Commercial Negotiation

[L4M5]

Core

Study Guide

Level 4

Diploma in Procurement
and Supply

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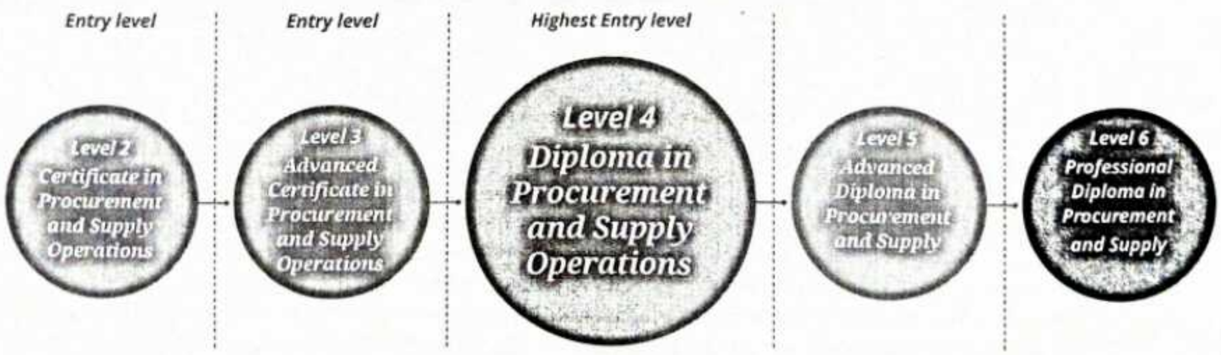
Your qualification

CIPS qualifications are regulated internationally to ensure we offer a recognised, professional standard in procurement and supply. CIPS Level 4* Diploma in Procurement and Supply is a vocationally related professional qualification. Formal recognition is included within the regulatory frameworks of an increasing number of countries such as the UK (England, Wales and Northern Ireland), UAE (including Dubai) and Africa (including Zambia). Further information on this recognition and the details of corresponding qualifications levels for other international qualifications frameworks are detailed on our website. CIPS members can have the confidence in our regulated qualifications, which reliably indicate the standard of knowledge, skills and understanding that you, as a learner, are required to demonstrate.

A step up from the Level 3 Advanced Certificate in Procurement and Supply Operations, the Level 4 Diploma in Procurement and Supply is a stepping stone to study on the CIPS Level 5 Advanced Diploma in Procurement and Supply. The content has been written using the CIPS Procurement and Supply Cycle as its focus, which presents a cyclical process of key steps faced by those procuring goods or services. The Diploma offers the most common entry route to the profession and should be used by learners to develop a professional 'tool box' which learners can apply in the practical environment and further develop at Levels 5 and 6.

In this way successful learners will possess transferable workplace skills, developing their operational and tactical abilities as they strive for managerial roles and responsibilities. It is aimed at those in the profession who have procurement and supply activity at the heart of their role. Learners will be expected to provide advice and guidance to key stakeholders on the performance of organisational procedures and processes associated with procurement and supply and will aspire to manage developments in and improvements to the related functions. Transferable skills are those such as communication, teamwork, and planning and completing tasks to high standards, all enable the learner to add value to the organisation.



Next steps

This qualification provides progression to the CIPS Level 5 Advanced Diploma in Procurement and Supply.

Level 5

** Refers to levels within the UK RQF. Other regulatory bodies may have different corresponding levels*

Based on the Tactical competency level of CIPS Global Standard

Guide to qualification content

What will I study?

60 Credits required for completion

Eight CORE modules make up 60 required credits

CORE Level 4 *Scope and Influence of Procurement and Supply (L4M1)* 12 CREDITS

CORE Level 4 *Defining Business Need (L4M2)* 6 CREDITS

CORE Level 4 *Commercial Contracting (L4M3)* 6 CREDITS

CORE Level 4 *Ethical and Responsible Sourcing (L4M4)* 6 CREDITS

CORE Level 4 *Commercial Negotiation (L4M5)* 6 CREDITS

CORE Level 4 *Supplier Relationships (L4M6)* 6 CREDITS

CORE Level 4 *Whole Life Asset Management (L4M7)* 6 CREDITS

CORE Level 4 *Procurement and Supply in Practice (L4M8)* 12 CREDITS

Who is it for?

This qualification is the essential toolkit for anyone planning a career in procurement and supply. Developed and written using the Procurement and Supply cycle** as its focus, it is at the same level as the first year of an undergraduate degree course. It is suitable for those in operational roles or those managing or supervising the procurement and supply function who want to develop their career and work towards MCIPS Chartered Procurement and Supply Professional.

What will I learn?

You will learn about making procurement and supply happen within an organisation, and you will be equipped with an essential range of knowledge and tools that you can apply immediately in your workplace. Learn how to apply practical, theoretical and technical knowledge, gain a clear understanding of procurement and supply and develop the ability to address complex, non routine problems.

On completion, you will be able to analyse, interpret and evaluate relevant information and ideas and have an informed awareness of differing perspectives and approaches within the profession. You will also be able to review the effectiveness and appropriateness of methods, actions and results.

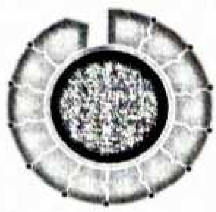
Entry requirements

This is the only entry point onto our Diploma qualifications. A minimum of at least two A-levels (or international equivalent) or a CIPS Level 3 Advanced Certificate qualification is required. Alternatively, you will need a minimum of two years' relevant experience in a business environment.

Credit values

To gain a qualification you are required to complete a total number of credits. This is a way of quantifying the required number of study hours. 1 credit is equivalent to 10 hours of study. Each module is given a credit value of 6 or 12 credits.

Total credits required for completion **60**

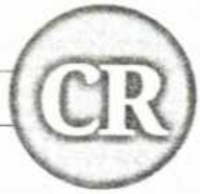


*** The Procurement cycle is the cyclical process of key steps when procuring goods or services. www.cips.org/en-gb/knowledge/procurement-cycle/***

About our exams and your study commitments

Objective Response exam format (OR)

These questions allow you to select a response from a list of possible answers. You will find these types of exams across all our qualifications levels and they are marked by computer and then moderated by CIPS examiners.



Constructed Response exam format (CR)

These questions require you to create or 'construct' a response to the question such as an essay or case study. You will find this type of exam in our diploma level qualifications and they will be marked by subject expert examiners.

Your total qualification time (TQT)

The TQT indicates the overall number of guided learning hours, additional self-study and assessment time that is required.

Guided learning hours (GLH)

It is expected that you will undertake 250 GLH. The definition of guided learning hours is: 'A measure of the amount of input time required to achieve the qualification. This includes lectures, tutorials and practicals, as well as supervised study in, for example, learning centres and workshops'.

Self-study requirement (SSR)

Additionally, we recommend that you also commit to at least 335 SSR hours. This includes wider reading of the subject areas and revision to give yourself the best preparation for successfully achieving the qualification.

Total exam time

All the modules in CIPS qualifications are assessed by an examination.

How to use this book

Welcome to this study guide for Commercial Negotiation. It contains all the information needed to prepare you for the assessment in this module.

This study guide follows the order of the module specification and each chapter relates to one of the learning outcomes below. You can also see the assessment criteria for each learning outcome.

Learning outcome 1

By the end of this chapter, you will have a broad understanding of key approaches in the negotiation of commercial agreements with external organisations, including the role of the procurement function and the buyer in these negotiations.

Learning outcome 2

By the end of this chapter, you will know how to prepare for negotiations with external organisations.

Learning outcome 3

By the end of this chapter, you will have an understanding of the fundamentals of how commercial negotiations should be undertaken at the actual 'in person' meeting stage with TOP.

Book features

Throughout this book there are a number of features to aid your learning and simplify your revision. Take a look at the different features you will find in the book below.

A Z

Glossary
These are the key terms and their definitions

Remember
This information is important, so you should make a note of it.

Check
These revision questions give you a chance to check you understand the content in this chapter.

Apply
These tasks give you a chance to test out your knowledge and understanding.

Recap
This information will summarise sections from previous chapters.

Case study
These case studies will relate the content you have learned to real-world examples.

Recommended reading
These books can give you more understanding on the subject.

Link to CIPS knowledge where members will be able to access additional resources to extend your knowledge, plus links to online eLearning content including videos, audio and interactive quizzes to recap and test your knowledge and understanding.

End of chapter assessments

At the end of each chapter in the book there is a set of exam-style questions to prepare you for your assessment.

End of Chapter Assessment

IDENTIFY

1 The National Health Service (NHS) in the UK is an example of an organisation from which sector?

a. Public
b. Private
c. Third
d. Primary

C
CORE MODULE

CIPS GLOBAL STANDARD
6.6 · 7.3 · 7.4

OR
OBJECTIVE RESPONSE EXAM

1.5 HRS
EXAM DURATION HOURS

60 HRS
MODULE LEARNING TIME

6 CREDITS

Commercial Negotiation [L4M5]

Module purpose

On completion of this module learners will be able to identify approaches to successfully achieving negotiated commercial agreements with external organisations.

Module aim(s)

The creation of formalised agreements is a critical part of the success of any organisation. Those involved in procurement and supply activity will therefore be able to effectively negotiate with stakeholders and/or suppliers and to understand the methods associated with preparing for and carrying out commercial negotiations. This module is designed for those who are faced with negotiations. It enables the learner to analyse approaches to the negotiation of agreements made with external parties, how to prepare for them and what techniques are available to ensure successful outcomes.

Credit value

Book features

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End of Chapter Assessment

IDENTIFY

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   a. Public
   b. Private
   c. Third
   d. Primary

CHAPTER 1

Understand key approaches in the negotiation of commercial agreements with external organisations

LO1

Learning outcome

By the end of this chapter, you will have a broad understanding of key approaches in the negotiation of commercial agreements with external organisations, including the role of the procurement function and the buyer in these negotiations.

Chapter overview

1.1 Analyse the application of commercial negotiations in the work of procurement and supply

You will understand:

- Definitions of commercial negotiation
- Negotiation in relation to the stages of the sourcing process
- Sources of conflict that can arise in the work of procurement and supply
- Team management and the influence of stakeholders in negotiations

1.2 Differentiate between the types of approaches that can be pursued in commercial negotiations

You will understand:

- Collaborative win-win approaches to negotiation
- Distributive win-lose approaches to negotiation
- Pragmatic and principled styles of negotiation
- Setting targets and creating a best alternative to a negotiated agreement (BATNA)

1.3 Explain how the balance of power in commercial negotiations can affect outcomes

You will understand:

- The importance of power in commercial negotiations
- Sources of personal power
- Organisational power: comparing the relative power of purchasers and suppliers

- How suppliers gather information on purchasers
- How purchasers can improve leverage with suppliers

1.4 Identify the different types of relationships that impact on commercial negotiations

You will understand:

- The relationship spectrum
- Building relationships based on reputation and trust
- Repairing a relationship

Introduction

> *We cannot negotiate with those who say 'What's mine is mine, and what's yours is negotiable.'*
>
> *John Fitzgerald Kennedy, US President (1961)*

> *From this day forward it's going to be only America First.*
>
> *Donald Trump, US President (2017)*

Stakeholders
From a negotiation perspective, stakeholders can be defined as persons or groups that have an interest (or stake) in the outcome of the negotiation you are leading or participating in

Regardless of the sector, industry or function that the professional buyer finds themselves in, one key skill that is essential in the procurement team is that of negotiation. Procurement staff may be required to negotiate not just with suppliers but also with internal users, budget holders, contract managers and a multiplicity of other internal and external **stakeholders**. Negotiation touches on a wide range of areas and the quotes from two well-known but very different USA presidents above demonstrate that there are various approaches which can be taken to achieve your objectives.

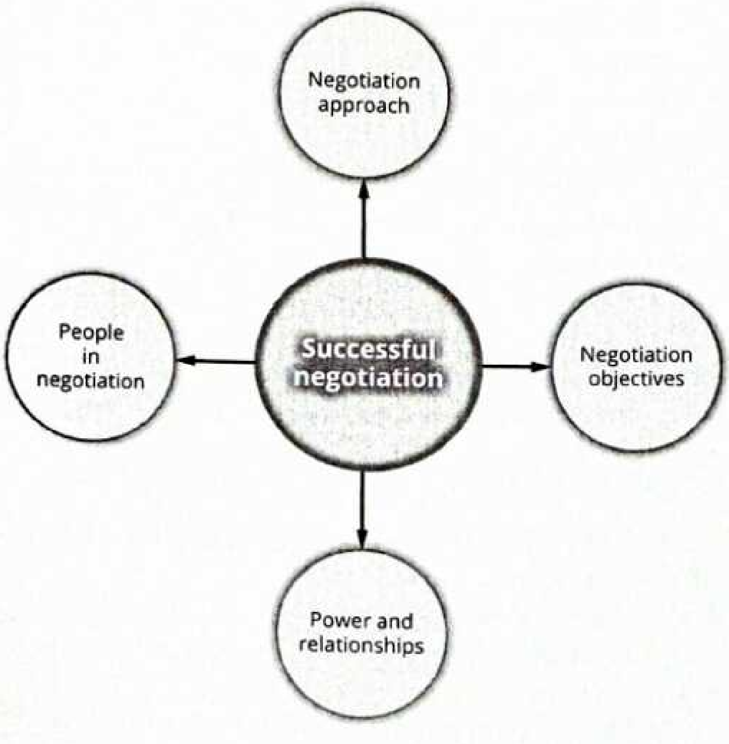

Figure 1.1 Successful negotiation

While it is possible to achieve a successful outcome to a negotiation without any preparation, or even by accident, this is unprofessional and not advisable. Achieving success in this way is rare, and for professional buyers, negotiation is an expected core skill that involves considerations of approach, objectives and people and power aspects. Practice and experience are essential to test and build your skills in this area. However, a strong foundation in the principles of commercial negotiation is an essential pre-requisite. This study guide does not seek to examine and critique all aspects of negotiation, nor does it make any claims that you will become an expert by reading it. It does however provide a solid foundation for those looking to learn the principles and practice of commercial negotiation from a professional buyer's perspective. It also covers the CIPS Commercial Negotiations syllabus for Level 4.

Commercial negotiation is a wide subject area incorporating elements of cost accounting, economics, maths, psychology, organisational behaviour, communications, politics, sales and procurement. More recently in the computer science field, developments in artificial intelligence and machine learning are incorporating elements of negotiation and therefore you may soon be negotiating with a robot. Much of the core theory has stood the test of time, but we must understand the relevance of this theory in our roles as procurement professionals working in organisations today. This study guide sets out to do this. Before we begin, however, it is important to note the two overarching points described below.

Negotiation is not always an option

The very fact that the other party (TOP) is willing to 'come to the negotiation table' is in itself an acknowledgement of the buyers' influence or power. Buyers in weak positions may not be able to negotiate improvements in price or indeed anything – it takes two parties to make a negotiation. In addition, there may be restrictions as to what can be negotiated in procurement, and when – for example, in government and public sector organisations. Always ensure that you follow any relevant regulations and legislation that might affect your decision on whether to negotiate. Similarly, always follow your organisation's internal policies and procedures.

Negotiation is not 'free'

There is typically a cost associated with the negotiation process, so the buyer must consider the cost–benefit analysis of negotiation. If the negotiation requires a good deal of preparation, analysis, senior staff time and facilitation costs, the potential benefit hoped for must justify this investment. The higher the relative cost and risk of the procurement, the more you invest in negotiation preparation and vice versa. However, life is too short to be negotiating everything. Professional buyers do not negotiate for the sake of it. Remember that the time spent preparing for and carrying out a negotiation also represents a cost to the supplier. As a general principle, suppliers tend to seek opportunities to pass these costs on to the buyer one way or another.

1.1 Analyse the application of commercial negotiations in the work of procurement and supply

Definitions of commercial negotiation

Those inexperienced in commercial negotiation typically tend to focus too much on the content of a commercial negotiation – for example, price, service levels or delivery. They neglect planning how the negotiation itself will be structured and conducted, or how they should prepare for it. Having a greater awareness of the process of negotiation will provide you with insight into what is happening in a negotiation and therefore a greater ability to influence the outcome. Although negotiation is typically seen as an event at a point(s) in time (for example, when the buyer meets the supplier), from a professional perspective the negotiation process can start long before the meeting stage, particularly in cases of high-value or high-risk procurements.

The negotiation can begin from the first communication between the buyer and the supplier, right through to the final signing of the contract, mobilisation, contract management and contract exit. There are multiple negotiation objectives a buyer can set and seek to achieve – these will be examined in later sections. It is the buyer's responsibility to negotiate the best terms, conditions and price for every purchase while maintaining or improving quality of service, as well as a productive working relationship with their suppliers.

Some definitions of negotiation

> *Discussion aimed at reaching an agreement.*
>
> (Source: Oxford Living Dictionaries)

> *To confer with another so as to arrive at the settlement of some matter.*
>
> (Source: Merriam-Webster)

> *To communicate with the objective of reaching an agreement by means, where appropriate, of compromise.*[1]

> *A process in which two or more people, with differing views, reach agreement by the use of different methods of persuasion.*[2]

> *A process through which parties move from their initially divergent positions to a point where agreement may be reached.*[3]

> *Negotiation is a process by which we search for terms to obtain what we want from someone who wants something from us.*[4]

Professor Gavin Kennedy highlights that we need to distinguish negotiation from other forms of decision-making by focusing on what is unique about it (the voluntary exchange) and not shared by other techniques such as persuasion, gambling (e.g., coin tossing), command decision, instruction, litigation and coercion. From consideration of these definitions there are some common factors that emerge.

Negotiation involves two or more parties and a channel of communication. This often means one-to-one discussions, but could involve negotiating in teams. Its objective is to reach an agreement or settlement of one or more issues where there is disagreement and/or divergent views. From the definitions we can surmise that negotiation should be viewed as a process. It involves a degree of co-operation between two or more parties, where the parties have some shared interests and some interests that are opposed or divergent. Through the negotiation process, something of value is exchanged and both/all parties will have their needs sufficiently satisfied so that they can arrive at a mutually agreeable settlement. The result of a successful negotiation is an agreement both parties can 'sign up to'; however, this does not imply that both parties are always equally satisfied or have gained equally from the agreement.

> *Apply*
> Consider what distinguishes negotiation from other forms of dispute resolution – such as those that Professor Gavin Kennedy contrasts it with – and note the differences. Based on these differences, can you suggest some commercial situations in which negotiation may not be appropriate or yield benefits?

Negotiation – content versus process

The content/subject matter of every negotiation will be different and it is desirable and helpful if the negotiators have familiarity with the subject matter (the category or commodity). However, detailed technical knowledge is not always essential or available from a procurement perspective. If required, subject matter/technical experts can be brought in to support/partner with procurement professionals in negotiations regarding business requirements, fact checking and stakeholder engagement.

On the other hand, the process (stages and sequence of events) for most commercial negotiations is arguably more or less the same, with similar approaches and stages involved. Skilled negotiators must be thoroughly familiar with these approaches and stages both in terms of their own planning and usage and also their use by the other party (TOP). The time and effort expended on these approaches and stages should be driven by an assessment of the relative cost and risk of the procurement, as well as an assessment of the potential benefits achievable through negotiations. Procurement professionals should be well placed to lead this assessment.

Content		**Process**
• What you are negotiating about • Unique to each negotiation	**Negotiation**	• How the negotiation is managed • Generic stages all negotiations go through

Figure 1.2 Negotiation – content versus process

In order to deliver an effective service, procurement and supply professionals need to display core skills in the area of negotiation. Although some people may appear to have a natural ability to negotiate, it is – essentially – a skill which can be learned through professional training, coaching and experience. Above all the skill can be developed and enhanced through practice and self-reflection (see section 3.4).

Negotiation in relation to the stages of the sourcing process

Overview

In this section we focus on the areas within procurement and supply where negotiation skills and knowledge are most likely to be applied. The importance of negotiation in relation to procurement is typically assumed to be during the sourcing process and before the buyer has actually awarded business/a contract to a supplier. In many cases this is true; however, procurement professionals should be aware that negotiation and negotiation skills can also be employed at multiple stages throughout the contract life cycle, even if this is not formally acknowledged. The need to negotiate can arise unexpectedly and with short notice in the case of a supply emergency or sudden change in requirements.

It should be noted that private sector organisations are normally free to negotiate what they want with whom they want and whenever they want, assuming it is of course legal. They are not constrained by public sector procurement rules or other restrictions that are typically placed on public sector organisations or those funded by the government. Commercial negotiations require by their nature confidentiality and a degree of secrecy which is not always compatible with requirements of transparency and openness in the public sector. The scope of public sector procurement is outside this syllabus; however, it is worth knowing that there is pressure on many public sector bodies to use rules-based tendering processes which normally have restrictions or even prohibitions on what can be negotiated, and when in the process this must be done. This does not mean negotiation skills are less important for public sector buyers, but it may mean they need to focus their efforts outside the core sourcing process – 'upstream' with internal stakeholders, and/or 'downstream' with suppliers after contract award and during the contract management phase.

In this section we will examine the stages of both the procurement and supply cycle and the contract management cycle in relation to negotiation, highlighting those areas where negotiation with external organisations is most likely to arise. Remember that in public sector procurement, opportunities for negotiation are likely to be more limited by regulations and legislation, especially during the pre-contract award stage. There is likely to be more opportunity for negotiation during the contract management stage.

Negotiation in relation to the procurement and supply cycle

The procurement and supply cycle is the cyclical process of key steps when procuring goods or services. The cycle can be accessed on the Knowledge section of the CIPS website and is an interactive tool developed to guide members through the procurement process with links to relevant knowledge to support you. For our purposes, we will consider how negotiation relates to the cycle and the stages within it, with a focus on the sourcing process and external organisations. We will also highlight the potential sources of conflict/divergent views that can arise at each stage.

The procurement and supply cycle attempts to cover all the key stages associated with traditional medium-/high-value one-off/first-time procurements following a tender process. Not all procurements involve tendering, and if the procurement is regular and/or routine, it is unlikely the buyer would need to spend much time and energy on all stages (re-buy) as long as there is satisfaction with current supplier price and performance.

1.1 LO1

Remember

In the private sector, the buyer may directly approach specific suppliers to negotiate without having to issue any tender documentation. Furthermore, they tend to have much more freedom to decide what should or should not happen at the core sourcing/tendering stages 4, 5, 6, 7 and 8 in the cycle.

Please note that for this syllabus, learners are not required to understand in depth what happens at each stage of the procurement and contract management cycles; however, it is expected that they can describe where negotiation may be relevant at each stage.

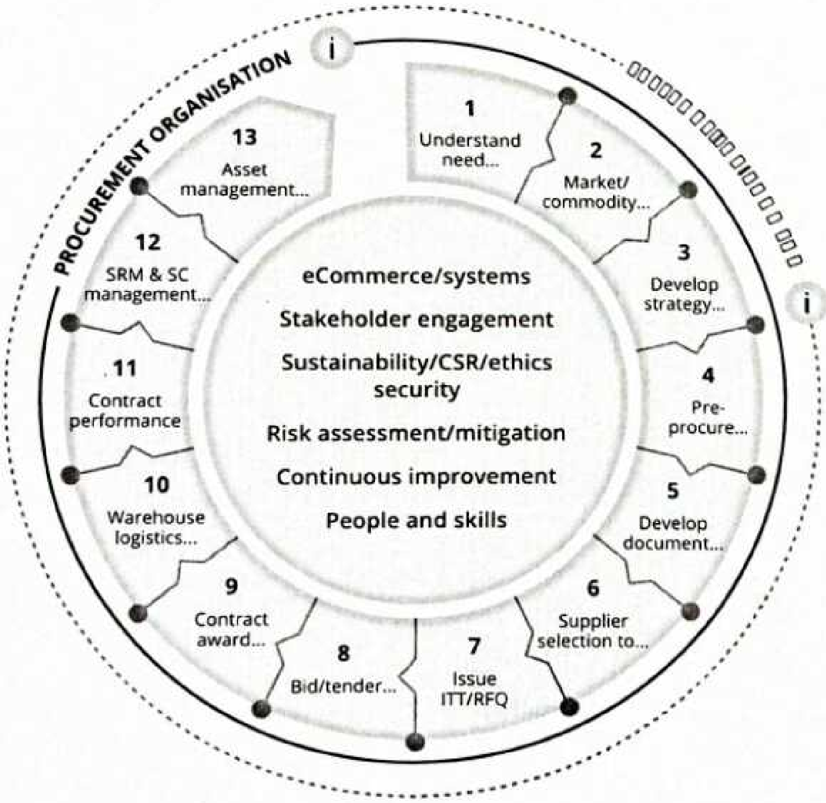

Figure 1.3 CIPS Procurement and Supply Cycle (Source: www.cips.org/en-gb/knowledge/procurement-cycle/. Copyright CIPS 2014. All rights reserved.)

CIPS Procurement and Supply Cycle	
Step	**Where negotiation situations typically arise**
1. Understand need and develop a high-level specification	**This step involves mainly internal negotiation with stakeholders.** It is a paradox, but the greatest yet most invisible procurement savings come from not buying at all – if the goods/services (typically indirect items) are not actually needed. Professional procurement managers

CIPS Procurement and Supply Cycle	
Step	**Where negotiation situations typically arise**
	have a duty to proportionately and constructively challenge specifications if there is genuine doubt over the need or how the need is expressed, e.g., by brand name or supplier. This is called demand management. Their first duty is to the organisation's treasury, not to functional managers. Demand management: negotiation/challenge between procurement and internal stakeholders over the need/requirement/specification. Remember that in any process or product, the greatest opportunity for cost reduction is at the design stage. Negotiation with the budget holder is needed regarding the target price to pay for the goods/services. Perhaps their budget is not realistic for the quality or performance requirements needed in the market?
2. Market/ commodity and options research (including make or buy assessment)	**This step informs the negotiation process.** Evaluation of bargaining power between the buyer and the different suppliers can start at this stage. Analysis of the market may suggest it might be sensible to focus on smaller suppliers where leverage may be greater, or focus on larger suppliers due to the likelihood for failure of the smaller suppliers. If local/national competition limits the buyer's negotiation power, it may be sensible to consider making enquiries beyond national borders/advertising requirements internationally.
3. Develop strategy/ plan	**This step is where the decision regarding whether and what to negotiate is made.** If you have established that there is competition in the market and you will benefit from negotiating with bidders/suppliers, then build this into your plan and timings. Remember that negotiation is not 'free' – you will need to think about the negotiation objectives, plan and resources. How much effort should you allow for? Will it be worth it?
4. Pre-procurement market test and market engagement	**This step is where 'supplier conditioning' can begin.** It may be sensible to engage with some or all of the market players before you go to tender to gain insights into market and supplier pricing and cost structures, strategies and trends. Meeting suppliers and/or hosting pre-tendering/bidder briefing sessions can also attract more interest in your business – or reveal your business is not as attractive as you may have thought, necessitating a change of strategy.

A Z

Supplier conditioning
The process of influencing a supplier or suppliers to behave in a certain way, or to accept certain circumstances

CIPS Procurement and Supply Cycle	
Step	**Where negotiation situations typically arise**
	Early supplier conditioning, e.g., focusing on the importance of a specific factor such as quality, cost or environmental standards publicly, can also put in suppliers' minds the need to focus on these areas in their bids/during negotiations. In some markets, there may be insufficient suppliers or evidence of monopoly or cartel behaviour, so you may need to undertake 'reverse marketing' or 'market shaping' – efforts to attract new entrants or substitute products from suppliers to your supply market.
5. Develop (tendering) documentation	**There is typically limited commercial negotiation activity here, especially in public sector procurement.** Mainly concerned with the development of the ITT or RFP – Invitation to Tender/Request for Proposal documentation to go to market with.
6. Supplier selection (to participate in tender/ negotiation)	**There is typically limited commercial negotiation activity here.** Generally, the shortlisting or down-selecting of suppliers from a larger number/general population to a smaller number/more targeted group is done via a pre-qualification questionnaire stage (PQQ), or initial evaluation of responses (desk work), such as expressions of interest received following advertisement of requirements.
7. Issue invitation to tender/request for quotation	**There is typically limited commercial negotiation activity here.** This stage normally follows on automatically from the preceding stage and is driven from the results of the evaluation of initial bids/PQQs with the highest scoring bidder(s) being invited to submit a formal priced bid or tender which may (or may not) be subject to a subsequent negotiation stage.
8. Bid/tender evaluation	**Commercial negotiation activity can take place here, although in the case of the public sector, buyers should ensure they follow any appropriate regulations.** This is the first stage where detailed commercial negotiation may start. The buyer has received the tender/bids or quotes from potential suppliers so has an 'opening position' from competing bidders from which negotiations may begin. Depending on the rules agreed or imposed, this bid from a pricing perspective can be seen as the supplier's initial (highest) price or final (lowest) price. In situations where the bidder expects negotiation after submission of their bid (post-tender negotiation) they may submit

CIPS Procurement and Supply Cycle	
Step	**Where negotiation situations typically arise**
	a price which allows for some downward flexibility or 'wiggle room' in the expected negotiation stage. However, if the buyer has made it clear the tendered price will be the 'final offer' price and/or if the buyer is unable to negotiate on price due to regulations (see 'Public sector procurement and commercial negotiation' below this table), then the price should be viewed as a best price. From an ethical perspective, it is arguable that the bidders should be told in advance how their bids will be evaluated and on what basis they will be invited to a further negotiation stage if that is the plan. Furthermore, if permitted and planned in, procurement professionals should only invite the most competitive bidders, e.g., first, second and third placed, to further negotiations based on their submitted bids, and not seek to approach a lower ranked bidder, e.g., fifth place, and get them to improve their offer so they dislodge first or second placed bids. Being perceived as fair is a big advantage in commercial negotiations. Competing bidders who have been ranked the highest, e.g., first, second, third, may be invited to make presentations to an evaluation team and answer questions on their bid and, if permitted, discuss their commercial offer with the buyer with a view to driving out more concessions/innovations/benefits for the buyer. Following these post-tender negotiations, this final shortlist of bidders may be asked to come back with a best and final offer (BAFO) which is then used by the buyer to make the final award recommendation.
9. Contract award	**Commercial negotiation activity can take place in the private sector. In public sector procurement, buyers must ensure they follow any relevant regulations which often prevent negotiation at this stage.** At this stage the buying organisation has decided on the supplier(s) they want, but there may be an opportunity to negotiate further concessions before informing the preferred supplier(s) and awarding them the contract(s). This is the stage where the buyer may be in the best position to extract concessions on condition the supplier is not aware the decision to award has already been made. Care must be taken here not to push too hard and 'get greedy'; the internal customer will not be grateful to procurement if the deal falls through on the back of a minor further concession given after customer sign-off. It is likely that in all but the most straightforward re-buy procurements there will be some items not core to the main contract that need to be bottomed out, such as

CIPS Procurement and Supply Cycle	
Step	**Where negotiation situations typically arise**
	mobilisation costs, payment terms, detailed schedules and key staff availability. Some of these items will need to be clarified and confirmed and an element of negotiation will be required here to get these items confirmed on the best terms for the buyer.
10. Delivery of goods/services	**There is typically limited commercial negotiation activity here.**
11. Contract performance review	**Commercial negotiation activity can take place here.** It is well established that unless managed proactively, supplier performance can decline over the life of a contract when complacency may set in. It may not be the buyer's responsibility, but someone in the buying organisation must review the performance of the contractor against what they promised to deliver as per the contract agreed/negotiated. The supplier may disagree with customer assessments of performance or achievement of key performance indicators (KPIs) and these may be subject to negotiation as the contractor may argue that the customer is also a contributing factor here, e.g., through lack of co-operation. In many contracts, payment to suppliers may be linked to performance in terms of delivery times, milestone achievements, successful user acceptance testing, positive feedback from end customers, etc. In these situations it should be expected that there will be a need to negotiate with suppliers regarding the discretional elements, i.e. those that cannot be objectively measured via a digital solution, data analytics, etc.
12. Supplier relationship management and development	**Commercial negotiation activity can take place here.** Please see 'Negotiation in relation to the contract management cycle' below.
13. End of contract – exit transition to new supplier	**Commercial negotiation activity can take place here.** This stage is often overlooked but can represent a high risk if arrangements regarding the contract end or transition to a new supplier have not been explicitly agreed or negotiated earlier with the incumbent supplier. The outgoing supplier's focus will likely be elsewhere in the final months of the contract. Negotiation leverage with this supplier is likely to be weak as they know soon they will be earning no more income from you and worse they may be handing over their business to a competitor. It's unlikely any

CIPS Procurement and Supply Cycle	
Step	**Where negotiation situations typically arise**
	concessions can be extracted now, and it is possible that the supplier may seek to maximise profit by reducing resource input costs to the minimum towards the end of the contract. From a negotiation perspective, it is hoped that orderly and smooth transition arrangements have been agreed regarding transfer of data, staff, assets, etc., and that the outgoing supplier will co-operate with the new supplier if applicable. In any case, procurement will need to monitor this situation carefully and be aware that achieving any gains via negotiations may be very difficult here.

Table 1.1 CIPS Procurement and Supply Cycle

Public sector procurement and commercial negotiation

Apply

As mentioned earlier, there are normally restrictions on when and under what circumstances buyers in the public sector can negotiate with tenderers, as negotiation is typically seen as not fully transparent. This is true in most jurisdictions around the world, including the European Union and most countries in which CIPS has a presence. Under the European Union public procurement directives, for example, all public sector bodies must abide by certain rules when they procure goods and services over a threshold value. These rules are codified under five procurement procedures.

1. Open Procedure
2. Restricted Procedure
3. Competitive Dialogue
4. Competitive Procedure with Negotiation
5. Innovation Partnerships

Under normal circumstances, there is no commercial negotiation allowed under the two most commonly used procedures, Open and Restricted. Under these procedures the prices and terms and conditions of contract should be decided via reference only to the tenderers' responses to the buyer's request for tenders, and not through 'post-tender negotiation'. Under the other procedures, negotiation within the rules is permitted. Interested learners can read more about these procedures on the CIPS website, but they are not examinable here.

Negotiation in relation to the contract management cycle

It is a myth that commercial negotiation ends at the award of a contract. Some would even say that this is where the real commercial negotiations begin. It is

1.1

well known that in some sectors such as transport, utilities and infrastructure, tenderers may 'bid low' or even make a loss to win major contracts with a view to negotiating lucrative changes, variations and 'add-ons' over the life of the contract, when the supplier is bedded in and the buyer is in a weaker position to push back or challenge. Even in less complex contracts it is very likely that there will be a need to negotiate with that supplier again after the awarding of the contract.

For many organisations, their focus regarding commercial negotiations effort is expended on their incumbent suppliers – the organisations they currently spend their money with and with whom, it is assumed or hoped, a contract is in place. It is essential therefore to consider negotiation in relation to contract management.

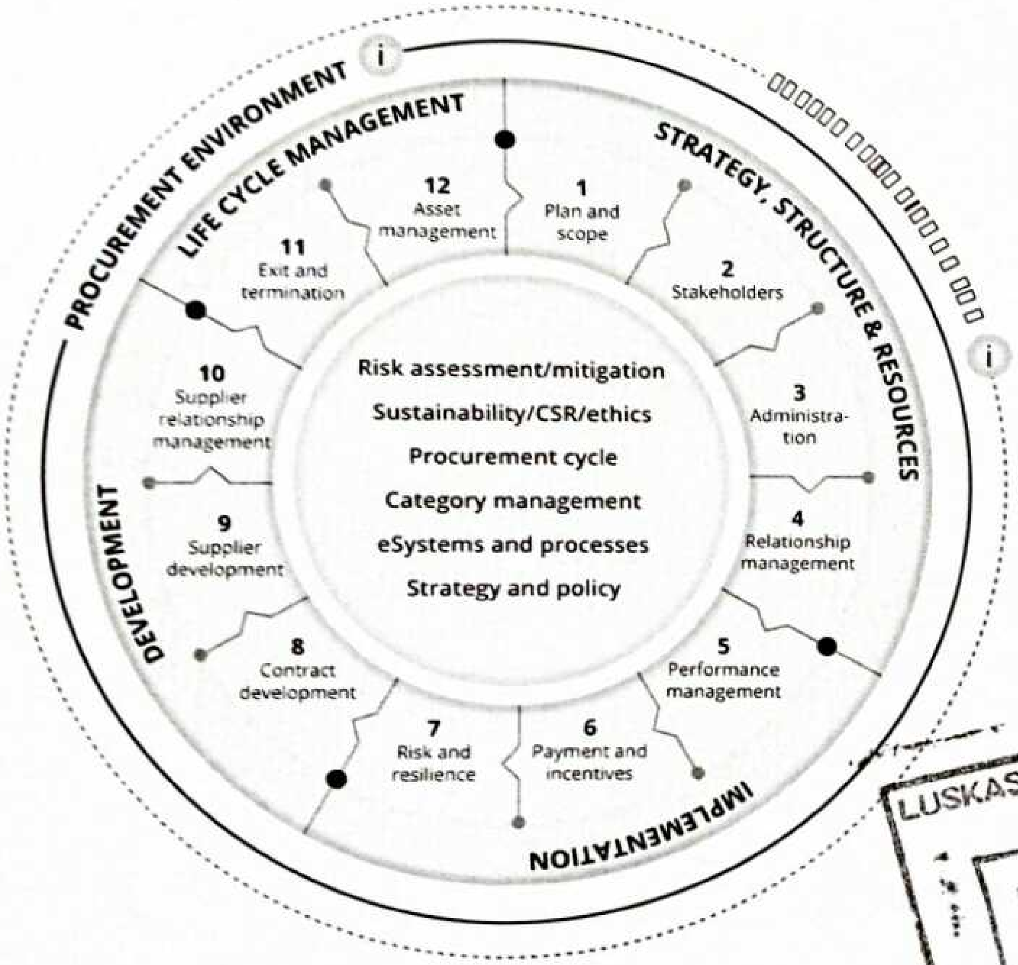

Figure 1.4 CIPS Contract Management Cycle

> *Contract Management is a continuous **procurement** process that ensures suppliers – and **buyers – adhere** to their agreed contractual obligations, **along with negotiating** any future changes that **need to take** place.*

(Source: www.cips.org/knowledge)

The CIPS Contract Management Cycle is structured and set out in the same style as the CIPS Procurement and Supply Cycle. Learners should familiarise themselves with this model with regard to how it affects negotiation.

CIPS Contract Management Cycle	
Step	**Where negotiation situations typically arise**
1. Planning and scoping	Agreement on scope of work to be done, responsibilities and obligations, 'what if' scenarios, disaster recovery, dealing with media, compliance to policies regarding slavery, ethics and corruption, staff on site, etc.
2. Stakeholder readiness	Expectations management with stakeholders. Make sure the relevant stakeholders, particularly those that directly deal with the supplier, understand the key elements of the contract agreed, particularly around performance KPIs and the customer's obligations.
3. Contract administration	Operational management and any minor schedule or specification changes required (bigger changes need to be considered under stage 8). Signing off work for payment. Many disputes with suppliers are over payment issues.
4. Relationship management	This is normally relevant only if there is potential benefit in a closer working relationship with a supplier, e.g., access to the supplier's technological (or other) innovations, cost-reducing approaches, or more efficient ways of working. Establish what, apart from payment, is attractive to the supplier, e.g., publicity, quicker payment, access to your technology, and consider whether this is worth trading in order to improve the relationship.
5. Performance management	It is well established that unless managed proactively, supplier performance can decline over the life of a contract when complacency may set in. It may not be the buyer's responsibility, but someone in the buying organisation must review the performance of the contractor against what they promised to deliver as per the contract that was agreed/negotiated. The supplier may disagree with customer assessments of performance or achievement of KPIs and these may be subject to negotiation as the contractor may argue that the customer is also a contributing factor here, e.g., through lack of co-operation. In many service contracts, payment to suppliers may be linked to performance in terms of delivery times, milestone achievements, successful user acceptance testing, positive feedback from end customers, etc. In these situations, it should be expected that there will be a need to negotiate with suppliers regarding the discretional elements, i.e. those that cannot be objectively measured via a digital solution, data analytics, etc.

CIPS Contract Management Cycle	
Step	**Where negotiation situations typically arise**
6. Payment and incentives	Negotiation of improvements in performance or additional services or goods (if permitted) in return for additional payments or other financial incentives.
7. Risk and resilience	External environment or other changes may mean risk share needs to be revisited, requiring negotiation.
8. Contract changes and development	Core area for negotiations within contracts.
9. Supplier development	Improvements in supplier capability, capacity, and product/service range can be negotiated. Changes in the buyer's technology platform, e.g., a move to e-invoicing, may require suppliers to change their technology suppliers or software.
10. Supplier relationship management (SRM)	SRM helps to create the right relationship and environment in which to work on new developments and evaluate the option of streamlining processes. Negotiations with long-term strategic critical suppliers should be carried out in a partnering style, with a win-win starting point assumed.
11. Exit and termination	Exit and termination of suppliers can raise multiple risks (particularly in services) that need to be managed with certain items negotiated/confirmed with suppliers, e.g., payment, ownership of assets, staff transfers, transition to a new supplier, etc. You should think about your exit from a contract and cover this in the contract to avoid any potentially difficult issues regarding termination negotiations potentially years later.
12. Asset management	In some situations, the buyer will need to negotiate with a supplier post-contract end, e.g., maintenance of assets outside of warranties, advice regarding disposal, upgrades and compatibility with new assets, etc.

Table 1.2 CIPS Contract Management Cycle

In theory, when a tenderer responds to an ITT which has the buyer's contract terms and conditions (Ts and Cs) attached, they are agreeing to abide by all the terms and conditions included in that contract and all other requirements set out in the tender documentation. However, in practice it would be naive to expect that without proactive management of the contract the supplier will adhere to all Ts and Cs, so periodic checking and some negotiation may be expected during the contract life.

Apply

Consider how negotiating with a contractor (a supplier who is already supplying you) over a change in price and delivery terms will differ from a negotiation with a potential supplier who has not yet supplied you, with whom you are meeting to agree price and delivery terms.

Sources of divergent positions (conflict) that can arise in procurement and supply

Above we considered definitions of negotiation, most of which referred to a process by which two parties with initially divergent positions on a subject move through discussion and the trading of concessions to an agreed joint position on that subject. In theory, without divergent positions there would be no need for negotiation as there would be nothing to negotiate. In practice, even if there is no obvious divergence, it may still be a good idea to be prepared to negotiate to confirm mutual understanding on any important areas which have the potential to be a source of conflict later.

There are multiple sources of divergent positions that can arise in situations where money is exchanged for goods and services. It would be impossible to identify them all here, but buyers need to be aware of the main areas where divergence or conflict can arise. The tables that follow identify two different types of sources: those that arise from the content or subject matter of the negotiation (what is being negotiated) and those that arise from the process of negotiation (how it is being negotiated).

Sources of divergent positions – the content of negotiations

Sources of divergent positions/conflict	Typical buyer position (starting point)	Typical supplier position (starting point)
Price	Would like to pay as little as possible for the goods and services.	Would like to charge as much as possible for the goods and services.
Quality	Would like the highest quality/service possible for the price.	Would like to deliver the required quality at the lowest cost.
Payment terms	Would like to pay as slowly/late as possible.	Would like to get paid as quickly as possible.
Risk share	Would like the supplier to take most of the risk.	Would like the buyer to take most of the risk.
Volumes and commitment	Would like maximum flexibility of supply with minimum commitment to volumes.	Would like minimum flexibility of supply with maximum commitment to volumes.

Sources of divergent positions/conflict	Typical buyer position (starting point)	Typical supplier position (starting point)
Contract terms and conditions	Would like the buyer's Ts and Cs to govern the contract.	Would like the supplier's Ts and Cs to govern the contract.
Dispute resolution/ contract governing law	Would like disputes to be resolved in buyer's jurisdiction.	Would like disputes to be resolved in supplier's jurisdiction.

Table 1.3 Content (subject matter) of negotiation

Apply

Identify, using examples, purchase spend categories or supply situations where each of these sources of divergent positions is most likely and least likely to be an issue. For example, in regards to payment terms, this is perhaps most likely to be an issue where you are buying expensive capital equipment with a long expected life, or paying for a project that will take more than 12 months to complete.

In many negotiations, divergence may arise not just over the content/subject matter of what you are trying to negotiate, but also the process or approach taken. The table below sets out some sources of divergence here.

Sources of divergent positions – the process of negotiations

Sources of divergent positions/conflict	Examples
Agenda and governance	• Who decides what can be negotiated, how the meeting is chaired and governed, and how much time is allowed? • Lack of faith in confidentiality from TOP (notwithstanding the existence of NDAs – non-disclosure agreements).
Conflicting negotiation styles of participants	• Participants adopt very different styles, e.g., one party adopts win-win style while other side adopts win-lose style.
Cultural differences	• Misunderstandings between parties based on local or organisational customs, traditions or conventions. Unintended insults or offence made regarding symbols, forms of address (e.g., using 'Mr'/'Ms' versus first name), punctuality, dress codes, attitude, etc.

Sources of divergent positions/conflict	Examples
Timescales/location	• Different views as to where and when negotiation meetings should take place, e.g., 'home or away' and time zone differences. • How many meetings are required? Duration?
Negotiation medium	• Different views of participants regarding use of phone/teleconference, face-to-face, group meetings/negotiation by e-mail.
Team size and make-up	• Different views regarding who should be present at negotiation meetings; commercial, technical, legal, stakeholder representation.
How negotiation will be closed out	• How will we know when negotiation is 'over'? • Is there a time limit or agreed objectives both sides are aiming for? • What is default position if negotiation fails?

Table 1.4 Process of negotiation

Conflict or divergence over the content/subject matter of the negotiation is perhaps inevitable in commercial life, but procurement professionals should seek to minimise conflict over the process through agreeing 'ground rules' and approach as far as possible with TOP in advance of any negotiation meetings. There will of course be situations where one or both parties see an opportunistic benefit in making it difficult to agree ground rules, and even purposely disrupting the agreed process, e.g., through arriving late, seeking to change the agenda at the last minute, etc. We will revisit these disruptive tactics in section 3.1.

Ultimately, we must assume that in most if not all normal commercial negotiations we want a deal. The work of procurement and supply professionals therefore frequently involves managing these divergent positions and negotiating with the parties so that open conflict does not develop, leading to a no-deal situation (lose-lose).

Procurement and supply and contract management cycles

Earlier, we considered the stages of both the procurement and contract management cycles, and where negotiation situations typically arise at the stages within these cycles. We will not revisit the cycles here, but if you review them, you will see that the potential negotiation situations arose for the following reasons.

- Buyers may see an opportunity to improve their position relative to their competitors or suppliers.
- Suppliers may see an opportunity to improve their position relative to their competitors or buyers.
- Buyers and suppliers may hold different assumptions or attitudes regarding what should happen at each stage.
- Mutual benefits may be achieved through negotiation at the relevant stage.
- Buyer and supplier objectives are in conflict at the relevant stages.

Conflict management and resolution

1.1 LO1

The existence of divergent positions and sources of conflict is inevitable in business, life in general and indeed how we govern our societies. Conflict of ideas can be a good thing and it can be argued that most human progress has taken place in societies where divergent views are encouraged or at least not subjugated. Conflict and challenge to the status quo is even built into political systems in many democratic countries where an official opposition party or grouping is designed into the machinery of government. The existence of this opposition is based on the assumption that government will be better if the ruling party or grouping is subject to robust and public challenge. Similarly, in business, good corporate governance requires to some degree a 'cold' formal challenge from auditors to the financial accounts and other key commercial decisions that may have been made during the audit period. Only through robust challenge via internal and external auditors can wider stakeholder groups feel confident that senior managers do not hold responsibility for evaluating their own performance and simply claim to have performed well.

It is essential to be aware of the likely sources of conflict in commercial negotiations as set out earlier in section 1.1. Here we are less interested in the sources of conflict and why divergent positions exist, but more in how individuals and groups deal with that conflict. In the case of politics, we seek in democratic societies to channel this conflict through electing representatives based on their election promises or manifesto. In the case of business and commerce, we seek to channel this conflict and seek resolution via negotiation.

> *Apply*
> There are some short articles you can access in the Knowledge section of the CIPS website on conflict resolution, which focus on more formal processes such as mediation, adjudication, arbitration, litigation and alternative dispute resolution (ADR). You may be aware of these processes from your study of other CIPS syllabuses, but if not, you should familiarise yourself with these and note how they differ from negotiation as a form of conflict resolution. They are not examinable in this syllabus, but it is interesting to note that they all, even litigation, involve an element of negotiation.

Game theory

Game theory is the scientific modelling of interactions between different parties each pursuing its own interests. The parties interact and choose their action in view of what they think the other parties might think and do.[5] Game theory can help in resolving conflicts and also has applications in commercial negotiations. You can find out more about the application of game theory to procurement negotiations by accessing the articles and case studies in the CIPS Knowledge section under the title 'Game Theory'. It is not examinable as a separate topic in this syllabus, but learners are encouraged to familiarise themselves with it as an influence on negotiation.

> *Apply*
> Review the section about game theory in the Knowledge section of the CIPS website and summarise in five points how it may apply to commercial negotiations.

Conflict management styles

We will now briefly introduce a very useful and, perhaps, the most famous model that simplifies conflict management styles into a format that can easily be understood and implemented. The Thomas–Kilmann conflict resolution model was designed by two psychologists, Kenneth Thomas and Ralph Kilmann, to illustrate the options we have when handling conflict. It is illustrated in figure 1.5 below.

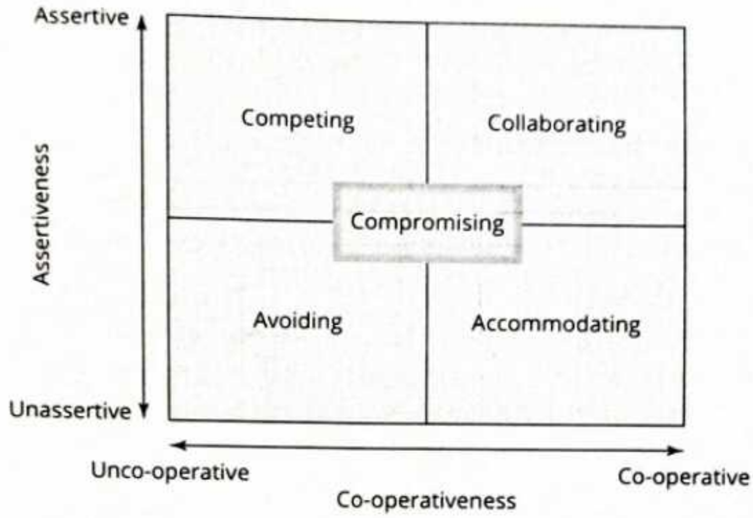

Figure 1.5 Thomas–Kilmann conflict mode instrument (Source: Copyright © 2009–2018 by Kilmann Diagnostics. All rights reserved. Original figure and text is available at: www.kilmanndiagnostics.com/overview-thomas-kilmann-conflict-mode-instrument-tki)

There are two dimensions in the model. The vertical axis, 'Assertiveness', is concerned with conflict responses based on our attempt to get what we want. The horizontal axis, 'Co-operativeness', is concerned with conflict responses based on helping others get what they want. There is also a central area that overlaps both dimensions. Taken together, this model shows five basic options to resolve conflict.[6]

1. Competing – objective to win

The starting point here is to take an assertive approach to resolving the conflict. Competing means pushing your point of view, adopting a defensive stance immediately with no intention of making concessions, and starting off with the attitude that you want to beat the other side (a zero-sum game). From a procurement point of view it might make sense to adopt this approach in situations where you know you are relatively strong. For example, you are spending a significant amount of money, there are plenty of competing suppliers, what is supplied is easy to change (with low switching costs) and not critical for operations, and no long-term relationship with suppliers is required. In these circumstances, pushing hard may well get you a better deal. Even if it does not you have little to lose and may then be able to fall back to a more accommodating style.

2. Accommodating – objective to yield

The starting point here is to take an unassertive and co-operative approach to resolving the conflict. Accommodating means conceding to TOP with little debate or 'fight', not challenging or strongly putting forward your own point of view and generally giving in and yielding to TOP's point of view. From a procurement point of view it might make sense to adopt this approach in situations where you know you are relatively weak, i.e. you are not spending a lot of money, the product or service supplied by this specific supplier is important to you and the price is within your budget. In these circumstances, there would be little point in seeking to push your supplier hard as there would be limited benefit to you and if you pushed too hard the supplier might walk away and you would lose significantly. Adopting an accommodating approach might also be appropriate when dealing with internal stakeholders on issues where you are content to concede for the sake of the relationship. Note we are assuming rationality and logic here. In situations where emotion, symbolic victory or face-saving is important, logic may not win out.

1.1

3. Avoiding – objective to delay

The starting point here is to take an unassertive and unco-operative approach to the conflict and not deal with it, perhaps because you need more time or further information before making a definitive decision. Avoiding means discouraging meeting TOP to discuss issues, sidestepping the issue, postponing an issue until a better time, or simply withdrawing from a threatening situation. From a procurement point of view it might make sense to adopt this approach in situations where you have established you are paying a low price compared to market, e.g., 20% below, and getting excellent service from a specific supplier who wants to meet you to renegotiate the contract. Delaying/avoiding this meeting for as long as possible is in your self-interest here. This is of course quite selfish behaviour and probably only sensible in the short term for cash flow purposes. Avoiding can be a useful strategy if timing is sensitive and you know that your position will be stronger or TOP's will be weaker at another time. It is by definition a short-term strategy, unless you can avoid forever.

4. Compromising – objective to find middle ground

The starting point here is more flexible with both an assertive and a co-operative approach being adopted, but only to some extent. Compromising means accepting that in order to get something from TOP you will have to give something to them and make concessions. Both sides get something but not everything. From a procurement point of view it might make sense to adopt this approach, for example, in the situation described under 'Avoiding' above: when you do eventually meet the supplier who you have accepted is delivering excellent value for money, you may accept that you will have to move and make some concessions on price, perhaps meeting at some middle ground – for example, a 10% price increase. Compromising can be criticised as an approach which accepts both sides will be somewhat dissatisfied, as it is effectively a lose-lose situation. However, it is a valid approach when long-term relationships are at stake and it is important to find some common ground on which to base an agreement.

5. Collaborating – objective to find a win-win solution for both

The starting point here is the exact opposite of 'Avoiding'. It means believing that there is a win-win solution whereby both parties can benefit through, for example, 'expanding the pie' instead of fighting over it. Collaborating requires developed conflict resolution skills based on mutual respect, a willingness to listen to others, and creativity in finding solutions. From a procurement point of view, it might make sense to adopt this approach in situations where you have identified that your supplier has significant potential to help you innovate and launch new products and/or services. You may approach this negotiation with a view that pushing hard on price or other variables is not sensible as there is much more to be gained from making yourself a more attractive customer, so you benefit from your supplier's know-how. Key to achieving a collaborative agreement is that both parties need to understand the other's perspective. Win-win means that both parties walk away having achieved 100% of their goals.

From most theoretical negotiation perspectives (including the CIPS point of view), the 'Collaborating' approach is generally seen as the most effective one to start with in most circumstances, assuming the ongoing relationship is important. For this reason, a large portion of the later sections of this chapter is dedicated to examining this approach in more detail. However, collaboration takes a great deal of time and is not always the right outcome to aim for. For example, it is unlikely to be the best option for routine purchases where the focus is more transactional and where the buyer has more power.

