



# 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 (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 Costs

Indirect Costs

Profit

Retail Price

Negotiated  
Price

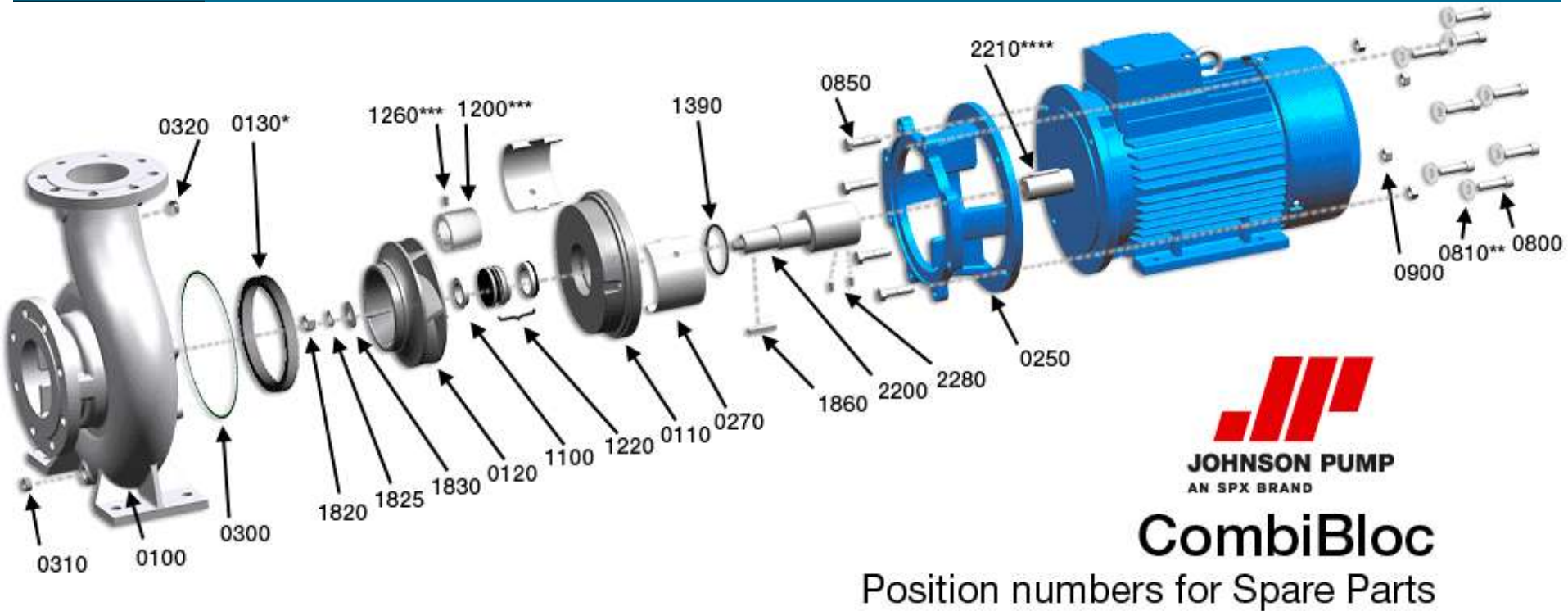
# Direct Materials

- 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

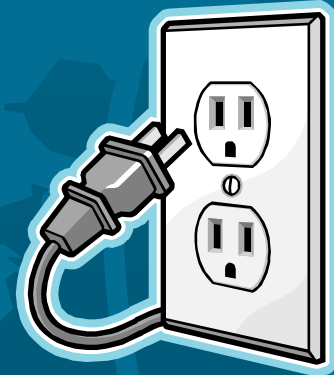
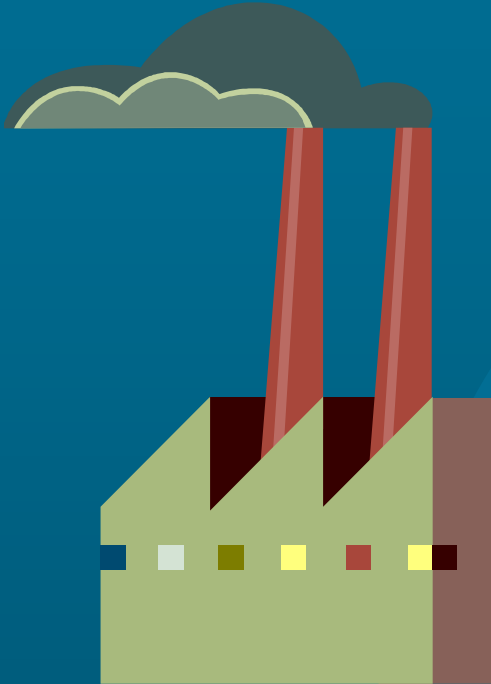
# Direct Cost items



