Welcome

- Workshop structure
  - #1 – Cost & Price principles
  - #2 – Negotiation Strategies related to cost & price
- Takeaways – Capture ideas & make use of them
- Handouts, Presentations and articles online:
  - www.mltweb.com/handouts/
  - www.mltweb.com/tools/tools.htm
  - www.mltweb.com/tools/imo.htm

Before we start …

<table>
<thead>
<tr>
<th>SAFETY AS A PRINCIPLE</th>
<th>LANGUAGE</th>
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<tbody>
<tr>
<td>Personal responsibility ...</td>
<td>Buyer =</td>
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<td>Our visitors &amp;</td>
<td>Contract Administrator =</td>
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<td>Our family &amp;</td>
<td>Contracting Officer =</td>
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<td>Our friends &amp;</td>
<td>Supply Chain Manager</td>
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<td>Ourselves</td>
<td>Contract =</td>
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<td>Purchase Order =</td>
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<td>Agreement</td>
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Taylor’s background and perspective

Our Path Today

1. Strategic negotiation as a policy
2. Strat re price
3. Strat re direct cost
4. Strat re indirect cost
5. Strat re profit & markup
6. Tips & Tactics
The Art of War

Win Without Fighting!

Prepare for war but do everything you can to win before it starts

Strategy: My action items

1. Discuss negotiation strategy and risks with management – *when it’s not a crisis*
2. Keep a list of strategic questions to ask during sales calls
3. Request strategic data and proposal details with all solicitations
4. Set aside time for a periodic strategic review with key suppliers

Write down your ideas as they come up today

1- If the proposed price varies from current market
   ❖ There is a reason for the variance - which might be critical
2- Buyers often fail to train their internal team
   ❖ More supportive if team understands process and risks
2- Buyers tend to focus negotiations on price or profit reduction
   ❖ Many other elements of the agreement can be improved
     www.mltweb.com/tools/articles/what.htm
   ❖ Reducing direct costs can yield compound savings
4- Total Acquisition Cost is as important as individual prices
   ❖ The significance of TAC should be a normal part of requisition process
5- Purchase terms & circumstances affect the price
   ❖ Changing our purchasing strategy can reduce costs & improve TAC
6- Sellers differentiate themselves with value-added services
   ❖ Buyers often don’t take advantage of all extras that are available
7- Contracts often fail to include valuable elements
   ❖ If it isn’t written into the contract – it will be lost

Strategy: Change the way we think about negotiations

➢ We know how to negotiate
➢ Normal part of our job
➢ Seek incremental benefits
➢ Finding responsible sellers
➢ Long term success is a shared responsibility among all departments
➢ Aligns with organization goals
➢ Training & teamwork
Poor Negotiation

- Incomplete contract
- Changes & claims
- Malicious compliance
- Seller loses money
- Buyer pays too much
- Contractor fails
- Legal costs
- Starting over

Buyer & Seller can both lose contract negotiation

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Quick Review: Typical Price Buildup Example

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<tr>
<th>Build</th>
<th>Base</th>
<th>Negotiate profit reduced 30%</th>
<th>Negotiate material</th>
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Negotiation tip: Work with the seller to reduce direct cost and split the savings

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Solicitation;

A buyer’s sharpest tool!

- Give the seller a chance to sell
- Demonstrate responsiveness
- Demonstrate responsibility
- Price & cost breakdown
- Data to prepare for changes
- Contingency information
  e.g. Spare parts lists, warranty, service, operating manuals
- Supplier’s price strategy
  e.g. price discounts, learning curve, delivery, production, raw materials, sourcing, inventory

What value can procurement add to a solicitation?