Taking these five conflict management styles and considering there are two parties to a conflict, there are potentially 25 possible combinations of styles that can be brought to any conflict situation. Some of these combinations are more congruent than others.

		Supplier				
		Compete	**Accommodate**	**Avoid**	**Compromise**	**Collaborate**
Buyer	**Compete**	1	2	3	4	5
	Accommodate	6	7	8	9	10
	Avoid	11	12	13	14	15
	Compromise	16	17	18	19	20
	Collaborate	21	22	23	24	25

Table 1.5 Possible combinations of conflict management styles

Apply
Consider the table above and, based on your knowledge of the Thomas–Kilmann model, select five combinations of styles that, if adopted from the outset, are likely to lead to a mutually satisfactory outcome, as well as five that are likely to lead to a mutually dissatisfactory outcome.

There is no 'right' approach to take, and multiple factors and considerations should feed into the decision regarding what approach to conflict management should be initially adopted, and which can perhaps be adopted as the next most preferable. Remember, however, that in negotiation you may not have a choice, as there are two parties to a negotiation, and TOP's approach may determine your response. The Thomas–Kilmann model is very helpful in describing the general approaches that can be adopted when considering the negotiation process, and can also be helpful in describing tactics and behaviours that can be adopted during a negotiation.

Summary

In summary, there are numerous sources of divergent positions and conflict that can arise in procurement and supply. The procurement function's very existence as a separate unit in an organisation is grounded on the notion of separation of duties which itself implies that procurement is expected to at least occasionally challenge both internal and external stakeholders in order to drive value for money. It is hoped that through negotiation, divergent positions can be reconciled, so that a result that is acceptable to all parties can be achieved. The sources of divergence and conflict outlined here will be referred to and revisited in more detail multiple times throughout this study guide.

1.1 LO1

Team management and the influence of stakeholders in negotiations

In the final part of this section, we will introduce and briefly outline the role of team management and the influence of stakeholders in negotiations.

Stakeholder influence

It is reasonable to assume that achieving maximum value for money and the most favourable contract terms are perhaps 'instinctual' objectives for procurement professionals in negotiations. However, it is important to always remember that commercial negotiation objectives should be driven by the business needs of the organisation, and not just the instincts of procurement. Organisations are made up of different stakeholder groups, some of whom may have different, even conflicting, objectives. From a negotiation perspective, stakeholders can be defined as persons or groups that have an interest (or stake) in the outcome of the negotiation you are leading or participating in.

For example, if negotiating terms for an important factory maintenance contract, there may be huge pressure to conclude negotiations as quickly as possible from Operations, while Finance may be focused on keeping within budgets and Legal may be concerned about specific risks they identified in the contract. All of these stakeholder groups' requirements must be taken into account and ideally they will be aligned around a strategy that seeks to achieve all objectives as far as possible. In many cases, this alignment is only achieved after internal negotiations with stakeholders.

Knowing you have the explicit support of your internal stakeholders regarding objectives is therefore a key pre-requisite before entering into any negotiations with suppliers. 'Success' in a commercial negotiation with an external supplier rings very hollow if you have to 'sell' it to your internal stakeholders or persuade them of this success. Furthermore, in negotiations with long-term incumbent suppliers, it may be obvious or discoverable by suppliers that procurement is not aligned with internal stakeholders, and so they may seek to 'divide and rule'.

Stakeholder influence in organisations will vary enormously depending on organisational ownership, structure and governance arrangements. CIPS distinguishes between three sets of stakeholders.

- Internal stakeholders
- Connected stakeholders
- External stakeholders

> *Apply*
> While studying the rest of this section, consider for your own organisation to what extent the listed stakeholder groups exert influence on the following.
>
> - Your procurement organisation, strategy and structure in general
> - Your procurement negotiations in particular

Internal stakeholders

Internal stakeholders is a broad stakeholder category that encompasses all those directly connected with the organisation. Managers and employees are perhaps the most obvious of these. In a nonprofit organisation, any volunteer workers will also be classed as internal stakeholders. The procurement department will have different dealings with different groups, for instance, communicating procurement policy changes to employees across the organisation, or gaining buy-in from management teams. Various key parameters, such as objectives, budget and team management will all be affected by internal stakeholders, as will organisational decision-making.

> *Remember*
> Internal stakeholder support will be important not just at the initial negotiation of the contract, but potentially throughout the life of the contract right through to exit.

> *Apply*
> Assume you have just started work as a CIPS qualified procurement manager in a newly created post in a company with no strategic procurement function. Consider ways you can 'market' the benefits of procurement to internal stakeholders who are used to negotiating their own deals with suppliers.

Connected stakeholders

Connected stakeholders are those who, by contractual or commercial relationships, have a significant stake in organisational activity. As a general rule, connected stakeholders (with the exception of suppliers) have a low level of influence on procurement negotiations.

External stakeholders

External stakeholders are individuals who can influence and be affected by an organisation but who are not themselves directly connected to the organisation. In the modern marketplace it is essential that organisations maintain a positive reputation. One way to achieve this is via an inclusive approach to stakeholder management, one that recognises the wants and needs of secondary, 'indirect' stakeholders in addition to those of internal stakeholders. External stakeholders will have very different objectives and degrees of influence and will be less likely to influence procurement.

> *Apply*
> Identify five negotiation situations where external stakeholder influence can affect commercial negotiations and outcomes with suppliers.

Stakeholder engagement and analysis

The key objective of stakeholder management is to achieve active involvement and commitment of key stakeholders to programmes/projects, and in the context of this module, the negotiation. Significant commercial negotiations can be viewed as mini projects in their own right, and are frequently managed as such, but the scope of this syllabus does not include project management. However, stakeholder management, a key element of project management, is critical to the success of most significant commercial negotiations. By engaging the right people in the right way, you can make a big difference to the definition of success and its achievement. For major negotiations, developing a thorough understanding of the stakeholders is therefore an essential step in your preparation for a negotiation. You will need to identify the best way of carrying out this analysis. It may be via a workshop with key business leads, or by engaging with them on a one-to-one basis.

Steps in stakeholder management and engagement

1. Identify key stakeholders – think of all the people who are affected by the negotiation, who have influence or power over it, or have an interest in its successful outcome.
2. Identify stakeholders' needs and expectations – build a deeper understanding of your stakeholders by anticipating their needs and expectations. Think about how they are likely to feel and react to the negotiation, then decide how the negotiation team members need to engage and communicate with each stakeholder based on what you identify.
3. Identify stakeholder level of influence and interest and plot them on a stakeholder map that groups them into four categories, as set out in the diagram below.

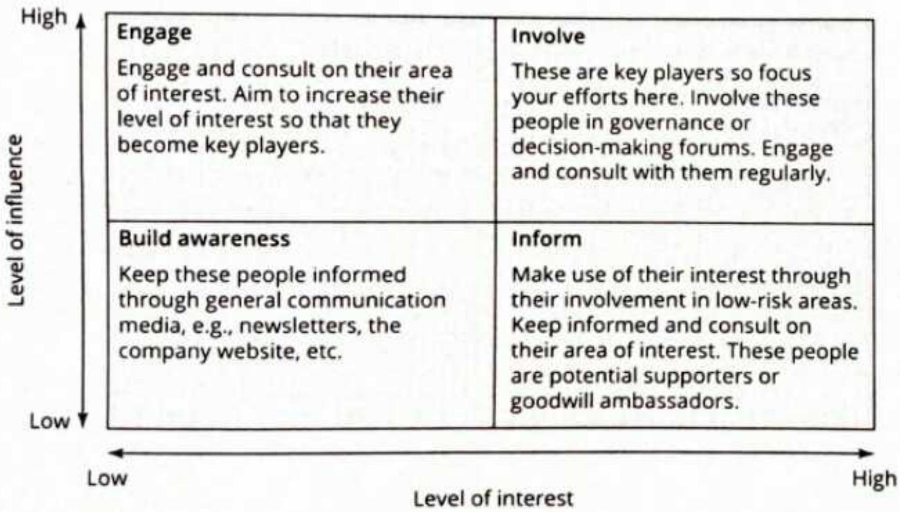

Figure 1.6 Stakeholder map

4. Identify stakeholders' current level of commitment and required level of commitment for project success. This will require judgment and consultation. Focus in particular on those in the 'Engage' box who are very important to getting a successful outcome but are currently not very interested.
5. Identify a relationship owner for each stakeholder – these are individuals from the negotiation or project team who take responsibility for engaging with stakeholders on a regular basis.
6. Decide how to engage and communicate – think about which channels are most appropriate. Consider one-to-ones, team meetings, forums and written communications. Also think about how frequently the relationship owner needs to engage with each stakeholder.
7. Record actions and provide status updates – set up a regular meeting/call for relationship owners within the negotiation team to report back on progress. The relationship owners are responsible for driving relationships and

providing regular updates to the communications or change lead, who adds this information into the stakeholder plan. Be specific and give details. Agree what actions need to be taken ahead of the next meeting.

Stakeholder support

In order to estimate the gap and the progress towards desired levels of support, a stakeholder support scale can be used by the procurement team internally. The support level scale measures stakeholder commitment. Current support levels for the procurement/negotiation objectives should be gained from engagement with key stakeholders. For example, in the example scale below, current support is shown as level 2, whereas we may need to move this to a level 4.

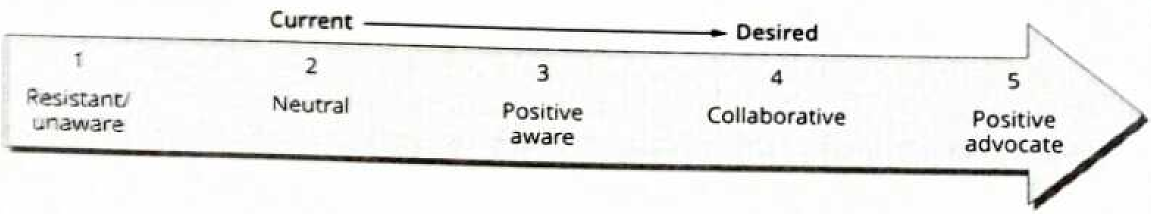

Figure 1.7 Stakeholder support level scale

The procurement/negotiation team may need to engage with management and stakeholders and address concerns so that the required level of commitment is achieved.

This is achieved through the execution of appropriate stakeholder engagement plans, which can require various communication and persuasion techniques and indeed negotiation skills to be employed. Many experienced procurement and supply professionals will attest that the most difficult negotiations they have are with colleagues in other internal functions such as Finance, Operations, Sales, and Legal and Risk.

Procurement managers and teams need support from internal key stakeholders when negotiating on their behalf. In some circumstances it may be necessary to develop a stakeholder engagement plan that targets the most important stakeholders to win over, so they move from being less supportive to being more supportive. Negotiation and other persuasion techniques that can assist in this objective will be addressed later.

> *Apply*
> Consider the distinct challenges that negotiations between procurement and other internal functions may present that are not encountered in negotiations with external suppliers. How might you deal with these?

The consideration of detailed stakeholder engagement plans is beyond the scope of this syllabus, but the negotiation skills and knowledge you will learn here should serve you well.

Team management

Earlier parts of section 1.1 highlighted that commercial negotiation activity can take place with suppliers and contractors on an ongoing basis during day-to-day dealings in the procurement and supply cycle, and contract management cycle. It is accepted that procurement professionals may routinely negotiate every day over the phone, online and in person with a wide range of stakeholders, without being part of a team. For more significant commercial negotiations, it is more likely that a team and not just one individual will be involved.

There are a number of benefits in adopting a team approach when negotiating with suppliers. Working as part of a team provides the following advantages.

- You are less likely to be intimidated.
- You are less likely to make unplanned concessions – team mates will stop you.
- Individual team members can focus on specific areas, e.g., commercial, technical, observing the other party.
- You can stage-manage your team and use certain tactical ploys.
- The risk of procurement fraud and sharp practice is reduced, and ethical behaviour is increased as there are more witnesses.
- Junior or new staff can learn a lot from observing/acting in a note-taking position.

The size, composition and roles of the team will vary depending on the risk and spend profile of the procurement/contract to be negotiated and, of course, the availability of key staff members to form the team. Different terms are applied by different writers to the various roles that make up a full negotiation team, but most agree broadly on the common roles outlined in figure 1.8.

> *Apply*
> Contrast your own experience in a negotiation situation (not necessarily commercial) where you were on your own, with one where you were part of a team. Note how you behaved or felt differently.

Negotiating team roles

Team roles	Responsibilities
Team leader	• Negotiation decision maker • Responsible for outcomes
Chief negotiator	• Spokesperson; leads negotiation meetings • Agrees changes to negotiation plan with the leader
Commercial lead	• Provision of commercial/financial subject matter expertise relevant to the negotiations • Feeds insight and suggestions through to leader
Technical lead	• Provision of specialist technical subject matter expertise • Feeds insight and suggestions through to leader
Observer	• Observes TOP • Checks body language, reactions and feeds insight to the leaders
Scribe	• Records important comments and information from the meetings for minutes and analysis

Figure 1.8 Team roles and responsibilities

Clearly, in many or most situations, it may be impractical to have six team members in attendance. However, even when there are just two of you, it is essential that you agree in advance your roles, your scripts (what you will and will not say) and your approach to the negotiation agenda. You should of course never disagree with your colleague(s) in front of TOP unless this is part of a tactical ploy, e.g., 'good cop, bad cop' (discussed in section 3.2).

It is essential that the negotiation team understand and accept their roles, and do not go beyond their agreed scripts or speak out of turn, unless explicitly invited to by the team leader. The appearance of a disciplined team with clearly defined roles, led by a competent team leader, sends a strong message to TOP that you take the negotiation meeting seriously and are ready for business.

Good negotiators – born or made?

> *Some people appear to be 'natural' negotiators: credited with charm, persuasiveness, 'winning ways', 'a born salesman', they win every point – indeed, the deal seems to be half over before they enter the room. Other people, on paper equally knowledgeable and qualified, seem to lack this special something – they appear, particularly to themselves, to be forever on the defensive, always backing down, never quite in control of the way things are going, a liability, easy meat for the 'born' salesperson or 'natural' negotiator. But with rare exceptions, natural-born talent has very little to do with successful negotiation. The top salespeople, the winning negotiators, the dominant diplomats, are trained, and train themselves, to succeed. They see negotiation as a process which can be analysed, practised, rehearsed and refined; they prepare beforehand and debrief themselves afterwards; they note what tactics and approaches work for them in particular circumstances, and with specific 'opponents'. They understand the rules and can rapidly tell whether the other party knows the process or not.*[7]

Paul Steele, a well-established expert and author on commercial negotiations, makes the point here that negotiation skills can be acquired and that negotiators are not born, but made. Training courses and study guides such as this one should provide you with the essential rules, established principles and proven techniques of the negotiation process, and equip you even for situations when the other party (TOP) does not accept any of this. The choice of which rules, principles or techniques you choose to accept and adopt will vary by situation, but there is no excuse for not knowing the rules – others in the organisation will expect you to be a subject matter expert.

Notwithstanding this, in reality it is likely that in any group or team there will be those that demonstrate stronger face-to-face negotiation skills than others, and it may therefore be sensible to place these individuals in lead roles. Only through experience will one be in a position to evaluate the relative negotiation strengths and weaknesses of an individual in a team and their preferred styles.

Negotiation team management is a critical success factor in the achievement of commercial negotiation objectives. It is covered in greater detail in a number of later sections of this study guide and we only intended to offer a brief overview here.

We will revisit team management in the following sections.

- Team approaches and styles: section 1.2
- Team selection: section 2.4

1.2 Differentiate between the types of approaches that can be pursued in commercial negotiations

At the end of this section you will understand the following.

- Collaborative win-win integrative approaches to negotiation
- Competitive win-lose approaches to negotiation
- Pragmatic and principled styles of negotiation
- Setting targets and creating a best alternative to a negotiated agreement (BATNA)

Collaborative win-win approaches to negotiation

We introduced the Thomas–Kilmann model of conflict resolution earlier, where one of the five approaches was collaboration. Collaborative approaches to managing conflict can be understood as those that aim to leave all parties satisfied at the end: both parties feel they have won at least something. The term 'win-win' is the more popular description for this collaborative or **integrative** approach to negotiation. Similarly, the 'win-lose' approach is the popular description for the **distributive** approach to negotiation. The figure below illustrates the key difference between the two approaches in a simple graphic.

A | Z

Integrative
Approach to negotiation used when the interested parties are attempting to create more of something of value to share, also known as collaborative approach or 'win-win'

Distributive
Approach to negotiation used when the interested parties are attempting to divide something up or distribute something of value, also known as zero-sum approach or 'win-lose'

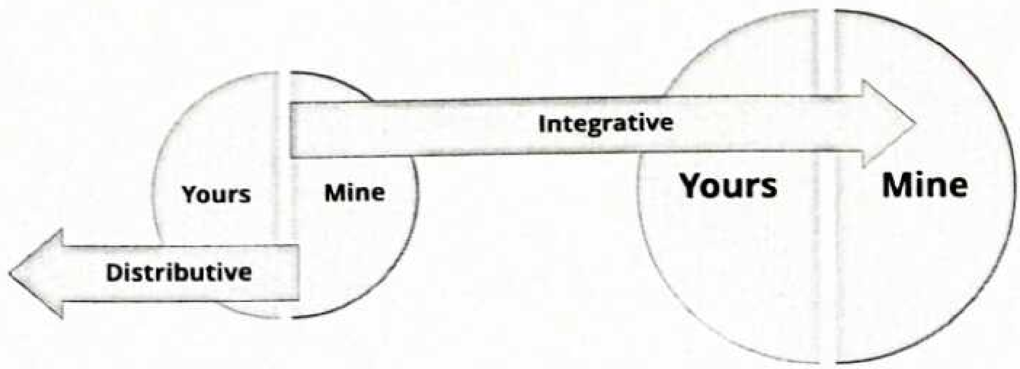

Figure 1.9 A comparison of integrative and distributive bargaining

Simply stated, the distributive approach assumes a fixed 'cake' or 'pie' that must be distributed among the parties so that if one party gains the other party loses, whereas the integrative approach assumes the pie can be expanded so both parties can benefit.

The integrative win-win approach to negotiation or bargaining is generally assumed to be the best approach to achieving your objectives, at least as a starting point. Almost every textbook, training course and university module on negotiation will make the argument that this is the most logical and rational approach to adopt at least as a starting posture. It has essentially, in mature economies, become the professional or orthodox approach to negotiations whether in the commercial, social or political domain. However, win-lose or distributive approaches to negotiation are still favoured by some, and some commentators believe that recent political events demonstrate the continued relevance of these approaches in contemporary negotiations. Both approaches will be considered in this section, but it is interesting to note there is considerably less written about the distributive approach and far less reference material for you to read than there is for the integrative approach.

Win-win as common sense?

CIPS believes that procurement and supply management professionals should aim for a mutually acceptable solution for both parties, where appropriate.[8] The balance of power in negotiations is always very important as it is rarely equal between the parties. Each party should be aware of their own bargaining position and what they want to achieve in the negotiation. From a CIPS perspective, short-term wins are often gained at the expense of the relationship and so must be used with care if the relationship is business-critical or there are longer-term considerations.

It is generally accepted that in business, and perhaps in all dealings with others, a 'good deal' is one where both parties feel good about the outcome. Feeling good about the outcome does not mean both parties achieved all they were after or that they shared the benefits 50:50; it simply means that both parties go away feeling they gained something from the negotiation. Neither party feels the need to challenge or perhaps later question the outcome or revisit or reopen negotiations. The resulting contract is more likely to be formed in an atmosphere of mutual trust and common interest where neither party feels a need to 'get even' or find a way to claw back the perceived loss.

A contrast with this is a situation where a buyer, through the exercise of purchasing power and threat to switch their supplier, drives prices down from a supplier to a level where their profits on the sales are now marginal. The supplier may agree reluctantly to this price reduction, but how will they feel towards this buyer? They may well look forward to the day that the same buyer really needs their assistance and then the supplier will extract the highest price they can ('getting even'). How can the buyer complain? The supplier is merely mirroring the approach taken by the buyer previously. In this situation, commercial goodwill may have been lost, and other buyers may become more attractive to the supplier. The supplier may even seek out new more profitable customers with a view to dropping the buyer.

If the situation described above was once-off, or no long-term relationship is envisaged, e.g., major corporate property deals, then perhaps win-lose can make sense to the stronger side. But the old adage 'once bitten, twice shy' holds some basic truths here that are hard to deny. A supplier who feels they got a bad deal following a win-lose negotiation with a buyer is unlikely to allow that to happen repeatedly. The next time, they will likely take steps to mitigate their perceived loss, even if they are not obvious – e.g., building in 'fat' or excessive margin to the initial price in future dealings. This will neutralise any perceived benefit TOP gets from adopting a win-lose approach and forcing down price next time.

Therefore it can be argued that integrative solutions are generally more satisfying for both sides in a negotiation, as the true needs and concerns of both sides will be met to some degree. As it is a collaborative process, the parties can only succeed by assisting each other. This hugely reduces the risk and hidden cost of ongoing ill will after the negotiation ends, and probably makes the negotiators' lives less stressful. Integrative, interest-based negotiation therefore can facilitate constructive, positive relationships and establish contracts between parties on a foundation of goodwill. It is important to note it can only facilitate these positive outcomes, it does not guarantee that TOP will not seek to be opportunistic at a later time during the life of the contract. Previous knowledge of the behaviour of TOP regarding honouring contractual and other commitments will be useful here in predicting longer-term outcomes.

As CIPS learners, and as professional buyers, it is reasonable to assume that many of your commercial negotiations will not be once-off deals with suppliers you will never meet again, but will be for contracts required over longer periods with suppliers with whom you may need to develop longer-term relationships. Furthermore, we made the point earlier that negotiation may take place at multiple stages within the contract life cycle. It should come as no surprise then that the emphasis in this study guide and indeed most other authoritative texts is on an integrative or win-win approach to negotiation, where both parties seek to expand the pie, creating value, as opposed to claiming value – at least as a starting point until TOP adopts a win-lose approach.

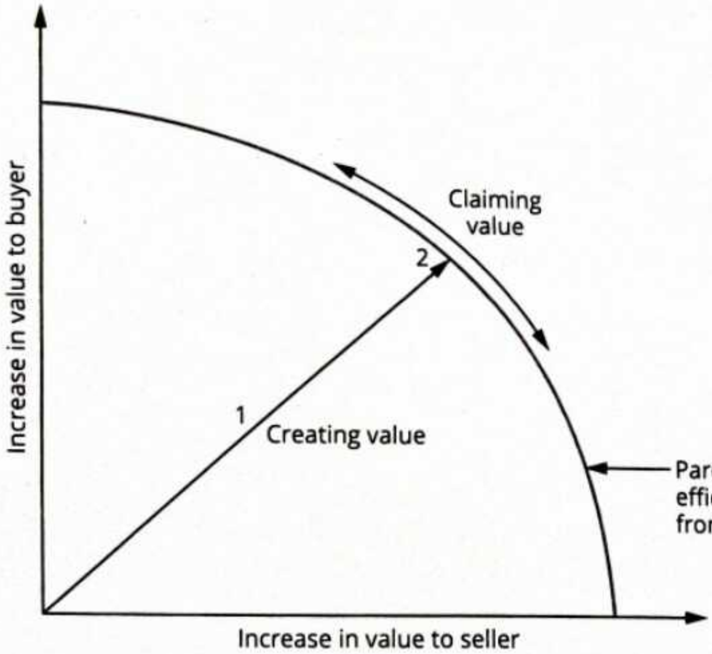

Figure 1.10 Creating versus claiming value (Source: adapted from Jeffrey Carter, www.pointsandfigures.com/2013/02/11/microeconomics-monday-efficiency-vs-equity)

Figure 1.10 above illustrates in a simple way the difference between creating and claiming value. In integrative bargaining, both parties seek to 'expand the pie' by pushing the value curve outwards (point 1–point 2) thus creating more value for both the buyer and the seller. 'Claiming value' (moving along the arc) is then less contentious and subject to conflict even if the value split is not 50:50, as both parties still come away with more than they would have got before the negotiation. In distributive bargaining there is no possibility, or the parties believe that there are no further possibilities, to expand the pie, so the focus is on claiming value and getting as much of the 'pie' as you can.

Distributive win-lose approaches to negotiation

In distributive bargaining (win-lose), you are negotiating for what is believed by the parties to be fixed resources: one fixed-size 'pie'. Distributive bargaining is therefore the approach to bargaining or negotiation that is typically used when the parties are trying to divide something that is of a fixed quantity. It tends to define the parties as adversaries. Distributive bargaining is associated with claiming value (as opposed to growing value), and is also known as 'zero-sum' or 'win-lose' bargaining. The parties assume that in order for one party to gain something, the other party must give something up. One or both parties believe that the 'pie' is fixed, so the more one side gets, the less the other side gets. Distributive bargaining tactics rarely assume the pie will be divided in half.

In distributive bargaining, your goal is to negotiate in such a way that when you reach an agreement, you have given up less than the other party. Your goal is to win as much as you can during the negotiation and, typically, that means that the other party has to give something up.[9] Integrative bargaining is also about maximising your gain, but both sides believe that the easiest and best way of doing this is through seeking win-win solutions where both sides benefit.

Many of the tactics and approaches we will discuss regarding integrative bargaining also apply to distributive bargaining, and it should not be assumed that win-win can be applied to all commercial negotiations, or that win-lose approaches are inherently inferior. Commercial situations often demand a distributive bargaining approach, if the 'pie' is inherently of a fixed size. In this case, any conflicts must be resolved by sharing it. This does not mean the parties will have to come to blows or that negotiations will necessarily be more difficult. It just means that adopting a distributive approach is actually the most honest approach, i.e. a reflection of reality, and that win-win approaches may be pointless or just 'window dressing'. Even Fisher and Ury concede that when a 'negotiator wants to maximize the value obtained in a single deal and when the relationship with the other party is not important, distributive bargaining tactics may be very useful'.[10]

Case study »

Using the distributive bargaining/win-lose approach

Examples of situations where a distributive bargaining/win-lose approach is commonly used include the following.

Property and land deals

In many once-off deals between suppliers and buyers such as land and buildings, in order to secure the asset, you will need to bid against other buyers: the more you pay, the higher the profit of the seller and vice versa.

Purchasing situations where price is the only variable

When negotiating for commodity-type products and services, where there are multiple competing suppliers, there may be no strategic benefit in an ongoing relationship.

Trade unions pay negotiations

With demands by trade unions/employees for higher pay from employers, employers may seek to link pay increases to productivity improvements (win-win). However, this may not be accepted, and so increasing pay may mean lower profits.

Government budget distribution

When the government is distributing a fixed amount of funds from the budget to different departments, e.g., Health, Housing, Defence or Transport Infrastructure, department representatives must make a case for more funding for their area knowing that if they get more, others must get less.

Distributive bargaining and integrative bargaining may both play a role in the same negotiation. While integrative bargaining allows negotiators to 'expand the pie' to its optimum size, the expanded 'pie' must still be distributed between the parties. This distributive negotiation may or may not be straightforward. The deciding factor is whether the available resources are now enough to give both parties what they want.

Case study

There are very few textbooks or Internet references on distributive bargaining/win-lose as a preferred general approach to commercial negotiation. One reason for this is that it is relatively simplistic in its approach and its measures of success: one party achieves what it wants, typically measured in immediate gain as per the negotiated agreement. It therefore does not require one to think too much about TOP's positions, objectives and interests. If the belief is that the 'pie' cannot be expanded then why spend time on creative solutions to benefit both sides?

By definition, there also tend to be fewer negotiation variables in distributive bargaining situations, with the price typically seen as key in a commercial setting, so again developing trading positions on multiple variables is not necessary – a key requirement when you are seeking to achieve a win-win outcome.

Another reason may be that if you are not in position of clear relative strength, then adopting a win-lose approach rarely makes commercial sense. If you do, TOP will likely reject your approach, walk away, or play along and indulge you so that you think you are winning, when in actual fact TOP is benefiting more.

As was pointed out in section 1.1, negotiation is not always an option. In situations where it is argued that suppliers hold the upper hand and are secure – e.g., global enterprise software providers such as Microsoft, SAP and Oracle – the need to make concessions and adopt a win-win approach may not be seen by suppliers as necessary: 'take it (the offer) or leave it'.

Search for 'distributive bargaining' online and note how most references tend to contrast it unfavourably with integrative bargaining. Is this justified?

Donald Trump, President of the USA and co-author of *The Art of the Deal* (1987), perhaps best epitomises the win-lose approach to negotiation both in his business career as a property developer and more recently as the US president. In the book, he sets out an 11-step formula for business success.

The 11-step formula proposed in *The Art of the Deal* by Donald Trump and Tony Schwartz is as follows.

1. Think big
2. Protect the downside and the upside will take care of itself
3. Maximize your options
4. Know your market
5. Use your leverage
6. Enhance your location
7. Get the word out
8. Fight back
9. Deliver the goods
10. Contain the costs
11. Have fun

These steps are meant to apply in general to business deals and not to negotiation in particular; nevertheless, a number of interesting observations can be made that align with the win-lose approach.

- There are many words associated with using 'hard' power and a competitive approach to conflict resolution: 'big', 'maximize', 'leverage', 'enhance', 'fight', 'contain'. None of the words can be associated with the use of 'soft' power or a collaborative/accommodating approach to conflict resolution.
- There are many references to 'your' position and interests, but none referring to TOP's position or interests, apart from the generic 'know your market'.
- There are no references to preparation, objective setting, measures, review or learning from mistakes – perhaps it is not perceived as being required if you are always negotiating from a position of strength?
- The last point, 'have fun', suggests that making deals is a game and can be entertaining – a perception rarely shared by most commercial organisations or busy buyers with limited market power.

A collaborative or integrative negotiation approach is one that takes into account the other party's wants, needs, concerns and fears. The focus is on finding a solution; both parties accept that they will have to give something up in order to reach agreement.

1.2 LO1

The collaborative or integrative approach does not require a 50:50 win-win or equal gain for each party to the negotiation. One party may successfully negotiate a far higher than 50% slice of the metaphorical pie, but if TOP stands to gain more than they expected, they may still accept the unequal division. As a general rule, Integrative bargaining tends to be more co-operative while distributive bargaining is typically more competitive.

These two negotiation approaches are considered to be incompatible. As mentioned previously, the integrative approach can be considered to be superior. Advocates argue that the 'pie' can almost always be expanded, or a way can be found to achieve a gain for each party through co-operation and a focus on interests rather than positions. The counter argument is that such an approach is naive and unrealistic, real-world negotiation often entailing competitive and hard bargaining as a matter of economic necessity.

Characteristics	Distributive view	Integrative view
Goal	Get as much of the pie as you can	Expand the pie so both parties can get more
Guiding principle	Win-lose	Win-win
Negotiation focus	Positions – keep interests confidential as may expose weakness	Interests – move away from positions ASAP to create movement
Information sharing	Low, 'need to know' only	High if helpful to TOP and not damaging to your interests
Dealing with issues	One at a time, 'thank and bank'	Discussion of several issues at a time; 'get all the issues on the table'
Solution sought	Conformance based; binary yes/no; 'you're either with us or against us'	Performance-based; creative solution that satisfies most of both sides' interests
Relationship with TOP	Short-term/once-off	Long term/regular engagement

Table 1.6 Distributive versus integrative bargaining

Pragmatic and principled styles of negotiation

The principled style of negotiation is essentially the codification and application of the win-win approach. The method of principled negotiation – where agreement can be reached without damaging relationships was first developed at the Harvard Program on Negotiation. The method was set out in the famous book, *Getting to Yes: negotiating an agreement without giving in* by Roger Fisher and William L. Ury, which was first published in 1981, and achieved bestseller status throughout the world.

Principled negotiation is an approach to negotiation that focuses mainly on the collaborative approach to conflict management and dispute resolution. Principled negotiation proposes using an integrative approach to finding a mutually agreed shared outcome. According to Fisher and Ury, 'a good agreement is one which is wise and efficient, and which improves relationships. Wise agreements satisfy both parties' interests and are fair and lasting'.[11]

There are some criticisms of the principled approach to negotiation, largely around it being based on the assumption that all parties are reasonable, open to a logical approach, want to reach an agreement and are focused on achieving the best outcome over the longer term. Clearly, experience tells us that it would be wrong to assume all commercial negotiations can take these assumptions for granted. However, it is still fair to say that the principled approach set out by Fisher and Ury has stood the test of time and is essential learning for all those involved in commercial negotiations. Even if one does not accept all the principles set out, the approach provides a ready-made pragmatic framework upon which any negotiation can be planned.

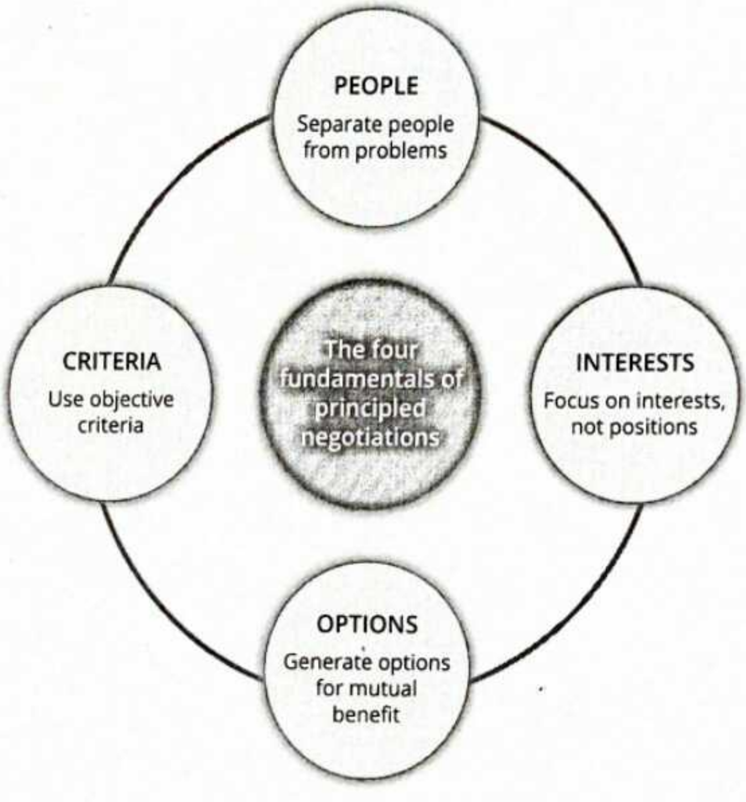

Figure 1.11 The four fundamentals of principled negotiations (Source: adapted from Getting to Yes by Fisher and Ury)

Principled negotiation is based on four fundamentals: people, interests, options and criteria.

1st principle: separate the people from the problem or issue

The first principle of Getting to Yes – 'separate the people from the problem' – concerns the way in which people interact within a negotiation.[12] People, particularly untrained negotiators, tend to become personally involved with the issues and the respective positions they are either expected to take or have taken. They may feel resistance to their position as a personal attack. They frequently

1.2 LO1

use a 'positional bargaining' process, in which each party uses their own opening position as a starting point and negotiates towards the other party's position. This encourages a win-lose approach: for example, the parties may begin with widely differing starting positions when haggling over a price, and any concession that brings the price closer to one party's target figure will take it further from the other party's. Fisher and Ury argue that positional bargaining is a wasteful approach, because it is an inefficient way of reaching an agreement, encourages stubbornness, and tends to lead to an outcome that satisfies one party's interests at the expense of the other party.

Professional negotiators in a commercial context understand that they are – for the most part – not negotiating for themselves but for their employer. They can disagree forcefully on the issues, but this does not mean they need to trade insults, become abusive or fall out. Depersonalising the situation and accepting that the subject matter of the negotiation and not the people should be the focus can be difficult for untrained negotiators, but this is a key skill to develop.

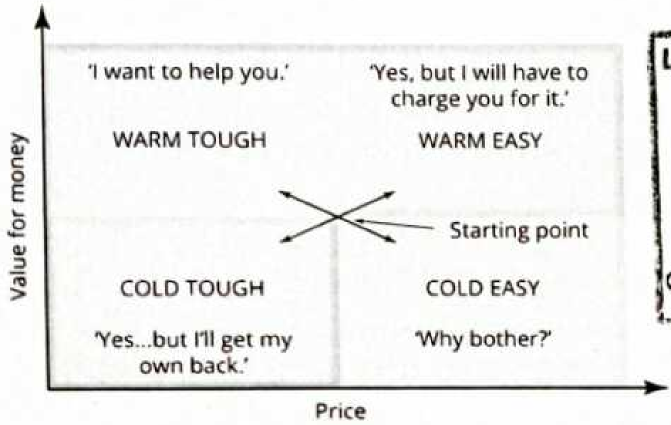

Figure 1.12 The price plateau (Source: Adapted from: Richard Russill, Purchasing Power: Your Suppliers, Your Profit)

The diagram above illustrates the principle of separating the people from the issues very well. 'Warm' and 'cold' refer to how you personally engage with TOP. 'Warm' means showing courtesy, respect, listening and empathy, while 'cold' means the opposite. 'Tough' and 'easy' refer to your focus on the problem or issues: 'tough' means focused, rigorous, analytical, logical and not distracted from achieving your interest, while 'easy' is the opposite.

If you start at the starting point (any given price and any given value for money/ service level), then from a buying perspective you will want to 'move' towards the top left – more value for money at a lower price. The principled approach suggests that separating the people from the issues and being warm with the person but tough on the issue is the best way to achieve this objective: 'I want to help you (help me)'. The likely results of the other three combinations of approaches are summarised in the quotes.

Clearly, there are situations where if you know the other party personally, separating the people from the issues is more difficult and may in effect be impossible. Indeed, this is one reason for the existence of a separate procurement function with rules and ethical codes particularly around declaring any conflicts, as it may be impossible or very difficult to be tough in negotiations with those we know personally. Developing close, trusting relationships may be essential for the business and those who need to work daily with the supplier on a project, but having some distance can help when it comes to the commercial negotiation elements.

The principled approach acknowledges that negotiators are people, who have different values, backgrounds and moods. This human aspect can be either helpful or unhelpful, so as a starting point, separating the people from the issues is desirable. The interrelationship between the parties can become difficult to separate from the problem that the parties are discussing.

Negotiating is a form of communication, and Fisher and Ury point out three common problems that can occur.

1. Trying to impress one's own team instead of clearly stating one's position to the other party and working towards an agreement
2. Not actively listening in order to understand the other party and find common ground, but listening for contentious points to contradict
3. Misunderstanding what the other party says, and/or rephrasing or summarising inaccurately

Here are some suggested ways to overcome these common problems.

- Empathise with TOP, imagine yourself in their position and try to see it from their perspective.
- Try not project your fear of things going wrong onto the other party before anything has actually happened.
- Try not to direct blame onto people (by using 'you'). Focus instead on the problem (talk about 'it'). Similarly, talk about the impact that a situation had on you (the outcome) rather than blaming or attacking the other person (the catalyst).
- Create a culture of openness where the other party can express themselves, but try to ensure your reaction to any emotional outpourings by TOP is reasoned and calm.
- Use apologies or expressions of understanding to calm down tense situations.
- Make it clear that you are listening carefully to the other party by repeating back key information to them.

2nd principle: focus on interests, not positions

The second principle – 'focus on interests, not positions' – concerns the distinction between the positions the parties hold and the underlying interests behind their positions. Positions are 'public' things that people in negotiations say they want and may involve demands, minimum requirements, policy red lines, quantitative targets or other specific stated aims. Although they are put forward as fixed or definite positions, for example, 'we must increase our price by 10% to cover our costs', they tend to be more flexible in reality than the underlying interests, e.g., the need to increase profit.

Interests are the underlying needs that people have that drive their positions and they tend to be more enduring, overarching and, ultimately, more useful to uncover and focus on. It is essential to uncover TOP's underlying interests in order to understand why they are taking a particular position on, for example, price, delivery or a particular contract term. Framing a problem in terms of the parties' interests rather than their positions often makes a solution possible that satisfies the interests of both parties. All negotiators in a commercial context will share certain basic interests or needs, such as the need for a fair price, minimisation of contract risk and preservation of the company's reputation.

Positions are easily visible. Interests, while more difficult to detect, may be a much more significant part of what motivates a negotiator.

Imagine a supplier enters a negotiation with the newly recruited category manager of a regular client. As an established supplier, he is taken aback by the category manager's insistence that he reduce the price of his company's service. A trained negotiator will ask questions or try by other means to deduce her real interests. As a new category manager, perhaps her underlying interest is not to reduce fees, but to look good to her boss in her new position. She may assume – perhaps wrongly – that coming back to her internal stakeholder with a lower fee rate card from the supplier will impress them. If this is her real interest, then she may respond well to a creative response from the supplier, such as non-price factors she could present to her boss as successful negotiation outcomes. The supplier could also remind her of the quality and value currently provided and how important the service is to the internal stakeholder.

1.2 LO1

It is important in principled negotiations not to focus on their parties' positions, but on the interests behind them. Each party must articulate their own interests and also empathise with the other party in order to understand the reasons for their behaviour and understand the other side of the argument. Asking targeted questions (assuming TOP will answer honestly) uncovers their interests and needs. Here are some suggested steps.

- Find out more about the party's position and why they hold that position.
- Clearly express your own interests and discuss these together.
- Focus on solutions rather than dwelling on the past.
- Focus clearly on your interests, but remain open to different proposals and positions.[13]

> A hunter took careful aim at a huge bear.
>
> About to pull the trigger, he heard the soothing voice of his prey:
>
> 'Isn't it better to talk than to shoot? What do you want? Let's negotiate.'
>
> Cradling his weapon, the hunter said: 'I want fur.'
>
> 'Good,' said the bear. 'That's negotiable. I only want a full stomach. Let's compromise.'
>
> So the two sat down and negotiated. After a time, the bear walked away alone. He had his full stomach, and the hunter had his fur coat.

Figure 1.13 Warning: some underlying interests are incompatible (Source: Joey Adams, Reader's Digest, February 1984)

Conflicting positions can be reconciled through principled negotiation where the focus is on uncovering TOP's interests through questioning and then working to meet those interests through bargaining and trading concessions. Conflicting interests are more difficult to reconcile and in some cases, such as the one illustrated in the fable above, they may be impossible to reconcile. There is no compromise or common ground between a hungry bear and a hunter seeking a bear skin trophy. Satisfying both parties is simply not possible, assuming both want to live. Skilled negotiators spend time and effort working out what TOP's real interests are and are less interested in the positions they take.

If the buyer, following pre-negotiation research, concludes that there are no common interests with TOP and/or that the identified interests are not compatible or reconcilable, then this suggests that at best, negotiating with TOP will be a waste of time, and at worst, negotiating may lead to a worse outcome. In some disputes between buyers and suppliers where there is no common interest, litigation or going to court to resolve the dispute may be the only way, as there may be insufficient common ground. Both parties believe they are right and only a third party, in this case a court or judge, can decide.

Tradeables
A negotiation variable such as price or contract length that can be traded with TOP in a negotiation

3rd principle: invent options for mutual gain

The third principle – 'invent options for mutual gain' – is about thinking creatively regarding the benefits both parties get from doing business. This principle aims to help the parties find a solution that both would benefit from. The more options – or **tradeables** – that can be brought to the table the better. If the parties cannot agree on one item then it can be 'parked' while the parties move on to item 2 and so on. By the time they come back to item 1 the issue may have gone away or TOP got what they wanted, so item 1 is not a 'showstopper' anymore. Listening carefully to TOP and asking targeted open questions can provide indications as to the value TOP may put on an item. Consider the scenario outlined under the '2nd principle' heading above, in which a supplier meets a new category manager for the first time, who tries to drive down prices. If the supplier deduced that the category manager wanted to impress her new boss, one option would be to offer an immediate fee discount in return for more favourable payment terms, such as 14 days instead of 45 days. This is unlikely to be noticed by the boss/business, but the fee discount would be a possible win-win. Inventing options for mutual gain requires creativity, research before the negotiation, and also the adoption of a problem-solving attitude in the meeting itself. Some examples of obstacles to creative problem-solving options, and ways to overcome them, are given in the table below.

Obstacles to identifying options for problem solving	Approaches to overcoming the obstacles
Problem definition in win-lose terms	Identify any mutual gains. With these in mind, make offers that will appeal to the other party and its stakeholders. This is important because the other party will need to justify the eventual decision to its stakeholders.
Limited options for negotiation	Invest time in brainstorming creative options. Workshops with existing suppliers may be useful for this.
Too great a focus on narrowing options at the expense of identifying an answer	Instead of looking for just one solution, broaden the range of possible options.
Premature decision on an option and failure to consider alternatives	Do not make any immediate decisions to rule any one option in or out: the process for devising ideas/options should be kept separate from the selection process. Ideas/options should be evaluated and a selection made only after a number of different options have been generated.
Collective assumption that the other party is responsible for generating the solution	Invest time in creating ways to facilitate easy decision-making. Having ready-made packages of options for discussion may be useful.

Table 1.7 Obstacles in negotiation and ways to overcome them (Source: adapted from Fisher, R. and Ury, W.L. (1981), Getting to Yes: Negotiating an agreement without giving in, London: Penguin)

Developing creativity around options and the packaging and repackaging of options is a valuable skill for negotiators. Clever negotiators are always looking for something that is easy or cheap for them to trade, but is very valuable to TOP and vice versa.

4th principle: insist on using objective criteria

The fourth principle – 'insist on using objective criteria' – is about making sure that the negotiation stays focused on outcomes based on objective criteria and that it is productive. When interests are opposed, the parties should seek to use objective criteria to resolve their differences. What success looks like needs to be defined and ideally agreed in advance of the negotiation by both parties – not the actual terms of that success, but the core objective, e.g., a contract for supply, or an agreement on how a key supplier can support the buyer in their expansion into a new market. The parties are making deals based on objective and practical criteria and there are no serious misunderstandings regarding definitions or what each party is committed to do.

In order to seek to negotiate a solution based on objective criteria, independent of the will of either side, parties must first develop objective criteria that both parties agree to. Criteria should be both legitimate and practical, such as comparison to external index price, industry-quality standard, scientific findings or professional standards. To test for objectivity, both sides need to commit to be bound by those standards.

Setting targets and creating a best alternative to a negotiated agreement (BATNA)

In the introduction to this study guide, we pointed out that negotiation is not free and can mean an investment of time and energy without any guarantee of success. It is true that in many commercial circumstances, we only negotiate when the alternative to negotiation – that is, no agreement – is worse. In short, we do not negotiate for the sake of it.

Having clarity about your targets is therefore essential. In commercial negotiations, these targets can take many forms, and will normally include price and other cost factors that make up the total cost of supply. In this section, we will consider how targets are set and what the subject matter of these targets can be. What will also be considered is what you can do if you do not achieve your targets and conclude you must walk away from the negotiation. You therefore need to understand your **BATNA**: your best alternative to a negotiated agreement. This is your 'plan B' or contingency plan if agreement cannot be reached.

A Z

Best alternative to a negotiated agreement (BATNA)
The fallback or backstop position if the negotiation fails to result in an agreement/no deal is agreed

Walk-away point
A position from which you cannot concede any more ground and must 'walk away'/ decline a deal

The zone of potential agreement – ZOPA

If any given negotiation is to succeed there must be, by definition, the potential for agreement. Entering into a negotiation where there is no potential for success is a waste of time, unless you have other objectives. In commercial negotiations, if the absolute highest price you can pay is $1000 per unit and the lowest price the supplier can offer is $1200 per unit, then assuming there are no other variables and you both stick to your bottom lines, there cannot be an agreement. Both parties could spend a lot of time establishing each other's **walk-away point**, only to realise that had they known this at the outset both parties could have saved themselves the time and energy seeking a negotiated agreement where one was not possible.

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Establishing if there is a zone of potential agreement is therefore essential when setting your targets and establishing your walk-away point - the point beyond which you cannot go in regards to price or other commercial terms.

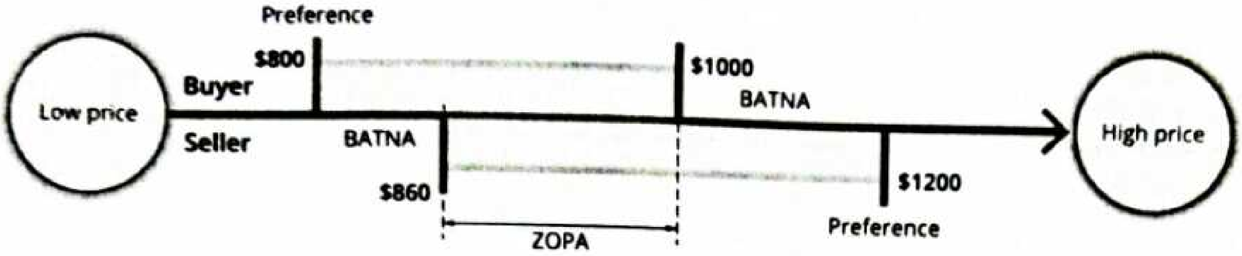

Figure 1.14 Zone of potential agreement (Source: adapted from www.alleywatch.com/2014/09/startup-negotiation-made-easy)

Figure 1.14 is a typical diagram of ZOPA. The buyer's perception is above the line and the seller's below the line. In this example, the buyer's maximum price is $1000, but they would of course prefer to pay less. They will open the negotiation at $800, which they know is not outlandish, as some suppliers (perhaps with a poorer track record) can offer this. The supplier's opening price is the 'list' price of $1200, but they know that very few buyers will pay this price and so must allow for bargaining downwards, based on volumes or a secure contract, etc. However, they cannot go below $860, as then there would be no profit.

The ZOPA in this diagram lies between $860 and $1000. Assuming the parties do not get distracted and keep their focus on the outcomes, we can expect that this negotiation will result in an agreement on a price between $860 and $1000. Clearly, what the agreed price actually is will be determined by the relative negotiation power and skill of the respective sides. The ZOPA model can be applied to any variable, not just price – for example, contract length, volumes, delivery frequency, service support hours, etc. – and can assist negotiators when thinking about their targets for all the objectives they want to achieve in a negotiation.

Negotiators also need to think about what will happen if there is no agreement and they cannot accept the offer on the table. This alternative may not be attractive: in our example, it may mean switching supply to the cheaper supplier with the poorer track record, but at least it is an alternative and this is important. Establishing your BATNA is therefore essential as part of the target-setting process.

Apply

How might you establish whether there is a ZOPA before entering into a commercial negotiation?

Identify the sources of information or insight that will assist you in avoiding time-wasting in a situation where there is no ZOPA.

Setting targets

Aim high but be realistic

In any negotiation, there will be things you will want to achieve, with varying degrees of importance attached to them. In commercial negotiations, price is most certainly a key variable and is perhaps the pivot around which all the other variables may be considered. Before entering into negotiations, it is essential that you set targets for all of the objectives you are seeking to achieve. It is impossible to claim success unless you set out your objectives in advance and then compare your performance and the outcomes of the negotiation with what you aimed to achieve. In some negotiations, you will know immediately or soon after the meeting if you have achieved success; in others it may take weeks, months or years.

1.2

In a negotiation environment, target-setting must also include establishing and locking down your walk-away points for each variable – the minimum you can accept. If you cannot achieve your objectives, you should have at least established your BATNA. We will examine the setting of targets in advance of the negotiation meeting in much more detail in section 2.3. Here we will provide an overview of the target-setting process and the variables that can be considered in the bargaining mix.

Apply

You are tasked with improving price and delivery frequency for a key purchase requirement from supplier X that you then supply to your customer Y. You have been buying at a price of $10 per unit for over 12 months, and the delivery is monthly. If you cannot achieve a price of $8.50 and fortnightly delivery frequency, you may lose a major contract with customer Y as you are aware of a new competitor Z in the market, who can offer this price and fortnightly delivery.

Your research concludes that customer Y is relatively loyal to you and is reluctant to drop you, as there are high switching costs. However, they need you to move closer to the competitor Z's offer. You also establish that price is more important to customer Y than delivery frequency. On this basis, you might create a simple target matrix as set out in the table below to guide your negotiation with supplier X.

	Price	Delivery
Opening	$8.00	Fortnightly
Target	$8.50	Fortnightly
Walk-away point	$9.00	Monthly

Table 1.8 Negotiation with supplier

Your overarching objective is to get supplier X to reduce their price, so it is closer to your competitor's price. You don't need to match it, based on your research and insight, and although you would like improved delivery, this is not essential. Your target price would be a match at $8.50, so you may open the negotiation looking for a price of $8.00, as this allows you to move up from there. You must get the price down to $9.00, as above this, you will likely lose the contract and both you and your supplier lose. This is your walk-away point: if you can't achieve this price, the negotiation will not have been a success.

Regarding delivery, you are less concerned here and more willing to trade, but you would still like to have improved delivery frequency. If you open the negotiation looking for weekly delivery, you know this is unrealistic, and as no one else in the market is offering this, it may only serve to irritate or aggravate the supplier – so you decide to open looking for fortnightly delivery. Your walk-away point here is what you are currently getting – monthly delivery – and although you want improved delivery, this is less essential than an improved price, so you are willing to concede here. However, it is still important to confirm in your targets that monthly delivery is the minimum requirement/walk-away point. If (for example) supplier X agreed that they could reduce the price to $9.00 on condition that they could relax delivery to every two months, you would have to walk away.

In this example, the zone of potential agreement (ZOPA) from your point of view is any price at or below $9.00 per unit, with the same or improved delivery frequency. In this example there were only two variables which had targets attached to them: price and delivery frequency. In reality there are typically many more variables that can be the subject of target-setting in negotiations.

In this example, how might you persuade supplier X to lower their price?

Generating negotiation options/variables/tradeables

Good negotiators understand that the more variables can be identified in a negotiation, the more likely the opportunity for a win-win outcome. If a supplier cannot move on price then rather than getting stuck in a dead end, the creative buyer will note the price, 'park' the issue (not the same as conceding), and consider other variables. If these other variables are negotiated in the buyer's favour, it may make the newly suggested price acceptable, as achieving concessions in these other areas might balance out any price issue. For example, if a buyer can negotiate better credit payment terms of 90 days instead of 30, this may be worth a lot in terms of cash flow costs, especially in a high interest rate environment.

At the planning stage of any negotiation (particularly complex, high-value ones), buyers should brainstorm all the possible variables they can bring to negotiation that can be traded. Some possible variables are listed below.

- Price
- Payment terms
- Length of contract/supply agreement
- Minimum quantities
- Lead time
- Contract terms and conditions (Ts and Cs)
- Publicity and reference site permissions
- Exclusivity of supply
- Intellectual property rights
- Added value services

Setting your trading limits/applying 'must, intend, like' (MIL) criteria

For each objective and variable/tradeable you will bring to the negotiation, you need to establish the following.

☺ **Must achieve:** minimum target/maximum you can concede on this point; the mandatory requirements or fall-back position price, so you are willing to concede here. However, it is still important to confirm in your targets that monthly delivery is the minimum requirement/walk-away point. If (for example) supplier X agreed that they could reduce the price to $9.00 on condition that they could relax delivery to every two months, you would have to walk away.

