

5 data-driven techniques that will allow you to wield this power to make the best use of them.

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# NEGOTIATION RESULTS THROUGH THE POWER OF DATA



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# INTRODUCTION

As a buyer, if you are in your supplier's top 10, you are a valued customer and you should be proud of that. Your supplier presents the new policy for the coming year and shows you the terms and conditions for the coming period. They would like to receive your response before the end of the week, so that management can sign on time. Last year you had few arguments to improve your contract. You know it's going to be a difficult year again, so you consult with your data management colleague before the meeting.

You share your screen with the supplier and show him what the average cost structure looks like in his industry. Materials account for about 38% of costs, energy is of little relevance at 1.2%, he reserves no less than 12% per year for depreciation and earns an extremely healthy profit with an average 27.4% EBIT. The conversation suddenly takes a radical turn.

*"Is the conclusion correct that costs are less important to you as a supplier, but that you attach great value to growth?" The supplier responds: "If you can offer us high sales, there are indeed opportunities to improve conditions...."*

## Forms of power

It is good to be aware that there is a power relationship between buyer and supplier. In short, there are three forms of power for the buyer: On the first form you have relatively little influence. The power of your position is usually a given and is largely determined by your employer. Do you work for a large or small company, are you unique for a supplier or do you fulfill a generic role and are you doing well or do you have to fight for survival.

The second form of power, the power of timing, is something you have more influence on. The tactics determine the result. With this you can play, build and create alternatives. Think about anticipating on the capacity with your suppliers or the deadlines in their budgeting.

But by far the most influence you have is on the power of information. This involves, for example, collecting information about the market, what the supplier is doing with your competitors, what the price developments and cost structures are, what the personal interests are, who decides, etc. The subjects and sources are almost inexhaustible. Immerse yourself in your discussion partner, dare to ask questions and, above all, look for factual information that you can discuss with your supplier.

You can use the power of information to create your own competitive advantage. Therefore, in the next pages are five data-driven techniques that you can use to reduce costs and significantly improve your position on the power balance.

1



the power of your position,

2



the power of timing,

3



the power of information.

# TECHNIQUE 1

## Let resource statistics work to your advantage

### THE RUBBER BAND CASE

Elastic mainly contains rubber. As soon as the price of rubber drops, this has a major impact on the purchase price. In this way, a purchaser received a seemingly decent price drop from the supplier, on his own initiative, of course. But after some research, it turned out that the price of Asian rubber had halved and that in Indonesia, the rubber determines no less than 62% of the cost price.

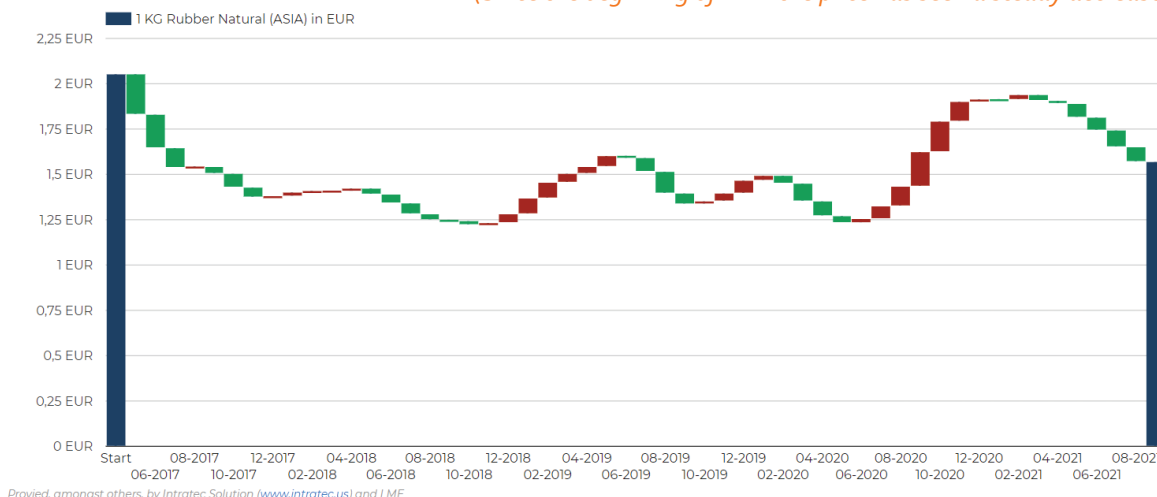
The price reduction received was significantly low. After the buyer confronted the supplier with the objective information (dear supplier, see attachment, please respond) the price was reduced by 25%. Effective date: the next day.

