CHAPTER
2

The Economic Roots of Conflict

https://doi.org/10.61030/jam9-pcsy

Introduction

Chapter 1 described conflict: the conditions that create it, the levels at which it arises and the forms it takes. Description, however, leaves the most practical question open. Why do some business relationships produce conflict again and again, while others run smoothly for decades? Personalities and misunderstandings play their part, but they rarely tell the whole story. Behind most business disputes lies an economic structure that can be identified before the parties meet, and a negotiator who reads it correctly knows where the conflict will break out, what it will be about and which side is likely to prevail.

This chapter introduces four economic roots of conflict, each recurring throughout the book. Section 2.1 shows that every transaction creates a surplus, a gain from trade to be divided, and its division is a lasting source of tension even between willing partners. Section 2.2 turns to the people who negotiate on behalf of firms and explains why agents do not always act in the interests of the principals they represent. Section 2.3 examines contracts, which can never foresee every future event, and shows how firms making investments tied to a single partner expose themselves to being held up. Section 2.4 asks where market power comes from and how it decides who can impose terms and who must accept them.

The four ideas correspond to the book's pillars. The surplus is the substance of **profit**; agency, incomplete contracts and market power are the main sources of **power**; and all four shape what each side can credibly say at the table, which is the raw material of **persuasion**. The chapter follows one case throughout: the partnership between Microsoft and OpenAI, rewritten twice in six months as the value it had created outgrew the agreement governing it. Two shorter cases examine Broadcom's licensing changes after its acquisition of VMware and the long dispute between Epic Games and Apple.

DEAL FILE

Microsoft and OpenAI Rewrite Their Partnership, Twice

In 2019 Microsoft invested US$1 billion in OpenAI, then a research laboratory controlled by a non-profit foundation. The bargain was simple. Microsoft supplied money and computing power through its Azure cloud, while OpenAI supplied research talent and the models it built. Microsoft invested further in later years, and before the restructuring of 2025 its interest was equivalent to 32.5 per cent of OpenAI's for-profit business (Microsoft, 2025). By then ChatGPT had become one of the most widely used consumer products in the world, and investors valued OpenAI at hundreds of billions of dollars. Success turned the partnership into a negotiation.

The first round ended on 28 October 2025. OpenAI's business was recapitalised as OpenAI Group, a public benefit corporation under the control of the non-profit OpenAI Foundation, and the two firms announced new terms redrawing who owns what, who may sell what to whom and what happens if OpenAI builds artificial general intelligence (AGI), which OpenAI's charter describes as highly autonomous systems that outperform humans at most economically valuable work. Six months later, on 27 April 2026, they amended the agreement again, this time loosening the ties between OpenAI and Microsoft's cloud.

Why the old agreement no longer fitted. The original arrangement had been written for a laboratory, not for one of the most valuable private companies in the world. Figure 2.1 shows how quickly that value grew. Between October 2024 and March 2026 the valuation at which investors bought new OpenAI shares rose more than fivefold, from US$157 billion to US$852 billion.

Three tensions grew inside the old agreement as this value rose. First, OpenAI's demand for computing power rose faster than any single supplier could comfortably meet, yet the agreement tied it closely to Microsoft's cloud. Second, the original structure limited OpenAI's ability to raise capital from other investors, which it now needed on a scale without precedent: its funding round of March 2026 alone raised US$122 billion in committed capital (OpenAI, 2026a). Third, and most delicately, Microsoft's rights did not extend to AGI, while OpenAI's own board would decide when AGI had been reached. A single judgement by one party could therefore end the other's access to the most valuable technology that either of them had financed.

At the same time, the partners had become rivals. Both sold AI services to the same corporate customers, and Microsoft was building models of its own. Each needed the other, and each feared depending on the other too much.

Questions to keep in mind. Why did a partnership that created so much value generate so much conflict over its division? Why could a contract signed in good faith in 2019 not settle the questions of 2025, and why did the settlement of 2025

Table 2.1

The Microsoft and OpenAI agreements at a glance

Parties	Microsoft; OpenAI, whose business became OpenAI Group PBC, a public benefit corporation controlled by the non-profit OpenAI Foundation
At stake	Ownership of OpenAI's business; Microsoft's rights to its technology; the exclusivity of Microsoft's cloud; revenue sharing; the treatment of AGI
Timeline	First investment in 2019; first new agreement on 28 October 2025; amended agreement on 27 April 2026
October 2025	Microsoft holds about 27 per cent of OpenAI Group, valued at about US$135 billion. OpenAI contracts to buy a further US$250 billion of Azure services, and Microsoft gives up its right of first refusal over OpenAI's computing. An independent expert panel must verify any declaration of AGI. Microsoft's rights to OpenAI's models and products run to 2032 and extend to models built after AGI
April 2026	OpenAI may offer all its products on any cloud, although they launch first on Azure. Microsoft's licence to OpenAI's technology becomes non-exclusive. Microsoft stops paying a revenue share to OpenAI, while OpenAI's payments to Microsoft continue until 2030 at the same rate, regardless of technological progress and subject to a total cap