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☺ **Must achieve:** minimum target/maximum you can concede on this point; the mandatory requirements or fall-back position

☺☺ **Intend to achieve:** realistic target you are aiming for on this point

☺☺☺ **Like to achieve:** stretch target to achieve on this point

It is essential that before entering negotiations, you have an agreed position with stakeholders or budget holders regarding your targets and what you can trade with. The remember feature below sets out the key steps in this process.

> *Remember*
>
> It is important to agree answers to the following key questions with other members of your team before entering negotiations.
>
> 1. What is the overarching objective of the negotiation?
> 2. What are the issues you need to settle with TOP to achieve your overarching objectives?
> 3. What are your 'must achieve' objectives with each issue? What are your 'nice to have' objectives with each issue?
> 4. What is your position on each issue?
> 5. What are your opening offers for each issue?
> 6. What would you prefer to trade? What are you unable to trade?
> 7. What justifications can you give for moving from your opening position closer to theirs?
> 8. What is your best guess as to what they will settle for?
> 9. What is your BATNA?

BATNA – best alternative to a negotiated agreement

> ***"The concept of the best alternative to a negotiated agreement describes the option for a negotiator if agreement cannot be reached. It proposes that a negotiator who must reach a deal is in a weaker position than a negotiator who has an alternative option."***
>
> *(Source: www.cips.org/knowledge)*

If TOP knows you cannot walk away because you have no alternative, then you will be in a weaker position. Having an alternative as a backup in case a negotiation fails to achieve your minimum objectives therefore provides you with a source of power in itself. The better your alternative to a negotiated agreement, the stronger your hand in any negotiation, and so it is worth seeking out your BATNA before you commence negotiations.

The importance of establishing your and TOP's BATNA cannot be overstated. Ultimately, in most negotiation settings, the party with the strongest BATNA will have the upper hand. Good negotiators realise that it is not the actual existence of a strong BATNA that gives you leverage in a negotiation, but TOP's perception or belief that you have a strong BATNA. In normal commercial negotiations, not all information is known to both sides, so conditioning, bluffing, and selective release of information during the process can create an impression in the mind of TOP of your relative strength or their relative weakness, which is not necessarily based on reality.

A BATNA is the standard you must judge the outcomes of any negotiation against. Establishing your BATNA involves three steps.

1. List everything you could do if you do not reach agreement.
2. Explore the best of your options and try to improve on them. The better your BATNA, the stronger you will be in the negotiation.
3. Finally, choose your best option. This is your BATNA.

Case study

Negotiating a new delivery schedule

You are preparing for a negotiation with key supplier X of a component that is essential for the production of your bestselling product range. This supplier provides a quality branded input that is difficult to source, but their weekly delivery has been very inconsistent recently. Despite numerous complaints, there has been no improvement in delivery, which has resulted in occasional stockouts and lost sales for your company. You have deduced that the supplier takes you for granted and is giving preference to other new customers. You now need them to agree to a tough new delivery schedule, or else you will have to source the item elsewhere.

BATNA step 1

Options:

1. Tolerate the inconsistent delivery.
2. Look elsewhere for supply – it will take a minimum of two months to source, assess quality, and re-tool manufacturing to allow for new components.
3. Seek to design the part out – this will take a minimum of three months.

BATNA step 2

Option 2 is agreed as the best. New supplier Y is found and assessed for quality. They would be very happy to supply with two months' lead time. Their brand name is not as well-known and their prices are a little higher.

BATNA step 3

Improve on option 2. Prior to negotiation with supplier X, place an order for two months' supply of components from them. Do not meet with supplier X until this two months' consignment has arrived in stock.

When you now meet to negotiate with supplier X, your BATNA is very strong. If they refuse to agree to the improved delivery on your terms, you can drop them on the spot and have enough stock to cover you while the new supplier is mobilised.

You do not, of course, want to drop them, but by gently letting it be known during the negotiation that you have built up stock and have an alternative supplier lined up, you will have hugely improved your negotiation position. Assuming they want to keep you as a customer, you are now in a much stronger position to negotiate an agreement for the new delivery schedule.

1.3 Explain how the balance of power in commercial negotiations can affect outcomes

At the end of this section you will understand the following.

- The importance of power in commercial negotiations
- Sources of personal power
- Organisational power: comparing the relative power of purchasers and suppliers
- How suppliers gather information on purchasers
- How purchasers can improve leverage with suppliers

The importance of power in commercial negotiations

> *Speak softly and carry a big stick.*
>
> *Theodore Roosevelt*

In the introduction to this study guide, we highlighted the fact that negotiation is not always an option, and that being invited to or being in a position to invite TOP to the negotiation table implies that you or your organisation has some influence over TOP, or that they want something from you.

In terms of price, buyers with little to no purchasing power, e.g., most consumers, are sometimes referred to as 'price takers', as there is acceptance that there is little they can do individually to influence prices or indeed other aspects of a supplier's offering. Negotiation can take up time and energy, so if TOP does not see any likely benefit from a negotiation they may simply decline to meet, or meet with no intention of making real concessions, or direct the buyer to the price list. Faced with a situation like this, creative buyers will look for other sources of leverage or power that might influence the supplier to see the benefit in making a concession.

Power therefore, or more precisely perceptions of power, are critically important in understanding the commercial negotiation process. From a commercial negotiation point of view, we are interested in power from both a personal and organisational perspective. When you are negotiating on behalf of your employer, you bring the power of your organisation (its brand, reputation and purchasing spend) as well your own personal power (that which is embedded within you) to the negotiation. It is the combination of these two factors, when compared to the combination TOP brings to the table, that defines which way the balance of power tips at the outset of any negotiation. This balance can of course be tipped the other way through applying proven negotiation techniques and tactics, which will be addressed in chapter 3. There are multiple definitions of power, but we are not required to consider these here – most revolve around the ability of one entity or party to influence or change the behaviour of another. One definition from the online Oxford Living Dictionaries is as follows.

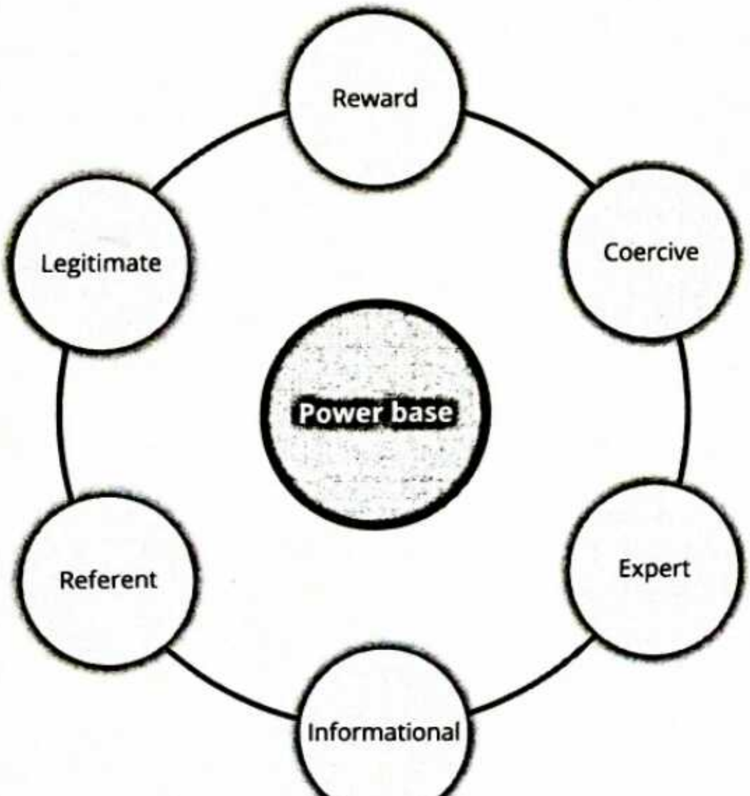
> *"The capacity or ability to direct or influence the behaviour of others or the course of events."*
>
> *(Source: Oxford Living Dictionaries)*

The term 'leverage' is now commonly used in business and commerce to refer to power, and for our purposes here, can be used interchangeably with power.

From a negotiation perspective, the ability to influence the behaviour of others or the course of events is clearly core to negotiation, and of enormous importance in seeking to achieve your objectives.

Sources of personal power

All of us possess power in some situations at some times, and some of us possess power in most situations at most times, but few if any of us possess power in all situations at all times. A useful model of personal power that has survived the test of time and provides a simple way to analyse negotiations is French and Raven's Power Base Model, which describes six bases of power, as shown in figure 1.15 below.



- Good negotiators recognise the different sources of relative personal power they possess in a negotiation.
- There is no one superior source of personal power; they will vary in their effectiveness based on the situation.
- The more personal power sources available the better, even if some not used – these can be used as a fallback.
- The use of teams with individuals who can call on different power bases as required can be very effective.

Examples include the following.

1. Budget holder = **reward and referent power:** 'I can make a decision right now to sign you up with the largest customer in the region.'
2. Technical representative = **expert power:** 'Your spec is not standard, it will cost us to adapt it.'
3. Procurement = **coercive and legitimate:** 'Sorry, no contract can be awarded unless you agree with our contract Ts and Cs.'

Figure 1.15 Sources of personal power (Source: based on French, J. and Raven, B. (1959). 'The Bases of Social Power'. In Studies in Social Power, D. Cartwright, Ed., pp. 150-167. Ann Arbor, MI: Institute for Social Research; Raven, B. H. (1965). 'Social influence and power'. In I.D. Steiner & M. Fishbein (Eds.), Current studies in social psychology (pp. 371–382). New York: Holt, Rinehart, Winston)

1. Legitimate power

This comes from the belief that a person has the formal right to make demands, and to expect others to be compliant and obedient. Legitimate power comes from rules, formal authority, organisation rank, staff grade, or official position held. For example, in the military (in theory at least), most if not all power comes from this

1.3 LO

power base, where rank trumps everything else. Things get done via orders. In commercial negotiations, legitimate power can be demonstrated by job title and rank; the national sales director of a major company is likely to be able to make more decisions in a negotiation without checking back with HQ than the regional sales director of that same company.

2. Reward power

This results from one person's ability to compensate or reward another for compliance. Reward power rests in the holder's ability to pay money or offer some other kind of attractive inducement (not always legal or ethical) to another person to get them to change their behaviour. In most commercial negotiations, buyers in larger organisations may be perceived to have more reward power than smaller ones, in that they can potentially award larger and more profitable longer-term contracts and/or introduce the supplier to the wider group. The reward does not need to be money, but could be introductions to other buyers in the group, positive references, agreement to trial new products, quicker payment or indeed any other variable that the buyer knows is attractive and valued by the supplier.

3. Expert power

This is based on a person's high levels of skill and knowledge. Formal training, qualifications and experience in a particular procurement category would give someone expert status and mean that in negotiations their voice is listened to as a more objective, informed knowledge leader. Expert power is based on facts, knowledge, research, insight and study. However, experts can disagree on these facts, knowledge and research, and over-reliance on experts can lead to deadlock. Having subject matter experts (SMRs) on the buyer's negotiation team can encourage suppliers to be honest with regard to technical claims they may make about their products or services. In some industries where technical expertise is particularly valued, e.g., aviation, pharmaceuticals, military, nuclear energy, biotechnology, etc., suppliers will sometimes recruit people with seemingly relevant qualifications in these areas for their sales teams, even if this technical knowledge is not actually required to sell a product line. The important thing is that the salesperson has the BSc (Pharma), PhD or ex-military rank on their business card and in their e-mail address field.

4. Referent power

This is the result of a person's perceived attractiveness, worthiness and right to others' respect, sometimes referred to as charisma in leaders. Others refer to this person's behaviour, attitudes and opinions when judging themselves as a good leader, manager or business partner. This person's power stems from their personality, way of engaging with others and habit of acting in a way that is in line with a strong set of values and principles. In commercial negotiations this source of power may be exercised through demonstrating honesty, fairness and respect in dealing with suppliers, while acting ethically at all times, respecting confidentiality, and creating a reputation for being 'tough but fair'. Suppliers will know you keep your word, do not overpromise and do not bluff. Over time, this personal reputation can become a very strong source of enduring power, particularly if this ethos is shared across the buying organisation.

5. Coercive power

This comes from the belief that a person can punish others for non-compliance, and can be considered as the flip side of reward power. Coercive power rests in the individual's ability to change other people's behaviour through threat, intimidation, use of guilt, ability to embarrass or shame, or withdrawal of benefits.

6. Informational power

This results from a person's ability to control the information that others need to accomplish something. Information is power. This personal power base has perhaps declined in recent years, with the ready availability of multiple alternative rich data sources for almost no cost from the Internet. Nevertheless, the concept of the 'gatekeeper' – the person with access to the key decision makers or confidential and sensitive information – is still relevant in commercial life. Most organisations, when seeking to respond to high-value tenders or when preparing for negotiations with TOP, will spend considerable effort seeking to establish who is on the other party's team. Do they know each person's individual agenda and motive? Who is the real decision maker? How do they make decisions? This information can be a source of leverage and used, for example, in an attempt to divide and rule TOP in a negotiation.

Check

Consider why most people stop at a red traffic signal when in a car. Everyone knows it is the law, but if you analyse it further, there may be other sources of power at work here influencing your behaviour. The more forces, the stronger the effect. Examples of the types of power that influence this situation include the following.

1. It is the law (legitimate power).
2. If you do not stop you may be fined/prosecuted by police (coercive power).
3. You know it is dangerous; you may put yourself or others in danger (informational power).
4. You feel better about yourself as you see yourself as a good citizen (reward power).
5. You are afraid of embarrassment if seen breaking the law by a friend/neighbour (referent power).

Table 1.9 shows examples of negotiation situations and the sources of power that are most likely to influence them.

	Likely power base effectiveness					
Negotiation situation	**Legitimate**	**Reward**	**Expert**	**Referent**	**Coercive**	**Informational**
Buyer seeking best price on commodity supplies		×			×	×
Buyer negotiating lowest total cost of ownership on capital equipment investment		×	×			×
Buyer negotiating in regulated or public sector	×	×	×	×		

Negotiation situation	Likely power base effectiveness					
	Legitimate	Reward	Expert	Referent	Coercive	Informational
Buyer seeking partnership with much larger strategically important supplier		×		×		
Buyer negotiating with representatives of sister companies in corporate group	×	×		×		
Buyer negotiating with supplier(s) of unproven high potential innovative solutions		×	×			×
Buyer negotiating with exclusive supplier seeking to exit contract to supply competitor	×	×			×	
Buyer seeking discounts from supplier based on benchmarked prices proving overcharging	×				×	×

Table 1.9 Personal power bases and effectiveness

Summary

By understanding these different forms of power, you can learn to recognise which power bases you can personally draw on, and also recognise the personal power bases being used by individuals you negotiate with from TOP. From a negotiation perspective, the more power bases you can draw on the better.

Organisational power: comparing the relative power of purchasers and suppliers

In the previous section, we considered the personal power bases that individuals can bring to negotiation meetings. To some extent, these power bases can be applied to organisations, but there are more useful, relevant and generally accepted models that should be used when we are seeking to establish where the balance of power lies between organisations. Organisations are, after all, made of many individuals with multiple agendas.

An individual buyer with limited personal power, representing a high-spending growing international company with a strong brand identity, has power by virtue of the organisation he or she represents, even if he or she does not exercise this power. Organisational power does not have a simple definition but in the context of commercial negotiations, it can be described as the capability of those representing an organisation to influence behaviours and decisions of others outside the organisation, by virtue of their association with their employing organisation. The relative power of purchasers and suppliers in any given negotiation situation is not always obvious, and intelligent buyers and suppliers can also change the perceptions TOP has of this power balance. Understanding the relative power in a buying organisation and a supplier in any given situation at a given point in time is essential in commercial negotiation planning and execution. It determines and influences the following.

- Whether you can realistically negotiate in the first place
- How ambitious you can be regarding objectives
- The strategies and tactics open to you to use
- Your walk-away point and your BATNA

In this section, we will consider well-established models used in procurement to assist in analysing and understanding the supply market dynamics and the key supplier characteristics of those you are negotiating with. From this understanding we can then establish where the balance of power may lie at a given point in time and in a given situation. This balance is not necessarily fixed, and there are strategies and tactics that intelligent buyers can use to alter the balance of power or the perceptions of the balance of power to their advantage. These strategies and tactics will be examined in section 3.2.

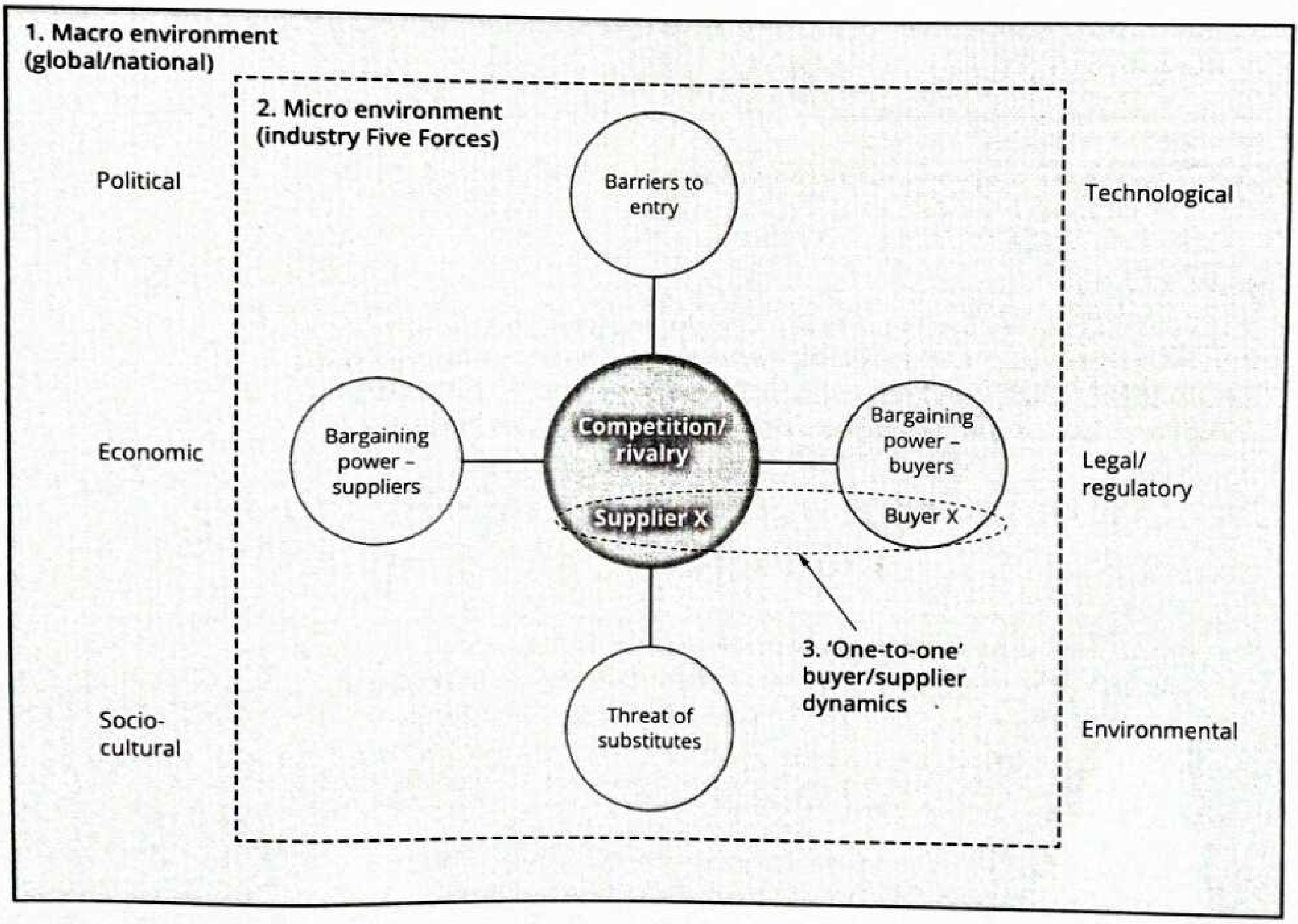


Figure 1.16 Influences on relative power of buyers versus suppliers – three levels (Source: Author's diagram incorporates Porter's Five Forces model, Porter, M.E. (1980). Competitive Strategy: Techniques for Analysing Industries & Competitors. The Free Press, NY)

Level 1: macro environment – STEEPLE analysis

1.3 LO1

Understanding the wider forces that influence the balance of power

All one-to-one commercial negotiations between a specific purchaser and a specific supplier take place within an industrial market and a larger business environment characterised by multiple forces which both parties typically have little control over. For example, no matter how strong a negotiator you are and how much purchasing power your organisation has, if you represent a supermarket chain negotiating for avocados just after a major international crop failure, your overall position will be weakened by this external force. Similarly, if you are a car assembler and during negotiations with a supplier for lithium battery-powered engines the government passes a new law that will ban diesel engines in the near future, it is likely that you will lose relative power through external forces (i.e. more buyer competition for your supplier's output) in the wider business environment. It is important therefore that all participants understand the 'bigger picture' regarding trends, developments, opportunities and threats that exist within their micro environment (industry) and macro environment (wider business environment).

Identification of sources of power in the wider business environment

Macro environmental influences will be examined on negotiations in more detail in section 2.2, so a brief overview will be provided here. You will probably be familiar with the STEEPLE framework from other modules. It provides a simple and easy to remember framework that highlights the six main external influences on a business. Buyers need to be aware of any relevant developments in the wider business environment, under the STEEPLE headings, which may be a source of negotiating power or weakness for either side when engaging with TOP.

Creative thinking is required here, but essentially, the two questions buyers should ask against each of the STEEPLE headings are as follows.

1. Are there any trends or changes here which can significantly affect my power in a commercial negotiation with TOP?
2. Are there any trends or changes here which can significantly affect TOP's power in a commercial negotiation?

If the answer to either of these questions is yes for any of the STEEPLE headings, note it, seek to evaluate its impact, and plan accordingly. We will revisit ways of dealing with these in your negotiation plan in later sections.

STEEPLE factor	Examples
Social	Changes in population growth and demographics, migration, where people choose to live, lifestyle and personal communication changes, ease of travel, cultural values, and health consciousness.
Technological	New innovations in the digital economy, Internet and communication technologies, genetics, transport, robotic process automation, artificial intelligence, blockchain, etc. Access to and cost of these innovations for organisations and individuals.
Economic	Inflation rates, interest rates, exchange rates, unemployment, and economic growth rates.

STEEPLE factor	Examples
Environmental	Changes brought on by global warming, weather changes and rising sea levels, declining fertile land supplies, overpopulation, congestion in cities, pollution and sustainability of natural resources.
Political	Stability and composition of the government in power and its policies regarding trade, commerce, conduct of business, planning, etc. Forthcoming elections and referendums and changes they may bring. The extent to which national and local government can influence the economy and a certain business. National and local government expenditure, and taxation on products and services.
Legal/regulatory	Changes in laws or regulations affecting your industry, your company and its activities, including consumer law, competition law, anti-discrimination law, health and safety law, etc.
Ethical	Factors relating to business ethics considers the forces within the organisation and the wider business environment which are linked to moral issues, social norms, cultural beliefs and values. Ethics tend to be context specific but will impact on the management processes and activities, as well as the behaviour of employees in the organisation.

Table 1.10 STEEPLE factors

The STEEPLE framework does not provide you with any answers on its own; it needs to be populated with relevant data and then have intelligence applied to it so that insights can emerge. These insights may then assist you in preparing for negotiations in general, and perhaps highlight hidden sources of relative power your organisation can bring to the negotiation table.

Apply

Consider the following three negotiation situations and note which STEEPLE elements are most likely to influence the negotiation outcomes and why.

1. An airline negotiating the purchase of a fleet of aircraft
2. The health department of a national government negotiating the prices of hospital drugs with big pharmaceutical companies
3. A global food company negotiating the supply of cocoa from West African producers

Level 2: micro environment (industry structure) – Porter's Five Forces analysis

The macro factors outlined above tend to exert influence on a large number of organisations across all industries. Therefore their impact on individual negotiations, although significant, may not vary very much across different negotiations. For example, the effects of high inflation or interest rates in an economy will normally mean that offering extended credit to a buyer is expensive. This effect will be the same in every market that buyers operate in which is affected by the high inflation rate. The factors we will consider in this section are less 'global' and mainly affect the players in a particular industry or market, and their relative power in negotiations.

1.3 LO1

The most accepted and established model to assist us here is the well-known Porter's 'Five Forces' model first put forward by Michael Porter of Harvard Business School in his article 'How competitive forces shape strategy' (1979).[14] Porter's Five Forces model presents a simple framework for assessing and evaluating the competitive strengths and position of a business organisation in its own micro environment or industry. This theory was developed to assist decision makers In defending and/or growing their market share and/or profits in an existing or new market. It considers five external forces that determine how competitive any particular market should be.

Porter's Five Forces are as follows.

1. **Intensity of industry rivalry**

   The extent to which you experience rivalry from your direct competition

2. **Bargaining power of customers**

   The extent to which your customers have a strong bargaining power over you

3. **Bargaining power of suppliers**

   The extent to which your suppliers have a strong bargaining power over you

4. **Threat of substitutes**

   The extent to which the need your products/services satisfy can be satisfied by other substitute products/services

5. **Threat of new entrants**

   The extent to which it is difficult for new competitors to enter your market

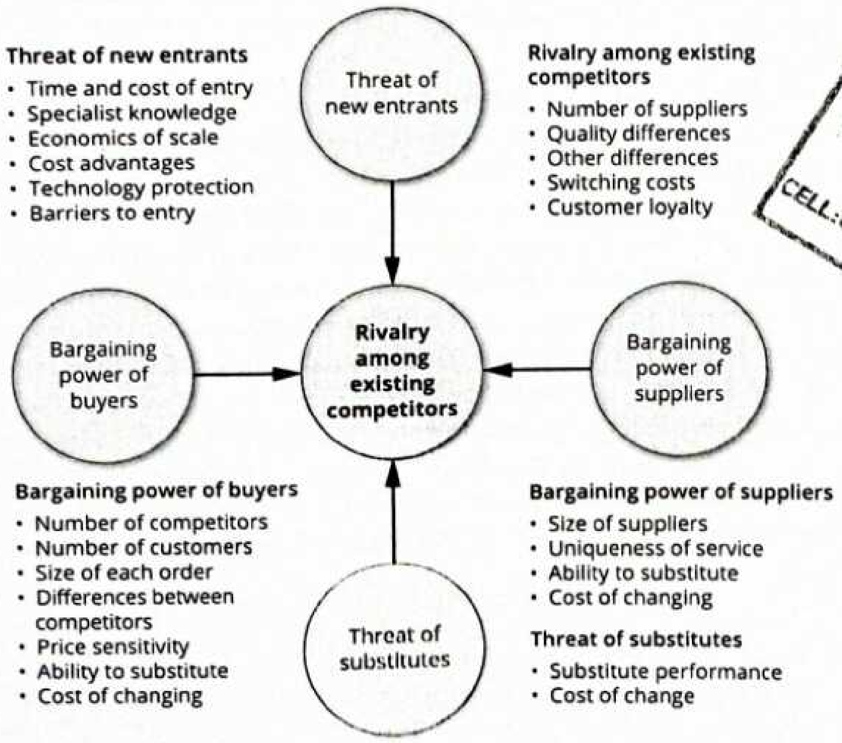


Figure 1.17 Market analysis – Porter's Five Forces (Source: adapted from Porter's Five Forces model, Porter, M.E. (1980). Competitive Strategy: Techniques for Analysing Industries & Competitors. The Free Press, NY)

The theory suggests that the strength of these forces determines industry structure and the level of competition in that industry. In general, the stronger the competitive forces in the industry, the less profitable it is for individual firms. An industry with low threats from new entrants (high barriers to entry) or substitutes, and with many buyers and few suppliers, will be seen as relatively uncompetitive. It will therefore be very attractive from a supplier's point of view due to its high profitability. The greater these competitive forces, the more difficult it is to make and sustain profits in the market, so making it less attractive in the long term.

As the theory was developed to address a supplier perspective, we need to apply it to the buyer or procurement perspective. Porter's Five Forces provide a broad insight into the balance of power in a buyer/supplier relationship, which is helpful when evaluating the strengths of a business' current competitive position and of the position it intends to move towards. Understanding where power lies allows negotiators to recognise areas of strength and mitigate against areas of weakness.

Level 3: one-to-one buyer/supplier dynamics

The third source of organisational power is power that is derived from the relative bargaining positions of the two organisations entering into, or currently in, a commercial relationship. Supplier positioning and supplier segmentation are the terms used to describe how buyers seek to classify their supplier based on relative importance.

> *Supplier positioning is the process of classifying spend with a supplier in terms of the profit potential and supply risk and assists in prioritising categories of spend and developing the right strategy.*

(Source: training.cips.org/en/Knowledge/Procurement-topics-and-skills/SRM-and-SC-Management/Supplier-Positioning1)

According to the goods/services supplied, suppliers can be classified from a buyer's perspective into one of four quadrants: commodity, strategic, routine or security. The classification can also depend on money spent, product complexity, breadth of supply base and the volume of supplied goods and/or services (Bueler, 2006)[15]. The differences and pros and cons of the different models are outside the scope of this syllabus and are well covered elsewhere, but essentially they differentiate four general categories of suppliers against supply risk and expenditure, and each category is given a label. This label reflects the power balance and determines how the buyer should view and treat this supplier, which therefore affects negotiation. The CIPS Australia paper, 'How to negotiate professionally' by Paul Steele (available online), usefully outlines the different perspectives taken by both buyers and sellers and how this can be used to understand your positioning.[16] The tables reproduced below are from this paper.

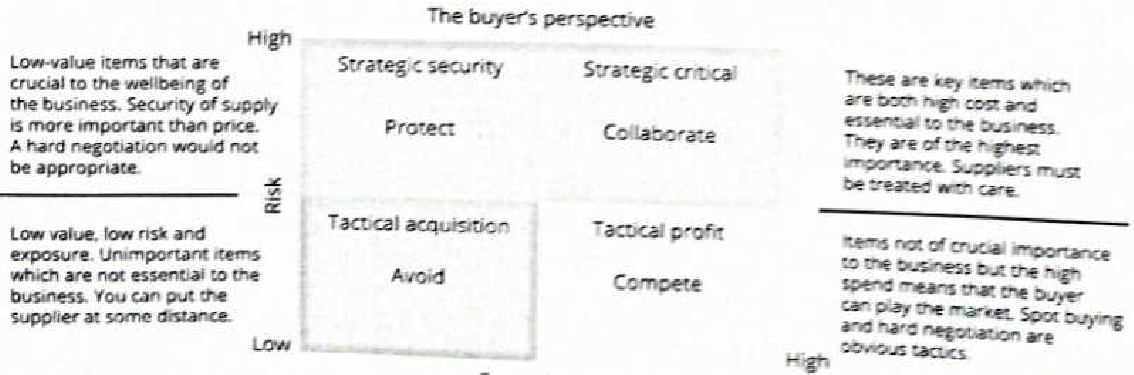


Figure 1.18 The buyer's perspective (Source: Paul Steele, 'How to Negotiate Professionally', www.cips.org/Documents/CIPSAWhitePapers/2007/How%20To%20Negotiate%20Professionally.pdf)

Classification of your suppliers against risk and spend will locate them in one of four quadrants. From a negotiation perspective, in general, the higher the risk associated with that supplier, the less power the buyer will have and vice versa. The higher the spend, the more leverage the buyer may have, and also the greater the incentive to drive a hard commercial deal. This matrix just gives the buyer's perspective of course, so it is necessary to also consider the seller's perspective.

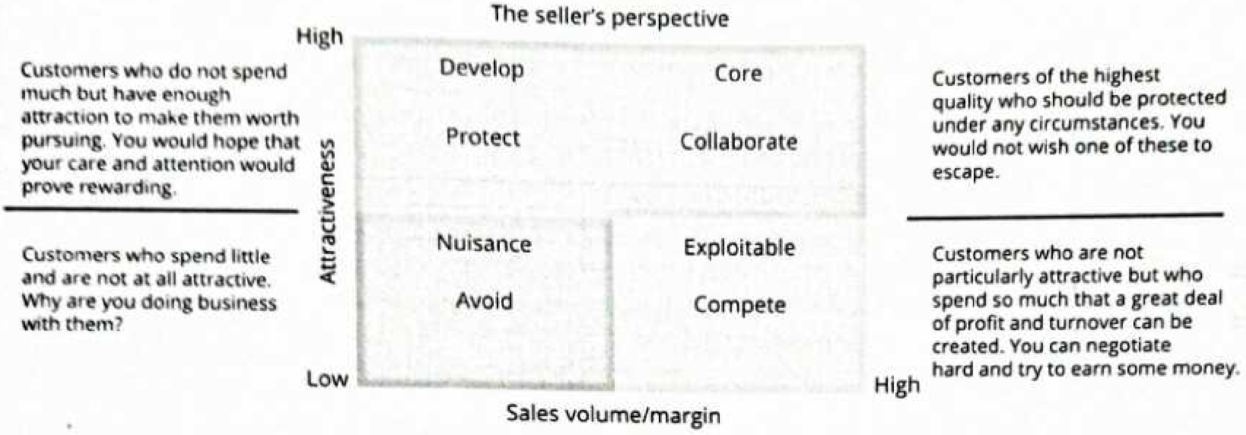


Figure 1.19 The seller's perspective (Source: Paul Steele, 'How to Negotiate Professionally', www.cips.org/Documents/CIPSAWhitePapers/2007/How%20To%20 Negotiate%20Professionally.pdf)

The seller's perspective and the concept of customer attractiveness will be examined in more detail later, but in terms of power dynamics between buyers and sellers, clearly if you are seen as a highly attractive customer, your leverage will be greater than if you are seen as an unattractive customer. It is necessary therefore to take into account both the buyer's and the supplier's perspectives to understand the power balance. Seeking to understand how the supplier sees you is therefore very important.

The buyer's and supplier's perspectives can be combined in one table to consider all the possible combinations. Consideration of both perspectives allows us to see where each of the three following scenarios applies.

1. A clear power balance in favour of the buyer in most situations
2. A clear power balance in favour of the supplier in most situations
3. An unclear, equally matched power balance, dependent on situation

How suppliers gather information on purchasers

Much of this study guide emphasises the importance of preparation for negotiations through developing an understanding of the supply market and gaining insights into the supplier you will be negotiating with. 'Most negotiations are won at the preparation stage' is a well-known adage.

> *Remember*
> While you are researching TOP, they are researching you, so it is useful to be aware of how suppliers gather information on those that they will be negotiating with, i.e. you and your organisation.

Publicly available sources on the Internet

With the widespread availability of the Internet, it can be expected that the search will begin with Google or another popular search engine.

> *Apply*
>
> Note what comes up when you type your organisation's name into Google. Is it accurate? Does it pick up on the things you would emphasise? What about adding a 'procurement' or 'negotiation' to your organisation's name? What comes back?
>
> You can also look at social media references to your company on Twitter, Facebook and LinkedIn. Suppliers will certainly try to find out about those they will be negotiating with. If your public profile has MCIPS at the end this may condition them to expect a tough but fair professional negotiator. (If you are not working or work for a small organisation just look up a well-known national supplier's name.)

From your research above you will have noted that well-known established companies will return multiple hits, possibly thousands, so clearly a more targeted search with the organisation's name filtered with keywords will be required here. The following could be searched for.

- Latest news, change, court case, High Court, etc.
- Procurement, supply, contracts, budget, spend, quality
- Operations, locations, corporate strategy
- Management, board, locations
- Expansion plans, new products and services, plant closures
- Disputes (with suppliers and/or customers)
- Customer reviews of your products and services
- Scandals involving corruption, fraud, or use of inferior inputs or tolerance of slavery in the supply chain
- Technology, digital, robotic process automation, artificial intelligence

In searching for information online, professional buyers must take note of the source of information and beware of fake news, paid-for advertorials and sources which may be biased or inaccurate. Cross-referencing and checking the information with other sources is advisable. There are, in addition to the search engines, plenty of publicly accessible industry news sites, comment forums and professional networking sites such as LinkedIn, where information on customers can be obtained.

Other sources of information

- **Paid-for subscriptions to trade magazines, specialist websites and paid-for industry reports**

  Specialised reports on industries and products which have details about individual companies can be purchased from a range of sources. Dun & Bradstreet is a well-established international firm that sells credit reports on subscription and Gartner sells reports on software suppliers that provide insights to inform suppliers about buyers.

- **Annual financial accounts/reports**

  These are issued by Companies House for public limited companies and by other registers for private companies

- **Customer tendering activity**

  Large tenders in the private sector may be advertised in the national press, and industry press/journals. In the public sector this is obligatory, and well-known national government sector tendering websites exist, e.g., the eTenders procurement website or TED Tenders Electronic Daily.

- **Industry and business ownership statistics**

  These are available from government and trade sector sources.

- **Industry conferences and exhibitions**

  These are a very useful way to meet buyers in person to try to get them to attend your seminar. Conference organisers also sell your registration data where permitted.

- **Supplier-sponsored conferences and exhibitions**

  Some suppliers sponsor conferences with the sole purpose to get current and potential customers and influencers to come and share their opinions and insights over lunches, seminars and workshops. Getting these staff off-site can be a very useful way to obtain insights and intelligence and possibly influence key stakeholders in ways that may concern procurement. In some organisations there are restrictions on attending these to prevent undue influence being brought to bear on unsuspecting attendees.

- **Employing ex-employees of customer organisations**

  Many large corporates target technical specifiers, key stakeholders and procurement staff from their customer base in order to gain insight into the organisations and their purchase decision-making process. For this reason, many organisations place restrictions on these staff working for suppliers or competitors for a certain period.

- **Industrial espionage**

  This means gathering data illegally through hacking into confidential company databases and files, or by bribing employees to provide useful information. This is of course completely unethical and illegal, but sadly it does happen, and buyers should be aware that suppliers may engage in this activity.

How purchasers can improve leverage with suppliers

A key factor that motivates commercial suppliers in a free market is money. This money is obtained from their customers via sales, contracts and agreements to supply. Therefore, it would follow that the bigger the customer and the greater the spend, the more attractive your business is, and the more suppliers will compete to win your business. In most but not all cases, a key source of leverage in the market is therefore your absolute and relative spend as a customer.

A key objective of strategic procurement and category management is therefore to ensure that the buyer maximises its spend leverage by channelling as much spend as possible across the organisation to as few suppliers as possible, in order to extract volume discounts, etc. All things being equal, for most organisations it makes sense to aggregate requirements in any given category. Doing this means that when you go to market via a tender or negotiation, you are going to market with the biggest contract in value possible, which will increase your leverage and attractiveness.

However, intelligent buyers know that they can also increase their leverage in the market with suppliers in ways that are not directly related to volume of spend or size of contracts. These methods are particularly important for organisations that are not big spenders and/or organisations that seek to attract suppliers which are interested in them for reasons other than short-term sales and profits. Therefore, understanding what makes customers attractive to their suppliers, other than money, is clearly very important in order to increase leverage.

Increasing leverage through spend concentration

The first port of call for the buyer tasked with increasing purchasing leverage with suppliers in any given market is to review their own organisation spend in that category. If that spend is spread across many suppliers and/or there are very few controls in place to encourage or oblige internal customers to buy from a list of preferred suppliers, then there may be an opportunity to increase leverage through consolidation of this spend to a smaller number of suppliers in the category – thus increasing your spend with this smaller group. This consolidation of spend does not mean you recommend that all customers buy from one vendor, but your analysis may suggest shifting some spend away from some suppliers and towards others. Supplier spend consolidation can take many forms as outlined below.

- **Vendor base reduction**

  Straightforward reduction of number of suppliers in any category.

- **Volume pooling**

  Pooling cross-organisational requirement until your order volume is high enough to attract new bidders/additional discounts.

- **Volume redistribution**

  Making recommendations following spend analysis to move spend from one supplier to another (see the case study below entitled 'Legal services spend analysis and consolidation').

- **Volume consolidation across categories**

  Certain purchase requirements may be common across a number of categories, e.g., insurance, transport and security, but may be being purchased separately meaning that opportunities for consolidation have been missed.

- **Standardisation and harmonisation of specifications**

  Analysis of specifications and standards for a high-spend purchased input, e.g., enterprise software licences, may show that there is little difference between them and that the specification can be standardised or at least harmonised across the group or across national, regional or global operations. This could open the door to much greater leverage, as the volumes and spend are much higher.

- **Forming purchasing consortia**

  In some situations, buyers may decide to come together and combine their purchase volumes to attract better deals. This clearly can only happen if the buyers are not in direct competition with each other and/or can somehow agree on how to share benefits. Government, public sector and voluntary bodies can engage in this activity, as can farmers all seeking to harvest at the same time and requiring expensive capital equipment for this purpose.

Increasing leverage through analytics – spend analysis overview

In order to identify opportunities where you can increase your leverage with suppliers, you need to understand your spend. Undertaking a spend analysis of your accounts payable (AP) data is an essential first step here. The three key questions you want to answer in this analysis are as follows.

1. How much are you spending on which categories/commodities?
2. Who in your organisation is spending the money (cost centre)?
3. Who are you spending this money with (vendor and contracts)?

When you have access to this data, also known as the spend cube (it measures three dimensions), you can identify potential opportunities that can then be presented in compelling graphics to stakeholders.

Spend cube
A review of spend data presented as a three-dimensional cube, highlighting the three dimensions usually reviewed: 1. sub-categories and commodity groups purchased across the organisation; 2. stakeholders or departments buying the category; 3. comparative spend with different suppliers

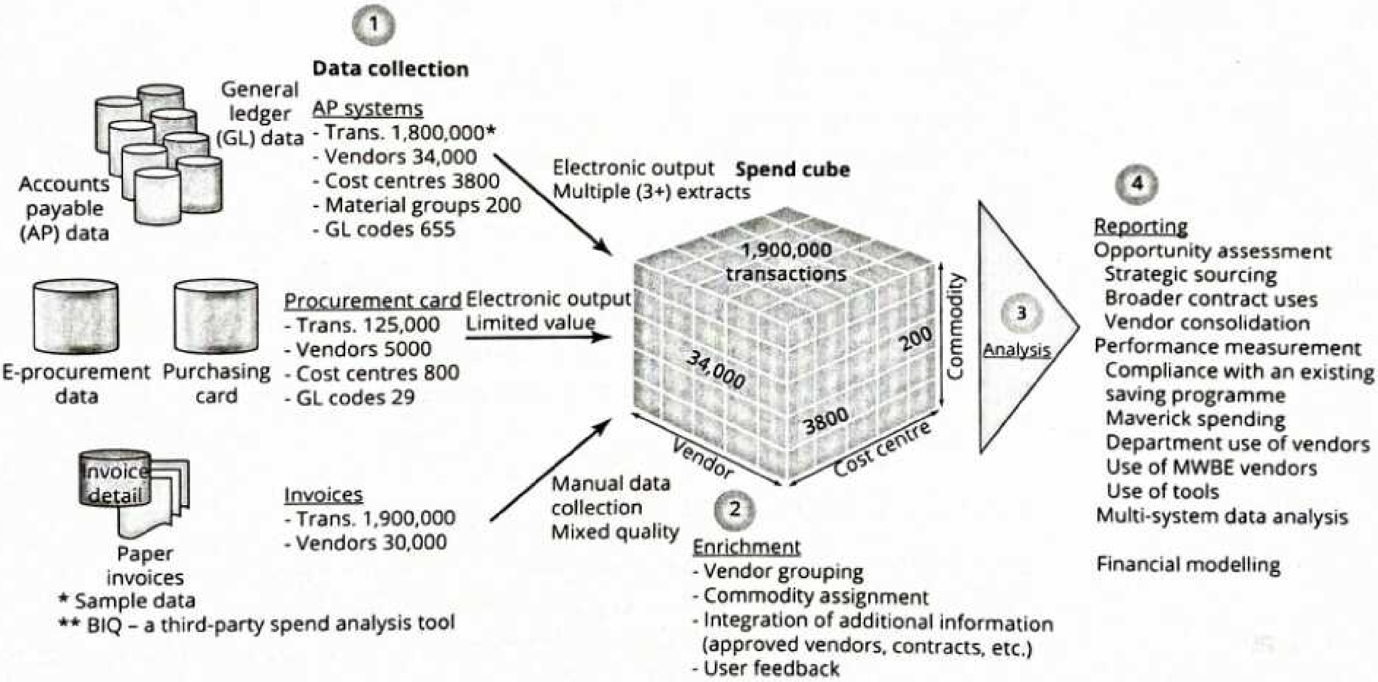


Figure 1.20 The spend cube

The scope of this syllabus does not extend to explaining how to develop a spend cube; however, we will address costs in more detail in section 2.1.

Increasing purchaser's leverage through other means

Customer attractiveness

In the commercial world it seems reasonable to assume that being a higher spending organisation compared to your competitors means you can drive better deals with suppliers purely through your spending power. In many cases this is true, but intelligent buyers know there are many other factors that can make a buyer attractive to a supplier that are not directly related to order value.

For starters, the size of spend is not everything. There are many successful suppliers who are quite happy supplying at a certain level or into a particular market, with little desire to break into new markets or take on the investment and risk required to expand their production significantly. Others may strategically decide to target smaller customers, so they themselves can retain some leverage in negotiations.

Where there are few suppliers to a market, or in a market where suppliers hold the balance of power, a buyer may decide to project itself as an attractive customer to secure business. The size of the buying organisation or its spend is immaterial here. The following may be sufficient to differentiate the buyer from other buying organisations.

- Simple procurement processes
- Simple contracting processes
- Clear and concise documentation
- Absence of onerous supplier terms and conditions
- On-time payment
- Transparent processes
- Ethical behaviour

In a market with a more equal balance of power, a supplier may still seek benefits that go beyond payment for the product/service being purchased. It may be a guarantee of exclusivity that is sought, or preferential treatment such as access to intellectual property, white papers, technology road maps or research and development.

It is therefore important that buyers entering into commercial negotiations put themselves into the shoes of a supplier, and look at things from the supplier's perspective when considering what makes a customer attractive in ways other than their current spend.

Buyer attractiveness model

This simple model allows us to consider supplier perceptions regarding their customer segments across two key variables: customer spend and customer attractiveness (non-spend factors). The resulting matrix produces four quadrants where customers are classified as follows.

Develop: low spend and high attractiveness

Overarching supplier objective: 'No need to make profits now; win and keep business with this customer as they are going places.'

Core: high spend and high attractiveness

Overarching supplier objective: 'Hold on to this customer and keep them happy but make sure we are making money as this is our core source of long-term profits.'

Nuisance: low spend and low attractiveness

Overarching supplier objective: 'Drop this customer at the first opportunity; in the meantime charge as much as we can as we don't really want their business.'

Exploit: high spend and low attractiveness

Overarching supplier objective: 'Milk this customer and charge a high price to compensate for all the pain they put us through.'

Attractiveness factors (examples)

- Reputation for innovation, quality and /or leading edge technology
- Prompt payment to suppliers
- Impressive reference site
- Positive brand association
- Learning opportunities
- Low transactional cost to do business with
- Useful business contacts can introduce new customers
- Willingness to test products and support innovations
- Respects confidentiality
- High ethical standards
- Nice people

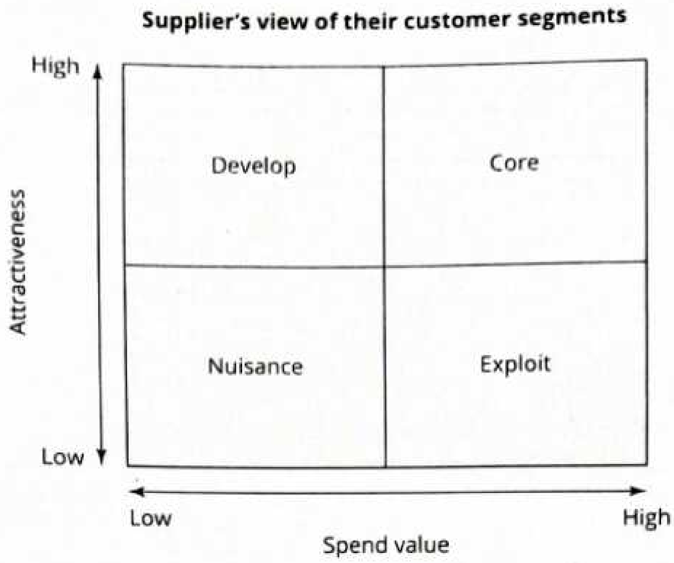


Figure 1.21 Customer attractiveness and purchasing power

Examples of general factors (non-spend value) that can make a customer attractive to a supplier are listed in figure 1.21 above.

Remember, unattractive buyers may not be aware they are perceived as such by suppliers, who are unlikely to tell them as long as they keep on paying, sometimes a premium price for this unattractiveness. Engaging the services of a third party to benchmark the relationship may be required to get a true view of how suppliers see you, beyond a source of income.

In summary, being perceived as an attractive buyer is always helpful, particularly in markets where supplier power is dominant. There are many examples of buyers maintaining supply during periods of shortage on the basis of their relative attractiveness and good relationships with their key suppliers. Furthermore, we have demonstrated here how being attractive to suppliers can mean you achieve a more competitive process and more attentive service.

1.4 Identify the different types of relationships that affect commercial negotiations

At the end of this section you will understand the following.

- The relationship spectrum
- Building relationships based on reputation and trust
- Repairing a relationship

The relationship spectrum

Professional buyers, when planning or engaging in negotiation with suppliers, should always be aware of where the intended and actual relationship with this supplier is positioned on the 'spectrum' or 'continuum' of commercial relationships. The relationship spectrum describes the range of commercial relationships between a buyer and supplier based on richness of communication, longevity and mutual dependence.

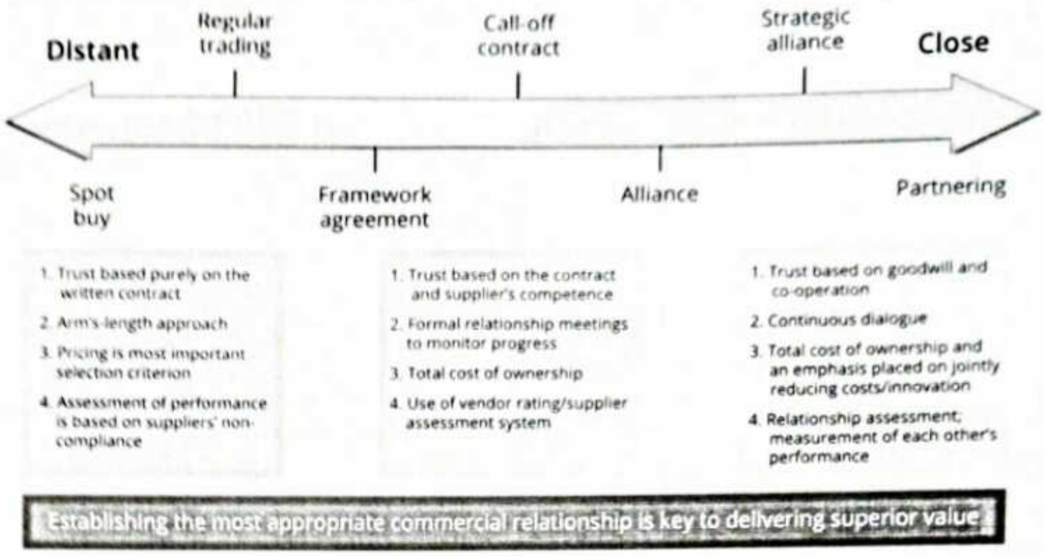


Figure 1.22 The relationship spectrum (Source: Mark Moore, Commercial Relationships, Tudor Business Publishing (1999))

The relationship spectrum is based on the important idea of supplier segmentation, whereby the buying organisation segments its supply base based on how important the supplier is perceived to be to the success of the buyer's organisation and the potential value that could be lost from a lack of proactive supplier relationship management.

This analysis normally results in the bulk of suppliers being deemed 'transactional' and potentially subject to win-lose negotiation, with a very small number of suppliers being deemed 'strategic'. In order to extract the maximum benefits from its strategic suppliers and ensure value delivery from the contract, different relationship strategies are recommended, including a much more collaborative and multi-dimensional approach to negotiation, sometimes more accurately described as a 'continuous dialogue'.

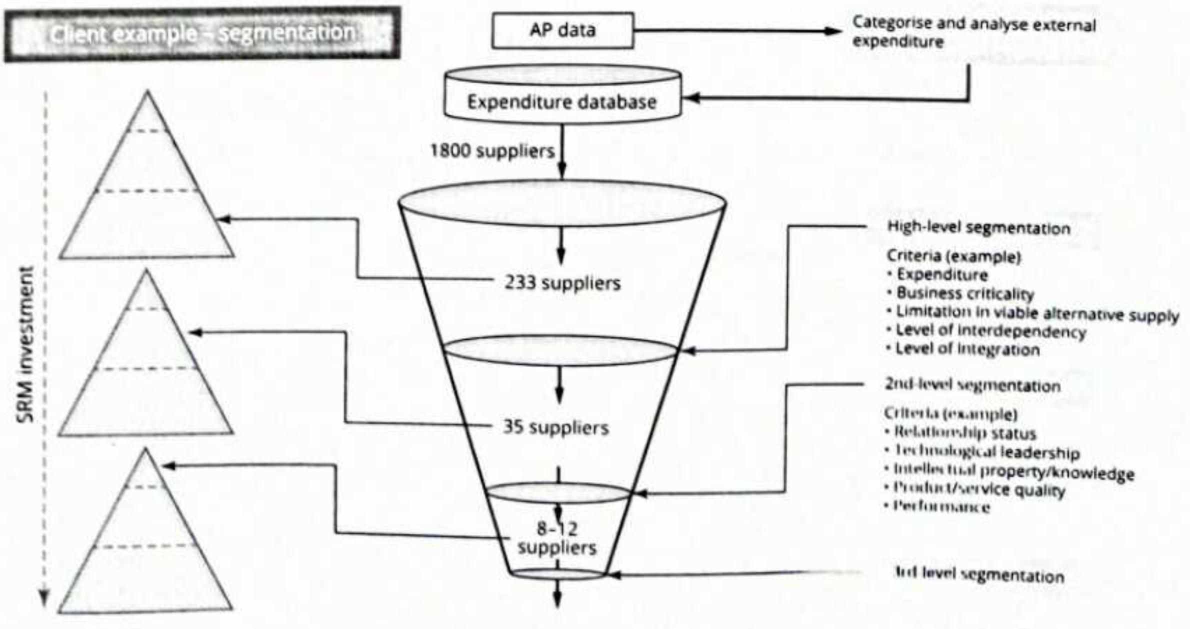


Figure 1.23 How suppliers are segmented

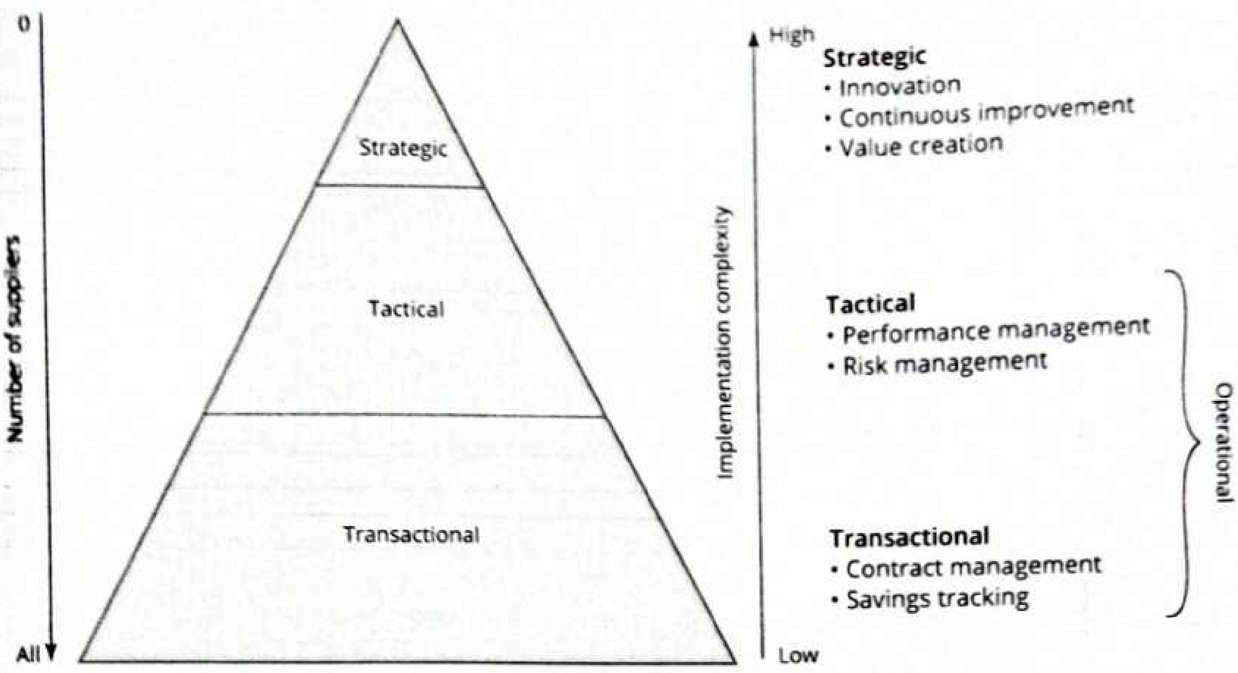


Figure 1.24 How suppliers are segmented

Given buyers' greater dependence on strategic suppliers across all areas of their business for provision of critical infrastructure, operational support and supplies, it is essential that buyers understand which suppliers they need to invest time in relationship development with, ensuring that their negotiations are informed by this. Buyers should also periodically review the segmentation of their suppliers as their relative importance will vary over time and can change in response to shifts in the external environment, e.g., technological or regulatory changes.

