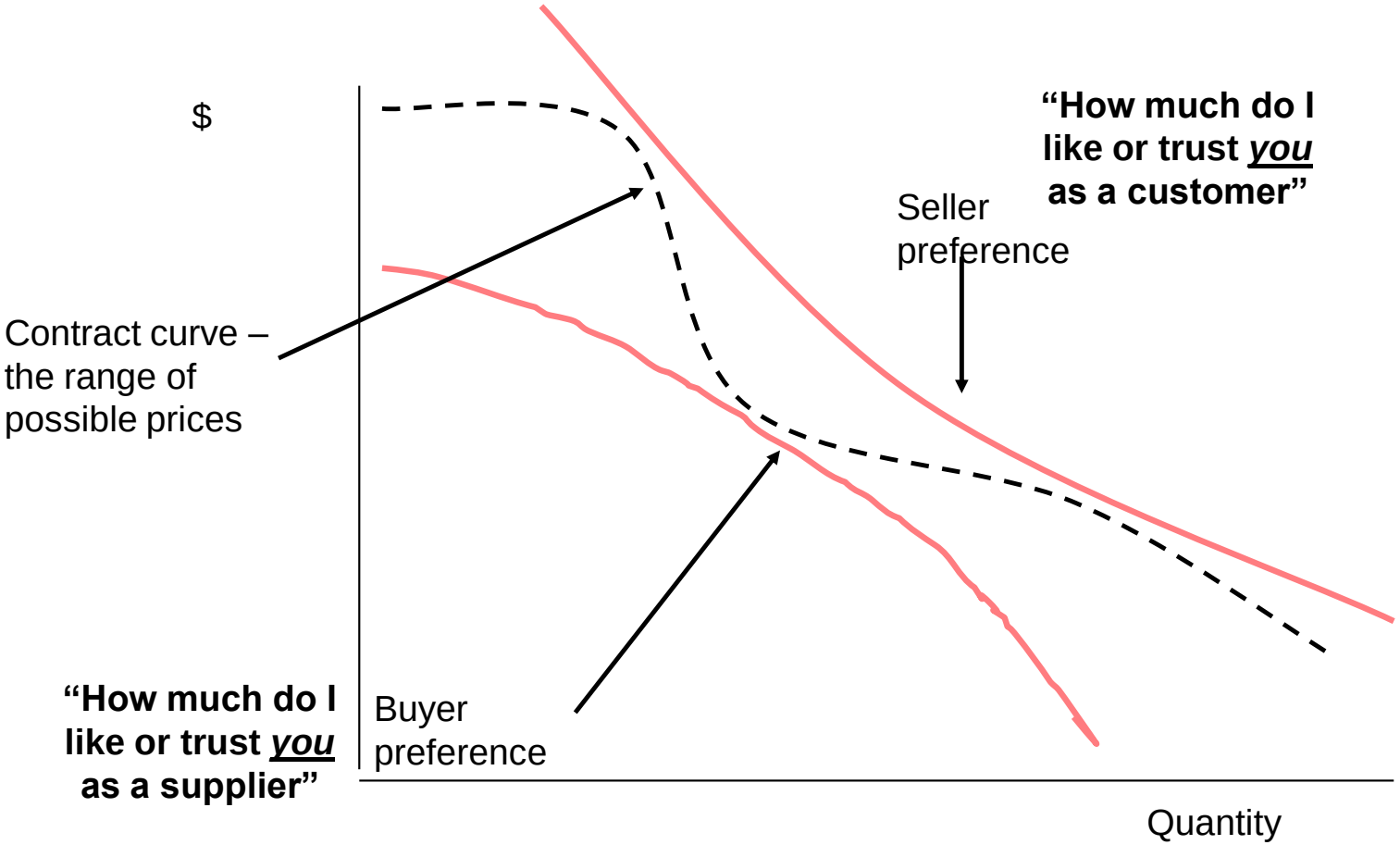
Pricing & Compensation

S Croom

'Preferences' The impact of trust on price



Price is a balance of risk and reward

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Assessing Risk

Risk is associated with uncertainty of outcomes

What forms of uncertainty may exist in supply relations?

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Operational Risk

From internal failure of processes, systems or people

External events (wildfires. Loss of ships..)

