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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 our cost models – things to think about
- 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.

Facing some hard realities



- 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

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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.

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?



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- 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.