Negotiate Value

Model 1 - See the Surplus

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Published on www.lorman.com - September 2018

Module 1

See the Surplus

Master the Mindset and Concept that Produce Successful Negotiation

Objectives

Lesson 1: The Professional Negotiator. Define the twin skills of negotiating and buying, and understand their impact on personal and professional success.

Lesson 2: Benefit – Price = Value. Establish the purpose of buying as attaining maximum value. Define the benefits that a Buyer derives from a purchase.

Lesson 3: Cost Buckets & Bullets. Explore the Seller's surplus, or Profit. Introduce the five key categories of cost across any purchase and industry, and learn to classify costs.

Lesson 4: You be the Judge. Diagram the surplus in a given transaction and classify the exchange as high-surplus, low-surplus, Buyer-dominated or Seller-dominated.

Lesson 5: Anchors Away. Apply the concepts in Module 1 in tactical defense against the most widely used negotiation tactic: price anchoring.

Lesson 1: The Professional Negotiator

A Central Skill
If I told you that I had practiced a certain skill thousands of times over the last 30 years, would you be impressed? What if I told you my ability at that skill was central to my financial situation?

Every day, we face the decisions of what to buy, where to buy, and how much to spend. Buying is as much a part of our lives as eating and sleeping. We are immediately paid or penalized for buying: money we save in a purchase is immediately to our benefit, and money we pay – or overpay – is gone forever.

> *A penny saved is a penny earned.*
> -Ben Franklin

Sometimes we are buying or selling in a classic "negotiation" with another party. But whether we are spending our personal money, buying things for work, or buying or selling face-to-face with another party, we are using similar skills.

So, <u>you</u> are a professional buyer. And you are a professional negotiator. The question is:

Are you any good?

For the Professional Buyer
This course is for those who:

- Own or influence substantial buying decisions
- Want to get more value for fewer dollars

Many of us are in this category both personally and professionally. Yet few pursue general buyer training of any type. While *selling* is the subject of many books and training courses, buying seems to be an *invisible skill*. It's all around us, we do it every day, yet it seems to go unrecognized.

Buyers who consistently capture high value do three things well:

1. They know what drives their value
2. They develop and increase their options
3. They follow a disciplined process

The great news is that these are *skills*. No one is born great at these skills, and EVERYONE can get better. Negotiate Value teaches the ideas and tactics needed to sharpen these skills.

A Departure from Classic Negotiation Training
Traditional Negotiation Training is geared toward "the big deal." The assumption is that students will in the near future find themselves locked in a hotel conference room for three

days hammering through the terms and conditions of an eight-figure joint venture, or fixing the boundaries of small countries after global conflicts. (Okay, that's over-dramatic, but you get the idea.)

There are good principles in classic negotiation that we will cover in this course, but our focus will differ, reflecting the truths that:

- Most people are rarely in the intensive, high-stakes negotiations, and more importantly
- Most value is won or lost BEFORE the two sides ever meet face to face.

Traditional negotiation training focuses on THE DEAL.

Negotiate Value focuses on capturing maximum VALUE. The approach overlaps with classical negotiation theory, but is useful as an organizational process to ensure not simply great pricing, but maximum value.

Most individuals and organizations under-value the skill of *buying.*

Remember

- You will make thousands of purchases in your life, including some large ones: this makes you a professional buyer.
- Regardless of your negotiating experience, you can improve your skills.
- Negotiations involve our two most valuable currencies: time and money.
- Enhancing our negotiating skills can lead to money saved and less time spent on the purchasing process.

Our two primary currencies in all negotiations and purchases are **time** and **money**.

When we think about what is important to us, we likely would say we would like to have more time and more money. Successful negotiation will result in both. But to achieve those results, we need to be aware of both the money and the time we spend. The exercises in this lesson will build awareness of how we spend our time and money.