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Sources of operational risk:

New technologies

Mergers & Acquisitions

New (complex) products

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Legal risk

Failure to comply with laws, contracts or regulations

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Purchasing/procurement risk

Interruptions to supply

Impact of poor performance on end user

Attractiveness of customer's business to the supplier

Value of contract

Difficulty of re-sourcing business

Damage to purchasing function from supplier non-performance

Quality of relationship with supplier

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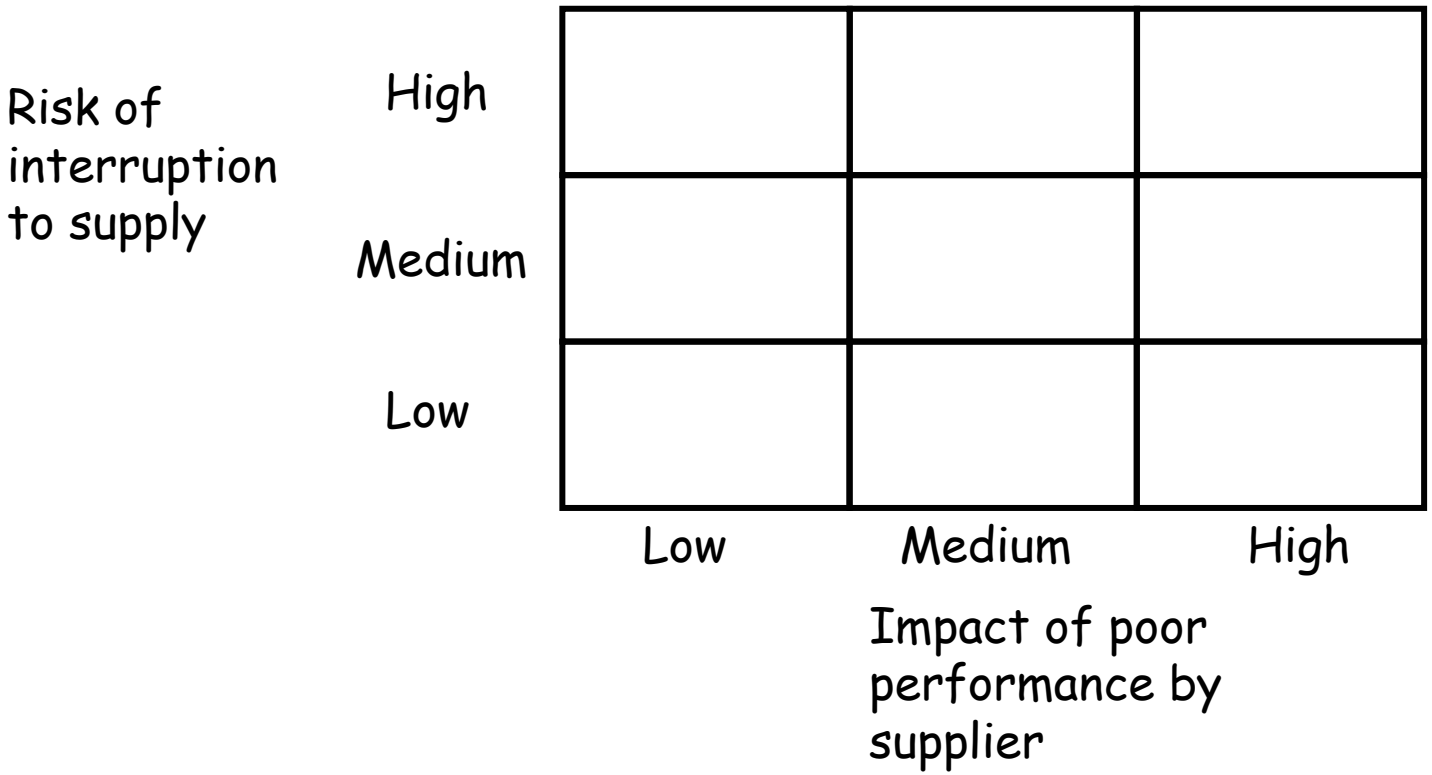
Risk matrices



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Building the price

Two teams – supplier & buyer

Build a price model for the following product (later slide)

- 500 per annum current demand
- At least 3 year contract
- Expectation of growth in demand
- Current product, introduced 2003
- Current annual sales 1,700 per annum
- Production normal capacity 2000

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USE:

- General construction dewatering
- Cellar or basement drainage on buildings
- Transfer and drainage of stormwater
- Circulation in decorative waterfalls and fountains
- Drainage of treated water in water treatment plants

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A submersible portable drainage pump, has the following features:

