in online advertising. He was convinced that getting the online ad business right was essential for Microsoft's future. The reason was clear: consumers and businesses were switching increasingly from desktop software like Microsoft's to free online services that do the same things. Ballmer noted that Microsoft was committed to becoming the leading player in that endeavor. It appeared very tough to catch Google in search advertising. Google dominates the market, taking in 77% of the revenues from those little tax ads that show up. Microsoft, after years of trying, is at 5% of U.S. search revenue. But Microsoft has a fighting chance on several other fronts. On the one hand, Microsoft is among the leaders in the fragmented field, on the other hand, Google is a bit player.

This article is for readers in all fields who must cope with or deal with conflict and resolve issues on a continual basis. Conflicts in the process of negotiation, improperly managed, within or between organizations or between parties, are frustrating and waste valuable time and resources, energy, and finances. Many business leaders when they are heavily engaged in a series of negotiation often fail to see themselves objectively and forget about improving the process of reaching agreements. The negotiation conducted between Microsoft and Yahoo in 2008 is a case in point. It can be conjectured that conflicts, managed well, can provide the impetus for growth, constructive change, and mutual benefits. New concepts or ideas for settling disputes, improving communication, and alternating the nature of certain discussions and debates are covered in this article. This

article is an outgrowth of a proceeding presented at a conference under the auspices of Japan Institute of Negotiation in 2009.

2. Introduction

Negotiation like communication is a broad field. It has many aspects beyond those involved in developing a working relationship. Negotiation—communication for the purpose of persuasion— is also said to be the pre-eminent mode of dispute resolution.

Those who embark on the study of negotiation or conflict resolution and management are often startled by the fact that any book dealing with negotiation describes a new definition. Inasmuch as the study of negotiation dates back to the ancient Romans, they used the term *negotiari*, signifying "to carry on business." *Negotiari* is a word stemming from the Latin words *neg* (*not*) and *optim* (*ease or leisure*), indicating "an engrossing task or work, not fun." This means that people in ancient Rome found that negotiation in the field of business and in diplomacy as well involved hard task and hard work.

During the past 2,000 or so years a number of people have come up with a number of definitions for "negotiations." Of course, while the definitions of negotiations differ, the basic concept remains the same. A close and hard look at the definitions reveals that negotiation includes: 1) two or more people or parties, with; 2) common interests, and 3) conflicting interests, who, 4) are to engage in a process of communication or interaction, with, 5) the aim of reaching agreement or compromise. Thus, negotiation can be defined as a process in which two or more parties or people come together to discuss common and conflicting interests through tradeoffs in order to reach a joint gain and an agreement of mutual benefits.

While a large number of negotiation researchers note that most disputes—be they interpersonal, inter-group, intergovernmental, or international—are soluble through means other than violence, coercion, withdrawal, or capitulation. Those who initiated the study of negotiation,

disputes and conflict resolution at Harvard University also believe that disputes challenge protagonists, interested observers, and would-be investors to find new and creative ways of promoting fair, efficient, and stable settlements.

An ability to settle conflicting interests or to settle differences wisely, will be as fully as instructive as success, and can stimulate creative efforts to explain and modify negotiation strategies. However, in reality such an ability does not come that easily.

Despite its importance, as Lax Sebernius points out, "the negotiation process is often misunderstood and badly carried out." (Lax Sebernius, 1986, *The Manager as Negotiator*, p.1) Inferior agreements result, if not endless bickering, needless deadlock, or spiraling conflict. The following negotiation case – a series of negotiations which took place between Microsoft and Yahoo in 2007 – reveals the difficulty as well as the subtleties of business negotiation. The purpose of this article is two fold The writer attempts to: 1) scrutinize the causes of the negotiation failure between Microsoft (MS, henceforth) and Yahoo in 2007; and 2) delve into barriers that spoiled the negotiation settlement between the two world famous leading business firms, and the issues that turned the potential mutually beneficial negotiations into a conflict that left everyone worse off.