	Transactional suppliers	Operational suppliers	Strategic suppliers
	• No business-critical commodity products/ service • Viable alternatives exist	• Tailored/specific products/ services that may be critical • Alternatives exist • Switching may be more difficult	• Highly customised/unique products/services • Significant impact on the business • Minimal alternatives • High switching costs
Procurement activities	• Regular sourcing events • Automated purchasing	• Limited sourcing events • Semi-automated purchasing activities	• No sourcing events • Customised purchasing activities
Relationship building	• Short-term • High-level	• Medium-term • Procurement staff and (senior) business stakeholders	• Long-term strategic business relationship involving senior procurement staff and senior management

	Transactional suppliers	Operational suppliers	Strategic suppliers
Communication	• Related to purchasing	• Discuss performance and financial aspects • Limited information sharing	• Regular communication • Full information sharing
Negotiation	• Limited negotiation - may not be worth effort • Focused on price and delivery • Over phone/e-mail/no meetings • Win-lose or win-win	• Selective targeted negotiations • Focused on wider cost and risk elements • Over phone/e-mail/ in-person buyers • Win-lose or win-win	• Regular structured negotiations • Focused on total cost - both parties • In person with stakeholders • Win-win

Table 1.11 The impact of supplier segmentation on negotiation approach

Building relationships based on reputation and trust

Reputation

'Reputation' is defined in the online Oxford Living Dictionaries as follows.

> *The beliefs or opinions that are generally held about someone or something.*
>
> *(Source: Oxford Living Dictionaries)*

> *A widespread belief that someone or something has a particular characteristic.*
>
> *(Source: Oxford Living Dictionaries)*

In a globalised commercial world characterised by dynamic markets and multiple companies competing for business, a positive corporate reputation can be an enormous asset. From a procurement point of view, reputational strength in a supplier might be based on some or all of the following characteristics.

- Quality of products or services
- Low cost/high value for money
- High ethical standards
- Reliability
- Cutting-edge technology
- Strong customer focus
- Engineering excellence

You should be aware of local and national supplier brands which have strong positive or negative reputational associations against these characteristics in your country. Very often, reputation is captured by a company brand, which for many organisations is their most valued asset and worth considerably more than the total of all other assets combined. Reputational risk, the risk of loss resulting from damage to an organisation's reputation, is therefore taken very seriously, particularly in markets where trust, quality and consumer sentiment are major factors driving success. The losses from damage to reputation can be significant, and in some cases fatal to companies.

Reputation is nevertheless a perception. For example, in cases where a company representative is charged with a criminal offence but is acquitted (found 'not guilty'), there may still be a suspicion that there is 'no smoke without fire' and their reputation can suffer unjustifiably. Similarly, as reputation is by definition based on historic performance, companies that will become highly successful in future may not yet have developed a reputation, while companies that have established a strong reputation in the past may since have declined in performance.

There are many examples of how one incident has caused huge damage to a company's reputation and a quick Internet search will uncover many. Three very famous examples are:

- **BP – Deepwater Horizon oil spill in the Gulf of Mexico**

  This hugely damaged BP's reputation as being among the cleanest and most environmentally conscious of the big oil companies.

- **Volkswagen – cheating on diesel emissions reporting**

  This hugely damaged its reputation for trust and honesty.

- **Samsung – Galaxy Note 7 battery catching fire**

  This hugely damaged Samsung's reputation for safety.

It is interesting to note that reputation has many facets, e.g., in Volkswagen's case, its reputation for trust and honesty suffered, but not its reputation for engineering excellence. Also, in the examples above, all the companies (after a drop in sales/ revenues/share prices) have recovered, but each still bears the scars of the scandal or incident.

> *Apply*
> The following link will take you to an article titled 'The six biggest brand disasters of the last decade'. It summarises the key facts behind some recent reputational disasters.
>
> www.worldfinance.com/special-reports/the-six-biggest-brand-disasters-of-the-last-decade

Building commercial relationships based on reputation

Reputation is perhaps more important than ever nowadays, with good or bad news spreading rapidly across multiple web-based channels. The Internet hosts new platforms where consumer reviews of products and services can be found, and reports on industrial products and services can be accessed for a fee. In many cases, a favourable reputation for product quality is based on real-life sustained product quality performance 'in the field'; however, professional buyers should retain a professional scepticism when it comes to relying on supplier reputation, and should withhold judgment until they have experienced the product or service themselves.

Many global companies spend millions nurturing their reputation through the media they know their buyers access, trying to create a positive image in the mind of the buyers even before they have had any dealings with them. Reputation should be earned, but professional buyers know that suppliers with resources can also to some extent buy it, at least partially through the following.

- **Sponsorship of prestigious events to drive brand association**

  Many major sports and cultural events are sponsored by corporates seeking to associate their brand with the positive feelings customers have towards these events. Most award ceremonies, including CIPS Supply Management Awards, attract sponsors seeking an association with the professional body.

- **Recruitment of salespeople with technical qualifications**

  Frequently, multi-national drug companies employ qualified pharmacists as sales staff, even though a degree in pharmacy is not required for this job. The qualification instils an element of trust and clinical professionalism when these staff meet with their counterparts in hospital buying departments. The same is true for aviation, military, engineering, IT, and many other technical areas.

- **Employment of high-profile sports people, celebrities or leaders, to bolster reputation**

  Some organisations offer lucrative contracts to people who have achieved success in another field, in the hope this success might rub off on them and/or to bolster their reputation, perhaps in an area they are weak in. For example, the relatively popular and jovial former President of the European Commission, José Manuel Barroso, joined Goldman Sachs, which is hardly known for popularity or joviality, when he left the European Commission.

- **Buying brands or smaller companies to acquire their reputational goodwill.**

  Cadbury (now Mondelez), the giant multi-national confectionary company, bought Green & Black's, a very small chocolate producer with a strong reputation for ethical buying of cocoa and organic ingredients. On Green & Black's product packaging, there is generally no prominent reference to its parent company.

In conclusion, professional buyers must exercise caution when building relationships with suppliers based on reputation. Reputation lags behind actual performance and may have been established in areas not beneficial to you. Compared with consumers, you should have access to richer data sources, and should have more time and technical capability to look beyond a positive reputation a supplier may have. It is true, however, that companies with positive reputations will seek to defend their reputation and so may be much more responsive to complaints regarding service, etc., in order to protect it. This can therefore be a potential source of buyer leverage in cases where a problem develops during the contract.

Trust

> *Trust, but verify.*
>
> *Ronald Reagan on USSR nuclear arms control negotiations*

1.4 LO1

Trust is a difficult concept to define, and it is often said that it cannot be established unless it has been tested. Of all the functions in an enterprise, it is arguable that procurement is sometimes viewed as a sceptical group. Being sceptical and basing decisions on evidence, as a default posture in procurement, is not necessarily a bad thing, and most experienced procurement managers will have learned by experience that trust without verification can be dangerous.

> *Trust is the expectation that the other party will behave in a predictable and mutually acceptable way. In inter-firm relationships, the presence or absence of trust can affect the level of cost in a relationship. The existence of trust is thought to lower the transaction costs in a relationship. For example, if a buyer has to inspect incoming goods to check that the goods supplied correspond to the goods ordered, this adds a layer of cost. This in turn reflects an absence of contractual trust. Some of the benefits of co-operative sourcing strategies are based on reducing system costs by substituting co-operation for opportunism.*

(Source: www.cips.org/knowledge)

Dr Mari Sako identified a taxonomy of three types of trust in commercial relationships, which is very useful from the perspective of procurement.

1. **Contractual trust**

   Trust based on the contract with TOP. 'I trust you because I can sue you and claim damages if you break this trust.' This is potentially the weakest source of trust if there is nothing else to base the trust on, but it is the quickest to establish.

2. **Competence trust**

   Trust based on TOP's professional qualifications or proven or certified technical capability or experience. 'I trust you to give me a diagnosis because you are a professional qualified medical doctor.'

3. **Goodwill trust**

   Trust based on knowing TOP has your interests at heart and will not behave opportunistically. 'I trust you because we have been friends for many years and you have never let me down even when I wronged you.' This is potentially the strongest type of trust, but it takes the longest time to build.

Relationships characterised by all three components are typically the most durable and least subject to opportunistic behaviour. It is useful to think about the three types of trust and how the relative importance of each can vary depending on the situation and the actors involved.

Building relationships based on trust

There is general agreement that trust takes time to be established and both parties need to have some shared experiences to be able to test and so confirm this trust. We can assume that in most procurement situations, using Sako's classifications, there is some contractual trust as there should be some sort of legally enforceable agreement. We are therefore more interested here in building up competence and goodwill trust.

To some extent, one party may have to be first to initiate the behaviours, actions or decisions that imply trust beyond what is expected as per the contract. Trust cannot be forced, but there are methods and behaviours that encourage it and destroy it.

Trust/partnership-building behaviours

- Joint issue resolution
- Quick sharing of information
- Joint agreement in (re-)evaluation of KPIs; objective joint assessment of performance
- Open discussions on root cause of failures
- Joint planning, focus on value for money
- Strong sense of ownership for high-quality service
- Commercial transparency and co-proposition of cost reduction and service improvement programmes
- Joint recognition and celebration of successes
- General mood: appreciation, trust, opportunity, excitement, self-examination

Trust/partnership-destroying behaviours

- 'Hallway' rumours of partnership breaking down
- Emotion-based assessments of performance, usually due to recent service breakdowns
- Quick blaming of other party for service or performance problems, fire-fighting, cost overruns, commercial disputes
- Constant shadowing and oversight, focus on controls
- Avoiding traditional decision makers in new contract agreement
- Avoidance of accountability
- General mood: resentment, distrust, resignation, overwhelm, frustration, blame

Highly collaborative relationships require a high degree of trust, and can be identified by the existence of some or all of the following factors.

Signs of trust in business relationships

- Mutually agreed and managed objectives and success measures for the contract, including KPIs
- Both sides accept the potential need to renegotiate terms when business conditions change
- Real-time sharing of information on needs and priorities
- Acceptance that there may be conflict, but that it will be managed through issue resolution, joint problem-solving teams and defined escalation routes
- Pride and strong effort, high employee and customer satisfaction
- On-time delivery of products and services, effective total cost reduction
- High-performance teams that feel empowered to get the job done
- Supplier is encouraged to and welcomes opportunity to innovate into the business
- Both parties bring ideas and share insight from the business/market
- As trust increases, organisations do not feel they need to monitor each other closely, allowing them to direct resources away from the project to do other work
- Clear criteria for decision-making

Similarly, relationships where trust has broken down can be identified by the existence of some or all of the following factors.

- Emotion-based assessments of performance
- Business case and strategic objective of a project, and therefore service level agreements, lose relevance over time
- Distrust in sharing strategic plans; supplier does not communicate business requests
- Highly reactive culture; no incentive to be proactive or accept blame
- Frequent escalation, progress delayed
- Resignation, resentment, blame, silo-based management
- Supplier loses its best staff members as a result of high staff turnover
- Cost overruns, over-inflated contingency funds or padding of proposals
- Unclear roles and responsibilities, unclear face-off teams, duplication of effort
- Supplier does not understand the buyer's business, few suggestions for improvement
- Resources employed to shadow or audit/govern vendors, shadow organisations emerge in functions where supplier involved, e.g., ICT
- Limited information and oversight for decision-making

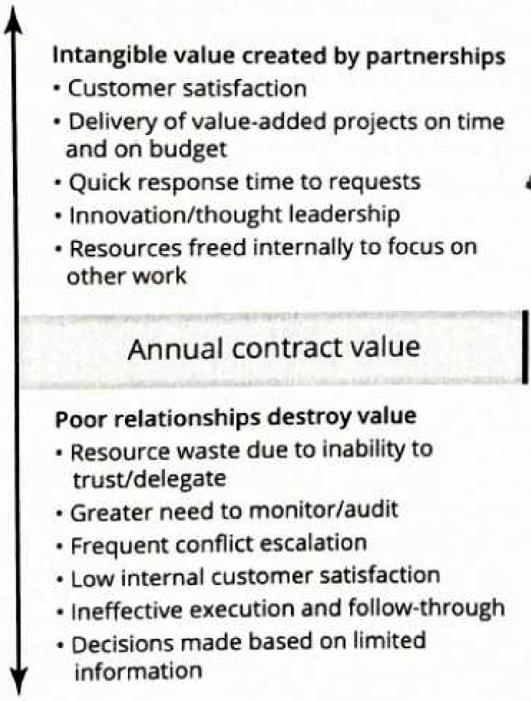


Figure 1.25 The value of trust

Good relationships with suppliers are not just nice to have for the sake of it. The existence of trust in commercial relationships and the adoption of a partnering approach (where appropriate) can have a significant impact on the value (tangible and intangible) obtained from contracts. There is real monetary value at stake. Relationship management has a significant impact on the value of vendor deals and the realisation of the business case. On many procurement consulting engagements this can amount to up to 40% of the contract value.

Repairing a relationship

There are many reasons why commercial relationships break down. In some cases, from a buyer's perspective this may not be an issue. For example, if the supplier is not providing an important input, they are being unresponsive and we know we will not need them again, it may suit us to end the relationship, assuming the buyer has a suitable BATNA. No one wants to create a reputation for being difficult to deal with (being tough is different) in business, but inevitably in the commercial world relationships will break down and sometimes we will need to reset or repair them. In some cases this breakdown will escalate beyond the buyer and supplier and may need to involve third parties via mediation, adjudication, arbitration, or ultimately litigation, where the parties go to court to resolve their dispute. These dispute resolution methods are out of the scope of this syllabus. Instead we will briefly consider what procurement can do to repair a relationship, with the assumption that there is a contract with the supplier.

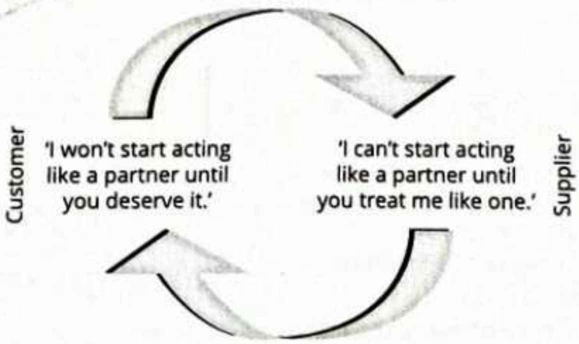
Vicious circle of blame

One important characteristic of procurement professionals should be that they make decisions on the basis of evidence and are driven by the overarching long-term needs of their employing organisation, its objectives, strategy and policies. This does not always align with what the internal customer wants, and we discussed earlier how you have to engage in difficult negotiations internally as well as externally, for the greater good. Being seen as an unattractive customer will cost the employer in the long run, and this reputation may spread among the supply base; so it can be helpful if they are seen as an 'honest broker' seeking to resolve the dispute and repair the relationship. Very often procurement professionals will find evidence of a vicious circle where the supplier blames the organisation (or less likely procurement), and the organisation blames the suppliers.

Customer rationale:

- You're trying to up-charge me or sell more scope after agreement.
- You've sent your B team in now that you have my business.
- You aren't providing me with cost transparency.
- You aren't getting our service under control.

'I am going to hold you to the contract, and not give you the benefit of the doubt.'



Supplier rationale:

- You don't listen to my suggestions or views of what's wrong.
- You don't share information with me.
- You don't resolve our issues or pay for our extra efforts.
- You always think we're out to get you.
- You don't give us access to decision makers.

'My hands are tied. I am going to stick to the agreement, worry about my own profitability, and not go the extra mile.'

Figure 1.26 Circle of blame

In order to break this vicious circle, procurement will need to use their negotiation and conflict management skills, adopting a collaborative and integrative approach. From your studies of chapter 1, you should be aware of the sources of conflict, misunderstandings and mistrust in relationships.

Your first action should be to establish the facts that led to the situation where the relationship broke down. Most day-to-day relationships between buying organisations and suppliers do not of course involve procurement staff, so you will need to consult with your business partners internally to establish their point of view of where the issues and sources of conflict are. You should also contact the supplier and get their side of the story – this is particularly true when you have previously identified the supplier as critical or otherwise important to your operations. Ideally, you will be able to apply principled negotiation here, separating the people from the issues, focusing on interests and not positions, and then looking for options for mutual benefit.

Assuming both parties want to repair the relationship, then following the negotiation you will put in place the agreed changes, structures, and programme that both sides agree will assist in resetting the relationship. In some cases it may be appropriate to involve a third party to facilitate elements of the 'repair', if the relationship is critical and there is a lot of personal interaction involved, e.g., complex on-site service delivery. To restart things, you may need to consider a 'relationship relaunch' event, joint triage teams and new governance structures for problem solving and escalation.

Chapter Summary

In this chapter we introduced the principles of negotiation and the contexts in which commercial negotiation takes place.

In section 1.1, we considered definitions of negotiation and reviewed areas where negotiation typically happens in the procurement and contract management cycles. We considered the sources of the divergent positions or 'conflict' that drives the need to negotiate, and the different approaches to managing these conflicts. We provided a description of key stakeholder groups and emphasised the importance of gaining their support. We highlighted the benefits of negotiating as part of a team, and the importance of identifying appropriate team members with a clear definition of roles.

In section 1.2, we explained alternative high-level approaches to negotiation that can be summarised as 'win-win' or integrative and 'win-lose' or distributive. We considered how targets can be set for a negotiation, and explained the important concept of BATNA – best alternative to a negotiated agreement.

In section 1.3, we considered the balance of power in commercial negotiations and how this can affect both the process and the outcomes. We looked at six sources of personal power that individuals can draw on in negotiations. We also considered sources of organisational power that derive from the wider business environment (STEEPLE influences), the nature and structure of the industry (Porter's Five Forces) and the relative strengths of the individual buying and selling organisations (supplier positioning).

In section 1.4, we considered the different types of relationship that can affect negotiations and referenced well-established models of supplier relationship management (SRM), e.g., segmentation of the supply base. We focused on 'trust' and 'reputation', and their influence on negotiations both at the contract award stage and also throughout the life of the contract.

End of Chapter Assessment

1. Describe the difference between content and process in the context of negotiation. DESCRIBE

2. Explain the following approaches to negotiation and the context in which they might happen. EXPLAIN
   a 'win-win' or integrative
   b 'win-lose' or distributive

3. Discuss two solutions to try when a commercial relationship has broken down. DISCUSS

Recommended reading

Steele, P. T. (n.d.), *How to Negotiate Professionally* [online]. Retrieved from: www.cips.org/Documents/CIPSAWhitePapers/2007/How%20To%20Negotiate%20Professionally.pdf [Accessed on: 28 February 2019]

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10 Fisher, R. and Ury, W. L. (1981), *Getting to Yes: Negotiating an agreement without giving in*. London: Penguin Books

11 Ibid.

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13 Ibid.

14 Porter, M. E. (1979), "How competitive forces shape strategy", *Harvard Business Review*, Volume 57, Issue 2, pp. 137–145

15 Bueler, D. (2006), *Supplier Segmentation – The Tool for Differentiation and Results* [online]. Retrieved from: www.instituteforsupplymanagement.org/files/Pubs/Proceedings/JHBueler.pdf [Accessed on: 26 February 2019]

16 Steele, P. (n.d.), *How to negotiate professionally* [online]. Retrieved from: www.cips.org/Documents/CIPSAWhitePapers/2007/How%20To%20Negotiate%20Professionally.pdf [Accessed on: 26 February 2019]

LO2

CHAPTER 2

Know how to prepare for negotiations with external organisations

Learning outcome

By the end of this chapter, you will know how to prepare for negotiations with external organisations.

Chapter overview

2.1 Describe the types of costs and prices in commercial negotiations

You will understand:

- Types of costs: direct and indirect, variable and fixed
- Break-even analysis: cost volume profit formulae
- Costing methods such as absorption, marginal or variable and activity-based costing
- Volumes, margins and mark-ups and their impact on pricing
- Negotiating prices

2.2 Contrast the economic factors that impact on commercial negotiations

You will understand:

- The impact of microeconomics and market types on commercial negotiations
- The influence of macroeconomic factors on commercial negotiations
- Sources of information on micro and macroeconomics

2.3 Analyse criteria that can be used in a commercial negotiation

You will understand:

- Setting objectives and defining the variables for a commercial negotiation
- Defining the variables and limits
- The bargaining mix
- Positions and interests
- Openings and presenting issues

2.4 Identify the resources required for a negotiation

- Choice of location
- Involving appropriate colleagues
- Use of telephone, teleconferencing or web-based meetings
- Room layout and surroundings

Introduction

Total cost of supply
The sum of all the costs associated with every activity directly associated with the supply of a good or service

The main factor that distinguishes commercial negotiations from all other types of negotiation is the centrality of the price element. In almost all commercial negotiations involving procurement, even if price is not an explicitly key variable, then underlying cost will be. For example, in cases where non-price factors such as contractual terms, warranty periods, service levels, supplier lead time, risk share, innovation, etc., are being negotiated, all of these variables can be evaluated in terms of impact on **total cost of supply** from a procurement perspective. It is possible, with access to the required data, to put an equivalent price or cost against almost all variables up for trade in a negotiation, and procurement teams are perhaps best placed to do this. For example, a five-year supplier's warranty on an electric pump could be very valuable if your data suggests there is normally a breakdown requiring expensive maintenance in that period. If, however, your data suggests that it is in year six that the pump typically fails, then this warranty is less valuable in cash terms to you.

Understanding cost behaviour and the impact of costs on suppliers' prices in general, and in particular within one-to-one negotiations with a supplier, is an essential core skill for procurement professionals. Notwithstanding all the strategic benefits of procurement that go with cost reduction, the ability to identify and deliver savings that feed straight to the bottom line is still expected as a core procurement skill. As more organisations outsource non-core services and spend greater amounts of money on external suppliers every year, the importance of procurement to profitability has never been more relevant. The profit leverage effect is well known within procurement, but less well known beyond the function, and is illustrated in the table and figure below.

Cost saving measures	Amount saved	Total business costs
Traditional areas of focus • Downsizing • Automation • Process • Re-engineering	Between 20% and 40%	Overhead Direct labour Indirect labour
Unexploited areas of focus • Procurement • Cost analysis • Supplier involvement	Between 60% and 80%	Purchased goods and services → Strategic sourcing

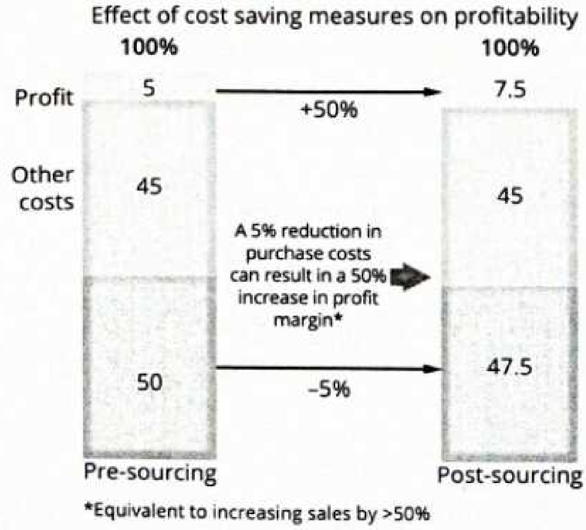


Figure 2.1 Profit leverage effect

A small percentage saving achieved through a negotiation can have a much bigger percentage impact on profits (or surplus in not-for-profit organisations), depending on your external spend and your cost structure. In this chapter, we first review core cost concepts in business and highlight how a solid understanding of these concepts can assist in achieving commercial negotiation objectives. In section 2.2 we will consider the wider economic forces and factors that set the context for the negotiation. We will then be ready to plan our negotiation and set objectives. In sections 2.3 and 2.4 we will consider these 'logistical' elements.

2.1 Describe the types of costs and prices in commercial negotiations

Types of costs: direct and indirect, variable and fixed

The term 'cost' has many applications in procurement. At its most simple level, suppliers incur costs in producing their goods or services and typically add a margin to arrive at a price charged to the customer that allows for some profit. The margin they add or seek to add is influenced by multiple factors, some of which we have addressed in the previous chapter – e.g., customer attractiveness. It is also affected, of course, by the negotiation process and to what extent suppliers can defend their price in the negotiation. Suppliers will often use references to their costs in setting prices and in negotiations, to explain why price concessions can or cannot be made.

In a free market, all commercial organisations need to make a profit in the long run on their operations, otherwise they will fail through inability to pay their staff, suppliers and taxes. The prices they charge to different customers, however, can vary significantly, so an understanding of cost structures will provide you with insights to help you in negotiations with suppliers. In this section we will consider direct and indirect costs and variable and fixed costs.

Direct and indirect costs

Direct costs

Direct costs are those costs of a product/service directly attributable/traceable to its production, for example, the cost of labour and materials directly used to produce the goods/services which the organisation sells.[1] In the case of a manufacturer of aircraft, this would include all the costs of materials and services bought and the costs of labour used in the factory to build the aircraft. In a restaurant, it would include food ingredients and staff.

Examples of direct costs include the following.

- Materials and services bought-in: the raw materials, bought-in parts and assemblies, and externally provided services, e.g., transport, used to produce the finished product

- **Labour or wages:** money paid to staff for the work involved in producing the product
- Expenses: other charges incurred that can be specifically attributed to a particular product, batch or service, e.g., software licence required to work on a product

Typically, direct costs should be relatively easy to calculate as all costs related to the item purchased or provided in-house should be traced to a cost centre, cost code or project. In some organisations there is poor discipline around using the correct cost code (typically issued from the finance department) when the business is ordering supplies or services, and so direct costs cannot be tracked with accuracy. This is why, in many organisations, orders cannot be released to suppliers without having the correct cost code attached. Many order-to-pay systems can check if this code is correct or 'looks right' and reject if there is any anomaly. Although this can be frustrating, if you need to send an order urgently, the whole basis on which direct and to a lesser extent indirect costs can be traced is based on correct use of cost codes by staff.

Indirect costs

Indirect costs are those costs that are not directly attributable to production, for example, the cost of advertising, the personnel department or the finance department.[2] These are often known as overheads (OHD).

Examples of indirect costs include the following.

- Materials and services not used in production: office and factory consumables that are not accounted for individually, such as stationery, cleaning materials and some spare parts for machinery
- Labour: all staff costs not directly attributable to production, such as management, sales and marketing, ICT support, R&D, store- and security-staff wages, and so on
- Expenses: rent, rates, insurance for plant and machinery, allowance for bad debts

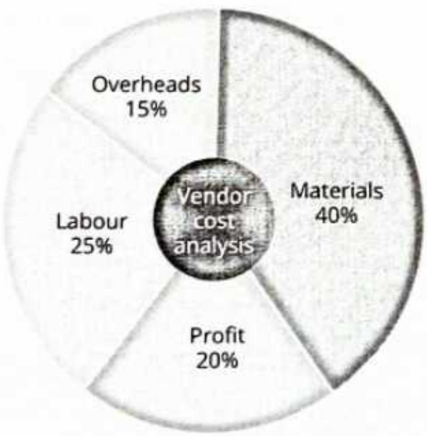


Figure 2.2 Cost breakdown pie chart

Indirect costs are just as 'real' as direct costs and need to be paid, so they must be apportioned in some way to the individual goods or services which are produced, so that these costs can be recovered in the price charged. Common ways are by reference to the number of items produced, the number of direct labour hours required to produce those items, or the amount of direct materials used.

For products with the example cost breakdown shown in figure 2.2 above, you could calculate how much to add to the price of each item to cover overheads as follows.

Charge for overheads = 60% of cost of labour

Or

Charge for overheads = 37.5% of cost of materials

Simple absorption of OHD against labour hours, material cost, etc., as illustrated above, ignores the drivers of those overheads and applies the same OHD charge to all customers regardless of how much OHD they are responsible for 'driving'. For example, a customer who always pays on time and has an excellent credit rating might reasonably object to paying even a small portion of the price to cover the supplier's bad debt costs. Attractive customers who drive lower overheads have a lower 'cost to serve' associated with them, and so may reasonably push for discounts on this basis. For this reason, procurement are very interested in how suppliers apportion or absorb OHD costs into finished goods and services prices, as this is sometimes quite arbitrary from a customer point of view, and so can be a basis for price negotiation. We will consider activity-based costing as an alternative way of attributing OHD costs later in section 2.1.

> *Apply*
> How might you identify procurement categories where a large proportion of the input cost is the supplier's overheads or indirect costs? Provide examples and propose how you might seek to negotiate a reduction in this element of cost in negotiations.

Variable and fixed costs

Most organisations incur some cost even if they do not produce anything as they need to pay for rent, travel, licences, technology infrastructure, etc. These costs are essentially fixed and do not vary much with the amount produced/output volume, at least within a given period.

Fixed costs (FC) are costs that do not vary with volume, e.g., factory rent cost, equipment, security of premises, salaried staff or staff on long-term contracts, vehicles.

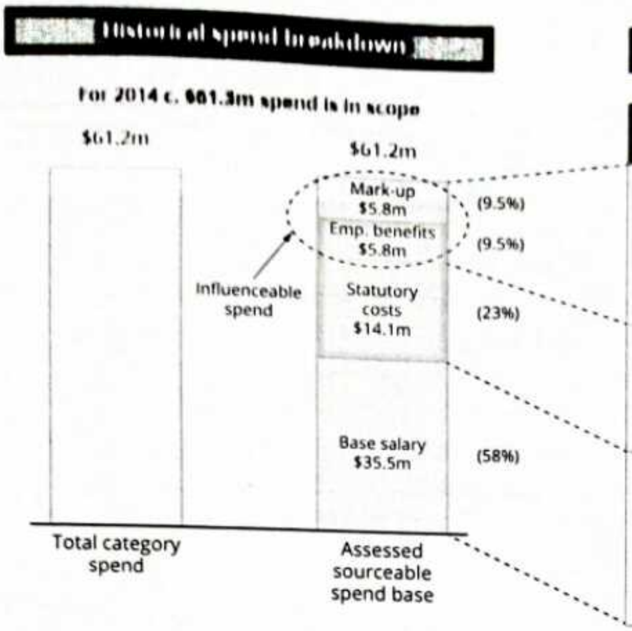
Variable costs (VC) are those which vary with the amount produced. The cost of materials in a production process is a variable cost.

Semi-variable costs are costs that have a fixed and a variable element such as most utilities. Gas, electricity and water have standing connection charges as well as charges per unit used.

Fixed costs are not fixed forever and will increase if, for example, a business expands and needs to open a second factory in order to increase output. It will then incur a 'step' jump in fixed costs. In an unpredictable business environment many organisations seek to reduce their fixed costs and convert fixed costs into more flexible or variable costs. Outsourcing, leasing and leveraging Internet technologies using others' fixed assets, e.g., Airbnb, Uber and Deliveroo, are examples of this approach, whereby some organisations have radically reduced fixed costs by hardly investing in any fixed assets. From a procurement perspective it is essential to understand your supplier's cost structure. The most fundamental level is the breakdown of delivered cost (price) into fixed and variable elements. This brings us onto the important concept of **addressability of spend**. The graph in figure 2.3 shows an analysis of supplier costs for temporary hospital nurses. Here, only 19% of the spend is addressable – that is, influenceable through negotiations – while 81% is essentially fixed by legal regulations.

A Z

Addressability of spend
Spend that is influenceable through negotiations or application of other savings effort or leverage with suppliers



Key points

Cost type	Benefits driver	Comment
Variable $11.6m	Supply side and process imp.	From a supply-side perspective, base salary and statutory costs can be identified as fixed costs (exception on labour rates is the UK where the base salary can vary).
Fixed $14.1m	Demand side	Supply-side benefit focus will be on 19% of the total costs which represents $11.6m of total temporary labour spend in 2014.
Fixed $35.5m	Demand side	Employee benefits can only partially be addressed as some elements (holidays and sick-pay are regulated through the government and therefore only the amount may vary per temporary labour agency)

Figure 2.3 Addressability of spend

Addressability of spend – procurement influence?

A key consideration when seeking to negotiate prices is therefore to establish what proportion of the spend is addressable, that is, potentially influenceable by procurement actions such as negotiation. If you break down the cost components of a supplier's price, you will see some areas are not addressable, for example, statutory minimum wages, regulation costs, commodity material inputs, etc. When you take away these non-addressable elements, it may be that procurement are only able to influence a small percentage of the price. In the example above, temporary agency staff costs account for only 19% of the spend, while the supplier's mark-up and employee benefits are actually addressable. The other costs are in effect fixed in the short-to-medium term. In price negotiations, in this example, procurement are looking at savings from $11.6m. If 10% were achieved on this through negotiation, i.e. $1.16m, this might be considered very significant from a procurement point of view, but will only register as a less than 2% saving on the category overall, and may not be noticed by budget holders or stakeholders. Perhaps procurement would be better off expending energy on challenging demand here instead?

> *Apply*
> Identify four purchase categories with relatively high fixed to variable cost ratios and four with high variable to fixed cost ratios. You should be able to justify your choices with evidence and assumptions.

Suppliers' fixed and variable costs: implications for negotiations

1. At high levels of output suppliers may need to open a new factory, buy more equipment or make some other fixed-cost investment. This may mean they will seek to charge higher prices to cover this step change in fixed costs.
2. Alternatively they may price higher to discourage demand at high capacity levels so that they do not need to open a new factory or recruit new staff.

2.1 LO2

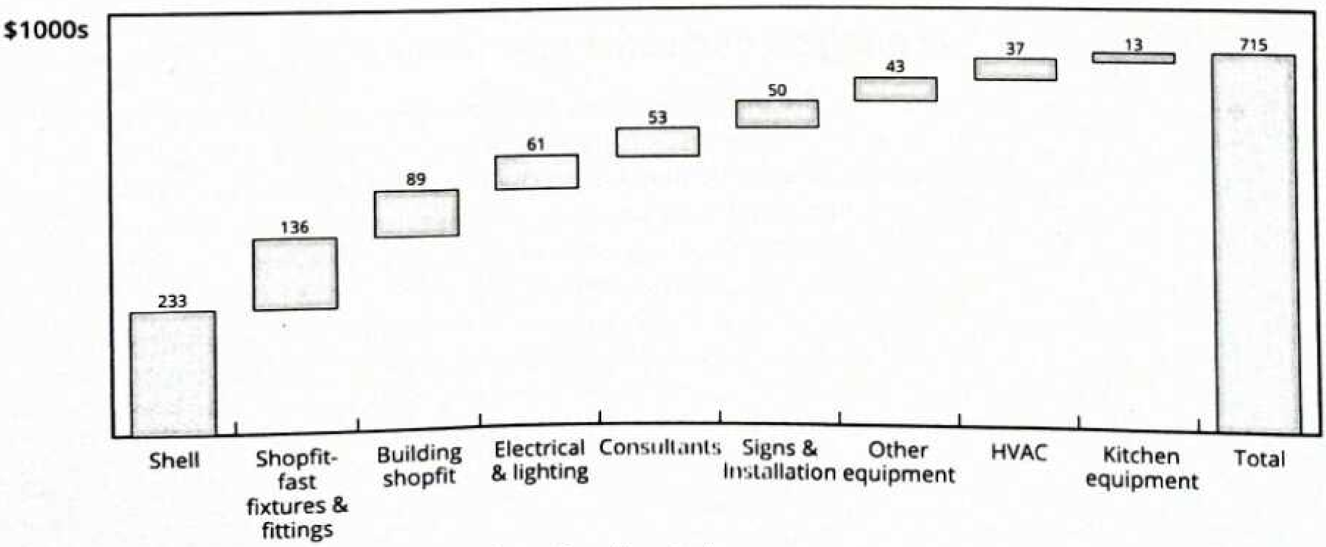
3. Suppliers with high FC:VC ratios, e.g., training providers, need high volumes to break even, but once achieved may be able to offer significant discounts for bulk orders.
4. Suppliers with high VC:FC ratios, e.g., agency staff providers, will not be able to offer significant discounts for bulk orders as most of their costs are variable.

Understanding your supplier's cost base

Understanding where and with whom your supplier spends their money, or understanding the 'cost breakdown' or 'price build up' of the goods and services you purchase from a supplier, will help you know where and when they can offer price concessions. For example, if you know a supplier's breakdown of cost for steel pipes is as set out in the pie chart in figure 2.2, and you are aware from an international commodity index that the raw material price of steel has dropped by 20%, all things being equal you can assume your supplier is enjoying an 8% reduction in overall cost (20% of 40%) and so may be more open to pressure for a price reduction based on this. They may deny they are seeing this reduction in input cost, but then you can challenge on the basis that on average the index suggests their competitors are getting it, and ask why they are not benefiting from it too. This can of course work the opposite way as it is likely that your supplier will be very forthcoming in providing evidence of the unavoidable cost increase they must pass on if the price of steel increases by 20%. In this case, armed with the cost breakdown analysis, you may be able to limit the increase to 8% based on logic, notwithstanding the 20% increase the supplier may seek from more naive buyers.

Visualising cost breakdowns

Cost information can be expressed with more impact through graphs that can be created using Excel and PowerPoint. These are more easily understood by wider stakeholder groups, and can assist in focusing them and getting their buy-in for negotiations. The figure below is a 'spend waterfall' graph showing the build-up of costs for shop fitting for a fast food restaurant chain.



Spend breakdown for all cost elements required for new shop fit for chain of fast food restaurants

Figure 2.4 The spend waterfall

You can also analyse your spend at organisation level and focus on the high-spending business areas or categories. The graphic below is a 'spend tree' showing all the spend, in this case, by departments in a regional council and then by spend category.

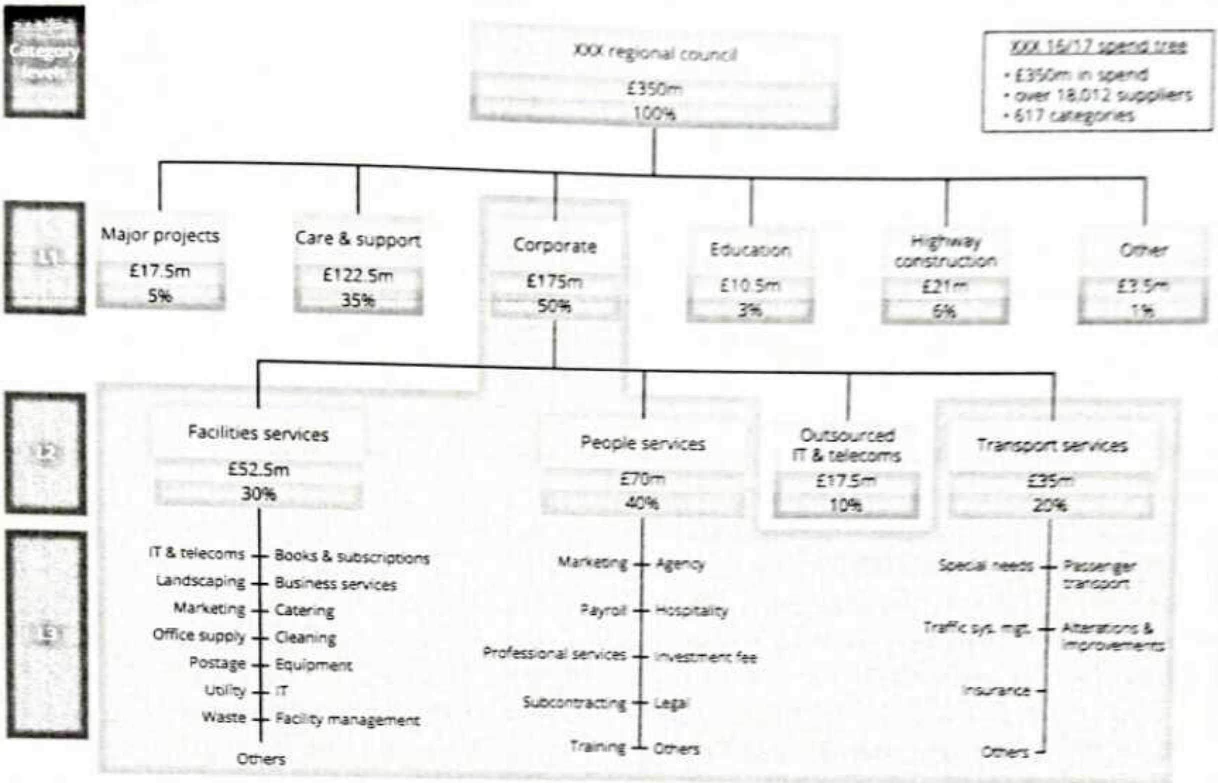


Figure 2.5 The spend tree

In the example above, the 'Corporate' category at level 1 accounts for over 50% of all spend and within that category the sub-category 'People services' accounts for the biggest portion with 'Agency' (temporary staff) alone being £50m. Unfortunately from a negotiation perspective, the bulk of 'Agency' cost is direct costs (wages paid to staff) and so it may be difficult to negotiate this down, so a commercial team may focus on another category.

Value analysis and value engineering

Understanding the constituent cost elements that make up price is particularly useful if the item you are buying is a large spend item and is bought regularly or repeatedly. This is true in mass production and high volume manufacturing or extractive industry. Understanding cost elements allows you to apply multi-disciplinary techniques such as value analysis and value engineering to processes or products where the analysis can identify elements that add cost but not value for you. You can then propose to suppliers (negotiate) that these elements are removed, substituted or designed out. In this way you are targeting suppliers' costs and not their profits and so co-operation is more likely. Some leverage with suppliers is required of course to make this happen. Ray Carter coined the useful mnenomic STOPS WASTE to remind buyers of ten cost-reduction ideas they can ask of themselves and their suppliers in any situation when considering a key purchased input.

STOPS WASTE:

- **Standardisation** – Can we use a standard specification?
- **Transportation** – Is the inbound transport classification appropriate?

- **Over-engineered** – Is the specification too tight?
- **Packaging** – Can packaging be reduced or eliminated?
- **Substitutes** – Can we use an adequate cheaper substitute material?
- **Weight** – Can we take weight out of the product?
- **Any unnecessary processing** – Is there any unnecessary design or feature?
- **Supplier's input** – Can the supplier assist with cost-reduction suggestions?
- **To make** – Is it cheaper to make it ourselves?
- **Eliminate** – If no one uses the feature can it be eliminated?

Exchange rate movements

Understanding your supplier's exposure to exchange rate movements in high-spend areas is also potentially a very useful insight. If exchange rates have moved favourably for your supplier, it is likely that you will hear nothing from them. However, if the movement is unfavourable to them, i.e. your currency has weakened relative to theirs, they will normally be quick to let you know. Pricing contracts in your own currency is a way to manage risk here, but this is not always possible if the power is on the supplier's side.

Insight into vendor supply capacity

In some markets suppliers experience peaks and troughs in demand and so buyers can increase their leverage through developing an understanding of how busy their vendor(s) are at particular times during the year or business cycle and targeting them at quieter periods. Similarly, if a buyer can develop an understanding of supplier capacity and to what extent have they covered their fixed costs, they may be able to target suppliers when their average costs are likely to be lowest.

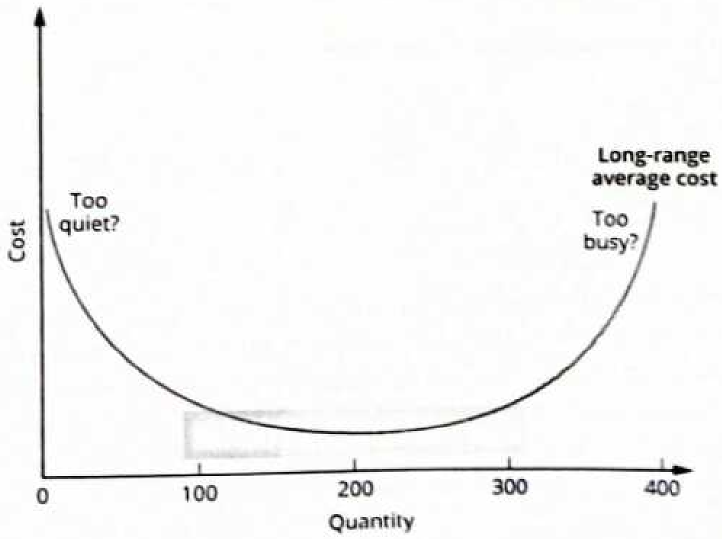


Figure 2.6 Supplier's cost curve

We will consider microeconomic factors in section 2.2, but in brief, basic microeconomic analysis suggests that, all things being equal, vendors' average costs will be higher at low and high capacity utilisation. For example, when a factory first opens there will be significant overheads or fixed costs to recoup, so suppliers may seek to load as much of this overhead as possible onto the early buyers if they can. As the factory wins more orders the average costs drop until they reach a low plateau or 'sweet spot' indicated in grey in the diagram, where long-range average cost (LRAC) is at its lowest. Buyers negotiating here will be in a stronger position to negotiate more favourable prices than the 'early' or 'later' buyers. As the factory approaches full capacity, average costs tend to rise again as equipment fails and staff must be paid overtime, and the only way to reduce average cost is to expand capacity by perhaps opening another factory – clearly a major and possibly risky investment for the supplier who needs a good incentive to do so, such as higher prices. We will revisit this in the next section on microeconomic factors.

Early procurement involvement

The earlier procurement get involved in the procurement processes, the better. If procurement are involved in design at the specification stage they can feed in prices and costs to designers so they know the likely budget implications of choices made. Sending in a procurement team to negotiate at or close to the end of the procurement process effectively ties their hands and limits their negotiation leverage. This is illustrated in the graph below.

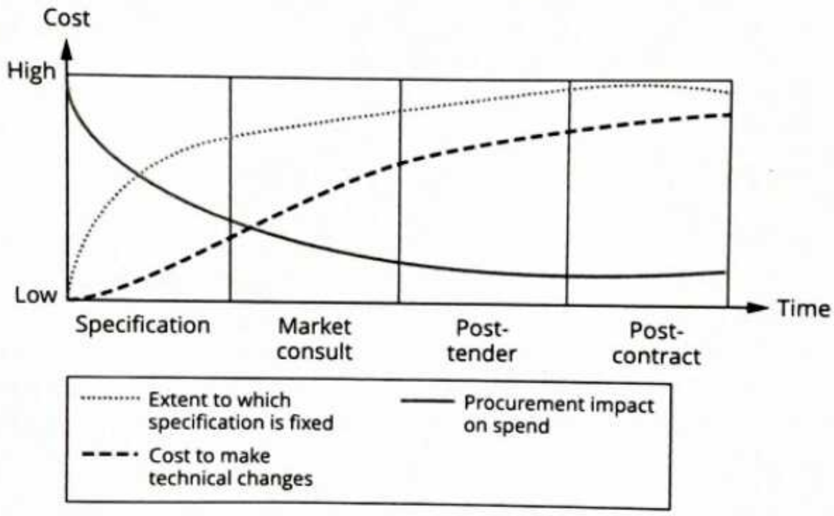


Figure 2.7 Procurement involvement over time

Break-even analysis: cost volume profit formulae

The analysis of costs into fixed and variable enables organisations to determine their break-even (BE) point – the point where total revenue from sales and total costs exactly balance. All costs need to be covered by sales revenue in order for a company to make a profit. If you know your fixed costs and your variable costs (a basic requirement in business) then you can work out the minimum quantity of goods or services you need to sell to break even.

Break-even point is measured in volume and can be worked out graphically or via formulae. You need to know your fixed costs, variable costs and the selling price. If selling price is below variable cost it will be impossible to break even at any volume as no contribution from the selling price is being made to cover fixed costs. Profits will never be achieved. If, for example, it costs you \$5 for ingredients per unit for the burgers you sell from your burger van and you pay \$500 rent per month for the van, then you can never make a profit selling at a price less than \$5 as you will not even cover your ingredients costs and so will have nothing left over to contribute to covering fixed costs (the van).

Any price above variable cost however will provide a contribution to fixed costs, and once fixed costs are covered, this contribution (price less variable cost) becomes profit. If you sell each burger for $10, this will more than cover the variable cost per unit and will deliver a profit once sales exceed the break-even point. This is shown in figure 2.8 below.

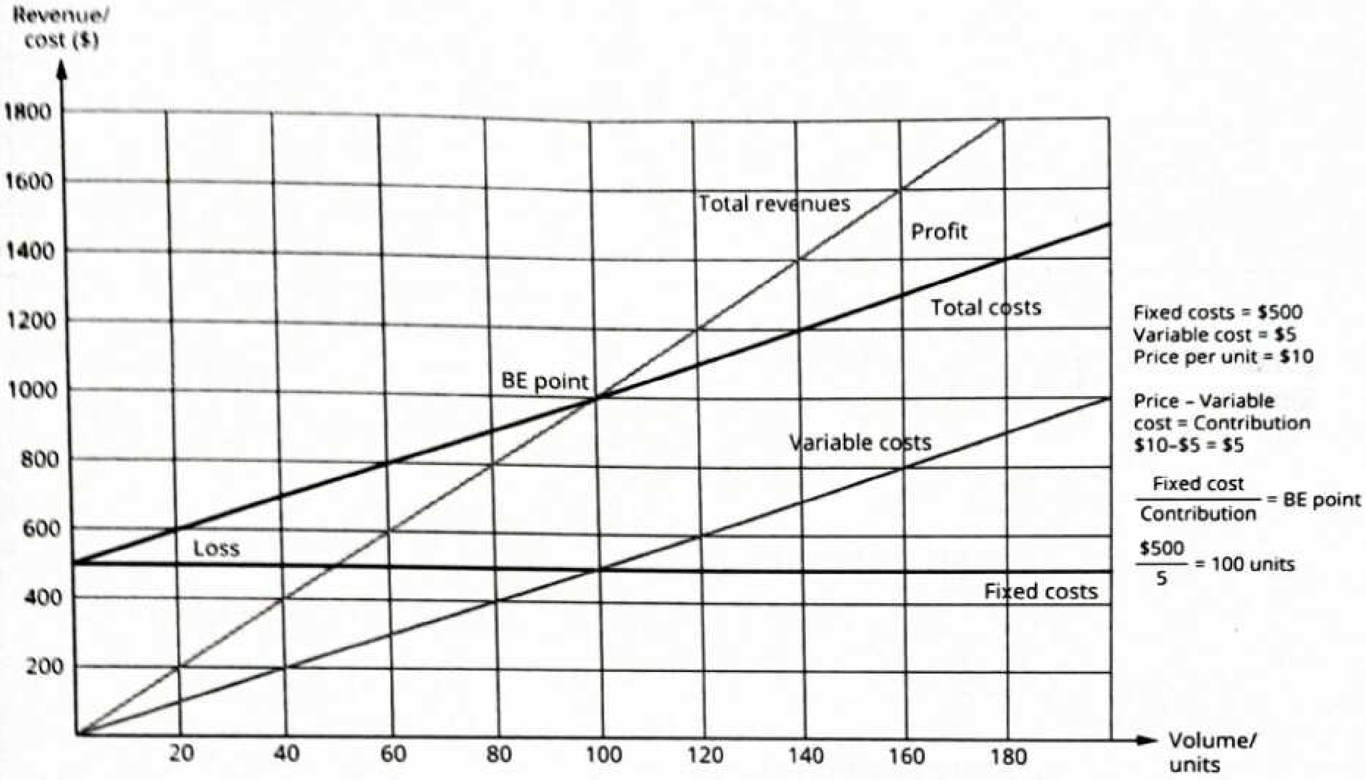


Figure 2.8 Break-even point graphed

Apply

In the example above, what would the break-even point be at $6, $8, or $12?

What would profit be at price $11 and volume 200? Using spreadsheets will facilitate far more complex calculations and cost modelling incorporating multiple input factors.

Break-even point formula:

Price - Variable cost = Contribution

$$\frac{\text{Fixed cost}}{\text{Contribution}} = \text{Break-even point (volume)}$$

The BE point is thus an important determinant of flexibility of pricing for suppliers. Before BE is achieved there will, in general, be much greater reluctance to offer price concessions to customers than after BE is achieved. At low levels of output, suppliers tend to be under pressure to shift as much OHD to 'early' customers as possible.

Case study

Negotiations training provider

Cost of hotel conference room/refreshments: $1000 up to 15 people

Cost of trainer (fee): $500

Price of course $300

BE point = 5 participants

In this case there is in effect no variable cost for the training provider. The cost of one additional participant once BE is achieved is $0. Imagine how strong your negotiation leverage would be if you knew that they had already achieved BE. Note that the supplier may not wish to discount publicly to protect their 'price integrity' but knowing they can do it at $0 cost is powerful. Perhaps they offer 'buy one get one free' (BOGOF), as this protects the core price of $300. They might also insist on confidentiality regarding the price you paid.