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Seller’s Price Strategy

- Protect against competition
- What the market will pay
- Cover Costs
- Desired Profit
  vs.
- Customer loyalty
- Perishability
- Quantity & trade discounts
- Distributor discounts
Buyer’s Purchasing Strategy

- Fact finding & preparation
- RFP/RFQ - strategic content
- Maximize market pressure
- Analyze price anomalies
- Find procurement options
- Finalize internal negotiations
- Set realistic price objectives
- BATNA threshold (Best Alternative To a Negotiated Agreement)

Strategy: Pricing Considerations

- If the proposed selling price varies from current market ...
  - there is a reason which could be critical
  - Identify and target significant cost drivers
    - Materials or labor?
    - Market conditions?
    - Shipping, packaging or handling?
    - Optional components?
  - Purchase terms can affect the overall cost
    - Quantity break
    - Long-term delivery or blanket orders
    - Consolidate requirements
    - Time purchases to coincide with production lulls
    - Reduce procurement ‘red tape’ and costs
  - Develop long-term relationship and target market as a team

Prices Are Set For A Reason

- Discuss, analyze and review the transaction to understand the price drivers
- Making changes in the purchasing process can be the fastest and easiest way to improve the agreement pricing
- What you don’t know about the price will cost you in the end

Key Points

- Change the deal
- materials, freight, Significant cost drivers can be identified and targeted to reduce the price ex.: better shipping method, grouping purchases, use less-expensive packaging, change materials, etc.

Strategy: Direct Costs
Direct Cost Drivers - Opportunities

*How can analysis be used to reduce the price?*

- Evaluate the total transaction costs (for both buyer and seller)
- Negotiate the lowest total cost (price plus TCA, TCO, COS, etc.)

Strategic Opportunities

- How can/will the seller add value to the agreement?
- What support can the seller provide – that we should be taking advantage of?
- What else can we collaborate on?

Indirect Cost Opportunities

*What elements are included in the seller’s indirect costs – that would be of value to me if I included in the contract?*

- Ex. “free shipping” as a marketing strategy
- Installation assistance, inspection, troubleshooting
- Application and design support
- Publicity, good will
- Trade-in, buy-back
- Dedicated sales team and support
- Online catalog – customized for your ordering team
- Product education and classes

Profit or Fee

*Do contractors have to make a profit?*

- Fixed fee, incentive fee, award fee
- Fee as a motivator
- Fee sharing arrangements
- Why is cost + fee a bad idea?
- How much is reasonable?
  - Industry average
  - Weighted Guidelines
  - Enough to get the job done right

Profit = “seller’s pride”

There are easier cost-reduction targets
Combine purchases
Long Term agreements
Split savings
Share marketing & publicity
Share risk

**Strategy:** Profit & Margin

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**Noncompetitive**

*Strategies for pushing back in noncompetitive situations*

- Independently verify a fair price
  - Then stop whining or start doing some homework
- Win-Win negotiation
  - Establish a relationship and help the supplier understand the value of a fair contract
  - Help the supplier reduce cost & make the contract more valuable
- Leverage buyer decisions
  - Long term agreement, different terms, order dates
- Publish requirement
  - Invite competition
- Raise visibility of the business impact and cost internally

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**More Cost Opportunities**

- Extra Castings
- Drops & excess
- Shop failure rate is really 8%?
- Inventory shrinkage
- Schedule flexibility
- Delivery flexibility
- Tooling, templates, molds

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**Even More Cost Opportunities**

- Labor to fabricate and service
- Labor category changes
- Learning Curve, setup time
- Raw material specification
- Material substitution, subcontracting, strategic materials, inventory value, acquisition assistance
- Training & downstream support
- Spare parts lists & inventory
- Marketing and advertising
- Audit and regulation support [e.g. sustainability, human rights]
We Are Better Negotiators!

We can win the war without fighting a battle

Bottom Line

When the Talking Starts

Don’t forget to listen
Don’t forget to stop talking

The common enemy = A malformed contract
Price vs Cost

- Pricing serves many purposes
  - New customers, move inventory, Market-based, competition, loss-leader
  - and sometimes make a profit
- Price is arbitrary
  - Prices must be negotiated
- Costs are business expenses
  - Costs can be mitigated or avoided

Consider TCA

- Evaluate the total transaction costs (for both buyer and seller)
  - Price + TCA + TCO + COS, etc. etc.
- A valuable concession is not always price
- Transfer costs to the party best able to manage the cost
  - Costco example

Negotiating With The Boss

- We can add value by....
- Extra costs include...
- Is this an illegal action?
- We would have also included...
- Have we considered these risks?
- Does this violate company policy?
- Have we provided for follow-on requirements, warranty, service, etc.?
- Since we are both trying to make the best decision for our company, we should consider alternatives....