First a firm disclaimer: external developments and circumstances are not only unpredictable, but can also have a huge impact on (purchasing) performance. It is a nice challenge to budget what your spend will be at the end of next year and how much you will have saved. But in all honesty, how much influence can a buyer really have on this? If the market leader takes over the number two, if a supplier goes bankrupt, if you get a new customer that increases your volume significantly ... these are all things whose impact will be many times greater than your negotiating skills. It is, however, a skill to translate these kinds of unexpected circumstances into purchasing advantages. Or, better yet, to have your contracts prepared in such a way that market changes automatically lead to predetermined improvements.

Even more complex are the macro-economic developments that lead to fluctuations in the price of raw materials and currencies. The impact of these is also much greater than the impact of your capabilities.



The table below shows the fluctuation in price of Rubber in Asia. (Since the beginning of 2021 the price has seen a steady decrease!)



# IN PRACTICE...

The prices of raw materials drop and the buyer presents the price drop as his own success. Or the prices rise and the buyer explains that 'despite huge price increases' only a few percent more was paid. The problem is that only few people within a company, other than the specialized buyer, are aware of the developments and the details within the purchase market.



Gerard the Buyer

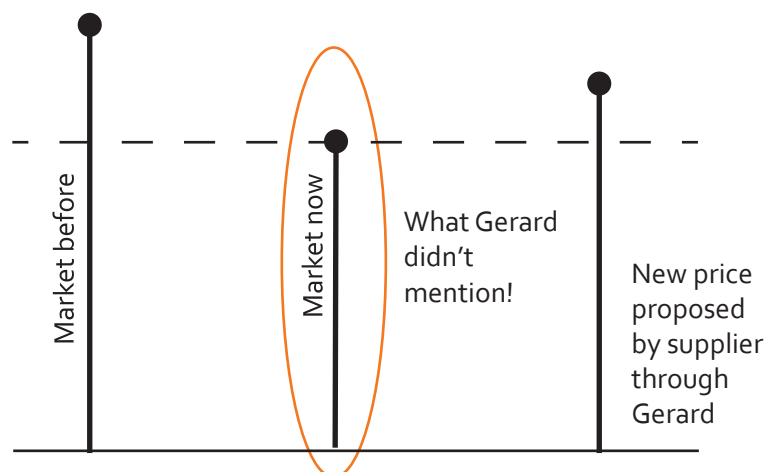
A buyer can therefore keep the information power to himself and communicate what is most convenient. Not every buyer will do this, but it is tempting.

A change in purchase price should actually be compared to the changing market conditions.

- What has happened to the exchange rates?
- What is the share of the raw material cost price within my purchased product?
- And what is the impact of volume changes?

If you weigh the purchase prices for your purchasing portfolio against the annual volume, you can compare this with the weighted price changes. Only then it becomes visible whether the development of the cost price runs parallel to that of the purchase price and (thus) whether the selling or the purchasing party has improved its margin. Only in this way you have a constructive substantiation of developments, based on factual data, which you can present to the supplier to ultimately get a fairer, better deal.

*Buyers often aren't sharing the whole story with you, in order to appear better!*



# TECHNIQUE 2

## Determine which components of the cost price are most relevant

### THE VALVE CASE

Within the Industrial Valve Manufacturing industry, 36% of the price is determined by the material. Many price increases are argued with raw material increases, but in this case the impact of a price change in the raw material is only slightly more than 1/3. Labor wages, on the other hand, are very high. Production-related wages in Italy represent 11% in this industry and other personnel (salaries + fringe

benefits) another 10%, so 21% together. Suppose the if the same production process takes place in Poland, then labour costs only 9%. That is a difference of 12% with Italy. Within this industry it is better for the buyer to focus on the location than on the development of raw material prices.

