

#### **Negotiation Leverage** How the principle behind a "baker's dozen" is a buyer's negotiation advantage





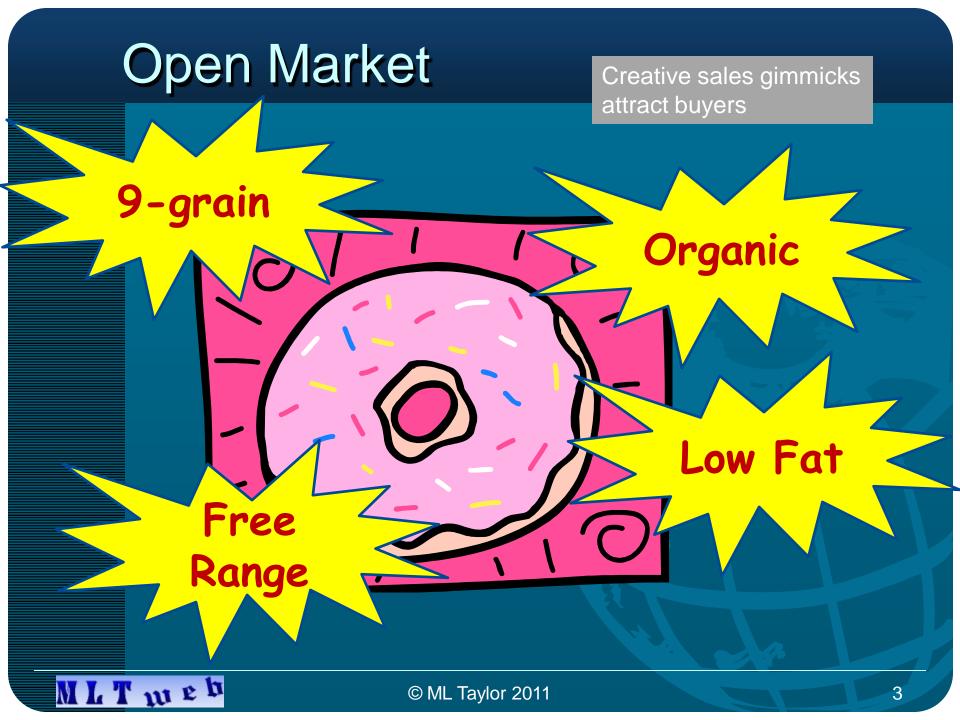
#### **1. Open Market Example**

2. Principles

**3. Strategies and Tactics** 

4. Path Forward & References





### **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 (13<sup>th</sup>) 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 13<sup>th</sup> donut based on 45 ¢ cost while the buyer is negotiating based on \$1 price



## **Typical Cost Model**



### **Direct Materials**

Raw materials in the product
 Can be a large/small percentage of total cost

Affected by :
 Material substitution
 Subcontracting

□ Strategic materials



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### **Direct Labor**

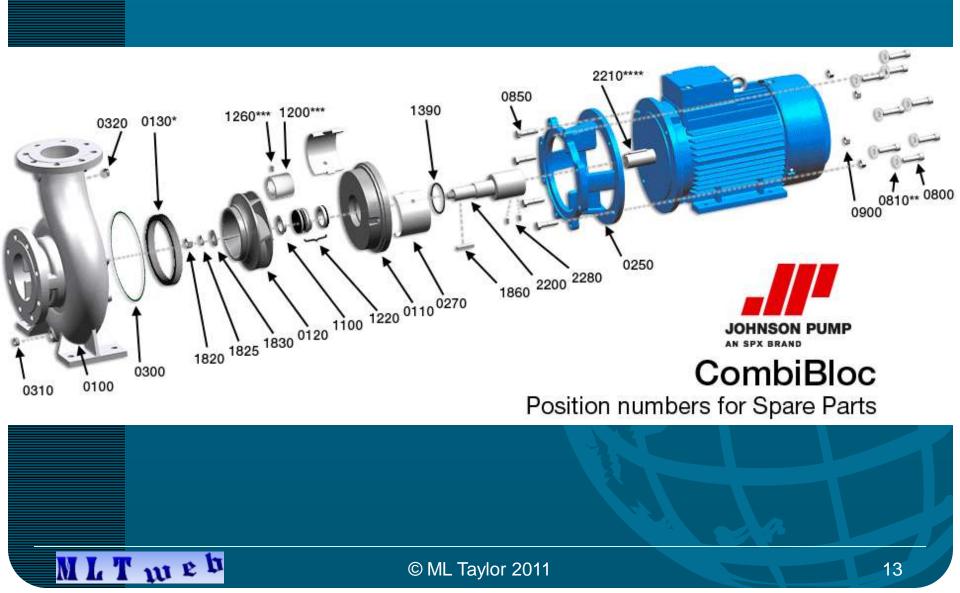


Labor to fabricate and provide service As a large percentage of total cost Labor categories Learning Curve, setup time, efficiency



