AVOID PRICE NEGOTIATION BY ADDING VALUE

By Michael Schatzki

Imagine this scenario. You are a sales representative for Baker distributing. One of your long-time customers, Albertson Metals, operates a mill that produces high nickel alloy ingots. Each year, this mill purchases approximately $500,000 worth of MRO products such as bar conditioning wheels, flap wheels, grinding belts, cutoff wheels, steel shot and grit, and other products for the mill's laboratories. Unfortunately, you are usually able to obtain only about 30% of this business.

During the last six months, you have been working intensively with the mill's management to convince them of the value of developing an integrated supply arrangement with you. They have reacted positively to your ideas and you have developed a proposal that you believe fits their needs perfectly. Among other things, you will:

- manage Albertson's inventory.
- stock all items with sufficient buffer stock to assure JIT availability.
- supply Albertson with OSHA-certified safety seminars on appropriate topics to be mutually agreed upon.
- provide 24 hour emergency delivery.
- invoice biweekly for items drawn from consignment.

You have submitted your proposal at a price that you believe fairly compensates you for your high level of service and for the special features included.

A week later you call the plant and are told, "We got your proposal and it's excellent. However, we have to refer anything of this magnitude to Corporate Purchasing." You call the Purchasing Department and speak to the buyer responsible for this contract. He says, "You've submitted an excellent proposal, and obviously you have done your homework. Unfortunately, we have something of an embarrassment of riches here. Two of your competitors also submitted excellent proposals. You should be aware that your pricing is extremely high compared to your competitors. As a result, at this time your proposal really is not competitive."

You explain to the buyer how you've worked with the plant for the last six months to develop this proposal. You discuss at length your excellent service record and how you have gone the extra mile to meet the plant's needs. The buyer acknowledges this but says, "Your competitors also have excellent service records but are willing to meet our needs at a much lower cost."

Did you see this coming? You worked hard to meet your customer's needs. You solved problems with your customer. You anticipated a win/win for everybody. Your goal was to avoid a price negotiation by differentiating yourself and focusing on your services and your added value to the customer. Now, at the last minute, price rears its ugly head. In fact, the purchasing agent says that price is the determining factor.

What do you do now? What should you have done throughout the sales process to prepare for the possibility of a serious price negotiation?

In our sales negotiation training programs we stress four key steps that will greatly improve your chances of making that sale while successfully negotiating to maintain your margins.

1. Be prepared for a price negotiation but don't lead with your wallet.
2. Think like the buyer.
3. Be brutally honest with yourself as to what your added value is really worth.
4. be aware that the negotiation starts when you say hello.

Let's look at each step.

1. Be prepared for a price negotiation but don't lead with your wallet.
As buying organizations have become more sophisticated, many realize that the key factor is not price but total cost. Therefore, it is sometimes possible to avoid price negotiations if the customer sees enough value. We know of one manufacturer who was approached by an automobile company to take over production of certain parts because their current supplier was not meeting expectations. The manufacturer called in its machine tool distributor with whom they had had a very good relationship. They said to the machine tool distributor, "We promised the automobile manufacturer that we could do it. Now it's up to you to make it happen. We're not here to negotiate the price - just make it work." The distributor sold $10 million worth of machine tools at list price, including a full turnkey operation and the placement of a full time technician at the manufacturer's location.

There's a lesson to be learned: If you think there is a possibility that you can make the sale based on your added value and services, try to leave price out of the discussion. Don't start with price concessions or discounts but focus on the added value.

On the other hand, with today's ferocious pressures to reduce costs, buyers never forget that price is an important component of cost. Usually, buyers will want to have the best of both worlds. They want you to solve their problems, add value, reduce their costs, and in addition, give them a better price, which further reduces their costs. Don't be surprised, don't be shocked, and don't be hurt. That's just the way the game is often played. As you start the process, you need to move forward in such a way that while you don't invite a price negotiation, if there is one, you're prepared.

2. Think like the buyer.
To negotiate effectively, take up residence in the buyer's mind. Say to yourself, what might actually be going on vs. what they're telling me? What they say may be the least important information. What they say to each other and what they're thinking is the key.

Let's go back to Albertson. We could imagine three different scenarios.

Scenario 1
Plant:” This proposal from Baker is great. We're going to save all kinds of costs and solve all kinds of problems. I know they appear a little pricey, but the cost savings are worth it." Purchasing: "Have you looked at any competitors?" Plant: "We've looked at two who say they can do it and have offered a much lower price, but their services really aren't there and we don't believe they can produce the cost savings." Purchasing: "Would you mind if I use the fact that you got two competitive lower cost quotes to try to bring Baker's price down?" Plant: "No problem, as long as you promise that we will get a contract with Baker without losing any of the services and added value they have promised us." Purchasing: "You have my guarantee."