Time and Money

In the famous words of Ben Franklin, “time is money.” But are they equal in value? Let’s consider this. Can you *find* more time or *make* more time? The answer – despite the common phrases of *“I’ll find the time”* or *“we can make time”* – is of course NO. However, you can make more money and sometimes you can even find money.

Time is your most scarce currency. Be sure to value it appropriately as you negotiate.

	Time is a non-renewable Resource
Consider	**When it is gone, it is gone…**
This	**Unlike money, it cannot be recovered.**

Homework

Buying with Time and Money

Your homework for Lesson One is to note all of the purchases that you make for one week and record the money and time spend on those purchases. You should list as least five, but more is better.

Purchase	Money	Time – Minutes
Coffee	$4.65	10 minutes waiting in line

Purchase	Money	Time – Minutes

Value – The price and the benefit

Lesson 2: Benefit – Price = Value

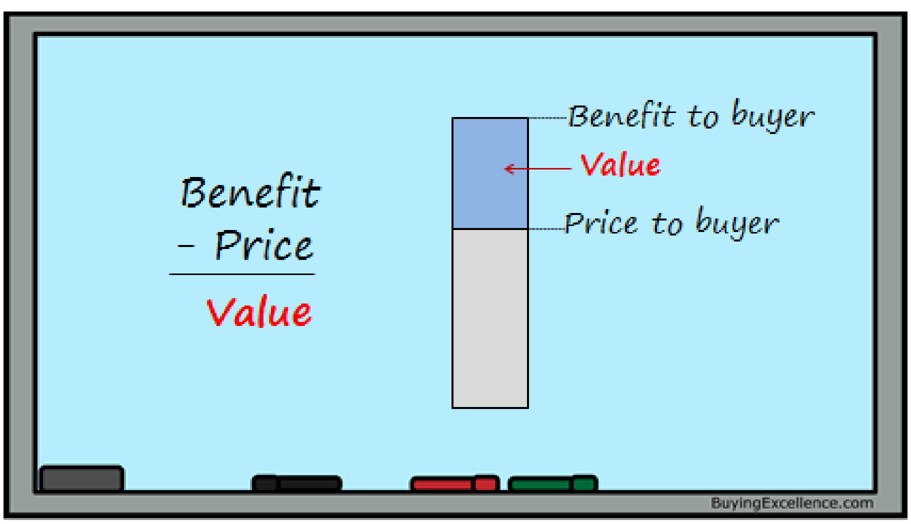
In Lesson 1, we discussed the elements of money and time. These are the primary currencies for the buyer.

Every purchase you make should be worth more than the purchase price you pay.

The time and money you spend on a purchase add up to the Price. One of our goals in negotiating (when we are the buyer) is to pay a lower price. But the overall goal of the Negotiate Value course is to – well – *negotiate* *VALUE*.

Our aim is to get the **maximum value consistently**. That is different from getting the lowest price.

How so? Price is one number: the amount you pay. Value is the distance between two numbers: the Price and the Benefit you gain from the purchase. You buy things not because they are worth what you pay, but because they are worth **more** than what you pay. If a potential purchase is worth only as much as the price, then you wouldn't really gain from the purchase (so you may as well keep your money).



Why do we tend to be so focused on price, and often ignore benefit? One reason is that it's simply the path of lower resistance. If I'm after the best price, here are the questions I need to answer:

- *Who sells this?*
- *What are the features?*
- *What is the range of pricing?*
- *What discounts/deals can we get?*

Those answers may take some research but are relatively easy to find, especially in the age of the internet.

Now contrast that with defining the *Benefit* of a purchase. That definition requires that we answer questions that cannot simply be found online:

- *What are you going to do with this?*
- *Why is this important to you?*
- *How does this fit in with your plans and goals?*

Remember

- The Price you pay includes both your time and your money.
- One of our primary goals in negotiating is to pay a lower price. But the overall goal is to negotiate VALUE.
- You buy things not because they are worth what you pay, but because they are worth more than what you pay.
- Value is the difference between the Price you pay and the Benefit you gain from the purchase.

