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Understanding how to negotiate with suppliers means understanding the supplier motives and what they desire!

*There are some very fundamental areas a contractor should understand in order to effectively position and ultimately negotiate the very best deals possible in their markets.*

*This article is designed to train contractors on the supplier financial matrix and make a contractor aware of what is available to them if the negotiate well!*

Many contractors can enhance their profits by improving how they approach the supplier negotiating process! It is a matter of understanding what the suppliers are really all about and what they want!

Most manufacturers reps, or distributor sales people are professionally training, and most contractors are not. By educating yourself as a contractor about what really is motivating the suppliers you do business with, it may lead to some very interesting conversations when it comes to negotiating to get more of what you want!

Most contractors when they negotiate have a target or an agenda of what they wanted

* Lower cost of parts, equipment or supplies
* More marketing dollars
* A better advertising arrangement
* A special trip incentive
* 100% monies – money that you direct as a contractor
* A Harley Davidson Motor Cycle

The real disconnect in the entire process is that most contractors do NOT ask for all the concessions they could get!

Why?

1. Very few contractors ever completely understand the power they have as retailers! Especially if you are good at what you do.
2. Many are not aggressive enough, or at least as aggressive as they could be. They’re targets were set to low. Some even fear the supplier?

The reasons why contractors may not be as good at negotiating as they could be are fairly simple:

* Most contractors do not really understand the supplier’s desires, what they want, and their motives. This makes the contractor unprepared to negotiate when it comes time. This lack of knowledge creates doubt about how aggressive to be. We are not suggesting a contractor doesn’t know what their costs should be! We are suggesting that because you don’t understand the other side’s financial model, you may have the wrong target picked out, or your timing is off, or a myriad of reasons why you may not get the very best deal you could have had!
* Most contractors do not have any clue as to how much power they hold – not referring to equipment or material cost reductions (although this is true) but influencing the consumer to buy whatever they recommend. The weaker the sales organization in the dealership – the more brand or manufacturer reliant the contractor becomes. You have the power to SELL the customer what you want to sell the customer – they trust your brand!
* Add these two above to the lack of understanding of the supplier financial model, meaning the contractor does not understand the costs in the suppliers business, and how far they can, or cannot go. This is due to a general lack of information for the contractor. The supplier’s financial model and metrics, including costs, are not readily available.

What you end with is a supplier that has insights into the contractor model (because they have information, they study and train professionally on this information (for example Lennox International now owns Service Experts and ISL – so they have access to and know the exact financial models of the contractor).

Other than an exceptional case, contractors unfortunately do not own any distribution or manufacturing operations, and have few insights into the channel for a distributor or a manufacturer supplier model. This is bad for the contractor negotiating.

**Not anymore!**

What you are about to learn could possibly change the way you negotiate with your suppliers. This article details the way suppliers:

1. Think
2. Act and React
3. Train, and in many cases don’t train their sales force
4. The supplier financial model.

How you respond to this information it is up to you! Will your supplier immediately lower your prices because you read or learned this model? Probably not! Can you find creative ways to help improve your negotiating practices, and improve your leverage? We think so!

*This article is NOT on negotiating styles – for that – see the site for materials on negotiating tactics and information that can help establish your negotiating pattern, and the framework.*

This material is designed to educate you as a contractor on how the suppliers manage the channel – both at the distributor level and for those manufacturers who control their own distribution as well. The materials are designed to help prepare you to make better negotiating choices, and understand how to get more of what you want out of your supplier relationship.

**Suppliers know what you don’t know**

**They know most contractors do not understand financial supplier metrics.**

**Suppliers DO train on the contractor metrics. To know about the contractors cost of labor by departmental segment and overhead costs etc., all in an effort to have enough information to make good business decisions about pricing to the market and you!**

**By having a supplier know your business, if you do not know their financial models, this lack of information puts you at a decided disadvantage.**

**Once you have the supplier business metrics – you can leverage your retailing power!**

**As a good retailer the supplier needs you far more than you need them due to the continued over capacity of the industry to build more furnaces and air conditioners than can be sold. Combine this with the manufacturer’s lust for market share, and your retailing leverage is very powerful indeed – if you are a quality company.**

Here are the steps to do just that, and get the absolute best available deal in the market. We will explore these steps in more detail:

Step 1. Learn the financial model of the suppliers and use it in negotiations. The purpose of understanding the model is clear – you are going to use this as a negotiating weapon. You will understand their bottom line – the point at which they have to stop – and this is where we want to be!

