Cost Counts

Mike Taylor, C.P.M.
March 2007
www.mltweb.com/mltweb.htm
Welcome

[Introductions]
- ML Taylor, C.P.M.
- [www.mltweb.com/bio.htm]

[Workshop Structure]
- Lunch, breaks, questions

[Takeaways]
- How to capture and use ideas
Sharing

Participant Introductions

- Company, background, interests
- Expertise & experience

The value of our collected expertise

- Product List
Goals

- Difference between cost & price
- Difference between direct and indirect Costs
- Cost and product pricing
- Analyze & Investigate Costs
- Reduce Acquisition costs
Cost or Price?

- **Pricing serves many purposes**
  - New customers, competition, move inventory, and sometimes make a profit

- **Price is arbitrary**
  - Prices can be negotiated

- **Costs are business expenses**
  - Costs must be mitigated or avoided
We Care About Supplier Cost

Cost Counts

- www.mltweb.com/tools/costcounts.htm

Direct impact to selling price

Long Term impact to Supply Chain health
Direct Materials

- Raw materials needed to make the product
- As a large/small percentage of total cost
- Material substitution, subcontracting, strategic materials, inventory value, acquisition costs
Direct Labor

- Labor to fabricate and provide service
- As a large percentage of total cost
- Labor categories
- Learning Curve, setup time, efficiency
Manipulating Price

- What is the value to seller of offering quantity discounts?
- What does it cost the seller to offer quantity breaks?
- Parametric Pricing
- Bulk pricing
- Distributor discounts
Indirect Costs

All Costs Are Not Created Equal
- www.mltweb.com/tools/indirect.htm

Hidden cost of direct charge labor
- Fully Burdened labor rate

Support organizations & Overhead

General and Administrative Costs
Indirect Cost Pools

- Similarity, allocability, consistency
- Avoid duplicate and overlapping charges
- Cost Pool vs. direct charge tradeoffs
MODEL PRICE PROPOSAL

The following model price proposal was taken from the DCAA Pamphlet 7641.90, titled Guidance for New Contractors.

Requests for copies of the pamphlet should be forwarded to:

Headquarters, DCAA
Attention: Operating Administrative Office
Building 4, Cameron Station
Alexandria, VA 22304-6178
(703)274-7285 (telephone requests)
(703)274-7567 (fax)

Background Information on the Model Company

Advanced Tank Technologies (ATT) was incorporated in the State of Maryland in 1985. ATT is a research and development concern specializing in engineering feasibility studies and surface vehicles design. As recently as 1992, ATT developed a small manufacturing capability that enables it to manufacture prototypes of its basic designs. ATT had to borrow funds from a local lending institution to establish this capability. ATT provides services primarily to major DOD contractors on a firm-fixed-price (FFP) basis.
Enclosure 1
Advanced Tank Technologies
Washington, D.C.
Proposal Submitted in Response to RFP DAAH01-94-R-0001

<table>
<thead>
<tr>
<th>Element of Cost</th>
<th>Amount $</th>
<th>Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Engineering Labor</td>
<td>207,695</td>
<td>Schedule 1</td>
</tr>
<tr>
<td>Manufacturing Labor</td>
<td>11,114</td>
<td>Schedule 1</td>
</tr>
<tr>
<td>Direct Labor Overhead @56.7%</td>
<td>124,064</td>
<td>Schedule 1 &amp; 3</td>
</tr>
<tr>
<td>Materials</td>
<td>105,450</td>
<td>Schedule 2</td>
</tr>
<tr>
<td>Material Handling Overhead @5%</td>
<td>5,273</td>
<td>Schedule 5</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td><strong>453,596</strong></td>
<td></td>
</tr>
<tr>
<td><strong>G &amp; A @8.1%</strong></td>
<td><strong>36,741</strong></td>
<td>Schedule 4</td>
</tr>
<tr>
<td>Estimated Cost</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Profit @10%</strong></td>
<td><strong>49,034</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Total Price</strong></td>
<td><strong>$539,371</strong></td>
<td></td>
</tr>
</tbody>
</table>

The total price is carried to Line 8D Total Price of the SF 1411 Contract Pricing Proposal Cover Sheet.
Why Cost Analysis

- www.mltweb.com/tools/why_cost.htm

Changes which can increase TCA/TCO
- Price escalation
- Post award changes, rejections, partial cancellations, spare parts, reorders, outages
Bottom Line Variables

100 or Not
- www.mltweb.com/tools/100_or_not.htm

- Scrap and rework
- Residual value & beneficial reuse
- Quantity and trade discounts
- Consolidated purchasing agreements
- Long term-relationships
Accounting System Issues

- Financial adequacy determination
- Sox and management controls
- GAAP and CAS
- Consistency, accuracy, disclosure statements, tax liabilities, records, liens, incurred vs. estimated costs
- Supporting documentation
Break Even Analysis