Sell Your Team: A new way to negotiate

- Not a heated wrangling between teams of lawyers and accountants
- A set of tools and work processes to
  - meet our needs and
  - attain our goals incrementally
- A communication process used to
  - reach a common understanding
- Each detail resolved and avoided
  - is a successful negotiation
- A team can outperform an individual

Even the most complex contracts consist of many finite elements
The problem with conflict of interest; it is not obvious to everyone
Your leadership test & responsibility
Colleagues, management and staff
We all want to support our company
Explain common mistakes:
- you’re the sole source...
- competitor can’t...
- we have a deadline...
Give people credit and recognition
They won’t feel like they have to grandstand

Train Your Team

Do I have to buy from this supplier?
What am I doing to prevent it?

Listen & Read
Ask questions
Propose accurately
Accountable
Earn their fee
Support policy
Be honest

I Expect Responsible Sellers Who...

What do sellers expect from us?

Smooth working relationship that both of us will value
No surprises!
Successful performance
Satisfied organization
Interest in a continuing relationship

Sellers: We have common objectives
We can both “win” a contract negotiation!
Strategy:

- Establish expectation and be consistent
- Bring information
- Bring suggestions
- Solve problems
- Earn the business

Fact Finding

- Gather information
  *From your team as well as the seller*
- Tour, travel and read
- Hard questions are easier when not negotiating
- Listen more than you talk
- Confirm all assumptions
- Other customers
- Competition
- Record, save & share

**THE most important lesson I’ve learned in govt. contracting!**

Are we Negotiating?

<table>
<thead>
<tr>
<th>BUYER'S SOLICITATION</th>
<th>SELLER'S PROPOSAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 ea., 70K A/C unit, complete</td>
<td>Used Cond. Extended Warranty EPA approved Award-winning design Experienced installers</td>
</tr>
</tbody>
</table>

**Who is doing a better job of negotiating? Buyer/Seller**

**RFP Targets Weakness**

- Personnel issues
- Past performance issues
- Delivery problems
- Product defects
- Delays
- Lack of proposal detail
- Status & progress reports

How can we proactively solve this issue in the solicitation?
What does the price include?
- Supplies (how much)
What does the price exclude?
- Extra cost items?
Primary price drivers?
- Mobilization, delivery, labor
What are we missing?
- What we know (or not) about pricing will help later

Strategy:
Get a Price
Breakdown

2X the work ≠ 2X the price

What can be changed?
- to improve the overall value
Can we reduce seller’s cost?
- and our price
What else can the seller do?
- at no extra cost or less than mine
Can we remove complexity?
- and reduce risks
What are we assuming?
- that should be verified
What is the contract missing?
- That should be added
What might change in performance?
Concessions are not always price

Unbalanced value
- elements of the contract are often worth more to one party than the other
Separate cost elements – look at the details
Unrelated cost drivers
Collaborate on cutting costs
Cost savings that can be shared

Cost Targets

Focus on what & why

Identify indirect cost elements
Eliminate if possible
Add to contract

Indirect Strategy

Increase the value of the contract by including all of the indirect benefits which are available. Even if we can’t negotiate a lower price, we can get more value and a better contract.
Costs = Long-Term Negotiation Opportunities

- Negotiate before bidding starts
- Information is power
- Buyer Advantages
  - Process and schedule control
  - $$
- Weakness can be mitigated

Preplanning, fact finding, better solicitation, trained seller, internal support

Technical folks might prefer a do-over rather than the alternative

Even in a formal bid process, we have leverage

Formal Bid Challenge?