Agitator
An agitator is provided on the end of the pump shaft. The agitator helps prevent air buildup inside the casing and also reduces clogging when solid objects enter the pump.
OIL LIFTER (patent pending)
The OIL LIFTER stabilizes the mechanical seal by supplying oil to the top seal faces even if the lubricant in the oil chamber falls below the rated value. This is supplied standard in HS pumps.
Continually Rated
The pump can run non stop 24/7 without overheating or cutting out.
CWL (Continuous Water Level) 90mm
Only 90mm of water is required for the pump to run, reducing the chance of failure at low levels. This also allows the pump to drain to much lower levels than allowed by most pumps.
Dual inside mechanical seal
The pump comes standard with a double mechanical seal. The seal is located completely within the oil chamber. This seal system does not rely on the pumped media for lubrication and cooling increasing the reliability and life of the seal.
Bearings
High grade bearings for high temperature operation are used. As the bearings are deep grooved and doubled shielded and covered permanently in grease, lubricating oil is not required.

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Pump structure
The semi vortex design of the HS minimises 'impeller lock' where foreign matter carried into the pump prevents rotation of the impeller. This design is resistant to wear and demonstrates minimum drop in performance even if impeller is worn.

Motor protection device
Miniature thermal protectors (MTPs) are built into its motor and integrated in motor windings. The MTP will cut the motor circuit in the event of excessive heat.

Materials of construction
Use of light and strong materials is used throughout the entire pump. This ensures the pump is easily transportable.

Cooling system / discharge port
The spiral design of the pump allows sand and silt laden water to pass through efficiently.

Anti-wicking cable entry
An anti-wicking block is provided at the cable entry of the pump. This unique feature protects the motor from ingress of water even if the cable sheath is damaged and the top of the cable is immersed in water.

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Price?

Obtaining materials at the right price can be a firm's success or failure

Price or acquisition cost, is largest component of total cost.

Right price, a fair and reasonable price to both the buyer and the seller

no magic formula for calculating

The right price is not equal for all suppliers

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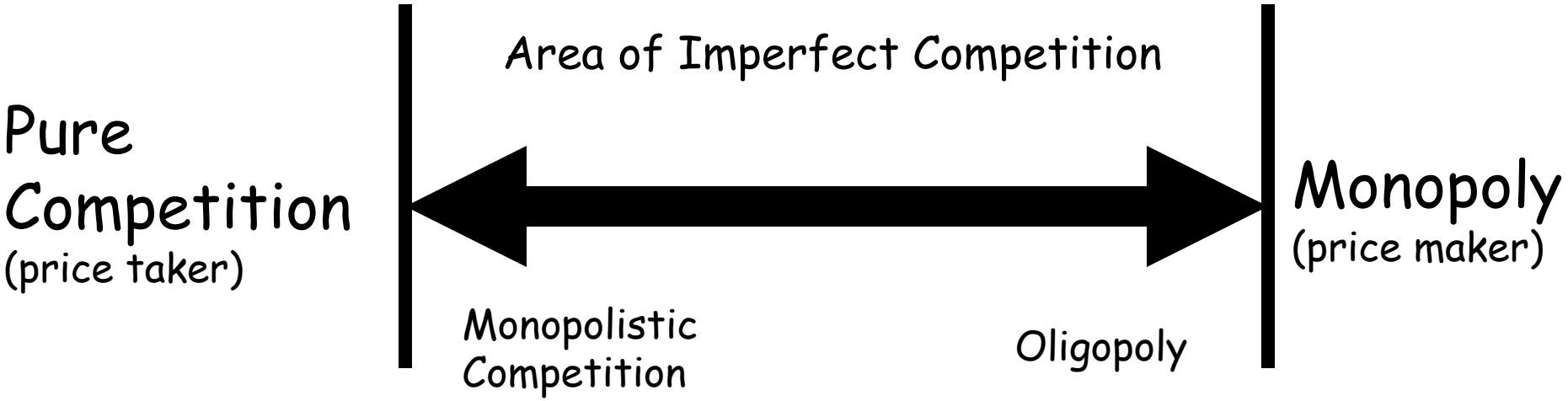
Conditions of Competition



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Variable-Margin Pricing

Frequent in suppliers that sell a line of products

Pricing is based on whole line

Results in prices on some products that are too high

Some prices are also artificially low

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Product Differentiation

Undifferentiated: not distinguished by specific differences

Differentiated: products appear different from those of their competitors

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Six Categories of Cost

Variable Manufacturing Costs

Fixed Manufacturing Costs

Semi Variable or Mixed Manufacturing Costs

- Examples: Maintenance, Utilities and Postage

Total Production Costs

- Sum of variable, fixed and semi variable costs

Direct Costs

Indirect Costs (Overhead)

