



Negotiation Leverage

How the principle behind a “baker’s dozen” is a buyer’s negotiation advantage

Agenda

1. Open Market Example

2. Principles

3. Strategies and Tactics

4. Path Forward & References

Open Market

Creative sales gimmicks
attract buyers

9-grain

Organic

**Free
Range**

Low Fat



Open Market example

- **Q:** How would a baker “up sell” a buyer who only wants 6 donuts?
- **A:** By offering special deal, “baker’s dozen”
- Why would the seller consider it?
 - ❑ He can make more profit and still cover his costs
- Why would the buyer consider it?
 - ❑ To avoid the next shopping trip and lock in today’s price

Donut Shopping

Qty	Donut cost each	Seller profit & OH	Value to Seller	Net sale	Buyer price each	Net cost to seller	Net profit
1	\$0.50	\$0.50	\$1.00	\$ 1.00	\$ 1.00	\$ 0.50	\$ 0.50
6	\$0.50	\$0.50	\$1.00	\$ 6.00	\$ 1.00	\$ 3.00	\$ 3.00
12	\$0.45	\$0.50	\$0.95	\$11.40	\$0.95	\$5.40	\$6.00
13	\$0.45	\$ -	\$0.45	\$ -	\$ -	\$ 0.45	\$ -
13	\$0.45	\$0.50	\$0.95	\$11.40	\$ 0.88	\$ 5.85	\$ 5.55

Incentive to Buyer
Price discount @ 88 ¢ ea.
7 extra donuts free

Incentive to seller
\$2.55 more profit
in one sale

Principle

- By changing the nature of the transaction and including an extra (13th) donut, the seller has enticed the buyer into a larger purchase (1 – dozen) because the going rate for a dozen donuts (\$1) is more valuable to the buyer than it is to the seller.

Why?

- Why would seller agree to cut profit?
 - ❑ Increase business volume
 - ❑ Lock out competition
 - ❑ Customer retention, loyalty, satisfaction
 - ❑ Lower costs
 - ❑ More predictable demand
- What are the other advantages to the buyer?
 - ❑ Supply chain costs & T.C.O.
*Ends up with an extra 6 to freeze for next time –
and one to eat on the way home*

Advantage Buyer

- Who has the negotiation advantage?
 - ❑ Can the seller force the buyer to buy 12?
 - ❑ Does the seller know if the buyer has funding for 12?
 - ❑ Can the seller control when the buyer shops?
 - ❑ Is there competition?
 - ❑ What are the other ways the buyer could affect the transaction cost?
 - standing order, packaging, transportation, scheduled deliveries, and ?

Cost vs. Price

- A supplier's cost for a product or service is almost always less than the selling price
- Thus an item purchased is more valuable to the buyer – than it is to the seller
- Negotiating based on the seller's cost for items and services will be more productive than negotiating the selling price
 - **In the Donut example, the seller is negotiating for the 13th donut based on 45 ¢ cost while the buyer is negotiating based on \$1 price**

