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Take the Uncertainty Out of Reverse Auctions

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Reverse auctions work, and they will improve the bottom line.

It is surprising that some supply management professionals are still waiting in the wings to use reverse auctions. A "just do it" attitude is all it takes to get started. There are a growing variety of reverse auction tools in the marketplace to do just that. These tools use the Web in some of the most effective ways seen in 20 years of buying and selling in business and public sectors. Reverse auctions complement strategic procurement techniques and effectively leverage purchasing volumes that drive real savings. So, what's not to like?

Simply put, there are two steps in conducting a reverse auction: (1) decide what to feature in the auction, and (2) decide what tool/platform to use in conducting the reverse auction.

While there is a definite place for full-service reverse auction models where third-party providers deliver additional expertise in specific markets or more complex procurements, the focus of this piece will be on the self-serve reverse auction that effectively puts the process in the buyer's tool kit. The trend of purchasing a license arrangement and conducting the auction with internal buyers — the ASP model — enables them to do everything third-party service providers did before, for significantly less money and with similar results.

Conducting Your Reverse Auction

The list of products and services that have been successfully reverse-auctioned continues to grow. With the wide variety of product offerings and the large number of spend categories that have been sourced in this manner — everything from ammonia to windshields — the risks and uncertainties continue to diminish. Even an imperfect event will save a supply manager some money (almost guaranteed). Today, with both full-service and ASP model offerings, it's a simple task to locate and purchase auction services.

Making it this far, you've probably decided to conduct your first online auction. The process can be boiled down into the following five steps:

Step one. Decide what to bid out. This process is really no different than any other important purchase. First, supply managers simply need a product or service that has a solid, clear purchasing description or specification. It's just like sourcing anything else — the better the purchasing description, consisting of clear specifications, drawings, statement of work (SOW), etc., the better the sourcing will be. Don't get caught up in simple or complex components — it can be either. Just like any other important sourcing project, the purchase description should stand on its own. The fewer questions from the supply base, the better chance for a successful event.

Also, ensure that there are at least three solid sources for the planned buy. While two sources can (and does) work, working with a minimum of three is better. More qualified suppliers participating are better than fewer, but keep the total number of suppliers manageable. Practically any supplier can participate in a reverse auction — from a sole proprietor to a Fortune 100 company. Suppliers simply need a computer and a connection to the World Wide Web. While in theory suppliers will be able to register themselves and learn about the process on their own, it's reasonable to expect the buyer to provide some training to participating suppliers in advance of the auction. Your auction service provider can also train your suppliers, but supplier training is a skill and function reasonably expected from your buyers. While each event and commodity is different, a range of two to 10 suppliers is a good standard. The key is not in the quantity of suppliers, but in the quality of suppliers.

The final factor for step one is dollar amount. Generally speaking, the more dollars sourced, the better the results. If supply managers want to source enough of the organization's requirements to attract suppliers, it must be robust enough so that the volume can be managed and leveraged by the supply base to drive savings and efficiencies, but it can't be so high as to create a risk potential for the firm. Reasonableness must rule.

Generally, successful auctions, especially first events, should be run at a minimum of \$100,000. Many successful auctions run for less, but it's better to have more volume, especially in the first attempt at using this tool. The real key is the return on investment, and it's generally easier to gain an ROI on a larger buy. Step one is really the most difficult part. A well-planned buy will always provide better sourcing results — it's no different with reverse auctions.

Step two. The next step is finding a software platform or reverse auction service provider to run the auction. Today, the choices are many — and growing. However, a few cautions are in order. There are basically two types of reverse auction companies. There are those that will conduct reverse auctions as add-ons to their other offerings. Because auctions are not their core business, unless supply management organizations have a strong corporate and financial commitment to use one of these companies, they can find better value with companies whose core business is reverse auctions.

While there are many companies in this category, it's important to find those with a proven track record and some history in this business. Supply managers should screen each firm's functionality by having it demonstrate past auctions run for other companies over a wide range of goods and services. It should also provide assistance in establishing the parameters of the auction. For example, the supply manager must decide how long to keep the event open and what visibility to give suppliers, and establish bid increments. The reverse auction service provider can help with these decisions, even if the supply management organization is just purchasing reverse auction software.

For expedience, the balance of the "five-step" process is summarized:

Step three. Communicate with and train suppliers.

Step four. Run the event.

Step five. Quickly award a winner and provide a concise debrief to those suppliers not selected. Feedback to suppliers is always welcome. In fact, the reverse auction process already provides suppliers great insight into their competitive markets, especially on price, which is a benefit to suppliers. At the conclusion of the event, each supplier should be contacted by the buyer and thanked for participating and provided some rational (i.e., past performance, technical capability, delivery, etc.) for the buyer's award decision.

A Reminder of Business Ethics

With the number of reverse auction service providers growing each day, the level of competition is growing and the price of the service is being pressured downward. However, some caution is in order. In this business climate, some reverse auction companies are being overly aggressive in their pricing models. Many offer the service for "free" or "at no cost to the buyer." The promises of low- or no-cost reverse auctions should raise a flag with any seasoned supply manager or buyer.

Because this is a technology and tool used by buyers, they should expect to pay for it. Business models that put the payment for the reverse auction service on the supplier are counterproductive and place the entire buy in a compromised position. Be wary of reverse auction business models that seek to place the cost for the service on the supplier. It's more ethical to provide the reverse auction service free to participating suppliers, in order for suppliers to focus on providing the best, most competitive pricing without the added burden of attempting to factor in a percentage to cover the reverse auction service charge. Conducting a fair and ethical online auction should be the foundation of every reverse auction.

This powerful tool and new process will generate real savings and will drive efficiencies with suppliers — with further benefits to a supply manager's organization and to the overall economy. Reverse auctions work, and they will improve the bottomline.