- Fixed Costs vs. Variable Costs
- Calculating profitability and quantity
- From a buyer’s perspective to amortize direct costs of special tooling
Pricing Models

- Market based
- Market share
- Competition based
- Loss Leader
Grouping Costs

- Strategy to reduce overall selling price
- Strategy to reduce acquisition price
- Leverage for ordering spare parts and operating supplies
The Federal Government

- CAS & disclosure statement
- Certified cost & pricing data
- TINA
- DCAA, ASPM & DCAA audit guidelines
- GAO & IG
- FAR part 30 (CAS) & 31 (financing)
- Buyer determinations
Vocabulary Review

Outline list
References

DCAA Audit Manual

www.dcaa.mil/
References

- DCAA Audit Manual
  - www.dcaa.mil/

- CAS Standards
  - www.access.gpo.gov/nara/cfr/waisidx_01/48cfr9904_01.html

- Society of Cost Estimating
  - www.sceaonline.org/

- Defense Acquisition University
  - www.dau.mil/
Discussion Topics

- Buyer-provided materials / services
- The power of a solicitation
- Post award changes
- Fact finding
Seminars and Workshops

A few of the handouts and outlines referenced in workshops and seminars presented during the recent year.

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   - Improve purchasing effectiveness by applying cost-effective innovation (thinking outside the box) to contracts for goods and services
2. Programs presented to the 2002 Leadership Workshop in Las Vegas.
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     Suggestions for improving affiliate web sites (2MB)
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   - Communication Committee
     Tools and resources for the communication committee (200KB)
   - Internal Communication Team
     A suggestion for addressing affiliate information overload
Focus on Negotiation

Use what we know about cost to negotiate a more cost-effective contract
Goals

- What is negotiation
- Personal planning & commitment
  - Prepare to win
- Getting started & fact finding
- Cost as a negotiation factor
- Negotiation in day-to-day actions
Objective:

Win without fighting!
Sun Tzu

Prepare for war and do everything you can to win before it starts
What Price Failure?

- A poorly formed contract
- A party who doesn’t want to perform
- Parties that do not understand obligations
- Getting nothing and starting over
Negotiating Frame of Mind

Win – Win
- www.mltweb.com/tools/win_win_oponent.htm
- www.mltweb.com/tools/negotiate1.htm

Preparation = success

The team

Establish common goals
- Long term success is a driver for each department
It’s Never Too Soon to Start

First impression & Fact finding
- www.mltweb.com/tools/toosoon.htm

The whole is greater than the parts
- www.mltweb.com/tools/fulldeal.htm
- www.mltweb.com/tools/whole.htm
Contract Opportunities

- New ways to handle old processes
- If it doesn’t add value - stop doing it
- New ways to add value
  - “We never did it before - no one asked…”

www.mltweb.com/tools/negotiate 2.htm
Getting Started

- Clear purpose for the discussion
- Knowledgeable parties
- Persons with authority
- Big Picture thinkers
Fact Finding

- Gathering facts and information
  - Tour, travel, read, salesmen, competitors, peer, trade shows
- Hard questions are easy before there is a contract on the table
- Confirm all assumptions
- Record the information
Leading Questions

- Shape the answer you want with the question you ask
- Misdirection or a real answer?
- Focus on issues not people
- Discussion; 100 or Not what questions would you ask to get a better response for examples?
  - Leading.htm
Ask Better Questions

Do I get a price break?
  - How much is the price break?

Do we get maintenance service?
  - How long is the maintenance coverage?

Can I buy a warranty?
  - What warranty?
Is there a better way to ask?

- Does it come with a spare tire?
- Does the pump include a coupling?
- Is mounting hardware included?
- Has it been approved by this city building inspector before? Where? When? Who?
- Where is the approved repair station?
- If it doesn’t work, then what?
ISSUES TO CONSIDER NEGOTIATING

Excerpts from the seminar: **PLANNING BETTER NEGOTIATIONS**

**MICHAEL L TAYLOR, C.P.M.**

Review this list before you negotiate any contract. Take advantage of all the opportunities and cover all the important issues.

