Chapter 5: Pricing Orders Responsibly

Fewer than half of Better Buying ratings show buyers are covering the costs of compliant production

Cost and cost negotiation zeroes in on a very sensitive point for discussion. Orders should be priced in such a way that suppliers can meet all the buyers' expectations, including compensation levels for workers that meet, at a minimum, buyer codes of conduct and legal requirements.

We asked suppliers completing ratings: "What percent of the orders did the price paid by the buyer cover the costs of compliant production?" The ratings for this category demonstrated large variability (0 to 5 stars), with the average rating being 4 stars. While 41% of ratings indicated that all the orders received from buyers were priced to cover compliant production, nearly 20% indicated that fewer than half of their orders met this critical threshold.

The findings from this pilot test cannot be generalized to the entire industry. The ratings submitted seemed to skew toward those of "better buyers." As a result, the high rate of orders not priced to cover compliant production is troubling and a clear indication of why compliance to minimum wage and benefit requirements of buyers and legal regulations are such a widespread problem.

A supplemental question not used for scoring asks suppliers whether they have evidence that would support their response. While 28% indicate this could be demonstrated through a variety of materials, a full 72% of the ratings indicated they have no evidence. Suppliers not having carefully formulated and documented costing practices is concerning, but isn't surprising.

In creating the Better Buying rating system, we were warned by suppliers that the question on pricing would be difficult for many to answer, but that we had to ask it because suppliers needed to get to the point where the exact costs of production, including R&D, factory improvements and other shared services are captured in overhead and allocated to customers and specific orders. While all of what Better Buying is measuring points to improvements buyers need to make in their purchasing practices, this is an area that suppliers can also work to improve.

An optional question dug into pricing a bit more to understand the extent that the buyer engages in high pressure negotiation strategies. Of the 43 ratings that answered this question, 63% answered “yes.” Those high-pressure negotiation strategies included the following:

- Asking suppliers to match a target price set by the buyer, or to match the prices the buyer received by other suppliers from different regions of the world.
- Asking suppliers to show all cost breakdowns from one region and then using those details to insist on specific cost reductions in other regions.
- Requiring suppliers to submit price bids or to turn around price quotations with little time to prepare.

Positive findings related to cost and cost negotiation were captured in best practices suppliers reported when submitting their ratings, among them:

- Allowing the supplier to use its own sources of raw material to lower the material cost and provide the best garment FOB cost.
- Paying premium prices for small orders.
- Carrying out a reasonable price negotiation with no pushing for small amounts.
- Offering loans with subsidized interest rates for factory expansion.

We expect some buyers to push back on the measure for cost and cost negotiation because we leave it up to the supplier to determine their cost model. Our guidance to suppliers will emphasize the need to consider the direct costs of materials, labor, testing, audits, transportation and others. But they’ll also be asked to consider the myriad of indirect expenses and capital investments and how those should be allocated. And of course, we expect suppliers to incorporate profit for themselves! Just as suppliers cannot be expected to meet elements of another suppliers’ cost model, Better Buying cannot dictate the “right” amount of overhead or profit suppliers should consider as they respond to this question.

Could some of the ratings be due to suppliers who are overzealous about the profits they think they should earn? Perhaps so. But on the other hand, we all know that suppliers routinely accept orders that they know will not cover the costs of production and they do so because it is often better than nothing and it can allow them to keep workers on the job.

Pricing orders responsibly is something buyers must improve and Better Buying will be able to track the improvements of specific buying companies over time.

How can you use the information Better Buying provides about cost and cost negotiation?

Buyers, even if you’ve not yet received detailed analysis of your own practices from Better Buying, the findings from our pilot test provide a lot for you to work with. Now would be a good time to begin thinking about how to support your suppliers so that they have enough time and the systems necessary to develop costs that encompass the full range of your compliance expectations and to allocate shared costs across multiple orders and multiple buyers. To be clear though, we’re not suggesting you demand they open their books on specific orders, a practice that some say can pit suppliers against each other in unfair competitions.

Suppliers, now is a good time to make sure you have developed a strategy to allocate costs of compliance across all your orders and customers, and to keep track of that. And be sure to participate in the upcoming cycle of Better Buying ratings later this fall, because the ratings you submit are needed to develop Better Buying scores for individual buying companies. When we have enough ratings and those scores go public, we know you'll want to use that knowledge to support negotiations with existing customers and vet new ones.

Marsha A. Dickson, Ph.D. and Doug Cahn
Co-Founders, Better Buying