Table 1 - Italy

Industrial Valve Manufacturing	% of sale	Values based on material costs	Values based on price/unit paid	Difference
+ Direct Materials	33,8%	3,512	3,720	0,208
+ Direct Labour <span>Italy</span> <span>X</span>   <span>v</span>	11,5%	1,190	1,260	0,070
+ Manufacturing Overhead	8,2%	0,855	0,905	0,051
<b>Cost of Sales</b>	<b>53,5%</b>	<b>5,557</b>	<b>5,885</b>	<b>0,329</b>
- General Services & Administration	17,8%	1,843	1,953	0,109
Total fringe benefits <span>?</span>	2,2%	0,226	0,240	0,013
Salaries <span>?</span>	7,6%	0,787	0,833	0,047
Total other expenses <span>?</span>	5,9%	0,608	0,644	0,036
Cost of Resales <span>?</span>	2,1%	0,223	0,236	0,013
EBIT <span>?</span>	28,7%	2,985	3,162	0,177
<b>Total (ex works)</b>	<b>100,0%</b>	<b>10,385</b>	<b>11,000</b>	<b>0,615</b>

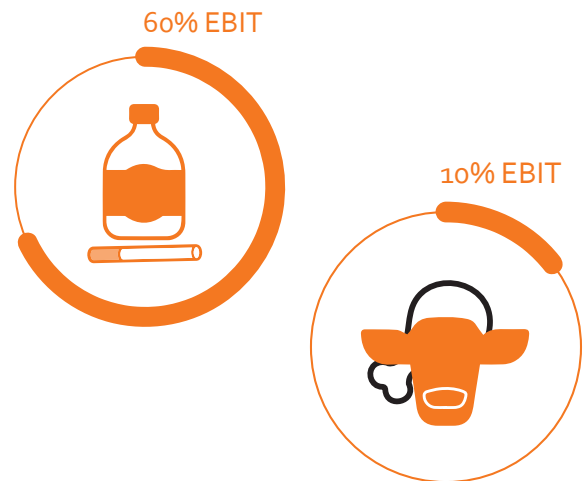
Table 2 - Poland

Industrial Valve Manufacturing	% of sale	Values based on material costs	Values based on price/unit paid	Difference
+ Direct Materials	42,5%	3,512	4,680	1,168
+ Direct Labour <span>Poland</span> <span>X</span>   <span>v</span>	5,2%	0,426	0,568	0,142
+ Manufacturing Overhead	8,6%	0,707	0,942	0,235
<b>Cost of Sales</b>	<b>56,3%</b>	<b>4,645</b>	<b>6,189</b>	<b>1,544</b>
- General Services & Administration	14,5%	1,193	1,590	0,397
Total fringe benefits <span>?</span>	1,0%	0,081	0,108	0,027
Salaries <span>?</span>	3,4%	0,282	0,375	0,094
Total other expenses <span>?</span>	7,4%	0,608	0,810	0,202
Cost of Resales <span>?</span>	2,7%	0,223	0,297	0,074
EBIT <span>?</span>	29,3%	2,417	3,220	0,804
<b>Total (ex works)</b>	<b>100,0%</b>	<b>8,255</b>	<b>11,000</b>	<b>2,745</b>

The tables above compare the cost price of a Valve, between Italy and Poland. (The data is sourced from our WTP database - check it out here).

# IN PRACTICE...

On average, companies spend 45% of their costs on materials. The other 55% is in profits and other items. But of course the differences per industry are enormous. For example, in the production of pleasures such as tobacco, syrup and distilling liquor, an EBIT of over 60% is achieved! While in slaughterhouses hardly any money is earned. The cost price share of the animal determines 80% of the total cost price. So, when the wrong purchases are made and a meat processor, for example, is stuck with a large contract with a retailer, the impact of is enormous.



