Buying Support Agency

TOPIC GUIDE: PRICE BREAKDOWN

This guide should be read in conjunction with the topic guide Negotiation Techniques Part II. Where a buyer is dealing with a supplier, it will be difficult to achieve suitable quality and delivery at best price. It is done by insisting that you have a detailed price breakdown, which you have a right to see and then have the supplier justify all figures. You may wish to involve a Technical expert or member of the Finance Department. The components of price are:

Labour - have it broken down to hours on each job, grades, rates for grades and overheads. Often nights, Saturday and Sunday rates will be used when the job is done in the day. Also lower grades of Staff will be charged than the rates used. What efficiency factor has been used; Staff should be 85% efficient.

Materials - check the detailed prices and involve a technical expert to ensure materials charged are reasonable. Consider if the supplier will actually source less expensively than quoted to you. Are prices firm or budgetary?

Inflation - prices should be for the current Financial Year. If the contract lasts beyond that year an addition is acceptable, but only for the portion of contract performed in the following Fiscal Year. A mark up of 2% for labour and 3% for material would be reasonable in 2001/2002, but ask for less. This can be offset by “learning curve” improvements, as the supplier should be able to do the job more efficiently the second year.

Commercial Risk - a percentage on materials and labour may have been built in to allow for risk on, say, warranty or liquidated damages clauses. You may wish to allow this or alternatively modify one of the clauses in the contract to reduce supplier risk. Ask a technical expert to agree this.

Overheads - there will be local overheads for management, accommodation, pay Staff, personnel department etc. There may also be allowances for training, drawings etc. and there could be redundancy costs at the end of the contract. There may be set up and close down costs. There will also be a central overhead for their HQ. Check that our contract carries only a fair percentage of total overhead by seeing how it has been arrived at.

Profit -	this should be between 3 and 15%. Insist it is low.
Contingency -	this is often called padding and is included to cover any poor assessment earlier or as a means of making more profit. Take it out.
Interest Charges -	our payment terms are 30 days from when the invoice is presented. Do not allow interest for this aspect. However, if capital equipment has been purchased for the task, it is reasonable to allow interest at about 7% per annum.

General Advice

By over complicating the figures, extra profit can be hidden in the pricing. Break it down into simple terms. In the end the amount agreed is "that which is reasonable in all the circumstances".

An example of a price build-up is as follows:

PRICE BUILD-UP

	%
Cost	
Padding	7
Negotiating Margin	7
Profit	18
	32%

Negotiating out the first 14% is easy.

Please find attached some examples of how you can be "conned", which was given at an actual training course for Sales Staff. It happens every day in our private lives; it will happen in your business dealings.

Techniques for Improving Gross Margin

The following are a few of the common techniques employed by Suppliers to improve the gross margin.

1. Transpose figures in price list. e.g. £7.95 becomes £9.75.
2. Add figures at front and rear of selling prices. e.g. Reconditioned gearbox; £316 becomes £1316.
3. Control "mark-ups" on factored items so that on anything bought at the selling price to the customer is controlled by the sales manager.

4. Review credit terms with customers at least every 6 months and reduce where possible.
5. Quadruple selling price on low value consumables.
6. Price out standard products as specials. e.g. Part 123/A list price £90.00 sold as 123/AS list price £140.00.
7. Note special selling prices/opportunities on customer terms cards so as to ensure consistency of pricing.
8. Do not give "blanket" terms, only give discounts on main items of usage.
9. Go to next size or range up in price list. e.g. 1234 sold as 1235 or 1334.
10. Book items out under special references when we have identified product they are used on.
11. When pricing quotes with several items use varying mark-ups.
12. On unusual items, make up a list price and show a discount to encourage the customer to place the business with us.
13. Move decimal point on items priced per 1000, per 100 etc.
14. Do not give discounts on higher margin items in quotes.
15. On quotes with several items, give total cost. Do not give individual prices.
16. If there are several price lists for a particular range or product, always use the highest.
17. Add price increased onto spurious items. e.g. if a customer buys 10 paper clips in May at £2.00 each and orders again in June, charge £2.15.
18. Include carriage charges such as airfreight in selling price. e.g. 50 sprockets to be sold at £4.00 each are priced at £4.80 to include airfreight.
19. Charge £2.00 carriage on all Advice Notes.
20. Charge for "special" transport, e.g. datapost, when not using such Staff but customer believes they are being used.
21. Mark up carriage charges by at least 50%.
22. Always charge carriage at highest published rates whilst using cheaper transport.
23. Charge carriage on invoices even when a carriage paid price has been agreed with the buyer.
24. Charge call-out on 24 hourly clock basis.