Typical Cost Model

Direct Costs

Indirect Costs

Profit

Retail Price

Negotiated
Price

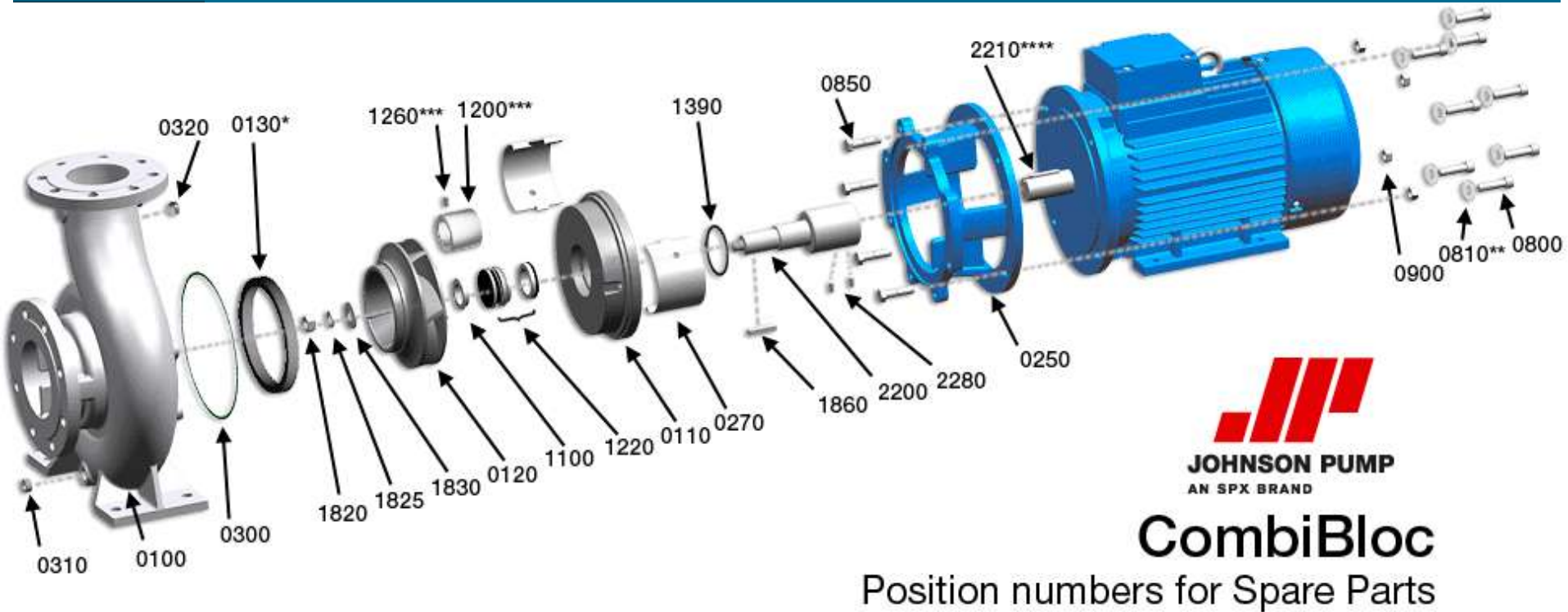
Direct Materials

- Raw materials in the product
- Can be a large/small percentage of total cost
- Affected by :
 - ❑ Material substitution
 - ❑ Subcontracting
 - ❑ Strategic materials

Direct Labor

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

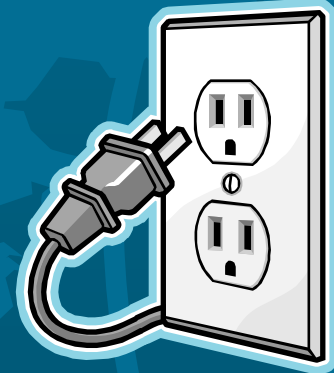
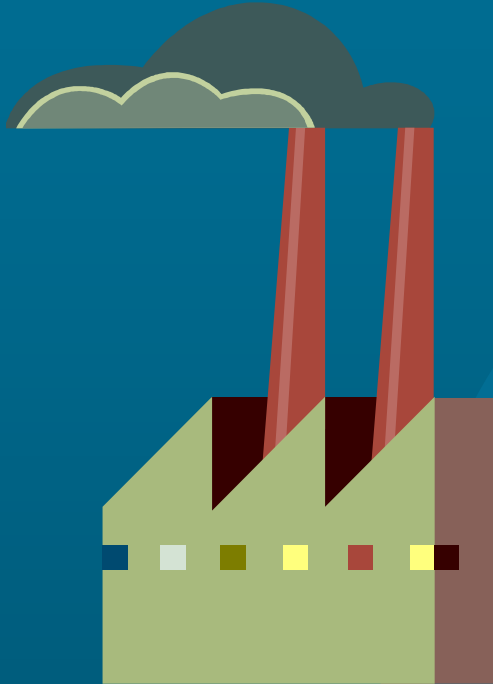
Direct Cost items



Example

- When General Mills & Costco team up to sell consumers an 8lb box of Cheerios
- Are we negotiating?
- Consumer's net cost per "O" is less because?