3. Why did the MS • Yahoo Deal Fail ?

No matter how skilled you are, there are limits to what you can get through negotiation. Even if you are regarded as a very hardnosed negotiator in the entire world, you will not be able to purchase the Kremlin or the White House. There is a prevailing notion among people that a person should not expect success in negotiation unless he/she can make the other side an offer which they find more attractive than their BATNA (the Best Alternative To a Negotiated Agreement). If that one seems impossible, then negotiation does not make sense. Instead, one has to concentrate on improving one's BATNA and changing theirs.

The negotiation between Microsoft Corp (henceforth MS) and Yahoo Inc. broke down on May 3, 2008, shortly after MS's Chief Executive Steve A. Ballmer and Yahoo's Chief Executive Jerry Yang met in Seattle, Washington. (Jerry Yang was born in Taiwan, moved to the United States aged ten and developed website concepts at Stanford.)

While the two companies had been involved in the three-month-old offer, it was MS that gave up its bid for Yahoo.

When it comes right down to the question of why MS walked away, the MS team reported that the main reason included differences over strategy and corporate cultural environments. But it was quite apparent that the final straw was a dispute over Yahoo's worth that amounted to billions of dollars. (Microsoft gives up bid for Yahoo, Japan Times, May 5, '08)

MS first raised its buyout price to \$ 33 a share from the initial \$31 offered, which added \$5 billion to the price. The \$ 33 offer meant a more than 70 percent premium over Yahoo's closing stock price on the night that MS made its unsolicited offer.

According to a letter written by Ballmer to Yang, the critical area was that Jerry Yang demanded at least \$ 5 billion more than that amount, that is \$ 37 a share-which MS was not willing to pay.

Ballmer said he had decided against launching a hostile bid for Yahoo by nominating a slate for the company's board of directors. He mentioned Yahoo had signaled that it would take action that could prolong such a proxy fight and make the company less valuable to MS, including striking the Google partnership.

But at least once before in the seesawing talks, Yang had intervened at the last minute to keep negotiations alive.

There was no meaningful dialogue before a letter MS sent to Yahoo on April 5, 2008, according to MS sources. MS in fact gave Yahoo three weeks in which to strike a deal or face a proxy fight.

Yahoo, which is known as an international power house and one of the most popular websites in the globe, with 600 million unique visitors each month, has weathered corporate storms, including the dot-com

meltdown in 2000 and the financial calamity after 9-11. It is number one in market share for e-mail and instant messages and number two in search ads. It has a market value of \$27.7 billion. Yang co-founded Yahoo with David Filo at Stanford in 1994, and he has been trying to steer a turn-around since he became the company's CEO 13 months ago. He believed Yahoo could dramatically improve its revenue in the next two years by extending the reach of its ad network, through new technologies such as the Zembra e-mail service and a slew of business partnerships with the likes of Walmart. com.

4. The Door Still Remains Open

Yang says that Yahoo remains open to renegotiations with Microsoft (MS) despite the two-week silence. You know somewhere along the way, Yang is saying to Icahn, "Look, if you can get your buddy Steve (Ballmer) back to the table at \$33 a share, we are all happy," Yarnis says. "Selling the company is fine, but at the same time, we are trying to negotiate what is the best deal for shareholders" Yang says. (USA Today July 29, '08)

Mr. Yang was desperate because Yahoo suffered a 16 percent fall in profits in the first three months of 2007. Yahoo lost market share to rivals such as Google and was being criticized for poor technology and a lack of innovation. It allowed the growing dominance of rival Google.

Unpredictable as the Yahoo-Microsoft – Icahn dance has been, analysts have widely divergent views on what will eventually become of Yang, Bostock and others. With Yahoo's stock languishing in the low – 20s, the board squandered a 50% premium on its stock when it rejected MS's initial offer, Yarnis says. "Yang can't hang on. He has so clearly mismanaged the Yahoo side, he has lost investor confidence."

Jeffrey Linsay, an analyst at Stanford C. Bernstein, predicted Icahn would not carry enough favor with Yahoo investors to oust Yahoo's board. But he foresees Yang and portions of the board being replaced.