The One-armed Fisherman

A one armed fisherman was bragging about the fish he caught. "How big was it?" a listener queried. At that point the fisherman held up his one hand and said, "THIS big."

A great price is fine, but it is simply one end of the fish. We can't judge the fish unless we see the head and the tail, and **we can't judge a purchase unless we see the price and the benefit**.

In reality, great prices can mislead us. Most of us have bought a piece of clothing that was a "steal" based on the markdown, only to later realize it didn't fit well or wasn't really our style. *A great price on the wrong buy is a bad deal.*

To capture the maximum value, we need to be experts in understanding Benefit.

Consider This

The profound truths in life are always simple.

Simple doesn't mean easy…

Defining Benefit is more difficult than Price

Apply It

Create your own definition

In Lesson Two, we have focused on two key terms; price and benefit. For this exercise, create your own definition of price and benefit. Include examples to support your newly created definition. Record your answers below:

Price____

____

**Example____

____

Benefit____

____

____

**Example____

____

Homework

Benefit Bullet Points

For the homework for Lesson Two, you can use the purchases you noted in the Lesson One homework or use new purchases. You should choose at least five purchases and list the key benefits for each purchase.

Purchase	Money/Time	Benefit
Coffee	$4.65 10 min	Energy for morning; Enjoy taste; Caffeine fix

Purchase	Money/Time	Benefit

Lesson 3: Cost Buckets & Bullets

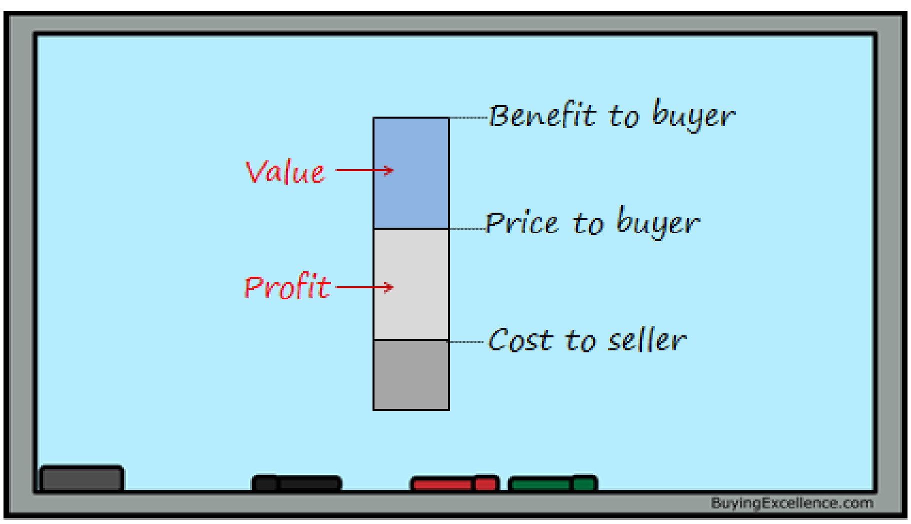
In Lesson 2 we took a look at the buyer's *surplus*; that is, the value determined by the difference between the benefit gained and the price. In this lesson we look at surplus from the seller's point-of-view.

Just as buyers buy to capture value, the seller also sells to capture value – in this case called profit. Profit is the difference between the price sold and the seller's costs. Because these terms are often used loosely or interchangeably, let's stick with consistent definitions throughout the course:

Price	• What the *buyer pays* for something.
Cost	• The *seller's costs* in creating & delivering what the buyer purchases.

When we bring in the Benefit, we can define the surplus equations for both buyer and seller:

Benefit – Price = Value (the Buyer's Surplus)
Price – Cost = Profit (the Seller's Surplus)



Price is not the ultimate end for the seller. A higher price may be good for the seller, but what ultimately matters is the Profit (what's left over after you take the cost away from the Price).