In the valve case described, material is less relevant and the focus should be on labour. For example, production in Poland leads to a potential reduction of €15 per valve. That's a whopping 24% reduction. For a technical wholesaler purchasing 1,500 of these

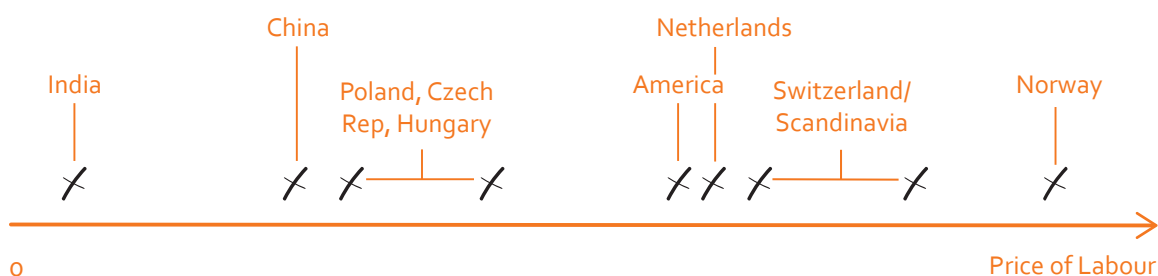
shut-off valves, the saving is €22,500. It is also noteworthy that the average profit in this industry is very high, at 28%. So the negotiation can be started with limited compassion.

## Let's talk about Labour costs... on a global scale!

If we focus purely on labor, Norway is the most expensive country to produce in. The average hourly wage including fringe benefits in manufacturing, is over \$60.00. Switzerland and the other Scandinavian countries follow with an average rate of between \$40.00 and \$60.00. The Netherlands is \$40,- just a

bit above America and Canada. At the bottom is India, still 40% lower than China. Hourly wages in Eastern Bloc countries like Poland, Czech Republic and Hungary are still only 10-20% higher than in the Far East. A country like Taiwan is now more expensive than Poland.

To put the labour costs into perspective:



# TECHNIQUE 3

## Calculate the economies of scale that your growth will generate

### THE CAMERA CASE

Within the audio and video equipment industry, material costs account for only 44% of the cost price. Besides raw materials these consist of purchased components. An important part of the costs are fixed: depreciation of buildings and machinery, R&D and overhead. The proportion of fixed costs is 39% (Overhead + General Service & Administration)

Material and labor costs (5.1% in Korea) are less relevant. Suppose you grow from 100 cameras to 125 cameras, then you can claim a 7% price drop. Your growth will not cause the manufacturer to build additional headquarters; many costs will remain the same. You contribute more to the coverage of fixed costs and can therefore benefit from the volume advantage. And in this case that is not small.

Table - Manufacturing costs

Audio and Video Equipment Manufacturing		% of sale	Values based on material costs
+	Direct Materials	44,2%	284,646
+	Direct Labour	Korea, Repub... X   v	33,145
+	Manufacturing Overhead	8,0%	51,560
<b>Cost of Sales</b>		<b>57,3%</b>	<b>369,351</b>
+	General Services & Administration	31,3%	201,977
	EBIT ?	11,3%	73,144
<b>Total (ex works)</b>		<b>100,0%</b>	<b>644,472</b>

If we assume that 70% of the overhead costs are really fixed and 90% are GSA (General Service & Administration), then this is a €50,- advantage. Your price will drop from € 691,- to € 641,-. For this purchaser this is a saving of €6.250. The calculation is as follows:

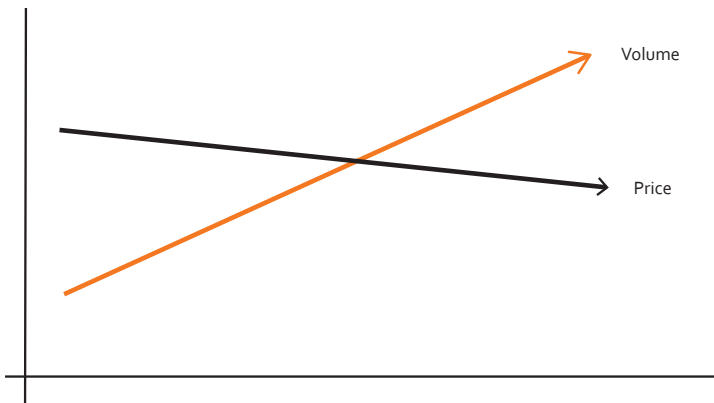
	Share in industry	Fixed	Fixed Overhead	Growth Share
Overall price change			-6,76%	
Manuf. Overhead	8,0%	70%	5,60%	
Gen. Services & Admin	31,3%	90%	28,21%	
Total fixed Overhead			31,81%	
Old WTP cost price (100 pcs)			644,472	x 0,20
New WTP cost price (125 pcs)			600,897	



# IN PRACTICE...

Volume is often underestimated in negotiation. There is often a contractual growth bonus, but most of the time it's just a fraction of a percentage. Moreover, the growth bonus is often only applied to the extra volume and not to the total volume.

## Economies of Scale



As a rule, you can assume that when the material costs and the labour factor are low (or vice versa: when development costs and overhead are high) the volume has a major impact on the price. Many elements are fixed and the variable costs are relatively low. For you as a buyer, the focus should therefore be on the development of purchasing volume or bundling volume.

# TECHNIQUE 4

## Make an estimate of the cost price of the product you are buying

### THE PAPER SHREDDER CASE

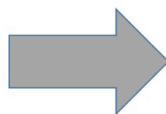
The supplier Fellowes announced a price increase of 7.3%. The BoM (Bill of Material) was shared as justification. When the materials were compared to the kilo prices of the various raw materials, the total value was only €40,4. Within the industry of small, commercial machines with production in China, the total cost came to a maximum of € 78,-. The

purchase price at that moment was €91,- so a price increase was off the table immediately. The content of the conversation then shifted to the exorbitant margin that was being applied to this product.

Table - Manufacturing costs paper shredder

Other Commercial and Service Industry Machinery Manufacturing	% of sale	Values based on material costs	Values based on price/unit paid	Difference
+ Direct Materials	48,9%	33,359	38,664	5,305
+ Direct Labour	1,3%	0,881	1,022	0,140
+ Manufacturing Overhead	9,0%	6,170	7,151	0,981
<b>Cost of Sales</b>	<b>59,2%</b>	<b>40,410</b>	<b>46,836</b>	<b>6,427</b>
+ General Services & Administration	20,7%	14,163	16,416	2,252
EBIT	20,1%	13,700	15,878	2,179
<b>Total (ex works)</b>	<b>100,0%</b>	<b>68,273</b>	<b>79,130</b>	<b>10,858</b>
Transport FE - EU	5,0%	3,414	3,957	0,543
Agent (corresponds with price/unit paid)	10,0%	6,827	7,313	1,086
<b>Grand Total</b>		<b>78,514</b>	<b>91,000</b>	<b>12,486</b>

The table above shows how the use of databases (such as WTP), can really give you insight into what you are paying versus what you should/could be paying.