Indirect Costs



Direct vs. Indirect

- The supplier's cost almost always includes an indirect cost component which is added to the direct cost to when selling a product or service
- Thus the value of an item to a seller is less before it's sold than it is when it is sold
- When a contractor "throws it away" they don't write off the same value as they would if they priced it and sold it
- If the contractor doesn't sell it – indirect costs are not recovered

Open Market Example Review

- When offering a 13th donut, was seller negotiating with direct or indirect cost elements?
 - ❑ Incremental cost of one more donut is marginal
 - ❑ Seller still has direct cost even if he discards it
 - ❑ Seller can “give it away” by recovering his direct cost as a charge against an indirect cost pool (rework, marketing, inventory loss)

Indirect Benefits

- Indirect costs often relate to intangible elements that enhance the transaction which, if not itemized in the contract, can be lost-value to the buyer
- Installation, regular maintenance checkups, service manuals, training, etc. are more expensive to buy as a separate item, than if they are included in the initial selling price and agreement

Advantage: Buyer

- Understanding pricing principles is power
- Buyer brings \$\$\$ and product demand to the marketplace
- Buyer brings future sales potential
- Buyer structures the agreement to get the most value for each \$
- Buyer writes the contract

What can go wrong?

Q: What is the worst thing that can happen when we contract for an item or service?

A: A bad or incomplete contract

Added Value

- Most sales generally do not include all of the possible ways a seller can be of value to the buyer
- Aggressive marketing strategy touts creative ways a seller can differentiate themselves from their competitors, but most are never included in the “price list” or offered as part of a sale
- What would a seller do to gain customer satisfaction, favorable reviews, referrals?

Actual Cost Model

Direct Costs

Indirect Costs

Profit

Retail
Price

Negotiated
Price

\$\$\$

\$\$\$

Unearned Profit

Win –Win Strategy

- Reach an agreement to form the best and most complete contract possible
- Create a contract which uses every possible way to reduce both buyer and seller costs

This might be a good time to get the CEOs involved so they can earn their share of the indirect costs. The CEOs will understand cost cutting and are in a position to make the right decisions.

Tactics

- Group or combine actions to reduce supplier costs
- Leverage for ordering spare parts and operating supplies with the initial purchase
- Eliminate one or more direct costs by providing materials, cut out paint, pick up
- Eliminate one or more indirect costs; sales, support, warranty,
- Make sure all tangible indirect cost items are included in the written agreement

Reality Check

➤ What did I leave on the table?

- ☐ What did I pay for and not receive?
- ☐ What could have been changed to make it a better agreement?
- ☐ What would the seller have been willing to do to accommodate my needs (at no extra cost or at a cost lower than mine)?
- ☐ What could I have done to lower the seller's cost and receive a price benefit greater than the cost impact to me?

Indirect Opportunities

➤ Indirect cost elements:

- ☐ Which are already be included in the price
- ☐ Are those written into the contract?
- ☐ Which could be added at no extra cost?
- ☐ Which should be on the table for deduction from the price?