- Sole Source
- Preferred Source
- Long Term agreement
- International & offshoring
- Urgent need
- Warranty & repairs
- Regulations

Strategy: Prepare for the tough challenges

If it was easy; engineering could do without us

What can we do today to mitigate tomorrow’s problems?

Establish effective communications
- Gain understanding
- Build trust and honesty
- Find common elements
- Each agreed detail is one step closer to a deal
- Record, repeat & reinforce

After a lot of little agreements – it’s a long way back - no one wants to start over

Build Consensus

If it was easy; engineering could do without us

What can we do today to mitigate tomorrow’s problems?
Seek Common Objectives

- Model: A middle-east truce
  - Establish trust, seek common goals and share in the efforts to attain peace

Examples:
- A sole-source product
- An emergency service call
- A fire system pump...
  - Both parties want a successful transaction – that’s a start
  - What else do we both want?

Add Value by Negotiating Missing Details

- Reduce cost and administration
- Enhance the ROI
- Reduce performance risks
- Mitigate future problems
- Change the nature of the transaction to strategic
- Contract element checklist

+ Contingency
+ Conditional
+ Essential
+ Optional

Can we use negotiation tactics and strategies and maintain a good working relationship?

- Can we use these “tactics” without being mean or cruel?
- Can we use these “tactics” on a friend?

Example: T-day, it can be done and you get better at resolving the incongruity with practice

Bottom Line: We practice win-win negotiating all the time

Sellers Manipulate Prices...

- Special deals
- Closeout Sale
- Loss leaders
- Parametric pricing
- Bulk pricing
- Buy 2 get 3
- Baker’s dozen donuts
- General Mills & Costco team up to sell a 4lb box of Cheerios
- Free Shipping!

What can we learn from these seller tactics?

Are we negotiating?
Verify Facts & Assumptions

- What do we think we know?
- What don’t we know?
- What the seller need/want?
- What is motivating the seller?
- Who will decide?
- Why/when would they walk?
- Is failure an option?

Don’t trust anyone else to write it. The written agreement must be exactly what you want it to say
- Plain language, bullets not prose, clear intent and meaning
- Daily summary, action items, points of agreement and contention
- Include performance requirements and important contract elements
- Timely distribution - everyone has a fair chance to confirm or disagree
- Better to find out about a misunderstanding before the contract is issued.
- Anything you don’t say – won’t happen
- Teamwork to make sure it’s complete

Unfortunately, not all contractors want to collaborate and sometimes we need to help them understand that working together is better than working alone.

If we can’t trust the contractor to sell it at a fair price, or perform as promised, then it’s time to employ a few more direct tactics.

Assembling a better contract

Isn’t that what we always wanted?
Tactics –

Sometimes we have to push...

Practice Positive Speak

Say it how you want others to feel it

This is a disaster – we’re all gonna die...... or

"This justification would be better if we...”

“I think we have reached a positive outcome given the circumstances”

“It looks like we have some opportunities for long term improvement”

Language

➢ Your price is preposterous
➢ You’re trying to cheat me
➢ You’re not the low bidder
➢ You can’t be serious
➢ I want to buy
➢ I need
➢ I can’t accept
➢ You are the worst salesman...

Success Depends On People

➢ Trust & respect
➢ Collaborative attitude
➢ Open & honest communication
➢ Understand the needs and goals of each participant
➢ Work together to mitigate risks
➢ Seek an agreement that encourages successful performance

People and their personalities are an important component of every attempt to reach an agreement?
Warning

- Relationships are important – but ultimate test will be in the written agreement
- People will change
- Opinions will change
- Circumstances will change –
- Writing must survive reorganization

Ask Questions

- Don’t assume anything. Verify everything.
- Do I have to buy materials in standard quantities?
  - I end up with more material than I need to make the current order.
  - Scrap value. Does the left-over or waste material have a residual value?
- What is the optimum labor mix?
  - Is it more cost effective to have more skilled labor at a higher price?
- What are the critical-path cost elements?
  - Make or buy options?
  - Commodity pricing and hedging
  - Subcontracting risks
  - Strategic Materials, labor agreements,
  - Price volatility
- What are the recurring vs. one-time costs?
  - Special tooling vs. near and long term savings
- Why is the price set at this level?