Scenario 2
Plant: "This proposal from Baker is great. We're going to save all kinds of costs and solve all kinds of problems. I know they appear a little pricey, but the cost savings are worth it." Purchasing: "Have you looked at any competitors?" Plant: "We've looked at two other competitors. They're almost as good as Baker and they are cheaper." Purchasing: "How much more do you think Baker is worth than the best of the two competitors?" Plant: "We think they're worth about 10% more." Purchasing: "O.K. We'll try to get Baker down so that they're no more than 10% above your best competitor, and of course we'll try to get them even lower than that. If we can't get them down, then we'll go with your No. 2 choice." Plant: "Sounds good to me."

Scenario 3
Plant: This proposal from Baker is great. We're going to save all kinds of costs and solve all kinds of problems. I know they appear a little pricey, but the cost savings are worth it." Purchasing: "Have you looked at any competitors?" Plant: "We've looked at two other competitors that can do the same thing Baker can. They all appear to have the same quality and would produce the same cost savings." Purchasing: "Then you don't care which one we go with as long as we get the best price." Plant: "Yes, they're basically the same, so go with the best price."

The buyer will almost always want you to believe that Scenario 3 is happening. But is it really? The profitability of your sale may depend on your ability to determine which scenario really is in operation.

3. Be brutally honest about the worth of your added value.
If it comes down to a price negotiation, your added value is worth only what the buyer is actually willing to pay for it. Say, for example, that the only difference between you and your prime competitor is that you have a better reputation in the marketplace. Is that of value? Of course. Is it important? Absolutely. Is it worth anything? That depends on the buyer. If a one buyer says, I'm willing to pay 2% more to go with Company A because of their better reputation, then it's worth 2% to that buyer. On the other hand, if another buyer says, I'm not willing to part with any hard, cold cash because of Company A's reputation, then for that buyer it is not worth anything." For each sale where you have one or more potential competitors, you need to do a value-added analysis in order to figure out the most the buyer would pay you vs. your competitor. Let's make up a simple example where you have just one competitor, Company A, and let's assume there are just four different components of value: service, reputation, delivery, and problem solving ability.

Based on your knowledge of the customer and the competition, you believe the customer thinks that you have a better reputation, provide better service and have better problem solving capabilities, but that your competitor is a little better on delivery. Furthermore, although your customer likes your reputation, they won't pay more for it. They like your service and feel that's worth up to 2% more. They believe that your problem solving capability has helped them overcome significant difficulties and that that's worth 4% more. On the other hand, you have had some delivery problems. While not fatal problems, the customer would be willing to pay your competitor up to 2% more for their better delivery.

Your value-added analysis sheet would look like this:

Value Added Item Vs. Company "A"	The Most Your Customer Would Pay Extra for That Added Value
Reputation	0%
Service	2%
Problem Solving	4%
Delivery	(-2%)

Under this scenario, your customer would be willing to pay you up to 4% more than your competitor. Of course your customer will often say, as our Albertson purchasing agent did, "You guys are all the same. You all provide good quality except your delivery isn't very good. You've got to get much more competitive with your pricing." If you've done the value-added analysis and it's accurate or reasonably accurate, you can see behind the purchasing agent's mask to what is really going on.

4. The negotiation starts when you say hello.
At this point you may be saying, "Everything you say is true but if I'm the Baker sales representative talking to the Albertson purchasing agent and he says to me, 'Your competitors are lower and you have got to cut your price,' what do I do now? That purchasing agent isn't going to tell me their real scenario, what they said to each other, or what they really think our added value is worth vs. our competitors."

Correct. If the first time you thought that there might be a price negotiation was when you were talking to the Albertson purchasing agent, it's too late. You don't have the information you need, and it's going to be difficult to get it.

And that takes us back to our first point. Be prepared for a price negotiation while you try to avoid one. The negotiation starts when you say hello. The time to start finding out who potential competitors might be, how your customer views them vs. you, the problems they've had with competitors, whether anybody can do as good a job as you can, etc., etc., is from the very beginning of your discussions with your customer.

Have as many contacts with your customer and with as many people in your customer's shop as possible. Ask direct questions, indirect questions, feel people out gently, and try to get a picture of their whole situation.

Prepare vigorously for a price negotiation, and at the same time do everything that you can to avoid one.