Summary

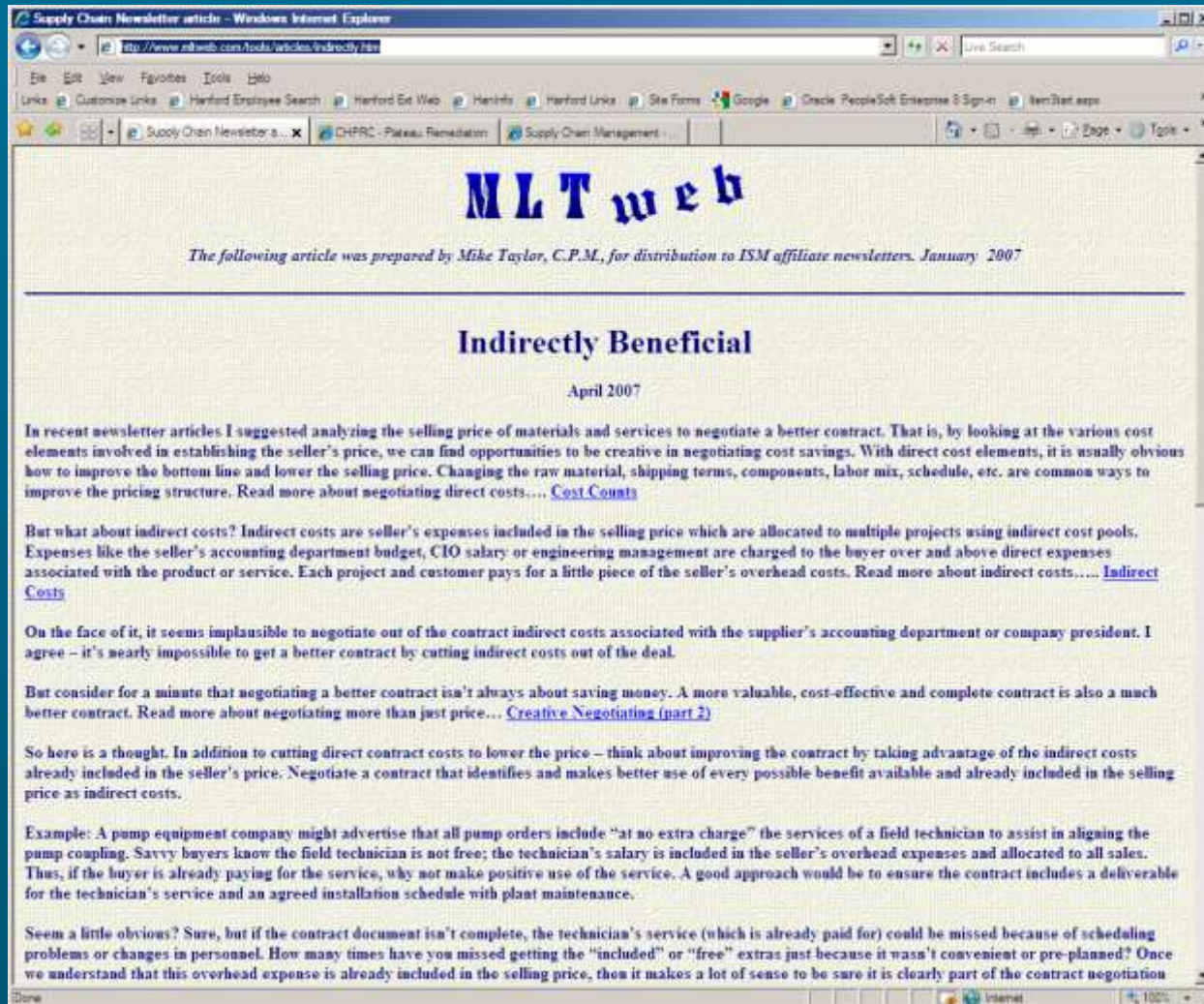
By understanding how a supplier prices an item or service and all the cost elements that make up a selling price, the Buyer discovers negotiation opportunities and gains a negotiation advantage over the seller