<table>
<thead>
<tr>
<th>Availability</th>
<th>Installation</th>
<th>Progress payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative charges</td>
<td>Insurance</td>
<td>Quality rate</td>
</tr>
<tr>
<td>Alternate Dispute Resolution</td>
<td>Intellectual property rights</td>
<td>Raw materials</td>
</tr>
<tr>
<td>Amortization schedule</td>
<td>Inventory Costs</td>
<td>Recycled content</td>
</tr>
<tr>
<td>Audit rights</td>
<td>Invoice method</td>
<td>Residual value</td>
</tr>
<tr>
<td>Bank &amp; Finance institution</td>
<td>Invoice terms</td>
<td>Restocking charges</td>
</tr>
<tr>
<td>Barter arrangements</td>
<td>Labor rates</td>
<td>Returns</td>
</tr>
<tr>
<td>Cancellation charges</td>
<td>Lead time</td>
<td>Risk of loss</td>
</tr>
<tr>
<td>Confidential information</td>
<td>Legal venue</td>
<td>Safety Stock</td>
</tr>
<tr>
<td>Contingencies</td>
<td>License agreements</td>
<td>Scrap recycling</td>
</tr>
<tr>
<td>Copyright</td>
<td>License fees</td>
<td>Spare parts</td>
</tr>
<tr>
<td>Changes</td>
<td>Maintenance</td>
<td>pricing/availability</td>
</tr>
<tr>
<td>Consignment inventory</td>
<td>Marketing support</td>
<td>Special marking</td>
</tr>
<tr>
<td>Cost Breakdown</td>
<td>Manufacturer's allotment</td>
<td>Specifications</td>
</tr>
<tr>
<td>Counter trade</td>
<td>Mediation</td>
<td>Stand-by rates</td>
</tr>
<tr>
<td>Currency</td>
<td>Meeting locations &amp; schedule</td>
<td>Start-up assistance</td>
</tr>
<tr>
<td>Customer visits</td>
<td>Mobilization costs</td>
<td>Storage of unused materials</td>
</tr>
<tr>
<td>Damages</td>
<td>Multiple deliveries</td>
<td>Subcontracting</td>
</tr>
<tr>
<td>Delivery</td>
<td>Obsolete Inventory</td>
<td>Termination Provisions</td>
</tr>
<tr>
<td>De-mobilization costs</td>
<td>Responsibility</td>
<td>Terms and conditions</td>
</tr>
<tr>
<td>Discounts</td>
<td>Overview</td>
<td>Testing</td>
</tr>
</tbody>
</table>


Negotiation Checklist

- What can be negotiated?
- Don’t leave home without it!
- What cost-related elements need to be added to the checklist?
Don’t negotiate with yourself

If you don’t ask for it, you won’t get it
  - How long is the extended warranty?
If you haven't asked you don’t know.
  - How extensive is the included spare parts kit?

We are ready to place the order today if you accept it that way

Article: Don’t be afraid to ask

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Hidden Costs

- A valuable concession is not always price
- Transferring costs to the party best able to manage the cost
- Costco example
  - Article: Costcounts
  - Article: Negotiate4.htm
Serve the Ball

Who’s problem is it?
- Price is too high
- Doesn’t meet specs
- None in stock
- Can’t deliver on time

Don’t waste energy fretting about it, 
*serve the problem to the other side*
- I’d buy today if the deal was right

Make the other person turn the deal down.
- Are you saying we can’t reach an agreement?
- You mean we have to start all over?
Break A Deadlock

- Change the terms
  - Agree to a 2-year purchase to make a deal?

- Change the people
  - Is there someone who does have the authority?

- Make it personal article: personal.htm

- Leave everyone a way to save face
  - Don’t make them admit it. Blame it on a typo

- A reason to sell it to the company
  - This is a great opportunity for long term business
Strategies to Watch Out For

- I’m on your side, the boss won’t like it
- Just one more thing after another
- I thought we agreed?
- It isn’t in the budget
- Our Procedure/ policy won’t allow it
- The plumber principle
Be More Effective

- Communication skills
- Expectation of efficiency
- Don’t procrastinate
- article: Negotiate3.htm
Personal Strategy

- Review the checklist before you begin
  - Mark all important issues
  - Assumption/ Confirmed/ Source
- Post a cheat sheet of common questions
- Build the contract as you go.
  - Touch all the bases, document it and get it signed
- Don’t forget the net as a research tool
- Failure analysis
  - Could negotiation have been more successful?
Evaluate Your Skill – Here
www.machiavellisworkshop.com/index.htm
RESOURCES

Resource Guide: Negotiation Skills in Purchasing

ISM Articles: [www.ism.ws]
- Team Negotiations in a Single Voice.
- Negotiation for New Product Designs.
- Improving Your Sole Source B2B Negotiation Techniques!
- 21st Century Negotiations.
Cost as a Negotiation Factor

- Economic Price Adjustment Clauses
- Bulk orders
- Inventory costs
- Long Term agreements
- Manufacturing Costs
Discussion Topics

- Buyer-provided materials / services
- The power of a solicitation
- Post award changes
- Fact finding
Discussion Examples

- Shop failure rate is really 8%?
- Extra castings?
- Long drops?
- Inventory shrinkage
- Schedule flexibility
- Delivery flexibility
- Instructor available
- Testing contractor on retainer
References & Resources

- MLTWweb Negotiation Articles and Links
  - www.mltweb.com/prof/tools.htm#NEGOTIATION

- Ross Reck’s Web Site
  - www.rossreck.com/index.asp

- Machiavelli’s Workshop
  - www.machiavellisworkshop.com/

- S.A.B. Negotiation Training
  - www.sabonline.com/

- The Negotiation Skills Company
  - www.negotiationskills.com/index2.php

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