Step 2. Strengthen your selling organization to be a powerhouse retailer so you can rely on your selling prowess, not on a manufacturer brand-name.

Step 3. Become a **true retailer – sell your brand** – and owe loyalty in the channel to no one. Dependency and loyalty to any brand or supplier weakens your position. This doesn’t mean you can’t be nice, or have great personal relationships and it doesn’t mean you can’t have a supplier relationship where you pay more and get more. It does mean the supplier needs to “GET” their position in life in your business and provide you with excellent value and that you understand that your business must “Shop” the supplier as a matter of good business practice on a regular basis.

Step 4. **Never carry just one major brand.** Carry at least two major brands, and ALWAYS make them compete for the same sales. If you carry one brand you will be dependent and lose control of leverage. Two major brands sets up channel competition and as we all know competition is good for you and for the consumer.

Step 5. Use the major brand that provides the very best value to your company. This means you will have too, **set-up a competition between the two brands** against each other. You will need to choose whom you will market in your selling system and do not rely on a brand! Rely on your selling system.

The supplier needs to understand clearly you can and will sell whatever you want, and it is not brand related. It is your selling system that produces results not their band.

**Manufacturers do NOT like other brands in their dealerships? Wonder why?**

**They understand this concept in step 5 and know they lose when you finally wake-up and realize it is YOUR brand and selling system that matters. After losing market share to others in the low priced equipment segment, most have introduced a lower end line of competitive equipment, so you don’t have to carry a second line – maintaining it is less costly for you as a retailer this way. Perhaps? Probably not though and in fact it really benefits them and relieves you of negotiating weaponry. By carrying a second MAJOR line, you have options they don’t like!**

Lessons to Understand before we begin negotiating:

Lesson 1 – The supplier financial model and how they negotiate. Learn how to understand them and use them in your favor.

**Some Supplier Basics:**

* Suppliers create budgets and have financial goals. These goals are based on standards they use called metrics – these metrics help them define how well they run their business. You need to know their metrics!
* Suppliers establish pricing to blend their pricing deals and margins to meet these goals. They have several markets they play in, retrofit, new house, parts & supplies, commercial and so forth. These markets are like buckets. Each bucket contains so many margin dollars and must be filled. Once a bucket is filled, decision making changes.
* They have pressure to grow margins and share of market – both! They love to make deals prior to the beginning of the year (target opportunity time is November/December). They are more flexible because these buckets, especially the lower margin buckets are not yet filled for the coming year. They can also change their planning to fit a newer deal, even go back to the “Factory” and ask for some help on a larger contractor. It happens almost every single day!
* A dealer who can sell well and move boxes is VERY Valuable! But only if they supplier truly believes you are a risk! That you can and will leave as a matter of good business decision-making. If they believe you will not leave, or you are bluffing, they are well-trained and will not budge. You must understand your power as a retailer creates leverage ONLY when you are a risk! A second major line whom you already sell does pose that risk!
* A supplier loves a dealer who can pay his bills on time and discount! You are like solid gold. A contractor that pays on time, or better yet discounts, has tremendous leverage in the market because most do not. The average supplier receivable is somewhere right around 42-45 days. So when you pay in 10, 20 or 30 you are more than average, you are a welcome sight to a supplier credit manager.
* Suppliers love contractors who market. They are trained to love their brand. So much so that they will concede price in many cases to a marketing oriented contractor knowing they get brand exposure in the market. So what you need to understand and convince the supplier is your ability as a retailer to create brand exposure is great!
* **Suppliers do NOT LIKE NOISE**. Noise is a contractor who publicly talks about their deals. The best deals are very quiet. Think about it.
* Most suppliers will use parts and supplies to blend their costs of equipment. Equipment margins are generally 10-15% lower than parts and materials margins based on the market segment the supplier is pricing for:

**Replacement Market:**

Parts & supplies - Materials run on average about 30-35% margin.

Equipment margins average around 20-22%. There are exceptions – these are blended averages. See the table for the financial breakdowns by market segment.

Here are the channel financial models:

Manufacturers sell to distributors and wholly owned factory branch operations at a cost **called the Transfer Cost.**

It is what they pay for the product. This transfer cost is the equivalent of the cost a manufacturer charges to independent distributor for the equipment.