Costing methods such as absorption, marginal or variable and activity-based costing

Absorption costing

Absorption costing is an approach to allocating overheads in which indirect costs are loaded or 'absorbed' into direct costs related to specific jobs, processes or outputs, using an estimated basis of allocation. Total absorption costing is an approach to dealing with allocation of overhead costs in which all the overhead costs such as rent, rates, premises, head office administration, etc., are fully recovered by being incorporated into the costs of products created. Even when cost accountants seek to apply intelligent methods to allocate overhead costs to each product being produced, this allocation method essentially represents a relatively arbitrary method of linking the overhead costs to a product or service.

Marginal or variable costing

Marginal cost is the cost of producing an additional unit of output. For example, supposing a supplier produces 100 units at a cost of $1000, and the cost of making 101 units is $1005. The average cost per unit is $10, but the marginal cost of the 101st unit is only $5. When negotiating with suppliers, buyers may seek to persuade the supplier to set a price that covers their marginal costs only, rather than adopt absorption costing. This was the basis of our logic in the 'Negotiations training provider' case study above, where we knew the marginal cost was in effect zero. Absorption costing means that the product absorbs all of the variable costs and a fixed percentage or value of overheads, even if overheads have been covered; marginal costing does not. In the example above, a marginal costing argument might be used to suggest a price of $6 per unit, covering the supplier's variable costs and making a contribution towards overheads and profit.[1] Clearly from a supplier perspective it is tempting to lower price and consider marginal cost-based pricing to increase sales; however, if a supplier develops a reputation for doing this their price integrity in the market can suffer and fewer buyers will be willing to pay the fully loaded price. Dynamic pricing, which is based on marginal costing, is used by airlines and many other organisations that are able to sell online generally in consumer markets, with the price varying depending on demand and whether nominal break-even or revenue targets have been reached. It is perhaps more relevant in spot-buying situations and less relevant in industrial and business-to-business negotiations where longer-term arrangements are sought.

A Z

Dynamic pricing[4]
The practice of varying the price for a product or service to reflect changing market conditions, in particular the charging of a higher price at a time of greater demand

Activity-based costing

Activity-based costing is an alternative approach to the allocation of overheads that recognises that traditional approaches such as allocating a standard percentage are relatively arbitrary and can lead to incorrect understanding of actual costs and profitability. As an example, let's say two products each require one hour's labour and the same material cost, but product A requires 60 minutes' of processing by an expensive machine, whereas product B requires six minutes' processing by the same machine. If the overhead apportionment is based on labour hours and a standard percentage is added, both products will be costed the same, and product B will subsidise product A. Under activity-based costing, a cost driver will be used to apply the overhead cost, and hence its real profitability will be measured.[5]

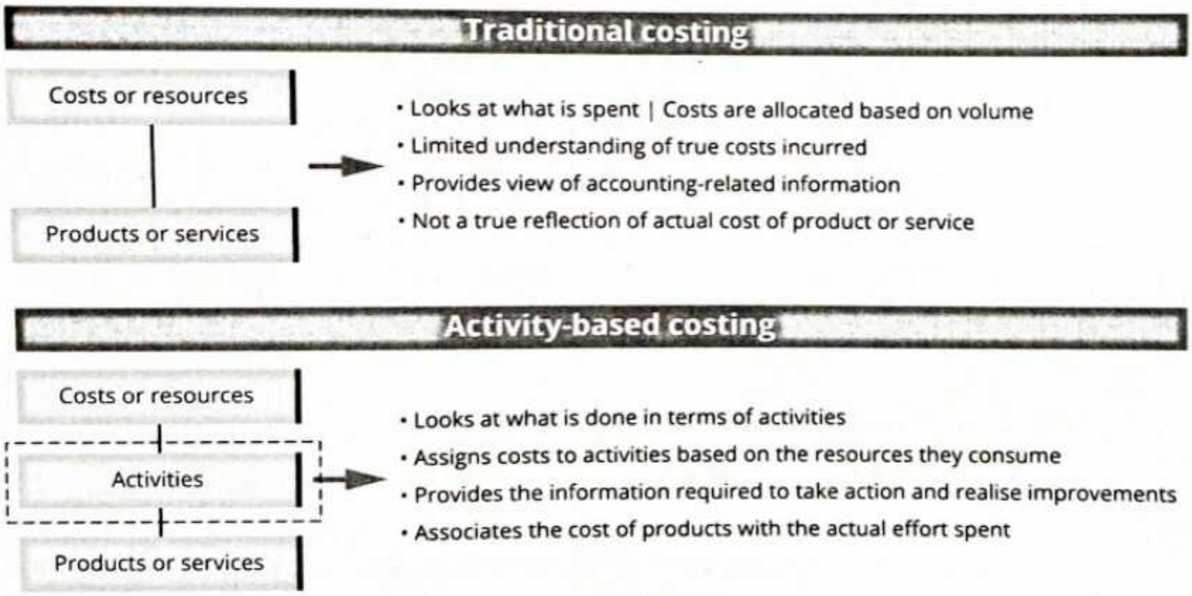


Figure 2.9 Comparing traditional and activity-based costing

Activity-based costing sits happily with Lean thinking. Under activity-based costing efficient customers can be rewarded for not driving as much activity as less efficient customers. For example, assume a software company offers first line telephone support to all its customers 24 hours a day. This cost will normally be recovered through the selling price of the software or licence fee. However, customers who do not use this support service are paying the same as those who do and are thus subsidising these other customers. Activity-based costing takes this into account and seeks to load more cost onto the customers who drive more activity and attract a higher cost to serve. There are potentially ethical issues with this form of costing in some consumer markets where it may be accepted all customers should pay the same for the sake of equity, e.g., insurance products. People seeking utility connections in rural areas, for example, may be charged the same connection fee even though it costs the utility company much more to connect a remote home than a home in an urban area. From our commercial negotiations perspective, we are not required to study cost accounting topics in detail but we are interested in the impact the chosen costing method has on the following.

- How the supplier builds up their costs and prices in general
- How the supplier applies this methodology to our requirements
- Whether changing the costing basis would favour us
- Areas where we may be able to push for cost reduction/saving

> *Apply*
>
> Find out what costing approach your company uses with the products and services you sell to your customers.
>
> Read the CIPS Knowledge Works Paper on 'Activity-based costing' on the CIPS website to get a thorough overview with detailed examples related to procurement.

Other cost concepts important in negotiations

Cost plus

Cost-plus contracts are agreements where the contractor's pricing is based on itemising allowable costs and then adding an agreed margin. Such a pricing basis may be appropriate when there is uncertainty about the scope or nature of the work and the client is willing to accept a level of financial risk.[6] The benefits of the approach include reduction in the contractor's contingencies, but the contractor may have limited incentives to act in the most economical way, unless the customer can benchmark or otherwise check purchased costs are reasonable. Cost plus is often associated with cost transparency where the buyer can see/has access to the supplier's costs for verification and benchmarking purposes.

Total cost of ownership/total cost of supply/whole life costing

The concept of total cost of ownership highlights the fact that the initial purchase price in many cases is a small component of the total life cost of some assets. Support, maintenance, training, insurance, security, energy consumption and disposal all add to the total cost of ownership in the case of equipment and assets.[7] Even in the case of items that are used up directly or indirectly in production there are factors that need to be considered when considering the total cost of supply, such as:

- Payment terms
- Delivery speed and lead time
- Service levels and response times
- Willingness and ability to hold inventory
- Provision of value-added services, e.g., unpacking, delivery to line, set-up, etc.

The concept of total cost of ownership or supply is widely used in procurement, though calculation of the total cost is not straightforward. All lifetime costs need to be identified and assumptions made about the scale of future costs, which are then incorporated in an overall cost model, so it can become quite complicated even before the time value of money is considered.[8] Nevertheless, from a good practice procurement perspective, estimates need to be made with wide parameters, e.g., +/– 20%, so that competing bids or negotiated offers can be compared from the total cost perspective.

> *Apply*
> Review the CIPS Position on Practice paper on 'Whole Life Costing' on the CIPS website for more discussion on its application in procurement and negotiation of contracts.

Volumes, margins and mark-ups and their impact on pricing

Margins and mark-ups

Margins and mark-ups are terms you will come across frequently in a retail or distribution environment, but they also have applicability in many other business-to-business (B2B) commercial negotiations. They are important and typically confidential measures used by suppliers in formulating prices. In some negotiations, e.g., retail and distribution, they may be openly discussed by both parties.

Mark-up is the amount added to the cost of an item to get to its selling price and is expressed as a percentage. It is commonly used in retail, reseller and wholesale markets where physical products are sold either directly to customers or via a distribution chain, where all members need to make a 'cut' or margin.

If something is bought for $50 and the selling price is $100 then the mark-up is 100%. This $50 can be considered gross profit but it does not equal net profit as many costs will need to be paid out of it. The mark-up must allow for all of these costs and a profit element if the seller intends to make a net profit.

Suppliers selling their products into long distribution chains also need to take account of distributor and retailer mark-ups when setting their own prices and when thinking about their price positioning from the final customer's point of view.

$$\text{Mark-up (\%)} = \frac{\text{Price} - \text{Cost}}{\text{Cost}} \times 100$$

Margin is simply the amount added to the cost of an item expressed as a percentage of the selling price. In the same case as set out above, if something is bought at $50 and the selling price is $100, then the gross margin is 50%.

$$\text{Margin (\%)} = \frac{\text{Price} - \text{Cost}}{\text{Price}} \times 100$$

Effect of volumes

Mark-ups and margins allow suppliers to make gross profits. Typically, at high volumes suppliers can make net profits at low margins, but at low volumes suppliers will need to charge a high margin to make net profits. In many countries, international and mobile phone call charges have come down by a huge amount – over 95% in some cases from their heights in the mid-1990s – yet the operators still make high profits due to the enormous increase in demand there has been for their products over the past 20 years and also the lowering of costs. If you are selling 100,000,000 minutes of 4G bandwidth every hour, you only need to make a tiny margin – a fraction of a percent on each minute – to very quickly accumulate significant profits.

On the other hand, consider a supplier of fresh fish to upmarket restaurants in London or New York. They may need to operate at a mark-up of 200% or more to cover the inability to buy in bulk that results from their need to buy every day from the market, as well as spoilage, cold chain costs, strict food standards, quality checks, complicated and expensive daily delivery schedules in city centres, and profit. Likewise, suppliers with slow-moving stock or those who offer emergency services, e.g., fixing storm-damaged roofs or broken shopfront windows where they have little regular business, can only survive by charging a high margin on their services, as sales are few and far between and stock and labour costs need to be covered.

Remember that every supplier operates under different cost structures and some are set up to be most profitable at a particular level of volume, so it is dangerous to assume all suppliers can survive on a lower margin if their volumes increase.

Intelligent buyers understand that mark-up and margin may define gross profits, but they tell you very little about a supplier's net profits. If a supplier is not making any net profit, under normal circumstances it will not survive.

- Sales revenue – Cost of sales (direct costs) = Gross profit
- Gross profit – (Indirect/operation costs) = Net/operating profit
- Net/operating profit is also known as profit before interest and tax (PBIT) or earnings before interest and tax (EBIT).

Reviewing suppliers' annual accounts can provide insights into supplier profitability, but this will be the aggregate level and so will need to be interpreted locally for your situation. Profitability in any case is not necessarily a good indicator of company strength or future prospects any more. Many disruptive new suppliers exploiting new technology, Internet access, robotic process automation and artificial intelligence took many years to make profits, e.g., Facebook, Amazon, Netflix and Google, and investors seem happy to wait.

> *Apply*
> Read the CIPS Guide 'Costing and Pricing – What the Buyer Needs to Know' on the Knowledge website, to reinforce your learning here. Remember to apply it to negotiations.

Pricing strategies used by suppliers

Suppliers will typically have pricing strategies/policies for items and/or services within category management groups. These strategies are more effective in consumer markets but are also used in B2B markets. Procurement professionals can usually spot these strategies and develop an appropriate response. A brief description of these strategies is outlined below.

Cost-plus pricing

- Supplier calculates total variable and fixed costs and adds a percentage
- Usually based on historical data and may ignore market forces

Premium pricing

2.1 LO2

- Supplier determined to charge a very high price, not connected with cost structures, usually based on its reputation and/or the perception that the product/service is of a superior quality
- Brand marketing is a prime driver of this approach
- Typically found in the early part of the product life cycle/when demand exceeds supply

Penetration pricing

- Supplier attempting to enter a new market or extend its share in an established one
- Characterised by price reductions to increase volume, followed by steady price increases; may even be loss leading at start (no profit made)

Marginal cost pricing

- Supplier recovers only the variable cost elements in its price
- Price will be well below the market price
- If near full capacity (as long as break-even point has been reached), goods and services can often be sold at a low price without loss of profit

Market pricing

- Supplier sells in line with what the market is prepared to pay
- Market price may be forced artificially high by cartel price fixing

Cost modelling and analytics

Most of us use spreadsheets in our daily working life and it is assumed that procurement professionals have at least a basic grasp of the powerful modelling capability of spreadsheets.

> *Apply*
> Ensure you develop your knowledge and understanding of using spreadsheets as all of the costing techniques discussed here can be easily demonstrated by reference to spreadsheets with multiple functions applied.

Creating a cost model with assumptions and estimates of supplier costs and profits against different volumes, time periods and contract terms is an essential skill in the preparation for commercial negotiations. The impact of time value of money, alternative margins, currency exchange rates, payment discounts and a whole range of assumptions can be modelled in these cost models to assist in establishing whether there is a ZOPA, and then setting your opening and walk-away prices or different packages of prices.

Cost-modelling outputs can also be visualised in creative and impactful ways with use of colourful pie charts, bar charts and interactive 'buttons' that help stakeholders to get a quick overview of otherwise complex information.

Procure to pay (P2P)
The system that connects the steps of the procurement process – from obtaining the raw materials through to making the payment

Procurement analytics

Many organisations have invested in advanced procurement analytics where rich data is extracted and processed from financial systems to support cost-reduction initiatives.

	Category visibility	P2P process compliance	Pricing and contracts	Risk and fraud
Insight	• A single global view of your spend data. Integrating all spend from all systems • Spend visibility – leveraging text analytics, supplier intelligence and third-party data sources • Category insight across suppliers, invoices and materials	• Analyse all data from requisitions, purchase orders, invoices and payments • Identify system and control weakness • Compliance reporting across P2P process • Retrospective POs • Payment term and working capital analysis and savings identification and modelling	• Digitise your contracts • Pricing • Payment terms • Rebates • Contractual obligations • Review contracts against AP data to drive compliance • Identify pricing issues • Identify cash rebates • Refunds	• Identify locational risks across your organisation • Match companies to third-party data sources • Corporate trees, risk profiling, modern slavery, green ratings, SME status, revenue, CEO, etc. • Identify fraud within your AP data • Duplicate payments
Value	• 5–10% saving identification • Supplier consolidation • Improved category management • Intelligently manage, negotiate savings and buy from suppliers	• Identify control weakness • Review and improve P2P and finance processes • Working capital savings • Improved purchasing control	• Digitised contract database • Pricing-related savings identification • Contractual rebates • Monitor supplier performance against contract	• Proactively manage risk • Identify fraud within your AP data • Duplicate payment identification • Ongoing monitoring

Table 2.1 Procurement analytics: a single platform that enables you to make better, faster decisions

The insights and value that procurement analytics can provide are summarised in the table above and go way beyond support for procurement negotiations.

> *Apply*
> Consider the table above and highlight some areas where the data would be helpful in commercial negotiations with your present suppliers.

The outputs of procurement analytics applications can be graphically presented in 'dashboards'. These make it very easy to examine and interrogate spend data and costs in order to quickly understand the issues, opportunities or risks by category, buyer, supplier or any other variable you may want to drill down into. The scope of the syllabus does not extend to the use of cost modelling and procurement analytics; however, it would be wrong not to mention that most professional buyers will have access to some software-enabled tools that support them in their analysis of costs in advance of negotiations. Buyers must of course understand the fundamentals of cost structures and cost behaviour, but when preparing for commercial negotiations other than the simplest, it is likely that support tools will be required. In any case TOP may have them!

'Should cost' analysis/benchmarking

The main benefit of procurement teams seeking to understand and gain insight into suppliers' prices and costs is that they will end up with a view of what a purchased input 'should cost'. This is particularly important when procuring projects or buying goods and services where price benchmarking may be difficult or not applicable. Knowing approximately what something should cost does not mean you can always negotiate this price, but it is clearly a major advantage to you in negotiations and can help you in setting realistic targets to achieve. In some cases, where the buyer has significant power, this knowledge can also be used to assist the supplier to reduce their cost base, e.g., through process improvements, in cases where, for example, they are not using the best technology or materials.

There are also multiple price benchmark sources you can access to give you an indication of market prices – Hays, the CIPS HR partner, for example, publishes salary guides for procurement and supply staff and contractors. There are multiple specialist subscription services where price indices can be accessed, and via the Knowledge Partnerships section of the CIPS website you can access Beroe benchmarks and analyst reports on a range of commodities and purchased inputs.

Developing an understanding of costs in the categories you work with is essential. Secondary data and information such as benchmarked prices are very helpful, but you should be careful not to over-rely on these. You will need to interpret these sources of price and cost information and consider them in terms of how relevant they are to your requirements, volumes, supplier landscape and of course your negotiation leverage.

Negotiating prices

> *Nowadays people know the price of everything and the value of nothing.*
>
> Oscar Wilde

It is assumed in commercial negotiations that from a buyer's perspective, price is always going to be a key variable to focus on. This is certainly true in situations where the purchased goods or services are fairly commoditised and easily available, and the ongoing relationship with the supplier is not important. In these environments your knowledge of cost structures as set out earlier in section 2.1 will be critical in driving a good deal. Bargaining over price alone, however, does not require the skills of a procurement professional, who will instead consider many more factors. Untrained negotiators are often impressed when they believe they have negotiated a significant price reduction from a bid price. Experienced professional procurement managers recognise, however, that in many of these situations, suppliers have merely padded out the bid or opening price with the sole intention of making concessions to placate naive customers.

From a professional procurement perspective, in a corporate environment your negotiation skills are more likely to be of benefit in more complex multi-factor situations where price is only one element that makes up total supply cost incurred in buying from a supplier. There are many ways for a supplier to recover price concessions given away in a negotiation if they feel they have been pushed too hard. As a procurement professional, you should never lose sight of the fact that an excessive focus on price other than in commodity-type markets can be counter-productive and can even lead to higher total costs of supply in the long run.

Savings levers

If driving greater value and efficiency from your supply base is your aim, you should remember that there are many ways to do this without seeking to negotiate lower prices. The table below sets out seven types of saving levers or means to deliver savings.

Saving levers & tactics						
Volume concentration	**Demand management**	**Best price evaluation**	**Global sourcing**	**Specification improvement**	**Joint process improvement**	**Relationships restructuring**
• Supplier reduction • Volume pooling • Volume redistribution • Volume consolidation across categories • Standardisation • Buying consortia	• Lower price product/ service • Approvals • Visibility • Budget linkages	• Benchmark internal prices • Model 'should costs' • Compare total cost of ownership • Competitive bidding • Index/cap prices • Commodity hedging	• International suppliers • Unbundling • Exchange rate hedging • Exchange rate price indexing • Price indexing	• Rationalise/ standardise parts • Part substitution • Off the shelf versus custom • System versus component • Value engineering • Life-cycle costs	• Process re-engineering • Integrated logistics • Joint product development • Long-term contracts • Call-off ordering • Online trading • Vendor managed inventory • On-site support	• Make versus buy/ outsourcing • Alliances/ partnerships • Joint ventures • Supplier development • Use manufacturers instead of distributors

Table 2.2 Saving levers and tactics

However, there will still be many situations where focusing on price in a negotiation is key, and so having a thorough understanding of the factors that drive the purchase price will be essential, and give you a significant advantage in commercial negotiations.

Purchase price cost analysis – putting it into practice

2.1 LO2

Purchase price cost analysis (PPCA) is an approach for establishing a detailed understanding of a supplier's cost to supply what you buy. It draws on your knowledge of costs set out in the previous section. Unlike analyses that describe averages, or rely on homogenised data, PPCA typically focuses on one process, one manufacturing line, one supplier, and one product or service. Cost analysis has been described as the most important tool for procurement professionals and It is essential knowledge when negotiating price.

Purpose of PPCA

Purchase price cost analysis (a combination of price analysis and cost analysis) Is a method for gathering, analysing and using price and cost information in a systematic way. The process allows the identification of future savings and opportunities to improve current costs. This is particularly useful for procurement professionals in dealings with suppliers as it can be used to drive down price in negotiations (tactical use), or to improve supplier cost structures over time through supplier development and business improvement programmes (strategic use).

PPCA involves identifying the supplier's price for a specific product, an assement of prices for the same/similar products in the wider marketplace to determine where the supplier's pricing fits within this, and an assessment of the cost breakdown of the supplier's product (or service). This cost breakdown will include materials, labour, transport, taxation, etc.). This allows the supplier's profit and any padded-out costs to be identified. Three questions are useful here.

- What drivers are acting on the supplier's costs?
- What is the right price?
- Is the current price too much?

The assessment can then be used to negotiate a lower price and identify cost improvement opportunities.

The PPCA approach involves objective information, based on detailed cost breakdowns, in contrast to purely comparative information, based on various quotations. At its heart is a stringent examination of all the costs that contribute to the price. This makes PPCA a versatile tool that promotes purchasing decisions based on a sound analysis of the various costs, and enables you to do the following.

- Set negotiating goals
- Validate pricing or support a challenge to pricing
- Identify cost drivers in the value chain
- Identify opportunities for improvement
- Establish a dialogue with a supplier based on cost versus price
- Establish supply relationships based on cost-plus pricing
- Identify loss leader quotes

When to use PPCA

- On big spend items, relative to total purchasing spend
- On items within categories that are 'Strategic' or planned to move into 'Strategic' from 'Leverage' (portfolio analysis)

- Especially on items within categories that are 'Tailored' (day one analysis). In addition it can also be used for 'Generic' and 'Custom' items
- On items within categories that have major impacts on your cost base

PPCA is a particularly useful technique when faced with limited or little competition, i.e. strategic commodities.

High-level questions to ask

- Is price related to the costs/market price/value/greed?
- What are the costs throughout the value chain?
- How much are the underlying raw materials/conversion cost/labour/OHDs/profit?
- Is the profit excessive?
- Do we want to develop cost-plus or open-book cost pricing?

Keys to success

- Start building up detailed cost profiles on the categories within the category management group.
- Shift the emphasis in discussion with suppliers from 'price' to 'cost'.
- Beware across-the-board percentage price increases. An increase in cost in one area does not justify a price increase when other costs may be decreasing.
- Try to obtain cost breakdowns during the initial enquiry. Suppliers tend to be most receptive at this stage.
- Map out each stage of the value chain and examine them critically for cost-reduction opportunities.[9]

Setting out how to undertake a detailed PPCA is outside the scope of this syllabus and will be covered elsewhere in your CIPS studies; however, the core elements have been set out here and getting started is not difficult.

> *Remember*
> In price negotiations it is always preferable and easier to target suppliers' costs, and not their margin or profits. But, if they cannot reduce their costs as they are fixed or otherwise not addressable, then the negotiation will be tougher and more creativity will be required.

Getting started with PPCA

- Create a simple cost model on paper, on a whiteboard with your colleagues and/or using a simple spreadsheet, starting with your best guesses about cost categories.
- Visit the supplier(s) if feasible and appropriate.
- Ask questions in personal interviews, round table discussions with supplier management and through solicitation tools, i.e. requests for information.
- Do desk research.
- Update and expand your starting point cost model, filling in data as it is gathered.

2.1 LO2

- Repeat the process.
- Consider presenting your model to the supplier(s) for reaction and feedback.

Table 2.3 on the following page provides an example checklist for a 'deep dive' analysis for a key purchased input. This level of data may not be feasible or necessary to obtain for most negotiations, but going into a price negotiation with little or no cost data is a recipe for failure. When investigating each cost driver in the table, first have a quick look to build a broad understanding without unduly unsettling the supplier, then use deeper analysis to build a much more detailed understanding of supplier costs. Do not expect to obtain all the data initially: plan the campaign over time. However, remember to condition suppliers from day one.

Cost drivers	Data from quick look	Data from deeper analysis	Points to remember
Material costs	• Materials used • Material flow	• Materials specifications • Material suppliers • Stock holding (length of time/ value of stock): raw material, WIP, finished product	• How well is the supplier purchasing materials? • What plans are there for waste elimination?
Process and labour costs	• Production process chart • Number of production and/or service workers	• Set-up and run times • Efficiency and utilisation • Shift patterns • Staffing levels: direct and support	• Are the rates fair and reasonable? • What drives are under way for productivity improvement?
Employment costs	• Total number of staff	• Benefit schemes • Performance bonus • Tax and insurance	• Are performance schemes linked to improved output over time? • How do such incentives affect payroll apportionment?
Overhead costs	• Space occupied • Site layout	• Breakdown on space, types of employees • Property owned/ rented • Likely other major cost	• What proportion of overheads are being allocated to your account? • Can you compare different suppliers' overhead structures?

Work-in-progress (WIP)
Inventory that is in the process of being manufactured but is not yet finished

[illegible]	Data from quick look	Data from deeper analysis	Points to remember
Distribution costs	• In-house or contracted out	• Suppliers of distribution services • Cost/km, or cost/kg/km	• What logistics improvements are possible?
Depreciation on equipment	• Obtain an equipment/machine list	• Age of machines • Cost of machines • Policy on depreciation	• Are you paying for machines fully depreciated? • What is the policy on reinvestment?
Profit	• Structured enquiry	• Questioning during on-site meetings • Use of profit: retained for investment or distributed to owners	• What is the policy on reinvestment versus shareholders' returns? • How does it compare with others in the sector?

Table 2.3 Purchase price cost analysis

Understanding suppliers' costs assists procurement to do the following.

- Explain to internal stakeholders what drives costs and so seek to reduce these to become a more attractive customer with a lower cost to serve, attracting lower prices
- Understand what elements of expenditure with supplier(s) are addressable and so potentially influenceable through commercial negotiations
- Establish realistic opening offers/price positions with suppliers and walk-away points
- Know the circumstances when suppliers can afford to make price concessions without it hurting their profits too much, and so focus on these

Remember

Understanding a supplier's cost breakdown, price build-up and pricing objectives will provide you with extremely useful insights. This information on its own, however, may not be enough to drive prices down, if, for example, your supplier has more power than you and/or is facing high demand. 'Proving' a supplier can supply more cheaply is not necessarily a good negotiation tactic, especially if you have limited leverage.

2.2 Contrast the economic factors that impact on commercial negotiations

Commercial negotiations do not take place in a vacuum and need to be understood in the context of the external factors that can affect the negotiation. In section 1.3 we briefly outlined the STEEPLE factors and how they can affect negotiations. In this section we will consider one of the STEEPLE factors, 'economic', in more detail. Microeconomics is a branch of economics that considers the behaviour of individuals and businesses and how decisions are made based on the allocation of limited resources based on demand and supply, prices and costs. Microeconomics is focused on the 'micro' or small, and it considers things at the level of the firm, industry and market. Macroeconomics on the other hand is focused on the 'macro' or large, and considers things at the level of the economy of the country, region or world. It covers the study of growth, inflation exchange rates and unemployment. Economic forces and factors cannot be ignored no matter how big and powerful you are as a buyer and so we will consider in this section the main microeconomic and macroeconomic factors that can affect negotiations.

The impact of microeconomics and market types on commercial negotiations

Microeconomics is a branch of economics that studies the behaviour of individuals and businesses (smaller things) and how decisions are made based on the allocation of limited resources. Microeconomics can be contrasted with macroeconomics, which is the study of economy-wide things such as growth, inflation and unemployment (bigger things).[10]

Microeconomics considers the factors that affect individual economic choices, the effect of changes in these factors on the individual decision makers, how their choices affect and are affected by markets, and how prices and demand are determined in individual markets. Microeconomics is itself a big subject so we will focus only on the selected topics that are most likely to affect procurement negotiations: the theory of demand, the theory of the firm, market structures and the demand for labour and other factors of production.

Scarcity, choice and opportunity cost

A key assumption underpinning microeconomics is that resources are limited and therefore scarce. Microeconomics focuses on how decision makers choose between scarce resources that have alternative uses. Consumers demand goods and services from producers who offer these for sale, but nobody can get everything they want from the economic system. Choices have to be made, and for every choice made another choice is forgone. A consumer may choose to pay for a university course for their child and in doing so may have to give up a home improvement project which they might have used the money for. In microeconomics, the forgone home improvement project is the **opportunity cost** of the university course. Similarly, organisations and companies need to take decisions about what to produce, and in doing so preclude themselves from producing alternative goods and services.

A | Z

Opportunity cost
The cost of the opportunity forgone by making a choice of one option over another

Producers (suppliers) also have to decide how much to produce and for whom, with the resources – known as factors of production – of land, labour, capital and enterprise at their disposal. Access by producers to factors of production and their cost will vary across geographies and will also be influenced by the STEEPLE factors we considered in section 1.3. For example, in countries where relative labour costs are low, e.g., China compared to the USA, it will generally make sense for producers to focus on supplying products with a high labour content, e.g., manufactured consumer products, in order to exploit their relative competitive advantage. In situations where land is abundant, e.g., in Canada, Russia and Australia, it will generally make sense for firms to focus on products where land is a key input, e.g., wheat and similar agricultural products, to be competitive. Awareness therefore of suppliers' access to the factors of production and their relative cost and scarcity may be useful to buyers in commercial negotiations.

Apply

Consider how your key suppliers' access to factors of production and their relative cost and scarcity might influence their growth and supply strategy in the future.

In addition to the restrictions on producers due to access to factors of production, their cost and scarcity, microeconomics calls out the law of diminishing returns. This law states that if one keeps on adding a variable factor of production (such as labour) to fixed factors (such as land), you will get proportionally less output from each additional unit of factor added until, eventually, overall output will start to decrease with each additional unit of factor added.

For example, a newly opened restaurant gets busier over the weeks due to favourable reviews, and recruiting more kitchen staff will help in expanding the production of meals. There will come a time, however, when adding another member of staff will simply crowd out the kitchen, causing productivity to actually decline. In situations like this, the only way producers can expand without facing diminishing returns and increasing costs will be to invest in the factor of production that is fixed, in this case a bigger kitchen or restaurant. This decision of course is normally not taken without lots of consideration. As an alternative, for example, the restaurant owner might decide to increase prices, thus reducing demand in normal circumstances. Choosing among these alternatives is an example of a microeconomic decision for the restaurant owner with timeframe (short or long run) a key consideration. A key distinction in microeconomics is made between the short run, where at least one input factor is fixed, and the long run, where all factors can be varied.

From a commercial negotiation perspective therefore it is useful to think about how your suppliers view the alternative economic choices open to them with regard to investment and growth when they face increasing or decreasing demand. Suppliers rely to different extents on the four factors of production: land, labour, capital and enterprise. Depending on the circumstances suppliers find themselves operating in, these factors may be fixed in the short or long run, and this will affect their decision-making. For example, agricultural producers rely mainly on land as a factor of production and although technological developments can improve its productivity, land is still ultimately a fixed factor for most suppliers in the short run. The arrival of new, Internet-enabled global businesses in the 'sharing economy', such as Airbnb, Uber, Deliveroo, etc., has of course disrupted traditional asset-based companies and notions of what factors of production are. Organisations among the largest in the world in retail, transport and accommodation operate with remarkably few physical assets: Amazon has no physical shops, Uber owns no vehicles, and Airbnb owns no property.

Apply

It is useful to consider the relative scarcity of the factors of production (land, labour, capital and enterprise) in the economy and industry you work in. Prices are driven up if one or more of these factors becomes relatively scarce, and buyers may seek substitutes or encourage alternatives to keep the prices paid down. Free movement of the factors labour, capital and enterprise is facilitated through trading blocs such as the European Union; however, land is not movable.

What are the implications of scarcity on factors of production in procurement negotiations?

How supply and demand determine price

In aggregate terms, all producers and all consumers in a market create forces called 'supply' and 'demand' respectively. Microeconomics proposes – and it is observed in a free market – that prices are determined by the interaction of these forces. If you ever visit a fresh produce market, you can observe that suppliers who set a price too high will be left with leftover stock, while those who set a price too low will typically be inundated by consumers seeking a bargain, and run out of stock too soon. If you were attending this market as a producer every day you would soon work out a price to charge that in effect balances supply and demand, assuming you want to sell all your stock. The interaction of buyers and suppliers within a market creates the price mechanism. This mechanism was described by Adam Smith as the 'invisible hand' that guides the actions of producers and consumers. This theory assumes situations where offerings are relatively standardised and producers have a good understanding of the prices that different producers charge.

In service markets where it is more difficult to compare suppliers' offerings, this becomes more difficult; however, professional buyers can access other data sources including previous price paid, to inform them of market prices. We addressed the importance of understanding 'ballpark' prices through benchmarking and research sources in section 2.1. In situations where there is a very good understanding of prices and costs in markets by buyers, known as 'perfect knowledge' in microeconomics, it is difficult for competing suppliers to charge different prices to different customers in the long run without a justification. Sometimes this justification is substantive, e.g., superior quality or unique elements, and sometimes suppliers need to work hard to create differentiation based on less substantive factors such as branding, reputation and customer loyalty. This is more marked in consumer markets.

Demand

Human wants may be infinite but demand is finite. In microeconomics, demand is a want backed by money. This is why economists normally never talk about a shortage or a surplus of goods or services without mentioning a price.

The factors that determine demand for a good or service include the following.

- The necessity of the item for firms/existence/subsistence
- The price of the good or service
- The prices of other goods and services, especially substitutes and complements
- The income of buyers

- The tastes and preferences of buyers (influenceable by marketing)
- Expectations of buyers about the future

For this syllabus you are not required to have a detailed knowledge of microeconomics graphs; however, you should be aware of how demand is typically graphed in a classic 'downward sloping demand curve'. Assuming rational behaviour, and all other things being equal, if you reduce the price of a normal good or service in most cases firms and people in aggregate will buy more, and if you increase a price the opposite will happen.

The graph below shows the resulting conventional demand curve.

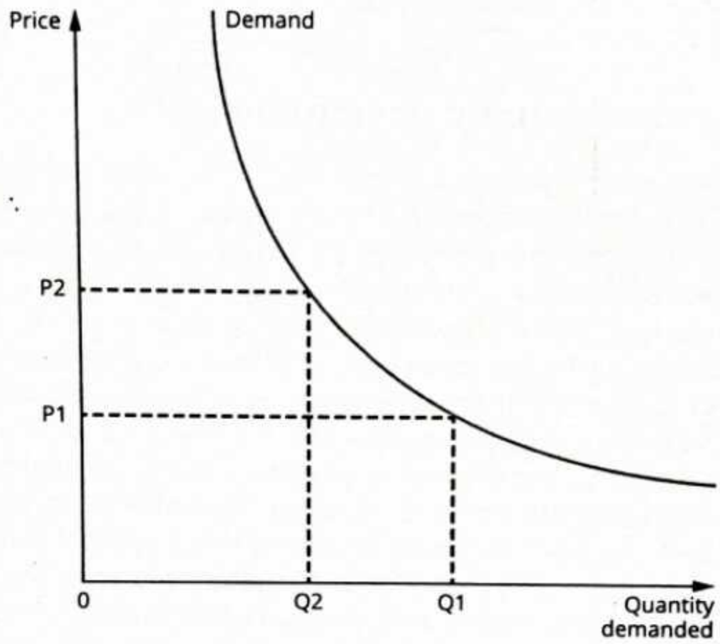


Figure 2.10 Demand curve

It can be seen that the price drop from P2 to P1 has caused the quantity demanded to increase from Q2 to Q1. A change in price will therefore cause a movement along the curve. When the price increases, the quantity demanded will reduce. This happens with most types of goods, with some exceptions where an increase in price can actually cause an increase in demand for the goods.

> *Apply*
> Can you think of a situation where an increase in the price of a product actually causes an increase in demand for that product, and a reduction in price leads to a reduction in demand?
>
> Exclusive luxury products and services are sometimes priced high, as this in itself may create more demand from those with lots of disposable income. You can look up 'Giffen good' if you are interested.

The position of the curve can also move and this is called a 'shift' in microeconomics. A shift occurs when an influencing factor other than price changes. For example, an increase in consumers' income may cause the demand for a good or service to increase at every price, as consumers have more money, and this will shift the whole curve away from the origin upwards and towards the right. The opposite will happen with a reduction in consumers' income, e.g., after an income tax increase.

Supply

In microeconomics, supply is the quantity of goods and services offered to the market by producers. Assuming rational behaviour in a free market, suppliers will be prepared to produce and bring to the market more goods and services the higher the price they can obtain. A good example of this was the huge increase in shale oil production out of the USA in the period from around 2008 when the oil price rose and stayed above $100 a barrel. At higher prices less efficient producers can enter the market and make profits. Therefore, the supply curve – when holding other factors constant – will slope upwards from left to right showing more supply at higher prices, as illustrated in figure 2.11 below.

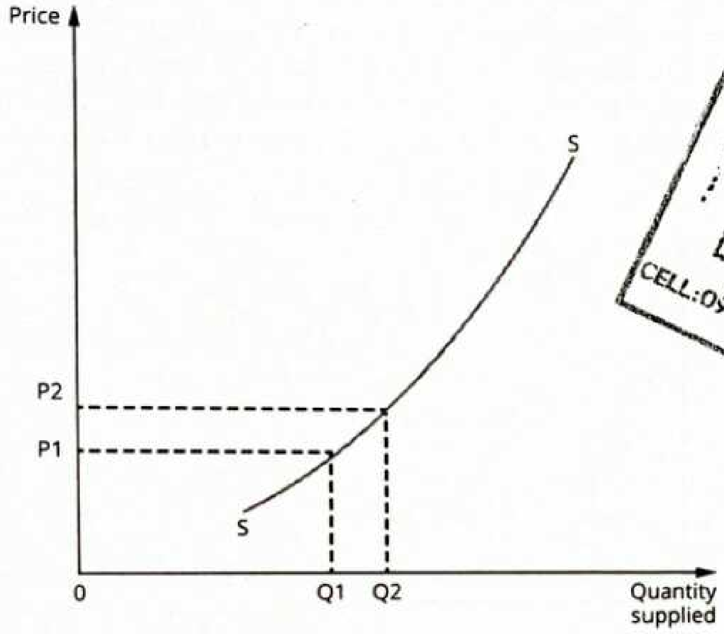


Figure 2.11 Supply curve

In the graph we can see that as price increases from P1 to P2, the quantity supplied increases from Q1 to Q2.

The determinants of supply are as follows.

- The physical feasibility and time and energy required to produce the products
- Price
- Prices of other goods and services
- Relative revenues and costs of making the good or service
- The objectives of producers and their future expectations
- Technology and innovation

Generally suppliers will keep supplying, as long as the extra cost of producing one more unit is less than the price they can sell that extra unit for (the marginal revenue is higher than the marginal cost). However, a firm may continue to produce as long as the marginal revenue exceeds its average variable costs, as in doing so it will be making a contribution towards covering its fixed costs. We discussed this under 'Marginal or variable costing' in section 2.1.

Following the same rationale as discussed with regard to demand, a movement along the supply curve will be brought about by a change in price, but a movement or 'shift' of the whole curve will be caused by a determinant other than price.

Apply
Consider the determinants of supply above other than price and set out what impact they have on supply from a microeconomic perspective.

Equilibrium price

In microeconomics, equilibrium price is determined when the quantity demanded is equal to the quantity supplied. At equilibrium price in a market, there will be no shortages and no surpluses. If we combine our supply and demand curves on one graph, the point at which they intersect determines the equilibrium price. If the price is set above this price and you read across the graph, you will see that supply exceeds demand and there will be a surplus. In order to reduce this surplus the price will need to fall. If you set price below this point, you will see that demand exceeds supply and there will be a shortage: in order to reduce this shortage, price will need to rise.

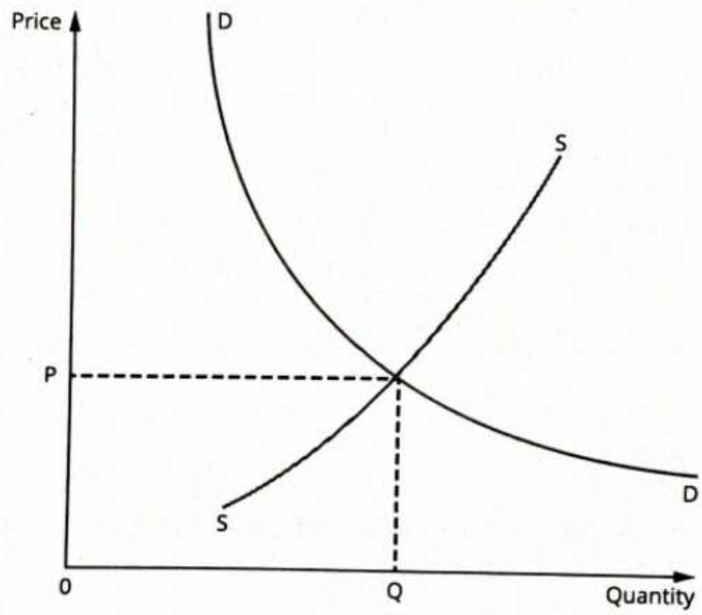


Figure 2.12 Graph showing equilibrium price

This is why whenever non-economists say there is a surplus or shortage of a good or service, economists tend to always qualify this by adding 'at a price'. From a classical economics perspective, at its simplest there is no such a thing as a shortage or surplus in a free market as the forces of demand and supply will result in an equilibrium price, even if that price is extremely high or low.

Although the equilibrium price is in reality an academic concept with limited impact on any particular commercial negotiation, from a procurement perspective it is useful to be aware of this concept and what market interventions by government, e.g., taxation, subsidies, government licensing, etc., might be acting on the equilibrium price.

Elasticity

Elasticity refers to the responsiveness of quantity demanded or quantity supplied to a change in price or another factor.

- The price of a product can be described as being elastic if a small change in price leads to a big change in demand.

- The price of a product can be described as being inelastic if a big change in price leads to a small change in demand.

This concept is very important to producers, particularly those selling into consumer markets, who have to estimate the potential effects of changing their prices over time. It is also important to government finance departments, which have to model the implications of imposing sales taxes on goods and services in order to predict tax revenues. For example, if a tax increase of 5% yields a net increase in tax revenue of only 3%, then it would not be rational to increase tax assuming the purpose was to increase government revenue.

Traditionally, essential goods and services such as electricity, fuel, basic foodstuffs, commuter transport, and habitual products such as tobacco, alcohol and sugar-based drinks are often cited as facing a relatively inelastic demand curve. This means when the price goes up the quantity demanded does not decrease very much and so they are often the targets of government taxation. Descriptions of elasticity only apply within a particular range of prices for a given product. Outside that price range, demand becomes very difficult to predict. Elasticity can be calculated via formulae, but detailed knowledge is not required here. Elasticity is typically described as being 'relative' as it is normally being compared to the elasticity of something else. In microeconomic graphs, elasticity and inelasticity can be shown by the slope of the demand curve. If a demand curve is almost horizontal, then the product pricing can be described as very elastic. If a demand curve is almost vertical, then the product pricing can be described as very inelastic.

Income elasticity is the responsiveness of the quantity of a product demanded, to changes in customers' income. When incomes increase, customers buy more of some items but less of others – this is measured by elasticity.

Cross-elasticity is the responsiveness of quantity demanded or supplied of good X to a change in price of good Y. This is very important in the case of substitute products. For example, as the price of lithium batteries for electric cars falls, the demand for petrol engine cars declines.

Elasticity is a concept that lends itself more to retail and consumer markets and aggregate demand considerations, and less to individual commercial negotiations, but you should be sure you understand the concept nonetheless. There are plenty of Internet resources you can access easily just by typing the term into a search engine, to check your understanding of elasticity and the other concepts highlighted here.

> *Apply*
> Why is the concept of elasticity generally less relevant to industrial/commercial buying than it is to consumer buying situations?

Markets and competition

In microeconomics, prices are largely determined by the forces of demand and supply, which we have briefly introduced in the previous section. Aggregate demand and supply are important determinants of the overall level of prices and their direction and speed of change (up or down), and professional buyers should be aware of these forces. However, in industrial markets, the prices actually paid by customers are determined by many other factors, including negotiation capability and market structure. In microeconomics, competition is the key determinant of the different ways in which firms within an industry may be structured. Four main structures are considered, all of which should be recognisable to a greater or lesser extent by procurement professionals.

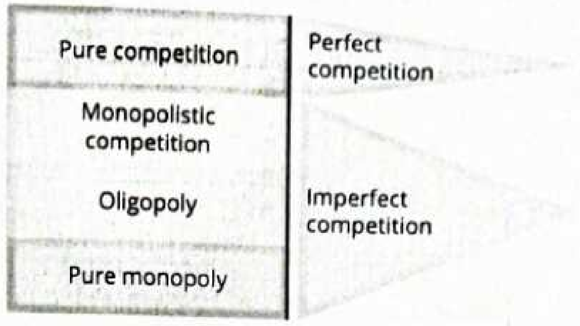


Figure 2.13 Four main structures of industries

1. Perfect or pure competition
2. Monopolistic competition
3. Oligopoly
4. Monopoly

The main criteria that distinguish the different market structures are the number and size of producers and consumers in the market, the characteristics of the goods and services being traded, and the degree to which information can flow freely.

Perfect competition

A perfectly competitive market is one with the following features.

- There are many firms producing identical or very similar (homogeneous) goods or services.
- There are no barriers to entry to the market or exit from the market – anyone can enter or leave easily.
- Both producers and consumers have perfect knowledge of the marketplace, prices, costs of production and influences on demand and supply.

Under these conditions, the price and quantity will always tend towards equilibrium as any producer that sets a price above equilibrium will not sell anything at all, and any producer that sets a price below equilibrium will obtain 100% market share in theory. The demand curve is perfectly elastic, which means that it will be horizontal. In a perfectly competitive market it is difficult to increase profits through pricing, and suppliers instead must focus on their cost structures. As these conditions imply, there are few examples of perfectly competitive markets in real life outside of fresh produce and commodities (crude oil, metals, coffee, cotton, etc.). In these markets, procurement professionals working for producers are particularly important, as cost management and delivery of savings may be the only way to increase profits since price is largely determined by market forces and out of the control of the producer.

In some countries, customers can choose their electricity provider from competing firms. Domestic electricity is a homogeneous product with little or no service element, and prices per kilowatt hour are easy to compare, so some customers regularly check prices and change suppliers. Many customers either do not have the time or knowledge to do this however, or believe the money saving is not worth the effort of switching. This is an example of where the assumption in economics of rational behaviour of firms and consumers does not hold true. With mass access to the Internet and the development of multiple price comparison websites many markets, particularly in financial services and consumer goods, are becoming much more transparent and less imperfect.

Procurement and negotiation implications

From a simplistic procurement perspective, a market with perfect competition is the most attractive market to be buying from: as there are many suppliers all selling the same products, there is plenty of choice and competition. Negotiation on price will be less important, as the price is determined by market forces with no individual supplier or buyer able to influence it significantly. Prices are much more variable even within long-term contracts and seeking a fixed price would create financial risk for both the buyer (market price may fall during the life of the contract) and the supplier (market price may rise during the life of the contract).

When pricing such contracts (where there is a major commodity input) it is often intelligent to agree a **contract price adjustment** mechanism to allow for market price changes so both sides share risk.

A Z

Contract price adjustment
A legal clause whereby the contract price can be varied, either up or down, by reference to an agreed formula, e.g., inflation rate or some other recognised index

Check
What would be the implications of insisting on a contracted fixed price from a supplier over 12 months as a buyer in a perfectly competitive market?

Monopoly

Monopoly is on the opposite end of the spectrum to perfect competition and exists when there is only one producer in the market. In reality a monopoly can also refer to a single company that has a dominant presence in a market with market share above 30%–50%. The 'FANG' companies, Facebook, Amazon, Netflix and Google, are often described as virtual monopolies in their markets.

Monopolies exist in many markets in real life for very different reasons. This may be because the producer has a legal right to be the only producer, e.g., via ownership of patents, copyright or registered design, or the producer may be a state monopoly (owned by the government). A monopoly could, left to its own devices, set its own price in the marketplace, which can give rise to what economists call 'super-normal profits'. For this reason, monopolies are usually subject to government control, or regulation, e.g., pharmaceutical pricing. In some circumstances, suppliers who would otherwise compete with each other may form cartels to give them monopoly-type powers where they collude to fix prices. This is illegal in most situations and in most countries, but one notable exception is OPEC (the Organization of the Petroleum Exporting Countries) which very explicitly and somewhat successfully seeks to control the price of oil by restricting production in its member states.

Procurement and negotiation implications

Despite the existence of competition, customers seem to tolerate monopolies if their products are desirable and as long as they do not price themselves out of the market. Many would consider companies like Microsoft, Apple, Google and Facebook as quasi monopolies dominating their respected domains. One does not need to purchase from these companies as there is a choice, but their product offerings are so dominant and accepted as the 'standard' that they can exert monopoly power.

In most commercial negotiations with monopoly-type organisations like these, one can expect that in general they will have far greater bargaining power – you will need them more than they need you. Their BATNA is stronger in the short run, but over time their power can be challenged effectively.

Ways of dealing with monopoly suppliers include the following.

- Making yourself an attractive buyer
- Seeking out alternatives/substitutes in a private or public manner
- 'Designing out' the requirement that forces you to go to the monopoly supplier, or seek to make the product, or threaten to make it yourself if feasible
- Lobbying government or campaigning, as part of an industry or trade body, for a reduction in barriers to entry that support the monopoly

Apply

Look up 'monopoly' and 'oligopoly' in supply management in various search engines and note the types of articles and references. Many will discuss how to deal with them in a negotiation setting.

Then reflect on your own experience or ask your colleagues to provide examples of monopoly suppliers your organisation has worked with. Alternatively, research an organisation you are familiar with and identify a type of monopoly supplier it depends on.

Make notes on the following questions.

- What would be the best strategy for improving this situation: attempting to break the monopoly or attempting to negotiate better terms for purchases from the monopoly supplier?
- Are there any alternatives to purchasing this product or service? Can a change in practice eliminate the need for it? Can the specification be adjusted enough for other suppliers to meet the need?
- How could the purchasing organisation go about negotiating better terms with the supplier? Search for creative solutions such as collaborating with another customer to purchase a larger quantity of the same product, adjusting schedules to allow for deliveries during the supplier's quieter times, or arranging fewer, larger purchases.
- Why is this a monopoly, and can this change? Can the nature of the procurement be altered? Can the leverage of the purchasing organisation be increased? Could the purchasing organisation partner with a different supplier in order to help them fulfil the requirement?
- What preparations would you make if you wanted to attempt to challenge the monopoly? What risks would the organisation face? Think about eliciting support from stakeholders, and establishing contingency plans for if supply were compromised by a retaliation from the supplier.

Oligopoly

An oligopoly exists when there are a small number of producers that exert a significant influence in a market. As there are so few producers, they are likely to have a high level of knowledge about the actions of each other, and are typically able to predict responses to changes in their strategies. As a criticism it has been said that oligopolists are more focused on their competitors' next move than on their customers'.

Examples of oligopolistic markets include global beer supply (dominated by three huge conglomerates), computer games consoles (dominated by two companies), global audit services (dominated by the 'Big Four' accounting firms) and many media, transport and airline companies in regional and national markets. Typical characteristics of oligopolistic markets are non-price competition/similar pricing for products and services, high investment in marketing and branding, and high barriers to entry.

Procurement and negotiation implications

From a procurement perspective, intelligent market engagement with suppliers in oligopolistic markets can yield significant benefits. There are fewer players to understand and assuming there is no cartel or collusive behaviour, they can be highly competitive and desperate to win business from each other through offering better deals to customers to win them from competitors and keep them. Of all the market types this is the one where procurement professionals can probably add most value through market insights, careful negotiations, planning and execution.

Monopolistic competition

Monopolistic competition exists in markets where there are many competing producers but they will try to use product differentiation, e.g., branding to distinguish themselves from other producers in the market. Although their products may be very similar, their ability to differentiate means that they can act as monopolies in the short run, irrespective of the actions of their competitors. For example, when purchasing supplies for luxury hotels or first class passengers on airlines, customers will expect luxury brands in their rooms/on the flight, thus 'forcing' the airline buyers to contract with a small number of luxury branded suppliers. Similarly, when buying microprocessors for laptops, Intel's brand strength in this market puts a lot of pressure on buyers in Dell, HP, Lenovo, etc., to buy Intel chips as they add value to the final products they assemble.

For monopolistic competition to exist, consumers must perceive differences between products sold by competing firms. There tend to be fewer barriers to entry or exit in these markets than in oligopolistic markets, and much more rivalry, as firms jostle for position and market share.

Procurement and negotiation implications

Procurement professionals with category expertise will know the difference between 'real' quality and perceived quality created in customers' minds on the back of clever advertising or branding. In many business-to-business markets, particularly those in mature markets with regulation and a high level of customer knowledge, what is available to purchase from competing suppliers could be said to be fairly similar. The differences, or differentiators, may be in customer service, pricing, or non-core product characteristics. It is for professional buyers to distinguish through market research what the real differentiators are that make a difference to their business and focus negotiations on these.

Conclusion

Microeconomics is a distinct subject with its own terminology, overarching assumptions, graphing styles and way of viewing the world. A basic knowledge of microeconomic concepts such as those set out here is very helpful in procurement, and many professional buyers will undertake further studies in the field of economics at university/college degree level. These concepts are useful in helping you to understand demand and supply, cost structures and competition at an aggregate level; however, they do not always translate into practical tools that can be used in commercial negotiations, where we need to take a more focused perspective. If you are interested in reading further in this area, there are plenty of introductory guides to microeconomics freely available on the Internet – just search under 'microeconomics basics' and you will find some good resources such as the Investopedia website (see www.investopedia.com).

The influence of macroeconomic factors on commercial negotiations

> *No man is an island.*
>
> *John Donne*

No matter how strong your bargaining position as a buyer, if you are negotiating for cocoa to make chocolate and there has recently been widespread crop failure in West Africa, what is likely to happen? Given the huge importance of this region for cocoa production, this will likely mean that less cocoa is available for sale on international markets. This relative shortage creates upwards pressure on the cocoa price, as there are the same number of buyers chasing less supply and so they will need to search harder and bid higher for the available stocks from South America or Indonesia. As a more powerful buyer, you may be able to negotiate a better price than a smaller buyer, but both of you will probably pay more. This is an example of a macroeconomic factor. All buyers, big and small, are generally affected by these national, regional or global macroeconomic factors.

> *Remember*
> Microeconomics is the study of the behaviour of individuals and businesses within a market, the factors that affect their choices and the effectas these choices have. Macroeconomics studies larger, economy-wide things such as growth, inflation and unemployment.

What is a macroeconomic factor?

Unlike a microeconomic factor which just affects individual firms or individuals, a macroeconomic factor is to do with the broad economy at the regional or national level, and so it affects a large population rather than a few individuals. Examples of generic macroeconomic factors are economic output, unemployment, inflation, savings and investment rates, and they are key indicators of economic performance that are closely monitored by governments, businesses and consumers. A macroeconomic factor can also include anything that influences the direction of a particular large-scale market – for example, government taxation policy, industry regulations or tariffs can affect the economy of a state or nation and can even have international implications.