Discussion Topics

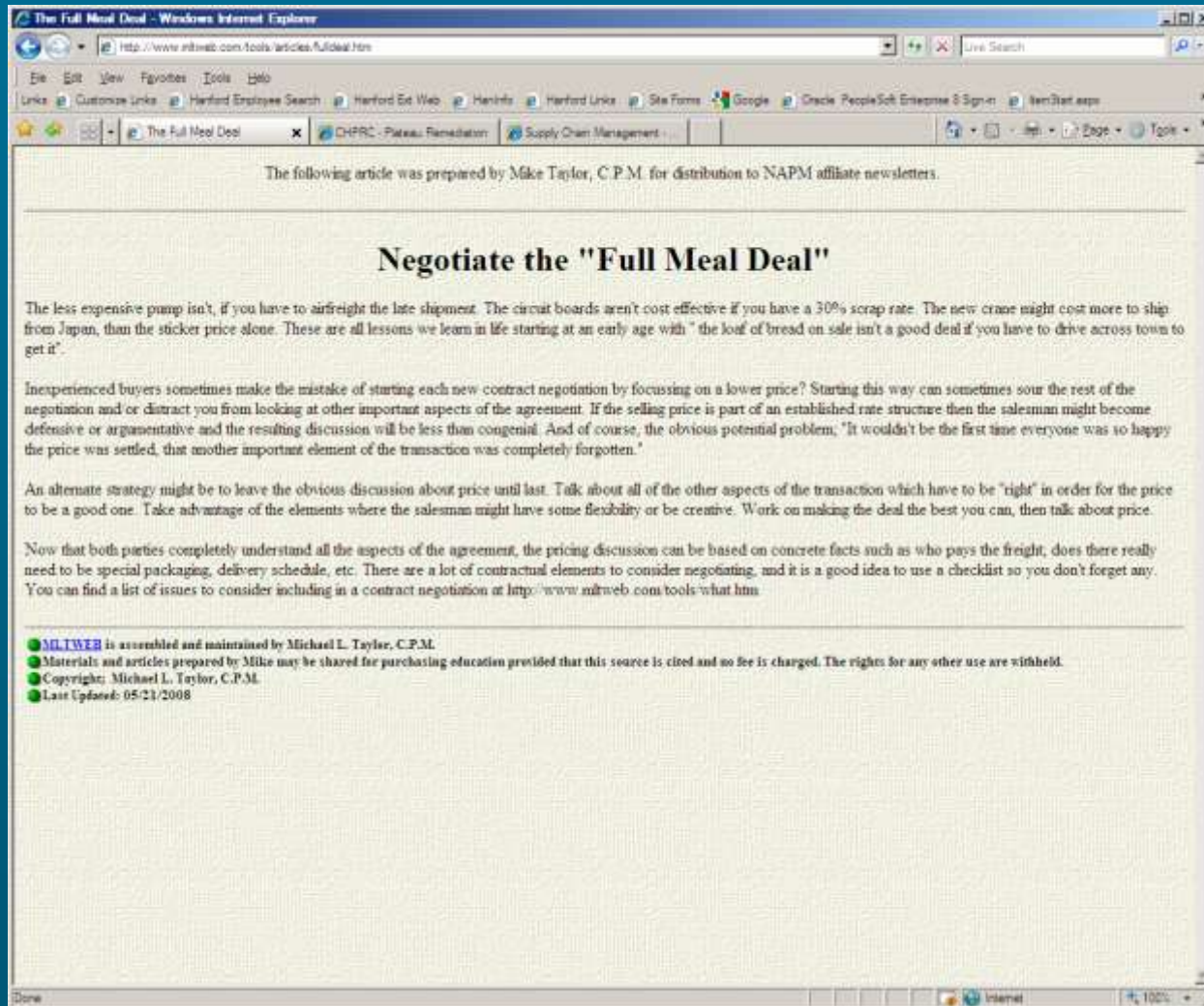
- Buyer-provided materials / services
- The power of a solicitation
- Post award changes
- Fact finding
- Long-term impact on the Supply Chain
- Buyer-Seller relationship