Whether we are buying or selling, we must understand the seller's cost to negotiate maximum value. What goes into Cost for a seller?

Cost analysis can be extremely detailed and complex. But even a few simple steps to understand cost can be extremely useful in negotiations. Nearly all of a seller's costs can be classified as one of the following:

- Materials
- Labor
- Overhead
- Cost of Sales
- Cost of Delivery

Different goods have different relative cost distributions. Labor and overhead are often among the highest costs.

Remember

- To understand the seller's surplus, you must understand the seller's Cost.
- The seller's Profit is the difference between the Price he sells for and his Costs.
- Different products have different distributions of Cost between materials, labor, sales, overhead, and delivery.
- Labor and overhead are often two underappreciated costs.

Do you remember *The Karate Kid*? In the original movie, there's the classic scene where Mr. Miyagi is training young Daniel. As part of the training Miyagi has his student waxing cars, and in a very particular way. Later in the movie those specific motions are shown to be extremely useful.

This is sort of the *"wax on, wax off"* part of the course. The exercises these first few weeks may seem simple, but they are useful for building muscles and analysis skills that we will use throughout the course.

If I could have you work all day on your negotiation skills, I wouldn't have you wax cars… I'd have you drawing "Value bar charts" and classifying costs.

Consider This

Surplus makes the world go 'round, at least economically.

Buyers buy to capture **Value** (Buyer's surplus)

Sellers sell to gain **Profit** (Seller's surplus)

Apply It

Classify the costs below for a commercial bakery as either Materials (M), Labor (L), Sales (S), or Delivery (D), or Overhead (O)

1. Rent for the factory and offices _______

2. Wages for the HR staff _______

3. Ingredients: flour, sugar, salt _______

4. Advertising the pies and cakes _______

5. Shipping fresh treats to restaurants _______

Homework

Cost Buckets Tool

For this exercise, choose a recent purchase that you made either personally or professionally and list the benefits for that purchase as we did in Lesson Two. Then weight the relative costs from the seller's perspective. Finally, classify the expense as one of the following:

- Materials (M)
- Labor (L)
- Overhead (O)
- Cost of Sales (S)
- Cost of Delivery (D)

Here's an example to get you started:

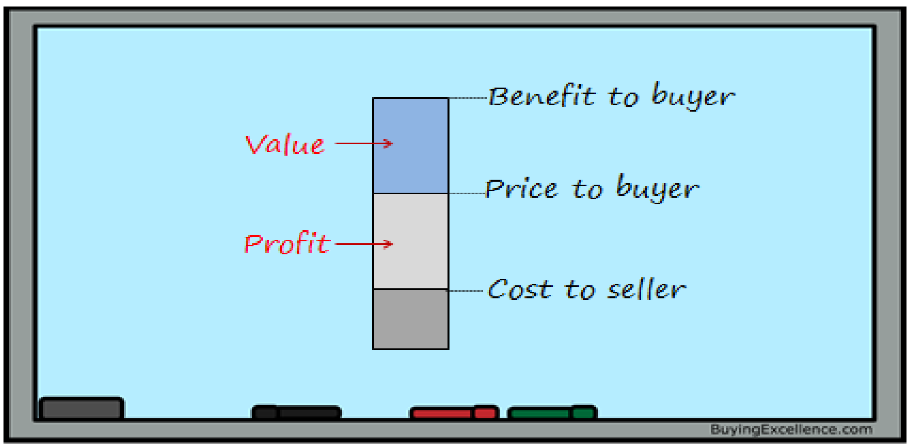
Purchase	Money/Time	Costs for Seller	Relative	Category
Coffee	$4.65 10 min	Milk, Coffee beans Barista Rent	+ +++ ++	M L O