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#### **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



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#### 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 13<sup>th</sup> 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

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#### Added Value

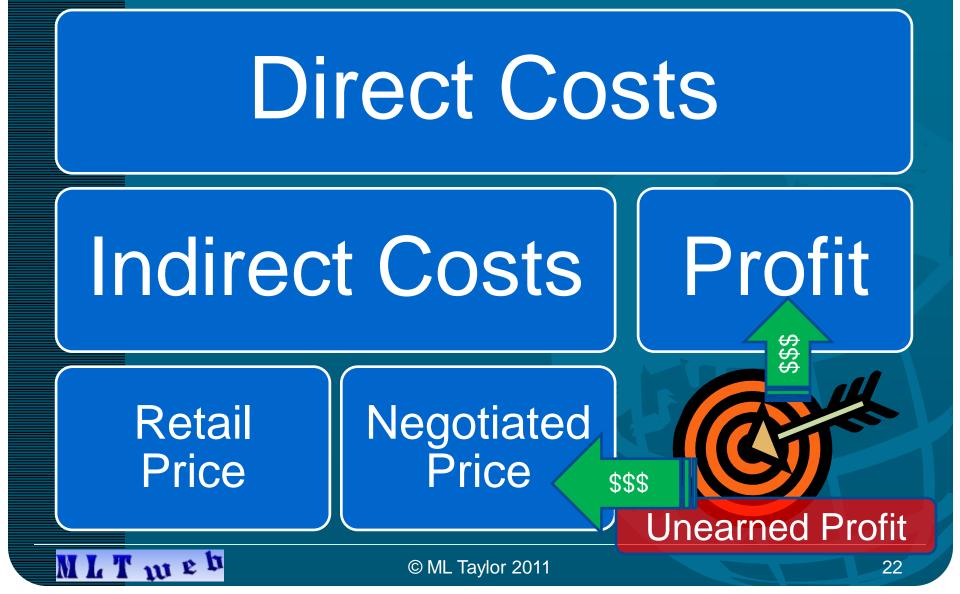
Most sales generally do not include all of the possible ways a seller can be of value to the buyer

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**



## 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

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## **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** 



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MLTWE The following article was prepared by Mike Taylor, C.P.M., for distri	
Why Cost Analysis	?
February 2007	
You may be asking yourself; "Why do I care about cost analysis. I don't place government contracts bottom line price is all I need to know."	where a cost breakdown analysis is required. The
You have a good point. It would be very nice to only have to worry about the final price; but consider	these examples:
<ol> <li>The seller calls to say that because of a 10% world-wide price increase for copper, the selling</li> <li>The seller announces that his utility company has raised electric rates by 10% because of a willo%.</li> <li>Your maintenance manager decides that he does not need the S10 gasket and the seller agree</li> <li>You agree to accept the valve unassembled so your inspectors don't have to take it apart to in labor at \$9.00 per hour and so reduces the selling price by \$9.00.</li> <li>You have a chance to back-haul the shipment from the seller's plant on one of your trucks. In the actual cost of commercial transportation.</li> <li>Because you are in the food service business, sellers are required to use very expensive food raised the price of his normal roller assembly by the value of a 5-gallon pail of the special grea? The seller casting.</li> </ol>	ter shortage and so all of his selling prices are bei to reduce the selling price by \$10. spect on receipt. The seller claims that will result i xchange the seller agrees to reduce the selling pr grade grease that is only available in 5-gallon pail se. schedule he will need 4-hours of overtime for the
True, you may not have to prepare a cost breakdown analysis before awarding your order – but in e seller's cost, the better.	ch of these real life situations, the more you know
Using the above scenarios, here are a few reasons why knowing the cost breakdown might help:	
<ol> <li>Sure, the price of copper may have risen 10%. But the copper part of our valve is only a small indirect overhead costs on top of the copper material, plus G&amp;A, plus profit. Thus, if the copper increase not a 10% increase to the whole selling price.</li> <li>Utility costs are generally included in G&amp;A expenses and added to the selling price. But Utility appropriate to pass along the whole utility price increase (and it might not be for a lot of reaso</li> </ol>	r part is only worth \$10 then you only want to agre costs are only a piece of the G&A adder. So ever
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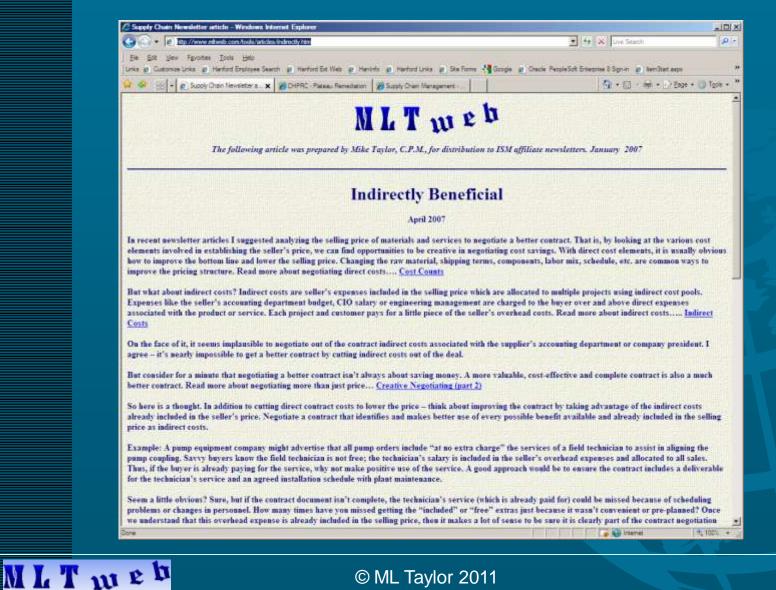