# 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 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

# 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

Supply Chain Newsletter article - Windows Internet Explorer  
http://www.mltweb.com/tools/articles/why\_cost.htm

## MLTweb

*The following article was prepared by Mike Taylor, C.P.M., for distribution to ISM affiliate newsletters.*

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### Why Cost Analysis?

February 2007

You may be asking yourself; "Why do I care about cost analysis. I don't place government contracts where a cost breakdown analysis is required. The seller's bottom line price is all I need to know."

You have a good point. It would be very nice to only have to worry about the final price; but consider these examples:

1. The seller calls to say that because of a 10% world-wide price increase for copper, the selling price of the valve must be raised by 10%
2. The seller announces that his utility company has raised electric rates by 10% because of a water shortage and so all of his selling prices are being raised by 10%.
3. Your maintenance manager decides that he does not need the \$10 gasket and the seller agrees to reduce the selling price by \$10.
4. You agree to accept the valve unassembled so your inspectors don't have to take it apart to inspect on receipt. The seller claims that will result in 1 less hour of labor at \$9.00 per hour and so reduces the selling price by \$9.00.
5. You have a chance to back-haul the shipment from the seller's plant on one of your trucks. In exchange the seller agrees to reduce the selling price by \$175 – the actual cost of commercial transportation.
6. Because you are in the food service business, sellers are required to use very expensive food-grade grease that is only available in 5-gallon pails. The seller raised the price of his normal roller assembly by the value of a 5-gallon pail of the special grease.
7. The seller calls one week before the valve is due to ship and says in order to make the delivery schedule he will need 4-hours of overtime for the shop to rework a defective casting.

True, you may not have to prepare a cost breakdown analysis before awarding your order – but in each of these real life situations, the more you know about the seller's cost, the better.

Using the above scenarios, here are a few reasons why knowing the cost breakdown might help:

1. Sure, the price of copper may have risen 10%. But the copper part of our valve is only a small percentage of the total price. You know that the seller adds indirect overhead costs on top of the copper material, plus G&A, plus profit. Thus, if the copper part is only worth \$10 then you only want to agree to a \$1 increase not a 10% increase to the whole selling price.
2. Utility costs are generally included in G&A expenses and added to the selling price. But utility costs are only a piece of the G&A adder. So even if it might be appropriate to pass along the whole utility price increase (and it might not be for a lot of reasons) the 10% increase should only be allocated based on the net