The relationships between various macroeconomic factors are extensively studied in the field of macroeconomics, which is a huge subject area within the field of economics. For the purposes of this syllabus, we will limit ourselves to the consideration of key generic macroeconomic factors and how they might affect commercial negotiations.

Winners and losers

Although changes in certain macroeconomic factors are normally seen as bad or good for an economy, it is important for us to remember to take the procurement standpoint which is often at odds with the prevailing view. For example, high growth rates in an economy may mean it is harder to get busy suppliers to bid for work, prices tend to increase and supplier quality may suffer as they rush to finish jobs. New protectionist regulations brought in to restrict imports in an effort to increase local employment, e.g., US trade policy under President Trump, can cause price increases as tariffs have to be paid. Unanticipated events such as wars, droughts or natural disasters, though quite understandably seen as bad things, can also present opportunities for someone somewhere commercially. In other words, when a macroeconomic factor such as interest rates or exchange rates changes, there will likely be, from a commercial negotiations point of view, both winners and losers.

Key macroeconomic factors

There are many macroeconomic factors that could influence procurement in general and commercial negotiations in particular. Here we will set out six that are agreed to be fairly significant.

1. Economy growth rate
2. Inflation rates
3. Interest rates
4. Currency exchange rates
5. Unemployment rate
6. Protectionism

Before we briefly examine each one in turn it is important to note three important considerations regarding macroeconomic factors and their potential impact on negotiations.

First consideration: changes and rates of changes

For any given negotiation it is not the macroeconomic factor itself that necessarily influences the negotiation but the change or rate of change of that factor. For example, in an economy where the official unemployment rate is 10%, this is a known fact, and it can be assumed that all buyers and suppliers are aware of it regardless of whether it has any impacts on commercial negotiations. It is factored into all economic activity, essentially. However, if this rate starts to fall with successive monthly official figures showing, for example, 9%, 8%, 7%, then this suggests that the economy is getting busier and implies prices suppliers charge may have to increase soon to attract workers in a more buoyant economy. Similarly, although many people in low price inflation economies where 5% per annum is considered high find it hard to understand how business is easily conducted in high inflation countries, say above 25% per annum, professionals in these countries will know that this is factored into negotiations. It is a change in the rate of inflation and the direction and extent of that change that will tend to have the greater impact, not the rate itself.

Second consideration: general versus particular effects

Macroeconomic factors are factors that have general effects on the economy and many businesses may be completely unaffected or affected more or less than others in the same industry by a change in a factor(s). It is important for professional procurement managers to remember this. For example, if the annual inflation rate is 15%, it does not imply that all businesses will see this 15% general price increase. Some companies may not buy much in the country or may pay their staff in a foreign currency unaffected by inflation, e.g., US dollars and not local currency. It is also an average measure, so it means some prices will have gone up by, say, 25% while others have gone up by only 5%, so more research and insight is required. Similarly, if a country's exchange rate has fallen relative to others, suppliers that need to import components to make their products may seek price increases to compensate for this fall.

Intelligent buyers will of course seek evidence that suppliers' costs are really affected by any macroeconomic factor and the extent to which this is affecting them and when. The supplier may have three months' worth of stock, so again there may be a delay before any price increase needs to be considered. Many established large suppliers go to great lengths to protect themselves from the impact of macroeconomic factors through buying from multiple sources, keeping multiple currency accounts and moving staff around the world when possible, e.g., in professional services markets. The controversial actions of many multi-national corporations locating their head offices in low-tax countries where their profits are then reported is an example of how they seek to insulate themselves from the macroeconomic effect of government fiscal and taxation policies in the 'home' country.

Third consideration: expectations/'consumer sentiment'

When it comes to macroeconomic factors, another key consideration is expectations regarding what might happen to these factors, or specifically the measures, metrics or percentage rates associated with these factors in the future. From industrial buyers and sellers to consumers, law makers, media commentators and academics, everyone has expectations about what might happen in the future and this can have a strong influence on commercial decision-making. Some people's expectations or opinions are so influential that they have to be very careful what they say, as it can immediately affect markets and commercial decision-making. Government ministers, directors in central banks, major global investors, and leaders of major trade bodies and global corporations fall into this category.

For example, if consumers believe inflation rates will increase in the near future, they are encouraged to buy now since their money will buy less in the future. This increased demand will feed into higher prices (demand pull) and higher inflation, thus fulfilling the expectation. Similarly, if bankers believe that the exchange rate in their country will fall soon, they may buy more foreign currency to shore up reserves, thus fuelling the expected currency depreciation and confirming the prediction. Of course these expectations are not always correct, and speculators in all sorts of financial markets bet on who will be right. There will be winners and losers.

Macroeconomic factors considered

2.2 LO2

1. Economic growth

Economic growth in simple terms refers to the level of buying and selling activities happening in an economy over a time period. It can be considered from a local, regional, national, trading bloc or global perspective. There are many measures and debates about the measures of the level of economic activity but it is typically measured by gross domestic product (GDP). GDP refers to the value of the total amount of goods and services a country produces. In general terms, when the GDP rate falls or slows down, there will be a fall in demand for goods and services demanded in the economy, with a fall in firms' revenues and profit margins, and when GDP is rising there will be an increase in demand. Some companies and organisations experience 'counter cyclical' demand whereby the demand for their products and services increases when growth slows and vice versa, e.g., cheaper substitute products.

Economies are often observed to go through up and down cycles (boom and bust) at the macroeconomic level. As growth leads to prosperity, this may raise certain prices due to increased demand. Higher prices drive the inflation rate up, reducing people's spending power and wealth, then households may suppress their spending in response. As supply begins to outweigh demand, prices may again dip, leading to additional prosperity until the next shift in economic supply and demand and so on.

Potential impact on commercial negotiations

Faster GDP growth generally means upward pressure on prices depending on the market tightening of supply, although in some markets more suppliers may be attracted by the higher prices. This is very difficult to generalise and needs to be considered on a case-by-case basis. Buyers should be aware of relative growth rates in the economies they are buying from as it may give an indication as to the future strategy of their suppliers – e.g., expansion into global markets or expansion 'at home'.

> *Apply*
> Find out the growth rate for your country for last year, this year and next year (forecast). Consider if and how changes in this growth rate might affect the supply and demand side of the organisation you work for.

2. Inflation rate

The inflation rate refers to the rate of price increase normally measured in percentage per year (pa). Inflation rate measures can be applied to a whole country through a general measure, e.g., consumer prices index (CPI) or retail price index (RPI), or to an industry or product/service area, e.g., labour rates, licence fee charges or commodity prices. These industry index rates can be accessed through multiple sources including CIPS *Supply Management* magazine. Inflation has the effect of reducing the value in purchasing power of a fixed unit of money over time. If inflation is 10% pa, then $10 today will be worth the equivalent of only about $9 in purchasing power in 12 months. High inflation and/or an expectation of an increase in inflation therefore has a major impact on commercial negotiations. In countries with high inflation, suppliers may demand payment in cash upfront or payment in another currency from a country with a lower inflation rate (a more stable store of money value).

Potential impact on commercial negotiations

If the inflation rate is running high then obtaining credit as a buyer is normally more difficult or expensive as money in the future will be worth less than money today. High inflation can also encourage people to spend now or buy assets as opposed to saving cash in the bank, as the purchasing power of their money is decreasing faster than in lower inflation situations. High inflation also directly affects the strength of your currency relative to currencies with lower inflation rates. Deflation is rare, but in more recent times some countries have experienced this, such as Japan.

> *Apply*
>
> Consider the range of purchased inputs required by your organisation and identify those most affected by changing inflation rates.
>
> Establish how your organisation deals with inflation in terms of setting selling prices, and also how you respond to requests for inflationary price rises from suppliers.

3. Interest rates

Interest rates are the charges levied by the banks for extending credit. Interest rates are influenced by the inflation rate which acts as a 'floor' rate. If inflation is running at 10% per year then it will normally be impossible to borrow at less than 10% per year. Interest rates are also influenced by competition in banking in finance markets and availability of money to lend out. Most businesses need to borrow money either for long-term capital investment or for short-term credit to finance production while waiting for invoices to be paid.

Potential impact on commercial negotiations

Increases in interest rates will lead to higher interest expenses payable by businesses that need to borrow and will therefore increase overheads. This will also make it more expensive in turn to extend credit to customers, potentially hurting sales. Buying items that normally require credit, e.g., capital equipment, may be delayed unless the supplier can assist with financing. If interest rates are higher than the return a company can get from investing in new plant and equipment, they may decide to delay investment and just keep the cash in the bank, thus affecting companies that make and sell plant and capital equipment. Increases in interest rates also affect consumers who need to borrow or have outstanding loans by increasing their servicing costs and reducing their disposable income. This potentially may cause a reduction in consumer demand which may reduce overall economic growth. If interest rates are too low and credit is too, cheap rates can fund a spending boom with consumers and businesses buying more than they can afford to pay back. The global financial crash of 2008 began in the USA on the back of this phenomenon.

4. Currency exchange rates

In general, when importing, buyers should seek to pay in their own home currency as their costs and profits are expressed in their currencies and so exchange rate uncertainty (but not risk) is avoided. This is not always possible, however, for multiple reasons outside the scope of this syllabus.

Currency exchange rates are determined by macroeconomic factors and demand and supply. In general, countries with stable political and economic systems, a growing economy and a strong rule of law will have stronger and more stable currencies than those without these characteristics. In the global economy the US dollar, the euro, the Swiss franc, the Japanese yen, the UK pound, and more recently the Chinese renminbi are seen as relatively strong and stable currencies and they dominate international trading.

A country's relative exchange rate with another at any point in time is determined by multiple factors that combine together including the following.

- Relative inflation rates
- Relative growth rates
- Demand and supply of the country's currency
- Economic, social and political stability

Potential impact on commercial negotiations

The effect of a change of relative exchange rates will be determined by which currency you pay your supplier in.

Currency you pay supplier	Change	Likely impact
Yours	Your currency appreciates	Supplier gets more: when converted to their currency they make more profit – buyer is in a strong position to negotiate discounts.
Yours	Your currency depreciates	Supplier gets less: when converted to their currency they make less profit – buyer is in a weak position to negotiate discounts.
Theirs	Your currency appreciates	Supplier's product becomes cheaper for you to buy, as you pay in their currency which has weakened. You may underspend budget or choose to buy more.
Theirs	Your currency depreciates	Supplier's product becomes more expensive for you to buy, as you pay in their currency which has strengthened. You may overspend budget or need to buy less.
Note: 'Theirs' can also refer to third-party trading currency if used, e.g., US$.		

Table 2.4 Effect of type of currency used on commercial negotiations

Movements in currency exchange rates have major impacts on the price of oil and products derived from oil as they are normally priced in US$. Organisations that are highly exposed to changes in exchange rates or commodity prices take positions on what they believe the price will be in the coming 6–12 months and negotiate through a process known as 'hedging' fixed prices to protect them from short-term fluctuations. Getting this decision right can have a major impact on the bottom line: see the case study below.

Case study

Fuel-hedging to fly higher at Ryanair CIPS Supply Management

Budget airline Ryanair has extended its fuel-hedging scheme in a bid to cash in on falls in prices. Announcing its results in the year to the end of March, the carrier said its fuel costs rose 59% during the period – up €466 million to €1.3 billion. The full year net profit of €105 million was down 78% on the previous financial year but 'ahead of market expectations'. Ryanair said 'substantially higher' oil prices saw fuel costs account for 45% of operating costs in the year to the end of March, compared to 37% in the previous financial year. Chief Executive Michael O'Leary said in a statement: 'We have taken advantage of recent falls in jet fuel prices to extend our hedging programme for the financial year to 2010 to 90% for the first three quarters.' Hedging commits an airline to paying a pre-determined price for future jet fuel purchases. O'Leary continued: 'Assuming that we hedge the balance of our fuel requirements at current rates this would reduce our fuel bill by approximately €450 million.' Last week, Virgin Atlantic released details of how a successful fuel-hedging strategy helped it to boost income. British Airlines also released its preliminary results last week, with Chief Executive Willie Walsh calling for greater efficiencies on the back of a pre-tax loss of £401 million.

(Source: www.cips.org/en/Supply-Management/News/2009/June/Fuel-hedging-to-fly-higher-at-Ryanair)

5. Unemployment rate

The unemployment rate is the number of unemployed people as a percentage of the labour force. Unemployed people are those who report that they are without work, that they are available for work and that they have taken active steps to find work in the last four weeks. The unemployment rate and its direction (up or down) at a point in time is seen as a key indicator of economic activity in a country. In countries with high unemployment consumer demand is likely to be suppressed as many people will not be earning a salary.

Potential impact on commercial negotiations

Companies in countries with high unemployment may need to export and find new markets in order to stay in business if domestic demand is depressed. If labour is a main cost input then these countries may experience a relative cost advantage in export markets as high unemployment typically puts downward pressure on wages and salaries. Migration of people in large numbers to countries with lower unemployment rates to find work can result from this and this can be destabilising. Low unemployment rates are often accompanied by upward pressure on wages particularly in countries where there is little migration permitted. Outsourcing of manufacturing and services from higher wage cost to lower wage cost countries has been prevalent in recent decades but is slowing down now due to lowering unemployment in countries such as India, China and Vietnam, where wage rates are rising fast.

6. Protectionism

Protectionist policies are measures a national government may introduce in order to restrict the quantity of goods imported into the country, such as quotas and tariffs. Protectionism is designed to protect against the potential short-term risks of liberal trade policies. These include the risk posed by competition from suppliers based abroad, which can weaken or even eliminate domestic industries, and the risk of large and unequally distributed losses and gains within the economy. However, protectionism can also have negative impacts on the economy: it harms consumers by raising the cost of imported goods, and harms the exporters of goods both in the protectionist country and in the countries being protected against. Most economists agree that protectionism harms economic growth, while free trade and deregulation encourage it.

Potential impact on commercial negotiations

From a procurement point of view, protectionism creates many challenges if you are importing goods or services, as their supply is likely to be restricted and/or the landed price is likely to increase.

> *Apply*
>
> 'China has warned it is "not afraid of a trade war" and unveiled a list of 128 US goods it is prepared to tax in response to President Donald Trump's tariffs. China's Ministry of Commerce said under the planned Chinese countermeasures against the US, American-produced fresh fruit, nuts, wine, seamless steel pipes and other goods would be hit first with a 15% tariff hike.[11]
>
> Imagining you are a Chinese exporter hearing this in 2018, consider what the impacts of a trade war might be on procurement negotiations with US customers.

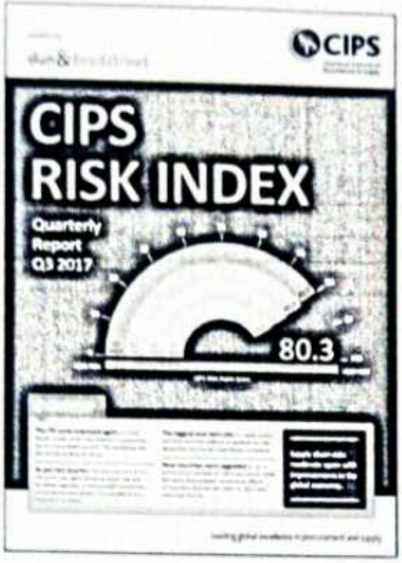
Conclusion

Macroeconomic factors take many forms and vary enormously in terms of their influence on negotiations. As a professional buyer you are expected to be aware of the factors that affect your organisation, particularly on the supply side. Tracking these factors, following forecasts and keeping abreast of developments here will help you make more informed decisions, not just in commercial negotiations but in wider sourcing decision-making.

Sources of information on micro and macroeconomics

Keeping abreast of current business and economic affairs globally and in your region will always be helpful in your professional life. There are far too many sources to name here, but economics is so much a part of everyone's life now, one only needs to read reputable newspapers and watch the main evening news on TV to keep updated with main events. Obviously, from a professional point of view, you should seek out sources that will have particular relevance to your industry (microeconomics) via more specialised Internet websites, business journals, industry interest groups and colleagues.

For macroeconomic factors, CIPS now provides access to an excellent source of insight and intelligence on macroeconomic factors via the online CIPS Risk Index Quarterly Report. Here you can understand the risks to which your supply chains are exposed with the CIPS Risk Index – powered by Dun & Bradstreet (D&B) – to gain an informed perspective on risk in the global supply environment.[12]



CRI CATEGORIES

1. Short-term economic outlook
2. Long-term economic potential
3. Market potential
4. FX risk
5. Transfer risk
6. Business environment quality
7. Business continuity
8. Insecurity/civil disorder risk
9. Expropriation/nationalisation risk

Figure 2.14 The CIPS Risk Index Quarterly Report (Source: www.cips.org/Documents/cips-for-business/1/CIPS_Risk_Index_powered_by_D_B_Q3-2017.pdf)

The Index helps you, as a sourcing professional, to understand the risks to which your supply chains are exposed. You can use the CIPS Risk Index Quarterly Report as an early warning of changes in the macro environment that may affect suppliers and your supply chain. You can then drill down from a global, quarterly, headline figure to a regional and country-level perspective, enabling you to develop robust risk management strategies and mitigate against risk. This report is composed of multiple unique assessments of 132 countries (comprising 90+% of global economic activity) across nine categories, on a monthly basis. The individual country scores are then aggregated to calculate a global supply risk score.

2.3 Analyse criteria that can be used in a commercial negotiation

You are now halfway through the syllabus coverage of this module, and only now will we consider the actual preparation for a specific negotiation, i.e. your strategy. The objective of developing a negotiation strategy is to determine the negotiation objectives and boundaries, determining your needs and wants, and prioritising them in order to best meet the strategic goals of the organisation. It has been said that most negotiations are won (or lost) at the preparation stage and, in reality, very few genuinely successful negotiation outcomes result from overconfident participants seeking to improvise, going in unprepared, on the day.

Your strategy can be short and simple and described on one page for a single variable non-strategic negotiation, or it may stretch to a 100+ page document or presentation deck for more strategic and commercially significant negotiations. The important thing is you are prepared and have a strategy.

Benefits of having a strategy

- Outcomes expected from the negotiation are clearly defined
- Process to achieve desired outcomes is clearly articulated
- Negotiation boundaries are clearly defined
- Supplier's position and objectives are understood or estimated
- Concessions that can be traded in the negotiation are identified in advance

Essentially, success in a negotiation cannot be claimed unless you can refer back to your objectives and show how you have achieved them.

In broad terms, negotiation plans/strategies involve four key activities.

1. Developing and prioritising your objectives and limits
2. Seeking to understand TOP's objectives
3. Developing concession plans
4. Planning the resources and logistics required and agreeing team roles.

In this section we will examine each of these activities.

Setting objectives and defining variables for a commercial negotiation

Introduction and recap of key concepts

When setting objectives for a negotiation, you will remember the importance of establishing your BATNA, which was covered in section 1.2. Your BATNA is your best alternative to a negotiated agreement, and the better it is, the stronger you will be in any negotiation as your walk-away point can be higher. If you have multiple qualified suppliers seeking your business, switching costs are low, and there are no benefits to having long-term relationships with suppliers, then if you do not get your way in a negotiation you can find an alternative supplier. Of course, it is rarely as simple as that, and regularly switching suppliers even in these circumstances is likely to create other perhaps hidden costs and risks.

We considered positions and interests before and emphasised the importance of focusing on your and TOP's interests. Negotiators may take positions, for example, by stating something publicly to the media – or their shareholders – but it is the underlying interests and motives that good negotiators focus on. When setting objectives for negotiations, it may be necessary to state a position to get the negotiation moving, e.g., a minimum percentage price drop or lead time reduction, or that the supplier must set up a local office, for example, but in general our interests, and not our stated positions, should drive our objective setting.

When setting objectives, two early key considerations are trust and the importance of the relationship with TOP.

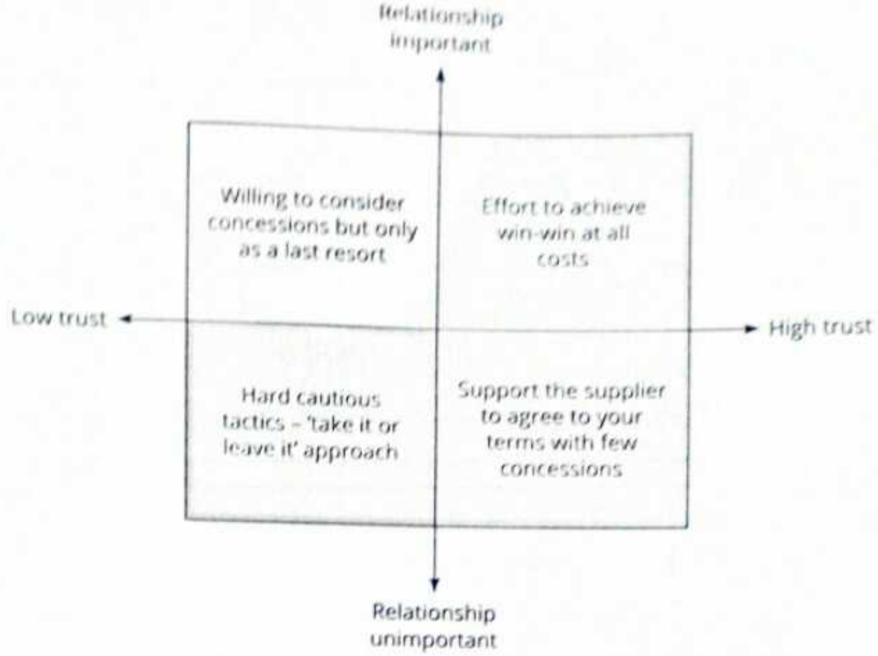


Figure 2.15 Relationship with TOP

If the ongoing relationship is important, you will seek to select tactics to ensure that TOP's needs are met as well as yours. If the ongoing relationship is unimportant, you will select tougher tactics to ensure that your needs are met and let TOP worry about their own needs.

In high-trust situations, you will tend to be more open with TOP about your settlement expectation, underlying needs, flexibility and personal concerns. In a low-trust situation, you will be cautious about revealing information to TOP.

Negotiation objectives/strategy – the process

Developing specific negotiation strategies in areas where risk or spend is high involves analysing a wide range of objectives and variables within the context of the organisation's business requirements. The amount of effort put into preparing for a particular negotiation will be a reflection of the importance that the organisation places on achieving its objectives in the negotiation. In the purchasing context this will largely be related to supply risk and value of contract; however, other variables as outlined in previous sections may also affect the amount of time and effort spent on preparation.

A robust and comprehensive negotiation plan enables the buyer to be in control of the situation and to prepare for alternative negotiation outcomes. To control and manage the relationship appropriately professional disciplines and processes need to be exercised. Successful negotiation is all about careful planning and execution of that plan. Once a strategy is agreed, it can be very tempting to launch into the negotiation, which many buyers enjoy. However, the buyer must map out what is required to be achieved and how it is going to be achieved, and in which order. This is where a carefully planned negotiation can really pay dividends. A plan also allows the buyer time to think through the strategy and tactics. It offers the buyer an opportunity to test these with other colleagues and hopefully identify any flaws or pitfalls in the plan. It also acts as a useful project planning tool and checklist to ensure that progress is being made towards the agreed goal. The preparation approach set out by Fisher and

Ury provides a good basic structure that we can use and you will find it helpful in any negotiation.

'Getting to Yes': Fisher and Ury's preparation stages

1. Set your overall objectives.
2. Try to establish their objectives.
3. Identify your tradeables/negotiation issues and set 'must, intend, like' (MIL) limits for each.
4. Determine your fallback/BATNA.
5. Develop scenarios around possible options.

We can now consider these stages in more detail. The framework that follows considers the steps in a slightly different sequence, but this is not important. What is important is that this must be done at the preparation stage before you meet TOP.

Please note there are many versions of this preparation approach put forward by different writers, training organisations and professional bodies, and you can research these on the Internet. You will find most of these are very similar. Comparing the minor differences in approaches to preparation is not examinable and is not significant for the purposes of this syllabus.

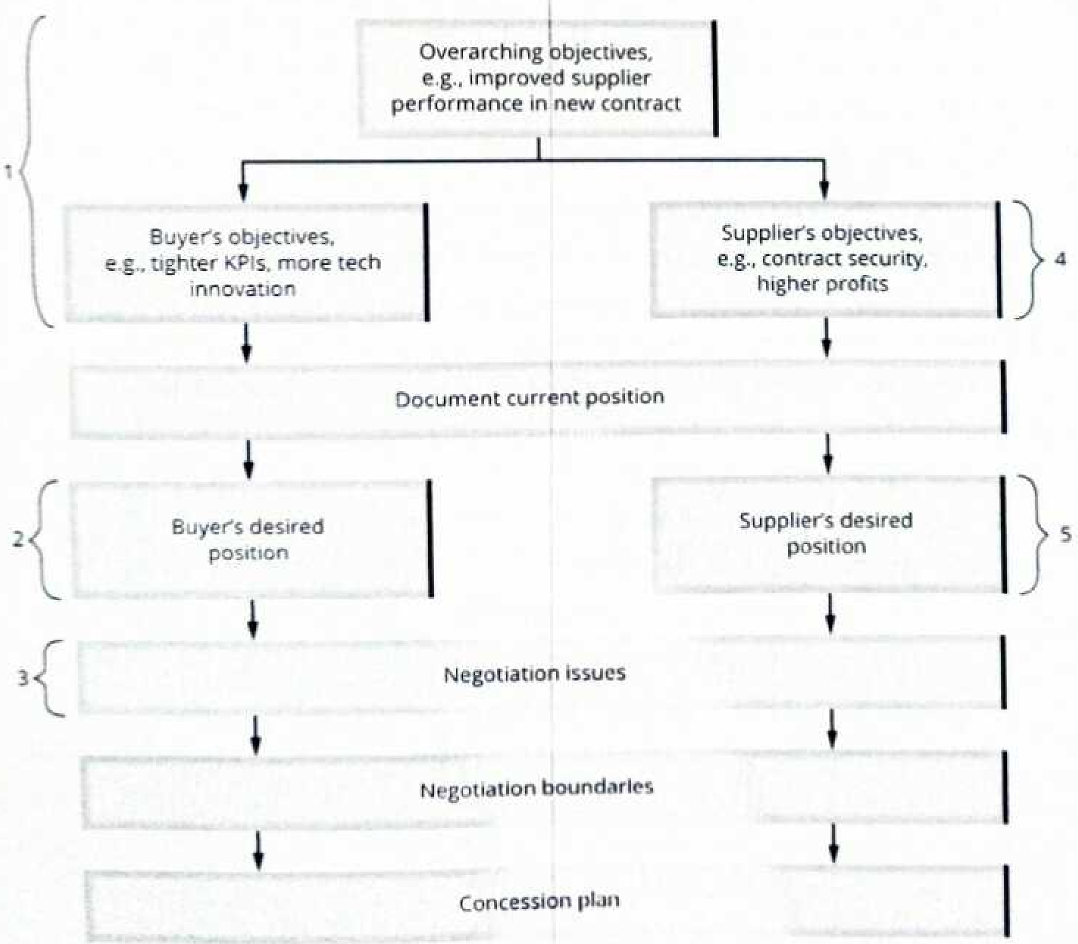


Figure 2.16 Negotiation strategy framework

Step 1

- Identify the overarching objectives and the organisational objectives that have necessitated the negotiation process.
- Develop specific objectives that will support the achievement of the overarching objectives, e.g., regarding price, KPIs, reporting, lead time, payment terms, etc.
- Agree the roles of the team.

The first stage in any negotiation preparation is to define your overall objectives which may be related to a single variable such as price in the case of a standardised requirement, or many variables in the case of capital equipment. Your negotiating strategy and tactics will all be focused on achieving your overall objectives.

If you have a team negotiation, then you will also need to establish roles for each team member. Useful roles include team leader, chief negotiator, commercial lead, technical lead, observer and scribe (see section 1.1).

Step 2

- Define the position you would like to be in at the end of the negotiation process.
- Consider a wide range of outcomes or options that you would like to achieve from the negotiation.
- Identify the preferred outcomes and prioritise in order of importance – 'must-haves' versus 'like-to-haves', using 'MIL' as follows.
    - Must = minimum requirement or least acceptable outcome
    - Intend = realistic target
    - Like = optimistic target or most desirable outcome
- Set objectives in terms of upper and lower limits and not just a fixed point.

The specific objectives you set for the negotiation will be informed by your research. If, for example, you know there are many buyers in competition for the supplier's products, this may have an impact on your ability to negotiate concessions.

In terms of the supplier and the product/service(s) in focus, buyers should investigate and be aware of multiple factors which we covered earlier, including the following.

- Cost factors and components that determine supplier prices
- The financial strength of the company
- The company's reputation in the marketplace
- The company's share of the market
- The share of a supplier's turnover the buyer would represent
- The importance a supplier attaches to the business that they are doing with you
- The type of organisational culture evident
- Who will be on the negotiating team

Step 3

- Identify major negotiation issues (the **bargaining mix**) in achieving the desired position and identify a plan for each issue separately.
- The areas in which the parties' current position differs from their desired position will form the negotiation.

Bargaining mix
All the issues in a project – each with different targets – that are up for negotiation

- Focus your planning on areas of common ground and not just on areas of potential conflict.
- Be creative and thorough in preparing this list.

The objective here is to identify all the variables (negotiation issues or tradeables) that you are prepared to bargain/move your position on. This is known as the bargaining mix and it is covered in more detail in the next section.

At the end of step 3 you will have your negotiation objectives, prioritised with best and worst trading limits established for each objective. All you have covered in this study guide regarding the business environment, market forces, supplier's position, cost and market structures and economic influences will feed into these objectives and the targets you set against them. A simple table such as the one set out below can then be developed to support you in the negotiation.

Main objective: achieve more competitive price with current supplier			
Negotiation issue	**'Must get' (worst case for buyer)**	**'Like to get' (best case for buyer)**	**Priority**
Price	Match other supplier's quote of \$55 per minute for all sites	Match lowest industry price of \$45 per minute for all sites	High
Price flexibility	Fixed prices for one year	Fixed prices for three years	Medium
Minimum annual commitment	\$2m spend	\$1m spend	Medium
Contract exit	Three months' notice	One month's notice	Low

Table 2.5 – Example table showing negotiation objectives

In this example, our buyer will be satisfied (but not delighted) if the negotiation results in the following agreement.

- The price is at or below \$55 per minute.
- Prices are fixed for at least a year.
- Committed (min) spend is less than \$2m per year.
- The contract termination notice period is less than three months.

This table will, in reality, be more complex and typically developed in Excel for significant negotiations, but will essentially follow the same structure. Typically, in a commercial negotiation, a buyer should of course aim high, but not so high as to alienate TOP with an opening demand or suggestion that is impossible. This may be perceived by TOP as insulting and/or may suggest the buyer does not understand the basic cost components/structures, etc., within the industry. The prioritisation of the objectives set out here shows that getting a concession on price is more important than conceding on contract exit notice period or minimum spend commitment. We will come back to 'opening' later in this chapter.

Steps 4 and 5

Determining the supplier's position enables insight to be developed into their needs and wants, enabling robust counter-responses to be prepared.

- Review existing research and insight on external influences, industry forces, macroeconomic issues and supplier positioning, etc., to inform your conclusions.
- Understand current contract(s) and performance on them by engaging with business stakeholders if the supplier is incumbent or an ex-supplier.
- Understand the supplier's capabilities to meet objectives and the level of investment/effort they need to accommodate objectives.
- Understand the supplier's representatives' incentives (if any) and objectives.
- By anticipating potential provider issues, effective counter-responses can be prepared to negate their concerns.
- Ask yourself 'what if TOP says/does/acts...?' questions to create scenarios that will help you prepare as far as possible for any surprises or unexpected approaches or responses in the negotiation.

Skilled negotiators seek to understand the needs of the other party, as well as their own. In doing so, it allows them to determine a strategy that ensures that their own needs are met. Failing to understand the other party's needs is one of the most common reasons for an unsuccessful negotiation. TOP acts for their own reasons, not yours. This is a difficult area and will involve a good degree of analysis and speculation. If you can establish TOP's objectives, then you will be in a strong position to know which concessions they will be willing to make, and which concessions you will have to make. Remember, they will be trying to work out your objectives too.

Ask yourself the following questions.

- How do they see your company and business?
- Do you represent a risk?
- Does your company have a good reputation in their eyes?
- Do they trust you?

We do not negotiate with organisations, we negotiate with individuals. It is therefore important to recognise that there are two levels of need.

- **The organisation** – what the organisation wants to achieve. This is generally well stated and understood (although how these needs can be satisfied often needs to be explored further).
- **The individual** – what is in it for the individual? This is generally not stated, rarely discussed, but very motivational. It is vitally important therefore that time is invested in understanding the needs of the individual.

Skilled negotiators are aware of the needs that occur at both levels, and develop creative options and strategies that attempt to satisfy these needs.

Apply

Identify ways in which you can develop insights into what a supplier's negotiation objectives might be, before meeting with them to negotiate each of the following.

1. A new transport contract for your company – a multi-site international food manufacturer
2. A new contract for cleaning services in one major hospital which is part of a bigger group
3. A 12-month extension to a contract you put in place initially for three months for temporary support for outsourced manufacturing.

Conclusion

Planning for an important commercial negotiation involves considerable preparation, but provides significant benefits.

- A robust and comprehensive plan allows you to be in control of the situation.
- It prepares you for alternative negotiation outcomes.
- It gives confidence in the meeting and provides a plan to achieve success.
- It makes you think about all that you want to achieve from a negotiation rather than just one aspect, e.g., price.
- By planning, it gives you time to think through your negotiation plan and the tactics you are going to employ.
- It also provides a framework that brings together all aspects of negotiating in a planned and determined way.
- It anticipates the strategies and tactics which the supplier(s) may employ.
- It requires you and your stakeholders to create a contingency plan together.

Next we will examine the process by which the variables and trading limits set out in the CST negotiation plan above were established.

The bargaining mix: positions and interests

The bargaining mix refers to the mix of variables that can be traded in a commercial negotiation situation. A good trade is when you trade something (a variable) that is relatively inexpensive to you but valuable to TOP.

There is an important principle here, in general: the more variables you can identify the better. The more variables you can identify and articulate, the lower the chances of the negotiation reaching deadlock as more possibilities are facilitated regarding more creative solutions. You can 'park' the controversial issue where there is no agreement on, e.g., price, and move on to another variable, e.g., contract length, and so on. By the time you get back to price the issue may have resolved itself if you or TOP has achieved a compensating attractive position on a tradeable elsewhere. Having multiple variables allows you to package and repackage offers by mixing and changing variables. You must of course set best and worst trading limits for each tradeable to ensure that you do not give away more than you planned or are authorised to.

The bargaining mix and the variables will differ according to what is being negotiated, and with whom. In a negotiation for a commodity item with few service variable elements associated such as electricity, fuel or steel, the main and possibly only variable may be price. For more complex procured requirements the list could be very long. The table below sets out just 14 possible variables that could be brought to the table in a negotiation to agree a professional services contract, e.g., legal, consulting or IT advisory project services. In a negotiation workshop you might identify many more.

Negotiation tradeables example – buying professional services	
Base price: day rate per staff grade	Seniority/experience level of staff
Volume discounts against base day rates	Treatment of expenses incurred

Negotiation tradeables example – buying professional services	
Length of contract/termination notice	Willingness to act as reference site
Lead time to start project	Knowledge transfer to client
Dedicated named staff	Contract management and reporting
Flexibility of hours and response time	Legal contract Ts and Cs
Exclusivity of supply	Working location and hours

Table 2.6 Example bargaining mix components for professional services

It is critical to recognise that the value of these tradeables will vary according to the macro business environment, the commercial situation you find yourself in, and TOP's interests and objectives. In the above example, if the buyer is in the aviation industry and TOP is desperate to break into this market, then it is likely that TOP will put a high value on the following.

- Your willingness to act as reference site – essential for TOP to build reputation
- A short lead time to start work – the sooner the better for TOP
- Your willingness to not insist on exclusivity – TOP want to expand in aviation

Alternatively, if TOP is already an established player in the aviation business, facing increased demand with a strong reputation, then it is likely they will put a high value on the following.

- Day rates – they can sell to your competitors if rates are too low.
- Lead time – they may want to delay start date so they can recruit/staff-up.
- Working location and hours – attractive enough to motivate valuable staff.

Apply

Consider the 14 variables set out in table 2.6, and for each variable, suggest a negotiation situation in any industry where that variable might be important to one side or the other, with reasons.

Bargaining mix – price

Even in negotiations where the main focus is price, experienced buyers can consider multiple variables around money.

- Price per unit with discounts/rebates for volume
- Payment terms (time period) and currency
- Treatment of inflation/price changes over contract life
- 'Learning curve' savings as supplier gets to know your business
- Payment against achievement of objectives/results
- Charges for upgrades/maintenance/after sales; support services
- Free services included that are usually chargeable, e.g., training, extended warranty

Concession planning

Once you have established your list of tradeables, you must now develop a concession plan. Good negotiators never give anything away that has not already been planned as part of the bargaining mix in the concession planning stage.

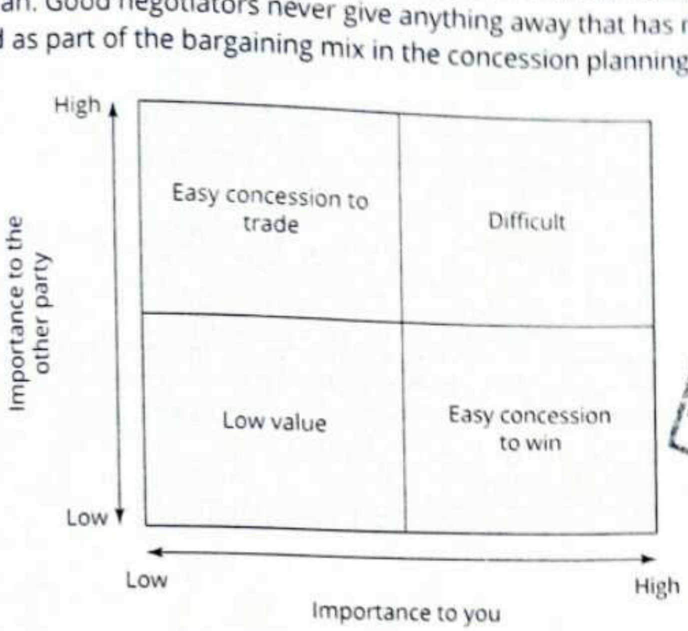


Figure 2.17 Concession planning

The concession plan helps to identify upfront what the variables that you can negotiate with are – the 'give and take items' to reach a successful outcome within your negotiation boundaries. A negotiation is a give and take; if you are not willing to give, you probably will not receive. Consideration of both sides leads to four types of concessions, as described below.

The difficult concessions

These are in the issues that have a high importance to both you and the other party. It is likely that it is going to be difficult to reach a consensus that satisfies both parties' needs. It is unlikely that these issues will make a good subject to start with, as they will be considered to be high-risk by all parties, and neither party will be willing to concede at least initially.

The easy concessions to win

These have a high value to you, but your research suggests they have little importance to the other party. When negotiating these concessions, try to win these as cheaply as possible by making as few concessions as you can.

The easy concessions to give away

These are of little importance to you, but your research suggests they are highly valued by the other party. When negotiating these concessions, try to win as many concessions as possible in return.

The low-value concessions for both parties

These are the issues that are of little importance to either party. Beware when negotiating these issues. They can either take up a disproportionate amount of your time relative to the benefits, or they can adversely affect the relationship for very little return. One tactic that could be employed is to persuade the other party that this issue is much more important to them than it really is and then try to make a trade.

Concession planning steps	
Step 1	**Identify concessions that will be made during negotiations.** Concessions should be of low cost to you and high benefit to TOP. Consider building 'false walls', i.e. make demands with the sole purpose of conceding on them during negotiations in return for a concession from TOP.
Step 2	**Plan a supporting statement for each concession to make a case to TOP that it is a sacrifice for you and of real value to them.** TOP should feel that each concession has been earned and has value. Something given for free has little perceived value regardless of its real value.
Step 3	**Build a hierarchy of concessions from lowest cost/easiest to trade to highest cost/most difficult to trade.** You should plan to concede if required on this basis – lowest cost first.
Step 4	**Plan to make concessions in small increments – a spreadsheet cost model/ready reckoner can be helpful. This will help in reminding you to do the following.** • Never give a concession without getting one in return. • Never make concessions that compromise imperative interests. • Keep as close to your desired position as possible.

Table 2.7 Concession planning tips

The concessions you would finally use in the negotiation will depend on the balance of power between the two parties (which we covered in section 1.3), and the business and economic environment context factors covered earlier in this chapter.

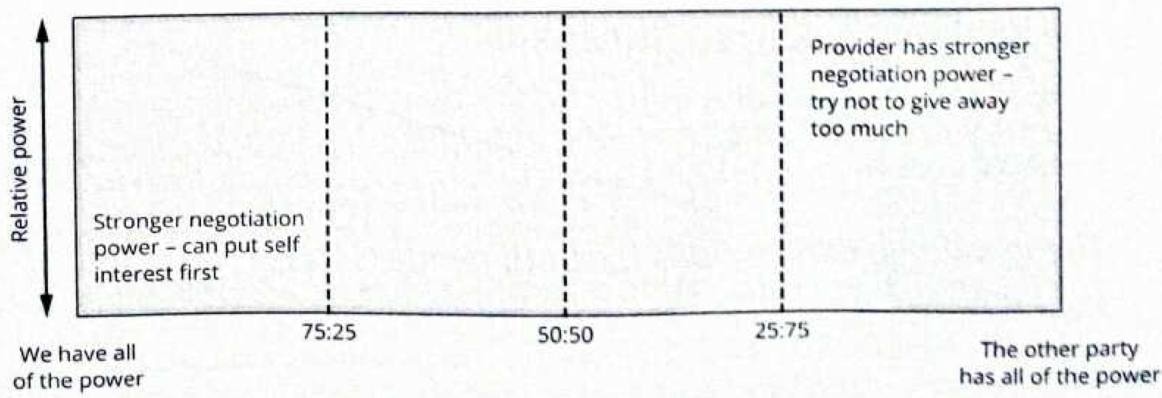


Figure 2.18 Activity redeveloping a negotiation plan

Openings and presenting issues

We will examine the stages of the negotiation meeting including the opening stage in section 3.1; however, it is essential that you plan your opening position before the meeting. What you say at the beginning of the meeting is very important in order to achieve the following.

- Establish that both parties agree on the subject matter/purpose of the negotiation
- Confirm the agenda, attendees and timings
- Continue (or start) the conditioning process
- Attempt to 'anchor' some key ideas or concepts with TOP
- Get the issues on the table without necessarily revealing their importance to you

As a buyer, it is normally easier for you to drive the agenda and indeed create it; however, a principled approach would be to seek supplier input. A clear agenda should help in avoiding surprises from TOP, but it cannot guarantee it, so your scenario planning should allow for this. Preparing a script can be a good idea, as knowing what not to say to the supplier may be just as important as knowing what to say to them.

In reality, multiple variables will influence your opening position, such as the type of negotiation, the relationship if any with TOP, the time allowed and the subject matter, and so you will need to vary your approach depending on these variables. The use of presentation slides, flipcharts and handouts may be employed if helpful, and so you should practise presentation skills if you are intending to open with a presentation. There are considerable resources online that provide you with top tips on making presentations and you should consult these for general advice. All sources agree on one key success factor: preparation; and in the case of key negotiations: rehearsal, which could include roleplays and simulations.

Get the issues on the table

Begin by clearly and logically stating your opening position regarding the issues to be discussed, what you would like to gain from the negotiation, and what you see as the benefits/advantages to the supplier in moving towards your position. Do not give away your position on the issues but ensure you get them on the table, e.g., if you want to negotiate improved lead times and credit terms, state this, but do not state what your target is on each. Your previous research will help you pitch so that what you are looking for is within the ZOPA (see section 1.2).

Allow TOP to state their opening position so you can establish and agree what areas are not common ground/agreed and therefore need to be addressed.

It is possible, but hopefully unlikely, that you establish that the distance between you is too great – for example, if they say they are not authorised to discuss lead time or credit, just price and volumes, then if they really mean this, i.e. if it is not just a position, further negotiation may be a waste of time. This should not happen if you have done your preparation and research on the supplier and have communicated an agenda to TOP.

In section 3.1 we will consider in more detail how you open a negotiation in the meeting stage.

2.4 Identify and assess the resources required for a negotiation

Choice of location

The location and environment in which the negotiation meeting is conducted are very important and can contribute to the tone of the negotiation. Key international negotiations in the political area are often held on 'neutral ground', for fairness, and to suggest that no one party is exercising more power over the other. In the commercial arena, power also comes into it and as a buyer you are already at an advantage if you have money to spend or more precisely, suppliers believe you have money to spend.

When buyers are contemplating meetings even with much larger supplier organisations, it is assumed that because they want to make a sale, they will expect to have to travel to meet you. Alternatively, you may have no choice over location due to logistics, timing or supplier negotiation team availability. Advances in teleconferencing and, more specifically, video conferencing technology have reduced the need to travel to negotiation meetings, so buyers should always consider if travelling is necessary given the potential costs and travel time commitment if not local. We will consider this later in this section. If you have a choice, you may elect not to meet on your site for reasons we will discuss here. In this section we will focus on the negotiation meeting itself, as it is acknowledged that many interactions between the buyer and TOP may have taken place at various locations, e.g., conferences, exhibitions and briefing sessions, prior to the core one-to-one negotiation meeting.

The ideal negotiation environment?

There are a potentially a considerable number of environmental tactics which can be manipulated by the host when hosting negotiations. Care should be taken in deciding whether or not to adopt some of these more questionable tactics as it can be very obvious that these tactics have been employed, e.g., sitting TOP facing into the sunlight. Use of these tactics can be seen as disrespectful and can have a significant and negative effect on the progress of negotiations. We will start therefore by assuming a principled negotiation standpoint.

From a **principled** point of view, the ideal negotiation environment is one with the following qualities.

- Both parties feel comfortable physically: temperature, lighting and seating.
- Travel to the location and check-in is easy; phone/web connectivity is good.
- Both parties have no concerns regarding security and confidentiality, including breaches, e.g., bugging/hacking/listening in.
- The facility is quiet, secure and in addition to the main negotiation room/area, there is access to a separate recess room(s) for breakouts.
- Negotiation teams (e.g., if more than one supplier) do not meet inadvertently in reception area before or after meetings, for example.
- Agenda and timings are agreed in advance, so participants can plan meals, breaks, etc.

- Refreshments are available to purchase with some choice.
- There is access to tele/video conferencing facilities if required.
- There are no surprises for the visiting party designed to distract or unsettle them.

From a principled point of view, the focus of the negotiation is on resolving the issues and not on winning temporary advantage over TOP through exploiting home advantage. It is assumed that TOP will spot any tricks, unfairness or tactical ploys, e.g., disturbances, and this will create the wrong starting point for any subsequent longer-term relationship. Of course, in the case of once-off tactical negotiations or those where the parties are in dispute, this may not hold true; although there is rarely any excuse for rudeness. For that reason, from the principled point of view, the location and room layout should not be viewed as a source of tactical advantage and should not be used to try to gain advantage over TOP or unfairly influence them in the meeting room.

From a pragmatic point of view, not all of these elements may be feasible, so the host may have to make compromises and explain these to TOP. If, for example, a separate recess room is not available, then it should be stated that if one side needs to confer in private/make a call back to HQ, etc., then TOP will leave the room temporarily. The ideal negotiation environment conditions may not always be possible in commercial life, but acknowledging this can make a difference if you are the host.

From a distributive win-lose partisan point of view, the host will seek to create an advantage for themselves either explicitly or more subtly. Explicit actions include a list which would read almost the opposite of the 'principled' list set out above, e.g., 'make TOP feel uncomfortable physically', 'do not provide refreshments', etc. Adopting such an extreme approach is high-risk, is unlikely to create an environment conducive to a good long-term outcome, and in general would not be seen as professional from a CIPS point of view. Professional buyers can get great deals without the need to exploit home advantage in such a discourteous and ham-fisted manner in a commercial negotiation. It is arguable also that any advantage gained through intentionally creating an uncomfortable environment to put short-term pressure on TOP is likely to be short-lived as TOP will likely reflect on this later and seek means to get even. In any case, in most significant commercial negotiations, although agreement may be indicated at the meeting, e.g., through oral agreement or shaking hands, the agreement is typically subject to contract or formal sign-off by senior stakeholder(s) back at base. With time to reflect on the undue/unfair pressure brought to bear on TOP during the negotiation meeting, they may well decide not to sign or seek to reopen negotiations.

Factors to consider if you have a choice

Home or away – home

It is assumed – rather like a sports team – that there is a home advantage, i.e. negotiating at your own site/location is advantageous to you. If you tour the famous football stadiums of FC Barcelona in Spain or Manchester United in the UK, you will see a notable difference in the home and away dressing rooms. All are world-class facilities but there are significant differences in size, space and comforts between the home and away area rooms. Although there is no home crowd to chant their support for you, negotiation 'at home' is certainly likely to be cheaper, easier to schedule and plan for you and more predictable in terms of surroundings. Most research shows that negotiators are more assertive on home ground, feeling more comfortable with easier access to data, experts and colleagues if required.

You can time unexpected 'interruptions' at specific times, and you can ensure TOP sees your state-of-the-art facilities, promotional material, industry awards and favourable press reviews of your products/services on the waiting area walls.

You potentially control the schedule, the timing of breaks and what refreshments are served, the room layout and location of any breakout rooms for recesses, and what TOP sees on your site. We say 'potentially' as confident negotiators within TOP's team may challenge you as the host if they perceive these elements are set up to favour the buyer too much.

The home advantage is even more marked in international negotiations where TOP is typically expected to at least attempt to follow local norms and customs even if it makes them uncomfortable, plus travelling long distances can be tiring and distracting. Furthermore, if your site requires security passes to be issued, visitors to be searched, and health and safety briefings to be made in addition to general waiting around, then it is likely that TOP may be somewhat less relaxed on meeting you than vice versa.

Practical considerations such as unsuitable facilities, on-site security and confidentiality restrictions or embarrassingly luxurious offices may mean you elect to negotiate off-site or at a neutral venue.

In normal circumstances however, all things being equal it is generally accepted that negotiating 'at home' is more advantageous.

Apply

Recall situations when you were in meetings with suppliers, customers and/or potential employers at job interviews. Did the location affect your mood, confidence, approach or any other behavioural factor? If so, try to recall how. If not, consider how it may have affected TOP. You may conclude that the impact of location is dependent on multiple factors and that generalisations are dangerous.

Home or away – away

Despite all the advantages pointed out above, there are many situations where it may be more beneficial to buyers to negotiate away from their own site/location. Visiting a supplier at their HQ or operational facility may facilitate you in assessing, albeit briefly, the culture of the organisation, how busy they seem and how staff engage with each other. Of course, you may not see any of this unless you request a formal site tour, but it is a consideration.

It is agreed that if you are a host, there is an expectation of at least basic courtesy, comfortable surroundings and refreshments, and assistance with onward travel/parking, etc. As a visitor, you do not have to worry about any of this, as the burden of organising the logistics should fall to TOP. On a practical level, it may be that your own offices do not have suitable negotiation spaces or the rooms you have are overbooked or difficult to access. In the cases of buying organisations in remote or relatively hard to reach locations, it may just be more practical for you to decide to meet TOP at their location or at a neutral or more convenient venue.

Neutral ground

Many negotiations take place over a series of meetings, so it can be agreed that the meeting location can move between both sides' venues. Under such circumstances, seeking to gain tactical advantage by manipulating the location and room layout is likely to be a waste of energy, as well as being potential embarrassing for both sides – in essence it just does not make sense.

Third-party locations such as conveniently located hotels with good business facilities are a popular option for many, although there is of course a direct cost associated that needs to be paid for by one or both parties. Holding negotiations in such neutral venues has many advantages and clearly removes most if not all of the perceived advantages and distractions of negotiating 'at home' or 'away'. Furthermore, a wider choice of catering/refreshments, easier access to transport when required and the capability to book additional hotel rooms for breakouts or overnight stays can make this a more attractive option for significant negotiations.

There are of course cheaper ways to access a suitable location, and a visit to most large hotel lobbies in big cities will provide ample evidence of multiple negotiations taking place over tea/coffee/lunch, with buyers and suppliers talking on mobile phones while leaning over laptops. There are of course significant confidentiality risks associated with negotiating in a public space, and you may be disturbed at any time by extraneous factors.

Room layout and surroundings

Reference was made earlier to the ideal negotiation environment from a principled perspective, and it is not proposed to go back over this. For the purposes of the CIPS syllabus, it is reasonable to assume that most commercial negotiations are based at least initially on a principled- or pragmatic-type approach, and so the room layout should follow these principles. Having access to a breakout room and ideally one each side, for significant negotiations, is probably essential. The importance of room layout, seat positions, etc., can be exaggerated, especially with trained negotiators who will pick up on any obvious tactics designed to undermine or unsettle them, such as the following.

- Positioning TOP facing the sunlight, near a draughty window, or by an annoying air conditioning unit
- Seating TOP team too close together, too close to the host, or too far apart from each other so that conferring is difficult
- Providing inferior quality seating to TOP
- High room temperature designed to tire TOP out, low room temperature designed to speed up a deal

It is important that your team seating is arranged to suit your roles, and as planned, so never let TOP change this unless absolutely necessary. For commercial negotiations, generally formal seating arrangements each side of long table are preferable to round table or informal arrangements. A commercial negotiation is not a counselling session or support group where sitting in a circle with no table may be desirable, and as it is likely that the opposing teams may need to pass written notes to each other or quietly concur during the meeting, traditional cross-table seating is normally desirable. It can be very frustrating for the team members of TOP to be forced to sit apart, or in close proximity to opposition team members, or in a position where they have insufficient desk space and elbow room.

Apply

Visit the Propertylogy website and read the article 'How to plan advantageous seating arrangements in negotiation' (www.propertylogy.com/negotiation/seating-arrangement-advantage). (There are also other similar websites with similar features.)

Do you think these tactics are useful? In what situations do you think they might work and not work in your professional and personal life? How do you think TOP would respond if you tried to use them?

Conclusion

Essentially, for trained negotiators under most circumstances, the physical location of negotiation and the room layout should not make much difference to the outcomes of the meeting (we will address international factors section 3.3). If you have followed the negotiation preparation steps outlined in the previous two sections, you will have a plan complete with objectives. This plan will allow for a number of alternative scenarios which you will have thought about.

You know you must not go beyond your trading limits, and your team roles and responsibilities are clearly set out. If this is the case, it should be unlikely that logistical factors will affect you significantly, particularly if you are part of a team and not on your own. Furthermore, as a trained negotiator you should be able to spot obvious tactical environmental ploys designed to unsettle you or put you at a disadvantage. You can either call these out – thus undermining their effectiveness and reducing their impact – and ask for the meeting to be reconvened in a more conducive environment, or just note, but ignore them.

Finally, as a buyer in a competitive market, you will have the advantage of having something TOP wants – money, revenue, a sale/deal to offer. If you feel uncomfortable, you should state this and insist that anything agreed is subject to approval back at HQ, or just end the meeting and walk out (as a last resort, of course). You should never consciously concede due to physical environmental factors/discomfort, and it is likely your superiors will be more sympathetic to you if you come home without a deal than with one agreed because you were uncomfortable.