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Cost, Volume, Profit Relationships

Number of units produced	Per Unit	500	1,000	1,500	2,000	2,500
Revenue	7.00	3,500.00	7,000.00	10,500.00	14,000.00	17,500.00
Variable Manufacturing Costs	2.25	1,125.00	2,250.00	3,375.00	4,500.00	5,625.00
Variable Portion of Mixed Mfg. Costs	0.30	150.00	300.00	450.00	600.00	750.00
Variable Selling, General & Administrative Costs	0.35	175.00	350.00	525.00	700.00	875.00
Total Variable Cost	2.90	1,450.00	2,900.00	4,350.00	5,800.00	7,250.00
Contribution Margin*	4.10	2,050.00	4,100.00	6,150.00	8,200.00	10,250.00
Fixed Manufacturing Costs		1,200.00	1,200.00	1,200.00	1,200.00	1,200.00
Fixed Portion of Mixed Mfg. Costs		450.00	450.00	450.00	450.00	450.00
Fixed Selling, General & Administrative Costs		700.00	700.00	700.00	700.00	700.00
Total fixed Cost		2,350.00	2,350.00	2,350.00	2,350.00	2,350.00
Operating Income		-300.00	1,750.00	3,800.00	5,850.00	7,900.00
Total Cost Per Unit (Mfg. + Non-Mfg. Costs)		7.60	5.25	4.47	4.08	3.84
Manufacturing Cost Per Unit (Variable Mfg. + Fixed Mfg.)		5.85	4.20	3.65	3.38	3.21
Operating Income Generated Per Unit		-0.60	1.75	2.53	2.93	3.16

Figure 17-1 –
Burt et al

Regulation by Competition

The factors stemming from competition determine the exact price each firm will quote

That is, when faced with the realities of competition, the price any specific firm will quote will be governed largely by *its need for business* and by *what it thinks its competitors will quote*, not by costs or profits

A firm tends to seek the highest price that is compatible with its long-range goals

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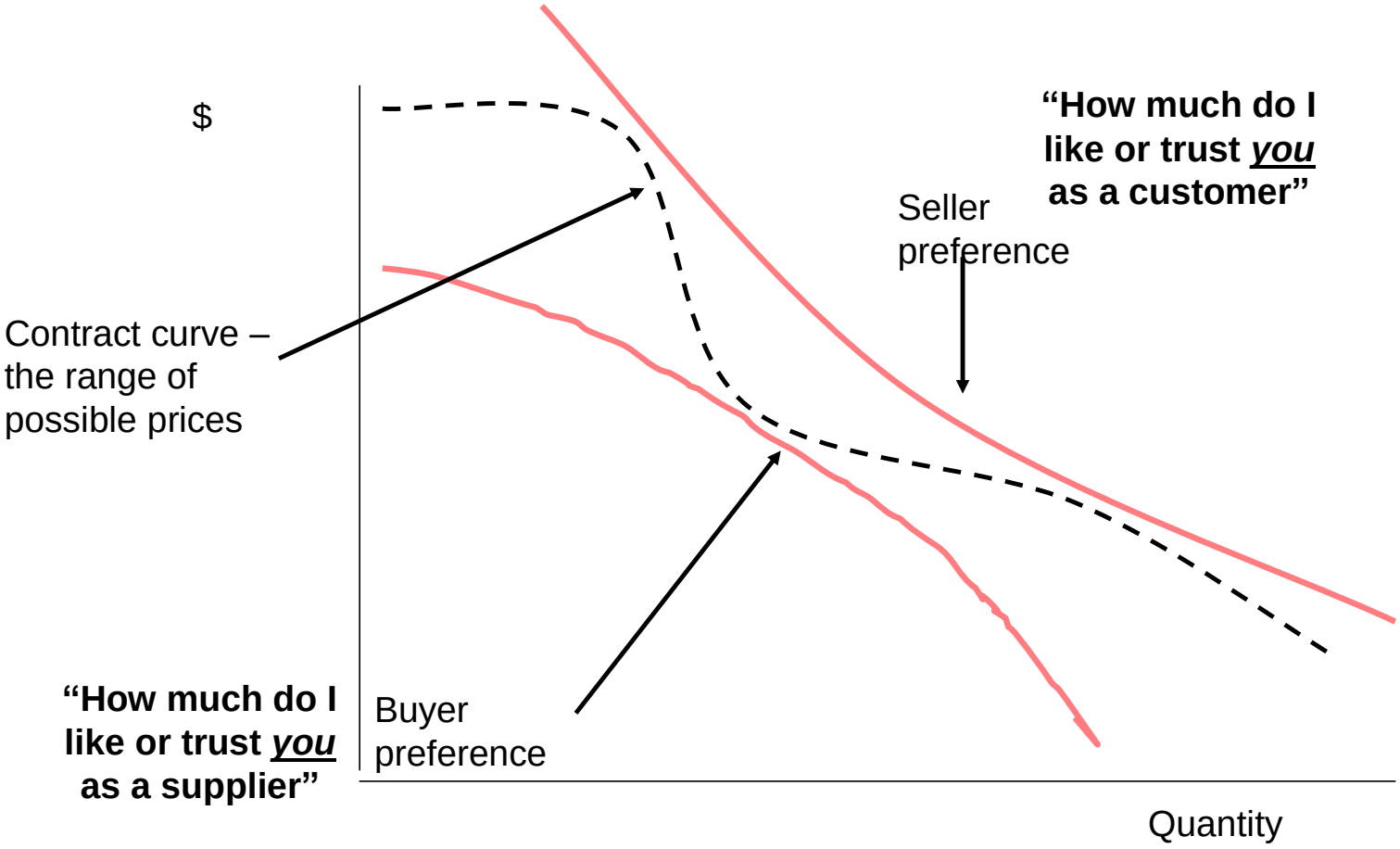
The impact of trust on price