In addition you will need to know:

* Transfer costs are the everyday prices – not the only prices
* There are special quotes for “Special” dealers
* There are new construction factory quotes
* There are volume rebates at year end that can be had
* And there are a host of supplier factory deals like specialized brand naming equipment for a large dealer.
* There are factory direct deals – special discounts for taking shipments direct from the factory such as shipping direct to the operations to save distribution costs
* There are “Special” National Account deals – including sell direct
* ARS & large retailers have a special deal on the front, back, and marketing
* Direct Energy and One Hour also have a deal

Most major suppliers have a pricing department. There are lots of names for these departments, but their function is the same – find a legal way to move more boxes and do it quietly!

The pricing desk is all about determining when to do a deal.

* Suppliers call the desk and say we need a special deal – and the deal gets done
* Contractors call the supplier and say we need a deal – and the cycle repeats!

Financial Model - What the Supplier Wants:

The manufacturer targets a 10% EBIT – Earnings before interest and taxes. They sell the product to the distribution channel at transfer costs that allow them to achieve about 7-8% pretax profits, trying their best to achieve 10% or better by having the factory cut costs, improve manufacturing, and create what are called manufacturing variances that lower the products costs.

*In effect, the manufacturers do this to fool their sales organizations. They don’t trust them to use the actual costs! Their fear is the sales force would “Give” it away. And you know what – they would!* ***Keep that in mind!***

The costs are set high enough to give the sales organization a cost target to use, they establish their prices, then the game the Chief Financial Officer and CEO play is to get the factory to buy better, and wring some variance out of the production processes by negotiating with suppliers for “Volume” discounts, cash discounts, and Earned Volume Rebates or what are called “EVR’s” or VR’s.

**This is important as this factory cost variance is one of the things they know you don’t know** about, and how often do you ask for a discount based on the factory cost changes, or the time of year the factory is operating?

As was stated earlier, most suppliers and manufacturers don’t really like their OWN SELLING ORGANIZATIONS to know too much about this whole process. They don’t necessarily trust the sales organizations disciplines.

You see, they set the factory price high because of the **FEAR** the sales organization will give it away if they had the **REAL** costs. And there you go! You want them to give it to you! And they will. Someone will!

The independent distributor targets an EBIT of around 3%-10%, and a margin of around 18-22%. It can be as low as 8% distributor margins, and as high as 35%. It depends a great deal on the mix of refrigeration, parts & materials, and higher end equipment. It all blends out to fill the buckets.

Always a good question to ask your supplier is what their business mix is. You can then infer from the answer what the overall margin looks like in the distributor organization. This becomes important so you have an idea about how aggressive to be.

Your information must be well organized to plot a sale and margin curve of your supplier – so when you establish your target for where you want your deal to end up, you did it based on quality information about your supplier. Here are the breakdowns.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Distributor / Supplier Margins:** | | | | | |
|  | **Retrofit** | **New Home** | **Commercial** | **National Account** | **Counter** |
| **Parts and Materials** | 30-35% | 6-10% | 6-15% | 12-20% | 40% |
| **Access Items** | 20-30% | 18-25% | 12-20% | 22-30% | 50-60% |
| **Refrigeration** |  |  | 30-40% | 35-50% | 50% |
| **High Efficiency Equipment** | 30-35% | 22-26% | 18-20% | 25-35% | 40% |
| **Std. Efficiency** | 16-20% | 8-15% | 8-15% | 15-22% | 35% |
|  |  |  |  |  |  |
| **SGA/Overhead** | Typical range from a low of 10-12%, but average at 14 – 20% | | | | |
| **Factory Margins being sold to Distributors / Factory Wholly Owned Operations:** | | | | | |
|  | **Retrofit** | **New Home** | **Commercial** | **National Account** | **Counter** |
| **Parts and Materials** | 25-30% | 10-12% | 10-12% | 12-20% | N/A |
| **Access Items** | 25-30% | 15-20% | 15-20% | 25-30% | N/A |
| **Refrigeration** | N/A | N/A | N/A | N/A | N/A |
| **High Efficiency Equipment** | 30% | 20-22% |  |  | N/A |
| **Std. Efficiency** | 25% | 12-15% | 8-15% | 20-30% | N/A |
|  |  |  |  |  |  |
| **SGA/Overhead** | Low end Suppliers 8-10%, average at 18-22% | | | | |

So a margin of 22% minus a SGA expense of 18% is a 4% Supplier EBIT.

