

Negotiations Applications for Capital Equipment

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by

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It has been said that capital equipment (CE) is called a **legacy acquisition**. This is from the viewpoint that the items purchased; building, equipment, etc., will often outlive the work life of the purchaser. In many specific acquisitions, the life of a piece of CE can often reach 30-40 years, if not further. Based upon this criteria it is essential that all negotiations be considered a serious priority for any organization. The decisions, typically made by the senior purchasing executives, purchasing directors or even supply managers require strategic planning and can impact the operations of the company. A poor decision cannot deliver the requisite value, will add cost to each unit of production, and thereby impact the bottom-line of a company throughout the life cycle of the equipment's useful life.

While the common vernacular refers to a 'cradle to cradle' application, many organizations still employ a cradle-to-grave mentality. This approach considers only the book value of the equipment being of value to the company and the future value not being fully appreciated or considered.

The area we have decided to address is the one that every purchaser, or supply manager can and will add initial value to the organization- the real area of direct negotiations. It has often been stated that the future of a company rests in the hands of the senior negotiator or the professional supply manager. In many organizations it is felt that the art and science of negotiation can grow with a person over time. However, if the entire professional life of a person could extend at only one company for their entire professional career; 30-40, years that could mean that a specific piece of equipment or a campus building might only be purchased once to twice in a professional's lifetime. Should the professional miss application the company could pay for this multiple times each year over the lifetime of a capital asset. Compounded by the cost of money, the loss or opportunity value or an inferior buy of the asset could have add on burden costs over the life of the asset.

It should be appreciated by the reader that the loss of value by such a poor constructed acquisition, the use of a defective specification, and an inept negotiation by a would-be professional could have a severe financial and competitive impact upon the organization. To this regard we often only delegate the most senior professional or senior executives with the responsibility of acquiring CE.

However, in the hands of a professional negotiator the opportunities, through which the acquisition of capital equipment, occur may seem endless. Sadly, many senior purchasers still attack and try and maneuver price near the apex or start of the negotiation process. Sadly, if the price of the asset arrives at the table before the other aspects of the CE purchase the negotiation posture of the supplier or vendor begins to firm or gel. Often price on a list of ten (10) different negotiation criteria arrives between numbers 8-10.

For example; if the CE is a piece of production or manufacturing equipment it is natural to assume that once the purchaser has selected to negotiate with the supplier they obviously have a strong desire for the offerings of their company. However, instead of addressing the typical price, delivery and standard terms as they often flow in a logical order the buyer starts with the thorough analysis in on the company's extended warranty for this type of equipment the buyer initiates the organization's approach with starting with extended warranty over the life of the asset even before we initiate the discussion on price. This could make the capital equipment provider feel that to even get to price this condition must be so satisfied to go forward. If the buyer elects to negotiate and accepts the providers offering for the transaction price of the equipment and then attacks the warranty the seller knows there is a need for the buyer to have this since he has already acquired the CE. What power does the buyer or supply manager now avail at the table? The sad reality is that while we like to advocate ourselves as master in the field of negotiations the true master in the craft, and especially for capital equipment, often resides on the other side of the table. Therefore, we need to employ some subtle but very critical tools experienced and advanced negotiations use frequently. These specific tools could employ the use of:

1. **Developing a specific negotiation checklist for CE items; equipment, tools or buildings,**
2. **Addressing each of the items in the matrix with a valuation or value or what is called a power leverage valuation,**
3. **Creating a risk module for assessing and calculating a risk determination of the most critical aspects of the negotiation portfolio,**
4. **Developing both a Price L-O-B and a Non-Price L-O-B for the particular items addressed in the negotiation checklist,**
5. **Developing a due diligence file of the product, service and company of the provider, and then**
6. **Assessing after each negotiation a negotiation post-mortem for assessing the strengths and weaknesses of the checklist or the approach employed by the negotiating professional.**

While the author would enjoy to detail and discuss the nuances of all the facets listed above we will highlight two critical and powerful tools for this article. The items to discuss will employ;
a) the Negotiation Checklist, and b) the L-O-B Profiles.