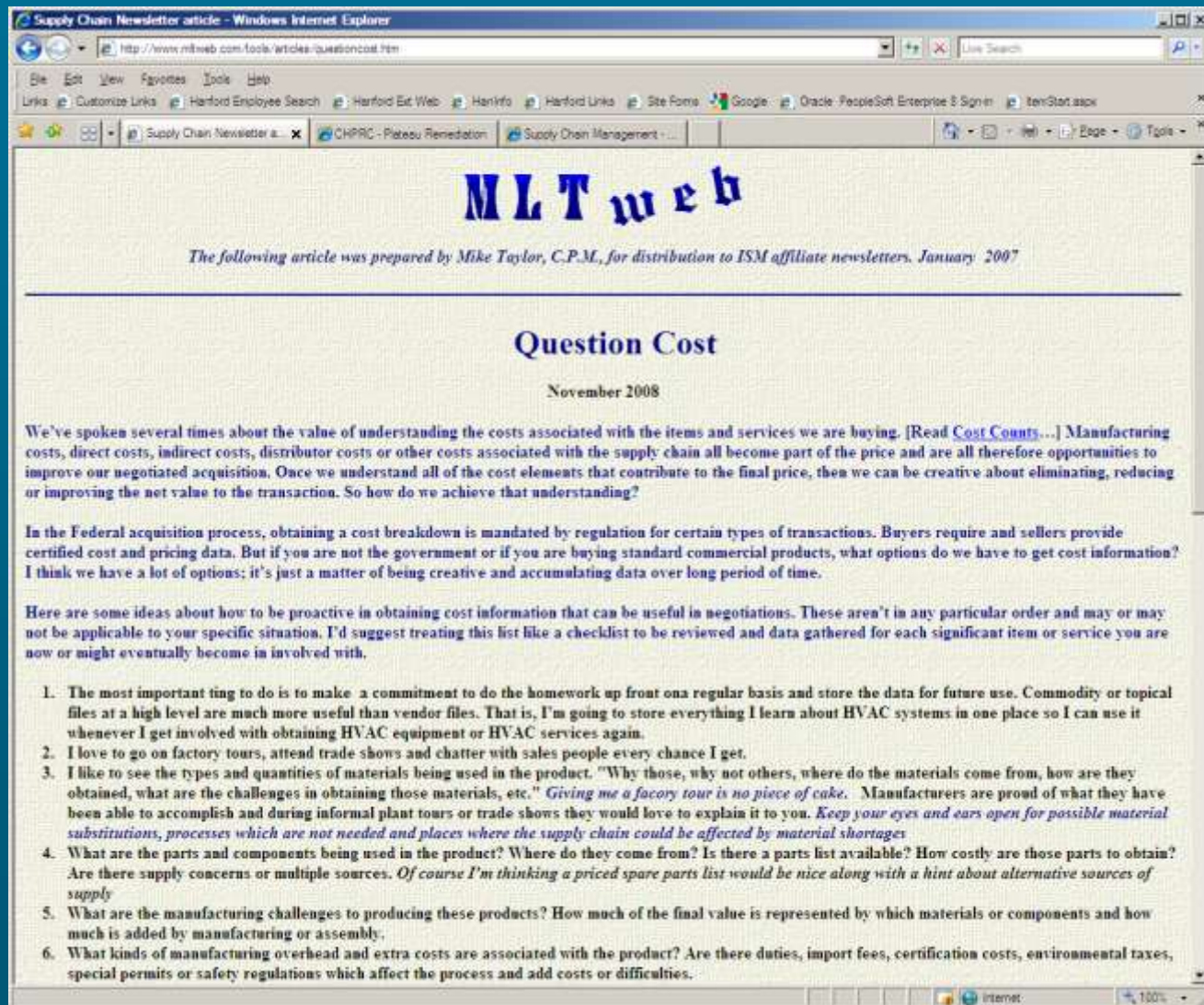




www.mltweb.com/tools/articles/fulldeal.htm









COST/PRICE PROPOSAL BREAKDOWN SUMMARY									
(FOR PROCUREMENTS UNDER THE THRESHOLD FOR SUBMISSION OF COST/PRICE DATA)									
NAME OF SUPPLIER:					DIVISION(S) AND LOCATION(S) WHERE WORK IS TO BE PERFORMED:				
SUPPLIER QUOTATION NUMBER:			MDC RFQ NO.:		TYPE OF CONTRACT:				
					<input type="checkbox"/> FP <input type="checkbox"/> FPI <input type="checkbox"/> CRF <input type="checkbox"/> CRFF				
SUPPLIES AND/OR SERVICES TO BE FURNISHED:					QUANTITY:		TOTAL AMOUNT OF QUOTATION:		
ELEMENTS OF COST TO SUPPLIER	PROPOSED COST/PRICE								
	NON-RECURRING (1)			RECURRING QTY.			TOTAL HOURS	SUPPLIER'S TOTAL COST	REF. NOTE (2)
	HOURS	RATE	AMOUNT	HOURS	RATE	AMOUNT			
MATERIAL: (3)									
Purchased Parts			\$0.00			\$0.00	0.00	\$0.00	
Subcontracted Items: (4)			\$0.00			\$0.00	0.00	\$0.00	
Raw Material (5)									
Inter-Otr./Co. Transfers: (6)									
Other: (7)									
Sub-Total Material									
MATERIAL BURDEN: (8)									
DIRECT LABOR: (9)									
Engineering									
Manufacturing									
Quality Assurance									
Other: (7)									
Sub-Total Direct Labor									
DIRECT LABOR BURDEN: (10)									
Engineering									
Manufacturing									
Quality Assurance									
Other: (7)									
Sub-Total DIL Burden									
TRAVEL: (10)									
SPECIAL TOOLING/TEST EQUIP.: (11)									
OTHER: (7)									
SUB-TOTAL DIRECT COST									
GENERAL & ADMIN. EXP.: (12)									
OTHER: (7)									
SUB-TOTAL COST:									
PROFIT/FEE:									
ROYALTIES:									
TAXES, CUSTOMS CHGS, ETC.: (12)									
OTHER: (7)									
TOTAL PRICE	0.00		\$0.00			\$0.00	0.00	\$0.00	

Q&A