Also recognize the factory has overhead. They have factories, marketing departments, ad budgets, lots of costs. So they establish a price point to a distributor or a wholly owned to make enough EBIT to run their factory operations. So in the channel you have two EBITs – one from manufacturer to wholesaler, the second from wholesaler to retailer.

Wholly owned factory branch operations target a blended margin of around 15-25% depending on the brand and how the transfer costs are established from the factory.

For the most part suppliers set their prices to target a 3-5% EBIT in the distribution channel once they figure out the buckets in the above model.

So from the charts above you can see a distributor or factory operation adept at getting their dealers to sell higher end equipment, and selling you parts and material supplies as well can get a healthier margin. In this case, you as a contractor typically sell at higher margins as well, but the lesson here is buy low sell high.

They have room to negotiate, and you need to get more of what they have! Top end distributors can make as much as 12-15% EBIT if they run effective operations.

So we have three ways to go here:

1. Get a negotiated deal based on volume from supplier using factory variance – a specialized quote you HAVE to REQUEST, or DEMAND.
2. Get a negotiated deal by creating risk to the supplier by taking business elsewhere.
3. Go elsewhere because you got the deal you wanted.

**We will deal with “How”** a bit later, but commit these figures to memory.

Remember:

1. The factory contributes any variance to profit and they only have a limited number of buckets. Some distributor has the special quotes and is passing it onto a contractor who has negotiated hard to get the deal! Are you one of them?
2. The factory works with the selling organization (wholly owned or independent) to use “Positive” factory variances to create price changes and move more boxes through a pricing desk. These are special quotes where the sales organization goes to the factory to get a special price. Is your TM offering this? I doubt it? Commercial and new home are notorious markets for this practice.

Lesson 2 – Brand name manufacturers have higher prices in the market because they use their brand to create “Pricing Leverage” – you don’t need.

Manufacturers with brand equity can use their brand as a lever because contractors are weak at selling consumers on their own contracting brand, their own guarantees, and their own promotions.

The contractor relies on the brand instead of their selling competency. Contractors who possess the very best pricing are not always the biggest purchasers, they are the best negotiators, and they share in common several characteristics:

1. They are growing and talk improved market share to suppliers.
2. They pay their bills on time or even discount.
3. **They sell well – and they sell what they want to sell.**

Do you really think it costs the major brands in the industry that much more to manufacture a product than it does Goodman? The answer is NO!

They all buy similar components use similar technology, and freight is the same. There just isn’t that much difference. **REALLY!**

They are EXTREMELY close when it comes to factory costs. Very close! It is the other stuff that makes the difference!

Some for example chooses a different strategy in the market.

A mass volume low overhead model, has given the other manufacturers fits, because they have exposed the real issues – that equipment is a commodity and you should be buying it cheaper than you are.

The dealers that have learned to do 1, 2 and especially 3 above can sell anything they want at any price. **Top tier brands with Top of Mind Awareness (TOMA) want you to believe their brand is essential to getting higher selling prices**, but customers buy the “Best Value” 83% of the time, 10% on Price Alone and 7% based on Status.

*As a contractor you create the value and status with your installation, you create the warranties or you can, and you create the selling process that makes consumers like and trust you!*

The equipment brand is only valuable if you allow it to be.

Do some manufacturers provide a higher quality of equipment? It is a fair question in this discussion. But how much better is Brand T than Brand AS or C or G? Same components, technology, design, ISO certifications…everyone has a pretty good product these days!

You are the retailer and you have the power in the channel and the manufacturers and distributors are fearful, contractors will figure this out.  **This is one of the reasons for the rise in buying groups!**

The TOP Tier brands of the world spend huge sums of money on brand development. They have substantial overhead costs, and we refer to this as S.G. & A. (costs of selling, general and administrative expenses). Goodman does not.

These “Brands” require their prices to be higher – and they do offer the value proposition of walking in the home and saying we have “Brand X” and that is worth something. The question is “How much?” They think a lot. They are wrong! If “Brand” is powerful – then you – the retailer is required to build your brand and become even more powerful in marketing!

They price their products higher and get you to rely on their brand, and their programs.

The argument about product quality is moot – most top tier brands have off brands – the same or similar product characteristics. So why do these off-brands get priced less?

