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Five Warning Signs That You've Cut a Bad Deal

Finance execs are always being told that their company has gotten the best price with the best terms. But how can you be sure? If you spot any of these five warning signs, chances are good that the deal isn't.

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As a finance executive responsible for signing off on large purchases for goods and services, you will inevitably ask, “Did we get a good deal?” And the response will usually be, "Yes." But the follow-up question – “How do we know?" – may elicit a less confident reply.

In fast-growing companies, you are focused on recruiting employees who can help drive that growth. So, while most of your team will strive to be good stewards of the company checkbook, their negotiation expertise is not likely to be a key factor in your hiring decision. Here are five warning flags that can alert you that a deal may not be as good as you’re being told it is.

1. The price is bundled

There’s no way to know if you’ve gotten a good deal if a single price includes multiple products or services. You should push for line item pricing, even if your negotiations have been based on the total expense. Among other benefits, a line-item approach allows you to compare and contrast and determine whether certain items could be more effectively procured from alternate vendors. Additionally, if services are combined within recurring contracts, you may find it difficult to align the business’s changing requirements with the contract. You may want to replace or remove individual items from the agreement at a later date, but bundled pricing will make it difficult to get fair value for the removed items.

2. The discount looks too good

Large discount percentages off an arbitrary list price can create the illusion of a good deal but the discount is only meaningful if the underlying price is reasonable. And be careful not to focus solely on the primary product or service during negotiations. Suppliers frequently offset competitively priced items with inferior pricing on ancillary products and services. As a result, higher margin items may begin to constitute a greater percentage of your overall spend if your product mix changes over time.

3. Your commitments are based on volume

Today’s good deal quickly can become tomorrow’s bad one. Your suppliers are negotiating based on the long-term value of the deal. Consequently, many contract terms are designed to improve vendor margins over time. Multi-year agreements, or the high cost of changing vendors, can limit your ability to bring in secondary suppliers, ensuring higher margins for your supplier if your business grows or their costs drop. On the other hand, if minimum volume commitments are part of the deal, you need to evaluate what the impact of a slowdown in your business would be. Might you find yourself paying for services you’re not receiving? During renegotiations of existing contracts, such commitments need special scrutiny. It’s not unheard of for a supplier to lower its per-unit cost while failing to address a corresponding drop in an annual commitment. When that happens, the write-down may become "sleeves off the vest" savings – an illusion.

4. The price began as a budget placeholder

Long before negotiations begin, managers often call on vendors for "something to put in the budget." The project has not yet been approved, and the vendor’s

price will not be heavily discounted at this time. But as soon as that phone call asking for "something" occurs, your company has lost significant leverage. The vendor has established a starting point for the negotiations, and it will believe they know how much you've budgeted for their product or service. Even if you subsequently bid the deal out, your expectations for what a good deal should look like may be based on that original quote, which was only intended to fill in a blank space. Contacting suppliers before negotiations begin should be avoided if possible or, if necessary, handled with care. Ideally, budget numbers should be based on third-party benchmarks because an early quote is effectively the beginning of a negotiation. The vendor's sales organization will kick into gear as soon as you reach out, before you have the chance to define a bargaining strategy.

5. There's too much or too little time to renew

Many agreements have auto-renewals or evergreen provisions, often in conjunction with pre-negotiated price increases. Such contracts may require significant notice of your intent not to renew, thereby greatly reducing your negotiating leverage if the deadline passes. On the other hand, vendors that provide complex services will take the opposite approach. Recognizing that there are significant costs and bother associated with switching suppliers, they will strive to push negotiations back as close to contract renewal time as possible. By the time you begin bargaining, you will have lost leverage in the negotiation simply because you don't have enough time to evaluate or implement a plan for changing partners.

If you or your organization has made any of these five mistakes, you may be overpaying for products and services. Think about it. The executives at your supplier's company will not be asking your account manager, "Did we get a good deal?" They'll know. You should, too.

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