Involving appropriate colleagues

As a buyer engaging in day-to-day commercial negotiations with suppliers over relatively low-value/low-risk requirements, you may frequently or always be negotiating on your own and not as part of a team. As the stakes get higher and the negotiation takes on greater strategic importance for your organisation, it makes sense to involve more team members with specific roles. There are a number of benefits in adopting a team approach when negotiating with suppliers, including the following.

- You are less likely to be intimidated.
- You are less likely to make unplanned concessions as your team mates will seek to stop you.
- Individual team members can focus on specific areas, e.g., commercial, technical, observing TOP.

- You can stage-manage your team and use certain tactical ploys, e.g., 'good cop, bad cop' (covered in section 3.2).
- Risk of procurement fraud and sharp practice is reduced and ethical behaviour increased as there are more witnesses.
- Junior or new staff can learn a lot from observing/acting in a note-taking position.

In this section we will examine key team roles and the influence of individual negotiation styles in the negotiation.

Who should be involved?

It should be clear from your reading up to now that the support, direction and involvement of many stakeholders is required in order to gather the required insight to agree objectives and prepare effectively for a commercial negotiation. When it comes to planning who should be involved and in attendance at the meeting stage, however, it is a different matter. The following questions should be considered.

- Is technical, operational, legal or non-commercial expertise required?
- Do we need a senior manager/director to attend and/or perhaps welcome TOP to indicate the importance of negotiation/acknowledge their commitment and show respect/give face?
- Will a decision be made at the negotiation? If so, who has authority to make it?
- Do we want/need a separate note taker/observer in attendance?
- Are required staff available (in person or on the phone) for the meeting?
- Are there significant logistical and cost challenges? The more people are involved, the more space and time must be invested.
- How many will be on TOP's negotiation team? Some sort of balance in numbers is desirable.
- What is the seniority level of TOP's team? Regional, national or global managers?
- Will additional attendees assist or detract from our planned approach? Can your colleagues be trusted to keep to the script?

Team roles

Only when you have answered the questions set out above can you move on to agreeing the roles of your team at the negotiation meeting. Please note that a team can be as few as two people, and one person can play one or more of these roles. The important thing is that you stick to the roles agreed.

- The **chair** is the person who controls the negotiation and ensures that everyone has his or her say on your side. This role may only be required in very complex or contentious negotiations, or those in the regulated or public sector.
- The **leading speaker**, typically a procurement team member, should be articulate and in control of the agenda and objectives. He/she will call on expert colleagues as required to support proposals and rebut counter-proposals. There may be more than one procurement team member taking this role, e.g., senior and junior manager.

- **Experts** may be in attendance and called on at any time during the negotiation to provide specific advice, rulings, or technical, legal, or financial information. They should only speak on instruction of the lead or chair.
- An **analyst or observer** carefully observes and monitors the progress of the negotiation towards the team's objectives, and feeds adapted strategy/tactics to the others.
- The **secretary/note taker** records all proposals and counter offers, observes the reactions and responses of the other side, and develops carefully worded agreements.

Another consideration when forming a negotiation team may be individual negotiation styles. See below.

Negotiation team member styles – personality and learning

Personality and working style

There is an enormous amount of literature in the field of psychology and organisational behaviour regarding personality types and working styles/learning styles, and when each is more effective in which situation.

Perhaps the best known is the Myers–Briggs Type Indicator, which indicates personality preferences in four dimensions.

1. Where you focus your attention – extraversion (E) or introversion (I)
2. The way you take in information – sensing (S) or intuition (N)
3. How you make decisions – thinking (T) or feeling (F)
4. How you deal with the world – judging (J) or perceiving (P)

Apply

Find the CIPS White Paper, 'How to Negotiate Professionally', by Paul Steele on the CIPS website. This article is recommended reading and on page 26 you will find a simple self-assessment questionnaire designed to measure your negotiation skills which you can complete quickly. Complete the questionnaire and consider your score. Do you agree with it? It is not scientific, but it is interesting and worth doing. Review the questions and consider the scores to work out your areas of strength and weakness.

There are many more sophisticated evaluation tools that seek to measure individuals' personality types, working styles and preferred negotiation styles, which you can find online or buy from specialist training organisations. Some are personality-based inventory/assessment tools such as Strength Deployment Inventory (SDI), which uses colour coding to illustrate dominant personal strengths, e.g., blue – altruistic/nurturing, red – assertive/directing, and green – analytical/autonomising.

These can be useful to establish the different styles of your team members. This analysis can then be used in theory to match the team member to the specific negotiation you are planning.

Learning and perception

How people learn and take on new information is also important in our understanding of negotiation styles. Kolb is perhaps the most famous writer in this area and he considered learning styles along two dimensions: perception and processing. In the perception dimension, people will have a preference on the continuum between 'concrete experience' and 'abstract conceptualization'. In the processing dimension, people take the results of their perception and process it against their preference along the continuum between 'active experimentation' and 'reflective observation'. This led him to conclude that there are four preferred learning styles for individuals. From our negotiation team perspective, understanding how our team members prefer to process information and learn is of course very useful, as we may want to ensure the team is made up of individuals with different learning styles to increase our chances of not missing anything verbal or non-verbal in the negotiation. We would of course also like to get an insight into TOP's personality types and learning styles.

The scope of this syllabus does not allow for a deep analysis of learning, perception and different personality types. Much of this material requires deeper study and is subject to much debate. However, when planning for an important negotiation, you should consider whether there might be benefits in seeking to understand the different working/learning styles of your team so that you can play to each individual's strengths. There are multiple questionnaires available online and in negotiation textbooks that will assist you in establishing your own preferred negotiation style. Most training courses will run a diagnostic exercise with participants to help you to understand your preferred style.

Seeking to mix your team so that you have different working/learning styles, to avoid 'group think' and/or so you match TOP's working/learning styles if known, can reduce the possibility of conflict and create a more productive context for negotiation.

Individual negotiation styles

A useful and simple shorthand for preferred negotiation styles is summarised by four simple descriptors: 'warm', 'tough', 'logical' and 'dealer', which can be applied to describe individuals' dominant preferred style in most circumstances.

Warm – a people person

Tough – a hard-nosed negotiator

Logic – a numbers person

Dealer – a trader who loves bargaining

Strengths and weaknesses of each style

Strengths	Weaknesses	How to deal with them
Friendly and accessible	Too accommodating	Build trust and listen
Good listener	Loses sight of essentials	Use their name frequently
Shows concern and empathy	Finds it difficult to deal with conflict	Use strong logic and demonstrate understanding

Strengths	Weaknesses	How to deal with them
Looks for mutual gain	Discloses information too readily	Emphasise their personal gain in the negotiation
Patient/trusting	May focus too much on personal issues	Summarise frequently and keep discussion focused
Relates well to people	Finds difficulty in dealing with people who do not value personal relationships	Emphasise long-term relationship

Table 2.8 Warm negotiating style

Strengths	Weaknesses	How to deal with them
Natural leader/assertive	Adopts rigid positions	Do not give a concession without obtaining something in return
Desire to achieve	Can be inflexible	Be warm and firm
Persistent	Does not build on ideas of others	Recess to relieve pressure
Assumes leading role in meetings	A selective listener	Use organisational power, if applicable
Decisive and keeps things moving	Impulsive and can be impatient	Use powerful arguments

Table 2.9 Tough negotiating style

Strengths	Weaknesses	How to deal with them
Grasps details	Tends to focus on issues and not the people involved	Get their list of requirements from the negotiation at the start
Precise	Gets too absorbed in the details	Listen and evaluate the facts carefully
Methodical	Cannot readily change styles of persuasion	Recess to analyse the issues
Plans well	May not see the global picture	Back up arguments with facts and figures
Always well prepared	Reaches deadlock more easily	Respect their expertise

Table 2.10 Logical negotiation style

Strengths	Weaknesses	How to deal with them
Builds relationships	Tends to neglect detail	Try to understand their underlying interests
Effective communicator	May shift position quickly	Summarise and test their understanding frequently
Listens to the other party	May be superficial in personal relationships	Trade concessions
Interrelates issues easily and makes quick decisions	Agreements made can be difficult to implement	Do not move too easily
Creative/sees opportunities	Tends to neglect long-term goals	Separate facts from assumptions

Table 2.11 Dealer negotiation style

As can be seen, each style has its relative strengths and weaknesses, and when considering their own and their team members' styles, buyers should consider the following questions.

- In what circumstances is your style most effective?
- In what circumstances is your style least effective?
- What positive outcomes accrue from the use of this style?
- What negative outcomes may result from the use of this style?

Conclusion

Recognising TOP team members' preferred style can be useful when in the negotiation meeting, as mirroring or responding to that style can be effective. The best negotiators recognise their own preferred default style, but can change their style to suit the circumstances. Effective negotiators have a complete repertoire of styles. With insight, feedback and practice, you can expand your repertoire and so adapt to suit the situation.

Use of telephone, teleconferencing or web-based meetings

For important commercial negotiations, if practicable it is desirable to plan for face-to-face meetings, and most of chapter 3 is dedicated to this. There are however many situations where this may not be practicable due to logistics, travel constraints, time availability or cost reasons. If potentially spending significant amounts of money, buyers will generally have the advantage of being able to insist on suppliers travelling to their location, but this is not always true. In many cases, they can also incur costs in terms of hosting visitors.

Many commercial negotiations could be considered routine or just not worth the investment for buyers, and using the phone can make more sense and can be more immediate. Furthermore, developments in teleconferencing and video conferencing and web-based meeting tools such as Skype allow negotiations to take place in an environment that can provide an equal and sometimes superior option for buyers to consider. In this short section we will briefly consider these alternatives. There are multiple sources of information on the Internet on the use of telephone, teleconferencing or web-based meetings. Just type 'teleconferencing' into Google and you can browse some of these providers' websites.

Apply

Read Simon Hazeldine's online article, 'Negotiating by telephone & e-mail – the challenges and practical solutions' (see 'Recommended reading' at the end of this chapter).

Challenges and disadvantages of face-to-face, in-person meetings

- In-person meetings require your team and TOP to be in the same place at the same time. In today's busy world, this is increasingly difficult to achieve.
- Someone has to take the time to plan and organise the facility, refreshments, etc., and worry about room layout, breakout spaces and welcoming guests.
- There may be travel and accommodation costs to consider, which can be substantial if you are negotiating with a number of suppliers in different locations.
- Travel and location challenges may mean meetings are more likely to be delayed until everyone has arrived or that meetings go ahead without all participants.
- It can be argued that the importance of physical meetings is overstated in today's digital world, where people make online purchases without ever speaking to a retailer, and many of us trust our money with online banks and our insurance with providers we have never met representatives of.

Negotiating over the phone

When negotiating over the phone you cannot see TOP, so the only cue/signal you have regarding their mood, interest and attitude is the person's voice intonation and any delay. There is no body language to interpret (either correctly or incorrectly).

It is recommended that prior to the phone negotiation, you have an agreed and timed agenda with TOP, and that you prepare scripts to assist you when moving through your agenda. Essentially, you should put into practice all of the preparation steps discussed earlier in this chapter. From a professional perspective, for a negotiation where there is a lot at stake, it is probably unwise to negotiate one-to-one over the phone without note-taking support at the very least, and ideally another colleague to corroborate what you have said and agreed in case of disputes later. This is also more transparent and reduces the opportunity and temptation for procurement fraud and sharp practice.

Advantages

- Can meet immediately, plus quick and cheap, facilitating more productivity
- Access to TOP may be easier
- Location is irrelevant on either side assuming you have an adequate connection

Disadvantages

- Both sides are more subject to distraction/interruption
- More prone to errors, omissions or misunderstandings regarding what is agreed, e.g., if complex
- You do not know how confidential TOP's environment is/who else is listening
- Mutually agreed record of meeting is more difficult to verify

Teleconferencing (audio conferencing)

Teleconferencing, whereby multiple participants on both sides can dial into a dedicated line, overcomes many of the challenges of traditional one-to-one telephone negotiation.

Advantages

- Most organisations can access this service, and if you just need to speak with TOP without any visual link, an audio conference is a simple way of doing this simply and efficiently. All you need is a landline or mobile phone and an account with an audio conferencing provider.
- It is said that teleconferencing can provide participants with increased objectivity because they are not distracted by the visual feed provided by the webcams or by meeting participants. This allows them to think more logically about the points being put forward during the discussion, and perhaps come to an agreement sooner.
- The use of the 'mute' button can facilitate each side conferring in private with colleagues if required during the meeting.
- If agreed in advance by all parties, the meeting or summing-up stage can be recorded as a true record of what was agreed, thereby reducing the risk of mistaken notes or denial by either party at a later date when the agreement is being committed to contract.

Video and web conferencing

Face-to-face negotiation meetings are now easily facilitated using web conferencing and webcams, without having to travel to meet in person. This addresses many of the drawbacks of telephone and teleconferencing. Everybody can see each other from wherever they are, whether in their office, home or anywhere else. The traditional advantages of meeting in person can be achieved much more easily with a web conference.[13]

Advantages

- Using webcams in a web conference means you are able to communicate both verbally and non-verbally. If you can read someone's body language, you will have access to a wealth of additional information that cannot be transmitted through a simple telephone meeting. Body language also influences how our words are interpreted by others. If your body language matches your words, this increases trust, rapport and understanding with TOP.
- It increases engagement. Having a visual connection with TOP adds an element of accountability for each person. This will discourage attendees from

attempting to multitask, which can happen if the meeting is being conducted over phones.

- It increases productivity. Web conferences allow you to share presentations or other screens so you can discuss or collaborate easily on project plans, pricing sheets and documents even when you are separated by thousands of kilometres. The time saved from travelling to the meeting can instead be used to achieve your goals and make decisions more efficiently.
- If agreed in advance by all parties, the meeting or summing-up stage can be recorded as a true record of what was agreed, thereby reducing the risk of mistaken notes or denial of what was agreed by either party, at a later date when the agreement is being committed to contract.

Disadvantages

- You and TOP will need access to the communications infrastructure: a dedicated web conference room with the required technology.
- The communications link can break down during the negotiation, and it potentially is more susceptible to hacking if security protocols are not robust.

Chapter Summary

In this chapter we considered how to best prepare for negotiations.

In section 2.1, we focused on costs and cost behaviour and emphasised the importance of commercial negotiators having a thorough understanding of all elements that make up a supplier's cost structure and therefore feed into price. We examined direct and indirect, variable and fixed costs, break-even analysis and cost volume profit formulae. We also compared costing methods such as absorption, marginal or variable, and activity-based costing. We considered how volumes, margins and mark-ups affect pricing. We concluded by highlighting that buyers can reduce costs through multiple savings levers, of which price negotiation is only one.

In section 2.2, we considered the economic factors that affect commercial negotiations. Microeconomic factors include the determinants of demand and supply, market structures and the level of competition, as well as the scarcity of factors of production. Important microeconomic concepts such as equilibrium price, elasticity, diminishing returns and opportunity cost were explained in the context of negotiation. The influence of macroeconomic factors on commercial negotiations was also set out here. Macroeconomic factors can have a major impact on prices, yet most organisations have no control or influence over them. Macroeconomic factors include the economy growth rate, inflation rates, interest rates, currency exchange rates, unemployment rates and level of protectionism in trade between countries. We ended this section by signposting sources of further information on micro and macroeconomic factors.

In section 2.3, we described the key steps/elements in preparation for a commercial negotiation. We considered how objectives can be set and the variables for a commercial negotiation defined (the bargaining mix). We emphasised the importance of setting limits to the variables (the things you can trade) in a negotiation, and also of developing a BATNA, your best alternative to a negotiated agreement if you have to walk away. We also considered the important differences between positions (the things people say they want) and interests (what people really want). Good negotiators focus on interests and are not distracted or put off by seemingly difficult opening positions of TOP.

In section 2.4, we considered the physical resources needed and the practical logistical factors that can affect negotiations. We reviewed the issues around the choice of location and surroundings for the negotiation, as well as the room layout and seating. We also considered team organisation and the involvement of appropriate colleagues. Finally, we considered recent developments in telephone, teleconferencing and web-based technologies, for the facilitation of negotiation meetings where the participants do not need to be in the same physical location but can meet 'virtually'.

End of Chapter Assessment

1. Describe two pricing strategies used by suppliers. DESCRIBE
2. Explain the difference between a perfectly competitive market and a monopoly. EXPLAIN
3. Discuss the qualities of an ideal negotiation environment. DISCUSS

Recommended reading

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13 Ferguson, S. (2017), *What are the pros and cons of face-to-face meetings?* [online]. Retrieved from: blog.teleconference.com.au/conference-call-blog/what-are-the-pros-and-cons-of-face-to-face-meetings [Accessed on: 27 February 2019]

LO3

CHAPTER 3

Understand how commercial negotiations should be undertaken

Learning outcome

By the end of this chapter, you will have an understanding of the fundamentals of how commercial negotiations should be undertaken at the actual 'in person' meeting stage with TOP.

Chapter overview

3.1 Identify the stages of a commercial negotiation

You will understand:

- Defining the phases of a negotiation: opening, testing, proposing, bargaining, agreement and closing.
- How behaviours typically change during the different stages of a negotiation

3.2 Appraise the key methods that can influence the achievement of desired outcomes

You will understand:

- The use of persuasion methods
- The use of tactics to influence the other party

3.3 Compare the key communication skills that help achieve desired outcomes

You will understand:

- Types of questions
- Effective listening
- Push and pull behaviours
- Non-verbal communication
- The influence of cultural in commercial negotiations
- The use of emotional intelligence in commercial negotiation

3.4 Analyse how to assess the process and outcomes of negotiations to inform future practice

You will understand:

- Reflecting on performance
- Opportunities for improvement and development
- Protecting relationships after the negotiation

3.1 Identify the stages of a commercial negotiation

Introduction

In this final chapter we focus on the meeting stage of the negotiation – the stage that all your preparation work has been leading up to, and the stage that attracts the most attention. This is the stage where your listening and questioning skills will be put to the test, and where careful exchange of information and interpretation of signals from TOP will be rewarded with a good deal for you, and ideally a deal TOP can accept.

In chapter 1 we stated that most negotiations are won at the preparation stage, and so it is essential to remember that preparation is key. In important commercial negotiations, no amount of persuasive skill, charm, intelligent questioning or tactical use of gambits and ploys can compensate for poor preparation. Being prepared in itself gives you a sense of confidence and direction. You know what you want, what your walk-away points are and what you can trade – there is no need to guess. Furthermore, trained negotiators TOP's team will quickly spot a poorly prepared buyer and can exploit that situation.

This chapter is shorter than the others as it is largely about the application of practical skills. Less reading around the subject is required and watching the video cases/accessing the recommended resources online is the best way to reinforce your knowledge. On most negotiation training courses this is the practical part, where learning is largely in a classroom-based setting through the application of principles in negotiation simulations or roleplays, interactive trading games, videos and reflections on outcomes by the observers.

Remember, you are not ready for the meeting stage if you have not prepared.

Negotiation preparation checklist	Done
Objectives and agenda agreed, team roles clear?	✓
Insights captured regarding relevant external influencing factors?	✓
Analysis of relevant cost and price issues?	✓
Understand the balance of power and supplier positioning?	✓
Insights into TOP objectives noted?	✓
Bargaining mix and trading limits agreed?	✓
Logistics all confirmed?	✓
Conclusion	**Ready to go**

Table 3.1 Negotiation preparation checklist

Defining the stages of a negotiation: preparation, opening, testing, proposing, bargaining, agreement and closure

3.1 LO3

The variety of negotiations procurement staff may be involved in is very wide and the multiple contexts were set out in chapter 1. Negotiation meetings will differ enormously in terms of the subject matter, time to prepare, time available in the meeting and the people involved. Most writers and negotiation experts would agree that, in terms of the meeting stage, there are sequential phases, stages or steps that typical negotiations pass through and that understanding these is essential. In a short negotiation these phases may last just minutes, while in complex international trade negotiations some phases may last weeks, months or even years. These phases are not set in stone and some negotiators may intentionally ignore the sequence in order to disrupt and confuse TOP or gain tactical advantage. There is, however, a generally accepted 'classic' and tried and tested approach to the sequence of negotiations, which we will set out here. For example, most writers agree you should probe or question before you move to bargaining.

In his book, *Negotiate: The Art of Winning*, Harry A. Mills sets the phases out as a mnemonic: 'RESPECT – the seven steps to agreement' (although step 1 is pre-meeting).

Step 1: **R**eady yourself (preparation stage)
Step 2: **E**xplore needs
Step 3: **S**ignal for movement
Step 4: **P**robe with proposals
Step 5: **E**xchange concessions
Step 6: **C**lose the deal
Step 7: **T**ie up the loose ends

As suggested by the 'RESPECT' acronym and set out in chapter 2, there is a general assumption that adopting the principled approach (win-win) to the meeting stage is the best starting point. Care must be taken in circumstances where your preparation suggests that TOP may not want to adopt a win-win approach or may have concerns about being seen to give away any concessions. Disruption through technology and radically new business models has been a strong force that has shaped markets all over the world recently and it is possible that you or TOP may decide that traditional negotiation models are not for you. Even if this is your conclusion, it is important that you know the generally agreed theory, so you can argue from a knowledgeable position, and because it is examinable in the syllabus.

In their book, *Business Negotiation: A Practical Workbook*, Steele and Beasor set out a number of steps for practical negotiation. The first five steps take place before the negotiation meeting, but the steps carried out during the meeting are listed in table 3.2.

Steele and Beasor's negotiation stages (from Step 6 onwards)	
The first phases	Step 6: When do we start?
	Step 7: The opening round
	Step 8: The power of questions
	Step 9: The skill of listening

Steele and Beasor's negotiation stages (from Step 6 onwards)	
Managing movement	Step 10: Who moves first?
	Step 11: It's your turn to move
	Step 12: Bargaining and dealing
	Step 13: The edge of the cliff
The end of the road	Step 14: Shaking hands

Table 3.2 Steele and Beasor's negotiation stages[1]

It is useful to note here the reference to the 'power' of questions and the 'skill' of listening; both are key areas that we will examine in this section and in more detail in section 3.3. Inexperienced negotiators, who view negotiation as high drama with lots of last-minute offers and brinkmanship, may be surprised and disappointed to see 'bargaining and dealing' called out as just one step of nine. Quick thinking and tactical bargaining and dealing have their place, and are essential skills in negotiation. However, this stage can actually be over quite quickly if both sides have, through intelligent questioning, tested TOP, know the ZOPA and want a good deal (not necessarily the best deal possible). Good negotiators do not bargain for any longer than necessary and do not get greedy. If they achieve their targets as set out in their negotiation plan, they will seek to close the deal.

Remember

Different writers may use alternative terms for the different phases of the negotiation, but most will agree that there are distinct phases and that there is a sequence or chronological order.

Supplier conditioning

Before we examine the typical stages of the negotiation meeting, it is worth considering the question set out as step 6 above: 'When do we start?' Steele and Beasor propose that, 'if you are thinking about when to start the negotiation, it may already be too late.'

Before you meet a supplier's representative for the first time, think about how your impressions regarding that person and their company are formed and, more specifically, how your expectations of the negotiation outcomes may also be affected. Example sources of expectation formation include the following.

- Supplier's reputation in the marketplace, brand value, price/quality perceptions, international reach, recent news reports, their office buildings and facilities
- Your experience of written communications with supplier: responsiveness, accuracy of paperwork and language, working hours (e.g., e-mail responses after office hours)
- Supplier's representative's job title, form of address, e.g., 'Dr', courtesy, way of communicating and qualifications, e.g., MCIPS, possibly on business card or career history via LinkedIn search

The impressions you form from these touch points may or may not influence you in negotiations, but unless you are very aware of your own hidden biases, it is difficult not to be at least somewhat 'conditioned' or subconsciously influenced by these factors. Anchoring is a well-known conditioning technique often used by sellers to create an expectation of a higher price through suggesting, stating or advertising very high prices initially. There is a known cognitive bias for individuals to rely too heavily on an initial piece of information offered (known as the 'anchor') when making decisions.

A Z

Anchoring
A well-known cognitive bias in negotiation whereby people have a tendency to give too much weight to the first number (price) put forward in a discussion and then adjust from that 'anchor'

More immediate conditioning factors on the day of the meeting could include the following.

- **Punctuality** – is TOP being late an accident or intentional? Perhaps to show who has the power and unnerve you?
- **Personal appearance** – degree of formality of business attire. In some cases, less formal dress can imply the supplier is very confident and can dress how they like, as their product/service is accepted as leading the field. Buyers can perhaps get away with more here, but impressions may be formed nevertheless.
- **Last-minute changes** of attendees or schedule – would this happen if you were seen as a key client?
- **Layout and organisation** of the negotiation room, hospitality offered, and breakout room access, as addressed in section 2.4 (if not at your location). For example, if meeting at the supplier's location, you may be taken past the factory floor if the supplier is busy and has lots of staff buzzing around, otherwise probably not!
- **Welcomed by the senior executive** of TOP, e.g., CEO/CPO, whose presence demonstrates how important it is that a deal is achieved, and who can also deliver a key conditioning message tailored to the negotiation, e.g., budgets being tight (prompted by the negotiation team of course).

Apply

You are a sales manager and you have been told by your boss that it is necessary to achieve an average 15% price increase on all sales in order to mitigate currency exchange rates which have moved sharply against you. The current inflation rate is 5% per annum and most customers, if they needed to, could buy elsewhere within three months, but your key customers are relatively loyal. What would you do? Choose from the option below.

a) Call the buyers within your key customers and ask for a price increase.

b) Send a letter to your customers requesting a price increase.

c) Request a meeting with the key customers' buyers to discuss next year's supply without specifying the reason.

In option c), negotiation can begin sooner than you may think! If you ask for a price increase 'cold' via a letter or call, it may not be taken well, and it also gives customers time to look around. If you meet them face-to-face, you can outline the problem you have but not actually ask for a price increase at that time – this is a seed-sowing exercise designed to 'condition' the buyer to expect a price increase at some time in the future. You may also be able to gauge the sensitivity of the buyer to a price increase.

Taken together, these conditioning factors can add up to a subtle, invisible and yet powerful force that can affect negotiators' expectations of the outcomes. Both sides may seek to play the 'conditioning game', particularly in the early stages of a negotiation/commercial relationship. Once there is an actual commercial/contractual relationship in place, real-life concrete experience regarding performance and not artificial conditioning factors will dominate how expectations are formed.

Therefore, in seeking to answer the question set out at the beginning, 'when do we start?', we must consider all of the interactions the buyer has had with TOP. The process of buyer and/or supplier conditioning can start well before the first meeting, and so this must be kept in mind when we are considering the early stages of the negotiation meeting.

Apply

Consider a situation where you attended a company office for the first time for a job interview, or a college for a CIPS course. Can you recall your first impressions? Did these match your expectations prior to your visit? Did these early conditioning factors affect your experience or decision?

The phases examined

We will now consider the typical individual phases of the negotiation meeting: what typically happens at each stage, some 'dos' and 'don'ts' and how behaviours can be expected to change during the different stages of the negotiation. It is fair to say that in a typical purchasing/supply negotiation, the buying side normally (but not always) has a head start due to the following factors.

- **Meeting agenda:** Assuming the sellers want your business, it is reasonable to assume the buyer can set the agenda or at least strongly influence it. This helps with the sequencing of topics, timings, attendees and location. TOP may seek to amend or push back on this, but typically the buyer will have the first opportunity to set the agenda.
- **Use of silence:** The seller has something to sell/say so the buyer can sit back and listen to some extent – silences are more embarrassing for the seller than the buyer. The use of silence should not be an excuse for a lack of preparation, and unless carefully managed, can come across as arrogant and/or uninformed.
- **You go first:** If the buyer has (it is assumed) invited or agreed to see the seller, then they can ask the seller to open with their proposal. It is always easier to respond to an opening than to have to make an opening statement, proposal or offer.

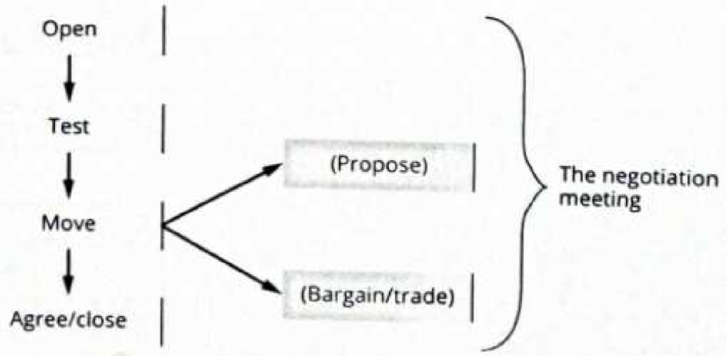

Figure 3.1 The key phases of negotiation

The opening phase: confirm understanding and get the issues on the table

3.1

The opening stage of the negotiation covers the very first few minutes when the parties meet and greet each other and are seated in the negotiation room in preparation for the main event. This stage sets the tone for the meeting and although nothing of substance is normally discussed at this stage, behaviours and what is said or not said here can be very telling. This is the stage where both parties are perhaps most sensitive and so small mistakes such as getting people's names or titles wrong, making an inappropriate comment as an icebreaker or being late can create a bad start to the meeting.

'You never get a second chance to make a first impression' is a well-known adage. If you go online and enter 'forming first impressions' into your browser, you will see multiple references to articles, videos and resources all focused on that critical first 60 seconds, 30 seconds, 7 seconds and even 1 second, when psychologists have shown that people form personal opinions that are sometimes difficult to change later. First impressions are important, so be on time, get the names of TOP right and offer to shake hands in a grip that is neither too firm nor too floppy, maintaining eye contact. Speak clearly and be courteous.

Small talk while being escorted to the meeting room and/or awaiting attendees can be useful to break the ice and so be prepared to ask about TOP's journey, the weather or non-controversial news or sports events if relevant. Trained negotiators will even seek to condition here and may use 'purposeful small talk', asking TOP 'how's business?' Alternatively they may seek an opinion on an external factor such as inflation, government regulations, or local economic factors. Late arrivals may offer an excuse that in itself is designed to condition – for example, apologising due to having to deal with a major new order just received or having to take a call from HQ regarding supply shortages due to customer demand, etc.

If there is any doubt regarding the agenda this is the time to raise it, so as a first action it may be appropriate to do so. The opening stage may also allow for a presentation by the supplier or, less typically, the buyer.

Typical behaviours at the opening stage: 'dos' and 'don'ts'

Do:

- **Be punctual and well presented,** and make sure you have any required documents, handouts, presentation decks, etc., printed and/or uploaded if required.
- **If you are hosting, welcome their arrival,** be courteous, and do not exploit home advantage in an obviously partisan way, e.g., seating TOP facing the sunlight.
- **Break the ice with some small talk:** ask about their journey; find out about them as people if unknown to you. Consider purposeful small talk where you ask how long they have been with the company, whether they sell a lot in your region, or how they are dealing with a local/regional business challenge.
- **Consider using visual aids to set out key objectives/make key points,** such as a flip chart, white board, notepad, PowerPoint presentation, etc.
- **Start the conditioning process:** if you have not already been conditioning, consider starting now, e.g., explaining how busy you are regarding growth plans, big investments happening to expand capacity that is putting pressure on your operating cost budget, etc.

- **Check authority:** it can be very frustrating to find out at the end of a negotiation that TOP does not have the authority to agree a deal or at least recommend a deal to HQ. Confirming this early on makes it more difficult for TOP to use certain delaying tactics, or at least makes them easier to anticipate, e.g., 'I need to get this signed off by HQ' or 'my sign-off limit is $1m, I can't go lower without HQ authority'.
- **Check agenda:** agenda setting is a key source of power in negotiations – for example, in negotiations with an incumbent supplier, procurement could add an agenda item 'cost efficiency initiatives', putting the onus on the supplier to come up with some ideas at the negotiation meeting. Clearly, in real life it may not be as simple as adding an agenda item, but it is important both sides understand this is a negotiation meeting and that they understand the content areas to be agreed. Confirming the agenda is therefore a useful way to check everyone is aligned on the objectives of the meeting, which may be to reach agreement at the meeting itself or to work towards it during one of a series of meetings. Setting or reconfirming timescales for the meeting may also be important here; however, there are circumstances when you or TOP may want to leave some flexibility here to avoid a 'cliff hanger' scenario, where both sides desperately seek to get the final concession before the close.
- **Employ the 'warm with the person/tough on the issue' approach from the start:** being warm and courteous with the person, especially at the opening stage, is not only normal business behaviour, but can also assist you in achieving your objectives. Not everyone responds to pressure the same way and if TOP feels stress or pressure due to rudeness or tactical ploys too early, it may be more difficult to extract concessions during the negotiation.

Don't:

- **Use a strong, pushy, cold or tough style at the opening.** If your plan concludes that you may need to take a hard line in one or more areas, or push your supplier to concede with the threat of losing the business or worse, e.g., litigation over a dispute, then try to hold out on this until a little later. You may find that you can achieve your objectives without having to push too hard. If you have set the supplier a challenge on cost reduction, for example, and they are meeting you to discuss this, let them open the conversation with their proposals, and listen first. There should be time to question, challenge and put TOP on the spot at a later stage in the negotiation meeting if required.
- **Put any markers down.** Good negotiators are very careful about 'red lines', i.e. markers or trading positions that cannot be gone beyond. Unless you are absolutely certain about something, setting out red lines, e.g., maximum price, minimum Ts and Cs, definite timelines, etc., may come back to hit you. You can let TOP know something is important to you without stating a red line, e.g., if you need to negotiate shorter lead times for hospital drugs down to say 60 hours and are currently getting 96 hours, you might state that 'delivery lead time is a key consideration in our decision-making and we need a significant improvement on what we are currently getting'. This puts the onus on the supplier to propose a shorter lead time in the negotiation and they may even offer a lead time that beats your target. However, by stating upfront 'we can't accept a lead time greater than 60 hours,' you may be putting a barrier up too early, when in fact a creative solution to your lead time challenge may be found later on in the negotiation.

Apply

You are buying a used car for cash advertised at $10,000. After some discussion with the seller, you ask what discount is available for cash. The seller replies 'What did you have in mind?' Which of the following do you do?

a) Suggest a 5% discount

b) Suggest a 10% discount

c) Suggest a 20% discount or more

d) Ask the seller again what the cash discount is

Answer: option d). Avoid putting down a 'marker' too soon! This is what the seller is trying to get you to do. A valid tactic is to ignore the question and repeat your own. This forces the seller to put a 'marker' down.

- **Criticise other organisations/TOP's previous contacts/third parties.** Until you are sure of who you are negotiating with and their views, alliances, opinions and personal connections, be careful here. You may upset TOP before you have even started the negotiation.

Apply

Imagine you have just started work as a senior buyer for a construction company X, having left your previous job in a competitor construction company Y. You are meeting with a potential supplier to discuss business opportunities and you mention your previous employer briefly in your introduction. Within a few minutes, TOP starts criticising your previous employer as being a bad customer and providing some examples to support this view. They say they would much prefer to work with your organisation and may even seek to sue company Y for contract breaches. Is this a good start to the meeting?

What might you take from this? Are there any positives?

From a professional procurement perspective, there are quite a few negatives.

1. Supplier does not respect confidentiality
2. Supplier is making assumptions that you left your previous employer due to being unhappy there (it may have been purely for career progression)
3. Supplier is assuming you are no longer close with ex-colleagues there
4. Supplier is litigious
5. Supplier is quite desperate to create a positive impression with you – but going about it the wrong way

At the end of the opening phase, you should check that you have got all the issues on the table that you want to discuss, without necessarily indicating how important each issue might be. You may also potentially decide that there is no point in starting to negotiate if the opening position from TOP is too far away from your ZOPA, and that if they are serious (not just bluffing), it may be better to stop proceedings and save everyone's time and energy. This is, of course, a radical are paid to sell and from a simplistic perspective their proposal cannot get worse if you are silent, only better! Listen to the answers.

- **Ask open 'why?', 'what?' and 'how?' questions** to elicit deeper insights into their needs, interests and expectations. Try not to sound too inquisitorial and perhaps explain your reasoning for needing to understand more about their operations, organisation, pricing structure or whatever the focus is. Closed questions (eliciting 'yes' or 'no' responses) are good for checking understanding and gaining definitive confirmation of facts and actions.
- **Develop new options** (in your head or on paper) to share with your team on a breakout session following any new or unexpected information picked up.
- **Check all key assumptions** made during the preparation stage as far as possible, e.g., 'we understand you can potentially deliver the medicines to all our sites with a 48-hour lead time from order; is this correct?'
- **Clarify your and their perceptions** in areas where there may be misinterpretations or alternative views on the same concept, e.g., 'by lead time we mean the elapsed time from sending our order to you electronically to us receiving your delivery to relevant wards/departments in the hospitals'. Make sure you are not talking at cross-purposes.
- **Show concern for TOP's needs and interests** if they state something is important to them; e.g., 'we understand and accept that in order to achieve the required lead time it may be necessary to submit orders in an agreed digital format.'
- **Summarise regularly and use paraphrasing** to ensure you have interpreted them correctly; e.g., 'so you are saying that you can only guarantee 48-hour lead time to ward/department level if we use your own web application/ software to place orders?'
- **Listen attentively with 'ears and brain'** to their answers, statements and questions and watch out for signals on red lines or sensitive areas.
- **Seek to identify and confirm any common ground** on which you agree, so this does not need to form part of the agenda or main focus of the negotiation.

Apply

You wish to sell your used car which cost $20,000 five years ago. Based on professional advice you would be lucky to get $10,000, although you have set a fallback minimum at $8000. Before you get around to putting it on the market a neighbour (not personally known to you) offers you $11,000. How do you respond?

a) Accept.

b) Ask for $12,000.

c) Say you only expected $10,000.

d) Stay silent.

e) Say you are surprised by his offer.

Write a justification for your answer.

Write a potential negative reaction for each of the other options from your neighbour.

Don't:

- **Interrupt, blame, use sarcasm, threaten, seek to score points, or talk too much** at this testing stage. The negotiation is just getting going, so it is still at a sensitive stage where opinions are being formed. There is time for tough talking later and the evidence you are noting here can probably be used more effectively at the proposing and bargaining stages.
- **Be embarrassed by long pauses.** It is normal and may imply they are thinking about what you have said. Professional buyers should never be embarrassed at long pauses or silences. Remember that silence is often used effectively as a tactic in a negotiation.
- **Confuse conflicts of interest with antagonism between people.** Good negotiators expect conflicts of interest on the subject matter and focus on this, not on the people.
- **Make any firm proposals,** accept any offers or even indicate acceptance at this stage, even if the offer sounds good. It is very early and from a buyer's perspective, unless you mess up, things can only get better as you progress through the phases and the seller feels the need to improve the offer.
- **Allow yourself to be drawn into an argument.** If your answer is interrupted, let it be; there will be an opportunity during the bargaining stage to use your more powerful arguments.

At the end of the testing phase you should have your key assumptions confirmed or clarified and understand the 'why and what' of the negotiation so that there is less risk of surprises later. It may be appropriate to take a short break or recess after the testing stage if your strategy/plan needs to change and you need to call HQ or confer with your team. You are now ready to start the critical negotiation meeting stages.

> *Remember*
> Before you start making/accepting proposals, it may be worth taking five minutes out with your team to pause and take stock of the situation, to confirm whether your objectives and strategy are still relevant or whether tweaks/'plan Bs' need to be invoked.

The proposing phase: asking 'if'

At this stage either side may start making tentative proposals regarding their offering. In the case of a negotiation where TOP has already submitted a tender or proposal, this stage may provide an opportunity for them to make proposals to improve on their initial offers in general or in areas highlighted by the buying side in advance.

Typical behaviours at the proposing stage: 'dos' and 'don'ts'

Do:

- **As far as possible, get the other side to propose first.** It is almost always advantageous to get some idea of what TOP is looking for even if it is their most optimistic outcome/unrealistic from your point of view. This is particularly true when the monetary value of the subject matter is unclear or subject to multiple assumptions regarding costings. Unless you have a good idea of what the ZOPA is, there is a risk that by proposing first you ask for something that is well within their reach. Tendering is very helpful here from a buyer's perspective.

Remember

If your organisation's plans change and you require a project to be started extremely quickly by a supplier, say the following week, it might be assumed that this demand may attract a premium payment. If, on the other hand, the supplier is experiencing a quiet period and has spare capacity, not only will they likely want to start ASAP but they may even be willing to offer a price concession for a start date that is 'brought forward'. By allowing them to make the first proposal regarding start times (in this case) you might get your key negotiation objective achieved for free. What might happen if you proposed first and stated the 'red line' requirement that you need them to start the following week? Good negotiators will always seek to get some free concessions if there is any possibility of it working and if there is nothing to lose. Getting TOP to propose first is key here and is something buyers can normally do more easily than suppliers.

- **Make tentative suggestions:** 'if' becomes 'what if', e.g., 'In principle, what if I agreed to... would you...?' Remember to use the conditional tense (in English). Words and expressions that use the conditional tense protect you, as you are not committing, but you are indicating that you would likely accept something, e.g., 'that sounds good', 'we could consider that', etc.
- **Present with confidence:** verbal, vocal and visual.
- **Aim high with initial proposals** but be realistic. Remember, it is unlikely you can negotiate a better deal than the one you first set out when proposing.
- **Acknowledge their proposal(s)** and build on them where possible. Unless their proposal(s) are absolutely unacceptable, try not to reject out of hand; consider parking the most contentious one(s) if they are going to cause early deadlock.
- **Keep saying 'if'** and use the formula, *'if you will... then we can consider...'*
- **Expect counter proposals/objections** and rely on your preparation to respond.
- **Introduce some of your opinions/alternative ideas**, be creative and seek to 'expand the pie'.
- **Summarise regularly,** e.g., *'so I understand you to be saying... are we correct?'* Good negotiators summarise frequently.
- **Consider linking your proposals.** If you have done your preparation, you may have multiple desirable outcomes based on different combinations of trading positions, so you can more easily link your proposals.
- **Ask questions** to clarify any points you are not clear about and make notes.
- **Consider proposing time-out** and allow for short recesses for each side to confer (if time allows) to consider problems.

Don't:

- **Interrupt,** as this leads to arguments.
- **Use irritating phrases** like 'our fair and reasonable proposal/offer' – it may not be seen as either fair or reasonable by TOP and can serve to irritate. Huthwaite research from 2014[2] found that in an hour of speaking time the

average negotiator would use 10–11 irritators, whereas a skilled negotiator would use two or three. This is because the skilled negotiator recognised (perhaps unconsciously, as often happens with behaviour) that irritators had the potential to create a difficult climate in the negotiation.

- **Use multiple points** to support your case – if you have multiple points seek to use them one at a time, if possible.
- **Use only your strongest point.** Experienced negotiators and barristers/lawyers in court will hold back on their strongest point and see if they can win the concessions they want without using it. For example, if you know you are authorised to award a two-year contract and the supplier is only expecting a 12-month contract at best, it may be better not to say this at the outset. Assuming you get a deal for a 12-month contract you can then ask what further concessions the supplier can offer for a two-year contract, giving you 'two bites at the cherry'.
- **Reject a proposal instantly.** If you are not happy with something, try not to say no – instead you can say, 'it may need adjustment', 'it's heading in the right direction', or 'it's not quite there yet.' Keep going!
- **Immediately make a counter proposal to their proposal.**

> *Remember*
> The word 'if' is very useful at this stage and allows you to test tentative proposals without committing yourself. Skilled negotiators use language very carefully.

The bargaining phase: using tradeables

The bargaining stage is the 'meat' of the negotiation meeting and is where both parties trade concessions; the preliminary stages are over and proposals move from being tentative and general to being more definite and specific. We covered the bargaining mix in section 2.3 so if you have prepared, you will have defined the variables for trading and you will know your trading limits. You will have set out which variables are easy for you to trade and which are more difficult, and you will have an idea of what TOP values the most and what they will be more and less willing to concede on. You may have this summarised in a one-page simple 'cheat sheet' if it is a simple negotiation or a complex multi-tab spreadsheet if more complex. The important point is that you must agree your bargaining range with your team/stakeholders before the meeting and not during it. If you have done this you are ready to bargain.

The shift from the proposing phase to the bargaining phase can be very sudden and prompted by time factors, impatience or natural progress; both sides have all the information they need, all that is left is to bargain. You should anticipate a short bargaining stage, particularly if the testing and proposing phases have elicited useful insights by both parties into each other's underlying interests, red lines and walk-away points, and the ZOPA is effectively confirmed.

Typical behaviours at the bargaining phase: 'dos' and 'don'ts'

Do:

- **Always lead with conditions before offering tradeables and making concessions,** e.g., 'if you can guarantee a 48-hour lead time from order to delivery, then we can consider reducing the payment period.'

- **Try to trade things that are easy for you to give but valuable for them.**
- **Use tradeables and make concessions in small steps** and in decreasing size, as this protects your integrity and makes TOP work harder. If you give away a big concession too soon, TOP may demand even more.
- **Make notes of all tradeables and concessions.**
- **Observe their non-verbal behaviour/body language very carefully** – we will address this in section 3.3.
- **Manage your non-verbal behaviour/body language particularly carefully.**
- **Consider linking issues:** agreement on one is conditional on agreement on them all. This favours the better-prepared side, as they will know the value of each issue/concession point.
- **Use time tactics** to your advantage. If there is a contentious issue/difficult demand from your point of view, it may be best to leave this to the end when the deal is almost complete and TOP is in a more positive or less anxious frame of mind. Beware that TOP may also do the same and 'filibust' (seek to waste time intentionally) if they know you are short of time.
- **Focus on all the options/variables involved** and not just the price: be creative.
- **Consider using silence to encourage TOP to move first** and/or keep moving.
- **Summarise regularly** to check mutual understanding and to make sure you are not talking at cross-purposes, e.g., 'so you are saying you can guarantee 48-hour delivery to the location we have specified but only if we use your software and reduce our payment time, otherwise it has to be 60 hours, is that correct?'

Don't:

- **Be surprised by how quickly the bargaining stage is completed.** If TOP has achieved their objectives and they are adopting a principled-type approach they may accept quicker than you expect.
- **Lose sight of your objective.** Be careful not to be caught out or distracted by new issues being introduced. Keep focused on your objectives and the subject matter of the negotiation at hand; beware of TOP seeking to add in something that was not up for negotiation, e.g., an additional contract, performance issue on current contract, introduction to your sister companies, etc.
- **Get greedy and blow the deal.** It may be tempting to push harder for a better deal if you have achieved your optimistic targets relatively easily or quickly, but be very careful here. TOP may realise you are getting a good deal and not appreciate you pushing harder and may walk away. Furthermore, you increase the risk of possible 'add-on' charges later and/or difficult closing and agreement if TOP learns that you were 'greedy'. Experience is important here, so defer to a more experienced colleague.
- **Make unplanned concessions.** A good negotiator never makes unplanned concessions, even if they pretend they are doing so in the meeting. This is definitely inadvisable unless new information emerges in the meeting that changes the basis of your concession plan. If you need to consider making an unplanned concession you will typically have to seek authority from HQ first.

Apply

During a negotiation with a long-term key supplier, they have asked for a price increase of 5% on a regularly supplied item. Current inflation is running at 5%. What is the most effective remark you can make now?

a) No.

b) Why?

c) I was thinking of a decrease.

d) I can only afford half.

e) Can it be delayed?

Answer: The best remark is c) and then a). This clearly indicates that getting the increase will not be easy, and this may reduce the seller's expectations. As you are a good customer, why not seek a price increase from others first? Inflation may be irrelevant unless it directly feeds into cost. Remark b) is next, but be careful as they might have a rational answer that makes it hard to argue against. Remarks d) and e), while not saying yes, do imply acceptance of the principle of increase, so the supplier will likely 'thank and bank'.

The agreement and closing phase

Remember, not all negotiations will get to this phase. This is the phase when it is either clear through explicit language, or strongly suggested through non-verbal signals, that TOP is ready to move to agreement. Judging when to close can be difficult and as with all phases of the negotiation, experience, observation, practice and reflection will be the best ways to learn here. Clearly time can be a helpful prompt. If the meeting is scheduled for two hours from 09:30, and at 11:15 all seems to be going well with movement from both sides through the phases, then it is self-evident that pretty soon one side needs to move to close and agree the deal or next steps. This can even be flagged at the start, e.g., 'we will seek to pause at 11:00 as a checkpoint, and take a view as to whether we are near a deal and if so, move to try to agree.' Another signal is the non-verbal behaviour and body language of TOP – considered in section 3.3.

Typical behaviours at the closing/agreement phase: 'dos' and 'don'ts'

Do:

- **Watch for closing/buying signals** from the other side (verbal and visual).
- **Check to ensure all issues have been resolved**. Be careful not to let your satisfaction or delight from a deal on the core element(s) distract you from checking if you have agreement on any issues you may have 'parked' earlier. This is where a team approach is helpful.
- **Consider using visual aids to summarise,** e.g., flip chart, white board, notepad or shared document being co-edited and projected onto a screen so that all can see.
- **Use 'summary close'** to lead to the final agreement: this is where you (not TOP) summarise all that has been agreed in bulleted form, noting all concessions and conditions (emphasising the concessions you have made), and highlighting if possible the benefits of agreeing to the deal proposed.

- **Make a decision to conclude/close** – accept their offer. It is important to explicitly state this so the negotiation cannot be opened again and what you have agreed is acknowledged by TOP. This may be indicated by a handshake, signing of a document and/or verbal explicit agreement to what you have summarised in writing.
- **Seek agreement in principle if TOP does not have the final authority.** It is likely that in many high-value, complex negotiations there will be multiple loose ends to tie up, and actual signing of a contract may require legal review and senior approval and further governance checks. If this is the case, you should still seek some sort of acknowledgement of what key terms were agreed or issues resolved from the negotiation. This acknowledgement does not need to be legally binding and may not be detailed. 'Heads of agreement' or 'heads of terms' are expressions sometimes used for this. Nowadays with smartphones, everyone should be able to send an e-mail on the spot or very soon after, confirming what was agreed. If TOP is unwilling to provide any acknowledgement at all, this may be a red flag. To avoid this situation, set out at the opening phase that if something is agreed they will need to confirm in writing immediately, or within an agreed (very short) period after.
- **Make your own private notes on the final agreement.** Capture any conspicuous points that otherwise would be lost, e.g., *'they seemed delighted'* or *'their team was not in agreement, but they still went with our offer'* or *'NB sales director mentioned they will be leaving/changing jobs in three months'.*
- **Shake hands on the agreement.** In most business cultures, shaking hands indicates agreement, but there are international differences here. Therefore, make sure that the intention is understood – you want to shake hands to indicate agreement, not just to say goodbye!
- **Leave the meeting as soon as possible thereafter.** The deal is unlikely to get any better and you may say something unintended if you stay around for a social event or to celebrate. Clearly, you need to use judgment here and you do not want to jeopardise the deal by offending your host afterwards. However, from a professional perspective and in line with CIPS Code of Ethics, you are better off leaving as soon as possible after you have achieved your objective and secured an agreement.

Don't:

- **Force an agreement by making 'final offers'.** If TOP concedes due to extreme time-pressure or perceived coercion, then it is likely they will seek to recoup this concession later through 'one more thing', 'add-on' or other post-agreement tactics. These tactics will be explained in section 3.2.
- **Get greedy** and ask for more concessions, as you run the risk of no agreement.
- **Get careless with information** during social events that follow the negotiation. As mentioned above, if you have to stay back, be very careful what you say and perhaps (from a procurement perspective) seek to steer clear completely of conversations around the agreement. The negotiation is over.
- **Accept ambiguity or uncertainty** about the terms of the agreement. As a rule, if there is any uncertainty about key issues, revisit and confirm mutual understanding. It will be much more difficult to do this later. There are of course occasions when this ambiguity may suit you and not TOP, so again judgment is required here.
- **Yield to pressure during the closing stage.** This is much more easily said than done, and much more difficult if you are on your own. Remember, a good negotiator does not exceed their trading limits unless there is new information/

their assumptions are proved wrong. Sometimes, no deal is better than a bad deal. Beware of usage of tactical ploys here such as 'split the difference' – typically the party that proposes this is the one that has most to gain from it, and they may even have 'created' the difference through establishing a 'false or straw wall'.

- **Tell them they could have got a better deal** if only they had negotiated differently. Once you have made agreement, be very careful what you say regarding options not explored by TOP. There will be exceptions, but in general this may leave TOP feeling stupid, and no one benefits from that.
- **Gloat publicly about the deal.** Celebrate, if a celebration is justified, back at the office. Public gloating, if it gets back to the supplier via the press or social media, will likely damage the relationship.

Apply

You are in a negotiation in which you and TOP are unable to reach agreement. Both sides believe firmly in their respective positions, and in many hours each has made only token movement. Which three of these six possible courses of action would be most appropriate now and in what sequence?

a) Change negotiators.

b) Offer a large concession.

c) Offer a further small concession.

d) Change the package and scope of the negotiation.

e) Let it go to deadlock.

f) Be open about your feelings at the lack of movement.

Answers: f), d) and a) are the best three options. Openness can be very powerful, and can put TOP under pressure to do something to relieve the situation. They are made to feel responsible for the lack of movement, hence option f) is the first choice. Option d) is second: the existing package will apparently produce no result and it may be worth seeing if a change will break the impasse. However, be careful that in making a change, this does not appear as a concession to the other party. Option a) may be worth trying since the 'chemistry' may not be right between those currently involved in the negotiation. Changing the people may produce a result.

Agreement confirmation

The scope of this syllabus does not extend to contracting, but at the end of the meeting there are general behaviours expected from a professional buyer.

Do:

- Always offer to prepare the agreement document.
- Immediately or ASAP after the negotiation, get the terms/details of agreement in writing if you have not already got it, to confirm mutual understanding.
- Detail who is to do what and timescales, and not just what was agreed: be specific and avoid misunderstanding.

- Have the agreement checked by legal advisors if required – if you use your standard Ts and Cs and contract template, this should be straightforward.
- Be organised on your side to get all the necessary sign-offs with minimum delay.
- Be aware of the temptation for TOP to reopen the negotiation on a particular issue, particularly if this was not nailed down in the negotiation or agreement.

Don't:

- Be tempted to slip in a few extra items when documenting the agreement. This is unethical and it is likely to be spotted, creating reputational risk for your employer or yourself, plus the changes may not be legally enforceable.
- Use ambiguous language in describing who does what – this could be subject to misinterpretation.
- Allow too much time to lapse between the end of the negotiation and the delivery of the agreement document. Memories may fade regarding concessions agreed and notes may be challenged. If you agree a deal, you should seek to formalise ASAP, unless there is a good reason not to.

3.2 Appraise the key methods that can influence the achievement of desired outcomes

The use of persuasion methods – 'push and pull'

Persuasion and influence defined

Persuasion can be defined as 'encouraging someone to do something that you want them to do for you'. Persuasion is reasoning with someone so that they will believe or do something they might not otherwise do. Persuasion can be considered as 'pushing' on TOP so that they accept the change in attitude or behaviour as a result of your actions, and is closely related to but distinct from 'influence'.