**Desire for Market share, remember this fact!**

Lesson 3 – Suppliers are PRIMARILY interested in moving more boxes

The industry is fragmented. We have too many contractors selling to a market size that cannot support all contractors (forget unlicensed).

This tends to keep prices depressed in the consumer market for lack of pricing systems, discipline, and the need to make a wage for some.

There is always someone out there with a lower bid – because they don’t know how to price, or simply need the work to pay the day’s wages. Either way, we have too many contractors – we are a fragmented industry.

The same is true at the manufacturing level – we can as an industry build more boxes than the retail market can sell.

This lesson simply means that manufacturers want to sell more boxes. It is a constant struggle – a fight – a major theme in the manufacturer boardroom discussions to move more boxes. Increase the market share.

In fact – you can categorize it as a business paradigm. Yes suppliers want to be profitable, but they also want to move more boxes. If you ask this question:

**Should I make more money or move more boxes?** The answer will be – BOTH! I have asked the question on numerous occasions always with the same answer - both.

Market share growth is a key measurement of success for executives – it’s what they want – all things being equal!

They want to be a major player in the industry – to build what we call scale. So they can negotiate better with their suppliers and feel powerful – that comes with the boxes.

Lesson 4 – Manufacturers and distributors who engage in dealer development processes - while they can be very effective – are still about moving more boxes. Period!

As a strategy, helping a dealer or contractor prosper is effective.

It is still about increasing market share and unitary penetration.

Trane had the Comfort Core in the 1970’s. Lennox had the Dealer Advisory program in the 1980’s. Others will no doubt continue to try. In the end, the single measurement that counts is how these programs or initiatives have helped move more boxes, and also the right kind of higher margin of higher efficiency-differentiated boxes.

So, take advantage of the development and the learning. But just remember, the game is about moving more boxes.

Lesson 5 – The Robinson-Patman Act - Deals are everywhere (EVR/VR/Price)

It says among other things – that a supplier may not grant preferential treatment on the basis of size or scale when it comes to price, or any form or competitive advantage such as co-op, without meeting what is known as functional availability. Pretty much they have to offer to others in a defined trading area.

**What is functional availability?**

It means any DEAL must be functionally available to everyone (meaning all the contractors can actually take advantage of the deal if it is offered to them). Deals such as buy $1,000,000 in inventory today and get 20% off this price do not meet functional available requirement. A small contractor buyer could not take advantage of this deal, so it is not functionally available. So it cannot (read should not) be offered in this manner. It can be a “Meet Competition” deal. Happens all the time.

In other words, when it comes to prices, marketing funds, and any other deal in the market that can change the balance of competition, it is supposed to be functionally available to all in the market.

The market is defined by the Government as a “Trading Area”. These trading areas are mapped, and anywhere inside of a trading area, the market deals must meet the requirements of the Robinson-Patman Act.

The law is very clear – no deals for the big guys that are not also available for the small guys within any given trading area and functionally available are they key wording! It was designed to protect small guys from big guys like the Old Standard Oil and all the companies who had scale.

Prices and deals can vary by trading area. Inside the trading area, any deal must meet Robinson-Patman guidelines. **EXCEPT!!!!!!!**

**Don’t get fooled!** Like most laws – there are loopholes. And the suppliers know them backwards and forwards.

A perfect example of what is called **“Meet Competition”** which states if you are meeting a competitor’s price, so long as you document the price in the market, you can change your price without letting others in the same market have that price. An effective method to defeat the requirement of functional availability!

One major manufacturer uses what is called a Competitive Discount Quotation. They use this method to grant price deals using the Robinson-Patman guidelines. Meaning, any sales person who wants to “Meet Competition” can do so without offering that price to anyone else. Kind of encourages the multiple line strategy doesn’t it?

While suppliers may maintain the party line that only new house contractors have this kind of deal – ask point blank if “NO” replacement contractor in their market has a “Special” meet competition quote of any kind? Read the eyes! Ask the Manager in the market the same question?

You can bet sure as you are reading this article there are:

1. Replacement contractors with special deals using new house quotes in the replacement market.
2. There are replacement contractors with **“Meet Competition”** quotes with price deals that are not part of the Zone/Metro/Area whatever market pricing you want to talk about.

These manufacturers may not be breaking any laws, but the deals are there, and it has to do with how the law is written, so this supplier simply takes advantage of it.