One theory making the rounds among analysts is that former AOL CEO Jonathan Miller could join Yahoo's board as an Icahn ally and might succeed Yang. Miller, a partner at venture firm Velocity Interactive Group, had no comment.

Again Linsey said "It's a nightmare scenario for shareholders" (And this thing will probably end in complete confusion."

"It is likely be resolved any time soon" says a corporate-governance expert. "What makes this one of the most unusual (corporate) ménages à trois is that MS has not decided where they want to be in the process."

5. Disputed Areas & Conflicting Interests

As was indicated before that there was no meaningful dialogue before a letter MS sent Yahoo April 5, 2008, according to MS sources. MS in fact gave Yahoo three weeks in which to strike a deal or face a proxy fight.

For the benefit of the reader, let us take a look at the process of negotiations which took place between MS and Yahoo right after April 5, 2008 paying attention to the disputed areas or critical incidents :

On April 15, 2008

The two companies held a meeting in Portland, Oregon to discuss how much Yahoo was worth and how difficult it would be to unite the two entirely different corporate cultures.

When MS asked for a number Yahoo could accept as an offer from MS, the Yahoo side did not give a specific number. But three days later, Yahoo's investment bankers gave their counterparts at MS the figure of \$40 a share.

MS, however, did not accept this. Thus, MS's next negotiation strategy was to allow the clock to run toward the April 26th deadline. On that day, as Mr. Yang's main concern was that the proxy fight was imminent, Yang and Yahoo's Chairman Roy Bostock called MS's COE Ballmer twice.

They indicated that they could live with less than \$40 and urged Ballmer not to go hostile or drop the figure.

They also suggested that the two companies could negotiate a smaller deal centering around a better alternative or search.

On April 30, teams representing both companies met in California and heard a new number from Yang – which was \$38. It set a new tone signaling that the negotiation was moving in the right direction.

On May 3, on the Saturday morning in Seattle, Jerry Yang and David Filo met with MS's CEO Ballmer in the airport and showed how conflicted they were about the entire process. Their offer – the bottom line – was that Yahoo's board could accept \$37 a share, but they added that they personally felt anything under \$38 was unfair. Ballmer offered MS's bottom line figure of \$33 on the spot – a much lower figure than what Yang and Fila expected. So in the final analysis, the two parties did not see eye-to-eye on the bottom line figure, and broke apart to reconsider.

In the afternoon, Ballmer gave a call to Yang and told him that he had had enough. Ballmer said on the day that MS had raised its buyout price to \$33 a share from the initial \$31 offered, which added \$5 billion to the price.

6. Timing Affected the Negotiation Outcome

On February 1, 2008 the cash-and-stock deal was worth \$44.6 billion when the announcement was made. The point was that its value fell to \$42 billion as MS's share price dropped.

As mentioned above, a \$33 -share offer could have represented more than a 70 percent premium over Yahoo's closing stock price on the night that MS made its unsolicited offer. The point of conflict in the negotiation deal was Yahoo's insistence on receiving at least \$5 billion more than the \$37 billion a- share offer, a figure MS was unwilling to pay. In reflecting on

the negotiation process, people who are familiar with MS's business philosophy said in effect that Jerry Yang and David Fila were not realistic about the company they had founded.

Most analysts predicted that there would be a sharp drop in Yahoo's share price—which had risen 7 percent to \$28.67 on Friday May 2, in expectation of a deal with MS because of another problem Yahoo had—a flurry of shareholder lawsuits accusing management of not looking out for investors' best interests. Many business observers worried that Yahoo's business would deteriorate which is why speed was so important for the negotiations. But there was no "speed" in Yahoo's business strategy.

7. Chronology:

MS's Decision to Abandon its Offer for Yahoo.

June 18, 2007: Yahoo-co founder Jerry Yang replaces Terry Semel as CED.

Janu. 31, 2008: Roy Bostock named Yahoo Chairman.

Feb. 1: After two years of talks and speculation, MS makes unsolicited offer to buy Yahoo for \$31 a share, or \$44.6 billion.

