Discussion Outline

- A distinction – some definitions before we start.
- Why would we even consider some form of open book?
- Some hard realities we needed to face
- Our process for separating commodity from value
- The things we did to get started
- Establishing the ground rules of the relationship, including identifying your walk-away points
- What have been the results of our efforts? Where do we stand right now?
- Questions (probably) and Answers (maybe)
A distinction for our purposes

- **Open Book:**
  - **Cost-plus relationship:** Actual costs rolled up and charged to customer with pre-negotiated margins / rates.
  - **Cost model relationship:** Cost models are negotiated prospectively, and charged to customer with pre-negotiated margins / rates

- **Price Transparency:**
  - Pricing is broken down to a highly granular level, supporting increased pricing / competitive analysis by the customer. No information is provided on underlying costs or margins.
  - Can satisfy the desire for “open book” in complex engineered products or systems like those provided by Dematic
Open Book - Why would we do such a thing?

- For us it began with 3 years of a customer threats, which led to
- A point of resignation, which led to
- An intensive study, which yielded
- An idea that this could become a semi-sustainable competitive advantage

This is where it landed for us. Once we realized we could use it for competitive advantage, we were in. If we can't do it to gain a competitive advantage, then we may comply, but we will never embrace it.
Your products or services are either commoditized / commoditizable (my word), or they are not.

- *My definition:* Your customers can satisfy their needs with products or services from readily available alternative sources, without respect to changes in price to reflect differences in quality, etc.

- The distinction is determined by the committed view of your customers.
  - *Your opinion on the subject means relatively little*

- Customers will treat commodities as commodities. You can resist it, and you may prolong it, but you cannot avoid it.
  - *By definition, your customers have the ability to exercise their choices*
Know thyself...

- If you are selling commodity products and services:
  - Go open book or don’t, but don’t believe your sustained resistance to the concept is, in itself, a sustainable strategy

- If you have sustainable competitive advantages:
  - **DO NOT** open these up to your customers in open book. Never. Why, for the love of all that is holy, would you?

- If, like us, you had never fully considered or defined the distinctions within your own business...
  - You have some work to do
Distinguishing Commodity vs. Value
Our moment of Zen, or “Our moment of Yem”

▪ ‘You try to sell your commodities at a premium and you give away your competitive advantages! **What is wrong with you people?**’ Dr. Yem Bolumole, Michigan State University
Getting Started

- Get help
  - We used MSU professors and Advanced Purchasing Dynamics consultants

- Distinguish commodity from competitive value
  - Create pricing strategies and “stories” for value-adding services

- Establish cost-plus or cost models for commodity products / services

- Establish the ground-rules.

- Get settled on walk-away elements. Set your limits.
We Optimize Your Supply Chain

Establishing Cost Models

- I can only speak to cost modeling versus “Cost +”
- Our process is prospective, and not retrospective (no cost auditing after the fact)
- Models were developed, and then validated against prior projects
  - We took advantage of the process and pivoted pricing previously allocated to commodity products / services to new value categories
Setting the ground rules

- **The relationship must be based on mutuality and trust**
  - Joint participation in value engineering, cost reduction, speed enhancement and other activities is required in order to build understanding and trust
  - Co-dependency requires that confidential information, including IP, be aggressively protected
  - An “Absolute Best Cost” approach to negotiation, when used, erodes trust

- **The relationship must be fundamentally beneficial to all stakeholders**
  - The enemy is cost, not margins
  - The relationship must increase the speed of our mutual execution
  - Requires longer term business award, and precludes the need for competitive bidding

- **The KPI's must reflect mutual points of focus**
  - Lead-time, or speed of execution, should be a primary target
  - Outcome based TCO reductions should be based on validated savings

- **The risks and benefits must be shared**
  - Successful relationships include both penalties and incentives
  - Award duration / extension recognized as key incentive
  - Implement a pre-defined mutual sharing agreement for cost reductions
Why insist on mutuality?

- Regardless of the good intentions and pretty talk, we won’t be able to sustain a healthy relationship if it isn’t objectively win/win.

- It forces the customer to “invest” in the relationship (you value less the things you get for free)

- Mutuality must be established at the strategic level of the customer.
  - Don’t cut the deal with the working level – their horizon is too short
  - Flush out the spirit and intent of your customer’s leadership through negotiation of the agreement
Why insist on formalized collaboration?

- Active cooperative continuous improvement / cost reduction focus keeps attention on cost, not margins.
- It establishes the focus on “we”. The alternative is that your customer will seek to fix you.
- Creating a team, process, and format for continuous improvement ensures your ability to manage / control scope.
Our walk-away issue

For us, open book must be accompanied by:

- Elimination of competitive bidding with future commitments to some degree
- Executive-level quarterly business reviews
- Acceptable relationship KPI’s including Total Cost of Ownership (TCO)
- Joint project teams reporting to a joint executive team:
  - VAVE team – reporting to joint exec. Team
  - Established Targeted TCO reduction team
Where are we?

- We have prepared our cost models and the reporting structures necessary to support open book.
- Our primary customer target has shown a hesitancy to move away from competitive bid – not ready to commit.
- Our work has led to identification of several “customer experience” improvements.
  - Now offering different levels of transparency in exchange for increasing levels of purchase commitment.