The same holds true for all suppliers.

Suppliers make deals with big guys and small guys alike. You aren’t likely to change this!

You need to get “A DEAL” and the way you get a deal is by using Robinson Patman and giving the supplier a reason to “Meet Competition”!

*Suppliers publish a Zone Price, or a Market price, or whatever they call it, and then using the Robinson Patman Act “Meet Competition” provision, they change the prices from “Market” to whatever they need to get the business.*

**This is very important to you as a contractor!**

In fact, the manufacturer using the CDQ, their most profitable contractors were always their most loyal purchasers because they did not change their prices off zone or published prices, because they didn’t have too. And thus, the rise of the buying group – a 3-5-8 % rebate on purchases, where did that money come from?

There was no threat from a competitor. No need to “Meet competition”.

The less loyal dealer in their eyes who carried multiple lines, and worked the sales person to understand that the other suppliers could get the business at some price point below market price, could get a meet competition deal.

The loyal dealer in the very same market, who sold only that brand, pays higher prices (market based) because he/she did not negotiate a meet competition deal.

Every supplier has a form of this system.

They can meet the competitive threat to maintain the business. In this manner the small guy or the big guy can negotiate a much better price on the cost of materials or equipment.

A sales person needs a copy of an invoice, a price sheet, or can in some cases write a letter to a file stating they saw the price if the contractor is unwilling to share.

In one case a contractor walked out of the room to take a call and left the competitive prices directly in front of the sales person so they could copy them down and know exactly where they needed to be to get the business. Next stop, the “Meet Competition” price deal!

The funny part of this whole equation is the very manufacturers who promote brand and demand retailer loyalty, use the same techniques being described here with their compressor suppliers, and other component manufacturers, and some have even gone so far as to vertically integrate – buying the component manufacturing to try to reduce costs!

Some (at least one) manufacturer/distributor entered into the retail vertical trying to use contractors at one time before failing and selling out to a Hedge fund.

**The lessons here are clear – study the facts!**

1. Never carry one major brand – always carry two – use them against one another. They use the channel against you!
2. Never sell brand – sell your company, your warranties (no homeowner risk guarantees), installation quality, the money (financing) and finally a product. Not brand! The future of our industry is the retailer – not the manufacturer or distributor!
3. Create a serious threat of competition between suppliers and when you have the power to sell whatever you want to the consumer because of how you sell, you will no longer worry about moving business from one supplier to the next for fear of brand retaliation.
4. Suppliers are going to try and set-up new or additional dealers – they have to – they need to – they will! **Get over it already!** If you are a selling machine, it doesn’t matter – brand is irrelevant to you. And you have the power to make it irrelevant to the consumer.
5. Use the two or more competing brands to leverage a better equipment and material cost structure.
6. Use the brands against one another to leverage a better co-op deal as well.
7. Do not be afraid to kick a supplier out – they’ll be back!
8. Ask for obsolete inventory returns.
9. Get it in writing – some suppliers thrive on changing the rules.

Lesson 6 – Deals extend beyond price to co-op, trips, free products, you name it.

Once you understand the Robinson-Patman Act, and the concept of leveraging a supplier the deals follow the pattern.

There is one other key concept you should understand. It is called “BREAKAGE!” Breakage refers to extra co-op or promotional money that is allocated to dealers and that is not used. That money, say a 2% co-op for all dealers based on purchased does not always get used by all dealers. Where does it go? Who gets it?

**It goes to only two places:**

1. To the suppliers bottom line at the end of the year.
2. To smart contractors co-op fund for use as part of a deal.

Those contractors who know about breakage – know this: Breakage exists and it can be acquired by those who know how to ask! Here’s how.

**Step 1.** You need to convince the supplier you are going to move more boxes – help him get what he/she wants – market share growth.

**Step 2.** To convince a supplier – you need an advertising and/or media plan. The plan lays out how this breakage can and will be used.

**Step 3.** Since you already have another major supplier – this could be important in your decision-making about who will be promoted this year.

Never forget – Supplier managers talk at the end of each year for planning purposes where they can get their growth for the next year. Their goals go up. They are expected to grow. This puts pressure on them to review where they can access more boxes. Use this to your advantage. Each year the deals can become a little sweeter.

**Step 4.** Ask for the advertising deal you want – the breakage is there. Get it!

Each of these buckets is counted on. They need to be filled-up with so many margins, or sales and margin and when all the buckets are added up, the supplier has made its goal for margin and EBIT.