Note. Author, based on Microsoft (2025) and OpenAI (2025b, 2026b).

last only six months? How did each side's bargaining power change as OpenAI grew? The four sections of this chapter answer these questions in turn, and the chapter returns to the case at its close.

2.1 Why Does Scarcity Turn into Conflict?

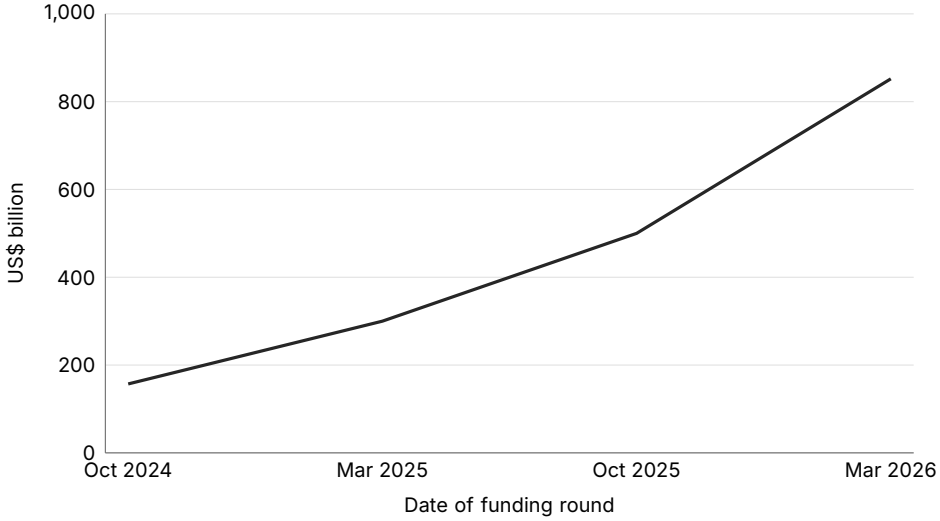
Every Deal Creates a Surplus

Economics begins with scarcity: there is never enough of what people want to satisfy everyone. In a market, scarcity takes a precise form. Whenever a buyer values a good more than it costs a seller to provide it, a trade between them creates value. The difference between the most the buyer would pay and the least the seller would accept is the **surplus** of the transaction. Trade makes both sides better off, but it leaves open how the gain will be shared.

Consider a component maker in Opole that supplies brake housings to a German carmaker. Producing one housing costs the supplier €40, including a normal return on its capital, so it will not sell for less. The carmaker can buy an equivalent part elsewhere, delivered and certified, for €60, so it will not pay more. Any price between €40 and €60 leaves both firms better off than not trading. Each housing therefore creates a surplus of €20, and the price decides who keeps it. In

Figure 2.1

Valuation of OpenAI in successive funding rounds, 2024 to 2026 (US$ billion)



Note. Author, based on OpenAI (2024b, 2025a, 2026a) and Microsoft (2025). Post-money valuations of private funding rounds, not market prices. The value for October 2025 is implied by Microsoft's stake of about 27 per cent, valued at about US$135 billion.

the vocabulary of introductory economics, the carmaker's share is its **consumer surplus**, the supplier's share its **producer surplus**, and their sum the **social** or **economic surplus** of the trade (Greenlaw et al., 2022). Figure 2.2 shows the division at a price of €50, and Table 2.2 compares three possible prices.

Table 2.2

Who keeps the surplus? One brake housing at three prices (€)