# IN PRACTICE...

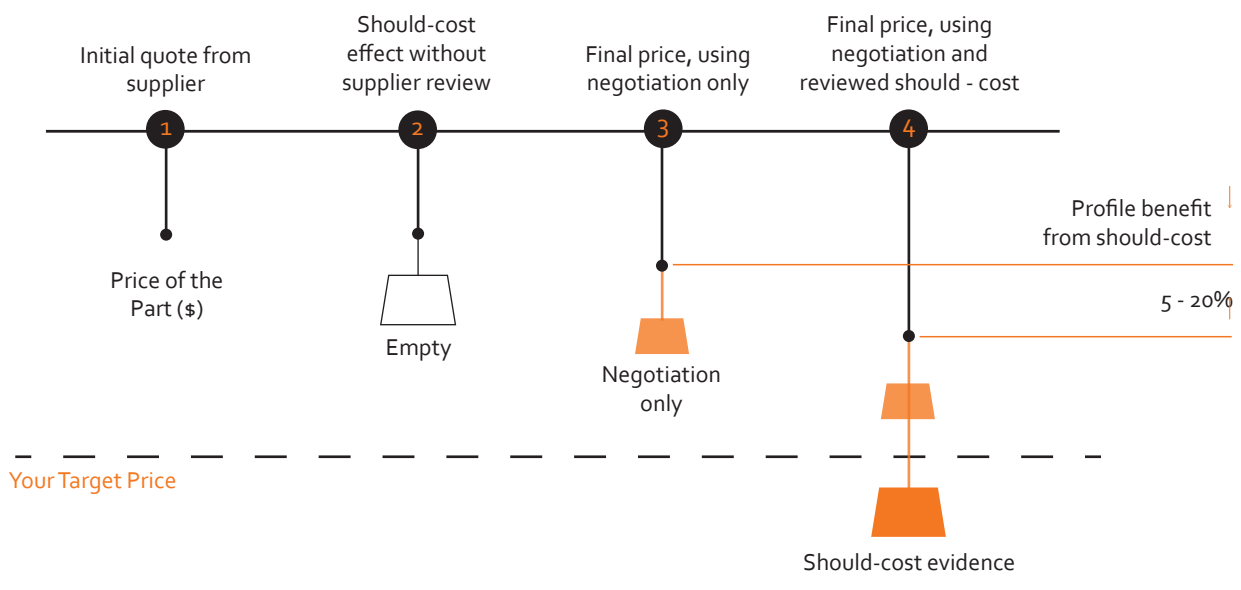
## Let's breakdown how offers are made...

The point of reference for a buyer is often the quotation you receive. Suppose you receive five quotations of €15, €14.85, €13.50, €13.10 and €12.45 respectively, then in your perception the price of €12.45 will be stored as unique and extremely competitive. No less than 12% lower than the other four and 17% lower than the highest. If you then negotiate with this supplier and you manage to make €12.45 into €12.00, then the following happens psychologically: you have shown yourself that €12.45 is a fantastic price and you have proven that you are a great buyer. The consequence is that you will defend this €12,- as a great deal in the future. Even if you always pay a 3% price increase on January 1st the following years.

Why does a supplier offer €12.45 while, based on the data-driven information, the cost price is only €7.50? The supplier may explain how it comes from €7.50 costs to a quote of €12.45. That is a mark-up of over 65%. In this way the supplier will have to demonstrate how the price is built up from the bottom up. And that is a completely different approach from the purchaser having to collect arguments why the price should be lowered from above. Moreover, such a dialogue will provide a lot of insights. A supplier will have to come back with the same facts and is therefore unconsciously working on an open book calculation. As a result, you will not only end up with much better prices, you will also learn which price elements are important for the future.

The big fallacy here is that within this process you never find out what the real value of the product or service is. *By understanding the true value of a product or service, a buyer is able to completely tilt the negotiation.*

Should-cost evidence will eventually lead to a price that is between 5-20% lower than negotiating in a regular way.



# TECHNIQUE 5

## Apply price discipline to make time work in your favour

### THE 2.5 MILLION CASE

A supplier of electrical products for the DIY market announced a price increase of no less than 25%. The customer bought 10 million of goods from this supplier annually. To support the price increase the customer received an extensive presentation with arguments and graphs. However, these figures were not neutral (read: manipulated) and the periods differed per part of the cost price.