Let’s Discuss Negotiating:

Here is the pattern you will see from a trained professional TM or Manager. They will establish an opening, a target, and a bottom line. It will look like this:

**Opening**

**Target**

**Bottom Line**

They will have this prepared before they see you! The opening is the position they establish in order to effectively be able to give you something as they negotiate with you to make you feel good! They will also have lots of items to trade as they yield their position. We call that “Nothing for Free”. As they give early and often, they will trade. Lower price, you attend training. Lower the price again, you buy more boxes. Lower price again, you advertise more this year etc.

The idea is to give early and to give often, making you see a concession pattern that creates an impression you are getting them closer to their bottom line figure on the deal, and in fact you are really getting closer to the target point they established. The concession pattern appears in red!

**Opening**

**Target**

**Bottom Line**

The concessions get closer and closer together. These can come in the form of concessions on trips, price, volume of products, co-op dollars, advertising deals, delivery, taking back obsolete parts or inventory, or many more variations.

The other key is the reasonable envelope, or what is the current reality of the price or position of the deal being discussed. You can ask for a price of $ 300 for a high efficiency furnace, but if the manufactured cost is $ 305 without burden of overhead and distribution logistics costs, you are outside the reasonable envelope.

The reasonable envelope for the high efficiency 90% furnace is illustrated below in Purple. The high points and the low points make up the reasonable envelop. This is where your knowledge of the financial models comes into play by working backwards and establishing overhead factors; you can darn near calculate the costs of the suppliers on almost any item. You can then apply factory variance deals to these as well, and create selling prices that you can then use to set-up your model of negotiating.

**Opening**

**Target**

**Bottom Line**

**$900 US**

**$700 US**

**$570 US**

**Market Price – High End $900 US**

**Low Market price – $520 US (quote)**

These are the supplier’s positions – the purple illustrates the actual market conditions, or the calculations you have made based on your own knowledge of the supplier financial model.

Now that you know the supplier financial models, work backwards. If the sale price to you on zone pricing is $900, and high efficiency products yield say a 35% margin, then the supplier cost is $585. That is the standard price from manufacturer to supplier. Work backwards again from $ 585 to figure the manufacturers costs and we can start to evaluate a “Special Quote” price point. The manufacturer desires a margin of 25% on a high efficiency product at a standard cost leaving a manufacturing cost of $438 without any variance. This includes the overhead from a manufacturer. These are the price points the suppliers (Manufacturer and distributor would like to average). Now you have some leverage. Figuring a special deal at a factory margin of 15% and a distributor margin at 10% you get a price point of $572 from a cost of $38 and those margins. That’s a lot different than $ 900? Those figures do NOT include price desk considerations for projects late in the year when the factory knows it has passed its breakeven and the variance is positive.

Now take out 10-20% for “OFF BRAND” and see where you get if you’re a company buying direct like a large national retailer (think ARS). Want to compete against that?

What you need to know is there are new home quotes out there in the market on the products being sold in the residential add-on and replacement market.

It happens.

Manufacturers and suppliers know this goes on and look the other way. If they looked hard enough they would find the practice and since the other guy doesn’t look they would cripple their selling organization.

Sounds like an opportunity!

Secondly, suppliers willingly (not all) make these deals to gather market share. They make special concessions and hide behind the “Meet Competition” provision of the law, to exercise their right to make the deal, and move some boxes.

It’s a game! Are you playing it well? Are you playing Checkers while manufacturers are playing Chess?

What we just said is new home pricing gets injected directly into the residential add-on markets. Here is how it happens.

A contractor, says, I am doing some new homes – gives a project name, project location, sometimes real, sometimes not for fear of other contractors getting wind of the potential development (Wink-wink)– sales people sometimes ask about it, often-times they do not – not wanting to upset their potential sales gain?

The sales person puts a quantity on the project quote, the pricing is negotiated and then the contractor orders using that number. You now have created a situation that has the following:

1. Meet competition
2. Sales person deniability to all other contractors
3. A new price in the market lower than the market zone price
4. A contractor who has the deal he/she wants
5. A manufacturer/supplier who can defend the position this is new house
6. More boxes being moved

So long as everyone and no one does their homework and digs too deeply, all you really get is price concession that is within the framework of the law, if not the integrity.