Long versus Short Run Considerations

In the long run, a firm must recover all costs or go out of business

- Plant and machinery must be maintained, modernized, and replaced

In the short run, a firm should recover variable costs and some portion of overhead rather than undergo a significant decline in business

- Unless such additional business would affect the pricing of current or future orders

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Price Analysis

Competitive price proposals

Regulated, catalog, or market prices

Internet / e-procurement

Comparison with historical prices

Independent cost estimates

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Competitive Price Proposals

At least two qualified sources have responded

The proposals are responsive to the buying firm's requirements

The supplier competed independently for the award

The supplier submitting the lowest offer does not have an unfair advantage over its competitors

The lowest evaluated price is reasonable

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Regulated, Catalog, and Market Prices

Catalog Price

- Price included in a catalog or list
- Must be dated
- Readily available for customer inspection

Market Price

- Price equals interaction of many buyers and sellers
- Supply and demand establish prices

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Internet / e-Procurement

Advanced communications using the Internet allows supply management personnel to view up-to-date pricing

Since the Internet does not have geographical constraints, the information is available worldwide

Among the capabilities the Internet enables are:

- Buying exchanges
- Reverse auctions
- Tailored global searches

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Historical Prices

How have conditions changed?

Were there one-time engineering, setup, or tooling charges in the original price?

What should be the effect of inflation or deflation on the price?

Will the new procurement create a situation in which the supplier should enjoy the benefits of learning?

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Independent Cost Estimates

Independent cost estimates may be used as a basis for comparison of prices

This method is not used if other methods are available

The price developed through an independent cost estimate should be “fair and reasonable”

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Purchasing Design Work

Separate supplier's charges into three categories:

1. Price for design and development work
2. Price for special tooling and equipment
3. Price for manufacturing

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Documenting a Price Analysis

The price analysis report should indicate:

- Information that was considered
- Weight given to each piece of information and why
- Logic supporting the determination that a seller's price is or is not reasonable
- Soundness of that logic

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Discounts

Trade Discounts

Quantity Discounts

1. specific quantity at one time
2. specified dollar total of any number of items at one time
3. specified dollar total of any number of items over an agreed-upon time period

Seasonal Discounts

Cash Discounts

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2/10, Net 30 Cash Discount Example

Most commonly used discount is 2 / 10, net 30

- A discount of 2 percent is given if the invoice is paid within 10 days

A 2 percent discount can be equated to a 36.5 percent annual interest rate

- A buyer not taking the discount is paying 2 percent of the dollar amount of the invoice to use the cash involved for 20 days
- In a 365-day year, there are 18.25 twenty-day periods (365/20 = 18.25)
- A 2/10 discount translates into an *annual* discount rate of 36.5 percent (2 percent times 18.25)

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Concluding Remarks

The *right price* is one of supply management's most important responsibilities

Conditions of competition should be analyzed

Cost structure should be understood

Price evaluation should consider TCO

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