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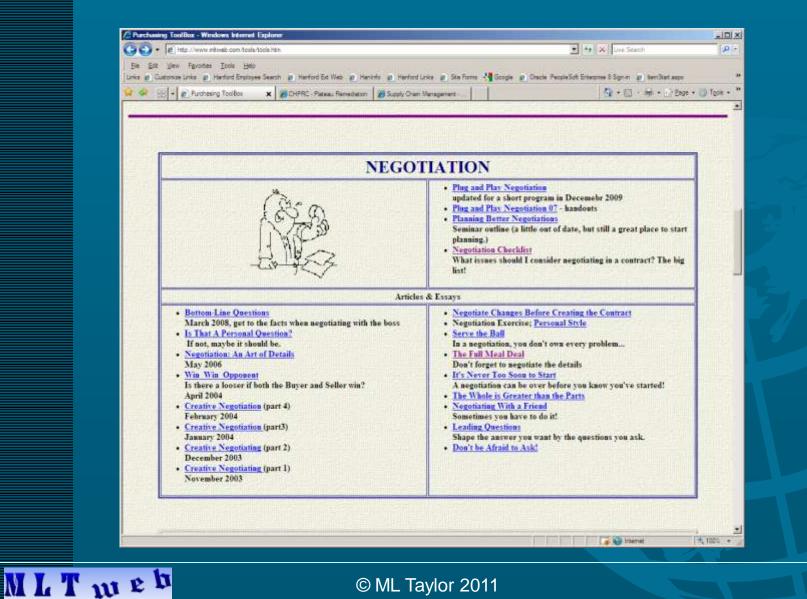
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Negotiate th	e "Full Meal Deal"		
The less expensive pump isn't, if you have to airfreight the late shipment. The circuit from Japan, than the sticker price alone. These are all lessons we learn in life starting et it'.	t boards aren't cost effective if you have a 30%		
Inexperienced buyers sometimes make the mistake of starting each new contract no negotiation and/or distract you from looking at other important aspects of the agree defensive or argumentative and the resulting discussion will be less than congenial the price was settled, that mother important element of the transaction was completed.	ment. If the selling price is part of an establishe And of course, the obvious potential problem,	ed rate structure then the salesman might be	ecome
An alternate strategy might be to leave the obvious discussion about price until last to be a good one. Take advantage of the elements where the salesman might have a			
Now that both parties completely understand all the aspects of the agreement, the p need to be special packaging, delivery schedule, etc. There are a lot of contractual You can find a list of issues to consider including in a contract negotiation at http://w	elements to consider negotiating, and it is a go		
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MLT we b The following article was prepared by Mike Taylor, C.P.M., for distribution to ISM affiliate newsletters. January 2007
Question Cost
November 2008
everal times about the value of understanding the costs associated with the items and services we are buying. [Read <u>Cost Counts</u> ] Manufacturing s, indirect costs, distributor costs or other costs associated with the supply chain all become part of the price and are all therefore opportunities to otiated acquisition. Once we understand all of the cost elements that contribute to the final price, then we can be creative about eliminating, reducing net value to the transaction. So how do we achieve that understanding?
I pricing data. But if you are not the government or if you are buying standard commercial products, what options do we have to get cost information? I of of options: it's just a matter of being creative and accumulating data over long period of time. leas about how to be proactive in obtaining cost information that can be useful in negotiations. These aren't in any particular order and may or may to your specific situation. I'd suggest treating this list like a checklist to be reviewed and data gathered for each significant item or service you are intually become in involved with.
mportant ting to do is to make a commitment to do the homework up front ona regular basis and store the data for future use. Commodity or topical igh level are much more useful than vendor files. That is, I'm going to store everything I learn about HVAC systems in one place so I can use it I get involved with obtaining HVAC equipment or HVAC services again. The top on factory tours, attend trade shows and chatter with sales people every chance I get. The text peep and quantities of materials being used in the product. "Why those, why not others, where do the materials come from, how are they that are the challenges in obtaining those materials, etc." <i>Giving me a facory tour is no piece of cake.</i> Manufacturers are proud of what they have to accomplish and during informal plant tours or trade shows they would love to explain it to you. <i>Keep your eyes and ease open for possible materials</i> <i>ms, processes which are not needed and places where the supply chain could be affected by material shortages</i> he parts and components being used in the product? Where do they come from? Is there a parts list available? How costly are those parts to obtain? supply concerns or multiple sources. <i>Of course I'm thinking a priced spare parts list would be nice along with a hint about alternative sources of</i> the manufacturing challenges to producing these products? How much of the final value is represented by which materials or components and how ded by manufacturing or assembly. s of manufacturing or estra costs are associated with the product? Are there duties, import fees, certification costs, environmental taxes, mist or safety regulations which affect the process and add costs or difficulties.