The Negotiation Checklist

Typically, when a buyer begins to construct a negotiation checklist they become a bit frustrated based upon the nature of our jobs. We delight in the encounter at the table with a person equally skilled on the other side. Sadly, the seller of the equipment, or a plant/building, to even IT hardware/software negotiates everyday with people equal to your skills and he often knows far better the prowess and functionality of the equipment at the table.

A checklist is not to make your life more complicated but to ensure we have every subtle nuisance and those aspects of both functionality and value clearly identified. This will allow us to determine its fair market price and then to leverage our skills against this would-be counter-part to affect a best-value solution for the organization.

There is not any defined limit to a negotiation checklist as that is up the creativity and experience of the negotiator, the particulars of the acquisition, the risks inherent to this decision as well as the competitive tapestry of the item under consideration. My standard negotiation checklist for acquiring CE has 91-defined criteria or boxes for items I review for possible consideration and inclusion at the negotiation table. Not all will be applicable in every negotiation but then it is already part of the package, reviewed for application and developed as part of a negotiation strategy. It should also be noted by the example below while a check list might only avail 91-boxes the total number of items under consideration could easily range between 150-250 points. Each checklist box only counts as a single checklist item for consideration despite the number of sub-components it has noted below each category.

For example, below is my box number #23 for CE negotiations. Again, this only looks like one point but in actual reality it counts as one but has ten subcomponents for the purchaser to address.

Criteria	Description	Value	Negotiation Position
#23	Warranty a) Type b) Coverage c) Item with limited coverage d) Items to add to the term e) Length of term f) Start after installation and acceptance testing g) Any invalidations h) LOP i) Develop warranty manual j) Defined risk of warranty waived	\$70-\$100k value of the item(s) cost	# 7-for h #11-for a,b,c,d # 21-for i

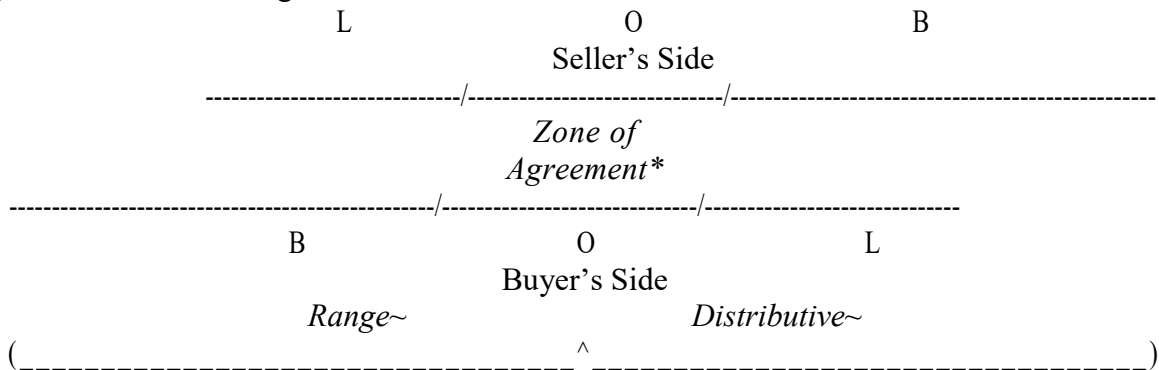
The L-O-B Profiles

While the world tries to identify a L-O-B as an acronym, it actually does not function as such. A L-O-B identifies the various section of a negotiation strategy for both the buyer and a seller. If you notice from the cross-section of a L-O-B diagram below the segments are reversed. If a person enjoys playing solitaire, then they will enjoy conducting a negotiation strategy.

The primary advantages of a L-O-B is that:

1. it forces the buyer/supply manager to enhance their range (offering) and not go in with only a limited or few negotiation concessions; this is referred to as enhancing the range, and
2. it also allows the negotiator to focus on the counterpart by converting your approved strategy to memory and managing the flow of the process instead of running to your notes for your next point.

