Insight

NEGOTIATION PLANNING: HOW DO YOU WORK OUT WHAT THE 'FINAL PRICE' SHOULD BE?

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Negotiation

"How do I know what I should pay for this?" is a fair question when planning a negotiation and one I frequently hear being asked, especially by those just starting out. There is a common misconception that somewhere out there lies a magic tool or approach used by the professionals to gain this insight. Sadly, there's not!

In some cases, with a bit of prior effort, research and planning, it is possible to establish with some degree of accuracy what we should expect to pay before we enter into negotiations. Unfortunately, perhaps for the majority of negotiations, we go in with very little or no information. There are lots of different reasons for this – complexities, history, market dynamics and market difficulty can all cloud our insight.

There are also steps that suppliers can take to be opaque. These include a) maintaining secrecy around commercial information and any statistics that would allow a cost breakdown to be established; b) added-value bundles; and c) implying they have a stronger position and that we need them even if we don't. The latter is a good example of projected power and is definitely one you should look out for when negotiating.

Fundamentally it is not in the supplier's best interest for us to know his price point, as this would clearly limit his or her power and possibilities. As a result, a supplier will do his or her utmost to keep as much data as possible hidden from us to protect their margins.

To establish what you should be paying with any degree of accuracy ultimately depends on what you are buying. As a simple example, imagine you are a retailer sourcing bread. By taking into consideration the ingredients and quantities used – most of which are commodities that have information on price freely available – together with an assessment of labour, manufacturing, transportation and other costs, you can come up with a price. With a bit of effort, you can even develop a dynamic cost model to track commodity price changes so that you know what you should be paying for bread on any given day. Assuming your analysis is correct, this can be vital information for your negotiation as it limits the supplier's options.

However, what would happen if you were to buy a branded bread that your customers expect to see on the shelves? For a start, the cost breakdown becomes less potent since you are buying the additional value of the brand, against which it is difficult to put a cost. Instead, the discussion changes as to how you can get back the most value for a price point higher than the breakdown.

Using a cost breakdown in a negotiation can be a powerful tool – but it will only work where what you are buying is non-complex and there are many supply options, ie: you have leverage. It will also only work if you are confident in your analysis. Then, if your facts and data suggest there is scope for a price reduction, then the supplier only has two possible responses if he or she is willing to engage in the debate:

RESPONSE ONE

The supplier could yield to the argument and concede on price. This could move discussions on to what a fair amount of profit might be, or what added value elements could be provided.

RESPONSE TWO

The supplier could completely reject the argument. This could, perhaps, be on the basis that your analysis or data is disputed. If this is the case, your next question then becomes "please help me see where my analysis is incorrect?"

For a cost breakdown to have any impact in a negotiation, the supplier needs to engage with the discussion. Once he or she is engaged, it then becomes difficult for them to back out, as highlighted above.

To give you another example, during a discussion with a builder, I asked if he could give me a cost breakdown showing the labour and key materials elements for the job I needed doing. Clearly, he had been asked this many times before as his response was very straight to the point. He said, 'I don't give breakdowns of price. I can list all the activities and materials within the job, but my price is my price and I believe it is fair for what we do.'

This was a very clever response as it completely stopped me in my tracks and there was no potential room for negotiation. It also meant I had a simple decision to make – did my need and previous homework about what I should expect to pay compared to his availability and reputation mean the price was right? It was. We agreed the deal without any further attempts from me to get a bit of added value. Quite simply, my power was limited to how much he wanted or needed that work at that particular time versus his reputation.

Like my builder, suppliers will typically aim to avoid ending up in such discussions. The exception to this is if they are confident their position stands up to scrutiny or they know they can hide profit, perhaps within the way overheads are dealt with or via hidden kickbacks from their own suppliers.

The notion of 'open book' costing, where suppliers volunteer the breakdown, is one of which you should be cautious unless you have confidence in the validity of the figures being tabled by the supplier. If the first time that these figures are presented is during a negotiation, then alarm bells should ring in your head and you should buy time to properly review and analyse what is being presented.

Always remember that there are a number of factors that create negotiation blindness around price points. From our perspective, these include a) a lack of research or understanding; and b) buying branded, unique or high value added goods and services.

To sum it all up, remember to do your homework in advance, have confidence in your own data analysis and best of luck if you decide to call the supplier's bluff!

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