The purchaser of this DIY store chain was able to fend off almost all arguments on the basis of fact-based data. By presenting the development of seven components of the cost price over the past few years, the impact could be negated. The buyer

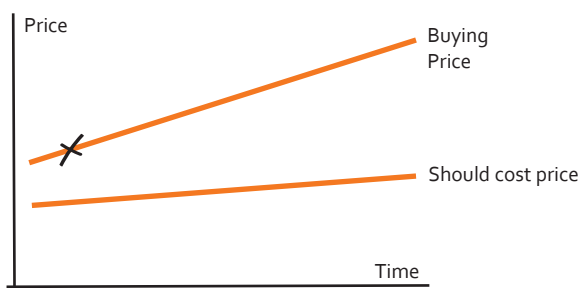
finally paid a serious price increase, but this was a fraction of the proposed 25%. Moreover, for the rest of her career, this purchaser had built up an authority that made suppliers a lot more cautious.



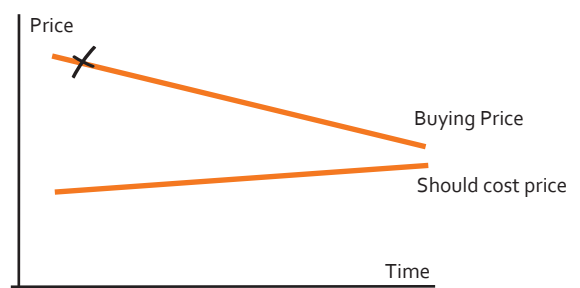
Greta the Greatest Buyer!

Suppose that you now have insight in the value of the materials of your product and you know what the most important parts of the cost price are within the production. Then it is only important to follow the development of these costs in time. This is price discipline: the ability to keep your competitive price on par. Here too, data is decisive.

Both the buyer and the seller use the term WTP. However, the meaning is the opposite. A seller tries to optimize his margin by making the distance between the selling price and the actual price as large as possible. He is looking for Willingness To Pay (WTP). The buyer, on the other hand, tries to minimize the difference between the purchase price and the actual cost. This is called What's The Price (also WTP).



Sales: Willingness To Pay



Purchase: What's The Price

# IN PRACTICE...

Virtually all elements that determine the cost price are subject to change. Raw materials become cheaper or more expensive, direct labour increases due to adjustments in the collective labour agreement or decreases due to increased efficiency. Depreciation decreases over time, until new investments are made. Energy and transport prices fluctuate, General Service & Administration (GSA) declines relatively as the organization grows and the profit contribution changes. Once you have insight in the development of the most important elements,

you determine what happens. Not only can you find out what happened, you can even see if you can work with your supplier to reduce certain costs in pursuit of Total Cost of Ownership (TCO). If you compare the development of the purchase price and the costs, it looks as follows:

	Fixed	Fixed Overhead	Growth Share
Direct Labour	18.36	3.50%	19.00
Service Overhead	10,08	1.00%	10.18
Cost of Sales	28.44		29.18
GSA & Other	4.32	-0.20%	4.32
Profit Before taxes	3.24	0.20%	3.25
Price	36.00		36.74
		Proposed by supplier	41.00
		Difference	11.6%

### 3. Procurement Performance: average buying price vs average WTP price

Only products that have commodities, industry, country, annual quantity and buying prices are included in this report.



# CONCLUSION

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## How does using data make your work more strategic?

Let's turn it around: what reasons would there be not to use data and not to negotiate more often on the basis of facts?

- 1** The purchaser does not have the information available
- 2** The buyer really doesn't have time for this
- 3** The buyer is not so analytical
- 4** The buyer does not dare confront the supplier with facts

The first obstacle has been solved by smart software. There are enough accessible and affordable tools available in the market so that this excuse does not really apply anymore. If there is too little time for preparation and data collection (point 2), then the challenge lies in classic time management: shifting priorities from operational work to tactical, increasing capacity, asking for help and learning to delegate.

You also often see that data-related work is transferred to a purchasing assistant or to data analysts within the company. In the latter case, data analytics is often set up centrally as a so-called mid-office.

In the case of points 3 and 4, the buyer has a wonderful opportunity. The purchaser can choose to distinguish himself by dedicating himself fully to this field and to immerse himself in the subject matter. A professional buyer owes it to the field and to the employer to apply factual data as a priority within the work.

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**More information about WTP and the Buynamics tools can be found on our website.**