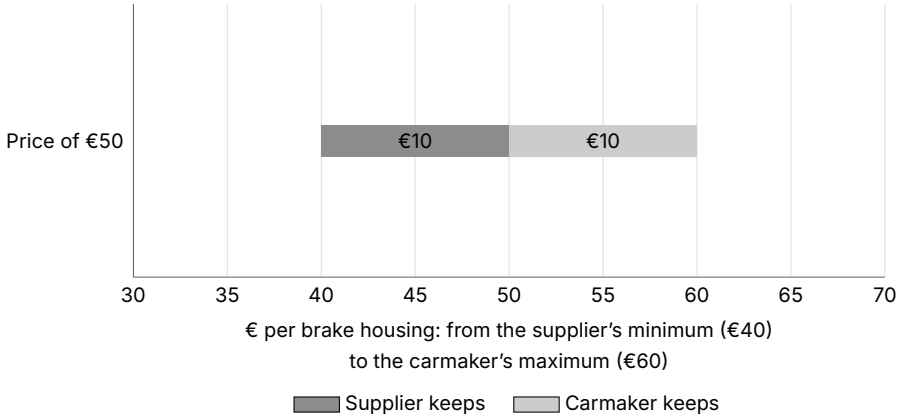
Price agreed	Supplier's gain (price minus 40)	Carmaker's gain (60 minus price)	Total surplus
42	2	18	20
50	10	10	20
58	18	2	20

Note. Author's worked example.

Table 2.2 shows the core of distributive conflict. Whatever the price, the total surplus is €20, and every euro that one firm gains, the other loses. The two limits, €40 and €60, are the parties' **reservation prices**, and the space between them

Figure 2.2

The surplus from one brake housing at a price of €50 (€ per unit)



Note. Author's worked example.

is what Raiffa (1982) called the zone of possible agreement. The negotiation decides where in that zone the price will fall. Because each side usually knows its own limit but not the other's, each has a reason to conceal it and to probe for the other's, which is why even friendly negotiations contain an element of contest.

Claiming Value and Creating Value

Walton and McKersie (1965) distinguished two kinds of bargaining that run through almost every negotiation. In **distributive bargaining** the parties divide a fixed amount, as in Table 2.2. In **integrative bargaining** they look for ways to enlarge the amount itself. The supplier and the carmaker might agree on a five-year contract allowing the supplier to buy a more efficient machine, lowering its cost to €36; or they might redesign the housing together so that it serves two models instead of one. Such moves raise the total surplus, and Chapter 8 examines them in detail.

Creating value, however, does not end the conflict. A larger surplus still has to be divided, and the moves which create value often expose the party making them. A supplier revealing its true costs in order to find savings also reveals how low a price it could accept. Lax and Sebenius (1986) called this permanent tension between creating value and claiming it the **negotiator's dilemma**: the openness needed to enlarge the surplus is the same openness that a tough counterpart can exploit to claim it. It explains why so many partnerships swing between cooperation and suspicion.

When the Surplus Is Large, Uncertain and Delayed

Conflict over division is sharpest under three conditions. The first is size: the more there is to divide, the more each side gains from a slightly larger share and the more it will spend on lawyers, delay and threats to obtain it. The second is uncertainty: when nobody can measure how much of the surplus each party produced, each can tell a plausible story in which it deserves more. The third is timing: when most of the surplus lies in the future, the parties must divide something that does not yet exist, and their estimates of it will differ.

All three conditions held for Microsoft and OpenAI. The surplus grew from a research budget into a business implicitly valued at about US$500 billion by October 2025. Nobody could say how much of this value came from OpenAI's researchers and how much from Microsoft's money, data centres and corporate customers, and most of it lay in products and revenues which did not yet exist. Each side could therefore argue, with some justice, that it deserved the larger share. The same three conditions explain the Hollywood strikes of Chapter 1, in which writers, actors and studios disagreed about the value of streaming and could not observe how much any title earned.

KEY MOVE

Before negotiating, estimate the surplus: what the deal is worth to each side compared with not dealing at all. You cannot judge a fair or a winning share of something you have not measured, and where the surplus is uncertain, agree first on how it will be measured.

2.2 Why Do Agents Not Always Act for Their Principals?

Principals, Agents and Hidden Information

Firms rarely negotiate in person. Shareholders hire managers, managers send sales teams and lawyers, and workers elect union leaders. In each case a **principal** delegates a task to an **agent**, whose interests are never quite the same. Jensen and Meckling (1976) showed that this relationship creates *agency costs*: the losses arising when agents pursue their own goals, together with what principals spend on monitoring and motivating them. Eisenhardt (1989) showed that the same logic applies wherever one party acts for another under uncertainty and unequal information.

Agency problems grow out of that unequal information, which takes two main forms.

- **Hidden action (moral hazard).** The principal cannot observe how hard or how loyally the agent works. A buyer cannot see whether its purchasing manager really pressed every supplier for a better price, or settled early to avoid an awkward meeting.
- **Hidden information (adverse selection).** One party knows something about quality or value which the other does not. Akerlof (1970) showed that in such markets the better offers can disappear, because buyers who cannot tell good from bad are willing to pay only for average quality, and sellers of good products then withdraw.