Purchase	Money/Time	Costs for Seller	Relative	Category

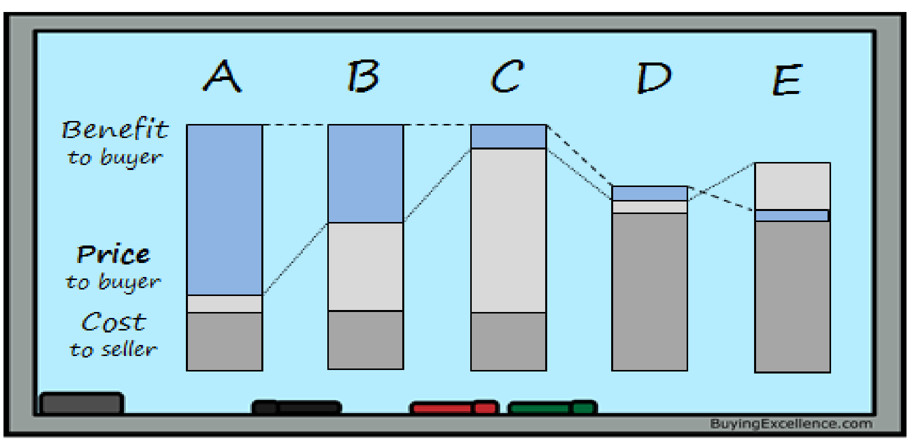
Lesson 4: You Be the Judge

The goal in Lesson Four is to think about every transaction in terms of the overall surplus. What's in it for the buyer and what's in it for the seller? Assessing surplus is a skill that you can develop with practice.

So far we have explored the surplus that a buyer captures as the Benefit of the purchase is greater than the Price paid. We have seen how the seller captures Surplus when the Cost of what they sell is less than the Price they collect. Remember the picture:



It all looks great on the bar chart, but what about reality? Real-life negotiations and purchases will end with differing results. In some cases, the buyer will seem to capture nearly the entire surplus because the purchase Price is so close to the seller's Cost. Other times it will be the opposite. In other transactions, it may seem like there's no surplus at all.



It is important to emphasize that not all transactions are equal. Some are high-surplus, and some are low-surplus. To judge which is which, you need to apply critical thought to understand both the benefit (for the buyer) and the cost (for the seller). Understanding the benefit and cost means that you will be able to view those in relation to the Price and judge surplus.

While you're judging, remember the words that Oscar Wilde said many years ago:

> *A cynic is someone who knows the price of everything, but the value of nothing.*

Cynics don't see the surplus; they just see the price. A keen judge of transactions finds surplus and value from both the buyer and the seller perspective.

Remember

- Real-life negotiations and purchases will end with differing results
- Not all transactions are equal; some are high-surplus and some are low surplus.
- Defining your benefit and defining the cost are important skills
- Become a value judge, not a cynic.

The healthiest transactions are characterized with ample surplus for both the buyer and the seller. Those deals are sustainable and repeatable, as both parties are satisfied with their purchase. As you start to judge the transactions around you, you will probably also see some where there seems to be little surplus for anyone to enjoy.

Consider This

The best negotiators are also master Surplus Detectives.

They seek it out and find it.

Sometimes they can increase it.

Apply It

Buyer Surplus versus Seller Surplus

For this activity, provide your own definition of buyer surplus and seller surplus below:

Buyer Surplus____

____

Seller Surplus____

____

What is the optimal distribution of surplus between the buyer and the seller? Does it differ depending on which side of the transaction you sit?

____

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____

Homework

Judging Surplus

Write down a list of five transactions that your company or organization has made in the past year. Evaluate each and decide whether it is a high-surplus, medium-surplus, or low-surplus purchase. Write high, medium, or low next to the item. Then in the third column write where you think the surplus landed: was it mostly with the buyer, with the seller, or about equal?