Feb. : Google's top lawyer says buyout could hurt Web innovation.

Feb. 4. : Yang tells employees that selling to MS is an option.

Feb. 11: Yahoo rejects MS's offer, saying it "substantially undervalues" the company's brand and worldwide assets.

Feb. 19: MS's Chairman Bill Gates tells the Associated Press the software maker isn't in talks with Yahoo about raising its offer. Yahoo leaders detail severance plans that would take effect after a buyout, which could make the deal more expensive for MS.

March 5.: Yahoo extends a deadline for nominating candidates to its board, buying time to strike an alternative deal. Yahoo is said to be in talks with Google, News Corp.'s

MySpace. com and Time Warner's AOL.

March 10: Senior executives meet near Yahoo's Sunnyvale, California, headquarters.

- March 18: Yahoo releases optimistic revenue forecast for next two years to justify rejecting bid.
- April 5: MS CEO Steve Ballmer gives Yahoo three weeks to agree on a buyout or expect the software maker to go hostile and potentially lower the offer price.
- April 9: Yahoo says it will try using Google's search ad engine instead of its own in a limited test. MS's general counsel, Brad Smith, raises antitrust concerns.
- April 26: MS's deadline for Yahoo to accept the offer expires. Both companies remain silent.
- May 1: Ballmer tells MS's employees that he "won't go a dime above." What he thinks Yahoo is worth and that he is willing to walk away from the deal.
- May 3: MS raises its bid to \$33 a share, but Yang says the board won't accept less than \$37. MS withdraws its offer.
- (Yahoo CEO Jerry Yang is understandably relaxed, as a man who just dodged a bullet. But he isn't ready to breathe too easy.)

Negotiation often fails when two parties fail to assess which interests are at stake. In seeking to understand the other party's interests, it is essential for the reader to keep in mind that interests depend on perceptions, that perceptions are subjective, and thus that to assess interests is to probe psyches. This process can be supported and strengthened by clear interpersonal communication, the advice of the third parties, role playing practices, and taking into account past behavior, training, professional affiliations, organizational positions, as well as those to whom the others defer. Taken as a whole, so far as the personal proximity between Mr. Ballmer of Microsoft and Mr. Yang of Yahoo goes, the gap was never narrowed.

8. Closing Remarks

The struggle between Microsoft and Yahoo provided a clear winner and loser while both firms assumed that the dispute could be resolved for a minimal sum of money and workable solutions. This case raised a central question for those people who are concerned over dispute resolution: Why did the negotiation fail even where there were possible solutions that would serve disputants better than a protracted struggle? This case at the same time provides readers with examples of barriers that can stand in the way of successful negotiation, effective settlement and conflict resolution. To this end, the author attempts to illustrate the following five broad types of barrier.

The first barrier concerns perceptual differences towards "preconceived merits and demerits of negotiations." Because the objective of negotiating is to serve the other party's interests, the chance of that happening increases when a person communicates them. The other side may not know, for example, what your interests are, and you may not know theirs. So both MS's negotiator and Yahoo's negotiator might have focused on past grievances instead of on future concerns or merits. Or either one of them was not listening to the other side and did not make their interests come alive. Yang time and again stressed the offer undervalued his company, but his voiced opinion or contention was not made known to Microsoft's CEO Mr. Ballmer.

The second set of barriers have to do psychology – assumptions about or preconceptions of the other party.

From the outset, it was apparent that Mr. Yang of Yahoo personally had a certain animosity toward Microsoft as a group organization.. This type of personal attitude – usually subconscious – often influences the course of communication in negotiation. As Roger Fisher maintains, making assumptions about someone based on their group characteristics is risky. Because it denies that person – his or her individuality before

negotiation gets underway, — which counterproductive once negotiations begin.

The third type of barrier, which is related to the aforementioned second type, is the condition of high anxiety, which often turns into a defensive attitude; this barrier existed on the part of Mr. Yang of Yahoo prior to the series of negotiations with Microsoft.