In principle both problems have the same remedy: align the agent's rewards with the principal's goals and narrow the information gap through monitoring, reporting or a right to verify. Every such remedy is costly, and none is complete.

Agency Problems at the Negotiating Table

Every negotiator is someone's agent, and so is the negotiator opposite. The result is a conflict behind each side of the table that can matter as much as the conflict across it. Table 2.3 gives typical examples.

Table 2.3

Agency problems in business negotiation

Agent	Principal	Possible divergence	Typical remedy
Sales representative paid on volume	The selling firm	Gives away margin to close more deals	Commission on margin, not only on volume
Lawyer paid by the hour	The client	Prolongs talks or litigation	Fixed or success-based fees; budgets
Union leader facing re-election	Union members	Avoids any deal that looks like a retreat	Membership ballots on the final offer
Chief executive in a takeover	Shareholders	Pursues size and prestige rather than value	Independent board committees; fairness opinions
Government trade negotiator	Citizens and firms	Favours organised interests or short-term headlines	Parliamentary scrutiny; publication of texts

Note. Author, based on Jensen and Meckling (1976) and Eisenhardt (1989).

Agency problems also explain several familiar tactics. A negotiator who says that a superior will never approve a concession may be telling the truth, or may be using a real or invented principal to gain leverage; Chapter 17 returns to this "limited authority" tactic. Conversely, a counterpart whose agent is paid on volume will often accept a lower price than its principal would wish, and a well-prepared negotiator can take this into account.

An Unusual Principal

In the Deal File, the agency problem took an unusual form. OpenAI's business was controlled by a non-profit board whose stated duty was to a mission, ensuring that advanced AI benefits humanity, rather than to investors. Microsoft, a large investor, therefore depended on decision makers who were not obliged to maximise its returns. The risk became visible in November 2023, when OpenAI's board dismissed its chief executive without consulting Microsoft, only to reinstate him within days after pressure from employees and investors; Chapter 3 examines that crisis. The recapitalisation of October 2025 kept the foundation in control but gave Microsoft and other investors conventional equity in a public benefit corporation, which must balance the interests of shareholders with its stated public purpose. In the language of this section, the parties tried to reduce the agency problem without abolishing the mission that created it.

KEY MOVE

Ask whom the other negotiator works for, and how he or she is paid and judged. The answer often predicts which offers will be accepted better than the merits of the offers themselves.

2.3 Why Do Contracts Break Down? Transaction Costs and Hold-Up

The Cost of Using the Market

Coase (1937) asked why firms exist at all if markets allocate resources so well. His answer was that using the market has costs: finding partners, negotiating terms, writing contracts and enforcing them. When these costs are high, it can be cheaper to organise an activity inside a firm, under managerial authority, than to buy it on the market. Williamson (1985) developed this insight into **transaction cost economics**, which asks which form of organisation (market, contract or firm) governs a given transaction at the lowest cost. Transactions are costly to govern, and prone to conflict, when three features are present:

- **asset specificity**: one party has invested in machines, skills, locations or data that are worth much less outside the relationship;
- **uncertainty**: the future is too unpredictable to be described in a contract;
- **frequency**: the parties deal with each other repeatedly, so the stakes of getting the governance right are high.

The same logic explains why multinational firms often prefer to own their foreign operations rather than license their technology to independent partners, a choice examined at length in the author's companion textbook on multinational

enterprise strategy (Kumar, 2026a). It also explains why foreign investors weigh the institutional quality of a host country so carefully: where contracts are hard to enforce, every specific investment becomes a hostage, a theme developed in the author's comparative study of foreign direct investment in India and Poland (Kumar, 2020) and in Chapter 15.

Incomplete Contracts and Hold-Up

No contract can foresee everything. Writing a complete contract would require the parties to list every possible future event and to agree on what should happen in each, which is impossible when the future is genuinely uncertain. Contracts are therefore **incomplete**. When something unforeseen happens, the parties must renegotiate, and they do so from positions that their earlier investments have changed.

A party that has made a **specific investment** is exposed. Once the investment is sunk, the other side can threaten to walk away and demand a larger share of the surplus, knowing that the investor's alternatives are poor. This is the **hold-up problem** (Klein et al., 1978; Williamson, 1985). Its most damaging effect is not the transfer of value after the event but the loss of value before it: a firm anticipating hold-up will invest less than it should, and some valuable projects will never begin. Hart (2017) has shown how this insight, developed in the property rights theory of Grossman and Hart (1986), explains when firms integrate and who should own the assets on which a relationship depends.