This works for price – areas such as Earned Volume Rebates or VR’s Volume Rebates, **trips, marketing funds, up-Front marketing monies, additional breakage for advertising money, and delivery are all dealt with differently.**

Here is where you can win.

Smart suppliers and there are a few – look at their financial models on what is known as a “Cost to Serve” basis. What Sales and gross profit dollars do I get from you, and what are my costs so I know how profitable you are. MOST DO NOT!

|  |  |
| --- | --- |
| Sales Revenues: | $300,000 In Purchases |
| Margin % : | 30% Gross Margin |
| Gross Profit Dollars: | $90,000 Gross Profit Dollars |
| Expenses: | **$9,000** in co-op (3% of sales) |
|  | $1,000 per TM visit x 12 = **$12,000** |
|  | **$10,000** other Expenses Amortized (% of their sales) |
|  | **$45,000** Admin Overhead Amortized (15% of their sales) |
|  | **= $76,000** total expenses |
| EBIT on Customer: | **$14,000 or 4.75% EBIT** |
| **This is a good customer.** | |

You should have this model yourself, and understand how far you go to get to the bottom line!

Example:

Change the model some with slightly lower sales and see how this affects the outcome:

|  |  |
| --- | --- |
| Sales Revenues: | $100,000 In Purchases |
| Margin % : | 30% Gross Margin |
| Gross Profit Dollars: | $30,000 Gross Profit Dollars |
| Expenses: | **$3,000** in co-op (3% of sales) |
|  | $1,000 per TM visit x 12 = **$12,000** |
|  | **$3,000** other Expenses Amortized (% of their sales) |
|  | **$15,000** Admin Overhead Amortized (15% of their sales) |
|  | **= $33,000** total expenses |
| EBIT on Customer: | **$<3,000> loss in EBIT** |
| **This is not a good customer.** | |

**So the prices need to be:**

1. Higher
2. TM’s must visit less frequently to curtail costs
3. Training and support tends to be less
4. Add to the situation – a contractors’ ability to pay, or NOT?

**So as a contractor you should begin to see how very valuable you are to a supplier** who needs a certain number of contractors that present the ability to sell boxes and pay their bills.

You also allow them to earn their EVR – the earned volume rebate. So if you went away, how much does it cost them to replace you? A bunch!

Having been there, and done that – it is a huge investment on a suppliers part to get new acquisition business to replace that which is lost – figure it is worth at a minimum of $ 15,000 to $20,000 in expenses to replace you plus what time it takes to ramp up a new dealer. Plus there are no guarantees any new dealer will buy as much and remain loyal?

It's always in the best interest of the supplier to cut a deal, to save the existing dealer, if they have their head screwed on straight.

What Have We Learned?

1. There is a game being played by suppliers– are you in it?
2. Distribution is all about a desire for market share and growth. Use that against them. Lust for market share is a major motivator.
3. Never carry one major line – it is a huge drawback – grant loyalty through percentage of purchases, not unilateral marketing by carrying one line.
4. Suppliers will negotiate if pressed into the mode.
5. Negotiate a “Meet Competition” special price quote. Leverage your ability to sell not with brand but with your marketing of guarantees.
6. Negotiate at or near the end of the year. Have a supplier move in your back pocket so you can shift sales and boxes to the other suppliers.
7. Do your homework on the supplier financial model and be more prepared than the TM. The more you know what you want, the more someone will probably give it to you!
8. Establish a network of contractors to determine the price points in the market being sold by suppliers. The deals are out there.
9. Get an EVR or VR – on purchases. Pay your bills on time.

Why is this Critical to Your Success?

* Suppliers – distributors and manufacture wholly owned operations do not want to compete with another major brand in your business – they hate this! It adds profit to your bottom-line when you leverage this concept.
* They hate even more having to compete in your business with a low-end supplier who provides good value because they know you know you can SELL ANYTHING YOU WANT!
* Getting the best set of costs from your supplier(s) is essential to adding dollars to your bottom-line and being competitive in the market.
* Having your suppliers understand you are going to continually negotiate with them and keep them under pressure is effective, if and only if you pay your bills, and demonstrate a true loss of business risk.
* Providing a supplier(s) with the things they want – growth and sales of key products for their financial success is an excellent way to improve your leverage if you have a second brand to use.
* **A proper negotiating strategy can impact your profits in a significant way!**