As Jack Gill aptly points out, defense arousal prevents the listener from concentrating on the message. Defensive negotiators (and communicators as well) send off multiple value, motive, and affect cues. By the same token, defensive recipients distort what they receive. As a negotiator or communicator becomes more and more defensive, he or she becomes less and less able to perceive accurately the motives, the values, and the emotions of the sender. (Gibb, JackR., Sept., 1961).

The application of stereotypes and evaluative attitudes are defense mechanisms in themselves, which also increase under stress. In the case of Mr. Yang, particularly in his talks with Mr. Ballmer, his subconscious defensive attitude towards Microsoft at large was not viewed as something productive by some observers even before the negotiation got underway. In the final analysis, this type of nonverbal element did not bring about good outcomes. Nor did it produce an atmosphere which a certain future relationship could or concessions made.

The fourth barrier is tied in with, what Mnookin and Ross call "a grab bag" of broad organizational, institutional, and structural factors that compromise the interests and aspirations of the disputing parties. These factors range from bureaucratic structures of — for instance — Microsoft and Yahoo, that restrict the free flow of information, to political considerations that restrain the freedom of leaders to make necessary compromises, abandon past promises and rhetoric, or risk alienating powerful factions in their constituency or organization. (Arrow, Mnookin, Ross, Tversky & Willson, 1995)

The fifth barrier is related to tactical and strategic barriers — self-interested actors often fail to reach efficient outcomes because their

rational calculations induce them to adopt strategies and tactics that preclude such efficiency. During the course of any negotiation, negotiators face a dilemma arising from the inherent tension between two different goals.

The first goal is made up of maximizing the joint value of the settlement—the pool of benefits or the size of the "pie" to be divided.

The second goal consists of maximizing their own share of the benefit of the pie. Undoubtedly, both Mr. Ballmer, CEO of Microsoft, and Mr. Yang of Yahoo, were aware of the fact their tactics and strategies could affect the size of the pie and of their own slice in several ways. But the tactics and strategies employed by both of them could not maximize the size of the pie, and they were unable to compromise their ability to achieve the largest possible slice.

Reflecting upon the disputed areas or the critical points in the May 3rd negotiation which took place between David Ballmer of Microsoft and Jerry Yang and David Filo of Yahoo in Seattle, it was found that while Yang and Filo mentioned to Mr. Ballmer that Yahoo's Board could accept \$37 a share, they also insisted that they personally felt anything under \$38 was unfair. While Ballmer offered MS's bottom line figure of \$33 on the spot — (a much lower figure than Yang and Filo expected), that figure did not satisfy the felt needs of Mr. Yang and Mr. Filo. As the bottom line figure was not what Yahoo people wanted, thus both Microsoft and Yahoo broke apart to reconsider.

In the afternoon of May 3rd, Ballmer gave a call to Yang and told him had had enough. Ballmer said on the day that MS had raised its buyout price to \$33 a share from the initial \$31 offered, which added \$5 billion to the price. But Mr. Yang and Fila of Yahoo were unable to accept that offer.

This means that negotiation tactics or ploys designed to increase the size of their own slice often impedes maximization and may shrink the size of the pie. What negotiation researchers would like to see happen is another round of negotiation between Microsoft and Yahoo—although the current CEO of Yahoo, Mr. Jerry Yang, might be replaced by someone else — which

could lead to more mutually satisfactory negotiation outcomes between the two firms. (November 24, 2008)

This is because in negotiation, the most compelling and unifying theme is the critical importance of good process. Many negotiation scholars emphasize that the need for negotiators to develop awareness and constructive processes: they are also positive in outlook and firmly believe that reframing how we negotiate and problem-solve is highly possible. At the same time, they are realistic and demonstrate how hard it is at times to change ingrained habits such as preconceptions or mindsets. In looking into Jerry Yang's personal preconceptions of Microsoft and his and images of Microsoft, it was found that Mr. Yang detested Microsoft even before the negotiation got underway. This psychological factor along with other aforementioned barriers played a critical role, and in the final analysis, it turned out to be counter-productive in coming to terms with Mr. Steve A. Ballmer of Microsoft.*

But we should not forget one fact: the game between Microsoft and Yahoo is not over yet. Thus, there is a likelihood that they will get back to the negotiating table and end up together.