The classic illustration is the relationship between General Motors and its body supplier, Fisher Body, in the 1920s, which ended with General Motors buying Fisher outright. The story is often told as a case of hold-up, although Coase (2000) later questioned that reading of the historical evidence. The lesson surviving the debate is that firms anticipate hold-up and design their relationships to limit it. Table 2.4 lists the main safeguards.

KEY MOVE

Before making an investment that only one partner can use, negotiate the safeguards. Once the investment is made, your bargaining position will be weaker, and the other side will know it.

Table 2.4

Safeguards against hold-up

Safeguard	How it works	Its cost
Vertical integration	Buy the partner, so that no outside party can hold you up	Large capital outlay; loss of market discipline
Long-term contract	Fix prices or price formulas in advance	Rigidity when conditions change
Mutual specific investment	Both sides invest, so both have something to lose	Requires trust to begin with
Multiple sourcing	Keep alternative suppliers or customers	Smaller volumes and higher unit costs
Renegotiation and exit clauses	Agree in advance how changes will be handled	Hard to draft; open to gaming
Third-party verification	Let an independent expert or arbitrator decide disputed facts	Fees, delay and the risk of an unwelcome verdict

Note. Author, based on Klein et al. (1978), Williamson (1985) and Hart (2017).

DEAL SNAPSHOT

Broadcom and VMware's Customers, 2023 to 2026

In July 2023 the European Commission cleared Broadcom's acquisition of VMware, the leading supplier of server virtualisation software, after Broadcom offered a remedy to preserve interoperability (Broadcom, 2023). The deal was completed in November 2023. Broadcom then stopped selling perpetual licences in favour of subscriptions and bundled many products under new terms. Its chief executive had publicly set the goal of raising VMware's annual earnings before interest, tax, depreciation and amortisation from about US$4.7 to 5 billion to US$8.5 billion within three years. European cloud providers complained of sharp price increases, compulsory multi-year subscriptions and bundling. In July 2025 their association, CISPE, asked the EU General Court to annul the Commission's clearance (Case T-503/25), arguing that the Commission had ignored the risk of Broadcom using VMware's dominant position to raise prices and deepen customer lock-in (CISPE, 2025). Firms that had built their infrastructure around one supplier's software had made precisely the kind of specific investment against which Table 2.4 warns. When the supplier changed hands and changed its terms, their room to negotiate was small, and they turned to the law to change the rules instead.

2.4 Where Does Market Power Come From?

Power Rooted in Market Structure

In a perfectly competitive market no firm can dictate terms, because buyers and sellers can always turn to someone else. Real markets are rarely like that. **Market power**, the ability to set prices or conditions above competitive levels without losing most customers, arises from several sources (Tirole, 1988). Porter (2008) showed how the bargaining power of buyers and suppliers depends on the structure of an industry: how many firms there are on each side, how important the product is to the buyer and how costly it is to switch. Shapiro and Varian (1999) added that in information industries, switching costs and network effects can lock customers in for years. Table 2.5 translates these sources into what a negotiator experiences at the table.

Table 2.5

Sources of market power and how they appear in negotiation

Source	Example	What the weaker side experiences
Concentration	Few suppliers of a critical input	Take-it-or-leave-it offers
Switching costs	Software, data and staff skills tied to one system	Price rises at contract renewal
Network effects	A platform that is valuable because everyone uses it	Terms set by the platform's rules
Control of a bottleneck	The only route to customers or to a key technology	Fees on every transaction
Legal protection	Patents, licences, exclusive concessions	No alternative supplier for a period

Note. Author, based on Porter (2008), Shapiro and Varian (1999) and Tirole (1988).