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The following article was prepared by Mike Taylor, C.P.M. for distribution to Na	APM affiliate newsletters.	
Negotiations:		
The Whole is sometimes greater tha	n the Parts	
Experienced negotiators guide the negotiation to focus on aspects of the transaction which are most important to them isn't any one element that is more important than the agreement as a whole. This gestalt negotiating strategy increases the		
In planning for a negotiation, we learn that there are many elements of the agreement to consider. Price is not the only el there are many dozens of elements that should be considered and negotiated. However, once the talking starts it's easy bigger picture. Details such as the negotiator's attitude, high price, slow delivery or poor quality can trigger an emotional	to get locked into just one or two details and loo	
We all understand that the long term cost of ownership, delivery, service and support are critical issues, and should be o away from a deal based on the salesman being condescending, or because the price isn't what you expected; and later o over? In this situation, if the detail is wrong, it's easy to forget the rest of the elements, stop the discussion too quickly at	wished that you had struck with it instead of havin	
Consider also the effect of a detailed-focused negotiation on the participants. If I tell the negotiator that the price is too I price. This can happen with any specific element of the negotiation. The more times I tell the negotiator, "the price is wro the negotiator will become defensive. We can both become frustrated and never get past this roadblock.		
However, if we avoid getting lost in the details, then the negotiator doesn't have to immediately respond to a specific iss elements of the agreement. Sure pricing may be the immediate issue (and it may be too high) but the negotiator in this ca 'whole deal' problem. They can bring in other issues to offset the price problem, long term cost of ownership, financing extending the discussion we give the negotiator some flexibility and we give ourselves a chance to re-think our position just price.	use now has the flexibility to be creative about sol rebates for future order, discounts for service, e	lving the tcBy
By characterizing the negotiation in this form 'I will issue the purchase order when the whole deal is the best' we avoid a We will work together to find the optimum solution. Lack of an agreement indicates that the discussion is incomplete, ar solution. We have also given a negotiator who has room to make a concession, but doesn't want to seem to be too easy saving way.	id we both are encouraged to keep searching for	a "better"
Here is another example.		
I can't start negotiating without knowing my delivery needs. However, once the talking starts, the delivery detail become decide that I can accept a few extra days for delivery time in exchange for packaging which better meets my user's need achieved if I had walked away from the negotiation when the suppler said he couldn't meet my delivery requirement. Ex creativity that made the deal work. We let each detail or element flex depending on its interaction with the other parts of	fs. This is a better deal for my company, than I w camination of the whole agreement, revealed oppo-	ouldn't have
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#### www.boeing.com/companyoffices/doingbiz/sccommon/docs/md1509.pdf

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