Last but not least, the following point should also be addressed:

while we have examined a series of negotiations conducted between Microsoft and Yahoo, one critical issue that has been overlooked was the area of third-party intervention – that is mediation.

Mediation is negotiation carried out with the assistance of a third party. The mediator, in contrast to the judge or arbitrator, has no power to impose an outcome on the disputing parties. While mediator lacks "teeth" in the negotiation process, the use of a mediator changes the dynamics of negotiation. Depending on what is impeding agreement, the mediator is in a position to: (1) help parties to understand each other; (2) deal with differences in perceptions and interests between negotiators; (3) invent solutions that meet the fundamental interests of all parties; (4) let parties know that their concerns are understood; and (5) promote a productive level of emotional expression or feeling because at the heart of many disputes are

personality problems—the case between Mr. Ballmer and Mr. Yang offers a good example.

The most important contribution of a third party in an intervention may be getting the parties together, taking minutes, telling parties what they have agreed to unwittingly. If Microsoft and Yahoo agreed to make the best use of a mediator, the dynamics of negotiation and the negotiation outcome might have been radically different. A mediator might have helped the two leading world companies resolve conflicts with better results for all.

*For instance, in a situation where there is a chance for agreement, the way you negotiate can make the difference between coming to terms and not, or between an outcome that you find favorable and one that is merely acceptable. How you negotiate may determine whether the pie is expanded or merely divided, and whether you have a good relationship with the other side or a strained one. When the other side seems to hold all the cards, how you negotiate is critical and how you persuade the other side is absolutely vital. Given only a small opportunity for success, the way in which you negotiate will determine whether you are able to take advantage of it.

Had Mr. Jerry Yang, CEO of Yahoo, understood the meaning of the above, the negotiation with Mr. Ballmer might have moved in a different direction. For Mr. Ballmer the game is far from over. Microsoft has a fighting chance on a few fronts.

On December 4, 2008 Mr. Ballmer hired the former ten-year Yahoo executive Dr. Qi Lu, and sent the following message to all Microsoft staff: This sudden announcement took many entrepreneurs around the world and those who are (and have been) concerned with the merger issue by surprise.

From: Steve BallmerSent: Thursday, December 04, 2008 1: 39 PMTo: Microsoft- All Employees (QBDG) Subject: New Leader of Online Services Group

Search, advertising and online services are critical to Microsoft's long-term strategy. To succeed, we need the right talent. Today, I'm

pleased to announce that Qi Lu will join Microsoft as president of our Online Services Group. Qi will oversee all efforts in search, our online advertising platform, and all of our online information and communications services. Qi will join Microsoft on Jan. 5 and report to me.

Qi is one of the most respected technical minds in the industry. He comes to Microsoft after 10 years at Yahoo, where he most recently served as executive vice president of engineering for all of Yahoo's search and advertising development efforts. Before joining Yahoo, Qi was a researcher at IBM's Almaden Research Center. He has a doctorate in computer science from Carnegie Mellon, and he holds 20 U.S. patents.

Qi's combination of deep technical expertise, proven leadership capability and broad business knowledge is rare in our industry. There is no one better qualified to guide our work to reinvent search and online advertising.

While I'm excited that Qi is joining Microsoft, I'm sorry to share the news that Brian McAndrews has decided to transition out of the company. Brian came to us with the acquisition of a Quantive in 2007. Since then, he has helped build a world-class business in online advertising that provides a solid foundation for future growth. I have great respect for the important contributions Brian has made to Microsoft, and I wish him the very best in the future.

On Monday at 4 p.m. Pacific Time, Qi will join me at Café Red West for an Employee Town Hall. I encourage you to attend or to watch the webcast. If you have questions for Qi or me, please send them in advance to and we'll try to answer as many as possible. Steve

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