**MLTweb**

## ISSUES TO CONSIDER NEGOTIATING

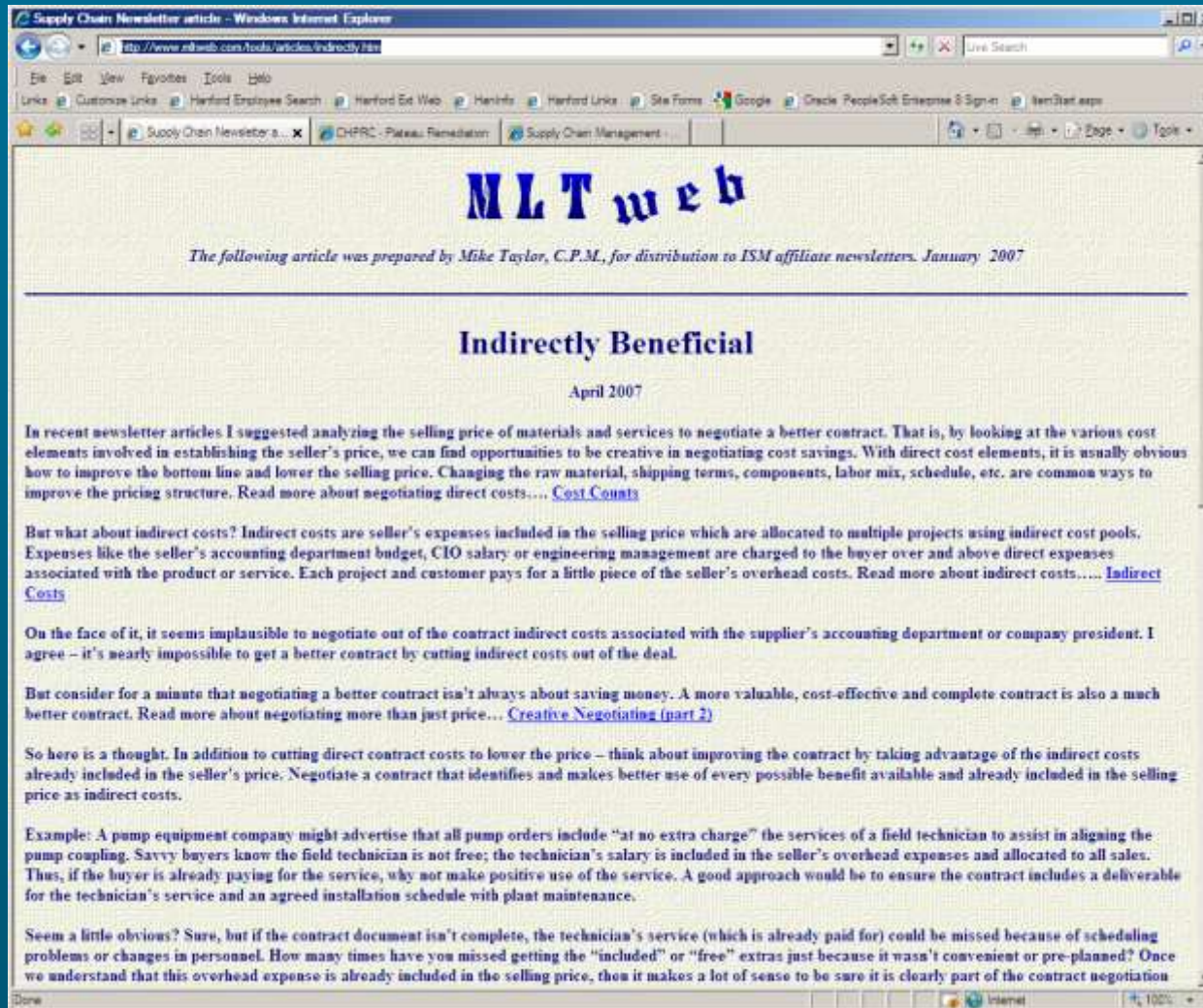
Excerpts from the seminar: [PLANNING BETTER NEGOTIATIONS](#)