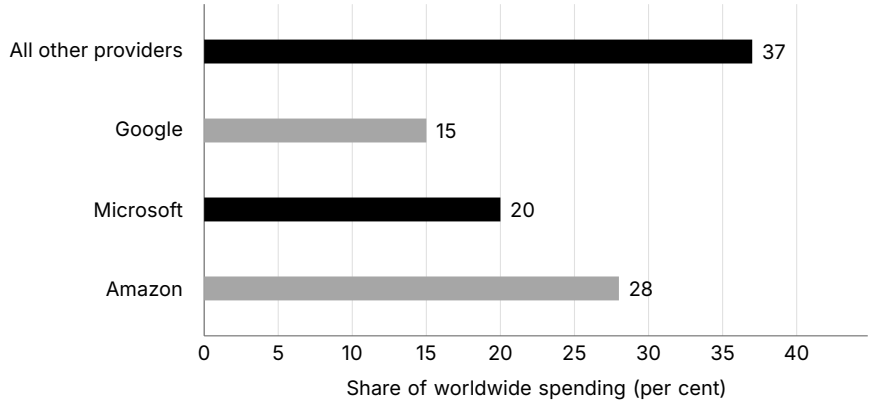
Measuring Concentration

Economists and competition authorities measure concentration with the **Herfindahl-Hirschman Index (HHI)**, the sum of the squared market shares of all firms in a market. A market served by a single firm scores 10,000; a market divided among a hundred firms with 1 per cent each scores 100. Under the merger guidelines of the US competition authorities, a market with an index above 1,800 is regarded as highly concentrated (US Department of Justice & Federal Trade Commission, 2023).

Cloud computing, the market at the heart of the Deal File, illustrates the measure. Figure 2.3 shows the shares of worldwide spending on cloud infrastructure services in the second quarter of 2026, when the market was worth US$143.4 billion in a single quarter.

Figure 2.3

Shares of the worldwide market for cloud infrastructure services, second quarter of 2026 (per cent)



Note. Author, based on Synergy Research Group (2026). "All other providers" is the remainder of the market and includes many firms with small individual shares.

Counting only the three leaders, the index is already $28^2 + 20^2 + 15^2 = 1{,}409$, and the true figure is higher, because the remaining providers add to it. For a firm buying cloud services, the practical meaning is plain: three suppliers are able to serve a very large customer, and moving from one to another is slow and expensive. For OpenAI, whose need for computing power exceeded what any provider could easily supply, the narrowness of this market was a source of dependence; for Microsoft, the right to be OpenAI's main supplier was a source of power. The agreements of 2025 and 2026 can be read as a step-by-step loosening of that dependence.

When Market Power Meets the Law

Market power is not illegal in itself, but its abuse can be. Competition authorities and courts therefore become hidden parties to many business negotiations. Since March 2024 the European Union's Digital Markets Act has imposed obligations on large platforms designated as "gatekeepers", limiting the terms they may impose on business users (Regulation (EU) 2022/1925, 2022). A weaker party unable to win at the table may try to change the rules of the table by turning to a regulator or a court, as CISPE did in the Broadcom case and as Epic Games did against Apple.

DEAL SNAPSHOT

Epic Games v. Apple, 2020 to 2026

Apple's App Store is the only route to customers on the iPhone, and Apple charges developers a commission on sales. Epic Games, the maker of *Fortnite*, sued in 2020. In 2021 the district court largely ruled for Apple but ordered it to allow developers to direct customers to cheaper payment options outside their apps. Apple responded by charging a commission of 27 per cent on purchases made through such links. On 30 April 2025 the district court held Apple in civil contempt for failing to comply and barred it from charging any fee on those purchases (*Epic Games, Inc. v. Apple Inc.*, 2025a). On 11 December 2025 the Court of Appeals for the Ninth Circuit upheld the contempt finding but sent the question of what commission Apple may charge back to the district court (*Epic Games, Inc. v. Apple Inc.*, 2025b). Apple then petitioned the US Supreme Court, which on 30 June 2026 agreed to review the contempt finding. Apple filed its brief in September 2026, Epic's was due in November and the case was set for argument on 11 January 2027; meanwhile, in August 2026, Justice Kagan refused Apple's request to halt the proceedings in the district court (Supreme Court of the United States, 2026). The dispute shows a firm with control of a bottleneck setting the terms, and a weaker party using the courts to renegotiate them over six years and counting.

KEY MOVE

Map the market before the meeting. Your real bargaining power depends less on your arguments than on how easily each side could find another partner, and on which authorities could change the terms.

BACK TO THE DEAL FILE

Reading the Microsoft and OpenAI Agreements

Seen through the four lenses of this chapter, the agreements of 2025 and 2026 are less peace treaties than a redesign of the relationship's economic architecture.

The surplus had outgrown its original division. The terms of 2019 divided a modest and speculative surplus. By 2025 the surplus was measured in hundreds of billions of dollars, and both sides could argue that it rested mainly on their own contribution. The growth shown in Figure 2.1 made the old division untenable for the party whose contribution was growing faster.

Each side faced an agency problem. Microsoft's investment was governed by a board bound to a non-profit mission rather than to investors. OpenAI, for

its part, depended on a partner whose managers answered to Microsoft's shareholders and were developing competing products.

Hold-up threatened in both directions. Microsoft had built substantial datacentre capacity to serve OpenAI, and OpenAI had built its products on Microsoft's cloud. The AGI clause was an incomplete contract in its purest form: a vital term depended on a future event which could not be defined in advance and which one party alone could declare.