Influence, on the other hand, is the ability to affect the manner of thinking of another. Influence can be considered as 'pulling' on TOP so that you achieve the same result, but TOP feels they have changed their attitude or behaviour as a result of their reflection and thinking, and not your direct actions. Influence can be defined as 'the act or power of producing an effect without apparent exertion of force or direct exercise of command'.[3]

Persuasion is more visible and real, and it is easier to direct towards a particular objective or target, e.g., a price or specific negotiation demand, whereas influence is less visible, more ephemeral and harder to direct towards a particular demand. Influence, however, can have a longer-lasting effect, as the person influenced is more likely to believe they are making their own free choice. Persuasion and influencing methods are both widely used at all phases in negotiations and are key skills for negotiators.

> *Remember*
>
> You should be able to give examples of how each of the six power bases could be used to persuade or influence TOP in a negotiation setting. Legitimate, reward, expert and coercive power bases lend themselves to persuasive push techniques, while informational and referent power bases lend themselves more to influencing pull techniques. Refer back to section 1.3.

> *Remember*
>
> You should be able to give examples of how each of the four negotiation styles can be used to persuade TOP to your point of view. Tough and logical styles lend themselves to persuasion, while warm and dealer styles lend themselves to influence. Refer back to section 2.4.

Choosing between push and pull

There are multiple variables to consider when choosing between push and pull. Professor Fiona Dent of Ashridge Business School proposes situations when each style might be most appropriate, breaking down push into 'directive' and 'reasoning' and pull into 'collaborative' and 'visionary', as shown in table 3.3.

Directive (push)	Collaborative (pull)
An individual-driven persuasion style in which the person seeking to influence another declares their own view/idea in the expectation that it will be accepted and followed by the other. This style is particularly effective in the following situations. • The influencer is an expert while the followers are not • The people being influenced are new/inexperienced • The situation necessitates very speedy action • The situation involves a safety- or security-critical issue or a strict deadline. If this persuasion style is not used effectively or appropriately, the influencer risks developing a reputation for being heavy handed and dictatorial.	A team-oriented persuasion style in which the person seeking to influence another involves the other party in the decision-making process. All parties are encouraged to offer views and ideas about the issue. This style is particularly effective in the following situations. • The influencer needs commitment from the other parties • The influencer is actively seeking innovative ideas from others • There is no clear solution to the issue at hand If this persuasion style is not used effectively or is overused, the influencer risks developing a reputation for being indecisive and weak.

Persuasive reasoning (push)	Visionary (pull)
An issue-driven persuasion style in which the person seeking to influence another gets other parties to buy into the influence's ideas by presenting them in an impartial, objective, logical, and rational way. This style is particularly effective in the following situations. • The influencer has a great deal of knowledge about the issue and a high credibility with others • The situation demands that the influencer gets others to buy-in to an unpopular decision • Research has identified a 'best' answer If this persuasion style is not used appropriately or is overused, the influencer risks developing a reputation for being inflexible and stubborn.	A persuasion style in which the person seeking to influence another does so by understanding the other party's'emotions, and stimulating that party's imagination to visualise the desired future goal of the influencer. This style is particularly effective in the following situations. • The organisation has just embarked on a complex change process • The influencer's goal is to attract others' attention and stimulate future debate • The current situation demands innovative thinking If this persuasion style is not used effectively or is overused, the influencer risks developing a reputation for being idealistic or egotistical.

Table 3.3 Defining persuasion methods (Source: adapted from Dent, F.E. and Brent, M., Influencing Style Preference Inventory (2009), Ashridge Business School)

Irritators

Beware of 'irritators' that can inhibit your persuasion and influencing success. Irritators are words or phrases which have the potential to irritate through self-praise or condescension, and/or display ignorance of the subject matter. Irritators lack any persuasive function, and are used to describe an individual negotiator's own position or proposal. Examples are words such as 'our fair proposal', 'our reasonable requirement', 'our generous offer', etc.[4]

Apply

Go online and search for 'persuasion and influencing skills in business'. Open a few websites and browse the opening lines to get a broader view of this area. Note the common factors that relate to pushing and pulling, and the situations and context where persuasion is considered. In many cases the assumption is that one is not dealing with a professional buyer but with consumers or untrained buyers.

Consider how the situation might be different if professional buyers trained in negotiation are involved.

You should be able to note a lot of differences between the ease of persuading a consumer or untrained person and the ease of persuading a professional negotiator.

The use of tactics to influence the other party

There are also many tactics and ploys that can be used to persuade others, particularly those not trained in negotiation. Most of us have probably heard the expression 'good cop, bad cop' and understand that it refers to an apparent ploy used by police to extract confessions from suspects in custody. The assumption is that the suspect is more likely to be persuaded to confess to the sympathetic 'good cop' than the much less sympathetic 'bad cop'. This is an example of a tactical ploy or gambit that may or may not pay off when used. This particular tactic can also be useful in commercial negotiations. There are dozens of these tactical ploys; many with slightly different names, which frequently invoke local slang and idiomatic English. It would not be feasible or particularly appropriate to seek to illustrate their use in real-life settings given the number, variety and cultural specificity of many of these, so we will just outline a few here. Good negotiators should, however, recognise them when they are being used by TOP, so that they can counter them. They can also consider using them at the opportune time. But in general these tactics should be used with care, as they can backfire; and in situations where a long-term relationship is desired, they can, if detected, become an irritant to TOP. This topic will be revisited in the CIPS elective Advanced Negotiation Level 5.

Remember

In negotiations, tactical ploys or gambits have two main objectives.

- To strengthen your perceived position in TOP's eyes
- To influence TOP's view of their own position

These ploys will work best if used sparingly and as part of your plan, and in most situations, their effectiveness will decrease over time and usage as TOP will recognise and be able to counter them. They are particularly effective if and when you are dealing with untrained negotiators, in consumer buying situations, and in once-off encounters. It is assumed that these situations will not apply in most cases in your professional life, so their importance from a syllabus perspective should not be overstated.

Most negotiation textbooks, courses and online resources list and explain how and when these gambits and tactical ploys are used, and what the counters to these are. As mentioned already, there are dozens of these, so we will just look briefly at ten to illustrate their usage.

Example tactical ploys

1. **Good cop/bad cop** – explained above: an act to make TOP warm to the 'good cop' and make more concessions than they would in absence of the 'bad cop'.
2. **Thank and bank** – say thank you when TOP offers you a concession and bank it, which makes it harder for TOP to take it back later. The counter is to say that 'nothing is agreed until everything is agreed'.
3. **Lack of authority,** 'board approval' – used to extract another concession so you can sign off there and then. For example, you could mention to TOP that you are authorised to sign off without seeking board approval if the price is less than $1 million. The counter is to establish exactly what authority

and sign-off level TOP has at the outset. If they are not senior enough, then perhaps defer the negotiation.

4. **Declaration of a public stance** – as a trade union leader you say publicly, e.g., to union members and the media, what you expect from a deal, e.g., a 10% pay rise. You then use this as emotional pressure with the employer in the (private) meeting to gain concessions so that you do not lose face, which in many cultures is highly undesirable. The counter is to explain that TOP should not negotiate outside the negotiation meeting room, and that this cannot be considered and is irrelevant.

5. **Getting peanuts** – pretending something that you need is not important, e.g., urgency. TOP may want to supply ASAP, so you might not need to pay extra – if you indicate its value you will be charged for it. The counter is to never be seen to just 'give something away', at least not without some effort to get something in return, even if it is just symbolic (always trade concessions).

6. **Salami (one slice at time)** – you ask for an exceptional once-off concession that is normally hard to get, e.g., extra-long payment period; once granted the precedent is set and will be easier to get again. The counter is that if you allow a concession as an exception, make sure this is documented and was only allowed against exceptional circumstances, and seek agreement to this from TOP.

7. **Outrageous initial demand** – your first demand, e.g., price quoted, is so high that TOP is shocked and you condition them to move closer to your position than they otherwise would (linked to anchoring). The counter is to have a rough estimate of price before meeting to negotiate the price.

8. **Add-on** – unexpected extras are added on after the negotiation that were not clarified or explicitly discussed, e.g., out of working hours support costs, hidden fees, discounts dependent on extra-prompt payment. The counter is diligence in documentation and explicit agreement on both sides that nothing in the agreement can be changed.

9. **Broken record** – you keep repeating something, e.g., the budgetary pressures you are under, to condition TOP to think you have no money. There is no counter to this; it works if used carefully and consistently.

10. **One more thing** – you wait until the end to ask for a concession you know is contentious; you may not get it, but as the deal is so close, TOP is more likely to concede as reopening the negotiation is not attractive. The counter is to set out the agenda at the start of the meeting. Get the issues on the table and ask TOP to agree that there is nothing else to discuss. Then state that other issues, if raised later, may not be addressable in this meeting.

Apply

You are the buyer of a range of machinery items and need to negotiate the price down by 10%. You are in negotiation and your supplier has just surprised you with a 5% reduction on the initial price offered. Which of the following would you do?

a) Tell them to increase it to 10%.

b) Say that if they will increase it to 10%, you will give them a longer contract.

c) Make a matching concession of your own.

d) Take a sarcastic line and tell them how sensible they were to make the concession.

e) Tell them it is nowhere near enough.

f) Thank them, but insist they look again to reduce the price further.

Answer: option f) is the best option. TOP has made a concession. They have moved towards you and your job is to keep them moving. By thanking TOP, you take psychological possession of the concession, making it very difficult for TOP to withdraw it. Being sarcastic or dismissive is inappropriate, as it could antagonise TOP, and will at the very least make them 'cold' towards you. While being tough in negotiation, you should always be encouraging the other party to feel 'warm' towards you.

Many of these tactics need to be applied in the context of national cultures or industry norms, and some will only work in very specific circumstances, so it is not proposed to address them here. Tactics must be used carefully, and in particular you must not overuse them. You should be aware of some of these tactics, however, as well as their counters.

Apply

Only a small selection of possible negotiation tactics has been explained here. Other examples include the following.

- Linking issues (favours the well-prepared)
- Adjournments
- Split the difference
- Nibble
- False or straw walls
- Onus transfer/rubber ball
- Take it or leave it
- Escalation
- Where's my coat?

1. Search the Internet for 'negotiation tactics'. See how many of those listed above you can find explanations for.
2. Note down the 'counters' to these tactics suggested.
3. Make up a list of your own top ten favourites that you may be able to use. Judgment, caution and experience are required when using these, and in many cases they will only work in once-off situations with parties who are not well known to each other. Tactical ploys and practical negotiation skills are covered in more detail in Advanced Negotiation Level 5.

3.3 Compare key communication skills that help achieve desired outcomes

Types of questions

In their book, *Business Negotiation: A Practical Workbook*, Steele and Beasor refer to the 'power' of questions. Good negotiators are aware of the different types of questions that they can ask in order to get an answer, and also the multiple different ways of asking the same question, if for some reason TOP is unwilling or reluctant to answer.

In many negotiations, the side with the most information and insight is at an advantage and intelligent questioning is the best way to elicit information at all stages of the negotiation meeting. Questioning in a negotiation is not just used to elicit information, it can be used for multiple purposes including the following.

- To condition TOP, e.g., by constantly asking about a specific issue (the 'broken record' tactic)
- To suggest you are naive/unaware of something – for tactical advantage
- To create an impression that you are more knowledgeable about the subject matter than you actually are
- To test the honesty of TOP by, for example, asking about something you already know the answer to
- To create and sustain movement in a negotiation if it stalls

Question styles

Different questioning styles can be used to elicit desired responses

Questioning style	When to use
Open questions What do you think about?	• To start a conversation • To build rapport • To get the negotiation started and get TOP to start first
Closed questions Can you offer 24hr?	• To generate a specific response • To receive affirmation on statement – often single word, yes or no • To seek specific information • To bring discussion to an end
Probing questions Tell me more about feature X on product Y.	• To seek further information when the first answer to the question is insufficient • To seek answers when TOP is being evasive • To gain more information and get to the bottom of the issue
Hypothetical questions If we wanted to buy globally could you supply?	• To try to get TOP to see things in a different way • To condition TOP into expecting something • To encourage creative thinking/facilitate identification of alternatives

Figure 3.2 Questioning styles

Different question styles can and should be used at different stages of the negotiation meeting to elicit different types of information. Typically, open questions (those that start with 'what', 'how' and 'why') are used at the opening and testing stages to uncover needs and underlying motives, and to allow the buyer to get a feel for what is in store in the negotiation.

When you ask an open question, it is arguable that the most important thing to do is to keep quiet and listen. Interrupting TOP is not only irritating, but may well stop them giving away useful information or making a concession. Remember that as a buyer you can use silence, within reason of course.

Probing questions are typically follow-up questions, and aim to elicit more detailed information on the back of the answer elicited from the open questions, e.g., 'can you expand on that last point?' or 'how would that work if these conditions do not hold true?' Probing questions are also useful to check that the supplier fully understands their offering, as well as your needs, and can also be used to communicate to the supplier that you know this category well. These questions are typically useful at the opening and testing stages.

Hypothetical questions, where you ask about a possible situation or abstract concept, are very useful at the testing and proposal phases. Here you can ask 'risk-free' questions that do not give away your position on a variable, but allow you to form a view of TOP's position on the issue or variable, e.g., 'how would your proposal change if we could offer a contract to cover region X as well as region Y?' or 'if we could pay in advance, what could you do on price?'

Closed questions are typically a signal that the negotiation is moving into the bargaining and potentially closing phases. Closed questions require a yes/no or simple answer, e.g., 'can you deliver to region X and Y with a 48-hour lead time?' or 'who will be the account manager?' or 'will you open a local office if we enter into a contract?' Asking closed questions too early can force TOP to take a position that they may feel they cannot move away from later, even if they want to and are within their limits.

Apply

Do not ask closed questions too early.

Suppose, for example, that a supplier is authorised to offer a 25% discount on an initial quoted price subject to achieving a 12-month contract for two regions. You open the meeting with a closed question, e.g., 'can you offer me 20% discount?' or 'what options are open to the supplier?' They are authorised to go even further than 20%, but by saying yes now, they may fear that you may push even harder, and as 20% is close to their trading limit and as you have offered nothing to trade for this concession, they may say no to protect themselves. What then? Do you stop? Assuming you continue after an embarrassing impasse, and the negotiation progresses, you have now pushed TOP into a corner, and although they can offer more than 20%, they will have to contradict themselves and lose face if they exceed the 20%. Your early closed question may have directly resulted in limiting the discount you could have potentially gained through asking more open, non-committal questions to test what might be possible in terms of discounts.

In light of the information here, what would be a better open question about price?

Apply

Go online and enter 'negotiation questions' into your search engine. You will see a wealth of resources you can access. Consider the videos you can access, many of which are five minutes or less, and produced by commercial training organisations or individuals. Take 15–30 minutes to watch a selection.

Take notes on the key points made in the videos regarding questioning techniques and question types. Note where there is general agreement and where there is divergence among the different presenters in the videos, and review this in the context of this module.

Effective listening

> *We have two ears and one mouth so that we can listen twice as much as we speak.*
>
> *Epictetus, ancient Greek philosopher*

Good listeners almost always turn out to be the better negotiators. This is because the best negotiators listen actively with both their ears and their brain. Skilled negotiators are attuned to both verbal and non-verbal communication signals from TOP; they note how other negotiators use word choice and sentence structure for effect, and they note vocal skills like pitch, tonal quality and rate of speech.

Common listening mistakes

Less skilled negotiators tend to run into three pitfalls that hinder effective listening.[5]

- They think of negotiation primarily as a job of persuasion, and to them, this means talking. They seem to forget that it is difficult to persuade other people when you do not know what motivates them.
- They tend to over-prepare for what they are going to say next, and use their listening time just waiting for their next opportunity to speak. In doing so, they may miss information vital to the negotiation.
- They fail to hear what they do not want to hear. They may not even be good enough listeners to know when the other party has no interest in their proposition.

Hearing is passive but listening is active, and some people need to learn to be a good, attentive listener. The following 'rules' of attentive listening will help you to become a successful negotiator.[6]

- **Be motivated to listen.** Realise that the person with the most information usually receives the better outcome in a negotiation.
- **Be alert to non-verbal cues.** Although it is critical to listen to what is being said, it is equally important for you to understand the attitudes and motives behind the words. A negotiator does not usually put their entire message into words. Their verbal message may convey honesty and conviction while gestures, facial expressions and tone of voice may convey doubt.
- **Do not interrupt when the other party is speaking.** When you interrupt a speaker, you are not only being rude, you may also be cutting off information that could help you later in the negotiation.

- **Fight off distractions.** Try to create a situation in which you can think clearly and avoid interruptions. Interruptions tend to prevent negotiations from proceeding smoothly, and may even cause a setback.
- **Write everything down.** It is amazing how much conflicting information will come up later in the negotiation. If you are able to correct TOP or refresh their memory with facts and figures from earlier in the session, you will earn both credibility and power. This is easier in team negotiations.
- **Listen with a goal in mind.** Know what you want to find out, and then listen and look for verbal and non-verbal cues that provide the information you are seeking.
- **Give the other party your undivided attention.** Your goal is to create a win-win outcome so that TOP will be willing to negotiate with you again. Therefore, they need to think that you are fair, honest and decent. One way to help achieve this goal is to pay close attention to what TOP says even if you disagree.
- **React to the message, not the person.** If you are going to react to something TOP says or does, react to the message, not the person. If they perceive a personal attack or take offence, they may not be willing to negotiate with you again. Research has shown that people are more likely to remember how someone made them feel over what was said.

Remember

Hearing is passive but listening is active.

Apply

Go online and find the 15-minute TED Talk given by William Ury: 'The power of listening'. Listen carefully and reflect on the key learning points made by Ury. William Ury is one the most famous writers on negotiation and an early proponent of the principled style of negotiation.

Write out five learning points for your revision from this video case study.

Improving your active listening skills

Here are some different techniques you can practise to help you be a better active listener. Even using three or four of these will help, and you should find yourself listening and hearing more of what another person is saying to you.

Improving your listening skills	
1. Probing	Ask questions to draw the person out and get deeper and more meaningful information – for example, 'what do you think would happen if you...?'
2. Encouragers	Use brief, positive prompts to keep the conversation going and show you are listening – for example, 'oh?', 'I understand', 'then?', 'and?'
3. Restating	To show you are listening, repeat every so often what you think the person said – paraphrasing what you heard in your own words, e.g., 'so you are saying...?'
4. Summarising	Bring together the facts and pieces of the problem to test understanding – skilled negotiators summarise and test understanding twice as much as unskilled ones (Huthwaite research, 2014)[7]. For example, 'so you are saying... is that correct?'

Improving your listening skills	
5. Reflecting	Instead of just repeating, consider reflecting the speaker's words in terms of feelings – for example, 'this issue seems really important to you...'
6. Giving feedback	Let the person know what your initial thoughts are on the situation. Share pertinent information, observations, insights and experiences (but do not give away too much).
7. Emotion labelling	Putting feelings into words will often help a person to see things more objectively. To help the person begin, use 'door openers' – for example, 'I'm sensing that you're feeling frustrated/worried/anxious...'
8. Validation	Acknowledge the individual's problems, issues and feelings. Listen openly and with empathy, and respond in an interested way – for example, 'I appreciate your willingness to talk about such a difficult issue...'
9. Use pauses and silence	Pause after TOP has stopped. This communicates that you are thinking about what they have said. Silences can assist comprehension; every second does not need to be filled by words.

Table 3.4 Different methods to improve listening skills (Source: adapted from www.psychcentral.com/lib/become-a-better-listener-active-listening)

Non-verbal communication

What is non-verbal communication?

Most communication between people in a negotiation is verbal, taking the form of talking, questioning, answering, pausing; literally 'verbalising' what each party is thinking and/or wants the other party to think they are thinking. Non-verbal communication in negotiations is to do with what is not explicitly verbalised, but can still communicate meaning. It can take the following forms.

- Body posture and movements
- Position of arms, hands and legs
- Facial expressions and hand gestures
- Tone of voice
- Level and type of eye contact
- Involuntary human physical reactions: blushing, dry throat, sweating, voice pitch
- Physical contact, e.g., handshake grip, slap on back
- The use by TOP of the physical space between the parties.

Non-verbal communication can be very important particularly in one-to-one, face-to-face negotiations. Most of us can tell when close colleagues, friends or family are in a sad or happy mood or are upset, angry, frustrated or anxious, even before they speak to us or tell us verbally. We can interpret the non-verbal signs through a mixture of personal knowledge of the individual's demeanour, and general non-verbal cues that are common across many people in a social setting. We can of course misinterpret these signs and again most of us will recall a time when we may have done this. Weeping for both grief and joy is an example of one physical reaction to two very different human emotions or moods.

Interpretation of non-verbal communication

Reading non-verbal signs correctly is not an accurate science and most professional negotiators are aware of the non-verbal signals they may themselves be giving off. Some may even 'game' this element of negotiation for tactical advantage, seeking to 'fake it', e.g., pretending to act nervously in order to get the upper hand. Some non-verbal cues are, however, very difficult or even impossible to fake or suppress, and so can provide valuable insight into what TOP is really thinking or feeling. Extreme surprise, embarrassment, anxiety and disgust are just four examples where our thoughts are often accompanied by involuntary visible physical reactions, e.g., widening eyes, blushing, sweating and physically recoiling.

Trained negotiators will consider non-verbal communication and body language as one source of signals from TOP, but will rarely rely wholly on this as a guide to what TOP is thinking or feeling. Furthermore, international and regional cultural considerations must of course be included here to avoid errors in interpretation. The importance of emotional intelligence in forming a more holistic perspective of what TOP may be thinking or feeling is also important. Both of these topics are covered later in this section.

The theory

In the late 1960s, Professor Albert Mehrabian published controversial and influential research findings proposing that what is said in words accounts on average for only 7% of what is ultimately interpreted by TOP in communications, the tone and facial expressions being far more important. Although this research has since been challenged, and there are now far more sophisticated models out there, this research emphasises a simple point that is key for negotiators. What you say in terms of your message forms only part of the final interpretation and 'decoding' of the message by TOP. To be precise, Mehrabian's findings focus on TOP's feelings and attitudes (not behaviours).

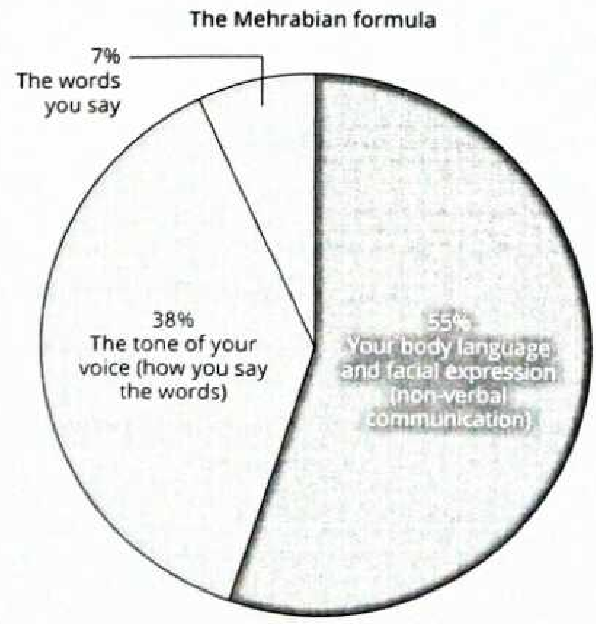

Figure 3.3 The importance of non-verbal communication (Source: based on Mehrabian (1967)[8])

Mehrabian's findings suggest the following about the way in which a speaker's feelings and attitudes are communicated to the listener.

- 7% of this type of information is communicated through words.
- 38% of the information is communicated through paralinguistic factors such as volume, pitch and tone of voice.
- 55% of the information is communicated through body language and facial expression.

Although feelings and attitudes do influence our behaviour, this is not by any means always the case. There are many situational and other factors that may mean we do not necessarily act on our feelings or attitudes, and in commercial negotiations driven by rational objectives and involving professional, trained teams, one could rightly question how important body language might be. Similarly, misinterpreting body language can be very risky. Therefore, unless you are sure and have validated your previous experience here, be cautious.

Case study

Interpretation errors

There is a famous story about a powerful trade union leader involved in tough pay talks with the bosses of a large company. At a critical stage of the meeting, the leader stood up and put his jacket on. The bosses interpreted this as him being about to walk out, which would lead to a breakdown in talks and a hugely damaging strike. They settled by making immediate pay concessions to the trade union leader. Many years later the leader admitted that his actions were not a tactic – he was merely getting cold and so put on his jacket!

Apply

Go online and enter 'negotiation body language' or 'negotiation non-verbal communication' into your search engine. You will see a wealth of resources you can access. Consider the videos you can access made by commercial training organisations, many of which are five minutes or less, and watch a selection. Take notes on the key points they make, where there is general agreement and where there is divergence, and then review this in the light of commercial negotiations from a procurement perspective.

The areas where there is general agreement tend to be about touching the face, not making eye contact, and speaking quickly with a high pitch, which are interpreted as being evasive or not being fully open. Other common observations concern leaning back, fidgeting and yawning, which are interpreted as a lack of interest. These are subject to a whole host of assumptions, cultural biases (typically defined by western business culture) and generalisations that you should think about and note.

The influence of international cultural differences in commercial negotiations

Recognising cultural differences

When we are negotiating with others in our own country or local region, it is reasonable to assume that cultural factors associated with particular nationalities, geographic regions, ethnic or language groups are not a key consideration. This is of course not the case when you are negotiating internationally with teams or individuals from very different cultural backgrounds to your own. Culture refers to the shared values of a society typically defined by a geographical area, e.g., southern Italy, by a country, e.g., Iran, or by a global region, e.g., East Asia, West Africa or Latin America. Some critics would say that globalisation has led to a blurring of cultural differences and that modern business negotiations are far less sensitive to these factors nowadays. Others will point to the rise of nationalism and protectionism around the world in 2018, with many world leaders explicitly taking a less internationalist view of things and emphasising their country's uniqueness.

Research by Ratui. I (ISMO 1983)[9] suggests that managers rated most effective by peers were those who admitted to having stereotypes, using them as a starting point, but continually revising them as they gained more experience. The extent to which values and attitudes that are dominant within a country or culture are shared by individual negotiators will, of course, vary. While it is easy to fall for cultural stereotypes and make incorrect and damaging assumptions, you also cannot assume in international negotiations that cultural differences do not exist. Recognising cultural difference is a necessary first step to anticipating potential threats and opportunities for business encounters with those from other countries.

Negotiations with people and organisations in/from other countries have increased in importance as business becomes more interconnected internationally and world trade grows. It is a subject area in itself and we can only provide a brief introduction and overview here within the syllabus. Interested learners can find plenty of specialist books and online resources for further reading to assist them, and this subject will be revisited in more detail in Level 5. There are many texts dedicated to providing practical guidance for identifying and dealing with differences in negotiation across cultures and geographies.

When are international cultural differences important in negotiations?

The number of situations where international cultural differences may affect negotiations are many and varied. A selection is included below.

- When you are buying complex purchases or those requiring a long-term and/or close working relationship with a foreign-based supplier
- When creating partnerships/joint ventures/long-term alliances with foreign suppliers where trust, empathy and mutual understanding are important
- When buying services where your organisation will be engaging with teams of people from other countries

- When the stakes are high and minor misunderstandings can lead to major problems
- When goodwill trust is essential for a good working relationship, as contractual trust is not deemed as important to TOP (e.g., redress in courts takes years)
- When there are different expectations and norms around the giving and receiving of corporate hospitality and gifts

Managing cultural differences

Some negotiators may not be aware of differences in cultural values and/or may choose to ignore the differences – 'business is business' – but this is not recommended from a professional perspective. In large multi-national organisations, it may be possible to employ or deploy staff with the same cultural background as part of the negotiation team, or use a local agent or overseas purchasing offices populated with native/local staff to smooth over any differences.

> *Apply*
> List five risks associated with ignoring cultural differences in negotiations, i.e. assuming TOP has the same values, ethics and assumptions about the important things in life as you do.

Evaluating cultural differences: Hofstede's cultural dimensions

The most accessible and practical research from a negotiation perspective is probably that of Geert Hofstede, who carried out numerous studies of how values in the workplace are influenced by national culture. His initial analysis considered over 100,000 employees of IBM in 70 countries across the world between 1967 and 1973. Further studies right up to the present day validated the earlier results, and included groups such as commercial airline pilots and students in 23 countries, and civil service managers in 14 countries. Hofstede defines culture as 'the collective programming of the mind distinguishing the members of one group or category of people from others'. The application of this research is used worldwide in many different settings.

From his research, he classified national cultures initially against four dimensions, but he has now expanded this to six.

- Power distance index
- Individualism versus collectivism
- Masculinity versus femininity
- Uncertainty avoidance index
- Long-term orientation versus short-term normative orientation
- Indulgence versus restraint

You should understand what these dimensions mean and consider them in the light of your own experience and national culture. These dimensions are summarised and explained in figure 3.4 below.

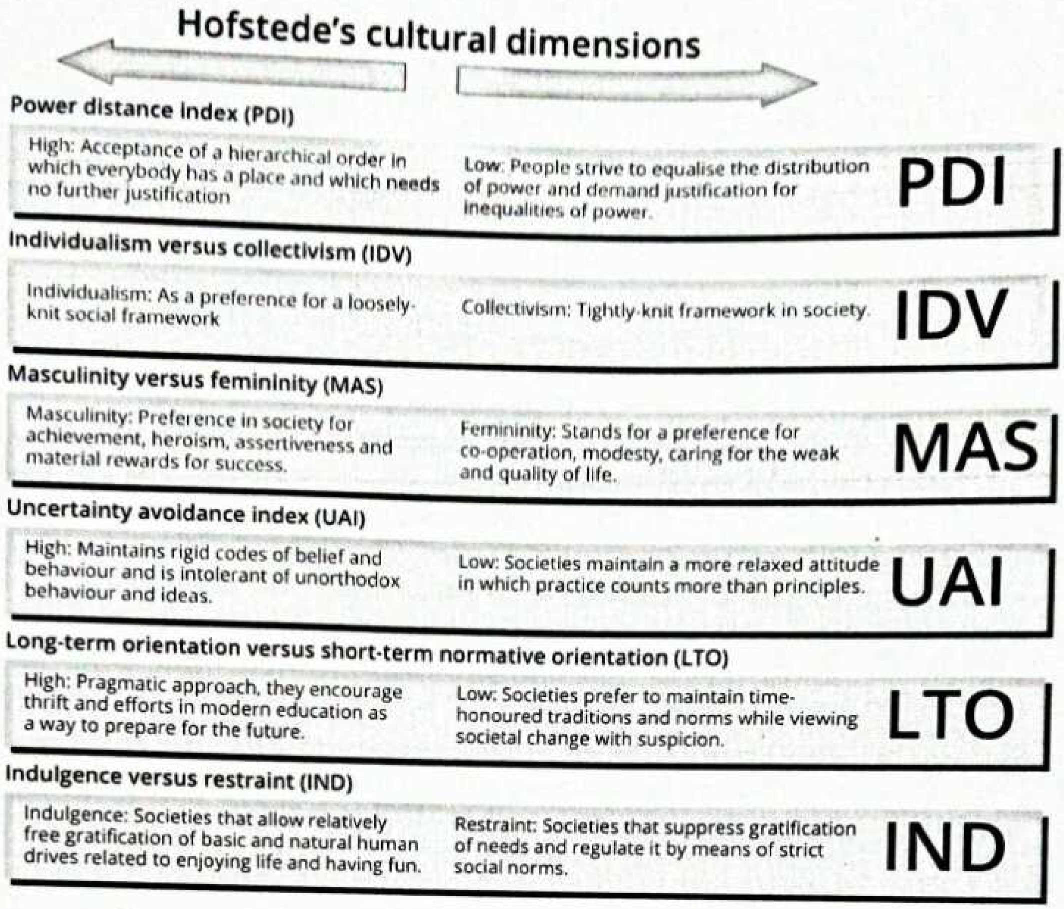

Figure 3.4 Hofstede's cultural dimensions (Source: Geert Hofstede, Gert Jan Hofstede, Michael Minkov, "Cultures and Organizations, Software of the Mind", Third Revised Edition, McGrawHill 2010, ISBN 0-07-166418-1. ©Geert Hofstede B.V. quoted with permission.)

> *Apply*
>
> Go online and go to the Hofstede Insights website: www.hofstede-insights.com/. Search for the country comparison tool, where you can enter the name of many countries into the search box. Enter your own country (or the one you identify most closely with) and you will see its score 1–100 against the six dimensions and a synopsis of the dominant cultural values you can expect there in business settings. Read the synopsis and reflect on it. Do you agree with the findings? Enter the name of other countries that have suppliers you need to do business with and consider the differences in the dimensions. This helps you to assess the scale and type of differences you can expect between your own national culture and that of TOP. The tool is potentially very helpful in preparing for negotiations where there are international cultural differences. Write notes on how you might use this insight in negotiations and bookmark it – it is bound to be helpful someday.

Hofstede's research is recognised globally, and although the country scores against cultural values inevitably generalise, it is better to start from this generalisation which has a strong evidence base than to approach a negotiation assuming you do not need to take account of cultural differences.

Apply

Practical application exercise

Consider Hofstede's six cultural dimensions as outlined above, and suggest how a very high score against a country might affect your approach to a negotiation there (in the absence of any other information). A suggested response is provided below for the power distance index.

Power distance index

A high score here might suggest that in negotiations it may be important to show a lot of courtesy and respect and possibly even deference to TOP. It may also imply you should dress formally and adopt formal titles with TOP, e.g., Mr/Ms, and do not assume familiarity or a casual tone.

Although our focus here is on international cultural differences, it is important to note that even where cultural differences have no impact on the negotiation, other more obvious factors when dealing with international companies may play a role in your overall sourcing decision, assuming everything else is equal (see below).

- Trust and payment issues: if things go wrong it is nearly always easier to seek redress and resolve disputes with a local supplier, where meeting face-to-face is easier, and where there is mutual understanding regarding acceptable and unacceptable behaviour in business dealings.
- Currency risk issues: in dealings between countries with relatively strong and stable currencies, buyers will normally want to pay in their currency while TOP will want payment in their currency.
- Legal and contracting issues: the importance placed on contracts versus personal relationships differs across jurisdictions, and lazy assumptions can get you in trouble here. Resolving commercial disputes in the courts in some countries can take just weeks, while in others it can take many years.
- Communication and logistics issues: physical meetings require one party to travel, which can be costly and time consuming, while time differences can mean there are limited time windows during normal working hours.
- Ethical and environmental issues: the importance of corporate social responsibility, concern for basic worker rights and the environment, as well as differing views of what constitutes corruption, can vary across the world.
- Political issues: sensitivities between countries over history, e.g., old colonial powers such as the UK, France, Spain, Portugal, Netherlands and Japan, the countries they occupied, language disputes, naming conventions, etc.

Apply

Have you encountered the issues and factors set out above? If so, note down how you/your company dealt with these issues. If you have no experience here, ask an appropriate colleague or fellow learner to explain how they addressed the challenges associated with international business dealings in general, and negotiations in particular.

The use of emotional intelligence in commercial negotiation

Traditional views of human 'intelligence' focused very much on the forms of intelligence associated with formal study and book learning. This is typically measured by standardised IQ (intelligence quotient) tests which seek to test abilities in areas such as the following.

- Visual and spatial processing
- Knowledge of the world
- Linguistic reasoning
- Working memory and short-term memory
- Quantitative reasoning

Historically, this cognitive intelligence was very highly regarded by employers when making recruitment and promotion decisions, and intelligence tests were a quite normal part of the hiring process for managers in many organisations. There was, however, always a debate regarding the importance ascribed to IQ, especially in common business situations where being 'street smart' is equally or more important than being 'book smart'. Since the 1990s, the concept of emotional intelligence has gained traction and is now a popularly recognised term. EQ (emotional quotient) is a measure of a person's level of emotional intelligence and refers to a person's ability to perceive, control, evaluate and express emotions.

> *Emotional Quotient is the set of skills that enables us to make our way in a complex world – the personal, social and survival aspects of overall intelligence, the elusive common sense and sensitivity that are essential to effective daily functioning. It has to do with the ability to read the political and social environment, and landscape them; to intuitively grasp what others want and need; what strengths and weaknesses are; to remain unruffled by stress; and to be engaging. The kind of person others want to be around and follow.*

(Source: The EQ Edge (2000), by Book, H.E. and Stein, S.J.)

EQ seeks to measure emotional intelligence and is centred on abilities such as the following.

- Identifying emotions
- Evaluating how others feel
- Controlling one's own emotions
- Perceiving how others feel
- Using emotions to facilitate social communication
- Relating to others

Clearly, in negotiation situations, both cognitive intelligence and emotional intelligence can play an important role. Understanding the business context, supply environment, cost structures, etc., and much of what we covered in chapter 2, can be termed 'cognitive intelligence'. However, success in negotiations often requires more than just cognitive intelligence, as people, emotions, moods and feelings are involved.

Emotional intelligence

You will find a number of papers and links on the topic of emotional intelligence (EI) on the CIPS Knowledge website. The application of emotional intelligence in commercial negotiations is more thoroughly addressed in Level 5.

Apply

EI and supply chain management

Find the article 'Why emotional intelligence matters in negotiations' on the Supply Chain 247 website (www.supplychain247.com/article/why_emotional_intelligence_matters_in_negotiations).
Read this article and reflect on the main points made in the short case studies. Do you agree with them? What assumptions are being made here that might not always hold true?

The CIPS Knowledge paper, jointly written with JCA Global, makes some useful general points that we can apply to commercial negotiations.

	Personal intelligence	Interpersonal intelligence
Behaviour	Self management	Relationship management
Feeling	Self awareness	Awareness of others
Attitude	Self regard	Regard for others

Table 3.5 The JCA Global model of emotional intelligence (Source: adapted from www.jcaglobal.com/emotional-intelligence/what-is-emotional-intelligence)

The JCA Global model of emotional intelligence, as set out in the CIPS Knowledge paper, consists of two parts.[10]

- **Personal intelligence:** having positive self regard, being self aware and managing your behaviour effectively
- **Interpersonal intelligence:** having a positive regard for others, being aware of others and managing your relationships effectively

This model illustrates that behaviour is driven by how the individual thinks and feels, which in turn is underpinned by their underlying attitudes.

> *"EI is about Awareness. Emotional Intelligence involves noticing, labelling and interpreting our emotions and the emotions of others."*

(Source: www.jcaglobal.com/emotional-intelligence/what-is-emotional-intelligence)

Good negotiators are attuned to all stimuli and not just the verbal and written information exchanged. Tone of voice, body language, facial expressions and other clues from TOP are noticed, and with experience and knowledge, interpreted 'correctly'. This interpretation may also involve knowledge of cultural norms and values. A smile, a 'yes' and the type of hospitality received (in a business context), can mean very different things in different international business cultures.

> *EI is about Self-Management. Emotional Intelligence is concerned with how people manage and get the best out of themselves and their innate resources. For example, deploying your full intellectual potential under pressure requires effective emotion regulation.*

(Source: www.jcaglobal.com/emotional-intelligence/what-is-emotional-intelligence)

Almost all of us have said or done things in the heat of the moment that we later regret. Decisions and arguments made when our emotions are running high are generally not as good as those made in a cooler moment. Being aware of the irritants or annoyances that can trigger a negative emotion is useful. Dealing with them is more difficult; however, with practice and in a team environment, this becomes easier. Experienced negotiators may show emotion, but when they do they are aware of this; they have calculated that in the circumstances it is an appropriate tactic to further their aims.

> *EI is about Relationships. Emotions serve an important social and adaptive function. They increase our awareness of others, providing information on the perspective of others and an understanding of why others behave the way they do. Therefore, Emotional Intelligence refers to the capacity to adapt our behaviour within the social context.*

(Source: www.jcaglobal.com/emotional-intelligence/what-is-emotional-intelligence)

Good negotiators can change between 'warm', 'tough', 'logical' and 'dealer' styles of negotiation in response to the situation they find themselves in and the people they are dealing with. Perhaps the greatest indicator of a good negotiator is the insight to know when to adapt by changing their style and approach.

> *Developing EI is about Practice. Like any skill, Emotional Intelligence can be developed and it takes practice. Noticing and managing our attitudes, emotions and behaviour in a changing social context is a continual process.*

(Source: www.jcaglobal.com/emotional-intelligence/what-is-emotional-intelligence)

A key way to grow and learn is to seek honest feedback from superiors, colleagues and fellow learners, if the situation presents itself.

Apply

Consider commercial negotiation situations and stages where emotional intelligence is likely to be equally or even more important than cognitive intelligence.

3.4 Analyse how to assess the process and outcomes of negotiations to inform future practice

Reflecting on performance

What do we mean by reflection?

Reflection simply means taking time to review what went well and what could have gone better after a negotiation session. It is key to improving the negotiation capabilities of individuals and teams in the future. Reflection can take place in a formal team setting, as well as on your own, in your own mind.

Negotiation skills are best learned through experience, observation and honest reflection on performance in a safe environment. Furthermore, if team members understand that a post-meeting review is part of the process, they may be more motivated to perform during the meeting, even if the negotiation objectives may not be met. Clearly, in most cases one cannot ask for feedback from TOP, and even if this was forthcoming it might be biased, so reflection on performance needs to take place among the negotiation team and, to a lesser extent, wider stakeholders – but only if they were closely involved in planning.

In the case of commercial negotiations, there are two sides and there will be situations where, no matter how hard you try and notwithstanding the detailed planning undertaken, you fail to meet the negotiation objectives set. In situations like this, there is still a benefit in reflecting on the negotiation and considering valuable lessons learned, even if there are no individual or performance issues to consider.

Giving positive group and individual feedback is easy, as is self-congratulation and, in many cases, it is hoped, this will be an accurate reflection on actual performance. When it comes to developmental or difficult feedback, it is only natural to want to move on and not reflect on the negative or developmental points, or why a negotiation did not achieve its objectives. But this is a mistake. The best learning opportunities come from reflection on what could be done better, and this can be achieved without blame, threat or condemnation. Everyone and every team will make mistakes and/or have areas where they could have improved. Clearly, if every reflection session concludes that an individual or team keeps making the same mistakes, then there is a case to change roles or consider alternative approaches. As stated at the start of the book, although negotiation techniques can be learned, some people may still have more natural ability or confidence, or just simply feel more comfortable in a negotiation setting, so one should not assume that everyone in the procurement team is equally matched.

Reflecting on performance should become a natural final step in the negotiation process. As with the negotiation itself, the amount of time and effort put into the reflection should be in line with the importance of the negotiation to the buying organisation.

Benefits of reflection

- Reflection makes participants more focused during the meeting.
- Lessons can be learned regarding what tactics worked/did not work.
- Participants get an opportunity to air their thoughts openly with colleagues.

- The strengths and weaknesses of the negotiation strategy can be confirmed.
- The strengths and weaknesses regarding individual/team skills can be identified for development.
- Negotiation is a skill and reflections on the experience can improve performance in future negotiation settings.
- Reflection assists current leaders in identifying future leaders through their capability to give and receive feedback.

Areas to consider

When reflecting on performance, you should always refer to your strategy and plan. There will of course be times when new information or unexpected behaviours or proposals from TOP mean you may need to adapt your approach, but if your planning was thorough, then even unexpected situations should be planned for. If TOP makes a proposal that is completely unexpected, then in most circumstances your best course of action is, where possible, to suggest a short recess while you take a few minutes to consider your options/response with your team or by calling HQ. Reflection questions will therefore need to be tailored to the negotiation, but a simple example list is included below.

Process	People	Objectives
Did logistics work or play any influencing role? Did agenda and timings work? Did the negotiation go through all the phases as planned? Did we/they use any tactical ploys? Did they work? If we reached agreement did we get written summary/agree heads of terms? Were there any surprises? Any lessons for next time?	Did we keep to agreed team roles? Did we communicate effectively within the team? Did we use an effective mixture of 'push' and 'pull' techniques? Did we present with confidence? How was our body language/ non-verbal communication? Did we ask the right questions? How did we respond to questions? Any lessons for next time?	Did we open well? Did we gain insights into key target areas? Did we achieve our objectives? Did we stay within our trading limits? What did we give away? Did we stick to our concession plan/ bargaining mix? Did we agree next steps? Was everything covered? Any lessons for next time?

Table 3.6 Example reflection questions

Undertaking a reflection activity on negotiation is good practice and should be automatic, with the time and effort being related to the importance of the negotiation. You can use a checklist based on the main components of the negotiation, such as the one set out above, or alternatively one based on the stages of the negotiation similar to the one set out below. If you negotiated alone you can still reflect.

Apply

Does your organisation encourage reflection and feedback on performance? Most leading-edge organisations build in feedback (sometimes 360 degree) on performance into progression and promotion decisions, and also train their managers on how to give constructive feedback.

Opportunities for improvement and development

3.4

The main purpose of reflecting and reviewing negotiations is to identify opportunities for improvement and development. It also provides a great training experience for new staff (knowledge transfer) if they observe the review meeting, and it feeds into the internal knowledge base of the team. It is very easy to intentionally or unintentionally miss this step, not reflect, and move on to the next negotiation. If the outcomes were successful, critics may say 'why bother?' If the outcomes were unsuccessful then human nature means we may be reluctant to revisit the situation through inertia.

> *Remember*
>
> Reflection must be built into the negotiation plan as the final action, and it is the responsibility of the procurement lead to make sure this happens, particularly in major commercial negotiations.

In situations where you are negotiating on your own, you may have to self-review, and the learnings may be limited to self-improvement.

There is no set way to review a negotiation, and the review can vary from a short five-minute high-level meeting with your team/boss right through to a full-day/half-day meeting complete with a detailed presentation to your wider stakeholder group. One key question you should always ask is – did it go to plan? The important thing is that the review is done and so the valuable learning is captured and not lost. Think about how useful it would be to you in a new job or when taking on a new category, prior to a negotiation with a key supplier, that you could access the review of the previous negotiation(s).

Negotiation prep card

- Current situation
- Value/cost arguments
- Pricing
- Counter arguments
- Concession strategy
- Negotiation tactics
- Negotiation process and outcomes

Figure 3.5 Negotiation prep card

When it comes to identifying opportunities for improvement and development, you should consider all stages including the preparations stage, as it is only after the negotiation meeting that you can confirm that your preparation was useful and sufficient, and that in the light of the actual negotiation, the resulting conclusions, assumptions and plans were reasonably 'correct'.

You are now at the end of this study guide and so should now be aware of all the stages and phases of the negotiation process. Each negotiation will be different, and will throw up different challenges, so you will need to focus on some areas more than others to get the best from a review, in order to identify opportunities for improvement and development. You can create a simple table (such as the one set out below) to prompt you regarding areas you may want to consider at a review.

Negotiation X – Review – Date: 10/10/2018 **Objectives achieved:** Yes/No/Partially **Team leader:** Luke Figueiredo **Category/value:** Telecoms/$2m three-year contract			
Negotiation focus area	**What did we do well?**	**What could we have done better?**	**Lessons/proposed improvements**
Preparation stage			
Team roles and management			
Stakeholder buy-in			
Understanding of relevant market/external forces			
Understanding of TOP position/ perceptions			
Data and research			
Our documentation			
Cost and price analysis			
Our objectives and bargaining mix			
Logistics issues			
Other specific points			
Meeting stage			
Our opening/presentation			
Our questioning and listening			
Trading concessions			
Use of time and recesses			
Non-verbal communication			
Sensitivity – culture issues			
Our use of persuasion and influencing techniques			
Our closing			
Individual performances			
Overall team performance			
Other specific points			

Table 3.7 Example of a negotiation self-review

3.4 LO3

Apply

Consider the table above and imagine you have returned from a major negotiation with your team. Try to complete the table with short comments/bullets based on a) a successful outcome; b) an unsuccessful one.

Protecting relationships after the negotiation

We made the point early on in this study guide that the CIPS preferred approach to negotiation, at least as a starting point, is the principled or win-win approach, where an agreement is sought that leaves both parties feeling at least somewhat satisfied. One reason for this was the simple reality that if you get an agreement through adopting a win-lose approach and forcing your terms on a reluctantly accepting other party, then it is likely that the subsequent commercial relationship may suffer down the line. TOP may seek to redress this situation through cutting corners somewhere, or by adopting a tougher approach if you seek any contract changes, innovations or help in the future. However, even with a win-lose outcome it is still important to act professionally and treat the other party respectfully in the negotiation.

It is important therefore to think about how hard you are willing to push a supplier if goodwill trust, and not just contractual trust, is important in the subsequent relationship. Your stakeholders in the business will not thank you if by driving through a hard deal the products or service they receive are affected in terms of quality or service level, or that the supplier's attitude is not as positive as it needs to be.

Not all negotiations will result in an agreement, so it is important to think about the ongoing relationships and their impacts on future business. If the negotiation is 'once-off' with a supplier and you know it is very unlikely you will have to deal with them again or engage with them for a long time, then you will be justifiably less concerned about the implications for immediate relationships. However, care should be taken here from a reputational point of view. Suppliers may be networked through industry trade bodies. Also, sales staff move around, so if they have had a bad experience in dealings with you, this may leak out and negatively affect your reputation as an attractive customer.

Tips to protect relationships

- Adopt a principled approach in negotiations and seek win-win.
- Accept it is OK to agree to disagree and express your wishes – it does not need to affect the relationship.
- Leave open the option of future business/references if there is no deal.
- Respect confidentiality.
- Do not lie to TOP – there should be no need if you are a good negotiator.
- Do not publicly criticise suppliers even if negotiations break down.
- Do not personalise criticisms or insult individuals – this will be remembered long after.

In general, if the maxim 'warm with the person – tough on the issue' guides your behaviour in commercial negotiations and you adopt the principled approach to negotiation, it will be less likely that the relationship with TOP will suffer unduly after a negotiation, whatever the outcome. There are two parties involved, of course, so you will never know this for sure until next time you meet them to negotiate.

Chapter Summary

In this chapter we focused on the skills and knowledge used at the face-to-face meeting phase of negotiations. We made the point at the start that if you have not done the required planning and preparation (chapter 1 and 2 material), then no amount of face-to-face negotiation skill will compensate for this.

In section 3.1, we considered the sequence and phases of the meeting stage, from opening, testing, proposing and bargaining, to closing and agreement. We explained some generally accepted 'dos' and 'don'ts' at each phase, and considered many different negotiation situations, as well as the importance of conditioning.

In section 3.2, we considered different methods at a high level that can be used to persuade or influence TOP to move closer to your position/agree a deal. We also described some negotiation tactics and ploys that can be used by buyers and sellers in order to gain a short-term tactical advantage in a negotiation.

In section 3.3, we examined the many communication skills needed to be an effective negotiator and focused on questioning, listening and the observation of non-verbal cues that TOP might signal to you unknowingly, or that you may signal yourself. We also considered the influence of international cultural differences on negotiations through the existence of different international cultural dimensions. We introduced the concept of emotional intelligence, and emphasised its potential importance alongside cognitive intelligence in achieving negotiation objectives.

In section 3.4, we considered how we might evaluate outcomes in negotiations and emphasised the importance of reflection by the team on their performance, so that there is continuous improvement by the team. We finally considered in brief how to protect relationships after negotiations, particularly in situations where no agreement was reached.

End of Chapter Assessment

DISCUSS — 1. Discuss three of the typical behaviours that occur during the bargaining phase of a negotiation.

DESCRIBE — 2. Describe three tactics that than can be used to influence the other party in a negotiation.

EXPLAIN — 3. Explain the impact that non-verbal communication can have on a negotiation.

3.4 LO3

Recommended reading

Huthwaite International, *Research Report – The strategies and tactics used by world class negotiators* [online]. Retrieved from: info.huthwaiteinternational.com/global-negotiation-research [Accessed on: 18 September 2018]

CIPS (n.d.), *Negotiations in Procurement* [online]. Retrieved from: www.cips.org/en-GB/knowledge/procurement-topics-and-skills/strategy-policy/negotiation/negotiations-in-procurement/ [Accessed on: 18 September 2018] – see the further reading and downloads section for specific topics.

Web resources as cited in this section regarding questioning, non-verbal communication, listening skills and negotiation gambits and ploys.

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Glossary

Addressability of spend
Spend that is influenceable through negotiations or application of other savings effort or leverage with suppliers

Anchoring
A well-known cognitive bias in negotiation whereby people have a tendency to give too much weight to the first number (price) put forward in a discussion and then adjust from that 'anchor'

Bargaining mix
All the issues in a project - each with different targets - that are up for negotiation

Best alternative to a negotiated agreement (BATNA)
The fallback or backstop position if the negotiation fails to result in an agreement/no deal is agreed

Contract price adjustment
A legal clause whereby the contract price can be varied, either up or down, by reference to an agreed formula, e.g., inflation rate or some other recognised index

Distributive
Approach to negotiation used when the interested parties are attempting to divide something up or distribute something of value, also known as zero-sum approach or 'win-lose'

Dynamic pricing
The practice of varying the price for a product or service to reflect changing market conditions, in particular the charging of a higher price at a time of greater demand

Integrative
Approach to negotiation used when the interested parties are attempting to create more of something of value to share, also known as collaborative approach or 'win-win'

Opportunity cost
The cost of the opportunity forgone by making a choice of one option over another

Procure to pay (P2P)
The system that connects the steps of the procurement process - from obtaining the raw materials through to making the payment

Spend cube
A review of spend data presented as a three-dimensional cube, highlighting the three dimensions usually reviewed: 1. sub-categories and commodity groups purchased across the organisation; 2. stakeholders or departments buying the category; 3. comparative spend with different suppliers

Stakeholders
From a negotiation perspective, stakeholders can be defined as persons or groups that have an interest (or stake) in the outcome of the negotiation you are leading or participating in

Supplier conditioning
The process of influencing a supplier or suppliers to behave in a certain way, or to accept certain circumstances

Total cost of supply
The sum of all the costs associated with every activity directly associated with the supply of a good or service

Tradeables
A negotiation variable such as price or contract length that can be traded with TOP in a negotiation

Walk-away point
A position from which you cannot concede any more ground and must 'walk away'/decline a deal

Work-in-progress (WIP)
Inventory that is in the process of being manufactured but is not yet finished

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CIPS
Chartered Institute of Procurement & Supply

About CIPS, the Chartered Institute of Procurement & Supply

The professional body

CIPS, a not-for-profit organisation that exists for the public good, is the voice of the profession, promoting and developing high standards of skill, ability and integrity among procurement and supply chain professionals.

Quality guaranteed

Our qualifications are recognised by OFQUAL in England and regulators in various countries, demonstrating that they meet specific quality standards.

The Global Standard

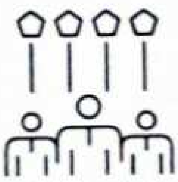
CIPS Global Standard in Procurement and Supply, which is freely available, sets the benchmark for what good looks like in the profession.

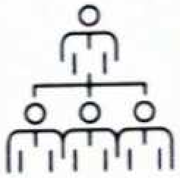
A commercial organisation

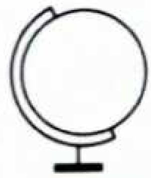
CIPS helps governments, development agencies, and businesses around the world to excel in procurement and supply, supporting them to improve and deliver results and raise standards.

A global community

We are the world's largest professional body dedicated to procurement and supply with a global community of over 200,000 professionals in over 150 countries, and offices in Africa, Asia, Australia, the Middle East, Europe and USA.


Global Standard freely available


Global network of over 200,000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