Clarification vs. Discussion

- Demonstrate understanding
- Resolve minor irregularities e.g. page numbering is wrong
- If we need the info. to make a selection decision = BAFO
- Improve value added = BAFO
- Material change = BAFO
- GAO case references

How can we avoid this situation next time?

Ask Leading Questions

- Make sure you get an answer
- Keep asking
- Focus on the issue not people
- Is there a competitive product?
- What makes yours better?
- Why can’t you…..?
- How many have you had to fix?
- What is the turn time for fixes?
- How can we make this happen?
Ask Better Questions

- Do I get a price break?
  How much is our price break?
- Do we get maintenance service?
  How long is the maintenance coverage?
- Do I get a warranty?
  Please explain the warranty

Shape the answer you want with the question you ask

Competition is a powerful friend!
- Collateral information and facts about product and other work
- Strike first
- Invitation to participate
- A comprehensive solicitation
- Ask the right questions
- Pick when and how to order
- This isn’t my first rodeo

Serve The Ball

- Who’s problem is it?
- If it’s not your problem, don’t waste energy fretting about it
- Who is in the best position to solve the problem?
- Get the ball over the net and clearly in the hands of the person who can resolve it
- When is the best time to talk with a salesman on a commission?
  - I'd buy today...
  - if the deal was right
  - I can sign the order now
  - You mean .. you want to turn the deal down?
  - I'd prefer to work it out ... rather than start over... with someone else
  - This could lead to future business

- How long is the included warranty?
- What is included in the spare parts kit?
- If we reach an agreement, I will.....
- Did you intend to reject the order?
- What payment discount did you offer?
- What do you want me to do with this [non] invoice?
- Are you telling me that you plan to breach the contract?

- 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
- The plumber principle
- Not our normal process
- Our Procedure/policy won’t allow it
- It’s not in the contract

- No one does that...
- I know they don’t ...
- Not normally what they do
- Seller will charge extra...
- I didn’t think they could...
- It should ...
- I assume...
Change the terms
- If we agree to a 2-year purchase can we make a deal?
- Change the people
- Is there someone who does have the authority?
- A way to save face
- Blame it on a typo
- A way to sell it
- This is a great opportunity for long term business

I always ask for 10%
- Please – because you like me
- I just have one more thing
- Losing control of the negotiation
- Negotiating with the wrong person

Make a checklist & refer to it often
- Identify important issues
- Confirm assumptions – check facts
- A cheat sheet of good questions
- Build the contract as you go
- Communicate often and effectively
- Anticipate and prepare
- Failure analysis

Good Buyer
- Makes decisions ahead of time
- Avoids the cow pies

Good negotiator
- Consistently reaches an agreement

Win-win negotiator
- Good buyer and seller relationship

Ethical negotiator
- Earns respect – not revenge

Great Negotiator
- all of the above

Break A Deadlock

Companies can have bad habits as well as people

Personal Action Plan

Recap
We Are Better Negotiators!

We can win the war without fighting a battle

Bottom Line

Discussion:
Value of a Long-Term Relationship

Buyer
• Reduced acquisition costs
• Shorter acquisition cycle
• Predictable costs

Seller
• Reduced selling cost
• Predictable demand

Reality: We negotiate long term relationships in our personal lives - often

Contractor Responsibility Checklist

Problem:
“Negotiations were not conducted because”
- Most negotiations are over before they start
- What will each gain in agreement?
- Pick the person, place and time
- Who will decide & how?
- Include powerful friends only if you can control them
- Intangible allies: precedent, policy, president

It’s
Never
Too Soon
To Plan....

Our New Target
A successful contract that both parties support

Negotiation Targets

Direct Costs

Indirect Costs

Profit

Retail Price

Negotiated Price

Unearned Profit

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