

Lowering Total Cost Through Reverse-Auctions

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Abstract: Supply managers are held accountable to reduce the cost of products and services they source and rely on tools to help them achieve this goal. Reverse-Auctions have maintained a strong history over the past five years of helping supply managers do this by meeting three objectives; they gain a reduction in their sourcing cost, a reduction in their process time reduction and an often significant price reduction. The supplier also meets several objectives that include process time reduction, sales cost reduction and therefore a competitive improvement. Additionally, suppliers gain an even greater advantage if they in turn use Reverse-Auction's to lower their cost of goods sold. This is the key to lowering the total cost of goods throughout the supply chain. This session is a joint industry-academic presentation and is intended to educate and guide supply managers at all levels to understand the benefits and risks of Reverse-Auctions. It will also dispel the myths of Reverse-Auctions while ultimately provide a quick means for them to get a better price faster.

The Opportunity: A key principle furthering professional purchasing is the use of information to reduce uncertainty and thus reduce total cost. Due to time constraints, purchasing professionals have always had to accept the trade-off between the time spent researching qualified suppliers to bid a purchase need, and the time spent managing the RFP or RFQ process. These time constraints typically imply only a fraction of their total annual spend ever gets quoted and the number of suppliers doing so are on the average of three to five. With such small participation it is invariably hard to know if they received the best market price.

Reverse-Auctions are one of the advanced tools enabling purchasing professionals to shift from "administering" the procurement process, to "managing" tools that automate many steps in the manually intensive sourcing process. This provides the ability to expand both the number of purchases bid and the number of suppliers participating, to ensure the best total cost of ownership is achieved. All this is accomplished with less time required from the supply manager. Companies using Reverse-Auctions now number in the thousands and their supply managers use it for a variety of purchases with results that top management clearly recognize.

The Savings Potential: Firms that embrace Reverse-Auctions as a strategic management technique are consistently enjoying a cost savings with a range that averages 12-24 percent. Some cases are only a fraction of this while others result in substantially higher savings. Many firms also achieve quality and process improvements along with cost savings either because the current supplier, recognizing there may be a reason the buyer went out for bid, decided to consciously look for cost reduction opportunities, or a new supplier wants to earn follow-on business. Normally, most auctions result in some savings, but in every case, the supply

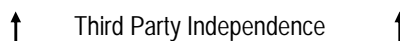
manager gains the advantage of additional market information. Depending on the Reverse-Auction model chosen, a supply manager can gain these advantages without even making an investment. Since suppliers have always incurred a cost of marketing and sales, or paid broker fees for business they gained, some Reverse-Auction providers maintain this tradition and are therefore able to offer the supply manager a no investment option. This can make this method of strategic sourcing a very easy option.

The Higher Good. Reverse-Auctions provide a proven and painless path to strategic cost reduction. e-Procurement focuses on using Internet methods for purchasing and offers significant advantages. The rationale is simple, in many organizations purchased products and services are the most significant expense, maybe 45% to 55% for the average firm. A five percent savings in those purchases would result in up to a 50% profit improvement for a firm that has a 5% profit margin. To realize the same improvement might take up to a 50% increase in sales. Tough for any firm regardless of it's market position. Any reductions in purchases immediately translate into bottom line improvements; and they preserve critical skills that would otherwise be lost in a reduction-in-force. Only focusing on other items, such marketing, overhead and production, can negatively affect sales efforts and might not result in true profit improvements for several months.

The Choices. There are different Reverse-Auction models. Successful Reverse-Auctions begin with two key ingredients; defining your criteria, then determining which model will best meet your needs. Defining your criteria allows you to segment your buys and will guide you to the appropriate model needed to achieve your desired results. Buys vary from standard to highly specialized, low to high risk, strategic to routine, small up to tens of millions of dollars. The following chart depicts available models and their attributes.

Reverse-Auction Models Available

	Self-Service 3rd Party Mgd	Consultative	Software	Application Service Provider
Characteristics:	Self-service tool Easy to use No software Full support	Outside assistance Detailed process Software install Full support	Software purchase Software install Train people Internally support	Web hosted app. Train people Internally support
Possible Fees:	None for buyer Supplier pays 2%	Consulting fees Percent of savings	Software License fees Internal support	License fees Training Internal support
Purchases:	All products and services, \$20k - \$millions	Strategic Very high volume \$tens of millions+	Various products Various prices	Various products Various prices
Total Time Est:	Several hours up to weeks	Several weeks up to months	Several days up to months	Several days up to weeks



Source: Sorcity.com, Inc.

The vast majority of buys within an organization are not overly complex and are perfect for the self-service, third-party managed model. Highly strategic buys in the tens of millions of dollars may justify a consulting engagement and months of preparation. You must determine what type of expertise is needed for a particular purchase and if that expertise resides within your organization. Highly strategic purchases may also require more internal resource time, therefore, cutting out many manual steps through a Reverse-Auction is an additional benefit many companies are realizing.

The Benefits. The benefits are clear and can be summarized in the chart below. Whether you are sourcing MRO items, direct materials, renewing annual agreements, consolidating buys, purchasing capital equipment or one time buys, there is a high probability that a Reverse-Auction can be applied.

Potential Benefits of e-Procurement

➤ Cost Reduction	Every dollar saved in procurement can result in a dollar of margin. Translates immediately into operating income.
➤ Price Reduction	On-line sourcing can reduce the sales related cost of suppliers, allowing them to be more competitive, while increasing their margins. Also allows for suppliers to go after business they might not otherwise see.
➤ Time Reduction	Average purchase and fulfillment cycle times can be drastically reduced allowing buyers to be quicker to market and more competitive. Allows for buyers to concentrate on more strategic issues and relationships.
➤ Pain Reduction.	By leveraging Internet technology, buyers can reduce e-business implementation costs, time and standardization. Provides long-term benefits.

Since it's often determined that more than one supplier can meet the terms and conditions of a purchase, the final decision is often based on price. Reverse-Auctions play an unbiased role here, supporting the first rule in the NAPM Principles and Standards of Purchasing Practice: "Avoid the intent and appearance of unethical or compromising practice in relationships, actions, and communications."

REFERENCES:

Web Sites.

www.unt.edu

www.sorcify.com