Examples:

Transaction	Buyer Surplus	Seller Surplus	Overall
Pens & Paper – low surplus stuff	Low	Low	Low
Advertising – sponsored an event – negative surplus for me…	Negative	High	Seller Surplus

Transaction	Buyer Surplus	Seller Surplus	Overall

Lesson 5: Anchors Away

Lesson Five is the final lesson in Module One: See the Surplus. Let's quickly review the previous lessons:

- In Lesson 1 we discussed the twin skills of negotiation and buying. They overlap so much that we can work on both together, and this is a great thing because YOU are a *professional buyer*.
- In Lesson 2 we considered our Benefit as buyers by identifying the main attributes that drove value in the purchases we made.
- Lesson 3 was a looked at the components of the seller's costs and how that drives the seller's profit.
- In Lesson 4 we wrapped the first three concepts together and judged transactions from all sides for value.

Module One is designed to get you thinking in the right way about buying and negotiating. We'll call on prior lessons here in Lesson 5 to conquer the most pervasive and effective negotiation tactic of all: *price anchoring.*

Price anchoring (or simply "anchoring") is so widely-used, and so effective, that it can make us lose a negotiation before we even know we're in one. You have likely experienced this and may not even know it. Retail stores are notorious for this with "slashed" prices. The sellers will lead you to believe a product is worth a certain price, but the price you are privileged to pay is much lower. This is price anchoring. It simply means setting a price reference point for a purchase. When anchoring is used successfully by a seller, the anchor price is seen as a valid comparison point. It makes the asking price appear legitimate and attractive.

Anchoring is an essential concept in negotiation, buying, and selling. Whether you are familiar with the term or not, you've certainly seen it in practice. Anchoring is used everywhere that anything is sold. Common anchors are the *Manufacturer's Suggested Retail Price (MSRP)*, competitor's product's price, or the listed price of a comparable product.

In face-to-face negotiating, both sides try to position an anchor for the value of the deal. The seller wants that anchor to be as high as possible, and the buyer wants the anchor to be as low as possible.

Why does it work? At the core, it's just plain HARD to figure out what something "is worth." Many people would not even know where to begin. Defining worth of a purchase seems to involve personal values, economics, and philosophy. We simply can't do all of that thinking every time we buy without blowing a fuse. So we build patterns and we take shortcuts.

Remember

- Price anchoring is setting a price reference for a purchase.
- Anchoring is used EVERYWHERE that anything is sold. Common anchors are the Manufacturer's Suggested Retail Price, competitor's product's price, or the listed price of a comparable product.
- It's just plain HARD to figure out what something "is worth" so we build patterns and we take shortcuts.

The experience of JC Penney is a fascinating experiment in the power of anchoring. In February 2012, Penney's largely abandoned their decade's long practice of relying on sales, discounting, and coupons. Instead, they assured shoppers that they had low pricing every day. The argument made logical sense, and even had an ethical appeal: the CEO said he believed customers were insulted by how department stores offered items at high prices, then offering discounts (i.e., relying on anchoring).

How did customers react to these new, "fair and square" prices? They ran to other stores. Without seeing that pre-markdown price, Penny regulars felt like they weren't getting as good a deal. Sales dropped 25% in a year at one of America's retailing legends. Recently, Penney's changed back to their prior pricing strategy, or as one headline put it "JC Penney Brings Back Fake Prices."

Consider This

Negotiate Value by connecting the price to more relevant information, such as the buyer's Benefit components, the seller's cost categories, and the surplus in the transaction.

Apply It

Anchor Pricing

Discuss why you believe anchor pricing works. What are some examples that you have experienced?

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Homework

List Anchors and Sources

List ten pricing anchors you see around you. They do not necessarily need to be purchases you make; you can gather them from advertising or other sources. Write below:

1. The item or service
2. The value of the anchor
3. The source of the anchor

As a bonus exercise, consider and write down alternative valid anchors.

Item	Anchor	Source
Shoes	$89.99	Original price
Electric Bill	$120	Last month's bill

Item	Anchor	Source