The new terms read like a list of safeguards. Table 2.6 matches the main provisions of the two agreements to the safeguards in Table 2.4.

Table 2.6

The agreements of 2025 and 2026 as a set of safeguards

Provision	Safeguard it represents	Problem it addresses
Microsoft converts its position into a stake of about 27 per cent (2025)	Partial integration	Aligns Microsoft's returns with OpenAI's long-term value
OpenAI commits to US$250 billion of Azure purchases (2025)	Long-term contract	Protects Microsoft's investment in capacity
Microsoft gives up its right of first refusal on computing (2025); OpenAI may sell on any cloud (2026)	Multiple sourcing	Reduces OpenAI's dependence on one supplier
An independent panel verifies any declaration of AGI, under the 2025 agreement	Third-party verification	Removes one party's power to trigger a vital clause alone
Fixed end dates for Microsoft's rights and for revenue sharing (2030 and 2032)	Renegotiation clause	Replaces open-ended uncertainty with known horizons
Revenue share payments no longer depend on technological progress and are capped (2026)	Revised long-term contract	Removes the link between payments and the disputed AGI trigger

Note. Author, based on Microsoft (2025) and OpenAI (2025b, 2026b).

Market power had shifted. In 2019 OpenAI needed Microsoft far more than Microsoft needed OpenAI. By 2026 OpenAI could raise capital from many investors, including Amazon, Nvidia and SoftBank, and could buy computing from several suppliers, while Microsoft's own AI strategy relied heavily on OpenAI's models. The amendment of April 2026, which made Microsoft's licence non-exclusive and freed OpenAI to sell through rival clouds, reflects that rebalancing; the companies did not publish the amount of the cap on OpenAI's revenue share payments. The scale of the stakes became clearer at the end of

July 2026, when Microsoft's annual report disclosed that its commercial arrangements with OpenAI had generated US$24.1 billion of revenue in the financial year to June 2026 (Microsoft, 2026).

Why the 2025 settlement lasted only six months. The speed of the second renegotiation is itself a lesson of this chapter. When the surplus is growing rapidly and the future is uncertain, any contract becomes incomplete almost as soon as it is signed. The parties did not fail. They treated their agreement as a framework to be revisited, which is how the most valuable relationships in fast-moving industries are often governed.

MA EXTENSION

Who Should Hold the Residual Rights?

Grossman and Hart (1986) argued that, because contracts are incomplete, what matters most is who holds the *residual rights of control*: the right to decide whatever the contract does not specify. Ownership should go to the party whose specific investments matter most for creating value, because that party is most exposed to hold-up. Hart and Moore (1990) extended the argument to many parties and assets, and Hart (2017) reviews the theory and its applications. Apply the theory to the Deal File. Whose investments were more important for creating value in 2019, and whose in 2026? Does an equity stake of about 27 per cent in a business controlled by a non-profit foundation allocate residual control efficiently? What role does an independent panel play when neither side can be trusted to hold a residual right alone, and why might the parties later have preferred to remove the AGI trigger from their payment terms altogether?

ETHICS CHECK

OpenAI was founded with a mission to ensure that advanced AI benefits all of humanity, and its non-profit foundation still controls the business. Microsoft's managers owe duties to their shareholders. When a mission-driven organisation negotiates with a profit-driven one, whose interests should prevail if they conflict? Should the public, which is affected by the technology but absent from the table, have a voice in such negotiations, and through whom?

Pillar Scorecard

Your Move

This is a constructed teaching case.

You run a family-owned firm near Wrocław that makes injection-moulded plastic parts. A large Scandinavian furniture group offers you a five-year contract for a new range of fittings. To meet its specifications you would need moulds and a production line costing PLN 6 million that no other customer could use. The group proposes a fixed price for the first year and "annual price reviews by

Table 2.7

Pillar Scorecard: Microsoft and OpenAI, 2025 and 2026

Pillar	Importance in this case	Evidence
Profit	Very high	A surplus of hundreds of billions of dollars had to be divided between partners who were also competitors
Power	Very high	Specific investments, dependence on one cloud, a concentrated market and a unilateral AGI trigger shaped each side's leverage
Persuasion	Moderate	Public statements stressed partnership and mission, but the outcome rested mainly on economic structure

mutual agreement" thereafter. It will not pay for the moulds, and its purchasing manager, you learn, receives a bonus based on annual savings.