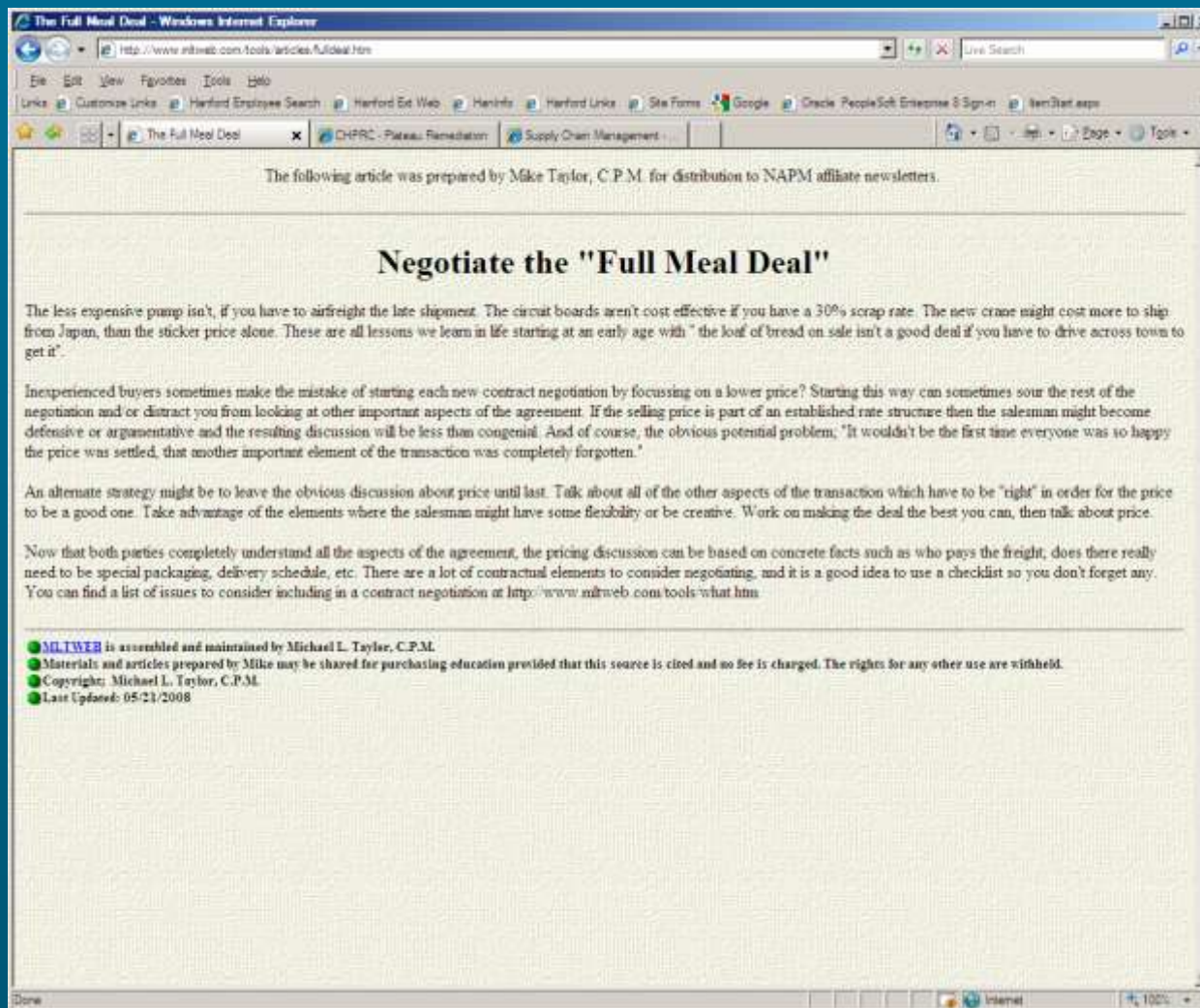
MICHAEL L TAYLOR, C.P.M.

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

<ul style="list-style-type: none"><li>• Availability</li><li>• Administrative charges</li><li>• Alternate Dispute Resolution</li><li>• Amortization schedule</li><li>• Audit rights</li><li>• Bank &amp; Finance institution</li><li>• Barter arrangements</li><li>• Cancellation charges</li><li>• Confidential information</li><li>• Contingencies</li><li>• Copyright</li><li>• Changes</li><li>• Consignment inventory</li><li>• Cost Breakdown</li><li>• Counter trade</li><li>• Currency</li><li>• Customer visits</li><li>• Damages</li><li>• Delivery</li><li>• De-mobilization costs</li></ul>	<ul style="list-style-type: none"><li>• Installation</li><li>• Insurance</li><li>• Intellectual property rights</li><li>• Inventory Costs</li><li>• Invoice method</li><li>• Invoice terms</li><li>• Labor rates</li><li>• Lead time</li><li>• Legal venue</li><li>• License agreements</li><li>• License fees</li><li>• Maintenance</li><li>• Marketing support</li><li>• Manufacturer's allotment</li><li>• Mediation</li><li>• Meeting locations &amp; schedule</li><li>• Mobilization costs</li><li>• Multiple deliveries</li><li>• Obsolete Inventory Responsibility</li><li>• Overages</li></ul>	<ul style="list-style-type: none"><li>• Progress payments</li><li>• Quality rate</li><li>• Raw materials</li><li>• Recycled content</li><li>• Residual value</li><li>• Restocking charges</li><li>• Returns</li><li>• Risk of loss</li><li>• Safety Stock</li><li>• Scrap recycling</li><li>• Spare parts pricing/availability</li><li>• Special marking</li><li>• Specifications</li><li>• Stand-by rates</li><li>• Start-up assistance</li><li>• Storage of unused materials</li><li>• Subcontracting</li><li>• Termination Provisions</li><li>• Terms and conditions</li><li>• Testing</li></ul>
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**NEGOTIATION**



- [Plug and Play Negotiation](#)  
updated for a short program in December 2009
- [Plug and Play Negotiation 07](#) - handouts
- [Planning Better Negotiations](#)  
Seminar outline (a little out of date, but still a great place to start planning.)
- [Negotiation Checklist](#)  
What issues should I consider negotiating in a contract? The big list!