The segments of a L-O-B diagram are as follows:

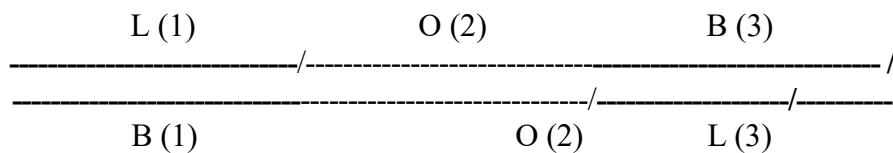


* The *Zone of Agreement* (Overlap) is actually the same region of both parties but does not necessarily have to start and end on the same numbers. The Seller may have \$3.79 as the mid-point of their Overlap where the Buyer may have \$3.69. However, both considerations are within the two hash marks.

~The *Range* and/or *Distributive* is merely the same names for the same points which covers the spectrum of the highest offer of the Seller and the lowest offer of the buyer.

The best way to appreciate the L-O-B is to see it as we explain the various segments. Track the graphic below as we explain. These include the various sections colored coded by both the buyer and seller's side of the graphic.

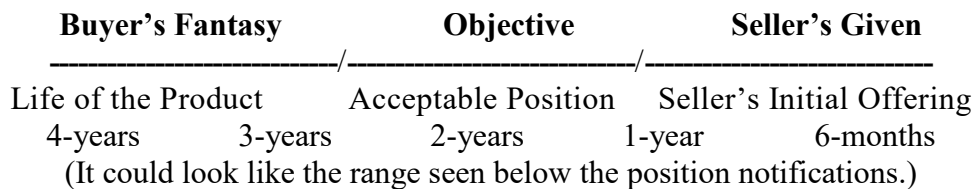
Seller's Side		Buyer's Side	
L (1)	The lowest amount a Seller would ever desire for their good or service-Seller's Cost.	B (1)	The lowest amount a Buyer would ever consider a Seller might accept for their good or service-Seller's Cost *70%. (Yes, a seller can sell for less than cost both for cause or for a short period.)
O (2)	Is the point of REAL negotiation agreement and serious consideration-Seller's Overlap.	O (2)	Is the point of REAL negotiation agreement and serious consideration-Buyer's Overlap
B (3)	This is the maximum amount the seller can ask for his good or service-Seller's MSRP. (mfgs. suggested retail price)	L (3)	This is the maximum amount the Buyer can expend for his good or service-Buyer's Budget. (The buyer's approved spend limit.)



In the ISM Negotiation Preparation class and Capital Equipment Purchasing session the participants receive not only the L-O-B Worksheets but also learn to create a well-defined negotiation range. In the development of a negotiation plan or strategy it is not uncommon for the buyer/supply manager to create from a single negotiation possibly 2-3 Price related L-O-B's and then 15-25 Non-Price related L-O-B plans for each negotiation. A Price related L-O-B has to be tied directly to a purchase price only, price of the equipment or structure. In these we seek to identify 12-15 planned concession patterns building up from the Buyer's B(1) position reaching toward the zone of overlap. A Non-Price related L-O-B is for everything else other than price, though they could represent a value; warranty, service, terms, etc. This category usually only extends the range to four to five positions past the Seller's offer point called the Given. These can also translate into a value derivative but only the price or cost L-O-B's is relegated to a price L-O-B.

The Non-Price L-O-B is segmented into five sections as shown below. The first section; the seller's Given is what the supplier avail to the buyer during the negotiation process. The complete opposite is referred to as the Buyer's Fantasy. This is what the buyer or buyer's organization would desire in their wildest dream or the maximum it is initiated from the seller's Given but the Buyer's Fantasy is the springboard for all the points which follow going backwards toward the sellers offering.

Non-Price L-O-B



The most exciting part of driving a negotiation from the position of knowledge derived power is that you can forecast to your company or client very closely to where the negotiation will arrive before even the start of the process. The other part it amplified to the counterpart that indeed the professional has entered the room-you. It is shown through all you seek, the enhancement of the negotiation range as well as what you acquire from the process when you walk out the door.