1. Estimate, in qualitative terms, the surplus the contract would create and who would capture it after the first year.
2. Identify the risk of hold-up and the moment at which it would arise.
3. What does the purchasing manager's bonus tell you about the agency problem on the other side of the table, and how might it affect your strategy?
4. Choose two safeguards from Table 2.4 and draft the clauses you would propose.
5. What information about the market for furniture fittings would strengthen your position?

Conclusion

Behind the personalities and the public statements, most business conflicts have an economic skeleton. A transaction creates value to be divided; the people who negotiate the division act for others whose interests they do not fully share; the contracts recording the division cannot foresee the future; and the structure of the market decides who can walk away. Microsoft and OpenAI did not renegotiate twice in six months because their executives misunderstood each other. They renegotiated because the economics of their partnership had changed beyond what each agreement could absorb, and because the balance of dependence between them was shifting. A negotiator who can read this skeleton can often predict where a conflict will break out before either side notices it, and can design safeguards before they are needed. This is the first meaning of the book's title: profit is not only what firms seek in a negotiation but also what sets them against each other. Knowing why a conflict exists, however, is not the same as knowing

how it will unfold. Chapter 3 follows conflict as a process, from its first signs through escalation to the ways in which individuals and organisations manage it and bring it to an end.

Exercises

A. Objective Questions

1. The surplus of a transaction is the difference between:
   a) the price and the seller's cost
   b) the most the buyer would pay and the least the seller would accept
   c) the buyer's budget and the market price
   d) revenue and profit

2. In Table 2.2, raising the price from €50 to €58:
   a) leaves the total surplus unchanged and shifts €8 per unit to the supplier
   b) reduces the total surplus
   c) increases the total surplus
   d) creates a loss for both firms

3. Lax and Sebenius (1986) called the tension between creating and claiming value:
   a) the hold-up problem
   b) adverse selection
   c) the winner's curse
   d) the negotiator's dilemma

4. According to Jensen and Meckling (1976), agency costs include:
   a) only the agent's salary
   b) taxes on agency fees
   c) losses from divergent interests plus the costs of monitoring and motivating agents
   d) only the cost of legal disputes

5. A purchasing manager who, unobserved by the employer, does not press suppliers hard illustrates:
   a) adverse selection
   b) moral hazard
   c) network effects
   d) vertical integration

6. Which feature does *not* raise transaction costs in Williamson's framework?
   a) asset specificity
   b) uncertainty
   c) a perfectly competitive spot market
   d) frequency of dealings

7. Hold-up occurs when:
   a) prices are set by auction
   b) a contract is fully enforced
   c) a buyer pays in advance
   d) a party that has made a specific investment is pressed to accept worse terms

8. A market served by four firms with shares of 40, 30, 20 and 10 per cent has a Herfindahl-Hirschman Index of:
   a) 100
   b) 1,000
   c) 3,000
   d) 10,000

9. Under the agreement of October 2025, any declaration that AGI has been reached must be verified by:
   a) an independent expert panel
   b) OpenAI's board alone
   c) Microsoft's board
   d) a US court

10. In Epic Games v. Apple, the source of Apple's market power stressed in this chapter is:
    a) a patent on smartphones
    b) government ownership
    c) low prices
    d) control of a bottleneck between developers and iPhone users

B. Short-Answer Questions

1. Define the surplus of a transaction and explain why its division is a source of conflict even between willing partners.

2. Distinguish distributive from integrative bargaining, and explain the negotiator's dilemma.

3. Explain the difference between moral hazard and adverse selection, giving one business example of each.

4. Why are contracts incomplete? Explain how an incomplete contract combined with a specific investment can lead to hold-up.

5. Name four safeguards against hold-up and state the main cost of each.

6. Calculate the Herfindahl-Hirschman Index for a market in which three firms hold 50, 30 and 20 per cent. Would US competition authorities regard it as highly concentrated?

7. Using Figure 2.3, explain why concentration in cloud computing mattered for the negotiations between Microsoft and OpenAI.

C. Long-Answer Questions

1. "Most business conflicts have an economic skeleton." Discuss this statement with reference to the four roots of conflict presented in this chapter, illustrating each with a case of your choice.
2. Analyse the agreements between Microsoft and OpenAI of October 2025 and April 2026 using transaction cost economics and the theory of incomplete contracts. Why did the first agreement last only six months?
3. Compare the Broadcom and VMware case with Epic Games v. Apple. In each case, what was the source of the stronger party's power, and why did the weaker party turn to regulators or courts rather than continue to negotiate?
4. You advise a Polish manufacturer considering a long-term supply contract with a much larger foreign customer. Using the concepts of surplus, agency, hold-up and market power, set out the risks it faces and the terms it should seek.

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