Articles & Essays

- [Bottom Line Questions](#)  
March 2008, get to the facts when negotiating with the boss
- [Is That A Personal Question?](#)  
If not, maybe it should be.
- [Negotiation: An Art of Details](#)  
May 2006
- [Win Win Opponent](#)  
Is there a looser if both the Buyer and Seller win?  
April 2004
- [Creative Negotiation](#) (part 4)  
February 2004
- [Creative Negotiation](#) (part 3)  
January 2004
- [Creative Negotiating](#) (part 2)  
December 2003
- [Creative Negotiating](#) (part 1)  
November 2003
- [Negotiate Changes Before Creating the Contract](#)
- [Negotiation Exercise; Personal Style](#)
- [Serve the Ball](#)  
In a negotiation, you don't own every problem...
- [The Full Meal Deal](#)  
Don't forget to negotiate the details
- [It's Never Too Soon to Start](#)  
A negotiation can be over before you know you've started!
- [The Whole is Greater than the Parts](#)
- [Negotiating With a Friend](#)  
Sometimes you have to do it!
- [Leading Questions](#)  
Shape the answer you want by the questions you ask.
- [Don't be Afraid to Ask!](#)

Supply Chain Newsletter article - Windows Internet Explorer  
http://www.mltweb.com/tools/articles/questioncost.htm

MLTweb

The following article was prepared by Mike Taylor, C.P.M., for distribution to ISM affiliate newsletters. January 2007

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## Question Cost

November 2008

We've spoken several times about the value of understanding the costs associated with the items and services we are buying. [Read [Cost Counts...](#)] Manufacturing costs, direct costs, indirect costs, distributor costs or other costs associated with the supply chain all become part of the price and are all therefore opportunities to improve our negotiated acquisition. Once we understand all of the cost elements that contribute to the final price, then we can be creative about eliminating, reducing or improving the net value to the transaction. So how do we achieve that understanding?

In the Federal acquisition process, obtaining a cost breakdown is mandated by regulation for certain types of transactions. Buyers require and sellers provide certified cost and 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 think we have a lot of options; it's just a matter of being creative and accumulating data over long period of time.

Here are some ideas 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 not be applicable 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 now or might eventually become involved with.

1. The most important thing to do is to make a commitment to do the homework up front on a regular basis and store the data for future use. Commodity or topical files at a high 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 whenever I get involved with obtaining HVAC equipment or HVAC services again.
2. I love to go on factory tours, attend trade shows and chatter with sales people every chance I get.
3. I like to see the types and quantities of materials being used in the product. "Why those, why not others, where do the materials come from, how are they obtained, what are the challenges in obtaining those materials, etc." *Giving me a factory tour is no piece of cake.* Manufacturers are proud of what they have been able to accomplish and during informal plant tours or trade shows they would love to explain it to you. *Keep your eyes and ears open for possible material substitutions, processes which are not needed and places where the supply chain could be affected by material shortages*
4. What are the 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? Are there supply concerns or multiple sources. *Of course I'm thinking a priced spare parts list would be nice along with a hint about alternative sources of supply*
5. What are the manufacturing challenges to producing these products? How much of the final value is represented by which materials or components and how much is added by manufacturing or assembly.
6. What kinds of manufacturing overhead and extra costs are associated with the product? Are there duties, import fees, certification costs, environmental taxes, special permits or safety regulations which affect the process and add costs or difficulties.



**COST/PRICE PROPOSAL BREAKDOWN SUMMARY**  
 (FOR PROCUREMENTS UNDER THE THRESHOLD FOR SUBMISSION OF COST/PRICE DATA) PAGE \_\_\_\_ OF \_\_\_\_

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"/> CRIF <input type="checkbox"/> CRPF					
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-Div./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 D/L Burden									
TRAVEL: (10)									
SPECIAL TOOLING/TEST EQUIP.: (11)									
OTHER: (7)									
SUB-TOTAL DIRECT COST									
GENERAL & ADMIN. EXP.: (8)									
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

